University of Central Florida (UCF) ACG2021 Principles of Financial Accounting Final Practice Exam (Sample)

Study Guide

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Questions

1. What statement typically reflects stockholders' equity?
   A. Income statement
   B. Statement of cash flows
   C. Balance sheet
   D. Statement of retained earnings

2. Which of the following would typically increase a company's cash flow?
   A. Increasing inventory
   B. Decreasing sales
   C. Collecting accounts receivable
   D. Paying off debts

3. What indicates a corporation's retained earnings?
   A. Assets minus liabilities
   B. Total sales revenue
   C. Profits not distributed as dividends
   D. Dividends paid to shareholders

4. What distinguishes cash basis from accrual basis accounting?
   A. Cash basis records transactions when cash is exchanged; accrual basis records them when incurred
   B. Cash basis does not account for expenses; accrual basis does
   C. Cash basis requires financial audits; accrual does not
   D. Cash basis is used for large corporations; accrual for small businesses

5. What does "authorized stock" refer to?
   A. The maximum number of shares a company can issue
   B. The number of shares currently outstanding
   C. The shares repurchased by the company
   D. The total shares sold to investors

6. What defines current liabilities?

A. Obligations expected to be settled within one year.

B. Long-term debts due in over five years.

C. Investments that will be liquidated within the year.

D. Equity investments in company stock.

7. What is the primary purpose of an income statement?

A. To list assets and liabilities of a company.

B. To summarize revenues and expenses to determine net income or loss.

C. To show the cash position of a company at a specific point.

D. To outline the company's market position.

8. Which cash flow method starts with net income and adjusts for changes to arrive at operating cash flows?

A. Direct cash flow method

B. Indirect cash flow method

C. Free cash flow method

D. Net cash flow method

9. What are the three important dates in the process of issuing dividends?

A. Declaration date, payment date, record date

B. Issuance date, execution date, payment date

C. Declaration date, date of record, payment date

D. Announce date, record date, execution date

10. Which principle requires a company to record warranty expense in the same period as the sale?

A. Matching principle

B. Revenue recognition principle

C. Conservatism principle

D. Historical cost principle

Answers

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

Explanations

1. What statement typically reflects stockholders' equity?

A. Income statement

B. Statement of cash flows

C. Balance sheet

D. Statement of retained earnings

The choice of the balance sheet as the statement that typically reflects stockholders' equity is accurate because the balance sheet presents a company's financial position at a specific point in time. It clearly outlines the accounting equation, which is assets equal liabilities plus stockholders' equity. Stockholders' equity is a crucial component of this equation and represents the residual interest in the assets of the entity after deducting liabilities. On the balance sheet, stockholders' equity includes common stock, preferred stock, additional paid-in capital, retained earnings, and often treasury stock. This gives stakeholders, such as investors and creditors, a clear snapshot of the value that shareholders hold in the company at that moment. The income statement, on the other hand, focuses on revenues and expenses over a period to determine net income but does not provide information about equity itself. The statement of cash flows shows the cash inflows and outflows categorized by operating, investing, and financing activities but also does not directly reflect stockholders' equity. Lastly, the statement of retained earnings provides details on changes in retained earnings over a specific period, which is a component of stockholders' equity, but it does not present the entire equity section as a whole as the balance sheet does. Thus, the balance sheet

2. Which of the following would typically increase a company's cash flow?

A. Increasing inventory

B. Decreasing sales

C. Collecting accounts receivable

D. Paying off debts

Collecting accounts receivable typically increases a company's cash flow because it converts credit sales into cash. When a company sells goods or services on credit, they record the sale as revenue but do not receive cash immediately. The accounts receivable balance represents the amount owed by customers. By successfully collecting these receivables, the company increases its cash balance, which is essential for funding operations, paying expenses, and investing in growth. In contrast, increasing inventory could tie up cash that could have been used elsewhere, resulting in a decrease in cash flow. Decreasing sales would obviously lead to lower cash inflows, negatively impacting cash flow. Paying off debts requires cash outflow, which reduces available cash, thus not increasing cash flow. Collecting accounts receivable is a direct source of cash and is vital for maintaining liquidity in the business.

3. What indicates a corporation's retained earnings?

A. Assets minus liabilities

B. Total sales revenue

C. Profits not distributed as dividends

D. Dividends paid to shareholders

A corporation's retained earnings represent the accumulative profits that have been generated by the company and are not distributed to shareholders as dividends. This figure reflects the portion of net income that is reinvested in the business for growth, debt repayment, or other corporate purposes, rather than being paid out to stockholders. Retained earnings are calculated as the beginning retained earnings balance, adjusted for net income or loss in the current period, and then reduced by any dividends paid. This dynamic showcases the corporation's ability to grow its equity base over time, signifying retained profits that can be utilized for future investments or to strengthen the financial position of the company. Thus, option C accurately captures this aspect of corporate finance by highlighting the importance of profits not distributed as dividends in contributing to the retained earnings balance.

4. What distinguishes cash basis from accrual basis accounting?

A. Cash basis records transactions when cash is exchanged; accrual basis records them when incurred

B. Cash basis does not account for expenses; accrual basis does

C. Cash basis requires financial audits; accrual does not

D. Cash basis is used for large corporations; accrual for small businesses

The distinction between cash basis and accrual basis accounting lies primarily in the timing of when transactions are recorded in the financial statements. Under cash basis accounting, revenues and expenses are recognized only when cash is actually received or paid. This approach provides a straightforward view of cash flow, as it aligns the recording of transactions with the actual cash movements in and out of the business. In contrast, accrual basis accounting records transactions when they are incurred, regardless of the timing of cash exchanges. This means that revenues are recognized when earned, and expenses are recognized when incurred, which may occur before cash exchanges take place. This method provides a more accurate picture of a company's financial position and performance over a given period, as it includes all relevant financial events, whether or not cash has changed hands. The other options do not accurately capture the fundamental differences between the two methods. For example, cash basis accounting does account for expenses, just not at the time they are incurred unless cash is paid. Similarly, both cash and accrual basis accounting can be used by various sizes of businesses and do not inherently require audits based on their designation.

5. What does "authorized stock" refer to?

A. The maximum number of shares a company can issue

B. The number of shares currently outstanding

C. The shares repurchased by the company

D. The total shares sold to investors

Authorized stock refers to the maximum number of shares that a company is legally allowed to issue as specified in its corporate charter. This figure represents the total potential shares available for issuance but does not necessarily reflect how many of those shares are currently sold to investors or are outstanding. It gives the company flexibility to issue more shares in the future if needed, without requiring further approval from shareholders each time new shares are issued. The other options relate to different concepts in stock management. While outstanding shares represent the shares currently held by shareholders, repurchased shares are those that the company buys back, and the total shares sold to investors would indicate the shares that have been issued and sold but does not account for the limit set by authorized stock. Understanding the definition of authorized stock is essential for evaluating a company's capacity for raising capital and its growth potential.

6. What defines current liabilities?

A. Obligations expected to be settled within one year.

B. Long-term debts due in over five years.

C. Investments that will be liquidated within the year.

D. Equity investments in company stock.

Current liabilities are defined as obligations that a company is expected to settle within one year or within its operating cycle, whichever is longer. This includes various short-term financial commitments such as accounts payable, short-term loans, and accrued expenses, which need to be paid off quickly in order to maintain operations and manage cash flow effectively. By measuring liabilities that will come due soon, stakeholders can better assess a company’s short-term financial health. Other options describe financial concepts that do not pertain to current liabilities. Long-term debts, for instance, relate to obligations beyond one year and therefore do not fit the definition of current liabilities. Investments that will be liquidated within the year refer to assets, while equity investments concern ownership interests rather than obligations, thus making them irrelevant in the context of defining liabilities.

7. What is the primary purpose of an income statement?

A. To list assets and liabilities of a company.

B. To summarize revenues and expenses to determine net income or loss.

C. To show the cash position of a company at a specific point.

D. To outline the company’s market position.

The primary purpose of an income statement is to summarize revenues and expenses to determine net income or loss. This financial statement provides essential insights into a company’s financial performance over a specific period, such as a quarter or a year. It details how much money a company has earned from its core operations (revenues) and the costs associated with those operations (expenses). By subtracting total expenses from total revenues, the income statement reveals whether the company had a profit or a loss during that period. This information is critical for stakeholders, including investors, creditors, and management, as it indicates how well the company is generating profit relative to its costs. Other choices, like listing assets and liabilities or showing the cash position, pertain to different financial statements, such as the balance sheet and the cash flow statement, respectively. These documents serve distinct purposes in presenting a company's overall financial health, but they do not provide the performance-focused insight that the income statement offers. Hence, the income statement stands out as the key report for analyzing a company’s profitability.

8. Which cash flow method starts with net income and adjusts for changes to arrive at operating cash flows?

A. Direct cash flow method

B. Indirect cash flow method

C. Free cash flow method

D. Net cash flow method

The indirect cash flow method is a way of preparing the cash flow statement that begins with net income, which is derived from the income statement. This method subsequently adjusts for non-cash transactions, changes in working capital, and other factors to provide a clearer picture of cash generated or used in operations. Starting with net income is beneficial because it reflects the company's profitability as reported on the income statement. Adjustments are then made to convert that net income into cash flow from operating activities by considering various factors such as depreciation, changes in accounts receivable, accounts payable, and inventory levels. These adjustments help clarify the actual cash movements, ensuring that non-cash items do not distort the cash flow. Other methods, such as the direct cash flow method, do not begin with net income; instead, they report cash receipts and payments directly, leading to a different approach altogether. The concepts of free cash flow and net cash flow methods focus on different aspects of cash management and reporting, but they do not specifically involve starting from net income as the indirect method does. Hence, the indirect cash flow method is the correct choice for the given question.

9. What are the three important dates in the process of issuing dividends?

A. Declaration date, payment date, record date

B. Issuance date, execution date, payment date

C. Declaration date, date of record, payment date

D. Announce date, record date, execution date

In the context of issuing dividends, the three important dates are the declaration date, date of record, and payment date. The declaration date is when the board of directors officially announces the dividend, indicating the amount of the dividend to be paid and establishing a record date for shareholders. This date is significant because it solidifies the company's obligation to pay the dividend. The date of record is crucial because it determines which shareholders are entitled to receive the declared dividend. Only those who own shares on this date will receive the dividend payment. This is important for the administrative processes involved in distributing dividends to the correct shareholders. Finally, the payment date is when the dividend is actually distributed to shareholders. This marks the completion of the dividend process and represents the moment when shareholders receive the cash or additional shares as specified. The other options do not accurately represent the key dates involved in the dividend declaration process. For example, terms like "issuance date" and "execution date" do not relate to dividend payments, and "announce date" is not a standard term in accounting for dividends. Understanding the roles of these three dates is essential for grasping how dividends are issued and managed in financial accounting.

10. Which principle requires a company to record warranty expense in the same period as the sale?

A. Matching principle

B. Revenue recognition principle

C. Conservatism principle

D. Historical cost principle

The matching principle is fundamental in accounting as it dictates that expenses must be recorded in the same period as the revenues they help to generate. This ensures that financial statements accurately reflect a company's financial performance during a specific period. In the context of warranties, the expense associated with warranty claims should be recognized at the time of the sale because the obligation to provide warranty services arises simultaneously with the revenue from the sale. By applying the matching principle, a company not only aligns its expenses with its revenues but also provides a more accurate depiction of its financial position. This leads to better decision-making for investors and management, as financial statements reflect the true cost of doing business in the period in which the sales occurred. Other principles, such as the revenue recognition principle, focus on when revenue can be recognized rather than the timing of expenses. The conservatism principle emphasizes recognizing potential losses, and the historical cost principle deals with how assets are recorded at their original cost rather than their current market value. Each of these principles serves a unique purpose, but for the scenario involving warranty expenses, the matching principle is the most relevant and accurate choice.