Bills of exchange

**What is Bills of Exchange:**

1. Suppose, Aayush sells goods worth 10,000 on credit to Aayushi, to be paid by Aayushi after 3 months.
2. Aayush Draws a bill of exchange for 10,000 to be payable after 6 months.
3. Aayushi accepts the Bill of Exchange.
4. So, Bill of exchange is an unconditional order by the maker to the acceptor to pay certain sum of money to the maker after certain time.
5. Aayush is Maker/Drawer/Holder or (Seller/Creditor)
6. Aayushi is Drawee or (purchaser/Debtor)

**Endorsement of Bill of Exchange:**

1. Aayush Owes 10,000 to Lavi. So, the bill transferred to Lavi. So, Aayush is the Endorser.
2. Aayush may transfer the bill to Lavi. This process is called Endorsement and person endorsing another party is called endorser.

**Discounting of Bills of Exchange:**

1. Suppose Aayush needs money now

2. He might get it encashed from the bank earlier than 3 months

3. Bank will charge some interest/Profit, so bank will give it less than 10,000

4. Suppose Bank Given 9,000 and later after 3 months bank will get 10,000 from Aayushi. Here 1000 will be the Interest/Profit of the bank.

This process is called Discounting of Bill.

**Who is Payee:**

Condition to being a payee-

1. Payee is same as Drawer.
2. Payee is the one who has discounted the bill.
3. Payee is the one in whose name bill has been endorsed.

**Features of Bills of Exchange:**

1. Acceptance by other person is must, otherwise it would not be a valid bill of Exchange

2. A bill of exchange must be in writing.

3. The order to make payment is unconditional

4. The bill of exchange must be signed by the person who created it.

5. The amount of money to be paid must be certain.

6. The date on which payment is made must be precise as well.

7. The bill of exchange must be made out to a specific individual.

8. It must be stamped in accordance with legal requirements.

**Maturity of the Bill of Exchange:**

A bill of exchange that is receivable on demand, upon sight, or on presentment is due to mature three days after the date of payment. Three days of grace are permitted (Section. 22).

Let us understand it with some example:

1. Bill drawn on 5th March—payable after 30 days—maturity date is 4th April—grace period by default=3 days—final date of maturity is 7th April.
2. Bill drawn on 5th March—payable after 1 month—maturity date is 5th April—grace period by default=3 days—final date of maturity is 8th April.
3. Bill drawn on 1st April—payable after 30 days—final date of maturity is 4th May.
4. Bill drawn on 1st April—payable after 60 days—final date of maturity is 3rd June.

**Accounting Treatment of Bills of Exchange:**

Bill of Exchange

**Aayush Aayushi**

Drawer Drawee

Creditor Debtor

Bills Receivable Bills Payable

There are two books in Bills of Exchange-

1. Books of Creditor
2. Books of Debtor

**Accounting treatment of bills of Exchange in the books of Creditor- 3 scenarios are there:**

1. Creditor Retains the bill till maturity- There are 2 scenarios to collect it.
2. **Collects on the date of maturity directly. For example-**

**On receiving the bill**

Bills receivable A/c Dr.

To Debtor A/c

**On maturity of the bill**

Cash/Bank A/c Dr.

To bills receivable A/c

1. **Collects through Bank**

**On receiving the bill**

Bills receivable A/c Dr.

To Debtor A/c

(Few days before maturity, bill is sent for collection to bank)

**On sending the bills for collection**

Bills sent for collection A/c Dr.

To Bills receivable A/c

**On receiving the advice from the bank that the bill has been collected**

Bank A/c Dr.

To bills sent for collection

1. Creditor can get the bill discounted from the bank

For example:

**On receiving the bill**

Bills receivable A/c Dr.

To Debtors A/c

**On discounting the bill**

Bank A/c Dr.

Discount A/c Dr.

To Bills receivable A/c

**Note:** On maturity, Accounts of creditor will not be impacted as creditor has already kind of sold it to the bank.

1. Creditor can endorse the bill in favour of creditor.

For Example-

**On receiving the bill**

Bills receivable A/c Dr.

To Debtors A/c

**On endorsing the bill**

Creditor’s A/c Dr.

To Bills receivable A/c

**Note:** On maturity, Accounts of creditor will not be impacted as creditor has already transferred it to other party.

**Accounting treatment of bills of Exchange in the Books of Debtor:**

It makes no difference whether the bill is retained till maturity, discounted or endorsed.

**On accepting the bill**

Creditor’s A/c Dr.

To bills payable A/c

**On maturity of the bill**

Bills payable A/c Dr.

To Bank A/c

**Dishonor of Bill, Retirement of Bill, Renewal of Bill, Accommodation of Bill:**

Dishonor of bill means that bill which was accepted by debtor was not honored. In other words at maturity the money which debtor owed was not returned.

**Accounting Treatment for Dishonor of Bill in:**

1. Books of Creditor
2. Books of Debtor

**Accounting treatment for dishonor of bill in Books of Creditor-** there are 3 secenarios for it.

1. **Creditor retains the bill till maturity-**
2. Collects on the date of maturity directly. For example-

On receiving the bill

Bills receivable A/c Dr.

To Debtor A/c

On maturity of the bill

Cash/Bank A/c Dr.

To bills receivable A/c

Now reverse entry- when the bill was kept with her till maturity.

Debtor’s A/c Dr.

To Bill Receivable A/c

1. Collects through Bank

On receiving the bill

Bills receivable A/c Dr.

To Debtors A/c

On sending the bills for collection

Bills sent for collection A/c Dr.

To Bills receivable A/c

On receiving the advice from the bank that the bill has been collected

Bank A/c Dr.

To bills sent for collection

Reverse entry:

When the bill was sent for collection-

Debtor’s A/c Dr.

To Bill sent for collection A/c

1. **Creditor can get the bill discounted from the bank-**

For example:

On receiving the bill

Bills receivable A/c Dr.

To Debtors A/c

**On discounting the bill**

Bank A/c Dr.

Discount A/c Dr.

To Bills receivable A/c

**Reverse Entry**

Debtor A/c Dr.

To bank A/c

1. **Creditor can endorse the bill in favor of his creditor**

For Example-

**On receiving the bill**

Bills receivable A/c Dr.

To Debtors A/c

**On endorsing the bill**

Creditor’s A/c Dr.

To Bills receivable A/c

**Reverse Entry**

Debtor A/c Dr.

To Creditors A/c

**Accounting treatment for dishonor of bill in Books of Debtor:**

**On accepting the bill**

Creditor’s A/c Dr.

To bills payable A/c

**On maturity of the bill**

Bills payable A/c Dr.

To Bank A/c

**Reverse Entry**

**Bills Payable A/c Dr.**

**To Creditor’s A/c**

**Retirement of Bill:**

1. Let Aayush Sells Goods on Credit to Aayushi
2. Aayush Draws a Bill of Exchange for 10,000 to be Payable after 3 months
3. Aayushi Accepts the Bill of Exchange

* Now suppose before the completion of 3 months Aayushi (Drawee /Debtor) Offers to pay the money because he has some extra funds.
* If Aayush (Drawer) agrees then bill is said to be Retired
* Aayushi would take some rebate (discount) because he is paying the money early.

So, transaction records in the books of holder is-

On retiring the acceptance and rebate allowed

Cash A/c Dr.

Rebate on bills A/c Dr.

To bills receivable A/c

In the books of Drawee-

Bills payable A/c Dr.

Cash A/c Dr.

To rebate on Bills A/c

**Renewal of bills:**

* Suppose after 3 months Aayushi is not able to pay
* Instead of dishonoring the bill Aayushi requests Aayush to Renew the Bill
* Renewing means to create a new bill and Cancel the old bill
* Since Aayush will get his money late, he asks for interest for this extra duration.
* So they will create a new bill with new date, cancel the old bill and Shall will Pay interest for this extra duration
* This whole process is called Renewal of Bill

**Accomodation of Bills:**

* Aayush has need of Money
* Aayush draws a bill upon Aayushi worth Rs. 5000 Payable after 3 months
* Aayushi Accepts the same
* Aayush then goes to Bank and gets it discounted at 12%. So Bank gives him 4850.
* Aayush uses this money.
* On Maturity Bank must take 5000 from Aayushi.
* Just before maturity Aayush gives 5000 to Aayushi.
* On the maturity date bank gets its 5000

Here, Accomodation party is Aayush and Accomodating Party is Aayushi.