ગુજરાત રાજ્યના શિક્ષણવિભાગના પત્ર-ક્રમાંક
મશબ/1215/178/છ, તા. 24-11-2016–થી મંજૂર

ELEMENTS OF ACCOUNTS

(Part 1)

Standard 12

PLEDGE

India is my country.

All Indians are my brothers and sisters.

I love my country and I am proud of its rich and varied heritage.

I shall always strive to be worthy of it.

I shall respect my parents, teachers and all my elders and treat everyone with courtesy.

I pledge my devotion to my country and its people.

My happiness lies in their well-being and prosperity.

રાજ્ય સરકારની વિનામૂલ્યે યોજના હેઠળનું પુસ્તક

Gujarat State Board of School Textbooks
'Vidyayan', Sector 10-A, Gandhinagar-382010

Subject Adviser
Shri R. H. Vyas

Authors
Dr H. C. Sardar (Convener)
Shri Pankajbhai C. Raval
Dr Dipak R. Raste
Dr R. K. Patel
Dr Jayesh A. Thakkar
Shri Sureshchandra J. Sahu
Shri Raghubhai T. Socha

Translators
Dr H. C. Sardar
Shri Pankajbhai C. Raval
Dr Dipak R. Raste
Dr R. K. Patel

Reviewers
Dr Bharat J. Acharya
Shri Neel A. Shastri
Shri Philomina L. Solanki
Shri Arvind B. Acharya
Shri Maulik B. Shah
Shri Parul M. Divan
Dr Manoj D. Shah
Shri Soham S. Desai
Shri Aliasgar T. Bookwala

Language Reviewer
Dr Bharti G. Dave

Co-ordinator
Dr Chirag N. Shah
(Subject Co-ordinator : Commerce)

Preparation and Planning
Dr Kamlesh N. Parmar
(Dy. Director : Academic)

Lay-out and Planning
Shri Haresh S. Limbachiya
(Dy. Director : Production)

PREFACE

The Gujarat Secondary and Higher Secondary Board has prepared new syllabi in accordance with the syllabi at the national level. These syllabi are approved by the Government of Gujarat.

The Gujarat State Board of School Textbooks takes pleasure in presenting this textbook to the students. It is prepared according to the new syllabus of **Elements of Accounts (Part 1)** for **Standard 12**.

This textbook is written and reviewed by expert teachers and professors. This textbook is published after incorporating the necessary changes suggested by the reviewers.

The Board has taken ample care to make this textbook interesting, useful and free of errors. However, suggestions are welcome to improve the quality of this book from persons taking interest in education.

H. N. Chavda
Director
Date : 03-02-2017

Dr. Nitin Pethani
Executive President
Gandhinagar

First Edition : 2017

Published by : H. N. Chavda, Director, on behalf of Gujarat State Board of School Textbooks, 'Vidyayan', Sector 10-A, Gandhinagar

Printed by :

FUNDAMENTAL DUTIES

It shall be the duty of every citizen of India*:

(a) to abide by the Constitution and respect its ideals and institutions, the National Flag and the National Anthem;

(b) to cherish and follow the noble ideals which inspired our national struggle for freedom;

(c) to uphold and protect the sovereignty, unity and integrity of India;

(d) to defend the country and render national service when called upon to do so;

(e) to promote harmony and the spirit of common brotherhood amongst all the people of India transcending religious, linguistic and regional or sectional diversities; to renounce practices derogatory to the dignity of women;

(f) to value and preserve the rich heritage or our composite culture;

(g) to protect and improve the natural environment including forests, lakes, rivers and wild life, and to have compassion for living creatures;

(h) to develop the scientific temper, humanism and the spirit of inquiry and reform;

(i) to safeguard public property and to abjure violence;

(j) to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement;

(k) to provide opportunities for education by parent, the guardian, to his child, or a ward between the age of 6 to 14 years as the case may be.

* Constiution of India : Section 51-A

CONTENTS

●

1

Introduction to Partnership

1. Introduction

The partnership form is emerged from capital and managerial limitations of sole proprietor firm. Following are the reasons for the emergence of partnership firm.

(i) An individual has sufficient funds but does not have required skill. (ii) An individual has required skill but does not have sufficient funds. (iii) To distribute business risk.

More than one person, additional capital, skill and managerial ability are required to run a business at a large level and for the expansion of any business. In these circumstances, more than one person gather and become the supplement to each other and commence a business; this form of business organisation means a partnership firm.

2. Meaning and Definition of Partnership

Section 4 of the Indian Partnership Act 1932, defines partnership as, "Partnership is the relation between the persons who have agreed to share the profit of a business carried on by all or any one of them acting for all."

The person who enter into such relationship are individually called 'partners' and collectively a 'firm'.

From the above definition it can be said that two or more persons who are competent to undertake a contract to earn profit from a legal business, the business is termed as partnership.

The business run collectively in partnership by two or more persons is known as partnership firm.

3. Characteristics of Partnership

(1) Creation by Contract : Partnership emerge through agreement. Partnership agreement can be in written or oral form. But written form is desirable and advisable.

(2) Profit Objective : Partnership firm forms to earn and distribute profit. The distribution of profit or loss is done amongst partners in their predetermined proportion. As per partnership act profit or loss is distributed in equal proportion if no provision is made in the contract.

(3) **Legal Business :** Partnership firm is formed to do a legal business.

(4) **Agent of Each other :** The business of partnership firm is run by all the partners or any one of them for all or more than one partner. Thus each partner is an agent of each other.

(5) **Number of Partners :** The section 464 of the companies Act, 2013 empowers the government to prescribe maximum number of partners in a firm subject to maximum of 100. The government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the companies (miscellaneous) Rules, 2014.

(6) **Unlimited Liabilities :** As per partnership Act partners are responsible to pay business obligation from their personal property when the firm does not have sufficient assets to pay liabilities of the business. Every partner individually and collectively is responsible to the partnership firm. Therefore the liability of each partner is unlimited.

(7) **Ownership and Management of Firm :** Partners are owners of business and they do the management of business. The management of business is done either by all the partners or by one partner or by more than one partner.

4. Partnership Deed

The emergence of partnership is from the agreement. Partners undertake agreement within the provisions of partnership act. Partnership deed acceptable to all the partners is prepared at the time of the commencement of a partnership firm. The partnership agreement can be written or oral. A written agreement of partnership is known as a partnership deed. A written partnership deed is desirable and advisable, so that the solution of any misunderstanding or dispute in future can be obtained on the basis of the provisions of the partnership deed. The partnership deed is a administrative constitution of partnership firm, where all provisions pertaining to firms' administration are included. Generally, the following content is included in the partnership deed.

(1) **Details of Partners :** The information about name, address and other details of patners is included.

(2) **Details of Firm :** The details like name and address of the firm are included.

(3) **Type of Business :** The information about the type of business is also included here.

(4) **Commencement of Partnership :** The information about the commencement date of the partnership firm is also covered in the deed.

(5) **Capital :** The amount of capital introduced by each partner is mentioned in the deed. It is not mandatory to bring a capital by each partner.

(6) **Interest on Capital :** Whether interest on capital is to be paid or not ? If yes, than what percentage ? These points are mentioned in the partnership deed. If no provision is made in partnership deed, no interest on capital is paid to the partners.

(7) **Drawings :** What maximum amount can be withdrawn by each partner is also mentioned in the partnership deed.

(8) **Interest on Drawings :** At what rate interest is to be charged on drawings made by the partner during the year is also mentioned in the partnership deed. There is no provision in the partnership act for the interest on drawings. But if necessary such provision can be included in the partnership deed.

(9) **Distribution of Profit and Loss :** In which proportion profit or loss of business will be distributed among the partners is provided in the partnership deed. If no provision is made in partnership deed, as per the partnership act profit or loss is distributed in equal proportion.

(10) **Salary, Bonus, Commission and Remuneration to the Partners :** There is no provision in partnership act for the payment of salary, bonus, commission and remuneration to the partners. If any partner takes active participation in the management of the partnership firm, a provision is made in the partnership deed for the payment of salary, bonus, commission and remuneration to the partners.

(11) **Interest on Loan Provided by Partner to Firm :** The rate of interest is to be mentioned in the partnership deed, when any partner has lended a loan to the firm. If no provision is made in the partnership deed, as per the partnership act, 6 % p.a. interest will be paid on the loan given by the partner to the firm. Interest on partners' loan is treated as an expense of business. Thus, it is debited to the profit and loss account.

(12) **Goodwill :** The computation to determine the value of goodwill at the time of the admission of a new partner and at the time of retirment or death of a partner is also mentioned in the partnership deed.

(13) **Admission - Retirement :** The provisions pertaining to admission of a new partner and the retirement or death of a partner is also mentioned in the partnership deed.

(14) **Dissolution of Firm :** In what circumstances firm will be dissolved ? What procedure will be adopted ? etc. These points are mentioned in the partnership deed.

The payment of salary, bonus, commission, remuneration or any other payment only to active partners of a partnership firm is available as deduction as per section 40(b) of Income Tax Act, 1961.

As stated in section 40(b) of Income Tax, any interest payable to partners will be disallowed, if no provision is made in the partnership deed. Therefore it is desirable to mention it in the partnership deed. As per section 40(b)(iv) of Income Tax Act, interest payment more than 12 % to the partners will not be given as deduction. As per partnership deed interest more than 12 % can be paid but deduction will be allowed, upto 12 %.

***Note :** Sections of Income Tax Act are given for the better understanding of students. It is not for examination purpose.

5. Provisions of Indian Partnership Act 1932, Pertaining to Accounting Treatments in the Absence of Partnership Deed

The following provisions of partnership Act 1932, will be applicable if no partnership deed is prepared or no clarification is made in the partnership deed.

(1) Each partner contributes capital in the firm by mutual agreement. There is no restriction in the act in this regard. It is not mandatory to bring a capital for each partner.

(2) Interest on the capital of partner cannot be paid.

(3) The distribution of profit and loss would remain in equal proportion.

(4) Interest on drawings of the partner can not be charged.

(5) Salary, bonus, commission or remuneration can not be paid to the partners.

(6) 6 % p.a. interest is payable for the loan given by any partner to the firm.

(7) In case of any reasonable expense incurred by the partner for the firm the partner has the right to reimburse it.

6. Capital Accounts of Partners

A capital account of each partner is prepared in the books of partnership firm to record the individual transactions done by the partner with the partnership firm.

An initial capital introduced by the partner and addition in capital in any means are recorded at the credit side of the capital account and transactions which reduce the capital are recorded at the debit side of the capital account.

There are two methods to maintain capital accounts in the books of partnership firm.

(1) Fluctuating Capital Account Method (2) Fixed Capital Account Method

(1) Fluctuating Capital Account Method : A method in which the opening balance of the capital account and the closing balance of the capital account of any partner is reported fluctuated (flexible) is known as fluctuating or temporary capital account method. Under this method to record all the transactions related to the partners, only one capital account is prepared in the books of firm.

Opening capital, additional capital introduced during the year, interest on capital, salary, bonus, commission, remuneration, interest on loan given by the partner, share of partner in divisible profit are credited at the credit side of the capital account. Drawings, interest on drawings, share of partner in divisible loss are debited at the debit side of the capital account. To record these transactions partners' capital account are debited or credited keeping in mind the nature of transaction. Consequently, during the year there is either increase or decrease in the opening balance of the capital account. So the balance of capital account of any partner keeps on changing every year. Thus, this method is known as fluctuating or temporary capital account.

All transactions between the partners and the partnership firm are recorded in the partners capital account. Under this method balance of partners' capital is either credit or debit. If there is credit balance in capital account it would appear at the liability side of the balance sheet and the debit balance would appear at the asset side of the balance sheet. A specimen of partners' capital accounts under fluctuating account method is as under :

Partners' Capital Accounts

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
*	To Balance b/d (Opening debit balance of capital A/c)	....	....	*	By Balance b/d (Opening credit balance of capital A/c)	....	....
	To Drawings A/c (Cash/bank/any other asset A/c)	....	....		By Cash/bank/any other assets A/c	....	....
	To Interest on drawings A/c	....	....		By Interest on capital A/c	....	....
**	To Profit and loss appropriation A/c (Divisible loss)	....	....		By Salary A/c	....	....
***	To Balance c/d (Closing credit balance of capital account)	....	....		By Bonus A/c	....	....
					By Commission A/c	....	....
					By Remuneration A/c	....	....
				**	By Profit and loss appropriation A/c (Divisible profit)	....	....
				***	By Balance c/d (Closing debit balance of capital A/c)	....	....
		....	....			....	....

* Balance b/d can be either debit balance or credit balance.

** There can be either divisible loss or divisible profit.

*** Balance c/d can be either debit balance or credit balance.

(2) **Fixed Capital Account Method :** A method of partners' capital under which no change is reported in opening balance and closing balance in the partners' capital account is known as fixed capital account method. Under this method to record all the transactions of the partners with the partnership firm, two accounts are maintained in the books.

(A) Partners' Capital Account

(B) Partners' Current Account

(A) Partners' Capital Account : Generally, under this method opening balance and closing balance of partners' capital account remains identical. There can be change in opening balance and closing balance of partners' capital account, if either additional capital is introduced or capital is withdrawn by the partners on the permanent basis. Under this method balance of partners' capital account remains credit balance. The credit balance of capital account is shown at the Capital-liability side of the balance sheet. Transactions other than permanent capital are recorded in the current account. A specimen of partners' capital accounts under fixed capital account method is as under.

Partners' Capital Account

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
....	To Cach/bank/any other asset (with-drawal of capital)	....	....	....	By Balance b/d (Opening credit balance)	....	....
....	To Balance c/d (Closing credit balance)	....	....	....	By Cash/bank/any other assets' A/c (Additional capital)	....	....
		....	....			....	....

(B) Partners' Current Account : Under fixed capital account method the account prepared to record the transactions of the partner with the partnership firm, other than permanent capital is known as current account. At the credit side of the current account, opening credit balance of current account, interest on capital, interest on credit balance of current account, salary, bonus, commission, remuneration and shares in divisible profit are recorded. At the debit side of current account, opening debit balance of current account, drawings, interest on drawings, interest on debit balance of current account and share in divisible loss are recorded. The closing balance of current account can be either debit or credit balance. If closing balance of current account is credit balance it is shown at the capital and the liability side of the balance sheet and debit balance is shown at the asset side. The specimen partners' current accounts is as shown on page no. 6.

Partners' Current Account

Dr   Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
....	To Balance b/d (Opening debit balance of current account)	....	....	....	By Balance b/d (Opening credit balance of current account)	....	....
	To Drawings A/c (cash/bank/any other asset A/c)	....	....		By Interest on capital A/c	....	....
	To Interest on drawings A/c	....	....		By Interest on credit balance of current account	....	....
	To Interest on debit balance of current A/c	....	....		By Salary A/c	....	....
	To Profit-loss Appropriation A/c (Divisible loss A/c)	....	....		By Bonus A/c	....	....
	To Balance c/d (Closing credit balance of current account)	....	....		By Commission A/c	....	....
					By Remuneration A/c	....	....
					By Profit-loss appropriation A/c (By Divisible profit)	....	....
					By Balance c/d (Closing debit balance of current A/c)	....	....
		....	....			....	....

Note : When current accounts of partners are not given in the question and no specification is given pertaining to the capital account, in this case capital accounts are maintained under fluctuating capital account method :

7. Difference Between Fixed Capital Account Method and Fluctuating Capital Account Method

Points of Difference	Fixed Capital Account Method	Fluctuating Capital Account Method
(1) **Meaning**	Where the opening balance and the closing balance of the partners' capital accounts is reported unchanged is known as fixed capital account method.	Where the opening balance and the closing balance of the partners' capital account is reported flexible is known as fluctuating capital account method.
(2) **Accounts**	To record all the transactions of the partners with the firm, two accounts are opened in the books of the firm : (i) capital account and (ii) current account.	To record all the transactions of the partners with the firm only capital account is opened in the books of the firm.

Points of Difference	Fixed Capital Account Method	Fluctuating Capital Account Method
(3) Treatments of transactions	In 'capital account', capital and changes in capital are recorded. Transactions other than permanent capital are recorded in the current account.	All transactions of capital and other than capital are recorded in the 'capital account'.
(4) Interest on capital	Generally, the amount of capital remains unchanged, therefore interest on capital remains constant.	The amount of capital keeps on changing, consequently interest on capital also keeps on changing.
(5) Balance of account	Balance of fixed capital account is always a credit balance. While current account can have a debit or credit balance.	Generally, balance of capital account is a credit balance. But under this method, there can be debit balance of capital account.
(6) Treatment in balance-sheet	Since fixed capital account has credit balance, it will be shown at the capital liability side of balance sheet. If current account has credit balance, it will be shown at the capital-liability side of balance sheet and debit balance at the asset side.	If capital account has a credit balance, it will be shown at the capital-liability side of the balance sheet and the debit balance at the asset side.

8. Drawing Accounts of Partners

When partners withdraw cash, goods or assets from the partnership firm for his personal use, this amount is known as drawings of partners. Withdrawn done by the partner from the partnership firm is debited to the drawing account. If provision is made, then interest on drawings is also debited to the drawing account. At the end of the year, in fluctuating capital account method drawing account is closed and the balance is transferred to the partners' capital account. In the fixed capital method it is debited to the partners' current account. Journal entry is passed as follows in this regard.

	Partners' Capital/Current A/c Dr To Partners' drawings A/c [Being partners' drawings account is closed and transfer it to partners' capital / current account.]	......	....	....

The specimen of drawings account is as follows :

Partners' Drawings Account

Dr Cr

Date	Particular	Amt. (₹)	Date	Particular	Amt. (₹)
    *	To Cash A/c To Bank A/c To Goods/assets A/c (Drawings done during the year) To Interest on drawings A/c	....		By Capital/Current A/c (Closing balance is transferred to Capital/Current account)	 ....
		....			....

Note : *When interest on drawing is debited to drawings account, it will not be debited to the capital/current account.

9. Profit-Loss Appropriation Account

To distribute profit and loss amongst the partners profit-loss appropriation account is prepared after the preparation of the profit-loss account in final accounts of the partnership firm. Profit-loss appropriation is a part of the profit-loss account. A separate preparation of this account is not mandatory.

Credit side of profit-loss appropriation account : At the credit side of the profit-loss appropriation account, net profit transferred from the profit-loss account, interest on drawings done by the partners, interest on debit balance of current accounts of partners are credited.

Debit side of profit-loss appropriation account : At the debit side of the profit-loss appropriation account net loss transferred from the profit-loss account, interest on partners' capital account, interest on credit balance of the current accounts of partners, salary-bonus, commission, remuneration to the partners, amount transferred to general reserve account are debited.

Allocation of profit-loss : After deduction of the total of the debit side of the profit-loss appropriation from the total of the credit side of profit-loss appropriation, difference (profit) is credited to partners' capital/current account in their profit-loss sharing ratio. After the deduction of the total of the credit side of profit-loss appropriation from the total of the debit side of the profit-loss appropriation, difference (loss) is debited to the partners' capital/current account in their profit-loss sharing ratio.

Profit-Loss Appropriation Account for the year ending ....
of Partnership firm of A, B and C

Dr Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Profit & Loss A/c (Net loss)	....	By Profit & Loss A/c (Net profit)	....
To Interest on partners' capital A/c		By Interest on partners' drawings A/c	
A		**A**	
B		**B**	
C	....	**C**	....
To Interest on credit balance of current accounts of partner	....	By Interest on debit balance of current accounts of partner	....
To Partners' salary A/c	....	By Partners' capital A/c (Divisible loss)	
To Partners' bonus, commission, remuneration A/c	....	**A**	
To General reserve A/c	....	**B**	
To Partners' capital A/c (Divisible profit)		**C**	....
A			
B			
C	....		
	....		....

Note : Commission to manager and interest on loan given by the partner are treated as the expense of the firm. Thus both are recorded at the debit side of the profit-loss account. The principle of matching concept is applicable to both of these, hence are debited to profit and loss account. A detailed information for interest on drawings, interest on capital and interest on loan of partners is given subsequently.

The interest on partners' loan is not mentioned in the partners' capital/current account. It's accounting effect is given separately. The partner's loan is the liability of a business. Outstanding interest on the loan also will be shown as liability in the balance sheet.

10. Difference Between Profit-Loss Account and Profit-Loss Appropriation Account

Points of difference	Profit-Loss Account	Profit-Loss Appropriation Account
(1) **Meaning**	After the preparation of the trading account, the account which is prepared to know the net profit or loss of the business is known as profit and loss account.	After the preparation of the profit and loss account, account which is prepared to distribute profit or loss amongst the partners, is known as profit and loss appropriation account.
(2) **Prepared by**	All business entities prepare profit and loss account.	Generally, partnership firm prepares profit and loss appropriation account.
(3) **Opening entry of account**	Gross profit or gross loss determined under trading account is shown as the opening entry of the profit and loss account.	Net profit or net loss determined under profit and loss account is shown as the opening entry of the profit and loss appropriation account.
(4) **Debit side**	At the debit side of this account, expenses other than purchase are recorded for e.g. administrative expenses, sales expenses, financial expenses, depreciation, interest on loan of partner, commission of manager, provision and other expenses and loss.	At the debit side of this account interest on capital, interest on credit balance of current account, salary, bonus, commisison and remuneration to the partners are recorded.
(5) **Credit side**	At the credit side of this account different revenues of business are recorded.	At the credit side of this account interest on drawings, interest on debit balance of current account are recorded.
(6) **Result of Account**	From this account net profit or net loss of the firm is ascertained.	From this account divisible profit or divisible loss of the firm is ascertained.
(7) **Balance of Account**	The balance of this account is transferred to the profit and loss appropriation account.	The ascertained divisible profit/loss is distributed among the partners.

Explanation and Journal Entries for Special Issues :

Particular	Journal Entry
(1) **Interest on Capital**	(i) When interest on capital is payable Interest on capital A/c ...Dr To partners' capital/current A/c (ii) To close interest on capital account and transfer it to profit and loss appropriation A/c Profit and loss appropriation A/c ...Dr To interest on capital A/c

Particular	Journal Entry
(2) Salary, Bonus, Commission, Remuneration to the Partners	(i) When salary, bonus, commission, remuneration are payable to partners Partners' salary, bonus, commission, remuneration A/c ...Dr To partners' capital/current A/c (ii) To close salary, bonus, commission, remuneration and transfer them to profit and loss appropriation A/c Profit and loss appropriation A/c ...Dr To partners' salary, bonus, commission, remuneration A/c
(3) Interest on Drawings	(i) When interest on drawings is charged Partners' capital/current A/c ...Dr To interest on drawings A/c (ii) To close interest on drawings A/c, Interest on drawings A/c ...Dr To profit and loss appropriation A/c
(4) Profit Transfered to General Reserve	(i) When profit is transfered to general reserve A/c Profit and loss appropriation A/c ...Dr To general reserve A/c
(5) Profit or Loss of Profit-Loss Appropriation A/c	When profit or loss of profit and loss appropriation is distributed among partners in their profit sharing ratio : (i) In case of profit Profit and loss appropriation A/c ...Dr To partners' capital/current A/c (ii) In case of loss Partners' capital/current A/c ...Dr To profit and loss appropriation A/c
(6) Interest on Loan of Partners	(i) When interest on loan is paid Interest on loan A/c ...Dr To cash A/c (ii) When interest on loan is outstanding Interest on loan A/c ...Dr To outstanding interest on loan A/c (iii) To close interest on loan A/c Profit and loss A/c ...Dr To interest on loan

Note : There can be combined journal entry for the above stated transactions no. 1 to 3.

Interest on Partners' Capital Account :

There can be different provisions for the interest on capital in the partnership deed. Interest on capital can be paid to the partners as per the following provisions of the partnership deed.

Provisions in Partnership Deed	Interest on Capital
(1) When there is no provision for interest on capital in the partnership deed.	Interest on capital cannot be paid.
(2) When the provision for interest on capital is made in the partnership deed but no clarification is provided to consider interest on capital as a charge or appropriation of profit.	(i) In case of loss, interest on capital cannot be paid. (ii) If profit is equal to interest of amount or more than that, in this case interest on capital can be paid as per the prescribed rate. (iii) If profit is less than interest on capital, amount equal to profit can be paid as interest on capital to the partners' in their capital proportion.
(3) When interest on capital is considered as a charge as per the partnership deed. (In case of either profit or loss interest will be paid.)	Whether profit is unsufficient or there is loss, interest on capital can be paid as per the prescribed rate. (In this circumstances profit and loss appropriation account would show the divisible loss.)

A and B are partners sharing profit-loss in the proportion of 4:1. Their capital as on 1-4-2016 is ₹ 4,00,000 and ₹ 2,00,000 respectively. Prepare profit and loss appropriation account or profit and loss account whichever is necessary for the year ending on 31-3-2017 under the following provisions pertaining to interest on capital if prescribed in the partnership deed.

(1) If a firm has a profit for the year ₹ 40,000 and no provision is made for interest on capital in partnership deed.

(2) If a firm has a profit for the year ₹ 80,000 and 10 % p.a. interest on capital is payable as per the provision of partnership deed.

(3) If a firm has a profit for the year ₹ 30,000 and 10 % p.a. interest on capital is payable as per the provision of partnership deed.

(4) If a firm has a profit for the year ₹ 30,000 and 10 % p.a. interest on capital is payable and interest on capital is considered as charge as per the provision of the partnership deed.

(5) If a firm has a loss for the year ₹ 10,000 and 10 % p.a. interest on capital is payable and interest on capital is considered as charge as per the provision of the partnership deed.

Ans.

(1) If no provision is made for interest on capital in partnership deed.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Partners' capital A/c			By Profit and loss A/c (Net profit)	40,000
A :	32,000			
B :	8000	40,000		
		40,000		**40,000**

(2) If provision in partnership deed is made to pay 10 % interest on capital.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)	80,000
A :	40,000			
B :	20,000	60,000		
To Partners' capital A/c				
A :	16,000			
B :	4000	20,000		
		80,000		**80,000**

(3) If provision in partnership deed is made to pay 10 % interest on capital.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)	30,000
A :	20,000			
B :	10,000	30,000		
		30,000		**30,000**

Note : Payable interest at 10 % to A ₹ 40,000 and to B ₹ 20,000 : total ₹ 60,000. While net profit is ₹ 30,000. Thus, interest on capital will be paid to the extent of net profit available. Interest on capital, equal to net profit ₹ 30,000 will be paid to the partners in their ratio of capital 2:1 (₹ 20,000 : ₹ 10,000).

(4) If provision in partnership deed is made to pay 10 % interest on capital and treated interest as charge.

Dr **Profit and Loss Appropriation Account for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)		30,000
A :	40,000		By Partners' capital A/c		
B :	20,000	60,000	(Net divisible loss (4:1)) :		
			A :	24,000	
			B :	6000	30,000
		60,000			**60,000**

(5) If provision in partnership deed is made to pay 10 % interest on capital and treated interest as a charge - when firm has net loss.

Dr **Profit and Loss Appropriation Account for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Net loss)		10,000	By Partners' capital A/c		
To Interest on partners' capital A/c			(Net divisible loss (4:1)) :		
A :	40,000		A :	56,000	
B :	20,000	60,000	B :	14,000	70,000
		70,000			**70,000**

Difference Between Charge Against Profit and Appropriation of Profit and Loss :

Points of Difference	Charge Against Profit	Appropriation of Profit and Loss
(1) **Principle of Matching Concept**	The principle of matching concept is applicable.	The principle of matching concept is not applicable.
(2) **Entry**	Charge against profit is recorded at the debit side of profit and loss account.	Appropriation of profit is recorded at debit side of profit and loss appropriation account.
(3) **When to record**	In all circumstances irrespective of profit or loss full amount is recorded.	Only in circumstances of profit, appropriation is recorded, no recording in case of loss.
(4) **Priority**	Expenses are recorded before appropriation of profit.	Appropriation is done after recording of all expenses.
(5) **Illustration**	Interest on partners' loan, rent payable to partner, commission to manager.	Interest on capital, commission to partner, transfer profit to general reserve.

Note : Above mentioned different provisions and illustrations for interest on capital of partners as well as the difference between charge against profit and appropriation of profit are explained for a better understanding of students in this regard. Questions and problems pertaining to these are not expected for examination.

11. Exclusive Illustrations :

Illustration 1 : Hiral, withdraws ₹ 500 in the beginning of every month. If 10 % p.a. interest is chargeable on drawings, determine annual drawings and interest on drawings.

Ans. : Total annual drawings = 500 × 12 = ₹ 6000

Interest on drawings = $I = \frac{PRN}{100}$

$= 500 \times \frac{10}{100} \times \frac{78}{12}$

$=$ ₹ 325

where, I = Interest P = Principal amount

R = Rate of interest N = Number of years

Explanation :

Table Showing Computation of Interest of Monthly Drawings

Month	**Drawings in the beginning of every month**	**Drawings at the end of every month**
1	12	11
2	11	10
3	10	9
4	9	8
5	8	7
6	7	6
7	6	5
8	5	4
9	4	3
10	3	2
11	2	1
12	1	0
Interest of total months	**78**	**66**

From the above table it can be ascertained that :

(i) If drawings is done in the beginning of every month, interest will be calculated for 78 months.

$\therefore \quad N = \frac{78}{12}$

(ii) If drawings is done at the end of every month, interest will be calculated for 66 months.

$\therefore \quad N = \frac{66}{12}$

Above stated interest on drawings under product method will be calculated as under :

The computation of above mentioned illustration can be done as follows :

Date of Drawing	Amount × Months = Principal Under .... Method
01-04-2016	500 × 12 = 6000
01-05-2016	500 × 11 = 5500
01-06-2016	500 × 10 = 5000
01-07-2016	500 × 9 = 4500
01-08-2016	500 × 8 = 4000
01-09-2016	500 × 7 = 3500
01-10-2016	500 × 6 = 3000
01-11-2016	500 × 5 = 2500
01-12-2016	500 × 4 = 2000
01-01-2017	500 × 3 = 1500
01-02-2017	500 × 2 = 1000
01-03-2017	500 × 1 = 500
Total	**= 39,000**

Interest on drawings $= 39{,}000 \times \frac{10}{100} \times \frac{1}{12}$

$= ₹\ 325$

Note : Problem pertaining to drawings in the beginning or at the end of the month are expected, no other computations are expected.

Illustration 2 : Hansa, Hitesh and Vijay are partners of a firm. Their capital proportion is 3:2:1. Hitesh is entitled to receive commission 10 % of net profit after deduction of his such share. What amount will be received by Hitesh, When profit of the firm is ₹ 1,65,000 at the end of the year.

Ans. : Assume profit after commission is ₹ 100, where commission is ₹ 10. Thus, profit before commission will be ₹ 110 (100 + 10), where commission is ₹ 10.

$$\text{Commission} = \text{Profit} \times \frac{\text{\% of commission}}{100 + \text{\% of commission}}$$

$\therefore$ Commission $= \frac{1{,}65{,}000 \times 10}{110}$

$= ₹\ 15{,}000$

$\therefore$ Profit after commission (Divisible profit) = Total profit − Commission

= 1,65,000 − 15,000

= 1,50,000

This will be distributed between partners in equal proportion. The share of Hitesh in profit ₹ 50,000.

$\therefore$ Total amount received by Hitesh = ₹ 50,000 Profit + ₹ 15,000 Commission

= ₹ 65,000

Explanation : (1) In the question proportion of partners' capital is given. Profit loss sharing ratio is not given. Thus, profit-loss will be distribuited between partners in equal proportion.

(2) Commission can be paid in two forms :

(i) Certain percentage of commission on profit before deduction of such commission.

(ii) Certain percentage of commission on profit after deduction of such commission.

(i) If commission is to be paid on profit before deduction of such commission, the computation of commission will be done as follows :

$$\text{Commission} = \text{Net profit} \times \frac{\text{\% of commission}}{100}$$

e.g., X and Y are partners sharing profit-loss in the proportion of 3:2. The profit of the firm for the year is ₹ 1,65,000. If 10 % commission on profit is payable to X, compute the amount of commission.

$$\text{Commission} = ₹\ 1,65,000 \times \frac{10}{100}$$

$$= ₹\ 16,500$$

Here, commission is to be calculated on the net profit. No specification is given whether commission is to be paid either before deduction of such commission or after that. Thus, commission will be computed from profit before deduction of such commission (on net profit).

(ii) If commission is payable from profit after deduction of such commission, the computation of commission will be done as follows :

In the above illustration X is entitled to get 10 % commission on profit after deducting such commission. It is computed as follows :

$$\text{Commission} = \text{Net profit} \times \frac{\text{\% of commission}}{100 + \text{\% of commission}}$$

$$= ₹\ 1,65,000 \times \frac{10}{110}$$

$$= ₹\ 15,000$$

Illustration 3 : The profit-loss sharing ratio of Jayesh, Suresh and Pankaj is 6:2:3. A manager has received his commission of ₹ 6600, at 10 % after deduction of such commission from profit. Ascertain distribution of profit amongst the partners.

Ans. : Profit and loss distribution proportion of Jayesh, Suresh and Pankaj = 6:2:3

Manager receives commission at 10 % from profit after deduction of his commission.

∵ ₹ 10 commission = ₹ 100 Divisible profit

∴ ₹ 6600 " (?) "

$$= \frac{6600 \times 100}{10}$$

= ₹ 66,000 Divisible profit

The profit-loss sharing ratio of partners is 6:2:3, distribution of profit will be as follows :

Jayesh : ₹ 66,000 × $\frac{6}{11}$ = ₹ 36,000

Suresh : ₹ 66,000 × $\frac{2}{11}$ = ₹ 12,000

Pankaj : ₹ 66,000 × $\frac{3}{11}$ = ₹ 18,000

Illustration 4 : Sheela, Surbhi and Seema are partners sharing profit-loss in the ratio of 5:7:9. Manager Sanket is entitled to receive 10 % commission from profit after deduction of his such commission. Surbhi receives share in profit ₹ 7000. Determine the amount of commission of Sanket. Also determine amount of profit before the commission of manager.

Ans. : (i) Manager is entitled to get commission from the profit after the deduction of his own commission. It means commission will be calculated on divisible profit.

Surbhi receives ₹ 7000 of divisible profit for her share of $\frac{7}{21}$. Assume total profit of the firm is 1.

Thus, $\frac{7}{21}$ share of Surbhi = Total profit of firm = ₹ 1

∴ ₹ 7000 share of Surbhi = Total profit (?)

$$= \frac{1}{1} \times \frac{7000 \times 21}{7}$$

= ₹ 21,000 divisible profit

(ii) Manager Sanket is entitled to get 10 % commission from the divisible profit

$$= ₹\ 21{,}000 \times \frac{10}{100}$$

= ₹ 2100

(iii) Profit before commission of manager = Divisible profit + Commission of manager

= ₹ 21,000 + ₹ 2100

= ₹ 23,100

Illustration 5 : Riya, Dilip and Kirtan are partners of a partnership firm. The share of Kirtan is $\frac{1}{5}$th of share of Dilip and share of Riya is double of share of Kirtan. Determine the amount of profit of each partner, if the profit of the firm at the end of the year was ₹ 1,92,000.

Ans. : Assume : Dilip's share of profit ₹ 1.

Share of Kirtan is $\frac{1}{5}$ of Dilip means $\frac{1}{5}$ of 1 = $\frac{1}{5}$. While share of Riya is double of the share of Kirtan, double of $\frac{1}{5}$ i.e. $\frac{1}{5} \times \frac{2}{1} = \frac{2}{5}$.

∴ Share of Riya $\frac{2}{5}$, Dilip $\frac{1}{1}$ and Kirtan $\frac{1}{5}$.

Thus, proportion of distribution of profit between partners :

Riya : Dilip : Kirtan

2 : 5 : 1

The distribuition of profit will be as follows :

Profit of Riya = 1,92,000 × $\frac{2}{8}$ = ₹ 48,000

Profit of Dilip = 1,92,000 × $\frac{5}{8}$ = ₹ 1,20,000

Profit of Kirtan = 1,92,000 × $\frac{1}{8}$ = ₹ 24,000

Illustration 6 : Milin, Hemant and Rasik have distributed profit of the firm of ₹ 1,89,000 in equal proportion, instead of distributing it in 1:2:4 proportion. To rectify this mistake what treatment will be given to the capital account ?

Ans. :

Particular	Milin (₹)	Hemant (₹)	Rasik (₹)
Correct distribution of profit in the proportion of 1:2:4	+ 27,000	+ 54,000	+ 1,08,000
Incorrect distribution of profit in the proportion of 1:1:1	− 63,000	− 63,000	− 63,000
Amount of difference	**− 36,000 Debit**	**− 9000 Debit**	**+ 45,000 Credit**

Rectification of Error : An excess credit to Milin's and Hemant's account is ₹ 36,000 and ₹ 9000 respectively, and ₹ 45,000 are less credited to Rasik's Account. So, Rasik's account will be credited and Milin's and Hemant's capital account will be debited.

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Milin's Capital/Current A/c Dr		36,000	
	Hemant's Capital/Current A/c Dr		9000	
	To Rasik's Capital/Current A/c			45,000
	[Being profit credited in wrong proportion is corrected.]			

Illustration 7 : Ram, Laxman and Sita are partners of a firm. On 1-4-2016 their capital was ₹ 40,000, ₹ 30,000 and ₹ 80,000 respectively. At the end of the year after distribution of profit it was realised that charging of interest on capital at 12 % is missed out. Write journal entry for rectification.

Ans. :

Particular	Ram (₹)	Laxman (₹)	Sita (₹)	Total (₹)
Interest on capital at 12 %	+ 4800	+ 3600	+ 9600	+ 18,000
Reduction in profit equal to amount of interest (₹ 18,000) In equal proportion (1:1:1)	− 6000	− 6000	− 6000	− 18,000
Accounting treatment of difference to Capital Account	**− 1200 Debit**	**− 2400 Debit**	**+ 3600 Credit**	−

Rectification of Error : ₹ 1200 and ₹ 2400 will be debited to Ram's and Laxman's capital account respectively and ₹ 3600 will be credited to Sita's capital account.

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Ram's Capital/Current A/c Dr		1200	
	Laxman's Capital/Current A/c Dr		2400	
	To Sita's Capital/Current A/c			3600
	[Being the computation of interest on capital at 12 % was missed out, is rectified.]			

Explanation : Total interest on capital is payable ₹ 18,000. So the same amount of ₹ 18,000 has to be reduced from the capital account of the partners, which will be debited in their profit-loss sharing ratio. Since profit-loss sharing is not given, amount will be debited in equal proportion.

Illustration 8 : Bhalchandra, Darshana and Ankit are partners sharing profit-loss in the ratio of 5:3:2. At the end of the year after the preparation of final account it is realised that, computation of interest on drawings is missed out. Interest on drawings were ₹ 1000, ₹ 800 and ₹ 600 respectively. Write journal entry for rectifications.

Ans. :

Particular	Bhalchandra (₹)	Darshana (₹)	Ankit (₹)	Total (₹)
Increase in profit equal to amount of interest on drawings (5:3:2)	+ 1200	+ 720	+ 480	+ 2400
Interest on drawings	− 1000	− 800	− 600	− 2400
Accounting treatment of difference to the Capital Account	**+ 200 Credit**	**− 80 Debit**	**− 120 Debit**	**−**

Rectification of Error :

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Darshana's Capital/current A/c Dr		80	
	Ankit's Capital/current A/c Dr		120	
	To Bhalchandra's Capital/Current A/c			200
	[Being computation of interest on drawings was missed out, is rectified.]			

Explanation : Total interest on drawings is ₹ 2400 (₹ 1000, ₹ 800 and ₹ 600), due to this profit would increase. This is to be credited to partners' capital account in their profit-loss sharing ratio. Thus in the proportion of 5:3:2 ₹ 1200, ₹ 720 and ₹ 480 will be credited respectively to the capital account of Bhalchandra, Darshana and Ankit. Interest on drawings will be debited to the capital account of respective partners.

Illustration 9 : Yusuf, Harun and Kodawala are partners sharing profit-loss in the proportion of 3:2:1. Yusuf and Harun have given assurance to Kodawala to give minimum ₹ 36,000 from profit. If for the year ending on 31-3-16 total profit of the firm was ₹ 1,80,000, how profit will be distributed among the partners ?

Ans. : Distribution of profit :

Yusuf : ₹ 1,80,000 $\times \frac{3}{6}$ = ₹ 90,000 Harun: ₹ 1,80,000 $\times \frac{2}{6}$ = ₹ 60,000

Kodawala : ₹ 1,80,000 $\times \frac{1}{6}$ = ₹ 30,000

It was assured by Yusuf and Harun to Kodawala that he will receive atleast ₹ 36,000 from profit. But deficit to Kodawala is ₹ 6000 (₹ 36,000 − ₹ 30,000) will be given to Kodawala by Yusuf and Harun in their profit-loss sharing ratio.

Amount of profit to be given to Kodawala : Yusuf : ₹ 6000 $\times \frac{3}{5}$ = ₹ 3600

Harun : ₹ 6000 $\times \frac{2}{5}$ = ₹ 2400

Amount of distributable profit amongst the partners :

Particular	Yusuf (₹)	Harun (₹)	Kodawala (₹)	Total (₹)
Distribution of profit in the profit-loss sharing ratio (3:2:1)	90,000	60,000	30,000	1,80,000
Payable and receivable amount	− 3600	− 2400	+ 6000	−
Actual distribution of profit	**86,400**	**57,600**	**36,000**	**1,80,000**

Illustration 10 : The closing capital of a partner Girish is ₹ 96,000 after giving effect of drawings of ₹ 6000 and divisible profit of ₹ 9000. Calculate 8 % p.a. interest on capital.

Ans. : Interest on capital is always calculated on the opening balance. Here, closing capital is provided. From that opening capital will be ascertained as follows :

Opening capital = Closing capital + Drawings − Profit

	Closing capital	₹	96,000
+	Drawings	₹	6000
		₹	1,02,000
−	Profit	₹	9000
	Opening capital	₹	93,000

∴ Interest on capital $= ₹\ 93{,}000 \times \frac{8}{100} = ₹\ 7440$

or

Dr **Girish's Capital Account** Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Drawings A/c	6000	By Balance b/d (Opening capital)	93,000
To Balance c/d (Closing capital)	96,000	By Profit and Loss A/c (profit)	9000
	1,02,000		**1,02,000**

∴ Interest on capital = ₹ 7440

Illustration 11 : Jennet, Akshra and Sapna are partners sharing profit-loss in equal proportion. Their total capital is of ₹ 3,00,000. The proportion of their capital is 2:3:5. Firm pays 6 % interest p.a. on the capital. Partner Akshra received ₹ 45,400 including interest on capital. Compute what amount inclusive of interest is received by Jennet and Sapna ?

Ans. :

Particular	Jennet (₹)	Akshra (₹)	Sapna (₹)
Capital in the proportion of 2:3:5	60,000	90,000	1,50,000
Interest on capital at 6 % p.a.	3600	5400	9000
Divisible profit (1:1:1)	+ 40,000	+ 40,000	+ 40,000
Profit including interest on capital	**43,600**	**45,400**	**49,000**

∴ Including interest on capital Jennet would receive total ₹ 43,600 and Sapna ₹ 49,000.

Explanation : Akshra received ₹ 45,400 with interest on capital.

∴ Akshra has received ₹ 40,000 (₹ 45,400 − ₹ 5400) towards share of profit.

All three partners are sharing profit-loss in equal proportion. Therefore Jennet and Sapna each of them has received ₹ 40,000 from profit.

Illustration 12 : Sharda and Jamna are partners of a firm. Their capital as on 1-4-2016 was ₹ 30,000 and ₹ 40,000 respectively. During the year Sharda has withdrawn ₹ 6000 on 1-4-2016 while Jamna ₹ 8000 on 1-1-2017. The provisions of partnership deed are as follows :

(1) Provide interest on capital at 10 % p.a.

(2) Provide interest on drawings 12 % p.a.

(3) Monthly salary of ₹ 500 is payable to Sharda for her active participation in business. An annual commission of ₹ 3000 is payable to Jamna.

On 1-10-2016 Sharda has given loan of ₹ 6000 to the firm. There is no provision in partnership deed for interest on loan. Sharda demands interest at 10 % p.a. on loan.

Profit for the year ending on 31-3-2017 before consideration of above provision and interest on loan of Sharda of the firm is ₹ 39,820.

From the above information prepare profit and loss appropriation account and partners' capital accounts of the firm.

Ans. :

Profit and Loss Appropriation Account for the Year Ending on 31-3-2017 of Firm of Sharda and Jamna

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c			By Profit and loss A/c (Net profit)		39,820
Sharda :	3000		By Interest on capital A/c		
Jamna :	4000	7000	Sharda :	720	
To Salary (Sharda)		6000	Jamna :	240	960
To Commission (Jamna)		3000			
To Partners' capital A/c (Divisible profit) :					
Sharda :	12,390				
Jamna :	12,390	24,780			
		40,780			**40,780**

Partners' Capital Accounts

Dr Cr

Date	Particular	Sharda (₹)	Jamna (₹)	Date	Particular	Sharda (₹)	Jamna (₹)
1-4-16	To Drawings A/c	6000	–	1-4-16	By Balance b/d	30,000	40,000
1-1-17	To Drawings A/c	–	8000	31-3-17	By Interest on capital A/c	3000	4000
31-3-17	To Interest on drawings A/c	720	240	31-3-17	By Salary A/c	6000	–
31-3-17	To Balance c/d	44,670	51,150	31-3-17	By Commission A/c	–	3000
				31-3-17	By Profit and loss appropriation A/c (Divisible profit)	12,390	12,390
		51,390	**59,390**			**51,390**	**59,390**

Explanation : (1) No clarification pertaining to capital account method is given in the problem, thus capital accounts are prepared on the basis of fluctuating capital account method. (2) No clarification is made in the partnership deed for interest on loan of Sharda, as per partnership act interest at 6 % p.a. is calculated for six month (from 1-10-2016 to 31-3-2017). It is debited to profit and loss account and will be shown at the liability side of balance sheet. (3) To determine interest on drawings, date of drawings is considered. (4) No clarification is made for profit-loss sharing ratio between the partners, profit is distributed amongst the partners in equal proportion.

Illustration 13 : Sudhanshu and Sarvesh are partners of a firm. Their profit-loss sharing ratio is 3:2. The capital of partners as on 1-4-2016 was ₹ 90,000. This is fixed capital. Capital of partners is in the proportion of 5:4. Drawings of the partners during the year was as follows :

Sudhanshu : ₹ 6000 on 1-7-2016

Sarvesh : ₹ 4000 on 1-10-2016

There is provision in partnership deed to pay interest on capital at 8 % p.a. and to charge interest on drawings at 12 % p.a. On 1-4-2016 balances in current accounts of partners ₹ 3000 credit balance and ₹ 2000 debit balance respectively for Sudhanshu and Sarvesh. Interest at 6 % p.a. on opening balance of current account is to be calculated. Sudhanshu is to be paid 5 % commission on profit after deduction of his commission from profit.

Before considering the above mentioned adjustments, profit of the firm for the year ending on 31-3-2017 is ₹ 37,770. From this information prepare a profit and loss appropriation account, partners' capital accounts and current accounts.

Ans. :

Profit and Loss Appropriation Account for the Year Ending on 31-3-2017 of Firm of Sudhanshu and Sarvesh

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		37,770
Sudhanshu :	4000		By Interest on drawings A/c :		
Sarvesh :	3200	7200	Sudhanshu :	540	
To Interest on current A/c (Sudhanshu)		180	Sarvesh :	240	780
To Commission A/c (Sudhanshu)		1490	By Interest on current A/c (Survesh)		120
To Partners' current A/c :					
(Divisible profit)					
Sudhanshu	17,880				
Sarvesh	11,920	29,800			
		38,670			**38,670**

Partners' Capital Accounts

Dr Cr

Date	Particular	Sudhanshu (₹)	Sarvesh (₹)	Date	Particular	Sudhanshu (₹)	Sarvesh (₹)
31-3-17	To Balance c/d	50,000	40,000	1-4-16	By Balance b/d	50,000	40,000
		50,000	**40,000**			**50,000**	**40,000**

Partners' Current Accounts

Dr Cr

Date	Particular	Sudhanshu (₹)	Sarvesh (₹)	Date	Particular	Sudhanshu (₹)	Sarvesh (₹)
1-4-16	To Balance b/d	–	2000	1-4-16	By Balance b/d	3000	–
1-7-16	To Drawings A/c	6000	–	31-3-17	By Interest on capital A/c	4000	3200
1-10-16	To Drawings A/c	–	4000				
31-3-17	To Interest on current A/c	–	120	31-3-17	By Interest on current A/c	180	–
31-3-17	To Interest on drawings A/c	540	240	31-3-17	By Commission A/c	1490	–
				31-3-17	By Profit and loss appropriation A/c	17,880	11,920
31-3-17	To Balance c/d	20,010	8760				
		26,550	**15,120**			**26,550**	**15,120**

Explanation : (1) The opening total capital of partners is ₹ 90,000, it is in the proportion of 5:4, so capital of Sudhanshu is of ₹ 50,000 and ₹ 40,000 of Sarvesh. This capital is considered as fixed capital and interest on capital is calculated on these amounts. (2) Interest on drawings : Sudhanshu for 9 months from 1-7-2016 to 31-3-2017, Sarvesh for 6 months from 1-10-2016 to 31-3-2017. (3) 5 % commission on profit is payable to Sudhanshu, but after deduction of such commission from profit.

Assume, profit after commission is ₹ 100 where commission will be ₹ 5. Therefore profit before deduction of commission will be ₹ 105 (100 + 5), where ₹ 5 commission are included.

∴ Commission of Sudhanshu $= \frac{31{,}290 \times 5}{105}$ (Total of credit side of profit and loss appropriation account is ₹ 38,670 – (Interest on capital ₹ 7200 + interest on current account ₹ 180) = ₹ 31,290)

= ₹ 1490

(4) Profit after commission (Divisible profit) = ₹ 29,800 (₹ 31,290 – ₹ 1490) will be distributed amongst the partners in the ratio of 3:2.

Divisble profit of Sudhanshu = ₹ 29,800 × $\frac{3}{5}$

= ₹ 17,880

Divisble profit of Sarvesh = ₹ 29,800 × $\frac{2}{5}$

= ₹ 11,920

Illustration 14 : Saksham, Samarth and Shrey are partners of firm. Their capital on 1-4-2016 was ₹ 1,00,000, ₹ 60,000 and ₹ 40,000 respectively. As per partnership deed : (1) Provide interest on capital at 8 % p.a. on capital of partners. (2) 10 % p.a. interest is chargeable to drawings. (3) Monthly salary of ₹ 600 is payable to Samarth. (4) Partners would share half profit in equal proportion and remaining half profit they will share in their opening capital proportion.

On 1-1-2017 Saksham and Shrey have withdrawn ₹ 5000 and ₹ 4000 respectively.

Partners have unanimously decided to transfer 10 % of divisible profit to general reserve. Before recording of above mentioned adjustments profit of the firm for the year ending on 31-3-2017 was ₹ 34,975.

From the above information prepare profit and loss appropriation account of the partnership firm for the year ending on 31-3-2017 and partners capital accounts.

Ans. :

Profit and Loss Appropriation Account for the year ending on 31-3-2017 of Partnership firm of Saksham, Samarth and Shrey

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		34,975
Saksham :	8000		By Interest on drawings A/c		
Samarth :	4800		Saksham :	125	
Shrey :	3200	16,000	Shrey :	100	225
To Salary (Samarth)		7200			
To General reserve A/c (10 % of divisible profit)		1200			
To Partners capital A/c (Divisible profit)					
Saksham :	4500				
Samarth :	3420				
Shrey :	2880	10,800			
		35,200			**35,200**

Partners' Capital Accounts

Dr | Cr

Date	Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)	Date	Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)
1-1-17	To Drawings A/c	5000	–	4000	1-4-16	By Balance b/d	1,00,000	60,000	40,000
31-3-17	To Interest on drawings A/c	125	–	100	31-3-17	By Interest on capital	8000	4800	3200
					31-3-17	By Salary A/c	–	7200	–
31-3-17	To Balance c/d	1,07,375	75,420	41,980	31-3-17	By P & L Appropriation A/c (Divisible profit)	4500	3420	2880
		1,12,500	**75,420**	**46,080**			**1,12,500**	**75,420**	**46,080**

Explanation :

(1) Before distribution of divisible profit, amount is to be transferred to general reserve. Total of credit side of profit and loss appropriation account is ₹ 35,200 (₹ 34,975 + ₹ 225) and total of debit side is ₹ 23,200 (₹ 16,000 + ₹ 7200).

$\therefore$ Divisible profit = ₹ 35,200 − ₹ 23,200 = ₹ 12,000

$\therefore$ General reserve = 10 % of divisible profit = $12{,}000 \times \frac{10}{100}$ = ₹ 1200

(2) Surplus of divisible profit after transfer of ₹ 1200 to general reserve is = ₹ 12,000 − ₹ 1200 = ₹ 10,800.

Divisible profit will be distributed as follows :

Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)	Total (₹)
$\frac{1}{2}$ of ₹ 10,800 in equal proportion ₹ 5400 (1:1:1)	1800	1800	1800	5400
Remaining ₹ 5400 in the proportion of opening capital (5:3:2)	2700	1620	1080	5400
Share of each partner in total Divisible Profit	**4500**	**3420**	**2880**	**10,800**

Illustration 15 : Shruti, Kashvi and Mary are partners of a firm. Total balance of their fixed capital on 1-4-2016 was ₹ 2,50,000. It was in the proportion of 2:2:1. Balances of their current accounts were as follows. Shruti ₹ 24,000 (credit), Kashvi ₹ 18,000 (debit) and Mary ₹ 12,000 (credit).

Provisions of partnership deed were as follows :

(1) $\frac{3}{5}$ of profit to be distributed in the proportion of 3:2:1 and remaining in the proportion of their opening capital.

(2) Provide p.a. 10 % interest on capital.

(3) Provide p.a. 8 % interest on opening balance of current account.

(4) Monthly salary of ₹ 500 is payable to Kashvi.

(5) 12 % p.a. interest is chargeable to drawings of partners.

Shruti has withdrawn ₹ 18,000 on 1-2-2017, Kashvi ₹ 12,000 on 30-11-2016 and Mary ₹ 20,000 on 1-10-2016.

Mary has introduced additional capital ₹ 24,000 on 1-1-2017. 5 % amount of net profit is to be transferred to the development fund (but not more than ₹ 6000). Than after 10 % commission on net profit is payable to Mary, but from profit after deduction of such her commission. Profit of the firm for the year ending on 31-3-2017, after credit of interest on drawings but before incorporation of other adjustments was ₹ 1,71,040. From the above information prepare profit and loss appropriation account for the year ending 31-3-2017 and partners' capital accounts and current accounts under fixed method.

Ans. : Profit and Loss Appropriation Account for the year ending on 31-3-2017 of Partnership firm of Shruti, Kashvi and Merry

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c			By Profit and loss A/c (Net profit)		1,69,000
Shruti :	10,000		By Interest on drawings :		
Kashvi :	10,000		Shruti :	360	
Mary :	5600	25,600	Kashvi :	480	
To Interest on current A/c :			Mary :	1200	2040
Shruti :	1920		By Interest on current A/c (Kashvi)		1440
Mary :	960	2880			
To Salary A/c (Kashvi)		6000			
To Development fund A/c		6000			
To Commission A/c (Mary)		12,000			
To Partners' current A/c (Divisible profit)					
Shruti :	55,200				
Kashvi :	43,200				
Mary :	21,600	1,20,000			
		1,72,480			**1,72,480**

Partners' Capital Accounts

Dr | Cr

Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)
31-3-17	To Balance c/d	1,00,000	1,00,000	74,000	1-4-16	By Balance b/d	1,00,000	1,00,000	50,000
					1-1-17	By Cash A/c	–	–	24,000
		1,00,000	**1,00,000**	**74,000**			**1,00,000**	**1,00,000**	**74,000**

Partners' Current Accounts

Dr | Cr

Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)
1-4-16	To Balance c/d	–	18,000	–	1-4-16	By Balance b/d	24,000	–	12,000
1-10-16	To Drawings A/c	–	–	20,000	31-3-17	By Interest on capital A/c	10,000	10,000	5600
30-11-16	To Drawings A/c	–	12,000	–	31-3-17	By Interest on current A/c	1920	–	960
1-2-17	To Drawings A/c	18,000	–	–	31-3-17	By Salary A/c	–	6000	–
					31-3-17	By Commission A/c	–	–	12,000
31-3-17	To Interest on drawings A/c	360	480	1200	31-3-17	By P & L Appropriation A/c (Divisible profit)	55,200	43,200	21,600
31-3-17	To Interest on current A/c	–	1440	–					
31-3-17	To Balance c/d	72,760	27,280	30,960					
		91,120	**59,200**	**52,160**			**91,120**	**59,200**	**52,160**

Explanation :

(1) Profit of the firm for the year ending on 31-3-17 (after credit of interest on drawings) ₹ 1,71,040. Total interest on drawings of all partners ₹ 2040 (₹ 360 + ₹ 480 + ₹ 1200) deduct it from ₹ 1,69,000 (₹ 1,71,040 – ₹ 2040) and so net profit will be ₹ 1,69,000. This is shown at credit side of profit and loss appropriation account.

(2) Interest on capital of Mary : $I = \frac{PRN}{100}$

Interest on opening capital on ₹ 50,000 = ₹ $\frac{50{,}000 \times 10 \times 1}{100}$ = ₹ 5000

Interest on additional capital on ₹ 24,000. Interest for 3 months (1-1-17 to 31-3-17)

$= 24{,}000 \times \frac{10}{100} \times \frac{3}{12}$ = ₹ 600

Total interest of capital = ₹ 5000 + ₹ 600 = ₹ 5600

(3) Development Fund : Profit before development fund and commission of Mary is ₹ 1,38,000. Total of the credit side of the profit and loss appropriation A/c is ₹ 1,72,480 − Total of the debit side ₹ 34,480 (₹ 25,600 + ₹ 2880 + ₹ 6000).

$\therefore$ Development Fund $= 1,38,000 \times \frac{5}{100}$

$= ₹\ 6900$

But this amount can not exceed to ₹ 6000.

$\therefore$ ₹ 6000 are transferred to the development fund.

(4) Commission to Mary : A surplus of profit after transferring of ₹ 6000 to the development fund is ₹ 1,32,000 (1,38,000 − 6000).

Assume profit after commission is ₹ 100 + commission ₹ 10

$\therefore$ Profit before commission ₹ 110

$\therefore$ Commission $= ₹\ 1,32,000 \times \frac{10}{110}$

$= ₹\ 12,000$

(5) Divisible profit = ₹ 1,32,000 − ₹ 12,000

= ₹ 1,20,000

Computation of divisible profit :

Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Total (₹)
$\frac{3}{5}$ of ₹ 1,20,000 in equal proportion ₹ 72,000 (3:2:1)	36,000	24,000	12,000	72,000
Remaining ₹ 48,000 in the proportion of opening capital (2:2:1)	19,200	19,200	9600	48,000
Share of each partner in total Divisible Profit	**55,200**	**43,200**	**21,600**	**1,20,000**

Illustration 16 : On 1-4-2016 Ranjana, Sushma and Joseph introduced capital of ₹ 1,28,000, ₹ 96,000 and 80,000 respectively and commenced a business. Sushma has withdrawn ₹ 8000 on 1-10-2016. While Ranjana has withdrawn ₹ 1200 at the end of each month.

As per the partnership deed :

(1) Provide 5 % p.a. interest on capital and charge 10 % p.a. interest on drawings.

(2) Profit-loss sharing ratio among partner is 5:3:2.

After incorporation of the above mentioned adjustment 2 % bonus is to be paid to Ranjana from the surplus of profit. On 31-3-2017 partners have decided that total capital of the firm, after the incorporation of the above mentioned adjustments, will be of ₹ 3,00,000. Their credit balance of capital accounts will be in the ratio of 2:2:1. For this adjustment necessary amount will be introduced or withdrawn by the partners.

Net loss of the firm for the year ending on 31-3-2017 was of ₹ 45,860. From the above information prepare profit and loss appropriation account for the year ending on 31-3-2017 as well as partners' capital accounts and drawings accounts.

Ans. : **Profit and Loss Appropriation Account for the year ending on 31-3-2017 of partnership firm of Ranjana, Sushma and Joseph**

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Net loss)		45,860	By Interest on drawings :		
To Interest on capital :			Ranjana :	660	
Ranjana :	6400		Sushma :	400	1060
Sushma :	4800		By Partners' capital A/c (divisible loss)		
Joseph :	4000	15,200	Ranjana :	30,000	
			Sushma :	18,000	
			Joseph :	12,000	60,000
		61,060			**61,060**

Dr **Partners' Capital Accounts** Cr

Date	Particular	Ranjana (₹)	Sushma (₹)	Joseph (₹)	Date	Particular	Ranjana (₹)	Sushma (₹)	Joseph (₹)
31-3-17	To Drawings A/c	15,060	8400	–	1-4-16	By Cash A/c	1,28,000	96,000	80,000
31-3-17	To P & L Appropriation A/c (Divisible loss)	30,000	18,000	12,000	31-3-17	By Interest on capital A/c	6400	4800	4000
31-3-17	To Cash A/c	–	–	12,000	31-3-17	By Cash A/c	30,660	45,600	–
31-3-17	To Balance c/d	1,20,000	1,20,000	60,000					
		1,65,060	**1,46,400**	**84,000**			**1,65,060**	**1,46,400**	**84,000**

Dr **Partners' Drawings Accounts** Cr

Date	Particulars	Ranjana (₹)	Sushma (₹)	Date	Particulars	Ranjana (₹)	Sushma (₹)
30-4-16	To Cash A/c	1200	–	31-3-17	By Capital A/c	15,060	8400
31-5-16	To Cash A/c	1200	–				
30-6-16	To Cash A/c	1200	–				
31-7-16	To Cash A/c	1200	–				
31-8-16	To Cash A/c	1200	–				
30-9-16	To Cash A/c	1200	–				
1-10-16	To Cash A/c	–	8000				
31-10-16	To Cash A/c	1200	–				
30-11-16	To Cash A/c	1200	–				
31-12-16	To Cash A/c	1200	–				
31-1-17	To Cash A/c	1200	–				
28-2-17	To Cash A/c	1200	–				
31-3-17	To Cash A/c	1200	–				
31-3-17	To Interest on drawings	660	400				
		15,060	**8400**			**15,060**	**8400**

Explanation :

(1) Interest on drawings of Ranjana $= 1200 \times \frac{10}{100} \times \frac{66}{12}$

$= ₹\ 660$

(2) There is divisible loss at the end of the year, so Ranjana will not get bonus.

(3) Total closing capital ₹ 3,00,000 is to be maintained in the ratio of 2:2:1 which is ₹ 1,20,000, ₹ 1,20,000 and ₹ 60,000 respectively. To maintain this capital Ranjana and Sushma will bring deficit of ₹ 30,660 and 45,600 in cash respectively. (It will be recorded in the credit side of capital account.) While Joseph will withdraw excess capital of ₹ 12,000. (It will be recorded in the debit side of the capital account.)

Limited Liability Partnership :

As per the Partnership Act 1932, the business liability of the partners of the firm is unlimited. The Limited Liability Partnership Act 2008, has been introduced as a new scheme to mobilize the small scale and medium scale industries of India; as well as to eliminate the limitation of unlimited liability of partners of a partnership firm. This form of business has the characteristics similar to partnership firms and companies. In this form of business the liability of partners is similar to the liabilities of the shareholders in the companies. In this form of business there should be minimum number of partners. Each partner of such business would be same as the agent of LLP (Limited Liability Partnership) but its scope will not be treated as the agent of other partner. The registration of LLP is mandatory.

This information is provided for better understanding of the students. It is not expected in the examination.

Exercise

1. Select appropriate option for each question :

(1) What is the interest on partners' capital for a partner ?

(a) An expense (b) Liability

(c) Income (d) Loss

(2) Under which method, the interest on capital keeps on changing during the year due to the changes in the capital ?

(a) Fluctuating capital accounts method (b) Fixed capital accounts method

(c) Current accounts method (d) None of the above

(3) In which account and on which side the share of partners' share profit is recorded under the fluctuating capital account method ?

(a) Debit to capital account (b) Credit to capital account

(c) Debit to current account (d) Credit to current account

(4) At the end of the year where will you transfer drawings account, in fixed capital account method ?

(a) To capital account (b) To current account

(c) To profit and loss account (d) To profit and loss appropriation account

(5) How would you consider the interest on debit balance of partners' current account for firm ?

(a) An expense (b) Liability

(c) Income (d) Loss

(6) What is the interest on drawings of partners for a partner ?

(a) An expense (b) Liability

(c) Income (d) Loss

(7) Debit balance of profit and loss appropriation account means ....

(a) gross profit (b) gross loss

(c) divisible profit (d) divisible loss

(8) What percentage of interest will be paid, when no provision is made pertaining to interest on capital in the partnership deed ?

(a) 6 % (b) 9 %

(c) 12 % (d) No interest

(9) What percentage of interest will be paid on the loan lent by the partner to the firm, when no such provision is made in the partnership deed ?

(a) 6 % (b) 9 %

(c) 12 % (d) No interest

(10) The capital proportion of A, B and C is 3:2:1 respectively. The divisible profit is ₹ 66,000. What will be the amount of profit of C ?

(a) ₹ 11,000 (b) ₹ 22,000

(c) ₹ 33,000 (d) ₹ 66,000

2. Answer the following questions in one sentence :

(1) What is partnership ?

(2) What is maximum and minimum limit of partners to constitute a partnership firm ?

(3) What is a partnership deed for a firm ?

(4) Describe the objectives to prepare a partnership deed.

(5) How are the administrative problems solved, when no written agreement is signed between the partners ?

(6) Describe partners' capital account methods of a partnership firm.

(7) Profit of a partner is credited to which account under fixed capital account method ?

(8) Additional capital introduced by partner on permanent basis is credited to which account in the fixed capital accounts method ?

(9) The debit balance of current account of partners' is shown on which side of balance sheet ?

(10) Write a journal entry to transfer drawings account to the capital account, at the end of the year.

(11) Profit and loss appropriation account is a part of which account ?

3. Answer the following questions in brief :

(1) A partner withdraws identical amount at the end of each month from the firm. At the end of the year total annual drawings is ₹ 12,000. 12 % p.a. interest is chargeable on drawings. Determine the amount of interest on drawings of the year.

(2) Amruta and Divya are the partners of a firm. Their capital ratio is 3:2. Amruta is to be paid 8 % comission on net profit, after deduction of such commission. What amount will be received by Amruta if profit of the year is ₹ 96,876.

(3) Vismay, Abhijit and Kunal are partners sharing profit-loss in the proportion of 3:2:4. Manager is to be paid 10 % commission on profit but after the deduction of his such share. The share of profit of Abhijit is ₹ 30,000. Determine the commission of manager.

(4) The profit-loss sharing ratio of Rajkumar, Kaushik and Sharma is 15:10:9. The total profit of the year of the firm is ₹ 68,000. Determine the share in profit of each partner.

(5) Mehta receives his share four times of Pandya. While Bajpai receives half of share of Mehta. Profit of firm at the end of the year is ₹ 87,500. Determine the share in profit of each partner.

(6) Profit of the partnership firm of Sheela, Surbhi and Sanket is ₹ 1,35,000. They have shared profit in the ratio 2:1:3 instead of 3:2:3. What accounting treatment is to be given to the capital account to rectify this error ?

(7) Ram, Rahim and Ishu are partners of a partnership firm. Their capital as on 1-4-2016 was ₹ 60,000, ₹ 40,000 and ₹ 50,000 respectively. After the distribution of the profit of the year, it was realised that charging of 6 % interest on partners' capital accounts was missed out. Write an entry for the rectification of error.

(8) Lata, Geeta and Pravina are partners of a partnership firm. After distribution of the profit of the year it was realised that charging of interest on partners' drawings account respectively ₹ 2700, ₹ 1200 and ₹ 1500 was missed out. Write an entry for the rectification of error.

(9) Mukesh, Dhaval and Vinod are the partners of a partnership firm. Their capital proportion is 4:2:3. Dhaval and Vinod has given assurance to Mukesh that he will get minimum ₹ 35,000 from the profit. The profit of the year is ₹ 90,000. How would you distribute the profit among the partners ?

(10) The closing capital of Raghuvir is ₹ 80,000. In which ₹ 12,500 drawings of current year and profit of ₹ 17,800 are recorded. What will be the interest at 6 % p.a. on the opening capital ?

(11) A, B and C are the partners sharing profit-loss in equal proportion. Their total capital is of ₹ 4,50,000. Their proportion of capital is 1:3:2. Firm pays interest on capital at 9 % p.a. Partner C has received ₹ 73,500 including interest on capital. Determine the amount payable including interest on the capital of A and B ?

4. Answer the following questions to the point :

(1) Explain the meaning of partnership.

(2) Describe the characteristics of partnership.

(3) Describe the accounting provisions of partnership act 1932, in absense of a partnership deed.

(4) What is profit-loss appropriation account ? Which items are disclosed in it ?

5. Write short-notes :

(1) Partnership deed

(2) Fluctuating capital accounts of partners

(3) Fixed capital accounts of partners

(4) Current accounts of partners

(5) Drawing accounts of partners

6. Distinguish between :

(1) Fixed capital accounts method and fluctuating capital accounts method

(2) Profit and loss account and profit and loss appropriation account

7. X and Y are partners of a partnership firm. They have not prepared partnership deed. There is difference of opinion between the partners. Please give legal advice to the partners.

(1) X demands 6 % p.a. interest on drawings of partners.

(2) Y is an active partner of the firm. He claims for remuneration and commission.

(3) X demands interest on capital of partners.

(4) X has lent loan of ₹ 20,000 to the firm. He demands interest on loan.

(5) Firm has lent loan of ₹ 25,000 to Y. X demands to charge interest on the loan.

(6) X demands to share profit between the partners in the proportion of capital.

8. Harpal and Chirag are the partners of a firm. On 1-4-2016 their capital is ₹ 60,000 and ₹ 1,00,000 respectively. During the year on 1-4-2016 Harpal has withdrawn ₹ 15,000 and Chirag has withdrawn ₹ 20,000 on 1-1-2017. Provisions of partnership deed are as follows :

(1) Provide 12 % p.a. interest on capital.

(2) Charge 9 % p.a. interest on drawings.

(3) ₹ 1000 per month are payable to Harpal for his active role in the firm, while 5 % commission of divisible profit is payable to Chirag.

On 1-12-2016 Harpal has given loan of ₹ 30,000 to the firm. There is no provision for interest on loan in the partnership deed. He claims 11 % interest on his loan. The profit to the firm on 31-3-2017 was ₹ 79,400, before above mentioned provisions but after charging interest on loan of Harpal.

From the above information prepare profit and loss appropriation account and partners capital accounts.

9. Bhadresh and Hiral are the partners of a firm. Their profit-loss sharing ratio is 3:2. On 1-4-2016 total capital of partners was ₹ 4,20,000. The proportion of their fixed capital is 4:3. On this day, balances of their current accounts are as follows : Bhadresh ₹ 36,000 (credit), Hiral 24,000 (debit).

As per partnership deed per annum 12 % interest is payable on the capital of the partners. Provide per annun 10 % interest on opening balances of the current accounts. Per annum 12 % interest is to be charged on drawings. ₹ 2400 per month as a salary are payable to Bhadresh for his active role in the firm.

On 1-10-2016 Bhadresh has withdrawn ₹ 36,000 and on 1-1-2017 Hiral has withdrawn ₹ 48,000. 10 % commission on net profit is payable Hiral, from net profit, but after deduction of his such share from net profit.

Before consideration of above mentioned adjustments the profit for the year ending on 31-3-2017 of the firm was ₹ 4,06,800.

From the above information prepare profit and loss appropriation account and partners capital account and current accounts as per the fixed method.

10. Sharda, Jamna and Ganesh are the partners of a firm. On 1-4-2016 their capital was ₹ 72,000, ₹ 48,000 and ₹ 24,000 respectively.

As per the partnership deed :

(1) 5 % per annum interest is payable on opening capital of partners.

(2) 8 % per annum interest will be charged on drawings.

(3) Monthly salary of ₹ 700 is payable to Sharda.

(4) Half profit will be distributed amongst the partners in equal proportion and remaining half profit in the proportion of their opening capital.

On 31-12-2016 Ganesh has withdrawn ₹ 6000 from the firm for his personal use.

Profit of the firm for the year ending on 31-3-2017 after charging interest on drawings but before consideration of above mentioned adjustment was ₹ 81,600. Before the distribution of the profit to the partners but after consideration of above mentioned adjustments from surplus of profit 20 % (but not less than ₹ 18,000) are to be transferred to the general reserve.

From the above information for the year ending on 31-3-2017, prepare profit-loss appropriation account and partners' capital accounts.

11. Isha, Saraswati and Laxmi are the partners sharing profit-loss in the proportion of opening capital. On 1-4-2016 balances of their fixed capital accounts were ₹ 40,000, ₹ 40,000 and ₹ 20,000 respectively. On the same day balance of their current accounts were as under :

Isha ₹ 5000 (credit), Saraswati ₹ 4000 (credit), Laxmi ₹ 3000 (debit)

Total drawings of partners during the year is ₹ 20,000. It is in the proportion of 2:1:2. On 30-6-2016 Isha has lent ₹ 3000 and on 1-10-2016 ₹ 2000 to the firm in the form of loan. On 30-11-2016 Laxmi has introduced addition capital of ₹ 12,000.

As per the partnership deed :

(1) Provide 10 % p.a. interest on capital.

(2) Respectively ₹ 800, ₹ 500 and ₹ 700 are to be recovered as interest on drawings.

(3) Provide 8 % p.a. interest on opening capital of current accounts.

(4) From 1-11-2016 monthly salary of ₹ 800 is payable to Isha for her active role in the firm.

(5) ₹ 3500 of divisible profit are to be transferred to building fund account.

Profit for the year ending on 31-3-2017 before incorporation of above mentioned adjustment but after incorporation of effect of interest on Isha's loan was ₹ 20,880.

Prepare profit and loss appropriation account, capital accounts and current accounts of partners.

12. Prerna, Paras and Jaishri are the partners of a firm. On 1-4-2016 their capital was ₹ 1,50,000, ₹ 90,000 and ₹ 60,000 respectively. Their drawings were as follows :

Prerna ₹ 15,000 on 1-7-2016 and Paras ₹ 24,000 on 30-10-2016.

They distribute half profit in the capital proportion and remaining in the ratio of 2:2:1. Jaishri has lent out loan of ₹ 30,000 on 1-10-2016 to the firm. As per partnership deed per annum 5 % interest on capital, per annum 12 % interest on drawings is to be calculated. Paras is to be paid annual salary of ₹ 18,000 for his active role in the firm. 10 % commission is to be given to Prerna from surplus of profit after providing for above mentioned provisions and after deduction of her such commission. For the year ending on 31-3-2017 profit of the firm before incorporation of the above mentioned adjustments but after charging interest on loan of Jaishri was ₹ 1,29,450.

It was decided that after the consideration of above mentioned adjustments and transfer of profit-loss to capital account, total capital of the firm would be identical to the opening capital, which should be in the proportion of 2:2:1. For this purpose required amount will be introduced by the partners and excess amount will be withdrawn by the partners.

Prepare profit and loss appropriation account, partners' capital accounts for the year ending on 31-3-2017.

●

2

Final Accounts (Financial Statements) of Partnership Firm

1. Introduction

Similar to the sole proprietor, the partnership firms also prepare its final accounts from the trial balance with the consideration of the adjustments at the end of the year to know the earned profit or incurred losses as well as the financial status of the business.

In the final accounts of a partnership firm, trading account, profit and loss account, profit and loss appropriation account, partners' capital accounts/current accounts and balance sheets are prepared.

2. Objectives of Final Accounts of Partnership

(1) **To ascertain gross profit or loss :** A partnership firm can ascertain gross profit or loss through the preparation of trading account.

(2) **To ascertain net profit or loss :** A partnership firm can ascertain net profit or loss through the preparation of profit and loss account. The profitability of the firm can be seen from the profit and loss account.

(3) **To ascertain divisible profit or loss :** All personal transactions and provisions of the partners with the firm can be ascertained through the preparation of profit and loss appropriation account.

(4) **To know financial status of the firm :** To know the financial status of the firm balance sheet is prepared. It provides information about assets, receivables, payables and capital of the firm.

(5) **For taxation purpose :** To know the taxable income of the firm final accounts are prepared.

3. Final Accounts of Partnership Firm :

Annual financial statements of the firm are prepared as follows with the consideration of balances recorded in the trial balance at the end of the accounting year and adjustments.

(1) **Trading Account :** Transactions pertaining to receipt and issue of goods, purchase of goods and production related expenses are recorded in the trading account. To ascertain gross profit or loss on the basis of these transactions account which is prepared is known as the trading account.

At the debit side of the trading account opening stock, purchase minus purchase return, as well as outward of goods due to other reason like withdrawal of goods, goods destroyed by fire, goods distributed as sample, goods given for donation are recorded. Purchase expenses like wages, carriage inward, octroi, frieght and production expenses like factory expenses, rent, taxes, electricity, fuel, coal, gas, royalty, depreciation on plant etc are also disclosed.

At the credit side of trading account sales minus sales return, sale of scrap and closing stock of goods are disclosed.

When trading account is closed and if total of credit side of trading account is more than debit side, difference is shown at debit side which is considered as gross profit. This gross profit is transferred to the credit side of profit and loss account. If total of debit side is more than credit side, difference is shown at credit side which is considered as gross loss. This gross loss is transferred to debit side of profit and loss account.

Specimen of Trading Account

Trading for the period ending on .... of ....

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		✓	By Sales	✓	
To Purchase	✓		Less : Sales return	✓	✓
Less : Purchase return	✓		By Sale of scrap A/c		✓
Less : Outward of goods	✓	✓	By Closing stock		✓
To Purchase expenses :			By Profit and loss A/c (Gross loss)		✓
Wages		✓			
Carriage inward		✓			
Railway Freight		✓			
Octroi		✓			
Import duty		✓			
Transportation cartage		✓			
Port charge		✓			
Demurrage		✓			
Wharfaje		✓			
To Production expenses :					
Production wages		✓			
Royalty		✓			
Factory expense (rent, taxes, electricity, fuel, coal, gas)		✓			
Consumable stores (oil, grease)		✓			
To Factory depreciation A/c		✓			
To Plant-machinery depreciation A/c		✓			
To Profit and loss (gross profit)		✓			
		✓			✓

(2) **Profit and Loss Account :** To ascertain net profit or loss, profit and loss account is prepared. At the debit of profit and loss account, gross loss transferred from trading account, administrative, expenses, sales-distribution expenses, financial expenses, depreciation on assets, sundry expenses and other losses of the firm are shown. While at the credit side, gross profit transferred from the trading account, incomes of business like interest received, rent received, commission received, dividend, brokerage, bad debts return, profit on sale of asset and other incomes are shown.

When profit and loss account is closed and if the total of credit side is more than the debit side, difference is shown at the debit side which is considered as the net profit. This net profit is transferred at the credit side of the profit and loss appropriation account. When the total of debit side is more than the credit side, difference is shown at the credit side, which is considered as the net loss. This net loss is transferred to the debit side of the profit and loss appropriation account.

Specimen of Profit and Loss Account

Profit and Loss Account for the Period Ending on .... of ....

Dr Cr

Particular		**Amt. (₹)**	**Particular**	**Amt. (₹)**
To Trading A/c (Gross loss)		✓	**By Trading A/c (Gross profit)**	✓
To Administrative expenses :			**By Incomes :**	
Salary, allowances, bonus		✓	Discount received	✓
Rent		✓	Rent received	✓
Insurance Premium		✓	Commission received	✓
Taxes		✓	Brokerage received	✓
Postage		✓	Consignment commission received	✓
Printing and Stationery		✓	Interest on investment	✓
Legal charges		✓	Interest on loan lent	✓
Audit fees		✓	Bad debts return	✓
Electricity expense		✓	Profit on sale of asset	✓
Contribution to providend fund		✓	Sale of old newspapers	✓
To Sales-Distribution Expense :			Income from scrap	✓
Carriage outward		✓	Sundry income	✓
Salesman salary - commission		✓	By Profit and loss appropriation A/c	✓
Advertisement expenses		✓	(Net loss)	
Discount allowed		✓		
Discount reserve		✓		
Expenses of show-room		✓		
Godown expense		✓		
Packing expense		✓		
To Financial Expenses :				
Interest on partners' loan		✓		
Interest on bank overdraft		✓		
Interest on borrowed loan		✓		
Bank charges commission		✓		
Manager commission		✓		
To Other Expenses-Loss :				
Donation expense		✓		
Assets depreciation		✓		
Bad debts (TB)	✓			
+ Bad debts (Adj.)	✓			
+ Bad debts reserve (Adj.)	✓			
	✓			
Less : Bad debts reserve (TB)	✓	✓		
Loss due to fire		✓		
Loss due to theft		✓		
Loss on sale of asset		✓		
Provision for expense/loss		✓		
To Profit and loss appropriation A/c		✓		
(Net profit)				
		✓		✓

(3) **Profit and Loss Appropriation Account :** To disclose the distribution of profit between the partners, profit and loss appropriation account is prepared in a partnership firm. Profit and loss appropriation account is a part of profit and loss account only. The separate preparation of it is not mandatory.

At the debit side of the profit and loss appropriation account, net loss transferred from profit and loss account, interest on partners' capital, interest on credit balance of current accounts, bonus, commission, salary and remuneration to partners' amount transferred to general reserve account are shown.

At the credit of profit and loss appropriation account, net profit transferred from profit and loss account, interest on drawings of partners, interest on debit balance of current accounts etc. are shown.

When profit and loss appropriation account is closed and if the total of credit side of it is more than the debit side, the difference is recorded at the debit side and it is considered as the divisible profit. This divisible profit is credited to partners' capital accounts or to partners current accounts when fixed capital account is maintained, in their profit-loss sharing ratio.

While total of debit side is more than difference is recorded at the credit side, which is considered as the divisible loss. This divisible loss is debited to partners' capital accounts or current account in their profit-loss sharing ratio.

Note : When separate profit and loss appropriation account is not prepared, to ascertain divisible profit or loss, all items of profit and loss appropriation account are shown in profit and loss account. This divisible profit or loss is transferred to partners' capital accounts. This is explained as a optional treatment. Not to be asked in examination.

Specimen of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account for the year ending on .... of ....

Dr   Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Net loss (From profit and loss A/c)	✓	By Net profit(From profit and loss A/c)	✓
To Interest on partners' capital A/c		To Interest on partners' drawings A/c	
A ✓		X ✓	
B ✓	✓	Y ✓	✓
To Interest on credit balance of		By Interest on debit balance of current	
current account of partner A/c	✓	account of partner A/c	✓
To Salary, bonus, commission,		By Partners' capital or current A/c	
remuneration to partner A/c	✓	(Divisible loss)	
To General reserve A/c	✓	X ✓	
To Partners' capital or current A/c		Y ✓	✓
(Divisible profit)			
X ✓			
Y ✓	✓		
	✓		✓

(4) **Partners' Capital Accounts :** Partners of a partnership firm undertake personal transactions with the firm. To record such transactions capital account of each partner is prepared in the books of the firm. Transactions which increase the capital of partner are recorded at the credit side and transactions which reduce the capital of partner are recorded at the debit side of the capital account.

First of all the opening capital of a partner is written at the credit side of the capital account and subsequently if additional capital introduced it also credited.. At debit side, capital returned to the partner is recorded. When partners capital accounts are closed the total of credit side generally remains more, thus difference is written at the debit side. This is known as the closing balance. This balance is shown at the capital-liability side as a permanent capital.

Specimen of Partners' Capital Accounts :

Partners' Capital Accounts

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
–	To Cash/bank/other asset A/c (Withdrawal of capital)	✓	✓	1-4	By Balance b/d (Opening capital)	✓	✓
31-3	To Balance c/d (Closing credit balance)	✓	✓	–	By Cash/bank/other asset A/c (Additional capital)	✓	✓
		✓	✓			✓	✓

(5) **Partners' Current Accounts :** There are personal transactions between partners and partnership firm other than the permanent capital. To record these transactions, accounts which are prepared are known as partners' current accounts.

At the credit side of partners' current accounts, opening credit balance of current account, interest on capital, interest on credit balance of current accounts, salary, bonus, commission and bonus to partners', share in divisible profit etc are recorded. On the debit side of the current account, opening debit balance of current account (if any), drawings, interest on drawings, interest on debit balance of current accounts, share in divisible loss etc are recorded.

When current account is closed and if the total of credit side is more than the debit side, difference is shown at the debit side. This is known as the closing balance. This balance is shown at the the Capital-liability side of the balance sheet. If the total of debit side is more, difference is shown at credit side. This is also known as the closing balance. But this balance is shown at Asset side of the balance sheet.

Specimen of Partners' Current Accounts :

Partners' Current Accounts

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
1-4	To Balance b/d (Opening debit balance of current A/c)	✓	✓	1-4	By Balance b/d (Opening credit balance)	✓	✓
–	To Drawings A/c	✓	✓	31-3	By Interest on capital A/c	✓	✓
31-3	To Interest on drawings A/c	✓	✓	31-3	By Interest on credit balance of current A/c	–	✓
31-3	To Interest on debit balance of current A/c	✓	–	31-3	By Salary, bonus, commission, remuneration A/c	✓	✓
31-3	To Divisible loss	✓	✓	31-3	By Divisible profit	✓	✓
31-3	To Balance c/d (Closing credit balance)	✓	✓	31-3	By Balance c/d (Closing debit balance)	✓	✓
		✓	✓			✓	✓

Note : All items of the current accounts will be shown in the capital accounts when current accounts are not given in a question.

(6) **Balance Sheet :** To know the financial status of the firm balance sheet is prepared at the end of an accounting year. Balance sheet is a statement. Where on one side of it, amount of capital and liabilities and on another side amount of assets are disclosed.

At capital and liability side of balance sheet of the partnership firm the balance of permanent capital accounts, credit balances of current accounts, creditors, bills payable, bank overdraft, expenses outstanding, incomes received in advance, loan borrowed, partners' loan, interest outstanding on partners' loan are disclosed. Besides, general reserve and other reserves etc are also disclosed.

At the asset side of the balance sheet fixed assets, investments, current and liquid assets like closing stock, debtors, cash balance, bank balance, bills receivables, incomes due but not received, prepaid expenses, loan lent, deffered revenue expenses, debit balance of current accounts etc are disclosed.

Specimen Balance Sheet :

Balance Sheet as at .... of ....

Capital-Liabilities	**Amt. (₹)**	**Assets**	**Amt. (₹)**
Fixed Capital Accounts :		**Non-Current Assets :**	
A	✓	**Fixed Assets :**	
B	✓	**Tangible Assets :**	
Current Accounts (Credit Balance) :		Land	✓
A	✓	Building	✓
B	✓	Leasehold properties	✓
Reserves :		Vehicles	✓
General reserve	✓	Machines	✓
Capital reserve	✓	Furniture and Fittings	✓
Other reserve	✓	**Intangible Assets :**	
Non-Current Liabilities :		Patent	✓
Loan from bank	✓	Trademark	✓
Loan from financial institutions	✓	Copyright	✓
Loan from friends	✓	Goodwill	✓
Partners' loan	✓	**Investments :**	
Current Liabilities :		Investments in government	
Bank overdraft	✓	securities	✓
Sundry creditors	✓	Investments of providend fund	✓
Bills payable	✓	**Other Non-Current Assets :**	
Expenses outstanding	✓	Deffered revenue expense	✓
Income received in advance	✓	**Current Assets :**	
Taxation provision	✓	Closing stock	✓
Providend fund	✓	Sundry debtors	✓
Interest outstanding on		Cash balance	✓
on partners' loan	✓	Bank balance	✓
		Incomes due	✓
		Loan lent	✓
		Bills receivable	✓
		Prepaid expenses	✓
		Current Accounts :	
		(In case of debit balance)	
		A	✓
		B	✓
	✓		✓

4. Adjustments of Final Accounts of Partnership Firm

At the end of an accounting year, to give complete shape to accounts, adjustments and adjustment entries are recorded. Adjustment entries and their accounting effect in an annual account of a firm is as under :

Adjustments, Adjustment Entries and their Effect in Annual Accounts

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(1)	Closing stock	Closing stock A/c ...Dr To trading A/c	(1) Asset side of balance sheet (2) Credit side of trading A/c
(2)	Outstanding expense	Respective expense A/c ...Dr To outstanding expense A/c	(1) Debit side of trading / P & L A/c add it to respective expense (2) Capital & liability side of balance sheet
(3)	Prepaid expense	Prepaid expense A/c ...Dr To respective expense A/c	(1) Asset side of balance sheet (2) Debit side of trading/P & L A/c deduct it from respective expense
(4)	Receivable income	Receivable income A/c ...Dr To respective income A/c	(1) Credit side of P & L A/c add it to respective income (2) Assets side of balance sheet
(5)	Income received in advance	Respective income A/c ...Dr To income received in advance A/c	(1) Liability side of balance sheet (2) Credit side of P & L A/c deduct from respective income
(6)	Depreciation on assets	Depreciation A/c ...Dr To respective asset A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet, deduct from respective asset
(7)	Bad debts written off (new/additional)	Bad debts A/c ...Dr To debtors A/c	(1) Debit side of P & L A/c, add it old bad debts (2) Asset side of balance sheet, deduct from debtors
(8)	Bad debts reserve	Profit and loss A/c ...Dr To bad debts reserve A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct from debtors
(9)	Discount reserve on debtors	Profit and loss A/c ...Dr To discount reserve on debtors A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct from debtors

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(10)	For unrecorded credit purchase	Purchase A/c ...Dr To creditors A/c	(1) Debit side of trading A/c add it to purchase (2) Liability side of balance sheet add it to creditors
(11)	For unrecorded credit sales	Debtors A/c ...Dr To sales A/c	(1) Asset side of balance sheet add it to debtors (2) Credit side of trading A/c add it to sales
(12)	For unrecorded credit purchase return	To creditors A/c ...Dr To purchase return A/c	(1) Liability side of balance sheet, deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase
(13)	For unrecorded credit sales return	Sales return A/c ...Dr To debtors A/c	(1) Credit side of trading A/c, deduct it from sales (2) Asset side of balance sheet, deduct it from debtors
(14)	Purchase return recorded to sales book	(1) Sales A/c ...Dr To debtors A/c (2) Creditors A/c ...Dr To purchase return A/c	(1) Credit side of trading A/c, deduct it from sales (2) Asset side of balance sheet deduct it from debtors (3) Liability side of balance sheet deduct it from creditors (4) Debit side of trading A/c deduct it from purchase A/c
(15)	Sales return recorded to purchase book	(1) Creditors A/c ...Dr To purchase A/c (2) Sales return A/c ...Dr To debtors A/c	(1) Liability side of balance sheet deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase (3) Credit side of trading A/c, deduct it from sales (4) Asset side of balance sheet, deduct it from debtors

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(16)	Credit purchase recorded to sales book	(1) Sales A/c ...Dr To debtors A/c (2) Purchase A/c ...Dr To creditors A/c	(1) Debit side of trading A/c, deduct from sales (2) Asset side of balance sheet, deduct from debtors (3) Debit side of trading A/c, add it to purchase (4) Liability side of balance sheet add it to creditors
(17)	Credit sales recorded to purchase book	(1) Creditors A/c ...Dr To purchase A/c (2) Debtors A/c ...Dr To sales A/c	(1) Liability side of balance sheet, deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase (3) Asset side of balance sheet, add it to debtors (4) Credit side of trading A/c, add it to sales
(18)	Interest on capital	Interest on capital A/c ...Dr To capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Liability side of balance sheet, add it to capital A/c
(19)	Interest on drawings	Drawings A/c ...Dr To interest on drawings A/c	(1) Liability side of balance sheet, add it to drawings (2) Credit side of profit and loss appropriation A/c
(20)	Salary to partners	Partners' salary A/c ...Dr To partners capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of partners current/ capital A/c
(21)	Interest on credit balance of current a/c of partners	Interest on partners current A/c ...Dr To partners current A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of partners current A/c
(22)	Interest on debit balance of current a/c of partners	Partners current A/c ...Dr To interest on partners current A/c	(1) Debit side of partners current A/c (2) Credit side of profit and loss appropriation A/c
(23)	Outstanding interest on partners' loan	Interest on loan A/c ...Dr To outstanding interest on partners' loan A/c	(1) Debit side of P & L A/c (2) Liability side of balance sheet,

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(24)	Transfer to general reserve	P & L Appropriation A/c ...Dr To general reserve A/c	(1) Debit side of profit and loss appropriation A/c (2) Liability side of balance sheet, add it to general reserve
(25)	Commission payable to partners	Partners commission A/c ...Dr To partners capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of current or capital A/c of partners
(26)	Interest on advanced loan	Outstanding interest on loan A/c...Dr To interest on loan A/c	(1) Asset side of balance sheet, A/c (2) Credit side of P & L A/c
(27)	Amortization of intangible assets like goodwill, patent, trademark, copy-right	Profit and loss A/c ...Dr To intangible asset A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct it from intangible asset
(28)	Unrecorded goods withdrawn for personal use	Drawings A/c ...Dr To purchase A/c	(1) Liability side of balance sheet, add it to drawings (2) Debit side of trading A/c deduct it from purchase
(29)	Goods issued for free sample	Advertisment A/c ...Dr To purchase A/c	(1) Debit side of P & L A/c (2) Debit side of trading A/c deduct it from purchase
(30)	Stationery stock	Stationery stock A/c ...Dr To stationery expense A/c	(1) Asset side of balance sheet (2) Debit side of P & L A/c, deduct it from stationery expense
(31)	Writting off lease-hold property	Profit and loss A/c ...Dr To leasehold property A/c	(1) Debit side of P & L A/c (2) Asset side, deduct it from lease hold property
(32)	Receivable Interest/ dividend on shares and other investments	Receivable interest/dividend A/c ...Dr To interest / dividend A/c	(1) Asset side of balance sheet (2) Credit side of profit and loss A/c
(33)	Personal asset introduced by partner	Assets A/c ...Dr To partners capital A/c	(1) Asset side of balance sheet (2) Liability side of balance sheet, add it to capital of partner

Note : With an objective to maintain equal distribution of marks to each chapter and also to make it convenient for the students to understand each topic, it is mandatory to provide 24 to 30 items in a trial balance for the question of final accounts in the examination. Total adjustments should be limited to 5. Not more than two effects of adjustments should be introduced in an adjustment. To explain all types of transactions with minimum questions in illustration and exercise, more transactions are covered in illustrations and exercise.

Illustration 1 : Ram and Shyam are partners of a firm sharing profit - loss in the ratio 6:4. From the following trial balance dated 31-3-2017 and adjustments, prepare annual accounts of the firm.

Trial Balance of Partnership Firm of Ram and Shyam as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital :**	
Ram	18,000	Ram	80,000
Shyam	16,000	Shyam	70,000
Debtors	45,000	Creditors	35,000
Stock (1-4-2016)	25,000	Purchase return	1500
Sales return	1000	Bank overdraft	8000
Cash balance	10,000	Sales	78,150
Purchase	60,000	Bad debts reserve	700
Discount allowed	500	Outstanding wages	1000
Bad debts	400	8 % Geeta's loan (1-10-2016)	15,000
Machines	18,250	Bills payable	200
Depreciation on machines	1750		
Furniture	8000		
Sundry expenses	1500		
Leasehold building (For four years)	7000		
Goodwill	40,000		
Trading expense	1250		
Rent and taxes	5000		
Carriage inward	400		
Bank interest	500		
Insurance premium	800		
Salary	15,000		
Wages	14,000		
Prepaid insurance	200		
	2,89,550		**2,89,550**

Adjustments : (1) Closing stock value ₹ 45,000, it's market value is 10 % more. (2) 5 % interest on partners capital is chargeable and on drawings 10 % interest is recoverable. (3) Provide 10 % depreciation on machine and 5 % on furniture. (4) Provide 5 % Bad debts reserve on debtors. (5) Outstanding expenses : salary ₹ 500, Sundry expense ₹ 150 and rent ₹ 150. (6) As per partnership agreement interest on capital is payable even in loss.

Ans. : Trading account of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		25,000	By Sales	78,150	
To Purchase	60,000		− Sales return	1000	77,150
− Purchase return	1500	58,500	By Closing stock		45,000
To Wages A/c		14,000			
To Carriage inward A/c		400			
To Profit and loss A/c (gross profit)		24,250			
		1,22,150			**1,22,150**

P & L account of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administration Expense :			By Trading A/c (Gross profit)	24,250
To Salary	15,000		By Profit and loss appropriation A/c	7800
+ Outstanding	500	15,500	(Net loss)	
To Sundry expense	1500			
+ Outstanding	150	1650		
To Trading expense A/c		1250		
To Rent & taxes	5000			
+ Outstanding	150	5150		
To Insurance premium		800		
Selling-Distribution Expense :				
To Discount allowed		500		
Financial Charges :				
To Bank interest		500		
To Interest on Geeta's loan		600		
Other Expense-Loss :				
To Bad debts (old)	400			
+ To Bad debts reserve (new)	2250			
	2650			
− By Bad debts reserve (old)	700	1950		
To Depreciation :				
Machinery	2000			
+ Furniture	400	2400		
To Leasehold building (written off)		1750		
		32,050		**32,050**

P & L appropriation a/c of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Gross loss)		7800	By Interest on drawings A/c :		
To Interest on capital :			Ram	1800	
Ram	4000		Shyam	1600	3400
Shyam	3500	7500	By Partners capital A/c (loss) :		
			Ram	7140	
			Shyam	4760	11,900
		15,300			**15,300**

Partners Capital A/c

Dr | Cr

Date	Particular	Ram (₹)	Shyam(₹)	Date	Particular	Ram (₹)	Shyam(₹)
31-3-17	To Drawings A/c	18,000	16,000	1-4-16	By Balance b/d	80,000	70,000
31-3-17	To Interest on drawings A/c	1800	1600	31-3-17	By Interest on capital A/c	4000	3500
31-3-17	To P & L appro. A/c (Divisible loss)	7140	4760				
31-3-17	To Balance c/d	57,060	51,140				
		84,000	**73,500**			**84,000**	**73,500**
				1-4-17	By Balance b/f	57,060	51,140

Balance Sheet of partnership firm of Ram and Shyam as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital :			**Non-Current Assets :**		
Ram	57,060		**Fixed Assets :**		
Shyam	51,140	1,08,200	**Tangible Assets :**		
Non-Current Liabilities :			Machines	20,000	
8 % Geeta's loan		15,000	– Depreciation	2000	18,000
Current Liabilities :			Furniture	8000	
Bank overdraft		8000	– Depreciation	400	7600
Interest on Geeta's loan		600	Leasehold property	7000	
Creditors		35,000	– Written off	1750	5250
Outstanding expenses :			Non-tangible assets : Goodwill		40,000
Salary	500		**Current Assets :**		
Sundry expense	150		Closing stock		45,000
Rent-taxes	150	800	Debtors	45,000	
Outstanding wages		1000	– Bad debts reserve	2250	42,750
Bills payable		200	Cash balance		10,000
			Prepaid insurance		200
		1,68,800			**1,68,800**

Note : (1) Interest for 6 months will be calculated at the rate of 8 % on Gita's loan

$$= 15{,}000 \times \frac{8}{100} \times \frac{6}{12} = ₹\ 600$$

(2) Leasehold property is acquired for 4 years for ₹ 7000, therefore during current year 7000 ÷ 4 = ₹ 1750 will be amortised.

(3) Depreciated price ₹ 18,250 + depreciation ₹ 1750 = ₹ 20,000 pre depreciation price.

Calculated depreciation $= \frac{1750}{20{,}000} \times 100 = 8.75\ \%$

Now, ₹ 2000 depreciation will be calculated at the rate of 10 % on ₹ 20,000.

Illustration 2 : The following is the trial balance as at 31-3-2017 of Jay and Vijay. Prepare revised Trading account, Profit and loss account, Current accounts and Balance sheet with consideration of necessary adjustments :

Trial Balance of Partnership Firm of Jay and Vijay as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital A/c :		
Jay		80,000
Vijay		60,000
Current A/c :		
Jay		20,000
Vijay	5000	
Closing stock	27,300	
Trading A/c		30,900
Cash on hand	280	
Current A/c with bank	7000	
Fixed deposit with bank	40,000	
Debtors	18,400	
Salary	18,500	
Freehold land	60,000	
Plant and Machines	20,000	
Furniture and fixtures	5000	
Factory on lease (Lease will be ended on 31-3-2021)	30,000	
Loan of partner Vijay (On 1-10-2016)		30,000
Discount reserve on debtors		380
Bad debt reserve		1000
Insurance premium	1000	
Printing and stationery	600	
Creditors / Suppliers		12,000
Bad debts	200	
Advertisment expense	600	
Travelling expense	400	
	2,34,280	**2,34,280**

Adjustments : (1) Prepaid insurance ₹ 200. (2) Jay withdrawn goods of ₹ 2000 from business for his personal use. (3) Goods of ₹ 4000 purchased on credit on 28-3-2017, which is not recorded in the books. (4) Write off ₹ 400 as bad debts and provide 5 % bad debts reserve. (5) There is no need of discount reserve on debtors. (6) Provide 20 % depreciation on plant and machines and 5 % on furniture and fittings.

Note : Credit balance of trading A/c is given in the trial balance. To incorporate the effect of adjustments and to ascertain revised gross profit, revised trading account will be prepared.

Ans. : Revised Trading Account of partnership firm of Jay and Vijay as on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Unrecorded purchase	4000		By Trading A/c (as per trail balance)	
− Drawings of goods	2000	2000	(Gross profit)	30,900
To Written off leasehold property		6000		
To P & L A/c (Revised gross profit)		22,900		
		30,900		**30,900**

Profit and Loss Account of partnership firm of Jay and Vijay as on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
Administrative Expense :			By Trading A/c (Revised gross profit)		22,900
To Salary		18,500	By Discount reserve on debtors		380
To Insurance primium	1000		By Partners current A/c (Divisible loss)		
− Prepaid	200	800	Jay	1635	
To Bad debts (old)	200		Vijay	1635	3270
+ To Bad debts (new)	400				
+ To Bad debts reserve (new)	900				
	1500				
− To Bad debts reserve (old)	1000	500			
To Printing and stationery		600			
To Travelling expense		400			
To Advertisement expense		600			
Depreciation :					
To Plant and machinery	4000				
+ To Furniture	250	4250			
To Interest on Vijay's loan		900			
		26,550			**26,550**

Dr **Partners' Current Accounts** Cr

Date	Particular	Jay (₹)	Vijay (₹)	Date	Particular	Jay (₹)	Vijay (₹)
1-4-16	To Balance b/d	–	5000	1-4-16	By Balance b/d	20,000	–
31-3-17	To Drawings A/c	2000	–	31-3-17	By Balance c/d	–	6635
31-3-17	To P & L A/c (Divisible loss)	1635	1635				
31-3-17	To Balance c/d	16,365	–				
		20,000	**6635**			**20,000**	**6635**

Balance Sheet of Partnership firm of Jay and Vijay as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Jay	80,000		**Fixed Assets :**		
Vijay	60,000	1,40,000	**Tangible Assets :**		
Current A/c : Jay		16,365	Freehold land		60,000
Non-Current Liabilities :			Plant-Machines	20,000	
Vijay's loan		30,000	– Depreciation	4000	16,000
Creditors	12,000		Furniture	5000	
+ Unrecorded purchase	4000	16,000	– Depreciation	250	4750
Outstanding interest on loan of Vijay		900	Lease hold factory	30,000	
			– written off	6000	24,000
			Non-Tangible Assets :		–
			Investments :		–
			Current Assets :		
			Closing stock		27,300
			Cash on hand		280
			Current A/c with bank		7000
			Fixed deposit with bank		40,000
			Debtors	18,400	
			– Bad debts (Adj.)	400	
				18,000	
			– Bad debts reserve (Adj.)	900	17,100
			Prepaid insurance premium		200
			Current A/c : Vijay		6635
		2,03,265			**2,03,265**

Note : (1) No profit-loss sharing is given. Thus loss is distributed in equal proportion. (2) Rate of interest on loan of partner Vijay is not given. Thus as per the provision of partnership act 1932 interest will be paid at 6 % for 6 months.

$$= 30{,}000 \times \frac{6}{100} \times \frac{6}{12} = ₹\ 900$$

Vijay's loan ₹ 30,000 will be disclosed as non-current liabilities in the balance sheet and outstanding interest of loan ₹ 900 as a current liability in the balance sheet.

Illustration 3 : Trial balance of partnership firm of Yash and Jash as on 31-3-2017 is as follows :

Trial Balance of partnership firm of Yash and Jash as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital A/c :**	
Yash	8000	Yash	50,000
Jash	4000	Jash	40,000
Stock (1-4-2016)	24,000	Suppliers	16,400
Customers	29,000	Sales	2,04,000
Purchase	1,30,800	Bills payable	8000
Wages	2000	Interest on investment	300
Bills receivables	6000	Bank overdraft	24,260
6 % Investments (1-4-16)	10,000	Goods returned	2800
Salary	12,000	Rent received	600
Cash balance	3500	Discount received	400
Discount allowed	1400	Bad debts reserve	2000
Goods returned	2400	Goods withdrawn for personal use	740
Bad debts	400	Outstanding wages	500
Stationery expense	800		
Office expense	2300		
Motor car	52,000		
Building	60,200		
Prepaid office expense	1200		
	3,50,000		**3,50,000**

Adjustments : (1) Interest at 5 % on capital and at 10 % on drawings for 6 months. (2) Closing stock ₹ 15,000, having market value ₹ 12,000. (3) Outstanding stationery expense ₹ 500. (4) Prepaid wages ₹ 400. (5) Rent received in advance ₹ 200 and discount is receivable ₹ 40. (6) From debtors written off ₹ 1000 as bad debts, provide 5 % bad debts reserve and 2 % discount on reserve on debtors. (7) Provide 10 % depreciation on motor car. (8) Goods worth ₹ 2000 destroyed by fire, insurance company has admitted claim of 80 % (9) 10 % commission is payable to Jash from profit after deduction of commission from profit.

Prepare annual accounts of partnership firm.

Trading Account of Partnership firm of Yash and Jash as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		24,000	By Sales	2,04,000	
To Purchase	1,30,800		− Sales return	2400	2,01,600
− Purchase return	2800		By Closing stock		12,000
	1,28,000				
− Goods withdrawn for personal use	740				
	1,27,260				
− Goods destroyed by fire	2000	1,25,260			
To wages	2000				
− Prepaid	400	1600			
To profit and loss A/c (Gross profit)		62,740			
		2,13,600			**2,13,600**

Profit and Loss Account of Partnership firm of Yash and Jash as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
Administrative expenses :			By Trading A/c (Gross profit)		62,740
To Salary		12,000	By Interest on investment	300	
To Stationery expense	800		+ Outstanding	300	600
+ outstanding	500	1300	By Rent	600	
To Office expense		2300	− Received in advance	200	400
Selling & distribution expense :			By Discount received	400	
To Discount allowed	1400		+ Outstanding	40	440
+ To Discount reserve on debtors (Adj.)	532	1932			
Other expenses-loss :					
To Bad debts (old)	400				
+ To Bad debts (new)	1000				
+ To Bad debts reserve (new)	1400				
	2800				
− To Bad debts reserve (old)	2000	800			
Depreciation : Motor car		5200			
To Loss on goods destroyed by fire		400			
To P & L App. A/c (Net profit)		40,248			
		64,180			**64,180**

Dr **P & L Appropriation A/c of Partnership firm of Yash and Jash as year ending on 31-3-17** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		40,248
Yash	2500		Interest on drawings :		
Jash	2000	4500	Yash	400	
To Jash's commission A/c		3304	Jash	200	600
To Partners' capital A/c (Divisible profit)					
Yash	16,522				
Jash	16,522	33,044			
		40,848			**40,848**

Note : (1) Profit-loss sharing ratio is in equal proportion.

(2) Jash's commission $= 36{,}348 \times \frac{10}{110} = ₹\ 3304.36 = ₹\ 3304$

Dr **Partners Capital Accounts** Cr

Date	Particular	Yash (₹)	Jash (₹)	Date	Particular	Yash (₹)	Jash (₹)
31-3-17	To Drawings A/c	8000	4000	1-4-16	By Balance b/d	50,000	40,000
31-3-17	To Interest on drawings A/c	400	200	31-3-17	By Interest on capital A/c	2500	2000
31-3-17	To Balance c/d	60,622	57,626	31-3-17	By Commission A/c	–	3304
				31-3-17	By P & L App. A/c (Divisible profit)	16,522	16,522
		69,022	**61,826**			**69,022**	**61,826**

Balance Sheet of partnership firm of Yash and Jash as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Yash	60,622		**Fixed Assets :** Building		60,200
Jash	57,626	1,18,248	Motar car	52,000	
Non-Current Liabilities :			– Depreciation	5200	46,800
Current Liabilities :			6 % investments		10,000
Bank overdraft		24,260	**Current Assets :** Closing stock		12,000
Bills payables		8000	Customers	29,000	
Suppliers		16,400	– Bad debts (Adj.)	1000	
Outstanding wages		500		28,000	
Outstanding stationery expense		500	– Bad debts reserve(Adj.)	1400	
Rent received in advance		200		26,600	
			– Discount reserve	532	26,068
			Cash balance		3500
			Discount receivable		40
			Bills receivable		6000
			Prepaid office expense		1200
			Prepaid wages		400
			Receivable interest on investments		300
			Insurance Co. (Claim amount)		1600
		1,68,108			**1,68,108**

Illustration 4 : Following is the trial balance of partnership firm of Ganga and Jamna as on 31-3-2017.

Trial Balance of partnership firm of Ganga and Jamna as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital :**	
Ganga	12,000	Ganga	30,000
Jamna	12,000	Jamna	36,000
Purchase	1,04,000	**Current Accounts :**	
Goods return	1600	Ganga	3000
Stock of goods (1-4-16)	16,000	Jamna	2400
Salary	18,000	Sales	1,84,000
Office expense	9000	Goods returned	1200
Carriage inward	3000	Bad debts reserve	6000
Carriage outward	4500	Bank loan	13,500
Bad debts	1400	Creditors	36,000
Debtors	67,000	Bills payable	1800
Bills receivable	2000	Loan borrowed	4000
Cash on hand	3400	General reserve	9600
Bank balance	5600		
Investments	14,000		
Machinery	30,000		
Building	24,000		
	3,27,500		**3,27,500**

Adjustments : (1) Value of closing stock ₹ 28,600, but market value of 20 % goods is 10 % more than book value. (2) 5 % interest is payable on capital to partners and annual bonus of ₹ 2000 payable to each partner. (3) Bad debts reserve is to be maintained of ₹ 3000 and provide 5 % discount reserve on debtors. (4) Provide 10 % depreciation on building and machines. (5) Purchase of ₹ 4000 is not recorded but included in the closing stock. (6) Receivable commission is of ₹ 2000 and outstanding office expense is ₹ 200. (7) The value of investment is determined at ₹ 12,000 and adjustment of difference is to be transferred to general reserve. (8) Loan of ₹ 600 was given to an employee, but debited to salary account. (9) Profit-loss sharing of partners is 3:7. Prepare annual accounts of partnership firm.

Trading Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		16,000	By Sales	1,84,000	
To Purchase	1,04,000		– Sales return	1600	1,82,400
+ Unrecorded	4000		By Closing stock		28,600
	1,08,000				
– Purchase returned	1200	1,06,800			
To Carriage inward A/c		3000			
To profit and loss A/c (Gross profit)		85,200			
		2,11,000			**2,11,000**

Profit and Loss Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expenses :			By Trading A/c (Gross profit)	85,200
To Salary	18,000		Outstanding commission	2000
− Loan to employee	600	17,400	By Bad debts reserve	1600
To Office expense	9000		(Transfered from debit side)	
+ Outstanding	200	9200		
Selling-Distribution Expenses :				
To Carriage outward		4500		
Other Expenses-Loss :				
To Bad debts (old)	1400			
+ To Bad debts reserve (adj.)	3000			
	4400			
− To Bad debts reserve (old)	6000			
Transferred at credit side	−1600			
Discount reserve to debtors		3200		
Depreciation :				
Mechines	3000			
Building	2400	5400		
To Profit and loss appropriation A/c (Net profit)		49,100		
		88,800		**88,800**

Profit and Loss Appropriation Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on capital :			By Profit and loss A/c (Net profit)	49,100
Ganga	1500			
Jamna	1800	3300		
To Bonus to partners :				
Ganga	2000			
Jamna	2000	4000		
To Partners' current A/c(Divisible profit)				
Ganga	12,540			
Jamna	29,260	41,800		
		49,100		**49,100**

Partners Capital Accounts

Dr | Cr

Date	Particular	Ganga (₹)	Jamna(₹)	Date	Particular	Ganga (₹)	Jamna(₹)
31-3-17	To Drawings A/c	12,000	12,000	1-4-16	By Balance b/d	3000	2400
31-3-17	To Balance c/d	7040	23,460	31-3-17	By Interest on capital A/c	1500	1800
				31-3-17	By Bonus A/c	2000	2000
				31-3-17	By P & L App.A/c (Divisible profit)	12,540	29,260
		19,040	**35,460**			**19,040**	**35,460**

Note : (1) Book value of investment is ₹ 14,000, but its value is determined at ₹ 12,000. Adjustment is to be recorded to general reserve. So ₹ 2000 will be deducted from general reserve A/c.

(2) Distributed profit : Ganga : $41,800 \times \frac{3}{10}$ = ₹ 12,540

Jamna : $41,800 \times \frac{7}{10}$ = ₹ 29,260

Balance Sheet of partnership firm of Ganga and Jamna as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Ganga		30,000	**Fixed Assets :**		
Jamna		36,000	Building	24,000	
Current A/c :			− Depreciation	2400	21,600
Ganga		7040	Machines	30,000	
Jamna		23,460	− Depreciation	3000	27,000
Reserves :			**Investments :**		
General reserve	9600		Investments	14,000	
− Investments written off	2000	7600	− Written off	2000	12,000
Non-Current Liabilities :			**Current Assets :**		
Bank loan		13,500	Closing stock		28,600
Loan borrowed		4000	Debtors	67,000	
Current liabilities :			− Bad debts reserve (Adj.)	3000	
Bills payable		1800		64,000	
Creditors	36,000		− Discount reserve (Adj.)	3200	60,800
+ Unrecorded purchase	4000	40,000	Cash on hand		3400
Outstanding office expense		200	Bank balance		5600
			Outstanding commission		2000
			Bills receivable		2000
			Loan to employee		600
		1,63,600			**1,63,600**

Illustration 5 : Shiv and Shankar are partners of a firm sharing profit-loss in the equal proportion. From the following trial balance as on dated 31-3-2017 and adjustments prepare final accounts of the firm.

Trial Balance of partnership firm of Shiv and Shankar as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital and Drawings :		
Shiv	10,000	1,00,000
Shankar	20,000	1,20,000
Opening stock	60,000	
Purchase and sales	61,000	80,000
7Custom duty	20,000	
Weighing machine charges / Tolai4	1000	
Providend fund and contribution to providend fund	1000	4000
Dead stock	22,000	
Salary-wages	12,000	
Loan of Shiv (From 1-7-2016)		20,000
Mahajan Lago	2000	
Factory building	1,00,000	
Depreciation on factory building	10,000	
Insurance premium	1200	
Prepaid insurance	600	
Demurrage	200	
Cash and bank	6000	18,000
Bills	30,000	14,000
Customers and traders	20,000	16,000
Professional tax	1000	
Outstanding salary		1400
Bad debts and bad debts reserve	1400	6000
Total	**3,79,400**	**3,79,400**

Adjustments : (1) The value of closing is ₹ 40,000, but market value is 20 % less than book value. (2) Goods was received of ₹ 1000, but invoice is not recorded in the purchase book. (3) 10 % interest is payable on capital and 5 % interest is chargeable on drawings. (4) Provide bad debts reserve of ₹ 3000 and keep 10 % discount reserve on debtors. (5) Shiv has withdrawn goods of ₹ 1000 and Shankar has withdrawn goods of ₹ 2000 for personal use recorded in sales book as credit sales. (6) As per partnership deed, interest on capital is payable, even if there is loss.

Trading Account of partnership firm of Shiv and Shankar for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		60,000	By Sales	80,000	
To Purchase	61,000		– Wrongly recorded withdrawal	3000	77,000
+ Unrecorded	1000				
	62,000		Closing stock		32,000
– Withdrawal of goods (1000 + 2000)	3000	59,000	By Profit and loss A/c (Gross loss)		43,200
To Depreciation on factory building		10,000			
To Custom duty		20,000			
To Weighing charges		1000			
To Mahajan Lago		2000			
To Demurrage		200			
		1,52,200			**1,52,200**

Profit and Loss Account of partnership firm of Shiv and Shankar for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Trading A/c (Gross loss)		43,200	By Bad debts reserve A/c (Transfered from debit side)	1600
Administrative Expenses :				
To Salary-wages		12,000	By Profit and loss Appropriation A/c (Net loss)	59,100
To Professional tax		1000		
To Insurance premium		1200		
To Contribution in PF		1000		
Selling and Distribution Expenses :				
Discount reserve on debts		1400		
Other Expenses - Loss :				
To Bad debts (trial balance)	1400			
+ Bad debts reserve (Adj.)	3000			
	4400			
– To Bad debts reserve (trial balance)	6000			
Transfered to credit side	–1600	–		
To Interest on Shiv's loan (At 6 % for 9 months)		900		
		60,700		**60,700**

Dr **P & L App. A/c of partnership firm of Shiv and Shankar for the year ending on 31-3-2017** Cr

Particular		**Amt. (₹)**	**Particular**		**Amt. (₹)**
To Profit and Loss A/c (Net loss)		59,100	By Interest on partners' drawings :		
Toi Interest on partners' capital :			Shiv	500	
Shiv	10,000		Shankar	1000	1500
Shankar	12,000	22,000	By Partners' capital A/c (Divisible loss)		
			Shiv	39,800	
			Shankar	39,800	79,600
		81,100			**81,100**

Balance Sheet as on 31-3-17 of Partnership Firm of Shiv and Shankar

Capital-Liabilities			**Amt. (₹)**	**Assets-Debts**		**Amt. (₹)**
Shiv		1,00,000		**Non-Current Assets :**		
+ Interest on capital		10,000		**Fixed Assets :**		
		1,10,000		Factory building		1,00,000
− Loss		39,800		**Current Assets :**		
		70,200		Customers	20,000	
− Drawings	10,000			− Wrong recorded	3000	
+ Goods withdrawal	1000				17,000	
+ Int. on drawings	500	11,500	58,700	− Bad debts reserve (Adj.)	3000	
Shankar :		1,20,000			14,000	
+ Interest on capital		12,000		− Discount reserve	1400	12,600
		1,32,000		Bill receivable		30,000
− Loss		39,800		Cash balance		6000
		92,200		Dead stock		22,000
− Drawings	20,000			Closing stock		32,000
+ Goods withdrawal	2000			Prepaid insurance		600
+ Int. on drawings	1000	23,000	69,200			
Non-Current Liabilities :						
Shiv's loan			20,000			
Current Liabilities :						
Providend fund			4000			
Outstanding salary			1400			
Outstanding interest on Shiv's loan			900			
Bank overdraft			18,000			
Traders		16,000				
+ Unrecorded purchase		1000	17,000			
Bills payable			14,000			
			2,03,200			**2,03,200**

Illustration 6 : Govind and Gopal had started partnership firm on 1-4-2016. Partners are entitled for 5 % interest on capital. 10 % commission is payable to Gopal on profit, after deduction of commission from the profit. Partners sharing profit-loss in the proportion of 3:2. There are several mistakes in the Trading Account and Profit-Loss Account prepared by an unexperienced accountant. You are asked to prepare revised annual accounts from the given trading account, profit-loss account and list of assets and liabilities and other information.

Trading Account and Profit and Loss Account as on 31-3-17

Dr | | | | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Purchase	2,48,600		By Sales	3,32,400	
+ Goods returned credit	2400		− Goods returned debit	600	3,31,800
	2,51,000		By Interest	600	
+ Closing stock	50,000	3,01,000	+ Discount received	800	1400
To Wages		11,200	By Net loss		27,200
To Carriage inward	8000				
− To carriage outward	4000	4000			
To Salary		18,000			
To Rent		12,000			
To Postage expense		600			
To Sundry expense		1200			
To Telephone expense		1600			
To Govind's drawing		6000			
To Gopal's drawing		4800			
		3,60,400			**3,60,400**

The position of assets and liabilities as on 31-3-2017 was as follows :

Assets : Stock ₹ 50,000, debtors ₹ 1,00,000, furniture ₹ 20,000, building ₹ 50,000, cash on hand ₹ 6000, bank balance ₹ 24,000

Liabilities : Creditors ₹ 40,000, bills payable ₹ 14,000, capital of Govind ₹ 1,00,000, capital of Gopal ₹ 30,000

Adjustments : (1) Write off bad debts of ₹ 2800. (2) Provide 2 % discount reserve on debtors. (3) Maintain bad debts reserve of ₹ 7200. (4) Provide 5 % depreciation on furniture and building.

Ans. : **Revised Trading Account of Govind and Gopal's Partnership Firm for the year ending on 31-3-2017**

Dr | | | | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Purchase	2,48,600		By Sales	3,32,400	
− Goods returned	600	2,48,000	− Goods returned	2400	3,30,000
To Wages		11,200	By Closing stock		50,000
To Carriage inward		8000			
To Profit and loss A/c (Gross profit)		1,12,800			
		3,80,000			**3,80,000**

Profit and Loss Account of Govind and Gopal's Partnership Firm
for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative expenses :			By Trading A/c (Gross profit)	1,12,800
To Salary		18,000	By Interest received	600
To Rent		12,000	By Discount received	800
To Postage expense		600		
To Sundry expense		1200		
To Telephone expense		1600		
Sales-distribution expenses :				
To Carriage outward		4000		
To Discount reserve - debtors		1800		
Other expense-loss :				
To Bad debts (Adj.)	2800			
+ Bad debts reserve (Adj.)	7200	10,000		
Depreciation :				
To Furniture	1000			
+ To Building	2500	3500		
Profit and Loss App. A/c (Net profit)		61,500		
		1,14,200		**1,14,200**

Profit and Loss Appropriation Account of Govind and Gopal's Partnership Firm
for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital :			By Profit and loss A/c (Net profit)	61,500
Govind	5000			
Gopal	1500	6500		
To Gopal's commission 10 %		5000		
To Partners capital A/c (Divisible profit)				
Govind	30,000			
Gopal	20,000	50,000		
		61,500		**61,500**

Partners' Capital Accounts

Dr Cr

Date	Particular	Govind(₹)	Gopal (₹)	Date	Particular	Govind(₹)	Gopal (₹)
31-3-17	To Drawings A/c	6000	4800	1-4-16	By Balance b/d	1,00,000	30,000
31-3-17	To Balance c/d	1,29,000	51,700	31-3-17	By Int. on capital A/c	5000	1500
				31-3-17	By Commission A/c	–	5000
				31-3-17	By P & L App. A/c	30,000	20,000
		1,35,000	**56,500**			**1,35,000**	**56,500**

Balance Sheet as on 31-3-17 of Partnership Firm of Govind and Gopal

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital :			**Non-Current Assets :**		
Govind	1,29,000		**Fixed Assets :**		
Gopal	51,700	1,80,700	Furniture	20,000	
Non-current liabilities :		–	– Depreciation	1000	19,000
Current liabilities :			Building	50,000	
Creditors		40,000	– Depreciation	2500	47,500
Bills payable		14,000	**Current Assets :**		
			Debtors	1,00,000	
			– Bad debts (Adj.)	2800	
				97,200	
			– Bad debts reserve (Adj.)	7200	
				90,000	
			– Discount reserve (Adj.)	1800	88,200
			Cash on hand		6000
			Bank balance		24,000
			Closing stock		50,000
		2,34,700			**2,34,700**

Illustration 7 : From the following Trial Balance dated 31-3-2017 and adjustments prepare final account of partnership firm of Parekh and Mehta.

Trial Balance as on 31-3-2017 of Partnership Firm of Parekh and Mehta

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Opening stock	30,000	**Capital :**	
Purchase	4,00,000	Parekh	50,000
Debtors	1,50,000	Mehta	50,000
Cash and Bank	12,000	Creditors	50,000
Rent-taxes	3000	Sales	6,00,000
Insurance premium	9000		
Salary	42,000		
Carriage inward	18,000		
Carriage outward	21,000		
Recoverable claims	5000		
Advertisement suspense A/c	9000		
Furniture and fittings (C.P. ₹ 30,000)	23,000		
Office equipments (C.P. ₹ 15,000)	10,000		
Tender deposit (From 1-10-16)	6000		
Bills receivables	6000		
Bad debts	4000		
Electricity expense	2000		
	7,50,000		**7,50,000**

Adjustments : (1) Closing stock was ₹ 1,05,000. (2) A purchase bill of ₹ 15,000 is received from creditors, but not recorded. (3) Recoverable claims from insurance co. settled for ₹ 2000. (4) From the advertisement suspense account, written off 50 % as a advertisment expense of current year. (5) Provide depreciation at 5 % on furniture and fittings and office equipments as per straight line method. (6) ₹ 1000 paid in advance for insurance premium. (7) 12 % interest is receivable on tender deposit. (8) A discounted bill of ₹ 2000 was dishonored on 30-3-2017, which was earliar discounted in the bank. (9) Provide 2 % bad debts reserve on debtors.

Ans. : Trading Account of Parenership of Parekh and Mehta for Year Ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Opening stock		30,000	By Sales	6,00,000
To Purchase	4,00,000		By Closing stock	1,05,000
+ Unrecorded	15,000	4,15,000		
To Carriage inward		18,000		
To Profit and loss A/c (Gross profit)		2,42,000		
		7,05,000		**7,05,000**

Profit and Loss Account of Parenership of Parekh and Mehta for year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative expense :			By Trading A/c (Gross profit)	2,42,000
To Insurance premium	9000		By Outstanding interest on	
− Prepaid	1000	8000	tender deposit	360
To Salary		42,000		
To Electricity expense		2000		
To Rent and taxes		3000		
Sales-distribution expense :				
To Carriage outward		21,000		
To Advertisement suspense - 50 %		4500		
Other expense-loss :				
To Loss on recoverable claim		3000		
Depreciation :				
Furniture and fittings	1500			
+ Office equipments	750	2250		
To Bad debts (Trial balance)	4000			
+ To Bad debts reserve (Adj.)	3040	7040		
To Capital A/c (Divisible profit) :				
Parekh	74,785			
Mehta	74,785	1,49,570		
		2,42,360		**2,42,360**

Note : No transactions pertaining to partners capital are given, like interest on capital, interest on drawings and other personal transactions of partners. Thus profit and loss appropriation account is not opened.

Balance Sheet of partnership firm of Parekh and Mehta as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Parekh	50,000		**Fixed Assets :**		
+ Divisible profit	74,785	1,24,785	Furniture and fittings	23,000	
Mehta	50,000		− Depreciation	1500	21,500
+ Divisible profit	74,785	1,24,785	Office equipments	10,000	
Liabilities :			− Depreciation	750	9250
Creditors	50,000		**Current Assets :**		
+ Unrecorded purchase	15,000	65,000	Debtors	1,50,000	
			+ Dishonored bill	2000	
				1,52,000	
			− Bad debts reserve 2 %	3040	1,48,960
			Tender deposit		6000
			Advertisement suspense A/c	9000	
			− 50 % written off	4500	4500
			Bills receivables		6000
			Closing stock		1,05,000
			Cash-bank	12,000	
			+ Insurance Co.'s settlement	2000	
				14,000	
			− Dishonored bill	2000	12,000
			Prepaid insurance		1000
			Outstanding interest on tender deposit		360
		3,14,570			**3,14,570**

Note : (1) Under straight line method of depreciation, depreciation is calculated on the cost price of furniture and fittings and office equipments. (2) On tender deposit 6 months interest at 12 % is calculated.

Illustration 8 : Radha and Mira are partners sharing profit-loss in proportion of 3:2. Their Trial Balance as on 31-3-2017 was as shown on page number 65 :

Trial Balance of partnership firm of Radha and Mira as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital Account :		
Radha	–	20,000
Mira	–	10,000
Current Account :		
Radha	5000	–
Mira	–	1000
Purchase and sales	15,000	32,000
Receivables and Payables	16,000	9800
Motor car	12,000	–
Goods returned	1000	500
Sundry expense	800	–
Providend fund and contribution to providend fund	200	4000
Bank and cash	2500	19,847
Opening stock	9000	–
Bank interest	142	–
Building	12,950	–
Stationery stock (1-4-16)	200	–
Stationery purchase	1000	–
Bad debts return	–	700
Sale of old newspapers	–	1000
Professional tax	800	–
Patent	4000	–
Trademark	5000	–
Carriage inward	200	–
Discount	125	325
Plant-machines	8325	–
Depreciation on plant-machines	675	–
Depreciation on motor car	2000	–
Freight and octroi	350	–
Discount reserve	–	250
Bad debt reserve	–	1000
Investments of providend fund	4000	–
Interest on providend fund investments	–	240
9 % Kanaiya's loan (1-6-16)	–	7000
Interest on loan	315	–
Insurance premium (Out of which premium of ₹ 400 is for the year ending on 30-6-2017)	600	–
Salary and wages	3730	–
Furniture	1500	–
Dead stock	150	–
Demurrage	100	–
Total	**1,07,662**	**1,07,662**

Adjustments : (1) Value of closing stock is ₹ 15,000, out of which 10 % and 15 % goods have market value less than book value by 12 % and 20 % respectively. (2) Stationery stock as on 31-3-17 ₹ 500. (3) A furniture of ₹ 600, sold to Kishan for ₹ 400 on 1-10-2016, which is recorded in the sales book. (4) Increase in the rate of depreciation to 10 % on plant and machines. (5) Provide 5 % depreciation on furniture. (6) Write off ₹ 600 from debtors as bad debts and provide bad debts reserve 5 %. (7) Provide 2 % discount reserve on debtors. (8) Goods of ₹ 3000 withdrawn by Mira for personal use on 1-1-17, it is recorded in the sales book. (9) Calculate 10 % p.a. interest on capital of partners. (10) ₹ 2000 annual salary will be given to Radha for her active participation in business.

Ans. : Trading Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		9000	By Sales	32,000	
To Purchase	15,000		− Sales returned	1000	
− Purchase returned	500			31,000	
	14,500		− Sales of furniture (Kishan)	400	
− Goods withdrawn (Mira)	3000	11,500		30,600	
To Demurrage		100	− Wrongly recorded drawings	3000	27,600
To Carriage inward A/c		200	By Closing stock		14,370
To Freight and octroi		350			
To Profit and loss A/c (Gross profit)		20,820			
		41,970			**41,970**

Profit and Loss Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expense :			By Trading A/c (Gross profit)	20,820
To Insurance premium	600		By Discount received	325
− Prepaid	100	500	By Bad debts returned	700
To Stationery expense :			By Sale of old newspapers	1000
Opening stock	200			
+ Purchase	1000			
	1200			
− Closing stock	500	700		
To Professional tax		800		
To Salary-wages		3730		
To Sundry expense		800		
To Contribution to PF		200		

Financial Expense :			
Interest on Loan (Kanaiya) :			
Interest paid 315			
+ Outstanding 210	525		
To Bank interest	142		
Sales-Distribution Expense :			
To Discount (Trial balance) 125			
+ Discount reserve (Adj.) 228			
353			
– Discount reserve (Trial bal.) 250	103		
Other Expenses-Loss :			
Depreciation :			
Motor car 2000			
+ Plant 675			
+ Addition 225 900	2900		
To Furniture :			
Furniture sold 15			
Remaining 45	60		
To Loss on sale of furniture	185		
To Bad debts (Adj.) 600			
+ Bad debts reserve (Adj.) 600			
1200			
– Bad debts reserve (Trial bal.) 1000	200		
To Profit and loss Appropriation A/c (Net profit)	12,000		
	22,845		**22,845**

Profit and Loss Appropriation Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Interest on Capital :		By Profit and loss A/c (Net profit)	12,000
Radha 2000			
Mira 1000	3000		
To Radha's salary A/c	2000		
To Partners' capital A/c (Divisible profit 3:2) :			
Radha 4200			
Mira 2800	7000		
	12,000		**12,000**

Dr **Partners Capital Accounts** Cr

Date	Particular	Radha (₹)	Mira (₹)	Date	Particular	Radha (₹)	Mira (₹)
1-4-16	To Balance b/d	5000	–	1-4-16	By Balance b/d	–	1000
31-3-17	To Drawings A/c	–	3000	31-3-17	Int. on capital A/c	2000	1000
31-3-17	To Balance c/d	3200	1800	31-3-17	By Salary A/c	2000	–
				31-3-17	By P&L App. A/c (Divisible profit)	4200	2800
		8200	**4800**			**8200**	**4800**

Balance Sheet of partnership firm of Radha and Mira as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Accounts :			**Non-Current Assets :**		
Radha	20,000		**Fixed Assets : Tangible Assets :**		
Mira	10,000	30,000	Furniture	1500	
Current Accounts :			– Sale	600	
Radha	3200			900	
Mira	1800	5000	– Depreciation	45	855
Non-Current Liabilities :			Motor car		12,000
Loan of Kanaiya		7000	Building		12,950
Provident fund	4000		Plant-Machines	8325	
+ Interest	240	4240	+ Depreciation (Trial bal.)	675	
Current Liabilities :				9000	
Bank overdraft		19,847	– Depreciation 10 % (Adj.)	900	8100
Creditors		9800	**Intangible Assets :**		
Outstanding interest of loan		210	Patent		4000
			Trademark		5000
			PF investment		4000
			Current Assets :		
			Dead stock		150
			Closing stock of goods		14,370
			Stationery stock		500
			Debtors	16,000	
			– Sale of furniture	400	
				15,600	
			– Wrongly recorded draiwngs of Mira	3000	
				12,600	
			– Bad debts (Adj.)	600	
				12,000	
			– Bad debts reserve (Adj.)	600	
				11,400	
			– Discount reserve 2 %	228	11,172
			Kishan's A/c (debtors)(furniture's sale)		400
			Prepaid insurance		100
			Cash balance		2500
		76,097			**76,097**

Explanation of adjustments :

(1) **Closing stock :**

₹ **15,000**

10 %	15 %	75 %
₹ 1500	₹ 2250	₹ 11,250
– 12 % 180	– 20 % 450	–
₹ 1320	₹ 1800	₹ 11,250 = ₹ 14,370

(2) **Depreciation and sale of furniture :**

Balance as per trial balance	₹ 1500
– Sale of furniture	₹ 600
Balance of furniture	₹ 900

Depreciation and loss on sale of furniture :

Opening balance of sale of furniture	₹ 600
– Depreciation : 6 months, 5 %	₹ 15
	₹ 585
– Selling price	₹ 400
Loss on sale of furniture	₹ 185

(To be shown debit side of profit and loss account)

Balance of furniture ₹ 900 $\times \frac{5}{100}$ = ₹ 45 Depreciation

\+ Depreciation on sale of furniture ₹ 15

To be shown debit side of P & L A/c ₹ 60

Deduct ₹ 45 from the balance of furniture of balance sheet.

(3) **Calculation of interest on Kanaiya's loan :**

$7000 \times \frac{9}{100} \times \frac{10}{12} =$ ₹ 525 Total interest

– Interest paid ₹ 315

₹ 210 Outstanding interest

(4) **Depreciation on plant-machinery :**

Balance as per trial balance	₹ 8325
+ Depreciation charged	₹ 675
Value before depreciation	₹ 9000
– Depreciation 10 %	900
Value after depreciation	8100
Depreciation charged	₹ 675
Outstanding	₹ 225
Total depreciation	₹ 900

Rate of depreciation $= \frac{675}{9000} \times 100 = 7.5$ %

New depreciation rate = 10 % ∴ 9000 × 10 %

	New depreciation	= 900	10 %
–	Old depreciation	= 675	7.5 %
	Yet to be recovered	= 225	

(To be shown debit side of profit and loss A/c)

(5) Furniture sold to Kishan on credit, thus it would appear in balance sheet at assets side.

Illustration 9 : Mahi and Rahi are partners sharing profit-loss in the proportion of 6:4. From the given trial balance dated 31-3-2017 and adjustments, prepare final accounts of partnership firm.

Trial Balance of partnership firm of Mahi and Rahi as on 31-3-2017

Debit Balances		Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :			**Capital Accounts :**	
Mahi	3000		Mahi	20,000
Rahi	2000	5000	Rahi	12,500
Opening stock		1750	Sales	2,00,000
Purchase		1,38,750	Purchase return	1250
Travelling expense :			Discount and allowance	1250
Rahi		3000	Dividend on share of SBI	50
Salesman		5250	Bank A/c	3000
Salary : Accountant		2500	Creditors	1250
Collection clerk		1250	Loan borrowed from friend	2500
Shop rent		900		
Debtors		5000		
Carriage (goods)		7500		
Advertisement expense		10,000		
Prepaid rent of shop (1-4-16)		75		
Discount and allowance		4250		
Donation expense		10,000		
Income tax		12,500		
Professional tax		125		
Bank overdraft interest		6000		
Bank commission		250		
Share of SBI		500		
Fixed assets		1250		
Fixed assets maintenance		500		
Cash balance		450		
Goodwill		25,000		
		2,41,800		**2,41,800**

Adjustments : (1) Provide 12 % interest on capital of partners and 5 % on drawings. (2) 3 % commission on sales is payable to Mahi. (3) Every month ₹ 300 is payable to Rahi for travelling expense done for business. (4) ₹ 50 interest is outstanding on loan of friend. (5) Shop rent is paid for 12 months for the year ending on 30-4-2017. (6) Provide 20 % depreciation on fixed assets. (7) There is doubtful recovery of ₹ 250. (8) Closing stock ₹ 19,025.

Ans. : Trading Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Opening stock		1750	By Sales	2,00,000
To Purchase	1,38,750		By Closing stock	19,025
− Purchase return	1250	1,37,500		
To Carriage (Goods)		7500		
To Profit and loss A/c (Gross profit)		72,275		
		2,19,025		**2,19,025**

Profit and Loss Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expense :			By Trading A/c (Gross profit)	72,275
To Salary of accountant		2500	By Discount allowance A/c	1250
To Professional tax		125	By Dividend on share of SBI	50
To Shop rent	900			
+ Prepaid of 2017 (1-4-16)	75			
	975			
− Prepaid of 2018 (1-4-17)	75	900		
Sales-Distribution Expense :				
To Salary of collection clerk		1250		
Advertisement expense A/c		10,000		
To Salesman travelling expense		5250		
To Discount - allowance A/c		4250		
To Other Expenses-Loss A/c :				
To Bank overdraft interest A/c		6000		
To Bank commission A/c		250		
To Fixed assets maintenance A/c		500		
To Outstanding int. on loan of friend		50		
To Donation expense A/c		10,000		
To Depreciation on fixed assets A/c		250		
To Bad debts reserve A/c		250		
To Income tax A/c		12,500		
P & L Appropriation A/c (Net profit)		19,500		
		73,575		**73,575**

Dr **Profit and Loss Appropriation Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
Interest on capital :			By Profit and loss A/c (Net profit)		19,500
Mahi	2400		**Interest on drawings :**		
Rahi	1500	3900	Mahi	150	
To Travelling expense A/c			Rahi	100	250
Rahi	3000				
+ Outstanding	600	3600			
To Mahi's commission A/c 3 %		6000			
To Partners' capital A/c(Divisible profit)					
Mahi	3750				
Rahi	2500	6250			
		19,750			**19,750**

Dr **Partners' Capital Accounts** Cr

Date	Particular	Mahi (₹)	Rahi (₹)	Date	Particular	Mahi (₹)	Rahi (₹)
31-3-17	To Drawings A/c	3000	2000	1-4-16	By Balance b/d	20,000	12,500
31-3-17	To Interest on drawing A/c	150	100	31-3-17	By Int. on capital	2400	1500
				31-3-17	By Travelling exp.	–	600
31-3-17	To Balance c/d	29,000	15,000	31-3-17	By Commission A/c	6000	–
				31-3-17	By P&L App. A/c (Divisible profit)	3750	2500
		32,150	**17,100**			**32,150**	**17,100**

Balance Sheet of partnership firm of Mahi and Rahi as on 31-3-17

Capital-Liabilities	Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Account :		**Non-Current Assets :**		
Mahi	29,000	**Fixed Assets :**		
Rahi	15,000	**Tangible Assets :**		
Non-Current Liabilities :		Fixed assets	1250	
Loan borrowed from friend	2500	– Depreciation	250	1000
Current Liabilities :		**Intangible Assets :** Goodwill		25,000
Bank A/c	3000	**Investments :**		
Creditors	1250	Shares of SBI		500
Interest outstanding of friend's loan	50	**Current Assets :**		
		Closing stock		19,025
		Debtors	5000	
		– Bad debts reserve (Adj.)	250	4750
		Cash balance		450
		Prepaid rent		75
	50,800			**50,800**

Note : (1)	Outstanding shop rent as per trial balance	₹ 900
	+ Paid in previous year of current year (1-4-16)	₹ 75
		₹ 975
	− Paid in current year of Next year (30-4-17)	₹ 75
	[900 ÷ 12 = 75]	₹ 900

(2) Income tax is expense of partnership firm. Thus disclosed the at debit side of P & L A/c.

Illustration 10 : Following are the annual accounts of partnership firm of Labh and Subh.

Profit and Loss Account of partnership firm of Labh and Shubh as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Cost of goods sold A/c		1,16,000	By Sales A/c	1,96,000
To Office expenses A/c		20,000	By Sundry income A/c	2000
To Sales expenses A/c		16,000		
To Financial expenses A/c		4000		
To Sundry expenses A/c		4000		
To Partners' capital A/c (Net profit)				
Labh	22,800			
Subh	15,200	38,000		
		1,98,000		**1,98,000**

Balance Sheet of partnership firm of Labh and Shubh as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts	Amt. (₹)
Capital :			**Non-Current Assets :**	
Labh	40,000		**Tangible Assets :**	
+ Net profit	22,800		Fixed assets	60,000
	62,800		Investments	12,000
− Drawings	12,000	50,800	Current assets (with debtors)	28,000
Shubh	30,000			
+ Net profit	15,200			
	45,200			
− Drawings	6000	39,200		
Liabilities		8000		
Suspense A/c		2000		
		1,00,000		**1,00,000**

After preparation of annual accounts the following adjustments are reported : (1) 5 % interest on capital is not calculated. (2) 10 % depreciation on fixed assets is to be provided. (3) Prepaid rent is ₹ 200. (4) Interest on investment is not received ₹ 400. (5) Maintain Bad debts reserve of ₹ 600. (6) Total of sales book is under cast by ₹ 2000. (7) Purchase of ₹ 800 is not recorded in the books. Write adjustment entries and prepare revised final accounts from the above information.

Adjustments

Date	Particular		LF No.	Debit (₹)	Credit (₹)
(1)	Interest on capital A/c	Dr		3500	
	To Labh's capital A/c				2000
	To Shubh's capital A/c				1500
	(Being 5 % interest on capital is charged to partners.)				
(2)	Depreciation A/c	Dr		6000	
	To fixed assets A/c				6000
	(Being depreciation is charged at 10 % on fixed assets.)				
(3)	Prepaid rent A/c	Dr		200	
	To rent A/c				200
	(Being prepaid rent is adjusted.)				
(4)	Outstanding intrest on investment A/c	Dr		400	
	To interest on investment A/c				400
	(Being interest on investment is not received.)				
(5)	Profit and Loss A/c	Dr		600	
	To Bad debts reserve A/c				600
	(Being provided bad debts reserve.)				
(6)	Suspense A/c	Dr		2000	
	To sales A/c				2000
	(Being total of sales book was under cost.)				
(7)	Purchase A/c	Dr		800	
	To creditors A/c				800
	(Being entry passed for unrecorded purchase.)				

Trading Account of partnership firm of Labh and Shubh for year ending of 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Cost of goods sold A/c	1,16,000		By Sales	1,96,000	
+ Unrecorded purchase	800	1,16,800	+ From suspense A/c	2000	1,98,000
To Profit and loss A/c (Gross profit)		81,200			
		1,98,000			**1,98,000**

Revised Profit and Loss Account of partnership firm of Labh and Shubh for year ending on 31-3-17

Dr | | | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Office expense	20,000		By Trading A/c (Gross profit)	81,200
− Prepaid rent	200	19,800	By Sundry income A/c	2000
To Sales expense		16,000	By Interest on investment A/c	400
To Financial expenses A/c		4000		
To Sundry expenses A/c		4000		
To Depreciation on fixed assets		6000		
To Bad dabts reserve		600		
To P & L App. A/c (Net profit)		33,200		
		83,600		**83,600**

Revised Profit and Loss Appropriation Account of partnership firm of Labh and Shubh for year ending of 31-3-17

Dr | | | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital :			By Profit and loss A/c (Net profit)	33,200
Labh	2000			
Shubh	1500	3500		
To partners' capital A/c (Divisible profit):				
Labh	17,820			
Shubh	11,880	29,700		
		33,200		**33,200**

Partners' Capital Accounts

Dr | | | Cr

Date	Particular	Labh (₹)	Shubh (₹)	Date	Particular	Labh (₹)	Shubh (₹)
31-3-17	To Drawings A/c	12,000	6000	1-4-16	By Balance b/d	40,000	30,000
31-3-17	To Balance c/d	47,820	37,380	31-3-17	By Interest on capital A/c	2000	1500
				31-3-17	By P&L App. A/c (Divisible profit)	17,820	11,880
		59,820	**43,380**			**59,820**	**43,380**

Balance Sheet of partnership firm of Labh and Shubh as on 31-3-17

Capital-Liabilities	Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Accounts :		**Non-Current Assets :**		
Labh	47,820	Fixed assets	60,000	
Shubh	37,380	– Depreciation 10 %	6000	54,000
Liabilities	8000	Investments		12,000
Unrecorded purchase	800	**Current Assets :**		
		Debtors	28,000	
		– Bad dabts reserve	600	27,400
		Interest outstanding on investments		400
		Prepaid rent		200
	94,000			**94,000**

Note : (1) Total of sales book is under cast by ₹ 2000. Thus it is added to sales and debited to suspense account. Consequently sales would increase by ₹ 2000 and suspense account will be closed. (2) Old profit shared by partner Labh and Shubh is ₹ 22,800 and ₹ 15,200 respectively. So total profit is ₹ 38,000. Proportion will be determined as follows :

$\frac{22800}{38000} \times 100 = 60\ \% : 3$

$\frac{15200}{38000} \times 100 = 40\ \% : 2$

∴ Labh and Subh would get in the proportion of 3:2. Divisible profit is calculated as per this proportion.

Revised devisible profit ₹ 29,700 will be shared as follows :

Labh $= 29{,}700 \times \frac{3}{5}$

$= 17{,}820$

Shubh $= 29{,}700 \times \frac{2}{5}$

$= 11{,}880$ are shown in the profit and loss appropriation account.

Exercise

1. Select appropriate option for each question :

(1) In which year partnership act was implemented in India ?

(a) 1923 (b) 1932

(c) 1947 (d) 1956

(2) In which proportion profit-loss will be shared between the partners if no provision is made in the partnership deed ?

(a) Capital proportion (b) Gaining ratio

(c) Sacrificing ratio (d) Equal proportion

(3) Credit balance of trading account represents ....

(a) gross profit (b) net profit

(c) gross loss (d) net loss

(4) Goods returned debit means ....

(a) purchase (b) purchase return

(c) sales (d) sales return

(5) Goods returned credit means ....

(a) purchase return (b) sales return

(c) purchase (d) sales

(6) Which balance is represented by bank overdraft ?

(a) Debit balance (b) Credit balance

(c) Debit and Credit (d) None of the above

(7) Where will you disclose the credit balance of profit and loss account which is shown in the trial balance ?

(a) Trading A/c (b) Profit and loss A/c

(c) Profit and loss appropriation A/c (d) Capital/current A/c

(8) Which transaction is shown at the debit side of the profit and loss appropriation account ?

(a) Interest on drawings (b) Interest on debit balance of current A/c

(c) Net profit (d) Amount to be transferred to general reserve

(9) Generally, which balance is maintained by current account ?

(a) debit (b) credit

(c) debit or credit (d) None of the above

(10) The financial position of business is disclosed by ....

(a) Trial balance (b) Trading A/c

(c) Balance sheet (d) Profit and loss A/c

2. Describe the objectives of the preparation of final accounts of a partnership firm.

3. Explain in brief, the method of the preparation of final accounts of a partnership firm.

4. State list of tangible and intangible assets.

5. Where will you disclose the following items given in a trial balance during the preparation of a final account of a partnership firm : (1) Bad debts returned (2) Depreciation : factory's building (3) Wages and salary (4) Providend fund investments (5) Bills payable (6) Goods withdrawn as drawings (7) Goods return credit (8) Goods return debit (9) Loan given to firm by a partner (10) Interest on investments of providend fund.

6. Where will you disclose the effects of the following adjustments during the preparation of final accounts of a partnership firm :

(1) Closing stock of stationery (2) Unrecorded credit sales (3) Commission payable to partner on net profit (4) Goods withdrawn by partner for personal use. (5) Interest on debit balance of Partners' current account (6) Certain amount is written off from leasehold property (7) Receivable income (outstanding income) (8) Prepaid expenses (9) Discount reserve on debtors.

7. **Write adjustment entries for the following adjustments :**
   (1) Book value of stock is ₹ 40,000, but its market value is 20 % less than the book value.
   (2) Salary outstanding ₹ 1000.
   (3) Mahendra lended loan of ₹ 25,000 to the firm, but 10 % for 6 months is outstanding on it.
   (4) Interest received in advance ₹ 500.
   (5) Provide depreciation at 8 % for 8 months on a building of ₹ 5,00,000.
   (6) Closing stock of stationery at the end of the accounting period is ₹ 250.
   (7) Closing balance at the end of accounting period, of debtors of business is ₹ 50,000, out which written off ₹ 4500 as bad debts. Provide 10 % bad debts reserve on debtors.
   (8) One partner has withdrawn goods of ₹ 5000 for personal use, this transaction is not recorded.
   (9) Goods of ₹ 3000 destroyed by fire. Insurance company has admitted the the claim of 80 %.

8. Brahma and Vishnu are partners of a firm sharing profit-loss in the proportion 3:2. From the trial balance dated 31-3-2017 and adjustments, prepare annual accounts of the firm :

Trial Balance of Partnership Firm of Brahma and Vishnu as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Brahma	5000	**Capital Accounts :** Brahma	55,000
Vishnu	5000	Vishnu	45,000
Leasehold building		Loan of Brahma (from 1-7-2016)	50,000
(from 1-4-16 for 10 years)	60,000	Discount received	400
Machinery (Office)	50,000	Creditors	25,000
Discount allowed	350	Commission	2500
Debtors	40,000	Bills payable	5000
Carriage outward	1200	Trading A/c	97,250
Furniture-fixtures	5000		
Salary	7500		
Bad debts	1200		
Bills receivable	20,000		
Trading expense	5900		
Cash balance	6000		
Stock (31-3-17)	73,000		
	2,80,150		**2,80,150**

Adjustments : (1) Provide depreciation 6 % on machinery and 20 % on furniture fixtures. (2) Written off ₹ 500 from debtors as bad debts. (3) Annual salary of ₹ 5000 and ₹ 4000 payable to Brahma and Vishnu respectively. (4) Commission ₹ 500 is receivable. (5) Outstanding salary ₹ 3000.

9. Parthiv and Priya are the partners of a partnership firm. From the Trial balance dated 31-3-2017 and adjustments, prepare final accounts of a partnership firm.

Trial Balance of Partnership Firm of Parthiv and Priya as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Parthiv	4800	**Capital Accounts :** Parthiv	24,000
Priya	3200	Priya	16,000
*Net cost of purchase	1,06,000	Sales	2,00,000
Stock of goods (31-3-17)	28,000	Payables	30,000
Receivables	48,000	Goods distribute as sample	2000
Wages-salary	10,000	Bank overdraft	14,000
Trading expense	16,000		
Building	50,000		
Furniture-fittings	10,000		
Office equipments	4000		
Packing material stock	4000		
Cash balance	2000		
	2,86,000		**2,86,000**

***Note :** Net cost of purchase means adjusted purchase.

Adjustments :

(1) Provide interest 8 % on capital and 12 % on drawings. Parthiv had withdrawn ₹ 400 at the end of each month and Priya had withdrawn on 1-10-16.

(2) Credit sales of ₹ 10,000 is not recorded and total of sales book of March is overcast by ₹ 2000.

(3) Write off additional bad debts of ₹ 2000 and provide 5 % bad debts reserve on debtors.

(4) Furniture of ₹ 4000 became obsolete, which is not recorded in the books.

(5) A court has finalised claim of ₹ 4000, for not meeting agreement to provide goods to a customer.

(6) Outstanding wages of ₹ 2000 is recorded to wages account but outstanding wages account is not recorded in the trial balance.

10. Luv and Kush are partners of a partnership firm. They distribute 60 % profit in the ratio of 3:2 and remaining in the proportion of 2:1. From the trial balance of the firm dated 31-3-17 and adjustments prepare profit and loss appropriation account, current accounts of partners and balance sheet of the firm.

Trial Balance of Partnership Firm of Luv and Kush as on 31-3-2017

Particular	Debit balance (₹)	Credit balance (₹)
Luv's capital - drawings	40,000	1,20,000
Kush's capital - drawings	12,000	80,000
Current accounts : Luv	–	8000
Kush	12,000	–
Profit and loss A/c	–	80,000
Stock (31-3-2017)	72,000	–
Prepaid insurance premium	3200	–
Building	1,60,000	–
Debtors and creditors	80,000	28,000
Cash and bank balance	4800	20,000
Bills payable	–	14,000
Mortgage loan	–	1,00,000
Goodwill	40,000	–
Outstanding wages	–	2800
Receivable rent	1600	–
Commission received in advance	–	800
Bad debts reserve	–	8000
Patents	12,000	–
Furniture	24,000	–
	4,61,600	**4,61,600**

Adjustments : (1) Provide interest on capital at 6 % and on drawings at 10 %. (2) Provide 10 % interest on opening balance of current accounts. (3) Monthly salary of ₹ 1800 is outstanding, payable to Kush. (4) After information of above mentioned adjustments, on remaining profit 10 % commission is payable to Kush.

11. From the Trial Balance and adjustments of partnership firm of Salim and Shabana, prepare final accounts of partnership firm.

Trial Balance of Partnership Firm of Salim and Shabana as on 31-3-2017

Particular	Debit balance (₹)	Credit balance (₹)
Capital Account : Salim	–	1,60,000
Shabana	–	1,20,000
Current Account : Salim	10,000	–
Shabana	–	40,000
Stock of goods (31-3-17)	54,600	–
Cash balance	560	–
Current account with bank	14,000	–
Fixed deposit of SBI	80,000	–
Debtors - creditors	36,800	24,000
Salary	37,000	–

Land-building	1,20,000	–
Plant-machinery	40,.000	–
Furniture	10,000	–
Insurance premium	2000	–
Leasehold machinery (from 1-4-16 for 5 years)	60,000	–
Stationery and printing	1200	–
Bad debts - bad debts reserve	400	2000
Advertisement expense	1200	–
Travelling expense	800	–
Trading A/c	–	61,800
Loan of Shabana (from 1-10-16)	–	60,000
Discount reserve	–	760
	4,68,560	**4,68,560**

Adjustments :

(1) Salim withdrew goods of ₹ 4000 for personal use. It is not recorded in the books.

(2) Goods of ₹ 8000 purchased at the end of the accounting year, which is not recorded.

(3) Prepaid insurance is ₹ 400.

(4) From debtors ₹ 800 is not recoverable. Provide 5 % bad debts reserve on debtors.

(5) Discount reserve on debtors is not required.

(6) Provide depreciation on plant-machinery at 20 % and on furniture at 5 %.

12. Dhara and Mira are partners sharing profit-loss in the proportion of 3:2. Final accounts of their partnership firm are as follows :

Trading Account and Profit and Loss Account of partnership firm of Dhara and Mira for year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To cost of goods sold		4,64,000	By sales	7,84,000
To office expense		80,000	By sundry income	7000
To show-room rent		10,000	By bad debts returned	1000
To packing expense		12,000		
To bad debts		8000		
To advertisement expense		14,000		
To selling-distribution expense		20,000		
To financial expense		6000		
To sundry expense		16,000		
To salary		8000		
To tax-insurance		2000		
Net profit : Dhara	91,200			
Mira	60,800	1,52,000		
		7,92,000		**7,92,000**

Balance Sheet of Partnership Firm of Dhara and Mira as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts	Amt. (₹)
Dhara :			**Non-current assets :**	
Capital	1,60,000		**Fixed assets :**	
+ Net profit	91,200		Building	2,40,000
	2,51,200		Plant-Machinery	20,000
− Drawings	48,000	2,03,200	Furniture	20,000
Mira :			Investments	24,000
Capital	1,20,000		**Current assets :**	
+ Net profit	60,800		Cash balance	10,000
	1,80,800		Bank balance	25,000
− Drawings	24,000	1,56,800	Bills receivable	5000
Creditors		32,000	Debtors	56,000
Bills payable		8000		
		4,00,000		**4,00,000**

After preparation of annual accounts, it is found that :

(1) 5 % interest on capital is not calculated. (2) 10 % depreciation on building is to be provided. (3) Prepaid salary is of ₹ 400. (4) Interest on investments not received ₹ 800. (5) Bad debts reserve of ₹ 1200 is to be maintained. (6) Credit purchase of ₹ 1600 is not recorded.

Prepare revised Trading account, Profit and loss a/c, Profit and loss appropriation a/c and Balance sheet.

13. Harsha and chhaya are partners of a partnership firm. From the following information prepare final accounts :

Trial Balance of Partnership Firm of Harsha and Chhaya as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Harsha (1-10-16)	5000	Capital accounts : Harsha	20,000
Chhaya (1-1-17)	10,000	Chhaya	30,000
Current account : Harsha	6000	Current account : Chhaya	4000
Interest on capital : Harsha	700	Interest on drawings : Harsha	100
Chhaya	1000	Chhaya	50
Machinery	40,000	Loan of Harsha (from 1-10-2016)	10,000
Interest on loan	200	Rent	12,000
Salary (Monthly ₹ 1000)	13,000	Creditors	5000
Salary of Chhaya	5500	Trading account	24,700
Debtors	15,000	Bank balance	5450
Receivable rent	2000	Interest on current account : Harsha	100
Bad debts	1300	Suspense account	300
Stock of goods (31-3-17)	10,000		
Insurance pre. (Out of which ₹ 1200 is for the year ending on 30-6-17)	2000		
	1,11,700		**1,11,700**

Adjustments :

(1) Provide interest 5 % on capital, 6 % on drawings and 10 % on opening balance of current a/c.

(2) Provide 10 % depreciation on machines.

(3) Monthly salary of Chhaya is ₹ 500.

(4) Total of sales book is under cast by ₹ 300.

(5) ₹ 1700 are to be transferred to general reserve.

14. Dharma and Karma are partners sharing profit-loss in their capital ratio. From the following information prepare their final accounts.

Trial Balance of Partnership Firm of Dharma and Karma as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Dharma	7500	Capital accounts : Dharma	1,40,000
Karma	5000	Karma	1,20,000
Opening stock	15,000	Sales	1,20,000
Purchase	80,000	Goods return debit	2000
Goods return credit	3000	Payables	79,000
Receivables	27,400	Salary outstanding	700
Salary (upto 28-2-17)	13,200	Loan of Dharma	30,000
Machinery	71,760	Discount received	6600
Depreciation on machine	6240	Bank overdraft	2800
Building	80,000	Current account : Karma	14,000
Wages	1600		
Insurance premium	1800		
Discount allowed	3200		
Interest on loan	1200		
Furniture	87,000		
Stationery expense	7000		
Advertisement expense	36,000		
Cash balance	51,200		
Current account : Dharma	17,000		
	5,15,100		**5,15,100**

Adjustments :

(1) Closing stock is of ₹ 21,000, in which stock of stationery of ₹ 2000 is included.

(2) On machinery, depreciation rate is to be increased upto 10 %.

(3) Credit sales of ₹ 1000, is recorded in the purchase return book by mistake.

(4) $\frac{1}{4}$ share of advertisement expense is to be carry forwarded to the next year.

15. With consideration of following trial balance and adjustments of Harsh and Yesha, prepare final accounts for the year ending on 31-3-17 of their firm.

Trial Balance of Partnership Firm of Harsh and Yesha as on 31-3-2017

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings :		
Harsh	5000	35,000
Yesha	2500	15,000
Goodwill	5000	–
Patent and Trade-mark	2700	–
Receivables and payables	31,000	25,000
Accounts of goods	40,000	89,250
Machines	15,000	–
Opening stock	6000	–
Furniture	3000	–
Goods return accounts	7500	5000
Wages	4000	–
Depreciation on furniture	300	–
Stationery and printing	1550	–
Building	46,000	–
Legal charges	6500	–
Cash balance	300	–
Railway frieght	600	–
Insurance premium	1150	–
Bills	4000	2500
Postage expense	2000	–
Bad debts and bad debts reserve	1500	2000
Discounts	750	1500
Stamps on hand and bad debts return	150	1250
12 % HDFC loan (1-7-16)	–	10,000
	1,86,500	**1,86,500**

Adjustments :

(1) Closing stock ₹ 10,000 out of which 50 % has no market value.

(2) Legal charges included of legal charges of building purchase ₹ 4000.

(3) Provide 5 % bad debts reserve on debtors.

(4) Provide depreciation 10 % on furniture and 5 % on building.

(5) $\frac{1}{3}$ share of patent and trade mark is to be written off.

16. Neela and Sheela are partners of partnership firm sharing profit-loss in capital proportion. From the following trial balance and adjustments prepare final accounts of the firm.

Trial balance of Partnership Firm of Neela and Sheela as on 31-3-17

Name of Accounts	Debit balances (₹)	Credit balances (₹)
Neela's capital and drawings	20,000	1,00,000
Sheela's capital and drawings	14,000	50,000
Suppliers and customers	90,000	60,000
Goods returned	2000	3000
Bills	15,000	20,800
Cash and Bank	1000	14,000
Bad debts and bad debts reserve	400	1300
Purchase and sales	1,40,000	2,60,500
Wages and outstanding wages	35,000	2000
Machinery	36,500	–
Depreciation on machinery	3500	–
Furniture	12,000	–
Opening stock	46,100	–
Prepaid insurance	200	–
Salary	23,000	–
Insurance premium	2000	–
Rent-taxes	12,000	–
Advertisement expenses	2900	–
Goodwill	72,000	–
Leasehold building (from 1-10-14 for 5 years)	14,000	–
8 % Leela's loan (1-11-16)	–	30,000
Total	**5,41,600**	**5,41,600**

Adjustments :

(1) Closing stock ₹ 1,10,000 and having market value 20 % more than book value.

(2) Per annum 6 % interest is payable on Partners' capital.

(3) Interest on drawings recoverable from partners : Neela ₹ 900, Sheela ₹ 600.

(4) Provide 5 % bad debt reserve on debtors.

(5) Outstanding expenses at the end of accounting year : rent ₹ 300 and salary ₹ 950.

(6) Provide depreciation : 10 % on machinery and 5 % on furniture.

17. Man and Mohan are partners of a firm sharing profit and loss in the proportion of 1:1. From the given below trial balance and adjustments prepare final accounts for the year ending on 31-3-2017.

Trial Balance of Patnership Firm of Man and Mohan as on 31-3-17

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings :		
Man	3000	2,80,000
Mohan	4500	2,20,000
Purchase-sales	80,000	1,20,000
Advertisment expense	7000	–
Carriage outward	850	–
Machines (office)	1,50,000	–
Purchase of office machine (1-4-16)	40,000	–
Building	2,50,000	–
Office salary	15,000	–
Customers - Suppliers	25,000	35,000
Goods returned	16,000	14,000
Weight charges	450	–
Loan of Man	–	10,000
Custom duty	1300	–
Goods stock (1-4-16)	42,000	–
Trading expense	1300	–
Wages and outstanding wages	750	2600
Commission paid in advance	350	–
Bank account and cash account	20,700	3000
Interest on loan	400	–
Investment in 8 % govt. security	30,000	–
Current accounts :		
Man	8000	–
Mohan	–	12,000
Total	**6,96,600**	**6,96,600**

Adjustments :

(1) The value of closing stock is ₹ 80,000. It's market value is 10 % more.

(2) Provide depreciation at 10 % on machines and building.

(3) Debtor of ₹ 10,000 became insolvent. 50 % amount will be received as per instructions of his receiver. Provide 5 % bad debt reserve.

(4) 10 % interest is outstanding on bank overdraft.

(5) Goods of ₹ 2000 is missed out to record in sales return book.

18. Sant and Mahant are partners of a firm sharing profit and loss in the proportion of 3:2. From the trial balance of 31-3-2017 and adjustments prepare final accounts of the partnership firm.

Trial Balance of Partnership Firm of Sant and Mahant as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital accounts :**	
Sant	7000	Sant	80,000
Mahant	3000	Mahant	40,000
Plant and Machines	33,300	Creditors	48,000
Addition in plant and machines	24,000	Sale of plants and machines	4800
(from 1-7-2016)		(on 1-4-16, book value ₹ 6900)	
Furniture-fittings	2560	Sales	2,68,000
Debtors	64,940	5 % loan from Gyani (from 1-10-16)	10,000
Advertisment expense	13,248	Commission	800
Cash-bank balance	8496		
Purchases	1,81,168		
Productive wages	45,272		
Electricity expense (Factory)	4296		
Rent-taxes (Office)	872		
Rent-taxes (Factory)	9384		
Technical expense	400		
Opening stock	33,696		
Factory expense	1780		
Office salary	8780		
Discount allowed	4800		
Carriage inward	1700		
Bad debts	836		
Office expenses	2072		
	4,51,600		**4,51,600**

Adjustments :

(1) There was stock of ₹ 85,500.

(2) Provide 15 % depreciation on plant and machines and 7.5 % on furniture and fittings.

(3) Provide bad debts reserve of ₹ 2000 on debtors.

(4) 6 % interest is payable on capital of partners.

(5) Outstanding expenses : Productive wages ₹ 784, advertisement expense ₹ 312, office salary ₹ 400, technical expense ₹ 320.

19. Jay and Prafulla are partners of a partnership firm sharing profit and loss in equal proportion. From the trial balance dated 31-3-17 and additional information, prepare financial accounts of the firm.

Trial Balance of Partnership Firm of Jay and Prafulla as on 31-3-17

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings : Jay	12,000	1,00,000
Prafulla	16,000	1,40,000
Current accounts : Jay	12,000	–
Prafulla	–	4000
Good stock (1-4-16)	60,000	–
Purchase and sales	2,00,000	3,80,000
Goods returned	7000	12,000
Cash and bank	3700	15,750
Bills	18,000	14,000
Rent (upto February 2017)	22,000	–
Building	1,20,000	–
Currents year's depreciation on building	12,000	–
Freight	5300	–
Furniture	84,600	–
Sale of furniture (1-10-16)	–	14,600
Debtors and creditors	48,000	16,800
Salary	20,000	–
Insurance premium (Including ₹ 3600 for the year ending on 30-6-17)	5700	–
Bad debts and bad debt reserve	1000	2000
Loan of Prafulla (from 1-10-16)	–	20,000
Waves	11,000	–
Discount	650	850
Trading expenses	1050	–
Advertisement expenses	8000	–
Machines (Addition of ₹ 12,000 on 31-12-16)	52,000	–
	7,20,000	**7,20,000**

Adjustments : (1) The value of closing stock is ₹ 60,000. Out of which the market value of 10 % goods is 20 % less and the market value of 20 % goods is 10 % less. The remaining goods of ₹ 42,000 is valued at 25 % less then book value. (2) Provide 10 % interest on capital, 9 % on balance of current accounts and 12 % on drawings. (3) Monthly salary of ₹ 700 is payable to Jay. He has withdrawn salary of 4 months which is included in salary. (4) Prafulla has introduced additional capital of ₹ 20,000 on 1-1-17. (5) Jay has withdrawn ₹ 1000 per month on the last date of each month. Prafulla has withdrawn on 1-10-2016. (6) Calculate depreciation at 9 % on machines and 5 % on furniture. (7) Prafulla has withdrawn goods of ₹ 2000 on 1-12-2016, which is recorded in the sales book at ₹ 2400. (8) One debtor of ₹ 2400 became insolvent and 40 paise per rupee dividend is receivable.

●

3

Valuation of Goodwill

1. Introduction

In practical reconstruction of a partnership firm as per the circumstances, assets and liabilities are revalued at the time of the reconstruction of a partnership. Issue of valuation of goodwill is taken place with revaluation of assets and liabilities. In this chapter, we will study about goodwill and its several aspects.

Firm has two types of assets : (1) Non-current assets (2) Current assets.

Intangible assets, fixed assets and long-term investment are included in non-current assets. Goodwill, patent, trademark, copyright etc. are included in intangible assets. These type of assets can not seen, but they have a value in the market. Goodwill is also an intangible asset which can not be seen but it has its value.

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections, which benefits the business. In accounting, monetary value of such advantage is known as 'Goodwill'.

2. Meaning of Goodwill

In simple words, "Goodwill is an intangible asset which shows the reputation of a firm in the market."

"Goodwill is the value of the reputation of a firm in respect to the profit earning over and above the expected profit."

A firm has a goodwill which has the capacity to earn more profit than a common firm and it is due to its own reputation, specific stable customer and other reasons. Value of goodwill depends on the profit earning capacity of a firm. In short we can say that goodwill does not exist in those businesses which earn normal profit or incur loss. Goodwill is shown in the balance sheet on the assets side under the head of non-current assets as intangible assets.

3. Factors Affecting Valuation of Goodwill

The valuation of goodwill depends on the earning ability of a firm. Business location, business period, types of business, competitiveness of business etc. are the factors that affect the business profit. Therefore, the same reasons also affect the valuation of goodwill. Following are the factors that affect the valuation of goodwill.

(1) **Nature of business :** Goodwill exists when a firm earns more profit than the expected profit, it earns profit due to a high value added product, it has more profit margin due to stable sales or it earns more profit due to some other reasons.

(2) **Location of business :** Often, the profit earning capacity of the business depends upon the business location. If the business is centrally located or it is at a place having heavy customer traffic then more profit earning can be seen in the business. The value of goodwill is high at such centrally located businesses. Thus, business location also affects the value of goodwill.

(3) **Period of business :** Generally, older the firm, higher the reputation in the market. Because majority of the customers are familiar and they have very close and long term relations with that particular business unit. Consequently, the value of such business is bound to be high. Thus, the period of business also has an impact on the value of goodwill.

(4) **Market situation :** The monopoly condition or limited competition enables the concerned firm earn to high profit. Therefore the value of goodwill is high in such business. Thus, the value of goodwill also depends on the situation of the business in the market.

(5) **Efficiency of managers :** The efficient management of a business increase the productivity and decreases the cost of a firm. Due to it, profit increase, which increase the value of goodwill.

(6) **Other special benefits :** Goodwill exists when a company enjoys special benefits and the overall profitability increases. For e.g. if a company can acquire license, patent or trademark or earn more profit or has been earning more profit, it is valued of having higher goodwill.

Apart from the above given factors, services after sales, past achievements of a firm, good labour relations etc. also become the reasons to earn more profit. Due to which the goodwill comes into existence.

4. Necessity for Goodwill Valuation

Normally, the need for valuation of goodwill arises at the time of the sale of a business. In the context of a company, the need for valuation of goodwill arises at the time of amalgamation and absorption. In the context of a partnership firm it may also arise in the following circumstances :

(1) Change in the profit sharing ratio amongst the existing partners

(2) Admission of new partner

(3) Retirement of a partner from existing partners

(4) Death of a partner from existing partners

(5) Conversion of partnership firm into a company

(6) Amalgamation of a partnership firm

Amalgamation means two partnership firm join to start a new firm.

5. Methods of Valuation of Goodwill

Since goodwill is an intangible asset, there are specific methods to determineits value. Valuation of goodwill depends on a profit earning capacity of a firm or a business. Prospective earning capacity means future maintainable profit. However, while determining the future maintainable profit, past year's profits are considered as the base. Various methods are available for the valuation of a goodwill. Generally, following methods are used for the valuation of a goodwill.

(1) Average profit method

(2) Weighted average profit method

(3) Super profit method

(4) Capitalization of profit method

(1) **Average Profit Method :** Under this method, the average of the past certain years are taken into consideration. Average profit is to be multiplied by the certain number of years for the valuation of goodwill. It is based on the assumption that a new business will take certain number of

years to earn the same profit. Therefore, the business purchaser is ready to pay the value of goodwill equal to the number of years of average profit. Generally, the multiplication of average profit and the number of years during which the anticipated profits are expected is known as goodwill.

(1) Average profit $= \dfrac{\text{Total profit of given years}}{\text{No. of years}}$

(2) Goodwill = Average profit × No. of years of purchase (defined years)

For example, if the past five years average profits of a business is ₹ 1,20,000. Three years are required to earn ₹ 1,20,000 annual profit for a new businessman. Under this method the value of goodwill is ₹ 1,20,000 × 3 = 3,60,000. Thus, profit receivable after three years is started from the current year.

Illustration 1 : Determine the value of goodwill based on 3 years purchase of last 5 years average profit, from the following information of a partnership firm of Nilesh and Nikunj. Last five years' profit information is as under :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000

Ans. :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000
Total	**10,35,000**

Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$

$= \dfrac{10{,}35{,}000}{5}$

Average profit = 2,07,000

Goodwill = Average profit × No. of years purchased

= 2,07,000 × 3

Goodwill = 6,21,000

Illustration 2 : Hasu and Vasu are partners of a firm. They contemplate to change their profit and loss distribution ratio from 2:1 to 1:1. Therefore, it is determined for valuation of goodwill. From the following information, determine the value of the firm's goodwill. As per the agreement of the partnership, the value of goodwill is to be computed at 5 years purchase of the average profit of last 4 years.

Year	Profit/Loss (₹)
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000

Ans. : Here loss is incurred in the year 2014-15. We must take the loss into consideration while calculating the average profit.

Note : Amount mentioned in ( ) is '–' means loss indication. In account whenever amount is mentioned in ( ) then it is called '–'.

Year	Profit
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000
Total	**2,40,000**

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{2,40,000}{4}$$

Average profit = 60,000

Goodwill = Average profit × No. of years purchased

= 60,000 × 5

Goodwill = 3,00,000

In simple average method, calculation of goodwill is based on the assumption that no change in the overall situation of profit is expected in future. This method does not consider the increasing and decreasing trends of profits. Capital employed is also not considered. To eliminate these limitations, various methods are used.

(2) **Weighted Average Profit Method :** We have seen that in simple average method the trend of profit is neglected. Sometimes, it can be seen that there is continuous increasing trend in profit. Under such circumstances, we should give more weightage to the profit of recent years and give comparatively less weightage to the profits of previous years. Generally the weightage of different year's profit are numbered as 1, 2, 3, 4,...

Average workout after giving weightage to different year's profit, it is called weightage average profit. If the computation of goodwill is made on the basis of weighted average profit then it is called weighted average method of goodwill.

If specific instruction is given that compute as per weighted average method or every year profit increasing or decreasing trend then compute goodwill as per the weighted average method.

As per this method, computation of goodwill should be done as shown on page number 93.

Step No. 1 : To prepare table.

Statement Showing Weighted Average Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	✓	1	✓
2013-14	✓	2	✓
2014-15	✓	3	✓
2015-16	✓	4	✓
		10	✓
		↑ Total weight	↑ Total profit (product)/weighted

Step No. 2 : Weightage average profit = $\frac{\text{Total weighted profit}}{\text{Total weight}}$

Step No. 3 : Goodwill = Weightage average profit × No. of years of purchase

Note : Average or weightage average method for computation of goodwill should be specified clearly.

Illustration 3 : From the following information find out weighted average profit.

Year	Profit
2013-14	40,000
2014-15	50,000
2015-16	60,000
2016-17	70,000

Ans. : In this illustration it can be seen that every year profit is increasing, it means the trend of profit is increasing. It can be also estimated that profit will be increased in future. In this type of circumstances, weightage average method for valuation of goodwill is a proper method. Here, the highest weight will be given to recent year (2016-17) or the highest profit is in this year. Gradually less weight will be given to the previous years.

It means 1 weight to year 2013-14, 2 wieght to year 2014-15, 3 weight to year 2015-16 and 4 weight to year 2016-17 will be given.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2013-14	40,000	1	40,000
2014-15	50,000	2	1,00,000
2015-16	60,000	3	1,80,000
2016-17	70,000	4	2,80,000
	Total	**10**	**6,00,000**

Step No. 2 : Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$= \dfrac{6,00,000}{10}$

Weighted average profit = 60,000

Illustration 4 : From the following information compute the value of goodwill of Mina and Bhadresh's firm at three years' purchase of weighted average profit on the basis of last five years.

Year	Profit
2012-13	80,000
2013-14	1,20,000
2014-15	1,40,000
2015-16	1,60,000
2016-17	1,70,000

Ans. : Here, the profit of last five years has upward trend, therefore the application of weighted average method for the computation of goodwill is relevant. Though, weighted average method for valuation of goodwill is specified in the example.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	80,000	1	80,000
2013-14	1,20,000	2	2,40,000
2014-15	1,40,000	3	4,20,000
2015-16	1,60,000	4	6,40,000
2016-17	1,70,000	5	8,50,000
	Total	**15**	**22,30,000**

Step No. 2 : Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$= \dfrac{22,30,000}{15}$

Weighted average profit = 1,48,666.67

= ₹ 1,48,667

Step No. 3 : Goodwill = Weighted average profit × No. of years purchase

= 1,48,667 × 3

Goodwill = 4,46,001

(3) **Super Profit Method :** In this method, capital employed by business, expected rate of return, expected profit, average profit etc. are used for super profit. The excess of average profit over the expected profit is called 'Super profit'. So, when a business earns excess profit over average profit,

then the amount of excess profit is called super profit. On the basis of this super profit, valuation of goodwill is made.

(1) Capital employed = Total assets ✓

− Total external liabilities ✓

✓

(2) Expected rate of return (It is given in example.)

(3) Expected profit $= \dfrac{\text{Capital employed} \times \text{Expected rate of return}}{100}$

(4) Average profit = (After adjustment)

(5) Super profit = Average profit − Expected profit

(6) Goodwill = Super profit × No. of years of purchase

Note : Capital employed is also known as net assets.

Illustration 5 : Pratibha and Pushpa are the partners of a firm. They want to change the profit and loss sharing ratio from 3:2 to 1:1. They decided to determine the valuation of goodwill.

On the basis of the firm's profit and other information, determine the valuation of goodwill on the basis of three years purchase of super profit.

Assets	₹ 12,00,000
Liabilities	₹ 4,00,000
Expected rate of return	10 %

Actual profit

Year	Profit (₹)
2014-15	1,30,000
2015-16	1,10,000
2016-17	1,20,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars		Amount (₹)
(1)	Capital employed :		
	Total assets =	12,00,000	
	− Total liabilities	4,00,000	
	Net assets / capital employed	8,00,000 →	8,00,000
(2)	Expected rate of return		10 %
(3)	Expected profit = Capital employed × Expected rate of return		80,000
	= 8,00,000 × 10 %		
(4)	Average profit :		1,20,000
	Year	**Profit (₹)**	
	2014-15	1,30,000	
	2015-16	1,10,000	
	2016-17	1,20,000	
		3,60,000	

	Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$ $= \dfrac{3,60,000}{3}$ **Average profit = 1,20,000**	
(5)	Super profit = Average profit − Expected profit = 1,20,000 − 80,000 = 40,000	40,000
(6)	Goodwill = Super profit × No. of years of purchase = 40,000 × 3 Goodwill = 1,20,000	1,20,000

Illustration 6 : Pooja and Prarthna's firm capital is ₹ 8,00,000 and expected rate of return is 12 %. Last three year's profit are ₹ 1,00,000, ₹ 1,40,000 and ₹ 90,000 respectively. Determine the value of goodwill of the firm on the basis of 2 yeras purchase of last three years average super profit.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	8,00,000
(2)	Expected rate of return (Interest rate in the market)	12 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 12 %	96,000
(4)	Average profit : **Year** — **Profit** 1 — 1,00,000 2 — 1,40,000 3 — 90,000 **3,30,000** Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$ $= \dfrac{3,30,000}{3}$ **Average profit = 1,10,000**	1,10,000
(5)	Super profit = Average profit − Expected profit = 1,10,000 − 96,000 = 14,000	14,000
(6)	Goodwill = Super profit × No. of years of purchase = 14,000 × 2 Goodwill = 28,000	28,000

(4) **Capitalization of Profit Method :** In this method, average profit of a business is computed and it is used to determine its capitalised value on the basis of normal / expected rate of return of the business. This type of profit received is called capitalisation of profit. Thus, capitalised profit means capitalised value of average profit on the basis of the expected rate of return.

$$\text{Capitalised profit} = \frac{\text{Expected profit}}{\text{Expected rate of return}} \times 100 \textbf{ or } = \frac{\text{Average profit}}{\text{Expected rate of return \%}}$$

e.g. Average profit of business is ₹ 90,000 and expected rate of return is 10 %. Capitalised profit will be found as under.

$$\text{Capitalised profit} = \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$$

$$= \frac{90{,}000}{10} \times 100$$

Capitalised profit = ₹ 9,00,000

Capitalised profit is compared with the capital employed in the business. If capitalised profit amount is more than the capital employed, then the difference amount is called goodwill. If capitalised amount is equal to the capital employed or less, then there is no goodwill of the business.

Goodwill = Capitalised profit − Capital employed

e.g. Capital employed is ₹ 7,00,000 and capitalised profit is ₹ 9,00,000, then goodwill is ₹ 2,00,000.

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 7,00,000

Goodwill = ₹ 2,00,000

Following explanation is not expected for exam.

Capitalised profit means how much net assets (capital employed) is required to earn average profit on the basis of expected rate of return. In this question expected rate of return is 10 %. Average profit is ₹ 90,000. So ₹ 9,00,000 net assets (capital employed) is required to earn ₹ 90,000 on the basis of 10 %. But actual net assets are ₹ 7,00,000. So ₹ 70,000 profit must be received on ₹ 7,00,000 at 10 %.

₹ 90,000 $\times \frac{100}{10}$ = ₹ 9,00,000 net assets required

− ₹ 70,000 $\times \frac{100}{10}$ = ₹ 7,00,000 actual net assets

₹ 20,000 $\times \frac{100}{10}$ = ₹ 2,00,000 difference of asset is called goodwill

(a) If capital employed is ₹ 9,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 9,00,000

Goodwill = 0

(b) If capital employed is ₹ 10,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 10,00,000

Goodwill = −1,00,000

There is no goodwill in (a) and (b). Capital employed and capitalised profit both are equal in (a). There is no goodwill in (b) because capital employed is more than capitalised profit.

In short, following steps are used for the computation of the valuation of the goodwill as per the capitalisation profit method.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	✓
	Total assets ✓	
	− Total liabilities ✓	
	Net assets / capital employed ✓	
(2)	Expected rate of return	✓
(3)	Average profit	✓
(4)	Capitalised profit $= \dfrac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	✓
(5)	Goodwill = Capitalised profit − Capital employed	✓

Note : If answer of step no. 5 is '0' (zero) or negative then no goodwill exists in that business.

Illustration 7 : From the following information of Manoj and Harish's firm, determine the value of goodwill by capitalised average profit method.

Year	Profit (₹)
2012-13	90,000
2013-14	1,00,000
2014-15	1,10,000
2015-16	1,30,000
2016-17	1,50,000

Additional information : (1) Assets of business ₹ 13,40,000 (2) Liabilities of business ₹ 3,40,000 (3) Normal expected rate of return of business is 10 %.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	10,00,000
	Assets = 13,40,000	
	− Liabilities 3,40,000	
	Net assets / capital employed 10,00,000	
(2)	Expected rate of return	10 %
(3)	Weighted average profit (As per note no. 1)	1,26,000
(4)	Capitalised profit $= \dfrac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	12,60,000
	$= \dfrac{1,26,000}{10} \times 100 = \mathbf{12,60,000}$	

(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 10,00,000 **Goodwill = 2,60,000**	2,60,000

Note no. 1 : Calculation of weighted average profit

In this example, profit is continuously increasing since last five years. Therefore, average profit will be computed as per the weighted average method.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,00,000	2	2,00,000
2014-15	1,10,000	3	3,30,000
2015-16	1,30,000	4	5,20,000
2016-17	1,50,000	5	7,50,000
	Total	**15**	**18,90,000**

$$\text{Weighted average profit} = \frac{\text{Total weighted profit}}{\text{Total weight}}$$

$$= \frac{18{,}90{,}000}{15}$$

Weighted average profit = ₹ 1,26,000

Super profit capitalization method : Super profit can be capitalised directly and can determine the value of goodwill. It is not required to capitalised the average profit under this method. Following computation should be done to determining value of goodwill.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed : Total assets ✓ − Total liabilities ✓ Capital employed ✓	✓
(2)	Expected rate of return	✓
(3)	Expected profit = Capital employed × Expected Rate of return	✓
(4)	Average profit	✓
(5)	Super profit (Average profit − Expected profit)	✓
(6)	$\text{Goodwill} = \frac{\text{Super profit}}{\text{Expected rate of return}} \times 100$	✓

Note : If super profit is zero or negative (−), then it is no goodwill exists in the business.

Illustration 8 : Determine the value of goodwill of Virat and Anushka's firm as per the capitalisation of super profit method.

(1) Capital employed = 7,80,000

(2) Expected rate of return = 12 %

(3) Last 5 years profit :

Year	Profit (₹)
2012-13	2,00,000
2013-14	2,70,000
2014-15	2,40,000
2015-16	2,50,000
2016-17	2,30,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	7,80,000
(2)	Expected rate of return	12 %
(3)	Expected profit = Capital employed × Expected rate of return = 7,80,000 × 12 % = 93,600	93,600
(4)	Average profit : **Year** — **Profit** 2012-13 — 2,00,000 2013-14 — 2,70,000 2014-15 — 2,40,000 2015-16 — 2,50,000 2016-17 — 2,30,000 **11,90,000** Average profit $= \frac{\text{Total profit}}{\text{No. of years}} = \frac{11,90,000}{5} = 2,38,000$	2,38,000
(5)	Super profit = Average profit − Expected profit = 2,38,000 − 93,600 = 1,44,400	1,44,400
(6)	Goodwill $= \frac{\text{Super profit}}{\text{Expected rate of return}} = \frac{1,44,400}{12\ \%} = 12,03,333.33$ Goodwill = 12,03,333	12,03,333

Special Illustration :

Illustration 9 : Harpal, Rajesh and Jayesh's firm's information is as under :

(1) Business assets : ₹ 10,00,000

(2) Business liabilities : ₹ 2,00,000

(3) Expected rate of return : 10 %

(4) Firm's last five years profit are as under :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000

From the above information, determine the value of goodwill of the firm.

(1) Calculate the goodwill of the firm equal to five years average profit.

(2) On the basis of 3 years purchase of average profit.

(3) On the basis of 2 years purchase of weighted average profit.

(4) On the basis of 4 years purchase of super profit (Weighted average basis).

(5) As per capitalisation profit method.

(6) As per capitalisation of super profit.

Ans. :

(1) As per last five years average profit method :

Goodwill :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000
	5,90,000

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{5,90,000}{5}$$

Average profit = 1,18,000

Goodwill = Average profit

∴ $\boxed{\textbf{Goodwill = 1,18,000}}$

(2) Goodwill is equal to 3 years purchase of average profit :

Average profit = 1,18,000 [5,90,000 / 5]

(As per previous calculation)

Goodwill = Average profit × No. of years of purchase

= 1,18,000 × 3

Goodwill = 3,54,000

(3) **Goodwill as per weighted average profit method :**

Statement Showing Computation of Weighted Average Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,10,000	2	2,20,000
2014-15	1,20,000	3	3,60,000
2015-16	1,30,000	4	5,20,000
2016-17	1,40,000	5	7,00,000
	Total	**15**	**18,90,000**

Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$= \dfrac{18,90,000}{15}$

Weighted average profit = ₹ 1,26,000

Goodwill = Weighted average profit × No. of years of purchase

= 1,26,000 × 2

Goodwill = 2,52,000

(4) **On the basis of 4 years purchase of super profit :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	8,00,000
	Total assets 10,00,000	
	− Total external liabilities 2,00,000	
	Capital employed 8,00,000	
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return	80,000
	= 8,00,000 × 10 % = 80,000	
(4)	Average profit : (Weighted average profit)	1,26,000
	Note : Here, weighted average profit ₹ 1,26,000 will be calculated as per previous method.	
(5)	Super profit = Average profit − Expected profit	46,000
	= 1,26,000 − 80,000 = 46,000	

(6)	Goodwill = Super profit × No. of years of purchase = 46,000 × 4 Goodwill = 1,84,000	1,84,000

(5) **Profit capitalisation method :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Average profit (Weighted average) (As per previous method)	1,26,000
(4)	Capitalised profit $= \dfrac{\text{Average profit}}{\text{Expected rate of return}} \times 100$ $= \dfrac{1,26,000}{10} \times 100 = \mathbf{12,60,000}$	12,60,000
(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 8,00,000 **Goodwill = 4,60,000**	4,60,000

(6) **Super profit capitalisation method :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 10 % = 80,000	80,000
(4)	Average profit (Weighted average) (As per previous method)	1,26,000
(5)	Super profit = Average profit − Expected profit = 1,26,000 − 80,000 = 46,000	46,000
(6)	Goodwill $= \dfrac{\text{Super profit}}{\text{Expected rate of return}} \times 100 = \dfrac{46,000}{10} \times 100$ Goodwill = 4,60,000	4,60,000

Note : (1) Value of goodwill is zero where super profit is zero or negative (−), it means no existence of goodwill. (2) If there is loss in business, then there is no existence of goodwill.

EXERCISE

1. Select the correct answer for each question :

(1) 'Goodwill' is which type of asset ?

(a) Tangible asset (b) Intangible asset

(b) Current asset (d) Fictitious asset

(2) Goodwill depends on which aspect ?

(a) On employee of business enterprise

(b) On management of business enterprise

(c) On assets of business enterprise

(d) On future maintainable profit

(3) Goodwill is a financial value of ....

(a) investment (b) prestige of business enterprise

(c) fixed assets (d) competition

(4) Goodwill is .... where individual skill is important.

(a) more (b) less

(c) zero (d) negative

(5) Which method is appropriate for the computation of goodwill when every year profit is increasing ?

(a) Simple average (b) Weighted average

(c) Annual growth rate (d) Compound growth rate

(6) Expected profit = ...

(a) Capital employed × Expected rate of return

(b) Average profit × Expected rate of return

(c) Weighted average profit × Expected rate of return

(d) Assets × Expected rate of return

(7) Super profit means ....

(a) Capital employed − Expected profit (b) Expected profit − Capital employed

(c) Average profit − Expected profit (d) Expected profit − Average profit

2. Answer the following questions in one sentence :

(1) What is goodwill ?

(2) What is revaluation of goodwill ?

(3) Which type of asset is 'goodwill' ?

(4) Under which head goodwill is shown in the balance sheet ?

(5) What is capitalised profit ?

(6) What is super profit ?

(7) What is average profit ?

(8) What is weighted average profit ?

3. Answer the following questions :

(1) Give the meaning of goodwill and explain the factors affecting to its valuation.

(2) Explain the nature of goodwill.

(3) Explain the simple average method for the valuation of goodwill.

(4) Explain the weighted average method for the valuation of goodwill.

(5) Explain the super profit method for the valuation of goodwill.

(6) Explain the profit capitalisation method for the valuation of goodwill.

4. From the following information of Bhavesh and Vipul's firm, compute the value of goodwill on the basis of 4 years purchase of last five years average profit. Information of last five years profit is as under :

Year	Profit (₹)
2011-12	1,00,000
2012-13	1,10,000
2013-14	1,80,000
2014-15	2,00,000
2015-16	1,50,000

5. Mahendra and Pravin are partners of a firm sharing profit and loss in the ratio of 3:2. They want to change their profit-loss sharing ratio to 1:1. Therefore, they decided to make valuation of goodwill. As per partnership agreement, value of goodwill to be determine on the basis of 5 years purchase of last 4 years average profit.

Year	Profit (₹)
2013-14	60,000
2014-15	80,000
2015-16	(20,000)
2016-17	30,000

6. From the following information find out weighted average profit :

Year	Profit (₹)
2013-14	60,000
2014-15	70,000
2015-16	90,000
2016-17	1,10,000

7. From the following information of Babulal and Kantilal's firm, determine the value of goodwill on the basis of 3 years purchase of last five years weighted average profit :

Year	Profit (₹)
2012-13	40,000
2013-14	60,000
2014-15	75,000
2015-16	90,000
2016-17	1,20,000

8. Pushpa, Pratibha and Bhavna are partners of a partnership firm. They decided to change their profit-loss sharing ratio from 3:2:1 to 1:1:1. Therefore they decided to make the valuation of goodwill. On the basis of partnership firm's profit and other information, determine the value of goodwill on the basis of three years purchase of super profit.

Assets : ₹ 6,00,000; Liabilities : ₹ 2,50,000; Expected rate of return : 10 %

Actual profit :

Year	Profit (₹)
2014-15	80,000
2015-16	70,000
2016-17	90,000

9. Capital of Meena and Manju's firm is ₹ 4,00,000 and expected rate of return is 10 %. Last three year's profits are ₹ 1,20,000, ₹ 1,10,000 and ₹ 1,00,000 respectively. Compute the value of goodwill two times of super profit on the basis weighted average method..

10. From the following information of Nairutva and Rutvik's firm determine the value of goodwill of partnership firm on the basis of capitalisation of weighted average profit method.

Year	Profit (₹)
2012-13	45,000
2013-14	50,000
2014-15	65,000
2015-16	75,000
2016-17	90,000

Additional information :

(1) Business assets : ₹ 6,00,000 (2) Business liabilities : ₹ 1,70,000

(3) Normal expected return of business is 10 %.

11. Determine the value of goodwill of Prabha and Prabhu's firm on the basis of capitalised super profit method.

(1) Capital employed : ₹ 9,00,000 (2) Expected rate of return : 12 %

(3) Last five years profit :

Year	Profit (₹)
2012-13	1,00,000
2013-14	1,40,000
2014-15	1,30,000
2015-16	1,50,000
2016-17	1,80,000

12. Rajesh and Harish are partners of a partnership firm. On the basis of their partnership firm's profit and other information, determine the value of goodwill on the basis of two years purchase of super profit.

(1) Capital employed : ₹ 8,00,000 (2) Expected rate of return : 12 %

(3) Previous years profit :

Year	Profit (₹)
2014-15	1,20,000
2015-16	90,000
2016-17	1,50,000

4

Reconstruction of Partnership

1. Introduction

We have studied about the nature of a partnership firm and its final accounts in the previous chapter. In this chapter we will study about the "Reconstruction (Reconstitution) of partnership". i.e. Changes in partnership due to several reasons.

Reasons for changes in partnership : Following are three reasons for the changes in a partnership.

Reasons for changes in a partnership

↓	↓	↓
The change in the ratio of profit and loss sharing between the continuing partners	Admission of existing partnership firm	Retirement or death of a partner of an existing partnership firm

In this chapter, we will discuss in detail about the change in profit and loss sharing ratio or distribution ratio between the existing partners. The detailed discussion on the admission of a new partner and the retirement or death of a partner has been made in the next chapter.

2. The Changes in Profit and Loss Sharing or Distributing Ratio Between the Continuing (Present) Partners

Generally, profit and loss sharing ratio between the partners in a partnership is not changed once it is agreed. e.g. profit and loss sharing ratio between A and B is 3:2. Generally this ratio is not changed. But if it is required, then it can be changed with the consent of all existing partners.

There may be following reasons for the change in profit and loss distribution ratio :

(1) When a partner in charge of the firm is not able to manage the firm on the grounds of illness or incapability or some personal reasons.

(2) When a partner can not devote enough time to run a business, the other partner has to substitute him and run the business.

(3) Due to retirement or death of a partner.

(4) Due to new partners' admission.

Explanation or Understanding with Illustration : Let us understand the above information (particulars) with an illustration.

Virat and Vaman are the partners in a firm sharing profit and loss in proportion of 1:1. Due to his illness, Vaman is not able to spare enough time for business. Therefore, they have decided to share the profit and loss in the ratio of 2:1.

After making changes in the profit and loss sharing ratio Virat will get $\frac{2}{3}$ part of the profit and Vaman will get $\frac{1}{3}$.

Prior to the above distribution, both used to get $\frac{1}{2}$ part of profit. From this we can say that the portion of share of profit for Virat is increased and that of Vaman is decreased. The same can be shown by the following calculation :

Changes in profit share = Old share − New share

In the above formula if the answer is '+' (positive) then it is called decrease in profit (sacrifice) sharing and if the answer is '−' (negative) then it is called increase in profit sharing (gain).

Changes in profit received by Virat = Old share − New share

$$= \frac{1}{2} - \frac{2}{3}$$

$$= \frac{3-4}{6}$$

$$= -\frac{1}{6}$$

Increase in profit ratio received by Virat = $-\frac{1}{6}$ (Gain)(As per above explanation)

Changes in profit received by Vaman = Old share − New share

$$= \frac{1}{2} - \frac{1}{3}$$

$$= \frac{3-2}{6}$$

$$= \frac{1}{6}$$

Decrease in profit ratio received by Vaman = $\frac{1}{6}$ (Sacrifice)(As per above explanation)

From the above calculation, it can be seen that the share of profit of Virat is increased by $\frac{1}{6}$ and Vaman lost the share of profit by $\frac{1}{6}$. i.e. $\frac{1}{6}$ share of profit, which is lost by Vaman, is gained by Virat. In this way, the increase in the share of profit of Virat is called 'gain' and decrease in the share of profit of Vaman is called 'sacrifice'. In this example Vaman's 'sacrifice' turns out to be 'gain' for Virat.

Generally, when there is a change in profit sharing ratio of the existing partner, then some partners have to sacrifice certain portion of their profit which will be the gain for the other partner. So at the time of the reconstruction of a partnership, two important points are to be noted :

(1) Sacrificing ratio (2) Gaining ratio

(1) Sacrificing Ratio :

When there is a change in the ratio of profit and loss sharing of existing partners, a portion of profit of certain partners is reduced. i.e. they get less share as compared to what they used to get before. This reduced share of profit of a partners is called "Sacrificing ratio".

In case of admission of a new partner in an existing partnership firm, old partners have to give certain share of profit in favour of the new partner. At that time, it is also required to calculate sacrificing ratio of old partners. The detailed discussion of admission of a new partner will be made in Chapter no. 5.

Sacrificing ratio depends on the changes in the old profit and loss sharing ratio of the parnters. In the existing partnership firm, sacrificing ratio is a difference between the old share and the new share of profit of one or more partners who have, sacrificed. As per the mathematical method,

Sacrificing ratio of a partner = Old share − New share

From the above formula we can say that if a partners' old share of profit is higher than the new share, it means that the partner has sacrified his share. Let us try to understand the sacrifice made by a partner through the following example.

- **When sacrifice is done by one partner :**

Illustration 1 : Ram, Shyam and Ghanshyam are the partners in a firm sharing profit and loss equally. They decided to share profit and loss in the ratio of 3:2:1 in future. In these circumstances, calculate which partner has sacrified and how much ?

Ans. :

	Ram		Shyam		Ghanshyam	Total
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	3	:	2	:	1	6
New share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	

Now let's calculate sacrifice ratio by partners.

Sacrifice by partner = Old share − New share

(1) Ram's sacrifice $= \frac{1}{3} - \frac{3}{6}$

$= \frac{2-3}{6}$

Ram's sacrifice $= \frac{-1}{6}$ (Gain)

Here, $\frac{-1}{6}$ share in sacrifice formula, it means Ram is gaining $\frac{1}{6}$ shares.

(2) Shyam's sacrifice $= \frac{1}{3} - \frac{2}{6}$

$= \frac{2-2}{6}$

$= \frac{0}{6}$

Shyam's sacrifice = 0 (No gain, no sacrifice)

From the above calculation sacrifice ratio of Shyam = 0. i.e. Shyam has sacrificed nothing, as his share of profit remains the same.

Old ratio $= \frac{1}{3}$

New ratio $= \frac{2}{6} = \frac{1}{3}$

(3) Ghanshyam's sacrifice $= \frac{1}{3} - \frac{1}{6}$

$= \frac{2-1}{6}$

Ghanshyam's sacrifice $= \frac{1}{6}$ (Sacrifice)

From the above illustration, the benefit to Ram of $\frac{1}{6}$ share is due to the sacrifice given by Ghanshyam of $\frac{1}{6}$ share.

From the above illustration we can say that while calculating the sacrificing ratio, if the answer is negative (–), then it is benefit to the partner and not sacrifice. i.e. Gain ratio = New profit sharing ratio – Old profit sharing ratio

Ram	Shyam	Ghanshyam	
$-\frac{1}{6}$	0	$\frac{1}{6}$	0
(Gain)		(Sacrifice)	

Note : Total of sacrifice share and total of gain share is always equal.

- **When more than one partner is sacrificing :**

Illustration 2 : Bhavesh, Vipul and Hiral are the partners in a firm sharing profit and loss in the ratio of 2:2:1. They decided to share profits and losses in the ratio of 3:2:1 in future. From this information, calculate the sacrificing ratio.

Ans. :

	Bhavesh		**Vipul**		**Hiral**	**Total**
Old ratio	2	:	2	:	1	5
Old share	$\frac{2}{5}$		$\frac{2}{5}$		$\frac{1}{5}$	
New ratio	3	:	2	:	1	6
New share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	

Share of sacrifice = Old share – New share

(1) Bhavesh's sacrifice $= \frac{2}{5} - \frac{3}{6}$

$= \frac{12-15}{30}$

$= \frac{-3}{30}$

Bhavesh's sacrifice $= \frac{-1}{10}$ (Gain)

(2) Vipul's sacrifice $= \frac{2}{5} - \frac{2}{6}$

$= \frac{12-10}{30}$

Vipul's sacrifice $= \frac{2}{30}$ (Sacrifice)

(3) Hiral's sacrifice $= \frac{1}{5} - \frac{1}{6}$

$= \frac{6-5}{30}$

Hiral's sacrifice $= \frac{1}{30}$ (Sacrifice)

From the above calculation it can be seen that the sacrifice by Vipul and Hiral is received by Bhavesh in the form of gain / benefit. Vipul sacrificed $\frac{2}{30}$ and Hiral sacrificed $\frac{1}{30}$. So sacrifice ratio between Vipul and Hiral is $\frac{2}{30}$: $\frac{1}{30}$ respectively. i.e. sacrificing ratio of Vipul and Bhavesh is 2:1.

As per the earlier discussion, some partners' sacrifice turns out to be a benefit for the other partners'. In the above illustration sacrifice by Vipul and Hiral become a gain for Bhavesh. The calculation is as under :

Vipul's sacrifice $= \frac{2}{30}$

Hiral's sacrifice $= \frac{1}{30}$

$\therefore$ Vipul and Hiral's total sacrifice $= \frac{2}{30} + \frac{1}{30}$

$= \frac{2+1}{30}$

$= \frac{3}{30}$

Vipul and Hiral's total sacrifice $= \frac{1}{10}$

Bhavesh's gain $= \frac{1}{10}$

So, from the above calculation, it can be seen that the benefit of $\frac{1}{10}$ received by Bhavesh, is in the ratio of 2:1 from Vipul and Hiral respectively.

- **Sacrifice by one partner and gain by more than one partners :**

Illustration 3 : Poonam, Dhaval and Komal are the partners in a firm. Their profit and loss sharing ratio is 3:2:1. All the partners have decided to change the profit and loss ratio and it is 1:2:2. Calculate the sacrificing ratio of partners.

Ans. :

	Poonam		**Dhaval**		**Komal**	**Total**
Old ratio	3	:	2	:	1	6
Old share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	
New ratio	1	:	2	:	2	5
New share	$\frac{1}{5}$		$\frac{2}{5}$		$\frac{2}{5}$	

The calculation of sacrifice by the partner :

Sacrifice = Old share − New share

(1) Poonam's sacrifice = Old share − New share

$$= \frac{3}{6} - \frac{1}{5}$$

$$= \frac{15-6}{30}$$

Poonam's sacrifice $= \frac{9}{30}$

(2) Dhaval's sacrifice = Old share − New share

$$= \frac{2}{6} - \frac{2}{5}$$

$$= \frac{10-12}{30}$$

Dhaval's sacrifice $= \frac{-2}{30}$ (Gain)

(3) Komal's sacrifice = Old share − New share

$$= \frac{1}{6} - \frac{2}{5}$$

$$= \frac{5-12}{30}$$

Komal's sacrifice $= \frac{-7}{30}$ (Gain)

As per the above calculation answers of Dhaval and Komal are negative (−). i.e. Dhaval and Komal have sacrificied nothing, but they received benefit of $\frac{2}{30}$ and $\frac{7}{30}$.

The benefit by Dhaval and Komal is due to Poonam's sacrifice. The calculation is as under :

Poonam's sacrifice $= \frac{9}{30}$

Dhaval's gain $= \frac{2}{30}$

Komal's gain $= \frac{7}{30}$

∴ Dhaval and Komal's gain $= \frac{2}{30} + \frac{7}{30} = \frac{9}{30}$

Here, the sacrifice of $\frac{9}{30}$ by Poonam, is equal to the total benefit of Dhaval and Komal.

Dhaval and Komal received the benefit of $\frac{2}{30}$ and $\frac{7}{30}$ respectively. i.e. the gain ratio between Dhaval and Komal is 2:7 which is received from Pooman.

Now, we try to understand the calculation of the gain ratio.

(2) Gaining Ratio :

When there is a change in profit and loss sharing ratio of partners, share of profit of some partners reduces and other partners share of profit increases. So some partners' share of profit is higher than the prior one. The higher share of profit of partners is called 'gaining ratio'.

If any partner retired or if there is death of any partner in the existing firm, share of profit of the retired or deceased partner will be received by the existing partners. At that time also, it becomes necessary to calculate the gaining ratio. The detailed discussion of retirement or death of an existing partner will be made in chapter 6.

If the new profit-loss sharing ratio is more compared to the old profit-loss sharing ratio then it is called gain. Gaining ratio is a difference between new profit-loss sharing ratio and old profit-loss sharing ratio received by the partners. As per the mathematical method,

Gain = New share − Old share

Let us try to understand the gaining ratio of partners with an illustration.

- **When any one partner is gaining :**

Illustration 4 : Dhruvil, Gopi and Mukund are partners the in a partnership firm. Their profit and loss sharing ratio is 1:1:1. All partners have decided to change the profit and loss sharing ratio in future to 1:2:3. Calculate the gain ratio.

Ans. :

	Dhuvil		Gopi		Mukund	Total
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	1	:	2	:	3	6
New share	$\frac{1}{6}$		$\frac{2}{6}$		$\frac{3}{6}$	

Now, let's calculate the gaining ratio of the partners.

Partner's gain = New share − Old share

(1) Dhruvil's gain $= \frac{1}{6} - \frac{1}{3}$

$= \frac{1-2}{6}$

Dhruvil's gain $= \frac{-1}{6}$ (Sacrifice)

(2) Gopi's gain $= \frac{2}{6} - \frac{1}{3}$

$= \frac{2-2}{6}$

$= \frac{0}{6}$

Gopi's gain = 0 (Zero)

(3) Mukund's gain $= \frac{3}{6} - \frac{1}{3}$

$= \frac{3-2}{6}$

Mukund's gain $= \frac{1}{6}$

As per the above calculation of gain, Dhruvil's gain answer is negative $(-)$ which shows that actually Dhruvil does not receive any benefit but he has to sacrifice his share because of the change in profit and loss sharing ratio. Gopi has neither sacrificed nor gained due to the change in profit and loss sharing ratio as there is no change in her profit and loss sharing ratio. Her new profit-loss sharing ratio $\frac{2}{6} = \frac{1}{3}$ and her old ratio is also $\frac{1}{3}$. Actually, gain by Mukund is due to Dhruvil's sacrifice.

From the above illustration, it can be seen that while calculating the gain ratio if the answer is negative $(-)$ then it is a sacrifice and not a gain.

- **When more than one partner are gaining :**

Illustration 5 : Dhyey, Siddhi and Prapti are the partners in a firm sharing profits and losses in the ratio of 1:1:1. All partners have decided to share profit and loss in the new ratio of 1:3:3. From the above information, find out the gain ratio.

Ans. :

	Dhyey		Siddhi		Prapti	Total
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	1	:	3	:	3	7
New share	$\frac{1}{7}$		$\frac{3}{7}$		$\frac{3}{7}$	

Gain = New share − Old share

(1) Gain to Dhyey $= \frac{1}{7} - \frac{1}{3}$

$= \frac{3-7}{21}$

Gain to Dhyey $= \frac{-4}{21}$ (Sacrifice)

(2) Gain to Siddhi $= \frac{3}{7} - \frac{1}{3}$

$= \frac{9-7}{21}$

Gain to Siddhi $= \frac{2}{21}$

(3) Gain to Prapti $= \frac{3}{7} - \frac{1}{3}$

$= \frac{9-7}{21}$

Gain to Prapti $= \frac{2}{21}$

As per the above calculation, while calculating the gain to Dhyey, answer is negative (–), so Dhyey is not gaining anything but he has sacrificed $\frac{4}{21}$ share of profit. Gain to Siddhi and Prapti is $\frac{2}{21}$ and $\frac{2}{21}$ respectively.

So, gain ratio between Siddhi and Prapti is $\frac{2}{21} : \frac{2}{21}$ i.e. 1:1 (2:2).

- **When more than one partner scrifices and gain is to any one partner :**

Illustration 6 : Sagar, Sarita and Palak are the partners in a firm sharing profits and losses in the ratio of 3:3:2. All partners have decided to change their profit and loss ratio to 1:1:1. Calculate gain and sacrifice by the partners.

Ans. :

	Sagar		Sarita		Palak	Total
Old ratio	3	:	3	:	2	8
Old share	$\frac{3}{8}$		$\frac{3}{8}$		$\frac{2}{8}$	
New ratio	1	:	1	:	1	3
New share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	

(1) **Explanation with gain formula :**

Gain = New share – Old share

(1) Gain to Sagar $= \frac{1}{3} - \frac{3}{8}$

$= \frac{8-9}{24}$

Gain to Sagar $= \frac{-1}{24}$ (Sacrifice)

(2) Gain to Sarita $= \frac{1}{3} - \frac{3}{8}$

$= \frac{8-9}{24}$

Gain to Sarita $= \frac{-1}{24}$ (Sacrifice)

(3) Gain to Palak $= \frac{1}{3} - \frac{2}{8}$

$= \frac{8-6}{24}$

Gain to Palak $= \frac{2}{24}$

As per the above calculation, Sagar and Sarita have sacrificed $\frac{1}{24}$ and $\frac{1}{24}$ respectively and Palak received the gain of $\frac{2}{24}$.

Gain to Palak = Sacrifice by Sagar + Sacrifice by Sarita

$$= \frac{1}{24} + \frac{1}{24}$$

$$= \frac{1+1}{24}$$

Gain to Palak $= \frac{2}{24}$

(2) Explanation with sacrifice formula :

Sacrifice = Old share − New share

(1) Sagar's sacrifice $= \frac{3}{8} - \frac{1}{3}$

$$= \frac{9-8}{24}$$

Sagar's sacrifice $= \frac{1}{24}$

(2) Sarita's sacrifice $= \frac{3}{8} - \frac{1}{3}$

$$= \frac{9-8}{24}$$

Sarita's sacrifice $= \frac{1}{24}$

(3) Palak's sacrifice $= \frac{2}{8} - \frac{1}{3}$

$$= \frac{6-8}{24}$$

Palak's sacrifice $= \frac{-2}{24}$ (Gain)

As per the above calculation, Sagar and Sarita have sacrificed and the benefit is received by Palak.

Gain to Palak = Sagar's sacrifice + Sarita's sacrifice

$$= \frac{1}{24} + \frac{1}{24}$$

$$= \frac{1+1}{24}$$

Gain to Palak $= \frac{2}{24}$

As per the above calculation we can say that the answer will remain same both in gain formula and sacrifice formula. In this way, whenever there is a change in profit and loss sharing ratio between the existing partners necessary calculation can be made by sacrifice or gain formula.

In short, whenever calculation is made by gain formula and if the answer is positive (+) then it is a gain and if the answer is negative (−) then it is a sacrifice.

Whenever calculation is made by the sacrifice formula and if the answer is positive (+) then it is a sacrifice and if the answer is negative (−) then it is a gain.

Difference Between Sacrifice Ratio and Gaining Ratio :

Sacrifice Ratio	Gaining Ratio
(1) **Meaning :** Old partners giving their profit share in favour of the new partners, OR changes in existing partners' profit-loss ratio due to the reconstruction of a partnership firm where any partners gives its profit share in favour of other partners is called sacrifice.	(1) Share of retiring partners received by existing partners, OR changes in existing partners' profit-loss sharing ratio, where some partner's sacrifice is received by existing partners is called gain ratio.
(2) **When is it computed ? :** At the time of admission of new partner and reconstruction of partnership firm, sacrifice ratio of old partners is computed.	(3) At the time of the retirement of a partner and at the time of the reconstruction of partnership, gaining ratio of existing partners is found.
(3) **Formula :** Sacrifice = Old share − New share	(3) Gain = New share − Old share
(4) **Why is it found ?** Sacrifice ratio is found to distribute the goodwill which is broughts in a new partner for his share and to give by adjustments of goodwill at the time of the reconstruction of a partnership firm.	(4) Gaining ratio is found for the share of goodwill to the retiring partner by the existing partners in their gain ratio and to give adjustment of goodwill due to the reconstruction of a partnership firm.

Now let us discuss another important point regarding the reconstruction of partnership.

3. Revaluation Accounts of Assets and Liabilities of a Partnership Firm and its Accounting Effects

The book value of assets and liabilities recorded in the books of a partnership firm when brought at present value it is called revaluation of assets. It means, recorded assets and liabilities are shown at new value which is called revaluation of assets and liabilities. Recorded assets and liabilities may be higher or lesser than its actual or real value. It may be possible that, with the passage of time, the price of fixed assets such as land and building may go up. In the same manner, there may not be any provision for reserve on debtors or bills receivable. In the same manner, it may be possible that liabilities increase or decrease or the liabilities remain unrecorded. Due to all these reasons if the partners have decided to revalue the assets and liabilities of the firm then its accounting effects are given.

- **Accounting effects of revaluation of assets and liabilities of a partnership firm :**

A special account is opened in the books of a partnership firm to record the accounting effects of the revaluation of assets and liabilities. This account is called the 'Revaluation Account'. Generally, whenever there is reconstruction of a partnership firm (changes in profit and loss sharing ratio), assets and liabilities of the firm are revalued. So assets and liabilities can be recorded at their real value in the firm's accounts and there is no possibility that any partner has to suffer because of the reconstruction of a partnership. For the same reasons, at the time of admission of a new partner in the existing partnership firm or at the time of retirement or death of a partner of the existing firm, assets and liabilities are revalued.

At the time of giving the accounting effect of revaluation, following rules should be remembered.

(1) If there is increase in assets-receivable then it is called profit.

(2) If there is decrease in assets-receivable then it is called loss.

(3) If there is increase in liabilities-provisions then it is called loss.

(4) If there is decrease in liabilities-provisions then it is called profit.

(5) If unrecorded assets are brought to books then it is a profit.

(6) If unrecorded liabilities are brought to books then it is a loss.

In above circumstances, when profit arise then respective account is debited and revaluation account is credited and when loss arise then the revaluation account is debited and the respective account is credited.

Balance of assets is always debit. Therefore, if assets value increases then assets account will be debited and revaluation account will be credited as it is a profit. On the contrary, if assets value decreases then revaluation account will be debited and assets account will be credited.

Balance of liabilities is always credit. Therefore if the liabilities value increases then the realisation account will be debited and the liabilities account will be credited, as it is a loss. On the contrary if the liabilities value decreases then the liabilities account will be debited and revaluation account will be credited.

Effect of changes (effect of adjustments) in the value of assets and liabilities are given in the revaluation account. So, it is also known, as profit and loss adjustment account.

At the time of revaluation of assets and liabilities, following journal entries are passed in the books of firm.

Journal Entry

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When there is an increase in the value of assets then :			
	Respective assets A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the assets value increase is recorded due to revaluation.]			
(2)	When there is decrease in the value of assets then :			
	Revaluation assets A/c Dr		✓	
	To Respective assets A/c			✓
	[Being the assets value decreased due to revaluation is recorded.]			
(3)	When there is a provision for doubtful debt or discount reserve etc. on debtor then :			
	Revaluation A/c Dr		✓	
	To Bad debt reserve A/c			✓
	To Discount reserve on debtors A/c			✓
	[Being the provision made for bad debts reserve and discount reserve on debtors.]			

	Particulars	L.F.	Debit (₹)	Credit (₹)
(4)	If there is an unrecorded assets, accrued income or prepaid expenses then :			
	Respective assets A/c Dr		✓	
	Accrued income A/c Dr		✓	
	Prepaid expenses A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the unrecorded assets, income receivable, and prepaid expenses are recorded.]			
(5)	If there is an increase in amount of liability then :			
	Revaluation A/c Dr		✓	
	To Respective liability A/c			✓
	[Being the liability amount increased due to revaluation.]			
(6)	If there is a decrease in amount of liability then :			
	Respective liability A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the liability amount decreased to due to revaluation.]			
(7)	When an entry made for unrecorded liability in the books then :			
	Revaluation A/c Dr		✓	
	To Outstanding liability			✓
	[Being the unrecorded liability is recorded.]			
(8)	When revaluation account is closed then :			
	(A) If profit of revaluation account :			
	Revaluation A/c Dr		✓	
	To Partner's capital/current A/c			✓
	[Being due to revaluation, profit is distributed between partners in the ratio of profit-loss.]			
	(B) If loss of revaluation account :			
	Partners' capital/current A/c Dr		✓	
	To Revaluation A/c			✓
	[Being due to revaluation, loss is distributed between partners in the ratio of profit-loss.]			

- **Specimen/proforma of revaluation account is as under :**

Dr Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Assets A/c (2)	✓	By Assets A/c (1)	✓
(Decrease in assets value)		(Increase in assets value)	
To Bad debt reserve A/c (3)	✓	By Assets A/c (4)	✓
To Discount reserve on debtors A/c (3)	✓	(Unrecorded assets)	
To Liabilities (Increase in liabilities) (5)	✓	By Accrued income A/c (4)	✓
To Outstanding liability A/c	✓	By Prepaid expenses A/c (4)	✓
(Increase in liability value) (7)		By Liability A/c (6)	✓
To Partners' capital A/c : Profit (8A)	✓	(Decrease in value)	
		By Partners' capital A/c : Loss (8B)	✓
	✓		✓

Note : The figure in the bracket shows No./Index of journal entries. It means revaluation account is a posting of journal entries of revaluation.

The above journal entry no. 8 will be passed after the preparation of the revaluation account. If the balance of revaluation account is credited then it is called profit and if it is a debit balance then it is called loss. The profit or loss is transferred to the present partners' capital accounhts in their old profit and loss sharing ratio, as the profit or loss has been increased before the changes made in the profit-loss sharing ratio.

Illustration 7 : Bhavna, Bharat and Bhumesh are the partners in a partnership firm sharing profit and loss in the ratio of 2:1:1. The following is their balance sheet as on 31-3-2017.

Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Land	5,00,000
Bhavna	6,00,000		Building	8,00,000
Bharat	6,00,000		Machinery	4,00,000
Bhumesh	5,40,000	17,40,000	Furniture	50,000
Creditors		2,00,000	Investment	50,000
Bills payable		60,000	Debtors	1,00,000
			Bills receivable	30,000
			Cash balance	20,000
			Bank balance	50,000
		20,00,000		**20,00,000**

Partners have decided to revaluate the assets and liabilities on the date of the above balance-sheet.

(1) The value of land is ₹ 7,00,000.

(2) The value of building is increased by ₹ 1,00,000.

(3) The market-value of machine is ₹ 2,50,000 which is to be recorded in the books.

(4) Provision for doubtful debts at 20 % on debtors.

(5) Creditors amounting to ₹ 10,000, are not required to be paid.

(6) Income receivable amounted to ₹ 5000 and outstanding expenses amounted to ₹ 3000 which are to be recorded.

From the above information, write journal-entry in the books of partnership firm for revaluation and prepare revaluation A/c.

Ans. : Journal Entry in the Books of Partnership Firm of Bhavna, Bharat and Bhumesh

Date	Particulars	L.N.	Debit (₹)	Credit (₹)
(1)	Land A/c Dr		2,00,000	
	To Revaluation A/c			2,00,000
	[Being due to revaluation, there is an increase in price of land ₹ 2,00,000.]			
(2)	Building A/c Dr		1,00,000	
	To Revaluation A/c			1,00,000
	[Being due to revaluation there is an increase in price of building ₹ 1,00,000.]			
(3)	Revaluation A/c Dr		1,50,000	
	To Machinery A/c			1,50,000
	[Being due to revaluation, there is decrease in price of machinery ₹ 1,50,000.]			
(4)	Revaluation A/c Dr		20,000	
	To Bad debt reserve A/c			20,000
	[Being the provision for doubtful debts ₹ 20,000 on ₹ 1,00,000 debtors @ 10 %.]			
(5)	Creditors A/c Dr		10,000	
	To Revaluation A/c			10,000
	[Being an amount of ₹ 10,000 not to be paid to creditors.]			
(6)	Receivable income A/c Dr		5000	
	To Revaluation A/c			5000
	[Being the unrecorded receivable income is recorded.]			
(7)	Revaluation A/c Dr		3000	
	To Outstanding expenses A/c			3000
	[Being the unrecorded outstanding expense is recorded.]			
	Total carry forward		4,88,000	4,88,000

Date	Particulars	L.N.	Debit (₹)	Credit (₹)
	Total bring forward		4,88,000	4,88,000
(8)	Revaluation A/c Dr		1,42,000	
	To Bhavna's capital A/c			71,000
	To Bharat's capital A/c			35,500
	To Bhumesh's capital A/c			35,500
	[Being the profit due to revaluation distributed among the partners in their profit sharing ratio.]			
	Total		**6,30,000**	**6,30,000**

Revaluation Account as on 31-3-2017 (Profit-loss adjustment A/c)

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		1,50,000	By Land A/c	2,00,000
To Bad debt reserve A/c		20,000	By Building A/c	1,00,000
To Outstanding expense A/c		3000	By Creditors A/c	10,000
Profit : To partners' capital A/c (2:1:1)			By Income receivable A/c	5000
Bhavna	71,000			
Bharat	35,500			
Bhumesh	35,500	1,42,000		
		3,15,000		**3,15,000**

Explanation :

Particulars	Old	New	Increased	Decreased	Profit	Loss	Revaluation A/c
Land	5,00,000	7,00,000	2,00,000	–	2,00,000	–	Credit
Building	8,00,000	9,00,000	1,00,000	–	1,00,000	–	Credit
Machinery	4,00,000	2,50,000	–	1,50,000	–	1,50,000	Debit
Bad debt reserve	–	20,000	20,000	–	–	20,000	Debit
Creditors Income	2,00,000	1,90,000	–	10,000	10,000	–	Credit
Receivable	–	5000	5000	–	5000	–	Credit
Outstanding Expenses	–	3000	3000	–	–	3000	Debit
					3,15,000	**1,73,000**	

Illustration 8 : Harish, Dhruvil and Manoj are the partners of a partnership firm. Their profit-loss sharing ratio is 3:2:1. Balance-sheet of the firm as on 31-3-2017 is as given on page no. 123.

Harish, Dhruvil and Manoj's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Land	3,00,000
Harish	3,65,000		Building	4,80,000
Dhruvil	3,00,000		Machinery	2,00,000
Manoj	1,00,000	7,65,000	Investment	1,20,000
Bank loan		4,50,000	Debtors	80,000
Creditors		1,00,000	Bills receivables	20,000
Bills payable		32,000	Bank balance	1,00,000
Outstanding expenses		18,000	Cash balance	40,000
			Income receivables	10,000
			Closing stock	15,000
		13,65,000		**13,65,000**

As on above balance sheet date, profit-loss sharing ratio is changed to 1:3:2 and also decided for revaluation of assets and liabilities of business as follows :

(1) Land value is increased upto ₹ 3,50,000 and building value is increased by ₹ 70,000.

(2) Machinery value keeps upto ₹ 1,50,000.

(3) Investment value decreased 20 %.

(4) Provide 10 % for bad debts reserve and 5 % for discount reserve on debtors.

(5) 50 % stock value decreased by 10 %.

(6) Unrecorded outstanding expense is amounted to ₹ 2000.

(7) Unrecorded prepaid rent ₹ 3000.

From the above information, write journal entries and prepare revaluation account in the books of partnership firm.

Ans. :

Journal Entries in the books of Harish, Dhruvil and Manoj's firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land A/c Dr		50,000	
	Building A/c Dr		70,000	
	To Revaluation A/c			1,20,000
	[Being increase in the value of land and building due to revaluation is recorded.]			
(2)	Revaluation A/c Dr		50,000	
	To Machinery A/c			50,000
	[Being decrease in the value of machinery due to revaluation is recorded.]			
	Total carry forward		1,70,000	1,70,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		1,70,000	1,70,000
(3)	Revaluation A/c Dr		24,000	
	To Investment A/c			24,000
	[Being decrease in the value of investment due to revaluation is recorded.]			
(4)	Revaluation A/c Dr		11,600	
	To Bad debt reserve A/c			8000
	To Discount reserves on debtors A/c			3600
	[Being the provision made for bad debt reserves on ₹ 80,000 debtors at 10 %. ₹ 8000 and ₹ 3600 discount reserves at 5 % on ₹ 72,000 (₹ 80,000 – ₹ 8000) are recorded.]			
(5)	Revaluation A/c Dr		750	
	To Stock A/c			750
	[Being the stock value decreased due to revaluation is recorded.]			
(6)	Revaluation A/c Dr		2000	
	To Outstanding exp. A/c			2000
	[Being the unrecorded outstanding expense is recorded in the book.]			
(7)	Prepaid rent A/c Dr		3000	
	To Revaluation A/c			3000
	[Being the unrecorded prepaid rent is recorded.]			
(8)	Revaluation A/c Dr		34,650	
	To Harish's capital A/c			17,325
	To Dhruvil's capital A/c			11,550
	To Manoj's capital A/c			5775
	[Being the profit due to revaluation is distributed between partners as per their old profit-loss sharing ratio (3:2:1)]			
	Total		**2,46,000**	**2,46,000**

Revaluation Account as on 31-3-2017 (Profit-loss Adjustment A/c)

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		50,000	By Land A/c	50,000
To Investment A/c		24,000	By Building A/c	70,000
To Bad debt reserve A/c		8000	By Outstanding rent A/c	3000
To Discount reserve on debtors A/c		3600		
To Stock A/c		750		
To Outstanding expense A/c		2000		
Profit : To partners' capital A/c :				
Harish	17,325			
Dhruvil	11,550			
Manoj	5775	34,650		
		1,23,000		**1,23,000**

Note : (1) Land value increased upto ₹ 3,50,000 means revaluation value is ₹ 3,50,000. Therefore, land value increased ₹ 50,000 due to revaluation (3,50,000 − 3,00,000 = ₹ 50,000 increased).

(2) Machinery value decreased upto ₹ 1,50,000 means revaluation value is ₹ 1,50,000. Therefore, machinery value decreased ₹ 50,000 due to revaluation (2,00,000 − 1,50,000 = ₹ 50,000 decreased).

Illustration 9 : Hardik and Alpesh are the partners of a partnership firm. Their profit-loss sharing ratio is 5:3. They want to change their profit-loss sharing ratio to 3:2. Therefore, they decided to have the revaluation of firm's assets and liabilities. From the following information prepare revaluation account and balance-sheet after revaluation in the books of firm.

Hardik and Alpesh's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land-building		2,00,000
Hardik	1,10,000		Machinery		80,000
Alpesh	90,000	2,00,000	Furniture		40,000
Current accounts :			Investments		60,000
Hardik	1,55,000		Closing stock		45,000
Alpesh	1,00,000	2,55,000	Debtors	30,000	
Creditors		35,000	− Bad debt reserves	1500	28,500
Bank overdraft		90,000	Bills receivables		15,000
Outstanding expenses		3500	Income receivable		5000
			Cash balance		1,10,000
		5,83,500			**5,83,500**

Additional information :

(1) Land and building value is to be increased by 25 %.

(2) Furniture value is to be decreased upto 90 %.

(3) Market value of machinery is ₹ 72,000.

(4) Book value of closing stock is ₹ 10,000, less than its market value.

(5) To keep total bad debt reserve ₹ 3600 on debtors.

(6) Creditor amounted to ₹ 5000 out of the total creditors are not to be paid.

(7) Unrecorded interest on bank overdraft is ₹ 4500.

Ans. :

Revaluation Account as on 31-3-2017

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Furniture A/c		4000	By Land-building A/c	50,000
To Machinery A/c		8000	By Closing stock A/c	10,000
To Bad debt reserve A/c		2100	By Creditors A/c	5000
To Outstanding bank overdraft interest A/c		4500		
Profit : To partners' current A/c : (5:3)				
Hardik	29,000			
Alpesh	17,400	46,400		
		65,000		**65,000**

Note : (1) Furniture value decreased upto 90 % means 10 % decrease. (100 % − 90 %)

(2) Book value of closing stock is less than market value means ₹ 10,000 market value is high.

(3) Partners' fixed capital accounts and current are separately given in balance sheet. Therefore, profit of revaluation account is transferred to the partners' current account.

Hardik and Alpesh's Partnership Firm's Balance Sheet After Revaluation

Liabilities			Amt. (₹)	Assets		Amt. (₹)
Capital accounts :				Land-building	2,00,000	
Hardik		1,10,000		+ 25 % increased	50,000	2,50,000
Alpesh		90,000	2,00,000	Machinery	80,000	
Current accounts :				− Decreased	8000	72,000
Hardik	1,55,000			Furniture	40,000	
+ Profit	29,000	1,84,000		− Decreased 10 %	4000	36,000
Alpesh	1,00,000			Investments		60,000
+ Profit	17,400	1,17,400	3,01,400	Closing stock	45,000	
Creditors			30,000	+ Increased	10,000	55,000
Bank overdraft		90,000		Debtors	30,000	
+ Outstanding interest		4500	94,500	− Bad debt reserve	3600	26,400
Outstanding expenses			3500	Bills receivables		15,000
				Income receivable		5000
				Cash balance		1,10,000
			6,29,400			**6,29,400**

4. Distribution of Reserves and Accumulated Profits Among the Partners :

Free Reserves created from the divisible profit of a partnership firm, and the balance of the accumulated profit (if any) are of current partners of the firm. General reserves, workers' accident compensation fund etc. are called reserve fund and credit balance of profit and loss account is called the accumulated profit. At the time of the reconstruction of a partnership firm reserve funds and the balance of accumulated profit are distributed amongst the existing (current) partners in their old profit-loss sharing ratio.

If there is debit balance (loss) of profit-loss account then it is also distributed among the existing partners in their old profit-loss sharing ratio. The same distribution is also made before the admission of a new partner. At the time of retirement or death of a partner also, balance of reserve fund and profit-loss account is distributed amongst the old partners in the old profit-loss sharing ratio.

Following journal entry is passed in the books of the firm for distributing reserve fund and accumulated profit.

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Profit-loss A/c (Profit)	Dr		✓	
	General reserves A/c	Dr		✓	
	Capital reserves A/c	Dr		✓	
	Reserve fund A/c	Dr		✓	
	Contingency reserves A/c	Dr		✓	
	Worker's accident compensation fund A/c	Dr		✓	
	Investment fluctuation fund A/c	Dr		✓	
	To Old partners' capital/Current A/c				✓

Note : If there is debit balance (loss) of profit-loss account and other defferred revenue expenditures in the book of a firm then the following journal entry is passed.

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Old partners' current/capital A/c Dr		✓	
	To profit-loss A/c (loss)			✓
	To advertisement campaign A/c			✓
	To research development expense A/c			✓
	To other non-written off revenue expenditure A/c			✓

Note : Fluctuating capital account method has no current account so reserve fund and profit-loss account are transferred to the capital account and in fixed capital account method they are transferred to the partners' current account.

Illustration 10 : Ram and Rahim are the partners of a partnership firm. Profit-loss sharing ratio between them is 4:3. The following are the balances in the books of the firm as on 31-3-2017.

Profit-loss A/c (debit balance)	₹ 14,000
Reserve fund	₹ 42,000
Workers' profit sharing fund	₹ 21,000
Workers' accident compensation fund	₹ 26,000

On the above date, Ram and Rahim decided on a new profit sharing ratio of 1:1. A claim of ₹ 5000 is outstanding against the workers' accident compensation fund. Pass journal entries showing distribution of accumulated profit or losses in the books of the firm.

Ans. : Here, partners have made a change in their profit-loss sharing ratio. Therefore, accumulated profit or loss and reserves will be distributed in the old profit-loss sharing ratio.

Debit balance of profit-loss account
₹ 14,000

(4:3)

Ram 8000 | Rahim 6000

Reserve fund = 42,000
Workers' accident compensation fund = 21,000
(₹ 26,000 − ₹ 5000 claim)

63,000

(4:3)

Ram 36,000 | Rahim 27,000

Note : (1) Workers' profit sharing fund is a liability for a firm, therefore, it is not distributed. (2) Total workers' accident compensation fund is ₹ 26,000, but ₹ 5000 claim is outstanding against it, therefore ₹ 5000 workers' accident compensation fund will be continued as a liability in the balance-sheet while balance ₹ 21,000 will be distributed between the old partners.

Journal entry in the books of Ram and Rahim's firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Ram's capital A/c Dr		8000	
	Rahim's capital A/c Dr		6000	
	To Profit-loss A/c			14,000
	[Being the profit-loss debit balance is distributed between existing partners in their old profit-loss sharing ratio.]			
(2)	Reserve fund A/c Dr		42,000	
	Workers' accident compensation fund A/c Dr		21,000	
	To Ram's capital A/c			36,000
	To Rahim's capital A/c			27,000
	[Being the balance of reserve fund and workman compensation fund are distributed between existing partners in their old profit sharing ratio.]			
	Total		**77,000**	**77,000**

Note : Above journal entry no. 2 is combined. Instead of it following separate journal entry will be passed.

(1)	Reserve fund A/c Dr		42,000	
	To Ram's capital A/c $(42{,}000 \times \frac{4}{7})$			24,000
	To Rahim's capital A/c $(42{,}000 \times \frac{3}{7})$			18,000
	[Being the balance of reserve fund is distributed between existing partners in their old profit-loss sharing ratio.]			
(2)	Workers' accident compensation fund A/c Dr		21,000	
	To Ram's capital A/c $(21{,}000 \times \frac{4}{7})$			12,000
	To Rahim's capital A/c $(21{,}000 \times \frac{3}{7})$			9,000
	[Being the workman's accident compensation fund is distributed between existing partners in their old profit-loss sharing ratio.]			

Note : Above journal entry no. 2 is combined.

(1) Maximum 10 adjustments can be included in a question if both journal entries and the revaluation accounts are asked to prepare.

(2) Maximum 5 adjustments can be included if journal entries, necessary accounts and balance sheet are asked to prepare.

This information has to be implemented also in the chapter on Reconstruction of partnership, Admission of partners and Retirement or death of partner.

Illustration 11 : From the following information, pass necessary journal entries and prepare a revaluation account and a balance-sheet after the effects of revaluation in the books of Rajesh and Jagdish.

Rajesh and Jagdish are the partners sharing profit-loss in the ratio of 3:2. Balance sheet of the firm as on 31-3-2017 is as below :

Rajesh and Jagdish's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land - building		1,00,000
Rajesh	1,40,000		Machinery		80,000
Jagdish	60,000	2,00,000	Furniture		20,000
General reserve		10,000	Investment (Market value ₹ 25,000)		30,000
Profit and Loss A/c		15,000	Debtors	60,000	
Creditors		95,000	− Bad debt reserve	3000	57,000
			Stock		23,000
			Cash balance		10,000
		3,20,000			**3,20,000**

Partners have decided for the revaluation of assets and liabilities of the firm and the future profit distribution ratio is 1:1. Information for the same is as under :

(1) Land-building value is to be increased by 20 %.

(2) The value of machinery and furniture is to be decreased by 20 %.

(3) Now, bad debts reserves is not required.

(4) ₹ 3000 repairing expense is required in stock.

(5) An amount of ₹ 5000 among creditors is now not to be paid, which is to be recorded.

(6) Outstanding expenses ₹ 6000 and income receivable ₹ 8000.

(7) The investment is to be shown at market value.

Ans. :

Journal Entries in the Books of Rajesh and Jagdish Firm

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land - building A/c Dr To Revaluation A/c [Being increase in the value of land building on their revaluation is recorded.]		20,000	 20,000
	Total carry forward		20,000	20,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		20,000	20,000
(2)	Revaluation A/c Dr		20,000	
	To Machinery A/c			16,000
	To Furniture A/c			4000
	[Being decrease in the value of machinery and furniture on their revaluation are recorded.]			
(3)	Bad debt reserves A/c Dr		3000	
	To Revaluation A/c			3000
	[Being the bad debt reserve is not required, due to its revaluation is recorded.]			
(4)	Revaluation A/c Dr		3000	
	To Stock A/c			3000
	[Being the repairing expenses for stock is recorded.]			
(5)	Creditors A/c Dr		5000	
	To Revaluation A/c			5000
	[Being the amount of ₹ 5000 is not payable to creditors recorded.]			
(6)	Revaluation A/c Dr		6000	
	To Outstanding expense A/c			6000
	[Being the unpaid expenses not recorded is recorded due to revaluation.]			
(7)	Income receivable A/c Dr		8000	
	To Revaluation A/c			8000
	[Being the income receivable due to revaluation is recorded.]			
(8)	Revaluation A/c Dr		5000	
	To Investment A/c			5000
	[Being the market value of investment decrease due to revaluation is recorded.]			
	Total carry forward		70,000	70,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		70,000	70,000
(9)	General reserve A/c Dr		10,000	
	To Rajesh's capital A/c			6000
	To Jagdish's capital A/c			4000
	[Being the general reserve distributed between existing partners in their old profit-loss sharing ratio.]			
(10)	Profit-loss A/c Dr		15,000	
	To Rajesh's capital A/c			9000
	To Jagdish's capital A/c			6000
	[Being the credit balance of profit-loss account is distributed between existing partners in their old profit-loss sharing ratio.]			
(11)	Revaluation A/c Dr		2000	
	To Rajesh's capital A/c			1200
	To Jagdish's capital A/c			800
	[Being the profit on revaluation is distributed between existing partners in their old profit-loss sharing ratio.]			
	Total		**97,000**	**97,000**

Revaluation account (Profit-loss adjustment A/c) of
Partnership firm of Rajesh and Jagdish as on 31-3-2017

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		16,000	By Land-building A/c	20,000
To Furniture A/c		4000	By Bad debt reserve A/c	3000
To Stock A/c		3000	By Creditors A/c	5000
To Outstanding expenses A/c		6000	By Income receivable A/c	8000
To Investment A/c		5000		
To Partners' capital A/c (Profit) :				
Rajesh's capital A/c	1200			
Jagdish's capital A/c	800	2000		
		36,000		**36,000**

Partners' Capital Account

Dr Cr

Particular	Rajesh(₹)	Jagdish(₹)	Particular	Rajesh(₹)	Jagdish(₹)
To Balance c/d	1,56,200	70,800	By Balance b/d	1,40,000	60,000
			By General reserve A/c	6000	4000
			By Profit-loss A/c	9000	6000
			By Revaluation A/c	1200	800
	1,56,200	**70,800**		**1,56,200**	**70,800**

Rajesh and Jagdish's partnership firm's balance sheet after revaluation

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land-building	1,00,000	
Rajesh :	1,40,000		+ Increase (20 %)	20,000	1,20,000
+ General reserves	6000		Machinery	80,000	
+ Profit-loss A/c	9000		− Decrease (20 %)	16,000	64,000
+ Revaluation profit	1200	1,56,200	Furniture	20,000	
Jagdish :	60,000		− Decrease (20 %)	4000	16,000
+ General reserves	4000		Investment (Market value)		25,000
+ Profit-loss A/c	6000		Debtors		60,000
+ Revaluation profit	800	70,800	Stock	23,000	
Creditors		90,000	− Decrease	3000	20,000
Outstanding expenses		6000	Cash balance		10,000
			Income receivables		8000
		3,23,000			**3,23,000**

Note : In above balance sheet, effects of general reserves, profit-loss account and revaluation account are given in the balance of capital account. Instead of it, capital accounts can be prepared and balance of capital account can be shown in the balance sheet as under :

Illustration 12 : Pushpa, Pratibha and Bhavna are the partners of a partnership firm, profit-loss sharing in the ratio of 3:2:1. Balance-sheet of a partnership firm as on 31-3-2017 is as given on page no. 134 :

Balance Sheet of Pushpa, Pratibha and Bhavna's Partnership Firm as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Pushpa	2,64,000		Land-building		1,80,000
Pratibha	1,20,000		Machinery		1,60,000
Bhavna	80,000	4,64,000	Furniture		40,000
General reserve		18,000	Investments		30,000
Worker's accident compensation fund		6000	**Current assets :**		
Non-current liabilities :			Debtors	1,60,000	
12 % bank loan		1,00,000	– Bad debts	10,000	
Current liabilities :				1,50,000	
Creditors		56,000	– Bad debts reserves	7500	1,42,500
Bills payable		6000	Bills receivables		7000
Bank overdraft		15,000	Stock		30,500
			Cash balance		63,000
			Profit-loss account		12,000
		6,65,000			**6,65,000**

As on above balance sheet date, partners have decided to change the profit-loss sharing ratio to 1:1:1 and have decided to revalue the assets and liabilities of the business. Following revaluation account is prepared for the revaluation of the business, assets and liabilities.

Revaluation Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	60,000	By Land-building A/c		40,000
To Furniture A/c	5000	By Creditors A/c		6000
To Investment A/c	3000	By Income receivables A/c		4000
To Bad debt reserve A/c	7500	Partners' capital A/c (Loss) :		
To Stock A/c	2500	Pushpa	18,000	
To Outstanding expenses A/c	8000	Pratibha	12,000	
		Bhavna	6000	36,000
	86,000			**86,000**

From the above information pass necessary journal entries, partners' capital accounts and balance-sheet after the revaluation in the books of the partnership firm.

Ans. : Revaluation account is already given in the example. It means posting of revaluation of liabilities- assets transactions are given. Therefore, journal entries of revaluation will be passed on the basis of the posting.

Effect of general reserves, workers' accident compensation fund and profit-loss account (debit balance) are given in the partners' capital accounts. Therefore, they are not in the revaluation accounts, but it's journal entries will be passed.

Separate journal entry can be passed for each transaction from the revaluation account, but here the revaluation account is given, therefore three journal entries can be passed for the effect of particulars mentioned in the revaluation account.

(1) Profit due to revaluation of assets-liabilities (2) Loss due to revaluation of assets-liabilities

(3) Profit-loss of revaluation account is distributed between the existing partners in their old profit-loss sharing ratio

Journal Entries in the Books of Pushpa, Pratibha and Bhavna's Firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Revaluation A/c Dr		86,000	
	To Machinery A/c			60,000
	To Furniture A/c			5000
	To Investment A/c			3000
	To Bad debt reserve A/c			7500
	To Stock A/c			2500
	To Outstanding expense A/c			8000
	[Being the changes in the value of assets liabilities due to revaluation are recorded.]			
(2)	Land-building A/c Dr		40,000	
	Creditors A/c Dr		6000	
	Income receivables A/c Dr		4000	
	To Revaluation A/c			50,000
	[Being the changes in the value of assets-liabilities due to revaluation are recorded.]			
(3)	Pushpa's capital A/c Dr		18,000	
	Pratibha's capital A/c Dr		12,000	
	Bhavna's capital A/c Dr		6000	
	To Revaluation A/c			36,000
	[Being the loss of revaluation is distributed between existing partners in their old profit-loss sharing ratio.]			
(4)	General reserve A/c Dr		18,000	
	To Pushpa's capital A/c			9000
	To Pratibha's capital A/c			6000
	To Bhavna's capital A/c			3000
	[Being the balance of general reserves is distributed between existing partners in their old profit-loss sharing ratio.]			
(5)	Workers' accident compensation fund A/c Dr		6000	
	To Pushpa's capital A/c			3000
	To Pratibha's capital A/c			2000
	To Bhavna's capital A/c			1000
	[Being the balance of workers' accident compensation fund is distributed between existing partners in their old profit-loss sharing ratio.]			
	Total carry forward		1,96,000	1,96,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		1,96,000	1,96,000
(6)	Pushpa's capital A/c Dr		6000	
	Pratibha's capital A/c Dr		4000	
	Bhavna's capital A/c Dr		2000	
	To Profit-loss A/c			12,000
	[Being the debit balance of profit-loss account is distribnuted between existing partners in their old profit-loss sharing ratio.]			
	Total		**2,08,000**	**2,08,000**

Dr **Partners' Capital A/c** Cr

Particulars	Pushpa (₹)	Pratibha (₹)	Bhavna (₹)	Particulars	Pushpa (₹)	Pratibha (₹)	Bhavna (₹)
To Profit-loss A/c	6000	4000	2000	By Balance b/d	2,64,000	1,20,000	80,000
To Revaluation A/c	18,000	12,000	6000	By General reserve A/c	9000	6000	3000
To Balance c/d	2,52,000	1,12,000	76,000	By Workers accident compen-sation fund A/c	3000	2000	1000
	2,76,000	**1,28,000**	**84,000**		**2,76,000**	**1,28,000**	**84,000**

Pushpa, Pratibha and Bhavna's Partnership Firm's Balance Sheet After Revaluation

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Pushpa	2,52,000		Land-building	1,80,000	
Pratibha	1,12,000		+ Increased	40,000	2,20,000
Bhavna	76,000	4,40,000	Machinery	1,60,000	
Non-current liabilities :					
12 % bank loan		1,00,000	– Decreased	60,000	1,00,000
Current liabilities :			Furniture	40,000	
Creditors	56,000		– Decreased	5000	35,000
– Decreased	6000	50,000	Investment	30,000	
Bills payable		6000	– Decreased	3000	27,000
Outstanding expenses		8000	**Current assets :**		
Bank overdraft		15,000	Debtors	1,50,000	
			– Bad debt reserve	15,000	1,35,000
			Bills receivables		7000
			Stock	30,500	
			– Decreased	2500	28,000
			Cash balance		63,000
			Income receivables		4000
		6,19,000			**6,19,000**

5. Goodwill

At the time of the reconstruction of a partnership firm, the problem of determining the value of 'goodwill' of the firm also arises. Meaning of goodwill, its nature, factors affecting its valuation and methods of valuation of goodwill are discussed at length in the previous chapter.

EXERCISE

1. Select appropriate option for each question :

(1) At the time of the reconstruction of a partnership firm .... is prepared.

(a) trading account (b) revaluation account

(c) realisation account (d) profit-loss appropriation account

(2) Where are the effects given when the value of assets increase at the time of the reconstruction of a partnership firm ?

(a) Addition in assets value and the revaluation account will be credited.

(b) Addition in assets value and the revaluation account will be debited.

(c) Subtract from assets value and the revaluation account will be credited.

(d) Subtract from assets value and the revaluation account will be debited.

(3) Where are the effects given when the value of liabilities decrease at the time of the reconstruction of a partnership firm ?

(a) Subtract from such liabilities and the revaluation account will be credited.

(b) Subtract from such liabilities and the revaluation account will be debited.

(c) Addition in such liabilities and the revaluation account will be credited.

(d) Addition in such liabilities and the revaluation account will be debited.

(4) Revaluation account is also known as ....

(a) Capital reserves account (b) Profit-loss appropriation account

(c) Profit-loss adjustment account (d) Profit-loss account

(5) In which ratio profit or loss of revaluation account is distributed between the partners ?

(a) Sacrifice ratio (b) Gain ratio

(c) New profit-loss ratio (d) Old profit-loss ratio

(6) Where is the accumulated profit as per the balance sheet is shown at the time of the reconstruction of a partnership firm ?

(a) Credit side of revaluation account

(b) Credit side of profit-loss appropriation account

(c) Credit side of partners' capital account

(d) Debit side of partners' capital account

(7) In the reconstruction of partnership firm, sacrifice = ...

(a) New profit-loss share $\times$ Old profit-loss share

(b) New profit-loss share $-$ Old profit-loss share

(c) Old profit-loss share $-$ New profit-loss share

(d) Old capital share $-$ New capital share

(8) In the reconstruction of a partnership firm, gain ratio = ...
- (a) New profit-loss share − Old profit-loss share
- (b) Old profit-loss share − New profit-loss share
- (c) New capital ratio − Old capital ratio
- (d) Old capital ratio − New capital ratio

(9) At the time of the reconstruction of a partnership firm, investments are shown at .... value in the balance-sheet after the revaluation.
- (a) Book value - market value
- (b) Cost value
- (c) Market value
- (d) Face value

(10) Where is the worker profit sharing fund shown in balance sheet at the time of the reconstruction of a partnership firm ?
- (a) Credit side of revaluation account
- (b) Liabilities of balance sheet after reconstruction
- (c) Credit side of partners' capital account
- (d) Debit side of partners' capital account

2. Answer the following questions in one sentence :

(1) What is reconstruction of a partnership firm ?
(2) What is revaluation account ?
(3) What is sacrifice ratio ?
(4) What is gain ratio ?
(5) How is the consolidated profit distributed ?
(6) In which account revaluation account's profit-loss is transferred ?
(7) At which value assets-liabilities are shown in the balance sheet after revaluation ?
(8) Which is the other name known for the revaluation account ?

3. Answer the following questions :

(1) Explain the meaning of a partnership reconstruction and the circumstances for reconstruction.
(2) Explain the sacrifice ratio with illustration.
(3) Explain the gain ratio with illustration.
(4) What is the revaluation of assets and liabilities ? Prepare specimen of revaluation account.
(5) Write specimen journal entries for revaluation in following circumstances :
- (a) When assets' value are increased and decreased.
- (b) When liabilities' value are increased and decreased.

(6) Write specimen journal entry for the distribution of reserve fund and accumulated profit of a partnership firm.
(7) Write journal for the following assets-liabilities revaluation :

Assets and Liabilities	Book value	Revaluation Value
Machinery	1,00,000	80,000
Land	3,00,000	5,00,000
Creditors	1,00,000	95,000
Outstanding expenses	–	3000
Income receivables	–	2000

(8) Difference between sacrifice ratio and gain ratio.

4. Amar and Akbar are the partners of a firm distributing profits-losses of the firm in equal proportion. They decided to change their profit-loss sharing proportion to 3:2 for future. Under this circumstances, calculate what sacrifice has been made by which partner.

5. Komal, Krupa and Karishma are the partners' of a partnership firm. They distribute profit-loss in the ratio of 3:2:1. All the partners have decided to change the profit-loss sharing ratio to 5:3:2 for future. From this information calculate the sacrifice ratio.

6. Sachin, Rahul and Rohit are the partners of a partnership firm. Profit-loss sharing ratio is 1:2:2 between them. All partners have decided to change profit-loss sharing ratio to 3:2:1. Calculate the sacrifice ratio of partners.

7. Dipak, Nilesh and Pratik are the partners of a partnership firm. Their profit-loss sharing ratio is 1:2:3, which is decided to change to 2:2:1 respectively for future. Under these circumstances, calculate what gain is received by which partners ?

8. Raju, Hasu and Sanju are the partners of a partnership firm. Their profit-loss sharing ratio is 5:4:3. All the partners have decided to change their profit-loss sharing ratio to 2:2:1. From this information find out gain the ratio.

9. Pravin, Mahendra and Arvind are the partners of a partnership firm. Their profit-loss sharing ratio is 5:2:2. All the partners have decided to change the profit-loss sharing ratio to $\frac{2}{9}$, $\frac{3}{9}$ and $\frac{4}{9}$ as new ratio. From this information find out what sacrifice has been made by which partner by using sacrifice formula.

From above information, by using gain formula find out what sacrifice has been made by which partner.

10. Rajesh, Pushpa and Pratibha are the partners of a "Shreenathji Traders" partnership firm. Their profit-loss sharing ratio is 2:3:1. Their firms' balance sheet as on 31-3-2017 is as under :

Shreenathji Traders' Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital : Rajesh	2,00,000		**Non-current assets :** Land	1,80,000
Pushpa	1,00,000		Building	3,00,000
Pratibha	2,00,000	5,00,000	Machinery	1,20,000
Non-current liabilities :			Investments	40,000
10 % bank loan		80,000	**Current assets :**	
Current liabilities : Creditors		1,70,000	Debtors	50,000
Bills payable		40,000	Bills receivables	10,000
Workers' profit sharing fund		29,000	Closing stock	35,000
Outstanding expenses		10,000	Bank balance	60,000
			Cash balance	30,000
			Income receivables	4000
		8,29,000		**8,29,000**

As on above date of the balance sheet, partners decided to change profit-loss sharing ratio to 1:1:1. On this date they decided to revalue the assets and liabilities for which information is as under :

(1) The value of land is to be increased upto ₹ 2,50,000 and building value is to be increased by ₹ 50,000.

(2) The value of machinery is to be decreased upto ₹ 80,000.

(3) The value of investments is to be reduced 30 %.

(4) Provision for bad debt reserve at 20 % and discount reserve of 5 % is to be made on debtors.

(5) The stock value of ₹ 15,000 is to be reduced by 20 %.

(6) An amount of ₹ 20,000 is not to be paid to creditors.

(7) ₹ 3000 for outstanding expenses and ₹ 2000 for income receivable are not recorded in the books.

Form the above information, write journal entries in the books of the partnership firm and also prepare the revaluation account.

11. Manju, Prabha and Meena are the partners of a partnership firm. Their profit-loss sharing ratio is 5:3:2. They want to change their profit-loss sharing ratio to 3:2:1. Therefore, they decided to revalue the assets-liabilities of the firm. From the following information prepare revaluation account and balance sheet after revaluation.

Manju, Prabha and Meena's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			**Non-current assets :**		
Manju	1,50,000		Land-building		1,00,000
Prabha	40,000		Machinery		50,000
Meena	30,000	2,20,000	Furniture		30,000
Current accounts :			Investments		50,000
Manju	10,000		**Current assets :**		
Prabha	20,000		Closing stock		40,000
Meena	9000	39,000	Debtors	25,000	
Non-current liabilities :			− Bad debt reserves	1000	24,000
12 % Bank loan		30,000	Bills receivables		5000
Current liabilities :			Cash balance		40,000
Creditors		40,000			
Bills payable		10,000			
		3,39,000			**3,39,000**

Additional information :

(1) The value of land-building is to be increased by 25 %.

(2) The value of furniture is to be reduced by 10 %.

(3) The value of machinery is to be kept 80 %.

(4) The book value of closing stock is ₹ 5000 more than its market value.

(5) Total amount of ₹ 2500 is to be kept for bad debts reserve on debtors.

(6) An amount of ₹ 3000 among the creditors is now not to be paid.

(7) Interest on bank loan for last three month is outstanding.

12. Alay and Sanket are the partners of a partnership firm. Profit-loss sharing ratio among them is 2:1. As on 31-3-2017, the following are the balances in the books of firm.

Profit-loss account (Debit balance)	₹ 18,000
Reserve fund	₹ 27,000
Workers' profit sharing fund	₹ 33,000
Workers' accident compensation fund	₹ 21,000

On the above date, Alay and Sanket decided to change their profit-loss sharing ratio to 1:1. A claim of ₹ 6000 is outstanding payable to workers against workers accident compensation fund. Pass journal entries showing distribution of accumulated profit-loss in the books of firm.

13. From the following information, pass necessary journal entries and prepare a revaluation account and a balance sheet after revaluation in the books of Sajan and Nirmi.

Sajan and Nirmi are the partners sharing profit-loss in the ratio of 5:3. Their firm's balance sheet as on 31-3-2017 is as under :

Balance Sheet as on 31-3-2017 of Sajan and Nirmi's Firm

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Sajan	80,000		Land-building		1,40,000
Nirmi	50,000	1,30,000	Machinery		80,000
General reserve		80,000	Furniture		30,000
Profit-loss account		48,000	Investments (Market value ₹ 18,000)		20,000
Non-current liabilities :			**Current assets :**		
12 % bank loan		70,000	Debtors	40,000	
Current liabilities :			– Bad debts reserve	1500	38,500
Creditors		32,000	Stock		31,500
Bills payable		10,000	Cash balance		30,000
		3,70,000			**3,70,000**

Partners decided to revalue the assets and liabilities of the firm and to distribute profit in the ratio of 1:1 for future.

(1) The value of land-building is to be increased by 10 %.

(2) The value of machinery and furniture is to be reduced by 40 %.

(3) ₹ 1000 bad debts reserve on debtors is not required.

(4) ₹ 1500 repairing expense is required for stock.

(5) ₹ 1500 out of creditors is now not to be paid which is to be recorded in the books.

(6) Outstanding expenses is ₹ 10,000 and income receivable is ₹ 2000.

(7) Investment is to be shown at its market value.

14. Dattu, Daya and Tarak are the partners of a partnership firm sharing profit-losses in the ratio of 4:3:2. Their firm's balance sheet as on 31-3-2017 is as under :

Balance sheet as on 31-3-2017 of Dattu, Daya and Tarak's firm

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			**Non-current assets :**		
Dattu	1,00,000		Land-building		90,000
Daya	50,000		Machinery		80,000
Tarak	50,000	2,00,000	Furniture		20,000
Reserves :			Investments		15,000
General reserve		36,000	**Current assets :**		
Workers accident compensation fund		23,000	Debtors	80,000	
Non-current liabilities :			− Bad debts	4000	
9 % bank loan		40,000		76,000	
Current-liabilities :			− Bad debts reserve	6000	70,000
Creditors		50,000	Bills receivable		5000
Bills payable		20,000	Stock		15,000
Bank overdraft		8000	Cash balance		55,000
			Profit-loss account		27,000
		3,77,000			**3,77,000**

As on above balance sheet date, partners changed profit-loss sharing ratio to 1:1:1 and the following revaluation account is prepared for the revaluation of assets and liabilities.

Revaluation Account

Dr Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	35,000	By Land-building A/c		10,000
To Furniture A/c	5000	By Creditors A/c		6000
To Investment A/c	3000	By Income receivables A/c		3000
To Bad debts reserve A/c	10,000	By Partners' capital A/c (Loss) :		
To Stock A/c	3000	Dattu	18,000	
To Outstanding expenses A/c	2000	Daya	13,500	
To Bank overdraft interest A/c	1500	Tarak	9000	40,500
	59,500			**59,500**

A claim of ₹ 5000 was against workers accident compensation fund.

From the above information write journal entries and prepare partners' capital account and balance sheet after revaluation.

●

5

Admission of a Partner

1. Introduction

Admission of a partner means reconstitution of the partnership. With the admission of a partner, the existing agreement comes to an end and a new agreement among all the partners including the new partner comes into existence. The capital contribution by the new partner, his share of profit, goodwill and other conditions are agreed upon. The new partner, on joining becomes liable for the liabilities of the firm and he is also entitled to have a share in the assets and profits of the firm.

Section 31 of the Indian Partnership Act, 1932 provides that a new partner shall not be admitted in the firm without the consent of all the existing partners, unless it has been agreed otherwise by the partners in the partnership agreement.

A new partner may be admitted in a continuing firm because of the following reasons :

(1) When the continuing firm needs additional capital

(2) When the continuing firm requires additional managerial ability

(3) When any continuing partner retires or dies

(4) When skilled and efficient employees of the firm need to continued in the firm, therefore he is admitted by the firm as a partner

(5) For the distribution of risk of the partnership firm

The share of future profits which the incoming partner receives is equal to the sacrifice of profit made by the existing partners of the firm. The new partner compensates the partner or partners who sacrifice their share in profits. The amount he pays against this sacrifice is called goodwill or premium for goodwill. Besides the goodwill or premium for goodwill, he also brings in capital to get right in the assets of the firm and brings goodwill to get right in the profits. Amount of capital remains in the firm while amount of goodwill is distributed among the old partners in their sacrificing ratio.

2. Effects of Admission of a New Partner

The effects of admission of a new partner are as follows :

(1) The old partnership comes to an end and new partnership comes into existence.

(2) New partner becomes entitled to share future profits of the firm and therefore the combined share of the old partners' profit gets reduced.

(3) New partner contribnutes an agreed amount of capital in cash or in kind and acquires right on the assets of the firm.

(4) Balances of accumulated profits and losses, reserves and fictitious assets appearing in the books on the date of admission is distributed to the old partners in their old profit sharing ratio.

(5) Assets are revalued and liabilities are reassessed and net change is adjusted in the old partners' capital accounts.

(6) The goodwill of the firm is revalued and new partner contributes his share of goodwill in a cash or kind and its accounting effect is given.

(7) Accounting effect is also given for maintaining agreed capital in the new firm among the old partners, if decided in the new partnership agreement.

Thus, at the time of admission of a new partner following adjustments are required to be made :

(1) Calculation of new profit and loss sharing ratio and old partners' sacrificing ratio.

(2) Accounting effects relating to goodwill.

(3) Accounting effect of profits/losses arising from revaluation of assets and reassessement of liabilities.

(4) Accounting effect of accumulated profits, losses and reserves

(5) Adjustment of change in capital.

Let us now discuss each of the above cases :

3. Change in Profit Sharing Ratio

The new partner acquires some share out of the future profit of the firm, which is sacrificed by the old partners. Consequently new profit sharing ratio of all the partners and sacrificing ratio of old partners come into existence after the admission of a new partner. Thus following two ratios are required to be calculated at the time of admission of a new partner.

(A) Calculation of new profit-loss sharing ratio

(B) Calculation of sacrificing ratio

Now let us discuss the computation of both the proportion in detail.

Calculation of new profit-loss sharing ratio and sacrificing ratio :

New profit sharing ratio means ratio in which all partners including the new partner decide to share future profit or loss of the firm.

New profit-loss sharing ratio can be calculated as per the following circumstances :

(1) When sacrificing share or sacrificing ratio of old partners is not given (In other words, when old ratio of old partners and profit share to be given to the old partner is given) :

When old profit-loss sharing ratio of old partners and profit share of new partner is given it is asumed that the remaining profit after giving share in profit to new partner will be distributed among old partners in their old profit-loss sharing ratio.

Illustration 1 : A and B are the partners in a firm sharing profit & loss in the ratio of 3:2. C is admitted for $\frac{1}{4}$th share in the profit. Calculate the new profit sharing ratio.

Ans. : Old sharing ratio of A and B = 3:2

Let the total share of profit = 1

C's share = $\frac{1}{4}$, after giving $\frac{1}{4}$th share to C,

Remaining share of A and B = Total profit − Share of new partner

$= 1 - \frac{1}{4}$

$= \frac{4-1}{4}$

$= \frac{3}{4}$

Remaining share for A and B is $\frac{3}{4}$ which is to be distributed in their old sharing ratio 3:2.

New share of old partners = Remaining share of profit × Share in old ratio

A's new share = $\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$

B's new share = $\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$

C's new share = $\frac{1}{4}$, Making denominator equal $\frac{1}{4} \times \frac{5}{5} = \frac{5}{20}$

∴ New profit sharing ratio of A, B and C = 9:6:5

Explanation : Here it is assumed that the old partners will maintain their relative old ratio even after the admission of a new partner. It means profit share to be given to the new partners will be sacrificed by the old partners in their old ratio only. Therefore, Relative old ratio = Sacrificing ratio = New ratio.

Sacrificing ratio of old partners can be calculated in illustration 1 as under :

	A		B		C
Old ratio	3	:	2	:	−
Old share	$\frac{3}{5}$	:	$\frac{2}{5}$	:	−
New ratio	9	:	6	:	5
New share	$\frac{9}{20}$	:	$\frac{6}{20}$	:	$\frac{5}{20}$

Sacrifice = Old share − New share

$A = \frac{3}{5} - \frac{9}{20} = \frac{12-9}{20} = \frac{3}{20}$

$B = \frac{2}{5} - \frac{6}{20} = \frac{8-6}{20} = \frac{2}{20}$

So, sacrificing ratio of A and B = 3:2.

Note : When sacrificing share or sacrificing ratio is not given and the old ratio of old partners and new partners' share is given, relative old ratio of old partners will be their sacrificing ratio.

(2) When the old ratio of old partners, share of new partner and the new ratio of old partners are given :

Illustration 2 : A and B are the partners of a firm sharing profit in the ratio of 2:1. C is admitted for $\frac{1}{5}$ share in the profit. In future, the profit sharing ratio of A and B would be 2:3.

Calculate the new profit sharing ratio.

Ans. : Assume that total share of profit = 1

Remaining share for A and B = Total share − New partners' share

$= 1 - \frac{1}{5}$

$= \frac{5-1}{5}$

$= \frac{4}{5}$

Remaining share of A and B is $\frac{4}{5}$ which will be distributed by A and B in their new ratio, that is 2:3.

New share of old partners = Remaining share of profit × Share in new ratio

A's new share = $\frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$

B's new share = $\frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$

C's new share = $\frac{1}{5}$, Making denominator equal, $\frac{5}{25}$

∴ New profit-loss sharing ratio of A, B and C = 8:12:5

(3) **When a new partner acquires specific share from old partners :**

When sacrifice made by old partners is given, new share of old partners can be obtained by substracting sacrificing share from old share.

Thus, new share of old partners = Old share − Sacrifice

Illustration 3 : A and B are the partners in a firm sharing profits and losses in the ratio of 4:3. They admitted C as a new partner with $\frac{1}{7}$ share. C obtained $\frac{2}{21}$ share from A, and $\frac{1}{21}$ from B. Calculate the new profit sharing ratio.

Ans. : Old profit sharing of A and B = 4:3 means $\frac{4}{7} : \frac{3}{7}$

Share of C = $\frac{1}{7}$

C obtains $\frac{2}{21}$ share from A and $\frac{1}{21}$ share from B.

∴ A's sacrifice = $\frac{2}{21}$ (from their own share)

B's sacrifice = $\frac{1}{21}$ (from their own share)

New share = Old share − Sacrifice

A's new share = $\frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$

B's new share = $\frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$

C's new share = $\frac{1}{7}$, Making denominator equal, $\frac{3}{21}$

∴ New profit-loss sharing ratio of A, B and C = 10:8:3

Explanation : (1) C's $\frac{1}{7}$th share must be equal to the sacrifice of A and B. It means,

C's share = A's sacrifice + B's sacrifice

$$= \frac{2}{21} + \frac{1}{21}$$

$$= \frac{3}{21}$$

$$= \frac{1}{7}$$

(2) A's sacrifice is $\frac{2}{21}$ and B's sacrifice is $\frac{1}{21}$. If the sacrificing ratio of A and B is to be ascertained, it will be $\frac{2}{21} : \frac{1}{21}$ it means 2:1.

Thus, sacrifice and sacrificing ratio are two different things. In the above illustration, sacrificing ratio is given instead of sacrifice of A and B, means it is given that A and B will sacrifice C's $\frac{1}{7}$th share in the ratio of 2:1, it is first necessary to calculate the sacrifice of A and B.

Sacrifice = New partners' share × Sacrificing ratio of old partners

A's new share $= \frac{1}{7} \times \frac{2}{3} = \frac{2}{21}$

B's new share $= \frac{1}{7} \times \frac{1}{3} = \frac{1}{21}$

New profit-loss sharing ratio can be ascertained only after calculating sacrificing share.

New share = Old share − Sacrifice

A's new share $= \frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$

B's new share $= \frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$

C's new share $= \frac{1}{7}$, Making denominator equal, $\frac{3}{21}$

$\therefore$ New profit-loss sharing ratio of A, B and C = 10:8:3

(4) **When sacrificing ratio of old partners is given :**

When sacrificing ratio of old partners is given, sacrificing share of old partners is to be ascertained first with the help of the following formula :

Sacrifice of old partners = Share of new partner × Sacrificing ratio of old partner

After calculating the sacrifice of old partners, new profit-loss sharing ratio of all partners is to be ascertained with the help of the following formula :

New share = Old share − Sacrifice

Illustration 4 : A and B are the partners of a firm sharing profits and loss in the ratio of 5:3. They admit C, a new partner, who acquires $\frac{1}{4}$th share in the firm. C obtains his share from A and B in the ratio of 3:1. Find out new profit-loss sharing ratio.

Ans. : Old profit sharing ratio of A and B = 5:3 means $\frac{5}{8} : \frac{3}{8}$.

C's share $= \frac{1}{4}$, C obtains his share from A and B in the ratio of 3:1.

Sacrifice of old partners = New partners' share × Sacrificing ratio of old partner

$\therefore$ A's sacrifice $= \frac{1}{4} \times \frac{3}{4} = \frac{3}{16}$

B's sacrifice $= \frac{1}{4} \times \frac{1}{4} = \frac{1}{16}$

New share of old partners = Old share − Sacrifice

$\therefore$ A's new share $= \frac{5}{8} - \frac{3}{16} = \frac{10-3}{16} = \frac{7}{16}$

B's new share $= \frac{3}{8} - \frac{1}{16} = \frac{6-1}{16} = \frac{5}{16}$

and C's new share $= \frac{1}{4}$, Making denominator equal, $\frac{4}{16}$

$\therefore$ New profit-loss sharing ratio of A, B and C = 7:5:4

(5) When old partners sacrifice particular fraction of their share in favour of the new partner :

Illustration 5 : A and B are partners. They admit C as a new partner. 'A' sacrifices $\frac{1}{5}$th of his share and B sacrifices $\frac{1}{4}$th of his share in favour of C. Calculate new profit and loss sharing ratio and sacrificing ratio.

Ans. : Old profit sharing ratio of A and B = 1:1 means $\frac{1}{2} : \frac{1}{2}$

A sacrifices $\frac{1}{5}$th of his share to C

$\therefore$ A's sacrifice = A's old share × Share of his sacrifice

$\therefore$ A's sacrifice $= \frac{1}{2} \times \frac{1}{5} = \frac{1}{10}$

B sacrifices $\frac{1}{4}$th of his share to C.

$\therefore$ B's sacrifice = B's old share × Share of his sacrifice

$\therefore$ B's sacrifice $= \frac{1}{2} \times \frac{1}{4} = \frac{1}{8}$

New share = Old share − Sacrifice

$\therefore$ A's new share $= \frac{1}{2} - \frac{1}{10} = \frac{5-1}{10} = \frac{4}{10}$

B's new share $= \frac{1}{2} - \frac{1}{8} = \frac{4-1}{8} = \frac{3}{8}$

A and B sacrifice some of their share in favour of C. Therefore share of A and B will reduce, which is received by C. Sacrifice of A and B will be deducted from their old share and sacrifice of A and B will be received by C.

C's new share $= \frac{1}{10} + \frac{1}{8} = \frac{4+5}{40} = \frac{9}{40}$

$\therefore$ New profit-loss sharing ratio of A, B and C $= \frac{4}{10} : \frac{3}{8} : \frac{9}{40}$; Making denominator equal,

$= \frac{16}{40} : \frac{15}{40} : \frac{9}{40} = 16 : 15 : 9$

Now, ascertainment of sacrificing ratio of A and B,

$\therefore$ A's sacrifice $= \frac{1}{10}$

B's sacrifice $= \frac{1}{8}$

$\therefore$ Sacrificing ratio of A and B $= \frac{1}{10} : \frac{1}{8}$; Making denominator equal $= \frac{4}{40} : \frac{5}{40}$

$= 4 : 5$

(6) When old partners sacrifice some share out of their share in favour of the new partner :

Illustration 6 : A and B are the partners of a firm sharing profit-loss in the ratio of 2:1. C is admitted as a new partner from 1-4-2017.

'A' sacrifices $\frac{1}{12}$ from his share while 'B' sacrifices $\frac{1}{6}$ from his share to C.

Determine the sacrificing ratio and the new profit-loss sharing ratio.

Ans. : Sacrificing ratio :

A's sacrifice $= \frac{1}{12}$ and B's; sacrifice $= \frac{1}{6}$. Making denominator equal, $\frac{1}{12}$ and $\frac{2}{12}$.

$\therefore$ Sacrificing ratio is 1:2

C's share (A's sacrifice + B's sacrifice)

$\therefore \quad \frac{1}{12} + \frac{1}{6} = \frac{1}{4}$

New profit-loss sharing ratio :

$$\left.\begin{array}{ll} \text{A's old share } \frac{2}{3} - \text{share of sacrifice } \frac{1}{12} = \frac{8-1}{12} & = \frac{7}{12} \\ \text{B's old share } \frac{1}{3} - \text{share of sacrifice } \frac{1}{6} = \frac{2-1}{6} & = \frac{1}{6} \\ \text{C's share} \qquad\qquad\qquad\qquad\qquad\quad = \frac{1}{4} & = \frac{1}{4} \end{array}\right] \text{Making denominator equal,}$$

New ratio of A, B and C = 7 : 2 : 3

(7) When one partner from old partners retains his old share after the admission of a new partner :

Illustration 7 : A, B and C are the partners of a firm. Their profit sharing ratio is $\frac{1}{2}$, $\frac{3}{10}$ and $\frac{1}{5}$ respectively. They admit D, as a new partner for $\frac{1}{6}$th share. C would retain his original share after D's admission. Calculate new profit-loss sharing ratio.

Ans. : Old ratio of A, B and C $= \frac{1}{2} : \frac{3}{10} : \frac{1}{5}$

$= 5:3:2$ (Making denominator equal)

New partner D's share $= \frac{1}{6}$

After admission of D, share of C $= \frac{1}{5}$ will be maintained

$\therefore$ Remaining share for A and B = Total share − C's share − D's share

$\therefore$ Remaining share for A and B $= 1 - \frac{1}{5} - \frac{1}{6}$ or $1 - \left(\frac{1}{5} + \frac{1}{6}\right)$

$= \frac{30-6-5}{30} = \frac{19}{30}$ or $\frac{30-(6+5)}{30} = \frac{19}{30}$

A and B will acquire remaining share $\frac{19}{30}$ in their relative ratio of 5:3.

$\therefore$ A's new share $= \frac{19}{30} \times \frac{5}{8} = \frac{95}{240}$

B's new share $= \frac{19}{30} \times \frac{3}{8} = \frac{57}{240}$ (Making denominator equal)

C's new share $= \frac{1}{5} = \frac{48}{240}$

D's new share $= \frac{1}{6} = \frac{40}{240}$

$\therefore$ New ratio of profit and loss = 95 : 57 : 48 : 40

(8) When sacrifice made by some old partners is given and sacrifice made by other old partners is not given :

Illustration 8 : A and B are partners sharing in the ratio of 3:2. They admitted C for $\frac{1}{5}$th of the profits. Out of which he takes $\frac{1}{20}$th from A and remaining share from B. Calculate new profit and loss sharing ratio.

Ans. : B's sacrifice = C's share $-$ A's sacrifice

(C's share is $\frac{1}{5}$ out of which he acquires $\frac{1}{20}$ from A and remaining B's sacrifice.)

$= \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$

New share = Old share $-$ Sacrifice

$\therefore$ A's new share $= \frac{3}{5} - \frac{1}{20} = \frac{12-1}{20} = \frac{11}{20}$

B's new share $= \frac{2}{5} - \frac{3}{20} = \frac{8-3}{20} = \frac{5}{20}$

C's new share $= \frac{1}{5} = \frac{4}{20}$

$\therefore$ New ratio of profit and loss = 11 : 5 : 4

Illustration 9 : A and B are the partners in a firm sharing profit-loss in the ratio of 4:1. C is admitted as a new partner for $\frac{1}{4}$th share in the firm. 'A' sacrificed $\frac{1}{4}$th of his share in favour of C. While 'B' sacrificed remaining share of C's share. Calculate new profit & loss sharing ratio.

Ans. : Old profit sharing ratio of A and B = 4:1 or $\frac{4}{5} : \frac{1}{5}$

Share of new partner C $= \frac{1}{4}$

'A' sacrificed $\frac{1}{4}$th of his share in favour of C.

$\therefore$ A's sacrifice $= \frac{4}{5} \times \frac{1}{4} = \frac{4}{20} = \frac{1}{5}$

(C's share is $\frac{1}{4}$, C receives $\frac{1}{5}$ from A, So, remaining share of $\frac{1}{4}$th, he will received from B)

$\therefore$ B's sacrifice = C's share $-$ A's sacrifice

$= \frac{1}{4} - \frac{1}{5} = \frac{5-4}{20} = \frac{1}{20}$

New share = Old share $-$ Sacrifice

$\therefore$ A's new share $= \frac{4}{5} - \frac{1}{5} = \frac{3}{5}$

B's new share $= \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$

C's new share $= \frac{1}{4}$

$\therefore$ New profit-loss sharing ratio $= \frac{3}{5} : \frac{3}{20} : \frac{1}{4}$

$= \frac{12}{20} : \frac{3}{20} : \frac{5}{20}$

$= 12 : 3 : 5$

4. Accounting Treatment of Goodwill as per Accounting Standard-26

Goodwill is an intangible asset. When a firm earns higher profit than normal profit, which is earned by its competitors, super profit arises. Goodwill arises due to the super profit earned by the firm. Goodwill arises in the firm because of the efforts made by old partners in past. On the admission of a new partner, old partners sacrifice some of their profit share in favour of the new partner. To compensate the profit share acquired by the new partner, he is required to give his share in goodwill of the firm, which is called as premium for goodwill. Premium for goodwill is distributed among the old partners in the sacrificing ratio.

Sometimes, on the admission of a new partner :

(i) If profit sharing ratio of an old partner does not change, even after the admission of a new partner, it means that he does not sacrifice and therefore he will not receive any amount for goodwill.

(ii) If new profit share of an old partner is more than the old profit share, he gains some profit share. On the other hand, other old partner sacrifices in favour of new partner as well as old partner. Therefore the old partner who gains will have to give goodwill by his share of gain which is calculated by taking new partners' share in goodwill as base. The sacrificing partners' capital account is credited and gaining partners' capital account is debited.

Now, let us discuss accounting treatments of goodwill on the admission of a new partner.

Before studying accounting treatment of goodwill at the time of the admission of a new partner, it is very important to refer , the accounting standard 26. Accounting standard for intangible assets, issued by the Institute of Chartered Accountants of India.

According to para 35 of accounting standard-26, ‘‘Internally generated goodwill should not be recognised as an asset.’’ Which means that internally generated goodwill should not be shown in the books of accounts.

As per para 36 of this Accounting Standard, ‘‘Internally generated goodwill is not recognised as an asset because it is not an identifiable resource.’’ (i.e. It is not separable nor does it arise from contractual or other legal rights.) It is controlled by the entity that can be measured reliably at cost.)

Reference : resource.cdn.icai.org/27292 abs-as-26 pdf.

Thus as per AS-26, internally generated goodwill does not arise due to a contract or any legal rights which are controlled by the firm and its cost can be decided specifically. Thus AS-26 specifies clearly that goodwill should be shown as an asset in the books only when some consideration is paid for goodwill. Internally generated goodwill should not be shown in the books of accounts.

At the time of the admission of a partner, goodwill is valued on the basis of internal resources of the firm like profit, capital employed; expected rate of return etc. Therefore, goodwill can not be shown as an asset in the balance sheet of the firm. Looking to this fact, old goodwill appearing in the balance sheet of the old firm must be written off among old partners in their old profit sharing ratio because old partnership is dissolved and a new partnership is reconstituted (reconstructed).

From the accounting point of view goodwill is a compensation for the profit sacrificed by old partners in favour of new partner. Therefore new partners' share in goodwill is received by old partners in their sacrificing ratio, and if any goodwill appears in the balance sheet of the old firm it must be written off in old profit-loss sharing ratio among the old partners.

From the accounting point of view, there may be different situations relating to treatment of goodwill. These are :

(1) When goodwill is paid privately by the new partner.

(2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business.

(3) When premium of goodwill is brought in cash by the new partner and it is withdrawn by the old partners fully or partly.

(4) When the new partner does not bring his share in goodwill in cash.

(5) When the new partner brings his share in goodwill partly in cash.

(6) When valuation of goodwill is made on the basis of partners' capital (hidden goodwill)

Let us study all these different situations related to the treatment of goodwill in detail.

(1) When the goodwill premium is paid privately by the new partner :

When the goodwill premium is paid privately by the new partner to the old partners, no entry is recorded in the books of accounts of the firm.

(2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business :

The amount of goodwill brought in cash or kind by the new partner is shared by the sacrificing partners (old partners) in their sacrificing ratio.

Accounting entries :

(1) When premium for goodwill brought in cash by the new partner :

Cash/Bank A/c ..... Dr

To Premium for goodwill A/c

(2) (i) **When premium for goodwill brought in by the new partner i.e. personal land, building, motor car brought in firm as a goodwill :**

Land and building A/c ....Dr

Motor car A/c ....Dr

Other assets A/c ....Dr

To Premium for goodwill A/c

Note : Instead of above two entries, we can pass one combined entry :

Cash/Bank A/c ....Dr

Land/Building A/c ....Dr

Motor car A/c ....Dr

Other assets A/c ....Dr

To Premium for goodwill A/c

(ii) **For the distribution of premium for goodwill among the partners in their sacrificing ratio :**

Premium for goodwill A/c ....Dr

To Old partners capital/current A/c

OR

If out of old partners, any partner gains in new profit-loss sharing ratio compared to old profit-loss sharing ratio, i.e. if sacrifice of an old partner is negative, he is also required to give goodwill by his share of gain to other sacrificing partners. Under this situation following journal entry is passed.

Premium for goodwill A/c ....Dr

Old partners' (gaining partners') capital/current A/c ....Dr

To Old partners' (sacrificing partners') capital/current A/c

Note : Goodwill appearing in the books (Balance sheet) of old partners is written off among the old partners in their old profit-loss sharing ratio for which following journal entry is passed :

Old partners' capital/current A/c ....Dr

To Goodwill A/c (shown in old balance sheet)

Note : (1) In every situation of accounting treatment of goodwill, old goodwill shown in the books of old firm is written off by debiting old partners capital / current accounts because old partnership comes to an end and new goodwill is valued for which accounting treatment is given as per AS-26.

(2) If it is specifically mentioned that capital accounts of partners are maintained on fixed capital accounts method, goodwill should be transferred to partners' current account. If it is not mentioned specifically, it is assumed that the partners maintain their capital accounts by fluctuating capital method and the effect of goodwill should be given to partners' capital account only.

When sacrificing share or sacrificing ratio of old partners is not given (old ratio of old partners and new partners' profit share are given) :

Illustration 10 : Aahna and Amina are partners sharing profit-loss in the ratio of 3:2. They admitted Aman as a new partner for $\frac{1}{4}$th share. The goodwill of the firm is valued at ₹ 1,20,000. Aman has to bring ₹ 50,000 as capital and his share of premium for goodwill in cash. Pass journal entries regarding goodwill.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		80,000	
	To Aman's capital A/c			50,000
	To Premium for Goodwill A/c			30,000
	[Being cash brought by Aman for capital and for premium for goodwill.]			
(2)	Premium for goodwill A/c Dr		30,000	
	To Aahna's capital A/c			18,000
	To Amina's capital A/c			12,000
	[Being premium for goodwill distributed by old partners in their sacrificing ratio of 3:2.]			

Explanation (1) New profit-loss sharing ratio :

Suppose total share of profit = 1

Share of Aman = $\frac{1}{4}$

$\therefore$ Remaining share of Aahna and Amina = $1 - \frac{1}{4} = \frac{4-1}{4} = \frac{3}{4}$

Remaining share of $\frac{3}{4}$ is distributed between Aahna and Amina in the ratio of 3:2.

$\therefore$ New share of Aahna = $\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$

New share of Amina = $\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$

New share of Aman = $\frac{1}{4} = \frac{5}{20}$

$\therefore$ New profit-loss sharing ratio = 9:6:5

(2) Sacrificing ratio :

Sacrifice = Old share − New share

Aahna = $\frac{3}{5} - \frac{9}{20} = \frac{12-9}{20} = \frac{3}{20}$

Amina = $\frac{2}{5} - \frac{6}{20} = \frac{8-6}{20} = \frac{2}{20}$

$\therefore$ Sacrificing ratio = 3:2

Note : When new sharing ratio or sacrificing ratio is not given, sacrificing ratio will be the old profit sharing ratio.

Share of goodwill of Aman = ₹ 1,20,000 $\times \frac{1}{4}$

= ₹ 30,000

Capital of Aman ₹ 50,000 and goodwill ₹ 30,000, total cash ₹ 80,000.

(3) Distribution of premium for goodwill in sacrificing ratio :

Aahna : ₹ 30,000 $\times \frac{3}{5}$ = ₹ 18,000

Amina : ₹ 30,000 $\times \frac{2}{5}$ = ₹ 12,000

When old ratio of old partners, new partners' share and profit-loss sharing ratio of all partners are given.

Illustration 11 : Aayush and Aaditya are the partners sharing profit and loss in the ratio of 5:3. They admitted Parth as a new partner in the firm for $\frac{1}{4}$th share. Parth brings land and building worth ₹ 1,00,000, motor car ₹ 50,000 and cash ₹ 30,000 for his capital and premium for goodwill. Goodwill of the firm is valued ₹ 1,60,000. The new profit and loss ratio is decided at 2:1:1. Give necessary journal entry.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land and building A/c Dr		1,00,000	
	Motor car A/c Dr		50,000	
	Cash A/c Dr		30,000	
	To Parth's capital A/c			1,40,000
	To Premium for Goodwill A/c			40,000
	[Being Parth brought in the firm land-building, motor car and cash as capital and premium for goodwill.]			
(2)	Premium for goodwill A/c Dr		40,000	
	To Aayush's capital A/c			20,000
	To Aaditya's capital A/c			20,000
	[Being premium for goodwill distributed between old partners in their sacrificing ratio 1:1.]			

Explanation (1) Sacrificing ratio :

Old profit-loss sharing ratio of Aayush and Aaditya = 5:3

New profit-loss sharing ratio of Aayush, Aaditya and Parth = 2:1:1

Sacrifice = Old share − New share

Aayush $= \frac{5}{8} - \frac{2}{4} = \frac{5-4}{8} = \frac{1}{8}$

Aaditya $= \frac{3}{8} - \frac{1}{4} = \frac{3-2}{8} = \frac{1}{8}$

∴ Sacrificing ratio = 1:1

(2) Share of Parth in goodwill :

Parth's share in goodwill = ₹ 1,60,000 $\times \frac{1}{4}$ = ₹ 40,000

(3) Capital brought by Parth :

Parth's share in capital =	Land and building	₹ 1,00,000
	Motor car	₹ 50,000
	Cash	₹ 30,000
	Total	₹ 1,80,000
Less : Amount of premium for goodwill brought by Parth		₹ 40,000
∴ Capital brought by Parth		₹ 1,40,000

(4) Distribution of premium for goodwill in sacrificing ratio :

Aayush : ₹ 40,000 $\times \frac{1}{2}$ = 20,000

Aaditya : ₹ 40,000 $\times \frac{1}{2}$ = 20,000

When old partners sacrifice some part of their share :

Illustration 12 : X and Y are the partners of a firm. They admitted Z as a new partner on 1 April, 2016. X sacrificed $\frac{1}{2}$ of his share and Y sacrificed $\frac{3}{4}$th of his share in favour of Z. X and Z maintain their accounts as per fixed capital method. Z brought in ₹ 60,000 for his capital and ₹ 20,000 for his share of premium for goodwill in cash. Goodwill appeared in the books of the firm at ₹ 30,000 as on 31-3-2016. Give necessary journal entries at the time of Z's admission.

Ans. : **Journal Entries**

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	X's current A/c Dr		15,000	
	Y's current A/c Dr		15,000	
	To Goodwill A/c			30,000
	[Being old goodwill written off among old partners in their old profit-loss ratio.]			
(2)	Cash A/c Dr		80,000	
	To Z's capital A/c			60,000
	To Premium for Goodwill A/c			20,000
	[Being Z brought cash as goodwill and capital.]			
(3)	Premium for goodwill A/c Dr		20,000	
	To X's current A/c			8000
	To Y's current A/c			12,000
	[Being premium for goodwill distributed between X and Y in their sacrificing ratio.]			

Explanation : Sacrificing ratio :

Old sharing ratio of X and Y = 1:1 (X sacrificed $\frac{1}{2}$ this share while Y sacrificed $\frac{3}{4}$ his share)

Sacrifice of X $= \frac{1}{2} \times \frac{1}{2} = \frac{1}{4} \times \frac{2}{2} = \frac{2}{8}$ (Making denominator equal)

Sacrifice of Y $= \frac{1}{2} \times \frac{3}{4} = \frac{3}{8}$

$\therefore$ Sacrificing ratio of X and Y $= \frac{1}{4} : \frac{3}{8} = 2:3$ Goodwill will be distributed between X and Y in this ratio.

When an old partner gains due to the admission of a new partner :

Illustration 13 : X and Y are the partners in a firm sharing profit and loss in the ratio of 4:3. They admitted Z as a new partner on 1 April 2016. At the time of admission of Z, balance of capital of X and Y are ₹ 30,000 and ₹ 40,000 respectively. They decide their new profit sharing ratio at 2:4:1. Z brought ₹ 50,000 as his capital and share of his goodwill in cash. On the date of admission of Z, goodwill of the firm was valued at ₹ 84,000. Goodwill appeared in the balance sheet of X and Y at ₹ 35,000.

Pass necessary journal entries and prepare all three partners' capital accounts.

Ans. :

Journal Entries

Date/No.	Particulars		L.F.	Debit (₹)	Credit (₹)
(1)	X's capital A/c	Dr		20,000	
	Y's capital A/c	Dr		15,000	
	To Goodwill A/c				35,000
	[Being old goodwill is written off among old partners A and B in their old ratio.]				
(2)	Cash/Bank A/c	Dr		62,000	
	To Z's capital A/c				50,000
	To Premium for goodwill A/c				12,000
	[Being Z, the new partner brought his capital and goodwill in cash.]				
(3)	Premium for goodwill A/c	Dr		12,000	
	Y's capital A/c	Dr		12,000	
	To X's capital A/c				24,000
	[Being the goodwill premium of Z and share in goodwill of Y's gain debited to their capital accounts and credited to X's capital account.]				

Capital Accounts of Partners

Dr Cr

Date	Particulars	X (₹)	Y (₹)	Z (₹)	Date	Particulars	X (₹)	Y (₹)	Z (₹)
1-4-16	To Goodwill A/c	20,000	15,000	–	1-4-16	By Balance b/d	30,000	40,000	–
1-4-16	To X's capital A/c	–	12,000	–	1-4-16	By Cash A/c	–	–	50,000
1-4-16	To Balance c/f	34,000	13,000	50,000	1-4-16	By Premium for goodwill A/c	12,000	–	–
					1-4-16	By Y's capital A/c	12,000	–	–
		54,000	**40,000**	**50,000**			**54,000**	**40,000**	**50,000**

Old and new profit-loss sharing ratios are given. Premium for goodwill is distributed in sacrificing ratio by deducting new share from old share.

Due to the admission of Z, sacrifice of X is $\frac{2}{7}$, while Y gains instead of sacrifice. Therefore Y's share in goodwill is debited to his capital account. Premium for goodwill and Y's share in goodwill, both will be credited to X's capital account.

Explanation (1) Sacrificing ratio :

Old profit sharing ratio of X and Y = 4:3

New profit sharing ratio of X, Y and Z = 2:4:1

Sacrifice = Old share − New share

X's sacrifice = $\frac{4}{7} - \frac{2}{7} = \frac{2}{7}$

Y's sacrifice = $\frac{3}{7} - \frac{4}{7} = -\frac{1}{7}$ (ratio of gain)

(2) Distribution of premium for goodwill :

Z's share in goodwill = ₹ 84,000 × $\frac{1}{7}$ = 12,000

Y gains in new profit-loss ratio, therefore Y will also give goodwill to X by his share of gain.

Goodwill payable by Y = 84,000 × $\frac{1}{7}$ = 12,000

(3) Goodwill receivable by X :

X's sacrifice = $\frac{2}{7}$

Goodwill receivable by X = $\frac{2}{7}$ × 84,000 = 24,000

(4) Old goodwill will be written off among old partners in their old ratio :

X : ₹ 35,000 × $\frac{4}{7}$ = 20,000

Y : ₹ 35,000 × $\frac{3}{7}$ = 15,000

(3) When new partner brings his share of goodwill premium in cash and it is withdrawn by the old partners :

When premium of goodwill is brought in cash by a new partner and it is withdrawn by the old partners, following journal entries are passed in the books of the firm :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When old goodwill of the firm appears in the balance sheet of the firm, it is written off between old partners' capital A/c in their old profit sharing ratio :			
	Old partners' capital A/c Dr		....	
	To Goodwill A/c			....
	[Being old goodwill written off between old partner in their old profit sharing ratio.]			
(2)	When new partner brings his share of goodwill and his capital in cash :			
	Cash A/c Dr		....	
	To New partners' capital A/c			....
	To Premium for goodwill A/c			....
	[Being new partner brought cash for his share of goodwill and capital.]			

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(3)	When premium for goodwill is distributed between old partners in their sacrificing ratio :			
	Premium for goodwill A/c Dr		....	
	To Old partners' capital A/c			....
	[Being premium for goodwill distributed between old partners' in their sacrificing ratio.]			
(4)	When premium for goodwill fully or partly withdrawn by old partners in cash :			
	Old partners' capital A/c Dr		....	
	To Cash A/c			....
	[Being old partners' withdrew their share of premium for goodwill fully or partly in cash.]			

Illustration 14 : A, B and C are partners sharing profit and losses in the ratio of 3:2:1. They admitted D as a new partner. D brought ₹ 80,000 as capital and ₹ 60,000 as goodwill in cash. New profit sharing ratio of A, B, C and D is decided at 4:3:2:3. Old partners withdrew 50 % of their share of goodwill in cash. Pass necessary journal entries. Partners maintain their capital accounts by fixed capital method.

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		1,40,000	
	To D's capital A/c			80,000
	To Premium for goodwill A/c			60,000
	[Being D brought his share of goodwill and capital in cash.]			
(2)	Premium for goodwill A/c Dr		60,000	
	To A's current A/c			40,000
	To B's current A/c			20,000
	[Being premium for goodwill is distributed between old partners in their sacrificing ratio.]			
(3)	A's current A/c Dr		20,000	
	B's current A/c Dr		10,000	
	To Cash A/c			30,000
	[Being 50 % goodwill withdrawn by old partners in cash.]			

Explanation :

Old and new profit-loss sharing ratio is given, therefore goodwill will be distributed in the sacrificing ratio by deducting new share from old share.

Sacrificing ratio :

Old profit sharing ratio of A, B and C = 3:2:1

New profit sharing ratio of A, B, C and D = 4:3:2:3

Sacrifice = Old share − New share

$A = \frac{3}{6} - \frac{4}{12} = \frac{6-4}{12} = \frac{2}{12}$

$B = \frac{2}{6} - \frac{3}{12} = \frac{4-3}{12} = \frac{1}{12}$

$C = \frac{1}{6} - \frac{2}{12} = \frac{2-2}{12} = 0$

$\therefore$ Sacrificing ratio of A and B = 2:1

(4) **When the new partner is not able to bring his share of premium for goodwill in cash :**

If a new partner does not bring his share of goodwill in cash, the new partners' capital account is debited by his share of goodwill and the sacrificing partners' capital accounts are credited in their sacrificing ratio. The following journal entries are recorded.

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When new partner brings his capital in cash :			
	Cash A/c Dr		....	
	To New partners' capital A/c			....
	[Being new partner brought his capital in cash.]			
(2)	When new partners' share of goodwill is debited to his capital A/c and distributed between old partners in their sacrificing ratio :			
	New partners' capital A/c Dr		....	
	To Old partners' capital A/c			....
	[Being new partners' capital A/c debited by his share of goodwill and old partners' capital accounts are credited in their sacrificing ratio.]			
	Note : There is no difference in journal entries for old goodwill written off and withdrawn in cash.			

Illustration 15 : A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{6}$th share of profit. C brought ₹ 1,00,000 in cash as capital. But he is not able to bring in his share of goodwill. The goodwill of the firm is valued at ₹ 3,00,000 at the time of admission of a new partner. Pass necessary journal entries.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		1,00,000	
	To C's capital A/c			1,00,000
	[Being C brought cash as his capital.]			
(2)	C's capital A/c Dr		50,000	
	To A's capital A/c			30,000
	To B's capital A/c			20,000
	[Being C's share in goodwill distributed to A and B in their sacrificing ratio.]			

Explanation : (1) : C's share in goodwill $= \frac{1}{6} \times 3,00,000 =$ ₹ 50,000

(2) : C's share of goodwill received by A and B in their sacrificing ratio :

A : $50,000 \times \frac{3}{5}$ = ₹ 30,000

B : $50,000 \times \frac{2}{5}$ = ₹ 20,000

Note : Here, old ratio = Sacrificing ratio = 3:2

(5) When only a part of the premium for goodwill is brought by a new partner in cash :

When only part of the premium for goodwill is brought by a new partner in cash the premium for goodwill account is credited for the amount of premium brought in cash by him. Thereafter his capital account is debited by the amount of goodwill not brought in cash and premium for goodwill account is debited by the amount of goodwill brought in cash and total share of new partner in goodwill is credited to old partners' capital accounts in their sacrificing ratio. Journal entries for old goodwill to write off and goodwill withdrawn by old partners will remain the same as in the earlier cases. Journal entries for new partners' share in goodwill in this situation are as follows :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When part of share in goodwill and his capital brought in by new partner in cash :			
	Cash A/c Dr		....	
	To New partners' capital A/c			....
	To Premium for goodwill A/c (Goodwill brought in cash)			....
	[Being new partner brought capital and his share of goodwill in cash.]			

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	Premium for goodwill A/c Dr		....	
	(Goodwill brought in cash)			
	New partners' capital A/c Dr		....	
	(Goodwill not brought in cash)			
	To Old partners' capital A/c			....
	[Being new partners' goodwill is distributed between old partners in their sacrificing ratio.]			
	Note : There is no change in writting off old goodwill among old partners in their old profit-loss sharing ratio.			

Illustration 16 : A and B are the partners in a firm sharing profit and loss in the ratio of 2:1. They admitted C as a new partner for $\frac{1}{3}$rd share in the profit of the firm. C brought ₹ 70,000 as capital and ₹ 30,000 as premium for goodwill in cash. Goodwill of the firm valued at ₹ 1,20,000 at the time of admission of a new partner. Goodwill appeared in the balance sheet of A and B at ₹ 60,000. New profit sharing ratio of all three partners is to be 1:1:1.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	A's capital A/c Dr		40,000	
	B's capital A/c Dr		20,000	
	To Goodwill A/c			60,000
	[Being old goodwill written off between old partners in the old ratio.]			
(2)	Cash A/c Dr		1,00,000	
	To C's capital A/c			70,000
	To Premium for goodwill A/c			30,000
	[Being C brought part of his share of goodwill and capital in cash.]			
(3)	Premium for goodwill A/c Dr		30,000	
	C's capital A/c Dr		10,000	
	To A's capital A/c			40,000
	[Being C's share of goodwill credited to A's capital A/c.]			

Explanation (1) : C's share of goodwill = 1,20,000 $\times \frac{1}{3}$ = 40,000

Goodwill not brought in cash by C

= ₹ 40,000 − ₹ 30,000 brought in cash

= ₹ 10,000

(2) : Sacrificing ratio :

Old profit sharing ratio of A and B = 2:1

New profit sharing ratio of A, B and C = 1:1:1

Sacrifice = Old share − New share

A : $\frac{2}{3} - \frac{1}{3} = \frac{1}{3}$

B : $\frac{1}{3} - \frac{1}{3} = 0$

Only A will receive goodwill brought by C.

(6) When goodwill is valued on the basis of net worth or capital of patners (Hidden goodwill)

When the amount of goodwill is not given, at the time of admission of a partner, goodwill of the firm is valued on the basis of net worth of the firm or capital of partners. For example, A and B whose capitals in the firm are at ₹ 50,000 and ₹ 30,000 respectively. They admit C as a new partner for $\frac{1}{5}$th share of profits and he brings in ₹ 40,000 as his share of capital. The sacrificing ratio of A and B is equal. In this case, the total capital of the firm should be ₹ 2,00,000 by taking C's capital as base.

($\frac{1}{5}$th share = ₹ 40,000 capital

1 share = ?

= ₹ 40,000 × 5 = ₹ 2,00,000)

But the combined capital of all three partners or net worth is ₹ 1,20,000.

(₹ 50,000 + ₹ 30,000 + ₹ 40,000)

Goodwill of the firm = Net worth of firm on the basis of new partner C's capital − New worth of the firm excluding goodwill

= ₹ 2,00,000 − ₹ 1,20,000

= ₹ 80,000

C's share of goodwill = ₹ 80,000 × $\frac{1}{5}$

= ₹ 16,000

C's share of goodwill ₹ 16,000 will be distributed between A and B in equal proportion, i.e. in their sacrificing ratio.

Illustration 17 : A and B are the partners sharing profit and loss in the ratio of 3:2. Their capital is ₹ 1,00,000 and ₹ 1,50,000 respectively as on 31-3-2016. On that day the balance sheet of the firm shows general reserve of ₹ 30,000. They admitted C as a new partner for $\frac{1}{4}$th share in profit on 1-4-2016. C brings ₹ 1,20,000 as a capital. Pass journal entries for goodwill. Show necessary calculation.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		1,20,000	
	To C's capital A/c			1,20,000
	[Being C brought capital in cash.]			

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	C's capital A/c Dr		20,000	
	To A's capital A/c			12,000
	To B's capital A/c			8000
	[Being C's share of goodwill distributed between A and B in their sacrificing ratio.]			

Explanation (1) : Calculation of goodwill of the firm :

Net wroth of the firm (including goodwill) on the basis of C's capital

$\frac{1}{4}$ = ₹ 1,20,000

1 = (?)

= ₹ 1,20,000 × 4 = ₹ 4,80,000

Net worth of the firm (excluding goodwill) = Old partners' capital + General reserve + New partner's capital

= ₹ 1,00,000 + ₹ 1,50,000 + ₹ 30,000 + ₹ 1,20,000

= 4,00,000

Goodwill of the firm = ₹ 4,80,000 − ₹ 4,00,000

= ₹ 80,000

C's share of goodwill = ₹ 80,000 × $\frac{1}{4}$

= ₹ 20,000

(2) : Distribution of C's goodwill :

C's share of goodwill will be distributed between A and B in their sacrificing ratio 3:2. (Old ratio = Sacrificing ratio = 3:2)

Goodwill receivable by A = ₹ 20,000 × $\frac{3}{5}$ = ₹ 12,000

Goodwill receivable by B = ₹ 20,000 × $\frac{2}{5}$ = ₹ 8000

5. Revaluation of Assets and Reassessment of Liabilities and its Accounting Effects

Fixed assets are recorded in the books of the firm at cost less depreciation. Book value of assets at the time of the admission of a new partner may be more or less than its market value. Some assets may not have been recorded in the books. Same thing is possible in the case of liabilities. Actual amount payable may be more or less than its book values. New partner is not entitled to receive any share in the profit due to the change in the values of assets and liabilities till the date of his admission. He will also not share such losses. Therefore, assets and liabilities are revalued at the time of the admission of a partner. To record the change in the values of assets and liabilities on account of their revaluation, an account called "Revaluation Account" is opened. It is also called as profit and loss adjustment A/c. Changes in the values of assets and liabilities are recorded in this account. Net profit or net loss of revaluation account is distributed among the old partners in their old profit sharing ratio.

Revaluation of assets and liabilities are recorded by two methods :

(1) When assets and liabilities are to be shown in the books of the new firm at their new values (Revaluation account)

(2) When assets and liabilities are to be shown in the books at their old values (Memorandum revaluation account)

(1) When assets and liabilities are to be shown in the books at their new values

In this method all changes in the values of assets and liabilities are recorded in the revaluation account or profit and loss adjustment account. The net gain or loss of the revaluation account or profit and loss adjustment account is distributed among the old partners in their old profit sharing ratio. Revaluation A/c is a nominal account. It is debited by the decrease in the value of assets and increase in the amount of liabilities. It is credited by the increase in the value of assets or decrease in the amount of liabilities. By closing the revaluation account; if it shows credit balance, it indicates net gain and if there is debit balance, it indicates net loss. Net profit or net loss of revaluation account is transferred to the capital accounts of the old partners in their old ratio and the assets and liabilities will appear in the balance sheet of the new firm at their revised values. (This is also explained in chapter 4.)

Journal Entries

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When value of assets increase :			
	Assets A/c Dr		✓	
	To Revaluation A/c			✓
(2)	When value of assets decrease :			
	Revaluation A/c Dr		✓	
	To Assets A/c			✓
(3)	When bad debt reserve and discount reserve is provided on debtors :			
	Revaluation A/c Dr		✓	
	To Bad debt reserve A/c			✓
	To Discount reserve on debtors A/c			✓
(4)	Accrued income, prepaid expense, unrecorded assets are to be recorded :			
	Accrued income A/c Dr		✓	
	Prepaid expense A/c Dr		✓	
	Assets A/c Dr		✓	
	To Revaluation A/c			✓
(5)	When liabilities increase :			
	Revaluation A/c Dr		✓	
	To Liabilities A/c			✓
(6)	When liabilities decrease :			
	Liabilities A/c Dr		✓	
	To Revaluation A/c			✓

	Particulars	L.F.	Debit (₹)	Credit (₹)
(7)	When unrecorded liability or unpaid liabilities are to be recorded :			
	Revaluation A/c Dr		✓	
	To Liabilities A/c			✓
	To Unpaid liabilities A/c			✓
(8)	When revaluation account is closed :			
	(A) If it is profit of revaluation account, it is distributed among old partners in their old profit sharing ratio :			
	Revaluation A/c Dr		✓	
	To Old partners' capital A/c			✓
	(B) If it is loss of revaluation account, it is distributed among old partners in their old profit sharing ratio :			
	Old partners' capital A/c Dr		✓	
	To Revaluation A/c			✓

Illustration 18 : Patel and Shah are partners in a firm sharing profit and loss in the ratio of 3:2. The balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Patents		10,000
Patel	1,20,000		Land-Building		1,40,000
Shah	1,30,000	2,50,000	Machinery		70,000
Loan		1,00,000	Furniture		80,000
Creditors		80,000	Motor car		1,20,000
Bills payable		20,000	Stock		40,000
Outstanding expense		30,000	Debtors	21,000	
			− Bad debt reserve	1000	20,000
		4,80,000			**4,80,000**

They admitted Raval as a new partner for $\frac{1}{5}$th share from 1-4-2016. Raval brought ₹ 2,00,000 as his capital. The partners decided to revalue assets and liabilities as follows :

(1) Land-building is to be appreciated by 20 %.

(2) Machinery is to be depreciated by 10 %.

(3) Furniture is valued at ₹ 60,000.

(4) Motor car is to be depreciated by 20 %.

(5) A provision for doubtful debt is to be kept at ₹ 5000.

(6) Patents are valueless.

(7) Outstanding interest on loan is ₹ 6000.

(8) Creditors and bills payable are to be paid 10 % less.

(9) Unrecorded investment is valued ₹ 20,000.

(10) Insurance premium which was debited to profit and loss account by ₹ 30,000. Out of this ₹ 10,000 is for next year.

Give necessary journal entries. Prepare revaluation account, partners' capital accounts and balance sheet after admission.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	Land-Building A/c Dr To Revaluation A/c [Being increase in the value of land-building is transferred to revaluation A/c.]		28,000	28,000
1-4-2016	Revaluation A/c Dr To Machinery A/c [Being decrease in the value of machinery is transferred to revaluation A/c.]		7000	7000
1-4-2016	Revaluation A/c Dr To Furniture A/c [Being decrease in the value of furniture is transferred to revaluation A/c.]		20,000	20,000
1-4-2016	Revaluation A/c Dr To Motor car A/c [Being decrease in the value of motor car is transferred to revaluation A/c.]		24,000	24,000
1-4-2016	Revaluation A/c Dr To Bad debt reserve A/c [Being increase in provision for bad debt is transferred to revaluation A/c.]		4000	4000
1-4-2016	Revaluation A/c Dr To Patents A/c [Being decrease in patent is transferred to revaluation A/c.]		10,000	10,000
1-4-2016	Revaluation A/c Dr To Outstanding interest on loan A/c [Being outstanding interest on loan is transferred to revaluation A/c.]		6000	6000

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	Creditors A/c Dr		8000	
	Bills payable A/c Dr		2000	
	To Revaluation A/c			10,000
	[Being decrease the value of creditors and bills payable is transferred to revaluation A/c.]			
1-4-2016	Investment A/c Dr		20,000	
	To Revaluation A/c			20,000
	[Being unrecorded investment is transferred to revaluation A/c.]			
1-4-2016	Prepaid insurance premium A/c Dr		10,000	
	To Revaluation A/c			10,000
	[Being prepaid insurance premium transferred to revaluation A/c.]			
1-4-2016	Patel's capital A/c Dr		1800	
	Shah's capital A/c Dr		1200	
	To Revaluation A/c			3000
	[Being the distribution of revaluation loss between old partners in their old ratio.]			
1-4-2016	Cash A/c Dr		2,00,000	
	To Raval's capital A/c			2,00,000
	[Being capital ₹ 2,00,000 brought in cash by new partner.]			
	Total		**3,42,000**	**3,42,000**

Revaluation Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	7000	By Land-Building A/c		28,000
To Furniture A/c	20,000	By Creditors A/c		8000
To Motor car A/c	24,000	By Bills payable A/c		2000
To Bad debt reserve A/c	4000	By Investment A/c		20,000
(New bad debt reserve ₹ 5000 – Old bad debt reserve ₹ 1000)		By Prepaid insurance premium A/c		10,000
To Patents A/c	10,000	By Loss transferred to old partners' capital A/c		
To Outsatnding interest on loan A/c	6000	Patel	1800	
		Shah	1200	3000
	71,000			**71,000**

Partners' Capital Account

Dr Cr

Particulars	Patel (₹)	Shah (₹)	Raval (₹)	Particulars	Patel (₹)	Shah (₹)	Raval (₹)
To Revaluation A/c	1800	1200	–	By Balance b/d	1,20,000	1,30,000	–
To Balance c/d	1,18,200	1,28,800	2,00,000	By Cash A/c	–	–	2,00,000
	1,20,000	**1,30,000**	**2,00,000**		**1,20,000**	**1,30,000**	**2,00,000**

Balance Sheet After Admission

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Land-Building		1,68,000
Patel	1,18,200		Machinery		63,000
Shah	1,28,800		Furniture		60,000
Raval	2,00,000	4,47,000	Motor car		96,000
Loan		1,00,000	Stock		40,000
Creditors		72,000	Debtors	21,000	
Bills payable		18,000	– Bad debt reserve	5000	16,000
Outstanding expenses		30,000	Investment		20,000
Outstanding interest on loan		6000	Prepaid insurance premium		10,000
			Cash		2,00,000
		6,73,000			**6,73,000**

Explanation : Assets and liabilities will be shown in the balance sheet at their new values.

(2) Memorandum Revaluation Account :

The partners may decide that the value of assets and liabilities will continue to appear in the books at the existing values, yet no partner may be put into any undue advantage or disdavantage because of change in values. In such case an increase or decrease in the amount of assets and liabilities is recorded in the Memorandum Revaluation Accounts. This account is divided into two parts. First part is similar to the revaluation account and in the second part, all entries of first part are reversed. The balance of first part (i.e. profit or loss on revaluation) is transferred to the capital accounts of the old partners in their old profit sharing ratio. The balance of the second part is transferred to all partners including the new partner, in the new profit-loss sharing ratio. (If there is profit in the first part, it becomes loss or debit balance in the second part and if it is debit balance or loss in the first part, it becomes credit balance or profit in the second part.) The journal entries are passed in the Memorandum Revaluation Account as follows :

Note : Memorandum Revaluation Account is given only for the information to students. It's concept and practical aspects are not expected in the examination.

Transaction	Journal Entries
(1) For increase in assets or decrease in liabilities	Assets A/c...Dr Liabilities A/c...Dr To Memorandum Revaluation A/c
(2) For decrease in assets or increase in liabilities	Memorandum Revaluation A/c...Dr To Assets A/c To Liabilities A/c
(3) For transferring the balance of the first part of the memorandum revaluation account to old partners capital a/c in old profit sharing ratio (If credit side exceeds debit side i.e. in case of profit.)	Memorandum Revaluation A/c...Dr To Old partners' capital A/c (Old profit-loss sharing ratio) **Note :** Accounting entry for loss is debited to partners' capital accounts and credited to the Memorandam Revaluation Account)
(4) For reversing the first entry :	Memorandum Revaluation A/c...Dr To Assets A/c To Liabilities A/c
(5) For reversing the second entry :	Assets A/c...Dr Liabilities A/c...Dr To Memorandum Revaluation A/c
(6) For transferring the balance i.e. profit or loss of the second part of the memorandum revaluation account to all including new partners' capital A/c in the new profit sharing ratio. There will be debit balance or loss in the second part as against entry no. 3 and reverse effect of entry no. 3 will be given in new ratio.	All partners' capital A/c...Dr (New profit-loss sharing ratio) To Memorandum Revaluation A/c

Illustration 19 : Pass necessary journal entries for illustration 18 and prepare memorandum revaluation account, partners' capital accounts and balance sheet after admission.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	Memorandum Revaluation A/c Dr		71,000	
	To Machinery A/c			7000
	To Furniture A/c			20,000
	To Motor car A/c			24,000
	To Bad debt reserve A/c			4000
	To Patents A/c			10,000
	To outstanding interest on loan A/c			6000
	[Being decrease in assets and increase in liabilities and provision are transferred to memorandum revaluation A/c.]			

Date/No.	Particulars		L.F.	Debit (₹)	Credit (₹)
1-4-2016	Land-Building A/c	Dr		28,000	
	Creditors A/c	Dr		8000	
	Bills payable A/c	Dr		2000	
	Investment A/c	Dr		20,000	
	Prepaid insurance premium A/c	Dr		10,000	
	To Memorandum Revaluation A/c				68,000
	[Being increase in assets and decrease in liabilities are transferred to memorandum revaluation account.]				
1-4-2016	Patel's capital A/c	Dr		1800	
	Shah's capital A/c	Dr		1200	
	To Memorandum Revaluation A/c				3000
	[Being loss of memorandum revaluation A/c is transferred to old partners capital A/c in their old profit sharing ratio.]				
1-4-2016	Machinery A/c	Dr		7000	
	Furniture A/c	Dr		20,000	
	Motor car A/c	Dr		24,000	
	Bad debt reserve A/c	Dr		4000	
	Patents A/c	Dr		10,000	
	Outstanding interest on loan A/c	Dr		6000	
	To Memorandum Revaluation A/c				71,000
	[Being reversing entry of decrease in assets and increase in liabilities and provisions.]				
1-4-2016	Memorandum Revaluation A/c	Dr		68,000	
	To Land-Building A/c				28,000
	To Creditors A/c				8000
	To Bills payable A/c				2000
	To Investment A/c				20,000
	To prepaid insurance premium A/c				10,000
	[Being reversing entry of increase assets and decrease liabilities and provisions.]				
1-4-2016	Memorandum Revaluation A/c	Dr		3000	
	To Patel's capital A/c				1440
	To Shah's capital A/c				960
	To Raval's capital A/c				600
	[Being profit balance of second part of memorandum revaluation A/c is transferred to all partners' capital A/c in their new profit sharing ratio.]				

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	Cash A/c Dr		2,00,000	
	To Raval's capital A/c			2,00,000
	[Being new partner brought capital of ₹ 2,00,000 in cash.]			
	Total		**4,84,000**	**4,84,000**

Memorandum Revaluation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c		7000	By Land-Building A/c		28,000
To Furniture A/c		20,000	By Creditors A/c		8000
To Motor car A/c		24,000	By Bills payable A/c		2000
To Bad debt reserve A/c		4000	By Investment A/c		20,000
To Patents A/c		10,000	By Prepaid insurance premium A/c		10,000
To Outstanding interest on loan A/c		6000	By Old partners' capital A/c (3:2) :		
			Patel	1800	
			Shah	1200	3000
		71,000			**71,000**
To Land-Building A/c		28,000	By Machinery A/c		7000
To Creditors A/c		8000	By Furniture A/c		20,000
To Bills payable A/c		2000	By Motor car A/c		24,000
To Investment A/c		20,000	By Bad debt reserve A/c		4000
To Prepaid insurance premium		10,000	By Patents A/c		10,000
To Profit transferred to all partners' capital A/c (12:8:5)			By Outstanding interest on loan A/c		6000
Patel	1440				
Shah	960				
Raval	600	3000			
		71,000			**71,000**

Partners' Capital Account

Dr | Cr

Particulars	Patel (₹)	Shah (₹)	Raval (₹)	Particulars	Patel (₹)	Shah (₹)	Raval (₹)
To Memorandum revaluation A/c	1800	1200	–	By Balance b/d	1,20,000	1,30,000	–
To Balance c/d	1,19,640	1,29,760	2,00,600	By Memorandum revaluation A/c	1440	960	600
				By Cash	–	–	2,00,000
	1,21,440	**1,30,960**	**2,00,600**		**1,21,440**	**1,30,960**	**2,00,600**

Balance Sheet as on 1-4-2016 After Admission

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Patent		10,000
Patel	1,19,640		Land-Building		1,40,000
Shah	1,29,760		Machinery		70,000
Raval	2,00,600	4,50,000	Furniture		80,000
Loan		1,00,000	Motor car		1,20,000
Creditors		80,000	Stock		40,000
Bills payable		20,000	Debtors	21,000	
Outstanding expenses		30,000	− Bad debt reserve	1000	20,000
			Cash		2,00,000
		6,80,000			**6,80,000**

Note : As memorandum revaluation account is prepared, all assets and liabilities are shown at their old values.

Explanation : New profit-loss sharing ratio

Old profit-loss sharing ratio of Patel and Shah 3:2

Share of Raval $= \frac{1}{5}$

Remaining share for Patel and Shah is $1 - \frac{1}{5} = \frac{4}{5}$

$\frac{4}{5}$th share will be divided between Patel and Shah in the ratio of 3:2

Patel's new share $= \frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$

Shah's new share $= \frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$

Raval's new share $= \frac{1}{5} = \frac{5}{25}$

$\therefore$ New ratio = 12:8:5

The two points are important about the memorandum revaluation account :

(1) If first part of the memorandum revaluation shows loss then the second part will show profit and if the first part shows profit then the second part will show loss.

(2) The value of assets and liabilities except cash and capital account, will continue to appear at old values in the balance sheet of the firm after reconstitution.

6. Distribution of Reserves and Accumulated Profit-Losses

(A) Accounting Treatments :

Balances of reserves, accumulated profits or losses or fictitious assets appearing in the books of the firm before the admission of a new partner, are distributed among old partners' in their old ratio because they were created out of the profits earned during earlier period before the new partner was admitted. The new partner should not be put to undue advantage or disadvantage due to such balances. The journal entry will be :

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
	Profit and loss A/c (Profit) Dr General reserve A/c Dr Capital reserve A/c Dr Reserve funds A/c Dr Contigency reserve A/c Dr Workmen compensation reserve A/c Dr Investment fluctuation reserve A/c Dr To old partners' capital/current A/c (Being balances of reserves and profit distributed between old partners in their old ratio.)			
	Old partners' capital/current A/c Dr To Profit-loss A/c (Loss) To Advertisement campaign exp. A/c To Research and development exp. A/c To Unamortised other revenue exp. A/c (Being balance of loss and fictitious assets distributed to old partners in their old ratio.)			

Workmen compensation fund is an amount set aside out of the profit to meet a future liability or a possible loss against workmen's compensation claim. At the time of the admission of a partner the surplus amount out of the amount payable i.e. amount of reserve in excess of the liability is distributed among the old partners in their old profit sharing ratio. If the amount of claim accepted is more then the reserve, the additional amount of claim is debited to the revaluation account and no surplus amount out of reserve will be distributed between old partners.

Investment fluctuation reserve is an amount set aside out of the profit to adjust the loss due to fall in the value of investments. At the time of the admission of a partner the surplus out of the investment fluctuation reserve after deducting decrease in the value of investment is distributed among the old partners in their old profit sharing ratio. If the loss due to decrease in the value of investment is more than the balance of reserve, additional amount is debited to the revaluation account.

Balances of reserves and revenue expenditure, not written off, shown in the balance sheet in old firm are recorded by two methods at the time of the admission of a new partner. If no instruction is given, the accounting effect will be given as per the explanation (1) given below :

Note : (1) When partners decide to distribute the balances of reserves and accumulated profits and losses : These balances must be distributed among old partners in their old profit-loss ratio even if no instruction is given in the question regarding reserves and accumulated profit and loss. Consequently these balances will not be shown in the balance sheet of the new firm.

(2) When partners decide to show the balances of reserves and accumulated profit and loss at the same value without any change : If partners decide not to make any change in the balance of reserves, accumulated profit and loss and fictitious assets and show these balances in the new balance sheet at their old values, in this situation if the net amount of such balances is credit, it is debited to the capital accounts of gaining partner including new partner by the amount of gain and credited to sacrificing partners' capital accounts by the amount of sacrifice. If net amount of such balances is debit, it is credited to the gaining partners' capital accounts by the amount of gain and debited to sacrificing partners' capital accounts by the amount of their sacrifice.

Illustration 20 : P and Q are the partners sharing profit and loss in the ratio of 2:1. They decided to admit R as a new partner on 1-4-2016. All three partners' new profit-loss sharing ratio is decided at 3:1:2. The balance sheet of R and Q show the following balances :

General reserve	: ₹ 10,000	
Profit-loss A/c	: ₹ 11,000	
Workmen compensation reserve	: ₹ 14,000	
Advertisement campaign expenditure	: ₹ 6000	
Research and development expenditure	: ₹ 3000	
Investment fluctuation reserve	: ₹ 10,000	
Investment	: ₹ 15,000	(Market value ₹ 14,000)

The firm accepted claim of ₹ 5000 for workmen's compensation.

From the following situation pass necessary journal entries :

(1) When the partners decide to distribute all balance of reserves and accumulated profit and loss.

(2) When partners decide not to distribute all the balance of reserve and profit and loss. But without any change all reserve balance is to appear in the balance sheet.

Ans. : (1) When partners decide to distribute balances of all reserves and accumulated profit and losses :

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	General reserve A/c Dr		10,000	
	Profit-loss A/c Dr		11,000	
	To P's capital A/c			14,000
	To Q's capital A/c			7000
	[Being balances of general reserve and profit and loss of the firm are distributed between old partners in their old profit sharing ratio.]			

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	Workmen's compensation reserve A/c Dr		14,000	
	To Claim for workmen compensation A/c			5000
	To P's capital A/c			6000
	To Q's capital A/c			3000
	[Being after provision for the accepted claim of workmen compensation, surplus amount is distributed between partners P and Q in their old ratio.]			
1-4-2016	Investment fluctuation reserve A/c Dr		10,000	
	To Investment A/c			1000
	To P's capital A/c			6000
	To Q's capital A/c			3000
	[Being a loss due to fall in the value of investment is adjusted against investment fluctuation reserve and remaining surplus is distributed between old partners in old sharing ratio.]			
1-4-2016	P's capital A/c Dr		6000	
	Q's capital A/c Dr		3000	
	To Advertisement campaign exp. A/c			6000
	To Research and development exp. A/c			3000
	[Being balances of advertisement compaign exp. and research and development exp. are written off by debiting old partners' capital accounts in their old ratio.]			

Note : (1) Claim for workmen's compensation of ₹ 5000 will appear in new balance sheet on liabilities side. (2) Investment of ₹ 14,000 will appear in new balance sheet on assets side. (3) Balance of reserves, profit, advertisement campaign expenses and research and development expenses will not appear in balance sheet.

(2) **When partners decide balance of reserves, profit and loss is to be appear in the new balance sheet without any change :**

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1-4-2016	R's capital A/c Dr		30,000	
	To P's capital A/c			15,000
	To Q's capital A/c			15,000
	[Being balance of reserves and profit and loss are debited to R's capital in his gaining ratio and distributed between P and Q in their sacrificing ratio.]			

Explanation (1) Balance of reserves, profits and losses :

	₹
General reserve	10,000
Profit-loss A/c	11,000
Workmen compensation reserve	9000
(₹ 14,000 – ₹ 5000 claim)	
Investment fluctuation reserve	9000
(₹ 10,000 – ₹ 1000 loss on investment)	
	39,000
Less : Advertisement campaign exp.	6000
Research and development exp.	3000
Net Amount (Credit balance)	**30,000**

(2) Sacrificing ratio :

Old profit-loss sharing ratio of P and Q = 2:1

New profit-loss sharing ratio of P, Q and R = 3:1:2

Sacrifice = Old share – New share

P's sacrifice $= \frac{2}{3} - \frac{3}{6} = \frac{1}{6}$

Q's sacrifice $= \frac{1}{3} - \frac{1}{6} = \frac{1}{6}$

∴ Sacrificing ratio = 1:1

The balance of reserves, profit and loss ₹ 30,000 is to be debited to R's capital account and credited to P's and Q's capital account in their sacrificing ratio.

(3) Different circumstances arising for reserves disclosed in the books of old partnership firm :

Reserves are created by a partnership firm against the possible losses in the assets. These assets are revalued at the time of the admission of a partner. Different situations arise at the time of revaluation. Required accounting treatments in such situation increases reliability of accounts. Theses reserves include investment fluctuation reserve, bad debt reserve, workers accident compensation reserve etc. This is explained as under.

Note : If it is not mentioned that the balance of profit and loss account has a credit balance or debit balance, in this case, assume that the balance is credit balance.

Illustration 21 : Esha and Rucha are the partners in a firm sharing profit-loss equally. Balances of their firm as on 31-3-2016 were as under :

Balance		₹
Investment	: ₹	50,000
Debtors	: ₹	40,000
Investment fluctuation reserve	: ₹	6000
Bad debt reserve	: ₹	3000
Workmen compensation reserve	: ₹	10,000
Workmen profit sharing fund	: ₹	2000

They admitted Eva as a new partner for $\frac{1}{5}$th share in the firm on 1-4-2016. Pass journal entries in following cases :

(1) If investments are valued as under :

(i) ₹ 48,000 (ii) ₹ 40,000

(iii) ₹ 60,000 (iv) ₹ 50,000

(2) If following amount of workmen compensation claim is accepted :

(i) Zero (ii) ₹ 6000

(iii) ₹ 12,000

(3) If provision for bad debt is to be made as follows :

(i) New provision for bad debt reserve is not required.

(ii) Provision for bad debt reserve on debtors is to be kept 10 %.

(iii) Provision for bad debt reserve on debtors is to be kept 5 %.

(iv) After writting off bad debt ₹ 5000 provision for bad debt reserve is to be kept at 10 %.

(v) All debtors are solvent.

Ans. :

(1)	(i) **If value of investment is ₹ 48,000 :**			
	Investment fluctuation reserve A/c Dr		6000	
	To Investment A/c			2000
	To Esha's capital A/c			2000
	To Rucha's capital A/c			2000
	[Being decrease in the value of investment is written off against investment fluctuation reserve and balance amount of investment fluctuation reserve is distributed among old partners in old profit-loss sharing ratio.]			
	(ii) **If value of investment is ₹ 40,000 :**			
	Investment fluctuation reserve A/c Dr		6000	
	Revaluation A/c Dr		4000	
	To Investment A/c			10,000
	[Being investment fluctuation reserve is written off against decrease in investment and balance amount of decrease is debited to revaluation A/c.]			

	(iii) **If value of investment is ₹ 60,000 :**			
	(A) Investment A/c Dr		10,000	
	To Revaluation A/c			10,000
	[Being increase in the value of investment is credited to revaluation account.]			
	(B) Investment fluctuation reserve A/c Dr		6000	
	To Esha's capital A/c			3000
	To Rucha's capital A/c			3000
	[Being balance of investment fluctuation reserve is distributed between old partners in old profit-loss sharing ratio.]			
	(iv) **If value of investment is ₹ 50,000 :**			
	Investment fluctuation reserve A/c Dr		6000	
	To Esha's capital A/c			3000
	To Rucha's capital A/c			3000
	[Being remaining balance of investment fluctuation reserve is distributed between old partners in old profit-loss sharing ratio.]			

Explanation : Explanation regarding investment fluctuation reserve.

Particulars / **Investments**	(i) ₹	(ii) ₹	(iii) ₹	(iv) ₹
New value	48,000	40,000	60,000	50,000
− Old value	50,000	50,000	50,000	50,000
Increase (Decrease)	(2000)	(10,000)	10,000	–

(1) Investment fluctuation reserve is ₹ 6000. Decrease in the value of investment is ₹ 2000 which is deducted from reserve and balance of reserve ₹ 4000 is credited to partners' capital accounts in their profit-loss sharing ratio.

(2) Decrease in investment is ₹ 10,000. Therefore ₹ 6000 of reserve will be fully utilised and balance of decrease ₹ 4000 (₹ 10,000 – ₹ 6000) is debited to revaluation account.

(3) Value of investment is increased by ₹ 10,000. Therefore entire amount of reserve is credited to partners' capital accounts.

(4) There is no change in the value of investment. Therefore entire amount of reserve is credited to partners' capital accounts.

(2)	(i) **If the claim of workmen compensation is zero :**			
	Workmen compensation reserve A/c Dr		10,000	
	To Esha's capital A/c			5000
	To Rucha's capital A/c			5000
	[Being balance of workmen compensation reserve is distributed between old partners in old profit-loss sharing ratio.]			

	(ii) If the claim of workmen compensation is ₹ 6000 : Workmen compensation reserve A/c Dr To Provision for workmen compensation claim A/c To Esha's capital A/c To Rucha's capital A/c [Being provision made for claim of workmen compensation and remaining balance of workmen compensation reserve is distributed between old partners' in old profit-loss sharing ratio.]		10,000	 6000 2000 2000
	(iii) If the claim of workmen compensation is ₹ 12,000 : Workmen compensation reserve A/c Dr Revaluation A/c Dr To Provision for workmen compensation claim A/c [Being provision made for claim of workmen compensation by fully utilising workmens' compensation reserve and balance amount of provision is debited to revaluation account.]		10,000 2000	 12,000

Explanation : Explanation regarding workmen compensation reserve :

Particulars / Investment	(i) ₹	(ii) ₹	(iii) ₹
Amount of accident compensation reserve	10,000	10,000	10,000
− Liabilities decided	Zero	6000	12,000
Increase (Decrease)	10,000	4000	(2000)

(1) The amount of option (i) and (ii) is ₹ 10,000 and ₹ 4000 respectively and it is created to the partners' capital accounts in their old profit-loss sharing ratio.

(2) In option (iii) the liability is decided as ₹ 12,000. ₹ 10,000 of reserve is only utilized and balance amount of ₹ 2000 is debited to the revaluation account.

(3)	(i) If new provision for bad debt reserve is not required bad debt reserve ₹ 3000 (old balance) will be deducted from debtors of ₹ 40,000 in balance sheet. Bad debt reserve is a provision for future possible bad debt. So it can not be distributed between old partners.			
	(ii) If provision for bad debt reserve on debtors is to be kept 10 % : Revaluation A/c...Dr To Bad debt reserve A/c [Being additional bad debt reserve is debited to revaluation account.]		1000	 1000
	Note : Provision for bad debt at 10 % (₹ 4000) will be deducted from debtors ₹ 40,000 and debtors at ₹ 36,000 will be shown in the new balance sheet of the firm.			

(iii) If provision for bad debt reserve is to be kept 5 % on debtors :

Bad debt reserve A/c...Dr To revaluation A/c [Being surplus of bad debt reserve is credited to revaluation account.]		1000	1000

Note : Provision for bad debt reserve at 5 % (₹ 2000) will be deducted from debtors of ₹ 40,000 and remaining debtors ₹ 38,000 will be shown in new balance sheet of new firm.

(iv) After writting off bad debt of ₹ 5000, the provision for doubtful debt is to be made at 10 % :

(A) Bad debt A/c...Dr		5000	
To Debtors A/c			5000
[Being bad debt written off.]			
(B) Revaluation A/c...Dr		2000	
Bad debt reserve A/c...Dr		3000	
To Bad debt A/c			5000
[Being bad debt written off against the old balance of bad debt reserve and additional amount of bad debt debited to revaluation account.]			
(C) Revaluation A/c...Dr		3500	
To Bad debt reserve A/c			3500
[Being new provision is made for bad debt reserve on debtors after deducting bad debt.]			

Note : In balance sheet of new firm, ₹ 5000 bad debt will be deducted from debtors of ₹ 40,000 and 10 % new bad debt reserve will be provided on balance of debtors ₹ 35,000 and debtors will be shown at ₹ 31,500 after deducting new bad debt reserve.

(v) If all debtors are good :

Bad debt reserve A/c...Dr		3000	
To Revaluation A/c			3000
[Being bad debt reserve is credited to revaluation account as it is now not required.]			

Note : As all debtors are good, bad debt reserve is not required and therefore it will be credited to the revaluation account and debtors will be shown at ₹ 40,000 in new balance sheet.

Particulars / Investment	(i) ₹	(ii) ₹	(iii) ₹	(iv) ₹	(v) ₹
Bad debt reserve (old) – Bad debt (new)	3000 –	3000 –	3000 –	3000 5000	3000 –
Surplus of old BDR – New bad debt reserve	3000 Sufficient	3000 4000	3000 2000	(2000)* 3500*	3000 Not required
		(1000)*	1000*	(5500)	3000*
	No accounting effect	Debited to revaluation account	Credited to revaluation account	Debited to revaluation account	Credited to revaluation account

Note : Workers' profit sharing fund is a liability for the firm, which will be shown in the new balance sheet on the liabilities' side after the reconstitution.

7. Change in Capital Accounts and Construction of New Balance Sheet

Illustration 22 : Bhavya and Shlok are partners in a firm sharing profit and loss in the ratio of 3:2. Balance sheet of their firm as on 31-3-2017 is as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Goodwill		1,00,000
Bhavya	4,00,000		Land-Building		3,50,000
Shlok	3,00,000	7,00,000	Machinery		2,00,000
General reserve		90,000	Stock		1,80,000
Workmen's compensation reserve		20,000	Debtors	1,20,000	
Investment reserve		10,000	– Bad debt reserve	10,000	1,10,000
Creditors		1,40,000	Investment		20,000
Bills payable		60,000	Cash-Bank		50,000
			Advertisement campaign expenditure		10,000
		10,20,000			**10,20,000**

They admitted Aayush as a new partner on 1-4-2017 on the following conditions :

(1) Aayush brought ₹ 5,00,000 as his capital and 1,00,000 as his share of goodwill in cash.

(2) Value of land-building is to be increased by ₹ 80,000.

(3) Value of machinery is to be reduced upto ₹ 1,60,000.

(4) Provision for doubtful debt is to be kept 10 % on debtors.

(5) Provision for outstanding repairing expense is to be made ₹ 8000.

(6) New profit and loss sharing ratio of all partners is to be kept at 2:1:2.

From the above particulars, pass journal entries. Prepare Revaluation a/c, Partners' capital a/c, Cash-bank a/c and new balance sheet after admission.

Journal Entries

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
1	General reserve A/c Dr		90,000	
	To Bhavya's capital A/c			54,000
	To Shlok's capital A/c			36,000
	[Being general reserve distributed between old partners in their old profit-loss ratio.]			

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
2	Workmen compensaiton reserve A/c Dr		20,000	
	To Bhavya's capital A/c			12,000
	To Shlok's capital A/c			8000
	[Being workmen compensation reserve distributed between old partners in their old profit-loss sharing ratio.]			
3	Investment reserve A/c Dr		10,000	
	To Bhavya's capital A/c			6000
	To Shlok's capital A/c			4000
	[Being investment reserve distributed between old partners in their old profit-loss sharing ratio.]			
4	Bhavya's capital A/c Dr		60,000	
	Shlok's capital A/c Dr		40,000	
	To Goodwill A/c			1,00,000
	[Being old goodwill written off between old partners in their old profit-loss sharing ratio.]			
5	Bhavya's capital A/c Dr		6000	
	Shlok's capital A/c Dr		4000	
	To Advertisement campaign exp. A/c			10,000
	[Being advertisement campaign expenditure written off between old partners in their old profit-loss sharing ratio.]			
6	Cash A/c Dr		5,00,000	
	To Aayush's capital A/c			5,00,000
	[Being capital brought by Aayush in cash.]			
7	Cash A/c Dr		1,00,000	
	To Premium for goodwill A/c			1,00,000
	[Being share in goodwill brought in cash by Aayush.]			
7	Premium for goodwill A/c Dr		1,00,000	
	To Bhavya's capital A/c			50,000
	To Shlok's capital A/c			50,000
	[Being premium for goodwill distributed between old partners in their sacrificing ratio.]			
9	Revaluation A/c Dr		50,000	
	To Machinery A/c			40,000
	To Bad debt reserve A/c			2000
	To outstanding repairing expense A/c			8000
	[Being decrease in machinery, increase in bad debt reserve and outstanding repairing expense debited to revaluation account.]			

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
10	Land-Building A/c Dr To Revaluation A/c [Being increase in land and building credited to revaluation account.]		80,000	 80,000
11	Revaluation A/c Dr To Bhavya's capital A/c To Shlok's capital A/c [Being profit of revaluation account distributed between old partners in old ratio.]		30,000	 18,000 12,000
	Total		**10,90,000**	**10,90,000**

Revaluation Account

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		40,000	By Land-building A/c	80,000
To Bad debt reserve A/c (New ₹ 12,000 – Old ₹ 10,000)		2000		
To Outstanding repairing expense A/c		8000		
To Profit : Old partners' capital A/c				
Bhavya	18,000			
Shlok	12,000	30,000		
		80,000		**80,000**

Partners' Capital Account

Dr Cr

Particulars	Bhavya(₹)	Shlok(₹)	Aayush(₹)	Particulars	Bhavya(₹)	Shlok(₹)	Aayush(₹)
To Advertisement campaign expenditure A/c	6000	4000	–	By Balance b/d	4,00,000	3,00,000	–
To Goodwill	60,000	40,000	–	By General reserve A/c	54,000	36,000	–
To Balance c/f	4,74,000	3,66,000	5,00,000	By Workmen's compensation reserve A/c	12,000	8000	–
				By Investment fluctuation reserve	6000	4000	–
				By Cash A/c	–	–	5,00,000
				By Premium for goodwill A/c	50,000	50,000	–
				By Revaluation A/c	18,000	12,000	–
	5,40,000	**4,10,000**	**5,00,000**		**5,40,000**	**4,10,000**	**5,00,000**

Dr **Cash-Bank Account** Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	50,000	By Balance c/f	6,50,000
To Aayush's capital A/c	5,00,000		
To Premium for goodwill A/c	1,00,000		
	6,50,000		**6,50,000**

Balance Sheet as on 1-4-2017 After Admission

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Land-Building	3,50,000	
Bhavya	4,74,000		+ Addition	80,000	4,30,000
Shlok	3,66,000		Machinery	2,00,000	
Aayush	5,00,000	13,40,000	− Reduction	40,000	1,60,000
Creditors		1,40,000	Debtors	1,20,000	
Bills payable		60,000	− Bad debt reserve	12,000	1,08,000
Outstanding repairing expense		8000	Stock		1,80,000
			Investment		20,000
			Cash-Bank		6,50,000
		15,48,000			**15,48,000**

Explanation (1) : Sacrificing ratio and distribution of goodwill :

Old ratio of Bhavya and Shlok = 3:2

New ratio of Bhavya, Shlok and Aayush = 2:1:2

Sacrifice = Old share − New share

Bhavya $= \frac{3}{5} - \frac{2}{5} = \frac{1}{5}$, Shlok $= \frac{2}{5} - \frac{1}{5} = \frac{1}{5}$

$\therefore$ Sacrificing ratio = 1:1

Both old partners will receive goodwill equally. (See illustration 2 for explanation of goodwill)

Illustration 23 : Tarana and Jineesha are partners in a firm. Their balance sheet as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Goodwill	14,000
Tarana	1,90,000		Land-Building	1,00,000
Jineesha	1,21,000	3,11,000	Machinery	80,000
Workmens' compensation reserve		12,000	Investment	50,000
Investment fluctuation fund		4000	Debtors	70,000
Provident fund		16,000	Stock	36,000
Bad debt reserve		20,000	Cash	40,000
Creditors		30,000	Research and development expense	8000
Outstanding expense		15,000	Profit-loss A/c	10,000
		4,08,000		**4,08,000**

They admitted Rihan as a new partner on 1-4-2017 on following conditions :

(1) Rihan will bring ₹ 2,00,000 as his capital and ₹ 18,000 for his share of goodwill in cash. Any difference in the amount of goodwill is to be adjusted to his capital account.

(2) New profit-loss sharing ratio will be 4:3:3.

(3) Goodwill is to be valued at ₹ 1,00,000.

(4) Claim accepted for workmen's compensation ₹ 8000.

(5) Jineesha will take over investment at ₹ 48,000.

(6) Accrued interest of ₹ 6000 is not recorded.

(7) Bills payable drawn by creditors for ₹ 10,000 is accepted but not been recorded in the books of accounts.

(8) Book value of land and building is 20 % less then the market value.

(9) Out of insurance premium paid, ₹ 12,000 is to be carried forward to next year.

Prepare revaluation account, partners' capital account, cash account and balance sheet after admission.

Revaluation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Old partners' capital A/c (Profit)			By Outstanding interest A/c	6000
Tarana	21,500		By Land-Building A/c	25,000
Jineesha	21,500	43,000	By Prepaid insurance premium	12,000
		43,000		**43,000**

Partners' Capital Account

Dr | Cr

Particulars	Tarana (₹)	Jineesha (₹)	Rihan (₹)	Particulars	Tarana (₹)	Jineesha (₹)	Rihan (₹)
To Investment A/c	–	48,000	–	By Balance b/d	1,90,000	1,21,000	–
To Goodwill A/c	7000	7000	–	By Workmen compensation reserve A/c	2000	2000	–
To Research and development expense A/c	4000	4000	–	By Investment fluctuation fund A/c	1000	1000	–
To Profit-loss A/c	5000	5000	–	By Cash A/c	–	–	2,00,000
To Tarana's capital A/c (Goodwill)	–	–	4000	By Premium for goodwill A/c	6000	12,000	–
To Jineesha's A/c A/c (Goodwill)	–	–	8000	By Rihan's capital A/c (Goodwill)	4000	8000	–
To Balance b/d	2,08,500	1,01,500	1,88,000	By Revaluation A/c	21,500	21,500	–
	2,24,500	**1,65,500**	**2,00,000**		**2,24,500**	**1,65,500**	**2,00,000**

Cash Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	40,000	By Balance c/d	2,58,000
To Rihan's capital A/c	2,00,000		
To Premium for goodwill A/c	18,000		
	2,58,000		**2,58,000**

Balance Sheet as on 1-4-2017 After Admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Land-Building	1,25,000
Tarana	2,08,500		Machinery	80,000
Jineesha	1,01,500		Debtors	70,000
Rihan	1,88,000	4,98,000	Stock	36,000
Provident fund		16,000	Cash	2,58,000
Creditors(30,000 – Bills payable 10,000)		20,000	Outstanding interest	6000
Workmen's compensation reserve		8000	Prepaid insurance premium	12,000
Bad debt reserve		20,000		
Outstanding expense		15,000		
Bills payable		10,000		
		5,87,000		**5,87,000**

Explanation (1) : Sacrificing ratio :

Old profit-loss sharing ratio of Tarana and Jineesha = 1:1

New profit-loss sharing ratio of Tarana, Jineesha and Rihan = 4:3:3

Sacrifice = Old share – New share

Tarana $= \frac{1}{2} - \frac{4}{10} = \frac{1}{10}$; Jineesha $= \frac{1}{2} - \frac{3}{10} = \frac{2}{10}$

∴ Sacrificing ratio = 1:2

∴ Goodwill will distributed to both old partners in 1:2 ratio.

(For explanation of goodwill see illustration no. 2)

(2) : Rihan's share in goodwill :

Share of Rihan in new goodwill = 1,00,000 × $\frac{3}{10}$ = 30,000

Rihan brought ₹ 18,000 in cash and remaining ₹ 12,000 does not bring in cash for goodwill.

Journal entries for goodwill will be as under :

(1)	Cash A/c...Dr	18,000	
	To Premium for goodwill A/c		18,000

(2) Premium for goodwill A/c...Dr 18,000

To Tarana's capital A/c 6000

To Jineesha's capital A/c 12,000

(3) Rihan's capital A/c...Dr 12,000

To Tarana's capital A/c 4000

To Jineesha's capital A/c 8000

(3) : Market value of land-building :

Book value of land-building is ₹ 1,00,000, which is 20 % less than its market value.

Suppose market value	₹ 100
– 20 %	₹ 20
Book value	₹ 80

Book value	Market value
₹ 80	₹ 100
₹ 1,00,000	(?)

$$= 100 \times \frac{1,00,000}{80}$$

$$= 1,25,000$$

Illustration 24 : Kanha and Kavisha are partners in a firm sharing profit-loss in the ratio of 2:3. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Building	1,10,000
Kanha	80,000		Machinery	50,000
Kavisha	1,00,000	1,80,000	Stock	30,000
Contingency reserve		15,000	Debtors	66,000
Workmen's compensation fund		40,000	Bank	14,000
Investment reserve		12,000	Investment	30,000
Creditors		50,000		
Bad debt reserve		3000		
		3,00,000		**3,00,000**

They admitted Palkhi as a new partner on 1-4-2016, on following terms :

(1) Kanha sacrifices $\frac{1}{2}$ of her share and Kavisha sacrifices $\frac{1}{4}$th of her share in favour of Palkhi.

(2) Goodwill of the firm is valued ₹ 80,000.

(3) Kanha and Kavisha will withdraw 50 % of their share of goodwill.

(4) Depreciation on machinery is to be provided at 10 %.

(5) Bad debt of ₹ 6000 is to be written off and provision for bad debt reserve is to be kept at 15 % on debtors.

(6) Market value of investment is ₹ 15,000.

(7) Claim for workmen's compensation to be accepted ₹ 50,000.

(8) 10 % of creditors are not to be paid.

(9) Palkhi will bring ₹ 1,20,000 as capital and her share of goodwill in cash.

Prepare necessary accounts and balance sheet of new firm.

Ans. :

Dr **Revaluation Account** Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Pro. for workmen's compensation	10,000	By Creditors A/c		5000
To Investment A/c	3000	By Loss transferred to old partners' capital A/c		
To Machinery A/c	5000	Kanha	10,000	
To Bad debt A/c	3000	Kavisha	15,000	25,000
To Bad debt reserve A/c	9000			
	30,000			**30,000**

Dr **Partners' Capital Account** Cr

Particulars	Kanha (₹)	Kavisha (₹)	Palkhi (₹)	Particulars	Kanha (₹)	Kavisha (₹)	Palkhi (₹)
To Bank A/c (Goodwill)	8000	6000	–	By Balance b/d	80,000	1,00,000	–
To Revaluation A/c	10,000	15,000	–	By Contigency reserve A/c	6000	9000	–
To Balance c/d	84,000	1,00,000	1,20,000	By Bank A/c	–	–	1,20,000
				By Premium for goodwill A/c	16,000	12,000	–
	1,02,000	**1,21,000**	**1,20,000**		**1,02,000**	**1,21,000**	**1,20,000**

Dr **Bank Account** Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	14,000	By Kanha's capital A/c	8000
To Palkhi's capital A/c	1,20,000	By Kavisha's capital A/c	6000
To Premium for goodwill A/c	28,000	By Balance c/d	1,48,000
	1,62,000		**1,62,000**

Balance Sheet as on 1-4-2016 After Admission

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Building		1,10,000
Kanha	84,000		Machinery		45,000
Kavisha	1,00,000		Stock		30,000
Rihan	1,20,000	3,04,000	Debtors	66,000	
Provision of workmen's compensation claim		50,000	– Bad debt	6000	
				60,000	
Creditors		45,000	– Bad debt reserve (15 %)	9000	51,000
			Investment		15,000
			Bank		1,48,000
		3,99,000			**3,99,000**

Explanation (1) Sacrificing ratio :

Old ratio of Kanha and Kavisha = 2:3

Kanha sacrificed $\frac{1}{2}$ of his share.

∴ Sacrifice of Kanha = $\frac{2}{5} \times \frac{1}{2} = \frac{2}{10}$

Kavisha sacrificed $\frac{1}{4}$th of her share.

∴ Sacrifice of Kavisha = $\frac{3}{5} \times \frac{1}{4} = \frac{3}{20}$

∴ Sacrificing ratio of Kanha and Kavisha = $\frac{2}{10} : \frac{3}{20}$ = 4:3 (Making denominator equal)

∴ Goodwill will be distributed to both the partners in 4:3 ratio.

(2) : Goodwill brought by Palkhi :

Share of Palkhi in new firm = Sacrifice of Kanha + Sacrifice of Kavisha

$= \frac{2}{10} + \frac{3}{20}$

$= \frac{4+3}{20} = \frac{7}{20}$

Goodwill brought by Palkhi = ₹ 80,000 × $\frac{7}{20}$ = ₹ 28,000

Goodwill brought by Palkhi will be distributed between Kanha and Kavisha in their sacrificing ratio.

Journal :

		Dr	Cr
(1)	Bank A/c...Dr	28,000	
	To premium for goodwill A/c		28,000
(2)	premium for goodwill A/c...Dr	28,000	
	To Kanha's capital A/c		16,000
	To Kavisha's capital A/c		12,000

(3) (1) Claim for workmen's compensation accepted is ₹ 50,000 against the provision for workmen's compensation ₹ 40,000. Therefore additional claim of ₹ 10,000 is debited to the revaluation account. (2) Decrease value of investment is ₹ 15,000 while investment fluctuation reserve is only ₹ 12,000. Therefore additional loss is debited to the revaluation account.

Illustration 25 : Bhavya and Deep are partners sharing profit & loss in the ratio of 5:3. Balance sheet of their firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities			Amt. (₹)	Assets	Amt. (₹)
Provident fund			20,000	Bank	40,000
Creditors			80,000	Debtors	60,000
Workmens' compensation reserve			40,000	Stock	40,000
Capital account :	Bhavya	1,00,000		Building	3,00,000
	Deep	1,30,000	2,30,000	Investment	70,000
Current account :	Bhavya	80,000			
	Deep	60,000	1,40,000		
			5,10,000		**5,10,000**

They admitted Vedang as a new partner on 1-4-2017 on the following conditions :

(1) Vedang will bring his personal furniture of ₹ 50,000 in the firm.

(2) Creditors include ₹ 40,000 payable to Vedang, which is to be transferred to his capital account.

(3) Vedang will share $\frac{1}{5}$ in future profit.

(4) Vedang will bring ₹ 30,000 in cash as goodwill.

(5) Goodwill of the firm valued at ₹ 2,00,000.

(6) Credit purchase of ₹ 10,000 was not recorded in creditors account and purchase account. But it is included in closing stock.

(7) Market value of stock of ₹ 30,000 is ₹ 24,000.

(8) Liability for workmen's compensation is ₹ 24,000.

(9) Outstanding interest on investment ₹ 16,000 is unrecorded.

Prepare balance sheet after admission.

Ans. :

Balance Sheet as on 1-4-2017 After Admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Furniture	50,000
Bhavya	1,00,000		Stock	34,000
Deep	1,30,000		Debtors	60,000
Vedang	90,000	3,20,000	Building	3,00,000
Current account :			Current account of Vedang	10,000
Bhavya	1,15,000		Investment	70,000
Deep	81,000	1,96,000	Outstanding interest on investment	16,000
Provident fund		20,000	Bank (₹ 40,000 + ₹ 30,000)	70,000
Workmen's compensation reserve		24,000		
Creditors (₹ 80,000 – ₹ 40,000 Vedang's capital A/c + 10,000 unrecorded)		50,000		
		6,10,000		**6,10,000**

Explanation : (1) **Revaluation Account**

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
Stock A/c	6000	Outstanding interest on investment	16,000
Creditors A/c	10,000		
	16,000		**16,000**

(2) : **Capital Account**

Dr Cr

Particulars	Bhavya (₹)	Deep (₹)	Vedang (₹)	Particulars	Bhavya (₹)	Deep (₹)	Vedang (₹)
To Balance c/d	1,00,000	1,30,000	90,000	By Balance b/d	1,00,000	1,30,000	–
				By Furniture A/c	–	–	50,000
				By Creditors A/c	–	–	40,000
	1,00,000	**1,30,000**	**90,000**		**1,00,000**	**1,30,000**	**90,000**

(3) : **Partners' Current Account**

Dr Cr

Particulars	Bhavya (₹)	Deep (₹)	Vedang (₹)	Particulars	Bhavya (₹)	Deep (₹)	Vedang (₹)
To Bhavya's current A/c (Goodwill)	–	–	6250	By Balance b/d	80,000	60,000	–
To Deep's current A/c (Goodwill)	–	–	3750	By Premium for goodwill A/c	18,750	11,250	–
To Balance b/d	1,15,000	81,000	–	By Vedang current A/c (Goodwill)	6250	3750	–
				By Workmen's compensation reserve A/c	10,000	6000	–
				By Balance c/d	–	–	10,000
	1,15,000	**81,000**	**10,000**		**1,15,000**	**81,000**	**10,000**

Explanation : New profit-loss sharing ratio of Bhavya and Deep is 5:3. Vedang is admitted with $\frac{1}{5}$th share. As no other information is given, relative ratio of Bhavya and Deep will remain the same i.e. 5:3. So, their sacrificing ratio will also be 5:3. Hence, goodwill will be distributed between old partners in the ratio of 5:3.

Illustration 26 : Shiya and Janki are the partners sharing profit and loss in the ratio of 1:2. They admitted Chandni as a new partner for $\frac{1}{6}$th share. Chandni brought ₹ 25,000 as her capital in cash. The capitals of Shiya and Janki after the adjustments of loss of revaluation A/c, goodwill and reserves are ₹ 60,000 and ₹ 70,000 respectively. They decided to keep the capital of all the partners in their new profit-loss sharing ratio by taking new partners' capital as the base. For this purpose, the amount of actual cash to be paid or brought in by the old partners. New profit-loss sharing ratio is 3:2:1. Prepare the partners' capital accounts.

Ans. : **Partners' Capital Accounts**

Dr Cr

Particulars	Shiya (₹)	Janki (₹)	Chandni (₹)	Particulars	Shiya (₹)	Janki (₹)	Chandni (₹)
To Cash A/c (Diff.)	–	20,000	–	By Balance b/d	60,000	70,000	–
				By Cash A/c	–	–	25,000
To Balance c/d	75,000	50,000	25,000	By Cash A/c(Diff.)	15,000	–	–
	75,000	**70,000**	**25,000**		**75,000**	**70,000**	**25,000**

Explanation (1) : New profit-loss sharing ratio of Shiya, Janki and Chandni = 3:2:1

On the basis of Chandni's capital total capital of new firm :

$\frac{1}{6}$: ₹ 25,000

1 : (?)

= 25,000 × 6

= 1,50,000

Shiya's capital in new firm = 1,50,000 × $\frac{3}{6}$ = ₹ 75,000

Janki's capital in new firm = 1,50,000 × $\frac{2}{6}$ = ₹ 50,000

Illustration 27 : Pandit and Pandya are partners in a firm sharing profit and loss in the ratio of 2:1. The balance-sheet of the firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Goodwill	30,000
Pandit	1,30,000		Building	2,00,000
Pandya	1,20,000	2,50,000	Furniture	40,000
Capital reserve		21,000	Stock	26,000
Workmen's saving A/c		10,000	Debtors	24,000
Workmen's profit sharing fund		12,000	Cash	80,000
10 % loan		50,000		
Creditors		57,000		
		4,00,000		**4,00,000**

They admitted Patel as a new partner as on 1-4-2016 on the following terms :

(1) New profit and loss sharing ratio is to be kept at 3:5:1.

(2) Patel brought ₹ 50,000 as his capital in cash.

(3) Interest on loan is outstanding for last year.

(4) Personal expenses ₹ 8000 of Pandya was debited to the profit and loss account.

(5) Reconstruction's expense of ₹ 12,000 is paid by Pandit.

(6) Goodwill is valued at ₹ 2,70,000.

(7) Capital of Pandit and Pandya in the new firm should be kept in new profit and loss ratio by taking Patel's capital as the base. For this purpose necessary adjustments are to be made in their current account.

Prepare necessary accounts and balance sheet of the new firm.

Dr **Revaluation Account** Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Outstanding interest on loan	5000	By Pandya's capital A/c		8000
To Pandit's capital A/c	12,000	By Partners' capital A/c (Loss)		
		Pandit	6000	
		Pandya	3000	9000
	17,000			**17,000**

Dr **Partners' Capital Accounts** Cr

Particulars	Pandya (₹)	Pandit (₹)	Patel (₹)	Particulars	Pandya (₹)	Pandit (₹)	Patel (₹)
To Goodwill A/c	20,000	10,000	–	By Balance b/d	1,30,000	1,20,000	–
To Revaluation A/c	–	8000	–	By Capital reserve A/c	14,000	7000	–
To Pandit's capital A/c	–	60,000	–	By Cash A/c	–	–	50,000
To Revaluation A/c	6000	3000	–	By Revaluation A/c	12,000	–	–
To Pandit's current A/c	70,000	–	–	By Patel's current A/c	30,000	–	–
To Balance c/d	1,50,000	2,50,000	50,000	By Pandya's capital A/c	60,000	–	–
				By Pandya's current A/c		2,04,000	
	2,46,000	**3,31,000**	**50,000**		**2,46,000**	**3,31,000**	**50,000**

Dr **Cash Account** Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	80,000	By Balance c/d	1,30,000
To Patel's capital A/c	50,000		
	1,30,000		**1,30,000**

Balance Sheet as on 1-4-2016 after admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Building	2,00,000
Pandya	1,50,000		Furniture	40,000
Pandit	2,50,000		Stock	26,000
Patel	50,000	4,50,000	Debtors	24,000
Workers' savings A/c		10,000	Cash	1,30,000
Workers' profit sharing fund		12,000	Pandya's current A/c	2,04,000
10 % Loan		50,000	Patel's current A/c	30,000
Creditors		57,000		
Outstanding interest on loan		5000		
Pandit's current A/c		70,000		
		6,54,000		**6,54,000**

Explanation : (1) Sacrificing ratio

Old ratio of Pandit and Pandya = 2:1

New ratio of Pandit, Pandya and Patel = 3:5:1

Sacrifice = Old share − New share

Sacrifice of Pandit = $\frac{2}{3} - \frac{3}{9} = \frac{6-3}{9} = \frac{3}{9}$

Sacrifice of Pandya = $\frac{1}{3} - \frac{5}{9} = \frac{3-5}{9} = -\frac{2}{9}$ (Gain)

(2) Entry for goodwill : Pandya gains, therefore he will also give goodwill to Pandit

Goodwill payable to Pandya = $\frac{2}{9} \times 2{,}70{,}000$ = ₹ 60,000

Goodwill payable to Patel = $\frac{1}{9} \times 2{,}70{,}000$ = ₹ 30,000

Goodwill receivable by Pandit = $\frac{3}{9} \times 2{,}70{,}000$ = ₹ 90,000

Patel does not bring Goodwill in cash.

Journal Entries :

Patel's current A/c...Dr	30,000	
Pandya's capital A/c...Dr	60,000	
To Pandit's capital A/c		90,000

Note : As capital of all partners is to be kept in new profit sharing ratio, by taking Patel's capital as base, goodwill of Patel is debited to his current account.

(3) Capital of partners in new profit-loss sharing ratio

For $\frac{1}{9}$th share of Patel, capital = ₹ 50,000

Total capital of firm 1 = (?)

= 50,000 × 9 = ₹ 4,50,000

Pandit's capital in new firm = $\frac{3}{9} \times 4{,}50{,}000$ = ₹ 1,50,000

Pandya's capital in new firm = $\frac{5}{9} \times 4{,}50{,}000$ = ₹ 2,50,000

Illustration 28 : A and B are partners sharing profit-loss in the ratio of 2:1. The balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Plant-Machinery		80,000
A	80,000		Building		50,000
B	40,000	1,20,000	Stock		17,000
Reserve fund		21,000	Debtors	50,000	
Creditors		75,000	− Bad debt reserve	4000	46,000
Bills payable		10,000	Cash-Bank		33,000
		2,26,000			**2,26,000**

They admitted C as a new partner on 1-4-2016 on following conditions :

(1) A sacrificed $\frac{1}{12}$th share and B sacrificed $\frac{1}{6}$th share from their profit share in favour of C.

(2) C will bring proportionate capital.

(3) C will bring his share of goodwill in cash. Goodwill is valued at ₹ 1,80,000.

(4) Fixed assets are to be depreciated at 10 %.

(5) All debtors are solvent.

(6) Insurance premium of ₹ 3000 is to be carried forward to the next year.

Prepare necessary account and the balance sheet.

Revaluation Account

Dr | | | | | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Plant-Machinery A/c	8000	By Bad debt reserve A/c		4000
To Building A/c	5000	By Prepaid insurance premium A/c		3000
		By Loss transferred to old partners capital A/c		
		A	4000	
		B	2000	6000
	13,000			**13,000**

Partners' Capital Accounts

Dr | | | | | | | Cr

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c	4000	2000	–	By Balance b/d	80,000	40,000	–
To Balance c/d	1,05,000	75,000	60,000	By Reserve fund A/c	14,000	7000	–
				By Premium for goodwill A/c	15,000	30,000	–
				By Cash A/c	–	–	60,000
	1,09,000	**77,000**	**60,000**		**1,09,000**	**77,000**	**60,000**

Cash Account

Dr | | | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	33,000	By Balance c/d	1,38,000
To C's capital A/c	60,000		
To Premium for goodwill A/c	45,000		
	1,38,000		**1,38,000**

Balance Sheet as on 1-4-2016 after admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Plant	72,000
A	1,05,000		Building	45,000
B	75,000		Stock	17,000
C	60,000	2,40,000	Debtors	50,000
Creditors		75,000	Cash	1,38,000
Bill payable		10,000	Prepaid insurance premium	3000
		3,25,000		**3,25,000**

Explanation : (1) Sacrificing ratio

Old ratio of A and B = 2:1

A's sacrifice = $\frac{1}{12}$

B's sacrifice = $\frac{1}{6} = \frac{2}{12}$

∴ Sacrificing ratio = 1:2

(2) Goodwill

C's share = A's sacrifice + B's sacrifice

$= \frac{1}{12} + \frac{2}{12} = \frac{3}{12} = \frac{1}{4}$

Goodwill brought by C $= \frac{1}{4} \times 1{,}80{,}000$

= ₹ 45,000

C's share of Goodwill ₹ 45,000 is to be distributed between A and B in their sacrificing ratio 1:2. (See illustration 6 for explanation.)

(3) C's capital

A's capital in new firm	₹ 1,05,000
B's capital in new firm	₹ 75,000
Total capital of A and B	₹ 1,80,000

C's share in profit = $\frac{1}{4}$

Total share in profit of A and B $= 1 - \frac{1}{4} = \frac{3}{4}$

A and B's share $\frac{3}{4}$ = Capital ₹ 1,80,000

C's share $\frac{1}{4}$ = (?)

$= 1{,}80{,}000 \times \frac{1}{4} \times \frac{4}{3}$

= ₹ 60,000

Illustration 29 : Chandni and Nihar are the partners sharing profit in the ratio of 3:2. Their balance sheet as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Creditors		64,000	Bank		56,000
General reserve		12,000	Debtors	80,000	
Investment fluctuation reserve		6000	− Provision for bad debt	4000	76,000
Workmen profit sharing fund		45,000	Investment		90,000
Capital account : Chandni	1,00,000		Building		60,000
Nihar	80,000	1,80,000	Machinery		25,000
		3,07,000			**3,07,000**

On 1-4-2016, they admitted Payal as a new partner on the following conditions :

(1) Payal brought ₹ 20,000 as goodwill in cash.

(2) Provision for doubtful debt is not required.

(3) Value of machinery is to be reduced by 10 %.

(4) Market value of building is ₹ 1,00,000.

(5) Market value of investments is ₹ 98,500.

(6) Payal will bring 20 % of total capital of Chandni and Nihar in the new firm as her capital.

(7) New profit sharing ratio is to be kept at 2:2:1.

(8) Chandni and Nihar will maintain their capital in the proportion of their new profit and loss sharing ratio.

Prepare necessary accounts and balance sheet.

Revaluation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		2500	By Doubtful debt reserve	4000
To Profit transferred to old partners			By Building A/c	40,000
capital A/c			By Investment A/c	8500
Chandni	30,000			
Nihar	20,000	50,000		
		52,500		**52,500**

Partners' Capital Accounts

Dr | Cr

Particulars	Chandni (₹)	Nihar (₹)	Payal (₹)	Particulars	Chandni (₹)	Nihar (₹)	Payal (₹)
To Bank A/c	26,800	–	–	By Balance b/d	1,00,000	80,000	–
To Balance c/d	1,34,000	1,34,000	53,600	By General reserve A/c	7200	4800	–
				By Investment fluctuation reserve A/c	3600	2400	–
				By Premium for goodwill A/c	20,000	–	–
				By Revaluation A/c	30,000	20,000	–
				By Bank A/c	–	26,800	53,600
	1,60,800	**1,34,000**	**53,600**		**1,60,800**	**1,34,000**	**53,600**

Cash / Bank Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	56,000	By Chandni's capital A/c	26,800
To Premium for goodwill A/c	20,000	By Balance c/d	1,29,600
To Payal's capital A/c	53,600		
To Nihar's capital A/c	26,800		
	1,56,400		**1,56,400**

Balance Sheet as on 1-4-2016 after Admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Account :			Bank	1,29,600
Chandni	1,34,000		Debtors	80,000
Nihar	1,34,000		Investment	98,500
Payal	53,600	3,21,600	Building	1,00,000
Creditors		64,000	Machinery	22,500
Workmen profit sharing fund		45,000		
		4,30,600		**4,30,600**

Explanation : (1) Sacrificing ratio

Old profit-loss sharing ratio of Chandni and Nihar = 3:2

New profit-loss sharing ratio of Chandni, Nihar and Payal = 2:2:1

Sacrifice = Old share – New share

Chandni's sacrifice $= \frac{3}{5} - \frac{2}{5} = \frac{1}{5}$; Nihar's sacrifice $= \frac{2}{5} - \frac{2}{5} = 0$

(2) **Capital of Chandni, Nihar and Payal**

Particulars	Chandni	Nihar
Opening balance	1,00,000	80,000
General reserve	7200	4800
Investment fluctuation reserve	3600	2400
Premium for goodwill	20,000	–
Revaluation profit	30,000	20,000
	1,60,800	**1,07,200**

Payal brought her share of capital, which is 20 % of total capital of Chandni and Nihar.

Chandni's capital = 1,60,800

Nihar's capital = 1,07,200

Total capital of Chandni and Nihar = 2,68,000

$\therefore$ Payal's capital = $2,68,000 \times \frac{20}{100}$ = ₹ 53,600

Chandni and Nihar maintained their total capital in their new profit sharing ratio.

Total capital of Chandni and Nihar is ₹ 2,68,000. New profit-loss sharing ratio = 2:2 = 1:1

$\therefore$ Chandni's capital = $2,68,000 \times \frac{1}{2}$ = ₹ 1,34,000

Nihar's capital = $2,68,000 \times \frac{1}{2}$ = ₹ 1,34,000

Note : Premium for goodwill is received by Chandni only.

Illustration 30 : Shivani and Niraj are the partners in a firm sharing profit and loss in the ratio of 1:2. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Goodwill	27,000
Shivani	1,00,000		Land-Building	1,50,000
Niraj	1,50,000	2,50,000	Machinery	50,000
Profit-loss A/c		9000	Stock	20,000
General reserve		15,000	Debtors	30,000
Creditors		25,000	Bills receivable	10,000
Bad debt reserve		8000	Cash	20,000
		3,07,000		**3,07,000**

They admitted Vijay as a new partner as on above date for the following terms :

(1) Bad debt reserve is to be kept ₹ 5000 on debtors.

(2) Goodwill is valued at ₹ 36,000.

(3) Value of land and building is to be appreciated by 10 %.

(4) Book value of machinery is 25 % more than its market value.

(5) Value of stock is to be decreased by 10 %.

(6) Vijay will bring 50 % of net assets of new firm as the capital and his share of gooodwill in cash.

(7) Shivani sacrifices $\frac{1}{3}$rd of her share and Niraj sacrifices $\frac{1}{3}$ share for Vijay.

Prepare necessary accounts and balance sheet after admission of a new partner.

Revaluation Account

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		10,000	By Bad debt reserve A/c	3000
To Stock A/c		2000	By Land-building A/c	15,000
To Profit transferred to old partners' capital A/c				
Shivani	2000			
Niraj	4000	6000		
		18,000		**18,000**

Partners' Capital Accounts

Dr Cr

Particulars	Shivani (₹)	Niraj (₹)	Vijay (₹)	Particulars	Shivani (₹)	Niraj (₹)	Vijay (₹)
To Goodwill A/c	9000	18,000	–	By Balance b/d	1,00,000	1,50,000	–
To Balance c/d	1,05,000	1,64,000	2,69,000	By Profit-loss A/c	3000	6000	–
				By General reserve A/c	5000	10,000	–
				By Premium for goodwill A/c	4000	12,000	–
				By Revaluation A/c	2000	4000	–
				By Cash A/c	–	–	2,69,000
	1,14,000	**1,82,000**	**2,69,000**		**1,14,000**	**1,82,000**	**2,69,000**

Cash Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	20,000	By Balance c/d	3,05,000
To Premium for goodwill A/c	16,000		
To Vijay's capital A/c	2,69,000		
	3,05,000		**3,05,000**

Balance Sheet as on 1-4-2016 After Admission

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Land-Building	1,65,000
Shivani	1,05,000		Machinery	40,000
Niraj	1,64,000		Stock	18,000
Vijay	2,69,000	5,38,000	Bills receivable	10,000
Creditors		25,000	Debtors	30,000
Bad debt reserve		5000	Cash	3,05,000
		5,68,000		**5,68,000**

Explanation (1) Sacrificing ratio

Old profit-loss sharing ratio of Shivani and Niraj = 1:2

Shivani sacrificed $\frac{1}{3}$rd of her profit share

∴ Sacrifice of Shivani $= \frac{1}{3} \times \frac{1}{3} = \frac{1}{9}$

Niraj sacrificed $\frac{1}{3}$rd from his profit share

∴ Sacrifice of Niraj $= \frac{1}{3}$

∴ Sacrificing ratio $= \frac{1}{9} : \frac{1}{3}$ = 1:3 (See illustration 5 for explanation)

(2) Distribution of goodwill

Share of Vijay = Sacrifice of Shivani + Sacrifice of Niraj

$$= \frac{1}{9} + \frac{1}{3}$$

$$= \frac{1+3}{9}$$

$$= \frac{4}{9}$$

Share of Goodwill of Vijay $= 36{,}000 \times \frac{4}{9}$ = ₹ 16,000

Goodwill of Vijay will be distributed between Shivani and Niraj in their sacrificing ratio 1:3.

(3) Book value of machinery is ₹ 50,000, which is 25 % more from its market value. Therefore if market value of machinery is ₹ 100, its book value is ₹ 125. Determine the market value of machine as under :

Book value	Market value
125	100
50,000	(?)

$$= 100 \times \frac{50{,}000}{125} = ₹\ 40{,}000$$

(4) Capital is brought by Vijay :

Vijay brought 50 % of net asset of new firm as capital

Net assets = Total assets − Total Liabilities

Total assets − Total liabilities is total capital

∴ 50 % of total capital is brought by Vijay as his share of capital in new firm.

Capital of Shivani in new firm	₹ 1,05,000
Capital of Niraj in new firm	₹ 1,64,000
Total capital of Shivani and Niraj in new firm =	₹ 2,69,000

50 % of total capital is brought by Vijay.

∴ Remaining 50 % capital is of Shivani and Niraj

∴ 50 % capital = ₹ 2,69,000 of Shivani and Niraj

50 % capital of Vijay = (?)

= ₹ 2,69,000

EXERCISE

1. Select appropriate alternative for each question :

(1) Balance of general reserve and credit balance of profit and loss account is transferred to .... account at the time of the admission of a new partner.

(a) capital account of newly admitted partner
(b) all partners' capital accounts including new partner
(c) old partners' capital accounts
(d) revaluation account

(2) Goodwill appearing in the books of the firm at the time of admission of the new partner is recorded as ....

(a) debited to old partners' capital accounts in their old profit-loss sharing ratio and goodwill account is credited
(b) credited to all partners' capital accounts including new partner in their new profit-loss sharing ratio.
(c) admitted partners' capital A/c Cr, Goodwill A/c Dr
(d) credited to old partners' capital accounts in their old profit-loss sharing ratio and goodwill account debited.

(3) Premium for goodwill brought by the partner is recorded on .... side.

(a) debit side of old partners' capital accounts in old profit-loss sharing ratio.
(b) credit side of old partners' capital accounts in their old profit-loss sharing ratio
(c) debit side of old partners' capital accounts in their sacrificing ratio
(d) credit side of old partners' capital accounts in their sacrificing ratio

(4) Revaluation account is .... type of account.

(a) personal (b) nominal
(c) real (d) temporary

(5) When new partner brings his share of goodwill in cash, ... account is credited.

(a) cash (b) premium for goodwill
(c) goodwill (d) his capital account

(6) As per accounting standard-26 .... goodwill can not be shown in the books.

(a) goodwill for which some amount is paid for consideration
(b) internally generated
(c) (a) and (b) both
(d) neither of (a) and (b)

(7) Revaluation account is also known as ....

(a) profit-loss account (b) profit and loss adjustment account

(c) profit and loss appropriation account (d) profit and loss suspense account

(8) When only old profit-loss sharing ratio is given; sacrificing ratio of partners = ...

(a) equal (b) old ratio

(c) old share – new share (d) can not be calculated

(9) Old partner is also required to give his share in goodwill to other old partner, when ....

(a) his capital is less

(b) his new share in new profit-loss ratio is more than his old share

(c) his new share in new profit-loss ratio is less than his old share

(d) his new share in new profit-loss ratio is equal to old share

(10) Profit or loss of revaluation account is transferred to .... account in .... ratio.

(a) old partners, equal (b) all partners, new profit-loss sharing ratio

(c) old partners, sacrificing ratio (d) old partners, old ratio

2. Answer following questions in one sentence :

(1) How is a new partner admitted in a firm ?

(2) For what purpose a new partner is admitted in a firm ?

(3) State necessary accounting adjustments at the time of the admission of a new partner.

(4) State rights of a new partner.

(5) Why assets and liabilities are revalued at the time of the admission of a new partner ?

(6) Why a new partner is required to give his share in goodwill ?

(7) What is sacrificing ratio ? How it is calculated ?

(8) Explain with reasons the accounting treatment of reserves and accumulated profit and loss appearing in the books of the firm at the time of the admission of a new partner.

(9) When revaluation account is debited and credited ?

(10) State provision for the goodwill as per accounting standard-26.

3. Calculate new profit and loss sharing ratio and sacrificing ratio :

(1) A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{4}$th share in profit.

(2) A and B are the partners sharing profit and loss in the ratio of $\frac{4}{5}$ and $\frac{2}{10}$. They admitted C as a new partner for 20 % profit of the firm.

(3) A and B are the partners in a firm. They admitted C for $\frac{1}{6}$th share as a new partner. After the admission of C, the new profit and loss sharing ratio of A and B will be 2:3.

(4) A and B are partners in a firm sharing profit and loss in the ratio of 2:1. They admitted C as a new partner for $\frac{1}{5}$th share in the profit. C will acquire $\frac{1}{10}$th share from A and $\frac{1}{10}$th share from B.

(5) A, B and C are the partners sharing profit and loss in the ratio of 5:3:2. They admitted D as a new partner. 'A' sacrifices $\frac{1}{20}$th from his share and 'B' sacrifices $\frac{3}{40}$th from his share in favour of D.

(6) A and B are the partners sharing profits in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{10}$th share of profit which he will acquire from A and B in equal proportion.

(7) A, B and C are the partners sharing profit in the ratio of 20 %, 40 % and 40 % respectively. They admitted D as a new partner for $\frac{1}{8}$th share in profit. D is to receive his share from B and C in the ratio of 3:2.

(8) A and B are the partners in a firm. They admitted C as a new partner for $\frac{1}{5}$th share in profit. Out of which C takes $\frac{1}{15}$th share from A and remaining share from B.

(9) A, B and C are the partners sharing profit and loss in the ratio of 4:3:3. They admitted D as a new partner for $\frac{1}{20}$th share of profit, out of which he takes $\frac{1}{40}$th from A and remaining share from B and C equally.

(10) A and B are the partners sharing profit and loss in the ratio of 3:1. They admitted C as a new partner. 'A' sacrifices $\frac{1}{3}$rd of his share and 'B' sacrifices $\frac{1}{4}$th of his share in favour of C.

(11) A and B are the partners sharing profit and loss in the ratio of 5:3. They admitted C as a new partner. A sacrifices 30 % his share and 'B' sacrifices 20 % of his share in favour of C.

(12) X and Y are the partners sharing profit and loss in the ratio of 2:1. They admitted Z as a new partner. 'X' sacrifices $\frac{1}{15}$th from his share and 'Y' sacrifices $\frac{1}{5}$th of his share in favour of Z.

(13) X, Y and Z are the partners sharing profit and loss in the ratio of 2:3:1. They admitted W as a new partner with $\frac{1}{6}$th share. Z will retain his original share in future also.

(14) X and Y are the partners sharing profit and loss in the ratio of 5:4. They admitted Z as a new partner. All the three partners will distribute future profit in equal proportion. (Calculate only sacrificing ratio.)

(15) X, Y and Z are the partners sharing profit and loss in the ratio of 3:2:1. They admitted W as a new partner. Their new profit-loss sharing ratio is to be 4:3:2:3. (Calculate only sacrificing ratio).

4. Pass necessary journals for the following transactions :

(1) A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{5}$th share of profit. C brings ₹ 80,000 as his capital in cash. C gave his share of goodwill personally to A and B. There was a balance of goodwill ₹ 25,000 in the books of firm before C's admission.

(2) A and B are the partners in a firm. C admitted as a new partner for $\frac{1}{4}$th share in profit. C brought ₹ 80,000 as his capital and his proportionate share of goodwill in cash. Goodwill of the firm is valued at ₹ 1,00,000.

(3) A and B are the partners sharing profit and loss in the ratio of 2:3. They admitted C as a new partner. C brought his share in capital and goodwill ₹ 40,000 and ₹ 60,000 in cash respectively. At the time of C's admission the balance of goodwill in balance sheet of the firm was ₹ 30,000. New profit and loss sharing ratio of all the partners is decided at 3:5:2.

(4) P, Q and R are the partners sharing profit and loss in the ratio of 3:2:1. They maintain their capital account by fixed capital method. They admitted S as a new partner. S brought cash ₹ 50,000, Furniture ₹ 40,000 and Motor car ₹ 60,000 as his capital and share of goodwill. Goodwill is valued at ₹ 2,40,000. At the time of S's admission goodwill appeared in the books of the firm at ₹ 90,000. New profit-loss sharing ratio of all the partners is decided at 4:3:2:3. Old partners withdrew 50 % goodwill of their share in cash.

(5) X and Y are the partners sharing profit and loss in the ratio of 1:3. Z admitted as a new partner. Z brought ₹ 65,000 as a capital and ₹ 36,000 as his share of goodwill in cash. After Z's admission, all partners decided to distribute the profit equally in future.

(6) M, N and O are the partners sharing profit and loss in the ratio of 4:3:3. They admitted P as a new partner. P brought ₹ 40,000 as goodwill in cash. New profit sharing ratio of all the partners is decided at 1:1:2:1. Balance of goodwill in old firm was ₹ 50,000.

(7) B and C are the partners. D admitted as a new partner in the firm. D brought ₹ 50,000 as a capital and ₹ 14,000 in cash out of his share in goodwill ₹ 20,000.

(8) A, B and C are the partners sharing profit and loss in the ratio of 3:2:4. They maintain their capital accounts by fixed capital method. They admitted D as a new partner. D brought ₹ 70,000 as capital and ₹ 30,000 as share of goodwill in cash. At the time of admission of D, the balance of goodwill was ₹ 45,000 in the balance sheet of the firm. At the time of admission, goodwill is valued of ₹ 1,80,000. New ratio of A, B, C and D decided at 1:1:1:1.

(9) A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{5}$th share. C brought ₹ 30,000 as capital in cash, but he could not bring his share of goodwill ₹ 10,000 in cash.

(10) P and Q are the partners sharing profit and loss in the equal proportion. They maintain their capital accounts by fixed capital method. They admitted R as a new partner. At the time of R's admission goodwill ₹ 70,000 was appearing in the balance sheet. R brought ₹ 40,000 as his capital in cash. Goodwill is valued at ₹ 1,60,000. New profit sharing ratio of P, Q and R is decided at 5:2:1.

(11) Capital of G and E is ₹ 80,000 and ₹ 60,000 respectively. They admitted B as a new partner for $\frac{1}{4}$th share in profit. B brought ₹ 50,000 as his capital. Calculate goodwill and pass necessary journal entries for goodwill.

(12) R, C and B are the partners sharing profit and loss in the ratio of 3:2:1. Their capital as on 1-4-2016 is ₹ 1,00,000, ₹ 60,000 and ₹ 50,000 respectively. On that date the balance of general reserve was ₹ 90,000. They admitted P as a new partner. P brought ₹ 1,80,000 as his capital. New profit and loss sharing ratio of all the partners is decided to 2:1:1:2. Calculate goodwill and pass necessary journal entries.

(13) X and Y are the partners sharing profit and loss in the ratio of 2:3. They admitted Z as a new partner for $\frac{1}{5}$th share. Goodwill is valued at ₹ 20,000. Balance of goodwill appeared at ₹ 15,000 in the balance sheet. Z brought ₹ 50,000 as his capital and 80 % of his share of goodwill in cash. Old partners withdrew 40 % amount of goodwill in cash which is credited to their capital account. After the admission of Z the profit of the first year of the new firm was ₹ 60,000. Pass necessary journal entries.

5. R and J are the partners sharing profit and loss in the ratio of 2:3. They admitted B as a new partner for $\frac{1}{6}$th share of profit. Following balances appeared in the books of R and J at the time of the admission of B :

General reserve ₹ 7000
Contigency reserve ₹ 5100
Workmen compensation reserve ₹ 6000
Bad debt reserve ₹ 4200
Investment fluctuation reserve ₹ 1900
Advertisement campaign expenditure ₹ 3400
Profit-loss A/c (Debit balance) ₹ 1600

Pass necessary journal entries.

6. K and R are the partners sharing profit and loss in the ratio of 4:1. They admitted P as a new partner for $\frac{1}{5}$th share. Following balances were appearing in the books of K and R at the time of admission of P.

Investment fluctuation reserve ₹ 2500
Workmen compensation reserve ₹ 7000
Bad debt reserve ₹ 3000
Investment ₹ 20,000
Debtors ₹ 70,000

Pass necessary journal entries in the following cases :

(1) If market value of investment is as under :
(i) ₹ 19,500 (ii) ₹ 22,000

(2) If following claim of workmen compensation is accepted :
(i) ₹ 6000 (ii) ₹ 8500

(3) If bad debt reserve is to be maintained on debtors :
(i) ₹ 4000 (ii) ₹ 2500
(iii) 10 % bad debt reserve is to be maintained after writting off bad debt ₹ 2000.

7. A and B are the partners sharing profit and loss in equal proportion. They admitted C as a new partner for $\frac{1}{4}$th share. Following balances were appearing in the balance sheet of A and B at the time of the admission of C.

Patents	₹	30,000	Goodwill	₹	20,000
Land-Building	₹	1,80,000	Machinery	₹	60,000
Stock	₹	35,000	Creditors	₹	40,000

On C's admission, they decided that,

(i) Patents are to be written off fully.
(ii) Value of land and building is to be increased by 20 %.
(iii) Value of machinery is to be decreased upto 60 %.
(iv) Stock was overvalued by ₹ 4000 than its cost price.
(v) Creditors of ₹ 6000 are not to be paid.

Pass necessary journal entries and prepare the revaluation account.

8. Aabha and Beena are partners in a firm sharing profit and loss in the ratio of 2:1. Their balance sheet as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			Goodwill		18,000
Aabha	80,000		Land-building		72,000
Beena	60,000	1,40,000	Machinery		40,000
General reserve		18,000	Stock		36,000
Workmen compensation reserve		4500	Debtors	24,000	
Investment fluctuation reserve		1500	– Bad debt reserve	2000	22,000
Creditors		28,000	Investment		8000
Bills payable		12,000	Cash-Bank		2000
			Advertisement campaign expenditure		6000
		2,04,000			**2,04,000**

They admitted Rushil as a new partner from 1-4-2017 on the following conditions :

(1) Rushil will bring ₹ 1,00,000 as his capital and ₹ 24,000 as goodwill in cash.

(2) Value of land and building is to be increased by ₹ 17,000.

(3) Value of machinery is to be decreased upto ₹ 32,000.

(4) Provision for bad debt is to be kept at 10 % on debtors.

(5) Provision for outstanding electricity bill is to be made at ₹ 1100.

(6) New profit sharing ratio of all three partners is to be kept at 2:1:2.

Pass necessary journal entries and prepare revaluation account, partners' capital account, cash-bank account and balance sheet after admission.

9. Aashtha and Aahna are partners in a firm. The balance sheet of the firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Goodwill	8400
Aashtha	76,000		Land-Building	40,000
Aahna	48,400	1,24,400	Machinery	32,000
Workmen compensation fund		4800	Investment	20,000
Investment fluctuation fund		1600	Debtors	25,200
Provident fund		6400	Stock	14,400
Bad debt reserve		8000	Cash	16,000
Creditors		12,000	Advertisement campaign expenditure	3200
Bills payable		6000	Profit-loss A/c	4000
		1,63,200		**1,63,200**

The admitted Sonu as a new partner as on 1-4-2017 on the following condition :

(1) Sonu will bring ₹ 80,000 as her capital and ₹ 7200 as her share of goodwill in cash.

(2) New profit and loss sharing ratio will be 4:3:3.

(3) Goodwill is to be valued at ₹ 40,000.

(4) The claim of workmen compensaiton is accepted at ₹ 3200.

(5) Aahna will take over investments at ₹ 19,200.

(6) Accrued interest on investment ₹ 2400 is not recorded.

(7) Accepted bills payable of ₹ 2000 which was drawn by creditors is not recorded.

(8) Book value of land-building is 20 % less then its market value.

(9) Out of insurance premium paid, ₹ 4800 is for next year.

Prepare necessary accounts and balance sheet after admission.

10. Vidit and Vishal are partners sharing profit and loss in the ratio of 2:3. The balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Building	66,000
Vidit	48,000		Machinery	30,000
Vishal	60,000	1,08,000	Stock	18,000
Contigency reserve		9000	Debtors	39,600
Workmen compensation reserve		24,000	Bank	8400
Investment reserve		7200	Investment	18,000
Creditors		30,000		
Bad debt reserve		1800		
		1,80,000		**1,80,000**

They admitted Bunty on 1-4-2016 as a new partner on the following terms :

(1) Vidit will sacrifice $\frac{1}{4}$th from his share and Vishal will sacrifice $\frac{1}{8}$th from his share in the favour of Bunty.

(2) Bunty will bring ₹ 72,000 as capital and his share of goodwill in cash.

(3) Goodwill of the firm is valued at ₹ 32,000.

(4) Vidit and Vishal withdrew 50 % of goodwill received by them in cash.

(5) Provision for depreciation on machinery is to be made at 10 %.

(6) Write off ₹ 3600 as bad debt from debtors and provision for bad debt is to be maintained at 15 %.

(7) Market value of investment is ₹ 9000 which is to be recorded in the books.

(8) Claim of workmen compensation is accepted at ₹ 30,000.

(9) 10 % of creditors are now not to be paid.

Prepare necessary account and balance sheet of new firm.

11. Prerna and Piyush are partners in a firm sharing profit and loss in the ratio of their capital. Balance sheet of their firm was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Building	90,000
Prerna	50,000		Furniture	17,500
Piyush	1,50,000	2,00,000	Machinery	1,07,500
Reserve fund		30,000	Stock	17,500
Creditors		40,000	Debtors	30,000
Outstanding expenses		1500	Cash-Bank	8250
			Accrued income	750
		2,71,500		**2,71,500**

They admitted Poyani as a new partner for $\frac{1}{5}$th share of profit on 31-3-2016 on following terms :

(1) Poyani brought ₹ 62,500 as capital and ₹ 24,000 as her share of goodwill in cash. 60 % amount of goodwill is withdrawn by the old partners.

(2) Market value of stock and machinery is ₹ 20,000 and ₹ 1,20,000 respectively.

(3) Provision for bad debt at 10 % and 2 % discount reserve on debtors is to be made.

(4) Creditors are to be paid ₹ 30,000.

(5) Value of building is to be increased by 15 % and value of furniture is to be increased by 20 %.

(6) Outstanding wages of ₹ 460 is not recorded in the books.

From the above information prepare necessary accounts and new balance sheet of the firm.

12. P and Q are partners sharing profit and loss in the ratio of 3:2. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			Land-Building		80,000
P	70,000		Debtors	22,000	
Q	50,000	1,20,000	− Bad debt reserve	2000	20,000
Provident fund		18,000	Stock		36,000
Creditors		22,000	Cash		4000
			Goodwill		20,000
		1,60,000			**1,60,000**

On above date they admitted R as a new partner on the following terms :

(1) R will bring ₹ 60,000 as capital in cash.

(2) Goodwill is valued at ₹ 30,000.

(3) R can not bring his share of goodwill in cash.

(4) Value of land and building is ₹ 90,000.

(5) Bad debt reserve is to be provided at 5 % on debtors.

(6) Value of stock is to be reduced by ₹ 400.

(7) Creditors of ₹ 500 are not to be paid.

(8) New profit and loss sharing ratio of all partners is decided at 5:2:3.

From the above information prepare necessary accounts and balance sheet after admission. Give necessary journal entries for goodwill.

13. A and B are partners in a firm sharing profit and loss in the ratio of 4:1. Balance sheet of their firm on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			Land-Building		35,000
A	75,000		Furniture		30,000
B	25,000	1,00,000	Investments		25,000
Current account :			Stock		15,000
A	8000		Debtors	5500	
B	2000	10,000	− Bad debt reserve	500	5000
Workmen accident compensation fund		5000	Bills receivable		2000
Creditors		4000	Cash-Bank		3000
Bills payable		1000	Goodwill		5000
		1,20,000			**1,20,000**

They admitted C as a new partner on above date on the following conditions. They decided to keep their new profit-loss sharing ratio at 3:1:1 :

(1) C will bring ₹ 20,000 as capital for his $\frac{1}{5}$th share of profit and ₹ 5000 as his share of goodwill in cash. Out of goodwill half amount is to be withdrawn by the old partners.

(2) Value of land and building is to be increased by 10 %. While value of furniture and stock is to be decreased by 5 %.

(3) Market value of investment is ₹ 35,000. Which is to be shown in the books.

(4) Provision for doubtfull debt is to be made at 10 % on debtors.

(5) Workmen accident compensation claim is accepted ₹ 1000.

(6) Dishonour expense of bills receivable ₹ 150 and bank charges ₹ 300 which are paid but not recorded in the books.

Prepare necessary accounts and balance sheet after admission of partners.

14. Rutvi and Princy are partners sharing profit and loss in the ratio of 5:3. The balance sheet of their firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Workmen's profit sharing fund		30,000	Bank	60,000
Creditors		1,20,000	Debtors	90,000
Workmen compensation reserve		60,000	Stock	60,000
Current account :			Building	4,50,000
Rutvi	1,50,000		Investments	1,05,000
Princy	1,95,000	3,45,000		
Capital account :				
Rutvi	1,20,000			
Princy	90,000	2,10,000		
		7,65,000		**7,65,000**

They admitted Manan as a partner on 1-4-2017 on the following terms :

(1) Manan will bring his personal furniture of ₹ 75,000 as capital.

(2) Out of creditors ₹ 60,000 are payable to Manan which is to be transferred to his capital account.

(3) Manan will be given $\frac{1}{5}$th share in future.

(4) Manan will bring ₹ 45,000 as goodwill in cash.

(5) Goodwill of firm is valued at ₹ 3,00,000.

(6) Credit purchase of ₹ 15,000 which was not recorded in creditors account and purchase account but it is included in closing stock.

(7) Market value of stock of ₹ 45,000 is ₹ 36,000.

(8) Liability of workmen compensation is ₹ 28,000.

(9) Accrued interest on investment ₹ 24,000 is not recorded.

Prepare new balance sheet after admission.

15. Riya and Gauri are the partners sharing profit and loss in the ratio of 1:2. They admitted Sanju as a new partner for $\frac{1}{5}$th share on 1-4-2017. Sanju brings ₹ 90,000 as capital in cash. After the adjustment of reserves, profit of revaluation and goodwill the capital of Riya and Gauri was ₹ 1,50,000 and ₹ 2,00,000 respectively. Partners decided to maintain new firms' total capital at ₹ 4,50,000 in their new profit and loss ratio. Necessary amount is to be brought or writhdrawn in cash. Prepare partners' capital account.

16. Parshvi and Aneri are the partners sharing profit and loss in the ratio of 2:1. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Goodwill		21,000
Parshvi	91,000		Building		1,40,000
Aneri	84,000	1,75,000	Furniture		28,000
Capital reserve		14,700	Stock		18,200
Workmen saving account		7000	Debtors		16,800
Workmen profit sharing fund		8400	Cash		56,000
10 % Loan from bank		35,000			
Creditors		39,900			
		2,80,000			**2,80,000**

On 1-4-2016 they admitted Henshi as a new partner on the following conditions :

(1) New profit and loss sharing ratio is to be kept at 3:4:2.

(2) Henshi brings ₹ 40,000 as capital.

(3) Interest on bank loan is outstanding for one year.

(4) Personal expense of Parshvi paid by the firm is debited to the profit and loss account ₹ 5600.

(5) Reconstruction expense is paid by Aneri ₹ 8400.

(6) Goodwill is valued at ₹ 90,000.

(7) Parshvi and Aneri will maintain their capital in the new firm in their new profit and loss sharing ratio by taking Henshi's capital as base. For this purpose necessary adjustments should be made in partners' current account.

Prepare necessary accounts and balance sheet after admission.

17. Ankita and Esha are the partners sharing profit and loss in the ratio of 2:1. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Machinery		64,000
Ankita	64,000		Furniture		40,000
Esha	32,000	96,000	Stock		13,600
General reserve		16,800	Debtors	40,000	
Creditors		60,000	− Bad debt reserve	3200	36,800
Bills payable		8000	Cash-Bank		26,400
		1,80,800			**1,80,800**

They admitted Arpita as a new partner on 1-4-2016 on the following conditions :

(1) Ankita sacrificed $\frac{1}{12}$th from her share and Esha sacrificed $\frac{1}{6}$th from her share in favour of Arpita.

(2) Arpita is to bring proportionate capital.

(3) Arpita is to bring her share of goodwill in cash. Goodwill of the firm is valued at ₹ 90,000.

(4) Fixed assets are to be depreciated by 10 %.

(5) All debtors are good.

(6) Insurance premium of ₹ 2400 out of ₹ 12,000 is to be carried forward to next year.

Prepare necessary accounts and balance sheet.

18. Jaini and Aanya are the partners sharing profit and loss in the ratio of 3:2. The balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		**Amt. (₹)**	**Assets**		**Amt. (₹)**
Capital :			Building		42,000
Jaini	70,000		Machinery		17,500
Aanya	56,000	1,26,000	Investment		63,000
General reserve		8400	Debtors	56,000	
Investment reserve		4200	− Bad debt reserve	2800	53,200
Workmen profit sharing fund		31,500	Bank		39,200
Creditors		44,800			
		2,14,900			**2,14,900**

They admitted Priyanka as a partner on 1-4-2016 on the following terms :

(1) Priyanka will bring ₹ 14,000 as goodwill in cash.

(2) Priyanka will bring her capital equal to 20 % of new total capital of Jaini and Aanya.

(3) New profit and loss sharing ratio is to be kept at 2:2:1.

(4) Provision for bad debt is not required.

(5) Machinery is to be reduced by 10 %.

(6) Market value of building is ₹ 70,000.

(7) Market value of investments is ₹ 68,950.

(8) Total capital of the old partners Jaini and Aanya after all adjustments will be maintained in their relative new ratio. For this purpose necessary adjustments will be made through bank.

Prepare necessary accounts and balance sheet.

19. Tapu and Sonu are the partners sharing profit and loss in the ratio of 1:2. The balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		**Amt. (₹)**	**Assets**	**Amt. (₹)**
Capital account :			Goodwill	54,000
Tapu	2,00,000		Land-Building	3,00,000
Sonu	3,00,000	5,00,000	Machinery	1,00,000
Profit-loss A/c		48,000	Stock	40,000
Creditors		50,000	Debtors	80,000
Bad debt reserve		16,000	Cash	40,000
		6,14,000		**6,14,000**

They admitted Goli as a new partner on the following terms :

(1) Goodwill is valued at ₹ 54,000.

(2) Bad debt reserve on debtors to be maintained at ₹ 10,000.

(3) Land-building is to be increased by 10 %.

(4) Book value of machinery is 25 % more than its market value.

(5) Value of stock is to be reduced by 10 %.

(6) Goli will bring his capital equal to 50 % of net assets of the new firm.

(7) Goli will bring his share of goodwill in cash.

(8) Tapu sacrifices $\frac{1}{3}$rd of his profit share and Sonu sacrifices $\frac{1}{6}$ share for Goli.

Prepare the necessary accounts and balance sheet. Also determine new profit-loss sharing ratio of all the three partners.

20. Meet, Jeet and Neel are the partners sharing profit and loss in the ratio of 3:2:1. The balance sheet of their firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Building	1,00,000
Meet	1,00,000		Machinery	80,000
Jeet	75,000		Investment	60,000
Neel	50,000	2,25,000	Debtors	40,000
General reserve		12,000	Stock	64,000
Investment fluctuation reserve		20,000	Cash	26,000
Workmen compensation reserve		15,000		
Workmen profit sharing fund		35,000		
Workmen saving account		40,000		
Creditors		23,000		
		3,70,000		**3,70,000**

On the above date they admitted Heer as a new partner on the following conditions :

(1) Meet sacrificed $\frac{1}{8}$th share and Neel sacrificed $\frac{1}{24}$th share from their profit in favour of Heer.

(2) Goodwill is valued at ₹ 60,000. Heer will bring her share of goodwill in cash.

(3) Market value of investment is ₹ 52,000, which is to be shown in books.

(4) Claim for workmen compensation is accepted at ₹ 18,000.

(5) Market value of machinery is ₹ 60,000 and market value of building is ₹ 1,26,000 which are to be brought in the books.

(6) Heer will bring ₹ 50,000 as her capital in cash.

(7) Capital of the partners shall be proportionate to their new profit sharing ratio, taking Heer's capital as base. Necessary effect is to be given in cash.

Prepare the necessary account and balance sheet after admission of Heer.

●

6

Retirement / Death of a Partner

1. Introduction

Retirement of a partner means retiring as a partner from a firm. As per Indian Partneship Act; 1932, when a partner retires from a firm for any reason or a partner dies, the partnership ends but the firm is not dissolved. Remaining partners can continue the firm and its business. For this purpose necessary accounting treatments of retirement are required to be given in the books of the firm. In this situation a partnership is reconstituted (reconstructed).

2. Circumstances of Retirement of a Partner

The circumstances of retirement of a partner can be divided into two parts :

(A) As per Indian Partnership Act

(B) Voluntary retirement of a partner due to his personal reasons

(A) As per Indian Partnership Act : As per Indian Partnership Act, partner can retire from the firm due to any of following reasons :

(1) Unanimously : Any partner can retire by unanimous consent of all the partners.

(2) By notice : A partner has right to retire from the firm by giving notice to other partners in writing indicating his intention of retirement from the firm.

(3) By contract : Any partner can retire as per the conditions of the partnership deed.

(4) Insolvency of a partner : A partnership of any partner ends from the date from which he is declared insolvent.

(5) Death of a partner : Partnership ends automatically due to the death of a partner.

(6) Expulsion by other partners : Subject to provision in partnership deed, a partner can be expelled by other partners.

(B) Voluntary retirement of a partner due to his personal reasons : A partner can decide to retire from the partnership due to his personal reasons. An active partner is required to give public notice regarding his retirement; otherwise he is responsible for the liabilities towards third parties arising from the activities after his retirement.

3. Important Accounting Aspects and Accounting Treatments

Following accounting aspects and accounting treatments are required to be taken into consideration when on the date of retirement a partner retires or dies and remaining partners decide to continue the business of the firm.

(1) Calculation of new profit-loss sharing ratio and calculation of gaining share of continuing partners.

(2) Valuation of goodwill and its accounting treatment.

(3) Revaluation of assets and liabilities.

(4) Distribution of accumulated reserves and balances of undistributed profits and losses.

(5) Determination of amount payable to the retiring or deceased partner.

(6) Payment of amount due to the retiring or deceased partner.

4. Calculation of New Profit and Loss Sharing Ratio and Gaining Ratio

When a partner retires or dies and the remaining partners continue the business of the firm, the new ratio of continuing partners is decided. The same way, the profit share of the retiring partner is distributed between the continuing partners. Consequently the gaining share of the continuing partners comes into existence. Now let us understand how the new profit sharing ratio and the gaining ratio is calculated.

Calculation of new profit-loss sharing ratio : Due to the retirement of a partner his profit share is distributed among the remaining continuing partners and therefore they are benefited in terms of profit share. Hence it becomes necessary to calculate the new profit-loss sharing ratio of the remaining partners. New share of continuing partners is obtained by adding their gain to their old share.

∴ New share = Old share + Gain and

Gain = New share − Old share

New profit-loss sharing ratio can be calculated as per the following circumstances :

(1) When gaining ratio or gain is not given, means old ratio is continued

(2) When gaining share of continuing partners is given

(3) When gaining ratio of continuing partners is given

(4) When old and new profit and loss sharing ratios are given

Now let us discuss the calculation of new profit sharing ratio in detail :

(1) When gaining ratio or gain is not given, means old ratio is continued : When the ratio in which the retiring partners' share is to be distributed among the continuing partners is not given, it is assumed that the continuing partners will continue to share the profit or loss in their respective old profit and loss sharing ratio. It means their old ratio will become the new ratio. In this situation new ratio of continuing partners becomes their old ratio by eleminating retiring partner's share.

Illustration 1 : M, N and O are the partners sharing profit and loss in the ratio of 4:3:2. Calculate new profit-loss sharing ratio under the following circumstances,

if (i) M retires

(ii) N retires

(iii) O retires

Ans. : Old ratio of M, N and O is 4:3:2.

(i) If M retires new profit and loss sharing ratio between N and O will be 3:2.

(ii) If N retires then new profit and loss sharing ratio of M and O will be 4:2 that is 2:1.

(iii) If O retires then new profit and loss sharing ratio of M and N will be 4:3.

Here the gaining ratio will be the old ratio of partners.

Gain = New share − Old share

When M retires :

	M		N		O
Old ratio :	4	:	3	:	2
New ratio :	Retired	:	3	:	2

N's gain $= \frac{3}{5} - \frac{3}{9} = \frac{27-15}{45} = \frac{12}{45}$

O's gain $= \frac{2}{5} - \frac{2}{9} = \frac{18-10}{45} = \frac{8}{45}$

∴ Gaining ratio of N and O = 12:8 i.e. 3:2.

Similarly when N retire the gaining ratio of M and O will be 2:1 and when O retires the gaining ratio of M and N will be 4:3.

Illustration 2 : M, N and O are the partners sharing profit and loss in the ratio of $\frac{4}{9}$, $\frac{1}{3}$ and $\frac{2}{9}$. Find out the new profit and loss sharing ratio under the following cases :

if (i) M retires

(ii) N retires

(iii) O retires

Ans. : Old profit and loss sharing ratio of M, N and O is $\frac{4}{9} : \frac{1}{3} : \frac{2}{9}$. Taking LCM, the ratio $= \frac{4}{9} : \frac{3}{9} : \frac{2}{9}$ i.e. 4:3:2. The new profit and loss sharing ratio in given circumstances will be as follows (Calculation will be the same as it is in illustration 1).

(i) If M retires then new profit and loss sharing ratio of N and O = 3:2.

(ii) If N retires then new profit and loss sharing ratio of M and O = 4:2 means 2:1.

(iii) If O retires then new profit and loss sharing ratio of M and N = 4:3.

Explanation : In the above illustrations if we calculate gaining ratio of the continuing partners,

Gain = New share − Old share

Under circumstances (i) if M retires,

	M		N		O
Old ratio	4	:	3	:	2
∴ Old share	$\frac{4}{9}$	:	$\frac{3}{9}$	:	$\frac{2}{9}$

On retirement of M, new ratio of N and O = 3:2

∴ New share of N and O $= \frac{3}{5} : \frac{2}{5}$

$\therefore$ Gain = New share − Old share

N's Gain $= \frac{3}{5} - \frac{3}{9} = \frac{27-15}{45} = \frac{12}{45}$

O's Gain $= \frac{2}{5} - \frac{2}{9} = \frac{18-10}{45} = \frac{8}{45}$

$\therefore$ Gaining ratio of N and O is $\frac{12}{45} : \frac{8}{45}$ means 12:8 or 3:2.

Thus, old ratio of N and O becomes their gaining ratio. Therefore,

Under circumstances (ii), if N retires, gaining ratio of M and O will be their old ratio 4:2 i.e. 2:1.

Under circumstances (iii), if O retires, gaining ratio of M and N will be their old ratio 4:3.

Note : Thus, by observing the above illustration we can say that when old profit and loss sharing ratio of remaining partners is continued even after the retirement of a partner, their gaining ratio also will be the same as old ratio. (Similar situation arises on the admission of a partner. Here gaining ratio is obtained while sacrificing ratio is obtained on admission. See illustration 1, chapter 4.)

(2) **When gaining share of the continuing partners is given :** When gaining share of continuing partners is given out of the retiring partners' share, new profit and loss sharing ratio will be calculated as under :

New share = Old share + Gain

Illustration 3 : X, Y and Z are the partners sharing profit and loss in the ratio of 3:2:1. Y retires as a partner. X gain $\frac{1}{9}$th share and Z gains $\frac{2}{9}$th share from the profit and loss share of Y. Calculate the new profit and loss sharing ratio of X and Z.

Ans. : Old ratio of X, Y and Z = 3:2:1

X gains $\frac{1}{9}$th share and Z gains $\frac{2}{9}$th share from $\frac{2}{6}$ share of Y.

$\therefore$ Gain of X $= \frac{1}{9}$ and Gain of Z $= \frac{2}{9}$. $\therefore$ Gaining ratio is 1:2.

New share = Old share + Gain

$\therefore$ X's new share $= \frac{3}{6} + \frac{1}{9} = \frac{9}{18} + \frac{2}{18} = \frac{11}{18}$

Z's new share $= \frac{1}{6} + \frac{2}{9} = \frac{3}{18} + \frac{4}{18} = \frac{7}{18}$

$\therefore$ New profit and loss sharing ratio of X and Z = 11:7

(3) **When gaining ratio of the continuing partners is given :** When the gaining ratio of continuing partners is given to distribute profit and loss share of the retiring partner, new profit and loss sharing ratio can be calculated as under :

First of all calculate gaining share of continuing partners by distributing retiring partners' share.

Gaining share of continuing partner = Share of the retiring partner × gaining share given to the respective partners

e.g. A, B and C are the partners sharing profit and losses in the ratio of 3:2:1. 'A' retires and his share is distributed between B and C in the ratio of 1:4.

A's share $= \frac{3}{6}$

A's $\frac{3}{6}$ share will be distributed by B and C in the ratio of 1:4.

So, B's gain $= \frac{3}{6} \times \frac{1}{5} = \frac{3}{30}$

C' gain $= \frac{3}{6} \times \frac{4}{5} = \frac{12}{30}$

So, gaining ratio of B and C = 1:4

Thereafter new profit and loss sharing ratio of B and C will be calculated as under :

New share = Old share + gain

$\therefore$ B's new share $= \frac{2}{6} + \frac{3}{30} = \frac{10}{30} + \frac{3}{30} = \frac{13}{30}$

C's new share $= \frac{1}{6} + \frac{12}{30} = \frac{5}{30} + \frac{12}{30} = \frac{17}{30}$

$\therefore$ New profit and loss sharing ratio of B and C = 13:17

Illustration 4 : O, B and C are the partners sharing profit and loss in the ratio of 4:5:1. O retires and his share is gained by B and C in the ratio of 1:4. Calculate new profit and loss ratio of B and C.

Ans. : Old ratio of O, B and C = 4:5:1

O's share is $\frac{4}{10}$ which is gained by B and C in the ratio of 1:4.

Gain = Retiring partners' share $\times$ Share of gaining ratio

B's Gain $= \frac{4}{10} \times \frac{1}{5} = \frac{4}{50}$

C's Gain $= \frac{4}{10} \times \frac{4}{5} = \frac{16}{50}$ So, gaining ratio of B and C = 1:4

New share = Old share + Gain

B's new share $= \frac{5}{10} + \frac{4}{50} = \frac{25}{50} + \frac{4}{50} = \frac{29}{50}$

C's new share $= \frac{1}{10} + \frac{16}{50} = \frac{5}{50} + \frac{16}{50} = \frac{21}{50}$

$\therefore$ New profit and loss sharing ratio of B and C = 29:21

Explanation : In the same illustration if B's gain $\frac{4}{50}$ and C's gain $\frac{16}{50}$ is given instead of gaining ratio 1:4, there is no need to calculate the gaining share of the continuing partners and new profit and loss sharing ratio can be calculated directly as under.

New share = Old share + Gain

$\therefore$ B's new share $= \frac{5}{10} + \frac{4}{50} = \frac{25}{50} + \frac{4}{50} = \frac{29}{50}$

C's new share $= \frac{1}{10} + \frac{16}{50} = \frac{5}{50} + \frac{16}{50} = \frac{21}{50}$

$\therefore$ New profit and loss sharing ratio of B and C = 29:21.

Note : Thus observing above, it can be seen that the gaining ratio and the gaining share are two different things. When gaining ratio is given, it is necessary to calculate first gaining share and new share can be calculated thereafter only. While new profit and loss sharing ratio can be directly calculated when the gaining share is given.

Illustration 5 : P, Q and R are the partners sharing profit and loss in the ratio of $\frac{1}{4}$, $\frac{1}{3}$ and $\frac{5}{12}$. Q retires. P and R decided to distribute Q's share in the ratio of 2:1. Calculate profit-loss sharing ratio of P and R.

Ans. : Old ratio of P, Q and R = $\frac{1}{4} : \frac{1}{3} : \frac{5}{12}$

Making LCM equal, the ratio is $\frac{3}{12} : \frac{4}{12} : \frac{5}{12}$.

Q retires and his share $\frac{4}{12}$ is gained by P and R in the ratio of 2:1.

$\therefore$ P's gain = $\frac{4}{12} \times \frac{2}{3} = \frac{8}{36}$

$\therefore$ R's gain = $\frac{4}{12} \times \frac{1}{3} = \frac{4}{36}$

Now, New share = Old share + Gain

$\therefore$ P's new share = $\frac{3}{12} + \frac{8}{36} = \frac{9}{36} + \frac{8}{36} = \frac{17}{36}$

R's new share = $\frac{5}{12} + \frac{4}{36} = \frac{15}{36} + \frac{4}{36} = \frac{19}{36}$

$\therefore$ New profit and loss sharing ratio of P and R = 17:19

Illustration 6 : R, B and I are the partners sharing profit and loss in the ratio of 5:4:3. B retires and $\frac{1}{4}$th share of B is acquired by R and remaining share is acquired by I. Find out new profit and loss sharing ratio of R and I.

Ans. : Old ratio of R, B and I = $\frac{5}{12} : \frac{4}{12} : \frac{3}{12}$

B retires and $\frac{1}{4}$ of his share $\frac{4}{12}$ is acquired by R.

$\therefore$ R's gaining share = $\frac{4}{12} \times \frac{1}{4} = \frac{4}{48} = \frac{1}{12}$

B's $\frac{1}{4}$th share is obtained by R, therefore $\frac{3}{4}$ $\left(1-\frac{1}{4}\right)$ share will be obtained by I.

$\therefore$ I's gain = $\frac{4}{12} \times \frac{3}{4} = \frac{12}{48} = \frac{3}{12}$

$\therefore$ Gain of R and I = $\frac{1}{12}$ and $\frac{3}{12}$

$\therefore$ Gaining ratio is 1:3.

New share = Old share + Gain

$\therefore$ R's new share = $\frac{5}{12} + \frac{1}{12} = \frac{6}{12}$

I's new share = $\frac{3}{12} + \frac{3}{12} = \frac{6}{12}$

$\therefore$ New profit and loss sharing ratio of R and I = $\frac{6}{12} : \frac{6}{12}$ = 1:1

Illustration 7 : M, N and C are the partners sharing profit and loss in the ratio of $\frac{1}{3}$, $\frac{1}{2}$ and $\frac{1}{6}$. C retires and his share is taken up by M. Calculate the new ratio of profit and loss sharing of M and N.

Ans. : Old sharing ratio of M, N and C = $\frac{1}{3} : \frac{1}{2} : \frac{1}{6}$

$= \frac{2}{6} : \frac{3}{6} : \frac{1}{6}$

C retires and his $\frac{1}{6}$ share is taken by M.

$\therefore$ M's Gain = $\frac{1}{6}$ and N's Gain = zero

New share = Old share + Gain

$\therefore$ M's new share = $\frac{2}{6} + \frac{1}{6} = \frac{3}{6}$

N's new share = $\frac{3}{6} + 0 = \frac{3}{6}$

$\therefore$ New profit and loss sharing ratio of M and N = 3:3 means 1:1

Illustration 8 : S, E, B and I are the partners sharing profits in the ratio of 4:3:2:1. B and I retires. B's share is acquired by S and I's share is acquired by E. Find out the new profit and loss sharing of S and E.

Ans. : Old ratio of S, E, B and I = $\frac{4}{10} : \frac{3}{10} : \frac{2}{10} : \frac{1}{10}$

B's share $\frac{2}{10}$ is acquired by S. So, S's gain = $\frac{2}{10}$

I's share $\frac{1}{10}$ is acquired by E. So, E's gain = $\frac{1}{10}$ $\therefore$ Gaining ratio is 2:1.

New share = Old share + Gain

$\therefore$ S's new share = $\frac{4}{10} + \frac{2}{10} = \frac{6}{10}$

E's new share = $\frac{3}{10} + \frac{1}{10} = \frac{4}{10}$

$\therefore$ New share of profit and loss sharing ratio = $\frac{6}{10} : \frac{4}{10}$

= 6:4 means 3:2

(4) When old and new profit and loss sharing ratios are given :

Gain = New share − Old share

Illustration 9 : U, P and A are the partners sharing profits and losses in the ratio of 4:3:2. U retires and P and A decide to share the future profit and loss in the ratio of 2:1. Calculate the gaining ratio of P and A.

Ans. : Old sharing ratio of U, P and A = 4:3:2

U retires.

New sharing ratio of P and A = 2:1

Gain = New share − Old share

$\therefore$ P's new share = $\frac{2}{3} - \frac{3}{9} = \frac{6-3}{9} = \frac{3}{9}$

A's new share = $\frac{1}{3} - \frac{2}{9} = \frac{3-2}{9} = \frac{1}{9}$

$\therefore$ Gaining ratio of P and A = 3:1

5. Accounting Treatment of Goodwill

On the death or retirement of a partner the continuing partners receive profit and loss share of the retiring or deceased partner. To compensate this gain in profit, continuing partners give the retiring partner, his share in firm's goodwill. Deceased or retiring partner is also entitled to receive his share in the firm's goodwill because the goodwill was earned by the firm when he was a partner.

As per the Accounting Standard-26, only that goodwill for which consideration is paid, can be recorded in the books of accounts. Internally generated goodwill can not be recorded in the books of accounts. At the time of the retirement of a partner also the goodwill of the firm is valued by internal assessment only, therefore no goodwill can be shown in the balance sheet of the firm as an asset. Therefore retiring or deceased partner will be given his share in the firm's goodwill by the continuing partners in their gaining ratio by making necessary adjustments only in capital accounts of the partners. Old goodwill (if any) appearing in the old balance sheet should be written off by debiting all the partners' capital accounts in their old profit sharing ratio, because the old partnership is dissolved.

Considering above, the accounting treatment of goodwill on death or retirement of a partner will be given as under :

(1) Old goodwill if any, appearing in the balance sheet of the old firm, it will be written off in old profit-loss sharing ratio among all the partners including the deceased or retiring partner. For which following journal entry is passeed.

All partners' capital/current A/c ...Dr

To goodwill A/c

(Being old goodwill written off among all the partners in their old profit-loss sharing ratio.)

(2) Retiring or deceased partner is given his share in goodwill in their gaining ratio :

Continuing partners' capital/current A/c ...Dr

To retiring/deceased partners' capital A/c

(Being goodwill given by the continuing partners to the retiring/deceased partner in their gaining ratio.)

Illustration 10 : I, C, W and A are the partners sharing profit and loss in the ratio of 4:3:2:1. I retired from 1-4-2016. Balance sheet of the firm shows goodwill at ₹ 20,000 at the time of the retirement of I. New profit-loss sharing ratio of C, W and A was decided at 2:2:1. Goodwill of the firm valued at ₹ 60,000 at the time of retirement of I. Write journal entry for goodwill.

Ans. :

Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
1-4-2016	I's capital A/c	Dr		8000	
	C's capital A/c	Dr		6000	
	W's capital A/c	Dr		4000	
	A's capital A/c	Dr		2000	
	To Goodwill A/c				20,000
	[Being existing goodwill written off in old ratio.]				
1-4-2016	C's capital A/c	Dr		6000	
	W's capital A/c	Dr		12,000	
	A's capital A/c	Dr		6000	
	To I's capital A/c				24,000
	[Being I's share of goodwill adjusted to C's, W's and A's capital account in their gaining ratio.]				

Explanation (1) : Gaining ratio :

Old profit and loss sharing ratio of I, C, W and A = 4:3:2:1

New profit and loss sharing ratio of C, W and A = 2:2:1

Gain = New share − Old share

C's gain = $\frac{2}{5} - \frac{3}{10} = \frac{1}{10}$

W's gain = $\frac{2}{5} - \frac{2}{10} = \frac{2}{10}$

A's gain = $\frac{1}{5} - \frac{1}{10} = \frac{1}{10}$

∴ Gaining ratio of C, W and A = 1:2:1

(2) : I's share in goodwill = $60{,}000 \times \frac{4}{10}$ = ₹ 24,000

I's share of goodwill will be given by C, W and A in their gaining ratio, 1:2:1.

Goodwill given by C = ₹ 24,000 × $\frac{1}{4}$ = ₹ 6000

Goodwill given by W = ₹ 24,000 × $\frac{2}{4}$ = ₹ 12,000

Goodwill given by A = ₹ 24,000 × $\frac{1}{4}$ = ₹ 6000

Illustration 11 : A, M, T and S are the partners of the firm sharing profit and loss in the ratio of 5:4:3:2. M retires as partner. At the time of the retirement of M, his share in firm's goodwill is ₹ 35,000. After retirement of M, partner A, T and S decided to share the future profit and loss in the ratio of 2:3:2. Pass the journal entry of goodwill.

Ans. :

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	T's capital A/c Dr		26,250	
	S's capital A/c Dr		17,500	
	To A's capital A/c			8750
	To M's capital A/c			35,000
	[Being A's and M's share of goodwill debited to T's and S's capital account in their gaining ratio.]			

Calculation 1 : Gaining ratio :

Old profit and loss sharing ratio of A, M, T and S = 5:4:3:2

New profit and loss sharing ratio of A, T and S = 2:3:2

Gain = New share − Old share

A's gain = $\frac{2}{7} - \frac{5}{14} = -\frac{1}{14}$ (Sacrifice)

T's gain = $\frac{3}{7} - \frac{3}{14} = \frac{6-3}{14} = \frac{3}{14}$

S's gain = $\frac{2}{7} - \frac{2}{14} = \frac{2}{14}$

Retiring partner M's share of goodwill = ₹ 35,000

A sacrifice his $\frac{1}{14}$ share out of his profit, therefore A will receive goodwill by the amount of his sacrifice.

Goodwill receivable by A :

Goodwill receivable by M for $\frac{4}{14}$th share = ₹ 35,000

Goodwill receivable by M for $\frac{1}{14}$th share = (?)

₹ 35,000 $\times \frac{1}{14} \times \frac{14}{4}$ = ₹ 8750

Goodwill receivable by M and A ₹ 35,000 and ₹ 8750 respectively. Total amount = ₹ 43,750.

T and S will give in their gaining ratio

T's gain = $\frac{3}{14}$

S's gain = $\frac{2}{14}$

∴ Gaining ratio of T and S = 3:2

Goodwill payable by T = ₹ 43,750 $\times \frac{3}{5}$ = ₹ 26,250

Goodwill payable by S = ₹ 43,750 $\times \frac{2}{5}$ = ₹ 17,500

Illustration 12 : B, R and T are the partners sharing profit and loss in ther ratio of 3:2:1. B retires. B's capital after distributing profit of revaluation account and accumulated reserves and profit-loss is ₹ 1,20,000. R and T decided to pay ₹ 1,50,000 as final settlement including goodwill to B. R and T will distribute future profit and loss in the ratio of 3:2. Write necessary journal entries for goodwill.

Ans. :

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
–	R's capital A/c Dr		16,000	
	T's capital A/c Dr		14,000	
	To B's capital A/c			30,000
	[Being goodwill given to B by his share in goodwill by R and T in their gaining ratio.]			

Explanation (1) : Total amount payable to B in final settlement of his account = ₹ 1,50,000

Less : Capital of B except goodwill = ₹ 1,20,000

Goodwill payable to B = ₹ 30,000

(2) : **Gaining ratio :**

Old ratio of B, R and T = 3:2:1

New ratio of R and T = 3:2

Gain = New share − Old share

R's Gain = $\frac{3}{5} - \frac{2}{6} = \frac{18-10}{30} = \frac{8}{30}$

T's Gain = $\frac{2}{5} - \frac{1}{6} = \frac{12-5}{30} = \frac{7}{30}$

∴ Gaining ratio of R and T = 8:7

6. Revaluation of Assets and Liabilities

Fixed assets are not shown at their market value in the books of the firm. Therefore there is difference between their book value and the market value. Some assets, liabilities and necessary provisions may not have been shown in the books. All profits and losses of the firm till the date of the retirement or death of a partner must be distributed among all the partners in their old profit-loss sharing ratio so that any partner may not get undue advantage or loss. Therefore, assets and liabilities are revalued at the time of the retirement or death of a partner and net increase or decrease in them is transferred to the revaluation account. Net profit or net loss of revaluation account is distributed among all the partners in their old profit-loss sharing ratio. Revaluation account is prepared in the same manner as it is prepared in the earlier chapter no. 5, in which

- Increase in assets and decrease in liabilities and provisions is credited to the revaluation account.
- Decrease in assets and increase in liabilities and provisions is debited to the revaluation account.
- Net profit or loss of revaluation account is distributed among all the partners in their old profit sharing ratio in their capital/current A/c.
- Assets and liabilities will be shown in the new balance sheet at their new values.

Memorandum Revaluation Account : Partners may also decide to show all the assets and liabilities at the same value in the new balance sheet after retirement. Memorandum revaluation account is prepared in such case. Memorandum revaluation account is prepared in the same manner as it is prepared in the previous chapter no. 5. Net increase or decrease in assets and liabilities are recorded in the first part of memorandum revaluation account in the same manner as they are shown in the revaluation account and net profit or net loss is distributed among all the partners in their old profit-loss sharing ratio. In the second part of the memorandum revaluation account all entries of the first part are reversed and therefore net profit of first part will become net loss and net loss of first part will become net profit of the second part which is distributed among the continuing partners except the retiring partners in their new profit-loss sharing ratio. All assets except cash and all liabilities will be shown in new balance sheet at their old values when memorandum revaluation account is prepared. **(Not expected in examination.)**

7. Distribution of Reserves and Accumulated Profit-Losses

Balances of reserves, undistributed profit or loss and balances of deferred revenue expenditure on the date of retirement or death are distributed among all the partners including retiring or deceased partners in their old profit-loss sharing ratio. Same journal entries in this respect as shown in previous chapter no. 5 "Admission of a Partner" are recorded at the time of the retirement or death of a partner.

8. Determination of Amount Payable to the Retiring Partner

Amount payable to the retiring partner is decided by preparing his capital account :

(1) Following amounts are credited to the retiring partners' capital account :

(i) Opening balance of capital account and credit balance of current account on the date of retirement.

(ii) Share in profit of revaluation account

(iii) Share in reserves and undistributed profit

(iv) Share in new value of goodwill

(v) Share in profit of the firm from the date of last balance sheet to the date of retirement.

(vi) Salary, commission, interest on capital, interest on loan given to the firm from the date of last balance sheet to the date of retirement. (If rate of interest on the partners' loan is not given; interest is payable on the partner's loan at the rate of 6 % p.a. till the date of retirement.)

(2) Following balances reduce capital, therefore they are debited to his capital account :

(i) Debit balance of current account

(ii) Drawings

(iii) Interest on drawings till the date of retirement

(iv) Share in undistributed loss and defferred revenue expenditure (fictitious assets)

(v) Share in old goodwill appearing in the books of the firm

(vi) Share in loss of revaluation account

(vii) Loan given by the firm to the retiring partner

The balance obtained by closing the retiring partners' capital account is the amount payable to the retiring partner. The amount payable to the retiring partner is paid in cash fully or partly and balance of the unpaid amount is transferred to his loan account, for which of the following entry is passed.

Retiring partners' capital A/c...Dr

To cash A/c

To retiring partners' loan A/c

Interest payable to retiring partners' loan account : Unpaid amount out of the total amount payable to the retiring partner is transferred to his loan account. If the rate of interest payable on such loan is not mentioned in the partnership deed, the interest is payable at the rate of 6 % per annum as per Indian Partnership Act, 1932.

Illustration 13 : The balance sheet of X, Y and Z is given below as on 31-3-2016.

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Goodwill		40,000
X	2,00,000		Land-Building		1,99,000
Y	1,20,000		Machinery		1,80,000
Z	1,00,000	4,20,000	Stock		50,000
General reserve		40,000	Debtors	70,000	
Partners' loan :			− Bad debt reserve	5000	65,000
Y	20,000		Bank balance		30,000
Z	30,000	50,000	Advertisement campaign expenditure		16,000
Creditors		80,000	Profit-loss A/c		20,000
Workmen compensation reserve		10,000			
		6,00,000			**6,00,000**

X, Y and Z are the partners of the firm sharing profit and loss in the ratio of 3:3:2. Y retires on 1-4-2016 on the following terms :

(1) Land and Building is to be valued at ₹ 2,20,000.

(2) Value of machinery is to be reduced by ₹ 30,000.

(3) The provision for doubtful debts is to be kept at 10 %.

(4) Liability for workmen compensation is accepted at ₹ 15,000.

(5) Goodwill of the firm is valued at ₹ 1,60,000. Y's share in goodwill is to be adjusted through the capital acccount of X and Z.

(6) The new ratio of profit and loss sharing of X and Z is decided at 1:1. From the above information pass necessary journal entries and prepare revaluation account, partners' capital account and balance sheet after the retirement of Y.

Ans. :

Journal Entries

No.	**Particulars**	**L.F.**	**Debit (₹)**	**Credit (₹)**
1.	General reserve A/c Dr		40,000	
	To X's capital A/c			15,000
	To Y's capital A/c			15,000
	To Z's capital A/c			10,000
	[Being balance of general reserve is distributed to all partners' capital accounts in their old profit sharing ratio.]			
2.	Revaluation A/c Dr		5000	
	Workmen compensation reserve A/c Dr		10,000	
	To Workmen compensation claim A/c			15,000
	[Being amount of workmen compensation reserve and access of claim over the reserve debited to the revaluation account.]			
3.	X's capital A/c Dr		15,000	
	Y's capital A/c Dr		15,000	
	Z's capital A/c Dr		10,000	
	To Goodwill A/c			40,000
	[Being old goodwill written off in old profit-loss sharing ratio.]			
	Total carry forward		95,000	95,000

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		95,000	95,000
4.	X's capital A/c Dr		6000	
	Y's capital A/c Dr		6000	
	Z's capital A/c Dr		4000	
	To Advertisement campaign expenditure A/c			16,000
	[Being balance of advertisement campaign expenditure is distributed to all partners' capital account in their old profit sharing ratio.]			
5.	X's capital A/c Dr		7500	
	Y's capital A/c Dr		7500	
	Z's capital A/c Dr		5000	
	To Profit and loss A/c			20,000
	[Being debit balance of profit and loss account distributed to all partners' capital account in their old ratio.]			
6.	Revaluation A/c Dr		32,000	
	To Machinery A/c			30,000
	To Bad debt reserve A/c			2000
	[Being decrease in machinery and increase in bad debt reserve transferred to revaluation A/c.]			
7.	Land-Building A/c Dr		21,000	
	To Revaluation A/c			21,000
	[Being increase in land and building transferred to revaluation A/c.]			
8.	X's capital A/c Dr		6000	
	Y's capital A/c Dr		6000	
	Z's capital A/c Dr		4000	
	To Revaluation A/c			16,000
	[Being loss of revaluation A/c distributed to all partners' capital accounts in their old profit sharing ratio.]			
9.	X's capital A/c Dr		20,000	
	Z's capital A/c Dr		40,000	
	To Y's capital A/c			60,000
	[Being Y's share in goodwill adjusted through capital accounts of X and Z in their gaining ratio.]			
10.	Y's loan A/c Dr		20,000	
	To Y's capital A/c			20,000
	[Being Y's loan transferred to his capital A/c.]			
	Total carry forward		2,80,000	2,80,000

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		2,80,000	2,80,000
11.	Y's capital A/c Dr		1,80,500	
	To Y's loan A/c			1,80,500
	[Being amount due to Y transferred to his loan account.]			
	Total		**4,60,500**	**4,60,500**

Revaluation Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	30,000	By Land-Building A/c		21,000
To Bad debt reserve A/c	2000	By Partners' capital A/c : loss		
(New ₹ 7000 – Old ₹ 5000)		X	6000	
To Workmen compensation claim A/c	5000	Y	6000	
		Z	4000	16,000
	37,000			**37,000**

Partners' Capital Accounts

Dr | Cr

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Adv. campaign expenditure A/c	6000	6000	4000	By Balance b/d	2,00,000	1,20,000	1,00,000
To Profit-loss A/c	7500	7500	5000	By General reserve A/c	15,000	15,000	10,000
To Goodwill A/c (old)	15,000	15,000	10,000	By Y's loan A/c	–	20,000	–
To Y's capital A/c (New goodwill)	20,000	–	40,000	By X's capital A/c (New goodwill)	–	20,000	–
To Revaluation A/c	6000	6000	4000	By Z's capital A/c (New goodwill)	–	40,000	–
To Y's loan A/c	–	1,80,500	–				
To Balance c/d	1,60,500	–	47,000				
	2,15,000	**2,15,000**	**1,10,000**		**2,15,000**	**2,15,000**	**1,10,000**

Balance Sheet as on 1-4-2016 After Retirement

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Land-Building		2,20,000
X	1,60,500		Machinery		1,50,000
Y	47,000	2,07,500	Stock		50,000
Partner Z's loan		30,000	Debtors	70,000	
Partner Y's loan		1,80,500	− Bad debt reserve	7000	63,000
Provision for workmen compensation claim		15,000	Bank balance		30,000
Creditors		80,000			
		5,13,000			**5,13,000**

Explanation : (1) Gaining ratio of continuing ratio

Old profit-loss sharing ratio of X, Y and Z = 3:3:2

New profit-loss sharing ratio of X and Z = 1:1

Gain = New share − Old share

$$\text{X's Gain} = \frac{1}{2} - \frac{3}{8} = \frac{4-3}{8} = \frac{1}{8}$$

$$\text{Z's Gain} = \frac{1}{2} - \frac{2}{8} = \frac{4-2}{8} = \frac{2}{8}$$

∴ Gaining ratio of X and Z = 1:2

(2) Share of goodwill of Y which is contributed by X and Z in their gaining ratio of 1:2

Y's share of goodwill = ₹ 1,60,000 × $\frac{3}{8}$ = ₹ 60,000

X and Z will give ₹ 60,000 for goodwill to Y in their gaining ratio 1:2.

Goodwill payable by X = ₹ 60,000 × $\frac{1}{3}$ = ₹ 20,000

Goodwill payable by Y = ₹ 60,000 × $\frac{2}{3}$ = ₹ 40,000

Journal Entry

No.	Particulars	L.F.	Debit (₹)	Credit (₹)
−	X's Capital A/c Dr		20,000	
	Z's Capital A/c Dr		40,000	
	To Y's Capital A/c			60,000

Note : (1) Old goodwill ₹ 40,000 is written off by debiting capital accounts of X, Y and Z in their old profit and loss sharing ratio. (2) The balance of workmen compensation reserve is ₹ 10,000. But accepted claim of workmen compensation is ₹ 15,000. Therefore, additional ₹ 5000 is debited to revaluation account as provision for workmen compensation claim.

Workmen compensation reserve A/c Dr...	10,000	
Revaluation A/c Dr...	5000	
To Workmen compensation claim A/c		15,000

(3) Amount paid to Y is not mentioned in the question, hence the total amount payable to Y is transferred to Y's loan account.

Illustration 14 : Ajay, Alpa and Amay are the partners of the firm sharing profit and loss in the ratio of 50 %, 30 % and 20 % respectively. The balance sheet of the firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Goodwill		50,000
Ajay	60,000		Other fixed assets		1,00,000
Alpa	50,000		Investments		60,000
Amay	80,000	1,90,000	Debtors	70,000	
Investment fluctuation fund		20,000	− Bad debt reserve	6000	64,000
Workmen compensation reserve		30,000	Stock		20,000
Creditors		40,000	Cash		16,000
Provident fund		60,000	Profit-loss A/c		30,000
		3,40,000			**3,40,000**

Ajay retires on 1-4-2017 on the following terms :

(1) The claim of workmen compensation is accepted at ₹ 20,000.

(2) The market value of investment is ₹ 45,000.

(3) Bad debts on debtors ₹ 2000 is to be written off and the provision for doubtful debts is to be kept at 5 %

(4) Fixed assets to be appreciated by 20 %.

(5) The book value of stock is over valued by ₹ 600 compared to its cost. The cost of stock is to be recorded.

(6) The value of goodwill of the firm is ₹ 1,00,000.

(7) Ajay is to be paid ₹ 10,000 in cash.

(8) The new profit and loss sharing ratio of Alpa and Amay is 1:4.

Prepare revaluation account, capital accounts of partners and the balance sheet after the retirement of Ajay.

Ans. :

Revaluation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Stock A/c		600	By Bad debt reserve A/c	
To Partners' capital A/c (Profit)			(₹ 6000 − Bad debts ₹ 2000 −	
Ajay	10,000		New bad debt reserve ₹ 3400)	600
Alpa	6000		By Fixed assets A/c	20,000
Amay	4000	20,000		
		20,600		**20,600**

Partners' Capital Accounts

Dr | Cr

Particulars	Ajay (₹)	Alpa (₹)	Amay(₹)	Particulars	Ajay (₹)	Alpa (₹)	Amay(₹)
To Goodwill A/c	25,000	15,000	10,000	By Balance b/d	60,000	50,000	80,000
To Profit-loss A/c	15,000	9000	6000	By Workmen comp. reserve A/c	5000	3000	2000
To Ajay's capital A/c (goodwill)	–	–	50,000	By Investment fluctuation fund A/c	2500	1500	1000
To Alpa's capital A/c (goodwill)	–	–	10,000	By Amay's capital A/c (goodwill)	50,000	10,000	–
To Cash A/c	10,000	–	–	By Revaluation A/c	10,000	6000	4000
To Ajay's loan A/c	77,500	–	–				
To Balance c/d	–	46,500	11,000				
	1,27,500	**70,500**	**87,000**		**1,27,500**	**70,500**	**87,000**

Balance Sheet as on 1-4-2017 After Retirement

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Fixed assets		1,20,000
Alpa	46,500		Investments		45,000
Amay	11,000	57,500	Debtors	70,000	
Ajay's loan		77,500	– Bad debt	2000	
Workmen compensation claim		20,000		68,000	
Creditors		40,000	– Bad debt reserve (5 %)	3400	64,600
Provident fund		60,000	Stock		19,400
			Cash (₹ 16,000 - ₹ 10,000 payment to Ajay)		6000
		2,55,000			**2,55,000**

Explanation (1) : Gaining ratio :

Old profit and loss sharing ratio of Ajay, Alpa and Amay = 5:3:2

New profit and loss sharing ratio of Alpa and Amay = 1:4

Gain = New share – Old share

Alpa's gain $= \frac{1}{5} - \frac{3}{10} = \frac{2-3}{10} = -\frac{1}{10}$ (Sacrifice)

Amay's gain $= \frac{4}{5} - \frac{2}{10} = \frac{8-2}{10} = \frac{6}{10}$

(2) : Calculation of goodwill :

Ajay is retiring, so goodwill receivable by him $= \frac{5}{10} \times 1,00,000 = 50,000$

Alpa's sacrifice $\frac{1}{10}$ share, therefore amount of goodwill receivable by her $= \frac{1}{10} \times 1,00,000 =$ ₹ 10,000

Amay is gaining, so goodwill contributed by him $= \frac{6}{10} \times 1,00,000 =$ ₹ 60,000

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
–	Amay's capital A/c Dr		60,000	
	To Ajay's capital A/c			50,000
	To Alpa's capital A/c			10,000

Explanation : Retiring partner Ajay as well as Alpa from the continuing partners sacrifice their profit share and therefore they receive goodwill by their sacrifice while Amay gains, therefore he will give goodwill by his gain.

Note : (1) Decrease in the value of investment is ₹ 15,000 while there is investment fluctuation fund against it and it is ₹ 20,000. Therefore the balance of investment fluctuation fund after writting off the decrease in investments ₹ 15,000 is ₹ 5000, which is credited to all the partners' capital accounts in their old profit and loss sharing ratio. For this following journal entry is passed :

Investment fluctuation fund A/c Dr...	20,000	
To Investments A/c		15,000
To Ajay's capital A/c		2500
To Alpa's capital A/c		1500
To Amay's capital A/c		1000

(2) Claim of workmen compensation accepted is ₹ 20,000 against the workmen compensation reserve of ₹ 30,000 and balance of reserve ₹ 10,000 is distributed among all the partners in their old profit and loss sharing ratio.

Workmen compensation reserve A/c Dr...	30,000	
To workmen compensation claim A/c		20,000
To Ajay's capital A/c		5000
To Alpa's capital A/c		3000
To Amay's capital A/c		2000

Illustration 15 : Gopi, Krishna and Ram are the partners of a firm sharing profit-loss in the ratio of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$. The balance sheet of the firm as on 31-3-2017 is as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Goodwill	1500
Gopi	30,000		Trademark	18,000
Krishna	20,000		Machinery	60,000
Ram	30,000	80,000	Investments (Market value ₹ 15,000)	40,000
Current Accounts :			Stock	12,000
Gopi	8,000		Debtors	26,000
Ram	10,000	18,000	Cash in bank	3000
Contingency reserve		12,000	Current account of Krishna	4500
Workmen compensation fund		9000		
Investment fluctuation fund		15,000		
Creditors		23,000		
Bad debt reserve		8000		
		1,65,000		**1,65,000**

Ram retires on 1-4-2017 on the following terms :

(1) The value of machinery is to be increased by 10 %.

(2) The value of trademark is to be reduced upto 40 %.

(3) Bad debt reserve on debtors is to be kept at 15 %.

(4) Discounted bills receivable of ₹ 1300 which is dishonoured on due date, 31-3-2017. No amount is received from the debtors.

(5) Goodwill of the firm is valued at ₹ 60,000.

(6) The new profit-loss sharing ratio of Gopi and Krishna is 2:1.

Prepare revaluation account, partners' current account, capital account and balance sheet after the retirement of Ram.

Ans. :

Dr **Revaluation Account** Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Investments A/c	10,000	By Machinery A/c		6000
To Trademark	10,800	By Bad debt reserve A/c		
To Bank A/c	1300	(₹ 8000 – ₹ 3900)		4100
(Dishonoured bills receivable)		By Partners' current A/c (Loss) :		
		Gopi	6000	
		Krishn	4000	
		Ram	2000	12,000
	22,100			**22,100**

Current Accounts of Partners

Dr Cr

Particulars	Gopi (₹)	Krishna(₹)	Ram (₹)	Particulars	Gopi (₹)	Krishna(₹)	Ram (₹)
To Balance b/d	–	4500	–	By Balance b/d	8000	–	10,000
To Goodwill	750	500	250	By Contingency reserve A/c	6000	4000	2000
To Ram's A/c (goodwill)	10,000	–	–	By Workmen compenstion fund	4500	3000	1500
To Revaluation A/c	6000	4000	2000				
To Ram's capital A/c	–	–	21,250	By Gopi's A/c (goodwill)	–	–	10,000
To Balance c/f	1750	–	–	By Balance c/f	–	2000	–
	18,500	**9000**	**23,500**		**18,500**	**9000**	**23,500**

Dr **Capital Accounts of Partners** Cr

Particulars	Gopi (₹)	Krishna(₹)	Ram (₹)	Particulars	Gopi (₹)	Krishna(₹)	Ram (₹)
To Ram's loan A/c	–	–	51,250	By Balance b/d	30,000	20,000	30,000
To Balance c/f	30,000	20,000	–	By Ram's current A/c	–	–	21,250
	30,000	**20,000**	**51,250**		**30,000**	**20,000**	**51,250**

Balance Sheet as on 1-4-2017 After Retirement

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Trademark (18,000 – 10,800)		7200
Gopi	30,000		Machinery		66,000
Krishna	20,000	50,000	Debtors	26,000	
Current account of Gopi		1750	– Bad debt reserve	3900	22,100
Ram's loan A/c		51,250	Investments		15,000
Creditors		23,000	(40,000 – (15,000 + 10,000))		
			Stock		12,000
			Cash in bank (₹ 3000 – ₹ 1300)		1700
			Current account of Krishna		2000
		1,26,000			**1,26,000**

Explanation (1) : Gaining ratio :

Old profit-loss sharing ratio of Gopi, Krishna and Ram $= \frac{1}{2} : \frac{1}{3} : \frac{1}{6} = \frac{3}{6} : \frac{2}{6} : \frac{1}{6} = 3:2:1$

New profit-loss sharing ratio of Gopi and Krishna = 2:1

Gain = New share – Old share

Gopi's gain $= \frac{2}{3} - \frac{3}{6} = \frac{4-3}{6} = \frac{1}{6}$; Krishna's gain $= \frac{1}{3} - \frac{2}{6} = \frac{2-2}{6} = 0$

(2) : Calculation of goodwill and its effect :

Goodwill receivable by Ram $= \frac{1}{6} \times 60{,}000 =$ ₹ 10,000

Krishna's gain is zero therefore goodwill of Ram is given by Gopi only.

Journal Entry

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
–	Gopi's current A/c Dr		10,000	
	To Ram's current A/c			10,000

Note : (1) Loss of investments is ₹ 25,000. While balance of investment fluctuation reserve is ₹ 15,000. Therefore additional loss of ₹ 10,000 is debited at revaluation account.

Investment fluctuation reserve A/c Dr...	15,000	
Revaluation A/c Dr...	10,000	
To Investments A/c		25,000

(2) Dishonored bills receivable :

(i) Bill receivables A/c Dr...	1300	
To Bank A/c		1300
(ii) Debtors A/c Dr...	1300	
To Bills receivables A/c		1300
(iii) Revaluation A/c Dr...	1300	
To Debtors A/c		1300
or		
Revaluation A/c Dr...	1300	
To Bank A/c		1300

(3) Trademark is to be reduced upto 40 % means, from 100 % .... to 40 %

Complete amount means, reduce upto 60 %.

9800 .... 10,800 7200

∴ 18,000's 60 % = ₹ 10,800 is to be reduced.

Illustration 16 : A, B and C are the partners of the firm sharing profit and loss in equal proportion. A retires as on 1-4-2014 after adjustment of goodwill, revaluation profit and reserves, balance of A's capital is ₹ 90,000. Amount due to A is to be paid in three equal annual instalments together with interest at 10 % p.a. Prepare A's loan account till it is finally paid. Financial year ends on 31st March.

Ans. :

A's Loan Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
31-3-15	To Bank A/c(30,000 + 9000)	39,000	1-4-14	By A's capital A/c	90,000
,,	To Balance c/f	60,000	31-3-15	By Interest A/c	9000
		99,000			**99,000**
31-3-16	To Bank A/c(30,000 + 6000)	36,000	1-4-15	By Balance b/d	60,000
,,	To Balance c/f	30,000	31-3-16	By Interest A/c	6000
		66,000			**66,000**
31-3-17	To Bank A/c(30,000 + 3000)	33,000	1-4-16	By Balance b/d	30,000
			31-3-17	By Interest A/c	3000
		33,000			**33,000**

- **Adjustment of capitals (i) When the total capital of the new firm is given**

Illustration 17 : P, V and R are the partners of the firm sharing profit and loss in the ratio of 5:3:2. R retires after the adjustment of profit of revaluation, reserves and goodwill, partners capital stood ₹ 50,000, ₹ 70,000 and ₹ 80,000 respectively. The entire capital of the firm as newly constituted is fixed ₹ 1,40,000 between P and V in their new profit-loss sharing ratio 3:2. Calculate the actual cash to be paid or to be brought in by the continuing partners. Pass the necessary journal entries with working notes and also prepare capital accounts of partners.

Ans. : Explanation (1) : Total new capital of P and V = ₹ 1,40,000, in proportion of 3:2,

P's new capital $= ₹\ 1{,}40{,}000 \times \frac{3}{5}$

$= ₹\ 84{,}000$

V's new capital $= ₹\ 1{,}40{,}000 \times \frac{2}{5}$

$= ₹\ 56{,}000$

(2) Calculation of the amount of cash to be paid or to be brought in :

	P (₹)	V (₹)
New capital	84,000	56,000
Less : Actual capital after adjustment	50,000	70,000
Capital to be brought in (paid off)	34,000	(14,000)
	Capital brought	Capital paid

₹ 34,000 cash to be brought by P. ₹ 14,000 additional cash withdrawn by V as capital.

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
–	Cash A/c Dr To P's capital A/c [Being necessary capital brought by P.]		34,000	34,000
–	V's capital A/c Dr To Cash A/c [Being additional capital withdrawn by V.]		14,000	14,000

Capital Accounts of Partners

Dr Cr

Particulars	P (₹)	V (₹)	R (₹)	Particulars	P (₹)	V (₹)	R (₹)
To R's loan A/c	–	–	80,000	By Balance b/d	50,000	70,000	80,000
To Cash A/c	–	14,000	–	By Cash A/c	34,000	–	–
To Balance c/f	84,000	56,000	–				
	84,000	**70,000**	**80,000**		**84,000**	**70,000**	**80,000**

(ii) **When the total capital of the new firm is not given and the amount paid to the retiring partner is to be brought in by the remaining partners :**

Illustration 18 : A, B and C are the partners sharing profit and loss in the ratio of 4:3:2 respectively. 'A' retired on 1-4-2017. The capital of A, B and C after all the adjustment of the revaluation of profit, reserves and goodwill were at ₹ 30,000, ₹ 80,000 and ₹ 90,000 respectively. All partners decide that A is to be paid amount due to him in cash which is to be brought in by B and C in such a way as to make their capitals proportionate to their new profit-loss sharing ratio. All necessary adjustments are to be made in cash. Give journal entries and prepare partners' capital account.

Ans. : Explanation (1) : Capital of new firm :

Old profit-loss sharing ratio of A, B and C = 4:3:2

After retirement of A, the new ratio of B and C = 3:2

Total capital of new firm :	B's capital	=	₹ 80,000
	C's capital	=	₹ 90,000
	Additional capital (Payable to A)	=	₹ 30,000
	Total capital of new firm	=	₹ 2,00,000

B's share in total capital of new firm = 2,00,000 × $\frac{3}{5}$ = ₹ 1,20,000 (New ratio)

C's share in total capital of new firm = ₹ 2,00,000 × $\frac{2}{5}$ = ₹ 80,000 (New ratio)

(2) Calculation of cash to be paid or brought in

	B (₹)	C (₹)
Capital required after adjustments	1,20,000	80,000
Less : Actual capital after adjustment	80,000	90,000
Cash to be brought in (paid off)	40,000	(10,000)
	Capital brought	Capital returned

Journal Entries

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
–	A's capital A/c	Dr		30,000	
	To cash A/c				30,000
	[Being amount due to A paid off.]				
–	Cash A/c	Dr		40,000	
	To B's capital A/c				40,000
	[Being additional capital brought by B.]				
–	C's capital A/c	Dr		10,000	
	To cash A/c				10,000
	[Being additional capital of C paid off.]				

Capital Accounts of Partners

Dr Cr

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Cash A/c	30,000	–	–	By Balance b/d	30,000	80,000	90,000
To Cash A/c	–	–	10,000	By Cash A/c	–	40,000	–
To Balance c/f	–	1,20,000	80,000				
	30,000	**1,20,000**	**90,000**		**30,000**	**1,20,000**	**90,000**

(iii) The retiring partner is to be paid in cash and an amount brought in by the remaining partner in cash in such a way that minimum cash is to be maintained :

Illustration 19 : A, B and C are the partners sharing profit and loss in the ratio of 5:3:1. 'A' retires on 1-4-2017. The capital of A, B and C after all adjustments regarding loss of revaluation account, reserves and goodwill stood at ₹ 60,000, ₹ 50,000 and ₹ 70,000 respectively. On that day balance of cash was ₹ 30,000. Partners decided as under :

(A) Amount due to A is to be paid in cash.

(B) The amount of cash to be paid or to be brought in by the remaining partners in such a way so as to make their capitals proportionate to their new profit-loss sharing ratio and minimum cash balance ₹ 20,000 is to be maintained.

Give journal entries with necessary calculation and prepare partners' capital account and cash account :

Ans. : Explanation (1) : Capital of B and C in new firm

Old profit and loss sharing ratio of A, B and C = 5:3:1

After the retirement of A, new profit and loss sharing ratio of B and C = 3:1

Share of cash to be brought in by B and C :

To make payment to A	=	₹ 60,000
Less : Available cash for payment to A	=	₹ 10,000
(₹ 30,000 – ₹ 20,000 cash to be maintained)		
Cash brought in by B and C		₹ 50,000

Total capital of new firm of B and C :

B's capital =	₹	50,000
+ C's capital =	₹	70,000
+ Additional capital =	₹	50,000
Total capital of B and C =	₹	1,70,000

(Necessary cash balance to maintain minimum cash balance and to pay dhes of 'A')

B's capital in new profit and loss sharing ratio = ₹ 1,70,000 × $\frac{3}{4}$ = ₹ 1,27,500 (As per new ratio)

C's capital in new profit and loss sharing ratio = ₹ 1,70,000 × $\frac{1}{4}$ = ₹ 42,500 (As per new ratio)

(2) : Cash to be brought in or paid off to B and C :

	B (₹)	**C (₹)**
New capital	1,27,500	42,500
Less : Capital after adjustment	50,000	70,000
Cash to be brought in as capital (or paid off)	77,500	(27,500)
	Capital brought	Capital paid

Journal Entries

Date/No.	**Particulars**	**L.F.**	**Debit (₹)**	**Credit (₹)**
1	A's capital A/c Dr		60,000	
	To Cash A/c			60,000
	[Being the due amount paid to A.]			
2	Cash A/c Dr		77,500	
	To B's capital A/c			77,500
	[Being required cash brought in by B as his capital.]			
3	C's capital A/c Dr		27,500	
	To Cash A/c			27,500
	[Being additional capital paid off to C.]			

Capital Accounts of Partners

Dr | Cr

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Cash A/c	60,000	–	–	By Balance b/d	60,000	50,000	70,000
To Cash A/c	–	–	27,500	By Cash A/c	–	77,500	–
To Balance c/f	–	1,27,500	42,500				
	60,000	**1,27,500**	**70,000**		**60,000**	**1,27,500**	**70,000**

Cash Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
1-4-17	To Balance b/d	30,000	1-4-17	By A's capital A/c	60,000
1-4-17	To B's capital A/c	77,500	1-4-17	By C's capital A/c	27,500
			1-4-17	By Balance c/f	20,000
		1,07,500			**1,07,500**

Illustration 20 : Karan, Fenil and Farshid are partners in a firm sharing profit and loss in the ratio of their capitals. Balance sheet of the firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Creditors		16,000	Goodwill		40,000
Workmen compensation reserve		12,000	Land-Building		2,00,000
Employee's profit sharing fund		30,000	Patents		60,000
Provident fund		45,000	Machinery		80,000
Capital Accounts :			Debtors	35,000	
Karan	2,00,000		– Bad debt reserve	5000	30,000
Fenil	1,20,000		Stock		53,000
Farshid	80,000	4,00,000	Bank		40,000
		5,03,000			**5,03,000**

Farshid retires on the above date. Partners decided the following terms of retirement :

(1) The new profit-loss sharing ratio of Karan and Fenil is to be kept at 2:3.

(2) Goodwill of the firm is to be valued at ₹ 80,000.

(3) Paid ₹ 60,000 for patents during current year which is for total 4 years.

(4) Machinery is to be depreciated by 10 %.

(5) Bad debt on debtors is to be written off ₹ 3000.

(6) ₹ 20,000 is to be paid to Farshid.

(7) Market value of stock is ₹ 54,000.

(8) New firm's total capital will be equal to total capital of old firm. The entire capital of the new firm is to be kept in new profit and loss sharing ratio of Karan and Fenil. All necessary adjustments are to be made through bank.

Prepare (i) Revaluation account (ii) Capital accounts of partners (iii) Bank account (iv) Balance Sheet after retirement of Farshid.

Ans. :

Revaluation Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Patent A/c	15,000	By Bad debt reserve A/c		2000
To Machinery A/c	8000	(₹ 5000 – ₹ 3000 bad debt)		
		By Stock A/c		1000
		By Partners' capital A/c (Loss) :		
		Karan	10,000	
		Fenil	6000	
		Farshid	4000	20,000
	23,000			**23,000**

Capital Accounts of Partners

Dr | Cr

Particulars	Karan (₹)	Fenil (₹)	Farshid (₹)	Particulars	Karan (₹)	Fenil (₹)	Farshid (₹)
To Goodwill A/c	20,000	12,000	8000	By Balance b/d	2,00,000	1,20,000	80,000
To Karan's capital A/c	–	8000	–	By Workmen compensation fund	6000	3600	2400
To Farshid's capital A/c (goodwill)	–	16,000	–	By Fenil's capital A/c (goodwill)	8000	–	16,000
To Bank A/c	–	–	20,000	By Bank A/c	–	1,58,400	–
To Revaluation A/c	10,000	6000	4000				
To Farshid's loan A/c	–	–	66,400				
To Bank A/c	24,000	–	–				
To Balance c/f	1,60,000	2,40,000	–				
	2,14,000	**2,82,000**	**98,400**		**2,14,000**	**2,82,000**	**98,400**

Bank Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	40,000	By Farshid A/c	20,000
To Fenil's capital A/c	1,58,400	By Karan A/c	24,000
		By balance c/f	1,54,400
	1,98,400		**1,98,400**

Balance Sheet as on 1-4-2017 After Retirement

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		16,000	Patents	45,000
Employee's profit sharing fund		30,000	Machinery	72,000
Provident fund		45,000	Debtors	32,000
Farshid's loan A/c		66,400	Stock	54,000
Capital Accounts :			Bank	1,54,400
Karan	1,60,000		Land-Building	2,00,000
Fenil	2,40,000	4,00,000		
		5,57,400		**5,57,400**

Explanation : (1) Distribution of goodwill

Old ratio of Karan, Fenil and Farshid = 5:3:2; New ratio of Karan and Fenil = 2:3

Gain = New share − Old share

Karan's gain $= \frac{2}{5} - \frac{5}{10} = -\frac{1}{10}$ (Sacrifice)

Fenil's gain $= \frac{3}{5} - \frac{3}{10} = \frac{3}{10}$

∴ Goodwill payable by Fenil = ₹ $80,000 \times \frac{3}{10}$ = ₹ 24,000

Karan also sacrifices his share, so he will also receive goodwill which is given by Fenil.

Goodwill receivable by Karan $= \frac{1}{10} \times 80,000$ = ₹ 8000

Goodwill receivable by Farshid $= \frac{2}{10} \times 80,000$ = ₹ 16,000

Journal Entries :	Fenil's capital A/c...Dr	24,000	
	To Karan's capital A/c		8000
	To Farshid's capital A/c		16,000

(2) Distribution of capital of new firm

New firm's total capital of ₹ 4,00,000 is same as old firm's total capital which is distributed between Karan and Fenil in their new profit and loss sharing ratio, 2:3.

∴ New capital of Karan $= 4,00,000 \times \frac{2}{5} = 1,60,000$; New capital of Fenil $= 4,00,000 \times \frac{3}{5} = 2,40,000$

Illustration 21 : L, M and N are partners of a firm. They share their profit and loss 40 %, 30 % and 30 % respectively. Balance sheet of the firm as on 31 March, 2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		60,000	Cash	13,000
Investment fluctuation reserve		15,000	Stock	32,000
Bad debt reserve		10,000	Debtors	80,000
Capital Accounts :			Investments	60,000
L	1,80,000		Building	2,20,000
M	1,00,000		Furniture	30,000
N	90,000	3,70,000	Advertisement campaign expenditure	20,000
		4,55,000		**4,55,000**

M retires on 1-4-2016. Terms of retirement were as under :

(1) M's share is to be distributed between L and N in the ratio of 3:2.
(2) Bad debt of ₹ 8000 is to be written off and provision for bad debt is to be kept at 10 % and provision for discount reserve is to be kept at 5 % on debtors.
(3) Market value of investment is ₹ 50,000.
(4) Market value of building is ₹ 2,50,000.
(5) Write off ₹ 1560 from furniture.
(6) The capital of L and N is to be kept in their new profit and loss sharing ratio and all necessary adjustments to be made through their current account.
(7) The value of goodwill of the firm is ₹ 50,000.
(8) N accepts creditors of ₹ 5500 to pay.

Prepare necessary accounts and prepare balance sheet after retirement also :

Ans. :

Revaluation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Bad debt reserve A/c		5200	By Building A/c	30,000
(₹ 10,000 – bad debt ₹ 8000 –				
New bad debt reserve ₹ 7200)				
To Discount reserve on debtors A/c		3240		
To Furniture A/c		1560		
To Partners' capital A/c (Profit) :				
L	8000			
M	6000			
N	6000	20,000		
		30,000		**30,000**

Capital Accounts of Partners

Dr | Cr

Particulars	L (₹)	M (₹)	N (₹)	Particulars	L (₹)	M (₹)	N (₹)
To Advertisement campaign exp.	8000	6000	6000	By Balance b/d	1,80,000	1,00,000	90,000
To M's capital A/c (goodwill)	9000	–	6000	By Investment fluctuation reserve A/c	2000	1500	1500
To M's loan A/c	–	1,16,500	–	By Revaluation A/c	8000	6000	6000
To Current A/c	19,880	–	–	By L's capital A/c (goodwill)	–	9000	–
To Balance c/f	1,53,120	–	1,10,880	By N's capital A/c (goodwill)	–	6000	–
				By Creditors A/c	–	–	5500
				By Current A/c	–	–	19,880
	1,90,000	**1,22,500**	**1,22,880**		**1,90,000**	**1,22,500**	**1,22,880**

Balance Sheet as on 1-4-2016 After Retirement

Liabilities		Amt. (₹)	Assets		Amt. (₹)
M's loan		1,16,500	N's current A/c		19,880
L's current A/c		19,880	Debtors	80,000	
Capital Accounts :			− Bad debt	8000	
L	1,53,120			72,000	
N	1,10,880	2,64,000	− Bad debt reserve	7200	
Creditors (₹ 60,000 − ₹ 5500)		54,500		64,800	
			− Discount reserve	3240	61,560
			Stock		32,000
			Investments		50,000
			Building		2,50,000
			Furniture		28,440
			Cash		13,000
		4,54,880			**4,54,880**

Explanation : (1) Distribution of goodwill

Old ratio of L, M and N = 4:3:3

Share of M to be distributed between L and N in ratio of 3:2.

∴ Gaining ratio of L and N = 3:2

M's share of goodwill = $50{,}000 \times \frac{3}{10}$ = ₹ 15,000

M's goodwill ₹ 15,000 is to be given by L and N in their gaining ratio 3:2.

Journal Entries :

L's capital A/c...Dr 9000

N's capital A/c...Dr 6000

To M's capital A/c...Dr 15,000

(2) New profit and loss sharing ratio of L and N

Old profit and loss sharing ratio of L, M and N = 4:3:3

Share of M $\frac{3}{10}$, which is gained by L and N in the ratio of 3:2.

∴ L's gain = $\frac{3}{10} \times \frac{3}{5} = \frac{9}{50}$

N's gain = $\frac{3}{10} \times \frac{2}{5} = \frac{6}{50}$

New share = Old share + Gain

∴ Share of L = $\frac{4}{10} + \frac{9}{50} = \frac{20+9}{50} = \frac{29}{50}$

Share of N = $\frac{3}{10} + \frac{6}{50} = \frac{15+6}{50} = \frac{21}{50}$

∴ New ratio = 29:21

(3) **Adjustment of total capital of new firm according to new profit sharing ratio of L and N**

Capital of L (₹ 1,90,000 − ₹ 17,000)	= ₹	1,73,000
Capital of N (₹ 1,03,000 − ₹ 12,000)	= ₹	91,000
Total capital of new firm	= ₹	2,64,000

Total capital to be distributed in the new profit-loss sharing ratio = 29:21

$\therefore$ New capital of L $= 2,64,000 \times \frac{29}{50}$ = ₹ 1,53,120

New capital of N $= 2,64,000 \times \frac{21}{50}$ = ₹ 1,10,880

Illustration 22 : P, Q and R are partners in a firm sharing profit and loss equally. Balance sheet of their firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Trademark		5400
P	9000		Land-Building		10,000
Q	6000		X Ltd.'s share		1500
R	6000	21,000	Stock		3000
General reserve		1200	Debtors	3000	
Investment fluctuation fund		360	− Bad debt reserve	240	2760
Creditors		4600	Cash-Bank		1500
			Profit-loss A/c		3000
		27,160			**27,160**

R retired on 31 March 2016, following terms were decided at the time of retirement :

(1) Goodwill is to be valued at 3 times the average profit of last five years.

(2) Value of land and building is ₹ 15,000.

(3) Market value of X Ltd.'s share is ₹ 1200.

(4) All debtors are good.

(5) A provision of ₹ 2000 for outstanding salary is to be made.

(6) Last four years profit of the firm was as under :

2011-12	₹ 6000
2012-13	₹ 2000
2013-14	₹ 3000
2014-15	₹ 2000

(7) Share of R will be gained by P.

(8) Amount due to R is to be paid in cash which is brought in by P and Q in such a way as to make their capitals in proportionate to their new profit and loss sharing ratio.

Prepare necessary accounts and new balance sheet.

Ans. :

Revaluation Account

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Outstanding salary A/c		2000	By Bad debt reserve A/c	240
To Partners' capital A/c (Profit) :			By Land-building A/c	5000
P	1080			
Q	1080			
R	1080	3240		
		5240		**5240**

Capital Accounts of Partners

Dr Cr

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Profit and loss A/c	1000	1000	1000	By Balance b/d	9000	6000	6000
To R's capital A/c	2000	–	–	By General reserve A/c	400	400	400
To Cash-bank A/c	–	–	8500	By Investment fluctuation fund	20	20	20
To Balance b/d	15,000	7500	–	By P's Capital A/c (goodwill)	–	–	2000
				By Revaluation A/c	1080	1080	1080
				By Cash-bank A/c	7500	1000	–
	18,000	**8500**	**9500**		**18,000**	**8500**	**9500**

Cash-Bank Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	1500	By R's capital A/c	8500
To P's capital A/c	7500	By Balance c/d	1500
To Q's capital A/c	1000		
	10,000		**10,000**

Balance Sheet as on 1-4-2016 After Retirement

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Land-Building	15,000
P	15,000		X Ltd.'s share	1200
Q	7500	22,500	Stock	3000
Creditors		4600	Debtors	3000
Outstanding salary		2000	Cash-bank	1500
			Trademark	5400
		29,100		**29,100**

Explanation : (1) Valuation and distribution of goodwill

Average profit $= \frac{6000 + 2000 + 3000 + 2000 - 3000}{5} =$ ₹ 2000

Goodwill = ₹ 2000 × 3 = ₹ 6000

R's share in goodwill $= 6000 \times \frac{1}{3} =$ ₹ 2000

∴ R's share of profit is to be transferred to P.

∴ P gives goodwill to R.

Journal Entries :

P's capital A/c...Dr	2000	
To R's capital A/c...Dr		2000

(2) New profit-loss sharing ratio

Old sharing ratio of P, Q and R = 1:1:1

R retires and his share is gained by P.

New share = Old share + Gain

∴ P's share $= \frac{1}{3} + \frac{1}{3} = \frac{2}{3}$

Q's share $= \frac{1}{3} + 0 = \frac{1}{3}$

∴ New profit-loss sharing ratio = 2:1

(3) New capital of P and Q

	P's capital (₹ 10,500 − ₹ 3000)	= ₹ 7500
+	Q's capital (₹ 7500 − ₹ 1000)	= ₹ 6500
+	Paid to R (Additional capital)	= ₹ 8500
	Total capital of new firm	= ₹ 22,500

∴ New capital of P $= 22{,}500 \times \frac{2}{3} =$ ₹ 15,000

New capital of Q $= 22{,}500 \times \frac{1}{3} =$ ₹ 7500

Illustration 23 : E, F and G are partners sharing profit and loss in the ratio of 4:3:3. E retires on 31-3-2015. Balance sheet of the firm on that day was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Goodwill	1000
E	8000		Land-building	6000
F	5000		Furniture	4000
G	2000	15,000	Stock	6600
General reserve		2000	Debtors	9000
Creditors		8000	Cash	400
Bills payable		2000		
		27,000		**27,000**

Following conditions were decided at the time of retirement :

(1) Value of goodwill is ₹ 4000.

(2) Value of fixed assets is to be appreciated by 20 %.

(3) Stock is found overvalued by 10 %.

(4) New profit-loss sharing ratio of F and G is decided at 4:1.

(5) Amount due to E is to be paid in cash and casn balance of ₹ 1000 in the new firm is to be maintained. For this purpose F and G brought cash in such a way as to make their capitals proportionate to their new profit sharing ratio.

Prepare necessary accounts and balance sheet of the new firm.

Ans. :

Revaluation Account

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Stock A/c		600	By Land-building A/c	1200
To Partners capital A/c (Profit) :			By Furniture A/c	800
E	560			
F	420			
G	420	1400		
		2000		**2000**

Capital Accounts of Partners

Dr Cr

Particulars	E (₹)	F (₹)	G (₹)	Particulars	E (₹)	F (₹)	G (₹)
To Goodwill A/c	400	300	300	By Balance b/d	8000	5000	2000
To E's capital A/c	–	1600	–	By General reserve A/c	800	600	600
To G's capital A/c	–	400	–	By F's capital A/c	1600	–	400
To Cash A/c	10,560	–	–	By Revaluation A/c	560	420	420
To Balance c/f	–	14,400	3600	By Cash A/c	–	10,680	480
	10,960	**16,700**	**3900**		**10,960**	**16,700**	**3900**

Cash Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	400	By E's capital A/c	10,560
To F's capital A/c	10,680	By Balance c/f	1000
To G's capital A/c	480		
	11,560		**11,560**

Balance Sheet as on 1-4-2015 After Retirement

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		8000	Land-Building	7200
Bills payable		2000	Furniture	4800
Capital Accounts :			Stock	6000
F	14,400		Debtors	9000
G	3600	18,000	Cash	1000
		28,000		**28,000**

Explanation : (1) Gaining ratio

Old profit-loss sharing ratio of E, F and G = 4:3:3

New profit-loss sharing ratio of F and G = 4:1

Gain = New share − Old share

$F = \frac{4}{5} - \frac{3}{10} = \frac{5}{10}$

$G = \frac{1}{5} - \frac{3}{10} = -\frac{1}{10}$ (Sacrifice)

(2) Distribution of goodwill

G sacrifice his share, so he will receive goodwill.

Goodwill receivable by E = $\frac{4}{10} \times 4000$ = ₹ 1600

Goodwill payable by F = $\frac{5}{10} \times 4000$ = ₹ 2000

Goodwill receivable by G = $\frac{1}{10} \times 4000$ = ₹ 400

Journal Entries :

F's capital A/c...Dr	2000	
To E's capital A/c		1600
To G's capital A/c		400

(3) : New capital of F and G

F's capital (₹ 6020 − ₹ 2300)	= ₹ 3720
G's capital (₹ 3420 − ₹ 300)	= ₹ 3120
Additional necessary capital	= ₹ 11,160
(Paid to E ₹ 10,560 + Required closing cash ₹ 1000 − Opening balance of cash ₹ 400)	
Total capital of F and G	= ₹ 18,000

∴ New capital of F = $18,000 \times \frac{4}{5}$ = ₹ 14,400

New capital of G = $18,000 \times \frac{1}{5}$ = ₹ 3600

9. Determination of Amount Payable to the Deceased Partner and Payment to his Executor

The retirement of a partner normally takes place at a planned date but the death of partner may occur any time. When a partner dies, his heirs are entitled to receive the amount due to the deceased partner. The heirs of the deceased partner are also entitled to receive the share of profits of the firm from the begining of the year to the date of death, interest on capital, salary etc. as well. The heirs of the deceased partner are entitled to receive the following :

(i) The amount standing to the credit of the deceased partner's capital account and current account

(ii) His share of accumulated profits and reserves

(iii) His share of profit of the revaluation account

(iv) His share in the goodwill of the firm

(v) His share in profits of the firm form the begining of the year to the date of death

(vi) Interest on capital upto the date of his death if provided by the partnership deed

(vii) His salary or commission upto the date of his death, if provided by the partnership deed

(viii) Loan given to the firm and its interest upto the date of his death

Following amounts are debited to his capital account :

(i) Debit balance of current account

(ii) His share in the loss of revaluation account

(iii) His share in accumulated losses

(iv) His share in deffered revenue expenditure

(v) His share in the old goodwill of the firm shown in the books of the firm

(vi) His drawings

(vii) Interest on drawings

(viii) His share in the loss that may have occurred till the date of his death, from the last balance sheet

The above adjustments are made in the capital account of the deceased partner and thereafter the balance of the capital account is transferred to his executor's account.

Deceased partners' capital A/c...Dr

To deceased partners' executor's A/c

- **Profit share to the deceased partner :**

He is entitled to receive his share in profit of the firm from the beginning of the year to the date of death. If he dies during the year before year ends, his share in profit is calculated without calculating the profit for the year of death. Therefore his share in profit from the beginning of the year till the date of death is calculated on the basis of the past profit or sales as follows :

(1) On the basis of last year's profit

(2) On the basis of average profit of past few years

(3) On the basis of previous year's sales and profit

e.g. 'A' died on 30-6-2016. His share in profit is $\frac{1}{5}$. Financial year ended on 31st March. Last three year's profit is as under :

2013-14	₹ 80,000
2014-15	₹ 60,000
2015-16	₹ 40,000

Sales for the year 2015-16 amounted to ₹ 2,00,000. Sales from the first three months of current year is ₹ 60,000.

Find out the deceased partners' share in the profit of the firm under following basis :

(1) On the basis of last year's profit

(2) On the basis of average profit of last three years

(3) On the basis of last year's sales and profit

Ans. : (1) On the basis of last year's profit :

Profit share for three months from 1-4-2016 to 30-6-2016 will be payable to A. Last year, 2015-16 profit is ₹ 40,000.

Share in profit of A $= ₹\ 40{,}000 \times \frac{1}{5} \times \frac{3}{12} = ₹\ 2000$

(2) On the basis of average profit of last three years :

Average profit $= \frac{80{,}000 + 60{,}000 + 40{,}000}{3} = ₹\ 60{,}000$

A's share of profit $= ₹\ 60{,}000 \times \frac{1}{5} \times \frac{3}{12} = ₹\ 3000$

(3) On the basis of last year's profit and sales :

Sales of 2015-16 ₹ 2,00,000 : Profit ₹ 40,000

Three months of 2016-17 sales ₹ 60,000 : (?)

$\frac{40{,}000 \times 60{,}000}{2{,}00{,}000} = ₹\ 12{,}000$ (Profit of the firm for 3 months)

Profit share of B $= 12{,}000 \times \frac{1}{5} = ₹\ 2400$

B's share of profit is payable before accounting year ends. Following journal entry is passed to give profit share to B.

Profit and loss suspense A/c...Dr
    To B's capital A/c

Other payments which affect profit like interest on capital, interest on loan, salary, commission etc. are also transferred to the profit and loss suspense account. For this journal entry will be :

(i) Interest on capital A/c...Dr
    Interest on loan A/c...Dr
    Salary A/c...Dr
    Commission A/c...Dr
        To Deceased partners' capital A/c

(ii) Profit and loss suspense A/c...Dr
        To Interest on capital A/c
        To Interest on loan A/c
        To Salary A/c
        To Commission A/c

Deceased Partners' Capital Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Current A/c (Debit balance)	✓	By Balance b/d	✓
To Revaluation A/c		By Current A/c (Credit balance)	✓
(Share in loss of revaluation account)	✓	By Reserve A/c (Share in reserve)	✓
To Profit and loss A/c		By Profit and loss A/c	
(Accumulated losses)	✓	(Share in accumulated profit)	✓
To Goodwill A/c - written off		By Revaluation A/c (Share in profit)	✓
(Share in old goodwill)	✓	By Other partners' capital A/c	
To Drawings A/c	✓	(Share in goodwill)	✓
To Interest on drawings A/c	✓	By Interest on capital A/c	✓
To Advertisement campaign exp. A/c	✓	By Salary or commission A/c	✓
To Profit and loss suspense A/c		By Loan A/c (given to firm)	✓
(Share in loss till the date of death)	✓	By Interest on loan A/c	✓
		By Profit and loss suspense A/c	
		(Share in profit till the date of death)	✓
	✓✓✓		✓✓✓

- **Payment to deceased partner :**

Payment to the executors of deceased partner is made as provided in the partnership deed or as agreed by the remaining partners and the executors. The dues may be paid :

Amount payable to the deceased partner is paid as under :

(1) Full in one instalment

(2) In more than one instalment

Following journal entries are passed when the payment is made as per above method :

(1) Full amount is paid in one installment,

Deceased partners' executors' A/c...Dr

To Bank A/c

(2) When payment is made in more than one instalment : In this case the executor is entitled to interest at 6 % p.a. unless agreed otherwise. As per Indian Partnership Act, 1932 the executor has option to take the share of profit instead of interest.

When instalment with interest is paid, following journal entry will be passed :

(i) When interest is due :

Interest A/c ...Dr

To Deceased partners' executors' A/c

(ii) When installment is paid including interest :

Deceased partners' executors' A/c...Dr

To Bank A/c

Illustration 24 : X, Y and Z are the partners sharing profit and loss in the ratio of 5:3:2. Balance sheet of the firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Fixed capital	80,000
X	50,000		Debtors	20,000
Y	80,000		Stock	80,000
Z	70,000	2,00,000	Cash	30,000
General reserve		20,000	Advertisement campaign expenditure	40,000
Creditors		30,000		
		2,50,000		**2,50,000**

Z died as on 31-12-2016. The terms of partnership deed are as under :

(1) Share of profit for the period from the closing of the last financial year to the date of death on the basis of the last year's profit to be given.

(2) Goodwill of the firms is to be valued on the basis of twice the average of the past three years' profits. Profit of last three years was as under :

2013-14 ₹ 80,000

2014-15 ₹ 70,000

2015-16 ₹ 60,000

Calculate amount payable to Z's executor by preparing his capital.

Ans. :

Z's Capital Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Advertisement campaign expenditure	8000	By Balance b/d	70,000
To Z's executors' A/c	1,03,000	By General reserve A/c	4000
		By Profit and loss suspense A/c (Share in profit)	9000
		By X's capital A/c (goodwill)	17,500
		By Y's capital A/c (goodwill)	10,500
	1,11,000		**1,11,000**

Explanation : (1) Z's share in profit

On the basis of last year, 2015-16 profit, from 1-4-2016 to till date of death 31-12-2016, for 9 months profit is payable to Z.

$$\text{Z's share in profit} = 60{,}000 \times \frac{2}{10} \times \frac{9}{12}$$

$$= ₹\ 9000$$

(2) Valuation of goodwill and share of Z in goodwill

$$\text{Average profit} = \frac{80{,}000 + 70{,}000 + 60{,}000}{3}$$

$$= ₹\ 70{,}000$$

$$\text{Goodwill of firm} = ₹\ 70{,}000 \times 2$$

$$= ₹\ 1{,}40{,}000$$

$$\text{Z's goodwill} = 1{,}40{,}000 \times \frac{2}{10}$$

$$= ₹\ 28{,}000$$

X and Y will give goodwill to Z in their gaining ratio :

Old ratio of X, Y and Z = 5:3:2

Old ratio of X and Y = Gaining ratio = 5:3

$$\text{Goodwill given by X} = ₹\ 28{,}000 \times \frac{5}{8}$$

$$= ₹\ 17{,}500$$

$$\text{Goodwill given by Y} = ₹\ 28{,}000 \times \frac{3}{8}$$

$$= ₹\ 10{,}500$$

Illustration 25 : A, B and C are the partners in a firm. Following are the balances as on 31-3-2015 in the books of the firm.

Capital : A ₹ 90,000, B ₹ 50,000, C ₹ 60,000

Contigency reserve ₹ 9000; Investment fluctuation reserve ₹ 3000; Goodwill ₹ 15,000

B died as on 30-6-2015

It was agreed by the remaining partners that :

(1) Interest on capital to B is to be allowed 12 % p.a.

(2) Drawing of B was ₹ 6000. Interest on drawing ₹ 300 will be charged.

(3) B's share of goodwill is to be valued at the profits credited to his account during the previous three completed years.

(4) B's share of profit is to be allowed on the basis of average of three completed years' profit before death. Profit of last three years was ₹ 60,000, ₹ 70,000 and ₹ 50,000 respectively.

(5) B's executors is to be paid ₹ 9200 immediately and the balance in two equal yearly instalments with interest at 6 % p.a.

(6) Profit and loss sharing ratio of A and C is to be kept 2:1 after B's death. Prepare B's executor's account and executor's loan account till it is finally paid.

Ans. :

B's Executor's Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
1-7-15	To Goodwill A/c	5000	1-7-15	By B's capital A/c	50,000
"	To Drawings A/c	6000	"	By Contigency reserve A/c	3000
"	To Interest on drawings A/c	300	"	By Investment fluctuation reserve A/c	1000
"	To Bank A/c	9200			
"	To B's executor's loan A/c	1,00,000	"	By Capital's Interest A/c	1500
				By A's capital A/c	60,000
				By Profit and loss suspense A/c	5000
		1,20,500			**1,20,500**

B's Executor's Loan Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
31-3-16	To Balance c/f	1,04,500	1-7-15	By B's executor's A/c	1,00,000
			31-3-16	By Interest A/c ($₹ 1,00,000 \times \frac{6}{100} \times \frac{9}{12}$)	4500
		1,04,500			**1,04,500**
30-6-16	To Bank A/c (50,000 + 4500 + 1500)	56,000	1-4-16	By Balance b/d	1,04,500
			30-6-16	By Interest A/c ($₹ 1,00,000 \times \frac{6}{100} \times \frac{3}{12}$)	1500
31-3-17	To Balance c/f	52,250	31-3-17	By Interest A/c ($₹ 50,000 \times \frac{6}{100} \times \frac{9}{12}$)	2250
		1,08,250			**1,08,250**
30-6-17	To Bank A/c ($₹ 50,000 + ₹ 2250 + ₹ 750$)	53,000	1-4-17	By Balance b/d	52,250
			30-6-17	By Interest A/c ($₹ 50,000 \times \frac{6}{100} \times \frac{3}{12}$)	750
		53,000			**53,000**

Explanation : (1) Interest on capital

$₹\ 50,000 \times \frac{12}{100} \times \frac{3}{12} = ₹\ 1500$

(2) Gaining ratio

Old ratio of A, B and C = 1:1:1

New ratio of A and C = 2:1

Gain = New share − Old share

A's gain = $\frac{2}{3} - \frac{1}{3} = \frac{1}{3}$

C's gain = $\frac{1}{3} - \frac{1}{3} = 0$. Entire share of B received by A.

(3) Share of goodwill payable to B

Goodwill of B to be calculated at the profits credited to his account during the previous three completed years.

Average profit of last three years = ₹ 60,000 + ₹ 70,000 + ₹ 50,000 = ₹ 1,80,000

Goodwill payable to B = ₹ 1,80,000 × $\frac{1}{3}$ = ₹ 60,000

A will give goodwill to B

(4) Share in profit of B

Average profit of last three years = $\frac{60{,}000 + 70{,}000 + 50{,}000}{3}$ = ₹ 60,000

B's Share in profit = ₹ 60,000 × $\frac{1}{3} \times \frac{3}{12}$ = ₹ 5000

Note : As per Partnership Act 1932, the deceased partners' executors are entitled to interest at 6 % p.a. on their loan.

Illustration 26 : M, N and O are the partners sharing profit and loss in the ratio of 2:1:2. Balance sheet as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Land-building	1,00,000
M	1,00,000		Machinery	60,000
N	60,000		Stock	36,000
O	80,000	2,40,000	Debtors	40,000
General reserve		10,000	Cash	11,000
Workmen compensation reserve		18,000	Loan to O	30,000
Creditors		42,000	O's current A/c	4000
Bad debt reserve		6000	Advertisement campaign expenditure	5000
Current Accounts :			Profit-loss A/c	60,000
M	20,000			
N	10,000	30,000		
		3,46,000		**3,46,000**

O died as on 1-12-2016. Provisions of partnership deed were as under :

(1) Land-building is to be appreciated by 10 %. (2) Value of machinery is to be reduced by 5 %.

(3) Provision for doubtful debts is to be kept at 10 % on debtors.

(4) Goodwill is to be valued at 3 years' purchase of the average profit of last 5 years.

(5) Previous 4 years profit was as under :

2011-12	₹ 80,000	2012-13	₹ 60,000
2013-14	₹ 70,000	2014-15	₹ 50,000

(6) O's share of profit till the date of his death based on last year's profit.

(7) New profit and loss sharing ratio of M and N is decided at 3:2.

(8) O's executors is to be paid ₹ 6800 immediately and the balance in 4 equal half yearly instalments with interest at 12 % p.a.

Prepare O's capital account and O's executor's account till it is finally paid.

Ans. :

O's Capital Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
1-12-16	To Advertisement campaign expenditure A/c	2000	1-12-16	By Balance b/d	80,000
,,	To Profit and loss A/c	24,000	,,	By General reserve A/c	4000
,,	To O's loan A/c	30,000	,,	By Workmen compensation reserve A/c	7200
,,	To O's current A/c	4000	,,	By Revaluation A/c	3600
,,	To Profit and loss suspense A/c (Loss)	16,000	,,	By M's capital A/c (goodwill)	24,000
,,	To Bank A/c	6800	,,	By N's capital A/c (goodwill)	24,000
,,	To O's executor's A/c	60,000			
		1,42,800			**1,42,800**

O's Executor's Account

Dr | Cr

Date	Particulars	Amt. (₹)	Date	Particulars	Amt. (₹)
31-3-17	To Balance c/f	62,400	1-12-16	By O's capital A/c	60,000
			31-3-17	By Interest A/c (₹ 60,000 $\times \frac{12}{100} \times \frac{4}{12}$)	2400
		62,400			**62,400**
31-5-17	To Bank A/c (15,000 + 2400 + 1200)	18,600	1-4-17	By Balance b/d	62,400
30-11-17	To Bank A/c (15,000 + 2700)	17,700	31-5-17	By Interest A/c (₹ 60,000 $\times \frac{12}{100} \times \frac{2}{12}$)	1200
31-3-18	To Balance c/f	31,200	30-11-17	By Interest A/c (₹ 45,000 $\times \frac{12}{100} \times \frac{6}{12}$)	2700
			31-3-18	By Interest A/c (₹ 30,000 $\times \frac{12}{100} \times \frac{4}{12}$)	1200
		67,500			**67,500**
31-5-18	To Bank A/c (₹ 15,000 + ₹ 1200 + ₹ 600)	16,800	1-4-18	By Balance b/d	31,200
30-11-18	To Bank A/c (₹ 15,000 + ₹ 900)	15,900	31-5-18	By Interest A/c (₹ 30,000 $\times \frac{12}{100} \times \frac{2}{12}$)	600
			30-11-18	By Interest A/c (₹ 15,000 $\times \frac{12}{100} \times \frac{6}{12}$)	900
		32,700			**32,700**

Explanation : (1) **Revaluation Account**

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		3000	By Land-building A/c	10,000
To Partners' capital A/c (Profit) :			By Bad debt reserve A/c	2000
M	3600			
N	1800			
O	3600	9000		
		12,000		**12,000**

(2) **Valuation of goodwill**

5 years average profit $= \dfrac{80{,}000 + 60{,}000 + 70{,}000 + 50{,}000 - 60{,}000}{5}$

$= \dfrac{2{,}00{,}000}{5}$

$=$ ₹ 40,000

Goodwill $= 40{,}000 \times 3$

$=$ ₹ 1,20,000

(3) **Distribution of goodwill**

Share of O in goodwill $= 1{,}20{,}000 \times \dfrac{2}{5}$

$=$ ₹ 48,000

Gaining ratio of M and N :

Gain = New share − Old share

$M = \dfrac{3}{5} - \dfrac{2}{5} = \dfrac{1}{5}$

$N = \dfrac{2}{5} - \dfrac{1}{5} = \dfrac{1}{5}$

∴ Gaining ratio of M and N = 1:1

∴ Goodwill is to be given by M and N to O in equal proportion.

Journal Entry :

M's capital A/c...Dr	24,000	
N's capital A/c...Dr	24,000	
To O's capital A/c...Dr		48,000

(4) : **O's share in profit :**

O died as 1-12-2016, so O will receive his share in profit from 1-4-2016 to 1-12-2016 i.e. for 8 months.

Last year 2015-16, the amount of loss is ₹ 60,000.

∴ O's share in loss $= 60{,}000 \times \dfrac{8}{12} \times \dfrac{2}{5}$

$=$ ₹ 16,000

Illustration 27 : A, B and C are the partners sharing profit and loss in the ratio of 3:2:1. The balance sheet of the firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		10,000	Goodwill	30,000
Partners' loan :			Patents	25,000
A	12,000		Building	80,000
B	20,000	32,000	Furniture	60,000
General reserve		18,000	Stock	50,000
Capital Accounts :			Debtors	60,000
A	90,000		Cash	15,000
B	90,000			
C	80,000	2,60,000		
		3,20,000		**3,20,000**

B died on 30-6-2016. Under the partnership agreement, the executor of B is entitled to receive following:

(1) Interest on his capital at 10 % p.a.

(2) Share in general reserve.

(3) His loan and outstanding interest on loan.

(4) Value of goodwill is decided at ₹ 30,000.

(5) Share of profit upto the date of death on the basis of last year's sales and profit. Sales for the year 2015-16 was ₹ 12,00,000. First three months sales of current year was ₹ 4,50,000. Net profit for the year 2015-16 was ₹ 2,40,000.

(6) Patents are to be written off fully. Building is to be appreciated by 20 %.

Prepare the balance sheet as on 30-6-2016 after the death of B.

Ans. :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		10,000	Building	96,000
A's loan		12,000	Furniture	60,000
B's executor's A/c		1,45,550	Stock	50,000
Capital Accounts :			Debtors	60,000
A	72,000		Cash	15,000
C	74,000	1,46,000	Profit and loss suspense A/c (30,000 profit + 2250 Interest on capital + 300 interest on loan)	32,550
		3,13,550		**3,13,550**

Explanation : (1) **Revaluation Account**

Dr Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Patents A/c	25,000	By Building A/c		16,000
		By Partners' capital A/c (Profit) :		
		A	4500	
		B	3000	
		C	1500	9000
	25,000			**25,000**

(2) **Capital Accounts of Partners**

Dr Cr

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c	4500	3000	1500	By Balance b/d	90,000	90,000	80,000
To Goodwill A/c	15,000	10,000	5000	By General reserve A/c	9000	6000	3000
To B's capital A/c	7500	–	2500	By Interest on capital A/c	–	2250	–
To B's executors' A/c	–	1,45,550	–	By B's loan A/c	–	20,000	–
To Balance c/f	72,000	–	74,000	By Interest on B's loan A/c	–	300	–
				By A's capital A/c	–	7500	–
				By C's capital A/c	–	2500	–
				By Profit and loss suspense A/c	–	30,000	–
	99,000	**1,58,550**	**83,000**		**99,000**	**1,58,550**	**83,000**

(3) Interest on capital to B from 1-4-2016 to 30-6-2016 = 3 months

$= ₹\ 90{,}000 \times \frac{10}{100} \times \frac{3}{12} = ₹\ 2250$

(4) Outstanding interest on loan to B for 3 months at 6 % p.a. (As not stated in the partnership deed)

$= ₹\ 20{,}000 \times \frac{6}{100} \times \frac{3}{12} = ₹\ 300$

(5) Distribution of goodwill and share of B in goodwill

Old ratio of A, B and C = 3:2:1

B died; gaining ratio of A and C = 3:1

Share of B in goodwill = $\frac{2}{6} \times 30{,}000 = ₹\ 10{,}000$

Which will be given by A and C in the ratio of 3:1.

Journal Entry :

A's capital A/c...Dr	7500	
C's capital A/c...Dr	2500	
To B's capital A/c		10,000

(6) B's share in the profit of the firm from 1-4-2016 to 30-6-2016 means 3 month's profit

If sales of 2015-16 ₹ 12,00,000 : Net profit ₹ 2,40,000

∴ 3 months sales of 2016-17 ₹ 4,50,000 : (?)

$$\frac{2,40,000 \times 4,50,000}{12,00,000} = ₹\ 90,000$$ (Three month's profit of the firm)

B's share in profit $= 90,000 \times \frac{2}{6} = ₹\ 30,000$

Note : B's share in profit, interest on capital and interest on loan should be transferred to profit and loss suspense account and it is shown on assets side of balance sheet.

	Interest on capital	₹	2250
+	Interest on loan	₹	300
+	Share in profit	₹	30,000
		₹	32,550

EXERCISE

1. Select appropriate alternative for each question :

(1) Debit balance of profit and loss account shown in the balance sheet at the time of retirement of a partner is ....

(a) recorded on the debit side of all partners' capital accounts including the retiring partner in their old profit-loss sharing ratio

(b) recorded on the credit side of all partners' capital accounts including the retiring partner in their old profit-loss sharing ratio

(c) credit side of the retiring partners' capital account only

(d) debit side of the remaining partners' capital accounts in their gaining ratio

(2) Goodwill shown in the balance sheet at the time of the retirement of a partner is recorded as ....

(a) shown in new balance sheet, if decided by partners

(b) debit side of all partners' capital accounts in their old profit-loss sharing ratio

(c) credit side of all partners' capital accounts in their old profit-loss sharing ratio

(d) debit side of reriting partners' capital account only

(3) Goodwill payable to the retiring partner is recorded as ....

(a) credit side of all partners' capital accounts, in their old profit-loss sharing ratio

(b) credit side of all partners' capital accounts, in their gaining ratio

(c) debit side of continuing partners' capital accounts, in their gaining ratio

(d) debit side of continuing partners' capital accounts, in their new profit-loss sharing ratio

(4) When only old profit-loss sharing ratio is given, gaining ratio of remaining partners will be ....

(a) 1:1 (b) old ratio

(c) capital ratio (d) can not be calculated

(5) A partner, except the retiring partner also receives goodwill when ....
   (a) his capital is more
   (b) new share in new profit-loss sharing ratio is more than his old share
   (c) new share in new profit-loss sharing ratio is less than his old share
   (d) new share and old share are equal

(6) Loss of revaluation account at the time of retirement or death is recorded in .... account in .... ratio on .... side of the capital accounts.
   (a) remaining partners, new profit-loss sharing, debit
   (b) all partners, old profit-loss sharing, credit
   (c) all partners, old profit-loss sharing, debit
   (d) all partners, equal proportion, debit

(7) If partnership deed is silent, interest is payable at .... on unpaid amount payable to the retiring partner.
   (a) 10 % p.a. (b) 12 % p.a.
   (c) 6 % p.a. (d) zero

(8) Accounting year ends on 31-3-2016. A partner dies on 30-6-2016. Deceased partners' share in profit is $\frac{1}{3}$. Profit share payable to the partner is to be calculated on the basis of last year's profit ₹ 24,000. .... amount will be paid as share in profit at the time of death.
   (a) ₹ 8000 (b) ₹ 24,000
   (c) ₹ 1333 (d) ₹ 2000

(9) Sweta, Geeta and Jyoti are equal partners. Gita retires. Gita's share is gained by Sweta and Jyoti equally. New profit and loss sharing ratio of Sweta and Jyoti will be ....
   (a) 3:1 (b) 2:1
   (c) 1:2 (d) 1:1

(10) Workmen profit sharing fund is recorded as .... at the time of the retirement of a partner.
   (a) a liability in new balance sheet
   (b) credited to all partners' capital account in their old profit-loss sharing ratio
   (c) debited to all partners' capital account in their old profit-loss sharing ratio
   (d) credited to the retiring partners' capital account

2. Answer following questions in one sentence :

(1) State the circumstances of the retirement of a partner.

(2) Which important accounting aspects are considered at the time of the retirement or death of a partner ?

(3) Which balances are credited to all partners' capital accounts in their old profit-loss sharing ratio ?

(4) Which balances are debited to all partners' capital accounts in their old profit-loss sharing ratio ?

(5) Explain accounting treatment of old goodwill appearing in the balance sheet of the firm at the time of the retirement of a partner.

(6) Explain accounting treatment of the new goodwill of the firm valued at the time of the retirement of a partner.

(7) When and why the profit and loss adjustment account is prepared ?

(8) Who gives the share in goodwill to the retiring or deceased partner ? Why ?

3. Calculate the new profit and loss ratio and gaining ratio for the following questions :

(1) X, Y and Z are the partners sharing profit and loss in the ratio of 5:3:2. Z retires.

(2) A, B and C are the partners sharing profit and loss in the ratio of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$ respectively. (A) If A retires (B) If B retires (C) If C retires.

(3) P, Q and R are the partners sharing profit and loss in the ratio of 40 %, 20 % and 40 % respectively. Q retires. P is acquiring $\frac{3}{20}$ and R is acquiring $\frac{1}{20}$ from Q's share.

(4) M, N and O are the partners sharing profit and loss in the ratio of 3:2:1. M retires. N is acquiring $\frac{1}{10}$ from M's share and balance is acquired by O.

(5) C, B and D are the partners sharing profit and loss in the ratio of 4:5:3. D retires and his share is taken up by C and B in the ratio of 2:1.

(6) A, M and C are the partners sharing profit and loss in the ratio of 3:5:2. M retires and his share is taken up by C only.

(7) P, Q, R and S are the partners sharing profit and loss in the ratio of 4:3:2:1. Q retires and his share of profit is gained equally by R and S.

(8) M, N, O and P are the partners sharing profit and loss in the ratio of 5:3:2:2. N and P retired. N's share is acquired by O and P's share is acquired by M.

(9) A, B and C are the partners sharing profit and loss in the ratio of $\frac{1}{2}$, 30 % and $\frac{1}{5}$ respectively. B's share is taken over by A and C in the ratio of 3:2.

(10) A, B and C are the partners sharing profit and loss in the ratio of 5:3:2. B and C sharing profit in the ratio of 40 % and 60 % after the retirement of A.

(11) A, B and C are the partners sharing profit and loss in the ratio of 3:2:1. C retires. The new profit and loss sharing ratio of A and B is decided at 7:5.

(12) A, B and C are the partners sharing profit in the ratio of 4:5:1. Following journal entry for goodwill is passed at the time of the retirement of B :

A's capital A/c...Dr	6000	
C's capital A/c...Dr	4000	
To B's capital A/c...		10,000

(13) A, B, C and D are the partners sharing profit and loss in the ratio of 4:3:2:1. C retires. After the retirement of C, A will maintain his old profit share.

4. Give necessary entry of goodwill for the following :

(1) Akruti, Prakruti and Sanskruti are the partners sharing profit and loss in the ratio of 5:3:2. Sanskruti retires. At the time of her retirement the goodwill is valued at ₹ 30,000.

(2) X, Y and Z are the partners sharing profit and loss in equal proportions. Goodwill appears at ₹ 42,000 in the books of the firm. At the time of retirement of X, the goodwill of the firm is valued at ₹ 1,20,000.

(3) L, M, N and O are the partners sharing profit and loss in the ratio of 5:4:3:3. L retires on 1-4-2017. At the time of retirement of L, goodwill appears at ₹ 75,000 in the books of old firm. The new profit and loss sharing ratio of M, N and O is decided at 3:1:1. On L's retirement, the goodwill of the firm is valued at ₹ 90,000.

(4) A, B and C are the partners of a firm. B retires. At the time of B's retirement, the goodwill of the firm is valued at ₹ 60,000. The new profit-loss sharing ratio of A and C decided at 7:2.

(5) B, R, T and S are the partners sharing profit and loss in the ratio of 4:3:1:2. B retires. Goodwill is appearing in their books at ₹ 20,000 and at the time of B's retirement, goodwill is valued at ₹ 60,000. R, T and S decided to share the future profits of new firm in the ratio of 1:2:2.

(6) A, M, U and L are the partners sharing profit and loss in the ratio of 6:4:3:2. U retires. His capital account after making adjustments for reserves and profit on revaluation is ₹ 80,000. Remaining partners have agreed to pay him ₹ 1,40,000 in full settlement of his claim. The new profit-loss sharing ratio of A, M and L is decided at 6:5:4 after the retirement of U.

5. Dhaval, Kamal and Naval are the partners sharing profit and loss in the ratio of 2:2:1. Naval retires on 31-3-2016. Balance sheet of the firm as on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Goodwill	10,000
Dhaval	30,000		Machinery	20,000
Kamal	20,000		Investments	10,000
Naval	10,000	60,000	Debtors	30,000
General reserve		5000	Stock	10,000
Investment fluctuation fund		2500	Cash-bank	5000
Bad debt reserve		2000		
Creditors		15,500		
		85,000		**85,000**

Following adjustments are agreed at the time of retirement :

(1) Value of machinery is ₹ 25,000 and value of stock is ₹ 5000.

(2) Value of investments is ₹ 8000, which is taken by Naval at this price.

(3) An amount of ₹ 5000 included in creditors is no longer payable.

(4) The provision for workmen compensation to be credited at ₹ 2000.

(5) The provision for doubtful debts is to be kept at 10 % on debtors.

(6) Goodwill of the firm is valued at ₹ 40,000.

Pass journal entries. Prepare necessary accounts and the balance sheet of the firm after Naval's retirement.

6. Rohit, Mohit and Virat are partners sharing profit and loss in the ratio of 4:3:2. Balance sheet of the firm as on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Goodwill		36,000
Rohit	1,60,000		Land-building		1,50,000
Mohit	96,000		Machinery		90,000
Virat	80,000	3,36,000	Stock		85,000
Reserve fund		45,000	Debtors	60,000	
Workmen compensation reserve		13,500	− Bad debt reserve	4000	56,000
Partners' loan :			Bank		63,000
Rohit	10,000		Advertisement campaign expenditure		4500
Mohit	16,000	26,000			
Creditors		64,000			
		4,84,500			**4,84,500**

Rohit retired on 1-4-2017. Terms of retirement is as under :

(1) Value of land-building is ₹ 1,80,000.

(2) Value of machinery is to be reduced by ₹ 15,000.

(3) Provision for doubtful debts is to be kept at 10 % on debtors.

(4) ₹ 5000 not payable to creditors.

(5) Valuation of goodwill is ₹ 1,80,000.

(6) New profit-loss sharing ratio of Mohit and Virat is 2:1.

(7) ₹ 20,000 are to be paid to Rohit and balance will be kept as loan.

Prepare Revaluation account, Partners' capital accounts and Balance sheet after retirement.

7. Vijay, Laxmi and Siddhi are the partners sharing profit and loss in the ratio of 5:3:2. Siddhi retired on 1-4-2016. Terms of retirement are as under :

(1) New profit-loss sharing ratio of Vijay and Laxmi is 2:3.

(2) Goodwill of the firm is valued at ₹ 60,000.

(3) Market value of investments is ₹ 40,000. Siddhi will take over investment at this value.

(4) ₹ 3000 to be written off from debtors and 5 % bad debt reserve is to be maintained.

(5) Value of stock shown in the book is ₹ 1000 more than its cost. It is to be recorded at cost.

(6) Claim of ₹ 7000 is accepted for workmen compensation.

(7) ₹ 12,000 to be paid to Siddhi immediately.

Balance sheet of the firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Land-building		1,30,000
Vijay	85,000		Machinery		70,000
Laxmi	64,000		Investments		60,000
Siddhi	71,000	2,20,000	Stock		35,000
Investment fluctuation fund		15,000	Debtors	23,000	
Workmen compensation fund		17,000	– Bad debt reserve	4000	19,000
Creditors		56,000	Cash		36,000
Provident fund		42,000			
		3,50,000			**3,50,000**

Prepare necessary accounts and balance sheet after retirement.

8. Jaya, Mamta and Smruti are the partners sharing profit and loss in the ratio of $\frac{2}{5}$, $\frac{5}{10}$ and $\frac{1}{10}$. Balance sheet of the firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Creditors		90,000	Goodwill	30,000
General reserve		70,000	Building	2,82,000
Capital Accounts :			Machinery	1,45,000
Jaya	2,00,000		Investments	33,000
Mamta	1,00,000		Stock	20,000
Smruti	90,000	3,90,000	Debtors	50,000
Current Accounts :			Loan to Smruti	30,000
Jaya	26,000		Current account : Smruti	10,000
Mamta	14,000	40,000		
Bad debt reserve		10,000		
		6,00,000		**6,00,000**

Smruti retired on 1-4-2017 as a partner. At the time of her retirement, partners decided that :

(1) ₹ 4000 is outstanding for rent payable.

(2) Interest on investment is receivable ₹ 2500.

(3) Investments to be sold for ₹ 35,000.

(4) Goodwill of the firm is valued at ₹ 2,00,000.

(5) Jaya and Mamta will share future profit in the ratio of 1:1.

Prepare necessary accounts and balance sheet after retirement.

9. Madhav, Radha and Gopi are the partners sharing profit and loss in the ratio of $\frac{1}{2}$, $\frac{1}{3}$ and $\frac{1}{6}$. Balance sheet of the firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Cash-bank		12,000
Madhav	1,36,000		Debtors	80,000	
Radha	50,000		– Bad debt reserve	5000	75,000
Gopi	54,000	2,40,000	Stock		62,000
Creditors		50,000	Investments (Market value ₹ 64,000)		58,000
Workmen compensation reserve		24,000	Patent		35,000
Employee provident fund		15,000	Building		75,000
Investment fluctuation reserve		12,000	Advertisement campaign expenditure		24,000
		3,41,000			**3,41,000**

Radha retired from 1-4-2016. Partners decided that :

(1) Value of patent is to be reduced by 20 % whereas value of building is to be reduced to 90 %.

(2) Liability of workmen compensation reserve is decided at ₹ 30,000.

(3) Bad debt reserve on debtors is to be increased by 5 %.

(4) ₹ 40,000 is to be paid to Radha as her share in goodwill.

(5) ₹ 500 received from bad debt written off earlier ₹ 3000.

(6) ₹ 5000 to be paid to Radha in cash and balance amount in two equal annual instalment with 10 % interest per annum.

Prepare Revaluation account, Partners' capital account and Balance sheet. Also prepare Radha's loan account till it is finally paid.

10. Deep, Jyoti and Geeta are the partners sharing profit and loss in the ratio of their capitals. Balance sheet of their firm as 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Goodwill		14,000
Deep	1,00,000		Land-building		2,90,000
Jyoti	1,50,000		Trademark		60,000
Geeta	1,00,000	3,50,000	Stock		50,000
General reserve		28,000	Debtors	40,000	
Creditors		60,000	– Bad debt reserve	6000	34,000
Provident fund		32,000	Bank		22,000
		4,70,000			**4,70,000**

Jyoti retired on the above date. Partners decided that,

(1) New profit and loss sharing ratio of Deep and Geeta is to be kept at 1:1. Goodwill of the firm valued at ₹ 70,000.

(2) Bad debt reserve on debtors is to be reduced upto 10 %.

(3) Stock is shown in the books at 25 % more than its cost, stock to be recorded at cost.

(4) ₹ 60,000 is paid for trademark during current year, which is for total 6 years.

(5) Liability of provident fund is decided at ₹ 35,000.

(6) Total capital of the new firm is to be kept as the total capital of the old firm. Deep and Geeta will maintain this capital in their new profit-loss sharing ratio. For this purpose the difference is to be transferred to their current accounts.

Prepare necessary accounts and balance sheet after retirement.

11. Moon, Star and Sun are the partners of a firm. Sun retires on 31-3-2017. Moon and Star will distribute future profit and loss in the ratio of 5:1. Balance sheet of their firm on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Building	2,40,000
Moon	1,60,000		Machinery	1,30,000
Star	2,00,000		Furniture	80,000
Sun	1,80,000	5,40,000	Stock	45,000
General reserve		90,000	Debtors	30,000
Creditors		60,000	Bank	1,75,000
Bills payable		10,000		
		7,00,000		**7,00,000**

Conditions of retirement were as under :

(1) Goodwill of the firm is valued at ₹ 60,000.

(2) Creditors are payable after one month, which are to be paid immediately at 12 % discount per annum.

(3) Computer, written off from the books is now valued at ₹ 12,000. Moon will take over the computer at this value.

(4) After retirement of Sun, Moon and Star will maintain their capital in the new profit and loss sharing ratio and difference is to be tansferred to bank account.

Prepare necessary accounts and balance sheet after retirement.

12. E, M and I are partners sharing profit and loss in the ratio of 5:3:2. Balance sheet of their firm on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Building		1,20,000
E	60,000		Machinery		80,000
M	30,000		Stock		30,000
I	50,000	1,40,000	Debtors	40,000	
Reserve fund		50,000	– Bad debt reserve	2000	38,000
Workmen profit sharing fund		30,000	Cash		22,000
Creditors		70,000			
		2,90,000			**2,90,000**

I retired on 31-3-2017. Conditions of retirement were as under :

(1) I's profit share will be gained by E and M in the ratio of 2:3.

(2) Goodwill of the firm is valued at ₹ 1,00,000.

(3) Bad debt reserve on debtors is to be increased by 10 %.

(4) Building is valued at 110 %.

(5) Value of machinery is to be reduced by 10 %.

(6) Annual insurance premium of ₹ 24,000 is paid for the year ended on 30-6-2017.

(7) E and M will maintain total capital of the firm ₹ 1,00,000 in their new profit and loss sharing ratio after retirement of I. Prepare necessary accounts and balance sheet after retirement.

Prepare necessary accounts and balance sheet after retirement.

13. L, B and W are the partners of a firm sharing profit and loss in the ratio of 2:2:1. Balance sheet of their firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital Accounts :			Goodwill	8000
L	20,000		Building	37,000
B	12,500		Debtors	13,000
W	5000	37,500	Stock	5500
General reserve		5000	Cash	2000
Creditors		20,000		
Outstanding expenses		3000		
		65,500		**65,500**

W retired on 1-4-2016. Terms of retirement were decided as under :

(1) Market value of building is ₹ 50,000.

(2) Book value of stock is 10 % more than its cost. Stock is to be recorded at its cost.

(3) Personal expenses of W ₹ 500 was debited to profit and loss account.

(4) Goodwill of the firm is valued at ₹ 80,000.

(5) L will gain $\frac{5}{40}$ and B will gain $\frac{3}{40}$ from W's share of profit.

(6) Amount due to W is to be paid in cash and the same amount will be brought in cash by L and B in such a manner that their capital may remain in their new profit-loss sharing ratio in the new firm.

Prepare necessary accounts and balance sheet of the new firm.

14. Chirag, Jigar and Keshav are the partners sharing profit and loss in ratio of 3:2:1. Balance sheet of their firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Land-building		50,000
Chirag	30,000		Machinery		20,000
Jigar	20,000		Investments		10,000
Keshav	10,000	60,000	Stock		10,000
General reserve		6000	Debtors	20,000	
Creditors		44,000	− Bad debt reserve	2000	18,000
			Cash		2000
		1,10,000			**1,10,000**

Keshav retired on 31-3-2016. Following conditions were decided at the time of retirement :

(1) Value of land-building is to be increased by 20 %.

(2) Machinery is valued at 90 % of its book value.

(3) Market value of investment is 150 % of its book value.

(4) Bad debt reserve on debtors is to be reduced by 5 %.

(5) Goodwill of the firm is valued at ₹ 36,000.

(6) ₹ 2000 is outstanding for salary payable to an employee.

(7) Chirag and Jigar will bring necessary amount in cash in such a manner that amount due to Keshav is to be paid in cash and balance of cash may remain in the firm as working capital ₹ 14,000 and their capital in the new firm become proportionate to their new profit-loss sharing ratio.

Prepare necessary accounts and balance sheet of new firm.

15. E, F and G are the partners sharing profit and loss in the ratio of 4:3:3. E retires on 31-3-2017. Balance sheet of the firm on that date was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Goodwill	1000
E	8000		Land-building	6000
F	5000		Free hold assets	3000
G	2000	15,000	Furniture	3000
General reserve		2000	Stock	6600
Creditors		8000	Debtors	7000
Bills payable		2000	Cash	400
		27,000		**27,000**

Following terms of retirement were decided in partnership agreement and among the partners :

(1) Goodwill of the firm is valued at ₹ 7000.

(2) Value of land-building ₹ 7000 and furniture ₹ 2000 is decided.

(3) Stock is over valued by 10 %. ₹ 5000 to be paid to E immediately and balance to be transferred to his loan account.

(4) F and G will bring necessary cash in equal proportion in such a manner that E is to be paid his dues fully and ₹ 2000 remain as working capital (cash).

Prepare profit and loss adjustment account, cash account, partners' capital accounts and balance sheet.

16. Kamal, Bimal and Vimal are the partners sharing profit and loss in the ratio of 1:2:3. Their balance sheet shows following balances on 31-3-2016.

Capital : Kamal ₹ 10,000, Bimal ₹ 20,000 and Vimal ₹ 30,000

General reserve ₹ 24,000

Loan of Vimal ₹ 10,000

Goodwill ₹ 12,000

Vimal died on 31-5-2016. Following conditions were provided in partnership deed :

(1) Goodwill of the firm is to be valued at two years purchase of average profit of last three years.

Profit of last three years were ₹ 25,000, ₹ 40,000 and ₹ 25,000.

(2) Profit share of the deceased partner till the date of death is to be decided on the basis of average profit of last three years.

(3) Interest on capital is to be allowed at 12 % per annum.

Prepare Vimal's capital account.

17. C, S and T are the partners of a firm sharing profit and loss in the ratio of 2:1:2. Balance sheet of their firm on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Land-building	1,40,000
C	80,000		Investments	70,000
S	70,000		Stock	50,000
T	1,00,000	2,50,000	Debtors	25,000
Workmen accident compensation fund		10,000	Cash	20,000
T's loan		25,000	Advertisement suspense account	15,000
Creditors		35,000		
		3,20,000		**3,20,000**

T died on 30-6-2017. As per partnership deed, following accounting treatments are necessary to be given at the time of death of a partner :

(1) Interest on capital is to be allowed at 6 % per annum.

(2) Interest on drawings is to be charged at 12 % p.a. T withdrew ₹ 20,000 on 1-5-2017.

(3) Goodwill is to be valued at two times the average profit of last three years :

Profit of last three years was as under :

2014-15 ₹ 80,000, 2015-16 ₹ 75,000 and 2016-17 ₹ 85,000

(4) Profit share to be given on the basis of profit of previous year.

Prepare T's executor's account.

18. E, V and M are the partners of a firm sharing profit and loss in the ratio of 3:2:1. Balance sheet of their firm on 31-3-2016 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Goodwill	24,000
E	1,00,000		Land-building	2,00,000
V	1,20,000		Machinery	60,000
M	90,000	3,10,000	Debtors	80,000
Investment reserve		10,000	Investments (Market value ₹ 26,000)	30,000
Bad debt reserve		6000	Cash	40,000
Provident fund		70,000	Profit-loss A/c	42,000
Workmen profit sharing fund		30,000		
Creditors		50,000		
		4,76,000		**4,76,000**

V died on 1-10-2016. As per partnership deed, following was decided among partners :

(1) Goodwill is valued at ₹ 1,20,000.

(2) New profit-loss sharing ratio of E and M decided at 2:1.

(3) V is to be given profit share till the date of his death on the basis of the profit of last year.

(4) 10 % reserve for bad debt to be provided on debtors.

(5) Land and building is valued 10 % more.

(6) ₹ 1000 salary per month is payable to V.

(7) ₹ 45,000 to be paid to V's executor immediately and balance amount in two equal yearly instalments with interest at 10 % per annum.

Prepare V's executor account and executor's loan account till it is finally paid.

19. A, T and M are the partners sharing profit and loss in the ratio of 4:1:1. Balance sheet of their firm on 31-3-2017 was as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Land-building	12,000
A	15,000		Furniture	6000
T	12,000		Motor car	8000
M	9000	36,000	Debtors	15,000
General reserve		3000	Stock	6000
Creditors		17,000	Loan to M	9000
Bills payable		1000	Cash	1000
		57,000		**57,000**

M died on 1-7-2017. As per partnership agreement among partners :

(1) Value of land and building and furniture is to be increased by 10 %

(2) Cost of stock is ₹ 5500, which is to be brought in the books.

(3) ₹ 400 to be written off as bad debt from debtors.

(4) Goodwill is valued at ₹ 7200.

(5) M is to be given share in profit till the date of his death on basis of sales and net profit of last year. Sales of last year was ₹ 8,00,000. Sales of first three months of current year was ₹ 4,00,000. Net profit of last year was ₹ 2,40,000.

(6) ₹ 1850 to be paid to M's executor in cash and balance amount in two equal annual instalments with interest at 12 % interest per annum.

Prepare M's executor's account and executor's loan account till it is finally paid.

●

7

Dissolution of Partnership Firm

1. Introduction

So far we have undertaken the study in context to continuation of business inspite of changes in partnership due to the admission of a partner or retirement or death of a partner. This brings to the end of a partnership, but it is not dissolution of a partnership firm.

The partnership firm and partnership automatically comes to an end when the current business is closed and all partners get separated. We will study the transactions related to dissolution in this chapter.

2. Meaning of Dissolution

Dissolution means end of existence. Here dissolution is to be studied in the context of dissolution of partnership and a partnership firm, where two issues are considered for dissolution.

(i) Dissolution of a partnership firm

(ii) Dissolution of a partnership

When a partnership firm closes down its business on a permanent basis, (or a firm becomes non-existent from legal point of view) it is known as dissolution of a partnership firm. In brief, when a running firm is closed and its business activities are closed it is dissolution of a partnership firm.

When except one partner, all partners get separated from a firm, this is also an end of a partnership. If this continuous one partner will become the owner of sole proprietor firm. In this case also a partnership firm gets dissolved. When running business of the firm is sold to a joint stock company - this is also dissolution of a partnership firm.

3. Dissolution of Firm and Partnership

It is essential to understand the meaning of firm dissolution and partnership dissolution, which is as follows :

(A) Dissolution of Firm : As per section 39 of Indian Partnership Act when all partners get separated through dissolution of firm, that brings end of their partnership - it is known as dissolution of firm. In this manner when partnership is dissolved and close down the firm, it is dissolution of firm. The business of the firm is closed down in these circumstances. As a result of dissolution, liabilities of the firm are paid from the realisation of the sale of assets. From the remaining surplus capital of partners is redeemed as per their contract.

When the entire business of the firm is sold, that is also dissolution of a partnership firm.

(B) Dissolution of Partnership : When business is not closed down due to retirement of a partner, death of a partner, insolvency of a partner or due to any other reasons, and remaining partners keep business continuous, it is a dissolution of old partnership. Except outgoing partners remaining partners keep business continuous, consequently, new partnership takes place. Generally, the proportion of partnership changes between continuing partners. In these circumstances partnership firm does not get dissolved. But new partnership comes into existence due to reorganisation of partnership.

Partnership is a relation of partners. While firm is a group name of all partners.

(C) Difference between dissolution of partnership and partnership firm :

Base	Dissolution of Partnership	Dissolution of Partnership Firm
Meaning	Reorganisation of partnership means dissolution of partnership.	Permanent end of partnership firm is dissolution of partnership firm.
Existence of Firm	The existence of firm remains continuous.	There is end of existence of the firm.
Books of Accounts	Books of accounts remains continuous.	Books of accounts are closed.
Settlement of Accounts	No accounts are settled. But profit or loss arised due to revaluation is credited or debited respectively to partners' capital accounts. Generally accounts of outgoing partners are settled.	Accounts are settled. Through realisation account disposal of assets is done and liabilities are paid. Surplus amount is paid to partners for their final settlement.
Interference of court	It is voluntary dissolution of partnership. No need of court's interference.	Whenever required court interferes.
Effect	There may not be dissolution of firm, due to dissolution of partnership.	There is automatic dissolution of partnership, when partnership firm is dissolved.

4. Dissolution of Partnership Firm

In this chapter we will undertake study of important aspects of the dissolution of a partnership firm. Subsequently we will undertake study of accounting treatments for the dissolution of a firm.

(A) Methods of dissolution of firm

(B) Legal and other provision for accounting settlement of dissolution

(C) Procedure of dissolution

(A) Methods of dissolution of firm :

As per Indian Partnership Act 1932 there are two methods for dissolution of partnership firm :

(1) Normal dissolution or dissolution without interference of court

(2) Dissolution by the court

(1) Normal dissolution or dissolution without interference of court : Through any of the following methods partnership can be dissolved without the interference of court.

(i) By agreement : When all partners agree to dissolve the firm, partnership firm can be dissolved at any point of time. It is voluntary dissolution.

(ii) Dissolution as per contract : Dissolution of a partnership firm can be done on the basis of predetermined contract between the partners.

(iii) Dissolution as per act : In the following conditions there is compulsory dissolution by the act.

(a) when all partners of the firm become insolvent; or except one, all partners become insolvent.

(b) when business of firm becomes illegal, this also brings dissolution of a partnership firm.

(iv) Dissolution on happenings of certain contingencies :

(a) if constituted for a fixed term, by the expiry of that term.

(b) if constituted to carry out specific aim, by the completion thereof.

(v) Dissolution by notice : Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or if no date is so mentioned, as from the date of the service of the notice.

(2) Dissolution by the court : When any partner file a suit for dissolution of a firm on any of the following grounds and the court orders to dissolve the firm.

(i) When any partner becomes of unsound mind.

(ii) When a partner becomes permanently incapable of performing his duties as a partner.

(iii) When a partner undertakes misconduct against partnership firm or against business of firm.

(iv) When a partner willfully and persistently breaches the partnership agreement.

(v) When a partner transfers his whole interest in the partnership to a third party without the consent of other partners.

(vi) When a firm continuously incurs losses and is unable to run a business due to loss.

(vii) When the court finds any other ground to be just and equitable for the dissolution of the firm.

(B) Legal and other provisions for accounting settlement of dissolution :

(1) For loss of a firm : As per Indian Partnership Act, the loss arised including capital deficit at the time of dissolution is executed in the following manner :

(a) First of all to be written off from the profit of the firm.

(b) If profit is not sufficient, then it will be met from the capital of the partners.

(c) If capital is not sufficient, then all partners would distribute this loss in their profit-loss sharing ratio and pay from their personal assets as per need.

(2) Liabilities of a firm and personal liabilities of partners : The liabilities of partners is unlimited. Thus for dues towards third party partners are responsible individually and collectively. As per legal provision, assets of the firm are used to discharge the liabilities of the firm and personal assets of partners are used to discharge their personal liabilities.

Since the liability of the partners is unlimited, after making the payment of personal liability from personal asset, surplus can be used to pay the liabilities of the firm.

(3) Partners' loan to firm : At the time of dissolution, first of all the dissolution expenses and then the liabilities of the firm are paid from the realisation of the assets of the firm. Than from surplus, the loan of partners is redeemed. If after making the payment of firms' liabilities, the available surplus is insufficient to return back loan of more than one partner and nothing can be recovered from partners, in this case the loan of these partners is redeemed in their loan proportion.

(4) Loan of partners' wife : If wife of a partner has given a loan to the firm from her personal fund, this loan will be treated as a liability towards the third party and will be redeemed accordingly.

If loan is given from the personal fund of her husband, then it will be treated as a loan of a partner.

(5) Liability of partners : Liability of partners is unlimited. If a partner or partners becomes insolvent, solvent partners are responsible to pay the dues of the firm from their personal property.

(6) Distribution of assets realisation of firm : The realisation of asset of the firm is paid in the following order :

(a) First of all dissolution expense is paid.

(b) Next, liabilities towards third parties are paid.

(c) Next, loan of partners paid.

(d) Finally, capital and balances of current accounts of partners are redeemed.

(e) Even if any surplus remains after the payment shown in (d), surplus will be distributed among all the partners in their profit-loss sharing ratio.

(C) General procedure of dissolution :

When a firm is dissolved, at that time all assets of the firm are sold and the payment is made in the mentioned order. Due to the accounting treatments of dissolution, books of accounts of the firm will be closed.

5. Accounting Treatments of Dissolution

At the time of dissolution of firm, all assets of firm are sold and liabilities are paid from the realised income. If surplus remains, capital is redeemed. Books of accounts are closed. To incorporate complete procedure the following accounting treatments are given.

(A) Preparation of necessary accounts : The following accounts are prepared to follow the accounting procedure of dissolution and to give the accounting treatments.

(1) Realisation Account

(2) Partners Loan Account (if any)

(3) Partners Capital Accounts / Current Accounts

(4) Cash / Bank Account

(1) Realisation Account : An account which is prepared at the time of dissolution to give the accounting treatments to dispose off assets and payment of liabilities, is known as 'Realisation Account'.

To close assets and liabilities excluding cash / bank account are transferred to realisation account at their book value at the time of the dissolution of a firm.

Subsequently amount realised from the sale of assets is debited to cash account and credited to the realisation account. Payment of liabilities is debited to realisation account and credited to cash account.

The difference of realisation account will be either profit or loss. This difference is allocated between the partners in their profit sharing ratio. Profit is credited to their capital account. Loss is debited to their capital account.

To incorporate above mentioned dissolution related accounting treatments, realisation account is prepared. (The specimen of realisation account is given subsequently.)

(2) **Partners' Loan Account :** Many times for financial assistance purpose partners provide loan to the business. At the time of dissolution of a firm, partners' loan are repaid prior to the redemption of the capital of partners. Thus at the time of dissolution partners' loan accounts are also prepared. (when loan is provided by the partners.)

(3) **Partners' Capital Accounts / Current Accounts :** Earlier detailed study of partners' capital accounts / current accounts is undertaken. At the time of dissolution, parnters' capital is redeemed after the payment of all the liabilities.

(4) **Cash / Bank Account :** Since firm is dissolved, all transactions are done in cash form or through bank. Cash account is not transferred at the realisation account. All cash receipts and payments are recorded in this account. At last, surplus is paid to the partners.

Journal entries for the preparation of Dissolution Accounts :

(A) Before recording journal entries prepare above stated necessary accounts

(B) Disclose balances in partners' capital accounts and cash / bank account

(C) Disclose balances in partners' loan accents (if any)

(1) Balances of accumulated reserve and undistributed profit :

First of all balances of accumulated reserves are the shown in the balance sheet of the firm, like general reserve, workmen compensation fund, credit balance of profit and loss account, debit balance of profit and loss account etc. These amounts are not transferred to the realisation account. These amounts are transferred to the partners capital account in their profit-sharing ratio. These accounts are not either assets or liabilities, but component of capital, hence it is transferred to the capital account. Journal entry for this is as follows :

(i) Reserves and credit balance of profit and loss account (profit) :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Reserves A/c Dr		✓	
	Investment fluctuation fund A/c Dr		✓	
	Workmen accident compensation fund A/c Dr		✓	
	Profit and loss A/c (Profit) Dr		✓	
	To Partners' capital A/c			✓
	[Being reserves and undistributed profit credited to partners' capital account in their profit and loss sharing ratio.]			

(ii) Debit balance of profit and loss account (loss) :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' capital A/c Dr		✓	
	To Profit and Loss A/c (loss)			✓
	[Being debit balance of profit and loss A/c (loss) debited to capital account of partners in their profit and loss sharing ratio.]			

(2) When assets are closed and transferred to the realisation account :

Assets always disclose debit balance. At the time of dissolution of a firm, except cash/bank account all assets accounts disclosed in balance sheet are transferred to the debit side of realisation account at their book value. To close assets account, their accounts are credited. e.g. Land-building, plant-machinery, furniture, investments, debtors, goodwill, patent, trademark, copyright, bills receivable etc. where journal entry will be as follows :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr		✓	
	To Land-building A/c			✓
	To Plant-machinery A/c			✓
	To Furniture A/c			✓
	To Investments A/c			✓
	To Debtors A/c			✓
	To Bills receivable A/c			✓
	To Other assets A/c			✓
	[Being assets accounts are closed and transferred to realisation account at their book value.]			

Note : On the date of dissolution, balance of cash or bank account disclosed in the balance sheet is not transferred to the realisation account. It's separate account is prepared and same balance is disclosed. Because realisation from sale of assets and payment of liabilities are shown in the cash account. At last, surplus is transferred to the capital account of partners.

(3A) When accounts of provisions are closed and transferred to the realisation account :

Provisions always disclose credit balance. At the time of dissolution of a firm all provisions account disclosed in balance sheet are transferred to the credit side of realisation account at their book value. To close provision accounts, their accounts are debited. e.g. bad debt reserve, depreciation fund account, discount reserve on debtors or bills receivable account etc.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bad debt reserve A/c Dr		✓	
	Depreciation fund A/c Dr		✓	
	Discount reserve on debtors and bills receivable A/c Dr		✓	
	To Realisation A/c			✓
	[Being provisions accounts are closed and transferred to realisation account.]			

(3B) When liabilities accounts are closed and transferred to the realisation account :

Liabilities always disclose credit balance. At the time of dissolution of a firm liabilities accounts disclosed in balance sheet are transferred to the credit side of the realisation account at their book value.

To close liabilities accounts their accounts are debited. e.g. creditors, bills payable, bank overdraft, providend fund, workmen profit sharing fund, outstanding expenses etc. Journal entry will be as follows :

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Creditors A/c	Dr		✓	
	Bills payable A/c	Dr		✓	
	Bank overdraft A/c	Dr		✓	
	Workmen profit sharing fund A/c	Dr		✓	
	Outstanding expenses A/c	Dr		✓	
	To Realisation A/c				✓
	[Being liabilities accounts are closed and transferred to realisation account.]				

Note : Since the settlement of partners' accounts is to be done, capital accounts of partners, current accounts of parnters, loan accounts of partners are not transferred to the realisation account. Their accounts are separately opened and balances are shown there in. At last these accounts are closed in dissolution.

(4) **When assets are sold :**

(A) **Sale of assets :** In this case assets are sold in open market. The realisation of sale of assets is debited to the cash/bank account and realisation account is credited.

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Cash/Bank A/c	Dr		✓	
	To Realisation A/c				✓
	[Being sale of assets is credited to realisation account.]				

(B) **When assets taken over by a partner :** When any asset is taken over by a partner at that time partners' account is debited and realisation account is credited.

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Respective Partners' capital A/c	Dr		✓	
	To Realisation A/c				✓
	[Being assets taken over by partner is debited to his account and credited to realisation account.]				

Note : (1) The realisable value must be given of all the tangible and intangible assets at the time of dissolution of a firm. It must be indicated in question if there is no realisable value of any tangible and intangible assets.

(2) When assets recorded in the books are given to the creditors recorded in the books for their dues : This kind of asset and creditor are already transferred in the realisation account. Thus the realisable value of asset and payable amount to creditor will not be recorded.

(C) **When income is received from unrecorded asset :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Cash A/c Dr To Realisation A/c [Being amount realised on unrecorded assets.]		✓	✓

(5) **When liabilities are paid :**

(A) **Paid in cash :** When liabilities of the firm are paid in cash, realisation account is debited and cash/bank account is credited.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Cash / Bank A/c [Being all liabilities are paid.]		✓	✓

(B) **When liabilities payment is accepted by a partner :** When any partner pays the liability or accepts to pay the liability of the firm, in this case realisation account is debited and respective partners' capital is credited.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Respective partners' capital A/c [Being partner has accepted liabilitiy for payment.]		✓	✓

Note : When no information is given about the payment of liability at the time of dissolution it will be assumed that the liability is paid as per the book value.

(C) **When unrecorded liability is paid :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Cash / Bank A/c [Being unrecorded liability is paid.]		✓	✓

(6) **When dissolution expense of partnership firm is paid :**

Generally, dissolution expense of partnership firm is borne by the firm itself. The accounting treatment of dissolution expense for different situations can be given as follows :

(A) When dissolution expense is paid by a firm and to be borne by the firm :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr		✓	
	To Cash / Bank A/c			✓
	[Being dissolution expense is paid.]			

(B) When any partner accepts liability :

(i) No accounting treatment is given, if the dissolution expense is to be borne and paid by any partner :

But, when any remuneration is payable to the respective partner to perform the responsibility of dissolution procedure, the following entry will be passed.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr		✓	
	To Respective partners' capital A/c			✓
	[Being remuneration is paid to partner for performance of dissolution procedure.]			

(ii) When the responsibility of the payment of the dissolution expense is accepted by a partner, but payment is made by the firm, in this case following journal entry will be passed.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Respective partners' capital A/c Dr		✓	
	To Cash / Bank A/c			✓
	[Being dissolution expense of the firm paid on the behalf of partner.]			

(7) When loan of partner is paid :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' loan A/c Dr		✓	
	To Bank / Cash A/c			✓
	[Being paid for loan of partner.]			

(8) Distribution of balance of realisation account :

The balance of realisation can be in the form of profit or loss. This profit or loss is distributed to the partners' current account or capital account in the profit-loss sharing ratio.

(A) **In case of profit :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Partners' current/capital A/c [Being profit of realisation account is distributed to partners' current/capital account.]		✓	✓

(B) **In case of loss :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' current/capital A/c Dr To Realisation A/c [Being loss of realisation account is distributed to partners' current/capital accounts.]		✓	✓

(9) **When partners' current accounts are closed :**

At the time of dissolution, partners' current accounts are to be closed and are transferred to capital accounts :

(i) **When current accounts show credit balance :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' current A/c Dr To Partners' capital A/c [Being balance current accouints of partners' are transfer to capital account.]		✓	✓

(ii) **When current accounts show debit balance :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' capital A/c Dr To Partners' current A/c [Being balance of current accounts of partners' are transfer to capital account.]		✓	✓

(10) **When partners' capital accounts are closed :**

(i) **When closing balance of partners' capital account is debit balance and partner brings cash :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Bank/Cash A/c Dr To Partners' capital A/c [Being partner brought cash for his debit balance of capital account.]		✓	✓

(ii) **When closing balance of partners' capital account is credit balance and payment is made to partner :**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Partners' capital A/c Dr To Bank/Cash A/c [Being cash is paid to partners for their credit balance of capital account.]		✓	✓

Note : All accounts will be closed after incorporation of above mentioned accounting treatments of dissolution of firm.

(11) **Accounting treatments of special transactions :**

(i) **When unrecorded assets are given to recorded creditor for his due :**

In these kind of circumstances from total amount of creditors, the amount of unrecorded assets is deducted and remaining amount of creditors is paid to them. e.g. there are total creditors of ₹ 90,000. One unrecorded asset is given to the book creditor of ₹ 50,000 against his due.

	Total creditors	₹ 90,000
Less :	Unrecorded assets given to the creditors	₹ 50,000
	Remaining creditors will be paid	₹ 40,000

It's journal entry will be as follows :

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Bank/Cash A/c [Being creditors are paid.]		40,000	40,000

(ii) **When partial payment is made for unrecorded liability through unrecorded asset :**

e.g. ₹ 40,000 are payable to Amul, but not recorded in the books. The unrecorded asset of ₹ 20,000 is given to him and remaining amount is paid by cheque.

	₹ 40,000	Payable for unrecorded liability
–	₹ 20,000	Given unrecorded asset
	₹ 20,000	Payable amount

In this case, following journal entry will be given for paid amount.

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Realisation A/c Dr To Bank A/c [Being amount is paid for unrecorded liability.]		20,000	20,000

Specimen of Realisation Account

Realisation Account

Dr Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets A/c :		**Journal entries no.**	**By Provisions A/c :**		**Journal entries no.**
Land-building	✓		Bad debt reserve	✓	
Plant-machineries	✓		Depreciation fund	✓	3(A)
Furniture	✓	(2)	Discount reserve on debtors -		
Investments	✓		bills receivable	✓	✓
Debtors	✓				
Bills receivable	✓		**By Sundry Liabilities A/c :**		
Other assets	✓	✓	Creditors	✓	
To Cash/Bank A/c			Bills payable	✓	
(Payment of liabilities)		5(A)	Bank overdraft	✓	3(B)
To Partners' capital A/c			Workmen profit sharing fund	✓	
(Liability accepted by partner)		5(B)	Outstanding expense	✓	✓
To Cash/Bank A/c			By Cash/Bank A/c		
(Payment of unrecorded liabilities)		5(C)	(Sale of assets)		4(A)
To Cash/Bank A/c			By Partners' capital A/c		
(Payment of dissolution expense)		6(A)	(Asset taken over by partner)		4(B)
To Partners' capital A/c			By Cash/Bank A/c		
(Remuneration of partner)		6(B)(ii)	(Sale of unrecorded asset)		4(C)
To Partners' current/capital A/c			By Partners' current/capital A/c		
(Distribution of profit of realisation account)		8(A)	(Distribution of loss of realisation account)		8(B)
		....			....

Illustration 1 : Pass journal entries for the following transactions :

(1) Land-building ₹ 1,00,000 and investments ₹ 50,000 are disclosed in the balance sheet at the time of dissolution. ₹ 80,000 and ₹ 60,000 are realised respectively from them.

Ans. : **Journal Entries**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		1,50,000	
	To Land-building A/c			1,00,000
	To Investments A/c			50,000
	[Being at the time of dissolution land-building and investments accounts are closed and transfer them to realisation account.]			

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	Cash/Bank A/c Dr		1,40,000	
	To Realisation A/c			1,40,000
	[Being amount realised from sale of land-building and investments.]			

(2) At the time of dissolution total assets of the firm are of ₹ 4,00,000. Out of that 40 % are current assets. Where cash is included of ₹ 20,000. 120 % of fixed assets are realised. 80 % are realised from current assets.

Ans. : Explanation :

Assets ₹ 4,00,000

Current assets 40 %
₹ 1,60,000

Cash ₹ 20,000

Other current assets (?)
₹ 1,40,000
× 80 %
₹ 1,12,000 Realised

Fixed assets (?) 60 %
₹ 2,40,000
× 120 %
₹ 2,88,000 Realised

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		3,80,000	
	To Fixed assets A/c			2,40,000
	To Current assets A/c			1,40,000
	[Being assets accounts are closed and transferred to realisation account.]			
2	Cash/Bank A/c Dr		4,00,000	
	To Realisation A/c			4,00,000
	[Being ₹ 2,88,000 realised from fixed assets and ₹ 1,12,000 realised from current assets.]			

(3) At the time of dissolution of firm, the value of machinery was of ₹ 70,000. It is taken by one partner for ₹ 78,000.

Ans. : **Journal Entries**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		70,000	
	To Machinery A/c			70,000
	[Being machinery account closed and transferred to realisation account.]			

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2	Partners' capital A/c Dr		78,000	
	To Realisation A/c			78,000
	[Being at the time of dissolution partner taken machines for ₹ 78,000.]			

(4) Dissolution expense of the firm is ₹ 20,000.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		20,000	
	To Cash/Bank A/c			20,000
	[Being dissolution expense paid.]			

(5) At the time of dissolution of partnership firm following assets are appeared in the book :

Building	₹ 2,00,000	Furniture	₹ 40,000
Goodwill	₹ 20,000	Machinery	₹ 30,000

Realised ₹ 2,20,000 from building, ₹ 50,000 for furniture and machinery at book value. No value is realised for goodwill. Pass necessary journal entries.

Ans. : **Journal Entries**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		2,90,000	
	To Building A/c			2,00,000
	To Furniture A/c			40,000
	To Goodwill A/c			20,000
	To Machinery A/c			30,000
	[Being firm is dissolved all assets are transferred to realisation account.]			
2	Cash/Bank A/c Dr		3,00,000	
	To Realisation A/c			3,00,000
	[Being ₹ 2,20,000 for building; ₹ 50,000 for furniture and ₹ 30,000 machinery are realised.]			

(6) Bad debt of ₹ 12,000 was written off, out of which ₹ 10,000 is received.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Cash/Bank A/c Dr		10,000	
	To Realisation A/c			10,000
	[Being amount received for bad debts.]			

(7) There is no value of goodwill in the books of a firm. But at the time of dissolution ₹ 35,000 realised for it.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Cash/Bank A/c Dr To Realisation A/c [Being realised for goodwill.]		35,000	35,000

(8) Partner Naresh accepts to pay ₹ 30,000 for bills payable.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr To Naresh's Capital A/c [Being Naresh has accepted to pay bills payable.]		30,000	30,000

(9) At the time of dissolution of the firm debtors are of ₹ 80,000 and creditors of ₹ 40,000. Partner Pratik accepts debtors at 20 % less than book-value and paid to creditors.

Ans. : **Journal Entries**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr To Debtors A/c [Being debtors are transferred to realisation account.]		80,000	80,000
2	Creditors A/c Dr To Realisation A/c [Being creditors are transferred to realisation account.]		40,000	40,000
3	Pratik's current/capital A/c Dr To Realisation A/c [Being Pratik has accepted debtors at 20 % less than book-value.]		64,000	64,000
4	Realisation A/c Dr To Pratik's current/capital A/c [Being Pratik has paid to creditors.]		40,000	40,000

(10) A partner Vijay has accepted responsibility for dissolution procedure of the firm. A firm has decided to pay remuneration of ₹ 12,000 for this task. A firm has paid him ₹ 6000 for expense.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		12,000	
	To Vijay's capital A/c			12,000
	[Being dissolution expense becomes payable to partner Vijay.]			
2	Vijay's A/c Dr		6000	
	To Cash/Bank A/c			6000
	[Being paid to Vijay for dissolution expense responsibility.]			

(11) Income tax liability of the partnership firm is determined for ₹ 35,000. It is not recorded in the books.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		35,000	
	To Cash/bank A/c			35,000
	[Being unrecorded income tax liability is paid.]			

(12) At the time of liquidation, after making payment of all liabilities and partners loan, surplus of asset is ₹ 60,000. The profit-loss sharing ratio of S, B and I are 4:3:3.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		60,000	
	To S's Current/capital A/c			24,000
	To B's Current/capital A/c			18,000
	To I's Current/capital A/c			18,000
	[Being excess of assets distributed among partners in the ratio of 4:3:3.]			

(13) Realised ₹ 25,000 for unrecorded machine, at the time of dissolution.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Cash A/c Dr		25,000	
	To Realisation A/c			25,000
	[Being realised from sale of unrecorded machine.]			

(14) On due payment of ₹ 35,000, unrecorded furniture of ₹ 20,000 given to Mahesh. The remaining amount is paid in cash.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		15,000	
	To Cash / Bank A/c			15,000
	[Being creditor, Mahesh of ₹ 35,000 is given unrecorded furniture of ₹ 20,000 and remaining amount of ₹ 15,000 paid in cash.]			

(15) One partner accepts to pay loan of his wife ₹ 40,000.

Ans. : **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Partners' wife's loan A/c Dr		40,000	
	To Respective partners' capital A/c			40,000
	[Being partner has accepted to pay his wife's loan.]			

Note : During formation of question paper : (1) In question paper for preparation of journal entries and realization maximum 10 adjustments should be given. (2) In question paper for preparation of journal entries, necessary accounts and balance sheet maximum 5 adjustments should be given.

Illustration 2 : Tushar and Dipak are partners sharing profit-loss in the proportion of 4:2. The balance sheet of their firm as on 31-3-2016 is as follows :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital Accounts :			Land-building		67,000
Tushar	68,000		Machinery		70,000
Dipak	49,000	1,17,000	Stock		22,000
General reserve		6000	Debtors	16,000	
Creditors		80,000	− Bad debt reserve	1000	15,000
Tushar's loan		42,000	Cash balance		71,000
		2,45,000			**2,45,000**

Firm is dissolved on 31-3-2016. You are provided the following information :

(1) Realised ₹ 93,000 from land-building.

(2) Tushar took machinery at ₹ 76,000.

(3) Realised ₹ 12,000 from stock.

(4) ₹ 15,000 recovered from debtors.

(5) Dissolution expense is ₹ 10,000.

Write necessary journal entries in the books of firm and prepare necessary accounts also.

Ans. :

Journal Entries

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
1	Realisation A/c Dr		1,75,000	
	To Land-building A/c			67,000
	To Machinery A/c			70,000
	To Stock A/c			22,000
	To Debtors A/c			16,000
	[Being all assets accounts are closed and transferred them to realisation account.]			
2	Creditors A/c Dr		80,000	
	Bad debt reserve A/c Dr		1000	
	To Realisation A/c			81,000
	[Being liability account and provision account are closed and transferred them to realisation account.]			
3	General reserve A/c Dr		6000	
	To Tushar's capital A/c			4000
	To Dipak's capital A/c			2000
	[Being genral reserve distributed to partners in their profit and loss sharing ratio.]			
4	Cash/bank A/c Dr		1,20,000	
	To Realisation A/c			1,20,000
	[Being amount realised from assets. (Land-building 93,000 + Stock 12,000 + debtors 15,000)]			
5	Turhar's capital A/c Dr		76,000	
	To Realisation A/c			76,000
	[Being machinery has taken by Tushar, transferred to his capital A/c.]			
6	Realisation A/c Dr		80,000	
	To Bank/Cash A/c			80,000
	[Being ₹ 80,000 paid to creditors.]			

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
7	Realisation A/c Dr		10,000	
	To Cash/Bank A/c			10,000
	[Being dissolution expense paid.]			
8	Tushar's loan A/c Dr		42,000	
	To Cash/Bank A/c			42,000
	[Being Tushar's loan returned to him.]			
9	Realisation A/c Dr		12,000	
	To Tushar's capital A/c			8000
	To Dipak's capital A/c			4000
	[Being profit of realisation account is distributed between partners in their profit and loss sharing ratio.]			
10	Tushar's capital A/c Dr		4000	
	Dipak's capital A/c Dr		55,000	
	To Cash/Bank A/c			59,000
	[Being final payment is made.]			

Realisation Account

Dr Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets A/c :			**By Sundry Liabilities A/c :**		
Land-building	67,000		Creditors	80,000	
Machinery	70,000		Bad debt reserve	1000	81,000
Stock	22,000		**By Cash A/c :**		
Debtors	16,000	1,75,000	Land-building	93,000	
To Cash A/c :			Stock	12,000	
To Creditors		80,000	Debtors	15,000	1,20,000
To Dissolution expense		10,000	By Tushar's capital A/c (Machinery)		76,000
To Capital A/c (Profit) :					
Tushar	8000				
Dipak	4000	12,000			
		2,77,000			**2,77,000**

Tushar's Loan Account

Dr | | | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c	42,000	By Balance b/d	42,000
	42,000		**42,000**

Partners' Capital Account

Dr | | | Cr

Particulars	Tushar(₹)	Dipak(₹)	Particulars	Tushar(₹)	Dipak(₹)
To Realisation A/c			By Balance b/d	68,000	49,000
(machinery)	76,000	–	By General reserve	4000	2000
To Cash/Bank A/c	4000	55,000	By Realisation A/c (Profit)	8000	4000
	80,000	**55,000**		**80,000**	**55,000**

Cash / Bank Account

Dr | | | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Balance b/d		71,000	**By Realisation A/c :**		
To Realisation A/c :			Creditors	80,000	
Land-building	93,000		Dissoluation expense	10,000	90,000
Debtors	15,000		By Tushar's loan A/c		42,000
Stock	12,000	1,20,000	**By Capital A/c :**		
			Tushar	4000	
			Dipak	55,000	59,000
		1,91,000			**1,91,000**

Second method for the preparation of realisation account :

It is a time consuming process to dispose off all the assets and the payment of liabilities after the dissolution of a partnership firm. In this method assets and liabilities are not transferred to realisation account. But accounts of assets and liabilities remain unaffected. Accounts of respective assets and liabilities are opened in this method.

Consequently (i) amount realised from the respective asset is debited to cash/bank account and credited to respective asset account. Any difference of respective asset account (profit or loss) is transferred to realisation account. (ii) amount paid for the respective liabilities is credited to cash/bank account and debited to respective liability account. Any difference of respective liability account (profit or loss) is transferred to the realisation account.

Dissolution expense is debited to the realisation account. At last realisation account is to be closed and the difference of realisation account is transferred to the partners capital accounts in their profit-loss sharing ratio.

Illustration 3 : Jhanavi, Yesha and Jvallit are partners sharing profit-loss in the proportion of 5:3:2. The firm was dissolved on 31-3-2016. On that firm has follows status :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Sundry assets	1,48,000
Jhanavi	50,000		Cash balance	2000
Yesha	30,000			
Jvallit	20,000	1,00,000		
Sundry liabilities		50,000		
		1,50,000		**1,50,000**

(1) ₹ 1,58,000 realised from sundry assets. (2) Liability is paid at 10 % discount. (3) The firm has paid government taxes of last two years of ₹ 3000. This was not recorded in the books. (4) Dissolution expense incurred ₹ 2000.

Prepare realisation account under second method.

Note : This second method of realisation account is not expected for exam. This is given for information purpose.

Ans. :

Realisation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c :			By Sundry assets A/c	10,000
Government taxes		3000	By Sundry creditors A/c	5000
Dissolution expenses		2000		
To Capital A/c :				
Jhanavi	5000			
yesha	3000			
Jvallit	2000	10,000		
		15,000		**15,000**

Sundry Assets Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	1,48,000	By Cash A/c	1,58,000
To Realisation A/c (Profit)	10,000		
	1,58,000		**1,58,000**

Sundry Liabilities Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c	45,000	By Balance b/d	50,000
To Realisation A/c	5000		
	50,000		**50,000**

Cash Account

Dr Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Balance b/d	2000	By Sundry liabilities A/c		45,000
To Sundry assets A/c	1,58,000	**By Realisation A/c :**		
		Government taxes	3000	
		Dissolution expense	2000	5000
		By Capital A/c :		
		Jhanavi	55,000	
		Yesha	33,000	
		Jvallit	22,000	1,10,000
	1,60,000			**1,60,000**

Partners' Capital Accounts

Dr Cr

Particulars	Jhanavi(₹)	Yesha (₹)	Jvallit(₹)	Particulars	Jhanavi(₹)	Yesha (₹)	Jvallit(₹)
To Cash A/c	55,000	33,000	22,000	By Balance b/d	50,000	30,000	20,000
				By Realisation A/c	5000	3000	2000
	55,000	**33,000**	**22,000**		**55,000**	**33,000**	**22,000**

Explanation :

(1) Sundry assets account and sundry liabilities account will not be transferred to the realisation account. Their accounts will be opened and balances will be written.

(2) Realisation of sundry assets of ₹ 1,58,000 is debited to cash account, credited to sundry assets account. The balance of sundry assets account ₹ 10,000 is profit, which credited to realisation account and debited to sundry assets account. Finally sundry assets account will be closed.

(3) ₹ 45,000 paid for sundry liabilities. This amount is debited to sundry liabilities account and credited to cash account. The balance of sundry liabilities account of ₹ 5000 is profit debited to sundry liabilities account and credited to realisation account. Finally, sundry liabilities will be closed.

(4) Government taxes and dissolution expense are debited to the realisation account and credited to the cash account, as they are not recorded in the books.

(5) The closing balance of realisation account ₹ 10,000 (profit) is debited to realisation account and credited to partners capital account in their profit-loss sharing ratio. Finally realisation account will be closed.

(6) The closing balance of partners' capital account is respectively ₹ 55,000; ₹ 33,000 and ₹ 22,000 are debited to their capital accounts and credited to cash account. At last all accounts are closed.

Illustration 4 : Vrushita, Dhyana and Sapana are partners sharing profit-loss in equal proportion. On 31-3-2017 partners have decided to dissolve the firm. Balance sheet of that day is given.

Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Goodwill	4000
Vrushita	56,000		Building	60,000
Dhyana	40,000		Furniture	20,000
Sapana	20,000	1,16,000	Debtors	40,000
Loan of Dhyana		8000	Stock	6000
Creditors		20,000	Cash balance	6000
Bills payable		16,000	Profit and loss A/c (Debit balance)	24,000
		1,60,000		**1,60,000**

Disposal of assets and liabilities is as follows :

(1) Vrushita has taken building for ₹ 52,000 and accepted to pay for bills payable.

(2) Sapana has taken stock for ₹ 8000.

(3) Realised ₹ 16,000 for furniture.

(4) ₹ 36,000 collected from debtors.

(5) Dissolution expense incurred ₹ 6000.

(6) Paid for unrecorded stationery bill of ₹ 2000.

(7) Bad debts of ₹ 4000 was written off in past, out of which ₹ 2000 received.

(8) No value is realised for goodwill.

As per partnership act, deficit of any partners' capital is to be paid immediately in cash by the partners'. Prepare necessary accounts for dissolution accounts.

Ans. :

Realisation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets :			**By Sundry Liabilities :**		
Goodwill	4000		Creditors	20,000	
Building	60,000		Bills payable	16,000	36,000
Furniture	20,000		By Vrushita's capital A/c (building)		52,000
Debtors	40,000		By Sapana's capital A/c (Stock)		8000
Stock	6000	1,30,000	**By Cash A/c :**		
To Cash A/c :			Furniture	16,000	
Stationery bill	2000		Debtors	36,000	
Dissolution expense	6000		Bad debt return	2000	54,000
Creditors	20,000	28,000	By Partners' capital A/c (Loss)		
To Vrushita's capital A/c (Bills payable)		16,000	Vrushita	8000	
			Dhyana	8000	
			Sapana	8000	24,000
		1,74,000			**1,74,000**

Dhyana's Loan Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c	8000	By Balance b/d	8000
	8000		**8000**

Dr **Partners' Capital Accounts** Cr

Particulars	**Vrushita (₹)**	**Dhyana (₹)**	**Sapana (₹)**	**Particulars**	**Vrushita (₹)**	**Dhyana (₹)**	**Sapana (₹)**
To Profit-loss A/c				By Balance b/d	56,000	40,000	20,000
(Loss)	8000	8000	8000	By Realisation A/c	16,000	–	–
To Realisation A/c				(Bills payable)			
(building)	52,000	–	–	By Cash A/c	–	–	4000
To Realisation A/c				(Deficit)			
(Stock)	–	–	8000				
To Realisation A/c							
(Loss)	8000	8000	8000				
Cash A/c	4000	24,000	–				
	72,000	**40,000**	**24,000**		**72,000**	**40,000**	**24,000**

Dr **Cash Account** Cr

Particulars	**Amt. (₹)**	**Particulars**		**Amt. (₹)**
To Balance b/d	6000	**By Realisation A/c :**		
To Realisation A/c :		Stationary bill	2000	
Furniture A/c	16,000	Dissolution expense	6000	8000
Debtors A/c	36,000	**By Realisation A/c :**		
Realisation A/c (Bad debt return)	2000	Creditors A/c		20,000
To Sapana's capital A/c	4000	Dhyana's loan		8000
		By Vrushita's capital A/c		4000
		By Dhyana's capital A/c		24,000
	64,000			**64,000**

Illustration 5 : Kaushal, Krina and Krupansh are partners sharing profit-loss in the proportion of 5:3:2. The balance sheet of firm as on 30-9-2016 was as follows :

Balance Sheet

Liabilities		**Amt. (₹)**	**Assets**		**Amt. (₹)**
Capital :			Cash		20,000
Kaushal	50,000		Krupansh's current A/c		20,000
Krina	30,000		Machinery		30,000
Krupansh	20,000	1,00,000	Investments		50,000
Current Accounts :			Goodwill		20,000
Kaushal	20,000		Stock		10,000
Krina	10,000	30,000	Debtors	1,20,000	
Profit and loss A/c		1,00,000	– Bad debt reserve	20,000	1,00,000
Investment fluctuation fund		10,000	Land-building	2,20,000	
Kaushal's loan		50,000	– Depreciation fund	20,000	2,00,000
Creditors		2,00,000	Motor car	1,30,000	
Bills payable		60,000	– Depreciation fund	30,000	1,00,000
		5,50,000			**5,50,000**

Partners have decided to dissolve the firm on the date of balance sheet :

(1) Dissolution expense was ₹ 20,000.

(2) Creditors are paid at 10 % discount.

(3) Unexpected expense paid ₹ 10,000.

(4) ₹ 20,000 received from bad debts which was written off two years back.

(5) Investments have taken by Kaushal for ₹ 60,000.

(6) Realisation of assets : Land-building ₹ 2,20,000
Motor car ₹ 80,000

(7) Stock realised at book-value, nothing is realised from goodwill.

(8) Full amount of debtors and machines is received.

Prepare necessary accounts.

Ans. : **Realisation Account**

Dr Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets :			**By Sundry Liabilities :**		
Goodwill	20,000		Creditors	2,00,000	
Land-building	2,20,000		Bills payable	60,000	2,60,000
Motor car	1,30,000		**By Reserves and Provisions :**		
Machinery	30,000		Bad debt reserve	20,000	
Investments	50,000		Land-building	20,000	
Debtors	1,20,000		Motor car	30,000	70,000
Stock	10,000	5,80,000	**By Cash A/c :**		
To Cash A/c :			Land-building	2,20,000	
Creditors	1,80,000		Motor car	80,000	
Bills payable	60,000		Machinery	30,000	
Unexpected expense	10,000		Debtors	1,20,000	
Dissolution expense	20,000	2,70,000	Stock	10,000	4,60,000
To Partners' Current A/c (Profit)			**By Cash A/c :**		
Kaushal	10,000		Bad debt return		20,000
Krina	6000		By Kaushal's current A/c		
Krupansh	4000	20,000	(investments)		60,000
		8,70,000			**8,70,000**

Kaushal's Loan Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Cash A/c	50,000	By Balance b/d	50,000
	50,000		**50,000**

Partners' Current Accounts

Dr | Cr

Particulars	Kaushal (₹)	Krina (₹)	Krupansh (₹)	Particulars	Kaushal (₹)	Krina (₹)	Krupansh (₹)
To Balance b/d	–	–	20,000	By Balance b/d	20,000	10,000	–
To Realisation A/c (investments)	60,000	–	–	By Profit and loss A/c	50,000	30,000	20,000
To Partners' capital A/c	25,000	49,000	6000	By Investment fluctuation fund	5000	3000	2000
				By Realisation A/c	10,000	6000	4000
	85,000	**49,000**	**26,000**		**85,000**	**49,000**	**26,000**

Partners' Capital Accounts

Dr | Cr

Particulars	Kaushal (₹)	Krina (₹)	Krupansh (₹)	Particulars	Kaushal (₹)	Krina (₹)	Krupansh (₹)
To Cash A/c	75,000	79,000	26,000	By Balance b/d	50,000	30,000	20,000
				By Partners' current A/c	25,000	49,000	6000
	75,000	**79,000**	**26,000**		**75,000**	**79,000**	**26,000**

Cash Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Balance b/d	20,000	**By Realisation A/c :**		
To Realisation A/c :		By Creditors		1,80,000
To Land-building	2,20,000	By Bills payable		60,000
To Motor car	80,000	By Unexpected expense		10,000
To Machinery	30,000	By Dissoulation expense		20,000
To Debtors	1,20,000	By Kaushal's loan A/c		50,000
To Stock	10,000	**By Capital A/c :**		
To Bad debt return	20,000	Kaushal	75,000	
		Krina	79,000	
		Krupansh	26,000	1,80,000
	5,00,000			**5,00,000**

Explanation :

(1) Provisions for assets (like depreciation fund and bad debt reserve) are closed by crediting them in realisation account. There will not be any other accounting entry of them.

(2) Kaushal has taken over Investments for ₹ 60,000. Thus, his current account is debited and realisation account is credited.

(3) Unexpected expense, dissolution are expenses of business. These are losses. Thus, they are debited to realisation account and credited to cash account.

(4) Bad debts return is recovery of bad debts written off. It is considered as profit. Thus, recorded at credit side of realisation account.

Illustration 6 : Abhishek, Anil and Rajesh are partners sharing profit-loss in the proportion of 2:3:1. They have decided to dissolve firm on 30-6-2016. On this date balance sheet is as follow, showing status of the firm.

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Machinery		2,00,000
Abhishek	2,00,000		Patent (Untangible assets)		2,00,000
Anil	3,00,000		Leasehold property		1,50,000
Rajesh	1,00,000	6,00,000	Stock		1,90,000
General reserve		60,000	Investments		2,00,000
Smt. Anil's loan		1,00,000	Debtors	1,60,000	
Prime bank's loan		2,00,000	− Bad debt reserve	10,000	1,50,000
Provision for leasehold property		60,000	Cash balance		1,50,000
Investment fluctuation fund		30,000	Profit and loss account (loss)		60,000
Creditors		2,50,000			
		13,00,000			**13,00,000**

Disposal of assets and liabilities is as follow :

(1) Abhishek has taken investments for ₹ 1,80,000.

(2) Anil has accepted to pay loan of his wife.

(3) ₹ 1,50,000 are recovered from debtors.

(4) Manhar has paid ₹ 10,000 for bad debts which was written off earlier.

(5) Remaining assets are sold for ₹ 10,80,000.

(6) Rajesh has accepted creditors of ₹ 1,00,000 for ₹ 80,000. Remaining creditors are paid ₹ 1,00,000 and accounts are settled.

(7) ₹ 20,000 are realised for unrecorded machine.

(8) Unrecorded liability of ₹ 30,000 is paid.

(9) Dissolution expense incurred ₹ 60,000. Prepare necessary accounts.

Ans. : **Realisation Account**

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets A/c :			**By Sundry Liabilities A/c :**		
Machinery	2,00,000		Smt. Anil's loan	1,00,000	
Patent	2,00,000		Prime bank's loan	2,00,000	
Leasehold property	1,50,000		Creditors	2,50,000	5,50,000
Stock	1,90,000		**By Reserve's and Provisions :**		
Investments	2,00,000		Leasehold property	60,000	
Debtors	1,60,000	11,00,000	Bad debt reserve	10,000	70,000
To Anil's capital A/c			By Abhishek's capital A/c		
(Smt. Anil's loan)		1,00,000	(investments)		1,80,000
To Rajesh A/c (Creditors)		80,000	**By Cash A/c :**		
To Cash A/c :			Debtors	1,50,000	
Dissolution expense	60,000		Sundry assets	10,80,000	
Creditors	1,00,000		Unrecorded asset (machine)	20,000	
Prime bank's loan	2,00,000		Bad debt recovered	10,000	12,60,000
Unrecorded liability	30,000	3,90,000			
To Partners' Capital A/c : (Profit)					
Abhishek	1,30,000				
Anil	1,95,000				
Rajesh	65,000	3,90,000			
		20,60,000			**20,60,000**

Cash Account

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Balance b/d		1,50,000	**By Realisation A/c :**		
To Realisation A/c :			Dissolution expense	60,000	
Debtors	1,50,000		Creditors	1,00,000	
Bad debt return	10,000		Unrecorded liability	30,000	
Assets	10,80,000		Prime bank's loan	2,00,000	3,90,000
Unrecorded assets	20,000	12,60,000	**By Partners' Capital A/c :**		
			Abhishek	1,60,000	
			Anil	6,10,000	
			Rajesh	2,50,000	10,20,000
		14,10,000			**14,10,000**

Partners' Capital Accounts

Dr | | | | | | | Cr

Particulars	Abhishek (₹)	Anil (₹)	Rajesh (₹)	Particulars	Abhishek (₹)	Anil (₹)	Rajesh (₹)
To Profit and loss				By Balance b/d	2,00,000	3,00,000	1,00,000
A/c (2:3:1)	20,000	30,000	10,000	By General reserve	20,000	30,000	10,000
To Realisation	1,80,000	–	–	By Investment			
A/c(investments)				fluctuation fund	10,000	15,000	5000
To Cash A/c				By Realisation A/c			
(return)	1,60,000	6,10,000	2,50,000	(Smt Anil's loan)	–	1,00,000	–
				By Realisation A/c			
				(Creditors)	–	–	80,000
				By Realisation A/c			
				Profit (2:3:1)	1,30,000	1,95,000	65,000
	3,60,000	**6,40,000**	**2,60,000**		**3,60,000**	**6,40,000**	**2,60,000**

- **Illustrations of balancing figures :**

When opening balance is not provided : Sometimes at the time of dissolution, balance sheet is not provided in the question. In this situation non-available information is to be ascertained. Thus to find out non-available information, it is required to prepare balance on the date of dissolution.

In brief, if balance sheet is not available on the date of dissolution, firstly, prepare balance sheet and than solve the problem.

Illustration 7 : Dipak, Parag and Pranay are partners sharing profit-loss in the proportion of $\frac{1}{2}:\frac{1}{3}:\frac{1}{6}$. They have decided to dissolve the firm on 31-5-2016. On that day, balance sheet was not prepared. But you are provided the following information.

(1) Total assets of the firm are ₹ 20,00,000. Out of which 40 % are current assets, where cash balance of ₹ 1,00,000 included.

(2) Liabilities are $\frac{3}{4}$ of total current assets, in which employee provident fund of ₹ 2,00,000 is not included. At the time of dissolution of the firm, disposal of assets and liabilities was as follows.

(i) 120 % of fixed assets are realised while 80 % of current assets are realised.

(ii) 100 % provident fund paid.

(iii) Other liabilities are paid at 10 % discount.

(iv) Dissolution expense was ₹ 1,00,000.

The total capital of the firm is reported in the profit-loss sharing ratio of partners. Prepare necessary accounts.

Ans. : From the given details, first of all balance sheet will be prepared. The profit-loss sharing ratio for Dipak, Parag and Pranay is $\frac{1}{2}:\frac{1}{3}:\frac{1}{6}$ respectively. By using lowest common factor, the proportion of profit and loss will be 3:2:1.

Ans. :

Balance Sheet Before Dissolution of the Firm

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Current assets	7,00,000
Dipak	6,00,000		Cash balance	1,00,000
Parag	4,00,000		Fixed assets	12,00,000
Pranay	2,00,000	12,00,000		
Employees provident fund		2,00,000		
Liabilities		6,00,000		
		20,00,000		**20,00,000**

Explanation :

(1) **Total Assets ₹ 20,00,000**

↓

Current assets 40 % — ₹ 8,00,000

Fixed assets (?) 60 % — ₹ 12,00,000

Current assets ₹ 8,00,000 ↓

Cash balance — ₹ 1,00,000

Other current assets (?) — ₹ 7,00,000

(2) Liabilities = Current assets $\frac{3}{4}$

$\therefore$ ₹ 8,00,000 $\times \frac{3}{4}$ = ₹ 6,00,000

(3) **Profit and loss sharing ratio :**

	Dipak		**Parag**		**Pranay**
	$\frac{1}{2}$		$\frac{1}{3}$		$\frac{1}{6}$
$\therefore$	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$
$\therefore$	3	:	2	:	1

(4)

	Total assets	₹ 20,00,000
−	Total liabilities	₹ 8,00,000
	Total capital	₹ 12,00,000

Total Capital ₹ 12,00,000

↓

Dipak	Parag	Pranay
3	2	1
₹ 6,00,000	₹ 4,00,000	₹ 2,00,000

Realisation Account

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets			**By Sundry Liabilities**		
To Fixed assets		12,00,000	By Employee provident fund		2,00,000
To Current assets		7,00,000	By Sundry liabilities		6,00,000
To Cash A/c :			**By Cash A/c :**		
To Provident fund		2,00,000	By Fixed assets		14,40,000
To Sundry liabilities		5,40,000	By Current assets		5,60,000
To Dissolution expense		1,00,000			
To Partners' Capital A/c : (Profit)					
Dipak	30,000				
Parag	20,000				
Pranay	10,000	60,000			
		28,00,000			**28,00,000**

Cash Account

Dr | Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Balance b/d		1,00,000	**By Realisation A/c :**		
To Realisation A/c :			Provident fund	2,00,000	
Fixed assets		14,40,000	Sundry liabilities	5,40,000	7,40,000
Current assets		5,60,000	**By Realisation A/c :**		
			Dissolution expense		1,00,000
			Partners' capital A/c :		
			Dipak	6,30,000	
			Parag	4,20,000	
			Pranay	2,10,000	12,60,000
		21,00,000			**21,00,000**

Partners' Capital Accounts

Dr   Cr

Particulars	Dipak(₹)	Parag(₹)	Pranay(₹)	Particulars	Dipak (₹)	Parag (₹)	Pranay(₹)
To Cash A/c	6,30,000	4,20,000	2,10,000	By Balance b/d	6,00,000	4,00,000	2,00,000
				By Realisation A/c (Profit)	30,000	20,000	10,000
	6,30,000	**4,20,000**	**2,10,000**		**6,30,000**	**4,20,000**	**2,10,000**

Illustration 8 : Arjun, Vaishali and Jalpa are partners sharing profit-loss in the ratio of 4:3:3. They have decided to dissolve the firm on 31-3-2016. On this date their information is as follow. Firm was lose making, thus it was dissolved.

(1) The capital of Arjun, Vaishali and Jalpa were ₹ 3,00,000, ₹ 2,00,000 and ₹ 1,00,000 respectively.

(2) Machinery ₹ 10,000; Debtors ₹ 2,80,000; Bills receivable ₹ 50,000; Stock ₹ 4,50,000; Sundry Creditors ₹ 3,00,000 and Bills payable ₹ 40,000.

At the time of dissolution :

(i) Vaishali has accepted collection at 20 % discount and to pay creditors.

(ii) Arjun has accepted stock at 10 % discount and to pay bills payable.

(iii) Jalpa has taken bills receivable for ₹ 35,000 and machinery at 10 % depreciated value.

Prepare necessary accounts.

Ans. : **Balance Sheet of the Firm Before Dissolution**

Liabilities	Amt. (₹)	Assets	Amt. (₹)
Capital :		Machinery	10,000
Arjun	3,00,000	Debtors	2,80,000
Vaishali	2,00,000	Bills receivable	50,000
Jalpa	1,00,000	Stock	4,50,000
Sundry creditors	3,00,000	Profit and Loss Account (?)	1,50,000
Bills payable	40,000		
	9,40,000		**9,40,000**

Note : Total of liabilities side is ₹ 9,40,000. The difference is of ₹ 1,50,000 appeared at assets side. This is debit balance of profit and loss account. The firm is loss making.

Realisation Account

Dr Cr

Particulars		Amt. (₹)	Particulars		Amt. (₹)
To Sundry Assets A/c :			**By Sundry Liabilities :**		
Machinery	10,000		Creditors	3,00,000	
Debtors	2,80,000		Bills payable	40,000	3,40,000
Bills receivable	50,000		**By Vaishali's Capital A/c :**		
Stock	4,50,000	7,90,000	Debtors		2,24,000
To Vaishali's Capital A/c :			**By Arjun's Capital A/c :**		
Creditors		3,00,000	Stock		4,05,000
To Arjun's capital : Bills payable		40,000	**By Jalpa's Capital A/c :**		
			Bills receivable	35,000	
			Machinery	9000	44,000
			By Partners' Captial A/c (Loss) :		
			Arjun	46,800	
			Vaishali	35,100	
			Jalpa	35,100	1,17,000
		11,30,000			**11,30,000**

Partners' Capital Accounts

Dr Cr

Particulars	Arjun (₹)	Vaishali (₹)	Jalpa (₹)	Particulars	Arjun (₹)	Vaishali (₹)	Jalpa (₹)
To Profit & loss A/c	60,000	45,000	45,000	By Balance b/d	3,00,000	2,00,000	1,00,000
To Realisation A/c	4,05,000	2,24,000	44,000	By Realisation A/c	40,000	3,00,000	–
To Realisation A/c (Loss)	46,800	35,100	35,100	By Cash A/c (Deficit)	1,71,800	–	24,100
To Cash A/c (Payment)	–	1,95,900	–				
	5,11,800	**5,00,000**	**1,24,100**		**5,11,800**	**5,00,000**	**1,24,100**

Cash Account

Dr Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Arjun's capital A/c	1,71,800	By Vaishali's capital A/c	1,95,900
To Jalpa's capital A/c	24,100		
	1,95,900		**1,95,900**

Illustration 9 : Total assets of firm of Amar and Akbar is ₹ 6,00,000. In which cash is included of ₹ 40,000. Net assets of the firm are ₹ 4,00,000. The proportion of capital and general reserve is 4:1. The capital of Amar is excess to capital of Akbar by ₹ 80,000. The realisation account loss is ₹ 80,000. Firm is dissolved. Prepare dissolution account.

Ans. : **Balance Sheet**

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Cash	40,000
Amar	2,00,000		Other assets	5,60,000
Akbar	1,20,000	3,20,000		
General reserve		80,000		
Liabilities		2,00,000		
		6,00,000		**6,00,000**

Net assets means surplus available after deduction of total liabilities from total assets.

∴ Net assets = Total assets − Total liabilities

Liabilities = Total assets − Net assets

= 6,00,000 − 4,00,000

= 2,00,000

Total of assets side = Total of liabilities side (Total of both sides of balance sheet are equal.)

6,00,000 = Capital + Reserve + Liabilities (2,00,000)

6,00,000 − 2,00,000 = Capital + Reserve

Capital + Reserve = 4,00,000

The proportion of capital and reserve is 4:1.

So, Reserve = $4,00,000 \times \frac{1}{5}$

= ₹ 80,000

Capital = $4,00,000 \times \frac{4}{5}$

= ₹ 3,20,000 is total capital.

Assume capital of Akbar is X.

∴ Amar's capital = X + 80,000.

Total capital = Amar's capital + Akbar's capital (X + X + 80,000)

3,20,000 = 2X + 80,000

∴ 3,20,000 − 80,000 = 2X

= 2,40,000 = 2X

∴ X = 1,20,000

Akbar's capital = 1,20,000

Amar's capital = 1,20,000 + 80,000

= 2,00,000

Realisation Account

Dr | Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Sundry assets A/c	5,60,000	By Liabilities A/c		2,00,000
To Cash A/c (Liabilities)	2,00,000	By Cash A/c (Assets realisation)		4,80,000
		By Partners' capital A/c : (Loss)		
		Amar	40,000	
		Akbar	40,000	80,000
	7,60,000			**7,60,000**

Partners' Capital Accounts

Dr | Cr

Particulars	Amar (₹)	Akbar(₹)	Particulars	Amar (₹)	Akbar(₹)
To Realisation A/c (Loss)	40,000	40,000	By Balance b/d	2,00,000	1,20,000
To Cash A/c	2,00,000	1,20,000	By General reserve	40,000	40,000
	2,40,000	**1,60,000**		**2,40,000**	**1,60,000**

Cash Account

Dr | Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Balance b/d	40,000	By Realisation A/c	2,00,000
To Realisation A/c	4,80,000	By Amar's capital A/c	2,00,000
		By Akbar's capital A/c	1,20,000
	5,20,000		**5,20,000**

EXERCISE

1. Select appropriate option for each question :

(1) How many methods are there for dissolution of a partnership firm ?

(a) One (b) Three

(c) Two (d) Four

(2) Which of the following account is opened to incorporate the accounting effect of assets and liabilities of the partnership firm at the time of dissolution ?

(a) Profit and loss accout (b) Profit and loss appropriation account

(c) Revaluation account (d) Realisation account

(3) What is the type of realisation account ?

(a) Balance sheet (b) personal

(c) Real (d) Nominal

(4) Which is the first payment made from the realisation of assets, at the time of the dissolution of a firm :

(a) Dissolution expense (b) Loan of partner's wife

(c) Liabilities towards third parties (d) Partners' loan

(5) Which of the following amount will be written at the credit side of realisation account, when there is balance of debtors ₹ 24,500 and bad debt reserve of ₹ 2500 in the balance sheet at the time of the dissolution of a firm ?

(a) ₹ 24,500 (b) ₹ 2500

(c) ₹ 22,000 (d) ₹ 27,000

(6) To which account credit balance of general reserve, workmen accident compensation fund, credit balance of profit and loss account is transferred at the time of the dissolution of a firm ?

(a) Realisation A/c (b) Cash A/c

(c) Profit and loss A/c (d) Partners' capital A/c

2. Give answer in one line for the following questions :

(1) Explain the meaning of dissolution of partnership.

(2) What is the dissolution of a partnership firm ?

(3) What is voluntary dissolution ?

(4) Who has to bear dissolution expense, at the time of dissolution of a firm ?

(5) How would you deal with the providend fund balance shown in the balance sheet at the time of dissolution ?

(6) How would you deal with bad debts return, which is written off earlier ?

(7) Explain the meaning of realisation account.

(8) Describe the methods of dissolution of a partnership firm.

(9) Where will you record the payment of bills payable under the second method of realisation account ?

3. Answer the following questions is brief :

(1) Which accounts are prepared to close the books at the time of dissolution of a partnership firm ? Describe it.

(2) In which circumstances court can pass the order for dissolution of a firm ? Explain.

(3) Write short note : Realisation account

(4) How would you deal with the following balances disclosed in the balance sheet at the time of the dissolution of a partnership firm ? Explain.

(i) General reserve (ii) Investment fluctuation fund

(iii) Workmen accident compensation fund (iv) Providend fund

(v) Debit balance of Profit and loss A/c (vi) Depreciation fund

(5) Describe the legal provisions pertaining to loss of dissolution of a partnership firm.

(6) Explain the normal procedure of partnership firm dissolution.

4. Answer the following questions as required :

(1) Distinguish between : First and second method of disposal of realisation account.

(2) How would you undertake accounting disposal of realisation of asset and payment of liability which are not recorded in the balance sheet at the time of the dissolution of a firm ? Explain.

(3) Give accounting treatments for goodwill of different circumstances when firm goes for dissolution.
(4) Explain in brief, legal provisions of accounting settlement for partnership firm dissolution.
(5) Explain methods of dissolution without the interference of court.
(6) Total assets are ₹ 1,50,000 of firm A and B where cash of ₹ 10,000 is included. Net assets of the firm are ₹ 1,00,000. The ratio of capital and reserve is 4:1. The capital of A is more then of B by ₹ 20,000. Loss of realisation account is ₹ 20,000. Firm is dissolved. Prepare opening balance sheet and ascertain opening capital of A and B.
(7) Prepare realisation account from question no. 6.
(8) Total asets of the firm at the time of dissolution is ₹ 2,00,000. Out of which 40 % are current assets (including cash ₹ 10,000). 120 % realised for fixed assets. While 80 % are realised of current asset. Pass journal entries.

5. Pass journal entries for the following transactions of firm in the case of firm's dissolution :

(1) At the time of dissolution the book value of goodwill is ₹ 56,000. No amount is realised.
(2) In the balance sheet land-building ₹ 8,00,000 and investments of ₹ 2,00,000 are disclosed. Respectively ₹ 9,00,000 and ₹ 1,50,000 are realised from them.
(3) Total assets of the firm are ₹ 2,00,000 out of which 40 % of are current assets (including cash of ₹ 10,000). Book value is realised.
(4) Goodwill is not disclosed in the book. But ₹ 50,000 are realised during dissolution.
(5) The value of laptop is ₹ 35,000. One partner has taken it for ₹ 25,000.
(6) A partner has accepted to pay loan of his Smt. ₹ 40,000, which was given to the firm.
(7) Income tax liability is now payable ₹ 30,000 it is not recorded in the book.
(8) After making payment of all liabilities and loan of partners of firm, surplus of assets is ₹ 1,20,000. The profit and loss sharing ratio of partners A, B and C are 5:3:2.
(9) Machine is disclosed in the book at the time of dissolution for ₹ 2,00,000. Book value is realised.
(10) One partner has accepted responsibility to undertake dissolution procedure. In the return of it, decided to pay remuneration of ₹ 20,000. On account of expense firm has paid him ₹ 12,000.
(11) There are debtors of ₹ 1,20,000 and creditors of ₹ 60,000 at the time of dissolution of firm. One partner has taken debtors at 20 % than book value less and accepted to pay creditors.
(12) The profit-loss sharing ratio between partners R, B and I is 3:2:1. Undertake the disposal of the following balances : (1) General reserve ₹ 18,000 (2) Debit balance of profit and loss A/c ₹ 12,000 (3) Workmen accident compensation fund ₹ 18,000.

6. Pass journal entries for the following transactions, when realisation account is prepared :

(1) Book value of machine is ₹ 50,000, which is taken over by partner Darshan for ₹ 55,000.
(2) Partner Bimal has accepted to pay bills payable of ₹ 15,000.
(3) Past bad debts was written off ₹ 11,000 out of which ₹ 6000 are recovered.
(4) Book value of sundry assets is ₹ 2,70,000 and realised ₹ 2,27,000.
(5) Sundry creditors ₹ 60,000, paid at 25 % discount.
(6) Unrecorded tax paid ₹ 5000.
(7) Dissolution expense paid ₹ 5000.
(8) Goodwill is not disclosed in the books. But ₹ 20,000 realised from sale of it, at the time of dissolution.

7. Naresh and Shaivil are partners sharing profit-loss in the proportion of 2:3. On 30-9-2016, they have decided to dissolve the firm. On this date their capital was ₹ 6,00,000 and ₹ 4,00,000 respectively. Total liabilities of the firm are ₹ 6,00,000. The balance of accumulated debit balance of profit and loss account is ₹ 1,00,000 and cash balance is ₹ 1,00,000. 50 % are realised from asets of firm. Dissolution expense is ₹ 1,00,000.

Prepare necessary accounts to close books of the firm.

8. On 1-1-2015, Tarakbhai, Jethalal and Popatlal are commenced partnership firm to share profit-loss in the proportion of 5:3:2. Their capital on that date was ₹ 5,00,000; ₹ 3,00,000 and ₹ 2,00,000. On 31-12-2016, they have decided to dissolve the firm. On this date the status of the firm was as follows :

Building	₹ 5,00,000	Machinery	₹ 3,00,000
Debtors	₹ 4,00,000	Bills receivable	₹ 1,00,000
Stock	₹ 2,00,000	Creditors	₹ 6,00,000
Bills payable	₹ 1,00,000	Cash balance	₹ 1,00,000

Debit balance of profit and loss A/c ₹ 1,00,000

Since firm was loss making, it is dissolved and the disposal of assets and liabilities are as follows :

(1) Tarakbhai has taken over building at 20 % more than book value against which accepted to pay to the creditors.

(2) Jethalal has taken machines at 10 % less and stock at 10 % more than book value. He has accepted to pay bills payable.

(3) Popatlal has taken debtors at 20 % less than book value.

Note : (1) Bills receivable becomes valueless.

(2) Outstanding government tax paid ₹ 80,000.

(3) Dissolution expense of firm ₹ 30,000.

You are asked to prepare realisation account, partners capital accounts and cash account.

9. Binal, Dharmistha and Mahesh are partners sharing profit-loss in the ratio of 4:3:2. Firm dissolved on 30-9-2016. On that day the status of the firm was as follows :

Balance Sheet

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital :			Sundry assets	14,80,000
Bimal	4,80,000		Cash balance	20,000
Dharmistha	3,60,000			
Mahesh	2,40,000	10,80,000		
Creditors		4,20,000		
		15,00,000		**15,00,000**

(1) ₹ 13,90,000 realised from sundry assets.

(2) Creditors are paid ₹ 3,70,000 as a final settlement.

(3) Dissolution expense paid ₹ 20,000.

(4) ₹ 30,000 paid for unrecorded taxes.

Prepare necessary accounts.

10. Satyam, Shivam and Sundaram are partners sharing profit-loss in the proportion of $\frac{1}{2}:\frac{1}{3}:\frac{1}{6}$.

The balance sheet of their firm as on 31-12-2016 is as under :

Balance Sheet

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			Land-building		2,50,000
Satyam	50,000		Machinery		1,50,000
Shivam	50,000		Investments		1,00,000
Sundaram	50,000	1,50,000	Patents		5000
General reserve		60,000	Goodwill		25,000
Investment fluctuation fund		50,000	Debtors	30,000	
Provident fund		1,00,000	− Bad debt reserve	5000	25,000
Creditors		2,00,000	Stock		15,000
Current Accounts :			Cash		5000
Satyam	5000				
Shivam	10,000	15,000			
		5,75,000			**5,75,000**

The firm was dissolved on 1st January, 2017. Disposal of assets and liabilities was done as under :

(1) Sale of land and building ₹ 4,00,000; machinery ₹ 1,00,000; investments ₹ 50,000 and stock ₹ 5000.

(2) From debtors ₹ 15,000 are received write off remaining.

(3) Out of total creditors, a creditor of 10 % was given unrecorded investments of ₹ 10,000 and remaining amount paid in cash. Remaining creditors are paid at 10 % discount.

(4) Unrecorded expense of stationery ₹ 6000 paid to Arihant Stationery Mart. No amount is realised for goodwill and patent.

(5) A remuneration of ₹ 15,000 was decided to pay to Shivam to perform dissolution procedure. Actual dissolution expense ₹ 6000 paid by Shivam.

Prepare necessary accounts to close books of the firm.

●

Answers

Exercise 1

1. **Select appropriate option for each question :**

(1) (c) (2) (a) (3) (b) (4) (b) (5) (c) (6) (a) (7) (d)

(8) (d) (9) (a) (10) (b)

3. (1) Interest on drawings ₹ 660

(2) Amruta's commission ₹ 7176, Divisible profit ₹ 44,850, Total received amount ₹ 52,026 (₹ 7176 commission + divisible profit ₹ 44,850)

(3) Divisible profit of the firm ₹ 1,35,000 (45,000 + 30,000 + 60,000), Commission of manager ₹ 13,500

(4) New profit and loss sharing ratio 15:10:9, Divisible profit : Rajkumar ₹ 30,000, Kaushik ₹ 20,000 and Sharma ₹ 18,000

(5) New profit and loss sharing ratio 4:1:2

Divisible profit - Mehta ₹ 50,000; Pandya ₹ 12,500 and Bajpai ₹ 25,000

(6) Rectification of error :

Sanket's capital/current A/c...Dr	16,875	
To Sheela's capital/current A/c		5625
To Surbhi's capital/current A/c		11,250

(7) Rectification of error :

Rahim's capital/current A/c...Dr	600	
To Ram's capital/current A/c		600

(8) Rectification of error :

Lata's capital/current A/c...Dr	900	
To Gita's capital/current A/c		600
To Pravina's capital/current A/c		300

(9) Distribution of profit : Mukesh ₹ 35,000, Dhaval ₹ 27,500 and Vinod ₹ 27,500

(10) Opening capital ₹ 74,700, Interest on capital ₹ 4482

(11) Receivable amount : 'A' ₹ 66,750 (₹ 60,000 profit + ₹ 6750 interest on capital)
'B' ₹ 80,250 (₹ 60,000 profit + ₹ 20,250 interest on capital)

8. Commission to Chirag ₹ 2500, Divisible profit ₹ 47,500, Share of each partner in profit Harpal ₹ 23,750 and Chirag ₹ 23,750, Closing balance of capital : Harpal ₹ 86,200, Chirag ₹ 1,17,800

9. Commission to Hiral ₹ 30,000, Divisible profit ₹ 3,00,000

Share in divisible profit : Bhadresh ₹ 1,80,000, Hiral ₹ 1,20,000

Closing balance of capital accounts : Bhadresh ₹ 2,40,000, Hiral ₹ 1,80,000

Closing balance of current accounts : Bhadresh ₹ 2,39,040 (credit), Hiral ₹ 95,760 (credit)

10. To general reserve A/c ₹ 18,000, Divisible profit ₹ 48,000

Share in divisible profit : Sharda ₹ 20,000, Jamna ₹ 16,000, Ganesh ₹ 12,000

Closing balance of capital accounts : Sharda ₹ 1,04,000, Jamna ₹ 66,400, Ganesh ₹ 31,080

11. Divisible profit ₹ 4500, Share in divisible profit : Isha ₹ 1800, Saraswati ₹ 1800, Laxmi ₹ 900

Closing balance of capital accounts : Isha ₹ 40,000, Saraswati ₹ 40,000, Laxmi ₹ 32,000

Closing balance of current accounts : Isha ₹ 6400 (credit), Saraswati ₹ 5620 (credit), Laxmi ₹ 8640 (debit)

12. Commission of Prerna ₹ 9000, Divisible profit ₹ 90,000

Share in divisible profit : Prerna ₹ 40,500 (₹ 22,500 + ₹ 18,000)

Paras ₹ 31,500 (₹ 13,500 + ₹ 18,000)

Jayshree ₹ 18,000 (₹ 9000 + ₹ 9000)

Closing balance of partners' capital accounts : Prerna ₹ 1,20,000, Paras ₹ 1,20,000, Jayshree ₹ 60,000

Excess capital ₹ 70,650 of Prerna and ₹ 21,000 of Jayshree will be withdrawn by them. While Paras will introduce capital deficit ₹ 1200.

Exercise 2

1. **Select appropriate option for each question :**

(1) (b) (2) (d) (3) (a) (4) (b) (5) (b) (6) (b) (7) (c)

(8) (d) (9) (c) (10) (c)

5.

Bad debts return	– Credit side of profit and loss account
Depreciation of factory building	– Debit side of trading account
Labour and salary	– Debit side of trading account
Investments of provident fund	– Asset side of balance sheet
Bills payable	– Capital and liability side of balance sheet
Goods withdrawn for personal use	– Will be deducted from purchase of trading account
Goods return credit	– Credit side of trading account, will be deducted from sales
Goods return debit	– Debit side of trading account, will be deducted from purchase
Loan to firm given by partner	– Capital and liability side of balance sheet
Interest on investments of provident fund	– Capital and liability side of balance sheet will be added provident fund account

6. (1) **Closing stock of stationery :**

Treatment : (1) Debit side of profit and loss A/c deducted from stationery expenses.

(2) Balance sheet, on asset side as closing stock of stationery.

(2) **Credit sales, not recorded :**

Treatment : (1) Credit side of trading A/c, added to sales

(2) Balance sheet, on asset side, added to debtors

(3) **Commission to partner on net profit :**

Treatment : (1) Debit side of profit and loss appropriation A/c

(2) Credit side of partners' capital/current A/c

(4) Goods taken by partner for his personal use :

Treatment : (1) Debit side of trading A/c; deducted from purchase

(2) Debit side of partners' capital/current A/c

(5) Interest on debit balance of partners' current A/c :

Treatment : (1) Debit side of partners' current A/c

(2) Credit side of profit and loss appropriation A/c

(6) Some amount is written off from lease hold asset :

Treatment : (1) Debit side of profit and loss A/c, lease hold asset written off

(2) Deducted from lease hold asset on asset side of balance sheet

(7) Income due but not received :

Treatment : (1) Credit side of profit and loss A/c, added to respective income

(2) Balance sheet on asset side

(8) Prepaid expenses :

Treatment : (1) Debit side of trading / profit and loss A/c, deducted from expenses

(2) Balance sheet, on asset side

(9) Provision for discount reserve on debtors :

Treatment : (1) Debit side of profit and loss A/c

(2) Balance sheet on asset side, deducted from debtors

7. Adjustment entry :

		Dr	Cr
(A)	Closing stock A/c ...Dr	32,000	
	To trading A/c		32,000
	[Being adjustment entry passed for closing stock.]		
(B)	Salary A/c ...Dr	1000	
	To outstanding salary A/c		1000
	[Being adjustment entry passed for outstanding salary.]		
(C)	Interest A/c ...Dr	1250	
	To Mahendra's loan A/c		1250
	[Being adjustment entry for interest due is passed.]		
(D)	Interest A/c ...Dr	500	
	To interest received in advance A/c		500
	[Being adjustment entry for interest received in advance is passed.]		
(E)	Depreciation A/c ...Dr	26,667	
	To building A/c		26,667
	[Being depreciation provided on building.]		

(F)	Stationery stock A/c ...Dr	250	
	To stationery expense A/c		250
	[Being adjustment entry passed for stationery stock.]		
(G)	(i) Bad debts A/c ...Dr	4500	
	To debtors A/c		4500
	[Being written off bad debts.]		
	(ii) Profit-loss A/c ...Dr	4550	
	To bad debt reserve A/c		4550
	[Being provision for bad debt reserve.]		
(H)	Drawings A/c ...Dr	5000	
	To purchase A/c		5000
	[Being partner withdrawn goods for his personal use.]		
(I)	Insurance Co. A/c ...Dr	2400	
	Loss due to fire A/c ...Dr	600	
	To purchase A/c		3000
	[Being 80 % amount of goods destroyed, insurance Co. admitted claim and adjustment entry for loss is passed.]		

8. Net profit, transferred to profit-loss appropriation A/c ₹ 68,750
Divisible profit : Brahamma ₹ 35,850, Vishnu ₹ 23,900
Balance of partners : Brahamma ₹ 90,850, Vishnu ₹ 67,900
Total of balance sheet ₹ 2,44,000

9. Gross profit ₹ 94,000, Net profit ₹ 65,200
Divisible profit : Parthiv ₹ 31,228, Priya ₹ 31,228
Balance of partners' : Parthiv ₹ 52,084, Priya ₹ 45,116
Total of balance sheet ₹ 1,47,200

10. Divisible profit : Luv ₹ 29,328, Kush ₹ 17,472
Balance of current accounts of partners' : Luv ₹ 1328, Kush ₹ 22,672
Total of balance sheet ₹ 3,89,600

11. Revised gross profit ₹ 57,800, Net loss ₹ 6540
Divisible loss : Salim ₹ 3270, Shabana ₹ 3270
Balance of current accounts of partners' : Salim ₹ 32,730 (Credit), Shabana ₹ 13,270 (Debit)
Total of balance sheet ₹ 4,06,530

12. Gross profit ₹ 3,18,400, Net profit ₹ 1,26,400
Divisible profit : Dhara ₹ 67,440, Mira ₹ 44,960
Balance of capital accounts of partners' : Dhara ₹ 1,87,400 and Mira ₹ 1,46,960
Total of balance sheet ₹ 3,76,000

13. Revised gross profit ₹ 25,000, Net profit ₹ 17,700
Divisible profit : Harsha ₹ 4000, Chhaya ₹ 4000
Balance of current accounts of partners' : Harsha ₹ 7250, Chhaya ₹ 700,
Total of balance sheet ₹ 72,250

14. Gross profit ₹ 41,400, Net loss ₹ 13,000
Balance of current accounts of partners' : Dharma ₹ 31,500 (debit), Karma ₹ 3000 (credit)
Total of balance sheet ₹ 3,78,300

15. Gross profit ₹ 41,150, Net profit ₹ 30,270
Divisible profit : Harsha ₹ 15,135, Yesha ₹ 15,135
Balance of capital accounts of partners' : Harsha ₹ 45,135, Yesha ₹ 27,635
Total of balance sheet ₹ 1,11,170

16. Gross profit ₹ 1,50,400, Net profit ₹ 88,550
Divisible profit : Neela ₹ 29,517, Sheela ₹ 59,033
Balance of capital accounts of partners' : Sheela ₹ 1,44,133, Neela ₹ 67,917
Total of balance sheet ₹ 3,41,100

17. Gross profit ₹ 71,500, Net loss ₹ 800
Divisible loss : Man ₹ 400, Mohan ₹ 400
Balance of current accounts of partners' : Man ₹ 11,400 (debit), Mohan ₹ 7100 (credit)
Total of balance sheet ₹ 5,58,200

18. Gross profit ₹ 68,040, Net profit ₹ 32,978
Balance of capital account of partners : Sant ₹ 93,267, Mahant ₹ 49,711
Divisible profit : Sant ₹ 15,467, Mahant ₹ 10,311
Total of balance sheet ₹ 2,03,044

19. Gross profit ₹ 1,55,400, Net profit ₹ 79,775
Divisible profit : Jaya ₹ 25,648, Prafulla ₹ 25,647
Balance of current accounts of partners' : Jaya ₹ 15,508, Prafulla ₹ 23,467,
Total of balance sheet ₹ 3,48,125

Exercise 3

1. **Select appropriate option for each question :**
(1) (b) (2) (d) (3) (b) (4) (b) (5) (b) (6) (a) (7) (c)

4. Average profit ₹ 1,48,000; Goodwill ₹ 5,92,000

5. Average profit ₹ 37,500; Goodwill ₹ 1,87,500

6. Weighted average profit ₹ 91,000

7. Weighted average profit ₹ 89,666.67 or 89,667; Goodwill ₹ 2,69,000

8. Capital employed ₹ 3,50,000; Expected profit ₹ 35,000
Average profit ₹ 80,000; Super profit ₹ 45,000; Goodwill ₹ 1,35,000

9. Expected profit ₹ 40,000; Weighted average profit ₹ 1,06,667; Super profit ₹ 66,667, Goodwill ₹ 1,33,333

10. Capital employed ₹ 4,30,000; Weighted average profit ₹ 72,667

Capitalised profit ₹ 7,26,670; Goodwill ₹ 2,96,670

11. Average profit ₹ 1,40,000; Super profit ₹ 32,000; Goodwill ₹ 2,66,667

12. Average profit ₹ 1,20,000; Super profit ₹ 24,000; Goodwill ₹ 48,000

Exercise 4

1. Select appropriate option for each question :

(1) (b) (2) (a) (3) (a) (4) (c) (5) (d) (6) (c) (7) (c)
(8) (a) (9) (c) (10) (b)

4. Sacrifice of Akbar $\frac{1}{10}$, Gain of Amar $\frac{1}{10}$

5. Sacrifice of Krupa $\frac{1}{30}$, Gain of Karishma $\frac{1}{30}$

6. Sacrifice of Rahul $\frac{2}{30}$, Gain of Sachin $\frac{9}{30}$, Sacrifice of Rohit $\frac{7}{30}$

7. Gain of Deepak $\frac{7}{30}$, Sacrifice of Pratik $\frac{9}{30}$, Gain of Nilesh $\frac{2}{30}$

8. Gain of Hasu $\frac{4}{60}$, Sacrifice of Raju $\frac{1}{60}$, Sacrifice of Sanju $\frac{3}{60}$

9. By formula of sacrifice : Sacrifice of Pravin $\frac{3}{9}$, Gain of Mahendra $\frac{1}{9}$, Gain of Arvind $\frac{2}{9}$

By formula of gain : Pravin $-\frac{3}{9}$, Mahendra $\frac{1}{9}$, Arvind $\frac{2}{9}$

10. Total of revaluation account ₹ 1,42,000; Profit of revaluation A/c ₹ 72,000

(Rajesh ₹ 24,000, Pushpa ₹ 36,000, Pratibha ₹ 12,000)

11. Total of revaluation A/c ₹ 28,000; Profit of revaluation A/c ₹ 7600

(Manju ₹ 13,800, Prabha ₹ 22,280, Meena ₹ 10,520)

Total of balance sheet ₹ 3,44,500

12.

(i)	Alay's capital A/c ...Dr	12,000	
	Sanket's capital A/c ...Dr	6000	
	To profit-loss A/c		18,000
(ii)	Reserve fund A/c ...Dr	27,000	
	Workmen accident compensation fund A/c ...Dr (₹ 21,000 – ₹ 6000)	15,000	
	To Alay's capital A/c		28,000
	To Sanket's capital A/c		14,000

13. Total revaluation A/c ₹ 57,500; Loss of revaluation A/c ₹ 39,000

(Sajan ₹ 24,375, Nirmi ₹ 14,625)

Total of balance sheet ₹ 3,39,500

14. Closing balance of capital : Dattu ₹ 94,000; Daya ₹ 45,500; Tarak ₹ 47,000

Total of balance sheet ₹ 3,07,000

Exercise 5

1. Select appropriate option for each question :

(1) (c) (2) (a) (3) (d) (4) (b) (5) (b) (6) (b) (7) (b)

(8) (b) (9) (b) (10) (d)

3.

	New profit-loss sharing ratio	Sacrificing ratio
(1)	9 : 6 : 5	3 : 2
(2)	16 : 4 : 5	4 : 1
(3)	2 : 3 : 1	Sacrifice of A only = $\frac{1}{6}$
(4)	17 : 7 : 6	1 : 1
(5)	18 : 9 : 8 : 5	A and B, 2 : 3
(6)	11 : 7 : 2	1 : 1
(7)	8 : 13 : 14 : 5	B and C, 3 : 2
(8)	13 : 11 : 6	1 : 2
(9)	30 : 23 : 23 : 4	2 : 1 : 1
(10)	8 : 3 : 5	4 : 1
(11)	35 : 24 : 21	5 : 2
(12)	9 : 4 : 2	1 : 3
(13)	8 : 12 : 5 : 5	X and Y, 2 : 3
(14)	–	2 : 1
(15)	–	2 : 1

4. **(1)** (i)

A's capital A/c ...Dr	15,000	
B's capital A/c ...Dr	10,000	
To goodwill A/c		25,000
[Being old goodwill written off among old partners in their old profit-loss sharing ratio.]		

(ii) C gives his share in goodwill to A and B privately, therefore no entry will be passed in the books of the firm.

(2) (i)

Cash A/c ...Dr	1,05,000	
To C's capital A/c		80,000
To premium of goodwill A/c		25,000
[Being C brought his share in capital and goodwill in cash.]		

	(ii)	Premium for goodwill A/c ...Dr	25,000	
		To A's capital A/c		12,500
		To B's capital A/c		12,500
		[Being premium for goodwill distributed to A and B in their sacrificing ratio.]		
(3)	(i)	A's capital A/c ...Dr	12,000	
		B's capital A/c ...Dr	18,000	
		To Goodwill A/c		30,000
		[Being old goodwill written off between old partners A and B in their old profit-loss sharing ratio.]		
	(ii)	Cash A/c ...Dr	1,00,000	
		To C's capital A/c		40,000
		To premium for goodwill A/c		60,000
		[Being C brought his share in goodwill and capital in cash.]		
	(iii)	Premium for goodwill A/c ...Dr	60,000	
		To A's capital A/c		30,000
		To B's capital A/c		30,000
		[Being premium for goodwill distributed to old partners A and B in their sacrificing ratio.]		
(4)	(i)	P's current A/c ...Dr	45,000	
		Q's current A/c ...Dr	30,000	
		R's current A/c ...Dr	15,000	
		To goodwill A/c		90,000
		[Being old goodwill written off among old partners in their old profit-loss sharing ratio by debiting their current accounts.]		
	(ii)	Cash A/c ...Dr	50,000	
		Furniture A/c ...Dr	40,000	
		Motorcar A/c ...Dr	60,000	
		To S's capital A/c		90,000
		To premium for goodwill A/c		60,000
		[Being S brought cash, furniture and motor car for his share in goodwill and capital.]		
	(iii)	Premium for goodwill A/c ...Dr	60,000	
		To P's current A/c		40,000
		To Q's current A/c		20,000
		[Being premium for goodwill distributed to old partners P and Q in their sacrificing ratio.]		

			Dr	Cr
	(iv)	P's current A/c ...Dr	20,000	
		Q's current A/c ...Dr	10,000	
		To cash A/c		30,000
		[Being 50 % of goodwill received by P and Q withdrawn in cash.]		
(5)	(i)	Cash A/c ...Dr	1,01,000	
		To Z's capital A/c		65,000
		To premium for goodwill A/c		36,000
		[Being cash brought by Z for his share in goodwill and capital.]		
	(ii)	Premium for goodwill A/c ...Dr	36,000	
		X's capital A/c ...Dr	9000	
		To Y's capital A/c		45,000
		[Being premium for goodwill and amount of X's gain in goodwill distributed to Y.]		
(6)	(i)	M's capital A/c ...Dr	20,000	
		N's capital A/c ...Dr	15,000	
		O's capital A/c ...Dr	15,000	
		To goodwill A/c		50,000
		[Being old goodwill written off among old partners in their old profit-loss sharing ratio.]		
	(ii)	Cash A/c ...Dr	40,000	
		To premium for goodwill A/c		40,000
		[Being premium for goodwill brought in cash by P.]		
	(iii)	Premium for goodwill A/c ...Dr	40,000	
		O's capital A/c ...Dr	20,000	
		To M's capital A/c		40,000
		To N's capital A/c		20,000
		[Being premium for goodwill and amount of goodwill by O's gain distributed to M and N in their sacrificing ratio.]		
(7)	(i)	Cash A/c ...Dr	64,000	
		To D's capital A/c		50,000
		To premium for goodwill A/c		14,000
		[Being cash brought ₹ 14,000 by D for his share in goodwill and capital.]		

	(ii)	Premium for goodwill A/c ...Dr	14,000	
		D's capital A/c ...Dr	6000	
		To B's capital A/c		10,000
		To C's capital A/c		10,000
		[Being premium for goodwill brought in cash and not brought in cash by D distributed to B and C in their sacrificing ratio.]		
(8)	(i)	A's current A/c ...Dr	15,000	
		B's current A/c ...Dr	10,000	
		C's current A/c ...Dr	20,000	
		To goodwill A/c		45,000
		[Being old goodwill written off among old partners in their old profit-loss sharing ratio.]		
	(ii)	Cash A/c ...Dr	1,00,000	
		To D's capital A/c		70,000
		To premium for goodwill A/c		30,000
		[Being capital and premium for goodwill brought in cash ₹ 30,000 by D.]		
	(iii)	Premium for goodwill A/c ...Dr	30,000	
		D's current A/c ...Dr	15,000	
		B's current A/c ...Dr	5000	
		To A's capital A/c		15,000
		To C's capital A/c		35,000
		[Being goodwill brought in cash by D and goodwill of B's gain distributed to A and C in their sacrificing ratio.]		
(9)	(i)	Cash A/c ...Dr	30,000	
		To C's capital A/c		30,000
		[Being capital brought by C in cash.]		
	(ii)	C's capital A/c ...Dr	10,000	
		To A's capital A/c		6000
		To B's capital A/c		4000
		[Being Cs share in goodwill debited to his capital account and distributed to A and B in their sacrificing ratio.]		
(10)	(i)	P's current A/c ...Dr	35,000	
		Q's current A/c ...Dr	35,000	
		To goodwill A/c		70,000
		[Being old goodwill written off among old partners in their old profit-loss sharing ratio.]		

		Dr	Cr
(ii)	Cash A/c ...Dr	40,000	
	To R's capital A/c		40,000
	[Being capital brought by R in cash.]		
(iii)	R's current A/c ...Dr	20,000	
	P's current A/c ...Dr	20,000	
	To Q's current A/c		40,000
	[Being R's share in goodwill and goodwill of P's gain debited to their current accounts and credited to Q's current A/c.]		

(11) Value of goodwill ₹ 10,000, B's share in goodwill ₹ 2500

		Dr	Cr
(i)	B's capital A/c ...Dr	2500	
	To G's capital A/c		1250
	To E's capital A/c		1250
	[Being B's share in goodwill debited to his account and distrbuited to G and E in their sacrificing ratio.]		
(ii)	Cash A/c ...Dr	50,000	
	To B's capital A/c		50,000
	[Being capital brought in cash by B.]		

(12) Valuation of goodwill ₹ 60,000, R and C's sacrificing ratio 1:1

		Dr	Cr
(i)	General reserve A/c ...Dr	90,000	
	To R's capital A/c		45,000
	To C's capital A/c		30,000
	To B's capital A/c		15,000
	[Being balance of general reserve distributed among old partners in their old profit sharing ratio.]		
(ii)	Cash A/c ...Dr	1,80,000	
	To P's capital A/c		1,80,000
	[Being capital brought by P in cash.]		
(iii)	P's capital A/c ...Dr	20,000	
	To R's capital A/c		10,000
	To C's capital A/c		10,000
	[Being P's share in goodwill distributed to R and C in their sacrificing ratio.]		

(13) New profit-loss sharing ratio of X, Y and Z, 8 : 12 : 5

		Dr	Cr
(i)	X's capital A/c ...Dr	6000	
	Y's capital A/c ...Dr	9000	
	To Goodwill A/c		15,000
	[Being old goodwill written off between old partners in their old profit-loss sharing ratio.]		

(ii) Cash A/c ...Dr 53,200
To Z's capital A/c 50,000
To premium for goodwill A/c 3200
[Being capital and ₹ 3200 for goodwill brought by Z in cash.]

(iii) Premium for goodwill A/c ...Dr 3200
Z's capital A/c ...Dr 800
To X's capital A/c 1600
To Y's capital A/c 2400
[Being goodwill brought in cash and not brought by Z distributed to X and Y in their sacrificing ratio.]

(iv) Profit-loss A/c ...Dr 60,000
To X's capital A/c 19,200
To Y's capital A/c 28,800
To Z's capital A/c 12,000
[Being profit after Z's admission distributed among all three partners in their new profit-loss sharing ratio.]

5. (i) General reserve A/c ...Dr 7000
Workmen compensation reserve A/c ...Dr 6000
Investment fluctuation reserve A/c ...Dr 1900
Contingency reserve A/c ...Dr 5100
To R's capital A/c 8000
To J's capital A/c 12,000
[Being balances of reserves distributed to old partners in their old profit-loss sharing ratio.]

(ii) R's capital A/c ...Dr 2000
J's capital A/c ...Dr 3000
To profit-loss A/c 1600
To advertisement campaign expenses A/c 3400
[Being balances of loss and fictitious assets written off between old partners in their old profit-loss sharing ratio.]

6. (1) (i) If market value of investment is ₹ 19,500
Investment fluctuation reserve A/c ...Dr 2500
To investment A/c 500
To K's capital A/c 1600
To R's capital A/c 400

(ii) If market value of investment is ₹ 22,000,
(a) Investment A/c ...Dr 2000
To Revaluation A/c 2000

(b) Investment fluctuation reserve A/c ...Dr	2500	
To K's capital A/c		2000
To R's capital A/c		500
(2) (i) If claim of workmen compensation is accepted at ₹ 6000,		
Workmen compensation reserve A/c ...Dr	7000	
To provision for workmen compensation A/c		6000
To K's capital A/c		800
To R's capital A/c		200
(ii) If claim of workmen compensation accepted at ₹ 8500,		
Workmen compensation reserve A/c ...Dr	7000	
Revaluation A/c ...Dr	1500	
To provision for workmen compensation A/c		8500
(3) (i) If ₹ 4000 bad debt reserve on debtors is required,		
Revaluation A/c ...Dr	1000	
To Bad debt reserve A/c		1000
(ii) If ₹ 2500 bad debt reserve on debtors is required,		
Bad debt reserve A/c ...Dr	500	
To Revaluation A/c		500
(iii) If 10 % bad debt reserve is required after writting off ₹ 2000,		
(a) Bad debt A/c ...Dr	2000	
To debtors A/c		2000
(b) Bad debt reserve A/c ...Dr	2000	
To Bad debt A/c		2000
(c) Revaluation A/c ...Dr	5800	
To Bad debt reserve A/c		5800
7. (i) Revaluation A/c ...Dr	58,000	
To patent A/c		30,000
To machinery A/c		24,000
To stock A/c		4000
(ii) Land-building A/c ...Dr	36,000	
Creditors A/c ...Dr	6000	
To Revaluation A/c		42,000
(iii) A's capital A/c ...Dr	8000	
B's capital A/c ...Dr	8000	
To Revaluation A/c		16,000

Loss of revaluation A/c ₹ 16,000.

8. Profit of revaluation A/c ₹ 7500; Sacrificing ratio of Abha and Bina 2 : 1.

Closing capital : Abha ₹ 1,01,000; Bina ₹ 70,500; Rushil ₹ 1,00,000

Closing cash balance ₹ 1,26,000; Total of balance sheet ₹ 3,12,600

9. Profit of revaluation A/c ₹ 17,200

Sacrificing ratio of Aastha and Aahna 1 : 2.

Entry for goodwill :

(i) Cash A/c ...Dr	7200	
To premium for goodwill A/c		7200
(ii) Premium for goodwill A/c ...Dr	7200	
To Aastha's capital A/c		2400
To Aahna's capital A/c		4800
(iii) Sonu's capital A/c ...Dr	4800	
To Aastha's capital A/c		1600
To Aahna's capital A/c		3200

Closing capital : Aastha ₹ 82,000; Aahna ₹ 39,200; Sonu ₹ 75,200

Closing cash balance ₹ 1,03,200; Total of balance sheet ₹ 2,32,000

10. Loss of revaluation A/c ₹ 15,000; Sacrificing ratio of Vidit and Vishal = 2 : 1

Banti's share in goodwill = ₹ 12,000

Closing capital : Vidit ₹ 49,600; Vishal ₹ 58,400; Banti ₹ 72,000

Closing bank balance ₹ 86,400; Total of balance sheet ₹ 2,37,000

11. Profit of revaluation A/c ₹ 38,000

Closing capital : Prerna ₹ 69,400; Piyush ₹ 2,08,200; Poyani ₹ 62,500

Closing cash and bank balance ₹ 80,350; Total of balance sheet ₹ 3,72,060

12. Profit of revaluation A/c ₹ 11,000; Sacrificing ratio of P and Q 1 : 2

Entry for goodwill :

(i) R's capital A/c ...Dr	9000	
To P's capital A/c		3000
To Q's capital A/c		6000

Closing balance of capital A/c : P : ₹ 67,600; Q : ₹ 52,400; R : ₹ 51,000

Closing cash balance ₹ 64,000; Total of balance sheet ₹ 2,10,500

13. Profit of revaluation A/c ₹ 10,750

Balance of capital A/c : A : ₹ 75,000; B : ₹ 25,000; C : ₹ 20,000

Balance of current A/c : A : ₹ 18,300; B : ₹ 3950

Closing cash and bank balance ₹ 25,050; Total of balance sheet ₹ 1,48,250

14. Profit or loss of revaluation A/c : Zero

Balance of capital A/c : Rutvi : ₹ 1,20,000; Princy : ₹ 90,000; Manan : ₹ 1,35,000

Balance of current A/c : Rutvi : ₹ 2,07,500; Princy : ₹ 2,29,500; Manan : ₹ 15,000 (Debit)

Closing bank balance : ₹ 1,05,000; Total of balance sheet ₹ 9,15,000

15. Closing capital : Riya : ₹ 1,20,000; Gauri : ₹ 2,40,000; Sanju : ₹ 90,000

New profit-loss sharing ratio = 4 : 8 : 3

Riya will withdraw additional capital ₹ 30,000, Gauri will bring required capital ₹ 40,000.

16. Loss of revaluation A/c : ₹ 6300

Partners' capital : Parshvi : ₹ 60,000; Aneri : ₹ 80,000; Hency : ₹ 40,000

Sacrifice of Parshvi = $\frac{9}{27}$, Gain of Aneri = $\frac{3}{27}$

Hency does not bring goodwill in cash. Journal entry for goodwill.

Aneri's capital A/c ...Dr	10,000	
Hency's current A/c ...Dr	20,000	
To Parshvi's capital A/c		30,000

Old goodwill debited to Parshvi and Aneri in their old profit-loss sharing ratio.

Balance of current A/c : Parshvi ₹ 47,000 (Credit); Aneri ₹ 1800 (Debit) Hency ₹ 20,000 (Debit)

Debit balance of current accounts will be shown on assets side of balance sheet and credit balance on liabilities side.

Hency does not bring her share of goodwill in cash which will be debited to her current account and threfore her capital will not reduce and capital of Parshvi and Aneri will be decided on the basis of Henci's capital ₹ 40,000 in new profit-loss sharing ratio. Total of balance sheet ₹ 3,19,000

17. Loss of revaluation A/c ₹ 4800

Balance of capital A/c : Esha : ₹ 51,000; Ankita : ₹ 79,500; Arpita : ₹ 43,500

Sacrificing ratio of Ankita and Esha = 1 : 2

Closing cash and bank balance ₹ 92,400; Total of balance sheet ₹ 2,42,000

18. Profit of revaluation A/c ₹ 35,000

Closing capital : Jaini : ₹ 93,800; Anya : ₹ 93,800; Priyanka : ₹ 37,520

Premium for goodwill will be credited to Jaini's capital account only. Jaini will withdraw ₹ 18,760. Anya will bring ₹ 18,760. Total of balance sheet ₹ 3,01,420

19. Profit of revaluation A/c ₹ 12,000; Sacrificing ratio of Tapu and Sonu = 2:3;

Goli's capital ₹ 5,21,000

Closing capital : Tapu : ₹ 2,08,000; Sonu : ₹ 3,13,000; Cash : ₹ 5,76,000

Total of balance sheet ₹ 10,92,000; New profit-loss sharing ratio = 4 : 9 : 5

20. Profit of revaluation A/c ₹ 3000; Sacrificing ratio of Meet and Neel = 3:1

Closing balance of capital : Meet : ₹ 1,12,500; Jeet : ₹ 1,00,000; Neel : ₹ 37,500; Heer : ₹ 50,000

Capital withdrawn by Meet ₹ 8500 and Neel ₹ 19,500. Capital brought by Jeet ₹ 16,000.

Closing cash balance ₹ 74,000; Total of balance sheet ₹ 4,16,000

Exercise 6

1. Select appropriate option for each question :

(1) (a) (2) (b) (3) (c) (4) (b) (5) (c) (6) (c) (7) (c)
(8) (d) (9) (d) (10) (a)

3.

	New profit-loss sharing ratio	Gaining ratio
(1)	5 : 3	5 : 3
(2) (a)	2 : 1	2 : 1
(b)	3 : 1	3 : 1
(c)	3 : 2	3 : 2
(3)	11 : 9	3 : 1
(4)	13 : 17	1 : 4
(5)	1 : 1	2 : 1
(6)	3 : 7	C's gain $\frac{5}{10}$
(7)	8 : 7 : 5	R and S, 1 : 1
(8)	M and O, 7 : 5	M and O, 2 : 3
(9)	17 : 8	A and C, 3 : 2
(10)	B and C, 2 : 3	1 : 1
(11)	7 : 5	1 : 1
(12)	7 : 3	3 : 2
(13)	A, B and C, 8 : 9 : 3	B and D, 3 : 1

4.

		Dr	Cr
(1)	Akruti's capital A/c ...Dr	3750	
	Prakruti's capital A/c ...Dr	2250	
	To Sanskruti's capital A/c		6000
(2) (i)	X's capital A/c ...Dr	14,000	
	Y's capital A/c ...Dr	14,000	
	Z's capital A/c ...Dr	14,000	
	To Goodwill A/c		42,000
(ii)	Y's capital A/c ...Dr	20,000	
	Z's capital A/c ...Dr	20,000	
	To X's capital A/c		40,000
(3) (i)	L's capital A/c ...Dr	25,000	
	M's capital A/c ...Dr	20,000	
	N's capital A/c ...Dr	15,000	
	O's capital A/c ...Dr	15,000	
	To Goodwill A/c		75,000

	(ii) M's capital A/c ...Dr	30,000	
	To L's capital A/c		30,000
(4)	A's capital A/c ...Dr	26,667	
	To B's capital A/c		20,000
	To C's capital A/c		6667
(5)	(i) B's capital A/c ...Dr	8000	
	R's capital A/c ...Dr	6000	
	T's capital A/c ...Dr	2000	
	S's capital A/c ...Dr	4000	
	To Goodwill A/c		20,000
	(ii) T's capital A/c ...Dr	18,000	
	S's capital A/c ...Dr	12,000	
	To B's capital A/c		24,000
	To R's capital A/c		6000
(6)	M's capital A/c ...Dr	20,000	
	L's capital A/c ...Dr	40,000	
	To U's capital A/c		60,000

5. Profit of revaluation A/c ₹ 2000; Naval's loan ₹ 9500

Closing balance of capital A/c : Dhaval : ₹ 25,000; Kamal : ₹ 15,000

Total of balance sheet ₹ 62,000

6. Profit of revaluation A/c ₹ 18,000; Rohit's loan ₹ 2,46,000

Closing balance of capital A/c : Mohit : ₹ 48,000; Virat : ₹ 68,000

Bank balance : ₹ 43,000; Total of balance sheet ₹ 4,37,000

7. Loss of revaluation A/c ₹ 6000; Siddhi's loan ₹ 31,800

Balance of capital A/c : Vijay : ₹ 93,000; Laxmi : ₹ 47,200

Cash balance : ₹ 24,000; Total of balance sheet ₹ 2,77,000

Journal entry for goodwill :

Laxmi's capital A/c ...Dr	18,000	
To Vijay's capital A/c		6000
To Siddhi's capital A/c		12,000

8. Profit of revaluation A/c ₹ 500

Balance of fixed capital account : Jaya ₹ 2,00,000; Mamta : ₹ 1,00,000

Balance of current account : Jaya : ₹ 22,200; Mamta : ₹ 34,250

Smruti's loan : ₹ 74,050; Total of balance sheet ₹ 5,34,500

Journal entry of goodwill :

(i)	Jaya's current A/c ...Dr	12,000	
	Mamta's current A/c ...Dr	15,000	
	Smruti's current A/c ...Dr	3000	
	To Goodwill A/c		30,000
(ii)	Jaya's current A/c ...Dr	20,000	
	To Smruti's current A/c		20,000

9. Loss of revaluation A/c ₹ 18,000; Radha's loan ₹ 75,000

Balance of capital A/c : Madhav ₹ 91,000; Gopi : ₹ 39,000

Total of balance sheet ₹ 3,00,000

First instalment on Radha's loan ₹ 45,000 (₹ 37,500 loan + ₹ 7500 interest)

Second instalment on Radha's loan ₹ 41,250 (₹ 37,500 loan + ₹ 3750 interest)

10. Loss of revaluation A/c ₹ 21,000; Jyoti's loan : ₹ 1,77,000

Balance of capital A/c : Deep ₹ 1,75,000; Gita : ₹ 1,75,000

Balance of current account of Deep = ₹ 92,000 (Debit)

Balance of current accounts of Gita = ₹ 92,000 (Debit)

Sacrificing ratio of Deep and Gita = 3 : 1; Total of balance sheet ₹ 6,22,000

11. Profit of revaluation A/c ₹ 12,600; Sun's loan : ₹ 2,34,200

Balance of capital A/c : Moon ₹ 3,30,333; Star : ₹ 66,067

Moon will bring ₹ 1,78,133. Star will withdraw ₹ 1,78,133.

Closing balance of bank = ₹ 1,15,600

Journal entry of goodwill :

Moon's capital A/c ...Dr	30,000	
To Star's capital A/c		10,000
To Sun's capital A/c		20,000

Total of balance sheet ₹ 6,40,600

12. Profit of revaluation A/c ₹ 6000; I's loan : ₹ 81,200

Balance of capital A/c : E : ₹ 58,000; M : ₹ 42,000

E will withdraw ₹ 22,000, M will bring ₹ 7200.

Cash balance = ₹ 7200; Total of balance sheet ₹ 2,81,200

New profit-loss sharing ratio of E and M = 29 : 21

13. Profit of revaluation A/c ₹ 13,000

New profit-loss sharing ratio of L and B = 21 : 19

Closing capital : L : ₹ 24,675; B : ₹ 22,325

Cash paid to W ₹ 22,500; Cash brought by L ₹ 10,675; Cash brought B ₹ 11,825

Total of balance sheet ₹ 70,000

14. Profit of revaluation ₹ 12,000; Paid to Keshav : ₹ 19,000

Closing capital : Chirag : ₹ 54,000; Jigar : ₹ 36,000

Cash brought : Chirag ₹ 18,600; Jigar ₹ 12,400

Total of balance sheet ₹ 1,36,000

15. Loss of revaluation A/c ₹ 600; E's loan ₹ 5960

F and G each will bring ₹ 3300.

Closing balance of capital : F : ₹ 7020; G : ₹ 4020

Total of balance sheet ₹ 27,000

16. Vimal's loan A/c ₹ 79,200

17. T's executor's loan A/c ₹ 1,76,975

18. Balance of executor's A/c ₹ 1,45,000; Balance of V's executor's A/c ₹ 1,00,000

First instalment ₹ 60,000 (₹ 50,000 + ₹ 10,000 interest)

Second instalment ₹ 55,000 (₹ 50,000 + ₹ 5000 interest)

19. Balance of M's executor ₹ 21,850

First instalment ₹ 12,400 (₹ 10,000 + ₹ 1800 interest + ₹ 600)

Second instalment ₹ 11,200 (₹ 10,000 + ₹ 900 interest + ₹ 300)

Exercise 7

1. Select appropriate option for each question :

(1) (c) (2) (d) (3) (c) (4) (a) (5) (b) (6) (d)

4. (6) A's capital ₹ 50,000; B's capital ₹ 30,000

7. Assets excluding cash ₹ 14,00,000; loss of realisation account ₹ 8,00,000

(To Naresh ₹ 3,20,000, To Shaival ₹ 4,80,000)

Total of opening balance sheet ₹ 16,00,000

8. Total of opening balance sheet ₹ 17,00,000; Loss of profit and loss account including of ₹ 1,00,000;

Loss of realisation account ₹ 2,00,000

9. Total of realisation account ₹ 19,00,000; Loss of realisation account ₹ 90,000;

Binal A/c ₹ 40,000; Dharmishtha A/c ₹ 30,000 and Mahesh A/c ₹ 20,000

10. Total of realisation account ₹ 9,25,000 and loss ₹ 57,000,

Transfer to partners' capital account from current account : Satyam ₹ 63,500; Shivam ₹ 64,000; Sundaram ₹ 19,500

Payment to partners : Satyam ₹ 1,13,500; Shivam ₹ 1,14,000 and Sundram ₹ 69,500,

Total of cash account ₹ 5,75,000