

BILL OF EXCHANGE & PROMISSORY NOTE

BILL OF EXCHANGE -MEANING AND FEATURES

Meaning:

As per Sec. 5 of the Negotiable Instruments Act, 1881, a **Bill of Exchange** (B/E) 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.

Note: When prepared by the **Maker** (i.e. Seller of Goods), it is called **Draft**. Once it is accepted by the **Acceptor** (i.e. Buyer of Goods), it becomes a valid Bill of Exchange.

Features of Bill of Exchange:

- ✓ It must be in **writing**.
- ✓ It must contain an **order** to pay. Order must be **unconditional**.
- ✓ It must be **dated**.
- ✓ The instrument must be to pay **money only** and the amount of money payable must be **certain**.
- ✓ The party must **sign** the instrument.
- ✓ It must be properly **stamped**.

Parties involved:

- (a) The person who **makes** the order is known as the **Drawer** (or Maker), i.e. Seller of Goods.
- (b) The person who **accepts** the order is known as the **Acceptor/ Drawee**, i.e. Buyer of Goods.
- (c) The person to whom the amount is payable is known as the **Payee**. [**Note:** The Drawer and Payee may be the same person. Sometimes, the Drawer may order the payment to a third party, i.e. Payee.]

PROMISSORY NOTE – DEFINITION AND FEATURES

Meaning:

As per Sec. 4 of the Negotiable Instruments Act, 1881, a Promissory Note (P/N or Pro-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**.

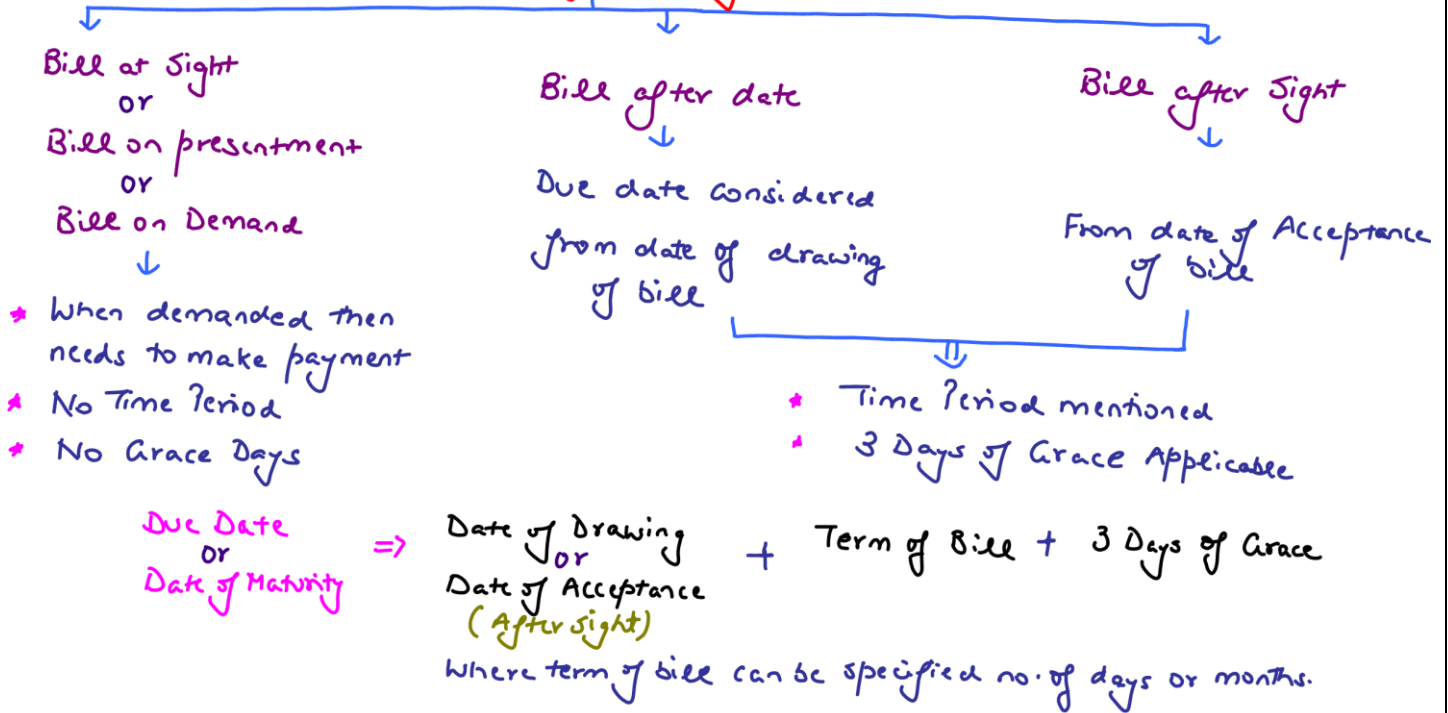
Note: A Promissory Note cannot be made payable to Bearer.

Features of a Promissory Note:

- ✓ P/N must be in **writing**.
- ✓ P/N must contain an **undertaking/promise to pay**. Mere acknowledgement of debt is not sufficient.
- ✓ The undertaking/promise to pay should be **unconditional and definite** (and not vague).
- ✓ P/N should be **signed by the Maker** himself.
- ✓ P/N should specify the Payee in clear terms
- ✓ Sum payable must be **certain**.
- ✓ P/N must be duly **stamped** and dated.
- ✓ It does **not** require any **acceptance**

CHART

Bills of Exchange



Note: If the month in which period terminates has no corresponding day, period will terminate on last day of such month.

Date of Maturity is holiday

Public / Gazetted
holiday

Preceding / Previous
working day

[26/1, 15/8, 2/10, Sundays]

Example: Date of Bill 1/6/20

(a) Term 3 Months

(b) Term 90 Days

Emergency / Unforeseen /
Sudden holiday

Succeeding / next
working day

Due Date / Maturity Date:

(a) $1/6/20 + 3M + 3D$

⇒ $1/9/20 + 3D$

⇒ $4/9/20$

(b) $1/6/20 + 90D + 3D$

⇒ $30/8 + 3D$

⇒ $2/9/20$

June = 29

July = $\frac{31}{60}$

Aug. + $\frac{30}{90}$

$\frac{90}{90}$

BASIC ENTRIES

Books of Drawer (A)

B - Dr 10000
To Sales 10000

B/R - Dr 10000
To B 10000

A Sale 10000 → B

Books of Drawee (B)

Purchases - Dr 10000
To A 10000

A - Dr 10000
To B/P 10000

Books of DRAWER (A)

	Held Bill Till Maturity	Discounting with Bank	Endorse to Creditor	Sent to Bank for collection
1) Event	-	Bank 9800 Discount 200 To B/R 10000	Creditor/C 10000 To B/R 10000	BSFC 10000 To B/R 10000
2) Maturity				
a) Honour	Bank 10000 To B/R 10000	-	-	Bank 10000 To BSFC 10000
OR b) Dishonour (Noting charges 100)	B 10100 To B/R 10000 To Bank 100	B 10100 To Bank 10100	B 10100 To C 10100	B 10100 To BSFC 10000 To Bank 100

Books of DRAWEE (B)

In all 4 cases, same entries to be passed :

Honour

B/P A/c - Dr 10000
To Bank A/c 10000

Dishonour

B/P A/c - Dr 10000
Noting charges A/c - Dr 100
To A 10100

DISHONOUR OF BILL OF EXCHANGE AND PAYMENT OF NOTING CHARGES

1. **Dishonour:** Non-payment of Bill of Exchange on the due date is called **Dishonour**.
2. **Noting:** In case of dishonour of a B/E on the due date, the fact of dishonour, and the causes of dishonour should be ascertained and recorded on the B/E itself. Otherwise, the Acceptor may prove that B/E was not properly presented to him on the due date and hence can escape from his liability.
3. **Charges:** Noting Charges refers to the fees paid to a Public Official known as "Notary Public", who records the fact and causes of dishonour of B/E.
4. **Accounting:** Noting Charges is incurred by the person presenting the B/E on the due date, and is recoverable from the person causing the dishonour, i.e. the Acceptor.

RETIREMENT OF BILL OF EXCHANGE

1. Reason for Retirement	2. Accounting for Retirement
<ul style="list-style-type: none"> Sometimes, the Acceptor of a B/E is ready to pay the amount, even before the due date. So, the Acceptor may request the Payee, for settling the payment before due date. This constitutes Retirement of Bill. 	<ul style="list-style-type: none"> Acceptor is entitled to receive certain Interest or Discount (called Rebate) for making payment before the due date. This Rebate on Bills Retired before due date, constitutes Income of Acceptor, and Expense of Payee.

Example

On 1st January, 2021, A sells goods for Rs. 10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 4th March, 2021, B retires his acceptance under rebate/discount of 12% per annum. Record these transactions in the journals of A and B

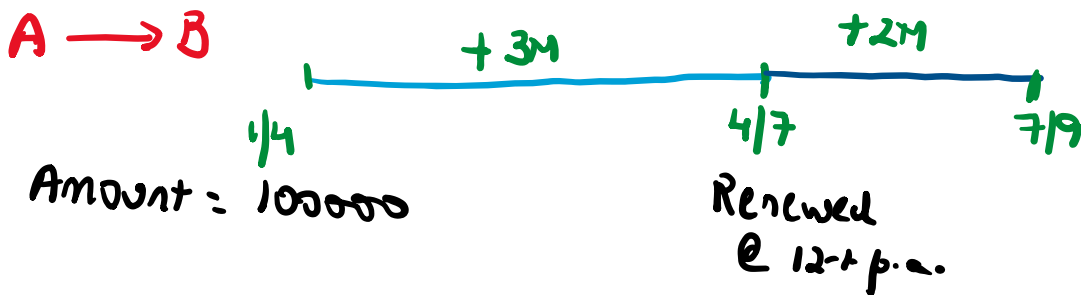
A	B
<p>1/1) B 10000) To Sales 10000</p> <p>1/1) B/R 10000) To B 10000</p> <p>4/3) Bank 9900) Disc./Rebate 100 To B/R 10000</p>	<p>Purchases 10000 To A 10000</p> <p>A 10000 To B/P 10000</p> <p>B/P 10000 To Bank 9900 To Disc./Rebate 100</p>
$\text{Rebate / Disc.} = 10000 \times 12\% \times \frac{1}{12} = 100$	

RENEWAL OF BILL OF EXCHANGE

1. Reason for Renewal	2. Accounting for Renewal
<ul style="list-style-type: none"> Sometimes, the Acceptor of a B/E is unable to pay the amount on the due date. In such case, the Acceptor may request the Drawer for an extension of time period. This constitutes Renewal of Bill. 	<ul style="list-style-type: none"> Old B/E will be cancelled. So, the earlier Journal Entry relating to acceptance of Old B/E will be reversed. New B/E will be made out. Journal Entries are passed for recording the New B/E. Sometimes, the value of New B/E = Value of Old B/E + Interest, if any.

The amount of the new bill may represent any of the following:

- a) Where the drawee pays nothing: Total of amount of original bill as well as the interest for the extended time period.
- b) Where the drawee pays the interest amount at the time of renewal: Amount of the Original bill.
- c) Where the drawee makes part payment of the original bill or interest amount or both: That part of total of amount of original bill as well as the interest for the extended time period on unpaid amount.



	Case 1		Case 2	
	(a)	(b)	(a)	(b)
Interest paid now	✓	x	✓	x
Int. Amount	2000 (12 × 12 × 1/4)	2000	1200 (60000 × 12 × 2/12)	1200
New Bill	100000	102000	60000	61200

DEALING WITH INSOLVENCY OF DRAWEE

1. **Meaning:** Insolvency of the Drawee means that he will be unable to pay his liabilities. This means that bills accepted by him will be dishonoured on the due date.

Books of the Drawer

(a) For dishonour of B/R	Drawee A/c Dr. To Bills Receivable A/c
(b) For recording final amount, if any, received	Cash A/c Dr. (Amt actually received) Bad Debts A/c Dr. (Balancing Figure) To Drawee Account (Total Amount due)

Books of the Drawee

(a) For dishonour of B/R	Bills Payable A/c Dr. To Drawer A/c
(b) For recording final amount, if any, paid	Drawer Account Dr. (Total Amount due) To Cash A/c (Amt actually paid) To Deficiency A/c (Balancing Figure)

Question

Mr. B accepted a bill for Rs. 10,000 drawn on him by Mr. A on 1st August, 2020 for 3 months. This was for the amount which B owed to A. On the same date Mr. A got the bill discounted at his bank for Rs. 9,800. On the due date, B approached A for renewal of the bill. Mr. A agreed on condition that Rs. 2,000 be paid immediately along with interest on the remaining amount at 12% p.a. for 3 months and that for the remaining balance B should accept a new bill for 3 months. These arrangements were carried through. On 31st December, 2020, B became insolvent and his estate paid 40%. Prepare Journal Entries in the books of Mr. A

Solution

Books of A

Date	Particulars	L.F.	Debit	Credit
01.08.2020	Bills receivable A/c Dr.		10,000	
	To B A/c			10,000
01.08.2020	Bank A/c Dr.		9,800	
	Discount on Bills A/c Dr.		200	
	To Bills Receivable A/c			10,000
04.11.2020	B A/c Dr.		10,000	
	To Bank A/c			10,000
04.11.2020	B A/c Dr.		240	
	To Interest A/c			240
	(Being the interest due from B for 3 months i.e., $8000 \times 3 / 12 \times 12\% = 240$)			
04.11.2020	Cash A/c Dr.		2,240	
	Bills receivable A/c Dr.		8,000	
	To B A/c			10,240
31.12.2020	B A/c Dr.		8,000	
	To Bills Receivable A/c			8,000
31.12.2020	Bank A/c Dr.		3,200	
	Bad Debts A/c Dr.		4,800	
	To B A/c			8,000

ACCOMODATION BILLS

1. Meaning:

- (a) Generally, B/E is drawn in support of a trade transaction, i.e. credit sales. However, B/E can also be utilized for raising finance (i.e. without a trade transaction).
- (b) When B/E is used for financing purposes, it is called as Accommodation Bill. (Note: An Accommodation Bill is referred to as "Kite".)
- (c) A single B/E or different bills are drawn by one party on the other and discounted with the Bank, the proceeds to be shared by both parties in agreed ratio
- (b) On the respective due dates of the B/E, both parties pay their respective dues to the Bank.

Question

A draws on B a bill of Rs. 45,000 on 1st June, 2020 for 3 months. B accepts the bill and sends it to A who discounted for Rs. 44,100. A immediately remits Rs. 14,700 (1/3rd proceeds) to B. On the due date A, being unable to remit the amount due, accepts a bill for Rs. 63,000 for three months which is discounted by B for Rs. 61,650. B sends Rs. 11,100 to A. On the due date A becomes insolvent, his estate paying forty paise in the rupee. Give the Journal Entries in the books of A and B.

Solution

Books of A

Date	Particulars	L.F.	Debit	Credit
01.06.2020	Bills receivable A/c Dr.		45,000	
	To B A/c			45,000
	(Being the acceptance received from B for mutual accommodation)			
01.06.2020	Bank A/c Dr.		44,100	
	Discount on Bills A/c Dr.		900	
	To Bills Receivable A/c			45,000
(Being bill discounted with bank)				
01.06.2020	B A/c Dr.		15,000	
	To Bank A/c			14,700
	To Discount on Bills A/c			300
(Being 1/3 rd proceeds remitted to B)				
04.09.2020	B A/c Dr.		63,000	
	To Bills Payable A/c			63,000
	(Being acceptance given to B on the failure of remittance of the amount due)			

04.09.2020	Bank A/c	Dr.	11,100	
	Discount on Bills A/c	Dr.	900	
	To B A/c			12,000
	(Being receipt of amount from B and discount amount credited to him)			
07.12.2020	Bills Payable A/c	Dr.	63,000	
	To B A/c			63,000
	(Being acceptance to B dishonoured due to insolvency)			
07.12.2020	B A/c	Dr.	42,000	
	To Bank A/c			16,800
	To Deficiency A/c			25,200
	(Being amount paid @40% & balance credited to deficiency account on failure of payment)			

Books of B

Date	Particulars	L.F.	Debit	Credit
01.06.2020	A's A/c	Dr.	45,000	
	To Bills Payable A/c			45,000
	(Being the acceptance given for the bill)			
01.06.2020	Bank A/c	Dr.	14,700	
	Discount on Bills A/c	Dr.	300	
	To A's A/c			15,000
	(Being 1/3 rd proceeds of the bill after discounting received from A)			
04.09.2020	Bills Receivable A/c	Dr.	63,000	
	To A's A/c			63,000
	(Being acceptance received from A to cover the amount due from him)			
04.09.2020	Bank A/c	Dr.	61,650	
	Discount on Bills A/c	Dr.	1,350	
	To Bills Receivable A/c			63,000
	(Being bill discounted with bank)			
04.09.2020	Bills Payable A/c	Dr.	45,000	
	To Bank A/c			45,000
	(Being own acceptance due on the date met)			
04.09.2020	A's A/c	Dr.	12,000	
	To Bank A/c			11,100
	To Discount on Bills A/c			900
	(Being amount remitted to A after getting the bill discounted)			
07.12.2020	A's A/c	Dr.	63,000	
	To Bank A/c			63,000
	(Being A's acceptance dishonoured on insolvency)			
07.12.2020	Bank A/c	Dr.	16,800	
	Bad Debts A/c	Dr.	25,200	
	To A A/c			42,000
	(Being the receipt of 40% of the amount due from A)			

TRADE BILL VS ACCOMODATION BILL

	Trade Bill	Accommodation Bill
1. Purpose	It is drawn and accepted for some consideration i.e. for trade purpose.	It is drawn and accepted without any consideration.
2. Need	It is drawn to settle a business transaction.	It is drawn to meet the financial requirements of the drawer / drawee / both temporarily.
3. Legal Status	The drawer can take legal action if the bill is dishonoured.	The drawer cannot take any legal action when the bill is dishonoured.
4. Discounting of bill	It may, or, may not be discounted with the bank.	It is always discounted with the bank.
5. Discounting charges	Discounting charges are borne by the drawer.	Divided between the drawer and drawee in the ratio of the proceeds.

Own Acceptance Received in form of B/R



(A)

B
To Sales

B/R
To B

C
To B/R

(B)

Purchases
To A

A
To B/P

-

B/R
To C

B/P
To B/R

(C)

B/R
To A

B
To B/R