

Name: KEY

## 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 romissory N ote - a written and signed promise to pay a sum of money at a specified time
  - N otes P ayable - promissory notes signed by a business and given to a creditor
  - D ate of the N ote - the day a note is issued
  - P rin ci p a l of a Note - the original amount of a note
  - M atu r i t y D ate of a Note - the date a note is due
  - I n ter e s - an amount paid for the use of money for a period of time
  - I n ter e s R ate 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)
	<u>180 days</u>

- **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 Rate	x	Time (as fraction of year)	=	Interest for Fraction of Year
\$1,500	x	10%	x	$\frac{180}{360}$	=	\$75.00

- **Paying a Note Payable**

- Interest Expense - the interest accrued on money borrowed
- On the maturity date, the borrower pays both the principal of the note and the interest expense. The payment is recorded in the cash payments journal.
- Maturity Value - 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.

### CASH PAYMENTS JOURNAL

PAGE

DATE	ACCOUNT TITLE	CK. NO.	POST REF.	GENERAL		ACCOUNTS PAYABLE DEBIT	PURCHASES DISCOUNT CREDIT	CASH CREDIT	
				DEBIT	CREDIT				
1 Aug 29	Notes payable	359		1500				1575	1
2	Interest expense			75					2

### SECTION 9.2: PREPAID EXPENSES

- Prepaid Expense - expenses paid in one fiscal period but not reported as expenses until a later 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.

### CASH PAYMENTS JOURNAL

PAGE

DATE	ACCOUNT TITLE	CK. NO.	POST REF.	GENERAL		ACCOUNTS PAYABLE DEBIT	PURCHASES DISCOUNT CREDIT	CASH CREDIT	
				DEBIT	CREDIT				
1 May 12	Supplies - Office	55		500				500	1

- 2) *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.

### CASH PAYMENTS JOURNAL

PAGE

DATE	ACCOUNT TITLE	CK. NO.	POST REF.	GENERAL		ACCOUNTS PAYABLE DEBIT	PURCHASES DISCOUNT CREDIT	CASH CREDIT	
				DEBIT	CREDIT				
1 May 15	Supplies Expense - Sales	56		2000				2000	1

- **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.

12,700 - 2,750

GENERAL JOURNAL						PAGE	
				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		Adjusting Entries					1
2	Dec 31	Supplies Expense - Office			9950		2
3		Supplies - Office				9950	3
4							4
5		Closing Entries					5
6	Dec 31	Income Summary			9950		6
7		Supplies Expense - Office				9950	7

- **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.

2,000 - 800

GENERAL JOURNAL						PAGE	
				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		Adjusting Entries					1
2	Dec 31	Supplies - Sales			800		2
3		Supplies Expense - Sales				800	3
4							4
5		Closing Entries					5
6	Dec 31	Income Summary			1200		6
7		Supplies Expense - Sales				1200	7

- **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.

- **Reversing Entry** - 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.

GENERAL JOURNAL						PAGE	
				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		REVERSING ENTRIES					1
2	JAN 1	SUPPLIES EXPENSE - SALES			800		2
3		SUPPLIES - SALES				800	3

### SECTION 9.3: ACCRUED EXPENSES

- A ACCURED E XPENSES - 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.

GENERAL JOURNAL						PAGE	
				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		ADJUSTING ENTRIES					1
2	DEC 31	INTEREST PAYABLE			31.25		2
3		INTEREST EXPENSE				31.25	3

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

GENERAL JOURNAL						PAGE	
				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		REVERSING ENTRIES					1
2	JAN 1	INTEREST PAYABLE			31.25		2
3		INTEREST EXPENSE				31.25	3



- **Payment of Note at Maturity**

- Example: On February 13<sup>th</sup>, Appliance Center pays its 60-day, 10% note payable for \$7,500 for its maturity value, \$7,625. Check No. 78.

CASH PAYMENTS JOURNAL								PAGE		
	DATE	ACCOUNT TITLE	CK. NO.	POST REF.	GENERAL		ACCOUNTS PAYABLE DEBIT	PURCHASES DISCOUNT CREDIT	CASH CREDIT	
					DEBIT	CREDIT				
1	Feb 13	NOTES payable	78		7500				7625	1
2		Interest Expense			125					2

- **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 divided 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

GENERAL JOURNAL							PAGE	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.				
					1 DEBIT	2 CREDIT		
1		ADJUSTING ENTRIES						1
2	Dec 31	SALARY EXP - Admin.			750			2
3		SALARY EXP - SALES			850			3
4		SALARY EXP. - WAREHOUSE			450			4
5		SALARIES PAYABLE				1960		5
6		EMPLOYEE INCOME TAX PAY.				326		6
7		SOC. SEC. TAX PAY.				133.25		7
8		MEDICARE TAX PAY.				30.75		8

add salaries - deductions

- **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.

GENERAL JOURNAL							PAGE	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.				
					1 DEBIT	2 CREDIT		
1		Reversing ENTRIES						1
2	JAN 1	SALARIES PAYABLE			1960			2
3		EMPLOYEE INCOME TAX PAY.			326			3
4		SOC. SEC. TAX PAY.			133.25			4
5		MEDICARE TAX PAY.			30.75			5
6		SALARY EXP - Admin.				750		6
7		SALARY EXP. - SALES				850		7
8		SALARY EXP. - WAREHOUSE				450		8

- **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

### GENERAL JOURNAL

PAGE

				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		Adjusting Entries					1
2	Dec 31	Payroll Taxes Exp.			191.90		2
3		Soc. Sec. Tax Pay.				133.25	3
4		Medicare Tax Pay.				30.75	4
5		Unemp. Tax Pay. - Fed.				3.60	5
6		Unemp. Tax Pay. - State				24.30	6

- **Reversing Entry for Accrued Employer Payroll Taxes Expense**

- Example: Record the reversing entry for the adjusting entry above.

### GENERAL JOURNAL

PAGE

				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		Reversing Entries					1
2	Jan 1	Soc. Sec. Tax Pay.			133.25		2
3		Medicare Tax Pay.			30.75		3
4		Unemp. Tax Pay. - Fed.			3.60		4
5		Unemp. Tax Pay. - State			24.30		5
6		Payroll Taxes Exp.				191.90	6

- **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 its 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.

### GENERAL JOURNAL

PAGE

				1		2	
	DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
1		Adjusting Entries					1
2	Dec 31	Federal Income Tax Exp.			1000		2
3		Federal Income Tax Pay.				1000	3