

# 11

## HIRE PURCHASE AND INSTALLMENT SALE TRANSACTIONS

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### Learning Objectives

After studying this chapter, you will be able to:

- ◆ Understand the salient features and nature of Hire purchase transactions.
- ◆ Journalise the Hire purchase entries both in the books of hire purchaser and the hire vendor.
- ◆ Learn various methods of accounting for hire purchase like Debtors method and Stock and Debtors method.
- ◆ Ascertain various missing values, required while accounting the hire purchase transactions, on the basis of given information.
- ◆ Calculate and record the value of repossessed goods and also to calculate the profit on re-sale of such goods.
- ◆ Draw the Hire-purchase Trading Account and calculate the profit on such transactions.
- ◆ Evaluate the profit on hire purchase of goods of small value.
- ◆ Understand the instalment payment system and also how it is different from hire purchase transactions.

### 1. Introduction

With an increasing demand for better life, the consumption of goods has been on the expanding scale. But, this has not been backed up by adequate purchasing power, transforming it into effectual demand, i.e., actual sale at set or settled prices. This has created the market for what is called **hire purchase**.

When a person wants to acquire an asset but is not sure to make payment within a stipulated period of time he may pay in instalments if the vendor agrees. This enables the purchaser to use the asset while paying for it in instalments over an agreed period of time. This type of a business deal is known as hire purchase transaction. Here, the customer pays the entire

amount either in monthly or quarterly or yearly instalments, while the asset remains the property of the seller until the buyer squares up his entire liability. For the seller, the agreed instalments include his interest on the assets given on credit to the purchaser. Therefore, when the total amount is paid in instalments over a period of time is certainly higher than the cash down price of the article because of interest charges. Obviously, both the parties gain in the bargain. By virtue of this, the purchaser has the right of immediate use of the asset. By this, he gets both credit and product from the same seller. From seller's view point, he derives the benefit by increase in sale and also he recovers his own cost of credit.

### 2. Nature of Hire Purchase Agreement

Under the Hire Purchase System the Hire Purchaser gets possession of the goods at the outset and can use it, while paying for it in instalments over a specified period of time as per the agreement. However, the ownership of the goods remains with the Hire Vendor until the hire purchaser has paid all the instalments. Each instalment paid by the hire purchaser is treated as hire charges for using the asset. In case he fails to pay any of the instalments (even the last one) the hire vendor will take back his goods without compensating the buyer, i.e., the hire vendor is not going to pay back a part or whole of the amount received through instalments till the date of default from the buyer.

### 3. Special Features of Hire Purchase Agreement

1. **Possession:** The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.
2. **Installments:** The goods are delivered by the hire vendor on the condition that a hire purchaser should pay the amount in periodical instalments.
3. **Down Payment:** The hire purchaser generally makes a down payment i.e an amount on signing the agreement.
4. **Constituents of Hire purchase instalments:** Each instalment consists partly of a finance charge (interest) and partly of a capital payment.
5. **Ownership:** The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.
6. **Repossession:** In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

### 4. Accounting Arrangements of Hire Purchase Transaction

The method of accounting for hire purchase transactions depends on the value of sales. If the goods have substantial sales value the accounting methods adapted may be (i) Cash price method or (ii) Interest suspense method. Hire purchase accounting methods for goods of small sales value may be (i) Debtors method or (ii) Stock and debtors method.

Asset taken on hire purchase basis should be considered like ordinary purchase. However, **it is necessary to disclose this fact by classifying it as "Asset on Hire Purchase"**.

## Accounting

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**Accordingly, amount due to the hire vendor should also be shown in his books as a liability—“Hire Purchase Creditors” with additional such classifications of amount of hire purchase instalment due and amount of hire purchase instalment not yet due.**

### 4.1 In the Books of Hire Purchaser

#### 4.1.1. Cash price method

Under this method, the full cash price of the asset is debited to the Asset Account and credited to the Hire Vendor Account. At the time of payment of instalment, Interest Account is debited and Hire Vendor Account is credited (with the interest on outstanding balance). When instalment is paid, the Hire Vendor Account is debited and Bank Account is credited. At the time of preparation of Final Accounts, interest is transferred to Profit and Loss Account and asset is shown in the Balance Sheet at cost less depreciation. The balance due to hire vendor is shown in the Balance Sheet as a liability (alternatively it can be shown as a deduction from Asset Account).

<b>Depreciation on asset acquired on hire purchase must be calculated on <i>cash price</i>.</b>
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#### Accounting

To have proper accounting record, one should know: (1) Date of purchase of the asset; (2) Cash price of the asset; (3) Hire purchase price of the asset; (4) The amount of down payment; (5) Number and amount of each instalment; (6) Rate of interest; (7) Method and rate of depreciation; (8) Date of payment of every instalment; and (9) Date of closing the books of account.

#### Journal Entries

1.	<i>On entering into the agreement</i> Asset Account To Hire Vendor Account	Dr. [Full cash price]
2.	<i>When down payment is made</i> Hire Vendor Account To Cash/Bank Account	Dr. [Down payment]
3.	<i>When an instalment becomes due</i> Interest Account To Hire Vendor Account	Dr. [Interest on outstanding balance]
4.	<i>When an instalment is paid</i> Hire Vendor Account To Bank Account	Dr. [Amount of instalment]
5.	<i>When depreciation is charged on the asset</i> Depreciation Account To Asset Account	Dr. [Calculated on cash price]

## Hire Purchase and Instalment Sale Transactions

6.	<i>For closing interest and depreciation account</i> Profit and Loss Account To Interest Account To Depreciation Account	Dr.
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However, a firm may maintain Provision for Depreciation A/c instead of charging depreciation to Hire Purchase Asset A/c. In such case the journal entry is:

Profit and Loss A/c	Dr.
To Provision for Depreciation for Asset on Hire Purchase A/c	

and naturally, Asset on Hire Purchase is shown at its historical cost.

### **Disclosure in the balance sheet**

#### Assets

Fixed Assets :	
Asset (at cash price)	XXXXXXXX.XX
Less : Depreciation	<u>XXXX.XX</u>
	<u>XXXXXXXX.XX</u>

#### Creditors :

Hire Purchase Creditors :	
Balance in hire vendor's A/c	XXXXX.XX
Instalment due	XXXXX.XX
Instalment not yet due	XXXXX.XX

### **Illustration 1**

*On January 1, 2008 HP and Co. acquired a pick-up Van on hire purchase from FM & Co. Ltd. The terms of the contract were as follows:*

- (a) *The cash price of the van was ₹ 1,00,000.*
- (b) *₹ 40,000 were to be paid on signing of the contract.*
- (c) *The balance was to be paid in annual instalments of ₹ 20,000 plus interest.*
- (d) *Interest chargeable on the outstanding balance was 6% p.a.*
- (e) *Depreciation at 20% p.a. is to be written-off using the straight-line method.*

*You are required to:*

- (a) *Give Journal Entries and show the relevant accounts in the books of HP and Co. from January 1, 2008 to December 31, 2010; and*
- (b) *Show the relevant items in the Balance Sheet of the purchaser as on December 31, 2008 to 2010.*

## Accounting

### Solution

#### In the books of HP & Co.

#### Journal

Date	Particulars		Dr.	Cr.
			₹	₹
2008 Jan. 1	Pick-up Van A/c To FM & Co. Ltd. A/c (Being the purchase of a pick-up van on hire purchase from FM & Co. Ltd.)	Dr.	1,00,000	1,00,000
"	FM & Co. Ltd. A/c To Bank A/c (Being the amount paid on signing the H.P. contract)	Dr.	40,000	40,000
Dec. 31	Interest A/c To FM & Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 60,000)	Dr.	3,600	3,600
"	FM & Co. Ltd. A/c (₹ 20,000+₹ 3,600) To Bank A/c (Being the payment of 1 <sup>st</sup> instalment along with interest)	Dr.	23,600	23,600
"	Depreciation A/c To Pick-up Van A/c (Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)	Dr.	10,000	10,000
"	Profit & Loss A/c To Depreciation A/c To Interest A/c (Being the depreciation and interest transferred to Profit and Loss Account)	Dr.	13,600	10,000 3,600
2009 Dec. 31	Interest A/c To FM & Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 40,000)	Dr.	2,400	2,400
	FM & Co. Ltd. A/c (₹ 20,000 + ₹ 2,400) To Bank A/c (Being the payment of 2 <sup>nd</sup> instalment along with interest)	Dr.	22,400	22,400

### Hire Purchase and Instalment Sale Transactions

2010 Dec. 31	Depreciation A/c To Pick-up Van A/c (Being the depreciation charged @ 10% p.a.)	Dr.	10,000			10,000
	Profit & Loss A/c To Depreciation A/c To Interest A/c (Being the depreciation and interest charged to Profit and Loss Account)	Dr.	12,400			10,000 2,400
	Interest A/c To FM & Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 20,000)	Dr.	1,200			1,200
	FM & Co. Ltd. A/c (₹ 20,000 + ₹ 1,200) To Bank A/c (Being the payment of final instalment along with interest)	Dr.	21,200			21,200
	Depreciation A/c To Pick-up Van A/c (Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)	Dr.	10,000			10,000
	Profit & Loss A/c To Depreciation A/c To Interest A/c (Being the interest and depreciation charged to Profit and Loss Account)	Dr.	11,200			10,000 1,200

#### Ledger of HP & Co. Ltd.

##### Pick-up Van Account

Date		Particulars	₹	Date		Particulars	₹
1.1.2008	To	FM & Co. Ltd. A/c	1,00,000	31.12.2008	By	Depreciation A/c	10,000
				31.12.2009	By	Balance c/d	<u>90,000</u>
			<u>1,00,000</u>				<u>1,00,000</u>
1.1.2009	To	Balance b/d	90,000	31.12.2009	By	Depreciation A/c	10,000
				31.12.2009	By	Balance c/d	<u>80,000</u>
			<u>90,000</u>				<u>90,000</u>
1.1.2010	To	Balance b/d	80,000	31.12.2010	By	Depreciation A/c	10,000
				31.12.2010	By	Balance c/d	<u>70,000</u>
			<u>80,000</u>				<u>80,000</u>

## Accounting

Dr.		FM & Co. Ltd. Account				Cr.	
Date		Particulars	₹	Date		Particulars	₹
1.1.08	To	Bank A/c	40,000	1.1.08	By	Pick-up Van A/c	1,00,000
31.12.08	To	Bank A/c	23,600		By	Interest c/d	3,600
31.12.08	To	Balance c/d	<u>40,000</u>				
			<u>1,03,600</u>				<u>1,03,600</u>
31.12.09	To	Bank A/c	22,400	1.1.09	By	Balance b/d	40,000
31.12.09	To	Balance c/d	<u>20,000</u>	31.12.09	By	Interest A/c	<u>2,400</u>
			<u>42,400</u>				<u>42,400</u>
31.12.10	To	Bank A/c	21,200	1.1.10	By	Balance b/d	20,000
			<u>21,200</u>	31.12.10	By	Interest A/c	<u>1,200</u>
							<u>21,200</u>

### Depreciation Account

Dr.						Cr.	
Date		Particulars	₹	Date	Particulars	₹	
31.12.2008	To	Pick-up Van A/c	10,000	31.12.2008	By Profit & Loss A/c	10,000	
31.12.2009	To	Pick-up Van A/c	10,000	31.12.2009	By Profit & Loss A/c	10,000	
31.12.2010	To	Pick-up Van A/c	10,000	31.12.2010	By Profit & Loss A/c	10,000	

Dr.		Interest Account				Cr.	
Date		Particulars	₹	Date	Particulars	₹	
31.12.2008	To	FM & Co. Ltd. A/c	3,600	31.12.2008	By Profit & Loss A/c	3,600	
31.12.2009	To	FM & Co. Ltd. A/c	2,400	31.12.2009	By Profit & Loss A/c	2,400	
31.12.2010	To	FM & Co. Ltd. A/c	1,200	31.12.2010	By Profit & Loss A/c	1,200	

### Balance Sheet of Gopinath & Co. as at 31<sup>st</sup> December, 2008

Liabilities	₹	Assets	₹
FM & Co. Ltd.	40,000	Pick-up Van	90,000

### Balance Sheet of Gopinath & Co. as at 31<sup>st</sup> December, 2009

Liabilities	₹	Assets	₹
FM & Co. Ltd.	20,000	Pick-up Van	80,000

## Hire Purchase and Instalment Sale Transactions

### Balance Sheet of Gopinath & Co. as at 31<sup>st</sup> December, 2010

<i>Liabilities</i>	₹	<i>Assets</i>	₹
FM & Co. Ltd.	20,000	Pick-up Van	70,000

**4.1.2 Interest suspense method:** Under this method, at the time of transfer of possession of asset, the total interest unaccrued is transferred to interest suspense account. At latter years, as and when interest becomes due, interest account debited and interest suspense account is credited.

#### Journal Entries

1.	<i>When the asset is acquired on hire purchase</i> Asset Account To Hire Vendor Account	Dr. [Full cash price]
2.	<i>For total interest payment is made</i> H.P. Interest Suspense Account To Hire Vendor Account	Dr. [Total interest]
3.	<i>When down payment is made</i> Hire Vendor Account To Bank Account	Dr.
4.	For Interest of the relevant period Interest Account To H.P. Interest Suspense Account	Dr. [Interest of the relevant period]
5.	When an instalment is paid Hire Vendor Account To Bank Account	Dr.
6.	<i>When depreciation is charged on the asset</i> Depreciation Account To Asset Account	Dr. [Calculated on cash price]
7.	<i>For closing interest and depreciation account</i> Profit and Loss Account To Interest Account To Depreciation Account	Dr.

#### Illustration 2

*If we apply this method to the figures from Illustration 1, the H.P. Interest Suspense Account, Interest Account and FM & Co. Ltd. Accounts and Balance Sheets will appear as follows:*



## Accounting

### Solution

#### H.P. Interest Suspense Account

Date	Particulars	₹	Date	Particulars	₹
1.1.2008	To FM & Co. Ltd. A/c (Note 1)	7,200	31.12.2008	By Interest A/c	3,600
		<u>7,200</u>	31.12.2008	By Balance c/d	<u>3,600</u>
1.1.2009	To Balance b/d	3,600	31.12.2009	By Interest A/c	2,400
		<u>3,600</u>	31.12.2009	By Balance c/d	<u>1,200</u>
1.1.2010	To Balance b/d	1,200	31.12.2010	By Interest A/c	1,200

Dr.		Interest Account				Cr.
Date	Particulars	₹	Date	Particulars	₹	
31.12.2008	To H.P. Interest Suspense A/c	3,600	31.12.2008	By Profit & Loss A/c	3,600	
31.12.2009	To H.P. Interest Suspense a/c	2,400	31.12.2009	By Profit & Loss A/c	2,400	
31.12.2010	To H.P. Interest Suspense A/c	1,200	31.12.2010	By Profit & Loss A/c	1,200	

Dr.		FM & Co. Ltd. Account				Cr.
Date	Particulars	₹	Date	Particulars	₹	
1.1.2008	To Bank A/c	40,000	1.1.2008	By Pick-up Van A/c	1,00,000	
31.12.2008	To Bank A/c	23,600	1.1.2008	By H.P. Interest Suspense A/c	7,200	
31.12.2008	To Balance c/d	<u>43,600</u>				
		<u>1,07,200</u>			<u>1,07,200</u>	
31.12.2009	To Bank A/c	22,400	1.1.2009	By Balance b/d	43,600	
31.12.2009	To Balance c/d	<u>21,200</u>				
		<u>43,600</u>			<u>43,600</u>	
31.12.2010	To Bank A/c	21,200	1.1.2010	By Balance b/d	21,200	

Balance Sheet of HP & Co. Ltd. as at 31 <sup>st</sup> December, 2008					
Liabilities		₹	Assets		₹
FM & Co. Ltd.	43,600		Pick-up Van	1,00,000	
Less: H.P. Interest Suspense	<u>3,600</u>	40,000	Less: Depreciation	<u>10,000</u>	90,000

## Hire Purchase and Instalment Sale Transactions

Balance Sheet of HP & Co. Ltd. as at 31 <sup>st</sup> December, 2009					
Liabilities		₹	Assets		₹
FM & Co. Ltd.	21,200		Pick-up Van	90,000	
Less: H.P. Interest	<u>1,200</u>	20,000	Less: Depreciation	<u>10,000</u>	80,000
Suspense					

Balance Sheet of HP & Co. Ltd. as at 31 <sup>st</sup> December, 2010					
Liabilities		₹	Assets		₹
			Pick-up Van	80,000	
			Less: Depreciation	<u>10,000</u>	70,000

Working Notes: (1) Total Interest = ₹ 3,600 + ₹ 2,400 + ₹ 1,200 = ₹ 7,200.

### 4.2 Books of the Hire Vendor

There are different methods of recording hire purchase transactions in the books of the hire vendor. It is selected according to the type and value of goods sold, volume of transactions, the length of the period of purchase, etc. The different methods are discussed below:

**4.2.1 Sales Method:** A business that sells relatively large items on hire purchase may adopt this method. Under this method, hire purchase sale is treated as a credit sale. The only exception is that the vendor agrees to accept payments in instalments and for that he charges interest. Generally, a special Sales Day Book is maintained for recording all sales under hire purchase agreement. The amount due from the hire purchaser at the end of the year is shown in the Balance sheet on the assets side as Hire Purchase Debtors.

#### Journal Entries

1.	<i>When goods are sold and delivered under hire purchase</i> Hire Purchaser Account To H.P. Sales Account	Dr. [Full cash price]
2.	<i>When the down payment is received</i> Bank Account To Hire Purchaser Account	Dr.
3.	<i>When an instalment becomes due</i> Hire Purchaser Account To Interest Account	Dr.
4.	<i>When the amount of instalment is received</i> Bank Account To Hire Purchaser Account	Dr.

## Accounting

5.	<i>For closing interest Account</i> Interest Account To Profit and Loss Account	Dr.
6.	<i>For closing Hire Purchase Sales Account</i> H.P. Sales Account To Trading Account	Dr.

*In this connection, the student should note the following:*

- (i) *The entire profit on sale under hire purchase agreement is credited to the Profit and Loss account of the year in which the sale has taken place.*
- (ii) *Interest pertaining to each accounting period is credited to the Profit and Loss Account of that year.*

**4.2.2 Interest Suspense Method:** This method is almost similar to the sales method, except the accounting for interest. Under this method, the hire purchaser is debited with full cash price and interest (total) included in the hire selling price. Credit is given to the H.P. Sales Account and Interest Suspense Account. When the instalment is received, the Bank Account is debited and the Hire Purchaser Account is credited. At the same time an appropriate amount of interest (i.e., interest for the relevant accounting period) is removed from the Interest Suspense Account and credited to the Interest Account. At the time of preparation of Final Accounts, interest is transferred to the credit of the Profit and Loss Account. The balance of the Interest Suspense Account is shown in the Balance Sheet as a deduction from Hire Purchase Debtors.

### Journal Entries

1.	When goods are sold and delivered under hire purchase Hire Purchase Account To H.P. Sales Account To Interest Suspense Account	Dr. [Full cash price + total interest] [Full cash price] [Total Interest]
2.	When down payment/instalment is received Bank Account To Hire Purchaser Account	Dr.
3.	For interest of the relevant accounting period Interest Suspense Account To Interest Account	Dr.
4.	For closing interest Account Interest Account To Profit and Loss Account	Dr.
5.	For closing Hire Purchase Sales Account H.P. Sales Account To Trading Account	Dr.

## Hire Purchase and Instalment Sale Transactions

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The disclosure in balance sheet of the respective parties will be:

### Balance Sheet of Hire Purchaser

Assets  
 Fixed assets :  
 Asset on Hire purchase  
 Add : Balance in Interest suspense A/c  
 Less : Depreciation

### Balance Sheet of Vendor

Assets  
 Current assets :  
 Hire purchase debtors  
 Less : Balance in Interest suspense A/c

### Illustration 3

X Ltd. purchased 3 milk vans from Super Motors costing ₹ 75,000 each on hire purchase system. Payment was to be made: ₹ 45,000 down and the remainder in 3 equal instalments together with interest @ 9%. X Ltd. writes off depreciation @ 20% on the diminishing balance. It paid the instalment at the end of the 1st year but could not pay the next. Super Motor agreed to leave one milk van with the purchaser, adjusting the value of the other two milk vans against the amount due. The milk vans were valued on the basis of 30% depreciation annually on written down value basis. X Ltd. settled the seller's dues after three months.

### Solution

#### In the Books of X Ltd.

		Dr. (₹)	Cr. (₹)
I Year			
Milk Vans purchased:			
Milk Vans A/c	Dr.	2,25,000	
To Vendor A/c			2,25,000
On down payment:			
Vendor A/c	Dr.	45,000	
To Bank			45,000
I Year end			
Interest A/c	Dr.	16,200	
(₹ 1,80,000 @ 9%)			
To Vendor A/c			16,200
Vendor A/c	Dr.	76,200	
To Bank A/c			76,200
Depreciation @ 20%			
Depreciation A/c	Dr.	45,000	
To Milk Vans A/c			45,000
II Year end			
Depreciation @ 20%			
Depreciation A/c	Dr.	36,000	
To Milk Vans A/c			36,000

## Accounting

Interest A/c (1,20,000 @ 9%) To Vendor A/c	Dr.	10,800	
<hr/>			10,800
Return of goods endor A/c To Milk Vans A/c	Dr.	73,500	
<hr/>			73,500
For Loss in Repossession Profit/Loss A/c To Milk Vans A/c	Dr.	22,500	
<hr/>			22,500
IIIrd Year Depreciation Depreciation A/c To Milk Vans A/c	Dr.	9,600	
<hr/>			9,600
Settlement of A/cs Vendor A/c To Bank	Dr.	57,300	
<hr/>			57,300

### Milk Vans Account

Year		₹	Year		₹
1	To Super Motors A/c	2,25,000	1 end	By Depreciation A/c	45,000
			"	By Balance c/d	<u>1,80,000</u>
		<u>2,25,000</u>			<u>2,25,000</u>
2	To Balance b/d	1,80,000	2 end	By Depreciation	36,000
			"	Super Motors	
				(value of 2 vans after	
				depreciation for	
				2 years @ 30%)	73,500
				" P & L A/c	
				(balancing figure)	22,500
				" Balance c/d	
				(one van less depre-	
				ciation for 2 years)	<u>48,000</u>
		<u>1,80,000</u>			<u>1,80,000</u>

### Super Motors Account

Year		₹	Year		₹
1	To Bank	45,000	1	By Milk Vans A/c	2,25,000
	" Bank	76,200		" Interest @ 9%	
	" Balance c/d	<u>1,20,000</u>		on ₹ 1,80,000	<u>16,200</u>
		<u>2,41,200</u>			<u>2,41,200</u>

### Hire Purchase and Instalment Sale Transactions

2	To Milk Van A/c	73,500		2	By Balance b/d	1,20,000
	" Balance c/d	<u>57,300</u>			" Interest	<u>10,800</u>
		<u>1,30,800</u>				<u>1,30,800</u>
3	To Bank	57,300		3	By Balance b/d	57,300

#### Illustration 4

A firm acquired two tractors under hire purchase agreements, details of which were as follows:

	Tractor A	Tractor B
Date of Purchase	1st April, 2009	1st Oct., 2009
	₹	₹
Cash price	14,000	19,000
Deposit	2,000	2,680
Interest (deemed to accrue evenly over the period of agreement)	2,400	2,880

Both agreements provided for payment to be made in twenty-four monthly instalments, commencing on the last day of the month following purchase, all instalments being paid on due dates.

On 30th June, 2010, Tractor B was completely destroyed by fire. In full settlement, on 10th July, 2010 an insurance company paid ₹ 15,000 under a comprehensive policy out of which ₹ 10,000 was paid to the hire purchase company in termination of the agreement. Any balance on the hire purchase company's account in respect of these transactions was to be written off.

The firm prepared accounts annually to 31st December and provided depreciation on tractors on a straight-line basis at a rate of 20 per cent per annum rounded off to nearest ten rupees, apportioned as from the date of purchase and up to the date of disposal.

You are required to record these transactions in the following accounts, carrying down the balances on 31st December, 2009 and 31st December, 2010:

- (a) Tractors on hire purchase.
- (b) Provision for depreciation of tractors.
- (c) Disposal of tractors.
- (d) Hire purchase company.

## Accounting

### Solution

#### Hire Purchase accounts in the buyer's books

		Tractors on Hire Purchase A/c			
2009		₹	2009		₹
April	1	To HP Co. - Cash price	14,000	Dec.31	By Balance c/d
					Tractor A 14,000
Oct.	1	" HP Co. - Cash price			Tractor B <u>19,000</u>
		Tractor B	<u>19,000</u>		
			<u>33,000</u>		<u>33,000</u>
2010		₹	2010		₹
Jan.	1	To Balance b/d		June30	By Disposal of
		Tractor A 14,000			Tractor A/c - Transfer 19,000
		Tractor B <u>19,000</u>	<u>33,000</u>	Dec.31	" Balance c/d <u>14,000</u>
			<u>33,000</u>		<u>33,000</u>
2011					
Jan.	1	To Balance b/d	14,000		
(b)		Provision for Depreciation of Tractors A/c			
2009		₹	2009		₹
Dec.	31	To Balance c/d	3,050	Dec.31	By P & L A/c :
					Tractor A 2,100
					Tractor B <u>950</u>
			<u>3,050</u>		<u>3,050</u>
2010		₹	2010		₹
June	30	To Disposal of Tractor		Jan. 1	By Balance b/d 3,050
		account—Transfer	2,850	Jun. 30	" P & L A/c
Dec.	31	" Balance c/d	4,900		(Depn. for Tractor B) 1,900
				Dec.31	" P & L A/c
					(Depn. for Tractor A) <u>2,800</u>
			<u>7,750</u>		<u>7,750</u>
2011					₹
Jan.	1	By Balance b/d	4,900		
(c)		Disposal of Tractor A/c			
2010		₹	2010		₹
June	30	To Tractors on hire		June30	By Provision for
		purchase—Tractor B	19,000		Depn. of Tractors A/c 2,850
				July 10	" Cash : Insurance 15,000
				Dec.31	" P & L A/c : Loss <u>1,150</u>
			<u>19,000</u>		<u>19,000</u>

### Hire Purchase and Instalment Sale Transactions

		Hire Purchase Co. A/c			
2009		₹	2009		₹
April 1	To Cash (deposit for Tractor A)	2,000	April 1	By Tractors on Hire Purchase A/c - Tractor A	14,000
April	" Cash—6 instalments @ ₹ 600	3,600	Oct. 1	" Tractors on Hire Purchase A/c —Tractor B	19,000
Sept.	" Cash—deposit for Tractor B	2,680	Dec.31	" Interest A/c : For Tractor A @ ₹ 100 for 9 months ₹ 900 For Tractor B @ ₹ 120 for 3 months ₹ 360	1,260
Oct. 1	" Cash—deposit for Tractor B	2,680			<u>34,260</u>
Oct. -	" Cash—3 instalments @ ₹ 600 for Tractor A	1,800			<u>34,260</u>
Dec.	" Cash—3 instalments @ ₹ 800	2,400			
Dec. 31	" Balance c/d	21,780			
		<u>34,260</u>			
			2010		
Jan.	To Cash—6 instalments @ ₹ 600 for Tractor A	3,600	Jan. 1	By Balance b/d	21,780
June	" Cash—6 instalments @ ₹ 800 for Tractor B	4,800	Jun. 30	" Interest A/c—for Tractor B @ ₹ 120 for 6 months	720
July 10	" Cash - final instalment for Tractor B	10,000	Dec.31	" Interest - for Tractor A @ ₹ 100 for 12 months	1,200
July-	" Cash - 6 instalments @ ₹ 600 for Tractor A	3,600			
Dec.	" Balance c/d	1,500			
	" P & L A/c—unpaid amount	200			
		<u>23,700</u>			<u>23,700</u>

#### Illustration 5

*A machinery is sold on hire purchase. The terms of payment is four annual instalments of ₹ 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 ₹ 6,000.*

*Show Machinery Account and Hire Vendor Account in the books of the purchaser who defaulted in the payment of the third yearly payment whereupon the vendor re-possessed the machinery. The purchaser provides depreciation on the machinery @ 10% per annum. All workings should form part of your answers.*



## Accounting

### Solution

#### Machinery Account

		₹			₹
I Yr.	To Hire Vendor A/c	15,533	I Yr.	By Depreciation A/c	1,553
				" Balance c/d	<u>13,980</u>
		<u>15,533</u>			<u>15,533</u>
II Yr.	To Balance b/d	13,980	II Yr.	By Depreciation A/c*	1,398
				" Balance c/d	<u>12,582</u>
		<u>13,980</u>			<u>13,980</u>
III Yr.	To Balance b/d	12,582	III Yr.	By Depreciation A/c*	1,258
				" Hire Vendor	11,000
				" Profit & Loss A/c	324
				(Loss on Surrender)	<u>12,582</u>
		<u>12,582</u>			<u>12,582</u>

\*It has been assumed that depreciation has been written off on written down value method. Alternatively straight line method may be assumed.

Depreciation has been directly credited to the Machinery Account; it could have been accumulated in provision for depreciation account.

#### Hire Vendor Account

		₹			₹
I Yr.	To Bank A/c	6,000	I Yr.	By Machinery A/c	15,533
	" Balance c/d	<u>12,639</u>		" Interest A/c	<u>3,106</u>
		<u>18,639</u>			<u>18,639</u>
II Yr.	To Bank A/c	6,000	II Yr.	By Balance b/d	12,639
	" Balance c/d	<u>9,167</u>		" Interest A/c	<u>2,528</u>
		<u>15,167</u>			<u>15,167</u>
III Yr.	To Machinery A/c	11,000	III Yr.	By Balance b/d	9,167
	(transfer)			" Interest A/c	<u>1,833</u>
		<u>11,000</u>			<u>11,000</u>

*Note* : Alternatively, total interest could have been debited to Interest Suspense A/c and credited to Hire Vendor A/c with consequential changes.

#### Working Notes:

		<i>Instalment Amount</i>	<i>Interest</i>	<i>Principal</i>
		₹	₹	₹
4th Instalment		6,000		
Interest	$6,000 \times \frac{20}{120}$	<u>1,000</u>	1,000	5,000
		5,000		

### Hire Purchase and Instalment Sale Transactions

Add : 3rd Instalment	<u>6,000</u>			
	11,000			
Interest    11,000 x $\frac{20}{120}$	<u>1,833</u>	1,833		4,167
	9,167			
Add : 2nd Instalment	<u>6,000</u>			
	15,167			
Interest    15,167 x $\frac{20}{120}$	<u>2,528</u>	2,528		3,472
	12,639			
Add : 1st Instalment	<u>6,000</u>			
	18,639			
Interest    18,639 x $\frac{20}{120}$	<u>3,106</u>	<u>3,106</u>		<u>2,894</u>
	<u>15,533</u>	<u>8,467</u>		<u>15,533</u>

#### Illustration 6

*X Transport Ltd. purchased from Delhi Motors 3 Tempos costing ₹ 50,000 each on the hire purchase system on 1-1-2008. Payment was to be made ₹ 30,000 down and the remainder in 3 equal annual instalments payable on 31-12-2008, 31-12-2009 and 31-12-2010 together with interest @ 9%. X Transport Ltd. write off depreciation at the rate of 20% on the diminishing balance. It paid the instalment due at the end of the first year i.e. 31-12-2008 but could not pay the next on 31-12-2009. Delhi Motors agreed to leave one Tempo with the purchaser on 1-1-2010 adjusting the value of the other 2 Tempos against the amount due on 31-12-2009. The Tempos were valued on the basis of 30% depreciation annually. Show the necessary accounts in the books of X Transport Ltd. for the years 2008, 2009 and 2010.*

#### Solution

		<b>X Transport Ltd.</b>			
		<b>Tempo Account</b>			
2008		₹	2008		₹
Jan. 1	To Delhi Motors	1,50,000	Dec.31	By Depreciation A/c :	
				20% on 1,50,000	30,000
				" Balance c/d	<u>1,20,000</u>
		<u>1,50,000</u>			<u>1,50,000</u>
2009			2009		
Jan. 1	To Balance b/d	1,20,000	Dec.31	By Depreciation A/c	24,000
				" Delhi Motors A/c	
				(Value of 2 tempos taken away)	49,000
				" Profit and Loss A/c	
				(balancing figure)	15,000

## Accounting

					" Balance c/d (Value of one tempo left)	<u>32,000</u>
						<u>1,20,000</u>
2010				2010		
Jan. 1	To	Balance b/d	32,000	Dec.31	By Depreciation A/c	6,400
					" Balance b/d	<u>25,600</u>
			<u>32,000</u>			<u>32,000</u>

### Delhi Motors Account

2008			₹	2008		₹	
Jan. 1	To	Bank (Down Payment)	30,000	Jan. 1	By	Tempos A/c	1,50,000
Dec. 31	"	Bank	50,800	Dec.31	"	Interest (9% on ₹ 1,20,000)	<u>10,800</u>
	"	Balance c/d	<u>80,000</u>				<u>1,60,800</u>
			<u>1,60,800</u>				
2009				2009			
Jan. 1	To	Tempo	49,000	Jan. 1	By	Balance b/d	80,000
Dec. 31	"	Balance c/d	38,200	Dec.31	"	Interest (9% on ₹ 80,000)	<u>7,200</u>
			<u>87,200</u>				<u>87,200</u>
2010			₹	2010		₹	
Dec. 31	To	Bank	41,638	Jan. 1	By	Balance b/d	38,200
				Dec.31	"	Interest (9% on ₹ 38,200)	<u>3,438</u>
			<u>41,638</u>				<u>41,638</u>

### Alternative Method

### Tempo Account

2008			₹	2008		₹	
Jan. 1	To	Bank A/c (down payment)	30,000	Dec. 31	By	Depreciation @ 20% on ₹ 1,50,000	30,000
Dec. 31	"	Delhi Motors A/c (1st instalment)	<u>40,000</u>		"	Balance c/d	<u>40,000</u>
			<u>70,000</u>				<u>70,000</u>
2009			₹	2009		₹	
Jan. 1	To	Balance b/d	40,000	Dec. 31	By	Depreciation A/c	24,000
Dec. 31	"	Delhi Motors A/c - creating a liability for ₹ 38,200, amount due (see 1st method)	<u>38,200</u>		"	Profit & Loss A/c (balancing figure)	22,200
			<u>78,200</u>		"	Balance c/d (Value of tempo left)	<u>32,000</u>
							<u>78,200</u>

### Hire Purchase and Instalment Sale Transactions

<b>2010</b>	₹	<b>2010</b>	₹
Jan. 1 To Balance b/d	32,000	Dec. 31 By Depreciation A/c	6,400
		" Balance b/d	<u>25,600</u>
	<u>32,000</u>		<u>32,000</u>
<b>Delhi Motors</b>			
<b>2008</b>	₹	<b>2008</b>	₹
Dec. 31 To Bank A/c	50,800	Dec. 31 By Tempo A/c	40,000
		By Interest A/c	<u>10,800</u>
	<u>50,800</u>		<u>50,800</u>
<b>2009</b>	₹	<b>2009</b>	₹
Dec. 31 To Balance c/d	<u>38,200</u>	Dec. 31 By Tempos A/c	<u>38,200</u>
<b>2010</b>		<b>2010</b>	
Dec. 31 To Bank A/c	41,638	Jan. 1 By Balance b/d	38,200
		Dec. 31 " Interest (9% on ₹ 38,200)	<u>3,438</u>
	<u>41,638</u>		<u>41,638</u>

#### Working Notes :

- (1) Value of a Tempo left with the buyer:

Cost	₹ 50,000
Depreciation @ 20% p.a. under WDV method for 2 years i.e. ₹ 10,000 + ₹ 8,000	<u>18,000</u>
Value of the Tempo left with the buyer at the end of 2nd year	<u>32,000</u>

- (2) Value of Tempos taken away by the seller:

No. of tempos Two	
Cost ₹ 50,000 × 2 =	₹ 1,00,000
Depreciation @ 30% Under WDV method for 2 years i.e. ₹ 30,000 + ₹ 21,000	<u>51,000</u>
Value of tempos taken away at the end of 2nd year	<u>49,000</u>

#### Illustration 7

*M/s Delhi Electronics sells colour TVs., on hire purchase basis. Cost per set is ₹ 14,000, Cash sale price ₹ 15,500 and hire purchase sale price is ₹ 16,800 for 12 monthly instalments payable by 10th of every month. However, the buyer has to make cash down ₹ 1,800 at the time of purchase.*

*Hire Purchase transactions (No. of sets) in 2010 - Jan. 10, Feb. 12, March 10, April 12, May 10, June 10, July 10, August 15, Sept. 11, Oct. 20, Nov. 20, Dec. 10.*

*Let us suppose all instalments are duly collected. Show necessary Journal Entries.*

## Accounting

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### Solution

Various relevant accounting information in relation to hire purchase transactions are computed as follows :

Total No. of Transactions	:	150
Cash down	:	₹ 1,800 × 150 = ₹ 2,70,000

### Installments Collected/Due

Transactions	No. of Installments collected			No. of Installments Due		
Jan.	10 × 11	=	110	10 × 1	=	10
Feb.	12 × 10	=	120	12 × 2	=	24
March	10 × 9	=	90	10 × 3	=	30
April	12 × 8	=	96	12 × 4	=	48
May	10 × 7	=	70	10 × 5	=	50
June	10 × 6	=	60	10 × 6	=	60
July	10 × 5	=	50	10 × 7	=	70
Aug.	15 × 4	=	60	15 × 8	=	120
Sept.	11 × 3	=	33	11 × 9	=	99
Oct.	20 × 2	=	40	20 × 10	=	200
Nov.	20 × 1	=	20	20 × 11	=	220
Dec.	<u>10 × 0</u>	=	<u>—</u>	<u>10 × 12</u>	=	<u>120</u>
	<u>150</u>		<u>749</u>	<u>150</u>		<u>1051</u>

Check:

Total Instalments for 150 hire purchase transactions are 1800. (150×12) of which 749 instalments fell due and collected and the balance 1051 instalments are not yet paid.

Amount collected for 749 instalments

$$\frac{\text{Rs. } 16,800 - \text{Rs. } 1,800}{12} \times 749 = ₹ 9,36,250$$

Amount not yet due

$$\frac{\text{Rs. } 16,800 - \text{Rs. } 1,800}{12} \times 1,051 = ₹ 13,13,750$$

Cash Down = ₹ 2,70,000

Total (₹ 16,800 × 150) = ₹ 25,20,000

Hire Vendor should recognise the amount of instalments collected and cash down value (i.e. ₹ 2,70,000 + ₹ 9,36,250) ₹ 12,06,250 as sale. Balance ₹ 13,13,750 is value of goods lying with the customer at hire purchase price. Stock Reserve should be computed and deducted from such amount to show the Hire Purchase Stock at cost.

## Hire Purchase and Instalment Sale Transactions

$$\begin{aligned} & \text{Goods lying with Hire Purchaser at Hire Purchase Price} \times \frac{\text{Cost}}{\text{Hire Purchase Price}} \\ \text{Stock at cost} &= \text{Rs. } 13,13,750 \times \frac{\text{Rs. } 14,000}{\text{Rs. } 16,800} \\ &= ₹ 10,94,792 \\ \text{Stock Reserve} = (\text{₹ } 13,13,750 - 10,94,792) &= ₹ 2,18,958 \end{aligned}$$

### Journal Entries

			₹	₹
(1) For Cash down at the time of hire transaction	Cash/Bank A/c	Dr.	2,70,000	
	To Hire Purchase Sale A/c			2,70,000
(2) When instalments fall due	Instalment Due A/c	Dr.	9,36,250	
	To Hire Purchase Sales			9,36,250
(3) On collection of instalments	Cash/Bank A/c	Dr.	9,36,250	
	To Instalment Due A/c			9,36,250
(4) For instalment not due at the year	Hire Purchase Stock A/c	Dr.	13,13,750	
	To Trading A/c			13,13,750
(5) For Stock Reserve	Stock Reserve A/c	Dr.	2,18,958	
	To Hire Purchase Stock A/c			2,18,958

If some instalments become due but not collected at the year end, such would appear in the Balance Sheet as an asset just like Sundry Debtors.

## 5. Debtors Method

In this method the Hire purchase Trading account is prepared.

The objective of preparing Hire Purchase Trading Account is to measure the profitability of the Hire Purchase division separately. Let us see how to prepare Hire Purchase Trading Account.

- (1) Credit all down payments and instalments falling due to hire purchase sales account. Transfer balance in Hire Purchase Sales Account to Hire Purchase Trading Account.
- (2) Transfer cost of all transactions to Hire Purchase Trading Account.

Hire Purchase Trading A/c		Dr.
To Shop Stock A/c		
- (3) Charge any special expenses to Hire Purchase Trading Account.
- (4) Treat instalments not yet due as stock lying with customers and transfer to Hire Purchase Trading Account.

## Accounting

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(5) Charge appropriate stock reserve.

### Illustration 8

With the information given in Illustration 6, prepare Hire Purchase Trading A/c.

### Solution

<b>Hire Purchase Trading A/c</b>			
	₹		₹
To Shop Stock (14,000 × 150)	21,00,000	By Hire Purchase	
" Stock Reserve	2,18,958	Sales A/c	12,06,250
" Profit—transferred to P & L A/c	<u>2,01,042</u>	Stock (with customers)—at hire purchase price	<u>13,13,750</u>
	<u>25,20,000</u>		<u>25,20,000</u>

### Illustration 9

M/s Wye & Co. sell goods on hire purchase, adding 50% to cost. From the following figures prepare the Hire Purchase Trading Account:

	₹
Goods with customers in Jan. 2010, instalments not yet due	5,400
Goods sold on hire purchase during 2010	25,500
Cash received from customers during 2010	20,100
Instalments due but not yet received at the end of the year, customers paying	1,800

All figures are on the basis of hire purchase price.

### Solution

#### Hire-purchase Trading Account for the year ending 31st Dec., 2010

Dr.	₹	Cr.	₹
To Stock with Customers on 1-1-2010 - hire purchase price	5,400	By Cash	20,100
" Goods sold on Hire- purchase A/c	25,500	" Instalments due	1,800
" Stock Reserve required	3000	" Goods sold on Hire Purchase A/c - loading	8,500
" Profit & Loss A/c	<u>7,300</u>	" Stock Reserve (Opening)	1,800
	<u>41,200</u>	" Stock with customers	9,000*
			<u>41,200</u>

#### \*Stock with Customers on 31-12-2010

	₹
Instalment not due on 1-1-2010	5,400
Goods sold on H.P.	<u>25,500</u>

## Hire Purchase and Instalment Sale Transactions

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		30,900
Less : Cash received	20,100	
Instalments due	<u>1,800</u>	<u>21,900</u>
		<u>9,000</u>

### 6. Ascertainment of Total Cash Price

We know that the basis for accounting in the books of the hire purchaser is the total cash price. Sometimes, the total cash price may not be given. For the purpose of ascertaining the total cash price we can use any of the following methods according to the need.

- (1) Calculation of total cash price when no annuity table is given.
- (2) Calculation of total cash price when annuity table is given.

### 7. Calculation of Total Cash Price when Annuity Table is not given

In this method, the interest included in the last instalment is to be calculated first with the help of the appropriate formula (explained below).

For example in a hire purchase transaction, apart from down payment, four other instalments are payable. The interest will be calculated first on the 4<sup>th</sup> instalment, then on the 3<sup>rd</sup> instalment, then on the 2<sup>nd</sup> instalment and lastly on the 1<sup>st</sup> instalment. Interest on down payment will be nil.

In this connection, it should be noted that the amount of interest will go on increasing from the 4<sup>th</sup> instalment to the 3<sup>rd</sup> instalment, from the 3<sup>rd</sup> instalment to the 2<sup>nd</sup> instalment and from the 2<sup>nd</sup> instalment to the 1<sup>st</sup> instalment.

We know that interest is to be calculated on the outstanding balance of cash price.

In this case, we will have to calculate the interest with the help of the total amount due on hire purchase price since the cash price is not known. For the purpose of calculating the interest, the following steps should be followed:

Step 1: Calculation the ratio between interest and the amount due with the help of the following formula:

$$\text{Ratio of interest and amount due} = \frac{\text{Rate of interest}}{100 + \text{Rate of interest}}$$

Step 2: Calculate the interest included in the last instalment by applying the following formula:

$$\text{Interest} = \text{Total amount due at the time of instalment} \times \text{Ratio of interest and amount due (as calculated in step 1)}$$

Step 3: Subtract the interest (as calculated in step 2) from this instalment to get the amount of outstanding cash price at the time of last instalment.

Step 4: Add the cash price calculated in Step 3 to the amount of instalment due at the end of the third year.



## Accounting

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- Step 5: Calculate the interest on the entire sum (cash price included in the 4<sup>th</sup> instalment + amount of 3<sup>rd</sup> instalment). Deduct this interest from the total amount due at the end of 3<sup>rd</sup> year to get the outstanding cash price at the time of 3<sup>rd</sup> instalment.
- Step 6: Add the cash price calculated in step 5 to the amount of instalment due at the end of 2<sup>nd</sup> year.
- Step 7: Calculate the interest on the entire sum so obtained in Step 6. Deduct this interest from the total amount due at the end of 2<sup>nd</sup> year to get the outstanding cash price at the time of 2<sup>nd</sup> instalment.
- Step 8: Add the cash price calculated in Step 7 to the amount of instalment due at the end of 1<sup>st</sup> year.
- Step 9: Calculate the interest on the entire sum so obtained in Step 8. Deduct this interest from the total amount due at the end of 1<sup>st</sup> year to get the outstanding cash price at the time of 1<sup>st</sup> instalment.
- Step 10: Add the cash price calculated in Step 9 to the amount of down payment, if any. The sum so obtained will be the total cash price.

### Illustration 10

A & Co. purchased a truck on hire purchase system. As per terms he is required to pay ₹ 70,000 down, ₹ 53,000 at the end of first year, ₹ 49,000 at the end of second year and ₹ 55,000 at the end of third year. Interest is charged @ 10% p.a.

You are required to calculate the total cash price of the truck and the interest paid with each instalment.

### Solution

(1) Ratio of interest and amount due =  $\frac{\text{Rate of interest}}{100 + \text{Rate of interest}} = \frac{10}{110} = \frac{1}{11}$

(2) **Calculation of Interest and Cash Price**

No. of instalments	Amount due at the time of instalment	Interest	Cash price
[1]	[2]	[3]	[4]
3 <sup>rd</sup>	55,000	1/11 of ₹ 55,000 = ₹ 5,000	50,000
2 <sup>nd</sup>	*99,000	1/11 of ₹ 99,000 = ₹ 9,000	90,000
1 <sup>st</sup>	**1,43,000	1/11 of ₹ 1,43,000 = ₹ 13,000	1,30,000

Total cash price = ₹ 1,30,000 + 70,000 (down payment) = ₹ 2,00,000.

\*₹ 50,000 + 2<sup>nd</sup> instalment of ₹ 49,000 = ₹ 99,000.

\*\* ₹ 90,000 + 1<sup>st</sup> instalment of ₹ 53,000 = ₹ 1,43,000.

## 8. Ascertainment of Interest

We know that the hire purchase price consists of two elements: (i) cash price; and (ii) interest. Cash price is the capital expenditure incurred for the acquisition of an asset and (ii) interest is the revenue expense for the delay in making the full payment. Ascertainment of any of these two gives the answer for the other, e.g., if we ascertain the total amount of interest, it becomes very simple to ascertain the cash price just by deducting the interest from the hire purchase price.

Interest is charged on the amount outstanding. Therefore, if the hire purchaser makes a down payment on signing the contract, it will not include any amount of interest. It should be noted that though the instalments of a hire purchase agreement may be equal, the interest element in each instalment is not the same.

At the time of calculating interest, students may face the following two situations:

- (a) When the cash price, rate of interest and the amount of instalments are given; and
- (b) When the cash price and the amount of instalments are given, but the rate of interest is not given.

Now, let us consider the above two situations.

### 8.1 When the cash price, rate of interest and the amount of instalments are given:

In this situation, the total amount of interest is to be ascertained first. It is the difference between the hire purchase price (down payment + total instalments) and the cash price. To calculate the amount of interest involved in each instalment the following steps are followed:

Step 1: Deduct down payment from the cash price. Calculate the interest at the given rate on the remaining balance. This represents the amount of interest included in the first instalment.

Step 2: Deduct the interest of Step 1 from the amount of first instalment. The resultant figure is the cash price included in the first instalment.

Step 3: Deduct the cash price of the 1<sup>st</sup> instalment (Step 2) from the balance due after down payment. It represents the amount outstanding after the 1<sup>st</sup> instalment is paid.

Step 4: Calculate the interest at the given rate on the balance outstanding after the 1<sup>st</sup> instalment. Deduct this interest from the amount of the 2<sup>nd</sup> instalment to get the cash price included in the 2<sup>nd</sup> instalment.

Step 5: Deduct the cash price of the 2<sup>nd</sup> instalment (Step 4) from the balance due after the 1<sup>st</sup> instalment. It represents the amount outstanding after the 2<sup>nd</sup> instalment is paid.

Repeat the above steps till the last instalment is paid.

**8.2 When the cash price and the amount of instalments are given, but the rate of interest is not given.** When the rate of interest is not given, but the cash price and the amount of instalments are given, the following steps are followed to calculate the interest:

## Accounting

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- Step 1: Calculate the total interest by deducting the cash price from the hire purchase price (i.e., down payment + amount of instalment x number of instalments).
- Step 2: Deduct down payment from the hire purchase price.
- Step 3: Calculate the amount of outstanding balance of the hire purchase price at the beginning of each year.
- Step 4: Calculate the ratio of outstanding balance of Step 3.
- Step 5: Calculate the amount of interest of each instalment on the basis of the ratio of Step 4.

## 9. Repossession

In a hire purchase agreement the hire purchaser has to pay up to the last instalment to obtain the ownership of goods. If the hire purchaser fails to pay any of the instalments, the hire vendor takes the asset back in its actual form without any refund of the earlier payments to the hire purchaser. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the asset is termed as **repossession**.

Repossessed assets are resold to any other customer after repairing or reconditioning (if necessary). Accounting figures relating to repossessed assets are segregated from the normal hire purchase entries. Repossessions are then accounted for in a separate "Goods Repossessed Account".

So far as the repossession of assets are concerned, the hire vendor can take back the whole of the asset or a part thereof depending on the agreement between the parties. The former is called "Complete Repossession" and the latter "Partial Repossession".

### 9.1 Complete Repossession

The hire vendor closes Hire Purchaser's Account by transferring balance of Hire Purchaser Account to Goods Repossessed Account.

The hire purchaser closes the Hire Vendor's Account by transferring the balance of Hire Vendor Account to Hire Purchase Asset Account and then finding the profit and loss on repossession in Asset Account.

Particulars	Books of hire purchaser	Books of hire vendor
Purchase/Sales	Asset A/c ...Dr. To Hire Vendor A/c	Hire Purchaser A/c ...Dr. To Sales A/c
Installment	Hire Vendor A/c ...Dr. To Cash A/c	Cash A/c ...Dr. To Hire Purchaser A/c
Interest	Interest A/c ...Dr. To Hire Vendor	Hire Purchaser A/c ...Dr. To Interest A/c
Repossession	Hire Vendor A/c ...Dr. To Asset A/c	Goods Repossessed A/c ..Dr. To Hire Purchaser

## 9.2 Partial Repossession

In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are as usual up to the date of default (excepting entry for payment) in the books of both the parties. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.

Assets are repossessed at a mutually agreed value (based on agreed rate of depreciation which is an enhanced rate). The hire vendor debits the Goods Repossessed Account and credit the Hire Purchaser Account with the value as agreed upon on the repossession. Similarly, the hire purchaser debits the Hire Vendor Account and credits the Assets Account with the same amount. If the repossessed value is less than the book value of the asset, the difference is charged to the Profit and Loss Account of the hire purchaser as '**loss on surrender**'.

For the remaining portion of the asset lying with the hire purchaser, the (Hire Purchaser) applies the usual rate of depreciation and shows the Asset Account at its usual written-down value.

### Illustration 11

*From the following prepare Hire Purchase Trading Account of M/s Kolkata Traders who sells goods on hire purchase basis at cost plus 25%.*

	₹
<i>Instalments not due on 31-12-2009</i>	3,00,000
<i>Instalments due and collected during 2010</i>	8,00,000
<i>Instalments due but not collected during 2010 including ₹ 10,000 for which goods were repossessed</i>	50,000
<i>Instalments not due on 31-12-2010 including ₹ 20,000 for which goods were repossessed</i>	3,70,000
<i>Instalments collected on repossessed stock</i>	15,000
<i>M/s Kolkata Traders valued repossessed stock at 60% of original cost.</i>	

### Solution

#### Working Notes:

(1) Hire Purchase Sales:	₹
Instalments due and collected	8,00,000
<i>Add:</i> Instalments due but not collected	<u>50,000</u>
	<u>8,50,000</u>
(2) Loss on Repossessed stock:	
Hire Purchase Price of Repossessed Stock	

## Accounting

Instalments Collected		15,000
Instalments Due		10,000
Instalments Not Due		<u>20,000</u>
		45,000
Cost Rs. 45,000 × $\frac{100}{125}$		36,000
Valuation on repossession Rs. 36,000 × $\frac{60}{100}$		21,600
Cost of instalments due + Instalments not yet due		
(Rs. 10,000 + 20,000) × $\frac{100}{125}$		24,000
Loss (₹ 24,000 – ₹ 21,600)		2,400
(3) Goods taken from shop stock at cost:		
H.P. Sales at cost $\left[ 8,50,000 \times \frac{100}{125} \right]$		6,80,000
Stock with customers 31-12-2010 at cost		
$\left[ \text{Rs. } 3,50,000 \times \frac{100}{125} \right]$		<u>2,80,000</u>
		9,60,000
Less : Stock with customers 31-12-2009 at Cost		<u>2,40,000</u>
$\left[ \text{Rs. } 3,00,000 \times \frac{100}{125} \right]$		<u>7,20,000</u>
(4) Bad Debt :		
Instalment due but not collected		10,000
Instalment not yet due at cost		
$\left[ \text{Rs. } 20,000 \times \frac{100}{125} \right]$		<u>16,000</u>
		26,000
Less: Cost of instalments due and instalments not yet due		<u>24,000</u>
		<u>2,000</u>

### Hire Purchase Trading A/c

	₹		₹
To Goods with customers at cost (31-12-2009)	2,40,000	By Hire Purchase Sale	8,50,000
" Shop Stock	7,20,000	" Goods with customers at cost (31-12-2010)	2,80,000

## Hire Purchase and Instalment Sale Transactions

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"	Bad Debt	2,000	
"	Loss on Repossession	2,400	
"	Profit & Loss A/c		
	Transfer of H.P. Profit	<u>1,65,600</u>	
		<u>11,30,000</u>	<u>11,30,000</u>

### 10. Stock and Debtors Method

In this method, Hire Purchase Stock Account, Hire Purchase Adjustment Account is maintained. Following are the entries to be made.

- (i) When goods are sold on hire purchase
- |                                 |     |                   |
|---------------------------------|-----|-------------------|
| Hire purchase stock A/c         | Dr. | Full H.P. Price   |
| To Stock A/c                    |     | Actual cost price |
| To Hire Purchase Adjustment A/c |     |                   |
- (Being the difference between cost and H.P. price)
- (ii) When instalments become due for payment
- |                            |     |  |
|----------------------------|-----|--|
| Hire purchase Debtors A/c  | Dr. |  |
| To Hire purchase Stock A/c |     |  |
- (iii) When cash is received
- |                              |     |  |
|------------------------------|-----|--|
| Cash A/c                     | Dr. |  |
| To Hire Purchase Debtors A/c |     |  |
- (iv) Stock Reserve on opening Stock
- |                                 |     |  |
|---------------------------------|-----|--|
| Stock Reserve A/c               | Dr. |  |
| To Hire Purchase Adjustment A/c |     |  |
- (v) Stock Reserve on closing Stock
- |                              |     |  |
|------------------------------|-----|--|
| Hire Purchase Adjustment A/c | Dr. |  |
| To Stock Reserve A/c         |     |  |

Hire purchase Debtors Account will consist of opening balance instalment due on goods sold on hire purchase on the debit side while cash received and closing balance on the credit side.

Hire purchase stock account will consist of opening balance and goods sold on hire purchase during the year in the debit side, while instalments due from debtors and closing balance on the credit side. The stock values are recorded at hire purchase price (i.e. cost + profit on H.P. Sales).

Hire purchase adjustment account will consist of stock reserve on opening stock and closing stock in the credit side and debit side respectively. Further the loading element in goods sold on hire purchase (profit) will be credited in this account. This account shows the actual profit earned by means of hire purchase system.

## Accounting

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### Illustration 12

The hire purchase department of B.G. Ltd. sells television sets and room coolers. This department was newly started in 2010. The relevant information is as follows:

	Television set ₹	Room coolers ₹
Cost	5,400	2,000
Cash Price	6,300	2,400
Cash down payment	900	400
Monthly instalment	600	200
Number of instalments	10	12

During the year, 100 television sets and 120 room coolers were sold on hire purchase basis. Two television sets on which 3 instalments only could be collected and 4 room coolers on which 5 instalments had been collected were repossessed. These were valued at ₹ 10,000 and after reconditioning at a cost of ₹ 1,000 were sold outright for ₹ 14,000. Other instalments collected and those due (customer still paying) were respectively as follows :

Television sets	270 and 20
Room coolers	400 and 30

Prepare Accounts on stocks and debtors system to reveal the profit of the Department.

### Solution

B.G. Limited			
Hire Purchase Stock A/c			
	₹		₹
To Goods sold on H.P.	10,26,000	By H.P. Debtors A/c	4,05,600
		" Goods Repossessed A/c (Instalments not due on repossessed goods)	14,000
		" Balance c/d (Instalment not yet due)	<u>6,06,400</u>
	<u>10,26,000</u>		<u>10,26,000</u>
Hire Purchase Debtors A/c			
To Hire Purchase Stock A/c	4,05,600	By Bank A/c	3,87,600
		By Balance c/d	<u>18,000</u>
	<u>4,05,600</u>		<u>4,05,600</u>

## Hire Purchase and Instalment Sale Transactions

### Goods Repossessed A/c

To	Hire Purchase Stock A/c	14,000	By	Hire Purchase Adjustment A/c (Balancing Figure)	4,000
				" Balance c/d	<u>10,000</u>
		<u>14,000</u>			<u>14,000</u>
To	Balance b/d	10,000	By	Bank (Sales)	14,000
"	Bank (Exp.)	1,000			
"	Hire Purchase Adjustment A/c (Profit)	<u>3,000</u>			
		<u>14,000</u>			<u>14,000</u>

### Goods sold on Hire Purchase A/c

To	Hire Purchase		By	Hire Purchase Stock A/c	10,26,000
"	Adjustment A/c (loading)	2,46,000			
"	Profit	<u>7,80,000</u>			
		<u>10,26,000</u>			<u>10,26,000</u>

### Hire Purchase Adjustment A/c

To	Goods repossessed A/c (Loss)	4,000	By	Goods sold on Hire Purchase (Loading)	2,46,000
"	Stock Reserve	1,44,971	"	Goods Repossessed (Profit on sale)	<u>3,000</u>
"	Profit	<u>1,00,029</u>			<u>2,49,000</u>
		<u>2,49,000</u>			<u>2,49,000</u>

### Working Notes :

- (i) Hire Purchase Price is ₹ 6,900 for each television set and ₹ 2,800 for each room cooler. Total cost and sales on this basis are as follows:

	H.P. Price	Cost
	₹	₹
Television sets (100)	6,90,000	5,40,000
Room Coolers (120)	<u>3,36,000</u>	<u>2,40,000</u>
	<u>10,26,000</u>	<u>7,80,000</u>
	<i>Television sets</i>	<i>Room Coolers</i>
	₹	₹

(ii) Cash collected				
Down payment				
	(900 × 100)	90,000	48,000	(400 × 120)
Instalments collected				
	(600 × 270)	1,62,000	80,000	(400 × 200)



## Accounting

Amount collected on Repossessed goods			
(3 × 2 × 600)	<u>3,600</u>	<u>4,000</u>	(5 × 4 × 200)
	<u>2,55,600</u>	<u>1,32,000</u>	
(iii) Instalment not yet due:			₹
Television: Total instalments on 98 sets			980
Instalments collected & due			<u>290</u>
			<u>690</u>
Amount of 690 instalments @ ₹ 600 each			4,14,000
Room Coolers:			
Total instalment on 116 Room Coolers			1,392
Less : Instalments collected & due			<u>430</u>
			<u>962</u>
Amount of 962 instalments @ ₹ 200 each = ₹ 1,92,400			
Total amount (4,14,000 + 1,92,400) = ₹ 6,06,400			
(iv) Stock Reserve :			
Television sets $\frac{1,500}{6,900} \times 4,14,000$			90,000
Room Coolers $\frac{800}{2,800} \times 1,92,400$			<u>54,971</u>
			<u>1,44,971</u>
(v) Instalment not due on repossessed goods:			₹
2 Television sets 7 instalments on each @ ₹ 600			8,400
4 Room Coolers 7 instalments on each @ ₹ 200			<u>5,600</u>
			<u>14,000</u>
(vi) Instalment due but not collected :			₹
Television sets (20 × ₹ 600)			12,000
Room Cooler (30 × ₹ 200)			<u>6,000</u>
			<u>18,000</u>

### Illustration 13

*Y Ltd. sells products on hire purchase terms, the price being cost plus 33-1/3%. From the following particulars for 2010, prepare Hire Purchase Stock Account, Shop Stock Account, Hire Purchase Debtors Account, Stock Reserve Account and Hire Purchase Adjustment Account (for profit) :*

2010		₹
Jan. 1	Stock out on hire at Hire Purchase Price	1,20,000

### Hire Purchase and Instalment Sale Transactions

	Stock in hand, at Shop	15,000
	Instalment due (Customers still paying)	9,000
Dec. 31	Stock out on hire at Hire Purchase Price	1,38,000
	Stock in hand, at Shop	21,000
	Instalments due (Customers still paying)	15,000
	Cash received during the year	2,40,000

#### Solution

#### Hire Purchase stock Account

		₹		₹	
2010			2010		
Jan. 1	To Balance b/d	9,000	Jan. 1	By Bank A/c	2,40,000
"	" Hire Purchase Stock A/c (instalments due during the year) (Balancing fig.)	<u>2,46,000</u>	"	" Balance c/d	15,000
		<u>2,55,000</u>			<u>2,55,000</u>

#### Hire Purchase Stock Account

		₹		₹	
2010			2010		
Jan. 1	To Balance b/d	1,20,000	Jan. -		-
"	" Goods sold on Hire Purchase (75%)	1,98,000	Dec. -		-
"	" H.P., Adj. A/c (25%)	<u>66,000</u>	Dec. 31	By H.P. Debtors A/c	2,46,000
		<u>3,84,000</u>	"	" Balance c/d	1,38,000
		<u>3,84,000</u>			<u>3,84,000</u>

#### Shop Stock Account

		₹		₹	
2010			2010		
Jan. 1	To Balance b/d	15,000	By	H.P. Stock A/c	
"	" Purchases A/c (Balancing fig.)	<u>2,04,000</u>		(Cost of Goods sold)	1,98,000
		<u>2,19,000</u>	"	Balance c/d	<u>21,000</u>
		<u>2,19,000</u>			<u>2,19,000</u>

#### Stock Reserve Account

		₹		₹	
2010			2010		
	To Hire Purchase Adjustment (transfer)	30,000	By	Balance b/d	
"	" Balance c/d	<u>34,500</u>		(25% on 1,20,000)	30,000
		<u>64,500</u>	"	Hire Purchase Adjustment A/c	<u>34,500</u>
		<u>64,500</u>			<u>64,500</u>

## Accounting

### Hire Purchase Adjustment Account

2010	₹	2010	₹
To Stock Reserve-Closing	34,500	By Stock Reserve-Opening	30,000
" Profit & Loss Account	<u>61,500</u>	" H.P. Stock	<u>66,000</u>
	<u>96,000</u>		<u>96,000</u>

### 11. Hire Purchase Agreement for Goods of Small Value

Till now, we have discussed on the hire purchase transactions for goods of substantial sales value – generally the fixed assets and the transactions were between **two business units**. Now, we should discuss on the transactions between a retailer and the consumers and the hire purchase of consumer durable. Here, it should be noted that accounting is important only from the point of view of the seller and not the buyer.

Due to numerous transactions on the sale of such items and that too of small value, it becomes practically inconvenient for a particular retailer to maintain separate accounts for each transaction. Also, the retailer does not want to know the profit earned or losses incurred on each transaction – rather he will be interested in knowing the overall profit or loss arising from all the transactions in a particular accounting period.

When the hire purchase transactions are numerous and value of the items is small, it is preferable to open separate **memorandum** hire purchase books. A Hire Purchase Sales Register is kept, to disclose both the hire purchase price and the cost price of the goods. This register should also show the number of instalments payable amount of down payment and the number of hire purchase agreement. In memorandum Hire Purchase Ledger accounts of the customers are kept. The sale price is debited to the individual customers' accounts and these accounts being credited with all instalments paid. The total of the "sale price" column is credited to a Control Account, which is debited with the total instalments received.

It must be noted that above entries are of a memorandum nature only, and do not form a part of the double entry system. In the general ledger, personal aspect is ignored, the entries being recorded in total only. A specimen of the Hire Purchase Sales Register is given below:

#### Hire Purchase Sales Register

S.No.	Date of Agreement	Name of Customer	Name of Article	Cost Price	H.P. Price	Down Payment	No. of installments	Instalments Due				Total Instalments Received	Instalments due but not received	Instalment not yet due
								1	2	3	4			

The book keeper should be very alert in recording the different items in the register and casting (totaling) of the individual column, because these are the basis for the ascertainment of the profit or loss from hire purchase business.

## 12. Ascertainment of Profit/Loss

There are two common methods of ascertaining profit/loss of goods of small value sold on hire purchase. These are:

- (a) the Hire Purchase Trading Account Method.
- (b) The Stock and Debtors Method.

### 12.1 Hire Purchase Trading Account Method

Under this method, a Hire Purchase Trading Account is prepared as follows:

**(a) Debit the Hire Purchase Trading Account by**

- (i) *Opening balance of H.P. Stock (Instalments not yet due)* brought forward from the previous year. Generally, it is shown at hire purchase price. If it is given at cost, convert that into Hire Purchase price by adding loading.
- (ii) *Opening balance of H.P. Debtors (Instalment due but not yet paid)* brought forward from the previous year.
  - (i) Value of goods sold on Hire Purchase during the accounting period.
  - (ii) Expenses incurred during the accounting period.
  - (iii) Loss on repossession of goods.

**(b) Credit the Hire Purchase Trading Account by**

- (i) *Cash received from hire purchase customers* during the accounting period. It includes down payment, hire purchase instalments of the previous year as well as of the current year collected during the accounting period.
- (ii) *Instalments due but not paid on goods repossessed.*
- (iii) *Closing balance of H.P. Stock (Instalment not yet due)* at hire purchase price carried forward to the next period. If it is not given in the problem, it can be calculated by preparing Memorandum Goods with H.P. Customers Account.
- (iv) *The closing balance of H.P. Debtors (Instalments due but not yet paid)* is carried forward to next period. If the closing balance of H.P. Debtors is not given in the problem, it can be calculated by preparing Memorandum H.P. Debtors Account.

**Pass adjustment entries for the following:**

(i)	For loading on opening balance of Hire Purchase Stock <i>(Instalments not yet due/Goods with H.P. Customers)</i> Stock Reserve Account To Hire Purchase Trading Account	Dr.
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## Accounting

(ii)	For loading on goods sold on Hire Purchase during the year Goods sold on Hire Purchase Account To Hire Purchase Trading	Dr.
(iii)	For loading on closing balance of Hire Purchase Stock (Instalments not yet due/Goods with H.P. Customers) Hire Purchase Trading Account To Stock Reserve Account	Dr.

The proforma of a Hire Purchase Trading Account is given below:

Dr.	Hire Purchase Trading Account				Cr.
Date	Particulars	₹	Date	Particulars	₹
To	Balance b/d: Hire Purchase Stock (at H.P. price)		By	Cash A/c	
			By	Goods Repossessed A/c (Instalments due but not paid)	
	Hire Purchase Debtors		By	Stock Reserve A/c	
To	Goods Sold on H.P. A/c (H.P. price)			(Loading on opening H.P. stock)	
To	Loss on Goods Repossessed A/c		By	Goods sold on H.P. A/c	
To	Expenses A/c			(Loading on goods sold)	
To	Stock Reserve A/c (Loading on closing H.P. stock)		By	Balance c/d: H.P. Stock (at H.P. price)	
To	Profit & Loss A/c			H.P. Debtors	

**12.1.1 Repossession:** When goods are repossessed for default in payment, the number of instalments due but not yet received on the goods are not recoverable. The amounts of these instalments in respect to the repossessed goods are transferred from the Memorandum Hire Purchase Debtors Account to the Goods Repossessed Account by debiting the latter and crediting the former in the Memorandum Hire Purchase Ledger.

**The following are the Journal Entries for repossession**

(1)	When the goods are repossessed Goods Repossessed Account To Hire Purchase Trading Account	Dr. [Instalments due but not yet paid]
-----	-------------------------------------------------------------------------------------------------	----------------------------------------

## Hire Purchase and Instalment Sale Transactions

(2)	<i>When there is a loss on repossession</i> <i>[Selling price/market price is less than Instalments due but not yet paid]</i> Hire Purchase Trading Account To Loss on Repossession Account	Dr.
(3)	<i>When there is a profit on repossession</i> <i>[Selling price/market price is greater than Instalments due but not yet paid]</i> Profit on Repossession Account To Hire Purchase Trading Account	Dr.

### 13. Calculation of Missing Figures

Sometimes in the examination, some figures required to calculate profit/loss are not given. These may be: (i) Hire Purchase Stock; (ii) Hire Purchase Debtors; (iii) Purchases; or (iv) Cash received, etc., Before preparing the Hire Purchase Trading Account, the missing item(s) should be calculated first. The following steps are followed:

**Step 1:** Draw up the following Memorandum Accounts.

- (a) Memorandum Stock at Shop Account.
- (b) Memorandum H.P. Stock Account/Stock with H.P. Customers Account.
- (c) Memorandum H.P. Debtors Account/Instalments Due Account

**Step 2:** Place the available figures in the respective accounts.

**Step 3:** Balance the account having maximum figures available. It will be helpful in finding out the missing figure of that account.

**Step 4:** Place the figures so calculated in Step 3 to the relevant account.

**Step 5:** Continue the process of transfer until all the figures are available.

The proforma of these accounts are given below:

Dr.	Memorandum Stock at Shop Account				Cr.
	Particulars	₹		Particulars	₹
To	Balance b/d (at cost)		By	Goods sold on Hire Purchase A/c (at cost)	
To	Purchases		By	Balance c/d	
Dr.	Memorandum Hire Purchase Stock				Cr.
	Particulars	₹		Particulars	₹
To	Balance b/d (at H.P. Price)		By	Cash A/c	
To	H.P. Stock A/c (total instalments due)		By	Goods Repossessed A/c (instalments not yet due)	
			By	Balance c/d	

## Accounting

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Dr.	Memorandum Hire Purchases Debtors Account				Cr.
	Particulars	₹		Particulars	₹
To	Balance b/d (at H.P. price)		By	Cash A/c	
To	H.P. Stock A/c (total instalments due)		By	Goods Repossessed A/c (install, due but not yet recd.)	
			By	Balance c/d	

### 14. Instalment Payment System

In instalment payment system the ownership of the goods is passed immediately to the buyer on the signing the agreement. Because of this basic difference the accounting entries under instalment payment system are slightly different from those passed under the hire-purchase system. The scheme of entries is as under:

**Books of buyer:** Buyer debits asset account with full cash price, credits vendor's account with full instalment price and debits interest suspense account with the difference between full cash price and full instalment price. Interest is debited to interest suspense account (not interest account) because it includes interest in respect of a number of years. Every year interest account is debited and interest suspense account is credited with the interest of current year. Interest account, at the end of the year, is closed by transferring to profit and loss account. The balance of interest suspense account (this is a debit balance) is shown in the balance sheet on the asset side. Vendor is paid the instalment due to him and entry for the depreciation is passed in the usual way.

**Books of Seller:** The seller debits the purchaser with the full amount (instalment price) payable by him and credits sales account by the full cash price and credits interest suspense account by the difference between the total instalment price and total cash price. Seller, like the buyer, also transfers the amount of interest due from the interest suspense account interest account every year. Interest account is closed by transferring to profit and loss account and the balance of interest suspense account is shown in the balance sheet on the liability side. On receiving the instalment the vendor debits cash/bank account and credits purchaser's account.

### 15. Difference of Hire Purchase Agreement and Instalment Payment Agreement

A hire purchase agreement is a contract of bailment coupled with an option to the hire purchaser to acquire the goods delivered to him under such an agreement. By the delivery of goods to the hire purchaser, the hire vendor merely parts with their possession, but not the ownership. The property or title to the goods is transferred to the hire-purchaser, on his paying the last instalment of the hire price or complying with some other conditions stipulated in the contract. At any time before that the hire-purchaser has the option to return the goods and, if

## Hire Purchase and Instalment Sale Transactions

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he does so, he has only to pay the instalments of price that by then have fallen due. The right or option to purchase is the essence of hire-purchase agreement. In the event of a default by the buyer (hire purchaser) in the payment of any of the instalments of hire price, the vendor can take back the goods into his possession. This is legally permissible since the property in the goods is still with the vendor.

On the other hand, it may have been agreed between the buyer and the seller that the price of the goods would be payable by instalments and the property would immediately pass to the buyer; in the event of a default of instalments, it would not be possible for the vendor to recover back the goods. He, however, would have the right to bring an action against the purchaser for the recovery of the part of the price that has not been paid to him.

*Analysis of the hire purchase price* : The hire purchase price is always greater than the cash price, since it includes interest payable over and above the price of the goods to compensate the seller for the sacrifice he has made by agreeing to receive the price by instalments and the risk that he thereby undertakes. It is thus made up of following elements:

- (a) cash price;
- (b) interest on unpaid instalments; and
- (c) a charge to cover the risk involved in the buyer defaulting to pay one or more of instalments of price or that of his returning the goods in a damaged condition.

Interest is the charge for the facility to pay the price for the goods by instalments after they have been delivered. The rate of interest is generally higher than that payable in respect of an advance or a loan since it also includes a charge to cover the risk that the hirer may fail to pay any of the instalments and, in such an event, the goods may have to be taken back into possession in whatever condition they are at the time. A separate charge on this account is not made as that would not be in keeping with the fundamental character of the hire-purchase sale.

### Illustration 14

*Krishna Agencies started business on 1<sup>st</sup> April, 2010. During the year ended 31<sup>st</sup> March, 2011, they sold under-mentioned durables under two schemes — Cash Price Scheme (CPS) and Hire-Purchase Scheme (HPS).*

*Under the CPS they priced the goods at cost plus 25% and collected it on delivery.*

*Under the HPS the buyers were required to sign a Hire-purchase Agreement undertaking to pay for the value of the goods including finance charges in 30 instalments, the value being calculated at Cash Price plus 50%.*

*The following are the details available at the end of 31<sup>st</sup> March, 2011 with regard to the products :*



## Accounting

Product	Nos. purchased	Nos. sold under CPS	Nos. sold under HPS	Cost per unit ₹	No. of instalments due during the year	No. of instalments received during the year
TV sets	90	20	60	16,000	1,080	1,000
Washing Machines	70	20	40	12,000	840	800

The following were the expenses during the year :

	₹
Rent	1,20,000
Salaries	1,44,000
Commission to Salesmen	12,000
Office Expenses	1,20,000

From the above information, you are required to prepare :

- Hire-purchase Trading Account, and
- Trading and Profit & Loss Account.

### Solution

**In the books of Krishna Agencies  
Hire-Purchase Trading Account  
for the year ended 31<sup>st</sup> March, 2011**

	₹	₹		₹	₹
To Goods sold on H.P. A/c:			By Bank A/c cash received		
TVs (60×₹ 30,000)	18,00,000		TVs (1,000×₹ 1,000)	10,00,000	
Washing Machines (40 × ₹ 22,500)	<u>9,00,000</u>	27,00,000	Washing Machines (800 ×₹ 750)	<u>6,00,000</u>	16,00,000
To H.P. Stock Reserve		4,62,000	By Instalment Due A/c:		
₹ 9,90,000 × $\frac{87.5}{187.5}$		7,98,000	TVs (80×₹ 1,000)	80,000	
To Profit & Loss A/c (H.P.profit transferred)			Washing Machines (40×₹ 750)	<u>30,000</u>	1,10,000
			By Goods sold on HP A/c: (Cancellation of loading)		
			₹ 27,00,000 × $\frac{87.5}{187.5}$		12,60,000
		<u>39,60,000</u>	By H.P. Stock (W.N 2)		<u>9,90,000</u>
					<u>39,60,000</u>

## Hire Purchase and Instalment Sale Transactions

### Trading and Profit & Loss Account for the year ended 31<sup>st</sup> March, 2011

	₹	₹		₹	₹
To Purchases:			By Sales:		
TVs (90×₹ 16,000)	14,40,000		TVs (20×₹ 20,000)	4,00,000	
Washing Machines (70 × ₹ 12,000)	8,40,000	22,80,000	Washing Machines (20 ×₹ 15,000)	3,00,000	7,00,000
To Gross profit c/d		1,40,000	By Goods sold on H.P. A/c (27,00,000– 12,60,000)		14,40,000
		24,20,000	By Shop Stock (W. N 3)		2,80,000
To Salaries		1,44,000			24,20,000
To Rent		1,20,000	By Gross profit b/d		1,40,000
To Commission		12,000	By H.P. Trading A/c (H.P. Profit)		7,98,000
To Office expenses		1,20,000			
To Net Profit		5,42,000			
		9,38,000			9,38,000

#### Working Notes:

(1) Calculation of per unit cash price, H.P. price and Instalment Amount:

Product	Cost ₹	Cash Price ₹ (Cost × 1.25)	H.P. price ₹ (Cash Price×1.50)	Instalment Amount (₹) (H.P. price/No. of instalments)
TV sets	16,000	20,000	30,000	1,000
Washing Machines	12,000	15,000	22,500	750

(2) Calculation of H.P. Stock as on 31<sup>st</sup> March, 2011:

Product	Total No. of Instalments (Nos.)	Instalments Due in 2007- 2008 (Nos.)	Instalments not due in 2007- 2008 (Nos.)	Amount ₹
TV sets	1800	1080	720	7,20,000
Washing Machines	1,200	840	360	<u>2,70,000</u>
				<u>9,90,000</u>

## Accounting

(3) Calculation of Shop Stock as on 31<sup>st</sup> March, 2011:

Product	Purchased(Nos.)	Sold (Nos.)	Balance (Nos.)	Amount ₹
TV sets	90	80	10	1,60,000
Washing Machines	70	60	10	<u>1,20,000</u>
				<u>2,80,000</u>

### Illustration 15

A acquired on 1st January, 2010 a machine under a Hire-Purchase agreement which provides for 5 half-yearly instalments of ₹ 6,000 each, the first instalment being due on 1st July, 2010. Assuming that the applicable rate of interest is 10 per cent per annum, calculate the cash value of the machine. All working should form part of the answer.

### Solution

#### Statement showing cash value of the machine acquired on hire-purchase basis

	Instalment Amount	Interest @ 5% half yearly (10% p.a.) = $\frac{5}{105} = \frac{1}{21}$ (in each instalment)	Principal Amount (in each instalment)
	₹	₹	₹
5th Instalment	6,000	286	5,714
Less: Interest	<u>- 286</u>		
	5,714		
Add: 4th Instalment	<u>6,000</u>		
	11,714	558	5,442
Less: Interest	<u>558</u>		(11,156-5,714)
	11,156		
Add: 3rd instalment	<u>6,000</u>		
	17,156	817	5,183
Less: Interest	<u>817</u>		(16,339-11,156)
	16,339		
Add: 2nd instalment	<u>6,000</u>		
	22,339	1,063	4,937
Less: Interest	<u>1,063</u>		(21,276-16,339)
	21,276		
Add: 1st instalment	<u>6,000</u>		
	27,276	1,299	4,701
Less: Interest	<u>1,299</u>		(25,977-21,276)
	<u>25,977</u>	<u>4,023</u>	<u>25,977</u>

The cash purchase price of machinery is ₹ 25,977.

### Summary

- **Under Hire Purchase System**, hire purchaser will pay cost of purchased asset in installments. The ownership of the goods will be transferred by the Hire Vendor only after payment of outstanding balance.
- **Under installment system**, ownership of the goods is transferred by owner on the date of delivery of goods.
- **Accounting Method when goods have substantial sales under Hire Purchase System**
  - ✓ Cash price Method
  - ✓ Interest suspense method
- **Accounting Method when goods have small sales under Hire Purchase System**
  - ✓ Debtor method
  - ✓ Stock & Debtor Method