

Bills of Exchange

Kerala · Class 11 · Accountancy — exam notes

A bill of exchange turns a buyer's informal credit promise into a legal, transferable document. That matters because the seller no longer has to wait for the due date — the bill can be discounted at a bank for cash today. This chapter covers the three parties, acceptance, the four things a holder can do with a bill, and the entries for discounting, endorsement, dishonour and renewal. Note: Bills of Exchange remains part of the Kerala SCERT Plus One syllabus.

Key terms & definitions

Bill of exchange

A written, unconditional order signed by the maker, directing a person to pay a certain sum of money to a specified person or to the bearer, on demand or at a fixed future date.

Drawer

The creditor — usually the seller — who writes the bill and orders payment.

Drawee

The debtor — usually the buyer — on whom the bill is drawn and who is ordered to pay.

Payee

The person who is to receive the money. Often the drawer and payee are the same person, but not necessarily.

Acceptance

The drawee's signature on the bill signifying agreement to pay. A bill becomes legally binding only when accepted.

Bills Receivable

In the drawer's books, an accepted bill held as an asset — the right to receive money on the due date.

Bills Payable

In the drawee's books, an accepted bill representing a liability — the obligation to pay on the due date.

Discounting a bill

Transferring a bill to a bank before maturity in exchange for immediate cash, less a discount charge for the unexpired period.

Endorsement

Transferring a bill to a third party — usually a creditor — by signing on its back, so that the creditor collects the amount instead.

Days of grace

Three days added to the nominal maturity of a time bill under the Negotiable Instruments Act, 1881, to arrive at the legal due date.

Dishonour

Failure or refusal by the drawee to pay the bill on its due date, which revives the original debt and any noting charges.

Accommodation bill

A bill drawn and accepted purely to raise finance between parties, with no underlying sale of goods. A genuine trade bill, by contrast, arises from an actual transaction.

The problem a bill solves

- You sell fabric worth ₹50,000 on credit; the retailer will pay only after 90 days, but you need cash now for your next purchase.
- An ordinary credit sale gives you only a book debt — you must wait, or plead.
- A bill of exchange converts that debt into a LEGAL, TRANSFERABLE instrument with a fixed date.
- Because it is transferable, a bank will buy it from you today for slightly less than face value.
- So the bill solves a timing problem: the buyer keeps his credit period, and the seller gets his cash.

The three parties

- DRAWER — the creditor, usually the seller, who writes the bill and orders payment.
- DRAWEE — the debtor, usually the buyer, who is ordered to pay.
- PAYEE — whoever is to receive the money; frequently the drawer himself, but it may be a third person.
- The bill becomes binding only on ACCEPTANCE — the drawee signs across it, agreeing to pay.
- Until acceptance, the document is merely an order the drawee has not agreed to.

Bill of exchange versus invoice — not the same thing

- An INVOICE is a statement of what has been sold and what is owed. It is evidence of a transaction.
- A BILL OF EXCHANGE is an unconditional ORDER TO PAY, accepted by the debtor, and is a negotiable instrument under the Negotiable Instruments Act, 1881.
- An invoice cannot be discounted at a bank or endorsed to a creditor; an accepted bill can.
- An invoice carries no acceptance and no fixed legal due date with days of grace.
- Confusing the two is a common error — an invoice records a sale, a bill finances it.

Calculating the due date

- For a bill payable a stated number of days after date, count the days from the date of drawing, EXCLUDING that date.
- To the date so arrived at, add THREE DAYS OF GRACE under the Negotiable Instruments Act, 1881, to get the legal due date.
- For a bill payable a number of MONTHS after date, take the corresponding date in the later month, then add three days of grace.
- If the due date falls on a public holiday, the bill matures on the PRECEDING business day.
- Always state in your working whether you have included days of grace.

What the holder can do with a bill

- RETAIN it until maturity and collect the full amount from the drawee.
- DISCOUNT it with a bank before maturity, receiving cash now less a discount charge.
- ENDORSE it to a creditor in settlement of what the holder owes him.
- SEND IT FOR COLLECTION through the bank, which collects on the due date on the holder's behalf.
- The choice determines which journal entries are required — this is what most exam questions test.

Discounting — worked example

- Rajesh, a fabric wholesaler, sells ₹50,000 of goods to Priya Textiles on 1 January 2024 and draws a 90-day bill, accepted on 2 January.
- On 15 February he discounts the bill with HDFC Bank at 12% per annum. The unexpired period to maturity is 45 days.
- $\text{DISCOUNT} = ₹50,000 \times 12/100 \times 45/360 = ₹750$.
- $\text{CASH RECEIVED} = ₹50,000 - ₹750 = ₹49,250$.
- ENTRY: Bank A/c Dr. ₹49,250; Discount (Discounting Charges) A/c Dr. ₹750; To Bills Receivable A/c ₹50,000.
- The discount is a FINANCE COST borne by the drawer — it is charged to the Profit & Loss Account.
- IMPORTANT: discounting does NOT reduce what the drawee owes. Priya still owes the full ₹50,000, but now to the bank.

When the bill is honoured after discounting

- If the drawee pays the bank directly on the due date, the drawer passes NO ENTRY.
- The reason is that the drawer already removed the bill from his books when he discounted it.
- So in the Rajesh example, when Priya pays the bank on the due date, Rajesh records nothing.
- This 'no entry' point is frequently tested and frequently missed.
- It is only on DISHONOUR that the drawer must record something again.

Dishonour and the drawer's continuing liability

- Dishonour means the drawee fails or refuses to pay on the due date.
- If the bill was DISCOUNTED, the bank recovers the amount from the drawer, who must then recover it from the drawee.
- ENTRY in the drawer's books: Drawee's Personal A/c Dr. (face value + noting charges) / To Bank A/c.
- The original debt is thus REVIVED — the drawee once again appears as a debtor.
- NOTING CHARGES are the fee paid to a notary public to record the dishonour officially; they are borne ultimately by the drawee and added to his account.
- This is why acceptance does NOT release the drawer: if the drawee defaults, the drawer remains liable to whoever holds the bill.

Renewal of a bill

- If the drawee cannot pay on the due date, he may request that the old bill be cancelled and a fresh bill drawn for a later date.
- The old bill is cancelled and the drawee's personal account is debited with its amount.
- INTEREST is usually charged for the extended period, either paid in cash or added into the new bill.
- A new bill is then drawn and accepted for the revised amount.
- Renewal is a mutual agreement made BEFORE dishonour — it is not the same as dishonour.

Accommodation bills

- Arun and Biju, two friends in business, draw a bill on each other with NO underlying sale, purely to raise money.
- Arun draws on Biju, Biju accepts, and Arun discounts the bill at a bank; the cash is shared as agreed.
- Each party must remit his share before the due date so the acceptor can meet the bill.
- The entries mirror a trade bill, except that the proceeds are SHARED and there is no Sales or Purchases entry.
- A TRADE bill arises from a genuine sale of goods; an ACCOMMODATION bill exists only to provide finance.

Formulas & formats

- Discount on a bill:
$$\text{Discount} = \text{Face Value} \times \text{Rate \%} \times (\text{Unexpired period} \div 12 \text{ months or } 360 \text{ days})$$

Example: $50,000 \times 12\% \times 45/360 = ₹750$
- Due date:
$$\text{Due date} = \text{Date of drawing} + \text{stated period (excluding the date of drawing)} + 3 \text{ DAYS OF GRACE}$$

(If it falls on a public holiday, the bill matures on the PRECEDING business day)
- Key entries in the DRAWER's books:
On sale : Drawee A/c Dr. / To Sales A/c
On acceptance : Bills Receivable A/c Dr. / To Drawee A/c
On discounting : Bank A/c Dr. + Discount A/c Dr. / To Bills Receivable A/c
On honour (if discounted) : NO ENTRY
On dishonour : Drawee A/c Dr. (incl. noting charges) / To Bank A/c
- Key entries in the DRAWEE's books:
On purchase : Purchases A/c Dr. / To Drawer A/c
On acceptance : Drawer A/c Dr. / To Bills Payable A/c
On payment : Bills Payable A/c Dr. / To Bank A/c
On dishonour : Bills Payable A/c Dr. + Noting Charges A/c Dr. / To Drawer A/c
- Bills Receivable (asset, drawer's books) ↔ Bills Payable (liability, drawee's books)

Important questions & model answers

3 marks Define a bill of exchange and name the three parties to it.

- A bill of exchange is 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.
- DRAWER — the creditor who writes the bill and orders payment, usually the seller.
- DRAWEE — the debtor on whom the bill is drawn and who is ordered to pay, usually the buyer.
- PAYEE — the person entitled to receive the amount; often the drawer himself.

3 marks Distinguish between a bill of exchange and an invoice.

- NATURE: An invoice is a statement of goods sold and the amount due; a bill of exchange is an unconditional order to pay a fixed sum on a fixed date.
- ACCEPTANCE: An invoice requires no acceptance; a bill becomes legally binding only when the drawee accepts it by signing.
- NEGOTIABILITY: An invoice cannot be discounted or endorsed; an accepted bill is a negotiable instrument and can be discounted with a bank or endorsed to a creditor.
- LEGAL STATUS: A bill is governed by the Negotiable Instruments Act, 1881, and carries days of grace; an invoice is only evidence of a transaction.

5 marks Rajesh sells goods worth ₹50,000 to Priya on 1 January 2024 and draws a 90-day bill, accepted on 2 January. On 15 February he discounts it at 12% p.a., 45 days before maturity. Compute the discount and pass the entry in Rajesh's books.

- $\text{DISCOUNT} = ₹50,000 \times 12/100 \times 45/360 = ₹750$.
- CASH RECEIVED from the bank = ₹50,000 – ₹750 = ₹49,250.
- ENTRY: Bank A/c Dr. ₹49,250
- Discount A/c Dr. ₹ 750
- To Bills Receivable A/c ₹50,000 — (Being the bill discounted with the bank).
- The ₹750 is a finance cost to Rajesh and is charged to the Profit & Loss Account.
- Priya's liability is unaffected — she still owes the full ₹50,000, now payable to the bank.

3 marks In the above case Priya pays the bank directly on the due date. What entry does Rajesh pass? Give the reason.

- Rajesh passes NO ENTRY at all.
- When he discounted the bill he already credited Bills Receivable A/c and removed the bill from his books.
- The bill is now the bank's asset, and payment by Priya to the bank does not affect Rajesh's accounts in any way.
- An entry would be required only if the bill were DISHONoured, because the bank would then recover the amount from Rajesh.

3 marks 'Once the drawee accepts a bill, the drawer is free of all liability.' Do you agree?

- No, this is incorrect.
- Acceptance makes the drawee primarily liable, but the drawer remains SECONDARILY liable on the instrument.
- If the drawee dishonours the bill, the holder — a bank that discounted it, or an endorsee — can recover the amount from the drawer.
- The drawer must then pay, and recover the amount together with any noting charges from the drawee, whose original debt is revived.
- So liability shifts in the first instance but does not disappear.

3 marks What is meant by discounting a bill? Does it reduce the drawee's liability?

- Discounting means transferring a bill to a bank before its due date and receiving immediate cash, less a discount charge for the unexpired period.
- It is a short-term financing arrangement between the HOLDER and the BANK.
- It does NOT reduce the drawee's liability in any way — he still owes the full face value.
- The only change is the identity of the person to whom he must pay: the bank instead of the original drawer.

3 marks How is the due date of a bill determined? Illustrate.

- Count the stated period from the date of drawing, EXCLUDING the date of drawing itself.
- To that date add THREE DAYS OF GRACE, as allowed by the Negotiable Instruments Act, 1881.
- Illustration: a bill dated 1 January payable two months after date matures nominally on 1 March; adding three days of grace makes the legal due date 4 March.
- If the due date falls on a public holiday, the bill matures on the PRECEDING business day.

2 marks What are noting charges? Who ultimately bears them?

- Noting charges are the fee paid to a notary public for officially recording the fact that a bill has been dishonoured, so that legal proof of dishonour exists.
- They are paid in the first instance by the holder of the bill.
- They are ultimately borne by the DRAWEE, because the amount is added to his personal account along with the face value of the dishonoured bill.

3 marks Distinguish between a trade bill and an accommodation bill.

- **PURPOSE:** A trade bill arises out of a genuine sale and purchase of goods; an accommodation bill is drawn purely to raise finance, with no underlying transaction.
- **CONSIDERATION:** A trade bill has consideration behind it; an accommodation bill has none.
- **PROCEEDS:** In a trade bill the drawer keeps the proceeds; in an accommodation bill the proceeds are shared between the parties as agreed.
- **ENTRIES:** A trade bill involves Sales or Purchases entries; an accommodation bill does not, and each party must remit his share before the due date.

3 marks What is renewal of a bill, and how does it differ from dishonour?

- Renewal occurs when the drawee, unable to pay on the due date, requests that the existing bill be cancelled and a fresh bill drawn for a later date, usually with interest for the extended period.
- The old bill is cancelled by debiting the drawee's personal account, interest is charged, and a new bill is drawn and accepted.
- Dishonour, by contrast, is the **FAILURE** or **REFUSAL** to pay on the due date, with no prior agreement.
- Renewal is a mutual arrangement made **BEFORE** maturity; dishonour is a default **AT** maturity that revives the debt and may involve noting charges.

Exam tips

- Always state whose books you are writing entries in. The same bill is Bills **RECEIVABLE** for the drawer and Bills **PAYABLE** for the drawee.
- Show the discount computation as a separate line — $50,000 \times 12\% \times 45/360 = ₹750$ — before the journal entry. Working carries marks.
- If a discounted bill is honoured, write 'No entry' and give the reason. Leaving the answer blank scores nothing; the explanation scores.
- On dishonour, remember to add **NOTING CHARGES** to the drawee's account, not to treat them as a separate loss.
- Mention days of grace whenever a due date is asked for — omitting them is a standard error.
- Do not write that discounting reduces the drawee's debt. It changes only the payee.
- Note that Bills of Exchange is part of the Kerala SCERT Plus One syllabus — do not skip it on the assumption that it has been removed elsewhere.

Quick revision

- Three parties: **DRAWER** (creditor/seller), **DRAWEE** (debtor/buyer), **PAYEE** (receiver).
- A bill binds only on **ACCEPTANCE** by the drawee.
- Invoice = evidence of sale; bill = negotiable order to pay, discountable and endorsable.
- Due date = period from date of drawing + 3 **DAYS OF GRACE**.
- Four options for the holder: retain, discount, endorse, send for collection.
- Discount = Face value $\times$ Rate $\times$ Time. Rajesh: $50,000 \times 12\% \times 45/360 = ₹750$; cash ₹49,250.
- Bill discounted then honoured → **NO ENTRY** in the drawer's books.
- Dishonour: Drawee A/c Dr. (face value + noting charges) / To Bank A/c — the old debt revives.
- Trade bill = real sale. Accommodation bill = finance only, proceeds shared.
- Drawer stays **SECONDARILY** liable even after acceptance.