

# **LEASES AND HIRE PURCHASE**

**Dr.Rachanaa Datey**

# USE BY BUSINESSES

- A lease or hire purchase agreement may be used to acquire an asset that is used by the business. This is different to a lease agreement for a short period, such as hiring a van for a week to assist in deliveries.
- A business may acquire a right to use a vehicle or piece of machinery through such an agreement, in which case it may be treated as an asset of the business.

# OWNERSHIP

- Most fixed assets are owned by the business.
- With a lease there is often no agreement for legal ownership of the asset to pass to the lessee.
- Under a hire purchase contract the hirer can obtain legal title by exercising an option to purchase.

# HIRE PURCHASE

- The hirer has the right to use the asset after payment of a deposit and in return for making regular payments over an interval of time. These are to cover the cost and interest. At the end of the period ownership will usually pass from the finance company to the business.
- The asset is shown as a fixed asset since the hirer has sole use of the asset and as long as payments are made the item can be treated as if the business owns the asset.
- In legal terms the business does not own the asset until it exercises the right to purchase.

# ACCOUNTING TREATMENT FOR HIRE PURCHASE

- The cost of the fixed asset is shown on the balance sheet. The cost shown excludes any interest paid.
- The net book value is the cost less any provision for depreciation.
- In the profit and loss account the interest paid during the year is shown, together with any depreciation.
- In the balance sheet the liability for future payments is shown. The liability does not include interest. The short term and long term liabilities are shown separately.

# LEASING

- The lessee uses the asset purchased by a finance company.
- The lessee makes hire/rental payments to the company during the period of the lease.
- Ownership of the asset never passes to the lessee.
- There are two types of lease:
  - Operating lease which is short-term and where the asset may be hired to several lessees.
  - Finance lease which is long term and where the asset is hired to only one lessee.

# ACCOUNTING TREATMENT FOR LEASING

- In the balance sheet the cost price, excluding interest is shown.
- Net book value is cost price less provision for depreciation.
- In the profit and loss account the interest for the year is shown together with any depreciation.
- In the balance sheet the liability for future lease payments is shown according to current and long term liabilities. The interest due is not shown as a liability.



**THANK YOU**