

Revision Notes
Chapter-6
Accounting for Bills of Exchange

Learning Objectives

After studying this chapter, students shall be able to:

- Understand the concept of Bill of Exchange and Promissory Note
- Distinguish between Bill of Exchange and Promissory Note.
- Define Important terms of Bill Exchange and Promissory Note.

Record the Accounting Treatment of Bill of Exchange under different circumstances.

Suggested Methodology: - Illustration-cum-Explanation Method.

A Bill of Exchange and Promissory Note both are legal Instruments which facilitate the credit sale of goods by assuring the seller that the amount will be recovered after a certain period of time. Both of these are legal instruments under the Negotiable Instruments Act, 1881.

Bill 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 the order of, a certain person or to the bearer of the instrument." Section 5 of the Negotiable Instrument Act, 1881.

Features of a Bill Exchange are:

1. A bill of exchange must be in writing
2. It must contain an order (and note a request) to make payment.
3. The order of payment must be unconditional.
4. The amount of bill of exchange must be certain.
5. The date of payment should be certain.
6. It must be signed by the drawer of the bill.
7. It must be accepted by the drawee by signing on it.
8. The amount specified in the bill exchange is payable either on demand or on the expiry of a fixed period.
9. The amount specified in the bill is payable either to a certain person or to his order or to

the bearer of the bill.

10. It must be stamped as per legal requirements.

Parties to a bill of exchange

1. **Drawer or maker:-** Drawer is the person who makes or writes the bill of exchange. Drawer is a person who has sold goods on credit or granted credit to the person on whom the bill of exchange is drawn. The drawer is entitled to received money from the drawee (acceptor).
2. **Drawee or Acceptor:-** Drawee is the person on whom the bill of exchange is drawn for acceptance. Drawee is the person who purchase goods on credit or to whom credit has been granted by drawer. The drawee is liable to pay money to the creditor/drawer.
3. **Payee:** Payee is the person who receives the payment from the drawee. Usually the Drawer and the payee is the same person. In the following cases, drawer and payee are two different persons.
 - i. When the bill is discounted by the drawer from his bank-payee in the bank.
 - ii. When the bill is endorsed by the drawer to his creditors, payee is the endorsee.

Kinds of Bills of Exchange

1. **Trade Bills:-** Those bills that are written because of business transactions are called trade bills.
2. **Accomodation Bill:-** Those bills that the business writes for mutual help are called accomodation bill.

Specimen of Bill of exchange

Amount →	Rs. 50,000		
		New Delhi 15th July, 2015	→ Place → Date
	Stamp		
	Three months after date pay to me or my order, the sum of Rs Fifty thousand only for value Received .		
	"Accepted" (Signed) (Mukesh Chand)		
Drawee →	To Mukesh Chand D-24, Sector-15 Rohini Delhi-39	(Signed) SANT KANWAR 151-, Sector-9 Rohini Delhi- 39	→ Drawer

Note:- Value received means the bill has been issued in exchange of some consideration. These words are very important because law does not consider those agreements which have been made without considerations.

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 or to the order of a certain person or to be the bearer of the instrument.

Features of promissory note

1. There must be an unconditional promise to pay a certain sum of money on a certain date.
2. It must be signed by the maker.
3. The name of the payee must be mentioned on it.
4. It must be stamped according to its value.

PARTIES TO PROMISSORY NOTE

1. **The maker:** The maker is the person who makes the promise to pay the amount on a certain date. Maker of a bill must sign the promissory note before giving it to the payee.
2. **The Payee:** The payee is the person who is entitled to get the payment from the maker of promissory note. Payee is the person who has granted the credit.

Specimen of Promissory Note

Amount → Rs. 50,000	Place → Delhi Date → Nov. 1, 2015
<div style="border: 1px solid black; width: 50px; height: 50px; display: flex; align-items: center; justify-content: center; margin: 0 auto;"> Stamp </div>	Two months after date, we promise to pay M/S Ram & Co. Or order sum of Rupees fifty thousand only for value received .
To Ram & Co. 20, Karol Bagh, New Delhi-05	(Signed) Sohan Lai & Sons 8, Chauhan Bangar Delhi

Distinction between Bills of Exchange and Promissory Note

S. No.	Basis of difference	Bills of Exchange	Promissory Note
1.	Drawer	The Drawer is the creditor.	The Drawer is the debtor
2.	No. of Parties	It has three parties namely <ul style="list-style-type: none"> • The drawer • The drawee • The Payee 	It has two parties namely: <ul style="list-style-type: none"> • The Maker • The Payee
3.	Order or Promise	It contains an order to make the payment.	It contains a promise to make the payment.
4.	Acceptance	It is valid only when accepted by the drawee.	It does not require any acceptance from the drawee.
5.	Payee	In case of bill of exchange, drawer can be the payee of the bill.	Drawer or maker cannot be the payee of Promissory note.

6.	Noting	It case of dishonor of bill Noting becomes important.	Noting is not necessary in case of dishonor of promissory note.
7.	Liability	The liability of the drawer arises only if the drawee fails to make payment.	The liability of the drawer (maker) is primary.

Important terms

1. **Term of Bill:** The period intervening between the date on which a bill is drawn and the date on which it becomes due for payment is called "Term of Bill".
2. **Due Date:** Due date is the date on which the payment of the bill is due.
 - i. In case of 'Bill at Sight':- Due date is the date on which a bill is presented for the payment
 - ii. In case of 'Bill after date':- Due Date = Date of Drawing + Term of Bill.
 - iii. In case of 'Bill after sight':-Due date = Date of Acceptance +Term of Bill.
3. **Days of Grace:** Drawee is allowed three extra days after the due date of bill for making payments. Such 3 days are known as 'Days of Grace'. It is a custom to add the days of grace.
4. **Date of Maturity:** The date which comes after adding three days of grace to the due date of a bill is called "Date of maturity".
5. **Discounting of Bill:** When the bill is encashed from the bank before its due date, it is known as discounting of bill. Bank deducts its charges from the amount of bill and is disburses the balance amount.
6. **Endorsement of Bill:** Endorsement of bill means the process by which drawer or holder of bill transfer the title of bill in favour of his/her creditors. The person transferring the title is called "Endorser" and the person to whom the bill is transferred called "Endorsee". Endorsement is executed by putting the signature at the back of the bill.
7. **Bill sent for Collection:** It is a process when the bill is sent to bank with instruction to keep the bill till maturity and collect its amount from the acceptor on the date of maturity.
8. **Dishonour of Bill:** When the drawee (or acceptor) of the bill fails to make payment of the bill on the date of maturity, it is called Dishonour of Bill.
9. **Noting of Bill:** To obtain the proof of dishonour of a bill, it is re-sent to the drawee through a legally authorized persons called Notary Public charges a small fee for Providing this service known as Noting charges.

10. **Retirement of a Bill:** When the drawee makes the payment of the bill before its due date it is called 'Retirement of a bill'.
11. **Renewal of a Bill:** Sometimes drawee is not in the position to pay the amount of the bill on maturity. Thus drawee request to the drawer to cancel the old bill & write a new bill with interest and if drawer agree, new bill is drawn with new maturity date. This process is called the 'Renewal of Bill'. The interest may be paid in cash or may be added in the amount of new bill.

Accounting Treatment of Bill Transations

A. On the Due Date bill is Honoured:-

Transactions	In the Books of Drawer	In the Books of Drawee
When goods are sold on credit by drawer	Drawee's A/c Dr.	Purchase A/c Dr.
	To sales A/c (good sold on credit)	To Drawer's A/c (goods Purchased)
When Bill is drawn & Accepted by the Drawee	Bill Receivable A/c Dr	Drawee's A/c Dr.
	To Drawee's A/c (Bill received from drawee)	To Bill Payable A/c

Note:- First Two entires are common in all the cases which we are going to discuss below.

Case-I When the bill was retained by drawer till maturity

Transactions	In the Books of Drawer	In the Books of Drawee
At the time of Maturity of bill	Cash/Bank A/c Dr.	Bill Payable A/c Dr.
	To Bill Receivable A/c (Being bill met on maturity)	To Cash/Bank A/c (Being bill met on maturity)

Case-II When the bill was discounted from the bank by owner before maturity.

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Transactions	In the Books of Drawer	In the Books of Drawee
At the time of Discounting the bill from Bank	Bank A/c Dr.	No Entry
	Discount A/c Dr	
	To Bill Receivable A/c	
At the time of Maturity of bill	No Entry	Bill Payable A/c Dr.
		To Cash/Bank A/c (Being bill met on maturity)

Case-III When the bill was endorsed in favour of creditor by drawer/holder

Transactions	In the Books of Drawer	In the Books of Drawee
At the time of endorsing of bill	Endorsee's A/c Dr.	No Entry
	To Bill Receivable A/c (Bill endorse in favour of Endorses)	
At the time of Maturity of bill	No Entry	Bill Payable A/c Dr.
		To Cash/Bank A/c (Being bill met on maturity)

Note :- In this case one additional book may be asked to maintained i.e. Endorsee Book

Transactions	In the Book of Endorse
At the time of Receiving the bill from Drawer/Debtor	Bill Receivable A/c Dr.
	To Drawer

	(Being Bill received from drawer)
At the time of Maturity of bill	Cash/Bank A/c Dr.
	To Bill Receivable A/c (Being Bill met on maturity)

Case-IV When the bill is sent to bank for collection

Transactions	In the Books of Drawer	In the Books of Drawee
At the time of bill sent for collection to bank	Bill sent for collection A/c Dr.	No Entry
	To Bill Receivable A/c (Being bill sent from collection to bank)	
At the time of Maturity of bill	Bank A/c Dr.	Bill Payable A/c Dr.
	To Bill sent for collection (Being bill sent for collection raised of maturity)	To Cash/Bank A/c (Being bill met on maturity)

Note:

- There will be no effect in the books of Drawee either the bill is discounted from the bank or endorsed to a creditor or sent to the bank for collection. The drawee makes the payment in normal manner.
- It is only in the books of drawer where an additional entry is passed to record the effect of the above transaction.

B. When Bill is dishonoured on the date of maturity.

Case I : Bill is retained by the drawer till the date of maturity.

Transactions	In the Book of Drawer	In the Books of Drawee

When bill is dishonoured	Drawee Dr.	Bills payable A/c Dr.
	To Bills Receivable	Noting charges A/c Dr.
	To Cash A/c	To Drawer
	(Being bill dishonoured & Nothing charges paid)	(Bill dishonoured)

Note:

Entry passed in the book of Drawee will be SAME in all cases.

Case II : When the bill was discounted by owner before maturity

Transactions	In the Book of Drawer	In the Books of Drawee
When bill is dishonoured	Drawee Dr.	Bills payable A/c Dr
	To Bank A/c	Noting charges A/c Dr
	(Being bill dishonoured & Nothing charges paid by bank)	To Drawer
		(Bill dishonoured)

Case III : When the bill was entered in favour of creditor by drawer/holder

Transactions	In the Book of Drawer	In the Books of Endorsee
When bill is dishonoured	Drawee Dr.	Drawer Dr.
	To Endorsee	To Bills Receivable A/c
	(Being bill dishonoured & Nothing charges paid by endorsees)	To Cash A/c

		(Bill bill dishonoured & Nothing Charges paid)
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Case IV : When the bill is sent to bank for collection

Transactions	In the Books of Drawer
When bill is dishonoured	Drawee Dr.
	To Bank A/c
	To Bill Sent for collection
	(Being bill dishonoured & Nothing charges paid by bank)

C. Renewal of a Bill

Transactions	In the Books of Drawer	In the Books of Drawee
Cancelling the Original Bill	Drawee Dr.	Bill Payable A/c Dr.
	To Bill Receivable A/c	To Drawer
	(Being the cancellation of bill receivable)	Being the cancellation of bill payable)
Amount of interest paid in cash	Cash A/c Dr.	Interest A/c Dr.
	To Interest A/c	To Cash A/c
	(Interest received in cash)	(interest paid in cash)
Recording of interest for extended period	Drawee Dr.	Interest A/c
	To Interest A/c	To Drawer
	(Interest charged for extended period)	(Interest payable for extended period)
Part payment Received or paid	Cash/Bank A/c Dr.	Drawer Dr.

	To Drawee	TO Cash/Bank A/c
	(Being the part payment Received)	(Being the part payment paid)
New bill Drawn/Accepted	Bill Receivable A/c Dr.	Drawer A/c Dr.
	To Drawee A/c	To Bill Payable A/c
	(Bill receivable drawn)	(Bill accepted)

D. Retiring bill under Rebate

Transactions	In the Books of Drawer	In the Books of Endorsee
When Drawee retires the bill before Maturity	Cash A/c Dr.	Bills Payable A/c Dr.
	Rebated A/c Dr.	To Cash A/c
	To Bill Receivable A/c	To Rebate A/c
	(The bills is retire under rebate before the date of maturity)	(The bills is retired under rebate before the date of maturity)

Points of Remember

1. When calculating Date of Maturity, the following point must be considered:

- i. In case “Bill at Sight” or “Bill on demand” 3 days of grace are NOT allowed.
- ii. When the term of bill is mentioned in no of days, then
 - Date of drawing the bill is not included.
 - Date of payment is included in determining date of maturity.
 - If date of maturity falls on a day which is public holiday; the maturity date of the bill shall be “PROCEEDING DAY”.
 - If maturity date is on an emergent holiday declared under the Negotiable Installment Act. 1881, the next working day immediately after the holiday will be considered as the date of maturity.

2. When the period is stated in months the date of maturity shall be calculated in terms of calendar months ignoring the no. of days in a month.