CHAPTER 8: ACCOUNTING FOR NOTES RECEIVABLE/PAYABLE

LEARNING OBJECTIVES:

- Differentiate between an interest bearing note and a non- interest bearing note.
- Be familiar with the details of a promissory note.
- Analyze and record transactions in discounting promissory notes.

- A note may be executed by the debtor when a loan is made from a creditor. A note may also be executed in exchange for services received, assets acquired or accounts not paid on due date.
- Evidences his right to claim from the maker a certain amount of money at a fixed future time.

LAW OF NEGOTIABLE INSTRUMENTS

- Defines a promissory note as an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer."
- It is a note executed by the debtor evidencing his obligation to pay his debt after a certain period of determinable time.

DETAILS OF A PROMISSORY NOTE

1. Maker – the person who executes the note
2. Payee – the person whom the amount in the note is payable
3. Face Value – the principal amount of money appearing on the face of the note borrowed by the debtor
4. Interest Rate – the annual rate of interest stated on the face of the note charged to the borrower
5. Term – the period of time from the issue date of the note to the maturity date of the note. This is the duration of time from which interest on the note will be computed. For basis of computation, a year is considered to have 12 months or 360 days.

6. Issue Date – the date when the note was signed and executed by the debtor.
7. Maturity Date – the date when the full payment of the note should be made by the debtor.
8. Maturity Value – the full payment to be made by the debtor as settlement of the account. For non- interest bearing note, the face value is the maturity value of the note. For interest bearing note, the maturity value is the face value of the note plus the amount of interest for the term of the note.

P100, 000 Manila, Philippines August 25, 2014

For value received, I promise to pay Joselito Lao the sum of One Hundred Thousand Pesos, 90 days after the date with a simple interest of 12 % per annum.

Due: November 23, 2014 (Sgd) McKenzie Brett Lao

1. Maker: McKenzie Brett Lao
2. Payee: Joselito Lao
3. Face Value: P100, 000
4. Interest Rate: 12%
5. Term: 90 days
6. Issue Date: August 25, 2014
7. Maturity Date: November 23, 2014
8. Maturity Value: 103, 000

Computation

7. Maturity Date

Term		90 days
No. of Days in August	31	
Less: Date of Transaction	25	
Remaining Days for August	6	
No. of Days in September	30	
No. of Days in October	31	67
Payment Date (Maturity Date)		23

8. Maturity Value

Maturity Value = Principal + Interest

= Principal + (Principal * Rate * Time)

= P100,000 + (P100,000 * .12 * 90/360)

= P100,000 + 3, 000

=P103, 000

Accounting for Notes Receivable-Pro- Forma Journal Entries

1. Sold merchandise on account

Accounts Receivable	xxx	
Sales		xxx

2. Received customer's note to be applied to account

Notes Receivable	xxx	
Accounts Receivable		xxx

3. Collected interest bearing note

Cash	xxx	
Notes Receivable		xxx
Interest Income		xxx

4. Collected non- interest bearing note

Cash	xxx	
Notes Receivable		xxx

5. Discounted customer's interest bearing note

Cash	xxx	
Interest Expense	xxx	
Notes Receivable Discounted		xxx
Interest Income		xxx

Note: The amount of Notes Receivable Discounted is the face value of the note. Interest Income is the interest for the full term of the note from the issuance date up to maturity date.

6. Discounted customer's non- interest bearing note

Cash	xxx	
Interest Expense	xxx	
Notes Receivable Discounted		xxx

7. Customer paid discounted note to the bank. (note was honored)

Notes Receivable Discounted	xxx	
Notes Receivable		xxx

8. Customer failed to pay the bank. (note was dishonored upon maturity)

Accounts Receivable	xxx	
Cash		xxx

Note: The amount in the journal entry is the maturity value of the note plus protest fees if any.

Notes Receivable Discounted	xxx	
Notes Receivable		xxx

Note: The amount in the journal entry is the face value of the note.

9. Customer paid the above account

Cash	xxx	
Accounts Receivable		xxx

Illustrative Example

1. On July 5, Gisel Ong Merchandising sold P200, 000 worth of merchandise to Niko Ong Trading on 30 days credit.

Accounts Receivable	200,000	
Sales		200,000
Sold merchandise on credit		

2. On August 4, Niko Ong Trading failed to pay Gisel Ong Merchandising after 30 days but issued 4 notes as follows:

a) 60 day 12% promissory note for P100, 000

b) 60 day non- interest bearing note for P50, 000

c) 30 day 10% promissory note for the P30,000

d) 10 day non- interest bearing note for the balance

Notes Receivable	200, 000	
Accounts Receivable		200,000
Received notes for the unpaid account		

3. Niko Ong Trading paid the 10 day non- interest bearing note.

Cash	20, 000	
Notes Receivable		20, 000

Received payment for the note

4. Collected the 30 day 10% interest bearing note from Niko Ong Trading with interest on maturity date.

Cash		30, 250	
	Notes Receivable		30, 000
	Interest Income		250

Collected note at maturity date

Interest = Principal x Rate x Time

= P30, 000 x .10 x 30/360

= P250

5. Discounted Niko Ong Trading's 60 day non- interest bearing note with the EastWest Bank on August 19 at 6%

Cash	49, 625	
Interest Expense	375	
Notes Receivable Discounted		50, 000

Discounted customer's non- interest bearing note

Computation:

Interest Expense = Maturity Value x Discount Rate x Discount Period

Since the note is non- interest bearing , the principal value is equal to maturity value. Discount period is the remaining number of days from the discount date to maturity date of note.

Maturity Date: October 3

Discount Date: August 19

Discount Period: August 19 to October 3 = 45 days

Interest Expense = P50,000 x 0.06 x 45/360

= P375

Cash Proceeds = Maturity Value – Interest Expense

= P50,000 – P375

= 49, 625

6. Discounted Niko Ong Trading's 60 day 12% note with Pacific Bank on August 19 at 15%.

Cash		100, 087.50	
Interest Expense		1, 912.50	
	Notes Receivable Discounted		100,000
	Interest Income		2, 000

Discounted customer's note with bank

Computation

Interest Income	= P x r x t
	= P100, 000 x .12 x 60/360
	= P2, 000
Maturity Value	= Principal + Interest
	= P100, 000 + 2,000
	=P102,000
Interest Expense	= Maturity Value x Dis. Rate X Dis. Period
	= P102, 000 X .15 x 45/360
	= P1, 912.50

Cash Proceeds = Maturity Value – Interest Expense

= P102, 000 - P1,912.50

= P100, 087.50

7. Niko Ong Trading paid the discounted note with Pacific Bank.

Notes Receivable Discounted	100,000	
Notes Receivable		100, 000

8. Assuming Niko Ong Trading dishonored the note of maturity date and the Pacific Bank charged a protest fee of P300.

Accounts Receivable	102, 300	
Cash		102, 300
Paid note dishonored by maker		

Notes Receivable Discounted	100,000	
Notes Receivable		100,000
Notes receivable dishonored by maker		

9. Niko Ong Trading settled its dishonored note.

Cash	102, 300	
Accounts Receivable		102, 300
Dishonored note settled by maker		

P500, 000 Manila, Philippines August 31, 2014

Sixty days after date, I promise to pay Flora Lao the sum of Five Hundred Thousand Pesos for value received with interest of 15 % per annum.

(Sgd) Muriel Bernardo

Exercise 2

Lay's Incorporated received a 90 day P40, 000 8% note dated June 15 from Pringle's Corporation and discounted the note with Taco Bank at 12% on July 15. From the problem, determine the following:

a. Due date of the note
b. Maturity Value of the note
c. Discount Period
d. Discount Amount
e. Cash Proceeds