1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 01 (Class XI, Semester - 1)
Module Name/Title	Bills of Exchange – Part 1
Module Id	keac_10601
Pre-requisites	Basic knowledge of journal entries
Objectives	After going through this lesson, the learners will be able to understand the following : • Hundies • What is bill of exchange • What is promissory note • Advantages of bills of exchange • Journal entries in the books of drawer
Keywords	Hundi, Bills of exchange, Drawer, Drawee, Promissory Note, Days of grace

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator (NMC)	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Mohd. Mamur Ali	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Prof. Shipra Vaidya	DESS, NCERT, New Delhi
Subject Matter Expert (SME)	CA. Sanjay Mutreja	Visiting Faculty Member Of ICAI And ICSI.
Review Team	Mrs. Savita Shangari	Gyan Bharti School, Saket, New Delhi

Introduction

The origin of negotiable instruments has remained a matter of speculation till date. It goes back to the time when things were exchanged for things called *Barter*.

Figure 1: An 1874 newspaper illustration from Harper's Weekly, showing a man engaging in barter: offering chickens in exchange for his yearly newspaper subscription.

Sources:https://upload.wikimedia.org/wikipedia/commons/0/05/Barter-Chickens_for_Subscription.jpg

From Figure 1, it is clear that no such thing like *money* was evident as a medium of exchange. Then money came into existence and as a medium of exchange made the payment simpler and faster for business transactions. As the business activities grew in size and volume the trading community began to expand their business ventures in other countries. Travelling long distances with huge amount of money made traders insecure and they feared theft and robbery. This led to the emergence of letter of credit guaranteeing the payment of a specific amount of money, either on demand or at a set time. These instruments are contemplated by a contract which (a) warrants the payment of money, (b) the promise of or order which is unconditional (c) capable of transfer by valid negotiation of the instrument. This gave rise to the origin of Hundies in India. In the year 1881 the Negotiable Instruments Act was enacted according to which three types of such instruments *viz.*, promissory note, bill of exchange and Cheque which includes demand draft also. (refer figure 3)

Figure 3 Specimen Negotiable Instruments

Reference: Varied sources

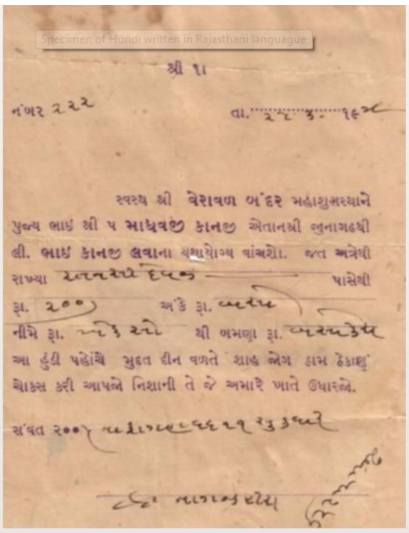
With the decline of Barter system and existence of currency and advancement in business and industry, it became inevitable to have credit transactions and the need to having the instruments emerged with an understanding to repay the amount at a later point of time. Hence the use of bill of exchange and promissory note came in use as negotiable instrument. In Indian subcontinent *Hundi* was popular as a kind of negotiable instrument. Hundi is also used as a bill of exchange but the Negotiable Instruments Act 1881 does not recognize *Hundi* as a negotiable instrument. Also there is no specific law regarding use of *Hundi* as a negotiable instrument. Hundi, Promissory Note and Bill of Exchange are discussed in detail, hereunder.

Hundies

Indigenous banking is an age old tradition in India. Historically it is believed that indigenous banking system played a prominent role in lending money, financing internal and foreign trade with cash and with letter of credit. The well developed financial system can be traced from *Kautilya's Arthshastra* where it is described as " All undertakings depend on financing. Hence, foremost attention shall be paid to treasury" Documents such as *Hundies* and *Chitti* were I use among Indian trading class for carrying on transactions in which money passed from hand to hand. *Hundi* as an instrument of exchange was prominent in Indian sub continent and was vernacular and was contemplated by a contract which (i) warrant the payment of money, the promise or order which is unconditional (ii) specifies the payee (iii) capable of change through transfer by valid negotiation. Although *Hundi* is a generic term derieved from the Sanskrit root ' *Hund'* which means to " to collect". This expresses the purpose of its usage and utilization. In this context, *Hundi* implies an unconditional order in writing made by a person to pay a certain sum of money to a person who is named in the order. The peculiar feature of *Hundi* is that it is an indigeneous bill of exchange and is written in vernacular languages.

Hundies as practiced by Indian Merchant Communities

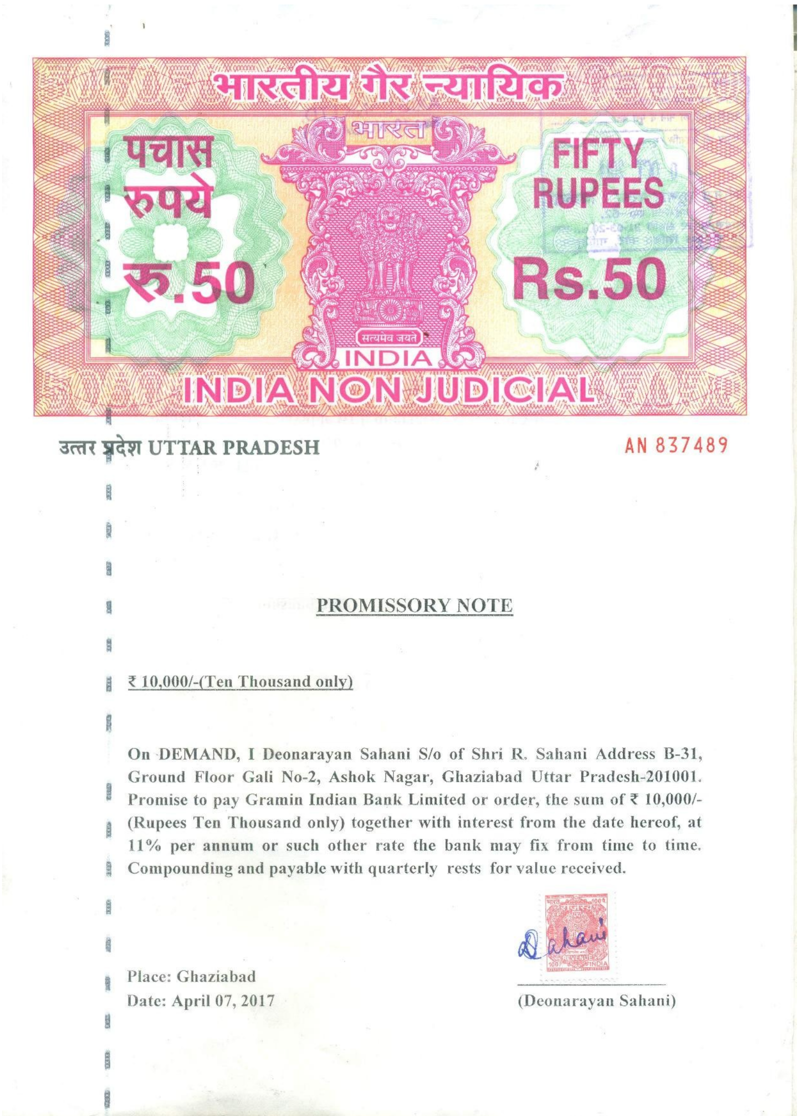
Name of Hundi	Broader Classification	Function of Hundi
Dhani - Jog	Darshani	Payable to any person- no liability over who received payment
Sah-Jog	Darshani	Payable to a specific person, someone ' respectable'. Liability over who received payment.
Firman-Jog	Darshani	Hundi made payable to order.
Dekhan-har	Darshini	Payable to the presenter or bearer
Dhani-Jog	Muddati	Payable to any person –no liability over who received payment , but payment over a fixed term.
Firman-Jog	Muddati	Hundi made payable to order following a fixed term.
Jokhmi	Muddati	Drawn against dispatched goods. If goods lost in transit , the drawer or holder bears the costs, and the Drawee carries no liability



Specimens of Hundi

Promissory Note

A promissory note is a financial instrument that contains a written promise by one party (the note's issuer or maker) to pay another party (the note's payee) a definite sum of money, either on demand or at a specified future date. A promissory note typically contains all the terms pertaining to the indebtedness, such as the principal amount, interest rate, maturity date, date and place of issuance, and issuer's signature. A promissory note can be either payable on demand or at a specific time. If the promissory note is unconditional and readily salable, it is called a negotiable instrument.


भारतीय गैर न्यायिक

भारत

पचास रुपये

FIFTY RUPEES

रु.50

Rs.50

सत्यमेव जयते

INDIA

INDIA NON JUDICIAL

उत्तर प्रदेश UTTAR PRADESH

AN 837489

PROMISSORY NOTE

₹ 10,000/-(Ten Thousand only)

On DEMAND, I Deonarayan Sahani S/o of Shri R. Sahani Address B-31, Ground Floor Gali No-2, Ashok Nagar, Ghaziabad Uttar Pradesh-201001. Promise to pay Gramin Indian Bank Limited or order, the sum of ₹ 10,000/- (Rupees Ten Thousand only) together with interest from the date hereof, at 11% per annum or such other rate the bank may fix from time to time. Compounding and payable with quarterly rests for value received.

Place: Ghaziabad

Date: April 07, 2017

(Deonarayan Sahani)

Figure 4: Specimen promissory note

According to Reserve Bank of India Act, promissory note payable to bearer is illegal, because then it becomes equal to a currency note. Another important point of observation is that promissory note do not require acceptance as it is the maker who gives the promise.

Parties to Promissory Note

There are two parties to promissory note:

- Maker: person who makes promissory note. Also called promissory because a promise is extended to have availed the credit.
- Payee: Person in whose favour it is drawn, also called Promisee.

Bill of exchange

A bill of exchange is a binding agreement by one party to pay a fixed amount of cash to another party as of a predetermined date or on demand. Till the time this instrument is accepted it is just a DRAFT. Once it is accepted, it becomes Bill Payable. A bill of exchange normally includes the following information:

1. *Title.* The term "bill of exchange" is noted on the face of the document.
2. *Amount*. The amount to be paid, expressed both numerically and written in text.
3. *As of*. The date on which the amount is to be paid. Can be stated as a certain number of days after an event, such as a shipment or receipt of a delivery.
4. *Payee*. States the name (and possibly the address) of the party to be paid.
5. *Identification number*. The bill should contain a unique identifying number.
6. *Signature*. The bill is signed by a person authorized to commit the drawee to pay the designated amount of funds.

Bill of exchange is of two types:

1. Trade Bill: these are drawn and accepted for normal sale and purchase transactions.
2. Accommodation bill: These are drawn and accepted for mutual help.

Parties to bill of exchange

There are three entities that may be involved with a bill of exchange transaction. They are:

1. *Drawee*. This party pays the amount stated on the bill of exchange to the payee.
2. *Drawer*. This party requires the drawee to pay a third party (or the drawer can be paid by the drawee).

1. *Payee*. This party is paid the amount specified on the bill of exchange by the drawee.

   A bill of exchange is transferable, so the drawee may find itself paying an entirely different party than it initially agreed to pay. The payee can transfer the bill to another party by endorsing the back of the document. A payee may sell a bill of exchange to another party for a discounted price in order to obtain funds prior to the payment date specified on the bill. The discount represents the interest cost associated with being paid early. If an entity accepts a bill of exchange, its risk is that the drawee may not pay. This is a particular concern if the drawee is a person or non-bank business. No matter who the drawee is, the payee should investigate the creditworthiness of the issuer before accepting the bill. If the drawee refuses to pay on the due date of the bill, then the bill is said to be *dishonored*.

Advantages of Bill of Exchange

1. **Enables credit transactions:** Bill of Exchange helps in doing credit transaction between buyer and seller on an agreed basis.
2. **Certainty of terms /conditions:** Both creditor and debtor is aware of the terms and conditions relating to the time and place of payment. Each and every term and condition is clearly defined and known to both parties.
3. **Legal evidence:** Bill of exchange is governed by the Negotiable Instrument Act 1881 , hence is a legal document and is a conclusive evidence of credit transaction. It serves as an evidence in the court of Law.
4. **Endorsement:** Bill of Exchange is transferable and can be used to settle down the third party debt through endorsement.
5. **Convenient means of Credit:** Even after giving the buyer an extension of time for making payment, Bill of Exchange can be discounted from the bank to get an early payment.

Terms used in Bill of Exchange

1. **Term of Bill**: Period from the start to date of bill becoming due.
2. **Due date**: When payment of bill is due.
3. **Maturity date:** Date on which the Bill of Exchange becomes due for payment i.e., *Maturity date = Due date + 3 days of grace*
4. **Days of Grace:** It is a custom to ad 3 days of grace. But if after adding 3 days of grace, the maturity date is a public holiday, then the maturity date will be the preceding working day.
5. **Discounted from Bank:** When payment is obtained from bank before maturity and credited to bank account of drawer on maturity.
6. **Bills sent to collection:** Bank keeps the bill till maturity and credit it to bank account of drawer on maturity.
7. **Endorsement:** when Bill of Exchange is used to settle the third party claims by transfer.
8. **Dishonour of bill:** When the bill is not met on maturity and the realization of bill is not met.
9. **Noting charges:** Fees paid to Notary for recording the dishonor of bill. It is paid by the holder of the bill and recovered from drawee.
10. **Retirement of Bill:** When the drawee makes the payment before the due date.

8. Accounting Treatment

Now, let us start with the accounting treatment. First of all we will see journal entries to be made in books of DRAWER.

(1) When Sale is made:

Debtor A/c Dr. (Debtor means Drawee for us)

To Sales A/c

(2) When bill recd. from drawee :

Bills Receivable A/c Dr.

To Debtor a/c

There are four cases in this regard:

Case A. When the bill is retained by drawer

a) No Entry is recorded for retaining the bill.

b) On Maturity will be:

Bank/Cash A/c Dr.

To Bill Receivable a/c

Case B. Bill discounted from bank

- Entry on discounting will be:

Bank A/c Dr.

Discount A/c Dr.

To Bills Receivable A/c

- On maturity no entry will be recorded since payment will be received by BANK and not the Drawer.

Case C. When the bill is endorsed to a 3rd Party (Creditor)

a) Entry on Endorsement.

Creditor A/c Dr.

To Bills Receivable A/c

- On maturity

No Entry will be recorded

Case D. Bill sent for collection.

a) Entry on sending the Bill.

Bills sent for collection A/c Dr.

To Bills Receivable A/c

b) Entry on maturity.

Bank A/c Dr.

To Bills Sent for Collection

Example

Amit sold goods for Rs. 20,000 to Sumit on credit on January 01, 2016. Amit drew a bill of exchange upon Sumit for the same amount for three months. Sumit accepted the bill and returned it to Amit. Sumuit met its acceptance on maturity. Record the necessary journal entries under the following circumstances:

1. When the bill was retained till its maturity by Amit
2. Amit discounted the bill @ 12% p.a. from his bank.
3. Amit endorsed the bill to his creditor Ankit
4. Amit retained the bill and on March 31, 2017 Amit sent the bill for collection to its bank. On
5. April 05, 2017 bank advice was received.

Case I: When the bill was retained till its maturity by Amit

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit on credit)		20,000	20,000
Jan. 01	Bills Receivables A/c Dr. To Sumit's A/c (Acceptance received, bill payable after 3 months)		20,000	20,000
April 05	Bank's A/c Dr. Bills Receivables A/c (Acceptance met by Sumit)		20,0000	20,000

Case II: When the bill was discounted from the bank

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c ((Sold goods to Sumit)		20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To Sales A/c ((Received acceptance, bill payable after 3 months)		20,000	20,000
March 31	Bills sent for Collection A/c Dr. To Bills Receivable A/c (Bill sent for collection)		20,000	20,000
April 05	Bank A/c Dr. To Bills sent for Collection A/c (bill sent to collection collected by bank)		20,000	20,000

Case III: When the bill was endorsed to Ankit

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit)		20,000	20,000
Jan. 01	Bills Receivables A/c Dr. To Sumit's A/c (Received acceptance, bill payable after 3 months)		20,000	20,000
Jan. 01	Bank's A/c Dr. Discount A/c Dr. Bills Receivables A/c (Bill discounted from bank)		19,400 600	20,000

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c (Sold goods to Sumit)		20,000	20,000
Jan. 01	Bills Receivables A/c Dr. To Sumit's A/c (Received acceptance, bill payable after 3 months)		20,000	20,000
Jan. 01	Ankit's A/c Dr. To Bills Receivables A/c (Bill endorsed to Ankit)		20,000	20,000

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c ((Sold goods to Sumit)		20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To Sales A/c ((Received acceptance, bill payable after 3 months)		20,000	20,000
March 31	Bills sent for Collection A/c Dr. To Bills Receivable A/c (Bill sent for collection)		20,000	20,000
April 05	Bank A/c Dr. To Bills sent for Collection A/c (bill sent to collection collected by bank)		20,000	20,000

Case IV: When the bill was sent to collection to bank

Books of Ankit

Journal

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
Jan. 01	Sumit's A/c Dr. To Sales A/c ((Sold goods to Sumit)		20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To Sales A/c ((Received acceptance, bill payable after 3 months)		20,000	20,000
March 31	Bills sent for Collection A/c Dr. To Bills Receivable A/c (Bill sent for collection)		20,000	20,000
April 05	Bank A/c Dr. To Bills sent for Collection A/c (bill sent to collection collected by bank)		20,000	20,000

Summary:

1. Bills of Exchange is governed by the Negotiable Instruments Act 1881.
2. Bills of Exchange are contemplated by a contract which (a) warrants the payment of money, (b) the promise of or order which is unconditional (c) capable of transfer by valid negotiation of the instrument.
3. Need for Bills of Exchange aroused with the decline of Barter system and existence of currency and advancement in business and industry, it became inevitable to have credit transactions and the need to having the instruments emerged with an understanding to repay the amount at a later point of time.
4. In Indian subcontinent *Hundi* was popular as a kind of negotiable instrument. Hundi is also used as a bill of exchange but the Negotiable Instruments Act 1881 does not recognize *Hundi* as a negotiable instrument. The peculiar feature of *Hundi* is that it is an indigenous bill of exchange and is written in vernacular languages.
5. A promissory note is a financial instrument that contains a written promise by one party (the note's issuer or maker) to pay another party (the note's payee) a definite sum of money, either on demand or at a specified future date.

6. A bill of exchange is a binding agreement by one party to pay a fixed amount of cash to another party as of a predetermined date or on demand. There are three entities that may be involved with a bill of exchange transaction. They are: *Drawee*, *Drawer Payee*.