Accounting 1

Lesson Plan

Name:  Terry Wilhelmi  

Day/Date:

Topic:  Accounting for Notes and Interest  

Unit:  4  

Chapter 24

I. Objective(s):  By the end of today’s lesson, the student will be able to:

• define accounting terms related to notes and interest.
• identify accounting concepts and practices related to notes and interest.
• calculate interest and maturity dates for notes.
• analyze and record transactions for notes payable and notes receivable.

II. Materials:

Textbook
Workbook
Transparencies

III. Anticipatory Set:

Sometimes a business receives more cash from sales than is needed to pay for purchases and expenses. When this occurs, a business may deposit the extra cash in a bank or other financial institution for a short period.

At other times, the receipt of cash from sales does not occur at the same time and in sufficient amounts to pay for needed purchases and expenses. When this occurs, a business needs to borrow additional cash or make arrangements with its vendors to delay payment for a period of time.

IV. Learning Activities:
PROMISSORY NOTES

Promissory note (Note)- a written and signed promise to pay a sum of money at a specified time.

Promissory notes are used when money is borrowed for a period of time from a bank or other lending agency. Sometimes a business requests a note from a customer who wants credit beyond the usual time given for sales on account.

A note, like a check, can be endorsed and transferred to a bank in return for cash. Thus, the business can get its money before the note is due.

Notes can also be useful in a court of law as written evidence of a debt.

Promissory Note on page 598 - terms, definitions, and illustration.

INTEREST on PROMISSORY NOTES

Interest - an amount paid for the use of money for a period of time.

Interest-bearing note - a promissory note that requires the payment of principal plus interest when the note is due.

Non-interest-bearing note - a promissory note that requires only the payment of the principal when the note is due.

The interest rate is stated as a percentage of the principal.

Interest at 10% means that 10 cents will be paid for the use of each dollar borrowed for a full year.

Maturity value - the amount that is due on the maturity date of a note.

A one-year interest-bearing note with a principal of $1000.00 and interest rate of 12% will have a maturity value of $1120.00.
Calculating interest

To calculate interest for one year:

$$\text{Principal} \times \text{Interest Rate} \times \text{Time in Years} = \text{Interest for One Year}$$

$$1000.00 \times 0.12 \times 1 = 120.00$$

To calculate interest for a fraction of a year:

$$\text{Principal} \times \text{Interest Rate} \times \text{Time as Fraction of Year} = \text{Interest for Fraction of Year}$$

$$1000.00 \times 0.12 \times \frac{3}{12} = 30.00$$

To calculate interest for a number of days:

$$\text{Principal} \times \text{Interest Rate} \times \text{Time as Fraction of Year} = \text{Interest for Fraction of Year}$$

$$1000.00 \times 0.12 \times \frac{60}{360} = 30.00$$

* A 360-day year is used for all interest calculations in this text.

Drill 24-D1

Calculating maturity date

The time between the date a note is issued and the date a note is due may be expressed in either years, months, or days.

When the time of a note is stated in months, the maturity date is calculated by counting the number of months from the date of issuance.

- A six-month note dated April 11 would be due on October 11.
When the time of a note is expressed in days, the maturity date is calculated by counting the exact number of days. The date the note is written is not counted, but the maturity date is counted.

Find the number of days remaining in the month the note was written. Add the days in the following months until the total equals the required number of days.

- A 60-day note dated March 3 is due on May 2.

<table>
<thead>
<tr>
<th>Date Range</th>
<th>Days</th>
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<tbody>
<tr>
<td>March 3 - March 31</td>
<td>28</td>
</tr>
<tr>
<td>April 1 - April 30</td>
<td>30</td>
</tr>
<tr>
<td>May 1 - May 2</td>
<td>2</td>
</tr>
</tbody>
</table>

To calculate a maturity date, remember that April, June, September, and November have 30 days; all other months, except February, have 31 days.

Drills 24-D2 and 24-D3

NOTES PAYABLE

- **Creditor** - a person or organization to whom a liability is owed.
- **Notes Payable** - promissory notes that a business issues to creditors.
- **Current liabilities** - liabilities due within a short time, usually within a year.

Notes payable are generally paid within one year, so are considered *current liabilities*.

**Issuing a note payable to borrow money from a bank**

When a business issues a note payable, the principal or face amount of the note is credited to a liability account titled **Notes Payable**. (Normal credit balance)
April 1, 20--

Issued a 6-month, 10% note, $6,000.00. Note Payable No. 4.

Cash Debit
Notes Payable Credited

Cash receipts journal entry - page 647.

The bank retains the original copy of the note until the maturity value is paid. A copy of the note payable is the source document used to record the transaction. No entry is made for interest until a later date when it is paid.

Paying principal and interest on a note payable at maturity

When a note payable reaches the maturity date, the maker of the note pays the maturity value (principal plus interest) to the payee.

Interest expense - the interest accrued on money borrowed.

The interest accrued on a note payable is debited to an expense account titled Interest Expense. (Normal debit balance). Listed in Other Expenses in a chart of accounts.

October 1, 20--

Paid cash for the maturity value of Note Payable No. 4: principal, $6,000.00, plus interest, $300.00; total, $6,300.00. Check No. 573.

Notes Payable Debited
Interest Expense Debited
Cash Credited

Cash payments journal entry - page 648.
Issuing and paying a note payable for an extension of time

A business may ask for an extension of time if it is unable to pay an account when due. When a request for more time is made, sometimes the business is asked to issue a note payable. **The note payable does not pay the amount owed to the vendor.** However, the form of the liability is changed from an account payable to a note payable.

April 5, 20--

Issued a 60-day note to Action Phone Company for an extension of time on this account payable, $2,000.00. Note Payable No. 5.

Accounts Payable/Action Phone Co.  Debited
Notes Payable  Credited

General journal entry - page 649.

When posted, Action Phone Company will have a zero balance in Acct. Pay. Ledger.

The maturity date for Note Payable No. 5 is June 4:

<table>
<thead>
<tr>
<th>Date Range</th>
<th>Days</th>
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<tbody>
<tr>
<td>April 5 - April 30</td>
<td>25 days (30 - 5 = 25)</td>
</tr>
<tr>
<td>May 1 - May 31</td>
<td>31 days</td>
</tr>
<tr>
<td>June 1 - June 4</td>
<td>4 days (Maturity date: June 4)</td>
</tr>
<tr>
<td></td>
<td>60 days</td>
</tr>
</tbody>
</table>

June 4, 20--  (interest due calculated, pg. 649)

Paid cash for the maturity value of Note Payable No. 5: principal, $2,000.00, plus interest, $40.00; total, $2040.00. Check No. 328.

Notes Payable  Debited
Interest Expense  Debited
Cash  Credited

Cash payments journal entry - page 650.
Issuing and paying a discounted note payable

Some banks require that the interest be paid at the time a note is issued.

**Bank discount** - interest collected in advance on a note.

**Discounted note** - a note on which interest is paid in advance.

**Proceeds** - the amount received for a note after the bank discount has been deducted.

May 3, 20--

Discounted at 10% a 3-month non-interest-bearing note, $3,000.00; proceeds, $2,925.00, interest, $75.00. Note Payable No. 6.

The amount of the discount and the proceeds are calculated as follows:

\[
\text{Maturity Value} \times \text{Discount Rate} \times \text{Time as Fraction of Year} = \text{Bank Discount}
\]

\[
$3,000.00 \times 10\% \times \frac{3}{12} = $75.00
\]

\[
\text{Maturity Value} - \text{Bank Discount} = \text{Proceeds}
\]

\[
$3,000.00 - $75.00 = $2,925.00
\]

- Cash Debited
- Interest Expense Debited
- Notes Payable Credited

Cash receipts journal entry - page 651.

August 3, 20--

Paid cash for the maturity value of non-interest-bearing Note Payable No. 6, $3,000.00. Check No. 450.

- Notes Payable Debited
- Cash Credited

Cash payments journal entry - page 651.
For a non-interest bearing note, the interest is paid when the note is issued; therefore, the maturity value equals the principal.

Assignment:

Be sure you know and understand:

- the meaning of terms 1 - 20, pg. 657.
- the answers to questions 1 - 15, pg. 657 - 658.
- answer Cases 1 - 2, pg. 658.
- do Drills 24-D1, 24-D2, and 24-D3, pgs. 658-659.
- do Problems 24-1 & 24-2, pgs. 660 - 661.
- read pages 652 - 657.

NOTES RECEIVABLE

Notes receivable - promissory notes that a business accepts from customers.

Notes receivable are generally paid within one year and are considered current assets.

Accepting a note receivable from a customer

A customer may ask for an extension of time if they are unable to pay an account when due. When a request for more time is made, a business may agree to accept a note receivable.

The note receivable does not pay the amount the customer owes. However, the form of the liability is changed from an account receivable to a note receivable.

A note receivable is preferred over an account receivable because it earns interest and it provides evidence of the debt in case legal action is required to collect.

- A note is recorded as a note receivable by the person or business to whom the amount of a note is payable.
• A note is recorded as a **note payable** by the maker of the note, the person or business who signs a note and thus promises to make payment.

When a business accepts a note receivable, the principal or face amount of the note is debited to an *asset* account titled *Notes Receivable*. (Normal debit balance)

**April 22, 20--**

Received a 2-month, 12% note from Ann Nance for an extension of time on her account, $800.00. Note Receivable No. 10.

| Notes Receivable     | Debited |
| Accounts Receivable/Ann Nance | Credited |

**General journal entry - page 653.**

When posted, Ann Nance will have a zero balance in Acct. Rec. Ledger.

**Collecting principal and interest on a note receivable at maturity**

When a note receivable reaches the maturity date, the payee of the note receives the maturity value (principal plus interest) from the maker of the note.

**Interest income** - the interest earned on money loaned.

The interest earned on a note receivable is credited to a *revenue* account titled *Interest Income*.

(Normal credit balance) Classified as *Other Revenue* in chart of accounts.

**June 22, 20--**

Received cash for the maturity value of Note Receivable No. 10: principal, $800.00, plus interest, $16.00; total, $816.00. Receipt No. 497.

| Cash                  | Debited |
| Notes Receivable      | Credited |
| Interest Income       | Credited |

**Cash receipts journal entry - page 654.**
After the entry is recorded, the original copy of Note Receivable No. 10 is marked **Paid** and returned to Ann Nance, the maker.

**Recording a dishonored note receivable**

**Dishonored note** - a note that is not paid when due.

**May 12, 20--**

Keith Leising dishonored Note Receivable No. 9, a 1-month, 12% note maturity value due today; principal, $200.00; interest, $2.00; total, $202.00. Memorandum No. 65.

<table>
<thead>
<tr>
<th>Accounts Receivable/Keith Leising</th>
<th>Debited</th>
<th>Notes Receivable</th>
<th>Credited</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income</td>
<td></td>
<td></td>
<td>Credited</td>
</tr>
</tbody>
</table>

**Purchase on Account**

<table>
<thead>
<tr>
<th>Accts. Rec./Keith Leising</th>
<th>Debited</th>
<th>Sales</th>
<th>Credited</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax Payable</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note Receivable**

| Notes Receivablebe | Debited | Accts. Rec./Keith Leising | Credited |

The interest income has been earned even though it has not been paid. Keith Leising owes the principal amount of the note plus the interest earned.

Celluphone does not write off the account right away when the note is dishonored, but continues to try to collect the account.

Later, Celluphone may decide that the account cannot be collected from Keith Leising. At that time the balance of the account will be written off as an **uncollectible account**:

| Allowance for Uncollectible Accounts | Debited | Accounts Receivable/Keith Leising | Credited |


Assignment:

Be sure you know and understand:

- the meaning of terms 21 - 23, pg. 657.
- the answers to questions 16, 19, pg. 658.
- do Problems 24-3 & 24-M, pgs. 661 - 662.

V. Closure:

To review for test do Study Guide 24 and Problem 24-M.

VI. Evaluation of Student Learning:

Students will be evaluated using Problems 24-M, and Chapter 24 test.