

ACCOUNTING FOR HIRE PURCHASE

Meaning and Concept of Hire-purchase system

Hire-purchase system is a special system of purchase and sale of goods. Under this system purchaser pays the price of the goods in instalments. The instalments may be annual, six monthly, quarterly, monthly fortnightly etc. Under this system the goods are delivered to the purchaser at the time of agreement before the payment of instalments but the title on the goods is transferred after the payment of all instalments as per the hire-purchase agreement. The special feature of a hire-purchase transaction is that the payment of every instalment is treated as the payment of hire charges by the purchaser to the hire vendor till the payment of the last instalment. After the payment of the last instalment, the amount of various instalments paid is appropriated towards the payment of the price of the goods sold and the ownership of the goods is transferred to the purchaser. Thus hire-purchase means a transaction where the goods are sold by vendor to the purchaser under the following conditions

- the goods will be delivered to the purchaser at the time of agreement.
- the purchaser has a right to use the goods delivered.
- the price of the goods will be paid in instalments.
- every instalment will be treated to be the hire charges of the goods which is being used by the purchaser.
- if all instalments are paid as per the terms of agreement , the title of the goods is transferred by vendor to the purchaser.

if there is a default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of various instalments.

A person who acquires an article under hire purchase is known as hire purchaser (or hirer). The owner who gives his article on hire purchase is known as the hire vendor (or vendor). The hirer and the vendor enter into a written agreement known as Hire Purchase Agreement, which contains the following details :

- (1) **Cash Price** : This is the purchase price payable if full payment is made immediately.
- (2) **Interest** : The agreement states the rate of interest charged by the vendor on the unpaid amount.
- (3) **Hire Purchase Price** : This means the total amount payable by the hirer, (also known as hire price) made up of the Cash Price of the article and Interest.
- (4) **Down Payment** : This is the initial amount payable at the time of signing the agreement. As soon as down payment is made, the hirer gets possession of the article and can start using it immediately.
- (5) **Instalment** : The agreement indicates the number of total instalments in which the balance amount is payable. The balance amount is equal to the Hire Purchase Price Less Down Payment. The agreement contains details of the amount and due date of each instalment. Each instalment amount is made up of part payment towards cash price plus interest.

OBJECTIVES

- 1) identify a hire purchase transaction;
- 2) record the transaction in the journal of hire-purchaser and hire vendor;

- 3) prepare necessary accounts in the ledger of hire-purchaser and hire vendor;
- 4) calculate cash price in a transaction of hire-purchase with and without the help of annuity table; and
- 5) solve the accounting problems of hire- purchase system and record hire purchase transactions in the books of accounts maintained in "Big Malls".

Characteristics of Hire-purchase system

The characteristics of hire-purchase system are as under

- Hire-purchase is a credit purchase.
- The price under hire-purchase system is paid in instalments.
- The goods are delivered in the possession of the purchaser at the time of commencement of the agreement.
- Hire vendor continues to be the owner of the goods till the payment of last instalment.
- The hire-purchaser has a right to use the goods as a bailer.
- The hire-purchaser has a right to terminate the agreement at any time in the capacity of a hirer.
- The hire-purchaser becomes the owner of the goods after the payment of all instalments as per the agreement.
- If there is a default in the payment of any instalment, the hire vendor will take away the goods from the possession of the purchaser without refunding him any amount.

5. ACCOUNTING METHODS

How hire purchase transactions are recorded depends upon the frequency and value of such transactions. If the vendor is basically a hire purchase trader, dealing in many such transactions involving even small values, he will need to prepare a separate Hire Purchase Trading Account to ascertain his gross profits from hire purchase dealings. He will then follow the "Stock method". However, if the vendor only sometimes enters into a hire purchase transaction by way of a special deal involving a substantial amount, he will follow the "Sales Method" to record his hire purchase transactions. Sales method is further divided into the following : (1) Full Cash Price method (also known as Credit Purchase Method or Sales Method); (2) Actual Cash Price Method (also known as Asset Accrual Method); and (3) Interest Suspense Method. We will be studying only the Full Cash Price Method (Sales Method) as per the syllabus.

6. FULL CASH PRICE METHOD [CREDIT PURCHASE METHOD OR SALE METHOD]

6.1 BOOKS OF HIRE PURCHASER

This method follows a practical approach and treats the hire purchaser as the owner of the asset right from the beginning. This method treats the "substance" of the HP agreement as more important than its "form".

Under this method, in the books of the hire purchaser, the full cash price is debited to the asset account and credited to the vendor's account at the time of signing the agreement or getting the possession of the goods, itself. Thus, under this method, entries are made as if asset is purchased for full price on credit on the date of agreement itself. Thereafter, the interest on each instalment is debited to the Interest Account and credited to the Vendor's Account. When the instalment is paid, Vendor's Account is debited and Cash or Bank Account is credited with the amount paid. This method, if used by the hire purchaser is also known as Credit Purchase Method.

6.2 BOOKS OF HIRE VENDOR

Under this method, in the books of the hire vendor, the full cash price is debited to the hire purchaser's Account and credited to the H.P. Sales Account at the time of signing the agreement or handing over the possession of the goods, itself. Thereafter, the interest receivable at the time of each instalment is debited to the Hire purchaser's account and credited to the Interest Earned Account. When the instalment amount is received, Cash or Bank Account is debited and Hire Purchaser's Account is credited with the amount received. Since the asset given on hire purchase is treated as sold, there is no question of charging any depreciation. This method if used by the hire vendor, is also known as Sale method.

Accounting In the books of Hire-purchaser

There are two methods of accounting in the books of Hire-purchaser. Their detailed description is as under:-

Asset Accrual Method:

Under this method it is considered that the hire-purchaser is the owner of the asset up to the value of the cash price paid by him in the form of down payment or the cash price paid included in various instalments. The following journal entries are recorded under this method.

Under Total Assets Value Method:

Under this method of accounting in the books of hire-purchaser, is done on the assumption that the ownership of the asset is also transferred to the purchaser with the delivery of goods. The following journal entries are recorded under this method.