



# CMA<sup>Q&As</sup>

Certified Management Accountant

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### QUESTION 1

Transfer pricing should encourage goal congruence and managerial effort In a decentralized organization, it should also encourage autonomous decision making.

Managerial effort is the

- A. Desire and the commitment to achieve a specific goal
- B. Sharing of goals by supervisors and subordinates
- C. Extent to which individuals have the authority to make decisions.
- D. Extent of the attempt to accomplish a specific goal

Correct Answer: D

Managerial effort is the extent to which a manager attempts to accomplish a goal. Managerial effort may include psychological as well as physical commitment to a goal.

### QUESTION 2

Cohasset Company currently manufactures all component parts used in the manufacture of various hand tools. A handle is used in three different tools. The unit cost budget for 201000 handles is

Direct material	\$ .60
Direct labor	.40
Variable overhead	.10
Fixed overhead	.20
Total unit cost	<u>\$1.30</u>

RandM Steel has offered to supply 20,000 handles to Cohasset for \$1.25 each, delivered. If Cohasset currently has idle capacity that cannot be used, accepting the offer will

- A. Decrease the handle unit cost by \$05.
- B. Increase the handle unit cost by \$ .15.
- C. Decrease the handle unit cost by \$15.
- D. Increase the handle unit cost by \$.05.

Correct Answer: B



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Since the fixed cost will be incurred whether the company makes or buys the part, the relevant unit cost of making the part is the \$1.10 variable cost (\$1.30 -- \$20 fixed overhead). The existence of idle capacity indicates that the firm has no opportunity cost to be considered in the calculation. Thus, accepting the offer would increase costs by \$.15 per unit.

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### QUESTION 3

What form of marketing assumes most people in the same demographic will react similarly to one marketing message?

- A. Direct marketing.
- B. Proactive marketing.
- C. Services marketing.
- D. Mass marketing.

Correct Answer: D

Mass marketing groups people into large categories based solely on their demographic traits, e.g., age, income, gender, or education level. It assumes most people in the same category will react similarly to one marketing message. Mass marketers rely primarily on mass media (television and print) to reach their targets in large numbers.

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### QUESTION 4

The method that recognizes the time value of money by discounting the after-tax cash flows over the life of a project, using the company's minimum desired rate of return is the

- A. Accounting rate of return method.
- B. Net present value method.
- C. Internal rate of return method.
- D. Payback method.

Correct Answer: B

The net present value (NPV) method computes the discounted present value of future cash inflows to determine whether they are greater than the initial cash outflow. The discount rate (cost of capital or hurdle rate) must be known to discount the future cash inflows. If the NPV is positive (present value of future cash inflows exceeds initial cash outflow), the project should be accepted. If the NPV is negative, the project should be rejected.

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### QUESTION 5

Union Electric Company must clean up the water released from its generating plant. The company's cost of capital is 12 percent for average risk projects, and that rate is normally adjusted up or down by 2 percentage points for high- and low- risk projects. Clean-Up Plan A, which is of average risk, has an initial cost of \$10 million, and its operating cost will be \$1 million per year for its 10-year life. Plan B, which is a high-risk project, has an initial cost of \$5 million, and its annual operating cost over Years 1 to 10 will be \$2 million. What is the approximate PV of costs for the better project?

- A. \$15,432,000



- B. \$15,650,000
- C. \$16,300,000
- D. \$17,290,000

Correct Answer: B

The cash flows of Plan A are discounted at 12%, the company's cost of capital for average risk projects. Plan B is evaluated with a lower cost of capital that reflects a greater risk of the cash outflow of the project. Thus, the cash flows of Plan B are discounted at 10% (12% -- 2%). the company's adjusted cost of capital for high risk projects. The net present value of each plan is the initial cost plus the present value of an annuity for 10 years at the appropriate rate multiplied times the annual operating cost. The present value factors are found in the tools section of CMA Test Prep.

$$\text{Plan A NPV} = \$10,000,000 + (\$1,000,000 \times 5.650)$$

$$\text{Plan A NPV} = \$15,650,000$$

$$\text{Plan B NPV} = \$5,000,000 + (\$2,000,000 \times 6.145)$$

$$\text{Plan B NPV} = \$17,290,000$$

Plan A has a lower NPV and thus is the better project.

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