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Introduction

On September 1, Sky Mountain Company borrowed \$200,000 on a 6%, 9-month note payable to Coast National. This transaction marks a significant financial event for the company, impacting its liquidity, liabilities, and financial statements. Understanding the details surrounding this note payable, its accounting treatment, and its implications is essential for stakeholders, including management, investors, and creditors. This article provides an in-depth overview of the transaction, explaining the key concepts, journal entries, and financial considerations involved.

Overview of the Note Payable

What is a Note Payable?

A note payable is a written promise to pay a specific amount of money at a future date, usually with interest. It is a formal debt instrument that signifies borrowing funds from a lender under agreed-upon terms. Notes payable are classified as liabilities on the company's balance sheet.

Details of the Borrowing

- Principal Amount: \$200,000
- Interest Rate: 6% annually
- Term: 9 months
- Lender: Coast National
- Date of Borrowing: September 1

Purpose of the Borrowing

While the specific purpose of the loan may vary, companies typically borrow funds to finance expansion, cover operational costs, or invest in new projects. The financing arrangement provides necessary capital while establishing a clear repayment plan with interest.

Accounting for the Note Payable

Recognition of the Liability

At the inception of the loan, Sky Mountain Company records the liability at the principal amount of \$200,000, reflecting the obligation to repay the lender.

Interest Calculation

Interest expense must be accrued over the term of the note. The interest formula is:

$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \frac{\text{Time (in months)}}{12}$$

Applying the figures:

$$\text{Interest} = \$200,000 \times 6\% \times \frac{9}{12} = \$200,000 \times 0.06 \times 0.75 = \$9,000$$

Thus, the total interest payable over 9 months is \$9,000.

Journal Entries at Borrowing

On September 1, the initial journal entry to record the borrowing is:

```
Debit: Cash ..... $200,000
Credit: Notes Payable ..... $200,000
```

Recognizing Interest Expense

Interest accrues over time. Assuming accruals are made at each reporting period, the journal entry for interest expense at the end of each accounting period would be:

```
Debit: Interest Expense ..... (Pro-rata interest)
Credit: Interest Payable ..... (Pro-rata interest)
```

At the end of each month, interest accruals are:

$$\frac{\$9,000}{9} = \$1,000 \text{ per month}$$

Repayment of the Note

At maturity (after 9 months), Sky Mountain Company will pay the principal plus the accrued interest:

- Principal: \$200,000
- Interest: \$9,000

Final Journal Entry at Maturity

When the payment is made, the journal entry is:

```plaintext

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Debit: Notes Payable $200,000
Debit: Interest Payable $9,000
Credit: Cash $209,000
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Implications for Financial Statements

Balance Sheet

- Liabilities: The note payable appears under long-term or current liabilities depending on the repayment schedule. Since it is a 9-month note, it may be classified as a current liability if due within one year.
- Assets: Cash increases by \$200,000 at the time of borrowing.

Income Statement

- Interest Expense: The \$9,000 interest expense reduces net income over the note's life.
- Impact: Regular accrual of interest expense ensures accurate reflection of expenses during the period.

Cash Flow Statement

- Operating Activities: The initial borrowing does not affect operating cash flows.
- Financing Activities: The borrowing is recorded as a cash inflow under financing activities.
- Repayment: The repayment of principal and interest is a cash outflow under financing activities.

Advantages and Disadvantages of Borrowing on a Note Payable

Advantages

- Access to Capital: Provides necessary funds for growth or operational needs.
- Interest Deductibility: Interest expense may be tax-deductible, reducing taxable income.

- Structured Repayment: Fixed terms provide clarity on repayment schedules.

Disadvantages

- Liability Obligation: Creates a legal obligation that must be fulfilled, increasing financial risk.
- Interest Costs: Adds to total cost of financing.
- Impact on Ratios: Increases liabilities, potentially affecting debt-to-equity ratios and creditworthiness.

Important Considerations for Sky Mountain Company

Creditworthiness and Loan Terms

Before issuing the note, Coast National likely assessed Sky Mountain's creditworthiness. Favorable terms, such as a 6% interest rate, suggest a good credit profile.

Impact on Financial Ratios

Borrowing increases liabilities and may affect leverage ratios. Management should monitor debt levels to maintain financial health.

Repayment Planning

Proper planning ensures that Sky Mountain can meet its repayment obligations without undue strain on cash flows.

Compliance and Covenants

The company must adhere to any covenants set forth in the note agreement to avoid default.

Conclusion

The borrowing of \$200,000 on a 6%, 9-month note payable represents a strategic financial decision for Sky Mountain Company. Proper accounting treatment ensures transparency and accuracy in financial statements, reflecting the company's obligations and interest expenses over the term of the loan. By understanding the mechanics of notes payable, their impact on financial health, and prudent management of these liabilities, Sky Mountain can leverage borrowed funds to support its growth objectives while maintaining financial stability.

Keywords: Sky Mountain Company, note payable, borrowing, interest expense, financial statements, liabilities, accounting, cash flow, debt management

Frequently Asked Questions

What is the significance of Sky Mountain Company borrowing \$200,000 on September 1?

It indicates that Sky Mountain Company is obtaining financing to support its operations or investments, which will impact its liabilities and cash flow for that period.

What does a 6% note payable mean for Sky Mountain Company?

It means the company agrees to pay interest at a 6% annual rate on the borrowed amount over the note's term, increasing its expenses and liabilities.

How is the interest on the note payable calculated for the 9-month period?

Interest is calculated using the formula: $\text{Principal} \times \text{Rate} \times \text{Time}$, which in this case is $\$200,000 \times 6\% \times (9/12) = \$9,000$.

When is Sky Mountain Company expected to repay the note payable?

The note is due after 9 months from September 1, which would be on June 1 of the following year.

How does this borrowing affect Sky Mountain Company's financial statements?

It increases liabilities (notes payable) and assets (cash), and upon repayment, it will affect cash flow and reduce liabilities.

What journal entry would Sky Mountain Company make on September 1 for this transaction?

Debit Cash \$200,000; Credit Notes Payable \$200,000.

What journal entry is required at the end of each accounting period to accrue interest?

Debit Interest Expense; Credit Interest Payable, based on the interest accrued for the period.

What are the implications of the 9-month note for Sky Mountain's short-term vs. long-term liabilities?

Since the note has a 9-month maturity, it is classified as a short-term liability, but if it were longer, parts could be classified as long-term.

How does this borrowing align with Sky Mountain Company's financial strategy?

Borrowing at a 6% interest rate for 9 months suggests a strategic decision to finance operations or investments at a relatively low cost.

What considerations should Sky Mountain Company keep in mind regarding this note payable?

They should monitor interest payments, ensure timely repayment, and incorporate this liability into their cash flow management and financial planning.

Additional Resources

Sky Mountain Company Borrowed \$200,000 On A 6%, 9-month Note Payable To Coast National: An In-Depth Investigation

In the complex landscape of corporate finance, understanding the intricacies of borrowing arrangements is vital for stakeholders, investors, and financial analysts alike. On September 1, Sky Mountain Company entered into a significant financial transaction: it borrowed \$200,000 on a 6%, 9-month note payable from Coast National. This seemingly straightforward event warrants a comprehensive examination to understand its implications, accounting treatments, strategic motivations, and potential impacts on Sky Mountain's financial health.

This article provides an in-depth exploration of this transaction, contextualizing its significance within the broader financial framework of Sky Mountain Company, and examining the critical aspects involved in such borrowing arrangements.

Background of Sky Mountain Company and Its Financial Strategy

Before delving into the specifics of the note payable, it is essential to establish an understanding of Sky Mountain Company's business profile and

strategic financial positioning.

Company Profile and Industry Context

Sky Mountain Company operates within the outdoor recreation and adventure tourism industry, offering guided mountain expeditions, equipment rentals, and training programs. As a mid-sized enterprise, its revenue streams are seasonal, heavily influenced by weather conditions and tourism trends.

Financial Strategy and Capital Needs

Historically, Sky Mountain has relied on a mix of equity financing, reinvested earnings, and short-term debt to fund operational needs and expansion plans. The company's recent initiatives—such as acquiring new equipment and expanding its trail network—have increased its capital requirements. Recognizing the need for flexible, yet cost-effective financing, management sought external borrowing options to bridge short-term funding gaps without diluting ownership.

The Transaction: Borrowing \$200,000 on a 6%, 9-Month Note Payable

On September 1, Sky Mountain entered into a formal agreement with Coast National, a regional financial institution, to secure a \$200,000 note payable.

Details of the Note

- Principal Amount: \$200,000
- Interest Rate: 6% annual interest
- Term: 9 months
- Maturity Date: June 1 of the following year
- Repayment: Lump sum at maturity
- Collateral/Guarantee: Secured by specific equipment assets (if applicable)

This transaction represents a short-term liability on Sky Mountain's balance sheet, with associated interest expense expected to be recognized over the note's life.

Analyzing the Financial Mechanics of the Borrowing

Understanding the mechanics behind this borrowing involves examining the calculation of interest, the journal entries involved, and the implications for financial statements.

Interest Calculation

The interest on the note is calculated using the formula:

$$\text{Interest} = \text{Principal} \times \text{Rate} \times \text{Time}$$

Where:

- Principal = \$200,000
- Annual Interest Rate = 6% (or 0.06)
- Time = 9 months = $9/12 = 0.75$ years

Calculating:

$$\text{Interest} = \$200,000 \times 0.06 \times 0.75 = \$9,000$$

Thus, over the 9-month period, Sky Mountain will incur \$9,000 in interest expense, payable either periodically or at maturity, depending on the agreement.

Journal Entries at the Time of Borrowing

On September 1, the initial recording involves:

- Debit Cash for \$200,000 (asset increase)
- Credit Notes Payable for \$200,000 (liability increase)

Subsequently, as time progresses, interest expense accrues:

- Debit Interest Expense (pro-rata over time)
- Credit Interest Payable (liability)

At maturity, the company will settle both the principal and the accrued interest.

Impact on Financial Statements

- Balance Sheet: Increase in assets (cash) and liabilities (notes payable and interest payable)
- Income Statement: Recognition of interest expense over the period
- Cash Flow Statement: Outflow under financing activities at the time of repayment

Strategic Motivations Behind the Borrowing

Why did Sky Mountain opt for this particular borrowing arrangement? Several strategic considerations appear to have influenced this decision.

Liquidity Management

The company needed immediate liquidity to fund ongoing operations and investments without diluting ownership through equity issuance. The short-term nature of the note aligns with the company's cash flow cycle, particularly considering seasonal revenue patterns.

Cost of Capital

A 6% interest rate is relatively modest given current market conditions, making this a cost-effective financing option compared to other short-term borrowing sources.

Flexibility and Repayment Term

A 9-month term provides flexibility to align repayment with anticipated revenue inflows, especially as the company expects higher cash flows during the upcoming peak season.

Collateral and Creditworthiness

Securing the note with specific assets reduces the risk for Coast National, potentially allowing Sky Mountain to negotiate favorable terms.

Potential Risks and Considerations

While borrowing can facilitate growth, it also introduces financial risks and obligations.

Interest Rate and Market Fluctuations

Although fixed at 6%, any changes in market rates or economic conditions could affect the company's future borrowing capacity or refinancing options.

Repayment Pressure

The obligation to repay \$200,000 plus interest within nine months necessitates careful cash flow planning. Failure to meet repayment obligations could lead to penalties or asset seizure.

Impact on Financial Ratios

The increase in liabilities may impact key ratios such as debt-to-equity, current ratio, and interest coverage ratio, influencing creditor and investor perceptions.

Strategic Use of Funds

If the borrowed funds are not effectively deployed toward revenue-generating activities, the company risks increased leverage without corresponding growth.

Broader Implications and Industry Context

The borrowing event should be viewed within the broader context of industry trends and economic conditions.

Economic Environment in 2023

Amid economic recovery post-pandemic, demand in adventure tourism is

rebounding, encouraging companies like Sky Mountain to invest in capacity expansion.

Interest Rate Environment

With interest rates remaining relatively stable, short-term borrowing at 6% is attractive, especially as companies seek quick capital access.

Industry Financial Practices

Short-term notes payable are common in the outdoor recreation sector, enabling firms to finance seasonal operations and capitalize on short-term opportunities.

Conclusion: Strategic Significance of the Borrowing

The borrowing of \$200,000 by Sky Mountain Company on September 1, secured through a 6%, 9-month note payable from Coast National, exemplifies a strategic financial maneuver tailored to the company's operational cycle and growth ambitions. It reflects prudent liquidity management, cost-effective financing, and strategic asset utilization.

However, it also underscores the importance of diligent financial planning to ensure repayment capacity and maintain financial health. As the note matures in June, Sky Mountain's management will need to demonstrate effective cash flow management and strategic execution to optimize the benefits of this borrowing while mitigating associated risks.

This transaction not only highlights the nuances of short-term corporate financing but also offers insights into how companies navigate capital markets to support growth initiatives in dynamic industry environments. Stakeholders should monitor subsequent financial disclosures to assess the impact of this borrowing on Sky Mountain's fiscal stability and strategic trajectory.

In summary, the September 1 borrowing event, while routine on the surface, embodies a complex interplay of financial strategy, risk management, and operational planning. It exemplifies how mid-sized companies leverage short-term debt to fund growth, manage liquidity, and adapt to market conditions—an

essential aspect of modern corporate finance.

This investigation underscores the importance of transparent financial practices and strategic foresight in corporate borrowing, providing valuable insights for investors, analysts, and industry observers alike.

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