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QUESTION 1

MS Trucking is considering the purchase of a new piece of equipment that has a net initial investment with a present value of \$300,000. The equipment has an estimated useful life of 3 years. For tax purposes the equipment will be fully depreciated at rates of 30%, 40%, and 30% in years one, two, and three, respectively. The new machine is expected to have a \$20,000 salvage value. The machine is expected to save the company \$170,000 per year in operating expenses. MS Trucking has a 40% marginal income tax rate and a 16% cost of capital. Discount rates for a 16% rate are:

	<u>Present Value of an Ordinary Annuity of \$1</u>	<u>Present Value of \$1</u>
Year 1	.862	.862
Year 2	1.605	.743
Year 3	2.246	.641

What is the profitability index for the project?

- A. 1.089
- B. 1.106
- C. 1.315
- D. 1.063

Correct Answer: A

The profitability index is the present value of the future net cash inflows divided by the present value of the net initial investment. The present value of the future net cash inflows is \$326,556. Hence, the profitability index is 1.089 (\$326,556 / \$300,000).

QUESTION 2

Mobile Home Manufacturing, Inc. is evaluating a proposed acquisition of a new machine at a purchase price of \$380,000 and installation charges that will amount to \$20,000. A \$15,000 increase in working capital will be required. The machine will have a useful life of four years, after which it can be sold for \$50,000. The estimated annual incremental operating revenues and cash operating expenses are \$750,000 and \$500,000, respectively, for each of the four years. Mobile Home's tax rate is 40%, and the cost of capital is 12%. Mobile Home uses straight-line depreciation for both financial reporting and income tax purposes. If Mobile Home accepts the project, the initial investment will be

- A. \$350,000
- B. \$365,000
- C. \$385,000
- D. \$415,000

Correct Answer: D



QUESTION 3

the rational decision-making process is most often typified by

- A. Perfect information.
- B. Bounded rationality.
- C. Selection of optimum decisions.
- D. Choice of the least risky solution.

Correct Answer: B

Rarely can decision makers know all possible courses of action, the variables that will affect them, and their precise outcomes. Decision makers face limitations of time, money, technical methods, and creativity. Accordingly, they are restricted to a bounded rationality. Because rationality is inherently limited, decisions invariably entail some risk.

QUESTION 4

Below are data conceding the hours spent by a manufacture's two products in its tow processes: Assembly Painting
Product A 21 14 Product B 32 8

The constraint is

- A. Product A
- B. Product B in Assembly
- C. The assembly activity
- D. Cannot be determined form the information given.

Correct Answer: C

In theory of constraints (TOC) analysis, the constraint (bottleneck) operation is the slowest part of the process. It can usually be identified as the one where work-in-Process backs up the most of this manufacturer's two operations, the one that requires the most total time is assembly.

QUESTION 5

Gram Co. develops computer programs to meet customers' special requirements. How should gram categorize payments to employees who develop these programs?

Direct Costs Value-Adding Costs

- A. Yes Yes
- B. Yes No



C. No No

D. No Yes

Correct Answer: A

Direct costs may be defined as those that can be specifically associated with a single cost object and can be assigned to it in an economically feasible manner. Wages paid to labor that can be identified with a specific finished good are direct costs. Value-adding costs may be defined as the costs of activities that cannot be eliminated without reducing the quality, responsiveness, or quantity of the output required by a customer or by an organization, Clearly, the amounts paid to programmers add value to computer programs.

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