

Problem 3

On August 1, 20X7, Desert Water Company purchased a water hauling truck. The sole consideration was a \$150,000 note due in one year. Interest of \$18,000 was included the face amount of the note. If Miller had purchased the truck for cash, the purchase price would have been only \$132,000.

- a) Prepare the appropriate journal entry to record the purchase on August 1, 20X7.
- b) Prepare the appropriate journal entry to record the year-end discount amortization on December 31, 20X7.
- c) Prepare the appropriate journal entry to record the payment of the note on July 31, 20X8.
- d) What was the actual rate of interest on this loan?

Worksheet 3

a), b), c)

| GENERAL JOURNAL | | | |
|-----------------|----------|-------|--------|
| Date | Accounts | Debit | Credit |
| 1-Apr | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| 31-Dec | | | |
| | | | |
| | | | |
| | | | |
| 31-Mar | | | |
| | | | |
| | | | |
| | | | |
| | | | |

d)

Solution 3

a), b), c)

| GENERAL JOURNAL | | | |
|-----------------|--|---------|---------|
| Date | Accounts | Debit | Credit |
| 1-Apr | Equipment | 132,000 | |
| | Discount on Note Payable | 18,000 | |
| | Note Payable | | 150,000 |
| | <i>To record note payable, issued at a discount</i> | | |
| | | | |
| 31-Dec | Interest Expense | 7,500 | |
| | Discount on Note Payable | | 7,500 |
| | <i>To record discount amortization for 5 months</i> | | |
| | | | |
| 31-Mar | Interest Expense | 10,500 | |
| | Note Payable | 150,000 | |
| | Discount on Note Payable | | 10,500 |
| | Cash | | 150,000 |
| | <i>To record discount amortization and repayment of note</i> | | |

d) The actual interest rate is about 13.6% ($\$18,000/\$132,000$).