

Part A

Bond Details	Euros (€)
Issue Amount	€ 11,000,000
Premium at maturity	€ 3,000,000
Face value of the bond	€ 14,000,000
Issue costs	€ 24,000

Other Details

Period to maturity	5 years
Coupon	0%

Calculate the Rate of Return

Divide face value by issue amount to get:	1.27
Divide 1 by the number of periods to get:	0.20
Raise 1.27 to the power of 0.20	1.05
Subtract 1 to get:	0.05
Rate of Investment	5%

Draft Reply to the Assistant Accountant

Issuance of the Bond

The company will debit cash and credit bonds payable with an amount equivalent to the issue amount of € 11,000,000. The accounting entries for this transaction will be as follows;

Accounting Entry	Details (Account)	Debit (Dr) Euros (€)	Credit (Cr) Euros (€)
To record the issuance of the bond;			
Debit	Cash	€ 11,000,000	
Credit	Bonds Payable		€ 11,000,000

Interest

The company will pay a premium on the bond equal to €3,000,000 at maturity. This premium is supposed to be spread throughout the term of the bond by debiting interest expense and crediting bonds payable even though it will only be paid at maturity.

Accounting Entry	Details (Account)	Debit (Dr) Euros (€)	Credit (Cr) Euros (€)
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To record the interest expense on the bond;

Year 1

	Price	Rate of Return	Interest Expense
Multiply the rate of return by the price;	€ 11,000,000	5%	€ 550,000
Debit	Interest Expense	€ 550,000	
Credit	Bonds Payable		€ 550,000

Year 2

	New Price	Rate of Return	Interest Expense
Multiply the rate of return by the price;	€ 11,550,000	5%	€ 577,500
Debit	Interest Expense	€ 577,500	
Credit	Bonds Payable		€ 577,500

Year 3

	New Price	Rate of Return	Interest Expense
Multiply the rate of return by the price;	€ 12,127,500	5%	€ 606,375
Debit	Interest Expense	€ 606,375	
Credit	Bonds Payable		€ 606,375

Year 4

	New Price	Rate of Return	Interest Expense
Multiply the rate of return by the price;	€ 12,733,875	5%	€ 636,694
Debit	Interest Expense	€ 636,694	
Credit	Bonds Payable		€ 636,694

Year 5

	New Price	Rate of Return	Interest Expense
Multiply the rate of return by the price;	€ 13,370,569	5%	€ 668,528
Debit	Interest Expense	€ 668,528	
Credit	Bonds Payable		€ 668,528

Treatment of Issue Costs

The issue costs cannot be included in the operating expenses for 2018. These costs refer to expenses related to underwriting, printing, legal and registration fees of the bond and do not accrue any benefit to the issuer of the bond. These costs are supposed to be amortized over the course of the bond. The accounting entries for this transaction will be as follows;

Accounting Entry	Details (Account)	Debit (Dr) Euros (€)	Credit (Cr) Euros (€)
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To account for the associated liability of the costs;

Debit	Debt Issuance Costs Account	€ 24,000	
Credit	Accounts Payable		€ 24,000

To Amortize the debt issuance fees over a period of five years using the straight line method;

Year 1

Debit	Debt Issue Expense	€ 4,800	
Credit	Debt Issuance Costs Account		€ 4,800

Year 2

Debit	Debt Issue Expense	€ 4,800	
Credit	Debt Issuance Costs Account		€ 4,800

Year 3

Debit	Debt Issue Expense	€ 4,800	
Credit	Debt Issuance Costs Account		€ 4,800

Year 4

Debit	Debt Issue Expense	€ 4,800	
Credit	Debt Issuance Costs Account		€ 4,800

Year 5

Debit	Debt Issue Expense	€ 4,800	
Credit	Debt Issuance Costs Account		€ 4,800

Preference Shares

Reedeemable preference shares are treated as a liability in the Statement of Financial Position (SOFPP). These shares are a liability as the company has to pay back a certain amount after an agreed period. Any dividend paid on the shares will be treated as an expense in the Income Statement.

Total Proceeds	€ 9,000,000
Nominal Value per share issued	€ 0.50
Total number of shares	€ 18,000,000

To record proceeds of the issuance of the shares;

Debit	Cash	€ 9,000,000	
Credit	Reedeemable Preference Shares Liability		€ 9,000,000

Accounting Entry	Details (Account)	Debit (Dr) Euros (€)	Credit (Cr) Euros (€)
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To account for the associated liability of the costs;

Debit	Debt Issuance Costs Account	€ 105,600	
Credit	Accounts Payable		€ 105,600

To Amortize the debt issuance fees over a period of five years using the straight line method;

Year 1

Debit	Debt Issue Expense	€ 21,120	
Credit	Debt Issuance Costs Account		€ 21,120

Year 2

Debit	Debt Issue Expense	€ 21,120	
Credit	Debt Issuance Costs Account		€ 21,120

Year 3

Debit	Debt Issue Expense	€ 21,120	
Credit	Debt Issuance Costs Account		€ 21,120

Year 4

Debit	Debt Issue Expense	€ 21,120	
Credit	Debt Issuance Costs Account		€ 21,120

Year 5

Debit	Debt Issue Expense	€ 21,120	
Credit	Debt Issuance Costs Account		€ 21,120

The dividends on redeemable share capital will be treated as finance costs since it is the nature of debt

Calculate the 7% finance cost on the issued debt as follows: € 630,000.00

Accounting entries

Debit	Finance Costs	€ 630,000	
Credit	Accounts Payable		€ 630,000

On payment:

Debit	Accounts payable	€ 630,000	
Credit	Cash		€ 630,000

Part B

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The bonds held by Sky Plc in both Stars Plc and Mars Plc should be treated in the same manner in the financial statements of the company. Uniformity in the accounting treatment of the bonds will help the

company determine which bonds are more profitable and therefore make better investment decisions. It is essential to take this approach given that one of the bonds face value is expected to fluctuate thereby altering the overall return at the end of the investment period. Similar accounting treatment will allow the company to manage its portfolio more effectively.

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Ledger Account for Sky Plc

Sky Plc

To record investment in bonds:

Debit	Investment in Bonds	€ 5,000,000	
Credit	Cash		€ 5,000,000

To record interest income:

To record investment in bonds:

Value of Bond € 5,000,000

Year 1

Debit	Cash	€ 350,000	
Credit	Interest Income		€ 350,000

New Value of the bond: € 5,350,000

Year 2

Debit	Cash	€ 374,500	
Credit	Interest Income		€ 374,500

New Value of the bond: € 5,724,500

Year 3

Debit	Cash	€ 400,715	
Credit	Interest Income		€ 400,715

New Value of the bond: € 6,125,215

Year 4

Debit	Cash	€ 428,765	
Credit	Interest Income		€ 428,765

New Value of the bond: € 6,553,980

Year 5			
Debit	Cash	€ 458,779	
Credit	Interest Income		€ 458,779