

3

HIRE-PURCHASE AND INSTALLMENT PAYMENT ACCOUNTS

Objectives

At the end of this chapter, students should be able to:

- Explain the operation of hire purchase and installment payment account;
- Make entries in the respective books of the hirer and the seller;
- Explain the importance of hire purchase to:
 - (a) The seller
 - (b) The hirer
 - (c) The society.

3.1 Introduction

Fixed assets can be acquired by outright cash purchase or hire purchase. If purchase of the assets is by cash, the buyer pays the purchase price and takes full possession. In case of credit purchase, the buyer pays shortly after taking possession. Under the hire purchase agreement, the buyer called the hirer takes possession of the assets while the seller retains the ownership of the asset. The hirer makes instalmental payments to the seller periodically. Each installment is made up of the capital value of the assets and hire purchase interest which is the cost of financing the acquisition of the assets. On completion of all the instalmental payments, the hirer becomes the owner of the assets. A deposit is usually paid to the seller of the asset before the hirer takes possession of the asset. The deposit is deducted from the cash price capital of the asset when calculating the hire purchase interest payable.

3.2 Hire-purchase and Installment Payment Account

Hire purchase is like any other buying activity: two parties are involved. These are the seller and the buyer known as the vendor and the hirer respectively. Hire purchase is defined as a system under which property or goods are acquired by Making an initial advance payment while the balance is paid instalmentally at an agreed rate. This system of trading enables the consumer to enjoy the goods even though he has not finished paying for it. Of course, he pays higher for this facility.

3.3 The System of Operation

Under the hire-purchase system, goods are released to the hirer and he agrees to make periodic instalmental payments of a fixed amount. The hirer cannot sell the goods while the instalmental payment has not been completed. It therefore means that the hirer only possesses goods and

ownership remains with the seller until the full price of the article has been paid. If the hirer defaults, the seller can recover the goods while the hirer forfeits the instalmental payments previously made. In any hire purchase operation, a guarantor is provided by the hirer and a witness by the vendor. A guarantor is a person to be held responsible in case of default by the hirer while a witness is a person to attest to the transaction between the hirer and the vendor. This is different from another type of instalment payment where the agreement is that the buyer becomes the owner as soon as the agreement is completed and the first instalment is paid. In this, if the buyer defaults, the seller can only sue to recover the unpaid instalments instead of recovering the goods. Hire-purchase prices are fixed higher than cash sales. The difference is the interest or finance charged on the amount tied up in the goods until full payment is made. Hire-purchase agreements terminate prematurely if the hirer completes payment before the specified period.

Activity

(a) Mention goods sold using the hire purchase system in your area.

(b) Visit a hire-purchase business and enquire about their activities.

Submit a report of your findings to your teacher.

3.4 Preparation of Account in the Seller's/ Vendors Ledger Accounts

Two different methods of accounting for sales under the system of hire-purchase will be discussed.

3.4.1 Method 1: This method involves the following:

- i. Hire-purchase trading account which involves debit cash with price of goods sent out on hire-purchase.
- ii. Credit cash selling with price of goods sent out on hire purchase by transferring to purchase trading account.
- iii. Seller's/Vendor's Account which involves debit cash with selling price of goods sent out on hire-purchase.
- iv. Debit total hire-purchase interest charged.
- v. Hire-purchase interest suspense account which involves debit hire-purchase interest suspense account. This is debit hire-purchase with interest apportioned to the accounting period.
- vi. Credit total hire purchase interest charged account.
- vii. General trading account which involve credit cash with selling price of goods sent our on hire purchase.
- viii. Profit and Loss Account.
- ix. Credit hire-purchase interest apportioned to accounting period.

Example 3.1

On 1st January 2010, Olatunde sold a car under a two-year hire-purchase agreement. He requested for an immediate deposit of N800, with four half-yearly installments of N8000, starting

from 1st July. Olatunde sold the car for N40,000 which includes interest of N2,280. He prepared his account annually and apportioned the interest to the year ended:

30th September, 2010 N560.00

30th September, 2011 N1140.00

30th September, 2012 N580.00

Show the necessary account in the ledger of the seller.

Solution

Hire-Purchase Trading Account

Date	Details	N	K	Date	Details	N	K
2010		37,720.00		2010		37,720.00	
Sept 30	General Trading			Jan 1	Hire-purchase account		
	Account	37,720.00				37,720.00	

Hire-Purchase Account			
Dr			Cr
Date	Detail	N	K
2010			
Jan 1	Hire-purchase Trading Account	37,720.00	
Jan 1	Hire-purchase interest suspense Account	2,280.00	
	Sept 30	Balance c/d	24,000.00
			40,000.00

2011

Oct 1	Balance c/d	24,000.00	Jan 1	Cash instalment	8,000.00
			July 1	Cash instalment	8,000.00
			Sept 30	Balance c/d	8,000.00
					24,000.00
		24,000.00			
2011					
Oct 1	Balance b/d	8,000.00			

Dr			Hire-Purchase Account				Cr		
Date	Detail		N	K	Date	Detail		N	K
2010					2010				
Sept 30 Profit & Loss					Jan 1	Hire-purchase			
Account			560.00			account		2,280.00	
Sept 30 Balance			1,720.00						
			<u>2,800.00</u>					<u>2,280.00</u>	
2011									
Sept 30 Profit & Loss			1,140.00						
Account									
Sept 30 Balance c/d			580.00					1,720.00	
			<u>1,720.00</u>					<u>1,720.00</u>	
					2011	Balance b/d		580.00	

It should be noted that goods sent out on hire-purchase are treated as sales at cash price in the trading account. In the balance sheet, goods treated as having been sold will not appear. However, the debit balance on the hire-purchase account will represent all outstanding and unpaid instalments. The balances on the hire purchase interest suspense account will represent the income apportioned to later accounting periods and must be deducted from the balance in the hire purchase account to show the value of the current asset.

3.4.2 Method 2: Stock method

Under the sales method, (in the example given above), it has been assumed that the seller has treated each hire purchase sales separately. In actual practice, commercial concerns deal with several sales. Thus, the previous method focuses attention on only one transaction. For numerous hire purchase transactions, a system has to be devised to greatly reduce the arithmetic calculations. In the trading account, sales are replaced by cash receivable (deposits and instalment receivable during the accounting period); the unpaid instalment not yet due are considered as stock, and not debtors. This must be reduced to cost. Generally, hire-purchase debtors pay in instalments which could be in arrears. The following are the accounting treatments of the hire purchase under the sales method.

- i. Personal Accounts in the Ledger
- ii. Debit hire purchase with selling price
- iii. Credit cash deposits
- iv. Credit cash installments
- v. Hire purchase Sales Account,
- vi. Debit deposits and installments for the period.
- vii. Debit installments not yet due but reduced to cost.
- viii. Credit hire-purchase account with selling price for each hirer.
- ix. Hire-Purchase Trading Account
- x. Debit cost price of article sold on hire purchase during the period

- xi. Debit gross profit transferred to profit and loss account.
 - xii. Credit deposits and installments for the period.
 - xiii. Credit installments not yet due but reduced to cost.
 - xiv General Trading account
 - xv. Show cost price of article sold on hire-purchase during the period as deduction from purchase on the debit side.
 - xvi. Profit and Loss Account.
 - xvii. Debit gross profit transferred from hire-purchase trading account.

Example 3.2

Dogara started a new business including a hire-purchase. During his first accounting year, he sold on the basis of hire purchase to the following customers: Tinuade: A sewing machine costing N320 Sold for N480, payable by a deposit of N48 and 36 instalments of N2 each. Aminu: A bicycle costing N200, sold for N400 payable by a deposit of N40 and 45 instalments of N8 each and; Ekpo: A TV set costing N240, sold for N320 payable by a deposit of N32 and 9 instalments of N32 each. Tinuade: Paid the deposit and 7 instalments, Ekpo paid the deposit and 2 instalments, a further instalment, from him being overdue. Dugan.s local purchase was N13,380, his ordinary sales were N16,000 and his closing stock in hand was N1000.

Solution

Hire Purchase Day Book

No	Name and Address	Article	Folio	Cost Price	Hire purchase price	Amount of Deposit	No of Instal.	Amount of each instalment	Remarks
1.,	Tinuade	Sewing machine	"	N K 320	N K 480	N K 48	36	12	
2.,	Aminu	Bicycle	"	200	400	40	45	8	
3.,	Ekpo	TV set		<u>240</u>	<u>320</u>	<u>32</u>	<u>9</u>	32	
				760	1200	120			

Dr	Hire Purchase personal Ledger			Credit	
	TIJUADE				
	N	K		# K	
1 st Year	Hire Purchase	480.00	1 st Quarter	Cash deposit	480.00
	Sales account		2 nd Quarter	Cash instalment	12.00
	sewing machine			Cash 2 instalment	24.00
			3 rd Quarter	Cash instalment	24.00
			4 th Quarter	Cash 2 instalment	24.00
				Balance c/d	348.00
		<u>480.00</u>		<u>480.00</u>	
	Balance b/d	348.00			

AMINU

	N	K		N	K
1 st Year Hire-Purchase			1 st Quarter	Cash deposit	40.00
Sales Account	400.00		2 nd Quarter	Cash 3 instalment	24.00
Bicycle			3 rd Quarter	Cash instalment	24.00
			4 th Quarter	Cash 2 instalment	24.00
				Balance c/d	288.00
	<u>400.00</u>			<u>480.00</u>	
Balance b/d	288.00				

EKPO

	N	K		N	K
1 st Year Hire-Purchase	320.00		1 st Quarter	Cash deposit	32.00
Sales Account			2 nd Quarter	Cash 3 instalment	32.00
TV set			3 rd Quarter	Cash instalment	32.00
				Balance c/d	224.00
	<u>320.00</u>			<u>320.00</u>	
Balance b/d	224.00				

Hire Purchase Sales Account

	N	K		N	K
Hire-Purchase Trading	372.00		Sunday Hire		
(amount due)			Tinuade		480.00
Balance c/d	828.00		Aminu		400.00
			Ekpo		320.00
	<u>1,200.00</u>			<u>1,200.00</u>	
			Balance b/d		828.00

Prepare the relevant hire purchase day book, the hire purchase ledger account and the general trading account. The amount due for the period (in the above example 3.2 is N372) debited to the hire purchase sales account is credited to the hire purchase trading account. The cost price, which are instalments not due, from the schedule of closing balances (that is, N260) also credited to the hire-purchase trading account and carried down as the value of stock out on hire purchase.

The cost price of the article (as shown in the hire purchase day book in the above example 3.2) is N760 which is debited to the hire-purchase trading account and deducted from purchases in the general trading account. The gross profit shown by this account is carried to the profit and

loss account. The percentage of the gross profit to the cost price of the article sold on hire-purchase during the period, adjusted for opening and closing stocks at cost, should remain constant or reflected as charged by the vendor.

This is the reason why overdue instalments and instalments

Hire-Purchase Trading Account

	₦ K		₦ K
General trading account	760.00	Hire purchase	
		Deposit & instalment	372.00
Gross profit transferred			
To profit and loss account	132.00	Instalment not yet due at cost	520.00
	<u>892.00</u>		<u>892.00</u>

General Trading Account

	₦ K		₦ K
Purchases	26,760.00	Sales	32,000.00
Loss transfer to			
Hire purchase			
Trading account	760.00	Stock - closing	2,000.00
	26,000.00		
Gross profit	760.00		
	<u>34,000.00</u>		<u>34,000.00</u>

paid are all credited to the hire-purchase trading account.

3.5 Buyer's (Hirer's) book

There are various methods of preparing hire purchase accounts. This depends on the nature, value of the goods, the length of payment and terms of agreement.

The two methods used here are explained below:

Method 1

- i. Credit the vendor's account with the cash price.
- ii. Credit vendor's account with interest for the period.
- iii. Credit cash account with each payment made.
- iv. Credit interest payable account with balance on the interest payable account.

In the balance sheet, the asset appears at full cash price less than any provision for depreciation.

The balance on the vendor's account represents instalment not yet paid less any interest apportioned to later accounting periods. The balance is

included under current liabilities. Another method of treating this is to deduct the balance from the cost price of the asset. All overdue instalments must be treated as current liabilities in the balance sheet.

Example. 3.3

On January 1, 2010, Chukwu bought a photocopying machine on hire-purchase from Maxi, for a cost price of N50,000. The

Solution

Dr Photocopy Machine Account				Cr			
Date	Details	N	K	Date	Details	N	K
2010							
Jan 1	Maxi Account	50,000					

Dr Maxi Account				Cr			
Date	Details	#	K	Date	Details	#	K
2010				2010			
Dec 31	Cash	27,500.00		Jan 1	Photocopying machine account	50,000.00	
Dec 31	Balance c/d	25,000.00		Dec 31	Interest at 5%	2,500.00	
		52,500.00				52,500.00	

2011				2011			
		#	K			#	K
Dec 31	Cash	27,500.00		Jan 1	Balance b/d	25,000.00	
				Dec 31	Interest 5%	2,500.00	
		27,500.00				27,500.00	

Interest Payable Account							
Date	Details	N	K	Date	Details	N	K
2010				2010			
Dec 31	MAXI A/c	2500.00		Dec 31	Profit & Loss account	2500.00	
2011				2011			
Dec 31	MAXI c/d	2500.00		Dec 31	Profit & Loss account	2500.00	

Dr	Cash Account (extract Only)				Cr
Date	Details		N	K	
2010					
Dec 31	MAXI		27,500.00		
2011					
Dec 31	MAXI		27,500.00		

Dr	Profit and loss Account (extract Only)				Cr		
Date	Details	N	K	Date	Details	N	K
2010							
Dec 31	interest payable c/d	2,500.00					
2011							
Dec 31	interest payable c/d	2,500.00					

agreement required payment to be made in two annual equal installments with the interest rate of 5% per annum on cost. Show the entries in the hirer's books.

Using the above example, assuming that depreciation was

Dr	Photocopy machine Account				Cr		
Date	Details	N	K	Date	Details	N	K
2010							
Jan 1	Jumai	50,000.00		2010	Depreciation to Profit & Loss Account	5000.00	
				Dec 31	Balance c/d	45,000	
		50,000.00				50,000.00	
2011							
	Balance b/d	45,000.00		2011	Depreciation to profit & loss	5000.00	
				Dec 31	Balance c/d	40,000.00	
		45,000.00				45,000.00	
2012							
Jan 1	Balance b/d	40,000.00					

written off on the photocopies from the date of purchase at the rate of 10% per annum on the machine account at the cash price, the second year, 2011, will appear thus;

In the balance sheet, the asset appears at full cash price less any provision for depreciation. The balance in the vendor's account represents installment not yet paid less any interest apportioned

to later accounting periods. Another method of

Balance Sheet (Extract Only)				Cr	
Dr	N	K		N	K
			Photocopying Machine	50,000.00	
			Less accumulated Depreciation (2 years)	<u>10,000.00</u>	
				40,000.00	

treating this is to deduct the balance from the cost price of the asset. All overdue and unpaid instalments must be treated as current liabilities in the balance sheet.

The balance sheet of the on-going example is shown below.

Method 2: Asset Account

This involves the following:

- i. Debit cash with purchase price excluding interest.
- ii. Vendor's account which involves debit deposits and instalments paid.
- iii. Credit cash with purchase price.
- iv. Credit interest charged.
- v. Hire purchase interest suspense account which involves debit hire purchase interest apportioned to the accounting period by transferring from the Hire Purchase Interest Suspense account.
- vi. Cash account credit deposit and interest paid.

Profit and Loss Account

Debit hire-purchase interest apportioned to the accounting period by transferring from hire purchase interest suspense account. The balance on the Vendor's Account represents all instalments unpaid, while that on the interest suspense account represents the interest apportioned to later accounting period.

Example 3.4

On July 1, 2010, Martin bought a car on hire-purchase from Sanusi for a cash price of N100, 000. The agreement required payment to be made in four equal half-yearly instalments first instalment being made on the date of purchase. The interest

Moto Car Account				Cr				
Dr	Date	Details	N	K	Date	Details	N	K
Date	2010				Bal c/d		100,000.00	
July 1	Sanusi		100,000.00					

Sanusi's Account

Date	Details	N	K	Date	Details	N	K
2010				2010			
July 1	cash	30,000.00		July 1	Motor car	100,000.00	
2010							
July 1	Cash	30,000.00			Interest suspense	20,000.00	
					Account		
June 30	Balance c/d	60,000.00					
		<u>120,000.00</u>				<u>120,000.00</u>	
				2011			
July 1	Cash	30,000.00		July 1	Balance c/d	60,000.00	
Jan 1	Cash	30,000.00					
		60,000.00				60,000.00	
		<u>60,000.00</u>				<u>60,000.00</u>	

Hire purchase Interest Suspense Account

Date	Details	N	K	Date	Details	N	K
Year 1	Sanusi's Account	20,000.00		Year 1	Profit and Loss Account	10,000.00	
		<u>20,000.00</u>			Balance c/d	10,000.00	
		<u>20,000.00</u>				<u>20,000.00</u>	
Year 2	Balance b/d	20,000.00		Year 2	Profit and Loss Account	10,000.00	

rate was charged at 10% per annum on cost. Martin prepared his books on June, 30. Show the given data in a motor car account on vendor's account and interest suspense account.

3.6 Summary

In this chapter, students have learnt that:

- Hire-purchase is a system under which goods are bought and payment made by agreed instalment, while the ownership of the goods remains in the seller until the last instalment is paid.
- Instalment payments is a system under which goods are bought and payment made by instalment but the ownership of the goods purchased crosses to the buyer immediately the

agreement is completed and the first instalment is paid. Goods sold out on hire purchase can be recovered by the seller while those sold out on instalmental agreement

3.7 Revision Questions

1. What do you understand by hire-purchase?
2. Explain the operation of the hire-purchase and the instalmental payment account.
3. State reasons for termination of hire-purchase agreement prematurely.
4. On July 1st , 2010, Chika bought a duplicating machine from Baba under a 3-year hire purchase agreement requiring an immediate deposit of N9,000 with 6 half yearly instalments of N3,500, commencing on January, 1st 2010. The interest charge included in the buying price was N4,000. Chika prepared his account annually, on December 31st and apportioned the interest charge of

N4,000 to the years end December, 31st ,2010 - N100, 2011 - N1600; and 2012 - N1400. From the given data, prepare the following:

- (a) Machinery Account
- (b) Bodams account
- (c) Interest payable Account

5. Which is not a method of preparing a hire-purchase account in the Hirer's (Buyer's) book?

- (A) Debit the asset account, credit vendor's account with the cash price.
- (B) Debit interest payable account, credit vendor's account with interest for the period.
- (C) Credit the asset account, debit vendor's account with the cash price.
- (D) Debit Vendor's account, credit account with each payment made.

6. On June 30, 2010, Danjuma sold a truck under a 2-year hire-purchase agreement, the terms provided for 8 quarterly instalments of N300 each, commencing on July 1st 2010.

The hirer, Damilola, paid N200 as deposit on delivery of the truck on June 30, 2010. The interest charge included in the hire purchase price was N4,000.Danjuma prepared her accounts on 31st December, 2011 and equally apportioned the interest receivable for the period of the hire purchase contract. From the given data, prepare the following:

- (a) Hire-Purchase Trading Account
- (b) Hire-Purchaser's (Damilola's) Account
- (c) Hire-Purchase Interest Suspense Account

7. On January 1, 2010, Anuoluwa purchased a grinding machine from Akinleye with a cash price of N9,000. She agreed to pay for it in equal instalments at a rate of 10% per annum. Depreciation on cost. From the given data, prepare the following:

- (a) Machine Account
- (b) Samuel (Vendor's) Account
- (c) Interest payable Account
- (d) Cash Account (extract only)
- (e) Profit and Loss account (extract only)