

## Bills of Exchange

### 1. Introduction

- Nowadays a large number of business transactions are made on credit basis. In case of credit sale of goods seller gets his money after certain period of time but in this case seller would like to get a written promise from the buyer to get the payment after a fixed period of time.
- Above written promise is either in the form of-
  - Bills of Exchange or
  - Promissory notes

### 2. Bills of Exchange

#### A. Definition

- A Bill of Exchange is an instrument in writing, containing an unconditional order signed by the maker directing to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

#### B. Parties to the Bills of Exchange

i) **Drawer**:- He is the person who draws the bill i.e. seller of the goods.

ii) **Drawee**:- He is the person on whom the bill is drawn for his acceptance i.e., buyer of the goods.

iii) **Payee**:- The payee is the person named in the bill to whom the amount is to be paid. Payee may be the drawer himself or a third person.

#### C. Types of Bills of Exchange

i) **Trade Bill**:- Bill is drawn and accepted for a trade transaction.

ii) **Accommodation Bill**:- Bills drawn and accepted for mutual help.

### 3. Promissory Note

#### A. Definition

A Promissory Note is an instrument in writing (not being a bank note or 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 or to the the bearer of the instrument.

#### B. Parties to the Promissory note

i) **Maker** :- He is the person who makes the promise to pay i.e., the buyer.

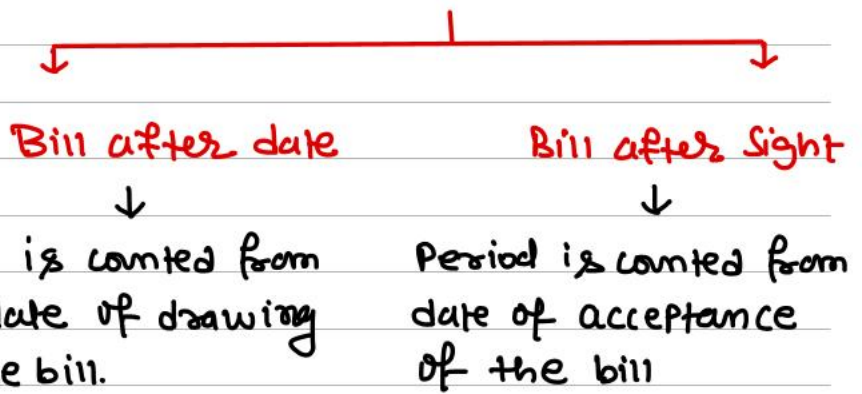
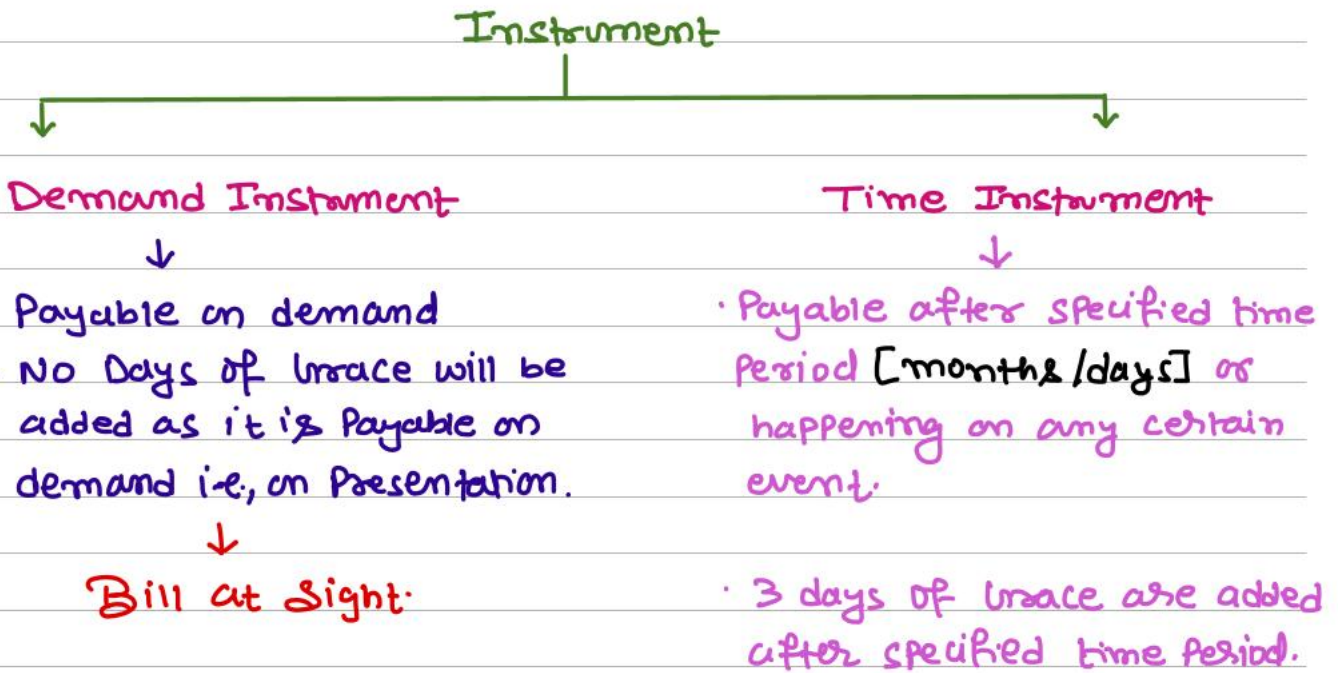
ii) **Payee** :- He is the person to whom payment is to be made i.e., the seller.

### 4. Difference between Bills of Exchange and Promissory note

Bills of Exchange	Promissory note
<ul style="list-style-type: none"><li>• It contains an unconditional order to pay</li></ul>	<ul style="list-style-type: none"><li>• It contains only a promise to pay</li></ul>
<ul style="list-style-type: none"><li>• There are 3 parties - Drawer, Drawee and Payee</li></ul>	<ul style="list-style-type: none"><li>• There are 2 parties - maker and payee</li></ul>
<ul style="list-style-type: none"><li>• Paid by acceptor</li><li>• Drawn by creditor</li><li>• Drawer and Payee may be the same person.</li></ul>	<ul style="list-style-type: none"><li>• Paid by maker</li><li>• Made by debtor</li><li>• maker and payee cannot be the same person.</li></ul>
<ul style="list-style-type: none"><li>• In this case notice of dishonour must be given</li></ul>	<ul style="list-style-type: none"><li>• notice of dishonour is not required in this case.</li></ul>
<ul style="list-style-type: none"><li>• Liability of drawer is secondary.</li></ul>	<ul style="list-style-type: none"><li>• Liability of maker is primary.</li></ul>

5. Date of maturity of Bill / Due Date of Bill

• Date of maturity of Bill depends on the type of instrument.



Calculation of Due Date

Case	Due Date
• If period stated in days	• Calculation will be in no. of days which includes date of Payment but excludes date of transaction
• If period stated in months	• Calculation will be in months, ignoring the actual day in any particular month.

Note: -i) Day of Grace will be added in above to find out maturity date.

ii) If maturity date falls on holiday, then -



iii) If the payer is unable to the amount of bill on its date of maturity then it is called Dishonour of bill.

iv) In case of dishonour of bills of exchange noting charges is to be paid. Noting charges shall be ultimately borne by the person who is responsible for dishonour of bill.

### 6: Recording of Transaction Related to Bills of Exchange

• When a bill is written, it is called drawing of bill. Since, the drawer draws the bill, a bill is Bills Receivable as the amount is receivable for him and for the drawers and Bills Payable for the drawee as the amount is Payable by him.

• Let 'A' is drawer and 'B' is drawee

BOOKS OF A  
i) Sale of goods  
B's A/c --- Dr.  
To Sales A/c

BOOKS OF B  
i) Purchase of goods  
Purchase A/c -- Dr  
To A's A/c

ii) On drawing, accepting and receipt of bill

ii) On Accepting the bill

Bills Receivable -- Dr  
To B's A/c

A's A/c ---- Dr  
To Bills Payable A/c

- Now once the bill is accepted by drawee and returned to the drawer, the drawer has the following options:
  - A. Retain the bill till the date of maturity
  - B. Discounting the bill with the bank
  - C. Endorsing the bill
  - D. Sending Bill for collection

A. Bill is Retained by the Drawer till the maturity

• In this case drawer either receives payment on due date or bill get dishonoured.

Honour of Bill

Dishonour of Bill

Bank A/c ---- Dr  
To Bills Receivable A/c

B's A/c ---- Dr  
To Bills Receivable A/c

B. Discounting of Bill from Bank

• Holder of the bill can raise money from bank against the bill before due date, it is called **Discounting of Bill**.

• Entry for discounting

Bank A/c ---- Dr ✓  
Discounting charges A/c ✓  
To Bills Receivable ✓

• Now, if on due date if bill is honoured then drawer is not required to record the same as he don't have the

bill and Bank receives money against the Bill.

- But, if bill get dishonoured on due date then drawer will be liable to bank for the amount of bill and noting charges, if any. However Drawer will be entitled to receive the amount from Drawee.

B's A/c ----- Dr. ✓  
To Bank A/c ✓  
[B/R + noting charges]

### C. Endorsing of Bill to Creditor

- On transferring the bill to a third party the bill is said to have endorsed. Entry for endorsing -

Endorsee/Creditor A/c --- Dr. ✓  
To Bills Receivable ✓

- As like in the previous case the drawer is required to pass entry on due date only if bill get dishonoured -

B's A/c ---- Dr. ✓  
To Creditor's A/c ✓

### D. Bill sent to Bank for Collection

- Drawer may send bill to the bank for collection. In such case bank will retain the bill till due date and present bill to the drawee for clearance on due date, it is known as Bill sent for collection.

- sending Bill for collection

Bill sent for Collection A/c --- Dr. ✓  
To Bills Receivable ✓

• on due date of bill

Honour of Bill

Bank A/c ---Dr ✓  
 Collection Charges ✓  
 To Bill sent for collection A/c ✓

Dishonour of Bill

B's A/c ---Dr ✓  
 Collection Charges ✓  
 To BSC ✓  
 To Bank Charges ✓

Note: However in all cases Drawee (B) Pass only following entries -

Honour of Bill

Bills Payable A/c ---Dr ✓  
 To Bank ✓

Dishonour of Bill

Bills Payable A/c ---Dr ✓  
 To A's A/c ✓

7. Renewal of Bill

• An acceptor/drawee may not be able to meet the bill on due date, so he may request the holder to cancel the first bill and draw a new bill, it is called renewal of bill.

• While renewing the bill, drawer usually charge some interest for the excess period. This interest may be paid in cash or to be paid along with the new bill.

• Journal Entries

i) Cancellation of first bill

B's A/c ---Dr ✓  
 To Bills Receivable A/c ✓

ii) Charging Interest

B's A/c ---Dr ✓  
 To Interest Income A/c ✓

ii) Drawing New Bill

Bills Receivable A/c	✓
Cash/Bank A/c	✓ [If received in Cash, otherwise added to Bill]
To B's A/c	✓

8. Retiring of Bill

• There may be a case when acceptor wants to pay the amount of bill before due date. In such case drawer allows some interest/discount for pre-payment, this discount is also called **rebate** and above process is called Retiring of bill.

• Journal Entry -

Books of Drawer

Books of Drawee

Bank A/c --- Dr.	✓	Bills Payable A/c --- Dr.	✓
Rebate A/c --- Dr.	✓	To Bank A/c	✓
To Bills Receivable A/c	✓	To Rebate A/c	✓

9. Insolvency of Acceptor

• It means acceptor is unable to pay the amount of bill. Bill is treated as dishonour.

• Journal Entries

Books of Drawer

i) Dishonour of Bill

B's A/c --- Dr.	✓
To Bill Receivable A/c	✓
To Bank A/c	✓
To Creditors A/c	✓
To BSC	✓

ii) Settlement of amount due

Bank A/c	----- Dr.	✓
Bad Debt A/c	--- Dr	✓
	To B's A/c	✓

### Books of Drawee

i) Dishonour of Bill

Bills Payable A/c	--- Dr.	✓
	To A's A/c	✓

ii) Settlement of Debt

A's A/c	----- Dr.	✓
	To Bank A/c	✓
	To Deficiency A/c	✓

### 10. Accommodation of Bill

• Usually bills are drawn for trading purpose i.e., for sale and purchase of goods, but the mechanism of bill can be utilised to raise finance also.

• It works as follows

- Suppose A and B in needs of funds and for the same A draws a bill on B for ₹ 1,00,000 and gets it discounted with the bank and share the fund with B.

- on due date A remit his share to B and B pays the whole amount of B.

- However, A or B may fails to do their respective part and then another bill may be drawn to settle the same.

Summary of Bill Receivable

Bill Receivable A/C ---- Dr.  
To B's A/C

