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Certified Management Accountant (CMA)

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### QUESTION 1

If a firm borrows \$590,000 at 10% and is required to maintain \$50,000 as a minimum compensating balance at the bank, what is the effective interest rate on the loan?

- A. 10.0%
- B. 11.1%
- C. 9.1%
- D. 12.2%

Correct Answer: B

At 10%, the interest on a \$500,000 loan is \$50,000 per year. However, the \$500,000 loan is effectively reduced to \$450,000 of usable funds by the compensating balance requirement. Thus, the borrower pays \$50,000 of interest for a \$450,000 loan, an effective rate of 11.1% ( $\frac{\$50,000}{\$450,000}$ ).

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### QUESTION 2

Maple Motors buys axles in order to produce automobiles. Maple carries an average credit balance of \$25,000,000 with its axle supplier. The axle supplier provides credit terms of 1/10 net 25. The nominal annual cost of Maple not taking the trade discount is closest to which one of the following? Assume a 360day year.

- A. 14.4%
- B. 14.5%
- C. 24.0%
- D. 24.2%

Correct Answer: D

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### QUESTION 3

Conversion costs do not include

- A. Depreciation.
- B. Direct materials.
- C. Indirect labor.
- D. Indirect materials.

Correct Answer: B

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Conversion costs are necessary to convert raw materials into finished products. They include all manufacturing costs, for example, direct labor and factory overhead, other than direct materials.

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#### QUESTION 4

CMR is a retail mail order firm currently using a central collection system that requires all checks to be sent to its Boston headquarters. An average of 5 days is required for mailed checks to be received, 4 days for CMR to process them, and 1 1/2 days for the checks to clear through the bank. A proposed lockbox system would reduce the mail and process time to 3 days and the check clearing time to 1 day. CMR has an average daily collection of \$100,000. If CMR should adopt the Lockbox system, its average cash balance would increase by

- A. \$250,000
- B. \$400,000
- C. \$650,000
- D. \$800,000

Correct Answer: C

Checks are currently tied up for 10 1/2 days (5 for mailing, 4 for processing, and 1 1/2 for clearing). If that were reduced to 4 days, Car\\'s cash balance would increase by \$650000 (6 1/2 days x \$100,000 per day).

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#### QUESTION 5

The process of dividing all potential consumers into smaller groups of buyers with distinct needs, characteristics, or behaviors, who might require a similar product or service mix, is called

- A. Strategic planning.
- B. Market segmentation.
- C. Product positioning.
- D. Objective setting.

Correct Answer: B

Market segmentation is the process of dividing all potential consumers into smaller groups of buyers with distinct needs, characteristics, or behaviors, who might require a similar product or service mix.

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#### QUESTION 6

A manufacturer produces a product that sells for \$10 per unit. Variable costs per unit are \$6 and total fixed costs are \$12,000. At this selling price, the company earns a profit equal to 10% of total dollar sales. By reducing its selling price to \$9 per unit, the manufacturer can increase its unit sales volume by 25%. Assume that there are no taxes and that total fixed costs and variable costs per unit remain unchanged. If the selling price were reduced to \$9 per unit, the profit would be

- A. \$3,000

- B. \$4,000
- C. \$5,000
- D. \$6,000

Correct Answer: A

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#### QUESTION 7

When making predictions about costs, what makes a cost relevant to a decision?

- A. Cost has already been paid.
- B. Cost must vary between alternatives.
- C. Cost must be paid in the future.
- D. Cost must both vary between alternatives and be paid in the future.

Correct Answer: D

To be relevant to a decision, a cost must vary between alternatives and be paid or incurred in the future.

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#### QUESTION 8

In joint-product costing and analysis, which one of the following costs is relevant when deciding the point at which a product should be sold to maximize profits?

- A. Separable costs after the split-off point.
- B. Joint costs to the split-off point.
- C. Sales salaries for the period when the units were produced.
- D. Purchase costs of the materials required for the joint products.

Correct Answer: A

Joint products are created from processing a common input. Common costs are incurred prior to the split-off point and cannot be identified with a particular joint product. As a result, common costs are irrelevant to the timing of sale. However, separable costs incurred after the split-off point are relevant because, if incremental revenues exceed the separable costs, products should be processed further, not sold at the split-off point.

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#### QUESTION 9

Siberian Ski Company recently expanded its manufacturing capacity, which will allow it to produce up to 15,000 pairs of cross country skis of the mountaineering model or the touring model. The Sales Department assures management that it can sell between 9,000 pairs and 13,000 pairs of either product this year. Because the models are very similar,

Siberian Ski will produce only one of the two models. The

following information was compiled by the Accounting Department:

	<u>Per-Unit (Pair) Data</u>	
	<u>Mountaineering</u>	<u>Touring</u>
Selling price	\$88.00	\$80.00
Variable costs	52.80	52.80

Fixed costs will total \$369,600 if the mountaineering model is produced but will be only \$316,800 if the touring model is produced. Siberian Ski is subject to a 40% income tax rate. If Siberian Ski Company desires an after-tax net income of \$24,000, how many pairs of touring model skis will the company have to sell?

- A. 13,118 pairs.
- B. 12,529 pairs.
- C. 13,853 pairs.
- D. 4,460 pairs.

Correct Answer: A

#### QUESTION 10

Jorelle Company's financial staff has been requested to review a proposed investment in new capital equipment. Applicable financial data is presented below. There will be no salvage value at the end of the investment's life and, due to realistic depreciation practices, it is estimated that the salvage value and net book value are equal at the end of each year. All cash flows are assumed to take place at the end of each year. For investment proposals, Jorelle uses a 12% after-tax target rate of return.

Investment Proposal			
<u>Year</u>	<u>Purchase Cost and Book Value</u>	<u>Annual Net After-Tax Cash Flows</u>	<u>Annual Net Income</u>
0	\$250,000	\$ 0	\$ 0
1	168,000	120,000	35,000
2	100,000	108,000	39,000
3	50,000	96,000	43,000
4	18,000	84,000	47,000
5	0	72,000	51,000

Discounted Factors for a 12% Rate of Return

<u>Year</u>	<u>Present Value of \$1.00 Received at the End of Each Period</u>	<u>Present Value of an Annuity of \$1.00 Received at the End of Each Period</u>
1	.89	.89
2	.80	1.69
3	.71	2.40
4	.64	3.04
5	.57	3.61
6	.51	4.12

The traditional payback period for the investment proposal is

- A. Over 5 years.
- B. 2.23 years.
- C. 1.65 years.
- D. 2.83 years.

Correct Answer: B

**QUESTION 11**

From the view point of the investor, which of the following securities provides the least risk?

- A. Mortgage bond.
- B. Subordinated debenture.
- C. Income bond.

D. Debentures.

Correct Answer: A

A mortgage bond is secured with specific fixed assets, usually real property. Thus, under the rights enumerated in the bond indenture, creditors will be able to receive payments from liquidation of the property in case of default. In a bankruptcy proceeding, these amounts are paid before any transfers are made to other creditors, including those preferences. Hence, mortgage bonds are less risky than the others listed.

#### QUESTION 12

Calamity Cauliflower Corporation is considering undertaking a capital project. The company would have to commit \$24,000 of working capital in addition to an immediate outlay of \$160,000 for new equipment. The project is expected to generate \$100,000 of annual income for 10 years. At the end of that time, the new equipment, which will be depreciated on a straight-line basis, is expected to have a salvage value of \$10,000. The existing equipment that would be sold to make room for the project has a historical cost of \$220,000 and accumulated depreciation of \$208,000. It has an estimated remaining useful life of 2 years and the remaining book value is being depreciated on a straight-line basis. A scrap dealer has agreed to buy it for \$8,000. The company's effective tax rate is 40%. Calamity Cauliflower's expected depreciation tax shield for the final year of the project is

- A. \$6,000
- B. \$5,200
- C. \$2,000
- D. \$0

Correct Answer: A

The old equipment has a remaining useful life of two years, after which it will be fully depreciated and no longer generating depreciation expense. Thus, the depreciation tax shield in the project's last year consists only of the annual depreciation expense on the new equipment  $[(\$160,000 \text{ historical cost} - \$10,000 \text{ estimated salvage value}) / 10 \text{ years}] \times 40\%$ , or \$6,000.

#### QUESTION 13

When a company offers credit terms of 2/10, net 30, the annual interest cost based on a 360-day year, is

- A. 24.0%.
- B. 35.3%.
- C. 35.3%.
- D. 36.7%.

Correct Answer: D

Assume that the gross amount of an invoice is \$1,000. With a 2% discount, the buyer will pay only \$980 on the tenth day. Thus, the seller is forgoing \$20 to receive payment 20 days sooner than would otherwise be required. The 20-day interest rate is  $20 / 980 = 2.04\%$ . The number of 20-day periods in a year is  $360 / 20 = 18$ . If the interest rate is 2.04% for each 20-day period, the annual interest rate (rounded to the nearest tenth) is  $18 \times 2.04\% = 36.7\%$ .

#### QUESTION 14

Which strategy for a global marketing organization is based on a portfolio of national markets?

- A. Creation of a division to manage international marketing
- B. A multinational strategy
- C. A glocal strategy
- D. Creation of an export department

Correct Answer: B

International marketing efforts take three basic forms: creation of an export department; creation of a division to manage international marketing, or global organization. The latter encompasses genuinely worldwide functions, e.g., manufacturing, marketing, finance, and logistics. Thus, world wide operations are the organization's focus, not merely that of a department or division of a national firm. A global organization may follow a multinational, global, or glocal strategy. A multinational strategy adopts a portfolio approach. Its emphasis is on national markets because the need for global integration is not strong. The product is customized for each market and therefore incurs higher production costs. Decision making is primarily local with a minimum of central control. This strategy is most effective given large difference between countries. Also, exchange rate risk is reduced when conducting business in this manner.

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#### QUESTION 15

Which of the five promotional tools of the marketing communications mix involves lobbying, sponsorship, community outreach, and gifts to charity?

- A. Direct marketing.
- B. Personal selling.
- C. Sales promotions.
- D. Public relations.

Correct Answer: D

Public relations consists of methods of protecting the image of the firm or a product. Typical platforms are lobbying, sponsorships (e.g., the U.S. Postal Service's sponsorship of a cycling team), community outreach, gifts to charity, and the firm's annual report.

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