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QUESTION 1

Conversion cost pricing

- A. Places minimal emphasis on the cost of materials used in manufacturing a product.
- B. Could be used when the customer furnishes the material used in manufacturing a product.
- C. Places heavy emphasis on indirect costs and disregards consideration of direct costs.
- D. Places heavy emphasis on direct costs and disregards consideration of indirect costs.

Correct Answer: B

Conversion costs consist of direct labor and factory overhead, the costs of converting raw materials into finished goods. Normally, a company does not consider only conversion costs in making pricing decisions, but if the customer were to furnish the raw materials, conversion cost pricing would be appropriate.

QUESTION 2

The amount of inventory that a company would tend to hold in safety stock would increase as the

- A. Usage rate of inventory per time period.
- B. Cost per unit of inventory.
- C. Current level of inventory.
- D. Cost of placing an order for merchandise.

Correct Answer: C

The optimal level of inventory is affected by the factors in the economic order quantity (EOQ) model and delivery or production lead times. These factors are the annual demand for inventory, the carrying cost, which includes the interest on funds invested in inventory, the usage rate, and the cost of placing an order or making a production run. The current level of inventory has nothing to do with the optimal inventory level.

QUESTION 3

Don Adams Breweries is considering an expansion project with an investment of \$1,500,000. The equipment will be depreciated to zero salvage value on a straight-line basis over 5 years. The expansion will produce incremental operating revenue of \$400,000 annually for 5 years. The company's opportunity cost of capital is 12%. Ignore taxes. What is the payback period of the project?

- A. 2 years.
- B. 2.14 years.
- C. 3.75 years.
- D. 5 years.



Correct Answer: C

QUESTION 4

A firm ships its product to a foreign subsidiary and charges a price that may increase import duties but lower the income taxes paid by the subsidiary. The most likely reason for these effects is that the

- A. Price is an arm's-length price.
- B. Price is a cost-plus price.
- C. Transfer price is too low.
- D. Transfer price is too high.

Correct Answer: D

A transfer price is the price charged by one subunit of a firm to another. When the subsidiary buyer is in a foreign country, the higher the transfer, the higher the potential tariffs. However, the tax levied on a subsequent sale by the subsidiary will be lower because of its higher acquisition cost.

QUESTION 5

N-Air Corporation uses a joint process to produce three products: A, B, and C, all derived from one input. The company can sell these products at the point of split-off (end of the joint process) or process them further. The joint production costs during October were \$10,000. N-Air allocates joint costs to the products in proportion to the relative physical volume of output. Additional information is presented in the opposite column.

Product	Units Produced	Unit Sales Price at Split-off	If Processed Further	
			Unit Sales Price	Unit Additional Cost
A	1,000	\$4.00	\$5.00	\$.75
B	2,000	2.25	4.00	1.20
C	1,500	3.00	3.75	.90

Assuming that all products were sold at the split-off point during October, the gross profit from the production process would be

- A. \$13,000



B. \$10,000

C. \$8,625

D. \$3,000

Correct Answer: D

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