

Quick Study 15-10

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Quick Study 15-10 covers fair value adjustments on long-term available for sale securities. See page 618 of your textbook for problem details.

Instructor comments are in purple.

Fair value adjustments are made for available for sale and trading securities since GAAP requires that these securities be reported at their fair market value. An unrealized gain or loss is calculated as the difference between the investment's cost and its current fair value.

When an investment is adjusted to fair value, it will generate an unrealized gain or loss. Unrealized gains (losses) are gains or losses that have not been "realized" since a sale has not been made. When an investment is sold, the gain (loss) is "realized" meaning it has actually occurred.

The Fair Value Adjustment account will always be used in fair value adjustment transactions but will either be debited or credited depending on whether the investment experienced an unrealized gain (credit) or loss (debit).

Recording unrealized gains (losses):

Treat losses like expenses --debit to increase; credit to decrease

Treat gains like revenues--debit to decrease; credit to increase

If you calculate an unrealize loss, debit the loss account and credit the Fair Value Adjustment account. If you calculate an unrealized gain, debit the Fair Value Adjustment account and credit the gain account.

See pages 601-603 of your textbook for more information.

Part 1. Market Adjustment

Dec. 31 Unrealized Loss - Equity	12,000*	
Fair Value Adjustment - Avail for Sale		12,000*
<i>Record change in value of securities</i>		
<i>*Cost \$70,000 - Fair Value \$58,000 = \$12,000 unrealized loss</i>		

Reporting Market Adjustments

Part 2. Each of the accounts used in the entry for part (1) would be reported on the balance sheet. The unrealized loss of \$12,000 is a reduction in equity. When the Fair Value Adjustment account contains a credit balance as shown here, it serves as a contra-asset account. This results in the reporting of the asset (long-term investment) at its fair value.