

Problem 2

Span Forklift invested in \$100,000 of face amount of 8-year bonds issued by Harris BioResearch Company on January 1, 20X1. The bonds were purchased at 102, and bear interest at a stated rate of 6% per annum, payable semiannually.

- a) Prepare the journal entry to record the initial investment on January, 20X1.
- b) Prepare the journal entry that Span Forklift would record on each interest date.
- c) Prepare the journal entry that Span Forklift would record at maturity of the bonds.
- d) How much cash flowed “in” and “out” on this investment, and how does the difference compare to total interest income that was recognized?

Worksheet

a), b), c)

GENERAL JOURNAL			
Date	Accounts	Debit	Credit
Issue			
Interest			
Maturity			

d)

Solution

a), b), c)

GENERAL JOURNAL			
Date	Accounts	Debit	Credit
Issue	Investment in Bonds	102,000	
	Cash		102,000
	<i>To record the purchase of \$100,000, 6%, 8-year bonds at 102 -- interest semiannually</i>		
Interest	Cash	3,000	
	Investment in Bonds		125
	Interest Income		2,875
	<i>To record the receipt of an interest payment (\$100,000 par X .06 interest X 6/12 months = \$3,000; \$2,000 premium X 6 months/96 months = \$125 amortization)</i>		
Maturity	Cash	100,000	
	Investment in Bonds		100,000
	<i>To record the redemption of bond investment at maturity</i>		

d) Total cash outflow was \$102,000, and total cash inflow was \$148,000 ($(\$3,000 \times 16 \text{ periods}) + \$100,000$). The \$46,000 difference is equivalent to the interest income that would be recognized over time ($\$2,875 \times 16 \text{ periods}$).