

# HIRE PURCHASE SYSTEM

## MEANING OF HIRE PURCHASE AGREEMENT

Hire purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes the agreement under which:

1. Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount, in periodical installments;
2. The property in the goods is to pass to such a person on the payment of the last installment; and
3. Such a person has a right to terminate the agreement at any time before the property so passes

## MEANING OF INSTALLMENT PURCHASE AGREEMENT

Installment purchase agreement means an agreement of sale under which:

1. The property in the goods is to pass to the buyer immediately on the signing of the contract of sale;
2. The buyer has no right to terminate the contract unless the seller defaults;
3. The seller has right only to sue for price if the buyer fails to pay any installment. He can not take back the goods from the purchaser.
4. The buyer may dispose off the goods and give good title to the bonafide purchase

## IMPORTANT TERMS IN HIRE PURCHASE AGREEMENT

1. **Hirer:** a 'hirer' means a person who obtains or has obtained possession of the goods from an owner under a hire purchase agreement.
2. **Hire vendor:** hire vendor means a person who delivers or has delivered the possession of goods to the hirer under a high purchase agreement.
3. **Cash price:** Cash price means the price at which the goods may be purchased by the hirer for cash.
4. **Down payment:** Down payment means an initial payment payable by the hirer at the time of entering into a hire purchase agreement.

5. Hire Purchase Price: Hire purchase price means the total sum payable by the hirer under a hire purchase agreement in order to complete the purchase of or acquisition of property in the goods to which the agreement relates and includes any sum so payable by the hirer under the hire purchase agreement by way of deposit or other initial payment. In the form of an equation, hire purchase price may be shown as under:

$$\text{Hire purchase price} = \text{Cash price} + \text{interest on outstanding balances}$$

6. Hire purchase charges: Hire purchase charges means the difference between hire purchase price and the cash price as stated in the hire purchase agreement. These hire purchase charges are popularly known as “interest”

# DISTINCTION BETWEEN HIRE PURCHASE AGREEMENT AND INSTALLMENT PURCHASE AGREEMENT

Basis of distinction	Hire Purchase agreement	Installment purchase agreement
1. Nature of contract	It is an agreement of hiring	It is an agreement of sale
2. Passing of title	The title to goods passes on last payment	The title to goods passes immediately as in the case of usual sale.
3. Return of goods	The hirer may return goods without further payment, except for accrued installment	Unless seller defaults, goods are not returnable
4. Right of seller	The seller may take possession of the goods if hirer is in default.	The seller can sue for price if the buyer is in default. He cannot take possession of the goods
5. Right of disposal	Hirer cannot hire out, sell, pledge or assign entitling transferee to retain possession as against the hire vendor.	The buyer may dispose off the goods and give good title to the bonafide purchase.

## DEFAULT AND REPOSSESSION

If a hire purchaser fails to pay any installment on the stipulated date, the hire purchaser is said to be at default.

In case of default by the hire purchaser, the hire vendor may repossess the goods.

Repossession means taking back the possession of goods by the hire vendor.

Subject to agreement, the repossession may be either complete or partial.

## Journal Entries

The various accounting entries in the books of the hire purchaser and hire vendor are shown below:

Case	In the Books of Hire Purchaser	In the Books of Hire Vendor
1. On transfer of Possession	Asset A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To H.P. Sales A/c
2. On making Down Payment	Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c
3. On making Interest due on unpaid balance	Interest A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To Interest A/c
4. On making payment of Instalment	Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c
5. On providing Depreciation	Depreciation A/c Dr. To Asset A/c	No Entry
6. On closure of Depreciation A/c	Profit & Loss A/c Dr. To Depreciation A/c	No Entry
7. On closure of Interest A/c	Profit & Loss A/c Dr. To Interest A/c	Interest A/c Dr. To Profit & Loss A/c



## Disclosure in Balance Sheet

At the end of each accounting period the balances of relevant accounts appear in the Balance Sheet as shown below:

### Disclosure in Balance Sheet

Balance Sheet of Hire Purchaser				Balance Sheet of Hire Vendor			
Liabilities	₹	Assets	₹	Liabilities	₹	Assets	₹
		Fixed Assets:				Current Assets:	
		Asset (at full cash price)	xxx			Hire Purchase Debtors	xxx
		Less: Depreciation till date	xxx				
		Less: Balance in Hire Vendor's Account	xxx				
			<b>xxx</b>				<b>xxx</b>

## **SITUATION – I : WHEN RATE OF INTEREST, TOTAL CASH PRICE AND IN STALLMENTS ARE GIVEN**

### **Illustration 7**

X purchases a car on hire-purchase system on 1.1.11. The total cash price of the car is ₹4,50,000 payable ₹90,000 down and three installments of ₹1,70,000, ₹1,50,000 and ₹1,08,460 payable at the end of first, second and third year respectively. Interest is charged at 10% p.a.

You are required to calculate interest paid by the buyer to the seller each year.

**Solution:** Following table is useful for calculating interest paid with each installment :

### Analysis of Instalments

Year	Opening Balance of Cash Price ₹	Installments ₹	Payment towards Principal/Cash Price ₹	Payment towards Interest ₹	Closing Balance of Cash Price ₹
01.01.11	4,50,000	90,000	90,000	-	3,60,000
31.12.11	3,60,000	1,70,000	1,34,000	36,000	2,26,000
31.12.12	2,26,000	1,50,000	1,27,400	22,600	98,600
31.12.13	98,600	1,08,460	98,600	9,860	-

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**SITUATION – II : WHEN RATE OF INTEREST AND INSTALLMENTS ARE GIVEN BUT TOTAL CASH PRICE IS NOT GIVEN.**

**Illustration 8**

X purchased a T.V on hire-purchase system. As per terms he is required to pay ₹ 3000 down, ₹4000 at the end of first year, ₹ 3000 at the end of second year, and ₹ 5000 at end of third year. Interest is charged at 12% p.a.

You are required to calculate total cash price of T.V and interest paid with each installment.

Calculation of Cash Price	Installment ₹	Analysis of Instalments	
		Interest ₹	Cash Price ₹
3rd Instalment			
(-) Interest $(12/112 \times 5,000)$	5,000		
	<u>536</u>	536	4,464
<b>Balance of Cash Price</b>	4,464		
(+) 2nd Instalment	<u>3,000</u>		
	7,464		
(-) Interest $(12/112 \times 7,464)$	<u>800</u>	800	2,200
<b>Balance of Cash Price</b>	6,664		
(+) 1st Instalment	<u>4,000</u>		
	10,664		
(-) Interest $(12/112 \times 10,664)$	<u>1,143</u>	1,143	2,857
<b>Balance of Cash Price</b>	9,521		
(+) Down Payment Total	<u>3,000</u>		
Cash Price	<u>12,521</u>	<u>-</u> 2,479	<u>3,000</u> <u>12,521</u>

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**SITUATION – III : WHEN ONLY INSTALLMENTS ARE GIVEN, BUT CASH PRICE AND RATE OF INTEREST ARE NOT GIVEN.**

**Illustration 9**

X & Co. purchased a Motor car on April 1, 2009 on hire-purchase paying ₹ 60,000 cash down and balance in four annual installments of ₹ 55,000, ₹ 50,000, ₹ 45,000 and ₹ 40,000 each. Each installment comprising equal amount of cash price at the end of each accounting period. You are required to calculate total cash price and amount of interest in each installment.

**Solution :** Hire-purchase Price

Down Payment	60,000
1st installment	55,000
2nd installment	50,000
3rd installment	45,000
4th installment	<u>40,000</u>
Total	<u>2,50,000</u>

As each installment comprises equal amount of cash price the differences in installment amounts are due to interest amount only. Assuming X is the amount of Cash Price in each installment and I is the amount of interest.

Thus for the installments, starting from last installment, we have the following equations:

$$\begin{aligned} \text{(i)} \quad X + I &= 40,000 \\ \text{(ii)} \quad X + 2I &= 45,000 \\ \text{(iii)} \quad X + 3I &= 50,000 \\ \text{(iv)} \quad X + 4I &= 55,000 \end{aligned}$$

Subtracting any preceding equation from the following equation we get  $I = ₹ 5,000$  and by substituting the value of I in any equation we get  $X = ₹ 35,000$ .

The hire-purchase price is divided into cash price and interest parts as under :

<b>Particulars</b>	<b>Cash Price</b> ₹	<b>Interest</b> ₹	<b>Installment</b> ₹
Down Payment	60,000	-	60,000
First installment	35,000	20,000	55,000
Second installment	35,000	15,000	50,000
Third installment	35,000	10,000	45,000
Fourth installment	35,000	5,000	40,000
Total	2,00,000	50,000	250,000
Total Cash Price	2,00,000		
Hire Purchase Price	2,50,000		
Total Interest	50,000		



## Illustration 11

On 1.1.2009 Mr. X took delivery from Mr. Y of 5 machines on a hire purchase system. ₹ 4,000 being paid on delivery and the balance in five installments of ₹ 6,000 each, payable annually on 31<sup>st</sup> December. The vendor company charges 5% interest p.a. on yearly balances. The cash price of 5 machines was ₹ 30,000. Show the entries (without narration) Assets Account, Mr. Y Account for 5 years assuming that the purchaser charges depreciation @20% on straight line method under (a) Asset Accrual Method and (b) under Sales Method.

### Solution:

#### Computation of Interest

Hire-purchase price	₹	₹
Down payment	4,000	
Interest ₹ 6,000 x 5 =	<u>30,000</u>	34,000
Less: Cash Price		<u>30,000</u>
	<b>∴ Interest</b>	<b><u>4,000</u></b>

## Analysis of Payments of Vendors

Year	Opening Balance of Cash Price ₹	Towards Principal ₹	Towards Interest ₹	Installment ₹	Closing balance of Cash Price ₹
01.01.2009	30,000	4,000	---	---	26,000
31.12.2009	26,000	4,700	1,300	6,000	21,300
31.12.2010	21,300	4,935	1,065	6,000	16,365
31.12.2011	16,365	5,182	818	6,000	11,183
31.12.2012	11,183	5,441	559	6,000	5,742
31.12.2013	5,742	5,742	258	6,000	NIL
			(bal. fig.)		
			4,000		

**In the Books of Mr. X**  
**Journal** (without narrations)

Date	Particulars	L/F	Dr.	Cr.
			Amount ₹	Amount ₹
2009 Jan. 1.	Assets A/c. Dr. To Mr. Y A/c.		4,000	4,000
	Mr. Y A/c. Dr. To Bank A/c.		4,000	4,000
Dec. 31.	Assets A/c. Dr. Interest A/c. Dr. To Mr. Y A/c.		4,700 1,300	6,000
	Mr. Y A/c. Dr. To Bank A/c.		6,000	6,000
	Depreciation A/c. Dr. To Assets A/c.		6,000	6,000
	Profit & Loss A/c. Dr. To Interest A/c. To Depreciation A/c.		7,300	1,300 6,000

2010 Dec. 31.	Assets A/c.	Dr.		4,935	
	Interest A/c.	Dr.		1,065	
	To Mr. Y A/c.				6,000
	Mr. Y A/c.	Dr.		6,000	
	To Bank A/c.				6,000
	Depreciation A/c.	Dr.		6,000	
	To Assets A/c.				6,000
	Profit & Loss A/c.	Dr.		7,065	
	To Interest A/c.				1,065
	To Depreciation A/c.				6,000
2011 Dec. 31.	Assets A/c.	Dr.		5,182	
	Interest A/c.	Dr.		818	
	To Mr. Y A/c.				6,000
	Mr. Y A/c.	Dr.		6,000	
	To Bank A/c.				6,000
	Depreciation A/c.	Dr.		6,000	
	To Assets A/c.				6,000
	Profit & Loss A/c.	Dr.		6,818	
	To Interest A/c.				818
	To Depreciation A/c.				6,000

Dr.

## Asset Account

Cr.

Date	Particulars	₹	Date	Particulars	₹
2009 Jan. 1.	To Mr. Y A/c.	4,000	2009 Dec.31.	By Depreciation A/c.	6,000
Dec. 31.	`` Mr. Y A/c.	4,700		`` Balance c/d.	2,700
		8,700			8,700
2010 Jan. 1.	To Balance b/d.	2,700	2010 Dec.31.	By Depreciation A/c.	6,000
Dec. 31.	`` Mr. Y A/c.	4,935		`` Balance c/d.	1,635
		7,635			7,635
2011 Jan. 1.	To Balance b/d.	1,635	2011 Dec.31.	By Depreciation A/c.	6,000
	`` Mr. Y A/c.	5,182		`` Balance c/d.	817
		6,817			6,817
2012 Jan. 1.	To Balance b/d.	817	2012 Dec.31.	By Depreciation A/c.	6,000
Dec. 31.	`` Mr. Y A/c.	5,441		`` Balance c/d.	258
		6,258			6,258
2013 Jan. 1.	To Balance b/d.	258	2013 Dec.31.	By Depreciation A/c.	6,000
Dec. 31.	`` Mr. Y A/c.	5,742			6,000
		6,000			6,000

Dr.		Mr. Y Account		Cr.	
Date	Particulars	₹	Date	Particulars	₹
2009			2009		
Jan. 1.	To Bank A/c.	4,000	Jan. 1.	By Asset A/c.	4,000
Dec. 31.	`` Bank A/c.	6,000	Dec.31.	`` Asset A/c.	4,700
				Interest A/c.	1,300
		10,000			10,000
2010			2010		
Dec. 31.	To Bank A/c.	6,000	Dec.31.	By Asset A/c.	4,935
				Interest A/c.	1,065
		6,000			6,000
2011			2011		
Dec. 31.	To Bank A/c.	6,000	Dec.31.	By Asset A/c.	5,182
				Interest A/c.	818
		6,000			6,000
2012			2012		
Dec. 31.	To Bank A/c.	6,000	Dec.31.	By Asset A/c.	5,441
				Interest A/c.	559
		6,000			6,000
2013			2013		
Dec. 31.	To Bank A/c.	6,000	Dec.31.	By Asset A/c.	5,742
				Interest A/c.	258
		6,000			6,000