INDIAN SCHOOL MUSCAT
Senior Section
Department of Commerce and Humanities

Class : 12

SOLVED SUPPORT MATERIAL
Part-A - PARTNERSHIP

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ACCOUNTANCY (055)

ACCOUNTING FOR PARTNERSHIP FIRMS-FUNDAMENTALS

Partnership 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 capital is introduced or a part of the capital is withdrawn 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 (₹)	Date	Particulars	J.F.	Amount (₹)
	To Bank A/c(permanent withdrawal of capital) To Balance c/d (closing balance)		xxx xxx		By Balance b/d (opening balance) By Bank A/c (fresh capital introduced)		xxx xxx

			xxx				xxx

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

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

					(for share of profit)		
			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, ascertained 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 (₹)	Particulars	Amount (₹)
To Profit and Loss A/c (if there is NET Loss)	xxx	By Profit and Loss A/c (if there is NET profit)	xxx
To Interest on Capital A/c	xxx	By Interest on Drawings	xxx
To Salary/Commission to Partner A/c	xxx		
To General Reserve A/c	xxx	By Partners' Cap A/cs or Current A/cs (distribution of loss)	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. (it will come in p& L A/c)

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. This helps 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 the Value of Goodwill

The main factors affecting the value of goodwill areas follow:

1. **Nature of business:** A firm that produces high value added products or having a stable demand is able to earn more profits and therefore 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 is 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 ascertain 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 = Capital employed X NRR/100

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

(ii) Super profits = Average profits/Actual profit - Normal Profits

(iii) Multiply the super profits by the required 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

Y's Capital A/c Dr. 5000

To Z's Capital A/c   5000

(Being Adjustment entry made)

Value : Sensitivity towards poor Fulfilling 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 ₹10,000 per year;

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

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

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

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 ₹15,00,000 and ₹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 (₹)	Y (₹)
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 ₹1,50,000 and ₹ 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 ₹50,000;

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

(a) If partnership deed provides for interest on capital @8% p.a. and the firm earned a profit of ₹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 ₹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 2016.

Date	**Harry (₹)**	**Ali (₹)**
2016	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 31st every year.

Guarantee of Profit

1. Ram, Mohan and Sohan are partners with capitals of ₹5,00,000, ₹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 ₹25,000, in any year. The net profit for the year ended March 31, 2016 is ₹2,00,000, before charging interest on capital.

You are required to show distribution of profit.

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

Past Adjustment

2. The net profit of X, Y and Z for the year ended March 31, 2016 was ₹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 ₹700, Y ₹500 and Z ₹300.

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

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

   (Ans: X Dr. ₹2,700, Y credit ₹2,600 and Z credit ₹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 - ₹25,000; 2013 - ₹40,000; 2014 - (₹15,000) loss; 2015 - ₹80,000; 2016 - ₹1,00,000

   Ans: ₹ 1,84,000

4. Capital employed in a business is ₹2,00,000. The normal rate of return on capital employed is 15%. During the year 2012 the firm earned a profit of ₹48,000. Calculate good will on the basis of 3 years purchase of super profit?

   (Ans: ₹54,000)

5. A business has earned average profits of ₹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 ₹10,00,000 and its external liabilities are ₹1,80,000. The normal rate of return is10%?

   (Ans: ₹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. (DELETED for 2020-21 Syllabus

***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 – liability side) Dr

Workmen's Compensation Fund A/c Dr

Investment Fluctuation Reserve A/c Dr

To Old Partners' Capital A/c (individually)

(In old profit sharing ratio)

(ii) For Losses

Old Partners' Capital A/cs Dr (individually)

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 the new partner acquires 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 ascertain the new profit sharing ratio among all the partners. This depends upon how 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 Dr B'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/CurrentA/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 withdraw old by partners A’s Capital A/c Dr B’s Capital A/c Dr To Cash/Bank A/c	**If premium amount withdraw old by partners** A’s Capital A/c Dr B’s Capital A/c Dr To Cash/Bank A/c	**If premium amount withdraw old by 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 ₹1,20,000 and ₹ 1,00,000 respectively. C is admitted for 1/5th share and he is bringing ₹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

Change in Profit Sharing Ratio among the existing Partners

Sometimes, the partners of a firm decide to change their existing profit sharing ratio without any admission or retirement of a partner. This result in a gain of additional share in future profits of the firm for some partner while a loss of a part there of for other partners. 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 in case 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 ₹ 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 (₹)	Particulars	Amount (₹)

To claim for damages To Machinery To Furniture	1,000 12,000 3,500	By Creditors By Oldpartners A .... B	500 ....
	16,500		16,500

Dr. **Bank/Cash A/c** Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2016 March 31	To Balance b/d To C's capital a/c To Premium a/c	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	....
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 .... A .... B .... C .... Creditors	 .... 1,000 99,500	Cash/Bank Debtors Stock Machines Furniture	.... 40,000 50,000 1,08,000 31,500

	....		....

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 ₹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 ₹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, 2016 (before Chintan's admission) was as follows:

Dr. **Balance Sheet as at 31-12-2016** **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 ₹12,000 as his share of goodwill premium.

ii) Buildings were valued at ₹45,000 and Machinery at ₹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: Gain on Revaluation ₹2,520. Balance Sheet ₹1,44,520).

Change in profit sharing ratio

1. 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, 2017. Their Balance Sheet as on March 31, 2017 was as follows:

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

It was also decide that:

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

a) With the consent of the all the partners
b) As per the terms of the partnership agreement
c) 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 ratio (in some cases).
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 ratio between partners A, B, & C is 4:5:6. So new ratio 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 ratio 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 ratio 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 (in gaining ratio)

To Retiring or Deceased partner capital a/c (With his/her share of Goodwill)

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 ₹ 60000. Pass necessary journal entry.

Sol:-

B's Capital a/c	Dr 15000
C's Capital a/c	Dr 15000
To A's Capital/c	30000

(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=30,000.

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 ₹ 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 30,000. Pass necessary journal entry

Q. 8. Jasdeep, Preet and Sanjay are partners with equal profit sharing ratio. Jasdeep decided to retire from the firm and new ratio is fixed as 5:3.Share of Goodwill of Roman 80,000.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 and if 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 2017 their Balance Sheet was as under:

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

N retired on 31st March 2017 and it was agreed that:

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

(ii) Machinery be valued at ₹1, 40,000; Patents at ₹40, 000 and Property at ₹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	(₹)	Particulars	(₹)
To Machinery	10,000	By Patents	10,000
To Profit transferred to Capital A/c: L 15,000 M 10,000 N 5,000	30,000	By Property	30,000
	40,000		40,000

Dr. Partners' Capital a/cs Cr.

Particulars	L	M	N	Particulars	L	M	N

To N's Loan a/c To balance c/d	 1,80,000	 1,45,000	85,000	By balance b/d By General Reserve By Profit on Revaluation	1,50,000 15,000 15,000	1,25,000 10,000 10,000	75,000 5,000 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: L 1,80,000 M 1,45,000 N 's Loan a/c Creditors	 85,000 1,50,00 0	Property Patents Machinery Stock Bank	1,50,000 40,000 1,40,000 1,90,000 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 Sundry Creditors Capitals: X 78,750 Y 70,000 Z 61,250	1,300 15,000 2,10,000	Cash at bank Debtors Stock Machinery Land and Building	10,000 16,000 20,300 60,00 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 ₹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 ₹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 28th February 2014. 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 2012, 2013 and 2014 were ₹ 7,000, ₹ 8,000 and ₹ 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 ₹ 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 yea₹ R dies on 1st January, 2015. The firm's profits for the last years 2011: ₹1, 20,000, 2012:₹ 80,000, 2013: ₹ 40,000, 2014: ₹ 80,000.Determine the amount that should be credited to R in respect of his share of goodwill.

Answer : Share of Goodwill= 60,000.

Calculation of the amount payable to the representative of deceased partner (2020- 2021 SYLLABUS ONLY CALCULATION NO DECEASED PARTNER CAPITAL ACCOUNT)

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

A. The balance standing on the credit of the deceased partner capital and current account
B. His share of profit in the goodwill of the firm.
C. His share of profit in the revaluation of assets and liabilities
D. His share of reserve and accumulated profit
E. His share of profit upto the date of death
F. 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 on 31st of March, 2013 stood as follows:

Particulars	(₹)	Particulars	(₹)
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 ₹ 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:

2000-2011	₹ 8,200
2001-2012	₹ 9,000
2002-2013	₹ 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	(₹)	Date	Particulars	(₹)
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 = ₹ 300

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

(iii) Share of Profit = 1,20,000 x 10/100 = ₹ 12,000 Bharti's Share = 2/6 x 12,000 = ₹ 4,000 (iv) Total Profit of Last 3 years :

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

Twice Profit = 27,000 x 2 = ₹ 54,000

Less: 20% of 54,000 = ₹ 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 1st 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: ₹ 15,000: 2012: ₹ 13,000; 2013; ₹ 12,000; 2014: ₹ 15,000 and 2015: ₹ 20,000.

(b) Patents be valued at ₹ 8,000; Machinery at ₹ 28,000; Buildings at ₹ 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 ₹ 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 General Reserve Capitals: Archana- 1,00,000 Bindu - 70,000 Charu - 70,000	200000 300000 240000	Cash Debtors Stock Furniture Land & Building	20,000 18,000 60,000 52,000 1,50,000
	290000		290000

Bindu died on the above date and the executors were paid in the following manner: a) Bindu's Share of Goodwill was ₹ 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 ₹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 31st March, 2015 their balance sheet was as follow:-

Virat's loan a/c

Liabilities	Amount	Assets	Amount
 Capital accounts: X 75,000 Y 62,500 Z 37,500 Creditors	 175000 42,000	Building Patents Machinery Stock Debtors Cash at Bank	50,000 15,000 75,000 37,500 20,000 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
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 31st January 2016.

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

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

DISSOLUTION OF PARTNERSHIP FIRM

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

(Except partner'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 ₹80, 000.
2. Firm paid ₹40, 000 as compensation to employees.
3. Sundry creditors amounted to ₹36, 000 which were settled at a discount of 15%.
4. There was an unrecorded bike of ₹40, 000 which was taken over by partner "B" at ₹30, 000.
5. Profit on realisation of ₹ 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 (Being stock is taken over by "A")		80,000
Realisation a/c Dr.	40,000	
To bank a/c (Being compensation paid to employee)		40,000
Realisation a/c Dr	30,600	
To Bank a/c (Being stock is taken over by "A")		30,600
B's capital a/c Dr.	30,000	
To Realisation a/c (Being bike is taken over by "B")		30,000
Realisation a/c Dr. To A capital a/c To B capital a/c	42000	 24,000 18,000

(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 Palak 20,000 Creditors	 30,000 10,000	Building Machinery Furniture Stock Sundry Debtors Cash at bank	17,000 8,000 2,000 4,500 5,500 3,000
	40,000		40,000

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

Close the books of accounts.

Ans.

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

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

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

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

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

Particulars	Amount	Particulars	Amount

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

a. Loan of ₹ 10,000 advanced by a partner to the firm repaid on the dissolution of the firm
b. X, a partner takes over an unrecorded asset (typewriter) at ₹ 300
c. Undistributed balance (debit) of profit and loss account ₹ 30,000. The firm has three partners X, Y and Z.
d. The assets of the firm realized ₹ 1, 25,000.
e. Y who undertakes to carry out the dissolution proceeding is paid ₹ 2,000 for the same.
f. Creditors paid ₹28, 000 in full settlement of their account of ₹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 ₹12, 000 is paid.
2) Stock worth ₹6, 000 is taken over by partner B.
3) Expenses on dissolution amounted to ₹1, 500 and were paid by partner A.
4) A typewriter completely written off in the books of accounts was sold for ₹ 200.
5) Loss on Realisation is of ₹ 14,000.
6) There was a balance of ₹ 21,000 in the general reserve account on the date of dissolution.
7) B also agrees to take over the creditor of ₹ 30,000 for ₹ 20,000.
8) A, one of the partners has given loan to the firm of ₹ 10, 000. It was paid back to him at the time of dissolution.
9) Profit and loss account balance of ₹ 56,000 appeared on the assets side of the balance sheet.
10) Deferred revenue advertising expenditure appeared at ₹28, 000.
11) An unrecorded investment realized ₹ 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.**

Particulars	Amount	Particulars	Amount
To Sundry Assets A/c: Machinery 76,000 Stock 34,000 Investments 30,000 Debtors 5.730 To Bank A/c-Creditors To A's Capital A/c-Expenses	 1,34,730 1,800	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
	1,70,740		1,70,740

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

Particualrs	A	B	Particulars	A	B
To Realisation A/c To Bank A/c	 1,12,070	9,720	By____________ By_____________ By Bank A/c	....	 7,650
	1,25,030	9,720		1,25,030	9,720

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

Particulars	₹	Particulars	₹
To _______ To realization A/c (assets realized) To B's capital A/c	 .... 1,24,910 7,650	By _________ By A's capital A/c	 1,12,070
	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:

Balance Sheet

Liabilities	₹	Assets	₹

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 ₹ 450 less. Stock was realized in full while debtors worth ₹ 300 proved bad. Expenses of Realisation were ₹ 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 ₹ 1, 50,000. The liabilities of the firm were as follows:

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

[Ans. Realisation loss ₹ 30,000; Ramesh brings in ₹ 2,500 and Mahesh is paid ₹ 22,500; Total of cash A/c ₹ 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 ₹ 20,000, cash being ₹1000 and in the course of dissolution a contingent liability of ₹ 2,650 not brought into the accounts matured and to be met. Their capitals stood at ₹ 12,000; ₹ 10,000; and 18,000 respectively. X had lent to the firm in addition to capital ₹ 14,000. The assets realize₹ 44,150.

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

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

Q. 7. X, Y and Z are partners sharing profits and losses in the ratio of 3:2:1. On 30th 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

Liabilities	₹	Assets	₹

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

Y reports the result of Realisation as follows:

Sundry Debtors ₹ 12,000, Stock ₹ 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 ₹ 380 Which Y, met personally. Prepare necessary Ledger Accounts.

[Ans. Realisation loss ₹ 66,000.Final Payment to X ₹ 56,250; Y ₹ 20,425. Cash brought in by Z ₹ 12,210. Total of Bank A/c ₹ 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	**₹**	**Assets**	**₹**
Creditors Capitals: X 1,20,000 Y 90,000 Z 60,000	34,000 2,70,000	Cash Stock Debtors Tools Car Machinery Buildings	25,000 62,000 37,000 8,000 12,000 60,000 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 ₹ 40,000, Tools ₹ 5,000. Machinery ₹ 78,000, Buildings ₹ 84,000. Car ₹ 25,000, Goodwill ₹ 60,000, Debtors ₹ 59,000. Creditors were settled at a discount of ₹ 720. There was unrecorded asset valued at ₹ 3,000, which was handed over to X for ₹ 2,000.Prepare Realisation account, cash account and partner's capital accounts.

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NOTE : Capital Adjustment in Admission & Retirement of Partner will not be tested for the year 2020-2021