

Plus One Accountancy Notes Chapter 7

Bill of Exchange

Summary:

Bill of Exchange:

A bill of exchange is an acknowledgment of debt given by one person to another, incorporating all the terms and conditions of payment.

Features and advantages of a bill:

A bill is a written unconditional order, it is signed by the creditor and accepted by the debtor, the amount of the bill is payable either on-demand or at a fixed period.

Parties to a bill of Exchange:

There are three parties, ie., drawer, drawee and payee.

Promissory Note:

A promissory note is an undertaking in writing given by the debtor to the creditor to pay the latter a certain sum of money in accordance with the conditions stated therein. There are two parties to a promissory note, the promisor and the promisee.

Maturity of Bill:

The term maturity refers to the date on which a bill or promissory note becomes due for payment. In arriving at the maturity date three days known as “days of grace” must be added to the date on which the period of credit expires instrument is payable.

Endorsement:

An endorsement is a written order on the back of the instrument by the payee or the holder for transferring his right to another person.

Accounting treatment:

A bill can be treated in the following four ways by its receiver.

1. When the drawer retains the bill with him till the date of its maturity and gets the same collected directly		
Transaction	Books of Creditor/ Drawer	Books of Debtor/ Acceptor
Sale/Purchase of goods	Debtors A/c. Dr. To Sales A/c	Purchase A/c Dr. To Creditor's A/c
Receiving/ Accepting Bills	Bills Receivable A/c Dr To Debtor's A/c.	Creditors A/c. Dr. To Bills payable A/c
Collection of the Bill	Cash/Bank A/c. Dr. To Bills Receivable	Bills Payable A/c Dr To cash/Bank A/c
2. When the bill is retained by the drawer with him and sent to bank for collection a few days before maturity		

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Transaction	Books of Creditor/ Drawer	Books of Debtor/ Acceptor
Sale/Purchase of goods	Debtors A/c. Dr. To Sales A/c	Purchase A/c Dr. To Creditor's A/c
Receiving/ Accepting the Bill	Bills Receivable A/c Dr. To Debtor's A/c.	Creditor's A/c. Dr. To Bills payable A/c
Sending the bill for Collection	Bills sent for Collection A/c. Dr. To Bills Receivable A/c	No Entry
On Receiving from the Bank advice that the bill has been collected	Bank A/c. Dr. To Bill sent for Collection A/c	Bills Payable A/c. Dr. To Bank A/c.

3. When the drawer gets the bill discounted from the bank

Transaction	Books of Creditor/ Drawer	Books of Debtor/ Acceptor
Sale/Purchase of goods	Debtor's A/c. Dr. To Sales A/c	Purchase A/c Dr. To Creditor's A/c
Receiving/ Accepting Bills	Bills Receivable A/c Dr. To Debtor's A/c.	Creditor's A/c. Dr. To Bills payable A/c
Discounting the bill	Bank A/c Dr. Discount A/c. Dr. To Bills Receivable A/c	No Entry
On Maturity of the bill	No entry	Bills Payable A/c. Dr. to Bank A/c.

4. When the bill is endorsed by the drawer in favour of his creditor

Transaction	Books of Creditor/ Drawer	Books of Debtor/ Acceptor
Sale/Purchase of goods	Debtors A/c. Dr. To Sales A/c	Purchase A/c Dr. To Creditor's A/c
Receiving/ Accepting Bills	Bills Receivable A/c To Debtor's A/c.	Creditors A/c. Dr. To Bills payable A/c
Endorsing the bill	Creditors A/c Dr. To Bills Receivable A/c	No Entry
On Maturity of the bill	No entry	Bills Payable A/c. Dr. To Bank A/c.

Dishonour of a bill:

A bill is said to have been dishonoured when the drawee fails to make the payment on the date of maturity. In this situation, liability of the acceptor is restored. Therefore, the entries made on the receipt of the bill should be reserved. The entries of dishonour of bill as follows

(i) When the bill was kept by drawer till maturity.

Drawee A/c	Dr.
To Bill Receivables A/c.	

ii) When the bill is endorsed

Drawee A/c	Dr.
To endorsee A/c	

iii) When the bill is discounted

Drawee A/c	Dr.
To Bank A/c	

iv) When the bill is sent for collection to the bank

Drawee A/c	Dr.
To Bill sent for collection A/c.	

Noting Charges:

When a bill is dishonoured due to non-payment, it is usual to get it 'noted', to establish the matter of dishonour. The noting is done by "Notary Public." Noting authenticates the fact of dishonour. For providing this service, a fees is charged by the Notary Public which is called Noting Charges. The following facts are generally noted by the Notary;

- Date, fact and reasons of dishonour;
- If the bill is not expressly dishonoured, the reasons why he treats it as dishonoured and;
- The amount of noting charges.

The entries recorded for noting charges in the drawers book are as follows:

When Drawer himself pays:

Drawee's A/c	Dr.
To Cash A/c	

Where endorsee pays:

Drawee's A/c	Dr.
To Endorsee A/c	

When the bank pays on discounted bill:

Drawee's A/c	Dr.
To Bank A/c	

Drawee's A/c
To Bank A/c

The entry recorded for noting charges in the book of drawee as follows:
For recording noting charges the drawee opens "Noting Charges Account".

Noting Charges A/c. Dr.
To Drawer's A/c.

Sometimes the acceptor of the bill foresees that it may be difficult to meet the obligation of the bill on maturity and may, therefore approach the drawer with the request for extension of time for payment.

Following journal entries are recorded in the case of renewal of the bill.

Transaction	Books of Drawer	Books of drawee
Cancellation of old Bill	Drawee's A/c. Dr. To Bill receivable A/c	Bills payable A/c Dr. To Drawer's A/c
Interest	Drawee's A/c. Dr. To Interest A/c.	Interest A/c. Dr. To Drawer's A/c
New Bill	Bill receivable A/c Dr Drawee's A/c. (Including Interest)	To Drawer's A/c Dr To Bills payable A/c (Including Interest)

Making payment of the bill of exchange before the due date is called retiring of the bill. To encourage the retirement of the bill, the holder allows some discount called “Rebate on bill” for the period between date of retirement and maturity. The rebate is calculated at a certain rate of interest.

(i) In the book of drawer:
On retiring the acceptance, rebate allowed.

Cash A/c.	Dr.
Rebate on bills A/c	Dr.
To bill receivable A/c.	

(ii) In the book of drawee:

Bills payable A/c. Dr.

To cash A/c. Dr.

To Rebate on Bills

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