

# Western Governors University (WGU) ACCT2020 D196 Principles of Financial and Managerial Accounting Practice Test (Sample)

## Study Guide



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**SAMPLE**

## **Questions**

- 1. What is the sequence of the flow of costs through a manufacturing operation?**
  - A. Raw materials, work-in-process, finished goods, cost of goods sold**
  - B. Cost of goods sold, raw materials, work-in-process, finished goods**
  - C. Work-in-process, raw materials, finished goods, cost of goods sold**
  - D. Finished goods, cost of goods sold, raw materials, work-in-process**
- 2. What is retained earnings?**
  - A. Earnings distributed to shareholders**
  - B. Business earnings that have been retained and reinvested**
  - C. Total sales revenue of a company**
  - D. Debt obligations of a business**
- 3. Which measure is the best for evaluating a company's economic performance?**
  - A. Gross profit**
  - B. Net income**
  - C. Cash flow from operations**
  - D. Return on equity**
- 4. What type of budget outlines the costs related to manufacturing overhead?**
  - A. Sales budget**
  - B. Operating budget**
  - C. Manufacturing overhead budget**
  - D. Cash budget**
- 5. Which of the following is a financial activity in the cash flow statement?**
  - A. Receiving investments from owners**
  - B. Cash receipts from sales**
  - C. Buying land and buildings**
  - D. Paying utility bills**

- 6. Which type of business organization has a major focus on direct materials, direct labor, and overhead?**
- A. Merchandising**
  - B. Service**
  - C. Retail**
  - D. Manufacturing**
- 7. Which financial statement summarizes the company's assets, liabilities, and equity at a specific point in time?**
- A. Income Statement**
  - B. Balance Sheet**
  - C. Statement of Cash Flows**
  - D. Statement of Changes in Equity**
- 8. Which of the following is classified as an expense item?**
- A. Loans payable**
  - B. Accounts receivable**
  - C. Cost of goods sold**
  - D. Accounts payable**
- 9. What is the primary purpose of accounting?**
- A. To collect taxes for the government**
  - B. To accumulate and report financial information for decision-making**
  - C. To manage investments**
  - D. To enforce financial regulations**
- 10. Which method is most commonly used for determining a company's discretionary financial needs (DFN)?**
- A. Weighted average cost of capital**
  - B. Percent of sales**
  - C. Regression analysis**
  - D. Cash flow analysis**

## **Answers**

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

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## **Explanations**

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## 1. What is the sequence of the flow of costs through a manufacturing operation?

- A. Raw materials, work-in-process, finished goods, cost of goods sold**
- B. Cost of goods sold, raw materials, work-in-process, finished goods
- C. Work-in-process, raw materials, finished goods, cost of goods sold
- D. Finished goods, cost of goods sold, raw materials, work-in-process

The sequence of the flow of costs through a manufacturing operation is essential for understanding how costs accumulate and transition through different stages of production. In a typical manufacturing environment, costs move in a specific order, starting with raw materials, then transitioning through work-in-process, followed by finished goods, and finally reaching cost of goods sold when the products are sold to customers. Starting with raw materials, these are the basic inputs used in the manufacturing process. As production begins, these costs move into work-in-process inventory, where they are combined with labor and overhead costs during the production cycle. Once the items are completed, the costs associated with these products are transferred to finished goods inventory. When the finished products are eventually sold, the associated costs are recognized as cost of goods sold on the income statement, reflecting the expense incurred to produce the items that have now generated revenue. This flow reflects the systematic transition of costs from one stage to another, ensuring accurate financial reporting and inventory management. Understanding this flow helps in accounting for costs effectively and managing the production process efficiently.

## 2. What is retained earnings?

- A. Earnings distributed to shareholders
- B. Business earnings that have been retained and reinvested**
- C. Total sales revenue of a company
- D. Debt obligations of a business

Retained earnings represent the portion of a company's profits that is not distributed to shareholders as dividends but is instead reinvested back into the business. This can be used for various purposes, such as funding research and development, purchasing new equipment, or paying down debt. Retained earnings are a vital indicator of a company's financial health and are reflected on the balance sheet in the equity section. By choosing to retain earnings, a company can enhance its growth potential while providing a buffer against possible economic downturns. Over time, retained earnings can contribute significantly to the overall value of a business, as they can help finance operations and investments without the need to incur additional debt or equity financing. This concept emphasizes the importance of not only generating profits but also strategically reinvesting them for future growth.

**3. Which measure is the best for evaluating a company's economic performance?**

- A. Gross profit**
- B. Net income**
- C. Cash flow from operations**
- D. Return on equity**

Net income is considered one of the best measures for evaluating a company's economic performance because it provides a comprehensive view of a company's profitability after all expenses, taxes, and costs have been deducted from total revenues. This figure reflects the overall financial health of the business and its ability to generate profit on a total basis, encompassing both operational performance and non-operational components like interest and taxes. While gross profit shows the earnings from sales after direct costs of goods sold are subtracted, it does not consider other significant expenses such as operating expenses, interest, and tax obligations, thus it may indicate a misleadingly positive view of a company's economic situation. Cash flow from operations is important as it measures the cash generated from the firm's core business operations, but it can be influenced by factors such as changes in working capital and may not directly indicate profitability. Return on equity is a useful metric to assess how effectively a company is using shareholders' equity to generate profits. However, it is based on net income, which can fluctuate based on accounting methods and non-operational items, potentially distorting the real performance of a company. In summary, net income stands out as a crucial indicator as it essentially combines the effects of revenues, all related costs, and overall financial performance,

**4. What type of budget outlines the costs related to manufacturing overhead?**

- A. Sales budget**
- B. Operating budget**
- C. Manufacturing overhead budget**
- D. Cash budget**

The manufacturing overhead budget is specifically designed to detail the costs associated with the production process that are not directly tied to direct labor or direct materials. This type of budget includes expenses such as utilities, depreciation, and indirect labor, which are crucial for understanding the full cost structure of manufacturing goods. By focusing on all the indirect costs required to support manufacturing activities, this budget helps managers plan and control overhead spending effectively, enabling a clearer view of total production costs. Understanding the manufacturing overhead budget is essential for accurate product costing, pricing strategies, and overall financial management within a manufacturing environment.

**5. Which of the following is a financial activity in the cash flow statement?**

**A. Receiving investments from owners**

**B. Cash receipts from sales**

**C. Buying land and buildings**

**D. Paying utility bills**

In the context of the cash flow statement, financial activities specifically relate to transactions involving the equity and debt of the company. Receiving investments from owners is classified as a financial activity because it involves raising capital through equity financing. This type of cash flow indicates how much money has been contributed by the owners or shareholders of the business, reflecting changes in ownership structure and the financing of operations or expansion. The other choices each fall under different categories of activities in the cash flow statement. Cash receipts from sales relate to operating activities, as they pertain to the day-to-day operations and revenue-generating activities of the company. Buying land and buildings is considered an investing activity, as it involves the acquisition of long-term operational assets. Paying utility bills also pertains to operating activities, reflecting the cash outflows for regular business expenses necessary to maintain operations. Thus, the correct identification of receiving investments from owners as a financial activity highlights its role in funding the business through owner contributions.

**6. Which type of business organization has a major focus on direct materials, direct labor, and overhead?**

**A. Merchandising**

**B. Service**

**C. Retail**

**D. Manufacturing**

The type of business organization that has a major focus on direct materials, direct labor, and overhead is the manufacturing business. In a manufacturing environment, companies produce goods that require raw materials (direct materials), labor to transform those materials into finished products (direct labor), and overhead costs associated with the production process (such as utilities, depreciation on equipment, and factory rent). These components are crucial in determining the cost of goods manufactured, which is a key part of financial statements and cost accounting in a manufacturing setup. The emphasis on these elements distinguishes manufacturing companies from other types, such as service or merchandising businesses, which do not directly convert materials into products in the same way. Service businesses focus on providing intangible services rather than physical goods, while merchandising businesses primarily buy and sell finished products rather than producing them.

**7. Which financial statement summarizes the company's assets, liabilities, and equity at a specific point in time?**

**A. Income Statement**

**B. Balance Sheet**

**C. Statement of Cash Flows**

**D. Statement of Changes in Equity**

The financial statement that summarizes a company's assets, liabilities, and equity at a specific point in time is the Balance Sheet. This statement provides a snapshot of what the company owns and owes, as well as the residual interest of the owners in the company, which is represented by equity. The Balance Sheet adheres to the accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Equity}$ . This fundamental equation highlights the relationship between what the company owns (assets) and what it owes (liabilities), along with the owner's claim on the assets (equity). By analyzing the Balance Sheet, stakeholders can assess the financial stability and liquidity of the company, as well as its overall financial health at that specific moment. Other financial statements serve different purposes; for instance, the Income Statement focuses on revenues and expenses over a period, while the Statement of Cash Flows tracks cash inflows and outflows, providing insights into liquidity and operational performance. The Statement of Changes in Equity outlines changes in equity from various events, such as issuing new shares or retaining earnings, but does not provide the comprehensive snapshot of the company's financial position like the Balance Sheet does.

**8. Which of the following is classified as an expense item?**

**A. Loans payable**

**B. Accounts receivable**

**C. Cost of goods sold**

**D. Accounts payable**

The classification of expense items in accounting is fundamental for understanding a company's financial performance. The cost of goods sold (COGS) is recognized as an expense because it reflects the direct costs attributable to the production of the goods that a company sells during a specific period. This includes costs such as materials and labor directly tied to the production process. When a business sells a product, it needs to account for what it cost to produce that product. COGS is deducted from sales revenue on the income statement to determine gross profit. Therefore, it directly affects profitability and is a vital metric for assessing operational efficiency. Other choices—loans payable, accounts receivable, and accounts payable—represent different categories in a business's financial structure. Loans payable and accounts payable are considered liabilities, which indicate obligations to pay debts. Accounts receivable refers to amounts owed to the company by customers and is classified as an asset, as it represents future cash inflows. In contrast, expense items like COGS directly reflect costs incurred in operating the business and have a profound impact on the net income calculation.

**9. What is the primary purpose of accounting?**

- A. To collect taxes for the government
- B. To accumulate and report financial information for decision-making**
- C. To manage investments
- D. To enforce financial regulations

The primary purpose of accounting is to accumulate and report financial information for decision-making. This involves systematically recording, classifying, and summarizing financial transactions in a way that provides stakeholders—such as management, investors, creditors, and regulatory agencies—clear insights into the financial health and performance of an organization. By presenting this information through financial statements and reports, accounting aids in business planning, evaluation of financial performance, and strategic decision-making. This foundational aspect of accounting ensures that individuals and entities can make informed choices regarding resource allocation, financial planning, and compliance with regulations. It goes beyond merely tracking numbers; it translates data into actionable information, enhancing an organization's ability to navigate its financial landscape effectively.

**10. Which method is most commonly used for determining a company's discretionary financial needs (DFN)?**

- A. Weighted average cost of capital
- B. Percent of sales**
- C. Regression analysis
- D. Cash flow analysis

The percent of sales method is commonly used for determining a company's discretionary financial needs (DFN) because it establishes a direct relationship between sales and the various components of working capital and financing requirements. By analyzing historical data, businesses can predict how changes in sales will impact their need for additional resources, such as inventory, accounts receivable, and accounts payable. This approach simplifies forecasting by applying a fixed percentage to projected sales figures, reflecting the assumption that certain costs and financial needs will naturally scale with sales volume. For example, if a company anticipates a 10% increase in sales, it can estimate that its need for inventory might also increase by the same percentage, allowing for more straightforward financial planning and budgeting. Other methods like weighted average cost of capital, regression analysis, and cash flow analysis can provide insights into different aspects of financial management, but they do not specifically focus on the direct link between sales and discretionary financial needs in the same straightforward manner as the percent of sales method does. This makes the percent of sales method particularly popular among financial managers aiming to quickly assess and respond to changes in sales and associated funding requirements.