

BONDS PAYABLE



ISSUING THE BOND



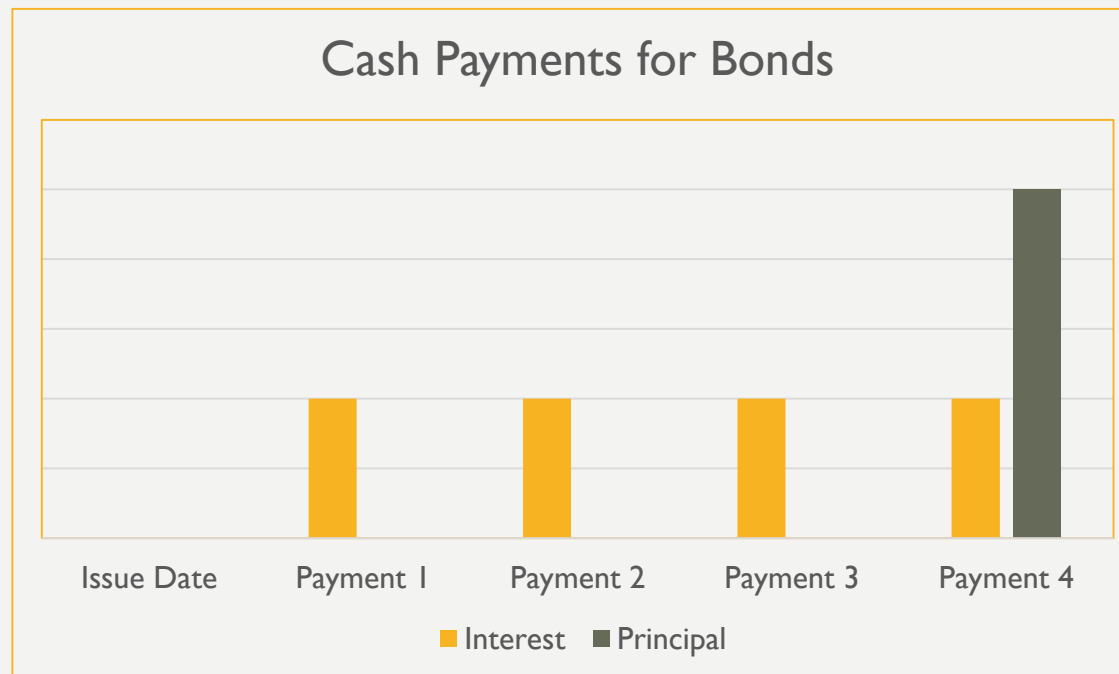
WHAT'S A BOND

- ❖ A different way to get a loan
- ❖ Rather than one bank, lots of people can loan you money
- ❖ “Lenders” can buy and sell the loan over its life
- ❖ Way to raise lots of debt all at one time



CASH PAYMENTS

- ❖ Pay interest periodically
- ❖ Pay principal at the end
- ❖ Example
 - ❖ \$100,000 principal
 - ❖ 4-year bond
 - ❖ Pay 4% interest
 - ❖ \$4,000 per payment



TERMINOLOGY

- ❖ Par (Face) Value

- ❖ Interest Rates

 - ❖ Coupon (Stated) Rate

 - ❖ Used to determine the interest paid per period

 - ❖ Market (Effective) Rate

 - ❖ Used for everything else



PRICING A BOND

EXAMPLE

- Par (Face) Value
 - 500 bonds @ 1,000 par value each
 - Will be paid back in 4 years
- Interest Rates
 - Coupon (Stated) Rate
 - 4% paid annually
 - Market (Effective) Rate
 - 3%

PRICING

- You promise to pay the buyer of the bonds:
 - \$500,000 in 4 years PLUS
 - \$20,000 (4% of the \$500,000) per year for 4 years
- Buyers of the bond is happy with a 3% return

Coupon	=	4%	
Market	=	3%	
500,000	x	.888	= 444,000
20,000	x	3.717	= 74,340
Bond Price			518,340



PRICING A BOND --DISCOUNT

EXAMPLE

- Par (Face) Value
 - 500 bonds @ 1,000 par value each
 - Will be paid back in 4 years
- Interest Rates
 - Coupon (Stated) Rate
 - 4% paid annually
 - Market (Effective) Rate
 - 5%

PRICING

- You promise to pay the buyer of the bonds:
 - \$500,000 in 4 years PLUS
 - \$20,000 (4% of the \$500,000) per year for 4 years
- Buyers of the bond requires a 5% return

Coupon	=	4%	
Market	=	5%	
500,000	x	.823	= 411,500
20,000	x	3.546	= 70,920
Bond Price			482,420



JOURNAL ENTRIES

❖ Premium

Cash	518,340	
Premium on Bonds Payable		18,340
Bonds Payable		500,000

❖ Discount

Cash	482,420	
Discount on Bonds Payable	17,580	
Bonds Payable		500,000



**JUST TAKES A
LITTLE PRACTICE**

