Chapter 8– Advanced Accounting, 3rd Edition by Hamlen, Huefner and Largay

Solutions to Practice Quiz

1. **Topic: Import and export transactions**
   LO 1
   Answer: a

   Rationale:
   2015 exchange gain = ($1.40 – $1.38) x 1,000,000 = $20,000
   2016 exchange loss = ($1.38 – $1.41) x 1,000,000 = $30,000

2. **Topic: Import and export transactions**
   LO 1
   Answer: b

   Rationale: Sales revenue is reported at the spot rate at the date of sale.

3. **Topic: Valuation of forward contracts**
   LO 1
   Answer: c

   Rationale: The contract locks in a selling price of $560,000, when the current market price of 1,000,000 real, delivered October 6, is $520,000. Therefore the contract is an asset valued at $40,000.

4. **Topic: Hedges of foreign-currency-denominated receivables and payables**
   LO 2
   Answer: b

   Rationale:
   Gain on accounts payable = ($1.38 – $1.29) x 1,000,000 = $90,000
   Loss on forward contract = ($1.36 – $1.275) x 1,000,000 = $85,000

5. **Topic: Hedges of foreign-currency-denominated receivables and payables**
   LO 2
   Answer: d

   Rationale: The inventory is initially recorded at the spot rate at the date of purchase, $1.380. There are no adjustments to the inventory account prior to sale.

6. **Topic: Hedges of foreign-currency-denominated firm commitments**
   LO 3
   Answer: a

   Rationale:
   Loss on firm commitment = (\$1.325 – \$1.300) x 1,000,000 = \$25,000
   Gain on forward contract = (\$1.325 – \$1.300) x 1,000,000 = \$25,000

7. **Topic: Hedges of foreign-currency-denominated firm commitments**
   LO 3
   Answer: b

   Rationale: The firm commitment account has a credit balance of \$25,000 on December 31, 2015. An additional loss of (\$1.330 – \$1.325) x 1,000,000 = \$5,000 increases the credit balance to \$30,000. When the inventory is delivered, the firm commitment adjusts the inventory value, and the entry is:

Inventory	1,300,000	
Firm commitment	30,000	
Foreign currency		1,330,000

8. **Topic: Hedges of foreign-currency-denominated forecasted transactions**
   LO 4
   Answer: d

   Rationale: Changes in the value of the forward contract are reported in other comprehensive income. The inventory is recorded at the spot rate on delivery, \$1.330.

9. **Topic: Hedges of foreign-currency-denominated forecasted transactions**
   LO 4
   Answer: b

   Rationale: The gain on the forward contract, reported in other comprehensive income, is (\$1.330 - \$1.300) x 1,000,000 = \$30,000. When the inventory is sold, this gain is reclassified as an adjustment to cost of goods sold. The entry is:

Cost of goods sold	1,300,000	
Other comprehensive income	30,000	
Inventory		1,330,000

10. Topic: Hedges of net investments
LO 5
Answer: b

Rationale: Exposure is a net asset position. Neutralize the risk by taking an opposite position (liability denominated in euros) or by locking in the selling price of the euro, with a forward sale or put option in euros.