Chapter 12

Acquiring Additional Capital for a Corporation

Section 12.3
Bonds Payable Transactions

Corporate Bonds Payable

Growing businesses may acquire capital from three sources:

1. Using retained earnings
2. Selling additional capital stock
3. Borrowing the funds

Selling additional capital stock

Advantages of selling stock:

- The additional capital becomes part of a corporation’s permanent capital.
- Dividends do not have to be paid to the stockholders.

Disadvantage:

- Ownership is spread over more shares and more owners

Borrowing additional capital

Advantages of borrowing:

- Stockholders' equity is not spread over additional shares of stock

Disadvantage:

- Interest must be paid on the loan which decreases net income
- Decreases in net income decreases the amount available for dividends
- The amount must be repaid in the future
- Loans can be difficult to obtain

Bonds

Bond

- A printed, long-term promise to pay a specified amount on a specified date and to pay interest at stated intervals.
- Similar to notes payable (1 year or less)
- Bonds are generally for longer periods of time (5, 10, or 20 years)
- Issued for larger amount of money than notes payable

Bond issue

- All bonds representing the total amount of a loan
- Usually sold to a securities dealer who sells individual bonds to the public.

Issuing Bonds

What do we know:

- Received cash
- For the face value of a five-year, 12%, $1000 par value bond issue, $250,000.

Transactions will be journalized in the Cash Receipts Journal.

Debit Cash $250,000

Credit Bonds Payable $250,000

Paying interest on Bonds

What do we know:

- Paid cash
- To bond trustee for annual interest on bond issue.
- The interest rate is 12%
- Balance owed is $250,000.

Calculate Annual interest:

$250,000 X 12% = $30,000

Record in the Cash Payment Journal

Debit Interest Expense	$30,000
Credit Cash	$30,000

Depositing Cash in a Bond Sinking Fund

Bond Sinking Fund

- Amount set aside to pay a bond issue when due
- Assures bondholders that the bond issue will be paid at maturity

What do we know:

- Paid cash to bond trustee
- For annual deposit to bond sinking fund, $50,000

Debit Bond sinking fund	$50,000
Credit Cash	$50,000

Depositing Cash to Sinking Fund and Recording Earned Income

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Retiring a Bond Issue

Retiring a bond issue

- Paying the amounts owed to bondholders for bond issue

Term bonds

- Bonds that mature on the same date

Serial bonds

- Portions of bonds mature at different dates.

Received notice from bond trustee that bond issue was retired using bond sinking fund, $250,000.

Debit Bonds Payable

$250,000

Credit Bond Sinking Fund

$250,000

Comparison of Capital Stock and Bonds as a Source of Corporate Capital

Capital Stock	Bonds
1. Stockholders are corporate owners.	1. Bondholders are corporate creditors.
2. Capital Stock is a stockholders' equity account.	2. Bonds Payable is a liability account.
3. Stockholders have a secondary claim against corporate assets.	3. Bondholders have a primary, or first, claim against corporate assets.
4. Dividends are paid to stockholders out of corporate net income.	4. Interest paid to bondholders is a corporate expense.
5. Dividends are not fixed costs and do not have to be paid if net income is insufficient.	5. Interest on bonds is a fixed expense; the expense must be paid when due; payment does not depend on amount of net income.
6. Amount received from sale of stock is relatively permanent capital; amount invested by stockholders does not have to be returned to them in foreseeable future.	6. Amount received from sale of bonds is not permanent; amount invested by bondholders must be returned to them on bonds' maturity date.