Problem 3

Preston Country Store invested in $100,000 of face amount of 8-year bonds issued by Hampton Food Supply Company on January 1, 20X1. The bonds were purchased at 98, 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 Preston would record on each interest date.

c) Prepare the journal entry that Preston 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	98,000	
	Cash		98,000
	To record the purchase of $100,000, 6%, 8-year bonds at 98 - interest semiannually		
Interest	Cash	3,000	
	Investment in Bonds	125	
	Interest Income		3,125
	To record the receipt of an interest payment ($100,000 par X .06 interest X 6/12 months = $3,000; $2,000 discount X 6 months/96 months = $125 amortization)		
Maturity	Cash	100,000	
	Investment in Bonds		100,000
	To record the redemption of bond investment at maturity		

d)