ACCOUNTANCY

Chapter 8: Accounting for Bills of Exchange

Accounting for Bills of Exchange

Introduction:

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. Both are legal instruments under the Negotiable Instruments Act, 1881.

- **Bills of Exchange:**

A bill of exchange is an instrument in writing, which consists of an unconditional order duly signed by the maker of the bill directing to pay a specific sum of money only to or to the order of a specific person or the bearer of the instrument.

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 in payable on demand 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:

Drawer: The drawer is the party that issues a bill of exchange. He is the seller of goods entitled to receive money from someone

Drawee or Acceptor: He/ she is the purchaser of goods on whom the bill is drawn and has to pay the amount that is mentioned in the bill.

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.

- When the bill is discounted by the drawer from his bank-payee in the bank.
- When the bill is endorsed by the drawer to his creditors, payee is the endorsee.

- **Advantages of bill of exchange:**

1. It helps in purchases and sales of goods on credit basis.
2. It is a legally valid document in the eyes of law. It assures a easier recovery to the drawer if drawee fails to make the payments.
3. A bill can be discounted from the bank before its date of maturity. By discounting with the bank, drawer can get the money before due date if required.
4. It can be easily transferred from one person to another by endorsement.
5. It helps in recovery of debt without sending reminders to the debtor.
6. It assures the seller about the timely recovery of debt. So, a drawer and drawee can plan about its cash management.

- **Promissory Note:**

The purchaser of the goods or debtor by himself prepares a note, signs it and gives it to the seller of the goods. It is known as a promissory note. A promissory note is an instrument in writing, which consists of an unconditional undertaking duly signed by the maker to pay a certain sum of money to, or to the order of, a certain person.

➢ **Features of Promissory Note:**

- It must be in writing.
- It must contain an unconditional promise to pay.
- The sum payable must be certain.
- It must be signed by the maker.
- The maker must sign it.
- It must be payable to a certain person.
- It should be properly stamped.

Parties to a Promissory Note:

1. **Maker or Drawer:** The maker or drawer is the person who makes or draws the

promissory note to pay a certain amount as specified in the promissory note. He is also called the promisor.

2. **Drawee or Payee:** Drawee or payee is the person in whose favour the promissory note is drawn. He is called the promisee.

The Distinction Between a Bill of Exchange and a Promissory Note:

Basis	Bill of Exchange	Promissory Note
1. Parties	There may be three parties, the drawer, the acceptor, and the payee.	There are two parties to it, i.e. the maker is the person who draws the note and signs it and the payee to whom the specific amount is payable.
2. Drawer	Bill of exchange is drawn by the purchaser who purchased goods on credit.	Promissory note is drawn by the debtor
3. Order and promise	Bill of exchange is an order to make payment.	It is a promise to make payment in the future.
4.Payee	The drawer of the bill can be the payee of the bill.	A maker of a promissory note cannot be the payee of it.

Terms in Bill of Exchange:

i. **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".

ii. **Due Date:** Due date is the date on which the payment of the bill is due.

iii. In case of 'Bill at Sight': - Due date is the date on which a bill is presented for the payment.

iv. In case of 'Bill after date': - Due Date = Date of Drawing + Term of Bill.

v. In case of 'Bill after sight': - Due date = Date of Acceptance + Term of Bill.

vi. **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.

vii. **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".

viii. **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.

ix. **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.

x. **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.

xi. **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.

xii. **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.

xiii. **Retirement of a Bill:** When the drawee makes the payment of the bill before its due date it is called 'Retirement of a bill'.

xiv. **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.

- **Accounting Treatment:**

  1. When the drawer retains the bill with him till the date of its maturity and gets, the same collected directly.
  2. When the bill is retained by the drawer with him and sent to the bank for collection a few days before maturity.
  3. When the drawer gets the bill discounted from the bank.
  4. When the drawer gets the bill discounted from the bank.

Class : 11th Accountancy
Chapter-8 : Bill Of Exchange

Bill Of Exchange

Features of Bill of Exchange
- Must be in writing
- An order to make payment
- It is unconditional
- Must be signed
- Payment must be certain
- must be payble to certain person
- must be stamped

Parties to a Bill of Exchange
- Drawer
- Drawee
- Payee
- Holder
- Acceptor

Types of Bills
- Demand Bills
- Term Bills
- Trade Bills
- Accommodation Bill

Features of Promissory Notes
- Promise to pay
- In writing
- Signed by maker
- Certain sum
- Stamped

Important Questions

Multiple Choice Questions-

Q1. On dishonor of a discounted bill whom does the bank look for payment

(a) Drawer

(b) Drawee

(c) Endorser

(d) Payee

Q2. Noting charges are ultimately borne by –

(a) Drawee

(b) Drawer

(c) Payee

(d) Maker

Q3. A Promissory note .... the acceptance

(a) Does not require

(b) Requires

(c) Makes

(d) Arranges

Q4. B has accepted the bill drawn on him by A. Which of the following statements is correct?

(a) A can endorse the bill, B cannot endorse the bill

(b) A can endorse the bill

(c) B cannot endorse the bill

(d) B can endorse the bill

Q5. At the time of renewal of a bill, ... account is debited in the books of the drawee.

(a) Interest

(b) Discount

(c) Rebate

(d) None of the options

Q6. A bill of Rs. 5,000 is discounted with the banker for RS. 4,750. The bill is dishonored at maturity. The drawee pays 60% of his acceptance. What is the amount of bad debts?

(a) Rs. 2,000

(b) Rs. 2100

(c) Rs. 1900

(d) Rs. 1800

Q7. Refusal by the acceptor to pay the bill on the maturity date is called –

(a) Dishonor of bill

(b) Retirement of bill

(c) Rebate on bill

(d) Discounting of bill

Q8. Find the due date of a bill of exchange dated 9th December, 2007, payable after 45 days.

(a) 25th January, 2008

(b) 24th January, 2008

(c) 26th January, 2008

(d) 27th January, 20008

Q9 The party which is ordered to pay the amount is known as –

(a) Drawee

(b) Payee

(c) Drawer

(d) None of the options

Q10. Three days are added for ascertaining the date of maturity. These are known as days of-

(a) Grace

(b) Maturity

(c) Payment

(d) None of the options

Very Short-

1. Is bill of exchange drawn by the debtor?
2. Does promissory note require acceptance?

3. What is the date of maturity of a bill of exchange?

4. What is the date of maturity of a bill of exchange? Calculate the due date of a bill of exchange written on July 13, 2017, for 30 days.

5 What is noting of the bill of exchange?

6. If the acceptor of the bill refuses to pay the bill on maturity, what is it called?

7. What are the two most used negotiable instrument.

8. What is the bill of exchange?

Short Questions-

1. Explain the characteristics of the bill of exchange?

2. If the acceptor of the bill refuses to pay the bill on maturity, what is it called?

3. Name any two types of commonly used negotiable instruments.

4. What is noting of a bill of exchange?

5. Explain briefly the procedure of calculating the date of maturity of a bill of exchange. Give example.

Long Questions-

1. Differentiate between bill of exchange and a promissory note.

2. P draws on Q three bills of exchange for Rs. 15,000, Rs. 12,000 and Rs. 9,000 respectively for goods sold to him on 1st February, 2013. These bills were for a month, 2 months and 3 months, respectively The first bill was endorsed to his creditor R. The second bill was discounted with his bank on 4th February 2013 @12% per annum discount and the third bill was sent to his bank for collection on 30th April. On the due dates, all the bills were duly met by Q. The bank sent the collection advice for the third bill after deducting Rs. 75 as collection charges. Pass the journal entries in the books of P and Q.

3. B owes A Rs.4,000 on 1st January 2018. B accepts a three mont is bill for Rs.3,900 being in full settlement of the claim. At its due date the bill is dishonoured. Noting charges Rs.50 are paid by A. Give the Journal Entries in the books of A and B.

Case Study Based Question-

1. Read the following hypothetical text and answer the given questions: -

   On 1st January 2018, Sushil drew on Parag, who is a debtor for ₹ 15,000 three bills of exchange: 1st: for ₹ 4,000 at one month, 2nd: for ₹ 5,000 at two months and 3rd: for ₹ 6,000 at three months.

   Parag accepted all three bills. On 10th January 2018, Sushil endorsed the first bill to his creditor Anand in full settlement of his account of ₹ 4,120. This bill was duly met on maturity.

   On 20th January 2018, the second bill was discounted from the bank for ₹ 4,850. This bill was dishonoured on the due date and the bank paid ₹ 40 as nothing. On Parag's request Sushil drew a fourth bill on Parag for 2 months for the amount due plus ₹ 200 as interest.

   Third bill was paid under a rebate of 15% p.a. one month before maturity. The fourth bill was sent to the bank for collection on 4th May 2018 and was duly met on maturity.

   Questions:

   1. What is the due date for the Second Bill of Exchange?

      (a) March 1, 2018

(b) March 2, 2018

(c) March 3, 2018

(d) March 4, 2018

2. What will be the journal entry for the bill endorsed by Sushil to Anand in the books of Sushil?

(a) Anand Dr. 4,000

To Bills Receivables (I) A/c 4,000

(Being bill endorsed to Anand for the full settlement of his account)

(b) Anand Dr. 4,120

To Discount Received A/c 120

To Bills Receivable (I) A/c 4,000

(Being bill endorsed to Anand for the full settlement of his account)

(c) Anand Dr. 4,120

To Discount Received A/c 120

To Parag 4,000

(Being bill endorsed to Anand for the full settlement of his account)

(d) No Entry will be done in the books of Sushil.

2. Read the following hypothetical text and answer the given questions: -

On 1st January 2017, Pravin sold goods to Navin for ₹ 1,00,000 received ₹ 25,000 in cash and drew two bills, first for ₹ 45,000 and second for ₹ 30,000 for two months each. Both the bills are duly accepted by Navin. First bill was endorsed to Shobha in settlement of her account of ₹ 45,500 and second bill was discounted from the Bank @ 12% p.a. On the due date of these bills, both bills were dishonoured. Shobha has paid ₹ 100 and Bank has paid `80 as Noting charges. Navin paid ₹ 20,000 and Noting charges in Cash and accepted a new bill for the balance at three months. The interest on balance @ 18% p.a. was paid in cash. The new bill is immediately endorsed to Jayesh. On the due date of the new bill, Navin became insolvent and nothing was recovered from the estate.

Questions:

1. What will be the journal entry in the books of Pravin for the first bill endorsed to Shobha dishonoured?

(a) Navin Dr. 45,100

Discount Received A/c 500

To Shobha 45,600

(Being first bill dishonoured and noting charges payable and the discount received account written of)

(b) Navin Dr. 45,100

To Sobha 45,100

(Being first bill dishonoured and noting charges payable written of)

(c) Navin Dr. 45,600

To Discount Received A/c 500

To Sobha 45,100

(Being first bill dishonoured and noting charges payable and the discount received account written of)

D. No Entry will be done in the books of Sushil.

2. What will be the journal entry for the bill accepted for the payment to be made to Praveen in the books of Navin?

(a) Bills Receivable A/c (I) Dr. 45,000

Bills Receivables A/c (II) Dr. 30,000

To Pravin 75,000

(Being acceptance given to Pravin for the two bills)

(b) Navin Dr. 75,000

To Bills Receivable (I) A/c 45,000

To Bills Receivable (II) A/c 30,000

(Being acceptance given to Pravin for the two bills)

(c) Navin Dr. 75,000

To Bills Payable (I) A/c 45,000

To Bills Payable (II) A/c 30,000

(Being acceptance given to Pravin for the two bills)

D. No Entry will be done in the books of Sushil.

Answer key

MCQ Answers-

1. Answer: (a) Drawer
2. Answer: Drawee
3. Answer: (a) Does not require
4. Answer: A can endorse the bill, B cannot endorse the bill
5. Answer: (a) Interest
6. Answer: (a) Rs. 2,000
7. Answer: (a) Dishonor of bill

8. Answer: (a) 25th January, 2008
9. Answer: (a) Drawee
10. Answer: (a) Grace

Very Short Answers-

1. Ans. No the bill of exchange is not drawn by a debtor.
2. Ans. No, the promissory note does not require acceptance.
3. Ans. The date of maturity of a bill of exchange is the date on which the bill becomes due for payment.
4. Ans. The date of maturity will be August 14, 2017.
5. Ans. Noting is referred to the recording of the fact of dishonour by a notary public.
6. Ans. In situations where the acceptor refuses or is not in a position to pay, such a condition causes breach of promise and leads to dishonour of bill.
7. The two most used negotiable instrument is.
   - Bill of exchange
   - Promissory Note
8. Bil of exchange is a written document signed by the head of the department or the makers guiding them to pay a certain amount for the order of a certain individual or the bearer of the device.

Short Answers-

1. The characteristics of the bill of exchange are.
   - A bill of exchange should be in writing
   - The order must be unconditional
   - The date of payment must be a fixed date
   - It should be signed by the drawee of the bill
   - It should be signed by the drawer of the bill

2. Ans. In case the acceptor refuses or not in a position to pay the bill then it is considered as the breach of the promise made at the time of the acceptance and is called dishonour of the bill.

3. Ans. A Negotiable instrument means a promissory note, bill of exchange or cheque either to order or bearer." Two negotiable instruments are bills of exchange and promissory notes.

4. Noting of a Bill means getting the Bill notified and presented on its dishonour with the Notary Public.

5. Ans. Maturity refers to the date on which a bill of exchange or promissory note

becomes due for payment. In arriving at the maturity date 3 days, known as days of grace must be added to the date on which the period of credit expires.

However, where the date of maturity is a public holiday e.g. all Sundays, 15 August etc., the instrument will become due on the preceding business day. But when an emergency holiday is declared under the Negotiable Instruments Act, 1881, which happens to be the date of maturity of a bill of exchange, then the date of maturity will be the next working day immediately after the holiday. Example: If a bill of Rs 2 lacs is drawn on 1stSept. 2008, payable after three months, then the due date or nominal date is 1stDec. 2008 while the bill is legally due on 4th Dec. 2008.

Long Answers-

1. Answer: The difference between a bill of exchange and promissory note are as follows:

Basis	Bill of Exchange	Promissory Note
Drawer	Creditor is the Drawer.	Debtor is the Drawer.
Order or Promise and Parties	It contains an order to make payment. There can be three parties to it viz. the drawer, the drawer and the payee.	It contains a promise to make payment. There are only two parties to it viz. the drawer and the payee.
Acceptance	t requires acceptance by the drawee or someone else on his behalf.	It does not require any acceptance.
Payee	Drawer and payee can be the same party.	Drawer cannot be the payee of it.
Copies	In case of foreign bill, three copies are made, otherwise only one copy is prepared.	Only one copy is prepared whether, it is foreign or local.
Liability	The liability of the drawer arises only if the acceptor does not pay.	The promisor has the primary liability to pay.
Stamps	Stamps are not required to be fixed, on the bills payable on demand. However, on the other bills, stamps are required to be fixed.	Stamps have to be fixed in any case.
Noting	In case of Dishonour, it is better to get it noted for non-payment.	In the case of promissory note noting is necessary.

2. Answer: P's JOURNAL

Date	Particulars		L/F	Debit Amount (Rs)	Credit Amount (Rs)
2015					
Feb 1	Q's A/c To Sales A/c (Being goods sold on credit)	Dr		36,000	36,000
Feb 1	Bills Receivable (No. 1) A/c Bills Receivable (No. 2) A/c Bills Receivable (No. 3) A/c To Q's A/c (Being the acceptances received)	Dr Dr Dr		15,000 12,000 9,000	36,000
Feb 1	R's A/c To Bills Receivable (No. 1) A/c (Being the bill endorsed in favour of creditor, R)	Dr		15,000	15,000
Feb 4	Bank A/c Discounting Charges A/c To Bills Receivable (No. 2) A/c (Being the bill discounted with the bank)	Dr Dr		11,760 240	12,000
Apr 30	Bills Sent for Collection A/c To Bill Receivable (No. 3) A/c (Being the bill sent to the bank for collection)	Dr		9,000	9,000
May 4	Bank A/c Bank Charges A/c	Dr Dr		8,925 75	9,000

	To Bills Sent for Collection A/c (Being the bill collected by the bank and collection charges deducted)				
	Total			1,17,000 ======	1,17,000 ======

Working Note Calculation of Discount = $12{,}000 \times \frac{12}{100} \times \frac{2}{12} = 240$

Q's JOURNAL

Date	Particulars		L/F	Debit Amount (Rs)	Credit Amount (Rs)
2015					
Feb 1	Purchases A/c To P's A/c (Being the goods purchased on credit)	Dr		36,000	36,000
Feb 1	P's A/c To Bills Payable (No. 1) A/c To Bills Payable (No. 2) A/c To Bills Payable (No. 3) A/c (Being the acceptances given)	Dr		36,000	15,000 12,000 9,000
Mar 4	Bills Payable (No. 1) A/c To Cash A/c (Being the bill met on maturity)	Dr		15,000	15,000
Apr 4	Bills Payable (No 2) A/c To Cash A/c (Being the bill met on maturity)	Dr		12,000	12,000

May 4	Bills Payable (No. 3) A/c To Cash A/c (Being the bill met on maturity)	Dr		9,000	9,000
	Total			1,08,000 ========	1,08,000 =======

3. Answer

BOOKS OF A

JOURNAL ENTRIES

Date	Particulars		L/F	(Rs.)	(Rs.)
1.1.18	B/R A/c	Dr.		3,900	
	Discount Allowed A/c	Dr.		100	
	To B (Being a bill drawn.)				4,000
4.4.18	B	Dr.		4,050	
	To B/R A/c				3,900
	To Discount Allowed A/c				100
	To Cash A/c (Being bill dishonour & nothing charges paid)				50

BOOKS OF B

JOURNAL ENTRIES

Date	Particulars		L/F	(Rs.)	(Rs.)
1.1.18	A	Dr.		4,000	
	To B/P A/c				3,900

	To Discount Received A/c (Being bill accepted.)				100
4.4.18	B/P A/c	Dr.		3,900	
	Nothing Charges A/c	Dr.		50	
	Discount Received A/c	Dr.		100	
	To A (Being bill dishonoured.)				4,050

Case Study Answer-

1. Answer:

   1.

   Solution: Due Date of Bill = Date of Bill Drawn + Period + Grace Days.

   2. (b)

   Solution: Journal entry for the bill endorsed by Sushil to Anand in the books of Sushil is

   Anand Dr. 4,120

   To Discount Received A/c 120

   To Bills Receivable (I) A/c 4,000

   (Being bill endorsed to Anand for the full settlement of his account)

2. Answer:

   1. (a)

   Solution: Journal entry in the books of Pravin for the first bill endorsed to Shobha dishonoured is

   Navin Dr. 45,100

   Discount Received A/c 500

   To Shobha 45,600

   (Being first bill dishonoured and noting charges payable and the discount received account written of)

   2. (c)

   Solution: Journal entry for the bill accepted for the payment to be made to Praveen in the books of Navin is

   Navin Dr. 75,000

To Bills Payable (I) A/c 45,000

To Bills Payable (II) A/c 30,000

(Being acceptance given to Pravin for the two bills)