



# ACCOUNTING FOR SPECIAL TRANSACTIONS



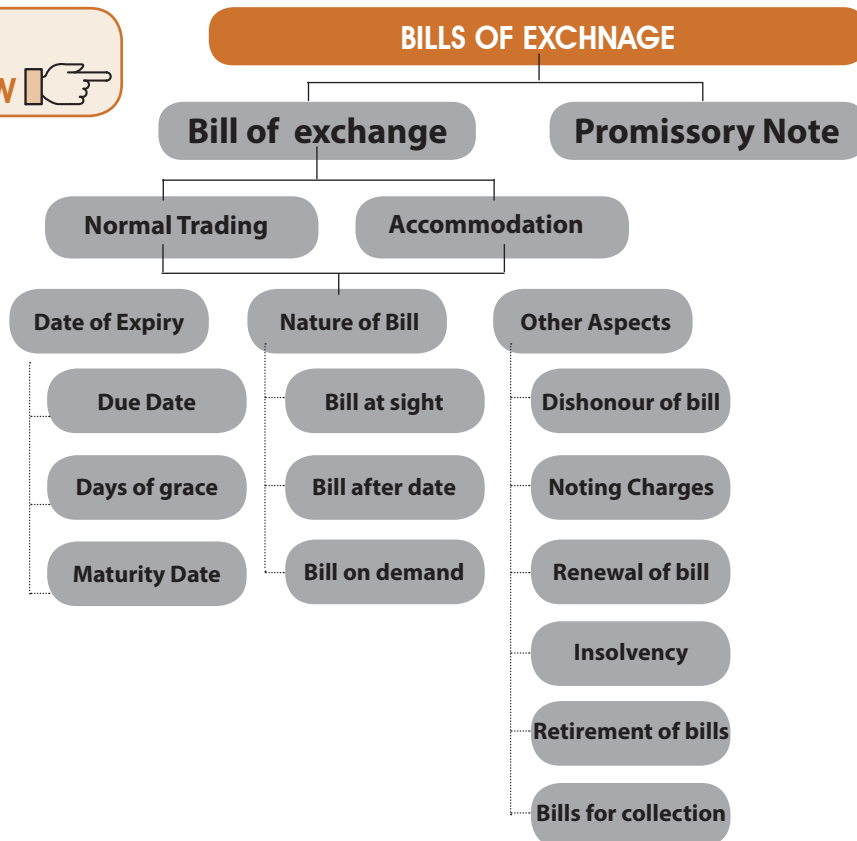
## UNIT 1 : BILLS OF EXCHANGE AND PROMISSORY NOTES

### LEARNING OUTCOMES

After studying this unit, you will be able to:

- ◆ Understand the meaning of Bills of Exchange and Promissory Notes and also try to grasp their underlying features.
- ◆ Understand the accounting treatments relating to issue, acceptance, discounting, maturity and endorsement of bills in the books of drawer and drawee.
- ◆ Learn the technique of accounting relating to accommodation bills.
- ◆ Learn the special treatment needed in case of insolvency as well as early retirement of bill.

### UNIT OVERVIEW





## 1.1 BILLS OF EXCHANGE

It is general practice that when goods are sold or services are provided, the seller extends a credit period to buyer. In sometimes, the seller may not be in a position to offer credit period and the purchase is not in a position to pay immediately. In such circumstances the seller would like that the purchaser should give a definite promise in writing to pay the amount of the goods on a certain date which he can use to generate immediate funds. Commercial practice has developed to treat these written promises into valuable instruments of credit that when a written promise is made in proper form and is properly stamped, it is expected that the buyer discharges his debt and the seller receives payment. This is because written promises are often accepted by banks and money is advanced against them. Also they can be endorsed, i.e., passed on from person to person. The written promise is either in the form of a Bill of Exchange or in the form of a promissory note.

A Bill of Exchange has been defined as an “instrument in writing containing an unconditional order signed by the maker directing 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”. When such an order is accepted in writing on the face of the order itself, it becomes a valid bill of exchange. Suppose A orders B to pay ₹50,000 for three months after date and B accepts this order by signing his name, then it will be a bill of exchange.

A Bill of Exchange has the following characteristics:

1. It must be in writing.
2. It must be dated.
3. It must contain an order to pay a certain sum of money.
4. The promise to pay must be unconditional.
5. The money must be payable to a definite person or to his order to the bearer.
6. The draft must be accepted for payment by the party to whom the order is made.
7. It should be properly stamped.
8. Payment must be in legal currency of the country.

The party which makes the order is known as the **drawer**. The party which accepts the order is known as the **acceptor** and the party to whom the amount has to be paid is known as the **payee**. The drawer and the payee can be the same.

A Bill of Exchange can be passed on to another person by endorsement. Endorsement on a bill of exchange is made exactly as it is done in the case of a cheque. The primary liability on a bill of exchange is that of the acceptor. If he does not pay, a holder can recover the amount from any of the previous endorsers or the drawee.

Sometimes, it may happen that a bill of exchange is drawn for foreign trade operations. Such a bill is known as “**Foreign Bill of Exchange**”. A foreign bill of exchange is one which is drawn in one country and is payable in another. It is generally drawn up in triplicate wherein each copy is sent by separate post so that at least one copy reaches the intended party. Payment will be made only on one of the copies and when such payment is made the other copies become useless. Section 12 of the Negotiable Instruments Act provides that all instruments, which are not inland instrument, are foreign.

A specimen of foreign bill of exchange is given below:

₹11,50,000	New Delhi
	July, 2016
Ninety days after date of this First Bill of Exchange (Second and Third of the same tenure and date being unpaid) pay to the order of M/s. Vencent John & Associates, London the sum of Rupees Eleven lakh Fifty thousand only, value received.	
To,	
Wallis Sons	Accepted
M/s. IONX	(Wallis Sons)
Birmingham, UK.	Stamp
	..... Drawee

The following are examples of foreign bills:

1. A bill drawn in India on a person resident outside India and made payable outside India.
2. A bill drawn outside India on a person resident outside India.
3. A bill drawn outside India and made payable in India.
4. A bill drawn outside India and made payable outside India.

## 1.2 PROMISSORY NOTES

A promissory note is an instrument in writing, not being a bank note or 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. Under Section 31(2) of the Reserve Bank of India Act a promissory note cannot be made payable to bearer.

A promissory note has the following characteristics:

1. It must be in writing.
2. It must contain a clear promise to pay. Mere acknowledgement of a debt is not a promissory note.
3. The promise to pay must be unconditional "I promise to pay ₹50,000 as soon as I can" is not an unconditional promise.
4. The promiser or maker must sign the promissory note.
5. The maker must be a certain person.
6. The payee (the person to whom the payment is promised) must also be certain.
7. The sum payable must be certain. "I promise to pay ₹50,000 plus all fine" is not certain.
8. Payment must be in legal currency of the country.
9. It should not be made payable to the bearer.

10. It should be properly stamped.
11. It does not require any acceptance.

#### Specimen of promissory note :

<b>Specimen of a Promissory Note</b>	
₹ 10,00,000/- only	Rohan 77, Sector-12, Ghaziabad March 01, 2017
Three months after date I promise to pay Priya or his order the sum of ₹ Ten lakh only, for value received.	
To, Priya S-11, Rohini, Delhi.	Stamp  (Rohan)
Payee	Maker

### 1.3 DIFFERENCES - BILL OF EXCHANGE AND PROMISSORY NOTE

<b>Bill of Exchange</b>	<b>Promissory Note</b>
A bill contains an unconditional order to pay	A promissory note contains only a promise to pay certain sum of money
There are generally 3 parties (Drawer, Drawee and Payee) in bill of exchange	There are 2 parties (Maker and Payee) in promissory note
A bill is paid by Acceptor	A promissory note is paid by maker
A bill is drawn by creditor	A promissory note is made by debtor
The drawer and payee may be same person in case of bill of exchange	In promissory note maker and payee can not be same person
In a bill of exchange the liability of drawer is secondary and conditional	In a promissory note the liability of a maker is primary and absolute
A bill of exchange can be accepted conditionally	A promissory note cannot be made conditionally
In a bill of exchange, notice of dishonor must be given	Notice of dishonor is not required in case of promissory note
In case of dishonor, a bill of exchange must be noted and protested	Noting and protest is not required in case of dishonor of a promissory note.



## 1.4 RECORD OF BILLS OF EXCHANGE AND PROMISSORY NOTES

A party which receives a Promissory Note or receives an accepted Bill of Exchange will treat it as a new asset under the name of Bills receivable. A party which issues a Promissory Note or accepts a Bill of Exchange will treat it as new liability under the heading of Bills Payable. We shall first deal with the entries in the books of the party which receives promissory notes or bills. (When we talk of bills, we include promissory notes also).

On receipt of Bill, the payee makes the following entry in his books of accounts:

Bills Receivable Account	Dr.
To Drawee/Maker of the note	

(1) A accepts a Bill of exchange drawn on him by B. In the books of B the entry will be :

Bills Receivable Account	Dr.
To A	

(2) A sends to B the acceptance of D. In this case also, the entry in the books of B will be :

Bills Receivable Account	Dr.
To A	

The person who receives the bill has three options. These are:

- (i) He can hold the bill till maturity. (Naturally in this case no further entry is passed until the date of maturity arrives).
- (ii) The bill can be endorsed in favour of another party say Z. In this case, the entry will be to debit the party which now receives the bill and to credit the Bills Receivable Account.

Z	Dr.
To Bills Receivable Account	

- (iii) The Bill of Exchange can be discounted with bank. The bank will deduct a small sum of money as discount and pay rest of the money.

Bank Account	Dr. (with the amount actually received)	
Discount Account	Dr. (with the amount of loss or discount)	
To Bills Receivable Account		

On the date of maturity there will be two possibilities:

- (a) The first is that the bill will be paid, that is to say, *met* or *honoured*. The entries for this will depend upon what was done to the bill during the period of maturity. If the bill was kept, the cash will be received by the party which originally received the bill. In his books, therefore, the entry will be :

Cash Account	Dr.
To Bills Receivable Account	

But if he has already endorsed the bill in *favour* of his creditor or if the bill has been discounted with the bank he will not get the amount; it will be the creditor or the bank which will receive the money. Therefore, in these two cases, no entry will be made in the books of the party which originally received the bill.

- (b) The second possibility is that the bill will be *dishonoured*, that is to say, the bill will not be paid. If the bill is *dishonoured*, the bill becomes useless and the party from whom the bill was received will be liable to pay the amount (and also the expenses incurred by the party).

Therefore, the following entries will be made :

1. If the bill was kept till maturity then :

Drawee / Maker of the note	Dr.
To Bills Receivable Account	

2. If the bill was endorsed in favour of a creditor, the entry is :

Drawee / Maker of the note	Dr.
To Bill payables	

3. If the bill was discounted with the bank :

Drawee / Maker of the note	Dr.
To Bank A/c	

Thus, it will be seen that in case of dishonour, the party which gave the bill has to be debited (because he has become liable to pay the amount). The credit entry is in Bills Receivable Account (if it was retained) or the Creditor or the bank (if it was endorsed/dischonoured in their favour).

## 1.5 TERM OF A BILL

The term of bill of exchange may be of any duration. Usually the term does not exceed 90 days from the date of the bill.

- ◆ When a bill is drawn **after sight**, the term of the bill begins to run from the date of 'sighting', i.e., when the bill is accepted.
- ◆ When a bill is drawn **after date**, the term of the bill begins to run from the date of drawing the bill.

## 1.6 EXPIRY / DUE DATE OF A BILL

The date on which the term of the bill terminates is called as 'Expiry/Due Date of the bill'.

## 1.7 DAYS OF GRACE

Every instrument payable otherwise than on demand is entitled to three days of grace.

## 1.8 DATE OF MATURITY OF BILL

The date which comes after adding three days to the expiry/due date of a bill, is called the date of maturity.

The maturity of a promissory note or bill of exchange is the date at which it falls due. Every promissory note or bill of exchange gets matured on the third day after the day on which it is expressed to be payable, except when it is expressed to be payable:

- (i) on demand,
- (ii) at sight, or
- (iii) on presentment

## 1.9 BILL AT SIGHT

Bill at Sight means the instruments in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note or bill of exchange is payable on demand-

- (a) when no time for payment is specified, or
- (b) when it is expressed to be payable on demand, or at sight or on presentment.

### **Notes:**

- (i) *'At sight' and 'presentment' means on demand.*
- (ii) *An instrument payable on demand may be presented for payment at any time.*
- (iii) *Days of grace is not to added to calculate maturity for such types of bill.*

## 1.10 BILL AFTER DATE

Bill after date means the instrument in which time for payment is mentioned. A promissory note or bill of exchange is a time instrument when it is expressed to be payable-

- (a) after a specified period.
- (b) on a specific day
- (c) after sight
- (d) on the happening of event which is certain to happen

### **Notes:**

- (i) *The expression 'after sight' means-*
  - (a) *in a promissory note, after presentment for sight*
  - (b) *in a bill of exchange, after acceptance or noting for non-acceptance or protest for non-acceptance.*
- (ii) *A cheque cannot be a time instrument because the cheque is always payable on demand. Though a cheque can be post dated and which can be presented on or after such date. A cheque has validity of 90 days from its date after that it becomes void, normally termed as 'Stale Cheque' as bank will not honour such cheque.*

## 1.11 HOW TO CALCULATE DUE DATE OF A BILL

The due date of each bill is calculated as follows:

Case	Due Date
(a) When the bill is made payable on a specific date.	(a) That specific date will be the due date.
(b) When the bill is made payable at a stated number of months(s) after date.	(b) That date on which the term of the bill shall expire will be the due date. <b>Note:</b> The term shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month. For example a bill signed on January 31st payable after 3 months will be due on April 30th.
(c) When the bill is made payable at a stated number of days after date.	(c) That date which comes after adding stated number of days to the date of bill, shall be the due date. <b>Note:</b> The date of Bill is excluded.
(d) When the due date is a public holiday.	(d) The preceding business day will be the due date.
(e) When the due date is an emergency/du unforeseen holiday.	(e) The next following day will be the date.

**Note:** The term of a **Bill after sight** commences from the date of acceptance of the bill whereas the term of a **Bill after date** commences from the date of drawing of bill.

## 1.12 NOTING CHARGES

It is necessary that the fact of dishonour and the causes of dishonour should be established. If the acceptor can prove that the bill was not properly presented to him for payment, he may escape liability. Therefore, if there is dishonour, or fear of dishonour, the bill will be given to a public official known as "**Notary Public**". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But if the bill is dishonoured they will note the fact of dishonour, with the reasons and give the bill back to their client. For this service they charge a small fee. This fee is known as **noting charges**. The amount of noting charges is recoverable from the party which is responsible for dishonour.

Suppose X received from Y a bill for ₹1,000. On Maturity the bill is dishonoured and ₹10 is paid as noting charges. The entry in this case will be

		₹	₹
Y	Dr.	1,010	
	To Bills Receivable Account		1,000
	To Bank A/c		10



Suppose X had endorsed this bill in favour of Z. In that case entry for dishonoured bill would have been

Y	Dr.	1,010	
To Z			1,010

This is because Z will claim ₹1,010 from X and X has the right of recovering ₹1,010 from Y. Similarly, if the bill has been discounted with a bank, entry will be :

Y	Dr.	1,010	
To Bank A/c			1,010

### 1.13 RENEWAL OF BILL

Sometimes the acceptor is unable to pay the amount and he himself moves that he should be given extension of time and in consideration agrees to bear interest for the extended time period (calculated from the date of renewal till the date of expected settlement). In such a case a new bill will be drawn and the old bill will be cancelled. If this happens entries should be passed for cancellation of the old bill. This is done exactly as already explained for dishonour. When the new bill is received entries for the receipt of the bill will be repeated. The amount of the new bill may represent any of the following:

- (i) *Where the drawee pays nothing:* Total of amount of original bill as well as the interest for the extended time period.
- (ii) *Where the drawee pays the interest amount at the time of renewal:* Amount of the Original bill.
- (iii) *Where the drawee makes part payment of the original bill or interest amount or both:* That part of total of amount of original bill as well as the interest for the extended time period on unpaid amount.

### 1.14 RETIREMENT OF BILLS OF EXCHANGE & REBATE

We have seen that renewal of a bill of exchange is made when a person does not have sufficient fund to pay for the bill of exchange on the due date and he requires a further period of credit. Many a time instances do arise when the acceptor has spare funds much before the maturity date of the bill of exchange accepted by him. In such circumstances he approaches the payee of the bill of exchange and asks him whether the payee is prepared to accept cash before the maturity date. In such cases the acceptor gets a certain **rebate** or interest or discount for premature payment. The rebate becomes the income of the acceptor and expense of the payee. It is a consideration of premature payment.

#### ILLUSTRATION 1

*Vijay sold goods to Pritam on 1st September, 2016 for ₹1,06,000. Pritam immediately accepted a three months bill. On due date Pritam requested that the bill be renewed for a fresh period of two months. Vijay agrees provided interest at 9% was paid immediately in cash. To this Pritam was agreeable. The second bill was met on due date. Give Journal entries in the books of Vijay and Pritam.*

**SOLUTION**

**Books of Vijay  
Journal**

2016			₹	₹
1-Sept.	Pritam To Sales Account (Sales of goods to Pritam as per Invoice No...)	Dr.	1,06,000	1,06,000
	Bills Receivable Account To Pritam (3 months acceptance received from Pritam for the amount due from him)	Dr.	1,06,000	1,06,000
Dec. 4	Pritam To Bills Receivable Account (Pritam acceptance cancelled because of renewal)	Dr.	1,06,000	1,06,000
	Pritam To interest (Interest @ 9% on ₹1,06,000 due from Pritam for 2 months because of renewal)	Dr.	1,590	1,590
	Bills Receivable Account Cash Account To Pritam [New acceptance for 2 months for ₹106,000 and Cash (for interest) received from Pritam]	Dr. Dr.	1,06,000 1,590	1,07,590
	Cash Account To Bills Receivable Account (Cash received against Pritam's second acceptance)	Dr.	1,06,000	1,06,000
2017 Feb. 7				

**Books of Pritam  
Journal**

2016			₹	₹
1-Sept.	Purchase Account To Vijay A/c (Purchase of goods from Vijay as per Invoice No...)	Dr.	1,06,000	1,06,000
	Vijay A/c To Bills Payables Account (3 months acceptance given to Vijay for the amount)	Dr.	1,06,000	1,06,000

Dec. 4	Bills Payable Account To Vijay A/c (Cancellation of bill because of renewal)	Dr.	1,06,000	1,06,000
	Interest Account To Vijay (Interest @ 9% on ₹1,06,000 due to Vijay for 2 months because of renewal)	Dr.	1,590	1,590
	Vijay Account To Cash Account To Bills Payable Account [New acceptance for 2 months for ₹106,000 and Cash (for interest) paid to Vijay]	Dr.	1,07,590	1,590 1,06,000
2017 Feb. 7	Bills Payable Account To Bank Account (Cash paid against second bill)	Dr.	1,06,000	1,06,000

### ILLUSTRATION 2

On 1st January, 2016, Ankita sells goods for ₹5,00,000 to Bhavika and draws a bill at three months for the amount. Bhavika accepts it and returns it to Ankita. On 1st March, 2016, Bhavika retires her acceptance under rebate of 12% per annum. Record these transactions in the journals of Ankita and Bhavika.

### SOLUTION

#### Journal Entries in the books of Ankita

Date	Particulars		₹	₹
Jan. 1	Bhavika's account To Sales account (Being the goods sold to Bhavika on credit)	Dr.	5,00,000	5,00,000
	Bills receivable account To Bhavika's account (Being the acceptance of bill received)	Dr.	5,00,000	5,00,000
1-Mar	Bank account Rebate on bills account To Bills receivable account (Being retirement of bill by Bhavika one month before maturity, the rebate being given to her at 12% p.a.)	Dr. Dr.	4,95,000 5,000	5,00,000

## Journal Entries in the books of Bhavika

Date	Particulars		₹	₹
2016				
Jan. 1	Purchases account Dr. To Ankita account (Being the goods purchased from Ankita on credit)		5,00,000	5,00,000
	Ankita Account Dr. To Bills Payable Account (Being the acceptance of bill)		5,00,000	5,00,000
1-Mar	Bills Receivable Account Dr. To Rebate Income Account To Bills receivable account (Being retirement of bill one month before maturity, the rebate being received at 12% p.a.)		5,00,000	5,000 4,95,000

 **ILLUSTRATION 3**

Journalise the following transactions in K. Katrak's books.

- (i) Katrak's acceptance to Basu for ₹2,500 discharged by a cash payment of ₹1,000 and a new bill for the balance plus ₹50 for interest.
- (ii) G. Gupta's acceptance for ₹4,000 which was endorsed by Katrak to M. Mehta was dishonoured. Mehta paid ₹20 noting charges. Bill withdrawn against cheque.
- (iii) D. Dalal retires a bill for ₹2,000 drawn on him by Katrak for ₹10 discount.
- (iv) Katrak's acceptance to Patel for ₹5,000 discharged by Patel. Mody's acceptance to Katrak for a similar amount.

 **SOLUTION**

**Books of K. Katrak**  
**Journal Entries**

			₹	₹
(i)	Bills Payable Account Dr. Interest Account Dr. To Cash A/c To Bills Payable Account (Bills Payable to Basu discharged by cash payment of ₹1,000 and a new bill for ₹1,550 including ₹50 as interest)		2,500 50	1,000 1,550

(ii)	(a) G. Gupta To M. Mehta (G. Gupta's acceptance for ₹4,000 endorsed to M. Mehta dishonoured, ₹20 paid by M. Mehta as noting charges)	Dr.	4,020	4,020
	(b) M. Mehta To Bank Account (Payment to M. Mehta on withdrawal of bill earlier received from Mr. G. Gupta)	Dr.	4,020	4,020
(iii)	Bank Account	Dr.	1,990	2,000
	Discount Account To Bills Receivable Account (Payment received from D. Dalal against his acceptance for ₹2,000. Allowed him a discount of ₹10)	Dr.	10	
(iv)	Bills Payable Account To Bills Receivable Account (Bills Receivable from Mody endorsed to Patel in settlement of bills payable issued to him earlier)	Dr.	5,000	5,000

**ILLUSTRATION 4**

On 1st January, 2016, Vilas draws a bill of exchange for ₹10,000 due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2016 Eknath retires the bill of exchange at a discount of 12% p.a. You are asked to show the journal entries in the books of Eknath.

**SOLUTION****Journal entries in the books of Eknath**

Date	Particulars	L.F.	Debit ₹	Credit ₹
Jan. 1	Vilas A/c To Bills Payable A/c (Being the bill draws by him accepted)	Dr.	10,000	10,000
Mar. 4	Bills Payable A/c To Bank A/c To Interest A/c (Discount A/c) (Being retirement of acceptance 1 month before maturity, interest allowed at 12% p.a.)	Dr.	10,000	9,900 100

### ILLUSTRATION 5

On 1st January, 2016, Vilas draws a Bill of Exchange for ₹10,000 due for payment after 3 months on Eknath. Eknath accepts to this bill of exchange. On 4th March, 2016, Eknath retires the bill of exchange at a discount of 12% p.a. You are asked to show the journal entries in the books of Vilas.

### SOLUTION

#### Journal entries in the books of Vilas

Date	Particulars		Debit ₹	Credit ₹
2016 Jan. 1	Bills Receivable A/c To Eknath A/c (Being bill of exchange no . . . drawn on Eknath due for payment on 4th April 2016)	Dr.	10,000	10,000
Mar. 4	Bank A/c Interest A/c (Discount) A/c To Bills Receivable A/c (Being retirement of bill of exchange due for maturity on 4th April, 2016 by Eknath 1 month before maturity, the rebate being given to him at 12% p.a.)	Dr. Dr.	9,900 100	10,000

### 1.15 INSOLVENCY

Insolvency of a person means that he is unable to pay his liabilities. This means that bills accepted by him will be dishonoured. Therefore, when it is known that a person has become insolvent, entry for dishonour of his acceptance must be passed. Later on, something may be received from his estate. When and if an amount is received, cash account will be debited and the personal account of the debtor will be credited. The remaining amount will be irrecoverable and, therefore, should be written off as bad debt. The students should be careful to calculate the amount actually received from an insolvent's estate and amount to be written off only after preparing his account.

In the books of drawee of the bill, the amount not ultimately paid by him due to insolvency, should be credited to **Deficiency Account**.

### ILLUSTRATION 6

Mr. David draws two bills of exchange on 1.1.2016 for ₹6,000 and ₹10,000. The bills of exchange for ₹6,000 is for two months while the bill of exchange for ₹10,000 is for three months. These bills are accepted by Mr. Thomas. On 4.3.2016, Mr. Thomas requests Mr. David to renew the first bill with interest at 18% p.a. for a period of two months. Mr. David agrees to this proposal. On 20.3.2016, Mr. Thomas retires the acceptance for ₹10,000, the interest rebate i.e. discount being ₹100. Before the due date of the renewed bill, Mr. Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate.

You are to give the journal entries in the books of Mr. David.

 SOLUTION

## Journal Entries in the books of Mr. David

2016			(₹)	(₹)
Jan. 1	Bills receivable (No. 1) A/c	Dr.	6,000	
	Bills receivable (No. 2) A/c	Dr.	10,000	
	To Mr. Thomas's A/c			16,000
	(Being drawing of bills receivable No. 1 due for maturity on 4.3.2016 and bills receivable No. 2 due for maturity on 4.4.2016)			
4-Mar	Mr. Thomas's A/c	Dr.	6,000	
	To Bills receivable (No.1) A/c			6,000
	(Being the reversal entry for bill No.1 on agreed renewal)			
4-Mar	Bills receivable (No. 3) A/c	Dr.	6,180	
	To Interest A/c			180
	To Mr. Thomas's A/c			6,000
	(Being the drawing of bill of exchange no. 3 due for maturity on 7.5.2016 together with interest at 18%p.a. in lieu of the original acceptance of Mr. Thomas)			
20-Mar	Bank A/c	Dr.	9,900	
	Discount A/c	Dr.	100	
	To Bills receivable (No. 2) A/c			10,000
	(Being the amount received on retirement of bills No.2 before the due date)			
7-May	Mr. Thomas's A/c	Dr.	6,180	
	To Bills receivable (No. 3) A/c			6,180
	(Being the amount due from Mr. Thomas on dishonour of his acceptance on presentation on the due date)			
7-May	Bank A/c	Dr.	3,090	
	To Mr. Thomas's A/c			3,090
	(Being the amount received from official assignee of Mr. Thomas at 50 paise per rupee against dishonoured bill)			
May 7	Bad debts A/c	Dr.	3,090	
	To Mr. Thomas's A/c			3,090
	(Being the balance 50% debt in Mr. Thomas's Account arising out of dishonoured bill written as bad)			

 **ILLUSTRATION 7**

Rita owed ₹1,00,000 to Siriman. On 1st October, 2016, Rita accepted a bill drawn by Siriman for the amount at 3 months. Siriman got the bill discounted with his bank for ₹99,000 on 3rd October, 2016. Before the due date, Rita approached Siriman for renewal of the bill. Siriman agreed on the conditions that ₹50,000 be paid immediately together with interest on the remaining amount at 12% per annum for 3 months and for the balance, Rita should accept a new bill at three months. These arrangements were carried out. But afterwards, Rita became insolvent and 40% of the amount could be recovered from his estate.

Pass journal entries (with narration) in the books of Siriman.

 **SOLUTION**

**In the books of Siriman**  
**Journal Entries**

Particulars	L.F.	₹	₹
Bills Receivable A/c To Rita (Being a 3 month's bill drawn on Rita for the amount due)	Dr.	1,00,000	1,00,000
Bank A/c Discount A/c To Bills Receivable A/c (Being the bill discounted)	Dr. Dr.	99,000 1,000	1,00,000
Rita To Bank A/c (Being the bill cancelled up due to Rita's inability to pay it)	Dr.	1,00,000	1,00,000
Rita To Interest A/c (Being the interest due on ₹ 50,000 @ 12% for 3 months)	Dr.	1,500	1,500
Bank A/c To Rita (Being the receipt of a portion of the amount due on the bill together with interest)	Dr.	51,500	51,500
Bills Receivable A/c To Rita (Being the new bill drawn for the balance)	Dr.	50,000	50,000
Rita To Bills Receivable A/c (Being the dishonour of the bill due to Rita's insolvency)	Dr.	50,000	50,000



Bank A/c	Dr.	20,000	
Bad Debts A/c	Dr.	30,000	
To Rita			50,000
(Being the receipt of 40% of the amount due on the bill from Rita's estate)			

## 1.16 ACCOMMODATION BILLS

Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. Suppose Boss needs finance for three months. In that case he may persuade his friend Kapoor to accept his draft. The bill of exchange may then be taken by Boss to his bank and get it discounted there. Thus, Boss will be able to make use of funds. When the three months period expires, Boss will send the requisite amount to Kapoor and Kapoor will meet the bill. Thus, Boss is able to raise money for his use. If both Boss and Kapoor need money, the same device can be used. Either Boss accepts a bill of exchange or Kapoor does. In either case, the bill will be discounted with the bank and the proceeds divided between the two parties according to mutual agreement. The discounting charges must also be borne by the two parties in the same ratio in which the proceeds are divided. On the due date the acceptor will receive from the other party his share. The bill will then be met. When bills are used for such a purpose, they are known as accommodation bills.

However, it may so happen that the drawer is not able to remit the proceeds to drawee on the due date. In such a case, the drawee may draw a bill on the drawer, and get it discounted with the bank to honour the first bill. If the new drawer (drawee of the first bill) also remits some proceeds of the new bill to new drawee (drawer of the first bill), then the proportion of discount to be borne by the new drawee will be based upon the proceeds remitted as well as the benefit obtained by him on the first bill (i.e., by not paying the amount due to the original drawee on due date).

Entries are passed in the books of two parties exactly in the way already pointed out for ordinary bills. The only additional entry to be passed is for sending the remittance for one party to the other party and also debiting the other party with the shared amount of discount.

### ILLUSTRATION 8

*On 1st July, 2016 Gorge drew a bill for ₹1,80,000 for 3 months on Harry for mutual accommodation. Harry accepted the bill of exchange. Gorge had purchased goods worth ₹1,81,000 from Jack on the same date. Gorge endorsed Harry's acceptance to Jack in full settlement. On 1st September, 2016, Jack purchased goods worth ₹1,90,000 from Harry. Jack endorsed the bill of exchange received from Gorge to Harry and paid ₹9,000 in full settlement of the amount due to Harry. On 1st October, 2016, Harry purchased goods worth ₹2,00,000 from Gorge. Harry paid the amount due to Gorge by cheque. Give the necessary Journal Entries in the books of Harry and Gorge.*



## SOLUTION

**In the books of Harry**  
**Journal Entries**

Date	Particulars	₹	₹
1.7.2016	Gorge's account To Bills payable account (Acceptance of bill drawn by Gorge)	Dr. 1,80,000	1,80,000
1.9.2016	Jack's account To Sales account (Sales made to Jack)	Dr. 1,90,000	1,90,000
1.9.2016	Bills receivable account Bank account Discount account To Jack's account (Acceptance received from Jack's endorsement of bill received from Gorge for ₹ 1,80,000 and ₹ 9,000 received in full settlement of the amount due)	Dr. 1,80,000 Dr. 9,000 Dr. 1,000	1,90,000
1.9.2016	Bills payable account To Bills receivable account (Own acceptance received from Jack's endorsement, cancelled)	Dr. 1,80,000	1,80,000
1.10.2016	Purchase account To Gorge's account (Purchases made from Gorge)	Dr. 2,00,000	2,00,000
	Gorge's account To Bank account (Amount paid to Gorge after adjusting ₹180,000 for accommodation extended to him)	Dr. 20,000	20,000

**In the books of Gorge**  
**Journal Entries**

Date	Particulars	₹	₹
1.7.2016	Purchases Account To Jack Account (Purchase of goods from Jack)	Dr. 1,81,000	1,81,000
1.7.2016	Bills Receivable Account To Harry Account (Acceptance by Harry of bill drawn on him)	Dr. 1,80,000	1,80,000

1.7.2016	Jack's account To Rebate Account To Bills Receivable Account (Harry's bill endorsed to Jack)	Dr.	1,81,000	1,000 1,80,000
1.10.2016	Harry Account To Sales account (Sales to Harry)	Dr.	2,00,000	2,00,000
1.10.2016	Bank Account To Harry account (Amount received from Gorge after adjusting ₹180,000 for accommodation extended by him)	Dr.	20,000	20,000

### ILLUSTRATION 9

For the mutual accommodation of 'X' and 'Y' on 1st April, 2016, 'X' drew a four months' bill on 'Y' for ₹4,000. 'Y' returned the bill after acceptance of the same date. 'X' discounts the bill from his bankers @ 6% per annum and remit 50% of the proceeds to 'Y'. On due date 'X' is unable to send the amount due and therefore 'Y' draws a bill for ₹7,000, which is duly accepted by 'X'. 'Y' discounts the bill for ₹6,600 and sends ₹1,300 to 'X'. Before the bill is due for payment 'X' becomes insolvent. Later 25 paise in a rupee received from his estate.

Record Journal entries in the books of 'X'.

### SOLUTION

#### In the books of X Journal Entries

Date	Particulars		Debit ₹	Credit ₹
1-Apr	Bills receivable account To Y's account (Acceptance received from Y for mutual accommodation)	Dr.	4,000	4,000
1-Apr	Bank account Discount account To Bills receivable account (Bill discounted for ₹ 3,920)	Dr. Dr.	3,920 80	4,000
	Y's account To Cash account To Discount account (Half of proceeds remitted to Y)	Dr.	2,000	1,960 40

Aug. 4	Y's account	Dr.	7,000	
	To Bills payable account			7,000
	(Acceptance given to Y, being unable to remit the due amount)			
	Bank account	Dr.	1300	
	Discount account $\left[ \frac{2,000 + 1,300}{6,600} \times 400 \right]$	Dr.	200	
	To Y's account			1500
(Amount received from Y and discount amount credited to him)				
	Bills payable account	Dr.	7,000	
	To Y's account			7,000
(Acceptance to Y dishonoured because of insolvency)				
	Y account	Dr.	3,500	
	To Bank account			875
	To Deficiency account			2,625
(Amount paid @ 25 paise in a rupee and balance credited to deficiency account as being unable to pay)				

### ILLUSTRATION 10

Anil draws a bill for ₹9,000 on Sanjay on 5th April, 2016 for 3 months, which Sanjay returns it to Anil after accepting the same. Anil gets it discounted with the bank for ₹ 8,820 on 8th April, 2016 and remits one-third amount to Sanjay. On the due date Anil fails to remit the amount due to Sanjay, but he accepts a bill for ₹12,600 for three months, which Sanjay discounts it for ₹ 12,330 and remits ₹ 2,220 to Anil. Before the maturity of the renewed bill Anil becomes insolvent and only 50% was realized from his estate on 15th October, 2016.

Pass necessary Journal entries for the above transactions in the books of Anil.

### SOLUTION

#### In the books of Anil Journal Entries

Date	Particulars		Debit Amount ₹	Credit Amount ₹
2016				
5-Apr	Bills receivable account	Dr.	9,000	
	To Sanjay's account			9,000
(Being acceptance received from Sanjay for mutual accommodation)				
8-Apr	Bank account	Dr.	8,820	
	Discount account	Dr.	180	
	To Bills receivable account			9,000
(Being bill discounted with bank)				



## 1.18 BILLS RECEIVABLE AND BILLS PAYABLE BOOKS

Bills receivable and bills payable books are journals (Day Books) to record in a chronological order the details of bills receivable and bills payable. When large number of bill transactions take place in an organization, it is convenient to maintain these books. Wherein any bill transaction takes place, the same is entered in the Day Books in the first instance. Postings to individual Debtors or Creditors accounts are made from the Day Books. Also totals of bills received or accepted are posted periodically to Bills Receivable Account and Bills Payable Account respectively.

Bills receivable book and bills payable book are very useful for following up the status of outstanding bills. When there are large number of bills and these bills fall due on different dates, some of these bills may not be honoured on maturity due to varied reasons. It is possible from these Day Books to trace the details of the outstanding bills and to identify the reasons for not honouring the bills. Given below are forms of Day Books for both bills receivable and bills payable:

### Bills Receivable Book (Folio No . . .)

Date of receipt	Voucher No.	Party from whom Received	Acceptor	Date of Bill	Due Date	Place of Payment	Amt. ₹	L.F.	Mode of Disposal

### Bills Payable Book (Folio No . . .)

Date of Acceptance	Drawer	Payee	Date of Bill	Due Date	Place of Payment	Amt. ₹	L.F.	Mode of Disposal



## SUMMARY

- ◆ 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”.
- ◆ A promissory note is an instrument in writing, not being a bank note or 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. Under Section 31(2) of the Reserve Bank of India Act a promissory note cannot be made payable to bearer.
- ◆ A party which receives a Promissory Note or receives an accepted Bill of Exchange will treat it as a new asset under the name of Bills receivable. A party which issues a Promissory Note or accepts a Bill of Exchange will treat it as new liability under the heading of Bills Payable.

 ... **TEST YOUR KNOWLEDGE****Multiple Choice Questions**

- On 1.1.2017, A draws a bill on B for ₹1,20,000 for 3 months' maturity date of the bill will be:  
(a) 1.4.2017 (b) 3.4.2017 (c) 4.4.2017
- On 16.6.2016 P draws a bill on Q for ₹1,25,000 for 30 days. 19th July is a public holiday, maturity date of the bill will be:  
(a) 19th July (b) 18th July (c) 17th July
- PQ draws a bill on XY for ₹130,000 on 1.1.2017. X accepts the same on 4.1.2017 for period of 3 months after date. What will be the maturity date of the bill:  
(a) 4.4.2017 (b) 3.4.2017 (c) 7.4.2017
- A draws a bill on B. A endorsed the bill to C. The payee of the bill will be  
(a) A (b) B (c) C
- A bill of ₹ 120,000 was discounted by Saras with the banker for ₹1,18,800. At maturity, the bill returned dishonoured, noting charges ₹ 200. How much amount will the bank deduct from Saras's bank balance at the time of such dishonour?  
(a) ₹1,20,000 (b) ₹1,18,800 (c) ₹1,20,200
- X draws a bill on Y for ₹300,000 on 1.1.2016 for 3 months after sight, date of acceptance is 6.1.2016. Maturity date of the bill will be:  
(a) 8.4.2016 (b) 9.4.2016 (c) 10.4.2016
- X sold goods to Y for ₹ 5,00,000. Y paid cash ₹4,30,000. X will grant 2% discount on balance, and Y request X to draw a bill for balance, the amount of bill will be:  
(a) ₹ 98,000 (b) ₹ 68,000 (c) ₹ 68,600
- On 1.1.2017, X draws a bill on Y for ₹ 5,00,000 for 3 months. X got the bill discounted 4.1.2017 at 12% rate. The amount of discount on bill will be:  
(a) ₹ 15,000 (b) ₹ 16,000 (c) ₹ 18,000
- Mr. Jay draws a bill on Mr. John for ₹ 3,00,000 on 1.1.2017 for 3 months. On 4.2.2017, John got the bill discounted at 12% rate. The amount of discount will be:  
(a) ₹ 9,000 (b) ₹ 6,000 (c) ₹ 3,000
- XZ draws a bill on YZ for ₹ 2,00,000 for 3 months on 1.1.2017. The bill is discounted with banker at a charge of ₹1,000. At maturity the bill return dishonoured. In the books of XZ, for dishonour, the bank account will be credited by:  
(a) ₹199,000 (b) ₹ 200,000 (c) ₹ 201,000

11. On 1.1.2017, XA draws a bill on YB for ₹ 1,00,000. At maturity YB request XA to renew the bill for 2 month at 12% p.a. interest. Amount of interest will be:
- (a) ₹ 2,000      (b) ₹ 1,500      (c) ₹ 1,800
12. A bill of exchange is drawn by a
- (a) Creditor      (b) Debtor      (c) Debenture holder
13. At the time of drawing a bill, the drawer credits
- (a) Bills Receivables A/c  
(b) Bills Payable A/c  
(c) Debtor's A/c
14. A promissory note is made by a
- (a) Seller      (b) Purchaser      (c) Endorsee
15. A bill of exchange contains
- (a) An unconditional order  
(b) A promise  
(c) A request to deliver the goods
16. A promissory note contains
- (a) An unconditional order  
(b) A promise  
(c) A request to deliver the goods
17. The rebate on the bill shows that
- (a) It has been endorsed  
(b) It has been paid after the date of maturity  
(c) It has been paid before the date of maturity
18. Notary Public may charge his fee from the
- (a) Holder of bill of exchange  
(b) Drawer  
(c) None

### Theory Questions

- Q1. Write short notes on:
- (a) Accommodation bill.



- (b) Renewal of bill.
- (c) Noting charges.

Q2. What is bill of exchange? How does it differ from Promissory Note?

### Practical Questions

- Q1 On 1st January, 2016, A sells goods for ₹10,000 to B and draws a bill at three months for the amount. B accepts it and returns it to A. On 1st March, 2016, B retires his acceptance under rebate of 12% per annum. Record these transactions in the journals of B.
- Q2 A draws upon B three Bills of Exchange of ₹ 3,000, ₹ 2,000 and ₹ 1,000 respectively. A week later his first bill was mutually cancelled, B agreeing to pay 50% of the amount in cash immediately and for the balance plus interest ₹100, he accepted a fresh Bill drawn by A. This new bill was endorsed to C who discounted the same with his bankers for ₹1,500. The second bill was discounted by A at 5%. This bill on maturity was returned dishonoured (nothing charge being ₹30). The third bill was retained till maturity when it was duly met.

Give the necessary journal entries recording the above transactions in the books of A.

Q3 Journalize the following in the books of Don:

- (i) Bob informs Don that Ray's acceptance for ₹ 3,000 has been dishonoured and noting charges are ₹ 40. Bob accepts ₹ 1,000 cash and the balance as bill at three months at interest of 10%. Don accepts from Ray his acceptance at two months plus interest @ 12% p.a.
- (ii) James owes Don ₹ 3,200; he sends Don's own acceptance in favour of Ralph for ₹ 3,160; in full settlement.
- (iii) Don meets his acceptance in favour of Singh for ₹ 4,500 by endorsing John's acceptance for ₹ 4,450 in full settlement.
- (iv) Ray's acceptance in favour of Don retired one month before due date, interest is taken at the rate of 6% p.a.

### ANSWERS/HINTS

#### MCQs

- |    |     |    |     |    |     |    |     |    |     |    |     |
|----|-----|----|-----|----|-----|----|-----|----|-----|----|-----|
| 1  | (c) | 2  | (b) | 3  | (a) | 4  | (c) | 5  | (c) | 6  | (b) |
| 7  | (c) | 8  | (a) | 9  | (b) | 10 | (b) | 11 | (a) | 12 | (a) |
| 13 | (c) | 14 | (b) | 15 | (a) | 16 | (b) | 17 | (c) | 18 | (a) |

### Theoretical Questions

- 1 (a) Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. When bills are used for such a purpose, they are known as accommodation bills.
- (b) When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, then he may request the drawer to cancel the original bill and draw on him a fresh bill for another period. And if the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period. This is called the renewal of bill.

(c) The charges paid to Notary public for notify the dishonour are noting charges. Refer para 1.12 for details.

- 2 A bill of exchange has been 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 certain person or to the bearer of the instrument”. When such an order is accepted by the drawee, it becomes a valid bill of exchange. A promissory note is an instrument in writing (not being a bank note or a government 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.

A promissory note needs no acceptance, as the debtor himself writes the document promising to pay the stated amount. Like bills of exchange, promissory notes are also negotiable instruments, and can be transferred by endorsement. In case of bill of exchange, the drawer and the payee may be the same person but in case of a promissory note, the maker and the payee cannot be the same person.

### Practical Questions

#### Answer 1

#### Journal Entries in the books of B

Date	Particulars	Debit ₹	Credit ₹
2016 Jan. 1	Purchases account Dr. To A's account (Being the goods purchased from A on credit)	10,000	10,000
	A's account Dr. To Bills payable account (Being the acceptance of bill given to A)	10,000	10,000
1-Mar	Bills payable account Dr. To Bank account To Rebate on bills account (Being the bill discharged under rebate @ 12% p.a.)	10,000	9,900 100

#### Working Note :

Calculation of rebate:

$$10,000 \times 12/100 \times 1/12 = ₹100$$

## Answer 2

## Journal of A

		₹	₹
Bills Receivable A/c	Dr.	6,000	
To B			6,000
(Three bills for ₹3,000, ₹2,000 and ₹1,000 drawn on B and duly accepted by him received)			
B	Dr.	3,000	
To Bills Receivable A/c			3,000
(Bill received from B cancelled for renewal)			
Cash Account	Dr.	1,500	
Bill Receivable Account	Dr.	1,600	
To B			3,000
To Interest Account			100
(Amount received on cancellation of the first bill, 50% along with a new bill for 50% of the amount plus interest ₹100)			
C	Dr.	1,600	
To Bills Receivable A/c			1,600
(A's acceptance endorsed in favour of C)			
Bank A/c	Dr.	1,900	
Discount A/c	Dr.	100	
To Bills Receivable A/c			2,000
(Second Bill for ₹ 2,000 discounted with the bank @ 5%)			
B	Dr.	2,030	
To Bank A/c			2,030
(Second Bill for ₹2,000 discounted with the Bank dishonoured, noting charges ₹30 paid by the Bank)			
Bank A/c	Dr.	1,000	
To Bills Receivable A/c			1,000
(Amount received on maturity of the third bill)			

**Note:** It is assumed that the bill for ₹1,600 has not yet fallen due for payment.

## Answer 3

## Books of Don

			₹	₹
(i)(a)	Ray To Bob (Ray's acceptance endorsed to Bob dishonoured on due date nothing charges paid by Bob ₹40)	Dr.	3,040	3,040
(b)	Bob Interest To Cash To Bills Payable A/c (Amount payable to Bob ₹3,040 settled by cash payment ₹1,000 and issue of new bill for ₹2,091 including interest ₹ 51 for three months on ₹2,040 @ 10% p.a.)	Dr. Dr.	3,040 51	1,000 2,091
(c)	Bills Receivable A/c To Ray To Interest (Bill received from Ray for ₹3,040 due against earlier acceptance dishonoured plus ₹ 60.80 interest for two months @ 12% p.a.)	Dr.	3,100.80	3,040.00 60.8
(ii)	Bills Payable A/c Discount A/c To James (Cancellation of bills payable to Ralph for ₹3,160 in settlement of ₹3,200 due from James)	Dr. Dr.	3,160 40	3,200
(iii)	Bills payable A/c To Bills Receivable A/c To Discount A/c (Settlement of acceptance issued to Mr. Singh by endorsement of John's Acceptance for ₹4,450)	Dr.	4,500	4,450 50
(iv)	Bank A/c Discount A/c Total Bills Receivable A/c (Amount received from Ray in settlement of Bills Payable, retired one month before due date)	Dr. Dr.	3,085.30 15.5	3,100.80