Lecture 11.04 – Bond Retirement

Bonds may be called or retired prior to maturity (aka, early extinguishment of debt). When this happens, the difference between the net carrying amount of the debt and the amount paid to retire the debt is reported as a gain/loss on the issuer’s income statement as part of continuing operations (ASC 470). The journal entry is basically the opposite of the original issuance. The plug to balance the entry is the **gain/loss**.

- Bonds Payable (face) X
- Premium (unamortized) X
- Loss (plug) X
  - BIC (unamortized) X
  - Discount (unamortized) X
  - Cash (amount to retire) X
  - Gain (plug) X

Note that if the fair value option under ASC 825 is elected, the net carrying value of the debt retired will equal the fair value of the debt at retirement. Any related gains/losses accumulated in other comprehensive income will be recognized in net income in the year of retirement.

**Bond Sinking Funds**

A fund set up for the retirement of bonds. The balance is treated as a noncurrent asset until the bonds mature. Any interest or dividends earned are added to the sinking fund balance and reported as income.
Lease and Nonlease Components

Some contracts that contain leases will have various components, some of which are lease components and some of which are nonlease components. When that is the case, lease components and nonlease components are accounted for separately, and lease payments are allocated to each of the separate components proportionately based on the standalone price of each lease and nonlease component.

- For example, nonlease components such as maintenance service obligations (i.e., the lessor is required to maintain the property) are separated from the lease components of a contract and are generally recognized as incurred, depending on the entity's accounting policy for maintenance.

- Generally, only lease components are accounted for under ASC 842. There are, however, practical expedients for both lessees and lessors under ASC 842 to account for the components together, if elected. For lessors to take advantage of the option to not separate the lease and nonlease components in a contract, both of the following tests must be met:
  - The timing and pattern of revenue for both components are the same.
  - The combined single lease component is classified as an operating lease.

- Some items specified in a lease, however, are not considered components and, as a result, no portion of the lease payments are allocated to them. An item in a contract is a component if it conveys some benefit, transferring a good or service, to the lessee. Neither the administrative cost of setting up a contract or initiating a lease nor the direct payment or reimbursement to the lessor of costs associated with ownership, such as payment of personal property taxes and insurance on the underlying asset, convey a good or service to the lessee that is separate from the benefit associated with the right to use the underlying property. As such, these are not components and no portion of the lease payments is allocated to them.
  - If taxes and/or insurance are billed to the lessee or the payments otherwise vary from year to year, the payments are treated like variable lease payments and, thus, are NOT part of the lease liability.
  - However, if taxes and/or insurance are included in the lease payment, the entire payment is still just treated as a lease payment—there is no allocation (even if the amounts are itemized in the contract). For example, if $500 of a $4,000 annual lease payment is itemized in the contract as payment to the lessor to cover taxes and insurance; the $500 is still included as part of total $4,000 annual lease payment; it's not allocated separately.