

Bond Debits and Credits

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Together we'll go far



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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

Two Methods of 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.

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

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.	-

<u>Period</u>	<u>Cash Received</u> (\$1MM x 2.75%)	<u>Interest Earned at 2.75%</u> (BV x 2.75%)	<u>Book Value</u>
			1,000,000
1	27,500	27,500	1,000,000
2	27,500	27,500	1,000,000
3	27,500	27,500	1,000,000
4	27,500	27,500	1,000,000
5	1,027,500	27,500	1,000,000



Discount Bonds

Discount Bonds – 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

<u>Period</u>	<u>Cash Received</u> (\$1MM x 2.75%)	<u>Interest Earned at 3%</u> (BV x 3.00%)	<u>Discount Accretion</u> (Int. Earn.- Cash Rec.)	<u>Remaining Discount</u>	<u>Book 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

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		
<u>Period</u>	<u>Cash Received</u> (\$1MM x 2.75%)	<u>Interest Earned at 2.5%</u> (BV x 2.5%)	<u>Premium Amortization</u> (Cash Rec.- Int. Earn.)	<u>Remaining Premium</u>	<u>Book Value</u>
				11,773	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

Zero Coupon/Discount Notes

Zero Coupon/Discount Notes – Interest Income

Description	Discount Note
Coupon	0.00%
Bond Equiv. Yield (BEY)	2.75%
Maturity	5 YR.
Amount	1,000,000
Purchase Price	87.32
Cash Invested	873,154
Discount	126,846

<u>Period</u>	<u>Cash Received</u>	<u>Discount Accretion</u>	<u>Interest Earned at 2.75%</u> (BV x 2.75%)	<u>Remaining Discount</u>	<u>Book Value</u>
				126,846	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

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

Straight Line Discount Bond – Interest Income

Straight Line – Discount Bond

		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		
<u>Period</u>	<u>Cash Received</u> (\$1MM x 2.75%)	<u>Interest Earned at 3%</u> (Cash + Accretion)	<u>Discount Accretion</u>	<u>Remaining Discount</u>	<u>Book Value</u>
				11,262	988,738
1	27,500	29,752	2,252	9,010	990,990
2	27,500	29,752	2,252	6,757	993,243
3	27,500	29,752	2,252	4,505	995,495
4	27,500	29,752	2,252	2,252	997,748
5	1,027,500	29,752	2,252	-	1,000,000



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