

UNLV Accounting Competency Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

- 1. Which inventory valuation method is primarily linked to the principle of cost flow assumptions?**
 - A. Weighted average method**
 - B. FIFO (First-In, First-Out)**
 - C. LIFO (Last-In, First-Out)**
 - D. Specific identification method**
- 2. What does the income statement report?**
 - A. Assets and liabilities at a specific date**
 - B. A company's revenues and expenses over a period of time**
 - C. Cash inflow and outflow within a quarter**
 - D. The overall equity of the shareholders**
- 3. What is the main role of management accounting?**
 - A. To prepare financial statements for external stakeholders**
 - B. To provide internal management with necessary information for decision-making**
 - C. To ensure compliance with legal regulations**
 - D. To calculate taxes owed**
- 4. What does working capital indicate about a company?**
 - A. Long-term financial obligations**
 - B. Current assets relative to market value**
 - C. Short-term financial health**
 - D. Overall profitability over a year**
- 5. What does the accounting equation define?**
 - A. The relationship between assets, liabilities, and equity**
 - B. The calculation of net income**
 - C. The process of financial reporting**
 - D. The rules for preparing financial statements**

6. Why is the revenue recognition principle significant?

- A. A. It dictates when cash is disbursed**
- B. B. Revenue should be recognized when it is earned, regardless of when cash is received**
- C. C. It prevents recording any revenue**
- D. D. It focuses solely on cash transactions**

7. An example of a liability is:

- A. Cash**
- B. Accounts payable**
- C. Inventory**
- D. Real estate**

8. What is an audit?

- A. An internal review of employee performance**
- B. A process of budget revision**
- C. An independent examination of financial information**
- D. A survey of customer satisfaction**

9. What is the accounting equation?

- A. Assets = Liabilities + Equity**
- B. Assets + Liabilities = Equity**
- C. Equity = Assets - Liabilities**
- D. Liabilities = Assets + Equity**

10. What are liquidity ratios used for?

- A. To measure profitability**
- B. To evaluate a company's ability to pay off its current obligations**
- C. To assess long-term solvency**
- D. To evaluate operational efficiency**

Answers

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

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Explanations

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1. Which inventory valuation method is primarily linked to the principle of cost flow assumptions?

- A. Weighted average method**
- B. FIFO (First-In, First-Out)**
- C. LIFO (Last-In, First-Out)**
- D. Specific identification method**

The FIFO (First-In, First-Out) inventory valuation method is primarily linked to the principle of cost flow assumptions because it assumes that the oldest inventory items are sold first. This approach aligns the flow of costs with the physical flow of inventory in many businesses, particularly those involving perishable goods or items that have a tendency to become outdated. Under FIFO, the cost of goods sold (COGS) reflects the cost of the earliest purchased items, leading to a balance sheet that showcases the more recent purchase costs in the ending inventory. This is particularly relevant in times of rising prices, as it can result in a lower COGS and higher net income, which is an important consideration for financial reporting and tax purposes. The principle of cost flow assumptions is crucial to ensure that a company's financial statements accurately reflect its inventory costs and profit levels, making FIFO a favored method in many industries. Other methods like LIFO or weighted average also involve cost flow assumptions but result in different financial implications and inventory evaluations.

2. What does the income statement report?

- A. Assets and liabilities at a specific date**
- B. A company's revenues and expenses over a period of time**
- C. Cash inflow and outflow within a quarter**
- D. The overall equity of the shareholders**

The income statement is designed to provide a detailed overview of a company's financial performance over a specified period of time, typically a quarter or a year. It summarizes the revenues generated from operations and the expenses incurred during that same period. The primary purpose of the income statement is to showcase how much profit or loss a company has made, essentially reflecting its operational effectiveness and profitability. By listing revenues and expenses, the income statement helps stakeholders understand how well the company is managing its resources to generate profits. This statement is crucial for investors and analysts as it allows them to assess the company's operational efficiency, make comparisons with previous periods, and evaluate potential future performance based on past behavior. In contrast, other options address different financial statements or concepts. One option pertains to the balance sheet, which focuses on assets and liabilities at a particular point in time, while another mentions cash flow, which is reported in the cash flow statement rather than the income statement. Lastly, equity is detailed in the statement of changes in equity and the balance sheet, not in the income statement. Thus, the focus on revenues and expenses in the income statement makes the second option the accurate representation of what is reported in this particular financial statement.

3. What is the main role of management accounting?

- A. To prepare financial statements for external stakeholders
- B. To provide internal management with necessary information for decision-making**
- C. To ensure compliance with legal regulations
- D. To calculate taxes owed

The main role of management accounting is to provide internal management with the necessary information for decision-making. This branch of accounting focuses on delivering relevant financial and non-financial information that helps managers plan, control, and make strategic decisions for the organization. Management accounting includes analytical methods and tools that support performance evaluation, budgeting, and forecasting, enabling managers to evaluate various aspects of the business efficiently. Unlike financial accounting, which is oriented toward external stakeholders and emphasizes historical data and compliance with accounting standards, management accounting is proactive and future-oriented. It aims to improve operational efficiency and support managerial strategies through timely and relevant information tailored to the organization's needs. This is crucial for understanding costs, profitability, and overall business performance, ultimately guiding strategic planning and resource allocation.

4. What does working capital indicate about a company?

- A. Long-term financial obligations
- B. Current assets relative to market value
- C. Short-term financial health**
- D. Overall profitability over a year

Working capital is a financial metric that reflects the short-term financial health and operational efficiency of a company. It is calculated by subtracting current liabilities from current assets. A positive working capital indicates that the company has enough short-term assets to cover its short-term obligations, which suggests good financial health and stability to meet day-to-day operations and obligations. This metric is crucial for assessing whether a business can transition its daily operational needs without requiring additional financing or taking on debt. For instance, if a company has a high level of working capital, it typically suggests that it can easily cover its short-term liabilities and provide a buffer against financial difficulties. In contrast, the other choices do not reflect the primary purpose of working capital. Long-term financial obligations relate more to long-term debt and are not covered by the working capital calculation. Current assets relative to market value do not provide an accurate picture of financial health since working capital focuses on liabilities rather than market valuation. Lastly, overall profitability over a year is assessed through profitability metrics like net income rather than working capital, which specifically targets the short-term financial condition.

5. What does the accounting equation define?

- A. The relationship between assets, liabilities, and equity**
- B. The calculation of net income
- C. The process of financial reporting
- D. The rules for preparing financial statements

The accounting equation defines the foundational relationship between a company's assets, liabilities, and equity. It is expressed as $\text{Assets} = \text{Liabilities} + \text{Equity}$, which illustrates that all the resources owned by a business (assets) are financed either by borrowing money (liabilities) or by the owners' own contributions (equity). This equation is central to the double-entry bookkeeping system, ensuring that the balance sheet remains balanced. Understanding this relationship is crucial for analyzing the financial health of a business, as it provides insights into how assets are funded and the level of financial leverage being utilized. The concepts of liabilities and equity further help in evaluating a company's capital structure and financial stability. In contrast, the other options address different aspects of accounting. The calculation of net income relates to the income statement rather than the balance sheet tied to the accounting equation. The process of financial reporting encompasses a wide range of activities that include not only the preparation of statements but also the analysis and communication of financial information. Finally, the rules for preparing financial statements, such as GAAP or IFRS, do not specifically define the relationship characterized by the accounting equation but rather guide how financial data should be presented.

6. Why is the revenue recognition principle significant?

- A. A. It dictates when cash is disbursed
- B. B. Revenue should be recognized when it is earned, regardless of when cash is received**
- C. C. It prevents recording any revenue
- D. D. It focuses solely on cash transactions

The revenue recognition principle is significant because it establishes the timeframe in which revenue can be recognized in the financial statements, ensuring that it is recorded when it is earned, rather than when the cash is received. This principle provides a more accurate depiction of a company's financial performance during a specific accounting period. By recognizing revenue when it is earned, businesses can reflect their actual business activities and economic realities, which aids stakeholders in making informed decisions based on an accurate assessment of profitability and operational success. This approach aligns with the accrual basis of accounting, which emphasizes the matching principle, whereby income is recorded in the same period as the expenses incurred to generate that income. This principle supports the integrity and reliability of financial reporting, as it ensures that revenues are not exaggerated or delayed beyond the period in which they were actually earned. It emphasizes the importance of recognizing revenue based on the completion of performance obligations, rather than merely tracking cash inflows, which can lead to misleading financial statements if cash transactions are misaligned with the timing of earned income.

7. An example of a liability is:

- A. Cash
- B. Accounts payable**
- C. Inventory
- D. Real estate

Liabilities represent obligations that a company owes to external parties, and accounts payable is a prime example of this concept. It refers to the amounts a business owes to suppliers or vendors for goods and services that have been received but not yet paid for. This obligation is expected to be settled in the near term, typically within one year, making it a current liability. Understanding liabilities is crucial because they play a key role in assessing a company's financial health. They affect cash flow, financial ratios, and overall business operations. In contrast, cash is an asset, which represents liquidity; inventory is also an asset, representing the goods available for sale; and real estate is a long-term asset that can appreciate and is used for business operations. Thus, accounts payable stands out as the only choice that accurately reflects a liability on a balance sheet.

8. What is an audit?

- A. An internal review of employee performance
- B. A process of budget revision
- C. An independent examination of financial information**
- D. A survey of customer satisfaction

An audit is fundamentally defined as an independent examination of financial information. This process is conducted to assess the accuracy and fairness of financial statements, ensuring they comply with applicable accounting standards and regulations. Auditors, who may be external or internal to the organization, review financial records, transactions, and controls to provide stakeholders with a level of assurance regarding the integrity of the financial reporting. The role of audits extends beyond mere verification; they also enhance accountability and transparency within an organization. By conducting an audit, stakeholders such as investors, creditors, and regulators can gain confidence in the reported financial position and performance of the entity. This is vital for making informed decisions based on the financial health of the organization. In contrast, the other options reflect different concepts that do not align with the definition of an audit. An internal review of employee performance focuses on human resources and operational effectiveness. A process of budget revision pertains to financial planning and adjustments, not an external examination. A survey of customer satisfaction is related to market research and feedback on products or services, which is entirely separate from the financial auditing process.

9. What is the accounting equation?

A. Assets = Liabilities + Equity

B. Assets + Liabilities = Equity

C. Equity = Assets - Liabilities

D. Liabilities = Assets + Equity

The accounting equation, which is fundamental to the double-entry bookkeeping system, asserts that the total assets of a business must equal the sum of its liabilities and equity. This relationship illustrates how resources are financed: either through borrowing (liabilities) or through the owners' contributions (equity). When we say that assets equal liabilities plus equity, it signifies that what the business owns (assets) is funded by what it owes (liabilities) and what the owners have invested (equity). This balance is crucial for maintaining the integrity of financial statements. Understanding this equation is essential for analyzing a company's financial health. Any modifications in either assets, liabilities, or equity will automatically affect the other components to keep the equation balanced. Thus, the choice that states "Assets = Liabilities + Equity" captures this critical principle effectively. The other statements do not reflect the accurate relationship defined by the accounting equation or misrepresent the relationship between the components, thus failing to establish the foundational balance necessary for understanding business financials.

10. What are liquidity ratios used for?

A. To measure profitability

B. To evaluate a company's ability to pay off its current obligations

C. To assess long-term solvency

D. To evaluate operational efficiency

Liquidity ratios are crucial financial metrics that assess a company's ability to meet its short-term obligations using its most liquid assets. The primary focus of liquidity ratios is to determine whether the company has enough current assets, such as cash, receivables, and inventories, to cover its current liabilities like payables, short-term debt, and other obligations due within a year. When analyzing liquidity ratios, investors, creditors, and analysts are primarily interested in understanding the financial stability and short-term health of a company. A high liquidity ratio indicates that the company can comfortably pay off its short-term liabilities, which is reassuring for stakeholders looking for financial stability. This focus on short-term obligations is why the correct choice refers specifically to evaluating a company's ability to pay off its current obligations. The other options, such as measuring profitability, assessing long-term solvency, and evaluating operational efficiency, pertain to different aspects of financial health and performance that are not directly related to liquidity.