

CONCEPT: DISCOUNT ON BONDS

- A bond is issued at a **discount** when the *stated interest rate* is _____ the *market interest rate*
 - The selling price of a bond is equal to the present value of the interest payments and principal payments

Stated Rate = Market Rate	The price of the bond will be _____ the face value
Stated Rate < Market Rate	The price of the bond will be _____ the face value
Stated Rate > Market Rate	The price of the bond will be _____ the face value

- Bonds are initially **issued** and the respective journal entry is made:

On January 1, 2018, ABC Company issues \$50,000 of 9% bonds payable maturing in five years. Interest is payable semi-annually on January 1 and July 1. The market interest rate was equal to 10%. The bonds were issued at 94.

January 1, 2018 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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- Interest is paid in cash. A journal entry is made for **interest expense and discount amortization**:

On January 1, 2018, ABC Company issues \$50,000 of 9% bonds payable maturing in five years. Interest is payable semi-annually on January 1 and July 1. The market interest rate was equal to 10%. The bonds were issued at 94.

July 1, 2018 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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- Interest is paid in cash. A journal entry is made for ***interest expense and discount amortization***:

On January 1, 2018, ABC Company issues \$50,000 of 9% bonds payable maturing in five years. Interest is payable semi-annually on January 1 and July 1. The market interest rate was equal to 10%. The bonds were issued at 94.

December 31, 2018 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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- On the maturity date, the company ***repays the principal*** and removes the bonds payable from the books:

On January 1, 2018, ABC Company issues \$50,000 of 9% bonds payable maturing in five years. Interest is payable semi-annually on January 1 and July 1. The market interest rate was equal to 10%. The bonds were issued at 94.

January 1, 2023 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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PRACTICE: In 2014, ABC Company issued \$100,000, 10%, bonds while the market interest rate was 12%. The bonds mature in the current year. The amount of principal that ABC Company will repay in the current year is equal to:

- \$0
- An amount greater than \$0 but less than \$100,000
- \$100,000
- Some amount greater than \$100,000