

## CHAPTER - 7

### BILL OF EXCHANGE & PROMISSORY NOTES

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### 1. PRELIMINARY

Commercial transactions are entered into on the basis of written promise to pay definite sum of money at definite point of time. These written promises can also be passed from one person to another. Such written promises are known as Negotiable Instruments or Bills of Exchanges. These instruments are means of creating credit. They are transferable by negotiation i.e. by endorsement. The following are the chief types of negotiable instruments -

1. Promissory Note
2. Bills of Exchange
3. Cheque

### 2. DEFINITIONS AS PER NEGOTIABLE INSTRUMENT ACT, 1881

1. **Bills of Exchange:** "A bill of Exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument".
2. **Cheque:** "A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand".
3. **Promissory Note:** "A Promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person".

**Note:** According to Reserve Bank of India Act, [Sec. 31(2)] no promissory note is payable to the bearer.

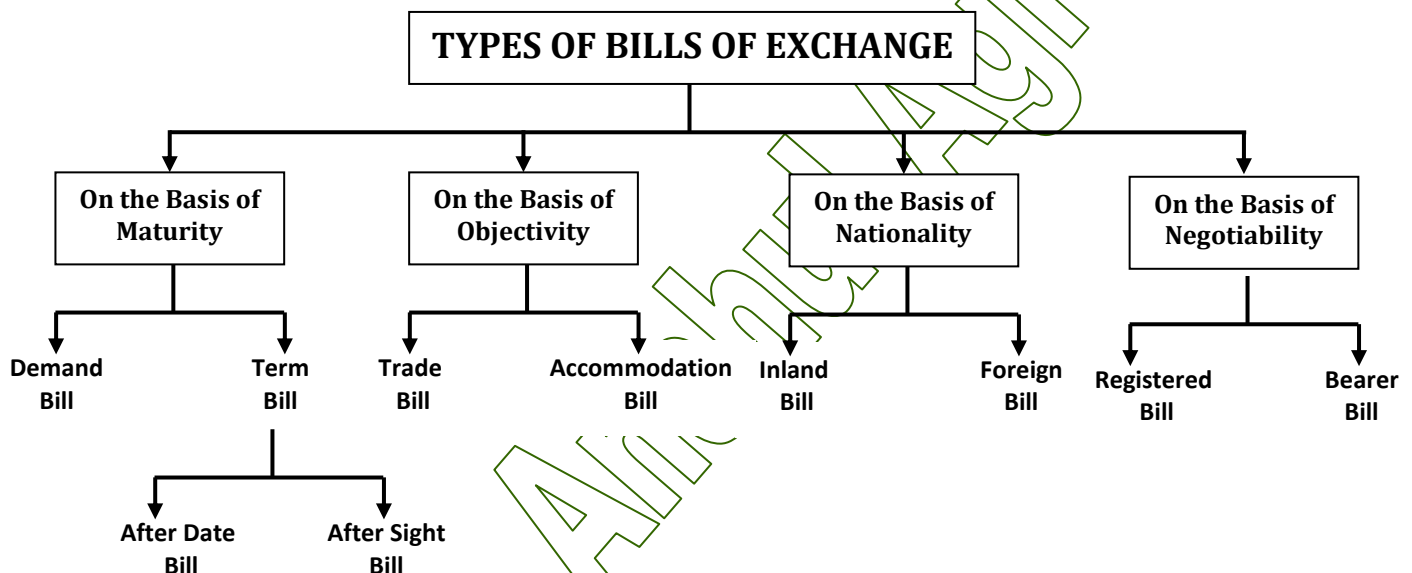


### 3. ESSENTIALS OF A BILLS OF EXCHANGE

1. It must be in writing.
2. It must be dated.
3. It must contain an order to pay a certain sum of money
4. The money must be payable to a definite person or his order or to the bearer.
5. It must be accepted for payment by the party to whom the order is made.
6. It must be properly stamped under the Indian Stamp Registration Act.

**Note:** Bill sent for acceptance by drawer to drawee is known as draft. It becomes Bill of exchange only on its acceptance.

### 4. TYPES OF BILLS OF EXCHANGE



### 5. CALCULATION OF DUE DATE AND MATURITY DATE

A Bill may be an '**After Date Bill**' or an '**After Sight Bill**'. An After Date Bill is a Bill whose due date is calculated from the date of drawal and an After Sight Bill is a bill whose due date is calculated from date of acceptance. (Tip: When nothing is mentioned, a bill is always assumed as an after date bill). There is no legal limitation on term/duration of the bill and it can be drawn for any duration. However, in common parlance, the term of the bill does not exceed 90 days from the date of bill.

**NOMINAL DUE DATE OF BILL** = Date of Drawal / Acceptance + Tenure / Duration / Tenor (Days / Months)

**LEGAL DUE DATE/MATURITY OF BILL** = Date of Drawal / Acceptance + Tenure/Duration / Tenor (Days/Months) + 3 Grace days

### IMPORTANT NOTES:

1. In Common Practice, the words Due Date and Maturity Date is used interchangeably.
2. Unless the bill is expressly payable on demand or at sight or on presentation three grace days are to be added.
3. As per Section 25 of Negotiable Instruments Act 1881, if the due date falls on the **Public Holiday**, bill shall become due for payment on the **preceding business day**.

**Public Holiday:** The expression public holiday means 'Gazette Holidays' i.e. those holidays which are listed in the official gazette of India. **Sundays** are also considered as Public Holidays.

Examples of Public Holidays - 26<sup>th</sup> January (Republic Day)  
15<sup>th</sup> August (Independence Day)  
25<sup>th</sup> December (Christmas)  
2<sup>nd</sup> October (Mahatma Gandhi Jayanti)

4. If the due date falls on holiday (emergency) declared under the Negotiable Instruments Act, and ratified in the Official Gazette, due date will be the **succeeding business day**.

**NOTE:** Thirty days are not necessarily equivalent to a month.

### Calculation of due date of Bills of Exchange

When the bill is made expressly payable after stated number of days / months, due date shall be calculated after adding 3 grace days. e. g. -

Date of Bill	Payable after	Days calculated	Due date
10.09.2018	2 months		
15.09.2018	40 days		
08.02.2018	1 month		
08.02.2018	30 days		
08.02.2018	121 days		

**Example 1:** A drawn a bill on B for 2 months after date on 12.6.2017, the due date will be -

Due Date of Bill of exchange = Date of Drawal + Tenure i.e. period + 3 Grace days  
= 12.6.2018 + 2 months + 3 grace days  
= 12.8.2018 + 3 grace days  
= 15.8.2018

15th August being Public Holiday, bill will be due on 14.8.2017

**Example 2:** A drawn a bill on B for 60 days after date on 12.12.2017, the due date will be -

= 12.12.2018 + 60 days + 3 grace days  
= 12.12.2018 + Dec. 19 days, Jan. 31 days, Feb. 10 days + 3 grace days  
= 13.2.2019

**Example 3:** A drawn on 12.06.2018 a bill on B for 2 months after sight accepted by the later on 14.6.2018, the due date will be -

Due Date of Bill of Exchange = Date of acceptance + Tenure i.e. period + 3 Grace days  
= 14.6.2018 + 2 months + 3 grace days  
= 14.8.2018 + 3 grace days  
= 17.8.2018



**Example 4:** A drawn on 12.06.2018 on B for 60 days after sight accepted by the later on 14.6.2018, the due date will be -

= 14.06.2018 + 60 days + 3 grace days

= 14.06.2018 + Jun. 16 days, Jul. 31 days, Aug. 13 days + 3 grace days

= 16.08.2018

## 6. SPECIMEN OF BILL OF EXCHANGE

<b>Rs. 1,25,000/-</b>	<div style="border: 1px solid black; width: 80px; height: 50px; margin: 0 auto;">Stamp</div>	Shreevardhan Complex, 4 <sup>th</sup> Floor, RNT Marg, Indore - 452001. 1 <sup>st</sup> Jan 2024
<b>Two months after date pay to UCO Bank or Bearer the sum of Rupees One Lakh Twenty Five Thousand only, for the value received</b>		
To, Mr. B 32, Indulal Complex, L.B.S. Road, Pune - 411 030.	<b>Accepted</b>  <b>(Mr. B)</b> (Date of Acceptance: ..... )	Sd/- <b>(Mr. A)</b>

## 7. PARTIES TO BILL OF EXCHANGE

1. **Drawer:** A party who draws a bill or makes the order is known as 'Drawer'. Drawer is also known as 'Maker'.
2. **Drawee:** A party who accepts a bill or order is known as 'Drawee'. Drawee is also known as 'Acceptor'.
3. **Payee:** A party to whom the amount is payable on due date is known as 'Payee'. Payee is also known as receiver.

A bill of exchange can be passed on to another person by endorsement. Endorsement is transfer of right to Receive the money of the bill of exchange on due date. Thus holder of the bill gets the right to receive the money on due date.

In different situations following are the payees.

No.	Situation	Holder of the instrument	Payer	Payee
1.	Bill retained by drawer	Drawer	Drawee	Drawer
2.	Bill sent to bank for collection	Drawer's Bank as an agent	Drawee	Drawer
3.	Bill endorsed	Endorsee	Drawee	Endorsee
4.	Bill discounted with bank	Discounting Bank	Drawee	Bank

The primary liability of a bill of exchange is that of drawee or acceptor. If however he does not pay, a holder has a right to recover the amount from any of the previous endorsers or the drawee.

**8. ESSENTIALS OF PROMISSORY NOTE**

1. It must be in writing.
2. It must be dated.
3. It must contain an unconditional promise to pay. Mere acknowledgement of debt is not a promissory note.
4. Promisor or maker must sign the instrument.
5. The promisor and promisee must be certain persons.
6. The sum payable must be certain.
7. It must be in legal currency of the country.
8. It should not be payable to the bearer (restriction under Reserve Bank of India Act).
9. It should be properly stamped.

**Note:** Promissory note is signed only by promisor.

**9. PARTIES TO PROMISSORY NOTE**

1. **Promisor** - A party who promise to pay money is known as 'Promisor'. Promisor is also known as 'Maker' or 'Payer'.
2. **Promisee** - A party who has received the promise to receive money is known as 'Promisee'. Promisee is also known as 'Receiver'.

**10. SPECIMEN OF PROMISSORY NOTE**

**Rs. 1,25,000/-**

Stamps

Kalpataru Estates, Phase-3,  
Pimple Gurav, Pune - 411 061.  
24<sup>th</sup> May, 2023

**Two months after date I promise to pay to UCO Bank or Bearer / order , the sum of Rupees One Lakh Twenty Five Thousand only, for the value received.**

**CA Anshul A. Agrawal**



## 11. DIFFERENCE BETWEEN BILL OF EXCHANGE AND PROMISSORY NOTE

BILLS OF EXCHANGE	POINT OF DIFFERENCE	PROMISSORY NOTE
A bill of exchange is an order to pay a certain sum of money.	<b>Meaning</b>	A promissory note is a promise to pay a certain sum of money.
There are 3 parties i. Drawer ii. Drawee iii. Payee	<b>Parties</b>	There are 2 parties i. Maker i.e. Promisor ii. Payee i.e. Promisee
A bill of exchange is drawn by a creditor	<b>Drawn by</b>	A promissory note is made by a debtor.
A bill of exchange must be accepted by drawee.	<b>Acceptance</b>	Acceptance is not necessary for a promissory note.
Notice of dishonour must be given to all persons liable to pay.	<b>Notice of Dishonour</b>	Notice of dishonour to the maker is not necessary in case of non-payment or non-acceptance of an instrument.
Defined under the Section. 5 of the Negotiable Instruments Act.	<b>Definition</b>	Defined under Section 4 of the Negotiable Instruments Act.

## 12. RECORDING OF BILLS OF EXCHANGE AND PROMISSORY NOTE

### 1. Bill Receivable:

A party who receives an Bill of Exchange or Promissory Note will treat the negotiable instrument as 'Bill Receivable'.

### 2. Bill Payable:

A party who accepts a bill of exchange or issues a promissory note will treat the negotiable instrument as 'Bill Payable'.

Accounting entries for Bills of Exchange or Promissory note are similar in the books of all parties.

## 13. UNDERSTANDING THE TERMS

- Retention of Bill:** When drawer holds the bill of exchange with himself till due date, bill is said to be retained by the drawer.
- Endorsement of Bill:** A bill of Exchange can be passed on to another person by endorsement. Endorsement of a bill of exchange is made exactly as it is done on case of a cheque. Bills are endorsed by drawer or holder of the bill in favour of his creditor in full or part settlement of his dues. There are no restrictions on number of endorsements.
- Discounting of Bill:** When drawer or holder of the bill (i.e. endorsee) is in need of funds, he normally discounts the bill with bank. Bank deducts discount in advance (similar to interest) and credit the



balance proceeds to the customer's ' ' account. In case of dishonour of bill by drawee, bank debits Customer's Account along with bank charges.

4. **Bill Sent to Bank for collection:** Instead of keeping a bill of exchange till the date of maturity, a person who received it, may send to bank with instructions that the bill should be retained till maturity and should be collected only on its realisation. Bank charges commission for this service.
5. **Holder of the Bill:** A person who holds the bill is known as 'Holder in Due Course'. Holder may be a drawer or bank or endorsee of a bill
6. **Honouring the negotiable instrument:** On proper presentation of the bill, when the commitment of payment is fulfilled by the acceptor of Bill of Exchange or issuer of Promissory Note on due date, it is known as honouring the negotiable instrument.
7. **Dishonour of negotiable instrument:** When the commitment of payment is not fulfilled by the acceptor of Bill of Exchange or issuer of Promissory Note on due date, it is known as act of dishonour of negotiable instrument.
8. **Noting charges:** If the negotiable instrument is dishonoured, the public official known as '**Notary Public**' will note the fact of dishonour for this service. Notary Public charges a fee. This fee is known as noting charges. The sum of noting charges is recoverable from the party, who is responsible for dishonour.
9. **Renewal of Bill:** When an acceptor is unable to honour the bill on due date, he himself approaches the drawer and requests him to give time extension. In such a case old bill is cancelled and new bill is drawn. This is also known as **cancellation of bill**. No bill can be cancelled by drawee with unilateral act without the consent of an drawer.  
On cancellation of old bill and drawal of new bill, there may be part payment by drawee to drawer and new bill may be drawn for balance amount along with interest at an agreed rate for extension of time period.
10. **Retirement of Bill:** When an acceptor has surplus funds and wants to honour the bill before a due date, he himself approaches the drawer and expresses his desire to pay earlier. In such a case there is a normal practice of allowing rebate or discount (to compensate early payment) by the drawer (i.e. receiver) to the drawee (i.e. payer).
11. **Insolvency:** When a person is unable to pay off his liabilities, he himself or any of his creditor may file a petition in the Court to declare the person as 'insolvent'. On accepting the petition by the court, the Court appoints an official which will be in charge of proceedings. Insolvent's assets are then disposed off by him and liabilities are paid off to claimants according to their rights (secured, unsecured etc.).  
In case of insolvency, bills accepted by insolvent will be dishonoured. **When it is known that a person is insolvent, entry for dishonour of his acceptance is passed without any reference to due date.**

On disposal of insolvent's assets by an official, a sum received by a creditor is known as '**dividend from insolvent's estate**'. The balance irrecoverable sum is then written off as bad debts.



## 14. DIFFERENCE BETWEEN COMMERCIAL AND ACCOMMODATION BILLS

COMMERCIAL BILLS	POINT OF DIFFERENCE	ACCOMMODATION BILLS
The bills are drawn and accepted in settlement of a commercial transaction.	<b>Origination</b>	The bills are drawn and accepted without any consideration but to accommodate the financial need.
The bill may not be necessarily discounted.	<b>Discounting with Bank</b>	The bill is necessarily discounted with bank.
Discount charges are borne by the drawer.	<b>Sharing of Discounting Charges</b>	Discount charges are shared by the parties in the ratio in which discounting proceeds are shared. (i. e. by drawer as well as drawee).
Loss on account of bankruptcy is 'Bad Debts', which is a business loss.	<b>Loss on Bankruptcy</b>	Loss on account of bankruptcy is not a business loss, but a personal loss.
Being a settlement of commercial transaction, drawee honours the bill on the due date on his own.	<b>Liability on Due Date</b>	Prior to the due, date drawer has to remit his share of accommodation to the drawee.

## 15. PRACTICAL PROBLEMS

### Q1. Trade Bill - Retirement

REG. PAGE NO.

On 1st January, 2018 A sells goods for Rs. 1,20,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 2018 B retires his acceptance under rebate of 12 % per annum. Record these transactions in the Journals of A and B.

### Q2. Trade Bill – Renewal

REG. PAGE NO.

X owed to Y Rs. 60,000 on 1st January, 2018. On the same date Y drew upon X a bill for the amount at 2 months and X returned the bill duly accepted. Y got the bill discounted at his bank at 12 % p. a. Before the bill was due for payment, X told Y that he was not able to pay the full amount and requested Y to accept Rs. 20,000 immediately and drew upon him another bill for the remaining amount for two months together with interest at 10 % p. a. Y agreed. The bill was duly met.

Give journal entries in the books of both X and Y.

### Q3. Trade Bill – Renewal + Insolvency

REG. PAGE NO.

A, the acceptor of a Rs. 60,000 trade bill maturing on 31st March, 2018, requests B, the holder, to renew the bill for 3 months. The latter, however, partially agrees thereto on an immediate payment of Rs. 20,000 plus interest at 12% p.a. in cash. A acts accordingly and accepts the renewed bill for the residue on 31st March, 2018.

On 1<sup>st</sup> June, 2018, A is adjudicated as insolvent and the drawer finally recovers on 1<sup>st</sup> July, 2018 a dividend of 40 paise in the rupee from the insolvent's estate. Journalise in the books of both the parties.



**Q4. Trade Bill – Multiple Transactions****REG. PAGE NO.**

Journalise the following in the books of Don:

- (i) Bob informs Don that Ray's acceptance for Rs. 3,000 has been dishonoured and noting charges are Rs. 40. Bob accepts Rs. 1,000 in cash and the balance as bill at three months at interest of 10%. Don accepts from Ray his acceptance at two months plus interest @ 12% P.A.
- (ii) James owes Don Rs. 3,200; he sends Don's own acceptance in favour of Ralph for Rs. 3,160; in full settlement;
- (iii) Don meets his acceptance in favour of Singh for Rs. 4,500 by endorsing John's acceptance for Rs. 4,450 in full settlement.
- (iv) Ray's acceptance in favour of Don retired one month before due date, interest is taken at the rate of 6% P.A.

**Q5. Trade Bill – All in One****REG. PAGE NO.**

Ram sold goods to Ahmed for Rs. 1,00,000 on 13th June, 2018 for which the latter accepted 4 bills of Rs. 25,000 each payable after 2 months, 4 months, 6 months and 8 months respectively. Ram retained the first bill. The second bill was sent to Bank for Collection. The third bill was endorsed in favour of Rahim. The fourth bill was discounted with his bankers at 15 % p. a.

The first bill was met on the due date. As regards the second bill, the drawee approached Ram on 23rd September 2018, paid him Rs. 15,000 and requested him to draw a fresh bill for the balance together with interest at 15 % p. a. The term of this bill was 3 months and the bill was duly paid on maturity. The third bill was retired one month before due date @ 12% P.A. Ahmed was declared as insolvent on 31<sup>st</sup> December 2018 and Ram's bankers accordingly debited Ram on that day in respect of fourth bill. It was ascertained that only 40 paise in a rupee could be recovered from Ahmed's estate.

Pass necessary journal entries in the books of Ram, Ahmed and Rahim.

**Q6. Accommodation Bill****REG. PAGE NO.**

A and B enter into an accommodation arrangement where under the proceeds are to be shared 2/3 and 1/3 respectively. A draws bill for Rs. 9,000 on B on 2nd January 2018 for 3 months. A gets it discounted with the Central Bank of India for Rs. 8,820 on 3rd January 2018 and remits B's share to him, which B receives on 5th January 2018. On the due date B pays the bill though A fails to remit the amount due to the former. On 6th April, A accepts a bill for Rs. 12,600 drawn on him by B for 3 months, which B discounts on 7th April for Rs. 12,330 and remits Rs. 2,220 to A the next day. Before the maturity of the second bill, A becomes insolvent and only 50 % was realised from his estate on 10th July, 2018.

Pass necessary Journal Entries in the Books of B.

**Q7. Accommodation Bill****REG. PAGE NO.**

Shubham draws on Rajendra a bill of Rs. 45,000 on 1st June 2018 for 3 months. Rajendra accepts the bill and sends to Shubham who gets it discounted for Rs. 44,100. Shubham immediately remits Rs. 14,700 to Rajendra. On the due date Shubham, being unable to remit amount due, accept a bill for Rs. 63,000 for 3 months which is discounted by Rajendra for 61,650. Rajendra sends Rs. 11,100 to Shubham. On the due date Shubham becomes insolvent, his estate paying forty paise in the rupee. Give Journal Entries in the books of Shubham and Rajendra.

**Q8. Accommodation Bill****REG. PAGE NO.**

For the mutual accommodation of 'X' and 'Y' on 1st April, 2018, 'X' drew a four months' bill on 'Y' for Rs. 40,000. 'Y' returned the bill after acceptance on the same date. 'X' discounts the bill from his bankers @ 6% per annum and remit 50% of the proceed to 'Y'. On due date 'X' is unable to send the amount due and therefore 'Y' draws a bill for Rs. 70,000, which is duly accepted by 'X'. 'Y' discounts the bill for Rs. 66,000 and sends Rs. 13,000 to 'X'. Before the bill is due for payment 'X' becomes Insolvent. Later 25 paise in a rupee was received from his Estate.

Record Journal Entries in the book of 'X' and 'Y'.

**Q9. Accommodation Bill****REG. PAGE NO.**

Arun and Anand were friends and in need of funds. On 01.01.2018 Arun drew a bill for Rs. 2,00,000 for 3 months on Anand. On 4.1.2018 Arun got the bill discounted at 10 % p. a. and remitted half of the proceeds to Anand. On due date, Anand met the bill even though Arun did not remit his share of accommodation to Anand. Arun accepted Anand's bill for Rs. 1,20,000 on 4.4.2018 for two months. This was discounted by Anand at 12 % p. a. Out of this Rs. 17,600 was paid to Arun after deducting Rs. 2,400 discounting charges. Due to financial crisis, Arun became insolvent and the bill drawn on him was dishonoured and his estate paid 50 %.

Give journal entries in the books of Arun and prepare Anand's account in Arun's books and Arun's account in the books of Anand.

CA CS Anshul Agrawal

*“Demonstrate such a Passion for your Desire, that You become Passion for your Desire”.*

*- Anshul A. Agrawal*