

CONCEPT: ZERO COUPON BONDS

- A **zero coupon bond** has no _____ payments. The stated rate on these bonds is _____.
- ☐ 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 zero coupon bonds maturing in five years. The market interest rate was equal to 8%. The bonds were issued at 85.

January 1, 2018 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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- There is no cash interest. However, a journal entry is made for **interest expense and discount amortization**:

On January 1, 2018, ABC Company issues \$50,000 of zero coupon bonds maturing in five years. The market interest rate was equal to 8%. The bonds were issued at 85.

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 zero coupon bonds maturing in five years. The market interest rate was equal to 8%. The bonds were issued at 85.

January 1, 2023 Journal Entry:

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
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PRACTICE: On January 1, ABC Company issues \$1,000,000 of zero coupon bonds at 75. The bonds mature in five years. Assuming that ABC uses the straight-line method for amortization of bond premiums and discounts, the journal entry at the end of the first year would include:

- A credit to Cash of \$50,000
- A credit to Interest Payable of \$50,000
- A credit to Discounts on Bonds Payable of \$50,000
- A credit to Bonds Payable of \$50,000
- None of the above