Principles of Accounting II

Accounting for Bonds Payable

Bonds are interest-bearing notes that require periodic interest payments. This chapter accounts for bonds from the issuer's point of view. From the issuer's viewpoint, bonds are a liability.

The amount that will be repaid at maturity is the face value or par value. Bonds generally sell in multiples of $1,000.

The rate of interest stated on the face of the bond is the contract rate or stated rate. The going rate of interest is known as the market or effective interest rate.

Issue Price of Bonds

The issue price of a bond is affected by the market rate of interest. The amount a company sells a bond for is determined by finding the present value of the face amount of the bonds plus the present value of the periodic interest payments. The **present value** of the face value and interest payments is always determined using the **market (effective) interest rate.**

If the market and contract interest rates are equal, a bond will sell at par value. If the contract rate is less than the market rate, the bond will sell at an amount less than face (this is known as a discount). If the contract rate is greater than the market rate, the bond will sell at an amount greater than face (this is known as a premium).

Recording the Issuance of a Bond

Cash is always debited for the amount of cash received by the company (as determined in the present value calculations above).

Bonds Payable is always credited for the face (par) value of the bonds.

Any difference between the cash received and the liability is either recorded as a debit to *Discount on Bonds Payable* or a credit to *Premium on Bonds Payable*.

Calculating Interest Payments and Interest Expense

Interest Payments on bonds are calculated by multiplying the par value of the bond by the **contract interest rate.** If interest is paid semiannually (twice a year), the number of periods is doubled and the interest rate is cut in half.

Bond interest expense is calculated by the contract rate on face value plus (minus) the discount (premium) amortization. (This is true whether using straight-line or effective interest method of amortization.)

Carrying Value-face value of bond less unamortized discount or plus unamortized premium.

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