Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Chapter 9 Notes**

**Accounting for Notes Payable, Prepaid Expenses, and Accrued Expenses**

**Section 9.1: Notes Payable**

* Business transactions occur throughout a fiscal period. Some transactions begin in one accounting period and are completed in a different accounting period. Therefore, some financial activities require the use of special accounting procedures.
  + For Example: some expenses, such as insurance and advertising, require cash payment before the benefit is received. Thus, a cash payment for these expenses may occur in the fiscal period before the related expense should be recognized.
* **Borrowing Money with a Note Payable**
  + **P\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ N\_\_\_\_\_\_\_\_\_\_** - *a written and signed promise to pay a sum of money at a specified time*
  + **N\_\_\_\_\_\_\_\_\_\_\_\_\_ P\_\_\_\_\_\_\_\_\_\_\_\_\_** - *promissory notes signed by a business and given to a creditor*
  + **D\_\_\_\_\_\_\_\_\_\_\_ of the N\_\_\_\_\_\_\_\_\_\_** - *the day a note is issued*
  + **P\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ of a Note** – *the original amount of a note*
  + **M\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ D\_\_\_\_\_\_\_\_\_ of a Note** – *the date a note is due*
  + **I\_\_\_\_\_\_\_\_\_\_\_\_\_\_** - *an amount paid for the use of money for a period of time*
  + **I\_\_\_\_\_\_\_\_\_\_\_\_\_\_ R\_\_\_\_\_\_\_\_\_\_ of a Note** – *the percentage of the principal that is paid for the use of the money*
* **Calculating the Maturity Date**
  + The number of days in each month during the term of the note impacts the maturity date.
  + Example: On March 2, Appliance Center signed a 180-day, 10% note, $1,500. Find the maturity date.

**Time Number of Days**

March 2 thru March 31 29 (31 – 2 = 29)

April 30

May 31

June 30

July 31

August 1 thru August 29 29 (Maturity date: Aug. 29)

180 days

* **Calculating Interest**
  + The interest rate of the note is stated as an annual rate.
  + The interest paid on the note is calculated by applying the annual rate for the portion of the year that the note is outstanding. *\*For ease of calculation, most banks use 360 rather than 365 as the number of days in a year.*
  + Example: (from above) Calculate the interest on 180-day, 10% note, $1,500 signed on March 2.

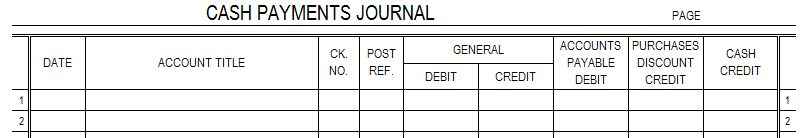
**Principal x Interest x Time = Interest for**

**Rate (as fraction of year) Fraction of Year**

$1,500 x 10% x 180 = $75.00

360

* **Paying a Note Payable**
  + **I\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ E\_\_\_\_\_\_\_\_\_\_\_\_\_** - *the interest accrued on money borrowed*
  + On the maturity date, the borrower pays both the principal of the note and the interest expense. They payment is recorded in the cash payments journal.
  + **M\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ V\_\_\_\_\_\_\_\_\_\_\_** - *the amount that is due on the maturity date of a note*
  + Example: August 29. Paid cash for the maturity value of the March 2 note: principal, $1,500, plus interest, $75; total, $1,575. Check No. 359.

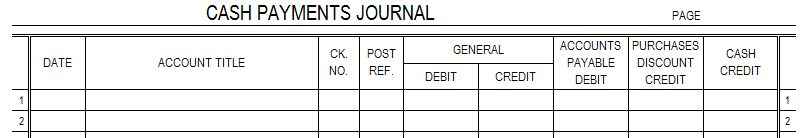


**Section 9.2: Prepaid Expenses**

* **P\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ E\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** - *expenses paid in one fiscal period but not reported as expenses until a late fiscal period, examples include supplies, insurance, advertising, and income taxes*
* Only that portion of cash payment for expenses that have been used in the current fiscal period should be reported as an expense in that fiscal period.
* Prepaid expenses may be recorded initially as assets or as expenses.

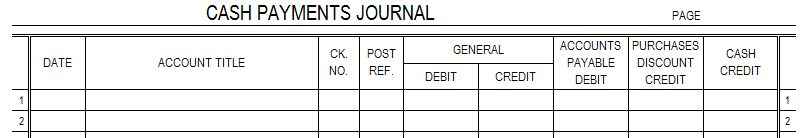
1. *As Assets*: Cash payments for supplies and insurance are debited to an asset, credited to cash.

* Example: May 12. Appliance Center bought office supplies, $500. Check No. 55.

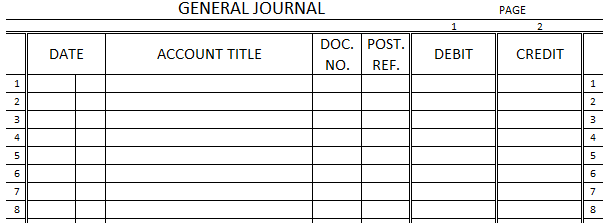


1. *As Expenses*: Cash payments for supplies and insurance are debited to an expense, credited to cash.

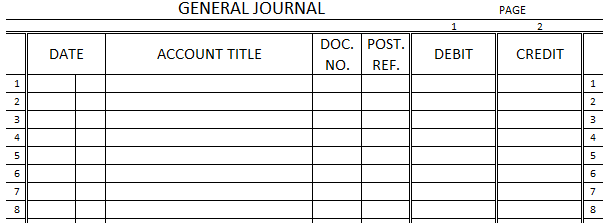
* Example: May 15. Appliance Center bought sales supplies, $2,000. Check No. 56.



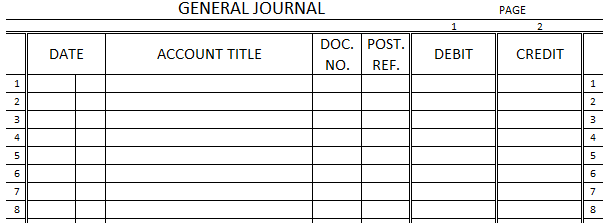
* **Adjusting and Closing Entries for Supplies Initially Recorded as an Asset**
  + Adjusting entries for supplies recorded as assets are debits to Supplies Expense and credit to Supplies. The amount shows the supplies used during a fiscal period. So the balance of Supplies Expense represents the amount of supplies used and Supplies represents the amount of supplies not yet used.
    - Example: At the end of the fiscal period, the office supplies inventory was $2,750 and the balance of the Supplies – Office account in the general ledger was $12,700. Record the adjusting and closing entry.



* **Adjusting and Closing Entries for Supplies Initially Recorded as an Expense**
  + When supplies are initially recorded as an expense, the balance of Supplies Expense represents the amount of the beginning supplies inventory plus the total amount of all supplies bought during the fiscal period. Nothing has been recorded in the supplies (asset) account during the fiscal period.
    - Example: On December 31, a physical count of the sales supplies determines that the sales supplies ending inventory is $800. Prior to the adjusting entry, the balance of Supplies Expense – Sales is $2,000. Record the adjusting and closing entry.



* **Reversing Entry – Supplies Initially Recorded as an Expense**
  + After the closing entries – for a business that records supplies as an expense – have been posted, the general ledger accounts are *not* ready for the next fiscal period. In order to prepare the ledger accounts for the new fiscal period, a reversing entry must be recorded at the beginning of the fiscal period.
    - **R\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ E\_\_\_\_\_\_\_\_\_\_\_** - *an entry made at the beginning of one fiscal period to reverse an adjusting entry made in the previous fiscal period; it is the exact opposite of the related adjusting entry*
    - *How do you know if you need a reversing entry?* If an adjusting entry *creates* a balance in an asset or a liability account, the adjusting entry is reversed.
    - Example: An adjusting entry of $800 for sales supplies was recorded on December 31. Record the reversing entry for this transaction on January 1.

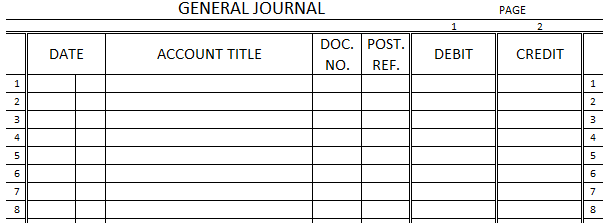


**Section 9.3: Accrued Expenses**

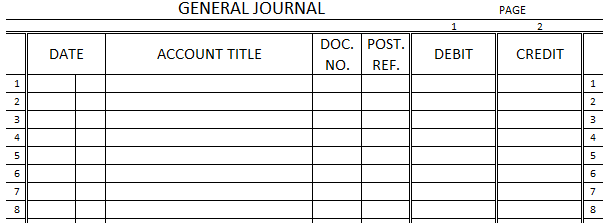
* **A\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ E\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** - *expenses incurred in one fiscal period but not paid until a later fiscal period; there are four possible accrued expenses:*

1. Accrued interest expense
2. Accrued salary expense
3. Accrued employer payroll taxes expense
4. Accrued federal income tax expense

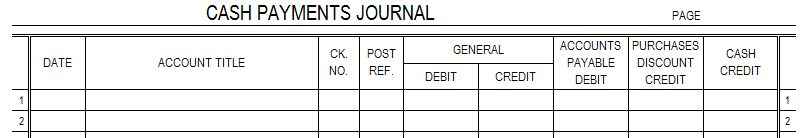
* **Journalizing Accrued Interest Expense**
  + Example: On December 31, Appliance Center has a 60-day, 10% note payable for $7,500, dated December 16, on which interest has accrued. Record the adjusting entry for the 15 days’ worth of accrued interest on the note, $31.25.



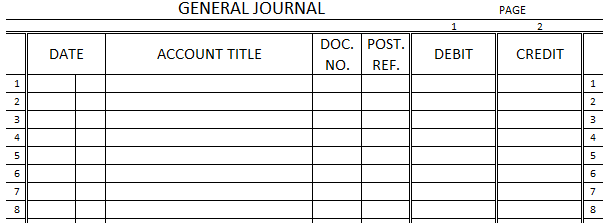
* **Reversing Entry for Accrued Interest** 
  + Example: Record the reversing entry for the above adjusting entry.



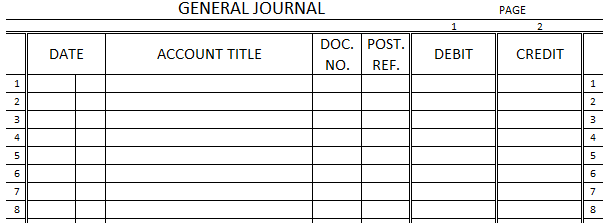
* **Payment of Note at Maturity**
  + Example: On February 13th, Appliance Center pays its 60-day, 10% note payable for $7,500 for its maturity value, $7,625. Check No. 78.



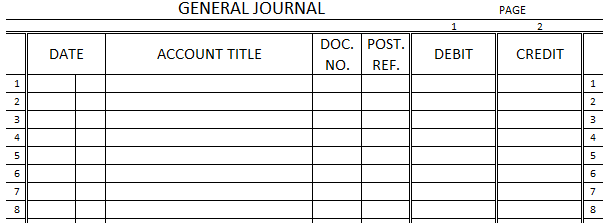
* **Journalizing Accrued Salary Expense**
  + Example: Appliance Center pays its employees each Friday for the time they worked during the previous week. On December 31, Appliance Center owes, but has not paid, the employees for Monday through Friday of the previous week. To determine the adjusting entry, Appliance Center must prepare the payroll register, but checks are not prepared or distributed until the normal payment date, January 5. The salaries and deductions were dived as follows:
    - Salaries-Administrative, $750
    - Salaries-Sales, $850
    - Salaries-Warehouse, $450
    - Federal Income Tax Withheld, $326
    - Social Security Tax Withheld, $133.25
    - Medicare Tax Withheld, $30.75



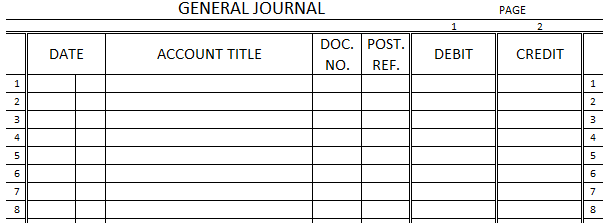
* **Reversing Entry for Accrued Salary**
  + After closing entries for payroll are recorded, the payroll expense accounts have zero balances. The salaries payable account reflects the salaries to be paid on the payment date. This entry removes the adjusting entry amounts from the payroll liability accounts. The salary expense accounts have contra balances after the reversing entry. When the payroll is paid in January, the amount debited in each account is offset by the credit contra balance.
  + Example: Record the reversing entry for the adjusting entry above.



* **Journalizing Accrued Employer Payroll Taxes Expense**
  + Example: Record the adjusting entry for accrued employer payroll taxes:
    - Social Security Tax, $133.25
    - Medicare Tax, $30.75
    - Unemployment Tax Payable – Federal, $3.60
    - Unemployment Tax Payable – State, $24.30



* **Reversing Entry for Accrued Employer Payroll Taxes Expense**
  + Example: Record the reversing entry for the adjusting entry above.



* **Journalizing Accrued Federal Income Tax Expense**
  + Corporations must pay federal income tax on net income. At the beginning of each year, the corporation makes an estimate of its federal income tax obligation. At the end of the year, the company revises it income tax estimate for the year. Any unpaid federal income tax is an accrued expense for which an adjusting entry must be made.
    - Example: On December 31, Appliance Center’s records show that quarterly income tax payments have been made for a total of $9,000. The company estimates that its income tax will be $10,000. Record the adjusting entry for the difference.

