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QUESTION 1

The statement of income for Dimmell Co presented below represents the operating results for the year just ended. Dimmell had sales of 1,800 tons of product during the current year. The manufacturing capacity of Dimmell's facilities is 3,000 tons of product.

Dimmell Co.
Statement of Income
For the Year Ended December 31, 2002

Sales	<u>\$900,000</u>
Variable costs	
Manufacturing	\$315,000
Selling costs	<u>180,000</u>
Total variable costs	<u>\$495,000</u>
Contribution margin	<u>\$405,000</u>
Fixed costs	
Manufacturing	\$ 90,000
Selling	112,500
Administration	<u>45,000</u>
Total fixed costs	<u>\$247,500</u>
Net income before income taxes	\$157,500
Income taxes (40%)	<u>(63,000)</u>
Net income after income taxes	<u><u>\$ 94,500</u></u>

If the sales volume is estimated to be 2,100 tons in the next year, and if the prices and costs stay at the same levels and amounts next year, the after-tax net income that Dimmell can expect for 2003 is

- A. \$135,000
- B. \$110,250
- C. \$283,500
- D. \$184,500

Correct Answer: A

QUESTION 2

A manufacturer contemplates a change in technology that would reduce fixed costs from \$800,000 to \$700,000. However, the ratio of variable costs to sales will increase from 68% to 80%. What will happen to break-even level of revenues?

- A. Decrease by \$301,470.50
- B. Decrease by \$500,000
- C. Decrease by \$1,812,500
- D. Increase by \$1,000,000

Correct Answer: D

QUESTION 3

Service marketing uses the traditional categories of marketing tools (the 4Ps) as well as which additional methods?

- A. Price, place, and promotion
- B. Price, place, and physical evidence
- C. Process, promotion, and people
- D. People, physical evidence, and process

Correct Answer: D

The traditional 4Ps are product, price, promotion, and place. The three additional Ps used in service marketing are people, physical evidence and presentation, and process. The right employees, if well trained and motivated, enhance customer satisfaction because many services require substantial customer-employee interaction. Physical evidence and presentation are what the customer perceives, such as the decorative features of a restaurant. A process is how the service is performed, for example, delivery of health care in a doctor's office, outpatient clinic, or hospital.

QUESTION 4

$$\$50,000 = \$7,791 \text{ (PV at } i \text{ for 10 periods)}$$

$$\$50,000 \div \$7,791 = 6.418$$

Using a PV table, 6.418 is PV at 9% for 10 periods.

The following forecasts have been prepared for a new investment by Oxford Industries of \$20 million with an 8-year life:

	<u>Pessimistic</u>	<u>Expected</u>	<u>Optimistic</u>
Market size	60,000	90,000	140,000
Market share, %	25	30	35
Unit price	\$750	\$800	\$875
Unit variable cost	\$500	\$400	\$350
Fixed cost, millions	\$7	\$4	\$3.5

Assume that Oxford employs straight-line depreciation, and that they are taxed at 35%. Assuming an opportunity cost of capital of 14%, what is the NPV of this project, based on expected outcomes?

- A. \$2,626,415
- B. \$4,563,505
- C. \$6,722,109
- D. \$8,055,722

Correct Answer: B

The first step is to calculate the annual cash flows from the project for the base case (the expected values). These may be calculated as shown:

<u>Description</u>	<u>How calculated</u>	<u>Value</u> <u>(\$ in millions)</u>
1. Revenues	$90,000 \times 0.30 \times \800	21.600
2. Variable cost	$90,000 \times 0.30 \times \400	10.800
3. Fixed cost	\$4,000,000	4.000
4. Depreciation	$\$20,000,000 \div 8$	2.500
5. Pretax profit	Item 1 – (Items 2 + 3 + 4)	4.300
6. Tax	Item 5 \times 0.35	1.505
7. Net profit	Item 5 – Item 6	2.795
8. Net cash flow	Item 7 + Item 4	5.295

This level of cash flow occurs for each of the 8 years of the project. The present value of an 8-year, \$1 annuity is 4.639 at 14%. The NPV of the project is therefore given by:

QUESTION 5

All of the following costs are relevant to a decision to accept or reject an order except

- A. Differential costs.

- B. Out-of-pocket costs.
- C. Replacement costs.
- D. Sunk costs.

Correct Answer: D

A sunk cost cannot be avoided because either the expenditure has occurred, or an irrevocable decision to incur the cost has been made. Sunk costs are irrelevant to management decision-making because they cannot vary with the option selected.

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