Hire Purchase

According to the hire purchase Act of 1972, ;the term hire purchase defined " an agreement under which goods are let on hire and which the hirer has an option to purchase them in accordance with the terms of the agreement

Agreement

a) Possession of goods is delivered by the owner there of to a person on the condition that person pays the agreed amount in periodic payments.
b) The property of the goods is to pass to such a person on the payment of the last of such installment.
c) Such a person has a right to terminate the agreement any time before the property so passes"
d) Payment to be made in installments over a specified period.

Features

1. The HPFC (Hire purchase finance company) purchases the equipment supplier and lets it on hire to the hirer to use it who is require to make down payment of 20-25 percent of the cost and pay balance with interest in equated monthly instalments in advance or arrears spread over 36-48 months.
2. The interest rate on hire purchase mostly flat rate.

Rights of Hirer

1. Right of protection
2. Right of Notices
3. Right to Repossession
4. Right of Statement
5. Right to Excess amount

Methods of Interest Calculation

1. Effective Rate of Interest or Annual percentage rate Method.

2. Sum of years Digits Method
3. Straight Line Method

Effective Rate of Interest

Steps:

1. Find HP principal = Cost of asset – Down Payment
2. Find total HP Amt. = (HP principal x Flat rate of int. x HP period of years)
3. Find total HP amount = (Step 1 + Step 2)
4. Find annual instalment amt. = (Step 3 / No. of instalments)
5. Find effective rate of interest (ERI) =

   Rate of Int. = PV of future annual instalments = PV of HP principal amount payable.
6. Find Annual Interest Amt. = Total principal OS at the beginning x ERI

Sum of years digits Method

Annual amt of int. = (Number of years of remaining HP period including the current year / Total of all digits representing the period of HP)

Where :

Total amount of interest for HP period = Total Amt. payable x Flate rate of interest.

Straight line Method

Annual amt. of interest = Total amt. of interest for HP period / No. of HP period

Method of Reporting

1. Disclosure in Hirer Books
2. Disclosure in Hire vendor Books

Hire Purchase Evaluation

Step 1: Calculate annual interest amount.

Step 2 : Find Principal amount outstanding at the beginning of each year =

Total outstanding Principal – principal paid in the previous year

Step 3: Find principal paid in the previous year = Annual instalment amt. – Annual int.

Step 4: Find Annual ITS = Annual Interest x Tax Rate

Step 5: Find annual Depreciation

Step 6: Find Annual DTS = Annual Depreciation x Tax rate

Step 7: Find total TS = Step 4 + Step 6

Step 8: Find annual instalment amt. = Total HP amt. + [HP Amt. Flate rate of interest] – NO. of HP years]

Step 9: Find PV Salvage value of asset = SV x PVF capital

Step 10: Find net cash outflow of HP = Step 8 – Step 7

Step 11: Find PV of net cash outflow of HP at the appropriate discount rate

Step 12: Find Total PV net cash out flow of HP = Step 11 – Step 9