

HIRE PURCHASE

Agreement where Hire Purchaser gets possession of goods at the outset while paying for it in instalments over specified period of time



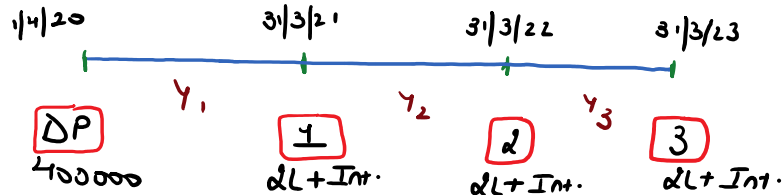
Cash Price 1000000

Down Payment 400000

Instalments (3): 200000 + Interest @ 12% p.a.

A: Hire Purchaser

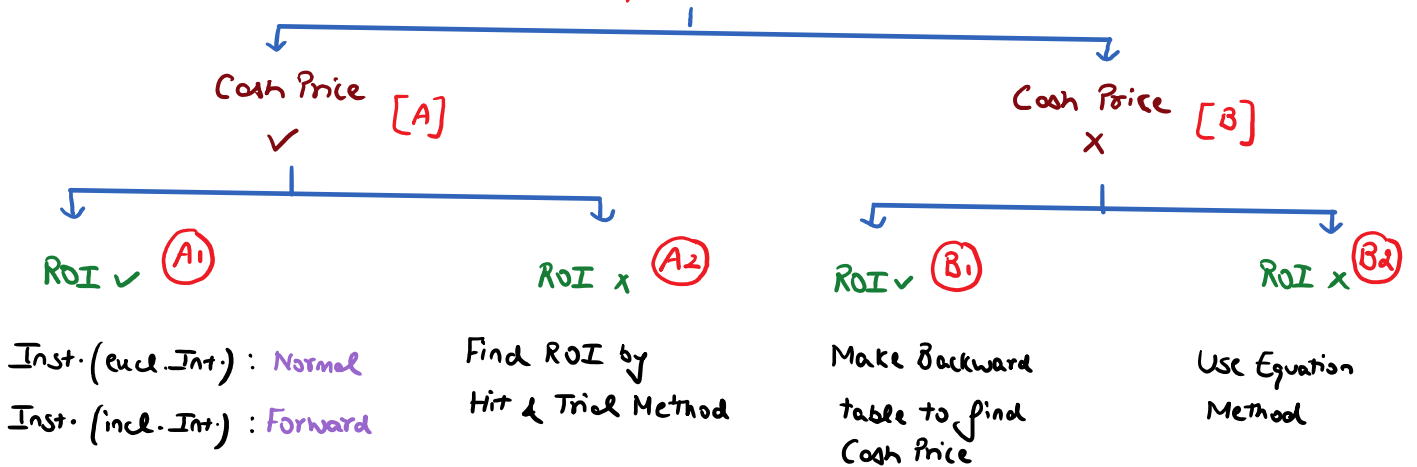
B: Hire Vendor



	Hire Purchase	Instalment Purchase
1) Ownership	When last instalment is paid	Immediately (ie. 1st Day)
2) Default	Goods can be Repossessed if hirer is in default	Seller can sue if buyer makes default. He cannot take possession of goods.
3) Parties	Hire Purchaser & Hire Vendor	Buyer & Seller
4) Responsibility for Risk of Loss	Hire Purchaser not responsible if he has taken reasonable precaution.	Buyer is responsible

CONCEPT 1: Basics

Computation



Case A1: (a) Cash Price ✓ ROI ✓ [Inst. excluding Interest] [NORMAL]

Cash Price = 1000000 Down Payment = 40% (400000). ROI: 12% p.a.
3 Instalments of 200000 each

Year/Inst. No.	O/s Principal	Interest (12% p.a.)	Payment
1	600000	6L x 12% = 72000	2L + 72000 = 272000
2	400000	4L x 12% = 48000	2L + 48000 = 248000
3	200000	2L x 12% = 24000	2L + 24000 = 224000

(b) Cash Price ✓ ROI ✓ [Instalments including Interest] [FORWARD TABLE]

Cash Price = 1000000 Down Payment = 40% (400000). ROI: 12% p.a.
3 Instalments of 250000 each.

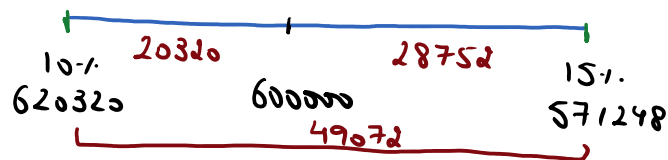
A YEAR	B O/s Bal. At Beginning	C = B x 12% Interest (12% p.a.)	D Instalment	E = D - C Principal	F = B - E O/s Bal. At End
1	600000	72000	250000	178000	422000
2	422000	50640	250000	199360	222640
3	222640	27360 (B.f.)	250000	222640	-
		<u>150000</u>			

Case A2: Cash Price ✓ ROI x [HIT & TRIAL METHOD]

(a) Cash Price = 1000000 DP = 40% (400000)
 3 Instalments of 272000, 248000, 224000

Hit & Trial Method

Year	Instalment	PVF @ 10%	Present value	PVF @ 15%	Present value
1	272000	0.909	247248	0.869	236368
2	248000	0.826	204848	0.756	187488
3	224000	0.751	168224	0.658	147392
			<u>620320</u>		<u>571248</u>
			[> 600000]		[< 600000]



[Diff. in Rates]
 $10 + \left(\frac{20320}{49072} \times 5 \right)$

12.07

$15 - \left(\frac{28752}{49072} \times 5 \right)$

12.07

(b) If 3 Instalments of 250000 each

Year	Instalment	Annuity factor @ 10% p.a.	Present value	Annuity factor @ 15%	Present value
1-3	250000	2.4868	621700	2.2832	570800



$10 + \frac{21700}{50900} \times 5$

=) 12.13

$15 - \frac{29200}{50900} \times 5$

12.13

Case B1: Cash Price x ROI ✓ [BACKWARD TABLE]

3 Instalments of 272000, 248000 & 224000. ROI = 12% p.a.

Down Payment = 40%.

A Year/Inst.No.	B O/s Balance At End	C Instalment	D = B+C O/s Bal. + Instalment	E = D x 12% / 112 Interest [12%] [224000 x 12% / 112]	F = D-E O/s Bal. At Beginning
3	-	224000	224000	24000	200000
2	200000	248000	448000	48000	400000
1	400000	272000	672000	72000	600000

DP = 40%. So 60% portion = 600000

$$\text{Cash Price} = \frac{600000}{60\%} = 1000000$$

Case B2: Cash Price x ROI x [EQUATION METHOD]

3 Instalments of 272000, 248000 & 224000. DP = 400000

Assuming cash price / Principal component in each instalment is equal.

Let P = cash price portion in each instalment

i = Interest

$$P + 3i = 272000$$

$$P + 2i = 248000$$

$$P + i = 224000$$

On solving we get:

$$i = 24000$$

$$P = 200000$$

$$\text{Cash Price} = (200000 \times 3) + 400000 = 1000000$$

CONCEPT: 2

ACCOUNTING METHODS UNDER HIRE PURCHASE

I. Cash Price/ Sales Method

S.No	Particulars	Books of Hire Purchaser	Books of Hire Vendor
1.	On Agreement	Asset A/c Dr. To Hire Vendor A/c (With Cash Price)	Hire Purchaser A/c Dr. To Sales/Asset A/c (With Cash Price)
2.	On Making Down Payment	Hire Vendor A/c Dr. To Cash & Bank A/c	Cash & Bank A/c Dr. To Hire Purchaser A/c
3.	When Interest is due	Interest A/c Dr. To Hire Vendor A/c	Hire Purchaser A/c Dr. To Interest A/c
4.	When Instalment is paid	Hire Vendor A/c Dr. To Cash & Bank A/c	Cash & Bank A/c Dr. To Hire Purchaser A/c
5.	On providing Depreciation*	Depreciation A/c Dr. To Asset A/c	No Entry
6.	Closure of Depreciation A/c	P&L A/c Dr. To Depreciation A/c	No Entry
7.	Closure of Interest A/c	P&L A/c Dr. To Interest A/c	Interest A/c Dr. To P&L A/c

*Note:-

However a concern may maintain Provision for Depreciation A/c instead of charging to Hire Purchase Asset A/c. In such case entry will be:

Depreciation A/c Dr.
To Provision for Depreciation A/c

DISCLOSURE IN BALANCE SHEET

BALANCE SHEET OF HIRE PURCHASER

Liabilities	Amount	Assets	Amount
Hire Vendor A/c (Creditor)	xx	Hire Purchase Asset xx Less Depreciation (xx)	xx

BALANCE SHEET OF HIRE VENDOR

Liabilities	Amount	Assets	Amount
		Hire Purchaser A/c (Debtor)	xx

II. Interest Suspense Method

S.No	Particulars	Books of Hire Purchaser	Books of Hire Vendor
1.	On Agreement	Asset A/c Dr. (CP) Interest Suspense A/c Dr. (Int) To Hire Vendor A/c (HPP)	Hire Purchaser A/c Dr. (HPP) To Sales/Asset A/c (CP) To Interest Suspense A/c (Int)
2.	On Making Down Payment	Hire Vendor A/c Dr. To Cash & Bank A/c	Cash & Bank A/c Dr. To Hire Purchaser A/c
3.	When Interest is due	Interest A/c Dr. To Interest Suspense A/c	Interest Suspense A/c Dr. To Interest A/c
4.	When Instalment is paid	Hire Vendor A/c Dr. To Cash & Bank A/c	Cash & Bank A/c Dr. To Hire Purchaser A/c
5.	On providing Depreciation*	Depreciation A/c Dr. To Asset A/c	No Entry
6.	Closure of Depreciation A/c	P&L A/c Dr. To Depreciation A/c	No Entry
7.	Closure of Interest A/c	P&L A/c Dr. To Interest A/c	Interest A/c Dr. To P&L A/c

*Note:-

However a concern may maintain Provision for Depreciation A/c instead of charging to Hire Purchase Asset A/c. In such case entry will be:

Depreciation A/c Dr.
To Provision for Depreciation A/c

DISCLOSURE IN BALANCE SHEET

BALANCE SHEET OF HIRE PURCHASER

Liabilities	Amount	Assets	Amount
Hire Vendor A/c xx (-) Interest Suspense (xx)	xx	Hire Purchase Asset xx Less Depreciation (xx)	xx

BALANCE SHEET OF HIRE VENDOR

Liabilities	Amount	Assets	Amount
		Hire Purchaser A/c xx (-) Interest Suspense (xx)	xx

CONCEPT: 3

DEFAULT AND 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. This act of recovery of possession of the asset is termed as repossession.

I. Complete Repossession

In case of complete repossession the hire vendor takes back the possession of all the goods. All entries till the date of default are passed in usual manner. The additional entries are as follows:

Books of Hire Purchaser

S.No	Particulars	Journal Entry
1.	For Closing Hire Vendor's Account	Hire Vendor A/c Dr. To Asset A/c <i>(With Value appearing in Hire Vendor A/c)</i>
2.	For Closing Asset Account	Balance of Asset A/c transferred to P&L A/c as Profit/Loss on surrender Loss: P&L A/c Dr. To Asset A/c Profit: Asset A/c Dr. To P&L A/c

Books of Hire Vendor

S.No	Particulars	Journal Entry
1.	On Repossession of Goods	Goods Repossessed A/c Dr. To Hire Purchaser A/c <i>(With agreed value of goods repossessed if given. If not given then consider value appearing in Hire Purchaser A/c)</i> Note: In case agreed value given then balance in Hire Purchaser A/c is Profit/Loss on repossession transferred to P&L A/c
2.	For Amount spent on reconditioning / repair of repossessed goods	Goods Repossessed A/c Dr. To Cash & Bank A/c
3.	For sale of repossessed goods	Cash & Bank A/c Dr. To Goods Repossessed A/c
4.	For Profit/Loss on sale of repossessed goods	Profit/Loss on sale transferred to P&L A/c Loss: P&L A/c Dr. To Goods Repossessed A/c Profit: Goods Repossessed A/c Dr. To P&L A/c

Example: A purchased 4 Trucks from B on hire purchase system.

Cash Price = 1000000 Down Payment = 40% 400000 . ROI: 12% p.a.

3 Instalments of 200000 each along with interest after each year.

Depreciation 10% p.a. WDV.

Default in 2nd instalment. B repossessed all the trucks.

[Complete Repossession]

Books of A
Truck A/c

<u>Yr 1</u>	To B's A/c	1000000	By Depreciation A/c	100000
			By Bal fd	900000
<u>Yr 2</u>	To Bal b/d	900000	By Depreciation A/c	90000
			By B's A/c	448000
			By P/L A/c (Loss) (B.P.)	362000

B's A/c

<u>Yr 1</u>	To Bank A/c (Down Payment)	400000	By Truck A/c	1000000
	To Bank A/c (200000 + 72000)	272000	By Interest A/c	72000
	To Bal fd	400000	[6L x 12%]	
<u>Yr 2</u>	To Truck A/c	448000	By Bal b/d	400000
			By Interest A/c	48000
			(4L x 12%)	

Books of B

A's A/c

<u>Yr 1</u>	To Sales A/c	1000000	By Bank A/c (DP)	400000
	To Interest A/c (6L X 12-1)	72000	By Bank A/c (2L + 72000)	272000
			By Bal dd	400000
<u>Yr 2</u>	To Bal b/d	400000	By Goods Repossessed *	448000
	To Interest A/c (4L X 12-1)	48000		

* Since value of Goods Repossessed not given.

If given then use that value. Eg: 350000

<u>Yr 2:</u>	To Bal b/d	400000	By Goods Repossessed A/c	350000
	To Interest A/c	48000	By P/L A/c (Loss)	98000

Preparation of Goods Repossessed A/c

Information given by Que: Expense on Repair = 40000

Sale of Repossessed Goods = 420000

Goods Repossessed A/c

To A's A/c	448000	By Bank A/c (Sale)	420000
To Bank A/c (Repairs)	40000	By P/L (Loss on Sale)	68000
		(B.P.)	

II. Partial Repossession

In case of partial repossession the hire vendor takes back the possession of a part of the goods. All entries till the date of default are passed in usual manner. The additional entries are as follows:

Books of Hire Purchaser

S.No	Particulars	Journal Entry
1.	For transfer of the agreed value of Goods Repossessed	Hire Vendor A/c Dr. To Asset A/c <i>(With Agreed Value of Goods Repossessed)</i>
2.	For Transfer of Profit/Loss on Default /Surrender	First find out the closing balance of Asset A/c* Thereafter balance of Asset A/c is transferred to P&L A/c as Profit/Loss on surrender Loss: P&L A/c Dr. To Asset A/c Profit: Asset A/c Dr. To P&L A/c
	* Closing Balance Value as if there is no Repossession x Balance no. of Assets Total no. of Assets	

Books of Hire Vendor

S.No	Particulars	Journal Entry
1.	On Repossession of Goods at Agreed Value	Goods Repossessed A/c Dr. To Hire Purchaser A/c <i>(With agreed value of goods repossessed)</i>
2./3./4.-	Same as in case of Complete Repossession	

Example: (Partial Repossession)

Same Example as earlier.

On Default of 2nd instalment, B repossessed 3 Trucks valuing as

PART 1: Asset A/c

Case 1: Consider 30% dep. on WDV basis.

		Truck A/c	
<u>Yrd.</u>	To Bal b/d	900000	
			By Depreciation A/c
			90000
			By B's A/c (WN)
			367500
			By P/L A/c (Bal. f.f.)
			240000
			By Bal b/d
			202500
		<u>900000 - 90000</u>	<u>810000</u>
			$\left[\frac{810000 - 90000}{4} \times 1 \right]$
			<u>202500</u>

Value of Goods Repossessed:

Cost of 3 Trucks = $\frac{10L}{4} \times 3 = 750000$

- Dep @ 30% (Year 1) (225000)

525000

- Dep. @ 30% (Year 2) (157500)

367500

Case 2: Amount paid against these 3 trucks less 25%.

Value of Goods Repossessed:

Amount paid = $\frac{400000 + 200000}{4} \times 3$

= $\frac{600000}{4} \times 3 = 450000$

Less 25% = (112500)

337500

PART d: Hire Vendor A/c

Case 1: B is paid off the balance with interest @ 15% p.a. after 4 months.

B's A/c (Hire Vendor A/c)

<u>Year 1</u> :	To Truck A/c	337500	By Bal b/d	400000
	To Bal c/d	110500	By Interest A/c (4L X 12%)	48000
		<u>110500</u>		<u>48000</u>
<u>Year 3</u> :	To Bank A/c	116025	By Bal b/d	110500
		<u>116025</u>	By Interest A/c [110500 X 15% X 4/12]	5525
				<u>5525</u>

Case 2: Prepare B's Account for 3rd year as well.

B's A/c (Hire Vendor A/c)

<u>Year 1</u> :	To Truck A/c	337500	By Bal b/d	400000
	To Bal c/d	110500	By Interest A/c (4L X 12%)	48000
		<u>110500</u>		<u>48000</u>
<u>Year 3</u> :	To Bank/To Bal c/d	123760	By Bal b/d	110500
		<u>123760</u>	By Interest A/c [110500 X 12%]	13260
				<u>13260</u>