

On June 1, Button Co. Borrowed \$1,000 Cash From National Bank By Signing A 120-day, 6% Interest-bearing

Understanding the Loan Transaction: Button Co. and National Bank

On June 1, Button Co. Borrowed \$1,000 Cash From National Bank By Signing A 120-day, 6% Interest-bearing note, marking a significant financial event for the company. This transaction involves many fundamental accounting principles and financial concepts that are essential for understanding how businesses manage short-term financing. In this article, we will explore the details of this borrowing, the accounting treatment, the calculation of interest, and the implications for Button Co.'s financial statements.

Details of the Borrowing Transaction

Basic Facts of the Loan

- Date of borrowing: June 1
- Loan amount (Principal): \$1,000
- Loan period: 120 days
- Interest rate: 6% annual rate
- Interest type: Interest-bearing note

This transaction involves Button Co. issuing a promissory note to National Bank, promising to pay back the principal along with accrued interest at the end of 120 days.

Understanding the Interest Rate and Period

The note's interest rate is annual, meaning the 6% rate applies over a full year. Since the note is for only 120 days, interest must be prorated accordingly.

Calculating the Interest on the Loan

Calculating interest on interest-bearing notes involves determining the amount of interest that accrues over the specific period.

Interest Formula

The general formula for interest is:

$$\text{Interest} = \text{Principal} \times \text{Rate} \times \frac{\text{Time (in days)}}{360 \text{ or } 365}$$

Most financial institutions and accounting standards use 360 days for simplicity, but some use 365 days. For this case, we will assume 360 days.

Interest Calculation

- Principal: \$1,000
- Annual Rate: 6% (or 0.06)
- Time period: 120 days

Applying the formula:

$$\text{Interest} = \$1,000 \times 0.06 \times \frac{120}{360} = \$1,000 \times 0.06 \times 0.3333 = \$20$$

Total interest to be paid at the end of 120 days: \$20

Accounting for the Loan: Journal Entries

Proper accounting treatment ensures that Button Co. accurately reflects the borrowing in its financial statements.

Initial Recognition of the Loan

When Button Co. receives the cash, the journal entry is:

Date	Account Title	Debit	Credit
June 1	Cash	\$1,000	
	Notes Payable (or Loan Payable)		\$1,000

This records the receipt of cash and the obligation to pay back the principal.

Accruing Interest Over Time

Interest expense accrues over the 120 days. At the end of each accounting period (e.g., monthly),

Button Co. should recognize interest expense proportionally:

Date	Account Title	Debit	Credit
-----	-----	-----	-----
Period end	Interest Expense	\$X	
	Interest Payable		\$X

Where X is the portion of interest accrued during the period.

At the End of the Loan Period

Upon maturity (after 120 days), Button Co. will pay the principal and interest:

Date	Account Title	Debit	Credit
-----	-----	-----	-----
Maturity	Notes Payable	\$1,000	
	Interest Payable	\$20	
	Cash		\$1,020

This settles the debt, including the accrued interest.

Implications for Financial Statements

Balance Sheet Impact

- Cash: increases by \$1,000 at the time of borrowing
- Liabilities: Notes Payable increases by \$1,000
- Interest Payable: increases as interest accrues over time
- At maturity: cash decreases by \$1,020, and liabilities decrease accordingly

Income Statement Impact

- Interest Expense: recognized periodically, impacting net income

Key Accounting Concepts in This Transaction

1. Recognition of Debt

Button Co. recognizes a liability (Notes Payable) equal to the borrowed amount of \$1,000.

2. Interest Expense Recognition

Interest cost is recognized over the period, matching expenses with the periods they relate to, following the matching principle.

3. Accrual Accounting

Interest is accrued over time, even if not paid until maturity, ensuring financial statements reflect the true financial position.

Additional Considerations for Button Co.

1. Discounting and Amortization

Since this note is interest-bearing, the company records interest expense based on the actual interest accrued. If the note was non-interest bearing, it might be discounted to present value.

2. Maturity and Repayment

At the end of 120 days, Button Co. must repay \$1,020, which includes the principal and interest.

3. Impact on Cash Flow

The initial receipt of cash improves liquidity, while repayment reduces cash and liabilities.

Summary of the Loan Process for Button Co.

1. Borrowing: Button Co. receives \$1,000 cash, records a liability.
2. Interest Accrual: Over the 120 days, interest accrues at \$20.
3. Financial Reporting: Interest expense is recognized periodically.
4. Maturity: At 120 days, Button Co. pays back \$1,020, settling both principal and interest.

Conclusion: Key Takeaways for Businesses Using Interest-Bearing Notes

- Understanding the terms of a loan, including interest rate and period, is vital for proper accounting.
- Accurate interest calculations ensure correct expense recognition and liability measurement.
- Recording the transaction properly impacts the balance sheet and income statement, providing stakeholders with a true picture of the company's financial health.

- Short-term borrowing like Button Co.'s is common for managing cash flow needs or financing specific projects.

Final Thoughts

The June 1 borrowing by Button Co. exemplifies a typical short-term financing transaction. By understanding the mechanics of interest calculation, journal entries, and financial statement impact, businesses can effectively manage their liabilities and ensure compliance with accounting standards. Proper recording and timely repayment of such notes are essential for maintaining financial stability and transparency.

Keywords: Button Co., loan transaction, interest-bearing note, short-term borrowing, accounting for notes payable, interest calculation, financial statements, journal entries, liabilities, interest expense, repayment.

Frequently Asked Questions

What is the significance of Button Co. borrowing \$1,000 from National Bank on June 1?

It indicates that Button Co. has obtained a short-term loan to meet its financial needs, which will impact its cash flow and liabilities on its financial statements.

How is the interest on the loan from National Bank calculated?

The interest is calculated using the formula: $\text{Principal} \times \text{Rate} \times \text{Time}$. For this loan, it is $\$1,000 \times 6\% \times (120/360) = \20 .

What accounting entry should Button Co. record on June 1 for this loan?

Button Co. should debit Cash \$1,000 and credit Notes Payable \$1,000 to record the receipt of the loan.

When will Button Co. recognize interest expense related to this loan?

Interest expense should be recognized over the loan period, typically accrued periodically, and fully at the end of 120 days, when the interest is paid.

What is the maturity date of this loan?

The loan's maturity date is 120 days after June 1, which is September 29.

How does this loan affect Button Co.'s financial ratios?

The loan increases liabilities and may affect ratios such as debt-to-equity and current ratio, potentially impacting the company's creditworthiness and financial analysis.

What are the implications if Button Co. fails to pay the interest and principal at maturity?

Failure to pay could lead to default, potential legal action from the bank, and damage to Button Co.'s credit rating and future borrowing ability.

Why is it important for Button Co. to record the interest expense periodically?

Periodic recording of interest ensures accurate financial statements, reflects true expenses, and complies with accounting principles like matching expenses with revenues.

Additional Resources

On June 1, Button Co. Borrowed \$1,000 Cash From National Bank By Signing A 120-day, 6% Interest-bearing Note

On June 1, Button Co., a growing enterprise specializing in innovative manufacturing solutions, took a strategic financial step by borrowing \$1,000 from National Bank. This transaction involved signing a promissory note that would mature in 120 days and carried an interest rate of 6%. This article delves into the intricacies of this borrowing, exploring the nature of interest-bearing notes, accounting implications, and the broader significance for Button Co.'s financial management.

Understanding the Borrowing Transaction

What Is a Promissory Note?

A promissory note is a written, unconditional promise by one party (the borrower) to pay a specific sum of money to another party (the lender) at a designated future date or on demand. It is a formal financial instrument that evidences a debt and outlines the terms of repayment, including the principal amount, interest rate, maturity date, and any other pertinent conditions.

In this case, Button Co. signed a 120-day, interest-bearing note with National Bank, committing to

repay the principal plus interest over approximately four months. This instrument serves both as a legal document and a financial agreement, ensuring clarity and enforceability.

The Role of Interest in the Note

Interest is the cost of borrowing money, expressed as a percentage of the principal. Here, the note bears a 6% annual interest rate, which means Button Co. will pay interest proportionate to this rate over the 120-day period.

Since the note is interest-bearing, the interest accrued is added to the principal to determine the total repayment amount at maturity. This contrasts with zero-interest notes, which are issued at a discount and do not explicitly state interest.

Calculating Interest and Total Repayment

Interest Formula

The interest on the note can be calculated using the simple interest formula:

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

Where:

- Principal = \$1,000
- Rate = 6% per year (or 0.06)
- Time = 120 days expressed as a fraction of a year

To convert days into years:

$$\text{Time in years} = 120 / 360$$

Many businesses and financial institutions use a 360-day year convention for simplicity in interest calculations.

$$\text{Interest} = \$1,000 \times 0.06 \times (120 / 360) = \$1,000 \times 0.06 \times 0.3333 \approx \$20$$

Thus, Button Co. will owe approximately \$20 in interest over the 120-day period.

Total Amount Due at Maturity

The total amount payable at the note's maturity includes both the principal and the accrued interest:

$$\text{Total Repayment} = \text{Principal} + \text{Interest} = \$1,000 + \$20 = \$1,020$$

This sum must be paid in full when the note matures, which is after 120 days from June 1, approximately on October 30.

Accounting for the Borrowing

Recognizing this transaction in Button Co.'s accounting records is vital for accurate financial statements. The process involves initial recording, accruing interest, and eventual repayment.

Initial Journal Entry on June 1

When Button Co. receives the cash, the journal entry reflects an increase in cash and a liability:

- Debit: Cash \$1,000
- Credit: Notes Payable \$1,000

This entry indicates that Button Co. has acquired cash, creating a liability that will be settled upon maturity.

Accruing Interest Expense

Since the interest accrues over the 120 days, but payment occurs at maturity, Button Co. must recognize interest expense periodically or at the end of the period. Assuming the company recognizes interest expense at the end of the period:

- Debit: Interest Expense \$20
- Credit: Interest Payable \$20

This entry reflects the accrued interest expense that increases liabilities until payment.

Alternatively, if the company prepares adjusting entries periodically, it might accrue interest monthly or quarterly, depending on accounting policies.

At Maturity: Payment of Principal and Interest

Upon maturity, the company settles the note:

- Debit: Notes Payable \$1,000
- Debit: Interest Payable \$20
- Credit: Cash \$1,020

This clears both the principal and accrued interest liabilities, reflecting the cash outflow.

Implications for Button Co.'s Financial Position

Impact on the Balance Sheet

The borrowing temporarily increases Button Co.'s liabilities via Notes Payable and Interest Payable. Specifically:

- Liabilities Increase: Notes Payable (\$1,000) at the outset, with a subsequent increase in Interest Payable (\$20) as interest accrues.
- Assets Increase: Cash increases by \$1,000 upon receipt.

At maturity, liabilities decrease by \$1,020, and cash decreases by the same amount, leaving the company's assets and liabilities adjusted accordingly.

Impact on the Income Statement

Interest expense of approximately \$20 reduces net income for the period in which it is recognized. This expense reflects the cost of borrowing and is essential for assessing profitability.

Strategic Considerations for Button Co.

Why Choose a Promissory Note?

Button Co. opted for a promissory note over other financing options due to several advantages:

- Fixed Terms: Clear repayment schedule and interest rate.
- Formal Agreement: Legally binding, providing assurance to both parties.
- Flexibility: The company can plan for repayment at maturity without ongoing obligations.

Financial Planning and Risk Management

Borrowing funds introduces considerations around:

- Interest Costs: The \$20 interest fee adds to borrowing costs, influencing profit margins.
- Cash Flow Implications: Ensuring sufficient cash at maturity to settle the note.
- Creditworthiness: Maintaining good relations with lenders like National Bank for future borrowing needs.

Broader Context and Industry Implications

Market Conditions and Borrowing Trends

In a broader economic context, borrowing at a 6% interest rate for 120 days suggests favorable lending conditions, possibly reflecting low-interest rates in the market or the company's strong credit standing.

Comparative Analysis

- Short-term vs. Long-term Borrowing: Short-term notes like this address immediate funding needs.
- Interest-bearing vs. Zero-interest Notes: Interest-bearing notes are common for transparent cost estimation, whereas zero-interest notes often involve discounts or other arrangements.

Conclusion

The June 1 borrowing by Button Co. exemplifies prudent financial management through the use of interest-bearing notes. By understanding the mechanics of interest calculation, accounting treatment, and strategic implications, businesses can navigate short-term financing effectively. This transaction not only provides necessary liquidity but also underscores the importance of meticulous record-keeping and planning in maintaining financial health.

As Button Co. prepares for the note's maturity, careful attention to cash flow and interest obligations will ensure smooth repayment and continued growth. Such financial instruments remain vital tools for companies seeking flexible, transparent, and manageable funding sources in a competitive market environment.

[On June 1 Button Co Borrowed 1 000 Cash From National Bank By Signing A 120 Day 6 Interest Bearing](#)

On June 1 Button Co Borrowed 1 000 Cash From National Bank By Signing A 120 Day 6 Interest Bearing

Related Articles

- [Red Blood Cell Production Increases When Red Blood Cell Production Increases When Carbon Dioxide Levels](#)
- [Part 3: Claim And EvidenceDraft A Defensible Claim About The Significance Of Plot Details In "The Story](#)
- [On A Test Flight A Rocket With Mass 400 Kg Blasts Off From The Surface Of The Earth. The](#)

[Rocket Engines](#)

[Back to Home](#)