

Accounting For Bills of Exchange

Meaning: According to the Negotiable Instruments Act 1881, a bill of exchange is defined as 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, or to the order of a certain person or to the bearer of the instrument. The following features of a bill of exchange emerge out of this definition.

- A bill of exchange must be in writing.
- It is an order to make payment.
- The order to make payment is unconditional.
- The maker of the bill of exchange must sign it.
- The payment to be made must be certain.
- The date on which payment is made must also be certain.
- The bill of exchange must be payable to a certain person.
- The amount mentioned in the bill of exchange is payable either on demand or on the expiry of a fixed period of time.
- It must be stamped as per the requirement of law.

Parties to a Bill of Exchange

There are three parties to a bill of exchange:

- (1) **Drawer** is the maker of the bill of exchange. A seller/creditor who is entitled to receive money from the debtor can draw a bill of exchange upon the buyer/debtor. The drawer after writing the bill of exchange has to sign it as maker of the bill of exchange.
- (2) **Drawee** is the person upon whom the bill of exchange is drawn. Drawee is the purchaser or debtor of the goods upon whom the bill of exchange is drawn.
- (3) **Payee** is the person to whom the payment is to be made. The drawer of the bill himself will be the payee if he keeps the bill with him till the date of its payment. The payee may change in the following situations:
 - (a) In case the drawer has got the bill discounted, the person who has discounted the bill will become the payee;
 - (b) In case the bill is endorsed in favour of a creditor of the drawer, the creditor will become the payee.

Promissory Note: According to the Negotiable Instruments Act 1881, a promissory note is defined as an instrument in writing (not being a bank note or a currency note), containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument. Therefore, a promissory note cannot be made payable to the bearer. This definition suggests that when a person gives a promise in writing to pay a certain sum of money unconditionally to a certain person or according to his order the document is called is a promissory note.

Following features of a promissory note emerge out of the above definition:

- It must be in writing
- It must contain an unconditional promise to pay.
- The sum payable must be certain.
- It must be signed by the maker.
- The maker must sign it.
- It must be payable to a certain person.
- It should be properly stamped.

Parties to a Promissory Note

There are two parties to a promissory note.

- **Maker or Drawer** is the person who makes or draws the promissory note to pay a certain amount as specified in the promissory note. He is also called the promisor.
- **Drawee or Payee** is the person in whose favour the promissory note is drawn. He is called the promisee.

Entries in the Books of Drawer and Drawee in different situations:

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	Debtor's A/c Dr To Sales A/c	Purchases 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
Collection of the bill	Cash/Bank A/c Dr To Bills Receivable A/c	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.

Transaction	Books of Creditor/Drawer	Books of Debtor/Acceptor
Sale/Purchase of goods	Debtor's A/c Dr To Sales A/c	Purchases 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 Bill Receivable A/c	<i>No entry</i>
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	Purchases 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
Discounting the bill	Bank A/c Dr Discount A/c Dr To Bills Receivable A/c	<i>No entry</i>
On maturity of the bill	<i>No entry</i>	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	Debtor's A/c Dr To Sales A/c	Purchases 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
Endorsing the bill	Creditor's A/c Dr To Bills Receivable A/c	<i>No entry</i>
On maturity of the bill	<i>No entry</i>	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 reversed.

Transaction	Books of Creditor/Drawer	Books of Debtor/Acceptor
When the bill was kept by the drawer till maturity	Debtor's A/c Dr To Bills Receivable A/c	Bills Payable A/c Dr To Creditor's A/c
When the bill was sent to bank for collection	Debtor's A/c Dr To Bill Sent for Collection A/c	Bills Payable A/c Dr To Creditor's A/c
When the bill was discounted with bank	Debtor's A/c Dr To Bank A/c	Bills Payable A/c Dr To Creditor's A/c
When the bill was endorsed	Debtor's A/c Dr To Creditor's A/c	Bills Payable A/c Dr To Creditor's A/c

Noting Charges: To establish beyond doubt that the bill was dishonoured, despite its due presentation, it may preferably to be *got noted* by Notary Public. Noting authenticates the fact of dishonour. For providing this service, a fee is charged by the Notary Public which is called *Noting Charges*.

The entries recorded for noting charges in the drawer's 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
When the bank pays in the event of sending the bill for collection to the bank	Drawee's A/c Dr To Bank A/c

The entry recorded for noting charges in the drawer's book is as follows:

Bills Payable A/c	Dr
Noting Charges A/c	Dr
To Creditor's A/c	