

### III. PROMISSORY NOTES RECEIVABLE

Customers who can't pay trade credit as scheduled are often asked to sign a note making the liability more formal. Interest is often charged and should the company extending credit need funds, the Note Receivable can be discounted (sold) to a bank.

Google "Software Tutorial Internet Library" for help learning many software packages.

#### ACCOUNTING FOR NOTES RECEIVABLE

Sold \$1,000 worth of merchandise to X Company on November 8, 1996. On December 8, X Company was unable to pay and signed a 90-day, 8%, \$1,000 note. If the note was paid when due, the following would have occurred:

|  | DR.      | CR.      |
|--|----------|----------|
| Nov. 8 Accounts Receivable                               | 1,000.00 |          |
| Sales  |          | 1,000.00 |
| READ FIRST --> To record sale to X Company.              |          |          |
| Dec. 8 Notes Receivable                                  | 1,000.00 |          |
| Accounts Receivable                                      |          | 1,000.00 |
| Note Receivable accepted for trade receivable due today. |          |          |
| Dec. 31 Interest Receivable                              | 5.11     |          |
| Interest Earned  |          | 5.11     |
| To adjust for interest earned.                           |          |          |
| March 8 Cash   | 1,020.00 |          |
| Interest Receivable                                      |          | 5.11     |
| Interest Earned (\$20.00 - \$5.11)                       |          | 14.89    |
| Notes Receivable   |          | 1000.00  |
| Collected note from X Company.                           |          |          |

| Ledger   |
|--|
| P = Principal<br>i = interest/year<br>n = time in years<br>I = Interest Earned |
| <b>Calculating Accrued Interest</b><br>on December 31, 1996                    |
| I = Pin<br>I = (\$1000) (.08) (23/360)<br>I = \$5.11                           |
| <b>Calculate Total Interest Due</b>  |
| I = Pin<br>I = (\$1000) (.08) (90/360)<br>I = \$20                             |

#### REVERSING ENTRY ALTERNATIVE

|                                |          |          |
|--------------------------------|----------|----------|
| Jan. 2 Interest Earned         | 5.11     |          |
| Interest Receivable            |          | 5.11     |
| To reverse adjusting entry.    |          |          |
| March 8 Cash                   | 1,020.00 |          |
| Interest Earned                |          | 20.00    |
| Note Receivable                |          | 1,000.00 |
| Collected note from X Company. |          |          |

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#### DISCOUNTING THE NOTE RECEIVABLE

Assume the above did not happen. On January 7, Darin's Music Emporium needed cash and discounted the X Company \$1,000 Note Receivable with B Bank which charged 12% interest. In effect they sold the note to B Bank. The Emporium received the value of the note (Face plus interest) minus bank interest charges from the discount date to the maturity date.

| DISCOUNT PERIOD       |           | DISCOUNT CHARGE   |
|-----------------------|-----------|---|
| Note Term             | 90 Days   |   |
| Time held by Darin's  |           | I = Pin   |
| Days in December      | 31        | I = (\$1020) (.12) (60/360)                                   |
| Date on Note          | <u>8</u>  | I = \$20.40   |
| Days held in December | 23        |   |
| Days in January       | <u>7</u>  |   |
| Days held by Darin's  | <u>30</u> | Note: The 60-day 6% rule applies. Move two places and double. |
| Discount Period       | 60        |   |

|  |        |          |
|--|--------|----------|
| Jan. 7 Cash (\$1020 - \$20.40)             | 999.60 |          |
| Interest Expense (\$5.11 + \$.40)          |        | 5.51     |
| Interest Receivable                        |        | 5.11     |
| Note Receivable                            |        | 1,000.00 |
| To discount X Co. Note for 60 days at 12%. |        |          |

Google "Statistics Internet Library" for free help learning Statistics

Note: Darin's Music Emporium was contingently liable for the debt of X Co. with Bank B. Should X Co. default, Darin would assume the debt. In addition, the high discount rate (12% vs. 8%) and long discount period of 60 days vs. the 30 days Darin held the note, resulted in an interest expense of \$5.51.