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Chapter 18

Bills of Exchange

In modern times a very large number of business transactions are made on credit basis. In case of credit sale of goods, the purchaser usually promises to make payment after a certain period. In such a case, the seller would like to get a written undertaking from the buyer to get the payment after a fixed period. As such, the seller prepares a document in which he puts in writing all the terms and conditions relating to sale of goods such as amount required to be paid; date of payment; place of payment. The buyer puts his signatures on the document and it is known as 'Bill of Exchange'. Such instruments are governed by Indian Negotiable Instruments Act, 1881.

DEFINITION OF BILL OF EXCHANGE

According to Indian Negotiable Instrument Act, 1881, "A Bill of Exchange is an instrument in writing, an unconditional order signed by the maker directing to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument."

CHARACTERISTICS OR FEATURES OF BILLS OF EXCHANGE

Following are the main characteristics of Bills of Exchange

1. A bill of exchange must be in writing.

2. It must contain an order (and not a request) to make payment.

3. The order must be unconditional.

4. The amount of bill of exchange must be definite.

5. The date of payment must be a fixed one.

6. It must be signed by the maker (drawer) of the bill.

7. It must be signed by the acceptor (drawee).

8. The amount mentioned in the bill is payable either on demand or on the expiry of a fixed period.

9. The amount is payable either to the bearer of the bill or to a specified person or to his order.

10. It bears stamps according to its amount or is drafted on a stamped paper of the court.

PARTIES TO A BILL OF EXCHANGE

(1) Drawer: He is the seller or creditor entitled to receive money from someone, He writes or draws the bill and is known as drawer.

(2) Drawee or Acceptor: He is the purchaser or the debtor on whom the bill is drawn and who is liable to pay the amount mentioned in the bill.

(3) Payee: The person to whom the payment is to be made is called payee.

ADVANTAGES OF BILLS OF EXCHANGE

(1) Helpful in the purchase and sale of goods on credit: A bill of exchange serves as a written evidence of debt. It is a proof that the purchaser of goods owes the amount written in it.

(2) Legal Document: It is a valid document in the eyes of law. If the drawee fails to make its payment, it would be easier to recover the amount legally.

(3) Discounting Facility: The holder of a bill need not wait till the due date of the bill to receive its payment as he can easily turn it into cash by discounting it from the bank before its due date.

(4) Endorsement Possible: A bill of exchange can be easily transferred from one person to another in settlement of debts as it is a negotiable instrument.

(5) Relief from sending reminders: The seller need not approach the purchaser time and again to demand the payment because the date of payment is fixed and written on the bill of exchange.

(6) Helpful in planning cash operations: The seller knows the time when he would receive the money and, as such, he can plan his cash operations accordingly.

(7) Convenient means of making foreign payment: Bills of Exchange enable the firms to receive and make payments in case of foreign trade also.

(8) Convenience for the purchaser: By accepting a bill, a purchaser gets time to make the payment. As such, he can purchase more goods and increase his business.

PROMISSORY NOTE

Sometimes, the purchaser of the goods or debtor himself writes a note, signs it and gives it to the seller of the goods. It is called a 'Promissory Note'.

According to Indian Negotiable Instrument Act, "A Promissory Note is an instrument in writing containing an unconditional undertaking signed by the maker to pay a certain sum of money to, or to the order of, a certain person".

FEATURES

(1) It must be in writing.

(2) There must be a promise to pay a certain sum of money in it.

(3) The promise to make payment must be unconditional.

(4) The amount to be paid must be specified (definite).

(5) It must be signed by the maker or promisor.

(6) The name of the payee must be mentioned in it.

(7) The promissory note cannot be made payable to bearer.

(8) It must be stamped according to its value.

PARTIES TO A PROMISSORY NOTE

There are two parties to a promissory note:

(1) Maker: - He is the person who writes a promissory note and signs it.

(2) Payee: - He is the person who is entitled to get the payment. There is no acceptor in case of a promissory note because the maker himself is liable to pay the amount.

Date of Maturity and Days of Grace

The date on which the payment of the bill becomes due is called the 'due date' or 'date of maturity'.

While calculating the due date of the bill, it is compulsory to add three days to the period of the bill. These three days are called 'Days of Grace'.

The following points are very significant for calculating the date of maturity: -

Bill at Sight: In a bill of exchange, the expressions, 'at sight' and 'on presentation' mean payable on demand. If no time for payment is mentioned in the bill, it is payable on demand. Such bills are not entitled to days of grace.

Bill after Date: Bill after date is the bill in which due date and date of maturity is ascertained on which the bill is drawn. 3 days grace period are allowed for ascertaining the date of maturity in case of bill after date.

Bill after Sight: The expression 'after sight' in a bill of exchange means after accepting. Thus, where a bill is payable at a fixed period 'after sight', the period begins to run from the date of acceptance. Three days of grace are allowed on such bills also.

ACCOUNTING TREATMENT

For the purpose of accounting, bills are divided into two categories:

1. Bills Receivable or B/R.

II. Bills Payable or B/P.

The person who is entitled to receive money draws the bill and gets it accepted from the person who is liable to pay. As such, the same bill is a Bill Receivable (B/R) from the point of view of the drawer and a Bill Payable (B/P) from the point of view of the acceptor.

Different Uses of Bills Receivable: - A party which holds a bill receivable can use it in either of the following ways: -

1. He may keep it till the date of maturity; or

2. He may discount it with the banker before the date of maturity; or

3. He may endorse it to some other party before the date of maturity; or

4. He may send it to his banker for collection.

(1) When the Bill is retained by the drawer in his own possession till the date of maturity

In such a case, the drawer will himself receive the payment of the bill on the date of maturity. The following entries are passed in the books of both the parties: -

Transactions	Drawer (suppose X)	Drawee (suppose Y)
1. When goods are sold	Y Dr. To Sales a/c (Goods sold on credit)	Purchase a/c Dr. To X (goods purchased from drawer)
2. When bill is drawn	B/R a/c Dr. To Y (Acceptance received from drawee)	X Dr. To B/P a/c (Acceptable given to drawer)
3. When the bill is retained by drawer till maturity and drawee pay the amount of bill on maturity	Bank a/c Dr. To B/R a/c (Amount of bill received on maturity)	B/P a/c Dr. To Bank a/c (Amount of bill pay on maturity)

(2) When the bill is discounted from the bank

If the holder of a B/R need money before the date of maturity, he can discount the bill from the bank in order to obtain cash for it. Bank deduct certain amount of discount from the face value of the bill and pay the balance to the person discounting the bill. The discount deducted by the bank is actually the amount of interest charged by the bank for lending the money.

Transactions	Drawer (suppose X)	Drawee (suppose Y)
1. When the drawer discounts the bill from the bank	Bank a/c Dr. Discounting charges a/c Dr. To B/R a/c (Bill discounted)	No Entry
2. When drawee pays the amount of bill	No Entry	B/P a/c Dr. To Bank a/c (Amount of bill paid to bank)

(3) Negotiation of a Bill

Negotiation means transfer of bills of exchange to another person in such a manner that the transferee of the bill become its holder, who has the right to possess the bill in his own name and to recover the amount mentioned therein from the concerned parties.

The bills of Exchange can be negotiated in two ways:

(a) Negotiation by delivery

(b) Negotiation by Endorsement and Delivery

Endorsement of Bill

Endorsement means signing of bills of Exchange for the purpose of transferring it to another. Where the holder of the bill receivable can endorse the bill to another person by putting his signature at the back of the bill. The person endorsing the bill is known as endorser and the person to whom bill is endorsed is called endorsee.

Transactions	Drawer (suppose X)	Drawee (suppose Y)	Endorsee (suppose Z)
1. If X endorsed bill in favour of Z	Z Dr. To B/R a/c (B/R endorsed to Z)	No Entry	B/R a/c Dr. To X (B/R received)
2. Y pays the amount of bill on due date	No Entry	B/P a/c Dr. To Banka/c (The amount of bill paid on due date)	Bank a/c Dr. To B/R a/c (The amount of the bill received)

Retiring of Bill under Rebate

When the drawee makes the payment of the bill before its due date, it is called retiring the bill. In such a case, the holder of the bill usually allows him discount technically called rebate.

Transactions	Drawer (suppose X)	Drawee (suppose Y)

If Y retires his acceptance before the due date	Bank a/c Dr. Rebate on bill a/c Dr. To B/R a/c (Amount received before due date and rebate allowed)	B/P a/c Dr. To Bank a/c To Rebate on bill a/c (Amount paid before due date and rebate received)

Dishonour of a Bill

When the acceptor of the bill refuses to pay the amount of the bill on the due date of maturity or becomes insolvent, it is called dishonour of the bill.

NOTING CHARGES

To establish the fact that the bill was properly presented and dishonoured the bill is usually handed over to a person called Noting Public. The noting public charges a small fees for the service rendered by him, which is called 'Noting charges'. Such charges are paid to the Notary public first by the holder of the bill, but are ultimately recovered from the acceptor because he is the person responsible for the dishonour.

Transactions	Drawer (Suppose X)	Drawee (suppose Y)
1. When 'Y' the acceptor of the bill dishonours the bill on the due date	Y Dr. To B/R a/c (Bill dishonoured and noting	B/P a/c Dr. To X
2.When 'X' pays noting charges	Y Dr. To Cash a/c	Noting Charges a/c Dr. To X
3. Usually a compound entry is passed for the two entries passed	Y Dr. To B/R a/c To Cash a/c	B/P a/c Dr. To X To Noting Charges a/c

Types of Bill

Bills may be of 2 types:

1. Trade Bill: When a bill is accepted to settle a trade debt it is known as 'trade bill'

2. Accommodating Bill: Sometime, in order to oblige a friend, a bill may be accepted without consideration. Such bill is known as Accommodating bill.