BILLS OF EXCHANGE

Introduction

A bill of exchange is a note drawn by the seller and accepted by the buyer. In India, the Negotiable Instruments Act 1981 governs the provisions for bills of exchange. As per this act, the bill of exchange is defined as " an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain some of money only to the order of the certain person or to the bearer of the instrument"

Features of a bill of exchange:

(a) It's an instrument in writing.

(b) It contains an unconditional order.

(c) It's signed by the drawer.

(d) It's drawn on a specific person.

(e) There is an order to pay a specific sum of money.

(f) It must be dated.

(g) It specifies to whom the payment is to be made e.g. to the maker or to person mentioned by him or to the bearer.

(h) The amount of money to be paid must be certain.

(i) It must be properly stamped

(j) It may be made payable on demand, or after a definite period of time.

Specimen of a bill of exchange:

Stamp	Address of Drawer
Three months after date pay to a sum of ₹50,000 (Fifty Thousands only) far the value received.	
To B accepted	

Parties to Bill of Exchange:

(a) **Drawer:** He is a person who draws the bill. Typically, he is the seller or a creditor.

(b) **Drawee:** He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the drawer on the due date.

(c) **Payee:** He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.

(d) **Endorsee:** He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.

(e) **Drawee in case of need:** Sometimes the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it: such a person is called the 'Drawee in case of need'.

Calculation of Due Date

Date of Maturity is also known as Due Date. The date on which the amount of the bill becomes payable is called 'Due Date' or 'Date of Maturity'. The period between the date of drawing of the bill and the due date is called Tenure of the Bill. To compute due date, three days (called Grace Period) are included to the date of maturity of the period of the bill.

The date of maturity of the period of bills depends on whether the bill is payable on date or bill is payable on sight.

If the bill is payable on date, the date of maturity is computed by including tenure of bill to date of drawing of the bill.

However, If the bill becomes due at sight, the date of maturity is counted by including tenure of the bill to the date of acceptance of the bill.

For computing the date of maturity, following points should be noted:

1) Days of grace are allowed on bills payable on maturity of a fixed period. In case of bills payable on demand, amount is required to be paid on presentation and no grace period is allowed.
2) If period of the bill matures on a date which is not there in the month in question, then the due date is taken as the last date of the month. For example, if a bill is drawn on 31.1.2013 and the period of the bill is 3 months, the period bill becomes payable on 30.4.2013 and after including grace days, due date is 3.5.2013.
3) In case the expiry date of a bill falls on a holiday, the bill becomes payable on the preceding day. But when the maturity date is a bank holiday or a Sunday and the second day of grace is also a holiday, the bill is payable on the next working day.
4) The tenure of the bill can be explained in months or in days. The due date of bill should be computed considering this fact in mind.

Hence, if S draws bill on A on 31.1.2013 of one month, the maturity date of the bill is computed as follows

Date of Drawing	31.1.2013
Tenure	+1 month
	28.2.2013
Days of Grace	+ 3 days
	3.3.2013

However, if tenure of the bill is 30 days, the expiry date of the bill is computed as follows :

Date of Drawing	31.1.2013
Tenure	+ 30 days
	2.3.2013
Days of Grace	+ 3 days
	5.3.2013

Hence, tenure of one month and 30 days are different.

Accounting entries

For the convenience of accounting, bills are classified into (i) Bills Receivable and (ii) Bills Payable. All bills are –

(i) Bills Receivable to those who receive the bills, and

(ii) Bills Payable to those who accept the bills.

Thus, the same bill is both a Bill Receivable and a Bill Payable.

Holder, of the bill, however, has following four options available to him :

(a) He may retain the bill till the date of maturity

(b) He may get the bill discounted

(c) He may endorse it to a third party in settlement of a debt

(d) He may send it to his banker for collection.

Usual entries for bill transactions are given below:

Transactions		**Drawer's Books**		**Drawee's Books**	
When the bill is drawn and accepted		Bills Receivable A/c To Debtor A/c	Dr.	Creditor To Bills Payable A/c	Dr.
When the bill is duly honoured on maturity		Bank A/c To Bills Receivable A/c (This entry will be made if the drawer retains the bill till due date and receives payment)	Dr.	Bills Payable A/c To Bank A/c	Dr.
When the bill is endorsed to a creditor		Creditor To Bills Receivable A/c	Dr.		
When the bill is discounted with the bank	(i)	Bank A/c To Bills Receivable A/c (with full amount of the bill)	Dr.		
	(ii)	Discount on Bills A/c To Bank A/c (with the amount of discount)	Dr.		
		Alternative combined entry : Bank A/c Discount on Bills A/c To Bills Receivable A/c	 Dr. Dr.		
When the bill is sent to bank for collection and the bill is duly collected	(i)	When sent: Bills for Collection A/c To Bills Receivable A/c	 Dr.		
	(ii)	When collected: Bank A/c To Bills for Collection A/c	 Dr.		
When the bill is retired before maturity		Bank A/c Discount on Bills (or Rebate) A/c To Bills Receivable A/c	Dr. Dr.	Bills Payable A/c To Bank A/c To Discount on Bills (or Rebate) A/c	Dr.

When the bill is dishonoured	**(i)**	**If retained by the drawer till maturity:** **Debtor A/c** **To Bills Receivable A/c**	**Dr.**	**Bills Payable A/c** **To Creditor A/c**	**Dr.**
	(ii)	If discounted with Bank Debtor A/c To Bank A/c	Dr.	Bills Payable A/c To Creditor A/c	Dr.
	(iii)	If endorsed to a creditor: Debtor A/c To Creditor A/c	Dr.	Bills Payable A/c To Creditor A/c	Dr.
	(iv)	If sent to Bank for collection: Debtor A/c To Bills for Collection A/c		Bills Payable A/c To Creditor A/c	Dr.
When Noting Charges are paid on dishonoured bill	(i)	If paid by drawer: Debtor A/c To Bank A/c		Noting Charges A/c To Creditor A/c	Dr.
	(ii)	If paid by endorsee: Debtor A/c To Creditor A/c	Dr.	Noting Charges A/c To Creditor A/c	Dr.
	(iii)	If paid by discounting Bank: Debtor A/c To Bank A/c	Dr.	Noting Charges A/c To Creditor A/c	Dr.
When the bill is renewed for a further period	(i)	For cancellation of the old bill: Debtor A/c To Bills Receivable A/c		Bills Payable A/c To Creditor A/c	Dr.
	(ii)	For interest on the extended period: Debtor A/c To Interest A/c		Interest A/c To Creditor A/c	Dr.
	(iii)	For drawing the new bill: Bills Receivable A/c To Debtor A/c		Creditor A/c To Bills Payable A/c	Dr.

Insolvency of Drawee (Acceptor)

Insolvency of acceptor means that he cannot pay the amount owed by him. Therefore , on insolvency of the acceptor, bill will be treated as dishonoured and entries for dishonour of bill will be passed in the books of respective parties. Later on , when some amount is realized from the property or estate of the insolvent acceptor, entry for cash received is passed and the balance of amount due from the insolvent acceptor is treated as bad debts. In the books of acceptor the amount not paid is transferred to deficiency account (or profit and loss account).

Normally, the amount paid by the insolvent person is expressed as percentage of the amount due and is called the 'Rate of Dividend'.

Accommodation Bill of Exchange

The basis for accommodation bill is not a trade transaction. It is drawn to accommodate the financial requirements of drawer or even a drawee. This transaction presupposes trust and understanding between the parties to the transaction. The drawer normally discounts this bill with the bank. The amount received from bank is either retained by the drawer for himself or shared between the drawer and the drawee. On the date of maturity, the drawee settles the bill with bank by effecting payment. The drawer will pay the drawee either full amount of the bill or his share.

Accounting entries for accommodation bill are:

Situations	Drawer's Books		Drawee's Books	

Drawing of a bill	Bills Receivable A/c
	    To Drawee A/c
		Dr.	Drawer A/c
			    To Bills Payable A/c
				Dr.

Discounting with bank	Bank A/c Discount A/c To Bills Receivable A/c	Dr. Dr.	No Entry	

Drawing of a bill	Drawee A/c
	To Bank A/c
		Dr.	Bank A/c
			    To Drawer
			Bills Payable A/c
			    To Bank A/c
				Dr.
				
				Dr.

ASSIGNMENTS FOR CLASS

1).

On 1.4.2017 A draws a bill on B for ₹1,00,000 3 months after date. B accepts the bills signs on it and returns to A.

Pass necessary journal entries in the books of A and B in each of the following cases:

The bill is hold by A till maturity.

The bill is discounted with bank immediately at a discount of 6 % p.a.

The bill is endorsed to C to make a final settlement of a due of ₹1,05,000 on 1.4.2017.

2).

Sagar purchased goods worth ₹1,000 from Ravi for which the latter drew a bill on the former, payable after one month. Sagar accepted it and returned it to Ravi. Ravi endorsed it to Kamal, and Kamal to Amal. Amal discounted the bill with State Bank of India at 6% p.a. On maturity, the bill was dishonoured, noting charge being ₹10.

Show the entries in the books of Ravi

3).

Sunil owed Anil ₹80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April. Sunil accepts it and returns it to Anil. On 15th April, Anil discounts it with Citi Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of ₹100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of ₹3,000 on 1st July. Before the new bill became due, Sunil retires the bill with a rebate of ₹500. Show journal entries in books of Anil.

4).

On 1st April Mr. Bala draws a bill of ₹1,20,000 on Mr. Lala for the amount due for 4 months. On getting acceptance, on 5th April, Bala endorses it to Mr. Kala in full settlement of his claim of ₹1,40,000 by paying the difference in cash. Lala approached Bala on 25th July saying that he needed to renew the bill for a further period of 4 months at an interest of 12% p.a. which Bala accepted. A fresh bill including interest was accepted by Lala on 1st August. Bala settled his liability to Kala by cheque. This was duly settled on the due date. Pass journal entries in the books of Bala and show Bills Receivables A/c

5).

Pass journal entries in the books of Hema for the following transactions :

Hema's acceptance to Nanda for ₹5,000 renewed for 3 month with interest at 10% p.a.

Nalini's acceptance to Hema was for ₹10,000 was retired one month before due date at a discount of 12% p.a.

Discounted Natasha's acceptance to Hema for ₹ 4,000 with the bank for ₹3,920

Neela requests Hema to renew her acceptance for ₹3,500 for 3 months. Hema accepted on the condition that interest of ₹ 100 was paid in cash which Neela did.

Received an acceptance from Geeta for ₹1,200 and it was endorsed to Seeta in full settlement of her claim.

6).

X bought goods from Y for ₹4,000. Y draws a bill on 1.1.2013 for 3 months which was accepted by X for this purpose. On 1.3.2013, X arranged to retire the bill at a rebate of 12% p.a. Show the entries in the books of X and Y.

7).

Vijay draws a bill for ₹60,000 and Anand accepts the same for mutual accommodation of both of them to the extent of Vijay 2/3rd and Anand 1/3rd. Vijay discounts it with bank for ₹56,400 and remits 1/3rd share to Anand. Before the due date, Anand draws another bill for ₹84,000 on Vijay in order to provide funds to meet the first bill on same sharing basis. The second bill is discounted at ₹81,600. With these proceeds, the first bill is settled and ₹14,400 were remitted to Vijay. Before the due date of the second bill, Vijay becomes insolvent and Anand receives a dividend of only 50 paise in a rupee in full satisfaction. Pass journal entries in the books of Vijay.

8).

Rahim, for mutual accommodation, draws a bill for ₹3,000 on Ratan. Rahim discounted it for ₹2,925. He remits ₹975 to Ratan. On the due date, Rahim is unable to remit his dues to Ratan to enable him to meet the bill. He, however, accepts a bill for ₹3,750 which Ratan discounts for ₹3,625. Ratan sends ₹175 to Rahim after discounting the above bill. Rahim agrees to bear discount as per the benefits derived by him. Rahim becomes insolvent and a dividend of 80 paise in the rupee is received from his estate.

Pass the necessary journal entries in the books of both the parties.