HIRE PURCHASE

→ This is a transaction which allows for the acquisition of an asset by paying for the deposit and taking possession of the asset immediately the deposit is paid. The balance is payable in installment and it is subjected to interest.

→ Accounting for hire purchase requires application of "substantive over form principle" where the economic aspect of a transaction overrides the legal aspect of the transaction.

Hire purchase price = Deposit + all installment

OR

Hire purchase = Cash price + interest.

Interest can be allocated using the following methods.

1. **Streaght line method.**
This is where the total interest is allocated equally over the hire purchase perod.

2. **Sum of digits method**
The interest is allocated on the basis of the sum of hire purchase perod.

3 **Acturial Method** - This involves discounting the cashflows.

Methods of accounting for hire purchase

There are two major methods of accounting.

1) **Interest Method.**
Under this method, sales recognized at cash price. Interest is computed separately and considered as an income. The method usually applies where the company has few units of sale which are of high value.

2) **Sales Method.**
Under this method, sales are recognized at hire purchase price.
The gross profit = Hire purchase price - Cost of sales
The interest is not recognized as a separate income.

Accounts prepared under this method include:
- Debtor account
- Repossession account
- Provision for URP account

Debtors Account

Bal b/d	xx	Bad debt	xx
Sales	xx	Repossession	xx
		Cash received	xx
		Bal c/d	xxx

Repossession A/c

Outstanding balance	xx	Revaluation	xx
		Unrealized profit	xx
gain	xx	loss	xx
	xx		xx

$$\text{Unrealized profit} = \frac{\text{outstanding Amount}}{\text{Hire purchase sales}} \times \text{Gross profit}$$

NB: For URP we compute for both debtors & repossession.

Provision for URP Account

Repossession A/C	xx	Bad bid	xx
Bad a/c (debtor)	xx	Income statement	xx
	xx		xx

1. Interest Method

Illustration 1

Idopesha Ltd has been in business for several years dealing in electronic goods. All goods are sold on hire purchase terms. The following trial balance was extracted from the books of the firm as at 31 March 2016.

	sh000	sh000
Ordinary share capital		53,200
Cash at bank and in hand	1800	
Account payable		5000
Operating expenses	16,000	
PPE (1 April 2015)	55000	
Depreciation (1 April 2015)		20,000
Hire purchase installment receivables	34200	
Hire purchase sales		55200
Purchases	24600	
Inventory (1 April 2015)	1800	
	133400	133400

Additional Information.

1. Inventory as at 31 March 2016 was valued at sh 2,400,000.
2. PPE should be depreciated at sh 5 million for the year ended 31 March 2016.
3. Each unit was sold on hire purchase basis on the following terms:

Cash price	40,000	
Deposit	(10,000)	30,000
Interest		6000
		36000

4. Assume that all sales are made at the end of each quarter, and the quarter ends on 31 March, June, Sep and December respectively. The balance due on each hire purchase sale is payable in four equally installment of sh 9000 per quarter payable at the end of each quarter and commencing in the quarter following that of which the sales was made.

The number of units sold during each quarter were as follows

Quarter to	number of unit sold
30 June 2015	100
30 Sep 2015	200
31 Dec 2015	300
31 March 2016	600

All installments were received on their due dates.

5. The sum of digits method is to be used to apportion interest, the appropriate amount being credited to the quarter in which the installment is received.

6. Included in the operating expense is a lease rental payment of sh 2 million paid at the commencement of the financial year. This relates to equipment whose fair value is sh 8 million. The payment has been treated as an operating lease whereas it is a finance lease. The duration of the lease is 5 years and interest is at 10% per annum. Lease rental are paid in advance.

Required.

a) Income statement for the year ended 31 Dec 2017 (10mks)

b) Statement of financial position as at 31 Dec 2017 (10mks)

Soln

1) closing inventory 21600

~~cost~~ ~~cost~~ ~~P~~ ~~ESS~~

18000

Amortization schedule

Period	Bal b/d	payment	Bal due	interest 10%	principle	Bal c/d
1	8000	2000	6000	600	1400	6600
2	6600	2000	4600	460	1540	5060

Interest 600 N.C.L = 4600

Dep 8000 ÷ 5 = 1600 CL = 2000

2) Sum of digit method

$1+2+3+4=10$

Interest	sh000
Q1 = 100 x 6000 =	600
Q2 = 200 x 6000 =	1200
Q3 = 300 x 6000 =	1800
Q4 = 600 x 6000 =	3600

Quarter 1	Quarter 2	Quarter 3	Quarter 4
$\frac{4}{10} \times 600 = 240$	$\frac{4}{10} \times 1200 = 480$	$\frac{4}{10} \times 1800 = 720$	$\frac{4}{10} \times 3600 = 1440$
$\frac{3}{10} \times 600 = 180$	$\frac{3}{10} \times 1200 = 360$	$\frac{3}{10} \times 1800 = 540$	$\frac{3}{10} \times 3600 = 1080$
$\frac{2}{10} \times 600 = 120$	$\frac{2}{10} \times 1200 = 240$	$\frac{2}{10} \times 1800 = 360$	$\frac{2}{10} \times 3600 = 720$
$\frac{1}{10} \times 600 = 60$	$\frac{1}{10} \times 1200 = 120$	$\frac{1}{10} \times 1800 = 180$	$\frac{1}{10} \times 3600 = 360$

$$\begin{array}{c|cccc|}
 & Q1 & Q2 & Q3 & Q4 \\
Q1 & - & - & - & - \\
Q2 & 240 & - & - & - \\
Q3 & 180 & 480 & - & - \\
Q4 & 120 & 360 & 720 & - \\
\end{array} \quad 2100$$

Kopesha Ltd.

Income statement for the year ended 31 March 2016

		sh000
Sales 1200 units × 40		48000
cost of sales		
opening stock	1800	
Purchases	24600	
Closing stock	(2400)	(24000)
Gross profit		24000
Interest income		2100
Expenses		
operating expenses (16000 - 2000)		(14000)
Depreciation - PPE		(5000)
- Lease		(1600)
Interest expense		(600)
profit		4900

Kopesha Ltd.

Statement of financial position as at 31 March 2016

	sh000
Assets	
Non-current Assets	
PPE (55000 - 20,000 - 5000)	30,000
Leased Equipment (8000 - 1600)	6400
Current Assets	
Inventory	2400
Receivables (34200 - 7200) → (55200 - 48000)	27000
Cash and bank	1800
Interest receivable	2100
	69700
Equity and liabilities	
Ord share capital	53200
profit	4900
Non-current liabilities	
lease obligation	4600
current liabilities	
Lease obligation	2000
Account payable	5000
	69700

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b. Balance sheet as at 31 Dec 2018 (10 marks)

2. Sales method.

HIRE PURCHASE

QUESTION ONE

Lipa pole ltd commenced business on 1 January 2016 as a supplier of refrigerators. All sales are made on hire purchase terms, with the company taking credit for the gross profit, including interest, in proportion to the installments collected.

Throughout the year ended 31 December 2016 and 2017, the total price including interest charged to every customer was 50% above the cost of goods sold or in the case of repossessed goods, 50% above the value at which the goods were taken back into the stock. The hire purchase contract required no deposit and provided for the payment of 12 equally monthly installments.

The following trial balance was extracted from the books of Lipa pole ltd as at 31 Dec 2017.

	Sh "000"	sh "000"
Share capital		35,000
Non-current asset at cost	10,000	
Provision for depreciation as at 1 Jan 2017		1,000
Hire purchase installment due less provision For unrealized profit as at 1 Jan 2017.	28,350	
Stock as at 1 Jan 2017 at cost	6600	
Purchases	59,000	
Cash received from customers		80,625
Bank balance	6500	
Creditors		4860
General expenses	16,150	
Revenue reserve as at 1 Jan 2017		5,115
	126,600	**126,600**

Additional information.

1. The sales, including interest for the year ended 31 December 2017 were sh. 94,650,000.
2. In October 2017, the company repossessed some goods which had cost sh. 4,800,000 and had been sold earlier in the year. The unpaid installment on these goods amounted to sh. 2,400,000 in respect of which nothing was recovered apart from the goods, which were taken back into the stock at a valuation of sh. 2,000,000 the repossessed goods were re-sold before the end of the financial year. The total selling price, both on the original sale and on resale of repossessed goods were included in the sales for the year ended 31 Dec 2017.
3. All installments were paid on time except for those referred to in note 2 above.
4. All goods unsold as at 31 Dec 2017 were in good conditions and were to be valued at cost
5. Provisions for depreciation on the non-current assets were to be provided at the rate of 10% per annum on cost.

Required:-

a) Income statement for the year ended 31 Dec 2017 (10mks)

b) Statement of financial position as at 31 Dec 2017 (10mks)

Soln

Hire purchase debtor A/C

Bal b/d	28,350	Cash received	80625
sales	94650	Repossession	2400
		Bal c/d	39975
	123000		123000

Repossession A/C

Debtors	2400	Valuation	2000
Gain	400	URP	800
	2800		2800

$URP = \frac{\text{outstanding Amount}}{\text{Hire purchase sales}} \times \text{gross profit}$

94650 — 150%

x — 100% x = 63100

gp = 94650 − 63100 = 31550

$URP_{debtors} = \frac{39975}{94650} \times 31550 = 13,325$

$URP_{Repossession} = \frac{2400}{7200} \times 2400 = 800$

Sales = 4800 x 150% = 7200

gp = 7200 − 4800 =

Lipa pole Ltd.
Income statement
for the year ended 31 Dec 2017

	Sh'000
Sales-original (94650-3000)	91650
-Repossession 2000x150%	3000
	94650
Cost of sales	
Original sales 91650÷1.5	(61100)
Repossession	(2000)
Gross profit	31550
Repossession gain	400
Expenses	
URP = 13325+800	(14125)
General expenses	(16150)
Depreciation 10%x10,000	(1000)
	675

Lipa pole Ltd.
Statement of financial position
As at 31 Dec 2017

	Sh'000
Non-current Asset	
Non current Asset 10,000-1000-1000	8000
Current Assets	
Bank Balance	6500
Debtors (39975-13325)	26650
Inventory = (6600+59000-61100)	4500
	45,650
Equity & liabilities	
Ord share capital	35000
Revenue reserve (5115+675)	5790
Creditors	4860
	45650

NOV 2017 Q 5b

W1 cost of sales

cash sales = 36000 → 150% x = 24000
x — 100%

Hire purchase 270,000 → 180% x = 150,000
x — 100%

W2 Unrealized Profit

270 − 150

URP = $\frac{\text{outstanding Amount}}{\text{Hire purchase sales}}$ × Gross profit = $\frac{113400}{270000}$ × 120000 = 50,400

Debtors Account

Bal b/d	1134	Cash received	157,734
sales	270000	Bal c/d	113400
	271134		271,344

Dep = 15% × 50,000 = 7500
cash sales = 1/3 × 7500 = 2500

1) Rejareja ltd.
Income statement for the year ended 30 Sep 2017

	Cash sales	Hire purchase	Total sales
Sales	36000	270000	306000
cost of sales	(24000)	(150000)	(174000)
Gross profit	12000	120000	132000
provision for URP (50400-504)	—	(49896)	(49896)
General expenses	(7800)	(57200)	(65000)
Depreciation	(2500)	(5000)	(7500)
profit	1700	7904	9604

Rejareja ltd.
statement of financial position as at 30 Sep 2017

Assets	54000
Non-current Asset	
PPE = 50000 − 22500 − 7500	20,000
Current Asset	
Inventory (7500 + 171000 − 174000)	4500
Receivables 113400 − 50400	63000
Cash	3104
Total Asset	90604
Equity and liabilities	
Ord share capital	37500
Retained profit 3500 + 9604	13104
Liabilities	
payables	40000
	90604