

Sheridan Company Issues \$270,000, 20-year, 7onds At 102. Prepare The Journal Entry To Record The Sale

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Understanding how Sheridan Company records the issuance of bonds at a premium is essential for accounting professionals, investors, and students alike. When a company issues bonds, the transaction impacts its financial statements significantly. In this article, we will explore the details behind Sheridan Company's bond issuance, analyze the key accounting principles involved, and guide you step-by-step to prepare the appropriate journal entry for this transaction. With a comprehensive overview, SEO optimization, and clear explanations, this guide aims to enhance your understanding of bond issuance accounting.

Overview of Sheridan Company's Bond Issuance

Details of the Bond Issue

Sheridan Company has issued bonds with the following key features:

- Principal (Face Value): \$270,000
- Term: 20 years
- Coupon Rate: 7%
- Issue Price: At 102 (which means 102% of face value)
- Type: Bonds payable (long-term liability)

The issuance at 102 indicates that the bonds were sold at a premium, as the price exceeds the face value by 2%. This premium reflects the market's perception of the company's creditworthiness or prevailing interest rates relative to the bond's coupon rate.

Why Bonds Are Issued at a Premium

When bonds are issued:

- At Face Value: When the coupon rate equals the market rate.
- Below Face Value (Discount): When the coupon rate is lower than the market rate.
- Above Face Value (Premium): When the coupon rate exceeds the market rate.

In Sheridan's case, bonds are issued at a premium because the coupon rate

(7%) is attractive compared to prevailing market rates, or due to other favorable factors.

Understanding Bond Pricing and Premiums

Bond Pricing Fundamentals

Bond price is determined based on:

- Present value of future cash flows: which include periodic interest payments and the principal repayment.
- Market interest rates: prevailing rates influence whether bonds sell at a premium or discount.

The formula for bond price:

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Bond Price = Present value of interest payments + Present value of principal  
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Where:

- Present value calculations are based on market interest rates, not coupon rates.

Implication of Bond Premium

The premium indicates:

- Investors are willing to pay more than face value for the bond.
- The company receives more cash upfront than the face amount.
- The premium is amortized over the bond's life as a reduction of interest expense.

Preparing the Journal Entry for Bond Sale

Step-by-Step Approach

To record the sale of bonds issued at a premium, follow these steps:

1. Calculate the issue price of the bonds.
2. Determine the cash received from the bondholders.
3. Record the liability (Bonds Payable) at face value.
4. Record the premium received when bonds are issued above face value.
5. Prepare the journal entry that reflects all these components.

Calculating the Cash Proceeds

Since bonds are issued at 102:

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Issue Price = Face Value x Issue Percentage

Issue Price = \$270,000 x 102% = \$270,000 x 1.02 = \$275,400

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This means Sheridan Company receives \$275,400 in cash from bondholders.

Journal Entry to Record the Sale of Bonds

Basic Components of the Journal Entry

The journal entry to record the bond issuance includes:

- Debit to Cash for the amount received.
- Credit to Bonds Payable for the face value.
- Credit or debit to Premium on Bonds Payable for the excess over face value.

Actual Journal Entry

Based on the calculations:

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Debit: Cash ..... \$275,400

Credit: Bonds Payable ..... \$270,000

Credit: Premium on Bonds Payable ..... \$5,400

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Explanation:

- Cash increases by the amount received from investors.
- Bonds Payable increases by the face value, representing the company's obligation.
- Premium on Bonds Payable is a liability account that reflects the premium received.

Accounting for Bond Premiums and Amortization

Understanding the Premium on Bonds Payable

The premium on bonds payable is a contra-liability account that reduces

interest expense over the life of the bonds.

Amortization of the Premium

Over the 20-year term, Sheridan Company will amortize the premium, which involves:

- Reducing interest expense in the income statement.
- Using methods such as straight-line or effective interest method.

Example: Straight-Line Amortization

If Sheridan Company opts for straight-line amortization:

- Total premium: \$5,400
- Number of periods: 20 years
- Annual amortization: $\$5,400 / 20 = \270 per year

This amortization reduces the interest expense reported annually.

Additional Accounting Considerations

Interest Payments and Periodic Recording

- Sheridan will record interest payments based on the coupon rate (7%) of the face value.
- The annual interest expense is affected by the premium amortization.
- Journal entries for interest payments and amortization are made periodically.

Impact on Financial Statements

- Balance Sheet: Bonds payable liability increases; premium increases liabilities.
- Income Statement: Interest expense is reduced by premium amortization.
- Cash Flows: Cash inflow from bond issuance; interest outflows periodically.

Conclusion: Key Takeaways for Bond Issuance Accounting

- Bonds issued at a premium are recorded by recognizing the cash received,

face value, and premium.

- The initial journal entry ensures accurate reflection of the company's liabilities and cash inflow.
- Premium amortization impacts interest expense and financial statements over the bond's lifespan.
- Proper understanding of bond pricing, premium calculation, and amortization methods is essential for accurate financial reporting.

Summary of the Journal Entry

Account	Debit	Credit
Cash	\$275,400	
Bonds Payable		\$270,000
Premium on Bonds Payable		\$5,400

This journal entry effectively captures the issuance of Sheridan Company's bonds at a premium, setting the foundation for subsequent interest expense recognition and amortization.

Final Thoughts: Why Accurate Bond Recording Matters

Accurate recording of bond issuance transactions is crucial for:

- Complying with accounting standards (e.g., GAAP or IFRS).
- Providing transparent and truthful financial reports.
- Supporting decision-making by investors and creditors.
- Ensuring correct calculation of interest expense and liabilities.

Understanding the principles behind bond issuance, the role of premiums, and proper journal entries enhances financial literacy and professional competence in accounting.

If you have further questions about bond accounting, consider consulting accounting standards, textbooks, or professional guidance to deepen your understanding. Proper application of these principles ensures sound financial reporting and compliance.

Frequently Asked Questions

What is the significance of issuing bonds at a premium, such as Sheridan Company's bonds at 102?

Issuing bonds at 102 means the bonds were sold at 102% of their face value, indicating they were issued at a premium. This typically occurs when the bond's coupon rate is higher than the prevailing market interest rates, making the bonds more attractive to investors.

How do you determine the amount received from the bond issuance for Sheridan Company?

Since the bonds are issued at 102, the amount received is 102% of the face value: $270,000 \times 102\% = \$275,400$.

What is the journal entry to record Sheridan Company's bond sale at a premium?

The journal entry is:

Debit Cash \$275,400

Credit Bonds Payable \$270,000

Credit Premium on Bonds Payable \$5,400.

Why is there a premium on bonds issued by Sheridan Company, and how does it affect the company's financial statements?

The premium arises because the bonds' coupon rate is likely higher than current market rates, making them more attractive. It increases the cash received and is recorded as a liability (Premium on Bonds Payable), which will be amortized over the bond's life, affecting interest expense and net income.

How are the premium and bond face value related in the journal entry?

The bond's face value (\$270,000) is recorded in Bonds Payable, while the premium (\$5,400) is recorded separately as a credit in Premium on Bonds Payable, representing the amount over the face value received upon issuance.

What steps are involved in preparing the journal entry for a bond issued at a premium?

Steps include: 1) calculating total cash received (issue price), 2) recording

the face value of bonds payable, 3) recording the excess as a premium, and 4) making corresponding debit to cash and credits to Bonds Payable and Premium on Bonds Payable.

How does the 20-year term of the bonds impact the accounting for Sheridan Company?

The 20-year term indicates the bonds will be outstanding for 20 years, requiring amortization of the premium over this period, affecting interest expense and the carrying amount of bonds payable over time.

What is the importance of accurately recording bond issuance transactions like Sheridan Company's?

Accurate recording ensures proper financial reporting, reflects true liabilities and equity, affects interest expense calculations, and maintains compliance with accounting standards.

If Sheridan Company issues bonds at 102, how is the premium amortized over the bond's life?

The premium is amortized over 20 years using methods like straight-line or effective interest method, reducing interest expense over time and gradually decreasing the premium balance on the books.

Additional Resources

Sheridan Company Issues \$270,000, 20-year, 7 Bonds At 102 – Prepare The Journal Entry To Record The Sale

When a company like Sheridan Company issues bonds, it is a strategic move to raise capital for various corporate needs, such as funding expansion, paying down debt, or financing new projects. Understanding how to record this transaction accurately in the company's accounting books is essential for maintaining transparent financial statements and ensuring compliance with accounting standards. In this guide, we will examine the process of issuing bonds at a premium, specifically focusing on Sheridan Company's issuance of \$270,000, 20-year bonds with a 7% coupon rate, sold at 102 (which indicates 102% of face value), and how to prepare the appropriate journal entry to record this sale.

Understanding Bond Issuance and Key Concepts

Before diving into the journal entry, it's important to grasp some fundamental concepts related to bond issuance:

What Are Bonds?

Bonds are debt securities issued by corporations or government entities to borrow funds from investors. In exchange, the issuer promises to pay periodic interest (coupon payments) and repay the face value of the bond at maturity.

Face Value (Principal)

This is the amount paid back to bondholders at maturity. In Sheridan's case, the face value is \$270,000.

Coupon Rate

The fixed interest rate paid annually or semi-annually based on the face value. Sheridan's bonds have a 7% coupon rate.

Issue Price and Premium/Discount

- Issue Price: The price at which bonds are sold to investors. It can be at par (100), at a premium (>100), or at a discount (<100).
- Premium: When bonds are sold above face value (e.g., at 102), indicating the bonds are more attractive, often due to a higher coupon rate relative to market rates.
- Discount: When bonds are sold below face value.

Why Bonds Are Sold at a Premium

When the coupon rate exceeds the prevailing market interest rates, investors are willing to pay more than the face value for the bond, resulting in a premium.

Details of Sheridan's Bond Issue

Let's analyze the specifics of Sheridan's bond issuance:

- Face Value: \$270,000
- Coupon Rate: 7%
- Term: 20 years
- Issue Price: 102% of face value
- Sale Price: $102\% \text{ of } \$270,000 = 1.02 \times \$270,000 = \$275,400$

Step 1: Calculate the Total Cash Received

The total cash received from the bond issuance is directly based on the issue price:

Total Cash Received = \$275,400

This amount includes the face value plus the premium.

Step 2: Determine the Premium on Bonds

The premium is the amount received over the face value:

Premium = Issue Price – Face Value

Premium = \$275,400 – \$270,000 = \$5,400

The premium reflects the additional amount investors are willing to pay due to favorable coupon rate or market conditions.

Step 3: Record the Bonds at Their Issue Price

In accounting, bonds payable are initially recorded at their cash proceeds, which in this case is \$275,400.

The accounting entry must:

- Recognize the Bonds Payable at face value (\$270,000).
- Record the Premium on Bonds Payable (\$5,400).
- Recognize the Cash received (\$275,400).

This ensures the company's liabilities are accurately reflected, with the premium recorded separately as a balance sheet account that amortizes over the life of the bonds.

Step 4: Prepare the Journal Entry

The Journal Entry to Record the Bond Sale

Debit: Cash for the total amount received:

- Cash: \$275,400

Credit: Bonds Payable at face value:

- Bonds Payable: \$270,000

Credit: Premium on Bonds Payable for the amount over face value:

- Premium on Bonds Payable: \$5,400

Summary of the journal entry:

Account	Debit (\$)	Credit (\$)
Cash	275,400	
Bonds Payable		270,000
Premium on Bonds Payable		5,400

Step 5: Considerations for Future Periods

While the initial journal entry is straightforward, the premium on bonds payable will be amortized over the life of the bonds, affecting interest expense and the carrying amount of the liability on the balance sheet.

Amortization of Premium

- Method: Typically, the straight-line method or effective interest method is used.
- Impact: The amortization reduces the bond interest expense over time, aligning the interest expense with the market rate at issuance.

Additional Insights

Why Is It Important to Record Bonds Correctly?

Accurately recording bond transactions ensures:

- Proper reflection of liabilities on the balance sheet.
- Correct calculation of interest expense in the income statement.
- Transparency for investors and regulators.
- Compliance with generally accepted accounting principles (GAAP).

Recognizing the Premium on Bonds Payable

The premium is a contra-liability account that adjusts the bond's carrying amount. Over the bond's life, this premium is amortized, decreasing interest expense and increasing net income during each period.

Summary: Key Takeaways

- Sheridan Company issued \$270,000, 20-year bonds at 102, resulting in total proceeds of \$275,400.
- The premium on bonds payable is \$5,400 (\$275,400 - \$270,000).
- The journal entry to record this transaction involves debiting cash, crediting bonds payable at face value, and crediting the premium.
- Proper accounting treatment includes subsequent amortization of the premium over the bond's life.

Final Thoughts

Issuing bonds at a premium like Sheridan Company did reflects favorable market conditions and investor confidence. Properly recording this transaction ensures the company's financial statements accurately reflect its liabilities and equity position. By understanding each component—issue price, premium, and journal entry—accountants can maintain clarity and compliance, ensuring the company's financial health is transparently reported to stakeholders.

In summary, the journal entry to record Sheridan Company's bond sale at 102 involves recognizing the cash received, the liability at face value, and the premium, setting the stage for accurate financial reporting throughout the bond's 20-year lifespan.

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