

Practice Quiz

1. Topic: Valuation of futures contract

LO 1

On April 1, 2016, a company enters a futures contract to buy 10,000 units of a commodity on May 31, 2016, at \$0.40/unit. The spot rate on April 1 is \$0.38/unit. It is now May 1, 2016, and prices for the commodity are as follows:

Spot rate.....	\$0.41/unit
Forward rate for delivery May 31, 2016.....	\$0.42/unit

The futures contract appears on the company's May 1 balance sheet as a:

- a. \$200 asset
- b. \$200 liability
- c. \$100 asset
- d. \$100 liability

2. Topic: Hedge effectiveness of futures

LO 1

On December 1, 2015, a company enters a futures contract to sell 100,000 units of a commodity in six months at \$6.00/unit. The company has 100,000 units of the commodity in inventory. The company assesses hedge effectiveness at its year-end, December 31, 2015.

Under which of the following conditions will the hedge *not* qualify for hedge accounting in 2016?

- a. During December, the futures market value declined by \$2,100 and the commodity inventory value increased by \$2,200
- b. During December, the futures market value increased by \$2,300 and the commodity inventory value declined by \$2,100
- c. During December, the futures market value increased by \$2,400 and the commodity inventory value declined by \$2,000
- d. During December, the futures market value declined by \$2,700 and the commodity inventory value increased by \$2,100

3. Topic: Hedging using options

LO 2

Which of the following investments qualifies for hedge accounting?

- a. Call option in soybeans, hedging an inventory of soybeans
- b. Put option in cocoa, hedging a forecasted purchase of cocoa
- c. Put option in General Electric stock, hedging an investment in GE stock, held as a trading security
- d. Call option in silver, hedging a forecasted purchase of silver

Use the following information to answer Questions 4, 5 and 6:

A company expects to purchase 100,000 units of a commodity in 120 days, and purchases 100,000 units of commodity futures for delivery in 120 days at \$25/unit, which is also the current spot price. The futures investment qualifies as a cash flow hedge. The company makes a \$30,000 margin deposit. In 120 days, the commodity's spot price is \$30/unit. The company closes out its futures position and purchases the commodity a few days later for \$29.50/unit. A few months later, the company sells the commodity for \$28/unit.

4. Topic: Cash flow hedge with futures

LO 1

How much cash will the company receive upon closing the futures contract?

- a. \$470,000
- b. \$500,000
- c. \$530,000
- d. \$480,000

5. Topic: Cash flow hedge with futures

LO 1

Prior to its sale, the purchased commodity will be carried on the company's books at:

- a. \$3,000,000
- b. \$2,950,000
- c. \$2,500,000
- d. \$2,800,000

6. Topic: Cash flow hedge with futures

LO 1

When the commodity is sold, the company's gross margin is:

- a. \$ 300,000
- b. \$(150,000)
- c. \$ 350,000
- d. \$ 320,000

Use the following information to answer Questions 7 and 8:

On December 31, 2016, a company holds 10,000 shares of General Electric stock, purchased on August 1, 2016, for \$20/share. The stock is categorized as available-for-sale, and GE stock has a market value of \$15.75/share on December 31. On December 31, 2016, the company holds an investment in put options for 10,000 shares of GE stock at a strike price of \$17/share, expiring June 30, 2017. The company paid \$2,000 for the put options on October 1, 2016, when GE stock had a market value of \$17/share. The options have a December 31 market value of \$13,000. The company's accounting year ends December 31.

7. Topic: Fair value hedge using options

LO 2

How is this information reported on the company's 2016 financial statements, assuming the options qualify as an effective hedge of the GE stock?

	<u>Income Statement</u>	<u>Other Comprehensive Income</u>
a.	\$0	\$31,500 loss
b.	\$11,000 gain	\$42,500 loss
c.	\$ 1,500 loss	\$30,000 loss
d.	\$31,500 loss	\$0

8. Topic: Option value

LO 2

The time value of the options on December 31, 2016, is:

- a. \$-0-
- b. \$ 500
- c. \$12,500
- d. \$13,000

9. Topic: Interest rate swap

LO 3

A company has variable rate debt and enters a receive variable/pay fixed interest rate swap to hedge its interest rate risk.

Changes in the value of the variable rate debt:

- a. Are not reported
- b. Are reported in other comprehensive income (equity)
- c. Are reported in income
- d. Offset the carrying value of the hedge investment

10. Topic: Interest rate swap

LO 3

A company has fixed rate debt and enters a receive fixed/pay variable interest rate swap to hedge its interest rate risk. Assume that interest rates rise. Which statement is *true*?

- a. The company reports a gain on the hedge and a loss on the debt, both reported in income.
- b. The company reports a loss on the hedge and a gain on the debt, both reported in income.
- c. The company reports a gain on the hedge and a loss on the debt, both reported in other comprehensive income
- d. The company reports a loss on the hedge and a gain on the debt, both reported in other comprehensive income