1. On January 1, 2011, Mason Manufacturing borrows $500,000 and uses the money to purchase corporate bonds for investment purposes. Interest rates were quite volatile that year and so were the fair values of Mason’s bond investment (an asset) and loan (a liability):

Fair Value

2011 Bond Investment Loan January 1, $500,000 $500,000 March 31 450,000 465,000 June 31 480,000 493,000 September 30 510,000 504,000 December 31 485,000 495,000

a. Mason is required to use fair value accounting for the bond investment. Prepare the journal entry to record the investment purchase on January 1, and the fair value adjustments required at the end of each quarter: March 31, June 30, September 30, and December 31.

b. Suppose that Mason uses conventional amortized cost accounting for the loan. The loan principal is due in five years. Ignore interest on the loan to simplify the problem. What will be the loan’s carrying value at the end of each quarter?

c. Suppose that instead Mason elects to use the GAAP fair value option permitted by ASC Topic 825 for the loan. What dollar impact will this change have on reported profits each quarter?

d. Which accounting approach – amortized cost or fair value – do you believe Mason should use for the loan? Why?

2. The Russell Company acquired a long-lived asset three years ago at a cost of three years ago at a cost of $125,000. Two years later the asset sustained impairment in value. At the time of the impairment the fair value of the asset was $25,000 and the carrying value was $50,000.

a. What is the entry to record the impairment?