Accounting for Commercial notes

Accounts receivable are customers debts based on the sales of goods. A note receivable is a written agreement known as the promissory note.

Note Receivable is an agreement made from one person or organization to another to make payment of certain amount at a certain date or when the payment is requested .

1) When individuals and companies lend or borrow money,

(2) When the amount of the transaction and the credit period exceeds normal limits, or (3) in settlement of accounts receivable.

In a promissory note, the party making the promise to pay is called the Maker.

The party to whom payment is to be made is called the payee.

Types of Notes Receivable:

1- With interest.

2- Without interest.

The note receivable with interest require the party that prepares the note, or the party that signs the note, to pay the face value of the note together with related interest at the maturity date.

The notes receivable with no interest payment requires the relevant party to pay only the face value on date of maturity. In reality, the face value of a note without interest has interest already included in it.

Features of Notes Receivable:

There are several features in the promissory note receivable to explain these features we can see the following example of notes with interest:

Promissory Note

Amount: ID 500000 Date: 1 June 2016

For the amount that I have received, I promise to pay according to the instruction of Ahmed Hassan, an amount of Dinar Five Hundred Thousands on 1st September, 2016 together with interest at the rate of 8%.

Signed: Salah Laith

a- Maker: In the above example, the maker of the note is Salah Laith and the party needs the payment, called the holder, and is Ahmed Hassan.

b- Maturity date: In the above example the maturity date is clearly stated as 1st September, 2016. Sometimes, the maturity date is not stated in this manner, but instead with statement such as the number of days or months from the date of the notes. For example, in the above, it can also be stated that the payment needs to be made "three months from date".

c- Period of the Note: this means the number of days up to the date of maturity.

The period of the note needs to be calculated accurately in order to determine the interest. For example the period of the note in the above example, from 1st June 2016 to 1st September 2016, is 91 days which is computed as follows.

June 29 (the first date is not taken into account)

July 31

August 31

91 days

d- Face value: The face value means the amount owed that is stated on the face of promissory note. The face value is also known as the principal. In the example above the face value or the principle is ID 500000.

e- Interest: The interest depends on three factors, namely the face amount (principal) that is the total amount loaned , specified maturity date or dates (Tenure), and the percentage of interest or (interest rate).

Interest on Notes calculated according to the following formula:

Face amount (principal) × annual rate × Fraction of the annual period

for the above example the interest is computed as follows:

500000 × 8% × 3/12 = ID 10000 we can also compute the interest as follows;

500000 × 8% × 91/365= ID 10000

Accounting for Notes Receivable

1- Interest- Bearing Notes:

This type of note receivable requires payment of a specified face amount at specific maturity date with interest.

Example (1): On May 1, 2016 Baghdad Company sold goods to Basra Company. Baghdad Co. agreed to accept a ID 700000, 6 month, 12% note in payment for the goods. Interest is payable at maturity.

Required:

Record the journal entries in Baghdad's company records.

Solution:

May 1, 2016

Note Receivable ……………………………………………700000

Sales revenue…………………………………………………700000

To record the sale of goods in exchange for note receivable

November 1, 2016

Cash (ID 700000 + ID 42000)……………………………………742000

Interest revenue (ID 700000 × 12% × 6/12)………………..………42000

Note receivable…………………………………………………………..700000

To record the collection of the note receivable at maturity date.

Example (2): On August 1, 2016 Baghdad company sold goods to Basra company . Baghdad Co. agreed to accept a ID 700000, 6 month, 12% note in payment for the goods. Interest is payable at maturity.

Required:

Record the journal entries in Baghdad's company records.

Solution:

August 1,2016

Note receivable ……………………………………………700000

Sales revenue………………………………………………..700000

To record the sale of goods in exchange for a note receivable

December 31, 2016

Interest receivable …………………………………………35000

Interest revenue (ID 700000 × 12% × 5/12)……………….35000

To record interest receivable for 5 months of 2016

February 1, 2017

Cash (ID 700000 × 12% × 6/12)……………………….742000

Interest revenue (700000 × 12% × 1/12)…………………7000

Interest receivable (accrued at December 31)………………35000

Note Receivable………………………………………………700000

To record collection of note receivable