Ch. 10

▶Long-Term Liabilities

Learning Objective 5

Describe bonds payable

Bonds Payable

- Large company issue bonds to public to raise money
- Company pays interest (usually semi-annually) to bondholders

Bond Terms

Principal or Maturity value
- Amount borrower must pay back on maturity date

Maturity date
- Date on which borrower must pay principal to the bondholders

Stated interest rate
- Annual rate of interest borrower pays to bondholders

Types of Bonds

- Term bonds
- Serial bonds
- Secured bonds
- Debenture

Bond Pricing

Maturity(par) value
- $1,000 bond issued for $1,000
- No discount or premium

Discount
- $1,000 bond issued for $980
- Issued below maturity value

Premium
- $1,000 bond issued for $1,015
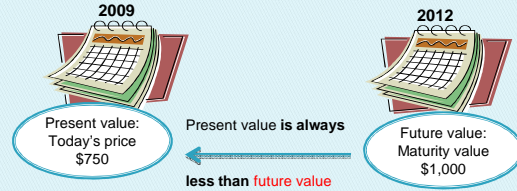- Issued above maturity value

Bond Prices

▸ Quoted as a percent of maturity value

> A $1,000 bond quoted a price of 101.5 would sell for $1,015

> A $1,000 bond quoted a price of 89.75 would sell for $897.50

Present Value

▸ Money earns income over time
▸ Investors will pay less than $1,000 now to receive $1,000 in the future

2009   **2012**

Present value: Today's price $750

Present value **is always**

less than future value

Future value: Maturity value $1,000

Bond Interest Rates

Stated interest rate	Market interest rate

Stated interest rate		Market interest rate	Issue price of bonds payable
9%	=	9%	Maturity value
9%	<	10%	Discount (below maturity value)
9%	>	8%	Premium (above maturity value)

Learning Objective 6

Measure interest expense on bonds using the straight-line amortization method

Accounting for Bonds Issued at Maturity Value

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Issue date	Cash		
	Bonds payable		
	To record issuance of 8% bonds at maturity value		
Int. pmt dates	Interest expense		
	Cash		
	To record semi-annual interest payment		

Accounting for Bonds Issued at Maturity Value (continued)

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Maturity date	Bond payable		
	Cash		
	To record payment of bonds at maturity		

Slide 13

Accounting for Bonds Issued at a Discount

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Issue date	Cash		
	Discount on bonds payable		
	Bonds payable		
	To record issuance of $100,000, 10-year, 8% bonds at 98		

Slide 14

Carrying Value of Bonds Payable

Long-term liabilities		
Bonds payable	$100,000	
Less: Discount on bonds payable	($2,000)	$98,000

Slide 15

Accounting for Bonds Issued at a Discount

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Int. pmt date	Interest expense	4,100	
	Discount on bonds payable		100
	Cash		4,000

Slide 16

Accounting for Bonds Issued at a Premium

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Issue date	Cash		
	Premium on bonds payable		
	Bonds payable		
	To record issuance of $100,000, 10-year, 8% bonds at 98		

Slide 17

Carrying Value of Bonds Payable

Long-term liabilities		
Bonds payable	$100,000	
Plus: Premium on bonds payable	$4,000	$104,000

Slide 18

Accounting for Bonds Issued at a Premium

GENERAL JOURNAL			
DATE	DESCRIPTION	DEBIT	CREDIT
Int. pmt date	Interest expense		
	Premium on bonds payable		
	Cash		

Carrying Value

Bonds payable		Premium	
$100,000		$200	$4,000
			$3,800

Adjusting Entries for Bonds Payable

▸ Interest payments seldom occur at year-end
  ◦ Interest must be accrued
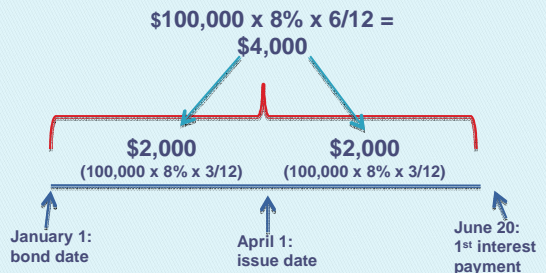
GENERAL JOURNAL				
DATE		DESCRIPTION	DEBIT	CREDIT
12	31	Interest expense		
		Discount on bonds payable		
		Interest payable		
		(100,000 x 8% x 3/12)		

Adjusting Entries for Bonds Payable

▸ The following interest payment entry will take into account the adjusting entry previously made

GENERAL JOURNAL				
DATE		DESCRIPTION	DEBIT	CREDIT
3	31	Interest payable		
		Interest expense		
		Discount on bonds payable		
		Cash		
		(100,000 x 8% x 1/12)		

Issuing Bonds Between Interest Payment Dates

$100,000 x 8% x 6/12 = $4,000

$2,000
(100,000 x 8% x 3/12)

$2,000
(100,000 x 8% x 3/12)

January 1:
bond date

April 1:
issue date

June 20:
1st interest
payment

Issuing Bonds Between Interest Payment Dates

GENERAL JOURNAL				
DATE		DESCRIPTION	DEBIT	CREDIT
4	1	Cash		
		Bonds payable		
		Interest payable		
6	30	Interest expense		
		Interest payable		
		Cash		

Learning Objective 7

Report liabilities on the balance sheet

Any Company
Classified Balance Sheet (partial)
December 30, 2010

Liabilities		
Current liabilities:		
Accounts payable	7,200	
Salaries payable	1,500	
Unearned revenue	400	
FICA tax payable	100	
Employee income tax payable	150	
Interest payable	2,100	
Current portion of long-term debt	5,000	
Total current liabilities		16,450
Long-term liabilities:		
Note payable	50,000	
Bonds payable, net of discount	98,200	
Total long-term liabilities		148,200
Total liabilities		164,650

Learning Objective 8

Compare issuing bonds to issuing stock

Bonds versus Stock

Issuing bonds	Issuing stock
‣ Must pay interest and principal to bondholders ‣ Reduces net income ‣ Can increase earnings per share	‣ Does not have to be "paid off" ‣ Does not affect net income ‣ Increases number of shares outstanding

End of Chapter 10