

# **FinQuiz.com**

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**CFA Level I 1<sup>st</sup> Mock Exam**

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**Revision 1**

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**FinQuiz.com – 1<sup>st</sup> Mock Exam 2016 (AM Session)**

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**Questions 1 through 18 relate to Ethical and Professional Standards**

1. According to Standard I-A ‘Knowledge of Law’, members and candidates are required to:
  - A. maintain readily accessible current reference copies of applicable statutes, rules and regulations.
  - B. dissociate from the activity if they have reasonable grounds to believe that employer’s or client’s activities are unethical.
  - C. report potential violations of the Code and Standards committed by fellow members and candidates to regulatory organizations.
  
2. Alonzo Myers manages accounts at GRTY Securities. Jerry Reed, one of his clients, e-mailed Myers to buy 300 shares in the IPO of JJKS Corp’s stock. Few days later, despite being a hot issue, Myers succeeded prorating 500 shares of JJKS Corp. for his clients. After purchasing 500 shares for his clients and 300 shares for Reed as per request, he purchased remaining 200 shares for his wife. Myers:
  - A. did not violate the standards by purchasing 200 shares for his wife and 300 shares for Reed.
  - B. violated the standards by purchasing 200 shares for his wife and only 300 shares for Reed.
  - C. violated the standards by purchasing 200 shares for his wife but is in compliance for purchasing 300 shares for Reed as per his request.
  
3. McKinney Alpha is an accredited research firm that only hires experienced and competent analysts offering them training and financial courses from time to time. The firm allows analysts to either prepare their own research or rely on secondary sources. Tyler Klein, an analyst at McKinney uses a research report prepared at Gemma Brokerage. If Klein will use that report, he will:
  - A. violate Standard I-C ‘Misrepresentation’ by relying on work not prepared by himself for his clients.
  - B. violate Standard IV-A ‘Loyalty to employers’ as he is not allowed to use the report prepared by Gemma Brokerage.
  - C. not violate any standard if he makes reasonable efforts to determine that research is sound and uses the information in good faith.

4. By complying with GIPS standards firms cannot:
- A. eliminate the need for in-depth due diligence on the part of the investor.
  - B. participate in competitive bids against other compliant firms throughout the world.
  - C. assure prospective clients that the reported historical track record is complete and fairly presented.
5. In conversation with a prospective client, a portfolio manager stated “I cannot guarantee that you will earn 18% on equities this year but I can provide you a range within which your return will lie. My range is quite popular among my clients and has a history of ten years. Each year, I develop the range by using financial models, economic forecasts and accredited reports. Based on the CFA Institute Standards, the portfolio manager:
- A. did not violate any standard.
  - B. violated standard I-C ‘Misrepresentation’.
  - C. violated standard III-D ‘Performance Presentation’.
6. Eleanor Chavez, CFA is a senior analyst at W&W Securities (W&WS) and is responsible for managing the High Beta Mutual Fund (HBMF). Curtis Fowler, aged 56 and dependent on his portfolio returns, is W&WS’s client. His portfolio will now be managed by Chavez, who has been asked to invest 20% of his portfolio funds in HBMF. Chavez fills the request forms and immediately purchases shares of HBMF for Fowler. Is Chavez in compliance with codes and standards, and if not, what should be the recommended course of action for Chavez?
- A. Yes, she is in compliance with codes and standards.
  - B. No, she should consult Fowler’s existing investment policy statement (IPS) and should judge the suitability of his investments in the context of his total portfolio.
  - C. No, she should make reasonable inquiry about Fowler’s risk and return objectives and financial constraints prior to taking investment action requested by Fowler.

7. Gilbert Love worked as financial analyst at Milton Securities. During his employment at Milton, Love covered Indigo Corp and developed detailed financial models, assumptions and supporting reports. When Milton switched his job, his new employer assigned him to analyze Indigo Corp. Milton developed a new model with improved assumptions and specifications and re-created the supporting records by gathering data from the covered company. Has Milton violated any CFA Institute Code and Standards?
- A. No, he is in compliance with the Code and Standards.
  - B. Yes, he has violated Standard V-C ‘Record Retention’ by re-creating the supporting records.
  - C. Yes, he violated ‘Misrepresentation’ and ‘Record Retention’ by developing the model and re-creating the supporting records for Indigo Corp.
8. According to Standard II-A ‘Material Non-Public Information’, if a member or candidate determines that information is material he should make reasonable efforts to:
- A. achieve public dissemination of the information.
  - B. alter current investment recommendations for clients.
  - C. protect information from those who can possibly act on that information.
9. Lauren Sims, marketing director of Karma Advisors, planned a brief performance presentation in five different U.S states where majority of the firm’s clients are located, in celebration of Karma’s five years of success. In his presentation, Sims clearly includes references to the information presented and also prepared a detailed information report to support his brief presentation. At the conclusion, Sims provided the report only to the clients who requested it. By failing to provide the report to all the clients who attended the session, Sims:
- A. violated Standard III-B ‘Fair Dealing’
  - B. violated Standard III-D ‘Performance Presentation’.
  - C. did not violate any CFA Institute codes and standards.

10. Mathew Chambers manages individual accounts, including his father's, at Harvey Securities. During a Sunday lunch at a restaurant with his friend Neil Rojas, Chambers noticed the directors of Navarro Motors sitting at the adjacent table. Rojas stated, "I believe Navarro has hired a new CEO as the firm is undertaking many positive amendments in its production process". On Monday Chambers noticed a \$1 increase in Navarro's share price and purchased 500 shares for his father's account. Chambers *least likely* violated:
- A. Standard VI-B 'Priority of Transactions'.
  - B. Standard II-A 'Material Non-public Information'.
  - C. Standard V-A 'Diligence and Reasonable Basis'.
11. Blanco Shell Investments (BSI) is a small family owned investment bank and its shares are relatively illiquid. In a casual meeting Brett Palmer, managing director at BSI, told his friend, Leon Fox, that BSI is going to earn substantial profits in its commodities business. In the next few days Fox purchases BSI shares while Palmer disposes his position in BSI and switches his job. Two months later BSI announces huge losses in its commodities business and the share price decreases by \$2. Palmer has violated the CFA Institute Standards of Professional Conduct concerning
- A. 'Market Manipulation' only.
  - B. 'Material Nonpublic Information' only
  - C. 'Market Manipulation' and 'Material Nonpublic Information'.
12. After 5-years of service with Jacob Securities as a financial planner, Shane Alvarado planned to start his own practice in his hometown. He informed his employer through email three days before starting his independent practice. The employer was on a business trip for a week and on his return he accepted his resignation. Alvarado always maintained his personal records related to training programs that he conducted at Jacob Securities, and he used that material in his new project. Alvarado:
- A. is in compliance with standards regarding timely notification and using his own personal records.
  - B. violated the standards by rendering services without receiving consent from his employer and by using records.
  - C. violated the standards by using records but is in compliance with standards in notifying his employer regarding his independent practice.

13. During the morning section of the CFA Level 1 exam, when the proctor made the final 5 minutes announcement, Enrique, a candidate next to Rachael noticed and told Rachael that she was not filling her answers on the sheet provided. Rachael immediately started transferring answers on to the answer sheet. When the proctor made the final announcement Rachael succeeded filling 100 circles and by the time proctor reached at her table, she had only 5 circles left to fill. Rachael instantly handed her sheet to the proctor. Is Rachael or Enrique in violation of the standard relating to conduct as members and candidates in the CFA Program?
- A. Only Enrique is in violation.
  - B. Only Rachael is in violation.
  - C. Both Rachael and Enrique are in violation.
14. Dan Fisher is an investment manager at Rotterdam Securities and often uses Topaz brokerage services for his clients. Corey Foster, Fisher's client, has directed him to use the services of Luna Brokerage House for him. Fisher believes that Topaz offers best price and better research reports compared to Luna. The best course of action for Fisher is to use the services of:
- A. Topaz for all of his clients as he is obligated to seek best price and best execution.
  - B. Luna for Foster and should disclose to him that he may not be getting best execution.
  - C. Topaz for all his clients as brokerage commission is the asset of the Rotterdam and will be used to maximize the value of client's portfolio.
15. Reginald Fuller manages institutional portfolios on behalf of BDY Advisors. Fuller also manages an account of a trust company named SOTO Trust. The trust offered Fuller a \$50,000 cash gift if he succeeded in achieving a 20% return this year. The best practice for Fuller includes:
- A. refusing the offer of SOTO trust to avoid a conflict of interest with his employer.
  - B. accepting the offer and achieving the target without compromising his objectivity towards other clients.
  - C. making an immediate written report to his employer specifying the \$50,000 cash offer proposed by the trust

16. GIPS standards *least likely* resolve misleading practices related to:
- A. survivorship bias.
  - B. varying time periods.
  - C. analyst financial statement adjustments.
17. Sullivan Investments, an asset management firm, complied with the GIPS standards on 1 January 2006. Can Sullivan link its non-GIPS compliance performance for periods beginning on or after 1 January 2000 with its GIPS compliance performance?
- A. No.
  - B. Yes.
  - C. Only if it discloses periods of non-compliance.
18. Which of the following statements is *most likely* correct regarding the major sections of GIPS standards?
- A. According to Section 4 ‘Disclosures’, firms are required to make negative assurance disclosures.
  - B. According to Section 3 ‘Composite Construction’, a composite return is the asset weighted average of the performance of all portfolios in the composite.
  - C. According to section 5 ‘Presentation and Reporting’, firms cannot include in GIPS-compliant presentations information not addressed by the GIPS standards.



**Questions 19 through 32 relate to Quantitative Methods**

19. Three friends Sam, Patricia and Robert will receive equal dollar amounts in two years, however they invested in such a way that:
- the interest rate offered to Patricia and Sam is same but compounding for Patricia is monthly and for Sam is quarterly.
  - compounding for Robert and Patricia is same but the interest rate offered to Robert is higher.

The present value of whose investment would be the lowest?

- A. Sam.
  - B. Robert.
  - C. Patricia.
20. Which of the following properties of correlation and covariance is *most likely* correct?
- A. Correlation only deals with linear relationships.
  - B. As the number of securities in a portfolio increases the importance of covariance decreases all else equal.
  - C. When correlation between two variables is  $> 0$  the variables have a perfectly positive linear relationship.
21. An analyst calculated the average return of a hedge fund by taking a random sample of 6 years' return. The hedge fund has been in existence for last 20 years. Assume the hedge fund return is normally distributed with a population mean and standard deviation of 34% and 42% respectively.

The 99% confidence interval around the population mean for the analyst's sample of hedge fund return is *closest* to:

- A.  $-0.0039 - 0.3361$ .
- B.  $-0.0977 - 0.5823$ .
- C.  $-0.1024 - 0.7824$ .

22. The efficiency of an unbiased estimator is measured by its:
- A. variance.
  - B. sample size.
  - C. mean value.
23. The investment performance of a fund for the year 2013 is as follows:
- On 1 January 2013, the fund had market value of \$70 million.
  - The holding period return for the fund from 1 January to 30 June was 18%.
  - On 1 July 2013 the fund received an additional \$35 million.
  - On 31 December 2013 the fund received total dividends of \$8 million.
  - The fund's market value on 31 December 2013 including \$8 million dividends was \$134 million.

The time-weighted return computed by the manager is *closest* to:

- A. 13.95%.
  - B. 22.22%.
  - C. 34.46%.
24. An analyst calculated the expected value of Howe Inc.'s EPS as \$5.91 based on the probability distribution of Howe's EPS for the current fiscal year.

Probability distribution for Howe's EPS	
Probability	EPS (\$)
0.12	7.75
0.45	6.20
0.33	5.50
0.10	3.75

The standard deviation of the Howe's EPS for the current fiscal year is *closest* to:

- A. 0.9662.
- B. 0.9829.
- C. 2.8816.

25. A professor is practicing a new method of teaching and is unsure about its impact on students' performance. His students generally maintained an average 3.2 GPA throughout the semester. He selects a sample of 25 students with a mean GPA of 3.0 and standard deviation of 0.62. The professor is concerned whether the sample results are consistent with the average GPA results of 3.2.

<i>df.</i>	$p = 0.05$	$p = 0.10$
24	1.711	1.318
25	1.708	1.316

Determine whether the null hypothesis is rejected or not at the 0.10 level of significance.

- A. The null hypothesis is rejected as the t-value of 1.6129 is  $> 1.318$  at the 0.10 significance level.
  - B. The null hypothesis is not rejected as -1.6129 does not satisfy either  $t > 1.711$  or  $t < -1.711$ .
  - C. The null hypothesis is not rejected as the calculated t value of 0.322 is less than 1.318 at the 0.10 significance level.
26. An analyst gathered the following information about return distributions of two portfolios.

	Kurtosis	Skewness
Portfolio A	2.5	-3.7
Portfolio B	1.3	+4.2

Which of the following statements is *most likely* correct regarding portfolio A and B?

- A. Portfolio A is more peaked than normal distribution.
  - B. Distribution of portfolio A has frequent small losses and few large gains.
  - C. For portfolio B, more than half of the deviations from the mean are negative.
27. For a normal random variable approximately 68% of all outcomes fall within:
- A. one standard deviation of the mean.
  - B. two standard deviations of the mean.
  - C. three standard deviation of the mean.

28. Given below are the sample monthly returns for ATD stocks.

January	18.5%
February	6.6%
March	-3.5%
April	-11.4%
May	5.4%
June	-17%

With the target return of 6.0%, the target semi-variance is *closest* to:

- A. 184.47.
  - B. 215.80.
  - C. 307.45.
29. Which of the following *best* describes the reason for choosing the NPV rule over the IRR rule when dealing with mutually exclusive projects?
- A. NPV rankings are affected by external interest rates or discount rates.
  - B. The reinvestment rates used by NPV are more conservative and therefore are economically more relevant.
  - C. IRR ranking assumes reinvestment at opportunity cost of capital that is less realistic and economically less relevant.
30. A lognormal distribution:
- A. is bounded below by 1 and has a long right tail.
  - B. is not completely described by two parameters i.e. the mean and the variance.
  - C. may well describe a stock price whose continuously compounded returns do not follow a normal distribution.
31. The type of chart drawn on a grid, which consists of column X's alternating with column O's and does not represent time or volume is *most likely* the:
- A. bar chart.
  - B. candlestick chart.
  - C. point and figure chart.

32. Which of the following statements is *most likely* correct regarding parametric and non-parametric tests?
- A. Parametric tests are relatively unaffected by violations of assumptions.
  - B. In a parametric test observations are converted into ranks according to their magnitude.
  - C. Nonparametric tests are considered distribution-free methods because they do not rely on any underlying distribution assumption.

**Questions 33 through 44 relate to Economics**

33. An auction in which each bidder submits a price or bid to the auctioneer simultaneously and independently is categorized as:
- A. Dutch auction.
  - B. English auction.
  - C. Sealed bid auction.
34. An analyst gathered the following national data (in millions of U.S dollars) for a country for the year 2013.

**Exhibit:**

Consumer spending (m)	\$461,580	Personal disposable income	\$555,790
Government spending	\$392,676	Interest paid by consumers	\$13,400
Personal Income	\$906,230	Consumer transfers to foreigners	\$1,500

- Using the data provided in exhibit 1, the household saving (in millions) is *closest* to:
- A. \$37,074.
  - B. \$68,904.
  - C. \$79,310.
35. Which of the following is *most likely* common among the assumptions of the Ricardian model and Heckscher-Ohlin model?
- A. Labor is a variable factor of production.
  - B. Capital is not a variable factor of production.
  - C. There are homogenous products and homogenous inputs.
36. When an increase in interest rate leads to a decline in savings, it implies that:
- A. individuals substitute future consumption for present consumption.
  - B. income effect of a higher interest rate is greater than substitution effect.
  - C. savings and interest rate patterns cannot be determined in terms of the income and substitution effect.

37. Aggregate demand (AD) curve will be flatter if:
- saving is highly sensitive to income.
  - investment expenditure is highly sensitive to interest rates.
  - money demand is highly sensitive to income and interest rates.
38. A consumer with a steeper indifference curve *most likely* indicates that his marginal rate of substitution ( $MRS_{XY}$ ) is:
- greater and he can give up more of good Y to get an additional unit of good X.
  - lower and he can give up more of good X to get an additional unit of good Y.
  - greater and he cannot gain from voluntary exchange with the consumer whose  $MRS_{XY}$  is lower.
39. Which of the following *most likely* represents valid criticisms concerning the neoclassical and Austrian schools?
- Neoclassical and Austrian policies are focused on the short term only.
  - Economic forecasts are imperfect as fiscal policies are implemented with a time lag.
  - It is difficult to achieve market equilibrium through reduction in generalized price and wage.
40. To determine the impact of changes in exchange rates on trade balance, the ‘absorption approach’ *most likely* exhibits the:
- effect of changing the relative price of domestic and foreign goods.
  - effect of exchange rates on aggregate expenditure or saving decisions.
  - microeconomic view of the relationship between exchange rates and trade balance.
41. Which of the following factors of production *most likely* include the cost of building, equipment and interest?

	<b>Building</b>	<b>Equipment</b>	<b>Interest</b>
A.	Land	Materials	Capital
B.	Capital	Materials	Land
C.	Capital	Capital	Capital

42. Leading economic indicators (LEI) are variables that:
- A. change before nominal GDP of economy changes.
  - B. provide information regarding economy's past condition.
  - C. are useful for predicting economy's near-term future state.
43. Which of the following characteristics *most likely* demonstrates that the firm is operating in monopolistic competition?
- |    | <b>Entry Barriers</b> | <b>Sellers</b> | <b>Long-run profits</b> |
|----|-----------------------|----------------|-------------------------|
| A. | Low                   | Many           | None                    |
| B. | High                  | Few            | Positive                |
| C. | Low                   | Few            | None                    |
44. To deal with short-run stabilization, as compared to monetary policy, fiscal policy is *most likely*:
- A. less effective as it is very time consuming.
  - B. more effective as it is easy to implement.
  - C. equally effective as both policies work well in combination.



**Questions 45 through 68 relate to Financial Reporting and Analysis**

45. On 1<sup>st</sup> January 2011, Arnold Inc. purchases a machine for \$325,000 and immediately leases the machine through a direct finance lease that requires five annual payments of \$56,000 starting from 1<sup>st</sup> January 2011. The carrying amount is equal to its purchase price and the relevant discount rate is 12%.

On 1<sup>st</sup> January 2012, the reduction in lease receivable is *closest* to:

- A. \$23,720.
  - B. \$79,720.
  - C. \$112,000.
46. Under IFRS cash receipt of interest cannot be classified as a (n):
- A. investing activity.
  - B. financing activity.
  - C. operating activity.
47. EBB Inc. entered into a three-year contract to construct a building with an estimated total cost of \$32 million. Due to limitations, project costs are uncertain and the output of the project cannot be measured reliably. If at the end of year 1 EBB spent \$26 million, under U.S. GAAP EBB would *most likely* recognize:
- A. \$26 million as cost of construction.
  - B. \$26 million as an increase in inventory account.
  - C. \$0 in any account until the project has completed.
48. Which of the following measures initially decrease as a result of a firm's decision to capitalize its expenditure instead of expensing them?
- A. Total assets.
  - B. Debt-to-equity.
  - C. Cash outflows from operations.

49. Which of the following statements is *most likely* correct regarding the audit of financial statements?
- A. Disclaimer of opinion occurs when an auditor issues an opinion despite scope limitations.
  - B. When an auditor has concerns regarding some unreported pending contingent liabilities he might issue a qualified opinion.
  - C. Auditors can provide absolute assurance about the accuracy and precision of financial statements if the opinion is unqualified.
50. When securities are classified as ‘available for sale’ securities in U.S. GAAP unrealized gains and losses are:
- A. reported in the income statement.
  - B. not reported in the income statement but are recognized in equity.
  - C. neither reported in the income statement nor recognized in equity.
51. Gloria Inc. ships 5 machines to a customer at \$5,550 per machine. The total cost for Gloria Inc. is \$26,250 and payment is due in 60 days. No cash changes hands at delivery. The accounting treatment related to this transaction at the time of shipment *most likely* includes:
- A. accounts receivable and revenue increased by \$27,750 and inventory decreased by \$26,250.
  - B. revenue increased by \$5,550, cost of goods sold decreased by \$26,250 and cash remains unchanged.
  - C. accounts receivable and revenue increased by \$27,750 and inventory and cost of goods sold decreased by \$26,250.
52. Which of the following statements is *most likely* correct regarding the depreciation of property, plant and equipment under IFRS and U.S. GAAP?
- A. Both IFRS and U.S. GAAP require an annual review of residual value and useful life.
  - B. Unlike IFRS, U.S. GAAP requires an annual review of residual value and useful life.
  - C. Unlike U.S. GAAP, under IFRS each component of an asset must be depreciated separately.

53. An analyst gathered the following information from a company's 2013 financial statements.

Net income	= \$24 million
Non cash charges	= \$6 million
Cash flow from operations	= \$12 million
After tax interest paid	= \$2.6 million
Capital expenditure	= \$9.5 million
Tax rate	= 35%

The free cash flow for the firm (FCFF) is *closest* to:

- A. \$5.1 million.
  - B. \$8.7 million.
  - C. \$11.1 million.
54. Which of the following statements *least likely* represents the correct treatment of impairment loss?
- A. It reduces investing cash flow in the year loss is reported.
  - B. It reduces the net income and carrying amount of assets.
  - C. It is considered a non-cash item and thus does not affect the cash flow statement.
55. Earnings smoothing can result from conservative choices to:
- A. overstate earnings in periods when a company's operations are struggling.
  - B. understate earnings in periods when a company's operations are struggling.
  - C. understate earnings in periods when a company's operations are performing well.

56. Which of the following is *least likely* an (International Organization of Securities Commissions) (IOSCO) principle for issuers? Issuers should:
- A. prepare their financial statements using internationally acceptable accounting standards.
  - B. timely, fully and accurately disclose financial results, risks and other material information to investors.
  - C. make consistent choices with respect to accounting standards and their financial statements should be comparable.
57. The elements directly related to measurement of financial performance *least likely* include:
- A. liabilities.
  - B. expenses.
  - C. capital maintenance adjustments.
58. An analyst gathered the following information for a firm:
- |  |                 |
|--|-----------------|
| Net income for the year                          | = \$8 million   |
| Beginning shareholders' equity                   | = \$25 million  |
| Unrealized gain on trading securities            | = \$1.5 million |
| Unrealized loss on available for sale securities | = \$2 million   |
| Foreign currency translation gain                | = \$1.5 million |
| Cash dividends for the year                      | = \$1 million   |
- The ending shareholders' equity of the company is *closest* to:
- A. \$30.0 million.
  - B. \$31.5 million.
  - C. \$33.0 million.

59. An analyst observed the following percentage changes in Hunt PAL Inc.'s financials from 2012 to 2013:

Revenue	+33%
Net Income	+38%
Assets	+27%

If the major portion of the growth in net income is attributed to non-recurring items, the analyst will *least likely* conclude that Hunt PAL Inc.:

- A. has increased its efficiency.
  - B. has failed to increase its profitability.
  - C. cannot easily attract equity capital.
60. The financial leverage ratio of a firm, whose total debt ratio is 54% and debt-to-equity is 1.15, is *closest* to:
- A. 0.47.
  - B. 0.62.
  - C. 2.13.
61. An investor asked two questions from an analyst regarding the goodwill of a company.

Question 1: Which goodwill is reflected in the stock price of a company?

Question 2: Which goodwill is recognized when an acquisition takes place?

The *most appropriate* response of the analyst to questions 1 and 2, respectively, is:

	Question 1:	Question 2:
A.	Economic	Accounting
B.	Accounting	Economic
C.	Economic & Accounting	Economic

62. Regarding business segments, companies are not required to provide:
- A. full financial statements for segments.
  - B. factors used to identify reportable segments.
  - C. disclose segment information under both IFRS and U.S. GAAP.
63. In 2012, the cost of ending inventory reported by T&M, a manufacturer of office equipment, was \$22 million. T&M compiles its financial statements in accordance with IFRS.

Exhibit 1

Replacement cost	\$20.5 million
NRV	\$21.2 million
NRV less profit margin	\$19.7 million

Based on the data shown in Exhibit 1, T&M would *most likely* write its inventory down by:

- A. \$0.8 million.
  - B. \$1.5 million.
  - C. \$2.3 million.
64. A publishing firm contributed \$250,000 to support some philanthropic projects. The firm immediately expensed that amount in its income statement for the current fiscal year. According to applicable tax legislation such contributions are not tax-deductible.

Which of the following statements is *most likely* correct?

- A. A temporary difference of \$250,000 gives rise to a deferred tax liability.
- B. A deferred tax asset arises, as taxable income is greater than accounting profit.
- C. The treatment of \$250,000 for accounting and tax purposes represents a permanent difference.

65. Under IFRS the definitional criteria for identifiable intangible assets *most likely* includes:
- A. the cost of the asset can be reliably measured.
  - B. it is probable that the expected future economic benefits of the asset will flow to the company.
  - C. the asset must be identifiable, under the control of company and expected to generate future economic benefits.
66. Knin Inc. issued a 6-year, 7% annual-coupon paying bond issue with a face value of \$10 million on 1<sup>st</sup> January 2011 when the market interest rate was 7.7%. Using the effective interest rate method, the interest expense on bonds reported in 31 December 2012 is *closest* to:
- A. \$700,000.
  - B. \$744,854.
  - C. \$748,308.
67. Pension expense for employees directly related to production is reflected by an increase in:
- A. salaries and other administrative expenses.
  - B. the net pension liability account in the balance sheet.
  - C. the inventory account and is expensed through cost of sales.
68. An investor uses simple stock screen criteria based on a P/E ratio of less than 5 and financial leverage ratio of less than 0.5. The investor will *least likely* exclude stocks of companies:
- A. with poor profitability.
  - B. with excessive financial risk.
  - C. that are expensive for good reason.

**Questions 69 through 76 relate to Corporate Finance**

69. The cash flows of projects A and B are given below:

Year	Cash flows	
	Project A	Project B
0	-1,500	-1,500
1	400	500
2	300	500
3	600	500
4	800	500

For a 12% internal rate of return, as compared to project B, the discounted payback period of project A is approximately:

- A. equivalent.
  - B. 0.93 years higher.
  - C. 1.25 years higher.
70. Net present value method assumes that cash flows are reinvested at the:
- A. internal rate of return.
  - B. accounting rate of return.
  - C. opportunity cost of capital.
71. Which of the following is *most likely* a correct implication of stock dividends to the shareholders?
- A. Generally stock dividends are taxable.
  - B. Stock dividends positively affect the market value of shareholders' wealth.
  - C. When stock dividends are paid shareholders' cost per share held decreases.



72. An analyst gathered the following information to estimate the cost of equity for JI Inc. located in Fiji.

**Exhibit 1**

Risk free rate	3.2%
Market risk premium	5.5%
Beta	1.3
U.S 10-year T-bond yield	2.84%
Fiji's 10-year dollar denominated Govt. bond yield	10.81%
Annualized SD of Fiji's stock market	44%
Annualized SD of Fiji's dollar denominated bond	37%

The sovereign yield spread and JI Inc.'s cost of equity are *closest* to:

- A. 7.97% and 18.51% respectively.
  - B. 9.48% and 19.83% respectively.
  - C. 7.97% and 22.67% respectively.
73. When a company finances share repurchases with cash:
- A. assets and shareholders' equity decrease and leverage increases.
  - B. assets and shareholders' equity decrease and leverage remains - unchanged.
  - C. leverage increases, shareholders' equity decreases and assets remain unchanged.
74. When a reliable current market price for a firm's debt is not available, the cost of debt can be estimated using the:
- A. matrix pricing model.
  - B. coupon rate of the same bonds.
  - C. interest expense of the firm's income statement.
75. A manager is computing the cost of trade credit for the terms 1.5/5 net 30. The account is paid on either the 15<sup>th</sup> day or the net day. The cost of credit is:
- A. 24.69% lower if the credit is paid on the net day.
  - B. 48.92% lower if the credit is paid on the net day.
  - C. 24.21% higher if the credit is paid on 15<sup>th</sup> day.

76. An analyst gathered the following financial information from Daniel Inc.

	<b>2013</b>	<b>Expected 2014</b>
Units Sold	1300	1400
Revenue (\$)	130,000	140,000
Operating income (\$)	38,000	52,000
Interest cost (\$)	12,000	12,000
Other financing cost (\$)	8,000	8,000
Tax (\$)	6300	11,200
Net Income (\$)	11,700	20,800

The degree of operating leverage of Daniel Inc. from 2013 to expected 2014 is *closest* to:

- A. 2.11.
- B. 3.68.
- C. 4.79.

**Questions 77 through 88 relate to Equity**

77. For short selling purposes if a security is extremely hard to borrow, the short rebate rate may be:
- A. very high.
  - B. negative or very low.
  - C. 10 basis points more than the overnight rate.
78. Which of the following statements is *most likely* correct regarding the fundamental weighting method?
- A. It is not biased towards shares of firms with largest market capitalization.
  - B. It is similar to momentum investment strategy where securities' weights are reduced when their relative investment values are increased.
  - C. It is biased towards highest priced stocks as they receive highest weights in the index.
79. Smith owns 500 shares of Wood Craft Inc. and the firm is going to elect 10 board directors. Under statutory voting Smith can cast:
- A. 500 votes to members in any desired proportion.
  - B. a maximum of 500 votes only for each member of board.
  - C. 5,000 votes and can spread them across candidates in any proportion.
80. An investor placed a market buy order for thinly traded shares of G.Z.T Inc. The main drawback for the investor would be that:
- A. the order may be filled at a low price.
  - B. it would be very difficult to execute the order.
  - C. the trade would be very expensive to execute.
81. The performance of commodity indices can be quite different from their underlying commodities because
- A. commodity returns are more volatile than commodity index returns.
  - B. returns of commodity indices are influenced by more than one factor.
  - C. commodity indices are relatively illiquid and depict less information transparency.

82. Which of the following statements is *most likely* correct? Enterprise value:
- A. is incapable of reflecting the real economic value of a company.
  - B. is prone to the negative earnings problem because of the use of EBITDA.
  - C. is applicable to the comparisons of companies with significantly different capital structures.
83. A firm will start paying dividends four years from now and thereafter that will be expected to grow 5% into perpetuity. Expected dividend in year 4 is \$5. If an investor's required rate of return is 7%, the intrinsic value of the stock is *closest* to:
- A. \$200.
  - B. \$204.
  - C. \$227.
84. Which of the following is *least likely* a macroeconomic influence that affects an industry's growth? Changes in:
- A. inflation.
  - B. interest rates.
  - C. technologies.
85. Which of the following *most* accurately illustrates the pricing rule used by the type of order driven market?

Uniform pricing rule	Discriminatory pricing rule	Derivative Pricing rule
----------------------	-----------------------------	-------------------------

- |                      |                   |                   |
|----------------------|-------------------|-------------------|
| A. Call market       | Continuous market | Crossing network  |
| B. Continuous market | Call market       | Crossing network  |
| C. Crossing network  | Call market       | Continuous market |
86. Asset based valuation models work well for companies that do not have a high proportion of:
- A. intangibles.
  - B. fixed assets.
  - C. current assets.

87. An investor holds 500 shares of Siena Inc. for one year on margin. Both the interest on loan and dividends on shares are paid at the end of the year. The other details are as follows:

Purchase price	\$45/share
Sale price	\$42/share
Dividend	\$1/share
Commission	\$0.1/share
Leverage ratio	1.5
Call money rate	4%

The investor's total loss is *closest* to:

- A. 7%.
  - B. 9%.
  - C. 10%.
88. The £40 par value of a non-callable non-convertible preferred stock with maturity in two years and £5 semi-annual dividend is trading for £53.22. If the required rate of return for the investor is 7%, the preferred stock is:
- A. over-valued.
  - B. fairly valued.
  - C. under-valued.

**Questions 89 through 94 relate to Derivatives**

89. Value of a forward contract at expiration is the value of the asset:
- A. plus the forward price.
  - B. minus the forward price.
  - C. minus the present value of the forward price.
90. A put option is selling for \$6 for which the exercise price is \$72 and the price of the underlying is \$77. The maximum profit to the buyer and the breakeven price of the underlying at expiration is:
- |    | Maximum profit to the buyer: | Breakeven price at expiration: |
|----|------------------------------|--------------------------------|
| A. | \$66                         | \$66.                          |
| B. | \$71                         | \$78.                          |
| C. | Unlimited                    | \$71.                          |
91. Derivative price *least likely* depends on:
- A. risk free rate.
  - B. investor's risk aversion.
  - C. Characteristics of the underlying.
92. A type of credit derivative in which credit protection buyer makes a series of regularly scheduled payments to credit protection seller while the seller makes no payment until a credit event occurs is categorized as a:
- A. total return swap.
  - B. credit linked note.
  - C. credit default swap.
93. The cost of protective put can *most likely* be reduced by:
- A. selling a call option and this strategy is known as 'collar'.
  - B. selling the stock and this strategy is known as 'insurance'.
  - C. taking a short call position and this strategy is known as 'covered call'.

94. Information can flow into the derivative before it gets into the spot market due to the fact that derivative markets:
- A. require less capital.
  - B. are highly centralized.
  - C. are operated by more professional traders.

**Questions 95 through 106 relate to Fixed Income**

95. Which of the following is the *highest* ranked unsecured debt?
- A. First lien loan.
  - B. Senior unsecured.
  - C. Senior subordinated.
96. A U.S. based firm has a position in a European bond for a par value of €50 million. For a 1 basis point increase in yield the market value of the investment changes to €49.85 million and for a 1 basis point decrease in yield investment value changes to €51.23 million. The price value of basis point for the investment is *closest* to:
- A. 0.013.
  - B. 0.027.
  - C. 0.690.
97. In repurchase agreements, repo margin provides a margin of safety to the:
- A. dealer, if the lender of the cash defaults.
  - B. cash lender, if the collateral's market value declines.
  - C. security lender, if the collateral's market value declines.
98. An investor purchases a 2-year zero-coupon bond with par value of \$1,000 at \$960. The implied interest earned on the bond is *closest* to:
- A. \$0.
  - B. \$21.
  - C. \$40.



99. An analyst observed the profitability and cash flows of firms A and B and collected the results below.

	<b>Firm A</b>	<b>Firm B</b>
Earnings before interest and tax	104 million	96.5 million
Free cash flow before dividends	-12.5 million	8.5 million
Free cash flow after dividends	N/A	0.5 million

- The firm(s) not suitable for deleveraging is (are):
- A. firm A only.
  - B. firm B only.
  - C. firms A and B.
100. An investor buys a 10-year, 7% annual coupon payment bond and sells the bond after 3 years. Assuming that the coupon payments are reinvested at 11.5% for 3 years. The interest on interest gain from compounding the coupon payments is *closest* to:
- A. \$2.51.
  - B. \$5.21.
  - C. \$23.5.
101. A recently issued sovereign bond for a given maturity is also referred to as:
- A. floating issue.
  - B. of the run issue.
  - C. benchmark issue.
102. A high yield bond issuer has offered the ‘change of control put’ to its bondholders. Under this covenant in the event of acquisition, the bondholder has a (n):
- A. right to put limits on how much secured debt an issuer can have.
  - B. option to change a certain percentage of his bond value with the equity of the issuer.
  - C. right to require the issuer to buy back their debt at par or at some premium to par.

103. An annual modified duration of a fixed rate bond is 5.75. Although there is no change in benchmark yields but due to improved financial reporting quality and a ratings upgrade, the flat price of the bond has increased from 98.10 to 101.65 per 100 of par value. The estimated change in the credit spread of the bond is *closest* to:

- A. -62.93 bps.
- B. -20.75 bps.
- C. 361.88 bps.

104. Current forward curve for one-year rates is given below:

Time Period	Forward Rate
0y1y	1.90%
1y1y	2.25%
2y1y	3.50%
3y1y	4.41%

The three-year implied spot rate is *closest* to:

- A. 2.55%.
- B. 3.18%.
- C. 4.41%.

105. For rating agencies, the primary factor in assigning their ratings is:

- A. likelihood of default.
- B. potential loss severity.
- C. priority of payment in the event of a default.

106. Consider a 2-year 5% semiannual coupon-paying bond and the following sequence of spot rates:

<b>Term to maturity</b>	<b>Spot Rates</b>
6-months	0.50%
12-months	1.25%
18-months	2.00%
24-months	2.25%

The yield to maturity of the bond is *closest* to:

- A. 2.2%.
- B. 3.0%.
- C. 4.5%.

**Questions 107 through 112 relate to Alternative Investments**

107. Mezzanine financing is capital provided:
- A. for major expansion.
  - B. to prepare for an IPO.
  - C. to initiate commercial manufacturing.
108. During periods of financial crises, the correlation between hedge funds and financial market performances may:
- A. increase.
  - B. decrease.
  - C. become 0.
109. The four broad categories of hedge fund strategies identified by HFRI are:
- A. Equity-driven, Market neutral, Arbitrage and Hedge strategies.
  - B. Event-driven, Relative value, Equity hedge and Macro strategies.
  - C. Event-driven, Equity driven, Relative value and Market neutral strategies.
110. For venture capital investing, later stage financing is the capital provided for a company:
- A. to prepare for an IPO.
  - B. to plan for major expansion.
  - C. to initiate commercial manufacturing and sales.
111. Which of the following is not a suitable risk return measure for alternative investments?
- A. Sortino ratio
  - B. Sharpe ratio
  - C. Safety-first risk

112. Jerry invested \$15 m in EV Fund of funds (EVFOF) that invested 75% with Tsar Hedge Fund (THF). EV FOF and THF have “1 & 10” and “2 & 20” fee structures respectively. Management fees are calculated using beginning of period capital and both management and incentive fees are computed independently. THF earned 17% annual return before management and incentive fees. Based on the data provided, net of fees return to Jerry is *closest* to:
- A. 7.08%.
  - B. 8.90%.
  - C. 9.44%.

**Questions 113 through 120 relate to Portfolio Management**

113. Which of the following quantifies and allocates the tolerable risk by specific metrics?
- A. Risk tolerance
  - B. Risk Budgeting
  - C. Enterprise risk management
114. When an investor's ability to take risk is above average but willingness is below average, the investor's risk tolerance is
- A. average.
  - B. above average.
  - C. below average.
115. The intercept of security characteristic line (SCL) is:
- A. Beta.
  - B.  $R_M - R_F$ .
  - C. Jensen's alpha.
116. Generating sufficient income and maintaining the real capital value of the fund are *most likely* the objectives of:
- A. insurance companies.
  - B. university endowments.
  - C. investment companies.
117. An investor earned -0.5% returns in predicting the one-week movement in the dollar/pound exchange rate from 06/01/13 to 06/07/13. The loss an investor can suffer by the end of June 2014 keeping the given return as representative of future losses is *closest* to:
- A. 1.98%.
  - B. 22.9%.
  - C. 29.6%.

118. Which of the following two measures are based on the total risk and provide similar rankings?
- A.  $M^2$  and Sharpe ratio.
  - B. Sharpe and Treynor ratios.
  - C. Treynor ratio and Jensen's alpha.
119. Generating higher returns from security selection *most likely* depends upon:
- A. lower index turnover and passive management.
  - B. higher informational efficiency and lower index turnover.
  - C. lower informational efficiency and higher skills of investment managers.
120. Assuming the correlation between an asset and market is 0.67 and the asset and market have standard deviations of 0.34 and 0.19 respectively, the market beta would be *closest* to:
- A. 0.09.
  - B. 1.00.
  - C. 1.20.