Problem 4

Newton Fish Company issued $500,000 of face amount of 5-year bonds on January 1, 20X1. The bonds were issed at 102, and bear interest at a stated rate of 6% per annum, payable semiannually. The premium is amortized by the straight-line method.

a) Prepare the journal entry to record the initial issue on January, 20X1.
b) Prepare the journal entry that Newton would record on each interest date.
c) Prepare the journal entry that Newton would record at maturity of the bonds.
d) How much cash flowed "in" and "out" on this bond issue, and how does the difference compare to total interest expense that was recognized?

Worksheet 4

a), b), c)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Issue			
Interest			
Maturity			

d)

Solution 4

a), b), c)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Issue	Cash	510,000	
	Premium on Bonds Payable		10,000
	Bonds Payable		500,000
	To record the issuance of $500,000, 6%, 5-year bonds at 102 – interest semiannually		
Interest	Interest Expense	14,000	
	Premium on Bonds Payable	1,000	
	Cash		15,000
	To record payment of an interest payment ($500,000 par X .06 interest X 6/12 months = $15,000; $10,000 premium X 6 months/60 months = $1,000 amortization)		
Maturity	Bonds Payable	500,000	
	Cash		500,000
	To record the redemption of bond issue at maturity		

d) Total cash inflow was $510,000, and total cash outflow was $650,000 (($15,000 × 10 periods) + $500,000). The $150,000 difference is equivalent to the interest expense that would be recognized over time ($15,000 × 10 periods).