

CHAPTER 6

MEANS OF PAYMENT AND PAYMENT THROUGH THE BANK

Objective

To enable the students to list and explain the major means of payment. In the process, students are expected to learn some terms such as the drawer, payee, drawee, bearer and cheques. In addition, they should also learn the conditions under which cheques are not money or legal tender.

6.1 The Means of Payment

6.1.1 Legal Tender:- This is anything (object) that the government authority of a state recognises as money. For instance all the currency notes issued by the Federal Government of Nigeria are recognized as money. Therefore legal tender is synonymous with money. Any legal tender must be acceptable as payment in all exchange transactions, (in buying and selling) in repayment of debts (between debtors and creditors) payment for service rendered (like wages and salaries and consultancy fees) within that country. That is all money denominations (₦500, ₦1 00, ₦50 down to 50 kobo) are recognised as money or legal tender. The legal tender in Nigeria is the Naira. But the national currencies of other countries are not recognized as legal tender/money in Nigeria.

For instance, Cedi (of Ghana); Leone (of Sierra Leone); dalasi (of Gambia); American Dollars and U.K Pound Sterling, etc. are not legal tender in this country (Nigeria).

6.1.2 Coins: Payment by coins is suitable in the following circumstances:

- (i) In everyday small transactions e.g. payments for bus or taxi fares, newspapers or magazines, light refreshments, etc.
- (ii) For payment to trade representatives who call in person.
- (iii) On a petty cash account basis in an organization, for running small expenses as they fall due.

The Limitations

- (i) Payment by coins is unsuitable for large purchases needing large sums of money. For instance, paying for two brand new deep freezers at about ₦60,500:00 each in coins is unreasonable.

- (ii) Large amount of coins are physical inconvenient for carriage. They are also too bulky to send by post unless changed into postal order.
- (iii) The post office authority does not accept postage of coins.
- (iv) Carrying large amount of coins for shopping purposes is not advisable as they could get lost through the carelessness of owners.
- (v) There is a limit beyond which coins cease to be legal tend. i.e it cannot be used to discharge legal obligations.

6.1.3 Banknotes: Payment with bank notes is possible in the following circumstances:-

- (i) Where payments are too large for the use of coins, but too small for the use of other means like cheques, money order, postal order etc.
- (ii) Where it is necessary to avoid the inconveniences of carrying large amounts of coins, e.g. during shopping.
- (iii) Where other means of payment e.g. cheques, postal or money orders are unacceptable. For instance, an individual buying a 504 Peugeot car from a retailer or wholesaler might be asked for raw cash, if the seller is uncertain about the reliability of other forms of payment. This step is usually taken in order not to fall a victim of cheques and bank-drafts forgers.

The Limitations

- (i) For certain large purchases from a variety of sellers, it is highly inconvenient to carry very many bank notes. For instance, a bookseller having purchases of ₦550,000:00 worth of goods to be made from more than one publisher at Ibadan, would find it highly inconvenient and unsafe to carry banks notes of such magnitude.
- (ii) Large amounts of bank notes are prone to loss through robberies, motor accidents, or through carelessness on the part of the owners.
- (iii) The post office authority requires that such bank notes should be under postage by registration using the special envelopes provided for postage of cash. Even then, there is a limit to which the authority accepts responsibility. Furthermore, experience has shown that the contents of such postages may get lost in transit, and customers often find it hard to recover such losses.

6.2 Payment Through Banks

6.2.1 The Cheque System

Payment by cheque is the most common form of payment through the banks. This is particularly so where the banking system is well developed. A cheque is a means of transferring money from an account holder's current account to the person named on the cheque. In other words it is a bill of exchange drawn upon a bank by a customer and payable on demand.

The Parties to a Cheque

- (i) ***The drawer:*** This is the person who issues the cheque for payment and whose account is debited.

- (ii) *The payee*: This is the person to whom the cheque is payable. If he receives it through the bank, his account is credited.
- (iii) *The drawee*: This is the bank, on which the cheque is drawn. The drawee pays out the money to the payee, and so is also the payer.

Types of cheques (The bearer cheque and the order cheque)

- (i) **The bearer cheque**: The bearer cheque, as its title implies, is payable to the bearer of the cheque, who could be anybody. A bearer cheque, is a personal cheque and belongs to whoever holds and presents it for payment. Most forms of salary and wage payments by means of cheques are by bearer cheques.
- (ii) **The order cheque**: An order cheque is a specific order to the bank that the person named on the cheque or his "Order" (nomine) should be paid the amount stated in the cheque. An order cheque is not loose or vague; rather it is issued to a specific person named on the cheque. Any attempt made by any other person to cash the cheque amounts to forgery or impersonation.
- (iii) **Crossed cheques**: Crossed cheques could be by (a) general crossing or (b) special crossing. To cross a cheque, two parallel lines are drawn across its face. Additional phrases might or might not be written between the two parallel lines for general crossing as shown below:

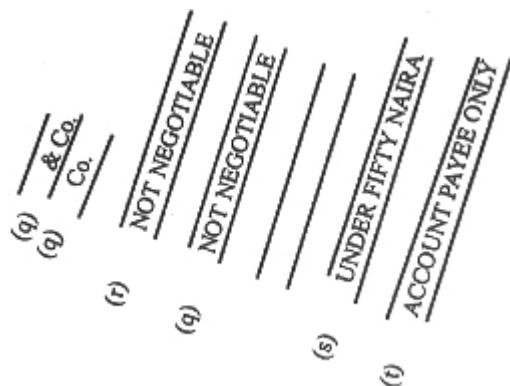


Fig. 6.1: Types of general crossing

Crossed cheques can only be paid through bank accounts. This is one of the precautions that make crossed cheques safer than open cheques, which are cashable™ across the counter.

Although a crossed cheque is safer, it can also be a problem to a person who is paid with it but has no bank account. Such a payee can cash the cheque by endorsing it to someone who has a bank account in exchange for either cash, or an open cheque for the same amount. (postal and money orders can also be crossed).

The following phrases on the face of crossed cheques along the parallel lines are parts of the security devices to make cheques safer:-

- (i) **"Not negotiable"**: It means that the original owner of the cheque is the lawful owner in case of theft or loss. Those who come by it fraudulently have no better claim

to it than the original owner. However, such cheques bearing "Not Negotiable™", can be passed on legitimately to others by mere endorsement.

- (ii) **"Under fifty naira":** This is to prevent possible fraud by adding any other figure to the amount on the cheque. For instance, if the cheque is for ₦48.00, the insertion of "under fifty Naira™" would reduce the chances of anyone adding 1 before ₦48.00, to make the figure ₦148.00.
- (iii) **Account payee only:** The drawee bank is by such an insertion, requested to credit only the payee's bank account with the proceeds of the cheque. Consequently, in the event of a query on the payment of the cheque, it will be traced to the payee's bank account only. Banks, by tradition, always, endeavour to abide by this request.

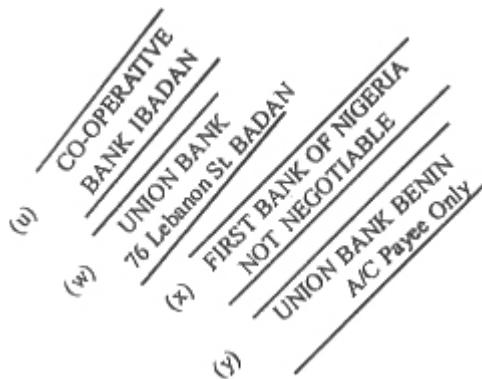


Fig. 6.2: Examples of special crossings

N.B.: u, w, x, y, represent addresses to banks to which the cheque is to be paid.

One would observe from the examples (u - y) above, that the names and addresses of the banks to which the cheques should be paid are stated on the cheque. This is why the cheques are not ordinarily crossed, but referred to as having "special"™ crossings. By stating the names of the banks to which they are to be paid, such cheques are not just paid into bank accounts, but to the named banks or bank accounts. They are, therefore, traceable to the banks in case of any query. These make cheques with crossings much safer than cheques with general crossings.

However, there are two limitations to the use of cheques with special crossings:

- (i) The payee must have a bank account, so that he does not experience the inconvenience involved in exchanging the cheque for cash.
- (ii) The name and address of the payee's bank must be known to the drawer; and this may be difficult to come by.

Terms Used in Connection with Cheques

- (i) **A Postdated cheque:** This is a cheque issued in advance of the date it is due for payment. If a payment of ₦50,000 would be due on 25th January, 2003, and a cheque dated accordingly, (that is as 25/1/03) but is issued on 1st January, 2003 or on any date before 25/1/03, it is a postdated cheque. Such postdated cheques are sometimes issued in advance of the date of payment to assure the creditor (would-be-payee) that the drawer is willing to pay the amount as, and when due. It means that, the payee

should not lodge the cheque with his bank until the due date, i.e., 25/1/03. If, however, it is lodged before the actual date on the cheque, the bank should not debit the drawer before the date inserted (the due date) on the cheque. If the payee is credited and the drawer debited before it is due, the bank can be queried by the drawer for such payment. In other words, the bank bears the amount, if paid in error, before the date indicated on the cheque.

- (ii) *An antedated cheque*: This is a cheque that bears a date earlier than that on which it is actually drawn - but the date should not be six months earlier, otherwise it becomes a stale cheque.
- (iii) *Stale Cheques*: A cheque, like a postal order, becomes stale if it is unpresented for payment within six months of the date shown on the cheque. For instance, a cheque date 2/2/03, but presented for payment on 3/8/03 i.e. one day after six months becomes stale and will be returned unpaid. It will be honoured however, everything being equal, if it were presented on either 17/8/03 or even on 2/8/03. That a cheque is returned stale, does not mean that the payee has lost his right to be paid by asking for a fresh cheque which he must represent within six months; (but in law, the drawer of a cheque remains liable on the cheque for up to six years from the time it is presented for payment, although banks usually stop payment after 6 months).
- (iv) *Marked cheques*: These are cheques on which the drawer's bankers have testified that the drawers have enough to pay for the amount stated on the cheques. For instance, if a drawer has ₦100,000 in his bank account and issued a cheque to the payee for ₦90,000, but the payee is in doubt if the drawer has as much in his bank account, the drawers' bank could be asked to mark the cheque i.e. to ascertain that the drawer has as much as ₦90,000 in his bank account. Once the bank marks the cheque, and until the marked cheque is cleared or paid off, the banker will not allow the drawer to withdraw from his bank account such amount that would reduce the drawer's account to below ₦90,000. This is because the banker has guaranteed that the cheque will be honoured.
- (v) *Certified cheques*: This is another device for injecting confidence into the payment by cheque system. Certified cheques are the banker's own cheques drawn on behalf of their customers to creditor for paying the amount so stated on the cheques to the payees. The customers would have paid an equivalent amount to the bankers, either by cash or by issuing personal cheques if they have up to that amount in their accounts. In exchange for such payments, the bankers would issue out their own cheques. Certified cheques are always almost as good as money, since the bankers are very unlikely to dishonour their own certified cheques. This is the form in which the West African Examinations Council has sometime been demanding payments for examination entries from their candidate (instead of payment by means of postal orders). While it is relatively easy for bank account holders, it could be difficult and expensive for persons with no account.
- (vi) *Dishonoured cheques or returned cheques*: Dishonoured and returned are used interchangeably in describing cheques which bankers refuse to pay for one reason or the other. In effect, they are dishonoured and marked R/D, that is, Returned to Drawer. Sometimes, if the amount by which an account holder overdraws his account is not much, the banker might honour the cheque; but this is a facility which must not be used so often or abused.

Here are some of the conditions or circumstances under which cheques are sometimes dishonoured (or returned unpaid to the drawers by their bankers - the drawees):

- (i) When the signature is irregular - i.e. not identical to the usual signature.
- (ii) When there is an unsigned alteration on the cheque.
- (iii) When the amount written in words is different from that written in figures, for instance, if ₦35.00 is written as forty-naira only.
- (iv) If there is a court notice to the effect that the drawer is bankrupt (declared by the court as being unable to pay his debts).
- (v) If the balance in the drawer's bank account falls short of the amount stated on the cheque. For instance, if the balance on the account is only ₦1 00,000 as against a cheque issued for ₦180,000 in the absence of previously arranged overdraft facilities.
- (vi) If there is a notice of the drawer's death.
- (vii) If the drawer had closed his account with the bank.
- (viii) If the drawer stopped the payment on time.

Terms Used for Dishonouring Cheques:

- (i) No sufficient funds (N/S), or insufficient funds (I/F).
- (ii) Account closed.
- (iii) Payment stopped. Payment could be stopped if the owner of the cheque feels he has been defrauded or if he has changed his mind about certain purchases for which he has made payment with the cheque. This must be in good faith and not with an intent to defraud the payee. Payment can also be stopped if the cheque owner has lost his cheque book.
- (iv) Signature or endorsement being irregular.
- (v) Not in order.

Travellers' Cheques

Traveller's cheques are cheques issued by banks to their customers who are travelling abroad and who would like to make payment in the course of their overseas journeys; since personal domestic bank cheques are unacceptable overseas. The customers pay a small commission for the issue of such cheques. Travellers' cheques become handy when (and it is common) there is restriction on the export of domestic currencies. Travellers' cheques could be cashed at any bank at home or abroad, and are acceptable as a means of payment in most hotels and shopping centres. They save travellers the burden of carrying large sums of the acceptable foreign currency on their overseas journeys.

In Nigeria, since the Obasanjo regime, of late 70's, travellers' cheques are obtainable only on presentation of a tax clearance certificate for three consecutive years (showing statement of paid income tax over the last three years). The amount obtainable is declared in the government financial statement (budget) every year, and this has much to do with the balance of payment position of the nation. As at 1981 in Nigeria, the maximum amount in foreign exchange and therefore, in travellers' cheque, is one thousand naira per person (₦1,000.00) and this is known as Basic Travel Allowance (BTA). It must be remarked,

however, that because of widespread forgery of travellers' cheques in the last few years, its conventional international acceptability as a means of exchange has been seriously shaken.

Cheque cards

These are not yet very popular in Nigeria, but they are common means of payment by cheques in Great Britain and the United States of America. Some customers, depending on their credit worthiness, are issued cards referred to as *bankers' cards or cheque cards*. With such cards, the holder could effect payment for purchases up to a stated amount, with the cards, one could also obtain cash, up to a given amount in any branch of any of the banks (not necessarily the holder's bank only) participating in the cheque card system. The card is presented by the holder when issuing a cheque for payment in respect of any purchases made. The specimen signature on the card must agree with the customer's signature on the issued cheque, signed in the presence of the payee. It is usual to copy the card's number onto the back of the issued cheque. This is similar to the credit cards mentioned in Chapter 3. In Nigeria, Union Bank of Nigeria Pic and the United Bank for Africa Pic provide cheque cards for their customers.

Cheques with receipts: By law and practice in banking, the payment of any amount in cheque constitutes a legitimate receipt on its own, whether the cheque is endorsed or not by the payee. However, there are some bank customers who continue to incorporate a form of receipts with their cheques, either on the form or on the back of the cheque. For the banks to recognize such cheques, however, the letter 'R' must be boldly printed on the cheque which the payee would then sign. However, other customers who pay by cheques could still ask their creditors for separate receipts of such payments.

The advantages of payment by cheques

- (i) *Safety:* Cheques are a very safe means of payment. The risk of loss through theft is minimized. Cheques can be posted unnoticed in letters. Crossed cheques provide the greatest insurance against fraud.
- (ii) *Convenience:* Payment by cheque is convenient in the following ways:
 - (a) Cheques can be used for payment without making visits to the banks or post offices; and without handling cash. Since cheque books are kept with the owners (the bank accounts holders), cheques are issued at will and at the convenience of the owner (the drawer).
 - (b) Similarly, cheques received are easily paid to the payee account for bank clearance.
 - (c) In most advanced countries, many traders would accept payment by cheques, especially if backed by cheque cards. Consequently, buyers can make as many purchases as they can afford, both planned or unplanned and make payment by cheques. This is more convenient than carrying a lot of cash.
 - (d) Since a cheque is a negotiable instrument, it could be passed to another person in settlement of debts by mere endorsement.

- (iii) *Legal receipts*: Payment by cheques constitutes a legal receipt, although drawers can still insist on separate receipts.
- (iv) *Record or statement of payment*: The sequence by which cheques undergo clearing processes forms a record or a statement of payments and receipts per account holder. Such statements assist payees and drawers to check on the position of their bank accounts.
- (v) *Economic use of bank deposits*: All payments into and out of a bank account pass through the coffers of the banking system. This enables the banks to make the most economic use of all their deposits.
- (vi) *Provision of reference*: Using a cheque presupposes that one has a bank account; and having a bank account gives a businessman a source of reference on his financial integrity and standing to those with whom he wishes to open new business ventures.

6.3 Other Means of Payment Through The Banks

We shall now discuss other means of payment through the banks besides cheques.

- (i) *Bankerâ€™s drafts*: These are orders by the issuing banks to their agents, representatives or their branches, to pay a stated amount to a creditor at a particular place. The bankâ€™s customer buys the order in form of a draft which he sends to a creditor in settlement of his indebtedness.
The draft is as sound and reliable as a bank certified cheque. Since the customer has made payment to his bank, the issuing bank now has to pay the creditors. Consequent upon the high reputation of banks for reliability, there is confidence in this form of payment.
- (ii) *Credit transfers*: These are means of transferring money from a debtor to a creditor in settlement of the formerâ€™s indebtedness to the latter. By a credit transfer, an account holder can also transfer money from his account, say at Enugu, to his bank account in Lagos.

The debtor would approach his bank and fill in a credit transfer form, pay in the correct amount plus a commission either by cash, or by issuing a cheque if he keeps a bank account. The bank would transfer the amount to the credit of the creditors, or transfer the amount to another named bank account number at another place. These services are now made available to even those who are holders of a bank account.

The same system could be used to pay wages and salaries to employees of a company. If a good number of the employeesâ€™ salaries are paid into their bank account, a list of the employeesâ€™, their banks, and the amount of individual net earnings are furnished to the bank in which the company keeps an account. The bank, consequently, would credit the individual accounts of the employees and debit the companyâ€™s account. In this way, the problem and inconveniences of carrying cash from the bank to the company premises to pay employees are reduced. It also saves time that would have been used to write out individual cheques for all the employees or customers.

- (iii) *Standing or bankerâ€™s order:* This is a form of standing instruction, for a specific period of time, from a customer to a bank that the latter should make some regular payments on behalf of the customer to a creditor or creditors. This is useful in payments of electricity, water and telephone bills, club subscriptions and insurance premiums. The bank makes such regular payments on behalf of the customer religiously, and debits the customerâ€™s account accordingly. The payments may be due at the end of a period, e.g. a month, and may be for a longer period, such as for 25 years or a life endowment premium. Payments by standing orders save the customer the trouble of writing different cheques for different accounts and also remove the likelihood of forgetting to pay certain bills.
 - (iv) *Debit transfer:* This is another form of standing or bankerâ€™s order, in the sense that, the bank customer has left a standing instruction that certain periodical payments should be made to the named creditor for a time to come. The customerâ€™s account is debited accordingly once the payment is effected. However, it is unlike the standing or bankerâ€™s order and the credit transfer because, the creditor has to ask for payment before he is paid. The bank in turn pays for the specific period once the creditorâ€™s request conforms to the customerâ€™s directive or instruction to the bank. It is used by most insurance companies in Nigeria for collecting customersâ€™ premiums. It is equally ideal for a situation, where payments might vary slightly in amount from time to time e.g. hire purchase, and instalmental payments that are worked on reducing balances of the debts.
 - (v) *Tradersâ€™ payment:* Tradersâ€™ payment facilities are similar to the credit transfer system. When different payments are to be made, one single cheque is drawn for the total of the payments and given to the bank credited to each.
- A credit slip is filled for each creditor, sent to his bankâ€™s head office, from where it is rerouted to the branch where he holds his account which is credited accordingly. The customerâ€™s (the drawerâ€™s) account is debited accordingly. Consequently, the cost of issuing so many cheques for payment of a number of creditors is reduced drastically.
- (vi) *Credit cards:* We can refer here to what we said earlier in this chapter on credit systems.

Summary

There are specific parties to a cheque as a means of payment: i.e. drawer, payee and drawee. There are also types of cheques with varying degree of safety respectively i.e. bearer, order, open, crossed and specially crossed cheques. By endorsement, cheques could be passed from one person to the other in settlement of accounts. There are also circumstances whereby cheques are not honoured by banks - unsigned alteration, irregular signatures, post and antedated cheques. In addition, there are advantages as well as disadvantages of payments by cheques. Other means of payment through he banks are by bankerâ€™s drafts, credit transfers, debit transfers, standing or bankersâ€™ orders, etc.

Revision Questions

A. Essay Questions

1. Explain these terms:
 - (a) General endorsement and restrictive endorsement.
 - (b) Bearer cheque and order cheque
 - (c) General crossing and special crossing
 - (d) "Negotiable" and "Not Negotiable"
2. Explain the following means of payment and give examples or situations where each is suitable?
 - (a) Bankers' draft
 - (b) Debit transfer
 - (c) Credit transfer
 - (d) Bankers' order
 - (e) Traders' payment
3. Under what circumstances would a banker refuse to honour a cheque?
4. Explain six advantages and two disadvantages of cheque as a means of payment.

B. Objective Questions

1. Any form of money which by law must be accepted when offered in payment is
 - A. Money Order
 - B. Bank Draft
 - C. Legal Tender
 - D. Promissory Note

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2. Which of the following, if used in payment, discharges the debtor of indebtedness or obligation?
 - A. Cheque
 - B. Bank Draft
 - C. Bank Note
 - D. Money Order
 - E. All of the above
3. Promissory notes, bank drafts and cheques are classified as
 - A. Bank deposits
 - B. Legal tender
 - C. Documents of title
 - D. Credit instruments
4. One of these is not a means of payment through the banks.

- A. Banker's draft
 - B. Credit transfers
 - C. Standing order
 - D. Travellers' cheque
5. As a means of payment, one of these normally constitutes a legal receipt, although drawers can still insist on separate receipt.
- A. Cheque
 - B. Credit transfer
 - C. Standing order
 - D. Travellers' cheque
6. One of these may not necessarily lead to a cheque being dishonoured.
- A. Drawer stops the cheque
 - B. Drawer's stop the cheque
 - C. Insufficient funds
 - D. Signature in order
7. Cheque is cleared when it is
- A. Honoured
 - B. Dishonoured
 - C. Stale
 - D. Post-dated
8. Certified cheques as a means of payment
- A. instil confidence
 - B. reinforce doubt
 - C. diminish confidence
 - D. are of no effect
9. Antedated cheque bears a date
- A. in advance of issue
 - B. earlier date of less than six month
 - C. of a year ago
 - D. of 12 months to come
10. One of these will not show on the cheque tab:
- A. payee's name
 - B. date of issue
 - C. bank charges
 - D. bank balance

Project

Try to collect as many of the following as possible and bring them to the class for discussion:

- (i) One naira coin.
- (ii) Cheque tubs (used by either mum or dad).
- (iii) Specimen copies of:
 - (a) bankersâ€™ draft
 - (b) credit transfer
 - (c) bankers order.