

York University AP/Adms 2500.03
Introduction to Financial Accounting
Midterm Examination #1 – Test Form A
Summer 2011

Time: 2 hours and forty minutes (160 minutes)

Questions: 21

Instructions:

1. Submit:

- ❖ **Only** the pink mark sense sheet will be collected: you may keep this midterm examination paper. Mark your answers on it for later reference.

2. Mark Sense Sheet:

- ❖ **Record** your name and student number and answer all questions on the computer mark sense sheet provided with an HB (soft lead) pencil. Bring several pencils in case one breaks. The computer will not recognize ink or hard lead pencils.
- ❖ **Test** Form is 'A' and Code is your Section (in the left column).
- ❖ **Fill** in the bubbles for your name and student number in pencil (your phone number is not required). Leave the last column of the student number BLANK.
- ❖ **If** you change an answer, use a high quality eraser to completely remove the previous mark. If the computer senses two answers to a question, only the first scanned will be recognized.

3. Exam Aids:

- ❖ **Only** calculators without alphanumeric programmable memories are allowed. It is strongly suggested you bring a couple of cheap 4 function computers to the exam in case one fails. Be prepared to be challenged by invigilators if you bring a “fancy” calculator.
- ❖ **Compact** foreign language/English dictionaries may be used. However, these will be examined by invigilators. If there are any loose pages or handwriting in the dictionary, it will be seized and you will be charged with academic dishonesty. Electronic dictionaries are banned.

4. Exam Strategy:

- ❖ **Careful** budgeting of time on an accounting exam is essential. Bring a watch and check your progress regularly. Poor time management is the most common reason for poor exam performance in accounting.
- ❖ **It** is always a good idea to attempt the questions you deem easiest first. In an interrupted exam that is not restarted, your exam will be scored based on questions attempted.
- ❖ **It** is essential to transfer your answers to the grading sheet after each question in case the exam is interrupted by fire alarm.
- ❖ **The** last ten minutes of an exam should be devoted to double checking your transfers. What you submit is what is graded. If you have not transferred your answers to the mark sense sheet at the end of the exam, the invigilator will not wait. Your answer sheet will be seized and it will be graded based on whatever questions have choices filled in.
- ❖ **Remember** there is no penalty for guessing on a multiple choice computer graded exam. Submit a choice for every question. Also note that in 2500, choice (E) *None of the above* does indeed represent a frequent correct choice to questions.

5. Exam room regulations:

- ❖ All personal belongings either on the floor or at the front of the exam room. All items on your desk will be examined by invigilators
- ❖ **Bring** appropriate ID as proof of registration. You will be required to sign in and show appropriate documentation. Students without ID will be allowed to write the exam, but will be photographed and asked to submit registration and photo ID to the School of Administrative Studies the next day. **No** student may leave the exam in the first hour. No student may start the exam after an hour. Students requiring restroom visits must be accompanied by an invigilator.
- ❖ **The** proctors will announce when there are 15 minutes remaining and any answers not transferred should be recorded at this time. No one is to leave their seat in the last 10 minutes.
- ❖ **When** time is called, the proctors will go down the rows collecting your answer sheets and this exam paper. They will not wait and they will not accept your sheet once they have passed. Any violation of this protocol will result in a grade of zero recorded for the exam.

6. Fire Alarms

- ❖ A frequent occurrence in York exams. In the event of a fire alarm, you are to leave your exam and answer sheet face down on your desk and immediately proceed outside with coats and all personal belongings. Print your surname on the back of the exam so you know which seat to return to. An invigilator will lead the group outside to a place of safety. There is to be no talking during the evacuation or outside. Most rooms are cleared so that exams can recommence, within 30 minutes of the alarm. You will be told after this time whether to reenter the room and recommence the exam or to go home.

7. Academic Dishonesty

- ❖ **You** are reminded that cheating is a serious offense which can result in expulsion from university
- ❖ **Exams** at York are held in regular classrooms, which may involve tiered seating. Consequently, neck exercises are not allowed during exams. First instance of wandering eyes has the student relocated to the front of the room. Second instance results in seizure of paper.

8. Special Instructions:

- ❖ **This** exam is a case, which then has a series of questions based on that case. While an attempt has been to minimize the impact of the impact of carry-forward errors in question design, some questions of necessity are related to multiple computations or previous questions, so an error potentially can have multi-mark impact. However, such questions are kept to an absolute minimum. Most questions stand alone.
- ❖ **In 2500**, invigilators answer no questions of interpretation.
- ❖ **Accounting** exams contain so many numbers that some times typos creep into the exam questions despite proofreading. If you notice what appears to be a typo ask the nearest invigilator. They will pass along questions regarding possible errors/ typos/missing data to the head invigilator. If there is a typo and it is caught early during the exam, a correction will be announced and placed on the front board. Typos caught late in the exam will just result in that particular question not being scored by the computer. If you believe a question contains an error and do not receive a response during the exam then this is an issue for you to send an email to your instructor post exam.

Dewey's Dew Worm Bait Supply

Dewey Dew had enjoyed fishing all her life. As a youngster her family lived on one of the lakes in Ontario's Muskoka Lakes and her father used to take her fishing several times a week. Even from the shore of their lakefront property there were fish to be caught and the dinner table often had scrumptious pickerel, small mouth bass, northern walleye and occasionally lake trout. Once the family had taken a vacation on Lake Nipissing near North Bay and her life's thrill was catching a 115 pound sturgeon which was a three hour battle to get into the boat. (*that's Dewey in the center of the photo – the one with the sunglasses....not the one with the whiskers...the picture was published internationally in Angler's Digest and she received \$5,000 for the photo and story*)



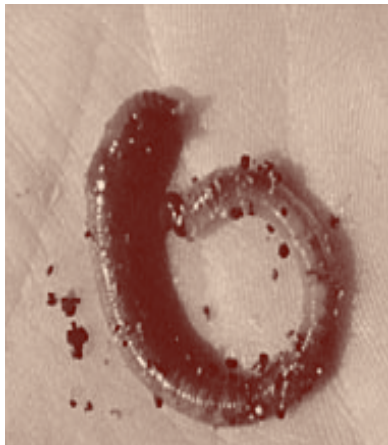
She had entered into several fishing contests in the Muskokas and Kawarthas and had several certificates and even one first place trophy in her bedroom.

Dewey had always dreamed of someday being a professional fishing guide, but she realized the really successful guides had their own seaplanes and lodges on remote northern Ontario lakes. Also with acid rain and depleting fish stocks who could say whether this could continue to be a life long career. Dewey sensibly decided to get a business education first which would both help her with running a business and be a

fallback in case she had to get one of those downtown office jobs someday. She enrolled in York University's BAS degree and majored in accounting.

University was expensive and her family was too poor to provide much financial assistance so Dewey decided to work part time and go to school part time. Since her ambition was to run her own fishing business she wanted something that would help her in that regard, rather than just work for Walmart or whatever. The idea came to her one day when out jogging on a local golf course near sunset and she got caught in a real cloudburst. She got drenched but noticed that the golf course was literally covered in long juicy worms who fled the ground to avoid drowning. From her childhood experiences, Dewey knew that there was nothing a fish dreamed of more than a fat juicy worm. However, the Canadian Shield of Northern Ontario was essentially worm destitute. Worms love rich dark soil and there were actually far more worms in cities than in the country.

Dewey did a little research using Google and Wikipedia and found out that most of North America's worm supply came from golf courses. They thrived so much in this environment that they became a nuisance by mounding the soil and detracting from the smooth bowling green surface that most courses craved. Rain was too unreliable an event to harvest worms and golf courses didn't like such activities when there were golfers present, but many golf courses allowed worm picking after dark. If you wore a powerful headlamp and were prepared to work on your hands and knees there was a particular species called 'nightcrawlers' *Lumbricus terrestris* that fed on the surface at night and were attracted to light. These were often close to a foot in length and made big holes, so golf courses were happy to get rid of them.



Dewey made enquiries at several Toronto area courses and for a very modest royalty of one cent per worm, they would indeed allow her to night harvest such worms. Although her background prevented her from being squeamish when handling the slimy, slithering things, she did resent some of the jokes from fellow students with her surname being used often in worm jokes. However, she was made of stern stuff and was able to focus on the joys of entrepreneurialship.

Dewey found out that at bait shops in the Muskokas, a box of 10 nightcrawlers would sell for \$8. Most baitshops had refrigerated cabinets to store worms and as long as she could deliver them onsite they would pay forty cents a worm.. Delivery expense would be a real problem with the price of gas and travel time to remote locations, but Dewey had a friend studying biological engineering who knew of a packing material called tripanzepoidal (tpz for short) that would retain enough moisture and oxygen such that worms could survive in it for two weeks. He also found a sturdy plastic container that was approved for Canada Post mail usage so that solved her shipping issue. She would mail the worms. In addition to the worms, each container would cost seventy five cents and the tpx packing would cost twenty five cents. Postage would be an additional dollar. Each container would hold one hundred worms. Bait shops would send her a cheque monthly based on the amount received.

That took care of the sales end, and now Dewey turned her attention to supply. If she picked the worms herself, labour cost would be zero and there would just be the one cent royalty. For the first month she did this but discovered that her grades were suffering. She got permission from her 2500 instructor to make an announcement in class and soon had more than 50 students willing to assist to raise a little beer money. She paid five cents a worm (minimum length 6 inches and in good health). The beauty of this operation was that since she was paying for product and not labour she was exempt from all the recordkeeping and payroll taxes normally associated with having employees.

Dewey didn't know for sure if she needed one but to be safe went to City Hall and bought a business licence for \$360 which was valid for three years. On the licence application she called her business **Dewey's Dew Worm Bait Supply**.

The \$300 came from her personal bank account that held the \$5,000 money from her photo sale but Dewey knew that she needed money for tuition and living expenses and her accounting professor had counseled her that many new businesses fail because of undercapitalization in the start up period (negative cash flow). Her bank was willing to give her a line of credit for \$3,000 for a \$50/month service charge fee if she maintained a minimum bank balance of \$1,000 at the bank. If the balance fell below \$1,000 the monthly fee would double and any unpaid loan balance would be due in full in 30 days. She was required to zero out the line of credit at the end of each fiscal year. One of the nice things about the line of credit is that it would help Dewey sleep sounder every night. It is a wonderful feeling being able to cope with unexpected costs and not threaten the firm's solvency. As soon as Dewey signed the agreement she borrowed \$1,000 on the line of credit and started a business bank account. She also transferred to this business account \$3,000 from her own personal bank account. This brought her personal investment to \$3,360.

Dewey picked her first worm the evening of April 1, 2001.
In the first two months of business Dewey's hand-kept records showed the following:

Dew worms picked by Dewey in April.....10,000

Dew worms picked by fellow students in May.....20,000
Containers sold to bait shops.....300 (half in April and half in May)
Unsold worm inventory May 31zero

On the advice of friends Dewey decided not to store and pack worms in her room in university residence. She was able to rent a small room in an industrial mall on Keele across from campus for \$400 per month. The one year lease required no security deposit but she did have to pay each months rent on the first day of the month.

She also went down to Liquidators World and picked up 5 really old fridges for \$50 each and paid cash Since these were on their last legs although in working condition, Dewey thought it more appropriate to expense these items directly rather than capitalize them. However she did buy a laptop computer to keep her records on for \$1200 cash. The laptop had an expected life of 4 years. If it was still working at that time Dewey figured she would probably donate it to the Foreign Student Association at York.

Golf courses were paid promptly so really the only outstanding bills that Dewey had at the end of month 2 was a \$400 advertising bill to advertise on commercial websites that catered to the bait-shop industry and a bill for a 2 year business insurance policy bought on opening day and costing \$720. On the revenue side, Dewey had not received May's cheques from bait shops as of May 31.

REQUIRED: Answer the following 20 questions about Dewey's Dew Worm Bait Supply (DDWBS). (Hint: The best way to approach the case is to set up T accounts and process all the transactions. These accounts will form the basis for many of your answers.)

Question 1

The type of business that DDWBS represents is a:

- A) Federal corporation
- B) Provincial corporation
- C) Unincorporated business
- D) Partnership
- E) None of the above

Question 2

The salvage value indicated for the laptop computer makes the depreciable base for this asset (numerator of the depreciation calculation):

- A) Same as the gross cost of the asset
- B) More than the gross cost of the asset
- C) Less than the gross cost of the asset
- D) One third of the gross cost of the asset
- E) None of the above

Question 3

Gross revenues for DDWBS for the two month period are:

- A) \$6,000
- B) \$8,000
- C) \$10,000
- D) \$12,000
- E) None of the above

Question 4

Cost of sales of (hint: as per advice from a local accountant, this would include picking costs, royalty costs for golf courses and packaging costs) DDWBS for the two month period are:

- A) zero
- B) \$600
- C) \$1,600
- D) \$1,800
- E) None of the above

Question 5

Worm royalties paid to Toronto golf courses for the two months are:

- A) zero
- B) \$300
- C) \$400
- D) \$500
- E) None of the above

Question 6

Cash shown on the May 31 Balance Sheet would be:

- A) \$5,750
- B) \$5,990
- C) \$6,425
- D) \$8,200
- E) None of the above

Question 7

If Dewey showed her personal bank account balance on the DDWBS balance sheet, the accounting concept that would most directly apply to a ruling on the appropriateness of such action would be:

- A) Historical cost
- B) Business entity
- C) Conservatism
- D) Matching
- E) None of the above

Question 8

Prepaid Expenses shown on the May 31 balance sheet would be:

- A) \$720
- B) \$360
- C) \$1,080
- D) \$340
- E) None of the above

Question 9

Long term Assets shown on the May 31 balance sheet would total:

- A) zero
- B) \$1200
- C) \$1450

- D) \$1,150
- E) None of the above

Question 10

Liabilities shown on the May 31 balance sheet would total:

- A) \$1,120
- B) \$1,000
- C) \$2,120
- D) \$2,480
- E) None of the above

Question 11

The accounting concept which is most relevant to the need for DDWBS to amortize its capital assets is:

- A) Historical cost
- B) Business entity
- C) Conservatism
- D) Matching
- E) None of the above

Question 12

If Dewey was approached by a businessman and asked to sell the business and was given the choice of being paid either the net assets of the firm at May 31 or a year's income (based on monthly results so far) which offer would seem more attractive to her?

- A) The year's income
- B) The net assets
- C) Both are equally good
- D) Not enough information to decide
- E) None of the above

Question 13

If Dewey hired her fellow students to pick worms at \$8 an hour (cash transactions and no records kept and hence no payroll issues) instead of paying them by the worm and it took them 200 hours to collect the 20,000 worms would this be:

- A) More advantageous to DDWBS's bottom line
- B) Less advantageous to DDWBS's bottom line
- C) Work out to be the same
- D) None of the above

Question 14

If the Balance Sheet and Income Statement of DDWBS was prepared on the cash basis would total assets be:

- A) Higher than on the accrual basis
- B) Lower than the accrual basis
- C) Same as the accrual basis
- D) Cash basis financials cannot be prepared from this data
- E) None of the above

Question 15

If the Balance Sheet and Income Statement of DDBWS was prepared on the cash basis instead of the accrual basis then Net income would be:

- A) Higher than on the accrual basis
- B) Lower than the accrual basis
- C) Same as the accrual basis
- D) Cash basis financials cannot be prepared from this data
- E) None of the above

Question 16

Dewey's chosen accounting treatment of the refrigerators leads to:

- A) Higher income than if she had capitalized the items
- B) Lower income than if she had capitalized the items
- C) The same income
- D) It cant be determined from the data
- E) None of the above

Question 17

Rent expense shown in the two month income statement would be:

- A) \$400
- B) \$600
- C) \$800
- D) \$1,000
- E) None of the above

Question 18

Total expenses other than Cost of Sales reported on the two month income statement would be:

- A) \$1,760
- B) \$1,860
- C) \$1,960

- D) \$2,060
- E) None of the above

Question 19

For the two month period ending May 31, DDWBS's operations (ignoring investment and financing transactions) provided:

- A) Positive cash flow
- B) Negative cash flow
- C) No cash flow
- D) Cash flow equal to income
- E) None of the above

Question 20

The line of credit arrangement with the bank:

- A) Should be disclosed as a note to the financial statements
- B) Need not be disclosed
- C) Should be disclosed on the Income Statement
- D) Should be disclosed on the Balance Sheet
- E) None of the above

Question 21

Dewey's accounting professor was impressed by Dewey's business and its potential and offered to pay her \$1,000 for the business and a salary of \$1500 a month with a guaranteed contract for three years. Dewey declined the offer. Ignoring tax implications and the time value of money, how much did Dewey forego by rejecting this offer?

- A) \$36,000
- B) \$54,000
- C) \$55,000
- D) \$60,000
- E) None of the above