

CHAPTER-3

HIRE PURCHASE SYSTEM

Introduction

A trader could sell goods either for cash or for credit. For goods sold on credit, the payments may be made by the buyer in lumpsum on a future date, or in instalments spread over for a specified period of time.

When goods are sold on credit, for which payment is made by the buyer in instalments over a period of time, it is called hire purchase or instalment system.

Hire Purchase System

Hire purchase system refers to the system wherein, the seller of goods delivers the goods to the buyer without transferring the ownership of goods. The payment for the goods will be made by the buyer in instalments. If the buyer pays all the instalments, the ownership of the goods will be transferred, on payment of the last instalment.

FEATURES:

- Agreement
- Price & interest
- Possession & use
- Ownership
- Keeping goods in good condition
- Default and repossession
- Termination
- Non-refundable

Instalment Purchase System

Instalment payment is a system where the buyer given the ownership as well as the possession of the goods at the time of signing the contract. The buyer has the facility to pay the price in instalments.

FEATURES:

- Agreement
- Price & interest
- Possession & use
- Ownership
- No repossession
- No termination
- Use at will

Basis	Hire Purchase	Installment System
Time of ownership	The buyer does not own the item until the final payment is made.	The buyer owns the item from the first payment and can use it or dispose of it as they wish.
Right to Terminate	Hirer has the right to terminate the agreement and return the goods.	No right to terminate the installment purchase agreement.
Charges	Monthly payments are termed Hire Charges.	Monthly payments are termed Installments.
Risk and repair	All the risks are borne by the financing company till the last payment.	All the risks are borne by the buyer from the first day.
Right to sell	Right to sell lies with the financing company.	Right to sell lies with the buyer.

Parties of Hire Purchase System:

- A. Hire Purchaser
- B. Hire Vendor

Hire Purchaser: A hire purchaser is a person who obtains the possession of goods for use with an option to either purchase it or return after use.

Hire Vendor: A hire Vendor is a person who owns the goods, & who parts with the possession of these goods to the buyer with an option of 'purchase or hire'.

Cash price: It refers to the price at which goods are sold under 'contract of sale'.

Hire Purchase price: It refers to the price at which the goods are sold under hire purchase system. It includes cash price of the goods & interest.

Installment Money: It refers to a part of hire purchase price paid by hire purchaser, in periodic intervals.

Deposit/down payment: It means any sum payable by the hirer under the hire purchase agreement by way of deposit or other initial payment.

Down payment i.e a payment made by hire purchaser to hire vendor at the time of taking delivery of goods or at the time of signing hire purchase agreement.

Net cash price: It refers to the difference between cash price of the goods and the deposit (down payment).

Net hire purchase price: It refers to the hire purchase price of the goods less delivery charges, registration charges, insurance charges.

Hire purchase charges: It refers to the difference between net hire purchase price & net cash price of the goods. It is also referred to as interest.

Statutory hire charges: It refers to the hire purchase charges according to the Hire Purchase Act,1972

Hire Purchase agreement: It is an agreement in writing between the owner & hirer, duly signed by both the parties:

- Possession of goods is delivered by the owner to the hirer on the condition that latter pays the agreed amount in periodical installments.
- The legal ownership of the goods is to pass to the hirer on the payment of the last instalment.
- The hirer as the right to terminate the agreement at any time before the passing of legal ownership in the goods.

DIFFERENCES BETWEEN SALES AND HIRE PURCHASES

BASIS OF DIFFERENCE	SALES	HIRE PURCHASE
1. Governing Act	Sale of goods act 1930	Hire purchase act 1972
2. Transfer of ownership	The ownership of the goods transferred to the buyer immediately signing into contract.	The ownership of the goods transferred to the buyer on payment of all instalments
3. Modes of payments	Buyer makes payment in either lump sum(cash sales),or in instalment (credit sales)	Buyer makes payment in instalment (credit sales)

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Accounting treatment in the books of hire purchaser

- Asset Accrual Method(legal considers legal ownership)
- Outright Property Method
- Interest Suspense Method

PROBLEMS

1)On 1st April 2021, the ABC company bought a machine from HMT ltd on hire purchase system. The cash price was Rs.26350 & the payment was made as follows:

Rs.10000 on signing an agreement & the 3 yearly instalment of Rs.6000 each. 5%interest is charged by the hire vendor. Calculate the interest for each year.

2)Calculate the value of each instalment from the following details: Cash price Rs.12000, down payment-20% of cash price; balance of cash price is payable in 3 equal instalments together with interest @10% on the outstanding cash.

3)On 1/4/2021 XYZ company Ltd. Took delivery from ABC company Ltd. A machine on hire purchase system Rs.1500 being paid on delivery and the balance in 5 annual instalments of Rs.3000 each payable annually on 31st March. The cash price of the machine was Rs.15000. Calculate the interest for each year.

4) Calculate the amount of interest & principal included in each instalment: Cash price =Rs.100000; Down payment=Rs.25000; 3 instalments of Rs.30000 each payable at the end of each year.

5) On 1st April 2021, X purchased a machinery from Y on hire purchase basis. Cash price=Rs.30000; Rs.8000 to be paid on signing the contract; Balance in 3 instalments of Rs.8000; Rate of interest @5%. Calculate the interest paid by the buyer to the vendor each year.

6) On 1st April 2021 Mohith company purchased a machinery from Anjith Company on hire purchase system. Rs.1500 being paid on delivery & the balance in 5 Instalments of Rs.3000 each payable annually on 31st March & cash price of the machine was Rs.15000. Calculate the amount of interest of each year.

ASCERTAINMENT OF CASH PRICE

Sometimes the total cash price is not given. A different method of calculation of cash price are as below:

- A. Without Annuity table
- B. With Annuity table
 - When the instalment is constant
 - When the instalments are varying

Without Annuity Table

Interest = Total amount due at the time of instalment × Rate of Interest/100 + rate of interest

7) Calculate The cash prize of an asset from the following

Rs.3000 paid at the time of agreement, Rs.21600 paid at the time of 1st year, Rs. 20700 paid at the time of 2nd year, Rs.19800 paid at the time of third year, Rs. 18900 pay at the time of 4th year. Rate of interest in 5% per annum. Rate of depreciation 25% p.a (straight line method)

8) Calculate the cash price of an asset from the following details:

Down payment -Rs.6000, 1st instalment-Rs.7200, 2nd instalment-Rs.6900, 3rd Instalment-Rs.6600, 4th instalment-Rs.6300 payable at the end of each quarter of the year. Rate of interest =20%, Rate of depreciation=15%(SLM).

9) Calculate the cash price of an asset sold under instalment system: Down payment-Rs.6000, 1st instalment-Rs.14400, 2nd instalment-Rs.13300, 3rd instalment-Rs.12200, 4th instalment-Rs.12100 paid half yearly; Rate of interest =20%p.a.

With the help of Annuity table

10) Vismaya & company purchased one machine on 1/1/18 on hire purchase basis. Rs.10000 being paid on signing the agreement & thereafter Rs.10000 being paid annually for 3 years. Interest was charged @5% p.a. Given present value of an annuity of Re.1 per annum at 5% Rs.2.7232. Calculate cash price of the machine.

11) Sandra Ltd. purchased a machine on hire purchase system. Down payment Rs.23250, 1st instalment-Rs.35000, 2nd instalment-Rs.40000, 3rd instalment-Rs.20000. The payment is made at the end of 1st year, 2nd year & 3rd year respectively. The rate of interest is 5% p.a. The annuity table shows that the present value of Re.1 for 3 years is 0.952, 0.907, 0.864 respectively. Calculate the cash price of the machine.

Asset Accrual Method

- 1) Interest in each instalment
- 2) Depreciation
- 3) Cash price for each instalment

12) Mr. Albin purchased 2 trucks on HPS on 1st April 2018, the cash price being Rs.56000 & payment is to be made as follows: On signing of the contract Rs.15000 & there after Rs.15000 being paid annually for 3 years. Interest @ 5%, depreciation was written off at the rate of 20% p.a. on the reducing balance method.

Pass the necessary ledger accounts in the books of Mr. Albin under Asset accrual method.

13) Mr. Jinu purchased a machine on HPS from Irfan Ltd on 1/4/20. The cash price of the machine was Rs.74500 & the payment was made as follows:

Down payment=Rs.20000; Balance 3 instalments of Rs.20000 each at the end of each year. 5% interest charged by the vendor. Jinu has decided to write off 10% depreciation annually on the diminishing balance method. Pass the journal entries in the books of Mr. Jinu under Asset Accrual Method.

14) On 1st April 2020 the Logistics Industries bought a machine from General Ltd. on hire purchase system. The cash price =Rs. 37250, at the time of signing the agreement Rs.10000, & the balance in yearly instalment of Rs.10000 each on 31st March every year. The general Ltd charges interest at 5% p.a. & depreciation @ 10% in reducing balance method.

Pass the journal entries & open the necessary accounts in the books of Logistics Industries under asset accrual method.

15) A Mini bus is purchased for Rs.160000 under HPS on 1st April 2018. The amount payable is Rs.40000 on entering the agreement & the balance in 3 annual instalments of Rs.50000 each at the end of the year. Depreciation is charged at 10% p.a. on written down value method. Show the necessary ledger accounts in the books of purchaser under asset accrual method.

16) On 1st April 2018 Mr. Nikhil purchased a washing machine from Ram enterprises in HPS. The cash price of the machine was Rs.25000, payable Rs.5000 on signing the agreement & the balance in 4 annual instalments of Rs.5000 **plus interest** at 5% p.a. payable on 31st December each year. Mr. Nikhil writes of depreciation @ 10% on diminishing balance method. Show the necessary ledger accounts in the books of Nikhil under asset accrual method.

17) Hisham purchased a plant costing Rs.40000 on 1st April 2018 from Logistics Ltd. under HPS, the terms being Rs.10000 down & the balance in three equal instalments together with interest at 20% p.a. on the outstanding cash price. Depreciation is to be charged @15% under straight line method. Prepare necessary ledger accounts in the books of Hisham under asset accrual method.

