

Chapter 10 Notes

Accounting for Notes Receivable, Unearned Revenue, and Accrued Revenue

10.1: NOTES RECEIVABLE

- Because of the nature of notes receivable and some types of revenue, special accounting procedures may be required at the end of a fiscal period.
 - For example, a note receivable issued in one fiscal period with a maturity date in the following fiscal period requires special accounting procedures.
 - Special accounting procedures are also required for two types of revenue:
 1. Revenue received in one fiscal period but not earned until the next fiscal period.
 2. Revenue earned in one fiscal period but not received until the next fiscal period.
- Notes Receivable - promissory notes that a business accepts from customers
 - These are usually due within a year and are therefore classified as current assets.
 - Notes receivable can be issued to customers who need an extension of time to pay on account. When this occurs, the amount to be received is changed from an account receivable to a note receivable.
 - Example: April 3. Accepts a 30-day, 12% note from Duane Jansen for an extension of time on his account, \$300. Note Receivable No. 11.

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	2016 APR 3	NOTES RECEIVABLE	NR 11		300		1	
2		AR DUANE JANSEN				300	2	

- **ISSUING A NOTE FOR A SALE**
 - Most sales on account assume that the customer will pay within 30 days or less. To promote sales, a company may allow its customers to sign a note extending payment over a longer period of time.
 - If no cash is received, the sale is recorded in a general journal. If a cash down payment is received, the transaction could be recorded in a cash receipts journal.
 - Example: April 4. Accepts a 90-day, 12% note from Mark Carver for the sale of an appliance, \$450. Note Receivable No. 12.

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1		NOTES RECEIVABLE	NR 12		450		1	
2		SALES				450	2	

- **RECEIVING CASH FOR A NOTE RECEIVABLE**

- Interest is earned for the period of time a note is outstanding. Because the interest rate is state as an annual rate, the actual interest earned must be computed as a fraction of a year (using 360 days).

- Example: May 3. Received cash for the maturity value of Note Receivable No. 11: principal, \$300, plus interest, \$3; total, \$303. Receipt No. 452.

Interest Calculation:

$$\begin{array}{rclclclcl} \text{Principal} & \times & \text{Interest Rate} & \times & \text{Fraction of Year} & = & \text{Interest} \\ \$300.00 & \times & 12\% & \times & \frac{30}{360} & = & \$3.00 \end{array}$$

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	GENERAL		ACCOUNTS RECEIVABLE CREDIT	SALES CREDIT	SALES TAX PAYABLE CREDIT	SALES DISCOUNT DEBIT	CASH DEBIT	
					DEBIT	CREDIT						
1	May 3	Notes Receivable	R452			300					303	1
2		Interest Income				3						2

- **RECORDING A DISHONORED NOTE RECEIVABLE**

- Dishonored Note - a note that is not paid when due
- The notes receivable account balance should include only the amount of notes receivable that a business expects to collect. Otherwise, Notes Receivable will be reported incorrectly on a balance sheet.
- Although a notes is dishonored, an accounts receivable still owes the money, so a journal entry is recorded to transfer the maturity value of the note to their account. The journal entry does not cancel the debt and the business will continue to try to collect the account.
 - Example: Ruth Javinsky dishonored Note Receivable No. 8, a 30-day, 12% note, maturity value due today: principal, \$250; interest, \$2.50; total, \$252.50. Memorandum No. 120.

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.			
					DEBIT	CREDIT	
1	July 1	Ruth Javinsky	M120		252.50		1
2		Notes Receivable				250	2
3		Interest Income				2.50	3

- **RECEIVING CASH FOR A DISHONORED NOTE RECEIVABLE**

- Sometimes payment may be received on a previously dishonored note. Additional interest is charged from maturity date to payment date.
- The time for computing additional interest begins when the note is dishonored and ends on the day cash is received.
 - Example: September 30. Received cash from Ruth Javinsky for dishonored Note Receivable No. 8; maturity value, \$252.50, plus additional interest, \$10.18; total, \$262.68. Receipt No. 201.

Time	Number of Days
June 1 through June 30	29 (30 - 1 = 29)
July	31
August	31
September 1 through September 30	30
Total number of days	121

Maturity Value	x	Interest Rate	x	Fraction of Year	=	Additional Interest
\$252.50	x	12%	x	$\frac{121}{360}$	=	\$10.18

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DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	GENERAL		ACCOUNTS RECEIVABLE CREDIT	SALES CREDIT	SALES TAX PAYABLE CREDIT	SALES DISCOUNT DEBIT	CASH DEBIT
				DEBIT	CREDIT					
2016 Sept 30	RUTH JAVINSKI	R201				252.50				262.68
	Interest Income				10.18					

10.2: UNEARNED AND ACCRUED REVENUE

- U neamed R venue - revenue received in one fiscal period but not earned until the next fiscal period, aka deferred revenue
 - Unearned revenue may be recorded initially as a liability or as revenue.
 - Only that part of unearned revenue actually earned should be recorded as revenue in a fiscal period. An adjusting entry is recorded to separate the earned and unearned portions of revenue.
 - Example: On December 1, Appliance Center received \$6,000 from Pace Delivery, \$2,000 per month for December, January, and February rent. The receipt was recorded as rent income and is included in the \$28,000 balance of Rent Income. At the end of the fiscal period, the January and February rent is unearned and should be reported in Unearned Rent. After the adjusting entry, the new balance of Rent Income, \$24,000, correctly reflects 12 months of rent. Record the adjusting entry on December 31.

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.		
					DEBIT	CREDIT
1	2016	Adjusting Entries				
2	Dec 31	Rent Income			4000	
3		Unearned Rent				4000

- **REVERSING ENTRY FOR UNEARNED REVENUE INITIALLY RECORDED AS A REVENUE**

- On December 31, Rent Income is closed as part of closing entries and therefore its balance is zero. reversing entries for unearned revenue are made to return the amount of unearned revenue to the account in which it was initially recorded.

- Example: January 1. Record the reversing entry for the adjusting entry above (Unearned Rent and Rent Income).

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	2017	REVERSING ENTRIES					1	
2	JAN 1	UNEARNED RENT			4000		2	
3		RENT INCOME				4000	3	

- **ADJUSTING ENTRY FOR ACCRUED INTEREST INCOME**

- **A** _____ **R** _____ - revenue earned in one fiscal period but not received until a later fiscal period

- Example: On December 31, Appliance Center has two notes receivable outstanding.

1. Note Receivable No. 12, a 60-day, 10% note dated December 1, \$500.
2. Note Receivable No. 13, a 30-day, 10% note dated December 16, \$700.

Note	Principal	x	Interest Rate	x	Fraction of Year	=	Accrued Interest Income
12	\$252.50	x	12%	x	$\frac{121}{360}$	=	\$10.18
13	\$700	x	10%	x	$\frac{15}{360}$	=	2.92
Total accrued interest income, December 31....							\$7.09

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	2017	ADJUSTING ENTRIES					1	
2	DEC 31	INTEREST RECEIVABLE			7.09		2	
3		INTEREST INCOME				7.09	3	

- **REVERSING ENTRY FOR UNEARNED REVENUE INITIALLY RECORDED AS A REVENUE**

- Example: January 1. Record the reversing entry for the adjusting entry above (Interest Income and Interest Receivable).

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	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	2017	REVERSING ENTRIES					1	
2	JAN 1	INTEREST INCOME			7.09		2	
3		INTEREST RECEIVABLE				7.09	3	