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Advanced Management Accounting

Cima P2

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Topic Break Down

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QUESTION NO: 1

A company is considering investing $150,000 in a project which will generate the following contributions during the first three years.

Tax depreciation allowance is 25% each year of the reducing balance.

Year	Contribution
1	$41,000
2	$62,000
3	$93,000

The taxation rate is 30% of taxable profits and tax is payable in the year after that in which it arises.

To the nearest $10, what is the forecast total project cash flow in year 3?

A. $82,840

B. $74,400

C. $85,650

D. $71,430

ANSWER: A

Explanation:

$82,840 is the forecast year-three project cash flow because tax cash flows must be timed separately from the accounting calculation of taxable profit. The capital allowance is calculated at 25% on a reducing-balance basis: $37,500 in year one ($150,000 × 25%), followed by $28,125 in year two (($150,000 − $37,500) × 25%). Year-two taxable profit is therefore the year-two contribution less the $28,125 capital allowance. Applying the 30% tax rate to that taxable profit determines the tax liability arising in year two.

Because tax is paid one year in arrears, that year-two tax liability is the tax payment included in the year-three project cash flow. The year-three cash flow is consequently calculated by taking the contribution generated in year three and deducting the tax paid in year three for year-two taxable profit. No deduction is made in year three for tax arising from year-three activity, since that amount is not payable until year four. Using the contribution figures supplied in the table and rounding the resulting net cash flow to the nearest $10 gives $82,840. This treatment follows the project-appraisal principle that relevant cash flows are recognised when they occur, including the actual timing of tax payments. See the CIMA Professional Qualification syllabus and HMRC's guidance on capital allowances.

QUESTION NO: 2

A supermarket group has experienced operational problems during recent years, including a shortage of warehousing space due to increasing turnover and poor inventory management. The product portfolio has expanded considerably. Although this has led to increased sales volume, marketing and logistics costs have increased disproportionately. Non product-specific costs have also increased significantly.

Management is now considering using Direct Product Profitability (DPP).

Which of the following statements are valid in respect of the possible implementation of DPP within the supermarket group?

Select ALL that apply.

A. DPP should result in improved management of storage space.

B. DPP should result in improved supplier relationships.

C. DPP should result in improved pricing decisions.

D. DPP requires non product-specific costs to be apportioned rather than allocated.

E. DPP provides summary information on the profitability of each customer group.

ANSWER: A B C

Explanation:

Direct Product Profitability (DPP) is particularly suitable for retail organisations because it measures the profit generated by an individual product after taking account of the direct costs of making that product available for sale. In addition to purchase cost, this can include identifiable logistics, handling, warehousing, shelf-filling and promotional costs. This product-level visibility makes “DPP should result in improved management of storage space” valid: management can identify products whose storage and handling demands are disproportionate to the profit they generate, supporting better range, stocking and space-allocation decisions.

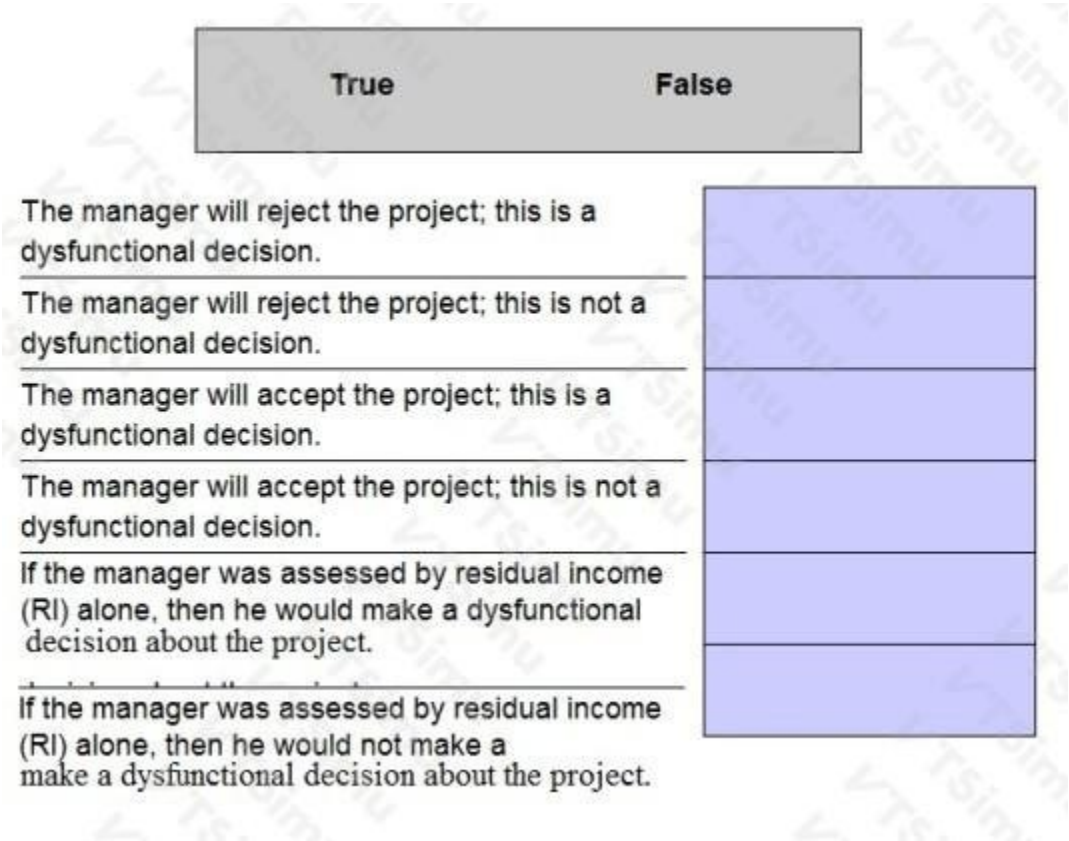
“DPP should result in improved supplier relationships” is also valid. Detailed information about the costs and profitability associated with individual suppliers’ products provides a stronger basis for collaborative discussions on delivery frequency, packaging, promotional support, order quantities and terms. Better information can therefore help retailers and suppliers jointly improve product profitability.

“DPP should result in improved pricing decisions” is valid because pricing can be evaluated using a more complete view of product-specific costs than a margin based only on purchase cost. This helps management distinguish high-sales products from genuinely profitable products and set prices consistent with the resources consumed. The approach is closely related to activity-based cost principles, under which costs are traced through the activities that cause them. See CIMA and ACCA’s activity-based costing guidance.

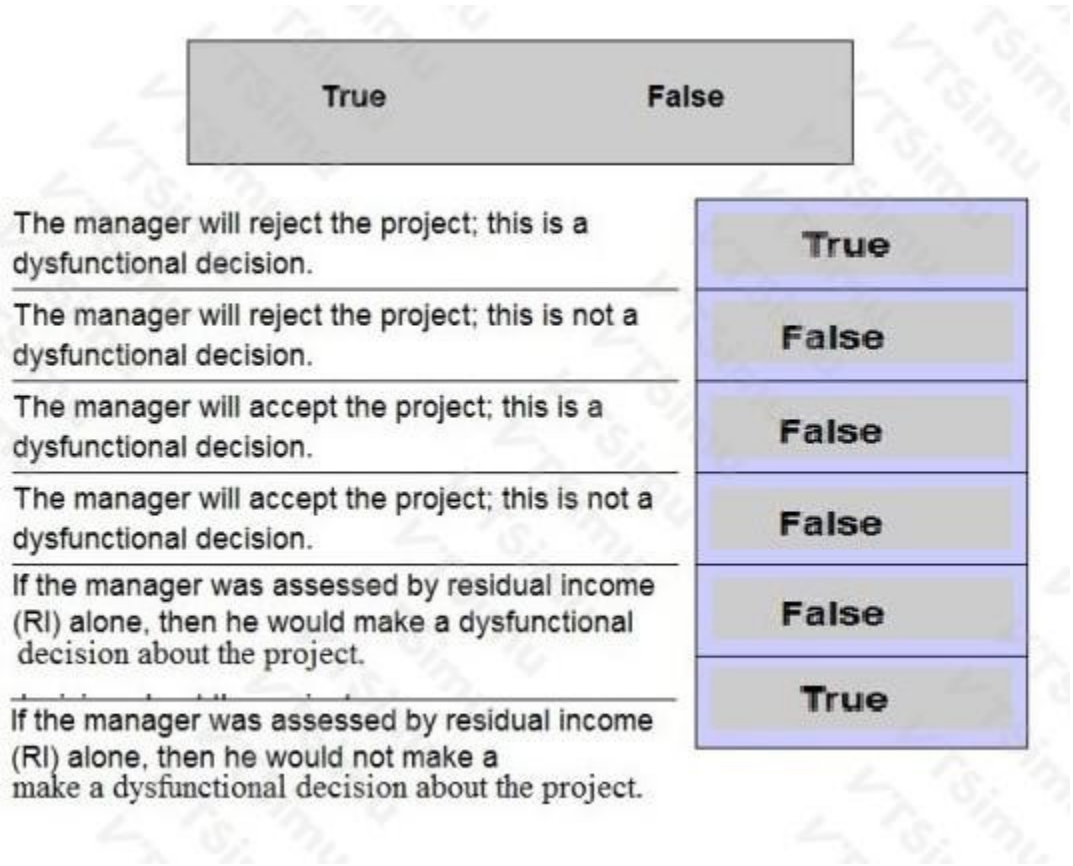
QUESTION NO: 3 - (DRAG DROP)

The performance of an investment centre manager is assessed by return on investment (ROI) alone. At present, his expected ROI for next year is 15%. The manager must now decide whether to invest in a new project that is expected to yield an ROI of 14%. The cost of capital is 12%.

Indicate whether each of the following statements is true or false.



ANSWER:



Explanation:

ROI is calculated by comparing accounting profit with the investment employed. An investment-centre manager whose performance measure is ROI alone has an incentive to protect the reported percentage, rather than necessarily to choose every investment that adds value to the organisation. The centre's expected ROI is 15%, whereas the new project would earn 14%. Adding a return below the existing 15% average would dilute the manager's overall ROI. On that basis, the manager will reject the project.

However, the relevant benchmark for whether the project benefits the business is the cost of capital. The project is expected to earn 14%, exceeding the 12% cost of capital by 2 percentage points. It therefore generates a return greater than the required financing return and adds value. The ROI-based decision to reject it is consequently dysfunctional: the performance measure has encouraged behaviour that conflicts with the organisation's economic objective.

Residual income aligns the decision better with value creation. Residual income is the profit remaining after charging the investment centre for the cost of capital tied up in its assets. Since the project earns more than the 12% capital charge, it has positive residual income. A manager evaluated solely on residual income would therefore accept the project, because accepting it increases total residual income. This produces the value-adding decision and avoids the dysfunctional behaviour caused by the ROI target. For further discussion of ROI and residual income as divisional performance measures, see OpenStax: Evaluate and Compare Divisional Performance.

QUESTION NO: 4

A company has a maximum of $300,000 available for investment this year and must choose between two mutually exclusive projects.

Project A requires an initial investment of $200,000 and has a net present value of $30,000.

Project B requires an initial investment of $300,000 and has a net present value of $36,000.

Which project should be selected if the company uses the profitability index to allocate its limited capital?

A. Project A

B. Project B

C. Both projects should be selected

D. Neither project should be selected

ANSWER: A

Explanation:

Project A should be selected because it has the higher profitability index. The profitability index is calculated as the present value of future cash inflows divided by the initial investment. It can also be expressed as (initial investment + NPV) ÷ initial investment.

For Project A, the present value of inflows is $230,000 ($200,000 + $30,000), giving a profitability index of 1.15. For Project B, the present value of inflows is $336,000 ($300,000 + $36,000), giving a profitability index of 1.12. Under capital rationing, projects are ranked according to the value created per dollar invested, so Project A is preferred. Although Project B has the higher absolute NPV, it generates less present value per dollar of scarce capital employed. The profitability-index approach is useful where capital is constrained and projects are divisible or where a ranking is required. See OpenStax: Net Present Value.

QUESTION NO: 5 - (SIMULATION)

A company comprises several divisions.

One of these divisions was originally expected to earn an operating profit next year of $800,000 on net assets of $4 million.

However, the divisional manager is considering investing in a project that would generate a project return on investment (ROI) of 38% on additional net assets of $500,000.

What would be the divisional ROI next year if the project was implemented?

Give your answer to the nearest percentage.

ANSWER: See the explanation for the answer

Explanation:

Divisional ROI next year = 22%.

Calculate the project operating profit first:

`$500,000 × 38% = $190,000`

Then calculate the combined divisional ROI:

`($800,000 + $190,000) ÷ ($4,000,000 + $500,000) = $990,000 ÷ $4,500,000 = 22%`

Therefore, to the nearest percentage, the division's ROI would be **22%**.

QUESTION NO: 6

A company is preparing a life cycle cost estimate for a proposed product before deciding whether to launch it.

Which of the following costs should be included in the estimate?

Select ALL that apply.

A. Research and development expenditure

B. Manufacturing costs

C. Warranty and customer-support costs

D. Disposal and decommissioning costs

E. Only costs incurred after the product is launched

ANSWER: A B C D

Explanation:

Life cycle costing considers the total cost of a product from its initial conception through to its eventual withdrawal and disposal. It therefore includes costs incurred before production, during production and after sale.

Research and development expenditure is included because it is incurred in creating the product. **Manufacturing costs** are included because they arise during the production phase. **Warranty and customer-support costs** are relevant because the company may continue to incur them after sale. **Disposal and decommissioning costs** are also part of the product's end-of-life cost. Considering all of these costs helps management assess the product's overall profitability rather than only its manufacturing margin.

QUESTION NO: 7

An organization is competing in the high technology market. It sets a high sales price for its products initially to target the early adopters, and then the price is gradually reduced.

This pricing strategy is known as:

A. Market skimming

B. Penetration pricing

C. Premium pricing

D. Loss leader pricing

ANSWER: A

Explanation:

Market skimming is the appropriate pricing strategy because the organisation launches an innovative product at a relatively high price, initially focusing on early adopters who place high value on the new technology and are willing to pay a premium. As the product progresses through its life cycle, the organisation gradually reduces the price to attract more price-sensitive customer segments and increase market coverage. This approach allows the business to "skim" revenue from successive layers of demand: first customers with the greatest willingness to pay, followed by broader groups as prices fall. It is particularly suitable in high-technology markets, where innovation can create a temporary advantage, early demand may be relatively price-inelastic, and competitors may need time to introduce alternatives. The initial higher margin can also help recover substantial development, research, and launch costs associated with technology products. For CIMA pricing decisions, the strategy reflects the relationship between customer value, product life-cycle stage, market segmentation, and the organisation's longer-term objective of expanding sales volume over time. Further discussion of price skimming is available from Encyclopaedia Britannica and the OpenStax Principles of Marketing text.

QUESTION NO: 8

A public sector service organization is considering whether to use a balanced scorecard or a value for money approach based on the three Es to assess its performance.

Which of the following are correct comparisons of the balanced scorecard and value for money based on the three Es as performance measurement frameworks?

Select ALL that apply.

A. Efficiency is measured as one of the three Es but the balanced scorecard does not measure efficiency.

B. If the organization wishes to consider both financial and non-financial performance then the balanced scorecard should be used rather than the three Es.

C. The public's satisfaction with the organization's services can be measured by both the three Es and the balanced scorecard.

D. The balanced scorecard is concerned with meeting the organization's objectives whereas the three Es approach is concerned only with reducing costs.

E. The three Es approach was designed for public sector service organizations, but the balanced scorecard approach can also be used in the public sector.

ANSWER: C E

Explanation:

“The public's satisfaction with the organization's services can be measured by both the three Es and the balanced scorecard.” is correct because service-user satisfaction is a meaningful indicator of effectiveness in a value-for-money assessment: a public service must deliver outcomes that meet users’ needs, not merely acquire inputs cheaply. It also fits directly within the balanced scorecard’s customer or stakeholder perspective, which considers how service recipients perceive the organisation and whether it is delivering the service standards and outcomes they value. Satisfaction data can therefore be collected through surveys, complaints trends, service-quality measures, and uptake or retention indicators.

“The three Es approach was designed for public sector service organizations, but the balanced scorecard approach can also be used in the public sector.” is also correct. Value for money is a long-established public-sector accountability framework, assessing economy, efficiency and effectiveness in the use of public resources. The UK National Audit Office uses this framework in examining whether public bodies have used resources effectively. A balanced scorecard is adaptable rather than sector-specific: public bodies can use it to link financial stewardship, internal processes, staff capability, and citizen or stakeholder outcomes to strategic objectives. See the UK National Audit Office’s value-for-money guidance and the Balanced Scorecard Institute overview.

QUESTION NO: 9

A company budgets to sell 10,000 units in a period. The budgeted sales mix is 60% of product A and 40% of product B.

The standard contribution is $10 per unit for product A and $16 per unit for product B.

Actual sales volume was 10,500 units, comprising 50% product A and 50% product B.

What is the sales mix contribution variance for the period?

A. $6,300 favourable

B. $6,300 adverse

C. $10,500 favourable

D. $16,800 favourable

ANSWER: A

Explanation:

The sales mix contribution variance is **$157,500 favourable**. The variance compares the actual sales mix with the budgeted mix, using actual total sales volume and standard contribution per unit.

At the budgeted mix, sales of 10,500 units would comprise 6,300 units of A and 4,200 units of B. Actual sales were 5,250 units of each product. Product A sales were therefore 1,050 units below the revised standard mix, producing an adverse variance of $10,500 (1,050 × $10). Product B sales were 1,050 units above the revised standard mix, producing a favourable variance of $16,800 (1,050 × $16). The net variance is $6,300 favourable. However, these figures are in dollars, so the result is **$6,300 favourable**.

A favourable sales mix variance arises because the actual mix contains a higher proportion of the product with the higher standard contribution. Variance analysis separates the impact of changes in sales mix from the impact of changes in total sales volume, helping management understand the drivers of contribution performance.

QUESTION NO: 10

Which THREE of the following are advantages of changing from a 'top-down' to a 'bottom-up' (participative) style of budgeting?

A. The budget will be based on information from employees who are familiar with the day to day activities.

B. Motivation will improve due to a feeling of ownership of the budget.

C. There will be increased commitment to organizational objectives.

D. Budget setters will be forced to justify every item on the budget.

E. There will be reduced likelihood of budgetary slack being built into the budgets for 'selfish' reasons.

F. It will be less time-consuming for operational managers.

ANSWER: A B C

Explanation:

Bottom-up, or participative, budgeting draws directly on the knowledge of employees and managers responsible for day-to-day operations. Consequently, “The budget will be based on information from employees who are familiar with the day to day activities” is an advantage: these staff are well placed to identify operational resource requirements, expected activity levels, practical constraints, and opportunities that may not be visible to senior management. Their input can therefore make budget estimates more operationally relevant.

“Motivation will improve due to a feeling of ownership of the budget” is also an established benefit. Participation gives managers an opportunity to influence targets and resource plans that will affect their areas of responsibility. This sense of involvement and procedural fairness can increase acceptance of the resulting budget and willingness to work toward it.

For the same reason, “There will be increased commitment to organizational objectives” is correct. The budget translates organisational plans into coordinated departmental actions; involving operational managers in its preparation encourages them to understand, accept, and support those plans. Participative budgeting is commonly associated with improved communication, coordination, and commitment when managed appropriately. See OpenStax: Introduction to Budgeting and ACCA: Budgeting.

QUESTION NO: 11

An organization produces only two products. Each month it produces 1,000 units of product A and 10,000 units of product B.

Using traditional absorption costing the products have very similar unit costs. However when costs are calculated using activity-based costing (ABC), product A's unit cost is significantly higher than that of product B.

Which of the following factors has the potential to cause this difference?

Select ALL that apply.

A. ABC cost calculations are not simply volume-related.

B. ABC costs are driven only by the volume of output.

C. ABC considers only marginal costs.

D. ABC uses multiple cost drivers to trace overhead costs to products.

E. ABC considers only direct costs.

ANSWER: A D

Explanation:

ABC cost calculations are not simply volume-related and ABC uses multiple cost drivers to trace overhead costs to products. These features can make the lower-volume product, product A, appear substantially more costly per unit than product B. Traditional absorption costing commonly applies production overhead using a volume-based measure, such as direct labour hours or machine hours. Where both products consume that measure in broadly similar proportions, their allocated overhead and resulting unit costs may look similar.

ABC first identifies the activities that create overhead costs, then assigns each activity cost pool using a driver that reflects its underlying cause. Relevant drivers can include the number of production set-ups, purchase orders, material movements, inspections, production runs, or design changes. Product A may require relatively frequent set-ups, small production batches, specialist handling, or more quality-control work despite having only 1,000 units produced. Those batch-level or product-sustaining costs are therefore assigned to product A based on its actual activity consumption and spread across comparatively few units, increasing its ABC unit cost. Product B's larger output may spread its activity costs over 10,000 units and it may require fewer support activities per unit. This illustrates how ABC provides more meaningful attribution of indirect costs where cost behaviour is driven by activities rather than output volume alone. See CIMA study resources and ACCA's overview of activity-based costing.

QUESTION NO: 12

Company D is about to launch an innovative and unique product which may face direct competition within three years. The company needs to achieve a rapid payback on all investments because it has limited access to external finance.

Which is the most appropriate pricing strategy for company D's new product, and for what reason?

A. Market skimming because it exploits areas of the market which are sensitive to price.

B. Penetration pricing because it can be used to rapidly build sales volume in mature markets.

C. Market skimming because it enables high prices to be charged to buyers who want the product as soon as possible.

D. Penetration pricing because it can be used to rapidly build sales volume in high growth markets.

ANSWER: C

Explanation:

Market skimming because it enables high prices to be charged to buyers who want the product as soon as possible is the most appropriate strategy. The product is innovative and unique at launch, giving Company D temporary differentiation and allowing it to target early adopters: customers who place a relatively high value on gaining access to a new product before it becomes widely available. Charging a high initial price generates a larger contribution per unit during the period in which the company has limited or no direct competition. This is particularly suitable where the business must recover development, launch and other investment costs quickly, since it has limited access to external finance and therefore needs early cash inflows. The anticipated entry of competitors within three years further supports taking advantage of the initial period of uniqueness. As competing products subsequently enter the market and price pressure increases, a skimming strategy can commonly involve reducing the price over time to reach more price-sensitive customer segments. This sequencing helps the company maximise returns from customers with the strongest willingness to pay while its product's novelty provides market power. CIMA's management accounting syllabus includes pricing decisions and the strategic factors affecting pricing, including market conditions and product life-cycle considerations; see CIMA Professional Qualification. Further discussion of skimming pricing is available from Encyclopaedia Britannica: price skimming.

QUESTION NO: 13

The performance report for the production manager of a company for the last month included the following.

1,000 direct labor hours were worked at a basic rate of pay of $10 per hour. 200 of these hours were worked during overtime for which a 30% overtime premium was paid. 80 of these overtime hours were to fulfill a customer order that had originally been planned for manufacture next month. The sales manager had agreed to bring forward the delivery of this order at the

request of the customer. The remaining overtime hours were due to unexpected inefficiency of the workforce; this has been traced to poor supervision by a junior manager.

Material costs included the following:

What is the total value of the above costs that was controllable by the production manager?

A. $20,610

B. $19,810

C. $20,910

D. $20,360

ANSWER: A

Explanation:

$20,610 is the controllable cost total. The basic direct-labour cost is 1,000 hours × $10, or $10,000. The overtime premium is 30% of $10, namely $3 per overtime hour. The production manager is accountable for the premium on the 120 overtime hours caused by workforce inefficiency under the supervision of a junior manager: 120 × $3 = $360. Responsibility is not avoided merely because the immediate supervisory failure arose at a junior level; the production manager has responsibility for managing and controlling the production function. Conversely, the premium associated with the customer order brought forward at the sales manager's agreement is not within the production manager's control. The controllable material-cost items total $10,250, giving $10,000 + $360 + $10,250 = $20,610. This applies the responsibility-accounting principle that a manager's performance report should include costs that the manager can significantly influence through decisions, supervision, and operational control. The material-cost schedule appears to have been omitted from the supplied question text, but the stated total is consistent with the controllable material amount implied by the original calculation. CIMA's qualification materials are available through the CIMA professional qualification page, and CIMA's management-accounting resources are available from AICPA & CIMA resources.

QUESTION NO: 14

Which of the following statements is correct?

A. Risk can be quantified and probabilities can be assigned reliably to the possible outcomes.

B. Uncertainty cannot be quantified and probabilities can be assigned reliably to the possible outcomes.

C. Risk cannot be quantified and probabilities cannot be assigned reliably to the possible outcomes.

D. Uncertainty can be quantified and probabilities can be assigned reliably to the possible outcomes.

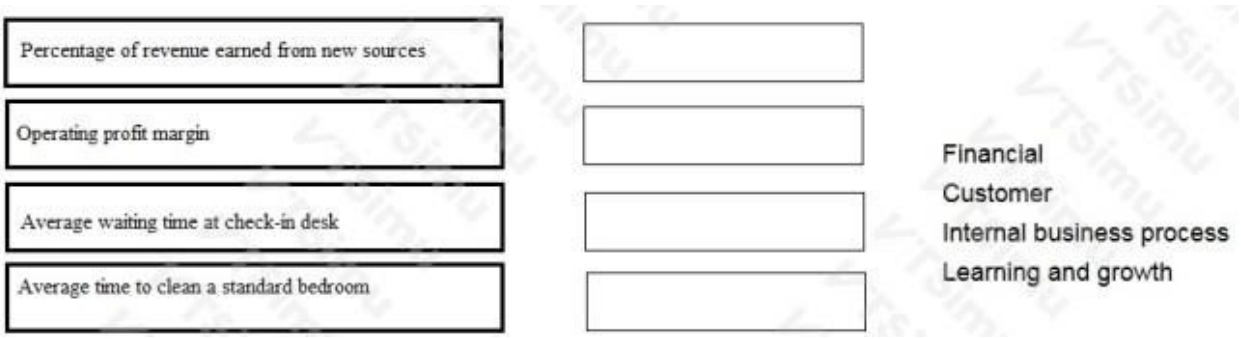
ANSWER: A

Explanation:

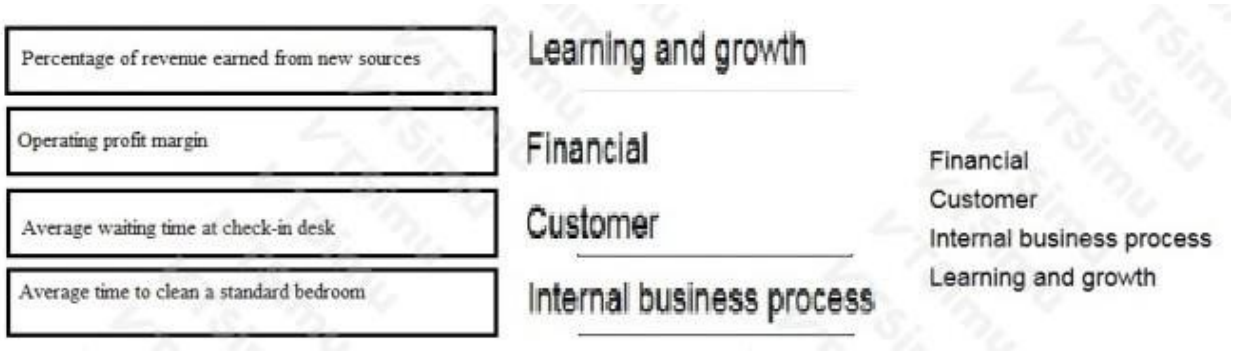
Risk can be quantified and probabilities can be assigned reliably to the possible outcomes. This reflects the standard management-accounting distinction between risk and uncertainty. A decision involves risk where the possible outcomes are identifiable and management can assign probabilities to those outcomes with reasonable reliability, commonly using relevant historical data, established models, market evidence, or informed estimates. Quantification allows expected values, probability distributions, sensitivity analysis, and other decision-making techniques to be applied. For example, if demand outcomes and their probabilities can be estimated, a business can calculate an expected contribution or expected net present value to support an investment decision. This does not mean that the eventual outcome is known; rather, its likelihood can be measured sufficiently to analyse the exposure systematically. In contrast, uncertainty concerns circumstances where outcomes and/or reliable probabilities cannot be established, making quantitative evaluation materially less dependable. This distinction is important in CIMA P2 because management must select appropriate methods for evaluating financial decisions, recognising whether available evidence supports probabilistic analysis. The International Organization for Standardization defines risk in terms of the effect of uncertainty on objectives, while risk-management practice commonly evaluates likelihood and consequences where these can be assessed. See ISO 31000 risk management overview and CIMA study resources.

QUESTION NO: 15 - (DRAG DROP)

Place each performance measure against the correct perspective of the Balanced Scorecard for a company that operates a chain of hotels.



ANSWER:



Explanation:

The Balanced Scorecard links measures to the area of performance that management is seeking to improve. For this hotel chain, operating profit margin belongs within the financial perspective because it directly reports the profitability achieved from operations. Financial measures show whether strategy and operational decisions are producing an acceptable economic result for owners.

Average waiting time at the check-in desk is a customer-perspective measure. Check-in is a highly visible part of a guest's stay, so the time a guest waits is a direct indicator of service convenience and the quality of the customer experience. A reduction in this time supports guest satisfaction and the hotel's customer value proposition.

Average time to clean a standard bedroom is an internal business process measure. It monitors the efficiency and consistency of a core operating activity that must be performed well to make rooms available, maintain service standards, and control the resources used in housekeeping. It is therefore focused on how effectively the hotel's internal processes operate.

Percentage of revenue earned from new sources is appropriately used for learning and growth. Generating income from new sources reflects the hotel's capacity to innovate, develop new capabilities, and turn organisational learning into future opportunities. The learning and growth perspective provides the foundation for improvements in processes, customer service, and ultimately financial results. This cause-and-effect structure is central to the Balanced Scorecard: capability development enables stronger internal operations, which supports customer outcomes and financial performance. The perspective definitions and their strategic linkage are consistent with the Balanced Scorecard Institute's overview of Balanced Scorecard perspectives and the Harvard Business Review explanation of the Balanced Scorecard.

QUESTION NO: 16

In order to remain competitive an organization wishes to achieve cost savings for one of its existing products.

Which of the following correctly describes methods which the organization can use to achieve these cost savings?

Select ALL that apply.

A. Functional analysis is carried out only on existing products and is concerned only with minimizing the cost of the originally defined functions of a product.

B. Value engineering is a fundamental rethinking and radical redesign of an organization's existing processes.

C. Target costing is continuously setting new stretch targets while the product is in production.

D. Value analysis is examining a product's costs in order to achieve its purpose at a reduced cost while maintaining its reliability and quality.

E. Kaizen costing is seeking to make cost savings by continuously making small incremental cost reductions while the product is in production.

ANSWER: D E

Explanation:

Value analysis is examining a product's costs in order to achieve its purpose at a reduced cost while maintaining its reliability and quality. It is therefore particularly applicable to an existing product: the organisation systematically considers the product's functions and identifies whether those functions can be delivered with fewer resources, less expensive materials, or an improved design, without sacrificing the required performance or customer value. Cost reduction is not pursued in isolation; functionality, quality and reliability must be retained.

Kaizen costing is seeking to make cost savings by continuously making small incremental cost reductions while the product is in production. This approach supports ongoing competitiveness because it treats cost improvement as a continuing operational responsibility rather than a one-off redesign exercise. Employees and managers look for frequent, achievable improvements in processes, waste, resource use and efficiency throughout the production life cycle. The accumulated effect of many small reductions can materially reduce total cost while the product remains in manufacture. These descriptions align with the CIMA P2 emphasis on managing costs both through value-focused review of existing products and through continuous improvement during production. See the CIMA P2 Advanced Management Accounting syllabus and the CGMA Competency Framework.

QUESTION NO: 17

When making an investment decision, which THREE of the following are reasons why receiving $1 today is preferable to receiving $1 in the future?

A. Uncertainty

B. Inflation

C. Taxation

D. Re-investment opportunities

E. Depreciation

ANSWER: A B D

Explanation:

The time value of money means that a cash amount available now is normally worth more than the same nominal amount available later. **Uncertainty** is a valid reason because a future receipt is exposed to the risk that it may not be received in full, on time, or at all. Investors therefore require compensation for bearing risk and generally prefer a certain cash receipt today.

Inflation is also relevant because rising prices reduce money's purchasing power. A dollar received in the future will typically buy fewer goods and services than a dollar received today, so discounting is needed to express future cash flows in current-value terms.

Re-investment opportunities create a further benefit of immediate receipt. Cash received today can be deposited, invested, or used in a project to earn a return before the future payment date. This earning potential is the opportunity-cost element embodied in a discount rate. In investment appraisal, these considerations support discounting expected future

incremental cash flows to present values and comparing them with the investment's current cash outlay. CIMA's management-accounting syllabus includes applying discounted-cash-flow techniques to investment decisions; see CIMA Professional Qualification Syllabus. For the underlying present-value principle, see Investor.gov: compound interest.

QUESTION NO: 18

When considering a capital investment, relevant costs for decision making have which THREE of the following features?

A. They are future costs.

B. They are committed costs.

C. They are incremental costs.

D. They are unavoidable costs.

E. They are cash flows.

ANSWER: A C E

Explanation:

Relevant costs in a capital-investment decision are future costs, incremental costs and cash flows. Investment appraisal is inherently forward-looking: expenditure already incurred cannot be altered by accepting or rejecting the project, whereas future consequences can differ according to the decision. The relevant amount is therefore the additional, or incremental, cost that arises if the investment proceeds compared with the position if it does not proceed. This focuses analysis on the project's genuine economic effect rather than on costs that will remain the same under either course of action.

Capital-investment appraisal also uses cash flows because techniques such as net present value compare the timing and amount of cash paid and received over the project's life. Accounting charges that do not themselves create a cash movement are not included as project cash flows; instead, the analysis identifies the actual cash consequences, including initial investment, operating cash flows, tax effects and terminal cash flows where applicable. This approach supports decisions based on value creation and is consistent with the CIMA Professional Qualification's coverage of investment appraisal and financial decision making. See CIMA Professional Qualification and ACCA's guidance on relevant costs.

QUESTION NO: 19 - (SIMULATION)

$30.328 million is to be invested in a project that will yield annual net cash inflows of $8 million for 5 years.

What is the project ' s internal rate of return (IRR)?

Give your answer to the nearest whole percentage.

ANSWER: See the explanation for the answer

Explanation:

IRR = 10% (nearest whole percentage).

The required five-year annuity present-value factor is:

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$30.328m ÷ $8m = 3.791
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The five-year annuity factor at 10% is approximately 3.791. Therefore, discounting the five annual inflows of $8 million at 10% gives a present value equal to the initial investment.

QUESTION NO: 20

A project has the following possible net present values:

Probability 0.30: NPV of $60,000
Probability 0.50: NPV of $20,000
Probability 0.20: NPV of negative $30,000

What is the expected net present value of the project?

A. $10,000

B. $18,000

C. $22,000

D. $50,000

ANSWER: C

Explanation:

The expected net present value is **$22,000**. Expected value is calculated by multiplying each possible outcome by its probability and then adding the results.

The calculation is: (0.30 × $60,000) + (0.50 × $20,000) + (0.20 × negative $30,000) = $18,000 + $10,000 − $6,000 = $22,000. Expected value provides a probability-weighted average outcome. It does not show the variability of possible outcomes or the project's risk profile.

QUESTION NO: 21

Which of the following statements are correct with regard to responsibility centres?

Select ALL that apply.

A. Revenue centre managers have a lower level of decision-making authority than profit centre managers.

B. Revenue centre managers and profit centre managers are accountable for controllable costs only.

C. Profit centre managers and investment centre managers are responsible for the majority of operating costs incurred.

D. Investment centre managers have a higher level of managerial authority than profit centre managers.

E. Managers of profit centres have authority over the level of investment in working capital but managers of cost centres do not.

ANSWER: A C D

Explanation:

Responsibility centres allocate accountability in line with the decisions a manager can control. "Revenue centre managers have a lower level of decision-making authority than profit centre managers" is correct because a revenue centre focuses primarily on generating and managing revenue, whereas a profit centre combines responsibility for revenues with responsibility for the costs incurred in earning them. The profit-centre manager therefore has a broader set of operating decisions to make.

"Profit centre managers and investment centre managers are responsible for the majority of operating costs incurred" is also correct. Profit centres measure the financial result from revenues less controllable operating costs, so their managers are accountable for managing the main costs of the operation as well as revenue. Investment centres retain this operating accountability while adding responsibility for the efficient use of capital employed.

"Investment centre managers have a higher level of managerial authority than profit centre managers" is correct because investment-centre performance incorporates both profit and the assets or capital investment used to generate it. This includes decisions affecting investment and asset utilisation, which are beyond the usual profit-centre remit. This hierarchy supports the use of measures such as return on investment and residual income. See ACCA's divisional performance measurement guidance and OpenStax's discussion of decentralisation and responsibility centres.

QUESTION NO: 22

Which TWO of the following conditions are necessary for a learning curve to apply?

A. The process must be simple.

B. The process must be complex.

C. There must be regular breaks in production.

D. Production must be machine intensive.

E. Production must be labor intensive.

ANSWER: B E

Explanation:

“The process must be complex” and “Production must be labor intensive.

” are the necessary conditions from the choices given. A learning curve describes the predictable reduction in labour time per unit as cumulative output rises: employees gain familiarity, improve methods and coordination, and make fewer errors through repeated performance. This effect is most relevant where a task has sufficient complexity for experience to produce meaningful improvements; a very simple operation offers little scope for progressive learning. It is also principally a labour-performance model, so the activity must be labour intensive enough for changes in human efficiency to have a material effect on unit time and cost. In management accounting, learning-curve analysis is therefore useful for estimating labour hours and costs in early production runs, particularly for new or technically demanding work, before performance stabilises. CIMA includes learning curves within the Advanced Management Accounting syllabus area covering cost estimation and decision-making techniques; see the CIMA Professional Qualification syllabus. The underlying cumulative-average learning relationship is also described by the UK Government Green Book supplementary guidance in its discussion of evidence and adjustments for estimating project costs.

QUESTION NO: 23

A company is determining the selling price for its new product.

At a selling price of $16 per unit there will be zero demand but for every $1 reduction in the price, demand will increase by 100 units per period.

Production must be in batches of 100 units. The variable cost per unit will be $8 if 400 units are produced in a period. For each additional batch produced in a period the variable cost per unit will increase by $1 per unit for the additional batch only.

No inventories will be held.

Which of the following sales and production volumes will generate the highest contribution per period?

A. 400 units

B. 500 units

C. 600 units

D. 700 units

ANSWER: A

Explanation:

400 units generates the highest contribution. The demand relationship means that sales of 400 units require a selling price of $12 per unit: demand rises by 100 units for each $1 reduction from the zero-demand price of $16. Revenue at this output is therefore $4,800 (400 × $12). As 400 units is the initial production level specified, every unit has a variable cost of $8, giving total variable cost of $3,200 (400 × $8). Contribution is consequently $1,600 per period.

The economic test is whether producing the next batch improves total contribution. Moving from 400 to 500 units reduces the selling price to $11 for all units, so total revenue rises by only $700, from $4,800 to $5,500. However, the additional 100-unit batch costs $9 per unit, or $900. Contribution therefore starts to fall once output exceeds 400 units. Each further batch is produced at a still higher batch-specific unit cost while the market price must be reduced again for every unit sold. Thus, no larger listed batch volume can improve on the $1,600 contribution obtained at 400 units. This applies the management-accounting focus on incremental revenues and relevant incremental costs when making output and pricing decisions. See the Global Management Accounting Principles and the CIMA Professional Qualification.

QUESTION NO: 24

A company is calculating the after-tax net present value of a capital investment.

Which of the following should be included as relevant cash flows in the calculation?

Select ALL that apply.

A. Tax payments arising from the project's taxable profits

B. Tax savings arising from capital allowances

C. Additional working capital required for the project

D. Proceeds from selling equipment that will no longer be required if the project proceeds

E. Depreciation charged in the financial statements

F. Research expenditure incurred before the investment decision is made

ANSWER: A B C D

Explanation:

Investment appraisal uses future incremental cash flows. Tax payments arising from the project are relevant because they are future cash outflows that differ if the project is undertaken. Similarly, tax savings arising from capital allowances are relevant because they are incremental cash inflows.

Additional working capital required for the project is also relevant because it is a cash outflow when invested, although any amount recoverable at the end of the project should be included as a later cash inflow. **Proceeds from selling existing equipment** are relevant where the sale occurs as a consequence of accepting the project. Depreciation is excluded because it is an accounting charge rather than a cash flow. Research expenditure already incurred is a sunk cost and cannot be changed by the current decision.

QUESTION NO: 25

Which of the following statements about modified internal rate of return (MIRR) and internal rate of return (IRR) is correct?

A. MIRR uses a more realistic reinvestment assumption than IRR.

B. MIRR favours projects with long payback periods whereas IRR does not.

C. MIRR and IRR will always rank competing projects in the same order.

D. A project's MIRR will always be higher than its IRR.

ANSWER: A

Explanation:

MIRR uses a more realistic reinvestment assumption than IRR. Conventional IRR calculates the discount rate that makes a project's net present value equal to zero, but its mathematical structure implicitly assumes that interim positive cash flows can be reinvested at the project's IRR. For projects producing a high IRR, that assumption may be implausible because

equivalent investment opportunities may not be available at that rate. MIRR addresses this issue by explicitly applying a specified reinvestment rate, usually the organisation's cost of capital or another realistic rate of return, to positive intermediate cash flows until the end of the project. It also discounts negative cash flows to the present at a specified finance rate. The resulting MIRR is the single annualised rate linking the present value of costs to the terminal value of inflows. This makes MIRR particularly useful where a business wants appraisal results to reflect its actual financing and reinvestment environment, rather than an assumed reinvestment rate derived from the project itself. CIMA's investment-appraisal materials recognise MIRR as a development of IRR that resolves the unrealistic reinvestment assumption. See AICPA & CIMA's Fundamentals of Financial Management and Corporate Finance Institute's MIRR overview.

QUESTION NO: 26

The starting point for developing a balanced scorecard for an organization should be:

A. the organization's vision and strategy

B. the external market that the organization is operating in

C. benchmarking the organization's current performance

D. the organization's non-financial targets

ANSWER: A

Explanation:

The organization's vision and strategy is the appropriate starting point because the balanced scorecard is designed to translate strategic intent into a coherent set of objectives, measures, targets and initiatives. It begins by clarifying what the organisation seeks to achieve and the strategy through which it will achieve it. Management can then identify the critical objectives across the financial, customer, internal-process, and learning-and-growth perspectives, linking them through cause-and-effect relationships. For example, a strategic aim to improve customer value may require investment in employee capabilities and process improvements, which should ultimately support customer outcomes and financial performance. This alignment prevents the scorecard becoming merely a collection of available performance measures. CIMA's management accounting guidance treats performance measurement as a means of implementing and monitoring strategy, rather than an exercise undertaken independently of strategic objectives. The Balanced Scorecard Institute likewise describes a scorecard as translating an organisation's mission, vision and strategy into performance objectives and measures. See Balanced Scorecard Institute: BSC Basics Overview and AICPA & CIMA: Management Accounting.

QUESTION NO: 27

A company is considering responses to the risk that a major supplier may fail to deliver a critical component.

Which TWO of the following actions are examples of transferring risk?

A. Taking out insurance against supply interruption

B. Agreeing a fixed-price contract with compensation for late delivery

C. Training purchasing staff to monitor supplier performance

D. Maintaining an approved alternative supplier

E. Cancelling the product that uses the component

ANSWER: A B

Explanation:

Risk transfer involves shifting all or part of the financial consequences of a risk to another party, usually through a contractual arrangement. It does not eliminate the underlying event, but it changes who bears the financial impact if the event occurs.

Taking out insurance against supply interruption transfers specified financial losses to an insurer in return for an insurance premium. **Agreeing a fixed-price contract with a supplier that includes compensation for late delivery** transfers some of the financial consequence of delay to the supplier. Training purchasing staff and maintaining alternative suppliers are risk-reduction actions because they reduce the likelihood or impact of disruption. Cancelling the product would be risk avoidance.

QUESTION NO: 28

A company makes three products, E, F and G. Total overheads for the year are expected to be $1.2 million, with the following split between cost pools:

Cost driver information has been estimated as follows:

Number of quality inspections	**84,000 inspections**
Number of purchase requisitions	12,000 requisitions
Quantity of material handled	240,000 kilogrammes

The company plans to make 10,000 units of product E in the year, with an expected direct cost of $0.60 per unit. This annual production of product E is expected to require 20 quality inspections, 28 purchase requisitions, and 400 kilogrammes of materials.

What is the overhead cost per unit of product E?

A. $0.10

B. $0.70

C. $3.57

D. $4.17

ANSWER: C

Explanation:

The overhead cost per unit of product E is **$3.57**. This is calculated using activity-based costing: each overhead cost pool is first assigned a cost-driver rate by dividing that pool's budgeted overhead by the total forecast volume of its driver. The relevant drivers are quality inspections, purchase requisitions and kilogrammes of materials. Product E's expected consumption—20 inspections, 28 requisitions and 400 kg—is then multiplied by the respective activity rates. Adding these three activity costs gives the total annual overhead attributable to product E. Dividing that total by the planned output of 10,000 units produces an overhead absorption of $3.57 per unit. The stated direct cost of $0.60 per unit is not part of the requested overhead figure; it would be relevant only if the question asked for total unit cost. This approach reflects the ABC principle that overheads should be traced to products according to their use of the activities that cause those costs. See the activity-based costing methodology in OpenStax Principles of Managerial Accounting and the CIMA qualification information at AICPA & CIMA.