

Notes Payable and Receivable

BEFORE
You

READ

What You'll Learn

1. Explain how businesses use promissory notes.
2. Calculate and record notes payable and notes receivable.
3. Explain the difference between interest-bearing and non-interest-bearing notes.
4. Journalize transactions involving notes payable.
5. Journalize transactions involving notes receivable.
6. Define the accounting terms introduced in this chapter.

Why It's Important

- Businesses often borrow and lend money.



Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

Exploring the *Real World* of Business

EVALUATING NOTES

Advanced Micro Devices

When Hector Ruiz took over as Chief Executive Officer of **Advanced Micro Devices (AMD)**, his work was cut out for him. Competition from Intel was fierce, and sales were down. From his start in a research lab at Texas Instruments to president of Motorola's Semiconductor Products Sector, Ruiz was known for profitable operations in the ever-changing semiconductor industry.

Believing the time was right for expansion, Ruiz began building AMD's newest "fab" (manufacturing facility) in Dresden, Germany. Fab 36 was expected to cost \$2.4 billion over four years.

Companies like **AMD** often issue notes for cash needs. Fab 36's funding is from bank loans, grants from the Federal Republic of Germany, and company equity.

What Do You Think?

When a bank loans money to a company like **Advanced Micro Devices**, what factors do you think it considers?



Working in the *Real World*

APPLYING YOUR ACCOUNTING KNOWLEDGE

Have you or your parents ever bought a new or used car? Chances are you made a down payment and then signed a note payable for the rest of the purchase price. When businesses buy costly items, such as manufacturing equipment or even an office building, they also sign a note payable. In this chapter you will learn how to calculate the interest on a business note and record the total amount payable.

Personal Connection

Have you noticed any items that your employer purchased that required signing a note payable? This could include purchases like equipment, buildings, vehicles, or land.

Online Connection

Go to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Working in the Real World** and select **Chapter 26**.





SECTION I

Promissory Notes

**BEFORE
YOU**

READ

Main Idea

The formula for calculating interest is
Principal \times Interest Rate \times Time.

Read to Learn...

- how promissory notes are used. (p. 752)
- how to calculate the interest on a note (p. 754)

Key Terms

promissory note	payee
note payable	interest rate
note receivable	maturity date
principal	maker
face value	interest
term	maturity value
issue date	

Many people sign a note to pay for the purchase of a vehicle over a certain period of time. The note may be with a company like Ford Motor Credit or a financial institution. In this chapter you will learn about notes payable and notes receivable.

A Promise to Pay

What Is a Promissory Note?

A **promissory note**, often shortened to *note*, is a written promise to pay a certain amount of money at a specific time. Promissory notes are formal documents that are evidence of credit granted or received. Laws require a promissory note to contain certain information as shown in **Figure 26–1**.

Notes Payable and Notes Receivable

A **note payable** is a promissory note that a business issues to a creditor when it borrows or buys on credit. A **note receivable** is a promissory note that a business accepts from a credit customer.

Principal or Face Value—amount being borrowed

Term of note—amount of time the borrower has to repay the note

Issue Date—date on which a note is written

Payee—person or business to which payment will be made

Interest Rate—fee charged for use of money; stated as a percentage of the principal

Maturity Date—due date of the note

Maker—the person or business promising to repay the principal and interest

NOTE 42

Date Sept. 14 20--

\$ 2,500.00

Ninety days after date I promise to pay to

Athletic Equipment Inc. the sum of

Two thousand five hundred dollars with interest at the rate of

11.5% per year.

Due date December 13, 20--

Michael Brown

Figure 26–1 Promissory Note

The Maturity Date of a Note

When a note is signed, the maker of the note agrees to repay the amount of the note within a certain period of time, usually stated in days, months, or years. This time period is the **term** of the note. Both the term and the **issue date** (date on which the note is signed) are needed to determine the **maturity date** (due date) of a note.

In the note in **Figure 26–1**, Michael Brown, manager of On Your Mark Athletic Wear, agreed to pay Athletic Equipment Inc. the principal plus interest 90 days from September 14. To determine the maturity date:

- | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|--|---------|--------------|-----------|---------------|---------|--------------|-------|--|---------|--------------|-----------|--------------|---------|-----------|-------|--|---------|--|-----------|------------|---------|-----------|-------|--|---------|--|-----------|-------------|---------|-----------|
| <p>1. Determine the number of days remaining in the month in which the note is issued. No interest is charged for the issue date, so subtract the date of the note from the number of days in the month.</p> <hr/> <p>2. Determine the number of days remaining after the first month. To do this subtract the number of days calculated in Step 1 from the term of the note.</p> <hr/> <p>3. Subtract the number of days in the next month (October) from the number of days remaining after Step 2.</p> <hr/> <p>4. Subtract the number of days in the next month (November) from the days remaining after Step 3.</p> <hr/> <p>5. Since there are only 13 days remaining, the due date is 13 days into the next month (December).</p> | <table border="0"> <tr> <td style="text-align: right;">30 days</td> <td style="text-align: right;">in September</td> </tr> <tr> <td style="text-align: right;">– 14 days</td> <td style="text-align: right;">issue date is</td> </tr> <tr> <td style="text-align: right;">16 days</td> <td style="text-align: right;">September 14</td> </tr> <tr> <td colspan="2"><hr/></td> </tr> <tr> <td style="text-align: right;">90 days</td> <td style="text-align: right;">term of note</td> </tr> <tr> <td style="text-align: right;">– 16 days</td> <td style="text-align: right;">in September</td> </tr> <tr> <td style="text-align: right;">74 days</td> <td style="text-align: right;">remaining</td> </tr> <tr> <td colspan="2"><hr/></td> </tr> <tr> <td style="text-align: right;">74 days</td> <td></td> </tr> <tr> <td style="text-align: right;">– 31 days</td> <td style="text-align: right;">in October</td> </tr> <tr> <td style="text-align: right;">43 days</td> <td style="text-align: right;">remaining</td> </tr> <tr> <td colspan="2"><hr/></td> </tr> <tr> <td style="text-align: right;">43 days</td> <td></td> </tr> <tr> <td style="text-align: right;">– 30 days</td> <td style="text-align: right;">in November</td> </tr> <tr> <td style="text-align: right;">13 days</td> <td style="text-align: right;">remaining</td> </tr> </table> | 30 days | in September | – 14 days | issue date is | 16 days | September 14 | <hr/> | | 90 days | term of note | – 16 days | in September | 74 days | remaining | <hr/> | | 74 days | | – 31 days | in October | 43 days | remaining | <hr/> | | 43 days | | – 30 days | in November | 13 days | remaining |
| 30 days | in September | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| – 14 days | issue date is | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 16 days | September 14 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <hr/> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 90 days | term of note | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| – 16 days | in September | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 74 days | remaining | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <hr/> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 74 days | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| – 31 days | in October | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 43 days | remaining | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <hr/> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 43 days | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| – 30 days | in November | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| 13 days | remaining | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
- The due date for this note is December 13.

Some businesses and banks use time calendars to calculate a note's maturity date. **Figure 26–2** on page 754 shows an example of a time calendar. The time calendar has two sets of days: (1) the day of the month (left and right columns), and (2) the day of the year, by month (middle column).

To calculate a maturity date using the time calendar, follow these steps:

1. Locate the issue date of the note (for example, 14) in the Day of month column. Move across the month columns to the issue month (September). In our example September 14 is the 257th day of the year.
2. Add the number of days in the term of the note (90) to the day of the year. The sum of the two numbers is 347 (257 + 90).
3. Find the number 347 in the month columns. The 347th day of the year is in December. The maturity month is December. Move across to the Day of month column. The 347th day of the year corresponds to the 13th day of the month. The due date of the note is December 13.

As You READ

Key Point

Number of Days in Months

January, March, May, July, August, October, and December have 31 days.

April, June, September, and November have 30 days.

February has 28 days (29 days in a leap year).

As You READ

In Your Own Words

Maker and Payee

Explain who the maker and the payee of a note are.

Day of month	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Day of month
1	1	32	60	91	121	152	182	213	244	274	305	335	1
2	2	33	61	92	122	153	183	214	245	275	306	336	2
3	3	34	62	93	123	154	184	215	246	276	307	337	3
4	4	35	63	94	124	155	185	216	247	277	308	338	4
5	5	36	64	95	125	156	186	217	248	278	309	339	5
6	6	37	65	96	126	157	187	218	249	279	310	340	6
7	7	38	66	97	127	158	188	219	250	280	311	341	7
8	8	39	67	98	128	159	189	220	251	281	312	342	8
9	9	40	68	99	129	160	190	221	252	282	313	343	9
10	10	41	69	100	130	161	191	222	253	283	314	344	10
11	11	42	70	101	131	162	192	223	254	284	315	345	11
12	12	43	71	102	132	163	193	224	255	285	316	346	12
13	13	44	72	103	133	164	194	225	256	286	317	347	13
14	14	45	73	104	134	165	195	226	257	287	318	348	14
15	15	46	74	105	135	166	196	227	258	288	319	349	15
16	16	47	75	106	136	167	197	228	259	289	320	350	16
17	17	48	76	107	137	168	198	229	260	290	321	351	17
18	18	49	77	108	138	169	199	230	261	291	322	352	18
19	19	50	78	109	139	170	200	231	262	292	323	353	19
20	20	51	79	110	140	171	201	232	263	293	324	354	20
21	21	52	80	111	141	172	202	233	264	294	325	355	21
22	22	53	81	112	142	173	203	234	265	295	326	356	22
23	23	54	82	113	143	174	204	235	266	296	327	357	23
24	24	55	83	114	144	175	205	236	267	297	328	358	24
25	25	56	84	115	145	176	206	237	268	298	329	359	25
26	26	57	85	116	146	177	207	238	269	299	330	360	26
27	27	58	86	117	147	178	208	239	270	300	331	361	27
28	28	59	87	118	148	179	209	240	271	301	332	362	28
29	29	...	88	119	149	180	210	241	272	302	333	363	29
30	30	...	89	120	150	181	211	242	273	303	334	364	30
31	31	...	90	...	151	...	212	243	...	304	...	365	31

NOTE: For leap years, after February 28, the number of the day is one greater than that given in the table.

Figure 26–2 Time Calendar

Calculation of Interest on a Note

How Do You Calculate Interest on a Note?

Interest is the fee charged for the use of money. The **interest rate** is the interest stated as a percentage of the principal. The interest on a promissory note is based on three factors: *principal*, *interest rate*, and *term of the note*.

Calculating Interest Using a Formula

The formula used to calculate interest follows:

$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \text{Time}$$

Interest rates are usually stated on an annual basis, that is, on a borrowing period of one year. To find the interest on a one-year promissory note, multiply the principal by the interest rate. The interest on an 11.5%, one-year \$2,500 promissory note is \$287.50 ($\$2,500 \times .115 = \287.50).

If the term of a promissory note is less than one year, the time in the calculation is expressed as a fraction of one year. The fraction may be stated in days or months. For example, on September 14 On Your Mark signed a note for \$2,500 at 11.5% interest for 90 days. Since the term

Connect to... ECONOMICS

Napoleon created the Bank of France in 1800 to control inflation and high prices. He required every citizen to pay taxes. The government used the taxes to make loans to businesses, which created jobs for the middle class. This policy made Napoleon popular.

of the note is expressed in days, 365 days is used as the denominator of the time fraction. The interest is calculated as follows:

$$\begin{array}{rccccccccc} \text{Principal} & \times & \text{Interest Rate} & \times & \text{Time} & = & \text{Interest} \\ \$2,500 & \times & .115 & \times & 90/365 & = & \$70.89 \end{array}$$

The interest on the note shown in Figure 26–1 on page 752 is \$70.89.

On the maturity date, On Your Mark will repay the maturity value of the note. **Maturity value** is the amount due at the due date. In our example the maturity value is \$2,570.89 (\$2,500.00 + \$70.89).

If the term of this note had been three months instead of 90 days, the denominator of the time fraction would be 12. The interest would be calculated as follows:

$$\begin{array}{rccccccccc} \text{Principal} & \times & \text{Interest Rate} & \times & \text{Time} & = & \text{Interest} \\ \$2,500 & \times & .115 & \times & 3/12 & = & \$71.88 \end{array}$$

The maturity value would be \$2,571.88 (\$2,500.00 + \$71.88).

Calculating Interest Using an Interest Table

To calculate interest, businesses and banks often use an interest table similar to the one in Figure 26–3. We use On Your Mark’s note to illustrate.

- Find the term of the note in the Day column, 90.
- Follow the row across until you reach the column for the interest rate, 11.5%. Where the Day row and the Interest column meet is a factor, 2.835616. The factor is based on a principal amount of \$100.
- Divide the principal of the note by 100. The result is 25 (\$2,500 ÷ 100).
- Multiply the result by the factor to find the interest. The interest is \$70.89 (25 × 2.835616).

In this example the interest calculated using both the equation and the interest table are the same. Sometimes small differences occur due to rounding.

SIMPLE INTEREST ON \$100 (365 DAY BASIS)											
DAY	11.50 % INTEREST	DAY	11.75 % INTEREST	DAY	12.00 % INTEREST	DAY	12.25 % INTEREST	DAY	12.50 % INTEREST	DAY	12.75 % INTEREST
30	0.945205	30	0.965753	30	0.986301	30	1.006849	30	1.027397	30	1.047945
60	1.890411	60	1.931507	60	1.972603	60	2.013699	60	2.054795	60	2.095890
90	2.835616	90	2.897260	90	2.958904	90	3.020548	90	3.082192	90	3.143836
120	3.780822	120	3.863014	120	3.945205	120	4.027397	120	4.109589	120	4.191781
150	4.726027	150	4.828767	150	4.931507	150	5.034247	150	5.136986	150	5.239726
180	5.671233	180	5.794521	180	5.917808	180	6.041096	180	6.164384	180	6.287671
210	6.616438	210	6.760274	210	6.904110	210	7.047945	210	7.191781	210	7.335616
240	7.561644	240	7.726027	240	7.890411	240	8.054795	240	8.219178	240	8.383562
270	8.506849	270	8.691781	270	8.876712	270	9.061644	270	9.246575	270	9.431507
300	9.452055	300	9.657534	300	9.863014	300	10.068493	300	10.273973	300	10.479452
330	10.397260	330	10.623288	330	10.849315	330	11.075342	330	11.301370	330	11.527397
360	11.342466	360	11.589041	360	11.835616	360	12.082192	360	12.328767	360	12.575342
365	11.500000	365	11.750000	365	12.000000	365	12.250000	365	12.500000	365	12.750000
366	11.531507	366	11.782192	366	12.032877	366	12.283562	366	12.534247	366	12.784932

Figure 26–3 Interest Table

As You

READ

Key Point

Interest Rates Interest rates are stated for a period of one year. To calculate interest on a note signed for a period of less than one year, express the term of the note as a fraction of one year.

AFTER
You

READ

Reinforce the Main Idea

Using a chart like this, describe the step-by-step procedure for determining the maturity value of a promissory note.

Determining the Maturity Value of a Promissory Note

↓
↓
↓

**Do the Math**

Marty Herick is the owner of CyberAction, a new computer-game store. Marty has just signed a promissory note with Excelsior Bank. He plans to use the loan to purchase and update his computer-game inventory. Using the formula, what is the interest on the \$20,000, 90-day note with a 10.5% interest rate? What is the maturity value?

**Problem 26-1 Calculating Interest and Finding Maturity Values**

Instructions Using the formula, compute the interest and maturity values for each of the following notes. Record your answers in your working papers. Use the interest table to check your computations.

	Principal	Interest Rate	Term
1.	\$ 4,000	11.5%	60 days
2.	10,000	11.75%	90 days
3.	6,500	12.75%	60 days
4.	900	12.25%	120 days

**Problem 26-2 Calculating Interest**

Instructions Calculate the interest for each of the following notes. Record your answers in your working papers.

	Principal	Interest Rate	Term
1.	\$ 600	15%	90 days
2.	3,500	12%	60 days
3.	9,600	9%	4 months
4.	2,500	10%	180 days



SECTION 2

Notes Payable

In this section you will journalize transactions involving notes payable. Recall that a note payable is a promissory note issued to a creditor. For example, a business may issue a note payable to borrow money from a bank. Notes that a business issues are recorded in the **Notes Payable** account. **Notes Payable** is a liability account; its normal balance is a credit. When the due date of a note extends beyond one year, the note is classified as a *long-term liability*.

Long-term liabilities are debts that become due after one year.

Businesses frequently issue two types of notes: interest-bearing notes and non-interest-bearing notes. We consider both types of notes in this section.

Interest-Bearing Notes Payable

What Is an Interest-Bearing Note Payable?

A note that requires the principal plus interest to be paid on the maturity date is called an **interest-bearing note payable**. The note issued by On Your Mark (in Section 1) is an interest-bearing note. Its maturity value is \$2,570.89 (\$2,500.00 principal + \$70.89 interest).

Recording the Issuance of an Interest-Bearing Note Payable

Let's record On Your Mark's interest-bearing note payable as an example.

Business Transaction

On April 3 On Your Mark borrowed \$7,000 from State Street Bank and issued a 90-day, 12% note payable to the bank, Note 6.

ANALYSIS

**Identify
Classify**
+/-

1. The accounts affected are **Cash in Bank** and **Notes Payable**.
2. **Cash in Bank** is an asset account. **Notes Payable** is a liability account.
3. **Cash in Bank** is increased by \$7,000. **Notes Payable** is increased by \$7,000.

**BEFORE
YOU**

READ

Main Idea

Businesses issue and accept two types of notes: interest-bearing notes and non-interest-bearing notes.

Read to Learn...

- what an interest-bearing promissory note is. (p. 757)
- why a "non-interest-bearing" note does have interest expense. (p. 759)

Key Terms

long-term liabilities
interest-bearing note payable
non-interest-bearing note payable
bank discount
proceeds
other expense

DEBIT-CREDIT RULE

4. Increases to asset accounts are recorded as debits. Debit **Cash in Bank** for \$7,000.
5. Increases to liability accounts are recorded as credits. Credit **Notes Payable** for \$7,000.

T ACCOUNTS

6. Cash in Bank		Notes Payable	
Debit + 7,000	Credit —	Debit —	Credit + 7,000

JOURNAL ENTRY

7. GENERAL JOURNAL						
						PAGE 12
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--					1
2	Apr. 3	Cash in Bank		7 000 00		2
3		Notes Payable			7 000 00	3
4		Note 6				4
5						5

Recording the Payment of an Interest-Bearing Note Payable

The maturity date of On Your Mark's note payable to State Street Bank is July 2. You can verify this by using the time calendar in **Figure 26–2** on page 754. The interest is \$207.12, calculated as follows:

$$\begin{array}{rclclcl} \text{Principal} & \times & \text{Interest Rate} & \times & \text{Time} & = & \text{Interest} \\ \$7,000 & \times & .12 & \times & 90/365 & = & \$207.12 \end{array}$$

The maturity value of the note is \$7,207.12 (\$7,000.00 principal + \$207.12 interest).

Business Transaction

On July 2 On Your Mark issued Check 3892 for \$7,207.12 payable to State Street Bank in payment of the note payable issued April 3.

ANALYSIS**Identify****Classify****+/-**

1. The accounts affected are **Notes Payable**, **Interest Expense**, and **Cash in Bank**.
2. **Notes Payable** is a liability account. **Interest Expense** is an expense account. **Cash in Bank** is an asset account.
3. **Notes Payable** is decreased by \$7,000. **Interest Expense** is increased by \$207.12. **Cash in Bank** is decreased by \$7,207.12.

DEBIT-CREDIT RULE

- Decreases to liability accounts are recorded as debits. Debit **Notes Payable** for \$7,000. Increases to expense accounts are recorded as debits. Debit **Interest Expense** for \$207.12.
- Decreases to asset accounts are recorded as credits. Credit **Cash in Bank** for \$7,207.12.

T ACCOUNTS

6. Notes Payable		Cash in Bank	
Debit — 7,000	Credit + 	Debit + 	Credit — 7,207.12
Interest Expense			
Debit + 207.12	Credit — 		

JOURNAL ENTRY

7. GENERAL JOURNAL							PAGE 22
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
1	20--						1
2	July 2	Notes Payable		7 000 00			2
3		Interest Expense		207 12			3
4		Cash in Bank			7 207 12		4
5		Check 3892					5

Non-Interest-Bearing Notes Payable

How Is Interest Paid on a Non-Interest-Bearing Note?

Sometimes a bank requires a borrower to pay the interest on a note in advance. On the issue date, the bank deducts the interest from the face value of the note. This reduces the amount of money the borrower receives. When interest is deducted in advance from the face value of the note, the note is called a **non-interest-bearing note payable**. The note is “non-interest-bearing” because no interest rate is stated on the note. The interest deducted in advance is called the **bank discount**. The interest rate used to calculate the bank discount is called the *discount rate*. The cash received by the borrower is called the **proceeds**. The proceeds equal the face value of the note minus the bank discount.

For a non-interest-bearing note payable, the maturity value is the same as the face value. This is because the interest is deducted from the face value on the issue date. **Figure 26–4** on page 760 shows an example of a non-interest-bearing note payable.



Figure 26–4 Non-Interest-Bearing Note Payable

	NOTE <u>13</u>	
\$ <u>1,500.00</u>	Date <u>June 12</u> 20 <u>--</u>	
<u>Ninety days</u> after date I promise to pay to		
<u>First Federal Bank</u> the sum of		
<u>One thousand five hundred</u> dollars.		
Due date <u>September 10, 20--</u>		
<u>Michael Brown</u>		

Calculating Non-Interest-Bearing Notes Payable

Let's calculate the proceeds of the non-interest-bearing note payable shown in **Figure 26–4**. The note was discounted at a rate of 12% by First Federal Bank, Note 13.

The first step in calculating the proceeds on a non-interest-bearing note is to calculate the bank discount. This is the interest on the note. (Notice that the formula is similar to the one used to compute interest on an interest-bearing note.)

$$\begin{array}{rccccccc} \text{Face Value} & \times & \text{Discount Rate} & \times & \text{Time} & = & \text{Bank Discount} \\ \$1,500 & \times & .12 & \times & 90/365 & = & \$44.38 \end{array}$$

The bank discount is subtracted from the face value of the note to determine the proceeds. The proceeds are \$1,455.62 (\$1,500.00 – \$44.38).

Recording the Issuance of a Non-Interest-Bearing Note Payable

The bank discount is recorded in a contra liability account called **Discount on Notes Payable**. The normal balance of **Discount on Notes Payable** is a debit. The bank discount is the future interest expense on the note. However, the bank discount is not recorded in an expense account until the note matures and the interest expense has been incurred.

Now that we calculated the discount, let's record the issuance of the non-interest-bearing note for On Your Mark.

Business Transaction

On June 12 On Your Mark signed a \$1,500, 90-day non-interest-bearing note payable that First Federal Bank discounted at a rate of 12%, Note 13.

ANALYSIS *Identify*

Classify

+/-

1. The accounts affected are **Cash in Bank**, **Discount on Notes Payable**, and **Notes Payable**.
2. **Cash in Bank** is an asset account. **Discount on Notes Payable** is a contra liability account. **Notes Payable** is a liability account.
3. **Cash in Bank** is increased by \$1,455.62. **Discount on Notes Payable** is increased by \$44.38. **Notes Payable** is increased by \$1,500.00.

DEBIT-CREDIT RULE

4. Increases to asset accounts are recorded as debits. Debit **Cash in Bank** for \$1,455.62. Increases to contra liability accounts are recorded as debits. Debit **Discount on Notes Payable** for \$44.38.
5. Increases to liability accounts are recorded as credits. Credit **Notes Payable** for \$1,500.00.

T ACCOUNTS

6. Cash in Bank		Notes Payable	
Debit + 1,455.62	Credit —	Debit —	Credit + 1,500.00
Discount on Notes Payable			
Debit + 44.38	Credit —		

JOURNAL ENTRY

7. GENERAL JOURNAL							PAGE 20
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
1	20--						1
2	June 12	Cash in Bank		1 455 62			2
3		Discount on Notes Payable		44 38			3
4		Notes Payable			1 500 00		4
5		Note 13					5
6							6

Businesses report the **Discount on Notes Payable** account on the balance sheet as a deduction from **Notes Payable**. The difference between the **Notes Payable** account and the **Discount on Notes Payable** account is the book value of notes payable. **Figure 26–5** shows the Liabilities section of the balance sheet for On Your Mark on June 30. It shows that the book value of notes payable is \$1,455.62 (\$1,500 – \$44.38).

On Your Mark Athletic Wear											
Balance Sheet											
June 30, 20--											
Liabilities											
Notes Payable									1	500	00
Less: Discount on Notes Payable									44	38	
									1	455	62

Figure 26–5 Reporting Non-Interest-Bearing Notes Payable on the Balance Sheet

As You READ

Compare and Contrast

Types of Notes Payable

How is an interest-bearing note payable similar to a non-interest-bearing note payable? How are they different?

Recording the Payment of a Non-Interest-Bearing Note Payable

When the non-interest-bearing note payable matures and is due, On Your Mark will

- pay First Federal Bank \$1,500, the face value of the note, and
- record the interest expense by transferring the bank discount to interest expense.

We will look at each of these individually and as a compound journal entry.

Business Transaction

On September 10 On Your Mark issued Check 4241 for \$1,500 to First Federal Bank in payment of the June 12 non-interest-bearing note payable.

ANALYSIS

Identify
Classify

+/-

1. The accounts affected are **Notes Payable** and **Cash in Bank**.
2. **Notes Payable** is a liability account. **Cash in Bank** is an asset account.
3. **Notes Payable** is decreased by \$1,500. **Cash in Bank** is decreased by \$1,500.

DEBIT-CREDIT RULE

4. Decreases to liability accounts are recorded as debits. Debit **Notes Payable** for \$1,500.
5. Decreases to asset accounts are recorded as credits. Credit **Cash in Bank** for \$1,500.

T ACCOUNTS

Notes Payable		Cash in Bank	
Debit	Credit	Debit	Credit
—	+	+	—
1,500			1,500

JOURNAL ENTRY

GENERAL JOURNAL						PAGE 42
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--					1
2	Sept. 10	Notes Payable		1 500 00		2
3		Cash in Bank			1 500 00	3
4		Check 4241				4
5						5

When a non-interest-bearing note payable matures, the amount of the bank discount is recognized as an expense. The bank discount is transferred from the **Discount on Notes Payable** account to the **Interest Expense** account. As the following T accounts demonstrate, **Interest Expense** is debited for \$44.38 and **Discount on Notes Payable** is credited for \$44.38. When this transaction is recorded, the balance of the **Discount on Notes Payable** account is reduced to zero.

Interest Expense		Discount on Notes Payable	
Debit	Credit	Debit	Credit
+	—	+	—
9/10 44.38		6/12 44.38	9/10 44.38

You could record two separate journal entries:

1. the payment of the non-interest-bearing note payable (in the cash payments journal), then
2. the interest expense (in the general journal)

It is simpler, however, to prepare one compound entry in the general journal as shown.

GENERAL JOURNAL						PAGE 43
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--					1
2	Sept. 10	Notes Payable		1 500 00		2
3		Interest Expense		44 38		3
4		Cash in Bank			1 500 00	4
5		Discount on Notes Payable			44 38	5
6		Check 4241				6
7						7

The **Interest Expense** account is classified as an other expense account. An **other expense** is a nonoperating expense. This means that the expense does not result from the normal operations of the business. Other expenses appear in a separate section on the income statement, as deductions from operating income.



AFTER
You

READ

Reinforce the Main Idea

Create a table similar to this one to list three facts about the types of notes covered in this section.

Type of Note	Fact #1	Fact #2	Fact #3

**Do the Math**

Franklin Enterprises can borrow \$10,000 for 30 days at 5% at the Jefferson City Bank or \$10,000 for 45 days at 4.5% at Lincoln National Bank. Answer the following questions.

1. Which bank note results in the least amount of interest expense?
2. How much in interest expense can be saved?

**Problem 26-3 Recording the Issuance of an Interest-Bearing Note Payable**

On June 12 Frank's Lobster Pound issued a \$9,000, 120-day, 12% note payable to American Bank of Commerce.

1. Which account is debited? What is the debit amount?
2. Which account is credited? What is the credit amount?
3. What is the classification of each account?
4. What is the maturity value of the note?

**Problem 26-4 Recording the Issuance of a Non-Interest-Bearing Note Payable**

On October 14 Canton Car Care Center issued a \$10,000, 60-day, 12% non-interest-bearing note payable to Canton National Bank.

1. Which accounts are debited and which are credited? What are the debit and credit amounts?
2. Compute the bank discount. What is the amount of the proceeds?



SECTION 3

Notes Receivable

In this section you will journalize transactions involving notes receivable. If you have ever loaned someone money and asked the person to repay the loan by a specific date, you understand the basic concept of a note receivable. Sometimes such a loan includes payment of a specified amount of interest; other times no interest is expected.

Recording the Receipt of a Note Receivable

How Do You Convert an Account Receivable to a Note Receivable?

When a customer needs additional time to pay an account receivable, he or she may be asked to sign a promissory note. The note replaces the account receivable. Promissory notes that a business accepts from customers are called *notes receivable*.

Notes Receivable is an asset account, and its normal balance is a debit. A note receivable is due on a specific date and carries an interest charge for the term of the note.

The interest earned on a note receivable is recorded in the **Interest Income** account. **Interest Income** is an other revenue account. **Other revenue**, also known as *nonoperating revenue* accounts, track revenue that a business receives from activities other than its normal operations. Other revenue appears in a separate section on the income statement, as an increase to operating income.

BEFORE YOU READ

Main Idea

Businesses record the receipt of a note receivable as well as the payment of the note.

Read to Learn...

- how to record a note receivable. (p. 765)
- how to record the payment of a note receivable. (p. 766)

Key Terms

other revenue

Business Transaction

On March 1 On Your Mark sold \$1,750 of merchandise on account to Joe Dimaio. That transaction was recorded in On Your Mark's sales journal. Joe cannot pay his account by the due date. On April 8 On Your Mark received a 60-day, 12.5% note dated April 6 for \$1,750 from Joe Dimaio to settle the account receivable, Note 4.

ANALYSIS Identify

Classify

+/-

1. The accounts affected are **Notes Receivable**, **Accounts Receivable** (controlling), and **Accounts Receivable—Joe Dimaio** (subsidiary).
2. **Notes Receivable**, **Accounts Receivable** (controlling), and **Accounts Receivable—Joe Dimaio** (subsidiary) are asset accounts.
3. **Notes Receivable** is increased by \$1,750. **Accounts Receivable** (controlling) and **Accounts Receivable—Joe Dimaio** (subsidiary) are decreased by \$1,750.

DEBIT-CREDIT RULE

- Increases to asset accounts are recorded as debits. Debit **Notes Receivable** for \$1,750.
- Decreases to asset accounts are recorded as credits. Credit **Accounts Receivable** (controlling) for \$1,750. Also credit **Accounts Receivable—Joe Dimaio** (subsidiary) for \$1,750.

T ACCOUNTS

6.

Notes Receivable		Accounts Receivable	
Debit +	Credit —	Debit +	Credit —
1,750			1,750

Accounts Receivable Subsidiary Ledger
Accounts Receivable—Joe Dimaio

Debit +	Credit —
	1,750

JOURNAL ENTRY

7.

GENERAL JOURNAL						PAGE 13
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--					1
2	Apr. 8	Notes Receivable		1 750 00		2
3		Accts. Rec./Joe Dimaio			1 750 00	3
4		Note 4				4

Recording the Payment of a Note Receivable

How Do You Record Payment of a Note?

The note from Joe Dimaio is due on June 5. The maturity value of the note is \$1,785.96 (\$1,750.00 principal + \$35.96 interest).

$$\begin{array}{rclclcl} \text{Principal} & \times & \text{Interest Rate} & \times & \text{Time} & = & \text{Interest} \\ \$1,750 & \times & .125 & \times & 60/365 & = & \$35.96 \end{array}$$

Business Transaction

On June 7 On Your Mark received a check dated June 5 for \$1,785.96 from Joe Dimaio in payment of the \$1,750 note of April 6 plus interest of \$35.96, Receipt 996.

JOURNAL ENTRY

GENERAL JOURNAL						PAGE 18
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	20--					1
2	June 7	Cash in Bank		1 785 96		2
3		Notes Receivable			1 750 00	3
4		Interest Income			35 96	4
5		Receipt 996				5

AFTER
You READ

Reinforce the Main Idea

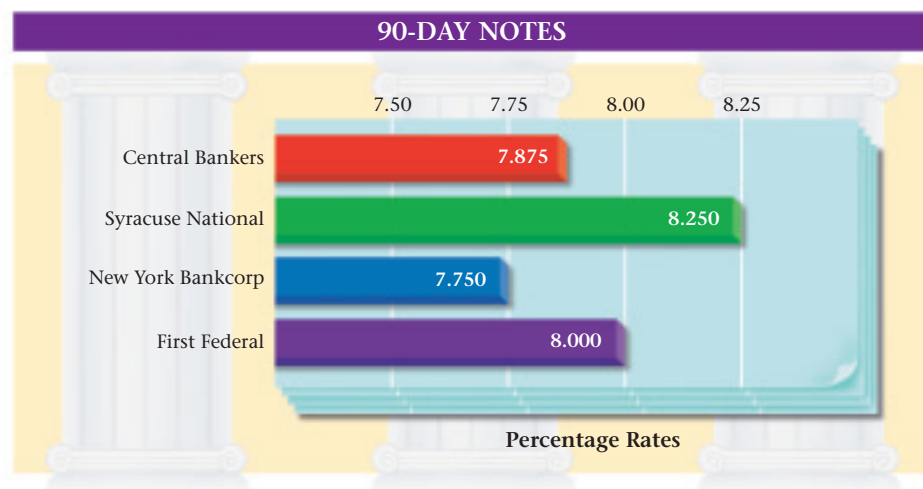
Create a table similar to the one here to determine which accounts to debit and credit for each transaction. Choose from these accounts and write the account title in the proper column: **Accounts Receivable/Customer; Cash in Bank; Interest Income; Sales; Sales Tax Payable; and Notes Receivable.**

Transaction	Account(s) Debited	Account(s) Credited
Sold merchandise on account to a charge customer plus sales tax		
Received an interest-bearing note in payment of the account receivable		
Received payment for the note		



Do the Math

Your accounting manager has just finished a graph illustrating the possible interest-bearing notes available from the region's banks. Review the graph and give your boss your recommendation of which bank will provide the best loan value.



Problem 26-5 Analyzing a Source Document

Instructions Examine the note illustrated here. In your working papers, make the appropriate journal entry on page 14 of the general journal for Eli's Catering Company. The note was discounted at a rate of 12% by First Federal Bank.

		NOTE <u>55</u>
\$ <u>2,500.00</u>	Date <u>June 12</u> 20--	
Ninety days _____ after date I promise to pay to		
First Federal Bank		the sum of
Two thousand five hundred and ^{no} / ₁₀₀ _____		dollars.
Due date <u>September 10, 20--</u>		
		Owner, <u>Eli's Catering Co.</u>

Key Concepts

1. A *promissory note*, often just called a *note*, is a written promise to pay an amount of money by a specific future date. It allows businesses to make purchases and pay for them at a later date.
2. A *note payable* is a promissory note that a business issues to a creditor or to a bank to obtain a loan. A *note receivable* is a promissory note that a business accepts from a credit customer. Laws require a promissory note to contain certain information:

- *maker*: person or business signing a note and promising to repay the principle and interest
- *payee*: person or business the payment will be made to
- *principal* or *face value*: amount borrowed
- *interest rate*: fee charged for use of money; stated as a percentage of the principal
- *term*: amount of time the borrower has to repay the note
- *issue date*: date on which a note is written
- *maturity date*: due date of the note

The formula used to calculate interest is:

$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \text{Time}$$

3. Here is a comparison of interest-bearing and non-interest-bearing notes payable:

	Interest-Bearing Note Payable	Non-Interest-Bearing Note Payable
Distinction	Interest rate is stated on note.	No interest rate is stated on the note.
Interest	Interest is paid at maturity date.	Interest is called bank discount. It is deducted from the face value on the note's issue date.
Example	Interest rate = 6% Face value = \$1,000 Term = 3 months	Bank discount = 6% Face value = \$1,000 Term = 3 months
Calculation	Interest = Principal \times Interest Rate \times Time Interest = \$1,000 \times 0.06 \times 3/12 Interest = \$15	Bank Discount = Face Value \times Discount Rate \times Time Bank Discount = \$1,000 \times 0.06 \times 3/12 Bank Discount = \$15
Proceeds	Proceeds = Face Value Proceeds = \$1,000	Proceeds = Face Value – Bank Discount Proceeds = \$1,000 – \$15 = \$985
Issuance of Note	Cash in Bank 1,000 Notes Payable 1,000	Cash in Bank 985 Discount on Notes Payable 15 Notes Payable 1,000
Payment of Note	Notes Payable 1,000 Interest Expense 15 Cash in Bank 1,015	Notes Payable 1,000 Interest Expense 15 Cash in Bank 1,000 Discount on Notes Payable 15

4. To record the *issuance* of an interest-bearing note payable:

Cash in Bank		Notes Payable	
Debit + xxx	Credit –	Debit –	Credit + xxx

To record the *payment* of an interest-bearing note payable:

Notes Payable		Interest Expense		Cash in Bank	
Debit	Credit	Debit	Credit	Debit	Credit
–	+	+	–	+	–
xxx		xxx			xxx

To record the *issuance* of a non-interest-bearing note payable:

Cash in Bank		Discount on Notes Payable		Notes Payable	
Debit	Credit	Debit	Credit	Debit	Credit
+	–	+	–	–	+
xxx		xxx			xxx

To record the *payment* of a non-interest-bearing note payable:

Notes Payable		Interest Expense		Cash in Bank		Discount on Notes Payable	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
–	+	+	–	+	–	+	–
xxx		xxx		xxx			xxx

5. To record the *receipt* of a note receivable converted from an account receivable:

Notes Receivable		Accounts Receivable (controlling/subsidiary)	
Debit	Credit	Debit	Credit
+	–	+	–
xxx			xxx

To record the *payment* of a note receivable:

Cash in Bank		Notes Receivable		Interest Income	
Debit	Credit	Debit	Credit	Debit	Credit
+	–	+	–	–	+
xxx		xxx			xxx

Key Terms

bank discount	(p. 759)	maker	(p. 752)	other revenue	(p. 765)
face value	(p. 752)	maturity date	(p. 752)	payee	(p. 752)
interest	(p. 754)	maturity value	(p. 755)	principal	(p. 752)
interest-bearing note payable	(p. 757)	non-interest-bearing note payable	(p. 759)	proceeds	(p. 759)
interest rate	(p. 752)	note payable	(p. 752)	promissory note	(p. 752)
issue date	(p. 752)	note receivable	(p. 752)	term	(p. 752)
long-term liabilities	(p. 757)	other expense	(p. 763)		

Check Your Understanding

1. Promissory Notes

- Name the two parties to a promissory note. Which party issues the note? Which party receives the note?
- Describe a situation in which a business might (a) receive a promissory note and (b) issue a promissory note.

2. Notes Payable and Notes Receivable

- What type of account is **Notes Payable**, and what is its normal balance?
- What type of account is **Notes Receivable**, and what is its normal balance?

3. Interest-Bearing and Non-Interest-Bearing Notes

- What is the difference between interest-bearing and non-interest-bearing notes?
- What is the difference between interest and a bank discount?

4. Notes Payable

- What accounts are affected by the *issuance* of an interest-bearing note payable, and how are they affected?
- What accounts are affected by the *payment* of an interest-bearing note payable, and how are they affected?

5. Journalizing Notes Receivable

- What accounts are affected by the *receipt* of a note receivable, and how are they affected?
- What accounts are affected by the *payment* of a note receivable, and how are they affected?

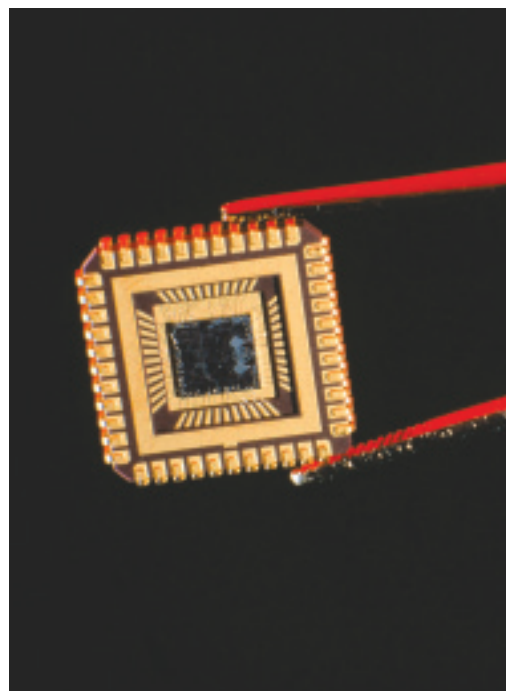
Apply Key Terms

As a staff accountant for Advanced Micro Devices, you have been asked to discuss the company's notes payable and receivable with the accounting clerks. Prepare note cards containing the terms below. Arrange these terms in meaningful groups. Explain why you have grouped terms together. Are they related? Are they part of the same thing? Is one the result of another? Are they opposites?

bank discount
face value
interest
interest-bearing
note payable
interest rate
issue date
long-term
liabilities

maker
maturity date
maturity value
non-interest-
bearing note
payable
note payable
note receivable
other expense

other revenue
payee
principal
proceeds
promissory note
term



Notes Receivable and Payable

Making the Transition from a Manual to a Computerized System

Task	Manual Methods	Computerized Methods
Recording notes receivable and payable transactions	<ul style="list-style-type: none"> Using the general journal, record the receipt or issuance of the note. Post the entry to the appropriate accounts in the general ledger and subsidiary ledgers. Journalize and post the entry to record the receipt or payment of cash and interest. Calculate new balances for all accounts affected. 	<ul style="list-style-type: none"> Using the general journal, record the receipt or issuance of the note. The entry is automatically posted to the appropriate accounts. Record receipts or payment of notes.



Peachtree® Q & A

Peachtree Question	Answer
How do I record the issuance of a note payable?	<ol style="list-style-type: none"> From the Tasks menu, select Receipts. Accept the Cash in Bank account number as the Cash account. Enter a Reference number, usually the note number. Click on the Apply to Revenues tab. Enter the Notes Payable account number and the note amount.
How do I record the receipt of a note receivable payment?	<ol style="list-style-type: none"> From the Tasks menu, select Receipts. Accept the Cash in Bank account number as the Cash account. Enter a Reference number, usually the note number. Enter the Notes Receivable account number and the note amount. Enter the Interest Income account number and amount.



QuickBooks Q & A

QuickBooks Question	Answer
How do I record the issuance of a note payable?	<ol style="list-style-type: none"> From the Banking menu, select Make Deposits. Accept Cash in Bank in the <i>Deposit To</i> field and enter the date. Enter the name of the payee. Enter Notes Payable as the account, an explanation, and the note amount.
How do I record the receipt of a note receivable payment?	<ol style="list-style-type: none"> From the Customers menu, select Make General Journal Entries. Enter the date and reference. Debit the Cash account for the total amount received. Credit Notes Receivable for the note portion of the amount received. Credit Interest Income for the interest portion of the amount received.

For detailed instructions, see your Glencoe Accounting Chapter Study Guides and Working Papers.

CHAPTER 26

Problems

Complete problems using:

Manual Glencoe
Working Papers

OR

Peachtree Complete
Accounting Software

OR

QuickBooks
Templates

Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 26-6

1. Select the problem set for Sunset Surfwear (Prob. 26-6).
2. Rename the company and set the system date.
3. Record the transactions using the **Receipts** and **Payments** options. Enter each transaction in the proper accounting period (month).
4. Print a Cash Receipts Journal and a Cash Disbursements Journal to proof your work.
5. Complete the Analyze activity.
6. End the session.

TIP: Set the date range on the journal reports to print the transactions for all of the periods.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 26-6

1. Restore the Problem 26-6.QBB file.
2. Record the transactions using the **Make Deposits** and **Write Checks** options. Enter each transaction in the proper accounting period (month).
3. Print a Journal report.
4. Complete the Analyze activity.
5. Back up your work.

Problem 26-6 Recording Transactions for Interest-Bearing Notes Payable

Instructions In your working papers, record the following transactions in a cash receipts journal (page 22) and a cash payments journal (page 26).

Date	Transactions
Jan. 14	Sunset Surfwear borrowed \$1,500 from First One Bank by issuing a 90-day, 12% interest-bearing note payable, Note 78.
Apr. 14	Issued Check 168 for \$1,544.38 to First One Bank in payment of the \$1,500 note issued on January 14, plus interest of \$44.38.
May 31	Borrowed \$12,400 from Merchant's Bank and Trust by issuing a 90-day, 12.5% interest-bearing note, Note 79.
Aug. 29	Paid Merchant's Bank and Trust the maturity value of the note issued on May 31, \$12,782.19, Check 284.

Analyze Calculate the amount of interest paid on notes in January.

Problem 26-7 Recording Transactions for Non-Interest-Bearing Notes Payable

Instructions In your working papers, record the following transactions in a cash receipts journal (page 14) and a cash payments journal (page 16).

Date	Transactions
June 10	InBeat CD Shop borrowed \$6,000 from BankOne by issuing a 60-day, non-interest-bearing note payable (proceeds, \$5,901.37) that the bank discounted at 10%, Note 67.
Aug. 9	Issued Check 205 for \$6,000 in payment of the note issued June 10 and recorded the interest expense.
30	Borrowed \$16,000 from Citizens Bank by issuing a 120-day, non-interest-bearing note payable less the 10.5% bank discount of \$552.33, Note 68.
Dec. 28	Issued Check 398 in payment of the note issued on August 30 and recorded the interest expense.

Analyze Explain why the account **Discount on Notes Payable** is used.

Problem 26–8 Recording Notes Payable and Notes Receivable

Instructions In your working papers, record the following transactions in a cash receipts journal (page 47), cash payments journal (page 56), and general journal (page 19) for Cycle Tech Bicycles.

Date	Transactions
Mar. 19	Borrowed \$9,000 from Desert Palms Savings and Loan by issuing a 90-day, 12% interest-bearing note payable, Note 87.
June 4	Received a 120-day, 13% note receivable for \$1,900 from Greg Kellogg as a time extension on his account receivable, Note 6.
17	Paid Desert Palms Savings and Loan the maturity value of the note issued on March 19, Check 2784.
Sept. 29	Received a check from Greg Kellogg for the maturity value of the note dated June 1, Receipt 628.
Oct. 6	Borrowed \$2,700 from Jonesboro Bank and Trust by issuing a 60-day, non-interest-bearing note payable discounted at 11.5%, Note 88.
Dec. 5	Prepared a check for the note issued on October 6 and recorded the interest expense, Check 3954.

Analyze Compute the amount of interest Cycle Tech Bicycles will earn on Greg Kellogg's June 4 note.

Problem 26–9 Recording Notes Payable and Notes Receivable

The following is a partial list of accounts used by River's Edge Canoe & Kayak.

101 Cash in Bank	205 Notes Payable
115 Accounts Receivable	207 Discount on Notes Payable
120 Notes Receivable	415 Interest Income
201 Accounts Payable	640 Interest Expense

Instructions In your working papers, record the following transactions in a cash receipts journal (page 67), cash payments journal (page 73), and general journal (page 27).

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SMART GUIDE

Step-by-Step Instructions: Problem 26–7

1. Select the problem set for InBeat CD Shop.
2. Rename the company and set the system date.
3. Record the transactions.
4. Print a Cash Receipts Journal and a Cash Disbursements Journal to proof your work.
5. Complete the Analyze activity.
6. End the session.

Step-by-Step Instructions: Problem 26–8

1. Select the problem set for Cycle Tech Bicycles.
2. Rename the company and set the system date.
3. Record the transactions.
4. Print a Cash Receipts Journal and a Cash Disbursements Journal to proof your work.
5. Complete the Analyze activity.
6. End the session.

Step-by-Step Instructions: Problem 26–9

1. Select the problem set for River's Edge Canoe & Kayak.
2. Rename the company and set the system date.
3. Record the transactions.
4. Print a Cash Receipts Journal and a Cash Disbursements Journal to proof your work.
5. Complete the Analyze activity.
6. End the session.

CONTINUE

Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 26-10

1. Select the problem set for Buzz Newsstand.
2. Rename the company and set the system date.
3. Record the transactions in the correct period.
4. Print a Sales Journal, Cash Receipts Journal, and a General Journal.
5. Complete the Analyze activity.
6. End the session.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 26-10

1. Restore the Problem 26-10.QBB file.
2. Record the transactions in the correct period.
3. Print a Journal report.
4. Complete the Analyze activity.
5. Back up your work.

SOURCE DOCUMENT PROBLEM

Problem 26-10

Use the source documents in your working papers to record the transactions for this problem.

Date	Transactions (cont.)
May 7	Borrowed \$4,000 from Union Bank by issuing a 60-day, 9.5% non-interest-bearing note, Note 284.
15	Issued a \$3,000, 90-day, 9% interest-bearing note to Trailhead Canoes in place of the amount owed on account, Note 285.
21	Received a 120-day, 10% note for \$1,200 from Cathy Wilcox for an extension of time on her account, Note 94.
July 6	Issued Check 4711 in payment of the non-interest-bearing note given to Union Bank on May 7.
Aug. 13	Issued Check 5044 for the maturity value of the note issued to Trailhead Canoes on May 15.
Sept. 18	Received a check from Cathy Wilcox for the maturity value of the note dated May 21, Receipt 5921.

Analyze

Compare Notes 284 and 285. Which of the two notes was most advantageous to River's Edge Canoe & Kayak?



Problem 26-10 Renewing a Note Receivable

Occasionally, on the maturity date, a note may be renewed instead of being paid. When this occurs, (1) the interest on the first note is paid, (2) the first note is canceled, and (3) a new note for the same principal amount is issued, usually at a higher interest rate. Buzz Newsstand had the following transactions.

Instructions In your working papers, record the following transactions on general journal page 24.

Date	Transactions
Mar. 14	Sold merchandise on account to Saba Nadal for \$1,800, plus sales tax of \$108.00, terms 30 days, Sales Slip 388.
Apr. 13	Accepted a 60-day, 9% note for \$1,908.00 from Saba Nadal in place of the account receivable, Note 416.
June 12	Received the interest due from Saba Nadal for the note dated April 13 and agreed to renew the note at 10% for 90 days, Receipt 1387 and Note 417.
Sept. 10	Received a check from Saba Nadal for the maturity value of the note issued June 12, Receipt 1555.

Analyze

Calculate the total amount of interest earned in March.

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:

- Future Business Leaders of America
- Business Professionals of America

Use a separate sheet of paper to record your answers.



Future Business Leaders of America

MULTIPLE CHOICE

- Signed a 90-day, 10% note
 - Debit Cash, credit Notes Receivable
 - Debit Cash, credit Notes Payable
 - Debit Accounts Receivable, credit Cash
 - Debit Cash, credit Accounts Receivable

Use the following information for questions 2 & 3.

October 15, Morton Co. accepts a 60-day, 11% note from Anderson Imports for an extension of time on its account, \$990.00 Notes Receivable No. 5.

- The credit for this transaction would be made to
 - Accounts Payable.
 - Accounts Receivable.
 - Notes Payable.
 - Notes Receivable.
- The effect of this transaction on the customer's account in the accounts receivable ledger is
 - to decrease the account balance.
 - to increase the account balance.
 - no change in the account balance.
 - not known.
- Find the interest and maturity value for a 60-day note with principal of \$1,500 and interest at 8 percent.
 - \$120.00 interest; \$1,620.00 maturity value
 - \$32.88 interest; \$1,532.88 maturity value
 - \$3.29 interest; \$1,503.29 maturity value
 - \$19.74 interest; \$1,519.74 maturity value



Business Professionals of America

MULTIPLE CHOICE

- Qupre, Inc. signed a 90-day, 9.75% note with First State Bank for \$1,200 on August 1. The maturity date for the note is
 - October 30.
 - November 1.
 - October 28.
 - November 2.

Need More Help?

Go to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Winning Competitive Events** and select **Chapter 26**.

- Practice Questions and Test-Taking Tips
- Concept Capsules and Terminology



CRITICAL Thinking

Notes Payable and Receivable

1. Explain what a promissory note is and distinguish between the two types, notes payable and notes receivable.
2. Explain how an interest-bearing note and a non-interest-bearing note differ.
3. Calculate the amount of interest to be charged on a \$12,000, 8.5%, 90-day interest-bearing note.
4. Explain the difference between interest expense and interest income.
5. You need to borrow \$10,000 for six months. Interest rates are expected to drop from 7% to 5.5% within the next week. How much would you save by waiting an additional week to obtain your loan?
6. Consider a \$5,000, 6%, 180-day interest-bearing note and a non-interest-bearing note for the same amount and time period with a bank discount of 6%. From the borrower's point of view, which is the better loan and why?

CASE STUDY

Merchandising Business: Restaurant/Retail Shop

Moreno's Italian Oven is open seven days a week for lunch and dinner. The restaurant seats 60 patrons in a day and averages 90 percent capacity. It is considering expanding into the space adjacent to the restaurant. The cost to remodel the area and buy additional kitchen and restaurant equipment is estimated at \$200,000. The rent on the additional space is \$1,200 a month.

INSTRUCTIONS

1. If Moreno's could double the number of customers served weekly, calculate how many it could serve per week.
2. If each customer spends an average of \$12 per meal, calculate the additional revenue the restaurant would earn per day if it expands and maintains 90 percent capacity.

a matter of ETHICS

Is the Boss Always Right?

You work for a large property management company. Your boss, Joan, is the senior accountant; and her boss, Frank, is vice president. For the past several months, Joan has been coming to work late, taking long lunches, and leaving early. When Frank calls, she has asked you to tell him that she is "away from her desk." You think Frank is getting suspicious, and you are starting to feel guilty about lying.

ETHICAL DECISION MAKING

- | | |
|----------------------------------|--|
| 1. What are the ethical issues? | 4. How do the alternatives affect the parties? |
| 2. What are the alternatives? | |
| 3. Who are the affected parties? | 5. What would you do? |

COMMUNICATING ACCOUNTING

Promote Your Project

You write the copy for and design brochures to highlight New South Bank's many financial products. Today you were asked to prepare a brochure explaining the value of non-interest-bearing notes. Write the copy for this brochure. Design it by hand or on a computer.



Allocating Time and Money

Good Times Amusement Park has offered you a full-time job. Before you can accept it, you must arrange for transportation.

INSTRUCTIONS List estimated costs of owning a car compared to using other transportation. How would each impact the use of your time and your budget?



Long-Term International Loans

The International Finance Corporation (IFC) helps finance projects in developing countries to reduce poverty and improve people's lives. Projects must be profitable and benefit the host country's economy. For instance, it has provided loans of about \$44 million to build a hospital and clinic in Mexico City. Other recipient sectors include transportation, education, and tourism.

INSTRUCTIONS Describe how IFC affects people in developing countries.



Your Vehicle Loan

If you want to buy a vehicle but cannot pay cash, you need to borrow from a financial institution. To do so, you will be required to sign a legally binding note to make monthly payments for a required period of time.

PERSONAL FINANCE ACTIVITY Assume you want to buy a preowned vehicle but do not have all of the cash needed, and prefer not to ask your parents for it. Write a plan considering all aspects of the purchase.

PERSONAL FINANCE ONLINE Log on to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Making It Personal** and select **Chapter 26**.



Evaluating Long-Term Debt

When considering a borrower's long-term debt, lenders often consider the debt to equity ratio. This ratio compares the resources the lender will provide to the borrower's resources. It is calculated by dividing total liabilities by total stockholders' equity. Here's an example:

$$\frac{\text{Total liabilities}}{\text{Total stockholder's equity}} = \frac{\$125,670}{\$103,680} = 1.21$$

This debt to equity ratio of 1.21 to 1 means that lenders would provide more resources than the borrower has. The higher the ratio, the higher is the lender's claims on the applicant's assets. A heavy reliance on creditors increases the risk that a business may not be able to meet its financial obligations during a business downturn.

INSTRUCTIONS

Obtain PETSMART's most recent balance sheet from the Internet or a public library. Use this and the February 2004 balance sheet in Appendix F for the following tasks.

1. Calculate PETSMART's debt to equity ratio for both years.
2. Compare how the ratio has changed. As a creditor, how would you interpret this change?

