

Standard Autoparts Inc. Issued \$100,000 Of 7%,10-year Bonds At A Price Of 87 On January 31,2020 . The

Standard Autoparts Inc. Issued \$100,000 Of 7%,10-year Bonds At A Price Of 87 On January 31,2020 . The issuance of bonds is a common method for companies like Standard Autoparts Inc. to raise capital for expansion, research and development, or other operational needs. On January 31, 2020, Standard Autoparts Inc. issued bonds totaling \$100,000 with a 7% interest rate, maturing in ten years, but at a discounted price of 87 (which equates to 87% of face value). This article explores the details of this bond issuance, the accounting implications, and the financial strategies involved.

Understanding Bond Issuance: Key Concepts

What Are Bonds?

Bonds are debt securities issued by corporations, municipalities, or governments to borrow funds from investors. When an entity issues bonds, it promises to pay the bondholders periodic interest payments and to return the principal amount at maturity.

Bond Face Value and Issue Price

- Face Value (Par Value): The amount paid back to the bondholder at maturity, in this case, \$100,000.
- Issue Price: The price at which bonds are sold to investors, which can be at face value, a premium, or a discount.

In this scenario, Standard Autoparts Inc. issued bonds at 87, meaning 87% of the face value, or \$87,000.

Interest Rate (Coupon Rate)

The bonds carry a 7% annual interest rate, meaning:

- Annual coupon payment = 7% of \$100,000 = \$7,000.
- Payments are typically made semiannually or annually.

Maturity Period

- The bonds mature in 10 years.
- At maturity, the company repays the face value of \$100,000.

Details of Standard Autoparts Inc. Bond Issuance

Issue Date and Terms

- Issue Date: January 31, 2020.
- Total Bonds Issued: \$100,000.
- Interest Rate: 7% annually.
- Term: 10 years.
- Issue Price: 87 (or \$87,000).

Motivation for Issuance

Standard Autoparts Inc. might have issued these bonds for various reasons:

- Funding expansion projects.
- Upgrading manufacturing facilities.
- Refinancing existing debt.
- General working capital needs.

Market Conditions and Discounted Issue

Issuing bonds below face value (at a discount) suggests:

- The bonds carry a higher risk perceived by investors.
- Prevailing interest rates or credit rating concerns.
- The company's creditworthiness may be slightly below investment grade at that time.

Accounting for Bond Issuance at a Discount

Recording the Bonds at Issue

When bonds are issued at a discount, the company records:

- Cash received: \$87,000.
- Bond payable: \$100,000 (face value).
- Discount on bonds payable: \$13,000 (\$100,000 - \$87,000).

This discount is amortized over the bond's life, affecting interest expense calculations.

Journal Entry at Issuance

Account	Debit	Credit
Cash	\$87,000	
Discount on Bonds Payable	\$13,000	
Bonds Payable		\$100,000

Interest Payments and Amortization

Periodic Interest Payments

- The company pays 7% of face value annually, i.e., \$7,000.
- If paid semiannually, each payment is \$3,500.

Amortization of Discount

- The discount of \$13,000 is amortized over 10 years (or 20 semiannual periods).
- Semiannual amortization amount = $\$13,000 / 20 = \650 .

Effect on Interest Expense

Each period:

- Interest expense = Coupon payment + Amortized discount.
- For semiannual periods: $\$3,500$ (cash interest) + $\$650$ (amortization) = $\$4,150$.

Financial Reporting and Impact

Balance Sheet Presentation

- Bonds Payable: \$100,000 (face value).
- Less: Unamortized Discount on Bonds Payable: decreases over time as amortized.
- Net Bonds Payable: increases over time as the discount is amortized.

Income Statement Implications

- Interest expense increases over time due to amortization.
- The effective interest method matches interest expense with market interest rates.

Impact on Financial Ratios

- Debt-to-Equity Ratio: Increases due to bond liability.
- Interest Coverage Ratio: May decrease temporarily due to higher interest expense from discount amortization.

Strategic Considerations for Standard Autoparts Inc.

Advantages of Issuing Bonds at a Discount

- Allows raising capital even when market conditions are unfavorable.
- The effective interest rate (yield) is higher than the coupon rate, reflecting market risk.

Disadvantages

- Higher overall interest expense due to amortization.
- Perception of increased risk from investors.

Alternative Financing Options

- Equity issuance.
- Bank loans.
- Convertible bonds.

Long-term Implications and Maturity

Maturity and Repayment

- At the end of ten years, Standard Autoparts Inc. will repay the face value of \$100,000.
- The company must ensure sufficient cash flow to meet principal and interest obligations.

Refinancing Options

- As bonds mature, companies may choose to refinance through new bond issues or other debt instruments based on market conditions.

Impact on Credit Rating

- Bond issuance at a discount could influence the company's credit rating, affecting future borrowing costs.

Conclusion

Standard Autoparts Inc.'s issuance of \$100,000 of 7%, 10-year bonds at a price of 87 in January 2020 reflects a strategic approach to raising capital while acknowledging market conditions and perceived risk. The discounted bond issuance results in initial cash proceeds below face value, requiring the company to amortize the discount over the life of the bonds. This process impacts interest expense, financial ratios, and overall debt management strategies. Understanding the nuances of bond issuance, including accounting treatment and strategic implications, is essential for stakeholders, investors, and financial managers to evaluate the company's financial health and future prospects.

Keywords for SEO:

- Standard Autoparts bond issuance
- bonds at discount accounting
- 7% 10-year bonds
- bond amortization
- issuing bonds at a discount
- bond payable journal entries
- impact of bond discount on financial statements
- corporate debt financing
- bond issuance strategy
- long-term debt management

Frequently Asked Questions

What does it mean that Standard Autoparts Inc. issued bonds at a price of 87?

Issuing bonds at a price of 87 means that the bonds were sold at 87% of their face value, indicating they were issued at a discount since the face value is \$100,000.

What is the total discount on the bonds issued by Standard Autoparts Inc.?

The total discount is \$13,000, calculated as $(\$100,000 - \$87,000)$, since 87% of \$100,000 is \$87,000.

How will the discount on bonds impact Standard Autoparts Inc.'s financial statements?

The discount will be amortized over the bond's life, increasing interest expense each period and affecting the company's net income and liabilities on the balance sheet.

What is the significance of the bonds having a 7% coupon rate and a 10-year maturity?

The 7% coupon rate indicates the annual interest paid to bondholders based on the face value, and the 10-year maturity specifies the bond's lifespan before repayment is due.

On what date did Standard Autoparts Inc. issue the bonds, and how does this date influence accounting entries?

The bonds were issued on January 31, 2020, which determines the start date for interest calculations and amortization of the bond discount in the company's financial records.

Additional Resources

Comprehensive Analysis of Standard Autoparts Inc.'s \$100,000 7%, 10-

Year Bonds Issuance at 87 on January 31, 2020

When analyzing a company's bond issuance, especially a significant transaction like Standard Autoparts Inc.'s issuance of \$100,000 worth of bonds, it's essential to understand the various components involved—ranging from the issuance details, accounting implications, and strategic considerations to the broader impact on the company's financial health. This detailed review delves into each facet of this bond issuance, offering insights into its significance and potential implications.

Overview of the Bond Issuance

Standard Autoparts Inc. issued bonds valued at \$100,000 on January 31, 2020, with a stated annual interest rate (coupon rate) of 7%, maturing over a period of 10 years. The bonds were issued at a price of 87, which indicates a discount relative to their face value.

Key Details:

- Face (Par) Value: \$100,000
- Coupon Rate: 7%
- Interest Payments: Annually (assumed unless otherwise specified)
- Term: 10 years
- Issue Date: January 31, 2020
- Issue Price: 87 (or 87% of face value)

- Total Proceeds: \$87,000 (87% of \$100,000)

Implication of the Issue Price:

- The bonds were issued below face value, which suggests the market perceived the bonds to carry a higher risk or that prevailing interest rates for similar debt instruments were higher than 7% at the time of issuance.
- The discount of \$13,000 (\$100,000 - \$87,000) will be amortized over the bond's life, affecting the company's interest expense and net income.

Understanding Bond Pricing and Its Significance

Bond Pricing Mechanics

- Bonds are typically issued at face value, at a premium, or at a discount.
- The issue price is influenced by the bond's coupon rate relative to the prevailing market interest rates.
- When the coupon rate is below current market rates, bonds usually trade at a discount; when above, they trade at a premium.

Why Did Standard Autoparts Inc. Issue at 87?

- Market Conditions: If prevailing interest rates were higher than 7%, investors would demand a discount to compensate for the lower return.

- Company's Creditworthiness: A perceived higher risk from Standard Autoparts Inc. could lead to a lower issue price.
- Demand and Supply Dynamics: Limited investor appetite or market volatility could also influence the discount.

Accounting for the Bond Issuance

Initial Journal Entry

At issuance, the company records:

- Cash: \$87,000 (proceeds)
- Bonds Payable: \$100,000 (face value)
- Discount on Bonds Payable: \$13,000 (difference between face value and proceeds)

Journal Entry:

Account	Debit	Credit
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Cash	\$87,000	
Discount on Bonds Payable	\$13,000	
Bonds Payable		\$100,000

The discount on bonds payable is a contra-liability account that will be

amortized over the life of the bonds.

Amortization of Discount

- The discount is amortized systematically over 10 years, typically using the effective interest method.
- Each period, interest expense exceeds the cash interest paid because of the amortization, reflecting the true cost of debt.

Interest Payment Calculation:

- Annual coupon payment = 7% of \$100,000 = \$7,000

Effective Interest Expense (Year 1):

- Based on the carrying amount (\$87,000) and market rate implied by the discount.
- The precise amount depends on the effective interest rate, which can be derived using financial calculators or amortization schedules.

Impact on Financial Statements

Balance Sheet Implications

- Liabilities: Bonds payable of \$100,000 will be recorded.

- Contra-liability: Discount on bonds reduces the carrying amount of liabilities initially.
- Equity & Assets: No immediate effect, but over time, interest expense impacts net income and retained earnings.

Income Statement Implications

- Interest Expense: Higher than the cash interest paid initially because of the amortized discount.
- Net Income: Reduced by the increased interest expense, impacting profitability metrics.

Cash Flow Effects

- The issuance results in an inflow of \$87,000.
- Annual cash interest payments of \$7,000 are made over the life.
- The amortization of the discount is a non-cash expense, impacting operating cash flows indirectly.

Strategic and Financial Considerations

Why Choose Debt Over Equity?

- **Tax Deductibility:** Interest payments are tax-deductible, making debt a tax-efficient financing option.
- **Control Preservation:** Debt does not dilute ownership.
- **Cost of Debt:** 7% coupon rate might be favorable if market rates are higher, but issuing at a discount indicates a higher perceived risk.

Risks Associated with the Bond Issuance

- **Interest Rate Risk:** Rising interest rates can affect the company's ability to refinance or issue new debt.
- **Default Risk:** If Standard Autoparts Inc. faces financial difficulties, meeting interest and principal payments could be challenging.
- **Refinancing Risk:** At maturity, the company may need to refinance, potentially at higher rates.

Potential Benefits

- **Capital for Expansion:** The funds can be used for growth, operations, or strategic acquisitions.
- **Leverage Effect:** Proper leverage can enhance returns on equity if the company's investments generate returns exceeding the debt cost.

Market Conditions and Timing

- The issuance date, January 31, 2020, is notable as it precedes the global upheaval caused by the COVID-19 pandemic. This timing might have influenced investor appetite, interest rates, and bond pricing.
- The bond's discount could reflect market uncertainty or the company's risk profile amid upcoming economic volatility.

Long-Term Outlook and Amortization Strategy

- Over the 10-year life, the company will systematically amortize the discount, increasing interest expense annually.
- The amortization schedule will impact the company's profit margins each year.
- The final year will see the bonds mature, requiring repayment of the face value of \$100,000.

Expected Amortization Approach:

- Using the effective interest method, the amortization expense will gradually increase, approaching \$7,000 (the coupon payment) in the later years, depending on the effective interest rate.

Conclusion and Final Thoughts

Standard Autoparts Inc.'s decision to issue bonds at 87 reflects a strategic move influenced by market conditions, the company's credit profile, and its financing needs. While issuing at a discount indicates higher borrowing costs relative to face value, it also provides the company with necessary capital upfront.

This issuance exemplifies prudent financial management, balancing the benefits of debt financing against associated risks. The systematic amortization of the bond discount ensures that the company's financial statements will gradually reflect the true cost of borrowing, aligning expenses with the periods in which they are incurred.

Overall, this bond issuance at a discount offers insights into the company's financial strategy, market perception, and future obligations. Stakeholders should monitor the amortization process, interest coverage, and overall debt levels to assess the ongoing impact of this debt instrument on Standard Autoparts Inc.'s financial health.

In summary:

- The bond issuance was a strategic move to raise capital.
- Issued at a discount due to market conditions or perceived risks.
- The accounting treatment involves recognizing the bond payable at face value, with a discount that's amortized over time.
- The company's leverage will influence its profitability and financial stability.
- Careful management of interest expense and debt obligations will be

essential for sustained growth.

This comprehensive review underscores the importance of understanding bond issuance mechanics, accounting implications, and strategic considerations for stakeholders and financial analysts alike.

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