Problem 5

Swan Industrial Supply Company issued $500,000 of face amount of 6-year bonds on January 1, 20X1. The bonds were issued at 97, and bear interest at a stated rate of 10% per annum, payable semiannually. The discount is amortized by the straight-line method.

a) Prepare the journal entry to record the initial issuance on January, 20X1.
b) Prepare the journal entry that Swan would record on each interest date.
c) Prepare the journal entry that Swan 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 5

a), b), c)

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

d)

Solution 5

a), b), c)

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Date	**Accounts**	**Debit**	**Credit**
Issue	Cash	485,000	
	Discount on Bonds Payable	15,000	
	Bonds Payable		500,000
	To record the issuance of $100,000, 10%, 6-year bonds at 97 – interest semiannually		
Interest	Interest Expense	26,250	
	Discount on Bonds Payable		1,250
	Cash		25,000
	To record payment of an interest payment ($500,000 par X .10 interest X 6/12 months = $25,000; $15,000 discount X 6 months/72 months = $1,250 amortization)		
Maturity	Bonds Payable	500,000	
	Cash		500,000
	To record the redemption of bond issue at maturity		

d) Total cash inflow was $485,000, and total cash outflow was $800,000 (($25,000 × 12 periods) + $500,000). The $300,000 difference is equivalent to the interest expense that would be recognized over time ($15,000 × 12 periods).