SECTION-D

Partnership Accounting

Partnership Accounting 4

This Module Includes

Partnership Accounting

SLOB Mapped against the Module

To develop detail understanding of accounting for changes in partnership structure and accounting in an LLP. (CMLO 4a, c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the accounting for admission of partner
- Know the process of accounting for retirement of partner
- Do the accounting in the event of death of a partner;
- Understand the treatment and accounting of joint life policy taken on partners;
- Learn the accounting in the event of dissolution of a partnership (including different methods of accounting for piecemeal distribution)
- Understanding the accounting of amalgamation of partnership firms;
- Do the accounting in the event of conversion of partnership firm to a company and sale of partnership firm to a company;
- Understand the concept of Limited Liability Partnership (LLP) and accounting thereof.

Admission of Partner

4.1

According to Section 4 of the Indian Partnership Act, 1932, the term 'partnership' refers to 'the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.' The persons who have entered into partnership agreement with each other are referred to as Partners, and they are collectively referred to as the Partnership Firm.

Sometimes for the requirement of additional capital, technical support or to improve managerial efficiency, a continuing partnership firm, in consensus with all the partners, decides to admit a new partner in their business.

Section 31(1) of the Indian Partnership Act, 1932 provides that a person can be admitted as a new partner only with the consent of all the existing partners, unless otherwise agreed upon.

This is a form of reconstruction of partnership, as because whenever a new partner is admitted to a firm, the partnership between/among the existing partners comes to an end which begins a new partnership.

Usually the following accounting adjustments are required at the time of such admission:

1. Computation of New Profit-Sharing Ratio
2. Revaluation of Assets and Liabilities
3. Memorandum Revaluation of Asset and liabilities (to bring the asset and liabilities to the book value)
4. Distribution of Reserves, Accumulated Profits and Losses
5. Adjustment for Goodwill
6. Adjustments regarding Capital Contribution of new partner and the Capitals of the existing partners
7. Adjustment for Life Policy.

Computation of New Profit-Sharing Ratio:

In the event of admission of a partner, the existing partners usually sacrifice a share of their future profit, which the new partner becomes entitled to.

The ratio in which each of the existing partners sacrifice their share of profit on the event of admission of a new partner is referred to as Sacrificing Ratio [which is basically, (Old Ratio – New Ratio)].

The new profit-sharing ratio may be agreed upon by the partners, or the mutual profit-sharing ratio among the existing partners may remain unchanged after giving away the share of the new partner.

Revaluation of Assets and Liabilities:

In order to unveil any 'secret profit' or 'secret loss' existing in the books of accounts, the revaluation of Assets and Liabilities are done at the time of Admission (or any other form of Reconstruction), so that they reflect their fair values. A firm earns profit as a result of increase in the value of assets and/or decrease in the value of liabilities.

Similarly loss suffered by an entity when there is decrease in assets and/or increase in liabilities. The effect of such revaluations are given by opening a Revaluation Account through the following journals:

Particulars		Journal Entry	
Assets	Upward revaluation:	Asset A/c To Revaluation A/c	Dr.
	Downward revaluation:	Revaluation A/c To Asset A/c	Dr.
	Recording of unrecorded asset	Asset A/c To Revaluation A/c	Dr.
Liabilities	Upward revaluation:	Revaluation A/c To Liability A/c	Dr.
	Downward revaluation:	Liability A/c To Revaluation A/c	Dr.
	Recording of unrecorded liability	Revaluation A/c To Liability A/c	Dr.
Revaluation Expenses	Paid by the firm	Revaluation A/c To Bank A/c	Dr.
	Paid by the partner	Revaluation A/c To Partner's Capital A/c	Dr.

A firm may decide to give the effect of such revaluations without incorporating the changes in the Balance Sheet values of those assets and liabilities. In that case, they have to open one Memorandum Revaluation Account. The preparation of Memorandum Revaluation Account involves the following:

(i) Record increase/decrease in the value of assets and liabilities as discussed.

(ii) Share the profit or loss on Revaluation amongst the old partners in their old profit sharing Ratio.

(iii) Reverse the increase/decrease in the value of assets and liabilities.

(iv) After reversal, calculate profit or loss.

(v) Share the profit/loss, after reversal amongst all the partners (including the new partner) in their new profit sharing ratio.

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Assets (Decrease)	x x	By Assets (Increase)	x x
To Liabilities A/c (Increase)	x x	By Libilities A/c (Decrease)	x x

Particulars	(₹)	Particulars	(₹)
To Partners Capital A/c (Share of Revaluation Profit) [Old Partners in old Profit sharing Ratio]	x x x x	By Partners Capital A/c (Share of Revaluation loss) [Old Partners in their Old profit sharing ratio]	x x
	xxx		xxx
To Reversal of Items b/d To Partners' Capital A/c (Revaluation Profit amount all partners in new profit sharing Ratio)	x x x x	By Revarsal of Items b/d By Partners' Capital A/c (Revaluation loss amought all partners in their new Profit sharing (Ratio)	x x x x
	xxx		xxx

Distribution of Reserves, Accumulated Profits and Losses:

Reserves and accumulated profits or losses refer to the profits/losses that had been earned in preceding accounting periods but not yet distributed to the existing partners. For reserves and accumulated profits, partners' capital accounts are credited and for accumulated losses partners' capital accounts are debited in the old profit sharing ratio. The accounting entries are as follows:

In case of Reserves/ Accumulated Profits			
Under Fluctuating Capital Method		**Under Fixed Capital Method**	
Reserves A/c	Dr.	Reserves A/c	Dr.
Profit and Loss A/c	Dr.	Profit and Loss A/c	Dr.
To Partners' Capital A/c		To Partners' Current A/c	
(Among old partners in old p.s.r.)		(Among old partners in old p.s.r.)	
In case of Accumulated Loss			
Under Fluctuating Capital Method		Under Fixed Capital Method	
Partners' Capital A/c	Dr.	Partners' Current A/c	Dr.
To Profit and Loss A/c		To Profit and Loss A/c	
(Among old partners in old p.s.r.)		(Among old partners in old p.s.r.)	

Adjustment for Goodwill:

Due to the existence of goodwill (generated by the old partners), a firm may have the capacity to earn super-normal profit, the share of which will be enjoyed by the new partner from the moment of admission to the firm. For this reason, an incoming partner is supposed to bring in, some extra amount in addition to the capital contribution. This extra amount is called Premium for Goodwill.

While studying Partnership Account, students may face difficulty in treatment of Goodwill and different author have taken different views while recording goodwill. It may be mentioned here that AS-26 has given a clear understanding about the recognition and treatment of goodwill. AS 26 have given clear indication about the recognition, measurement and recording of intangible Asset i.e. Goodwill. Whether the asset is tangible or intangible, to record in the books of account, it must pass through the Asset recognition criteria i.e. (1) Future economic benefits flow to the organization (2) Reliably measured the cost of Goodwill. Usually, goodwill is an internally generated intangible assets and hence cannot fulfill the asset recognition criteria with reliability. Hence, goodwill is not shown in the books of Accounts.

Since goodwill cannot be shown in the books of Account, the treatment will be as below under different situations through new partner's capital/current Account.

In case of admission : A new partner, when admitted, pays premium for goodwill, may not pay or pays partly.

(i) When premium for goodwill is paid by the new partner
Bank/Cash/any other mode A/C Dr.
To Old partners capital/ Current Account (in sacrificing ratio)

(ii) When the new partner does not pay premium towards goodwill
New partner's capital/ Current A/C Dr.
To Old partners capital/ Current Account (in sacrificing ratio)

(iii) When new partner pays premium partly
New partner's capital/ Current A/C Dr (to the extent not paid)
Bank/Cash/any other mode A/C Dr
To Old partners capital/ Current Account (in sacrificing ratio)

There may be situation that Goodwill has already been shown in the Balance sheet before admission of the new partner. Under this situation the said goodwill would not be disturbed and will be maintained in the Balance sheetasx it is not known whether the said goodwill is self generated or purchased goodwill. It may also be noted that when goodwill is shown in the Balance sheet, the new partner will not pay premium for such goodwill as it has already been transferred to old partners capital account. If the question specifically says to write off the goodwill, students may do so with old partners in old profit sharing ratio.

Incase of retirement and Death of a partner the treatment of goodwill will be as under:

Remaining partners Capital/current A/C Dr.

To Retiring/Deceased partner Capital/Current Account

(in gaining ratio)

In case of dissolution/sale/conversion, no special treatment is required. The treatment will be same as other assets like tangible assets.

When the incoming partners brings in his share of Premium for goodwill then it is to be shared among the existing partners in the Sacrificing Ratio.

There are different methods of valuation of goodwill. They are discussed as under:

Valuation of Inherent or Non-Purchased Goodwill

Sl No.	Name of the Method	Description of the method	Other Consideration
1.	**Average Profits Methods**	Under this method - **Value of Goodwill = Agreed Number of Years (Purchase) × Average Maintainable Profits** Average Maintainable/Profit Average Annual Profits 00 [Simple average or may be weighted average considering the trend of profits] Less: "Exceptional/Casual Income 00 Add: Abnormal Loss 00 00 Add: Capital Expenditure wrongly charged against profits 00 00 Less: Provision for Taxation (As may be required) 00 Adjusted Maintainable Profits 000 ("Adjustments for undercharged or overcharged Depreciation or under or over valuation of stocks to be made, if required)	i. If profits are fluctuating, simple average is taken. If profits show an increasing trend, weights may be used. If profits constantly decrease, the lowest of the profits after adjustments may be considered. ii. Exceptional Income or Expense of any particular year, should better be adjusted against the profit of that year. iii. More weightage is usually given to later years.
2.	**Super Profits Method**	Super Profit = Future maintainable profits – Normal Return on Capital Employed Goodwill = Super Profit × No. of years Steps to be followed Steps (a) Calculation of Capital employed OR Average Capital Employed	i. Calculation of Average capital Employed cannot be made if current years' profits are not separately given. ii. Trading Profits exclude any non trading income like Interest on Non-trading investments. iii. Adjustments against profits including provision for managerial remuneration, should be made. iv. If there is any change in the value of any fixed asset on revaluation, that does not affect Annual Trading Profit.

Sl No.	Name of the Method	Description of the method	Other Consideration
			But adjustment for over charged or undercharged depreciation may be required to adjust the profits. v. If there is any decrease in the value of any Current Asset like bad debts or reduction of stock and that has not been adjusted, the adjustment should be made for finding out correct Trading Profit of the current year. vi. For calculating capital employed, proposed dividend need not be deducted. [Please see valuation of shares']
		Sundry Assets 00 **Excluding:** i. Goodwill But including Goodwill at Cost Paid for ii. Non-trading assets and iii. Fictitious Assets Less: (i) Current Liabilities & Provisions -00 (ii) Contingent & Probable Liabilities -00 (Trading) **Capital Employed** 00 Less: ½ of Current years trading profits after taxation (if the profits remain undistributed) -00 **Average Capital Employed** 000 **Step (b) Average Annual Adjusted Profits (Maintainable) 00** **Step (c) Calculate Normal Return on Capital Employed or Average Capital Employed** [Say at 10% or 12%, etc. — as may be given or assumed] **Step(d) Deduct Normal Return (c) from Average Maintainable Profits (b).**	

Sl No.	Name of the Method	Description of the method	Other Consideration
		The difference is called **Annual Super Profit** **Step (e) Goodwill = Annual Super Profit × No. of Years for which the Super Profit can be maintained.** [Usually expressed as...years purchase of super profit]	
3.	**Capitalization of Profits Methods** **(A) Profits**	Under the method follow these steps – a. Calculate Annual Maintainable Profit as shown above. b. Calculate normal Capital Employed capitalizing the above profit by applying the normal rate of return. $\text{Normal Capital Employed} = \frac{\text{Maintainable Profit}}{\text{Normal Rate of Return}} \times 100$ c. Calculate actual Capital Employed d. Goodwill = Normal Capital Employed – Actual capital Employed.	Here also the profits should be adjusted considering necessary adjustments for managerial remunerations, change of depreciation, etc.
	(B) Capitalization of Super Profits	a. Calculate Super profit as said under Method 2. b. $\text{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$	
4.	**Annuity Method**	It is a derivative of super profit concept. If super profit is expected to be earned uniformly over a number of years, Goodwill is computed with the help of Annuity Table. Calculate Super Profit as discussed before **Goodwill = Annual Super ProfitxPresent Value of Annuity of ₹ 1.**	Here also similar principles as said before should be followed for calculating — Capital Employed or Average Capital Employed, Annual Average Profits and Annual Super Profits.

Adjustments regarding capital contribution of new partner and the capitals of the existing partners

At the time of admission the incoming partner is required to bring capital into the firm, the amount of which is mutually agreed upon by the partners. The capital introduced by the new partner may be either in cash or in the form of any other assets. Necessary adjustments regarding revaluation profit/loss, distribution of reserves, adjustment for goodwill etc. are effected in the books of the firm and thus, the adjusted capital account balances are found out which are shown in the Balance Sheet after admission of the new partner.

The partners may decide to maintain the closing balances of their capital accounts in a pre-determined ratio.

Adjustment for Life Policy:

Joint Life Insurance Policy is a common Life insurance policy which covers the lives of all the partners of the firm and the premium of which is borne by the firm. The Surrender Value of the Joint Life Policy as on the date of admission is to be considered for the accounting purpose. The Maturity Value is irrelevant in these cases.

Illustration 1

A and B are currently partners in a firm sharing Profit/Loss in the ratio of 4 : 3. A new partner C is admitted and after his admission new profit sharing ratio between A, B and C becomes 5: 3 : 2. What will be the sacrifice ratio of A and B after admission of C?

Solution:

Calculation of Sacrificing Ratio of A & B after C's admission

	A	:	B	:	C
Old Ratio	4	:	3		
New Ratio	5	:	3	:	2

$$A = \frac{4}{7} - \frac{5}{10} = \frac{40 - 35}{70} = \frac{5}{70}$$

$$B = \frac{3}{7} - \frac{3}{10} = \frac{30 - 21}{70} = \frac{9}{70}$$

Sacrificing Ratio is 5 : 9

Illustration 2

X, Y and Z are partners in the ratio of 3 : 2:1. W is admitted with $^{1}/_{6}$ th share in future profits. Z would retain his original shares. Find out the new profit sharing ratios of the partners.

Solution:

X's New share	= 3/6 - (1/6 × 3/5) = 12/30
Y's New share	= 2/6 - (1/6 × 2/5) 1=8/30
Z's share	= 1/6
W's share	= 1/6
Therefore, New Profit Sharing Ratio	= X:Y:Z:W = 12:8:5:5

Illustration 3

S and N are partners sharing Profit /(Loss) in the ratio of 5:3. They admit J into partnership for $\frac{3}{10}$th in the Profit /(Loss) in which J acquired $\frac{1}{5}$th share from S and $\frac{1}{10}$th share from N respectively.

Calculate the new profit and loss sharing ratios of the partners.

Solution:

$$\text{S's new share } = \left[\frac{5}{8} - \frac{1}{5}\right] = \frac{25 - 8}{40} = \frac{17}{40}$$

$$\text{N's new share } = \left[\frac{3}{8} - \frac{1}{10}\right] = \frac{15 - 4}{40} = \frac{11}{40}$$

$$\text{J's share} = \frac{3}{10} = \frac{12}{40}$$

Hence New profit/loss sharing ratios of the partners = 17:11:12

Illustration 4

X and Y are partners sharing profit/loss in the ratio of 5:4. They admit Z into partnership for $\frac{1}{5}$th the share in the profits which is given $\frac{2}{15}$th by X and $\frac{1}{15}$th by Y. Z brings ₹ 1,50,000 as his capital and ₹ 60,000 as premium. Goodwill account appears in the books at ₹ 1,65,000; Give necessary journal entries in the books of the firm at the time of Z's admission and find out the new profit sharing ratio.

Solution:

Journal

Particulars		Dr. (₹)	Cr. (₹)
i. Bank A/c	Dr.	2,10,000	
To, Z's Capital A/c			1,50,000
To, Premium for Goodwill A/c			60,000
(Being amount brought in as capital and premium for goodwill by Z)			
iii. Premium for goodwill A/c	Dr.	60,000	
To, X's Capital A/c			40,000
To, Y's Capital A/c			20,000
(Being transfer of premium brought by Z to X & Y's A/c)			
(Assuming that the goodwill shown in the books of account is purchased goodwill)			
(if it is a self generated Goodwill an extra entry as below will be passed to cancel the said goodwill between old partners in old profit sharing ratio then above tow entries I & ii will be passed))			
X's Captal Account	Dr	91667	
Y's Capital Account	Dr	73333	
To Goodwill Account			165000

New Profit sharing ratio will be:

X's new share = $\frac{5}{9} - \frac{2}{15} = \frac{25-6}{45} = \frac{19}{45}$

Y's new share = $\frac{4}{9} - \frac{1}{15} = \frac{20-3}{45} = \frac{17}{45}$

Y's new share = $\frac{1}{5}$ or $\frac{9}{45}$

Hence new ratio = 19 : 17 : 9

Note : From the above question , it is seen that goodwill is in the books at Rs.165000. Now the question is whether the said goodwill is self generated goodwill or purchased goodwill. If purchased goodwill, no need to writeoff from the books of account and whatever premium paid by the new partner will be shared by old partners in their sacrificing ratio. If self generated goodwill, first cancel that goodwill with old partners in old profit sharing ratio and distributed the premium paid by new partners as goodwill among the old partners in sacrificing ratio.

Illustration 5

X & Y share profit & loss in the ratio of 5:3. They admit Z with 1/5th share of profits. He pays ₹ 80,000 as capital but does not contribute anything towards goodwill which is valued at ₹ 60,000. The capitals of the Partners are fixed. All adjustments are to be made through partners' current accounts. Their Balance Sheet as on March 31, 2023 is as follows:

Balance Sheet as on 31.03.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital:			Plant and Machinery		50,000
X—	80,000		Investments		31,000
Y—	60,000	1,40,000	Sundry Debtors		60,000
Current account:			Stock and Trade		90,000
X—	5,000		Bank		30,000
Y—	6,000	11,000			
General Reserve		60,000			
Sundry Creditors		50,000			
		2,61,000			**2,61,000**

Additional Information:

(i) Plant and Machinery is valued at ₹ 46,000 and stock at ₹ 96,000.

(ii) One Creditor for ₹ 6,000 is dead and nothing is likely to be paid on this account.

(iii) The Capital accounts are to be proportionately adjusted on the basis of Z's capital and his share of profit, through Current accounts

(iv) Partners decide to maintain the General Reserve in the books of the firm.

Prepare Revaluation Account, Capital and Current Accounts, Bank Account and Balance Sheet of the new firm.

Solution:

Dr. **Revaluation Account** **Cr.**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
To Plant & Machinery A/c		4,000	By Stock A/c		6,000
To Partner's Current A/c			By Creditors A/c		6,000
X—	5,000				
Y—	3,000	8,000			
		12,000			**12,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Balance c/d	2,00,000	1,20,000	80,000	By Balance B/d By Bank A/c By Partners' Current A/c (b.f.)	80,000 — 1,20,000	60,000 — 60,000	— 80,000 ---
	2,00,000	**1,20,000**	**80,000**		**2,00,000**	**1,20,000**	**80,000**

Dr. **Partners' Current Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To General Reserve A/c	30,000	18,000	12,000	By Balance b/d	5,000	6,000	-
				By Revatuation A/c	5,000	3,000	-
To X's Current A/c	-	-	7,500	By Z's Current A/c	7,500	4,500	-
To Y's Current A/c	.	-	4,500	By General Reserve A/c	37,500	22,500	-
To Partners' Capital A/c	1,20,000	60,000	-	By Bank A/c (B/F)	95,000	42,000	24,000
	1,50,000	**78,000**	**24,000**		**1,50,000**	**78,000**	**24,000**

Note:

(1) General Reserve is to be maintained in the books of the firm hence is credited to old partners' capital A/c & debited to all partners' capital A/c.

(2) Sacrificing Ratio = X : Y

Old Ratio 5 : 3

Share of Z = 1/5 th

Share of X & Y in the firm = 1 – 1/5 = 4/5

X's share = 4/5 x 5/8 = 5/10

Y's share = 4/5 x 3/8 = 3/10

5/10: 3/10: 2/10 = New Ratio

Sacrificing Ratio = Old Ratio — New Ratio.

X = 5/8 – 5/10 = 10/80

Y = 3/8 – 3/10 = 6/80

Sacrificing Ratio = 10:6

(3) Adjustment for goodwill

Z's share of Goodwill = ₹ 60,000 × 1/5 = ₹ 12,000

X's share in Goodwill of Z = ₹ 12,000 × 10/16 = ₹ 7,500 in Sacrificing Ratio.

Y's share in Goodwill of Z = ₹ 12,000 × 6/16 = ₹ 4,500 in Sacrificing Ratio.

(4) Adjustment for capital

Total Capital of the firm according to capital contribution of Z = ₹ 80,000 × 5 = ₹ 4,00,000.

X's Capital balance = ₹ 4,00,000 × 5/10 = ₹ 2,00,000

Y's Capital balance = ₹ 4,00,000 × 3/10 = ₹ 1,20,000

Z's Capital balance = ₹ 4,00,000 × 2/10 = ₹ 80,000

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	30,000		
To Z's Capital A/c	80,000		
To X's Capital A/c	95,000		
To Y's Capital A/c	42,000	By Balance c/d	2,71,000
To Z's Capital A/c	24,000		
	2,71,000		**2,71,000**

Balance Sheet as on 31.03.23

Liabilities	(₹)	Assets	(₹)
Capital:		Bank	2,71,000
X	2,00,000	Debtors	60,000
Y	1,20,000	Stock	96,000
Z	80,000	Machine	46,000
Current A/c:		Investment	31,000
X	---		
Y	---		
General Reserve	60,000		
Sundry Creditors	44,000		
	5,04,000		**5,04,000**

Note: It is assumed that the partners will bring necessary fund in cash to adjust their capital through Current A/c.

Illustration 6

The Balance Sheet of a firm as on 31 .3.2023 was

Liabilities	(₹)	Assets	(₹)
Capital: Sun	50,000	Property	35,000
Moon	41,000	Motor car	7,500
Loan (Sun)	5,000	Furniture	1,000
General Reserve	5,000	Debtors	25,000
Sundry Creditors	15,000	Stock	45,000
Outstanding Expenses	1,500	Cash	4,000
	1,17,500		**1,17,500**

The profit sharing ratio between Sun & Moon was 3 : 2. They decided to admit Pluto as a new partner from 1st April, 2023 on the following terms & conditions:

(1) Property & Motor Car to be revalued at ₹ 45,000 & ₹ 6,500 respectively and 5% provision to be created on debtors.

(2) Pluto should pay premium for goodwill to be valued at 2 years' purchase of last three years average profits. Such amount of premium was to be credited to old partners loan accounts.

(3) Pluto should pay ₹ 37,500 as capital.

(4) The new profit sharing ratio should be 2: 1: 1.

(5) Last three years' profit were ₹ 5,000, ₹ 6,000 and ₹ 7,500.

The last three years' books of accounts, on verification, disclosed the following discrepancies:

2020-21 : Bad debts previously written of recovered ₹ 400, credited to Debtors Account, Closing Stock under valued by ₹ 1,250.

2021-22 : Furniture purchased ₹ 300 debited to Purchases Account,

Depreciation was provided @ 10% on reducing balance method but Closing Stock was overvalued by ₹ 2,000.

2022-23 : A purchase invoice of ₹ 1,000 was omitted from the books and Closing Stock was undervalued by ₹ 1,000.

Pass the journal entries at the time of admission of Pluto and prepare the Balance Sheet just after his admission.

Solution:

Dr. **Revaluation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Motor Car A/c To Provision for Bad Debts A/c	1,000 1,250	By Property A/c	10,000
To Profit on Revaluation: Sun 3/5 4,650 Moon 2/5 3,100	7,750		
	10,000		**10,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	Sun (₹)	Moon (₹)	Pluto (₹)	Particulars	Sun (₹)	Moon (₹)	Pluto (₹)
				By Balance b/d	50,000	41,000	—
				By Cash A/c	—	—	37,500
				By Profit on Revaluation	4,650	3,100	—
To Balance c/d	57,650	46,100	37,500	By General Reserve	3,000	2,000	
	57,650	**46,100**	**37,500**		**57,650**	**46,100**	**37,500**

Calculation of sacrificing / gaining ratio of sun & moon because of admission , Pluto.

	Sun: Moon : Pluto
Old Ratio	3:2
New Ratio	2:1:1
Sacrificing ratio (Sun's)	$\frac{3}{5} - \frac{2}{4} = \frac{12-10}{20} = \frac{2}{20}$
Moon's Sacrificing ratio =	$\frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$

Or, 2: 3

Dr. **Statement showing Adjusted Profit Account** **Cr.**

Particulars	2020-21 (₹)	2021-22 (₹)	2022-23 (₹)
Profits	5,000	6,000	7,500
Bad Debts Recovered	+ 400	—	—
Closing Stock Undervalued	+ 1,250	- 1,250	—
Furniture purchased debited to Purchases A/c		+ 300	—
Depreciation		-30	-27
Clossing stock overvalued		- 2,000	+ 2,000
Purchases not recorded			- 1,000
Closing stock undervalued			+ 1,000
	6,650	**3,020**	**9,473**

Calculation of premium to be paid by Pluto Average profit of 3 year's:

$$\frac{₹(6,650 + 3,020 + 9,473)}{3} = ₹6,381$$

Goodwill = ₹6,381 × 2 = ₹12,762

Pluto's share of goodwill = ₹12,762 × $\frac{1}{4}$ = ₹3,190.50

Adjustment Entries for rectification of past errors

Journal

Particulars		Dr. (₹)	Cr. (₹)
Furniture A/c	Dr.	243	
Debtors A/c	Dr.	400	
To Adjusted P/L A/c			643
Adjusted P/L A/c	Dr.	20	
To Provision for doubtful debts A/c			20
Closing Stock A/c	Dr.	1,000	
To Adjusted P/L A/c			1,000
Adjusted P/L A/c	Dr.	1,000	
To Creditors A/c			1,000
Adjusted P/L A/c	Dr.	623	
To Sun's Capital A/c			373.80
To Moon's Capital A/c			249.20

Journal

Particulars		Dr. (₹)	Cr. (₹)
Property A/c	Dr.	10,000	
To Revaluation A/c			10,000
(Being revaluation of property done at the time of admission of Pluto)			
Revaluation A/c	Dr.	2,250	
To Motor Car A/c			1,000
To Provision for bad debts A/c			1,250
(Being revaluation done of motor car & Provision calculated on debtors @ 5%)			
Revaluation A/c	Dr.	7,750	
To Sun's Capital A/c			4,650
To Moon's Capital A/c			3,100
(Being profit on revaluation distributed to Partner's Capital A/c)			
Cash A/c	Dr.	37,500	
To Pluto's Capital A/c			37,500
(Being cash brought in by Pluto as his share of capital)			
Cash A/c	Dr.	3,190.50	
To Pluto's Capital A/c			3,190.50
(Being cash .brought by Pluto for his share of goodwill)			
Pluto's Capital A/c	Dr.	3,190.50	
To Sun's Loan A/c			1,276.20
To Moon's Loan A/c			1,914.30
(Being Pluto's share of premium for goodwill credited to Old Partner's Capital A/c in their sacrificing ratio)			

Balance Sheet (Post-Admission)

Liabilities	(₹)	Assets	(₹)
Capital:		Property (35,000 + 10,000)	45,000.00
Sun	58,023.80	Motor Car (7,500 - 1,000)	6,500.00
Moon	46,349.20	Furniture (1,000 + 243)	1,243.00
Pluto	37,500.00	Debtors (25,000 + 400 - 1,270)	24,130.00
Loan (Sun)	6,276.20	Stock	46,000.00
Loan (Moon)	1,914.30	Cash (4,000 + 37,500 + 3,190.50)	44,690.50
Sundry creditors	16,000.00		
Outstanding Expenses	1 ,500.00		
	1,67,563.50		**1,67,563.50**

Illustration 7

P and Q are partners sharing profits and losses in the ratio of 5:4. On 1st April, 2022 they admitted their Manager R into partnership for $\frac{1}{5}$ th the share of the profits. As Manager, R was receiving a salary of ₹ 60,000 per year and a commission of 5 percent on the net profit after charging such salary and commission. It is, however, agreed that any excess over his former remuneration to which R becomes entitled as a partner is to be borne by Q.

The profits of the firm for the year ended 31st March, 2023 amounted to ₹ 4,27,500. You are required to show the division of profits among the partners.

Solution:

(i) R's remuneration as Manager

Salary ₹ 60,000 & Commission ₹ 4,27,500 - ₹ 60,000 = ₹ 3,67,500 × $\frac{5}{105}$ = ₹17,500

Or ₹ 60,000 + ₹ 17,500 = ₹ 77,500

(ii) R's share in profit = ₹ 4,27,500 × $\frac{1}{5}$ = ₹ 85,500; it excess over above (i)

= ₹ 85,500 - ₹ 77,500 = ₹ 8,000 which to be borne by Q

(iii) Share in profits of P & Q

P = ₹ 4,27,500 - ₹ 77,500 = ₹ 3,50,000 × $\frac{5}{9}$ = ₹ 1,94,444

Q = ₹ 3,50,000 × $\frac{4}{9}$ = ₹ 1,55,556 - ₹ 8,000 = ₹ 1,47,556

Dr. Profit and Loss Appropriation Account Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To P's Capital A/c:		1,94,444	By Profit for the year		4,27,500
To Q's Capital A/c:	1,55,556				
Less: transferred to R:	8,000	1,47,556			
To R's Capital A/c					
As Manager:	77,500				
Add: Transferred from Q	8,000	85,500			
		4,27,500			**4,27,500**

Illustration 8

A and B were partners of a firm sharing profits and losses in the ratio 2:1. The Balance Sheet of the firm as at 31st March, 2023 was as under:

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Plant and Machinery	5,00,000
A	8,00,000	Building	9,00,000
B	4,00,000	Sundry Debtors	2,50,000
Reserves	5,25,000	Stock	3,00,000
Sundry Creditors	2,75,000	Cash	1,50,000
Bills Payable	1,00,000		
	21,00,000		**21,00,000**

They agreed to admit P and Q into the partnership on the following terms:

(i) The firm's goodwill to be valued at 2 years' purchase of the weighted average of the profits' of the last 3 years. The relevant figures are:

Year ended 31.03.2020 - Profit ₹37,000

Year ended 31.03.2022 - Profit ₹40,000

Year ended 31.03.2023 - Profit ₹45,000

(ii) The value of the stock and Plant & Machinery were to be reduced by 10%.

(iii) Building was to be valued at ₹ 10,11,000.

(iv) There was an unrecorded liability of ₹ 10,000.

(v) A, B, P & Q agreed to share profits and losses in the ratio 3 : 2 :1:1.

(vi) The value of reserve, the values of liabilities and the values of assets other than cash were not to be altered.

(vii) P and Q were to bring capitals equal to their shares of Profit considering B's capital as base after all adjustments.

You are required to prepare:

(1) Memorandum Revaluation Account,

(2) Partner's Capital Accounts and

(3) The Balance Sheet of the newly constructed firm.

Solution:

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Stock A/c To Plant & Machinery A/c To Unrecorded Liability A/c To Profit transferred to Partners' Capital A/c (in old ratio) A = ₹14,000 B = ₹7,000	30,000 50,000 10,000 21,000	By Building	1,11,000
	1,11,000		**1,11,000**
To Building	1,11,000	By Stock A/c By Plant & Machinery A/c By Unrecorded liability A/c By Loss transferred to Partners' Capital A/c s (in new ratio) A = ₹9,000 B = ₹6,000 P = ₹3,000 Q = ₹3,000	30,000 50,000 10,000 21,000
	1,11,000		**1,11,000**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A (₹)	B (₹)	P (₹)	Q (₹)	Particulars	A (₹)	B (₹)	P (₹)	Q (₹)
To Memorandum Revaluation A/c	9,000	6,000	3,000	3,000	By Balance b/d	8,00,000	4,00,000	—	—
To Reserves A/c	2,25,000	1,50,000	75,000	75,000	By Memorandum Revaluation A/c	14,000	7,000	—	—
To A & B A/c (W.N.2)	—	—	12,000	12,000	By Reserves A/c	3,50,000	1,75,000	—	—
To Balance c/d (Refer W.N.3)	9,50,000	4,30,000	2,15,000	2,15,000	By P & O A/c (W.N.2)	20,000	4,000	—	—
					By Cash A/c (Bal. fig.)	—	—	3,05,000	3,05,000
	11,84,000	**5,86,000**	**3,05,000**	**3,05,000**		**11,84,000**	**5,86,000**	**3,05,000**	**3,05,000**

Balance Sheet of newly reconstituted firm as on 31.03.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Plant and Machinery	5,00,000
A — ₹9,50,000		Building	9,00,000
B — ₹4,30,000		Sundry Debtors	2,50,000
P — ₹2,15,000		Stock	3,00,000
Q — ₹2,15,000	18,10,000	Cash	7,60,000
Reserves	5,25,000	(₹1,50,000 + ₹3,05,000 + ₹3,05,000)	
Sundry Creditors	2,75,000		
Bills Payable	1,00,000		
	27,10,000		**27,10,000**

Working Notes:

1. Calculation of Goodwill Weighted Average Profit:

Year	Profit (₹)	Weight	Weighted Profit (₹)
2019	37,000	1	37,000
2020	40,000	2	80,000
2021	45,000	3	1,35,000
		6	2,52,000

Weighted Average Profit = ₹2,52,000/6 = ₹42,000

Goodwill is valued at 2 year's purchase

Value of Goodwill: ₹42,000 × 2 = ₹84,000

2. (a) Profit Sacrificing Ratio

Particulars	Old Shares	New Shares Share	Sacrificed Share	Gained
A	2/3	3/7	5/21	—
B	1/3	2/7	1/21	—
p	—	1/7	—	1/7
Q	—	1/7	—	1/7

(b) Adjustment for Goodwill

Partners	Goodwill as per old ratio (₹)	Goodwill as per new ratio (₹)	Effect (₹)	
A	56,000	36,000	+ 20,000	—

Partners	Goodwill as per old ratio (₹)	Goodwill as per new ratio (₹)	Effect (₹)	
B	28,000	24,000	+ 4,000	—
P	—	12,000	—	12,000
Q	—	12,000	—	12,000
	84,000	**84,000**	**24,000**	**24,000**

Journal

Particulars		Dr. (₹)	Cr. (₹)
P's Capital A/c	Dr.	12,000	
Q's Capital A/c	Dr.	12,000	
To A's Capital A/c			20,000
To B's Capital A/c			4,000

3. Calculation of closing capitals of P and Q

B's capital is taken as base. Closing capital of B after all adjustments is 4,30,000.

Total capital of firm will be = ₹4,30,000 × 7/2 = ₹15,05,000 Hence, P's and Q's closing capital should be ₹2,15,000 (₹15,05,000 × 1/7) each i.e. at par with B (as per new profit and loss sharing ratio).

Illustration-9

The balance sheet of Amit. Bhusan and Charan, who share profit and losses as 3:2:1 respectively, as on 01.04.2023 is as follows

Liabilities	Amount(₹)	Assets		Amount (₹)
Capital Accounts : Amit	1,80,000	Machinery		1,50,000
Bhusan	1,60,000	Furniture		1,50,000
Charan	1,40,000	Debtors	80,000	
Current Accounts: Bhusan	16,000	Less: Provision	4,000	76,000
Creditors	1,20,000	Stock		2,10,000
		Cash		20,000
		Current Account : charan		10,000
	6,16,000			6,16,000

Dev is admitted as a partner on the above data for $1/5^{th}$ share in the profit and loss.
Following are agreed upon:

1) The profit and loss sharing ratio among the old partners will be equal
2) Dev brings in ₹ 1,50,000 as capital but is unable to bring the required amount of premium for goodwill
3) The goodwill of the firm is valued at ₹ 60,000

4) Assets and liabilities are to be valued as follows:
   Machinery ₹ 2,60,000 : Furniture ₹ 1,28,000 : Provision for doubtful debts @ 10% on debtors .
5) Necessary adjustment regarding goodwill and profit/loss on revolution are to made through the Partner's Current Accounts .
6) It is decided that the revalued figures of assets and liabilities will not appear in the Balance Sheet of the new firm.
7) Capital Accounts of the old partners in the new firm should be proportionate the new profit and loss sharing ratio, taking Dev's Capital as base. The existing partner's will not bring cash for future Capital. The necessary adjustment are to be made through the partner's current Account

Prepare Partner's Capital & Current Account, and the Balance Sheet of the new firm after admission

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Particular	Amit	Bhusan	Charan	Dev	Particulars	Amit	Bhusan	Charan	Dev
					By Balance b/d	1,80,000	1,60,000	1,40,000	
					By Bank A/c				1,50,000
To Balance c/d	2,00,000	2,00,000	2,00,000	1,50,000	By Partner's Current A/cs (bal. fig)	20,000	40,000	60,000	
	2,00,000	2,00,000	2,00,000	1,50,000		2,00,000	2,00,000	2,00,000	1,50,000

PARTNER'S CURRENT ACCOUNTS

Dr. Cr.

Particular	Amit	Bhusan	Charan	Dev	Particulars	Amit	Bhusan	Charan	Dev
To Balance b/d	-	-	10,000	-	By Balance b/d	-	16,000		-
To Amit & Bhusan (Profit)	-		3,000	6,000	By Dev & Charan Amit	7,000	2,000		
To Amit and Bhusan (Goodwill adjustment)			6,000	12,000	By Dev & Charan (Goodwill adjustment)	14,000	4,000		
To Partners Capital A/cs	20,000	40,000	60,000		By Balance c/d		18,000	79,000	18,000
To Balance c/d	1,000								
	21,000	40,000	79,000	18,000		21,000	40,000	79,000	18,000

Balance Sheet of New Firm after Dev's Admission

Liabilities	₹	Assets		₹
Amit	2,00,000	Machinery		1,50,000
Bhushan	2,00,000	Furniture		1,50,000
Charan	2,00,000	Stock		2,10,000
Dev	1,50,000	Debtors	80,000	
Current Account: Amit	1,000	Less: Provision	4,000	76,000
Creditors	1,20,000	Cash		1,70,000
		Current Account		
		Bhusan	18,000	
		Charan	79,000	
		Dev	18,000	1,15,000
	8,71,000			8,71,000

Working Notes:

1. Dev. Joins the business for 1/5th share and bring ₹ 1,50,000 ascapital. Thus total cap[ital of new firm will be ₹ 7,50,000 (1,50,000*5). Total capital of Amit, Bhushan 7 Charan will be ₹ 6,00,000 (7,50,000 – 1,50,000) which will be shared by them equally i.e. 2,00,000 each

2. **New Profit-Sharing Ration**

Amit	Bhushan	Charan	Dev
4/5×1/3	4/5×1/3	4/5× 1/3	1/5
4/15	4/15	4/15	3/15

NR= 4:4:4:3

3. **Adjustment of Goodwill**

Sacrifice/Gain of Partners

Amit	Bhushan	Charan	Dev
4/15-3/6 -21/90 (Sacrifice)	4/15×2/6 = 6/90 (Sacrifice)	4/15 × 1/6 = 9/90 (gain)	1/5 (Gain)

JOURNAL ENTRY TO ADJUST GODWILL

Charan [₹ 60,000 × 9/90]	Dr.	₹ 6,000	
Dev [₹ 60,000 × 1/5]	Dr.	₹ 12,000	
To Amit [₹ 60,000 × 21/90]			₹ 14,000
To Bhushan [₹ 60,000 × 6/90]			₹ 4,000

4. **Net Effect of Revolution of Assets and liabilities**

Increase in value of Machinery	₹ 56,000
Decrease in value of Furniture	(₹ 22,000)
Increase in Provision for Doubtful Debts	(₹ 4,000)
Net Effect of Revolution of Assets and liabilities	₹ 30,000

Journal Entry to Adjust on Revolution

Charan [₹ 30,000 × 9/90]	Dr. 3,000	
Dev [₹ 30,000 × 1/5]	Dr. 6,000	
To Amit [30,000 × 21/90]		7,000
To Bhusan [30,000 × 6/90]		2,000

Retirement of Partner

4.2

PARTNERSHIP ACCOUNTS: RETIREMENT

Partners form a partnership business. But sometimes a partner may decide to discontinue from the firm for different reasons. Normally the retirement takes place by consent of all the partners and/or by other mode of communication by the intended partner to all other partners.

As per Section 32 of the Indian Partnership Act, 1932 a partner may retire:

- With the consent of all the existing partners; or
- In accordance with an express agreement by the partners; or
- By giving a written notice to all other partners of his intention to retire in case of 'Partnership at Will'.

Like admission, retirement of a partner is another mode of reconstitution of partnership firm.

After retirement of a partner, the other partners may continue the business. For paying off the retiring partner(s), some specific adjustments are required to be done in the books of the firm. These are discussed as follows:

- Calculation of new profit sharing ratio and gaining ratio,
- Distribution of reserves and accumulated profits and losses,
- Revaluation of assets and liabilities,
- Adjustment for goodwill,
- Adjustment for Joint Life Policy (JLP),
- Settlement of final balance of the retiring partner,
- Adjustment of existing partners' capital accounts.

Calculation of New Profit Sharing Ratio and Gaining Ratio

As a consequence of retirement, the share of profit of the retiring partner gets distributed to the continuing partners which results in again in the share of the continuing partners. The ratio in which the continuing partners will share future profits and losses is known as the New Profit Sharing Ratio.

The ratio in which the continuing partners acquire the share of profit forgone by the retiring partner is referred to as Gaining Ratio. It is calculated by taking the difference between the old profit sharing ratio and the new profit sharing ratio.

Distribution of Reserves and Accumulated Profits and Losses

The balance of reserves or profit and loss account are distributed among all the partners (including the retiring partner), in their Old Profit Sharing Ratio in the event of Retirement.

Revaluation of Assets and liabilities

The logic for revaluation of Assets and liabilities at the time of retirement of a partner is same as that at the time of admission of a new partner. In case of retirement, the revaluation profit or loss is distributed among all the partners in the Old Profit Sharing Ratio.

Adjustment for Goodwill

The goodwill of the existing partnership firm had been created and developed by all the existing partners (including the retiring partner). That is why the continuing partners are required to compensate the retiring partner in their Gaining Ratio and the necessary adjustments for Goodwill is required to be made. Gaining ratio is the ratio of the gain or increase in the profit share that is made by the continuing partners on the retirement of an outgoing partner. It is calculated by taking the difference between the old profit sharing ratio and new profit sharing ratio. The accounting treatment of goodwill in the event of retirement of a partner is as under:

The Capital Accounts of the partners are required to be adjusted:

Gaining Partners' Capital A/c Dr. (in Gaining Ratio)
To Outgoing Partner's A/c (with his share of goodwill)

Adjustment for Joint Life Policy (JLP)

Joint Life Insurance Policy is a common Life insurance policy which covers the lives of all the partners of the firm and the premium of which is borne by the firm. The Surrender Value of the Joint Life Policy as on the date of reconstitution (i.e. Admission, Retirement, Change in Profit Sharing Ratio) is to be considered for the accounting purpose. Either this should be adjusted through the Capital Account of partners or raised in the books of Account to the extent of Surrender value. The Maturity Value is irrelevant in these cases.

Settlement of Final Balance of the Retiring Partner:

After considering all the points discussed above, the amount due to the retiring partner is ascertained and to be settled in a mode as decided by the firm according to the terms of the partnership deed; or in the absence of such deed it is to be mutually decided by the partners.

The amount due to the retiring partner can either be discharged immediately after his retirement by paying off the whole amount using the business funds (i.e. Cash or Bank), or, if the firm is having paucity of liquid funds, then the retiring partner is paid in a certain number of instalments. In such case, the firm opens a Loan Account in the name of the retiring partner. Right of retiring partner under Section 37 of the Indian Partnership Act,1932: The retiring partner has the option of claiming higher of the following amounts:

(a) Share in Profits: The retiring partner's profit share is determined since the date of retirement which is to be calculated in the ratio of the present adjusted capitals or

(b) Interest @ 6% per annum: Such interest is calculated on the amount due to the retiring partner from the firm for the period starting from the date of retirement up to the date of settlement.

Illustration 9

P, Q and R sharing profits and losses equally, had been trading for many years. R decided to retire on 31.3.2023 on which date Balance Sheet of the firm is as follows.

Liabilities	(₹)	Assets	(₹)
Capital accounts:		Cash	36,000
P	1,20,000	Debtors	74,000
Q	85,000	Stock	60,000
R	75,000	Plant and Machinery	1,20,000
Creditors	85,000	Land and Building	75,000
	3,65,000		**3,65,000**

Value of goodwill was agreed as ₹93,000. Land and building increased in value, it being agreed at ₹1,05,600, plant and machinery was revalued at ₹1,00,500 and it was agreed to provide 6% in respect of debtors. Prepare Revaluation Account, Capital Accounts and Balance Sheet.

Solution:

In the Books of the Firm

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Plant & Machinery A/c		19,500	By Land & Building A/c	30,600
To Provision for Bad Debts A/c		4,440		
To Capital A/c (Profit)				
P	2,220			
Q	2,220			
R	2,220	6,660		
		30,600		**30,600**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Balance	1,06,720	71,720	—	By Balance	1,20,000	85,000	75,000
To Loan A/c	—	—	1,08220	By Revaluation A/c	2,220	2,220	2,220
	15,500	15,500		By P & Q	—	—	31,000
	1,22,220	**87,720**	**1,08,220**		**1,22,220**	**87,720**	**1,08,220**

Balance Sheet as on 31.3.2023

Liabilities	(₹)	Assets		(₹)
Capital Accounts:		Cash		36,000
P	106720	Debtors	74,000	
Q	71720	Less: Provision	4,440	69,560
Loan Account: R	1,08,220	Stock		60,000
Creditors	85,000	Plant & Machinery		1,00,500
		Land & Building		1,05,600
	3,71,660			**3,71,660**

Illustration 10

A, B and C were in partnership sharing profits in the proportion of 5:4:3. The Balance Sheet of the firm as on 31st March, 2023 was as under :

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Goodwill	40,000
A	1,35,930	Fixtures	8,200
B	95,120	Stock	1,57,300
C	61,170	Sundry Debtors	93,500
Sundry Creditors	41,690	Cash	34,910
	3,33,910		**3,33,910**

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore entered into as on 31st March, 2023, the terms of which were as follows:

(i) The Profit & Loss Account for the year ended 31st March, 2023, which showed a net profit of ₹48,000 was to be reopened. B was to be credited with ₹4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing ratio was to be revised as from 1st April, 2021 to 3:4:4.

(ii) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The Fixtures were to be revalued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

(iii) The valuations arising out of the above agreement were Goodwill ₹56,800 and Fixture ₹10,980.

(iv) B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate Goodwill from the Balance Sheet, to retain the Fixtures on the books at revised value, and to increase the provision for doubtful debts to 6%.

You are required to submit the Journal Entries necessary to give effect to the above arrangement and to draw up the Capital Accounts of the partners after carrying out all adjustment entries as stated above.

Solution:

In the books of the firm
Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023 March 31	A's Capital A/c [5/12 of ₹48,000]	Dr.	20,000	
	B's Capital A/c [4/12 of ₹48,000]	Dr.	16,000	
	C's Capital A/c [3/12 of ₹48,000]	Dr.	12,000	
	To Profit & Loss Adjustment A/c			48,000
	[Profits of ₹48,000 already shared by A, B & C as 5 : 4 : 3 written back]			
	Profit & Loss Adjustment A/c	Dr.	4,000	
	To B's Capital A/c			4,000
	[B Credited with bonus of ₹4,000 for his extra work]			
	Profit & Loss Adjustment A/c	Dr.	44,000	
	To A's Capital A/c [3/11 of ₹44,000]			12,000
	To B's Capital A/c [4/11 of ₹44,000]			16,000
	To C's Capital A/c [4/11 of ₹44,000]			16,000
	[The remaining profits re-distributed as 3 : 4 : 4]			
	Goodwill A/c	Dr.	16,800	
	Fixtures A/c	Dr.	2,780	
	To Profit & Loss Adjustment A/c			19,580
	[Values of assets increased on revaluation]			
	Profit & Loss Adjustment A/c	Dr.	1,870	
	To Provision for doubtful debts A/c			1,870
	[Provision created @ 2% on Debtors]			
	Profit & Loss Adjustment A/c	Dr.	17,710	
	To A's Capital A/c [3/11]			4,830
	To B's Capital A/c [4/11]			6,440
	To C's Capital A/c [4/11]			6,440
	[Profit on Revaluation shared among all partners as 3 : 4 : 4]			
	A's Capital A/c	Dr.	1,32,760	
	To A's Loan A/c			1,32,760
	[Transfer of A's dues to his Loan A/c]			
	B's Capital A/c [3/5]	Dr.	36,324	
	C's Capital A/c [2/5]	Dr.	24,216	
	To Goodwill A/c			56,800
	To Provision for doubtful debts A/c			3,740
	[Goodwill Account written off and provision on debtors increased by 4% further on ₹93,500]			

Dr. **Partners' Capital Account** **Cr.**

Date	Particulars	A (₹)	B (₹)	C (₹)	Date	Particulars	A (₹)	B (₹)	C (₹)
31.3.22	To Profit & Loss Adjustment A/c	20,000	16,000	12,000	31.3.22	By Balance b/d Profit and Loss	1,35,930	95,120	61,170
	To Loan A/c (Balance Transferred)	1,32,760	-	-		By Adjustment A/c (Bonus)	-	4,000	-
	To Goodwill & Provision for Doubtful Debts	-	36,324	24,216		By Profit & Loss Adjustment A/c	12,000	16,000	16,000
	To Balance c/d	-	69,236	47,394		By Profit & Loss Adjustment A/c	4,830	6,440	6,440
		1,52,760	**1,21,560**	**83,610**			**1,52,760**	**1,21,560**	**83,610**

Illustration 11

Compass, Cone and Circle are in partnership sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 31st December, 2022 was as follows :

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital accounts :			Machinery (at Cost)	50,000	
Compass	40,000		Less : Provision for Dep.	8,000	42,000
Cone	60,000				
Circle	20,000	1,20,000	Furniture		1,000
Reserve		30,000	Sundry Debtors	80,000	
Sundry Creditors		60,000	Less : Prov. for Doubtful Debts	3,000	77,000
			Stocks		50,000
			Cash at Bank		40,000
		2,10,000			**2,10,000**

On 31st March, 2023 Cone retired and Compass and Circle continued in partnership, sharing profits and losses in the ratio of 3 : 2. It was agreed that adjustments were to be made in the Balance Sheet as on 31st March, 2022, in respect of the following :

(a) The Machinery was to be revalued at ₹45,000

(b) The Stock was to be reduced by 2%

(c) The Furniture was to be reduced to ₹600

(d) The Provision for Doubtful Debts would be ₹4,000

(e) A provision of ₹300 was to be made for Outstanding Expenses.

The Partnership agreement provided that on the retirement of a partner, goodwill was to be valued at ₹24,000 and Cone's share of the same was to be adjusted into the accounts of Compass and Circle. The profit up to the date of retirement was estimated at ₹18,000. Cone was to be paid off in full, Compass and Circle were to bring such an amount in cash so as to make their capital in proportion to the new profit sharing ratio. Subject to the condition that a cash balance of ₹20,000 was to be maintained as working capital.

Pass the necessary journal entries to give effect to the above arrangements and prepare the Partners' Capital Accounts on 31st March, 2023.

Solution:

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
31.3.2023	Reserve A/c	Dr.		30,000	
	To Compass' Capital A/c				15,000
	To Cone's Capital A/c				10,000
	To Circle's Capital A/c				5,000
	(Reserve transferred to the capital accounts of the partners in 3 : 2 : 1)				
	Machinery A/c	Dr.		3,000	
	To Revaluation A/c				3,000
	(Value of the machinery increased on Cone's retirement)				
	Revaluation A/c	Dr.		2,700	
	To Stock A/c				1,000
	To Furniture A/c				400
	To Provision for Bad Debts A/c				1,000
	To Outstanding Expenses A/c				300
	(Value of the assets reduced on Cone's retirement)				
	Revaluation A/c	Dr.		300	
	To Compass' Capital A/c				150
	To Cone's Capital A/c				100
	To Circle's Capital A/c				50
	(Profit on revaluation transferred to the capital accounts of the partners)				
	Compass's Capital A/c	Dr.		2,400	
	Circle's Capital A/c	Dr.		5,600	
	To Cone's Capital A/c				8,000
	(Cone's share of goodwill to be adjusted against remaining partner's capital accounts in the gaining ratio of 3 : 7)				
	Profit and Loss Suspense A/c	Dr.		18,000	
	To Compass' Capital A/c				9,000
	To Cone's Capital A/c				6,000
	To Circle's Capital A/c				3,000
	(Estimated profit transferred to the capital accounts of the partners)				

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank Account Dr. To Profit and Loss Suspense Account (Assumed that cash has been generated due to profit accrued in this three months)		18,000	 18,000
	Cone's Capital A/c Dr. To Bank A/c (Payment is made to Cone on his retirement)		84,100	 84,100
	Bank A/c Dr. To Compass' Capital A/c To Circle's Capital A/c (Cash to be brought in by Compass and Circle as per agreement)		46,100	 16,430 29,670

Dr. **Partners' Capital Account** **Cr.**

Particulars	Compass (₹)	Cone (₹)	Circle (₹)	Particulars	Compass (₹)	Cone (₹)	Circle (₹)
To Cone's Capital A/c	2,400	—	5,600	By Balance b/d	40,000	60,000	20,000
" Bank A/c (Bal. fig.)	—	84,100	—	" Reserve A/c	15,000	10,000	5,000
" Balance c/d	78,180	—	52,120	" Revaluation A/c			
				— Profit	150	100	50
				" Share of Profit	9,000	6,000	3,000
				" Compass' Capital A/c	—	2,400	—
				" Circle's Capital A/c	—	5,600	—
				" Bank A/c (Bal. fig.)	16,430	—	29,670
	80,580	**84,100**	**57,720**		**80,580**	**84,100**	**57,720**
				By Balance b/d	78,180	—	52,120

Working Notes :

1. **Total value of goodwill ₹24,000**

   ∴ Cone's share of goodwill = ₹24,000 × 2/6 = ₹8,000 to be adjusted against Compass's and Circle capital in 3 : 7.

   Computation of ratio : Compass = 3/5 - 3/6 = 3/30 (gain) Circle = 2/5 - 1/6 = 7/30 (gain)

2. Bank Related Transactions

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	40,000	By Cone's Capital	84,100
" Profit — increase in Cash	18,000	By Balance c/d (to be maintained)	20,000
" Compass and Circle's Capital (balance figure)	46,100		
	1,04,100		**1,04,100**

3. Total adjusted capitals of Compass and Circle :

Particulars	(₹)
Compass' Capital ₹(40,000 + 15,000 + 150 + 9,000 – 2,400)	61,750
Circle's Capital :	
₹(20,000 + 5,000 + 50 + 3,000 – 5,600)	22,450
Add : Total Cash to be brought in	46,100
Combined adjusted capitals	1,30,300

∴ Compass' Capital = ₹1,30,300 × 3/5 = ₹78,180 Circle's Cap. = ₹1,30,300 × 2/5 = ₹52,120

Notes: It is assumed that there is inflow of cash to the Business equivalent to estimated profit from 1.1.22 to 31.3.22

Illustration 12

The Balance Sheet of A, B and C who are sharing profits in proportion to their capital stood as follows on March 31st 2023:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Land and Buildings		50,000
A	40,000		Plant and Machinery		17,000
B	30,000		Stock		16,000
C	20,000	90,000	Debtors	10,000	
Creditors		13,800	Less: Provision	200	9,800
			Cash at Bank		11,000
		1,03,800			**1,03,800**

B retired on the above date and the following was agreed upon:

(i) The stock be depreciated by 6%.

(ii) That the provision for doubtful debts be brought up to 5% on Debtors.

(iii) That the Land and Buildings be appreciated by 20%.

(iv) That a provision for ₹ 1,540 be made in respect of outstanding legal charges.

(v) That the Goodwill of the entire firm be fixed at ₹ 21,600 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.

(vi) That the assets and liabilities (except Cash at Bank) were to appear in the Balance Sheet at their old figures.

(vii) That the entire capital of the firm as newly constituted by fixed at ₹ 56,000 between A and C in the proportion of 5: 3 (actual cash to be brought in as paid off, as the case may be).

Show the Balance Sheet after B's retirement.

Solution:

Balance Sheet as on 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account:			Land and Building		50,000
A	35,000		Plant and Machinery		17,000
C	21,000	56,000	Stock		16,000
B's Loan A/c		39,600	Debtors	10,000	
Creditors		13,800	Less: Provision for Bad Debt	200	9,800
			Cash at Bank (₹ 11,000 + ₹ 5,600)		16,600
		1,09,400			**1,09,400**

Note: Since assets and liabilities will appear in the Balance Sheet at their old figure Memorandum Revaluation Account should be opened.

Working Notes:

Gaining Ratio

$$A = \frac{5}{8} - \frac{4}{9} = \frac{45 - 32}{72} = \frac{13}{72}$$

$$C = \frac{3}{8} - \frac{2}{9} = \frac{27 - 16}{72} = \frac{11}{72}$$

Hence, gaining ratio = 13: 11

Memorandum Revaluation Account

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Under valuation of Stock		960	By Overvaluation of Land and Building		10,000
To Provision for Bad Debts ₹(500-200)		300			
To Provision for legal changes		1,540			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Profit on Rev:					
A	3,200				
B	2,400				
C	1,600	7,200			
		10,000			**10,000**
To Reversal of items		10,000	By Reversal of items:		
To Over valuation of Land and Building			By Undervaluation of Stock		960
			By Provision for Bad Debts		300
			By Provision for legal changes		1,540
			By Capital A/c		
			Profit to be written-back		
			A-5/8 =	4,500	
			C-3/8 =	2,700	7,200
		10,000			**10,000**

B's share of goodwill = ₹21,600 × 3/9 = ₹7,200

The entry being:

Particulars		Debit (₹)	Credit (₹)
A's Capital A/c	Dr.	3,900	
C's Capital A/c		3,300	
To, B's Capital A/c			7,200
(Being gaining ratio)			

Dr. Partners' Capital Account Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Memo. Reval. A/c	4,500	-----	2,700	By Balance b/d	40,000	30,000	20,000
To B's Capital A/c	3,900	-----	3,300	By Revaluation A/c –Profit	3,200	2,400	1,600
To B's Loan A/c	----	39,600	-----	By A's capital A/c	-----	3,900	-----
				By B's Capital A/c	-----	3,300	-----
To Balance c/d	35,000*	-----	21,000	By Bank A/c (Balance Fig.)	200	-----	5,400
	43,400	**39,600**	**27,000**		**43,400**	**39,600**	**27,000**

* Total Capital = ₹56,000 in 5 : 3, i.e., A ₹35,000; C ₹21,000.

RETIREMENT-CUM- ADMISSION

In many cases, whenever an existing partner retires, another partner joins the continuing partners in the firm. This situation is referred to as Retirement-cum-Admission. The principles of accounting in the event of admission of a partner and retirement of a partner have been separately discussed. In this section, the combined effect of simultaneous admission and retirement has been highlighted. It should be remembered that no separate treatment is practically needed i.e. same principles for admission and retirement are followed but only two sets of transactions are incorporated simultaneously.

Illustration 13

Gita and Mita are equal partners. Gita, by agreement, retires and Lata joins the firm on the basis of one third share of profits on 01.04.2023. The balances of the books as on 31st March 2023 were:

Particulars	Dr. (₹)	Cr. (₹)
Good will	10,000	
Fixed Assets at Cost	1,20,000	
Current Assets:		
Stock	60,000	
Debtors	40,000	
Bank	8,000	
Creditors		20,000
Provision for Depreciation		12,000
Capital Accounts:		
Gita		1,04,000
Mita		1,02,000
	2,38,000	**2,38,000**

Goodwill and Fixed Assets valued at ₹30,000 and ₹1,40,000 respectively and it was agreed to be written up accordingly before admission of Lata as partner. Sufficient money is to be introduced so as to enable Gita to be paid off and leave ₹5,000 cash at Bank; Mita and Lata are to provide such sum as to make their Capitals proportionate to their share of profit. Assuming the agreement was carried out, you are required to pass the journal entries and prepare the Balance Sheet after admission of Lata.

Solution:

In the books of the firm
Journal

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
2023	Goodwill A/c	Dr.		20,000	
April 1	Fixed Asset A/c	Dr.		20,000	
	Prov. for Depreciation A/c	Dr.		12,000	
	To Revaluation A/c				52,000
	(Increased value of assets transferred to Revaluation A/c)				

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2023 April 1	Revaluation A/c Dr.		52,000	
	To Gita's Capital A/c			26,000
	,, Mita's Capital A/c			26,000
	(Profit on revaluation transferred)			
	Gita's Capital A/c Dr.		1,30,000	
	To Bank A/c			1,30,000
	(Amount paid to Gita)			
	Bank A/c Dr.		1,27,000	
	To Mita's Capital A/c			42,000
	,, Lata's Capital A/c			85,000
	(Additional cash to be brought in to make their capital in proportion).			

Balance Sheet as on April 1, 2023

Liabilities	(₹)	Assets	(₹)
Capital:		Goodwill	30,000
Mita	1,70,000	Fixed Assets	1,40,000
Lata [WN: 2]	85,000	Stock	60,000
Creditor	20,000	Debtors	40,000
		Cash at Bank [WN: 1]	5,000
	2,75,000		**2,75,000**

Working Notes:

1. **Bank balance on 1.4.2023**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	8,000	By Gita's capital A/C	1,30,000
To Mita's capital 42,000 []WN 4 Lata's Capital 85,000	1,27,000	,, Balance c/d	5,000
	1,35,000		**1,35,000**

2. Capital of the new firm

Particulars	(₹)
Goodwill	30,000
Fixed Asset	1,40,000
Stock	60,000
Debtors	40,000
Cash at Bank	5,000
	2,75,000
Less: Creditors	20,000
	2,55,000

Mita = ₹2,55,00 × 2/3 = ₹1,70,000

Lata = ₹2,55,000 × 1/3 = ₹85,000

3. Profit on Revaluation

Dr. Revaluation Account Cr.

Particulars	(₹)	Particulars	(₹)
To Capital A/c		By Goodwill A/c	20,000
Profit on Revaluation :		,, Fixed Assets A/c	20,000
Gita 26,000		,, Prov. For Depreciation A/c.	12,000
Mita 26,000	52,000		
	52,000		**52,000**

4. Amount to be brought in by Mita

Particulars	(₹)	(₹)
Capital to be maintained [WN: 2]		1,70,000
Less: Opening balance	1,02,000	
Profit on Revaluation [WN: 3]	26,000	1,28,000
To be brought in by Mita		42,000

Illustration 14

X, Y, & Z were equal partners. Their Balance Sheet as on 31.12.2022 was as follows :

Partners' Capital			Land & Freehold Property	1,00,000
X	1,00,000		Plant & Machinery	2,00,000
Y	1,00,000		Furniture & Equipment	50,000
Z	2,00,000	4,00,000	Stock in-trade	1,00,000

Partner's Current A/c :			Sundry Debtors	1,00,000
X	50,000		Balance with Bankers	1,50,000
Y	75,000			
Z	25,000	1,50,000		
Sundry Creditors		1,50,000		
		7,00,000		**7,00,000**

On 1.1.2023, X retired and it was agreed that he should be paid all his dues in full on that date. For this purpose, goodwill was to be calculated on the basis of 3 years purchase of past 3 years profits which amounted to ₹1,00,000, ₹1,40,000 and ₹1,20,000 respectively.

In order to meet his obligation, a bank loan was arranged on 1.1.2023 for ₹2,00,000 pledging the fixed assets as security.

Further, to compensate a loyal manager Q, it was agreed between Y and Z that Q should be admitted as a partner, who should bring in, over and above a capital of ₹1,00,000, his share of Goodwill in cash to serve as working capital. Y and Z agreed to forego 1/3rd of their individual share of profits to Q.

Prepare Partners Capital Accounts, Partners' Current Accounts and opening Balance Sheet of the firm as on 1.1.2023.

Solution:

Dr. **Partners' Capital Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Q (₹)	Particulars	X (₹)	Y (₹)	Z (₹)	Q (₹)
To Cash A/c (Final settlement)	2,70,000	-	-	-	By Balance b/d	1,00,000	1,00,000	2,00,000	-
					" X's Current A/c (Transfer)	1,70,000	-	-	-
To Balance c/d	-	1,00,000	2,00,000	1,00,000					
					" Cash A/c (Capital introduced)	-	-	-	1,00,000
	2,70,000	**1,00,000**	**2,00,000**	**1,00,000**		**2,70,000**	**1,00,000**	**2,00,000**	**1,00,000**

Dr. **Partners' Current Account** **Cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To X's Capital A/c (Tran)	1,70,000	-	-	By Balance b/d	50,000	75,000	25,000
				" Y's Current A/c	60,000	-	-
To X's Current A/c	-	60,000	60,000	" Z's Current A/c	60,000	-	-
To Balance c/d	-	75,000	25,000	" Cash A/c	-	60,000	60,000
	1,70,000	**1,35,000**	**85,000**		**1,70,000**	**1,35,000**	**85,000**

Balance Sheet as on 1.1.2022

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Partners' Capital A/cs :			Land and Freehold Property		1,00,000
Y	1,00,000		Plant & Machinery		2,00,000
Z	2,00,000		Furniture & Equipment		50,000
Q	1,00,000	4,00,000	Stock		1,00,000
			Debtors		1,00,000
Partner's Current A/cs :			Cash at Bank (WN: 2)		3,00,000
Y	75,000				
Z	25,000	1,00,000			
Bank loan (Secured)		2,00,000			
Sundry Creditors		1,50,000			
		8,50,000			**8,50,000**

Working Notes :

(1) Valuation of Goodwill

$$\text{Average Annual Profits} = \frac{₹\ (1,00,000 + 1,40,000 + 1,20,000)}{3} = ₹\ 1,20,000$$

∴ Goodwill = 3 × ₹1,20,000 = ₹3,60,000

Premium to be paid by Q = 1/3 of ₹3,60,000 = ₹1,20,000 and to be shared by Y and Z equally. Similarly, X should be provided ₹1,20,000 by Y and Z equally.

2. Balance with Bank on 1.1.2023

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,50,000	By X's Capital A/c	2,70,000
To Bank Loan A/c	2,00,000		
To Cash A/c (Premium for goodwill)	1,20,000		
To Q's capital A/c	1,00,000	By Balance c/d	3,00,000
	5,70,000		**5,70,000**

Illustration 15

X,Y and Z are partners sharing profits and losses in the proportion to 3:2:2, respectively. The Balance Sheet of the firm as on 01.01.2023 was as follows:

Liabilities		(₹)	Assets	(₹)
Capital Accounts;	(₹)		Plant and Machinery	72,000
X	1,00,000		Furniture	28,000
Y	80,000		Stock	1,12,000
Z	70,000	2,50,000	Sundry Debtors	96,000
Bank overdraft		20,000	Cash at Bank	18,000
Sundry Creditors		56,000		
		3,26,000		**3,26,000**

X retired on 01.01.2023 on which date R is admitted as new partner. For the purpose of adjusting the rights as between on partners' goodwill to be valued at ₹84,000 and Sundry Debtors and Stock to be reduced by ₹16,000 and to ₹1,00,000 respectively. X is to receive ₹44,000 in cash on the date of retirement and the balance due to him is to remain as loan at 8% p.a. Repayment of loan to be made at the end of each year by annual installments representing 25% of the future profit before charging interest on loan.

R is to bring in ₹1,00,000 in cash as his capital on the date of admission. The new partners are to share profits and losses equally after paying the interest on X's Loan.

The net profit for the year ended 31st December 2023, is ₹64,000 before taking into account the installment payable to X.

You are required to show:

(a) Profit and Loss Appropriation Account for the year ended 31st December,2023.

(b) Capital Accounts of the new partners; and

(c) X's Loan Account as on 31st Dec, 2023.

Solution:

In the books of firm

Revaluation Account

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Provision for Bad Debts		16,000	By Goodwill	84,000
To Stock		12,000		
To Share of Profit:				
- X 3/7	24,000			
- Y 2/7	16,000			
- Z 2/7	16,000	56,000		
		84,000		**84,000**

Dr. **Capital Account** Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Bank – Repayment	44,000	-	-	By Balance c/d	1,00,000	80,000	70,000
„ X's Loan A/c	80,000	-	-	„ Revaluation A/c			
„ Balance c/d	-	96,000	86,000	- Profit	24,000	16,000	16,000
	1,24,000	**96,000**	**86,000**		**1,24,000**	**96,000**	**86,000**

Profit and Loss Appropriation Account
for the year ended 31.12.2023

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Loan Redemption Fund A/c		16,000	By Profit and Loss A/c	
(25% of ₹64,000)			- Net Profit	64,000
„ Share of Profit:				
- Y (1/3)	16,000			
- Z (1/3)	16,000			
- R (1/3)	16,000	48,000		
		64,000		**64,000**

Dr. **Partners' Capital Account** Cr.

Particulars	Y (₹)	Z (₹)	R (₹)	Particulars	Y (₹)	Z (₹)	R (₹)
To Balance c/d	1,12,000	1,02,000	1,16,000	By Balance c/d	96,000	86,000	-
				„ Bank A/c	-	-	1,00,000
				„ Share of profit	16,000	16,000	16,000
				By Balance b/d	1,12,000	1,02,000	1,16,000
	1,12,000	**1,02,000**	**1,16,000**		**1,12,000**	**1,02,000**	**1,16,000**

Dr. **X's 8% Loan Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c	16,000	By X's Capital A/c	80,000
To Balance c/d	70,400	" Interest [80,000 × 8%]	6,400
	86,400		**86,400**
		By Balance c/d	70,400

Illustration 16

P, Q and R were partners sharing Profits & Losses as 2 : 3 : 5. P retired on 31.03.2022 and X joined as a new partner on the same date, the new profit sharing ratio between Q, R and X being 2 : 3 : 1. The Balance Sheet of P, Q & R on 31.03.2023 was as follows :

Liabilities		(₹)	Assets	(₹)
Sundry Creditors		50,000	Cash in hand	2,000
Loan from X		50,000	Cash at Bank	93,000
General Reserve		40,000	Sundry Debtors	30,000
Capitals :			Stock	20,000
P	10,000		Machinery	30,000
Q	15,000		Buildings	10,000
R	20,000	45,000		
		1,85,000		**1,85,000**

X was admitted on the following terms :

(i) Machinery was to be depreciated by ₹3,000

(ii) Buildings were revalued at ₹30,000

(iii) Stock was to be written off by ₹5,000

(iv) Provision of 5% was made against doubtful debts

(v) General Reserve would be apportioned among the partners

(vi) The firm's Goodwill was to be valued at two years purchase of the average profits of the last three years

(vii) The amount due to P was retained in the business as a loan but X's Capital contribution should be 1/5th of the combined adjusted capitals of Q and R. His capital would be transferred from his Loan Account,

(viii) the Goodwill would be wiped off from the books after X's admission.

(ix) Partners decided not to alter the book values of assets & liabilities after admission.

The profits/losses during the last 3 years had been 31.03.2021 ₹20,000 (Profit) 31.03.20212 ₹15,000 (loss) and 31.03.2023 ₹40,000 (Profit).

Show the Memorandum Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm.

Solution:

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Machinery A/c	3,000	By Building A/c	20,000
" Stock	5,000		
" Prov. for doubtful Debts	1,500		
" P/Capital A/c			
(Share of Rev. Profit)			
P – ₹2,100			
Q – ₹3,150			
R – ₹5,250	10,500		

	20,000		**20,000**
To Reversal of Items b/d	20,000	By Reversal of Items b/d	
Building		Machinery	3,000
		Stock	5,000
		Provision for D/Debts	1,500
		By P/Capital A/c	
		(Share of Rev. Profit)	
		Q – 3,500	
		R – 5,250	
		X – 1,750	10,500
	20,000		**20,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	X (₹)	Particulars	P (₹)	Q (₹)	R (₹)	X (₹)
To Memorandum Rev A/c					By Balance b/d	10,000	15,000	20,000	-
- Share of loss	-	3,500	5,250	1,750	By General Reserve	8,000	12,000	20,000	-
To Goodwill writtenoff	-	10,000	15,000	5,000	By Memorandum Rev A/c				
					- Share of profit	2,100	3,150	5,250	-
To P's loan A/c	26,100				By Goodwill raised	6,000	9,000	15,000	-
(transfer)					By Loan from X A/c	-	-	-	19,880
					(Transfer)				
To Balance c/d	-	25,650	40,000	13,130					
	26,100	**39,150**	**60,250**	**19,880**		**26,100**	**39,150**	**60,250**	**19,880**

Capital Balance of X = 1/5 of (₹25,650 + ₹40,000) = 1/5 × ₹65,650 = ₹13,130

Therefore from X's loan A/c :

Loan from X A/c Dr. ₹19,880

To, X's Capital A/c ₹19,880

Balance Sheet of Q, R & X
as at 31.3.2023

Liabilities	(₹)	Assets	(₹)
S/Creditors	50,000	Building	10,000
Loan for X	30,120	Machinery	30,000
Loan from P	26,100	Stock	20,000
Capitals :		Debtors	30,000
Q : 25,650		Cash in hand	2,000
R : 40,000		Cash at Bank	93,000
X : 13,130	78,780		
	1,85,000		**1,85,000**

Working Notes :

1. Valuation of Goodwill

Average Annual Profits = [₹20,000 + (₹15,000) + ₹40,000]/3 = ₹45,000/3 = ₹15,000.

Goodwill = 2 × ₹15,000 = ₹30,000

Illustration 17

A, B and C are in partnership sharing Profits and Losses in the ratio 3:2:1 respectively. The Balance Sheet of the partnership firm as on 31st March, 2023 is as under:

Capital & Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts			Premises		1 80,000
A	1,70,000		Plant		74,000
B	1,30,000		Vehicles		30,000
C	70,000	3,70,000	Fixtures		4,000
Current Accounts			Current Account		
A	7,428		B		5,018
C	9,356	16,784	Stock		1,24,758
Loan-C		56,000	Debtors		69,960
Creditors		38,072	Cash in hand		1,520
Bank Overdraft		8,400			
		4,89,256			**4,89,256**

C decides to retire from the business as on the above date and D is admitted as a partner on that date. The following matters agreed:

(i) Assets revalued as : Premises - ₹2,40,000, Plant- ₹70,000 Stock - ₹1,08,358.

(ii) A provision of ₹6,000 is created against debtors.

(iii) Goodwill is to be recorded in the books on the day C retires at ₹ 84,000. The partners in the new firm do not wish to maintain a Goodwill Account so that amount is to be written-off against the New Partners' Capital Accounts.

(iv) A and B are to share profit in the same ratio as before, and D is to have the same share of profits as C.

(v) C is to take a car at its book value of ₹ 7,800 in part payment, and the balance of all he is owed by the firm in cash except ₹ 40,000 which he is willing to leave as a Loan Account.

(vi) The partners in the new firm are to start on an equal footing so far as Capital and Current Account are concerned. D is to contribute cash to bring his Capital and Current Account to the same amount as the original partner from the old firm who has the lower investment in the business. The original partner in the old firm who has the higher investment will draw out cash so that his capital and current account balances equal those of his new partners. -

(vii) Revaluation profit or loss is to be adjusted in the Partners' Current Account.

You are required to prepare Revaluation Account, Partners' Capital Accounts, Partners' Current Accounts, C's Loan Account, Bank Account and Balance Sheet of the newly constituted firm as at April 1, 2023.

Solution:

(a) **In the books of the firm**

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Plant A/c		4,000	By Premises A/c	60,000
To Stock A/c		16,400		
To Provision for doubtful debts A/c		6,000		
To Partner's Current A/c s		33,600		
A	16,800			
B	11,200			
C	5,600			
		60,000		**60,000**

(b)

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D(₹)
To Goodwill A/c (3:2:2)	36,000	24,000	—	24,000	By Balance b/d	1,70,000	1,30,000	70,000	—
To Loan A/c	42,000	—	84,000*	—	By Goodwill A/c (3:2:1)	42,000	28,000	14,000	—
To Bank A/c	—	—	—	—	By Bank A/c	—	—	—	1,58,000
To Balance c/d	1,34,000	1,34,000	—	1,34,000					
	2,12,000	**1,58,000**	**84,000**	**1,58,000**		**2,12,000**	**1,58,000**	**84,000**	**1,58,000**

* As mentioned in the illustration that goodwill is to be recoreded in the books on the day C retires at ₹84,000.

(c) Dr. **Partners' Current Account** Cr.

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D(₹)
To Balance b/d	—	5,018	—	—	By Balance b/d	7,428	—	9,356	—
To C's Loan A/c	—	—	14,956	—	By Revaluation A/c	16,800	11,200	5,600	—
To Bank A/c	18,046	—	—	—					
To Balance c/d	6,182	6,182	—	6,182	By Bank A/c	—	—	—	6,182
	24,228	**11,200**	**14,956**	**6,182**		**24,228**	**11,200**	**14,956**	**6,182**

(d) Dr. **C's Loan Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Vehicles A/c	7,800	31.03.23	By Balance b/d	56,000
	To Bank A/c (Bal. fig.)	1,07,156		By C's Capital A/c	84,000
	To Balance c/d	40,000		By C's Current A/c	14,956
		1,54,956			**1,54,956**

(e) Dr. **Bank Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To D Capital A/c	1,58,000	31.03.23	By Balance b/d	8,400
	To D Current A/c	6,182		By C's Loan A/c	1,07,156
	To Balance c/d	11,420		By A's Capital A/c	42,000
				By A's Current A/c	18,046
		1,75,602			**1,75,602**

(f) **Balance Sheet of as on 01 .04.2023**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Premises		2,40,000
A	1,34,000		Plant		70,000
B	1,34,000		Vehicles		22,200
D	1,34,000	4,02,000	Fixtures		4,000
Current Accounts:			Stock		1,08,358
A	6,182		Debtors	69,960	
B	6,182		Less: Provision for bad debts	6.000	63,960
D	6,182	18,546	Cash		1,520
C's Loan Account:		40,000			
Creditors		38,072			
Bank Overdraft		11,420			
		5,10,038			**5,10,038**

Working Notes:

Calculation of New P.S.R.

D's share = B's share = $\frac{2}{6}$

A's share = $\frac{3}{6}$;

B's share = $\frac{2}{6}$

$\therefore$ A:B:D = $\frac{3}{6} : \frac{2}{6} : \frac{2}{6}$ = 3:2:2

Death of Partner

4.3

If a continuing partner dies, then it leads to reconstitution of partnership firm.

In the event of death of a partner, the other partners may decide to continue the business which requires certain adjustments to be made in the books of accounts of the existing partnership firm which are as follows:

- Calculation of new profit sharing ratio and gaining ratio,
- Distribution of reserves and accumulated profits and losses,
- Revaluation of assets and liabilities,
- Adjustment for goodwill,
- Adjustment for Joint Life Policy (JLP),
- Adjustment for interim period's profit/loss,
- Settlement of final balance of the deceased partner to his Executor.

Calculation of new profit sharing ratio and Gaining Ratio:

As a consequence of death, the share of profit of the deceased partner gets distributed to the continuing partners which results in again in the share of the continuing partners. The ratio in which the continuing partners will share future profits and losses is known as the New Profit Sharing Ratio. The ratio in which the continuing partners acquire the share of profit forgone by the deceased partner is referred to as Gaining Ratio. It is calculated by taking the difference between the old profit sharing ratio and the new profit sharing ratio.

Distribution of Reserves and Accumulated Profits and Losses:

The balance of reserves or undistributed profit (as represented by balance of Profit & Loss Account) are distributed among all the partners (including the Executor of deceased partner) in their old profit sharing ratio in the event of death of a partner.

Revaluation of assets and liabilities:

The logic for revaluation of Assets and liabilities at the time of death of a partner is same as that at the time of admission of a new partner. In case of death, the revaluation profit or loss is distributed among all the partners (including the Executor of the deceased partner) in the Old Profit Sharing Ratio.

Adjustment for Goodwill:

The goodwill of the existing partnership firm had been created and developed by all the existing partners (including the deceased partner). So, the continuing partners are required to compensate the deceased partner in their Gaining Ratio and the necessary adjustment for Goodwill is required to be made...

Adjustment for Joint Life Policy (JLP):

The mode of accounting for Joint life policy depends upon the accounting policy of the firm. Either JLP is treated as an asset or as an expense in the books of the firm. Unlike Admission and Retirement, the Surrender Value has no role to play, only the maturity value of the Joint Life Policy is to be taken into consideration in the case of death of a partner.

Adjustment for interim period's profit/loss:

Unlike Admission and Retirement, the date of which are generally pre-planned, the death of a partner can take place anytime during the Accounting Period. In such case, the amount of profit or loss, starting from the opening date of the accounting period ending up to the date of death, is to be determined (which is called as the interim period's profit or loss) and the share of the deceased partner in such Profit/Loss is to be duly accounted for. For this purpose, generally a temporary account is opened in the books of the firm called P/L Suspense A/c.

Normally two approaches are there to estimate the profit or loss for the interim period:

(i) **On Time Basis:** Here the average profit of last periods is considered, which is apportioned between the pre-death period and the post-death period.

(ii) **On Sales Basis:** Under this approach, the rate of profit on sales earned in the last year is computed and is applied to the interim period's sales.

Settlement of final balance of the deceased partner to his Executor:

The amount payable to the representative of the deceased partner (commonly known as Executor) can be made either immediately or as deferred settlement. The accounting procedure involved is similar to that followed in case of retirement of a partner. The mode of payment depends on the agreement between the partners. It may be:

(i) **Lump Sum Payment:** If the firm has sufficient funds, the total amount payable on account of the deceased partner is transferred to his Representative's Account (or Executor). Such Representative's Account is debited and Bank Account is credited on payment of the dues.

(ii) **Instalment Payment/Loan Payment:** The firm may not have enough funds to make prompt payment. In such a case, the total amount payable is transferred to a loan account in the name of the legal representative or executor. The loan is paid off gradually by installments after considering interest on unpaid balance. The word "Loan" may or may not be appended with the Account. But its gradual payment will definitely resemble the payment of loan.

Illustration 18

A, B and C have been in business partnership for some years, Sharing Profit in the proportions of 4:3:3. The balances in the books of the firm as on 31st March, 2023 subject to final Adjustment, were as under:

	Dr. (₹)	Cr. (₹)
Capital Account - A		3,00000
Capital Account - B		1,50,000
Capital Account - C		1,80,000
Profit for the year before charging interest		3,12,000
Land and Buildings	2,40,000	
Furniture and Fixtures	45,000	
Stock	3,75,000	

	Dr. (₹)	Cr. (₹)
Debtors	60,000	
Bank	1,20,000	
Creditors		90,000
Partner's Drawings - A	48,000	
Partner's Drawings - B	72,000	
Partner's Drawings - C	72,000	
Total	**10,32,000**	**10,32,000**

C died on 30.09.2022. The Partnership deed provided that:

(1) Interest was to be credited on Capital accounts of partners at 10% P.A. on the balance at the beginning of the year.

(2) On the death of a Partner:

(i) Goodwill was to be valued at three years' purchase of average Annual Profits of three years up to the date of death, after deducting interest on Capital Employed at 8% P;A. and a fair remuneration for each of the partners;

(ii) Fixed Assets were to be valued by an independent valuer and all other assets and liabilities to be taken at Book Value.

(3) Wherever necessary, profit or loss should be apportioned on a time basis.

(4) The amount due to the deceased partner's Sole Heir was to receive interest @ 12% P.A. from the date of death until paid.

It was ascertained that:

(a) Profits for three years, before charging partners' interest were: 2019-20; ₹3,36,000, 2020-21 : ₹3,78,000 and 2021-22: ₹3,60,000 respectively.

(b) The independent valuation at the date of death revealed: Land and Buildings ₹3,00,000 and Furniture and Fixtures ₹30,000.

(c) A fair remuneration for each of the Partners would be ₹75,000 P.A. and that the Capital employed in business to be taken as ₹7,80,000 throughout.

It was agreed among the Partners that:

(i) Goodwill was not to be shown as an asset of the firm as on 31.03.2023. Therefore, adjustment for goodwill was to be made in Capital Accounts.

(ii) A and B would share equally from the date of death of C.

(iii) Depreciation on revised value of assets would be ignored.

You are required to prepare:

(i) Revaluation Account

(ii) Partners' Capital Accounts

(iii) Partners' Current Accounts

(iv) C's Heir Account

(v) Balance Sheet as on 31.03.2022

Solution:

(i) In the Books of firm

Dr. **Revaluation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Furniture and Fixture A/c To Partners' Capital A/c s (A- ₹18,000, B - ₹13,500, C - ₹13,500)	15,000 45,000	By Land and Building A/c	60,000
	60,000		**60,000**

Dr. **(ii) Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To C's Capital A/c - Goodwill	19,980	39,960	------	By Balance b/d	3,00,000	1,50,000	1,80,000
To C's Current A/c. - Transfer	-----	-----	25,650	By Revaluation A/c	18,000	13,500	13,500
To C's Heir A/c	-----	-----	2,27,790	By A's Capital A/c Goodwill	-------	-------	19,980
To Balance c/d	2,98,020	1,23,540	------	By A's Capital A/c Goodwill	-------	-------	39,960
	3,18,000	**1,63,500**	**2,53,440**		**3,18,000**	**1,63,500**	**2,53,440**

Dr. **(iii) Partners' Current Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	48,000	72,000	72,000	By P/L Appropriation A/c (Interest on Capital A/c)	30,000	15,000	9,000
To Balance c/d	91,716	40,266		By P/L Appropriation A/c	1,09,716	97,266	37,350
				By Capital A/c (Transfer)	-------	-------	25,650
	1,39,716	**1,12,266**	**72,000**		**1,39,716**	**1,12,266**	**72,000**

Dr. **(iv) C's Heir Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance c/d	2,41,458	By C's Capital A/c By Profit & Loss Appropriation	2,27,790 13,668
	2,41,458		**2,41,458**

(v) Balance Sheet as on 31st March, 2023

Liabilities	(₹)	Assets	(₹)
Capital Account - A	2,98,020	Land and Buildings	3,00,000
Capital Account - B	1,23,540	Furniture and Fixtures	30,000
Current Account - A	91,716	Stock	3,75,000
Current Account - B	40,266	Debtors	60,000
C's Heir Account	2,41,458	Bank	1,20,000
Creditors	90,000		
	8,85,000		**8,85,000**

Working Note:

(1) Adjustment in Regard to Goodwill

Particulars		(₹)
Aggregate profits for three years upto date of death (30.09.2021) are as follows:		
Profit for the year ended 30.9.20: (½ of ₹ 3,36,000 + ½ of ₹ 3,78,000)		3,57,000
Profit for the year ended 30.9.21: (½ of ₹ 3,78,000 + ½ of ₹ 3,60,000)		3,69,000
Profit for the year ended 30.9.22: (½ of ₹ 3,60,000 + ½ of ₹ 3,12,000)		3,36,000
Total profits for three years		10,62,000
Average profits (₹ 10,62,000 ÷ 3)		3,54,000
Less: interest on capital employed (8% on ₹7,80,000)	₹62,400	
Fair remuneration to partners	₹2,25,000	2,87,400
Adjusted average profit for goodwill		66,600
Goodwill is the purchase of 3 year's profit = 3 × ₹66,600		1,99,800

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before death (4:3:3)	79,920	59,940	59,940
Right of goodwill after death (1:1)	99,900	99,900	—
Gain (+) / Sacrifice(-)	**(+) 19,980**	**(+) 39,960**	**(-) 59,940**

Profit & Loss Appropriation Account

Dr. Cr.

Particulars	01.04.21 to 30.09.22	01.10.21 to 31.03.23	Particulars	01.04.21 to 30.09.22	01.10.21 to 31.03.23

To Partners' Current A/c			By Profit & Loss A/c	1,56,000	1,56,000
Interest on Capital A/c - A	15,000	15,000	(Apportioned on Time Basis)		
Interest on Capital A/c - B	7,500	7,500			
Interest on Capital A/c- C	9,000				
To Interest on hire C's A/c (-12%)	—	—			
Partners' Current A/cs - A	49,800	13,668			
Partners' Current A/cs - B	37,350	59,916			
Partners' Current A/cs - C	37,350	59,916			
	1,56,000	**1,56,000**		**1,56,000**	**1,56,000**

Illustration 19

A, B and C are partners in a firm sharing profits and losses as 3:2:1. Their Balance Sheet as on 31st March, 2023 was as follows:

(₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
Partners' Capital A/c		Land and Building	210
A	145	Plant and Machinery	255
B	110	Stock	125
C	75	Debtors	95
General Reserve	165	Bills Receivable	25
Partners' Loan:		Cash in Hand	3
A	30	Cash at Bank	37
B	20		
Sundry Creditors	205		
	750		**750**

B died on 1 August, 2023. His account is to be-settled under the following terms:

(i) Goodwill will be valued at 3 years purchase of last four accounting years average profit. Profits were :2019-2020 ₹135 Lakh, 2020-2021 ₹145 Lakh, 2021-2022 ₹131 Lakh and 2022-2023 ₹165 Lakh.

(ii) Land and Building will be valued at ₹ 250 Lakh and Plant and Machinery will be valued at ₹ 240 Lakh.

(iii) For the purpose of calculating B's share in the profits of 01.04.2023 to 31.07.2023, the profits for the year 2022-2023 will be taken as base.

(iv) Interest on Partners' Loan will be calculated @ 6% per annum.

(v) A sum of ₹50 Lakh to be paid immediately to B's Executor and the balance to be paid on 1 December, 2023 together with interest @ 10% per annum.

You are required to pass necessary journal entries to record the above transactions and amount payable to B's Executor's Account.

Solution:

Books of the firm

Journal

(₹ in Lakh)

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.08.23	Land & Building A/c	Dr.		40	
	To Revaluation A/c				40
	(For increase in the value of land and building)				
‘’	Revaluation A/c	Dr.		15	
	To Plant & Machinery A/c				15
	(For degrease in the value of Plant & Machinery)				
‘’	Revaluation A/c	Dr.		25	
	To A's Capital A/c				12.5
	To B's Capital A/c				8.333
	To C's Capital Ac				4.167
	(For profit on revaluation)				
‘’	General Reserve A/c	Dr.		165	
	To A's Capital A/c				82.5
	To B's Capital A/c				55
	To C's Capital A/c				27.5
	(For transfer of general reserve)				
‘’	A's Capital A/c	Dr.		108	
	C's Capital A/c	Dr.		36	
	To B's Capital A/c				144
	(For the adjustment of goodwill)				
‘’	Profit & Loss Suspense A/c	Dr.		18.333	
	To B's Capital A/c				18.333
	(For the adjustment of profit from 1.4.23 to 1.8.23)				
‘’	B's Loan A/c	Dr.		20	
	To B's Capital A/c				20
	(Balance transferred)				

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
‘’	Interest on B’s Loan A/c	Dr.		0.40	
	To B’s Capital A/c				0.40
	(Interest on B’s Loan from 1.04.18 to 1.08.18 credited to B’s Capital A/c)				
‘’	B’s Capital A/c	Dr.		356.066	
	To B’s Executor’s A/c				356.066
	(Being balance of B’s Capital A/c transferred to his Executor’s A/c = 110 + 8.333 + 55 + 144 + 18.333 + 20 + 0.40)				
‘’	B’s Executor’s A/c	Dr.		50	
	To Bank A/c				50
	(Amount paid)				
‘’	Interest A/c	Dr.		10.202	
	To B’s Executor’s A/c				10.202
	(For interest due)				
01.12.23	Bs Executor’s A/c	Dr.		316.268	
	To Bank A/c				316.268
	(Amount due to Bs Executor including interest, paid)				

(₹ in lakh)

Dr. B’s Executor’s Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
1.08.23	To Bank A/c	50	1.08.23	By Capital A/c	356.066
1.12.23	To Bank A/c	316.268	1.12.23	By Interest A/c	10.202
		366.268			**366.268**

Working Notes:

(1) Calculation of Share of B in Goodwill:

Average of past four years profits = ₹ (135 Lakh + 145 Lakh + 131 Lakh + 165 Lakh)/4 = ₹ 144 Lakh

Value of Firm’s Goodwill = ₹ 144 Lakh × 3 = ₹ 432 Lakh

B’s Share in Goodwill = ₹ 432 Lakh × 2/6 = ₹ 144 Lakh, which will be credited to B’s Capital A/c and debited to A’s Capital A/c & C’s Capital A/c in the ratio of 3:1

(2) B’s Share in profit from 01 .04.2023 to 1.8.2023 = (₹ 165 × 4/12) × 2/6 = ₹ 18.333 Lakh

(3) Interest on B’s Loan from 01.04.2023 to 1.8.2023 = ₹ 20 Lakh × 6% × 4/12 = ₹ 40,000

(4) Interest to B’s Executor’s from 01.08.2023 - 01.12.2023 = ₹ 356.066 Lakh – ₹ 50 Lakh

= ₹ 306.066 × 10% × 4/12 = ₹ 10.2022 Lakh

Illustration 20

The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1:2: 2 as on 31st December, 2022:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	10,000	Goodwill	15,000
Capital A/c :		Debtors	10,000
A 10,000		Machinery	20,000
B 20,000		Buildings	30,000
C 20,000	50,000	Stock	10,000
General Reserve	5,000	Cash at Bank	5,000
Investment Fluctuation Fund	3,000	Investments	10,000
Bad Debts Reserve	2,000		
Bank Loan	30,000		
	1,00,000		**1,00,000**

C died on 31st March, 2023. His account is to be settled under the following terms :

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March 2022 is to be calculated proportionately on the average profit of 3 years. The profits were: 2018: ₹ 3,000, 2019: ₹ 7,000, 2020: ₹ 10,000, 2021 ₹ 14,000, 2022: Loss ₹ 12,000. During 2022 a Moped costing ₹ 4,000 was purchased and debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are : Stock ₹ 12,000, Building ₹ 35,000, Machinery ₹ 25,000 and Investments ₹ 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Solution:

Books of firm

Journal

Date	Particulars		L. F.	Dr. (₹)	Cr. (₹)
2022	Stock A/c	Dr.		2,000	
	Buildings A/c	Dr.		5,000	
	Machinery A/c	Dr.		5,000	
	Moped A/c [₹4,000 – Depr. ₹1,000]	Dr.		3,000	
	To Revaluation A/c				15,000
	[Values of assets increased on revaluation]				

Date	Particulars		L. F.	Dr. (₹)	Cr. (₹)
	General Reserve A/c	Dr.		5,000	
	Investment Fluctuation Fund A/c	Dr.		3,000	
	Bad Debts Reserve A/c	Dr.		2,000	
	To A's Capital A/c				2,000
	To B's Capital A/c				4,000
	To C's Capital A/c				4,000
	[Transfer of Reserves etc. to Partners Capitals in 1 : 2 : 2]				
	Revaluation A/c	Dr.		2,000	
	To Investment A/c				2,000
	[Value of investments reduced]				
	Revaluation A/c	Dr.		13,000	
	To A's Capital A/c				2,600
	To B's Capital A/c				5,200
	To C's Capital A/c				5,200
	(Being profit on revaluation shared in 1 : 2 : 2)				
	A's Capital A/c	Dr.		1,000	
	B's Capital A/c	Dr.		2,000	
	C's Capital A/c	Dr.		2,000	
	To Goodwill A/c				5,000
	[Value of Goodwill reduced]				
	A's Capital A/c	Dr.		3,333	
	B's Capital A/c	Dr.		6,667	
	To Goodwill A/c				10,000
	[Value of Goodwill shared between A & B in the ratio of 1 : 2]				
	Profit & Loss Suspense A/c	Dr.		500	
	To C's Capital A/c				500
	[Estimated share of Profit till his date of death transferred to the decreased partner's Capital]				
	C's Capital A/c	Dr.		27,700	
	To C's Executors A/c				27,700
	[Total dues to the deceased partner transferred to his Executor's A/c]				

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c (1:2:2)	1,000	2,000	2,000	By Balance b/d	10,000	20,000	20,000
To Goodwill A/c (1:2)	3,333	6,667	-	" Revaluation A/c	2,600	5,200	5,200
To C's Executors A/c (Balance transferred)			27,700	"Sundry Reserves A/c	2,000	4,000	4,000
To Balance c/d	10,267	20,533	-	" P & L Suspense A/c	-	-	500
	14,600	**29,200**	**29,700**		**14,600**	**29,200**	**29,700**

Balance Sheet as at 31.3.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital A/cs :			Buildings		35,000
A	10,267		Machinery		25,000
B	20,533	30,800	Moped		3,000
C's Executor's A/c		27,700	(cost less depreciation)		
Bank Loan		30,000	Investments		8,000
Sundry Creditors		10,000	Stock		12,000
			Debtors		10,000
			Bank		5,000
			Profit & Loss Suspense A/c (Dr.)		500
		98,500			**98,500**

Working Notes :

1. Adjusted profit for 2022

	(₹)
Loss	(12,000)
Add : Cost of MopedWrongly treated as Travelling Expense	4,000
Less : Depreciation not charged on Moped @ 25% on ₹ 4,000	(1,000)
Adjusted Loss	(9,000)

2. Valuation of Goodwill

Total Profit/Loss for the last 5 years = ₹(3,000 + 7,000 + 10,000 + 14,000– 9,000) = ₹ 25,000

Average Profit = ₹ 25,000/5 = ₹ 5,000; Goodwill = 2 × ₹ 5,000 = ₹ 10,000

But Goodwill is appearing at Balance Sheet at ₹ 15,000.

Over valuation of Goodwill ₹ 5,000 should be written off among A, B & C as 1:2:2.

The balance of Goodwill between A & B in the ratio 1:2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years = ₹(10,000 + 14,000 – 9,000)/3 = ₹ 5,000

Estimated Profit for 3 months [Jan - March, 2022] = ₹ 5,000 × 3/12 = ₹ 1,250

C's share of profit = ₹ 1,250 × 2/5 = ₹ 500

Treatment of Joint Life Policy 4.4

In case of death of a partner of an existing partnership business, any amount due towards the deceased partner is required to be paid by the firm to his/ her legal representatives. This payment happens to be a burden for a firm because it has to be paid all of a sudden, and thus it may adversely affect the financial position of the firm. In order to overcome such a situation, a firm usually takes an insurance policy to cover the lives of the partners.

Such insurance policy can be taken either on the name of the partners - individually or jointly. The premium on such insurance is paid by the firm. This policy happens to be an asset of the firm on which all the partners have their proportionate stake. So, it should be adequately accounted for in case of change in constitution of a firm (i.e. Admission, Retirement, Change in profit sharing ratio etc.) and also in the event of death of a partner. The insurance policy matures on the death/ expiry of a partner, or on the expiry of the policy period, whichever occurs earlier. On the basis of the number of persons that have been covered under an insurance policy agreement, the life insurance policy taken by a firm may be classified into two types – Individual Life Insurance Policy and Joint Life Insurance Policy.

The life insurance policy that is taken by a partnership firm covering the lives of all its partners is referred to as Joint Life Policy. It is a single policy that covers the lives of all the partners of the firm. Such a policy matures in the event of the death of any one of the partners of the firm or on the date of maturity, whichever is earlier.

The accounting of joint life policy involves accounting on payment of the premium of such policy, accounting in the event of reconstitution of the firm (using the surrender value), and accounting in the event of death of a partner (using the maturity value). The maturity value and surrender value of joint life policy have a significant role in partnership accounting.

Maturity value (also known as Sum Assured) refers to the amount receivable by the firm from the insurance company in the event of the death of a partner or on the expiry of the policy period.

A firm may decide to terminate i.e. surrender an insurance policy before its date of maturity. In that case, the insurance company pays an amount to the insured and this amount is referred to as 'Surrender Value'. This surrender value does not remain constant over the years. It gradually increases with time. It is considered to be its 'fair value' for the purpose of accounting.

There are two broad methods of JLP accounting:

Method A: JLP is not treated as an asset in the books of the firm

Method B: JLP is treated as an asset in the books of the firm

Method A: JLP is not treated as an asset in the books of the firm

Under this method, the insurance premium paid on the joint life policy is treated as an 'expense' of the firm and not as an asset. The insurance premium is debited to the Profit & Loss A/c and JLP A/c does not appear in the Balance Sheet. The surrender value of the JLP does not get reflected in the books.

On payment of insurance premium on joint life policy the following entries are passed as under:

Joint Life Policy Premium A/c	Dr.
To Bank A/c	
P/L A/c	Dr.
To Joint Life Policy Premium A/c	

On change in constitution of firm (i.e. Admission, Retirement, Change in profit sharing ratio etc.)

The surrender value of the JLP is accounted for in any one of the following two ways:

- By raising and writing-off JLP Account; or
- By adjusting the capital accounts of the partners

Raising and writing-off JLP Account	**Raising of JLP A/c**	
	JLP A/c	Dr.
	To Existing Partners' Capital A/c (in old p.s.r.)	
	Writing-off JLP A/c	
	Continuing Partners' Capital A/c	Dr.
	To JLP A/c (in new p.s.r.)	
Adjusting the capital accounts of the partners	Gaining Partners' Capital A/c	Dr.
	To Sacrificing Partners' Capital A/c	

On the event of death of a partner

The JLP taken by the firm matures, and the policy value is received by the firm and it gets distributed among all the existing partners in their old profit sharing ratio. It is accounted for as under:

On maturity of the JLP	JLP Receivable A/c	Dr.
	To Existing Partners' Capital A/c (in old p.s.r.)	
On receipt of maturity value	Bank A/c	Dr.
	To JLP Receivable A/c	

Method B: JLP is treated as an asset in the books of the firm

Under this method, the insurance premium paid on the joint life policy is treated as 'investment in an asset' of the firm. It is reflected in the Balance Sheet at its surrender value.

The surrender value of the JLP on any date happens to be lower than the amount of the total amount of insurance premium paid on the JLP over the years. So, to maintain the JLP A/c at its surrender value, the difference between the amount of premium paid and the surrender value as on the date of preparation of the Balance Sheet is written-off. For the purpose of ensuring that the JLP A/c is reflected at its surrender value, there are two recognised methods of accounting. They are discussed as under:

Approach 1: Surrender Value Method

In this case one ledger account – Joint Life Policy Account (JLP A/c) is maintained. The insurance premium paid on the joint life policy is recorded in the JLP A/c as under:

JLP A/c Dr.

To Bank A/c

Thereafter for ensuring that this JLP A/c is maintained at its 'surrender value', the excess of premium paid over the increase in surrend-er value is debited to the Profit & Loss A/c by passing the following entry:

P/L A/c Dr.

To JLP A/c

This ensures that JLP A/c appears in the Balance Sheet of the firm at its 'Surrender value'.

Approach 2: Joint Life Policy Reserve Method

Under this method, two ledger accounts are maintained – Joint Life Policy Account (JLP A/c) and Joint Life Policy Reserve Account (JLP Reserve A/c).

In this case, the insurance premium paid on the joint life policy is treated as an investment in joint life policy. It is debited to the JLP A/c as under:

JLP A/c Dr.

To Bank A/c

Moreover, the insurance premium paid on the joint life policy is considered as an 'appropriation of profit' and so it is provided through JLP Reserve A/c. In this case, an amount equal to the insurance premium is debited to the Profit & Loss Appropriation A/c, as follows:

P/L Appropriation A/c Dr.

To JLP Reserve A/c

Both the JLP A/c and JLP Reserve A/c appear in the Balance Sheet of the firm in the Asset-side and Liabilities-side respectively.

Further, for ensuring that JLP A/c and JLP Reserve A/c are maintained at its 'surrender value', the excess of premium paid over the increase in surrender value is adjusted between JLP A/c and JLP Reserve A/c by passing the following entry:

JLP Reserve A/c Dr.

To JLP A/c

The above entry ensures that both JLP A/c and JLP Reserve A/c appear in the Balance Sheet of the firm at the 'Surrender value'.

On change in constitution of firm (i.e. Admission, Retirement, Change in profit sharing ratio)

Under the 'Surrender Value Method': JLP is considered as an asset and it already appears in the books of the firm at the surrender value. As such no further accounting treatment is required.

Under the 'JLP Reserve Method': both the JLP A/c and JLP Reserve A/c appear in the books of the firm at surrender value.

Cases	Treatment
If the partners decide not to maintain the JLP Reserve A/c	JLP Reserve A/c is written-back and distributed among the existing partners' in old P.S.R.: JLP Reserve A/c Dr. To Existing Partners' Capital A/c (in old P.S.R.)
If the partners decide to keep on maintaining the JLP Reserve A/c	Adjustment is required to be made through Partners' Capital A/c: Gaining Partners' Capital A/c Dr. To Sacrificing Partners' Capital A/c

On the event of death of a partner

The JLP matures, and the maturity value of the policy is received by the firm. Thereafter it gets distributed among all the existing partners in their old p.s.r.

Transactions	Surrender Value Method	JLP Reserve Method
On death of partner i.e. maturity of the JLP	JLP Receivable A/c Dr. To JLP A/c (with Maturity Value)	JLP Receivable A/c Dr. To JLP A/c (with Maturity Value)
On receipt of maturity value	Bank A/c Dr. To JLP Receivable A/c	Bank A/c Dr. To JLP Receivable A/c
Closing of JLP Reserve A/c by transfer to JLP A/c	N.A.	JLP Reserve A/c Dr. To JLP A/c (with 'last recorded Surrender Value')
Closing of JLP A/c	JLP A/c Dr. To All Partners' Capital A/c (with the difference between 'last recorded surrender value' and 'maturity value' in old P.S.R.)	JLP A/c Dr. To All Partners' Capital A/c (with the difference between 'current year premium paid, if any' and 'maturity value' in old P.S.R.)

Illustration 21

Naresh, Rohit and Krishna are partners sharing profits and losses in the ratio of 2:2:1. On 1st January, 2019, they took out a joint life policy of ₹ 2,00,000. Annual premium of ₹ 10,000 was payable on 1st January each year. Last premium was paid on 15th January, 2023. Rohit died on 1st March, 2023, and policy money was received on 31st March, 2023. The surrender value of policy as on 31st March each year were as follows:

2020	:	Nil
2021	:	₹ 2,000
2022	:	₹ 5,000

Show Joint Life Policy accounts as on 31st March each year assuming that:

(i) The premium is charged to profit and loss account every year.

(ii) The premium is debited to joint life policy account and the balance of the joint life policy account is adjusted every year to its surrender value.

Solution:

(i)

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Partner's Capital A/c Naresh ₹80,000 Rohit ₹80,000 Krishna ₹40,000	2,00,000	31.03.22	By Bank (Policy Money Received)	2,00,000
		2,00,000			**2,00,000**

(ii)

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Bank A/c (Premium)	10,000	31.03.20	By P & L A/c	10,000
		10,000			10,000
01.11. 21	To Bank A/c (Premium)	10,000	31.03. 21	By P & L A/c	8,000
			31.03. 21	By Balance c/d	2,000
		10,000			10,000
01.04.21	To Balance b/d	2,000	31.03.21	By P & L A/c	7,000
01.01.22	To Bank A/c (Premium)	10,000	31.03.22	By Balance c/d	5,000
		12,000			12,000
01.04.22	To Balance b/d	5,000			
01.01.23	To Bank A/c (Premium)	10,000	31.03.23	By Bank A/c (Police Money Received)	2,00,000
31.03.23	To Partner's Capital A/c Naresh ₹74,000 Rohit ₹74,000 Krishna ₹37,000	1,85,000			
		2,00,000			**2,00,000**

Dissolution of Partnership Firms including Piecemeal Distribution

4.5

Whenever a reconstitution takes place within a Partnership in the form of admission, retirement or death of a Partner, the existing partnership is dissolved. The Partnership firm, may however, continue, if the remaining partners desire so.

But if the partnership firm is discontinued for any reason, that is called Dissolution of the firm. Dissolution of Firm – when does it take place [in accordance with the Indian Partnership Act of 1932]

1. By Mutual consent of all the partners or in accordance with a contract made by them [Section 40]
2. By Notice – given in writing, by any partner to all other partners if the Partnership is at will [Section 43].
3. On the happening of any one of the following events : [Section 42] :
   (i) expiry of the term, where the Partnership was constituted for a fixed term;
   (ii) completion of the adventure for which the firm was constituted;
   (iii) Death of a partner,
   (iv) Adjudication of a Partner as insolvent.
4. Compulsory Dissolution [Section 41]
   (i) Where all the partners or all but one are adjudged insolvent.
   (ii) If any event occurs making it unlawful for the business of the firm to be carried on.
5. Dissolution by Court: According to Section 44 of the Indian Partnership Act the court, at the suit of a partner, may dissolve a firm on any one of the grounds namely –
   (i) insanity of a partner;
   (ii) permanent incapability of a partner to do his duties;
   (iii) if a partner is guilty of misconduct that might affect prejudicially the carrying on of the business;
   (iv) If a partner willfully or persistently commits breach of agreement;
   (v) If a partner transfers all his shares to a third party or has allowed his share to be charged under the Provisions of Rule 49 of order XXI of the First Schedule to the Code of Civil Procedure, 1908;
   (vi) If the court considers that the business cannot be carried on except at loss;
   (vii) On any other ground on which the court considers the dissolution as just and equitable.

Settlement of Accounts on Dissolution

According to Section 48 of the Indian Partnership Act the following rules should be observed for settlement of Accounts after dissolution, subject to agreement by partners :

(a) Regarding Losses : "Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits". [Section 48(1)]

(b) Regarding Assets : "The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :

(i) in paying the debts of the firm to third parties;

(ii) In paying each partner ratably what is due to him from the firm for advances as distinguished from capital;

(iii) In paying to each partner ratably what is due to him as capital; and

(iv) The residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits." [Section 48(2)]

Accounting Entries Regarding Dissolution

The two separate aspects of Dissolution for which accounting entries have to be made are:

[A] Realization of Assets and Payment of liabilities and [B] Settlement of the dues of the Partners,

[A] Realization of Assets and Payment of liabilities

(i) Prepare Realisation Account

(ii) Trausfer all assets (except cash, bank & fictitious assets) and liabilities at book values to Realisation Account.

Journal Entries

Item/Purpose	Entry	Special Points to be noted
1. Transfer of book values of assets as recorded in the Balance Sheet	Realization A/c Dr. To Sundry Assets [Book value] (including goodwill if any, shown in the Balance Sheet) Realization A/c Dr. To Debtors A/c Provision for Bad Debts A/c Dr. To Realization A/c.	(a) Cash or Bank A/c are not to be credited unless the firm, as a whole, is sold out as a going concern. (b) Debit balance of any Cap. A/c etc. or Debit balance of P/L A/c not to be transferred to Realization A/c. (c) If there is any Provision for bad Debts, debit Realization A/c and credit Debtors A/c with gross figure. Then debit Provision A/c and credit Realization A/c. Same treatment for Provision for Depreciation.
2. Realization/Sale of above assets	Cash/Bank A/c (amt. realized) Dr. Or Partners Cap. A/c Dr. (agreed value at which a partner takes over an asset/assets) To Realization A/c.	

Item/Purpose	Entry	Special Points to be noted
3. Shares etc. received as purchase consideration	In exchange of the firm's assets. Shares A/c Dr. To Realization A/c. (agreed value)	
4. Closing the External liabilities	External Liabilities A/c Dr. (such as creditors, outstanding expenses, Bank Loan etc.) To Realization A/c. (book value)	(a) Alternatively – this entry may be passed (combining 4,5 & 6) Liability A/c .... Dr. To Bank A/c (actual amt. paid) OR, To Partners Cap. A/c (agreed value) To Realization A/c (Discount, if any received on payment/discharge) (b) Where assets and liabilities are taken over by another business on making some lump sum payment, separate entries for realization of assets and / payment of liabilities need not be made.
5. External liabilities paid off	Realization A/c. Dr. To Cash/Bank A/c (actual amt. paid)	
6. External liabilities taken over by any partner	Realization A/c. Dr. To Particular Partner's Cap. A/c (agreed value)	
7. Unrecorded asset sold or taken over by any partner	Cash / Bank A/c Dr. Partners Capital A/c Dr. To Realisation A/c	
8. If any unrecorded liability is paid.	Realization A/c Dr. To Cash/Bank A/c (actual amt.)	
9. If shares etc. received and shown in (3) above are sold out or transferred to partners.	Cash/Bank A/c Dr. Or, Partners Cap. A/c Dr. [excluding insolvent partner] To shares A/c	For sale, there may be profit or loss on sale which is transferred to Realization A/c.
10. Payment of Expenses of Realization.	Realization A/c Dr. To Cash/Bank A/c (if paid by the firm) Or, To Partners Cap. A/c (if paid by any partner)	If a partner bears such expenses personally in pursuance of a separate agreement – NO ENTRY is required.

Item/Purpose	Entry	Special Points to be noted
11. Balance of Realization Account representing Profit or Loss on Realization.	Realization A/c. Dr. To Partners Cap. A/c (Profit shared in Profit Sharing Ratio) Or, Partner's Cap. A/c Dr. To Realization A/c. (Loss shared in Profit Sharing Ratio)	

[B] Settlement of Partners Dues – through Capital Accounts

Item/Purpose	Entry	Special Points to be noted
1. Prepare Capital Accounts with balance as per Balance Sheet before the dissolution.	By Balance b/d (Cr. balance) To Balance b/d (Dr. balance)	
2. Transfer of Current A/c, if any.	Partner's Current A/c … Dr. To Partner's Cap. A/c. (Credit Balance) Or Partner's Capital A/c … Dr. To Partner's Current A/c (Debit balance)	
3. Undistributed Profit, Reserve, Joint Life Policy Reserve, Investment Fluctuation Fund, Contingency Reserve etc. transfer.	Profit & Loss (Cr.) A/c… Dr. Or, Any Reserve A/c …….. Dr. To Partner's Capital A/cs [Profit sharing ratio]	
4. Undistributed Loss, Fictitious/ Unrealizable Assets etc. transfer.	Partners Capital A/c… Dr. To Profit & Loss (Dr.) A/c Or, To Fictitious Assets A/c (Profit Sharing Ratio)	Example of unrealizable Asset- Advertisement Suspense A/c
5. Any loan taken from any partner	Partner's Loan A/c …. Dr. To Cash/Bank A/c	u/s 48 Repayment of loan should enjoy priority over repayment of capital.

Item/Purpose	Entry	Special Points to be noted
6. Any loan given to any partner	Cash/Bank A/c….. Dr. To Partner's Loan A/c Or Partner's Capital A/c ..... Dr. To Partner's Loan A/c	If such amount is realized. Adjustment of loan against Capital
7. If any Partner's Capital A/c shows a debit balance (after balancing)	Cash/Bank A/c….. Dr. To Particulars Partner's Capital A/c [Cash brought in to make up the shortfall]	If the deficient partner is insolvent, treatment will be different- Vide – Insolvency of Partner.
8. Payment of credit balance (after final balancing)	Particulars Partner's Cap. A/c Dr. To Cash/Bank A/c	Same as above

Illustration 22

A, B and C sharing profits in 3 : 1 : 1 agree upon dissolution. They each decide to take over certain assets and liabilities and continue business separately.

Balance Sheet
as on date of dissolution

Liabilities		(₹)	Assets		(₹)
Creditors		6,000	Cash at Bank		3,200
Loan		1,500	Sundry Assets		17,000
Capitals:	(₹)		Debtors	24,200	
A	27,500		Less: Bad Debts Provision	1,200	23,000
B	10,000		Stock		7800
C	7,000	44,500	Furnitures		1,000
		52,000			**52,000**

It is agreed as follows:

(i) Goodwill is to be ignored.

(ii) A is to take over all the Fixtures at ₹ 800; Debtors amounting to ₹ 20,000 at ₹ 17,200. The creditors of ₹ 6,000 to be assumed by A at the figure.

(iii) B is to take over all the stocks at ₹ 7,000 and certain of the sundry assets at ₹ 7,200 (being book value less 10%)

(iv) C is take over the remaining sundry assets at 90% of book values less ₹ 100 allowances and assume responsibility for the discharge of the loan, together with accruing interest of ₹ 30 which has not been recorded in the books of the firm.

(v) The expenses of dissolution were ₹ 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare Realisation Account, partners' Capital Accounts and Bank Account.

Solution:

In the books of A, B and C

Dr. Realisation Account Cr.

Particulars		(₹)	Particulars		(₹)
To Sundry Assets:			By Provision for bad debts		1,200
			Capital Account A :		
Sundry Assets	₹17,000		Fixtures	₹800	
Debtors	₹24,200		Debtors	₹17,200	
Stock	₹7,800				18,000
Fixtures	₹1,000		B: Stock	₹7,000	
		50,000	Sundry Assets	₹7,200	
					14,200
,, Bank – Expenses		270	C: Sundry Assets		8,000
,, Capital Account			By Bank: Collection from Debtors		2,100
C- Interest on loan		30	By Loss on realization:		
			A (3/5)	₹4,080	
			B (1/5)	₹1,360	
			C (1/5)	₹1,360	6,800
		50,300			**50,300**

Dr. Capital Account Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Dissolution Assets taken	18,000	14,200	8,000	By Balance b/d	27,500	10,000	7,000
				,, Creditors	6,000	-	-
,, Dissolution A/c Loss	4,080	1,360	1,360	,, Loan(with interest)	-	-	1,530
,, Bank — Final payment	11,420	-	-	,, Bank Final receipts	-	5,560	830
	33,500	**15,560**	**9,360**		**33,500**	**15,560**	**9,360**

Bank Account

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	3,200	By Dissolution Account	
,, Dissolution A/c		Expenses	270
Collection from Debtors	2,100	,, Capital Account:	
,, Capital Accounts:		A	11,420
B 5,560			
C 830	6,390		
	11,690		**11,690**

Working Notes: (₹)

1. **Realization of Sundry Assets:**

Sundry Assets (Book Value)	17,000
Less: Taken by B [7,200 × (100/90)]	8,000
Remaining at book value	9,000

Taken by C: 90% of Book value

i.e. (₹9,000 × (90/100) = ₹8,100 – ₹100 for allowance = ₹8,000

2. **Collection from Debtors:** (₹)

Debtors (Book Value)	24,200
Less: Taken by (Book value)	20,000
	4,200

Remaining at 50% i.e., ₹ 2,100

Illustration 23

X, Y and Z sharing profits & Losses in the ratio of 2 : 2: 1 agreed upon dissolution of their partnership on 31st December, 2023 on which date their Balance Sheet was as under :

Liabilities	(₹)	Assets	(₹)
Capital :		Fixed Assets	50,000
X	40,000	Joint Life Policy (at surrender Value)	10,000
Y	30,000		
Reserve Fund	10,000	Debtors ₹10,000	
Joint Life Policy Fund	10,000	Less : Provision for	
Creditors ₹19,000			
Less: Prov ₹500	18,500	Bad Debts ₹500	9,500

Liabilities	(₹)	Assets		(₹)
Salary Outstanding	2,000	Stock at Invoice Price	₹10,000	
		Less: Price loading	₹2,000	8,000
		Investments	₹8,000	
		Less: Fluctuation Fund	₹500	7,500
		Capital Account –Z		2,000
		Bank		23,500
	1,10,500			**1,10,500**

Investments were taken over by X at ₹ 6,000, creditors of ₹ 10,000 were taken over by Y who has agreed to settle account with them at ₹ 9,900. Remaining creditors were paid ₹ 7,500. Joint Life Policy was surrendered and Fixed Assets realized ₹ 70,000, Stock and Debtors realized ₹ 7,000 and ₹ 9,000 respectively. One customer, whose account was written off as bad, now paid ₹ 800 which is not included in ₹ 9,000 mentioned above. There was an unrecorded asset estimated at ₹ 3,000, half of which as handed over to an unrecorded liability of ₹ 5,000 in settlement of claim of ₹ 2,500 and the remaining half was sold in the market which realized ₹ 1,300.

Y took over the responsibility of completing the dissolution and he is granted a salary of ₹ 400 per month. Actual expenses amounted to ₹ 1,100. Dissolution was completed and final payments were made on 30th April, 2024.

You are required to prepare the Realization Account, Capital Account and Bank Account.

Solution:

Books of the firm

Dr. **Realization Account** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Fixed Assets A/c		50,000	By Provision on Debtors A/c		500
To Joint Life Policy A/c		10,000	By Provision on Stock A/c		2,000
To Debtors A/c		10,000	By Investment Fluctuation		
To Stock (at I. P.)		10,000	Fund A/c		500
To Investments A/c		8,000	By Joint Life Policy Fund A/c		10,000
To Pro. for Disc. on		500	By Creditors A/c		19,000
Creditors A/c			By Outstanding Salary A/c		2,000
To Y's Capital A/c		10,000	By X' Capital A/c		6,000
[Creditors taken			(Investments taken over)		
over- see Note]			By Bank A/c :		
To Bank A/c :			Joint Life Policy	10,000	
Creditors paid off	7,500		Fixed Assets	70,000	
Unrecorded liability	2,500		Stock	7,000	
paid [1/2 × 5,000]			Debtors	9,800	
Outstanding Salary	2,000		Unrecorded Assets (Sold)	1,300	

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
Outstanding Expense	1,100	13,100	Bad Debt Recovered	800	98,100
To Y's Cap. A/c		1,600			
[Salary 400 × 4]					
To Partner's Capital A/c					
(Profit on Realization)					
X [2/5]	9,960				
Y [2/5]	9,960				
Z [1/5]	4,980	24,900			
		1,38,100			**1,38,100**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	23,500	By Realization A/c	
To Realization A/c		Creditors	7,500
Joint Life Policy	10,000	Unrecorded Liability	2,500
Fixed Assets	70,000	Outstanding Salary	2,000
Stock	7,000	Expenses	1,100
Debtors	9,800	By X's Capital A/c	47,960
Unrecorded Assets	1,300	By Y's Capital A/c	55,560
		By Z's Capital A/c	4,980
	1,21,600		**1,21,600**

Dr. **Partners' Capital Account** **Cr.**

Date 2023	Particulars	X (₹)	Y (₹)	Z (₹)	Date 2023	Particulars	X (₹)	Y (₹)	Z (₹)
	To Balance b/d	-	-	2,000		By Balance b/d	40,000	30,000	-
	To Realization A/c	6,000	-	-		By Reserve Fund [2:2:1]	4,000	4,000	2,000
	To Bank A/c (Balance withdrawn)	47,960	55,560	4,980		By Realization A/c (Profit)	9,960	9,960	4,980
						By Realization A/c (Creditors)	-	10,000	-
						By Realization A/c (4 months Salary)	-	1,600	-
		53,960	**55,560**	**6,980**			**53,960**	**55,560**	**6,980**

Note :

1. Unrecorded Asset and unrecorded liability were not recorded. Any part of such asset utilized to discharge any part of such liability and discount received there on have been ignored.

   But unrecorded asset realized (debts previously written off now recovered) has been recorded. Similarly unrecorded asset sold has been recorded.

2. Y took over creditors of ₹ 10,000. This has been recorded. How he settles such liability is his personal matter. The discount on payment does not benefit the firm.

Special considerations for a retiring partner and the estate of a deceased partner in relation to debts contracted by the partnership firm:

(a) debts due on the date of retirement/death: the retiring partner and the estate of the deceased partner is liable for the whole of the debts due by the firm at the date of retirement or death, to the extent of their share.

(b) debts incurred after retirement: where the notice of retirement is not published in accordance with law, the retiring partner is liable for debts contracted after retirement.

(c) deceased/ insolvent partner: the estate of a deceased or bankrupt partner will not be liable for debts contracted by the firm after the death or bankruptcy.

Applicability of Section 37 of the Partnership Act:

In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the dues are not settled, then such retired partner or the executor is entitled to the following :

Maximum of :

Interest @ 6% p.a. on the amount due to them(i.e. if the amount is unsettled, like, rate of interest on loan to be allowed to the retired partner or the executor is not mentioned)

Or

The share of profit earned for the amount due to the partner

Conditions :

(a) The surviving partners/continuing partners continue to carry on the business of the firm.

(b) The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.

(c) There is no contract to the contrary of the options contained in Section 37 i.e. share in the profits or interest @ 6% p.a. on the unsettled capital.

Example : Unsettled capital of C ₹ 52,000 (Date of retirement : 30.09.22, financial year 2022-2023). Net Profit earned by the firm after C's retirement ₹ 25,000. Capitals of A: ₹ 57,000 and B: ₹ 76,000)

C is entitled to the maximum of the following :

(i) Interest on unsettled capital = ₹ 52,000 × 6% × 6 months = ₹ 1,560

(ii) Profit earned out of unsettled capital = Profit × Retired or Deceased Partner's unsettled

Dues/ Total Capital of the firm (including the amount due to the retired or deceased partner)

= ₹ (25,000 × 52,000)/(₹ 52,000 + 57,000 + 76,000) = ₹ 7,027.

Insolvency of a partner

If a partner becomes insolvent and fails to pay his debit balance of Capital A/c either wholly or in part, the unrecoverable portion is a loss to be borne by the solvent partners. The question now arises is that, in what ratio they will share this loss. Prior to the decision in the leading case of Garner vs. Murray this loss was borne by the solvent partners in the profit sharing ratio just like ordinary losses.

Decision in Garner vs. Murray Case

Justice Joyee held in the case of Garner vs. Murray that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss). Unless otherwise agreed, the decision in Garner vs. Murray requires –

(i) That the solvent partners should bring in cash equal to their respective shares of the loss on realization;

(ii) That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

In case of fixed capital system, capitals as per last Balance Sheet represent last agreed capitals. In case of fluctuating capital system, however, all necessary adjustments in respect of reserved, unappropriated profits or losses (but not realization profit or loss), Drawings A/c., undisclosed liabilities and assets etc. must be made to get last agreed capitals. A partner who has nil or negative balance in his capital account before dissolution does not contribute anything to the loss arising as a result of insolvency of a partner.

Criticism of the decision of Garner vs. Murray

The following criticism may be advocated against the decisions laid down in Garner vs. Murray principle:

(i) If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;

(ii) This principle does not apply if there are only two partners;

(iii) In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on reasilation which is immaterial and useless; and

(iv) If any solvent partner who possess more private asset but contributes less capital, he will naturally, as per Garner vs. Murray decision, bear less amount of deficiency of the insolvent partner than the other solvent partner who possess less private assets but contributes more capital to the firm. This is not justified.

Applicability in India

According to sub section (ii) of Sec 48(b) of the Indian Partnership Act, if a partner becomes insolvent or otherwise incapable of paying his share of the contribution, the solvent partners must share ratably the available assets (including their own contribution to the capital deficiency). That is to say, the available assets will be distributed in proportion to their capitals.

Thus, under the Indian Partnership Act also the solvent partners are required to make good their share of the realization loss (i.e., capital deficiency). The total cash available after making good the solvent partners' share of capital deficiency shall be shared by the solvent partners in proportion to their capitals. As a result of this the ultimate debit balance of the insolvent partner's Capital A/c. is borne by the solvent partners in capital ratio.

The provision of the Indian Partnership Act in this respect are, thus, similar to the rules laid down by the decision in Garner vs. Murray.

When there is a specific provision in the Partnership Deed as to how the deficiency of an insolvent partner is to be borne by the solvent partners, such provision must be followed, because the provision of the Act will apply only when there is no specific agreement.

Illustration 24

A, B and C are in partnership sharing profit and losses equally and agreed to dissolve the firm on 30.06.2023. On that date their Balance Sheet stood as follows:

Balance Sheet
as at 30th June, 2023

Liabilities	(₹)	Asset	(₹)
Capital A/c (₹)		Sundry Asset	50,000
A 34,000		Profit & Loss A/c	12,000
B 24,000	58,000	Capital A/c	
Creditors	12,000	C	8,000
	70,000		**70,000**

The assets are realised at 50% of the book value. Realization expenses amounted to ₹5,000. C became insolvent and received ₹2,000 from his estates.

Close the book of the firm under

(i) Fixed Capital Method and

(ii) Fluctuating Capital Method applying Garner Vs. Murray principle.

Solution:

In the books of A, B & C

Dr. **Realization Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Sundry Asset A/c	50,000	By Bank A/c	
" Bank A/c		Amount Realised	25,000
" Expense	5,000	" Capital A/c	
		By Loss on Realization	
		A ₹10,000	
		B ₹10,000	
		C ₹10,000	30,000
	55,000		**55,000**

Working Notes:

(a) Under Fixed Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partner A and B as per their last agreed capital given in the Balance Sheet i.e., 17:12.

(b) Under Fluctuating Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partners A & B as the following adjusted capital which will be considered as the last agreed capital i.e., after adjusting the debit balance of Profit and Loss Account.

Particulars	A (₹)	B (₹)
Capital as per Balance Sheet	34,000	24,000
Less: Debit balance of P&L A/c (equally)	(-) 4,000	(-) 4,000
	30,000	**20,000**

∴ Ratio = 3:2

(a) Capital Account under Fixed Capital Method

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
" Realisation A/c Loss	10,000	10,000	10,000	" Bank A/c	---	---	2,000
" Profit & Loss A/c Loss	4,000	4,000	4,000	" Bank A/c	10,000	10,000	---
" C's Capital A/c	11,724	8,276	---	" A's Capital	---	---	11,724
" Bank A/c (bal. fig.)	18,276	11,724	---	" B's Capital	---	---	8,276
	44,000	**34,000**	**22,000**		**44,000**	**34,000**	**22,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	25,000	By Realisation A/c	
" Capital A/c		Expenses	5,000
A 10,000		" Creditors	12,000
B 10,000		" Capital A/c	
C 2,000	22,000	A	18,276
		B	11,724
	47,000		**47,000**

(b) Under Fluctuating Capital Method

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
" Realisation A/c Loss	10,000	10,000	10,000	" Bank A/c	10,000	10,000	---

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
" Profit & Loss A/c Loss	4,000	4,000	4,000	" Bank A/c	---	---	2,000
" C's Capital A/c	12,000	8,000	---	" A's Capital	---	---	12,000
" Bank A/c (bal. fig.)	18,000	12,000	---	" B's Capital	---	---	8,000
	44,000	**34,000**	**22,000**		**44,000**	**34,000**	**22,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realisation A/c	25,000	By Realisation A/c	
Assets realized		Expenses	5,000
" Capital A/c		" Creditors	12,000
A	10,000	" Capital A/c	
B	10,000	A	18,000
C	2,000	B	12,000
	47,000		**47,000**

Illustration 25

Ram, Rahim and Robert are partners of the firm ABC sharing profits and losses in the ratio of 5: 3: 2. The Balance Sheet of the firm as on 01.4.2023 is given below:

Liabilities	(₹)	Assets	(₹)
Partners Capital:		Goodwill	50,000
Ram	3,00,000	Machinery	4,55,000
Rahim	2,50,000	Furniture	10,000
Robert	2,00,000	Stock	2,00,000
General Reserve	1,05,000	Debtors	3,00,000
Loan	95.000	Cash & Bank	35,000
Sundry Creditors	1,00,000		
	10,50,000		**10,50,000**

Partners of firm decided to dissolve the firm. The firm decided to settle the loan creditors directly. Ram took over goodwill for 75,000. Rahim took over machinery and furniture at 90% of book value and sundry creditors at book value.

Robert took over stock at 95% of book value and debtors at 90% of the book value. Partners have to pay cash if the assets taken over had exceeded the amounts due to them.

Prepare:

(i) Realisation Account;

(ii) Partners Capital Account; and

(iii) Cash Account of the firm to show the dissolution proceedings.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goodwill	50,000	By Loan.	95,000
To Machinery	4,55,000	By Sundry creditors	1,00,000
To Furniture	10,000	By Ram's Capital A/c	75,000
To Stock	2,00,000	By Rahim's Capital A/c	4,18,500
To Debtors	3,00,000	By Robert's Capital A/c	
To Cash (Loan)	95,000	95% of 2,00,000	
To Rahim's Capital A/c	1,00,000	90% of 3,00,000	4,60,000
		By Ram's Capital	30,750
		By Rahim's Capital	18,450
		By Robert's Capital	12,300
	12,10,000		**12,10,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	Ram	Rahim	Robert	Particulars	Ram	Rahim	Robert
To Realisation A/c	75,000	4,18,500	4,60,000	By Balance b/d	3,00,000	2,50,000	2,00,000
To Realisation A/c	30,750	18,450	12,300	By General Reserve	52,500	31,500	21,000
To Cash (b/f)	2,46,750			By Realisation A/c		1,00,000	2,51,300
				By Cash A/c (b/f)		55,450	
	3,52,500	**4,36.950**	**4,72,300**		**3,52,500**	**4,36,950**	**4,72,300**

Dr. **Cash Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance bid	35,000	By Loans A/c	95,000
To Rahim Capital A/c	55,450	By Ram Capital A/c	2,46,750
To Robert Capital A/c	2,51,300		
	3,41,750		**3,41,750**

Illustration 26

Ram, Rahim and Robert are partners in a firm sharing profits and losses in the proportion of 3:3:2. Their Balance Sheet as on 31.03.2023 was as follows:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Partners Capital Account:			Bank		55,000
Ram	75,000		Stock		69,000
			Investments		6,000

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Rahim	75,000		Debtors		70,000
Robert	1,00,000	2,50,000	Laud and Building		1,25,000
Partners Current Accounts:			Goodwill		25,000
Ram	15,000				
Rahim	25,000				
Robert	12,500	52,500			
Sundry creditors		47,500			
		3,50,000			**3,50,000**

They decided to dissolve the firm on 01.04.2023. They report the result realization as follows:

	(₹)	
Land and Buildings	90,000	— realized in cash
Debtors	60,000	— realized in cash
Investments	5,500	— taken over by Ram
Stock	75,500	— taken over by Rahim
Goodwill	18,000	— taken over by Robert

The realization expenses amounted to ₹ 2,000. You are required to close the books of accounts of the firm.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Stock	69,000	By Sundry Creditors	47,500
To Investments	6,000	By Bank (assets realized)	1,50,000
To Debtors	70,000	By Ram's Capital A/c (investments)	5,500
To Land & Buildings	1,25,000	By Rahim's Capital A/c (Stock)	75,500
To Goodwill	25,000	By Robert's Capital A/c (Goodwill)	18,000
To Bank (Expenses)	2,000	By Loss transferred to Current A/c:	
To Bank (Creditors)	47,500	(₹)	
		Ram 18,000	
		Rahim 18,000	
		Robert 12,000	48,000
	3,44,500		**3,44,500**

Dr. Partners' Current Account Cr.

Particulars	Ram (₹)	Rahim (₹)	Robert (₹)	Particulars	Ram (₹)	Rahim (₹)	Robert (₹)
To Realisation A/c	5,500	75,500	18,000	By Balance b/d	15,000	25,000	12,500
To Realisation A/c	18,000	18,000	12,000	By Capital A/c	8,500	68,500	17,500
	23,500	**93,500**	**30,000**		**23,500**	**93,500**	**30,000**

Dr. **Partners' Capital Account** Cr.

Particulars	Ram (₹)	Rahim (₹)	Robert (₹)	Particulars	Ram (₹)	Rahim (₹)	Robert (₹)
To Current A/c	8,500	68,500	17,500	By Balance C/d	75,000	75,000	1,00,000
To Bank A/c (Bal. Fig)	66,500	6,500	82,500				
	75,000	**75,000**	**1,00,000**		**75,000**	**75,000**	**1,00,000**

Dr. **Bank Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	55,000	By Realisation A/c (expenses)	2,000
To Realisation (Assets realized)	1,50,000	By Realisation A/c (Creditors)	47,500
		By Ram's Capital A/c	66,500
		By Rahim's Capital A/c	6,500
		By Robert's Capital A/c	82,500
	2,05,000		**2,05,000**

If all the partners are insolvent

Since all partners are insolvent, creditors cannot expect to be paid in full. In such a case Sundry Creditors should not be transferred to Realization Account. Cash in hand together with the amount realized on sale of assets and surplus from private estate of partners, if any, less expenses will be applied in making payment to the creditors. The balance of Creditors Account represents the deficiency to be borne by them which to be transferred to a Deficiency Account. The balance of Capital Accounts should also to be transferred to the Deficiency Account to close the books. Alternatively, the deficiency to be borne by the Creditors may be directly adjusted in between Creditors Account and Capital Accounts.

The following entries required to be passed :

(i) To, pay-off the creditors

Creditors A/c	Dr.	(Total Creditors)
To Bank A/c		(Amount paid)
To Deficiency A/c		(Amount unpaid)

(ii) When deficiency is transferred

Deficiency A/c Dr.

To Partners' Capital A/c

Illustration 27

A, B and C were equal partners in a firm. Their Balance Sheet as on 31st March, 2023 was as follows:

Liabilities	(₹)	Assets	(₹)
A's Capital	1,60,000	Building	4,00,000
C's Capital	1,00,000	Machinery	4,00,000
A's Loan	2,00,000	Furniture and Fixtures	1,60,000
Creditors	10,00,000	Stock	1,60,000
		Book Debts	2,00,000
		Cash at Bank	10,000
		B's Capital (Overdrawn)	1,30,000
	14,60,000		**14,60,000**

The firm was dissolved as all the partners were declared insolvent. The assets were realized as under:

Book debts: 45% less; Building: ₹1,60,000; Stock: ₹1,00,000; Machinery: ₹2,00,000; and Furnitures and fixtures; ₹40,000. Realization expenses were ₹10,000.

Partner	Private Assets (₹)	Private Liabilities (₹)
A	2,50,000	2,50,000
B	2,00,000	1,80,000
C	2,30,000	2,50,000

You are required to prepare:

(i) Realisation Account,

(ii) Bank Account,

(iii) Creditors Account,

(iv) Partners' Capital Account, and

(v) Deficiency Account.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars		(₹)
To Building	4,00,000	By Bank		
To Machinery	4,00,000	Book debts	1,10,000	
To Furniture	1,60,000	Building	1,60,000	
To Stock	1,60,000	Stock	1,00,000	
To Book debts	2,00,000	Machinery	2,00,000	
To Bank - Realisation exp.	10,000	Furniture	40,000	6,10,000
		By Partners' Capital A/c: (Realisation loss)		7,20,000
	13,30,000			**13,30,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,000	By Realisation	10,000
To Realisation A/c	6,10,000	By Creditors A/c (Bal. Fig.)	6,30,000
To B's Capital A/c (Excess of B's estate)	20,000		
	6,40,000		**6,40,000**

Dr. **Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank	6,30,000	By Bal b/d	10,00,000
To Deficiency A/c (Bal. Fig.)	3,70,000		
	10,00,000		**10,00,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Bal. b/d		1,30,000		By Bal. b/d	1,60,000		1,00,000
To Realisahon loss (7.20,000 in 1:1:1)	2,40,000	2,40,000	2,40,000	By A's Loan A/c	2,00,000		
				By Bank A/c.		20,000	
To Deficiency	1,20,000			By Deficiency A/c		3,50,000	1,40,000
	3,60,000	**3,70,000**	**2,40,000**		**3,60,000**	**3,70,000**	**2,40,000**

Dr. **Deficiency Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To B's Capital A/c	3,50,000	By Creditors A/c	3,70,000
To C's Capital A/c	1,40,000	By A's Capital A/c	1,20,000
	4,90,000		**4,90,000**

Illustration 28

P, Q, R and T have been carrying on business in partnership sharing profits and losses in the ratio of 4:1:2:3. The following is their Balance Sheet as on 31st March, 2023:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Premises		2,80,000
P	7,00,000		Furnitures		30,000
T	3,00,000	10,00,000	Stock-in-Trade		2,00,000
Trade Creditors		3,00,000	Trade Debtors	3,50,000	
			Less: Provision for Bad Debts	50,000	3,00,000
			Cash at Bank		1,40,000
			Capital Accounts:		
			Q	2,00,000	
			R	1,50,000	3,50,000
		13,00,000			**13,00,000**

It has been agreed to dissolve the partnership on 1st April, 2023, on basis of the following points agreed upon between the partners:

(i) P is to take over Trade Debtors at 80% of Book Value (₹3,50,000);

(ii) T is to take over the stock in Trade at 95% of the value; and

(iii) R is to discharge Trade Creditors.

(iv) The realisation is: Premises ₹2,75,000 and Furnitures ₹25,000.

(v) The expenses of realisation come to ₹30,000.

(vi) Q is found insolvent and ₹21,900 is realised from his estate.

Note: The loss arising out of capital deficiency may be distributed following decision in Garner vs. Murray.

You are required to prepare:

(a) Realisation Account

(b) Bank/Cash Account

(c) Capital Accounts of the Partners.

Solution:

In the books of Firm

Realisation Account

Dr. Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Trade debtors A/c	3,50,000	2023	By Provision for Bad Debts A/c	50,000
April 1	To Stock in Trade A/c	2,00,000	April 1	By Trade Creditor A/c	3,00,000
	To Premises A/c	2,80,000		By P's Capital A/c	2,80,000
	To Furniture A/c	30,000		(Trade Debtors taken over)	
	To R's Capital A/c	3,00,000		By T's Capital A/c	1 ,90,000
	Trade credit discharged)	30,000		(Stock-in-trade taken over)	
	Co Bank/Cash (Expenses)			By Bank A/c	3,00,000
				(Assets realised)	
				By Partners' Capital A/c	70,000
				(P: 28,000: Q: 7,000; R: 14,000: T: 21,000)	
		11,90,000			**11,90,000**

Bank Account

Dr. **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Balance b/d	1,40,000	2023	By Realisation A/c (expenses)	30,000
April 1	To Realization A/c	3,00,000	April 1	By Partners' Capital A/c	
	To Partner's Capital A/c:			P:	2,90,430
	P:	28,000		R:	1,50,000
	Q:	21,900		T:	54,470
	R:	14,000			
	T:	21,000			
		5,24,900			**5,24,900**

Partners' Capital Account

Dr. Cr.

Particulars	P (₹)	Q (₹)	R (₹)	T (₹)	Particulars	P (₹)	Q (₹)	R (₹)	T (₹)
To Balance b/d	—	2,00,000	1,50,000	—	By Balance b/d	7,00,000	—	—	3,00,00
To Realisation A/c	2,80,000	—	—	1,90,000	By Realisation A/c (Trade Credit discharged)	—	—	3,00,000	—
To Realisation A/c (Loss)	28,000	7,000	14,000	21,000					
To Capital A/c (WN-2)	129,570	—	—	55,530	By Bank/Cash A/c (W.N. 1)	28.000	—	14,000	21,000
To Bank/Cash A/c	2,90,430	—	1,50,000	54,470	By Bank/Cash (W.I)	—	21,900	—	—
					By P's Capital A/c	—	1,29,570	—	—
					By T's Capital A/c	—	55,530	—	—
	7,28,000	**2,07,000**	**3,14,000**	**3.21,000**		**7,28,000**	**2,07,000**	**3,14,000**	**3.21,000**

Working Notes :

(1) Q's deficiency of ₹ 1,85,100 (₹ 2,07,000 - ₹ 21,900) should be shared by P and Tin the ratio of their capital i.e. 7:3. R will not bear any loss on deficiency, because at the time of dissolution he had a debit balance in his Capital Account.

(2) The amount realised from the estate of Q is ₹ 21,900.

Illustration 29

Balance Sheet as at 30.10.2023

Liabilities	(₹)	Asset	(₹)
Capitals		Fixed Assets	1,00,000
P	5,000		
Q	3,000		
R	2,000	Cash	10,000
Bank Loan	60,000		
Sundry Creditors	40,000		
	1,10,000		**1,10,000**

All the partners were declared insolvent. Profit sharing ratio : 5 : 3 : 2. Assets realized ₹ 60,000. Prepare necessary ledger accounts to close the books of the firm.

Solution :

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Fixed Assets	1,00,000	By Cash A/c (realisation)	60,000
		By Partners Capital A/cs	
		(loss on realisation)	
		P: 20,000	
		Q: 12,000	
		R: 8,000	40,000
	1,00,000		**1,00,000**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
				By Balance b/d	5,000	3,000	2,000
To Realization A/c	20,000	12,000	8,000	By Deficiency A/c	15,000	9,000	6,000
	20,000	**12,000**	**8,000**		**20,000**	**12,000**	**8,000**

Dr. **Deficiency Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Partners Capital A/cs :			
P	15,000	By Bank Loan A/c	18,000
Q	9,000	By Creditors	12,000
R	6,000		
	30,000		**30,000**

Dr. **Bank Loan Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Deficiency A/c	18,000	By Balance b/d	60,000
To Cash A/c	42,000		
	60,000		**60,000**

Dr. **Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Deficiency A/c	12,000	By Balance b/d	40,000
To Cash A/c	28,000		
	40,000		**40,000**

Dr. **Cash Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,000	By Bank Loan A/c	42,000
To Realisation A/c	60,000	By Creditors A/c	28,000
	70,000		**70,000**

Note :

The total deficiency of the partners i.e. the firm is ₹30,000. This is shared between the external liabilities in the ratio of their amount outstanding ₹60,000 : ₹40,000 = 3 : 2

Bank Loan A/c	Dr.	₹18,000	
Creditors A/c	Dr.	₹12,000	
To Deficiency A/c			₹30,000

Return of Premium to a partner on dissolution before expiry of term :

Conditions :

(i) A partner was admitted in the partnership firm for a fixed term period,

(ii) Such partner had paid a premium for goodwill at the time of admission.

(iii) The partnership firm has dissolved.

Exceptions : The partner will not be entitled to any claim under any of the following conditions :

(i) the firm is dissolved due to death of a partner

(ii) the dissolution is due to the misconduct of the partner claiming refund

(iii) dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Amount of Refund: the amount to be repaid will be determined having regard to the terms upon which the admission was made and to the length of the period agreed upon and the period that has expired.

Liability of other partners: the amount of refund payable shall be borne by the other partners in their profit sharing ratio.

Ilustration 30

X was admitted into partnership for 5 years, for which he paid a premium of ₹ 1,20,000. After 39 months, the partnership firm was dissolved due to misconduct of Mr. Z , another partner of the firm. Y, being the third partner. Profit Sharing Ratio : Y : Z : X = 5 : 3 : 2.

Solution:

X is entitled to claim the refund of premium paid at the time of admission, since the admission was for a fixed term period and the firm is getting dissolved due to a misconduct of Mr.Z, another partner of the firm.

The amount of refund is

= (Total Premium Paid × Unexpired term of the partnership) / Total term of the partnership

= 1,20,000 × 21/60 = ₹ 42,000

This shall be shared by the other partners Y and Z in their profit sharing ratio 3 : 2.

Y's Capital A/c	Dr.	₹25,200	
Z's Capital A/c	Dr.	₹16,800	
To X's Capital A/c			₹42,000
(Being premium paid during admission now refunded to X after adjusting capitals of other partners)			

Piecemeal Distribution

Till now the discussion was based on the implicit assumption that all assets were realized and settlement was done on the same date. In fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

The order of the payment will be as follows :

(i) Realisation expenses

(ii) For provision for expenses that are to be made

(iii) Preferential creditors (say, Income Tax or any payment made to the Government)

(iv) Secured creditors – upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors

(v) Unsecured creditors – in proportion to the amount of debts, if more than one creditor

(vi) Partners' loan – if there is more than one partner – in that case, in proportion to the amount of loan

(vii) Partners' capital – the order of payment may be made by any one of the following two methods:

(a) Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

(b) Maximum Possible Loss Method

Surplus Capital Method

This method is applicable when all the partners are solvent. The following steps are to be followed to calculate the surplus capital:

1. Adjusted capital: the balance lying in the capital accounts of the partners are adjusted with the undistributed profit or loss, drawings and reserves.
2. Base capital: the adjusted capital is divided by the unit of profit share and the minimum amount is called the base capital. For example if profit sharing ratio is 5:3:2 the respective capitals will be divided by 5, 3 and 2 respectively.
3. Proportionate capital: the amount is ascertained by multiplying the base capital with unit of profit share. For example if base capital is ₹20,000 it is multiplied by 5,3 and 2 respectively.
4. Surplus capital: it is ascertained by the difference of adjusted capital and the proportionate capital.

The process continues until we get an absolute surplus.

Example: (Computation of Surplus Capital)

Balance of Capital Accounts

X : ₹ 35,000, Y: ₹ 33,000, AND Z : ₹ 18,000. Reserves ₹ 10,000. Profit sharing ratio 5:3:2.

Statement Showing Surplus Capital

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Capital Balance	A		35,000	33,000	18,000
Add Reserves (5:3:2)	B		5,000	3,000	2,000
Adjusted Capital	C		40,000	36,000	20,000
Unit Share of Profit	D		5	3	2
Capital per Unit of Profit Share	E		8,000	12,000	10,000
Base Capital (being minimum)	F	8,000			
Unit Share of Profit	G		5	3	2

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Proportionate Capital (F × G)	H		40,000	24,000	16,000
Surplus Capital (C – H)	I		0	12,000	4,000
Unit Share of Profit	J			3	2
Capital per Unit of Profit Share	K			4,000	2,000
Base Capital (being minimum)	L	2,000			
Unit Share of Profit	M			3	2
Proportionate Capital (L × M)	N			6,000	4,000
Absolute Surplus Capital (I – N)	O			6,000	0

Implication:

The above table indicates that Y will get the first preference of settlement by ₹6,000. Thereafter, Y and Z will be settled in the ratio of 3:2. Any balance left will then be open to X Y and Z in the ratio of 5:3:2.

Example: (Distribution of Cash)

A, B and C were partners sharing profits and losses as 2:1:1. The balance sheet as on 31.03.2023 when they dissolved their partnership was as under:

Liabilities	(₹)	Assets	(₹)
Capital :			
A	60,000	Sundry assets	1,85,000
B	50,000	Cash	15,000
C	30,000		
Reserves	10,000		
B's Loan	20,000		
Creditors	20,000		
Government Due	10,000		
	2,00,000		**2,00,000**

₹ 2,000 was spent for packaging of materials before sale. The realization were made on different dates as under:

April ₹15,000; May ₹ 20,000; June ₹ 30,000; July ₹ 60,000; August ₹40,000.

The collections were distributed as and when realized. Prepare a statement showing the distribution of cash collected.

Solution:

Computation of Surplus Capital

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Capital Balance	A		60,000	50,000	30,000
Add: Reserves (2:1:1)	B		5,000	2,500	2,500
Adjusted Capital	C		65,000	52,500	32,500
Unit Share of Profit	D		2	1	1
Capital Per Unit of Profit Share	E		32,500	52,500	32,500
Base Capital (Being Minimum)	F	32,500			
Unit Share of Profit	G		2	1	1
Proportionate Capital (F × G)	H		65,000	32,500	32,500
Surplus Capital (C – H)	I		0	20,000	0
Unit Share of Profit	J		-	-	-
Capital Per Unit of Profit Share	K		-	-	-
Base Capital (Being Minimum)	L		-	-	-
Unit Share of Profit	M		-	-	-
Proportionate Capital (L × M)	N		-	-	-
Absolute Surplus Capital (I – N)	O		-	-	-

Statement Showing Distribution of Cash

Particulars	(₹)	External Debt		B's Loan (₹)	Partners Capital		
		Govt. Due (₹)	Creditors (₹)		A (₹)	B (₹)	C (₹)
Balance as on 31.03.2023	15,000	10,000	20,000	20,000	65,000	52,500	32,500
Less: expense for packaging	2,000						
	13,000						
Payment of govt. dues	10,000	10,000					
	3,000	NIL					
Payment to creditors	3,000		3,000				
	NIL		17,000	20,000	65,000	52,500	32,500
1ST Realisation	15,000						

Particulars	(₹)	External Debt		B's Loan (₹)	Partners Capital		
		Govt. Due (₹)	Creditors (₹)		A (₹)	B (₹)	C (₹)
Payment to creditors	15,000		15,000				
			2,000	20,000	65,000	52,500	32,500
2nd Realisation	20,000						
Payment to creditors	2,000		2,000				
Paid to B	18,000			18,000			
				2,000	65,000	52,500	32,500
3rd Realisation	30,000						
Paid to B	2,000			2,000			
Payment of surplus capital to B	20,000					20,000	
Payment to partners (2:1:1)	8,000				4,000	2,000	2,000
					61,000	30,500	30,500
4th Rrealisation	60,000						
Paid to partners (2:1:1)	60,000				3,0000	15,000	15,000
					31,000	15,500	15,500
5th Realisation	40,000						
Paid to partners (2:1:1)	40,000				20,000	10,000	10,000
Loss on Realisation					11,000	5,500	5,000

Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital (determined on the basis of minimum capital per unit of profit) to determine surplus capital of the partners. Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio. This ensures that final balances of partners show their share of realisation profit/loss and thus, no settlement need to be dome at that point of time.

Illustration 31

Partners M, N and P have called upon you to assist them in winding up the affairs of their partnership on 30th June, 2023. Their Balance Sheet as on that date is given below :

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	17,000	Cash at Bank	6,500
Capital		Sundry Debtors	22,000
Accounts : M	67,000	Stock in trade	13,500
N	45,000	Plant and Equipment	99,000
P	31,500	Loan : M	12,000
		Loan : N	7,500
	1,60,500		**1,60,500**

(a) The partners share profits and losses in the ratio of 5 : 3 : 2.

(b) Cash is distributed to the partners at the end of each month.

(c) A summary of liquidation transaction are as follows :

July :

₹ 16,000 — collected from Debtors; balance is irrecoverable.

₹ 10,000 — received from sale of entire stock.

₹ 1,000 — liquidation expenses paid.

₹ 8,000 — cash retained in the business at the end of the month.

August :

₹ 1,500 — liquidation expenses paid; as part of the payment of his capital, P accepted an equipment for ₹ 10,000 (book value ₹ 4,000).

₹ 2,500 — cash retained in the business at the end of the month.

September :

₹ 75,000 — received on sale of remaining plant and equipment.

₹ 1,000 — liquidation expenses paid. No cash is retained in the business.

Required : Prepare a Schedule of cash payments as on 30th September, showing how the cash was distributed.

Solution :

Statement showing the Distribution of Cash (According to Proportionate Capital Method)

Particulars	Creditors (₹)	Capital		
		M (₹)	N (₹)	P (₹)
A. Balance Due	17,000	55,000	37,500	31,500
B. Amount Distributed as on 31st July	17,000	—	—	6,500
C. Balance Due (A – B)	—	55,000	37,500	25,000
D. Cash paid to 'N' and Equipment Given to P on 31st August.			4,000	10,000

Particulars	Creditors (₹)	Capital		
		M (₹)	N (₹)	P (₹)
E. Balance Due (C – D)		55,000	33,500	15,000
F. Amount Paid to Partners on 30th September		41,500	25,400	9,600
G. Loss on Realisation (Unpaid Balance) [E – F]		13,500	8,100	5,400

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capital (₹)

Particulars	M	N	P
A Balance of Capital Accounts	67,000	45,000	31,500
B Less : Loan	12,000	7,500	—
C Actual Capital (A – B)	55,000	37,500	31,500
D Profit Sharing Ratio	5	3	2
E Actual Capital ÷ Profit Sharing Ratio	11,000	12,500	15,750
F Proportionate Capitals Taking M's Capital as Base Capital	55,000	33,000	22,000
G Excess of Actual Capitals Over Proportionate Capitals (C – F)		4,500	9,500
H Profit Sharing Ratio	—	3	2
I Surplus Capital ÷ Profit Sharing Ratio	—	1,500	4,750
J Revised Proportionate Capital taking N's Capital as Base Capital	—	4,500	3,000
K Excess of Surplus Capital over Revised Proportionate Capitals (G – J)	—	—	6,500

Scheme of distribution of available cash : First instalment up to ₹ 6,500 will be paid to P. Next instalment up to ₹ 7,500 will be distribution between N and P in the ratio of 3 : 2. Balance realisation will be distributed among M, N and P in the ratio of 5 : 3 : 2.

(ii) Statement showing the Calculation of Cash Available for Distribution

Particulars	July (₹)	August (₹)	September (₹)
A Opening Balance	6,500	8,000	2,500
B Add : Net amount realised (Gross amount — Expenses)	25,000	(1,500)	74,000
C Less : Closing Balance	8,000	2,500	—
D Amount available for distribution (A + B – C)	23,500	4,000	76,500

(iii) Statement showing the Manner of Distribution of amount available in August and September

Particulars	July (₹)	August (₹)	September (₹)
First ₹ 7,500	—	4,500	3,000
Balance ₹ 83,000	41,500	24,900	16,600
(Cash and Equipment)	41,500	29,400	19,600
Less : Actual Distribution in August	—	4,000	10,000
Manner of Distribution in September	41,500	25,400	9,600

Illustration 32.

The firm of Blue Collars presented you with the following Balance Sheet drawn as on 31st March 2023 :

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	37,000	Cash in hand	3,000
Capital Accounts :		Sundry Debtors	34,000
L 40,000		Stock in trade	39,000
K 30,000		Plant and Machinery	51,000
J 27,000	97,000	Current Accounts :	
		K 4,000	
		J 3,000	7,000
	1,34,000		**1,34,000**

Partners shared profits and losses in the ratio of 4 : 3 : 3. Due to difference among the partners, it was decided to wind up the firm, realise the assets and distribute cash among the partners at the end of each month.

The following realisations were made :

(i) May — ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500.

(ii) June — Balance of debtors realised ₹ 10,000. Balance of stock fetched ₹ 24,000.

(iii) August — Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.

(iv) September — Part of machinery valued in the books at ₹ 5,000 was taken by K, in part discharge at an agreed value of ₹ 10,000. Balance of machinery was sold for ₹ 30,000 (net).

Partners decided to keep a minimum cash balance of ₹ 2,000 in the first 3 months and ₹ 1,000 thereafter.

Required : Show how the amounts due to partners will be settled.

Solution :

(i) Statement showing the Distribution of Cash (According to Proportionate Capital Method)

Particulars	Creditors (₹)	Capital		
		L (₹)	K (₹)	J (₹)
A Amount Due	37,000	40,000	26,000	24,000

Particulars	Creditors (₹)	Capital		
		L (₹)	K (₹)	J (₹)
B Amount Distribution as on 31st May	35,500	—	—	—
C Balance Due (A – B)	1,500	40,000	26,000	24,000
D Amount Distributed as on 30th June				
First ₹ 1,500	1,500			
Next ₹ 5,333	—	5,333	—	—
Next ₹ 4,667	—	2,667	2,000	—
Balance ₹ 22,500	—	9,000	6,750	6,750
E Balance Due (C – D)		23,000	17,250	17,250
F Amount Distributed as on 31st August		7,360	5,520	5,520
G Balance Due (E – F)		15,640	11,730	11,730
H Add : Profit on Realisation (₹ 41,000 – ₹ 39,100)		760	570	570
I Amount Distributed (Including Machinery Taken by K) as on 30th September.		16,400	12,300*	12,300
* Includes Value of Machinery ₹ 10,000 and Cash ₹ 2,300				

Working Notes :

(i) Assumption : As the firm is dissolved due to difference among the partners, all partners are presumed to be solvent and the problem has been worked out on the basis of the highest relative capital.

(ii) Statement showing the Calculation of Highest Relative Capitals

Particulars	L (₹)	K (₹)	J (₹)
A Actual Capitals	40,000	26,000	24,000
B Profit Sharing Ratio	4	3	3
C Actual Capitals ÷ Profit Ratio	10,000	8,667	8,000
D Proportionate Capitals Taking J's Capital as Base Capital	32,000	24,000	24,000
E Surplus Capital of L and K (A – D)	8,000	2,000	—
F Profit Sharing Ratio	4	3	_
G Surplus Capital ÷ Profit Sharing Ratio	2,000	667	_
H Revised Proportionate Capital of L and J	2,667	2,000	—
I Revised Surplus Capital of L (E – H)	5,333	—	—

While distributing surplus among partners, 1st instalment up to ₹ 5,333 will be paid to L, next instalment up to ₹ 4,667 will be distributed between L and K in the ratio of 4 : 3 and the Balance among L, K and J in the ratio of 4 : 3 : 3.

(iii) Statement showing the Calculation of Cash available each month

Particulars	May (₹)	June (₹)	August (₹)	September (₹)
A Opening Balance	3,000	2,000	2,000	1,000
B Add : Amount realised Less Expenses	34,500	34,000	17,400	30,000
C Less : Closing blance	2,000	2,000	1,000	—
D Total Cash available for Distribution (A+B–C)	35,500	34,000	18,400	31,000

(iv)

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Sundry Debtors	34,000	By Sundry Creditors	37,000
To Stock in trade	39,000	By Cash/Bank	1,17,000
To Plant and Machinery	51,000	By L (Assets taken over)	10,000
To Cash/Bank :			
Creditors	37,000		
Expenses	1,100		
To Profit transferred to Capital A/c	1,900		
	1,64,000		**1,64,000**

Illustration 33.

A partnership firm was dissolved on 30th June, 2023. Its Balance Sheet on the date of dissolution was as follows :

Liabilities	(₹)	Assets	(₹)
Capitals :		Cash	5,400
Atrik	38,000	Sundry Assets	94,600
Mohit	24,000		
Rupa	18,000		
Loan A/c — Mohit	5,000		
Sundry Creditors	15,000		
	1,00,000		**1,00,000**

The assets were realised in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 14,500 in full settlement of their account. Expenses of realisation were estimated to be ₹ 2,700 but actual amount spent on this account was ₹ 2,000. This amount was paid on 15th September. Draw up a Memorandum of distribution of Cash, which was realised as follows :

On 5th July	₹	12,600
On 30th August	₹	30,000
On 15th September	₹	40,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Solution :

Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)

	Particulars	Creditors (₹)	Mohit's Loan (₹)	Atrik (₹)	Mohit (₹)	Rupa (₹)
A	Balance Due	15,000	5,000	38,000	24,000	18,000
B	Cash Paid (₹ 5,400 – ₹ 2,700)	2,700	—	—	—	—
C	Balance Unpaid (A – B)	12,300	5,000	38,000	24,000	18,000
D	1st Installment of ₹ 12,600	11,800	800	—	—	—
E	Balance Unpaid (C – D)	500	4,200	38,000	24,000	18,000
F	Less : Written-off	500				
G	2nd Installment of ₹ 30,000		4,200	16,320	2,320	7,160
H	Balance Unpaid (E – F – G)			21,680	21,680	10,840
I	3rd Installment (₹ 40,000 + ₹ 700)			16,280	16,280	8,140
J	Unpaid Balance (H – I) = Loss on Realisation			5,400	5,400	2,700

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capitals

	Particulars	Atrik (₹)	Mohit (₹)	Rupa (₹)
A	Actual Capitals	38,000	24,000	18,000
B	Profit-Sharing Ratio	2	2	1
C	Actual Capitals ÷ Profit Sharing Ratio	19,000	12,000	18,000
D	Proportionate Capitals Taking Mohit's Capital as Base Capital	24,000	24,000	12,000
E	Surplus Capital [A–D]	14,000	Nil	6,000
F	Surplus Capital ÷ Profit Sharing Ratio	7,000	—	6,000
G	Revised Proportionate Capitals Taking Rupa's Capital as the Basis	12,000	—	6,000
H	Revised Surplus Capital (E – G)	2,000	—	—

(ii) Distribution of Second Instalment of ₹ 30,000

Particulars	Mohit's Loan (₹)	Atrik (₹)	Mohit (₹)	Rupa (₹)
First ₹ 4,200	4,200	—	—	—
Next ₹ 2,000 (Absolute Surplus)		2,000	—	—
Next ₹ 18,000 (Balance of Surplus)		12,000	—	6,000
Balance ₹ 5,800 (2 : 2 : 1)	4,200	2,320	2,320	1,160
Total ₹ 30,000		16,320	2,320	7,160

Illustration 34

East, South and North are in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively. They decide to dissolve the business on 31st July, 2023 on which date their Balance Sheet was as follows :

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Land and Buildings	30,810
East	38,700	Motor car	5,160
South	10,680	Investment	1,080
North	11,100	Stock	19,530
Loan account : North	3,000	Debtors	11,280
Creditors	10,320	Cash	5,940
	73,800		**73,800**

The assets were realised piecemeal as follows and it was agreed that cash should be distributed as and when realised :

			(₹)
14th	August		10,380
20th	September		27,900
16th	October		3,600
		North took over investment as follows at a value of:-	
15th	November		1,260
18th	November		19,200

Dissolution expenses were originally provided for an estimated amount of ₹ 2,700, but actual amount spent on 25th October was ₹ 1,920. The creditors were settled for ₹ 10,080.

Required : Prepare a statement showing distribution of cash amongst the partners, according to Proportionate Capital Method.

Solution :

Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)

	Particualr	Creditors (₹)	Loan (₹)	East (₹)	South (₹)	North (₹)
A	Balance Due	10,320	3,000	38,700	10,680	11,100
B	Paid to Creditors [₹ 5,940 – ₹ 2,700]	3,240	—	—	—	—
C	Balance Due (A - B)	7,080	3,000	38,700	10,680	11,100
D	Amount paid on 14th August	6,840	3,000	540		
E	Less : Written off	240	—	38,160	10,680	11,100
F	Balances Due (D - E)	(240)	—	—	—	—
G	Amount paid on 20th September			38,160	10,680	11,100
	(i) First 4,860 (i.e. ₹ 5,400 – ₹ 540)			4,860	—	—
	(ii) Balance ₹ 23,040			33,300	10,680	11,100
H	Balance Due (F - G)			17,280	—	5,760
I	Amount paid on 16th October			16,020	10,680	5,340
J	Balance Due (H-I)			1,800	1,200	600
K	Amount paid on 25th October (being excess over estimated expenses ₹ 780)			14,220 390	9,480 260	4,740 130
L	Balance due (J - K)			13,830	9,220	4,610
M	Cash brought in by North			630	420	210
N	Balance Due (L-M)			13,200	8,800	4,400
O	Amount paid on 18th November			9,600	6,400	3,200
P	Balance unpaid (N-O)			3,600	2,400	1,200

Working Note :

Statement Showing the Calculation of Highest Relative Capitals

	Particulars	East (₹)	South (₹)	North (₹)
A	Actual Capitals	38,700	10,680	11,100
B	Profit Sharing Ratio	3	2	1
C	Actual Capital ÷ Profit Sharing Ratio	12,900	5,340	11,100
D	Proportionate capitals taking South's Capital as Base Capital (being the smallest) × PSR	16,020	10,680	5,340
E	Surplus capital (i.e. Excess of Actual Capitals over proportionate capital) [A-D]	22,680	—	5,760

	Particulars	East (₹)	South (₹)	North (₹)
F	Profit Sharing Ratio	3	—	1
G	Surplus Capital ÷ Profit Sharing Ratio	7,560	—	5,760
H	Revised Proportionate Capitals taking North's Capital as Base Capital	17,280	—	5,760
I	Revised Surplus Capital [E-H]	5,400	—	—
J	Distribution Sequence			
	First ₹ 5,400 [To East]	5,400	—	—
	Next ₹23,040 [To East & North in the ratio of 3:1]	17,280	—	5,760
	Balance ₹19,200 [To East, South & North in the ratio of 3:2:1]	9,600	6,400	3,200

Maximum Loss Method :

Steps

(1) Prepare a statement showing distribution of cash

(2) Pay off the external Liabilities

(3) After all the payment is made for the external liabilities, the partners will be paid off.

Total Due of Partners	xxx
Less : Net/Balance of Realisation	(x)
Maximum Loss	xxx

(4) The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.

(5) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.

(6) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.

(7) Repeat the steps (3) to (6) till final realisation.

PROBLEMS ON MAXIMUM LOSS METHOD

Illustration 35

The following is the Balance Sheet of X, Y and Z, who were sharing in the ratio 5 : 3 : 2, on 31st December, 2023 when they decided to dissolve the partnership.

Liabilities	(₹)	Assets	(₹)
Capital Account		Cash	20,000
- X	55,000	Other assets	13,04,000
- Y	37,500		
- Z	31,500		
Loan Account - Y	2,00,000		
Crditors	10,00,000		
	13,24,000		**13,24,000**

Note : There was a bill for ₹ 4,000 due on 01.04.2024 under discount.

Other assets realised as under :

1st January : ₹ 8,85,000, 1st February : ₹ 3,00,000 ; 1st March : ₹ 8,000; 1st April : ₹ 5,000; 1st May : ₹ 10,000. The expenses of realisation were expected to be ₹ 5,000, but ultimately amounted to ₹ 4,000 only and were paid on 1st May. The acceptor of the bill under discount met the bill on the due date.

Required : Prepare a statement showing the monthly distribution of cash according to Maximum Loss Method.

Solution:

Statement showing the Distribution towards Firm's Outside debts' & Partners' Loan

	Particulars	Creditors (₹)	Y's Loan (₹)
A	Amount Due	10,00,000	2,00,000
B	Amount paid on 1st Jan. (₹ 20,000 + ₹ 8,85,000 – ₹ 5,000)	9,00,000	—
C	Balance Due (A - B)	1,00,000	2,00,000
D	Amount paid on 1st February	1,00,000	2,00,000
E	Balance Due (C - D)	Nil	Nil

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

	Particulars	Total (₹)	X (₹)	Y (₹)	Z (₹)
(i)	Distribution of ₹ 4,000				
A.	Amount due as on 1st March	1,24,000	55,000	37,500	31,500
	Less : Max. Possible Loss if the remaining nothing (₹ 1,24,000 – ₹ 4,000) in the ratio of 5 : 3 : 2	1,20,000	60,000	36,000	24,000
	Note : Cash available = ₹ 8,000 – ₹ 4,000 (Reserved for discounted B/R) = ₹ 4,000				
	Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315	—	5,000	(2,717)	(2,283)
		—	—	(1,217)	5,217
	Adjustment of Y's Deficiency (charged to Z)	—	—	1,217	(1,217)
B.	Cash paid as on 1st March	4,000	—	—	4,000
(ii)	Distribution of ₹ 9,000 (including amount kept reserved for B/R no longer required)		—		
C.	Balance due (A-B)	1,20,000	55,000	37,500	27,500
	Less : Max. Possible Loss (₹ 1,20,000 – ₹ 9,000)	1,11,000	55,500	33,300	22,200
	Note : Cash available = ₹ 5,000 + ₹ 4,000 = ₹ 9,000		(500)	4,200	5,300

	Particulars	Total (₹)	X (₹)	Y (₹)	Z (₹)
	Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315	—	500	(272)	(228)
D.	Cash paid as on 1st April	9,000	—	3,928	5,072
(iii)	Distribution of ₹ 11,000				
E.	Balance due (C-D)	1,11,000	55,000	33,572	22,428
	Less : Max. Possible Loss (₹ 1,11,000 – ₹ 11,000)	1,00,000	50,000	30,000	20,000
F.	Cash paid as on 1st May	11,000	5,000	3,572	2,428
G.	Unpaid Balance (E - F)	1,00,000	50,000	30,000	20,000

Illustration 36

The following is the Balance Sheet of P, Q and R on 31st August, 2023 when they decided to dissolve the partnership. They share profits in the ratio of 2 : 2 : 1.

Liabilities	(₹)	Assets	(₹)
Creditors	2,000	Sundry Assets	48,500
P's Loan	5,000	Cash	500
P's Capital	15,000		
Q's Capital	18,000		
R's Capial	9,000		
	49,000		**49,000**

The assets realised the following sums in instalments.

I— ₹ 1,000, II— ₹ 3,000, III— ₹ 3,900, IV— ₹ 6,000, V— ₹ 20,000.

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only.

Required : Show, how at each stage, the cash received should be distributed among partners according to Maximum Loss Method.

Solution :

Statement showing the Realisation and Distribution of Cash

	Installments	Realisation (₹)	Creditors (₹)	Partners' Loans (₹)	Partners' Capital (₹)
(I)	(After taking into account cash and amount set aside for expenses)	1,000	1,000		
(II)		3,000	1,000	2,000	
(III)		3,900		3,000	900

Installments	Realisation (₹)	Creditors (₹)	Partners' Loans (₹)	Partners' Capital (₹)
(IV)	6,000	—	—	6,000
(V) (including saving in expenses)	20,100	—	—	20,100
	34,000	**2,000**	**5,000**	**27,000**

Statement showing the Distribution of Cash among partners
(According to Maximum Loss Method)

Particulars	Total (₹)	P (₹)	Q (₹)	R (₹)
(i) Distribution of ₹ 900				
A. Balance Due	42,000	15,000	18,000	9,000
B. Less : Max. Possible loss, if the remaining assets prove to be worthless (₹ 42,000 – ₹ 900) in the ratio (2 : 2 : 1)	41,100	16,440	16,440	8,220
C. Deficiency of P's Capital charged to Q and R in the ratio of their Capitals i.e., 18,000 : 9,000 (Garner vs. Murray)	—	1,440	(960)	(480)
D. Amount paid	900	—	600	300
(ii) Distribution of ₹ 6,000				
E. Balance after payment (A -D)	41,100	15,000	17,400	8,700
F. Less : Max. Possible loss (₹ 41,100 – ₹ 6,000)	35,100	14,040	14,040	7,020
G. Amount paid	6,000	960	3,360	1,680
(iii) Distribution of ₹ 20,100				
H. Balance after payment (E - G)	35,100	14,040	14,040	7,020
I. Less : Max. Possible loss (₹ 35,100 – ₹ 20,100)	15,000	6,000	6,000	3,000
J. Amount paid	20,100	8,040	8,040	4,020
K. Unpaid balance (H - J)	15,000	6,000	6,000	3,000

Illustration 37

Rahul, Roshan and Rohan were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The partnership was dissolved on 30th June, 2023 when the position was as follows :

Liabilities	(₹)	Assets	(₹)
Capitals :		Cash in hand	28,000
Rahul	1,40,000	Sundry Debtors	2,94,000

Liabilities	(₹)	Assets	(₹)
Roshan	70,000	Stock in trade	1,12,000
Rohan	14,000		
Creditors	2,10,000		
	4,34,000		**4,34,000**

There was bill for ₹ 10,000, due on 30th November, 2023, under discount. It was agreed that the net realisations should be distributed in their due order (at end of each month) but as safely as possible. The realisations and expenses were as under :

Date	Stock and Debtors (₹)	Expenses (₹)
31st July	84,000	7,000
31st August	1,26,000	5,400
30th September	70,000	4,900
31st October	77,000	3,500
30th November	35,500	3,500

The Stock was completely disposed off and amounts due from debtors were realised, the balance being irrecoverable. The acceptor of the bill under discount met the billl on the due date. Prepare a Statement showing the piecemeal distribution of cash according to Maximum Loss Method.

Solution :

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

	Particulars	Creditors (₹)	Rahul (₹)	Roshan (₹)	Rohan (₹)
A.	Balance Due	2,10,000	1,40,000	70,000	14,000
B.	Cash on hand on 30th June paid to creditors	28,000	—	—	—
C.	Balance outstanding (A – B)	1,82,000	1,40,000	70,000	14,000
D.	Cash paid on 31st July	77,000	—	—	—
E.	Balance outstanding (C – D)	1,05,000	1,40,000	70,000	14,000
F.	₹ 1,05,000 paid to creditors on 31st August	1,05,000	—	—	—
G.	Balance outstanding (E – F)	—	1,40,000	70,000	14,000
	Balance available for distribution (₹1,20,600 – ₹ 1,05,000 – ₹ 10,000) = ₹ 5,600				
	Less : Maximum loss (₹ 2,24,000 – ₹ 5,600) in ratio of 3 : 2 : 1		(1,09,200)	(72,800)	(36,400)

	Particulars	Creditors (₹)	Rahul (₹)	Roshan (₹)	Rohan (₹)
	Balance		30,800	(2,800)	(22,400)
	Deficiency of Roshan and Rohan's capital charged to Rahul		(25,200)	2,800	22,400
H.	Cash paid on 31st August		5,600	—	—
I.	Balance outstanding (G – H)		1,34,400	70,000	14,000
	Less : Maximum Loss (₹ 2,18,400 – ₹ 65,100)		(76,650)	(51,100)	(25,550)
	Balance		57,750	18,900	(11,550)
	Deficiency of Rohan's capital charged to Rahul and Roshan (2 : 1)		(7,700)	(3,850)	11,550
J.	Cash paid on 30th September		50,050	15,050	—
K.	Balance outstanding (I – J)		84,350	54,950	14,000
	Less : Maximum loss (₹ 1,53,300 – ₹ 73,500)		(39,900)	(26,600)	(13,300)
L.	Cash paid on 31st October		44,450	28,350	700
M.	Balance outstanding (K – L)		39,900	26,600	13,300
	Less : Maximum loss (₹ 79,800 – ₹42,000*)		(18,900)	(12,600)	(6,300)
N.	Cash paid on 30th November		21,000	14,000	7,000
O.	Unpaid Balance (M – N)		18,900	12,600	6,300

***Note :** Cash available on 30th November = (₹ 35,500 – ₹3,500) + ₹10,000 (Reserved for Discounted B/R, now no longer required) = ₹42,000.

Illustration 38

E, F and G were partners in a firm, sharing profits and losses in the ratio of 3 : 2 : 1, respectively. Due to extreme competition, it was decided to dissolve the partnership on 31st December, 2023. The Balance Sheet on that date was as follows :

Liabilities		(₹)	Assets	(₹)
Capitals Accounts :			Machinery	1,54,000
E	1,13,100		Furniture and Fittings	25,800
F	35,400		Investments	5,400
G	31,500	1,80,000	Stock	97,700
Current Accounts :			Debtors	56,400
E	26,400		Bank	29,700
G	6,000	32,400	Current Account : F	18,000
Reserves		1,08,000		
Loan Account : G		15,000		
Creditors		51,600		
		3,87,000		**3,87,000**

The realisation of assets is spread over the next few months as follows :

February, Debtors, ₹ 51,900; March : Machinery, ₹ 1,39,500; April, Furniture, etc. ₹ 18,000; May : G agreed to take over Investments at ₹ 6,300; June, Stock, ₹ 96,000.

Dissolution expenses, originally provided, were ₹ 13,500, but actually amounted to ₹ 9,600 and were paid on 30th April. The partners decided that after creditors were settled for ₹ 50,400, all cash received should be distributed at the end of each month in the most equitable manner.

Required : Prepare a statement of actual cash distribution as is received following "Maximum Loss basis".

Solution :

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

Particular		Creditors G's Loan (₹)		Capital Accounts			
				E (₹)	F (₹)	G (₹)	Total (₹)
A	Balance due [Creditors net of discount]	51,600	15,000	1,93,500	53,400	55,500	3,02,400
	Paid to Creditors and G	50,400	15,000	—	—	—	—
B	Balance due (A - B) Max. Possible	—	—	1,93,500	53,400	55,500	3,02,400
C	Loss if remaining assets fetch nothing (₹ 3,02,400 – ₹ 2,700) in the ratio of 3 : 2 : 1			1,49,850	99,900	49,950	2,99,700
	Adjustment of F's Deficiency between E and G in the ratio of their fixed capitals i.e. ₹1,13,100 : ₹31,500			43,650	(46,500)	5,550	
				(36,370)	46,500	(10,130)	
	Balance Adjustment of G's Deficiency			7,280	—	(4,580)	
	(charged to E)			(4,580)		4,580	2,700
D	Cash paid to E on 28th Feb.			2,700	—	—	2,99,700
E	Balance due (C - D)			1,90,800	53,400	55,500	
	Possible Max. Loss (₹ 2,99,700 – ₹ 1,39,500)						1,60,200
F	Cash paid on 31st Mar.			80,100	53,400	26,700	1,39,500
G	Balance Due (E - F)			1,10,700	—	28,800	1,60,200
	Possible Max. Loss			80,100	53,400	26,700	
	(₹1,60,200 – ₹21,900)						1,38,300
H	Cash paid on 30th April			69,150	46,100	23,050	21,900
I	Balance Due (G - H)			10,950	7,300	3,650	1,38,300
J	Maximum Loss (₹1,38,300 – ₹ 6,300)			69,150	46,100	23,050	1,32,000
K	Cash brought in by G			66,000	44,000	22,000	

Particular		Creditors	G's Loan (₹)	Capital Accounts E (₹)	F (₹)	G (₹)	Total (₹)
L	Balance Due (I + K)			3,150	2,100	1,050	(6,300)
	Possible Max. Loss			66,000	44,000	22,000	1,32,000
	(₹ 1,32,000 – ₹96,000)			18,000	12,000	6,000	36,000
M	Cash paid on 30th June			48,000	32,000	16,000	96,000
N	Unpaid Balance (L – N)			18,000	12,000	6,000	36,000

Working Note :

Statement showing the Calculation of Cash Available for Distribution

Particular		February (₹)	March (₹)	April (₹)	May (₹)	June (₹)
A	Opening Balance	29,700	—	—	—	—
B	Add : Net Amount realised	51,900	1,39,500	18,000	—	96,000
C	Less : Provision for Expenses	13,500	—	—	—	—
D	Add : Provision no longer required	—	—	3,900	—	—
E	Cash available for distribution (A + B – C + D)	68,100	1,39,500	21,900	—	96,000

Amalgamation of Partnership Firms

4.6

As defined earlier, a Partnership firm is formed with two or more persons. But it can also be formed in any of the following ways.

(A) When two or more sole proprietors forms new partnership firm;

(B) When one existing partnership firm absorbs a sole proprietorship;

(C) When one existing partnership firm absorbs another partnership firm;

(D) When two or more partnership firms form new partnership firm.

The amalgamation is used to be done to avoid competition amongst them and to maximize the profit of the firm/firms.

Accounting entries under different situation are in below:

(A) When two or more sole proprietors form a new partnership firm

When two or more sole proprietorship businesses amalgamate to form a new partnership firm, the existing sets of books will be closed and a new set of books of accounts to be opened, recording all assets, liabilities and transactions of the partnership.

Steps to be taken for the existing books.

Step 1 : Prepare the Balance Sheet of the business on the date of dissolution.

Step 2 : Open a Realisation Account and transfer all assets and liabilities, except cash in hand and cash at bank, at their book values.

However, cash in hand and cash at bank are transferred to Realisation Account only when they are taken over by the new firm.

Step 3 : All undistributed reserves or profits or losses (appearing in the balance sheet) are to be transferred to Partners' Capital Accounts.

Step 4 : Calculate Purchase Consideration on the basis of terms and conditions agreed upon by the parties. Generally, purchase consideration is calculated on the basis of agreed value of assets and liabilities taken over by the new firm. The purchase consideration is calculated as under:

	(₹)
Agreed values of assets taken over	xxxx
Less: Agreed values of liabilities assumed	(xxx)
Purchase consideration	xxxx

Step 5 : Credit Realisation Account by the amount of Purchase Consideration.

Step 6 : If there are any unrecorded assets or liabilities, they are to be recorded.

Step 7 : The Profit or loss on relisation (balancing figure of Realisation Account) to be transferred to the Capital Account of the proprietor.

Step 8 : To ensure that all the accounts of the Sole Proprietor's business are closed.

Accounting Entries in the Books of Amalgamating Sole Proprietors :

1. For transferring sundry assets to Realisation Account

   Realisation A/c Dr.

   To Sundry Assets A/c [Individually]

   (Assets transferred to Realisation Account at their book values except Cash and Bank i.e. if not taken over by the new firm)

2. For transferring sundry liabilities to Realisation Account

   Liabilities A/c Dr.

   To Realisation A/c [Individually]

   (Liabilities transferred to Realisation Account at their book values)

3. For the amount of purchase consideration

   New Firm A/c Dr.

   To Realisation A/c

   (Purchase consideration due from the new firm)

4. For assets taken over by the proprietor

   Capital A/c Dr.

   To Realisation A/c

   (Assets taken over by the proprietor)

5. For realisation of assets not taken over by the new firm

   Bank A/c Dr.

   To Realisation A/c

   (Realisation of assets not taken over by the new firm)

6. For recording of unrecorded assets

   Assets A/c Dr.

   To Capital A/c

   (Unrecorded assets are recorded)

7. For realisation of unrecorded assets

   Bank A/c Dr.

   To Assets A/c

   (Realisation of unrecorded assets)

   (**Note:** If unrecorded assets are taken over by the new firm, it is also transferred to Realisation Account along with other assets.)

8. For payment of liabilities not taken over

    Realisation A/c Dr.

        To Bank A/c

    (Payment of liabilities not taken overby the new firm)

9. For recording of unrecorded liabilities

    Capital A/c Dr.

        To Liabilities A/c

    (Being the unrecorded liabilities are recorded)

10. For payment of unrecorded liabilities

    Liabilities A/c Dr.

        To Bank A/c

    (Payment of unrecorded liabilities)

    (**Note :** If unrecorded liabilities are taken over by the new firm, it is also transferred to Realisation Account along with other liabilities.)

11. For liabilities taken over by the proprietor

    Realisation A/c Dr.

        To Capital A/c

    (Being liabilities assumed by the proprietor)

12. For realisation expenses

    Realisation A/c Dr.

        To Bank A/c

    (Realisation expenses paid)

13. For profit on realisation

    Realisation A/c Dr.

        To Capital A/c

    (Profit on realisation transferred to Capital Account)

14. For loss on realisation

    Capital A/c Dr.

        To Realisation A/c

    (Loss on realisation transferred to Capital Account)

15. For accumulated profits / reserves

    Reserves A/c Dr.

    Profit and Loss A/c Dr.

        To Capital A/c

    (Undrawn profits transferred to Capital Account)

16. For accumulated losses

Capital A/c	Dr.	
To Profit and Loss A/c (if any)		
(Accumulated losses transferred to Capital A/c))		

17. For settlement of purchase consideration by the New firm

Capital in New Firm A/c	Dr.	
To New Firm A/c		
(Settlement of purchase consideration)		

18. For final adjustment

Capital A/c	Dr.	
To Capital in New Firm A/c		
To Bank A/c (if any)		
(Final adjustment to close the books of account)		

Accounting Entries in the Books of the New Firm

The new firm records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is, more than the net assets (assets minus liabilities) acquired, it represents goodwill. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents capital reserve.

1. If the net acquired assets is equal to purchase consideration.

Assets A/c	Dr.	[Acquired value]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]

2. If the net acquired asset is more than the purchase consideration:

Assets A/c	Dr.	[Acquired value]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]
To Capital Reserve A/c		[Purchase consideration - net assets]

3. If the net acquired asset is less than the amount of purchase consideration, it represents goodwill.

Assets A/c	Dr.	[Acquired value]
Goodwill A/c	Dr.	[Purchase consideration - net assets]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]

Illustration 39

A and B carry on independent business and their position on 31.03.2023 are reflected in the Balance Sheet given below :

Liabilities	A (₹)	B (₹)	Assets	A (₹)	B (₹)
Sundry creditors for purchases	1,10,000	47,000	Stock-in-trade	1,70,000	98,000
			Sundry Debtors	89,000	37,000
Sundry creditors for expenses	750	2,000	Cash at bank	13,000	7,500
			Cash in hand	987	234
Bills payable	12,500	-	Furniture and Fixtures	2,750	1,766
Capital A/c	1,53,000	95,500	Investments	513	—
	2,76,250	**1,44,500**		**2,76,250**	**1,44,500**

Both of them want to form a partnership firm from 1.4.2023 in the style of AB & Co. on the following terms:

(a) The capital of the partnership firm would be ₹ 3,00,000 and to be contributed by them in the ratio of 2:1.

(b) The assets of the individual businesses would be evaluated by C at which values, the firm will take them over and the value would be adjusted against the contribution due by A and B.

(c) C gave his valuation report as follows :

Assets of A : Stock-in trade to be written-down by 15% and a portion of the sundry debtors amounting to ₹9,000 estimated unrealisable; furniture and fixtures to be valued at ₹ 2,000 and investments to be taken at market value of ₹ 1,000.

Assets of B : Stocks to be written-up by 10% and sundry debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book values.

(d) The firm is not to consider any creditors other than the dues on account of purchases made.

(e) Creditors for expenses waived their claims.

You are required to pass necessary Journal entries in the books of A and B. Also prepare the opening Balance Sheet of the firm as on 01.04.2023.

Solution :

In the books of A

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023	Realisation A/c	Dr.	2,76,250	
Apr.1	To Stock-in-trade A/c			1,70,000
	To Sundry Debtors A/c			89,000
	To Cash at bank A/c			13,000
	To Cash in hand A/c			987
	To Furniture & Fixture A/c			2,750
	To Investments A/c			513
	(Transfer of different Assets to Realisation A/c)			

Date	Particulars		Dr. (₹)	Cr. (₹)
	Creditors for Goods A/c	Dr.	1,10,000	
	Creditors for Expenses A/c	Dr.	750	
	Bills Payable A/c	Dr.	12,500	
	To Realisation A/c			1,23,250
	(Transfer of different liabilities to Realisation A/c)			
	AB & Co. A/c (Note 1)	Dr.	1,18,987	
	To Realisation A/c			1,18,987
	(Purchase consideration due)			
	Capital A/c	Dr.	34,013	
	To Realisation A/c			34,013
	(Realisation loss transferred to Capital A/c)			
	Capital in AB & Co. A/c	Dr.	1,18,987	
	To AB & Co. A/c			1,18,987
	(Settlement of purchase consideration)			
	Capital A/c	Dr.	1,18,987	
	To Capital in AB & Co. A/c			1,18,987
	(Final adjustment to close the books of account)			

In the books of B

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023	Realisation A/c	Dr.	1,44,500	
Apr.1	To Stock-in-trade A/c			98,000
	To Sundry Debtors A/c			37,000
	To Cash at bank A/c			7,500
	To Cash in hand A/c			234
	To Furniture & Fixture A/c			1,766
	(Transfer of different Assets to Realisation A/c)			
	Creditors for Goods A/c	Dr.	47,000	
	Creditors for Expenses A/c	Dr.	2,000	
	To Realisation A/c			49,000
	(Transfer of different liabilities to Realisation A/c)			
	AB & Co. A/c	Dr.	1,01,750	
	To Realisation A/c			1,01,750
	(Purchase consideration due)			

Date	Particulars		Dr. (₹)	Cr. (₹)
	Realisation A/c To Capital A/c (Realisation Profit transferred to Capital A/c)	Dr.	6,250	 6,250
	Capital in AB & Co. A/c To AB & Co. A/c (Settlement of purchase consideration)	Dr.	1,01,750	 1,01,750
	Capital A/c To Capital in AB & Co. A/c (Final adjustment to close the books of account)	Dr.	1,01,750	 1,01,750

Balance Sheet of AB & Co. as on 01.04.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Furniture & Fittings	3,766
A	2,00,000	Investments	1,000
B	1,00,000	Stock-in-trade	2,52,300
Sundry creditors for purchases	1,57,000	Sundry Debtors	1,11,450
Bills payable	12,500	Cash at bank	99,763
		(13,000 + 7,500 + 81,013 - 1,750)	
		Cash in hand (987 + 234)	1,221
	4,69,500		**4,69,500**

Working Notes :

(1) Calculation of purchase consideration :

Particulars	A (₹)	B (₹)
Furniture	2,000	1,776
Investments	1,000	-
Stock-in-trade	1,44,500	1,07,800
Sundry Debtors	80,000	31,450
Cash at bank	13,000	7,500
Cash in hand	987	234
	2,41,487	1,48,750
Less : Sundry creditors for purchases	1,10,000	47,000
Bills payable (Assumed arising out of credit purchases)	12,500	-
Net assets taken over by the AB & Co.	1,18,987	1,01,750
Capital as per agreement	2,00,000	1,00,000
Less: Net assets taken over	1,18,987 (+)	1,01,750 (-)
Cash to be introduced (+) / withdrawn (-)	81,013	1,750

(B) When an existing partnership firm absorbs a sole proprietorship

When a sole proprietorship is taken over by an existing firm, the original business of the sole proprietor is dissolved and compensated by a share of the partnership firm which is acquiring it. In this case, assets and liabilities of the sole proprietorship business are taken over by the partnership firm at agreed values. **The procedures for closing the books of account of the sole proprietorship are same as explained earlier**.

However, the following points are to be noted:

(i) The assets and liabilities of the sole proprietorship taken over by the existing firm, are added with the existing assets and liabilities of the firm.

(ii) The capital of the new partner (the sole proprietorship) is equal to the purchase consideration agreed upon.

(iii) Calculation and treatment for goodwill and Capital reserve are same as explained in situation (A).

(iv) Before amalgamation, all the assets and liabilities of the firm may be revalued. Any profit or loss on revaluation is transferred to the Partners' Capital Accounts in the old profit-sharing ratio.

(v) Goodwill of the firm is to be adjusted by crediting the Partners' Capital Accounts in their old profit-sharing ratio.

(vi) Balance of reserve and surplus of the firm is also to be credited to partners' Capital Accounts in the old profit-sharing ratio.

Illustration 40

Following are the Balance Sheets of partners X and Y (sharing profits and losses in the ratio of their capital) and the sole proprietor Z as on 31.03.2023 :

Liabilities	Partners X & Y	Sole Proprietor Z	Assets	Partners X & Y	Sole Proprietor Z
Capital			Goodwill	-	2,000
X	15,000	-	Building	25,000	-
Y	5,000	-	Stock	10,000	15,000
Z	-	10,000	Bills receivable	5,000	5,000
Creditors	26,000	13,000	Debtors	4,000	6,000
Loan	-	5,000	Cash in Hand	2,000	-
	46,000	**28,000**		**46,000**	**28,000**

The partners decided to admit Z as a partner and Z agreed to amalgamate his business with that of the partnership on the following terms :

1. The new profit-sharing ratio among X, Y, and Z will be in the ratio of their capitals.
2. The building is to be appreciated by ₹ 15,000 and provision @ 5 % is to be created on debtors.
3. The goodwill of the partnership is valued at ₹ 10,000 and of the sole proprietor at ₹ 1,500; both are to be recorded in the books.
4. Stock is to be taken at ₹ 9,200 and ₹ 16,800, respectively of the firm and the sole proprietor.

Prepare ledger accounts to close the books of Z, to make necessary Journal entries in the books of the firm and prepare the Balance Sheet of the re-constituted partnership.

Solution :

Working Note : Calculation of purchase consideration

Assets taken over :	(₹)	(₹)
Goodwill	1,500	
Stock	16,800	
Bills receivable	5,000	
Debtors	6,000	29,300
Less: Liabillties taken over:		
Creditors	13,000	
Loan	5,000	
Provision for bad debts	300	18,300
Purchase consideration		11,000

In the books of Z

Dr. **Realisation Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Goodwill A/c	2,000		By Creditors A/c	13,000
	To Stock A/c	15,000		By Loan A/c	5,000
	To Bills receivable A/c	5,000		By Partners X & Y A/c	11,000
	To Debtors A/c	6,000			
	To Capital A/c - Profit	1,000			
		29,000			**29,000**

Dr. **Capital Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Partners X & Y A/c	11,000		By Balance b/d	10,000
				By Realisation A/c	1,000
		11,000			**11,000**

Dr. **Partners X & Y Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Realisation A/c	11,000		By Capital A/c	11,000
		11,000			**11,000**

In the Books of X & Y

Journals

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	Building A/c	Dr.		15,000	
	To Revaluation A/c				
	(Increase in the Value of Building)				15,000
	Revaluation A/c	Dr.		1,000	
	To Stock A/c				
	To Provision for Bad Debt A/c				800
	(Decrease in the value of assets)				200
	Revaluation A/c	Dr.		14,000	
	To X Capital A/c				
	To Y Capital A/c				10,500
	(Profit on revaluation transferred)				3,500
	Goodwill A/c	Dr.		10,000	
	To X Capital A/c				
	To Y Capital A/c				7,500
	(Goodwill raised in the books)				2,500
	Goodwill A/c	Dr.		1,500	
	Stock A/c	Dr.		16,800	
	Bills Receivable A/c	Dr.		5,000	
	Debtors A/c	Dr.		6,000	
	To Loan A/c				5,000
	To Creditors A/c				13,000
	To Provision for Bad Debt A/c				300
	To Z Capital A/c				11,000
	(Assets and liabilities taken over)				

Balance Sheet of X, Y & Z (after absorption) as at 01.04.2023

Liabilities	(₹)	Assets	(₹)	(₹)
Capital Account		Goodwill		11,500
- X	33,000	Building		40,000
- Y	11,000	Stock		26,000
- Z	11,000	Bills Receivable		10,000
Loan	5,000	Debtors	10,000	
Crditors	39,000	Less: Provision	500	9,500
		Cash in hand		2,000
	99,000			**99,000**

(C) When one firm takes over another firm

In this case, the procedures for closing of books are same as earlier. The assets of the absorbed firm added with the firm who absorbed the firm.

The treatment for capital reserve and goodwill are same as before.

Illustration 41

Following is the Balance sheet of AB & Co. and CD & Co. as on 31.03.2023.

Liabilities	AB & Co. (₹)	CD & Co. (₹)	Assets	AB & Co. (₹)	CD & Co. (₹)
Bank Loan	10,000	-	Stock-in-trade	32,000	24,000
Bills Payable	30,000	40,000	Sundry Debtors	18,000	30,000
Capital A	60,000	-	Machinery	60,000	20,000
Capital B	30,000	-	Cash in hand	12,000	2,000
Capital C		36,000	Furniture	8,000	6,000
Capital D		24,000	Investments	-	18,000
	130,000	**100,000**		**130,000**	**100,000**

AB & Co. absorbed CD & Co. on 01.04.2023 on the following terms:

(a) The value of the goodwill of CD & Co. would be ₹ 12,000;

(b) The investments of CD & Co. to be sold out for ₹ 24,000 and the realised cash will be introduced in the acquiring business;

(c) The stock of CD & Co. to be reduced to ₹ 22,000;

(d) The machinery of CD & Co. will be increased by 40%;

(e) The Furniture of CD & Co. will be reduced by 10%.

It was further agreed that for AB & Co., following are the adjustments to be made :

(i) Assets are to be revalued as follows :

Goodwill- ₹ 16,000; Stock - ₹ 40,000; Machinery - ₹ 84,000; Furniture - ₹ 7,200;

(ii) Bank loan to be repaid

Show necessary Ledger Accounts to close the books of CD & Co. and to prepare necessary Journal entry and Balance Sheet of AB & Co. after absorption.

Solution :

Working Notes:

Calculation of Purchase Consideration

Assets taken over :	(₹)
Machinery	28,000
Furniture	5,400
Stock	22,000

Assets taken over :	(₹)
Debtors	30,000
Cash (₹ 24,000 + ₹ 2,000)	26,000
Goodwill	12,000
	1,23,400
Less : **Liability taken over**	
– Bills payable	40,000
Purchase consideration	83,400

In the books of CD & Co.

Realisation Account

Dr. Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Stock-in-trade	24,000		By Bills Payable A/c	40,000
	" Sundry Debtors	30,000		By AB & Co A/c	83,400
	" Machinery	20,000			
	" Cash in hand	26,000			
	" Furniture	6,000			
	To Partners' Capital A/cs:				
	C - 8,700				
	D - 8,700	17,400			
		123,400			**123,400**

Cash Account

Dr. Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Balance b/d	2,000		By Realisation A/c	26,000
	To Investments A/c	24,000			
		26,000			**26,000**

Partners' Capital Account

Dr. Cr.

Date	Particulars	C (₹)	D (₹)	Date	Particulars	C (₹)	D (₹)
	To Capital in				By Balance b/d	36,000	24,000
	AB & Co. A/c	47,700	35,700		By Profit on Sale of	3,000	3,000
					Investment A/c		
					By Realisation A/c	8,700	8,700
		47,700	**35,700**			**47,700**	**35,700**

In the books of AB & Co.

Dr. Partners' Capital Account Cr.

Date	Particulars	A (₹)	B (₹)	Date	Particulars	A (₹)	B (₹)
	To Balance c/d	83,600	53,600		By Balance b/d	60,000	30,000
					By Goodwill A/c	8,000	8,000
					By Revaluation A/c	15,600	15,600
		83,600	**53,600**			**83,600**	**53,600**

Balance Sheet as on 01.04.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts		Goodwill	28,000
A	83,600	Machinery	1,12,000
B	53,600	Furniture	12,600
C	47,700	Stock	62,000
D	35,700	Debtors	48,000
Bills payable	70,000	Cash ₹(26,000 + 12,000 – 10,000)	28,000
	2,90,600		**2,90,600**

Journal

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
2023	Bank Loan A/c	Dr.		10,000	
	To Cash A/c				10,000
	(Being the bank loan repaid)				
	Goodwill A/c	Dr.		16,000	
	To A's Capital A/c				8,000
	To B's Capital A/c				8,000
	(Being the goodwill raised)				
	Stock A/c	Dr.		8,000	
	Machinery A/c	Dr.		24,000	
	To Revaluation A/c				32,000
	(Being increase in the value of assets)				
	Revaluation A/c	Dr.		800	
	To Furniture A/c				800
	(Being the decrease in the value of furniture)				

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	Revaluation A/c	Dr.		31,200	
	To A's Capital A/c				15,600
	To B's Capital A/c				15,600
	(Being the profit on revaluation transferred to Partners' Capital A/cs in the profit-sharing ratio)				
	Goodwill A/c	Dr.		12,000	
	Machinery A/c	Dr.		28,000	
	Furniture A/c	Dr.		5,400	
	Stock A/c	Dr.		22,000	
	Debtors A/c	Dr.		30,000	
	Cash A/c	Dr.		26,000	
	To Bills Payable A/c				40,000
	To C 's Capital A/c				47,700
	To D's Capital A/c				35,700
	(Being the introduction of capital by C & D)				

(D) When two or more partnership firms form a new partnership firm

When two or more partnership firms amalgamate to form a new partnership firm, the books of account of the old firm is to be closed. In the books of each old firm, a Realisation Account to be opened. The accounting entries of the amalgamating firm is same as before as they were absorbed.

Illustration 42

Two partnership firms, carrying on business under the style of R & Co. (Partners A & B) and W & Co. (Partners C & D) respectively, decided to amalgamate into RW & Co. with effect from 1st April 2023. The respective Balance Sheets of both the firms as on 31st March, 2023 are in below :

Liabilities	R (₹)	W (₹)	Assets	R (₹)	W (₹)
Capital B	19,000	-	Goodwill	-	5,000
Capital C	-	10,000	Machinery	10,000	-
Capital D	-	2,000	Stock-in-trade	20,000	5,000
Bank Loan	15,000	-	Sundry Debtors	10,000	10,000
Creditors	10,000	9,500	Cash in hand	-	1,500
			Capital - A	4,000	-
	44,000	**21,500**		**44,000**	**21,500**

Profit sharing ratios are : A & B = 1:2; C & D = 1:1. Agreed terms are :

(i) All fixed assets are to be devalued by 20%.

(ii) All stock in trade is to be appreciated by 50%.

(iii) R & Co. owes ₹ 5,000 to W & Co. as on 31st March 2013. This is settled at ₹ 2,000. Goodwill is to be ignored for the purpose of amalgamation.

(iv) The fixed capital accounts in the new firm (RW & Co.) are to be : Mr A ₹ 2,000; Mr. B ₹ 3,000; Mr C ₹ 1,000 and D ₹ 4,000.

(v) Mr. B takes over bank overdraft of R & Co. and contributed to Mr. A the amount of money to be brought in by Mr. A to make up his capital contribution.

(vi) Mr C is paid off in cash from W & Co. and Mr. D brings in sufficient cash to make up his required capital contribution.

Pass necessary Journal entries to close the books of both the firms as on 31st March 2023.

Solution :

Calculation of Purchase Consideration

Assets taken over :		**R & Co. (₹)**	**W & Co. (₹)**
Plant & Machinery		8,000	-
Stock-in-trade		30,000	7,500
Sundry Debtors [(* After adjustment of ₹ 3,000		10,000	*7,000
(₹ 5,000 – 2,000)]	(A)	48,000	14,500
Liability taken over:			
Sundry Creditors [(* ₹ (10,000 – 3000)]	(B)	*7,000	9,500
Purchase consideration	(A-B)	41,000	5,000

In the books of R & Co.

Journals Dr. Cr.

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
31.3.23	Realisation A/c	Dr.		40,000	
	To Machinery A/c				10,000
	To Stock-in-trade A/c				20,000
	To Sundry Debtors A/c				10,000
	(Different assets transferred)				
	Sundry Creditors A/c	Dr.		10,000	
	To Realisation A/c				10,000
	(Sundry creditors transferred to Realisation Account)				
	Bank Loan A/c	Dr.		15,000	
	To B Capital A/c				15,000
	(Bank overdraft taken over by B)				

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	RW & Co. A/c	Dr.		41,000	
	To Realisation A/c				41,000
	(Purchase consideration due)				
	Realisation A/c	Dr.		11,000	
	To A Capital A/c				3,667
	To B Capital A/c				7,333
	(Profit on realisation transferred to partners capital in the ratio of 1:2)				
	B Capital A/c	Dr.		2,333	
	To A Capital A/c				2,333
	(Deficit in A's capital made good by B)				
	A Capital A/c	Dr.		2,000	
	B Capital A/c (3,000 + 36,000)	Dr.		39,000	
	To RW & Co. A/c				41,000
	(Capital accounts of the partners closed by transfer to RW & Co.)				
	Alternatively Shows:				
	A Capital A/c	Dr.		2,000	
	B Capital A/c	Dr.		3,000	
	Loan from B A/c	Dr.		36,000	
	To RW & Co. A/c				41,000

Note : It should be noted that the credit balance in B's capital account is ₹ 39,000. His agreed capital in RW & Co is ₹ 3,000 only. Since there is no liquid assets in R & Co. from which B can be repaid, the excess amount of ₹ 36,000 should be taken over by RW & Co. as loan from B.

In the books of W & Co.

Journals

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
31.3.23	Realisation A/c	Dr.		20,000	
	To Goodwill A/c				5,000
	To Stock-in-trade A/c				5,000
	To Sundry Debtors A/c				10,000
	(Different Assets transferred)				

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Sundry Creditors A/c	Dr.		9,500	
	To Realisation A/c				9,500
	(Sundry creditors transferred)				
	RW & Co. A/c	Dr.		5,000	
	To Realisation A/c				5,000
	(Purchase consideration due)				
	C's Capital A/c	Dr.		2,750	
	D's Capital A/c	Dr.		2,750	
	To Realisation A/c				5,500
	(Loss on realisation transferred to Capital Account equally)				
	Cash A/c	Dr.		4,750	
	To D's Capital A/c				4,750
	(Being the necessary amount brought in by D to make up his required capital contribution)				
	C's Capital A/c	Dr.		7,250	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	To Cash A/c				6,250
	(Capital accounts of the partners closed by transfer to RW & Co. and balance paid by cash)				
	Alternatively Shows:				
	C's Capital A/c	Dr.		6,250	
	To Cash A/c				6,250
	(Being the C's Capital is paid off)				
	C's Capital A/c	Dr.		1,000	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	(Being the Partner's Capital transferred to RW & Co.)				

Dr. **Realization Account** **Cr.**

Particulars	R & Co. (₹)	W & Co. (₹)	Particulars	R & Co. (₹)	W & Co. (₹)
To Goodwill	-	5,000	By Creditors	10,000	9,500
" Machinery	10,000	-	By RW & Co.	41,000	5,000
" Stock-in-trade	20,000	5,000	By C's Capital		2,750

Particulars	R & Co. (₹)	W & Co. (₹)	Particulars	R & Co. (₹)	W & Co. (₹)
" Sundry Debtors	10,000	10,000	By D's Capital		2,750
" Cash in hand	-				
" A's Capital	3,667				
" B's Capital	7,333				
	51,000	**20,000**		**51,000**	**20,000**

Dr. **Partners' Capital Accounts of R & Co.** **Cr.**

Date	Particulars	A (₹)	B (₹)	Date	Particulars	A (₹)	B (₹)
2022	To Balance b/d	4,000	—	2022	By Balance b/d	—	19,000
Mar	" A Capital A/c	—	2,333	Mar	" Realisation A/c (Profit)	3,667	7,333
	" Loan A/c	—	36,000		" Bank overdraft A/c	—	15,000
	" R W & Co. A/c	2,000	3,000		" B's Capital A/c	2,333	—
		6,000	**41,333**			**6,000**	**41,333**

Dr. **Partners' Capital Accounts of W & Co.** **Cr.**

Date	Particulars	C (₹)	D (₹)	Date	Particulars	C (₹)	D (₹)
2022	To Realisation A/c (Loss)	2,750	2,750	2022	By Balance b/d	10,000	2,000
Mar	" Cash A/c	6,250	—	Mar	" Cash A/c	—	4,750
	" R W & Co. A/c	1,000	4,000				
		10,000	**6,750**			**10,000**	**6,750**

Illustration 43

A and B carry on independent business in provisions and their position as at 31.3.2023 are reflected in the Balance Sheets given below:

	A (₹)	B (₹)
Stock in Trade	1,70,000	98,000
Sundry Debtors	89,000	37,000
Cash at Bank	13,000	7,500
Cash in hand	987	234
Furniture and Fixtures	2,750	1,766
Investments	513	-----
	2,76,250	**1,44,500**

	A (₹)	B (₹)
Represented by Sundry Creditors for		
Purchases	1,10,000	47,000
Expenses	13,250	2,000
Capital Account	1,53,000	95.500
	2,76,250	**1,44.500**

Both of them want to. form a partnership firm from 1st April, 2023 on the following understanding:

(a) The capital of the partnership would,be ₹3 lakhs which would be contributed by them in the ratio of 2 :1.

(b) The assets of the individual business would be evaluated by C at which values, the firm will take them over and the value would be adjusted against the contribution due by A and B.

(c) C gave his valuation report as follows:

Business of A: Stock in Trade to be written down by 15% and a portion of Sundry Debtors amounting to ₹9,000 estimated unrealisable not to be assumed by the firm; furniture and fixtures to be valued at ₹2,000 and investments to be taken of market value of 1,000. Assets of B: Stocks to be increased by 10%, and Sundry Debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book value.

(d) The firm is not to assume any Creditors other than the dues on account of purchases made.

Prepare the opening Balance Sheet of the firm.

Solution:

Calculation Net Assets taken over

	A (₹)	B (₹)
Investments	1,000	—
Sundry debtors	80,000	31,450
Furniture & fixtures	2,000	1,766
Stock in trade	1,44,500	1,07,800
Cash in hand	987	234
Cash at bank	13,000	7,500
	2,41,487	1,48,750
Less: Sundry Trade Creditors	1,10,000	47,000
	1,31,487	1,01,750
Add: Additional Cash bought is by A	68,513	—
Less: Excess Amount transferred to Current A/c.	—	1,750
	2,00,000	**1,00,000**

M/s A & B

Balance Sheet as at 01.04.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital			Furniture and Fixtures		3,766
A	2,00,000		Investments		1,000
B	1,00,000	3,00,000	Sundry Debtors		1,11,450
Sundry Creditors		1,57,000	Stock in Trade		2,52,300
B's Current A/c		1,750	Cash in hand		1 ,221
			Cash at Bank		89,013
		4,58,750			**4,58,750**

Conversion of Partnership Firm into a Company and Sale of Partnership Firm to a Company

4.7

For various reasons, an existing partnership may sell its entire business to an existing Joint Stock Company. It can also convert itself into a Joint Stock Company. The former case is the absorption of a partnership firm by a Joint Stock Company but the latter case is the flotation of a new company to take over the business of the partnership.

In either of the above cases, the existing partnership firm is dissolved and all the books of account are closed. Broadly, the procedure of liquidation of the partnership business is same as what has already been explained in "Amalgamation of Partnership"

Some important points :

(1) The Purchase Consideration is satisfied by the Company either in the form of cash or shares or debentures or a combination of two or more of these. The shares may be equity or preference shares. The shares may be issued at par or at a premium. For the partnership, the issue price is relevant which may form a part of the purchase consideration.

(2) In the absence of any agreement, share received from purchasing company should be distributed among the partners in the same ratio as profits and losses are shared.

Accounting Entries in the books of selling firms.

1. For transferring different assets to Realisation Account

   Realisation A/c Dr. [Individually]

   To Sundry Assets A/c

   (Assets transferred to Realisation Account at their book values)

2. For transferring different liabilities to Realisation Account

   Liabilities A/c Dr. [Individually]

   To Realisation A/c

   (Liabilities transferred to Realisation Account at their book values)

3. For purchase consideration due

   Purchasing Co. A/c Dr

   To Realisation A/c

   (Purchase consideration due from the new firm)

4. For assets taken over by the proprietor

   Capital A/c Dr

   To Realisation A/c

   (Assets taken over by the proprietor)

5. For realisation of assets not taken over by the Company

   Bank A/c Dr.

   To Realisation A/c

   (Realisation of assets not taken over by the new firm)

6. For recording unrecorded assets

   Assets A/c Dr

   To Capital A/c

   (Unrecorded assets recorded)

7. For realisation of unrecorded assets

   Bank A/c Dr

   To Assets A/c

8. For payment of liabilities not taken over

   Realisation A/c Dr

   To Bank A/c

   (Payment of liabilities not taken over by the new firm)

9. For recording unrecorded liabilities

   Capital A/c Dr

   To Liabilities A/c

   (Being the unrecorded liabilities recorded)

10. For payment of unrecorded liabilities

    Liabilities A/c Dr

    To Bank A/c

    (Payment of unrecorded liabilities)

    (**Note:** If unrecorded liabilities are taken over by the Company, it is also transferred to Realisation Account along with other liabilities.)

11. For liabilities taken over by the proprietor

    Realisation A/c Dr

    To Capital A/c

    (Being liabilities assumed by the proprietor)

12. For realisation expenses

    Realisation A/c Dr.

    To Bank A/c

    (Realisation expenses paid)

13. For profit on realisation

Realisation A/c	Dr
To Capital A/c	

(Profit on realisation transferred to Capital Account)

14. For loss on realisation

Capital A/c	Dr
To Realisation A/c	

(Loss on realisation transferred to Capital Account)

15. For accumulated profits / reserves

Reserves A/c	Dr
Profit and Loss A/c	Dr
To Capital A/c	

(Undrawn profits transferred to Capital Account)

16. For Loss : Reverse entry of 15.

17. For transferring partners' current accounts (Credit balances) to capital accounts

Partners' Current A/cs	Dr.
To Partners' Capital A/cs	

If there is a debit balance in current account, the reverse entry shall be recorded.

18. For Settlement of purchase consideration by the company

Shares in Purchasing Co.	Dr.
Debentures in Purchasing Co.	Dr.
Cash A/c	Dr.
To Purchasing Co. A/c	

19. For final adjustment

Partners' Capital A/cs	Dr.
To Shares in Purchasing Co. A/c	
To Debenture in Purchasing Co. A/c	
To Cash A/c	

Accounting Entries in the books of the Purchasing Company

The purchasing company will record all the assets and liabilities at agreed values. Calculation of Goodwill and Capital Reserve same as explained earlier.

1. **For assets and liabilities taken over:**

(When net assets taken over is less than the Purchase consideration)

Assets A/c	Dr.	(Agreed Value)
Goodwill A/c	Dr.	(Balancing figure)
To Liabilities A/c		(Agreed Value)
To Firm A/c		(Purchase Consideration)
(Being different assets and liabilities taken over)		

(When net assets taken over is more than the Purchase consideration)

Assets A/c	Dr.	(Agreed Value)
To Liabilities A/c		(Agreed Value)
To Firm A/c		(Purchase Consideration)
To Capital Reserve A/c		(Balancing Figure)
(Being different assets and liabilities taken over)		

2. **For discharge of Purchase Consideration:**

Firm A/c	Dr	(Purchase Consideration)
To Share Capital A/c		(Face value of shares issued)
To Securities Premium A/c		(if any)
To Debentures A/c		
To Bank A/c		

Illustration 44

X and Y were in partnership in XY & Co. sharing profits in the proportions 3:2. On 31st March 2023, they accepted an offer from P Ltd. to acquire at that date their fixed assets and stock at an agreed price of ₹ 7,20,000. Debtors, creditors and bank overdraft would be collected and discharged by the partnership firm.

The purchase consideration of ₹ 7,20,000 consisted of cash ₹ 3,60,000, debentures in P Ltd. (at par) ₹ 1,80,000 and 12,000 Equity Shares of ₹ 10 each in P Ltd. X will be employed in P Ltd. but, since Y was retiring X agreed to allow him ₹ 30,000 in compensation, to be adjusted through their Capital Accounts. Y was to receive 1,800 shares in P Ltd. and the balance due to him in cash. The Balance Sheet of the firm as on 31.03.2023 is in below :

Liabilities	(₹)	Assets	(₹)
X's Capital Account	1,20,000	Fixed Assets	4,80,000
Loan from X	2,10,000	Stock	45,000
Bank overdraft	1,50,000	Debtors	75,000
Creditors	1,80,000	Y's Capital Account	60,000
	6,60,000		**6,60,000**

The sale of the assets to P. Ltd. took place as agreed; the debtors realised ₹ 60,000 and creditors were settled for ₹ 1,71,000. The firm then ceased business. You are required to pass necessary Journal entries and show: (a) Realisation Account (b) Bank Account (c) Partners' Capital Accounts.

Solution:

In the books of XY & Co.

Journals

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
31.3.23	Realisalion A/c	Dr.		6,00,000	
	To Fixed Assets A/c				4,80,000
	To Stock-in-trade A/c				45,000
	To Sundry Debtors A/c				75,000
	(Different Assets transferred)				
	Creditors A/c	Dr.		1,80,000	
	To Realisation A/c				1,80,000
	(Sundry creditors transferred)				
	P Ltd A/c	Dr.		7,20,000	
	To Realisation A/c				7,20,000
	(Purchase consideration due)				
	Bank A/c	Dr.		3,60,000	
	Debentures in P Ltd.	Dr.		1,80,000	
	Shares in P Ltd.	Dr.		1,80,000	
	To P. Ltd A/c				
	(Purchase consideration Received)				7,20,000
	Bank A/c	Dr.		60,000	
	To Realisation A/c				60,000
	(Debtors realized)				
	Realisation A/c	Dr.		1,71,000	
	To Bank A/c				1,71,000
	(Payment to Creditors)				
	Realisation A/c	Dr.		1,89,000	
	To X Capital A/c				1,13,400
	To Y Capital A/c				75,600
	(Profit on realisation transferred to Capital Account)				
	Loan from X	Dr.		2,10,000	
	To X Capital				2,10,000
	(Loan Balance transferred)				

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	X Capital A/c	Dr.		30,000	
	To Y Capital A/c				30,000
	(Adjustment for compensation)				
	X Capital A/c	Dr.		4,13,400	
	To Share in P Ltd				1,53,000
	To Debenture in P Ltd.				1,80,000
	To Bank A/c				80,400
	(Final settlement of accounts of X)				
	Y Capital A/c	Dr.		45,600	
	To Shares in P Ltd.				27,000
	To Bank				18,600
	(Final settlement of accounts of Y)				

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Fixed Assets A/c	4,80,000	By Creditors A/c	1,80,000
To Stock A/c	45,000	By Bank A/c (Debtors realised)	60,000
To Debtors A/c	75,000	By P Ltd A/c (Purch. Consid.)	
To Bank A/c (creditors payment)	1,71,000	Bank	3,60,000
To X's Capital A/c (profit)	1,13,400	Debentures in P Ltd	1,80,000
To Y's Capital A/c (profit)	75,600	Shares in P Ltd.	1,80,000
	9,60,000		**9,60,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realisation A/c	60,000	By Balance b/d	1,50,000
(Debtors realised)		By Realisation A/c	1,71,000
To S Ltd. A/c	3,60,000	(Crs payment)	
(Purchase Consideration)		By Capital A/c - X	80,400
		By Capital A/c - Y	18,600
	4,20,000		**4,20,000**

Dr. **Partners' Capital Accounts** **Cr.**

Dt.	Particulars	X (₹)	Y (₹)	Dt.	Particulars	X (₹)	Y (₹)
	To Balance b/d	-	60,000		By Balance b/d	1,20,000	-
	To Y Capital A/c	30,000			By Loan from X	2,10,000	-
	To Shares in P Ltd	1,53,000			By Realisation A/c	1,13,400	75,600
	To Debentures in		27,000		(profit)		
	P Ltd A/c				By X 's Capital A/c		
	To Bank A/c (final	1,80,000				-	30,000
	payment)	80,400	-				
			18,600				
		4,43,400	**1,05,600**			**4,43,400**	**1,05,600**

Note :

Value of equity shares	**(₹)**	**(₹)**
Total Purchase consideration		7,20,000
Discharged:		
In Cash	3,60,000	
By Debentures	1,80,000	5,40,000
Balance by 12,000 Equity shares of ₹ 10 per each		1,80,000

So the cost of each equity share be ₹ 1,80,000/12,000 = ₹ 15 per share.

Thus in the books of P Ltd. Security premium will be ₹ 12,000 × 5 = ₹ 60,000

Illustration 45

Suchandra, Ashmita and Kasturi were running partnership business sharing Profit and Losses in 2:2:1 ratio. Their Balance Sheet as on 31.03.2023 stood as following: (₹ in 000's)

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Fixed Capital			Fixed Assets		920.00
Suchandra	690.00		Investment		115.00
Ashmita	460.00		Current Assets:		
Kasturi	230.00	1,380.00	Stock	230.00	
Current Account:			Debtors	632.50	
Suchandra	138.00		Cash in Bank	287.50	1,150.00
Kasturi	92.00	230.00			
Unsecured Loan		230.00			
Current Liabilities		345.00			
		2,185.00			**2,185.00**

On 1.4.2023, they agreed to form new company TT (P). Ltd. with Ashmita and Kasturi each taking up 460 eq. share of ₹10 each, which shall take over the firm as going concern including Goodwill, but excluding cash and bank balance.

The following are also agreed upon:

(a) Goodwill will be valued at 3 years purchase of super profit.

(b) The actual profit for the purpose of Goodwill valuation will be ₹ 4,60,000.

(c) The normal rate of return will be 18% p.a. on Fixed Capital.

(d) All other assets and liabilities will be taken at Book value.

(e) Ashmita and Kasturi are to acquire interest in the new company at the ratio 3:2.

(f) The purchase consideration will be payable partly in shares of ₹10 each and partly in cash. Payment in cash being to meet the requirement to discharge Suchandra, who has agreed to retire.

(g) Realisation expenses amounted to ₹ 1,17,300.

You are required to close the books of the firm by passing necessary journal entries.

Solution:

	Particulars		Dr. (₹)	Cr. (₹)
(a)	Realization A/c	Dr.	26,49,600	
	To Fixed Assets A/c			9,20,000
	To Investment A/c			1,15,000
	To Stock A/c			2,30,000
	To Sundry Debtors A/c			6,32,500
	To Goodwill N			6,34,800
	To Bank A/c (Realization Expenses)			1,17,300
	(Being transfer of Assets To, Realization A/c)			
(b)	Unsecured loan A/c	Dr.	2,30,000	
	Current liabilities A/c	Dr.	3,45,000	
	To Realisation A/c			5,75,000
	(Being transfer of liabilities To, Realization A/c)			
(c)	Suchandra's Capital A/c	Dr.	46,920	
	Ashmita's Capital A/c	Dr.	46,920	
	Kasturi's Capital A/c	Dr.	23,460	
	To Realisation A/c			1,17,300
	(Being transfer of realization losses To, partner's Capital A/c)			
(d)	TT (P) Ltd. A/c	Dr. W.N.(3)	19,57,300	
	To Realisation A/c			19,57,300
	(Being purchase consideration due)			
(e)	Goodwill A/c	Dr.W.N. (2)	6,34,800	
	To Suchandra's Capital A/c			2,53,920
	To Ashmita's Capital A/c			2,53,920
	To Kasturi's Capital No			1 ,26,960
	(Being transfer of goodwill To, parties Capital A/c)			

	Particulars		Dr. (₹)	Cr. (₹)
(f)	Suchandra's Current A/c	Dr.	1,38,000	
	Kasturi's Current A/c	Dr.	92,000	
	To Suchandra's Capital A/c			
	To Kasturi's Capital A/c			
	(Being transfer of Current A/c balances To, Capital A/c)			
(g)	Suchandra's Capital A/c	Dr.	10,35,000	
	To Bank A/c			10,35,000
	(Being amount of Capital paid To, Suchandra)			
(h)	Ashmita's Capital A/c	Dr.	11,500	
	To Kasturi's Capital A/c			11,500
	(Being amount payable by Kasturi To, Ashmita in order To, make their claim in new company as 3:2)			
(i)	Bank A/c	Dr.	8,64,800	
	Shares in TT (P) Ltd. A/c	Dr.	10,92,500	
	To TT (P). Ltd. A/c			19,57,300
	(Being amount received, amount shares in Tata (P) Ltd. distributed for Purchase consideration)			

Working Notes:

1. **Dr.** **Ashmita's Capital A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realiztion A/c	46,920	By Balance c/d	4,60,000
To Kasturi's Capital	11,500	By Goodwill A/c	2,53,920
To Shares in TT (P) Ltd.	6,55,500		
	7,13,920		**7,13,920**

Dr. **Kasturi's Capital A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realization A/c	23,460	By Balance c/d	2,30,000
To Shares in TT (P) Ltd.	4,37,000	By Goodwill A/c	1,26,960
		By Current A/c	92,000
		By Ashmita's Capital A/c	11,500
	4,60,460		**4,60,460**

2. **Calculation of goodwill.**

Normal Ratio of return = 1 8% p.a. or fixed capital

= ₹ 13,80,000 × 18%

= ₹ 2,48,400

Actual Profit	=	₹ 4,60,000
(-) Normal Profit	=	₹ 2,48,400
Super Profit	=	₹ 2,11,600
Goodwill	= ₹ 2,11,600 × 3 years of purchase of S.P.	
	= ₹ 6,34,800	
Suchandra's Share	= ₹ 6,34,800 × 2/5	
	= ₹ 2,53,920	
Ashmita's Share	= ₹ 6,34,800 × 2/5	
	= ₹ 2,53,920	
Kasturi's Share	= ₹ 6,34,800 × 1/5	
	= ₹ 1,26,960	

3. Computation of Purchases Consideration

Investments	₹ 1,15,000
Fixed Assets	₹ 9,20,000
Stock	₹ 2,30,000
Debtors	₹ 6,32,500
Goodwill	₹ 6,34,800
	₹ 25,32,300
Less: Unsecured loan	₹ 2,30,000
Current liabilities	₹ 3,45,000
	₹ 19,57,300

4. Calculation of cash required from TT (P) Ltd.

Cash required to pay to Suchandra	₹ 10,35,000
Less: Cash available after expenses (₹ 2,87,500 - ₹ 1,17,300)	₹ 1,70,200
Cash received for purchase Consideration	₹ 8,64,800

5. Shares of ₹ 10,92,500 are to be issued to Ashmita and Kasturi in the ratio of 3:2

Ashmita ₹10,92,500 × $\frac{3}{5}$ = ₹6,55,500

Kasluri ₹10,92,500 × $\frac{2}{5}$ = ₹4,37,000

Accounting of Limited Liability Partnership

4.8

In the recent times, a new form of business organisation, namely the Limited Liability Partnership has been formed which combines the features of two common forms of business – the partnership and the company.

Meaning of Limited Liability Partnership (LLP)

Limited Liability Partnership is a specific form of business organisation consisting of partners whose liability is limited to the capital contribution made by them. It is a combination of both partnership and company and has the characteristics of both these forms of organisations. Unlike a partnership, the partners of a limited liability partnership have limited liability (similar to that in the company) which implies that personal assets of the partners will not be not used for paying off the debts of the organisation.

In India, all limited liability partnerships are governed by the Limited Liability Partnership Act, 2008 which came into effect from April 1, 2009.

NB: the provisions of Indian Partnership Act, 1932 shall not apply to a limited liability partnership.

Nature of Limited Liability Partnership

The nature of a limited liability partnership can be understood from the following:

- A limited liability partnership is a body corporate formed and incorporated under a statute.
- It has a legal entity separate from that of its partners.
- Any change in the partners of a limited liability partnership would not affect the existence, rights or liabilities of the limited liability partnership.

Features of Limited Liability Partnership

Some of the important features of a limited liability partnership registered in India are:

- A limited liability partnership is a body corporate.
- It is formed and incorporated under the Limited Liability Partnership Act, 2008.
- Any individual or body corporate may be a partner in a limited liability partnership.
- Every limited liability partnership shall have at least two partners.
- Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.
- Every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name.

Books of Accounts of Limited Liability Partnership

As per Sec. 34 of Limited Liability Partnership Act, 2008, a limited liability partnership shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.

As per Rule 24(1) of the Limited Liability Partnership Rules, 2009 every limited liability partnership shall keep books of accounts which are sufficient to show and explain the limited liability partnership's transactions, and are such as to:

(a) Disclose with reasonable accuracy, at any time, the financial position of the limited liability partnership at that time; and

(b) Enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act.

The books of account shall contain:

(a) particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;

(b) a record of the assets and liabilities of the limited liability partnership;

(c) statements of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and

(d) any other particulars which the partners may decide.

Rule 24(3) of the Limited Liability Partnership Rules, 2009 specifies that the books of accounts which a limited liability partnership is required to keep shall be preserved for eight years from the date on which they are made.

Statement of Account and Insolvency

Every limited liability partnership shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the limited liability partnership. As per Sec. 36 of the said Act, such Statement of Account and Insolvency filed by a limited liability partnership with the Registrar shall be available for inspection by any person in such manner and on payment of such fees as may be prescribed. Every limited liability partnership shall file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner, and accompanied by such fees as may be prescribed.

Rule 24(3) of the Limited Liability Partnership Rules, 2009 specifies that every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of the six months of the financial year to which the Statement of Account and Solvency relates. Such Statement of Account and Solvency has to be signed on behalf of the limited liability partnership by its designated partners.

Every limited liability partnership has to prepare the following statement of account as prescribed in Part B of LLP Form 8 pursuant to Rule 24 of Limited Liability Partnership Rules, 2009:

1. Statement of Assets and Liabilities; and
2. Statement of Income and Expenditure.

The format of the Statement of Assets and Liabilities is as follows:

Particulars	Figures as at the end of the current reporting period (in ₹)	Figures as at the end of the previous reporting period (in ₹)
(I) CONTRIBUTION AND LIABILITIES		
(1) Partner's funds		
Contribution received		
Reserves and surplus (including surplus being the profit/loss made during year)		
(2) Liabilities		
Secured loans		
Unsecured loans		
Short term borrowings		
Creditors/Trade payables - Advance from customers		
Amount of other liabilities		
Other liabilities (to specify)		
Provisions		
For taxation		
For contingencies		
For insurance		
Other provisions (if any)		
Total		
(II) ASSETS		
Gross Fixed assets (including intangible assets)		
Less: depreciation and amortization		
Net fixed assets		
Investments		
Loans and advances		
Inventories		
Debtors/trade receivables		
Cash and cash equivalents		
Amount of other assets		
Other assets (to specify)		
Total		

The details of contingent liabilities are required to disclosed separately as under:

(a) Whether there are any contingent liabilities to report? Yes/ No

(b)	(c)	(d)
S. No.	**Description of contingent liability**	**Amount**

The format of the Statement of Income and Expenditure is as follows:

Particulars	**Figures for the period (Current reporting period) From (DD/MM/YYYY) To (DD/MM/YYYY (in ₹)**	**Figures for the period (Previous reporting period) From (DD/MM/YYYY) To (DD/MM/YYYY (in ₹)**
Income Gross turnover Less: Excise duty or service tax Net Turnover Details (I) Domestic turnover (a) Sale of goods manufactured (b) Sale of goods traded (c) Sale or supply of services (II) Export turnover (a) Sale of goods manufactured (b) Sale of goods traded (c) Sale or supply of services Other income Increase/ (decrease) in stocks including for raw materials, work in progress and finished goods		
Total Income		
Expenses Raw material consumed Purchases made for re-sale Consumption of stores and spare parts		

Power and fuel		
Personnel Expenses		
Administrative expenses		
Payment to auditors		
Selling expenses		
Insurance expenses		
Depreciation and amortization		
Interest		
Other expenses		
Total expenditure		
Net Profit or Net Loss (before taxes)		
Provision for Tax		
Profit after Tax		
Profit transferred to Partners' account		
Profit transferred to Reserves and Surplus		

Failure to maintain books of accounts, prepare Statement of Account and Solvency etc.

Any limited liability partnership which fails to comply with the provisions as set out u/s 34 shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5,00,000, and every designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1,00,000.

Annual Return

As per Sec. 35 of Limited Liability Act, 2008, every limited liability partnership shall file an Annual Return duly authenticated with the Registrar within sixty days of closure of its financial year in such form and manner, and accompanied by such fees as may be prescribed. Any limited liability partnership which fails to comply with the provision as set out u/s 35 shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5,00,000. If a limited liability partnership contravenes the provisions of this section, the designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1,00,000. As per Sec. 36 of the said Act, the Annual return filed by a limited liability partnership with the Registrar shall be available for inspection by any person in such manner and on payment of such fees as may be prescribed. If in any return, any person makes any statement which is false in any material particular knowing it to be false or, which omits any material fact knowing it to be material, he shall be punishable with imprisonment which may extend to two years, and also be liable to fine which may extend to ₹5,00,000 but which shall not be less than ₹1,00,000.

Audit of books of accounts

The accounts of the limited liability partnership shall be audited in accordance with the prescribed rules. An auditor or auditors of a limited liability partnership shall be appointed for each financial year of the LLP for auditing its accounts. A person shall be qualified for appointment as an auditor of a limited liability partnership unless he is a Chartered Accountant in practice.

Illustration 46

P and Q are the partners of a limited liability partnership - M/s P&Q LLP dealing in electrical goods. The following is their trial balance as on March 31, 2023:

Name of Accounts	Dr. (₹)	Cr. (₹)
Inventories on April 1, 2022	4,50,000	
Equipment	5,50,000	
Premises	8,00,000	
Bank	9,46,500	
Sundry Debtors	3,60,000	
Sundry creditors		1,65,000
Secured loan		1,80,000
Unsecured loan		1,35,000
Returns outward		67,500
Outstanding expenses		24,000
Sales revenue from goods traded		53,00,000
Revenue from services rendered		2,35,000
Indirect Tax on turnover	1,35,000	
Interest received on investment		67,500
Purchases	29,47,500	
Salaries	8,45,000	
Rent & Rates	3,12,000	
Stationery charges	13,200	
Communication charges	27,300	
Insurance	54,800	
Advertisement	44,200	
Delivery charges	48,000	
Interest on debt	95,500	
Furniture & Fixture	5,40,000	
Long-term investments	3,15,000	
Cash	2,10,000	

General Reserve		270,000
P's contribution		1,300,000
Q's contribution		950,000
	8,694,000	**8,694,000**

Additional information:

(a) Unsold inventories on 31.03.2023 worth ₹5,62,500.

(b) Outstanding rent amounts to ₹36,000.

(c) Rate of depreciation on Furniture & Fixture @ 10%.

(d) Depreciate equipment by ₹67,500

(e) Provisions to be created: ₹22,500 for possible bad debts and ₹180,000 for taxation.

Considering the additional information provided above, you are required to prepare:

(i) Statement of Income and Expenditure for the year ended March 31, 2023; and

(ii) Statement of Assets and Liabilities as on that date.

Solution:

M/s P&Q LLP

Statement of Income and Expenditure for the year ended March 31, 2023

Particulars	(₹)	(₹)
Income		
Gross Turnover [53,00,000+235,000]	55,35,000	
Less: Excise duty	(1,35,000)	
Net Turnover Details		54,00,000
Other income: Interest on investments		67,500
Increase in inventories [Closing 562,500 – Opening 450,000]		1,12,500
Total Income		55,80,000
Expenses		
Purchases	29,47,500	
Less: Returns outward	(67,500)	28,80,000
Salaries		8,45,000
Rent & Rates	3,12,000	
Add: Outstanding	36,000	3,48,000
Stationery charges		13,200

Particulars	(₹)	(₹)
Communication charges		27,300
Insurance		54,800
Advertisement		44,200
Delivery charges		48,000
Interest on debt		95,500
Depreciation: on Furniture & Fixture	54,000	
on Equipment	67,500	1,21,500
Provision for bad debts		22,500
Total expenditure		45,00,000
Net Profit or Net Loss (before taxes) (Total Income – Total Expenditure)		10,80,000
Less: Provision for Tax		1,80,000
Profit after Tax		9,00,000
Profit transferred to Reserves and Surplus		9,00,000

Statement of Assets and Liabilities as on March 31, 2023

Particulars	(₹)	(₹)
(I) CONTRIBUTION AND LIABILITIES		
(1) Partner's funds		
P's Contribution	13,00,000	
Q's Contribution	9,50,000	22,50,000
General Reserves		2,70,000
Profit earned in 2022-23		9,00,000
(2) Liabilities		
Secured loans		1,80,000
Unsecured loans		1,35,000
Sundry creditors		1,65,000
Outstanding expenses [24,000 + 36,000]		60,000
Provision for taxation		1,80,000
Total		**41,40,000**
(II) ASSETS		
Premises		8,00,000

Particulars	(₹)	(₹)
Equipment	5,50,000	
Less: Depreciation	67,500	4,82,500
Furniture & Fixture	5,40,000	
Less: Depreciation	54,000,	4,86,000
Net fixed assets		17,68,500
Investments: Long-term		3,15,000
Inventories		5,62,500
Sundry Debtors	3,60,000	
Less: Provision for bad debts	22,500	3,37,500
Cash and cash equivalents		
Bank	9,46,500	
Cash	2,10,000	11,56,500
Total		41,40,000

Solved Case(s)

Amal, Bimal and Kamal were the partners in a firm which is engaged in the manufacturing of leather shoes. Their business is located in the outskirts of the city of Kanpur in Uttar Pradesh. The partners are in this business since 1997, and they share profits and losses in the ratio of 3:2:1.

On November 5, 2022, Kamal met with a serious road accident while travelling from Lucknow to Kanpur after attending a meeting with one of their customers. After being hospitalized for three long months, he was released in the first week of February 2023. During this time, he realised that it would not be possible for him to continue as a partner in this business and so he decided to retire from the firm. He communicated his decision to the other partners and it was mutually agreed upon that Kamal will continue till the end of this financial year and thereafter retire from the business, while the other partners will continue. The Balance Sheet of the firm as on 31.03.2022 was as follows:

Liabilities		(₹)	Assets	(₹)
Capital Accounts:			Plant	40,000
Amal	45,000		Building	50,000
Bimal	35,000		Furniture	4,000
Kamal	25,000	1,05,000	Debtors	30,000
Profit & Loss A/c		12,000	Stock	25,000
Reserve fund		15,000	Bank	3,500
Creditors		20,500		

Liabilities	(₹)	Assets	(₹)
	1,52,500		1,52,500

Kamal retired on that date subject to the following conditions:

(i) Goodwill of the firm to be valued at Rs. 36,000;

(ii) Building is to be appreciated by 20%;

(iii) Plant and Furniture are to be depreciated by 10% and 15% respectively;

(iv) Provision to be made for doubtful debts @ 5%.

Amal and Bimal are to bring in cash, if necessary, in their profit sharing ratio to pay off Kamal's dues on retirement and leave a sum of Rs. 10,000 as working capital.

1. Ascertain the amount of profit or loss arising to the firm out of revaluation. Also state the share of individual partner therein.
2. Determine the amount of cash to be brought in by Amal and Bimal to pay off Kamal's dues.
3. Draft the post-retirement Balance Sheet of the partnership firm.

Answer:

1. The amount of profit or loss arising to the firm out of revaluation is - ₹39,900 share of individual partner therein are ₹19,950, ₹13,300 and ₹6,650 respectively.

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Provision for Doubtful Debts A/c		1,500	By Goodwill A/c	36,000
To Depreciation on Plant A/c		4,000	By Building A/c	10,000
To Depreciation on Furniture A/c		600		
To Partner's Capital A/c				
- Amal's Capital (3/6)	19,950			
- Bimal's Capital (2/6)	13,300			
- Kamal's Capital (1/6)	6,650	39,900		
		46,000		**46,000**

2. Additional amount to be brought in by Amal and Bimal: (₹)

	(₹)
Amount paid to Kamal	36,150
Add: required working capital to be maintained	10,000
	46,150
Less: Cash at Bank as per existing balance Sheet	3,500
Amount to be brought in	42,650

So, Amount to be brought in by Amal = 42,650 × 3/5 = 25,590

Amount to be brought in by Bimal = 42,650 × 2/5 = 17,060

3. **Balance Sheet as at 31.03.2023**

Liabilities		(₹)	Assets		(₹)
Capital A/C			Goodwill		36,000
Amal	1,04,040		Buildings		60,000
Bimal	74,360	1,78,400	Plant		36,000
			Furniture		3,400
Creditors		20,500	Debtors	30,000	
			Less: Provision	1,500	28,500
			Stock		25,000
			Bank [Note 1]		10,000
		1,98,900			**1,98,900**

Working Notes:

Dr. **Partners' Capital Account** **Cr.**

Particulars	Amal (₹)	Bimal (₹)	Kamal (₹)	Particulars	Amal (₹)	Bimal (₹)	Kamal (₹)
To Bank A/c	-	-	36,150	By Balance b/d	45,000	35,000	25,000
- Dues paid off (Bal. fig.)				By Reserve Fund A/c	7,500	5,000	2,500
				By Revaluation A/c - Profit	19,950	13,300	6,650
				By Profit & Loss A/c	6,000	4,000	2,000
To Balance c/d (Bal. fig.)	1,04,040	74,360	-	By Bank A/c (Def.)	25,590	17,060	-
	1,04,040	**74,360**	**36,150**		**1,04,040**	**74,360**	**36,150**
				By Balance b/d	1,04,040	74,360	-

Exercise

A. Theoretical Questions:

Multiple Choice Questions

1. Sacrificing ratio is:
   a. New Profit sharing ratio - old profit sharing ratio.
   b. Equal to old profit sharing ratio
   c. Equal
   d. Old profit sharing ratio - new profit sharing ratio.
2. Which of the following is not an essential feature of a partnership firm?
   a. Mutual agency.
   b. Existence of business.
   c. Association of two or more people.
   d. Compulsory registration
3. Generally sacrifice ratio is concerned with the situation of:
   a. Admission of a new partner
   b. Retirement of a partner
   c. Dissolution of firm
   d. Conversion of firm into company
4. Which of the following account is mainly prepared at the time of dissolution of the firm?
   a. Revaluation A/c
   b. Goodwill A/c
   c. Realization A/c
   d. Memorandum Revaluation A/c

Answers:

1	d	2	d	3	a	4	d

State True or False

1. In absence of partnership deed the profit or loss should be distributed among partners in their capital ratio.
2. In absence of partnership deed, partners are entitled to interest on capital @ 6% p.a.
3. New-partner pays premium for goodwill, which will be shared by old partners in their new profit sharing ratio.
4. When the capitalization of profits method is used then the value of goodwill on the basis of future maintainable profits is more than that of on the basis of super profits.
5. It is necessary to revalue of assets and liabilities at the time of admission of a new partner.
6. After the death of a partner, the combined shares of continuing partners decrease.
7. Changes in profit sharing ratio among the existing partners may occur at any time during the financial year.
8. Loss on Realisation should be distributed according to capital ratio.
9. The surrender value of Joint Life Policy is distributed among all partners in their old ratio upon retirement.
10. Adjustments are recorded in Partner's Current Account in Fixed Capital Method.

Answers:

1	**False**	**2**	**False**	**3**	**False**	**4**	**False**	**5**	**True**
6	**False**	**7**	**True**	**8**	**False**	**9**	**True**	**10**	**True**

Fill in the Blanks

1. Profit or Loss on revaluation is shared among the partners in _________ Ratio.
2. Realisation account is opened at the time of __________ of firm.
3. Memorandum revaluation account is prepared when the _________ of assets and liabilities are not altered.
4. Interest to be allowed @ 0.75 per cent per month on Partners Capital of ₹ 60 Lakh; Manager's Commission @ 5 per cent of Net Profit before charging such commission. If the Net Profit before charging interest on capital and manager's commission amounted to ₹ 14.85 Lakh, then manager's commission will be _____________.
5. The amount due to deceased partner is paid to his/ her _____________.

6. Surplus capital method is suitable when all partners are _____________.

7. Profit or loss on revaluation of assets and liabilities is shared by the _____________.

8. At the time of admission of a partner, General Reserve is distributed among the partners in _____________ sharing ratio.

9. If there is any change in profit sharing ratio of the partners, the old partnership will be _____________

10. An incoming partner contributes _____________ to share in the total assets and _____________ for future profits.

Answer:

1	**Old profit sharing**	2	**Dissolution of the firm**
3	**Book value**	4	**₹ 47,250**
5	**Executors**	6	**Solvent**
7	**Old Partners**	8	**Old Profit.**
9	**Terminated**	10	**Capital, goodwill**

B. Numerical Questions

⊙ Multple Choice Questions

1. X and Y are partners with the capital of ₹ 50,000 and ₹ 30,000 respectively. Interest Payable on Capital is 10% p.a. If the profits earned by the firm is ₹ 4,800, what will be the Interest on Capital for X and Y?

   a. ₹ 5,000 and ₹ 3,000

   b. ₹ 3,000 and ₹ 1,800

   c. No interest will be paid to the partners

   d. None of the above

2. X and Y were partners sharing profit/losses as 3:2. They admit Z as a new partner, giving him 1/5th share of future profits. What should be the new profit sharing ratio?

   a. 12:8:5

   b. 3:2:1

   c. 8:12:5

   d. 5:8:12

3. B and D are partners, sharing profit or loss in the ratio 3 : 2. They admit K for 1/6th share of profits in the firms of which she takes 2/3rd from B and 1/3rd from D. What will be the new profit sharing ratio?

   a. 44: 31: 15

   b. 31: 44: 15

   c. 32: 41: 14

   d. 15: 31: 44

4. G and C are partners. They are entitled for 9% interest on their capital contributions. The firm allowed ₹ 54,000 towards interest on capital to partners. What will be the capital contribution of each partner if interest on Gunnu's capital is ₹13,500 more than the interest on Chinu's capital?

   a. ₹ 2,25,000

   b. ₹2,55,000

   c. ₹2,50,000

   d. ₹2,15,000

Answers:

1	**b**	**2**	**a**	**3**	**a**	**4**	**a**

Comprehensive Numerical Problems

1. A, B and C are the partners in Cosco Engineering Works sharing profits and losses at 6: 3: 5. The Balance Sheet as on 31.12.2023 is given below:

   Balance Sheet as on 31st December 2023

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital Accounts:			Land and Building	10,000
A	25,000		Furniture & Fixture	5,000
B	15,000	40,000	Debtors	30,000
Current Accounts:			Stock	23,100
A	1,000		Bank	2,500
B	500	1,500	C's Current Accounts	4,900
Reserve		1,400		
Creditors		28,600		
Mortgage Loan		4,000		
		75,500		75,500

It was decided by the partners to dissolve the partnership on 31.12.2023. The following amount has been realized:

Furniture & Fixture ₹ 2,000; Land and Building ₹ 6,000; Debtors ₹ 20,000 and Stock ₹ 15,000. Creditors are agreed to forgo 25% in full settlement of their total dues. The full amount of Mortgage Loan has been paid. Realisation expenses paid for ₹ 1,650. It was ascertained that B had become insolvent, and B's estate had contributed only 50 paise in a rupee.

You are required to prepare Realisation Account, Bank Account and Partners Capital Account following the rule given in Garner Vs. Murray.

[**Answer:** Loss on realisation ₹19,600; Final dividend from B ₹ 4,400; Bln paid off to A ₹ 23,850 and C ₹ 14,350]

2. M/s P and Co., having P and Q as equal partners, decided to amalgamate with R and Co., having R and S as equal partners on the following terms and condition:

   (i) The new firm PR and Co. to pay ₹ 12,000 to each firm for Goodwill.

   (ii) The new firm to take over investments at 10% depreciation, land at ₹ 66,800, premises at ₹ 53,000, machinery at ₹ 9,000 and only the trade liabilities of both the firms. The Debtors being taken over at given value.

   (ii) Type writers (written off) worth ₹ 800, belonging to R & Co., and not appearing in the balance sheet was also not taken over by the new firm.

   (iv) Bills Payable pertains to trade transaction only.

   (v) All the four partners in the new firm to bring in ₹ 1, 60,000 as capital in equal shares.

The following were the Balance Sheets of both firms on the date of amalgamation: (₹)

Liabilities	P & Co.	R & Co.	Assets	P & Co.	R & Co.
Trade Creditors	20,000	10,000	Cash	15,000	12,000
Bills Payable	5,000	-	Investments	10,000	8,000
Bank Overdraft	2,000	10,000	Debtors ₹ 10,000		
P's Loan	6,000	-	Less: ₹ 1,000	9,000	4,000
Capital :			Furniture	12,000	6,000
P	35,000	-	Premises	30,000	-
Q	22,000	-	Land	-	50,000
R	-	36,000	Machinery	15,000	-
S	-	20,000	Goodwill (Purchased)	9,000	-
General Reserve Investment	8,000	3,000			
FluctuationFund	2,000	1,000			
	1,00,000	80,000		1,00,000	80,000

Assuming immediate discharge of bank overdraft, pass necessary Journal Entries to close the books of P & Co. and R & Co. Also pass Journal entries in the books and prepare the Balance Sheet of the New Firm.

[**Answer:** Purchase Consideration of A & Co. ₹ 80,000 and B & Co. ₹ 80,000, Total of Balance Sheet ₹ 1,95,000]

3. Amar, Akbar and Anthony are equal partners of M/S. Andal & Co. The Balance Sheet of the firm as on 31.12.2023 was as follows:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account:			Fixed Assets:		
Ram	50,000		Land	50,000	
Manas	1,00,000		Building	70,000	
Param	(30,000)	1,20,000	Plant & Machinery	2,00,000	3,20,000
			Current Assets:		
Loan from bank		5,00,000	Stock	3,00,000	
Creditors		1,00,000	Debtors	1,00,000	4,00,000
		7,20,000			7,20,000

On the date, it is decided to convert the partnership into limited company called Pandal limited on the following items:

a. Land to be revalued at ₹ 1,50,000

b. Plant and machinery is to be revalued at ₹ 2,50,000.

c. Depreciation amounting ₹ 20000 is to be written off on building.

d. A provision of 10% books valued to be mate of obsolete stock.

e. Provision of doubtful debts made at 10% of debtors.

f. A discount of 6% would be earned on creditors when paid out.

g. The new company issue ₹ 12,000 equity shares 10 each credited as full paid up, such share capital being valued at ₹ 1,50,000 and the balance payable is to be discharge by issue of 10% debentures of ₹ 100 each.

Show the necessary ledger accounts to close the books of Andal & Co. and show the opening balance sheet of the new company. All partners are solvent and have sufficient cash resource as may be necessary to settle the respective accounts, Shares and debentures are divided equal among the partner.

[**Answer:** Profit on Realisation of Amar ₹ 32,000, Akbar ₹ 32,000, Anthony ₹ 32,000; Purchase Consideration ₹ 2,16,000; Cash Brought in by Anthony ₹ 70,000; Total of Balance Sheet ₹ 8,10,000]

4. Abhi, Sara and Parth carry on business in partnership under the style of M/s A & Co sharing profits and losses in the ratio of 5:3:2. They have floated A Pvt. Ltd for the purpose of takeover of their business. The following is the Balance Sheet of the firm as on 31st December, 2023:

Liabilities	(₹)	Assets		(₹)
Capital Account:		Cash		6,000
Abhi	1,01,000	Bank		14,000
Sara	1,51,000	Debtors	60,000	
Parth	1,33,000	(-) Provision	2,000	58,000
		Stock		42,000
Creditors	50,000	Fixed Assets at WDV		3,00,000
		Expenditure related to A. Pvt. Ltd:		
		Formation Expenses	12,000	
		Bank Account (note-1)	3,000	
				15,000
	4,35,000			4,35,000

Note-1: (In the name of A Pvt. Ltd.) Deposit of par value of 300 equity shares of ₹ 10 each, subscribed equally by the partners as subscribers to the memorandum and article of association. On that day A Pvt. Ltd took over the business for a total consideration of ₹5,00,000 (excluding 300 shares allotted as subscribers of memorandum). The purchase consideration was to be discharge by the allotment of equity shares of ₹10 each at par in the profit- sharing ratio and 15% debenture of ₹100 each at par for surplus capital. The directors of A. Pvt Ltd revalued fixed assets of A & Co. as ₹ 4,00,000.

You are asked to:

(a) State the number of equity shares and debenture allotted by A Pvt Ltd to Abhi, Sara & Parth.

(b) Show the journal entries in connection with the above transaction in the books of A Pvt Ltd. Show your workings.

[**Answer:** Profit on Realisation of Abhi ₹59,000, Sara ₹35,400, Parth ₹23,600; No. of equity shares issued: Abhi 16,000, Sara 9,600, Parth 6,400; No. of debentures issued: Sara 904, Parth 926]

Unsolved Case

M/s PQR is a partnership business in Guwahati, Assam engaged in the wholesale of edible oil. The business has three partners, P, Q and R who started the business way back in October 1987. As per their partnership deed, the partners share profits and losses in the ratio of 5: 3: 2.

Even though their business was going on pretty well, none of their daughters and sons agreed to carry on the business started by their fathers. So, during the year 2022-23, the partners mutually decided to dissolve their business after the close of the accounts for that financial year. The Balance Sheet of the firm as on 31.03.2023 is given below:

Liabilities		(₹)	Assets	(₹)
Capital Accounts:			Machinery	5,00,000
P	1,00,000		Car	1,00,000
Q	4,00,000		Debtors	4,50,000
R	2,00,000	7,00,000	Stock	6,00,000
Creditors		10,00,000	Bank	50,000
		17,00,000		**17,00,000**

Machinery and stock are sold for ₹ 2,50,000 and ₹ 1,80,000 respectively. Car is taken over by Q for ₹ 1,20,000. An amount of ₹ 2,00,000 could be realized from the Debtors. It was agrred between P, Q and R that any deficiency of any partner in Capital account is to be met by other partners in their profit sharing ratio. During the dissolution process, P was declared insolvent, the third partner, R could bring in ₹ 50,000 only.

1. Ascertain the amount of profit or loss arising in the event of dissolution of the firm.
2. Determine the amount of deficiency of P and how such deficiency has been borne by the other partners.
3. Show the settlement of the Bank Account of the firm as at the end of the dissolution process.