

# ADVANCED ACCOUNTING

## 3<sup>rd</sup> SEMESTER

**TOPIC:**

# **Hire Purchase System – Features – Accounting Treatment**

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# **HIRE PURCHASE SYSTEM**

## **Introduction:**

By now you must have been familiar to various aspects of Book-keeping and Accountancy. You must have understood the concept of double entry system. Now-a-days the books of accounts are maintained under double entry system by all big business houses and multinationals. You know that the sales is the Key factor of success of business. The profit of a business always depends on the volume of its sales. A big business house can effect sales on cash basis as well as on credit basis. The credit sales are very important and essential for the growth of business.

The sale proceeds under such sales are not immediately collected but are collected under certain arrangements such as Hire-purchase system or Instalment payment system or collection after a certain period together with interest on outstanding balances. Hire-purchase system is the most secured and effective tool of collecting the proceeds of a credit sale.

## Learning Objectives

- ✓ identify a hire purchase transaction;
- ✓ record the transaction in the journal of hire-purchaser and hire vendor;
- ✓ prepare necessary accounts in the ledger of hire-purchaser and hire vendor;
- ✓ calculate cash price in a transaction of hire-purchase with and without the help of annuity table; and

- solve the accounting problems of hire-purchase system and record hire purchase transactions in the books of accounts maintained in “Big Malls”.

## **Meaning and Concept of Hire-purchase system**

Hire-purchase system is a special system of purchase and sale of goods. Under this system purchaser pays the price of the goods in instalments. The instalments may be annual, six monthly, quarterly, monthly fortnightly etc.

Under this system the goods are delivered to the purchaser at the time of agreement before the payment of instalments but the title on the goods is transferred after the payment of all instalments as per the hire-purchase agreement. The special feature of a hire-purchase transaction is that the payment of every instalment is treated as the payment of hire charges by the purchaser to the hire vendor till the payment of the last instalment..

After the payment of the last instalment, the amount of various instalments paid is appropriated towards the payment of the price of the goods sold and the ownership or the goods is transferred to the purchaser.

- ✓ If all instalments are paid as per the terms of agreement , the title of the goods is transferred by vendor to the purchaser.

Thus hire-purchase means 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 agreement.
- ✓ the purchaser has a right to use the goods delivered.
- ✓ the price of the goods will be paid in instalments.
- ✓ every instalment will be treated to be the hire charges of the goods which is being used by the purchaser.



- ✓ if there is a 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 various instalments.

## **Characteristics of Hire-purchase system**

Before discussing the characteristics of hire-purchase system, we must know what is a hire purchase agreement and what are the contents of a hire-purchase agreement. Hire-purchase agreement means a contract between the hire vendor and the hire purchaser regarding the sale of goods under certain conditions.

Usually every hire-purchase agreement shall contain the following terms:

- ✓ the cash price of the goods, cash price means the price at which goods may be purchased against cash payment.
- ✓ the hire-purchase price, hire purchase price means the total amount which is payable by the hire-purchaser under the agreement.
- ✓ the date on which the hire-purchase agreement will commence.
- ✓ the description of the goods that will be delivered to the hire-purchaser at the commencement of the agreement.

- ✓ the number of instalments to be paid by the hire-purchaser along with the amount of each instalment and the date of payment of each instalment.
- ✓ the down payment if any, the down payment means the amount which is required to be paid by hire-purchaser to the hire vendor at the time of commencement of hire-purchase agreement.
- ✓ the rate interest charged by the hire vendor (optional).

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# Installment Purchase System

## Meaning:

The Installment system is almost similar to the hire purchase system. The main difference between the two is that in installment system, the buyer gets the ownership rights as soon as the contract is signed with the seller. If he makes any default in payment of any installment, the seller can repossess the article only with the help of the Court.

Hire purchase and installment systems facilitate brisk sale of consumer durable.

Commodities like two wheeler, television sets, radios, refrigerators, cycle, furniture etc., are sold in large volumes under hire purchase and installment system.

The products to be sold under these systems should be

1. durable,
2. high in quality,
3. fashionable
4. standardized; and
5. high priced.

## **Concept Of Installment Purchase System:**

An installment system is just like a credit purchase and hire purchase system of selling and buying goods. Like hire purchase, in installment system an agreement is made between buyer and seller to purchase and sell of goods. The buyer makes certain down payment at the time of signing agreement and the balance is paying in installment over a period of time

An installment system is a credit sale in which payments are made in installments over a period of time. In this system, the buyer gets the possession as well as ownership of the goods right at the time of signing the agreement. During the course of paying the installment, if the buyer makes default in paying the installment, the vendor cannot responses the goods

In that case, the vendor can sue the buyer for recovery of dues. Like in hire purchase even the paid installments also can not be forfeited in case of default in paying installment. Thus, it can be said that installment system is a kind of credit sale where installments are entertained over the period and default in such payment cannot responses the goods and in that case, the vendor can only sue the buyer for the recovery of amount due.



# Features of Installment Purchase System

Under the installment purchase system, there is an outright sale of goods with the buyer having the facility to pay the purchase price in a certain number of agreed installments. In this system, a certain amount is paid as a down payment amount at the time of signing the agreement. The buyer makes certain down payment at the time of signing an agreement and the balance is paying in installment over a period of time.

The following are the features of an installment purchase system:

(1) The installment purchase system is just like an outright credit sale of goods. Under this system of purchase, the buyer acquires possessions of the goods immediately at the time of agreement and not after paying the last installment which is the case with hire purchase system.

(2) The buyer makes the payment in different installments over a period of time as agrees upon in the agreement. The Buyer is required to make payment in installment over a period of time which ranges from 1 year for products like television or air conditioners to 20 years in case of purchase of apartments.

(3) Under the installment purchase system, the buyer gets the immediate possession as well as the ownership of goods. Since ownership has passed the buyer cannot return the goods to the seller if he or she does not like the product.

(4) The seller can not responses the good if the buyer made default in the payment of installment but he/she can sue against the buyer for the recovery of the amount due.

(5) In case of default in the payment of installment, the total amount of installments already paid by the buyer can not be forfeited. In case of default in respect of the last Installment, the seller has no right to take back the goods. The seller can only sue the buyer for the unpaid balance.

(6) Under the installment system, the buyer can sell or mortgage the goods even before clearing all the installments.

The buyer can also transfer the goods even if he or she has not paid the last installment because the owner has already passed at the time of the agreement.

(7) The risk of goods/assets are to be borne by the buyer just after signing the agreement. If the buyer fails to make the future payment,

the seller cannot repossess the goods but he can sue against the buyer for the amount receivable.

(8) The buyer of the goods under an installment purchase system has no right to return the goods to the seller. In this system, the installment price includes both the cash price and the amount of interest for delayed payment.

**THANK YOU**