

## CH-4 HIRE PURCHASE SYSTEM

Hire purchase =Rent-to-own

Hire Purchase System is a method of purchasing the goods with an arrangement to make payment (of the purchase price) in instalments over time.

There is an agreement between the seller called hiree or vendor and the buyer called purchaser or hirer and this agreement is called hire purchase agreement

Purchase price of the goods and services is paid in a number of agreed instalments. That means, purchase price is not paid in one lump sum either at the time of signing the agreement or at a future date. Instead, it is paid in a few instalments over a period of time.

As the purchase price is not paid in one lump sum at the time of purchase, it (i.e., hire purchase) is a kind of credit purchase.

Under the system of hire purchase, though the full amount is not paid at the time of purchasing (i.e., at the time of signing the agreement) the seller hands over the goods to the buyer on signing the agreement. In other words, the hire purchaser takes possession of the goods purchased on hire purchase basis.

Therefore, the buyer is able to start using these goods for the intended purpose immediately after signing the agreement. And the hire purchaser has the right to use the goods purchased on hire purchase basis as the bailer

However, the legal **ownership of the goods (i.e., title to the goods) remains with the seller and it is passed on to the hire purchaser only after the receipt of all instalments including the last instalment as per the agreement.** As a result, the hire vendor continues to be the owner of the goods till the receipt of last instalment from the hire purchaser.

As the **title to the goods is not transferred from seller to buyer till the receipt of last instalment** in accordance with the provisions of the agreement, all earlier instalments paid (prior to the payment of last instalment) are considered as hire charges (till the payment of last instalment). And the hire purchaser becomes the owner of the goods only after the payment of all instalments as per the Provisions of the agreement (i.e., after the payment of last instalment, the hire vendor transfers the ownership of the goods to hire purchaser).

As already stated, the legal ownership of the goods sold on hire purchase system is not transferred to the buyer by the seller until the receipt of last instalment from the buyer.

Therefore, if the hire purchaser fails to pay any of the instalments, the hire vendor has the right to take back (i.e., repossess) the goods from the hire purchaser.

Similarly, the hire purchaser also has an option to terminate the agreement any time but before the payment of last instalment and return the goods to the seller (if he is not willing and/or not able to pay the remaining instalments).

When the agreement is terminated [either because the seller takes back the possession of the goods from the hire purchaser (for non-payment of any of the instalments) or because

of hire purchaser returning the goods to hire vendor any time before the last instalment is paid] the hire vendor need not return or refund the instalments already paid (by the buyer) to the buyer.

Hence, the instalments already paid are considered as the hire charges for using the goods by the hirer till the goods are taken back by the hire vendor or returned by the hire purchaser.

The unique feature of hire purchase system is that the payment of every instalment is considered as the payment of hire charges by the hirer to the hire vendor till the payment of the last instalment. After the payment of the last instalment, the amount of different instalments paid is appropriated towards the payment of the price of the goods sold and the ownership of the goods is transferred to the hire purchaser by the owner (i.e., hire vendor).

### **Important Terms:**

- **Cash Price:** Price which is payable if full payment is made immediately.
- **Down payment:** The amount payable at the time of signing the contract.
- **Contract Price:** Down payment + Instalment Or Cash Price + Interest
- **Reserve for after sale service**

Methods of calculating examples

1. **Cash price & Rate of interest both are given=** Start calculating interest in each instalment and move further in solution
2. **Cash price & Rate of Interest both are not given=** Equation method i.e. assume cash price X and amount of interest as Y
3. **Rate of interest is not given =** Ratio method
4. Interest is not included in the amount of instalment= Calculate interest on balance amount of cash price
5. Contact price calculation
6. Cash price is not given= Reverse calculation from last instalment
7. Calculation of cash price from Annuity table
8. Repair Reserve included in cost of asset
9. CP and amount of depreciation
10. Interest and Depreciation are given & amount of that instalment is not given= calculation with the help of Interest or depreciation

## ACCOUNTING TREATMENT

### JOURNAL ENTRIES

Sr.No.	Transaction	In the books of Purchaser	In the books of Seller
<u>1</u>	On signing the contract	No Enrty	Hirer's A/C Dr. To Sales A/C
<u>2</u>	Payment on signing contract (down payment)	Asset A/C Dr. To Bank A/C	Bank A/C Dr. To Hirer's A/C
<u>3</u>	Instalment due	Asset A/C Dr. Interest A/C Dr. To Vendor's A/C	Hirer's A/C Dr. To Interest A/C
<u>4</u>	Instalment is paid	Vendor's A/c Dr. To Bank A/C	Bank A/C Dr. To Hirer's A/C
<u>5</u>	Depreciation	Depreciation A/C Dr. To Asset A/C	NO ENTRY
<u>6</u>	Depreciation & Interest will be transferred to P/L	P/L A/C Dr. To Interest A/C To Depreciation A/C	Interest A/c Dr. To P/L A/C

**Note: Entry No. 3 to 6 will be repeated every year.**

#### EXERCISE:

- 1) Shri Haren purchased a machine of Rs.9,72,000 on 9-9-2017 on hire purchase. They paid Rs.81,000 on the day of contract and remaining amount in three 6 months equal instalment with 9% interest. Calculate amount of interest of each instalment.

2) Shefali purchased one machine under hire purchase system from Deepak on 1-1-2016. The amount was to be paid as under:

On 1-1-2016	11,000
On 31-12-2016	13,200
On 31-12-2017	12,100

Find out cash price of machine and amount of interest in each instalment.

3) Gita has purchased one machinery on hire purchase agreement. The cash price of machinery is Rs.90,000. The amount is to be paid on agreement Rs.30,000 and balance amount is paid by three equal annual instalments of Rs.30,000 each. Compute the interest of third year.

4) A machine was purchased for Rs.60000 on hire purchase. Rs.12000 was paid on signing the agreement and the balance was paid in four equal annual instalments of Rs.18000 each. Find out interest for all the years.

Q.5 On 1-04-2023 Mona purchased a machine from kavya on Hire purchase system. The terms of contract were as under:

1. The cash price of machine is Rs.1,00,000
2. On signing the contract, 20% of the cash price is to be paid.
3. The balance amount of the cash price is to be paid in four half yearly instalments of Rs.20,000 each together with the interest on 30<sup>th</sup> sep. and 31<sup>st</sup> March every year.
4. The interest is to be charged at 12% p.a. on the amount of the balance of the cash price outstanding. The machine is to be depreciated at 10% p.a. as per reducing balance method. Accounting year of both ends on 31<sup>st</sup> March.

Prepare: 1. Machine Account 2. Kavya's A/c in the books of Mona.:

Q.6 Trusha has purchased Motor car from Trupti a motor on 1-04-2021. Payment terms are as follows:

Date	Amount
1-04-2021	1,00,000
31-03-2022	90,000
31-03-2023	80,000

31-03-2024	70,000
31-03-2025	60,000

Interest is to be compute @20% p.a. on opening balance of each year. Depreciation is to be computed @10% as per written down value method. Prepare motor car A/c and Trupti's A/c in the books of Trusha.

Q.7 On 1-1-2018 a machine was purchased on hire purchase, its cash price being Rs.2,07,000. Rs.20,000 was paid on signing the contract and the remaining amount was payable in eleven half yearly instalments of Rs.20,000 each including interest. The first instalment was payable after six months. Depreciation is calculated at 10% p.a. on reducing balance method. Prepare following accounts only for two years:

1. Machine A/c 2. Vendor's A/c 3. Interest A/c

Q.8 Shri Het bought a machine from Vraj Engineering co. Ltd. On hire purchase system on 1-01-2020. Rs.1250 was to be paid on signing the agreement and balance in three instalments as follows:

Date	Amount
First Instalment	1625
Second Instalment	1500
Third Instalment	1375

Depreciation is charged at 10% p.a. on SLM. The books of firm are closed on 31<sup>st</sup> December. Prepare Machine A/c in the books of Het.

Q.9 Bhargavi purchased Activa from Josely Auto, Patan on hire purchase system on 1-01-2018. The cash price of Activa was Rs.40,000. Payments were made as under:

Date	Amount
1-01-2018	6000
31-12-2018	11,000
31-12-2019	11,000
31-12-2020	11,000
31-12-2021	11,000

Depreciation had to written off at 10%. Prepare necessary ledger accounts in the books of Bhargavi.

Q.10 Parth purchased a machine on hire purchase system from Herin Traders on 1-04-2013. 20% amount was paid at the time of signing the contract and remaining was to be paid in four yearly instalments as follows:

Date	Amount
First Instalment	1,41,400
Second Instalment	1,21,100
Third Instalment	1,15,500
Fourth Instalment	1,39,973

The following journal entry was passed in the books of Herin Traders on 31-03-2017:

Interest account A/c dr. 11,557	
To P & L A/c	11,557

Depreciation is to be charged at 10% p.a. by diminishing balance method. Prepare in the books of Parth: Machine A/c and Herin traders

Q11) A company purchased Machinery from Amit Ltd. on hire purchase Method on 1-4-2020. As per agreement Rs. 40,000 cash paid at the time of agreement and balance paid in three instalments as mentioned below on 31st March every year: Rs. 46800, Rs. 43200, and Rs. 39600. Find the cash price. (April 2024)

Q12) In a hire purchase agreement the down payment is Rs. 50,000 and the total amount of three equal instalments including interest is Rs.1,80,000 in which interest is Rs. 30,000, find the cash price of the property. (APRIL 2024)

Q13) Karmyug has purchased a computer on hire purchase bases from TM Computer Traders on 1st January, 2020 Payment terms are us under.( 2024)

DATE	Amount with interest
01 - 01-2020	62,500
31-12-2020	56,250
31-12-2021	50,625
31-12-2022	32,500
31-12-2023	28,750

Interest is to be charged on the opening balance at 15%. Depreciation is to be charged at 10% on reducing balance method. Prepare in the books of Karmyug.

- (1) Computer Account
- (2) Interest Account
- (3) Depreciation

Q14) On 1st January 2021, Hiyan purchased a machine with a cash price of ₹1,39,000. ₹49,000 was paid at the time of the contract, and thereafter, three annual instalments of ₹40,000 each were paid. Find the amount of interest included in each instalment. (APRIL 2025-VNSGU)

Q15) Fill the blanks. (VNSGU APRIL 2025)

1. Cash price + Interest = \_\_\_\_\_
2. Interest paid at the end of the year and depreciation are transferred to \_\_\_\_\_.

Q16) Following is the Machine A/c in the books of Chhaya who purchased the machine from Shalini on 1-4-21 on hire purchase system. Complete the following account by find the question marked amounts.(VNSGU APRIL 2025)

Date	Particulars	Rs.	Date	Particulars	Rs.
1-4-21	To Bank	?	31-3-22	By Depreciation	?
31-3-22	To Shalini	48,000	31-3-22	By Balance	?
		?			?
1-4-22	To Balance	?	31-3-23	By Depreciation	?
31-3-23	To Shalini	48,000	31-3-23	By Balance	?
		?			?
1-4-23	To Balance	?	31-3-24	By Depreciation	19,440
31-3-24	To Shalini	48,000	31-3-24	By Balance	?
		?			?

Assume 10% depreciation rate on reducing balance method.

Amount paid on signing contract is Rs. 96,000.

Q17) Shah purchased a truck on hire purchase system from Gabani on 01-04-2024. He paid the following amounts towards the purchase of the truck.(VNSGU APRIL 2025)

Depreciation is calculated at 20% using reducing balance method. Interest rate is 15% per annum. Prepare Truck A/c in the books of Shah.

Date	Rs.
01-04-24	10% of cash price
31-07-24	35,600
30-11-24	26,000
31-03-25	16,800

UDHNA COLLEGE