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QUESTION 1

If the one month FF/\$ exchange rate is 8.0200-50 this implies:

A. the bank is willing to commit itself today to sell dollars in one month for 8.0200 francs or to buy them for 8.0250 francs.

B. the bank is willing to commit itself today to buy dollars in one month for 8.0200 francs or to sell them for 8.0250 francs.

C. the bank is willing to commit itself today to buy dollars for 8.0200 francs or to sell them for 8.0250 francs.

D. the bank is willing to commit itself today to buy dollars in one month for 8.0200 francs or to sell them for 8.0150 francs.

E. none of these answers

Correct Answer: B

In a forward, or futures, contract, a commitment is irrevocably made on the transaction date, but delivery takes place later, here a month later. The bid-ask quotation here implies that the bank is willing to commit itself today to buy dollars in one month for 8.0200 francs or to sell them for 8.0250 francs.

QUESTION 2

Which of the following describes a change in reporting entity?

A. A company acquires a subsidiary that is to be accounted for as a purchase.

- B. None of these answers.
- C. A business combination is made using the pooling-of-interests method.
- D. A manufacturing company expands its market from regional to nationwide.

E. A company acquires additional shares of an investee and changes from the equity method of accounting to consolidation of the subsidiary.

Correct Answer: C

A change in reporting entity can occur in the following ways: initial publication of consolidated financial statements; change in consolidation policy regarding subsidiaries; and pooling of interests.

QUESTION 3

Which of the following statements is most correct?

A. None of these statements are correct.

B. If a firm finds that the cost of debt financing is currently less than the cost of equity financing, an increase in its debt ratio will always reduce its cost of capital.



C. A firm can use retained earnings without paying a flotation cost. Therefore, while the cost of retained earnings is not zero, the cost of retained earnings is generally lower than the after-tax cost of debt financing.

D. The capital structure which minimizes the firm\\'s cost of capital is also the capital structure which maximizes the firm\\'s stock price.

E. The capital structure which minimizes the firm\\'s cost of capital is also the capital structure which maximizes the firm\\'s earnings per share.

Correct Answer: D

The optimal capital structure is the one that maximizes the price of the firm\\'s stock, and this generally calls for a debt ratio which is lower than the one that maximized expected EPS.

QUESTION 4

Polk Products is considering an investment project with the following cash flows: tCash Flow 0-100,000 140,000 290,000 330,000 460,000 The company has a 10 percent cost of capital. What is the project\\'s discounted payback?

A. 2.67 years

B. 1.86 years

C. 2.49 years

D. 1.67 years

E. 2.11 years

Correct Answer: B

The PV of t = 1 CF is found as follows: N = 1, I = 10, PMT = 0, FV = 40,000, and, thus PV = - \$36,363.64.

Similarly, find the PV of t = 2 CF which is \$74,380.17. Since the sum of these PVs is greater than the t = 0 CF of \$100,000, we know the discounted payback is less than two years. We can now solve for the discounted payback period as follows: DP = 1 + (\$100,000 - \$36,363.64)/\$74,380.17 = 1.86.

QUESTION 5

Costs that can be reasonably associated with specific revenues but not with specific products should be

- A. capitalized and then amortized over a period not to exceed 60 months.
- B. expensed in the period in which the related revenue is recognized.
- C. capitalized and then amortized over a period not to exceed 40 years.
- D. allocated to specific products based on the best estimate of the production processing time.
- E. charged to expense in the period incurred.

Correct Answer: B



The expense recognition principle of "associating cause and effect" or "matching" applies when a direct cause and effect relationship can be demonstrated between costs and particular revenues.

QUESTION 6

Government borrowing to fund current spending tends to cause ______ to rise. Subsequently, the local currency will ______ causing the trade deficit to rise.

- A. savings rate, depreciate
- B. national income, depreciate
- C. inflation, depreciate
- D. marginal propensity to consume, appreciate
- E. interest rates, appreciate

Correct Answer: E

Government borrowing creates demand for loanable funds, and therefore increases the price of such funds, i.e. the interest rate. When interest rates rise versus foreign rates, the value of the local currency rises on the foreign exchange market. This causes imports to be less expensive locally and exports to be more expensive abroad, and therefore tends to cause the current account trade deficit to widen.

QUESTION 7

What is the present value of \$250 per year for 6 years, with the first cash flow occurring today, rather than 1 year from now? Assume interest is 7% per year, compounded annually.

A. \$1,209.48

B. \$1,500.00

C. \$1,191.63

- D. \$1,275.05
- E. \$1,293.55
- Correct Answer: D

Recognize that this question is an annuity due situation, since the first cash flow occurs immediately or at the beginning of each period. Annuities where the first payment occurs 1 period from today (or at the end of each period) are called "ordinary" annuities. This requires placing the calculator into "Begin" mode prior to solving the question. NOTE: Be sure to place the calculator OUT OF annuity due mode after this question before going on to subsequent questions, or you will get the wrong answers! On the BAII Plus, press 2nd BGN. If the display shows END, then press 2nd SET and then 2nd Quit. This will place the BAII Plus into annuity due mode (you can tell this because the BAII Plus will display BGN in small letters). Now press 6 N, 7 I/Y, 250 PMT, 0 FV, CPT PV. Place the calculator back into End mode (for ordinary annuities) by pressing 2nd BGN and then if the calculator is displaying BGN, press 2nd SET and 2nd Quit. The BGN letters should disappear from the display. On the HP12C, press BlueShift END, which is the blue function on the front of the 8 digit key. This places the HP12C into Begin mode (the HP12C shows the word BEGIN in the display when in this mode). Then press 6 n, 7 i, 250 PMT, 0 FV, PV. To place the HP12C back into ordinary annuity mode (or END mode),



press BlueShift BEG (the blue function written on the front of the 7 digit key). Note that the answer is displayed as a negative number. Make sure the BAII Plus has the value of P/Y set to 1.

QUESTION 8

Firm A has just paid a cash dividend of \$6.2 per share. If the growth rate is expected to be 6% and the

price of the stock is \$24.90, the expected return on the stock is:

A. 32.39%

B. 26.39%

C. 20.39%

D. 24.90%

Correct Answer: A

Po = D1/(k-g). In this case, g = 6%, D1 = Do*(1+g) = 6.2*1.06 = \$6.572 and Po = \$24.90. Therefore, k = 32.39%. Note that Brigham and Houston refer to k as the cost of retained earnings; this is the same as the expected rate of return demanded by shareholders, which is the same as the rate of return on common equity.

QUESTION 9

Relationships with and Responsibilities to Clients and Prospects are dealt with under:

A. Standard I

B. Standard III

- C. None of these answers
- D. Standard II
- E. Standard V
- F. Standard IV
- Correct Answer: F

Relationships with and Responsibilities to Clients and Prospects are dealt with under Standard IV.

QUESTION 10

Which measure of central tendency is used to determine the average annual percent increase?

A. Mode

B. Mean



- C. Weighted mean
- D. Median
- E. Geometric mean

Correct Answer: E

The formulaic presentation of the geometric mean is suited for calculating percentage changes. The geometric mean of a set of n positive numbers and is defined as the nth root of the product of the n numbers. The two main uses of the geometric mean (GM) are:

1.

To average percents, indexes, and relatives, and

2.

To determine the average percent increase in sales, production or other business or economic series from one time period to another.

QUESTION 11

Holding other things constant, an increase in a firm\\'s ROE will

- A. have no effect on the firm\\'s expected growth rate.
- B. decrease the earnings multiplier.
- C. increase the earnings multiplier.
- D. decrease the firm\\'s expected growth rate.

Correct Answer: C

An increase in a firm\\'s return on equity (ROE) will increase its expected growth rate of earnings and dividends. This, in turn, will increase the earnings multiplier.

QUESTION 12

The assumptions underlying technical and fundamental analysis differ in many respects. Which of the following is an important difference between technical analysis and fundamental analysis? Choose the best answer.

A. None of these answers is correct.

B. All of these choices are important differences between technical analysis and fundamental analysis.

C. Technical analysis assumes that securities "price in" information immediately, whereas fundamental analysts assume that securities markets "price in" information gradually.

D. Technical analysis assumes that the Weak Form of the Efficient Market Hypothesis is correct, whereas fundamental analysis assumes that it is incorrect.



E. Technical analysis is not reliant on financial statements whereas fundamental analysis is heavily reliant on financial statements.

Correct Answer: E

Of all the differences between technical analysis and fundamental analysis, perhaps the most important is the fact that technical analysis assumes that securities markets are not weak form efficient, whereas fundamental analysis assumes that the Weak Form of the EMH is correct. Technical analysts assume that securities markets will "price-in" relevant information gradually, and that securities prices follow observable trends and patterns. Fundamental analysts, on the other hand, generally assume that past price information cannot be used to predict movements in securities prices.

QUESTION 13

Scenario analysis ignores:

- A. the range of likely values that key variables can take.
- B. changes in some of the key variables.
- C. effect on the NPV of changes in project variables.
- D. none of these answers.

Correct Answer: D

It is the Sensitivity Analysis that ignores the range of likely values that key variables can take. This is rectified using Scenario Analysis.

QUESTION 14

What degree of relationship do values of the correlation coefficient (r) with magnitudes close to 1.00 indicate?

A. Weak

- B. Strong
- C. Moderate
- D. None
- Correct Answer: B

The closer to 1, the stronger the relationship.

QUESTION 15

What is the value of a preferred stock with a par value of \$150, an annual dividend equal to 15% of par value, and a required rate of return of 12%?

A. \$150.00



- B. \$187.50
- C. Not enough information
- D. \$123.49
- E. 230.54
- Correct Answer: B

The value of a preferred stock is the present value of its dividends, which is equal to the annual dividend divided by the required rate of return. In this question, the annual dividend is equal to $150 \times .15 = 22.5$, and the preferred stock is worth 22.5/0.12 = 187.50

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