

Investor (Bond holder): Entity that owns corporation stock, investment in bonds, interest revenue

Investee: Corporation that issues stock, bonds payable, interest expense

Held- to-maturity

- Recorded at amortized cost, interest received semi-annually, issued in \$1000 denominations, price as percent of par, fluctuate with market interest rates

Accounting for held-to-maturity investment

- Initially recorded at cost
- Interest revenue recorded at semiannual interest payment date
- Premium or discount is amortized
 - o Carrying value is adjusted towards face value
- Face value received at maturity

Amortization of held-to-maturity investment

- Increases long term investment account as it reaches maturity
- Records interest revenue earned from carrying amount increases

Accounting Methods for Long-term Investments

Percentage ownership by the investor	GAAP accounting method
Less than 20%	Fair market value
20-50%	Equity
Greater than 50%	Consolidation

Carrying amount of investment

- Original cost of investment + Debit balance in allowance to adjust investments to market or - credit balance in allowance to adjust investments to market

Unrealized Gains and Losses

- Fair value declines- Debits- unrealized loss on investments
- Fair value increases- credit- unrealized gain on investments

Present Value:

- What amount in the future is worth today
- Often called discounting
- Single amount or annuity

Present Value of Investments in Bonds

- Market price of bonds equal
 - o Present Value of principal received at maturity (single amount)
 - o Present value of interest payments- annuity

Time Value of Money

- Prefer payments now vs. in future due to interest factor
- Applicable to both personal and business decisions

Time Value of Money Factors

- Principal amount (p)
 - o Single lump sum
 - o Annuity
- Number of periods (n)
- Interest rate (i)

Present Value and Future Value

- PV + Interest earned = Future Value

Contingent Liability: Potential Liability that depends on future outcome events

- Accrue (recognized)
 - o Loss probable
 - o Amount estimable
- Disclose
 - o Loss reasonably possible

Interest Rates and Bond Prices

- Bonds are always sold at markets price (PV)
- Two interest rates to set bond price
 - o Stated interest rate (coupon rate)
 - Printed on bond certificate
 - Determines cash interest paid to bond
 - o Market interest rate (effective interest)
 - Demanded by investors for loaning money
 - Varies minute to minute
 - Stated rate differs from market rate

NEED

Issue Price of Bonds Payable			
Case A			
Stated interest rate	= Market interest rate	Therefore	Issued at par
Case B			
Stated interest rate	< Market interest rate	Therefore	Issued at discount
Case C			
Stated interest rate	>Market Interest Rate	Therefore	Issued at premium

S9-1

Date	Account and explanation	Debit	Credit
July 31	Inventory	11,000	
	Note payable inventory buy issuing a bond payable		11,000

Date	Account and explanation	Debit	Credit
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April 30	Interest Expense (11000 x .12 x 9/12)	990	
	Accrued interest expense		990

Date	Account and explanation	Debit	Credit
July 31	Note payable, short term	11,000	
	Interest Payable	990	
	Interest Expense (11000 x .12 x 3/12)	330	
	Cash		12320
	Paid note payable and Interest maturity		

Balance sheet April 30, 2013

- Note payable, short term 11000
- Interest Payable 990

Income Statement, April 30, 2013

- Interest Expense 990

Chapter 9

- Current Liabilities

- o Obligations due within one year
- o Two types:
 - Known amounts
 - Accounts payable- amounts owed for products or services purchased on account
 - o Accounts payable turnover= cost of goods sold/ Average accounts payable
 - o Days payable outstanding= 365/ accounts payable turnover
 - Short-term notes payable
 - o Due within one year
 - o Used to borrow cash or purchase asset
 - o Accrue interest

Date	Account and explanation	Debit	Credit
Dec 1	Inventory	30,000	
	Note payable, short term		30,000
	Purchased note payable by issuing a 3-month, 9% note		
Dec 31	Interest expense	225	
	Interest payable		225
	Accrued interest on note payable		
	(30,000 x 9% x 1/12)		

- Sales tax payable
 - o Levied on retail sales
 - o Collected from customers and remitted
 - o Cash 105,000
 - Sale 100,000
 - Sale tax payable 5,000
- Accrued liabilities
 - o Results from expenses incurred but not yet paid
 - o Categories
 - Salaries and wages
 - Interest payable
 - Income tax payable
- Payroll liabilities
 - o Major expense of most companies
 - o Salary, wage, commission
- Unearned revenues
- Current portion of long-term debt
 - o Longer term debt often paid in installments
 - o Amount of principal payable within one year
 - o Company reclassifies amount from long-term to current

- Estimated amounts

- Contingent Liabilities

- o Potential liability that depends on future outcome from past event
 - Accrue: loss probable, amount estimable
 - Disclosure: Loss reasonably possible

A current Liability must be paid out of current profits

- False - paid from CASH

Purchasing merchandise inventory on account results in a liability

- True

Bonds Payable

- Debts of issuing company
- Bond certificate states: Company name, principal, maturity date, interest rate, interest payment dates

Types of Bonds

- Term

- Serial
- Secured
- Unsecured

Bond Prices

- Quotes as percent of maturity value

Premium	Discount
Prices above face	Price below face
Credit Balance	Debit balance
Market Price decreases toward maturity value	Market price increases towards maturity value

At maturity date: Face value = Market Value

Interest Rates and Bond prices

- Bonds always sold at market price (Bond's PV)
- Two interest rates set bond price
 - o Stated interest rate (coupon rate)- differs from market value
 - Printed in bond
 - Determines cash interest paid to bondholders
 - o Market interest rate (effective interest rate)
 - Demanded by investors for loaning money

Interest Payment= Face Value x Stated interest rate X (1/2)

Interest expense= Carrying amount x market interest rate x (1/2)

Amortization= discount or premium/ # of interest payments

- Interest Expense= interest payment (+/-) amortization

Retiring Bonds before Maturity

- Can relieve high interest payments, can borrow at a lower interest rate
- Callable feature: issuer can pay off bonds at a prearranged prices, results in loss or gain

Convertible Bonds and Notes

- Bondholders can exchange bonds for stock
- Investors benefit from
 - o Guaranteed receipt of principal and interest on bonds
 - o Potential for gains on stock

Leases

- Operating
 - o Lessee has right to use the asset
 - o Lessor retains risk and rewards of owning
 - o Lessee records rent expense
- Capital
 - o Lessee has right to use the asset
 - o Lessee assumes risk and rewards of ownership
 - o Lessee capitalizes the leased asset and records as a long-term liability
- Capital Criteria
 - o Transfer of title at end of lease
 - o Bargain purchase option
 - o Lease term > 75% of useful life
 - o Present value of lease payments > 90% of fair value of asset

Pensions and Postretirement Liabilities

- Expense recorded while employees work for the company
- Cash contributed into pension plan assets
- Obligation grows for future payments to employees
- Underfunded: Plan assets less than obligation
- Overfunded: Plan assets greater than obligation

S9-6

- 155,500 (200,000 x .7775)
- 207,000 (200,000 x 1.0350)

A bond with a face value of 1000 and a quoted price of 102 has a selling price of 1020

- True

S9-7

- Discount
- Premium
- Par
- Discount

If the interest rate on a bond is 8% and the market interest is 7% the bond will be issued at a price above par value of the bond

- True

Chapter 10

Corporate Characteristics

- Advantages: separate legal entity, continuous life, transfersability of ownership, limited liability
- Disadvantages: Separation of ownership and management, corporate tax, gov regulation

Organizing a Corporation

- Incorporators obtain a charter from the state (includes authorization to issue shares of stock)
 - o Pay fees, sign the charter, file documents with the state, agree to set of bylaws