IMANET-CMA Q&As

Certified Management Accountant (CMA)

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QUESTION 1

The following information regarding a change in credit policy was assembled by the Wilson Wax Company. The company has a required rate of return of 11% and a variable cost ratio of 50%. The opportunity\\' cost oaf longer collection period is assumed to be negligible.

	Old Credit Policy	New Credit Policy
Sales	$4,600,000	$4,960,000
Average collection period	30 days	35 days

The pretax cost of carrying the additional investment in receivables, assuming a 360- dayyear, is

A. $5,439

B. $10,878

C. $13,778

D. $98,890

Correct Answer: A

The cost of carrying receivables equals average receivables times the variable cost ratio times the cost of money. Under the old policy, average daily sales are $12,778 ($4,600,000 ?360 days). Given a 30- day average collection period, the average receivables balance is $383,340 ($12,778 x 30 days). Under the new policy, average daily sales are $13,778 ($4,960,000 ?360 days), and the average receivables balance is $482,230 ($13,778 x 35 days). Hence, the average balance is $98,890 higher under the new policy. Because the company\\'s incremental (variable) costs are 50% of sales, the additional investment is $49,445 ($98,890 x 50%). The interest rate, or required rate of return1 is 11%. Thus, the incremental pretax carrying cost is $5,439 ($49,445 x 11%).

QUESTION 2

A financial manager usually prefers to issue preferred stock rather than debt because

A. Payments to preferred stockholders are not considered fixed payments

B. The cost of fixed debt is less expensive since it is tax deductible even if a sinking fund is required to retire the debt.

C. The preferred dividend is often cumulative, whereas interest payments are not.

D. In a legal sense, preferred stock is equity, therefore, dividend payments are not legal obligations

Correct Answer: D

For a financial manager, preferred stock is preferable to debt because dividends do not have to be paid on preferred stock, but failure to pay interest on debt could lead to bankruptcy. Thus, preferred stock is less risky than debt. However, debt has some advantages over preferred stock, the most notable of which is that interest payments are tax deductible. Preferred stock dividends are not.

QUESTION 3

Junk bonds are

A. Securities rated at less than investment grade.

B. Worthless securities.

C. Securities that are highly risky but offer only low yields.

D. Considered illegal since the collapse of the Drexel Burnham Lambert firm

Correct Answer: A

Junk bonds are high-risk and therefore high-yield securities that are normally issued when the debt ratio is very high. Thus, the bondholders have as much risk as the holders of equity securities. Such bonds are not highly rated by credit evaluation companies. Junk bonds have become accepted because of the tax deductibility of the interest paid.

QUESTION 4

The amount Morton Company must borrow to pay the supplier within the discount period and cover the compensating balance is

A. $55,000.

B. $55,056.

C. $55,556.

D. $54,444.

Correct Answer: D

The company will need $49,000 (98% x $501000) to pay off the invoice. In addition, it will need a

compensating balance equal to 10% of the loan. This can be written in equation form as:

Loan $49,000 + (.1) Loan.

Thus, the loan amount needed is $54,444 ($49,000 ?.9).

QUESTION 5

Short-term, unsecured promissory notes issued by large firms are known as

A. Agency securities.

B. Bankers\\' acceptances.

C. Commercial paper.

D. Repurchase agreements.

Correct Answer: C

Commercial paper is the term for the short-term (typically less than 9 months), unsecured, large denomination (often over $100,000) promissory notes issued by large, credit-worthy companies to other companies and institutional investors. In many instances, the maturity date is only a few days after issuance.