FINANCIAL ACCOUNTING
(Volume - II)

J. MADEGOWDA
GIRIDHAR K.V.
INCHARA P.M. GOWDA

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Financial Accounting
(Volume – II)

As per New Syllabus for Second Semester, B.Com, Kuvempu University

J. Madegowda
Dean (Acad), Akshara Institute of Management Studies,
Opp. JNNCE, Akshara Nagara,
Channamubapura, Savalanga Road,
Shivamogga – 577 204 (Karnataka).

Giridhar K. V.
Assistant Professor of Commerce,
Sahyadri Commerce and Management College,
Shivamogga – 577 201.

Inchara P M Gowda
Researcher, Shivamogga.

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Preface to the Second Edition

It has been more than four years since the first edition of this book was placed before the readers and we are happy about the popularity of the first edition of the book, Financial Accounting (Volume – II). This, along with the revision of course curricula of B. Com programme of Kuvempu University in particular encouraged us to revise this book. In this backdrop, we have revised the book thoroughly updating all chapters - all chapters are revised thoroughly – both theoretical framework and also analyzing and solving a few more illustrations on different theoretical aspects.

We wish to place on records our sincere thanks to Sri Niraj Pandey and Sri Vijay Pandey of Himalaya Publishing House Pvt., Ltd., for publishing the second edition of the book. We also thank Sri Madhu, S of Siddhi Softtek for the neat DTP work. Finally, we request the readers to send their comments, suggestions, etc., to improve the quality of the book further.

J. Madegowda, Ph.D.,
November 2018

Giridhar K V MBA., M.Com., MA (Econ), PHDHRM., PGDMM., Ph.D.,
Inchara P M Gowda, MBA., PGDFM, PGDFIM, Ph.D.,
E-mail: giridhar.malnad@gmail.com
Preface to First Edition

Course curricula of B.Com programme of Kuvempu University have been revised on a continuous basis keeping in mind the changes in the corporate environment. Minor revisions are made every year and comprehensive revision once in three years. For this purpose, thorough discusses are held both formally and informally including careful study of course curricula of many a number of reputed universities and interactions with experts. Further, workshops are held to discuss and finalize the course curricula. During 2012, Commerce Teachers' Forum of Kuvempu University in association with the Department of Post-Graduate Studies and Research in Commerce of Kuvempu University had series of meetings and workshops, and outcome of all these exercises is the new course curricula for B.Com programme effective from 2013-14 academic year. The unique feature of the new curricula is the right blend of both theory and practicals. Further, at least one course on Accounting is made mandatory for each of six semesters of B.Com. One such course prescribed by the university for the first semester of B.Com is the Advanced Financial Accounting (Course - 203).

We are happy to place before the teachers and students the Advanced Financial Accounting (Financial Accounting, Volume – II) which is prepared keeping in mind the syllabus of Advanced Financial Accounting course prescribed for the second semester of B.Com of Kuvempu University. This volume is the outcome of our experience in teaching Accounting courses for different levels and for many years. This book is prepared systematically explaining the concepts, procedure, rationale, etc., unequivocally followed many appropriate illustrations drawn from the question papers of previous examinations. A large number of problems are solved wherein each important and difficult adjustment/ entry is explained in the form of working notes. And the presentation and analysis are simple but systematic. We are confident that this book satisfies the needs and expectations of students and teachers. For preparing this book, many a number of books have been referred and we wish to acknowledge their services. We wish to place on record our profound gratitude to Sri. Vijay Pandey of Himalaya Publishing House for his effort to bring out this book on time. We are also thankful to Sri. Madhu, S of Sri Siddhi Softtek for his systematic DTP work. Finally, we request the readers to send their suggestions, if any for further improvement of the book.

5 February 2014

J. Madegowda
K. V. Giridhar
giridhar.malnad@gmail.com
Syllabus
B.Com, Semester – II
Course – 203: Financial Accounting - II

Course Objectives: To acquaint students with different accounting practices in the company.

Pedagogy: Combination of lectures, assignments, and group discussion.

Teaching Hours per Week: 4 Maximum Marks: 100 Examination Duration: 3 hours

Course Inputs


Unit - 2: **Departmental Accounts** (8 hours): Meaning, Objectives, Basis of Allocation of Expenses, Trading and Profit and Loss Account in Columnar Form and Balance Sheet.

Unit - 3: **Branch Accounts** (14 hours): Introduction, Meaning, Objectives, Types of Branches - Dependent Branches, Features; Supply of Goods at Cost Price and Invoice Price; Branch Account in the books of Head Office, Debtors System only and Problems.


Skill Development Activities
(1) Collect Hire Purchase Agreement – analyze and prepare a note on the same
(2) List out the basis of apportionment of common expenses
(3) Collect transactions relating to any branch and prepare a Branch Account
(4) Prepare a Claim Statement with imaginary figures to submit to insurance company
(5) Collect Royalty Agreement with regard to any suitable situation – analyze and prepare a note on the same
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Annexure – I: Question Paper Pattern

Annexure – I: Model Question Paper
CHAPTER OUTLINE

(A) Introduction
(B) Hire Purchase System – Meaning and Definitions
   Features of Hire Purchase System
   Conditions of Hire Purchase Transactions
(C) Important Terms used in Hire Purchase Accounting
(D) Hire Purchase and Sales - Differences
(E) Leasing, Instalment Sales and Hire Sale/Purchase
(F) Accounting Entries for Hire Purchase/Sale in the Books of Hire Purchaser and Hire Vendor
(G) Calculation of Hire Purchase Interest
(H) Calculation of Cash Price of the Asset
(I) Calculation of Depreciation
(J) Default and Repossession – Accounting Treatment in the Books of Hire Purchaser and Hire Seller

Learning Objectives

After studying the chapter, you should be able,

- To understand the meaning of Hire Purchase transactions and also the differences between Sales and Hire Purchase/Sales.
- To learn the methods of accounting for Hire Purchase/Sale transactions in the books of both the Hire Purchaser and Hire Seller – both Journal Entries and Ledger Accounts.
- To understand the procedure of accounting for default, repossesson and sale in the books of both the Hire Purchaser and Hire Seller.
- To solve the problems on Hire Purchase/Sale with the help of the theoretical knowledge gained.
INTRODUCTION

There are many ways to purchase and sell the goods and services including the assets. The important methods are cash sales and credit sales. In the case of cash sales, the buyer purchases the goods and services by making the cash payment, and both the possession and ownership are transferred immediately from the seller to the buyer. Even in the case of credit sales, both the possession and ownership are transferred from the seller to the buyer immediately after finalization of the negotiation but the payment of the price is deferred. Besides these traditional methods of sales, one can also find today a few more methods of sale and purchase. One such method is the hire purchase system.

With this introduction, let us now discuss the meaning, definitions, features and conditions of hire purchase system/transactions.

HIRE PURCHASE SYSTEM – MEANING AND DEFINITIONS

A review of available literature on hire purchase system shows different interpretations to the term ‘hire purchase’. However, a study of these views enables to understand the meaning of the term in the right perspective. Hence, the different views on hire purchase are summarized below.

The term ‘hire purchase’ originated in the United Kingdom and this is similar to rent-to-own system in the United States of America. Hire Purchase System is a method of purchasing the goods with an arrangement to make payment (of the purchase price) in instalments over time. The purchaser is, therefore, leasing the goods and does not obtain the ownership of the goods until he pays the full amount of the contract. However, physical possession of goods is given by the seller to the buyer immediately after the finalization and signing of the agreement called, hire purchase agreement.

Hire purchase is a system for purchasing merchandise such as cars, furniture, etc., in which the buyer takes possession of the merchandise on payment of a deposit and completes the purchase by paying a series of regular instalments while the seller retains the ownership of the merchandise until the final instalment is paid.

It (i.e., hire purchase system) is also defined as a system by which a buyer pays for a thing in regular instalments while enjoying the use of it. During the repayment period, ownership (i.e., title) of the item does not pass to the buyer. Upon the full payment of the amount/loan, the title passes to the buyer.

It (i.e., hire purchase system) is a method of paying for something in which the buyer pays part of the cost immediately and then makes small regular payments until the debt is completely paid.

It (i.e., hire purchase system) is a system of purchase wherein the seller gives the physical possession of the goods to the buyer immediately after signing of the agreement on the condition that the purchase price should be paid by the buyer in a specific number of instalments and the ownership of the goods will be transferred after the receipt of all instalments.

Like the above, few more definitions, interpretations, views, etc., of hire purchase system can be found in the literature. However, all these definitions, views, etc., focus on some of the important parts of hire purchase system and these important parts are in the form of the features. A careful observation of the above definitions, etc., helps to identify the important features of hire purchase system as presented below.
FEATURES OF HIRE PURCHASE SYSTEM

Based on the definitions, interpretations, etc., presented above, the important features of hire purchase system are identified and presented below.

(1) There is an agreement between the seller (called, hire seller or hire vendor) and the buyer (called, hire purchaser or hirer) and this agreement is called, hire purchase agreement.

(2) Purchase price of the goods and services is paid in a number of agreed instalments (also called, hire). 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.

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

(4) 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.

(5) 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.

(6) 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).

(7) 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.

(8) 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).

(9) 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.

(10) 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).
Financial Accounting

CONDITIONS OF HIRE PURCHASE TRANSACTIONS

Sale and purchase of goods and services under hire purchase system are subject to certain conditions. The important conditions are (in addition to a few more presented under the head ‘Important Terms in Hire Purchase Accounting’) are identified and presented below.

1. The hire vendor delivers the goods or asset to the hire purchaser at the time of agreement i.e., after singing agreement.
2. The hire purchaser has the right to use the goods delivered to him by the hire vendor under hire purchase system.
3. The purchase price of the goods acquired under hire purchase system is paid in installments.
4. Each installment (paid by the hire purchaser) is treated as the hire charges for allowing the hirer to use the goods.
5. If all instalments are paid by the hirer in accordance with the Provisions of the agreement, the title to the goods (i.e., legal ownership) is transferred by the hire vendor to the hire purchaser. Besides, the hirer has the right to buy the goods (purchased on hire purchase system) at any time before the payment of last instalment. In this case, the hirer is expected to give at least 14 days’ notice to the hire vendor and he is eligible for the rebate calculated as shown below. That means, the hirer has to pay the hire vendor only hire purchase price or the balance thereof as reduced by the rebate as shown below.

   
   \[ \text{Rebate} = \frac{2}{3} \times \frac{\text{Number of Instalments Due}}{\text{Total Number of Instalments}} \times \text{Hire Purchase Charges} \]

6. If there is a default in the payment of any of the instalments, the hire vendor has the right to take back the goods from the possession of the hire purchaser without refunding him any amount received earlier in the form of instalments. Similarly, the hirer has the right to terminate the hire purchase agreement for valid reasons any time before the payment of last instalment.

In the light of above, let us now discuss a few important terms used in Hire Purchase Accounting System.

(C) IMPORTANT TERMS USED IN HIRE PURCHASE ACCOUNTING

A few terms which are used frequently in this chapter and the terms which are new require some description. Hence, the important terms used in Hire Purchase Accounting are analyzed and presented below.

1. **Hire Purchase Agreement** is 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/conditions of the agreement and includes an agreement under which (i) possession of goods is delivered by the owner thereof to a person on the condition that such person pays the agreed amount in periodical instalments, (ii) the property in the goods is to pass to such person on the payment of the last of such instalments, and (iii) such person has a right to terminate the agreement at any time before the property so passes [Section 2 (c) of Hire Purchase Act, 1972 rescinded by a subsequent government notification of 30 August 1973]. This agreement, to be valid, must include/specify, among others, the following.
(a) The agreement should be in writing (preferably in print) so that anybody can read the contents of the agreement without any difficulty.

(b) The agreement should be signed by both the hire vendor and hire purchaser. If there is a contract of guarantee, the agreement should be signed even by the surety. **Contract of Guarantee** in relation to hire purchase agreement means a contract whereby a person (i.e., surety) guarantees the performance of all or any of the hirer’s obligations under the hire purchase agreement.

(c) The agreement should state clearly (i) the hire purchase price, (ii) cash price of the goods, (iii) the date of commencement of the agreement, (iv) number of instalments, amount of each instalment, date upon which each instalment is payable, mode of payment, the person to whom the payment should be made, place of payment, etc., (v) the goods to which the agreement relates, etc.

(d) The agreement should also specify unequivocally the rights of both the hire vendor (including the right to cancel the agreement and to take back the possession of goods) and the hire purchaser (including the right to terminate the agreement if he wishes for valid reasons).

(2) **Hire purchase price** (i.e., purchase price) represents the total sum payable by the hirer under a hire purchase agreement by way of a deposit or initial payment (called, **down payment**) and subsequent periodical instalments. Usually, the purchase price under hire purchase system (called, **hire purchase price**) is higher than the purchase price if the same goods had been purchased on cash basis (called, **cash price**). That means, **Hire Purchase Price > Cash (Purchase) Price**. Hire purchase price is also called, **net hire purchase price**. If the hire purchase price includes the charges for (a) delivery expenses, (b) registration fee, (c) insurance premium, etc., they should be subtracted to arrive at the net hire purchase price.

(3) **Cash price** represents the price at which the goods may be purchased by the hirer for cash (i.e., on cash basis).

(4) **Interest**, therefore, represents the difference between the hire purchase price of the goods and the cash price of the same goods. Hence, **Interest = (Hire Purchase Price – Cash Price)**. However, it (i.e., either interest or hire purchase price) does not include any amount payable by the hirer as penalty or compensation or damages for breach of any of the Provisions of the agreement. It (i.e., interest) is also called, **hire purchase charges**. It (i.e., hire purchase charges), therefore, represents the difference between the hire purchase price and the cash price of the goods sold on hire purchase system. In order to restrict the hire vendor from charging exorbitant hire purchase charges, Section 7 (2) of the Hire Purchase Act, 1972 (**Limitation on Hire Purchase Charges**) imposes not more than 30% or a lower rate computed by using the following formula.

\[
\text{Statutory Charges} = \left[ \frac{\text{Cash Price Instalment} \times \text{Rate} \times \text{Time}}{100} \right]
\]

where,

(a) **Cash Price Instalment** represents the amount of cash price instalment (₹). The cash price instalment with respect to a hire purchase instalment may be determined by using the following formula.

\[
\text{Cash Price Instalment} = \left[ \frac{\text{Net Cash Price} \times \text{Hire Purchase Instalment}}{\text{Hire Purchase Price}} \right]
\]
(b) **Time** (expressed in years and fractions of a year) refers to the time that elapses between the date of agreement and the date on which the hire purchase instalment corresponding to the cash price is payable under the agreement.

(5) **Hirer or Hire Purchaser** means the person who obtains the possession of goods from the owner of the goods under hire purchase agreement.

(6) **Owner or Hire Seller or Hire Vendor** is the person who lets and delivers the possession of goods to a hirer under hire purchase agreement.

(7) **Hire** represents the sum payable periodically by the hirer to the hire vendor for the goods purchased under a hire purchase agreement.

(8) **Down Payment** is the amount paid by the hirer to the hire vendor at the time of signing the agreement or at the time of taking delivery of the goods by the hirer from hire vendor.

(9) **Instalment** represents a part of the difference between the hire purchase price and down payment (payable by the hirer to the hire vendor periodically as per agreement). After making the down payment, the remaining amount (i.e., the difference between the hire purchase price and the down payment) of the hire purchase price is paid periodically (say, yearly, half-yearly, quarterly, monthly, etc) in few parts at the end of each of the period.

\[
\text{Instalment Amount} = \frac{(\text{Hire Purchase Price} - \text{Down Payment})}{\text{Number of Instalments given}}
\]

As the hire purchase price comprises both cash price and interest, the amount of each instalment includes a part towards cash price (i.e., principal amount) and another part towards interest for a particular period (on the outstanding balance).

(10) **Repossession** refers to the hire seller taking back the possession of the asset which was sold to the hire purchaser on hire purchase system for non-payment of one or more instalments.

After discussing the meaning of a few important terms used in Hire Purchase Accounting, let us now discuss the differences between Hire Purchase and Sales.

**HIRE PURCHASE AND SALES - DIFFERENCES**

Though hire purchase also results, ultimately, in the sale of goods, it differs from sale as presented below.

### Hire Purchase and Sales – Differences

<table>
<thead>
<tr>
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<th>Sales</th>
<th>Hire Purchase</th>
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<tbody>
<tr>
<td>(1)</td>
<td>Transfer of Ownership</td>
<td>In the case of sale, ownership of goods is transferred from seller to buyer immediately after the finalization of sale transaction.</td>
<td>In the case of hire purchase, ownership of goods is transferred to the hirer on payment of last instalment by the hirer.</td>
</tr>
<tr>
<td>(2)</td>
<td>Payment</td>
<td>In the case of sale, if the payment is made in lump sum immediately on the finalization of sale transaction, it is called, <strong>cash sales</strong>. If the price is paid after sometime (after finalization of sale transaction) in future, it is called, <strong>credit sales</strong>.</td>
<td>In the case of hire purchase, payment is made in instalments (but not in single lump sum payment).</td>
</tr>
</tbody>
</table>
Hire Purchase Accounting

| (3) | Interest | Purchase price includes only cash purchase price and no element of interest is included in the purchase price. | Hire purchase price includes not only the cash purchase price but also some portion towards interest for the instalments due. |
| (4) | Non-payment | On non-payment of any sale consideration (i.e., selling price), the seller cannot take back the goods from the buyer. However, he can take legal action against the buyer. | On non-payment of any instalment, the seller can take back the goods from the hirer and repossess the goods sold under hire purchase system. |
| (5) | Termination of Contract | Once the sale is completed, neither seller nor buyer can terminate the contract of sale (unless, it is genuine for damage of goods, etc.). | Either the buyer or the seller can terminate the contract at any point of time before the payment of last instalment (of course, with valid reasons and with advance information to other party). |
| (6) | Insolvency | When the buyer becomes insolvent, the seller has to bear the risk of loss (if full payment of price is not made). | When the hirer becomes insolvent, the seller can repossess the goods and need not undergo any risk of loss. |
| (7) | Sales Tax | A sale is subject to levy of sales tax at the time of finalization of contract of sales (i.e., at the time of finalization of sale transaction). | In the case of hire purchase, sales tax is levied at the time of transfer of ownership (i.e., when the buyer pays the last instalment). |

After discussing the differences between Hire Purchase and Sales, let us now discuss (very briefly) the difference between Leasing, Instalment Sale and Hire Sale/Purchase.

**Leasing**, **Instalment Sale and Hire Sale/Purchase**

**Leasing** is a contractual arrangement wherein one person pays another for using latter’s assets. The person who uses the asset (of another party) is called, lessee and the person whose asset is used (by the lessee) is called, lessor. For using the asset, lessee makes a series of payments called, rentals or instalments to the lessor. Therefore, lessor is able to recover either major portion or entire cost of the asset plus earn some interest from the rentals received from the lessee.

Similarly, hire purchase differs from **instalment sale**. Major difference is the transfer of ownership. In the case of instalment sale, the ownership passes to the purchaser with the payment of the first instalment. And as already pointed out, in the case of hire purchase, ownership remains with the seller until the last instalment is paid and the hirer gets the ownership only after paying the last instalment. Similarly, there are a few more differences as presented below.
Hire Purchase System and Instalment Purchase System – Differences

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Basis/Variable</th>
<th>Hire Purchase System</th>
<th>Instalment Purchase System</th>
</tr>
</thead>
<tbody>
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<td>(1)</td>
<td>Nature of Transaction</td>
<td>Initially, it is similar to a contract of hire and subsequently, it transforms into sales.</td>
<td>It is an agreement of sale of goods and services from the very beginning.</td>
</tr>
<tr>
<td>(2)</td>
<td>Transfer of Ownership</td>
<td>In the case of hire purchase, ownership of goods is transferred to the hirer on payment of all instalments (to the hire vendor).</td>
<td>The title to the goods transfers at the time of signing the agreement.</td>
</tr>
<tr>
<td>(3)</td>
<td>Repossession of Goods</td>
<td>On non-payment of any instalment, the seller can take back the goods sold under hire purchase system.</td>
<td>On non-payment of any instalment or all instalments, the seller cannot take back the goods from the buyer. Of course, the seller can take legal action against the buyer.</td>
</tr>
<tr>
<td>(4)</td>
<td>Return of Goods</td>
<td>With advance intimation, the hire purchaser may return the goods without obligation for further payment (except for instalment overdue).</td>
<td>Goods cannot be returned (except for seller’s default).</td>
</tr>
<tr>
<td>(5)</td>
<td>Risk</td>
<td>Risk is on the hire seller till the payment of last instalment. On the payment of all instalments, risk transfers to the hire purchaser.</td>
<td>Risk is not on the seller of goods and services.</td>
</tr>
</tbody>
</table>

After analyzing the a few aspects of Hire Purchase/Sale transactions, let us now discuss one of the core aspects viz., accounting for hire purchase transactions.

(F) ACCOUNTING ENTRIES FOR HIRE PURCHASE TRANSACTIONS IN THE BOOKS OF HIRE PURCHASER AND HIRE SELLER

Different hire purchase transactions are recorded in the books of both the hire vendor and hire purchaser. Further, one or more method/s is/are available for recording the hire purchase transactions in the books of each of the two parties. Summary is presented below (Figure - 1.1) followed by a detailed analysis.

![Figure - 1.1: Methods of Accounting for Hire Purchase Transactions]
I. ACCOUNTING ENTRIES IN THE BOOKS OF HIRE PURCHASER

As already pointed out, there are three methods to account for different hire purchase transactions in the books of hirer or hire purchaser. They are (A) Asset Accrual Method, (B) Credit Purchase with Interest Method and (C) Interest Suspense Account Method.

I (A) Asset Accrual Method

This method is also called, Proportional Capitalization Method, Gradual Capitalization Method or Actual Cash Price Paid Method. As the name itself indicates, this method assumes that the asset accrues to the hirer gradually to the extent of payment made towards the cash price of the asset acquired on hire purchase basis. Therefore, in the books of the hirer or hire purchaser, Asset Account is debited to the extent of only the instalment amount paid towards the cash price of the asset. In other words, Asset Account is debited with the instalment towards cash price of the asset every time instalment is paid. The salient features of this method are as follows.

1. As both the amount due and the interest due thereon (i.e., on the amount due) are zero at the time of signing the hire purchase agreement (i.e., at the time of delivery of the asset), down payment, if any, made is only towards the cash price of the asset (but not towards interest also). Therefore, the amount of down payment is debited to Asset A/c crediting Cash or Bank A/c.

2. Each instalment payable is towards both the cash price of the asset (called, instalment cash price) and the interest accrued on the amount outstanding (from the date of immediately preceding instalment paid and the date of the current instalment payment). When the instalment is due for payment, a portion of instalment towards cash price is debited to Assets A/c and the remaining portion pertaining to interest is debited to Interest A/c crediting Hire Seller’s A/c. When the payment is made, Hire Seller’s A/c is debited and Cash or Bank A/c is credited.

3. Since the hire purchaser starts using the asset acquired under hire purchase system, the asset is subject to wear and tear. Hence, depreciation is provided in the books of the hirer, usually, at the end of each accounting year. Therefore, Depreciation A/c is debited and Asset A/c is credited.

4. As both the amounts of interest paid (as a part of instalment amount) and depreciation charged constitute the expenses (i.e., items of Nominal Accounts), both are transferred to Profit and Loss A/c at the end of each accounting year by debiting Profit and Loss A/c (for the aggregate of interest and depreciation) crediting Interest A/c (for the amount of interest) and Depreciation A/c (for the amount of depreciation).

With this introduction about the nature of Asset Accrual Method, the journal entries for different hire purchase transactions in the books of hire purchaser are presented below.
10

Financial Accounting

(1) For recording down payment made at the time of signing the hire purchase agreement, the following entry is passed. It may be noted here that if no down payment is made, the following entry is not required.

\[
\begin{align*}
\text{Asset A/c Dr.} & \quad \text{₹} \\
\text{To Bank/Cash A/c} & \quad \text{₹}
\end{align*}
\]

(Being the amount of down payment made)

Alternatively, the following two entries may be passed:

\[
\begin{align*}
\text{Asset A/c Dr.} & \quad \text{₹} \\
\text{To Hire Seller’s A/c} & \quad \text{₹}
\end{align*}
\]

(Being the down payment due)

\[
\begin{align*}
\text{Hire Seller’s A/c Dr.} & \quad \text{₹} \\
\text{To Bank/Cash A/c} & \quad \text{₹}
\end{align*}
\]

(Being the payment of down payment)

The number of journal entries for the subsequent instalment payment/s (subsequent to down payment or signing of hire purchase agreement if no down payment is made) depends upon the whether the instalments are paid annually or more frequently (such as half-yearly, quarterly, monthly, etc). Therefore, both the cases are analyzed separately below.

**When the instalments are paid annually**, the following four entries should be passed – one each for recording (i) instalment amount due, (ii) payment of instalment amount, (iii) for charging depreciation on the asset acquired on hire purchase basis, and (iv) for transferring the amounts of interest and depreciation to the Profit and Loss A/c as presented below.

(2) For recording the amount of instalment due to the hire vendor, the following entry is passed.

\[
\begin{align*}
\text{Asset A/c Dr.} & \quad \text{₹} \\
\text{Interest A/c Dr.} & \quad \text{₹} \\
\text{To Hire Seller’s A/c} & \quad \text{₹}
\end{align*}
\]

(Being the instalment due)

(3) For recording the payment of instalment amount to the hire vendor, the following entry is passed.

\[
\begin{align*}
\text{Hire Seller’s A/c Dr.} & \quad \text{₹} \\
\text{To Bank/Cash A/c} & \quad \text{₹}
\end{align*}
\]

(Being instalment amount paid to hire seller)

(4) For recording the depreciation on the asset, the following entry is passed at the end of the year.

\[
\begin{align*}
\text{Depreciation A/c Dr.} & \quad \text{₹} \\
\text{To Asset A/c} & \quad \text{₹}
\end{align*}
\]

(Being the amount of depreciation charge)

(5) For transferring the amounts of interest and depreciation to the Profit and Loss A/c, the following entry is passed at the end of the year.
Hire Purchase Accounting

Profit and Loss A/c
   To Interest A/c Dr. ₹
   To Depreciation A/c Dr. ₹
   (Being the amounts of interest and depreciation transferred to Profit and Loss A/c)

If the instalments are paid more frequently such as half-yearly, quarterly, etc., then two sets of entries are passed – one set of entries for each of all instalments (for the accounting year) except the last instalment, and the second set of entries for the last instalment (of the accounting year). The following two entries are passed at the end of each of the instalments (except the last instalment for the accounting year) in the year (entries for the instalment due and paying the instalment. These two entries are same as that for annual instalments).

(6) For recording the amount of instalment due to the hire vendor, the following entry is passed.
   Asset A/c Dr. ₹
   Interest A/c Dr. ₹
   To Hire Seller’s A/c ₹
   (Being the amount of instalment due – towards both the cash price and interest)

(7) For recording the payment of instalment amount to the hire vendor, the following entry is passed.
   Hire Seller’s A/c Dr. ₹
   To Bank/Cash A/c ₹
   (Being the amount of instalment paid)

Further, all the four entries (as in the case of annual instalment) are passed at the end of the accounting year (i.e., with the payment of last instalment of the accounting year) as presented below.

(8) For recording the amount of last instalment of the accounting year due to the hire vendor, the following entry is passed.
   Asset A/c Dr. ₹
   Interest A/c Dr. ₹
   To Hire Seller’s A/c ₹
   (Being the instalment due – towards both the cash price and interest)

(9) For recording the payment of last instalment amount of the accounting year to the hire vendor, the following entry is passed.
   Hire Seller’s A/c Dr. ₹
   To Bank/Cash A/c ₹
   (Being the amount of instalment paid)

(10) For recording the depreciation on the asset for the whole accounting year, the following entry is passed at the end of the year.
    Depreciation A/c Dr. ₹
    To Asset A/c ₹
    (Being the amount of depreciation charge)
(11) For transferring the amounts of interest and depreciation (for the whole year) to the Profit and Loss A/c, the following entry is passed at the end of the year.

Profit and Loss A/c Dr. ₹

To Interest A/c ₹

To Depreciation A/c ₹

(Being the amounts of interest and depreciation transferred to Profit and Loss A/c)

I (B) **Credit Purchase with Interest Method**

This method considers the assets acquired on hire purchase basis as acquired on outright credit basis with interest. Therefore, on the date of signing the hire purchase agreement, the asset acquired is debited to Asset A/c with cash price and Hire Seller’s A/c is credited in the books of the hire purchaser. The important features of this method are as follows.

1. As the asset acquired (on hire purchase basis) is considered as acquired on outright credit basis, cash purchase price (of the assets) is debited to the Asset A/c crediting Hire Seller’s A/c on the date of signing the hire purchase agreement.

2. Down payment made, if any, at the time of signing hire purchase agreement is considered as a payment made to the hire vendor on account. Hence, an entry debiting Hire Seller’s A/c and crediting Bank/Cash A/c is passed.

3. Interest on the outstanding balance of the cash price of the asset acquired is brought into book, at the end of each instalment, by debiting Interest A/c and crediting Hire Seller’s A/c.

4. Each instalment paid is treated as a payment made to the hire vendor on account by debiting Hire Seller’s A/c and crediting Bank/Cash A/c.

5. Depreciation computed on the basis of cash price of asset is charged annually (accounting year) by debiting Depreciation A/c and crediting the Asset A/c.

6. At the end of each accounting year, both the interest and depreciation are transferred to the Profit and Loss A/c by debiting Profit and Loss A/c, and crediting Interest A/c and Depreciation A/c.

In the light of the above introduction, an analysis of entries for hire purchase transactions under Credit Purchase with Interest Method is made below.

1. For recording the asset acquired on hire purchase basis, the following entry is passed for the cash price of the asset so acquired and this entry is passed on the date of signing the hire purchase agreement.

   Asset A/c Dr. ₹

   To Hire Seller’s A/c ₹

   (Being the cash price of the asset acquired on hire purchase basis)

2. For recording the down payment made, if any, the following entry is passed. It may be noted here that the down payment is made to hire seller on account.

   Hire Seller’s A/c Dr. ₹

   To Bank/Cash A/c ₹

   (Being the amount of down payment made)
For the purpose of recording the instalment amount paid, the procedure differs (as under Asset Accrual Method) from annual instalments to half-yearly, quarterly, etc. In the case of **annual instalments**, the following four entries are passed at the end of each of the annual instalments.

(3) For recording the amount of instalment interest due to the hire vendor, the following entry is passed.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest A/c</td>
<td>To Hire Seller’s A/c</td>
</tr>
<tr>
<td>(Being the amount of instalment interest due)</td>
<td></td>
</tr>
</tbody>
</table>

(4) For recording the payment of instalment amount to the hire vendor, the following entry is passed.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hire Seller’s A/c</td>
<td>To Bank/Cash A/c</td>
</tr>
<tr>
<td>(Being the amount of instalment paid)</td>
<td></td>
</tr>
</tbody>
</table>

(5) For recording the depreciation on the asset, the following entry is passed at the end of the year.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation A/c</td>
<td>To Asset A/c</td>
</tr>
<tr>
<td>(Being the amount of depreciation charge)</td>
<td></td>
</tr>
</tbody>
</table>

(6) For transferring the amounts of interest and depreciation to the Profit and Loss A/c, the following entry is passed at the end of the accounting year.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and Loss A/c</td>
<td>To Interest A/c</td>
</tr>
<tr>
<td>To Depreciation A/c</td>
<td></td>
</tr>
<tr>
<td>(Being the amounts of interest and depreciation transferred to Profit and Loss A/c)</td>
<td></td>
</tr>
</tbody>
</table>

On the other hand, if the instalments are paid more frequently such as **half-yearly, quarterly, etc.**, then, the following two entries (for instalment interest amount due and for payment of instalment amount) are passed at the end of each of the instalments (except the last instalment for the accounting year).

(7) For recording the amount of instalment interest due to the hire vendor, the following entry is passed.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest A/c</td>
<td>To Hire Seller’s A/c</td>
</tr>
<tr>
<td>(Being the amount of instalment interest due)</td>
<td></td>
</tr>
</tbody>
</table>

(8) For recording the payment of instalment amount to the hire vendor, the following entry is passed.

<table>
<thead>
<tr>
<th>Debit Accounts</th>
<th>Credit Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hire Seller’s A/c</td>
<td>To Bank/Cash A/c</td>
</tr>
<tr>
<td>(Being the amount of instalment paid)</td>
<td></td>
</tr>
</tbody>
</table>
Besides, at the end of the last instalment for the accounting year, all the four entries (as required for annual instalment) are passed as reproduced below.

(9) For recording the amount of last instalment interest due (for the accounting year) to the hire vendor, the following entry is passed.

\[
\begin{align*}
\text{Interest A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Hire Seller’s A/c} & \quad \text{Dr.} \quad ₹ \\
\text{(Being the amount of instalment interest due)}
\end{align*}
\]

(10) For recording the payment of last instalment amount (for the accounting year) to the hire vendor, the following entry is passed.

\[
\begin{align*}
\text{Hire Seller’s A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Bank/Cash A/c} & \quad \text{Dr.} \quad ₹ \\
\text{(Being the amount of instalment paid)}
\end{align*}
\]

(11) For recording the depreciation on the asset for the whole accounting year, the following entry is passed at the end of the year.

\[
\begin{align*}
\text{Depreciation A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Asset A/c} & \quad \text{Dr.} \quad ₹ \\
\text{(Being the amount of depreciation charge)}
\end{align*}
\]

(12) For transferring the amounts of interest and depreciation (for the entire accounting year) to the Profit and Loss A/c, the following entry is passed at the end of the year.

\[
\begin{align*}
\text{Profit and Loss A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Interest A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Depreciation A/c} & \quad \text{Dr.} \quad ₹ \\
\text{(Being the amounts of interest and depreciation transferred to Profit and Loss A/c)}
\end{align*}
\]

I (C) Interest Suspense Account Method

Under this method, total hire purchase price is divided into cash purchase price and interest component. Asset A/c is debited with cash price. Similarly, Interest Suspense A/c is debited with the total interest (i.e., the difference between hire purchase price and cash price). And the total hire purchase price is credited to Hire Seller’s A/c. Further, the amount of interest included in each of the instalments is credited to Interest Suspense A/c debiting Interest A/c as presented below.

(1) For recording the purchase of asset on hire purchase basis, the following entry is passed. This entry is passed at the time of signing the hire purchase agreement and taking delivery of the asset by the hirer from the hire vendor.

\[
\begin{align*}
\text{Asset A/c} & \quad \text{Dr.} \quad ₹ \\
\text{Interest Suspense A/c} & \quad \text{Dr.} \quad ₹ \\
\text{To Hire Seller’s A/c} & \quad \text{Dr.} \quad ₹ \\
\text{(Being the amount of hire purchase price of the asset comprising both the cash price and interest)}
\end{align*}
\]
For recording down-payment made at the time of signing hire purchase agreement and taking delivery of the asset, the following entry is passed.

Hire Seller’s A/c Dr. ₹
To Bank/Cash A/c ₹
(Being the amount of down payment made)

For recording the amount of interest on outstanding instalments due, the following entry is passed at the end of each year.

Interest A/c Dr. ₹
To Interest Suspense A/c ₹
(Being the amount of interest due)

For recording the payment of each instalment, the following entry is passed.

Hire Seller’s A/c Dr. ₹
To Bank/Cash A/c ₹
(Being the amount of instalment paid)

For recording the depreciation on the asset for the whole accounting year, the following entry is passed at the end of each year.

Depreciation A/c Dr. ₹
To Asset A/c ₹
(Being the amount of depreciation charge)

For transferring the amounts of interest and depreciation to the Profit and Loss A/c, the following entry is passed at the end of each year.

Profit and Loss A/c Dr. ₹
To Interest A/c ₹
To Depreciation A/c ₹
(Being the amounts of interest and depreciation transferred to Profit and Loss A/c)

Though any of the above three methods can be used to record the hire purchase transactions in the books of the hire purchaser, the first method (viz., Asset Accrual Method) is preferred for usual Hire purchase problems in the absence of specific information to use a particular method. The second method (viz., Credit Purchase with Interest Method) is preferred for hire purchase problems with default in the payment of instalment/s and the repossession. Though the third method (viz., Interest Suspense Account Method) can also be used for hire purchase transactions, this method is normally used for purchases on instalment system.

Illustration – 1.1: On 1 January 2016, Scooter Ltd., sold a scooter on hire purchase basis for ₹ 1,00,000 to be paid as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>On signing the agreement</td>
<td>12,000</td>
</tr>
<tr>
<td>At the end of first year</td>
<td>17,000</td>
</tr>
<tr>
<td>At the end of second year</td>
<td>16,000</td>
</tr>
<tr>
<td>At the end of the third year</td>
<td>55,000</td>
</tr>
</tbody>
</table>
Interest included in ₹ 1,00,000 being charged on cash value at 10% per annum. You are required to,

1. Ascertain cash value of the scooter.
2. Pass journal entries in the books of the hire purchaser.

[B.Com., Kuvempu University, November 2011]

Solution: It is known that, Instalment Amount = (Instalment Cash Price + Instalment Interest). And the instalment interest is charged on the unpaid cash price balance at the beginning of instalment. Therefore,

1. If instalment cash price is ₹ 100, then the instalment interest works out to ₹ 10 (as the rate of interest is 10%).
2. Instalment Amount = (Instalment Cash Price, ₹ 100 + Instalment Interest, ₹ 10) = ₹ 110. Therefore,
3. Instalment Interest to Instalment Amount = \[ \frac{\text{Rate of Interest, } 10}{100 + \text{Rate of Interest, } 10} = \frac{10}{110} \]

It may be noted here that instalment interest is computed on the unpaid cash price at the beginning of the instalment. And reverse method (i.e., starting from last instalment) is used to ascertain the cash price or cash value of the scooter. In this background, cash price of scooter is computed and presented below.

### Calculation of Instalment Interest and Instalment Cash Price

<table>
<thead>
<tr>
<th>Instalment Number</th>
<th>Instalment Amount</th>
<th>Instalment Balance</th>
<th>(Instalment) Interest</th>
<th>(Instalment) Cash Price (= Instalment Amount – Instalment Interest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>III</td>
<td>55,000</td>
<td>55,000</td>
<td>₹ 55,000 × (10 ÷ 110) = 5,000</td>
<td>₹ 55,000 – ₹ 5,000 = 50,000</td>
</tr>
<tr>
<td>II</td>
<td>16,000</td>
<td>66,000</td>
<td>₹ 66,000 × (10 ÷ 110) = 6,000</td>
<td>₹ 16,000 – ₹ 6,000 = 10,000</td>
</tr>
<tr>
<td>I</td>
<td>17,000</td>
<td>77,000</td>
<td>₹ 77,000 × (10 ÷ 110) = 7,000</td>
<td>₹ 17,000 – ₹ 7,000 = 10,000</td>
</tr>
<tr>
<td>DP</td>
<td>12,000</td>
<td>-</td>
<td>-</td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td>1,00,000</td>
<td>18,000</td>
<td>82,000</td>
<td></td>
</tr>
</tbody>
</table>

From the above, it is obvious that the cash price or cash value of scooter = ₹ 82,000 and total interest = ₹ 18,000. Hence, total hire purchase price = ₹ 1,00,000.

In the Books of Hire Purchaser (Credit Purchase with Interest Method)

### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>L</th>
<th>F</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-01-2016</td>
<td>Scooter’s A/c</td>
<td>Dr.</td>
<td></td>
<td>82,000</td>
</tr>
<tr>
<td></td>
<td>To Scooter Ltd’s A/c</td>
<td></td>
<td></td>
<td>82,000</td>
</tr>
<tr>
<td></td>
<td>(Being the cash price of scooter purchased on hire</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>purchase basis)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-01-2016</td>
<td>Scooter Ltd’s A/c</td>
<td>Dr.</td>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td>(Being down payment made)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Hire Purchase Accounting

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit (Dr.)</th>
<th>Credit (Cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-12-2016</td>
<td>Interest A/c Dr. To Scooter Ltd’s A/c (Dr. 7,000)</td>
<td>Dr. 7,000</td>
<td>Cr. 7,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Scooter Ltd’s A/c Dr. To Bank A/c (Dr. 17,000)</td>
<td>Dr. 17,000</td>
<td>Cr. 17,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Profit and Loss A/c Dr. To Interest A/c (Dr. 7,000)</td>
<td>Dr. 7,000</td>
<td>Cr. 7,000</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Interest A/c Dr. To Scooter Ltd’s A/c (Dr. 6,000)</td>
<td>Dr. 6,000</td>
<td>Cr. 6,000</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Scooter Ltd’s A/c Dr. To Bank A/c (Dr. 16,000)</td>
<td>Dr. 16,000</td>
<td>Cr. 16,000</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Profit and Loss A/c Dr. To Interest A/c (Dr. 6,000)</td>
<td>Dr. 6,000</td>
<td>Cr. 6,000</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Interest A/c Dr. To Scooter Ltd’s A/c (Dr. 5,000)</td>
<td>Dr. 5,000</td>
<td>Cr. 5,000</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Scooter Ltd’s A/c Dr. To Bank A/c (Dr. 55,000)</td>
<td>Dr. 55,000</td>
<td>Cr. 55,000</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Profit and Loss A/c Dr. To Interest A/c (Dr. 5,000)</td>
<td>Dr. 5,000</td>
<td>Cr. 5,000</td>
</tr>
</tbody>
</table>

**Working Notes:**

1. Unpaid Balance at the beginning of second instalment = (₹ 50,000 Unpaid balance of cash price at the beginning of last instalment + ₹ 16,000 Second instalment).
2. Unpaid Balance at the beginning of first instalment = (₹ 50,000 cash price of last instalment + ₹ 10,000 cash price of second instalment + ₹ 17,000 First instalment).
3. Down payment. Interest is not calculated on down payment as it (i.e., interest) is calculated only on outstanding amount after making the down payment.
4. As there is no information about depreciation, necessary (depreciation-related) entries are not passed.

**II. Accounting Entries in the Books of Hire Seller or Vendor – Credit Sale with Interest Method**
In the books of hire seller or vendor, hire sale (purchase) transactions are normally recorded under Credit Sale with Interest Method. The entries are, therefore, just reverse of the entries in books of hirer or hire purchaser under Credit Purchase with Interest Method. However, the following are the journal entries for the hire sale transactions under Credit Sale with Interest Method in the books of the hire seller or hire vendor.

1. Hire sale is considered, on the date of signing the agreement, as outright credit sale. Therefore, Hire Purchaser’s A/c is debited with the entire cash price of the goods sold and the Hire Sales A/c is credited with the same cash price of the goods sold. Of course, at the end of the first accounting year, Hire Sales A/c is closed by transferring to Trading A/c (i.e., by debiting Hire Sales A/c and crediting Trading A/c with cash price). However, the following entry is passed to record the outright credit sale of goods.

Hire Purchaser’s A/c  Dr.  ₹
To Hire Sales A/c  ₹
(Being the cash price of the goods sold)

2. For recording down payment received at the time of singing the agreement (and delivering the goods), the following entry is passed. It may be noted here that if no down payment is received, the following entry is not required.

Bank/Cash A/c  Dr.  ₹
To Hire Purchaser’s A/c  ₹
(Being the amount of down payment received)

As far as the entries for the instalments are concerned, they differ from annual instalments to half-yearly, quarterly, etc., instalments. In the case of annual instalments, three entries, as presented below, are passed at the end of each of the annual instalments. It may be noted here that there is no entry for depreciation-related event in the books of the hire seller.

3. Interest due from hirer on the amount of outstanding balance is brought into account, at the end of each instalment, by debiting Hire Purchaser’s A/c and crediting Interest A/c with the amount of instalment interest due. Therefore, the following entry is passed at the end of each year for recording the amount of instalment interest due from hirer or hire purchaser.

Hire Purchaser’s A/c  Dr.  ₹
To Interest A/c  ₹
(Being the amount of instalment interest due from hirer)

4. Each instalment received is considered as receipt of cash from the hire purchaser on account. Therefore, Bank/Cash A/c is debited and Hire Purchaser’s A/c is credited. That means, for recording the receipt of each instalment from the hire purchaser, the following entry is passed.

Bank/Cash A/c  Dr.  ₹
To Hire Purchaser’s A/c  ₹
(Being the amount of instalment received)

5. At the end of each accounting period, interest (an item of income i.e., an item of Notional Account) is transferred to the Profit and Loss A/c by debiting Interest A/c and crediting Profit and Loss A/c. In other words, for recording the transfer of interest income, the following entry is passed at the end of each year in the books of the hire seller.
Interest A/c
To Profit and Loss A/c
(Being the amount of instalment interest income transferred to Profit and Loss A/c)

On the other hand, if the instalments are received more frequently (say, **half-yearly**, quarterly, etc), then at the end of each instalment (except the last instalment for the accounting year), the following two entries are passed.

(6) For recording the amount of instalment interest due from the hire purchaser, the following entry is passed.

<table>
<thead>
<tr>
<th>Hire Purchaser’s A/c</th>
<th>Dr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Interest A/c</td>
<td>₹</td>
</tr>
</tbody>
</table>

(Being the amount of instalment interest due from hirer)

(7) For recording the receipt of instalment amount from the hire purchaser, the following entry is passed.

<table>
<thead>
<tr>
<th>Bank/Cash A/c</th>
<th>Dr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Hire Purchaser’s A/c</td>
<td>₹</td>
</tr>
</tbody>
</table>

(Being the amount of instalment received)

Besides, at the end of the last instalment for the accounting year, all the three entries (as required for annual instalment) are passed as reproduced below.

(8) For recording the amount of instalment interest due from the hirer or hire purchaser, the following entry is passed at the end of each year.

<table>
<thead>
<tr>
<th>Hire Purchaser’s A/c</th>
<th>Dr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Interest A/c</td>
<td>₹</td>
</tr>
</tbody>
</table>

(Being the amount of instalment interest due from hirer)

(9) For recording the receipt of instalment amount from the hire purchaser, the following entry is passed.

<table>
<thead>
<tr>
<th>Bank/Cash A/c</th>
<th>Dr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Hire Purchaser’s A/c</td>
<td>₹</td>
</tr>
</tbody>
</table>

(Being the amount of instalment received)

(10) At the end of each accounting year, interest is transferred to Profit and Loss A/c by passing the following entry in the books of the hire seller.

<table>
<thead>
<tr>
<th>Interest A/c</th>
<th>Dr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Profit and Loss A/c</td>
<td>₹</td>
</tr>
</tbody>
</table>

(Being the amount of instalment interest income transferred to Profit and Loss A/c)

**Illustration – 1.2:** Malnad Coffee Works Ltd., bought coffee drying machine costing ₹ 6,56,000 from Xavier Ltd on 1 January 2016 on hire purchase basis. ₹ 2,00,000 was paid on signing the contract and the balance in three annual instalments of ₹ 2,00,000 (each) by the end of December every year. Interest was charged at 15% per annum. Life of the machine was expected to be four years.
You are required to pass the journal entries and necessary ledger accounts in the books of (a) Malnad Coffee Works Ltd., and (b) Xavier Ltd.

Solution:

### Instalment Interest and Instalment Cash Price

<table>
<thead>
<tr>
<th>Instalment Number</th>
<th>Installment Amount</th>
<th>Unpaid Cash Price balance at the beginning of the instalment (year)</th>
<th>Interest</th>
<th>Cash Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>DP</td>
<td>2,00,000</td>
<td>0</td>
<td>0</td>
<td>2,00,000</td>
</tr>
<tr>
<td>I</td>
<td>2,00,000</td>
<td>₹ 4,56,000</td>
<td>68,400</td>
<td>1,31,600</td>
</tr>
<tr>
<td>II</td>
<td>2,00,000</td>
<td>₹ 3,24,400</td>
<td>48,660</td>
<td>1,51,340</td>
</tr>
<tr>
<td>III</td>
<td>2,00,000</td>
<td>₹ 1,73,060</td>
<td>26,940</td>
<td>1,73,060</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,00,000</strong></td>
<td>1,44,000</td>
<td><strong>6,56,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

In the Books of Malnad Coffee Works Ltd., (Credit Purchase with Interest Method)

### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>L</th>
<th>F</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-01-2016</td>
<td>Machinery A/c&lt;br&gt;To Xavier Ltd’s A/c&lt;br&gt;(Being the cash price of machine purchased on hire purchase basis)</td>
<td>Dr</td>
<td></td>
<td>6,56,000</td>
<td>6,56,000</td>
</tr>
<tr>
<td>01-01-2016</td>
<td>Xavier Ltd’s A/c&lt;br&gt;To Bank A/c&lt;br&gt;(Being down payment made)</td>
<td>Dr</td>
<td></td>
<td>2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Interest A/c&lt;br&gt;To Xavier Ltd’s A/c&lt;br&gt;(Being interest due on unpaid cash price balance)</td>
<td>Dr</td>
<td></td>
<td>68,400</td>
<td>68,400</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Xavier Ltd’s A/c&lt;br&gt;To Bank A/c&lt;br&gt;(Being the payment of first instalment)</td>
<td>Dr</td>
<td></td>
<td>2,00,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Depreciation A/c&lt;br&gt;To Machinery A/c&lt;br&gt;(Being the depreciation for the year)</td>
<td>Dr</td>
<td></td>
<td>1,64,000</td>
<td>1,64,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Profit and Loss A/c&lt;br&gt;To Interest A/c&lt;br&gt;To Depreciation A/c&lt;br&gt;(Being interest and depreciation transferred to Profit and Loss A/c)</td>
<td>Dr</td>
<td></td>
<td>2,32,400</td>
<td>68,400</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Interest A/c&lt;br&gt;To Xavier Ltd’s A/c&lt;br&gt;(Being interest due on unpaid cash price amount)</td>
<td>Dr</td>
<td></td>
<td>48,660</td>
<td>48,660</td>
</tr>
</tbody>
</table>
### Hire Purchase Accounting

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2016</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Xavier Ltd’s A/c Dr.</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the payment of second instalment)</td>
<td></td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Depreciation A/c Dr.</td>
<td>1,64,000</td>
</tr>
<tr>
<td></td>
<td>To Machinery A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being annual depreciation charged)</td>
<td></td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Profit and Loss A/c Dr.</td>
<td>2,12,660</td>
</tr>
<tr>
<td></td>
<td>To Interest A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Depreciation A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being interest and depreciation transferred to Profit and Loss A/c)</td>
<td></td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Interest A/c Dr.</td>
<td>26,940</td>
</tr>
<tr>
<td></td>
<td>To Xavier Ltd’s A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the third and last instalment interest due)</td>
<td></td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Xavier Ltd’s A/c Dr.</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being the payment of third and last instalment)</td>
<td></td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Depreciation A/c Dr.</td>
<td>1,64,000</td>
</tr>
<tr>
<td></td>
<td>To Machinery A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being annual depreciation charged)</td>
<td></td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Profit and Loss A/c Dr.</td>
<td>1,90,940</td>
</tr>
<tr>
<td></td>
<td>To Interest A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Depreciation A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being interest and depreciation transferred to Profit and Loss A/c)</td>
<td></td>
</tr>
</tbody>
</table>

**Alternative Methodology for presenting Journal Entries:** As the journal entries are same for each instalment and/or year, journal entries may be passed in columnar basis as presented below.

In the Books of Malnad Coffee Works Ltd (Credit Purchase with Interest Method)

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2016</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>Jan 1</td>
<td>Machinery A/c Dr.</td>
<td>6,56,000</td>
</tr>
<tr>
<td></td>
<td>To Xavier Ltd’s A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(being cash price of machine acquired on hire purchase basis)</td>
<td></td>
</tr>
<tr>
<td>Jan 1</td>
<td>Xavier Ltd’s A/c Dr.</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being down payment made)</td>
<td></td>
</tr>
<tr>
<td>Dec 31</td>
<td>Interest A/c Dr.</td>
<td>68,400</td>
</tr>
</tbody>
</table>
To Xavier Ltd’s A/c
(Being instalment interest due)

Dec 31

Xavier Ltd’s A/c Dr. 2,00,000
To Bank A/c 2,00,000
(Being payment of instalment with interest)

Dec 31
Depreciation A/c Dr. 1,64,000
Machinery A/c 1,64,000
(Being the depreciation charge)

Dec 31
Profit and Loss A/c Dr. 2,32,400
To Interest A/c 68,400
To Depreciation A/c 1,64,000
(Being the transfer of interest and depreciation to Profit and Loss A/c)

Ledger Accounts in the books of Malnad Coffee Works (Credit Purchase with Interest Method)

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-01-2016</td>
<td>To Xavier Ltd’s A/c</td>
<td>6,56,000</td>
<td>31-12-2016</td>
<td>By Depreciation A/c</td>
<td>1,64,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6,56,000</td>
<td></td>
<td>By Balance c/d</td>
<td>4,92,000</td>
</tr>
<tr>
<td>01-01-2017</td>
<td>To Balance b/d</td>
<td>4,92,000</td>
<td>31-12-2017</td>
<td>By Depreciation A/c</td>
<td>1,64,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4,92,000</td>
<td></td>
<td>By Balance c/d</td>
<td>3,28,000</td>
</tr>
<tr>
<td>01-01-2018</td>
<td>To Balance b/d</td>
<td>3,28,000</td>
<td>31-12-2018</td>
<td>By Depreciation A/c</td>
<td>1,64,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3,28,000</td>
<td></td>
<td>By Balance c/d</td>
<td>1,64,000</td>
</tr>
<tr>
<td>01-01-2019</td>
<td>To Balance b/d</td>
<td>1,64,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

To Xavier Ltd’s A/c
(Being instalment interest due)

Dec 31

To Bank A/c 2,00,000
(Being payment of instalment with interest)

Dec 31
Depreciation A/c 1,64,000
Machinery A/c 1,64,000
(Being the depreciation charge)

Dec 31
Profit and Loss A/c 2,32,400
To Interest A/c 68,400
To Depreciation A/c 1,64,000
(Being the transfer of interest and depreciation to Profit and Loss A/c)
In the Books of Xavier Ltd., (Credit Purchase with Interest Method)

### Journal Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-01-2016</td>
<td>Malnad Coffee Works Ltd’s A/c</td>
<td>Dr.</td>
<td>6,56,000</td>
</tr>
<tr>
<td></td>
<td>To Hire Sale (or Machinery) A/c</td>
<td></td>
<td>6,56,000</td>
</tr>
</tbody>
</table>
### Financial Accounting

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-01-2016</td>
<td>Bank A/c (Being the cash price of the machine sold on hire sale basis)</td>
<td>2,00,000</td>
<td>01-01-2016</td>
<td>By Bank A/c (Being down payment received on sale of machine on hire sale basis)</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Malnad Coffee Works Ltd’s A/c (Being interest due on unpaid balance of cash price)</td>
<td>68,400</td>
<td></td>
<td>To Interest A/c</td>
<td>68,400</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Bank A/c (Being first instalment amount received)</td>
<td>2,00,000</td>
<td>31-12-2016</td>
<td>To Interest A/c</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2016</td>
<td>Interest A/c (Being interest transferred to Profit and Loss A/c)</td>
<td>68,400</td>
<td>31-12-2016</td>
<td>To Profit and Loss A/c</td>
<td>68,400</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Malnad Coffee Works Ltd’s A/c (Being interest is due on unpaid balance)</td>
<td>48,660</td>
<td>31-12-2017</td>
<td>To Interest A/c</td>
<td>48,660</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Bank A/c (Being the receipt of second instalment amount)</td>
<td>2,00,000</td>
<td>31-12-2017</td>
<td>To Malnad Coffee Works Ltd’s A/c</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2017</td>
<td>Interest A/c (Being the instalment interest income transferred to Profit and Loss A/c)</td>
<td>48,660</td>
<td>31-12-2017</td>
<td>To Profit and Loss A/c</td>
<td>48,660</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Malnad Coffee Works Ltd’s A/c (Being the third and last instalment interest due)</td>
<td>26,940</td>
<td>31-12-2018</td>
<td>To Interest A/c</td>
<td>26,940</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Bank A/c (Being the receipt of third and last instalment amount)</td>
<td>2,00,000</td>
<td>31-12-2018</td>
<td>To Malnad Coffee Works Ltd’s A/c</td>
<td>2,00,000</td>
</tr>
<tr>
<td>31-12-2018</td>
<td>Interest A/c (Being interest transferred to Profit and Loss A/c)</td>
<td>26,940</td>
<td></td>
<td>To Profit and Loss A/c</td>
<td>26,940</td>
</tr>
</tbody>
</table>

**Ledger Accounts in the Books of Xavier Ltd**

Dr. | Malnad Coffee Works Ltd’s A/c | Cr.
---|-------------------------------|---
01-01-2016 | To Hire Sale A/c (or) | 6,56,000 | 01-01-2016 | By Bank A/c | 2,00,000
<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
<th>Date</th>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-12-2016</td>
<td>By Profit and Loss A/c</td>
<td>68,400</td>
<td>31-12-2016</td>
<td>By Malnad Ltd’s A/c</td>
<td>68,400</td>
</tr>
<tr>
<td>31-12-2016</td>
<td></td>
<td>68,400</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31-12-2017</td>
<td>By Profit and Loss A/c</td>
<td>48,660</td>
<td>31-12-2017</td>
<td>By Malnad Ltd’s A/c</td>
<td>48,660</td>
</tr>
<tr>
<td>31-12-2017</td>
<td></td>
<td>48,660</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31-12-2018</td>
<td>By Profit and Loss A/c</td>
<td>26,940</td>
<td>31-12-2018</td>
<td>By Malnad Ltd’s A/c</td>
<td>26,940</td>
</tr>
<tr>
<td>31-12-2018</td>
<td></td>
<td>26,940</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Working Notes:**

1. DP = Down payment. In the case of down payment, entire amount is towards cash price of the asset acquired under hire purchase system. This is for the reason that the unpaid cash price balance at the time of signing the agreement is zero and therefore, interest is also zero.
2. Unpaid Cash Price Balance at the beginning of first instalment = (Cash price, ₹ 6,56,000 – Down payment, ₹ 2,00,000) = ₹ 4,56,000.
3. First Instalment Interest = (Unpaid cash price balance at the beginning of first instalment, ₹ 4,56,000 × Rate of interest, 15%) = ₹ 68,400.
4. First Instalment Cash Price = (First instalment, ₹ 2,00,000 – First instalment interest, ₹ 68,400) = ₹ 1,31,600.
5. Unpaid Cash Price Balance at the beginning of second Instalment = (Unpaid cash price balance at the beginning of first instalment, ₹ 4,56,000 – First instalment cash price, ₹ 1,31,600) = ₹ 3,24,400.
6. Second Instalment Interest = (Unpaid cash price balance at the beginning of second instalment, ₹ 3,24,400 × Rate of interest, 15%) = ₹ 48,660.
7. Second Instalment Cash Price = (Second instalment, ₹ 2,00,000 – Second instalment interest, ₹ 48,660) = ₹ 1,51,340.
8. Unpaid Cash Price Balance at the beginning of last (i.e., third) Instalment = (Unpaid cash price balance at the beginning of second instalment, ₹ 3,24,400 – Second instalment cash price, ₹ 1,51,340) = ₹ 1,73,060.
9. Last Instalment Interest = (Last instalment, ₹ 2,00,000 – Unpaid cash price balance at the beginning of last instalment, ₹ 1,73,060) = ₹ 26,940.
Annual Depreciation = (₹ 6,56,000 cash price ÷ 4 years of useful life) = ₹ 1,64,000.

Hire Sale A/c is closed, at the end of the first year, by transferring the cash price of the asset sold on hire sale basis to Trading A/c (i.e., by debiting Hire Sale A/c and crediting Trading A/c).

i.e., Malnad Coffee Works Ltd.

After discussing the accounting for different hire purchase transactions in the books of both the hire purchaser and hire vendor, let us now discuss the method of computing the amount of instalment interest.

(G) CALCULATION OF HIRE PURCHASE INTEREST

As already stated, hire purchase interest which is also called, hire purchase charges or instalment interest represents the difference between the hire purchase price and cash price of the goods. In other words, it represents the excess of hire purchase price over the cash price.

\[
\text{Interest or Hire Purchase Charges} = \left( \frac{\text{Hire Purchase Price}}{\text{Cash Purchase Price}} \right) - 1
\]

Interest should be paid by the hire purchaser to hire seller on the unpaid or outstanding balance of the cash price of the asset acquired under hire purchase system. Further, every instalment paid by the hirer includes a portion towards cash price and another portion towards interest [(a) from the date of previous instalment or down payment to the date of payment of current instalment, and (b) on the balance after the payment of previous instalment (i.e., balance at the beginning of the current instalment period)]. It may be noted here that each instalment paid (except the down payment which is only towards cash price) is towards both cash price and interest. Hence, it is necessary to understand the procedure of computing the interest or instalment interest or hire purchase interest. And the procedure differs from one situation to another depending upon the information available. The different situations are identified and presented below (Figure - 1.2) followed by an analysis of computational procedure.

![Figure - 1.2: Calculation of Hire Purchase Interest - Different Situations](image)

(1) **When Cash Price, Instalment Amount and Rate of Interest are given**, the following procedure is used to determine each instalment interest (except the last instalment).

(a) Determine the unpaid (or outstanding) balance of cash price (of the asset acquired on
Hire Purchase Accounting

hire purchase basis) at the beginning of each instalment as follows.

\[
\text{Unpaid Balance of Cash Price at the beginning of first Instalment} = \left(\text{Cash Price of the Asset} - \text{Down Payment}\right)
\]

\[
\text{Unpaid balance of Cash Price at the beginning of second Instalment} = \left(\text{Unpaid balance of Cash Price at the beginning of first Instalment} - \text{First Instalment Cash Price}\right)
\]

\[
\text{Unpaid Balance of Cash Price at the beginning of third Instalment} = \left(\text{Unpaid Balance of Cash Price at the beginning of second Instalment} - \text{Second Instalment Cash Price}\right)
\]

The above procedure is used to compute the unpaid or outstanding balance of cash price of the asset acquired on hire purchase basis at the beginning of any instalment including the last instalment.

(b) Based on the unpaid balance of cash price at the beginning of each instalment as computed above, and using the rate of interest given, determine the amount of instalment interest (for each of the instalments except the last instalment) for a year or half year or quarter, etc., depending upon whether the instalments are yearly instalments, half-yearly instalments, etc.

\[
\text{Instalment Interest} = \left(\text{Unpaid balance of Cash Price at the beginning of (each) instalment}\right) \times \left(\text{Rate of Interest}\right)
\]

(c) Last instalment interest may be computed as follows.

\[
\text{Last Instalment Interest} = \left(\text{Last Instalment Amount} - \text{Unpaid Balance of Cash Price at the beginning of last Instalment}\right)
\]

Illustration – 1.3: Mr. Shashi bought a refrigerator under hire purchase system for a cash price of ₹ 15,675 with the following terms.

(a) ₹ 4,500 to be paid on signing the agreement.

(b) Balance to be paid in three equal instalments of ₹ 4,500 at the end of each year.

(c) The rate of interest charged for the hire purchase is 10% per annum.

Calculate the amount of hire purchase interest showing all necessary working notes supporting your answer.

Solution:

<table>
<thead>
<tr>
<th>Instalment Amount</th>
<th>Instalment Number</th>
<th>Unpaid Cash Price balance at the beginning of the instalment (year)</th>
<th>Interest</th>
<th>Cash Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,500</td>
<td>DP(^1)</td>
<td>0(^a)</td>
<td>0(^b)</td>
<td>4,500(^c)</td>
</tr>
<tr>
<td>4,500</td>
<td>I</td>
<td>11,175(^b)</td>
<td>1,118(^c)</td>
<td>3,382(^d)</td>
</tr>
<tr>
<td>4,500</td>
<td>II</td>
<td>7,793(^e)</td>
<td>779(^f)</td>
<td>3,721(^g)</td>
</tr>
<tr>
<td>4,500</td>
<td>III</td>
<td>4,072(^h)</td>
<td>428(^i)</td>
<td>4,072(^i)</td>
</tr>
<tr>
<td>18,000</td>
<td>Total</td>
<td></td>
<td>2,325</td>
<td>15,675</td>
</tr>
</tbody>
</table>
Working Notes:

(a) DP = Down payment. In the case of down payment, entire amount is towards cash price of the asset acquired under hire purchase system. This is for the reason that the unpaid cash price balance at the time of signing the agreement is zero and therefore, interest is also zero.

(b) Unpaid Cash Price Balance at the beginning of first Instalment = (Cash price, ₹ 15,675 – Down payment, ₹ 4,500) = ₹ 11,175.

(c) First Instalment Interest = (Unpaid cash price balance at the beginning of first instalment, ₹ 11,175 × Rate of interest, 10%) = ₹ 1,117.5 ≈ ₹ 1,118.

(d) First Instalment Cash Price = (First instalment, ₹ 4,500 – First instalment interest, ₹ 1,118) = ₹ 3,382.

(e) Unpaid Cash Price Balance at the beginning of second Instalment = (Unpaid cash price balance at the beginning of first instalment, ₹ 11,175 – First instalment cash price, ₹ 3,382) = ₹ 7,793.

(f) Second Instalment Interest = (Unpaid cash price balance at the beginning of second instalment, ₹ 7,793 × Rate of interest, 10%) = ₹ 779.3 ≈ ₹ 779.

(g) Second Instalment Cash Price = (Second instalment, ₹ 4,500 – Second instalment interest, ₹ 779) = ₹ 3,721.

(h) Unpaid Cash Price Balance at the beginning of last Instalment = (Unpaid cash price balance at the beginning of second instalment, ₹ 7,793 – Second instalment cash price, ₹ 3,721) = ₹ 4,072.

(i) Last Instalment Interest = (Last instalment, ₹ 4,500 – Unpaid cash price balance at the beginning of last instalment, ₹ 4,072) = ₹ 428.

(2) **When Cash Price, Instalment Cash Price and Interest Rate are given**, it is necessary to determine the instalment interest for each of the instalments. This is calculated on the basis of, (i) unpaid cash price at the beginning of each instalment, (ii) rate of interest, and (iii) duration of instalment.

Out of three variables required to compute the instalment interest amount, two (viz., rate of interest and instalment duration) are known as they are given. Hence, the third variable viz., unpaid cash price balance at the beginning of each instalment (including the last instalment) should be computed as shown below.

\[
\text{Unpaid Cash Price Balance at the beginning of first instalment} = \text{Cash Price} - \text{Down Payment}
\]

\[
\text{Unpaid Cash Price Balance at the beginning of second instalment} = \text{Unpaid Cash Price Balance at the beginning of first instalment} - \text{First Instalment Cash Price}
\]

\[
\text{Unpaid Cash Price Balance at the beginning of third instalment} = \text{Unpaid Cash Price Balance at the beginning of second instalment} - \text{Second Instalment Cash Price}
\]

Similarly, unpaid cash price balance at the beginning of any instalment (including the last instalment) can be computed by using the above procedure. Alternatively, the unpaid cash price balances at the beginning of different instalments (and instalment interest) can be
computed by preparing a statement as presented below.

**Unpaid Cash Price Balance and Instalment Interest**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Unpaid Cash Price Balance (₹)</th>
<th>Rate of Interest (%)</th>
<th>Instalment Interest (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash price of the asset acquired on hire purchase basis</td>
<td>1,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Down payment</td>
<td>10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of 1(^{st}) instalment</td>
<td>90,000</td>
<td>10</td>
<td>9,000</td>
</tr>
<tr>
<td>Less: First instalment cash price</td>
<td>30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of 2(^{nd}) instalment</td>
<td>60,000</td>
<td>10</td>
<td>6,000</td>
</tr>
<tr>
<td>Less: Second instalment cash price</td>
<td>30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of 3(^{rd}) instalment</td>
<td>30,000</td>
<td>10</td>
<td>3,000</td>
</tr>
</tbody>
</table>

**Illustration – 1.4:** Mr. Anil purchased a washing machine on 1 January 2015 from Adi Traders on hire purchase basis, the details of which are as follows.

(a) Cash price of washing machine: ₹ 25,000.

(b) Down payment: ₹ 10,000 and the remaining amount in three equal annual instalments commencing from 1 January 2016 (first instalment) with interest on the outstanding amount.

(c) Rate of interest 12% per annum.

Determine the amount of interest payable with each of the three instalments and the hire purchase price.

**Solution:** Cash Price = ₹ 25,000 and Down Payment = ₹ 10,000. Therefore, remaining amount = ₹ 15,000 (i.e., Cash price, ₹ 25,000 – Down payment, ₹ 10,000). Hence, Annual Instalment = ₹ 5,000 (i.e., remaining amount, ₹ 15,000 ÷ Number of instalments, 3).

**Unpaid Cash Price Balance and Instalment Interest**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Unpaid Cash Price Balance (₹)</th>
<th>Rate of Interest (%)</th>
<th>Instalment Interest (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash price of the asset acquired on hire purchase basis</td>
<td>25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Down payment</td>
<td>10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of first instalment</td>
<td>15,000</td>
<td>12</td>
<td>1,800</td>
</tr>
<tr>
<td>Less: First instalment cash price (on 1 January 2016)</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of second instalment</td>
<td>10,000</td>
<td>12</td>
<td>1,200</td>
</tr>
<tr>
<td>Less: Second instalment cash price (on 1 January 2017)</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>∴ Unpaid cash price balance at the beginning of third instalment</td>
<td>5,000</td>
<td>12</td>
<td>600</td>
</tr>
<tr>
<td>Less: Third instalment cash price (on 1 January 2018)</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
<td></td>
<td>3,600</td>
</tr>
</tbody>
</table>
Instalment Amount and Hire Purchase Price

<table>
<thead>
<tr>
<th>Instalment Number</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash Price</td>
</tr>
<tr>
<td>Down payment</td>
<td>10,000</td>
</tr>
<tr>
<td>First instalment</td>
<td>5,000</td>
</tr>
<tr>
<td>Second instalment</td>
<td>5,000</td>
</tr>
<tr>
<td>Third instalment</td>
<td>5,000</td>
</tr>
<tr>
<td>Total</td>
<td>25,000</td>
</tr>
</tbody>
</table>

Therefore, hire purchase price = ₹ 28,600; and the amount of interest payable is ₹ 1,800; ₹ 1,200 and ₹ 600 with instalments – 1, 2 and 3 respectively.

(3) **When Cash Price and Instalment Amount are given**, the computation of instalment interest and the total interest involves the following steps.

(a) Ascertain the total hire purchase price by computing the sum of down payments and instalments amounts.

(b) The difference between the total hire purchase price and the cash price represents the total interest. Therefore, Total Interest = (Hire Purchase Price – Cash Price).

(c) Apportion the total interest amount among different instalments in the ratio of unpaid hire purchase price at the beginning of each instalment.

**Illustration – 1.5:** Cash price of an asset is ₹ 56,000, and the hire purchase price of the same asset is ₹ 60,000 payable ₹ 15,000 as down payment and the balance in three equal instalments at ₹ 15,000.

Calculate instalment interest and split the instalment amount into instalment cash price and instalment interest.

**Solution:** Total Interest = (Hire Purchase Price, ₹ 60,000 – Cash Price, ₹ 56,000) = ₹ 4,000. Unpaid hire purchase price balance at the beginning of,

(a) First Instalment = (Hire purchase price, ₹ 60,000 – Down payment, ₹ 15,000) = ₹ 45,000

(b) Second Instalment = (Unpaid hire purchase price at the beginning of first instalment, ₹ 45,000 – First instalment, ₹ 15,000) = ₹ 30,000

(c) Third Instalment = (Unpaid hire purchase price at the beginning of second instalment, ₹ 30,000 – Second instalment, ₹ 15,000) = ₹ 15,000

That means, unpaid hire purchase price balances at the beginning of instalments – 1, 2 and 3 are ₹ 45,000; ₹ 30,000; and ₹ 15,000 respectively. Hence, interest amount of ₹ 4,000 is apportioned to instalments – 1, 2 and 3 in the ratio of 3 : 2 : 1 (*i.e.*, 45,000 : 30,000 : 15,000). Hence, the amount of interest payable with,

(a) First Instalment = (3/6th of ₹ 4,000) = ₹ 2,000

(b) Second Instalment = (2/6th of ₹ 4,000) = ₹ 1,333

(c) Third Instalment = (1/6th of ₹ 4,000) = ₹ 667

**Instalment Amount, Instalment Cash Price and Instalment Interest**

<table>
<thead>
<tr>
<th>Instalment Number</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Instalment</td>
</tr>
<tr>
<td>Down payment</td>
<td>15,000</td>
</tr>
<tr>
<td>First instalment</td>
<td>15,000</td>
</tr>
</tbody>
</table>
Hire Purchase Accounting

<table>
<thead>
<tr>
<th>Second instalment</th>
<th>15,000</th>
<th>1,333</th>
<th>13,667</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third instalment</td>
<td>15,000</td>
<td>667</td>
<td>14,333</td>
</tr>
<tr>
<td>Total</td>
<td>60,000</td>
<td>4,000</td>
<td>56,000</td>
</tr>
</tbody>
</table>

Notes:
1. Hire purchase price = ₹ 60,000
2. Total interest = ₹ 4,000
3. Cash price = ₹ 56,000

Illustration – 1.6: On 1 January 2013, M/s ABC & Co., took delivery of a machine from DL&F Co., on hire purchase basis, ₹ 1,500 being paid on delivery and the balance in five equal instalments of ₹ 3,000 payable annually on 31 December. The cash price of the machine was ₹ 15,000.

Calculate the amount of interest for each year with necessary working notes. [B.Com., Kuvempu University, May 2011]

Solution: Hire Purchase Price = [Down payment ₹ 1,500 + (₹ 3,000 annual instalment × 5 instalments)] = (₹ 1,500 + ₹ 15,000) = ₹ 16,500. Therefore, Total Interest = (Hire Purchase Price, ₹ 16,500 – Cash Price, ₹ 15,000) = ₹ 1,500. This ₹ 1,500 should be apportioned to five instalments on the basis of unpaid hire purchase price balance at the beginning of each instalment. Unpaid hire purchase price balance at the beginning of,

(a) First Instalment = (Hire purchase price, ₹ 16,500 – Down payment, ₹ 1,500) = ₹ 15,000
(b) Second Instalment = (Unpaid hire purchase price at the beginning of first instalment, ₹ 15,000 – First instalment, ₹ 3,000) = ₹ 12,000
(c) Third Instalment = (Unpaid hire purchase price at the beginning of second instalment, ₹ 12,000 – Second instalment, ₹ 3,000) = ₹ 9,000
(d) Fourth Instalment = (Unpaid hire purchase price at the beginning of third instalment, ₹ 9,000 – Third instalment, ₹ 3,000) = ₹ 6,000
(e) Fifth Instalment = (Unpaid hire purchase price at the beginning of fourth instalment, ₹ 6,000 – Fourth instalment, ₹ 3,000) = ₹ 3,000

That means, unpaid hire purchase price balances at the beginning of instalments – 1, 2, 3, 4 and 5 are ₹ 15,000; ₹ 12,000; ₹ 9,000; ₹ 6,000 and ₹ 3,000 respectively. Hence, interest amount of ₹ 1,500 should be apportioned to instalments – 1, 2, 3, 4 and 5 in the ratio of 5 : 4 : 3 : 2 : 1 (i.e., 15,000 : 12,000 : 9,000 : 6,000 : 3,000). Hence, the amount of interest payable with,

(a) First Instalment = (5/15th of ₹ 1,500) = ₹ 500
(b) Second Instalment = (4/15th of ₹ 1,500) = ₹ 400
(c) Third Instalment = (3/15th of ₹ 1,500) = ₹ 300
(d) Fourth Instalment = (2/15th of ₹ 1,500) = ₹ 200
(e) Fifth Instalment = (1/15th of ₹ 1,500) = ₹ 100

<table>
<thead>
<tr>
<th>Instalment Amount, Instalment Cash Price and Instalment Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instalment Number</td>
</tr>
<tr>
<td>----------------------</td>
</tr>
<tr>
<td>Down payment</td>
</tr>
<tr>
<td>First instalment</td>
</tr>
<tr>
<td>Second instalment</td>
</tr>
</tbody>
</table>