

Chapter 7 Handout

Facts: On January 1, 2009, Alpha sold land to Beta that originally cost Alpha \$500,000. Beta gave Alpha a \$700,000, 2-year, 2% note. The prevailing interest (imputed) rate for notes such as this one is 10%. The market price of the land cannot be determined.

Required: Prepare the journal entries on Alpha's books to record the sale of the land and interest at the end of each year. Assume interest is paid at the end of each year and the effective interest method of amortization is used.

Solution:

2009

Jan 1	Notes Receivable	700,000	
	Discount on Notes Receivable		97,187
	Land		500,000
	Gain on Sale		102,813

T2, n=2, i=10%	$\$700,000 \times .82645 =$	\$578,515
T4, n=2, i=10%	$\$700,000 \times 2\% \times 1.73554 =$	24,298 (rounded)
	Net present value of land	<u>\$602,813</u>

Discount on Notes Receivable = \$700,000 - \$602,813 = \$97,187

Net present value of land	\$602,813
Cost of land	<u>500,000</u>
Gain on sale of land	<u>\$102,813</u>

Dec 31	Cash	14,000	
	Discount on Notes Receivable	46,281	
	Interest Revenue		60,281
	$\$602,813 \times 10\% =$	\$60,281 (rounded)	
	$\$700,000 \times 2\% =$	<u>14,000</u>	
	Amortization of discount	<u>\$46,281</u>	

2010

Dec 31	Cash	14,000	
	Discount on Notes Receivable	50,906	
	Interest Revenue		64,906

Amortization of discount = \$97,187 - \$46,281 = \$50,906

or

$(\$602,813 + 46,281) \times 10\% =$	\$64,909 (rounded)
$\$700,000 \times 2\% =$	<u>14,000</u>
	\$50,909
Rounding adjustment	<u>3</u>
Amortization of discount	<u>\$50,906</u>