

## CHAPTER 21

# LEASE & HIRE PURCHASE

### INTRODUCTION

21.1 This chapter contains the recommended accounting system for transactions relating to fixed assets purchased or sold under hire purchase and leases by Urban Local Bodies (ULBs). The accounting principles and procedures given in this chapter is based on specific references taken from Indian Accounting Standard (AS) 19 on 'Accounting for Leases' issued by the Institute of Chartered Accountants of India. In case of any other guidance/ clarifications the same shall be obtained by referring to AS 19.

21.2 A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

21.3 A lease is classified as a finance lease if it transfers substantially all risks and rewards incident to ownership. All other leases are classified as operating leases. Classification is made at the inception of the lease. Whether a lease is finance lease or an operating lease depends on the substance of the transaction rather than the form. Contextually under finance lease agreement the ownership passes on to the lessee on completion of the lease and in the case of an operating lease the ownership always remains with the Lessor.

22.4 Hire purchase agreement is a contract, more fully called contract of hire with an option of purchase, in which a person hires goods for a specified period and at a fixed rent, with the added condition that if he retains the goods for the full period and pay all the installments of rent as they become due the contract shall determine and the title vest absolutely in him.

22.5 Accounting of leases and hire purchase transactions shall be divided into the following situations:

- Finance lease in the books of lessee.
- Operating lease in the books of lessor.
- Finance lease in the books of lessor
- Operating lease in the books of Lessee

- Hire Purchase in the books of buyer.
- Hire Purchase in the books of seller.

21.6 Considering the general position ULB as lessee in the case of Finance leases and lessor in the case of Operating lease are provided in this manual. While both situations are covered in respect of Hire Purchase.

## **ACCOUNTING RECORDS AND PROCEDURES**

21.7 *This section describes the records, registers, documents, forms, accounting entries, etc., in respect of accounting for transactions related to Fixed Assets under lease and hire purchase. For the purposes of accounting of Fixed Assets under a lease or hire purchase all the forms applicable, are generally applicable in respect of the transactions of the ULBs including in respect of Fixed Assets.*

### **ACCOUNTING PRINCIPLES:**

21.8 The following Accounting Principles shall govern the recording, accounting and treatment of transactions relating to Fixed Assets acquired/given under Lease and Hire Purchase:

- a. Finance lease in the books of lessee
  - At the commencement of the lease term, finance leases shall be recorded as an asset and a liability. Such recognition shall be at an amount equal to the cost.
  - Finance lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance
  - Charge shall be allocated as to produce a constant periodic rate of interest on the remaining balance of the liability for each of the period.
  - Depreciation on such assets shall be provided at the same rates as in case of owned assets.
  
- b. Operating lease in the books of Lessor
  - Assets given under operating lease shall be accounted as its assets in the same manner similar to any other fixed assets owned and used by the ULB.
  - Lease income from operating leases shall be recognised as income on a straight-line basis over the lease term. Lease income shall be accrued on the respective due dates.
  - Any amount incurred that results in improvement or increase of the useful life of the assets under operating lease shall be capitalised as like any other asset used by the ULB for its own operations; Depreciation on such assets shall be provided at the

same rates as in case of owned assets.

c. Hire purchase in the books of buyer

- The purchase price shall be capitalised as the cost of fixed assets.
- Hire Purchase (HP) installments shall be apportioned between the finance charge and the reduction of the principal outstanding. The finance charge shall be allocated so as to produce a constant periodic rate of interest on the remaining balance of the liability;
- The total amount of interest portion out of the 'HP Payable' shall be accounted by debiting to a control account under current assets. This amount will be adjusted on accounting of finance charges
- The depreciation principle for assets purchased under HP should be consistent with that for owned assets.

d. Hire purchase in the books of seller

- The sale price (including the interest portion) shall be accounted as receivable from HP agreement;
- HP installments shall be apportioned between the interest income and the reduction of the principal amount receivable (the finance income to be allocated so as to produce a constant periodic rate of interest on the remaining balance of the receivable);
- The total amount of interest portion out of the 'HP Receivable' shall be accounted by crediting to a control account under current assets. This amount will be adjusted while accounting for finance charges

## **ACCOUNTING FOR FINANCE LEASE IN THE BOOKS OF LESSEE**

### **Accounting for Acquisition/Purchase of Fixed Assets**

21.9 Recording of purchase of Fixed Assets: Delivery / installation of fixed assets purchased under a 'Finance Lease' shall be as per the agreement. To record the purchase of the fixed assets under a finance lease (for example at a cost Rs.25,00,000), the Accounts Department shall pass the following entry:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
410-+(a)	Fixed Assets (please specify the type) *	Dr.	2,500,000		Journal Book, Ledger, Register of Movable/Immovable Assets
470-30-(b)	Interest control payable – Leases	Dr.	250,000		
350-80-(b)	To Lease Charges payable	Cr.		27,50,000	

(a) Insert Minor Head Codes as applicable

(b) Insert detailed head codes as applicable.

\* All the fixed assets belonging to a class of assets shall be accounted under that asset class. For instance, the acquisition of a building for any purpose shall be accounted under the asset head of Buildings.

*Note: The postings in the Ledger Accounts of “Fixed Asset” Account, “ Lease Charges Payable”, “Interest Control Payable” Account shall be carried out as indicated in Chapter 5 – General Accounting Procedures. The postings in the Ledger Accounts shall be similarly carried out in respect of all other accounting entries described subsequently in this chapter. Whenever, the cash or the bank account is involved, there will be no entry in the Journal Book.*

21.10 ‘Interest control payable – Leases account’ is in the nature of a control account, which represents an equivalent amount of unpaid interest portion included in the ‘Lease Charges Payable’. The balance in this account gets reduced at the period ends by accounting for the finance charges portion of the lease payments dues for the period.

### Lease payments

21.11 The periodical lease payments shall be accounted as per the lease agreement, the accounting entry for periodical lease payment (for example if the annual lease payment inclusive of interest is Rs 2,75,000) is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
350-80-(a)	Lease Charges Payable	Dr.	2,75,000		Cash Book, Ledger
450-21-(a)	To Bank Account*	Cr.		2,75,000	

\* Specify names of the Bank and Account number

(a) Include Detailed Head Codes of Account as applicable

### Finance Charges

21.12 The portion of finance charges out of the lease payments due for the current period shall be identified at the period ends and accounted as finance charges for the period. The accounting entry for recording the finance charges is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
240-60-(a)	Interest on Leases	Dr.	25,000		Journal Book, Ledger
470-30-(a)	To Interest control payable – Leases	Cr.		25,000	

(a) Include Detailed Head Codes of Account as applicable

### Depreciation Charge

21.13 At the end of the accounting year, depreciation shall be provided on each class of fixed assets under finance lease at the prescribed rates. The amount of depreciation to be provided each year shall be computed by applying the depreciation rate to the cost of acquisition or written down values as the case may be. The calculation and accounting of depreciation shall be same as explained in para 20.16 of Chapter 20 on Fixed Assets.

## ACCOUNTING FOR OPERATING LEASES IN THE BOOKS OF LESSOR

### Lease rental income

21.14 Recording of accrual of lease rental ■ The lease rentals due for the period shall be accrued in accordance with the lease agreement. For example, if there is an agreement for rental of Furniture under an operating lease for a monthly rental of Rs.5,000 it shall be accounted on a monthly basis. The accounting entry for this is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
431-40-(a)	Receivables from other sources – Lease rental To Other rent -	Dr.	5,000		Cash Book, Ledger
130-80-(a)	Lease Rental	Cr.		5,000	

(a) Include Detailed Head Codes of Account as applicable

21.15 Recordings of receipt of lease rentals : The lease rentals shall be received in accordance with the lease agreement. The accounting entry for this is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.)	Credit Amount (Rs.)	Books to be
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			Illustrative figures	Illustrative figures	entered into
450-21-(a)	Bank Account * To Receivables From Other Sources	Dr.	5,000		Cash Book, Ledger
431-40-(a)	– Lease rental	Cr.		5,000	

\* Specify name of the Bank and Account number

(a) Insert Detailed Minor Head Codes of account as applicable

21.16 Accounting of Fixed assets and depreciation: Accounting treatments for the Fixed assets given under an operating lease and depreciation on those assets shall follow the same principles and procedures as laid down in Chapter 21 on Fixed Assets

#### Period end procedures:

21.17 Accrual of lease rentals: The Accounts Department shall identify the total lease rentals due for the period under reporting and compare the same with the lease rental income recognised till date in the books and account for differences if any.

### ACCOUNTING OF HIRE PURCHASE (HP) IN THE BOOKS OF BUYER

#### Down payment against purchase of Asset under Hire purchase agreement

21.18 The HP agreement may have clauses for down payments either before or after delivery or receipt of the asset depending on the terms of the HP agreement.

21.19 To record the down payment made, the following entry shall be passed:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
460-40-(a)	Advance for HP Assets	Dr.	25,000		Cash Book, Register of Advances, Ledger Accounts
450-21-(a)	To Bank Account*	Cr.		25,000	

\* Specify Name of the Bank and Account number

(a) Insert Detailed Head Codes as applicable.

#### Accounting for Acquisition/Purchase of Fixed Assets

22.20 Recording of purchase of Fixed Assets: To record the purchase of the Fixed Asset under a hire purchase agreement, the Accounts Department shall pass the following entry:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative	Credit Amount (Rs.) Illustrative	Books to be
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			figures	figures	entered into
410-(a)	Fixed Assets (please specify the type)	Dr.	2,50,000		Journal Book, Ledger, Register of Movable/Immovable Assets and Register of Advances
470-30-(a)	Interest control payable - HP	Dr.	50,000		
330-60-(a)	To Other Term Loans- HP	Cr.		2,75,000	
460-40-(a)	To Advance for HP Assets	Cr.		25,000	

- (a) Insert Minor Head Codes of Account as applicable  
(b) Insert Detailed Head Codes of account as applicable.

### HP Installments

21.21 Assuming that in the example given in the previous para carries an annual installment repayment of Rs.27, 500. The accounting entry for the payment of installment is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
330-60-(a)	Other Term Loans- HP	Dr.	27,500		Cash Book, Ledger
450-21-(a)	To Bank Account*	Cr.		27,500	

\* Specify names of the Bank and Account number

- (a) Include detailed Head Codes of Account as applicable

### Finance Charges

21.22 The portion of interest out of the 'HP payable' due for the period under reporting shall be identified at the period ends and accounted as 'finance charges for that period. Assuming that in the annual repayment of Rs.27,500 includes interest charge of Rs 5,000, the accounting entry for recording the interest charges are as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
240-60-(a)	Other Interest - HP	Dr.	5,000		Journal Book, Ledger
470-30-(a)	To Interest control payable - HP	Cr.		5,000	

- (a) Include Detailed Head Codes of Account as applicable

### Depreciation Charge

21.23 At the end of the accounting year, depreciation shall be provided on each class of Fixed Asset purchased under HP at the prescribed rates. The amount of depreciation to be provided each year shall be computed by applying the depreciation rate to the cost or written down values of the Fixed Assets as the case may be. The calculation and accounting entries for Depreciation on Fixed Assets purchased under HP shall be same as explained in para 20.16 of Chapter 20 on Fixed Assets.

### Period end procedures:

21.24 Recording of interest portion of the installments due appropriately: The Accounts Department shall identify the interest portion of the installments payable for the period under reporting and accordingly account for the Interest Charges for the period.

### ACCOUNTING OF HIRE PURCHASE (HP) IN THE BOOKS OF SELLER

#### Down payment received under Hire purchase agreement

21.25 The HP agreement may have clauses for down payments to be received from the buyer up-front either before or after delivery of the asset depending on the terms of the HP agreement.

21.26 For example, the accounting entry for 10% down payment received on the sale of assets costing Rs 250,000 is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
450-21-(a)	Bank Account*	Dr.	25,000		Cash Book, Register of Advances, Ledger Accounts
350-80-(a)	To Other Liabilities- HP Advance received	Cr.		25,000	

\* Specify Name of the Bank and Account number

(a) Insert Detailed Head Codes of Account as applicable

#### Sale of Assets under HP

21.27 To record the sale of the assets under an HP agreement and adjust the 'down payment' received, the Accounts Department shall pass the following entry:

Code of	Accounting Entry	Dr./	Debit Amount	Credit	Books to be
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Account		Cr	(Rs.) Illustrative figures	Amount (Rs.) Illustrative figures	entered into
350- 80-(a)	Other Liabilities - HP Advance received	Dr.	25,000		Journal Book, Ledger, Register of Movable/Immovable Assets
460-80-(a)	Other Current assets – HP Installments receivable	Dr.	2,75,000		
410-(b)	To Fixed Assets(please specify the type)	Cr.		275,000	
350-80-(a)	To Other Liabilities- Interest control receivables – HP	Cr.		25,000	

(a) Insert Detailed Head code of Account as applicable

(b) Insert Minor & Detailed Head Codes of Account as applicable

### Installment receipts

21.28 The periodical hire purchase installments due shall be received as per the HP agreement. Assuming that in the example given in the previous para carries an annual installment repayment of Rs.27, 500. The accounting entry for receipt of the installment is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
450-21-(a)	Bank Account*	Dr	27,500		Cash Book, Ledger
460-80-(a)	To Other Current assets - HP Installments Receivable	Cr.		27,500	

\* Specify names of the Bank and Account number

(a) Include Detailed Head Codes of Account as applicable

### Interest Income

21.29 The portion of interest income out of the 'Receivables - HP' due for the period under reporting shall be identified at the period ends and accounted as 'Interest Income for that period. Assuming that in the annual repayment of Rs.27,500 includes interest charge of Rs 5,000, the accounting entry for recording the interest is as follows:

Code of Account	Accounting Entry	Dr./ Cr	Debit Amount (Rs.) Illustrative figures	Credit Amount (Rs.) Illustrative figures	Books to be entered into
350-80-(a)	Interest control receivables – HP To Other Interest	Dr.	5,000		Journal Book, Ledger
171-80-(a)	Income - HP	Cr.		5,000	

(a) Include Detailed Head Codes of Account as applicable

## **Period end procedures:**

21.30 Recording of interest portion of the installments due appropriately: The Accounts Department shall identify the interest portion of the installment receivable for the period under reporting and accordingly account for the Interest Charges for the period.

## **INTERNAL CONTROLS**

21.31 The following internal controls shall be observed by the ULB:

a. For Finance lease /Hire purchase in the books of lessee /buyer:

- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that the 'purchase of fixed assets' under a finance lease or HP and the terms (lease/HP rentals, lease/HP periods and interest rate) of the lease/HP agreement is approved before recording the capitalisation.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that the interest charges included in the Lease Charges/HP Payable for the period under reporting are accounted appropriately.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that penalties or additional interests on account of delay in installment dues are provided as per the Lease /HP agreement

b. For Operating Leases in the books of Lessor

- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that lending the 'fixed assets' under a operating lease and the terms (lease rentals, lease periods) of the lease agreement are approved before recording of any lease rental income.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that penalties or additional interests on account of delay in installment dues are raised timely and accounted as per the Lease agreement.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall have a system of conducting physical verification of fixed assets throughout the year so that each fixed asset is verified at least once during the year. Alternatively, a periodical confirmation of the assets held under operating lease from the lessee shall also be obtained. Any

discrepancies with the Fixed Assets Register and the physical verification sheets or confirmation shall be reconciled.

- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that the fixed assets given under operating leases are updated in the Register of Immovable Properties with the name of the lessee and location.

For Hire Purchase in the books of Seller

- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that 'sale of fixed assets' under a hire purchase agreement and the terms (HP installments, periods and interests) of the agreement are approved before recording the sale of assets.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that the interest income included in the HP Installments due for the period under reporting are accounted appropriately.
- The Executive Officer /Secretary & in case of Municipal Corporation the Head of the Accounts Department shall ensure that penalties or additional interests on account of delay in installment dues are levied and accounted as per the HP agreement.

### **Presentation in financial statements**

2132 The various heads of account used for the accounting of Fixed Assets shall be reflected in the Financial Statements or the Schedules attached to the Financial Statements of the ULBs. All such Financial statements and schedules shall be affixed with signature/seal of the Commissioner or authority authorised by him in this behalf and in case other ULBs the Executive Officer/Secretary.

2133 The schedule of Income and Expenditure Statement in respect of Fixed Assets under a finance lease is provided below.

### **Schedule I-3: Schedule of Rental income from Municipal Properties**

Code No.	Particulars	Current Year Amount(Rs.)	Previous Year Amount (Rs.)
	<b>Current Liabilities</b>		
350-80--(a)	Others- Lease Charges payable		
350-80-(a)	Others- HP Advance		
350-80-(a)	Interest control Receivables – HP		
	<b>Total</b>		

(a) Include Detailed Head Codes of Account as applicable

### Schedule B-15: Sundry Debtors (Receivables)

Code No.	Particulars	Gross Amount (Rs.)	Provision for Outstanding revenues (Rs.)	Net amount (Rs.)	Previous year Net amount (Rs.)
1	2	3	4	5 = 3 – 4	6
431-40-(a)	Receivables from Other sources- HP				
	Less than 2 years *				
	More than 2 years*				
	Sub-total				
431-40-(a)	Receivables from Other sources – Lease Charges				
	Less than 2 years *				
	More than 2 years*				
	Sub-total				
	<b>Total</b>				

(a) Include Detailed Head Codes of Account as applicable

### Schedules B-18: Schedule of Loans, advances & Deposits

Code No.	Particulars	Current Year Amount(Rs.)	Previous Year Amount (Rs.)
460-40-(a)	Advance to Suppliers - HP Assets		
	<b>Total</b>		

(a) Include Detailed Head Codes of Account as applicable

### Schedules B-17: Schedule of Cash & Bank

Code No.	Particulars	Current Year Amount(Rs.)	Previous Year Amount (Rs.)
	<b>Current Assets</b>		
450-10-(a)	Cash Account		
450-21-(a)	Bank Account		
	<b>Total</b>		

(a) Include Detailed Head Codes of Account as applicable

## Schedule B-10: Fixed Assets

Code No	Particulars	Gross Block (410)				Accumulated Depreciation (411)				Net Block	
		Opening Balance	Additions during the period \$	Deductions during the period	Cost at the end of the year	Opening Balance	Additions during the period	Deducti ons during the period	Total at the end of the year	At the end of current year	At the end of the previous year
410-10-(a)	Land										
410-20-(a)	Buildings										
410-30-(a)	Roads and Bridges										
410-31-(a)	Bridges & Fly –overs										
410-32-(a)	Sewerage and drainage										
410-33-(a)	Water works										
410-40-(a)	Plants & Machinery										
410-50-(a)	Vehicles										
410-60-(a)	Office & other equipment										
410-70-(a)	Furniture, fixtures, fittings and electrical appliances										
410-80-(a)	Public Lighting										
410-90-(a)	Other fixed assets										
	<b>Total</b>										

Additional disclosures to the Schedule

(1) Value of fixed assets under dispute or litigation shall be provided. The status of the legal case as at the reporting date of the financial statements shall also be mentioned.

(2) The details & value of assets, which are not yet physically identified/traced, shall be disclosed separately.

(3) Details and value of assets under leases and hire purchase needs to be disclosed as a note

Note:

- Gross Block means cost of acquisition of fixed asset. Opening Balance in Gross Block as on the first day of the year represents the closing balance of the previous year. For instance, the opening balance as on 1<sup>st</sup> April 2002 shall be equal to the closing asset balance as on 31<sup>st</sup> March 2002.
- Land includes areas used as and for the purpose of public places such as parks, squares, gardens, lakes, museums, libraries, godowns etc. Buildings include office and works buildings, commercial buildings, residential buildings, school and college buildings, hospital building, public buildings temporary structures and sheds, etc.
- Roads and bridges include roads and streets, pavements, pathways, bridges, culverts and subways.
- Sewerage and drainage include sewerage lines, storm water drainage lines and other similar drainage system.
- Waterworks include water storage tank, water wells, bore wells, Water pumping station, Water transmission & distribution system, etc.
- No depreciation is to be charged on "Land"(01)
- All the assets under leases and hire purchase needs to be quantified by referencing in a note



