



CA FOUNDATION

The Institute of Chartered Accountants of India

PRINCIPLES AND PRACTICE OF ACCOUNTING

PART - II

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Accounting for Special Transactions

Bills of Exchange

Meaning:-

In India the Negotiable Instruments Act 1981 governs the provisions for bill of Exchange.

It 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 the order of the certain person or to the bearer of the instrument.

Parties to Bill of Exchange:-

The parties involved in transaction that use bill of exchange as a mode of settlement are:-

- ★ Drawer: He is a person who draws the bills. Typically he is the seller or a creditor.
- ★ Drawee:- He is the person on whom the amount the bills 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.
- ★ 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.

★ **Endorser**:- Person who transfers rights of payment.

★ **Endorsee**: he is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.

★ **Bearer**:- Person in possession of bearer bill.

Holder:-

According to Sec. 8 of the Negotiable Instruments Act a Holder is 'Any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereon'. It indicates the person who is legally entitled to receive the money due on the instrument is called the Holder.

Holder in due Course:-

Acc. to Sec. 9 of the Negotiable Instrument Act, the holder is due course in a particular kind of holder.

The person of a negotiable instrument is called holder if he/she satisfies the following conditions.

- He/She has obtained the instrument for valuable consideration.

- He/She became the holder of the instrument before the maturity of the instrument.

- He/She must acquire the instrument bona fide and having no cause to believe that, any defect existed in the title of a person from whom he derived his title.

Dishonour of Bill:-

- ✓ Dishonour of a Bill means that the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place.
- ✓ To provide a legal evidence of Dishonour, the fact of Dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'.
- ✓ The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'.
- ✓ These charges are to be paid by the holder of the bill on the date of default.

* Discounting of Bills:->

- ✓ If the holder of a bill receivable cannot wait till the date of maturity of the bill and needs cash before the due date, then he can get the bill dishonoured from the bank.
- ✓ At the time of discounting it, the bank pays cash after deducting the discount from the value of the bill.

✓ The discount which is to be deducted depends upon the rate of interest and the remaining period of the bill and is calculated as follows:-

✓ $\text{Discount} = \text{Amount of the bill} \times \text{Remaining period to Maturity} \times \text{Rate of Interest}$

Tenure:-→

The bill is payable at sight, on demand, it becomes due immediately on presentation for payment. In the same way if the bill is not payable on demand becomes due on the third day from the date of maturity. These three days are called Days of Grace.

Day of Maturity:-→

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".

Types of Bills of Exchange:-

- (a). Trade bill: The bill is drawn to settle a trade transaction.
- (b). Accommodation bill: The bill is used without a Trade transaction and is for mutual benefit.

Promissory Note:-→

★ A person, by whom any amount is payable himself prepares and signs a written undertaking to pay. Here the credit document is called a "promissory Note".

★ It's a written document and contains an undertaking or promise to pay.

★ As per Indian Negotiable Instrument, Act a "promissory Note" is "an instrument in writing (not being a bank note a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money, or to the Order of a certain person".

★ The person to whom the amount is payable is called promisee or Payee.

Difference between Bills of Exchange and Promissory Note.

The differences between these two items are as under:

Bills of Exchange	Promissory Note.
① It is drawn by the Seller.	① It is drawn by the Purchaser.
② It involves an Order to make payment.	② It involves a promise to make payment.
③ It consist of three parties viz the drawer, the acceptor and the payee.	③ It consist of two parties, namely, the promisor (or maker) & promisee (or payee).
④ To be effective, it must be accepted.	④ It does not need acceptance.
⑤ Drawer and the payee can be the same person.	⑤ Maker and payee cannot be the same person.

(C) Acceptor is required to make payment of due date, in case of any default, drawer is liable to pay the amount to payee.

(D) Drawer or maker is required to make payment on due date.

Accounting Treatment:-

(A) When the drawer retains the bill till Maturity:-

Situations	Drawer's books	Drawee's books	Endorsee's books
Drawing of a bill	B/R A/c Dr. To Drawee A/c	Drawer A/c Dr. To B/P A/c	No applicable
Payment on due date	Bank A/c/cash A/c Dr. To B/R A/c	B/P A/c Dr. To Bank/cash A/c	No applicable
Dishonoured on due date	Drawee A/c Dr. To B/R A/c To Bank A/c/cash A/c (for nothing charge)	B/P A/c Dr. Nothing change A/c To Drawer A/c	No applicable

(B) When the drawer discounts the bill with bank before Maturity:-

Situations.	Drawer's Book	Drawee's Book.
Drawing of a bill	B/R A/c Dr To Drawee A/c	Drawer A/c Dr To B/P A/c
Discounting with the bank	Bank A/c Dr. Dis. A/c Dr. To B/R A/c	No Entry.
Payment due date	No Entry	B/P A/c Dr To Bank A/c
Dishonoured on due date	Drawee A/c Dr. To Bank A/c (Bill + nothing charges)	B/P A/c Dr Nothing charges A/c Dr To Drawer A/c

c) When the drawer endorses the bill to a person before Maturity:-

Situations	Drawer's books	Drawee's books	Endorsee's book.
Drawing of a bill	B/R A/c Dr To Drawee A/c	Drawer A/c Dr. To B/R A/c	Not applicable.
Endorsement	Endorsee A/c Dr To B/R A/c	No Entry	B/R A/c Dr To Drawer A/c
Payment on due date	No Entry	B/P A/c Dr To Bank A/c / cash	Bank A/c Dr To B/R A/c.

Dishonoured on due date	Drawee A/c Dr To Endorsee A/c (Bill + Nothing changes)	B/P A/c Dr Nothing changes A/c Dr To Drawee A/c	Drawer A/c Dr To B/R A/c To Bank A/c (Nothing changes)
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Q. When the drawer sends the bill to bank for collection before maturity :-

Situations	Drawer's books	Drawee's Books
Drawing of a bill	B/R A/c Dr To Drawee A/c	Drawer A/c Dr To B/P A/c
Sending for collection	Bill for collection Dr To B/R A/c	No entry
Payment on due date	Bank A/c Dr Collection charges A/c Dr To Bill for collection	B/P A/c Dr To Bank A/c
Dishonoured on due date	Drawee A/c Dr To Bill for collection A/c To Bank A/c (Bill & nothing changes)	B/P A/c Dr Nothing changes A/c Dr To Drawer A/c

② Renewals of Bills:-

Transactions	Entries in the books of Drawer	Entries in the book of Drawee
(i) For dishonour of Bills	Usual Entry	Bills Payable A/c Dr To Drawer A/c
(ii) For interest on renewed period	Drawee A/c Dr To Interest A/c	Interest A/c Dr To Drawer A/c
(iii) If interest is paid in cash	Cash A/c Dr To Interest A/c	Interest A/c Dr To Cash A/c
(iv) For fresh Bill	Bills Receivable A/c Dr To Drawee A/c	Drawer A/c Dr To Bills Payable A/c

Practice problems:-

Example 1:- Sunil Owned Anil 8000, Anil draws a bill on Sunil for that amount for 3 Months, on 1st April 2015. Sunil accepts it and returns it to Anil. On 15 April 2015, Anil discounts it with CD Bank at a discount at 12% p.a. On the due date the Bill was dishonoured, the bank paid discount nothing charges of 100 Anil settles the Bank's claim along charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of 3000 on 1st July 2015. Before the new bill became due, Sunil retires the bills with

with the rebate of 500. Show journal entries in books of Amil.

Date	Particulars.	LF	Dr (₹)	Cr (₹)
2015				
April 1	Bills Receivable A/c Dr. To Sunil's A/c (Being Acceptance by Sunil)		80000	80000
2015				
April 15	Bank A/c Dr. Dis. A/c Dr. To Bills Receivable A/c (Being discounting of the bill @ 12% p.a. and discounting charges for 25 Months)		78000 2000	80000
2015				
June 30	Sunil's A/c Dr. To Bank A/c (Being dishonour of the bill & nothing charges paid by bank)		80100	80100
2015				
June 30	Bank a/c Dr. To Cash A/c (Being cash paid for Bank)		80100	80100
2015				
July 1	Sunil's A/c Dr. To Interest A/c (Being dishonour of the bill Interest due from Sunil)		3000	3000

2015	Bill Receivable A/c	Dr.		83100	
July 1	To Sunil's A/c				83100
	(Being new acceptance by Sunil for ₹ 80,100 & Interest ₹ 3000)				
	Bank A/c	Dr.		82600	
	Rebate A/c	Dr.		500	
	To Bills Receivable A/c				83100
	(Being the Amount received on Retirement of the bill)				

Example 2: On 1st April 2015 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 2015 Bala endorses it to Mr. Kala in full settlement of his claim of 140000 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 received accepted. A fresh Bill including interest was accepted by Lala on 1st August 2015. 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 Lala. Also shows Bills Receivables Amount and Bills payable Amount.

Ans. In the Books of Bala.

Date	Particulars	L.F.	Dr (₹)	Cr (₹)
2015				
April 1	Bills Receivable A/c Dr		120000	
	To Mr Lala's A/c			120000
	(Being acceptance by lala)			
2015			140000	
April 15	Kala's A/c Dr			20000
	To Cash A/c			120000
	To Bills Receivable A/c			
	(Being bill endorsed to kala and cash payment made to him)			

2015				
July 25	Lala A/c Dr		120000	
	To Kala's A/c			120000
	(Being cancellation of bill for renewal)			
2015				
July 25	Lala's A/c Dr		4800	
	To Interest A/c			4800
	(Being Interest due from Bala)			
2015				
July 25	Kala's A/c Dr		120000	
	To Bank A/c			120000
	(Being claim of Mr. Kala settled)			

2015	Bills Receivable A/c Dr.	124800	
Aug 1	To Lala's A/c		
	(Being acceptance by Lala with interest) of ₹ 3000		124800
2015	Bank A/c Dr.	124800	
Nov. 30	To Bills Receivables A/c		124800
	(Being payment received on due date)		

Dr. Bills Receivable Account Cr.					
Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
1-Apr-15	To Lala A/c	120000	5-Apr-15	By Lala A/c	120000
1-Aug-15	To Lala A/c	124800	30-Nov-15	By Bank A/c	124800
		244800			244800

In the Books of Lala.

Dr. Bills Payable Account Cr.					
Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2015 July 25	To Balon A/c	120000	2015 April 1	By Bala A/c	120000
2015 July			" Aug. 1	By Bala A/c	124800
2015 Nov 30	To Bank A/c	124800			
		244800			244800

Journal Entries in the Book of Lala.

Date	Particulars	IF	Dr (₹)	Cr (₹)
2015	Bank's A/c Dr.		120000	
April	To Bills payable A/c (Being Acceptance of Bala's Bill)			120000
2015	Bills Payable A/c Dr.		120000	
July 25	To Bala's A/c (Being Cancellation of the bill for renewal)			120000
2015	Interest A/c Dr.		4800	
August 1	To Bala's A/c (Being Interest due to Bala)			4800
2015	Bala's A/c Dr.		124800	
Aug. 1	To Bills payable A/c (Being Bala's bill accepted with Interest)			124800
2015	Bills payable A/c Dr.		124800	
Nov 30	To Bank A/c (Being settlement of the bill due)			124800

Example 3: → On 1st January 2015, P draws three months bill of exchange for 30000 on his debtor, Q who accepts it on the same date. P discounts the bill

On 4th January 2015 with his bankers, the discount rate being 6% p.a. on the due date, the bill is dishonoured, the noting charges being 200. Q immediately makes an offer to P to pay him 10000 cash on account and to settle the balance by agreeing to accept one bill of Exchange for 12,000 at one month and the other for the balance at three months, the latter including at 12% p.a. for both the bills. P accepts the arrangement. The bill for 12000 is met on the due date, but the other bill is dishonoured. Show Q's Account and Bills Receivable Account in the books of P.

Solution:-

In the books of P

Dr.			Cr.		
Q's Account					
Date	Particulars	Amount	Date	Particulars	Amount
2015			2015		
Jan 1	To Balance b/d	30000	Jan 1	By Bills Receivable	30000
Apr 4	To Bank A/c (dishonoured + noting charge)	30200	April 4	By Bank A/c	10000
Apr 4	To Interest A/c	366	April 4	By Bills Receivable	12000
July 7	To Bills Receivable A/c	8566		By Bills Receivable	
				(8200 + 366)	8566
		69132			69132
July 8	To Balance b/d	8566			

Bills Receivable Account

Cr.

Dr.