Corporate Bonds and Their Bookeeping Records

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Abstract

In the Republic of Macedonia there is a single stock exchange of securities which operates as Macedonian stock exchange. Since its establishment until today, according to the legal regulations, the Macedonian Stock Exchange is the only place where trades in securities in Macedonia have been realized, primarily due to the fact that for such a small market the concentration of offers and demands of securities is a key factor in improving the financial situation in the economy and increasing of this type of transactions. When it comes to the market of bonds, then it can be emphasized that a key limiting factor for its development is the non existence of a wide range of bonds. Except the government bonds, in the Republic of Macedonia there are also corporate bonds that are classified according to the type of issuer of bonds i.e. public enterprises, transport and industrial enterprises, bonds of banks, etc. This type of bonds contain a real risk of non-payment, and they are not issued without pledge-collateral. Regarding the level of liquidity, they are with less liquidity than the government bonds, but on the other hand they offer significantly higher rates of return than long-term government, municipal and agency bonds. The financial market is fulfilled with variety of forms, characteristics and structure of securities, but the most important are those that can be found in the portfolio of the investors, regardless of whether they are in the portfolio of managers or individual investors - individuals. In fact, the portfolio is structured through selecting securities according to durability, return, liquidity and the investment preferences or the knowledge of the sector of interest. The prices of these securities vary and are affected by the changes of the prevailing interest rates and their specific risk factors. Investing in securities, like any other investment bear risks. However investing in bonds is a less risky form of investing than investing in stocks, especially if government and municipal bonds and bonds from profitable companies with high credit rating are bought.

Keywords
Corporate bonds, Bookkeeping records, Financial markets, Bonds, Exchange rate risk.

1. Introduction

The bonds of enterprises or the corporate bonds are long-term debt securities which are emitted by enterprises in order to gather funds for financing business activities and above all for capital investments. The corporate bonds from the perspective of the issuer is an alternative for taking a long-term loan or issuing shares. Financing with corporate bonds has its negative sides (defined costs of financing, proportion of the financial leverage and increase of the credit risk, significant expenditures within the limited time of maturity, etc.). The corporate bonds from the perspective of the investors are an alternative for investment in government bonds or stocks. They bring advantages (higher return compared to government bonds, lower risk from investing in shares, preferential payment order compared to the shares, clearly defined income, put option, convertible bonds). Of course, this kind of bonds have also their negative sides of investing (higher risk compared to the government bonds, they do not entail control over the operations of the enterprise as it is the case with the shares, they do not bring an increased income in case of good performance, call options). The interest rates on the corporate bonds can be paid in different ways: at once, along with the principal when the bond is mature or in instalments. [1]

The repayment of instalments is done in equal amounts for each defined period (bond for fixed income) although it may be in different amounts (bond with variable income). Unlike the government bonds, the corporate bonds can have fixed and variable interest. It should be pointed out that compared to all the other instruments issued by the enterprise, the bond contains a right to priority payment in respect of the holders of ordinary and priority shares. This kind of right is applied to flows (incomes) as well as to the property of the company-publisher and it refers to the total obligation of the issuer to the bond holders (principal and coupon). The corporate bonds represent, above all, a great credit instrument and they are followed by lower costs for the company than conventional loans. [2]

During the research and the treatment of the subject matter in this paper scientific research methods were applied, if we take into account the complexity of the research topic. At the beginning the method of abstraction or analysis of individual parts that affect the issue studied is used. For this purpose the following is explained accounting aspect of securities which affect the corporate governance, where corporate governance is a set of principles of the internal organization of the companies that enables effective communication among all stakeholders in a company, including shareholders, the board, managers, employees and other parties. Using the deductive method first we point out the most important i.e the main problem of the research and then we explain all the details and parts. [3] As a main goal and also an integral part of the corporate bonds are the characteristics of cooperate bonds, the subsequent measurement of investment in securities and the Impairment of the value of the securities required for a corporate management. In the last part we present the purpose of promoting the concept of corporate governance which provides an insight into the principles that help in making quality decisions concerning issues with the highest strategic importance for companies.

2. Characteristics of corporate bonds

There are two types of corporate bonds: bearer bonds or registered bonds. In the bearer bonds the coupons are tied to the bond and at the time of the payment of the coupon the owner (holder) is entitled with a payment for the coupon when submitting to the issuer. [4]

- Bearer bond - a bond with a coupon in which the owner of the bond presents the coupon to the issuer in order of interest payment due to maturing of the coupon.
- Bond to a name – when it comes to the bond to a name, the identification data of the owner are inscribed on the code of the issuer and the coupon payment is sent to the registered owner.
- Term bonds - bonds where the whole emission matures on the same date.
- Serial bonds - bonds that mature on dates that follow, with a payment of a part of the emission on each date.
- Mortgage bonds - bonds issued to finance certain projects that are at stake of issuing bonds. They are insured bonds that are issued by the issuer in order to buy a certain real estate, which then is used as collateral to secure the debt to investors. The mortgage bond allows the lender, the bond holder to acquire his right over the promised asset, leading to his legal right to sell if the obligations of the issuer to the lender are not fulfilled. The acquired right over the property in the form of a collateral, gives another opportunity to the creditor that

involves storage and management of the property. The mortgage collateral is important for the holders of mortgage bonds because it puts them into a better position ahead of other creditors.
Equipment trust certificates - bonds with a collateral in tangible property other than immovable object (eg. trains, cars, airplanes, etc.). This kind of guarantee where the equipment is the collateral compared to the real estate in a form of a mortgage has significantly greater sales value, which makes it more acceptable among investors. Many years ago the railway companies have found a very suitable way to finance their needs for equipment (locomotives, wagons, carts, etc.), indebted with lowest interest rates on the markets for corporate bonds. Because of the high standardization of the equipment fleet, it could have been used by many different railway companies, which were considered as a great insurance. [5]
Debenture - Bonds covered only by the general credit of the issuing company without insurance by any particular asset or collateral.
Subordinated debenture - are uninsured debenture that in case of liquidation of a debtor is charged with mortgage bonds and ordinary debenture. [6]

- Convertible bonds - these are bonds that can be exchanged for other securities of the company issuing as the owner of the bond wishes. These bonds have hybrid characteristics. Namely, it is a form of debt, which clause for converting is favourable to their holders, investors. They (investors) are entitled to convert the bonds into a defined number of shares.

  This feature can be used as a way of realizing capital profit, in cases when the price of the shares for which the bond is convertible at a given moment takes a high rise. The convertible or the exchangeable bonds entitle the investors to replace them for a number of ordinary shares. The replacement coefficient represents a key indicator in this form of bonds and shows how many shares are gained for a bond. The possibility for realizing capital profit based on the raise of the share prices presents the main incentive for investors to invest in these bonds.
- Callable bonds - bonds which allow the issuer to force the owners of the bonds to sell again to the issuer at a price above the nominal value (at a price of a recall). These kind of bonds contain a clause for recalling, which gives the issuer the right to buy the issued bonds in a certain period of time after their issuance, at a price that is equal or higher than their nominal value.

This clause for recalling is not acceptable for the investors, but, that is why the issuers offer higher interest rates as compensation. The use of this clause for recalling by the issuer of the previously issued bonds by their owners depends on the market movements of the interest rates. It is obvious that this will be realized only if the interest rates fall, which will initiate a rise in the price of the bond, sometimes even more than the cost of the recall, which will allow the issuer to perform revocation.
Provisions of the amortization fund – the bonds covering a claim against the publisher, he (the publisher- the issuer) should annually withdraw a certain amount of bonds.
The issuers with the corporate bond are obliged to pay the agreed coupons to the purchasers on a predetermined date and on the maturity date so to pay the principal of the bond. The coupon rate is usually fixed for the entire duration of the lifespan of the bond.
The corporate bonds are usually in the form of bonds with a fixed maturity, term bonds, ie they are valid for several years after they become payable. Mostly maturity of corporate bonds ranges from 20 to 30 years.

3. Accounting aspect of securities

The accounting treatment (the recognition and measurement / evaluation) of investment in securities is regulated by IAS 39 - Financial Instruments: Recognition and Measurement. Investing in debt and equity securities is a financial instrument and according to MS 39 in accounting it is classified according to the so-called 'Intention of management in terms of their purpose" in one of the following categories: [7]

- Financial instruments held for trading,
- Financial instruments available for sale, but not held for trading purposes and
- Financial instruments held to maturity.

The classification of investments in securities must be carried out during the acquisition / purchasing of instruments (securities) on which their accounting treatment. depends.

- Securities held for trading are those that were acquired mainly for the purpose of generating profit from short-term fluctuations of the price or the dealer network and there is an evidence / trading model for realization of profits in a short term.
- Securities available for sale - at the time of their acquisition it is not certain for what purpose they would serve i.e. whether they are going to be sold in a short term or held for sale for more than a year or held to maturity (in the case of bonds).
- Securities held to maturity are instruments with fixed or determined payments and fixed maturity for which the Company has definite intention and ability to hold them to maturity.
- The initial recognition occurs exclusively in the moment when the investor purchases the securities.
- The initial measurement of securities, regardless of their classification, is carried out according to their purchase value/cost (cost of acquisition, together with transaction costs), which is an objective (fair) value of the given compensation for the securities.

The objective value of securities can be measured reliably when:

- There is no objective quoted price for the securities in an active public market for securities (for example, the prices of all securities listed on the official and regular market are published on the website of the Macedonian Stock Exchange regularly, on a daily basis).
- The debt securities were rated by an independent rating agency and their cash flows can be reasonably estimated and
- There is an appropriate evaluation model for securities, for which the input data can be reliably measured considering the fact that they originate from active markets. Transaction costs, according to PM 13 of IAS 39 include fees and commissions which are paid to agents, consultants, brokers and dealers, agents from regulatory agencies and markets for securities (broker commission%, commission on CSD-central depository of securities 0.1% and stock exchange tax 0.1%).

3.1. Subsequent measurement of investments in securities

The securities that are held for trading are subsequently measured according to their objective value, without any kind of reduction for transaction costs that may occur at their disposal.

The securities that are available for sale are subsequently measured according to their objective value, without any kind of reduction for transaction costs that may occur at their disposal - identical to the previous ones.

The securities that are held to maturity are subsequently measured at their amortized cost using the effective interest rate method.

- Amortized cost is the amount at which they were initially recognized, reduced for repayment of the principal, but the damages from non payment were taken into account.
- The effective interest rate method is a method for calculating amortization using the effective interest rate securities, which discounts the estimated future cash payments to maturity.

The company must assess at each reporting date of the balance sheet whether there is any objective evidence of impairment (decrease) in the value of securities (higher accounting then estimated recoverable value) as a result of one or more events after initial recognition.

A detailed calculation of impairment is done in order to assess whether impairment loss (expense) should be recognized.

4. Results and Discussion

The corporate bonds mostly differ between each other in whether they are insured (collaterized) or not, which allows to classify many types of corporate bonds. Except the general creditworthiness of the issuer, the function of providing corporate bonds can be performed by the real estate property through mortgage of the issuer, as well as his personal property. So the insured corporate bonds give preference to the creditor in order to acquire ownership over the property which was pledged as security by the borrower, in case of absence of repayment. In government bonds, the first sale is performed by the central bank, which operates as an agent on the behalf of the state and that can organize an auction for that purpose. As buyers of bonds the following institutions may occur: banks, other financial institutions, businesses, even individuals, who are usually represented by intermediaries - (brokers and dealers). Further operations with government bonds can take place directly in contact with the buyers and sellers (unorganized market) or at an institutional money market. In order to start issuing corporate bonds, the company must obtain an approval from the competent authority in the country (Commission for Securities). Issuing bonds has a complex procedure. First, the volume of the capital that is planned to gather by issuing bonds and the type of bond, the interest rate, the nominal value given on the bonds and others are determined. After receiving an approval from the competent authority, the company makes a decision to issue bonds. Then, an agreement that regulates the rights of creditors and responsibilities of the user is concluded. This agreement is usually concluded with a financial organization that is selected by the issuer of the bonds and that has legal authority to represent all the current and future buyers of bonds of the company. This organization is actually a guardian (trustee). The company can carry out the first sale of bonds so that they will sell them to a financial institution or to the public, through a specialized organization (investment bank). The mediator may occur as a guarantee that the bonds will be sold, with what it takes upon itself the risk of the sale.

4.1. Example: Recording of issuing of corporate bonds

A company has a planned capital investment of EUR 10 million, but has no personal funds to carry out the investment, and does not want to borrow loans from commercial banks, so a possible source of capital is the issuance of securities - corporate bonds. For that purpose the company on 31.12.15:

- issued an emission of 10,000,000 bonds, intended for a wide audience,
- the nominal value of one bond is EUR 1
- the company will collect EUR 10 million borrowed funds
- it obliges to repay the capital in 5 years, with interest rate of 2% per year to the holders of corporate bonds,
- if the holders of corporate bonds want to "recover the invested assets" the bonds can be sold on the secondary capital market.

Booking

1000 Transaction account 10,000,000
    2850 Long-term liabilities for issued bonds 10,000,000
For the issue of 10,000,000 corporate bonds

1900 Accrued interest 600,000
    2850 Interest on bonds 600,000
Interest on issued bonds for a period of 5 years

Recording of payment of corporate bonds

2850 Long-term liabilities for bonds	2,200,000	
1000 Transaction account		2,200,000
4834 Interest on issued bonds	200,000	
1900 Accrued interest		200,000

The first installment and interest from issuing of 10,000,000 corporate bonds is paid. The interest is calculated on the residual amount of the obligation.

5. Conclusion

From this paper we can conclude that corporate bonds and their bookkeeping records are of great importance.
These are the main points derived from the analyze:

- Characteristics of corporate bonds - are described in order to understand their characteristics, where they can be characterized as bonds of the bearer or registered bonds.
- Accounting aspect of the securities - is described in order to see the accounting treatment (recognition and measurement / evaluation) of the investment in securities and the classification of investments in securities which must be carried at acquisition / purchase of instruments (securities of value).
- Subsequent measurement of investment in securities – the securities are subsequently measured at their objective value, without any reduction for transaction costs which may occur on their sale.
- Damage of the value of securities - the impairment of the value of securities is a responsibility of the company which must estimate at each reporting date of the balance sheet, whether there is any objective evidence of impairment (decrease) of the value of securities.

The bond market is composed of instruments for long - term loans and those traded on the money market. The conditions needed for development of the corporate bond market are: full acceptance of the international accounting standards, improvement of the corporate management of companies, creating credit rating agencies and decline in interest rates in the banking system. The bonds must have a maturity date – an exactly defined period in which the company must return the principal and the interest to the investors. The payoff is certain and regulated, the risk of the holders of bonds is reduced and the general situation of the company is also important, because the credit rating of the company depends on the price of corporate bonds.

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