**BILL OF EXCHANGE**

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

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

**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 either 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**

**1. Drawer:** 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 receive money from the drawee (acceptor).

**2. Drawee:** 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.

**3. 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.

**(i)** When the bill is discounted by the drawer from his bank-payee in the bank.

**(ii)**When the bill is endorsed by the drawer to his creditors, payee is the endorsee.

**Specimen of Bill of exchange**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| Amount: | Rs. 50,000 |  | New Delhi15th July 2015 | Place |
|  |  |  | Date |
|  | Stamp |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Three months after day pay to me or my order, the sum of Rs Fifty thousand only for Value Received |  |
|  |  |
|  |  |  |  |  |
|  | “Accepted,, |  |  |  |
|  |  |  |  |  |
|  |  |  |  |  |
|  | Signed |  |  |  |
|  | (Mukesh Chand) |  |  |  |
|  |  |  | (Signed) |  |
|  | To |  |  |  |
| Drawee: | Mukesh ChandD-24, Sector – 15,Rohini, Delhi – 39 |  | SANT KANWAR151 – Sector – 9Rohini, Delhi – 39 | Drawer |

**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 considerations.

**PROMISSORY NOTE**

A Promissory note is an instrument in writing (not beings a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only or to the order of a certain person or to be the bearer of the instrument

**Features of promissory note**

**1.** There must be an unconditional promise to pay a certain sum of money on a certain date.

**2.** It must be signed by the maker.

**3.** The name of the payee must be mentioned on it.

**4.** It must be stamped according to its value.

**PARTIES TO PROMISSORY NOTE**

**1. 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 it to the payee.

**2. 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**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |
| Amount: | Rs. 50,000 |  |  | Place: Delhi |
|  |  |  |  | Date: Nov 1, 2015 |
|  | Stamp |  | Two months after date, we promise to pay M/S Ram & Co. Or order sum of Rupees fifty thousand only for value received. |
|  |  |
|  |  |
|  |  |
|  |  |  |  | (Signed) |  |
| To |  |  |  |  |  |
|  | Ram & Co. |  |  | Sohan Lal & Sons. |  |
|  | 20, Karol Bagh, |  |  | 8, Chauhan Bangar |  |
|  | New Delhi – 05 |  |  | Delhi |  |

|  |  |  |  |
| --- | --- | --- | --- |
| S. No. | Basis of difference | Bills of Exchange | Promissory Note |
| 1. | **Drawer** | The Drawer is the creditor. | The Drawer is the debtor |
| 2. | **No. of Parties** | It has three parties namely· The drawer· The drawee· The Payee | It has two parties namely:· The Maker· The Payee |
| 3. | **Order or Promise** | It contains an order to make the payment. | It contains a promise to make the payment |
| 4. | **Acceptance** | It is valid only when accepted by the drawee. | It does not require any acceptance from the drawee. |
| 5. | **Payee** | It case of bill of exchange, drawer can be the payee of the bill | Drawer or maker cannot the payee of Promissory note. |
| 6. | **Noting** | It case of dishonor of bill Noting becomes important. | Noting is not necessary in case of dishonor of promissory note. |
| 7. | **Liability** | The liability of the drawer arises only if the drawee fails to make payment | The liability of the drawer (maker) is primary |

**Distinction between Bills of Exchange and Promissory Note**

**Important terms**

**1. 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’.

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

**(*i*)**In case of ‘Bill at Sight’:- Due date is the date on which a bill is presented for the payment

**(*ii*)**In case of ‘Bill after date’:- Due Date: – Date of Drawing + Term of Bill.

**(*iii*)** In case of ‘Bill after sight’:-Due date: – Date of Acceptance +Term of Bill.

**3. 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.

**4. 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’.

**5. 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. Rebate

**6. 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.

**7. 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.

**8. 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.

**9. 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.

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

**11. 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 new bill.

**Points of Remember**

**1. When calculating Date of Maturity, the following point must be considered:**

**(*i*)** In case “Bill at Sight” or “Bill on demand” 3 days of grace are NOT allowed.

**(*ii*)** When the term of bill is mentioned in no of days, then

· Date of drawing the bill is not included.

· Date of payment is included in determining date of maturity.

· If date of maturity falls on a day which is public holiday; the maturity date of the bill shall be “PROCEEDING DAY’.

· If maturity date is on an emergent holiday declared under the Negotiable Installment Act. 1881, the next working day immediately after the holiday will be considered as the date of maturity.

**2.** When the period is stated in months the date of maturity shall be calculated in terms of calendar months ignoring the no. of days in a month.

**Case 1:**A retains the bill till the date of maturity and also paid the noting charges.

**Case 2:**A discounts the bill from his bank on 4th June @12% per annum. Noting charges has been paid by bank.

**Case 3**: A endorses the bill in favour of C on June 1. C paid the noting charges.

**Case 4**: A sent the bill to his bank for collection on July 1. Bank paid the noting charges.

The third bill was paid by shyam under rebate of 12 % p.a. one month prior to date of maturity. The fourth bill was lodged with bank for collection and it was duly met. pass necessary Journal entries in the books of amit and shyam.

Name any two types of commonly used negotiable instruments.

**ANSWER:**

The two types of commonly used negotiable instruments are:

1. Cheques

2. Bills of exchange

**Question 2:**

Write two points of distinction between bills of exchange and promissory note.

**ANSWER:**

|  |  |  |
| --- | --- | --- |
| **Basis of Difference** | **Bills of Exchange** | **Promissory Note** |
| Drawer | It is drawn by a creditor. | It is drawn by a debtor. |
| Parties | There are three parties involved, namely drawer, drawee and payee. | There are two parties involved, namely maker and payee. |

**Question 3:**

State any four essential features of bill of exchange.

**ANSWER:**

The four essential features of bills of exchange are:

1. It must be a written document.

2. It is an unconditional order to pay by the drawer to the drawee.

3. The maker of bill must sign it, without which it will **not** be a legal proof.

4. The amount to be paid along with its expiry date must be specifically mentioned (both in figures and words) in a bill of exchange.

**Question 4:**

State the three parties involved in a bill of exchange.

**ANSWER:**

The following three parties are involved in a bill of exchange.

**1. Drawer** who makes the bill

**2. Drawee** who accepts the bill

**3. Payee**who receives the payment

**Question 5:**

What is meant by maturity of a bill of exchange?

**ANSWER:**

Maturity of a bill means a date on which the bill is due for payment. Maturity date of the bill differs on the basis of the terms and conditions of the bill. There are three types of bill, *viz*. after date bill, after sight bill and at sight bill.

**1. After date bill:** In case of after date bill, the payment of the bill is made on the maturity date of the bill. The maturity date of the bill is ascertained by adding three days of grace period with the specified period of the bill (***which starts from the date of drawing***). For example, if a bill is drawn on 1st March, 2011 and payable after one month; its maturity date is 4th April. If the maturity date happens to be a gazetted holiday, then the bill is due for payment one day before. However, if the maturity date happens to be a casual holiday, then the bill is due for payment after one day.

**2. After sight bill:** In case of after sight bill, the payment of the bill is made on the maturity date of the bill. The maturity date of the bill is ascertained by adding three days of grace period with the specified period of the bill (***which starts from the date of acceptance by the drawee***). For example, if a one month bill is drawn on 1st March, 2011 and is accepted by the drawee on 5th March, 2011; its maturity date is 8th April. In this case, the date of the bill starts from 5th March and **not** from 1st March. If the maturity date happens to be a gazetted holiday, then the bill is payable one day before. However, if the maturity date happens to be a casual holiday, then the bill is payable after one day.

**3. At sight bill:** In case of at sight bill, the due date of the bill is considered as and when the bill is presented for payment by the holder of the bill. In this case, there is **no** grace period. The bill becomes due whenever it is presented for payment.

**Question 6:**

What is meant by dishonour of a bill of exchange?

**ANSWER:**

Dishonour of a bill happens when the acceptor of the bill fails to make the payment on the date of maturity of the bill. Hence, liability of the acceptor is restored. Entries made for recording dishonour of the bill of exchange are reverse of the entries of recording drawing of the bill.

*In the books of drawer*

|  |  |
| --- | --- |
| Acceptor A/c | Dr. |
|   | To Bills Receivable A/c |   |
| (Bill dishonoured) |   |

*In the books of acceptor/drawee*

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
|   | To Drawer A/c |   |
| (Bill dishonoured) |   |

**Question 7:**

Name the parties to a promissory note

**ANSWER:**

The parties to a promissory note are given below.

**1. Promissor,** who makes the note and undertakes to pay the amount of promissory note.

2. **Payee,**who receives the payment.

**Question 8:**

What is meant by acceptance of a bill of exchange?

**ANSWER:**

A bill is drawn in favour of a person from whom the amount is due. In other words, a bill of exchange is drawn by the creditors on his/her debtors to make payment of specific amount, on a mentioned date. Generally, a bill is drawn by a seller to a purchaser. Purchaser accepts the bill for the amount due on account of the credit sales. The bill may be accepted for the amount due other than credit purchases, such as commission payable, salary outstanding, etc. A bill cannot come into existence without the acceptance of a debtor.

**Question 9:**

What is Noting of a bill of exchange.

**ANSWER:**

When a bill is presented for payment and acceptor fails to make payment, the bill gets dishonoured. In order to keep a legal proof of dishonour, the bill gets noted by the Notary public (which is approved by the government). In exchange of the Notary service, Notary public charges fees, known as Noting charges. Notary public notes the following facts:

1. Date and amount of the bill

2. Reasons for dishonour

3. Amount of Noting charges

**Question 10:**

What is meant by renewal of a bill of exchange?

**ANSWER:**

When an acceptor of a bill does **not** have sufficient fund to meet the obligations of the bill on time, he/she requests the drawer for extension (of time) for payment. If the drawer agrees, then a new bill is drawn which is known as renewal of bill. Generally, a bill is renewed on the condition that the drawee has to pay interest for the extended period.

**Question 11:**

Give the performa of a Bills Receivable Book.

**ANSWER:**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Serial Number** **of Bill** | **Date Received** | **Date of Bill** | **Received From Whom**  | **Drawer** | **Acceptor** | **Where payable** | **Term** | **Due date** | **Ledger Folio** | **Amount** | **Cash Book Folio** | **Remarks** |
|   |   |   |   |   |   |   |   |   |   |   |   |      |

**Question 12:**

Give the performa of a Bills Payable Book.

**ANSWER:**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Serial Number** **of Bill** | **Date of Bill** | **Given To Whom**  | **Drawer** | **Payee** | **Payable Where**  | **Term of Bill**  | **Due Date** | **Ledger Folio** | **Amount Paid** | **Date** | **Cash Book Folio** | **Remarks** |
|   |   |   |   |   |   |   |   |   |   |   |   |     |

**Question 13:**

What is retirement of a bill of exchange?

**ANSWER:**

When a holder receives the amount of a bill before the maturity date on the request of the acceptor, then it is called retirement of the bill of exchange. Holder of the bill may give discount for such earlier payment. This discount is termed as ‘rebate’.

Entry in the books of the holder of the bill

|  |  |
| --- | --- |
| Cash A/c | Dr. |
| Rebate A/c | Dr. |
|   | To Bills Receivable A/c |   |
| (Bill amount received before maturity and rebate allowed) |   |

Entry in the books of the acceptor (drawee) of the bill

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
|   | To Cash A/c |   |
|   | To Rebate A/c |   |
| (Bill paid and received rebate for early payment) |   |

**Question 14:**

Give the meaning of rebate.

**ANSWER:**

If the drawee expresses his/her wish to pay the bill before the due date to the holder, and if the holder accepts his/her request, then on account of the early payment, the holder may give some discount. This discount is termed as rebate. In other words, rebate is a discount given by the holder to the drawee (or acceptor) for his/her request of early payment of the bill before the due date. It is an expense for the drawer and hence, is debited to the drawer’s books. On the other hand, as it is a gain for the acceptor of bill, so it is credited in the drawee’s books.

Entry in the books of drawer of the bill:

|  |  |
| --- | --- |
| Cash A/c | Dr. |
| Rebate A/c | Dr. |
|   | To Bills Receivable A/c |   |
| (Bill honoured before maturity) |   |

Entry in the books of drawee of the bill:

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
|   | To Cash A/c |   |
|   | To Rebate A/c |   |
| (Bill paid and rebate received) |   |

**Question 15:**

Give the performa of a Bill of Exchange.

**ANSWER:**

Performa of a Bill of exchange is given below.

|  |  |  |
| --- | --- | --- |
| Mr. X (The Drawer)Rs 25,000 |   | New DelhiMay 01, 2011 |
| Two months after date pay to me or my order, the sum of rupees twenty five thousand only, for value received |
| https://img-nm.mnimgs.com/img/study_content/curr/1/13/17/2370/14257/Gr11_Acc_NCERT_TQ_Chap8_DP_Ami_mal_html_26f72040.gifAccepted(Signed)ToMr. Z (The Drawee)May 01, 2011Tilak Nagar,New Delhi 110018 |   | (Signed)Mr. XJanak Puri, New Delhi110032  |

**Question 1:**

A bill of exchange must contain an unconditional promise to pay. Do you agree with a statement?

**ANSWER:**

According to Negotiable Instrument Act, 1981, “*A 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 sum of money only to, or to the order of, a certain person or to the bearer of the instrument*.”

A bill of exchange contains an unconditional promise to pay a certain sum of money on an agreed date to the drawer or the bearer by the drawee of the bill.

**An unconditional order to pay:** It is one of the important characteristic of a negotiable instrument. Unconditional order implies **no** condition should be attached by the acceptor regarding the payment. The conditions like, payment of bill (only in case of profit on sales), payment of bill (only if the prices of goods increase), etc. should **not** be attached with the bill. Moreover, the language of the bill should **not** be ambiguous.

**Question 2:**

Briefly explain the effects of dishonour and noting of a bill of exchange.

**ANSWER:**

When a bill is presented for payment and the acceptor fails to make the payment, the bill gets dishonoured. In this situation, liability of the acceptor is restored.

**Entry in the books of drawer (*if Noting charges are not paid***):

|  |  |
| --- | --- |
| Drawee | Dr. |
|   | To Bills Receivable A/c |   |
| (Bill dishonoured) |   |

Entry in the books of drawee:

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
|   | To Drawer |   |
| (Bill dishonoured) |   |

Noting charges are charged by the notary public for keeping a proof that the bill is dishonoured. The noting charges are paid by the holder of the bill but actually due on the drawee or the acceptor of the bill..

Notary public notes the below given facts.

1. Date and amount of bill

2. Reasons for dishonour

3. Amount of noting charges

**Effect of Noting charges in the books of holder of bill (*if Noting charges are paid*):**

|  |  |
| --- | --- |
| Drawee | Dr. |
|   | To Bills Receivable A/c |   |
|   | To Cash A/c (Noting charges) |   |
| (Bill dishonoured and Noting charges paid) |   |

In the books of drawee:

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
| Noting charges A/c | Dr. |
|   | To Drawer |   |
| (Bill dishonoured and Noting charges due) |   |

**Question 3:**

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

**ANSWER:**

The procedure to calculate the date of maturity of a bill of exchange is given below.

1. Ascertain the date on which the bill will be honoured.

2. Add three days of grace to the above date.

For example, a bill with maturity period of one month is drawn on 1st July and due date is 1st September. Then add 3 days of grace and payment will be made on 4th September.

Days of grace depend on the following situations:

**1. Declared holidays:** If the payment day happens to be a national holiday or Sunday, then the preceding day becomes the payment day.

For example,

1. If a bill is drawn on 12th July and its due date is 12th August, then after adding 3 days of grace the maturity day is 15th August. However, as 15th August is a national holiday; so, 14th August becomes the payment day.
2. If a bill is drawn on 1st May and the maturity period is of one month, then the due date is 1st June. After adding 3 days of grace, the payment date becomes 4th June. However, if 4th June happens to be a Sunday, then the payment will be made on 3rd June.

**2. Undeclared holidays:** If the payment day happens to be an emergency holiday, then the succeeding day becomes the payment day. For example, if a bill is drawn on 1st May and is payable after 15 days, then, after adding 3 days of grace period, the due date becomes 18th May. However, if a national strike is declared on 18th May, then 19th May becomes the due date of the bill

**Question 4:**

Distinguish between bill of exchange and promissory note.

**ANSWER:**

|  |  |  |
| --- | --- | --- |
| **Basis of Difference** | **Bills of Exchange** | **Promissory Note** |
| Order or promise | It is an order to pay. | It is a promise to pay. |
| Parties | There are three parties involved, drawer, acceptor and payee. | There are two parties involved, maker and payee. |
| Drawer | It is drawn by the creditor. | It is drawn by the debtors. |
| Acceptance | It needs acceptance by the drawee. | As it is prepared by promissor, so no acceptance is required. |
| Payee | Drawer and payee may be the same. | Promissor **cannot** be the payee. |
| Noting | In case of dishonour of the bill, the bill may get noted. | Noting is **not** necessary. |
| Liability | Drawer is **not** primarily liable. | Promissor is the primarily liable. |

**Question 5:**

Briefly explain the purpose and benefits of retiring a bill of exchange to the debtor and the creditor.

**ANSWER:**

When a holder receives the amount of a bill before the maturity date on request of the acceptor, it is called retirement of the bill of exchange. Holder of the bill may give discount for such earlier payment. This discount is termed as ‘rebate’.

Rebate is given by the holder to the acceptor of the bill on account of payment before the due date. Rebate is a loss for the holder of the bill; so, it is debited in the books of the holder when payment is received.

|  |  |
| --- | --- |
| Cash A/c | Dr. |
| Rebate A/c | Dr. |
|   | To Bills Receivable A/c |   |
| (Payment received and rebate allowed for early payment) |   |

Acceptor of the bill gets rebate for the payment made before the due date. The rebate is a gain for the drawee; so, it is credited in the books of the drawee.

|  |  |
| --- | --- |
| Bills Payable A/c | Dr. |
|   | To Cash A/c |   |
|   | To Rebate A/c |   |
| (Bill paid before the due date and rebate received for early payment) |   |

**Question 6:**

Explain briefly the purpose and advantages of maintaining of a Bills Receivable Book.

**ANSWER:**

Bills Receivable Book is a special purpose book that is maintained to keep records of bills received from the debtors. It contains details such as acceptor’s name, date of bill, due date, amount, etc. for future references. It is totalled periodically and its balance is transferred to the debit side of the bills receivable account.

**Benefits of Maintaining the Bill Receivable Book**

**1. Availability of information:**All the information related to the bills receivable, such as amount, due date, etc., are recorded at one place and hence are easily accessible.

**2. Possibility of fraud:** Since all the bills are recorded at one place, possibility of fraud is minimised.

**3. Responsibility:** The person who maintains the bills receivable book will also be responsible for any errors or omissions. Therefore, higher degree of accountability and responsibility exists. Also, if any error is detected, then it can be fixed quickly.

**4. Time efficient:** Recording of bills receivable through the bills receivable book takes lesser time than that of journal entry. Therefore, it saves time of the accountant in recording numerous transactions of repetitive and routine nature.

**Question 7:**

Briefly explain the benefits of maintaining a Bills Payable Book and state how is its posting is done in the ledger?

**ANSWER:**

A Bills Payable Book is a special purpose book, maintained to keep records of acceptance of bills, given to the creditors. It contains details of the amount, date of bill, due date, to whom acceptance is given, etc., for future references. It is totalled periodically and its balance is transferred to the credit side of the bills payable account.

**Benefits of Maintaining Bills Payable Book**

**1. Availability of information:** All the information related to the bills payable are recorded at one place, such as the amount, due date, etc.

**2. Possibility of fraud:** Since all the bills are recorded at one place, possibility of fraud is minimised.

**3. Responsibility:** All the transactions are recorded by the same person. Therefore, errors can be easily detected and rectified. This leads to a higher degree of responsibility and accountability of the accountant.