# CMA$^{Q\&As}$

Certified Management Accountant

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**QUESTION 1**

The technique that incorporates the time value of money by determining the compound interest rate of an investment such that the present value of the after-tax cash inflows over the life of the investment is equal to the initial investment is called the

A. Internal rate of return method.

B. Capital asset pricing model.

C. Profitability index method.

D. Accounting rate of return method.

Correct Answer: A

The internal rate of return (IRR) is the discount rate at which the present value of the cash inflows equals the present values of the cash outflows (including the original investment). Thus, the NPV of the project is zero at the IRR. The IRR is also the maximum borrowing cost the firm can afford to pay for a specific project. The IRR is similar to the yield rate/effective rate quoted in the business media.

**QUESTION 2**

On January 1. Crane Company will acquire a new asset that costs $400,000 and is anticipated to have a salvage value of $30,000 at the end of 4 years. The new asset - Qualifies as 3-year property under the Modified Accelerated Cost Recovery System (MACRS). Will replace an old asset that currently has a tax basis of $80,000 and can be sold now for $60,000. Will continue to generate the same operating revenues as the old asset ($200 .000 per year). However, savings in operating costs will be experienced as follows: a total of $ 120.000 in each of the first 3 years and $90,000 in the fourth year. Crane is subject to a 40% tax rate and rounds all computations to the nearest dollar. Assume that any gain or loss affects the taxes paid at the end of the year in which it occurred. The company uses the net present value method to analyze projects using the following factors and rates:

| Period | Present Value of $1 at 14% | Present Value of $1 Annuity at 14% | MACRS |
|---|---|---|---|
| 1 | .88 | .88 | 33% |
| 2 | .77 | 1.65 | 45 |
| 3 | .68 | 2.33 | 15 |
| 4 | .59 | 2.92 | 7 |

The present value of the depreciation tax shield for the fourth year MACRS depreciation of Crane Company\\'s new asset is?

A. $0.

B. $6,112.

C. $6,608.

D. $16,520.

Correct Answer: C

The firm will be able to deduct 7% of the asset\\'s cost during the fourth year of the asset\\'s life. The deduction is $28,000 ($400,000 x 7%), and the tax savings is $11,200 ($28,000 x 40%). The present value of this amount is $6,608 ($11,200 x .59 PV of $1 at 14% for four periods).

**QUESTION 3**

The Childers Company sells widgets. The company breaks even at an annual sales volume of 75.000 units Actual annual sales volume was 100,000 units, and the company reported a profit of $200,000. The annual fixed costs for the Childers Company are

A. $800,000

B. $600,000

C. $75,000

D. Insufficient information to determine amount of fixed costs

Correct Answer: B

**QUESTION 4**

Many retail stores have found that it is more profitable to sell a product carrying the store\\'s brand name as opposed to the more well-known brands. This is an example of a

A. Manufacturer\\'s brand

B. National brand

C. Private brand

D. Co-brand

Correct Answer: C

When a manufacturer agrees to place a retail store\\'s own name on a product, it is referred to a s a private brand.

**QUESTION 5**

A firm has $3 million in total assets and $1.65 million in equity. How much of its $500,000 capital budget should be debt-financed to retain the same debt-equity ratio?

A. $50,000

B. $225,000

C. $275,000

D. $450,000

Correct Answer: B

The firm\\'s total assets are $3 million and total equity is $1.65 million. Thus, liabilities are $1.35 million ($3 million - $1.65 million). The current debt-equity ratio is 1.35 to 1.65, or 45% ($1.35 million ?$3 million) to 55% ($1.65 million ?$3 million). Thus, to maintain this ratio, 45% of all new investment should come from debt financing. Multiplying 45% times the $500,000 capital budget results in a need for $225,000 in debt financing.