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QUESTION 1

company wants to open a new store in one of three nearby shopping malls. In Mall A, the rent will be \$300,000 per year. In Mall B, the rent will be 4% of gross revenues. In Mall C, the rent will be \$150,000 per year plus 3% of gross revenues. Assume that revenues and all other elements under consideration are the same for all three malls. If the company expects revenues to be \$10,000,000 per year, which mall should be chosen?

- A. Mall A,
- B. Mall B.
- C. Mall C.
- D. The company will be indifferent between two of the choices.

Correct Answer: C

If the company expects revenues to be \$10,000,000 per year, the calculation is as follows. Mall A: \$300,000 Mall B: $\$10,000,000 \times 4\% = \$400,000$ Mall C: $\$10,000,000 \times 3\% + \$150,000 = \$450,000$ Thus, Mall A is preferable

QUESTION 2

The management of Pelican, Inc. is evaluating a proposed acquisition of a new machine at a purchase price of \$180,000 and with installation costs of \$10,000. A \$9,000 increase in working capital will be required. The machine will have a useful life of four years, after which it can be sold for \$30,000. The estimated annual incremental operating revenues and cash operating expenses are \$450,000 and \$300,000, respectively, for each of the four years. Pelican's effective income tax rate is 40%, and the cost of capital is 12%. Pelican uses straight-line depreciation for both financial reporting and income tax purposes. If the project is accepted, the estimated incremental after-tax operating cash flows at the end of the first year will be?

- A. \$99,000
- B. \$106,000
- C. \$108,000
- D. \$150,000

Correct Answer: B

QUESTION 3

Which one of the following characteristics distinguishes income bonds from other bonds?

- A. The bondholder is guaranteed an income over the life of the security.
- B. By promising a return to the bondholder, an income bond is junior to preferred and common stock.
- C. Income bonds are junior to subordinated debt but senior to preferred and common stock.

D. Income bonds pay interest only if the issuing company has earned the interest.

Correct Answer: D

An income bond is one that pays interest only if the issuing company has earned the interest, although the principal must still be paid on the due date. Such bonds are riskier than normal bonds

QUESTION 4

Positive operating income is shown on a cost-volume-profit chart when the

- A. Total variable expense line exceeds the total fixed expense line.
- B. Total expense line exceeds the total sales revenue line.
- C. Total sales revenue line exceeds the total fixed expense line.
- D. Total sales revenue line exceeds the total expense line.

Correct Answer: D

A cost-volume-profit chart contains elements (lines, points, axes) that identify variable cost, fixed cost, the breakeven point, total revenue, profit, and volume in units. When the total sales revenue line rises above the total expense line, a company will have positive net income.

QUESTION 5

Multi Frame Company has the following revenue and cost budgets for the two products it sells: The budgeted unit sales equal the current unit demand, and total fixed overhead for the year is budgeted at \$975,000. Assume that the company plans to maintain the same proportional mix. In numerical calculations, Multi Frame rounds to the nearest cent and unit. The total number of units Multi Frame needs to produce and sell to break even is

	Plastic Frames	Glass Frames
Sales price	\$10.00	\$15.00
Direct materials	(2.00)	(3.00)
Direct labor	(3.00)	(5.00)
Fixed overhead	(3.00)	(4.00)
Net income per unit	\$ 2.00	\$ 3.00
Budgeted unit sales	100,000	300,000

- A. 150,000 units.

B. 8. 354,545 units.

C. 177,273 units.

D. 300,000 units.

Correct Answer: A

The calculation of the breakeven point is to divide the fixed costs by the contribution margin per unit. This determination is more complicated for a multi-product firm. If the same proportional product mix is maintained, one unit of plastic frames is sold for every three units of glass frames. Accordingly, a composite unit consists of four frames: one plastic and three glass. For plastic frames, the unit contribution margin is \$5 (\$10-- \$2 --\$3). For glass frames, the unit contribution margin is \$7 (\$15 --\$3-- \$5). Thus, the composite unit contribution margin is \$26 (\$5 + \$7 + \$7 + \$7), and the breakeven point is 37,500 packages (\$975,000 EC + \$26). Because each composite unit contains four frames, the total units sold equal 150,000.

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