Bills of Exchange

CBSE · Class 11 · Accountancy — exam notes

A bill of exchange is a written, signed order by which a seller (drawer) directs a buyer (drawee) to pay a fixed sum on a definite future date to a named payee. This chapter covers how such bills and promissory notes are drawn, accepted, discounted, endorsed, renewed, retired, and dishonoured, and how each event is journalised in the books of both the drawer and the drawee. Syllabus note: 'Accounting for Bills of Exchange' was withdrawn from the CBSE Class 11 Accountancy syllabus for 2025-26 under the 30% reduction, so it is not examinable in the current CBSE annual exam. It remains a core foundational topic that is still prescribed by several State boards and earlier CBSE years, is assumed knowledge in professional courses (CA/CMA Foundation), and is studied here for concept mastery.

Key terms & definitions

Bill of Exchange
A written instrument containing an unconditional order, signed by the maker, directing a certain person to pay a fixed sum of money only to, or to the order of, a specified person or to the bearer.

Drawer
The person who writes and signs the bill — usually the seller or creditor who is entitled to receive the money. The drawer treats the accepted bill as Bills Receivable.

Drawee
The person on whom the bill is drawn and who is ordered to pay — usually the buyer or debtor. After signing the bill (acceptance) the drawee becomes the acceptor and treats it as Bills Payable.

Payee
The person to whom the bill amount is to be paid. The payee may be the drawer himself or any third party to whom the drawer transfers the bill.

Acceptance
The drawee's signed assent to the order in the bill, normally by writing 'Accepted' across the face and signing it. Only after acceptance does the bill become legally enforceable against the drawee.

Promissory Note
A written, signed instrument containing an unconditional promise by the maker (debtor) to pay a fixed sum to, or to the order of, a specified person. It has only two parties — maker and payee — and needs no acceptance.

Days of Grace
Three extra days added by custom and law to the nominal payment period of a time bill before it legally falls due.

Due Date (Date of Maturity)
The date on which a bill becomes legally payable — the nominal expiry date plus three days of grace. If that date is a public holiday, the bill matures on the preceding business day; if it is an emergency/sudden holiday, it matures on the next business day.

Discounting of a Bill
Encashing a bill with a bank before maturity. The bank pays the holder the bill value less interest for the unexpired period (the discount) and itself collects the full amount from the acceptor on the due date.

Endorsement
Transfer of a bill to another person by the holder signing on its back. The endorser passes on the right to receive payment but retains a contingent liability if the bill is later dishonoured.

Dishonour of a Bill
Failure of the acceptor to pay the bill on its due date. The bill loses its status as Bills Receivable/Bills Payable and the original debtor-creditor relationship is restored.

Noting Charges
The fee paid to a Notary Public for officially recording (noting) the fact of dishonour. The charge is ultimately borne by the party responsible for the dishonour — i.e. the drawee/acceptor.

Renewal of a Bill

Cancellation of an existing bill before maturity and replacement with a fresh bill for a later date, usually for the original amount plus interest charged for the extended period.

Retirement of a Bill

Payment of a bill by the acceptor before its due date. In return the holder usually allows a rebate (interest for the unexpired time) as a reward for early payment.

Accommodation Bill

A bill drawn and accepted without any underlying sale of goods, purely to raise funds. The proceeds are shared by the parties, and the acceptor remains liable to an outside holder even though no real trade took place.

Meaning, Features and Need for a Bill of Exchange

- A bill of exchange is a credit instrument that converts an open trade debt into a formal, dated, legally enforceable claim.
- Essential features: it must be in writing, contain an unconditional order (not a request) to pay, be signed by the drawer, specify a certain sum of money, name or make ascertainable the drawee and payee, be properly stamped, and be payable on demand or on a fixed/determinable future date.
- The order must be unconditional — making payment depend on an event destroys its character as a bill.
- It is governed by the Negotiable Instruments Act, 1881, which makes it freely transferable, gives a transferee who takes it in good faith and for value (a holder in due course) a clean title, and fixes the liabilities of the parties.
- Need/advantages: it provides documentary evidence of debt, fixes a definite date of payment, allows the seller to raise immediate cash by discounting, can be used to settle the holder's own debts by endorsement, and gives legal recourse on dishonour.

Parties to a Bill of Exchange

- Drawer — writes, signs and issues the bill; normally the creditor/seller. The drawer is the original payee unless the bill is payable to a third party.
- Drawee — the person directed to pay; normally the debtor/buyer. On accepting the bill the drawee is called the acceptor.
- Payee — the person entitled to receive payment. The payee may be the drawer, the endorsee, or any third party named in the bill.
- Other persons who may appear later: the endorser (a holder who transfers the bill), the endorsee (the person to whom it is transferred), and the holder (any person legally entitled to the bill and its proceeds).

Bill of Exchange vs Promissory Note

- Number of parties: a bill has three parties (drawer, drawee, payee); a promissory note has two (maker, payee).
- Nature of instrument: a bill is an order to pay; a promissory note is a promise to pay.
- Who prepares it: a bill is drawn by the creditor (seller); a promissory note is made by the debtor (buyer).
- Acceptance: a bill payable after a period needs the drawee's acceptance to be binding; a promissory note needs no acceptance because the maker himself promises to pay.
- Liability: in a bill the drawer's liability is secondary (it arises if the acceptor defaults); in a promissory note the maker's liability is primary and absolute.
- Both instruments are negotiable, must be in writing, be properly stamped, and state a certain sum payable on demand or after a fixed period.

Bill of Exchange vs Cheque

- A cheque is a special kind of bill of exchange that is always drawn on a banker.
- A cheque is always payable on demand; an ordinary bill may be payable on demand or after a fixed period.
- A cheque requires no acceptance (the bank's holding of the customer's balance serves the purpose); a time bill must be accepted by the drawee.
- A cheque does not need stamping and no days of grace are allowed on it; a time bill is stamped and enjoys three days of grace.
- A cheque may be crossed to restrict how it is collected; crossing does not apply to ordinary bills.

Important Terms — Tenure, Days of Grace and Due Date

- Bill at sight / on demand: payable as soon as it is presented; no days of grace are allowed on such bills.
- Bill after date: tenure counted from the date the bill is drawn.
- Bill after sight: tenure counted from the date the bill is accepted.
- Three days of grace are added to time bills to arrive at the legal due date.
- Calculating the due date in months: add the stated number of months to the date of drawing/accepting, then add three days of grace. The period ends on the corresponding date of the relevant month; if that month is shorter, the last day of that month is taken before adding grace.
- Calculating the due date in days: count the exact number of days (excluding the date of transaction) and then add three days of grace.
- Holiday rule: if the due date is a known public holiday (e.g. a declared festival), the bill matures on the immediately preceding business day; if it is an emergency/unexpected holiday, it matures on the next business day.

Accounting Treatment — Honour of a Retained Bill

- When the bill is drawn and accepted, the drawer converts the debtor into Bills Receivable and the drawee converts the creditor into Bills Payable.
- If the holder simply keeps the bill till maturity and the acceptor pays, the drawer receives cash/bank and cancels Bills Receivable, while the drawee pays cash/bank and cancels Bills Payable.
- No profit or loss arises on a simple honour — only the form of the asset/liability changes (debtor to bill, then bill to cash).
- Entries are dated on the date of acceptance and again on the date of maturity (after the days of grace).

Discounting of a Bill

- Discounting means selling the bill to a bank before maturity to obtain immediate funds.
- The bank deducts discount = Bill amount × Rate × Unexpired period; the holder receives the net proceeds.
- In the drawer's books, Bank is debited with the net amount, Discount on Bills (an expense in the Profit & Loss A/c) is debited with the discount, and Bills Receivable is credited with the full face value.
- The drawee passes no entry on discounting — to the acceptor it makes no difference who finally collects the money; the liability on the due date is unchanged.
- On the due date, if the acceptor pays the bank, the drawer passes no further entry because the bill has already left his books.
- Time for the discount is computed on the unexpired period only — from the date of discounting to the due date (including days of grace).

Endorsement of a Bill

- Endorsement is the transfer of a bill by the holder, by signing on its back, usually to settle his own debt to a creditor.
- In the endorser's (drawer's) books, the creditor (endorsee) is debited and Bills Receivable is credited with the face value.
- In the endorsee's books, Bills Receivable is debited and the endorser's account is credited.
- The drawee passes no entry on endorsement; his liability remains unchanged.
- An endorser carries a contingent liability: if the bill is dishonoured at maturity, the endorsee can recover from the endorser, who may in turn proceed against earlier parties.

Bill Sent for Collection

- Instead of discounting, the holder may hand the bill to his bank merely for safe-keeping and collection on the due date.
- When sent, the holder debits 'Bills Sent for Collection A/c' and credits Bills Receivable (the asset simply changes location, not ownership).
- When the bank collects on maturity, the holder debits Bank and credits Bills Sent for Collection.
- No discount arises because the bill is not encashed early; the bank may charge a small collection fee, debited as bank charges.

Dishonour of a Bill

- Dishonour occurs when the acceptor fails to pay on the due date; the bill ceases to be Bills Receivable/Bills Payable and the original debt revives.
- Case 1 — bill retained by drawer: drawer debits the drawee (with face value, plus noting charges if any) and credits Bills Receivable; if noting charges were paid, credit Cash/Bank for them.
- Case 2 — bill discounted with bank: on dishonour the bank returns the bill, so the drawer debits the drawee (face value + noting charges) and credits Bank with the total it recovers; Bills Receivable is not credited because it had already been removed on discounting.
- Case 3 — bill endorsed: the endorsee (now the holder) returns the dishonoured bill; the drawer debits the drawee (face value + noting charges) and credits the endorsee with the total it must repay him.
- Case 4 — bill sent for collection: the drawer debits the drawee (face value + noting charges) and credits Bills Sent for Collection (and Bank for the noting charges paid by the bank).
- In every case the drawee/acceptor debits Bills Payable (face value) and debits Noting Charges, crediting the drawer/holder with the total — restoring the drawee's liability to the creditor.
- Noting charges are an expense for the drawee, who is responsible for the dishonour; they are recovered by whoever paid them.

Noting and Protesting

- On dishonour the holder may have the fact formally recorded by a Notary Public — this is called noting; for larger or foreign bills a formal protest may be drawn up.
- Noting establishes legally admissible evidence that the bill was duly presented and dishonoured.
- The fee charged by the notary is the noting charges; it is first paid by the holder but is ultimately recovered from the party at fault (the drawee/acceptor).
- Noting is optional for inland bills but valuable as proof in any later legal action against the parties.

Renewal of a Bill

- Renewal happens when the acceptor cannot pay on time and both parties agree to cancel the old bill and draw a fresh one for a later date.
- Step 1 — cancel the old bill: the drawer debits the drawee and credits Bills Receivable; the drawee debits Bills Payable and credits the drawer (reversing the original acceptance).
- Step 2 — record interest for the extended period: the drawer debits the drawee and credits Interest Received (Income); the drawee debits Interest (Expense) and credits the drawer. Interest may be paid in cash or added to the new bill.
- Step 3 — draw the new bill: the drawer debits Bills Receivable and credits the drawee for the new amount (old balance plus any interest carried forward); the drawee debits the drawer and credits Bills Payable.
- If part payment is made at renewal, cash/bank is recorded for that part and only the balance (plus interest) is carried into the new bill.

Retirement of a Bill

- Retirement means the acceptor pays the bill before its due date.
- As a reward for early payment the holder allows a rebate (also called discount/interest), calculated for the unexpired period.
- In the drawer's books: debit Cash/Bank with the amount actually received and debit Rebate Allowed (an expense) with the rebate, crediting Bills Receivable with the full face value.
- In the drawee's books: debit Bills Payable with the face value, crediting Cash/Bank with the amount paid and crediting Rebate Received (an income) with the rebate.
- Rebate is the mirror image of discount — an expense to the holder who gives it and an income to the acceptor who enjoys it.

Accommodation Bills

- An accommodation bill is drawn and accepted without any genuine sale, purely as a device to raise short-term finance.
- The accommodated party usually discounts the bill, and the proceeds (and the discount cost) are shared in the agreed ratio.
- On maturity the party who used the funds must remit the amount to the acceptor so that the acceptor can meet the bill.
- Risk: a holder in due course who took the bill in good faith can compel the acceptor to pay even though no goods were sold; if the drawer fails to provide funds, the acceptor bears the loss and must recover separately from the drawer.
- Trade bills (backed by a real sale) differ from accommodation bills (no underlying trade) in purpose, though their journal entries follow the same mechanics.

Formulas & formats

- Discount on a bill = Bill amount × Rate of discount × (Unexpired period in days ÷ 365) [use ÷12 when the period is given in whole months]
- Due date = Date of drawing/accepting + nominal period (months or days) + 3 days of grace
- ACCEPTANCE – Drawer's books: Bills Receivable A/c Dr. To Drawee's (Debtor) A/c
- ACCEPTANCE – Drawee's books: Drawer's (Creditor) A/c Dr. To Bills Payable A/c
- HONOUR (bill retained) – Drawer: Cash/Bank A/c Dr. To Bills Receivable A/c | Drawee: Bills Payable A/c Dr. To Cash/Bank A/c
- DISCOUNTING – Drawer: Bank A/c Dr. (net proceeds); Discount on Bills A/c Dr. (discount) To Bills Receivable A/c (face value) | Drawee: No entry
- ENDORSEMENT – Drawer: Creditor (Endorsee) A/c Dr. To Bills Receivable A/c | Endorsee: Bills Receivable A/c Dr. To Endorser A/c | Drawee: No entry
- BILL SENT FOR COLLECTION – On sending: Bills Sent for Collection A/c Dr. To Bills Receivable A/c ; On collection: Bank A/c Dr. To Bills Sent for Collection A/c
- DISHONOUR (bill retained) – Drawer: Drawee A/c Dr. (face + noting) To Bills Receivable A/c (face) To Cash/Bank A/c (noting paid) | Drawee: Bills Payable A/c Dr. (face); Noting Charges A/c Dr. To Drawer A/c (face + noting)
- DISHONOUR (discounted bill) – Drawer: Drawee A/c Dr. (face + noting) To Bank A/c (face + noting) | Drawee: Bills Payable A/c Dr.; Noting Charges A/c Dr. To Drawer A/c
- DISHONOUR (endorsed bill) – Drawer: Drawee A/c Dr. (face + noting) To Endorsee A/c (face + noting) | Drawee: Bills Payable A/c Dr.; Noting Charges A/c Dr. To Drawer A/c
- RENEWAL – Cancel old: Drawee A/c Dr. To Bills Receivable A/c (drawer) / Bills Payable A/c Dr. To Drawer A/c (drawee). Interest: Drawee A/c Dr. To Interest A/c (drawer) / Interest A/c Dr. To Drawer A/c (drawee). New bill: Bills Receivable A/c Dr. To Drawee A/c (drawer) / Drawer A/c Dr. To Bills Payable A/c (drawee)
- RETIREMENT – Drawer: Cash/Bank A/c Dr. (amount received); Rebate Allowed A/c Dr. To Bills Receivable A/c (face) | Drawee: Bills Payable A/c Dr. (face) To Cash/Bank A/c (amount paid) To Rebate Received A/c

Important questions & model answers

1 mark **Define a bill of exchange and name its three parties.**

- A bill of exchange is a written instrument containing an unconditional order, signed by the maker, directing a certain person to pay a fixed sum on a determinable date to a specified person or the bearer.
- Its three parties are the drawer (who writes it), the drawee (who is ordered to pay), and the payee (who receives the money).

1 mark **What are 'days of grace' and how do they affect the due date of a bill?**

- Days of grace are the three extra days added by law to the nominal period of a time bill before it becomes legally payable.
- The due date is therefore the nominal expiry date plus three days; bills payable at sight or on demand are not allowed any days of grace.

3 marks **Distinguish between a bill of exchange and a promissory note on any three bases.**

- Parties: a bill has three parties (drawer, drawee, payee); a promissory note has only two (maker, payee).
- Nature: a bill is an unconditional order to pay, whereas a promissory note is an unconditional promise to pay.
- Drawn/made by: a bill is drawn by the creditor (seller); a promissory note is made by the debtor (buyer).
- Acceptance: a time bill must be accepted by the drawee to be binding; a promissory note needs no acceptance since the maker himself promises to pay.

3 marks **On 1 April 2024, Anil sold goods to Bharat for ₹60,000 and drew a bill for 3 months which Bharat accepted. Bharat honoured the bill on the due date. Pass journal entries in the books of Anil (the drawer).**

- The due date is 4 July 2024 (1 April + 3 months = 1 July, plus 3 days of grace).
- 1 Apr 2024 — Sale on credit: Bharat A/c Dr. ₹60,000 To Sales A/c ₹60,000.
- 1 Apr 2024 — On acceptance: Bills Receivable A/c Dr. ₹60,000 To Bharat A/c ₹60,000.
- 4 Jul 2024 — On honour: Cash/Bank A/c Dr. ₹60,000 To Bills Receivable A/c ₹60,000.
- Net effect: the credit sale becomes a bill, and on maturity the bill is converted into cash; no profit or loss arises on a simple honour.

4 marks **X drew a bill on Y for ₹80,000 for 3 months. After one month X discounted it with the bank at 12% per annum. Show the discounting entry in X's books and explain why Y passes no entry.**

- Unexpired period after discounting = 2 months (plus 3 days of grace, usually ignored when months are given).
- Discount = ₹80,000 × 12% × 2/12 = ₹1,600; net proceeds = ₹80,000 – ₹1,600 = ₹78,400.
- Entry in X's (drawer's) books: Bank A/c Dr. ₹78,400; Discount on Bills A/c Dr. ₹1,600 To Bills Receivable A/c ₹80,000.
- Discount on Bills is a financial expense charged to the Profit & Loss A/c.
- Y (the drawee) passes no entry on discounting because his liability of ₹80,000 on the due date is unchanged — it is immaterial to him whether X or the bank finally collects the money.

4 marks **P drew a bill on Q for ₹50,000. P endorsed it to his creditor R. On the due date the bill was dishonoured and noting charges of ₹500 were paid by R. Pass the journal entry for dishonour in the books of P and of Q.**

- On endorsement P had credited Bills Receivable and debited R; R had debited Bills Receivable; Q passed no entry.
- On dishonour, P must repay R the bill amount plus noting charges and revive Q's debt.
- In P's (drawer's) books: Q A/c Dr. ₹50,500 To R A/c ₹50,500.
- In Q's (drawee's) books: Bills Payable A/c Dr. ₹50,000; Noting Charges A/c Dr. ₹500 To P A/c ₹50,500.
- Q ultimately bears the ₹500 noting charges because he is responsible for the dishonour.

4 marks **Distinguish between renewal and retirement of a bill, and state how rebate on retirement is treated in the books of the drawer and the drawee.**

- Renewal: the acceptor cannot pay on time, so the old bill is cancelled and a fresh bill (usually with interest added) is drawn for a later date.
- Retirement: the acceptor pays the bill before its due date, and in return the holder allows a rebate for the unexpired period.
- Rebate is an expense to the drawer (debited as Rebate/Discount Allowed) and an income to the drawee (credited as Rebate/Discount Received).
- Renewal therefore involves an interest charge added by the holder, whereas retirement involves a rebate given by the holder.

6 marks **A drew a bill on B for ₹1,00,000 for 3 months. On maturity B requested renewal. A agreed, charged interest at 18% per annum for the extended 3 months, and drew a new bill including the interest. Pass the journal entries in the books of A (the drawer).**

- Interest for the extension = ₹1,00,000 × 18% × 3/12 = ₹4,500.
- Step 1 — cancel the old bill on maturity: B A/c Dr. ₹1,00,000 To Bills Receivable A/c ₹1,00,000.
- Step 2 — charge interest for the extended period: B A/c Dr. ₹4,500 To Interest A/c ₹4,500.
- Step 3 — draw the new bill for ₹1,04,500 (old amount + interest): Bills Receivable A/c Dr. ₹1,04,500 To B A/c ₹1,04,500.
- B's account now stands settled, and A holds a new bill of ₹1,04,500 maturing three months later.
- Interest of ₹4,500 is credited to A's Profit & Loss A/c as income earned on the extension.

3 marks **Explain an accommodation bill and the chief risk it carries for the acceptor.**

- An accommodation bill is drawn and accepted without any genuine sale of goods, purely to raise short-term funds; the proceeds of discounting are shared by the parties.
- The accounting entries are identical to those of a trade bill — only the underlying purpose differs.
- Chief risk: a holder in due course who took the bill in good faith can compel the acceptor to pay even though no goods were sold.
- If the drawer who used the money fails to remit funds before maturity, the acceptor must pay from his own pocket and then recover separately from the drawer — bearing the full credit risk.

4 marks **M held a bill of ₹40,000 drawn on N, which M had discounted with the bank. The bill was dishonoured on maturity and the bank paid ₹300 as noting charges. Pass the journal entry in M's books on dishonour and explain why Bills Receivable is not credited.**

- On discounting, M had already removed the bill from his books (Bank A/c Dr.; Discount A/c Dr. To Bills Receivable A/c), so Bills Receivable no longer exists in M's ledger.
- On dishonour the bank recovers the face value plus noting charges (₹40,000 + ₹300 = ₹40,300) from M, and M revives N's debt.
- Entry in M's books: N A/c Dr. ₹40,300 To Bank A/c ₹40,300.
- Bills Receivable is not credited because there is no bill left in M's books to cancel; the credit goes to Bank, which is the party from whom the amount is now reclaimed.

Exam tips

- State the dishonour case first (retained, discounted, endorsed, or sent for collection) — the credit side of the drawer's entry changes (Bills Receivable vs Bank vs Endorsee vs Bills Sent for Collection) even though the debit (Drawee A/c with face + noting) stays the same.
- Compute discount only on the UNEXPIRED period (date of discounting to due date), never on the full tenure — losing marks here is the commonest error.
- Use ÷365 when the period is stated in days and ÷12 when it is stated in whole months; do not mix the two for the same bill.
- Remember the holiday rule: a due date falling on a declared public holiday moves to the PRECEDING business day, but on a sudden/emergency holiday it moves to the NEXT business day.
- Noting charges are always finally borne by the drawee/acceptor; debit them in the acceptor's books and add them to the amount recovered from him in the holder's books.
- Renewal = interest CHARGED by the holder (income to drawer); retirement = rebate ALLOWED by the holder (expense to drawer). Do not confuse the two.
- The drawee passes NO entry on discounting, endorsement, or sending a bill for collection — his liability is unchanged until honour or dishonour.
- Always write the narration/date and label every account as 'A/c'; in three-line and longer answers show the working for discount, interest, or rebate explicitly to earn method marks.

Quick revision

- Bill of exchange = unconditional WRITTEN ORDER to pay; promissory note = unconditional WRITTEN PROMISE to pay (3 parties vs 2 parties).
- Drawer = creditor/seller (holds Bills Receivable); Drawee/Acceptor = debtor/buyer (holds Bills Payable); Payee = receiver of money.
- Due date = nominal period + 3 days of grace; sight/demand bills get NO grace.
- Acceptance: Drawer → B/R Dr. To Drawee; Drawee → Drawer Dr. To B/P.
- Discounting: Drawer → Bank Dr. + Discount Dr. To B/R; Drawee → no entry.
- Endorsement: Drawer → Endorsee Dr. To B/R; Endorsee → B/R Dr. To Endorser; Drawee → no entry.
- Dishonour: Drawee A/c Dr. (face + noting) in the drawer's books; credit B/R / Bank / Endorsee / Bills Sent for Collection depending on what was done with the bill. Drawee → B/P Dr. + Noting Charges Dr. To Drawer.
- Renewal: cancel old bill, add interest (income to drawer), draw new bill for old amount + interest.
- Retirement: early payment with rebate — Rebate Allowed (expense, drawer) and Rebate Received (income, drawee).
- Accommodation bill: no real sale, funds shared; acceptor still liable to a holder in due course.