

Accounting for Hire Purchase System

Discipline Courses-I

Semester-I

Paper : I

Unit-VII

Lesson: Accounting for Hire Purchase System

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Lesson: Accounting for Hire Purchase System

Table of Contents:

- 1: Learning Outcomes
- 2: Introduction
- 3: Hire Purchase System
- 4: Hire purchase system Vs. Installment system
- 5: Terms used in Hire purchase Agreement
- 6: Calculation of Interest
- 7: Accounting for Hire Purchase
 - 7.1: Cash price method
 - 7.2: Debtor System
 - 7.3: Stock and Debtor System
- 8: Default and Repossession
 - 8.1: Accounting treatment in case of full repossession
 - 8.2: Accounting treatment in case of partial repossession
- 9: Hire purchase trading A/C at cost, at selling price/Debtor System
- 10: Calculation of Missing Figures
- 11: Stock and Debtor System
- 12: Lease
 - Summary
 - Exercises
 - References

1. Learning Outcomes:

After you have read this lesson, you should be able to:

- understand hire purchase system and the process,
- differentiate between hire purchase system and the simple installment system,
- calculate the interest involved in hire purchase system,
- understand the accounting of hire purchase through different methods used in the real world,
- comprehend the process of repossession of goods and its accounting,
- differentiate between the concept of hire purchase and lease.

2. Introduction:

In business one requires different types of resources varying from simple tools to big machineries, men power, land, finance etc. The tools and machinery and such assets may be needed for a temporary period or a very long period. One may have adequate finance to purchase those or may borrow finance for fulfilling the need. But some may neither have adequate finance nor are in the position of borrowing the sum. What alternative is left to them?

They can acquire the asset on rent, on credit, on installment or can go for hire purchase. They simply need to enter into an agreement.

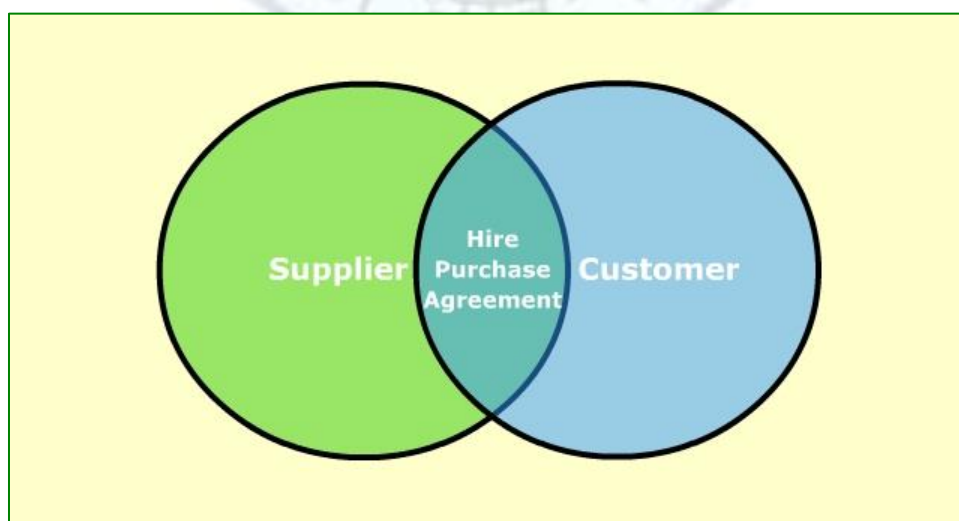
3. Hire Purchase System

Hire purchase system is a method of buying goods or assets in which the purchaser takes the possession as soon as an initial installment of the price is paid but the ownership is obtained only after all the agreed number of subsequent installments are paid. However in case of default, the vendor can take back the possession of goods. It is also relevant to state that the sums paid by the hire purchaser, prior to the repossession of goods by the hire vendor, are treated as hire charges for using the property and the same are never refundable.

The installments include interest and depreciation charges.

A hire purchase agreement differs from a credit-sale agreement and sale by installment because under these transactions ownership passes on signing the contract.

Figure 1: Parties involved in Hire Purchase



Under this method, the purchaser does not need to spend the entire amount in one go or borrow a large amount of money,, rather can procure the right for the immediate use of an asset. It is a financial facility that permits the use of asset in return of regular payments without transferring the ownership. In addition, the hirer acquires the right to buy the asset, after the use of an asset for a particular period on paying a small or nominal amount of money.

Accounting for Hire Purchase System

The acquisition of asset, specifically the expensive capital asset, calls for careful financial planning. There is no point making outright cash payment, but prudent to adopt the ways of spreading the cost over a period of time to match or coincide with that of generation of revenue by business. The hire purchase system is believed to be the most common source of finance for investment in capital assets.

The assets that are suitably financed through this method are like:

- Tools
- Plants and machinery
- Cars
- Commercial vehicles
- Agricultural equipment
- Computers including software packages
- Office equipment, etc.

The system of hire purchase is governed by the Hire Purchase Act 1972. This Act defines a hire purchase as "an agreement under which goods are let on hire and the hirer has an option to purchase them in accordance with the terms and conditions laid in the agreement". The agreement defines very clearly and specifically the terms and conditions to be followed by the hirer and the owner:

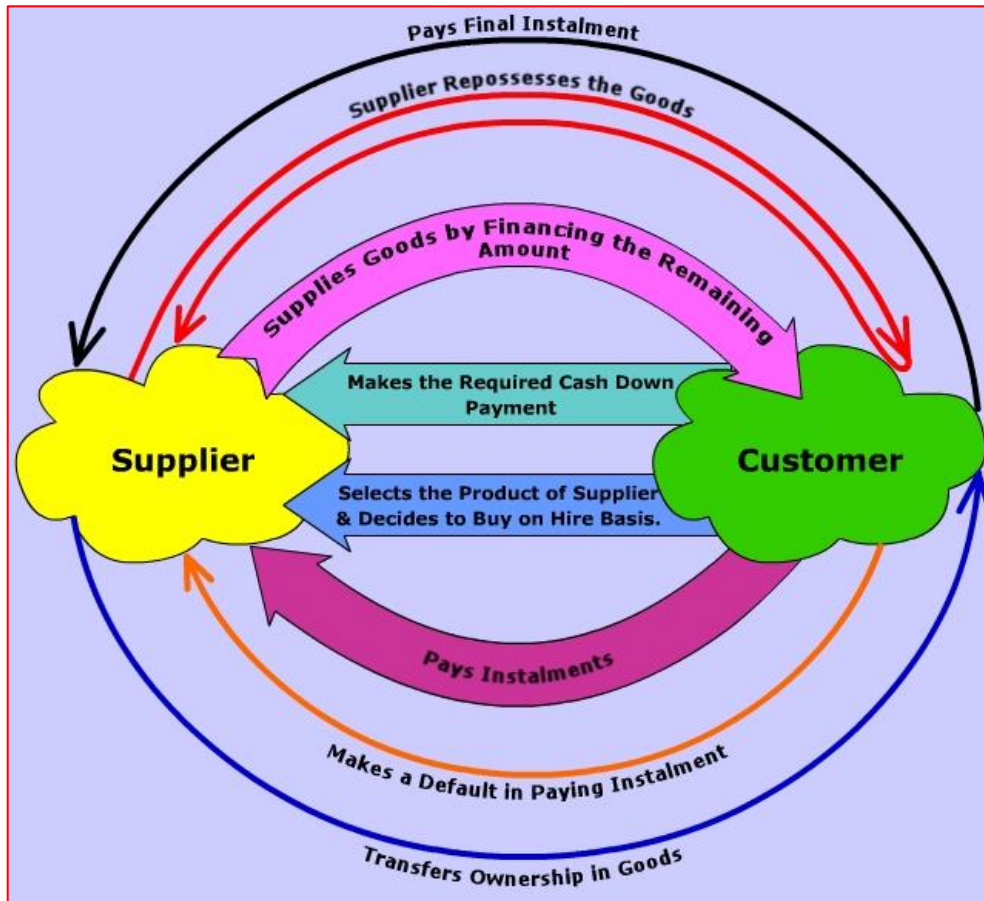
- i) The owner of the goods would pass them to the person who would pay an agreed sum of amount in cash or by cheque as specified or agreed upon, in the specified number of periodic installments;
- ii) The ownership of such goods would pass to such person only after the payment of last installment by the hirer in the manner as agreed upon;
- iii) The hirer has the right to terminate the agreement at any time before the transfer of such property.

Value Addition 1: Did You Know?
Hire Purchase Agreement
In order to avoid the clashes among the involved parties and to make it enforceable at law it is important that the agreement is prepared in accordance with the provisions of the Hire purchase Act 1972.
As per the Act, the hire purchase agreement must specifically contain the date of commencement of the agreement, the hire purchase price, the cash price of the goods, number of installments agreed to be paid, the amount and the date on which the installment is to be paid, the person who has to be paid, the place where it is payable, and the details of the relevant goods.
It should also specify that part of the hire purchase price which is to be paid in the mode other than cash or cheque.
If the agreement is not specifically clear about these details the hirer gets the right of filing a suit for rescinding (cancelling) agreement.
Source: http://www.vakilno1.com/bareacts/hirepurchase/hirepurchaseact.html

The law permits the owner to sell the goods, if they are fit for selling and the hirer had disclosed the particular purpose for which the goods were hired and the hirer returns the goods or he defaults to pay the required installments.

Figure 2: Concept of Hire Purchase

Accounting for Hire Purchase System



There is difference between a hire purchase and a financing option. The figures below make it clear that there are three parties involved in the financing option rather than two in the hire purchase system. The third one is the financier or the banker. Also the process differs in the manner that a substantial part of financing is done by a financier and not by the supplier as in the case of hire purchase. On receiving the down payment from the customer and the financing approval from the banker, the supplier delivers goods to the customer and passes the ownership of title to the financier. The customer keeps paying the installments to the financier. On the payment of the last installment, the ownership in goods is passed to the customer. However, if a default is made in paying the installments, it is the financier who repossesses the goods from the customer as the supplier gets out of picture once he has delivered goods and its title.

Figure 3: Concept of Financing Assets

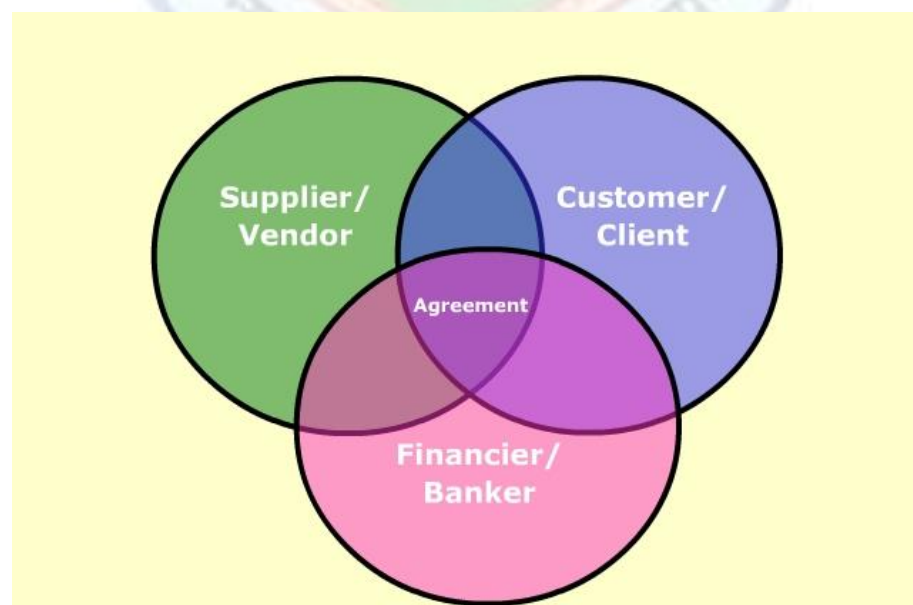
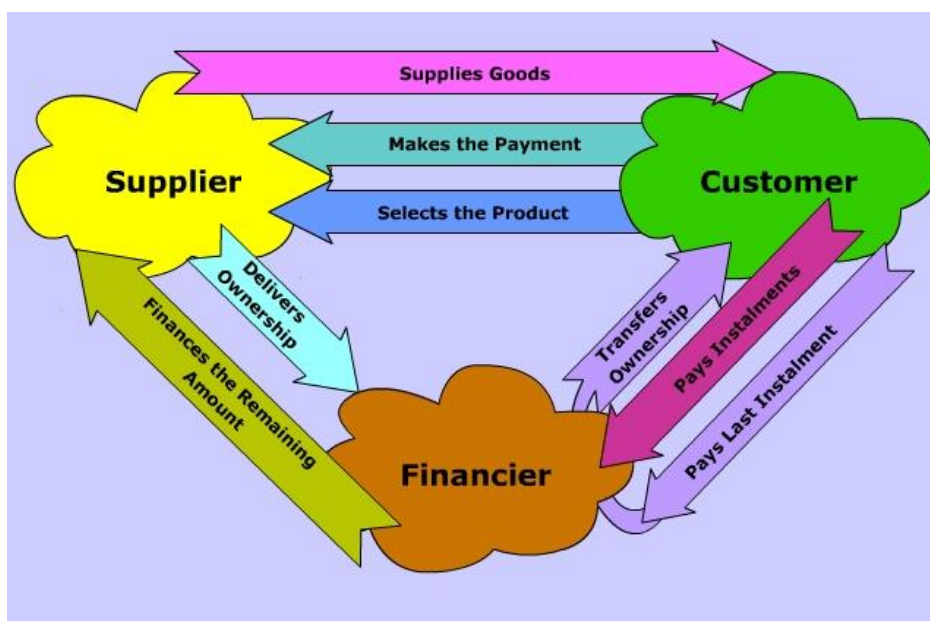


Figure 4: Process of Financing Assets



4. Hire Purchase System Vs. Installment System

Though Hire purchase system and the installment system both involve the payment by way of installments yet they are different from each other in the following ways:

Hire Purchase System	Installment System
1) It is a contract of hire.	1) It is a contract of sale.
2) It is governed by Hire Purchase Act 1972.	2) It is governed by Sale of Goods Act 1930.
3) The property in goods (ownership) is transferred to the purchaser from the vendor only after the last installment is paid.	3) The title of goods (ownership) passes immediately to the buyer as in the case of usual sale.
4) Price is paid by purchaser through installment which is treated as hire.	4) Every installment is treated as payment towards the price of goods.
5) The seller may take possession of the goods back if the hirer is in default.	5) The seller can only sue for unpaid price if the buyer is in default. He cannot take possession of the goods.
6) The purchaser cannot transfer or temper the goods until he pays final installment.	6) The buyer has right to sell, transfer or dispose off the goods at any time.
7) The purchaser possesses the right to terminate the agreement at any time before the property is so passed.	7) The buyer has no right to terminate the agreement and return the goods.

Value Addition 2: Did You Know?

History of Hire Purchase

The first use of hire purchase was evidenced in 19th century for enabling the carriers to procure wagons for the use in business.

Basically, it means exactly what its name suggests; a hiring of the goods until a certain condition is met, when they become the property of the hirer. This condition is usually the completion of all of the payments. The advantage to the finance company is obvious; the property in the goods remains theirs until the goods are paid for. Therefore the finance company has, at least a partial security for their debt. In the 1950s and 1960s it acquired a bad reputation. This was due to the way that some finance companies were dealing with their customers. This led to the first Hire Purchase Acts.

These acts, in the main, established two fundamental and far reaching legal principles:
 1/ One third of the total amount payable has been paid, the finance company cannot recover the goods without the hirers consent. Unless the finance company first obtains a Court Order.

2/ If an innocent "private buyer in good faith" purchases the goods from the hirer, the finance company cannot take those goods from the innocent purchaser. That is, the finance companies property in those goods is lost. To meet those conditions the innocent

Accounting for Hire Purchase System

buyer must:

A/ Be a genuine private buyer, that is not be engaged in any way in the motor trade.

B/ Be ignorant of the fact that the person from whom the goods was purchased was hiring them under a Hire Purchase agreement.

These principles have remained intact up to the present day. In the early 1970s the Hire Purchase Acts and Money Lenders Acts were replaced by new piece of legislation, The Consumer Credit Act 1974. The essential parts of the old Hire Purchase Acts remained intact; however there was now a requirement for businesses engaged in the offering of credit to be licensed.

In later years, civil procedures have been the subject of two judicial reviews, the first instigated by the then Lord Chancellor, the other (recent) following a report by Lord Woolfe. Although neither of these has led to any legislative changes, radical changes have been made to the County Court system. The result of all this is that the system is now much faster, slicker, and easier to use. Under the present system, anyone running a finance company, would do well to consider undertaking their own legal work.

5. Terms used in Hire Purchase Agreement

There are many terms that are used in hire purchase transactions and accounting, but only few are explained here.

- a) Hirer: Also known as hire purchaser, the one who purchase goods under hire purchase agreement
- b) Hire Vendor: The person who sells goods under hire purchase agreement.
- c) Cash price: It is actual price of goods charged under normal cash sale or the price at which the goods may be purchased by hirer for cash.
- d) Down payment: Down payment means an initial payment payable by the hirer at the time of entering into a hire purchase agreement.
- e) Hire purchase price: The total amount payable under the terms of hire purchase agreement in the form of down payment and installments. In other words, the total of down payment and installments is called hire-purchase price.

$$\text{Hire purchase price} = \text{Down Payment} + \text{Installments}$$

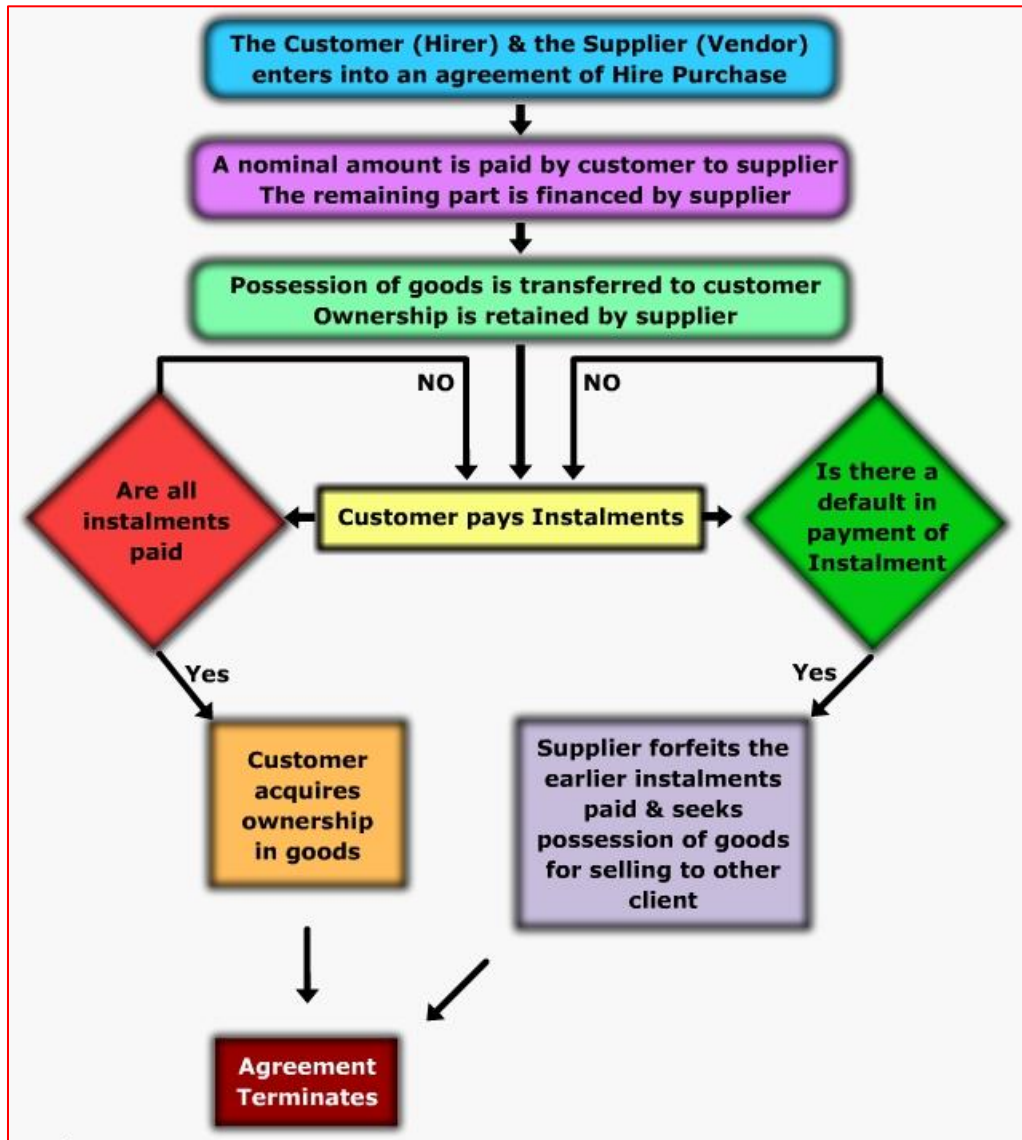
Since, installments are spread over a longer period, the seller charges interest and it is included in the aforesaid installments. Hence installments include payment towards cash price financed and interest on the amount financed.

$$\text{Hire-purchase price} = \text{Cash Price} + \text{Interest}$$

- f) Hire purchase charges: Hire purchase charges are the difference between hire purchase price and cash price. These charges are known as interest.

Figure 5: Process of Hire Purchase

Accounting for Hire Purchase System



6. Calculation of Interest

The hire purchase price consists of (a) payment towards cash price, and (b) the interest. The interest is charged on the unpaid cash price, which decreases with every installment paid. Hence the amount of cash price and interest is not the same even in equal installment for the simple reason that on every next installment, charge for interest decreases and payment for principal increases.

On the basis of information given, problems of calculation of interest can be classified as:

- Case 1: Given: Rate of interest, Total cash price and Hire Purchase Price**
- Case 2: Given: Rate of interest and installments**
- Case 3: Given: Rate of interest and installments (Annuity method)**
- Case 4: Given: Rate of interest and Cash price**
- Case 5: Given: Total cash price and hire purchase price**

Each of the above cases are described in brief below.

Case 1: Calculation of Interest when Given: Rate of interest, Total cash price and Hire Purchase Price

Illustration 1: (Unequal Installments)

On 01.04.2005, V purchased a computer from X Ltd hire purchase basis. The cash price of computer is Rs. 75,000 payable Rs. 15,000 as cash down and three installments of Rs. 23,000, Rs. 22,000 and Rs. 21,000 on 31st March 2006, 2007 and 2008 respectively. Interest is charged @ 5% p.a. calculate the amount of interest paid by buyer to seller every year.

Solution 1:

Rs

Accounting for Hire Purchase System

		Total Cash price	75,000
	Less :	Down payment	15,000
			60,000
	Add :	Interest on Rs. 60,000 @ 5% p.a. for one year	3,000
			63,000
	Less :	First installment	23,000
			40,000
	Add :	Interest on Rs. 40,000 @ 5% p.a. for one year	2,000
			42,000
	Less :	Second installment	22,000
			20,000
	Add :	Interest (Balancing figure)	1,000
			21,000
	Less :	Third installment	21,000

Illustration 2: (Equal Installments)

On 1st Jan 2007, Globe Press purchased a printing machine on hire purchase system from Modern Machinery Company. The payment was to be made as Rs. 30,000 down and balance in three equal annual installments of Rs. 20,000 each payable on 31 December every year. The vendors company charged interest @8% p.a. The cash down value of machine was Rs. 81,543 Calculate the interest on three installments.

Solution 2:

			Rs
		Cash price	81,543
	Less :	Down payment	30,000
			51,543
	Add :	Interest on Rs. 51,543 @ 8% pa for one year	4,123
			55,666
	Less :	1 st Installment	20,000
			35,666
	Add :	Interest on Rs. 27,420 @ 8% p.a. for one year	2,853
			38,519
	Less :	2 nd Installment	20,000
			18,519
	Add :	Interest on 18,519 @ 8% p.a. for one year (Balancing figure)	1,481
			20,000
	Less :	3 rd Installment	20,000

Case 2: When Given: Rate of interest and installments

Illustration 3:

On 1st April 2004, Mr. Shyam purchased machinery from M/s Vee Kay Enterprises on hire purchase basis. The term of payment being Rs. 16,000 down Rs. 27,200 at the end of 2004, Rs. 18,000 at the end of year 2005, Rs. 9,200 by the end of year 2006 and Rs. 16,800 at the end of 2007. Interest is charged @ 5% p.a.

Solution 3:

In this type of question we start calculation of interest from last installment, since last installment includes cash payment of last installment and interest towards that pending installment only.

Suppose, Cash price installment = Rs 100
 Interest @ 5% = Rs 5
 Hire purchase installment = Rs 105
 So, interest on Hire purchase installment is = 5/105

Year	Installment Rs	Amount outstanding Rs	Interest Rs	Cash price Rs
2007	16,800	16,800	16,800 x 5	16,800-800

Accounting for Hire Purchase System

			105	
			= 800	= 16,000
2006	9200	9,200+16,000	$25,200 \times 5$ 105	9200-1200
		= 25,200	= 1,200	= 8,000
2005	18,000	18,000+8,000+ 16,000	$42,000 \times 5$ 105	18,000 - 2,000
		= 42,000	= 2,000	= 16000
2004	27,200	27,200+16,000 +16,000+ 8,000	$67,200 \times 5$ 105	27,200 - 3,200
		= 67,200	= 3,200	= 24,000
Down Payment	16,000	-	-	16,000
	Hire Purchase Price = Rs. 87,200	-	Total Interest = Rs. 7,200	Total Cash Price = Rs. 80,000

Illustration 4:

Vikram purchased machinery on Hire Purchase System on 1 July, 2005. The hire purchase price is Rs. 75,000 to be payable in 5 bi-annually installments of Rs. 15,000 each. The rate of interest is 10% p.a. Calculate the cash price.

Solution 4:

In this question we have bi-annual installments i.e. each installment is to be paid after six months. So the interest will accrue for every 6 months on outstanding balance @ 5% (1/2 of 10% p.a.)

Installment	Installment Amount Rs	Amount outstanding Rs	Interest Rs	Cash price Rs
V	15,000	15,000	$15,000 \times 5$ 105	15,000- 714
			= 714	= 14,286
IV	15,000	15,000+14,286	$29,286 \times 5$ 105	15,000- 1,395
		= 29,286	=1,395	=13,605
III	15,000	15,000+13,605 14,286	$42,891 \times 5$ 105	15,000- 2,042
		= 42,891	=2,042	=12,958
II	15,000	15,000+12,958+13,605+14,286	$55,849 \times 5$ 105	15,000- 2,660
		=55,849	=2,660	=12,340
I	15,000	15,000+12,340+12,958+13,605+14,286	$68,092 \times 5$ 105	15,000- 3,247
		= 68,189	= 3,247	= 11,753
	Hire Purchase Price = Rs. 75,000	-	Total Interest = Rs. 10,058	Total Cash Price = Rs. 64,942

Illustration 5:

Veena purchases an air conditioner on the hire purchase system. She pays Rs. 7,500 down and Rs. 4,000 at the end of 2 years, 4 year and 6 year. Interest is charged by the vendor @ 10% at 2 yearly rests on the unpaid balance. Calculate interest paid with each installment.

	Rs
Solution 5:	Suppose cash price
	100
	Interest @ 10% p.a. for 2years
	20
	Hire purchase installment
	120
	Interest on hire purchase installment=
	20

Installment	Installment Amount Rs	Amount outstanding Rs	Interest Rs	Cash price Rs
End of 6 th year	4,000	4,000	4,000 x 20	4,000-667

Accounting for Hire Purchase System

			120	
			= 667	= 3,333
End of 4 th year	4,000	4,000+3,333	7,333 x 20 120	4,000-1,222
		= 7,333	= 1,222	= 2,778
End of 2 nd year	4,000	4,000+2,778 +3,333	10,111x20 120	4,000-1,685
		= 10,111	=1,685	=2,315
Down Payment	7,500	-	-	7,500
	Hire Purchase Price = Rs. 19,500	-	Total Interest = Rs. 3,574	Total Cash Price = Rs. 15,926

Note: - If interest is charged @ 10% p.a. at yearly rest. Then

	Rs
Suppose cash price be	100
+ Interest @ 10% p.a. for 1 year	10
	110
+ Interest @ 10% p.a. for 1 year	11 (10% of 110)
Hire purchase installment	121
Interest on hire purchase installment=	21
	121

Case 3: Given: Rate of interest and installments (Annuity method)

Annuity means a series of equal payments at fixed intervals. Annuity table is used to find out the present value of annuity for a number of years at a certain rate of interest.

Illustration 6: (Equal Installments)

Ramesh purchases a computer from M/s Software. The term of payment is being Rs. 10,000 annually for 3 years. The rate of interest charged 5% p.a. Calculate cash price of computer with the help of annuity tables.

Solution 6:

Annuity table shows present value of annuity of Re. 1@ 5% p.a. interest for three years is Rs. 2.7233.

$$\text{Cash price of Computer} = 10,000 \times 2.7233 = \text{Rs. } 27,233$$

Illustration 7: (Unequal Installments)

Soni purchased machinery by paying Rs. 10,000 down, Rs. 10,000 at the end of 1st year, 15,000 at the end of 2nd year and 10,000 at the end of 3rd year. Rate of interest charged is 5% p.a. Calculate cash price with the help of annuity tables.

Solution 7:

Annuity table shows that present value of one rupee for 1, 2 and 3 years at 5% interest is 0.9529, 0.9070 & 0.8639 respectively

$$\begin{aligned} \text{Cash price of Machinery} &= \text{Down payment} + (\text{First installment} \times \text{PV of annuity}) + \\ & \quad (\text{2nd installment} \times \text{PV of annuity}) + (\text{3rd installment} \times \text{PV of annuity}) \\ &= 10,000 + (10,000 \times 0.9529) + (15,000 \times 0.9070) \\ & \quad + (10,000 \times 0.8639) \\ &= \text{Rs. } 10,000 + 9,529 + 13,605 + 8,639 = \text{Rs. } 41,773 \end{aligned}$$

Case 4: Given: Cash Price and Rate of Interest

Illustration 8:

On 1st Jan. 2005, Y Ltd purchased a machine costing Rs. 70,000 from Z Ltd on hire purchase basis. The terms of payment being Rs. 10,000 down and balance in 3 annual

Accounting for Hire Purchase System

installments of Rs. 20,000 each together with interest @ 10% p.a. calculate the Hire purchase price of machine.

Rs

Solution 8:

	Total cash price	70,000
	Less: Down payment	10,000
		60,000
Add: Interest @ 10% on 60,000 for 1 year		6,000
		66,000
Less: 1 st installment (20,000+6,000)		26,000
		40,000
Add: Interest @ 10% on 40,000 for 1 year		4,000
		44,000
Less: 2 nd installment (20,000+4,000)		24,000
		20,000
Add: Interest @ 10% on 20,000 for 1 year		2,000
		22,000
Less: 3 rd installment (20,000+2,000)		22,000

Total Hire purchase price = Down payment + First installment + Second Installment + Third installment
 = 10,000 + 26,000 + 24,000 + 22,000
 = **Rs. 82,000**

Case 5: Given: Total cash price and hire purchase price

Illustration 9:

Aruna purchase a refrigerator on hire purchase basis. The cash price of refrigerator is Rs. 20,000. The terms of payment being Rs. 5,000 down and balance in 3 equal installments of Rs. 6,000 each, payable on 31st March every year. Calculate amount of interest included in each of the annual installment.

Solution 9:

Cash price = Rs. 20,000
 Hire purchase price = Down payment + Total Amount of installments
 = 5,000 + 6,000 x 3
 = 5,000 + 18,000
 = Rs. 23,000

Total Interest = Hire purchase price - cash price
 = (23,000-20,000)
 = Rs. 3,000

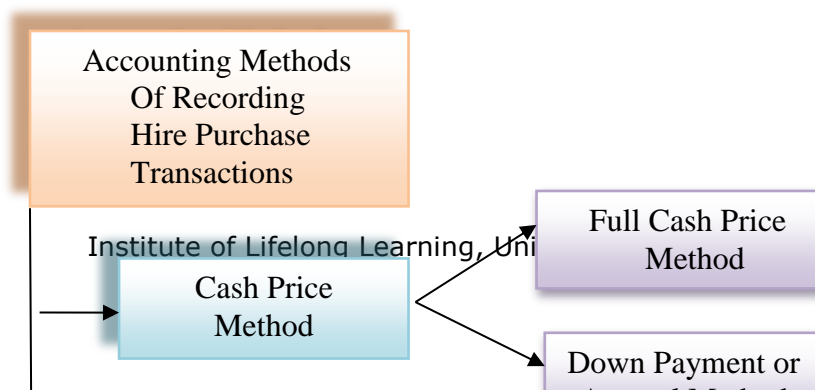
When rate of interest is not given, the amount of total interest is apportioned in the ratio of amount outstanding at the end of each year.

Year	Amount outstanding at the end of year Rs	Ratio	Interest apportioned Rs
I	18,000	3	3/6 x 3,000 = 1,500
II	12,000	2	2/6 x 3,000 = 1,000
III	6,000	1	1/6 x 3,000 = 500
		6	Rs. 3,000

7. Accounting for Hire Purchase

Accounting for hire purchase can be recorded under various methods of recording hire-purchase transaction:

Figure 6: Accounting for Hire Purchase



Accounting for Hire Purchase System

7.1 Cash Price Method

There are two methods for making accounting entries of the hire purchase transaction in the Books of the hire purchaser.

- 1) Full cash price method:** When asset is recorded at full cash price.
The following journal entries will be passed:-

In the books of Hire Purchaser

First Year

- | | | | |
|-------|---|----|-------------------------------|
| (i) | On purchases of the Asset:
Asset on Hire Purchase Account | Dr | With full cash price of Asset |
| | To Hire Vendor's Account. | | |
| (ii) | On making down payment on delivery
Hire Vendor's Account | Dr | With amount of down payment |
| | To Bank / Cash Account. | | |
| (iii) | For interest due on installment
Interest on Hire Purchase Account | Dr | With amount of interest due |
| | To Hire Vendor's Account | | |
| (iv) | On payment of Hire Purchase installment
Hire Vendor's Account | Dr | With amount of installment |
| | To Cash / Bank Account | | |
| (v) | For depreciation charged on the asset
Depreciation Account | Dr | |
| | To Asset on Hire Purchase | | |
| (vi) | For transfer of interest
Profit and Loss Account | Dr | |
| | To Interest on Hire Purchase Account | | |
| (vii) | For transfer of depreciation
Profit and Loss Account | Dr | |
| | To Depreciation Account | | |
- Or**
- | | | | |
|--|--------------------------------------|----|--|
| | Profit and Loss Account | Dr | |
| | To Interest on Hire Purchase Account | | |
| | To Depreciation Account | | |

Second and subsequent years entries (iii), (iv), (v), (vi) and (vii) will be repeated with their respective amount of interest and depreciation provided.

In the Books of Hire Vendor

First Year

- | | | | |
|-------|---|----|-------------------------------------|
| (i) | On Sale of asset under Hire Purchase
Hire Purchaser's Account | Dr | With total cash cash price of asset |
| | To Hire Purchase Sale Account | | |
| (ii) | On receiving down payment
Cash / Bank Account | Dr | With amount of down payment |
| | To Hire Purchaser's Account | | |
| (iii) | For interest due on installment
Hire Purchaser's Account | Dr | With amount of interest |
| | To Interest on Hire Purchase Sales A/c | | |

Accounting for Hire Purchase System

Add: Interest @ 5% p.a. on Rs. 32,700 for one year	1,635
	34,335
Less: First Installment	12,000
	22,335
Add: Interest @ 5% p.a. on Rs. 22,335 for one year	1,117
	23,452
Less: Second Installment	12,000
	11,452
Add: Interest on Rs. 11,452 @ 5% for one year (Balancing Figure)	548
Third Installment	12,000

(a) **Full Cash Price Method**

In the Books of Sharad Steel Ltd.

Journal Entries

Date	Particulars	Debit Amount Rs	Credit Amount Rs
2004 April	1 st Machine on Hire Purchase Account Dr To Hire Vendor's Account	44,700	44,700
	Hire Vendor's Account Dr To Cash Account	12,000	12,000
2005 31 st March	Interest on Hire Purchase Account Dr To Hire Vendor's Account	1,635	1,635
	Hire Vendor's Account Dr To Cash Account	12,000	12,000
	Depreciation Account Dr To Machine on Hire Purchase	4,470	4,470
	Profit and Loss Account Dr To Depreciation Account	6,105	4,470
	To Interest on Hire Purchase Account		1,635
2006 March	31 st Interest on Hire Purchase Account Dr To Hire Vendor's Account	1,117	1,117
	Hire Vendor's Account Dr To Cash Account	12,000	12,000
	Depreciation Account Dr To Machine on Hire Purchase	4,023	4,023
	Profit and Loss Account Dr To Interest on Hire Purchase Account	5,140	1,117
	To Depreciation Account		4,023
2007 31 st March	Interest on Hire Purchase Account Dr To Hire Vendor's Account	548	548
	Hire Vendor's Account Dr To Cash Account	12,000	12,000
	Depreciation Account Dr To Machine on Hire Purchase	3,621	3,621
	Profit and Loss Account Dr To Depreciation Account	4,169	3,621
	To Interest on Hire Purchase Account		548

In the Books of Hire Vendor

Date	Particulars	Debit Amount Rs	Credit Amount Rs
2004 1 st April	Sharad Steels Ltd. Dr To Hire Purchase Sales Account	44,700	44,700
	Cash Account Dr To Sharad Steel Ltd.	12,000	12,000
	Sharad Steels Ltd. Dr To Interest on Hire Purchase Account	1,635	1,635
	Cash Account Dr To Sharad Steels Ltd.	12,000	12,000
	Interest on Hire Purchase Account Dr To Profit and Loss Account	1,635	1,635
2005	Sharad Steel Ltd. Dr To Interest on Hire Purchase Account	1,117	1,117

Accounting for Hire Purchase System

31 st March	Cash Account	Dr	12,000	
	To Sharad Steel Ltd.			12,000
	Interest on Hire Purchase Account	Dr	1,117	
	To Profit and Loss Account			1,117
2006	Sharad Steel Ltd.	Dr	548	
	To Interest on Hire Purchase Account			548
31 st March	Cash Account	Dr	12,000	
	To Sharad Steels Ltd.			12,000
	Interest on Hire Purchase Account	Dr	548	
	To Profit and Loss Account			548

(b) Accrual Method

In the books of Sharad Steels Ltd. Journal

Date	Particulars		Debit Amount Rs	Credit Amount Rs
2004 1 st April	Machine on H P Account	Dr	12,000	
	To Hire Vendor's Account			12,000
	Hire Vendor's Account	Dr	12,000	
	To Cash Account			12,000
2005 31 st March	Machine on HP Account	Dr	10,365	
	Interest on HP Account	Dr	1,635	
	To Hire Vendor Account			12,000
	Hire Vendor Account	Dr	12,000	
	To Cash Account			12,000
	Depreciation Account	Dr	4,470	
	To Machine on HP			4,470
	Profit and Loss Account	Dr	6,105	
	To Interest on HP			1,635
	To Depreciation Account			4,470
2006 31 st March	Machine on HP Account	Dr	10,883	
	Interest on HP Account	Dr	1,117	
	To HP Vendor Account			12,000
	HP Vendor Account	Dr	12,000	
	To Cash Account			12,000
	Depreciation Account	Dr	4,023	
	To Machine on HP			4,023
	Profit and Loss Account	Dr	5,140	
	To Interest on HP			1,117
	To Depreciation Account			4,023
2007 31 st March	Machine on HP Account	Dr	11,452	
	Interest on HP	Dr	548	
	To Hire Vendor Accounts			12,000
	HP Vendor Account	Dr	12,000	
	To Cash Account			12,000
	Depreciation Account	Dr	3,621	
	To Machine on HP Account			3,621
	Profit and Loss Account	Dr	4,169	
	To Interest on HP			548
	To Depreciation Account			3,621

The Journal Entries in the Books of Hire Vendor are same.

Illustration 11:

On 1st April, 2005 Mr. Sharma purchased from Veena, a machine on hire purchase basis. The hire purchase price was Rs. 80,000, payable as to Rs. 20,000 as down payment and three annual installments of Rs. 20,000 each; the first annual installment being payable on 31st March, 2006. Ms. Veena disclosed the she was charging interest @ 5% per annum.

Mr. Sharma charged depreciation on the machine @ 15% per annum on diminishing balances of the machine. Calculate the cash price of the machine. Also prepare: (a) Ms. Veena Account (b) Machine Account in the books of Sharma and (c) Sharma Account in the books of Ms. Veena.

Solution 11:

Accounting for Hire Purchase System

Year	Installment Amount Rs	Amount Outstanding Rs	Interest Rs	Cash Price Rs
2008	20,000	= 20,000	= 20,000 x 5/105 = 952	20,000-952 = 19,048
2007	20,000	= 20,000 + 19,048 = 39,048	= 39,048 x 5/105 = 1,859	20,000-1,859 = 18,141
2006	20,000	= 20,000 + 18,141 + 19,048 = 57,189	= 57,189 x 5/105 = 2,723	= 2,090-2,723 = 17,277
2006	Down Payment	-	-	20,000
		Hire Purchase Price = Rs 80,000	Interest = Rs 5,534	Cash Price = Rs 74,466

In the Books of Sharma

Dr	Veena's Account		Cr
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		Rs.			Rs.
2005 April 1	Cash Account (Down payment)	20,000	2005 April 1	Machine on HP	74,466
2006 March 31	Cash Account (First Installment) Balance C/d	20,000	2006 March 31	Interest on HP	2,723
		37,189			
		77,189			77,189
2007 March 31	Cash Account (second Installment) Balance C/d	20,000	2006 April 1	Balance B/d	37,189
		19,048	2007 March 31	Interest on HP	1,859
		39,048			39,048
2008 March 31	Cash Account (Third installment)	20,000	2007 April 1	Balance B/d	19,048
			2008 March 31	Interest on HP	952
		20,000			20,000

Machine on Hire Purchase Account

Dr			Cr
----	--	--	----

		Rs.			Rs.
2005 April 1	Ms. Veena	74,466	2006 March 31	Depreciation Balance C/d	11,170 63,296
		74,466			74,466
2006 April 1	Balance B/d	63,296	2007 March 31	Depreciation Balance C/d	9,494 53,802
		63,296			63,296
2007 April 1	Balance B/d	53,802	2008 March 31	Depreciation Balance C/d	8,070 45,732
		53,802			53,802

In the Books of Ms Veena

Dr	Sharma's Account		Cr
----	------------------	--	----

		Rs.			Rs.
2005 April 1	HP Sales Account	74,466	2005 April 1	Cash Account (Down Payment)	20,000
2006 March 31	Interest on HP	2,723	2006 March 31	Cash Account (First Installment) Balance c/d	20,000 37,189
		77,189			77,189

Accounting for Hire Purchase System

2006 April 1	Balance B/d	37,189	2007 March 31	Cash Account (second Installment)	20,000
2007 31 March	Interest on HP	1,859		Balance C/d	19,048
		39,048			39,048
2007 April 1	Balance b/d	19,048	2008 March 31	Cash Account (Third Installment)	20,000
2008 March 31	Interest on HP	952			
		20,000			20,000

8. Default and Repossession

When a hire purchaser fails to pay any installment and makes as default, the hire vendor has the right to re-possess goods under hire purchase agreement. In case of default by purchaser, the hire vendor not only re-possess goods but also forfeits the amount of installments already received, thus treating the amount of installments paid as hire charges. There are two possibilities.

- (i) Full Repossession: When the hire vendor takes back all the goods sold to hire purchaser.
- (ii) Partial repossession: When the hire vendor takes the possession of only some of the total assets sold to hire purchaser and balance of goods are retained by hire purchaser.

8.1 Accounting Treatment in Case of Full Repossession

In the books of Hire Purchaser

When the goods are repossessed by the hire vendor, then the hire purchaser closes both Hire Vendor Account and Asset on Hire Purchase Account on the date of default by making the following entries.

- (i) Hire Vendor's Account Dr (with amount outstanding)
 To Asset on Hire Purchase Account
- (ii) Any balance left in the asset account is transferred to profit and loss account.
 Profit and Loss Account Dr (with Balancing figure)
 To Asset on Hire Purchase Account

In the Books of Hire Vendor

On the date of default the hire vendor closes hire purchaser account by transferring the balance to Goods Repossessed Account.

Goods Repossessed Account Dr (with balance outstanding)
 To Hire Purchaser's Account

The newly opened Goods Repossessed Account is further debited with expenses incurred on the repair of goods repossessed and credited with cash received from resale of goods. Any balance left in good repossession account, being profit or loss on resale, is transferred to Profit and Loss Account.

- (a) Good Repossessed Account Dr (with amount of expenses)
 To Cash Account
- (b) Cash Account Dr (with resale price)
 To Good Repossessed Account
- (C) Profit and Loss Account Dr (with amount of loss)
 To Goods Repossessed Account

OR

Goods Repossessed Account Dr. (With amount of profit)
 To Profit and Loss Account

Illustration 12:

On 1st April, 2006, Rohit acquired a truck from a dealer on hire purchase basis, cash price of which was Rs. 8,00,000. The terms of payment being; Rs. 2,00,000 cash down; Rs. 2,45,000 at the end of the first year; Rs. 2,30,000 at the end of second year; and Rs. 2,15,000 at the end of third year. The dealer charged interest @ 7½% per annum.

Rohit depreciated the truck at 10% per annum on written down value method. After having made the down payment and having paid the first installment on 31st March 2007, he could not pay the second installment on 31st March, 2008. The hire-vendor took

Accounting for Hire Purchase System

possession of the truck and after spending Rs. 30,000 on the repairs of the truck, sold it for Rs. 5, 00,000.

Prepare the ledger accounts in the books of both the parties.

Solution 12:

Calculation of Interest	
	Rs
Cash Price of the Truck	= 8, 00,000
Less Down Payment	<u>2, 00,000</u>
	6, 00,000
Add: Interest on Rs. 6, 00,000 @ 7½% for one year	<u>45,000</u>
	6, 45,000
Less: 1 st Installment	<u>2, 45,000</u>
	4, 00,000
Add: Interest on Rs. 4, 00,000 @ 7½% for one year	<u>30,000</u>
Balance on 31 st March, 2008	<u>4, 30,000</u>

In the Books of Rohit (Hire Purchaser)

Dr		Hire Vendor's Account		Cr	
		Rs.			Rs.
2006 April 1	Cash Account (Down Payment)	2,00,000	2006 April 1	Truck on Hire Purchase	8,00,000
2007 March 31	Cash Account (first installment) Balance c/d	2,45,000	2007 March 31	Interest on HP	45,000
		4,00,000			
		8,45,000			8,45,000
2008 March 31	Truck on HP	4,30,000	2007 April 1 2008 March 31	Balance b/d Interest on HP	4,00,000 30,000
		4,30,000			4,30,000

Dr		Truck on HP Account		Cr	
		Rs.			Rs.
2006 April 1	Hire Vendor Account	8,00,000	2007 March 31	Depreciation Account Balance c/d	80,000 7,20,000
		8,00,000			8,00,000
2007 April 1	Balance b/d	7,20,000	2008 March 31	Depreciation Account Hire Vendor P&L Account	72,000 4,30,000 2,18,000
		7,20,000			7,20,000

In the Books of Hire Vendor

Dr		Rohit's Account		Cr	
		Rs.			Rs.
2006 April 1	Hire Purchase Sale	8,00,000	2006 April 1	Cash Account (Down payment)	2,00,000
2007 March 31	Interest on HP	45,000	2007 March 31	Cash Account (first installment) Balance c/d	2,45,000 4,00,000
		8,45,000			8,45,000
2007 April 1 2008 March 31	Balance B/d Interest on HP	4,00,000 30,000	2008 March 31	Goods Repossessed Account	4,30,000
		4,30,000			4,30,000

Accounting for Hire Purchase System

Dr	Goods Repossessed Account				Cr
		Rs.			Rs.
2008	Rohit Account	4,30,000	2008 March	Cash Account	5,00,000
March 31	Cash Account (repairs)	30,000	31	(Resale)	
	Profit & Loss Account (Profit on resale)	40,000			
		5,00,000			5,00,000

8.2 Accounting Treatment in Case of Partial Repossession

In partial repossession, only some of the total assets sold to hire purchases are repossessed and balance of goods are retained by hire purchaser.

All the journals entries are same as in case of full repossession except the following difference. In case of default i.e. in case of non-payment of installments, goods on hire purchase are divided into parts:

- Goods retained with hire purchaser
- Goods repossessed by vendor

Goods retained with hire purchaser are valued at cost less normal rate of depreciation to the date and shown as closing balance of the asset on hire purchase account in the books of hire vendor. Goods taken back by hire vendor are valued at agreed price. There can be following possibilities in calculation of agreed price.

- (i) Goods repossessed may be valued on the basis of enhanced rate of depreciation i.e. agreed value of good repossessed is calculated after charging rate of depreciation higher than normal rate applied by hire purchaser.
- (ii) Any amount determined by mutual agreement between hire purchaser and hire vendor may be taken as agreed value.
- (iii) Agreed value may also be taken as a certain percentage of cash price or hire purchase price.

The hire purchaser does not close the account of hire vendor and hire vendor does not close the account of hire purchaser in their respective books. However, following entries are made.

In Books of Hire Purchaser

- (a) Hire Vendor's Account Dr (With agreed value)
To Asset on Hire Purchase Account
 The balance of vendor's account is carried forward to next period.
- (b) Value of goods retained by the purchaser shown as closing balance in the goods on hire purchase account and balance is transferred to profit and loss account.
Profit and Loss Account Dr
To Asset on Hire Purchase Account

In the Books of Hire Vendor

- (a) Goods Repossessed Account Dr (with agreed amount)
To Hire Purchaser's Account

The balance of hire purchaser's account will be carried forward to next year.

However, all the entries relating to repairs and resale of goods repossessed will be same as in case of full repossession.

Illustration 13 :

On 1st Jan., 2007, five computers were purchased by A on the Hire purchase system. The cash price of each computer is Rs. 40,000. The payment was to make as follows:

10% cash price down.

25% of cash price at the end of each of the subsequent half-years.

The payment due on 31st December, 2007 could not be made and hence computers were seized by the vendor but after negotiation. A was allowed to keep three computers on the condition that the value of the other two computers would be adjusted against the amount due, the computers being valued at cost less 25% depreciation, A's books were closed on 30th June each year and be charged 15% depreciation on computers on the original cost.

The vendor spent Rs. 5,000 on getting the computer reconditioned and sold them for Rs. 70,000. Show the necessary accounts in the books of both parties.

Solution 13:

Calculation of Interest
 Cash Price of five computers= Rs. 40,000 x 5

Accounting for Hire Purchase System

Hire Purchase Price (HPP) = Rs. 2, 00,000
 of five computers = Rs. 2, 20,000

Total Interest = HPP – Cash Price
 = Rs. (2, 20,000 – 2, 00,000)
 = Rs. 20,000

Installment	Amount Due Rs	Ratio	Interest	Rs.
1	2,00,000	4	20,000 x 4/10	8,000
2	1,50,000	3	20,000 x 3/10	6,000
3	1,00,000	2	20,000 x 2/10	4,000
4	50,000	1	20,000 x 1/10	2,000
				20,000

Value of Computers taken away
 No. of Computers = 2
 Cost of Computers = 2 x 40,000
 = Rs.80, 000
 Less Depreciation = 20,000
 @ 25%
Rs. 60,000

Value of Computers left with hire purchaser
 No. of Computers = 3
 Cost of Computers = 40,000 x 3
 = Rs. 1, 20,000
 Less Depreciation @ 15% = Rs. 18,000
Rs. 1, 02,000

In the Books of A (Hire Purchaser)

Dr		Hire Vendor's Account		Cr	
		Rs.			Rs.
2007 Jan. 1	Cash Account (Down payment)	20,000	2007 Jan. 1	Computers on HP	2,00,000
	Cash Account (firstinstallment)	50,000		Interest on HP	8,000
June 30	Balance C/d	1,38,000	June 30		
		2,08,000			2,08,000
2007 Dec. 31	Computers on HP Balance C/d	60,000	2007 July 1	Balance b/d	1,38,000
		84,000	Dec. 31	Interest on HP	6,000
		1,44,000			1,44,000

Dr		Computers on Hire Purchase Account		Cr	
		Rs.			Rs.
2007 Jan. 1	Hire Vendor Account	2,00,000	2007 June 30	Depreciation Account	15,000
				Balance c/d	1,85,000
		2,00,000			2,00,000
2007 July 1	Balance b/d	1,85,000	2008 Dec. 31	Depreciation Account	15,000
				Hire Vendor P&L Account (b/f)(loss)	60,000 8,000
				Balance c/d	1,02,000
		1,85,000			1,85,000

In the Books of Hire Vendor

Dr		A's Account		Cr	
		Rs.			Rs.
2007 Jan. 1	Hire Purchase Sale Account	2,00,000	2007 Jan 1	Cash Account (Down payment)	20,000
June 30	Interest on HP	8,000		Cash Account (firstinstallment)	
Dec. 31	Interest on HP	6,000	June 30	Good Repossessed	50,000

Accounting for Hire Purchase System

			Dec. 31	Account Balance C/d	60,000
					84,000
		2,14,000			2,14,000

Goods Repossessed Account

		Rs.			Rs.
2007	A's Account	60,000	2007		
Dec. 31	Cash Account	5,000	Dec. 31	Cash Account	70,000
	(repairs)			(Resale)	
	Profit and Loss	5,000			
	Account				
	(profit on sale)				
		70,000			70,000

Illustration 14:

XYZ Ltd sold 3 cars for a total cash sale price Rs. 6, 00,000 on hire purchase basis to V on 1.1.2004. The terms of agreement provided for Rs. 1, 80,000 cash down and the balance of the cash price in three equal installments together with interest at 10% per annum compounded annually. The installments were payable as: 1st installment on 31.12.2005, 2nd installment on 31.12.2006 and 3rd installment on 31.12.2007. V paid first installment on time but failed to pay thereafter. On his failure to pay the second installment XYZ Ltd repossessed two cars and valued them at 50% of the cash price. V charges 10% p.a. depreciation on diminishing balance method. Prepare necessary ledger accounts in the books of V.

Solution 14:

(i) Calculation of Interest (in Rs)

	Total cash price	6,00,000
	Less Down payment	1,80,000
		4,20,000
Add :	Interest on Rs. 4,20,000 @ 10% for one year	42,000
	Balance outstanding on 31-12-2004	462,000
Add :	Interest on Rs. 46200 @ 10% p.a. for on year	46,200
	Balance outstanding on 31-12-2005	5,08,200
Less :	1st installment [1,40,000(420000/3)+42,000+46200]	2,28,200
	Balance on 1-12-2006	2,80,000
Add :	Interest on Rs. 2,80,00 @ 10% p.a. for one year	28,000
	Balance outstanding on 31-12-2006	3,08,000

(ii) Value of cars repossessed

No of cars	=	2
Cash price of two cars:	=	4, 00,000
		(2, 00,000x2)
Less: 50%	=	2, 00,000
		2, 00,000

(iii) Value of car retained by V

No. of car	1	
Cash price of Car	2, 00,000	
Less Depreciation for 2004 @ 10%	20,000	
	1, 80,000	
Less: Depreciation for 2005	18,000	
	1, 62,000	
Less Depreciation for 2006	16,200	
	1, 45,800	

In the Books of V

Dr XYZ Ltd Cr

		Rs			Rs
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Accounting for Hire Purchase System

2004 Jan,1	Cash Account (Down Payment)	1,80,000	2004 Jan,1	Cars on HP	6,00,000
Dec,31	Balance c/d	4,62,000	Dec,31	Interest on HP	42,000
		6,42,000			6,42,000
2005 Dec,31	Cash Account (firstinstallment)	2,28,200	2005 Jan,1	Balance b/d	4,62,000
	Balance c/d	2,80,000	Dec,31	Interest on HP Account	46,200
		5,08,200			5,08,200
2006 Dec,31	Cars on HP Account	2,00,000	2006 Jan,1	Balance c/d	2,80,000
	Balance c/d	1,08,000	Dec,31	Interest on HP Account	28,000
		3,08,000			3,08,000

Dr		Cars on HP Account				Cr
2004 Jan,1	XYZ ltd	6,00,000	2004 Dec,31	Depreciation Account	60,000	
				Balance c/d	5,40,000	
		6,00,000			6,00,000	
2005 Jan,1	Balance b/d	5,40,000	2005 Dec,31	Depreciation Account	54,000	
				Balance c/d	4,86,000	
		5,40,000			5,40,000	
2006 Jan,1	Balance b/d	4,86,000	2006 Dec,31	XYZ ltd	2,00,000	
				Depreciation Account	48,600	
				P& L Account (loss)	91,600	
				Balance c/d	1,45,800	
		4,86,000			4,86,000	

Illustration 15:

Suresh purchased seven computers on hire purchase on 1.7.2006. The cash price of each computer was Rs. 25,000. He was to pay 20% of the cash price at the time of delivery and the balance in five half yearly installments starting from 31-12-2006 with interest @ 5% p.a.

On Suresh failure to pay the installment due on 30-06-2007, it was agreed that Suresh would return three computers to hire vendor and remaining four could be retained by him. The returning price of three computers was Rs. 20,250. Suresh charges depreciation @ 20% p.a.

Hire vendor after spending Rs. 750, on repairs sold away all the three computers for Rs. 20,000. Show necessary ledger accounts in the books of Suresh and hire vendor assuming that books are closed on 30th June.

Solution 15:

(i) Calculation of interest

		Rs
	Total cash price of seven computers	175,000
Less	Down payment of seven computers	35,000
	Balance amount due as on 1-7-2006	1,40,000
Add :	Interest on 1,40,000 @ 5% for 6 months i.e. up to 31-12-2006	3,500
	Balance amount due as on 31-12-2006	1,43,500
Less :	1st installment paid on 31-12-2006	31,500
	(28,000+3,500)	
	Balance amount due as on 1-1-2007	1,12,000

Accounting for Hire Purchase System

Add :	Interest on Rs. 1,12,000 @ 5% p.a. for 6 months up to 30-6-2007 Balance amount due as on 30-6-2007	2,800 <hr style="width: 50%; margin: 0 auto;"/> 1,14,800
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(ii) Value of computers retained by Suresh

No of computers retained	=	4
Total cash Price of 4 computers	=	1, 00,000
Less: Depreciation for one year @ 20% p.a	=	20,000
Book value of computers as on 30-6-2007		<hr style="width: 50%; margin: 0 auto;"/> 80,000

In the Books of Suresh

Dr		Hire Vendor's Account		Cr				
2006	July,1	Cash Account (Down payment)	35,000	2006	July,1	Computer on HP	1,75,000	
	Dec,31	Cash Account (first installment)	31,500		Dec,31	Interest on HP	3,500	
	2007	Computers on HP	20,250		2007	June,30	Interest on HP	2,800
	June,30	Balance c/d	94,550					
			1,81,300				1,81,300	

Dr		Computers on Hire Purchase Account		Cr			
2006	July,1	Hire Vendor's Account	1,75,000	2007	June,30	Depreciation Account	35,000
						Hire Vendor P&L Account (loss)	20,250
						Balance c/d	39,750
			1,75,000				80,000
							1,75,000

In the Books of Hire Vendor

Dr		Suresh's Account		Cr				
2006	July,1	Hire Purchase sales	1,75,000	2006	July,1	Cash Account (down payment)	35,000	
	Dec,31	Interest on HP	3,500		Dec,31			
	2007	June,30	Interest on HP	2,800	2007	June,30	Cash Account (first installment)	31,500
							Goods Repossessed	20,250
							Balance c/d	94,550
			1,81,300					1,81,300

Dr		Goods Repossessed Account		Cr			
		Rs			Rs		
2007	June,30	Suresh's Account	20,250	2007	June,30	Cash Account (Resale)	20,000
		Cash Account (Repairs)	750			P&L Account (loss)	1,000
			21,000				21,000

9. Hire purchase Trading Account or Debtor System

Sometimes, business sells goods both on cash basis and hire purchase basis. When numerous items of the small value such as cycles, fans, radios, TV etc are sold on hire purchase basis involving many transactions during an accounting year, it becomes very difficult to maintain separate accounts for each customer, calculation of interest and profit & Loss. It will involve lot of cost, efforts and time. Under such circumstances, Hire Purchase Trading account is adopted. For keeping records of hire purchase method transactions a separate book called Hire Purchase Register or Hire Purchase Sales book is maintained to record date of contract, name of hire purchaser, cost price, hire purchase price, down payment, number of installments and amount of each installment

Accounting for Hire Purchase System

with dates when they become due. At the end of the year, profit or loss on hire purchase is calculated by extracting the following information from accounting records:

- 1) Cost of goods sold on hire purchase.
- 2) Total cash received from hire purchase customer (down payment + installments) during the year,
- 3) Installments due but not paid by the hire purchase customer,
- 4) Installments not yet due. It is also known as stock lying with hire purchase customers.

Hire purchase Trading Account may either be prepared at cost or at hire purchase price.

(i) Hire Purchase Trading Account at cost

Under this method all transactions are recorded at cost. The following entries will be made in this method.

- 1) **For recording Opening Balances.**
 Hire Purchase Trading Account Dr (Cost Price)
 To Stock with HP Customers Account

or

- Installments Not Due Account Dr
 To Installments Due Account (Hire Purchase Price)
- 2) **For goods sold on hire purchase basis during the year**
 Hire Purchase Trading Account Dr (Cost Price)
 To Goods Sold on Hire Purchase Account
- 3) **On receipt of cash from HP customers including cash down**
 Bank/Cash Account Dr (Down payment and
 To Hire Purchase Trading Account installments received)
- 4) **On repossession of goods due to non-payment of installment due**
 Goods Repossessed Account Dr (with agreed/estimated value)
 To Hire Purchase Trading A/c
- 5) **For recording closing balances**
 Installment Due A/c Dr (Hire Purchase Price)
 Stock with HP customer Account/ Dr (Cost Price)

or

- Installment Not Due Account Dr
 To Hire Purchases Trading A/c
- 6) **In case of profit**
 Hire Purchase Trading A/c Dr (Profit)
 To Profit and Loss A/c
- 7) **In case of loss**
 Profit and Loss A/c Dr (Loss)
 To Hire Purchase Trading A/c

Dr.	Hire purchase Trading Account (At cost)		Cr.
Particulars	Rs.	Particulars	Rs.
Balance b/d		Cash Received from HP Customer	—
Stock with HP customer (at cost)		Goods Repossessed (Agreed value)	—
Installment Due (at HP Price)		Balance c/d	
Goods Sold on HP basis (cost)*		Stock with HP customer (at cost)	—
Profit & Loss Account (Profit)		Installment Due (at HP Price)	—
(Balancing Figure)		Profit & Loss Account(loss)	—
		(Balancing figure)	—

*Cost of Goods Sold on HP is arrived as:
 Stock at shop in the beginning (at cost)
 Add: Purchases during the year
 Less: Stock at shop at the end.

Illustration 16:

SV Electronics sell electronic appliances on hire purchase basis. The hire purchase price is cost plus 40%. From the following particulars prepare Hire Purchase Trading Account for the year ended 31st March 2010.

2009		Rs
April, 1	Stock at shop at cost	1,000
	Installments not due not paid	3,500
	Installments due	1,250
2010		

Accounting for Hire Purchase System

March, 31	Stock at shop at cost	1,500
	Installments not due not paid	2,800
	Installments due	3,250
	Goods repossessed valued at (Installment due Rs. 1,000)	250
	Cash received during the year	12,500
	Purchase made during the year	8,000

Solution 16:

In the books of SV Electronics
Hire Purchase Trading Account
 for the year ended 31st March 08

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
Balance b/d:		Cash Received	12,500
Stock with HP Customers A/C (1)	2,500	Goods Repossessed A/C (valued at)	250
Installment Due Account	1,250	Balance c/d:	
Goods Sold on HP A/C (3)	7,500	Stock with HP Customers A/C (2)	2,000
Profit & Loss Account (Profit) (Balancing figure)	6,750	Installment Due	3,250
	19,500		19,500

1) Stock with HP customers/Installments not due in the beginning

	Rs
At Hp Price	3500
Less Profit elements (3500 x 40/140)	1000
Value at cost	2500

2) Stock with HP customers/Installments not due at the end

At HP price	2,800
Less Profit element (2800 x 40/140)	800
Value at Cost	2,000

3) Goods Sold on HP basis

Stock at shop in the beginning (at cost)	1000
Add: Purchases during the year	8000
Less: Stock at shop at the end.	1500
Goods sold on HP	7500

ii) Hire Purchase Trading Account (At selling price)

The entries are same as in Hire Purchase Trading A/c at cost, but for elimination of profit margin from opening stock with HP customer, goods sold on hire purchase and closing stock with HP Customer, the following additional entries are made:

(i) **For adjusting/removing loading on Goods sold on HP basis**

Goods Sold on HP A/c	Dr
To Hire Purchase Trading A/c (With profit element)	

(ii) **For adjusting/removing loading on opening stock with HP customer**

Stock Reserve A/c	Dr
To Hire Purchase Trading A/c (With profit element)	

(iii) **For adjusting/removing loading on closing stock with HP customer**

Hire Purchase Trading A/c	Dr
To Stock Reserve A/c (With profit element)	

Performa Hire Purchase Trading A/c (At Selling Price)

Dr		Cr	
Particulars	Rs.	Particulars	Rs.

Accounting for Hire Purchase System

Stock with HP Customers A/C(in the beginning)	HPP	Cash Received during the year	-
Installment Due A/C(in the beginning)	HPP	Goods Repossessed from defaulting customers (valued at)	Agreed Value
Goods sold on HP A/C(during the year)	HPP Profit Element	Stock Reserve Account (loading on opening stock)	Profit Element
Stock Reserve Account (loading on closing stock)		Goods sold on HP basis (loading on goods sold on HP)	Profit Element
Hire Purchase Expenses A/C Profit & Loss Account (profit)(Balancing figure)		Stock with HP customer A/C (at the end)	HPP
		Installment Due A/C (at the end)	HPP
		Profit & Loss Account (loss) (Balancing figure)	

Illustration 17:

XYZ Ltd. sells goods on hire purchase system. The hire purchase price includes a profit of 30% on cost. From the following particulars prepare Hire Purchase Trading Account for the year ended 31st March 2010.

		Rs
April 1, 2009	Stock out with HP Customers (at SP/HPP)	15,600
	Installment due	9,000
March, 31 2010	Goods sold on HP (At SP/HPP)	1,82,000
	Installment not due/Stock with HP customers	78,000
	Hire Purchase Expenses	6,600
	Cash received from HP Customers	1,36,000
	Installments due	20,000
	Goods Repossessed valued at (Installment due Rs. 6,000)	1,600

Solution 17:

In the Books of XYZ Ltd.

Hire Purchase Trading Account (at HPP)
for the year ended March 31st, 2008

Dr	Rs	Cr	
Stock with HP customer Account	15,600	Cash Account	1,36,000
Installment Due Account		Goods Repossessed Account	1,600
Goods Sold on HP basis Account	9,000	Stock Reserve Account(1)	3,600
Stock Reserve Account(3)	1,82,000	Goods Sold on HP basis Account(2)	42,000
Hire Purchase Expenses Account		Installment not due/Stock with HP customers Account	78,000
P & L Account (Profit)	18,000	Installment Due	20,000
	6,600		
	50,000		
	2,81,200		2,81,200

1. Loading on Opening Stock = $15,600 \times 30/130 = 3600$.
2. Loading on goods sold on HP = $1,82,000 \times 30/130 = 42,000$.
3. Loading on closing stock = $78,000 \times 30/130 = 18,000$

10. Calculation of Missing Figures

In most of examination problems, information required for the preparation of Hire Purchase Trading Account such as opening or closing balance of Stock with HP customers or installment not due or installment due, cash received from customers or any other figure is missing. For calculation of these missing figures, the following three accounts are prepared:

1. Shop Stock Account (Always at cost price)
2. Stock with the Hire Purchase Customers / Installment Not Due Account.(Always at HPP)
3. Installment Due Account.(Always at HPP)

Accounting for Hire Purchase System

First Account

Dr		Cr
Shop Stock Account (At cost price)		
Balance b/d (opening stock)	-	Stock with HP customer (Being goods sold at hire purchase at cost)
Purchases	-	Balance c/d (Closing stock)
		-

Second Account

Dr		Cr
Stock with HP customers A/C (At HPP)		
Balance b/d Shop Stock Account	--	Installment Due A/C (Being installments due during the year)
Goods sold to HP Customer (transfer from Shop Stock Account)	(cost+Profit)	Balance c/d
		-

Third Account

Dr		Cr
Installments Due Account (At HPP)		
Balance b/d	-	Cash Received
Stock with HP customer (Installment due, transferred from Stock with HP customer A/C)	-	Goods Repossessed
		Balance c/d
		-

Illustration 18:

Raj Electronics sells goods on Hire Purchases basis at a profit of 50% on cost. From the following information, prepare Hire Purchase Trading Account for the year ended 31st December 2009 (a) at cost (b) at selling price/HPP.

		Rs.
Jan. 1	Stock with Hire Purchase Customers (At SP)/HPP	9,000
	Stock at shop at cost	18,000
	Installments due	5,000
Dec. 31	Cash Received from Customers	60,000
	Goods Repossessed (installments due Rs. 2,000) valued at	500
	Installment due	9,000
	Stock at shop at cost (excluding goods repossessed)	20,000
	Goods purchased during the year	60,000

Solution 18:

Calculation of missing figures
In the Books of Raj Electronics

Dr		Cr
Stock at Shop A/c (At cost price)		
	Rs.	Rs.
Balance b/d	18,000	Stock with HP (b/f) (at cost)
Purchases	60,000	Balance c/d
	78,000	78,000

Accounting for Hire Purchase System

Dr	Installment Due Account/ Stock with H.P. Customers A/c (at HPP)	Cr
	Rs.	Rs.
Balance b/d	9,000	Installment due (Transfer from installment due) 66,000
Stock at Shop (58,000 + 29,000 Profit) (Goods sold on HP) & (Transfer from Stock at Shop)	87,000	Balance c/d (b/f) 30,000
	96,000	96,000

Dr	Hire Purchase Debtors Account/ Installment Due A/c (At HPP)	Cr
	Rs.	Rs.
Balance b/d	5,000	Cash Received 60,000
Stock with HP (b/f)	66,000	Good Repossessed (installment due but not paid) 2,000
		Balance c/d 9,000
	71,000	71,000

Hire Purchase Trading Account (at cost) for the year ended 31 st Dec, 2009			
Dr	Rs.	Cr	Rs.
Balance b/d		Cash Account	60,000
Stock with HP Customers or		Good Repossessed Account	500
Installments Not Due Account	6,000	(Agreed Value)	
Installments Due Account	5,000	Balance c/d	
Goods sold on HP basis (at cost)(B/f of Shop Stock Account)	58,000		
Profit & Loss A/c (Profit)	20,500	Installments not due	20,000
		Installments due	9,000
	1,09,500		1,09,500

Hire Purchase Trading Account (At HPP) for the year ended 31 st Dec. 2009			
Dr	Rs.	Cr	Rs.
Balance b/d		Cash Account	60,000
Stock with HP customers/Installments Not Due Account	9,000	Goods Repossessed Account (Agreed value)	500
Installments Due Account	5,000	Stock Reserve Account (1)	3,000
Goods sold at HP basis (during the year)	87,000	Goods sold at HP Basis (2)	29,000
Stock Reserve (3)	10,000	Balance c/d	
Profit & Loss A/c (balancing figure)(Profit)	20,500	Installments Not Due/ Stock with HP customers)	30,000
		Installments Due Account	9,000
	1,31,500		1,31,500

1. Loading on opening stock at HP
= $50/150 \times 9,000 = 3,000$
2. Loading on goods sold at HP
= $50/150 \times 87,000 = 29,000$
3. Loading on closing stock at HP
= $50/150 \times 30,000 = \text{Rs. } 10,000$

11. Stock and Debtors System

This is an alternative method of calculating profit or loss on hire purchase transactions. Under this method, beside the three ledger accounts namely Shop Stock Accounts, Installment Not Due A/c and Installment Due A/c (already been discussed in 11.10), Hire Purchase Adjustment Account is prepared (instead of Hire Purchase Trading A/c) for

Accounting for Hire Purchase System

calculation of profit or loss on hire purchase transactions. If goods have been repossessed, the Goods Repossessed A/c should also be prepared.

The following journal entries are made under this method:

- (i) When goods are purchased for shop stock

Shop Stock Account	Dr.	(Cost price)
To Purchases Account		
- (ii) When goods are sold on Hire Purchase

Hire Purchase stock A/c	Dr.	(HP Price)
To Shop Stock A/c		
	Dr	(Cost)
To Hire Purchases Adjustment A/c		
- (iii) When installments become due

Hire Purchase Debtors A/c	Dr.	(HP Price)
To Hire Purchase Stock A/c		
- (iv) When cash is received from hire purchase debtors

Cash Account -	Dr.	
To Hire Purchase Debtors A/c		
- (v) When goods are repossessed on default

Goods Repossessed A/c	Dr.	(Agreed Value)
A/c	Dr.	(Loss on Repossession)
To Hire Purchase Debtors A/c		
- (vi) For reserve on opening Stock with Hire Purchase Customers

Stock Reserve A/c	Dr.	Loaded Price
To Hire Purchase Adjustment A/c		
- (vii) For reserve on closing stock with hire purchase customers.

Hire Purchase Adjustment A/c	Dr.	Loaded Price
To Stock Reserve A/c		
- (viii) For profit on Hire Purchase.

Hire Purchase Adjustment A/c	Dr.	(Profit)
To Profit & Loss A/c		

Or

Profit & Loss A/c	Dr.	(Loss)
To Hire Purchase Adjustment A/c		

Dr	Hire Purchase Adjustment A/c	Cr
	Rs.	Rs.
Stock Reserve Account (loading on closing stock)	-	Stock Reserve Account (loading on opening stock)
Loss on Goods Repossessed	-	Goods sold on HP Basis/Hire Purchase Stock Account (load)
		Profit on Repossession
Hire Purchase Expenses	-	Profit & Loss A/c (Loss)
Profit & Loss A/c (Profit) (Balancing figure)	-	(Balancing figure)

Illustration 19:

Gupta and Co. have a hire-purchase department. Goods are sold on hire purchase at cost plus 33 1/3%. From the following particulars, prepare Shop Stock A/c, HP Debtors A/c, HP Stock A/c & HP Adjustment A/c

		Rs
1-1-2009	Stock out with HP Customer at HPP	8,000
	Stock at Shop at Stock	1,000
	Installment Due	600
1-1-2009 to 31-12-2009	Cash received from Customers	16,000
	Goods Repossessed (Installments due Rs. 4,000) valued at (this has been included in the Stock at Shop at the end at Rs1,000)	1,000
31-12-2009	Installments Due	1,000
	Stock at Shop (including goods repossessed)	2,400
	Stock out with HP Customer at HPP	9,200

Verify your results by preparing Hire Purchase Trading Account.

Accounting for Hire Purchase System

Solution 19:

Dr	Shop Stock A/c (At Cost)		Cr
	Rs.		Rs.
Balance b/d	1,000	HP Stock A/c (Cost)	16,200
Purchases (B/f)	16,600	Balance c/d (2,400 - 1,000)	1,400
	17,600		17,600

Dr	Installment Not Due A/c / HP Stock A/c (At HPP)		Cr
	Rs.		Rs.
Balance b/d	8,000	Installment Due	20,400
Shop Stock A/c (Being good sold at HP) (balancing Figure)	21,600	Balance c/d	9,200
	29,600		29,600

Dr	Installment Due A/c / HP Debtors A/c (At HPP)		Cr
	Rs.		Rs.
Balance b/d	600	Cash Account	16,000
HP Stock A/c (Installments due) (Balancing Figure)	20,400	Good Repossessed	4,000
		Balance c/d	1,000
	21,000		21,000

Dr	Hire Purchase Adjustment A/c		Cr
	Rs.		Rs.
Stock Reserve Account (loading on closing stock)	2,300	Stock Reserve Account (loading on opening stock)	2,000
Loss on Goods Repossessed (4000 - 1000)	3,000	Goods sold on HP Basis Account (loading on goods sold on HP basis during the year)	5,400
Profit & Loss A/c(Profit) (Balancing Figure)	2,100		
	7,400		7,400

Alternatively:

Dr	Hire Purchase Trading A/c		Cr
	Rs.		Rs.
Balance b/d		Cash Received	16,000
Stock with HP Customers/Installments Not Due A/c	8,000	Good Repossessed Account	1,000
Installments Due A/c	600	Stock Reserve Account	2,000
Goods Sold at HP	21,600	Goods Sold at HP Account (loading on goods sold)	5,400
Stock Reserve Account	2,300	Balance c/d	
Profit & Loss A/c (Profit) (Balancing Figure)	2,100	Installment Not Due / Stock with HP Customers account	9,200
		Installments Due A/c	1,000
	34,600		34,600

Illustration 20:

Raman of Delhi sells goods on hire purchase basis. He adds 50% to the cost of goods sold while selling goods at hire purchase. From the information given below, prepare Hire Purchase Adjustment A/c and all other relevant ledger accounts to show profits or loss. Also verify your results by preparing Hire Purchase Trading A/c.

April 1, 2009	Rs.
Stock/Goods out on Hire Purchase (at cost price)	40,000
Installments Due	1,500
Purchases during the year	3,02,000
Cash received during the year	4,53,000
Total amounts of installments that fell during the year	4,63,500

Accounting for Hire Purchase System

One customer to whom goods had been sold for Rs. 7,500 paid only five installments of Rs. 500 each. On his failure to pay the monthly installments of Rs. 500/- each due in November and December, 2009, the goods were repossessed on 31st Dec., 2009 after legal proceedings.

Solution 20:

Dr	Stock at Shop A/c (At Cost Price)		Cr
	Rs.		Rs.
Purchases	3,02,000	HP Stock A/c (Balancing figure)	3,02,000
	3,02,000		3,02,000

Dr	Installment Due/HP Stock A/c (At HPP)		Cr
	Rs.		Rs.
Balance b/d (40,000 + 20,000)	60,000	HP Debtors A/c	4,63,500
		Goods Repossessed Account	4,000
Stock Shop A/c (3,02,000 + 1,51,000)	4,53,000	Balance c/d (Balancing figure)	45,500
	5,13,000		5,13,000

Dr	Installment Due/HP Debtors A/c (At HPP)		Cr
	Rs.		Rs.
Balance B/d	1,500	Cash received	4,53,000
HP Stock A/c (B/f)	4,63,500	Goods Repossessed	1,000
		Balance C/d	11,000
	4,65,000		4,65,000

Dr	HP Adjustment A/c		Cr
	Rs.		Rs.
Stock Reserve	15,167	Stock Reserve	20,000
Loss on goods repossessed	Nil	Goods sold at HP	1,51,000
Profit & Loss A/c (Profit)	1,55,833		
	1,71,000		1,71,000

Alternatively:

Dr	HP Trading A/c (At HPP)		Cr
	Rs.		Rs.
Balance b/d HP Stock Account	60,000	Cash Received	4,53,000
HP Debtors Account	1,500	Goods Repossessed Account	5,000
Goods Sold at HP Basis	4,53,000	Stock Reserve	20,000
Stock Reserve Account	15,167	Goods sold at HP Basis	1,51,000
Profit & Loss A/c (Profit)	1,55,833	Balance C/d	45,500
		HP Stock at end	
		HP Debtors Account at the end.	11,000
	6,85,500		6,85,500

(1) On Goods Repossessed out of total 15 (7500/500) installments; 5 paid, and 2 are due and not paid and 8 are not yet due. Hence,

Goods Repossessed A/c	5,000	
To HP Stock A/c		4,000 (500x8)
To HP Debtors A/c		1,000 (500x2)

In the absence of any information, valuation of goods repossessed does not change.

Illustration 21:

R & Co. records transactions relating to hire-purchase business on stock & debtors system. It sold to Ramesh a tape recorder for which he is required to pay in all Rs. 2,400 in the form of 12 monthly installments of Rs. 200 each. Ramesh paid four installments in time but thereafter stopped paying installments. R & Co. after the

Accounting for Hire Purchase System

seventh installment had also become due repossessed the tape recorder. R & Co. valued repossessed tape recorder at Rs. 1,700. In the books of the company pass a journal entry to record the effect of repossession of tape recorder from Ramesh.

Solution 21:

Goods Repossessed A/c – Dr.	1,700	
To Installments Not Due A/c (5*200)	1,000	
To Installments Due A/c (3*200)	600	
To Hire Purchase Adjustment A/c	100	
(Balancing figure)		

Note: - If goods repossessed are valued at price which is less than Installment not due & Installment Due, in that case difference is treated as loss and debited to Hire Purchase Adjustment A/c.

Illustration 22:

Vikram had delivered goods to his customers on hire purchase system at hire purchase price Rs. 46,000. He normally sells goods in the open market at retail price showing gross profit of 30% on that price. In order to sell goods at hire purchase price he adds 15% to retail price. During the year, goods actually costing Rs. 2,800 were returned by a customer who had paid nothing. Installments received during the year Rs. 18,400. Calculate:

- (i) Stock with hire purchase customer
- (ii) Profit or loss transferred to Profit & Loss A/c

Solution 22:

In the Books of Vikram

Dr	Stock with HP Customers Account (At HPP)		Cr
Goods Sold at HP	Rs.	46,000 Installment Due (transferred from HP Debtors Account) Balance C/d (Balancing Figure)	Rs. 23,000 23,000 46,000
	46,000		46,000

Dr	HP Debtors Account/Installment Due A/c (At HPP)		Cr
Stock at HP (Balancing figure)	Rs.	23,000 Cash received Goods Repossessed (1) Balance C/d	Rs. 18,400 4,600 -
	23,000		23,000

Dr	HP Adjustment A/c		Cr
Stock Reserve (loading) (23,000 x 45/115) Loss on Good Repossessed (4600 – 2800) Profit & Loss A/c(Profit)	Rs.	9,000 1,800 7,200 18,000	Rs. 18,000 18,000
	18,000		18,000

Working Notes

Let Retail Price be	=	Rs. 100
Profit on retail price	=	Rs. 30 (30% of Rs. 100)
Cost Price	=	Rs. 70
HP Price	=	100 + 15% of 100
	=	Rs. 115
Profit	=	HP Price – Cost Price
	=	Rs 115 – 70
	=	Rs. 45
1) Value of goods repossessed		
Cost Price	=	Rs. 2,800
HP Price	=	Rs. 2800 x 115/70
	=	Rs. 4,600

Illustration 23:

Accounting for Hire Purchase System

Nelco Co. sold a Colour TV Set to Suresh on hire purchase system on 01-01-2006 for Rs. 18,400. Suresh paid Rs. 4,000 on the same date to receive the delivery of TV Set and agreed to pay the balance in 6 equal monthly installments, each installment becoming due on the last day of each month.

Suresh paid three installments in time but failed to pay the other installments. In May 2006 (before the monthly installment has become due) the seller repossessed the TV Set. The repossessed was valued at Rs. 7,000. Show necessary ledger accounts in the books of Nelco Co.

Solution 23:

In the Books of Nelco Co.

Dr	Stock with HP Customers A/c (At HPP)		Cr
	Rs.		Rs.
Goods sold at HP	18,400	Installment Due (2400 x 4 + 4,000)	13,600
		Goods Repossessed (2400 x 2)	4,800
	18,400		18,400

Dr	Installment Due A/c (At HPP)		Cr
	Rs.		Rs.
Stock at HP	13,600	Cash Received (4000 + 2400 x 3)	11,200
		Goods Repossessed (2400 x 1)	2,400
	13,600		13,600

Dr	Goods Repossessed A/c		Cr
	Rs.		Rs.
Stock with HP	4,800	Hire Purchase Adj. A/c (loss)	200
Installment Due	2,400	Balance C/d	7,000
	7,200		7,200

Illustration 24:

Delhi TV House sells goods both on Cash and hire purchase basis and records hire purchase transactions on stock and Debtors System and closes its books on December 31st every year.

On 01-04-2009, it sold to Sajan a color TV Set & VCR, the other particulars are as follows:

Item	TV Set	VCR
Cash Price	Rs. 9,000	Rs. 16,000
Down Payment	Rs. 2,000	Rs. 4,000
No. of installments	10	8
Amount of each installments	Rs. 1,000	Rs. 2,000
Mode of Payment	Monthly	Bi-monthly
First installment due on	01-05-2009	01-06-2009

Sajan paid all installments due except for those due on December 1, 2009. It was decided that TV House will take back VCR at an agreed price of Rs. 10,000.

VCR repossessed was sold for Rs. 12,000 after repair charges which amounted to Rs. 500 only. Prepare necessary ledger accounts to record the above transactions and find out the profits.

Solution 24:

In the Books of Delhi TV House

Dr	Stock with HP Customers A/c (At HPP)		Cr
	Rs.		Rs.
Goods Sold on HP (1)	32,000	Installment Due (2)	22,000
		Goods Repossessed A/c (4)	8,000
		Balance C/d (5)	2,000
	32,000		32,000

Accounting for Hire Purchase System

Dr	HP Debtors/Installment Due A/c (At HPP)		Cr
	Rs.		Rs.
Stock at HP	22,000	Cash received (3)	19,000
		Goods Repossessed (4)	2,000
		Balance C/d	1,000
	22,000		22,000

Dr	Goods Repossessed A/c		Cr
	Rs.		Rs.
Stock at HP	8,000	Cash Account (Sale Price of Repossessed Goods)	12,000
Installment due	2,000		
Cash (Repairs)	500		
HP Adjustment A/c (Profit)	1,500		
	12,000		12,000

Dr	Hire Purchase Adjustment A/c		Cr
	Rs.		Rs.
Stock Reserve (7)	500	Goods sold at HP (6) (loading)	7,000
Profit & Loss A/c	8,000	Goods Repossessed (Profit on Disposal)	1,500
	8,500		8,500

Working Notes:

	TV	VCR
Cash Price	Rs 9,000	Rs 16,000
Down Payment	2,000	4,000
HPP	1,000 x 10 + 2,000	2,000 x 8 + 4,000
	= 12,000	= 20,000
Profit	3,000	4,000
1) Goods Sold at HP	Rs	
TV	12,000	
VCR	20,000	
	32,000	
2) Installment due during year		Rs
TV = Down Payment		2,000
Installments (8x1, 000)		8,000
		10,000
VCR = Down Payment		4,000
Installments (4x2000)		8,000
		12,000
3) Total = 10,000 + 12,000 = 22,000		
Cash Received		Rs
TV = Down Payment		2,000
Installments (7x1, 000)		7,000
		9,000
VCR = Down Payment		4,000
Installments (3x2,000)		6,000
		10,000
Total = 19,000		
4) Good Repossessed		Rs
Good Repossessed A/c Dr	10,000	
To Installment Due A/c		2,000
To Stock at HP A/c		8,000
		10,000
5) Stock with HP Customers at HPP at the end		

Accounting for Hire Purchase System

Installment Not Due on TV= 2 installments of Rs. 1,000 each
= Rs 2,000

6)	Stock Reserve on goods sold at HP	Rs
	TV	3,000
	VCR	4,000
		7,000
7)	Stock Reserve on Closing Stock (T V Set)	
	TV 2,000 × $\frac{3,000}{12,000}$ =	Rs. 500

Illustration 25:

Neeru Ltd. commenced business on 18th April, 200p. The business is to sell VCPs & VCRs both for cash and on hire purchase basis. Information about terms is given below:

	VCPs (Rs.)	VCRs (Rs.)
Cash Price	10,000	30,000
Cost	8,000	24,000
Down Payment	2,000	6,000
Monthly Installments	1,000	3,000
No. of Installments	10	12

The company purchased goods costing Rs. 1, 00, 00,000 in all and made cash sales totaling Rs. 86, 00,000. Stock in hand on 31st March, 2008 was valued at Rs. 12, 00,000. Hire purchase transactions were as follows:

	Number Sold	Installment Collected	Installments due (Customer Paying)
VCPs	20	110	10
VCRs	40	260	15

3 VCPs and 2 VCRs on which only 4 installments were collected were repossessed and were valued at Rs. 32,000. This is not included in the figure of stock mentioned above. Prepare accounts showing profit or loss made by company by adopting "Stock & Debtors" System.

Solution 25:

Dr	Stock with HP Customer A/c (At HPP)		Cr
	Rs.		Rs.
	Goods Sold at HP (1)	19,20,000	Installment Due (3)
			12,91,000
			(Being installment due during the year)
			Balance C/d (4)
			6,29,000
	19,20,000		19,20,000

Dr	Installment Due A/c (AT HPP)		Cr
	Rs.		Rs.
	Stock with HP customer	12,91,000	Cash Received (2)
			11,70,000
			Good Repossessed (5)
			66,000
			Balance C/d
			(10*1,000+15*3,000)
			55,000
	12,91,000		12,91,000

Dr	Goods Repossessed A/c		Cr
	Rs.		Rs.
	Installment Due account	66,000	HP Adjustment Account (loss)
			34,000
			Balance C/d
			32,000
	66,000		66,000

Dr	HP Adjustment A/c		Cr
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Accounting for Hire Purchase System

	Rs.		Rs.
Stock Reserve (6)	2,63,667	Goods Sold on HP (Loading)	8,00,000
Goods Repossessed Account	34,000	(20x4000 + 40x18000)	
(loss)			
Profit & Loss A/c	5,02,333		
	8,00,000		8,00,000

Dr		General Trading A/c	Cr	
	Rs.		Rs.	
Purchases	1,00,00,000	Sales for Cash	86,00,000	
Gross Profit	14,22,333	Goods Sold HP Customers (Cost)	11,20,000	
		(19,20,000 – 8,00,000)		
		Closing Stock	12,00,000	
		HP Adjustment Account	5,02,333	
		(Profit)		
	1,14,22,333		1,14,22,333	

Working Notes

	VCPs	VCR
Cost	8,000	24,000
Down Payment	2,000	6,000
Installment	1,000	3,000
No. of Installments	10	12
HPP	$200 + (1000 \times 10) = 12,000$	$6000 + (3000 \times 12) = 42,000$
Profit	4,000	18,000

1) Goods Sold at HP		
VCP 20 @ Rs. 12,000	=	2,40,000
VCR 40 @ Rs. 42,000	=	<u>16,80,000</u>
	=	<u>19,20,000</u>
2) Cash Received		
VCP Down Payment 20 x 2,000		40,000
Installments 110 x 1,000		<u>1,10,000</u>
		<u>1,50,000</u>
VCR Down Payment 40 x 6,000		2,40,000
Installments 260 x 3,000		<u>7,80,000</u>
		<u>10,20,000</u>

Total = Rs 1,50,000 + Rs 10,20,000 = Rs 11,70,000		
3) Installment Due		
VCP		
Down Payment 20 @ 200		40,000
Installment Collected & due (110 + 10) = 120		
Add: Installment due (3x6) = 18		
3 repossessed VCP 138 @ 1,000 each		<u>1,38,000</u>
		<u>1,78,000</u>
VCR		
Down Payment 40 @ 6,000	=	2,40,000
Installment Collected & due (260 + 15) = 275		
Add: Installments due on (2 x 8) = 16		
2 VCRs Repossessed = 291 @ 3,000 each		<u>8,73,000</u>
		<u>11,13,000</u>

Total = 1,78,000 + 11,13,000 = 12,91,000

4) Installments Not Due		
VCP		
Units sold less repossessed x no. of Installment 17x10	=	170
Less: Installments Collected & due excluding for goods repossessed (110+10 – 3x4)	=	108

Accounting for Hire Purchase System

62 @ Rs. 1,000 each		<u>62</u> = 62,000
VCR		
Unit Sold less repossessed x No. of Installment (40+2) x12	=	456
Less: Installments collected & Due excluding for goods repossessed (260+15 - 2x4)		<u>267</u>
		<u>189</u>
189 @ Rs. 3,000 each		<u>5, 67,000</u>
Total = 62,000+5,67,000= Rs. 6, 29,000		
(5) Goods Repossessed		
VCP 3 x 10	=	30
Less Collected 3 x 4	=	12
18 @ Rs. 1,000 each	=	18,000
VCR 2 x 12	=	24
Less Collected (2 x 4)	=	8
	=	16 @ Rs. 3,000 each
	=	48,000
Total=18,000+48,000 = Rs. 66,000		
(6) Stock Reserve on Installments not due		
VCP 62,000 x 4,000	=	20,667
		<u>12,000</u>
VCR 5, 67,000 x 18,000	=	2, 43,000
		<u>42,000</u>
	=	<u>2, 63,667</u>

12. Lease

According to AS-19 - A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments, the right to use an asset for an agreed period of time. The fundamental characteristic of a lease is that ownership never passes to the business customer. Instead, the leasing company claims the capital allowances and passes some of the benefit on to the business customer, by way of reduced rental charges. The business customer can generally deduct the full cost of lease rentals from taxable income, as a trading expense. As with hire purchase, and the business customer will normally be responsible for maintenance of the equipment.

Lease may be of two types:

- Financial Lease
- Operating Lease

Financial Lease

According to AS-19- A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. At lease it must give an option to the lessee to purchase the asset he has used at the expiry of the lease. Under this lease the lessor recovers 90% of the fair value of the asset as lease rentals and the lease period is 75% of the economic life of the asset. The lease agreement is irrevocable. Practically all the risks incidental to the asset ownership and all the benefits arising there from are transferred to the lessee who bears the cost of maintenance, insurance and repairs. Only title deeds remain with the lessor. Financial lease is also known as 'capital lease'.

The finance lease or 'full payout lease' is closest to the hire purchase alternative. The leasing company recovers the full cost of the equipment, plus charges, over the period of the lease. Although the business customer does not own the equipment, they have most of the 'risks and rewards' associated with ownership. They are responsible for maintaining and insuring the asset and must show the leased asset on their balance sheet as a capital item. When the lease period ends, the leasing company will usually agree to a secondary lease period at significantly reduced payments. Alternatively, if the business wishes to stop using the equipment, it may be sold second-hand to an unrelated third party. The business arranges the sale on behalf of the leasing company and obtains the bulk of the sale proceeds.

Operating Lease

Accounting for Hire Purchase System

An operating lease is a lease other than a finance lease. If a business needs a piece of equipment for a shorter time, then operating leasing may be the answer. The leasing company will lease the equipment, expecting to sell it secondhand at the end of the lease, or to lease it again to someone else. It will, therefore, not need to recover the full cost of the equipment through the lease rentals. This lease agreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Computers hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets with high-cost and high technology. This type of leasing is common for equipment where there is a well-established secondhand market (e.g. cars and construction equipment). The lease period will usually be for two to three years, although it may be much longer, but is always less than the working life of the machine. Assets financed under operating leases are not shown as assets on the balance sheet. Instead, the entire operating lease cost is treated as a cost in the profit and loss account.

Financial Lease vs. Operating Lease

	Financial Lease		Operating Lease
1)	Financial lease is long term contract covering the entire life of an asset.	1)	Operating Lease is usually for two or three years, although it may be much longer, but is always less than the working life of the asset.
2)	Financial lease transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee.	2)	This lease agreement gives to the lessee only a limited right to use the asset.
3)	Under financial lease, lessee is given option to purchase the asset at the end of the lease period at a nominal cost.	3)	Under operating lease, lessee is not given an option to purchase the asset at the end of the lease period.
4)	The leasing company recovers the full cost of the equipment, plus charges over the period of the lease as lease rental.	4)	Lease rental from any lessee is not sufficient to cover the cost of the asset.
5)	The lease agreement is irrevocable.	5)	The lease agreement is revocable at a short notice.
6)	The lessee is responsible for the maintenance, insurance and repairs of the asset.	6)	The lessor is responsible for the maintenance & repairs of the asset.
7)	The lessee shows the leased asset in his balance sheet as capital item.	7)	Asset financed under operating lease is not shown as asset in the balance sheet of the lessee and the entire operating lease cost is treated as a cost in P&L A/c.

Summary:

- Hire purchase system is a method of buying goods in which the purchaser takes possession of goods as soon as an initial installment of the price is paid.
- However, ownership is obtained only when all the agreed number of subsequent installments is paid.
- In case the hirer does not pay any or even the last installment the vendor gets the right to repossess the goods and forfeit the paid amount as the hire charge.
- The hire purchase system is governed under the Hire Purchase Act 1972.
- Hire purchase system differs from installment system.
- There are various methods of recording hire-purchase transaction such as; Full cash price method, Down payment / Accrual method, Debtor system/Method, Stock & Debtor system/Method etc.

Exercises:

A. Short Answer Questions:

1. Compare the two systems of purchase and Hire Purchase and Installment System.

Accounting for Hire Purchase System

2. What do you mean by Goods Repossessed? How they are treated in the books of Hire Vendor.
3. Differentiate between partial repossession and full repossession from accounting point of view.
4. Explain the provisions of Hire Purchase Agreement under Hire Purchase Act, 1972.
5. Distinguish between operating lease and finance lease.
6. What is meant by Good Repossessed? How are they treated in the books of account under stock and Debtors method of Hire Purchase System?
7. Mention the point of difference between the Hire Purchase System and Installment System: (a) from the legal point of view, and
(b) from accounting point of view.

B. Practical Questions:

1. On 1st Jan 2005, Sapna purchased machinery from Sonu Brothers on hire purchase basis. The cash price of machine is Rs 25,000. The terms of payment being Rs 10,000 down and balance to be paid in three annual installments of Rs 5,000 each plus interest @ 10% p.a. Calculate hire purchase price and interest.
2. On 1st April 2005, Neelam purchased a machine on hire purchase basis. The cash price of the machine is Rs 1, 00,000. The terms of payment being Rs 10,000 down and the balance in 4 equal installments of Rs 25,000 each payable on 31st march every year. Neelam charged depreciation @ 20% p.a.
Prepare necessary ledger accounts in the books of Neelam and Hire Vendor.
3. Shyam purchased car on 1st Jan 2005 from Hindustan Motors Ltd on hire purchase basis. He agreed to pay Rs 50,000 on taking delivery of car and pay three annual installments of Rs 88,000 each. The vendor charged interest @ 10% p.a. Shyam charged depreciation @ 15% p.a on w.d.v basis. Pass journal entries in the books of Shyam.
4. On 1st Jan 2007, Sahiba purchased an air conditioner from Neeraj Electronics on hire purchase basis. The payment is to be made as: Rs 5,000 on delivery and the balance by following installments on 31st Dec in each year:

2007	Rs 10,000
2008	Rs 10,000
2009	Balance Amount

Neeraj Electronics charged interest @ 10% on the yearly basis. The cash price of air conditioner is Rs 30,000. Depreciation @ 10% p.a on w.d.v is to be charged. Show Air conditioner on Hire Purchase Account and Neeraj Electronics Account in the books of Sahiba.
5. On 1st July 2005, X Ltd purchase machinery from Y Ltd on hire purchase basis. The cash price of machine is payable as Rs 20,000 down and the balance in three equal annual installments together with interest @ 10% p.a. The amount of last installment including interest was Rs 27,500. Depreciation was to be provided @ 10% p.a. on written down value method. Show Machinery Account and Y Ltd Account in the books of X Ltd.
6. A machinery is sold on hire purchase. The terms of payment are four annual installments of Rs 6,000 at the end of each year commencing from the date of agreement. Interest is charged @ 20% and is included in the annual payment of Rs 6,000. Show Machinery Account and Hire Vendor Account in the books of purchaser who defaulted in the payment of third yearly payment whereupon the vendor repossessed the machinery. The purchaser provides depreciation on the machinery @ 10% p.a on w.d.v.
7. On 1st Jan 2006 five trucks were purchased by Naveen on hire purchase system. The cash price of each truck is Rs 1, 00,000. The payment was to be made as follows:

10% of cash price down
25 % of cash price at the end of each subsequent half years.

The payment due on 31st Dec 2006 could not be made. The vendor seizes all the trucks, spends Rs 20,000 on their repairs and sells them for Rs 4, 00,000. You are required to prepare Naveen's Account and Goods Repossessed Account in the books HP Vendor and HP vendor's Account and Trucks on HP Account in the books of Naveen assuming hire purchaser charges depreciation @ 15% p.a on written down value method.
8. The Roxy Dry Cleaners purchased from the vendor two machine of Rs 10,000 each on hire purchase system. The payment was to be made Rs 5,000 down and the remainder in three equal installments of Rs 5,000 each together with interest @ 5% p.a. The Roxy Dry Cleaners write off depreciation @ 10% p.a on w.d.v. They could not pay the second installment. After negotiation it was agreed that the vendor would have one machine with purchaser adjusting the value of other against amount due treating the machine @ 20% depreciation on diminishing balance. Show HP Vendor's Account and Machinery on HP in the books of Roxy Dry Cleaners.

Accounting for Hire Purchase System

9. Transport Ltd. Purchased 2 Trucks costing Rs 1, 60,000 each from Pal Auto Ltd. on 1st Jan 2007. The terms were: Payment on delivery Rs 40,000 for each truck, remainder in 3 equal installments together with interest at 10% p.a to be paid at the end of each year. Transport Ltd. Write off 25% depreciation each year on the diminishing balance method. Transporter Ltd. paid the installment due on 31stDecember, 2007 and 31st December, 2008 but could not pay the final installment. Pal Auto Ltd repossessed one truck adjusting its value against the amount due. The repossession was done on the basis of 30% depreciation on diminishing balance method. Prepare HP vendor's Account and Trucks on HP Account in the books of Transport Ltd.
10. ABC Ltd. purchased 2 machines costing Rs 80,000 each from X on 1stJan, 2005 on the hire purchase system. The terms were:
Payment on delivery Rs 20,000 for each machine; Balance in 3 equal installments together with interest at 10% p.a to be paid at the end of each year.
ABC Ltd writes off 25% depreciation each year on the diminishing balance method. ABC Ltd. could not pay final installment. X repossessed one machine adjusting its value against the amount due. The repossessed machine was valued on the basis of 30% p.a depreciation on diminishing balance method. The vendor spent Rs 5,000 for the repairs and sold it for Rs 35,000.
Pass journal entries in the books of X and prepare X Accounts and Machines on HP Account in the books of ABC Ltd.
11. Mr. Vikram is a hire purchaser trader and sells goods on hire purchase basis at cost plus 50%. From the following information, prepare Hire Purchase Trading Account to determine profit for the year ending 31 March 2009:
- | | Rs |
|---|-----------|
| April, 2008 | |
| Stock with customers (at H.P Price) | 45,000 |
| Stock at shop (at cost) | 90,000 |
| Installment Due | 25,000 |
| Goods Repossessed (installment due Rs 10,000) | 2,500 |
| Cash received from customers | 3,00,000 |
| March 31, 2009 | |
| Stock at shop (excluding repossessed goods) | 1, 00,000 |
| Installment due but not received | 45,000 |
| Stock with customers at HPP | 1,50,000 |
12. Shyam Brothers have a Hire Purchase department which sells goods at cost plus 50%. From the following information you are required to ascertain the profit made for the year ended 31st march 2008 using Stock and Debtor Method:
- | | |
|--|-----------|
| Stock on hire with customer at selling (on 1-4-2007) | 54,000 |
| Stock at shop (at cost) on 1-4-2007 | 1, 08,000 |
| Installment due on 1-4-2007 | 30,000 |
| Cash received from customer | 3,60,000 |
| Goods repossessed (installment due Rs 12,000) | 3,000 |
| Installment due from paying customer | 54,000 |
| Closing stock at shop (including repossessed goods) | 1,23,000 |
| Purchases made in the year | 3,60,000 |
13. Tarun sells goods on hire purchase basis also. He fixes hire purchase price by adding 50% to the cost of the goods to him. The following are the figures relating to his hire purchase business for the year 2008.
- | | |
|--|-----------|
| Balance on Hire purchase Stock account on 1-1-2008 | 24,000 |
| Balance on Hire purchase Debtors account on 1-1-2008 | 600 |
| Selling price of the goods sold on hire purchase | 1, 81,200 |
| Cash Received from Customers | 1, 84,800 |
| Total amount of installments that fell due during the year | 1, 85,400 |
- One customer to whom goods had been sold for Rs 2,400 paid only three installments of Rs 200. On his failure to pay the monthly installment of Rs 200 due on 4 December, 2008 the goods were repossessed on 28-12-2008 after legal notice.
14. Ramesh Ltd. Sells a product on hire purchase basis. It has the following transactions for the year ending 31st March 2010.
- | | Rs |
|--|-----------|
| 2009, April 1 | |
| Stock out on hire at hire purchase price | 60,000 |
| Stock at hand (at shop) | 7,500 |
| Installment due (Customers still paying) | 4,500 |
| 2010, March 31 | |
| Stock out on hire at hire purchase price | 69,000 |
| Stock at hand (at shop) | 10,500 |
| Installment due | 7,500 |
| Cash received during the year | 1, 20,000 |
- The business follows the practice of charging gross profit at 25% of selling price. Prepare necessary ledger accounts to record these transactions in the books of the Ramesh Ltd in a manner as to show the cost of purchase made and profit earned during the year.

Accounting for Hire Purchase System

15. The Hire Purchase department of Naveen Electronics sells TV and coolers on hire purchase basis. The relevant information for the year ended 31st March 2008 is as follows:

	TV Rs	Cooler Rs
Cost	5,400	2,000
Cash price	6,300	2,400
Cash down payment	900	400
Monthly installment	600	200
No of installments	10	12

During the year, 200TV and 240 coolers were sold on hire purchase basis. 4 TV on which 3 installments only could be collected and 8 coolers on which 5 installments had been collected were repossessed. These were valued at Rs 20,000, after reconditioning at cost of Rs 2,000; they were sold outright for Rs 28,000. Other installments collected and those due were respectively as follows:

TV	540	and 40
Coolers	800	and 60

Prepare accounts on Stock and Debtors system to reveal profit of the department.

Answers to Practical Questions:

- 1: HPP=Rs 28,000, Interest=Rs 3,000;
- 2: Interest, I=Rs4, 000, II=Rs3, 000, III=Rs2, 000, IV=Rs1, 000;
- 3: Cash Price=Rs 2, 68,843, Interest, I=Rs 21, 884, II=Rs 15,273, III=Rs 8,000);
- 4: Balance Installment=Rs 10,175;
- 5: Cash Price= Rs 95,000, Installment, I=Rs 32,500, II=Rs 30,000, III=Rs 27,500;
- 6: Cash Price=Rs 15,532, Interest, I=Rs 3,107, II=Rs 2,528, III=Rs 1,833, IV=Rs 1,000, Loss on Repossession=Rs323;
- 7: Loss on Repossession=Rs 65, 000, Profit on Resale=Rs 20,000;
- 8: Loss on Repossession=Rs 1,700;
- 9: Loss on Repossession=Rs12, 620, value of Truck Repossessed=Rs54,880;
- 10: Loss on Repossession=Rs6, 310, Profit on Sale=Rs2,560;
- 11: Profit=Rs1,02,500;
- 12: Profit=Rs1,23,000;
- 13: Profit=Rs62,334;
- 14: Profit=Rs30,750;
- 15: Profit=Rs2,00,057.

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