

# Bonds



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Bonds are one of the sources of finances through which organizations can raise money to fund their long term capital expenditure. Issuing bonds and issuing equity are therefore two different options available to firms to exercise when requiring expanding. Bond issue is relatively inexpensive as compared to equity issues and also provides significant tax benefits to the issuer also. Usually, bonds are issued at face value i. e. the principal value which will ultimately be paid to the lender at the end of the bond term whereas some issuers also issue bonds at premium or discounts. Bonds carrying premium are issued at a price above the face value of the bond whereas bonds issued at discount are normally below the face value of the bond.

There are various reasons as to why the bonds are normally issued at face value, or at discount or at premium and this largely depends upon the different circumstances. If the overall reputation and creditworthiness of the firm is relatively good in the market and investors have relatively better expectations of the future performance of the firm than the firm may be able to sell its bonds at premium. Selling on premium may also be because of the fact that existing bond issues having similar risk characteristics may be offering lower interest rates therefore by if the issuer is willing to offer higher rate of return to the lenders than it may be possible that the bond will be issued at premium.

Similarly, bonds may be offered at discount because issuing firm may not enjoy the relatively better credit ratings in the industry and investors are not willing to put more money into the firm. Selling at discount can also be due to the fact that overall yield offered by the bond may be significantly lower than the existing bonds of same risk category thus investors, in order to get compensated for the opportunity forgone to earn higher interest demand

from issuing firms to offer their bonds at discount. (Navarro, 2003)

Finally issuing bonds at face value indicates the indifference of the investors towards the company i. e. investors may not have relatively more trust in the future prospects of the company and may be expecting to earn normal rate of returns on their investment. Selling at face value does not however mean that the firm is not doing well or may be facing difficulties in future but in actual it indicates the ability of the firm to match its offerings according to the market expectations.

There are different reporting requirements for bonds issued at premium, discount and face value. Bonds issued at face value are amortized usually through straight line method and the liability of the issuer gradually reduces. However, reporting mechanism of bonds issued at premium is relatively more complex because it requires the amortization of premium over the maturity period of the bond also. Premium is separately recorded and booked at the time of issuing the bonds and is reported as a part of equity. Every year the premium is taken into income according to the straight line amortization schedule. On the other hand, issuers have to expense out the amount of discount offered at the time of issue over the period of bond and discount amount is taken as expense and reported as an expense in profit and loss statement of the issuing firm. (Marshall, McManus, & Viele, 2003)

#### Bibliography

1. Marshall, D. H., McManus, W. W., & Viele, D. F. (2003). Accounting. New York: McGraw Hill Professional.
2. Navarro, P. (2003). When the Market Moves, Will You Be Ready? New York: McGraw-Hill Professional.