



Module-A Unit-8

JAIIB PAPER-3

Accounting & Financial Management for Bankers(AFM)



JAIIB AFM Module A Unit 8- Bills of Exchange

Types of Instruments of Credit

In a business, credit transactions play very important role. For manufacturing goods, manufacturer purchases raw materials, the majority of which will be on credit.

Credit may also be granted by a moneylender, a banker or financial institution. Credit is, generally, provided by obtaining, a written document called '**Instrument of Credit**'. The serves as a proof of existence of credit.

- Bills of Exchange
- Promissory Notes

Bills of Exchange

- **Drawer:** A person who draws the bill.
- **Drawee:** A person on whom the bill is drawn
- **Payee:** A person who is going to receive money.

Features of Bills of Exchange

- A bill of exchange an instrument in writing.
- It is drawn and signed by the maker i.e. drawer of the bill.
- Contains an unconditional order to a person i.e. drawee.
- The specified amount is payable to the person whose name is mentioned in the bill or to his order or to the bearer.
- It specifies the date by which amount should be paid. (Section 5 of Negotiable Instrument Act).
- Payment of the bill must be in the legal currency of the country.
- It must be properly stamped.
- It must bear a revenue stamp.

Bills of Exchange Example

Mr. Abhinav srivastav draws a bill on Ms. Alpa jha for 3 months for ₹ 50,000, payable to Mr. Niraj kumar or his order on 15th April 2019.

Mr. Abhinav srivastav has ordered Ms. Alpa jha to pay ₹ 50,000 to Mr. Niraj kumar. If the order is acceptable to Ms. Alpa jha, he will write across the bill as follows:

Accepted

Ms. Alpa jha

Sector 56, Noida, UP

17th April 2019

When the drawee writes such acceptance on the bill, it becomes a bill of exchange. In the above example Mr. Abhinav srivastav is the drawer of the bill, Ms. Alpa jha is the acceptor and Mr. Niraj kumar is the Payee. Ms. Alpa jha will pay the amount to Mr. Niraj kumar.

Promissory Notes

A written undertaking by the buyer to make a payment on a specified date can take the form of a bill of exchange or a promissory note. We have seen earlier that a bill of exchange is drawn by the creditor and accepted by the debtor. A promissory notes, on the other hand, is written by the debtor (buyer) promising the creditor (seller) to pay a specified sum after a specified period. Thus, it can be defined as:

Features of Promissory Notes

- An instrument in writing
- Containing an unconditional undertaking
- Signed by the maker to pay a certain sum of money
- To or to the order of a certain person or the bearer of the instrument (section 4 of the Negotiable instrument Act)

In a case of Promissory notes, there are two parties:

- **Maker:** A person who makes the note and promises to make the payment.
- **Payee:** A person who is to receive money.

Or

- **The holder:** A holder is basically the person who holds the notes. He may be either the payee or some other person.

Essential Elements of a Promissory Note

- Written notes
- Express undertaking
- Unconditional promise
- Specific amount
- Legal tender

Example:

Promissory Note	
<u>Amount</u>	<u>Date</u>
<div style="border: 1px solid black; width: 100px; height: 20px; margin: 0 auto; display: flex; align-items: center; justify-content: center;">Stamp</div>	
<u>Term</u> months after date, I promise to pay _____ or order, The sum of _____, for value received.	
<u>Signature</u> <u>Name of Maker</u> <u>Address of Maker</u>	

Difference between Bills of Exchange and Promissory Note

Bills of Exchange	Promissory Notes
It is an unconditional order to pay	It is an unconditional promise to pay.
It is made by a creditor.	It is made by a debtor.
Acceptance by debtor is necessary	No acceptance is required
On dishonor of a bill, it is usually noted by the notary Public.	Nothing is not necessary.

Cheque

Essential Features of cheque

- A cheque must have to fulfill all the essential elements of a bill of exchange.
- It must be payable to bearer or to order but in either case, it must be payable on demand.
- The banker named pays it when it is presented for payment.
- The signature must tally with the specimen sign of the drawer kept in the bank
- A cheque must be dated.
- A cheque drawn with a future is valid but the same is payable on or after such specified period.

Difference between Bills of Exchange and Cheque

Bills of Exchange	Cheque

A bill of exchange can be drawn upon any person including a bank.	A cheque can be drawn only upon a bank.
A bill of exchange requires acceptance.	A cheque does not requires any acceptance
The acceptor of a bill of exchange is allowed three days of grace after the date maturity of the bill.	A cheque is always payable on demand
Notice of dishonor is necessary	Notice does not requires any stamp.
A bill of exchange must be stamped	A cheque does not require any stamp.

Term And Due Date Of A Bill

Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment matures on the date it falls due. This period of a bill is **called 'Term' or 'Tenor' of the bill**. The date of maturity in such cases is calculated after adding three days of grace to the actual period of the bill. Let us suppose, a bill is drawn on 1st March for a period of one month, then, its due date will be 1st April plus three days of grace, i.e. 4th April. If the due date falls on a public holiday say 26th January, then it becomes due on the previous working day, i.e. 25th January.

Accommodation Bill

Accommodation Bills are drawn and accepted with no consideration passed or received. The Bill, which is drawn just to oblige a friend, who is in need of money, of course without any trading activities, with sole intention of raising funds required for ready cash is known as Accommodation Bill.

The accommodating party, i.e., the drawee accepts the Bill drawn by the accommodated party (drawer). That is the Drawer of the accommodation bill can be called accommodated party and drawee can be called accommodating party. After the Bill is accepted, the drawer discounts it with a bank and obtains the cash.

Before the due date of the Bill, Drawer provides funds to the Acceptor, who honours the Bill. Since the acceptance is given without consideration and to help the accommodated party to raise the funds, the accommodated party has to discharge the Bill by himself or provide funds to accommodating party.

Thus, there is always a mutual understanding between the parties and hence, **these bills are called Accommodation Bills.**

Example:

Mr. A accepted a bill for Rs 20,000 drawn by B to enable the latter to raise funds at three months on 1st October 2004. The bill was duly discounted by B at their Bank at 6% per annum. On the due date B remitted the amount to the acceptor and the Bill was duly met. Pass journal entries in the books of both the parties.

SOLUTION

B's Journal				A's Journal				
			Rs	Rs		Rs	Rs	
2004 Oct. 1	Bills Receivable Account To A Account (Being Bill drawn on A for 3 months)	Dr	20,000	20,000	B Account To Bills Payable Account (Being acceptance of Bill drawn by B)	Dr	20,000	20,000
Oct. 2	Cash Account Discount on Bills Account To Bills Receivable (Being Bill discounted at 6% p.a.)	Dr Dr	19,700 300	20,000	NO ENTRY			
2005 Jan. 4	A Account To Cash Account (Being amount paid to A to meet the Bill on the due date)	Dr	20,000	20,000	Cash Account To B Account (Being cash received from B to honour the Bill)	Dr	20,000	20,000
Jan. 4	NO ENTRY				Bills Payable Account To Cash Account (Being bill honoured on maturity)	Dr	20,000	20,000

Discount: $20,000 \times 6/100 \times 3/12 = \text{Rs } 300$

Bill Books

Two types of Bill Books

- Bills Receivable Book
- Bills Payable Book

Bills Receivable Book

Bills receivable book is a book where all the bills, which are received, are recorded and posted directly to the credit of respective customer's account from there. The total amount of bills so received during the period, either at the end of the week or month, is to be posted to, in one lump sum, to the debit of the bills receivable account. **The usual form of bills receivable book, with imaginary figures is shown below.**

N o.	Date of Receipt	From whom	Acceptor	Date of bill	Term	Date due	Where payable	Amount	L. F	How Disposed off	Remarks
1	1/1/20	A	A	1/1/20	1 month	1/1/20	Delhi	4000	-	-	-

Bills Payable Book

This is a book where all particular relating to the bills accepted are recorded and , posted from there, directly to the debit of the respective creditor's account. The total amount of the bills so accepted during the period, either at end of the week or month, is

to be posted in one lump sum to the credit of bills payable account. **The usual form of 'Bill payable book' with imaginary figures,**

N o.	Date of Receipt	Drawn by	Payee	Date of bill	Term	Date due	Where payable	Amount	L. F	How Disposed off	Remarks
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Important Terms

- **Honouring of Bill:** When the drawee pays the amount of the bill on due date, the bill is said to be 'Honoured Bills'.
- **Dishonour of Bill:** When the drawee does not pay the amount of the bill on due date, the bill is said to be 'Dishonoured Bills'.
- **Discounting of Bills:** The drawer may discount the bill with the bank before the due date. The bank charges discounting charges from the drawer at a certain rate.

Thus, at the time of discounting the bank deposits the net amount after charging such amount of discount in the account of the holder of the bill.

Discount = Amount of bill

× Rate of interest × discount / 100 × Remaining period to maturity / 12

- **Endorsement of bills:** Transfer of bill to some other person by the holder.
- **Retirement of bills:** When a drawee pays the bill before its due date. It is called retirement of bill.
- **Renewal of bill:** Renewal of bill of exchange is an act of cancellation of old bill before its maturity in return of a new bill, including interest, for an extended period. It is done by drawer on request of drawee.
- **Accommodation of bill:** An accommodation bill is a bill of exchange signed for by a person (the accommodation party) acting as a guarantor. The accommodation party is liable for the bill should the acceptor fail to pay at maturity. Accommodation bills are sometimes also referred to as windbills or windmills.
- **Notary Public:** A notary public of the common law is a public officer constituted by law to serve the public in non-contentious matters usually concerned with estates, deeds, powers-of-attorney, and foreign and international business.
- **Rebate:** When a bill is paid by drawee before due date, some allowance is given to him. This allowance is called 'Rebate'.

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