

## **NEGOTIABLE INSTRUMENTS**

"Negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer. The negotiable instrument in India is governed by the Negotiable Instrument Act 1881.

### **Act How enacted in India.**

The Act was originally drafted in 1866 by the India Law Commission and introduced in December, 1867 in the Council and it was referred to a Select Committee. Objections were raised by the mercantile community to the numerous deviations from the English Law which it contained. The Bill had to be redrafted in 1877. After the lapse of a sufficient period for criticism by the Local Governments, the High Courts and the chambers of commerce, the Bill was revised by a Select Committee. In spite of this Bill could not reach the final stage. In 1880 by the Order of the Secretary of State, the Bill had to be referred to a new Law Commission. On the recommendation of the new Law Commission the Bill was re-drafted and again it was sent to a Select Committee which adopted most of the additions recommended by the new Law Commission. The draft thus prepared for the fourth time was introduced in the Council and was passed into law in 1881 being the Negotiable Instruments Act, 1881.

What is the need for these instruments?

Within the growth in the economy, commercial activities increased to a great extent. The growing demands for money could not be met by mere supply of currencies and coins and the instrument of credit took the function of money which they represented.

It is quite often that, in business goods are sold on credit basis. In such a situation, the seller may want that the buyer should give a promise or undertaking in writing that the amount will be paid on a certain date. This written promise is normally called as hundi. If the same written instrument is made in

proper form and properly stamped, it is assumed that the buyer paid the debt and the seller collected the payment.

### **Bills of exchange:**

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.

<b>Bill of Exchange</b>	
London, 31 January 2000	Amount US\$ 250,000
At 60 days after sight	pay against this Sole Bill of Exchange
to the order of	Ourselves
the sum of	US Dollars Two hundred and fifty thousand
for value	Received
To:	For and on behalf of:
Singapore Import Banking Company Bank Street Singapore	UK Export Company Ltd
Drawn under UK Export Banking Company Ltd, Documentary Credit Nº 12345, Dated 29 September 1999	<i>James Smith</i> James Smith, Director

### **Parties to the bills of exchange**

1. The drawer: The party who makes the order is known as drawer (**to whom it is bills receivable**)
2. The drawee: The party who accepts the order is known as the drawee or acceptor (**to whom it is bills payable**).
3. **Drawee in case of need:** When the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a "drawee in case of need".
4. **Acceptor for honour:** any person who accepts the bills in order to protect the honour of the drawer or of any one of the endorser, such person is called an "acceptor for "honour".
5. **The payee:** The party to whom the money is paid is known as the payee. The drawer or the payee may be the same person.

### **Features of Bills of exchange:**

1. It must be in writing
2. It must be dated
3. It must contain an order to a person(drawee) to pay certain sum of money
4. The order must be unconditional
5. It must be signed by the maker
6. It must be for a specific sum of money and for a specific period
7. The sum of money must be payable to a person (drawer) or to his order or to the bearer.
8. It must be accepted by the drawee by putting his signature. The acceptance may be general or qualified.

**General acceptance:** when accepted by the drawee without any further conditions.

**Qualified acceptance:** when accepted by the drawee by adding further conditions such as time, place, amount or parties.

### **Types of Bills of exchange:**

It may be trade bill or accommodation bills.

It may also be inland bill or foreign bills

**Trade bill:** When bills are drawn to settle a trade debt owing to the drawer by the drawee, it is known as trade bills.

**Accommodation Bills:** When bills are accepted without any consideration, but just oblige a friend who is temporarily in need of money is known as accommodation bills.

**Tenure of Bills:** The date on which the bills drawn and accepted and the date on which it become due, the intervening period is called the tenure of bills.

Based on tenure bill may

**On demand or at sight bill:** These bills are payable when it is presented to the drawee or acceptor.

**After date and after sight bill:** In case of after date bill, the date is counted from the day on which bill is drawn and in case of after sight bill, the date is counted from the day on which bill is accepted by the drawee.

**Date of maturity:** The date on which the bill is payable is called the date of maturity. It is normal practice in business that three days will be allowed as grace days.

**Public holiday:** When the day on which a bill of exchange is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day.



Bank A/c. Dr.  
Discount A/c. Dr.  
    To Bills receivable A/c.

**5] Before maturity when bill is endorsed in favour of creditor:**

Creditors/endorsee A/c. Dr.  
    To Bills Receivable A/c.

**6] Before maturity when bill is sent to bank for collection:**

Bills sent for collection A/c. Dr.  
    To bills receivable A/c.

**7] When money is collected by bank:**

Bank A/c Dr.  
    To Bills sent for collection A/c.

**How to record these transactions in the books of drawee**

**1] When goods are purchased on credit:**

Purchases A/c. Dr.  
    To Seller or Debtors A/c.

**2] When bill is drawn and accepted:**

Seller or Debtors A/c. Dr.  
    To Bills payable A/c.

**3] When bill is matured and payment made:**

Bills payable A/c. Dr.  
    To Cash A/c. or Bank A/c.

**4] Before maturity when bill is discounted with bank by drawer:**

Bills payable A/c. Dr.  
    To Cash A/c. or Bank A/c.

**5] Before maturity when bill is endorsed in favour of creditor:**

Creditors/endorsee A/c. Dr.

To Bills Receivable A/c.

**6] Before maturity when bill is sent to bank for collection:**

No entries in the books of drawee, he simply the money to the holder of the bill instead of making payment to the drawer

**Problem:** A bill for Rs.45000/- is drawn by Mohan on Ram and accepted by the latter payable at Canara Bank. Show what entries to be recorded in the books of both the parties under each of the following circumstances:

If the bill is retained till the due date and realised money on maturity

If the bill is discounted with banker for Rs.43800/-

If the bill is endorsed in favour of their creditor vardhan

If the bill is sent to bank for collection.

**Dishonour of bills – entries in the books of drawer**

**1] When bill is retained till maturity:**

Drawee A/c.	Dr.
To Bills Receivable A/c.	
To cash A/c.	

**2] When the bill is discounted with the bank:**

Drawee A/c.	Dr.
To Bank A/c.	

**3] When the bill is endorsed:**

Drawee A/c.	Dr.
To Endorsee A/c.	

**4] When the bill is sent for collection:**

Drawee A/c.	Dr.
To Bills sent for collection A/c.	
To Bank A/c.	

**Dishonour of bills – entries in the books of drawer**

Bills Payble A/c.	Dr.
Noting charges A/c.	Dr.
To Supplier A/c.	

**Renewal of Bills:** When the acceptor unable to pay the amount, he may request the drawer to give extra time, in such case, the old bill will be cancelled and a new bill will be drawn in its place.

**Retiring of bills:** When the acceptor wants to settle the amount before the due date of the bill, he can make payments before the due date , such process is called retiring of bills.

### Objective type questions

1] Which of the following is not a negotiable instrument?

A] Bearer cheque	B] Promissory note	C] Crossed Cheque	D] Bills of exchange
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2] Indian currency is a

A] Hundi	B] Promissory note	C] Crossed Cheque	D] Bills of exchange
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3] Ramesh sold goods to Ganesh for Rs.200000/-. Ganesh paid Rs.50000/- Ramesh had given 3% discount on the balance and request Ganesh to draw bill for the balance amount, the bill amount will be

A] 145500/-	B] 150000/-	C] 194000/-	D] 144000/-
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4] Anand draws a bill on Balan for Rs.500000/- on 01/01/2010, Balan accepts the same on 04/01/2010. Period of bill 3 months after date. What will be the due date

A] 05/04/2010	B] 03/04/2010	C] 04/04/2010	D] 07/04/2010
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5] Anand draws a bill on Balan for Rs.500000/- on 01/01/2010, Balan accepts the same on 04/01/2010. Period of bill 3 months after sight. What will be the due date

A] 05/04/2010	B] 03/04/2010	C] 04/04/2010	D] 07/04/2010
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6] Chandran draws bill on David. Chandran endorses the bill to Elango. The payee of the bill will be

A] chandran	B] David	C] Elango	D] None
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7. Fazil draws a bill on Gokul for Rs.250000/- on 01/01/2010 for three months. On 04/03/2010, Fazil discounted the bill @12%. The amount of discount will be

A] 7500/-	B] 30000/-	C] 5000/-	D] 2500/-
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8. Hari discounted a bill of Rs.120000/- with the banker for Rs.118000/-. On maturity the bill is returned dishonoured, noting charges Rs.200/-. How much will bank deduct from hari's account?

A] 120000/-	B] 118000/-	C] 120200/-	D] 119800/-
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9. If the due date of the bill is public holiday, then the due date will be

A] the next day	B] the previous day	C] same day	D] date mutually agreed by both parties
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10. On 01/04/2006, Issac draws a bill on John for Rs.500000/- due for payment after three months. John accepted the bill. On 04/6/2006, John retires the bills at a discount of 12% p.a. What is amount of discount for John for the premature?

A] Rs.10000/-	B] Rs.60000/-	C] Rs.15000/-	D] Rs.5000/-
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11. On 01/05/2011, Kamal draws a bill on Lal for Rs.300000/-. At maturity, Lal request kamal to draw a fresh bill for two months together will 10% interest. Noting charges paid Rs.600/-. The amount of interest will be

A] Rs.2550/-	B] Rs.30000/-	C] Rs.5100/-	D] Rs.5000/-
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12. On 01/7/2011 Mahesh draw a bill on Naresh for Rs.500000/-. At maturity, the bill is returned dishonoured as Naresh become insolvent and 40 paise per rupee is recovered from his estate. The amount recovered is

A] Rs.200000/-	B] Rs.300000/-	C] Rs.0/-	D] Rs.80000/-
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13. The purpose of accommodation bill is

A] for purchase or sale of goods	B] time pass	C] genuine business motive	D] when both the parties in need of funds
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14. For mutual accommodation of Oswin and Praveen, Praveen accepts a bill drawn on him by Oswin for 3 months Rs.600000/-. The bill is discounted at 10% p.a. and remitted half of the proceeds to Praveen. What is the amount remitted?

A] Rs.292500/-	B] Rs.300000/-	C] Rs.270000/-	D] Rs.250000/-
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15. Which of the following is not a foreign bill



- 1] A bill drawn in India on a person residing outside India and made payable outside India  
 2] A bill drawn outside India, on a person residing outside India  
 3] A bill drawn outside India, made payable in India  
 4] A bill drawn on person residing in India and made payable in India.

A] 1	B] 2	C] 3	D] 4
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**ANSWERS**

1] c	2] b	3] a	4]c	5] d	6] c	7] a	8] c	9] b	10] d
11] c	12] a	13] d	14] a	15]d					