

Sample Level I Questions

These sample questions were developed to give candidates an indication of the question formats used on the actual examination.

1. Anthony Buchard, CFA, disclosed a complaint by a former client on his annual professional conduct statement. The CFA Institute Professional Conduct Program sent Buchard a Notice of Inquiry and requested a copy of the client complaint. Buchard provided a copy of the complaint; however, several parts of the complaint were blackened out. Buchard refused to provide a complete copy of the complaint because it contained confidential client information. According to the *Standards of Practice Handbook*, Buchard should:
 - A. provide a complete copy of the complaint to the Professional Conduct Program.
 - B. maintain all client information as confidential, including the information contained in the client complaint.
 - C. sign a confidentiality agreement with the client that requires Buchard to keep the client complaint confidential.
 - D. disclose only those parts of the complaint that contain information related to the client's illegal activities or that are outside the scope of the confidential client relationship.

2. According to the *Standards of Practice Handbook*, which of the following activities is *least likely* to breach a member's duty to a client?
 - A. Failing to vote proxies.
 - B. Failing to establish the investment objectives of the client.
 - C. Using soft dollar arrangements to pay firm management expenses.
 - D. Disclosing confidential client information to the CFA Institute Professional Conduct Program.

3. Beth Patrick, a fixed income analyst at a brokerage company, assists her company's traders by developing in-house bond ratings to supplement those of the major bond rating services. The traders use disparities in the ratings to construct profitable investment strategies. Patrick makes inferences from nonmaterial private information and news events, which she reflects in her bond ratings. Patrick's approach:
 - A. reflects the mosaic theory.
 - B. violates confidentiality rules.
 - C. violates insider trading rules.
 - D. reflects the misappropriation of information theory.

4. Monique Stein, CFA, conducted a thorough analysis and issued a research report on a manufacturing company. In the report, which was made available to all clients of her firm, Stein included her opinion that she was uncertain about the ability of the company to perform on a contract. The Chief Executive Officer of the company disagreed and submitted a complaint to Stein's supervisor. The complaint alleged that employees of the manufacturing company explained the contract to Stein, but that she did not accept their explanation. According to the *Standards of Practice Handbook*, did Stein violate the CFA Institute Standard of Professional Conduct relating to:

	<u>communication with clients and prospective clients?</u>	<u>diligence and reasonable basis?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

5. For an investment portfolio, the Sharpe ratio is used to measure:

- A. risk per unit of mean return.
- B. mean return per unit of risk.
- C. risk per unit of mean excess return.
- D. mean excess return per unit of risk.

6. An analyst gathered the following information about the net profit margins of companies in two industries:

<i>Net Profit Margin</i>	<i>Industry K</i>	<i>Industry L</i>
Mean	15.0%	5.0%
Standard deviation	2.0%	0.8%
Range	10.0%	15.0%

Compared with the other industry, the relative dispersion of net profit margins is smaller for Industry:

- A. L, because it has a smaller mean deviation.
- B. L, because it has a smaller range of variation.
- C. K, because it has a smaller standard deviation.
- D. K, because it has a smaller coefficient of variation.

7. An individual deposits \$10,000 at the beginning of each of the next 10 years, starting today, into an account paying 9 percent interest compounded annually. The amount of money in the account at the end of 10 years will be *closest* to:
- A. \$109,000.
 - B. \$143,200.
 - C. \$151,900.
 - D. \$165,600.
8. An investor wants to have \$1 million when she retires in 20 years. If she can earn a 10 percent annual return, compounded annually, on her investments, the lump-sum amount she would need to invest today to reach her goal is *closest* to:
- A. \$100,000.
 - B. \$117,459.
 - C. \$148,644.
 - D. \$161,506.
9. In hypothesis testing, a Type II error is:
- A. rejecting a true null hypothesis.
 - B. rejecting a false null hypothesis.
 - C. failing to reject a true null hypothesis.
 - D. failing to reject a false null hypothesis.
10. An investment promises to pay \$100 one year from today, \$200 two years from today, and \$300 three years from today. If the required rate of return is 14 percent, compounded annually, the value of this investment today is *closest* to:
- A. \$404.
 - B. \$444.
 - C. \$462.
 - D. \$516.
11. According to new classical economists, is financing a reduction in current taxes by government borrowing likely to result in an increase in:
- | | aggregate demand? | the real interest rate? |
|----|-------------------|-------------------------|
| A. | No | No |
| B. | No | Yes |
| C. | Yes | No |
| D. | Yes | Yes |

12. Which of the following is *least likely* to explain why government regulation is usually a sub-optimal response to monopolistic markets?
- A. Regulatory agencies often reflect the views of special interests.
 - B. Owners of regulated companies can lack the incentive to operate at a low cost.
 - C. Regulatory agencies may lack information about the true costs and profits of companies.
 - D. Regulatory agencies can typically enforce marginal cost pricing but not average cost pricing.
13. The law of diminishing marginal utility states that the:
- A. marginal return derived from making successive units of investment eventually declines.
 - B. additional satisfaction derived from consuming successive units of a product eventually declines.
 - C. additional satisfaction derived from consuming successive units of a product is limited by the amount of disposable income.
 - D. additional satisfaction derived from consuming successive units of a product can be increased by reducing the product price.
14. For a U.S. GAAP company, which of the following statements *best* describes the relationship between the amount of accounting profits and the amount of economic profits of a company?
- A. Accounting profits and economic profits are similar.
 - B. Economic profits are greater than accounting profits.
 - C. Accounting profits are greater than economic profits.
 - D. No systematic relationship exists between accounting and economic profits.
15. If the effects are fully anticipated, what impact is expansionary monetary policy *most likely* to have on real economic activity?
- A. Little or no impact.
 - B. Large expansionary impact.
 - C. Moderate expansionary impact.
 - D. Moderate contractionary impact.

Questions 16-20 assume U.S. GAAP (generally accepted accounting principles) unless otherwise noted.

16. An analyst gathered the following information about the new capital lease obligation a company made at the beginning of the year:

Annual end of year payments	\$16,000
Term of the lease	10 years
Appropriate discount rate	10%
Depreciation method	Straight-line
Salvage assumption	Zero salvage value

In the first year of the lease, the cash flow from financing section of the lessee company's statement of cash flows will contain a lease-related cash outflow that is *closest* to:

- A. \$6,169.
B. \$9,831.
C. \$14,400.
D. \$16,000.
17. An analyst has determined that Megamore Industries uses the LIFO inventory method. Megamore's reported gross income for the year is *most likely* to be overstated and require adjustment by the analyst if, during the year, Megamore experienced a(n):
- A. increase in inventory prices.
B. decrease in inventory prices.
C. increase in inventory quantities.
D. decrease in inventory quantities.
18. In the Statement of Cash Flows for a U.S. company, which of the following *best* describes how interest received and interest paid, respectively, are classified?

	<u>Interest received</u>	<u>Interest paid</u>
A.	Operating	Operating
B.	Operating	Investing
C.	Investing	Operating
D.	Investing	Investing

19. An analyst gathered the following information about a fixed asset purchased by a company:

- Purchase price \$12,000,000
- Estimated useful life 5 years
- Estimated salvage value \$2,000,000

Using the double-declining-balance depreciation method, the company's depreciation expense in Year 2 will be *closest* to:

- A. \$2,000,000.
- B. \$2,400,000.
- C. \$2,880,000.
- D. \$7,680,000.

20. The following information applies to a company's preferred stock:

- Current price \$47.00 per share
- Par value \$50.00 per share
- Annual dividend \$3.50 per share

If the company's marginal corporate tax rate is 34 percent, the after-tax cost of preferred stock is *closest* to:

- A. 4.62%.
- B. 4.91%.
- C. 7.00%.
- D. 7.45%.

21. The divisor for the Dow Jones Industrial Average (DJIA) is *most likely* to decrease if a stock in the DJIA:

- A. has a stock split.
- B. has a reverse split.
- C. pays a cash dividend.
- D. is removed and replaced.

22. A silver futures contract requires the seller to deliver 5,000 Troy ounces of silver. An investor sells one July silver futures contract at a price of \$8 per ounce, posting a \$2,025 initial margin. If the required maintenance margin is \$1,500, the price per ounce at which the investor would first receive a maintenance margin call is *closest* to:

- A. \$5.92.
- B. \$7.89.
- C. \$8.11.
- D. \$10.80.

23. The current price of an asset is 100. An out-of-the-money American put option with an exercise price of 90 is purchased along with the asset. If the breakeven point for this hedge is at an asset price of 114 at expiration, then the value of the American put at the time of purchase must have been:

- A. 0.
- B. 4.
- C. 10.
- D. 14.

24. An analyst gathered the following information about a company:

- 2001 net sales \$10,000,000
- 2001 net profit margin 5.0%
- 2002 expected sales growth -15.0%
- 2002 expected profit margin 5.4%
- 2002 expected common stock shares outstanding 120,000

The company's 2002 expected earnings per share is *closest* to:

- A. \$3.26.
- B. \$3.72.
- C. \$3.83.
- D. \$4.17.

25. Industry life cycles are typically categorized by the:

- A. level of competition.
- B. rates of growth in sales.
- C. level of productive capacity.
- D. rates of growth in return on equity.

26. Does trading take place at market prices that are updated continuously throughout the entire trading day in the case of:

	<u>exchange traded funds?</u>	<u>traditional mutual funds?</u>
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

27. If an investor's required return is 12 percent, the value of a 10-year maturity zero-coupon bond with a maturity value of \$1,000 is *closest* to:
- A. \$312.
 - B. \$688.
 - C. \$1,000.
 - D. \$1,312.
28. Which of the following is *least likely* to affect the required rate of return on an investment?
- A. Real risk-free rate.
 - B. Asset risk premium.
 - C. Expected rate of inflation.
 - D. Investors' composite propensity to consume.
29. An individual investor's investment objectives should be expressed in terms of:
- A. risk and return.
 - B. capital market expectations.
 - C. liquidity needs and time horizon.
 - D. tax factors and legal and regulatory constraints.
30. With respect to the security market line (SML) and the value of a stock, if the stock's estimated return is greater than its expected (required) return, the stock plots:
- A. above the SML and is overvalued.
 - B. below the SML and is overvalued.
 - C. above the SML and is undervalued.
 - D. below the SML and is undervalued.
31. An investor with a portfolio located on the capital market line to the left of the market portfolio has:
- A. a lending portfolio.
 - B. a borrowing portfolio.
 - C. lower unsystematic risk than the market portfolio.
 - D. higher unsystematic risk than the market portfolio.
32. Which of the following statements *best* reflects the importance of the asset allocation decision to the investment process? The asset allocation decision:
- A. helps the investor decide on realistic investment goals.
 - B. identifies the specific securities to include in a portfolio.
 - C. determines most of the portfolio's returns and volatility over time.
 - D. creates a standard by which to establish an appropriate investment time horizon.