Arizona State University (ASU) ACC231 Uses of Accounting Information I Exam 2 Practice (Sample)

Study Guide

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Questions

1. Which of the following describes a tangible asset?

   A. Goodwill

   B. Patents

   C. Machines used in production

   D. Trademarks

2. In accounting, what is a variance?

   A. The difference between budgeted and actual financial results

   B. The total income of a business

   C. A type of financial asset

   D. The cost of goods sold

3. What is the purpose of the ‘expense recognition principle’?

   A. To ensure that all expenses are recorded at the end of the fiscal year.

   B. It dictates that expenses should be recognized in the same period as the revenues they help to generate.

   C. To allow flexibility in reporting available cash.

   D. To mandate the approval of expenses by a manager before recording.

4. Which of these represents a current liability?

   A. Mortgage Payable

   B. Wages Payable

   C. Equipment

   D. Land

5. What does GAAP stand for?

   A. Generally Accepted Accounting Policies

   B. Generally Applied Accounting Procedures

   C. General Accounting Assessment Practices

   D. Generally Accepted Accounting Principles

6. What does 'working capital' represent in a business?

A. The total amount of assets owned by a business

B. The difference between current assets and current liabilities

C. The total revenue generated in a fiscal year

D. The net income of a business after all expenses

7. What does the term 'Accumulated Depreciation' represent on the balance sheet?

A. Total value of all assets

B. Reduction in the value of fixed assets

C. Total liabilities of the company

D. Value of cash reserves

8. How does the 'FIFO' inventory method function?

A. Assumes the newest inventory items are sold first

B. Assumes inventory items are sold in the order they were purchased

C. Values inventory based on the most recent purchase price

D. Assumes all inventory items are equal in value

9. What does 'depreciation' account for in financial statements?

A. The increase in asset value over time

B. The allocation of the cost of a tangible asset over its useful life

C. The total cash generated from sales

D. The immediate expense of purchasing an asset

10. Which of the following is typically a characteristic of a corporation?

A. Unlimited liability for owners

B. Transferability of ownership through stocks

C. Direct management by all shareholders

D. Taxation at the personal income level

Answers

1. C
2. A
3. B
4. B
5. D
6. B
7. B
8. B
9. B
10. B

Explanations

1. Which of the following describes a tangible asset?

A. Goodwill

B. Patents

C. Machines used in production

D. Trademarks

A tangible asset is a physical asset that can be seen and touched, holding intrinsic value due to its physical form. In this context, machines used in production are a clear example of tangible assets because they represent physical items that a business can utilize in operations and that provide measurable value. On the other hand, goodwill, patents, and trademarks are classified as intangible assets. Goodwill refers to the value of brand reputation and customer relationships, patents are legal rights protecting inventions or processes, and trademarks represent recognizable signs or symbols associated with a business. All these are non-physical in nature and do not have a tangible form, which distinguishes them from tangible assets like machines.

2. In accounting, what is a variance?

A. The difference between budgeted and actual financial results

B. The total income of a business

C. A type of financial asset

D. The cost of goods sold

A variance in accounting refers to the difference between budgeted and actual financial results. This concept is crucial for financial analysis and management performance evaluation. When businesses prepare budgets, they are essentially setting financial goals based on forecasts and expectations. As actual results come in, comparing them to these budgeted figures helps businesses understand how well they are performing financially. For example, if a company budgeted $100,000 in sales for a quarter but actually achieved $90,000 in sales, the variance would be negative $10,000. This analysis allows management to identify areas that may require corrective action or further scrutiny, such as cost management or sales strategies. Variances can be categorized as favorable or unfavorable. A favorable variance occurs when actual results exceed budgeted figures, indicating better-than-expected performance, while an unfavorable variance indicates the opposite. Recognizing and analyzing variances aids organizations in making informed decisions and improving financial outcomes over time.

3. What is the purpose of the ‘expense recognition principle’?

A. To ensure that all expenses are recorded at the end of the fiscal year.

B. It dictates that expenses should be recognized in the same period as the revenues they help to generate.

C. To allow flexibility in reporting available cash.

D. To mandate the approval of expenses by a manager before recording.

The purpose of the expense recognition principle is to dictate that expenses should be recognized in the same period as the revenues they help to generate. This is a fundamental concept in accrual accounting that ensures financial statements accurately reflect the company’s financial performance during a specific period. By aligning expenses with the corresponding revenues, it allows for a more accurate assessment of profitability and ensures that the income statement provides a true picture of the company's earnings. This principle is critical for reflecting the economic reality of a business's operations, as it helps stakeholders understand how costs relate to revenue generation. For example, if a company incurs costs to produce goods, those expenses should be recorded in the same period when the sales for those goods occur, ensuring that stakeholders can see the relationship between revenue and the costs incurred to generate that revenue, ultimately aiding in better decision-making. In contrast, recording all expenses at the end of the fiscal year lacks the nuance of matching costs to revenues and may misrepresent a company's financial health during a given time period. Allowing flexibility in cash reporting does not align with the adherence to accounting principles or provide meaningful information about a company’s performance. Additionally, requiring managerial approval before recording expenses may introduce delays and does not inherently relate to the timing and matching of expenses to revenues

4. Which of these represents a current liability?

A. Mortgage Payable

B. Wages Payable

C. Equipment

D. Land

Wages Payable is indeed a current liability because it represents the amount that a company owes to its employees for work that has been performed but not yet paid for, and is expected to be settled within one year. Current liabilities are obligations that are expected to be paid off within a year and typically include items like accounts payable, short-term loans, and accrued expenses such as wages. In contrast, Mortgage Payable is a long-term liability if it is scheduled for repayment over a period longer than one year, as it typically involves larger, longer-term financing for a property. Equipment and Land are not liabilities at all; they are classified as assets. Equipment refers to the tangible goods a company uses to produce goods and services, while Land is a type of fixed asset representing real estate owned by the company. Thus, Wages Payable stands out as the correct representation of a current liability in the context provided.

5. What does GAAP stand for?

A. Generally Accepted Accounting Policies

B. Generally Applied Accounting Procedures

C. General Accounting Assessment Practices

D. Generally Accepted Accounting Principles

GAAP stands for Generally Accepted Accounting Principles. This term refers to the established set of standards and guidelines that govern the preparation of financial statements in the United States. It includes the principles, concepts, and conventions that dictate how accounting is practiced, ensuring that financial statements are consistent, comparable, and transparent for users, including investors, creditors, and regulatory agencies. These principles cover various aspects of accounting, such as revenue recognition, asset classification, and financial statement presentation. Compliance with GAAP is crucial for organizations as it enhances the credibility and reliability of their financial reporting, providing assurance to stakeholders that the financial statements accurately reflect the company's financial position and performance. The other choices, while related to accounting, do not accurately define GAAP and instead refer to phrases that are either incorrect or not commonly recognized in the field of accounting. Understanding GAAP is essential for anyone involved in financial reporting or analysis, as it forms the foundation of sound accounting practices.

6. What does 'working capital' represent in a business?

A. The total amount of assets owned by a business

B. The difference between current assets and current liabilities

C. The total revenue generated in a fiscal year

D. The net income of a business after all expenses

Working capital is a crucial financial metric that indicates a company's short-term liquidity position and operational efficiency. It represents the difference between current assets and current liabilities. Current assets include items that can be converted to cash within a year, such as cash, inventory, and accounts receivable, while current liabilities are obligations due within the same time frame, such as accounts payable and short-term debts. By assessing this difference, businesses can determine whether they have enough assets to cover their short-term obligations. Sufficient working capital is vital for maintaining smooth operations, paying off debts, and managing day-to-day expenses. If a company has positive working capital, it signifies financial health, suggesting that it can readily meet its short-term liabilities using its current assets. Conversely, negative working capital can be a red flag, indicating potential liquidity problems that could hinder the company’s operations and lead to financial distress. In contrast, the other options mention items that do not directly relate to the working capital concept. The total amount of assets owned by a business and total revenue generated in a fiscal year do not account for liabilities, while net income is determined after all expenses and does not reflect the immediate financial position related to current operational capabilities. Therefore, the measure of working capital specifically highlights the balance between

7. What does the term 'Accumulated Depreciation' represent on the balance sheet?

   A. Total value of all assets

   B. Reduction in the value of fixed assets

   C. Total liabilities of the company

   D. Value of cash reserves

The term 'Accumulated Depreciation' represents the total reduction in the value of fixed assets due to wear and tear, obsolescence, or usage over time. It is recorded as a contra asset on the balance sheet, which means it reduces the gross value of the fixed assets listed. When companies purchase fixed assets such as machinery, buildings, or vehicles, these assets are initially recorded at their purchase prices. As time passes, these assets lose value. Accumulated depreciation captures that decrease in value, allowing users of financial statements to get a clearer picture of the current book value of the assets. This practice is essential for correctly matching expenses with revenues in accounting, as it allows companies to allocate the cost of an asset over its useful life, thus reflecting a more accurate financial position. Understanding this concept is crucial for analyzing a company's performance and assessing its asset management efficiency. In contrast, the other options do not accurately reflect the definition of accumulated depreciation. The total value of all assets refers to the gross asset total without accounting for depreciation. The total liabilities represent obligations and debts of the company, while the value of cash reserves pertains to liquid assets available to the company. None of these options relate to the concept of accumulated depreciation as they address

8. How does the 'FIFO' inventory method function?

   A. Assumes the newest inventory items are sold first

   B. Assumes inventory items are sold in the order they were purchased

   C. Values inventory based on the most recent purchase price

   D. Assumes all inventory items are equal in value

The FIFO (First In, First Out) inventory method operates on the principle that the oldest inventory items are sold first. This means that when a company sells its products, it is assumed that the products purchased first (or produced first) are the ones being sold before any newer inventory. Using FIFO can have significant implications for financial reporting and tax calculations. In periods of rising prices, FIFO typically results in lower cost of goods sold, as the older, cheaper inventory costs are matched against current revenues. This leads to higher reported profits and corresponds to a higher taxable income. Additionally, FIFO helps businesses manage their inventory efficiently and is often used in industries where products have a shelf life, such as food and pharmaceuticals, because it minimizes the risk of obsolescence. This understanding of FIFO highlights its operational and accounting significance, illustrating that the method aligns sales with the order of inventory acquisition, affecting both financial outcomes and inventory management practices.

9. What does 'depreciation' account for in financial statements?

A. The increase in asset value over time

B. The allocation of the cost of a tangible asset over its useful life

C. The total cash generated from sales

D. The immediate expense of purchasing an asset

Depreciation represents the systematic allocation of the cost of a tangible asset over its useful life, providing a way to match the asset's expense with the revenue it helps generate over time. This method reflects the decline in value of the asset as it is used, allowing businesses to accurately represent their financial position and operational performance in their financial statements. By spreading the cost of an asset over several periods, depreciation aligns the expense recognition with the periods that benefit from the asset, enhancing the accuracy of profit calculations. As a result, financial statements more accurately reflect the current value of assets and the company’s overall financial health. This approach also assists in complying with accounting principles like the matching principle, which dictates that expenses should be recognized in the same period as the revenues they help generate. Thus, the choice explaining depreciation correctly highlights its function in accounting and financial reporting.

10. Which of the following is typically a characteristic of a corporation?

A. Unlimited liability for owners

B. Transferability of ownership through stocks

C. Direct management by all shareholders

D. Taxation at the personal income level

The characteristic of transferability of ownership through stocks is fundamental to the structure of a corporation. When a company is incorporated, it issues shares of stock, which represent ownership interests in the corporation. These shares can be bought or sold in the stock market, allowing shareholders to easily transfer their ownership without needing to disrupt the operations of the corporation itself. This feature provides liquidity for investors and can attract more capital since it allows new investors to buy in and existing investors to exit their investment. In contrast, other characteristics mentioned do not align with the nature of a corporation. For example, unlimited liability is a defining feature of sole proprietorships and partnerships where owners can be personally liable for business debts. Direct management by all shareholders typically applies to smaller companies, such as partnerships or sole proprietorships, where all owners may participate actively in management. However, corporations are generally managed by a board of directors and hired management, separating ownership from daily operations. Lastly, corporations face taxation at the corporate level. They are distinct entities that pay taxes on their income, and when profits are distributed as dividends, shareholders are taxed again at the personal income level, which is known as double taxation. Therefore, the transferability of ownership through stocks is a key feature that facilitates investment