

**IMPORTANT TERMS AND CONCEPTS RELATING TO  
NOTES RECEIVABLE  
Chapter 9**

**Important Terms**

Promissory Note-a written promise to pay a specified amount of money either on demand or at a definite future date. Promissory Notes may be used in exchange for goods or services, in exchange for loaned funds, or in exchange for an outstanding account receivable.

Principal-amount stated on the face of the note.

Payee-person to whom the principal is owed.

Maker-person who signs the note and promises to pay the principal.

Interest-the charge for the use of money over a period of time. Interest is generally stated as an annual percentage rate.

The maker of the note will have interest expense.

The payee of the note will have interest revenue.

Origination Date -the day the note was “made”.

Maturity Date-the date the principal and interest are due to the payee.

Maturity Value-the total amount due on the maturity date. Principal plus interest.

The time of the note is the period of time from the origination date to the maturity date. Time may be expressed in days, months, or years.

Honoring a Note-paying the note in full on the maturity date.

Dishonoring a Note-not paying the note at the maturity date.

**Additional Terms**

Factoring-selling accounts receivable to a financial institution. The financial institution usually charges a factoring fee for their services. The amount a company receives for factoring accounts receivable is the amount of the accounts receivable less the factoring fee.

Pledging-using accounts receivable as security for a loan.

Discounting-selling notes receivable to a financial institution.

Proceeds-amount the seller receives from discounting a note. (See the footnote on page 425 for a calculation of proceeds from discounting a note.) The proceeds received for discounting a note may be more or less than the principal of the note. Factors affecting this amount include the interest rate, the discount rate, and the period of time the note has been held by the payee.

Discount Rate-the amount the financial institution charges for discounting a note.

Note Discounted With Recourse-the seller of the note retains the risk of loss if the note is dishonored.

Contingent Liability-a liability for a known amount that will exist if a certain future event occurs.

## Notes Receivable Journal Entries Chapter 9

Since we are dealing with Notes Receivable, the entries will be from the perspective of the payee.

### Receipt of the Note

Notes Receivable  
Sales or Cash or Accounts Receivable

A subsidiary ledger is generally not kept for Notes Receivable. The notes are filed and serve as a reference for all information regarding each Note Receivable account.

### Payment of the Note by the Maker- Honored Note

Cash  
Notes Receivable  
Interest Income

Cash should generally be debited for the maturity value of the note.

### Dishonored Note

Accounts Receivable  
Notes Receivable  
Interest Income

Dishonored notes do not disappear, but are removed from notes receivable and become an unsecured account receivable. Even though no cash has been received, interest has been earned through the use of the money by the maker of the note and therefore interest income should be recognized.

### Adjustment for Accrual of Interest

Interest Receivable  
Interest Income

This adjustment is made (if necessary) at the end of the fiscal period.

## **Interest Computation**

Interest is generally recorded when the note is repaid.

$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \text{Time} \quad (\mathbf{P} \times \mathbf{R} \times \mathbf{T})$$

The time period of a note is stated as a fraction of days, months, or years. For example, interest on a 90-day note with a principal of \$1,000 and an annual interest rate of 10% would be calculated as follows:

Principal	X	Rate	X	Time
\$1,000	X	.1	X	90/360

For simplicity, a year is treated as having 360 days.

When calculating any end-of-period interest accrual, use only the time that the note has been held—not the full period of the note.