

ADVANCED ACCOUNTING

3rd SEMESTER

TOPIC:

Instalment Purchase system – Accounting Treatment

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ADVANTAGES OF HIRE PURCHASE AND INSTALLMENTS SYSTEMS

1. The hire purchase and installment schemes enable the buyers to buy goods which are beyond their reach.
2. It also enables the business to find buyers for their products. A business cannot always look for cash parties for products that are expensive in nature.
3. It widens the market
4. Middlemen are eliminated

5. It has helped the finance companies to develop their business. Now-a-days finance companies finance several articles widely under hire purchase and installment system.

6. Price is stabilized.

7. As convenience and luxury goods are sold under hire purchase and installment system, the standard of living of the people increases.

8. Sellers can increase their sales. Moreover, sales under the hire purchase and installment system are more profitable.

9. These days, most business houses come out with a number of offers, like free gifts, exclusively for hire-purchase customers.

DISADVANTAGES OF HIRE PURCHASE AND INSTALLMENT SYSTEMS

1. Hire purchase and installment system tempt the buyers to buy goods which are beyond their means. So, it becomes extravagant.
2. The buyer pays a very high price for the article under such schemes. This is because, he has to pay interest on the outstanding balance.
3. The need of the hour is savings. Schemes like hire-purchase make the people spendthrifts.

4. Hire purchase price is higher than the cash price. Buyers under hire purchase system are charged interest. The rate of interest is often higher.

5. If buyers default in payment, goods sold under hire purchase system are repossessed by the hire vendor. The purchaser suffers a huge loss on repossessed goods.

6. Hire purchase and installment transactions are cumbersome. An agreement has to be entered into and guarantee is to be given. More legal formalities are to be gone through.

7. The rate of default under hire purchase and installment system is higher. It is because only people with inadequate means buy under this system.

8. A number of legal formalities will have to be fulfilled by the buyer. He may have to find a guarantor. The agreement must be prepared and signed by both the seller and the buyer and it must be witnessed. The document of title will vest with the vendor/financier till the dues are cleared by the hirer.

HIRE PURCHASE SYSTEM AND INSTALLMENT SYSTEM DIFFERENCES

Hire-Purchase System:

(1) The parties to the contract are called hire-purchase and hire-vendor.

(2) The property in the goods passes from hire-vendor to hire-purchaser only after the hire-purchaser has paid all of the stipulated number of installments.

(3) The relation between hire-purchase and hire-vendor is that of a bailee and a bailor. As a result, the hire-purchaser has no right of disposal of goods till he becomes the owner.

(4) If the hire-purchaser has taken as much care of the goods as is required to be taken by a bailee, he is not responsible for the loss of the goods.

(5) If the hire-purchaser makes a default in payment of an installment, the hire-vendor gets the right to repossess the goods.

(6) The hire purchaser can terminate the contract. He will return the goods but will not be required to pay the remaining installments. However in cases, he may be required to pay a sum not exceeding the termination charges mentioned in the contract.

Installment System:

(1) The parties to the contract are called buyer and seller.

(2) The property in the goods passes from seller to buyer as soon as the contract is signed. In other words, the buyer becomes the owner of the goods immediately on the signing of the contract.

(3) It is a contract of sale. No bailment is involved. As a result, the buyer can dispose of the goods as he likes.

(4) As risk lies with ownership and the buyer becomes owner of the goods on signing of the contract, any loss of goods will have to be borne by the buyer.

(5) If the buyer makes a default in payment of an installment, the seller can only sue for the balance of the amount unpaid together with interest; he cannot repossess the goods.

(6) The buyer cannot terminate the contract and escape the liability of the payment of the remaining installments.

Accounting Treatment Of Hire Purchase System Or Methods Of Recording Hire Purchase Transactions

Journal Entries In The Books Of Hire Purchaser

There are two methods of recording hire purchase transactions in the books of the hire purchaser:

i. When the asset is recorded in full cash price-:full cash price method

ii. When the asset is recorded at cash price actually paid in each installment-: Actual cash price method.

1. For the purchase of asset:

First Method

Asset A/C (full cash price).....Dr.

To vendor A/C

Second Method

No entry

2. *For the payment made for 'down payment'*

First Method

Vendor A/C.....Dr.

To bank A/C

Second Method

Asset A/C.....Dr.

To Bank A/C

3. For installment due

First Method

Interest A/C.....Dr.

To vendor A/C

4. For the payment of installment (both method)

Vendor A/C.....Dr.

To Bank A/C

*5. For charging depreciation(on the basis of cash value)
(both methods)*

Depreciation A/C.....Dr.

To Asset A/C

6. For transfer of interest and depreciation(both methods)

Profit and loss A/C.....Dr.

To depreciation A/C

To interest A/C

Note: *entries 3,4,5 and 6 will be repeated year after year
until the final installment is paid.*

Journal Entries In The Books Of Vendor

1. For selling goods on hire purchase

Hire purchase A/C.....Dr.(full cash price)
To sales/hire purchase sales A/C

2. For receiving down payment

Cash/bank A/C.....Dr.
To hire purchaser A/C

3. For installment due

Hire purchaser A/C.....Dr.

To Interest A/C

4. For receiving the installment

Cash/bank A/CDr.

To hire purchaser A/C

THANK YOU