

**DEMONSTRATION PROBLEM**

On March 1, Wesley Motors Company, Inc., issued \$20,000,000 of 20-year, 9 percent bonds, dated March 1. Interest is payable on March 1 and September 1. The corporation's fiscal year extends from January 1 through December 31. The following transactions relate to the bond issue for the first two years.

**Year 1**

- Mar. 1 Sold the bond issue for 97.
- Sept. 1 Paid the semiannual interest on the bonds.
- Dec. 31 Deposited \$350,000 in a bond sinking fund.
  - 31 Made an adjusting entry to record accrued interest payable.
  - 31 Made an adjusting entry to record amortization of bond discount.
  - 31 Closed the Interest Expense account.

**Year 2**

- Jan. 1 Reversed adjusting entry for accrued interest payable.
  - 14 Bought various securities with sinking fund cash; cost, \$350,000.
- Mar. 1 Paid the semiannual interest on bonds.
- July 28 Recorded the receipt of \$20,640 of income derived from sinking fund investments, depositing the cash in the sinking fund.
- Aug. 7 Bought various securities with sinking fund cash; cost, \$20,640.
- Sept. 1 Paid the semiannual interest on bonds.
- Dec. 31 Recorded the receipt of \$16,380 of income derived from sinking fund investments, depositing the cash in the sinking fund.
  - 31 Deposited \$466,000 in a bond sinking fund.
  - 31 Made an adjusting entry to record accrued interest payable.
  - 31 Made an adjusting entry to record amortization of bond discount.
  - 31 Closed the Sinking Fund Income account.
  - 31 Closed the Interest Expense account.

**Instructions**

1. Record the transactions in general journal form (start on page 45).
2. Post entries to Interest Expense (account no. 581) and Discount on Bonds Payable (account no. 242). Label adjusting, closing, and reversing entries.

**Solution**

GENERAL JOURNAL

	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	<i>Year</i>	<i>1</i>				1
2	<i>Mar.</i>	<i>1</i> <i>Cash</i>		<i>19,400,000.00</i>		2
3		<i>Discount on Bonds Payable</i>	<i>242</i>	<i>600,000.00</i>		3
4		<i>Bonds Payable</i>			<i>20,000,000.00</i>	4
5		<i>Sold 20-year, 9 percent bonds, dated</i>				5
6		<i>March 1, at 97.</i>				6
7						7
8	<i>Sept.</i>	<i>1</i> <i>Interest Expense</i>	<i>581</i>	<i>900,000.00</i>		8
9		<i>Cash</i>			<i>900,000.00</i>	9
10		<i>Paid semiannual interest on bonds.</i>				10
11		<i>( \$20,000,000 x 0.09 x 6 / 12 )</i>				11
12						12
13	<i>Dec.</i>	<i>31</i> <i>Sinking Fund Cash</i>		<i>350,000.00</i>		13
14		<i>Cash</i>			<i>350,000.00</i>	14
15		<i>Deposit in bond sinking fund.</i>				15
16						16
17		<i>Adjusting Entries</i>				17
18		<i>31</i> <i>Interest Expense</i>	<i>581</i>	<i>600,000.00</i>		18
19		<i>Interest Payable</i>			<i>600,000.00</i>	19
20		<i>( \$20,000,000 x 0.09 x 4 / 12 )</i>				20
21						21
22		<i>31</i> <i>Interest Expense</i>	<i>581</i>	<i>25,000.00</i>		22
23		<i>Discount on Bonds Payable</i>	<i>242</i>		<i>25,000.00</i>	23
24		<i>( \$600,000 ÷ 20 years x 10 / 12 )</i>				24
25						25
26		<i>Closing Entry</i>				26
27		<i>31</i> <i>Income Summary</i>		<i>1,525,000.00</i>		27
28		<i>Interest Expense</i>	<i>581</i>		<i>1,525,000.00</i>	28
29						29
30	<i>Year</i>	<i>2</i> <i>Reversing Entry</i>				30
31	<i>Jan.</i>	<i>1</i> <i>Interest Payable</i>		<i>600,000.00</i>		31
32		<i>Interest Expense</i>	<i>581</i>		<i>600,000.00</i>	32
33						33
34		<i>14</i> <i>Sinking Fund Investments</i>		<i>350,000.00</i>		34
35		<i>Sinking Fund Cash</i>			<i>350,000.00</i>	35
36		<i>Bought various securities.</i>				36
37						37
38	<i>Mar.</i>	<i>1</i> <i>Interest Expense</i>	<i>581</i>	<i>900,000.00</i>		38
39		<i>Cash</i>			<i>900,000.00</i>	39
40		<i>Paid semiannual interest on bonds.</i>				40
41		<i>( \$20,000,000 x 0.09 x 6 / 12 )</i>				41
42						42
43						43

**Solution (continued)**

	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	<i>Year</i>	2				1
2	<i>July</i>	28		20,640.00		2
3		<i>Sinking Fund Cash</i>				
3		<i>Sinking Fund Income</i>			20,640.00	3
4		<i>Received income on sinking fund</i>				4
5		<i>investments.</i>				5
6						6
7	<i>Aug.</i>	7		20,640.00		7
8		<i>Sinking Fund Investments</i>				
8		<i>Sinking Fund Cash</i>			20,640.00	8
9		<i>Bought various securities.</i>				9
10						10
11	<i>Sept.</i>	1	581	900,000.00		11
12		<i>Interest Expense</i>				
12		<i>Cash</i>			900,000.00	12
13		<i>( \$20,000,000 x 0.09 x 6 / 12 )</i>				13
14						14
15	<i>Dec.</i>	31		16,380.00		15
16		<i>Sinking Fund Cash</i>				
16		<i>Sinking Fund Income</i>			16,380.00	16
17		<i>Received income on sinking fund</i>				17
18		<i>investments.</i>				18
19						19
20		31		466,000.00		20
21		<i>Sinking Fund Cash</i>				
21		<i>Cash</i>			466,000.00	21
22		<i>Deposit in bond sinking fund.</i>				22
23						23
24		<i>Adjusting Entries</i>				24
25		31	581	600,000.00		25
26		<i>Interest Expense</i>				
26		<i>Interest Payable</i>			600,000.00	26
27		<i>( \$20,000,000 x 0.09 x 4 / 12 )</i>				27
28						28
29		31	581	30,000.00		29
30		<i>Interest Expense</i>				
30		<i>Discount on Bonds Payable</i>	242		30,000.00	30
31		<i>( \$600,000 ÷ 20 years )</i>				31
32						32
33		<i>Closing Entries</i>				33
34		31		37,020.00		34
35		<i>Sinking Fund Income</i>				
35		<i>Income Summary</i>			37,020.00	35
36						36
37		31		1,830,000.00		37
38		<i>Income Summary</i>				
38		<i>Interest Expense</i>	581		1,830,000.00	38
39						39
40						40

**Solution (concluded)**

GENERAL LEDGER

ACCOUNT Discount on Bonds Payable

ACCOUNT NO. 242

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
Year	1					
Mar.	1	J45	600,000.00		600,000.00	
Dec.	31	Adjusting		25,000.00	575,000.00	
Year	2					
Dec.	31	Adjusting		30,000.00	545,000.00	

ACCOUNT Interest Expense

ACCOUNT NO. 581

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
Year	1					
Sept.	1	J45	900,000.00		900,000.00	
Dec.	31	Adjusting	600,000.00		1,500,000.00	
	31	Adjusting	25,000.00		1,525,000.00	
	31	Closing		1,525,000.00	0.00	
Year	2					
Jan.	1	Reversing		600,000.00		600,000.00
Mar.	1	J45	900,000.00		300,000.00	
Sept.	1	J46	900,000.00		1,200,000.00	
Dec.	31	Adjusting	600,000.00		1,800,000.00	
	31	Adjusting	30,000.00		1,830,000.00	
	31	Closing		1,830,000.00	0.00	