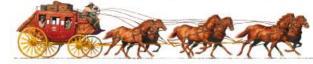


Bond Debits and Credits

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Together we'll go far



Bond Debits and Credits

This communication is not intended as accounting or tax advice

Investment Securities Designations – ASC 320 (FAS 115)

Classification	Unrealized Gains and Losses	Carrying Value
Held-to-Maturity (HTM): Bonds for which the investor has the intent and ability to hold to maturity	N/A	Amortized Cost
Available-for-Sale (AFS): Bonds not classified as HTM	Recognized in Other Comprehensive Income (OCI) net of tax. OCI is a component of shareholders' equity.	Fair Value
Trading: Bonds that are actively traded. Usually used for investment funds or broker dealers	Recognized in earnings and by extension, shareholders' equity.	Fair Value

Note: GAAP permits a company to elect the Fair Value Option wherein unrealized gains and losses are recognized in income similar to Trading classification above. However, securities transactions would be reflected as Investing Activities in the Statement of Cash Flows. The Fair Value Option is irrevocable. (You can't avoid the hit when rates start to rise.)

Entries to record the purchase of bonds are dependent upon price e.g., par, discount, or premium

Bond Record

Bond purchased at par – (100.00)

Investment in Bond (face amount) 1,000,000
Interest Receivable 20,000

Cash 1,020,000

Bond purchased at a discount – (97.00)

Investment in Bond (face amount) 1,000,000 Interest Receivable 20,000

> Discount on bonds 30,000 Cash 990,000

Bond purchased at a premium – (103.00)

Investment in Bond (face amount) 1,000,000 Interest Receivable 20,000 Premium on bonds 30,000

Cash 1,050,000

Recognizing Interest Income

Effective Yield Method

• The periodic interest income recorded is the market rate paid for the security multiplied by the book value of the security. The rate always remains the same (for fixed income instruments), but the interest income and premium or discount recorded vary according to the changing book value.

Two Methods of recognizing interest income

Straight Line Method

• The premium or discount paid for an instrument is amortized or accreted in equal periodic amounts over the life of the instrument. This method is acceptable as long as the results aren't materially different from the Effective Yield Method – the preferred method.

Par Bonds – Interest Income

Description Par Debenture
Coupon 2.75%
Bond Equiv. Yield (BEY) 2.75%
Maturity 5 YR.
Amount 1,000,000
Purchase Price 100
Cash Invested 1,000,000
Prem./Disc. -

Cash **Interest Book Period Received** Earned at 2.75% **Value** (BV x 2.75%) (\$1MM x 2.75%) 1,000,000 27,500 27,500 1,000,000 1 2 27,500 27,500 1,000,000 27,500 3 27,500 1,000,000

27,500

27,500

1,000,000

1,000,000

27,500

1,027,500

Par Bonds

Source: Wells Fargo Securities, LLC, U.S. GAAP

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Discount Bonds – Interest Income

DescriptionDiscount DebentureCoupon2.75%Bond Equiv. Yield (BEY)3.00%Maturity5 YR.Amount1,000,000Purchase Price98.87Cash Invested988,738Discount11,262

Discount Bonds

<u>Period</u>	Cash Received (\$1MM x 2.75%)	Interest Earned at 3% (BV x 3.00%)	Discount <u>Accretion</u> (Int. Earn Cash Rec.)	Remaining <u>Discount</u>	Book <u>Value</u>
				11,262	988,738
1	27,500	29,621	2,121	9,141	990,859
2	27,500	29,685	2,185	6,956	993,044
3	27,500	29,750	2,250	4,705	995,295
4	27,500	29,818	2,318	2,387	997,613
5	1,027,500	29,887	2,387	(0)	1,000,000

Premium Bonds – Interest Income

Description	Premium Debenture	
Coupon	2.75%	
Bond Equiv. Yield (BEY)	2.50%	
Maturity	5 YR.	
Amount	1,000,000	
Purchase Price	101.18	
Cash Invested	1,011,773	
Premium	11.773	

Premium Bonds

<u>Period</u>	Cash <u>Received</u> (\$1MM x 2.75%)	Interest Earned at 2.5% (BV x 2.5%)	Premium Amortization (Cash Rec Int. Earn.)	Remaining Premium 11,773	Book <u>Value</u> 1,011,773
1	27,500	25,260	2,240	9,533	1,009,533
2	27,500	25,204	2,296	7,237	1,007,237
3	27,500	25,147	2,353	4,884	1,004,884
4	27,500	25,088	2,412	2,472	1,002,472
5	1,027,500	25,028	2,472	0	1,000,000
			l		

Zero Coupon/Discount Notes – Interest Income

DescriptionDiscount NoteCoupon0.00%Bond Equiv. Yield (BEY)2.75%Maturity5 YR.Amount1,000,000Purchase Price87.32Cash Invested873,154Discount126,846

Zero Coupon/Discount Notes

<u>Period</u>	Cash <u>Received</u>	Discount <u>Accretion</u>	Interest <u>Earned at 2.75%</u> (BV × 2.75%)	Remaining Discount	Book <u>Value</u> 873,154
1	-	24,012	24,012	102,834	897,166
2	-	24,672	24,672	78,162	921,838
3	-	25,351	25,351	52,812	947,188
4	-	26,048	26,048	26,764	973,236
5	1,000,000	26,764	26,764	(0)	1,000,000

Straight Line Discount Bond – Interest Income

Description Discount Debenture Coupon 2.75% **Bond Equiv. Yield (BEY)** 3.00% **Maturity** 5 YR. **Amount** 1,000,000 **Purchase Price** 98.87 **Cash Invested** 988,738 **Discount** 11,262

Cash **Interest** Discount Remaining **Book Period** Received Earned at 3% Accretion Discount **Value** (\$1MM x 2.75%) (Cash + Accretion) 11,262 988,738 27,500 9,010 29,752 2,252 990,990 1 27,500 2 29,752 2,252 6,757 993,243 27,500 29,752 2,252 4,505 995,495 3 27,500 997,748 29,752 2,252 2,252

29,752

2,252

1,000,000

Straight Line – Discount Bond

Source: Wells Fargo Securities, LLC, U.S. GAAP

1,027,500

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