

HIRE PURCHASE SYSTEM

There are different methods of sales, i.e., it may be cash sales or credit sales. In case of cash sales the buyer pays money and the seller transfer the property to the buyer immediately. In case of credit sales, the buyer pays the money later, but the seller transfer the property to the buyer at the time of sale itself.

Another method of sales is hire purchase sales, here the buyer pays only a part of the money initially and take possession of the property, the balance will be paid in installments, on payment of last installment, the seller transfer the ownership of the property to the buyer. Until then, the seller is the legal owner of the property.

In case if the buyer fails to pay any installment, the seller is having the right to take back the possession of the goods and also forfeit the amount already paid by the buyer.

Normally, the price of the property under hire purchase system is higher than the cash price, since, the cost is paid in different installments, the seller will charge interest.

The above sales governed under the Hire Purchase Act 1972 which came into force with effect from 01/09/1973.

Important terminology:

Hirer / Hire purchaser - the person who purchase property under Hire purchase system.

Hire vendor – The seller who sells property under the hire purchase system.

Hire purchase price – the price at which property sold under the hire purchase system.

Down payment - the amount paid initially by the hirer.

Cash price – the price at which the same property purchased for cash in the market.

Hire charges – the difference between hire purchase price and cash price / the total Interest payment

Installment money – the amount every installment the buyer pays alongwith interest

Rights of the hire purchaser/ hirer:

The hirer can terminate the agreement, after giving 14 days notice in advance to the hire vendor. However, he should have settled all the dues and if any excess money is paid, which he can get refund from the hire vendor.

The hirer can also make preclosure, after giving 14 days notice in advance to the hire vendor about his intention to pay the balance amount in full settlement. In such cases, he is eligible for rebate

$$2/3 \times (\text{HP charges} \times \text{no of installment due/total installment})$$

Rights of the Hire vendor:

- When the hire purchaser fails to pay any installments,
 - The vendor can terminate the agreement
 - Repossess the goods
 - Retain the amount already paid by the hire purchaser as charges for enjoying the property so far.

When permission of the court is required to take possession of the goods

When the HP price is less than Rs.15000/- and 1/2 of the price has been paid. In other cases, 3/4th of the price has already been paid by the hire purchaser.

Limitation on hire charges

- The hire charges should not exceed 20% of the installment price or $SC = (CP \times R \times T L / 100)$ which ever is less.
- SC = Statutory charges
- CP = Cash Price.
- R = Rate of interest 10% or more as determined by the government.
- TL = Time limit as determined by the government.

Hire purchase trading Account

When the hire vendor sells goods of lesser value under the hire purchase system, it is not easy to maintain accounts for all hire purchasers. In such cases, the hire vendor will open hire purchase trading account and enter all hire purchase transactions. Another method, followed in this case is stock and debtors system.

Accounting treatment:

The accounting treatment consist of how to record the transactions in the books of hire purchaser and hire vendor and how to compute the interest and cash price out of the installment price.

In the books of the Hire purchaser:

Transactions	First method	Second method
Assets purchased under HP system	Asset A/c. (cash price) To Hire vendor A/c.	No entry
When down payment is made	Hire Vendor A/c.	Asset A/c.

	To Cash/bank A/c.	To Cash/Bank A/c.
When interest due	Interest A/c. To Hire vendor A/c.	No entry
When installment due	No entry	Asset A/c. Interest A/c. To Hire vendor A/c.
When installment paid	Hire vendor A/c. To Cash/bank A/c.	Hire vendor A/c. To Cash/bank A/c.
Depreciation on Assets	Depreciation A/c. To Assets A/c.	Depreciation A/c. To Assets A/c.
Transferring interest and depreciation	Profit and loss A/c. To Interest A/c. To Depreciation A/c.	Profit and loss A/c. To Interest A/c. To Depreciation A/c.

In the books of the Hire Vendor:

Transactions	First method	Interest suspense method
Goods sold under HP system	Hirer A/c. (cash price) To H P sales A/c.	Hirer A/c.(HP Price) To HP Sales A/c.(cash price) To Interest Suspense A/c.
When down payment is received	Cash / bank A/c.. To Hirer A/c.	Cash / bank A/c.. To Hirer A/c.
When interest due	Hirer A/c. To Interest A/c.	Interest suspense A/c. To Interest A/c.
When installment is received	Cash / bank A/c.. To Hirer A/c.	Cash / bank A/c.. To Hirer A/c.
Transferring interest	Interest A/c. To Profit and Loss A/c.	Interest A/c. To Profit and Loss A/c.

Problem No.1 The hire purchase price of an asset is Rs.120000 and the cash price is Rs.100000/- which is payable in eight equal installments. The purchaser after the completion of 3rd installments wants to close the HP sales by making one time payment. What is the amount of rebate available?

$$\frac{2}{3} \times (\text{HP charges} \times \text{no of installment due/total installment})$$

$$\text{Rebate} = \frac{2}{3} \times (20000 \times \frac{5}{8}) \text{ Rs.8333/-}$$

Under hire purchase system, the important aspect is the calculation of interest

Problem No. 2 The madras company purchased a machine from Bombay Machine company on hire purchase agreement on 01st Jan.2006 paying cash Rs.100000/- and agreeing to pay further installments of Rs.100000/- each on 31st December of every year. The cash price of the machine is Rs.372500/- and the interest charged at the rate of 5% p.a. The madras company writes off 10% every year of the value of machine on the reducing instalment system.

Open necessary accounts in the books of both the companies.

First aspect is the calculation of interest amount in the installment. Here all information is given

Particulars	Cash price	Interest	Installment		
			Cash price	Interest	Total
Cash price	372500	5%			
Less: Down payment	100000		100000		100000
	272500				
Less: first installment	86375		86375	13625	100000
	186125				
Less: Second installment	90694		90694	9306	100000
	95431				
Less; third installment	95431		95431	4569	100000
	0		372500	27500	400000

In the Books of Madras Company

Machine A/c.	372500	
To Bombay Machine Limited A/c.		372500
(being asset purchased on hire purchase from Bombay machine limited)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being down payment of Rs.100000 paid)		

interest A/c.	13625	
To Bombay Machine Limited A/c.		13625
(being interest due for the first installment)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being first installment paid)		

Depreciation A/c.	37250	
To Machinery A/c.		37250
(being depreciation charged at the rate of 10% on cash price)		

Profit and loss A/c.	50875	
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To Depreciation A/c.		37250
To Interest A/c		13625
(being the depreciation and interest is transferred to profit and loss account)		

interest A/c.	9306	
To Bombay Machine Limited A/c.		9306
(being interest due for the second installment)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being second installment amount paid)		

Depreciation A/c.	33525	
To Machinery A/c.		33525
(being depreciation charged at the rate of 10% on cash price)		
Profit and loss A/c.	42831	
To Depreciation A/c.		33525
To Interest A/c		9306
(being the depreciation and interest is transferred to profit and loss account)		

Interest A/c.	4569	
To Bombay Machine Limited A/c.		4569
(being interest due for the third installment)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being third and final installment amount paid)		

Depreciation A/c.	30173	
To Machinery A/c.		30173
(being depreciation charged at the rate of 10% on cash price)		

Profit and loss A/c.	34742	
To Depreciation A/c.		30173
To Interest A/c		4569
(being the depreciation and interest is transferred to profit and loss account)		

MACHINE ACCOUNT

To Bombay Machine Ltd. A/c.	372500	By Depreciation A/c.	37250
		By Balance C/d.	335250
	372500		372500
To Balance B/d	335250	By Depreciation A/c.	33525
		By Balance C/d.	301725
	335250		335250
To Balance B/d.	301725	By Depreciation A/c.	30173
		By Balance C/d.	271552
	301725		301725

BOMBAY MACHINE LIMITED ACCOUNT

To cash A/c.	100000	By machine A/c.	372500
To cash A/c.	100000	By Interest	13625
To Balance C/d.	186125		
	386125		386125
To cash A/c.	100000	By Balance B/d.	186125
To Balance C/d.	95431	By interest A/c.	9306
	195431		195431
To Cash A/c.	100000	By Balance B/d.	95431
		By interest A/c.	4569
	100000		100000

In the Books of Bombay Machines Limited

Madras Company A/c.	372500	
To Hire purchase sales A/c.		372500
(being good sold under hire purchase system)		

cash A/c.	100000	
To Madras Company A/c.		100000
(being down payment of Rs.100000 received)		

Madras Company A/c.	13625	
To Interest A/c.		13625
(being interest due for the first installment)		

cash A/c.	100000	
To Madras Company A/c.		100000

(being first installment received)

Madras Company A/c.	9306	
To Interest A/c.		9306
(being interest due for the second installment)		

cash A/c.	100000	
To Madras Company A/c.		100000
(being second installment received)		

Madras Company A/c.	4569	
To Interest A/c.		4569
(being interest due for the third installment)		

cash A/c.	100000	
To Madras Company A/c.		100000
(being third installment received)		

Problem No. 2 X limited purchased from Y limited a machine under the HP system on 01/01/2008. Its hire purchase price Rs.95000/- and cash price Rs.86800/-
 Rs.5000/- paid on delivery
 Rs.10000/- paid after 4 months
 Rs.15000/- paid after 6 months
 Rs.30000/- paid after 9 months and
 Rs.35000/- paid after 12 months.

Calculate the amount of interest in each installment.

Total Interest = Hire purchase price – cash price 95000-86800 = 8200/-

Interest for first installment = $8200/10 \times 4 = 3280$

Interest for second installment = $8200/10 \times 3 = 2460$

Interest for third installment = $8200/10 \times 2 = 1640$

Interest for fourth installment = $8200/10 \times 1 = 820$

Total Interest = 8200

Problem No 4. On 1st January 2005, Ram limited purchased a motor car from yogesh limited on hire purchase system. The cash price of which was payable as Rs.120000/ down and the balance in 3 equal annual installments together with interest @ 10% p.a. The amount of cash installments including interest was Rs.176000/-. Depreciation was to be provided at 20% p.a on the reducing balance.

At the end of the 3rd year the motor car was sold for Rs.3,00,000/-. Show motor care and vendor account.

In the given sum cash price is not given the installment amount includes interest also. We have to segregate the interest portion from the installment amount

Last instalment paid Rs.176000 (This include cash price and interest, therefore let us assume, this 176000 is a combination principal and interest)

176000 x 10/110 16000 therefore, in the first installment interest is Rs.16000and the balance cash priceRs.160000

Second installment paid Rs.176000+160000

336000 x 10/110 30545

First installment = 145454+160000+176000 = 481454 x 10/110= 43768

OBJECTIVE TYPE QUESTIONS ON HP

1.Hire purchase Act came into force with effect from

A] 01/09/1973	B]01/09/1972	C]31/03/1973	D]01/04/1973
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2. In Hire purchase, the possession of goods transferred at the time

A] sales	B] down payment paid	C] full cash price paid	D] full HP price paid
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3. In Hire purchase, the ownership of goods transferred at the time

A] sales	B] down payment paid	C] full cash price paid	D] full HP price paid
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4. Hire charges means

A] the total interest	B] the installment amount	C] cash price	D] down payment
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5. When the hire purchaser wants to breach the contract, he has to give

A] one month notice	B] 14 days notice	C] two months notice	D] 28 days notice
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6. When the hirer wants to transfer the assets to third party in the middle of the hire purchase agreement

A] Assets A/c. To Transferor A/c. To Vendor A/c.	B] Assets A/c. To Vendor A/c.	C] Assets A/c. To Transferor A/c.	D] Assets A/c. To Cash A/c.
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7. When there is a default in the hire purchase sales, the hire vendor takes back the possession of the property, what would be the journal entry in the books of the hire vendor

A] Goods Repossessed A/c. To Hirer A/c.	B] Cash A/c. To hirer A/c.	C] Bills Receivable A/c. To hirer A/c.	D] Assets A/c. To hirer A/c.
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8. In case of goods of small value, the account used by hire vendor to know the profit is

A] Hire purchase trading account	B] Hirer A/c.	C] Consolidated P and L A/c.	D] None
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9. The cash price of the machine is Rs.300000/- and the Hire purchase price is Rs.400000/- and repayable in 4 equal instalments, what is the amount of interest for the 1st instalment

A] 40000	B] 30000	C] 20000	D] 10000
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10. M/s. India Motors limited sells scooters on hire purchase system. The terms of payment are Rs.10000/- on delivery Rs.10400/- at the end of 1st year Rs.9600/- at the end of 2nd year and Rs.8800/- at the end of 3rd year inclusive of interest. What is the amount of interest?

A] 4800/-	B] 2400/-	C] 1600/-	D] 800/-
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11. In hire purchase system, hire-buyer maintains his accounts under:

A] Asset accrual system	B] Total cash price method	C] Any of two method	D] higher of the A & b above
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12. Which of the following would account for the interest charges relating to hire purchase?

A] HP Interest A/c. To vendor A/c.	B] HP Interest A/c. To P and L A/c.	C] P and L A/c. To Vendor A/c.	D] Cash A/c. Dr. To H. P. Interest A/c.
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13. Accounting entry for sale of goods on hire purchase in the books of hire vendor will be

A] HP A/c. (Cash price) To Hire Sales A/c.	B] HP A/c.(H.P.Price) To Hire sales A/c.	C] Hire Sales A/c. (Cash price) To Hire purchaser	D] Hire Sales A/c. (Hire purchase price) To Hire purchaser
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14. Accounting for hire purchase sale in the books of hire vendor is entered at the pattern of

A] Royalty accounts	B] Accounting for credit sales	C] Accounting for joint venture	D] none of the above
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15. Under hire purchase system, the buyer becomes the owner of goods

A]	Immediately after the receipt of goods
B]	Immediately after the down payment
C]	Immediately after the payment of last installment
D]	On the date of agreement

16. What is cash price?

A]	The price at which goods purchased by the seller		
B]	Hire purchase price	C] The price of cash sale	D] none of the above

17. The last installment paid under hire purchase comprises

A] cash price only	B] interest only	C] cash price and interest	D] cash price, interest & down payment
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18. The cash price and hire purchase price of a machine was Rs.20000 and Rs.240000 respectively. The payment of this transaction was made in four equal installments. The amount of interest included in the last statement will be

A] 400	B] 1200	C] 1600	D] 4000
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19. What is the right of hire-vendor, when the hire purchaser makes default in payment of installment?

A]	Repossess the goods fully or partly
B]	Forfeit the installments which was paid
C]	Repossess the goods and forfeit the installments, both rights
D]	No right

20. Which of the following price is the basis for calculating depreciation on the assets in the books of hire purchaser

A] hire purchase price	B] cash price	C] cost price	D] market price
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21] Joint Venture with B account is an example of

A] personal account	B] Nominal account	C] Real account	D] Fictitious asset account
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ANSWERS

1] a	2] b	3] d	4] a	5] b	6] a	7] a	8] a	9] a	10] d
	12] a	13] a	14] b	15] c	16] c	17] c	18] a	19] c	20] b