ACCOUNTING FOR PARTNERSHIP FIRMS-FUNDAMENTALS

Accounting Process in Partnership

Journal/Subsidiary Books

↓

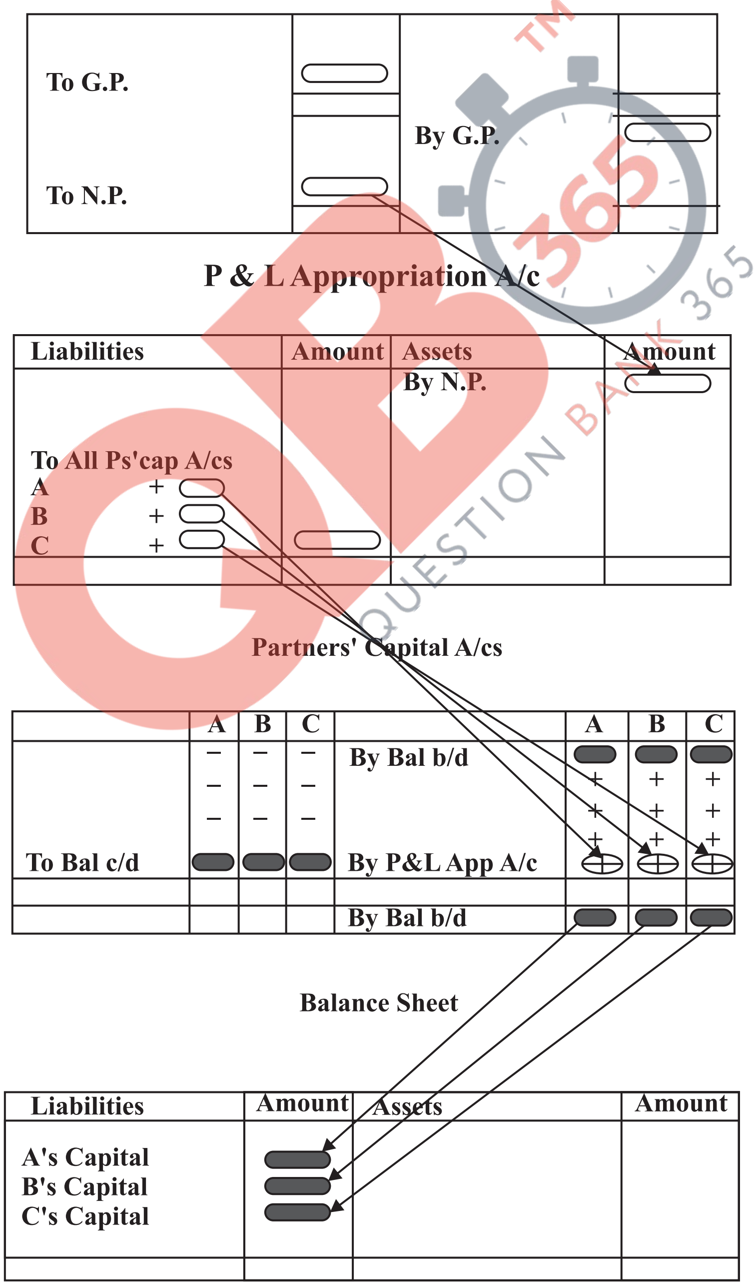
Ledger

↓

Trial Balance

↓

Trading and P&L A/c



Meaning and Definition

According to Section 4 of the Partnership Act 1932 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all"

Features of partnership Firm

1) Association of two or more persons: There must be at least two persons and maximum of 50 persons to form a partnership and they must be competent to contract.
2) Partnership Agreement or Deed: There must be an agreement among partners to form a partnership. It can be written or oral.
3) Legal Business: The business of the partnership firm must be a legally allowed business.
4) Sharing of Profits or Losses: The partners must share profits or losses in a certain ratio.
5) Mutual Agency: The partners mutually take part in daily routine work or the work may be carried on by one or more partners on behalf of the other partners. Every partner is legally liable for the acts of all other partners, whether he is taking part in the activities of the firm or not.
6) Unlimited Liability: Partners' liability to the third parties is unlimited. If there are losses, and the firm is not able to pay its debts fully, then all the partners shall be jointly and severally liable to pay the debts of the firm to an unlimited extent.

Partnership Deed: The document, which contains terms of the agreement, is called' Partnership Deed'. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.

Provisions of Partnership Act, 1932 in the absence of Partnership Deed:

(a) **Profit Sharing Ratio**: If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners.

(b) **Interest on Capital**: No interest on capital is payable if the partnership deed is silent on the issue.

(c) **Interest on Drawings**: No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.

(d) **Interest on Advances**: If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall been titled to get an interest on the amount at the rate of 6 percent per annum.

(e) **Remuneration for Firm's Work**: No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm.

Fixed and Fluctuating Capital Accounts of Partners

There are two methods by which the capital accounts of partners can be maintained. These are: (i) fixed capital method, and (ii) fluctuating capital method.

Fixed Capital Method: Under the fixed capital method, the capitals of the partners shall remain fixed unless additional capitalis introduced or a part of the capital is with drawn as per the agreement among the partners. All items likes hare of profit or loss, interest on capital, drawings, interest on drawings, etc. are recorded in separate accounts, called Partner's Current Account. The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital. The partners' current account on the other hand, may show a debit or a credit balance. Thus under this method, two accounts are maintained for each partner viz., capital account and current account, While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance shall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.

The partner's capital account and the current account under the fixed capital method would appear as shown below:

Dr. **Partner's Capital Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Bank A/c(permanent withdrawal of capital)		xxx		By Balance b/d (opening balance)		xxx
	To Balance c/d (closing balance)		xxx		By Bank A/c (fresh capital introduced)		xxx
Date			xxx				xxx

Dr. **Partner's Current Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Drawings		xxx		By Balance b/d		xxx
	To Interest on drawings		xxx		By Salaries/Commission		xxx
	To Profit and Loss		xxx		By Interest on capital		xxx
	Appropriation A/c (for share of loss)		xxx		By Profit and Loss		xxx
	To Balance c/d		xxx		Appropriation A/c (for share of profit)		xxx
Date			xxx				xxx

Fluctuating Capital Method: Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc. are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method. The proforma of capital accounts prepared under the fluctuating capital method is given below:

Dr. **Partner's Capital Account** **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	To Drawings		xxx		By Balance b/d		xxx
	To Bank (permanent withdrawal of capital)		xxx		By Bank (fresh capital introduced)		
	To Interest on drawings		xxx		By Salaries/Commission		xxx
	To Profit and Loss Appropriation A/c (for share of loss)		xxx		By Interest on capital		xxx
	To Balance c/d				By Profit and Loss Appropriation A/c (for share of profit)		xxx
Date			xxxx				xxxx

Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.

You know that in the case of sole partnership the profit or loss, as certained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and as certain the final figure of profit and loss to be distributed among the partners, in their profit sharing ratio.

The Proforma of Profit and Loss Appropriation Account is given as follows:

Dr. **Profit and Loss Appropriation Account** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Profit and Loss A/c (if there is loss)	xxx	By Profit and Loss A/c (if there is profit)	xxx
To Interest on Capital A/c	xxx	By Interest on Drawings	xxx
To Salary/Commission to Partner A/c		By Partners' Cap A/cs or Current A/cs (distribution of loss)	xxx
To General Reserve A/c	xxx		
To Partners' Cap A/cs or Current A/cs (Distribution of Profit)	xxx		
	xxxx		xxxx

***Note: Interest on partner's loan is to be treated as a charge against profits.**

Past Adjustments

If after closing the accounts for the year it is the discovered that some errors have been committed, then these errors have to be rectified. Some adjustment entries have to be passed to rectify the error. The entries are made through Profit & Adjustment A/c. These entries are to rectify the errors committed in past, therefore, they are known as 'Past Adjustments'. Generally the following types of errors are committed:

(i) Interest on Capital and on Drawings have been omitted.

(ii) Interest on Capital and on Drawings have been provided at higher or lower rates than the rates agreed in the Deed.

(iii) Salary or commission to partners either not given or a higher or lower amount has been given.

(iv) Profit shared in a wrong ratio.

Adjustment Chart

Particulars	**A**	**B**	**C**	**Firm**
+ Interest on Capital	+	+	+	
+ Partner's Salary/Commission	+	+	+	
- Interest on Drawings	–	–	–	
Excess profit taken back in their P&L sharing ratio	+	+	+	–
	–	–	–	
	+	–	+	

* Assumed that there are three partners A, B and C.

* Assumed that all errors are related to omission

* + means Cr the partner's capital A/c

* - means Dr the partner's capital A/c

* In last + amount should be equal to - amount

Note: Similarly following errors can be rectified accordingly:

(i) Interest on Capital and on Drawings have been provided at higher or lower rates than the rates agreed in the Deed

(ii) Salary or commission to partners either a higher or lower amount has been given.

Guarantee of Profit to a Partner

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if his share of profit is lower than the guaranteed amount. The deficit shall be borne either by one of the old partners or by all the old partners in a particular agreed ratio. If there is no agreement, then in their old profit sharing ratio, if his actual share of profit is more than the guaranteed amount, then, he will be given his actual share of profit. He gets the guaranteed amount or the actual share of profit, **whichever is higher.**

(a) **Guarantee given by all partners**

(i) Compare the amount of guarantee and his actual share of profit. If guaranteed amount is more than his actual share of profit, then the guaranteed amount will be debited to profit and loss Appropriation Account and the partner's account will be credited with the guaranteed amount.

(ii) The deficiency shall be shared by other partners in their profit sharing ratio.

(b) **Guarantee given by One Partner only**

First calculate his share of profit. Compare it with the guaranteed amount. The amount of deficiency is to be charged from the partner who gave guarantee.

(c) **Guarantee given to a partner by other partners in a ratio different from their profit sharing ratio**

Distribute profit among all the partners in the profit sharing ratio. Work out the amount of deficiency by comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

Goodwill

Meaning of Goodwill

Over a period of time, a well - established business develops an advantage of good name, reputation and wide business connections. Thishelps the business to earn more profits as compared to a newly setup business. In accounting, the monetary value of such advantage is known as "goodwill".

Factors Affecting theValue of Goodwill

The main factors affecting the value of goodwill areas follows:

1. Nature of business: A firm that produces high value added products or having as table demand disable to earn more profits and there fore has more goodwill.
2. Location: If the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high.
3. Efficiency of management: A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of good will also be high.
4. Market situation: The monopoly condition or limited competition enables the concerned to earn high profits which leads to higher value of goodwill.
5. Special advantages: The firm that enjoys special advantages like import licenses, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators, patents, trade marks, etc. enjoy higher value of goodwill.

Need for Valuation of Goodwill

In a partnership firm, goodwill needs to be valued 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;
4. Death of a partner; and
5. Dissolution of a firm involving sale of business as a going concern.
6. Amalgamation of partnership firm

Methods of Valuation of Goodwill

1. **Average Profits Method**

   (a) **Simple Average**

   Stepwise procedure to calculate Goodwill under this method:

   Step1: Work out profits or losses given for each of the past year after taking into account abnormalities, if any.

   Step2: Calculate average by dividing the total profit of all the years by the number of years.

   Step3: Goodwill= Average Profit x Number of year's purchase.

   (b) **Weighted Average**

   This is a better method than the simple average method. It takes into account the importance of each year. Under this method, earlier years are less important than the recent years. Thus, each year's profit is multiplied by its respective number (weight) in chronological order. The latest year will be given the highest weight and the earliest year will be given lowest weight. Each profit figure will be multiplied by its weight and then the total of these products will be calculated. This total will be divided by the total of weights.

   Then Goodwill = Weighted average x number of years' purchase

2. **Super Profit Method**

   Stepwise procedure to calculate Goodwill under this method:

   Calculate the average profit,

   1. Calculate the normal profit on the capital employed on the basis of the normal rate of return, Formula = Normal Profit = Capital Employed x NRR / 100
   2. Calculate the super profits by deducting normal profit from the average profits, Formula- Super Profit = Average Profit - Normal Profit
   3. Goodwill = Super profits x number of years' purchase.

3. **Capitalisation Method**

   Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

   (a) **Capitalisation of Average Profits**: This involves the following steps:

   (i) As certain the average profits based on the past few years' performance.

   (ii) Capitalize the average profits on the basis of the normal rate of return to as certain the capitalised value of average profits as follows:
   Average Profits x 100/Normal rate of Return

   (iii) As certain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).
   Capital Employed/Net Assets = Total Assets (excluding goodwill) – Outside Liabilities

   (iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e. (ii)–(iii).

Capitalisation of Super Profits: It involves the following steps.

(i) Calculate capital employed of the firm,which is equal to total assets minus outside liabilities.

(ii) Calculate normal profits on capital CE = Total Assets - Outside Liabilities employed.

(iii) Calculate average profit for past years, as specified.

(ii) Super profits = average profits/Actual profit - normal profits

(iii) Multiply the super profits by there quired rate of return multiplier, that is, Goodwill = Super Profits × 100/ Normal Rate of Return

Note: In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

Question

X,Y and Z share profit in the ratio of 2:3:5.They earned a profit of Rs 1,50,000 for the year ended 31-12-2015. The profit was by mistake distributed among X,Y and Z in the ratio of 3:2:1,respectively. This error was noted in the beginning of the new year. They have set up an old age Home for the old and poor in the city.

Identify the business values and give the missing figures in the following solution

Particulars	X	Y	Z	Firm
1. Profit distributed in wrong ratio taken back Dr.	(-)75000	(-)50000	(-)25000	+1,50,000
2. The same profit now correctly distributed in correct ratio Cr.	+30000	+45000	+75000	- 1,50,000
Adjustment required Dr.	-45,000	-5,000	+50,000	

And give adjustment entry.

X's Capital A/c Dr. 4500.00

Y's Capital A/c Dr. 5000.00

To Z's Capital A/c Dr. 5000.00

(Being Adjustment entry made)

Value : Sensitivity towards poor Fulfiling social responsibility

Practical Problems:

Partnership Deed

1. Mohan and Shyam are partners in a firm. State whether the claim is valid if the partnership agreement is silent in the following matters:

(i) Mohan is an active partner. He wants a salary of Rs.10,000 per year;

(ii) Shyam had advanced a loan to the firm. He claims interest@10% per annum;

(iii) Mohan has contributed Rs.20,000 and Shyam Rs.50,000 as capital. Mohan wants equal share in profits.

(iv) Shyam wants interest on capital to be credited @6% perannum.

2. State whether the following statements are true or false:

(i) Valid partnership can be formulated even without a written agreement between the partners;

(ii) Each partner carrying on the business is the principal as well as the agent for all the other partners;

(iii) Methods of settlement of dispute among the partners can't be part of the partnership deed;

(iv) If the deed is silent, interest at the rate of 6% p.a. would be charged on the drawings made by the partner

Division of Profit

3. X and Y are partners with capitals of Rs.15,00,000 and Rs.10,00,000 respectively. They agree to share profits in the ratio of 3:2. Show how the following transactions will be recorded in the P & L Appropriation and capital accounts of the partners in case:

   (i) The capitals are fixed, and

   (ii) the capitals are fluctuating. The books are closed on March 31, every year.

Particulars	**X (Rs.)**	**Y (Rs.)**
Additional capital contributed	3,00,000	2.00,000
on July1,2015		
Interest on capital	5%	5%
Drawings (during 2015-16)	30,000	20,000
Interest on drawings	12%	12%
Salary	20.000	–
Commission	10,000	7,000

The profits for the year ending 31st March,2016 were Rs 71,500.

Hint: If the capitals are fixed: X's capital A/c-Rs 18,00,000; Y's capital A/c-Rs 12,00,000 X's current A/c-Rs 20,700; Y's current A/c-Rs 80.

If the capitals are fluctuating: X's capital A/c-Rs 18,20,700; Y's capital A/c-Rs 12,00,800

Interest on Capital & Interest on Drawings

A and B are partners sharing profits and losses in the ratio of 3:2. Their capital accounts showed balances of Rs.1,50,000 and Rs. 2,00,000 respectively on Jan 01, 2003. Show the treatment of interest on capital for the year ending December 31, 2006 in each of the following alternatives:

If the partnership deed is silent as to the payment of interest on capital and the profit for the year is Rs.50,000;

If partnership deed provides for interest on capital @8% p.a. and the firm incurred a loss of Rs.10,000 during the year;

(a) If partnership deed provides for interest on capital @8% p.a. and the firm earned a profit of Rs.50,000 during the year;

(b) If the partnership deed provides for interest on capital @8% p.a. and the firm earned a profit of Rs.14,000 during the year.

Hint: In the absence of any information interest on capitals will be appropriation of profit

4. Manu, Harry and Ali are partners in a firm sharing profits and losses equally. Harry and Ali with drew the following amounts from the firm, for their personal use, during 2006.

Date	Harry (Rs.)	Ali (Rs.)
2006	5,000	7,000
January, 01		
April, 01	8,000	4,000
September, 01	5,000	5,000
December, 01	4,000	9,000

Calculate interest on drawings if the rate of interest to be charged is 10 percent, and the books are closed on December 31 every year.

Guarantee of Profit

1. Ram, Mohan and Sohan are partners with capitals of Rs.5,00,000, Rs.2,50,000 and 2,00,000 respectively. After providing interest on capital @10% p.a. the profits are divisible as follows:

   Ram ½, Mohan 1/3 and Sohan 1/6. Ram and Mohan have guaranteed that Sohan's share in the profit shall not be less than Rs.25,000, in any year. The net profit for the year ended March 31, 2016 is Rs.2,00,000, before charging interest on capital.

   You are required to show distribution of profit.

   (Ans: Profit to Ram, Rs.48,000, Mohan, Rs.32,000 and Sohan, Rs.25,000)

Past Adjustment

2. The net profit of X, Y and Z for the year ended March 31, 2006 was Rs.60,000 and the same was distributed among them in their agreed ratio of 3:1:1. It was subsequently discovered that the under mentioned transactions were not recorded in the books:

   (i) Interest on Capital @5% p.a.

   (ii) Interest on drawings amounting to X Rs.700, Y Rs.500 and Z Rs.300.

   (iii) Partner's Salary: X Rs.1000, Y Rs.1500 p.a.

   The capital accounts of partners were fixed as: X Rs.1,00,000, Y Rs.80,000 and Z Rs.60,000. Record the adjustment entry.

   (Ans: X Dr. Rs.2,700, Y credit Rs.2,600 and Z credit Rs.100]

Valuation of Goodwill

3. Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years? The profits/losses for the last five years were as follows:

   2012 - Rs25,000; 2013 - Rs40,000; 2014 - (Rs15,000) loss; 2015 - Rs80,000; 2016 - Rs1,00,000

   Ans: Rs 1,84,000

4. Capital employed in a business is Rs.2,00,000. The normal rate of return on capital employed is 15%. During the year 2002 the firm earned a profit of Rs.48,000. Calculate good will on the basis of 3 years purchase of super profit?

   (Ans: Rs.54,000)

5. A business has earned average profits of Rs.1,00,000 during the last few years.

Find out the value of goodwill by capitalisation method, given that the assets of the business are Rs.10,00,000 and its external liabilities are Rs.1,80,000. The normal rate of return is10%?

(Ans: Rs.1,80,000)

ADMISSION OF PARTNER

Accounting Steps:

Step1: Revaluation of Assets and Reassessment of Liabilities.

Step2: Treatment of Accumulated Profits or Losses.

………………………………………….After welcome of new partner

Step3: New Profit sharing ratio and sacrificing ratio.

Step4: Treatment of Goodwill.

Step5: Adjustment of capital and New Balance Sheet.

***Note:** First two steps are calculated on the basis of old balance sheet,old partners'capital A/cs and old profit sharing ratio. If, firstly these two steps are completed by students then there will be no chance of mistake in accounting treatment.

Step1:Revaluation of Assets and Reassessment of Liabilities.

The journal entries recorded for revaluation of assets and reassessment of liabilities are as follows

For

(i) For increase in the value of an asset

Asset A/c	Dr.	
To Revaluation A/c		(Gain)

(ii) For reduction in the value of an asset

Revaluation A/c	Dr.	
To Asset A/c		(Loss)

(iii) Appreciation in the amount of a liability

Revaluation A/c	Dr.	
To Liability A/c		(Loss)

(iv) For reduction in the amount of a liability

Liability A/c	Dr.	
To Revaluation A/c		(Gain)

(v) For an unrecorded asset

Asset A/c	Dr.	
To Revaluation A/c		(Gain)

(vi) For an unrecorded liability

Revaluation A/c Dr.

To Liability A/c (Loss)

(vii) For transfer of gain on Revaluation if credit balance

Revaluation A/c Dr.

To Old Partners Capital A/cs **(Old ratio)**

(individually)

(viii) For transferring loss on revaluation

Old partner's Capital A/cs Dr.

(Individually) **(Oldratio)**

To Revaluation A/c

Step2: Treatment of Accumulated Profits or Losses.

The journal entries recorded for Accumulated Profits or Losses are as follows:

(i) For Accumulated Profit

Reserve A/c Dr

Profit & Loss A/c(Profit) Dr

Workmen's Compensation Fund A/c Dr

Investment Fluctuation Reserve A/c Dr

To Old Partners' Capital A/c (individualy)

(In old profit sharing ratio)

(ii) For Losses

Old Partners' Capital A/cs Dr (individualy)

To Profit & Loss A/c(Loss)

To Deferred Revenue Expenses A/c (**In old profit sharing ratio**)

Step3: New Profit sharing ratio and Sacrificing ratio.

New Profit Sharing Ratio

When new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the old partners sacrifice a share of their profit in favour of the new partner. But, what will be the share of new partner and how he will acquire it from the existing partners is decided mutually among the old partners and the new partner. However, if nothing is specified as to how does the new partner acquire his share from the old partners; it may be assumed that he gets it from them in their profit sharing ratio. In any case, on admission of a new partner, the profit sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing ratio of the incoming partner. Hence, there is a need to as certain the new profit sharing ratio among all the partners. This depends upon how does the new partner acquires his share from the old partners for which there are many possibilities. Let us understand it with the help of the following illustrations.

Illustration 1

Anil and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for 1/5 share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal and Sumit.

Solution: Sumit's share = 1/5

Remaining share = 1-1/5=4/5

Anil's new share = 4/5 x3/5=12/25

Vishal's new share = 4/5 x 2/5 = 8/25

Sumit's share = 1x5/5x5 = 5/25

New profit sharing ratio of Anil, Vishal and Sumit will be12:8:5.

Note: It has been assumed that the new partner acquired his share from old partners in old ratio.

Illustration 2

Akshay and Bharati are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for 1/5th share in the future profits of the firm which he gets equally from Akshay and Bharati. Calculate new profit sharing ratio of Akshay, Bharati and Dinesh.

Solution: Dinesh's share = 1/5 or 2/10

Akshay's share = 3/5 – 1/10 = 5/10

Bharti,s share = 2/5 – 1/10 = 3/10

So, new profit sharing ratio is 5:3:2

Illustration 3

Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders 1/4 of his share and Shyam 1/3 of his share in favour of Ghanshyam. Calculate new profit sharing ratio of Ram, Shyam and Ghanshyam.

Solution:

Ram sacrifice = 3/5 x 1/4 = 3/20

Shyam sacrifice = 2/5 x 1/3 = 2/15

Ram's new share= 3/5 – 3/20 = 9/20

Shyam's new share = 2/5 – 2/15 = 4/15

Ghanshyam's new share = 3/20 + 2/15 = 17/60

So new ratio is 27:16:17

Sacrificing Ratio

The ratio in which the old partners agree to sacrifice their share of profit in favour of the incoming partner is called sacrificing ratio. The sacrifice by a partner is equal to:

Old Share of Profit – New Share of Profit

Step4: Treatment of Goodwill.

There are different situations relating to the accounting treatment of goodwill at the time of admission of new partner. All these are given in detail under the following categories:

(I) Goodwill paid by the new partner to the old partners privately:

No entry will be passed in the books of the firm. Entry for cash brought in by him as capital shall only be passed.

However if there is any goodwill a/c existing in the balance sheet of old partners before admission, it should be immediately written off among the old partners in old ratio.

(II) When amount of goodwill brought in by new partner:

In this case there may be three situations:

Exp: Supposed there are two partners A and B. C is admitted as new partner.

When new partner brings his share of goodwill in cash If there is any goodwill a/c in the balance sheet of old partners A's Capital A/c Dr B's Capital A/c Dr To Goodwill A/c (Being old goodwill written off in old ratio)	When new partner is not able to brings his share of goodwill in cash If there is any goodwill a/c in the balance sheet of old partners A's Capital A/c/Current A/c Dr B's Capital A/c Current A/c Dr To Goodwill A/c (Being old goodwill written off in old ratio)	When new partner brings only part of his share of goodwill in cash If there is any goodwill a/c in the balance sheet of old partners A's Capital A/c DrB's Capital A/c Dr To Goodwill A/c (Being old goodwill written off in old ratio)
Cash/Bank A/c Dr To Premium A/c To C's Capital A/c (Being cash brought in by new partner for premium and capital)	Cash/Bank A/c Dr To C's Capital A/c (Being cash brought in by new partner for capital)	Cash/Bank A/c Dr To Premium A/c To C's Capital A/c (Being cash brought in by new partner for a part of premium and capital)
Premium for Goodwil A/c Dr To A's Capital A/c To B's Capital A/c (Being premium amount transferred to old partners' capital A/cs in sacrificing ratio)	C's Capital A/c/C's Current A/c Dr To A's Capital A/c To B's Capital A/c (Being new partner's share of goodwill credited to old partners in sacrificing ratio)	Premium for Goodwill A/c Dr To A's Capital A/c To B's Capital A/c (Being a part of premium brings in cash transferred to old partners' capital A/cs in sacrificing ratio) …………………………................. C's Cap/Current A/c Dr To A's Capital A/c To B's Capital A/c (Being new partner's cap a/c Dr for part of premium not bring in cash and Cr to old partners in sacrificing ratio)
If premium amount withdrawn by old partners A's Capital A/c Dr B's Capital A/c Dr To Cash/Bank A/c	**If premium amount withdrawn by old partners** A's Capital A/c Dr B's Capital A/c Dr To Cash/Bank A/c	**If premium amount withdrawn by old partners** A's Capital A/c Dr B's Capital A/c Dr To Cash/Bank A/c

(III) When New Partner brings his share of goodwill in kind:

Exp: Supposed there are two partners A and B. C is admitted as new partner.

When new partner brings his share of goodwill in kind	
If there is any goodwill a/c in the balance sheet of old partners	
A's Capital A/c	Dr
B's Capital A/c	Dr
To Goodwill A/c	
(Being old goodwill written off in old ratio)	
Assets A/c	Dr
To Premium for Goodwill A/c	
To C's Capital A/c	
(Being cash brought in by new partner for premium and capital)	
Premium for Goodwill A/c	Dr
To A's Capital A/c	
To B's Capital A/c	
(Being premium amount transferred to old partners' capital A/cs in sacrificing ratio)	
If premium amount withdrawn by old partners	
A's Capital A/c	Dr
B's Capital A/c	Dr
To Cash/Bank A/c	

(IV) **Hidden Goodwill:**

Sometimes the value of Goodwill is not given. It is inferred or estimated from other related information given in question.

Exp: A and B are two partners in 3:2 ratio. Their capitals are Rs 1,20,000 and Rs 1,00,000 respectively. C is admitted for 1/5th share and he is bringing Rs 80,000 as his capital. Calculate the value of goodwill.

Solution:

Value of Goodwill = (C's Capital x 5/1) – (A's Capital+B's Capital+C's Capital)

= (80,000 x 5/1) – (1,20,000+1,00,000+80,000)

= 4,00,000 – 3,00,000

= 1,00,000

So C's share of Goodwill = 1,00,000 x 1/5 = 20,000

***Note:** It means new partner C does't bring his share of goodwill in cash. So in this case journal entries will be same as given in table of **(II)** situation

Step5: Adjustment of capital and New Balance Sheet.

After the admission of a partner, the capitals of all partners may be adjusted as per agreement. The adjustment may take any of the following forms:

(I) **Adjustment of the capitals of the old partners on the basis of new partner's capital Steps:**

(i) Calculate the total capital of the firm on the basis of new partner's capital and his share in profits.

Total Capital/New Capital= New partner's capital x Reciprocal of the proportion of his share in profit

(ii) Calculate the new capitals of all partners by dividing total capital in new ratio.

(iii) Prepare old partners' capital a/cs (after all adjustments regarding Revaluation, General Reserve , Goodwill etc) and find out the actual balances of their capitals.

(iv) Compare the new capitals as in (ii) with old capital balances as in (iii) and work out surplus or deficiency.

(v) Surplus will be paid back to the old partners and if there is deficiency the same will be contributed in cash by the old partners.

(If it is specifically required under agreement, the surplus can be Cr to their current a/cs and deficiency can be Dr to their current a/cs)

(vi) If goodwill is not brought in cash, it can be adjusted either (i) through new partner's capital a/c – this will reduce his original capital contributed by him or (ii) if it is adjusted through new partner's current a/c – this will not affect the original capital contributed by him.

(II) **Finding the new partner's sufficient capital on the basis of the old partners' capital or the total capital of the firm**

Steps:

(i) Prepare old partners' capital a/cs(after all adjustments regarding Revaluation, General Reserve , Goodwill etc)

(ii) Calculate the total Capital of the new firm as follows:

Total Capital of the firm =

$$\left(\begin{array}{c}\text{Combined adjusted}\\\text{capital of old partners}\end{array}\right) \text{ x } \left(\begin{array}{c}\text{Reciprocal of the combined}\\\text{proportion of their share of profit}\end{array}\right)$$

(iii) New partner's capital will be equal to his share of the total capital.

(iv) If goodwill is not brought in cash by the new partner, it should be better Dr to his Current Account. This will make the calculation of his sufficient capital more accurate and simple.

Change in Profit Sharing Ratio among the existing Partners

Sometimes,thepartnersofafirmdecidetochangetheirexistingprofitsharingratiowithoutanyadmission orretirementofapartner.Thisresultinagainofadditionalshareinfutureprofitsofthefirmforsomepartner swhilealossofapartthereofforotherpartners. In this case, first of all, loss and gain in the value of goodwill (if any) will have to be adjusted. Losing partners can be credited and gaining partners debited with appropriate amounts without good will account appearing in the books, as explained earlier in the context of the admission of a new partners. Any change, in the profit sharing ratio, like admission of partner, may also involve adjustments in respect of revaluation of assets and liabilities, transfer of accumulated profit and losses to partners' capital accounts in the old profit sharing ratio and adjustment of partners' capitals, if specified, so as to make them proportionate to the new profit sharing ratio. All this is done in the same way as incase of admission of a partner.

Question based on missing figure

A and B are partners sharing profit in the ratio of 4:1. They admit C on 31-3-2016 with ¼ shares. He brings Rs 60,000 and he brings his share in cash. The information given below is incomplete. Give the correct missing figures. Old partners have withdrawn their goodwill.

Dr. Revaluation A/c Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To claim for damages To Machines To Furniture	1,000 12,000 3,500	By Creditors By Old partners A …….. B ………	500 ………
	16,500		16,500

Dr. Bank/Cash A/c Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2016 March 31	To Balance b/d To C's capital a/c To Premium a/c	2016 15,000 ………… ………… …………	2016 March 31	By A's capital a/c (goodwill withdrawn) By B's capital a/c (goodwill withdrawn) By Balance c/d	2016 ………… ………… ………… …………
2016 April 1	To Balance b/d	…………			

Dr. Partners' Capital a/cs Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2016 March 31	To cash a/c (goodwill withdrawn) To Revaluation a/c (Loss) To Balance c/d	…… …… …… ……	…… …… …… ……	xxx xxx …… ……	2016 March 31 March 31 March 31	By Balance b/d By Premium a/c By cash a/c	80,000 12,000 xxx ……	80,000 3,000 xxx ……	xxx xxx xxx ……
					2016 April 1	By Balance b/d	……	……	……

Dr. **Balance Sheet as at 31-3-2016** Cr.

Particulars		Amount	Particulars	Amount
Capital			Cash/Bank	....
A	....		Debtors	40,000
B	....		Stock	50,000
C	....	....	Machines	1,08,000
....		1,000	Furniture	31,500
Creditors		99,500		
		....		....

Practical Questions

New ratio and sacrificing ratio

1. A and B were partners in a firm sharing profits and losses in the ratio of 3:2.

   They admit C into the partnership with 1/6 share in the profits. Calculate the new profit sharing ratio? (Ans: 3:2:1)

2. P and Q are partners sharing profits in 2:1 ratio. They admitted R into partnership giving him 1/5 share which he acquired from P and Q in 1:2 ratio. Calculate new profit sharing ratio. (Ans:3:1:1)

3. Sandeep and Navdeep are partners in a firm sharing profits in 5:3 ratio. They admit C into the firm and the new profit sharing ratio was agreed at 4:2:1. Calculate the sacrificing ratio? (Ans:1:1.)

Goodwill

4. Amar and Samar were partners in a firm sharing profits and losses in 3:1 ratio. They admitted Kanwar for 1/4 share of profits. Kanwar could not bring his share of good will premium in cash. The Goodwill of the firm was valued at Rs.80,000 on Kanwar's admission. Record necessary journal entry for good will on Kanwar's admission.

Revaluation a/c,Accumulated profit or losses, Partners' capital a/cs & their adjustment, Balance Sheet of new firm

5. Azad and Babli are partners in a firm sharing profits and losses in the ratio of 2:1. Chintanis admitted into the firm with 1/4 share in profits. Chintan will bring in Rs.30,000 as his capital and the capitals of Azad and Babli are to be adjusted in the profit sharing ratio. The Balance Sheet of Azad and Babli as on December 31, 2006 (before Chintan's admission) was as follows:

Dr. **Balance Sheet as at 31-12-2015** Cr.

Liabilities		Amount	Assets	Amount
Creditors		8.000	Cash in hand	2,000
Bills payables		4,000	Cash at Bank	10,000
General Reserve		6,000	Sundry Debtors	8,000
Capital accounts:			Stock	10,000
			Furniture	5,000
Azad	50,000		Machinery	25,000
Babli	32,000	82,000	Building	40,000
		1,00,000		1,00,000

It was agreed that:

i) Chintan will bring in Rs.12,000 ashish are of good will premium.

ii) Buildings were valued at Rs.45,000 and Machinery at Rs.23,000.

iii) A provision for doubtful debts is to be created @ 6% on debtors.

iv) The capital accounts of Azad and Babli are to be adjusted by opening current accounts.

v) Record necessary journal entries, show necessary ledger accounts and prepare the Balance Sheet after admission.

(Ans: Gainor Revaluation Rs.2,520. Balance Sheet Rs.1,44,520).

Change in profit sharing ratio

6. Dinesh, Ramesh and Suresh are partners in a firm sharing profits and losses in the ratio of 3:3:2. They decided to share the profits equally w.e.f. April 1, 2015. Their Balance Sheet as on March 31, 2015 was as follows:

Liabilities		**Amount**	**Assets**	**Amount**
Creditors		1,50,000	Cash at Bank	40,000
General Reserve		80,000	Bills Receivables	50,000
Partners'Loan:			Sundry Debtors	60,000
Dinesh	40,000		Stock	1,20,000
Ramesh	30,000	70,000	Fixed Assets	2,80,000
P's Capital accounts:				
Dinesh	1,00,000			
Ramesh	80,000			
Suresh	70,000			
		2,50,000		
		5,50,000		5,50,000

It was also decide that:

1. The fixed assets should be valued at Rs.3,31,000.
2. A provisions of 5% on sundry debtors be made doubtful debts.
3. Goodwill of the firm is valued at Rs 90,000.
4. The value of stock be reduced to Rs 1,12,000.

Prepare Revaluation a/c, partners' capital a/cs and Balance Sheet.

(Ans: Total of balance sheet Rs 5,90,000.)

RETIREMENT AND DEATH OF A PARTNER

A partner has right to retire from the firm after giving due notice in advance. After retirement a new partnership comes into existence between the remaining partners. Partner can retire from the firm in the following circumstances.

With the consent of the all the partners

As per the terms of the partnership agreement

By giving a notice in writing to all other partners, if the partnership is at will.

The retirement of a partner is called reconstitution of the partnership firm because the old agreement is terminated but the firm continues and the new agreement comes into force.

Following accounting treatments are done while retiring a partner.

1) Calculation of a new ration and gaining/sacrificing ration (in some cases) ration.
2) Treatment of goodwill.
3) Adjustment of revaluation of assets and liabilities.
4) Adjustment of undistributed reserves and profits and losses a/c.
5) Capital adjustments and preparing opening balance sheet.

CALCULATION OF NEW RATIO AND GAINING RATIO: -

New ratio = Old share + Acquired share

Gaining ratio = New ratio- Old ratio

Gaining ratio is calculated to ascertain the amount of goodwill payable to retiring or deceased partner by the remaining partners.

Q.1. A, B, & C are partners with ratio 4:5:6. Find out new ratio if i) A retires ii). B retires iii) C retires.

Sol. Old ration between partners A, B, & C is 4:5:6. So new ration i). 5:6, ii) 4:6, iii) 4:5

Q.2. A, B, & c are partners with ratio 3:2:1. Find out new ratio if A retires and his share is purchased by B alone.

Sol. Old ration between partners A, B, & C is3:2:1. A retires leaving the share of 3/2 and this share is purchased by B. so B's new share 2/6 +3/6 =5/6 and c's share is 1/6. So new share is 5:1.

Q.3. Roman, Preet and Sanjay are partners with equal profit sharing ratio. Roman decided to retire from the firm and new ration is fixed as 5:3, determine the gaining ratio.

Sol. Gaining Ratio = New Ratio – Old Ratio

Preet's Gaining Ratio = 5/8-1/3=15-8/24=7/24

Sanjay's Gaining = 3/8-1/3=9-8/24=1/24

Gaining Ratio = 7: 1

Q.4. A, B and C were partners sharing profits in the ratio of 5:3:2. B retires on January 1, 2016 with A and C agreeing to share the profits in future in the ratio of 6:4. Find the gaining ratio.

Sol. Gaining Ratio = New Ratio – Old Ratio

A's Gaining Ratio = 6/10-5/10 = 1/10

C's Gaining Ratio = 4/10-2/10=2/10

Gaining Ratio = 1:2

TREATMENT OF GOODWILL:-

The retiring partner share of goodwill is credited to capital account of respective partner and debited to remaining partners' capital in gaining ratio.

JOURNAL ENTRY:-

Gaining partner capital a/c/Current A/c Dr (With the share of Goodwill)

To Retiring or Deceased partner capital a/c (in gaining ratio)

The existing goodwill (if any) will be written off by debiting all partners' capital account in their old ratio and crediting the goodwill account.

Old partners' capital a/c/ current a/c Dr (in old ratio)

To Goodwill a/c (Goodwill existing goodwill)

Special Note: - Goodwill cannot be shown in books unless and until it is purchased by paying some consideration. (AS-26)

Q.5. A, B and C are partners in a firm sharing profits in the ratio of 5:3:2. A retires and his share is taken up by B and C equally. Goodwill of the firm is Rs. 60000. Pass necessary journal entry.

Sol:-

B's Capital a/c Dr 15000.00

C's Capital a/c Dr 15000.00

To A's Capital/c 30000.00

(Being adjustment of goodwill done on retirement of A)

Working Note: - Old Ratio is 5:3:2, New Ratio 11:9 and gaining ratio is 1:1.A's share of goodwill =60000*5/10=30000.

Numerical For practice

Q.6. A, B and C were partners sharing profits in the ratio of 2:2:1. B retires on January 1, 2016 with A and C agreeing to share the profits in future in the ratio of 3:2.Goodwill of the firm is Rs. 75000. Pass necessary journal entry.

Q.7. X, Y and Z are partners with ratio 3:2:1. Y retires and his share is purchased by Z alone. Goodwill of the firm is 30000.00. Pass necessary journal entry

Q. 8. Roman,Preet and Sanjayare partners with equal profit sharing ratio. Roman decided to retire from the firm and new ration is fixed as 5:3.Share of Goodwill of Roman 80000.00.Pass necessary journal entry.

Q.9. What is difference between sacrificing ratio and Gaining ratio.

Distribution of profit and loss on revaluation at the time of retirement/ Death of partner

Profit/Loss on revaluation will be shared between all the partners in their old profit sharing ratio.

(Journal entries for the revaluation of assets and liabilities and finding out profits or losses thereof has been explained in previous lessons)

Journal entry for the transfer of profit and loss on revaluation at the time of retirement/ death of a partner.

For Profits:

Revaluation A/C Dr.

To All Partner's Capital A/C (in old ratio)

(Being profit on revaluation transferred to all partners' capital account in old profit sharing ratio)

For losses:

All the partners' capital A/C Dr. (in old ratio)

To Revaluation A/c

(Being loss on revaluation transferred to all partners' capital account in old profit sharing ratio)

Treatment of undistributed profit at the time of retirement/death of the partner.

Special Note: - Reserves are always undistributed profits whereas P&L a/c may be profits or losses. If P&L a/c is having credit balance or given on liability side it is profit andif P&L a/c is having debit balance or given on assets side it is loss.

The undistributed **profits** are transferred to all partners' capital account in the old profit sharing ratio.

General Reserve a/c Dr.

Profit & Loss a/c Dr.

To All partners' capital account (in old ratio)

(Being undistributed profits transferred to all partners' capital accounts in old ratio)

Treatment of undistributed losses at the time of retirement/death of a partner

The **undistributed losses** are transferred to all partners' capital accounts in their old profit sharing ratio.

All partners' Capital a/c Dr. (in old ratio)

To profit & loss a/c

(Being undistributed losses are transferred to all partners' capital account in old profit ratio)

Q,1. L, M and N were partners sharing profits and losses in the ratio of 5:3:2. On 31st March 2016 their Balance Sheet was as under:

Liabilities	Amount	Assets	Amount
Capitals:		Property	1,20,000
L 1,50,000		Patents	30,000
M 1,25,000		Machinery	1,50,000
N 75,000	3,50,00	Stock	1,90,000
General Reserve	30,000	Bank	40,000
Creditors	1,50,000		
	5,30,000		

N retired on 31st March 2016 and it was agreed that:

(i) Goodwill of the firm is to be valued at Rs.2, 00,000.

(ii) Machinery be valued at Rs.1, 40,000; Patents at Rs.40, 000 and Property at Rs.1, 50,000 on this date.

Prepare partners' Capital Account and Revaluation Account and balance sheet.

Solution: - Working Notes:-

Old Ratio=5:3:2, New ratio after retirement 5:3, Gaining ratio= 5:3 share of goodwill of retiring partner = 200000*2/10=40000.00

Dr. Revaluation a/c Cr.

Particulars	(Rs)	Particulars	(Rs)
To Machinery	10,000	By patents	10,000
To Profit transferred to		By Property	30,000
Capital A/c:			
L 15,000			
M 10,000			
N 5,000	30,000		
	12,000		40,000

Dr. Partners' Capital a/cs Cr.

Particulars	L	M	N	Particulars	L	M	N
To N's Loan a/c	....	....	85,000	By balance b/d	1,50,000	1,25,000	75,000
To balance c/d	1,80,000	1,45,000	....	By General Reserve	15,000	10,000	5,000
	1,80,000	1,45,000	85,000	By Profit on Revaluation	15,000	10,000	5,000
	1,80,000	1,45,000	85,000		1,80,000	1,45,000	85,000

Opening Balance Sheet of New Firm

Liabilities	Amount	Assets	Amount
Capitals:		Property	1,50,000
L 1,80,000		Patents	40,000
M 1,45,000	3,25,000	Machinery	1,40,000
N 's Loan a/c	85,000	Stock	1,90,000
Creditors	1,50,000	Bank	40,000
	5,60,000		5,60,000

Numerical For practice

Q 1 X, Y, and Z were in partnership sharing profits in the ratio of 3: 2. On this date Balance Sheet is as follows:-

Liabilities	Amount	Assets	Amount
Provision for Doubtful Debts	1,300		
Sundry creditors	15,000	Cash at bank	10,000
Capitals:		Debtors	16,000
X 78,750		Stock	20,300
Y 70,000		Machinery	60,00
Z 61,250	2,10,000	Land and Building	1,20,000
	2,26,300		2,26,300

Z retires on the above date and the new profit sharing ratio between X and Y will be 5:4 following terms were agreed:

1) Land and buildings be reduced by 10%.
2) Out of the Insurance premium paid during the year Rs.5, 000 be carried forward as unexpired.
3) There is no need of any provision for doubtful debts.
4) Goodwill of the firm be valued at Rs.36, 000 and adjustment in this respect be made without raising a goodwill a/c.

Pass necessary journal entries: Prepare the capital accounts and the new balance sheet.

Q.2. A, B, C and D were partners sharing profits in the ratio of 3:3:2:2 respectively. On 1st April, 2014, D retired owing to ill health. It was decided by A, B and C that in future their profit sharing ratio would be 3:2:1. Complete the following Journal in this regard:

Date	Particulars	L.F.	Dr.	Cr.
	A's capital A/c Dr.		....	
	B's capital A/c Dr.		....	
	C's capital A/c Dr.		....	
	D's capital A/c Dr.		10,000	
	To			....
	(Being the existing goodwill written off)			
	A's capital A/c Dr.		1,20,000	
	B's capital A/c Dr.		....	
	To C's capital A/c			....
	To D's capital A/c			....
	(being the adjustment for the goodwill made on account of change in profit sharing ratio)			

Calculation of share of profit of the deceased partner

In case of death of a partner during the accounting year the executor of the deceased partner is entitled to a share of profit earned by the firm from the date of last balance sheet to the date of the death. The following two methods are adopted for ascertaining the profit of that period:

(a) On the basis of time:-

Deceased partner's share= Last year profit/Average profits x period (in months/days)/12/365

X Deceased partner's ratio

Note: Period here means from the period from the beginning of the year to the date of death.

(b) On the basis of sales: sales for the period *rate/100

Journal entry

Profit& loss Suspense a/c Dr (with the share of profit for the period)

To deceased partner's capital a/c

Numerical For practice

1) Ram, Manohar and Joshi were partners in a firm. Joshi died on 28^{th} February 2004. His share of profit from the closure of the last accounting year till the date of death was to be calculated on the basis of the average of three completed years' profits before the death. Profits for 2002, 2003 and 2004 were Rs. 7,000, Rs. 8,000 and Rs. 9,000 respectively. Calculate Joshi's share of profit till his death and pass the necessary journal entry for the same.

Answer : Share of Profit Rs. 444.44

2) P, R and S are in the partnership sharing profits in the ratio of 4:3:1 respectively. It is provided in the partnership deed that, on the death of any partner, his share of goodwill is to be valued at half of the profits credited to his account during the previous four completed years. R dies on 1st January, 2005. The firm's profits for the last years 2011: Rs.1, 20,000, 2012:Rs. 80,000, 2013: Rs. 40,000, 2014: Rs. 80,000.Determine the amount that should be credited to R in respect of his share of goodwill.

Answer : Share of Goodwill= 60000.

Calculation of the amount payable to the representative of deceased partner

The representative of the deceased partner is entitled to the following.

i. The balance standing on the credit of the deceased partner capital and current account

ii. His share of profit in the goodwill of the firm.

iii. His share of profit in the revaluation of assets and liabilities

iv. His share of reserve and accumulated profit

v. His share of profit upto the date of death

vi. Interest on capital if provided in the partnership agreement

The following amount will be debited to the account of the deceased partner for ascertaining the amount due to his representative.

i. His drawings

ii. Interest on drawings, if provided in the partnership deed

iii. His share of losses on revaluation of assets and liabilities

iv. His share of losses upto the date of his death

v. Loan to deceased partner.

Q.1. Arti, Bharati and Seema are partners in a firm sharing profits in the proportion of 3:2:1. Their Balance Sheet as on31st of March, 2013 stood as follows:

Particulars	(Rs)	Particulars	(Rs)
Bills payable	12,000	Buildings	21,000
Creditors	14,000	Cash in hand	12,000
General Reserve	12,000	Cash lit Bank	13,700
Capital Accounts:		Debtors	12,000
Arti	20,000	Bills Receivable	4,300
Bharti	12,000	Stock	1,750
Seema	8,000	Investment	13,250
	78,000		78,000

Bharati died on 30th June, 2013 and according to the deed of the said partnership her executors are entitled to be paid as under:

(i) The capital to her credit at the time of her death and interest thereon “10% per annum.

(ii) Her proportionate share of general reserve.

(iii) Her share of profits for the intervening period will be based on the sales during that period. Sales were calculated as Rs. 1,20,000. The rate of profit during past three years had been10% on sales.

(iv) Goodwill according to her share of profit to be calculated by taking twice the amount of profits of the last three years less 20%. The profits of the previous three years were:

2000-2001	Rs. 8,200
2001-2002	Rs. 9,000
2002-2003	Rs. 9,800

The investments were sold at par and her executors were paid out.

Prepare Bharti's Capital Account and her Executor's Account.

Dr. **Bharti’s Capital Account** **Cr.**

Date	Particulars	(Rs)	Date	Particulars	(Rs)
30.07.14	To Bharti’s Executor A/c (Balancing Figure)	34,700	30.07.14	By Balance b/d	12,000
			30.07.14	By General Reserve	4,000
			30.07.14	By Interest on Capital	300
			30.07.14	By P & L Suspense	4,000
			30.07.14	By Aarti’s Capital A/c	10,800
				By Seema’s Capital A/c (Goodwill)	3,600
		34,700			34,700

Dr. **Bharti's Executors' a/c** Cr.

Date	Particulars	(Rs)	Date	Particulars	(Rs)
30.07.14	To Bank A/c (Bal. Fig.)	34,700	30.07.14	By Bhart's Capital A/c	34,700 ....

Working Notes:

(i) Interest on Capital = 12,000 x 10/100 x 3/12 = Rs. 300

(ii) Share in General Reserve = 12,000 x 2/6 = Rs. 4,000

(iii) Share of Profit = 1,20,000 x 10/100 = Rs. 12,000

Bharti's Share = 2/6 x 12,000 = Rs. 4,000

(iv) Total Profit of Last 3 years :

8,200 + 9,000 + 9,800/3 = 27,000

Twice Profit = 27,000 x 2 = Rs. 54,000

Less: 20% of 54,000 = Rs. 54,000 – 10,800 = 43,200

Bharti's shares of goodwill = 43,200 x 2/6 = 14,400

Numerical For practice

1) A, B and C were partners in a firm sharing profits in the ratio of 5:3:2. On 31st March, 2015 their Balance sheet was as under:

Liabilities	Amount	Assets	Amount
Creditors	7,000	Buildings	20,000
Reserves	10,000	Machinery	30,000
A's Capital	30,000	Stock	10,000
B's Capital	25,000	Patents	6,000
C's Capital	15,000	Cash	21,000
	87,000		87,000

C died on Ist October, 2015. It was agreed between his executors and the remaining partners that:

(a) Goodwill be valued and 2 years' purchase of the average profits of the previous five years, which were 2011: Rs. 15,000: 2012: Rs. 13,000; 2013; Rs. 12,000; 2014: Rs. 15,000 and 2015: Rs. 20,000.

(b) Patents be valued at Rs. 8,000; Machinery at Rs. 28,000; Buildings at Rs. 30,000.

(c) Profit for the year 2005-06 be taken as having accrued at the same rate as the previous year.

(d) Interest on capital be provided at 10% p.a

(e) A sum of Rs. 7,750 was paid to his executors immediately.

Prepare C's capital account and his executors account at the time of his death.

2). Archana, Bindu and Charu were partners sharing profits in the ratio of 3:2:1. Their Balance Sheet as on 1st April 2010 was:

Liabilities	Amount	Assets	Amount
Creditors	200000	Cash	20,000
General Reserve	300000	Debtors	18,000
Capitals:		Stock	60,000
Archana- 1,00,000		Furniture	52,000
Bindu - 70,000		Land & Building	1,50,000
Charu - 70,000	240000		
	290000		290000

Bindu died on the above date and the executors were paid in the following manner:

a) Bindu's Share of Goodwill was Rs. 6,000;

b) A provision for doubtful debts @ 5% was to be made on debtors;

c) Land & Building were to be depreciated by 5% and Stock was valued at Rs.61900.

Pass necessary journal entries for the above transactions on Bindu's Death.

Q.3. X, Y and Z were partners in a firm sharing profits and losses in the ratio of 5:3:2. On 31.3.2015 their balance sheet was as followers.

Virat's loan a/c

Liabilities		Amount	Assets	Amount
			Building	50,000
Capital accounts:			Patents	15,000
X	75,000		Machinery	75,000
Y	62,500		Stock	37,500
Z	37,500	175000	Debtors	20,000
Creditors		42,000	Cash at Bank	20,000
		217500		217500

Z died on 31ST July, 2015. It was agreed that:

(a) Goodwill be valued at year's purchase of the average profit of the last four years, which were as follows: Years Profits

Years	Profits
2011-2012	32,500
2012-2013	30,000
2013-2014	40,000
2014-2015	37,500

(b) Machinery be valued at 70,000; Patents at 20,000 and Building at 62,500.

(c) For the purpose of calculating Z's share of profit in the years of his death the profits in 2014-2015 should be taken to have been accrued the same scale as in 2015-2016.

(d) A sum 17,500 was paid immediately to the executors of Z and the balance was paid in four half early installments together with interest at 12% p.a starting from 31.1.2016.

Prepare Z's capital account showing amount due to Z's executor.

Ans: Amount due to Z's executor=Rs 60000

RETIREMENT/ DEATH AND SETTLEMENT OF LOAN

It may be agreed among the partners that the principal amount will be paid in a few equal instalments with interest.

Q.1. Sachin, Virat and Kaif were partner in the firm. Virat retired on March31, 2016. All revaluation and goodwill adjustments were made and his claim came to be Rs. 320000. The amount has been transferred to Virat's Loan a/c. Prepare loan a/c

i). If the amount is paid in four equal instalments plus interest @12%.

ii). If they pay on instalment of Rs. 140000 at the end of year including interest on outstanding balance of the first two years and the balance including interest on third year.

Sol. for i).

Virat's loan a/c

Date	Particulars	(Rs)	Date	Particulars	(Rs)
2017 Mar.31	By Bank a/c By Balance c/d	118400 240000	2016 Mar,31 2017 Mar,31	By Virat's Capital a/c By Interest	3,20,000 38400
		358400			358400
2018 Mar, 31	By Bank a/c By Balance c/d	108800 160000	2017 April ,1 2018 Mar, 31	By Balance b/d By Interest	240000 28800
		268800			268800
2019 Mar, 31 2020 Mar, 31	By Bank a/c By Balance c/d	99200 80000	2018 April ,1 2019 Mar, 31	By Balance b/d By Interest	160000 19200
		179200			179200
2020Mar, 31	By Bank a/c	89600	2019 April ,1 2020 Mar, 31	By Balance b/d By Interest	80000 9600
		89600			89600

Virat's loan a/c

Date	Particulars	(Rs)	Date	Particulars	(Rs)
2017 Mar.31	By Bank a/c By Balance c/d	140000 218400	2016 Mar,31 2017 Mar,31	By Virat's Capital a/c By Interest	3,20,000 38400
		358400			358400
2018 Mar, 31	By Bank a/c By Balance c/d	140000 104608	2017 April ,1 2018 Mar, 31	By Balance b/d By Interest	218400 26208
		244608			244608
2019 Mar, 31	By Bank a/c	117161	2018 April ,1 2019 Mar, 31	By Balance b/d By Interest	104608 12553
		171161			171161

Numerical For practice

Q.1. Sunny, Riya and Kavi were partner in the firm. Sunny retired on March 31, 2014. All revaluation and goodwill adjustments were made and his claim came to be Rs. 4, 00,000. The amount has been transferred to Sunny's Loan a/c. Prepare loan a/c

i) If the amount is paid in four equal instalments plus interest @10%.

ii) If they pay on instalment of Rs. 1,60,000 at the end of year including interest on outstanding balance of the first two years and the balance including interest on third year.

<u>DISSOLUTION OF PARTNERSHIP FIRM</u>

Meaning of dissolution of partnership firm

Dissolution of partnership firm means that the firm closes down its business and comes to an end. On the dissolution of partnership firm, assets of the firm are sold and liabilities are paid off and out of remaining amount the accounts of partners are settled.

Thus, in case of dissolution of partnership, the firm may continue i.e. it does not mean the dissolution of firm. But in case of dissolution of the firm, the partnership is automatically dissolved.

Modes of dissolution of partnership firm:-

1) By mutual Agreement (Sec. 40)
2) Compulsory Dissolution (Sec. 41)
3) On Happening of an event (Sec. 42)
4) By Notice (Sec. 43)
5) By order of the Court (Sec. 44)

Difference between Realisation Account and Revaluation Account.

Realisation A/c is prepared at the time of dissolution of firm and Revaluation A/c is prepared at the time of admission/retirement or death of a partner.

Journal entries:-

For closing of various asset accounts on the dissolution of partnership firm

Realization A/c Dr.

To Sundry Asset a/c (By Name)

(Except cash, bank balance and fictitious assets)

(Only those assets which can be converted into cash are transferred to Realisation a/c. If provisions against any asset exists then asset at gross value is transferred to Realisation a/c and provision is created to Realisation a/c)

For closing various liabilities accounts on the dissolution of partnership firm

Sundry Liabilities a/c Dr (By name)

To Realisation a/c

(Exceptpartner's loan, capital and accumulated profits)

(Only those liabilities which relate to third party are transferred to Realization a/c.)

For payment of liability (Whether recorded or unrecorded)

Realisation a/c Dr

To Cash or Bank a/c

(For liability paid)

For assuming of liability by partner (Whether recorded or unrecorded)

Realisation a/c Dr

To Partner capital a/c

(For liability paid)

For sale of asset (Whether recorded or unrecorded)

Cash or Bank a/c Dr

To Realisation a/c

(For cash realized from sale of asset)

For asset taken over by partner (Whether recorded or unrecorded)

Partner Capital a/c Dr

To Realisation a/c

(For cash realized from sale of asset

For payment of realization expenses by firm

Realisation a/c Dr

To Cash or Bank a/c

(For realization expenses paid)

For payment of realization expenses by Partner

Realisation a/c Dr

To Partner capital a/c

(For realization expenses paid)

For payment of partner's loan by firm

Partner's Loan a/c Dr

To Cash or Bank a/c

(For partner's loan paid)

The undistributed **profits** are transferred to all partners' capital account in their sharing ratio.

General Reserve a/c Dr

Profit & Loss a/c Dr

To All partners' capital account (in their ratio)

(Being undistributed profits transferred to all partners' capital accounts)

The **undistributed losses** are transferred to all partners' capital accounts in their profit sharing ratio.

All partners' Capital a/c Dr. (in their ratio)

To profit & loss a/c

(Being undistributed losses are transferred to all partners' capital account)

Accounts prepared at the time of dissolution of partnership firm

1. Realisation a/c
2. Partner's Loan a/c
3. Partners' capital a/c
4. Cash or Bank a/c

Q.1 What journal entries would be passed for the following transactions on the dissolution of a firm, after various assets (other than cash) and third parties liabilities have been transferred to Realisation account?

1. Partner "A" took over the stock worth Rs.80, 000.
2. Firm paid Rs.40, 000 as compensation to employees.
3. Sundry creditors amounted to Rs.36, 000 which were settled at a discount of 15%.
4. There was an unrecorded bike of Rs.40, 000 which was taken over by partner "B" at Rs.30, 000.
5. Profit on realisation of Rs. 42,000 was to be distributed between A and B in the ratio of 4:3.

Sol:-

A's capital a/c	Dr	80,000	
To Realisation a/c			80,000
(Being stock is taken over by "A")			
Realisation a/c	Dr	40,000	
To bank a/c			40,000
(Being compensation paid to employee)			
Realisation a/c	Dr	30,600	
To Bank a/c			30,600
(Being stock is taken over by "A")			
B's capital a/c	Dr	30,000	
To Realisation a/c			30,000
(Being bike is taken over by "B")			
Realisation a/c	Dr	42000	
To A's capital a/c			24000
To B's capital		18000	
(Being profit on Realisation distributed to partners)			

Q.2 Charu and Palak are partners are partners in a firm and they decided to dissolve the partnership as on 31st March, 2012. On that day, their balance sheet was as follows:

Liabilities		Amount	Assets	Amount
Capitals: Charu	10,000		Building	17,000
Palak	20,000	30,000	Machinery	8,000
			Furniture	2,000
Creditors		10,000	Stock	4,500
			Sundry Debtors	5,500
			Cash at bank	3,000
		40,000		40,000

Amongst the partners, Charu decided to take over machinery at Rs.7, 500 while Palak took over building at Rs. 18,000. Stock realized its full value while furniture was sold at a discount of 10 per cent. Debtors were settled at Rs.5, 000 and Realisation expenses amounted to Rs.750.

Close the books of accounts.

Ans.

Dr. **Realisation a/c** **Cr.**

Liabilities	Amount	Assets	Amount
To Building	17,000	By creditors	10000
To Machinery	8,000	*By Charu* capital A/c (machinery)	7500
To Furniture	2,000	By Palak's capital A/c (building)	18000
To Stock	4,500	By cash at bank(stock)	4500
To Sundry Debtors	5,500	By cash at bank(furniture)	1800
To cash at bank(creditors)	10000	By cash at bank(debtors)	5000
To cash at bank(exp.)	750	By Charu's capital A/c -- 475	
		By Palak's capital A/c-- 475	950
	47750		47750

Dr. **Partner's Capital a/c** **Cr.**

Liabilities	Charu	Palak	Assets	Charu	Palak
To realisation	7500	1800	By balanced b/d	10000	20000
To realisation	475	475			
To Cash at bank	2025	1525			
	10000	20000		10000	20000

Dr. **Cash at Bank a/c** **Cr.**

Liabilities	Amount	Assets	Amount
To Cash at bank	3000	By realisation a/c	10000
To realisation a/c	4500	By realisation a/c (expenses)	750
To realisation a/c	1800	By Charu's capital A/c	2025
To realisation a/c	5000	By Palak's capital A/c	1525
	14300		14300

Numerical For practice

Q.1. What journal entries would be passed for the following transactions on the dissolution of a firm, after various assets (other than cash) and third parties liabilities have been transferred to Realisation account?

1). Loan of Rs. 10,000 advanced by a partner to the firm repaid on the dissolution of the firm
2). X, a partner takes over an unrecorded asset (typewriter) at Rs. 300
3). Undistributed balance (debit) of profit and loss account Rs. 30,000. The firm has three partners X, Y and Z.
4). the assets of the firm realized Rs. 1, 25,000.
5). Y who undertakes to carry out the dissolution proceeding is paid Rs. 2,000 for the same.
6). Creditors paid Rs.28, 000 in full settlement of their account of Rs.30, 000.

Q.2. A and B sharing profits and losses in the ratio of 5:2, for the following transactions on the dissolution of a firm, after various assets and third party liabilities have been transferred to Realisation account:

1) Bank loan Rs.12, 000 is paid.
2) Stock worth Rs.6, 000 is taken over by partner B.
3) Expenses on dissolution amounted to Rs.1, 500 and were paid by partner A.
4) A typewriter completely written off in the books of accounts was sold for Rs. 200.
5) Loss on Realisation is of Rs. 14,000.
6) There was a balance of Rs. 21,000 in the general reserve account on the date of dissolution.
7) B also agrees to take over the creditor of Rs. 30,000 for Rs. 20,000.
8) A, one of the partners has given loan to the firm of Rs. 10, 000. It was paid back to him at the time of dissolution.
9) Profit and loss account balance of Rs. 56,000 appeared on the assets side of the balance sheet.
10) Deferred revenue advertising expenditure appeared at Rs.28, 000.
11) An unrecorded investment realized Rs. 7,000.

Pass journal entries in the books of A and B.

Q.3. A and B, were partners sharing profits and losses in the ratio of 4:3, decided to dissolve the partnership firm as at 31-03-15. From the information given below, complete Realisation a/c, Partner's Capital A/c and Bank A/c:

Dr. **Realization a/c** **Cr.**

Liabilities	Amount	Assets	Amount
To Sundry Assets A/c: Machinery 76,000 Stock 34,000 Investments 30,000 Debtors 5.730	1,34,730	By Provisions for doubtful debts By sundry creditors By Bank A/c-assets realized By Loss on Realisation transferred to Capital a/c : A ________ B 9720	500 22,650
To Bank A/c-Creditors			
To A's Capital A/c-Expenses	1,800		
	1,70,740		1,70,740

Dr. **Partners Capital a/c** Cr.

Liabilities	A	Amount	Assets	A	B
To Realisation A/c		9,720	By_____________	....	....
To Bank A/c	1,12,070		By______________	....	
			By Bank A/c	....	7,650
	1,25,030	9,720		1,25,030	9,720

Dr. **Bank a/c** Cr.

Liabilities	Rs.	Assets	Rs.
To ________	....	By ________	....
To realization A/c (assets realized)	1,24,910	By A's capital A/c	1,12,070
To B's capital A/c	7,650		
	1,35,220		1,35,220

Q.4. J, K and L decided to dissolve their partnership firm on 31st march, 2012. Heir balance sheet on the day stood as under:

Dr. **Bank a/c** Cr.

Liabilities			Rs.	Assets	Rs.
Capitals:	J	10,000		Land	45,000
	K	10,000		Furniture	5,000
	L	10,000	30,000	Stock	4,000
J's Loan A/c			12,000	Debtors	5,000
Creditors			18,000	Bank	1,000
			60,000		60,000

Land was sold for the 15% above the book value while furniture was settled for Rs. 450 less. Stock was realized in full while debtors worth Rs. 300 proved bad. Expenses of Realisation were Rs. 600. Record the above transactions by passing necessary journal entries.**[Ans. Profit on realization. 5,400]**

Q.5. Ramesh and Mahesh were in partnership sharing profits and losses in the ratio of 3:1. They agreed to dissolve the firm. The assets realized Rs. 1, 50,000. The liabilities of the firm were as follows:

Creditors Rs. 90,000; Loan from Ramesh Rs. 40000, Ramesh's capital Rs. 20,000 and Mahesh's Capital Rs. 30,000. Show by mean of accounts the distribution of cash realized.

[Ans. Realisation loss Rs. 30,000; Ramesh brings in Rs. 2,500 and Mahesh is paid Rs. 22,500; Total of cash A/c Rs. 1, 52,500]

Q. 6. X, Y and Z are in partnership sharing in 7:5:8. They decided to dissolve the partnership. At the date of dissolution their creditors amounted to Rs. 20,000, cash being Rs.1000 and in the course of dissolution a contingent liability of Rs. 2,650 not brought into the accounts matured and to be met. Their capitals stood at Rs. 12,000; Rs. 10,000; and 18,000 respectively. X had lent to the firm in addition to capital Rs. 14,000. The assets realizers. 44,150.

Prepare the Realisation account and the partner's capital accounts. Also show the cash account.

[Ans. Realisation Loss Rs. 31500Total of cash A/c Rs. 45,150]

Q. 7. X, Y and Z are partners sharing profits and losses in the ratio of 3:2:1. On 30^{th} June, 2015, they agreed to dissolve the partnership, they appointed Y to realize the assets and distribute the proceeds. Y is to receive 5% commission on the sale of assets (except cash) as his remuneration and is to bear all expenses of Realisation. Their balance sheet was as follows:

Balance Sheet

Dr. **Bank a/c** **Cr.**

Liabilities		Rs.	Assets	Rs.
Sundry creditors		15,275	Cash at bank	3,740
Reserve fund		12,000	Sundry debtors	20,000
Profit and loss A/c		1,500	Stock	42,200
Capital accounts:			Plant and Machinery	61,000
X	70,000		Goodwill	15,000
Y	30,000		Current a/c - Z	23,460
Z	20,000	1,20,000		
Current accounts				
X	12,500			
Y	4,125	16,625		
		165400		165400

Y reports the result of Realisation as follows:

Sundry Debtors Rs. 12,000, Stock Rs. 18,250, Plant and Machinery at 25% less than book value. Goodwill was valueless. Creditors were paid in full and the expenses of Realisation amounted to RS. 380 Which Y, met personally. Prepare necessary Ledger Accounts.

[Ans. Realisation loss Rs. 66,000.Final Payment to X Rs. 56,250; Y Rs. 20,425. Cash brought in by Z Rs. 12,210. Total of Bank A/c Rs. 91,950.]

Q.8. X, Y and Z carrying on business as a partnership firm decided to dissolve the firm on 30.6.2011 when their balance sheet was as follows:

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Creditors		34,000	Cash	25,000
Capitals:			Stock	62,000
X	1,20,000		Debtors	37,000
Y	90,000		Tools	8,000
Z	60,000	2,70,000	Car	12,000
			Machinery	60,000
			Buildings	1,00,000
		304000		304000

The partnership deed provided that profits will be divided in the ratio of 3:2:1 respectively among X, Y and Z. Assets realized as follows: Stock Rs. 40,000, Tools Rs. 5,000. Machinery Rs. 78,000, Buildings Rs. 84,000. Car Rs. 25,000, Goodwill Rs. 60,000, Debtors Rs. 59,000. Creditors were settled at a discount of Rs. 720. There was unrecorded asset valued at Rs. 3,000, which was handed over to X for Rs. 2,000.Prepare Realisation account, cash account and partner's capital accounts.

Ans. Realisation profit Rs. 74,720.Final payment to X Rs. 1, 55,360; Y Rs. 1, 14, 907, Z Rs. 72, 453. Total of cash a/c Rs. 3, 76,000.