Bills of Exchange

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Fundamentals Of Accounting

Learning Objectives

After studying this unit, you will be able to :

- Understand the meaning of Bills of Exchange and Promissory Notes and also try to grasp their underlying features.
- Grasp the accounting treatments relating to issue, acceptance, discounting, maturity and endorsement of bills and notes in the books of drawer and drawee.

Continued

- Learn the technique of accounting relating to accommodation bills.
- Learn the special treatment needed in case of insolvency as well as early retirement of bill.

Bills of Exchange- Meaning

A Bill of Exchange has been 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”. When such an order is accepted in writing on the face of the order itself, it becomes a valid bill of exchange.

NOTES

The following points should be noted:

1. A Bill of Exchange must be in writing.
2. It must be dated.
3. It must contain an order to pay a certain sum of money.
4. The money must be payable to a definite person or to his order to the bearer.
5. The draft must be accepted for payment by the party whom the order is made.

PROMISSORY NOTE

A promissory note is an instrument in writing, not being a bank note or 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. Under Section 31(2) of the Reserve Bank of India Act a promissory note cannot be made payable to bearer. A promissory note has the following characteristics.

Characteristics- Promissory Note

1. It must be in writing.
2. It must contain a clear promise to pay. Mere acknowledgement of a debt is not a promissory note.
3. The promise to pay must be unconditional "I promise to pay Rs. 500 as soon as I can" is not an unconditional promise.
4. The promiser or maker must sign the promissory note.
5. The maker must be a certain person.

Continued

6. The payee (the person to whom the payment is promised) must also be certain.
7. The sum payable must be certain. “I promise to pay Rs. 500 plus all fine” is not certain.
8. Payment must be in legal currency of the country.
9. It should not be made payable to the bearer.
10. It should be properly stamped.

Accounting – Bills of Exchange & Promissory Notes

On receipt of Bill :

Bills Receivable A/c ....Dr.

To Party A/c

Example :

(1) A accepts a Bill of exchange drawn on him by B. In the books of B the entry will be :

Continued

Bills Receivable Account

To A

(2) A sends to B the acceptance of D. In this case also, the entry in the books of B will be:

Bills Receivable A/c ....Dr.

To A

Options

Example:

The person who receives the bill has three options. These are :

(i) He can hold the bill till maturity. (Naturally in this case no further entry is necessary until the date of maturity arrives).

(ii) The bill can be endorsed in favour of another party. In the case the entry will be to debit the party which now receives the bill and to credit the Bills Receivable Account.

Continued

A ....Dr.

To Bills Receivable Account

(iii)

The Bill of Exchange can be discounted with bank. The bank will deduct. A small sum of money as discount and pay the rest of the money.

Continued

Bank Account Dr. (with the amount actually received)

Discount Account Dr. (with the amount of loss or discount)

To Bills Receivable Account

Example 3 :

On the date of maturity there will be two possibilities. The first is that the bill will be paid, that is to say, met or honoured. The entries for this will depend upon what was done to the bill during the period of maturity. If the bill was kept, the

Continued

Cash Account .....Dr.

To Bills Receivable Account

But if he has already endorsed the bill in favour of his creditor or if the bill has been discounted with the bank he will not get the amount; it will be the creditor or the bank wich will receive the money. Therefore, in these two cases, no entry will be made in the books of the party which originally received the bill.

Continued

The second possibility is that the bill will be dishonoured, that is to say, the bill will not be paid. If the bill is dishonoured, the bill becomes useless and the party from whom the bill was received will be liable to pay the amount (as also the expenses incurred by the party).

Therefore, the following entires will be made :

Continued

1. If the bill was kept till maturity then :

    Party (giving the bill)

    To Bills Receivable Account

2. If the bill was endorsed in favour of a creditor, the entry is :

    Party (giving the bill)

    To Creditors

3. If the bill was discounted with the bank :

    Party (giving the bill)

    To Bank A/c

Continued

Thus it will be seen that in case of dishonour, the party which gave the bill has to be debited (because he has become liable to pay the amount). The credit entry is in Bills Receivable Account (if it was retained) or the Creditor or the bank (if it was endorsed in their favour).

HOW TO CALCULATE DUE DATE OF A BILL

The due date of each bills is calculated as follows:

Case	Due Date
(a) When the bill is made payable on a specific date. (b) When the bill is made payable at a stated number of month(s) after date	(a) That specific date will be the due date. (b) That date on which the term of the bill shall expire will be the due date

Continued

	Note: The term shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month.

Continued

(c) When the bill is made payable at a stated number of days after date.	(c) That date which comes after adding stated number of days to the date of bill, shall be the due date. **Note:** The date of Bill is excluded.
(d) When the due date is a public holiday.	(d) The preceding business day will be the due date.

Continued

(e) When the due date is an emergency/ unforeseen holiday.	(e) The next following day will be the due date.

Note: The term of a **Bill after sight** commences from the date of acceptance of the bill whereas the term of a **Bill after date** of drawing a bill commences from the date of drawing of bill.

Illustration 1

Mohan sold goods to Gupta on 1st September, 2005 for Rs. 1,600. Gupta immediately accepted a three months bill. One due date Gupta requested that the bill be renewed for a fresh period of two months. Mohan agrees provided interest at 9% was paid immediately in cash. To this Gupta was agreeable. The second bill was met on due date. Give Journal entries in the books of Mohan.

Solution

Books of Mohan
Journal

2005			Dr. Rs.	Cr. Rs.
Sept. 1	Gupta To Sales Account (Sales of goods to Gupta as per Invoice No.)	Dr.	1,600	 1,600
	Bill Receivable Account To Gupta	Dr.	1,600	 1,600

Continued

Dec. 4	(3 months acceptance received from Gupta for the amount due from him)			
	Gupta To Bills Receivable Account (Gupta's acceptance cancelled because of renewal)	Dr.	1,600	1,600
	Gupta To interest (Interest @ 9% on Rs. 1,600 due from Gupta for 2 months because of renewal)	Dr.	24	24

Continued

	Bills receivable Account	Dr.	1,600	
	Cash Account	Dr.	24	
	To Gupta			1,624
	[New acceptance for 2 months for Rs. 1,600 and Cash (for interest) received from Gupta]			
2006 Feb.7	Cash Account	Dr.	1,600	
	To Bills receivable Account			1,600
	[Cash received against Gupta's second acceptance]			

Illustration 2

R owed Rs. 1,000 to S. On 1st October, 2005, R accepted a bill drawn by S for the amount at 3 months. S got the bill discounted with his bank for Rs. 900 on 3rd October, 2005. Before the due date, R approached S for renewal of the bill. S agreed on the conditions that Rs. 500 be paid immediately together with interest on the remaining amount at 12% per annum

Continued

for 3 months and for the balance, R should accept a new bill at three months. These arrangements were carried out. But afterwards, R became insolvent and 40% of the amount could be recovered from his estate

Pass journal entries (with narration) in the books of S.

Solution

In the books of S Journal

Particulars	**L.F.**		**Dr.** **Rs.**	**Cr.** **Rs.**
Bills Receivable A/c To R (Being a 3 month's bill drawn on R for the amount due)		Dr.	1,000	 1,000
Bank A/c Discount A/c To Bills Receivable A/c (Being the bill discounted)		Dr. Dr.	900 100	 1,000

Continued

R To Bank A/c (Being the bill cancelled up due to R's inability to pay it)		Dr.	1,000	 1,000
R To Interest A/c (Being the interest due on Rs. 500 @ 12% for 3 months)		Dr.	15	 15
Bank A/c To R (Being the receipt of a portion of the amount due on the bill together with interest		Dr.	515	 515

Continued

Bills Receivable A/c To R (Being the new bill drawn for the balance)		Dr.	500	 500
R To Bills Receivable A/c (Being the dishonour of the bill due to R's insolvency)		Dr.	500	 500
Bank A/c Bad Debts A/c To R (Being the receipt of 40% of the amount due on the bill from R's estate)		Dr. Dr.	200 300	 500

Illustration 3

Mr. David draws two bills of exchange on 1.1.2005 for Rs. 6,000 and Rs. 10,000. The bills of exchange for Rs. 6,000 is for two months while the bill of exchange for Rs. 10,000 is for three months. These bills are accepted by Mr. Thomas. On 4.3.2005, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of

Continued

Two months. Mr. David agrees to this proposal. On 20.3.2005, Mr. Thomas retires the acceptance for Rs. 10,000, the interest rebate i.e. discount being Rs. 100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

Solution

Journal Entries in the books of Mr. David

2005		**Dr. (Rs.)**	**Cr. (Rs.)**
Jan.1	Bills receivable (No. 1) A/c Dr. Bills receivable (No. 2) A/c Dr. To Mr. Thomas's A/c (Being drawing of bills receivable No.1 due for maturity on 4.3.2005 and bills receivable No. 2 due for maturity on 4.4.2005	6,000 10,000	 16,000

Continued

March 4	Mr. Thomas's A/c Dr. To Bills receivable (No.1) A/c (Being the reversal entry for bill No.1 on agreed renewal)	6,000	 6,000
March 4	Bills receivable (No. 3) A/c Dr. To Interest A/c To Mr. Thomas's A/c (Being the drawing of bill of exchange no.3 due for maturity on 7.5.2005 together with interest at 18% p.a. in lieu of the original acceptance of Mr. Thomas)	6,180	 180 6,000

Continued

March 20	Bank A/c Dr. Discount A/c Dr. To Bills receivable (No.2) A/c (Being the amount received on retirement of bills No.2 beofore the due date)	9,900 100	10,000
May 7	Mr. Thomas's A/c Dr. To Bills receivable (No.3) A/c (Being the amount due from Mr. Thomas on dishonour of his acceptance on presentation on the due date	6,180	6,180

Continued

May 7	Bank A/c Dr. To Mr. Thomas's A/c (Being the amount received from official assignee of Mr. Thomas at 50 paise per rupee against dishonoured bill)	3,090	3,090
May 7	Bad debts A/c Dr. To Mr. Thomas A/c (Being the balance 50% debt in Mr. Thomas's Account arising out of dishonoured bill written as bad)	3,090	3,090

BILLS FOR COLLECTIONS

When a person received a bill of exchange he may decide to receive the total amount by keeping it till the date of maturity. But in order to ensure safety, he may sent it to bank with instructions that the bill should be retained till maturity and should be realised on that date. This does not mean discounting because the bank will not credit the client until the amount is actually realised. If the bill

Entries

Is sent to the bank with such instructions it is known as “Bill sent for collection”.

It is better to make a record of this also in books by passing following entry :

Bills for Collection Account Dr.

To Bills Receivable Account

When the amount is realised the entry will be

Continued

Bank Account Dr.

To Bills for Collection Account

When the amount is not honoured, the entry will be

Party (from whom the bills

was received) Dr.

To Bills for collection A/c

RETIREMENT OF BILLS OF EXCHANGE

We have seen that renewal of a bill of exchange is made when a person does not have sufficient funds to pay for the bill of exchange on the due date and he requires a further period of credit. Many a time instances do arise when the acceptor has spare funds much before the maturity date of the bill of

Continued

exchange accepted by him. In such circumstances he approaches the payee of the bill of exchange and asks him whether the payee is prepared to accept cash before the maturity date. In such cases the acceptor gets a certain rebate or interest or discount for premature payment. The interest becomes the income of the acceptor and expense of the payee. It is a consideration of premature payment.

Illustration 4

On 1st January, 2006, Vilas draws a bill of exchange for Rs. 10,000 due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2006. Eknath retires the bill of exchange at a discount of 12% p.a. You are asked to show the journal entries in the books of Vilas.

Solution

Journal entries in the books of Eknath

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
Jan. 1	Vilas A/c	Dr.	10,000	
	To Bills Payable A/c			10,000
	(Being the bill draws by him accepted)			

Continued

Mar. 4	Bills Payable A/c	Dr.	10,000	
	To Bank A/c			9,900
	To Interest A/c (Discount A/c)			100
	(Being retirement of acceptance 1 month before maturity, interest allowed at 12% p.a.			

MCQ 1

On 1.1.05 X draws a bill on Y for Rs. 20,000for 3 months due date of the bill will be :

(a) 1.4.05
(b) 3.4.05
(c) 4.4.05
(d) 4.5.05

MCQ 2

On 15.8.05 X draws a bill on Y for 3 months for Rs. 20,000. 18th Nov was a sudden holiday, due date of the bill will be:

(a) 17th Nov (b) 18th Nov

(c) 19th Nov (d) 15th Nov

MCQ 3

On 16.6.05 X draws a bill on Y for Rs. 25,000 for 30 days . 19th July is a public holiday, due date of the bill will be:

(a) 19th July (b) 18th July

(c) 17th July (d) 16th July

MCQ 4

X draws a bill on Y for Rs 30,000 on 1.1.05 X accepts the same on 4.1.05. Period of the bill 3 months after date. What will be the due date of the bill:

(a) 4.4.05

(b) 3.4.05

(c) 7.4.05

(d) 8.4.05

MCQ 5

X draws a bill on Y. X endorsed the bill to Z. The payee of the bill will be

(a) X

(b) Y

(c) Z

(d) None

MCQ 6

A bill of 12,000 was discounted by A with the banker for 11,880. At maturity, the bill returned dishonoured noting charges Rs 20. How much amount will the bank deduct from A's bank balance at the time of such dishonour?

(a) 12,000
(b) 11,880
(c) 12,020
(d) 11,900

MCQ 7

X draws a bill on Y for Rs. 20,000 on 1.7.05 for 3 months after sight, date of acceptance is 6.1.05. Due date of the bill will be:

(a) 8.1.05

(b) 9.1.05

(c) 10.1.05

(d) 11.1.05

MCQ 8

X sold goods to Y for Rs. 1,00,000. Y paid cash Rs. 30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:

(a) 98,000

(b) 68,000

(c) 68,600

(d) 70,000

MCQ 9

On 1.1.05 X draws a bill on Y for Rs 50,000 for 3 months. X got the bill discounted 4.1.05 at 12% rate. The amount of discount on bill will be:

(a) 1500 (b) 1600

(c) 1800 (d) 1450

MCQ 10

Mr. A draws a bill on Mr. Y for Rs. 30,000 on 1.1.06 for 3 months. On 4.2.06. X got the bill discounted at 12% rate. The amount of discount will be:

(a) 900 (b) 600

(c) 300 (d) 650

MCQ 11

X draws a bill on Y for Rs. 20,000 for 3 months on 1.1.05. The bill is discounted with banker at a charge of Rs. 100. At maturity the bill return dishonoured. In the books of X, for dishonour, the bank account will be credited by:

(a) 19,900 (b) 20,000

(c) 20,100 (d) 19,800

MCQ 12

On 1.1.05 X draws a bill on Y for Rs 10,000. At maturity Y request X to renew the bill for 2 month a 12% p.a. interest. Amount of interest will be:

(a) 200 (b) 150

(c) 180 (d) 190

MCQ 13

On 1.1.05 X draws a bill o n Y for Rs. 15000 for 3 months. At maturity Y request X to accept Rs. 5000 in cash and for balance to draw a fresh bill for 2 months together with 12% p.a. interest, amount of interest will be:

(a) 200 (b) 300

(c) 240 (d) 380

MCQ 14

On 1.8.05 X draw a bill on Y "for 30 days after sight". The date of acceptance is 8.8.05. The due date of the bill will be:

(a) 8.9.05 (b) 10.9.05

(c) 11.9.05 (d) 9.9.05

MCQ 15

On 1.6.05 X draw a bill on Y for Rs. 25,000. At maturity Y request X to accept Rs. 5,000 in cash and noting charges incurred Rs. 100 and for the balance X draw a bill on Y for 2 months at 12% p.a. Interest amount will be:

(a) 410 (b) 420

(c) 440 (d) 400

MCQ 16

On 1.1.05 X draw a bill on Y for Rs. 50,000. At maturity, the bill returned dishonoured as Y become insolvent and 40 paise per rupee is recovered from his estate. The amount recovered is:

(a) 20,000

(b) Nil

(c) 30,000

(d) 40 paise

MCQ 17

X draws a bill on Y for Rs 3000. X endorsed to Z. Y will pay the amount of the bill to:

(a) X

(b) Z

(c) To himself

(d) None

MCQ 18

On 1.1.05 X draw a bill on Y for 3 months for Rs. 10,000. On 4.3.05 Y pay the bill to X at 12% discount, the amount of discount will be:

(a) 100 (b) 200

(c) 300 (d) 50

MCQ 19

Ram draws on Aslam a bill for Rs. 60,000 on 1.4.01 for 2 months. Aslam accepts the bill and sends it to Ram who gets it discounted for Rs. 58,800. Ram immediately remits Rs. 19,600 to Aslam. On due date, Ram being unable to remit the amount due accepts a bill for Rs. 84,000 for 2 months which is discounted by Aslam for Rs. 82,200. Aslam sends Rs. 14,800 to Ram out of the same. How much discount will be borne by Ram at the time of 14,800 remittances.

(a) 1200 (b) 1800 (c) 1100 (d) 800

MCQ 20

Mr. Bobby sold goods worth Rs. 25,000 to Mr. Bonny. Bonny immediately accepted a bill on 1.11.01, payable after 2 months. Bobby discounted this bill @ 18% p.a. on 15.11.01. On the due date Bonny failed to discharge the bill. Later on Bonny became insolvent and 50 paise is recovered from Bonny's estate. How much amount of bad debt will be recorded in the books of Bobby:

(a) 12,500 (b) 9,437 (c) 11,687 (d) 13,650

THE END

Bills Of Exchange