Notes Payable

Key Topics to Know

Short-term Notes Payable:
- Term of one year or less
- Interest rate stated per year, not for the term of the note
- Typically one payment is made at maturity that includes both principal and interest
- Interest expense must be accrued at the end of an accounting period

Long-term Notes Payable:
- Term of longer than one year
- Interest rate stated per year, not for the term of the note
- Periodic payments are made throughout the term of the note
- Payments include both principal and interest
- Principal portion of the payment is "going forward", reducing the amount outstanding for the next period; Interest portion of the payment is "in arrears", being calculated of the outstanding balance of the note for the period just ending
- Interest expense must be accrued at the end of an accounting period

Practice Problems

Problem #1- Entries for a short-term note payable

T Company purchases inventory using a 60-day, 12% note for $15,000, dated December 1. The maker honors the note at maturity.

Required:
a) What is the journal entry to record the issuance of the note?
b) What is the maturity date of the note?
c) What is the maturity value of the note?
d) What is the journal entry on December 31?
e) What is the journal entry on the maturity date?

Problem #2 - Entries for a short-term note payable

On June 1, Jasper Company signed a $25,000, 120-day, 6% note payable to cover a past due account payable.

Required:
a) What is the total amount of interest to be paid on this note?
b) Prepare the journal entries to record payment of the note.
c) Prepare the company's journal entry to record the note's issuance.

Problem #3 – Entries for a long-term note payable

On January 1, Year 1 W Company borrowed $70,000 cash by signing a 9% installment note that is to be repaid with four annual year-end payments of $21,607, the first of which is due on December 31, Year 1.

Required:
a) Prepare the company's journal entry to record the note's issuance.
b) Prepare the journal entries to record the first and second installment payments.

Problem #4 – Amortization table for a long-term note payable

F Company purchased two new delivery vans for a total of $250,000 on January 1, Year 1. F Company paid $40,000 cash and signed a $210,000, 3-year, 8% note for the remaining balance. The note is to be paid in three annual end-of-year payments of $81,487 each, with the first payment on December 31, Year 1. Each payment includes interest on the unpaid balance plus principal.

Required: Prepare a note amortization table

Multiple Choice Questions

1. Q Company issued a $20,000 note to the Capital Bank on August 1. The note carried a one-year term and a 12% rate of interest. The adjusting entry on Fallon's books to record accrued interest expense on December 31 will
   a) Decrease assets and decrease retained earnings by $1,000.
   b) Increase liabilities and decrease equity by $800.
   c) Increase liabilities and decrease equity by $1,000.
   d) Decrease equity and increase liabilities by $2,400.

2. On October 1, B Company borrowed $10,000 from F Bank by signing a one-year, 6% note. On December 31, B Company failed to make the adjusting entry to accrue the related interest. This error will cause:
   a) Net income for the current year to be overstated and liabilities for the current year to be overstated.
   b) Net income for the current year to be understated and net income for the next year to be overstated.
   c) Net income for the next year to be understated and liabilities for the current year to be understated.
   d) Net income for the current year to be understated and liabilities for the current year to be overstated.

3. H Company borrowed $10,000 from T Bank on March 1. H Company is to repay the principal and interest on February 28 of the next year The interest rate is 8%. If the year-end adjustment is properly recorded, what will be the effects of the accrual on H Company's current year financial statements?
   a) Increase assets and increase liabilities
   b) Increase assets and increase revenues
   c) Increase liabilities and increase expenses
   d) No effect

4. Which of the following best describes the accrual of interest?
   a) Assets and stockholders' equity decrease.
   b) Assets and liabilities decrease.
   c) Net income and expenses decrease.
   d) Expenses and liabilities increase.

5. P Company borrowed $25,000 cash on October 1 and signed a nine-month,

8% interest-bearing note payable with interest payable at maturity. The amount of interest expense to be reported in the year the note matures is:
a) $1,000
b) $300
c) $500
d) $750

6. M Company borrowed $50,000 cash on April 1, and signed a one-year 12%, interest-bearing note payable. The interest and principal due on March 31 of the following year will be:
a) $50,000
b) $51,500
c) $54,000
d) $56,000

7. In each succeeding payment on an installment note:
a) The amount that goes to decreasing the carrying value of the note increases.
b) The amount that goes to decreasing the carrying value of the note decreases.
c) The amount that goes to decreasing the carrying value of the note is unchanged.
d) The amounts paid for both interest and principal increase proportionately.

8. In each succeeding payment on an installment note:
a) The amount of interest expense increases.
b) The amount of interest expense decreases.
c) The amount of interest expense is unchanged.
d) The amounts paid for both interest and principal increase proportionately.

9. On July 1, R Company borrowed $250,000 cash by signing a 10-year, 8% installment note requiring equal payments each June 30 of $37,258. What is the appropriate journal entry to record the issuance of the note?
a) Debit Cash $250,000; debit Interest Expense $37,258; credit Notes Payable $287,258.
b) Debit Notes Payable $250,000; credit Cash $250,000.
c) Debit Cash $37,258; credit Notes Payable $37,258.
d) Debit Cash $250,000; credit Notes Payable $250,000.

10. On January 1, Year 1, S Company borrowed $100,000 on a 10-year, 7%

installment note payable. The terms of the note require S Company to pay 10 equal payments of $14,238 each December 31 for 10 years. The required general journal entry to record the first payment on the note on December 31, Year 1 is:

a) Debit Interest Expense $7,000; debit Notes Payable $7,238; credit Cash $14,238.
b) Debit Notes Payable $7,000; debit Interest Expense $7,238; credit Cash $14,238.
c) Debit Notes Payable $10,000; debit Interest Expense $7,000; credit Cash $17,000.
d) Debit Notes Payable $14,238; credit Cash $14,238.

Solutions to Practice Problems

Problem #1 - Entries for a note payable

a)	Inventory	15,000	
	Notes Payable		15,000
b)	The maturity date of the note is January 30.		
c)	The maturity value of the note is $15,300		
	15,000 X. 12 X 60 / 360		
d)	Interest expense	150	
	Interest payable		150
e)	Notes payable	15,000	
	Interest expense	150	
	Interest payable	150	
	Cash		15,300

Problem #2 - Entries for a short-term note payable

a. $25,000* 0.06 * 120/360 = $500

b.	6/1	Accounts payable	25,000	
		Notes payable		25,000
c.	9/29	Notes payable	25,000	
		Interest expense	500	
		Cash		25,500

Problem #3 – Entries for a long-term note payable

a)

Year 1			
Jan. 1	Cash	70,000	
	Notes Payable		70,000

b)

Year 1			
Dec. 31	Notes Payable	15,307	
	Interest Expense ($70,000 * 0.09)	6,300	
	Cash		21,607
Year 2			
Dec. 31	Notes Payable	16,685	
	Interest Expense ($54,693 * 0.09)	4,922	
	Cash		21,607

Problem #4 – Amortization table for a long-term note payable

Period End	Beginning Balance	Interest Expense	Notes Payable	Cash Paid	Ending Balance
12/31/Yr 1	$210,000	$16,800	$64,687	$81,487	$145,313
12/31/Yr 2	145,313	11,625	69,862	81,487	75,451
12/31/Yr 3	75,451	6,036	75,451	81,487	0

Solutions to Multiple Choice Questions

1.	C
2.	C
3.	C
4.	D
5.	A
6.	D
7.	A
8.	B
9.	D
10.	A