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# ACCOUNTING FOR HIRE PURCHASE

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## Chapter

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### INTRODUCTION

Hire purchase has been associated with financing of commercial vehicles for road transport operations. It has emerged, in recent years, as a source of equipment financing and an alternative to lease financing. A hire purchase agreement has two aspects, firstly, an aspect of bailment of goods subject to the hire purchase agreement, and secondly, an element of sale that fructifies when the option to purchase is exercised by the intending purchaser. Though the option to purchase is allowed in the very beginning, it can be exercised only at the end of the agreement. The interest component of each hire purchase installment is computed on the basis of a flat rate of interest and the effective rate component of interest is applied to the declining balance of the original loan amount to determine the interest of each installment. The property in the goods does not pass at the time of the agreement is with the intending seller; it only passes later when the option is exercised by the intending purchaser.

### CONCEPTS AND CHARACTERISTICS OF HIRE PURCHASE

A hire purchase can be defined as a contractual arrangement under which the owner lets his goods on hire to the hirer and offers an option to the hirer for purchasing the goods in accordance with the terms of the contract. According to the Hire Purchase Act, 1972, an agreement which fulfills the following conditions is also a Hire Purchase Agreement:

- (i) The possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodic installment;
- (ii) The property in such goods is to pass to such person on the payment on the last of such installments; and
- (iii) Such person has the right to terminate the agreement at any time before the property so passes.

So, the distinct features of a hire purchase transaction are:

- (1) The option to purchase the goods at any time during the term of the agreement and;
- (2) The right available to the hirer to terminate the agreement at any time before the payment of the last installment.

Therefore, from the hirer's angle, a hire purchase contract can be compared to a cancelable lease contract with a call (purchase) option.

The call option and the time of termination available with the hirer form the basis for distinguishing a hire purchase transaction from other asset-financing plans like installment sale and conditional sale where the buyer is committed to pay the full price.

A hire purchase differs from installment sale on one more count. In installment sale, the ownership of the asset is transferred to the buyer on payment of the first installment whereas in a hire purchase, the ownership is transferred to the hirer only when he exercises the option to purchase or a payment of the last installment.

The salient features of a hire purchase transaction are therefore as follows:

- (1) The finance company (the counterpart of the lessor) purchases the equipment from the equipment supplier and lets it on hire to the hirer.
- (2) The hirer is required to make a down payment of 20 to 25 per cent of the equipment cost and repay the balance with interest in equated monthly installments spread over 36 to 48 months either in advance or in arrears.

As an alternative to the down payment plan, some finance companies offer a deposit-linked plan. Under this plan, the hirer is required to invest 20 to 25 per cent of the equipment cost in the fixed deposits of the company. In return, the hirer is provided with 100 per cent finance which has to be repaid with interest in equated monthly installment spread over 36 to 48 months. On payment of the last installment, the deposit with accumulated interest is returned to the hirer.

- (3) The interest component of each hire purchase installment is calculated on the basis of a flat rate of interest. The rate of interest charged usually lies in the band of 13-15% p.a.
- (4) During the currency of the contract (hire period), the hirer can opt for an early repayment and purchase the asset. The hirer, exercising this option, is required to pay the remaining amount of hire purchase installments (installments which have not fallen due) less an interest rebate. The interest rebate is calculated in different ways which are discussed in the following part.
- (5) Theoretically, the hirer can exercise the cancelable option and terminate the contract giving due notice to the finance company. But in practice, such terminations are few and far inbetween because the hirer loses the tax shields on capital allowances (like depreciation) by exercising this option.

## CALCULATION OF INTEREST

The transaction under Hire purchase system requires calculation of interest as well as installment comprising of interest. There are two situations which is explained with the help of examples.

### (1) When interest rate is given

The Sachin Co. purchases a motor vehicle from Sehwaq Company on a hire purchase agreement on January 1, 2009 paying cash ₹ 20,000 and agreeing to pay further 3 installments of ₹ 20,000 each on 31<sup>st</sup> December each year. The cash price of the car is ₹ 70,000 and Sehwaq Company charges interest rate @ 10% p.a. Compute the amount of interest at the end of every year.

#### Solution:

Particulars	Jan 2009	Dec 2009	Dec 2010	Dec 2011
Op. cash price	70,000	50,000	35,000	18,500
Installment	20,000	20,000	20,000	20,000
Interest @10%	-	5,000	3,500	1,500
Closing Cash price (1—4)	50,000	35,000	18,500	NIL

In the last year, Interest rate = Installment – Opening cash price

For other years, interest should be calculated at opening cash price.

### (2) When rate of interest is not given

The Dhoni Company purchases a motor vehicle from Gambhir Co. on a hire purchase agreement on Jan 1, 2009 paying cash ₹ 20,000 and agreeing to pay for the 3 installments of ₹ 20,000 each on 31<sup>st</sup> December each year. The cash price of car is ₹ 70,000. Compute the amount of interest at the end of the year.

#### Solution:

$$\begin{aligned}
 \text{Interest} &= \text{Total price paid} - \text{Cash price} \\
 &= 20,000 \times 4 - 70,000 \\
 &= 10,000
 \end{aligned}$$

Particulars	Jan 2009	Dec 2009	Dec 2010	Dec 2011
1) Op. Hire price	80,000	60,000	40,000	20,000
2) Installment	20,000	20,000	20,000	20,000
3) Interest	—	$10,000 \times 3/6$ = 5,000	$10,000 \times 2/6$ = 3333	$10,000 \times 1/6$ = 1,667

4) Cash price () (2 – 3)	20,000	15,000	16667	18333
5) Hire price (1—2)	60,000	40,000	20,000	NIL

## ACCOUNTING ENTRIES FOR HIRE PURCHASE

### 1. In the Books of Hire Purchaser

Particulars	L.F.	Debit (₹)	Credit (₹)
(a) For transaction/dealing: Asset A/c Dr. To Vendor A/c		xx	xx
(b) For down payment: Vendor A/c Dr. To Bank A/c		xx	xx
(c) For interest due: Interest A/c Dr. To Vendor A/c		xx	xx
(d) For installment payment: Vendor A/c Dr. To Cash/Bank A/c		xx	xx
(e) For depreciation: Depreciation A/c Dr. To Asset A/c		xx	xx
(f) For transferring depreciation: P & L A/c Dr. To Depreciation A/c		xx	xx
(g) For transferring interest: P & L A/c Dr. To Interest A/c		xx	xx

### 2. In the Books of Vendor

Particulars	L.F.	Debit (₹)	Credit (₹)
(a) For dealing/transaction: Hire Purchase A/c Dr. To Sales A/c		xx	xx
(b) For receiving down payment: Bank A/c Dr. To Hire Purchases A/c		xx	xx
(c) For Interest due: Hire Purchases A/c Dr. To Interest		xx	xx

(d) For installment receipt:			
Cash/Bank A/c	Dr.	xx	
To Hire Purchase A/c			xx
e) For transferring interest:			
Interest A/c	Dr.	xx	
To P & L A/c			xx

**Illustration 1**

On-1-4-2000, Z purchased motor car from V. The cash price of the motor car was ₹ 2,50,000. Down payment of ₹ 1,00,000 was made on 1-4-2000 and the balance cash price was paid by installments of ₹ 50,000 per year (starting from 31-3-2001) together with interest at 18 p.a. Z writes off depreciation on motor car at 20% p.a. under written down value method. He closes his books on 31st March every year. You are required to:

- Prepare the table showing analysis of payments.
- Prepare Motor Car A/c and V's A/c in the books of Z for the years 2000-2001, 2001-2002 and 2002-2003.

**Solution:****(1) Analysis of Payments**

1-4-2000	Cost of Motor Car	2,50,000
— " —	<b>Less:</b> Down Payment	1,00,000
	Balance	<u>1,50,000</u>
31-3-2001	<b>Add:</b> Interest @ 18%	27,000
		<u>1,77,000</u>
— " —	<b>Less:</b> 1st installment (50,000 + 27,000)	77,000
— " —	Balance	<u>1,00,000</u>
31-3-2002	<b>Add:</b> Interest @ 18%	18,000
		<u>1,18,000</u>
31-3-2002	<b>Less:</b> 2nd installment (50,000 + 18,000)	68,000
— " —	Balance	<u>50,000</u>
31-3-2003	<b>Add:</b> Interest @ 18%	9,000
		<u>59,000</u>

		59,000	
— " —	Less: 3rd installment	59,000	
— " —	Balance	NIL	

**In the books of Z**  
**Motor Car Account**

Date	Particulars	₹	Date	Particulars	₹
2000 Apr. 1	To V's A/c	2,50,000	2001 Mar. 31 31	By Depreciation A/c By Balance c/d	50,000 2,00,000
		<b>2,50,000</b>			<b>2,50,000</b>
2001 Apr. 1	To Balance b/d	2,00,000	2002 Mar. 31 31	By Depreciation A/c By Balance c/d	40,000 1,60,000
		<b>2,00,000</b>			<b>2,00,000</b>
2002 Apr. 1	To Balance b/d	1,60,000	2003 Mar. 31 31	By Depreciation A/c By Balance c/d	32,000 1,28,000
		<b>1,60,000</b>			<b>1,60,000</b>

**V's Account**

Date	Particulars	₹	Date	Particulars	₹
2000 Apr. 1	To Bank A/c	1,00,000	2000 Apr. 1	By Motor Car A/c	2,50,000
2001 Mar. 31 31	To Bank A/c To Balance c/d	77,000 1,00,000	2001 Mar. 31	By Interest A/c	27,000
		<b>2,77,000</b>			<b>2,77,000</b>
2002 Mar. 31 31	To Bank A/c To Balance c/d	68,000 50,000	2002 Apr. 1	By Balance b/d	1,00,000
		<b>1,18,000</b>			<b>1,18,000</b>

**Illustration 2**

UFO Ltd. had purchased a machine, on Hire Purchase System from HP Ltd. The terms are that UFO Ltd. would pay ₹ 40,000 as down payment on signing of the agreement and 4 annual installments of ₹ 22,000 each commencing from the beginning of the next year. UFO Ltd.

charged depreciation @ 20 p.a on cost under W.D.V. System. HP Ltd. charged interest @ 10% p.a. in their hire purchase contract.

Prepare Machinery Account and HP Ltd. Account for 5 years in the books of UFO Ltd.

**In the books of UFO Ltd.**

**Calculation of Cash Price and Interest**

Year	Balance at beginning	Interest @ 10%	Total	Instalment Amount	Balance at (3 - 4) the end
1st	6,9737	6,974	76,711	22,000	54,711
2nd	54,711	5,471	60,182	22,000	38,182
3rd	38,182	3,818	42,000	22,000	20,000
4th	20,000	2,000	22,000	22,000	NIL
				<b>88,000</b>	

$$\begin{aligned}
 \text{Cash Price} &= \text{Down Payment} + \text{Balance at the Beginning} \\
 &= 40,000 + 69,737 \\
 &= 1,09,737
 \end{aligned}$$

**Dr. Machinery Account Cr.**

Date	Particulars	₹	Date	Particulars	₹
Year 1 Beginning	To HP Ltd. A/c	1,09,737	Year 1 End	By Depreciation A/c (20%)	21,947
		<b>1,09,737</b>		By Balance c/d	87,790
					<b>1,09,737</b>
Year 2 Beginning	To Balance b/d	87,790	Year 2 End	By Depreciation A/c (20%)	17,558
		<b>87,790</b>		By Balance c/d	70,232
					<b>87,790</b>
Year 3 Beginning	To Balance b/d	70,232	Year 3 End	By Depreciation A/c (20%)	14,046
		<b>70,232</b>		By Balance c/d	56,186
					<b>70,232</b>
Year 4 Beginning	To Balance b/d	56,186	Year 4 End	By Depreciation A/c (20%)	11,237
				By Balance c/d	44,949

Year 5		<b>56,186</b>	Year 5		<b>56,186</b>
Beginning	To Balance b/d	44,949	End	By Depreciation A/c (20%)	8,990
				By Balance c/d	35,959
		<b>44,949</b>			<b>44,949</b>

**Dr. HP Ltd. Account Cr.**

Date	Particulars	₹	Date	Particulars	₹
Year 1			Year 1		
Beginning	To Bank A/c	40,000	Beginning	By Machinery A/c	1,09,737
End	To Balance c/d	76,711	End	By Interest A/c	6,974
		<b>1,16,711</b>			<b>1,16,711</b>
Year 2			Year 2		
Beginning	To Bank A/c	22,000	Beginning	By Balance b/d	76,711
End	To Balance c/d	60,182	End	By Interest A/c	5,471
		<b>82,182</b>			<b>82,182</b>
Year 3			Year 3		
Beginning	To Bank A/c	22,000	Beginning	By Balance b/d	60,182
End	To Balance c/d	42,000	End	By Interest A/c	3,818
		<b>64,000</b>			<b>64,000</b>
Year 4			Year 4		
Beginning	To Bank A/c	22,000	Beginning	By Balance b/d	42,000
End	To Balance c/d	22,000	End	By Interest A/c	2,000
		<b>44,000</b>			<b>44,000</b>
Year 5			Year 5		
Beginning	To Bank A/c	<b>22,000</b>	Beginning	By Balance b/d	<b>22,000</b>

### Illustration 3

On 1st Jan., 2001, Amar purchased an Audio System on hire purchase system. The terms of contract were as under:

- (a) The cash price of the Audio System was ₹ 1,30,000.
- (b) ₹ 40,000 was to be paid on signing of the contract.

(c) The balance was to be paid in annual installments of ₹ 30,000 each plus interest.

(d) Interest chargeable on the outstanding balance was 6% p.a.

(c) Depreciation @ 10% p.a. is to be written off on W.D.V. basis.

You are required to prepare for 3 years:

(1) A statement showing calculation of interest.

(2) Audio System's A/c

(3) Depreciation A/c

(4) Vendor Company's A/c.

**Solution:**

**In the books of Amar  
Calculation of Interest**

Date	Particulars	₹
1.1.01	Cost	1,30,000
1.1.01	<b>Less:</b> Down payment	40,000
1.1.01	Balance	90,000
31.12.01	<b>Add:</b> Interest @ 6%	5,400
		95,400
31.12.01	<b>Less:</b> 1st installment (30,000 + 5,400)	35,400
31.12.01	Balance	60,000
31.12.02	<b>Add:</b> Interest @ 6%	3,600
		63,600
31.12.02	<b>Less:</b> 2nd installment (30,000 + 3,600)	33,600
31.12.02	Balance	30,000
31.12.02	<b>Add:</b> Interest @ 6%	1,800
		31,800
31.12.03	<b>Less:</b> Final installment	31,800
31.12.03	Balance	NIL

Dr.		Audio System's Account				Cr.
Date	Particulars	₹	Date	Particulars	₹	
2001 Jan. 1	To Vendor		2001 Dec. 31	By Depreciation A/c	13,000	

	Company's A/c	1,30,000	Dec. 31	By Balance c/d	1,17,000
		<b>1,30,000</b>			<b>1,30,000</b>
2002 Jan. 1	To Balance b/d	1,17,000	2002 Dec.31	By Depreciation A/c	11,700
			Dec.31	By Balance c/d	1,05,300
		<b>1,17,000</b>			<b>1,17,000</b>
2003 Jan. 1	To Balanc b/d	1,05,300	2003 Dec.31	By Depreciation A/c	10,530
			Dec.31	By Balance c/d	94,770
		<b>1,05,300</b>			<b>1,05,300</b>

**Dr. Depreciation Account Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001 Dec. 31	To Audio System's A/c	13,000	2001 Dec. 31	By P & L A/c	13,000
		<b>13,000</b>			<b>13,000</b>
2002 Dec. 31	To Audio System's A/c	11,700	2002 Dec. 31	By P & L A/c	11,700
		<b>11,700</b>			<b>11,700</b>
2003 Dec. 31	To Audio System's A/c	10,530	2003 Dec. 31	By P & L A/c	10,530
		<b>10,530</b>			<b>10,530</b>

**Dr. Vendor Company's Account Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001 Jan. 1	To Bank A/c	40,000	2001 Jan. 1	By Audio System's A/c	1,30,000
Dec. 31	To Bank A/c	35,400	Dec. 31	By Interest A/c	5,400
Dec. 31	To Balance c/d	60,000			
		<b>1,35,400</b>			<b>1,35,400</b>
2002 Dec. 31	To Bank A/c	33,600	2002 Jan. 1	By Balance b/d	60,000
Dec. 31	To Balance c/d	30,000	Dec. 31	By Interest A/c	3,600
		<b>63,600</b>			<b>63,600</b>
2003 Dec. 31	To Bank A/c	31,800	2003 Jan. 1	By Balance b/d	30,000
			Dec. 31	By Interest A/c	1,800
		<b>31,800</b>			<b>31,800</b>

**Illustration 4**

On 1st January, 2000 Raja delivered to Kishore a machine on hire purchase basis, ₹ 50,000 was paid on delivery and the balance in five installments of ₹ 50,000 each payable on 31st December every year. The cash price of the machine was ₹ 3,00,000. Show the Machinery account and Raja's A/c in the books of Kishore assuming that he close his books on 31st December every year and the rate of depreciation 20% p.a. on W.D.V. and rate of interest is 5% p.a. Installment is excluding interest. Use Credit Purchase Method.

**Solution:****In the books of Kishore**

Dr.			Cr.		
<b>Machinery A/c</b>					
Date	Particulars	₹	Date	Particulars	₹
2000 Jan. 1	To Raja's A/c	3,00,000	2000 Dec.31	By Depreciation A/c	60,000
			2000 Dec.31	By Balance c/d	2,40,000
		<b>3,00,000</b>			<b>3,00,000</b>
2001 Jan. 1	To Balance b/d	2,40,000	2001 Dec.31	By Depreciation A/c	48,000
			2001 Dec.31	By Balance c/d	1,92,000
		<b>2,40,000</b>			<b>2,40,000</b>
2002 Jan. 1	To Balance b/d	1,92,000	2002 Dec.31	By Depreciation A/c	38,400
			2002 Dec.31	By Balance c/d	1,53,600
		<b>1,92,000</b>			<b>1,92,000</b>
2003 Jan. 1	To Balance b/d	1,53,600	2003 Dec.31	By Depreciation A/c	30,720
			2003 Dec.31	By Balance c/d	1,22,880
		<b>1,53,600</b>			<b>1,53,600</b>
2004 Jan. 1	To Balance b/d	1,22,880	2004 Dec.31	By Depreciation A/c	24,576
			2004 Dec.31	By Balance c/d	98,304
		<b>1,22,880</b>			<b>1,22,880</b>

Dr.			Cr.		
<b>Raja's A/c</b>					
Date	Particulars	₹	Date	Particulars	₹
2000 Jan. 1	To Bank A/c	50,000	2000 Jan. 1	By Machinery A/c	3,00,000
2000 Dec. 31	To Bank A/c	62,500	2000 Dec.31	By Interest A/c	12,500

Dec.31	To Balance c/d	2,00,000			
		<b>3,12,500</b>			<b>3,12,500</b>
2001			2001		
Dec.31	To Bank A/c	60,000	Jan.1	By Balance b/d	2,00,00
Dec.31	To Balance c/d	1,50,000	Dec.31	By Interest A/c	10,000
		<b>2,10,000</b>			<b>2,10,000</b>
2002			2002		
Dec.31	To Bank A/c	57,500	Jan.1	By Balance b/d	1,50,000
Dec.31	To Balance c/d	1,00,000	Dec.31	By Interest A/c	7,500
		<b>1,57,500</b>			<b>1,57,500</b>
2003			2003		
Dec.31	To Bank A/c	55,000	Jan.1	By Balance b/d	1,00,000
		50,000	Dec.31	By Interest A/c	5,000
		<b>1,05,000</b>			<b>1,05,000</b>
2004			2004		
Dec.31	To Bank A/c	52,500	Jan.1	By Balance b/d	50,000
			Dec.31	By Interest A/c	2,500
		<b>52,500</b>			<b>52,500</b>

**Illustration 5**

'B' Ltd. purchased a machinery on installment system from 'A' Ltd. The cash down price for the machinery was ₹ 80,000. The price was to be paid as ₹ 25,536 down payment and the balance in 3 equal annual installments of ₹ 20,000 each commencing from the end of the first year at 5% interest per annum. Show the (a) Machinery A/c, (b) 'A' Ltd. A/c and (c) Interest A/c in the books of 'B' Ltd. assuming that the depreciation is charged at 10% p.a. on reducing balance method.

**Solution:****(a) In the Books of B Ltd.**

Dr.			Cr.		
<b>Machinery A/c</b>					
Year	Particulars	₹	Year	Particulars	₹
1st yr.	To A Ltd. A/c	25,536	1st yr.	By Depreciation A/c	8,000
	To B Ltd. A/c	20,000	End	By Balance c/d	37,536
		<b>45,536</b>			<b>45,536</b>
2nd yr.	To Balance b/d	37,536	2nd yr.	By Depreciation A/c	7,200
	To A Ltd. A/c	20,000		By Balance c/d	50,336
		<b>57,536</b>			<b>57,536</b>
3rd yr.	To Balance b/d	50,336	3rd yr.	By Depreciation A/c	6,480
	To A Ltd. A/c	20,000		By Balance c/d	63,856
		<b>70,336</b>			<b>70,336</b>

(b)

**A Ltd. A/c**

Year	Particulars	₹	Year	Particulars	₹
1st yr.	To Cash A/c	25,536	1st yr.	By Machinery A/c	25,536
	To Cash A/c	22,723		By Machinery A/c	20,000
				By Interest A/c	2,723
		<b>48,259</b>			<b>48,259</b>
2nd yr.	To Cash A/c	21,723	2nd yr.	By Machinery A/c	20,000
				By Interest A/c	1,723
		<b>21,723</b>			<b>21,723</b>
3rd yr.	To Cash A/c	20,723	3rd yr.	By Machinery A/c	20,000
				By Interest A/c	723
		<b>20,723</b>			<b>20,723</b>

(c)

**Interest A/c**

Year	Particulars	₹	Year	Particulars	₹
1st yr.	To A Ltd. A/c	2,723	1st yr.	By P & L A/c	2,723
		2,723			2,723
2nd yr.	To A Ltd. A/c	1,859	2nd yr.	By P & L A/c	1,859
		1,859			1,859
3rd yr.	To A Ltd. A/c	954	3rd yr.	By P & L A/c	954
		954			954

**Working Note:****Calculation of Interest**

Year	Down	I	II	III
1. Opening Cash Price	80,000	54,464	37,187	19,046
2. Installment Down Payment Amount	25,536	20,000	20,000	20,000
3. Interest	-	2,723	1,859	954
4. Cash Price Paid (2 – 3)	25,536	17,277	18,141	19,046
5. Closing Cash Balance (1 – 4)	54,464	37,187	19,046	NIL

**Illustrations 6**

X Ltd. has purchased a machine on hire purchase system from Y Ltd. The terms are that X Ltd. would pay ₹ 20,000/- down payment on signing of the agreement and 4 annual installments of ₹ 11,000/- each commencing from the beginning of the next year. X Ltd. charged depreciation at the rate of 10 per cent per annum on cost under diminishing balance system. Y Ltd. charged interest at the rate of 10% per annum in their hire purchase contract. Prepare Machinery Account and Y Ltd. Account for 5 years in the books of X Ltd. The cash price of the machinery on the date of agreement was ₹ 55,000/.

**Solution:****Analysis of Payment**

Date/Year		Instalment	Interest	Principal	Closing Balance
1st Year	Cash Price	-	-	-	55,000
	Down Payment	20,000	-	20,000	35,000
1st Year	1st Installment	11,000	3,500	7,500	27,500
2nd Year	2nd Installment	11,000	2,750	8,250	19,250
3rd Year	3rd Installment	11,000	1,925	9,075	10,000
4th Year	4th Installment	11,000	825	10,175	-
		<b>64,000</b>	<b>9,000</b>	<b>55,000</b>	

**In the Books of 'X' Ltd. (Hire Purchase System)**

Dr.		Machinery A/c		Cr.	
Date	Particulars	₹	Date	Particulars	₹
1st Year	To 'Y' Ltd. A/c	20,000	1st Year	By Depreciation A/c	5,500
-	To 'Y'. Ltd. A/c	7,500		By Balance c/d	22,000
		<b>27,500</b>			<b>27,500</b>
2nd Year	To Balance b/d	22,000	2nd Year	By Depreciation A/c	4,950
-	To 'Y' Ltd. A/c	8,250		By Balance c/d	25,300
		<b>30,250</b>			<b>30,250</b>
3rd Year	To Balance b/d	25,300	3rd Year	By Depreciation A/c	4,453
-	To 'Y' Ltd. A/c	9,075		By Balance c/d	29,920
		<b>34,375</b>			<b>34,375</b>
4th Year	To Balance b/d	29,920	4th Year	By Depreciation A/c	4,010
-	To 'Y' Ltd. A/c	10,175		By Balance c/d	36,085
		<b>40,095</b>			<b>40,095</b>

5th Year	To Balance b/d	36,085	5th Year	By Depreciation A/c	3,609
				By Balance c/d	32,476
		<b>36,085</b>			<b>36,085</b>

**'Y' Ltd.**

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Bank A/c	20,000	1st Year	By Machinery A/c	20,000
	To Balance c/d	11,000		By Machinery A/c	7,500
			By Interest A/c	3,500	
		<b>31,000</b>			<b>31,000</b>
2nd Year	To Bank A/c	11,000	2nd Year	By Balance b/d	11,000
	To Balance c/d	11,000		By Machinery A/c	8,250
			By Interest A/c	2,750	
		<b>22,000</b>			<b>22,000</b>
3rd Year	To Bank A/c	11,000	3rd Year	By Balance b/d	11,000
	To Balance c/d	11,000		By Machinery A/c	9,075
			By Interest A/c	1,925	
		<b>22,000</b>			<b>22,000</b>
4th Year	To Bank A/c	11,000	4th Year	By Balance b/d	11,000
	To Balance c/d	11,000		By Machinery A/c	10,175
			By Interest A/c	825	
		<b>22,000</b>			<b>22,000</b>
5th Year	To Bank A/c	11,000	5th Year	By Balance b/d	11,000
		<b>11,000</b>			<b>11,000</b>

**Working Notes****Calculation of Depreciation**

Original Cost - 1st Year	55,000
(-) Dep. 1st Year for @ 10%	<u>5,500</u>
WDV at the end of 1st Year	49,500
(-) Dep. for 2nd Year @ 10%	<u>4,950</u>
WDV at the end of 2nd Year	44,550
(-) Dep. for 3rd Year @ 10%	<u>4,455</u>
WDV at the end of 3rd Year	40,095
(-) Dep. for 4th Year @ 10%	<u>4,010</u>
WDV at the end of 4th Year	36,085

(-) Dep. for 5th Year	3,609
Balance	<u>32,476</u>

**Illustration 7**

X Transport Ltd. purchased from TATA Motors 3 cars costing ₹ 50,000 each on the hire purchase system on 01-01-2003. Payment was to be made ₹ 30,000 down and the remainder in 3 equal installments payable on 31-12-2003, 31-12-2004 and 31-12-2005 together with interest @ 9% p.a. X Transport Ltd. wrote off depreciation @ 20% on the diminishing balance. It paid the installment due at the end of the first year, i.e., 31-12-2004 but could not pay the next on 31-12-2004. TATA Motors agreed to leave one car with the purchaser on 1-1-2005 adjusting the value of the other two cars against the amount due on 1-1-2005. The cars were valued on the basis of 30% depreciation annually.

Show the necessary accounts in the books of X Transport Ltd. for the years 2003, 2004 and 2005.

**Solution:****Analysis of Payment**

Date	Opening Balance of cash Price	Principal	Interest	Installment	Closing Balance of Cash Price
1.1.03	1,50,000	30,000	—	—	1,20,000
31.12.03	1,20,000	40,000	10,800	50,800	80,000
31.12.04	80,000	40,000	7,200	47,200	40,000
31.12.05	40,000	40,000	3,600	43,600	—

**Calculation of Depreciation**

	2nd Car	1st Car	Total
Original Cost on 1.1.2003	1,00,000	50,000	1,50,000
(-) Dep. @ 20%	20,000	10,000	30,000
W.D.V. as on 1.1.2004	80,000	40,000	1,20,000
(-) Dep. @ 20%	16,000	8,000	24,000
W.D.V. as on 1.1.2005	64,000	32,000	96,000
(-) Repossessed value on 1.1.2005 (1,00,000 — (30,000 + 30,000) (Dep. I + Dep. II)	40,000		(40,000)
Loss on Repossession	24,000		(24,000)
(-) Dep. on 31.12.05	-	6,400	6,400
W.D.V. as on 1.1.2006	-	25,600	25,600

## In the Books of X Transport Ltd.

Dr.			Motor Car A/c		Cr.	
Date	Particulars	₹	Date	Particulars	₹	
1.1.03	To Tata Motors A/c	30,000	31.12.03	By Depreciation A/c	30,000	
31.12.03	To Tata Motors A/c	40,000		By Balance c/d	40,000	
		<u>70,000</u>			<u>70,000</u>	
1.1.04	To Balance b/d	40,000	31.12.04	By Depreciation A/c	24,000	
31.12.04	To Tata Motors A/c			By Balance c/d	56,000	
		<u>80,000</u>			<u>80,000</u>	
1.1.05	To Balance b/d	56,000	1.1.05	By Tata Motors (Repossessed)	40,000	
31.12.05	To Tata Motors A/c	40,000	-	By Loss on Repossession A/c	24,000	
			31.12.05	By Depreciation A/c	6,400	
				By Balance c/d	25,600	
		<u>96,000</u>			<u>96,000</u>	

## Tata Motors A/c

Dr.			Cr		
Date	Particulars	₹	Date	Particulars	₹
1.1.07	To Bank A/c	30,000	1.1.03	By Motor Car A/c	30,000
31.12.03	To Bank A/c	50,800	31.12.03	By Motor Car A/c	40,000
				By Interest A/c	10,800
		<u>80,800</u>			<u>80,800</u>
31.12.04	To Bank A/c	47,200	31.12.04	By Motor Car A/c	40,000
				By Interest A/c	7,200
		<u>47,200</u>			<u>47,200</u>
1.1.05	To Motor Car A/c (Repossessed)	40,000	1.1.05	By Motor Car A/c (Final Installment)	40,000
		<u>40,000</u>			<u>40,000</u>

## Exercise

1. C Ltd. purchased machinery from D Ltd. on hire purchase basis on 1st January, 2003. The term of the contract were as follows:

- The cash price of the machine was ₹ 3,00,000.
- ₹ 60,000 was paid on signing the contract on 1st January, 2003.

- (c) The balance was paid in three installments of ₹ 80,000 each together with interest @ 15% p.a.
- (d) Depreciation is charged @ 10% p.a. under Reducing Balance Method.

Pass necessary journal entries for three years under Interest Suspense method.

2. X Ltd. purchased Machinery from Y Ltd. on hire purchase basis on 1st January, 2003. The terms of the contract were as follows:

- (a) The cash price of the machine was ₹ 1,50,000.
- (b) Hire purchase price ₹ 1,86,000.
- (c) ₹ 30,000 was paid on signing the contract on 1 January, 2003.
- (d) Depreciation is charged @ 10% S.L.M. method.

Books are closed on 31st December, 2003.

Pass necessary journal entries by Interest Suspense Method for the year ended 31st December, 2003, 31st December, 2004, 31st December, 2005.

3. The Kalyan Trading Company purchased Motor Truck from Thane Motor Company on a hire purchase agreement on 1st Jan., 2003 paying cash ₹ 10,000 and agreeing to pay further three installments of ₹ 10,000 each on 31st December each year. The cash price of the Motor Truck is ₹ 37,250 and the Thane Motor Company charges interest at 5% p.a. The Kalyan Trading Company writes off 10% p.a. as depreciation on the Reducing Balance System. The company closes its accounts on 31st December every year.

Show the necessary ledger accounts in the books of Kalyan Trading Company.

4. M/s Thakkar Transport Co. purchased a truck from Ashok Leyland on hire purchase system on 1st April, 2003 paying ₹ 2,70,000 against delivery as down payment. The cash price was ₹ 15,30,000. M/s Thakkar Transport Co. paid the balance in four installments at the year end on 31st March including interest @ 10% p.a. on the unpaid amount, as follows:

₹ 5,76,000	Ist Installment
₹ 4,42,000	IInd Installment
₹ 3,15,000	IIIrd Installment
₹ 1,98,000	Final Installment

They charged depreciation on the truck @ 15% p.a. on diminishing balance method. Show Truck Account, Ashok Leyland Account, Interest Account in the books of M/s Thakkar Transport Co. as per hire purchase system.

5. Rane Brothers are engaged in coal mining. They purchased Wagons from Indian Wagons Ltd. on hire purchase system on 1st Jan., 2005. The cash price of the Wagon was ₹ 2,30,000. They paid ₹ 50,000 as down payment and the balance in three annual installments

of ₹ 60,000 each plus interest at 10% per annum. Depreciation at 10% per annum was charged on Wagons on diminishing balance method. Show the following Ledger Accounts for three years ending 31st December every year in the books of M/s Rane Brothers: (a) Wagon A/c, (b) Indian Wagons Ltd. A/c and (c) Interest A/c.

## OBJECTIVE TYPE QUESTIONS

### 1. State whether the following statements are true or false

- (i) Initial payment made by hire purchaser is termed as down payment.
- (ii) Installment including interest paid to vendor is known as cash price.
- (iii) Interest is calculated on closing price of hire purchase for every year.
- (iv) Sale price excluding interest portion is termed as cash price.
- (v) Hire purchase price is equal to cash price.

**Ans: (i) True, (ii) False, (iii) False, (iv) True, (v) False**

### 2. Match the Column

#### Group 1

- (i). Down payment
- (ii) Interest
- (iii) Last installment
- (iv) Depreciation on hire purchas asset

#### Group 2

- (a) On opening balance
- (b) Initial payment
- (c) Calculated on cash price
- (d) Cash price Interest

**Ans: (i) (b), (ii) (a), (iii) (d), (iv) (c)**

### 3. Multiple Choice Question

1. Hire purchase comprise of hire purchaser and \_\_\_\_\_.
  - (a) Vendor
  - (b) 2 parties
  - (c) Lawyer
  - (d) Goods
2. Interest is equal to total price \_\_\_\_\_.
  - (a) Installment
  - (b) Cash price
  - (c) Opening balance
  - (d) Closing balance
3. Last year interest amount = Installment — \_\_\_\_\_.
  - (a) Closing price
  - (b) Cash price
  - (c) Opening price
  - (d) Total price

4. For down payment, \_\_\_\_\_ A/c is debited in the books of hire purchaser.
- (a) Assets (b) Cash  
(c) Depreciation (d) Vendor
5. For depreciation, \_\_\_\_\_ A/c is credited.
- (a) Vendor (b) Assets  
(c) Cash (d) Interest

