

Arizona State University (ASU) ACC232 Financial Accounting I Exam 2 Practice (Sample)

Study Guide



Everything you need from our exam experts!

Copyright © 2025 by Examzify - A Kaluba Technologies Inc. product.

ALL RIGHTS RESERVED.

No part of this book may be reproduced or transferred in any form or by any means, graphic, electronic, or mechanical, including photocopying, recording, web distribution, taping, or by any information storage retrieval system, without the written permission of the author.

Notice: Examzify makes every reasonable effort to obtain from reliable sources accurate, complete, and timely information about this product.

SAMPLE

Questions

SAMPLE

1. Debt securities acquired by a corporation which are accounted for by recognizing unrealized holding gains or losses as other comprehensive income are classified as what?
 - A. Held-to-maturity debt securities
 - B. Trading debt securities
 - C. Available-for-sale debt securities
 - D. Never-sell debt securities
2. What is the main function of the income statement?
 - A. To track individual transaction details
 - B. To provide a summary of cash flow activities
 - C. To show profit or loss over a specific period
 - D. To manage ongoing financial obligations
3. What is an audit?
 - A. An internal review process for employee performance
 - B. An independent examination of financial information of any entity
 - C. A method to calculate taxable income
 - D. A procedure to establish new accounting policies
4. What does liquidity refer to in financial terms?
 - A. The ability of a company to generate profit
 - B. The ability of a company to meet its short-term obligations
 - C. The speed at which assets can be sold
 - D. The measure of a company's operational efficiency
5. Available-for-sale debt securities are accounted for at:
 - A. Amortized cost only
 - B. Fair value with unrealized gains in net income
 - C. Fair value with unrealized holdings recognized in other comprehensive income
 - D. Market value without recognition of gains or losses

6. In a bond investment with a yield greater than the coupon rate, which accounting concept would apply?
- A. Amortization of premium
 - B. Accrued interest
 - C. Amortization of discount
 - D. Fair value adjustment
7. What should a company do when sales are made with a right of return?
- A. Should not recognize any revenue.
 - B. Should recognize revenue for the full sales price.
 - C. Records the returned asset in a separate inventory account.
 - D. Records the estimated returns in the Sales Revenue account.
8. How does segment reporting enhance financial transparency?
- A. By reporting only total company earnings
 - B. By disclosing detailed performance metrics for each segment
 - C. By omitting management comments
 - D. By focusing solely on external stakeholders
9. What is the discount percentage for season slips reserved in 2028 if paid by December 31, 2026?
- A. 5%
 - B. 10%
 - C. 20%
 - D. 15%
10. On purchase of held-to-maturity securities, which journal entry is correct?
- A. Dr Cash, Cr Debt Investments
 - B. Dr Debt Investments, Cr Cash
 - C. Dr Expense, Cr Debt Investments
 - D. Dr Debt Investments, Cr Equity

Answers

SAMPLE

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

SAMPLE

Explanations

SAMPLE

1. Debt securities acquired by a corporation which are accounted for by recognizing unrealized holding gains or losses as other comprehensive income are classified as what?

A. Held-to-maturity debt securities

B. Trading debt securities

C. Available-for-sale debt securities

D. Never-sell debt securities

The classification of debt securities that recognizes unrealized holding gains or losses as other comprehensive income falls under available-for-sale debt securities. This category is specifically designed for investment securities that a company intends to hold for an indefinite period but might be disposed of before maturity. Unlike trading securities, which are marked to market with unrealized gains and losses reflected directly in earnings, available-for-sale securities have their unrealized gains and losses reported in other comprehensive income. This treatment allows for a separation of income from ongoing operations and fluctuations from market valuations, offering a more nuanced view of a corporation's financial health. The other classifications, such as held-to-maturity and trading securities, have different accounting treatments that do not align with the criteria mentioned in the question. Held-to-maturity securities are recorded at amortized cost and do not recognize any unrealized gains or losses, while trading securities are always marked to market and recorded in the income statement, not as part of comprehensive income. Thus, available-for-sale debt securities is the appropriate classification in this context.

2. What is the main function of the income statement?

A. To track individual transaction details

B. To provide a summary of cash flow activities

C. To show profit or loss over a specific period

D. To manage ongoing financial obligations

The primary function of the income statement is to provide a summary of a company's revenues and expenses over a specific period, ultimately showing the profit or loss during that timeframe. This financial statement is essential for understanding a company's operational performance, as it highlights how much money the company earned (revenue) and how much it spent (expenses). By comparing revenues and expenses, stakeholders can see if the company is generating profit or experiencing a loss during the reporting period. An income statement is crucial for investors, management, and creditors, as it indicates the profitability of the business and informs decisions regarding investments and resource allocation. This performance measurement is typically reported quarterly or annually, making it a vital tool for assessing the ongoing financial health of an organization.

3. What is an audit?

- A. An internal review process for employee performance
- B. An independent examination of financial information of any entity**
- C. A method to calculate taxable income
- D. A procedure to establish new accounting policies

An audit is an independent examination of financial information of any entity. This process involves a systematic review and evaluation of the financial statements, compliance with accounting principles and regulations, and the overall accuracy and reliability of financial reporting. The purpose of an audit is to provide assurance to stakeholders, such as investors, management, and regulators, that the financial statements present a true and fair view of the entity's financial position and performance. This independent nature is critical because it helps ensure that the auditors are impartial and objective, providing a level of trust and credibility to the financial reporting process. Audits can be performed on various entities, including corporations, government agencies, and nonprofits, making this process integral to financial transparency and accountability. In contrast, the other choices refer to processes that do not encapsulate the full essence of what an audit entails. Internal reviews focus on performance evaluations and may not relate specifically to financial statements, calculating taxable income is related to tax compliance rather than auditing, and establishing new accounting policies does not involve reviewing historical financial data or providing assurance on its accuracy.

4. What does liquidity refer to in financial terms?

- A. The ability of a company to generate profit
- B. The ability of a company to meet its short-term obligations**
- C. The speed at which assets can be sold
- D. The measure of a company's operational efficiency

Liquidity in financial terms primarily refers to the ability of a company to meet its short-term obligations. When assessing a company's financial health, liquidity is a critical factor, as it indicates whether the company has sufficient liquid assets—such as cash, cash equivalents, and receivables—that can be readily converted into cash to pay off immediate liabilities. This aspect of financial analysis is essential for understanding the timing of cash flows and the risk of financial distress. Companies with high liquidity can easily navigate unexpected expenses or downturns in revenue, while those with low liquidity may struggle to fulfill financial commitments, impacting their operational viability. The other choices touch on different financial concepts: profitability relates to the generation of income, the speed of asset liquidation addresses aspects of market conditions rather than the company's operational liquidity specifically, and operational efficiency measures how well a company utilizes its resources but does not directly relate to its short-term financial obligations.

5. Available-for-sale debt securities are accounted for at:

- A. Amortized cost only
- B. Fair value with unrealized gains in net income
- C. Fair value with unrealized holdings recognized in other comprehensive income
- D. Market value without recognition of gains or losses

Available-for-sale debt securities are indeed accounted for at fair value, with any unrealized gains and losses recognized in other comprehensive income, rather than in net income. This means that while these securities are intended to be held for an indefinite period and may not be actively traded, fluctuations in their fair value do not impact the entity's net earnings until they are sold. Instead, these unrealized gains and losses are reported in a separate component of equity, which contributes to a more comprehensive view of an organization's financial position. The recognition of unrealized gains and losses in other comprehensive income allows for a clearer reflection of the performance of the securities while maintaining the integrity of net income, which may be impacted by operational results. This accounting treatment also helps investors and stakeholders understand the potential value fluctuations of an entity's investments without immediately affecting reported earnings. Understanding this framework is crucial for evaluating the financial statements of companies and assessing their investment portfolios. The classification of available-for-sale securities allows for strategic financial reporting, providing insights into the company's performance and risk exposure without distorting immediate earnings calculations.

6. In a bond investment with a yield greater than the coupon rate, which accounting concept would apply?

- A. Amortization of premium
- B. Accrued interest
- C. Amortization of discount
- D. Fair value adjustment

In a bond investment where the yield is greater than the coupon rate, the bond is selling at a discount. This is because investors demand a higher yield than what the bond is offering through its coupon payments, indicating that the bond is less attractive compared to other investment opportunities. The correct answer pertains to the amortization of discount. When a bond is issued at a price lower than its face value, the difference between the face value and the issue price represents a discount. Over the life of the bond, this discount is amortized, meaning that the bond's carrying amount increases progressively to reach its face value at maturity. This process allows the investor to recognize additional interest income over time, reflective of the higher effective yield. Understanding this concept is crucial for properly accounting for bonds held as investments, as it affects the recognized interest income and the overall valuation of the investment in financial statements.

7. What should a company do when sales are made with a right of return?

- A. Should not recognize any revenue.
- B. Should recognize revenue for the full sales price.
- C. Records the returned asset in a separate inventory account.
- D. Records the estimated returns in the Sales Revenue account.

When sales are made with a right of return, the best practice involves estimating potential returns and appropriately accounting for them. Recording the returned asset in a separate inventory account helps the company keep track of items that may come back, reflecting the company's true inventory levels. It ensures that financial statements present a more accurate picture of both inventory and potential revenue. By not recognizing any revenue or recognizing the full sales price without considering the likelihood of returns, the financial statements could present a distorted view of the company's current financial position. Estimating returns also involves adjusting the revenue figures to reflect only those sales expected to be finalized, providing a clearer picture of actual revenue. Thus, maintaining a separate inventory account for anticipated returns allows the company to manage its assets more effectively while adhering to accounting principles related to revenue recognition.

8. How does segment reporting enhance financial transparency?

- A. By reporting only total company earnings
- B. By disclosing detailed performance metrics for each segment
- C. By omitting management comments
- D. By focusing solely on external stakeholders

Segment reporting enhances financial transparency by disclosing detailed performance metrics for each segment of a company's operations. This approach allows investors, analysts, and other stakeholders to gain a clearer understanding of how different parts of the business are performing. By breaking down financial information by segment, stakeholders can assess the profitability, revenue, and expenses associated with each division, which fosters a better understanding of the business's overall performance. This detailed insight helps in various ways, such as evaluating the effectiveness of management strategies in different areas and identifying trends that may not be apparent when viewing consolidated financial statements. By contributing to an informed analysis of the company, segment reporting promotes accountability and provides a comprehensive picture of the company's financial health.

9. What is the discount percentage for season slips reserved in 2028 if paid by December 31, 2026?

- A. 5%
- B. 10%
- C. 20%
- D. 15%

To determine the discount percentage for season slips reserved in 2028 if paid by December 31, 2026, it's essential to understand the context of booking and processing discounts offered over time. Discounts are typically structured based on the early payment of a reserved service to incentivize customers to pay ahead of time, improving cash flow for the business. In this scenario, a 20% discount suggests that the incentive for early payment is quite significant and is designed to encourage immediate commitment to a future service. This is particularly plausible in settings where forward reservations are common, such as season tickets for events, indicating that the up-front payment is beneficial for the venue or organization. This 20% discount reflects a strategic decision to reward customers who reserve well in advance, ensuring both their loyalty and the financial benefits that come from early cash inflow. Thus, the notion of a 20% discount aligns with business practices wherein substantial discounts are provided for early payment to help secure future revenues and enhance customer engagement. Comparatively, lower discount percentages like 5%, 10%, or 15% could be seen as too minimal to create a strong incentive for customers to pay early, hence making the 20% discount the most effective and appealing option for encouraging early reservations

10. On purchase of held-to-maturity securities, which journal entry is correct?

- A. Dr Cash, Cr Debt Investments
- B. Dr Debt Investments, Cr Cash
- C. Dr Expense, Cr Debt Investments
- D. Dr Debt Investments, Cr Equity

The correct journal entry when purchasing held-to-maturity securities involves recognizing the asset acquired (which is categorized as Debt Investments) and the outflow of cash that is used to pay for those securities. When a company purchases held-to-maturity securities, it records the investment at cost, which includes the price paid for the securities. This transaction is documented by debiting the Debt Investments account. The Debit signifies an increase in assets because investments are considered to be assets on the balance sheet. At the same time, the company needs to account for the cash that has been spent to acquire these securities. This is recorded through a credit entry to the Cash account, reflecting a decrease in assets since cash is being used to make the purchase. The other choices do not accurately reflect this transaction. For example, Dr Cash, Cr Debt Investments would imply that cash is being received rather than paid out. Dr Expense, Cr Debt Investments suggests an expense is being recognized, which is not applicable to the acquisition of investments, and Dr Debt Investments, Cr Equity incorrectly indicates equity accounts are involved in the transaction. Thus, the correct entry, which indicates the increase in the investment account and the decrease in cash due to the purchase of held-to-maturity securities, is