

HIRE PURCHASE SYSTEM

MEANING

Hire Purchase system is a system in which the goods are delivered to the purchaser at the time of agreement before the payment of instalments but the title of the goods is transferred after the payment of all instalments as per the hire purchase agreement.

It is a special system of purchase and sale of goods. Under this system the purchaser pay the price of goods in instalments.

CONDITIONS OF HIRE PURCHASE AGREEMENT

- Hire purchase is a transaction where the goods are sold by vendor to the purchaser under the following conditions:
- The goods will be delivered to the purchaser at the time of the agreement
- The purchaser has a right to use the goods delivered
- The price of the goods will be paid in the instalments.
- Every instalment will be treated to be the hire charges of the goods which is being used by the purchaser.
- If all the instalments are paid as per the terms of agreement, the title of the goods is transferred by the vendor to the purchaser.
- If there is default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of instalments.

FEATURES OF HIRE PURCHASE AGREEMENT

1. **TRANSFER OF POSSESSION ONLY:** The hire vendor transfers only the possession of goods to the hire purchaser immediately after the agreement of hire purchase is made.
2. **GOVERNING ACT:** Hire purchase system is governed under the Hire Purchase Act, 1972. This act came into force on 1 September, 1973.
3. **CREDIT PURCHASE:** Hire purchase is a credit purchase as the goods are sold for payment that is to be done in future period of time.
4. **TERMINOLOGY:** The following terms are used in the agreement of hire purchase:
 - ***Hire Purchaser:*** The buyer in the hire purchase agreement who purchases the goods on hire basis
 - ***Hire Vendor:*** The seller in the hire purchase agreement who sell the goods on the hire basis.

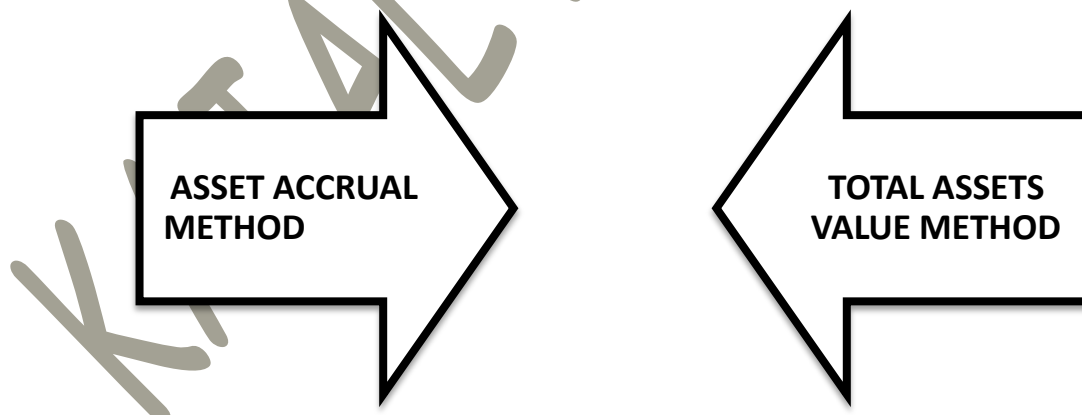
- **Cash Payment:** The amount to be paid on outright purchase in cash.
 - **Down Payment:** Initial payment made at the time of signing the hire purchase agreement.
 - **Hire Purchase Price:** The amount to be paid if the goods are purchased under the hire purchase system. It includes cash price and interest on future instalments.
5. **RIGHT TO TERMINATE:** The hire purchase has a right to terminate the agreement at any time in the capacity of a hirer.
 6. Goods should be delivered in the possession of the purchaser at the time of commencement of agreement.
 7. Hire Vendor continues to be the owner of the goods till the last payment of instalment is over.
 8. If there is default in the payment of any instalment, the hire vendor will take away the goods from the possession of the purchaser without refunding him any amount.
 9. Each instalment consists of partly interest and part of capital payment.

ACCOUNTING TREATMENT

The accounting treatment of hire purchase is as under:

IN THE BOOKS OF THE HIRE PURCHASER

There are two methods of accounting in the books of the hire purchaser:



❖ **ASSET ACCRUAL METHOD**

Under this method it is considered that the hire purchaser is the owner of the asset up to the value of cash price paid by him in the form of down payment or the cash price paid included in the various instalments.

The following journal entries are recorded under this method:

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	On Taking Delivery Of Asset No Entry			
	On Making Down Payment Asset A/C.....Dr. To Cash/ Bank A/C			
	On Becoming Instalment Due Asset A/C.....Dr. Interest A/C.....Dr. To Hire Vendor A/C			
	On Payment Of Instalment Hire Vendor A/C.....Dr. To Cash/ Bank A/C			
	On Charging The Depreciation Depreciation A/C.....Dr. To Asset A/C			
	On Transfer Of Interest And Depreciation To Profit And Loss A/C Profit And Loss A/C.....Dr. To Interest A/C To Depreciation A/C			

❖ **TOTAL ASSETS VALUE METHOD**

Under this method of accounting in the books of hire purchaser, is done on the assumption that the ownership of the asset is also transferred to the purchaser with the delivery of goods. The journal entries to be passed are:

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	On Taking Delivery Of Asset At The Time Of Agreement Asset A/CDr. To Cash/ Bank A/C			
	On Making Down Payment Hire Vendor A/C.....Dr. To Cash/ Bank A/C			

	On Becoming Instalment Due Interest A/C.....Dr. To Hire Vendor A/C			
	On Payment Of Instalment Hire Vendor A/C.....Dr. To Cash/ Bank A/C			
	On Charging The Depreciation Depreciation A/C.....Dr. To Asset A/C			
	On Transfer Of Interest And Depreciation To Profit And Loss A/C Profit And Loss A/C.....Dr. To Interest A/C To Depreciation A/C			

POSTING IN LEDGER ACCOUNTS

After passing the journal entries, the accounts opened in the ledger are as follows:

- Asset a/c
- Vendor's a/c
- Interest a/c
- Depreciation a/c

IN THE BOOKS OF THE HIRE VENDOR

There is only one method to record the journal entries in the books of hire vendor. The journal entries are as follows

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	On Taking Delivery Of Asset To Hire Purchaser At The Time Of Agreement Hire Purchaser A/C.....Dr. To Hire Sales A/C			
	On Receipt Of Cash At The Time Of Agreement (Down Payment) Cash/ Bank A/C.....Dr. To Hire Purchaser A/C			
	On Interest Being Due Hire Purchaser A/C.....Dr. To Interest A/C			
	On Receipt Of Instalment Cash/ Bank A/C.....Dr.			

To Hire Purchaser A/C
On Transfer Of Balance Of Hire Sales Account To Trading Account
Hire Sales A/C.....Dr. To Trading A/C
On Transfer Of Interest To Profit And Loss A/C
Interest A/C.....Dr. To Profit And Loss A/C

POSTING IN LEDGER ACCOUNTS

The ledger Accounts opened are:

- Hire Purchaser A/c
- Hire Sales A/c
- Interest A/c

INSTALMENT SYSTEM

MEANING

An instalment system is a credit sale system in which payments are made in instalments over a period of time. In this system, the buyer gets the possession of the goods as well as the ownership of the goods right at the time of signing the agreement.

During the course of paying the instalment, the vendor cannot responses to the goods. In that case, the vendor can sue the buyer only for the recovery of dues.

FEATURES OF INSTALMENT SYSTEM

1. Instalment purchase system is just like an outright credit sale of goods.
2. The buyer makes the payment in different instalment over a periods of time as agrees upon in the agreement.
3. Under instalment system, the buyer gets the immediate possession as well as the ownership of the goods.
4. The seller cannot claim the good back if the buyer made default in the payment of instalment.
5. In case of default in the payment of instalment, the total amount of instalments already paid by the buyer cannot be forfeited.

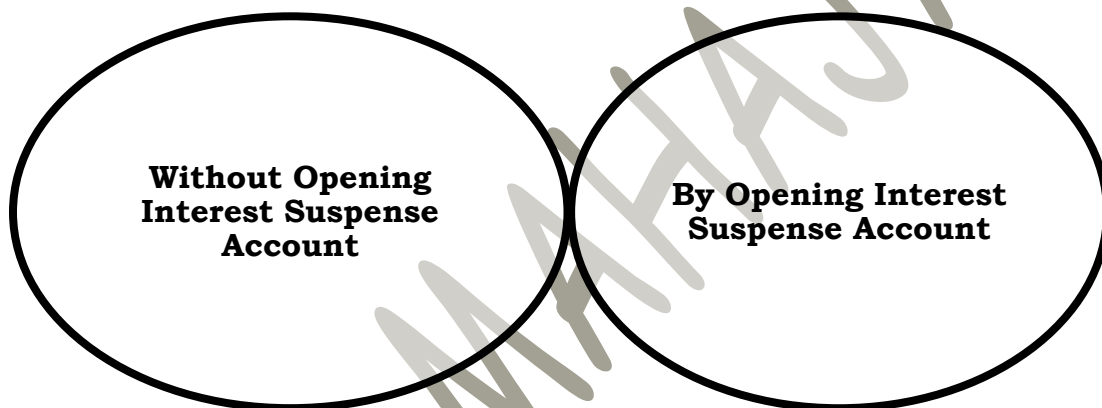
6. Under this system, the buyer can sell or mortgage the goods as the ownership is with the buyer.
7. Risk of the goods/ assets are to borne by the buyer just after signing the agreement.
8. The buyer of the goods under this system has no right to return the goods to the seller.

ACCOUNTING TREATMENT

The accounting treatment in the books of the buyer and seller is as follows:

IN THE BOOKS OF THE BUYER

There are two methods of recording transactions:



❖ WITHOUT OPENING INTEREST SUSPENSE ACCOUNT

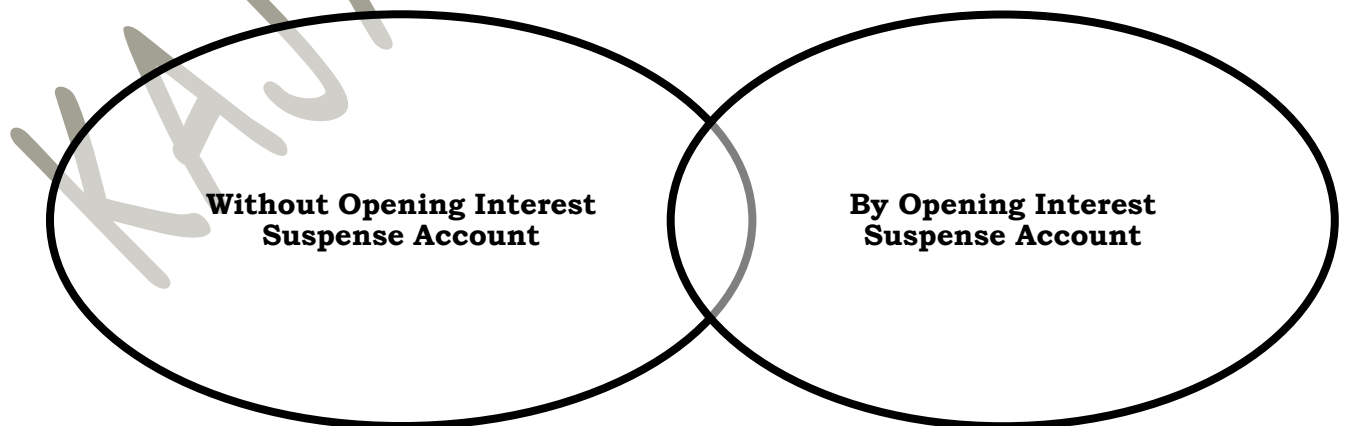
DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	For Purchasing Assets			
	Asset A/C.....Dr.			
	To Vendor A/C			
	For Payment Of Cash Down Value			
	Vendor A/C.....Dr.			
	To Bank A/C			
	For Payment Of Instalment			
	Vendor A/C.....Dr.			
	To Bank A/C			
	For Depreciation Charges			
	Depreciation A/C.....Dr.			
	To Asset A/C			
	For Transferring Interest To Profit And Loss Account			
	Profit And Loss Account.....Dr.			
	To Interest A/C			

❖ **BY OPENING INTEREST SUSPENSE ACCOUNT**

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
For Purchasing Assets				
	Asset A/C.....		Dr.	
	Interest Suspense A/C.....		Dr.	
	To Vendor A/C			
For Payment Of Cash Down Value				
	Vendor A/C.....		Dr.	
	To Bank A/C			
For Interest Due				
	Interest A/C.....		Dr.	
	To Interest Suspense A/C			
For Payment Of Instalment				
	Vendor A/C.....		Dr.	
	To Bank A/C			
For Depreciation Charges				
	Depreciation A/C.....		Dr.	
	To Asset A/C			
For Transferring Interest And Depreciation To Profit And Loss Account				
	Profit And Loss Account.....		Dr.	
	To Interest A/C			
	To Depreciation A/C			

IN THE BOOKS OF THE VENDOR

Here again entries are recorded by two methods:



❖ **WITHOUT OPENING INTEREST SUSPENSE ACCOUNT**

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	For Selling Goods			
	Buyer A/C.....Dr.			
	To Sales A/C			
	For Receiving Cash Down Value			
	Bank A/C.....Dr.			
	To Interest A/C			
	For Interest Due			
	Buyer A/C.....Dr.			
	To Interest A/C			
	For Receiving Instalment			
	Bank A/C.....Dr.			
	To Buyer A/C			
	For Transferring Interest			
	Interest A/C.....Dr.			
	To Profit And Loss A/C			
	For Transferring Sales To Trading Account			
	Sales A/C.....Dr.			
	To Trading A/C			

❖ **WITH OPENING INTEREST SUSPENSE ACCOUNT**

DATE	PARTICULARS	L.F.	DEBIT	CREDIT
	For Selling Goods			
	Buyer A/C.....Dr.			
	To Sales A/C			
	For Receiving Cash Down Value			
	Bank A/C.....Dr.			
	To Interest A/C			
	For Interest Due			
	Interest Suspense A/C.....Dr.			
	To Interest A/C			
	For Receiving Instalment			
	Bank A/C.....Dr.			
	To Buyer A/C			
	For Transferring Interest			
	Interest A/C.....Dr.			
	To Profit And Loss A/C			
	For Transferring Sales To Trading Account			
	Sales A/C.....Dr.			
	To Trading A/C			

ADVANTAGES

- This system enables the buyers to buy the goods which are beyond their reach.
- It widens the market
- Middlemen are eliminated
- As convenience and luxury goods are sold, the standard of living increases.
- Sellers can increase their sales by adopting this method.

DISADVANTAGES

- This system tempts the buyers to buy the goods beyond their reach. So this is extravagant.
- The buyer pays higher price for the article as interest charge is usually more.
- There are many legal formalities which are quite cumbersome.

DIFFERENCE BETWEEN HIRE PURCHASE SYSTEM AND INSTALMENT SYSTEM

BASIS OF DIFFERENCE		HIRE PURCHASE SYSTEM	INSTALMENT SYSTEM
NATURE OF CONTRACT	OF	It is like a contract for hire and becomes contract of sale only after the payment of last instalment.	It is a contract of sale from the very beginning.
TRANSFER OF OWNERSHIP	OF	Transfer of ownership takes place after the payment of last instalment.	Ownership is transferred in the very beginning of the contract.
RIGHT OF REPOSSESSION	OF	Vendor can repossess the asset on default in the payment of instalment	Vendor enjoys no right of repossession on default by the purchaser.
RIGHT TO FORFEIT THE INSTALMENT	TO	Vendor can forfeit the amount received in instalment on default in payment by the purchaser.	Instalment paid cannot be forfeited by vendor, he can only sue for the balance due.
RIGHT TO RETURN ASSETS	TO	Purchaser can return the goods anytime that he likes but he cannot claim back the instalments paid.	Purchaser enjoys the right to return the goods.
LIABILITY FOR REPAIR	FOR	The liability for repairs of asset until the payment of last instalments is of vendor	The liability for repairs is of purchaser as he has the ownership of the goods

RISK	Until the payment of last instalment, the risk is borne by the vendor.	As the ownership of the goods is with the buyer, so the risk is borne by the buyer.
BECOMING THE DEBTOR	Purchaser becomes a hirer and does not become a debtor.	Purchaser becomes the debtor
SALE OR MORTGAGE OF ASSET BY THE PURCHASER	Purchaser cannot sell or mortgage the asset before paying the last instalments.	Purchaser can sell or mortgage the asset from the very beginning of the contract.
BAILMENT	Purchaser is like a bailee	Purchaser is not the bailee but the owner of the asset.
LIABILITY FOR SAFETY OF ASSETS	Purchaser is liable for the safety of the assets.	Purchaser is not liable for the safety of the asset.

CONCLUSION

In essence, the hire purchase system is suitable for the buyers who need the asset for the short period or are not sure of long term needs. The cushion of returning of the asset gives them leverage.

Instalment system is useful for those who are sure of utilizing the asset till its lifetime and those who are capable of taking the responsibility of assets in terms of its repairs and maintenance and wear and tear.