Chapter 15: Long-Term Liabilities

DO IT! 1  Bond Terminology

State whether each of the following statements is true or false.

_______ 1. Mortgage bonds and sinking fund bonds are both examples of secured bonds.

_______ 2. Unsecured bonds are also known as debenture bonds.

_______ 3. The stated rate is the rate investors demand for loaning funds.

_______ 4. The face value is the amount of principal the issuing company must pay at the maturity date.

_______ 5. The market price of a bond is equal to its maturity value.

Solution

1. True. 2. True. 3. False. The stated rate is the contractual interest rate used to determine the amount of cash interest the borrower pays. 4. True. 5. False. The market price of a bond is the value at which it should sell in the marketplace. As a result, the market price of the bond and its maturity value are often different.

Related exercise material: E15-1 and DO IT 15-1.

DO IT! 2a  Bond Issuance

Giant Corporation issues $200,000 of bonds for $189,000. (a) Prepare the journal entry to record the issuance of the bonds, and (b) show how the bonds would be reported on the balance sheet at the date of issuance.

Solution

(a)

<table>
<thead>
<tr>
<th>Cash</th>
<th>189,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount on Bonds Payable</td>
<td>11,000</td>
</tr>
<tr>
<td>Bonds Payable</td>
<td>200,000</td>
</tr>
<tr>
<td>(To record sale of bonds at a discount)</td>
<td></td>
</tr>
</tbody>
</table>

(b)

<table>
<thead>
<tr>
<th>Long-term liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds payable</td>
</tr>
<tr>
<td>Less: Discount on bonds payable</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Action Plan

✓ Review the types of bonds and the basic terms associated with bonds.

✓ Record cash received, bonds payable at face value, and the difference as a discount or premium.

✓ Report discount as a deduction from bonds payable and premium as an addition to bonds payable.

DO IT! 2b  

**Bond Redemption**

R & B Inc. issued $500,000, 10-year bonds at a discount. Prior to maturity, when the carrying value of the bonds is $496,000, the company redeems the bonds at 98. Prepare the entry to record the redemption of the bonds.

**Solution**

There is a gain on redemption. The cash paid, $490,000 ($500,000 × 98%), is less than the carrying value of $496,000. The entry is:

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds Payable</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Discount on Bonds Payable</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Gain on Bond Redemption</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>490,000</td>
<td></td>
</tr>
</tbody>
</table>

(To record redemption of bonds at 98)


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DO IT! 3  

**Long-Term Notes**

Cole Research issues a $250,000, 6%, 20-year mortgage note to obtain needed financing for a new lab. The terms call for annual payments of $21,796 each. Prepare the entries to record the mortgage loan and the first payment.

**Solution**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Mortgage Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(To record mortgage loan)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>15,000*</td>
<td>15,000</td>
</tr>
<tr>
<td>Mortgage Payable</td>
<td>6,796</td>
<td>6,796</td>
</tr>
<tr>
<td>Cash</td>
<td>21,796</td>
<td>21,796</td>
</tr>
</tbody>
</table>

(To record annual payment on mortgage)

*Interest expense = $250,000 × 6% = $15,000.

FX Corporation leases new equipment on December 31, 2017. The lease transfers ownership to FX at the end of the lease. The present value of the lease payments is $240,000. After recording this lease, FX has assets of $2,000,000, liabilities of $1,200,000, and stockholders’ equity of $800,000. (a) Prepare the entry to record the lease, and (b) compute and discuss the debt to assets ratio at year-end.

Solution

(a) Leased Asset—Equipment 240,000
Lease Liability  240,000
(To record leased asset and lease liability)

(b) The debt to assets ratio = $1,200,000 ÷ $2,000,000 = 60%. This means that 60% of its assets were provided by creditors. The higher the percentage of debt to assets, the greater the risk that the company may be unable to meet its maturing obligations.


DO IT! Exercises

**DO IT! 15-1** State whether each of the following statements is true or false.

_____ 1. Mortgage bonds and sinking fund bonds are both examples of debenture bonds.

_____ 2. Convertible bonds are also known as callable bonds.

_____ 3. The market rate is the rate investors demand for loaning funds.

_____ 4. Annual interest on bonds is equal to the face value times the stated rate.

_____ 5. The present value of a bond is the value at which it should sell in the market.

**DO IT! 15-2a** Eubank Corporation issues $500,000 of bonds for $520,000. (a) Prepare the journal entry to record the issuance of the bonds, and (b) show how the bonds would be reported on the balance sheet at the date of issuance.

**DO IT! 15-2b** Prater Corporation issued $400,000 of 10-year bonds at a discount. Prior to maturity, when the carrying value of the bonds was $390,000, the company redeemed the bonds at 99. Prepare the entry to record the redemption of the bonds.

**DO IT! 15-3** Detwiler Orchard issues a $700,000, 6%, 15-year mortgage note to obtain needed financing for a new lab. The terms call for annual payments of $72,074 each. Prepare the entries to record the mortgage loan and the first installment payment.

**DO IT! 15-4** Huebner Corporation leases new equipment on December 31, 2017. The lease transfers ownership of the equipment to Huebner at the end of the lease. The present value of the lease payments is $192,000. After recording this lease, Huebner has assets of $1,800,000, liabilities of $1,100,000, and stockholders’ equity of $700,000. (a) Prepare the entry to record the lease, and (b) compute and discuss the debt to assets ratio at year-end.

Evaluate statements about bonds.

(LO 1)

Prepare journal entry for bond issuance and show balance sheet presentation.

(LO 2)

Prepare entry for bond redemption.

(LO 2)

Prepare entries for mortgage note and installment payment on note.

(LO 3)

Prepare entry for lease, and compute debt to assets ratio.

(LO 4)
CONTINUING PROBLEM

COOKIE CREATIONS: AN ENTREPRENEURIAL JOURNEY

(Note: This is a continuation of the Cookie Creations problem from Chapters 1 through 14.)

CC15 Natalie and Curtis have been experiencing great demand for their cookies and muffins. As a result, they are now thinking about buying a commercial oven. They know which oven they want and how much it will cost. They have some cash set aside for the purchase and will need to borrow the rest. They met with a bank manager to discuss their options.

Go to the book’s companion website, [www.wiley.com/college/weygandt](http://www.wiley.com/college/weygandt), to see the completion of this problem.