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QUESTION 1

In which industry structure is differentiation absent, and all sellers charge the same price?

- A. Monopoly
- B. Monopolistic competition
- C. Oligopoly
- D. Pure competition

Correct Answer: D

An industry consists of firms selling products or services that are substitutes. One way to describe an industry considers the number of sellers and the extent of differentiation of products and services. In pure competition, differentiation is absent and the same prices are charged by all sellers.

QUESTION 2

Sylvan Corporation has the following capital structure. Debenture bonds \$10,000,000 Preferred equally 110001000
Common equally 39,000,000

The financial leverage of Sylvan Corporation would increase as a result of

- A. Issuing common stock and using the proceeds to retire preferred stock.
- B. Maintaining the same dollar level of cash dividends as the prior year, even though earnings have increased by 7%.
- C. Financing its future investments with a higher percentage of bonds.
- D. Financing its future investments with a higher percentage of equity funds.

Correct Answer: C

Financial leverage is the use of borrowed money to earn money for the benefit of shareholders. The expectation is that investment earnings will be greater than the interest paid on the borrowed funds. Increasing debt (such as bonds) increases financial leverage.

QUESTION 3

The first step in the sales planning process is to

- A. Assemble all the data that are relevant in developing a comprehensive sales plan
- B. Develop management guidelines specific to sales planning, including the sales planning process and planning responsibilities
- C. Prepare a sales forecast consistent with specified forecasting guidelines, including assumptions
- D. Secure management commitment to attain the goals specified in the comprehensive sales plan



Correct Answer: B

Sales planning is a starting point for many other plans. The resources required, revenues to be earned, and costs to be incurred depend on sales. The sales plan of an operating unit should include as much specific information from that unit's management as possible, but must conform to the strategic plans or corporate management. Thus, top management must provide a context within which operational managers can prepare their plans. Corporate support include economic forecasts, overall market sales forecasts, and capital budgets.

QUESTION 4

The Keego Company is planning a \$200,000 equipment investment which has an estimated 5-year life with no estimated salvage value. The company has projected the following annual cash flows for the investment.

Year	Projected Cash Inflows	Present Value of \$1
1	\$120,000	.91
2	60,000	.76
3	40,000	.63
4	40,000	.53
5	40,000	.44
Totals	<u>\$300,000</u>	<u>3.27</u>

Assuming that the estimated cash inflows occur evenly during each year, the payback period for the investment is

- A. 1.67years.
- B. 4.91 years.
- C. 2.50 years.
- D. 1.96years.

Correct Answer: C

The payback period is the number of years required to complete the return of the original investment. The principal problems with the payback method are that it does not consider the time value of money and the inflows after the payback period. The inflow for the first year is \$120,000, the second year is \$60,000, and the third year is \$40,000, a total of \$220,000. Given an initial investment of \$200,000, the payback period must be between 2 and 3 years. If the cash inflows occur evenly throughout the year, \$20,000 (\$200,000 --\$120,000-- \$60,000) of cash inflows are needed in year 3, which is 50% of that year's total. Thus, the answer is 2.5 years.

QUESTION 5

Determining the appropriate level of working capital for a firm requires

- A. Changing the capital structure and dividend policy of the firm.
- B. Maintaining short-term debt at the lowest possible level because it is generally more expensive than long-term debt.



C. Offsetting the benefit of current assets and current liabilities against the probability of technical insolvency.

D. Maintaining a high proportion of liquid assets to total assets in order to maximize the return on total investments.

Correct Answer: C

Working capital finance concerns the determination of the optimal level, mix, and use of current assets and current liabilities. The objective is to minimize the cost of maintaining liquidity, while guarding against the possibility of technical insolvency. Technical insolvency is defined as the inability to pay debts as they come due.

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