

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

Features of Bill of Exchange:

- A Bill of Exchange must be in writing
- It must contain an order (not a request) to make payment
- The order of payment must be unconditional
- The amount of Bill of Exchange must be certain
- The date of payment should be certain
- It must be signed by the Drawer of Bill
- It must be accepted by the drawee by signing on it
- The amount specified in the bill exchange is payable either on demand on the expiry of a fixed period.
- The amount specified in the bill is payable either to certain person or to his order or to the bearer of the bill.
- It must be stamped as per legal requirement.

Parties to a Bill Exchange:

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).

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.

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.

1. When the bill is discounted by the drawer from his bank- payee is the bank.
2. 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. **Accommodation Bill** :- Those bills that the business writes for mutual help are called accommodation bill.

Specimen of Bill of Exchange

Amount Rs- 50,000	Place Delhi Date Nov 1 2019
STAMP	Three Months after date pay to me or my order, The sum of Rs. Fifty Thousand only, value Received
	Signed Sant Kumar 151- Sector 9 Rohini Delhi-39 ← <i>Drawer</i>
To, Ram & Co. → 20, karol Bagh New Delhi-05	<i>Drawee</i>

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 consideration. ”.

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 or the bearer of the instrument. Section 4 of Negotiable Instrument Act 1881.

Features of promissory note:

- There must be an unconditional promise to pay a certain sum of money on a certain date.
- It must be signed by the maker.
- The name of the payee must be mentioned on it.
- Specified amount is payable to the specified person or to his order or to the bearer.
- It must be stamped according to its value.
- Date of payment is specified

PARTIES TO PROMISSORY NOTE

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 to the payee.

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

<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 2px;">Amount</td> <td style="padding: 2px;">Rs- 50,000</td> </tr> </table>	Amount	Rs- 50,000	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 2px;">Place</td> <td style="padding: 2px;">Delhi</td> </tr> <tr> <td style="padding: 2px;">Date</td> <td style="padding: 2px;">Nov 1 2019</td> </tr> </table>	Place	Delhi	Date	Nov 1 2019	
Amount	Rs- 50,000							
Place	Delhi							
Date	Nov 1 2019							
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 2px; text-align: center;">STAMP</td> </tr> </table>	STAMP	Two months after date, we promise to pay M/S Ram & Co. Or order sum of Rupees fifty thousand only for value received						
STAMP								
To, Ram & Co. 20, Karol Bagh, New Delhi-05	Signed Sant Kumar 151- Sector 9 Rohini Delhi-39							

Distinction between Bills of Exchange and Promissory Note

Basis	Bill of Exchange	Promissory Note
Drawer	The Drawer is the creditor.	The Drawer is the debtor.
Order and Promise	It contains an order to make the payment	It contains a promise to make the payment
No Of parties	It has three parties namely: Drawer/Drawee and payee	It has two parties namely: Promisor and payee
Acceptance	It requires acceptance from the drawee	It does not require any acceptance from the drawee
Payee	Drawer can be the payee of the bill	Drawer or maker cannot be the payee of promissory note
Noting	In case of dishonour of bill, Noting becomes important.	Noting is not necessary
Liability	The liability of the drawer arises only if the drawee fails to make the payment	Promisor has the Primary Liability to pay

Important Terms:

- 1) **Bill at Sight or on Demand:** Bill at sight means the instruments in which no time for payment is mentioned. A Bill of Exchange or a promissory note is payable on demand when no time

for payment is specified or it is expressed to be payable on demand.

- 2) **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".
- 3) **Due Date**: Due date is the date on which the payment of the bill is due.
 - In case of '**Bill at Sight**':- Due date is the date on which a bill is presented for the payment
 - In case of '**Bill after date**' :- Due Date = Date of Drawing + Term of Bill.
 - In case of '**Bill after sight**' :- Due date = Date of Acceptance + Term of Bill.
- 4) **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.
- 5) **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".
 - Days of Grace is not allowed when the bill is payable "**on Demand**" or "**at sight**"
 - If the maturity date falls on a day which is a Public Holiday, the maturity date shall be preceding business day.

Illustration 1: A bill of exchange for Rs. 25,000 is drawn by A on B on 1st April 2013 for 3 Months, B accepted the bill on 10th April, 2013. Find the DUE DATE and DATE OF MATURITY if

Case I : The bill is Bill After date. Case II : The bill is Bill After Sight.

Solution :

Due Date of Maturity

Case I- When the Bill is "Bill After date". Due date -1st July 2013 and Maturity Date- 4th July 2013

Case II- When the Bill is " Bill After Sight". Due Date 10th July 2013 and Maturity Date- 13th July 2013

- 6) **Discounting of Bill**: When the bill is encashed from the bank before the due date, it is known as discounting of bill. Bank deducts its charges from the amount of the Bill and it disburses the balance amount.

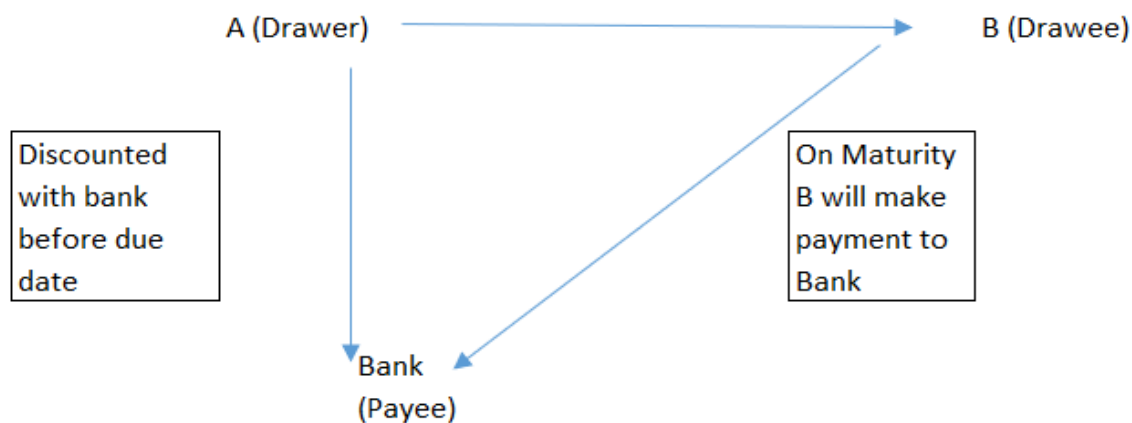


Illustration 2 : Ram sold goods to Shyam for Rs. 30,000 at credit on 1st April 2015 and draw a bill for same, accepted by Shyam. Ram discounts the bill with his bank on 4th May 2013 @ 9% per annum. The due date is 1st July 2013. Find Out:

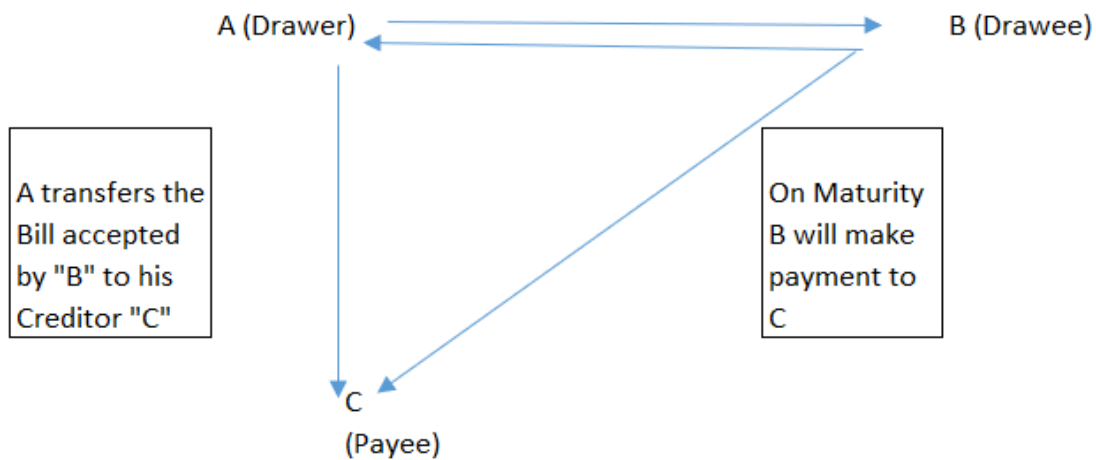
- (i) The amount of discounting charges.
- (ii) The amount that Ram will receives from his bank at the time of discounting the Bill.

Solution:

$$\begin{aligned}
 \text{(i) Discounting Charges} &= \text{Amount of Bill Discounted} * \text{Rate}/100 * \\
 &= 30,000 \times 9/100 \times 2/12 \\
 &= \text{Rs.450}
 \end{aligned}$$

Ram will receive from his bank Rs. 29,550 (i.e. Rs. 30,000-Rs.450) at the time of discounting the bill.

- 7) **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 receiving the Bill becomes authorized to receive the payment. 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.



- 8) **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.
- 9) **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.
- 10) **Noting of Bill:** Bill when sent through a Notary Public and is dishonoured, Notary Public makes a noting of Dishonour. It is called "Noting of a Bill".
- 11) **Noting Charges:** It is the fee paid to Notary Public for noting and protesting the bill of its dishonor.
- 12) **Retirement of a Bill:** When the drawee makes the payment of the bill before its due date it is called 'Retirement of a bill'. The Holder (Drawer) allows drawee a rebate of certain amount calculated at a certain rate percent per annum from the date of retirement to the date of maturity.
- 13) **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 the new bill.

Illustration 3 : A requests B to renew his acceptance for Rs. 25,000 for 3 months together with interest @ 18 % p.a. Calculate the amount of new bill drawn on A.

Solution:

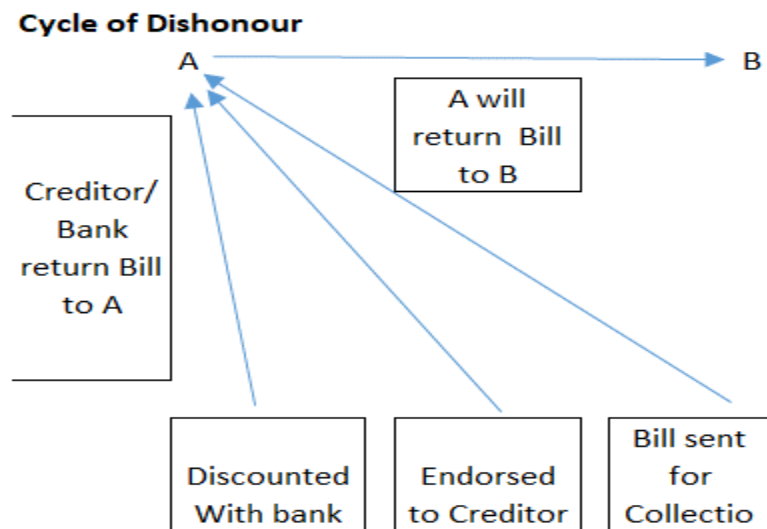
$$\text{Interest} = \text{Amount Outstanding} * \text{rate}/100 * \text{Period of new Bill}/12$$

$$= 25,000 * 18/100 * 3/12$$

$$= 1,125$$

$$\text{Amount of New Bill} = \text{Rs. } 25,000 + \text{Rs. } 1,125 = \text{Rs. } 26,125$$

** Amount Outstanding = Amount of Bill cancelled - any part payment made cash at the time of renewal of bill.



ACCOUNTING TREATMENT OF BILL TRANSACTIONS

The Holder of the Bill of Exchange has the following options to deal with the Bill:

- 1) Retain the Bill till maturity
- 2) Discount the bill with bank
- 3) Endorse the Bill in favour of a Creditor
- 4) Sent the bill for collection

Transactions	In the Books of Drawer (Mr. A)			In the Books of Drawee/ Acceptor (B)
	1	2	3	
			4	
	When the Bill is retained till Maturity	When the Bill is discounted with bank	When the Bill is endorsed to Creditor (Mr. C)	When the Bill is sent to Bank for Collection
Sale of Goods on Credit	Debtors (B) _____ Dr To sales	Debtors (B) _____ Dr To sales	Debtors (B) _____ Dr To sales	Purchases A/c _____ Dr To Creditors A/c (A)
Acceptance of Bill by Debtor	Bills Receivable _____ Dr To Drawee (B)	Bills Receivable _____ Dr To Drawee (B)	Bills Receivable _____ Dr To Drawee (B)	Drawer's A/c (A) _____ Dr To Bills payable A/c
Bill Discounted by the Bank	N/A	Bank A/c _____ Dr Discounting Charges _____ Dr To Bills Receivable A/c	N/A	No Entry
Bill Endorsement	N/A	N/A	N/A	No Entry
Bill Sent for Collection	N/A	N/A	N/A	No Entry
Honour of a Bill of Exchange on Due Date	Cash/bank A/c _____ Dr To Bills Receivable	N/A (as the Bill is with Bank)	N/A (as the Bill is with Creditor)	Bills payable _____ Dr To Cash/Bank
Dishonour of a Bill on due date (If noting charges are not incurred)	Acceptors/Drawee (B) A/c _____ Dr To Bills Receivable	Acceptor/ Drawee (B) _____ Dr To Bank A/c	Acceptor/ Drawee (B) _____ Dr To Endorsee's A/c	Bills payable _____ Dr To Drawers (A) A/c
Dishonour of a Bill on due date (If noting charges are incurred)	Acceptors/Drawee (B) A/c _____ Dr (BR+NC) To Bills Receivable (BR) To Noting Charges (NC)	Acceptors/Drawee (B) A/c _____ Dr (BR+NC) To Bank A/c (BR+NC)	Acceptors/Drawee (B) A/c _____ Dr (BR+NC) To Endorsee's (C) (BR+NC)	Bills Payable _____ Dr Noting Charges _____ Dr To Drawers (A) A/c

Note**

Noting Charges is paid by the person who is having the bill and recovers the amount from the person from he has received the bill

The ultimate burden of Noting Charges lies on Drawee/Acceptor

In the Books of Drawer (Mr. A)				In the Books of Drawee/ Acceptor (B)
Transactions	1	2	3	4
	When the Bill is retained till Maturity	When the Bill is discounted with bank	When the Bill is endorsed to Creditor (Mr. C)	When the Bill is sent to Bank for Collection
Retirement of Bill under rebate	Cash/Bank A/c _____ Dr Rebate A/c _____ Dr To Bills Receivable A/c	N/A	N/A	N/A
Renewal of a Bill				Bills Payable A/c _____ Dr To Cash/Bank A/c To Rebate Received
Step 1				
Cancellation of Old Bill	Acceptor/Drawee A/c _____ Dr To Bills Receivable	Acceptor/Drawee (B) _____ Dr To Bank A/c	Acceptor/Drawee (B) _____ Dr To Endorsee's A/c	Bills payable _____ Dr To Drawers (A) A/c
Step 2				
Part payment By Drawee	Cash A/c _____ Dr To Acceptors/Drawee A/c _____ Dr	Cash A/c _____ Dr To Acceptors/Drawee A/c _____ Dr	Cash A/c _____ Dr To Acceptors/Drawee A/c _____ Dr	Drawer's A/c _____ Dr To Cash A/c
Step 3				
Interest Charged to Drawee on remaining amount	Acceptor/Drawee A/c _____ Dr To Interest	Acceptor/Drawee A/c _____ Dr To Interest	Acceptor/Drawee A/c _____ Dr To Interest	Interest A/c _____ Dr To Drawers (A) A/c
Step 4				
Acceptance of New Bill	Bills Receivable _____ Dr To Drawee (B)	Bills Receivable _____ Dr To Drawee (B)	Bills Receivable _____ Dr To Drawee (B)	Drawer's A/c (A) _____ Dr To Bills payable A/c