CHAPTER 1

Financial Statements of Not-for-Profit Organisations

MEANING OF KEY TERMS USED IN THE CHAPTER

1. Not-for-Profit Organisations	Not-for-Profit Organisations are those organisations whose objective is not to earn profit but to render services to its members and to the society.
2. Receipts and Payments Account	Receipts and Payments Account is a summary of cash and bank transactions prepared at the end of the accounting period. It records all receipts and payments, whether of revenue or capital nature, and irrespective of the period to which they relate.
3. Income and Expenditure Account	Income and Expenditure Account is the summary of income and expenditure of the year. *It is like Profit and Loss Account.* It shows *surplus or deficit*. It is prepared on accrual basis of accounting.
4. Surplus	Excess of income over expenditure of a Not-for-Profit Organisation is termed as **surplus**.
5. Deficit	Excess of expenditure over income of a Not-for-Profit Organisation is termed as **deficit**.
6. Subscription	Amount received on an annual basis at the time of renewal of the membership by a non-profit organisation is subscription.
7. Legacy	Legacy is the amount received by an organisation from a deceased person under his will.
8. Donation	It is the amount donated to the organisation in cash or kind.
(a) **General Donation**	When the donor does not specify any condition for using the amount of donation, it is known as **general donation**.
(b) **Specific Donation**	If the donation is for a specific purpose, say for the construction of a room or pavilion, it is known as **specific donation**.
9. Entrance Fee/ Admission Fee	The amount paid by a person at the time of becoming member of a Not-for-Profit Organisation.
10. Life Membership Fee	It is the amount received from a member in lump sum for which he is given the membership of the organisation for the whole life.
11. Fund Based Accounting	It is a system of accounting whereby donations, incomes, etc., relating to a particular fund is credited to it and expenses are debited.

CHAPTER SUMMARY

- **Not-for-Profit (Non-trading) Organisations** are those organisations, which are set-up not for earning profits but for rendering services to public and/or members. Examples are: schools, hospitals, literary societies, etc. These organisations do not prepare Profit and Loss Account but instead prepare Receipts and Payments Account and Income and Expenditure Account.
- **Receipts and Payments Account** is a summary of transactions appearing in the Cash Book showing receipts and payments during an accounting period under appropriate heads of accounts.
- **Income and Expenditure Account** is an account drawn to show the results of the activities of such organisations. It is drawn on the same lines as the Profit and Loss Account.

- **Fund Based Accounting:** If an organisation has established a fund for a specific purpose or has received donation for specific purpose. It is credited to a separate Fund Account. The expenses relating to it and income from it are debited and credited respectively to that fund.
  Credit balance in the Fund Account is shown in the liabilities side of the Balance Sheet. In case, the balance in Fund Account (Other than Fund for Assets) is debit, it is transferred (debited) to Income and Expenditure Account.

Treatment of Special Items

- **Entrance Fee/Admission Fee:** Entrance Fee/Admission Fee is a revenue receipt and therefore accounted as an income and credited to Income and Expenditure Account.
- **Life Membership Fee:** These receipts are of non-recurring nature and should be added to Capital Fund in the Balance Sheet.
- **Special Receipt:** It is not credited to Income and Expenditure Account but is shown in the liabilities side of the Balance Sheet. Example: Contribution towards Annual Dinner. Expense incurred against Special Receipt is written off against it. Balance, if any, is transferred to Income and Expenditure Account.
- **General Donations:** General donations are credited to Income and Expenditure Account.
- **Specific Donations:** Specific donations are shown in the liabilities side of the Balance Sheet.
- **Legacy:** Legacy is the amount received as donation by a Not-for-Profit Organisation under will of a deceased person. When donor does not specify conditions for its use, it is accounted as revenue receipt and credited to Income and Expenditure Account. But if a condition is specified for its use, it is accounted as capital receipt and credited to a Specific Fund Account maintained for the purpose.
- **Sale of Assets:** Gain (Profit) on sale of assets is credited to Income and Expenditure Account and loss is debited to Income and Expenditure Account.
- **Sale of Old Sports Materials Already Written Off** is credited to Income and Expenditure Account.
- **Subscriptions:** It is accounted as income. Current year's subscriptions are calculated as follows:

	Subscriptions Received during the year		...
Add:	Subscriptions outstanding for the year	...	
	Subscriptions received in advance in the beginning of the year	...	...
			...
Less:	Subscriptions outstanding in the beginning of the year	...	
	Subscriptions received in advance at the end of the year	...	...
			...

- **Consumption of 'Consumable Goods' to be shown in the Income and Expenditure Account**
  Consumed Goods = Opening Stock of Consumable Goods + Purchases – Closing Stock.

Solved Questions

Illustration 1.

How will you deal with the following items while preparing the Income and Expenditure Account for the year ending on 31st March, 2012:

Particulars	*As at 1st April, 2011* (₹)	*As at 31st March, 2012* (₹)
Creditors for Sports Materials	2,000	1,300
Stock of Sports Materials	3,000	500

During 2011–12, the payment made to these creditors was ₹ 10,800. There were no cash purchases of sports material. *(MSE Chandigarh 2015)*

Solution: *Calculation of Credit Purchase of Sports Material:*

Dr. CREDITORS FOR SPORTS MATERIAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Cash A/c	10,800	By Balance *b/d*	2,000
To Balance *c/d*	1,300	By Stock of Sports Material A/c (Credit Purchases) (Balancing Figure)	10,100
	12,100		12,100

INCOME AND EXPENDITURE ACCOUNT (AN EXTRACT)

Dr. *for the year ended 31st March, 2012* *Cr.*

Expenditure		₹	Income	₹
To Sports Materials Consumed:				
Opening Stock	3,000			
Add: Purchase	10,100			
	13,100			
Less: Closing Stock	500	12,600		

Illustration 2.

From the following information of a Not-for-Profit organisation, show the Sports Material items in the Income and Expenditure Account for the year ending 31st March, 2009:

Particulars	*As at 31st March, 2008* (₹)	*As at 31st March, 2009* (₹)
Stock for Sports Material	2,200	5,800
Creditors for Sports Material	7,800	9,200
Advance to Suppliers for Sports Material	15,000	25,000

Payment to suppliers for the sports material during the year was ₹ 1,20,000, there were no cash purchases made. *(KVS 2015)*

Solution:

AN EXTRACT OF INCOME AND EXPENDITURE ACCOUNT

Dr. *for the year ended 31st March, 2009* *Cr.*

Expenditure	₹	Income	₹
To Sports Material Consumed	1,07,800		

Working Notes:

1. *Dr.* CREDITORS FOR SPORTS MATERIAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d* (Advance)	15,000	By Balance *b/d*	7,800
To Bank A/c	1,20,000	By Stock of Sports Material A/c (Credit Purchase) (*Bal. Fig.*)	1,11,400
To Balance *c/d*	9,200	By Balance *c/d* (Advance)	25,000
	1,44,200		1,44,200

2. *Dr.* STOCK OF SPORTS MATERIAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	2,200	By Income and Expenditure A/c (Bal. Fig.) (*Sports Material Consumed*)	1,07,800
To Creditors for Sports Material A/c (Transfer)	1,11,400	By Balance *c/d*	5,800
	1,13,600		1,13,600

Illustration 3.

Show how are the following items dealt with while preparing the final accounts for the year ending on 31st March, 2019 in each of the following alternative cases:

Case 1. Prize awarded ₹ 12,000.

Case 2. Prize awarded ₹ 12,000, Prize Fund as at 31st March, 2018 ₹ 25,000.

Case 3. Prize awarded ₹ 12,000, Prize Fund as at 31st March, 2018 ₹ 25,000. Donation received for prizes during the year 2018–19 ₹ 10,000, Prize Fund Investment at 31st March, 2018 ₹ 25,000, interest received on 10% Prize Fund Investment ₹ 2,500. *(CBSE 2007, Modified)*

Solution:

Case 1.

INCOME AND EXPENDITURE ACCOUNT
for the year ended 31st March, 2019

Dr. *Cr.*

Expenditure	₹	Income	₹
To Prize Awarded	12,000		

Case 2.

BALANCE SHEET *as at 31st March, 2019*

Liabilities		₹	Assets	₹
Prize Fund—Opening Balance	25,000			
Less: Prize Awarded	12,000	13,000		

Case 3.

BALANCE SHEET *as at 31st March, 2019*

Liabilities		₹	Assets	₹
Prize Fund—Opening Balance	25,000		10% Prize Fund Investment	25,000
Add: Donation Received	10,000			
Int. on Prize Fund Investment	2,500			
	37,500			
Less: Prize Awarded	12,000	25,500		

Note: When a specific fund has been created, it is shown in the liabilities side and investment out of specific fund is shown in the assets side of the Balance Sheet. Any receipt relating to fund is added to the fund and related expenses are deducted from the fund.

Illustration 4.

Show the following information in the Balance Sheet of the Cosmos Club as on 31st March, 2019:

Particulars	Dr. (₹)	Cr. (₹)
Tournament Fund		1,50,000
Tournament Fund Investment	1,50,000	
Income from Tournament Fund Investment		18,000
Tournament Expenses	12,000	

Additional Information: Interest Accrued on Tournament Fund Investment ₹ 6,000.

(*CBSE Sample Paper 2008, Modified*)

Solution:

Cosmos Club

BALANCE SHEET *as at 31st March, 2019*

Liabilities		₹	Assets	₹
Tournament Fund	1,50,000		Tournament Fund Investment	1,50,000
Add: Income from Tournament Fund Investment	18,000		Accrued Interest on Tournament Fund Investment	6,000
Accrued Interest on Tournament Fund Investment	6,000			
	1,74,000			
Less: Tournament Expenses	12,000	1,62,000		

Notes:

1. All incomes pertaining to Tournament Fund are added and expenses are deducted from Tournament Fund.
2. Accrued interest on Tournament Fund Investment will be added to fund and also shown as an asset.

Illustration 5.

Subscription received during the year 2018–19	₹ 50,000
Subscription outstanding at the closing of 2018–19	₹ 8,000
Subscription outstanding at the beginning of 2018–19	₹ 6,000

Calculate the amount of subscription to be credited to Income and Expenditure Account for the year 2018–19. *(CBSE 2006, Modified)*

Solution:

Calculation of subscription to be credited to Income and Expenditure Account:

Particulars	₹
Subscription received during the year	50,000
Add: Outstanding at the end of 2018–19	8,000
	58,000
Less: Outstanding at the beginning of 2018–19	6,000
Amount to be credited to Income and Expenditure A/c	52,000

Illustration 6.

From the following extracts of the Receipts and Payments Account and the additional information, you are required to compute the income from subscription for the year ended 31st March, 2019 and show the subscription item in the Final Accounts of the club:

RECEIPTS AND PAYMENTS ACCOUNT
for the year ended 31st March, 2019

Dr. *Cr.*

Receipts	₹	Payments	₹
To Subscriptions	10,000		

Additional Information: ₹

(i) Subscription outstanding on 31st March, 2018 2,000
(ii) Subscription outstanding on 31st March, 2019 4,000
(iii) Subscription received in advance on 31st March, 2018 3,000
(iv) Subscription received in advance on 31st March, 2019 2,000

(CBSE 2007, Modified)

Solution:

Dr. INCOME AND EXPENDITURE ACCOUNT *for the year ended 31st March, 2019* *Cr.*

Expenditure	₹	Income		₹
		By Subscription	10,000	
		Add: Outstanding (31st March, 2019)	4,000	
			14,000	
		Less: Outstanding (31st March, 2018)	2,000	
			12,000	
		Less: Advance (31st March, 2019)	2,000	
			10,000	
		Add: Advance (31st March, 2018)	3,000	13,000

BALANCE SHEET *as at 31st March, 2019*

Liabilities	₹	Assets	₹
Advance Subscription	2,000	Subscription Outstanding	4,000

Illustration 7.

From the following information, compute the outstanding subscription for the year 2012:

		₹
(i)	A club has 70 members, each paying annual subscription of	1,000
(ii)	Subscription received during 2012	70,000
(iii)	Subscription received in advance as at 31st December, 2011	12,000
(iv)	Subscription received in advance as at 31st December, 2012	11,000
(v)	Subscription outstanding as at 31st December, 2011	16,000
(vi)	Subscription of ₹ 8,000 are still in arrears for the year 2011	

(*MSE Chandigarh 2015*)

Solution:

Dr. SUBSCRIPTION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Outstanding Subscription A/c (in the beginning)	16,000	By Advance Subscription A/c (in the beginning)		12,000
To Income and Expenditure A/c (₹ 1,000 × 70)	70,000	By Bank A/c		70,000
		By Outstanding Subscription A/c:		
To Advance Subscription A/c	11,000	(at the end) For 2011	8,000	
		For 2012 (Bal. Fig.)	7,000	15,000
	97,000			97,000

Illustration 8.

In 2018–19, the actual salaries paid amounted to ₹ 10,200. Ascertain the amount chargeable to Income and Expenditure Account for the year ending on 31st March, 2019 from the following:

Particulars	₹
Prepaid Salaries on 31st March, 2018	1,200
Prepaid Salaries on 31st March, 2019	600
Outstanding Salaries on 31st March, 2018	900
Outstanding Salaries on 31st March, 2019	750

(*CBSE 2006, Modified*)

Solution: *Calculation of amount of salaries chargeable to Income and Expenditure Account:*

Particulars	₹
Total Salaries paid in 2018–19	10,200
Add: Outstanding Salaries on 31st March, 2019	750
	10,950
Less: Outstanding Salaries on 31st March, 2018	900
	10,050
Less: Prepaid Salaries on 31st March, 2019	600
	9,450
Add: Prepaid Salaries on 31st March, 2018	1,200
Salaries debited to Income and Expenditure Account for the year ended 31st March, 2019	10,650

Illustration 9.

From the following Receipts and Payments Account of Sonic Club and from the additional information, compute the amount of salaries for the year 2018–19 to be shown in Income and Expenditure Account and in the Balance Sheet of 2017–18 and of 2018–19:

AN EXTRACT OF RECEIPTS AND PAYMENTS ACCOUNT

Dr. *for the year ended 31st March, 2019* *Cr.*

Receipts	₹	Payments		₹
		By Salaries:		
		2017–18	20,000	
		2018–19	2,80,000	
		2019–20	18,000	3,18,000

Additional Information:

		₹
(i)	Salaries outstanding on 31st March, 2018	25,000
(ii)	Salaries outstanding on 31st March, 2019	45,000
(iii)	Salaries paid in advance as on 31st March, 2018	10,000

Solution:

Sonic Club

BALANCE SHEET (AN EXTRACT) *as at 31st March, 2018*

Liabilities	₹	Assets	₹
Outstanding Salaries	25,000	Prepaid Salaries	10,000

INCOME AND EXPENDITURE ACCOUNT

Dr. *for the year ended 31st March, 2019* *Cr.*

Expenditure		₹	Income	₹
To Salaries	3,18,000			
Less: Outstanding (2017–18)	20,000			
	2,98,000			
Less: Prepaid (2019–20)	18,000			
	2,80,000			
Add: Outstanding for 2018–19 (Note)	40,000			
	3,20,000			
Add: Prepaid (31.3.2018)	10,000	3,30,000		

BALANCE SHEET (AN EXTRACT) *as at 31st March, 2019*

Liabilities		₹	Assets	₹
Outstanding Salaries:			Prepaid Salaries	18,000
For 2017–18 (₹ 25,000 – ₹ 20,000)	5,000			
For 2018–19 (₹ 45,000 – ₹ 5,000)	40,000	45,000		

Note:

	₹
Outstanding Salaries on 31st March, 2019	45,000
Less: Salary still outstanding for 2017–18 (₹ 25,000 – ₹ 20,000)	5,000
Thus, Outstanding salaries for 2018–19 must be	40,000

Illustration 10.

From the following information, prepare Income and Expenditure Account of the Club for the year ended 31st March, 2013 and ascertain the Capital Fund on 31st March, 2012:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *for the year ended 31st March, 2013* *Cr.*

Receipts		₹	Payments	₹
Balance *b/f*		39,100	Salary	6,000
Subscriptions:			Newspapers	4,100
2011–2012	2,400		Electricity Bill	2,000
2012–2013	53,000		Fixed Deposit (on 1.7.2012 @ 9% p.a.)	40,000
2013–2014	1,000	56,400	Books	21,200
Sale of Old Newspapers		2,500	Rent	13,600
Government Grants		20,000	Furniture	21,000
Sale of Old Furniture (Book value ₹ 8,000)		11,400	Balance *c/f*	22,400
Interest on Fixed Deposits		900		
		1,30,300		1,30,300

Additional Information:

(i) Subscriptions outstanding as on 31st March, 2012 were ₹ 4,000 and on 31st March, 2013 were ₹ 5,000.

(ii) On 31st March, 2013, Outstanding Salary was ₹ 1,200 and Outstanding Rent was ₹ 2,400.

(iii) The Club owned Furniture ₹ 30,000 and Books ₹ 14,000 on 1st April, 2012.

(*MSE Chandigarh 2015*)

Solution:

Dr. INCOME AND EXPENDITURE ACCOUNT *for the year ended 31st March, 2013* *Cr.*

Expenditure		₹	Income		₹
To Salary	6,000		By Subscription (WN 1)		56,400
Add: Outstanding (31.3.2013)	1,200	7,200	By Sale of Old Newspapers		2,500
To Newspapers		4,100	By Government Grants		20,000
To Electricity Bill		2,000	By Gain (Profit) on Sale of Furniture		3,400
To Rent	13,600		By Interest on Fixed Deposits	900	
Add: Outstanding (31.3.2013)	2,400	16,000	*Add:* Accrued Interest	1,800	2,700
To Surplus (Excess of Income over Expenditure)		55,700			
		85,000			85,000

Calculation of Capital Fund on 31st March, 2012:

BALANCE SHEET *as at 31st March, 2012*

Liabilities	₹	Assets	₹
Capital Fund (Bal. Fig.)	87,100	Bank	39,100
		Subscription Due	4,000
		Furniture	30,000
		Books	14,000
	87,100		87,100

Working Notes:

1. *Dr.* SUBSCRIPTION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Outstanding Subscription A/c	4,000	By Bank A/c (Total Subscription)	56,400
To Income and Expenditure A/c (*Bal. Fig.*)	56,400	By Outstanding Subscription A/c (at the end)	5,000
To Advance Subscription A/c (at the end)	1,000		
	61,400		61,400

2. Government Grants being not for specific purpose are treated as **Revenue Receipts** and thus, are credited to Income and Expenditure Account.

Illustration 11.

From the following Receipts and Payments Account of Sonic Club and from the given additional information, prepare Income and Expenditure Account for the year ending 31st December, 2006 and the Balance Sheet as at that date:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *for the year ended 31st December, 2006* *Cr.*

Receipts	₹	Payments	₹
To Balance *b/d*	1,90,000	By Salaries	3,30,000
To Subscriptions	6,60,000	By Sports Materials	4,00,000
To Interest on Investments @ 8% p.a. for full year	40,000	By Balance *c/d*	1,60,000
	8,90,000		8,90,000

Additional Information:

(i) The club had received ₹ 20,000 for subscription in 2005 for 2006.

(ii) Salaries had been paid only for 11 months.

(iii) Stock of Sports Materials on 31st December, 2005 was ₹ 3,00,000 and on 31st December, 2006 ₹ 6,50,000. (*KVS 2015*)

Solution:

Sonic Club

Dr. INCOME AND EXPENDITURE ACCOUNT *for the year ended 31st December, 2006* *Cr.*

Expenditure		₹	Income		₹
To Salaries	3,30,000		By Subscription	6,60,000	
Add: Outstanding Salaries	30,000	3,60,000	*Add:* Received in 2005	20,000	6,80,000
To Sports Material:			By Interest on Investments		40,000
Opening Stock	3,00,000				
Add: Purchases	4,00,000				
	7,00,000				
Less: Closing Stock	6,50,000	50,000			
To Surplus (*i.e.*, Excess of Income over Expenditure)		3,10,000			
		7,20,000			7,20,000

BALANCE SHEET *as at 31st December, 2006*

Liabilities		₹	Assets	₹
Outstanding Salaries		30,000	Cash	1,60,000
Capital Fund (WN)	9,70,000		Stock of Sports Materials	6,50,000
Add: Surplus	3,10,000	12,80,000	Investments	5,00,000
		13,10,000		13,10,000

Working Note:

Calculation of Capital Fund on 1st January, 2006:

BALANCE SHEET *as at 1st January, 2006*

Liabilities	₹	Assets	₹
Subscription Received in Advance	20,000	Cash	1,90,000
Capital Fund (*Balancing Figure*)	9,70,000	Stock of Sports Material	3,00,000
		Investments (₹ 40,000 × 100/8)	5,00,000
	9,90,000		9,90,000

Illustration 12.

Following amounts relate to a Charitable Hospital:	₹
Stock of medicines on 1st April, 2017	50,000
Creditors for medicines on 1st April, 2017	1,00,000
Medicines purchased during 2017–18	1,20,000
Value of medicines of due date expired during the year	5,000
Stock of medicines on 31st March, 2018	25,000

What amount of medicines consumed during the year ended 31st March, 2018 is debited to Income and Expenditure Account?

Solution:

	₹
Opening Stock of Medicines during the year	50,000
Add: Medicines purchased during the year	1,20,000
	1,70,000
Less: Closing Stock of Medicines	25,000
Amount to be debited to Income and Expenditure Account	1,45,000

Note: Value of medicines due date of which expired will not be considered because stock of medicines has already been reduced by this amount.

Illustration 13.

Following is the Receipts and Payments Account of Excellent Recreation Club for the year ended 31st March, 2018:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Receipts	₹	Payments	₹
To Cash in Hand	500	By Salaries	24,000
To Cash at Bank	5,650	By Rent	7,200
To Subscriptions	45,500	By Postage	300
(including ₹ 1,000 for 2016–17 and		By Printing and Stationery	2,550
₹ 1,500 for 2018–19)		By Electricity Charges	3,000
To Interest on Investments	20,000	By Meeting Expenses	1,500
To Bank Interest	250	By Library Books	10,000
To Sale of Furniture	3,000	By Investments in Bonds	10,000
		By Cash in Hand	1,550
		By Cash at Bank	14,800
	74,900		74,900

Following additional information is also supplied to you:

(i) On 1st April, 2017, the Club had following assets and liabilities—

(a) Investments ₹ 4,00,000; (b) Furniture ₹ 30,000; (c) Library Books ₹ 50,000 and (d) Liability for Rent ₹ 600 and for Salaries ₹ 2,000.

(ii) On 31st March, 2018, rent of ₹ 800 and salaries of ₹ 2,500 were in arrears.

(iii) The book value of furniture sold was ₹ 2,500.

Prepare Income and Expenditure Account of the Club for the year ended 31st March, 2018 and Balance Sheet as at that date.

Solution:

Excellent Recreation Club
INCOME AND EXPENDITURE ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Expenditure	₹	Income			₹
To Salaries (WN 2)	24,500	By Subscriptions:		45,500	
To Rent (WN 3)	7,400	*Less:* Subscriptions:			
To Postage	300	For 2016–17	1,000		
To Printing and Stationery	2,550	For 2018–19	1,500	2,500	43,000
To Electricity Charges	3,000	By Interest on Investments			20,000
To Meeting Expenses	1,500	By Bank Interest			250
To Excess of Income over Expenditure		By Gain (Profit) on Sale of Furniture			500
(Surplus) transferred to Capital Fund	24,500	(₹ 3,000 – ₹ 2,500)			
	63,750				63,750

BALANCE SHEET *as at 31st March, 2018*

Liabilities		₹	Assets		₹
Subscriptions Received in Advance		1,500	Furniture	30,000	
Outstanding Liabilities for:			*Less:* Sale during the year	2,500	27,500
Salaries	2,500		Library Books	50,000	
Rent	800	3,300	Addition during the year	10,000	60,000
Capital Fund as at 1st April, 2017	4,84,550		Investments	4,00,000	
Add: Surplus for the year	24,500	5,09,050	Addition during the year	10,000	4,10,000
			Cash at Bank		14,800
			Cash in Hand		1,550
		5,13,850			5,13,850

Working Notes:

1. BALANCE SHEET *as at 1st April, 2017*

Liabilities		₹	Assets	₹
Outstanding Liabilities for:			Furniture	30,000
Salaries	2,000		Library Books	50,000
Rent	600	2,600	Investments	4,00,000
Capital Fund		4,84,550	Cash at Bank	5,650
(Balancing Figure)			Cash in Hand	500
			Subscriptions in Arrears	1,000
		4,87,150		4,87,150

		₹
2.	Salaries paid during the year	24,000
	Less: Salaries outstanding (1st April, 2017)	2,000
		22,000
	Add: Salaries outstanding (31st March, 2018)	2,500
	Salaries to be debited to Income and Expenditure Account	24,500
3.	Rent paid during the year	7,200
	Less: Rent outstanding (1st April, 2017)	600
		6,600
	Add: Rent outstanding (31st March, 2018)	800
	Rent to be debited to Income and Expenditure Account	7,400

Illustration 14.

The Balance Sheet of Excellent Recreation Club as at 1st April, 2017 and the Receipts and Payments Account for the year ended 31st March, 2018 are:

BALANCE SHEET *as at 1st April, 2017*

Liabilities	₹	Assets	₹
Capital Fund	4,20,000	Premises	4,00,000
Creditors for Stationery	10,000	Furniture	20,000
		Bank Balance	10,000
	4,30,000		4,30,000

RECEIPTS AND PAYMENTS ACCOUNT
Dr. *for the year ended 31st March, 2018* *Cr.*

Receipts	₹	Payments	₹
To Balance *b/d*	10,000	By Electricity Charges	12,000
To Subscriptions	86,000	By Furniture	30,000
To Donations	33,000	By Salaries	60,000
To Sundry Receipts	27,500	By Creditors for Stationery	25,000
		By General Expenses	21,000
		By Balance *c/d*	8,500
	1,56,500		1,56,500

Additional Information:

(i) On 30th September, 2017, old furniture was donated to the Red Cross and new furniture was purchased on 1st October, 2017. Depreciation @ 10% p.a. is to be provided on the furniture.

(ii) On 31st March, 2018, creditors for stationery were ₹ 4,800 and the value of the unused stationery was ₹ 5,400.

(iii) A payment of ₹ 5,000 for stationery by the Club was to be debited to the General Expenses.

You are required to prepare Income and Expenditure Account for the year ended 31st March, 2018 and Balance Sheet as at that date.

Solution:

Excellent Recreation Club
INCOME AND EXPENDITURE ACCOUNT
Dr. *for the year ended 31st March, 2018* *Cr.*

Expenditure		₹	Income	₹
To Electricity Charges		12,000	By Subscriptions	86,000
To Salaries		60,000	By Donations	33,000
To General Expenses	21,000		By Sundry Receipts	27,500
Add: Stationery Consumed	5,000	26,000		
To Stationery Consumed (WN 2)		9,400		
To Furniture (Donated to Red Cross)		20,000		
To Depreciation on Furniture (@ 10% p.a. on ₹ 30,000 for 6 months)		1,500		
To Surplus—Excess of Income over Expenditure		17,600		
		1,46,500		1,46,500

BALANCE SHEET *as at 31st March, 2018*

Liabilities		₹	Assets		₹
Creditors for Stationery		4,800	Cash at Bank		8,500
Capital Fund	4,20,000		Stock of Stationery		5,400
Add: Surplus—Excess of Income			Premises		4,00,000
over Expenditure	17,600	4,37,600	Furniture	30,000	
			Less: Depreciation	1,500	28,500
		4,42,400			4,42,400

Working Notes:

1. *Dr.* CREDITORS FOR STATIONERY ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2018			2017		
?	To Bank A/c	25,000	April 1	By Balance *b/d*	10,000
March 31	To Balance *c/d*	4,800	2018		
			March 31	By Stock of Stationery A/c (Bal. Fig.) (Credit Purchases)	19,800
		29,800			29,800

2. CONSUMPTION OF STATIONERY

Particulars		₹
Stock of Stationery (Credit Purchases)		19,800
Less: Stationery to be debited to General Expenses	5,000	
Unused Stock on 31st March, 2018	5,400	10,400
Stationery Consumed (to be debited to Income and Expenditure Account)		9,400

Unsolved Questions

1. Compute the income from subscription for the year 2018–19 from the following particulars relating to a club:

	1st April, 2018	*31st March, 2019*
	₹	₹
Outstanding Subscription	19,000	14,000
Advance Subscription	5,600	10,400

Subscription received during 2018–19 ₹ 2,97,800.

[*Subscription Income—₹ 2,88,000.*]

2. Salaries paid by a Youth Club during 2018–19 amounted to ₹ 16,000. Information about prepaid and unpaid is given below. How will this item appear in the Income and Expenditure Account for the year ended on 31st March, 2019?

	31st March, 2018	*31st March, 2019*
	₹	₹
Prepaid Salary	1,200	2,000
Unpaid Salary	2,500	1,500

[*Salary Expenses—₹ 14,200.*]

3. How will you deal with the following items while preparing the Final Accounts of a club for the year 2018–19?

	31st March, 2018	*31st March, 2019*
	₹	₹
Outstanding Lockers Rent	4,600	6,300
Advance Lockers Rent	3,000	4,000

Lockers Rent received during the year 2018–19 ₹ 32,000.

[*Lockers Rent Income for 2018–19—₹ 32,700.*]

4. On the basis of the following information, calculate the amount of stationery to be shown in Income and Expenditure Account for the year ended 31st March, 2019:

	₹
Stock of stationery on 1st April, 2018	3,000
Creditors of stationery on 1st April 2018	2,000
Amount paid for stationery during the year	10,800
Stocks of stationery on 31st March, 2019	500
Creditors of stationery on 31st March, 2019	1,300

[*Stationery Used*—₹ *12,600.*]

5. Show how would you deal with the following items of the Cosmopolitan Club as on 31st March, 2019:

Particulars	Dr. (₹)	Cr. (₹)
Tournament Fund	...	10,000
Tournament Fund Investment	10,000	...
Income from the Tournament Fund Investment	...	1,200
Tournament Expenses	800	...

[*Closing Balance of Tournament Fund*—₹ *10,400.*]

6. Receipts and Payments Account of Friends Club showed that ₹ 6,85,000 were received by way of subscriptions for the year ended on 31st March, 2018.

The additional information was as under:

(a) Subscription outstanding as on 31st March, 2017 were ₹ 65,000.

(b) Subscription received in advance as on 31st March, 2017 were ₹ 41,000.

(c) Subscription outstanding as on 31st March, 2018 were ₹ 54,000.

(d) Subscription received in advance as on 31st March, 2018 were ₹ 25,000.

Show how the above information would appear in the final accounts for the year ended on 31st March, 2018 of Friends Club.

[*Subscription credited to Income and Expenditure Account for the year ended on 31st March, 2018 is ₹ 6,90,000. Subscription outstanding as on 31st March, 2018 is ₹ 54,000 and should be shown on the assets side of the Balance Sheet as on 31st March, 2018 and subscriptions received in advance of ₹ 25,000 as on 31st March, 2018 on the liabilities side of the Balance Sheet as on 31st March, 2018.*]

[**Hint:** *Subscription credited to Income and Expenditure Account*

= ₹ 6,85,000 + ₹ 41,000 + ₹ 54,000 – ₹ 65,000 – ₹ 25,000 = ₹ 6,90,000.]

7. Following is the Receipts and Payments Account of Literacy Club for the year ended 31st March, 2019:

Dr. *Cr.*

Receipts		₹	Payments	₹
To Balance *b/d*		19,550	By Salary	3,000
To Subscriptions:			By Newspapers	2,050
2017–18	1,200		By Electricity	1,000
2018–19	26,500		By F.D. (on 1.7.2018 @ 9% p.a.)	20,000
2019–20	500	28,200	By Books	10,600
To Sale of Old Newspapers		1,250	By Rent	6,800
To Government Grants		10,000	By Furniture	10,500
To Sale of Old Furniture (Book value ₹ 7,000)		5,700	By Balance *c/d*	11,200
To Interest on Fixed Deposits		450		
		65,150		65,150

Additional Information:

(i) Subscriptions outstanding as on 31st March, 2018 were ₹ 2,000 and on 31st March, 2019 ₹ 2,500.

(ii) On 31st March, 2019, outstanding salary was ₹ 600 and rent outstanding was ₹ 1,200.

(iii) The club owned furniture ₹ 15,000 and books ₹ 7,000 on 1st April, 2018.

Prepare Income and Expenditure Account of the club for the year ended 31st March, 2019 and ascertain Capital Fund on 31st March, 2018. (*CBSE 2008, Modified*)

[*Surplus—₹ 24,850; Capital Fund (31.3.2018)—₹ 43,550; Balance Sheet Total (31.3.2019)—₹ 70,700.*]

8. Following is the Receipts and Payments Accounts of Chennai Sports Club for the year ended 31st March, 2019:

Dr. *Cr.*

Receipts	₹	Payments	₹
Balance *b/d*	5,000	Salary	12,000
Subscriptions	26,000	Furniture	10,000
Tournament Fund	15,000	Office Expenses	8,000
Sale of Old Newspapers	2,000	Tournament Expenses	21,000
Legacy	35,000	Sports Equipments	20,000
Entrance Fees	4,000	Balance *c/d*	16,000
	87,000		87,000

Additional Information: On 31st March, 2019, subscription outstanding was ₹ 4,000 and on 31st March, 2018 subscription outstanding was ₹ 3,000. Salary outstanding on 31st March, 2019 was ₹ 2,000.

On 1st April, 2018, the club had building ₹ 80,000, furniture ₹ 20,000, 10% Investment ₹ 45,000 and Sports Equipment ₹ 25,000. Depreciation charged on these items including purchases was 10%.

Prepare Income and Expenditure Account of the club for the year ended 31st March, 2019 and ascertain the Capital Fund on 31st March, 2018. (*CBSE 2008, Modified*)

[*Surplus—₹ 29,000; Capital Fund (31.3.2018)—₹ 1,78,000; Balance Sheet Total (31.3.2019)—₹ 2,09,000; Accrued Interest on Investment is ₹ 4,500, i.e., 10% of ₹ 45,000.*]

[**Hint:** Legacy (Donation) is credited to Income and Expenditure Account, it being not for specific purpose.]

9. Subscriptions received during the year ended 31st March, 2019 by Royal Club were as under:

	₹
2017–18	3,000
2018–19	93,000
2019–20	2,000
Total	98,000

The club has 500 members each paying @ ₹ 200 as annual subscription. Subscriptions outstanding as on 31st March, 2018 were ₹ 8,000. Calculate the amount of subscriptions to be shown as income in the Income and Expenditure Account for the year ended 31st March, 2019 and show the relevant data in the Balance Sheet as at 31st March, 2019.

[**Hint:** INCOME AND EXPENDITURE ACCOUNT (AN EXTRACT)

Dr. *for the year ended 31st March, 2019* *Cr.*

Expenditure	₹	Income	₹
		By Subscription (500 × ₹ 200)	1,00,000

BALANCE SHEET (AN EXTRACT)
as at 31st March, 2019

Liabilities	₹	Assets		₹
Subscription Received in Advance	2,000	Subscriptions Outstanding:		
		2017–18	5,000	
		2018–19	7,000	12,000

]

10. There were 450 members in a club each paying an annual subscription of ₹ 50. ₹ 500 were in arrears as at 31st December, 2018. Subscriptions received during 2019 were ₹ 22,300 including ₹ 450, for 2018 and ₹ 750 for the year 2020. Calculate amount of subscriptions in arrears as at 31st December, 2019 by preparing the Subscriptions Account.

[*Subscriptions in arrears—₹ 1,450* (*2018—₹ 50 and 2019—₹ 1,400*).]

11. How will you deal with the following case while preparing the final accounts of a non-profit organisation?

	1st April, 2018 (₹)	*31st March, 2019* (₹)
Stock of Stationery	600	100
Creditors for Stationery	400	260
Advance paid for Stationery	40	60

Amount paid for stationery during 2018–19 was ₹ 2,160.

[*Amount to be posted for stationery to the Income and Expenditure A/c for 2018–19—₹ 2,500; Advance paid for stationery and stock of stationery will appear on the Assets side of the Balance Sheet and creditors for stationery on the Liabilities side of the Balance Sheet.*]

12. During 2018–19, the miscellaneous expenses paid by Young India Club were ₹ 6,500. Find out the expenses chargeable to Income and Expenditure Account for the year ended 31st March, 2019.

Additional Information	*31st March, 2018*	*31st March, 2019*
	₹	₹
Prepaid Expenses	600	800
Outstanding Expenses	1,000	1,200

[*Miscellaneous Expenses—₹ 6,500.*]

13. From the following Receipts and Payments Account, prepare Income and Expenditure Account for 2018:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *Cr.*

Receipts	₹	Payments	₹
To Balance as at 1st January, 2018:		By Salaries	3,500
Cash	550	By Rent	1,200
Bank	2,800	By Printing and Stationery	100
To Subscriptions	3,900	By Newspapers	90
including (₹ 200 for 2017 and ₹ 150 for 2019)		By Postage, etc.	130
To Investments	850	By Steel Almirahs	350
To Sale of Furniture	600	By Defence Bonds	1,000
To Sale of Old Newspapers	40	By Cash Balance (31st December, 2018)	970
To Entrance Fees	100	By Bank Balance (31st December, 2018)	2,500
To Life Membership Fees	1,000		
	9,840		9,840

[*Deficit—₹ 1,330.*]

14. Following particulars relate to Madura Club for the year ended 31st December, 2018:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *Cr.*

Receipts		₹	Payments	₹
To Balance *b/d*		60,000	By Salaries	1,24,500
To Subscriptions:			By Stationery	24,000
Arrear	2,400		By Rates and Taxes	36,000
Current	1,26,600		By Telephone	6,000
Advance	4,800	1,33,800	By Investments	75,000
To Profit from Canteen		90,000	By Advertisements	10,500
To Miscellaneous Receipts		4,500	By Postage	8,800
To Interest on Investments		10,800	By Newspapers	1,200
To Sale of Old Newspapers		400	By Sundries	35,000
To Dividends		48,500	By Balance *c/d*	27,000
		3,48,000		3,48,000

You are required to prepare Income and Expenditure Account and Balance Sheet after making the following adjustments:

(a) There are 450 members each paying an annual subscription of ₹ 300, ₹ 2,700 being in arrears for 2017 in the beginning of this year.

(b) Stock of Stationery on 31st December, 2017 was ₹ 3,000 and on 31st December, 2018 was ₹ 5,400.

(c) Cost of Building is ₹ 6,00,000. Depreciate it at 5%.

[*Surplus—₹ 15,600; Capital Fund as at 1st January, 2018—₹ 6,65,700; Balance Sheet Total—₹ 6,86,100.*]

15. From the following Receipts and Payments Account and other information given, prepare Income and Expenditure Account and Balance Sheet of the Sivaji Social Club:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *for the year ended 31st March, 2019* *Cr.*

Receipts	₹	Payments	₹
To Balance (1st April, 2018)	7,000	By Prizes	2,200
To Subscriptions	24,000	By Games Equipments	2,000
To Profit on Dance Show	14,800	By Rent	10,500
To Collections (Matches)	2,500	By Rates	3,000
To Competition Fees	1,800	By Printing	1,600
To Sales of Refreshments	8,200	By Stationery	2,200
		By Postages	1,900
		By Secretary's Expenses	1,400
		By Repairs (Equipment)	2,700
		By Wages	12,000
		By Refreshments	5,100
		By Balance (31st March, 2019)	13,700
	58,300		58,300

The following matters should be taken into account:

(a) Capital Fund as at 1st April, 2018 ₹ 42,000.

(b) Fixed Assets owned by the Club as at 1st April, 2018—Furniture and Fittings ₹ 15,000; Games Equipments ₹ 20,000. These are to be depreciated @ 10% on opening values.

(c) Amounts outstanding as at 31st March, 2019—Printing ₹ 400; Refreshments ₹ 700.

(d) On 31st March, 2019—Rent paid in advance ₹ 1,500; Subscriptions due ₹ 1,200; Subscriptions in advance ₹ 500.

[*Excess of Income over Expenditure—₹ 6,300; Balance Sheet Total—₹ 49,900.*]

16. From the following Receipts and Payments Account of Pioneer Cricket Club and the additional information given, prepare Income and Expenditure Account for the year ended 31st March, 2019 and Balance Sheet as at that date:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *for the year ended 31st March, 2019* *Cr.*

Receipts		₹	Payments		₹
To Balance *b/d:*			By Maintenance		6,820
Cash	3,520		By Crockery		2,650
Bank	27,380		By Match Expenses		13,240
6% Fixed Deposit	30,000	60,900	By Salaries		11,000
To Subscriptions		40,000	By Conveyance		820
(including ₹ 6,000 for 2017–18)			By Upkeep of Lawns		4,240
To Entrance Fees		2,750	By Postage and Stationery		1,050
To Donation		5,010	By Cricket Goods		9,720
To Interest on Fixed Deposits		900	By Sundry Expenses		2,000
To Tournament Fund		20,000	By Investments		5,700
To Sale of Crockery		2,000	By Tournament Expenses		18,800
(Book Value ₹ 1,200)			By Balance *c/d:*		
			Cash	2,200	
			Bank	23,320	
			6% Fixed Deposits	30,000	55,520
		1,31,560			1,31,560

Additional Information:

(i) Salary outstanding is ₹ 1,000.

(ii) Opening balance of stock of Postage and Stationery and Cricket goods is ₹ 750 and ₹ 3,210 respectively. Closing stock of the same is ₹ 900 and ₹ 2,800 respectively.

(iii) Outstanding Subscriptions for 2017–18 and 2018–19 are ₹ 6,600 and ₹ 8,000 respectively.

[*Surplus, i.e., Excess of Income over Expenditure—₹ 2,210; Opening Capital Fund—₹ 72,660; Balance Sheet Total—₹ 77,070.*]

17. Sweet Valley Sports Club gives you the following Receipts and Payments Account for the year ended 31st March, 2019:

Dr. RECEIPTS AND PAYMENTS ACCOUNT *Cr.*

Receipts		₹	Payments		₹
To Opening Balance:			By Rent		6,000
In Hand	3,000		By Salaries to Coaches		30,000
At Bank	30,000	33,000	By Tournament Expenses		10,000
To Subscriptions		65,000	By Office Expenses		20,000
To Tournament Receipts		20,000	By Sports Equipments		15,000
To Life Membership Fees		30,000	By Mowing Machine		12,000
To Entrance Fees		6,000	By Closing Balance:		
To Donations for Pavilion		25,000	In Hand	16,000	
			At Bank	70,000	86,000
		1,79,000			1,79,000

Subscriptions include ₹ 5,000 for 2017–18 and ₹ 4,000 were still due in respect of subscriptions for 2018–19. Sports Equipments in hand on 31st March, 2018 were ₹ 10,000. The value of the equipments in hand on 31st March, 2019 was ₹ 21,000. The mowing machine was purchased on 1st October, 2018 and is to be depreciated @ 10% p.a. Income from Tournament should be credited to a newly opened Tournament Fund.

Prepare Income and Expenditure Account of the Club for the year ended 31st March, 2019 and Balance Sheet as at that date.

[*Surplus—₹ 9,400; Capital Fund (Opening)—₹ 48,000; Balance Sheet Total—₹ 1,22,400.*]

CHAPTER 2

Accounting for Partnership Firms—Fundamentals

MEANING OF KEY TERMS USED IN THIS CHAPTER

1.	**Partnership**	Partnership is a relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
2.	**Partners**	Partners are the persons who have agreed to carry on a partnership business and share its profits and losses.
3.	**Firm**	Partners carrying on the business are collectively known as **firm**. The name under which the business is carried on is called **firm name**.
4.	**The Partnership Act, 1932**	It is an Act that governs the partnership firms. In case, Partnership Deed is silent on an issue, provisions of the Indian Partnership Act, 1932 are applied.
5.	**Partnership Deed**	Partnership Deed is a written agreement among the partners detailing the terms and conditions of the partnership.
6.	**Capital**	Capital is the amount contributed by the partners in the firm. Capital may be fixed or fluctuating.
7.	**Fixed Capitals**	Fixed Capitals mean that capitals of the partners remain fixed and change with the introduction or withdrawal of capital. When capitals are fixed two accounts for each partner are maintained, *i.e.*, Capital Account and Current Account.
8.	**Fluctuating Capitals**	Fluctuating Capitals mean that capitals of the partners do not remain fixed but change with each entry. When capitals are fluctuating, only one account, *i.e.*, Capital Account is maintained for each partner.
9.	**Drawings**	Drawings mean withdrawal by the partner from the firm in cash or kind for his or her personal use.
10.	**Profit-sharing Ratio**	Profit-sharing Ratio is the ratio in which the partners have agreed to share profits and losses of the firm.
11.	**Past Adjustments**	Past Adjustments refer to those adjustments which are related to past period that occurred due to errors or omissions in the books of the firm or giving effect to a new agreement with retrospective effect.
12.	**Guarantee of Profit**	Guarantee of Profit means minimum guaranteed profit given to a partner or partners of the firm. It may be given by a partner or partners or by the firm.

CHAPTER SUMMARY

Meaning of Partnership as per Section 4 of the Indian 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."

Nature: A partnership firm has no separate legal entity apart from the partners constituting it.

'Partners', 'Firm' and 'Firm Name': The persons who have entered into partnership with one another are individually called **partners** and collectively a **firm**. The name under which the business of the firm is carried on is called the **firm name**.

Essential Elements (Main Features) of Partnership

1. There must be two or more persons.
2. There must be an agreement.
3. There must be lawful business.
4. There must be sharing of profits of business.
5. There must be a mutual agency, *i.e.*, the business must be either carried on by all or any of them acting for all.

Partnership Deed

The document containing the terms and conditions of the agreement between partners is known as the **Partnership Deed**. The Partnership Deed usually includes the following:

(i) Name and address of the firm.
(ii) Names and addresses of all partners.
(iii) Date of commencement of partnership.
(iv) Capital to be contributed by each partner.
(v) Whether interest is to be allowed on capitals.
(vi) Whether any partner is to be allowed salary.
(vii) Profit-sharing Ratio among partners.
(viii) The rights and duties of each partner.
(ix) Method of valuation of goodwill in case of admission or retirement or death of a partner.
(x) Mode of settlement of accounts in case of retirement/death of a partner or dissolution of the firm.

Benefits or Advantages of having a Partnership Deed

(i) It facilitates functioning of the business.
(ii) It is helpful in the settlement of disputes arising among partners.
(iii) It helps in avoiding misunderstandings among the partners.

Provisions Applicable in the Absence of Partnership Agreement/Partnership Deed

(i) Interest is not allowed on Partners' Capitals or charged on drawings.
(ii) Partner is not entitled to salary or remuneration for the work done for the firm.
(iii) Interest @ 6% p.a. is allowed on the loans by any partner.
(iv) Profits or losses are divided equally among the partners.

- **Interest on Partner's Loan to the Firm:** If a partner gives a loan to the firm, he is entitled to an interest on such loan at an agreed rate of interest. If there is no agreement as to the rate of interest on loan, the partner is entitled to interest on loan @ 6% p.a. Such interest is a **charge against the profit**. It should be debited to **Profit and Loss Account**.
- **Rent Paid to Partner:** Rent paid to partner, like interest on loan by a partner, is a charge against the profit and not an appropriation of profit. It is, therefore, *debited* to Profit and Loss Account and *credited* to Rent Payable Account.
- **Manager's Commission** and **Partners' Commission** to be calculated on corrected Net Profit of Profit and Loss Account, if the question is silent. It should be kept in mind that manager's commission is a charge against the profit whereas, partners' commission is an appropriation of profit.

Methods of Maintaining Capital Accounts of Partners

The Partners' Capital Accounts may be maintained according to the Fixed Capital Method or the Fluctuating Capital Method.

Fixed Capital Accounts Method: Under this method, capitals of partners *remain unchanged* except under special circumstances. In the case of fixed capital, *two* accounts are maintained for each partner, *viz.*, (*i*) Fixed Capital Account, and (*ii*) Current Account. All adjustments regarding drawings, interest on drawings, salary, interest on capital, commission and share of profits or losses are made in *Current Account*. Fixed Capital Account cannot have a debit balance, *i.e.*, negative balance.

Fluctuating Capital Accounts Method: Under this method, a single Capital Account for each partner is maintained. All transactions relating to it or withdrawals are credited and debited to this account. Be it introduction of capital, interest on capital or drawings, salary, commission and share of profit and loss.

If question is silent, partner's capital should be assumed to be **fluctuating**.

- **Remuneration (Salary or Commission) to a Partner:** Remuneration (Salary or Commission) to a partner is to be allowed if the partnership deed or agreement provides for it.

  A: Commission as percentage of the Net Profit or Distributable Profit before charging such commission:

  $$\text{Net Profit before Commission} \times \frac{\text{Rate of Commission}}{100}$$

  B: Commission as percentage of the Net Profit or Distributable Profit after charging such commission:

  $$\text{Net Profit before Commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

  Remuneration (Salary or commission) to a partner *being an appropriation of profit* is transferred to the *debit of the Profit and Loss Appropriation Account* and not to the *debit of the Profit and Loss Account.*

- **Interest on Drawings:** If the Partnership Deed so provides, interest on drawings is charged from the partners. The interest so charged is credited to the Profit and Loss Appropriation Account and debited to the Partners' Capital or Current Accounts.
- *If dates of drawings are not given, interest on total drawings is calculated for average period, i.e.,* ***6 Months****.*
- Interest @ 10% without the word 'per annum' means interest is to be calculated without any reference of time.
- **Interest on Capital:** Interest on capital is calculated on time basis, taking into consideration any additional capital introduced or any existing capital withdrawn.
- Interest is allowed only if there is a provision in the Partnership Deed.
- As interest is an appropriation of profit, it is provided through Profit and Loss Appropriation Account instead of Profit and Loss Account (except when it is a charge against profit).

Past Adjustments

Past adjustments are made to rectify errors and omissions committed in the past by passing adjustment entry for each adjustment or a single adjustment entry through the Capital/Current Accounts of partners for the net amount of the errors and omissions, as is required by the question.

Guarantee of Minimum Profit to a Partner

Sometimes, a partner may be guaranteed a minimum amount of his share in profits. Such a guarantee may be provided by one or some or all of the partners in an existing profit-sharing ratio or in some other agreed ratio. If in any year, the actual share of profit is less than the guaranteed amount, the deficiency is borne by the guaranteeing partners in their agreed ratio.

SPECIMEN OF PARTNERSHIP DEED

THIS DEED OF PARTNERSHIP IS MADE on this **1st day of April, 2019** by and between

Ms. Deepali D/o Mr. Hitesh Dutta R/o 403 Green Heavens, Kolkata CGHS LTD., Plot No. 35, Sector-4, Chittranjan Park, Kolkata, West Bengal hereinafter referred to as the First Party (which expression shall deem and include her heirs, executors, administrators, representatives, assigns and agents),

And

Ms. Manju D/o Mr. Debanuj Choudhury R/o 1, L-75A, Airport Road, Maya Enclave, Kolkata, West Bengal hereinafter referred to as Second Party (which expression shall deem and include her heirs, executors, administrators, representatives, assigns and agents).

WHEREAS the above named parties have decided to start the partnership business of **ready-made clothes**.

WHEREAS, they have decided to carry on the business under the name and style of ***C4T***.

AND WHEREAS they have agreed to the terms and conditions among themselves to carry on the business.

AND WHEREAS the parties to this Deed have decided to reduce the terms and conditions agreed to among them into writing.

NOW THIS INDENTURE IS WITNESSETH AS FOLLOWS

Name of the Firm

1. That the name and style of the firm under which the business shall be carried shall be ***C4T***.
2. That the partners shall be at liberty to change the name of the firm as agreed between them as and when they desire.

Partners of the Firm

3. That the partners of the firm ***C4T*** shall be

   Ms. Deepali D/o Mr. Hitesh Dutta R/o 403 Green Heavens, Kolkata CGHS LTD., Plot No. 35, Sector-4, Chittranjan Park, Kolkata, West Bengal, and

   Ms. Manju D/o Mr. Debanuj Choudhury R/o 1, L-75A, Airport Road, Maya Enclave, Kolkata, West Bengal.

Date of Commencement of Business

4. That the business of the Partnership pursuant to this Deed of Partnership shall be deemed to have commenced with effect from **1st April, 2019**.

Business of the Firm

5. That the firm shall carry on the business of manufacturing and selling of fashion clothes for teens.
6. That they may, by their mutual consent, start and carry on any other business or businesses.

Place of Business

7. That the principal place of partnership business shall be situated at 7, Park Street, Kolkata, West Bengal or at such other place or places, as shall be agreed to by the partners from time to time.

Capital Contribution

8. That partners shall contribute capital of ₹ 5,00,000 each.
9. That the partners may agree to increase the capital of the firm by bringing in additional contribution on the terms and conditions as may be mutually decided among the partners.

Interest on Capital

10. That the partners shall not be entitled to interest on capital.

Remuneration to Partners

11. That the partners shall attend business of the partnership diligently and carry on the same for the greatest advantage of the firm.
12. That partners shall not be paid remuneration for the work carried out by them for the firm.

Profit-Sharing Ratio

13. That the Profits or Losses, as the case may be, of the partnership business shall be shared by the partners equally.

Accounts

14. That the accounts of the partnership shall be maintained following the accrual concept according to the financial year, *i.e.*, from 1st April to 31st March each year.
15. That first financial year of the firm shall end on 31st March, 2020.

Introduction of a New Partner

16. That a new partner may be introduced with the consent of all the partners on such terms and conditions as the partners agree upon with the Person to be introduced as a partner, in the firm.

Retirement or Death of a Partner

17. That any partner may retire from the partnership, after a period of three years by giving a notice to the other Partner(s) of not less than three months in writing and at the expiry of such notice period he shall be deemed to have retired.
18. That on the death of any partner, during the continuance of the partnership, the firm shall not be dissolved; the surviving nominee of that partner shall have the option to claim the share of the deceased partner or to join in the partnership business.

Dissolution of Firm

19. That the firm shall be dissolved with the consent of all the partners or in accordance with the Provisions of Indian Partnership Act, 1932.

Banking Account

20. That banking accounts may be opened with one or more scheduled banks and shall be operated by any of the partners.

General

21. That the firm shall maintain its accounts and other books at the place of business and shall not be removed from the place of business without the consent of all the partners.
22. Subject to the contract between the partners, the property of the firm includes all property and rights and interest in the originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purpose and in the course of business of the firm, and includes also the goodwill of the business.
23. Each partner shall—
    (i) Be just and faithful to other partners in the transactions relating to partnership business;
    (ii) Pay the private debts and indemnify the other partners and assets of the firm against the same and all other proceedings, costs, claims or demands in respect thereof;
    (iii) Give full information and truthful explanations of all matters relating to the affairs of the partnership to all the partners at all times.

24. No partner shall without the consent of the other partners—
    (i) Engage in any other business that is similar to the business carried on by the firm, directly or indirectly;
    (ii) Enter into partnership on behalf of the firm.
25. That the terms of the Partnership Deed may be altered by the written consent of the Parties to this DEED.
26. That in the case of any dispute arising out of this DEED between the Parties of this DEED, it shall be decided by Arbitration as provided for under the Indian Arbitration Act, 1996.
27. That the other matters for which no provision is made in this DEED, shall be decided upon by the majority of the partners for the time being of the partnership.
28. The terms and conditions not specifically given in this DEED will be termed as per the provisions of the Indian Partnership Act, 1932.

IN WITNESS WHEREOF the Parties hereto have set and subscribed their respective hands to these presents the day, month and year first written above.

WITNESSES	**SIGNATURES OF PARTNERS**
1. ___________________	**Deepali**
	(Party of the First Part)
2. ___________________	**Manju**
	(Party of the Second Part)

Solved Questions

Illustration 1 (*Interest on Capital and Drawings when Capitals are Fixed*).

Simmi and Sonu are partners in a firm, sharing profits and losses in the ratio of 3 : 1. Profit and Loss Account of the firm for the year ended 31st March, 2018 shows net profit of ₹ 1,50,000. Prepare Profit and Loss Appropriation Account considering the following information:

(i) Partners' capitals on 1st April, 2017: Simmi—₹ 30,000; Sonu—₹ 60,000.
(ii) Current Accounts balances on 1st April, 2017:
Simmi—₹ 30,000 (Cr.); Sonu—₹ 15,000 (Cr.).
(iii) Partners' drawings during the year amounted to: Simmi—₹ 20,000; Sonu—₹ 15,000.
(iv) Interest on capital was allowed @ 5% p.a.
(v) Interest on drawings was to be charged @ 6% p.a. at an average of six months.
(vi) Partners' salaries: Simmi—₹ 12,000; Sonu—₹ 9,000.

Also, show the Partners' Current Accounts.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To Partners' Salaries A/c:			By Profit and Loss A/c (Net Profit)		1,50,000
Simmi	12,000		By Interest on Drawings A/cs:		
Sonu	9,000	21,000	Simmi (₹ 20,000 × 6/100 × 6/12)	600	
To Interest on Capital A/cs:			Sonu (₹ 15,000 × 6/100 × 6/12)	450	1,050
Simmi (5% of ₹ 30,000)	1,500				
Sonu (5% of ₹ 60,000)	3,000	4,500			
To Profit transferred to:					
Simmi's Current A/c	94,163				
Sonu's Current A/c	31,387	1,25,550			
		1,51,050			1,51,050

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	Simmi (₹)	Sonu (₹)	Particulars	Simmi (₹)	Sonu (₹)
To Balance *c/d*	30,000	60,000	By Balance *b/d*	30,000	60,000
	30,000	60,000		30,000	60,000

Dr. PARTNERS' CURRENT ACCOUNTS Cr.

Particulars	Simmi (₹)	Sonu (₹)	Particulars	Simmi (₹)	Sonu (₹)
To Drawings A/c (Bank A/c)	20,000	15,000	By Balance *b/d*	30,000	15,000
To Interest on Drawings A/c	600	450	By Partners' Salaries A/c	12,000	9,000
To Balance *c/d*	1,17,063	42,937	By Interest on Capital A/c	1,500	3,000
			By Profit and Loss Appropriation A/c (Profit)	94,163	31,387
	1,37,663	58,387		1,37,663	58,387

Illustration 2 (*Partnership Deed does not Exist*).

Ram, Rahim and Karim are partners in a firm. They do not have a Partnership Deed. In the matter of distribution of profits they have put forward the following claims:

(i) Ram, who has contributed more capital than Rahim and Karim, demands interest on the capital @ 12% p.a. and the share of profit in the capital ratio. But Rahim and Karim do not accept it.

(ii) Rahim has devoted full time to manage the business and demands salary of ₹ 5,000 per month. But Ram and Karim do not agree with him.

(iii) Karim demands interest on the loan of ₹ 2,00,000 advanced by him to the firm @ 10% p.a.

How will the disputes be settled? Prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims is ₹ 4,50,000 at the end of the first year of their business.

Solution:

Since they do not have a Partnership Deed, following provisions of the Indian Partnership Act, 1932 shall apply for settling the dispute:

(i) Interest on capital is not payable to any partner. Therefore, Ram is not entitled to interest on capital. The profit after transferring 10% of divisible profit to reserve shall be distributed among partners equally.

(ii) Remuneration is not payable to any partner. Therefore, Rahim is not entitled to any salary.

(iii) Interest on loan by a partner is payable @ 6% p.a. Therefore, Karim is to get ₹ 12,000 (*i.e.*, interest @ 6% p.a. on ₹ 2,00,000). Interest on loan is debited to Profit and Loss Account and not to Profit and Loss Appropriation Account because interest on loan is a charge on profit. Thus, it should be paid whether there is profit or not.

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended ...* *Cr.*

Particulars		₹	Particulars	₹
To Reserve (10% of ₹ 4,38,000)		43,800	By Profit and Loss A/c (Net Profit)	4,38,000
To Profit transferred to:			(₹ 4,50,000 – ₹ 12,000, interest on	
Ram's Capital A/c	1,31,400		Karim's Loan)	
Rahim's Capital A/c	1,31,400			
Karim's Capital A/c	1,31,400	3,94,200		
		4,38,000		4,38,000

Illustration 3 (*Fixed Capital Accounts*).

Where are the following items shown when:

(a) Capital Accounts are fixed; and

(b) Capital Accounts are fluctuating.

(i) Salary to a partner,

(ii) Drawings made by a partner,

(iii) Fresh capital introduced by a partner,

(iv) Share of profit earned by a partner, and

(v) Commission payable to a partner.

Solution:

(a) **When Capital Accounts are fixed**

(i) Credit side of Partner's Current Account.

(ii) Debit side of Partner's Current Account.

(iii) Credit side of Partner's Capital Account.

(iv) Credit side of Partner's Current Account.

(v) Credit side of Partner's Current Account.

(b) **When Capital Accounts are fluctuating**

(i) Credit side of Partner's Capital Account.

(ii) Debit side of Partner's Capital Account.

(iii) Credit side of Partner's Capital Account.

(iv) Credit side of Partner's Capital Account.

(v) Credit side of Partner's Capital Account.

Illustration 4.

Pass the Journal entries to record the following transactions in the books of the firm of *A* and *B* before distributing the profits earned?

(i) Commission of ₹ 5,000 payable to *B*.

(ii) Interest on Capital: *A*—₹ 8,000; *B*—₹ 5,000.

(iii) Salary payable to *A*—₹ 20,000 p.a.

(iv) Transfer to the General Reserve—₹ 25,000.

Solution:

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Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Commission A/c	...Dr.		5,000	
	To *B*'s Capital A/c				5,000
	(Commission payable to *B* credited to his Capital Account)				
	Profit and Loss Appropriation A/c	...Dr.		5,000	
	To Commission A/c				5,000
	(Amount of commission payable to *B* transferred)				
	Alternatively, one entry may be passed as follows:				
	Profit and Loss Appropriation A/c	...Dr.		5,000	
	To *B*'s Capital A/c				5,000
	(Amount of commission payable to *B*)				
(ii)	Interest on Capital A/c	...Dr.		13,000	
	To *A*'s Capital A/c				8,000
	To *B*'s Capital A/c				5,000
	(Interest on Capitals credited to Partners' Capital Accounts)				
	Profit and Loss Appropriation A/c	...Dr.		13,000	
	To Interest on Capital A/c				13,000
	(Interest on capitals transferred)				
	Alternatively, one entry may be passed as follows:				
	Profit and Loss Appropriation A/c	...Dr.		13,000	
	To *A*'s Capital A/c				8,000
	To *B*'s Capital A/c				5,000
	(Interest on capital payable to *A* and *B*)				
(iii)	Partner's Salary A/c	...Dr.		20,000	
	To *A*'s Capital A/c				20,000
	(Salary payable to *A* credited to his Capital Account)				
	Profit and Loss Appropriation A/c	...Dr.		20,000	
	To Partner's Salary A/c				20,000
	(Salary payable to *A* transferred)				
	Alternatively, one entry may be passed as follows:				
	Profit and Loss Appropriation A/c	...Dr.		20,000	
	To *A*'s Capital A/c				20,000
	(Salary payable to *A* credited to his Capital Account)				
(iv)	Profit and Loss Appropriation A/c	...Dr.		25,000	
	To General Reserve A/c				25,000
	(Amount transferred to General Reserve)				

Note: Partners' Capital Accounts are assumed to be fluctuating.

Illustration 5 (*Calculation of Interest on Capital and Drawings*).

On 1st April, 2017, *A* and *B* commenced business with contributing capitals of ₹ 2,00,000 and ₹ 3,00,000 respectively. The terms of the partnership agreement are:

(i) Profit/loss be shared in the ratio of 2 : 3 between *A* and *B*.

(ii) Partners shall be entitled to interest on capital at the commencement of each year @ 6% p.a.

(iii) Interest on drawings shall be charged @ 8% p.a.

During the year ended 31st March, 2018, the firm earned a profit of ₹ 1,92,800 before adjustment of interest on capital and drawings. The partners withdrew during the year ₹ 30,000 each at the end of every quarter commencing from 30th June, 2017.

Pass the Journal entries, prepare Profit and Loss Appropriation Account and Capital Accounts of the partners.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c		1,92,800
A	12,000		(Net Profit)		
B	18,000	30,000	By Interest on Drawings A/cs (Note):		
To Profit transferred to Capital A/cs:			*A*	3,600	
A (2/5)	68,000		*B*	3,600	7,200
B (3/5)	1,02,000	1,70,000			
		2,00,000			2,00,000

PARTNERS' CAPITAL ACCOUNTS

Dr. | *Cr.*

Date	Particulars	*A* ₹	*B* ₹	Date	Particulars	*A* ₹	*B* ₹
2018				2017			
March 31	To Drawings A/c	1,20,000	1,20,000	April 1	By Bank A/c	2,00,000	3,00,000
	To Interest on Drawings A/c	3,600	3,600	2018 March 31	By Interest on Capital A/c	12,000	18,000
	To Balance *c/d*	1,56,400	2,96,400		By Profit and Loss Appropriation A/c	68,000	1,02,000
		2,80,000	4,20,000			2,80,000	4,20,000

Note: When the fixed amount is withdrawn at the end of each quarter, interest on drawings will be charged on total drawings for average period of 4.5 months, *i.e.*, ₹ 1,20,000 × 4.5 /12 × 8/100 = ₹ 3,600.

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Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2018				
March 31	Profit and Loss A/c ...Dr.		1,92,800	
	To Profit and Loss Appropriation A/c			1,92,800
	(Net profit transferred to Profit and Loss Appropriation Account)			
	Interest on Capital A/c ...Dr.		30,000	
	To *A*'s Capital A/c			12,000
	To *B*'s Capital A/c			18,000
	(Interest on capital allowed @ 6% p.a.)			
	Profit and Loss Appropriation A/c ...Dr.		30,000	
	To Interest on Capital A/c			30,000
	(Interest on Capital transferred to Profit and Loss Appropriation Account)			
	A's Drawings A/c ...Dr.		1,20,000	
	B's Drawings A/c ...Dr.		1,20,000	
	To Cash/Bank A/c			2,40,000
	(Drawings made by the partners during the year)			
	A's Capital A/c ...Dr.		1,20,000	
	B's Capital A/c ...Dr.		1,20,000	
	To *A*'s Drawings A/c			1,20,000
	To *B*'s Drawings A/c			1,20,000
	(Amount of drawings transferred to their respective Capital Accounts)			
	A's Capital A/c ...Dr.		3,600	
	B's Capital A/c ...Dr.		3,600	
	To Interest on Drawings A/c			7,200
	(Interest charged on drawings of the partners)			
	Interest on Drawings A/c ...Dr.		7,200	
	To Profit and Loss Appropriation A/c			7,200
	(Interest on Drawings transferred to Profit and Loss Appropriation Account)			
	Profit and Loss Appropriation A/c ...Dr.		1,70,000	
	To *A*'s Capital A/c			68,000
	To *B*'s Capital A/c			1,02,000
	(Divisible profit distributed in the ratio of 2 : 3)			

Illustration 6.

A, *B* and *C* were partners in a firm. On 1st April, 2008 their fixed capitals stood at ₹ 50,000; ₹ 25,000 and ₹ 25,000 respectively.

As per the provisions of the Partnership Deed:

(i) *B* was entitled for a salary of ₹ 5,000 p.a.

(ii) All the partners were entitled to interest on capital @ 5% p.a.

(iii) Profits were to be shared in the ratio of capitals.

The net profit for the year ended 31st March, 2009 of ₹ 33,000 and 31st March, 2010 of ₹ 45,000, was divided equally without providing for the above terms.

Pass an adjustment Journal entry to rectify the above error. *(AI 2011 C)*

Solution:

ADJUSTMENT JOURNAL ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2010				
March 31	*C*'s Current A/c ...Dr.		9,000	
	To *A*'s Current A/c			8,000
	To *B*'s Current A/c			1,000
	(Required adjustment for correcting wrong distribution of profits)			

Working Note:

STATEMENT SHOWING ADJUSTMENT TO BE MADE

Particulars		*A* (₹)	*B* (₹)	*C* (₹)	Total
(i) Amount already credited as Share of Profit, now reversed:					
31st March, 2009		11,000	11,000	11,000	33,000
31st March, 2010		15,000	15,000	15,000	45,000
	(Dr..)	26,000	26,000	26,000	78,000
(ii) Amount which should have been credited:					
Salary:	31st March, 2009	...	5,000	...	5,000
	31st March, 2010	...	5,000	...	5,000
Interest on Capital:	31st March, 2009	2,500	1,250	1,250	5,000
	31st March, 2010	2,500	1,250	1,250	5,000
Share of Profit*:	31st March, 2009	11,500	5,750	5,750	23,000
	31st March, 2010	17,500	8,750	8,750	35,000
	(Cr.)	34,000	27,000	17,000	78,000
(iii) Net Effect [(i) – (ii)]		8,000 Cr.	1,000 Cr.	9,000 Dr.	...

**Calculation of Share of Profit (31st March, 2009)*:

Adjusted Profits = ₹ 33,000 – ₹ 5,000 (Salary) – ₹ 5,000 (Interest on Capital) = ₹ 23,000

A's Share = ₹ 23,000 × 2/4 = ₹ 11,500

B's Share = ₹ 23,000 × 1/4 = ₹ 5,750

C's Share = ₹ 23,000 × 1/4 = ₹ 5,750

Calculation of Share of Profit (31st March, 2010):

Adjusted Profits = ₹ 45,000 – ₹ 5,000 (Salary) – ₹ 5,000 (Interest on Capital) = ₹ 35,000

A's Share = ₹ 35,000 × 2/4 = ₹ 17,500

B's Share = ₹ 35,000 × 1/4 = ₹ 8,750

C's Share = ₹ 35,000 × 1/4 = ₹ 8,750.

Illustration 7.

A and *B* were in a partnership sharing profits and losses in the ratio of 3 : 2. In appreciation of the services of *C* who was in receipt of a salary of ₹ 24,000 per annum and a commission of 5% of the net profit after charging such salary and commission, they took him into partnership from 1st April, 2017 giving him 1/8th share of profits. The agreement provided that any excess over his former remuneration to which *C* becomes entitled will be borne by *A* and *B* in the ratio of 2 : 3. The profit for the year ended 31st March, 2018 amounted to ₹ 4,44,000.

Prepare Profit and Loss Appropriation Account.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Particulars		₹	Particulars	₹
To Profit transferred to:			By Profit and Loss A/c (Net Profit)	4,44,000
A's Capital A/c	2,40,000			
Less: Transferred to *C*	4,600	2,35,400		
B's Capital A/c	1,60,000			
Less: Transferred to *C*	6,900	1,53,100		
C's Capital A/c	44,000			
Add: Transferred From *A*	4,600			
Transferred From *B*	6,900	55,500		
		4,44,000		4,44,000

Working Notes:

	₹	₹
1. Profit for the year = ₹ 4,44,000		
C's Share as partner (1/8 × ₹ 4,44,000)		55,500
Less: Amount payable to *C* as employee:		
Salary	24,000	
Commission [$\frac{5}{105}$(₹ 4,44,000 – ₹ 24,000)]	20,000	44,000
Deficiency		11,500

Deficiency chargeable to *A* and *B* in the ratio of 2 : 3

∴ *A* to bear = 11,500 × 2/5 = ₹ 4,600; *B* to bear = 11,500 × 3/5 = ₹ 6,900.

2. Profits for the year available to *A* and *B*

(₹ 4,44,000 – *C*'s share as Manager ₹ 44,000) = ₹ 4,00,000

A's Share of Profit = ₹ 4,00,000 × 3/5 = ₹ 2,40,000

A's Share of Profit after adjusting deficiency = ₹ 2,40,000 – Share in deficiency
= ₹ 2,40,000 – ₹ 4,600 = ₹ 2,35,400

B's Share of Profit = ₹ 4,00,000 × 2/5 = ₹ 1,60,000

B's Share of Profit after adjusting deficiency = ₹ 1,60,000 – Share in deficiency
= ₹ 1,60,000 – ₹ 6,900 = ₹ 1,53,100.

Illustration 8.

X and *Y* are partners. As per the terms of agreement interest is allowed on capitals @ 8% p.a. and charged on drawings @ 10% p.a. *X* withdrew ₹ 20,000 per month at the end of each month and *Y* withdrew ₹ 60,000 at the end of each quarter. You are required to fill up the missing figures (?) in the following accounts:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To ?		?	By Profit and loss A/c (Net Profit)		?
To Interest on Capital A/cs:			By Interest on Drawings A/cs:		
X	80,000		*X*	?	
Y	?	1,44,000	*Y*	?	?
To Profit transferred to Capital A/cs:					
X (2/3)	?				
Y (1/3)	1,40,000	?			
		?			?

PARTNERS' CAPITAL ACCOUNTS

Dr. | *Cr.*

Particulars	*X* (₹)	*Y* (₹)	Particulars	*X* (₹)	*Y* (₹)
To ?	?	?	By ?	?	?
To ?	?	?	By *X*'s Salary A/c	1,80,000	
To ?	?	?	By ?	?	?
			By ?	?	?
	?	?		?	?

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To ***X*'s Salary A/c**		**1,80,000**	By Profit and loss A/c (Net Profit)		**7,24,000**
To Interest on Capital A/cs:			By Interest on Drawings A/cs:		
X	80,000		*X*	**11,000**	
Y	**64,000**	1,44,000	*Y*	**9,000**	**20,000**
To Profit transferred to Capital A/cs:					
X (2/3)	**2,80,000**				
Y (1/3)	1,40,000	**4,20,000**			
		7,44,000			**7,44,000**

PARTNERS' CURRENT ACCOUNTS

Dr. | *Cr.*

Particulars	*X* (₹)	*Y* (₹)	Particulars	*X* (₹)	*Y* (₹)
To **Drawings A/c**	**2,40,000**	**2,40,000**	By **Balance *b/d***	**10,00,000**	**8,00,000**
To **Interest on Drawings A/c**	**11,000**	**9,000**	By *X*'s Salary A/c	1,80,000	
To **Balance *c/d***	**12,89,000**	**7,55,000**	By **Interest on Capital A/c**	**80,000**	**64,000**
			By **Profit and Loss App. A/c**	**2,80,000**	**1,40,000**
	15,40,000	**10,04,000**		**15,40,000**	**10,04,000**

Working Notes:

1. ***X's* Share of Profit** = ₹ 1,40,000 (*Y*) × $\frac{3}{1} \times \frac{2}{3}$ = ₹ 2,80,000.
2. **Interest on Drawings:**

   X = ₹ 2,40,000 × $\frac{11}{2} \times \frac{1}{12} \times \frac{10}{100}$ = ₹ 11,000;

   Y = ₹ 2,40,000 × $\frac{9}{2} \times \frac{1}{12} \times \frac{10}{100}$ = ₹ 9,000.

3. ***Y's* Interest on Capital** = ₹ 1,44,000 – ₹ 80,000 = ₹ 64,000.
4. **Net Profit** = Salary + Interest on Capital + Profit transferred to Capital Accounts – Interest on Drawings.

Illustration 9.

Sharma and Verma were partners in a firm sharing profits in the ratio of 4 : 1. Their capitals on 1st April, 2008 were: Sharma ₹ 5,00,000 and Verma ₹ 1,00,000. The Partnership Deed provided that Sharma will get a commission of 10% of the net profit after allowing a salary of ₹ 5,000 per month to Verma. The profit of the firm for the year ended 31st March, 2009 was ₹ 2,80,000.

Prepare Profit and Loss Appropriation Account of Sharma and Verma for the year ended 31st March, 2009. *(AI 2009 C)*

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2009

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Verma's Capital A/c (Salary)		60,000	By Profit and Loss A/c (Net Profit)	2,80,000
To Sharma's Capital A/c (Commission) [10/100 (₹ 2,80,000 – ₹ 60,000)]		22,000		
To Profit transferred to:				
Sharma's Capital A/c (₹ 1,98,000 × 4/5)	1,58,400			
Verma's Capital A/c (₹ 1,98,000 × 1/5)	39,600	1,98,000		
		2,80,000		2,80,000

Illustration 10.

Simran and Puneet are partners in a firm sharing profits and losses equally. On 1st April, 2017, capitals of the partners were: Simran—₹ 2,00,000 and Puneet—₹ 1,60,000. Profit and Loss Account of the firm showed net profit of ₹ 3,75,000 (before interest on Puneet's Loan) for the year ended 31st March, 2018. Considering following information, prepare Profit and Loss Appropriation Account of the firm and Partners' Capital Accounts:

(i) Interest on capital to be allowed @ 6% p.a.

(ii) Interest on Puneet's Loan Account of ₹ 1,00,000 for the whole year.

(iii) Interest on drawings of partners @ 6% p.a. Drawings being Simran—₹ 40,000 and Puneet—₹ 30,000.

(iv) Transfer 10% of the distributable profit to General Reserve.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c—Net Profit		3,69,000
Simran	12,000		(After Interest on Puneet's Loan)		
Puneet	9,600	21,600	(₹ 3,75,000 – ₹ 6,000) (WN 1)		
To General Reserve A/c (WN 3)		34,950	By Interest on Drawings A/cs:		
To Share of Profit transferred to:			Simran	1,200	
Simran's Capital A/c	1,57,275		Puneet	900	2,100
Puneet's Capital A/c	1,57,275	3,14,550			
		3,71,100			3,71,100

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Simran (₹)	Puneet (₹)	Particulars	Simran (₹)	Puneet (₹)
To Bank A/c (Drawings)	40,000	30,000	By Balance *b/d*	2,00,000	1,60,000
To Interest on Drawings A/c	1,200	900	By Interest on Capital A/c	12,000	9,600
To Balance *c/d*	3,28,075	2,95,975	By Profit and Loss		
			Appropriation A/c (Profit)	1,57,275	1,57,275
	3,69,275	3,26,875		3,69,275	3,26,875

Working Notes:

1. Interest on Partner's Loan is allowed @ 6% p.a., as there is no agreement. It will be shown on the debit side of the Profit and Loss Account being a charge on profit.
2. As the date of drawings is not mentioned, interest is calculated for the average period, *i.e.,* 6 months.
3. General Reserve is calculated @ 10% of ₹ 3,49,500 (*i.e.,* ₹ 3,69,000 + ₹ 1,200 + ₹ 900 – ₹ 21,600).

Illustration 11.

X and *Y* entered into partnership on 1st April, 2017 and contributed ₹ 4,80,000 and ₹ 3,60,000 respectively as their capitals. On 1st October, 2017, *X* granted a loan of ₹ 1,20,000 to the firm. The terms of the partnership agreement are as follows:

(i) Interest on capital @ 12% p.a. and Interest on Drawings @ 10%.

(ii) *X* to get a monthly salary of ₹ 12,000 and *Y* to get salary of ₹ 54,000 per quarter.

(iii) *X* is entitled to a commission of 2% on sales. Sales for the year were ₹ 21,00,000.

(iv) 20% of profits before charging Interest on Drawings but after making appropriations to be transferred to General Reserve.

(v) Profits and losses are to be shared in the ratio of their capital contribution up to ₹ 4,20,000 and above ₹ 4,20,000 equally.

Profit for the year ended 31st March, 2018, before providing for interest was ₹ 11,06,400. Drawings of *X* and *Y* were ₹ 2,40,000 and ₹ 3,00,000 respectively.

Prepare Profit and Loss Appropriation Account and Partners' Capital Accounts.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c:		
X (₹ 4,80,000 × 12/100)	57,600		Net Profit	11,06,400	
Y (₹ 3,60,000 × 12/100)	43,200	1,00,800	*Less:* Interest on *X*'s Loan	3,600	11,02,800
To Partners' Salary:			(₹ 1,20,000 × 6/12 × 6/100)		
X (₹ 12,000 × 12)	1,44,000		(Note 1)		
Y (₹ 54,000 × 4)	2,16,000	3,60,000	By Interest on Drawings A/cs: (Note 2)		
To *X*'s Commission		42,000	*X* (₹ 2,40,000 × 10/100 × 6/12)	12,000	
(2% of ₹ 21,00,000)			*Y* (₹ 3,00,000 × 10/100 × 6/12)	15,000	27,000
To General Reserve (Note 3)		1,20,000			
To Profit transferred to:					
X's Capital A/c	2,83,500				
Y's Capital A/c	2,23,500	5,07,000*			
		11,29,800			11,29,800

*Division of Profit:

Partners	Up to ₹ 4,20,000	₹ 87,000 (above ₹ 4,20,000)	Total
X	₹ 2,40,000	₹ 43,500	₹ 2,83,500
Y	₹ 1,80,000	₹ 43,500	₹ 2,23,500
Total	₹ 4,20,000	₹ 87,000	₹ 5,07,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* ₹	*Y* ₹	Particulars	*X* ₹	*Y* ₹
To Drawings A/c	2,40,000	3,00,000	By Bank A/c	4,80,000	3,60,000
To Interest on Drawings A/c	12,000	15,000	By Interest on Capital A/c	57,600	43,200
To Balance *c/d*	7,55,100	5,27,700	By Partners' Salary A/c	1,44,000	2,16,000
			By *X*'s Commission A/c	42,000	...
			By Profit and Loss Appro. A/c (Profit)	2,83,500	2,23,500
	10,07,100	8,42,700		10,07,100	8,42,700

Notes:

1. As per The Indian Partnership Act, 1932, Interest on loan is to be allowed @ 6% p.a.
2. Interest on Drawings has been calculated for an average period of 6 months as the date of drawings is not given.
3. Transfer to Reserve = 20% of (₹ 11,02,800 – ₹ 1,00,800 – ₹ 3,60,000 – ₹ 42,000) = ₹ 1,20,000.

Illustration 12 (*Distribution of Profit in wrong Profit-Sharing Ratio*).

X, *Y* and *Z* shared the profit of ₹ 7,50,000 in the ratio of 2 : 2 : 1 without providing for interest on *Y*'s Loan. *Y* granted a loan of ₹ 5,00,000 in the beginning of accounting year, whereas the Partnership Deed is silent on interest on loan and the profit-sharing ratio. Give necessary adjustment entry.

Solution:

ADJUSTMENT JOURNAL ENTRY

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	X's Capital A/c	...Dr.		60,000	
	Y's Capital A/c	...Dr.		60,000	
	To *Z*'s Capital A/c				90,000
	To *Y*'s Loan A/c				30,000
	(Profit distributed in wrong ratio, now rectified after providing for interest on loan)				

STATEMENT SHOWING THE ADJUSTMENT TO BE MADE

Particulars	*X*'s Capital A/c		*Y*'s Capital A/c		*Z*'s Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Amount already credited as share of profit in the ratio of 2 : 2 : 1	3,00,000	...	3,00,000	...	1,50,000	...	...	7,50,000
Amount which should have been credited as share of profit (₹ 7,50,000 – ₹ 30,000) in the ratio of 1 : 1 : 1	...	2,40,000	...	2,40,000	...	2,40,000	7,20,000	...
	3,00,000	2,40,000	3,00,000	2,40,000	1,50,000	2,40,000	7,20,000	7,50,000
Net Effect	60,000 Dr.	...	60,000 Dr.	...	...	90,000 Cr.	...	30,000*

*Interest on loan ₹ 30,000 (*i.e.*, ₹ 5,00,000 × 6/100) is a charge against profit. It is an expense for the firm and hence, is debited to Profit and Loss Account. On the other hand, it is a gain for partner as a lender and hence is credited to his Loan Account and not to his Capital Account. Being a charge against profits, it should be transferred to the debit of Profit and Loss Account and not to the debit of Profit and Loss Appropriation Account.

Illustration 13 (*Guarantee by the Firm as well as by Partners*).

A, *B*, *C* and *D* are partners sharing profits and losses in the ratio of 4 : 3 : 2 : 1. Their capitals as at 1st April, 2017 were ₹ 3,00,000; ₹ 2,50,000; ₹ 1,50,000 and ₹ 1,00,000 respectively.

D's share of profits *excluding* interest on capital has been guaranteed by the firm to be not less than ₹ 2,50,000. *C*'s share of profits *including* interest on capital and salary guaranteed by *A* is not less than ₹ 2,60,000.

The profit for the year ended 31st March, 2018 were ₹ 9,00,000 before interest on capital @ 10% and salary to *C* @ ₹ 10,000 per month.

Prepare Profit and Loss Appropriation Account and distribute the profit.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c	9,00,000
A (₹ 3,00,000 × 10/100)	30,000		—Net Profit	
B (₹ 2,50,000 × 10/100)	25,000			
C (₹ 1,50,000 × 10/100)	15,000			
D (₹ 1,00,000 × 10/100)	10,000	80,000		
To *C*'s Salary A/c (₹ 10,000 × 12)		1,20,000		
To Share of Profit transferred to Capital A/cs: [(₹ 9,00,000 – ₹ 80,000 – ₹ 1,20,000) = ₹ 7,00,000]				
A: 4/10 of ₹ 7,00,000	2,80,000			
Less: Firm's Deficiency borne (WN 1) (₹ 1,80,000 × 4/9)	80,000			
Deficiency borne of *C*	25,000	1,75,000		
B: 3/10 of ₹ 7,00,000	2,10,000			
Less: Firm's Deficiency (₹ 1,80,000 × 3/9)	60,000	1,50,000		
C: 2/10 of ₹ 7,00,000	1,40,000			
Less: Firm's Deficiency (₹ 1,80,000 × 2/9)	40,000			
	1,00,000			
Add: Deficiency recovered from *A* (WN 2)	25,000	1,25,000		
D: 1/10 of ₹ 7,00,000	70,000			
Add: Deficiency recovered from *A*, *B* and *C*	1,80,000	2,50,000		
		9,00,000		9,00,000

Working Notes:

1. *Calculation of firm's deficiency:*

		₹
D's share of profit *excluding* interest on Capital has been guaranteed by the firm		2,50,000
Less: *D*'s share of profits (₹ 7,00,000 × 1/10)		70,000
Firm's deficiency borne by *A*, *B* and *C*		1,80,000

2. *Calculation of deficiency recovered by C from A:*

C's share of profits (₹ 7,00,000 × 2/10)		1,40,000
Less: *C*'s share in firm's deficiency (₹ 1,80,000 × 2/9)		40,000
		1,00,000
Add: Interest on Capital	15,000	
Salary	1,20,000	1,35,000
		2,35,000
Deficiency recovered from *A* (*Balancing Figure*)		25,000
C's share of profits *including* interest on capital and salary is guaranteed by *A*		2,60,000

Illustration 14 (*Guarantee and Past Adjustment*).

The partners of a firm distributed the profit for the year ended 31st March, 2018, ₹ 4,50,000 in the ratio of 3 : 2 : 1 without providing for the following:

(i) Salary to *X* and *Z* of ₹ 7,500 p.a. each.

(ii) Commission to *Y* of ₹ 22,500.

(iii) *Y* and *Z* had guaranteed a minimum profit of ₹ 1,75,000 to *X*.

(iv) Profit was to be shared in the ratio of 3 : 3 : 2.

Pass necessary Journal entry for the above adjustment in the books of the firm.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018 March 31	*X*'s Capital A/c To *Y*'s Capital A/c To *Z*'s Capital A/c (Required adjustment made to rectify the errors)	...Dr.		42,500	 15,000 27,500

Working Notes:

1. ADJUSTMENT TABLE

Particulars	*X*'s Capital A/c		*Y*'s Capital A/c		*Z*'s Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Salaries to be paid to *X* and *Z*	...	7,500	...	...	...	7,500	15,000	...
Commission to be paid to *Y*	...	...	...	22,500	...	...	22,500	...
Profit to be shared (WN 2)	...	1,75,000	...	1,42,500	...	95,000	4,12,500	...
Profit of ₹ 4,50,000 already distributed in 3 : 2 : 1, now to be debited	2,25,000	...	1,50,000	...	75,000	...	...	4,50,000
Total	2,25,000	1,82,500	1,50,000	1,65,000	75,000	1,02,500	4,50,000	4,50,000
Net Effect (Dr./Cr.)	42,500 (Dr.)		15,000 (Cr.)		27,500 (Cr.)		NIL	

2. PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2018

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Partner's Salary:			By Profit and Loss A/c (Net Profit)	4,50,000
X	7,500			
Z	7,500	15,000		
To *Y*'s Commission A/c		22,500		
To Profit transferred to:				
X's Capital A/c	1,75,000			
Y's Capital A/c	1,42,500			
Z's Capital A/c	95,000	4,12,500		
		4,50,000		4,50,000

3. **Distribution of Profit:** Profit of ₹ 4,12,500 (*i.e.*, ₹ 4,50,000 – ₹ 15,000 – ₹ 22,500) will be distributed among *X*, *Y* and *Z* in the ratio of 3 : 3 : 2. *X*'s share = ₹ 4,12,500 × 3/8 = ₹ 1,54,687. *Y* and *Z* had guaranteed minimum profit of ₹ 1,75,000 to *X*. *Guaranteed profit is higher than his actual profit.* Therefore, out of ₹ 4,12,500, first ₹ 1,75,000 will be credited to *X* and balance of ₹ 2,37,500 will be distributed between *Y* and *Z* in ratio of 3 : 2. *Y* will get 3/5 of ₹ 2,37,500, *i.e.*, ₹ 1,42,500 and *Z* will get 2/5 of ₹ 2,37,500, *i.e.*, ₹ 95,000.
Final distribution will be *X*—₹ 1,75,000; *Y*—₹ 1,42,500 and *Z*—₹ 95,000.

Illustration 15 (*Appropriation of Profit*).

Complete the missing amounts (?) in the following accounts:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars		₹
To Partners' Salary A/c:			By Net Profit as per Profit and Loss A/c	3,00,000	
B's Current A/c	?		*Less:* Interest on *B's* Loan		
C's Current A/c	?	?	(₹ 20,000 × 6/100)	?	?
To Interest on Capital A/c:			By Interest on Drawings A/c:		
A's Current A/c	11,000		*A's* Current A/c	?	
B's Current A/c	8,750		*B's* Current A/c	?	
C's Current A/c	4,500	24,250	*C's* Current A/c	?	?
To Profit transferred to Current A/cs:					
A	?				
B	?				
C	?	?			
		3,06,500			3,06,500

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Balance *b/d*		4,000		By Balance *b/d*	10,000		5,000
To Drawings *A/c*	?	?	?	By Salary A/c		20,000	30,000
To Interest on Drawings A/c	3,300	2,200	2,200	By Interest on Capital A/c	?	?	?
To Balance *c/d*	38,600	67,450	35,750	By Profit and Loss App. A/c	92,900	92,900	46,450
	1,13,900	1,21,650	85,950		1,13,900	1,21,650	85,950

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Bank A/c			10,000	By Balance *b/d*	1,00,000	80,000	50,000
To Balance *c/d*	?	?	?	By Bank A/c	20,000	15,000	
	1,20,000	95,000	50,000		1,20,000	95,000	50,000

Solution:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars		₹
To Partners' Salary A/c:			By Net Profit as per Profit and Loss A/c	3,00,000	
B's Current A/c	**20,000**		*Less:* Interest on *B's* Loan		
C's Current A/c	**30,000**	**50,000**	(₹ 20,000 × 6/100)	**1,200**	**2,98,800**
To Interest on Capital A/c:			By Interest on Drawings A/c:		
A's Current A/c	11,000		*A's* Current A/c	**3,300**	
B's Current A/c	8,750		*B's* Current A/c	**2,200**	
C's Current A/c	4,500	24,250	*C's* Current A/c	**2,200**	**7,700**
To Profit transferred to Current A/cs:					
A	**92,900**				
B	**92,900**				
C	**46,450**	**2,32,250**			
		3,06,500			3,06,500

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Balance *c/d*		4,000		By Balance *b/d*	10,000		5,000
To Drawings *A/c*	**72,000**	**48,000**	**48,000**	By Partners' Salary A/c		20,000	30,000
To Interest on Drawings A/c	3,300	2,200	2,200	By Interest on Capital A/c	**11,000**	**8,750**	**4,500**
To Balance *c/d*	38,600	67,450	35,750	By Profit and Loss App. A/c	92,900	92,900	46,450
	1,13,900	1,21,650	85,950		1,13,900	1,21,650	85,950

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Bank A/c			10,000	By Balance *b/d*	1,00,000	80,000	50,000
To Balance *c/d*	**1,20,000**	**95,000**	**40,000**	By Bank A/c	20,000	15,000	
	1,20,000	95,000	50,000		1,20,000	95,000	50,000

Illustration 16 (*When Partnership Deed does not Exist*).

Amit presents following Profit and Loss Appropriation Account to his partner Bishan:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars	₹
To Amit's Capital A/c—Salary		1,00,000	By Profit and Loss A/c (Net Profit)	2,94,000
To Bishan's Capital A/c—Salary		70,000		
To Interest on Capital @ 6% p.a.:				
Amit on ₹ 5,00,000	30,000			
Bishan on ₹ 2,00,000	12,000	42,000		
To Interest on Amit's Loan @ 6% p.a.		12,000		
To Profit transferred to:				
Amit's Capital A/c (5/7 of ₹ 70,000)	50,000			
Bishan's Capital A/c (2/7 of ₹ 70,000)	20,000	70,000		
		2,94,000		2,94,000

Bishan is of the opinion that he has not been treated fairly. The partnership is not supported by a Partnership Deed. Point out whether the Profit and Loss Appropriation Account prepared by Amit is as per the provisions of the Indian Partnership Act, 1932.

You are required to redraw Profit and Loss Appropriation Account on the basis of the Provisions of Indian Partnership Act, 1932.

Solution: The account presented by Amit is not correct because when Partnership Deed does not exist, provisions of the Indian Partnership Act, 1932 apply. Therefore,

(i) Salary will not be paid to any of the partners.

(ii) Interest on capitals will not be allowed.

(iii) Both partners will share profit equally.

(iv) Interest charged on Amit's Loan @ 6% p.a. is in order. Interest on such loan being a charge against the profit, shall be transferred to the debit of the Profit and Loss Account and not to the debit of the Profit and Loss Appropriation Account.

Redrawn Profit and Loss Appropriation Account is as follows:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* Cr.

Particulars		₹	Particulars	₹
To Profit transferred to Capital A/cs:			By Profit and Loss A/c (Net Profit)	2,82,000
Amit (1/2)	1,41,000		(After interest on loan)	
Bishan (1/2)	1,41,000	2,82,000	(₹ 2,94,000 – ₹ 12,000)	
		2,82,000		2,82,000

Illustration 17 (*Salary/Commission/Rent Payable to Partners*).

A and *B* are partners sharing profits and losses in the ratio of 3 : 1. On 1st April, 2017, their capitals were: *A*—₹ 50,000 and *B*—₹ 30,000. During the year ended 31st March, 2018, they earned net profit of ₹ 74,000. The terms of partnership are:

(i) Interest on the capital is to be allowed @ 6% p.a.

(ii) *A* will get commission @ 2% on turnover.

(iii) *B* will get a salary of ₹ 500 per month.

(iv) *B* will get commission of 5% on profits after deduction of interest, salary and commission (including his own commission).

(v) *A* is entitled to a rent of ₹ 2,000 per month for the use of his premises by the firm. It is paid to him by cheque at the end of every month.

Partners' drawings for the year were: *A*—₹ 8,000 and *B*—₹ 6,000. Turnover for the year was ₹ 3,00,000. After considering the above factors, you are required to prepare Profit and Loss Appropriation Account and Capital Accounts of the Partners.

Solution:

In the Books of *A* and *B*

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2018* Cr.

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c—Net Profit (WN 3)	50,000
A (₹ 50,000 × 6/100)	3,000			
B (₹ 30,000 × 6/100)	1,800	4,800		
To Partner's Salary A/c (*B*) (₹ 500 × 12)		6,000		
To Commission A/cs:				
A (WN 1)	6,000			
B (WN 2)	1,581	7,581		
To Profit transferred to Partners' Capital A/cs:				
A (3/4)	23,714			
B (1/4)	7,905	31,619		
		50,000		50,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	*A* (₹)	*B* (₹)	Date	Particulars	*A* (₹)	*B* (₹)
2018				2017			
March 31	To Drawings A/c	8,000	6,000	April 1	By Balance *b/d*	50,000	30,000
March 31	To Balance *c/d*	74,714	41,286	2018			
				March 31	By Interest on Capital A/c	3,000	1,800
				March 31	By Partner's Salary A/c	...	6,000
				March 31	By Commission A/c	6,000	1,581
				March 31	By Profit and Loss Appropriation A/c (Profit)	23,714	7,905
		82,714	47,286			82,714	47,286

Working Notes:

1. *A*'s Commission = 2/100 × ₹ 3,00,000 = ₹ 6,000
2. *B*'s Commission:
   Net profit after charging interest, salary and *A*'s Commission
   but before charging *B*'s Commission = ₹ (50,000 – 4,800 – 6,000 – 6,000) = ₹ 33,200

Profit after Commission	*Commission*	*Profit before Commission*
100	5	105
	x	33,200

∴ x = 5/105 × ₹ 33,200 = ₹ 1,581.

3. Rent payable to a partner for the use of his premises is a charge against profit not an appropriation of profit. Hence, Amount transferred to Profit and Loss Appropriation Account is ₹ 50,000 (*i.e.*, ₹ 74,000 – ₹ 24,000).

Illustration 18.

A, *B* and *C* are partners sharing profits in the ratio of 5 : 4 : 1. *C* is given a guarantee that his share of profit in any given year would be ₹ 50,000. Deficiency, if any, would be borne by *A* and *B* equally. Profit for the year ending 31st March, 2018 was ₹ 4,00,000.

Pass necessary entries in the books of the firm.

Solution:

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
March 31	Profit and Loss A/c ...Dr.		4,00,000	
	To Profit and Loss Appropriation A/c			4,00,000
	(Net profit transferred to Profit and Loss Appropriation Account)			
	Profit and Loss Appropriation A/c ...Dr.		4,00,000	
	To *A*'s Capital A/c			2,00,000
	To *B*'s Capital A/c			1,60,000
	To *C*'s Capital A/c			40,000
	(Net profit distributed among the partners in the ratio of 5 : 4 : 1)			
	A's Capital A/c ...Dr.		5,000	
	B's Capital A/c ...Dr.		5,000	
	To *C*'s Capital A/c (₹ 50,000 – ₹ 40,000)			10,000
	(Deficiency of *C*'s share in profits, met by *A* and *B* equally)			

Working Note: When the net profit of ₹ 4,00,000 is distributed amongst the partners in the ratio of 5 : 4 : 1, *C* gets ₹ 40,000 (*i.e.*, 1/10th of ₹ 4,00,000). But his guaranteed profit is ₹ 50,000. The shortfall of ₹ 10,000 (*i.e.*, ₹ 50,000 – ₹ 40,000) is to be borne by *A* and *B* equally. In effect, shortfall borne by *A* is ₹ 5,000 (*i.e.*, 1/2 of ₹ 10,000) and *B* is ₹ 5,000 (*i.e.*, 1/2 of ₹ 10,000).

Illustration 19.

A and *B* are partners sharing profits and losses in the ratio of 3 : 2 with capitals of ₹ 4,00,000 and ₹ 3,00,000 respectively. Interest on capital is agreed @ 5% p.a. *B* is to be allowed an annual salary of ₹ 30,000 which has not been withdrawn. Profit for the year ending 31st March, 2018 prior to calculation of interest on capital but after charging *B*'s salary is ₹ 1,20,000. A provision of 5% of the profit is to be made in respect of commission to the manager. Prepare an account showing the appropriation of profit.

Solution:

Dr. PROFIT AND LOSS ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars	₹	Particulars	₹
To Manager's Commission A/c (@ 5% on ₹ 1,50,000)	7,500	By Profit (₹ 1,20,000 + ₹ 30,000) (Note)	1,50,000
To Net Profit transferred to Profit and Loss Appropriation A/c	1,42,500		
	1,50,000		1,50,000

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars		₹	Particulars	₹
To *B*'s Salary A/c		30,000	By Profit and Loss A/c (Net Profit)	1,42,500
To Interest on Capital A/cs:				
A	20,000			
B	15,000	35,000		
To Profit transferred to:				
A's Capital A/c	46,500			
B's Capital A/c	31,000	77,500		
		1,42,500		1,42,500

Note: Manager is an employee of the firm. Commission payable to him/her is in the nature of salary. Therefore, it is debited to Profit and Loss Account to determine net profit.

Unsolved Questions

1. *A* and *B* are partners in a firm sharing profits equally. They had advanced ₹ 30,000 as loan in their profit-sharing ratio on 1st October, 2017. The Partnership Deed is silent on the question of interest on the loan from partners. Compute the interest payable by the firm to the partners, assuming the firm closes its books on 31st March each year.

   [**Ans.:** *Interest on partner's loan = ₹ 15,000 × 6/100 × 6/12 = ₹ 450.*]

2. On 1st April, 2017, *A* and *B* entered into partnership contributing ₹ 60,000 and ₹ 45,000 respectively. They agreed to share profits and losses in the ratio of 3 : 2. *B* is allowed salary of ₹ 12,000 per year. Interest on capital is to be allowed @ 10% p.a. During the year, *A* withdrew ₹ 9,000 and *B* withdrew ₹ 18,000 as drawings. Interest on drawings paid by *A* and *B* were ₹ 150 and ₹ 210 respectively. Profit for the year ended 31st March, 2018 before the above adjustments was ₹ 35,000. Show distribution of profits by preparing Profit and Loss Appropriation Account of the firm. Prepare Partners' Capital Accounts also.

   [**Ans.:** *Profit: A—₹ 7,716; B—₹ 5,144 and Balances of Capital A/cs: A—₹ 64,566; B—₹ 48,434.*]

3. Ram and Mohan are equal partners. Their capitals are ₹ 4,000 and ₹ 8,000 respectively. After the accounts for the year are prepared it is discovered that interest @ 5% p.a. on capital as provided in the Partnership Deed has not been credited to the Capital Accounts before distribution of profits. It is decided to make an adjusting entry in the beginning of the next year.

Give necessary adjustment entry. [**Ans.:** *Debit Ram and Credit Mohan by ₹ 100.*]

4. *X* and *Y* are partners in a firm sharing profits in the ratio of 3 : 2. They have a manager, *Z*, who gets ₹ 10,000 p.m. salary *plus* commission of 5% of the profit after charging his salary and commission. Now, they decide to admit *Z* as a partner, giving him 1/5th share in the profits of the firm. Any excess amount which *Z* receives as a partner (over his salary and commission) will be borne by *X*. The profit for the year ended 31st March, 2018 amounted to ₹ 8,40,000 after charging *Z*'s salary. Prepare Profit and Loss Appropriation Account showing the division of profit for the year.

[**Ans.:** *Z's Share as a Manager = ₹ 1,60,000; Z's Share as a Partner = ₹ 1,92,000 Deficiency of ₹ 32,000 to be met by X. Final Share of Profit: X = ₹ 4,48,000; Y = ₹ 3,20,000; Z = ₹ 1,92,000.*]

5. *A* and *B* are partners sharing profits and losses equally with capitals of ₹ 30,000 and ₹ 20,000 respectively. Their drawings during the year 2018–19 are:

		₹
A's drawings on	30th June, 2018	500
	31st July, 2018	600
	1st October, 2018	450
	1st March, 2019	1,400

B drew ₹ 300 at the end of each month. The Deed provides for interest on capitals and drawings @ 6% p.a. Calculate interest on capitals and drawings for the year ended 31st March, 2019.

[**Ans.:** *Interest on Capitals: A—₹ 1,800 and B—₹ 1,200; Interest on Drawings: A—₹ 67 and B—₹ 99.*]

6. Kalu and Lalu are partners in a firm. Their capitals on 1st April, 2017 were: Kalu ₹ 50,000 and Lalu ₹ 30,000. They share profits and losses in the ratio of 3 : 2. They earned profits of ₹ 55,000 for the year ended 31st March, 2018. Their Drawings were: Kalu ₹ 3,500 and Lalu ₹ 2,400.

Prepare Profit and Loss Appropriation Account and the Partners' Capital Accounts after taking into consideration the following facts:

(a) Partners' Salaries—Kalu ₹ 500 per month, Lalu ₹ 400 per month.

(b) Interest is payable @ 5% p.a. on the Partners' Capitals.

(c) Interest is to be charged @ 5% p.a. on the Partners' Drawings.

[**Ans.:** *Divisible Profit: Kalu—₹ 24,208.50 and Lalu—₹ 16,139; Balance of Capital: Kalu—₹ 79,121 and Lalu—₹ 49,979.*]

7. Ripa, Rini and Rima are three partners in a firm. According to Partnership Deed, the partners are entitled to draw ₹ 700 per month. On 1st day of every month Ripa, Rini and Rima draw ₹ 700, ₹ 600 and ₹ 500 respectively. Interest on capitals and interest on drawings are fixed @ 8% p.a. and 10% p.a. respectively. Profit during the year 2017–18 was ₹ 75,500 out of which ₹ 20,000 is transferred to the General Reserve. Rini and Rima are entitled to receive a salary of ₹ 3,000 and ₹ 4,500 p.a. respectively and Ripa is entitled to receive commission @ 10% on net distributable profits after charging such commission.

On 1st April, 2017, the balances of their Capital Accounts were ₹ 50,000, ₹ 40,000 and ₹ 35,000 respectively.

You are required to show the Profit and Loss Appropriation Account for the year ended 31st March, 2018 and the Capital Accounts of Partners in the books of the firm.

[**Ans.:** *Net Divisible Profit—₹ 35,609; Ripa's Commission—₹ 3,561; Closing Balance of Capital A/cs: Ripa—₹ 60,576; Rini—₹ 50,480; Rima—₹ 47,844.*]

[**Hint:** *Interest on Drawings* (For 6.5 months): Ripa ₹ 455; Rini ₹ 390; Rima ₹ 325.

Ripa's Commission = 10/110 of [₹ 75,500 + ₹ 1,170 (Interest on Drawings) – ₹ 20,000 (General Reserve) – ₹ 10,000 (Interest on Capital) – ₹ 7,500 (Salary)] = ₹ 3,561.]

8. *A* and *B* formed a partnership on 1st April, 2017. They agreed that out of profits:

(a) *A* should receive a salary of ₹ 500 per month;

(b) Interest on capitals should be allowed @ 6% p.a. and

(c) Remaining profits be divided equally.

A contributed a capital of ₹ 50,000 on 1st April, 2017 but *B* brought in his capital of ₹ 1,00,000 on 1st July, 2017. During the year, the drawings were: *A* ₹ 15,000 and *B* ₹ 20,000. Profit for the year ended 31st March, 2018 before the above noted salary and interest was ₹ 50,000.

Prepare Profit and Loss Appropriation Account and the Capital Accounts of the Partners.

[**Ans.:** *Capital Accounts: A—₹ 62,250; B—₹ 1,02,750.*]

9. *A* and *B* had been sharing profits and losses equally. After dividing the profits for the year 2017–18 ₹ 60,000, it was agreed that they would share profits and losses from 1st April, 2017 in the ratio of 3 : 2. At that time it was also found that while preparing accounts for 2017–18, interest on capital @ 5% p.a. was ignored. The fixed capitals of *A* and *B* were ₹ 1,00,000 and ₹ 80,000 respectively.

Pass a single adjustment entry to adjust the accounts of the partners. *(Foreign 1995, Modified)*

[**Ans.:** *Dr. B's Current A/c—₹ 5,600 and Cr. A's Current A/c—₹ 5,600.*]

10. Shiv and Shanker were partners in a firm sharing profits in 3 : 2 ratio. Their fixed capitals were ₹ 1,70,000 and ₹ 2,10,000 respectively. The Partnership Deed provides the following:

(a) Interest on Capital @ 12% p.a.

(b) Interest on Drawings @ 18% p.a.

Shiv withdrew ₹ 12,000 on 30th June, 2018 and Shanker withdrew ₹ 18,000 on 30th September, 2018. The profit for the year ended 31st March, 2019 was ₹ 97,000, which was distributed among the partners without providing for the above adjustments. Pass adjustment entry. *(Foreign 2008, Modified)*

[**Ans.:** *Dr. Shiv's Current A/c and Cr. Shanker's Current A/c by ₹ 6,636.*]

11. *A, B* and *C* are partners in a firm. *A* and *B* sharing profits in the ratio of 5 : 3 and *C* receiving a salary of ₹ 150 per month, *plus* a commission of 5% on the profits after charging such salary and commission or 1/5th of the profits of the firm, whichever is larger. Any excess of the latter over the former is, under the partnership agreement, to be borne personally by *A*.

The profits for the year ended 31st March, 2018 amounted to ₹ 10,710 after charging *C*'s salary.

Prepare Profit and Loss Appropriation Account showing the division of the profits of the year.

[**Ans.:** *Share of Profit: A—₹ 6,183; B—₹ 3,825; C—₹ 2,502.*]

[**Hint:** For *C*: (i) (₹ 150 × 12) + (5/105 × ₹ 10,710) = ₹ 2,310 or

(ii) *C*'s share = 1/5 [₹ 10,710 (Profit) + ₹ 1,800 (Salary)] = ₹ 2,502

C will get ₹ 2,502 since Option (*ii*) is higher than Option (*i*).

Deficiency = ₹ 2,502 – ₹ 2,310 = ₹ 192, borne by *A*.

Share of profit before adjusting deficiency: *A* = 5/8 × (₹ 12,510 – ₹ 2,310);

B = 3/8 × (₹ 12,510 – ₹ 2,310).]

12. Abha and Bhrat were partners. They shared profits and losses equally. On 1st April, 2014 their Capital Accounts showed balances of ₹ 3,00,000 and ₹ 2,00,000 respectively. Calculate the amount of profit to be distributed between the partners if the Partnership Deed provided for Interest on Capital @ 10% p.a. and the firm earned a profit of ₹ 50,000 for the year ended 31st March, 2015. *(Delhi 2016 C)*

[**Ans.:** *Profit Available for Distribution—NIL.*]

13. Akshat, Bilal and Charu are partners dealing in the sale of sports equipment. Akshat without the knowledge of Bilal and Charu is also running the business of supplying sports equipment to a few sports clubs in which his son is a member. He is earning good profits from this business but did not inform Bilal and Charu about this. Was Akshat correct in doing so? Indicate a value which he did not follow. *(Delhi 2016 C)*

[**Ans.:** *No. The Values of Honesty and being Fair are Violated.*]

14. If the Partners' Capital Accounts are fixed where will the following be recorded?

(a) Salary payable to a partner,
(b) Drawings made by a partner,
(c) Fresh capital introduced by a partner,
(d) Share of profit of the firm,
(e) Share of loss of the firm,
(f) Commission payable to a partner,
(g) Interest on capital, and
(h) Interest on drawings.

[**Ans.:** *On Credit Side of Current A/c*—(a), (d), (f) *and* (g);
On Debit Side of Current A/c—(b), (e) *and* (h);
On Credit Side of Capital A/c—(c).]

15. Nusrat and Sonu were partners in a firm sharing profits in the ratio of 3 : 2. During the year ended 31st March, 2015 Nusrat had withdrawn ₹ 15,000. Interest on her drawings amounted to ₹ 300.

Pass necessary Journal entry for charging interest on drawings assuming that the capitals of the partners were fixed. *(Delhi 2016)*

16. Tom and Harry were partners in a firm sharing profits in the ratio of 5 : 3. During the year ended 31st March, 2015 Tom had withdrawn ₹ 40,000. Interest on his drawings amounted to ₹ 2,000.

Pass necessary Journal entry for charging interest on drawings assuming that the capitals of the partners were fluctuating. *(AI 2016)*

17. Manpreet and Jaspreet were partners sharing profits and losses in the ratio of 3 : 2. They decided that from 1st April, 2015 they will share profits and losses equally. On that date, the Balance Sheet of the firm had credit balance of ₹ 1,00,000 in General Reserve. Jaspreet was of the opinion that it should be credited to the Capital Accounts equally. Manpreet was of the opinion that it should be credited to the Capital Accounts in their old profit-sharing ratio. Jaspreet agreed to the views of Manpreet. Explain what arguments must have been put forward by Manpreet to which Jaspreet agreed.

18. Mahesh and Ramesh are partners with capitals of ₹ 50,000 and ₹ 60,000 respectively. On 1st January, 2018, Mahesh gives a loan of ₹ 10,000 and Ramesh introduced ₹ 20,000 as additional capital. Profit for the year ended 31st March, 2018 was ₹ 15,200. There is no Partnership Deed. Both Mahesh and Ramesh expect interest @ 10% p.a. on the loan and additional capital advanced by them.

Show how the profits would be divided? Give reasons.

[**Ans.:** *Divisible Profit—₹ 15,050 being Mahesh's share and Ramesh's share—₹ 7,525 each.*]

[**Hints:** *Reasons:* (i) Interest on Partner's loan will be allowed @ 6% p.a.
(ii) No interest on partner's capital will be allowed.
(iii) Profits will be shared equally between partners.]

19. Jagmohan and Ramesh were partners with capital contribution of ₹ 10,00,000 and ₹ 5,00,000 respectively. They do not have a Partnership Deed. Jagmohan wants that the firm should allow interest on capital @ 6% p.a. Ramesh convinced Jagmohan that interest cannot be allowed on capital to which Jagmohan agreed after discussion. What argument must have been put forward by Ramesh that convinced Jagmohan?

20. Sunil and Jatinder were partners in a firm. Their drawings during the year were ₹ 1,00,000 and ₹ 75,000 respectively. They do not have a Partnership Deed. Jatinder wanted that the firm should charge interest on drawings @ 6% p.a. Sunil convinced Jatinder that interest cannot be charged on drawings to which Jatinder agreed after discussion. What argument must have been put forward by Sunil that convinced Jatinder?

21. Black and White are partners with capitals of ₹ 30,000 and ₹ 20,000 respectively. Profits for the year ended 31st March, 2018 amounted to ₹ 27,100. It is agreed that 5% interest on capital shall be allowed. There is no agreement regarding sharing of profits or partnership salary. Black is a whole-time partner whereas White does not attend business regularly. Black claims ₹ 600 salary per month and 60% of balance profits. White advanced ₹ 10,000 as loan and he now claims 10% interest.

State how you will settle the accounts.

[**Ans.:**	*Black (₹)*	*White (₹)*
Interest on Capital @ 5%	*1,500*	*1,000*
Interest on Loan @ 6% p.a.	...	*600*
Residue of profit equally	*12,000*	*12,000*.]

22. From the following Balance Sheet of *X* and *Y*, calculate interest on capital @ 6% p.a. payable to *Y* for the year ended 31st March, 2018:

Liabilities	₹	Assets	₹
X's Capital A/c	50,000	Sundry Assets	1,10,000
Y's Capital A/c	40,000		
Contingency Reserve (transferred in 2017–18)	20,000		
	1,10,000		1,10,000

During the year, *Y*'s drawings were ₹ 15,000 and profit for the year ended 31st March, 2018 was ₹ 30,000.

[**Ans.:** *Interest on Y's Capital—₹ 3,000.*]

23. *P*, *Q* and *R* were partners in a firm sharing profits in the ratio of 1 : 2 : 2. After division of the profit for the year ended 31st March, 2018, their capitals were: *P* ₹ 1,50,000; *Q* ₹ 1,80,000 and *R* ₹ 2,10,000. During the year, they withdrew ₹ 20,000 each. The profit for the year was ₹ 60,000. The Partnership Deed provided that the interest on capital will be allowed @ 10% p.a. While preparing final accounts, interest on partners' capitals was not allowed.

You are required to calculate capital of *P*, *Q* and *R* as at 1st April, 2017 and pass necessary adjustment entry for providing interest on capital. Show your working clearly. *(Delhi 2002, Modified)*

[**Ans.:** *Opening Capitals: P ₹ 1,58,000; Q ₹ 1,76,000; R ₹ 2,06,000; Debit Q with ₹ 4,000; R with ₹ 1,000 and Credit P with ₹ 5,000.*]

24. *A*, *B* and *C* were partners in a firm. On 1st April, 2017 their capitals stood at ₹ 50,000, ₹ 25,000 and ₹ 25,000 respectively. As per the provisions of the Partnership Deed:

(a) *C* was entitled for a salary of ₹ 1,500 per month.
(b) Partners were entitled to interest on capital @ 5% p.a.
(c) Profits were to be shared in the ratio of capitals.

The net profit for the year ended 31st March, 2018 of ₹ 45,000 was divided equally without providing for the above terms.

Pass an adjustment entry to rectify the above error.

[**Ans.:** *A's Capital A/c* (*Dr.*) *₹ 1,500; B's Capital A/c* (*Dr.*) *₹ 8,250; C's Capital A/c* (*Cr.*)*—₹ 9,750.*]

25. *A*, *B* and *C* entered into partnership on 1st April, 2009 to share profits and losses in the ratio of 5 : 3 : 2. *A* guaranteed that *C*'s share of profit, after charging interest on capital @ 5% p.a., would not be less than ₹ 15,000 in any year.

The capitals were as follows: *A*—₹ 1,60,000; *B*—₹ 1,00,000 and *C*—₹ 80,000.

Profit for the year ended 31st March, 2018 amounted to ₹ 79,500 before providing for interest on capital. Show Profit and Loss Appropriation Account. [**Ans.:** *Share of Profit: A—₹ 28,750; B—₹ 18,750; C—₹ 15,000.*]

26. After the accounts of a partnership have been drawn up and the books closed, it is discovered that interest on capitals for the year 2016–17 and 2017–18 has been credited to partners though there is no such provision in the Partnership Deed. The amounts involved are:

Partners	*Interest Credited*	
	2016–17 (₹)	2017–18 (₹)
A	350	360
B	200	210
C	110	110

You are required to put through adjustment entries as on 1st April, 2018, if the profits were shared as follows:

2016–17—1 : 1 : 1; 2017–18—3 : 4 : 3

It may be assumed that capitals are fixed.

[**Ans.:** *2016–17:*

For Interest on Capital: *Dr. A's Current A/c by ₹ 350; B's Current A/c by ₹ 200 and C's Current A/c by ₹ 110;*
Cr. Profit and Loss Adjustment A/c ₹ 660.

For Profit: *Dr. Profit and Loss Adjustment A/c by ₹ 660;*
Cr. A's Current A/c by ₹ 220; B's Current A/c by ₹ 220 and C's Current A/c by ₹ 220.

2017–18:

For Interest on Capital: *Dr. A's Current A/c by ₹ 360; B's Current A/c by ₹ 210 and C's Current A/c by ₹ 110;*
Cr. Profit and Loss Adjustment A/c ₹ 680;

For Profit: *Dr. Profit and Loss Adjustment A/c by ₹ 680*
Cr. A's Current A/c by ₹ 204; B's Current A/c by ₹ 272 and C's Current A/c by ₹ 204.]

Note: If question requires necessary single Adjustment Entry:
Dr. *A*'s Current A/c by ₹ 286;
Cr. *B*'s Current A/c by ₹ 82 and *C*'s Current A/c by ₹ 204.

27. On 31st March, 2018, the balances in the Capital Accounts of Ekta, Ankit and Chahat after making adjustments for profits and drawings were ₹ 1,50,000, ₹ 2,10,000 and ₹ 2,70,000 respectively. Subsequently, it was discovered that the interest on capital and drawings had been omitted.

(a) The profit for the year ended 31st March, 2018 was ₹ 1,20,000.

(b) During the year Ekta withdrew ₹ 24,000 and Ankit and Chahat each withdrew a sum of ₹ 24,000 in equal instalments in the middle of each quarter.

(c) The interest on drawings was to be charged @ 5% p.a. and interest on capital was to be allowed @ 10% p.a.

(d) The profit-sharing ratio among the partners was 1 : 2 : 3.

Showing your working notes clearly, pass the necessary rectifying entry.

[**Ans.:** *Dr. Chahat's Capital A/c—₹ 5,400; Cr. Ekta's Capital A/c—₹ 5,400.*]

CHAPTER 3

Goodwill: Nature and Valuation

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. Goodwill — Goodwill is the value of good name or reputation enjoyed by a firm that enables it to earn profit over and above the normal profits. It is an intangible asset.

2. Purchased Goodwill — Purchased Goodwill means goodwill for which consideration has been paid.

3. Self-generated Goodwill — Self-generated Goodwill is the goodwill that has been generated by the business because of which it is able to earn higher profit.

4. Methods of Valuation of Goodwill

(i) Simple Average Profit Method — It is calculated by taking the average profit for a specified number of years and multiplying it with the number of years of purchase.
Goodwill = Average Profit × No. of Years' Purchase.

(ii) Weighted Average Profit Method — It is calculated by multiplying the profit for each year with the weight assigned to it. The amounts so arrived at are totalled and divided by the total of weights. The weighted average profit is multiplied by the number of years of purchase.
Goodwill = Weighted Average Profit × No. of Years' Purchase.

(iii) Super Profit Method — Super profit is the profit earned by the business that is in excess of the normal profit. Goodwill is determined by multiplying the super profit by the number of years' purchase.
Goodwill = Super Profit × No. of Years' Purchase.

Capitalisation Method

(iv) Capitalisation of Average Profit — Under Capitalisation Method, capitalised value of the business is determined by capitalising the average profit by the normal rate of return. Out of the value so determined, value of net assets is deducted, the balance amount is the value of goodwill.
Goodwill = Capitalised Value of Business – Net Assets.

(v) Capitalisation of Super Profit — Under this method, super profit is capitalised at the normal rate of return.

$$\textbf{Goodwill} = \textbf{Super Profit} \times \frac{100}{\textbf{Normal Rate of Return}}.$$

CHAPTER SUMMARY

- **Goodwill:** Goodwill is the benefit and advantage of the good name, reputation and connection of a business. It is the attractive force which brings in customers. It is one factor which distinguishes an old established business from a new business at its first start.
- **Nature and Characteristics of Goodwill**
  - (i) It is an intangible asset and not a fictitious asset.
  - (ii) It helps to earn more than normal profit.
  - (iii) It is an attractive force which brings in customers to the old place of business.
  - (iv) It is composed of a variety of elements.
  - (v) It is difficult to ascertain the exact value of goodwill.
- **Factors Affecting the Value of Goodwill:** Value of goodwill depends upon the capacity of a business to earn profit in excess of normal profits. Therefore, all such factors which help to increase the profits of a business will also affect the value of goodwill. These factors are: 1. Efficiency of Management, 2. Quality of products, 3. Favourable location, 4. Contracts, 5. Control over raw materials, and 6. Other factors like after sale service, good customer relations, etc.
- **Classification of Goodwill:** Goodwill can be classified into two groups:
  1. *Purchased Goodwill:* Purchased goodwill means goodwill acquired by paying money or money's worth. It may be purchased as an intangible asset but generally it arises when a business is purchased and purchase consideration is more than the value of net assets (*i.e.*, Assets – Liabilities) acquired. The difference amount is the value of purchased goodwill. It is recorded in the books of account.
  2. *Self-generated Goodwill or Non-purchased Goodwill:* It is an internally generated goodwill which arises from a number of attributes that a running business possessed. It is not recorded in the books.
- **Need for Valuation of Goodwill for Partnership Firms**

  For partnership firms the need for valuation of goodwill arises in the following circumstances:
  - (i) When there is a change in the profit-sharing ratio of existing partners.
  - (ii) When a new partner is admitted.
  - (iii) When a partner retires or dies.
  - (iv) When the firm is sold as a going concern.
  - (v) When two or more firms are amalgamated.
  - (vi) When a partnership firm is converted into a company.
- **Methods of Valuation of Goodwill:**
  1. *Average Profit Method:* Goodwill = Average Profit × No. of Years' Purchase.
  2. *Super Profit Method:* Goodwill = Super Profit × No. of Years' Purchase.
  3. *Capitalisation of Super Profit:* Goodwill = Super Profit × 100/Normal Rate of Return.
  4. *Capitalisation of Average Profit:* Goodwill = Capitalised Value of the Business – Net Assets.
- **Capital Employed:** Capital employed means capital invested in the firm to carry on business.
  - (i) *Liabilities Side Approach:*

    Capital Employed = Capital + Reserves – Goodwill, if any, existing in the books – Fictitious Assets – Non-trade Investments.
  - (ii) *Assets Side Approach:*

    Capital Employed = All Assets (except goodwill, non-trade investments and fictitious assets) – Outside Liabilities.

Solved Questions

Illustration 1.

Brick, Sand and Cement were in partnership sharing profits and losses in the ratio of 5 : 3 : 2. They decide to take Lime into partnership from 1st April, 2019. For this purpose, Goodwill is to be valued at 80% of the average annual profits of the previous three or four years, whichever is higher.

The profits were:	₹
Year ended 31st March, 2018	48,000
Year ended 31st March, 2017	30,000
Year ended 31st March, 2016	31,500
Year ended 31st March, 2015	45,000

Calculate the value of Goodwill.

Solution:

CALCULATION OF AVERAGE PROFIT

Based on 3 years' profits	₹	Based on 4 years' profits	₹
Year ended 31st March, 2018	48,000	Year ended 31st March, 2018	48,000
Year ended on 31st March, 2017	30,000	Year ended 31st March, 2017	30,000
Year ended on 31st March, 2016	31,500	Year ended 31st March, 2016	31,500
		Year ended 31st March, 2015	45,000
	1,09,500		1,54,500
Average Profit = ₹ 1,09,500/3 = ₹ 36,500		**Average Profit = ₹ 1,54,500/4 = ₹ 38,625**	

Four years' average profit is higher than the three years' average profit. Therefore, the value of Goodwill will be 80% of ₹ 38,625 = ₹ 30,900.

Illustration 2.

XY & Co., a partnership firm, intends to estimate the value of its Goodwill on the basis of three years' purchase of super profit of the firm. The capital employed in the firm is ₹ 1,50,000 and the normal rate of return is 20%. Profits for the last four years were:

2014–15—₹ 35,000 2015–16—₹ 38,000

2016–17—₹ 42,000 2017–18—₹ 45,000

Solution:

Capital Employed = ₹ 1,50,000

Normal Rate of Return = 20%

∴ Normal Profit = ₹ 1,50,000 × 20/100 = ₹ 30,000

$$\text{Average Profit} = \frac{₹\ 35,000 + ₹\ 38,000 + ₹\ 42,000 + ₹\ 45,000}{4}$$

= ₹ 40,000.

Super Profit = Average Profit – Normal Profit

= ₹ 40,000 – ₹ 30,000 = ₹ 10,000

Goodwill = Super Profit × No. of Years' Purchase

= ₹ 10,000 × 3 = ₹ 30,000.

Illustration 3.

On 1st April, 2018, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. Its creditors amounted to ₹ 5,000 on that date. The firm had a Reserve Fund of ₹ 10,000 while Partners' Capital Accounts showed a balance of ₹ 60,000. If the normal rate of return is 20% and the Goodwill of the firm is valued at ₹ 24,000, at four years' purchase of super profit, find the average profit per year of the existing firm.

Solution:

Goodwill is valued at four years' purchase of Super Profit, which is ₹ 24,000.

Therefore, Goodwill = Super Profit × 4

or ₹ 24,000 = Super Profit × 4

or Super Profit = ₹ 24,000/4 = ₹ 6,000

Again, Normal Profit = Capital Employed × Normal Rate of Return/100

= (Capital + Reserve) × 20/100

= (₹ 60,000 + ₹ 10,000) × 20/100 = ₹ 14,000.

Super Profits are the excess of average profit over normal profit.

Therefore, Super Profit = Average Profit – Normal Profit

or ₹ 6,000 = Average Profit – ₹ 14,000

or Average Profit = ₹ 14,000 + ₹ 6,000 = ₹ 20,000.

Illustration 4.

X and *Y* are partners sharing profits equally. They decide to admit *Z* for an equal share. For this purpose, the Goodwill is to be valued on the basis of capitalisation of average profit. The net assets of the firm are ₹ 3,20,000. Average maintainable profit of the firm is ₹ 45,000. The normal rate of return may be taken as 12% p.a. Calculate the Value of Goodwill according to Capitalisation of Average Profit Method.

Solution:

$$\text{Capitalised Value of the Firm} = \frac{\text{Average Maintainable Profit}}{\text{Normal Rate of Return}} \times 100$$

$$= \frac{₹\ 45{,}000}{12} \times 100 = ₹\ 3{,}75{,}000.$$

Goodwill = Capitalised Value of the Firm – Net Assets

= ₹ 3,75,000 – ₹ 3,20,000 = ₹ 55,000.

Illustration 5.

A firm earns ₹ 80,000 as its average profits. The rate of normal profit being 10%, the assets of the firm amounted to ₹ 10,00,000 and liabilities are ₹ 4,40,000. Calculate the value of Goodwill according to Capitalisation of Average Profit Method.

Solution:

$$\text{Capitalised Value of the Firm} = \frac{₹\ 80{,}000 \times 100}{10} = ₹\ 8{,}00{,}000.$$

Net Assets = Total Assets – Outside Liabilities

= ₹ 10,00,000 – ₹ 4,40,000 = ₹ 5,60,000

Goodwill = Capitalised Value of the Firm – Net Assets

= ₹ 8,00,000 – ₹ 5,60,000 = ₹ 2,40,000.

Illustration 6.

A firm earns a profit of ₹ 2,00,000. The Normal Rate of Return in a similar type of business is 10%. The value of total assets (excluding Goodwill) and total outsiders' liabilities as on the date of valuation of Goodwill are ₹ 22,00,000 and ₹ 5,60,000 respectively. Calculate the value of Goodwill according to Capitalisation of Super Profit Method.

Solution:

Average Profit (Given) = ₹ 2,00,000

Normal Profit = (₹ 22,00,000 – ₹ 5,60,000) × 10/100 = ₹ 1,64,000

Super Profit = ₹ 2,00,000 – ₹ 1,64,000 = ₹ 36,000

Goodwill = ₹ 36,000 × 100/10 = ₹ 3,60,000.

Illustration 7 (*Average Profit Method when Adjustments are Made*).

A purchased *B*'s business with effect from 1st April, 2018. It was agreed that the firm's goodwill is to be valued at two years' purchase of average normal profit of the last three years. The profits of *B*'s business for the last three years were:

2015–16 — ₹ 1,00,000 (including an abnormal gain of ₹ 10,000).

2016–17 — ₹ 1,10,000 (after charging an abnormal loss of ₹ 20,000).

2017–18 — ₹ 80,000.

Calculate value of the firm's goodwill.

Solution:

	Normal Profits	₹
Profit for 2015–16	(₹ 1,00,000 – ₹ 10,000)	90,000
Profit for 2016–17	(₹ 1,10,000 + ₹ 20,000)	1,30,000
Profit for 2017–18	(₹ 80,000)	80,000
Total profits for last three years		3,00,000

$$\text{Average Normal Profit} = \frac{₹\ 3,00,000}{3} = ₹\ 1,00,000$$

Goodwill = 2 years' purchase of 3 years' average normal profit

= ₹ 1,00,000 × 2 = ₹ 2,00,000.

Illustration 8.

Bharat and Bhushan are partners in a retail business. Balances in Capital and Current Accounts as on 31st March, 2018 were:

	Capital Account	Current Account
Bharat	₹ 2,00,000	₹ 50,000
Bhushan	₹ 2,40,000	₹ 10,000 (Dr.)

The firm earned an average profit of ₹ 90,000. If the normal rate of return is 10%, find the value of goodwill.

Solution:

$$\text{Capitalised Value of the Business} = \frac{\text{Average Profit} \times 100}{\text{Normal Rate of Return}}$$

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

Capital Employed = ₹ 2,00,000 + ₹ 2,40,000 + ₹ 50,000 – ₹ 10,000 = ₹ 4,80,000

Goodwill = ₹ 9,00,000 – ₹ 4,80,000 = ₹ 4,20,000.

Illustration 9.

From the following information, calculate value of goodwill of M/s. Amit and Sumit:

(i) At three years' purchase of Average Profit.

(ii) At the two years' purchase of Super Profit.

(iii) On the basis of Capitalisation of Super Profit.

(iv) On the basis of Capitalisation of Average Profit.

Information:

(a) Average Capital Employed—₹ 6,00,000.

(b) Net Profit/Loss of the firm for the past three years: 2016—₹ 2,00,000 (Profit); 2017—₹ 1,00,000 (Loss); 2018—₹ 2,30,000 (Profit).

(c) Normal Rate of Return on capital is 12%.

(d) Remuneration of each partner ₹ 30,000 per annum to be considered as a charge against profit.

(e) Assets—₹ 6,50,000; Partners' Capital—₹ 6,00,000.

Solution:

(i) *Calculation of Goodwill at three years' purchase of Average Profit:*

$$\text{Average Profit} = \frac{₹\ 2{,}00{,}000 - ₹\ 1{,}00{,}000 + ₹\ 2{,}30{,}000}{3} = ₹\ 1{,}10{,}000$$

Average Normal Profit = Average Profit – Partners' Remuneration

= ₹ 1,10,000 – ₹ 60,000 = ₹ 50,000

Value of Goodwill = Average Normal Profit × Number of Years' Purchase

= ₹ 50,000 × 3 = ₹ 1,50,000.

(ii) *Calculation of Goodwill at three years' purchase of Super Profit:*

Normal Profit = Capital Employed × Normal Rate of Return/100

= ₹ 6,00,000 × 12/100 = ₹ 72,000

Super Profit = Average Profit – Normal Profit

= ₹ 50,000 – ₹ 72,000 = (₹ 22,000)

Since the firm does not have Super Profit, the value of goodwill is nil.

(iii) *On the basis of Capitalisation of Super Profit:*

The firm does not have Super Profit. Hence, the value of goodwill is nil.

(iv) *On the basis of Capitalisation of Average Profit:*

$$\text{Goodwill} = \text{Total Capitalised Value of Business} - \text{Net Assets}$$

$$\text{Total Capitalised Value of Business} = \frac{\text{Average Normal Profit} \times 100}{\text{Normal Rate of Return}}$$

$$= \frac{₹\ 50{,}000 \times 100}{12} = ₹\ 4{,}16{,}666 \text{ or } ₹\ 4{,}16{,}667 \text{ (say)}$$

$$\text{Net Assets} = \text{Total Assets} - \text{Outside Liabilities}$$

$$\text{Outside Liabilities} = \text{Total Assets} - \text{Partners' Capital}$$

$$= ₹\ 6{,}50{,}000 - ₹\ 6{,}00{,}000 = ₹\ 50{,}000$$

$$\therefore \quad \text{Net Assets} = ₹\ 6{,}50{,}000 - ₹\ 50{,}000 = ₹\ 6{,}00{,}000$$

$$\text{Value of Goodwill} = ₹\ 4{,}16{,}667 - ₹\ 6{,}00{,}000 = (₹\ 1{,}83{,}333)$$

The value of goodwill is nil since capitalised value of business is less than the net assets.

Illustration 10 (*Weighted Average Profit when Past Adjustments are Made*).

Akhil and Nikhil are partners sharing profits equally. They admitted Dinesh into partnership. It was agreed to value goodwill at three years' purchase following Weighted Average Profit Method on the basis of past five years' profits. Weights assigned to each year would be—years ended 31st March, 2014–1, 2015–2, 2016–3, 2017–4 and 2018–5.

The profits for these years were—₹ 90,000, ₹ 80,000, ₹ 1,25,000, ₹ 1,50,000 and ₹ 1,75,000 respectively.

Verification of books of account revealed the following:

1. There was an abnormal loss of ₹ 15,000 during the year ended 31st March, 2014.
2. There was an abnormal gain of ₹ 10,000 during the year ended 31st March, 2016.
3. Closing Stock as on 31st March, 2017 was overvalued by ₹ 15,000.

Calculate value of goodwill.

Solution:

1. CALCULATION OF NORMAL PROFIT

Year Ended	Profit (₹)	Adjustment (₹)	Normal Profit (₹)
31st March, 2014	90,000	15,000	1,05,000
31st March, 2015	80,000	...	80,000
31st March, 2016	1,25,000	(10,000)	1,15,000
31st March, 2017	1,50,000	(15,000)*	1,35,000
31st March, 2018	1,75,000	15,000*	1,90,000

*Closing Stock being overvalued on 31st March, 2017 means that profit for the year is shown at higher amount. It has effect on the profit for the next year. Profit for next year is shown at lower amount as Closing Stock of previous year is carried forward as Opening Stock of next year.

2. CALCULATION OF WEIGHTED PROFIT

Year Ended	Profit (₹)	Weights	Weighted Profit (₹)
31st March, 2014	1,05,000	1	1,05,000
31st March, 2015	80,000	2	1,60,000
31st March, 2016	1,15,000	3	3,45,000
31st March, 2017	1,35,000	4	5,40,000
31st March, 2018	1,90,000	5	9,50,000
		15	21,00,000

$$\text{Weighted Average Profit} = \frac{\text{Total of Weighted Profit}}{\text{Total of Weights}} = \frac{₹\ 21,00,000}{15} = ₹\ 1,40,000$$

Number of Years' Purchase = 3

∴ Value of Goodwill = Weighted Average Profit × Number of Years' Purchase

= ₹ 1,40,000 × 3 = ₹ 4,20,000.

Illustration 11.

The average profit earned by a firm is ₹ 80,000 which includes undervaluation of stock of ₹ 8,000 on an average basis. The capital invested in the business is ` 8,00,000 and the normal rate of return is 8%. Calculate goodwill of the firm on the basis of 7 times the super profit.

(Delhi 2015 C)

Solution: Average Profit = ₹ 80,000

Undervaluation of Stock = ₹ 8,000

Adjusted Average Profit = ₹ 80,000 + ₹ 8,000 (Note) = ₹ 88,000

$$\text{Normal Profit} = \text{Capital Employed (Investment)} \times \frac{\text{Normal Rate of Return}}{100}$$

= ₹ 8,00,000 × = ₹ 64,000

Super Profit = Adjusted Average Profit – Normal Profit

= ₹ 88,000 – ₹ 64,000 = ₹ 24,000

Goodwill = Super Profit × 7

= ₹ 24,000 × 7 = ₹ 1,68,000.

Note: Undervaluation of stock reduces the net profit. Hence, it is added to determine adjusted profit.

Unsolved Questions

1. *X* and *Y* are partners sharing profits and losses in the ratio of 3 : 2. They admit *Z* for 1/5th share. For this purpose, the Goodwill of the firm is to be valued on the basis of three years' purchase of last five years' average profits.

The profits were:

Year	2013–14	2014–15	2015–16	2016–17	2017–18
Profits (₹)	50,000	60,000	40,000	65,000	80,000

The profit of 2016–17 was calculated after charging ₹ 5,000 for loss of goods by fire. Calculate the Goodwill of the firm. [**Ans.:** *Value of Goodwill = ₹ 1,80,000.*]

2. Calculate the value of Goodwill as on 1st April, 2018 on the basis of three years' purchase of the average profits of the last five years. The profits and losses for the years were: 2013–14—(Loss) ₹ 80,000 (including Profit on sale of furniture during the year ₹ 4,000), 2014–15—₹ 1,84,000, 2015–16—₹ 1,00,000 (profit on sale of machinery during the year ₹ 10,000); 2016–17—₹ 1,50,000; 2017–18—₹ 1,80,000 (including loss on sale of computer ₹ 10,000). [**Ans.:** *Goodwill = ₹ 3,18,000; Average Profit = ₹ 1,06,000.*]

3. A firm earns profit of ₹ 1,00,000. The Normal Rate of Return in a similar type of business is 10%. The value of total assets (excluding Goodwill) and total outsiders' liabilities as on the date of valuation of Goodwill are ₹ 12,00,000 and ₹ 3,80,000 respectively. Calculate the value of Goodwill according to Capitailisation of Super Profit Method. **[Ans.:** *Goodwill = ₹ 18,000 (Super Profit) × 100/10 = ₹ 1,80,000.*]

4. Ravi and Kant are partners in a business with balances in their Capital and Current Accounts as on 31st March, 2018 were:

	Capital Account	Current Account
Ravi	₹ 2,50,000	₹ 50,000
Kant	₹ 3,00,000	₹ 25,000 (Dr.)

The firm earned an average profit of ₹ 1,25,000. If the normal rate of return is 10%, find the value of goodwill by Capitalisation Method. [**Ans.:** *Value of Goodwill = ₹ 6,75,000.*]

5. Calculate the goodwill of a firm on the basis of three years' purchase of the weighted average profit of the last four years. Profits of these four years ended 31st March, were:

Year Ended	31st March, 2015	31st March, 2016	31st March, 2017	31st March, 2018
Profits (₹)	40,400	49,600	40,000	60,000

The weights assigned to each year ended 31st March are: 2015—1; 2016—2; 2017—3 and 2018—4.

You are provided with the following additional information:

(i) On 31st March, 2017, a major plant repair was undertaken for ₹ 12,000 which was charged to revenue. The said sum is to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on Written Down Value Method.

(ii) The Closing Stock for the year ended 31st March, 2016 was overvalued by ₹ 4,800.

(iii) To cover management cost an annual charge of ₹ 9,600 should be made for the purpose of goodwill valuation. **[Ans.:** *Value of Goodwill = ₹ 1,31,880.*]

6. Mahesh and Suresh are partners and they admit Naresh into partnership. They agreed to value goodwill at three years' purchase on Weighted Average Profit Method taking profits for the last five years. They assigned weights from 1 to 5 beginning from the earliest year and onwards. The profits for the last five years were as follows:

Year ended	31st March, 2014	31st March, 2015	31st March, 2016	31st March, 2017	31st March, 2018
Profits (₹)	1,25,000	1,40,000	1,20,000	55,000	2,57,000

Books of Account revealed the following:

(i) A second hand machine was purchased for ₹ 5,00,000 on 1st July, 2016 and ₹ 1,00,000 were spent to make it operational. ₹ 1,00,000 were wrongly debited to Repairs Account. Machinery is depreciated @ 20% p.a. on Written Down Value Method.

(ii) Closing Stock as on 31st March, 2017 was undervalued by ₹ 50,000.

(iii) Remuneration to partners was to be considered as charge against profit and remuneration of ₹ 30,000 p.a. for each partner was considered appropriate.

Calculate the value of goodwill. [**Ans.:** *Value of Goodwill—₹ 3,15,000.*]

7. Rakesh and Ashok earned a profit of ₹ 5,000. They employed capital of ₹ 25,000 in the firm. It is expected that the normal rate of return is 15% of the capital. Calculate amount of goodwill if goodwill is valued at three years' purchase of super profit. [**Ans.:** *Goodwill—₹ 3,750.*]

8. A firm earns ₹ 3,00,000 as its annual profit, the rate of return being 12%. Assets and liabilities of the firm amounted to ₹ 36,00,000 and ₹ 12,00,000 respectively. Calculate value of goodwill by Capitalisation Method. [**Ans.:** *Goodwill—₹ 1,00,000.*]

9. Anish and Manish are partners and they admit Ravish into partnership. They agreed to value goodwill at three years' purchase on Weighted Average Profit Method taking profits for the last five years. They assigned weights from 1 to 5 beginning from the earliest year and onwards. The profits for the last five years were as follows:

Year ended	31st March, 2014	31st March, 2015	31st March, 2016	31st March, 2017	31st March, 2018
Profits (₹)	1,25,000	1,40,000	1,20,000	55,000	2,57,000

Books of Account revealed the following:

(i) A second hand machine was purchased for ₹ 5,00,000 on 1st April, 2016 and ₹ 1,00,000 were spent to make it operational. ₹ 1,00,000 were wrongly debited to Repairs Account. Machinery is depreciated @ 20% p.a. on Written Down Value Method.

(ii) Closing Stock as on 31st March, 2017 was undervalued by ₹ 50,000.

(iii) Remuneration to partners was to be considered as charge against profit and remuneration of ₹ 20,000 p.a. for each partner was considered appropriate.

Calculate the value of goodwill. [**Ans.:** *Value of Goodwill—₹ 3,12,000.*]

CHAPTER 4

Change in Profit-Sharing Ratio Among the Existing Partners

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. Reconstitution of Partnership	Reconstitution of Partnership means change in relationship among the partners.
2. Change in Profit-sharing Ratio	Change in Profit-sharing Ratio means change in ratio in which profit or loss of the firm is shared by the partners.
3. Sacrificing Partners	The partners whose shares decrease as a result of change in profit-sharing ratio are known as **Sacrificing Partners**.
4. Gaining Partners	The partners whose shares increase due to change in profit-sharing ratio are known as **Gaining Partners**.
5. Sacrificing Ratio	Sacrificing Ratio is the ratio with which the profit share of the partners decrease.
6. Gaining Ratio	Gaining Ratio is the ratio with which the profit share of the partners increase.
7. New Profit-sharing Ratio	It is the ratio in which all partners (including incoming partner) are to share future profits.
8. Accumulated Profits	Accumulated Profits mean profits of the firm that have not been distributed among the partners.
9. Reserve	Reserve means amount set aside out of profits to meet a contingency or to strengthen the financial position of the firm.
10. Revaluation of Assets	Revaluation of Assets means change in value of assets, *i.e.*, present value being different from that of book value.
11. Reassessment of Liabilities	Reassessment of Liabilities means reassessing the liabilities, *i.e.*, whether the liability is more or less than that shown in the books of account.

CHAPTER SUMMARY

- **Meaning of the Reconstitution of a Firm:** Any change in existing agreement of partnership amounts to the reconstitution of a firm.
- **Circumstances when Reconstitution of a Firm takes Place:**
  1. On change in the profit-sharing ratio of existing partners.
  2. On admission of a new partner.
  3. On retirement of an existing partner.
  4. On death of a partner.
  5. On amalgamation of two or more partnership firms.
- **Meaning of Change in Profit-Sharing Ratio:** A change in profit-sharing ratio implies a purchase of share of profit by one partner from another partner.

- **Sacrificing Partners:** The partners whose shares have decreased due to change in the profit-sharing ratio are known as **sacrificing partners**.
- **Gaining Partners:** The partners whose shares have increased due to change in the profit-sharing ratio are known as **gaining partners**.
- **Sacrificing Ratio:** The ratio in which one or more partners sacrifice their share in profit in favour of one of more partners is known as **sacrificing ratio**.
- **Gaining Ratio:** The ratio in which one or more partners gain in profit from the other partner or partners is known as **gaining ratio**.

  Sacrificing/(Gaining) Share = Old Share − New Share.
- **Adjustment Required at the Time of Change in Profit-Sharing Ratio:**
  (i) Adjustment of Goodwill.
  (ii) Adjustment of Gain (Profit)/Loss arising from the Revaluation of Assets and Reassessment of Liabilities.
  (iii) Adjustment of the Reserves, Accumulated Profits and Losses.
  (iv) Adjustment of Capital.
- Reserves, Accumulated Profits and Losses are distributed among the existing partners in their old profit-sharing ratio and will not be shown in the New Balance Sheet.

  When Reserves are to be shown in future or in the New Balance Sheet: Gaining partners compensate the sacrificing partners for the share of reserves and profits which is proportionate to the share gained.
- **Revaluation of Assets and Reassessment of Liabilities at the time of change in profit-sharing ratio:** Any profit or loss arising on such revaluation is shared by the existing partners in their old profit-sharing ratio.

  There are *two methods* of Revaluation of Assets and Reassessment of Liabilities:
  1. **When revised (changed) values are to be recorded in the books:** Revaluation of assets and reassessment of liabilities is passed through **Revaluation Account**. The gain (profit) or loss on revaluation is transferred to the old partners' Capital (or Current) Accounts in their old profit-sharing ratio.
  2. **When revised (changed) values are not to be recorded:** The net effect of revaluation of assets and reassessment of liabilities is adjusted through Capital (or Current) Accounts of partners. An adjustment entry is passed based on gain/sacrifice of partner.

Accounting Treatment of Goodwill

A. When Goodwill is adjusted through Partners' Capital Accounts:

In Case of Fluctuating Capitals		*In Case of Fixed Capitals*	
Gaining Partners' Capital A/cs To Sacrificing Partners' Capital A/cs (In sacrificing ratio)	...Dr.	Gaining Partners' Current A/cs To Sacrificing Partners' Current A/cs (In sacrificing ratio)	...Dr.

B. When Goodwill is Raised and written off:

In Case of Fluctuating Capitals		*In Case of Fixed Capitals*	
Goodwill A/c To Partners' Capital A/cs	...Dr.	Goodwill A/c To Partners' Current A/cs	...Dr.
Partners' Capital A/cs To Goodwill A/c	...Dr.	Partners' Current A/cs To Goodwill A/c	...Dr.

Accounting Treatment of Existing Goodwill

Goodwill appearing in the Balance Sheet as on the date of reconstitution is written off in the old profit-sharing ratio unless the partners decide to carry the value in the books of account.

All Partners' Capital/Current* A/cs	...Dr.	[In old ratio]
To Goodwill A/c		[With existing book value of Goodwill]

*In case of Fixed Capitals

Solved Questions

Illustration 1.

Following is the Balance Sheet of *X*, *Y* and *Z*, who share profits and losses in the ratio of 2 : 3 : 1 as at 31st March, 2018:

BALANCE SHEET

Liabilities	₹	Assets		₹
X's Capital A/c	1,00,000	Goodwill		12,000
Y's Capital A/c	2,00,000	Land and Building		3,50,000
Z's Capital A/c	3,00,000	Investments (Market Value ₹ 96,000)		1,00,000
Workmen Compensation Reserve	30,000	Stock		80,000
Investments Fluctuation Reserve	10,000	Debtors	3,00,000	
Creditors	5,00,000	*Less:* Provision for Doubtful Debts	10,000	2,90,000
		Cash at Bank		2,96,000
		Advertisement Suspense A/c		12,000
	11,40,000			11,40,000

The partners changed their profit-sharing ratio to 3 : 2 : 1 *w.e.f.* 1st April, 2018. The following terms are agreed upon:

(i) Goodwill is to be valued at two years' purchase of average profit of last three completed years. The profits were:
2015–16—₹ 45,000; 2016–17—₹ 90,000; 2017–18—₹ 1,35,000.

(ii) Land and Building was found undervalued by ₹ 25,000 and Stock was found overvalued by ₹ 8,000.

(iii) Provision for Doubtful Debts is to be made equal to 5% of the Debtors.

(iv) Claim on account of Workmen Compensation is ₹ 18,000.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		8,000	By Land and Building A/c	25,000
To Provision for Doubtful Debts A/c		5,000		
To Gain (Profit) transferred to:				
X's Capital A/c	4,000			
Y's Capital A/c	6,000			
Z's Capital A/c	2,000	12,000		
		25,000		25,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Goodwill A/c (Written off)	4,000	6,000	2,000	By Balance *b/d*	1,00,000	2,00,000	3,00,000
To *Y*'s Capital A/c (WN 1 and 2)	30,000	...	...	By *X*'s Capital A/c (WN 1 and 2)	...	30,000	...
To Advertisement Suspense A/c (Written off)	4,000	6,000	2,000	By Revaluation A/c	4,000	6,000	2,000
To Balance *c/d*	72,000	2,33,000	3,01,000	By Workmen Compensation Reserve A/c	4,000	6,000	2,000
				By Investments Fluctuation Reserve A/c	2,000	3,000	1,000
	1,10,000	2,45,000	3,05,000		1,10,000	2,45,000	3,05,000

BALANCE SHEET
as at 1st April, 2018

Liabilities	₹	Assets		₹
X's Capital	72,000	Land and Building		3,75,000
Y's Capital	2,33,000	Investments		96,000
Z's Capital	3,01,000	Stock		72,000
Creditors	5,00,000	Debtors	3,00,000	
Workmen Compensation Claim	18,000	*Less:* Provision for		
		Doubtful Debts	15,000	2,85,000
		Bank		2,96,000
	11,24,000			11,24,000

Working Notes:

1. *Statement showing Sacrifice/(Gain) made by each partner:*

	X	*Y*	*Z*
Old Share	2/6	3/6	1/6
New Share	3/6	2/6	1/6
Difference (Gain or Sacrifice)	–1/6	1/6	NIL
	Gaining Partner	Sacrificing Partner	

X gains 1/6th share and *Y* sacrifices 1/6th share.

2. *Calculation of Goodwill:*

(i) Average Profit $= \dfrac{₹\ 45,000 + ₹\ 90,000 + ₹\ 1,35,000}{3} = ₹\ 90,000$

(ii) Firm's Goodwill $= ₹\ 90,000 \times 2 = ₹\ 1,80,000$

Y's Share of Goodwill $= ₹\ 1,80,000 \times 1/6 = ₹\ 30,000$, which is compensated by *X* (being the gaining partner).

3. (i) *For Workmen Compensation Reserve:*

		₹	₹
Workmen Compensation Reserve A/c	...Dr.	30,000	
To Workmen Compensation Claim A/c			18,000
To *X*'s Capital A/c			4,000
To *Y*'s Capital A/c			6,000
To *Z*'s Capital A/c			2,000

(ii) *For Investments Fluctuation Reserve:*

		₹	₹
Investments Fluctuation Reserve A/c	...Dr.	10,000	
To Investments A/c			4,000
To *X*'s Capital A/c			2,000
To *Y*'s Capital A/c			3,000
To *Z*'s Capital A/c			1,000

Illustration 2.

X, *Y* and *Z* are partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1. Their Balance Sheet as at 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Sundry Creditors		50,000	Cash at Bank	1,01,000
General Reserve		50,000	Sundry Debtors	1,00,000
Capital A/cs:			Stock	2,10,000
X	3,00,000		Machinery	2,60,000
Y	3,00,000		Building	2,25,000
Z	2,00,000	8,00,000	Advertisement Suspense	4,000
			(Deferred Revenue Expenditure)	
		9,00,000		9,00,000

Partners decided that with effect from 1st April, 2018 they would share profits and losses equally. It was agreed that:

(i) Stock is to be valued at ₹ 2,00,000.

(ii) Value of Machinery is to be decreased by 10%.

(iii) A Provision for Doubtful Debts is to be made on Sundry Debtors @ 5%.

(iv) Building to be appreciated by ₹ 50,000.

(v) It was agreed that *Z* would carry out reconstituting the firm for which he will be paid remuneration of ₹ 5,000.

Partners agreed that revised (changed) values of assets and liabilities are to be recorded in the books. Pass necessary accounting entries and prepare Revaluation Account.

Solution:

JOURNAL

Date		Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018					
April	1	Revaluation A/c ...Dr.		41,000	
		To Stock A/c			10,000
		To Machinery A/c			26,000
		To Provision for Doubtful Debts A/c			5,000
		(Decrease in the value of assets and provision made for doubtful debts)			
April	1	Building A/c ...Dr.		50,000	
		To Revaluation A/c			50,000
		(Increase in the value of building)			
April	1	Revaluation A/c ...Dr.		5,000	
		To *Z*'s Capital A/c			5,000
		(*Z*'s remuneration for reconstituting the firm)			
April	1	Revaluation A/c ...Dr.		4,000	
		To *X*'s Capital A/c			1,600
		To *Y*'s Capital A/c			1,600
		To *Z*'s Capital A/c			800
		(Transfer of gain (profit) on revaluation to the Capital Accounts of Partners in their old profit-sharing ratio)			

April	1	General Reserve A/c ...Dr.		50,000	
		To X's Capital A/c			20,000
		To Y's Capital A/c			20,000
		To Z's Capital A/c			10,000
		(General Reserve credited to the Partners' Capital Accounts in their old profit-sharing ratio)			
April	1	X's Capital A/c ...Dr.		1,600	
		Y's Capital A/c ...Dr.		1,600	
		Z's Capital A/c ...Dr.		800	
		To Advertisement Suspense A/c			4,000
		(Transfer of Advertisement Suspense Account to all partners in old profit-sharing ratio)			

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		10,000	By Building A/c	50,000
To Machinery A/c		26,000		
To Provision for Doubtful Debts A/c		5,000		
To Z's Capital A/c (Remuneration)		5,000		
To Gain (Profit) transferred to:				
X's Capital A/c (2/5)	1,600			
Y's Capital A/c (2/5)	1,600			
Z's Capital A/c (1/5)	800	4,000		
		50,000		50,000

Illustration 3.

Jaspal, Apoorv and Ankit are partners sharing profits and losses in the ratio of 5 : 3 : 2. Their Balance Sheet as at 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Sundry Creditors		1,50,000	Cash in Hand	75,000
Salaries Payable		50,000	Cash at Bank	1,50,000
General Reserve		2,00,000	Sundry Debtors	2,00,000
Capital A/cs:			Stock	50,000
Jaspal	5,00,000		Land and Buildings	5,00,000
Apoorv	3,00,000		Machinery	2,00,000
Ankit	2,00,000	10,00,000	Computers	1,75,000
			Furniture	50,000
		14,00,000		14,00,000

Profit sharing ratio *w.e.f.* 1st April, 2018 was decided to be 2 : 2 : 1. It was agreed by partners to carry out following adjustments:

(i) A computer for ₹ 25,000 was purchased on credit on 31st March, 2018 but was not recorded due to oversight.

(ii) Stock is to be reduced by ₹ 10,000.

(iii) Provision for Doubtful Debts is to be created @ 5%.

(iv) Land and Buildings to be appreciated by 10% and Machinery to be reduced by 5%.

(v) Goodwill of the firm is valued at ₹ 1,00,000.

(vi) Total capital of the firm was to be ₹ 10,00,000 and is to be in their profit-sharing ratio. Excess or short capital is to be adjusted through their Current Accounts.

Pass the Journal entries and prepare Balance Sheet of the new firm.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Computers A/c ...Dr.		25,000	
	To Supplier's A/c			25,000
	(Computer purchased on credit remained unrecorded, now recorded)			
	Revaluation A/c ...Dr.		30,000	
	To Stock A/c			10,000
	To Provision for Doubtful Debts A/c			10,000
	To Machinery A/c			10,000
	(Decrease in value of assets recorded and provision made)			
	Land and Buildings A/c ...Dr.		50,000	
	To Revaluation A/c			50,000
	(Increase in value of land and buildings recorded)			
	Revaluation A/c ...Dr.		20,000	
	To Jaspal's Capital A/c			10,000
	To Apoorv's Capital A/c			6,000
	To Ankit's Capital A/c			4,000
	(Gain (profit) on revaluation credited to Partners' Capital Accounts in their old profit-sharing ratio)			
	Apoorv's Capital A/c ...Dr.		10,000	
	To Jaspal's Capital A/c			10,000
	(Jaspal's sacrificed share of goodwill adjusted by debiting Apoorv (gaining partner))			
	General Reserve A/c ...Dr.		2,00,000	
	To Jaspal's Capital A/c			1,00,000
	To Apoorv's Capital A/c			60,000
	To Ankit's Capital A/c			40,000
	(General Reserve credited to Capital Accounts)			
	Jaspal's Capital A/c ...Dr.		2,20,000	
	Ankit's Capital A/c ...Dr.		44,000	
	To Jaspal's Current A/c			2,20,000
	To Ankit's Current A/c			44,000
	(Excess capital transferred to respective Partners' Current Accounts)			
	Apoorv's Current A/c ...Dr.		44,000	
	To Apoorv's Capital A/c			44,000
	(Shortfall in capital of Apoorv debited to his Current Account)			

BALANCE SHEET OF THE NEW FIRM

as at 1st April, 2018

Liabilities		₹	Assets		₹
Sundry Creditors		1,50,000	Cash in Hand		75,000
Salaries Payable		50,000	Cash at Bank		1,50,000
Supplier's A/c (Computer)		25,000	Sundry Debtors	2,00,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	10,000	1,90,000
Jaspal	4,00,000		Stock		40,000
Apoorv	4,00,000		Land and Buildings		5,50,000
Ankit	2,00,000	10,00,000	Machinery		1,90,000
Current A/cs:			Computers (₹ 1,75,000 + ₹ 25,000)		2,00,000
Jaspal	2,20,000		Furniture		50,000
Ankit	44,000	2,64,000	Current Account:		
			Apoorv		44,000
		14,89,000			14,89,000

Working Notes:

1. *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		10,000	By Land and Buildings A/c	50,000
To Provision for Doubtful Debts A/c		10,000		
To Machinery A/c		10,000		
To Gain (Profit) transferred to:				
Jaspal's Capital A/c	10,000			
Apoorv's Capital A/c	6,000			
Ankit's Capital A/c	4,000	20,000		
		50,000		50,000

2. *Calculation of Sacrifice/(Gain) of each Partner:*

	Jaspal	Apoorv	Ankit
Old Share	5/10	3/10	2/10
New Share	2/5	2/5	1/5
Sacrifice/(Gain) = Old Share – New Share	$= \frac{5-4}{10}$	$= \frac{3-4}{10}$	$= \frac{2-2}{10}$
	= 1/10	= –1/10	Nil
	Sacrifice	(Gain)	

Value of Goodwill = ₹ 1,00,000

∴ Apoorv will compensate Jaspal = ₹ 1,00,000 × $\frac{1}{10}$ = ₹ 10,000.

3. Total capital of the new firm = ₹ 10,00,000

Profit-sharing Ratio = 2 : 2 : 1

∴ Capital of Jaspal, Apoorv and Ankit will be ₹ 4,00,000; ₹ 4,00,000 and ₹ 2,00,000 respectively.

4. *Dr.* PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Jaspal ₹	Apoorv ₹	Ankit ₹	Particulars	Jaspal ₹	Apoorv ₹	Ankit ₹
To Jaspal's Capital A/c	...	10,000	...	By Balance *b/d*	5,00,000	3,00,000	2,00,000
To Partners' Current A/cs	2,20,000	...	44,000	By Revaluation A/c	10,000	6,000	4,000
To Balance *c/d*	4,00,000	4,00,000	2,00,000	By General Reserve A/c	1,00,000	60,000	40,000
				By Apoorv's Capital A/c	10,000	...	...
				By Partner's Current A/c	...	44,000	...
	6,20,000	4,10,000	2,44,000		6,20,000	4,10,000	2,44,000

Illustration 4 (*Distribution of General Reserve and Accumulated Profits*).

A, *B* and *C* are partners sharing profits in the ratio of 3 : 2 : 1. On 1st April, 2018, they decided to share the profits equally. On that date, there was a credit balance of ₹ 1,20,000 in their Profit and Loss Account and ₹ 60,000 in the General Reserve. Pass necessary Journal entry in the books of the firm.

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Profit and Loss A/c ...Dr.		1,20,000	
	General Reserve A/c ...Dr.		60,000	
	To *A*'s Capital A/c			90,000
	To *B*'s Capital A/c			60,000
	To *C*'s Capital A/c			30,000
	(Undistributed profits and general reserve, transferred to Capital Accounts of the Partners in their old profit-sharing ratio)			

Illustration 5.

Neha, Anita and Aqsa are partners sharing profits and losses in the ratio 4 : 4 : 2. Their Balance Sheet as at 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Capital A/cs:			Buildings	2,00,000
Neha	3,50,000		Machinery	3,00,000
Anita	3,00,000		Computers	50,000
Aqsa	2,50,000	9,00,000	Investments (Market Value ₹ 1,10,000)	1,50,000
Investments Fluctuation Reserve		50,000	Sundry Debtors	2,00,000
Sundry Creditors		60,000	Cash in Hand	15,000
Outstanding Liabilities		5,000	Cash at Bank	85,000
			Advertisement Suspense	15,000
		10,15,000		10,15,000

They decided to share profits and losses equally *w.e.f.* 1st April, 2018. They agreed that:

(i) The value of Buildings be brought down by 10%.

(ii) The value of Machinery be brought down by 5%.

(iii) A Provision for Doubtful Debts be created @ 5% on Sundry Debtors.

(iv) An unrecorded asset (computer) of value ₹ 15,000 be brought into books.

(v) Outstanding liabilities were no longer payable.

(vi) Goodwill is to be valued at 3 years' purchase of average profit of last 5 years. The profits for the last 5 years were 2017–18—₹ 1,00,000; 2016–17—₹ 90,000; 2015–16—₹ 20,000 (Loss); 2014–15—₹ 60,000 and 2013–14—₹ 60,000.

(vii) Aqsa was to carry out the reconstitution of the firm at a remuneration of ₹ 5,000, including expenses. Expenses came to ₹ 2,000.

Pass the Journal entries and prepare Revaluation Account.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	Revaluation A/c	...Dr.		45,000	
	To Buildings A/c				20,000
	To Machinery A/c				15,000
	To Provision for Doubtful Debts A/c				10,000
	(Fall in value of buildings and machinery recorded and provision for doubtful debts made)				
	Computers A/c	...Dr.		15,000	
	Outstanding Liabilities A/c	...Dr.		5,000	
	To Revaluation A/c				20,000
	(Unrecorded asset accounted and liability not payable written off)				
	Revaluation A/c	...Dr.		5,000	
	To Aqsa's Capital A/c				5,000
	(Remuneration of Aqsa credited to her account)				
	Neha's Capital A/c	...Dr.		12,000	
	Anita's Capital A/c	...Dr.		12,000	
	Aqsa's Capital A/c	...Dr.		6,000	
	To Revaluation A/c				30,000
	(Loss of Revaluation Account debited to Partners' Capital Accounts in their old profit-sharing ratio)				
	Investments Fluctuation Reserve A/c	...Dr.		50,000	
	To Investments A/c				40,000
	To Neha's Capital A/c				4,000
	To Anita's Capital A/c				4,000
	To Aqsa's Capital A/c				2,000
	(Fall in value of investments adjusted against reserve and the balance reserve credited to Partners' Capital Accounts)				
	Aqsa's Capital A/c	...Dr.		23,200	
	To Neha's Capital A/c				11,600
	To Anita Capital A/c				11,600
	(Adjustment of goodwill made by debiting Aqsa (gaining partner) and crediting Neha and Anita (sacrificing partners))				

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Buildings A/c	20,000	By Computers A/c		15,000
To Machinery A/c	15,000	By Outstanding Liabilities A/c		5,000
To Provision for Doubtful Debts A/c	10,000	By Loss transferred to:		
To Aqsa's Capital A/c (Remuneration)	5,000	Neha's Capital A/c	12,000	
		Anita's Capital A/c	12,000	
		Aqsa's Capital A/c	6,000	30,000
	50,000			50,000

Working Notes:

1. Value of Goodwil = Average Profit × Number of Years' Purchase

$$\text{Average Profit} = \frac{₹\,1,00,000 + ₹\,90,000 - ₹\,20,000 + ₹\,60,000 + ₹\,60,000}{5} = ₹\,58,000$$

Value of Goodwill = ₹ 58,000 × 3 = ₹ 1,74,000.

2. *Sacrificing/(Gaining) Share:*

Particulars	*Neha*	*Anita*	*Aqsa*
A. Old Profit Share	2/5	2/5	1/5
B. New Profit Share	1/3	1/3	1/3
C. Sacrifice/(Gain) (A – B)	$= \frac{2}{5} - \frac{1}{3} = \frac{6-5}{15}$ $= \frac{1}{15}$ (Sacrifice)	$= \frac{2}{5} - \frac{1}{3} = \frac{6-5}{15}$ $= \frac{1}{15}$ (Sacrifice)	$= \frac{1}{5} - \frac{1}{3} = \frac{3-5}{15}$ $= -\frac{2}{15}$ (Gain)

3. Aqsa will compensate both Neha and Anita ₹ 11,600 each.
4. Expenses of ₹ 2,000 for reconstitution of the firm will not be recorded as these were to be borne by Aqsa and are also paid by her. In case, the expenses were paid by the firm, following additional entry will be passed:

Aqsa's Capital A/c	...Dr.	₹ 2,000	
To Cash/Bank A/c			₹ 2,000
(Expenses to be borne by Aqsa paid by the firm)			

Illustration 6.

Vijay, Sanjay and Ajay are partners sharing profits in the ratio of 3 : 2 : 1 respectively. From 1st April, 2018, they decided to share profits in the ratio of 2 : 3 : 1. The Partnership Deed provides that in the event of any change in profit-sharing ratio, the goodwill should be valued at three years' purchase of the average of five years' profits. The profits and losses of the preceding five years are:

Year	2013–14	2014–15	2015–16	2016–17	2017–18
Profit/Loss (₹)	?	9,00,000	10,20,000	11,40,000	4,20,000 (Loss)

JOURNAL ENTRY ON CHANGE IN PROFIT-SHARING RATIO

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Sanjay's Capital A/c ...Dr.		3,00,000	
	To Vijay's Capital A/c			3,00,000
	(Adjustment made for goodwill on change in profit-sharing ratio)			

Calculate the profit for 2013–14.

Solution: *Calculation of Gain or Sacrifice of Partners:*

	Vijay	Sanjay	Ajay
(i) Their New Shares	2/6	3/6	1/6
(ii) Their Old Shares	3/6	2/6	1/6
(iii) Difference (i) – (ii)	–1/6	1/6	?
	(Sacrifice)	**(Gain)**	

Thus, Vijay is a sacrificing partner and Sanjay is a gaining partner.

- Compensation payable as goodwill by Sanjay to Vijay for 1/6th share = ₹ 3,00,000.
- Goodwill of the firm = ₹ 3,00,000 (Compensation) × 6/1 = ₹ 18,00,000.
- Average Profit = ₹ 18,00,000/3* = ₹ 6,00,000

  *Goodwill = Average Profit × 3 years' purchase.
- **Profit for 2013–14**

  Let the profit for 2013–14 = X

$$₹\ 6{,}00{,}000 \text{ (Average Profit)} = \frac{X + ₹\ 9{,}00{,}000 + ₹\ 10{,}20{,}000 + ₹\ 11{,}40{,}000 - ₹\ 4{,}20{,}000}{5}$$

$$₹\ 30{,}00{,}000 = X + ₹\ 9{,}00{,}000 + ₹\ 10{,}20{,}000 + ₹\ 11{,}40{,}000 - ₹\ 4{,}20{,}000$$

Hence, X = ₹ **3,60,000.**

Illustration 7.

Neha, Alka and Nimrat are partners sharing profits in the ratio of 2 : 2 : 1. They decided to share profits equally *w.e.f.* 1st April, 2018. On that date, value of goodwill is determined at ₹ 75,000. Following Revaluation Account and Capital Accounts were drawn giving effect to the agreed adjustments:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Computers A/c	10,000	By Land and Buildings A/c		15,000
To Provision for Workmen Compensation Claim A/c	50,000	By Provision for Doubtful Debts A/c		5,000
To Stock A/c	10,000	By Loss transferred to:		
		Neha's Capital A/c	20,000	
		Alka's Capital A/c	20,000	
		Nimrat's Capital A/c	10,000	50,000
	70,000			70,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Neha ₹	Alka ₹	Nimrat ₹	Particulars	Neha ₹	Alka ₹	Nimrat ₹
To Revaluation A/c	20,000	20,000	10,000	By Balance *b/d*	2,00,000	1,50,000	1,00,000
To Neha's Capital A/c	...	...	5,000	By Profit and Loss A/c	8,000	8,000	4,000
To Alka's Capital A/c	...	...	5,000	By Nimrat's Capital A/c	5,000	5,000	...
To Balance *c/d*	1,93,000	1,43,000	84,000				
	2,13,000	1,63,000	1,04,000		2,13,000	1,63,000	1,04,000

From the above information, identify six adjustments made.

Solution:

Adjustments made are:

(i) Value of Computers is reduced by ₹ 10,000.

(ii) A claim on account of Workmen Compensation is estimated at ₹ 50,000.

(iii) Value of Stock is reduced by ₹ 10,000.

(iv) Value of Land and Buildings is increased by ₹ 15,000.

(v) Provision for Doubtful Debts amounting to ₹ 5,000 is written back.

(vi) Balance of Profit and Loss Account of ₹ 20,000 is credited to Partners' Capital Accounts in their old profit-sharing ratio.

(vii) Nimrat is the Gaining Partner. Her Capital Account is debited by ₹ 10,000 (*i.e.*, 2/15 of ₹ 75,000) and Neha's Capital Account and Alka's Capital Account is credited by ₹ 5,000 each for goodwill in their sacrificing ratio, *i.e.*, 1 : 1.

Illustration 8 (*Change in Profit-sharing Ratio and Valuation of Goodwill*).

Sohan and Ram are partners sharing profits and losses in the ratio of 3 : 1. Their capitals were ₹ 60,000 and ₹ 40,000 respectively. From 1st April, 2018, it was agreed to change the profit-sharing ratio to 3 : 2. According to the Partnership Deed, goodwill is to be valued at three years' purchase of the average of five years' profits. The profits of the previous five years were: 2013–14—₹ 30,000; 2014–15—₹ 40,000; 2015–16—₹ 50,000; 2016–17—₹ 60,000 and 2017–18 —₹ 70,000 respectively.

Pass necessary Journal entry to give effect to the above arrangement through Capital Accounts.

Solution:

(i) *Valuation of Goodwill:*

$$\text{Average Profit} = \frac{₹\ 30{,}000 + ₹\ 40{,}000 + ₹\ 50{,}000 + ₹\ 60{,}000 + ₹\ 70{,}000}{5} = ₹\ 50{,}000$$

$$\text{Goodwill} = \text{Average Profit} \times \text{Number of Years' Purchase}$$

$$= ₹\ 50{,}000 \times 3 = ₹\ 1{,}50{,}000.$$

Effect of Change in Profit-sharing Ratio (*i.e.*, Gain or Sacrifice of partners):

Sacrifice/(Gain) = Old Share – New Share

Sohan = 3/4 – 3/5 = 3/20 (Sacrifice)

Ram = 1/4 – 2/5 = –3/20 (being negative, it is a gain).

Compensation (Goodwill) payable by Ram to Sohan = 3/20 of ₹ 1,50,000 = ₹ 22,500.

(ii) *The Journal Entry to adjust Goodwill is:*

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Ram's Capital A/c ...Dr. To Sohan's Capital A/c (Amount of goodwill credited to Sohan for his sacrificed share)		22,500	 22,500

Illustration 9.

X, *Y* and *Z* are partners sharing profits in the ratio of 3 : 2 : 1. From 1st April, 2018, *Y* decided to devote only part of time to the business and accepted to receive one half of his previous share of profits. Sacrificed share of *Y* is taken equally by *X* and *Z*. For this purpose, goodwill of the firm was valued at ₹ 3,00,000. Calculate new profit-sharing ratio and pass an adjustment entry for treatment of goodwill due to change in the profit-sharing ratio.

Solution:

Y's Sacrificed Share = 2/6 × 1/2 = 1/6, which is distributed equally between *X* and *Z*.

X's New Share = Old Share + Acquired Share

$$= 3/6 + (1/6 \times 1/2) = \frac{3}{6}+\frac{1}{12}=\frac{6+1}{12}=\frac{7}{12}$$

Y's New Share = Old Share – Sacrificed Share

$$= \frac{2}{6}-\frac{1}{6}=\frac{1}{6} \text{ or } \frac{2}{12}$$

$$Z\text{'s New Share} = 1/6 + (1/6 \times 1/2) = \frac{1}{6}+\frac{1}{12}=\frac{2+1}{12}=\frac{3}{12}$$

Hence, New Profit-sharing Ratio of *X*, *Y* and *Z* = 7/12 : 2/12 : 3/12 = 7 : 2 : 3.

Since *Y* has sacrificed 1/6th share, he will be compensated with ₹ 50,000 (*i.e.*, ₹ 3,00,000 × 1/6) for goodwill by *X* and *Z* equally because they have gained in equal proportion.

ADJUSTMENT ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	*X*'s Capital A/c (₹ 50,000 × 1/2)	...Dr.		25,000	
	Z's Capital A/c (₹ 50,000 × 1/2)	...Dr.		25,000	
	To *Y*'s Capital A/c				50,000
	(Adjustment made for goodwill)				

Illustration 10.

Ashish, Aakash and Akhil are partners sharing profits in the ratio of 5 : 3 : 2. They decided to share profits in future in the ratio of 2 : 2 : 1 w.e.f. 1st April, 2018. Calculate the Sacrificing and Gaining Ratio.

Solution:

Sacrificed Share = Old Share – New Share

$$\text{Ashish} = \frac{5}{10}-\frac{2}{5}=\frac{5-4}{10}=\frac{1}{10} \quad (\textit{i.e.}, \text{Sacrifice})$$

$$\text{Aakash} = \frac{3}{10}-\frac{2}{5}=\frac{3-4}{10}=-\frac{1}{10} \quad (\textit{i.e.}, \text{Gain})$$

$$\text{Akhil} = \frac{2}{10}-\frac{1}{5}=\frac{2-2}{10}=0.$$

Unsolved Questions

1. Nardeep, Hardeep and Gagandeep were partners in a firm sharing profits in 2 : 1 : 3 ratio. Their Balance Sheet as on 31st March, 2015 was as follows:

Liabilities		₹	Assets	₹
Creditors		1,00,000	Land	1,00,000
Bills Payable		40,000	Building	1,00,000
General Reserve		60,000	Plant	2,00,000
Capital A/cs:			Stock	80,000
Nardeep	2,00,000		Debtors	60,000
Hardeep	1,00,000		Bank	10,000
Gagandeep	50,000	3,50,000		
		5,50,000		5,50,000

From 1st April, 2015 Nardeep, Hardeep and Gagandeep decided to share the future profits equally. For this purpose it was decided that:

(a) Goodwill of the firm be valued at ₹ 3,00,000.

(b) Land be revalued at ₹ 1,60,000 and building be depreciated by 6%.

(c) Creditors of ₹ 12,000 were not likely to be claimed and hence be written off.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the reconstituted firm. (*AI 2016*)

[**Ans.:** *Gain (Profit) on Revaluation—₹ 66,000; Partners' Capital Accounts: Nardeep—₹ 2,42,000; Hardeep—₹ 71,000; Gagandeep—₹ 1,63,000. Balance Sheet Total—₹ 6,04,000.*]

2. *X*, *Y* and *Z* are partners sharing profits in the ratio of 2 : 2 : 1. Their Balance Sheet as at 31st March, 2018 stood as follows:

Liabilities		₹	Assets		₹
Sundry Creditors		1,20,000	Cash in Hand		55,000
Outstanding Expenses		15,000	Cash at Bank		2,10,000
General Reserve		75,000	Bills Receivable		20,000
Profit and Loss A/c		50,000	Sundry Debtors	1,10,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	10,000	1,00,000
X	3,00,000		Stock		2,00,000
Y	2,80,000		Machinery		3,50,000
Z	2,20,000	8,00,000	Computers		1,00,000
			Furniture		25,000
		10,60,000			10,60,000

The partners agreed to share profits *w.e.f.* 1st April, 2018 in the ratio of 5 : 3 : 2. They also agreed to the the following:

(i) Value of stock be increased to ₹ 2,25,000.

(ii) Provision for Doubtful Debts be written back, all debtors being good.

(iii) Value of Machinery be reduced by 5%.

(iv) Value of Computers be reduced to ₹ 82,500.

(v) Goodwill of the firm for the purpose was valued at ₹ 1,00,000.

Pass an adjustment entry giving effect to the above arrangement and prepare Balance Sheet of the firm after adjustments when:

(i) The partners decide to carry the assets and liabilities at their revised values and General Reserve and Profit and Loss Account at their existing values.

(ii) The partners decide to carry assets and liabilities including General Reserve and Profit and Loss Account at their existing values by passing a single adjustment entry.

[**Ans.:** *In Both the Cases: Balance Sheet Total*—₹ *10,60,000.*]

CHAPTER 5

Admission of a Partner

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. **Admission of a Partner**	Admission of a Partner means new partner being admitted in the firm.
2. **New Profit-sharing Ratio**	New Profit-sharing Ratio is the ratio in which all the partners, including the new or incoming partner, share future profits and losses of the firm.
3. **Sacrificing Ratio**	Sacrificing Ratio is the ratio in which the old or existing partners forego, *i.e.*, sacrifice their share in profits in favour of the new partner.
4. **Goodwill**	Goodwill is an intangible asset resulting from the efforts made in past by the existing (old) partners of the firm which results in continuous profits.
5. **Revaluation of Assets**	Revaluation of Assets means change in the value of assets, *i.e.*, present value being different from the book value of the assets.
6. **Reassessment of Liabilities**	Reassessment of Liabilities means reassessing the liabilities and determining the change, *i.e.*, whether the liability is more or less than that shown in the books of account.
7. **Revaluation Account or Profit and Loss Adjustment Account**	It is a nominal account to which increase in the value of assets and decrease in the amount of liabilities is credited. Decrease in the value of assets and increase in the amount of liabilities is debited. It is closed by transferring the profit or loss to the Capital Accounts of the old or existing partners in their old profit-sharing ratio.
8. **Reserve**	Reserve means Accumulated or undistributed profits. It is created out of profits for general or specific purpose.
9. **Workmen Compensation Reserve**	It is a reserve created out of profit for payment of compensation to workers.
10. **Investments Fluctuation Reserve**	It is a reserve created to meet the fall in the value of investment.

CHAPTER SUMMARY

- When the existing partners of a firm allow a new person to become a partner in the firm, it is called **admission of a partner**.
- **Adjustments:** The matters that require *adjustment* at the time of admission of a new partner are:
  - (i) Adjustment for change in the Profit-sharing Ratio.
  - (ii) Adjustment for Goodwill.
  - (iii) Adjustment of Gain (Profit)/Loss arising from the Revaluation of Assets and Reassessment of Liabilities.
  - (iv) Adjustment of Deferred Revenue Expenditure.
  - (v) Adjustment of Reserves, Accumulated Profits and Losses.
  - (vi) Adjustment of Capital (if so agreed).

- The ratio in which all partners including the incoming partner share future profits and losses is known as the **new profit-sharing ratio**.
- The ratio in which the old (existing) partners have agreed to sacrifice their share in profits in favour of an incoming partner is called the **sacrificing ratio**.

Sacrificing Ratio = Old Ratio – New Ratio.

Notes: 1. Unless agreed otherwise, the **New Profit-sharing Ratio** of Old Partners will be the same as their **Old Profit-sharing Ratio**.

2. Unless agreed otherwise, **Sacrificing Ratio** of Old Partners will be the same as their old Profit-sharing Ratio.

- **Accounting Treatment of Goodwill:** New Partner has to compensate the sacrificing partners by paying them an amount, called as **Goodwill** or **Premium for Goodwill**.

Note: *Write off the existing goodwill (if any) appearing in the Balance Sheet of the firm by debiting the Old Partners' Capital Accounts (in case of fluctuating capital) or Partners' Current Accounts (in case of fixed capital) in their old profit-sharing ratio and crediting the Goodwill Account. Unless agreed otherwise, it is presumed that the old partners sacrifice in their old profit-sharing ratio.*

ACCOUNTING ENTRIES FOR GOODWILL

1. *Goodwill (Premium) Paid Privately*	*No Entry*	
2. *Goodwill brought in Cash*	Cash/Bank A/c To Premium for Goodwill A/c	...Dr.
Distribution of Goodwill	Premium for Goodwill A/c To Sacrificing Partners' Capital A/cs *Or* To Sacrificing Partners' Current A/cs (When Capitals are Fixed)	...Dr. [In sacrificing ratio]
3. *Goodwill withdrawn by the Sacrificing (Old) Partners*	Sacrificing Partners' Capital A/cs To Cash/Bank A/c	...Dr.
4. *Goodwill not brought in Cash*	New Partner's Current A/c To Sacrificing Partners' Capital A/cs	...Dr. [In sacrificing ratio]
5. *Goodwill brought in kind*	Assets A/c To Premium for Goodwill A/c	...Dr.

Note: If incoming partner brings a part of his share of Goodwill in Cash then **unpaid share of goodwill** should be debited to his **Current Account**. Debit Balance of Current Account will appear in the Assets side of Balance Sheet.

- **Revaluation Account** or the **Profit and Loss Adjustment Account** is prepared to revalue the assets and reassess the liabilities of the firm at the time of reconstitution of the firm.

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Decrease in Value of Assets	...	By Increase in Value of Assets	...
To Increase in amount of Liabilities	...	By Decrease in amount of Liabilities	...
To Unrecorded Liabilities A/c	...	By Unrecorded Assets A/c	...
To *Gain (Profit)** trfd. to the Old Partners' Capital A/cs (in the old profit-sharing ratio)	...	By *Loss** trfd. to the Old Partners' Capital A/cs (in the old profit-sharing ratio)	...
	...		...

*Either of the two will appear.

- **Need to Revalue Assets and Reassess Liabilities:** Assets are revalued and liabilities are reassessed at the time of admission of a partner so that the new partner is not put to an advantage or a disadvantage because of changes in the value of assets and liabilities as on the date of admission.
- **Revaluation Account is prepared:**
  1. To ascertain the Gain (Profit)/Loss arising on account of Revaluation of Assets and Reassessment of Liabilities.
  2. To record the effect of Revaluation of Assets and Reassessment of Liabilities at their revised values.
- **Accumulated Profits** or **General Reserve** are also credited to the old partners in their old profit-sharing ratio. If there are any undistributed losses, they will be debited to the Old Partners' Capital Accounts.
- **Excess of Workmen Compensation Reserve over the Workmen Compensation Claim (Liability)** should be **credited to Old Partners' Capital Accounts** in their **Old Profit-sharing Ratio**.
- **Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value** of investment should be **credited to Old Partners** in their **Old Profit-sharing Ratio.**
- **Adjustment of Capital:**

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

  Step 1. Calculate the total capital of the firm on the basis of capital of new partner.

  $$\text{Total Capital of the Firm} = \frac{\text{Capital of Incoming Partner}}{\text{Share of Profit of Incoming Partner}}.$$

  Step 2. Determine the new capital of each partner.

  New Capital of Old Partner = Total Capital of New Firm × Share of Profit of Old Partner.

  Step 3. Ascertain the present capitals of old partners (Adjusted).

  Step 4. Find out Surplus/Deficit Capital by comparing Step 2 and Step 3.

  Step 5. Adjust the surplus or deficit through Cash or Current Accounts (as the case may be).

  (b) *Calculation of new partner's capital on the basis of old partners' capitals:*

  Step 1. Determine the total adjusted capitals of the old partners.

  Step 2. Determine the total capital of the new firm.

  $$\text{Total Capital of New Firm} = \frac{\text{Total Adjusted Old Capital of Old Partners}}{\text{Total Combined New Share of Old Partners}}.$$

  Step 3. Determine the total capital of the incoming partner as follows:

  Total Capital of New Firm (Step 2) × Share of incoming partner.

Important Notes:

1. In the absence of an agreement, **Surplus or Shortage of Capital** is **adjusted in Cash** and not by transfer to Current Accounts.
2. There is a difference between '*Z* is to contribute 1/5th of the total Capital of the New Firm' and '*Z* is to contribute 1/5th of the combined capital of the old partners'.

Solved Questions

Illustration 1.

A and *B* were partners sharing profits in the ratio of 3 : 2. They admitted *C* and *D* as new partners. *A* surrendered 1/3rd of his share in favour of *C* and *B* surrendered 1/4th of his share in favour of *D*. Calculate new profit-sharing ratio of *A, B, C* and *D*.

Solution:

A's old share of profit = 3/5

A surrendered 1/3rd of his share in favour of *C, i.e.*, 3/5 × 1/3 = 3/15 *or* 1/5

A's share of profit in the new firm = $\frac{3}{5}-\frac{3}{15}=\frac{9-3}{15}=\frac{6}{15}$

B surrendered 1/4th of his share in favour of *D, i.e.*, 2/5 × 1/4 = 2/20 *or* 1/10

B's share of profit in the new firm = $\frac{2}{5}-\frac{2}{20}=\frac{8-2}{20}=\frac{6}{20}$

C's share of profit in the new firm = $\frac{3}{15}$

D's share of profit in the new firm = $\frac{2}{20}$

New Profit-sharing Ratio of *A, B, C* and *D* = $\frac{6}{15} : \frac{6}{20} : \frac{3}{15} : \frac{2}{20}$

= 24 : 18 : 12 : 6 *or* 4 : 3 : 2 : 1.

Illustration 2.

Determine new profit-sharing ratio:

(i) *K, L* and *M* are partners sharing profits and losses in the ratio of 3 : 2 : 1. They admit *N* for 1/6th share. *M* would retain his original share.

(ii) *A, B* and *C* are partners sharing profits in the ratio of 3 : 2 : 5. They admit *D* and give him 1/4th share. Share is contributed by them in the ratio of 1 : 1 : 3.

(iii) *A* and *B* are partners sharing profits in the ratio of 5 : 4. They admit *C* for 1/9th share, which he acquires from *A*. *(Delhi 2008 C)*

Solution:

(i) Let the total share = 1; Share of *M* and *N* = $\frac{1}{6}+\frac{1}{6}=\frac{1}{3}$; Remaining share = 1 – $\frac{1}{3}=\frac{2}{3}$.

Shares of *K* and *L* are calculated by dividing the remaining share in their future profit-sharing ratio (which in this case is the old ratio since nothing is given as to how *N* gets his share from *K* and *L*) as under:

K's New share = $\frac{3}{5}$th of $\frac{2}{3}=\frac{6}{15}$. *L*'s New share = $\frac{2}{5}$th of $\frac{2}{3}=\frac{4}{15}$

New Ratio of *K, L, M* and *N* = $\frac{6}{15}:\frac{4}{15}:\frac{1}{6}:\frac{1}{6}$ *or* $\frac{12}{30}:\frac{8}{30}:\frac{5}{30}:\frac{5}{30}$ = 12 : 8 : 5 : 5.

Note: *M* would retain his original share. He is not a sacrificing partner.

(ii) Sacrifice made by the old partners is:

A's sacrifice = 1/4 × 1/5 = 1/20; B's sacrifice = 1/4 × 1/5 = 1/20;

C's sacrifice = 1/4 × 3/5 = 3/20.

New profit share is determined by deducting the sacrifice made by old partners from their old profit share. Thus, new profit share of

A = 3/10 – 1/20 = 5/20; B = 2/10 – 1/20 = 3/20; C = 5/10 – 3/20 = 7/20; D = 1/4 *or* 5/20.

Thus, New Profit-sharing Ratio of A, B, C and D will be 5 : 3 : 7 : 5.

(iii) Old ratio of A and B = 5 : 4 *or* 5/9 : 4/9

C's share, which he acquires from A = 1/9

Remaining share of A = 5/9 – 1/9 = 4/9

New Profit-sharing Ratio of A, B and C = 4/9 : 4/9 : 1/9 *or* 4 : 4 : 1.

Illustration 3.

X and Y are in partnership sharing profits and losses in the ratio of 4 : 1. They admit Z into the firm for an equal share. Calculate sacrificing ratio.

Solution:

Calculation of Sacrificing Ratio

Partners	Old Share	New Share	Sacrifice/Gain
X	4/5	1/3	4/5 – 1/3 = 7/15 **(Sacrifice)**
Y	1/5	1/3	1/5 – 1/3 = –2/15 **(Gain)**

Illustration 4.

X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit Z as a partner for 1/5th share. This share is contributed by them in the ratio of 2 : 3. Goodwill of the firm is valued at ₹ 50,000. Z brings in the necessary amount in cash as his share of firm's goodwill and ₹ 30,000 as his capital. Pass necessary Journal entries if capitals are fixed under each of the following alternative cases:

Case 1. When the amount of goodwill is retained in the firm.

Case 2. When the amount of goodwill is withdrawn by the concerned partners to the extent of 50% of what is credited to them.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Case 1	Cash A/c ...Dr.		40,000	
	To *Z*'s Capital A/c			30,000
	To Premium for Goodwill A/c (₹ 50,000 × 1/5)			10,000
	(Amount brought in by *Z* for his share of goodwill and capital)			
	Premium for Goodwill A/c (₹ 50,000 × 1/5) ...Dr.		10,000	
	To *X*'s Current A/c (₹ 10,000 × 2/5)			4,000
	To *Y*'s Current A/c (₹ 10,000 × 3/5)			6,000
	(Share of *Z* in goodwill credited to *X* and *Y* in their sacrificing ratio, *i.e.*, 2 : 3)			

Case 2	Cash A/c ...Dr. To *Z*'s Capital A/c To Premium for Goodwill A/c (₹ 50,000 × 1/5) (Amount brought in by *Z* for his share of goodwill and capital)		40,000	 30,000 10,000
	Premium for Goodwill A/c (₹ 50,000 × 1/5) ...Dr. To *X*'s Current A/c (₹ 10,000 × 2/5) To *Y*'s Current A/c (₹ 10,000 × 3/5) (Share of *Z* in goodwill credited to *X* and *Y* in their sacrificing ratio, *i.e.*, 2 : 3)		10,000	 4,000 6,000
	X's Current A/c (₹ 5,000 × 2/5) ...Dr. *Y*'s Current A/c (₹ 5,000 × 3/5) ...Dr. To Cash A/c (50% of ₹ 10,000) (50% of the amount of goodwill credited to *X* and *Y* withdrawn by them)		2,000 3,000	 5,000

Illustration 5 (*When Incoming Partner does not bring in his Share of Goodwill in Cash and Capitals are Fixed*).

X and *Y* are partners in a firm, sharing profits and losses in the ratio of 3 : 2. They admit *Z* into the firm for 1/5th share. *Z* acquires his share from *X* and *Y* in the ratio of 2 : 3. Goodwill of the firm is valued at ₹ 30,000. *Z* brings in ₹ 1,00,000 through cheque, as his share of capital but is unable to bring in the amount of his share of goodwill. Pass necessary Journal entries if capitals are fixed under each of the following alternative cases:

Case 1. When goodwill is not appearing in the books.

Case 2. When goodwill is appearing in the books at ₹ 15,000.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Case 1	Bank A/c ...Dr. To *Z*'s Capital A/c (Amount brought in by *Z* as his capital)		1,00,000	 1,00,000
	Z's Current A/c (₹ 30,000 × 1/5) ...Dr. To *X*'s Current A/c (₹ 6,000 × 2/5) To *Y*'s Current A/c (₹ 6,000 × 3/5) (Share of *Z* in goodwill credited to *X* and *Y* in their sacrificing ratio, *i.e.*, 2 : 3)		6,000	 2,400 3,600
Case 2	*X*'s Current A/c (₹ 15,000 × 3/5) ...Dr. *Y*'s Current A/c (₹ 15,000 × 2/5) ...Dr. To Goodwill A/c (Existing goodwill written off in old ratio, *i.e.*, 3 : 2)		9,000 6,000	 15,000
	Bank A/c ...Dr. To *Z*'s Capital A/c (Amount brought in by *Z* as his capital)		1,00,000	 1,00,000
	Z's Current A/c (₹ 30,000 × 1/5) ...Dr. To *X*'s Current A/c (₹ 6,000 × 2/5) To *Y*'s Current A/c (₹ 6,000 × 3/5) (Share of *Z* in goodwill credited to *X* and *Y* in their sacrificing ratio, *i.e.*, 2 : 3)		6,000	 2,400 3,600

Illustration 6.

Balance Sheet of *X* and *Y* who share profits and losses in the ratio of 3 : 2 as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Sundry Creditors		1,30,000	Cash at Bank	10,000
Bills Payable		35,000	Cash in Hand	5,000
Reserves		35,000	Debtors	20,000
Profit and Loss A/c		20,000	Stock	1,00,000
X's Capital	48,000		Fixed Assets	1,30,000
Y's Capital	32,000	80,000	Goodwill	25,000
			Advertisement Expenditure	10,000
		3,00,000		3,00,000

They agreed to take *Z* as a partner from 1st April, 2018 for 1/5th share in the profits of the firm. *Z* brings in ₹ 60,000 as his capital. Give Journal entries to record the goodwill.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	*X*'s Capital A/c (₹ 25,000 × 3/5)	...Dr.		15,000	
	Y's Capital A/c (₹ 25,000 × 2/5)	...Dr.		10,000	
	To Goodwill A/c				25,000
	(Existing value of goodwill written off by debiting the old partners in their old ratio)				
April 1	*Z*'s Capital/Current A/c (₹ 1,40,000 × 1/5)	...Dr.		28,000	
	To *X*'s Capital A/c (₹ 28,000 × 3/5)				16,800
	To *Y*'s Capital A/c (₹ 28,000 × 2/5)				11,200
	(*Z*'s share of goodwill adjusted through Capital Accounts by crediting sacrificing partners in their sacrificing ratio) (WN)				

Working Note: *Calculation of Hidden Goodwill:*

		₹
Net worth (or total capital) of the new firm on the basis of capital brought in by *Z* (₹ 60,000 × 5/1)		3,00,000
Less:	Net worth of the new firm (Adjusted Capitals of the Old Partners + Incoming Partner's Capital) [(₹ 48,000 + ₹ 32,000 + ₹ 35,000 + ₹ 20,000 – ₹ 10,000 – ₹ 25,000 for existing goodwill) + ₹ 60,000]	1,60,000
Value of Firm's Goodwill		1,40,000

Some Typical Cases of Revaluation of Assets and Reassessment of Liabilities with Explanation

Illustration 7.

X and *Y* are partners sharing profits in the ratio of 3 : 2. Pass Journal entries for the following on the admission of *Z*, a new partner.

(i) Value of furniture is to be increased by ₹ 10,000 (*Book value of furniture is ₹ 50,000*).

(ii) Value of furniture is to be increased to ₹ 50,000 (*Book value of furniture is ₹ 40,000*).

(iii) Value of furniture is to be brought up to 120% of its value (*Book value of furniture is ₹ 20,000*).

(iv) Stock is found undervalued by ₹ 4,000 (*Book value of stock is ₹ 25,000*).

(v) Stock is found overvalued by ₹ 5,000 (*Book value of stock is ₹ 30,000*).

(vi) A debtor whose dues of ₹ 10,000 were written off as bad debts last year, paid ₹ 6,000 in full settlement.

(vii) Rent of ₹ 5,000 is outstanding.

(viii) A bill of ₹ 2,000 for electricity charges has been omitted to be accounted.

(ix) Half of Machinery is taken by *Y* for ₹ 40,000 and balance is revalued at ₹ 37,000 (*Book value of machinery is ₹ 80,000*).

(x) Machinery is taken by *Y* for ₹ 70,000 (*Book value of machinery is ₹ 65,000*).

(xi) Out of the amount of insurance premium which was debited to Profit and Loss Account, ₹ 5,000 is to be carried forward to next year.

or

Insurance premium amounting to ₹ 15,000 was debited to Profit and Loss Account of which ₹ 5,000 is related to next year.

(xii) There is a claim for damages against the firm for which a provision of ₹ 15,000 is to be made.

(xiii) There is a liability of ₹ 10,000 included in creditors, that is not likely to arise.

(xiv) An unrecorded accrued income of ₹ 12,000 is to be accounted.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Furniture A/c ...Dr.		10,000	
	To Revaluation A/c			10,000
	(Increase in the value of furniture recorded)			
(ii)	Furniture A/c ...Dr.		10,000	
	To Revaluation A/c			10,000
	(Increase in the value of furniture recorded)			
(iii)	Furniture A/c ...Dr.		4,000	
	To Revaluation A/c			4,000
	(Increase in the value of furniture recorded)			
(iv)	Stock A/c ...Dr.		4,000	
	To Revaluation A/c			4,000
	(Increase in the value of stock recorded)			
(v)	Revaluation A/c ...Dr.		5,000	
	To Stock A/c			5,000
	(Decrease in the value of stock recorded)			
(vi) (a)	Cash/Bank A/c ...Dr.		6,000	
	To Bad Debts Recovered A/c			6,000
	(Bad debts recovered)			
(b)	Bad Debts Recovered A/c ...Dr.		6,000	
	To Revaluation A/c			6,000
	(Gain due to bad debts recovered recorded)			

(vii)	Revaluation A/c ...Dr. To Outstanding Rent A/c (Liability for rent outstanding recorded)		5,000	5,000
(viii)	Revaluation A/c ...Dr. To Outstanding Electricity Expenses A/c (Liability for electricity charges recorded)		2,000	2,000
(ix) (a)	Revaluation A/c ...Dr. To Machinery A/c (Decrease in the value of machinery recorded) (₹ 80,000 – ₹ 40,000 – ₹ 37,000 = ₹ 3,000)		3,000	3,000
(b)	*Y*'s Capital A/c ...Dr. To Machinery A/c (Half of machinery taken over by *Y* at the book value)		40,000	40,000
(x) (a)	Machinery A/c ..Dr. To Revaluation A/c (Increase in the value of machinery recorded)		5,000	5,000
(b)	*Y*'s Capital A/c ...Dr. To Machinery A/c (Machinery taken over by *Y* at the revalued figure)		70,000	70,000
(xi)	Prepaid Insurance Premium A/c ...Dr. To Revaluation A/c (Prepaid insurance premium recorded)		5,000	5,000
(xii)	Revaluation A/c ...Dr. To Provision against Claim for Damages A/c (Provision against claim for damages recorded)		15,000	15,000
(xiii)	Sundry Creditors A/c ...Dr. To Revaluation A/c (Decrease in the amount of sundry creditors recorded)		10,000	10,000
(xiv)	Accrued Income A/c ...Dr. To Revaluation A/c (Unrecorded accrued income recorded)		12,000	12,000

Explanation:

(i) The value of furniture is to be increased by ₹ 10,000. It means, furniture will appear in the Balance Sheet of reconstituted firm at ₹ 60,000 (*i.e.*, ₹ 50,000 + ₹ 10,000).

(ii) The value of furniture is to be increased to ₹ 50,000. It means, there is an increase of value of ₹ 10,000 and furniture will appear in the Balance Sheet of reconstituted firm at ₹ 50,000.

(iii) The value of furniture is to be increased to 120% of its book value of ₹ 20,000. It means, there is an increase of ₹ 4,000 and furniture will appear in the Balance Sheet of reconstituted firm at ₹ 24,000 (*i.e.*, 120% of ₹ 20,000).

Precaution: Be careful about the language of adjustment, *e.g.*, there exists difference between **' Furniture increased by 40%' and 'Furniture increased to 40%'.**

(iv) Due to undervaluation, stock was shown at a lower amount. Now its value is to be increased by ₹ 4,000. Stock will appear in the Balance Sheet of the reconstituted firm at ₹ 29,000 (*i.e.*, ₹ 25,000 + ₹ 4,000).

(v) Due to overvaluation, stock was shown at a higher amount. Now, its value is to be decreased by ₹ 5,000. Stock will appear in the Balance Sheet of the reconstituted firm at ₹ 25,000.

(vi) Amount recovered in the form of bad debts written off last year is a gain for the firm. So, Revaluation Account will be credited with such gain.

(vii) Rent outstanding increases the firm's liability. Revaluation Account will be debited with such amount. Rent outstanding will appear in the Balance Sheet of reconstituted firm at ₹ 5,000.

(viii) The bill for electricity charges was omitted to be accounted. So, 'Outstanding Electricity Expenses' being a liability will appear in the liabilities side of the Balance Sheet.

(ix) *There are two aspects of this transaction:*

1st Journal entry records the total decrease in the value of machinery by ₹ 3,000.

2nd Journal entry records the machinery taken by *Y*.

(x) *There are two aspects of this transaction:*

1st entry records the increase in the value of machinery by ₹ 5,000.

2nd entry records machinery taken by *Y*.

(xi) The amount of ₹ 5,000 is the prepaid insurance. It will appear as 'Prepaid Insurance Premium' in the assets side of the Balance Sheet of reconstituted firm at ₹ 5,000.

(xii) A claim for damages against the firm increases the firm's liability against which a provision is to be made. It will be debited to Revaluation Account and must be shown in the liabilities side of the Balance Sheet.

(xiii) As a liability of ₹ 10,000 is not like to arise, it will reduce the amount of sundry creditors.

(xiv) The amount of ₹ 12,000 is accrued income. So, it will appear as 'Accrued Income' in the assets side of the Balance Sheet of reconstituted firm.

Illustration 8.

P and *S* were partners in a firm sharing profits in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Bank Overdraft		20,000	Cash in Hand	8,000
Creditors		30,000	Debtors	30,000
Provision for Doubtful Debts		1,000	Bills Receivable	40,000
General Reserve		15,000	Stock	50,000
V's Loan		20,000	Building	90,000
Capital A/cs:			Land	1,48,000
P	1,00,000			
S	1,80,000	2,80,000		
		3,66,000		3,66,000

On 1st April, 2018, they admitted *V* as a new partner on the following conditions:

(i) *V* will get 1/8th share in the profits of the firm.

(ii) *V*'s Loan will be converted into his capital.

(iii) The goodwill of the firm was valued at ₹ 80,000 and *V* brought in his share of goodwill in cash.

(iv) A Provision for Doubtful Debts was to be made equal to 5% of the Debtors.

(v) Stock was to be reduced by 5%.

(vi) Land was to be appreciated by 10%.

Prepare Revaluation Account, Partners' Capital Accounts of *P*, *S* and *V* and Balance Sheet of the new firm as at 1st April, 2018. *(Delhi 2002, Modified)*

Solution:

In the Books of the Firm

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		500	By Land A/c	14,800
To Stock A/c		2,500		
To Gain (Profit) transferred to:				
P's Capital A/c	7,080			
S's Capital A/c	4,720	11,800		
		14,800		14,800

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*P* ₹	*S* ₹	*V* ₹	Particulars	*P* ₹	*S* ₹	*V* ₹
To Balance *c/d*	1,22,080	1,94,720	20,000	By Balance *b/d*	1,00,000	1,80,000	...
				By *V*'s Loan A/c	...	...	20,000
				By Premium for Goodwill A/c	6,000	4,000	...
				By Revaluation A/c	7,080	4,720	...
				By General Reserve A/c	9,000	6,000	...
	1,22,080	1,94,720	20,000		1,22,080	1,94,720	20,000

BALANCE SHEET OF M/s *P*, *S* AND *V as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs:			Land		1,62,800
P	1,22,080		Building		90,000
S	1,94,720		Bills Receivable		40,000
V	20,000	3,36,800	Debtors		30,000
Creditors		30,000	Stock (₹ 50,000 – ₹ 2,500)		47,500
Provision for Doubtful Debts		1,500	Cash	8,000	
Bank Overdraft		20,000	*Add:* Paid by *V*	10,000	18,000
		3,88,300			3,88,300

Illustration 9.

X and Y sharing profits in the ratio of 3 : 2 had the following Balance Sheet as at 31st March, 2018:

Liabilities		₹	Assets		₹
Creditors		15,000	Cash		5,000
General Reserve		12,000	Debtors	20,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	800	19,200
X	54,000		Patents		14,800
Y	36,000	90,000	Investments		8,000
Current A/cs:			Machinery		72,000
X	10,000		Goodwill		10,000
Y	2,000	12,000			
		1,29,000			1,29,000

On 1st April, 2018, they decided to admit Z on the following terms:

(i) A Provision of 5% is to be created on Debtors.

(ii) Accrued Income of ₹ 1,500 does not appear in the books and ₹ 5,000 are outstanding for salaries.

(iii) The present market value of Investments is ₹ 6,000. X takes over the investments at this value.

(iv) The new profit-sharing ratio of partners will be 4 : 3 : 2.

(v) Z will bring in ₹ 20,000 as his capital.

(vi) Z is to pay in cash an amount equal to his share in the firm's goodwill valued at twice the average profit of the last three years which were ₹ 25,000; ₹ 26,000 and ₹ 30,000 respectively.

(vii) Half the amount of goodwill is withdrawn by the old partners.

Prepare Revaluation Account, Partners' Capital Accounts, Current Accounts and opening Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Provision for Doubtful Debts A/c	200	By Accrued Income A/c		1,500
To Outstanding Salaries A/c	5,000	By Loss transferred to:		
To Investments A/c	2,000	*X*'s Current A/c (3/5th)	3,420	
		Y's Current A/c (2/5th)	2,280	5,700
	7,200			7,200

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* ₹	*Y* ₹	*Z* ₹	Particulars	*X* ₹	*Y* ₹	*Z* ₹
To Balance *c/d*	54,000	36,000	20,000	By Balance *b/d*	54,000	36,000	...
				By Cash A/c	...	...	20,000
	54,000	36,000	20,000		54,000	36,000	20,000

Dr. PARTNERS' CURRENT ACCOUNTS Cr.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Investments A/c	6,000	...	By Balance *b/d*	10,000	2,000
To Revaluation A/c	3,420	2,280	By General Reserve A/c	7,200	4,800
To Goodwill A/c	6,000	4,000	By Premium for Goodwill A/c	8,400	3,600
To Cash A/c	4,200	1,800			
To Balance *c/d*	5,980	2,320			
	25,600	10,400		25,600	10,400

OPENING BALANCE SHEET OF THE RECONSTITUTED FIRM *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Creditors		15,000	Cash		31,000
Outstanding Salaries		5,000	Debtors	20,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	1,000	19,000
X	54,000		Accrued Income		1,500
Y	36,000		Patents		14,800
Z	20,000	1,10,000	Machinery		72,000
Current A/cs:					
X	5,980				
Y	2,320	8,300			
		1,38,300			1,38,300

Working Notes:

1. As there are Current Account balances appearing in the Balance Sheet, it means that the Capital Accounts are fixed. Hence, all transactions relating to the Capital Accounts will be passed through the Current Accounts.
2. Goodwill appearing in the Balance Sheet is written off by the old partners in their old profit-sharing ratio.
3. *Calculation of Goodwill:*

$$\text{Average Profit} = \frac{₹\,25{,}000 + ₹\,26{,}000 + ₹\,30{,}000}{3} = ₹\ 27{,}000$$

$$\text{Goodwill} = ₹\ 27{,}000 \times 2 = ₹\ 54{,}000$$

   Z brings in his share of goodwill in cash.

   Therefore, the amount of goodwill brought in by Z = ₹ 54,000 × $\frac{2}{9}$ = ₹ 12,000.

4. X Sacrifices $= \frac{3}{5} - \frac{4}{9} = \frac{7}{45}$; Y Sacrifices $= \frac{2}{5} - \frac{3}{9} = \frac{3}{45}$; Thus, Sacrificing Ratio of X and Y = 7 : 3.

Illustration 10.

Following was the Balance Sheet as at 31st March, 2018 of *A, B* and *C* sharing profits and losses in the ratio of 6 : 5 : 3 respectively:

Liabilities		₹	Assets	₹
Capital A/cs:			Land and Building	24,000
A	19,000		Furniture	3,500
B	16,000		Stock	14,000
C	8,000	43,000	Debtors	12,600
Creditors		9,000	Cash	900
Bills Payable		3,000		
		55,000		55,000

They admit *D* into partnership from 1st April, 2018 and give him a share of 1/8th in the rupee on the following terms:

(i) *D* should bring in ₹ 4,200 as goodwill and ₹ 7,000 as capital.

(ii) Furniture be depreciated by 12%.

(iii) The Stock be depreciated by 10%.

(iv) Provision of 5% be created for Doubtful Debts.

(v) The value of Land and Building having over-depreciated, be brought up to ₹ 31,000.

(vi) After making the above adjustments, the Capital Accounts of the old partners (who continue to share in the same proportion as before) be adjusted on the basis of the proportion of *D*'s Capital to his share in the business, *i.e.*, cash to be paid or brought in by the old partners, as the case may be.

Prepare Profit and Loss Adjustment Account, Cash Account, and opening Balance Sheet of the new firm.

Solution: **In the Books of the Firm**

Dr. PROFIT AND LOSS ADJUSTMENT ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Furniture A/c		420	By Land and Building A/c	7,000
To Stock A/c		1,400		
To Provision for Doubtful Debts A/c		630		
To Gain (Profit) transferred to:				
A's Capital A/c (6/14)	1,950			
B's Capital A/c (5/14)	1,625			
C's Capital A/c (3/14)	975	4,550		
		7,000		7,000

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	900	By *A*'s Capital A/c (WN 3)	1,750
To *D*'s Capital A/c	7,000	By *B*'s Capital A/c (WN 3)	1,625
To Premium for Goodwill A/c	4,200	By Balance *c/d*	9,350
To *C*'s Capital A/c (WN 3)	625		
	12,725		12,725

BALANCE SHEET OF *A, B, C* AND *D as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs: *A*	21,000		Land and Building		31,000
B	17,500		Furniture		3,080
C	10,500		Debtors	12,600	
D	7,000	56,000	*Less:* Provision for Doubtful Debts	630	11,970
Creditors		9,000	Stock		12,600
Bills Payable		3,000	Cash		9,350
		68,000			68,000

Working Notes:

1. *Calculation of New Profit-Sharing Ratio:*
   D joins the business for 1/8th share. Therefore, remaining 7/8th (*i.e.*, 1 – 1/8) share will be shared by the old partners in their old ratio, *i.e.*, 6 : 5 : 3 respectively. Therefore, *A*'s New share = 6/14 × 7/8 = 42/112;
   B's New share = 5/14 × 7/8 = 35/112; *C*'s New share = 3/14 × 7/8 = 21/112; and *D*'s share = 1/8th or 14/112.
   Thus, New Profit-sharing Ratio among *A*, *B*, *C* and *D* = 42 : 35 : 21 : 14 = 6 : 5 : 3 : 2.

2. *Determination of the Combined Capital of the New Firm:*
   Taking *D*'s Capital as base, the combined capital of the new firm is ₹ 7,000 × 8/1 = ₹ 56,000. Total capital of the new firm will be contributed by the partners in their new profit-sharing ratio, *i.e.*, 6 : 5 : 3 : 2.
   Therefore, capitals of the partners in new firm will be:
   A—₹ 21,000; *B*—₹ 17,500; *C*—₹ 10,500; *D*—₹ 7,000.

3. *Dr.* PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	*D* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹	*D* ₹
To Cash A/c (Bal. Fig.)	1,750	1,625	...	...	By Balance *b/d*	19,000	16,000	8,000	...
					By Cash A/c	...	...	...	7,000
To Balance *c/d* (WN 2)	21,000	17,500	10,500	7,000	By Premium for Goodwill A/c	1,800	1,500	900	...
					By P & L Adj. A/c	1,950	1,625	975	...
					By Cash A/c (Bal. Fig.)	...	...	625	...
	22,750	19,125	10,500	7,000		22,750	19,125	10,500	7,000

Illustration 11.

Anil and Sunil are partners sharing profits and losses in the ratio of 3 : 2. They admit Charan as a new partner from 1st April, 2018. Anil gives 1/3rd of his share while Sunil gives 1/10th from his share to Charan. Their Balance Sheet as at 31st March, 2018, is given below:

Liabilities		₹	Assets	₹
Anil's Capital	32,600		Land and Building	6,000
Sunil's Capital	40,400	73,000	Investments	5,000
Workmen's Compensation Reserve		2,000	(Market Value ₹ 4,500)	
Investments Fluctuation Reserve		1,000	Debtors	30,000
Employees' Provident Fund		1,000	Stock	10,000
Provision for Doubtful Debts		1,000	Bank	27,000
		78,000		78,000

Terms of Charan's admission are as follows:

(i) Charan brings ₹ 30,000 as his capital. His share of Goodwill was determined to be ₹ 18,000. He could bring in only 60% of his share.

(ii) Land and Building was found to be undervalued by ₹ 10,000, stock was found overvalued by ₹ 7,000 and provision for doubtful debts is to made equal to 5% of the debtors.

(iii) Capital Accounts of the old partners to be re-adjusted in the new profit-sharing arrangement on the basis of Charan's Capital, any excess or deficiency to be adjusted in cash.

You are required to:

(a) Pass Journal entries.

(b) Prepare Partners' Capital Accounts.

(c) Balance Sheet of the new firm.

Show your workings clearly.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Cash/Bank A/c	...Dr.		40,800	
	To Charan's Capital A/c				30,000
	To Premium for Goodwill A/c				10,800
	(Amount brought in by Charan as capital and 60% of his share of Premium for Goodwill)				
	Premium for Goodwill A/c	...Dr.		10,800	
	Charan's Current A/c	...Dr.		7,200	
	To Anil's Capital A/c				12,000
	To Sunil's Capital A/c				6,000
	(Share of Charan in goodwill credited to Anil's Capital Account and Sunil's Capital Account in their sacrificing ratio) (WN 1)				
	Land and Building A/c	...Dr.		10,000	
	To Revaluation A/c				10,000
	(Increase in value of Land and Building)				
	Revaluation A/c	...Dr.		7,500	
	To Stock A/c				7,000
	To Provision for Doubtful Debts A/c				500
	(Value of stock decreased and further provision for doubtful debts made)				
	Revaluation A/c	...Dr.		2,500	
	To Anil's Capital A/c				1,500
	To Sunil's Capital A/c				1,000
	(Gain (profit) on revaluation transferred to Old Partners' Capital Accounts in their old profit-sharing ratio)				
	Investments Fluctuation Reserve A/c	...Dr.		500	
	To Investments A/c				500
	(Value of investments brought down to market value)				
	Workmen Compensation Reserve A/c	...Dr.		2,000	
	To Anil's Capital A/c				1,200
	To Sunil's Capital A/c				800
	(Workmen Compensation Reserve credited to Anil's and Sunil's Capital Accounts in their old profit-sharing ratio)				
	Investments Fluctuation Reserve A/c	...Dr.		500	
	To Anil's Capital A/c				300
	To Sunil's Capital A/c				200
	(Excess Investments Fluctuation Reserve credited to Anil's and Sunil's Capital Accounts in their old profit-sharing ratio)				
	Anil Capital A/c	...Dr.		7,600	
	Sunil Capital A/c	...Dr.		18,400	
	To Bank A/c				26,000
	(Amount withdrawn by Anil and Sunil to make their capitals proportionate)				

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Anil ₹	Sunil ₹	Charan ₹	Particulars	Anil ₹	Sunil ₹	Charan ₹
To Bank A/c (Withdrawal) (Balancing Figure)	7,600	18,400	...	By Balance *b/d*	32,600	40,400	...
To Balance *c/d* (WN 4)	40,000	30,000	30,000	By Workmen Comp. Reserve A/c	1,200	800	...
				By Investments Fluctuation Reserve A/c	300	200	...
				By Revaluation A/c (Gain)	1,500	1,000	...
				By Bank A/c	...	...	30,000
				By Charan's Current A/c	4,800	2,400	...
				By Premium for Goodwill A/c	7,200	3,600	...
	47,600	48,400	30,000		47,600	48,400	30,000

BALANCE SHEET (*After Charan's Admission) as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		16,000
Anil	40,000		Investments		4,500
Sunil	30,000		Debtors	30,000	
Charan	30,000	1,00,000	*Less:* Provision for Doubtful Debts	1,500	28,500
Employees' Provident Fund		1,000	Stock		3,000
			Bank (WN 5)		41,800
			Charan's Current A/c		7,200
		1,01,000			1,01,000

Working Notes:

1. *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Stock A/c		7,000	By Land and Building A/c	10,000
To Provision for Doubtful Debts A/c		500		
To Gain (Profit) on Revaluation:				
Anil's Capital A/c	1,500			
Sunil's Capital A/c	1,000	2,500		
		10,000		10,000

2. *Calculation of Sacrificing Ratio:* Anil Sunil

Existing Ratio 3 : 2

Anil's Sacrifice $= \frac{3}{5}\times\frac{1}{3}=\frac{1}{5}$; Sunil's Sacrifice $= \frac{1}{10}$

Hence, Sacrificing Ratio $= \frac{1}{5}:\frac{1}{10}=2:1$

Premium for Goodwill of ₹ 18,000 shall be distributed between Anil and Sunil in the Sacrificing Ratio, *i.e.*, 2 : 1

Anil's Share $=$ ₹ $18,000\times\frac{2}{3}=$ ₹ 12,000 ; Sunil's Share $=$ ₹ $18,000\times\frac{1}{3}=$ ₹ 6,000.

3. *Calculation of New Profit-sharing Ratio:*

Share acquired by Charan: From Anil = $\frac{3}{5} \times \frac{1}{3} = \frac{1}{5}$; from Sunil = $\frac{1}{10}$

Anil's New Share = $\frac{3}{5} - \frac{1}{5} = \frac{2}{5}$; Sunil's New Share = $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$; Charan's Share = $\frac{1}{5} + \frac{1}{10} = \frac{2+1}{10} = \frac{3}{10}$

Thus, New Profit-sharing Ratio of Anil, Sunil and Charan = $\frac{2}{5} : \frac{3}{10} : \frac{3}{10}$ *or* 4 : 3 : 3.

4. *Total Capital of New Firm on the basis of Charan's Capital* = $\frac{\text{Capital of the New Partner (Charan)}}{\text{Share of Profit of Charan}}$

$$= \frac{₹\,30{,}000}{3/10} = ₹\,30{,}000 \times \frac{10}{3} = ₹\,1{,}00{,}000$$

Anil's Capital = ₹ 1,00,000 $\times \frac{4}{10}$ = ₹ 40,000; Sunil's Capital = ₹ 1,00,000 $\times \frac{3}{10}$ = ₹ 30,000;

Charan's Capital = ₹ 30,000.

5. *Bank Balance:*

		₹
Opening Balance		27,000
Add: Brought by Charan		40,800
		67,800
Less: Capital Withdrawn by Anil	7,600	
Capital Withdrawn by Sunil	18,400	26,000
Closing Balance		41,800

Illustration 12 (*Proportionate Capital Introduced by Incoming Partner*).

Sahaj and Nimish are partners in a firm. They share profits and losses in the ratio of 2 : 1. Since both of them are specially abled, sometimes they find it difficult to run the business on their own. Gauri, a common friend decides to help them. Therefore, they admitted her into partnership for a 1/3rd share. She brought her share of goodwill in cash and proportionate capital. At the time of Gauri's admission, the Balance Sheet of Sahaj and Nimish was as under.

Liabilities		₹	Assets	₹
Capital A/cs:			Machinery	2,40,000
Sahaj	2,40,000		Furniture	1,60,000
Nimish	1,60,000	4,00,000	Stock	1,00,000
General Reserve		60,000	Sundry Debtors	60,000
Creditors		60,000	Cash	40,000
Employees' Provident Fund		80,000		
		6,00,000		6,00,000

It was decided to:

(i) Reduce the value of stock by ₹ 10,000.

(ii) Depreciate furniture by 10% and appreciate machinery by 5%.

(iii) ₹ 6,000 of the debtors proved bad. A provision of 5% was to be created on Sundry Debtors for doubtful debts.

(iv) Goodwill of the firm was valued at ₹ 90,000.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the reconstituted firm. *(Delhi 2013, Modified)*

Solution:

Dr. REVALUATION ACCOUNT Cr.

Particulars	₹	Particulars		₹
To Stock A/c	10,000	By Machinery A/c		12,000
To Furniture A/c	16,000	By Loss transferred to:		
To Bad Debts A/c	6,000	Sahaj's Capital A/c (22,700 × 2/3)	15,133	
To Provision for Doubtful Debts A/c 5/100 (₹ 60,000 – ₹ 6,000)	2,700	Nimish's Capital A/c (22,700 ×1/3)	7,567	22,700
	34,700			34,700

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	Sahaj ₹	Nimish ₹	Gauri ₹	Particulars	Sahaj ₹	Nimish ₹	Gauri ₹
To Revaluation A/c (Loss)	15,133	7,567	...	By Balance *b/d*	2,40,000	1,60,000	...
To Balance *c/d*	2,84,867	1,82,433	2,33,650	By General Reserve A/c	40,000	20,000	...
				By Premium for Goodwill A/c (₹ 90,000 × 1/3)	20,000	10,000	...
				By Bank A/c (WN 1)	...	...	2,33,650
	3,00,000	1,90,000	2,33,650		3,00,000	1,90,000	2,33,650

BALANCE SHEET OF THE NEW FIRM
as at...

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		2,52,000
Sahaj	2,84,867		Furniture		1,44,000
Nimish	1,82,433		Stock ₹ (1,00,000 – 10,000)		90,000
Gauri	2,33,650	7,00,950	Sundry Debtors	60,000	
Creditors		60,000	*Less:* Bad Debts	6,000	
Employees' Provident Fund		80,000		54,000	
			Less: Provision for Doubtful Debts	2,700	51,300
			Cash		40,000
			Bank (WN 2)		2,63,650
		8,40,950			8,40,950

Working Notes:

1. *Calculation of the amount to be brought in by Gauri as Capital:*
   (a) *Adjusted Combined Capital of the Old Partners:*
   = ₹ 2,84,867 + ₹ 1,82,433 = ₹ 4,67,300.

   (b) *Total Capital of the New Firm:*
   $$= \frac{\text{Adjusted Combined Capital of the Old Partners}}{\text{Combined Share of Profit of Old Partners}} = ₹\ 4{,}67{,}300 \times 3/2 = ₹\ 7{,}00{,}950.$$

   (c) *Calculation of Gauri's Proportionate Capital:*
   = ₹ 7,00,950 × 1/3 = ₹ 2,33,650.

2. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Gauri's Capital A/c	2,33,650	By Balance *c/d*	2,63,650
To Premium for Goodwill A/c	30,000		
	2,63,650		2,63,650

Illustration 13 (*Calculation of Investment to be made to become a Partner*).

A commenced his business with a capital of ₹ 5,00,000 on 1st April, 2013. During the five years ended 31st March, 2018, the results of his business were:

Year Ended		₹
31st March, 2014	Loss	10,000
31st March, 2015	Profit	26,000
31st March, 2016	Profit	34,000
31st March, 2017	Profit	40,000
31st March, 2018	Profit	50,000

During this period, he withdrew ₹ 80,000 for his personal use. On 1st April, 2018, he admitted *B* into partnership on the following terms:

(i) Goodwill is to be valued at 3 times the average profit of last five years.

(ii) *B* will have 1/2 share of the future profits.

(iii) He will bring in his share of goodwill in cash.

(iv) He will bring in capital in cash equal to that of *A* after his admission.

Calculate amount to be brought in by *B* and pass entries to record the transactions pertaining to admission. *(Foreign 1991, Modified)*

Solution:

(i) *Calculation of share of goodwill to be brought in by B:*

	₹
(a) Total profits for five years (– ₹ 10,000 + ₹ 26,000 + ₹ 34,000 + ₹ 40,000 + ₹ 50,000)	1,40,000
(b) Average profit (₹ 1,40,000/5)	28,000
(c) Value of goodwill (₹ 28,000 × 3)	84,000
(d) Share of goodwill to be brought in by *B* (₹ 84,000/2)	42,000

(ii) *Calculation of A's Capital as at 31st March, 2018:*

Capital as at 1st April, 2013	5,00,000
Add: Net profit for five years	1,40,000
	6,40,000
Less: Drawings	80,000
Capital as at 31st March, 2018	5,60,000

(iii) *Calculation of amount to be invested by B:*

A's Capital after *B*'s admission = ₹ 5,60,000 + Amount of goodwill to be brought in by *B*

= ₹ 5,60,000 + ₹ 42,000 = ₹ 6,02,000

Therefore, *B* will have to bring ₹ 6,02,000 as Capital and ₹ 42,000 as goodwill,

i.e., total amount to be brought in by *B* = ₹ 6,44,000.

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	Cash A/c ...Dr.		6,44,000	
	To *B*'s Capital A/c			6,02,000
	To Premium for Goodwill A/c			42,000
	(Amount brought in by *B*)			
April 1	Premium for Goodwill A/c ...Dr.		42,000	
	To *A*'s Capital A/c			42,000
	(Amount of goodwill credited to *A*'s Capital Account)			

Illustration 14 (*Comprehensive*).

A and *B* are partners in a firm sharing profits and losses in the ratio of 7 : 3. Their Balance Sheet as at 31st March, 2018 is:

Liabilities		₹	Assets		₹
Sundry Creditors		40,000	Cash in Hand		36,000
Bank Overdraft		20,000	Sundry Debtors	46,000	
Reserve		10,000	*Less*: Provision for		
Capital A/cs:			Doubtful Debts	2,000	44,000
A	50,000		Stock-in-Trade		50,000
B	40,000	90,000	Furniture		30,000
		1,60,000			1,60,000

On 1st April, 2018, *C* joins the firm as the third partner for 1/4th share of the future profits on the following terms and conditions:

(i) Goodwill is valued at ₹ 40,000 and *C* is to bring in the necessary amount in cash as premium for goodwill.

(ii) 20% of the reserve is retained as a Contingency Reserve.

(iii) Stock-in-Trade is to be reduced by 40% and Furniture is to be reduced to 40%.

(iv) *A* is to pay off the Bank Overdraft.

(v) *C* is to introduce ₹ 30,000 as his share of capital to which amount other partners' capitals shall have to be adjusted.

Prepare Balance Sheet of the new firm after *C* has become a partner. Show the workings clearly.

Solution: BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Sundry Creditors		40,000	Cash in Hand (WN 3)		76,000
Contingency Reserve		2,000	Sundry Debtors	46,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	2,000	44,000
A	63,000		Stock (₹ 50,000 – ₹ 20,000)		30,000
B	27,000		Furniture		12,000
C	30,000	1,20,000			
		1,62,000			1,62,000

Working Notes:

1. *Dr.* PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Revaluation A/c (Loss) (WN 4)	26,600	11,400	...	By Balance *b/d*	50,000	40,000	...
				By Premium for Goodwill A/c	7,000	3,000	...
To Cash A/c (Surplus) (Balancing Figure)	...	7,000	...	By Reserve A/c	5,600	2,400	...
				By Bank Overdraft A/c	20,000	...	...
To Balance *c/d* (WN 2)	63,000	27,000	30,000	By Cash A/c	...	...	30,000
				By Cash A/c (Deficit) (Balancing Figure)	7,000	...	...
	89,600	45,400	30,000		89,600	45,400	30,000

2. *Calculation of New Profit-sharing Ratio and Proportionate Capital:*

   C joins the firm for 1/4th share of profits. Therefore, 3/4th (*i.e.*, 1 – 1/4) will be shared by *A* and *B* in the ratio of 7 : 3.

   A's new share = 3/4 × 7/10 = 21/40; *B*'s new share = 3/4 × 3/10 = 9/40; *C*'s share = 1/4 or 10/40.

   ∴ New Profit-sharing Ratio = 21 : 9 : 10.

   Total Capital of the new firm on the basis of *C*'s Capital = ₹ 30,000 × 4/1 = ₹ 1,20,000.

   A's Capital in New Firm = ₹ 1,20,000 × 21/40 = ₹ 63,000;

   B's Capital in New Firm = ₹ 1,20,000 × 9/40 = ₹ 27,000.

3. The partners decide to retain 20% of Reserve as Contingency Reserve. Therefore, the balance, *i.e.*, ₹ 8,000 is distributed between the old partners in their old profit-sharing ratio.

4. *Dr.* CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	36,000	By *B*'s Capital A/c	7,000
To *C*'s Capital A/c	30,000	By Balance *c/d*	76,000
To Premium for Goodwill A/c	10,000		
To *A*'s Capital A/c	7,000		
	83,000		83,000

5. *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Stock A/c (₹ 50,000 × 40/100)*	20,000	By Loss transferred to:		
To Furniture A/c (₹ 30,000 × 60/100)**	18,000	*A*'s Capital A/c (₹ 38,000 × 7/10)	26,600	
		B's Capital A/c (₹ 38,000 × 3/10)	11,400	38,000
	38,000			38,000

*Stock-in-Trade is to be reduced by 40% means deduct 40% of the book value of stock. Thus, stock is to be shown at 60% of the book value.

**Furniture is to be reduced to 40% means 60% of the book value of furniture is to be written off.

Illustration 15 *(When the new partner brings proportionate capital).*

A and *B* are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		66,000
A	70,000		Furniture		30,000
B	60,000	1,30,000	Investments		40,000
General Reserve		20,000	Stock		46,000
Bank Loan		18,000	Debtors	38,000	
Creditors		72,000	*Less:* Provision for Doubtful Debts	4,000	34,000
			Cash		24,000
		2,40,000			2,40,000

On 1st April, 2018, they admitted *C* for 25% share in profits on the following terms:

(i) *C* brings in capital proportionate to his share after all adjustments and ₹ 8,000 for goodwill out of his share of ₹ 14,000.

(ii) Reduce Furniture by 10%.

(iii) Half of Investments was to be taken over by *A* and *B* in their profit-sharing ratio and remaining valued at ₹ 26,000.

(iv) New ratio will be 3 : 3 : 2.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet after *C*'s admission. *(Delhi 1999, Modified)*

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Furniture A/c		3,000	By Investments A/c	6,000
To Gain (Profit) transferred to:				
A's Capital A/c	1,800			
B's Capital A/c	1,200	3,000		
		6,000		6,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Investments A/c	12,000	8,000	...	By Balance *b/d*	70,000	60,000	...
To Balance *c/d*	84,400	62,600	49,000	By Cash A/c (WN 3)	...	...	49,000
				By *C*'s Current A/c (WN 2)	5,400	600	...
				By Premium for Goodwill A/c	7,200	800	...
				By General Reserve A/c	12,000	8,000	...
				By Revaluation A/c —Gain (Profit)	1,800	1,200	...
	96,400	70,600	49,000		96,400	70,600	49,000

BALANCE SHEET OF *A, B* AND *C as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		66,000
A	84,400		Furniture		27,000
B	62,600		Investments		26,000
C	49,000	1,96,000	Debtors	38,000	
Bank Loan		18,000	*Less:* Provision for Doubtful Debts	4,000	34,000
Creditors		72,000	*C*'s Current A/c		6,000
			Stock		46,000
			Cash ₹ (24,000 + 8,000 + 49,000)		81,000
		2,86,000			2,86,000

Working Notes:

1. A part of Goodwill brought in by *C* in cash has been shared by *A* and *B* in their sacrificing ratio of 9 : 1.
   Calculation of Sacrificing Ratio:

Partners	Old Share	New Share	Sacrifice (Old Share – New Share)	Sacrificing Ratio
A	3/5	3/8	3/5 – 3/8 = 9/40	*A* : *B*
B	2/5	3/8	2/5 – 3/8 = 1/40	9 : 1

2. Goodwill not brought in cash out of his share by ₹ 6,000 will be recorded as follows:

C's Current A/c	...Dr.	₹ 6,000	
To *A*'s Capital A/c			₹ 5,400
To *B*'s Capital A/c			₹ 600

3. *Capital brought in by C:*
   C's share in profits = 25% or 1/4
   For 3/4th share, combined capitals of *A* and *B* (after adjustments) are (₹ 84,400 + ₹ 62,600) ₹ 1,47,000.
   ∴ Total capital of New Firm = ₹ 1,47,000 × 4/3 = ₹ 1,96,000.
   ∴ *C*'s capital in New Firm = ₹ 1,96,000 × 1/4 = ₹ 49,000.

Illustration 16 **(Admission-cum-Retirement:** *Workmen Compensation Reserve***).**

X, *Y* and *Z* are partners sharing profits and losses in the ratio of 5 : 3 : 2. On 1st April, 2018, *R* is admitted into the partnership for 1/5th share in profits and brings ₹ 1,00,000 as his capital. On the same date *Z* retires from the firm. On that date, balance in Workmen Compensation Reserve is valued at ₹ 35,000. Claim for workmen compensation was determined at ₹ 25,000. Give necessary Journal entries.

Solution:

JOURNAL

Date		Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018						
April	1	Workmen Compensation Reserve A/c	...Dr.		25,000	
		To Workmen Compensation Claim A/c				25,000
		(Workmen Compensation Reserve equivalent to claim is transferred to Workmen Compensation Claim Account)				
April	1	Workmen Compensation Reserve A/c	...Dr.		10,000	
		To *X*'s Capital A/c				5,000
		To *Y*'s Capital A/c				3,000
		To *Z*'s Capital A/c				2,000
		(Balance of Workmen Compensation Reserve in excess distributed among old partners in old ratio)				
April	1	Bank A/c	...Dr.		1,00,000	
		To *R*'s Capital A/c				1,00,000
		(Capital brought in by *R* for 1/5th share)				

Illustration 17 (Admission-cum-Retirement: *Investment Fluctuation Reserve***).**

A, *B* and *C* are partners sharing profits in the ratio of 5 : 3 : 2. *A*, by agreement, retires and *D* joins the firm on the basis of one third share of profit on 1st April, 2018 bringing ₹ 50,000 towards capital. An extract of their Balance Sheet as at 31st March, 2018 is as follows:

Liabilities	₹	Assets	₹
Investment Fluctuation Reserve	3,750	Investment (at Cost)	50,000

Pass Journal entries if market value of Investment is ₹ 55,000.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Investment Fluctuation Reserve A/c ...Dr.		3,750	
	To *A*'s Capital A/c			1,875
	To *B*'s Capital A/c			1,125
	To *C*'s Capital A/c			750
	(Transfer of Investment Fluctuation Reserve to Partners' Capital Accounts in their old profit-sharing ratio)			
	Investment A/c ...Dr.		5,000	
	To Revaluation A/c			5,000
	(Value of Investment brought up to market value)			
	Revaluation A/c ...Dr.		5,000	
	To *A*'s Capital A/c			2,500
	To *B*'s Capital A/c			1,500
	To *C*'s Capital A/c			1,000
	(Transfer of gain (profit) on revaluation)			
	Bank A/c ...Dr.		50,000	
	To *D*'s Capital A/c			50,000
	(Capital brought in by *D*)			

Illustration 18 (*Adjustment of Capital to be made by Cash*).

A, *B* and *C* are partners sharing profits and losses in the ratio of 2 : 3 : 5. On 31st March, 2018, their Balance Sheet was:

Liabilities		₹	Assets	₹
Creditors		64,000	Cash	18,000
Bills Payable		32,000	Bills Receivable	24,000
Profit and Loss A/c		14,000	Furniture	28,000
Capital A/cs:			Stock	44,000
A	36,000		Debtors	42,000
B	44,000		Investments	32,000
C	52,000	1,32,000	Machinery	34,000
			Goodwill	20,000
		2,42,000		2,42,000

They admit *D* into partnership from 1st April, 2018 on the following terms:

(i) Furniture, Investments and Machinery to be reduced by 15%.

(ii) Stock is revalued at ₹ 48,000.

(iii) Outstanding Rent amounted to ₹ 1,800.

(iv) Prepaid Salaries ₹ 800.

(v) *D* brings in ₹ 32,000 as his capital and ₹ 6,000 for goodwill in Cash for 1/6th share of future profits of the firm.

(vi) Capital of the partners shall be proportionate to their profit-sharing ratio, taking *D*'s capital as base.

(vii) Adjustment of capitals to be made in cash.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and the Balance Sheet of the new firm.

Solution:

In the Books of the Firm

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Furniture A/c	4,200	By Stock A/c		4,000
To Investments A/c	4,800	By Prepaid Salaries A/c		800
To Machinery A/c	5,100	By Loss transferred to:		
To Outstanding Rent A/c	1,800	*A*'s Capital A/c	2,220	
		B's Capital A/c	3,330	
		C's Capital A/c	5,550	11,100
	15,900			15,900

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	*D* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)	*D* (₹)
To Revaluation A/c (Loss)	2,220	3,330	5,550	...	By Balance *b/d*	36,000	44,000	52,000	...
					By Cash A/c	...	...	...	32,000
To Goodwill A/c (2 : 3 : 5)	4,000	6,000	10,000	...	By P & L A/c	2,800	4,200	7,000	...
To Cash A/c (Bal. Fig.)	1,780	...	...	...	By Premium for Goodwill A/c (2 : 3 : 5)	1,200	1,800	3,000	...
To Balance *c/d*	32,000	48,000	80,000	32,000	By Cash A/c (Bal. Fig.)	...	7,330	33,550	...
	40,000	57,330	95,550	32,000		40,000	57,330	95,550	32,000

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	18,000	By *A*'s Capital A/c	1,780
To *B*'s Capital A/c	7,330	By Balance *c/d*	95,100
To *C*'s Capital A/c	33,550		
To *D*'s Capital A/c	32,000		
To Premium for Goodwill A/c	6,000		
	96,880		96,880

BALANCE SHEET OF *A*, *B*, *C* AND *D as at 1st April, 2018*

Liabilities		₹	Assets	₹
Bills Payable		32,000	Cash	95,100
Creditors		64,000	Stock	48,000
Outstanding Rent		1,800	Debtors	42,000
Capital A/cs:			Bills Receivable	24,000
A	32,000		Prepaid Salaries	800
B	48,000		Investments	27,200
C	80,000		Furniture	23,800
D	32,000	1,92,000	Machinery	28,900
		2,89,800		2,89,800

Working Notes:

1. *New Profit-Sharing Ratio is calculated as under:*

   Let total profit be = 1

   D gets = 1/6th share

   Remaining profit = 1 – 1/6 = 5/6 will be shared by *A*, *B* and *C* in their old profit-sharing ratio.

   A's share = 5/6 × 2/10 = 2/12

   B's share = 5/6 × 3/10 = 3/12

   C's share = 5/6 × 5/10 = 5/12

   Thus, New Profit-sharing Ratio of *A*, *B*, *C* and *D* = 2/12 : 3/12 : 5/12 : 1/6 *or* 2 : 3 : 5 : 2.

2. *Adjustment of Capital:*

   For 1/6th share *D* brought capital = ₹ 32,000

   ∴ Total capital of the New firm = ₹ 32,000 × 6/1 = ₹ 1,92,000

   A's Capital = ₹ 1,92,000 × 2/12 = ₹ 32,000; *C*'s Capital = ₹ 1,92,000 × 5/12 = ₹ 80,000

   B's Capital = ₹ 1,92,000 × 3/12 = ₹ 48,000; *D*'s Capital = ₹ 1,92,000 × 2/12 = ₹ 32,000.

Illustration 19 (Admission-cum-Death: Treatment of Goodwill).

A and *B* are partners in a firm sharing profits in the ratio of 3 : 2. They admitted *C* as a partner for 1/5th share of profit on 1st April, 2018. He brings ₹ 4,500 as a premium out of his share of ₹ 6,000. On the same date *B* died. According to his will, the executors should donate his share to a school for providing scholarships to the students.

Pass Journal entries to give effect to the above.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Cash A/c ...Dr.		4,500	
	To Premium for Goodwill A/c			4,500
	(*C* brings only a part of his share of goodwill)			
April 1	Premium for Goodwill A/c ...Dr.		4,500	
	C's Current A/c ...Dr.		1,500	
	A's Capital A/c ...Dr.		6,000	
	To *B*'s Capital A/c			12,000
	(Sacrificing partner (*B*) compensated with the share of goodwill)			

Working Notes:

1. *Calculation of Gaining/Sacrificing Share:*

	A	*B*	*C*
(i) Old Share	3/5	2/5	...
(ii) New Share	4/5	...	1/5
Sacrifice/(Gain) (i – ii)	–1/5 (Gain)	2/5 (Sacrifice)	–1/5 (Gain)

2. *Calculation of Share of Goodwill:*

   For 1/5th Share of *C*, Goodwill = ₹ 6,000

   Value of Firm's Goodwill = ₹ 6,000 × 5/1 = ₹ 30,000

   For 2/5th sacrifice of *B*, value of Goodwill = ₹ 30,000 × 2/5 = ₹ 12,000

   For 1/5th Gain of *A*, value of Goodwill = ₹ 30,000 × 1/5 = ₹ 6,000.

Illustration 20.

Bishan and Krishan are partners sharing profits and losses in the ratio of 3 : 2. They admit Amit for 1/10th share which he acquires equally from Bishan and Krishan.

Calculate the New Profit-sharing Ratio.

Solution: Share surrendered by Bishan = 1/10 × 1/2 = 1/20

Share surrendered by Krishan = 1/10 × 1/2 = 1/20

New Share = Old share – Share surrendered

$$\text{Bishan's New Share} = \frac{3}{5} - \frac{1}{20} = \frac{12-1}{20} = \frac{11}{20}$$

$$\text{Krishan's New Share} = \frac{2}{5} - \frac{1}{20} = \frac{8-1}{20} = \frac{7}{20}$$

$$\text{Amit's Share} = \frac{1}{10} \ \textit{or} \ \frac{2}{20}$$

$$\text{New Profit-sharing Ratio} = \frac{11}{20} : \frac{7}{20} : \frac{2}{20} = 11:7:2.$$

Illustration 21.

X, Y and Z are partners sharing profits in the ratio of 4 : 3 : 3. They admitted A into partnership for 1/5th share which he took from the old partners in the ratio 1 : 2 : 3. Calculate the new profit-sharing ratio.

Solution:

A acquires from $X = \frac{1}{6}$ th of $\frac{1}{5} = \frac{1}{30}$; from $Y = \frac{2}{6}$ th of $\frac{1}{5} = \frac{2}{30}$; from $Z = \frac{3}{6}$ th of $\frac{1}{5} = \frac{3}{30}$

New Share = Old Share – Share Surrendered

$$X\text{'s New Share} = \frac{4}{10} - \frac{1}{30} = \frac{12-1}{30} = \frac{11}{30}$$

$$Y\text{'s New Share} = \frac{3}{10} - \frac{2}{30} = \frac{9-2}{30} = \frac{7}{30}$$

$$Z\text{'s New Share} = \frac{3}{10} - \frac{3}{30} = \frac{9 \quad 3}{30} = \frac{6}{30}$$

$$A\text{'s Share is } \frac{1}{5} \ \textit{or} \ \frac{6}{30}$$

$$\text{Thus, New Profit-sharing Ratio} = \frac{11}{30} : \frac{7}{30} : \frac{6}{30} : \frac{6}{30} = 11:7:6:6.$$

Illustration 22 (*Adjustment of Accumulated Profits and Losses*).

A, *B* and *C* were partners in a firm sharing profits and losses in the ratio of 3 : 1 : 1. On 1st April, 2018, their Balance Sheet stood as:

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets	₹
Capital A/cs:			Land and Building	1,50,000
A	1,00,000		Machinery	50,000
B	30,000		Furniture	10,000
C	20,000	1,50,000	Investments (Market value ₹ 28,000)	30,000
General Reserve		25,000	Current Assets	1,18,000
Profit and Loss A/c		35,000	Advertisement Suspense	25,000
Investments Fluctuation Reserve		20,000	(Deferred Revenue Expenditure)	
Workmen Compensation Reserve		23,000		
Employees' Provident Fund		30,000		
Creditors		1,00,000		
		3,83,000		3,83,000

They admitted *D* into partnership for 1/5th share of profits on the above date. A claim for workmen compensation is estimated at ₹ 13,000.

Pass necessary Journal entries to adjust the accumulated profits and losses.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	Investments Fluctuation Reserve A/c	...Dr.		2,000	
	To Investments A/c				2,000
	(Value of investments brought down to market value)				
	Workmen Compensation Reserve A/c	...Dr.		13,000	
	To Provision for Workmen Compensation Claim A/c				13,000
	(Workmen compensation claim provided for)				
	General Reserve A/c	...Dr.		25,000	
	Profit and Loss A/c	...Dr.		35,000	
	Investments Fluctuation Reserve A/c	...Dr.		18,000	
	[₹ 20,000 – (₹ 30,000 – ₹ 28,000)]				
	Workmen Compensation Reserve A/c	...Dr.		10,000	
	(₹ 23,000 – ₹ 13,000)				
	To *A*'s Capital A/c				52,800
	To *B*'s Capital A/c				17,600
	To *C*'s Capital A/c				17,600
	(Transfer of accumulated profits to old partners in their old profit-sharing ratio)				
	A's Capital A/c	...Dr.		15,000	
	B's Capital A/c	...Dr.		5,000	
	C's Capital A/c	...Dr.		5,000	
	To Advertisement Suspense A/c				25,000
	(Transfer of accumulated losses to old partners in their old profit-sharing ratio)				

Notes:

1. Market value of investments is less than its Book Value by ₹ 2,000. This loss is met out of Investments Fluctuation Reserve. After meeting the loss, remaining balance of Investments Fluctuation Reserve, *i.e.*, ₹ 18,000 is distributed among old partners in their old profit-sharing ratio.
2. Employees' Provident Fund is a statutory liability and not a reserve.

Illustration 23.

Usha and Asha are partners in a firm sharing profits in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2019 was:

Liabilities		₹	Assets		₹
Creditors		27,000	Cash		24,000
General Reserve		18,000	Debtors	48,000	
Bills Payable		5,000	*Less:* Provision for Doubtful Debts	4,800	43,200
Capital A/cs:			Stock		30,000
Usha	40,000		Patents		7,400
Asha	35,000	75,000	Building		20,400
		1,25,000			1,25,000

Neelam is admitted into the partnership giving her 1/5th share in the profits. Neelam is to bring in ₹ 30,000 as her capital and her share of goodwill in cash subject to the following terms:

(i) Goodwill of the firm to be valued at ₹ 50,000.

(ii) Stock to be reduced by 10% and the Provision for Doubtful Debts be reduced by ₹ 2,400.

(iii) Patents to be valueless.

(iv) There was a claim against the firm for damages amounting to ₹ 2,000. The claim has now been accepted.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm. *(Delhi, AI, Foreign 2004, Modified)*

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Stock A/c	3,000	By Provision for Doubtful Debts A/c		2,400
To Patents A/c	7,400	By Loss transferred to:		
To Claim for Damages A/c	2,000	Usha's Capital A/c	6,000	
		Asha's Capital A/c	4,000	10,000
	12,400			12,400

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Usha ₹	Asha ₹	Neelam ₹	Particulars	Usha ₹	Asha ₹	Neelam ₹
To Revaluation A/c —Loss	6,000	4,000	...	By Balance *b/d*	40,000	35,000	...
				By General Reserve A/c	10,800	7,200	...
To Balance *c/d*	50,800	42,200	30,000	By Cash A/c	...	...	30,000
				By Premium for Goodwill A/c	6,000	4,000	...
	56,800	46,200	30,000		56,800	46,200	30,000

BALANCE SHEET OF THE NEW FIRM *as at 31st March, 2018*

Liabilities		₹	Assets		₹
Bills Payable		5,000	Cash (₹ 24,000 + ₹ 40,000)		64,000
Creditors		27,000	Stock (₹ 30,000 – ₹ 3,000)		27,000
Claim for Damages		2,000	Debtors	48,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	2,400	45,600
Usha	50,800		Building		20,400
Asha	42,200				
Neelam	30,000	1,23,000			
		1,57,000			1,57,000

Note: Neelam's Share of Goodwill = ₹ 50,000 × 1/5 = ₹ 10,000.

Illustration 24.

Annu and Mannu are partners sharing profits in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2009 was as follows:

BALANCE SHEET OF ANNU AND MANNU *as at 31st March, 2009*

Liabilities		₹	Assets		₹
Creditors		56,000	Cash in Hand		77,000
General Reserve		10,000	Debtors	42,000	
Investments Fluctuation Fund		4,000	*Less:* Provision for Doubtful Debts	7,000	35,000
Capital A/cs:			Investments (Market value ₹ 19,000)		21,000
Annu	1,19,000		Building		98,000
Mannu	1,12,000	2,31,000	Plant and Machinery		70,000
		3,01,000			3,01,000

Sonu was admitted on that date for 1/4th share of profit on the following terms:

(i) Sonu will bring ₹ 56,000 as his share of capital.

(ii) Goodwill of the firm is valued at ₹ 84,000 and Sonu will bring his share of Goodwill in cash.

(iii) Plant and Machinery is appreciated by 20%.

(iv) All Debtors are good.

(v) There is a liability of ₹ 9,800 included in Sundry Creditors, which is not likely to arise.

(vi) New profit-sharing ratio will be 2 : 1 : 1.

(vii) Capitals of Annu and Mannu will be adjusted on the basis of Sonu's share of capital and any excess or deficiency will be made good by withdrawing or bringing in cash by the concerned partners as the case may be.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm. *(Delhi 2012 C)*

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Gain (Profit) transferred to:			By Plant and Machinery A/c	14,000
Annu's Capital A/c	18,480		By Provision for Doubtful Debts A/c*	7,000
Mannu's Capital A/c	12,320	30,800	By Creditors A/c	9,800
		30,800		30,800

**All Debtors are good* means Provision for Doubtful Debts is no longer required and hence is credited to Revaluation Account.

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Annu (₹)	Mannu (₹)	Sonu (₹)	Particulars	Annu (₹)	Mannu (₹)	Sonu (₹)
To Cash A/c (Bal. Fig.)	41,080	85,720	...	By Balance *b/d*	1,19,000	1,12,000	...
				By General Reserve A/c	6,000	4,000	...
To Balance *c/d* (WN 3)	1,12,000	56,000	56,000	By Revaluation A/c (Gain)	18,480	12,320	...
				By Investments Fluctuation Fund A/c (WN 1)	1,200	800	...
				By Premium for Goodwill A/c (WN 2)	8,400	12,600	...
				By Cash A/c (Capital)	...	...	56,000
	1,53,080	1,41,720	56,000		1,53,080	1,41,720	56,000

BALANCE SHEET OF THE NEW FIRM *as at 31st March, 2009*

Liabilities		₹	Assets	₹
Creditors (₹ 56,000 – ₹ 9,800)		46,200	Cash in Hand (WN 4)	27,200
Capital A/cs:			Debtors	42,000
Annu	1,12,000		Investments (Market Value)	19,000
Mannu	56,000		Building	98,000
Sonu	56,000	2,24,000	Plant and Machinery	84,000
		2,70,200		2,70,200

Working Notes:

		₹	₹
1. Investments Fluctuation Fund A/c	...Dr.	4,000	
To Investments A/c			2,000
To Annu's Capital A/c			1,200
To Mannu's Capital A/c			800
(Transfer of excess Investments Fluctuation Fund to Old Partners' Capital Accounts in their old profit-sharing ratio)			

2. Sonu's share of Goodwill = ₹ 84,000 × 1/4 = ₹ 21,000, which is credited to Annu's and Mannu's Capital Accounts in their sacrificing ratio.

Calculation of Sacrificing Ratio (Sacrifice = Old Share – New Share):

$$\text{Annu's Sacrifice} = \frac{3}{5} - \frac{2}{4} = \frac{12 \quad 10}{20} = \frac{2}{20}\text{; Mannu's Sacrifice} = \frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$$

$$\text{Sacrificing Ratio} = \frac{2}{20} : \frac{3}{20} \text{ or } 2:3.$$

Share of Annu in Goodwill = ₹ 21,000 × 2/5 = ₹ 8,400

Share of Mannu in Goodwill = ₹ 21,000 × 3/5 = ₹ 12,600.

3. *Calculation of adjusted capital of Annu and Mannu on the basis of Sonu's Capital:*

$$\text{Total Capital of the New Firm} = \frac{\text{Capital of the New Partner (Sonu)}}{\text{Share of Profit of the New Partner}}$$

$$= \frac{₹\,56{,}000}{1/4} = ₹\,56{,}000 \times \frac{4}{1} = ₹\,2{,}24{,}000$$

Thus, Annu's Capital in New Firm = ₹ 2,24,000 × 2/4 = ₹ 1,12,000; and

Mannu's Capital in New Firm = ₹ 2,24,000 × 1/4 = ₹ 56,000.

4. *Dr.* CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	77,000	By Annu's Capital A/c	41,080
To Sonu's Capital A/c	56,000	By Mannu's Capital A/c	85,720
To Premium for Goodwill A/c	21,000	By Balance *c/d*	27,200
	1,54,000		1,54,000

Illustration 25 (Fundamentals and Admission: *Guarantee to a New Partner***).**

X and *Y* are partners in a firm sharing profits in the ratio of 3 : 1. On 1st April, 2017, they decide to admit *Z* for 1/5th share in profits with a guaranteed amount of ₹ 1,50,000 p.a. The new profit-sharing ratio is agreed at 3 : 1 : 1. The firm earned a profit of ₹ 4,80,000 for the year ended 31st March, 2018. *X* undertook to meet the liability arising out of the guaranteed amount to *Z*. Calculate how the profits will be distributed and prepare Profit and Loss Appropriation Account for the year ended 31st March, 2018.

Solution:

Particulars	*X*	*Y*	*Z*
Divided Net Profit of ₹ 4,80,000 in the ratio of 3 : 1 : 1	₹ 4,80,000 × 3/5 = ₹ 2,88,000	₹ 4,80,000 × 1/5 = ₹ 96,000	₹ 4,80,000 × 1/5 = ₹ 96,000

However, *Z*'s minimum guaranteed profit is ₹ 1,50,000. So, there is deficiency of ₹ 54,000, to be borne by *X* personally.

X's New Share of Profit = ₹ 2,88,000 – ₹ 54,000 = ₹ 2,34,000

Y's Share of Profit = ₹ 96,000

Z's New Share of Profit = ₹ 96,000 + ₹ 54,000 = ₹ 1,50,000.

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars	₹	Particulars	₹
To Profit Transferred to:		By Profit and Loss A/c	4,80,000
X's Capital A/c	2,34,000	(Net Profit)	
Y's Capital A/c	96,000		
Z's Capital A/c	1,50,000		
	4,80,000		4,80,000

Illustration 26 (Fundamentals and Admission: *Guarantee to a New Partner***).**

X and *Y* are partners, sharing profits and losses in the ratio of 2 : 1. On 1st April, 2017, they admit *Z* with 1/4th share in profits with guaranteed profit of ₹ 25,000. Any deficiency arising on that account shall be met by *X* and *Y* equally. Trading profits of the firm for the year ended 31st March, 2018 amounted to ₹ 76,000. Show the distribution of profits.

Solution:

Step 1: *Calculation of New Shares:*

Let the Total Share be = 1, *Z*'s share = 1/4, Remaining Share = 1 – 1/4 = 3/4

X's New Share = 2/3 × 3/4 = 2/4; *Y*'s New Share = 1/3 × 3/4 = 1/4; *Z*'s Share = 1/4.

So, New Ratio of *X*, *Y* and *Z* = 2 : 1 : 1.

Step 2: *Z*'s Share of Profit = ₹ 76,000 × 1/4 = ₹ 19,000.

Step 3: Deficiency = Guaranteed amount – ₹ 19,000

= ₹ 25,000 – ₹ 19,000 = ₹ 6,000.

Step 4: Deficiency is to be borne by X and Y equally as follows:

X = ₹ 6,000 × 1/2 = ₹ 3,000; Y = ₹ 6,000 × 1/2 = ₹ 3,000.

Step 5: *Division of Profit:*

X's Share = ₹ 76,000 × 2/4 = ₹ 38,000 – ₹ 3,000 = ₹ 35,000.

Y's Share = ₹ 76,000 × 1/4 = ₹ 19,000 – ₹ 3,000 = ₹ 16,000.

Z's Share = ₹ 76,000 × 1/4 = ₹ 19,000 + ₹ 3,000 (X) + ₹ 3,000 (Y) = ₹ 25,000.

Illustration 27.

Following is the Balance Sheet as at 1st April, 2018 of Sushil and Satish who are in partnership sharing profits and losses in the ratio of 5 : 2:

Liabilities		₹	Assets		₹
Sundry Creditors		1,30,000	Bank		10,000
Capital A/cs:			Stock		20,000
Sushil	80,000		Debtors	30,500	
Satish	70,000	1,50,000	*Less:* Provision for Doubtful Debts	500	30,000
			Plant and Machinery		50,000
			Building		1,70,000
		2,80,000			2,80,000

On the above date, they admitted Samir as new partner on the following terms:

(i) That Samir will bring in ₹ 1,00,000 for his capital and the necessary amount of goodwill/premium for goodwill for 3/8th share in future profits.

(ii) Goodwill of the firm on Samir's admission was valued at ₹ 1,40,000.

(iii) That new profit-sharing ratio will be 2 : 3 : 3.

Pass necessary Journal entries to carry out these and prepare Balance Sheet of the firm after Samir's admission as a partner.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	Bank A/c	...Dr.		1,52,500	
	To Premium for Goodwill A/c				52,500
	To Samir's Capital A/c				1,00,000
	(Samir brought in his capital and his share of goodwill premium)				
April 1	Premium for Goodwill A/c (WN 2)	...Dr.		52,500	
	Satish's Capital A/c (WN 3)	...Dr.		12,500	
	To Sushil's Capital A/c				65,000
	(Goodwill/premium for goodwill brought by Samir transferred to the Capital A/c of Sushil and also Satish's Capital A/c is proportionately debited for gain)				

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	Sushil ₹	Satish ₹	Samir ₹	Date	Particulars	Sushil ₹	Satish ₹	Samir ₹
2018					2018				
April 1	To Sushil's Capital A/c	...	12,500	...	April 1	By Balance *b/d*	80,000	70,000	...
April 1	To Balance *c/d*	1,45,000	57,500	1,00,000	April 1	By Bank A/c	...	...	1,00,000
					April 1	By Satish's Capital A/c	12,500	...	...
					April 1	By Premium for Goodwill A/c	52,500	...	...
		1,45,000	70,000	1,00,000			1,45,000	70,000	1,00,000

BALANCE SHEET
as at 1st April, 2018

Liabilities		₹	Assets		₹
Sundry Creditors		1,30,000	Bank		1,62,500
Capital A/cs:			Stock		20,000
Sushil	1,45,000		Debtors	30,500	
Satish	57,500		*Less:* Provision for Doubtful Debts	500	30,000
Samir	1,00,000	3,02,500	Plant and Machinery		50,000
			Building		1,70,000
		4,32,500			4,32,500

Working Notes:

1. *Calculation of Sacrificing Ratio* (*Sacrifice = Old Share – New Share*):

   Sushil = $\frac{5}{7}-\frac{2}{8}=\frac{40-14}{56}=\frac{26}{56}$ (Sacrifice); Satish = $\frac{2}{7}-\frac{3}{8}=\frac{16-21}{56}=-\frac{5}{56}$ (Gain).

2. Samir's share of premium (Goodwill) = 3/8 × ₹ 1,40,000 = ₹ 52,500.

3. Since Satish is gaining on Samir's admission, hence, he will also compensate Sushil proportionately by ₹ 12,500 (*i.e.*, ₹ 1,40,000 × 5/56).

Illustration 28 (*Hidden Goodwill*).

A and *B* are partners with capitals of ₹ 1,60,000 and ₹ 1,20,000 respectively. They admit *C* as a partner on 1st April, 2019 for 1/4th share in profits of the firm. *C* brings in ₹ 1,60,000 as his share of capital.

Pass Journal entries on *C*'s admission.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2019				
April 1	Bank A/c ...Dr.		1,60,000	
	To *C*'s Capital A/c			1,60,000
	(Cash brought in by *C* for his capital)			
April 1	*C*'s Capital/Current A/c ...Dr.		50,000	
	To *A*'s Capital A/c			25,000
	To *B*'s Capital A/c			25,000
	(Credit given for goodwill to *A* and *B* on *C*'s admission) (WN 2)			

Working Notes:

1. In the absence of any agreement profits are shared equally.
2. *Calculation of Hidden Goodwill:*

C's Capital for 1/4th share = ₹ 1,60,000

(a) Total capital of the new firm = ₹ 1,60,000 × 4 = ₹ 6,40,000

(b) *A*, *B* and *C*'s Capitals = ₹ 1,60,000 + ₹ 1,20,000 + ₹ 1,60,000 = ₹ 4,40,000

∴ **Goodwill of the firm = ₹ 2,00,000** [(a) – (b)]

Thus, *C*'s share of Goodwill = 1/4 × ₹ 2,00,000 = ₹ 50,000.

Illustration 29.

The Balance Sheet of Madan and Mohan who share profits and losses in the ratio of 3 : 2, as at 31st March, 2010 was as follows:

Liabilities		₹	Assets		₹
Creditors		28,000	Cash at Bank		10,000
Workmen's Compensation Reserve		12,000	Debtors	65,000	
General Reserve		20,000	*Less:* Reserve for Doubtful Debts	5,000	60,000
Capital A/cs:			Stock		30,000
Madan	60,000		Investments		50,000
Mohan	40,000	1,00,000	Patents		10,000
		1,60,000			1,60,000

They decided to admit Gopal on 1st April, 2010 for 1/4th share on the following terms:

(i) Gopal shall bring ₹ 25,000 as his share of premium for goodwill.

(ii) That unaccounted Accrued Income of ₹ 500 be provided for.

(iii) The market value of Investments was ₹ 45,000.

(iv) A Debtor whose dues of ₹ 1,000 were written off as Bad Debts paid ₹ 800 in full settlement.

(v) A claim of ₹ 2,000 on account of Workmen Compensation to be provided for.

(vi) Patents are undervalued by ₹ 5,000.

(vii) Gopal to bring in capital equal to 1/4th of the total capital of the new firm after all adjustments.

Prepare Revaluation Account, Capital Accounts of Partners and the Balance Sheet of the new firm. *(Delhi 2011 C)*

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Investments A/c		5,000	By Accrued Income A/c	500
To Gain (Profit) transferred to:			By Bad Debts Recovered A/c	800
Madan's Capital A/c	780		By Patents A/c	5,000
Mohan's Capital A/c	520	1,300		
		6,300		6,300

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Madan (₹)	Mohan (₹)	Gopal (₹)	Particulars	Madan (₹)	Mohan (₹)	Gopal (₹)
To Balance *c/d*	93,780	62,520	52,100	By Balance *b/d*	60,000	40,000	...
				By General Reserve A/c	12,000	8,000	...
				By Revaluation A/c	780	520	...
				By Workmen Compensation Reserve A/c	6,000	4,000	...
				By Premium for Goodwill A/c	15,000	10,000	...
				By Bank A/c (WN 1)	...	....	52,100
	93,780	62,520	52,100		93,780	62,520	52,100

BALANCE SHEET OF THE NEW FIRM *as at 1st April, 2010*

Liabilities		₹	Assets		₹
Creditors		28,000	Cash at Bank (WN 2)		87,900
Workmen Compensation Claim		2,000	Debtors	65,000	
Capital A/cs:			*Less:* Reserve for Doubtful Debts	5,000	60,000
Madan	93,780		Stock		30,000
Mohan	62,520		Investments		45,000
Gopal	52,100	2,08,400	Patents		15,000
			Accrued Income		500
		2,38,400			2,38,400

Working Notes:

1. *Calculation of Gopal's Capital:*
   (i) Total adjusted capital of Madan and Mohan = ₹ 93,780 + ₹ 62,520 = ₹ 1,56,300.
   (ii) *Calculation of Total Capital of the New Firm:*
   Gopal joins the firm for 1/4th share
   Therefore, Madan and Mohan will share 3/4th (*i.e.*, 1 – 1/4) of the firm's profit.
   (iii) Total Capital of the Firm = $\dfrac{\text{Adjusted Combined Capital of the Old Partners}}{\text{Combined Share of Profit of the Old Partners}}$
   = ₹ 1,56,300 × 4/3 = ₹ 2,08,400.
   (iv) Gopal's Capital in the New Firm = ₹ 2,08,400 × 1/4 = ₹ 52,100.

2. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	10,000	By Balance *c/d*	87,900
To Gopal's Capital A/c	52,100		
To Premium for Goodwill A/c	25,000		
To Bad Debts Recovered A/c	800		
	87,900		87,900

Unsolved Questions

1. *A* and *B* share profits in the ratio of 5 : 4. They admit *C* for 2/7th share which he takes 3/14th from *A* and 1/14th from *B*. Calculate new profit-sharing ratio. *(Delhi 1999)*

[**Ans.:** *New Profit-sharing Ratio—43 : 47 : 36.*]

2. *L* and *M* are sharing profits and losses in the ratio of 2 : 2. They admit *N* as a partner who takes 1/4th share from *L* and 1/8th share from *M*. Calculate new profit-sharing ratio of the partners. *(Foreign 2003)*

[**Ans.:** *New Profit-sharing Ratio—2 : 3 : 3.*]

3. *A*, *B* and *C* are partners sharing profits and losses in the ratio of 3 : 2 : 1. *D* is admitted. The new profit-sharing ratio among *A*, *B*, *C* and *D* will be 3 : 3 : 2 : 2. Calculate gain/sacrifice.

[**Ans.:** *A sacrificed 6/30; B sacrificed 1/30 and C gained 1/30.*]

4. *X* and *Y* shared profits in the ratio of 7 : 3. *Z* was admitted as a partner. *X* surrendered 1/7th of his share and *Y* surrendered 1/3rd of his share in favour of *Z*. Calculate new ratio and sacrificing ratio. *(Foreign 2005)*

[**Ans.:** *New Ratio of X, Y and Z—3 : 1 : 1; Sacrificing Ratio of X and Y—1 : 1.*]

5. *A* and *B* are partners sharing profits in the ratio of 3 : 2. They admit *C* into partnership. *C* pays a premium of ₹ 1,000 for 1/4th share of profits. The new ratio is 3 : 3 : 2. Goodwill Account appears in the books at ₹ 1,000. Give necessary Journal entries. *(AI 2002 C, Foreign 2003)*

[**Ans.:** *(i) Dr. A's Capital A/c by ₹ 600 and B's Capital A/c by ₹ 400; Cr. Goodwill A/c by ₹ 1,000; (ii) Dr. Cash A/c and Cr. Premium for Goodwill A/c by ₹ 1,000; (iii) Dr. Premium for Goodwill A/c by ₹ 1,000; Cr. A's Capital A/c by ₹ 900 and B's Capital A/c by ₹ 100; sacrificing ratio, i.e., 9 : 1.*]

6. *A* and *B* are partners sharing profits equally. They admit *C* into partnership; *C* paying only ₹ 1,000 for premium out of his share of premium of ₹ 1,800 for 1/4th share of profit. Goodwill Account appears in the books at ₹ 6,000. All the partners have decided that goodwill should not appear in the new firm's books. Give necessary Journal entries. *(Delhi 1994, AI 2003)*

[**Ans.:** *Dr. Cash A/c and Cr. Premium for Goodwill A/c by ₹ 1,000; Dr. Premium for Goodwill A/c by ₹ 1,000 and C's Current A/c by ₹ 800; Cr. A's Capital A/c by ₹ 900 and B's Capital A/c by ₹ 900 in Sacrificing Ratio 1 : 1 and ₹ 6,000 existing goodwill is to be written off between old partners in the old ratio.*]

7. *A* and *B* are partners sharing profits and losses in the ratio of 2 : 1. They admit *C*, their Manager, into partnership who is to get 1/3rd share in the business. *C* brings in ₹ 10,000 for his capital and ₹ 3,000 for 1/3rd share of goodwill. *A*, *B* and *C* agree to share future profits equally. The amount of goodwill is withdrawn from the business. Pass necessary Journal entries in connection with *C*'s admission.

8. (a) Ashok and Ramu are partners sharing profits in the ratio of 7 : 3 respectively. Their capitals on 1st January, 2006 were ₹ 80,000 and ₹ 60,000 respectively. They admitted Vijay into the partnership on that date giving him 1/5th share in future profits, which he acquired equally from Ashok and Ramu. Vijay is to bring in ₹ 50,000 as his share of capital.

Find new profit-sharing ratio and value of the goodwill of the firm.

(b) Record necessary Journal entries on Vijay's admission from the above mentioned transactions. *(Foreign 2006)*

[**Ans.:** *New Ratio—3 : 1 : 1; Value of Goodwill of the Firm—₹ 60,000; Dr. Bank A/c and Cr. Vijay's Capital A/c by ₹ 50,000; Dr. Vijay's Capital/Current A/c by ₹ 12,000 and Cr. Capital Accounts of Ashok and Ramu by ₹ 6,000 each.*]

[**Hint:** Hidden Goodwill = (₹ 50,000 × 5/1) – (₹ 80,000 + ₹ 60,000 + ₹ 50,000) = ₹ 60,000.]

9. *X* and *Y* are partners sharing profits in the ratio of 3 : 1. They admit *Z* as a partner for 1/4th share. His share of goodwill is ₹ 18,000. Give Journal entries in the following cases:

(a) When the amount of goodwill is paid privately.

(b) When the goodwill is received in cash and retained in the business.

(c) When the goodwill is received in cash and withdrawn by the old partners.

10. Ram and Shyam are partners sharing profits and losses in the ratio of 3 : 1. They agreed to admit Mohan into the partnership firm.

Mohan is to bring in ₹ 40,000 as his capital and ₹ 12,000 as goodwill for 1/4th share of future profits. This he acquires in the ratio of 2 : 1 from Ram and Shyam. The amount of goodwill brought in by Mohan is to remain in the business. At the time of Mohan's admission a General Reserve of ₹ 16,000 existed in the books of the old firm. For the purpose of admission, the assets and liabilities are to be revalued as:

(a) Buildings were appreciated by ₹ 20,000.

(b) The Provision for Doubtful Debts was reduced from ₹ 2,000 to ₹ 1,000.

(c) A provision of ₹ 1,000 was to be made for an outstanding bill for repairs.

Pass necessary Journal entries in connection with Mohan's admission and also calculate future profit-sharing ratio of the partners. [**Ans.:** *New Profit-sharing Ratio—7 : 2 : 3.*]

11. *M* and *S* are partners sharing profits in the ratio of 2 : 1. Their Balance Sheet stood at 31st March, 2018 as:

BALANCE SHEET

Liabilities		₹	Assets	₹
Sundry Creditors		44,000	Cash at Bank	17,000
Capital A/cs:			Sundry Debtors	15,000
M	30,000		Bills Receivable	4,000
S	20,000	50,000	Stock	25,000
			Furniture and Fixtures	3,000
			Land and Building	30,000
		94,000		94,000

R, a differently abled person, is very efficient in office management. He is admitted to partnership with effect from 1st April, 2018 on the following terms:

(a) He brings in ₹ 15,000 as his capital for 1/4th share and pays ₹ 6,000 for goodwill, half of which is to be withdrawn by *M* and *S*.

(b) There is likely to be a claim against the firm for damages for which a provision to the extent of ₹ 1,500 is to be made.

(c) A bill for ₹ 300 for electricity charges has been omitted to be accounted. It should, therefore, now be provided for.

(d) The Stock is to be reduced to ₹ 23,000 and Furniture and Fixtures by ₹ 1,000.

(e) 5% Reserve for Bad and Doubtful Debts to be created.

(f) The value of Land and Building is to be appreciated by 20%.

(g) That included in the Sundry Creditors is an item of ₹ 1,200 which is not paid and, therefore, has to be written back.

(h) The profit-sharing ratio of the old partners will not change.

You are required to show necessary accounts and Balance Sheet of the new firm stating the proportion in which the partners will share profits in future.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 1,650; Closing Balance of Capital A/cs: M—₹ 33,100; S—₹ 21,550; R—₹ 15,000; Balance Sheet Total—₹ 1,14,250.*]

12. *A* and *B* share profits in the proportion of 3/4 and 1/4. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Sundry Creditors		41,500	Cash at Bank	26,500
General Reserve		4,000	Bills Receivable	3,000
Capital A/cs:			Debtors	16,000
A	30,000		Stock	20,000
B	16,000	46,000	Fixtures	1,000
			Land and Building	25,000
		91,500		91,500

On 1st April, 2018, *C* was admitted into partnership for 1/5th share on the following terms:

(a) *C* pays ₹ 10,000 as his capital.

(b) *C* pays ₹ 5,000 for goodwill. Half of this sum is to be withdrawn by *A* and *B*.

(c) Stock and Fixtures be reduced by 10% and a 5% Provision for Doubtful Debts be created on Debtors and Bills Receivable.

(d) The value of Land and Building be appreciated by 20%.

(e) There being a claim against the firm for damages, a liability to the extent of ₹ 1,000 should be created.

(f) An item of ₹ 650 included in Sundry Creditors is not likely to be claimed and hence should be written back.

Record the above transactions (Journal entries) in the books of the firm assuming that the profit-sharing ratio between *A* and *B* has not changed. Prepare Balance Sheet on the admission of *C*.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 1,600; Capital A/cs: A—₹ 36,075; B—₹ 18,025; C—₹ 10,000; Balance Sheet Total—₹ 1,05,950.*]

13. *X* and *Y* are partners sharing profits and losses equally. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		30,000
X	30,000		Plant and Machinery		20,000
Y	20,000	50,000	Furniture and Fittings		5,000
Current A/cs:			Stock		15,000
X	8,000		Debtors	15,000	
Y	6,000	14,000	*Less:* Provision for Doubtful Debts	1,000	14,000
Creditors		26,000	Bills Receivable		6,000
Bills Payable		10,000	Bank		10,000
		1,00,000			1,00,000

Z is admitted as a partner from 1st April, 2018 for 1/4th share under the following terms:

(a) *Z* is to introduce ₹ 25,000 as capital and also ₹ 10,000 as goodwill premium by cheque.

(b) Creditors included a sum of ₹ 1,500 which was not to be paid. A liability for compensation to workers amounted to ₹ 2,000 existed that was not recorded.

(c) Provision for Doubtful Debts is to be created @ 10% on Debtors.

(d) In regard to the Partners' Capital Accounts, Fixed Capital Accounts Method is to be converted into Fluctuating Capital Accounts Method.

(e) Bills of ₹ 4,000 accepted from Creditors were not recorded in the books.

(f) *X* provides Loan of ₹ 10,000 by cheque to the business carrying interest @ 15% p.a.

(g) Partners withdrew amount of goodwill.

You are required to prepare Revaluation Account, Partners' Capital Accounts, Bank Account and Balance Sheet of the new firm.

[**Ans.:** *Loss on Revaluation—₹ 1,000; Partners' Capital A/cs: X—₹ 37,500; Y—₹ 25,500; Z—₹ 25,000; Balance Sheet Total—₹ 1,34,500; Creditors—₹ 20,500; Bills Payable ₹ 14,000; Bank—₹ 45,000.*]

14. Following is the Balance Sheet as at 31st March, 2018 of Sushil and Satish who are in partnership sharing profits and losses in the ratio of 3 : 2:

Liabilities		₹	Assets		₹
Capital A/cs:			Freehold Premises		10,000
Sushil	25,000		Machinery		5,400
Satish	9,000	34,000	Stock		12,500
Creditors		18,400	Debtors	22,500	
			Less: Provision for Doubtful Debts	4,000	18,500
			Cash at Bank		6,000
		52,400			52,400

They admit Samir into partnership with effect from 1st April, 2018 on the following conditions:

(a) Samir to bring in ₹ 6,000 as capital and ₹ 4,800 for 2/7th share of goodwill, both the sums remaining in the business.

(b) Freehold premises have been revalued at ₹ 15,000; Stock to be discounted @ 10% and Provision for Doubtful Debts to be reduced by ₹ 1,000.

Pass Journal entries in the books of the firm to record the transactions relating to Samir's admission and prepare Balance Sheet of Sushil, Satish and Samir as at 1st April, 2018.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 4,750; Balance Sheet Total—₹ 67,950.*]

15. *X*, *Y* and *Z* were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. Following is their Balance Sheet as at 31st March, 2018:

Liabilities		₹	Assets	₹
Capital A/cs:			Land and Building	5,00,000
X	3,00,000		Furniture	1,50,000
Y	2,00,000		Stock	2,00,000
Z	1,00,000	6,00,000	Bills Receivable	50,000
General Reserve		3,00,000	Sundry Debtors	75,000
Sundry Creditors		60,000	Cash at Bank	25,000
Bills Payable		40,000		
		10,00,000		10,00,000

W is to be admitted as a partner with effect from 1st April, 2018 on the following terms:

(a) *W* will bring in ₹ 1,50,000 as capital and ₹ 1,20,000 as premium for goodwill. Half of the goodwill will be withdrawn by the partners.

(b) *W* will be entitled to 1/6th share of the profits of the firm.

(c) The assets will be revalued as: Land and Building—₹ 5,60,000; Furniture—₹ 1,20,000; Stock—₹ 1,60,000 and Sundry Debtors—₹ 70,000.

(d) The claim of a creditor for ₹ 23,000 is paid as ₹ 20,000.

(e) Half of the General Reserve is to be withdrawn by the partners.

You are required to show Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

[**Ans.:** *Loss on Revaluation—₹ 12,000; Partners' Capital A/cs: X—₹ 3,99,000; Y—₹ 2,66,000; Z—₹ 1,33,000; W—₹ 1,50,000; Balance Sheet Total—₹ 10,25,000; Balance of Creditors—₹ 37,000; Cash at Bank—₹ 65,000.*]

16. *V* and *N* were partners in a firm sharing profits in the ratio of 7 : 3. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Creditors		10,000	Cash	15,500
Bills Payable		15,000	Debtors	20,000
Provision for Doubtful Debts		500	Bills Receivable	50,000
General Reserve		10,000	Stock	30,000
P's Loan		80,000	Building	1,00,000
Capital A/cs:			Land	1,00,000
V	1,50,000			
N	50,000	2,00,000		
		3,15,500		3,15,500

On 1st April, 2018, they admitted *P* as a new partner on the following terms:

(a) *P* will get 1/5th share in the profits of the firm.

(b) *P*'s Loan will be converted into her capital.

(c) The goodwill of the firm was valued at ₹ 2,00,000 and *P* brought her share of goodwill premium in cash.

(d) The Provision for Doubtful Debts was to be made equal to 4% of Debtors.

(e) Stock was to be reduced by 5%.

(f) Land was to be appreciated by 10%.

Prepare Revaluation Account, Capital Accounts of *V*, *N* and *P* and Balance Sheet of the new firm as at 1st April, 2018. *(OD 2002, Modified)*

[**Ans.:** *Gain (Profit) on Revaluation—₹ 8,200; Capital A/cs: V—₹ 1,90,740; N—₹ 67,460; P—₹ 80,000; Balance Sheet Total—₹ 3,64,000.*]

17. *A* and *B* are partners in a firm sharing profits and losses in the ratio of 3 : 1. On 1st April, 2018 their Balance Sheet was:

Liabilities		₹	Assets	₹
Capital A/cs:			Goodwill	20,000
A	2,00,000		Plant	1,00,000
B	80,000	2,80,000	Patents	10,000
Sundry Creditors		70,000	Stock	1,42,000
			Sundry Debtors	50,000
			Cash at Bank	8,000
			Profit and Loss A/c	20,000
		3,50,000		3,50,000

They admit *C* into partnership with 1/6th share in profits on the following terms:

(a) Goodwill is to be valued at one year's purchase of the five years' average profit which were ₹ 20,000; ₹ 30,000; ₹ 30,000; ₹ 50,000 and ₹ 50,000 respectively.

(b) *C* agrees to contribute 1/4th of the combined capital of *A* and *B* in the new firm.

(c) Plant is to be written down to ₹ 90,000 and Patents written up to ₹ 12,000.

(d) A Provision for Doubtful Debts is to be created @ 2% of Sundry Debtors.

(e) A liability of ₹ 5,000 included in Sundry Creditors is not likely to arise.

Give Journal entries and Balance Sheet after the admission of *C*.

[**Ans.:** *Loss on Revaluation—₹ 4,000; Capital A/cs: A—₹ 1,71,500; B—₹ 70,500; C—₹ 60,500; Balance Sheet Total—₹ 3,67,500.*]

[**Hint:** Firm's Goodwill = ₹ 36,000; *C*'s Share of Goodwill = ₹ 6,000.]

18. Following was the Balance Sheet of *A*, *B* and *C* sharing profits and losses in the proportion of 6/14, 5/14 and 3/14 respectively:

Liabilities		₹	Assets	₹
Capital A/cs:			Land and Building	50,400
A	36,900		Furniture	7,350
B	33,600		Stock	29,400
C	19,800	90,300	Debtors	26,460
Creditors		18,900	Cash	1,890
Bills Payable		6,300		
		1,15,500		1,15,500

They agreed to take *D* into partnership and give him 1/8th share on the following terms:

(a) *D* should bring in ₹ 16,000 as his capital.

(b) Furniture be reduced by ₹ 920.

(c) Stock be reduced by 10%.

(d) A provision of ₹ 1,320 be made for outstanding repair bills.

(e) The value of Land and Building having appreciated be brought up to ₹ 65,100.

(f) *D* should bring in ₹ 8,820 as his share of goodwill.

(g) After making the above adjustments the Capital Accounts of the old partners (who continue to share in the same proportions as above) be adjusted on the basis of the proportions of *D*'s Capital to his share in the business.

Pass Journal entries to give effect to the above arrangements and prepare opening Balance Sheet of the firm as newly constituted.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 9,520; Partners' Capital Accounts: A—₹ 48,000; B—₹ 40,000; C—₹ 24,000; D—₹ 16,000; Balance Sheet Total—₹ 1,54,520.*]

19. Hari and Ram were in partnership, sharing profits and losses equally. On 1st April, 2017, Suraj was admitted into partnership on the following terms:

Suraj is to have 1/6th share in the profits/losses, which he had got from Hari paying him ₹ 40,000 for that share as goodwill. Out of this amount, Hari is to withdraw ₹ 30,000 and the balance amount is to remain in the firm. It was further agreed that the value of Investments should be reduced to ₹ 18,000 and Plant to be valued at ₹ 29,000. Creditors were to be reduced by ₹ 3,000 as one of the creditors has closed his business and gone. Suraj is to bring in proportionate capital on his admission.

The Balance Sheet as at 31st March, 2017 was:

Liabilities		₹	Assets	₹
Creditors		1,05,000	Cash at Bank	40,000
Capital A/cs:			Book Debts	60,000
Hari	60,000		Stock	50,000
Ram	60,000	1,20,000	Investments	30,000
			Furniture	10,000
			Plant	35,000
		2,25,000		2,25,000

The profit for the year ended 31st March, 2018 was ₹ 60,000 and the drawings were:

Hari ₹ 15,000; Ram ₹ 22,500 and Suraj ₹ 7,500. Journalise the entries on Suraj's admission and give the Capital Accounts and the Balance Sheet as at 31st March, 2018.

[**Ans.:** *Revaluation Loss—₹ 15,000; Capital Accounts (31.3.2018): Hari—₹ 67,500; Ram—₹ 60,000; Suraj—₹ 25,500; Balance Sheet Total—₹ 2,55,000.*]

20. *X* and *Y* were partners sharing profits in the ratio of 2 : 1. Their Balance Sheet as on 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Provision for Doubtful Debts		250	Cash	18,250
Sundry Creditors		59,000	Debtors	15,000
Capital A/cs:			Stock	32,000
X	27,000		Land and Building	30,000
Y	18,000	45,000	Profit and Loss A/c	9,000
		1,04,250		1,04,250

Z was admitted to the partnership with effect from 1st April, 2018 on the following terms:

(a) He will bring ₹ 15,000 as his capital for one-fourth share and pay ₹ 6,000 for Goodwill, half of which was to be withdrawn by *X* and *Y*.

(b) There is likely to be a claim against the firm for damages, a provision of ₹ 1,500 was to be made for the same.

(c) A bill for ₹ 1,300 for electricity charges has been omitted, now it is to be provided for.

(d) A provision of 5% on Debtors was to be created for doubtful debts.

(e) Included in Sundry Creditors was an item of ₹ 1,200 which was not to be paid and therefore, had to be written back.

After making the above adjustments, the Capital Accounts of *X* and *Y* were to be adjusted on the basis of *Z* capital. Actual cash was to be brought in or to be paid off as the case may be.

(Foreign 2012, Modified)

[**Ans.:** *Revaluation Loss—₹ 2,100; Capital A/cs: X—₹ 30,000; Y—₹ 15,000 and Z—₹ 15,000. Balance Sheet Total—₹ 1,20,600.*]

21. A firm has two partners *B* and *C*, sharing profits in the ratio of 3 : 2. They admit *A* into the firm on 1st April, 2018, when the Balance Sheet of the firm was:

Liabilities		₹	Assets	₹
Capital A/cs:			Machinery	18,000
B	30,000		Furniture	18,000
C	10,000	40,000	Investments	9,000
Profit and Loss A/c		7,500	Stock	6,000
Creditors		7,000	Debtors	4,000
Bills Payable		2,500	Cash	2,000
		57,000		57,000

Terms of *A*'s admission are:

(a) *A* is to bring in ₹ 20,000 as his capital for a 1/3rd share of profit and ₹ 3,500 as his share of goodwill.

(b) Value of Machinery and Stock is to be reduced by ₹ 7,000 and ₹ 1,000 respectively and the value of the Furniture to be increased by ₹ 3,000.

(c) Capital of the partners shall be proportionate to their profit-sharing ratio, taking *A*'s Capital as the base. Excess capital is to be withdrawn in cash by the partner concerned and the deficiency is to be made up by bringing cash.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm after the above adjustments.

[**Ans.:** *Loss on Revaluation—₹ 5,000; Capital A/cs: A—₹ 20,000; B—₹ 24,000; C—₹ 16,000; Balance Sheet Total—₹ 69,500.*]

22. The Balance Sheet of a partnership firm of *X* and *Y*, who were sharing profits in the ratio of 5 : 3 respectively, as at 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Creditors		25,000	Cash at Bank	11,200
General Reserve		20,000	Bills Receivable	12,800
Capital A/cs:			Debtors	20,000
X	75,000		Stock	35,000
Y	60,000	1,35,000	Furniture	21,000
			Machinery	30,000
			Building	50,000
		1,80,000		1,80,000

On the above date, *Z* was admitted on the following terms:

(a) *Z* was to get 1/5th share in the profits.
(b) *Z* was to pay ₹ 50,000 as Capital and ₹ 16,000 for his share of Goodwill.
(c) Machinery was to be depreciated by 10% and Building was to be appreciated by 20%.
(d) Stock was valued at 25% above cost. It was to be brought into the books of the new firm at cost price.
(e) There was a liability for repairs to Furniture amounted to ₹ 600; the same was to be recorded in the books.
(f) Capital Accounts of the old partners were to be adjusted in the new profit-sharing ratio by opening the necessary Current Accounts.

Prepare Revaluation Account, Capital Accounts and initial Balance Sheet of the new firm.

[**Ans.:** *Loss on Revaluation—₹ 600; Capital: X—₹ 1,25,000; Y—₹ 75,000; Z—₹ 50,000; Current A/c: X—₹ 27,875* (*Dr.*); *Y—₹ 1,725* (*Dr.*); *Balance Sheet Total—₹ 2,75,600; Cost Price of Stock—₹ 28,000.*]

23. *X* and *Y* are partners in a firm. They share profits and losses as *X*—3/5th and *Y*—2/5. Their Balance Sheet as on 1st April, 2018 is given below:

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		3,00,000
X	7,00,000		Plant and Machinery		4,00,000
Y	3,50,000	10,50,000	Patents		1,60,000
Creditors		2,60,000	Stock		2,50,000
Bills Payable		2,40,000	Debtors	3,00,000	
			Less: Provision for Doubtful Debts	6,000	2,94,000
			Cash at Bank		1,46,000
		15,50,000			15,50,000

They agree to admit *Z* into partnership on the following basis:

(a) *Z* will pay ₹ 3,00,000 as capital and Capital Accounts of other partners to be adjusted in their new profit-sharing ratio on the basis of *Z*'s Capital.
(b) Goodwill of the firm is valued at ₹ 2,50,000. *Z* fails to bring his share of goodwill.
(c) Plant and Machinery is to be depreciated by 15%, stock by ₹ 40,000, Land and Building are to be appreciated by ₹ 1,60,000.
(d) New profit-sharing ratio will be 5 : 3 : 2.

Prepare necessary ledger accounts.

[**Ans.:** *Sacrificing Ratio—1 : 1; Revaluation Gain (Profit)—₹ 60,000; Partners' Capital A/cs: X—₹ 7,50,000; Y—₹ 4,50,000 and Z—₹ 3,00,000; Z's Current A/c—₹ 50,000; (Dr.); Cash at Bank—₹ 4,86,000; Balance Sheet Total—₹ 20,00,000.*]

[**Hint:** Capitals of old partners are to be adjusted on the basis of incoming partner's (*Z*) capital and *Z* is unable to bring his share of goodwill of ₹ 50,000 (*i.e.*, ₹ 2,50,000 × 2/10), the adjustment for goodwill will be through his Current A/c. Thus, *Z*'s Current A/c will be debited by ₹ 50,000 and *X*'s and *Y*'s Capital A/cs will be credited by ₹ 25,000 each.]

24. Amrit and Baldev were carrying on business in partnership sharing profits in the ratio of 3 : 2. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets		₹
Amrit's Capital	50,000		Land and Building		25,000
Baldev's Capital	25,000	75,000	Furniture		10,000
Creditors		16,000	Stock		46,000
Bills Payable		14,000	Debtors	20,000	
			Less: Provision for Doubtful Debts	600	19,400
			Cash at Bank		4,600
		1,05,000			1,05,000

Chetan is admitted into parstnership on the following terms:

(a) New profit-sharing ratio of Amit, Baldev and Chetan will be 5 : 3 : 2.

(b) Land and Building is to be appreciated by ₹ 5,000; Furniture is to be depreciated by 10%, Provision for Doubtful Debts is to be increased by ₹ 300 and Outstanding Expenses of ₹ 200 are to be recorded.

(c) Chetan will bring ₹ 20,000 as his capital and ₹ 6,000 as his share of goodwill.

(d) The capitals of all the partners will be in their profit-sharing ratio; Amrit and Baldev making the necessary adjustments in cash.

Prepare (i) Revaluation Account; (ii) Partners' Capital Accounts; (iii) Bank Account and (iv) Balance Sheet immediately after recording the above-mentioned transactions.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 3,500; Capital A/cs: Amrit—₹ 50,000; Baldev—₹ 30,000; Chetan—₹ 20,000; Balance Sheet Total—₹ 1,30,200.*]

25. Jain and Gupta were partners in a firm sharing profits and losses in the ratio of 4 : 3. The following is the Balance Sheet of the firm as at 31st March, 2018:

BALANCE SHEET OF JAIN AND GUPTA *as at 31st March, 2018*

Liabilities		₹	Assets		₹
Sundry Creditors		20,000	Cash		14,800
Bills Payable		3,000	Debtors	20,500	
Bank Overdraft		17,000	*Less:* Provision for Doubtful Debts	300	20,200
Capital A/cs:			Stock		20,000
Jain	70,000		Plant		40,000
Gupta	60,000	1,30,000	Building		75,000
		1,70,000			1,70,000

They agreed to admit Mishra as partner with effect from 1st April, 2018 with 1/4th share in profits on the following terms:

(a) Mishra will bring in capital to the extent of 1/4th of the total capital of the new firm after all adjustments have been made.

(b) Building is to be appreciated by ₹ 14,000 and Plant to be depreciated by ₹ 7,000.

(c) The provision for doubtful debts on Debtors is to be raised to ₹ 1,000.

(d) Mishra will bring in ₹ 21,000 as his share of goodwill.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm immediately after Mishra's admission.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 6,300; Balance Sheet Total—₹ 2,49,733.*]

[**Hint:** *Calculation of Mishra's Capital:* Combined Capital of Jain and Gupta (after adjustments) for 3/4th share = ₹ 85,600 + ₹ 71,700 = ₹ 1,57,300
New Firm's Total Capital = ₹ 1,57,300 × 4/3
Mishra's Capital for 1/4th share = ₹ 1,57,300 × 4/3 × 1/4 = ₹ 52,433.]

26. *A*, *B* and *C* are partners sharing profits and losses in the ratio of 2 : 3 : 5. On 31st March, 2018, their Balance Sheet was:

Liabilities		₹	Assets	₹
Creditors		64,000	Cash at Bank	18,000
Employees' Provident Fund		32,000	Bills Receivable	24,000
Profit and Loss A/c		14,000	Furniture	28,000
Capital A/cs:			Stock	44,000
A	36,000		Debtors	42,000
B	44,000		Investments	32,000
C	52,000	1,32,000	Machinery	34,000
			Goodwill	20,000
		2,42,000		2,42,000

They admit *D* into partnership on the following terms:

(a) Furniture, Investments and Machinery to be depreciated by 15%.

(b) Stock is revalued at ₹ 48,000.

(c) Goodwill to be valued at ₹ 24,000.

(d) Employees' Provident Fund liability is to be increased by ₹ 1,800.

(e) Prepaid Salaries ₹ 800.

(f) *D* to bring in ₹ 36,000 towards capital for 1/6th share and Partners to readjust their Capital Accounts on the basis of their profit-sharing ratio.

(g) *D* is not in a position to bring in any amount for his share of firm's goodwill. The partners decide that the necessary adjustments should be made through *D*'s Current Account.

Prepare Revaluation Account, Partners' Capital Accounts, Bank Account and Balance Sheet of the new firm. [**Ans.:** *Loss on Revaluation—₹ 11,100;*
Partners' Capital Accounts: A—₹ 36,000; B—₹ 54,000; C—₹ 90,000; D—₹ 36,000.
A will bring ₹ 2,620; B will bring ₹ 13,930 and C will bring ₹ 44,550 in Cash.
Cash at Bank—₹ 1,15,100; Balance Sheet Total—₹ 3,13,800.]

[**Hint:** *For Adjustment of Goodwill:*
Dr. D's Current A/c—₹ 4,000;
Cr. A's Capital A/c—₹ 800; *B*'s Capital A/c—₹ 1,200 and *C*'s Capital A/c—₹ 2,000.]

27. *A* and *B* are partners sharing profits in the ratio of 3 : 2. They admit *C* into the firm for 3/7th share in profits which he takes 2/7th from *A* and 1/7th from *B* and brings ₹ 10,000 as premium out of his share of ₹ 16,000. Pass Journal entries for the above.

[**Ans.:** *(i) Dr. Bank A/c and Cr. Premium for Goodwill A/c by ₹ 10,000.*
(ii) Dr. Premium for Goodwill A/c—₹ 10,000;
Cr. A's Capital A/c—₹ 6,667 and B's Capital A/c—₹ 3,333.
(iii) Dr. C's Current A/c—₹ 6,000;
Cr. A's Capital A/c—₹ 4,000 and B's Capital A/c—₹ 2,000.]

28. *X* and *Y* are partners in a firm sharing profits and losses in the ratio of 3 : 2. They admit *Z* as a new partner for 1/5th share. Goodwill of the firm is valued at ₹ 10,000. Goodwill already appears in the books at ₹ 5,000. *Z* brings in 60% of his share of goodwill and ₹ 40,000 as his capital in cash. The amount of goodwill brought in cash is withdrawn by the concerned partners to the extent of 30% of what is credited to them. The profit for the first year of new partnership amounted to ₹ 20,000.
Pass necessary Journal entries to adjust goodwill and to distribute profits.

[**Ans.:** *Sacrificing Ratio—3 : 2 and New Profit-sharing Ratio—12 : 8 : 5.*]

29. *A* and *B* are partners sharing profits and losses in the ratio of 3/4 : 1/4. They agree to admit *C* into the business. *C* is to get 1/4th share of future profits. At the time of *C*'s admission, there was a General Reserve of ₹ 4,000 appearing in the Balance Sheet of *A* and *B*. Revaluation of assets and liabilities resulted in gain of ₹ 2,000. Pass necessary Journal entries on *C*'s admission.

30. *A* and *B* are partners in a firm sharing profits and losses in the ratio of 2 : 1. On 31st March, 2018, their Balance Sheet stood as follows:

Liabilities		₹	Assets	₹
A's Capital	1,60,000		Buildings	80,000
B's Capital	1,20,000	2,80,000	Furniture	24,000
General Reserve		96,000	Stock	48,000
Creditors		64,000	Debtors	2,40,000
			Cash at Bank	48,000
		4,40,000		4,40,000

It was decided to admit *C* into the firm with effect from 1st April, 2018 subject to the following terms and conditions:

(a) *C* will bring in ₹ 84,000 of which ₹ 36,000 will be treated as his share of goodwill to be retained in the business.

(b) *C* will be entitled to 1/4th share of the profits.

(c) ₹ 9,000 is to be provided for Doubtful Debts.

(d) Furniture is to be reduced by 5%.

(e) Stock is to be revalued at ₹ 42,000.

You are required to prepare necessary Ledger Accounts and Balance Sheet of the firm after the admission of *C* from the above informations.

[**Ans.:** *Loss on revaluation—₹ 16,200; Capital A/cs: A—₹ 2,37,200; B—₹ 1,58,600; C—₹ 48,000; Balance Sheet Total—₹ 5,07,800; Bank Balance—₹ 1,32,000.*]

31. *M* and *N* are partners in a firm sharing profits and losses in the ratio of 5 : 3. On 31st March, 2018, their Balance Sheet was:

BALANCE SHEET OF *M* AND *N*

Liabilities		₹	Assets	₹
Sundry Creditors		4,000	Stock	8,000
Bills Payable		2,000	Sundry Debtors	7,200
Capital A/cs:			Cash at Bank	500
M	12,000		Cash in Hand	300
N	10,000	22,000	Machinery	12,000
		28,000		28,000

On 1st April, 2018, the partners decide to admit *R* as a partner on the following terms:

(a) New profit-sharing ratio of *M, N* and *R* will be 7 : 5 : 4.

(b) *R* shall bring in ₹ 8,000 as his capital and ₹ 4,000 for his share of goodwill.

(c) *M* and *N* will draw half of the goodwill in cash.

(d) Machinery is to be valued at ₹ 15,000; Stock at ₹ 10,000 and a Provision for Doubtful Debts of ₹ 1,000 is to be created.

(e) There is a liability of ₹ 2,000, being the outstanding salary payable to employees of the firm. This liability is not included in the creditors. Partners decide to show this liability in the books of account of the new firm.

Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of *M, N* and *R*.

[**Ans.:** *Revaluation Gain (Profit)—₹ 2,000; Partners' Capital A/cs: M—₹ 14,750; N—₹ 11,250; R—₹ 8,000; Balance Sheet Total—₹ 42,000.*]

32. Following is the Balance Sheet of *A* and *B* (who share profits in the ratio of 3 : 2) as at 31st March, 2018:

Liabilities		₹	Assets	₹
Sundry Creditors		15,000	Building	18,000
Capital A/cs:			Machinery	15,000
A	20,000		Stock	12,000
B	25,000	45,000	Debtors	10,000
			Bank	5,000
		60,000		60,000

On 1st April, 2018, *C* was admitted on the following terms:

(a) *C* is to pay ₹ 25,000 as his capital and ₹ 10,000 as his share of goodwill for 1/5th share of profits.

(b) The new profit-sharing ratio will be 5 : 3 : 2.

(c) The assets are to be revalued as Building ₹ 25,000; Machinery ₹ 12,000; Stock ₹ 12,000; Debtors (because of doubtful debts) ₹ 9,500.

(d) It was found that there was a liability for ₹ 1,500 for goods received but not recorded in books.

Give Journal entries to record the above. Also, give the Ledger Accounts and Balance Sheet after *C's* admission. [**Ans.:** *Gain (Profit) on Revaluation—₹ 2,000; Capital A/cs: A—₹ 26,200; B—₹ 30,800; C—₹ 25,000; Bank Balance—₹ 40,000; Balance Sheet Total—₹ 98,500.*]

33. *X* and *Y* are partners sharing profits and losses in the ratio of 5 : 3. Their Balance Sheet as at 31st March, 2018 is:

Liabilities		₹	Assets		₹
Capital A/cs:			Furniture		40,000
X	40,000		Patents		10,000
Y	50,000	90,000	Sundry Debtors	44,000	
General Reserve		14,000	*Less:* Provision for Doubtful Debts	5,000	39,000
Sundry Creditors		30,000	Stock		20,000
			Cash at Bank		22,000
			Cash in Hand		3,000
		1,34,000			1,34,000

On 1st April, 2018, they take *Z* into the partnership on the following terms:

(a) *Z* brings in ₹ 25,000 as his capital but cannot bring in ₹ 3,600 as his share of goodwill.

(b) Patents are written off from the books.

(c) General Reserve will appear in the books of the new firm at its original value.

(d) A Provision for Doubtful Debts is to be maintained @ 5% on Sundry Debtors.

(e) The new profit-sharing ratio of *X*, *Y* and *Z* is 2 : 4 : 1.

You are required to show Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm. [**Ans.:** *Loss on Revaluation—₹ 7,200; Partners' Capital A/cs: X—₹ 48,800; Y— ₹ 39,600; Z—₹ 23,000; Balance Sheet Total—₹ 1,55,400; Goodwill adjustment: Dr. Y's Captial A/c by ₹ 4,950 and Z's Current A/c by ₹ 3,600; Cr. X's Captial A/c by ₹ 8,550.]*

CHAPTER 6

Retirement of a Partner

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. **Retirement of a Partner**	When a partner ceases to be a partner of the firm but the firm continues, it is known as **retirement of a partner**.
2. **Gaining Ratio**	The ratio in which the continuing partners acquire the retiring partner's profit share is called **gaining ratio**.
3. **New Profit-sharing Ratio**	The ratio in which the continuing partners (*i.e.*, partners other than retiring partner) decide to share future profits and losses, is known as **new profit-sharing ratio**.

CHAPTER SUMMARY

- **Meaning of Retirement of a Partner:** When a partner ceases to be partner of the firm but firm continues, it is termed as **retirement of a partner**.
- **How can a Partner Retire:** A partner may retire from the firm:
  (i) With the consent of all other partners;
  (ii) In accordance with an express agreement by the partners; or
  (iii) By giving a written notice to the remaining partners of his intention to retire, in case of '*Partnership at will*'.
- **Adjustments at the Time of Retirement of a Partner:** Accounting problems that arise and settled are: calculation of the new profit-sharing ratio and gaining ratio, revaluation of assets and reassessment of liabilities, adjustment of goodwill, adjustment of reserves, accumulated profits and losses, computation of share of the retiring partner in profit or loss till the date of retirement.
- **New Profit-sharing Ratio:** The ratio in which the continuing partners, *i.e.*, partners other than the retiring partner decide to share future profits and losses, is known as the **new profit-sharing ratio**.

  New Share = Old Share + Acquired Share
- **Gaining Ratio:** The ratio in which the continuing partners acquire the retiring partner's profit share is known as the **gaining ratio**.

  Gain of a Partner = New Share – Old Share
- **Accounting Treatment of Goodwill:** When a partner retires, his share of profit is taken by the remaining partners. *The remaining partners then compensate the retiring partner in the form of goodwill in their gaining ratio.* The following entry is recorded for this purpose:

  Remaining Partners' Capital/Current* A/cs ...Dr. [In gaining ratio]
  To Retiring Partner's Capital/Current* A/c [Retiring Partner's Share of Goodwill]

If goodwill already appears in the old Balance Sheet, it is written off by recording the following entry:

All Partners' Capital/Current* A/cs ...Dr. [In old ratio]

To Goodwill A/c

*In case of Fixed Capitals

- **Revaluation of Assets and Reassessment of Liabilities:** At the time of retirement of a partner, assets are revalued and liabilities are reassessed; the difference is recorded in the Revaluation Account. The balance in the Revaluation Account is transferred to the Capital Accounts of all the partners (including the retiring partner) in their old profit-sharing ratio.
- **Adjustment of Reserves, Accumulated Profits and Losses:** At the time of retirement of a partner balances of reserves, accumulated profits and losses are transferred to Capital Accounts of all partners in their old ratio.

  However, if partners decide to record the net effect of reserves, accumulated profits and losses without affecting their old values, an adjustment entry is passed through Capital Accounts of gaining partners and sacrificing partners.
- **Amount Due to a Retiring Partner:** The total amount due to a retiring partner may include:

  (i) Capital on the date of the last Balance Sheet.

  (ii) Loan by the Partner to the firm.

  (iii) Interest or salary, if any, payable to him.

  (iv) Share of profit or loss till the date of retirement.

  (v) Share in the gain (profit) or loss on revaluation of assets and reassessment of liabilities.

  (vi) Share in the goodwill of the firm.

  (vii) Share in the General Reserve or Profit and Loss Account appearing in the Balance Sheet.

  Out of the total of (i) to (vii), the amount of Loan to the partner, drawings and interest on drawings till the date of retirement are deducted.

  The net amount payable will be settled by paying him through cash/bank or by transferring it to a separate Loan Account.

Solved Questions

Illustration 1.

X, Y and Z are partners sharing profits in the ratio of 4/9 : 1/3 : 2/9. Y retires and surrenders 1/9th from his share in favour of X and the remaining in favour of Z. Calculate new profit-sharing ratio and gaining ratio.

Solution: Y's share of profit = 1/3

Y surrenders in favour of $X = \frac{1}{9}$; in favour of $Z = \frac{1}{3} - \frac{1}{9} = \frac{3-1}{9} = \frac{2}{9}$

Calculation of New Profit-sharing Ratio and Gaining Ratio

Partners	Old Share (i)	Gaining Share (ii)	New Share (i + ii)
X	4/9	1/9	5/9
Z	2/9	2/9	4/9

Gaining Ratio = $\frac{1}{9} : \frac{2}{9}$ or 1 : 2; New Profit-sharing Ratio = $\frac{5}{9} : \frac{4}{9}$ or 5 : 4.

Illustration 2.

Subhash, Mohan, Usha and Rinku are partners sharing profits in ratio of 3 : 2 : 3 : 2. On the retirement of Usha, goodwill was valued at ₹ 2,40,000. Usha's share of goodwill will be given to her by adjusting it into the Capital Accounts of Subhash, Mohan and Rinku. Give necessary entries for the treatment of goodwill when the new profit-sharing ratio is 3 : 1 : 6.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Rinku's Capital A/c (₹ 2,40,000 × 4/10) ...Dr.		96,000	
	To Mohan's Capital A/c (₹ 2,40,000 × 1/10)			24,000
	To Usha's Capital A/c (₹ 2,40,000 × 3/10)			72,000
	(Goodwill adjusted by debiting gaining partner (Rinku for 4/10) and crediting sacrificing partners (Mohan for 1/10 and Usha for 3/10)) (WN)			

Working Note:

Calculation of Gaining Ratio: Gain of a Partner = New Share – Old Share

Subhash's Gain = $\frac{3}{10} - \frac{3}{10} = 0$; Mohan's Gain = $\frac{1}{10} - \frac{2}{10} = \left(-\frac{1}{10}\right)$ Sacrifice; Rinku's Gain = $\frac{6}{10} - \frac{2}{10} = \frac{4}{10}$.

Thus, Rinku is the only gaining partner. She will compensate not only Usha but also Mohan, the sacrificing partner.

Illustration 3.

X, *Y* and *Z* are partners sharing profits in the ratio of 4 : 3 : 2. *Y* retires on 1st April, 2017 and *X* and *Z* decide to share future profits in the ratio of 5 : 3. Then immediately *W* is admitted for 3/10th share of profits half of which was gifted by *X* and the remaining share was taken by *W* equally from *X* and *Z*. Goodwill of the firm is valued at 1,08,000. *W* brings in the required amount of goodwill. The profit for the year ended 31st March, 2018 after *W*'s admission was ₹ 50,000. Pass the necessary Journal entries to adjust goodwill and to distribute profits.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2017	*X*'s Capital A/c	...Dr.		19,500	
April 1	*Z*'s Capital A/c	...Dr.		16,500	
	To *Y*'s Capital A/c				36,000
	(*Y*'s share of goodwill adjusted in the Capital Accounts of gaining partners in their gaining ratio, *i.e.*, 13 : 11)				
	Bank A/c (₹ 1,08,000 × 3/20)	...Dr.		16,200	
	To Premium for Goodwill A/c				16,200
	(Amount of goodwill brought in by *W* for purchased share of profit, *i.e.*, 3/20)				
	Premium for Goodwill A/c	...Dr.		16,200	
	To *X*'s Capital A/c				8,100
	To *Z*'s Capital A/c				8,100
	(Goodwill credited to sacrificing partners in their sacrificing ratio, *i.e.*, 1 : 1)				
2018	Profit and Loss Appropriation A/c	...Dr.		50,000	
March 31	To *X*'s Capital A/c				20,000
	To *Z*'s Capital A/c				15,000
	To *W*'s Capital A/c				15,000
	(Profit credited to all partners in their new profit-sharing ratio, *i.e.*, 4 : 3 : 3)				

Working Notes:

1. *Calculation of Gaining Ratio of X and Z:*

$$X\text{'s Gain} = \frac{5}{8} - \frac{4}{9} = \frac{13}{72};\quad Z\text{'s Gain} = \frac{3}{8} - \frac{2}{9} = \frac{11}{72}$$

Hence, Gaining Ratio of *X* and *Z* = $\frac{13}{72} : \frac{11}{72}$ = 13 : 11.

2. *Calculation of New Ratio of X, Z and W:*

	X	*Z*
A. New Share after *Y*'s retirement:	5/8	3/8

B. Gifted by *X* = 1/2 of 3/10 = 3/20

C. Share acquired by *W* (other than gift):

From *X* = 1/2 of 3/20 = 3/40

From *Z* = 1/2 of 3/20 = 3/40

D. New Share of *X* (after *W*'s admission) = $\frac{5}{8} - \frac{3}{20} - \frac{3}{40} = \frac{25-6-3}{40} = \frac{16}{40}$

New Share of *Z* (after *W*'s admission) = $\frac{3}{8} - \frac{3}{40} = \frac{15-3}{40} = \frac{12}{40}$

W's Share = 3/10

New Ratio of *X*, *Z* and *W* = $\frac{16}{40} : \frac{12}{40} : \frac{3}{10}$ = 16 : 12 : 12 or 4 : 3 : 3.

Illustration 4.

(a) Give the Journal entry to distribute 'Workmen Compensation Reserve' of ₹ 70,000 at the time of retirement of Neeti, when there is a claim of ₹ 25,000 against it. The firm has three partners Raveena, Neeti and Rajat. *(Delhi 2013)*

(b) Give the Journal entry to distribute 'Workmen Compensation Reserve' of 60,000 at the time of retirement of Sajjan, when there is no claim against it. The firm has three partners Rajat, Sajjan and Kavita. *(AI 2013)*

(c) Give the Journal entry to distribute 'Investment Fluctuation Reserve' of ₹ 4,000 at the time of retirement of *Z*, when investments (market value ₹ 19,000) appears at ₹ 20,000. The firm has three partners *X*, *Y*, and *Z*. *(CBSE 2013)*

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(a)	Workmen Compensation Reserve A/c	...Dr.		70,000	
	To Raveena's Capital A/c				15,000
	To Neeti's Capital A/c				15,000
	To Rajat's Capital A/c				15,000
	To Workmen Compensation Claim A/c				25,000
	(Workmen Compensation Reserve after adjusting claim credited to Partners' Capital Accounts in their old ratio)				
(b)	Workmen Compensation Reserve A/c	...Dr.		60,000	
	To Rajat's Capital A/c				20,000
	To Sajjan's Capital A/c				20,000
	To Kavita's Capital A/c				20,000
	(Workmen Compensation Reserve transferred to Partners' Capital Accounts in their old ratio)				
(c)	Investment Fluctuation Reserve A/c	...Dr.		4,000	
	To *X*'s Capital A/c				1,000
	To *Y*'s Capital A/c				1,000
	To *Z*'s Capital A/c				1,000
	To Investments A/c				1,000
	(Value of Investments brought down to market value and surplus Investment Fluctuation Reserve transferred to Partners' Capital Accounts in their old profit-sharing ratio)				

Illustration 5 (*Treatment of Goodwill and Revaluation of Assets and Reassessment of Liabilities; Amount due to Retiring Partner be Treated as Loan*).

A, *B* and *C* share profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as at 31st March, 2018 was as follows:

Liabilities		₹	Assets		₹
Creditors		60,000	Cash		36,000
Bills Payable		32,000	Debtors	50,000	
General Reserve		24,000	*Less:* Provision for Doubtful Debts	7,000	43,000
Capital A/cs:			Stock		36,000
A	80,000		Furniture		60,000
B	80,000		Machinery		1,40,000
C	60,000	2,20,000	Goodwill		21,000
		3,36,000			3,36,000

B retires on 1st April, 2018 on the following terms:

(i) Provision for Doubtful Debts be raised by ₹ 2,000.

(ii) Outstanding Claim for Damages of ₹ 2,200 be provided.

(iii) Creditors be reduced by ₹ 12,000.

(iv) Goodwill of the firm be valued at ₹ 45,000. Goodwill not to appear in books.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of *A* and *C*.

(AI 1999 C, Delhi 2002 C, Modified)

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		2,000	By Creditors A/c	12,000
To Outstanding Claim for Damages A/c		2,200		
To Gain (Profit) on Revaluation transferred to:				
A's Capital A/c	3,900			
B's Capital A/c	2,600			
C's Capital A/c	1,300	7,800		
		12,000		12,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Goodwill A/c (Note 1)	10,500	7,000	3,500	By Balance *b/d*	80,000	80,000	60,000
To *B*'s Capital A/c	11,250	...	3,750	By General Reserve A/c	12,000	8,000	4,000
To *B*'s Loan A/c	...	98,600	...	By Revaluation A/c—Gain	3,900	2,600	1,300
To Balance *c/d*	74,150	...	58,050	By *A*'s Capital A/c	...	11,250	...
				By *C*'s Capital A/c	...	3,750	...
	95,900	1,05,600	65,300		95,900	1,05,600	65,300

BALANCE SHEET OF *A* AND *C* *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Bills Payable		32,000	Cash		36,000
Creditors		48,000	Stock		36,000
Outstanding Claim for Damages		2,200	Debtors	50,000	
B's Loan A/c		98,600	*Less:* Provision for Doubtful Debts	9,000	41,000
Capital A/cs:			Furniture		60,000
A	74,150		Machinery		1,40,000
C	58,050	1,32,200			
		3,13,000			3,13,000

Notes: 1. The existing goodwill is written off in the old ratio.

2. *B*'s share of Goodwill = ₹ 45,000 × 2/6 = ₹ 15,000 will be contributed by *A* and *C* in their gaining ratio, *i.e.*, 3 : 1. Thus,
A's contribution for *B*'s Goodwill = ₹ 15,000 × 3/4 = ₹ 11,250 and
C's contribution for *B*'s Goodwill = ₹ 15,000 × 1/4 = ₹ 3,750.

Illustration 6.

Jyoti, Ruchi and Yogesh were sharing profits and losses in proportion to their capitals. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets		₹
Capital A/cs:			Building		1,00,000
Jyoti	80,000		Machinery		48,000
Ruchi	60,000		Stock		18,000
Yogesh	40,000	1,80,000	Debtors	20,000	
Sundry Creditors		21,600	*Less:* Provision for Doubtful Debts	400	19,600
			Bank		8,000
			Cash		8,000
		2,01,600			2,01,600

Ruchi retired on 1st April, 2018. They agreed to the following adjustments in the books of accounts to decide Ruchi's share:

(i) Building to be appreciated by 20%.
(ii) The Provision for Doubtful Debts to be increased to 5% on Debtors.
(iii) Out of total insurance premium paid, ₹ 3,000 to be treated as Prepaid Insurance. This amount was earlier debited to the Profit and Loss Account.
(iv) Machinery to be reduced by 20%.
(v) Goodwill of the firm is valued at ₹ 72,000. Ruchi's share to be adjusted in the accounts of Jyoti and Yogesh.
(vi) Jyoti and Yogesh also decide that the total capital of the firm after Ruchi's retirement be ₹ 1,80,000 in their profit-sharing ratio, *i.e.*, actual cash to be brought in or paid to a partner as the case may be.

You are required to prepare Revaluation Account, Capital Accounts of all Partners and the Balance Sheet of Jyoti and Yogesh.

Solution:

In the Books of Firm

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c (₹ 1,000 – ₹ 400)		600	By Building A/c	20,000
To Machinery A/c		9,600	By Prepaid Insurance A/c	3,000
To Gain (Profit) transferred to:				
Jyoti's Capital A/c	5,689			
Ruchi's Capital A/c	4,267			
Yogesh's Capital A/c	2,844	12,800		
		23,000		23,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Jyoti ₹	Ruchi ₹	Yogesh ₹	Particulars	Jyoti ₹	Ruchi ₹	Yogesh ₹
To Ruchi's Capital A/c —Goodwill (WN 1)	16,000	...	8,000	By Balance *b/d*	80,000	60,000	40,000
To Bank A/c	...	88,267	...	By Revaluation A/c —Gain (Profit)	5,689	4,267	2,844
To Balance *c/d* (WN 2)	1,20,000	...	60,000	By Jyoti's Capital A/c	...	16,000	...
				By Yogesh's Capital A/c	...	8,000	...
				By Bank A/c (Bal. Fig.)	50,311	...	25,156
	1,36,000	88,267	68,000		1,36,000	88,267	68,000

BALANCE SHEET OF JYOTI AND YOGESH
as at 1st April, 2018

Liabilities		₹	Assets		₹
Capital A/cs:			Building		1,20,000
Jyoti	1,20,000		Machinery		38,400
Yogesh	60,000	1,80,000	Prepaid Insurance		3,000
Sundry Creditors		21,600	Debtors	20,000	
			Less: Provision for Doubtful Debts	1,000	19,000
			Stock		18,000
			Bank (WN 3)		3,200
		2,01,600			2,01,600

Working Notes:

1. Ruchi's share of goodwill = ₹ 72,000 × 3/9 = ₹ 24,000, which is contributed by Jyoti and Yogesh in their gaining ratio of 2 : 1 as: Jyoti: ₹ 24,000 × 2/3 = ₹ 16,000; Yogesh: ₹ 24,000 × 1/3 = ₹ 8,000.
2. *Capital of Jyoti and Yogesh in New Firm:*
   Total capital of the firm after Ruchi's retirement will be ₹ 1,80,000. It will be shared by Jyoti and Yogesh in the ratio of 4 : 2, *i.e.*, 2 : 1. Therefore, capital of Jyoti will be ₹ 1,20,000 (*i.e.*, ₹ 1,80,000 × 2/3) and that of Yogesh will be ₹ 60,000 (*i.e.*, ₹ 1,80,000 × 1/3).

3. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d* (₹ 8,000 + ₹ 8,000)	16,000	By Ruchi's Capital A/c	88,267
To Jyoti's Capital A/c	50,311	By Balance *c/d*	3,200
To Yogesh's Capital A/c	25,156		
	91,467		91,467

Illustration 7.

A, B and *C* are partners sharing profits in the ratio of 4 : 3 : 1. Their Balance Sheet as at 31st March, 2018 is:

Liabilities		₹	Assets		₹
Creditors		70,000	Cash in Hand		80,000
Bills Payable		30,000	Cash at Bank		20,000
Workmen Compensation Reserve		20,000	Stock		75,000
General Reserve		80,000	Debtors	1,30,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	5,000	1,25,000
A	2,00,000		Motor Car		1,50,000
B	3,00,000		Investments		1,00,000
C	2,00,000	7,00,000	Plant and Machinery		1,20,000
			Building		2,30,000
		9,00,000			9,00,000

On 1st April, 2018, *B* retires from the firm selling his share of profit to *A* for ₹ 36,000 and to *C* for ₹ 45,000 in the ratio of 4 : 5. For the purpose of *B*'s retirement, it was agreed that:

(i) Stock is to be appreciated by 20% and Building by 10%.

(ii) Motor Car is to be valued at ₹ 70,000.

(iii) Provision for Doubtful Debts is increased to 10%.
(iv) Investments are sold for ₹ 2,30,000.
(v) Claim on account of Workmen Compensation is ₹ 12,000.
(vi) Amount due to *B* is to be settled on the following basis:
50% on retirement and the balance 50% within one year.
(vii) The capital of the newly constituted firm is fixed at ₹ 6,00,000 to be divided among *A* and *C* in the profit-sharing ratio. Adjustment is to be made in cash.

Calculate new profit-sharing ratio and prepare Revaluation Account and Partners' Capital Accounts.

Solution:

(i) *Calculation of New Profit-sharing Ratio:*

B's share is 3/8 which he is surrendering in favour of *A* and *C* in the ratio of 4 : 5.

Therefore *A* will get 4/9 of 3/8 = 1/6 and *C* will get 5/9 of 3/8 = 5/24.

Total share of *A* in the new firm will be: 4/8 + 1/6 = 16/24 *or* 2/3.

Total share of *C* in the new firm will be: 1/8 + 5/24 = 8/24 *or* 1/3.

New Profit-sharing Ratio = 2 : 1.

(ii) *Dr.* REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		8,000	By Stock A/c	15,000
To Motor Car A/c (₹ 1,50,000 – ₹ 70,000)		80,000	By Building A/c	23,000
To Gain (Profit) transferred to:			By Investments A/c	1,30,000
A's Capital A/c	40,000		(₹ 2,30,000 – ₹ 1,00,000)	
B's Capital A/c	30,000			
C's Capital A/c	10,000	80,000		
		1,68,000		1,68,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To *B's* Capital A/c (WN 1)	36,000	...	45,000	By Balance *b/d*	2,00,000	3,00,000	2,00,000
				By General Reserve A/c	40,000	30,000	10,000
To Cash A/c (50% of dues)	...	2,22,000	...	By *A's* Capital A/c	...	36,000	...
				By *C's* Capital A/c	...	45,000	...
To *B's* Loan A/c	...	2,22,000	...	By Revaluation A/c —Gain (Profit)	40,000	30,000	10,000
To Balance *c/d*	4,00,000	...	2,00,000	By Workmen Compensation Reserve A/c (WN 3)	4,000	3,000	1,000
				By Bank A/c (WN 2)	**1,52,000**	...	**24,000**
	4,36,000	4,44,000	2,45,000		4,36,000	4,44,000	2,45,000

Working Notes:

1. *B* sold his share to *A* and *C* in the ratio of 4 : 5. The consideration of ₹ 36,000 + ₹ 45,000 will be credited to his Capital Account and the respective amount will be debited to *A*'s Capital Account and *C*'s Capital Account.

2. Total Capital of the new firm is ₹ 6,00,000. New Profit-Sharing Ratio is 2 : 1.
   A's Share of Capital = ₹ 6,00,000 × 2/3 = ₹ 4,00,000
   C's Share of Capital = ₹ 6,00,000 × 1/3 = ₹ 2,00,000
   After all adjustments, *A*'s Capital is (₹ 2,00,000 + ₹ 40,000 + ₹ 40,000 + ₹ 4,000 – ₹ 36,000) = ₹ 2,48,000. Therefore, *A* will bring in (₹ 4,00,000 – ₹ 2,48,000) = ₹ 1,52,000.
   After all adjustments, *C*'s Capital is (₹ 2,00,000 + ₹ 10,000 + ₹ 10,000 + ₹ 1,000 – ₹ 45,000) = ₹ 1,76,000. Therefore, *C* will bring in (₹ 2,00,000 – ₹ 1,76,000) = ₹ 24,000.
3. Balance of Workmen Compensation Reserve (₹ 20,000 – ₹ 12,000 = ₹ 8,000) is credited to Partners' Capital Accounts in their old profit-sharing ratio.

Illustration 8. *(Admission-cum-Retirement: Workmen Compensation Reserve).*

X, *Y* and *Z* are partners sharing profits and losses in the ratio of 5 : 3 : 2. On 1st April, 2018, *R* is admitted into the partnership for 1/5th share in profits and brings ₹ 1,00,000 as his capital. On the same date *Z* retires from the firm. On that date, balance in Workmen Compensation Reserve is valued at ₹ 35,000. Claim for workmen compensation was valued at ₹ 25,000. Give necessary Journal entries.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Workmen Compensation Reserve A/c ...Dr.		25,000	
	To Workmen Compensation Claim A/c			25,000
	(Reserve equivalent to claim is transferred to Workmen Compensation Claim Account)			
April 1	Workmen Compensation Reserve A/c ...Dr.		10,000	
	To *X*'s Capital A/c			5,000
	To *Y*'s Capital A/c			3,000
	To *Z*'s Capital A/c			2,000
	(Balance of workmen compensation reserve in excess distributed among old partners in old ratio)			
April 1	Bank A/c ...Dr.		1,00,000	
	To *R*'s Capital A/c			1,00,000
	(Capital brought in by *R* for 1/5th share)			

Illustration 9. *(Admission-cum-Retirement: Investment Fluctuation Reserve).*

A, *B* and *C* are partners sharing profits in the ratio of 5 : 3 : 2. *A*, by agreement, retires and *D* joins the firm on the basis of one third share of profit on 1st April, 2018 bringing ₹ 50,000 towards capital. An extract of their Balance Sheet as at 31st March, 2018 is as follows:

Liabilities	₹	Assets	₹
Investments Fluctuation Reserve	3,750	Investment (at Cost)	50,000

Pass Journal entries if market value of Investment is ₹ 55,000.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Investments Fluctuation Reserve A/c ...Dr.		3,750	
	To *A*'s Capital A/c			1,875
	To *B*'s Capital A/c			1,125
	To *C*'s Capital A/c			750
	(Transfer of Investments Fluctuation Reserve to Partners' Capital Accounts in their old profit-sharing ratio)			

	Particulars		L.F.	Dr.	Cr.
	Investment A/c	...Dr.		5,000	
	To Revaluation A/c				5,000
	(Value of Investment brought up to market value)				
	Revaluation A/c	...Dr.		5,000	
	To *A*'s Capital A/c				2,500
	To *B*'s Capital A/c				1,500
	To *C*'s Capital A/c				1,000
	(Transfer of gain (profit) on revaluation)				
	Bank A/c	...Dr.		50,000	
	To *D*'s Capital A/c				50,000
	(Capital brought in by *D*)				

Illustration 10. *(Admission-cum-Retirement: Distribution of Profits).*

Harsh, Rajneesh and Nikhil were partners sharing profits in the ratio of 6 : 4 : 5. On 1st April, 2017. Nikhil retires from the firm and on the same date Deepanshu is admitted into partnership for 2/9th share in profits. Harsh, Rajneesh and Deepanshu decided to share future profits in the ratio 4 : 3 : 2. They earned profit of ₹ 9,00,000 for the year ended 31st March, 2018. Pass necessary Journal entry.

Solution:

In the Books of Harsh, Rajneesh and Deepanshu

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
April 1	Profit and Loss Appropriation A/c	...Dr.		9,00,000	
	To Harsh's Capital A/c				4,00,000
	To Rajneesh's Capital A/c				3,00,000
	To Deepanshu's Capital A/c				2,00,000
	(Profit for the year ended 31st March, 2018 distributed among partners including new partner in the ratio of 4 : 3 : 2)				

Illustration 11. *(Admission-cum-Retirement: Treatment of Existing Goodwill).*

A, *B* and *C* were partners sharing profit equally. On 31st March, 2018, *D* was admitted into the firm for 1/6th share in profits and on the same date *B* retires from the firm. On that date, goodwill appears in the books at ₹ 30,000. Pass necessary Journal entry.

Solution:

In the Books of *A*, *B*, *C* and *D*

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
Mar 31	*A*'s Capital A/c	...Dr.		10,000	
	B's Capital A/c	...Dr.		10,000	
	C's Capital A/c	...Dr.		10,000	
	To Goodwill A/c				30,000
	(Existing goodwill appearing in the books written off by debiting old partners in old ratio)				

Illustration 12. *(Admission-cum-Retirement: Distribution of Profit).*

P, *Q* and *R* were partners sharing profits in the ratio of 3 : 2 : 1. On 1st April, 2017, *R* retires selling his share of profit for ₹ 96,000. On the same date, *S* is admitted into the partnership for 25% share in profits. *P*, *Q* and *S* decided to share future profits in the ratio of 2 : 1 : 1. The profit for the year ended 31st March, 2018 was ₹ 48,000. Partners decided to donate woollen clothes, blankets and Medical Van for flood affected area of Jammu and Kashmir.

Pass Journal entries to (i) record the sale of *R*'s share to *P* and *Q* and (ii) distribute the profit between *P*, *Q* and *S*.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2017				
April 1	*S*'s Capital/Current A/c ...Dr.		1,44,000	
	To *Q*'s Capital/Current A/c			48,000
	To *R*'s Capital/Current A/c			96,000
	(Adjustment made of Goodwill by debiting the gaining partner and crediting sacrificing partners)			
2018				
March 31	Profit and Loss Appropriation A/c ...Dr.		48,000	
	To *P*'s Capital/Current A/c			24,000
	To *Q*'s Capital/Current A/c			12,000
	To *S*'s Capital/Current A/c			12,000
	(Profit distributed between the partners in new ratio)			

Working Notes:

1. *Calculation of Sacrifice/(Gain) Share:*

	P	*Q*	*R*	*S*
Old Share	3/6	2/6	1/6	...
New Share	2/4	1/4	...	1/4
	NIL	1/12 Sacrifice	2/12 Sacrifice	–3/12 Gain

2. *Calculation of Share of Goodwill:*

		₹
R's Share of Goodwill for 1/6th Share	=	96,000
Goodwill of the firm = ₹ 96,000 × 6/1	=	5,76,000
Q's Sacrificing Share = ₹ 5,76,000 × 1/12	=	48,000
R's Sacrificing Share = ₹ 5,76,000 × 2/12	=	96,000
S's Gaining Share = ₹ 5,76,000 × 3/12	=	1,44,000

Illustration 13. *(Admission-cum-Retirement: Revaluation of Assets).*

Ram and Shyam are partners sharing profits and losses in the ratio of 3 : 2. They are doing the business of recycling the old furniture and refurbishing them for resale. On 1st April, 2018, Shiv is admitted for 1/2 share in profits and brings ₹ 2,00,000 for his share of capital and ₹ 60,000 for his share of goodwill. On the same date, Shyam retires from the firm. Ram and Shiv decided to share future profits equally. For this purpose assets were revalued from ₹ 10,00,000 to ₹ 9,00,000. Ram and Shiv decided to open a charitable dispensary to provide free medical facilities to poor and needy people of flood affected victims of Bihar.

Journalise.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Revaluation A/c ...Dr.		1,00,000	
	To Assets A/c			1,00,000
	(Decrease in value of assets)			
April 1	Ram's Capital A/c ...Dr.		60,000	
	Shyam's Capital A/c ...Dr.		40,000	
	To Revaluation A/c			1,00,000
	(Revaluation loss distributed among old partners in their old ratio)			
April 1	Bank A/c ...Dr.		2,60,000	
	To Shiv's Capital A/c			2,00,000
	To Premium for Goodwill A/c			60,000
	(Amount brought in by Shiv)			
April 1	Premium for Goodwill A/c ...Dr.		60,000	
	To Ram's Capital A/c (₹ 60,000 × 1/5)			12,000
	To Shyam's Capital A/c (₹ 60,000 × 4/5)			48,000
	(Sacrificing partners compensated with share of goodwill)			

Working Note:

Calculation of Gaining/Sacrificing Share:	Ram	Shyam	Shiv
New Share	1/2	...	1/2
Old Share	3/5	2/5	...
	–1/10	–2/5 or –4/10	1/2 or 5/10
	Sacrifice	Sacrifice	Gain

Illustration 14.

M, *N* and *O* are partners in a firm sharing profits in the ratio of 4 : 3 : 2. *N* retires and it is decided that *N*'s share of goodwill be adjusted in the accounts of *M* and *O*. Fill in the missing figures in the following Journal entry. Also calculate the value of firm's goodwill.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	M's Capital A/c ...Dr.		?	
	O's Capital A/c ...Dr.		10,000	
	To *N*'s Capital A/c			?
	(*N*'s share of goodwill debited to the account of gaining partners in their gaining ratio)			

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	M's Capital A/c	...Dr.		**20,000**	
	O's Capital A/c	...Dr.		10,000	
	To *N*'s Capital A/c				**30,000**
	(*N*'s share of goodwill debited to the account of gaining partners in their gaining ratio)				

Working Notes:

1. *Calculation of M's Gain to be debited:*

   As *O*'s Gain for 2/6 = ₹ 10,000

   So, *M*'s Gain for 4/6 = ₹ 10,000 × 6/2 × 4/6 = ₹ 20,000.

2. Gaining Ratio between *M* and *O* is 4 : 2 or 2 : 1.

3. *Calculation of Value of Firm's Goodwill:*

   For 3/9th *N*'s Share of Goodwill = ₹ 30,000

   So, total value of firm's goodwill = ₹ 30,000 × 9/3 = ₹ 90,000.

Illustration 15.

Complete the missing figures in the Accounts and Balance Sheet:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Patents A/c	2,000	By Investments A/c		2,600
To Plant and Machinery A/c	5,000	By Loss transferred to:		
To Provision for Doubtful Debts A/c	400	*X*'s Capital A/c	?	
		Y's Capital A/c	?	
		Z's Capital A/c	?	?
	7,400			7,400

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Goodwill A/c	3,000	2,000	1,000	By Balance *b/d*	68,000	32,000	21,000
To *Z*'s Capital A/c (Goodwill)	?	?		By Workmen Compensation Reserve	4,500	3,000	1,500
To Revaluation A/c (Loss)	2,400	1,600	800	By Investments Fluctuation Reserve	3,000	2,000	1,000
To Advertisement Expenditure A/c	1,800	1,200	600	By *X*'s Capital A/c (Goodwill)			3,000
To Investments A/c			17,600	By *Y*'s Capital A/c (Goodwill)			2,000
To Bank A/c			4,250				
To *Z*'s Loan A/c			?				
To Bills Payable A/c			?				
To Balance *c/d*	?	?					
	75,500	37,000	28,500		75,500	37,000	28,500

BALANCE SHEET OF *X* AND *Y*

as at 1st April, 2018

Liabilities		₹	Assets		₹
Sundry Creditors		?	Cash at Bank		1,500
Workmen Compensation Claim		3,000	Debtors	40,000	
Employees' Provident Fund		6,000	*Less:* Provision for Doubtful Debts	2,400	37,600
Bills Payable		2,125	Stock		37,650
Z's Loan		2,125	Patents		8,000
X's Capital	65,300		Plant and Machinery		?
Y's Capital	30,200	95,500			
		1,29,750			1,29,750

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Patents A/c	2,000	By Investments A/c		2,600
To Plant and Machinery A/c	5,000	By Loss transferred to:		
To Provision for Doubtful Debts A/c	400	*X*'s Capital A/c	**2,400**	
		Y's Capital A/c	**1,600**	
		Z's Capital A/c	**800**	**4,800**
	7,400			7,400

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* ₹	*Y* ₹	*Z* ₹	Particulars	*X* ₹	*Y* ₹	*Z* ₹
To Goodwill A/c	3,000	2,000	1,000	By Balance *b/d*	68,000	32,000	21,000
To *Z*'s Capital A/c (Goodwill)	**3,000**	**2,000**		By Workmen Compensation Reserve	4,500	3,000	1,500
To Revaluation A/c (Loss)	2,400	1,600	800	By Investments Fluctuation Reserve	3,000	2,000	1,000
To Advertisement Expenditure A/c	1,800	1,200	600	By *X*'s Capital A/c (Goodwill)			3,000
To Investments A/c			17,600	By *Y*'s Capital A/c (Goodwill)			2,000
To Bank A/c			4,250				
To *Z*'s Loan A/c			**2,125**				
To Bills Payable A/c			**2,125**				
To Balance *c/d*	**65,300**	**30,200**					
	75,500	37,000	28,500		75,500	37,000	28,500

BALANCE SHEET OF *X* AND *Y as at 1st April, 2018*

Llabilities		₹	Assets		₹
Sundry Creditors (Balancing Figure)		**21,000**	Cash at Bank		1,500
Workmen Compensation Claim		3,000	Debtors	40,000	
Employees' Provident Fund		6,000	*Less:* Provision for Doubtful Debts	2,400	37,600
Bills Payable		2,125	Stock		37,650
Z's Loan		2,125	Patents		8,000
X's Capital	65,300		Plant and Machinery (Balancing Figure)		**45,000**
Y's Capital	30,200	95,500			
		1,29,750			1,29,750

Illustration 16.

Complete the following Accounts and Balance Sheet:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Plant A/c		?	By Building A/c	1,00,000
To Furniture A/c		6,000		
To Provision for Doubtful Debts A/c		?		
To Partners' Capital A/cs (Gain):				
A (₹ 39,000 × 3/6)	19,500			
B (₹ 39,000 × 2/6)	13,000			
C (₹ 39,000 × 1/6)	6,500	39,000		
		?		?

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	35,000	By *C*'s Capital A/c	?
To *A*'s Capital A/c	?	By Balance *c/d*	1,00,000
To *B*'s Capital A/c	?		
	4,61,500		4,61,500

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Bank A/c			3,61,500	By Balance *b/d*	4,50,000	3,50,000	2,50,000
To *C*'s Capital A/c (Goodwill)	36,000	24,000		By Reserves and Surplus	75,000	50,000	25,000
To Balance *c/d*	8,24,400	5,99,600		By Profit and Loss A/c	60,000	40,000	20,000
				By *A*'s Capital A/c			?
				By *B*'s Capital A/c			?
				By Revaluation A/c	?	?	?
				By Bank A/c	2,55,900	1,70,600	
	8,60,400	6,23,600	3,61,500		8,60,400	6,23,600	3,61,500

BALANCE SHEET OF *A* AND *B* (NEW FIRM) *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs:			Building (₹ 5,00,000 + ₹ 1,00,000)		6,00,000
A	8,24,400		Plant (₹ 4,00,000 – ₹ 40,000)		3,60,000
B	5,99,600	14,24,000	Furniture (₹ 40,000 – ₹ 6,000)		34,000
Creditors		2,05,000	Stock		2,50,000
			Debtors	3,00,000	
			Less: Provision for Doubtful Debts	15,000	2,85,000
			Bank		1,00,000
		16,29,000			16,29,000

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Plant A/c		**40,000**	By Building A/c	1,00,000
To Furniture A/c		6,000		
To Provision for Doubtful Debts A/c		**15,000**		
To Partners' Capital A/cs (Gain):				
A (₹ 39,000 × 3/6)	19,500			
B (₹ 39,000 × 2/6)	13,000			
C (₹ 39,000 × 1/6)	6,500	39,000		
		1,00,000		**1,00,000**

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	35,000	By *C*'s Capital A/c	**3,61,500**
To *A*'s Capital A/c	**2,55,900**	By Balance *c/d*	1,00,000
To *B*'s Capital A/c	**1,70,600**		
	4,61,500		4,61,500

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Bank A/c			3,61,500	By Balance *b/d*	4,50,000	3,50,000	2,50,000
To *C*'s Capital A/c (Goodwill)	36,000	24,000		By Reserves and Surplus	75,000	50,000	25,000
				By Profit and Loss A/c	60,000	40,000	20,000
To Balance *c/d*	8,24,400	5,99,600		By *A*'s Capital A/c			**36,000**
				By *B*'s Capital A/c			**24,000**
				By Revaluation A/c	**19,500**	**13,000**	**6,500**
				By Bank A/c	2,55,900	1,70,600	
	8,60,400	6,23,600	3,61,500		8,60,400	6,23,600	3,61,500

BALANCE SHEET OF *A* AND *B* (NEW FIRM) *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Capital A/cs:			Building (₹ 5,00,000 + ₹ 1,00,000)		6,00,000
A	8,24,400		Plant (₹ 4,00,000 – ₹ 40,000)		3,60,000
B	5,99,600	14,24,000	Furniture (₹ 40,000 – ₹ 6,000)		34,000
Creditors		2,05,000	Stock		2,50,000
			Debtors	3,00,000	
			Less: Provision for Doubtful Debts	15,000	2,85,000
			Bank		1,00,000
		16,29,000			16,29,000

Illustration 17 (*Treatment of Goodwill and Revaluation of Assets and Reassessment of Liabilities; Amount due to Retiring Partner be Treated as Loan*).

X, *Y* and *Z* were partners sharing profits and losses in the ratio of 1/2 : 1/3 : 1/6 respectively. Balance Sheet of the firm as at 31st March, 2018 stood as follows:

Liabilities		₹	Assets		₹
Creditors		9,500	Cash at Bank		1,250
Bills Payable		2,500	Debtors	8,000	
General Reserve		6,000	*Less:* Provision for Doubtful Debts	250	7,750
Capital A/cs:			Stock		12,500
X	20,000		Delivery Vans		4,000
Y	15,000		Machinery		17,500
Z	12,500	47,500	Building		22,500
		65,500			65,500

Y retired on 1st April, 2018 subject to the following terms:

(i) Goodwill of the firm be valued at ₹ 9,000 and *Y*'s share of the goodwill be adjusted in the accounts of *X* and *Z*.

(ii) Machinery to be decreased by 10% and Delivery Vans by 15%.

(iii) Stock to be appreciated by 20% and Building by 10%.

(iv) Provision for Doubtful Debts to be increased by ₹ 975.

(v) Provision for Workmen Compensation to the extent of ₹ 825, to be created.

It was agreed that *X* and *Z* will share profits in future in the ratio of 3 : 2 respectively.

Prepare Revaluation Account, Capital Accounts of Partners and Balance Sheet of the New Firm.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		975	By Stock A/c	2,500
To Machinery A/c		1,750	By Building A/c	2,250
To Delivery Vans A/c		600		
To Provision for Workmen Compensation A/c		825		
To Gain (Profit) on Revaluation transferred to:				
X's Capital A/c	300			
Y's Capital A/c	200			
Z's Capital A/c	100	600		
		4,750		4,750

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To *Y*'s Capital A/c (Note 2)	900	...	2,100	By Balance *b/d*	20,000	15,000	12,500
To *Y*'s Loan A/c (Note 1)	...	20,200	...	By Revaluation A/c —Gain (Profit)	300	200	100
To Balance *c/d*	22,400	...	11,500	By *X*'s Capital A/c (Note 2)	...	900	...
				By *Z*'s Capital A/c (Note 2)	...	2,100	...
				By General Reserve A/c	3,000	2,000	1,000
	23,300	20,200	13,600		23,300	20,200	13,600

BALANCE SHEET OF *X* AND *Z* *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Bills Payable		2,500	Cash at Bank		1,250
Creditors		9,500	Stock		15,000
Provision for Workmen Compensation		825	Debtors	8,000	
Y's Loan A/c		20,200	*Less:* Provision for Doubtful Debts	1,225	6,775
Capital A/cs:			Delivery Vans		3,400
X	22,400		Machinery		15,750
Z	11,500	33,900	Building		24,750
		66,925			66,925

Notes: 1. The question is silent in respect of payment to *Y*. Therefore, the amount due to *Y* has been transferred to his Loan Account.

2. *Y*'s share of goodwill = ₹ 9,000 × $\frac{1}{3}$ = ₹ 3,000, which is to be contributed by *X* and *Z* in their gaining ratio, *i.e.*, 3 : 7. Thus, *X* and *Z* will be debited by ₹ 900 and ₹ 2,100 respectively.

3. *Calculation of Gaining Ratio:*

$$X\text{'s Gain} = \frac{3}{5} - \frac{1}{2} = \frac{6-5}{10} = \frac{1}{10} \text{ or } \frac{3}{30};$$

$$Z\text{'s Gain} = \frac{2}{5} - \frac{1}{6} = \frac{12-5}{30} = \frac{7}{30}.$$ Thus, Gaining Ratio of *X* and *Z* = 3 : 7.

Illustration 18.

A, *B* and *C* are partners in a firm sharing profits in the ratio of 3 : 2 : 1. On 31st March, 2018, the Balance Sheet of the firm stood as:

BALANCE SHEET

Liabilities		₹	Assets	₹
Creditors		1,35,900	Cash	47,000
Capital A/cs:			Debtors	80,000
A	1,50,000		Stock	1,16,900
B	1,00,000		Building	2,30,000
C	1,00,000	3,50,000	Profit and Loss A/c	12,000
		4,85,900		4,85,900

B retired on the above mentioned date on the following terms:

(i) Building to be appreciated by ₹ 70,000.

(ii) Provision for Doubtful Debts to be made @ 5% on Debtors.

(iii) Goodwill of the firm is valued at ₹ 1,80,000 and adjustment in this respect to be made in the continuing partners' Capital Accounts without raising the Goodwill Account.

(iv) ₹ 30,000 to be paid to *B* immediately and the balance in his Capital Account to be transferred to his Loan Account.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and the Balance Sheet of the firm after *B*'s retirement.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		4,000	By Building A/c	70,000
To Gain (Profit) transferred to:				
A's Capital A/c	33,000			
B's Capital A/c	22,000			
C's Capital A/c	11,000	66,000		
		70,000		70,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To *B's* Capital A/c (Note)	45,000	...	15,000	By Balance *b/d*	1,50,000	1,00,000	1,00,000
To Profit and Loss A/c	6,000	4,000	2,000	By Revaluation A/c	33,000	22,000	11,000
To Cash A/c	...	30,000	...	— Gain (Profit)			
To *B's* Loan A/c	...	1,48,000	...	By *A's* Capital A/c (Note)	...	45,000	...
To Balance *c/d*	1,32,000	...	94,000	By *C's* Capital A/c (Note)	...	15,000	...
	1,83,000	1,82,000	1,11,000		1,83,000	1,82,000	1,11,000

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	47,000	By *B's* Capital A/c	30,000
		By Balance *c/d*	17,000
	47,000		47,000

BALANCE SHEET OF *A* AND *C as at 1st April, 2018*

Liabilities		₹	Assets		₹
Creditors		1,35,900	Cash		17,000
B's Loan A/c		1,48,000	Stock		1,16,900
Capital A/cs:			Debtors	80,000	
A	1,32,000		*Less:* Provision for Doubtful Debts	4,000	76,000
C	94,000	2,26,000	Building		3,00,000
		5,09,900			5,09,900

Note: *B's* share of goodwill ₹ 60,000 (*i.e.*, ₹ 1,80,000 × 1/3) has been debited to Capital Accounts of *A* and *C* in their gaining ratio, *i.e.*, 3 : 1 and credited to *B's* Capital Account.

Illustration 19.

Complete the following Accounts and Balance Sheet:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		5,000	By Computer A/c	12,000
To Warranty Claim A/c		?	By Land and Building A/c	50,000
To Provision for Outstanding Repairs A/c		15,000		
To Gain (Profit) transferred to:				
A's Capital A/c	?			
B's Capital A/c	?			
C's Capital A/c	?	?		
		62,000		62,000

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To *B*'s Capital A/c	?		?	By Balance *b/d*	?	?	?
—Goodwill				By Capital A/cs:			
To Bank A/c		50,000		*A*		45,000	
To *B*'s Loan A/c—Trsf.		3,20,000		*C*		15,000	
To Balance *c/d*	4,20,000		1,40,000	By Revaluation A/c	15,000	10,000	5,000
				—Gain (Profit)			
	4,65,000	3,70,000	1,55,000		4,65,000	3,70,000	1,55,000
				By Balance *b/d*	4,20,000		1,40,000

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Creditors A/c		1,08,000	Cash at Bank		28,000
Provision for Outstanding Repairs		?	Debtors	1,00,000	
Warranty Claim		12,000	*Less:* Provision for Doubtful Debts?	?	
B's Loan		3,20,000	Stock		90,000
Capital A/cs:			Computer		12,000
A	4,20,000		Machinery		2,40,000
C	1,40,000	5,60,000	Land and Building	5,00,000	
			Add: Appreciation	50,000	5,50,000
		10,15,000			10,15,000

Solution:

Dr. REVALUATION ACCOUNT Cr.

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c		5,000	By Computer A/c	12,000
To Warranty Claim A/c		**12,000**	By Land and Building A/c	50,000
To Provision for Outstanding Repairs A/c		15,000		
To Gain (Profit) transferred to:				
A's Capital A/c	**15,000**			
B's Capital A/c	**10,000**			
C's Capital A/c	**5,000**	**30,000**		
		62,000		62,000

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To *B*'s Capital A/c	**45,000**		**15,000**	By Balance *b/d*	**4,50,000**	**3,00,000**	**1,50,000**
—Goodwill				By Capital A/cs:			
To Bank A/c		50,000		*A*		45,000	
To *B*'s Loan A/c—Trsf.		3,20,000		*C*		15,000	
To Balance *c/d*	4,20,000		1,40,000	By Revaluation A/c	15,000	10,000	5,000
				— Gain (Profit)			
	4,65,000	3,70,000	1,55,000		4,65,000	3,70,000	1,55,000
				By Balance *b/d*	4,20,000		1,40,000

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets		₹
Creditors		1,08,000	Cash at Bank		28,000
Provision for Outstanding Repairs		**15,000**	Debtors	1,00,000	
Warranty Claim		12,000	*Less:* Provision for Doubtful Debts	**5,000**	**95,000**
B's Loan		3,20,000	Stock		90,000
Capital A/cs:			Computer		12,000
A	4,20,000		Machinery		2,40,000
C	1,40,000	5,60,000	Land and Building	5,00,000	
			Add: Appreciation	50,000	5,50,000
		10,15,000			10,15,000

Unsolved Questions

1. *A*, *B* and *C* are partners in a firm sharing profits in the ratio of 5 : 3 : 2 respectively. *B* retires and his share is taken up by *A* and *C* in the ratio of 2 : 1. Then immediately, *D* is admitted for 25% share of profits, half of which was gifted by *A* and remaining share was taken by *D* equally from *A* and *C*. Calculate new profit-sharing ratio after *D* 's admission. [**Ans.:** *New Ratio—41 : 19 : 20.*]

2. *A, B* and *C* are partners sharing profits in the ratio of 4 : 3 : 2. *B* retires and goodwill of the firm is valued at ₹ 10,800. No goodwill appears as yet in the books of the firm. *A* and *C* decide to share future profits in the ratio of 5 : 3. Pass Journal entries. [**Ans.:** *Dr. A's Capital A/c by ₹ 1,950 and C's Capital A/c by ₹ 1,650; Cr. B's Capital A/c by ₹ 3,600.*]

3. Ravi, Mukesh, Naresh and Yogesh are partners in a firm sharing profits in the ratio of 2 : 2 : 1 : 1. On Mukesh's retirement, the goodwill of the firm is valued at ₹ 90,000. Ravi, Naresh and Yogesh decided to share the future profits equally. Pass necessary Journal entry for the treatment of goodwill. No goodwill is to be shown in the books of the firm. *(AI 1999)*

   [**Ans.:** *Dr. Naresh and Yogesh by ₹ 15,000 each; Cr. Mukesh by ₹ 30,000; Gaining Ratio 1 : 1.*]

   [**Hint:** Gaining Ratio, *i.e.*, Ravi = 1/3 – 2/6 = 0; Naresh = 1/3 – 1/6 = 1/6; Yogesh = 1/3 – 1/6 = 1/6. Hence, Naresh and Yogesh gain in the ratio of 1 : 1.]

4. *X*, *Y* and *Z* were partners in a firm sharing profits in the ratio of 1/5 : 2/5 : 2/5. On 15th April, 2018, *X* retires and the new profit-sharing ratio of *Y* and *Z* was 3 : 2. On *X*'s retirement the goodwill of the firm was valued at ₹ 60,000. Calculate the gaining ratio and pass necessary Journal entry on *X*'s retirement for the treatment of goodwill. [**Ans.:** *Dr. Y's Capital A/c and Cr. X's Capital A/c by ₹ 12,000.*]

   [**Hint:** Only *Y* is gaining. He will be debited for the entire share of *X* in goodwill, *i.e.*, 1/5 of ₹ 60,000 = ₹ 12,000.]

5. *X*, *Y* and *Z* are partners in a firm sharing profits and losses equally. The Balance Sheet of the firm as at 31st March, 2018 stood as follows:

Liabilities		₹	Assets	₹
Creditors		10,900	Cash in Hand and Cash at Bank	8,600
General Reserve		6,000	Debtors	20,000
Employees' Provident Fund		2,000	Stock	10,000
Capital A/cs:			Investments (At cost)	5,000
X	30,000		Freehold Property	40,000
Y	20,000		Trademarks	2,000
Z	20,000	70,000	Goodwill	3,300
		88,900		88,900

Z retires on 1st April, 2018 subject to the following adjustments:

(a) Freehold Property be valued at ₹ 58,000.

(b) Investments be valued at ₹ 4,700 and Stock be valued at ₹ 9,400.

(c) A Provision of 5% be made for Doubtful Debts.

(d) Trademarks are valueless.

(e) An item of ₹ 1,200 included in Creditors is not likely to be claimed.

(f) Goodwill be valued at one year's purchase of the average profit of the past three years, *viz.*, 2015–2016: ₹ 12,000; 2016–2017: ₹ 10,000 and 2017–2018: ₹ 9,500.

Pass Journal entries, give Capital Accounts and the Balance Sheet of the remaining partners.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 15,300; Z's Loan A/c—₹ 29,500; Capitals: X—₹ 34,250; Y—₹ 24,250; Balance Sheet Total—₹ 99,700.*]

6. The Balance Sheet of *M, N* and *O* who are sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Bills Payable		6,400	Cash in Hand	150
Sundry Creditors		12,500	Cash at Bank	25,500
Profit and Loss A/c		4,500	Bills Receivable	5,400
Capital A/cs:			Book Debts	17,800
M	40,000		Stock	22,300
N	25,000		Furniture	3,500
O	20,000	85,000	Plant and Machinery	9,750
			Building	24,000
		1,08,400		1,08,400

M retires from business on 1st April, 2018 and his share in the firm is to be ascertained on revaluation of assets as follows:

Stock ₹ 20,000; Furniture ₹ 3,000; Plant and Machinery ₹ 9,000; Building ₹ 20,000 and ₹ 850 is to be provided for Doubtful Debts.

The goodwill of the firm is agreed to be valued at ₹ 6,000 and adjustment in this respect was to be made in the continuing Partners' Capital Accounts without raising Goodwill Account.

M is to be paid ₹ 11,050 in cash on retirement and balance in three equal yearly instalments with interest @ 5% p.a.

Pass Journal entries and give the Loan Account of *M* till it is finally closed. (*Foreign 1994, AI 2002 C, Modified*)

[**Ans.:** *Loss on Revaluation—₹ 8,400; M's Loan A/c—₹ 30,000.*]

7. The Balance Sheet of *A*, *B* and *C* who were sharing the results in proportion to their capitals as at 31st March, 2018 is:

Liabilities		₹	Assets		₹
Bills Payable		1,000	Bank Balance		2,750
Sundry Creditors		2,450	Debtors	2,500	
Capital A/cs:			*Less:* Provision for Doubtful Debts	50	2,450
A	10,000		Stock		4,000
B	7,500		Plant and Machinery		4,250
C	5,000	22,500	Factory Building		12,500
		25,950			25,950

B retired on the following day and the adjustments made as follows:

(a) Stock was reduced by 6%.

(b) Factory Building was appreciated by 20%.

(c) Provision for Doubtful Debts was created up to 5%.

(d) Provision for Legal charges to be made ₹ 385.

(e) Goodwill of the firm be fixed at ₹ 5,400 and *B*'s share be adjusted into the accounts of *A* and *C*.

(f) The capital of the new firm be fixed at ₹ 14,000 in the profit-sharing ratio.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of *A* and *C* transferring *B*'s Capital Account to his Loan Account.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 1,800; Balances: A's Capital A/c—₹ 9,333; C's Capital A/c—₹ 4,667; B's Loan A/c—₹ 9,900; Cash at Bank—₹ 2,350; Balance Sheet Total—₹ 27,735.*]

8. The Balance Sheet of *A, B* and *C* who were sharing profits in proportion to their capitals, stood as at 31st March, 2018:

Liabilities		₹	Assets		₹
Creditors		27,600	Cash at Bank		22,000
Capital A/cs:			Debtors	20,000	
A	80,000		*Less:* Provision for Doubtful Debts	400	19,600
B	60,000		Stock		32,000
C	40,000	1,80,000	Machinery		34,000
			Building		1,00,000
		2,07,600			2,07,600

B retired on 1st April, 2018 and the following was agreed upon:

(a) Stock be reduced by 6%.

(b) Provision for Doubtful Debts to be brought up to 5% on Debtors.

(c) Building be appreciated by 20%.

(d) Provision of ₹ 3,080 be made in respect of Outstanding Legal Charges.

(e) Goodwill of the entire firm be valued at ₹ 43,200 and *B*'s share of it be adjusted into the accounts of *A* and *C* who are going to share future profits in the ratio of 5 : 3.

(f) That the entire capital of the firm as newly constituted to be fixed at ₹ 1,12,000 between *A* and *C* in the ratio of 5 : 3 (actual cash to be brought in or paid off as the case may be).

You are required to prepare Revaluation Account, Capital Accounts of Partners and the Balance Sheet of the firm after *B*'s retirement.

[**Ans.:** *Gain (Profit) on Revaluation—₹ 14,400; Amount brought in by C—₹ 5,400; Amount paid to A—₹ 8,600; Balance Sheet Total—₹ 2,21,880.*]

9. Vijay, Vivek and Vinay were partners in a firm sharing profits in 2 : 2 : 1 ratio. On 31st March, 2018, Vivek retired from the firm. On the date of Vivek's retirement the Balance Sheet of the firm was:

Liabilities		₹	Assets		₹
Creditors		54,000	Bank		55,200
Bills Payable		24,000	Debtors	12,000	
Outstanding Rent		4,400	*Less:* Provision for Doubtful Debts	800	11,200
Provision for Legal Claims		12,000	Stock		18,000
Capital A/cs:			Furniture		8,000
Vijay	92,000		Premises		1,94,000
Vivek	60,000				
Vinay	40,000	1,92,000			
		2,86,400			2,86,400

On Vivek's retirement it was agreed that:

(a) Premises will be appreciated by 5% and Furniture will be appreciated by ₹ 2,000. Stock will be reduced by 10%.

(b) Provision for Doubtful Debts was to be made at 5% on Debtors and Provision for Legal Damages to be increased up to ₹ 14,400.

(c) Goodwill of the firm was valued at ₹ 48,000.

(d) ₹ 50,000 from Vivek's Capital Account will be transferred to his Loan Account and the Balance be paid by cheque.

Prepare Revaluation Account, Partner's Capital Accounts and the Balance Sheet after Vivek's retirement.

[**Ans.:** *Gaining Ratio—2 : 1; Revaluation Profit—₹ 7,700; Partners' Capital A/cs: Vijay—₹ 82,280, Vinay—₹ 35,140, Payment to Vivek—₹ 32,280; Total of Balance Sheet—₹ 2,64,220.*]

CHAPTER 7

Death of a Partner

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. **Gaining Ratio** — The ratio in which the continuing partners acquire the outgoing or deceased partner's profit share is called **gaining ratio**.
2. **New Profit-sharing Ratio** — The ratio in which the continuing partners (*i.e.*, partners other than deceased partner) decide to share future profits and losses, is known as **new profit-sharing ratio**.
3. **Profit and Loss Suspense Account** — It is the account which is debited or credited to adjust the share of profit or loss till the date of death of the deceased partner when profit-sharing ratio of the continuing partners does not change.

CHAPTER SUMMARY

- The problems arising on the death of a partner are similar to those arising on retirement of a partner. Assets are revalued and liabilities are reassessed; the resultant gain (profit) or loss is transferred to the Capital Accounts of all partners including the deceased partner. *Goodwill, Accumulated Profits or Losses and General Reserve are also dealt in the same manner as is in the case of retirement.*
- **Deceased Partner's Share of Goodwill** *is adjusted by debiting Gaining Partners' Capital Accounts and crediting Deceased Partner's Capital Account.*
- **Share of Profit up to the Date of Death:** If a partner dies on any date after the date of the Balance Sheet, his share of profit is calculated from the beginning of the year to the date of death on the basis of time or sales. When his share of profit is calculated on the basis of time, it may be on the basis of previous years' profit or average profit of past years.

  Journal Entry when Profit-sharing Ratio of remaining or continuing partners does not change:

  Profit and Loss Suspense A/c ...Dr.

  To Deceased Partner's Capital A/c

  Journal Entry when Profit-sharing Ratio of remaining or continuing partners changes:

  Continuing (Gaining) Partners' Capital/Current A/cs ...Dr. [In Gaining Ratio]

  To Deceased Partner's Capital A/c

  In Case of Loss: Reserve of the above entry is passed.
- **Amount Due to a Deceased Partner:** The deceased partner's share is also calculated in the same way as in the case of retiring partner. Amount due to a deceased partner shown by his Capital Account is transferred to his Executors' Account. The entry will be:

  Deceased Partner's Capital A/c ...Dr.

  To Deceased Partner's Executors' A/c
- **Settlement of a Deceased Partner's Executors' Account:** If the amount is paid in cash or in instalments, the entry will be:

  Deceased Partner's Executors' A/c ...Dr.

  To Cash/Bank A/c
- In the absence of an agreement, the retiring partner or legal heir of deceased partner at his option is entitled to receive **either interest @ 6% p.a.** till the due amount is paid **or share of the profit** which has been earned by using the amount due to him (Section 37).

Solved Questions

Illustration 1.

Priya, Riya and Siya are partners sharing profits in the ratio of 4 : 3 : 1 respectively. It is provided in the Partnership Deed that on the death of any partner, her share of goodwill was to be valued at half of the profits credited to her account during the four previous completed years.

Riya died on 1st January, 2012. The firm's profits for the last four years were: 2008—₹ 1,20,000; 2009—₹ 80,000; 2010—₹ 40,000 and 2011—₹ 80,000. Determine the amount that should be credited to Riya in respect of her share of Goodwill. On the date of Riya's death, one of the old Debtors whose account was closed last year by transfering his debt amounting to ₹ 8,000 to Bad Debts Account, has now promised to pay the amount fully.

Pass necessary Journal entries for the above mentioned transactions at the time of Riya's death. *(AI 2012 C)*

Solution:

Firm's total profits for last four years = ₹ 1,20,000 + ₹ 80,000 + ₹ 40,000 + ₹ 80,000 = ₹ 3,20,000

$$\text{Riya's share of last four years' profit} = ₹\ 3{,}20{,}000 \times \frac{3}{8} = ₹\ 1{,}20{,}000$$

$$\text{Riya's share of Goodwill} = ₹\ 1{,}20{,}000 \times \frac{1}{2} = ₹\ 60{,}000.$$

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Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2012					
Jan. 1	Priya's Capital A/c (₹ 60,000 × 4/5)	...Dr.		48,000	
	Siya's Capital A/c (₹ 60,000 × 1/5)	...Dr.		12,000	
	To Riya's Capital A/c				60,000
	(Being Riya's share of goodwill adjusted)				

Note: No accounting entry will be passed for the promise made by a debtor whose account was closed last year by transferring his debts amounting to ₹ 8,000 to Bad Debts Account, since it is an event and not a transaction.

There is another view that promise to pay be recognised as income (Bad Debts Recovered) and debtors be increased by ₹ 8,000. In that case, following entries would also be passed in addition to above entry:

		₹	₹
Debtors A/c	...Dr.	8,000	
To Bad Debts Recovered A/c			8,000
Bad Debts Recovered A/c	...Dr.	8,000	
To Revaluation A/c			8,000
Revaluation A/c	...Dr.	8,000	
To Priya's Capital A/c			4,000
To Riya's Capital A/c			3,000
To Siya's Capital A/c			1,000

Illustration 2 (*Preparation of Deceased Partner's Capital Account*).

Bhatt and Seth were carrying on a business in partnership sharing profits and losses in the ratio of 3 : 2. They closed their books of account every year on 31st March. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Bhatt's Capital	90,000		Furniture	20,000
Seth's Capital	60,000	1,50,000	Stock	1,00,000
Reserve		30,000	Debtors	50,000
Creditors		20,000	Cash	30,000
		2,00,000		2,00,000

Seth died on 1st August, 2018. Partnership Deed provided that in the event of death of a partner, partner's heirs would be entitled to be paid out:

(i) Capital to his credit till the date of death.

(ii) His share of reserve till the date of the last Balance Sheet.

(iii) His share of profits till the date of his death based on the average profits of the last three accounting years.

(iv) By way of goodwill, his share of total profits for the preceding three accounting years.

The profits for the three preceding accounting years were:

31st March, 2016	₹ 41,800
31st March, 2017	₹ 39,200
31st March, 2018	₹ 45,000

Prepare Seth's Capital Account by transferring due amount to Seth's Legal Heir's Loan Account. Clearly show your calculations.

Solution:

Dr. SETH'S CAPITAL ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2018			2018		
August 1	To Seth's Legal Heir's Loan A/c —Transfer	1,28,000	April 1	By Balance *b/d*	60,000
			August 1	By Reserve A/c	12,000
			August 1	By Profit and Loss Suspense A/c —Profit	5,600
			August 1	By Bhatt's Capital A/c (Goodwill)	50,400
		1,28,000			1,28,000

Working Notes:

1. *Average Profit of the three preceding accounting years:*

$$\text{Average Profit} = \frac{₹\ 41,800 + ₹\ 39,200 + ₹\ 45,000}{3} = \frac{₹\ 1,26,000}{3} = ₹\ 42,000.$$

2. Seth's Share of Profit for four months of 2018–19 = $₹\ 42,000 \times \frac{4}{12} \times \frac{2}{5} = ₹\ 5,600$.

3. Seth's Share of Goodwill = $₹\ 1,26,000 \times \frac{2}{5} = ₹\ 50,400$.

Illustration 3.

A, *B* and *C* were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2017, their Balance Sheet stood as:

Liabilities		₹	Assets	₹
Capital A/cs:			Goodwill	25,000
A	1,50,000		Leasehold	1,00,000
B	1,25,000		Patents	30,000
C	75,000	3,50,000	Machinery	1,50,000
Workmen Compensation Reserve		10,000	Stock	50,000
General Reserve		20,000	Debtors	1,40,000
Sundry Creditors		1,55,000	Cash at Bank	40,000
		5,35,000		5,35,000

C died on 1st August, 2017. It was agreed that:

(i) Goodwill of the firm is to be valued at 2½ years purchase of the average of annual profits of the last 4 years. The profits for the preceding years were ₹ 65,000; ₹ 60,000; ₹ 80,000 and ₹ 75,000.

(ii) Machinery be valued at ₹ 1,40,000; Patents be valued at ₹ 40,000; Leasehold be valued at ₹ 1,25,000 on 1st August, 2017.

(iii) For the purpose of calculating *C*'s share in the profits of 2017–18, the profits in 2017–18 should be taken to have accrued on the same scale as in 2016–17.

(iv) A sum of ₹ 21,000 to be paid immediately to the executors of *C* and the balance to be paid in four equal half-yearly instalments together with interest @ 10% p.a.

Prepare *C*'s Capital Account and *C*'s Executors' Account for 2017–18.

Note: The firm closes its accounts on 31st March every year. *(AI 2006, Modified)*

Solution:

Dr. *C*'S CAPITAL ACCOUNT *Cr.*

Date		Particulars	₹	Date		Particulars	₹
2017				2017			
Aug.	1	To Goodwill A/c	5,000	April	1	By Balance *b/d*	75,000
Aug.	1	To *C*'s Executors' A/c (Balancing Figure)	1,21,000	Aug.	1	By Revaluation A/c (Gain)	5,000
						By *A*'s Capital A/c (Goodwill)	21,875
						By *B*'s Capital A/c (Goodwill)	13,125
						By Profit and Loss Suspense A/c (WN 2)	5,000
						By Workmen Compensation Reserve A/c	2,000
						By General Reserve A/c	4,000
			1,26,000				1,26,000

Dr. C'S EXECUTORS' ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Aug. 1	To Bank A/c	21,000	Aug. 1	By *C's* Capital A/c	1,21,000
2018			2018		
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 5,000)	30,000	Jan. 31	By Interest A/c (₹ 1,00,000 × 10/100 × 6/12)	5,000
Jan. 31	To Balance *c/d*	75,000			
		1,26,000			1,26,000
2018			2018		
March 31	To Balance *c/d*	76,250	Feb. 1	By Balance *b/d*	75,000
			March 31	By Interest A/c (₹ 75,000 × 10/100 × 2/12)	1,250
		76,250			76,250

Working Notes:

		₹
1.	*Calculation of Goodwill:*	
	(a) Total profits for past 4 years	2,80,000
	(b) Average profit (₹ 2,80,000/4)	70,000
	(c) Goodwill (₹ 70,000 × 2½)	1,75,000
	(d) *C's* share (₹ 1,75,000 × 2/10)	35,000

2. *C's* share of profit to the date of death = ₹ 75,000 × 4/12 × 2/10 = ₹ 5,000.

Illustration 4.

The Balance Sheet of *X*, *Y* and *Z* who are sharing profits in the ratio of 2 : 3 : 1, as at 31st March, 2018 is given below:

Liabilities		₹	Assets	₹
X's Capital A/c	2,00,000		Goodwill	24,000
Y's Capital A/c	4,00,000		Land and Building	5,00,000
Z's Capital A/c	6,00,000	12,00,000	Investments	1,00,000
Workmen Compensation Reserve		40,000	(Market Value ₹ 92,000)	
Investments Fluctuation Reserve		20,000	Stock	1,60,000
Provision for Doubtful Debts		20,000	Debtors	6,00,000
Creditors		7,20,000	Bank	5,92,000
			Advertising Suspense A/c	24,000
		20,00,000		20,00,000

Z died on 1st April, 2018 and *X* and *Y* decided to share future profits and losses in the ratio of 3 : 2 and 50% of the amount payable to *Z* is to be paid immediately and the balance in two equal instalments together with interest @ 10% p.a.

Other Information:

(i) Goodwill is to be valued at two years' purchase of average profits of last three completed years. The profits were—2015–16 ₹ 90,000; 2016–17 ₹ 1,80,000 and 2017–18 ₹ 2,70,000.

(ii) Land and Building was found undervalued by ₹ 50,000 and Stock was found overvalued by ₹ 16,000.

(iii) Provision for Doubtful Debts is to be made equal to 5% of the Debtors.

(iv) Claim on account of Workmen Compensation is ₹ 16,000.

Pass necessary Journal entries and prepare the necessary Ledger Accounts and the Balance Sheet of the new firm.

Solution:

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	*X*'s Capital A/c ...Dr.		8,000	
	Y's Capital A/c ...Dr.		12,000	
	Z's Capital A/c ...Dr.		4,000	
	To Goodwill A/c			24,000
	(Existing goodwill written off)			
April 1	*X*'s Capital A/c (₹ 3,60,000 × 8/30) ...Dr.		96,000	
	To *Y*'s Capital A/c (₹ 3,60,000 × 3/30)			36,000
	To *Z*'s Capital A/c (₹ 3,60,000 × 5/30)			60,000
	[Goodwill adjusted by debiting gaining partner (*X* for 8/30) and crediting sacrificing partners (*Y* for 3/30) and (*Z* for 5/30)] (WN 1 and 2)			
April 1	Land and Building A/c ...Dr.		50,000	
	To Revaluation A/c			50,000
	(Increase in value of assets recorded)			
April 1	Revaluation A/c ...Dr.		26,000	
	To Stock A/c			16,000
	To Provision for Doubtful Debts A/c			10,000
	(Decrease in value of assets and increase in provisions recorded)			
April 1	Revaluation A/c ...Dr.		24,000	
	To *X*'s Capital A/c			8,000
	To *Y*'s Capital A/c			12,000
	To *Z*'s Capital A/c			4,000
	(Transfer of gain (profit) on revaluation)			
April 1	Workmen Compensation Reserve A/c ...Dr.		40,000	
	To Workmen Compensation Claim A/c			16,000
	To *X*'s Capital A/c			8,000
	To *Y*'s Capital A/c			12,000
	To *Z*'s Capital A/c			4,000
	(Transfer of workmen compensation reserve)			
April 1	Investments Fluctuation Reserve A/c ...Dr.		20,000	
	To Investments A/c			8,000
	To *X*'s Capital A/c			4,000
	To *Y*'s Capital A/c			6,000
	To *Z*'s Capital A/c			2,000
	(Transfer of investment fluctuation Reserve)			
April 1	*X*'s Capital A/c ...Dr.		8,000	
	Y's Capital A/c ...Dr.		12,000	
	Z's Capital A/c ...Dr.		4,000	
	To Advertisement Suspense A/c			24,000
	(Transfer of balance of Advertisement Suspense Account)			
April 1	*Z*'s Capital A/c ...Dr.		6,62,000	
	To *Z*'s Executors' A/c			6,62,000
	(Balance in *Z*'s capital transferred to Executors' Account)			
April 1	*Z*'s Executors' A/c ...Dr.		3,31,000	
	To Bank A/c			3,31,000
	(50% of amount due paid to *Z*'s executors)			

Dr. REVALUATION ACCOUNT Cr.

Particulars		₹	Particulars	₹
To Stock A/c		16,000	By Land and Building A/c	50,000
To Provision for Doubtful Debts A/c		10,000		
To Gain (Profit) on Revaluation transferred to:				
X's Capital A/c	8,000			
Y's Capital A/c	12,000			
Z's Capital A/c	4,000	24,000		
		50,000		50,000

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Goodwill A/c	8,000	12,000	4,000	By Balance *b/d*	2,00,000	4,00,000	6,00,000
To *Y*'s Capital A/c (Goodwill)	36,000	...	...	By *X*'s Capital A/c (Goodwill)	...	36,000	60,000
To *Z*'s Capital A/c (Goodwill)	60,000	...	...	By Revaluation A/c (Gain)	8,000	12,000	4,000
To Adv. Susp. A/c	8,000	12,000	4,000	By Work. Com. Res. A/c	8,000	12,000	4,000
To *Z*'s Executors' A/c	...	...	6,62,000	By Inv. Fluc. Res. A/c	4,000	6,000	2,000
To Balance *c/d*	1,08,000	4,42,000	...				
	2,20,000	4,66,000	6,70,000		2,20,000	4,66,000	6,70,000

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets		₹
X's Capital	1,08,000		Land and Building		5,50,000
Y's Capital	4,42,000	5,50,000	Investments		92,000
Z's Executors' A/c (WN 3)		3,31,000	Stock		1,44,000
Creditors		7,20,000	Debtors	6,00,000	
Workmen Compensation Claim		16,000	*Less:* Provision for Doubtful Debts	30,000	5,70,000
			Bank		2,61,000
		16,17,000			16,17,000

Working Notes:

1. *Calculation of Gain/(Sacrifice) of Share:*

	New Share	*Old Share*	*Difference*
X	3/5	2/6	3/5 – 2/6 = 8/30 (Gain)
Y	2/5	3/6	2/5 – 3/6 = – 3/30 (Sacrifice)

2. *Calculation of Goodwill:*

(i) Average Profit = $\frac{₹\ 90,000 + ₹\ 1,80,000 + ₹\ 2,70,000}{3}$ = ₹ 1,80,000.

(ii) Firm's Goodwill = ₹ 1,80,000 × 2 = ₹ 3,60,000.

(iii) *Z*'s share in Goodwill = ₹ 3,60,000 × 1/6 = ₹ 60,000.

Since, *Y* is sacrificing 3/30 of his share of profit, therefore, *X* will also compensate *Y* proportionately by ₹ 36,000 (*i.e.*, ₹ 3,60,000 × 3/30).

3.

Dr. Z'S EXECUTORS' ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Bank A/c	3,31,000	By *Z*'s Capital A/c	6,62,000
To Balance *c/d*	3,31,000		
	6,62,000		6,62,000

Illustration 5.

A, *B* and *C* were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. *C* died on 30th June, 2017. Balance Sheet of the firm as at 31st March, 2017 is as follows:

BALANCE SHEET *as at 31st March, 2017*

Liabilities		₹	Assets	₹
A's Capital	1,20,000		Plant and Machinery	1,20,000
B's Capital	80,000		Furniture	75,000
C's Capital	40,000	2,40,000	Investments	20,000
A's Current A/c	8,000		Stock-in-Trade	32,000
B's Current A/c	2,500	10,500	Sundry Debtors	25,000
General Reserve		30,000	Bills Receivable	11,000
Bills Payable		17,000	Cash at Bank	18,500
Sundry Creditors		20,000	Cash in Hand	11,000
			C's Current A/c	5,000
		3,17,500		3,17,500

Following decisions were taken by the surviving partners:

(i) Goodwill of the firm is valued at ₹ 30,000.

(ii) A Provision for Doubtful Debts is to be raised @ 5% on Debtors.

(iii) While Plant and Machinery is to be depreciated by 10%, Furniture and Stock-in-Trade are to be appreciated by 5% and 10% respectively.

(iv) Advertising Expenses ₹ 2,100 are to be carried forward to the next accounting year and, therefore, it is to be adjusted through the Revaluation Account.

(v) *A* and *B* are to share profits and losses equally in future.

(vi) Profit for the year ended 31st March, 2017 was ₹ 4,08,000 and *C*'s share in profit is to be determined on the basis of profit for the year ended 31st March, 2017.

(vii) The Fixed Capital Accounts Method is to be converted into the Fluctuating Capital Accounts Method by transferring Current Account balances to the respective Partners' Capital Accounts.

Prepare Revaluation Account, Capital Accounts of the three Partners, showing the necessary adjustments at *C*'s death; and prepare *C*'s Executors' Account to show that *C*'s Executors were paid in two half-yearly equal instalments *plus* the interest of 10% p.a. on the unpaid balance; the first instalment was paid on 31st December, 2017.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Provision for Doubtful Debts A/c	1,250	By Furniture A/c		3,750
To Plant and Machinery A/c	12,000	By Stock-in-Trade A/c		3,200
		By Advertising Expenses A/c		2,100
		By Loss on Revaluation transferred to:		
		A's Capital A/c	2,100	
		B's Capital A/c	1,400	
		C's Capital A/c	700	4,200
	13,250			13,250

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Partner's Current A/c	...	...	5,000	By Balance *b/d*	1,20,000	80,000	40,000
To *C's* Capital A/c (WN 1)	...	5,000	...	By Partners' Current A/cs	8,000	2,500	...
To Revaluation A/c	2,100	1,400	700	By General Reserve A/c	15,000	10,000	5,000
To *C's* Capital A/c (WN 2)	...	17,000	...	By *B's* Capital A/c (Goodwill)	...	...	5,000
To *C's* Executors' A/c	...	...	61,300				
To Balance *c/d*	1,40,900	69,100	...	By *B's* Capital A/c (WN 2)	...	...	17,000
	1,43,000	92,500	67,000		1,43,000	92,500	67,000

Dr. *C'S* EXECUTORS' ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2017			2017		
Dec. 31	To Bank A/c (₹ 30,650 + ₹ 3,065)	33,715	June 30	By *C's* Capital A/c	61,300
			Dec. 31	By Interest A/c (@ 10% for 6 months) (₹ 61,300 × 10/100 × 6/12)	3,065
2018					
March 31	To Balance *c/d*	31,416	2018		
			March 31	By Interest A/c*	766
		65,131			65,131
2018			2018		
June 30	To Bank A/c	32,182	April 1	By Balance *b/d*	31,416
			June 30	By Interest A/c (₹ 30,650 × 10/100 × 3/12)	766
		32,182			32,182

*(₹ 61,300 + ₹ 3,065 – ₹ 33,715) × 10/100 × 3/12 = ₹ 766.

Working Notes:

1. *Gain/(Sacrifice) of Each Partner:*

	A	*B*	*C*
New Share	1/2	1/2	...
Old Share	3/6	2/6	1/6
Gain/(Sacrifice)	1/2 – 3/6 = Nil	1/2 – 2/6 = 1/6	–1/6 (Sacrifice)

∴ *B* will compensate *C* for his share of Goodwill, *i.e.*, ₹ 30,000 × 1/6 = ₹ 5,000. He is only gaining partner.

2. Share of profit of *C* from 1st April, 2017 to 30th June, 2017 is debited to *B*'s Capital Account due to change in new profit-sharing ratio.
3. *C's* Share of profit = ₹ 4,08,000 × 1/6 × 3/12 = ₹ 17,000.
4. The date of closing the accounts is 31st March and date of payment of instalment is 30th June.

Illustration 6.

The Balance Sheet of *M*, *N* and *O* who are sharing profits and losses in the ratio of 5 : 3 : 2 respectively was as follows on 31st March, 2018:

Liabilities		₹	Assets		₹
Sundry Creditors		12,000	Goodwill		10,000
Employees' Provident Fund		6,000	Patents		52,000
Investment Fluctuation Reserve		7,000	Machinery		62,400
Workmen Compensation Reserve		7,000	Investment		6,000
Capital A/cs:			Stock		20,000
M	1,35,000		Sundry Debtors	24,000	
N	95,000		*Less:* Provision for Doubtful Debts	4,000	20,000
O	74,000	3,04,000	Loan to *O*		1,000
			Cash at Bank		600
			Advertisement Expenditure		2,000
			Profit and Loss A/c		1,50,000
			O's Drawings		12,000
		3,36,000			3,36,000

O died on 1st April, 2018 and *M* and *N* decide to share future profits and losses in the ratio of 3 : 5. It was agreed that:

(i) Goodwill of the firm be valued at 2½ years' purchase of average of four completed years' profits which were: 2014–15—₹ 2,02,000; 2015–16—₹ 28,000; 2016–17—₹ 32,000.

(ii) • Patents are undervalued by ₹ 14,000 and machinery overvalued by ₹ 13,600.
- All debtors are good. A debtor whose dues of ₹ 400 were written off as bad debts paid 50% in full settlement.
- Unaccounted Accrued Income of ₹ 2,200 is to be accounted.
- ₹ 1,000 included in Sundry Creditors is not likely to arise.
- A claim of ₹ 1,000 on account of Workmen Compensation to be provided for.

(iii) Investment be sold for ₹ 8,200 and a sum of ₹ 11,200 be paid to executors of *O* immediately. The balance to be paid in four equal half-yearly instalments with interest @ 10% p.a. at half year rest.

Show Revaluation Account, Capital Account of Partners and the Balance Sheet of the new firm.

Note: Firm enjoys bank overdraft facility.

Solution:

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Machinery A/c		13,600	By Patents A/c	14,000
To Gain (Profit) transferred to:			By Provision for Doubtful Debts A/c	4,000
M's Capital A/c	5,000		By Bad Debts Recovered A/c	200
N's Capital A/c	3,000		By Accrued Income A/c	2,200
O's Capital A/c	2,000	10,000	By Sundry Creditors A/c	1,000
			By Investment A/c	2,200
		23,600		23,600

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*M* (₹)	*N* (₹)	*O* (₹)	Particulars	*M* (₹)	*N* (₹)	*O* (₹)
To Drawings A/c	...	...	12,000	By Balance *b/d*	1,35,000	95,000	74,000
To Goodwill A/c	5,000	3,000	2,000	By Revaluation A/c (Profit)	5,000	3,000	2,000
To Profit and Loss A/c	75,000	45,000	30,000				
To *M*'s Capital A/c	...	8,750	...	By *N*'s Capital A/c (Goodwill) (WN 1)	8,750	...	14,000
To *O*'s Capital A/c	...	14,000	...				
To *O*'s Loan A/c	...	...	1,000	By Investment Fluctuation Reserve A/c	3,500	2,100	1,400
To Advertisement Expenditure A/c	1,000	600	400	By Workmen Compensation Reserve A/c	3,000	1,800	1,200
To Bank A/c	...	...	11,200				
To *O*'s Executors' A/c	...	...	36,000				
To Balance *c/d*	74,250	30,550	...				
	1,55,250	1,01,900	92,600		1,55,250	1,01,900	92,600

BALANCE SHEET OF THE NEW FIRM *as at 1st April, 2018*

Liabilities		₹	Assets	₹
Sundry Creditors		11,000	Patents	66,000
Employees' Provident Fund		6,000	Machinery	48,800
O's Executors' A/c		36,000	Stock	20,000
Workmen Compensation Claim		1,000	Sundry Debtors	24,000
Bank Overdraft (WN 3)		2,200	Accrued Income	2,200
M's Capital A/c	74,250			
N's Capital A/c	30,550	1,04,800		
		1,61,000		1,61,000

Working Notes:

1. *Calculation of Gain/(Sacrifice) of Each Partner:*

$$M\text{'s Gain} = 3/8 - 5/10 = \frac{15-20}{40} = -5/40 \text{ (Sacrifice)};$$

$$N\text{'s Gain} = 5/8 - 3/10 = \frac{25-12}{40} = 13/40 \text{ (Gain)}.$$

2. *Adjustment of Goodwill:*

$$\text{Firm's Goodwill} = \frac{(₹\,2{,}02{,}000 + ₹\,28{,}000 + ₹\,32{,}000 + ₹\,1{,}50{,}000)}{4} \times 2.5 = ₹\,70{,}000$$

M's Sacrificed Share of Goodwill = ₹ 70,000 × 5/40 = ₹ 8,750;

N's Gained Share of Goodwill = ₹ 70,000 × 13/40 = ₹ 22,750;

O's Sacrificed Share of Goodwill = ₹ 70,000 × 2/10 = ₹ 14,000.

N is the only gaining partner.

3. *Dr.* BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	600	By *O*'s Capital A/c	11,200
To Investment A/c (Sale)	8,200		
To Bad Debts Recovered A/c	200		
To Balance *c/d*	2,200		
	11,200		11,200

Illustration 7. *(Admission-cum-Death: Treatment of Goodwill).*

A and *B* are partners in a firm sharing profits in the ratio of 3 : 2. They admitted *C* as a partner for 1/5th share of profit on 1st April, 2018. He brings ₹ 4,500 as a premium out of his share of ₹ 6,000. On the same date *B* died. According to his will, the executors should donate his share to a school for providing scholarships to the students.

Pass Journal entries to give effect to the above.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
April 1	Cash A/c ...Dr.		4,500	
	To Premium for Goodwill A/c			4,500
	(A part of share of goodwill brought by *C*)			
April 1	Premium for Goodwill A/c ...Dr.		4,500	
	C's Current A/c ...Dr.		1,500	
	A's Capital A/c ...Dr.		6,000	
	To *B*'s Capital A/c			12,000
	(Sacrificing partner (*B*) compensated with the share of goodwill)			

Working Notes:

1. *Calculation of Sacrifice/(Gain) Share:*

	A	*B*	*C*
Old Share	3/5	2/5	...
New Share	4/5	...	1/5
	–1/5 Gain	2/5 Sacrifice	–1/5 Gain

2. *Calculation of Share of Goodwill:*
   For 1/5th Share of *C*, Goodwill = ₹ 6,000
   Value of Firm's Goodwill = ₹ 6,000 × 5/1 = ₹ 30,000
   For 2/5th sacrifice of *B*, value of Goodwill = ₹ 30,000 × 2/5 = ₹ 12,000
   For 1/5th Gain of *A*, value of Goodwill = ₹ 30,000 × 1/5 = ₹ 6,000.

Illustration 8. *(Death-cum-Admission: Share of Profit to the Deceased Partner).*

Ram, Manohar and Joshi were partners in a firm. Joshi died on 30th June, 2018 and on the same date his daughter Arpita is admitted for 1/5th share in profits. She brings ₹ 80,000 for her share of capital. Joshi left a will and according to it, his total dues were to be donated to an Old Age Home in the locality where business was being carried on. According to the agreement, the share of profits of a deceased partner up to the date of death is to be calculated on the basis of the average profits for the last five years. The net profits for the last 5 years ended 31st March, were: 2013–14—₹ 24,000; 2014–15—₹ 8,000; 2015–16—₹ 16,000; 2016–17—₹ 10,000 (loss) and 2017–18—₹ 16,000. Ram, Manohar and Arpita decided to visit old age homes regularly to help the aged people.

Pass Journal entries to give effect to the above.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
June 30	Profit and Loss Suspense A/c ...Dr.		900	
	To Joshi's Capital A/c			900
	(Share of profit credited to the deceased partner)			
	Bank A/c ...Dr.		80,000	
	To Arpita's Capital A/c			80,000
	(Arpita brings her share of capital in cash)			

Working Note:

$$\text{Average Profit} = \frac{₹\,24,000 + ₹\,8,000 + ₹\,16,000 - ₹\,10,000 + ₹\,16,000}{5} = \frac{₹\,54,000}{5} = ₹\,10,800$$

$$\text{Joshi's Share of Profit} = ₹\,10,800 \times \frac{3}{12} \times \frac{1}{3} = ₹\,900.$$

Illustration 9 (*Treatment of Goodwill*).

D, E, F, P and *Z* were partners in a firm sharing profits and losses in the ratio of 5 : 4 : 3 : 2 : 1 respectively. Unfortunately, *P* and *Z* met with a tragic car accident in which both of them died.

The goodwill of the firm was valued at ₹ 1,50,000 and *D, E* and *F* decided to share the future profits and losses in the ratio of 4 : 6 : 5.

Give the Journal entries to record the above.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	E's Capital A/c	...Dr.		20,000	
	F's Capital A/c	...Dr.		20,000	
	To *P*'s Capital A/c				20,000
	To *Z*'s Capital A/c				10,000
	To *D*'s Capital A/c				10,000
	(Goodwill adjusted by debiting gaining partners and crediting sacrificing partners)				

Working Note:

STATEMENT SHOWING THE REQUIRED ADJUSTMENT FOR GOODWILL

Partners	*D* (₹)	*E* (₹)	*F* (₹)	*P* (₹)	*Z* (₹)
Share of Goodwill before Death of *P* and *Z* (5 : 4 : 3 : 2 : 1)	50,000	40,000	30,000	20,000	10,000
Share of Goodwill after Death of *P* and *Z* (4 : 6 : 5)	40,000	60,000	50,000	...	...
Gain (+)/Sacrifice (–)	(–)10,000	(+)20,000	(+)20,000	(–)20,000	(–)10,000

Alternatively:

	D	*E*	*F*
I. Their New Shares	4/15	6/15	5/15
II. Their Old Shares	5/15	4/15	3/15
III. Gain/(Sacrifice) (I – II)	(1/15) (Sacrifice)	2/15 (Gain)	2/15 (Gain)

In this case, *D* has also sacrificed his share to the extent of 1/15 in favour of *E* and *F*. They are required to compensate *D* along with *P* and *Z* for their sacrifice.

Illustration 10.

Following is the Balance Sheet of Punita, Rashi and Seema who are sharing profits in the ratio 2 : 1 : 2 as on 31st March, 2013:

Liabilities			₹	Assets	₹
Creditors			38,000	Building	2,40,000
Bills Payable			2,000	Stock	65,000
Capital A/cs:	Punita	1,44,000		Debtors	30,000
	Rashi	92,000		Cash at bank	5,000
	Seema	1,24,000	3,60,000	Profit and Loss A/c	60,000
			4,00,000		4,00,000

Punita died on 30th September 2013. She had withdrawn ₹ 44,000 from her capital on July 1, 2013. According to the partnership agreement, she was entitled to interest on capital @ 8% p.a. Her share of profit till the date of death was to be calculated on the basis of the average profits of the last three years. Goodwill was to be calculated on the basis of three times the average profits of the last four years. The profits for the years ended 2009–10, 2010–11 and 2011–12 were ₹ 30,000, ₹ 70,000 and ₹ 80,000 respectively.

Prepare Punita's Capital Account to be rendered to her executors. *(Sample Paper 2015)*

Solution:

Dr. PUNITA'S CAPITAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Bank A/c (Drawings)	44,000	By Balance *b/d*	1,44,000
To Profit and Loss A/c (₹ 60,000 × 2/5)	24,000	By Interest on Capital A/c (WN 1)	4,880
To Punita's Executors' A/c (Balancing Figure)	1,22,880	By Profit and Loss Suspense A/c (WN 2)	6,000
		By Rashi's Capital A/c (WN 3)	12,000
		By Seema's Capital A/c (WN 3)	24,000
	1,90,880		1,90,880

Working Notes:

1. *Interest on Capital* = ₹ 1,44,000 × 8/100 × 3/12 = ₹ 2,880
   = ₹ 1,00,000 × 8/100 × 3/12 = ₹ 2,000
   Total = ₹ 4,880

2. *Punita's Share in Profit till Death* = $\dfrac{(₹\ 70{,}000 + ₹\ 80{,}000 - ₹\ 60{,}000)}{3} \times 6/12 \times 2/5 = ₹\ 6{,}000.$

3. *Value of Firm's Goodwill* = $\dfrac{₹\ 30{,}000 + ₹\ 70{,}000 + ₹\ 80{,}000 - ₹\ 60{,}000}{4} \times 3 = ₹\ 90{,}000.$

   Punita's Share in Goodwill = ₹ 90,000 × 2/5 = ₹ 36,000, which is contributed by Rashi and Seema in their gaining ratio, *i.e.*, 1 : 2.

Illustration 11.

Dev, Swati and Sanskar were partners in a firm sharing profits in the ratio of 2 : 2 : 1. On 31st March, 2014, their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Capital A/cs:			Building	1,04,000
Dev	77,000		Inventory	16,000
Swati	87,000		Trade Receivables	23,000
Sanskar	46,000	2,10,000	Cash	40,000
Trade Payables		17,000	Profit and Loss A/c	57,000
Bank Loan		13,000		
		2,40,000		2,40,000

On 30th June, 2014 Dev died. According to partnership agreement, Dev was entitled to interest on capital at 12% per annum. His share of profit till the date of his death was to be calculated on the basis of the average profits of last four years. The profits of the last four years were:

Year	2010–11	2011–12	2012–13	2013–14
Profit (₹)	2,04,000	1,80,000	90,000	(57,000) Loss

On 1st April, 2014, Dev withdrew ₹ 15,000 to pay for his medical bills.

Prepare Dev's Account to be presented to his executors. *(Delhi 2015)*

Solution:

Dr. DEV'S CAPITAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Drawings A/c (Medical Bills)	15,000	By Balance *b/d*	77,000
To Profit and Loss A/c (WN 3)	22,800	By Interest on Capital A/c (WN 1)	2,310
To Dev's Executors' A/c (Balancing Figure)	51,935	By Profit and Loss Suspense A/c (WN 2)	10,425
	89,735		89,735

Working Notes:

1. Date of Death of Dev = 30th June, 2014

Period from 1st April, 2014 to 30th June, 2014 = 3 Months.

$$\textit{Interest on Dev's Capital} = ₹\,77{,}000 \times \frac{12}{100} \times \frac{3}{12} = ₹\,2{,}310.$$

2. *Calculation of Dev's Share in Profit:*

(i) Average Profit of the Firm = $\dfrac{₹(2{,}04{,}000 + 1{,}80{,}000 + 90{,}000 - 57{,}000)}{4} = ₹\,1{,}04{,}250.$

(ii) Dev's Share of Profit = ₹ 1,04,250 × 2/5 × 3/12 = ₹ 10,425.

3. *Share in Profit and Loss A/c (Debit Balance of Profit and Loss A/c)* = ₹ 57,000 × 2/5 = ₹ 22,800.

Illustration 12.

A, B and *C* are partners sharing profits in the ratio of 4 : 3 : 1. As per Partnership Deed, 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.

B died on 1st May, 2018. The firm's profits for the last four years ended 31st March, were:

2015—₹ 1,00,000; 2016—₹ 80,000; 2017—₹ 60,000; 2018—₹ 1,60,000.

Calculate the amount that should be credited to *B* in respect of his share of goodwill.

Solution: Total Profit for the last 4 years = ₹ (1,00,000 + 80,000 + 60,000 + 1,60,000)
= ₹ 4,00,000.

Profit credited to *B* during the last 4 years = ₹ 4,00,000 × 3/8 = ₹ 1,50,000.

B's Share of Goodwill is valued at half of the profits credited to his Account during the last 4 years = ₹ 1,50,000 × 1/2 = ₹ 75,000.

Unsolved Questions

1. *DK*, *PK* and *GK* were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. *PK* died on 31st May, 2018. 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 of profits before death. Profits for the years ended 31st December, 2015, 2016 and 2017 were ₹ 17,000; ₹ 15,000 and ₹ 13,000 respectively.

   Calculate *PK*'s share of profit till his death and pass the necessary Journal entry for the same.

   [**Ans.:** *PK's Share of Profit—₹ 1,875.*]

2. From the following information, estimate share of the deceased partner in profits from the accounting date till the date of death:

Sales for the year 2017—₹ 4,00,000; Profit for the year 2017—₹ 80,000; Date of death 1.4.2018; Sales from 1.1.2018 to 31.3.2018—₹ 70,000; Share of deceased partner—2/5.

[**Ans.:** *% of Profit to Sales—20%; Profit for the relevant period—₹ 14,000; Share of the deceased partner—₹ 5,600.*]

3. *X*, *Y* and *Z* were partners in a firm. *Z* died on 31st May, 2018. 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 of profits before death. Profits for the years ended 31st March, 2016, 2017 and 2018 were ₹ 18,000; ₹ 19,000 and ₹ 17,000 respectively.

Calculate *Z*'s share of profit till his death and pass necessary Journal entry for the same when:

(i) profit-sharing ratio of remaining partners does not change, and

(ii) profit-sharing ratio of remaining partners changes, new ratio being 3 : 2.

[**Ans.:** *(i) Dr. Profit and Loss Suspense A/c and Cr. Z's Capital A/c—₹ 1,000; (ii) Dr. X's Capital A/c—₹ 800; Y's Capital A/c—₹ 200; Cr. Z's Capital A/c—₹ 1,000.*]

4. The Balance Sheet of *A*, *B* and *C*, who were sharing profit in the ratio of 3 : 3 : 4, as on 31st March, 2018 was as follows:

Liabilities		₹	Assets	₹
Bills Payable		5,000	Cash	16,000
Loan		12,000	Bank	50,000
General Reserve		10,000	Stock	44,000
Capitals A/cs:			Furniture	47,000
A	60,000		Land and Building	60,000
B	60,000		*A*'s Loan	10,000
C	80,000	2,00,000		
		2,27,000		2,27,000

A died on 30th June, 2018. The Partnership Deed provided for the following on the death of a partner:

(i) Goodwill of the firm be valued at two years' purchase of average profit for the last three years.

(ii) Share of profit or loss till the date of death was to be calculated on the basis of sales. Sales for the year ended 31st March, 2018 amounted to ₹ 4,00,000 and that from 1st April to 30th June, 2018 to ₹ 1,50,000. The profit for the year ended 31st March, 2018 was ₹ 1,00,000.

(iii) Interest on Capital was to be provided @ 6% p.a.

(iv) The average profit of the last three years was ₹ 42,000.

(v) According to *A*'s will, the executors should donate his share to a "Home meant for Physically Challenged Children".

Prepare *A*'s Capital Account to be rendered to his executors.

[**Ans.:** *A's Executors' A/c—₹ 90,350; A's Share of Profit—₹ 11,250; A's Share of Goodwill—₹ 25,200.*]

5. Anil, Bhanu and Chandu were partners in a firm sharing profits in the ratio of 5 : 3 : 2. On 31st March, 2018, their Balance Sheet was as under:

Liabilities		₹	Assets	₹
Creditors		91,000	Buildings	2,00,000
Bank Overdraft		1,00,000	Machinery	30,000
Reserve Fund		6,000	Stock	10,000
Capital A/cs:			Patents	11,000
Anil	30,000		Debtors	8,000
Bhanu	25,000		Cash	8,000
Chandu	15,000	70,000		
		2,67,000		2,67,000

Due to an accident, Anil died on 1st October, 2018. Anil's family became financially weak. Bhanu and Chandu decided to admit Anil's daughter in the business. It was agreed between Anil's executors and the remaining partners that:

(a) Goodwill to be valued at 2½ years' purchase of the average profit of the previous four years which were: Year 2014–15: ₹ 13,000; Year 2015–16: ₹ 12,000; Year 2016–17: ₹ 20,000; Year 2017–18: ₹ 15,000.

(b) Patents be valued at ₹ 8,000; Machinery at ₹ 28,000; and Building at ₹ 2,50,000.

(c) Profit for the year 2018–19 be taken as having accrued at the same rate as that of the previous year.

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

(e) Half of the amount due to Anil be paid immediately.

Prepare Anil's Capital Account and Anil's Executors' Account as on 1st October, 2018.

[**Ans.:** *Anil's Share of Goodwill—₹ 18,750; Anil's Share of Profit—₹ 3,750. Amount Paid to Anil's Executors—₹ 39,750; Amount still payable to Anil's Executors—₹ 39,750.*]

6. *X, Y* and *Z* were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. *Z* died on 31st March, 2018. The Balance Sheet of the firm as at that date was:

Liabilities		₹	Assets	₹
X's Capital A/c	1,20,000		Plant and Machinery	1,20,000
Y's Capital A/c	80,000		Furniture and Fittings	75,000
Z's Capital A/c	40,000	2,40,000	Investments	20,000
X's Current A/c	8,000		Stock-in-Trade	32,000
Y's Current A/c	2,500	10,500	Sundry Debtors	25,000
Reserve		30,000	Bills Receivable	11,000
Bills Payable		17,000	Cash at Bank	11,000
Sundry Creditors		20,000	Cash in Hand	18,500
			Z's Current A/c	5,000
		3,17,500		3,17,500

The following decisions were taken by the remaining partners:

(a) A Provision for Doubtful Debts is to be raised at 5% on Sundry Debtors.

(b) While Plant and Machinery is to be depreciated by 10%, Furniture and Stock-in-Trade are to be appreciated by 5% and 10% respectively.

(c) Advertising Expenses ₹ 2,100 are to be carried forward to the next accounting year and, therefore, it is to be adjusted through the Revaluation Account.

(d) Goodwill of the firm is valued at ₹ 30,000.

(e) The Fixed Capital Accounts Method is to be converted into the Fluctuating Capital Accounts Method by transferring the Current Account balances to the respective Partners' Capital Accounts.

Prepare the Revaluation Account and Partners' Capital Accounts.

[**Ans.:** *Loss on Revaluation—₹ 4,200; Capital Account Balances: X—₹ 1,37,900; Y—₹ 89,100; Z's Executors' A/c—₹ 44,300.*]

CHAPTER 8

Dissolution of a Partnership Firm

MEANING OF KEY TERMS USED IN THIS CHAPTER

1. **Dissolution of Firm**	**Dissolution of the firm** means business of the firm comes to an end. Assets of the firm are sold and liabilities are paid. In effect, economic relationship among the partners comes to an end.
2. **Dissolution of Partnership**	It means change in economic relationship among partners of the firm but the firm continues its business. In other words, there is dissolution of partnership whenever a partnership is reconstituted, *viz*., admission, retirement, death or insolvency of a partner.
3. **Firm's Debts**	Firm's Debts means the debts owed by the firm to outsiders.
4. **Private Debts**	Private Debts means debts owed by a partner to any other person.
5. **Realisation Account**	It is the account to which assets owned by the firm and liabilities owed to outsiders are transferred at the time of firm's dissolution. Amounts realised from assets and payments of liabilities are recorded in this account. The balance is Gain (Profit) or Loss on realisation of assets and settlement of liabilities.
6. **Unrecorded Assets**	Assets which are not recorded in the books (Balance Sheet) of the firm but exist are called **unrecorded assets**.
7. **Unrecorded Liability**	Liability which is not recorded in the books of the firm but payable is known as **unrecorded liability**.

CHAPTER SUMMARY

- **Dissolution of a partnership between all the partners of a firm is called Dissolution of the Firm:** In case of dissolution of a firm, the business of the firm is closed, assets are realised and liabilities are paid.
- **Dissolution of partnership refers to the change in the existing relations of the partners:** The firm continues its business. It may take place on admission/retirement/death/insolvency of a partner or change in the profit-sharing ratio.

Settlement of Accounts (Section 48)

- **Treatment of Losses:** Losses including deficiencies of capital are to be paid in the following order:
  - (i) First out of profits of the firm;
  - (ii) Then out of capitals of the partners;
  - (iii) Lastly by partners individually in their profit-sharing ratio. [Section 48(a)]
- **Application of Assets:** Assets of the firm, including any sum contributed by the partners to meet the deficiencies of capital are applied in the following order:
  - (i) In paying firm's debts to the third parties;
  - (ii) In paying to each partner rateably what is due to him on account of loans and advances;
  - (iii) In paying to each partner rateably what is due to him on account of capital; and
  - (iv) The surplus, if any, is distributed among the partners in their profit-sharing ratio. [Section 48(b)]

Treatment of Firm's Debts and Private Debts (Section 49)

(a) Firm's property is applied first towards the payment of firm's debts; then the surplus, if any, is applied towards the payment of partner's private debts to the extent to which the concerned partner is entitled to share in the surplus; and

(b) Partner's private property is applied first in payment of his private debts and the surplus, if any, in payment of firm's debts if the firm's liabilities exceed the firm's assets.

- **Closing of Firm's Books:** Firm's books are closed by preparing the following accounts:
  (i) Realisation Account; (ii) Loan by Partner Account; (iii) Loan by Firm to Partner Account; (iv) Partners' Capital Accounts; and (v) Bank or Cash Account.
- **Realisation Account:** It is prepared on dissolution of a firm. The object or purpose of preparing the account is to determine gain (profit) or loss on realisation of assets and payment of liabilities.

Accounting Entries Relating to Realisation Account

Transfer of assets (except cash and bank balances)	Realisation A/c To Sundry Assets A/c	...Dr.	[At book value]
Transfer of liabilities (except partners' loan, capital and undistributed profits)	Sundry Liabilities A/c To Realisation A/c	...Dr.	[At book value]
Sale of assets	Bank/Cash A/c To Realisation A/c	...Dr.	[At selling price]
Assets taken over by a partner	Concerned Partner's Capital A/c To Realisation A/c	...Dr.	[At agreed value]
Assets taken over by a Partner against Payment of his Loan	Partner's Loan A/c To Realisation A/c To Realisation A/c	...Dr.	[With Loan Amount] [Agreed Value] [Loan Amount *less* Agreed Value]
Sale of unrecorded asset	Bank/Cash A/c To Realisation A/c	...Dr.	[Amount received on sale]
Payment of liabilities	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Any liability taken over by a partner	Realisation A/c To Concerned Partner's Capital A/c	...Dr.	[At agreed value]
Payment of realisation expenses paid by the firm	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Payment of unrecorded liability (which did not appear in the Balance Sheet)	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Payment of realisation expenses by any partner on firm's behalf	Realisation A/c To Concerned Partner's Capital A/c	...Dr.	[Amount of payment]
Credit balance of Realisation Account Gain(Profit)	Realisation A/c To Partners' Capital A/cs	...Dr.	[In profit-sharing ratio]
Debit balance of Realisation Account (Loss)	Partners' Capital A/cs To Realisation A/c	...Dr.	[In profit-sharing ratio]

Points to Remember

- An Asset (*e.g.*, Debtors) against which a provision or reserve exists, is transferred to Realisation Account at its gross value.
- *Fictitious asset* like debit balance of Profit and Loss Account or Deferred Revenue Expenditure *is not transferred* to *Realisation Account*. It is debited to Partners' Capital Accounts in their profit-sharing ratio.
- Balances of *Partners' Capital Accounts/Current Accounts* are not transferred to *Realisation Account*.
- Balances of *Partners' Current Accounts* are transferred to respective Partners' Capital Accounts.
- Loan provided by the firm to the partner is transferred to the debit side of his Capital Account.
- Balance of *Realisation Account* means gain (profit) (if it has credit balance) and loss (if it has debit balance) on *realisation*.
- Gain (Profit) or Loss on *realisation* is transferred to Partners' Capital Accounts in the profit-sharing ratio.
- Balance at Bank is not transferred to Realisation Account.
- ***If the question is silent about the realisation of any asset***, it is assumed that such asset has not realised any amount.
- ***If the question is silent about the payment of a liability***, it has to be paid out in full.

Solved Questions

Illustration 1.

Pass Journal entries for the following transactions:

(i) Realisation expenses amounted to ₹ 10,000.

(ii) Realisation expenses amounted to ₹ 5,000 were paid by a partner.

(iii) Realisation expenses amounted to ₹ 5,000 were paid by the firm on behalf of a partner.

(iv) A partner was paid remuneration (including expenses) of ₹ 7,500 to carry out dissolution of the firm. Actual expenses were ₹ 10,000.

(v) Dissolution expenses were ₹ 8,000. Out of the said expenses, ₹ 3,000 were to be borne by the firm and the balance by a partner. ₹ 8,000 are paid by the firm.

(vi) Dissolution expenses were ₹ 8,000; ₹ 3,000 were to be borne by the firm and the balance by a partner. The expenses were paid by a partner.

(vii) Realisation expenses of ₹ 5,000 were to be borne and paid by a partner.

(viii) *X*, the partner, is paid remuneration of ₹ 5,000 for completing the dissolution process. Realisation expenses of ₹ 8,000 are met by the firm.

(ix) Realisation expenses of ₹ 5,000 were to be borne by *X*, a partner. However, it was paid by *Y*.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Realisation A/c ...Dr. To Cash/Bank A/c (Dissolution expenses paid) **Explanation:** The expenses of dissolution are borne and paid by the firm, since the question does not specify who is to bear the dissolution expenses. Therefore, the expenses are treated to be expenses of the firm.		10,000	 10,000
(ii)	Realisation A/c ...Dr. To Concerned Partner's Capital A/c (Dissolution expenses paid by the partner credited to his Capital Account) **Explanation:** The expenses of dissolution are borne by the firm but paid by the partner on behalf of the firm. Therefore, Concerned Partner's Capital Account is credited.		5,000	 5,000
(iii)	Concerned Partner's Capital A/c ...Dr. To Cash/Bank A/c (Dissolution expenses paid by the firm on behalf of the partner debited to his Capital Account) **Explanation:** The expenses of dissolution are borne by the partner but are paid by the firm. Therefore, Concerned Partner's Capital Account is debited. Since the amount is paid by the firm, Cash/Bank Account is credited.		5,000	 5,000

(iv)	Realisation A/c ...Dr. To Concerned Partner's Capital A/c (Remuneration to partner credited to his Capital Account) **Explanation:** Partner is paid ₹ 7,500 towards his remuneration and expenses of dissolution. The excess expenses, *i.e.*, ₹ 2,500 (₹ 10,000 – ₹ 7,500) will be borne by the partner and not by the firm.		7,500	7,500
(v)	Realisation A/c ...Dr. Concerned Partner's Capital A/c ...Dr. To Cash/Bank A/c (Dissolution expenses paid by the firm, firm's share of expenses debited to Realisation Account and balance to Concerned Partner's Capital Account) **Explanation:** Total expenses of dissolution are ₹ 8,000. Out of this, ₹ 3,000 is to be borne by the firm and balance ₹ 5,000 by the partner. Therefore, ₹ 3,000 is debited to Realisation Account. Balance ₹ 5,000 is debited to Concerned Partner's Capital Account. Cash/Bank Account is credited because the expenses are paid by the firm.		3,000 5,000	 8,000
(vi)	Realisation A/c ...Dr. To Concerned Partner's Capital A/c (Realisation expenses paid by the partner credited to his Capital Account) **Explanation:** Total expenses of dissolution ₹ 8,000 are paid by the partner. Out of these expenses, firm is to bear ₹ 3,000. Since the partner has paid the dissolution expenses on behalf of the firm, Realisation Account is debited and Concerned Partner's Capital Account is credited with ₹ 3,000. Entry is not passed for ₹ 5,000, it being borne and also paid by the partner.		3,000	3,000
(vii)	No entry is to be passed. **Explanation:** Entry for expenses of dissolution will not be passed because the expenses (₹ 5,000) are borne and also paid by the partner.			
(viii)	(a) Realisation A/c ...Dr. To *X*'s Capital A/c (Remuneration payable to *X* for completing dissolution process) (b) Realisation A/c ...Dr. To Cash/Bank A/c (Realisation expenses paid) **Explanation:** *X*, the partner, is paid ₹ 5,000 as remuneration for completing dissolution process. However, the expenses of dissolution are met by the firm. Therefore, *X*'s Capital A/c is credited with ₹ 5,000 (remuneration) and ₹ 8,000 being expenses met by the firm is debited to Realisation Account and credited to Cash/Bank A/c.		5,000 8,000	 5,000 8,000
(ix)	*X*'s Capital A/c ...Dr. To *Y*'s Capital A/c (Realisation expenses to be borne by *X*, paid by *Y*)		5,000	5,000

Illustration 2 (*Dissolution—Journal Entries*).

What Journal entries will be passed in the books of *A* and *B* sharing profits and losses in the ratio of 3 : 1, for the following transactions on dissolution of the firm?

(i) An unrecorded asset realised ₹ 25,000.

(ii) Stock of ₹ 20,000 was taken by partner *A*.

(iii) Creditors were paid ₹ 30,000.

(iv) *B* to bear realisation expenses for which he will get ₹ 1,900. The actual expenses paid by *B* were ₹ 1,500.

(v) There was a balance of ₹ 10,000 in the General Reserve Account on the date of dissolution.

(vi) Gain (Profit) on Realisation of ₹ 40,000 is to be distributed between partners *A* and *B* in the ratio of 3 : 1.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Bank A/c	...Dr.		25,000	
	To Realisation A/c				25,000
	(Realisation of an unrecorded asset)				
(ii)	*A*'s Capital A/c	...Dr.		20,000	
	To Realisation A/c				20,000
	(Stock taken by *A*)				
(iii)	Realisation A/c	...Dr.		30,000	
	To Bank A/c				30,000
	(Payment made to creditors)				
(iv)	Realisation A/c	...Dr.		1,900	
	To *B*'s Capital A/c (Note)				1,900
	(Expenses payable to *B*)				
(v)	General Reserve A/c	...Dr.		10,000	
	To *A*'s Capital A/c				7,500
	To *B*'s Capital A/c				2,500
	(Transfer of General Reserve)				
(vi)	Realisation A/c	...Dr.		40,000	
	To *A*'s Capital A/c				30,000
	To *B*'s Capital A/c				10,000
	(Transfer of realisation gain (profit))				

Note: When it is agreed that partner will bear the realisation expenses and for this he is paid an agreed amount, then amount payable to the partner is debited for expenses.

Illustration 3.

Pass necessary Journal entries for the following transactions on dissolution of the firm of Sudha and Shiva after various assets (other than cash) and outside liabilities have been transferred to Realisation Account:

(i) Sudha agreed to pay off her husband's loan ₹ 19,000.

(ii) A Debtor whose debt of ₹ 9,300 was written off as bad in the books paid ₹ 7,500 in full settlement.

(iii) Shiva took over all Investments at ₹ 13,300.

(iv) Sundry Creditors ₹ 10,000 were paid at 9% discount.

(v) Realisation expenses ₹ 3,400 were paid by Sudha for which she was allowed ₹ 3,000.

(vi) Loss on realisation ₹ 9,400 was divided between Sudha and Shiva in 3 : 2 ratio. *(AI 2011)*

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Realisation A/c	...Dr.		19,000	
	To Sudha's Capital A/c				19,000
	(Sudha's husband loan taken by Sudha)				
(ii)	Bank A/c	...Dr.		7,500	
	To Realisation A/c				7,500
	(Bad debts recovered)				
(iii)	Shiva's Capital A/c	...Dr.		13,300	
	To Realisation A/c				13,300
	(Investments taken by Shiva)				
(iv)	Realisation A/c	...Dr.		9,100	
	To Bank A/c				9,100
	(Sundry creditors settled)				
(v)	Realisation A/c	...Dr.		3,000	
	To Sudha's Capital A/c				3,000
	(Realisation expenses borne by Sudha)				
(vi)	Sudha's Capital A/c	...Dr.		5,640	
	Shiva's Capital A/c	...Dr.		3,760	
	To Realisation A/c				9,400
	(Loss on realisation transferred to Partners' Capital Accounts)				

Illustration 4.

Disha, Mohit and Nandan are partners. They decide to dissolve their firm. Pass necessary Journal entries for the following after various assets (other than Cash and Bank) and the third party liabilities have been transferred to Realisation Account.

(i) An old typewriter which was not recorded in the books was sold for ₹ 2,000 whereas its expected value was ₹ 5,000.

(ii) Stock of ₹ 70,000 was taken by Disha at a discount of 30%.

(iii) Total creditors of the firm were ₹ 20,000. A creditor for ₹ 2,000 was untraceable and other creditors accepted payment allowing 10% discount.

(iv) Mohit paid realisation expenses of ₹ 18,000 out of his private funds, who was to get remuneration of ₹ 13,000 for completing the dissolution process and was responsible to bear all realisation expenses.

(v) Nandan had taken a loan of ₹ 50,000 from the firm, which was paid fully by him to the firm.

(vi) ₹ 12,000 were recovered from a Debtor which was written off as Bad Debts last year.

(Delhi 2012 C)

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Bank A/c ...Dr.		2,000	
	To Realisation A/c			2,000
	(Unrecorded typewriter sold for ₹ 2,000)			
(ii)	Disha's Capital A/c ...Dr.		49,000	
	To Realisation A/c			49,000
	(Stock of ₹ 70,000 taken by Disha at a discount of 30%)			
(iii)	Realisation A/c ...Dr.		16,200	
	To Bank A/c			16,200
	(Payment made to creditors)			
(iv)	Realisation A/c ...Dr.		13,000	
	To Mohit's Capital A/c			13,000
	(Remuneration credited for completing the dissolution process)			
(v)	Bank A/c ...Dr.		50,000	
	To Loan to Nandan A/c			50,000
	(Loan advanced to Nandan recovered)			
(vi)	Bank A/c ...Dr.		12,000	
	To Realisation A/c			12,000
	(₹ 12,000 recovered from a debtor which was written off as Bad Debts last year)			

Illustration 5.

Parul, Payal and Priyanka are partners. They decided to dissolve their firm. Pass necessary Journal entries for the following after various assets (other than Cash and Bank) and the third party liabilities have been transferred to Realisation Account:

(i) There were total Debtors of ₹ 76,000. A Provision for Doubtful Debts also stood in the books at ₹ 6,000. ₹ 12,000 Debtors proved bad and rest paid the amount due.

(ii) Parul agreed to pay off her husband's loan of ₹ 7,000 at a discount of 5%.

(iii) A machine which was not recorded in the books was taken over by Payal at ₹ 3,000, whereas its expected value was ₹ 5,000.

(iv) A contingent liability (not provided for) of ₹ 4,000 was also discharged.

(v) The firm had a debit balance of ₹ 27,000 in the Profit and Loss Account on the date of dissolution.

(vi) Priyanka paid realisation expenses of ₹ 15,000 out of her pocket and she was to get a remuneration of ₹ 18,000 for completing the dissolution process. *(AI 2012 C)*

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Bank A/c	...Dr.		64,000	
	To Realisation A/c				64,000
	(Debtors of ₹ 12,000 proved bad and rest paid the amount)				
(ii)	Realisation A/c	...Dr.		6,650	
	To Parul's Capital A/c				6,650
	(Parul agreed to pay off her husband's loan at a discount of 5%)				
(iii)	Payal's Capital A/c	...Dr.		3,000	
	To Realisation A/c				3,000
	(Unrecorded machine taken by Payal)				
(iv)	Realisation A/c	...Dr.		4,000	
	To Bank A/c				4,000
	(Contingent liability discharged)				
(v)	Parul's Capital A/c	...Dr.		9,000	
	Payal's Capital A/c	...Dr.		9,000	
	Priyanka's Capital A/c	...Dr.		9,000	
	To Profit and Loss A/c				27,000
	(Accumulated loss distributed)				
(vi)	Realisation A/c	...Dr.		33,000	
	To Priyanka's Capital A/c				33,000
	(Realisation expenses of ₹ 15,000 paid by Priyanka and remuneration of ₹ 18,000 also credited to her account)				

Illustration 6.

Hanif and Jubed were partners in a firm sharing profits in the ratio of their capitals. On 31st March, 2013, their Balance Sheet was as follows:

BALANCE SHEET OF HANIF AND JUBED *as at 31st March, 2013*

Liabilities		₹	Assets	₹
Creditors		1,50,000	Bank	2,00,000
Workmen Compensation Reserve		3,00,000	Debtors	3,40,000
General Reserve		75,000	Stock	1,50,000
Hanif's Current Account		25,000	Furniture	4,60,000
Capital A/cs:			Machinery	8,20,000
Hanif	10,00,000		Jubed's Current Account	80,000
Jubed	5,00,000	15,00,000		
		20,50,000		20,50,000

On the above date the firm was dissolved:

(i) Debtors were realised at a discount of 5%. 50% of the stock was taken over by Hanif at 10% less than the book value. Remaining stock was sold for ₹ 65,000.

(ii) Furniture was taken over by Jubed for ₹ 1,35,000. Machinery was sold as scrap for ₹ 74,000.

(iii) Creditors were paid in full.

(iv) Expenses on realisation ₹ 8,000 were paid by Hanif.

Prepare Realisation Account. *(AI 2014)*

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Debtors	3,40,000	By Creditors		1,50,000
To Stock A/c	1,50,000	By Bank A/c (Assets Realised):		
To Furniture A/c	4,60,000	Debtors (₹ 3,40,000 – 5%)	3,23,000	
To Machinery A/c	8,20,000	Stock	65,000	
To Bank A/c (Creditors)	1,50,000	Machinery	74,000	4,62,000
To Hanif's Capital A/c	8,000	By Hanif's Capital A/c		67,500
(Realisation Expenses)		(Stock) (₹ 75,000 – 10%)		
		By Jubed's Capital A/c (Furniture)		1,35,000
		By Loss transferred to:		
		Hanif's Capital A/c	7,42,333	
		Jubed's Capital A/c	3,71,167	11,13,500
	19,28,000			19,28,000

Illustration 7 (*Dissolution and Unrecorded Liability*).

Following is the Balance Sheet of Vishnu, Sanjiv and Sudhir as at 31st March, 2018:

Liabilities		₹	Assets		₹
Bills Payable		20,000	Cash/Bank		8,000
Creditors		18,000	Bills Receivable		12,000
Mrs. Vishnu's Loan		20,000	Stock		25,000
Outstanding Salary		5,000	Sundry Debtors	40,000	
Investments Fluctuation Fund		10,000	*Less*: Provision for		
Workmen Compensation Reserve		15,000	Doubtful Debts	4,000	36,000
Capital A/cs:			Land and Building		50,000
Vishnu	40,000		Furniture		10,000
Sanjiv	30,000		Computer		5,000
Sudhir	18,000	88,000	Investments		30,000
		1,76,000			1,76,000

Profit and loss sharing ratio of the partners is 5 : 3 : 2. On the above date, partners decided to dissolve the firm. The assets realised as follows:

Bills Receivable were realised at a discount of 5%. All Debtors were good. Stock realised ₹ 22,000. Land and Building realised at 40% higher than the book value. Furniture was sold for ₹ 8,000 by auction and auctioneer's commission amounted to ₹ 500. Computer was taken by Vishnu for an agreed valuation of ₹ 3,000. Investments were sold in the open market at a price of ₹ 35,000, for which a commission of ₹ 600 was paid to the broker. Bills Payable were paid at full amount. Creditors, however, agreed to accept 10% less. All other liabilities were paid at their book value. The firm retrenched their employees three months before the dissolution of the firm and firm had to pay ₹ 20,000 as compensation. This liability was not appearing in the above Balance Sheet. A Workmen Compensation Claim of ₹ 5,000 has arisen.

Close the books of the firm by preparing Realisation Account, Partners' Capital Accounts and Bank Account.

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars			₹
To Sundry Assets—Transfer:			By Sundry Liabilities:			
Bills Receivable	12,000		Bills Payable			20,000
Stock	25,000		Creditors			18,000
Sundry Debtors	40,000		Mrs. Vishnu's Loan			20,000
Land and Building	50,000		Outstanding Salary			5,000
Furniture	10,000		Investments Fluctuation Fund			10,000
Computer	5,000		Provision for Doubtful Debts			4,000
Investments	30,000	1,72,000	Workmen Compensation Reserve			5,000
To Cash/Bank A/c:			By Cash/Bank—Assets Realised:			
Bills Payable	20,000		Debtors		40,000	
Creditors	16,200	36,200	Stock		22,000	
To Cash/Bank A/c:			Land and Building		70,000	
Mrs. Vishnu's Loan	20,000		Furniture	8,000		
Outstanding Salary	5,000		*Less:* Commission	500	7,500	
Employees'			Investments	35,000		
Compensation	20,000		*Less:* Commission	600	34,400	
Workmen Compensation Claim	5,000	50,000	Bills Receivable		11,400	1,85,300
To Gain (Profit) transferred to:			By Vishnu's Capital A/c			3,000
Vishnu's Capital A/c	6,050		—Computer			
Sanjiv's Capital A/c	3,630					
Sudhir's Capital A/c	2,420	12,100				
		2,70,300				2,70,300

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Vishnu ₹	Sanjiv ₹	Sudhir ₹	Particulars	Vishnu ₹	Sanjiv ₹	Sudhir ₹
To Realisation A/c —Assets taken over	3,000	...	...	By Balance *b/d*	40,000	30,000	18,000
To Cash/Bank A/c (Bal. Fig.)	48,050	36,630	22,420	By Workmen Compensation Reserve A/c (WN)	5,000	3,000	2,000
				By Realisation A/c—Gain	6,050	3,630	2,420
	51,050	36,630	22,420		51,050	36,630	22,420

Dr. CASH/BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	8,000	By Realisation A/c—B/P and Creditors	36,200
To Realisation A/c—Assets Realised	1,85,300	By Realisation A/c—Liabilities	50,000
		By Vishnu's Capital A/c—Final Payment	48,050
		By Sanjiv's Capital A/c—Final Payment	36,630
		By Sudhir's Capital A/c—Final Payment	22,420
	1,93,300		1,93,300

Working Note: Compensation claim payable to workmen is ₹ 5,000, hence, amount of Workmen Compensation Reserve to the extent of claim is transferred to Realisation Account. The balance amount of Workmen Compensation Reserve is distributed among the partners in their profit-sharing ratio. If there was no liability then the whole amount of Workmen Compensation Reserve would have been credited to Partners' Capital Accounts in their profit-sharing ratio.

Illustration 8.

A, B and *C* were partners in a firm and shared profits in the ratio of 3 : 2 : 1. On 31st March, 2018 their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Creditors		65,000	Cash	22,500
Bills Payable		20,000	Debtors	52,300
Employees' Provident Fund		12,000	Stock	36,000
Investments Fluctuation Reserve		6,000	Investments	15,000
Commission Received in Advance		8,000	Plant	91,200
Capital A/cs:			Profit and Loss A/c	54,000
A	80,000			
B	50,000			
C	30,000	1,60,000		
		2,71,000		2,71,000

On this date the firm was dissolved. *A* was appointed to realise the assets. *A* was to receive 5% commission on the sale of assets and was to bear all expenses of realisation.

A realised the assets as follows:

Debtors ₹ 30,000; Stock ₹ 26,000; Investments 75% of book value; Plant ₹ 42,750. Expenses of realisation amounted to ₹ 4,100.

Commission received in advance was returned to the customers after deducting ₹ 3,000.

The firm had to pay ₹ 7,200 for outstanding salary not provided for earlier. Compensation paid to employees amounted to ₹ 9,800. This liability was not provided for in the above Balance Sheet. ₹ 25,000 had to be paid towards Employees' Provident Fund.

Prepare Realisation Account, Partners' Capital Accounts and Cash Account.

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Sundry Assets—Transfer:			By Creditors	65,000	
Debtors	52,300		By Bills Payable	20,000	
Stock	36,000		By Employees' Provident Fund	12,000	
Investments	15,000		By Investments Fluctuation Reserve	6,000	
Plant	91,200	1,94,500	By Commission Received in Advance	8,000	1,11,000
To *A's* Capital A/c (Commission)		5,500	By Cash A/c—Assets Realised:		
(5/100 × ₹ 1,10,000)			Debtors	30,000	
To Cash A/c—Liabilities Paid:			Stock	26,000	
Commission Received in			Investments	11,250	
Advance	5,000		Plant	42,750	1,10,000
Outstanding Salary	7,200		By Loss transferred to:		
Employees' Compensation	9,800		*A's* Capital A/c	55,500	
Employees' Provident Fund	25,000	47,000	*B's* Capital A/c	37,000	
To Cash A/c:			*C's* Capital A/c	18,500	1,11,000
Creditors	65,000				
Bills Payable	20,000	85,000			
		3,32,000			3,32,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Realisation A/c —Loss	55,500	37,000	18,500	By Balance *b/d*	80,000	50,000	30,000
To Profit and Loss A/c	27,000	18,000	9,000	By Realisation A/c —Commission	5,500	...	...
To Cash A/c	4,100*	...	...	By Cash A/c —Cash brought in	1,100	5,000	...
To Cash A/c —Final Payment	...	...	2,500				
	86,600	55,000	30,000		86,600	55,000	30,000

*Actual amount spent by *A* (to realise the assets) is treated as his drawings.

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	22,500	By Realisation A/c—Liabilities Paid	47,000
To Realisation A/c—Assets Realised	1,10,000	By Realisation A/c (₹ 65,000 + ₹ 20,000)	85,000
To *A*'s Capital A/c—Cash brought in	1,100	By *A*'s Capital A/c—Realisation Expenses	4,100
To *B*'s Capital A/c—Cash brought in	5,000	By *C*'s Capital A/c—Final Payment	2,500
	1,38,600		1,38,600

Illustration 9.

X and *Y* were partners in a firm sharing profits and losses in the ratio of 3 : 2. On 31st March, 2018, they decide to dissolve the partnership firm, when the Balance Sheet was as under:

Liabilities		₹	Assets		₹
Trade Creditors		1,60,000	Bank		72,000
Bills Payable		40,000	Stock		1,60,000
Loan from *X*		10,000	Debtors	1,32,000	
Loan from Mrs. *X*		30,000	*Less:* Provisions	12,000	1,20,000
Employees' Provident Fund		26,000	Plant and Machinery		60,000
Workmen Compensation Reserve		4,000	Land and Building		76,000
General Reserve		40,000	Investment (Face Value ₹ 5,000)		20,000
Profit and Loss A/c		30,000	Goodwill		30,000
X's Capital A/c	1,32,000		Prepaid Insurance		2,000
Y's Capital A/c	88,000	2,20,000	Deferred Revenue Advertisement Expenses		20,000
		5,60,000			5,60,000

Note: There is a bill for ₹ 5,000 under discount. The bill was received from *W*.

Give necessary Journal entries to record the transfer of Assets and Liabilities to Realisation Account.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018					
March 31	Realisation A/c	...Dr.		4,80,000	
	To Stock A/c				1,60,000
	To Debtors A/c				1,32,000
	To Plant and Machinery A/c				60,000
	To Land and Building A/c				76,000
	To Investment A/c				20,000
	To Goodwill A/c				30,000
	To Prepaid Insurance A/c				2,000
	(Transfer of assets to Realisation A/c)				
	Trade Creditors A/c	...Dr.		1,60,000	
	Bills Payable A/c	...Dr.		40,000	
	Loan from Mrs. *X* A/c	...Dr.		30,000	
	Provision for Doubtful Debts A/c	...Dr.		12,000	
	Employees' Provident Fund A/c	...Dr.		26,000	
	To Realisation A/c				2,68,000
	(Transfer of Liabilities and Provisions to Realisation Account)				

Illustration 10.

Taking the same Balance Sheet as given in Illustration 9 along with the following information, give the necessary Journal entries to record the realisation of various assets and payment of various liabilities:

(i) *X* took over 60% of the stock at a discount of 20%.

(ii) Remaining stock was sold at a profit of 20% on cost.

(iii) ₹ 20,000 of the book debts proved bad.

(iv) Land and Building sold for ₹ 5,00,000 through broker who charged 2% commission.

(v) Half the trade creditors accepted plant and machinery at an agreed valuation of ₹ 54,000 and cash in full settlement of their claims after allowing discount of ₹ 16,000.

(vi) Investment realised 200% of their face value.

(vii) '*Y*' undertook to pay Mrs. *X*'s loan.

(viii) Remaining trade creditors were paid 90% in final settlement including an investment of ₹ 4,000 unrecorded in the books.

(ix) Bills Payable falling due on 30th April, 2018 were discharged at a discount of 12% p.a.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	X's Capital A/c (₹ 96,000 – ₹ 19,200)	...Dr.		76,800	
	To Realisation A/c				76,800
	(60% of the stock taken over by *X* at a discount of 20%)				
	Bank A/c	...Dr.		6,88,800	
	To Realisation A/c				6,88,800
	(Stock (₹ 64,000 + ₹ 12,800), Debtors (₹ 1,12,000), Land and Building (₹ 4,90,000) and Investment (₹ 10,000) realised)				
	Realisation A/c	...Dr.		30,000	
	To *Y*'s Capital A/c				30,000
	(Payment made of Mrs. *X*'s Loan by *Y*)				
	Realisation A/c	...Dr.		1,17,600	
	To Bank A/c				1,17,600
	(Payment made to creditors 90% of ₹ 80,000 – ₹ 4,000 + ₹ 10,000 and bills payables (₹ 40,000 – ₹ 400))				

Illustration 11.

The book value of assets (other than cash and bank) transferred to Realisation Account was ₹ 5,00,000. 50% of the assets were taken by a partner '*X*' at a discount of 10%, 40% of the remaining were sold off at a profit of 25% on cost and 10% of the balance being obsolete realised nothing and remaining were handed over to a creditor in full settlement. Give Journal entries to record the realisation of assets.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	X's Capital A/c	...Dr.		2,25,000	
	Bank A/c	...Dr.		1,25,000	
	To Realisation A/c				3,50,000
	(Assets having book value of ₹ 2,50,000 taken away by '*X*' for ₹ 2,25,000 and the assets having book value of ₹ 1,00,000 sold for ₹ 1,25,000)				

Illustration 12.

The amount of liabilities transferred to Realisation Account was ₹ 3,50,000. 50% of the liabilities were paid out at a discount of 5%. 50% of the remaining were undertaken by a partner '*Z*' to pay. Remaining creditors accepted the stock at an agreed value of ₹ 1,00,000 and cash ₹ 3,500 in full settlement.

Give Journal entries to record the payment of liabilities.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Realisation A/c	...Dr.		2,57,250	
	To Bank A/c				1,69,750
	To *Z*'s Capital A/c				87,500
	(Payment made to creditors, 50% of ₹ 3,50,000 – ₹ 8,750 + ₹ 3,500 = ₹ 1,69,750 and the liabilities of ₹ 87,500 undertaken by *Z*)				

Illustration 13.

A, *B* and *C* share profits of a business in the ratio of 2 : 2 : 1 respectively. They decide to dissolve the firm on 31st March, 2018. Give the necessary Journal entries to record the realisation of following unrecorded assets in the books of the firm:

(i) There is an old typewriter which had been written off completely from the books. It is estimated to realise ₹ 2,000. It is taken by '*B*' a partner at the estimated price *less* 20%.

(ii) There was an old furniture in the firm which had been written of completely in the books. This was sold for ₹ 5,000.

(iii) '*Z*' an old customer whose account for ₹ 3,000 was written off as bad debt in the previous year, paid 40%.

(iv) '*B*' agreed to take over the firm's goodwill (not recorded in the books of the firm) at a valuation of ₹ 80,000.

(v) There were 1,000 shares of ₹ 100 each of Moontrack Ltd. acquired at a cost of ₹ 80,000 which had been written off completely from the books. These shares are valued at ₹ 50,000 and divided among the partners in their profit-sharing ratio.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	*B*'s Capital A/c	...Dr.		1,600	
	To Realisation A/c				1,600
	(Unrecorded typewriter taken by *B*)				
(ii)	Bank A/c	...Dr.		5,000	
	To Realisation A/c				5,000
	(Unrecorded furniture realised)				
(iii)	Bank A/c	...Dr		1,200	
	To Realisation A/c				1,200
	(Debt earlier written off recovered)				
(iv)	*B*'s Capital A/c	...Dr.		80,000	
	To Realisation A/c				80,000
	(Unrecorded goodwill taken over by *B*)				
(v)	*A*'s Capital A/c	...Dr.		20,000	
	B's Capital A/c	...Dr.		20,000	
	C's Capital A/c	...Dr.		10,000	
	To Realisation A/c				50,000
	(Unrecorded shares taken away by partners in their profit-sharing ratio)				

Illustration 14.

There was one unrecorded asset estimated at ₹ 15,000, half of which was given to settle unrecorded liability of ₹ 25,000 in settlement of a claim of ₹ 12,500 and remaining half was sold in the market at a profit of ₹ 1,000. Give necessary Journal entries.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c	...Dr.		8,500	
	To Realisation A/c				8,500
	(Remaining half of unrecorded asset realised 1/2 of ₹ 15,000 + ₹ 1,000 = ₹ 8,500)				
	Realisation A/c	...Dr.		12,500	
	To Bank A/c				12,500
	(Remaining half of unrecorded liability discharged) (Note)				

Note: No entry is to be passed for unrecorded asset given to settle unrecorded liability. The actual amount patowards unrecorded liability (after adjusting the agreed value of the asset).

Illustration 15.

Pass the Journal entries for the following:

(i) Expenses of realisation ₹ 5,000.

(ii) Expenses of realisation ₹ 3,000 paid by a partner '*Z*'.

(iii) '*X*' a partner agreed to take over the responsibility of completing dissolution work at an agreed remuneration of ₹ 5,000 and to bear all realisation expenses. Actual realisation expenses amounted to ₹ 4,000 were paid by *X* out of his private fund.

(iv) Realisation expenses amounted to ₹ 20,000 were paid by the firm on behalf of *Z*, a partner, with whom it was agreed at ₹ 15,000.

(v) Realisation expenses amounted to ₹ 7,000. It was agreed that the firm will pay 3,000 and balance by *Y*, a partner.

(vi) Dissolution expenses amounted to ₹ 10,000 were paid by *Z* a partner, on behalf of the firm.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Realisation A/c ...Dr.		5,000	
	To Bank A/c			5,000
	(Expenses paid by the firm)			
(ii)	Realisation A/c ...Dr.		3,000	
	To *Z*'s Capital A/c			3,000
	(Expenses paid by *Z*)			
(iii)	Realisation A/c ...Dr.		5,000	
	To *X*'s Capital A/c			5,000
	(Remuneration due to *X*)			
(iv) (a)	Realisation A/c ...Dr.		15,000	
	To *Z*'s Capital A/c			15,000
	(*Z*'s Capital A/c credited for realisation expenses)			
(b)	*Z*'s Capital A/c ...Dr.		20,000	
	To Bank A/c			20,000
	(Partner charged for expenses of dissolution as agreed)			
(v)	Realisation A/c ...Dr.		3,000	
	To Bank A/c			3,000
	(Realisation expenses ₹ 3,000 paid by the firm out of ₹ 7000 and balance borne by *Y*)			
(vi)	Realisation A/c ...Dr.		10,000	
	To *Z*'s Capital A/c			10,000
	(Realisation expenses paid by *Z* on behalf of the firm)			

Illustration 16.

Following is the Balance Sheet of Luv and Kush as at 31st March, 2018:

Liabilities		₹	Assets		₹
Mrs. Luv's Loan		1,50,000	Bank		76,000
Mrs. Kush's Loan		1,00,000	Debtors	3,00,000	
Trade Creditors		3,00,000	*Less:* Provision for Doubtful Debts	20,000	2,80,000
Bills Payable		1,00,000	Investments		1,00,000
Outstanding Expenses		50,000	Stock		4,00,000
Capital A/cs:			Truck		7,50,000
Luv	10,00,000		Plant and Machinery		8,00,000
Kush	8,00,000	18,00,000	Kush: Drawings		94,000
		25,00,000			25,00,000

The firm was dissolved on 31st March, 2018. The following were the adjustments:

(i) Half of the stock was sold at 10% less than the book value and the remaining half was taken by Luv at 20% more than the book value.

(ii) During the course of dissolution a liability under action for damages was settled at ₹ 20,000.

(iii) *Assets realised as follows:* Plant and Machinery ₹ 10,00,000, Truck ₹ 12,00,000. Goodwill was sold for ₹ 2,50,000, Bad debts amounted to ₹ 50,000, half the investments were sold at book value.

(iv) Luv promised to pay off Mrs. Luv's Loan and took half the investments at 10% discount.

(v) Trade Creditors and Bills payable were due on average basis of one month after 31st March, but were paid immediately on 31st March at 12% discount per annum.

Prepare Realisation A/c, Partners' Capital Accounts and Bank Account.

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Debtors A/c		3,00,000	By Trade Creditors A/c		3,00,000
To Investments A/c		1,00,000	By Bills Payable A/c		1,00,000
To Stock A/c		4,00,000	By Outstanding Expenses A/c		50,000
To Truck A/c		7,50,000	By Provision for Doubtful Debts A/c		20,000
To Plant and Machinery A/c		8,00,000	By Mrs. Luv's Loan A/c		1,50,000
To Bank A/c—Liability for Damages		20,000	By Mrs. Kush's Loan A/c		1,00,000
To Bank A/c:			By Bank A/c— Asset Realised:		
Creditors (₹ 3,00,000 – ₹ 3,000)	2,97,000		Stock	1,80,000	
Bills Payable (₹ 1,00,000 – ₹ 1,000)	99,000		Plant and Machinery	10,00,000	
Outstanding Expenses	50,000	4,46,000	Truck	12,00,000	
To Luv's Capital A/c (Mrs. Luv's Loan)		1,50,000	Goodwill	2,50,000	
To Bank A/c (Mrs. Kush's Loan)		1,00,000	Debtors	2,50,000	
To Gain (Profit) transferred to:			Investments	50,000	29,30,000
Luv's Capital A/c	4,34,500		By Luv's Capital A/c—Stock		2,40,000
Kush's Capital A/c	4,34,500	8,69,000	By Luv's Capital A/c—Investments		45,000
		39,35,000			39,35,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Luv (₹)	Kush (₹)	Particulars	Luv (₹)	Kush (₹)
To Drawings A/c	...	94,000	By Balance *b/d*	10,00,000	8,00,000
To Realisation A/c	2,40,000	...	By Realisation A/c	1,50,000	...
To Realistion A/c	45,000	...	—Mrs. Luv's Loan		
To Bank A/c (Final Payment)	12,99,500	11,40,500	By Realisation A/c—Gain	4,34,500	4,34,500
	15,84,500	12,34,500		15,84,500	12,34,500

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	76,000	By Realisation A/c—Liability for Damages	20,000
To Realisation A/c—Sales of Assets	29,30,000	By Realisation A/c—Mrs. Kush's Loan A/c	1,00,000
		By Realisation A/c—Liabilities	4,46,000
		By Luv's Capital A/c (Final Payment)	12,99,500
		By Kush's Capital A/c (Final Payment)	11,40,500
	30,06,000		30,06,000

Illustration 17.

Following is the Balance Sheet of *A* and *B* as at 31st March, 2018:

Liabilities		₹	Assets		₹
Capital A/cs:			Goodwill		40,000
A's	80,000		Building		1,00,000
B's	80,000	1,60,000	Plant and Machinery		80,000
General Reserve		6,000	Furniture and Fittings		20,000
Profit and Loss		2,000	Investments		61,200
A's Loan		40,000	Stock		34,800
Mrs. *A*'s Loan		80,000	Debtors	68,000	
Creditors		1,00,000	*Less:* Provision for Doubtful Debts	8,000	60,000
Bills Payable		60,000	Bills Receivable		40,000
Investment Fluctuation Reserve		11,200	Cash at Bank		52,000
Employees' Provident Fund		44,800	Advertisement Suspense		16,000
		5,04,000			5,04,000

Note: There was a bill for ₹ 4,000 under discount. The bill was received from *Z*.

The firm was dissolved on 31st March, 2018 and the following transactions took place:

(i) *A* agreed to pay his wife's loan.
(ii) Debtors realised ₹ 48,000.
(iii) *B* took all the investments at ₹ 48,000.
(iv) Other assets realised as follows: Plant and Machinery ₹ 65,000, Furniture and Fittings ₹ 20,000, Building ₹ 2,00,000, Goodwill ₹ 24,000.
(v) *A* accepted stock at ₹ 32,000 and *B* took over Bills Receivable at 20% discount.
(vi) *Z* proved insolvent and first and final dividend of 25% was received from his estate.
(vii) An outstanding bill of ₹ 2,000 for repairs was paid off. Creditors were settled at 5% discount.
(viii) Realisation Expenses amounted to ₹ 8,000.

Pass Journal entries and also prepare necessary ledger accounts.

Solution:

In the Book of M/s *A* and *B*

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018	Realisation A/c ...Dr.		4,44,000	
March 31	To Goodwill A/c			40,000
	To Building A/c			1,00,000
	To Plant and Machinery A/c			80,000
	To Furniture and Fittings A/c			20,000
	To Investments A/c			61,200
	To Stock A/c			34,800
	To Debtors A/c			68,000
	To Bills Receivable A/c			40,000
	(Transfer of assets to Realisation Account)			

	Provision for Doubtful Debts A/c ...Dr. Mrs. *A*'s Loan A/c ...Dr. Creditors A/c ...Dr. Bills Payable A/c ...Dr. Investment Fluctuation Reserve A/c ...Dr. Employees' Provident Fund A/c ...Dr. To Realisation A/c (Transfer of outside liabilities and provisions to Realisation Account)		8,000 80,000 1,00,000 60,000 11,200 44,800	 3,04,000
	Realisation A/c ...Dr. To *A*'s Capital A/c (Payment of Mrs. *A*'s loan by *A*)		80,000	 80,000
	Bank A/c ...Dr. To Realisation A/c (Amount realised from Debtors)		48,000	 48,000
	B's Capital A/c ...Dr. To Realisation A/c (Investments taken away by *B*)		48,000	 48,000
	Bank A/c ...Dr. To Realisation A/c (Realisation of Plant and Machinery at ₹ 65,000, Furniture and Fittings at ₹ 20,000, Building at ₹ 2,00,000 and Goodwill at ₹ 24,000)		3,09,000	 3,09,000
	A's Capital A/c ...Dr. To Realisation A/c (Stock taken by *A*)		32,000	 32,000
	B's Capital A/c ...Dr. To Realisation A/c (Bills Receivable taken by *B*)		32,000	 32,000
	Realisation A/c ...Dr. To Bank A/c (Contingent liability discharged)		4,000	 4,000
	Bank A/c ...Dr. To Realisation A/c (First and final divined of 25 paise in a rupee received from the estate of *Z*)		1,000	 1,000
	Realisation A/c ...Dr. To Bank A/c (Payment of liabilities: Creditors ₹ 95,000, Bills Payable ₹ 60,000, Employees' Provident Fund ₹ 44,800 and Outstanding Repairs Bill ₹ 2,000)		2,01,800	 2,01,800
	Realisation A/c ...Dr. To Bank A/c (Payment of Realisation Expenses)		8,000	 8,000
	Realisation A/c ...Dr. To *A*'s Capital A/c To *B*'s Capital A/c (Transfer of realisation gain (profit))		36,200	 18,100 18,100
	A's Loan A/c ...Dr. To Bank A/c (Payment of *A*'s loan)		40,000	 40,000

	General Reserve A/c ...Dr.		6,000	
	Profit and Loss A/c ...Dr.		2,000	
	To *A*'s Capital A/c			4,000
	To *B*'s Capital A/c			4,000
	(Transfer of accumulated profits and reserves to Capital Accounts)			
	A's Capital A/c ...Dr.		8,000	
	B's Capital A/c ...Dr.		8,000	
	To Advertisement Suspense A/c			16,000
	(Transfer of deferred revenue expenditure to Capital Accounts)			
	A's Capital A/c ...Dr.		1,42,100	
	B's Capital A/c ...Dr.		14,100	
	To Bank A/c			1,56,200
	(Final payment to partners)			

Ledger Accounts

Dr. REALISATION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Goodwill A/c	40,000	By Provision for Doubtful Debts A/c	8,000
To Building A/c	1,00,000	By Mrs. *A*'s Loan A/c	80,000
To Plant and Machinery A/c	80,000	By Creditors A/c	1,00,000
To Furniture and Fittings A/c	20,000	By Bills Payable A/c	60,000
To Investments A/c	61,200	By Investment Fluctuation Fund A/c	11,200
To Stock A/c	34,800	By Employees' Provident Fund A/c	44,800
To Debtors A/c	68,000	By Bank A/c—Debtors	48,000
To Bills Receivable A/c	40,000	By *B*'s Capital A/c—Investments	48,000
To *A*'s Capital A/c—Mrs. *A*'s Loan	80,000	By Bank A/c—Plant and Machinery, Furniture and Fittings, Building and Goodwill	3,09,000
To Bank A/c—Contingent liability on account of Bills Discounted	4,000	By *A*'s Capital A/c—Stock	32,000
To Bank A/c—Creditors, B/P, PF, and Repairs Bill	2,01,800	By *B*'s Capital A/c—B/R	32,000
To Bank A/c—Realisation Expenses	8,000	By Bank A/c—*Z*	1,000
To Gain (Profit) transferred to:			
A's Capital A/c	18,100		
B's Capital A/c	18,100		
	7,74,000		7,74,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	Particulars	*A* (₹)	*B* (₹)
To Realisation A/c	...	48,000	By Balance *b/d*	80,000	80,000
To Realisation A/c	32,000	...	By Realisation A/c	80,000	...
To Realisation A/c	...	32,000	By Realisation A/c —Gain on Realisation	18,100	18,100
To Advertisement Suspense A/c	8,000	8,000	By General Reserve A/c	3,000	3,000
To Bank A/c (Final Payment)	1,42,100	14,100	By Profit and Loss A/c	1,000	1,000
	1,82,100	1,02,100		1,82,100	1,02,100

Dr. A'S LOAN ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Bank A/c	40,000	By Balance *b/d*	40,000

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	52,000	By Realisation A/c—Contingent liability	4,000
To Realisation A/c—Debtors	48,000	By Realisation A/c	2,01,800
To Realisation A/c—Plant and Machinery,	3,09,000	—Creditors, B/P, PF, and Repairs Bill	
Furniture and Fitting, Building and Goodwill		By Realisation A/c—Realisation Expenses	8,000
To Realisation A/c—*Z*	1,000	By *A*'s Loan A/c	40,000
		By *A*'s Capital A/c (Final Payment)	1,42,100
		By *B*'s Capital A/c (Final Payment)	14,100
	4,10,000		4,10,000

Note: 1. Employees' Provident Fund is a liability.

2. Advertisement Suspense Account is debited to Partners' Capital Accounts in their profit-sharing ratio.

Illustration 18.

X, *Y* and *Z* were partners in a firm sharing profits in the ratio of 2 : 2 : 1. In spite of repeated reminders by the authorities, the partners kept dumping hazardous material into a nearby river. The court ordered for the dissolution of their partnership firm. On 31st March, 2018, their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Creditors		50,000	Cash	60,000
Bank Loan		35,000	Debtors	75,000
Employees' Provident Fund		15,000	Stock	40,000
Investment Fluctuation Reserve		10,000	Investments	20,000
Commission received in Advance		8,000	Plant	50,000
Capital A/cs:			Profit and Loss A/c	3,000
X's	50,000			
Y's	50,000			
Z's	30,000	1,30,000		
		2,48,000		2,48,000

On this date the firm was dissolved. *X* was appointed to realise the assets. *X* was to receive 5% commission on the sale of assets (except cash) and was to bear all expenses of realisation. *X* realised the assets as follows:

Debtors 20% less, Stock ₹ 35,500, Investments 80%, Plant 90% of the book value.

Expenses of realisation amounted to ₹ 7,500 paid by the firm on *X*'s behalf. Commission received in advance was returned to the customers after deducting ₹ 3,000. Firm had to pay ₹ 8,500 to outstanding salary not provided for earlier. Compensation paid to employees amounted to 17,000. This liability was not provided for in the above Balance Sheet. ₹ 20,000 has to be paid for Provident Fund.

Prepare Realisation Account, Capital Accounts of Partners and Cash Account.

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Sundry Assets:			By Sundry Liabilities:		
Debtors	75,000		Creditors	50,000	
Stock	40,000		Bank Loan	35,000	
Investments	20,000		Employees' Provident Fund	15,000	
Plant	50,000	1,85,000	Investment Fluctuation Reserve	10,000	
To Cash A/c:			Commission Reserved in Advance	8,000	1,18,000
Creditors	50,000		By Cash A/c—Assets Realised:		
Bank Loan	35,000		Debtors	60,000	
Commission Received in			Stock	35,500	
Advance (₹ 8,000 – ₹ 3,000)	5,000		Investments	16,000	
Compensation to Employees	17,000		Plant (₹ 50,000 × 90/100)	45,000	1,56,500
Employees' Provident Fund	20,000		By Loss transferred to:		
Outstanding Salary	8,500	1,35,500	*X's* Capital A/c	21,530	
To *X's* Capital A/c—Commission		7,825	*Y's* Capital A/c	21,530	
(₹ 1,56,500 × 5/100)			*Z's* Capital A/c	10,765	53,825
		3,28,325			3,28,325

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Profit and Loss A/c	1,200	1,200	600	By Balance *b/d*	50,000	50,000	30,000
To Realisation A/c (Loss)	21,530	21,530	10,765	By Realisation A/c	7,825	...	...
To Cash A/c (Drawings)	7,500	...	...				
To Cash A/c (Final Payment)	27,595	27,270	18,635				
	57,825	50,000	30,000		57,825	50,000	30,000

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	60,000	By Realisation A/c	1,35,500
To Realisation A/c (Assets Realised)	1,56,500	By *X's* Capital A/c	7,500
		By *X's* Capital A/c (Final Payment)	27,595
		By *Y's* Capital A/c (Final Payment)	27,270
		By *Z's* Capital A/c (Final Payment)	18,635
	2,16,500		2,16,500

Illustration 19.

Ajit, Brijesh and Chandni are partners sharing profits in the ratio of 3 : 1 : 1. In spite of repeated reminder by the authorities, they kept dumping hazardous material into a nearby river. The court ordered for the dissolution of their partnership firm on 31st March, 2013. The financial position of the firm on that date was as follows:

Liabilities		₹	Assets		₹
Creditors		12,000	Cash		6,400
Loan		3,000	Debtors	48,400	
Capital A/cs:			*Less:* Provision for Doubtful Debts	2,400	46,000
Ajit	55,000		Stock		15,600
Brijesh	20,000		Furniture		2,000
Chandni	14,000	89,000	Other Sundry Assets		34,000
		1,04,000			1,04,000

Additional Information:

(i) Ajit was to take over furniture at ₹ 1,600 and debtors amounting to ₹ 40,000 at ₹ 34,200; the Creditors of ₹ 12,000 were to be paid by him at this figure.

(ii) Brijesh was to take over all the stock at ₹ 14,000 and some of the Other Sundry Assets at ₹ 14,400 (being 10% less than book value).

(iii) Chandni took over remaining Other Sundry Assets at book value.

(iv) The expenses of dissolution were ₹ 540. The remaining debtors were sold to a debt collecting agency for 50% of book value.

Prepare Realisation Account, Partners' Capital Accounts and Cash Account to close the books of the firm. (*CBSE 2013 Set I, II, III Foreign, Modified*)

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Assets:			By Liabilities:		
Debtors	48,400		Provision for Doubtful Debts	2,400	
Stock	15,600		Creditors	12,000	
Furniture	2,000		Loan	3,000	17,400
Other Sundry Assets	34,000	1,00,000	By Ajit's Capital A/c—Assets:		
To Ajit's Capital A/c—Creditors		12,000	Furniture	1,600	
To Cash A/c—Loan		3,000	Debtors	34,200	35,800
To Cash A/c—Exp.		540	By Brijesh's Capital A/c—Assets:		
			Stock	14,000	
			Sundry Assets	14,400	28,400
			By Chandni's Capital A/c		18,000
			[₹ 34,000 – (₹ 14,400 × 100/90)]		
			By Cash A/c—Debtors		4,200
			[50/100 (₹ 48,400 – ₹ 40,000)]		
			By Loss transferred to:		
			Ajit's Capital A/c	7,044	
			Brijesh's Capital A/c	2,348	
			Chandni's Capital A/c	2,348	11,740
		1,15,540			1,15,540

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Ajit ₹	Brijesh ₹	Chandni ₹	Particulars	Ajit ₹	Brijesh ₹	Chandni ₹
To Realisation A/c—Loss	7,044	2,348	2,348	By Balance *b/d*	55,000	20,000	14,000
To Realisation A/c	35,800	28,400	18,000	By Realisation A/c —Creditors	12,000	...	...
To Cash A/c (Balancing Figure)	24,156	...	...	By Cash A/c (Balancing Figure)	...	10,748	6,348
	67,000	30,748	20,348		67,000	30,748	20,348

Dr. CASH ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	6,400	By Realisation A/c	3,000
To Realisation A/c	4,200	By Realisation A/c (Exp.)	540
To Brijesh's Capital A/c (Cash Brought in)	10,748	By Ajit's Capital A/c (Final Payment)	24,156
To Chandni's Capital A/c (Cash Brought in)	6,348		
	27,696		27,696

Illustration 20.

X and *Y* are partners sharing their profits and losses in the ratio of 3 : 1. They decide to dissolve their firm on 31st March, 2018. Their Balance Sheet as at the above date was:

Liabilities		₹	Assets	₹
Bank Overdraft		30,000	Leasehold Property	40,000
Creditors		44,000	Machinery	35,000
Capital A/cs:			Furniture	7,000
X	54,000		Investments	10,000
Y	27,000	81,000	Stock	35,000
			Debtors	24,000
			Commission Receivable	3,000
			Cash at Bank	1,000
		1,55,000		1,55,000

Leasehold Property, Machinery and Furniture were divided among themselves and valuations were agreed at ₹ 60,000 and ₹ 40,000 respectively for *X* and *Y*. *X* agreed to pay Creditors and *Y* agreed to meet the Bank Overdraft.

Commission Receivable was realised.

Realisation expenses were ₹ 3,000.

Stock is worth 80% of book value. Investments are worth ₹ 18,000. Stock and other assets except those stated above are divided equally. The accounts are settled by cash payment.

Show the Ledger Accounts.

Solution:

Ledger Accounts

Dr. REALISATION ACCOUNT Cr.

Particulars		₹	Particulars	₹
To Sundry Assets—Transfer:			By Creditors	44,000
Leasehold Property	40,000		By Bank Overdraft	30,000
Machinery	35,000		By *X*'s Capital A/c	60,000
Furniture	7,000		(Leasehold Property, Machinery	
Investments	10,000		and Furniture)	
Stock	35,000		By *Y*'s Capital A/c	40,000
Debtors	24,000		(Leasehold Property, Machinery	
Commission Receivable	3,000	1,54,000	and Furniture)	
To *X*'s Capital A/c (Creditors)		44,000	By Bank A/c (Commission)	3,000
To *Y*'s Capital A/c (Bank Overdraft)		30,000	By *X*'s Capital A/c (Assets) (Note)	35,000
To Bank A/c (Realisation Expenses)		3,000	By *Y*'s Capital A/c (Assets) (Note)	35,000
To Gain (Profit) transferred to:				
X's Capital A/c (3/4)	12,000			
Y's Capital A/c (1/4)	4,000	16,000		
		2,47,000		2,47,000

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	*X* ₹	*Y* ₹	Particulars	*X* ₹	*Y* ₹
To Realisation A/c—Assets	60,000	40,000	By Balance *b/d*	54,000	27,000
To Realisation A/c—Assets	35,000	35,000	By Realisation A/c:		
To Bank A/c (Balancing Figure)	15,000	...	Creditors	44,000	...
			Bank Overdraft	...	30,000
			By Realisation A/c (Gain (Profit))	12,000	4,000
			By Bank A/c (Balancing Figure)	...	14,000
	1,10,000	75,000		1,10,000	75,000

Dr. BANK ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Balance *b/d*	1,000	By Realisation A/c (Expenses)	3,000
To Realisation A/c (Commission)	3,000	By *X*'s Capital A/c—Final Payment	15,000
To *Y*'s Capital A/c—Cash brought in	14,000		
	18,000		18,000

Note: Assets valuation has been computed for equal division between *X* and *Y* as follows:

Stock ₹ 28,000 (*i.e.*, ₹ 35,000 × 80/100) + Investments ₹ 18,000 + Debtors ₹ 24,000 = ₹ 70,000.

Divided between *X* and *Y* equally:

X = ₹ 70,000 × 1/2 = ₹ 35,000; and *Y* = ₹ 70,000 × 1/2 = ₹ 35,000.

Illustration 21 (*Value of Assets not Given*).

Ram, Mohan and Sohan are partners sharing their profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2018, Ram's Capital and Mohan's Capital were ₹ 90,000 and ₹ 60,000 respectively. But Sohan owed ₹ 15,000 to the firm. The Creditors were of ₹ 60,000. The assets realised ₹ 1,50,000.

Prepare Realisation Account, Partners' Capital Accounts and Bank Account.

Solution:

Dr. REALISATION ACCOUNT *Cr.*

Particulars	₹	Particulars		₹
To Sundry Assets A/c (WN)	1,95,000	By Creditors		60,000
To Bank A/c—Creditors	60,000	By Bank A/c—Assets Realised		1,50,000
		By Loss transferred to:		
		Ram's Capital A/c	22,500	
		Mohan's Capital A/c	13,500	
		Sohan's Capital A/c	9,000	45,000
	2,55,000			2,55,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Ram ₹	Mohan ₹	Sohan ₹	Particulars	Ram ₹	Mohan ₹	Sohan ₹
To Balance *b/d*	...	...	15,000	By Balance *b/d*	90,000	60,000	...
To Realisation A/c (Loss)	22,500	13,500	9,000	By Bank A/c	...	...	24,000
To Bank A/c (Amt. Paid)	67,500	46,500	...	(Amount Received)			
	90,000	60,000	24,000		90,000	60,000	24,000

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Realisation A/c—Assets Realised	1,50,000	By Realisation A/c—Creditors	60,000
To Sohan's Capital A/c—Amount Received	24,000	By Ram's Capital A/c—Final Payment	67,500
		By Mohan's Capital A/c—Final Payment	46,500
	1,74,000		1,74,000

Working Note: *Calculation of Value of Sundry Assets:*

MEMORANDUM BALANCE SHEET *as at 31st March, 2018*

Liabilities		₹	Assets	₹
Creditors		60,000	Sohan's Capital	15,000
Capital A/cs:			Sundry Assets (Balancing Figure)	1,95,000
Ram	90,000			
Mohan	60,000	1,50,000		
		2,10,000		2,10,000

Illustration 22 (*Dissolution of Firm*).

Complete the following accounts:

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Sundry Assets (Transfer):			By Sundry Liabilities (Transfer):		
Stock A/c	18,000		Creditors A/c	88,500	
Debtors A/c	42,000		Bills Payable A/c	23,000	
Furniture A/c	12,000		Ms. Wolf's Loan A/c	40,000	1,51,500
Machinery A/c	?	1,78,500	By Bank A/c (Assets Realised):		
To Bank A/c (Liabilities Paid):			Stock	10,500	
Bills Payable	23,000		Debtors	?	
Creditors	?		Machinery	88,500	?
Ms. Wolf's Loan	38,500		By Fox's Capital A/c (Furniture Taken Over)		7,500
Claim for Damages	2,000	?	By Bank A/c (Recovery of Bad Debts)		1,800
To Bank A/c (Expenses)		2,100	By Loss on Realisation:		
			Fox's Capital A/c	?	
			Wolf's Capital A/c	?	?
		3,30,830			3,30,830

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Fox ₹	Wolf ₹	Particulars	Fox ₹	Wolf ₹
To Profit and Loss A/c	11,250	11,250	By Balance *b/d*	?	?
To Realisation A/c (Furniture Taken Over)	?		By Bank A/c	10,390	8,890
To Realisation A/c (Loss)	21,640	21,640			
	40,390	32,890		40,390	32,890

Dr. BANK ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Balance *b/d*		4,500	By Realisation A/c (Liabilities Paid)	1,50,230
To Realisation A/c—			By Realisation A/c (Expenses)	?
Assets Realised	1,26,750			
Recovery of Bad Debts	1,800	1,28,550		
To Fox's Capital A/c (Cash Brought in)		?		
To Wolf's Capital A/c (Cash Brought in)		?		
		1,52,330		?

Solution:

In the Books of Fox and Wolf

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Sundry Assets (Transfer):			By Sundry Liabilities (Transfer):		
Stock A/c	18,000		Creditors A/c	88,500	
Debtors A/c	42,000		Bills Payable A/c	23,000	
Furniture A/c	12,000		Ms. Wolf's Loan A/c	40,000	1,51,500
Machinery A/c	**1,06,500**	1,78,500	By Bank A/c (Assets Realised):		
To Bank A/c (Liabilities Paid):			Stock	10,500	
Bills Payable	23,000		Debtors	**27,750**	
Creditors	**86,730**		Machinery	88,500	**1,26,750**
Ms. Wolf's Loan	38,500		By Fox's Capital A/c (Furniture Taken Over)		7,500
Claim for Damages	2,000	**1,50,230**	By Bank A/c (Recovery of Bad Debts)		1,800
To Bank A/c (Expenses)		2,100	By Loss on Realisation:		
			Fox's Capital A/c	**21,640**	
			Wolf's Capital A/c	**21,640**	**43,280**
		3,30,830			3,30,830

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Fox ₹	Wolf ₹	Particulars	Fox ₹	Wolf ₹
To Profit and Loss A/c	11,250	11,250	By Balance *b/d*	**30,000**	**24,000**
To Realisation A/c (Furniture Taken Over)	**7,500**		By Bank A/c	10,390	8,890
To Realisation A/c (Loss)	21,640	21,640			
	40,390	32,890		40,390	32,890

Dr. BANK ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Balance *b/d*		4,500	By Realisation A/c (Liabilities Paid)	1,50,230
To Realisation A/c			By Realisation A/c (Expenses)	**2,100**
Assets Realised	1,26,750			
Recovery of Bad Debts	1,800	1,28,550		
To Fox's Capital A/c (Cash Brought in)		**10,390**		
To Wolf's Capital A/c (Cash Brought in)		**8,890**		
		1,52,330		**1,52,330**

Illustration 23 (*Considering GST*).

Kumar, Sham and Ram were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Due to a difference of opinion, they decided to dissolve the firm with effect from 1st April, 2018 on which date its Balance Sheet was as under:

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets	₹
Capital A/cs:			Plant and Machinery	80,000
Kumar	60,000		Furniture	45,000
Sham	40,000		Car	25,000
Ram	30,000	1,30,000	Stock-in-Trade	30,000
Current A/cs:			Sundry Debtors	71,000
Kumar	8,000		Cash at Bank	14,000
Sham	10,000	18,000	Current A/c:	
Sundry Creditors		1,20,000	Ram	3,000
		2,68,000		2,68,000

The following information is given:

(i) Plant and Machinery of book value ₹ 40,000 were taken by Kumar at an agreed value of ₹ 45,000 and the remaining Machinery realised ₹ 50,000.

(ii) Furniture realised ₹ 40,000.

(iii) Car was taken by Sham for ₹ 30,000.

(iv) Sundry Debtors included a Bad Debt for ₹ 1,200 and the rest were realised at a cash discount of 10%.

(v) Stock worth ₹ 5,000 was taken by Ram for ₹ 5,200 and the rest realised at 20% above their book value.

(vi) A Creditor for ₹ 2,000 was untraceable and other creditors accepted payment allowing 15% discount.

(vii) Realisation Expenses paid to an agency carrying out dissolution amounted to ₹ 5,000.

(viii) Sale of Plant and Machinery, Furniture, Car, Stock and Realisation Expenses are subject to levy of CGST and SGST @ 9% each.

You are required to pass the Journal entries, prepare Realisation Account, CGST and SGST Accounts, Bank Account, and Partners' Capital Accounts showing final payments to them.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
(i)	Realisation A/c ...Dr.		2,51,000	
	To Plant and Machinery A/c			80,000
	To Furniture A/c			45,000
	To Car A/c			25,000
	To Stock-in-Trade A/c			30,000
	To Sundry Debtors A/c			71,000
	(Assets transferred)			

(ii)	Sundry Creditors A/c	...Dr.	1,20,000	
	To Realisation A/c			1,20,000
	(Liability transferred)			
(iii)	Kumar's Capital A/c	...Dr.	53,100	
	To Realisation A/c			45,000
	To Outut CGST A/c			4,050
	To Output SGST A/c			4,050
	(Machinery taken by Kumar, CGST and SGST charged @ 9% each)			
(iv)	Bank A/c	...Dr.	59,000	
	To Realisation A/c			50,000
	To Output CGST A/c			4,500
	To Output SGST A/c			4,500
	(Balance machinery sold, charged CGST and SGST @ 9% each)			
(v)	Bank A/c	...Dr.	47,200	
	To Realisation A/c			40,000
	To Output CGST A/c			3,600
	To Output SGST A/c			3,600
	(Furniture sold, charged CGST and SGST @ 9% each)			
(vi)	Sham's Capital A/c	...Dr.	35,400	
	To Realisation A/c			30,000
	To Output CGST A/c			2,700
	To Output SGST A/c			2,700
	(Car sold to Sham, charged CGST and SGST @ 9% each)			
(vii)	Bank A/c	...Dr.	62,820	
	To Realisation A/c			62,820
	(Debtors realised)			
(viii)	Ram's Capital A/c	...Dr.	6,136	
	To Realisation A/c			5,200
	To Output CGST A/c			468
	To Output SGST A/c			468
	(Stock taken by Ram, charged CGST and SGST @ 9% each)			
(ix)	Bank A/c	...Dr.	35,400	
	To Realisation A/c			30,000
	To Output CGST A/c			2,700
	To Output SGST A/c			2,700
	(Balance stock sold, charged CGST and SGST @ 9% each)			
(x)	Realisation A/c	...Dr.	1,00,300	
	To Bank A/c			1,00,300
	(Creditors paid)			

(xi)	Realisation A/c ...Dr.		5,000	
	Input CGST A/c ...Dr.		450	
	Input SGST A/c ...Dr.		450	
	To Bank A/c			5,900
	(Being the realisation expenses paid along with CGST and SGST @ 9% each)			
(xii)	Output CGST A/c ...Dr.		18,018	
	To Input CGST A/c			450
	To Bank A/c			17,568
	(Being the Output CGST deposited after setting off Input CGST)			
(xiii)	Output SGST A/c ...Dr.		18,018	
	To Input SGST A/c			450
	To Bank A/c			17,568
	(Being the Output SGST deposited after setting off Input SGST)			

Dr. OUTPUT CGST ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Input CGST A/c	450	By Kumar's Capital A/c	4,050
To Bank A/c (Balancing Figure)	17,568	By Bank A/c	4,500
		By Bank A/c	3,600
		By Sham's Capital A/c	2,700
		By Ram's Capital A/c	468
		By Bank A/c	2,700
	18,018		18,018

Dr. OUTPUT SGST ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Input SGST A/c	450	By Kumar's Capital A/c	4,050
To Bank A/c (Balancing Figure)	17,568	By Bank A/c	4,500
		By Bank A/c	3,600
		By Sham's Capital A/c	2,700
		By Ram's Capital A/c	468
		By Bank A/c	2,700
	18,018		18,018

Dr. INPUT CGST ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Bank A/c	450	By Output CGST A/c	450

Dr. INPUT SGST ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Bank A/c	450	By Output SGST A/c	450

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Sundry Assets (Transfer):			By Sundry Creditors A/c		1,20,000
Plant and Machinery A/c	80,000		By Kumar's Capital A/c		45,000
Furniture A/c	45,000		(Plant and Machinery Taken Over)		
Car A/c	25,000		By Sham's Capital A/c		30,000
Stock-in-Trade A/c	30,000		(Car Taken Over)		
Sundry Debtors A/c	71,000	2,51,000	By Ram's Capital A/c		5,200
To Bank A/c (Payments):			(Stock Taken Over)		
Sundry Creditors—	1,00,300		By Bank A/c (Assets Realised):		
85% of ₹ (1,20,000 – 2,000)			Machinery	50,000	
Realisation Expenses	5,000	1,05,300	Furniture	40,000	
To Gain (Profit) on Realisation:			Debtors—	62,820	
Kumar's Capital A/c	13,360		90% of ₹ (71,000 – 1,200)		
Sham's Capital A/c	8,016		Stock—	30,000	1,82,820
Ram's Capital A/c	5,344	26,720	120% of ₹ (30,000 – 5,000)		
		3,83,020			3,83,020

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Kumar (₹)	Sham (₹)	Ram (₹)	Particulars	Kumar (₹)	Sham (₹)	Ram (₹)
To Partner's Current A/c	...	...	3,000	By Balance *b/d*	60,000	40,000	30,000
To Realisation A/c	45,000	...	...	By Partners' Current A/cs	8,000	10,000	...
(Plant and Machinery)				By Realisation A/c	13,360	8,016	5,344
To Output CGST A/c	4,050			(Gain)			
To Output SGST A/c	4,050						
To Realisation A/c	...	30,000	...				
(Car Taken Over)							
To Output CGST A/c		2,700					
To Output SGST A/c		2,700					
To Realisation A/c	...	...	5,200				
(Stock Taken Over)							
To Output CGST A/c			468				
To Output SGST A/c			468				
To Bank A/c	28,260	22,616	26,208				
(Final Payment)							
	81,360	58,016	35,344		81,360	58,016	35,344

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	14,000	By Realisation A/c	1,00,300
To Realisation A/c	50,000	By Realisation A/c	5,000
To Output CGST A/c	4,500	By Input CGST A/c	450
To Output SGST A/c	4,500	By Input SGST A/c	450
To Realisation A/c	40,000	By Output CGST A/c (CGST Deposited)	17,568
To Output CGST A/c	3,600	By Output SGST A/c (SGST Deposited)	17,568
To Output SGST A/c	3,600	By Kumar's Capital A/c (Final Payment)	28,260
To Realisation A/c	62,820	By Sham's Capital A/c (Final Payment)	22,616
To Realisation A/c	30,000	By Ram's Capital A/c (Final Payment)	26,208
To Output CGST A/c	2,700		
To Output SGST A/c	2,700		
	2,18,420		2,18,420

Note: Balances of Partners' Current Accounts are transferred to Capital Accounts.

Unsolved Questions

1. *B*, *C* and *D* are partners in a firm sharing profits in the ratio of 2 : 1 : 2 respectively. On 1st March, 2013 the firm was dissolved. After transferring assets (other than cash) and third party liabilities to the 'Realisation Account' you are provided with the following information:

   (a) There was a debit balance of ₹ 24,000 in the firm's Profit and Loss Account.

   (b) A piece of machinery not recorded in the books was sold for ₹ 4,000.

   (c) Creditors of ₹ 50,000 were paid ₹ 45,000 in full settlement of accounts.

   Pass necessary Journal entries for the above transactions in the books of the firm at the time of dissolution. *(AI 2013 C)*

   [**Hints:** (a) Dr. *B*'s Capital A/c ₹ 9,600; *C*'s Capital A/c ₹ 4,800 and *D*'s Capital A/c ₹ 9,600. Cr. Profit and Loss A/c ₹ 24,000.

   (b) Dr. Bank A/c and Cr. Realisation A/c by ₹ 4,000.

   (c) Dr. Realisation A/c and Cr. Bank A/c by ₹ 45,000.]

2. *X*, *Y* and *Z* are partners in a firm. Their profit-sharing ratio is 5 : 3 : 2. Pass necessary Journal entries for the following transactions at the time of dissolution of the firm:

   (a) Realisation expenses ₹ 5,000 paid.

   (b) Realisation expenses amounted to ₹ 3,000. Mr. *X*, one of the partners, has to bear these expenses.

   (c) *Y*, one of the partners, took over a machine for ₹ 10,000.

   (d) *Z*, one of the partners, agreed to take over the Creditor of ₹ 30,000 for ₹ 20,000.

   (e) *Y*, one of the partners, had given loan to the firm of ₹ 20,000. It was paid back to him at the time of dissolution.

   (f) Profit and Loss Account balance of ₹ 50,000 appeared on the assets side of the Balance Sheet.

   (g) Bank loan ₹ 50,000 was paid.

   (h) An unrecorded asset realised ₹ 17,000.

   (i) Stock worth ₹ 20,000 was taken over by *Z* for ₹ 14,000.

   (j) Gain (Profit) on Realisation of ₹ 30,000 is to be distributed between partners *X, Y and Z*.

3. Dipali and Rajashri are partners in a firm sharing profits and losses in the ratio of 3 : 2. They decided to dissolve their firm on 31st March, 2018, when their Balance Sheet was:

Liabilities		₹	Assets	₹
Capital A/cs:			Freehold Property	16,000
Dipali	17,500		Investments	4,000
Rajashri	10,000	27,500	Sundry Debtors	2,000
Sundry Creditors		2,000	Stock	3,000
Profit and Loss A/c		1,500	Bank	2,000
			Cash	4,000
		31,000		31,000

The partners decided to dissolve the firm on the above date. Dipali took over the Investments at an agreed value of ₹ 3,800. Other assets were realised as follows:

Freehold Property: ₹ 18,000; Sundry Debtors: ₹ 1,800; Stock: ₹ 2,800.

Creditors of the firm agreed to accept 5% less. Expenses of realisation of assets amounted to ₹ 400. There was a computer printer in the firm, which was bought out of the firm's money, was not shown in the above Balance Sheet. It is now sold for ₹ 1,000.

Close the firm's books of accounts by preparing Realisation Account, Partners' Capital Accounts and Bank Account.

[**Ans.:** *Gain (Profit) on Realisation—₹ 2,100; Total of Bank A/c—₹ 29,600; Amount payable to Dipali—₹ 15,860; Rajashri—₹ 11,440.*]

4. Following was the Balance Sheet of Deepak and Neeru sharing profits and losses in the ratio of 3 : 2 as at 31st March, 2018:

Liabilities		₹	Assets		₹
Creditors		38,000	Cash		11,500
Mrs. Deepak's Loan		10,000	Stock		6,000
Neeru's Loan		15,000	Debtors	20,000	
Reserve Fund		2,500	*Less:* Provision for Doubtful Debts	1,000	19,000
Deepak's Capital	10,000		Furniture		4,000
Neeru's Capital	8,000	18,000	Plant		28,000
			Investments		10,000
			Profit and Loss A/c		5,000
		83,500			83,500

The firm was dissolved on 31st March, 2018 and the following was the result:

(a) Deepak took Investments at ₹ 8,000 and agreed to pay the loan of his wife.

(b) The assets realised as follows:

Stock ₹ 1,000 less; Debtors ₹ 18,500; Furniture ₹ 500 more; Plant ₹ 3,000 less.

(c) Expenses of realisation were ₹ 600.

(d) Creditors were paid off less 2½% discount.

Show Ledger Accounts to close the books of the firm.

[**Ans.:** *Loss on Realisation—₹ 5,650; Deepak receives—₹ 7,110; Neeru receives—₹ 4,740; Total of Cash A/c—₹ 64,500.*]

5. Amar, Akbar and Antony were partners in a firm sharing profits and losses in the ratio of 4 : 4 : 2. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets		₹
Sundry Creditors		9,000	Land		8,000
Amar's Loan		7,000	Plant	17,000	
General Reserve		5,000	*Less:* Depreciation	1,000	16,000
Capital A/cs:			Loose Tools		3,000
Amar	24,000		Stock		20,000
Akbar	20,000		Sundry Debtors	30,000	
Antony	15,000	59,000	*Less:* Provision for Doubtful Debts	2,000	28,000
			Cash at Bank		5,000
		80,000			80,000

The partners decided to dissolve the firm with effect from 31st March, 2018. In order to give effect to this decision, draw up a Realisation Account, Partners' Capital Accounts and the Bank Account, after taking into consideration the following:

(a) Amar agreed to take over part of the business for which he agreed to pay ₹ 10,000 for Goodwill, which had not been previously valued.

(b) Amar also took over Land at book value and Plant at ₹ 12,000.

(c) Loose Tools, Stock and Sundry Debtors realised ₹ 2,000; ₹ 15,000 and ₹ 22,000 respectively.

(d) Sundry Creditors were paid off at a discount of 10%.

(e) The expenses of realisation were ₹ 1,500.

(f) A contingent liability of ₹ 1,000 which occurred during the period was duly paid-off.

[**Ans.:** *Loss on Realisation—₹ 7,600; Cash paid to Akbar—₹ 18,960; Antony—₹ 14,480; Cash brought in by Amar—₹ 40; Total of Bank A/c—₹ 44,040.*]

Note: Amar's Capital Account shows a debit balance of ₹ 7,040 (after all adjustments) so we have transferred his Loan Account to his Capital Account for final settlement.

6. Cloud, Storm and Rain were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Due to difference in opinion, they decided to dissolve the partnership with effect from 1st April, 2018 on which date the firm's position was as under:

BALANCE SHEET *as at 1st April, 2018*

Liabilities		₹	Assets	₹
Capital A/cs:			Plant and Machinery	80,000
Cloud	60,000		Furniture and Fixtures	45,000
Storm	40,000		Motor Car	25,000
Rain	30,000	1,30,000	Stock-in-Trade	30,000
Current A/cs:			Sundry Debtors	71,000
Cloud	8,000		Cash at Bank	14,000
Storm	10,000	18,000	Current A/c:	
Sundry Creditors		1,20,000	Rain	3,000
		2,68,000		2,68,000

The following information is given:

(a) Plant costing ₹ 40,000 was taken over by Cloud at an agreed value of ₹ 45,000 and the remaining Machinery realised ₹ 50,000.

(b) Furniture and Fixtures realised ₹ 40,000.

(c) Motor Car was taken over by Storm for ₹ 30,000.

(d) Sundry Debtors included a Bad Debts of ₹ 1,200 and the rest was realised subject to a cash discount of 10%.

(e) Stock worth ₹ 5,000 was taken over by Rain for ₹ 5,200 and the rest realised at 20% above their book value.

(f) A creditor for ₹ 2,000 was untraceable and other creditors accepted payment allowing 15% discount.

(g) Realisation expenses amounted to ₹ 5,000.

You are required to show Realisation Account and the Capital Accounts of the Partners on dissolution showing final payments to them.

[**Ans.:** *Gain (Profit) on Realisation—₹ 26,720. Final Payment: Cloud—₹ 36,360; Storm—₹ 28,016; Rain—₹ 27,144.*]

7. *X*, *Y* and *Z* commenced business on 1st April, 2016 with capitals of ₹ 1,00,000; ₹ 80,000 and ₹ 60,000 respectively. Profits and losses were shared in the ratio of 4 : 3 : 3 respectively. Capitals carried interest @ 5%.

During 2016–17 and 2017–18, they made profits of ₹ 40,000 and ₹ 50,000 before allowing interest on capital. Drawings of each partner were ₹ 10,000 per year.

On 31st March, 2018, the firm was dissolved. Creditors on that date were ₹ 24,000. The assets realised a net amount of ₹ 2,60,000.

Prepare Capital Accounts of Partners for two years till the books are finally closed and the Realisation Account. [**Ans.:** *Assets at the time of dissolution were ₹ 2,94,000; Loss on Realisation ₹ 34,000; Final Payment: X—₹ 1,02,910; Y—₹ 77,570; Z—₹ 55,520.*]

8. Jathi, Sethi and Rathi were sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2018 their Balance Sheet was:

Liabilities		₹	Assets		₹
Jathi's Capital	28,000		Furniture		11,000
Sethi's Capital	19,000		Investments		7,000
Rathi's Capital	8,000	55,000	Stock		38,000
Sundry Creditors		9,500	Debtors	8,000	
			Less: Provision for Doubtful Debts	400	7,600
			Cash		900
		64,500			64,500

The firm was dissolved. Rathi took Investments at an agreed value of ₹ 7,500. Furniture, Stock and Debtors realised ₹ 48,400. ₹ 9,000 were paid to Sundry Creditors in full settlement. The expenses of realisation were ₹ 600. The partners' accounts were settled by receipt or payment of cash.

Show Realisation Account, Partners' Capital Accounts and Cash Account to close the books of the firm.

[**Ans.:** *Loss on Realisation—₹ 7,800; Jathi to be paid—₹ 24,100; Sethi to be paid—₹ 16,660; Rathi pays—₹ 1,060.*]

9. Sharma, Verma and Gupta were partners sharing profits in the ratio of 3 : 2 : 1. Their Balance Sheet as at 31st March, 2018 stood as follows:

Liabilities		₹	Assets	₹
Sundry Creditors		21,500	Cash	1,000
Loan		21,500	Stock	25,000
Sharma's Capital	6,000		Debtors	18,000
Verma's Capital	5,000		Furniture	5,000
Gupta's Capital	3,000	14,000	Machinery	8,000
		57,000		57,000

The firm was dissolved on 1st April, 2018. The fixed assets realised ₹ 2,000 whereas Stock and Debtors realised ₹ 33,000 in all. The expenses on dissolution were ₹ 600.

Prepare necessary Ledger Accounts, assuming that the necessary cash has been brought in by the partners.

[**Ans.:** *Loss on Realisation—₹ 21,600; Amount brought in by Sharma—₹ 4,800; Verma—₹ 2,200 and Gupta—₹ 600; Total of Cash A/c—₹ 43,600.*]

10. *A, B* and *C* were partners sharing profits and losses in the ratio of 2 : 2 : 1. On 1st April, 2018, their Balance Sheet was:

Liabilities		₹	Assets		₹
Creditors		24,000	Cash at Bank		24,400
Reserve		10,000	Debtors	16,000	
Capital A/cs:			*Less:* Provision for Doubtful Debts	400	15,600
A	30,000		Stock		12,000
B	24,000		Furniture		4,000
C	12,000	66,000	Building		44,000
		1,00,000			1,00,000

The firm was dissolved on that date. The assets realised were:

	₹
Debtors	14,000
Stock	10,000
Furniture	2,000
Building	50,000

The Creditors were settled for ₹ 22,000. It was found, however, that there was a liability of ₹ 6,000 for damages which had to be paid. Realisation expenses amounted to ₹ 2,000.

Prepare Realisation Account, Partners' Capital Accounts and Bank Account to close the books of the firm.
[**Ans.:** *Loss on Realisation—₹ 5,600; Cash paid to A—₹ 31,760; B—₹ 25,760; C—₹ 12,880.*]

11. *J*, *S* and *R* were in partnership sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as at 31st March, 2018 was:

Liabilities		₹	Assets	₹
Capital A/cs:			Building	10,000
J	12,000		Plant	22,000
S	8,600		Stock	12,200
R	10,400	31,000	Debtors	5,000
Reserve Fund		3,000	Accrued Interest	1,000
Employees' Provident Fund		3,000	Cash	2,800
Depreciation Reserve		5,000		
Creditors		11,000		
		53,000		53,000

It was agreed to dissolve the firm and the terms of the dissolution were:

(a) *J* took Building at book value and agreed to pay Creditors.

(b) Accrued Interest was not collected whereas there was a contingent liability of ₹ 600 which was met.

(c) Other assets realised Plant—₹ 25,000; Stock—₹ 11,200; Debtors—₹ 4,600.

(d) Realisation expenses ₹ 600.

Prepare Realisation Account, Partners' Capital Accounts and Cash Account.

[**Ans.:** *Gain (Profit) on Realisation—₹ 4,400; Final Payments to Partners: J—₹ 16,700; S—₹ 11,067; R—₹ 11,633.*]

12. Amal and Bimal were partners in a firm sharing profits in the ratio of 4 : 1. They decided to dissolve the firm on 1st March, 2018. From the information given below, complete Realisation Account, Partners' Capital Accounts and Bank Account:

In the Books of Amal and Bimal

Dr. REALISATION ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Assets:			By Provision for Doubtful Debts A/c		2,000
Stock	10,000		By Creditors A/c		76,000
Debtors	40,000		By Amal's Capital A/c (Stock)		?
Fixed Assets	80,000	1,30,000	By Bank A/c:		
To Bank A/c (Creditors)		?	Debtors	37,600	
To Gain (Profit) transferred to:			Fixed Assets	1,22,000	1,59,600
Amal's Capital A/c		?			
Bimal's Capital A/c		7,920			
		2,45,600			2,45,600

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Amal ₹	Bimal ₹	Particulars	Amal ₹	Bimal ₹
To Bank A/c (Realisation Expenses)	2,000		By Balance *b/d*	20,000	60,000
To Advertisement Expenditure A/c	?	200	By Reserve A/c	16,000	?
To Realisation A/c (Stock)	8,000		By Realisation A/c	31,680	?
To Bank A/c	?	?			
	67,680	71,920		67,680	71,920

Dr. BANK ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *b/d*	47,000	By Realisation A/c	76,000
To Realisation A/c	?	By Amal's Capital A/c (Realisation Expenses)	?
		By Amal's Capital A/c	56,880
		By Bimal's Capital A/c	71,720
	2,06,600		2,06,600

Solution (Hint):

Realisation Account: Bank A/c (Creditors)—₹ **76,000**; Amal's Capital A/c (Profit)—₹ **31,680**; Amal's Capital A/c (Stock)—₹ **8,000**.

Amal's Capital Account: Advertisement Expenditure A/c—₹ **800**; Bank A/c (Final Payment)—₹ **56,880**.

Bimal's Capital Account: Reserve A/c—₹ **4,000**; Realisation A/c—₹ **7,920**; Bank A/c (Final Payment)—₹ **71,720**.

Bank Account: Realisation A/c—₹ **1,59,600**; Amal's Capital A/c (Realisation Expenses)—₹ **2,000**.

Working Notes:

1. Bimal's Share in profits is 1/5 and his share in Reserve = ₹ 4,000.
   So, Total Reserve = ₹ 4,000 × 5/1 = ₹ 20,000. Amal's Share in Reserve = ₹ 20,000 × 4/5 = ₹ 16,000.
2. *B*'s share in profits is 1/5 and his share in Advertisement Expenses = ₹ 200.
   So, total Advertisement Expenses = ₹ 200 × 5/1 = ₹ 1,000.
   A's Share in Advertisement Expenses = ₹ 1,000 × 4/5 = ₹ 800.

13. *A, B* and *C* were partners sharing profits in the ratio of 2 : 2 : 1. They decided to dissolve their firm on 31st March, 2018 when the Balance Sheet was:

Liabilities		₹	Assets		₹
Creditors		40,000	Cash		40,000
Bills Payable		46,000	Debtors	70,000	
Employees' Provident Fund		32,000	*Less:* Provision for Doubtful Debts	6,000	64,000
Mrs. *A*'s Loan		38,000	Stock		50,000
C's Loan		30,000	Investments		60,000
Investments Fluctuation Reserve		16,000	Furniture		42,000
Capital A/cs:			Machinery		1,36,000
A	1,20,000		Land		1,00,000
B	1,00,000		Goodwill		30,000
C	1,00,000	3,20,000			
		5,22,000			5,22,000

Following transactions took place:

(a) *A* took over Stock at ₹ 36,000. He also took over his wife's loan.
(b) *B* took over half of Debtors at ₹ 28,000.
(c) *C* took over Investments at ₹ 54,000 and half of Creditors at their book value.
(d) Remaining Debtors realised 60% of their book value. Furniture sold for ₹ 30,000; Machinery ₹ 82,000 and Land ₹ 1,20,000.
(e) An unrecorded asset was sold for ₹ 22,000.
(f) Realisation expenses amounted to ₹ 4,000.

Prepare necessary Ledger Accounts to close the books of the firm. *(Foreign 2003, Adapted)*

[**Ans.:** *Loss on Realisation—₹ 77,000* (*being A's share—₹ 30,800; B's share—₹ 30,800; C's share—₹ 15,400*); *Final Payments: A—₹ 91,200; B—₹ 41,200; C—₹ 50,600; Total of Cash Account—₹ 3,15,000.*]

[**Hint:** Employees' Provident Fund is a statutory liability towards employees. It must be paid.]