

# Notes Receivable



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# lecture 3



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## Notes Receivable

**Note Receivable** : A business may lend money to an individual or to a customer. These loans are typically short term, due to be repaid to the business within one year. In this case, the current asset account **Note Receivable** is used to keep track of amounts that are owed to the business.

A **note receivable** is a loan contract that specifies the principal (amount of the loan), the interest rate stated as an annual percentage, and the terms stated in number of days or months.

### Balance Sheet

<b>ASSETS</b>			
<b>Current assets:</b>			
Cash			\$40,000
Accounts receivable	\$28,000		
Less: Allowance for doubtful accounts	3,000	25,000	
Merchandise inventory		60,000	
Supplies		18,000	
Prepaid rent		12,000	
Prepaid insurance		6,000	
Prepaid taxes		4,000	
Note receivable		2,000	
<b>Total current assets</b>			<b>\$167,000</b>
<b>Fixed assets:</b>			
Equipment	\$16,000		
Less: Accumulated depreciation	2,000	14,000	
Van	30,000		
Less: Accumulated depreciation	5,000	25,000	
Building	200,000		
Less: Accumulated depreciation	70,000	130,000	
Land		110,000	
<b>Total fixed assets</b>			<b>279,000</b>
<b>Intangible assets:</b>			
Patents			14,000
<b>Total assets</b>			<b>\$460,000</b>

## 1- Issue Date

There are situations where a company may receive a short-term note.

- a. A direct short-term loan for cash when an employee or other individual asks to **borrow** money and the company agrees and distributes cash.

Date	Account	Debit	Credit
	Note Receivable	XXX	
	Cash		XXX

- b. A company sells merchandise to a customer on account and gives the customer days or months to pay.

Date	Account	Debit	Credit
	Accounts Receivable	XXX	
	Sales		XXX

- c. After days or months the customer's accounts receivable amount is due, but the customer is unable to pay. If both parties agree, the customer's Accounts Receivable account balance can be transferred to the Note Receivable account on that date

Date	Account	Debit	Credit
	Note Receivable	XXX	
	Accounts Receivable		XXX

## 2- Maturity (Due) Date

At the end of the term of the loan, on the maturity date, the note is void. At that time the Note Receivable account must be credited for the principle amount. In addition, the amount of interest earned must be recorded in the journal entry as Interest Revenue.

The amount of interest is calculated using the following equation:

$$\text{Principal} * \text{Rate} * \text{Time} = \text{Interest Earned}$$

Date	Account	Debit	Credit
	Cash	XXX	
	Note Receivable		XXX
	Interest Revenue		XXX

**Example 1:** Assume that at June 1, 2012 **Ahmed** sold \$10,000 of merchandise on account to **Ali**. **Ali** later requested more time to pay, and agreed to give a formal **three-month** note bearing interest at 12% per year.

**Required :** Record the journal entries .

**Sol /**

**June 1**

Notes Receivable 10,000

Accounts Receivable 10,000

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**August 31**

Principal \* Rate \* Time = Interest Earned

$(\$10,000 * 12\% * 3/12) = 300$

Cash 10,300

Notes Receivable 10,000

Interest Income 300

**Example 2 :** Royal Company has made the following transactions in the year 2018 :

- ❖ **17/10/2018 Royal Company** lent \$50,000 to **Estroz LDT** against a promissory note for 120 days at an annual interest rate of 7%.
- ❖ **26/10/2018 Xander LDT** issued a promissory note to **Royal Company** for the past due account in the amount of \$15,000 at an annual interest rate of 8% to mature in 60 days.
- ❖ **15/11/2018 Royal Company** collected a promissory note in the amount of \$25,000 and related interest issued by **Smith LDT** on 18/8/2018 at an annual interest rate of 7%.

**Required:** Record the required journal entries for the year 2018 in the Royal Company books.

**Sol /**

**17/10/2018**                      Notes receivable      50,000

                                    Cash                      50,000

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**26/10/2018**                      Notes receivable    15,000

                                    Accounts receivable    15,000

**15/11/2018**

Principal \* Rate \* Time = Interest Earned

$$25,000 * 7\% * 90/365 = 431.5$$

Cash 25,431.5

Notes receivable 25,000

Interest income 431.5

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**Homework :**

- 1/1/2020 Company A sells machinery to Company B for \$300,000, with payment due within 30 days.
- After late of nonpayment by Company B, both parties agree on 1/4/2020 that Company B will issue a note payable for the principal amount of \$300,000, at an interest rate of 10% .

Required: Record the required journal entries for the year 2020 in the A Company books.