

BILLS OF EXCHANGE

Theory

Introduction:

- ❖ Credit is the backbone of modern business. It is a powerful instrument to promote sales.
- ❖ In most of the businesses a large number of transactions take place on credit.
- ❖ In case of credit transaction, the buyer promises the seller that he will pay the amount of goods purchased after a certain period. This promise can either be by word of mouth or in writing.
- ❖ The written promise, if made in proper form, is taken as if the payment has been made by the buyer. The promise in writing is of TWO forms:
 - a) Bills of Exchange and
 - b) Promissory Note

Commercial practices have developed written promises into valuable instruments of credit.

Definition:

Section 5 of the negotiable instrument act (1881) defines a bill of exchange as an instrument in writing containing an un-conditional order signed by the maker to pay a certain sum of money only to him (or) to the person ordered (or) to the bearer of the instrument.

Following are the essentials of a bill of exchange

- a. It must be in writing.
- b. It must be dated.
- c. It must contain an order by the seller to the purchaser to make the payment in future.
- d. The order contained in the bill must be un-conditional.
- e. The money must be payable to a definite person or to order or to the bearer.
- f. The amount should be paid within a stipulated time.
- g. It must be properly stamped as required by the Indian Stamps Act.

Parties in Bill of Exchange:

- a. **The Drawer:** The person who draws the Bill is called the drawer. He is the creditor and writes a bill of exchange on his debtor, he puts his signature on the bill of exchange. Generally he sold goods to debtor on credit.

- b. **The Drawee:** The person on whom the Bill is drawn for its acceptance by him is called Drawee. He is also known as acceptor. He is the debtor and a bill is written on him by the drawer, order him to make a certain payment after a fixed period and accepts the bill. Without the acceptance of the drawee a bill of exchange can not be considered as valid document.

- c. **The Payee:** He is the person to whom payment of the bill is to be made on the maturity date. Sometimes the drawer and the payee can be one party when payment is to be made to the drawer.

BILLS OF EXCHANGE

1. FEATURES OF PROMISSORY NOTE / BILL OF EXCHANGE

Particulars	Promissory Note	Bill of Exchange
Nature	Unconditional Undertaking to pay	Unconditional Order to pay
Parties	Maker and Payee	Drawer, Drawee and Payee
Authorisation	It is signed by the maker	It is signed by the drawer
Example	Rupee Note	Bills drawn during normal business
Liability	Liability is on the Maker	(a) Primary liability on the drawee. (b) Secondary liability on the drawer
Act	According to RBI Act a promissory note cannot be made payable to bearer. It should be properly stamped.	Negotiable Instruments Act, 1981 governs the provisions for bills of exchange.

2. CALCULATION OF DUE DATES

Related Term	<ul style="list-style-type: none"> • Sight – Means Acceptance • Grace days – 3
Specified days after sight	Count specified days from the date immediately after the date of acceptance and also include 3 grace days.
Specified days / Months after date	The Starting date shall be date of drawal
When Due date is public holiday and known before	The Due dates shall be the immediate preceding Business (Working) day
When Due date is public holiday & declared suddenly	The Due date shall be the immediate succeeding Business (Working) day

3. NO OF DAYS IN EACH MONTH

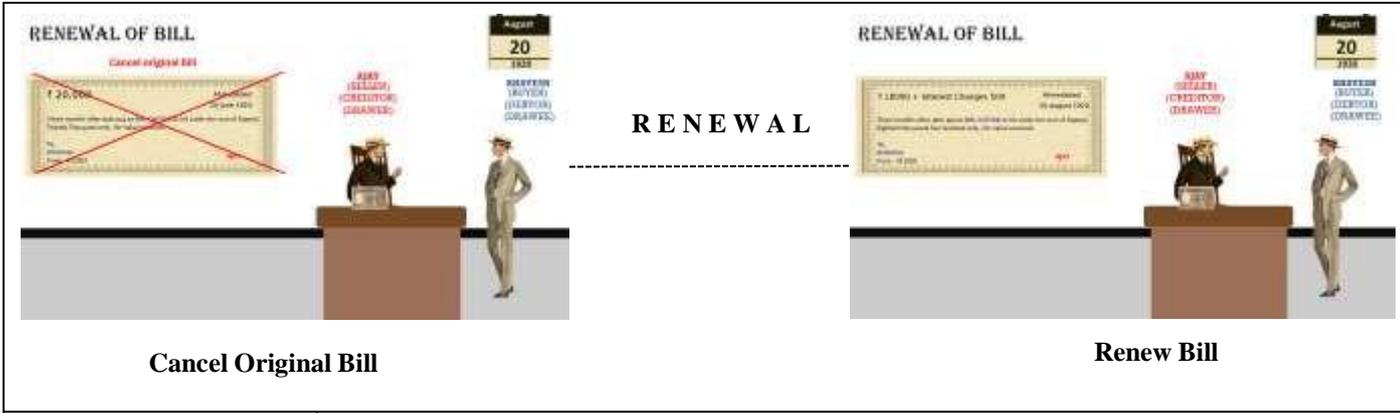
January – 31 Days	April – 30 Days	July – 31 Days	October – 31 Days
February – 28 Days (29 Days if Leap Yr.)	May – 31 Days	August – 31 Days	November – 30 Days
March – 31 Days	June – 30 Days	September – 30 Days	December – 31 Days

4. SIGNIFICANT PUBLIC HOLIDAYS

01.01. – New Year	26.01. – Republic Day	01.05 – May day
02.10. – Gandhi Jayanthi	15.08. – Independence Day	25.12.2010 – Christmas

5. SPECIAL SITUATIONS

Retirement	<ul style="list-style-type: none"> • When bills are paid before the due date. • Calculate Rebate (called discount / Interest) = Amount paid \square Int. Rate \square No. of days or Months between date of payment & due date \square 365 or 12 • <i>'Rebate' is generally equal to the amount of interest for the remaining period of the bill. Rebate is an expense for the party receiving the payment and gain to the acceptor of the bill making the payment.</i>
Renewal	<ul style="list-style-type: none"> • When bills are not paid on due date and are renewed for further period. • Calculate Interest = Amount Unpaid \square Int. Rate \square No. of days or Months between date of renewal & fresh due date \square 365 or 12 • Steps for renewal of Bill <ul style="list-style-type: none"> ○ Cancellation of original bill ○ Part payment by drawee to drawer ○ Interest charged by drawer to drawee ○ Fresh bill drawn by drawer on drawee

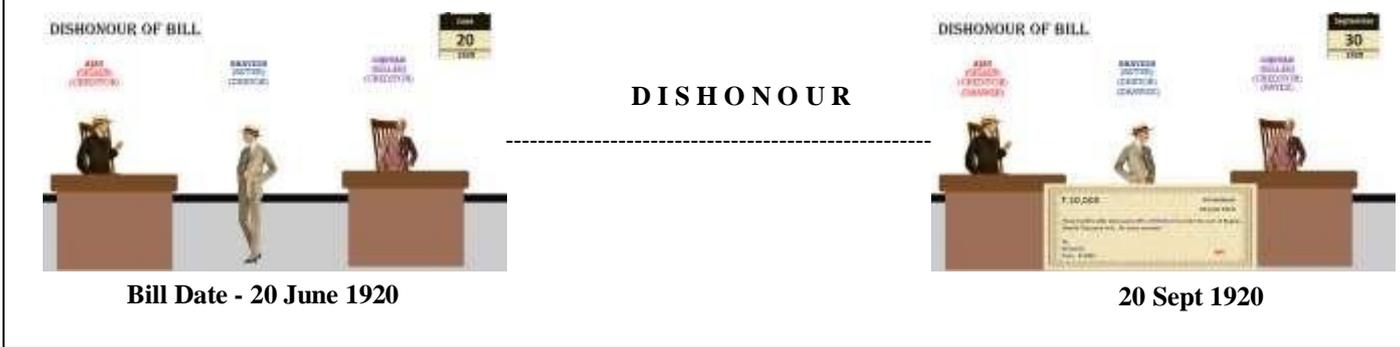


Discounting

- The bills are discounted with the banker by the drawer and Money is received from the bank.
- Discount will be deducted by the bank. $\text{Discount} = \text{Amount of Bill} \times \text{Int. Rate} \times \text{No. of days or Months between date of discounting \& due date} \div 365 \text{ or } 12$
- If the drawee does not pay, then the bank can recover the money from the drawer.
- Discount is an expense for the holder receiving the payment and gain to the bank.

Dishonour

- Acceptor refuses to honour his commitment on due date
- *Recording the fact of dishonour on the bill by the 'Notary public' is called "Noting" and the amount charged by him for his services are called 'Noting Charges'.*
- Dishonour of bill recorded in Bills receivable Book.



Endorsement	<ul style="list-style-type: none"> • When the bills receivable is transferred in favour of any other person by the drawer. • Transferor–Endorser; • Transferee – Endorsee • There is no limit on number of endorsements that can be made. On due date, the last endorsee holding the bill presents the bill to the acceptor for payment.
-------------	--

BILL IS ENDORSED TO A THIRD PARTY

July
5
1920

SAMEER
(Third Party)



CHINMAY
(SELLER)





Bill sent for collection:	<ul style="list-style-type: none"> • These agencies realise the bills on behalf of the drawer and charge a nominal commission or collection charges for it.
---------------------------	--

BILL SENT FOR COLLECTION



Date - 20 June 1920

BILL SENT FOR COLLECTION

BILL SENT FOR COLLECTION



Bank Officer
30 Sept 1920

6. ACCOMMODATION BILLS ('FICTITIOUS BILLS')

- **Meaning:** Bills drawn by one trade on another, when they are in need of funds.
- **Feature:** There is no sale / purchase by one party on the other.

- **Discounting:** The drawer of the above bill will discount the bill with the bank and share the proceeds.
- **Discounting Charges:** are shared by both the parties in the ratio in which they share the amount of bill.

Situations arising in case of Accommodation Bill

- Both the parties, drawer and drawee, honour their commitments on due date i.e. drawer remits his share in accommodation and drawee honours the bill on due date.
- In spite of non-remittance from drawer, drawee honours the bill.
- Drawer remits his share in accommodation, but drawee dishonours the bill.
- Drawer does not remit his share in accommodation and drawee dishonours the bill.

7. JOURNAL ENTRIES

Drawer (Creditor)		Drawee (Debtor)	
1.	When goods are sold on credit Drawee A/c Dr To Sales A/c (Being goods sold on credit)	1.	When goods are purchased on credit Purchase A/c Dr To Drawer A/c (Being goods purchased on credit)
2.	When bill is drawn Bills receivable A/c Dr To Drawee A/c (Being bill drawn on drawee)	2.	When Bill is accepted Drawer A/c Dr To Bills Payable A/c (Being bill accepted on drawer)
3.	If bill is honoured by drawee on the due date.		
	a) When bill kept with himself by drawer till the due date.		
i)	Cash A/c Dr To Bills receivable A/c (Being cash received on bill)	i)	Bills Payable A/c Dr To Cash A/c (Being Bill honoured on the due date and cash paid to Drawer)
	b) When drawer discounted the bill in bank		
i)	Bank A/c Dr Discount A/c Dr To Bills receivable A/c (Being bill discounted in the bank)	i)	No Entry
ii)	No entry	ii)	Bills payable A/c Dr To cash A/c (Being bill honoured on the due date and cash Paid to bank)
	c) When drawer endorsed the bill to the third party		
i)	Endorsee A/c Dr To Bill receivable A/c (Being the bill endorsed)	i)	No entry
ii)	No entry	ii)	Bills payabel A/c Dr To Cash A/c (Being bill honoured on the due date and cash paid to endorse).
	d) When bill sent to bank for collection before the due date		

i)	Bill sent for collection A/c To Bills receivable A/c (Being bill sent to bank for collection before the due date).	Dr	i)	No Entry	
ii)	Bank A/c To Bill sent for collection A/c (Being amount collected on bill by bank on the due date)	Dr	ii)	Bills Payable A/c To Cash A/c (Being bill honoured on the due date and cash paid to bank).	Dr

Dishonour of a Bill of Exchange

Drawer		Drawee			
a) When bill kept with himself till due date by drawer					
i)	Drawee A/c To Bills Receivable A/c (Being bill dishonoured by drawee on the due date)	Dr	i)	Bills Payable A/c To Drawer A/c (Being the bill dishonoured).	Dr
b) When drawer discounted the bill in the bank.					
i)	Drawer A/c To Bank A/c (Being bill dishonoured by drawee on the due date and amount collected by bank).	Dr	i)	Bills Payable A/c To Drawer A/c (Being the bill dishonoured)	Dr
c) When drawer endorsed bill to third party.					
i)	Drawee A/c To Endorsee A/c (Being bill dishonoured by drawee on the due date and amount payable to endorse)	Dr	i)	Bills payable A/c To Drawer (Being the bill dishonoured)	Dr
d) When bill sent to bank for collection before due date.					
i)	Drawee A/c To Bill sent for collection (Being bill dishonoured by drawee on the due date and bank unable to collect bill amount)	Dr	i)	Bills Payable A/c To Drawer A/c (Being the bill dishonoured)	Dr

Renewal of a Bill

In the Books of Drawer	In the Books of Drawee
a) For Interest due	
Drawee A/c To Interest A/c (Being Interest receivable from Drawee)	Interest A/c To Drawer A/c (Being Interest payable to drawer)
b) For partial payment	
Cash A/c To Drawee A/c (Being partial payment received)	Drawer A/c To Cash A/c (Being partial payment made)
c) For new bill drawn	
Bills receivable A/c To Drawee A/c (Being new bill drawn with interest)	Drawee A/c To Bills payable (Being new bill accepted with interest)

Retirement of Bill

Drawer	Drawee
When the Bill is retired before the due date	
Cash / Bank A/c Dr Rebate / Discount A/c To Bills Receivable A/c	Bills Payable A/c Dr To Cash / Bank A/c To Rebate / Discount A/c

Insolvency:

In the Books of Drawer	In the Books of Drawee
When nothing is received from drawee:	When nothing is paid to drawer:
Bad debts A/c Dr To Drawee A/c	Drawer A/c Dr To Deficiency A/c
When Partial payment recovered from drawee:	When partial payment made to drawer:
Bad debts A/c Dr Cash A/c To Drawee A/c	Drawer A/c Dr To Cash A/c To Deficiency A/c