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QUESTION 1

Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing \$70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040. The Moores received \$8,400 in gross receipts from their rental property during 1994. The expenses for the residential rental property were:

- A. \$0
- B. \$500
- C. \$900
- D. \$1,000
- E. \$1,250
- F. \$1,300
- G. \$1,500
- H. \$2,000
- I. \$2,500
- J. \$3,000
- K. \$10,000
- L. \$25,000
- M. \$50,000
- N. \$55,000
- O. \$75,000

Correct Answer: I

Explanation:

"I" is correct. \$2,500. Rental activity net income is reported on page one; the gross income (\$8,400) is fully reportable; and all deductions listed (total = \$5,900) are fully deductible for a net of \$2,500.

QUESTION 2

ABC International has numerous foreign exchange transactions. Management has elected to hedge transactions as a means of mitigating transaction exposure to exchange rate risk. What is the most effective means that ABC International can use to avoid overhedging?

- A. ABC should acquire parallel loans to provide a means for liquidating unneeded hedge securities.



- B. ABC should acquire the maximum amount required to hedge known and projected transactions.
- C. ABC should acquire the minimum amount required to hedge known transactions.
- D. ABC should enter into a cross hedging agreement.

Correct Answer: C

Explanation:

Choice "c" is correct. ABC should only acquire the minimum amount of hedge contracts needed to offset the effect of known transactions.

Choice "a" is incorrect. Parallel loans represent a swap contract for hedging long-term transaction exposure and are not specifically designed to mitigate the risk of overhedging.

Choice "b" is incorrect. Acquisition of the maximum number of hedge contracts for known and projected transactions exposes the organization to greater risk of overhedging since projected transactions might not materialize.

Choice "d" is incorrect. Cross hedging involves techniques related to currencies that do have hedge instruments available to mitigate risk and are not specifically designed to avoid overhedging.

QUESTION 3

When applying value chain analysis, a firm sends its production manager to visit the operations of its major supplier in an attempt to determine if there are cost-savings capabilities that could be implemented at the supplier's warehouse. The firm is performing which form of value chain analysis?

- A. Internal differentiation analysis.
- B. Internal costs analysis.
- C. Vertical linkage analysis.
- D. None of the above.

Correct Answer: C

Explanation:

Choice "c" is correct. Analyzing the vertical linkage of a firm means understanding the activities of the suppliers and buyers of the product and determining where value can be created external to the firm's operations.

Choices "a", "b", and "d" are incorrect, per the above Explanation.



QUESTION 4

In 1992, Anchor, Chain, and Hook created ABC Associates, a general partnership. The partners orally agreed that they would work full time for the partnership and would distribute profits based on their capital contributions. Anchor contributed \$5,000; Chain \$10,000; and Hook \$15,000. For the year ended December 31, 1993, ABC Associates had profits of \$60,000 that were distributed to the partners. During 1994, ABC Associates was operating at a loss. In September 1994, the partnership dissolved. In October 1994, Hook contracted in writing with XYZ Co. to purchase a car for the partnership. Hook had previously purchased cars from XYZ Co. for use by ABC Associates partners. ABC Associates did not honor the contract with XYZ Co. and XYZ Co. sued the partnership and the individual partners.

- A. Anchor's share of ABC Associates' 1993 profits was \$20,000.
- B. Hook's share of ABC Associates' 1993 profits was \$30,000.

Correct Answer: B

Explanation:

Choice "b" is correct. Unless otherwise agreed, partners share profits equally. Here, the partners agreed to share profits on the basis of their contributions, which were in a ratio of 1:2:3 respectively for Anchor, Chain, and Hook. Thus, Anchor's share of the 1993 profits was \$10,000, Chain's share was \$20,000, and Hook's share was \$30,000.

QUESTION 5

John and Mary were divorced in 1991. The divorce decree provides that John pay alimony of \$10,000 per year, to be reduced by 20% on their child's 18th birthday. During 1992, John paid \$7,000 directly to Mary and \$3,000 to Spring College for Mary's tuition. What amount of these payments should be reported as income in Mary's 1992 income tax return?

- A. \$5,600
- B. \$8,000
- C. \$8,600
- D. \$10,000

Correct Answer: B

Explanation:

Choice "b" is correct. Alimony would be income to Mary while child support would not. Funds qualify as child support only if 1) a specific amount is fixed or is contingent on the child's status (e.g., reaching a certain age), 2) it is paid solely for the support of minor children, and 3) it is payable by decree, instrument or agreement. The actual use of the funds is irrelevant to the issue. In this case, \$2,000 ($20\% \times \$10,000$) qualifies as child support. The other \$8,000 is alimony, which would be income to Mary.



Choice "a" is incorrect. Take 80% of the \$10,000 paid, not 80% of the \$7,000 received by Mary.

Choice "c" is incorrect. Only \$8,000 would be alimony per the divorce decree ($80\% \times \$10,000$).

Choice "d" is incorrect. The 20% reduction when the child turns 18 makes 20% of the \$10,000 payment, or \$2,000, child support, which is nontaxable to Mary.

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