4-4-1929

Letter from H. M. Johnstone, Librarian, Bureau of Information, American Institute of Accountants, to Niles & Niles Re: Request for Answer to Inquiry on Mortgage Bond Premium Liability.

H. M. Johnstone

American Institute of Accountants

OFFICE OF
THE LIBRARIAN

INCORPORATED UNDER THE LAWS OF THE DISTRICT OF COLUMBIA

135 CEDAR STREET, NEW YORK

April 4, 1929.

Niles & Niles,
60 Broadway,
New York, N.Y.

Gentlemen:

The Bureau of Information has received the following question:

"A corporation has sold through underwriters a mortgage bond issue of $500,000. The indenture provides for the annual retirement of $10,000 of the bonds at $105 and creates a reserve annually to provide for the premium obligation.

"The corporation has purchased in the open market $75,000 of its bonds at $95. To do so it has been necessary to borrow an equal amount at the bank and has pledged as security against the loan the $75,000 of bonds in question. Barring unforeseen circumstances, the corporation has decided not to resell the bonds purchased but they must of course be kept alive inasmuch as they are 'hocked' to secure a loan.

"Should the bonds so purchased be carried at cost or par?

"In any event, isn't there an immediate realization of a five point profit on each bond and should it not be reflected in profits at the time of purchase?

"Inasmuch as the bank loan is a current liability, shouldn't pledged bonds be carried as a current asset?

"Until the bonds are cancelled there is the legal obligation to the trustees that an adequate reserve be created annually to provide for the premium factor at date of actual redemption. This is now being done and it applies also to bonds purchased. So much of the reserve applicable to the bonds purchased is, however, ineffective and consequently sets up an over-stated liability.

Niles & Niles 4/4/29.

"What entry, if any, is required to equalize the bond premium liability that in effect is cancelled when the bonds are purchased? Bear in mind the legal necessity for carrying the reserve provisions until it has been proved to the satisfaction of the trustees that the bonds so purchased have actually been cancelled."

If you can supply an answer to the above inquiry, it will be of assistance in the work of the Bureau of Information.

Very truly yours,

H. M. Johnstone

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HMJ:EP Librarian.