CMA Part 2 Practice Exam — Paper A

Strategic Financial Management

Duration: 4 hours

Instructions:

Complete all 100 multiple-choice questions first (3 hours)

Then answer 2 essay questions (1 hour)

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Instructions

MCQs:

100 questions, 3 hours allotted

Each MCQ carries 3.75 marks (375 total marks ÷ 100 questions)

Attempt all MCQs first before moving to essays

Minimum 50% score required in MCQs to proceed to essays

Essay Questions:

2 questions, 1 hour allotted

Each essay carries 62.5 marks (125 total marks ÷ 2 essays)

Essays are scenario-based and require written analytical answers

Percentage-wise Topic Breakdown of MCQs (Example)

Financial Statement Analysis	No. of Questions	Percentage (%)
Financial Statement Analysis	25	25%
Financial Statement Analysis	20	20%
Financial Statement Analysis	20	20%
Risk Management	10	10%
Investment Decisions	10	10%
Professional Ethics	15	15%
Total	**100**	**100%**

Summary for Candidates

Total marks: 500
MCQs weight: 375 marks (75%)
Essays weight: 125 marks (25%)
Passing score: 360 or above (combined MCQs + essays)
E**xam duration**: 4 hours (3 hours MCQs + 1 hour essays)

Section A: Multiple Choice Questions (100 Questions)

Decision Analysis (25 Questions)

The contribution margin per unit is calculated as:
A) Selling price – Variable cost per unit
B) Fixed cost – Variable cost
C) Selling price – Fixed cost
D) Total revenue – Total cost
Answer: A
The margin of safety represents:
A) Sales above break-even point
B) Fixed costs
C) Variable costs
D) Profit margin
Answer: A
What happens to net operating income when sales increase above break-even?
A) It increases
B) It decreases
C) It remains the same
D) It becomes zero
Answer: A
Incremental analysis is used to:
A) Decide whether to discontinue a product
B) Calculate tax payments
C) Prepare financial statements
D) Allocate overheads
Answer: A
A company uses penetration pricing to:
A) Quickly gain market share
B) Maximize short-term profits
C) Discourage competition by raising prices
D) Ignore customer preferences
Answer: A
The payback period method ignores:
A) Time value of money
B) Cash inflows
C) Initial investment

D) Risk
Answer: A
Which is NOT a capital budgeting technique?
A) Net Present Value (NPV)
B) Internal Rate of Return (IRR)
C) Payback Period
D) Contribution Margin
Answer: D
The margin of safety ratio is:
A) Margin of safety ÷ Actual sales
B) Fixed costs ÷ Sales
C) Variable costs ÷ Sales
D) Contribution margin ÷ Sales
Answer: A
Break-even sales dollars is calculated by:
A) Fixed costs ÷ Contribution margin ratio
B) Fixed costs × Contribution margin
C) Variable costs + Fixed costs
D) None of the above
Answer: A
Incremental revenue is:
A) Additional revenue from a decision
B) Total revenue
C) Fixed revenue
D) None of the above
Answer: A
Incremental cost is:
A) Additional cost from a decision
B) Total cost
C) Fixed cost
D) None of the above
Answer: A
Decision to accept a special order should be based on:
A) Incremental revenue exceeding incremental cost
B) Total revenue
C) Fixed costs
D) None of the above
Answer: A
Activity-based costing assigns overhead costs based on:
A) Activities that cause costs
B) Direct labor hours only
C) Total sales
D) None of the above
Answer: A
Contribution margin is important because it:
A) Covers fixed costs and profit

B) Is equal to total revenue
C) Is the same as net income
D) None of the above
Answer: A
Cost-volume-profit analysis is most useful for:
A) Short-term profit planning
B) Long-term investments
C) Tax planning
D) None of the above
Answer: A
A price skimming strategy involves:
A) Charging a high initial price then lowering it later
B) Charging the lowest price possible
C) Keeping prices constant
D) Ignoring competitor prices
Answer: A
The margin of safety in units is:
A) Actual sales – Break-even sales
B) Fixed costs ÷ Contribution margin
C) Variable costs × Sales
D) Total sales ÷ Profit
Answer: A
A flexible budget is most useful when:
A) Activity levels vary
B) Activity levels are fixed
C) Only fixed costs exist
D) Variable costs are zero
Answer: A
Scenario analysis involves:
A) Considering multiple future possible outcomes
B) Ignoring market trends
C) Using fixed assumptions
D) None of the above
Answer: A
Regression analysis helps in:
A) Estimating relationships between variables
B) Ignoring data trends
C) Setting fixed budgets
D) None of the above
Answer: A
The main limitation of payback period is:
A) It ignores cash flows beyond the payback period
B) It accounts for time value of money
C) It measures profitability accurately
D) It considers all cash flows
Answer: A

A high contribution margin ratio indicates:
A) A large portion of sales contributes to fixed costs and profit
B) High variable costs
C) Low profit margin
D) Low sales
Answer: A
Cost-plus pricing involves:
A) Adding a markup to cost
B) Setting price below cost
C) Ignoring costs
D) None of the above
Answer: A
The break-even point will increase if:
A) Fixed costs increase
B) Selling price increases
C) Variable costs decrease
D) Sales volume increases
Answer: A
CVP analysis assumes:
A) Costs can be accurately split into fixed and variable
B) Costs are all fixed
C) Costs are all variable
D) None of the above
Answer: A

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Corporate Finance (20 Questions)

Capital structure refers to:
A) The mix of debt and equity financing
B) Company's asset composition
C) Marketing strategy
D) Sales targets
Answer: A
Weighted Average Cost of Capital (WACC) is used to:
A) Evaluate investment projects
B) Calculate sales
C) Prepare tax returns
D) Determine salary budgets
Answer: A
Cost of debt is:
A) Usually lower than cost of equity because interest is tax-deductible
B) Higher than cost of equity
C) Irrelevant to capital structure

D) Equal to cost of equity
Answer: A
Dividend policy impacts:
A) Cash flows and shareholder returns
B) Only tax payments
C) Marketing expenses
D) Production costs
Answer: A
Working capital management aims to:
A) Manage short-term assets and liabilities efficiently
B) Manage long-term assets
C) Ignore cash flow
D) Increase debts
Answer: A
Efficient inventory management:
A) Reduces holding costs and prevents stockouts
B) Increases unnecessary stock
C) Has no impact on cash flow
D) None of the above
Answer: A
Payables management should:
A) Utilize credit terms while maintaining supplier relations
B) Pay all bills immediately
C) Ignore supplier terms
D) None of the above
Answer: A
Corporate restructuring includes:
A) Mergers, acquisitions, divestitures
B) Day-to-day sales
C) Product pricing
D) Marketing campaigns
Answer: A
Divestiture refers to:
A) Selling off parts of the business
B) Buying new businesses
C) Launching products
D) Hiring employees
Answer: A
Leveraged buyout (LBO) is:
A) Acquisition using significant debt
B) Equity financing
C) Marketing strategy
D) Product launch
Answer: A
Capital budgeting decisions involve:
A) Evaluating long-term investments

B) Managing cash payments
C) Marketing plans
D) Day-to-day operations
Answer: A
A low debt-to-equity ratio indicates:
A) Lower financial risk
B) High leverage
C) High profitability
D) Poor liquidity
Answer: A
Cost of equity is typically estimated by:
A) Capital Asset Pricing Model (CAPM)
B) Dividend payout
C) Sales growth
D) None of the above
Answer: A
The dividend discount model (DDM) assumes:
A) Future dividends grow at a constant rate
B) Dividends remain unchanged
C) Dividends decrease over time
D) None of the above
Answer: A
The primary objective of corporate finance is to:
A) Maximize shareholder wealth
B) Minimize costs only
C) Increase sales volume
D) None of the above
Answer: A
The cost of retained earnings is generally:
A) Equal to the cost of equity
B) Lower than cost of debt
C) Higher than cost of debt
D) Zero
Answer: A
A company's capital structure is considered optimal when:
A) WACC is minimized
B) Debt is maximized
C) Equity is zero
D) Interest expense is highest
Answer: A
The primary goal of dividend policy is to:
A) Balance current income and future growth
B) Maximize dividend payout regardless of profits
C) Avoid paying dividends
D) Maximize retained earnings only
Answer: A

In working capital management, cash conversion cycle measures:
A) Time to convert inventory and receivables into cash
B) Time to produce goods
C) Total working capital
D) Days payable outstanding
Answer: A
Inventory turnover ratio indicates:
A) How many times inventory is sold and replaced
B) Total inventory held
C) Days to pay suppliers
D) Days sales outstanding
Answer: A
Short-term financing is usually used to:
A) Finance working capital needs
B) Buy fixed assets
C) Fund long-term investments
D) Pay dividends
Answer: A
The pecking order theory suggests companies prefer financing in this order:
A) Internal funds, debt, equity
B) Equity, debt, internal funds
C) Debt, equity, internal funds
D) None of the above
Answer: A
An increase in accounts receivable days will:
A) Increase cash conversion cycle
B) Decrease liquidity
C) Have no effect
D) Increase profit margins
Answer: A
The DuPont analysis decomposes ROE into:
A) Profit margin, asset turnover, and financial leverage
B) Sales growth and dividends
C) Debt ratio and liquidity
D) None of the above
Answer: A
Capital budgeting is critical because:
A) It involves large, long-term investments impacting future cash flows
B) It is short-term cost control
C) It deals with daily operations
D) None of the above
Answer: A

Financial Statement Analysis (20 Questions)

Liquidity ratios measure:
A) Ability to meet short-term obligations
B) Profitability
C) Solvency
D) Efficiency
Answer: A
Current ratio formula is:
A) Current Assets ÷ Current Liabilities
B) Total Assets ÷ Total Liabilities
C) Net Income ÷ Sales
D) None of the above
Answer: A
Quick ratio excludes:
A) Inventory from current assets
B) Cash
C) Accounts receivable
D) Prepaid expenses
Answer: A
Return on Assets (ROA) is:
A) Net Income ÷ Total Assets
B) Net Income ÷ Equity
C) Gross Profit ÷ Sales
D) None of the above
Answer: A
Debt to Equity ratio indicates:
A) Financial leverage
B) Liquidity
C) Profitability
D) Asset efficiency
Answer: A
Times interest earned ratio measures:
A) Ability to cover interest expenses
B) Profitability
C) Liquidity
D) Asset turnover
Answer: A
Inventory turnover ratio indicates:
A) Efficiency in managing inventory
B) Liquidity
C) Debt levels
D) Profit margins
Answer: A
Earnings per share (EPS) is:
A) Net income available to shareholders ÷ Number of shares
B) Total assets ÷ Number of employees
C) Sales ÷ Number of shares

D) None of the above
Answer: A
The price-to-earnings (P/E) ratio reflects:
A) Market expectations of growth
B) Dividend yield
C) Book value per share
D) None of the above
Answer: A
Financial leverage amplifies:
A) Returns and losses
B) Sales volume
C) Operating expenses
D) None of the above
Answer: A

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Risk Management (10 Questions)

Enterprise Risk Management (ERM) is:
A) A comprehensive approach to managing risk aligned with strategy
B) Managing only financial risks
C) Ignoring risks
D) None of the above
Answer: A
Risk appetite defines:
A) The level of risk an organization is willing to accept
B) The likelihood of a risk occurring
C) The financial loss due to risk
D) None of the above
Answer: A
Risk transfer can be achieved by:
A) Insurance
B) Avoidance
C) Acceptance
D) None of the above
Answer: A
Operational risk includes:
A) Failures in processes
B) Market risk
C) Credit risk
D) None of the above
Answer: A
Risk mitigation means:
A) Reducing the impact or likelihood of risks
B) Ignoring risks

C) Accepting all risks
D) None of the above
Answer: A
The risk management process includes:
A) Identification, assessment, response, monitoring
B) Only risk identification
C) Only risk acceptance
D) None of the above
Answer: A
Key risk indicators are:
A) Metrics that provide early warning signs
B) Total risk amount
C) Risk appetite levels
D) None of the above
Answer: A
Scenario analysis in risk management:
A) Examines different possible future scenarios
B) Ignores uncertainty
C) Fixes budgets permanently
D) None of the above
Answer: A
Risk monitoring ensures:
A) Controls are effective and risks are managed
B) Risks are ignored
C) Only financial risks are tracked
D) None of the above
Answer: A
Risk communication involves:
A) Sharing risk information with stakeholders
B) Hiding risk data
C) Ignoring regulations
D) None of the above
Answer: A

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Investment Decisions (10 Questions)

Capital budgeting decisions evaluate:
A) Long-term investment projects
B) Short-term expenses
C) Marketing plans
D) Payroll budgets
Answer: A
Net Present Value (NPV) is:
A) Present value of cash inflows minus initial investment

B) Total sales minus expenses
C) Revenue minus cost
D) None of the above
Answer: A
Internal Rate of Return (IRR) is:
A) Discount rate where NPV = 0
B) Interest rate on loans
C) Cost of equity
D) None of the above
Answer: A
Payback period measures:
A) Time to recover initial investment
B) Profit margin
C) Total cash flow
D) None of the above
Answer: A
Real options analysis provides:
A) Managerial flexibility in investment decisions
B) Fixed investment plans
C) Ignores market uncertainty
D) None of the above
Answer: A
A project with positive NPV:
A) Should be accepted
B) Should be rejected
C) Has negative returns
D) None of the above
Answer: A
A limitation of IRR is:
A) Multiple IRRs can occur with non-standard cash flows
B) It accounts for time value of money
C) It is easy to calculate
D) None of the above
Answer: A
Capital rationing occurs when:
A) Capital is limited and projects must be prioritized
B) Unlimited funds are available
C) Projects are always accepted
D) None of the above
Answer: A
Discounted Payback Period considers:
A) Time value of money
B) Only payback time
C) Profitability
D) None of the above
Answer: A

The hurdle rate is:
A) Minimum acceptable rate of return on a project
B) Interest rate on loans
C) Dividend yield
D) None of the above
Answer: A

Professional Ethics (15 Questions)

Professional ethics require accountants to:
A) Act with integrity, objectivity, and confidentiality
B) Ignore laws
C) Manipulate data
D) None of the above
Answer: A
Conflict of interest occurs when:
A) Personal interest conflicts with professional duties
B) Company profits rise
C) Sales increase
D) None of the above
Answer: A
Confidentiality means:
A) Not disclosing client information without consent
B) Sharing client information freely
C) Ignoring regulations
D) None of the above
Answer: A
Whistleblowing involves:
A) Reporting unethical behavior
B) Hiding fraud
C) Ignoring errors
D) None of the above
Answer: A
Integrity in accounting means:
A) Honesty and fairness
B) Deceiving stakeholders
C) Manipulating numbers
D) None of the above
Answer: A
Ethical dilemmas require:
A) Careful analysis and adherence to professional standards
B) Ignoring rules
C) Personal gain

D) None of the above
Answer: A
Professional behavior includes:
A) Compliance with laws and regulations
B) Misleading clients
C) Breaching confidentiality
D) None of the above
Answer: A
Objectivity requires accountants to:
A) Avoid bias and conflicts of interest
B) Favor management
C) Hide information
D) None of the above
Answer: A
Ethics in management accounting:
A) Protects reputation and public trust
B) Is optional
C) Encourages dishonesty
D) None of the above
Answer: A
Accountability means:
A) Taking responsibility for actions
B) Avoiding responsibility
C) Blaming others
D) None of the above
Answer: A
A management accountant discovers that financial reports have been manipulated. What is the first ethical action they should take?
A) Report the issue internally following company policy
B) Ignore the manipulation
C) Share it publicly without informing management
D) Alter the reports themselves
Answer: A
Professional skepticism means:
A) Questioning and critically assessing audit evidence
B) Accepting information without verification
C) Ignoring inconsistencies
D) Blindly trusting management
Answer: A
Which of the following is NOT part of professional ethics in accounting?
A) Confidentiality
B) Integrity
C) Objectivity
D) Personal gain at all costs
Answer: D

Ethical guidelines require accountants to:
A) Avoid actions that discredit the profession
B) Hide financial irregularities
C) Support unethical practices if requested
D) Disclose confidential information without consent
Answer: A
If a conflict of interest cannot be avoided, a professional accountant should:
A) Disclose the conflict fully and seek guidance
B) Ignore the conflict
C) Use it for personal advantage
D) Hide it from stakeholders
Answer: A
Which financial ratio best measures a company's ability to pay its short-term liabilities with its most liquid assets?
A) Current Ratio
B) Quick Ratio
C) Debt to Equity Ratio
D) Return on Assets
Answer: B
The main purpose of a sensitivity analysis in capital budgeting is to:
A) Examine how changes in key assumptions affect project outcomes
B) Determine the initial investment cost
C) Calculate tax implications
D) Forecast sales growth
Answer: A
Which of the following is NOT typically considered a financial risk?
A) Credit risk
B) Market risk
C) Operational risk
D) Liquidity risk
Answer: C
Ethical behavior in management accounting includes all EXCEPT:
A) Maintaining confidentiality
B) Providing misleading information
C) Acting with integrity
D) Avoiding conflicts of interest
Answer: B
When a company chooses to finance its operations primarily through debt, it is said to be using:
A) High financial leverage
B) Low financial leverage
C) Equity financing
D) Operating leverage
Answer: A

Section B: Essay Questions (2 Questions)

Essay Question 1: Risk Management Framework

Question:
Explain the key components of Enterprise Risk Management (ERM) and how a company can apply ERM to improve its strategic decision-making.

Comprehensive Answer:

Enterprise Risk Management (ERM) is a holistic approach for managing all types of risks that an organization faces in alignment with its strategic objectives. The key components include:

Risk Identification: Systematically identifying risks that could impact the organization from all sources (operational, financial, strategic, legal, environmental, etc.).

Risk Assessment: Evaluating the likelihood and potential impact of identified risks using qualitative and quantitative methods such as risk matrices and value-at-risk models.

Risk Response: Developing strategies to manage risks—avoidance, mitigation, transfer (insurance), or acceptance depending on risk appetite.

Risk Monitoring and Reporting: Continuously monitoring risk environment, the effectiveness of controls, and reporting to senior management and the board.
Communication and Culture: Promoting risk awareness and a culture of risk management throughout the organization.

Application in Strategic Decision-Making:

By integrating ERM into strategic planning, companies can anticipate potential threats and opportunities, prioritize resources efficiently, and make informed decisions that balance risk and reward. For example, a company may diversify suppliers to reduce supply chain risk or adjust investment strategies based on risk assessments, improving resilience and long-term value.

Essay Question 2: Capital Budgeting Techniques

Question:
Compare and contrast Net Present Value (NPV) and Internal Rate of Return (IRR) methods in capital budgeting. Discuss the advantages and limitations of each.

Essay Question 2: Capital Budgeting Techniques

Net Present Value (NPV):

NPV calculates the difference between the present value of cash inflows and outflows over a project's lifetime using a discount rate (usually WACC).
A positive NPV indicates the project is expected to add value to the firm.

Advantages:
Accounts for time value of money
Provides direct measure of value addition in currency units
Facilitates comparison of mutually exclusive projects

Limitations:
Requires an accurate estimate of discount rate and cash flows
May be less intuitive for some decision-makers
Internal Rate of Return (IRR):
IRR is the discount rate at which the project's NPV equals zero, effectively the expected rate of return.
A project is accepted if IRR exceeds the required rate of return.

Advantages:
Provides a single percentage return figure that is easy to understand
Useful for ranking projects when capital is limited
Limitations:
Can give multiple IRRs for projects with unconventional cash flows
Assumes reinvestment at IRR which may not be realistic
May be misleading for projects of different durations or sizes

Conclusion:
While both methods are widely used, NPV is generally preferred for its direct measure of value creation and consistency with wealth maximization principles. IRR's intuitive appeal makes it useful for communicating project attractiveness, but its limitations require cautious interpretation.