

## RECORDING OF HIRE PURCHASE TRANSACTIONS IN THE BOOKS OF HIRE PURCHASER AND HIRE VENDOR

There are 3 methods of recording hire purchase transactions in the books of hire purchaser. They are:

- Cash price method/ credit purchase method
- Interest suspense method
- Asset accrual method/ partial accrual method

Among the three methods mentioned above, only cash price method and interest suspense method are preferred by the accounting professionals. Asset accrual method follows that on payment of each instalment, the hire purchaser becomes the owner of that portion of goods for which the payment has been made by him. But this assumption is against the fundamental concepts of hire purchase, namely, a) instalment paid is treated as rent and not as part payment of the of purchase price. b) the legal ownership of the goods passes on to the purchaser only after the last instalment is paid.

Let us discuss the other two methods recommended by the ICAI in detail.

**CASH PRICE METHOD/ CREDIT PURCHASE METHOD:**

This method treats the purchase of asset as credit purchase on the very date of signing the hire purchase agreement. That is why, this method is also called as credit purchase method. All the payments made in the form of down payment and instalments are treated as repayment of loan with interest.

Accounting treatment:

Journal entries in the books of Hire purchaser.

1. On signing hire purchase agreement: Asset a/c To Hire Vendor's a/c Dr	With full amount of cash price of the asset.
2. Down payment, if any: Hire Vendor's a/c To Bank a/c Dr	With the amount paid toward s down payment
3. Instalment interest due: Interest a/c To Hire Vendor's a/c Dr	With the instalment interest amount, calculated on the outstanding balance.
4. Payment of instalment: Hire Vendor's a/c To Bank a/c Dr	With the amount of instalment paid
5. Depreciation on asset: Depreciation a/c To Asset a/c Dr	Depreciation is calculated on the cash price of the asset
6. Transfer of interest and depreciation to profit or loss account: Profit or Loss a/c To Interest a/c To Depreciation a/c Dr	Both interest and depreciation are nominal expenses for the hire purchaser hence it is transferred to the P/L a/c.

### INTEREST SUSPENSE METHOD:

Under this method, at the time of transfer of possession of asset i.e., on signing the hire purchase, the total interest un-accrued is transferred to interest suspense a/c. At the latter years when the interest becomes due, the interest a/c is debited and interest a/c is credited.

Total interest is calculated here as hire purchase price - cash price of the asset.

[remember that the hire purchase price is always more than the cash price of the goods because it includes interest for the unpaid value of the cash price of the goods.]

Accounting treatment:

Journal entries in the books of Hire purchaser.

1. On signing hire purchase agreement: Asset a/c To Hire Vendor's a/c Dr	With full amount of cash price of the asset.
2. Total interest payable: Hire purchase Interest Suspense a/c Dr To Hire Vendor's a/c	With total interest payable.
3. Down payment, if any: Hire Vendor's a/c To Bank a/c Dr	With the amount paid towards down payment
4. Instalment interest due: Interest a/c To Hire purchase Interest Suspense a/c Dr	With the instalment interest amount
5. Payment of instalment: Hire Vendor's a/c To Bank a/c Dr	With the amount of instalment paid
6. Depreciation on asset: Depreciation a/c To Asset a/c Dr	Depreciation is calculated on the cash price of the asset
7. Transfer of interest and depreciation to profit or loss account: Profit or Loss a/c To Interest a/c To Depreciation a/c Dr	Both interest and depreciation are nominal expenses for the hire purchaser hence it is transferred to the P/L a/c.

Note: the entries in both the methods are almost the same except for an extra entry in the interest suspense method for total interest payable.