Notes Receivable

Promissory Note
• Written promise to pay a certain sum on a certain date to a payee
• Negotiable (can be sold or transferred from one holder to another)
• Must be signed by maker with a stated interest rate and date for payment
• A “zero interest” bearing note has the interest as part of the face amount

Uses of notes
• Can extend the time necessary to pay for goods or services
• Is wise for high credit risk or new, unknown customers
• Can secure loans for employees
• Facilitates and expedites sales of property, plant and equipment

Valuation
• Short term notes (3 months or less) are at face value (original amount)
• Long term notes are carried at present value
  o There are two interest rates: stated (on the note) and market (what the market demands)
  o When the stated rate on the note varies from the market rate:
    ▪ A discount (lowers value of note) results (stated<market)
    ▪ A premium (raises value of note) results (stated>market).
  o Carrying value = face amount plus premium or less discount
• An imputed interest rate is used when a borrower and a lender are both independent and need to negotiate (agree on) a rate equal to similar instruments of issuers with same credit ratings.
• Allowances are used in a manner similar to accounts receivable.
• If it is probable the creditor will be unable to collect, this is impairment
  o The note should be written off

Disposition: Transfer or Sale
• The new holder of the receivable is the legal owner
• Holder’s rights are protected vs. secured creditor (see Law handout)

Factoring
Factors are finance companies or banks that buy receivables from businesses for a fee and are skilled in collecting from debtors. Arrangements can be:
• With recourse: seller guarantees payment to purchaser
• Without recourse: purchaser assumes risk of collection and absorbs any credit losses

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<td>Cash</td>
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<td>Due from factor</td>
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<tr>
<td>Accounts Receivable</td>
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