

INSTALLMENT NOTES PAYABLE

Future Horizons Inc. planned to borrow \$40,000 for 4 years on January 1, 2002, paying interest of 12%. Bank A required four equal payments of \$10,000 on Principal plus accrued interest while Bank B required 4 equal payments. The entries below were considered and Bank B's requirements were accepted.

BANK A

Jan. 1	2002	Cash	40,000	
		Notes Payable		40,000
		Signed \$40,000 in notes payable with maturities of 1,2,3, and 4 years.		
Dec. 31	2002	Notes Payable (\$40,000/4)	10,000	
		Interest Expense (\$40,000) (.12)	4,800	
		Cash		14,800
Dec. 31	2003	Notes Payable (\$40,000/4)	10,000	
		Interest Expense (\$30,000) (.12)	3,600	
		Cash		13,600
Dec. 31	2004	Notes Payable (\$40,000/4)	10,000	
		Interest Expense (\$20,000) (.12)	2,400	
		Cash		12,400
Dec. 31	2005	Notes Payable (\$40,000/4)	10,000	
		Interest Expense (\$10,000) (.12)	1,200	
		Cash		11,200

BANK B

The \$40,000 note represents the present value of a 4-year annuity with interest at 12% compounded annually. Equal payments would be calculated as follows:

$$P = A(PVMA)$$

$$\$40,000 = A(3.037)$$

$$A = \$13,171$$

Note: BOP abbreviates Beginning of Period
EOP abbreviates End of Period

Period Ending	(a) Principal BOP	(b) Period Payment	(c) Interest (a) (.12)	(d) Principal Reduction (b-c)	Principal (EOP) (a-d)
12/31/02	\$40,000	\$13,171	\$ 4,800	\$ 8,371	\$31,629
12/31/03	31,629	13,171	3,795	9,376	22,253
12/31/04	22,253	13,171	2,670	10,501	11,752
12/31/05	11,752	13,171	<u>1,419</u>	<u>11,752</u>	0
			<u>\$12,684</u>	<u>\$40,000</u>	

CASH RECEIPT AND ANNUAL PAYMENTS

Jan. 1	2002	Cash	40,000	
		Notes Payable		40,000
		Signed \$40,000 in notes payable with maturities of 1,2,3, and 4 years.		
Dec. 31	2002	Notes Payable	8,371	
		Interest Expense	4,800	
		Cash		13,171
Dec. 31	2003	Notes Payable	9,376	
		Interest Expense	3,795	
		Cash		13,171
Dec. 31	2004	Notes Payable	10,501	
		Interest Expense	2,670	
		Cash		13,171
Dec. 31	2005	Notes Payable	11,752	
		Interest Expense	1,419	
		Cash		13,171

Note: Year 4's interest is equal to the period payment minus the remaining principal (\$13,171 - \$11,752) = \$1,419.

Note: This is a one-page Learning Unit with the Practice Set on the next page.