Problem 6

Danish Bakery issued $1,000,000, face amount, of 8% bonds on January 1, 20X3. The bonds are 10-year bonds, and Interest is payable every 6 months. At the time of issue, the market rate of interest was only 6%, so the bonds were issued at a premium.

a) Prepare calculations showing that issue price was approximately $1,148,779.
b) Use the effective-interest method of amortization, and prepare the journal entries that Danish Bakery would record on January 1, 20X3, June 30, 20X3, and December 31, 20X3.
c) Show how the bonds would appear on Danish Bakery's December 31, 20X3 balance sheet.

Worksheet 6

a)

b)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
1-Jan			
30-Jun			
31-Dec			

c)

Bonds Payable

Plus: Premium on bonds payable

Solution 6

a)

Periodic interest payments ($1,000,000 X 4%)		$ 40,000		
Present value factor (20 period annuity, 3%)	X	14.8775	$	595,099
Maturity value		$ 1,000,000		
Present value factor (20 periods, 3%)	X	0.5537	$	553,680
Issue price of bond			$	1,148,779

b)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
1-Jan	Cash	1,148,779	
	Premium on Bonds Payable		148,779
	Bonds Payable		1,000,000
	To record the issuance of $1,000,000, 8%, 5-year bonds at $1,148,779		
30-Jun	Interest Expense	34,463	
	Premium on Bonds Payable	5,537	
	Cash		40,000
	To record payment of interest ($1,000,000 X .04 = $40,000; $1,148,779 X .03 = $34,463)		
31-Dec	Interest Expense	34,297	
	Premium on Bonds Payable	5,703	
	Cash		40,000
	To record payment of interest ($1,000,000 X .04 = $175,000; ($1,148,779 – $5,537) X .03 = $34,297)		

c)

Bonds Payable	$ 1,000,000	
Plus: Premium on bonds payable	137,540	$ 1,137,540