CHAPTER – 11

PARTNERSHIP AND LLP ACCOUNTS

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1. DEFINITION

Sec. 4 of the Indian Partnership Act, 1932 defines Partnership as -

"The relationship between persons who have agreed to share the profits of a business carried on by all or by any of them acting for all".

2. LIMITED LIABILITY AND GENERAL PARTNERSHIP

LIMITED LIABILITY PARTNERSHIP	POINT OF DIFFERENCE	GENERAL PARTNERSHIP
A partnership in which liability of partners is limited to the extent of their contribution (except in case of fraud) is known as Limited Liability Partnership.	**Meaning**	A partnership in which liability of partners is Unlimited i.e. partners are personally liable for business liabilities, is known as Limited General Partnership.
Parties to LLP are known as Designated Partners.	**Parties**	Parties to Partnership firm are known as Partners.
LLP is governed as per Limited Liability Partnership Act 2008 by Registrar of Companies (ROC).	**Applicable Law & Governing Authority**	General Partnership is governed as per Indian Partnership Act 1932 by Registrar of Firms (ROF).
Minimum – 2 Maximum – No Limit	**Number of Partners**	Minimum – 2 Maximum – 50
LLP is a separate legal entity.	**Separate Legal Entity**	Partnership is not a separate legal entity.
LLP have perpetual succession.	**Perpetual Succession**	Partnership do not have perpetual succession.
Registration of LLP is Mandatory.	**Registration**	Registration of a partnership firm is Optional.

NOTE: For the purpose of this topic, the scope of the topic is restricted to General Partnership Only. Other aspects about LLP and LLP Act 2008 is taught in the subject of Law.

3. PROVISIONS AFFECTING ACCOUNTING TREATMENT

Law does not make it obligatory for the partners to reduce in writing all the terms and conditions. In the absence of any such agreement, the law provides the following guiding rules:

1. Every partner is entitled to share profits equally.
2. No partner is entitled to interest on capital.
3. No interest on drawings is to be charged by the firm to a partner.
4. A partner is not entitled to any salary for taking part in carrying on the firm's business.
5. A partner is entitled to interest on advances (over and above the agreed capital contribution) at the rate of **six per cent** per annum.
6. Every partner being joint owner of partnership, partner is entitled have equal share in the property.

4. IMPORTANT POINTS

1. Fixed and Fluctuating Capital:

Partners' contribution towards the business of the firm is called as capital. When such capitals of the partners are not allowed to change, except in extraordinary circumstances, the contributions by the partners are called fixed capitals. When the capitals of the partners, are required to be fixed then adjustment regarding interest on capitals, salary to partners, drawings, profits or losses are done through current accounts. A credit balance in the current account indicates that the partner has not fully drawn out his share of profits, interest on capital, etc. On the other hand a debit balance in the current account shows that the partner has overdrawn his share of profit, interest on capital, etc.

When the partners agree not to keep their capitals fixed, they are called fluctuating capital accounts. In this case all adjustments regarding interest on capital, drawings, profits or losses etc. are done through the capital accounts.

2. Profit and Loss Appropriation Account:

In case of partnership the net profit is transferred to Profit and Loss Appropriation Account to show the distribution of profit (or losses) after deducting the interest on capital, partner's salary, commission and after adding interest on drawings.

3. Minor as a Partner:

A minor may be admitted to the benefit of partnership. He will Share profits, but not losses. On attaining majority, he has an option to continue or not to continue as a partner in a firm.

After attaining majority, a minor partner has to give notice within six months of attaining majority, for his continuance in the firm to the continuing partners.

4. Net Loss/ Insufficient Profit and Interest on Capital:

Subject to an agreement between partners in conformity with Partnership Deed, interest on capital is to be provided only out of profits of the firm. Therefore, if there is no profit, there will be no interest on capital. If profit before interest on capital is less than the interest amount (i.e. in case of insufficient or inadequate profit), then the available profit is shared by partners in their capital ratio as partners get profit by way of interest on capital only.

5. **Concept of Minimum Guaranteed Profit:** Sometimes, a person may be admitted as a partner in partnership firm with some guaranteed amount of takeaway. Such takeaway may include aggregate of salary, commission and profits received by the partner from the firm. In such case, if his total takings falls short of the minimum guaranteed amount, then such deficiency is to be borne by those other partners, who have given such guarantee in the agreed ratio.

6. **Hidden/Inferred/Implied Goodwill:** Usually, an incoming partner has to pay an amount towards his capital contribution as well as towards his share of Goodwill in the new firm. In most of the cases, such amounts are given separately. However, in some cases such capital and goodwill contribution is not given separately. In such cases, we have to find out the amount of goodwill out of such total contribution. Such goodwill, included in aggregate contribution is known as 'Hidden Goodwill'.

7. **Rights of an Outgoing Partner u/s 37:** Section 37 of The Partnership Act 1932 gives special right to an outgoing (Retiring/Deceased) partner. Unless otherwise provided in the Partnership Deed, where any partner has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts, the outgoing partner is entitled at his option
   (a) Share of the profits from the date of cessation of partner till the date of final settlement in the ratio in which his capital was outstanding as on the date of cessation of partner; or
   (b) Interest at the rate of 6% per annum.

5. GOODWILL

A firm builds up the reputation after getting an adequate experience in the trade or business. It is the value of reputation or name and fame of a business. Though it is an intangible asset, it is not certainly a fictitious asset. It is a valuable asset, if the concern is profitable. The value of reputation depends upon:

i. Favorable location
ii. Favorable long term contract, as regards supply of raw material or of finished goods.
iii. Exclusive use of patents, copyright or trademarks owned by the firm.
iv. Personal reputation of partners / partnership firm
v. Quality of products or quality of services rendered
vi. Active, intelligent, dynamic and forward looking management
vii. Long standing experience in the existing line of business etc.

Profit is the most important single factor attached to the valuation of goodwill therefore it is defined as **"the value of expected profits, over and above normal level of profit".** Thus goodwill is associated with extraneous or super profits.

Goodwill is valued on the basis of either of the following methods -

1. **Average Profits Method:**

   Under this method goodwill is valued on the basis of certain number of years' purchase of the average annual profits of the past years.

   Goodwill = Number of years' purchase as agreed x Average annual profit.

   This method of goodwill is not usually followed in practice, as the goodwill is really attached with the profit, over and above the normal level of profit. Under this method there will be a value attached to the goodwill, even though an enterprise is not earning normal or expected profits.

2. Super Profit Method:

Under this method goodwill is valued on the basis of certain number of years' purchase of super profits

Goodwill = Number of years' purchase as agreed x Annual Super Profits

Annual Super Profit = Annual profit - Normal / Expected Annual Profit

Normal Annual Profit = $\frac{\text{Average Capital employed}}{100} \times \text{Normal Rate of Return}$

If future maintainable profit is less than the normal expected profit, there is no super profit, hence no goodwill. Annual excess profit brings value to the goodwill.

3. Annuity Method of Super Profits:

The logic behind super profits method is that the amount paid for goodwill will be recouped within next 3 / 4 / 5 years. Time is a crucial factor for the investor. If the loss of interest is to be considered, what should be paid for goodwill, is the present value of goodwill (arrived at by discounting at normal rate of interest).

Goodwill = Present value of goodwill arrived at under the Super Profits Method

4. Capitalisation Method:

In this case the total value of business is found out by capitalising the profits on the basis of normal/expected rate of return as per the following formula:

$$= \frac{\text{Estimated annual profit}}{\text{Normal rate of return}} \times 100$$

The value of the goodwill under this method is ascertained by deducting the value of assets (other than good will) of the firm, from the total value of business as ascertained. The value of goodwill under this method is generally of much higher value than obtained under the super profit method.

As goodwill is one of the valuable asset of the firm, it is necessary to value the goodwill in the following circumstances.

i. Change in profit sharing ratio of partners
ii. Admission of the partner
iii. Retirement or death of a partner
iv. Dissolution/sale of business of a firm

6. ADMISSION OF PARTNER

1. Treatment of goodwill
2. Revaluation of assets and liabilities
3. Change in profit sharing ratio
4. Capital contribution

1. Treatment of Goodwill: Depending upon the share of profit of a new partner, he may bring his share of goodwill in cash, which may be retained in the firm or withdrawn by the existing partners. If incoming partner is unable to bring his share of goodwill in cash, he may allow the existing partners to raise a goodwill account in the firm's books, prior to his admission.

Accounting Entries:

No.	Transaction	Goodwill is shown as an asset	Goodwill is to be raised	Goodwill Account is not to be raised
1.	**Goodwill Valuation**			
1A.	Revaluation of Goodwill i. Increase in valuation ii. Decrease in valuation	Goodwill A/c .... Dr. To Old Partners' Capital A/cs (Old profit sharing ratio) Old Partners' Capital A/cs .... Dr. To Goodwill A/c (Old profit sharing ratio)		
1B.	Raising of Goodwill		Goodwill A/c .... Dr. To Old Partners' Cap. A/cs (Old profit sharing ratio)	
1C.	Adjustment of Goodwill in Partners' capital Accounts			Gaining Part. Cap. A/c .... Dr. To Losing Part. Cap. A/c. (Losing / Gaining ratio)
2.	**Goodwill brought in by incoming Partner**	Bank A/c .... Dr. To New Partners' Cap. A/c	Bank A/c .... Dr. To New Part. Capital A/c	Bank A/c .... Dr. To New Part. Cap. A/c
3.	**Write off of Goodwill**	All Partners' Cap. A/c .... Dr. (including new partner) To Goodwill A/c (New Profit Sharing Ratio)	All Part. Capital A/c .... Dr. (including new partner) To Goodwill A/c (New Profit Sharing Ratio)	
4.	**Withdrawal of Goodwill brought in by incoming partner**	Old Partners' Cap. A/cs .... Dr. To Bank A/c (Sacrificing ratio)	Old Partners' Cap. A/cs .... Dr. To Bank A/c (Sacrificing ratio)	Old Partners' Cap. A/cs .... Dr. To Bank A/c (Sacrificing ratio)

Private settlement of Goodwill:

If partners desire to settle goodwill privately, no accounting entry in the books of firm, as incoming partners will pay his shares of goodwill to old partners in the sacrificing ratio.

Inferred Goodwill:

Sometimes the value of goodwill is not specifically given and has to be inferred from the arrangement of capital and profit sharing ratio.

Sacrificing Ratio = Old Profit Sharing Ratio - New Profit Sharing Ratio

Gaining Ratio = New Profit Sharing Ratio - Old Profit Sharing Ratio

Note: AS 26 'Intangible Assets' does not permit the recognition of internally generated Goodwill in the books of accounts.

Hidden Goodwill:

If on admission, the new partner introduces capital in excess of his proportionate share in the total capital of the firm, the excess capital introduced is treated as his contribution towards goodwill.

Hidden Goodwill = Total capital of the firm on the basis of new partner's share – Total existing capital of the firm + New partner's contribution (towards capital and goodwill)

Example: Tom and Dick are partners sharing profits and losses in the ratio of 3:2. Harry is admitted in the firm as new partner with 1/6th share for which he contributes Rs. 20,000 towards capital. Capital balances of Tom and Dick as on the date of admission are Rs. 50,000 and Rs. 30,000 respectively. Find out the value of Hidden Goodwill?

Solution:

Hidden Goodwill= (Rs. 20,000 X 6) – (Rs. 50,000 + Rs. 30,000 + Rs. 20,000)

= Rs. 1, 20,000 – Rs. 1, 00,000 = Rs. 20,000

2. Revaluation of Assets and Liabilities:

When a new partner is admitted, he should not get benefit or suffer from any change in the valuation of assets and liabilities prior to his admission. It is therefore necessary to revalue the assets and liabilities of the Partnership Firm at the time of admission of a new partner.

A. When the changed valuation of assets and liabilities is to be recorded in the books:

Sr. No.	Transaction	Accounting Entry
1.	**Increase in value of an asset** **Creation of new asset**	Respective Asset A/c ..... Dr. To Revaluation A/c
2.	**Decrease in value of an asset** **Write off of asset**	Revaluation A/c ..... Dr. To Respective Asset A/c
3.	**Increase in value** **Provision of Liabilities**	Revaluation A/c ..... Dr. To Respective Liability / Provision A/c
4.	**Decrease in value of liability** **Write back of excess provision**	Respective liability / Provision A/c ..... Dr. To Revaluation A/c
5.	**Transfer of Profit / Loss on Revaluation** **Profit on revaluation** **Loss on revaluation**	Revaluation A/c ..... Dr. To Old Partners' Capital A/cs (old profit sharing ratio) Old Partners' Capital A/c ..... Dr. To Revaluation A/c (old profit sharing ratio)

Note: Any reserve or accumulated profits appearing in the books should be transferred to all the partners (including retiring one) in the old Profit Sharing Ratio.

B. When the changed values of assets and liabilities are not to be altered:

In this case profit or loss on revaluation is found out by preparing a memorandum statement and then the profit or loss on revaluation is adjusted in the Capital Accounts of the partners.

Sr. No.	Transaction	Accounting Entry
1.	**Profit on revaluation**	Memorandum Revaluation A/c ..... Dr. To Old Partners Capital A/cs (Old profit sharing ratio) All partner's Capital A/c ..... Dr. (including new partner) To Memorandum revaluation A/c (new profit sharing ratio) **or** Gaining Partners' Capital A/c ..... Dr. To Losing Partners Capital A/c. (Gaining/Losing Ratio)

Sr. No.	Transaction	Accounting Entry
2.	**Loss on revaluation**	Old Partner Capital A/cs ..... Dr. To Memorandum Revaluation A/c (Old profit sharing ratio) Memorandum Revaluation A/c ..... Dr. To All Partners' Capital A/c (including new partner) (new profit sharing ratio) **or** Losing Partners' Capital A/cs ..... Dr. To Gaining Partners' Capital A/c

3. **Change In Profit Sharing Ratio:** Incoming partner may be given share from:
   - i. Either of the old partners
   - ii. All the old partners in their respective profit sharing ratio
   - iii. All the partners in the ratio, other than their profit sharing ratio.

Examples:

1. A, B and C are sharing profits and losses in the ratio of 3: 2: 1 respectively, D is admitted in the partnership firm for 1/6 th share, which is diverted from A's share.

   Therefore Profit Sharing Ratios –

	A	B	C	D
Old Profit Sharing Ratio:	3/6	2/6	1/6	-
New Profit Sharing Ratio:	2/6	2/6	1/6	1/6

A's Profit Sharing Ratio = Old ratio - share diverted to D = 3/6 - 1/6 = 2/6

2. A, B and C are sharing profits and losses in the ratio of 2: 2: 1 respectively. D is admitted into the partnership firm for 1/6th share.

	A	B	C	D
Old Profit Sharing Ratio:	2/5	2/5	1/5	-
New Profit Sharing Ratio:	2/6	2/6	1/6	1/6

A's Profit Sharing Ratio = 2/5 (1 - 1/6)

B's Profit Sharing Ratio = 2/5 (1 - 1/6)

C's Profit Sharing Ratio = 1/5 (1 - 1/6)

Note: Unless otherwise specified the old partners will continue to share in their respective old profit sharing ratio.

3. X, Y and Z are sharing profits and losses in the ratio of 3: 3: 2 respectively. P is admitted into the partnership firm for 1/4th share. All the old partners agreed to sacrifice in equal proportions.

	X	Y	Z	P
Old Profit Sharing Ratio:	3/8	3/8	2/8	-
New Profit Sharing Ratio:	7/24	7/24	4/24	6/24

X's Profit Sharing Ratio: 3/8 - (1/3 X 1/4)
Y's Profit Sharing Ratio: 3/8 - (1/3 X 1/4)
Z's Profit Sharing Ratio: 2/8 - (1/3 X 1/4)

4. A and B are sharing profits and losses in the ratio of 3: 2. C is admitted into the partnership firm. The profit sharing ratio between B and C will remain the same as between A and B.

	A	B	C
Old Profit Sharing Ratio:	3/5	2/5	-
New Profit Sharing Ratio:	9/19	6/19	4/19

A's Profit Sharing Ratio is assumed as 1
So, B's Profit Sharing Ratio = 2/3 X 1 = 2/3
and, C's Profit Sharing Ratio = 2/3 X 2/3 = 4/9

New Ratio

	A		B		C
	1		2/3		4/9
or	9	:	6	:	4

4. **Capital Contribution:** In a partnership firm the partners may not bring their capital contribution necessarily in the profit sharing ratio. In case of disproportionate capitals, partnership deed usually contains a clause of interest on capital. If capital contribution is to be made in the profit sharing ratio, on admission of a partner, capital accounts of existing partners are reviewed by taking capital of the new partner as a base or taking the capital of the new firm as the base and then dividing total capital in the profit sharing ratio. Any excess/short capitals of the existing partners in this case may be transferred to or from current accounts.

Notes:

1. Sometimes the incoming partner is guaranteed in respect of his minimum share of profits in a concern. The guarantee to the incoming partners may be given either by -
   i. Either of the old partners
   ii. By all the old partners in their respective old profit sharing ratio. In this case incoming partner will be entitled to his share of profit or minimum guaranteed sum, whichever is higher. The deficit (if any) is adjusted in the partners capital accounts, who have guaranteed the minimum amounts of profit.

   There may be an agreement to recoup the deficit out of subsequent years excess profits. In this case surplus profits will have to be adjusted in the partners capital accounts, who have given the guarantee.
2. Prior to admission of a partner it is essential to distribute all accumulated profits (viz. Reserves, Profits etc.) and losses by transferring them to capital accounts of old partners in their old Profit Sharing Ratio.
3. A minor may be admitted to the benefits of the partnership firm. A minor partner will however share only profits and not losses.

7. RETIREMENT OF A PARTNER

1. Treatment of Goodwill
2. Revaluation of assets and liabilities
3. New Profit Sharing Ratio
4. Settlement of Retiring Partner's dues

1. Treatment of Goodwill:

Accounting Entries:

No.	Transaction	Goodwill is shown as an asset	Goodwill is to be raised	Goodwill Account is not to be raised
1.	**Goodwill Valuation**			
1A.	Revaluation of Goodwill i. Increase in valuation ii. Decrease in valuation	 Goodwill A/c .... Dr. To Old Partners' Capital A/cs (Old profit sharing ratio) Old Partners' Capital A/cs .... Dr. To Goodwill A/c (Old profit sharing ratio)		
1B.	Raising of Goodwill		Goodwill A/c .... Dr. To Old Partners' Cap. A/cs (Old profit sharing ratio)	
1C.	Adjustment of Goodwill in Partners' capital Accounts			Gaining Part. Cap. A/c.... Dr. To Losing Part. Cap. A/c.
2.	**Write off of Goodwill**	All Partners' Cap. A/c .... Dr. continuing partners To Goodwill A/c (New Profit Sharing Ratio)	All Part. Capital A/c .... Dr. (excluding retired partner) To Goodwill A/c (New Profit Sharing Ratio)	

2. Revaluation of Assets and Liabilities:

The method of dealing with revaluation of assets is exactly similar to that followed at the time of admission of a partner. The revaluation account is prepared and balance is transferred to all the partners accounts, including the retiring one in the old Profit Sharing Ratio. Assets and liabilities will then appear in the books at changed values. But if it is desired that assets and liabilities would continue to appear in the books at the old values, a Memorandum Revaluation Account is opened for adjusting the Profit/Loss on revaluation to all partners including retiring one in the old Profit Sharing Ratio and the balance in the account is then transferred to continuing partners capital accounts in the Profit Sharing Ratio.

Sr. No.	Transaction	Accounting Entry
1.	**Increase in value of an asset** **Creation of new asset**	Respective Asset A/c ..... Dr. To Revaluation A/c
2.	**Decrease in value of an asset** **Write off of asset**	Revaluation A/c ..... Dr. To Respective Asset A/c
3.	**Increase in value** **Provision of Liabilities**	Revaluation A/c ..... Dr. To Respective Liability / Provision A/c
4.	**Decrease in value of liability** **Write back of excess provision**	Respective liability / Provision A/c ..... Dr. To Revaluation A/c
5.	**Transfer of Profit / Loss on Revaluation** **Profit on revaluation** **Loss on revaluation**	 Revaluation A/ ..... Dr. To Old Partners' Capital A/cs (old profit sharing ratio) Old Partners' Capital A/c ..... Dr. To Revaluation A/c (old profit sharing ratio)

Note: Any reserve or accumulated profits appearing in the books should be transferred to all the partners (including retiring one) in the old Profit Sharing Ratio.

3. New Profit Sharing Ratio:

1. When one partner retires and nothing is mentioned regarding the new ratio between remaining partners then in that case, the remaining partners are to continue sharing profits in the old ratio, e.g.

   X, Y and Z were partners sharing profits in the ratio of 1/2, 2/5 and 1/10. Y retired from the firm.

	X	Y	Z
Old Profit Sharing Ratio:	5/10	4/10	1/10
New Profit Sharing Ratio:	5/6	-	1/6

2. Sometimes remaining partners purchase the share of the retiring partner otherwise in their Profit Sharing Ratio. In that case new ratio of the remaining partner is calculated by adding to their old ratio, what they have purchased e.g. A, B and C were partners sharing profits in the ratio of 1/5, 1/3 and 7/15 respectively. C retires and his share was taken up by A and B in the ratio of 3: 2.

	A	B	C
Old Profit Sharing Ratio:	3/15	5/15	7/15
New Profit Sharing Ratio:	36/75	39/75	-

A : $3/15 + (3/5 \times 7/15)$
$= 3/15 + 21/75$
$= 36/75$

B : $5/15 + (2/5 \times 7/15)$
$= 5/15 + 14/75$
$= 39/75$

4. Amount due to Retiring Partner:

Amount due to retiring partner is arrived at after considering balances in capital and current accounts, share of profit upto the date of retirement, goodwill, profit/loss on revaluation, drawings, interest on capital/drawings etc.

The dues of the retiring partner may be settled -

i. Out of existing funds/assets available with the firm.
ii. Out of additional capital contribution to be brought in by the continuing partners.
iii. Out of capital contribution of the new partner
iv. In lumpsum value after some time (along with interest at an agreed rate)
v. In instalments (along with interest at agreed rate)

Note: In case the account of the retiring partner is not settled immediately and there is no agreement to guide the rights of outgoing partner, Sec. 37 of the Partnership Act applies. As per this section, when any member of the firm ceases to be partner and the continuing partners carry on the firm's business with the property of the retired partner without any final settlement, then in absence of any contract to the contrary, the outgoing partner is entitled at the option of himself to such share of profits made since then as may be attributable to the use of his property or to interest at 6 % p. a. thereon.

8. RETIREMENT AND ADMISSION OF PARTNERS

Quite often retirement of one partner and admission of another takes place simultaneously. This is done sometimes to ensure that management is not hindered due to the retirement of one partner or it may be a case of succession i.e. son is taking the place of father retiring due to old age or reasons of health. There is no separate accounting treatment for dealing with cases of retirement and admission. One has to apply combination of techniques.

Note: In case of gift of share by the retiring partner to the incoming partner, goodwill adjustment is not made in partners accounts, as gift is always without any consideration.

9. DEATH OF A PARTNER

1. Accounting treatment
2. Joint Life Policy and Several Life Policies

1. Accounting Treatment: Death of a partner dissolves the partnership and the rights of the deceased partner would depend on the provisions of the partnership deed. Usually surviving partners purchase the share of the deceased partner and carry on the business. There are no special problems involved on account of death of either partner, except that death may occur at any time during the year and this means that the executors of the deceased partner would be entitled to his share of profits upto the date of his death. The partnership deed usually states how his share is to be determined. In absence of any agreement, accounts will have to be prepared on the date of death and profit or loss is to be ascertained.

Apart from the deceased partner's share of profit upto the date of his death, the treatment involved in accounting is not different from that of in case of retirement. After ascertaining the amount due to the deceased partner, the balance in his capital/current account should be transferred to the Executor's Account.

If deceased partners dues are settled with legal heirs and there is no agreement to the contrary, Section 37 of the Partnership Act applies. According to this section, the executor would be entitled at his choice either to interest at 6 % p.a. on the amount due from the date of death to the date of payment or that amount of profit earned by firm with the help of deceased partner's dues.

2. Joint Life Policy and Several Life Policies: On the death of a partner, the balance in deceased partner's Capital Account should be paid to his legal representative. The funds are invariably provided out of sale of assets of the business. Such a position puts even the surviving partners in difficulty, because sale of assets means closure of business. To provide funds to pay to the legal representatives of a deceased partner, without upsetting the working capital of firm, it is usual to take out a joint life policy on lives of the partners. The Insurance Company undertakes to pay a fixed sum of money on the death of either of the partner of the firm. There can be several life policies on the life of each partner. Accounting treatment is the same in both the cases.

Accounting Treatment:

i. **Premium paid treated as an expense:** In this method premium paid is written off as an expenses to profit and loss account. Provision for prepaid expenses may be made on time basis. In this case amount received from the insurance company either on surrender of policy or on the death of a partner results in a gain. The account is closed by transfer to the Capital Accounts of all partners in the profit sharing ratio.

ii. **Premium paid treated as an asset (to the extent of surrender value):** In this method policy account is maintained at its surrender value and difference in the account is transferred to Profit and Loss Account. Amount received from the insurance company in excess of the surrender or maturity value results in a gain. The account is closed by transfer to the capital accounts of all partners in the profit sharing ratio.

iii. **Premium paid treated as an asset and reserve is maintained:** Under this method premium paid is debited to Policy Account. At the end of the year amount equal to premium is charged to Profit and Loss Account and credited to Policy Reserve Account. Policy Account and Policy Reserve Account are adjusted so as to leave a balance in each account equal to the surrender value of the policy at the end of the year. On death of either partner, the amount received is credited to the Joint Life Policy Account, the amount standing to the credit of Joint Policy Reserve Account is also transferred to it and then it is closed by transfer to the capital accounts of all partners in the Profit Sharing Ratio. Thus under this method, the whole of the premium is treated as an expense and yet the existence of the policy is disclosed in the Balance Sheet.

10. PRACTICAL PROBLEMS

Q1. Basic Provisions – ICAI SM Illu.2 (Ch.10 U2) **REG. PAGE NO.**

Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims.

(i) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio.

(ii) Rahim has devoted full time for running the business and demands salary at the rate of Rs. 500 p.m. But Ram and Karim do not agree.

(iii) Karim demands interest on loan of Rs. 2,000 advanced by him at the interest which is Rs. 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to Rs. 45,000 at the end of the first year of their business.

Q2. P & L Appropriation A/c – ICAI SM Illu.3 (Ch.10 U2) **REG. PAGE NO.**

A and B start business on 1st January, 2022, with capitals of Rs. 30,000 and Rs. 20,000. According to the Partnership Deed, B is entitled to a salary of Rs. 500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2022 the firm earned a profit, before charging salary to B and interest on capital amounting to Rs. 25,000. During the year A withdrew Rs. 8,000 and B withdrew Rs. 10,000 for domestic purposes. Prepare Profit and Loss Appropriation Account.

Q3. P & L Appropriation A/c: Change in PSR during the year **REG. PAGE NO.**

A and B commenced business as partners on January 1, 2018, introducing Rs. 1,00,000. each for equal share in profits. However, as fresh capital of Rs. 50,000 was needed by September 30, 2018 and as this was introduced by A, the profit sharing ratio was changed to 3: 2 on and from October 1, 2018.

B was entitled to monthly drawings of Rs. 1,000 subject to interest at 6 % per annum. The profit for the year 2018 before adjustment of interest on drawings was Rs. 24,000 and for the purpose of division between partners, it was assumed to have accrued evenly through the year.

Show how the profit for the year is to be distributed between the partners and also their capital accounts.

Q4. Concept of Minimum Guaranteed Profit – ICAI SM Illu.8 (Ch.10 U1) **REG. PAGE NO.**

A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than Rs. 250,00,000.

Total profits of the firm for the year ended 31st March, 2022 were Rs. 900,00,000. Calculate share of profits for each partner when;

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally.

Q5. Calculation of Goodwill – ICAI SM Illu. 1 (Ch.10 U2) **REG. PAGE NO.**

Lee and Lawson are in equal partnership. They agreed to take Hicks as one-fourth partner. For this it was decided to find out the value of goodwill. M/s. Lee and Lawson earned profits during 2019-2022 as follows:

Year	**Profits (Rs.)**
2019	1,20,000
2020	1,25,000
2021	1,30,000
2022	1,50,000

On 31.12.2022 capital employed by M/s. Lee and Lawson was Rs. 5,00,000. Rate of normal profit is 20%. Find out the value of goodwill following various methods.

Q6. Calculation of Goodwill – ICAI SM Illu. 2 (Ch.10 U2) **REG. PAGE NO.**

The following particulars are available in respect of the business carried on by Rathore

			Rs.
(1)	Capital Invested		1,50,000
(2)	Trading Results:		
	2015	Profit	40,000
	2016	Profit	36,000
	2017	Loss	6,000
	2018	Profit	50,000
(3)	Market Rate of interest on investment	10%	
(4)	Rate of risk return on capital invested in business	2%	
(5)	Remuneration from alternative employment of the proprietor (if not engaged in business).	Rs. 6,000 per annum	

You are requested to compute the value of goodwill on the basis of 5 years' purchase of super profit of the business calculated on the average on the average profits of the last four years.

Q7. Calculation of Goodwill – ICAI SM Illu. 10 (Ch.10 U2) **REG. PAGE NO.**

Antoo, Bantoo and Chintoo were in partnership sharing profits and losses 3:4:3 respectively. The accounts of the firm are made up to 31st March every year. The partnership provided, interalia, that: On the retirement of a partner the goodwill was to be valued at three years' purchase of average profits of the past four years up to the date of the retirement after deducting interest @12%p.a. on capital employed and remuneration of Rs. 2,000 p.m.to each partner. On 1st April 2022, Antoo retired and it was agreed on his retirement to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet. It was agreed that the capital employed would be Rs. 6,50,000. Bantoo and Chintoo were to continue the partnership, sharing profits and losses equally after the retirement of Antoo. The following were the amounts of profits of earlier years before charging salary to partners and interest on capital employed.

Year	**Profit**
2018-19	2,60,000
2019-20	2,75,000
2020-21	2,65,000
2021-22	2,80,000

You are required to compute the value of goodwill and show the adjustment there of in the books of the firm.

Q8. Calculation of Goodwill – ICAI RTP N19 (Old Syllabus) **REG. PAGE NO.**

Vasudevan, Sunderarajan and Agrawal are in partnership sharing profit and losses at the ratio of 2:5:3. The Balance Sheet of the partnership as on 31.12.2019 was as follows:

Balance Sheet

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Capital A/c:		Sundry Fixed Assets	5,00,000
Vasudevan	85,000	Inventory	1,00,000
Sundarajan	3,15,000	Trade Receivables	50,000
Agrawal	2,25,000	Bank	5,000
Trade Payables	30,000		
	6,55,000		**6,55,000**

The partnership earned profit Rs. 2,00,000 in 2019 and the partners withdrew Rs. 1,50,000 during the year. Normal rate of return 30%. You are required to calculate the value of goodwill on the basis of 5 years' purchase of super profit. For this purpose, calculate super profit using average capital employed.

Q9. Concept of Hidden Goodwill **REG. PAGE NO.**

A, B and C were partners sharing profits and losses in the ratio of 5: 3: 2 with their capital balance of Rs. 50,000. Rs. 30,000 and Rs. 20,000 respectively. They admitted D as $1/4^{th}$ partner who brings Rs. 50,000 towards his contribution of capital as well as goodwill. Calculate the amount of Hidden Goodwill and record the necessary journal entry in the books of the firm.

Q10. Admission of a Partner – ICAI SM Illu.4 (Ch.10 U3) **REG. PAGE NO.**

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March, 2022 is as below:

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Trade Payables	12,850	Land & Buildings	25,000
Outstanding Liabilities	1,500	Furniture	6,500
General Reserve	6,500	Inventory of Goods	11,750
Capital Accounts:		Trade Receivables	5,500
Mr. Dalal	12,000	Cash in Hand	140
Mr. Bannerji	12,000	Cash at Bank	960
Mr. Mallick	5,000		
	49,850		**49,850**

The partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2022 on the following terms:

(1) Mr. Mistri shall bring Rs. 5,000 towards his capital.

(2) The value of Inventory should be increased by Rs. 2,500 and Furniture should be depreciated by 10%.

(3) Reserve for bad and doubtful debts should be provided at 10% of the Trade receivables.

(4) The value of land and buildings should be enhanced by 20%.

(5) The value of the goodwill be fixed at Rs. 15,000.

(6) General Reserve will be transferred to the Partners' Capital Accounts.

(7) The new profit sharing ratio shall be: Mr. Dalal 5/15, Mr. Banerji 5/15, Mr. Mallick 3/15 and Mr. Mistri 2/15.

The outstanding liabilities include Rs. 1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books.

Prepare (i) Revaluation Account, (ii) The Capital Accounts of the partners, (iii) Balance Sheet of the firm after admission of Mr. Mistri.

Q11. Admission of a Partner **REG. PAGE NO.**

'R' and 'S' are equal partners in a firm. They decide to admit 'T' as a new partner for one third share and to readjust the Balance Sheet values for this purpose. The Balance Sheet of the firm as at 31st March, 2018 was as under:

Liabilities		**Rs.**	**Assets**		**Rs.**
Creditors		5,000	Machinery		5,000
Bills Payable		2,000	Furniture		3,500
Capital:			Stock		3,000
R	7,500		Debtors	5,800	
S	5,000	12,500	Less: Reserve for Bad Debts	300	5,500
			Cash		2,500
Total		**19,500**	**Total**		**19,500**

The following adjustments were to be made before T's admission:

a) Rs. 500 more to be provided for Bad Debts.

b) Furniture is to be valued at Rs. 3,000 and Value of Machinery is to be appreciated by Rs. 1,000.

c) Investments worth Rs. 600 (not included in the Balance Sheet) are to be taken into account.

d) 'T' brings Rs. 5,000 for the Capital and Rs. 2,000 for Goodwill. The amount of Goodwill is withdrawn by 'R' and 'S' in their due proportions. Prepare the Balance Sheet of the firm after admission of 'T' as a partner. Pass Journal entries and prepare the Balance Sheet after admission.

Q12. Admission of a Partner **REG. PAGE NO.**

Red and White are partners in a firm sharing profits and losses in the ratio of 3: 2. On 1st July, 2018 the position of the firm was as follows.

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Building	50,000
Red	1,50,000		Machinery	2,50,000
White	98,000	2,48,000	Furniture	40,000
General Reserve		84,000	Stock	60,000
Sundry Creditors		1,70,000	Debtors	90,000
			Cash	12,000
Total		**5,02,000**	**Total**	**5,02,000**

Blue joined the firm as a partner from this date and the following terms and conditions were agreed upon:

a. Red, White and Blue will share the future profits of the firm in the ratio 5:3:2 respectively.
b. Blue would first pay Rs. 10,000 as his share of Goodwill and this sum is to be retained in the business.
c. The value of Machinery is to be increased by Rs. 20,000 and stock is to be written down by 10 %.
d. Blue would then introduce such an amount of Capital in Cash which should be proportionate to the combined Capital accounts of Red and White after making all adjustments

It was decided that the Capital Accounts of Red and White would be adjusted on the basis of Blue's Capital by opening Current Accounts.

Show the Capital Accounts of the partners and Balance Sheet of the firm after Blue's admission.

Q13. Admission of a Partner: Memorandum Revaluation **REG. PAGE NO.**

A and B are partners in a firm sharing profits and losses in the ratio of 3: 2. On 31st March 2016 the position of the firm was as follows.

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Freehold Premises	2,00,000
A	2,00,000		Plant	40,000
B	1,00,000	3,00,000	Furniture	20,000
Trade Payables		50,000	Office Equipment	25,000
			Inventories	30,000
			Trade Receivables	25,000
			Bank	10,000
Total		**3,50,000**	**Total**	**3,50,000**

On 1st April 2016, they admitted C on the following terms:

1. C will bring Rs. 50,000 as capital and Rs. 10,000 for goodwill for 1/5th share.
2. Provision for doubtful debts is to be made on Trade Receivables @ 2%.
3. Inventory to be written down by 10%.
4. Freehold premises is to be revalued at Rs. 2,40,000, plant at Rs. 35,000, Furniture Rs. 25,000 and office equipment at Rs. 27,500.
5. Partners have agreed that the values of assets and liabilities remains the same and as such there should not be any change in their book values as a result of the aforementioned adjustments.

You are required to make necessary adjustments in the capital of the partners and show the Balance Sheet of the new firm.

Q14. Retirement of a Partner **REG. PAGE NO.**

On 31st March, 2018, the Balance Sheet of M/s. Ram, Rahul and Rohit sharing profits and losses in proportion to their capitals, stood as follows:-

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Land and Buildings	2,00,000
Ram	3,00,000		Machinery	2,00,000
Rahul	2,00,000		Stock in trade	1,00,000
Rohit	1,00,000	6,00,000	Sundry Debtors	2,00,000
Sundry Creditors		2,00,000	Cash and Bank balances	1,00,000
Total		**8,00,000**	**Total**	**8,00,000**

On 31st March, 2018 Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis:-

1. Land and Buildings be appreciated by 30 %.
2. Machinery be depreciated by 20 %.
3. Stock to be valued at Rs. 80,000.
4. Provision for bad debts be made at 5 %.
5. Old credit balances of Sundry Creditors Rs. 10,000 be written back.
6. Joint Life Policy of the partners surrendered and cash obtained Rs. 60,000.
7. Goodwill of the entire firm be valued at Rs. 1,80,000 and Ram's share of the Goodwill be adjusted in the Accounts of Rahul and Rohit who share the future profits equally. No Goodwill account being raised.

8. The total capital of the firm is to be the same as before retirement. Individual capitals are to be maintained in their profit sharing ratio.
9. Amount due to Ram is to be settled on the following basis:
   50 % on retirement and the balance 50% within one year.

Pass Journal Entries in the books of the firm and prepare Balance Sheet as on 1st April 2018 of M/s Rahul and Rohit.

Q15. Retirement of a Partner **REG. PAGE NO.**

P, Q and R were partners sharing profits and losses in ratio of 5: 3: 2 respectively. They had taken out a joint life policy of the face value of Rs. 20,000. On 31st March 2018 its surrender value was Rs. 4,000. On this date the balance sheet of the firm stood as under:

Liabilities		Rs.	**Assets**	Rs.
Sundry Creditors		5,300	Fixed assets	25,000
Expenses outstanding		700	Stock	11,000
Reserve		3,000	Book debts	9,000
Capitals:			Cash at Bank	2,000
P	20,000			
Q	10,000			
R	8,000	38,000		
Total		**47,000**	**Total**	**47,000**

On this date Q decided to retire and for the purpose -

i. Goodwill was valued at Rs. 15,000
ii. Fixed Assets were valued at Rs. 30,000 and
iii. Stock was considered as worth Rs. 10,000

Q was to be paid through cash brought in by P and R in such a way as to make their capitals proportionate to their new profit sharing ratio which was to be 3: 2 respectively. Goodwill was to be passed through books without raising a goodwill account; the joint life policy was also not to appear in the balance sheet.

Record these matters in the journal of the firm and prepare the resultant balance sheet.

Q16. Death of a Partner **REG. PAGE NO.**

X, Y and Z carried on business in partnership, profits being divisible X 1/2, Y 1/3 and Z 1/6.
The Balance Sheet on 31st March, 2018 showed their capitals to be -
X - Rs. 20,000 Y - Rs. 15,000 Z - Rs. 10,000
On 30th June, 2018, X died and you are instructed to prepare an account for presentation to his executors having regard to the following facts -

a. The firm had insured the partners' lives severally, X for Rs. 10,000, Y for Rs. 7,500 and Z for Rs. 5,000. The premium have been charged to Profit and Loss Account and surrender value on 30th June, 2018 amounted in each case to 1/2 of the sum assured.
b. Capital carried interest at 6 % per annum.
c. X's drawings from 1st April, 2018 to the date of his death amounted to Rs. 3,500

X's share of profits for the portion of the current financial year for which he lived was to be taken at the sum calculated on the average of the last three completed years and goodwill was to be raised on the basis of two years' purchase of the average profit of those three years.
The annual profits were Rs. 7,500, Rs. 8,000 and Rs. 9000 respectively.
Show the account of the Executors of X.

Q17. Death of a Partner **REG. PAGE NO.**

The following was the Balance Sheet of Om & Co. in which X, Y and Z were partners sharing profits and losses in the ratio of 1: 2: 2 as on 31.3.2018. Mr. Z died on 31st December, 2018. His account has to be settled under the following terms:

Balance Sheet of Om & Co. as on 31.3.2018

Liabilities	Rs.	**Assets**	Rs.
Sundry Creditors	20,000	Goodwill	30,000
Bank Loan	50,000	Building	1,20,000
General Reserve	30,000	Computers	80,000

Capital Accounts:			Stock	20,000
X	40,000		Sundry Debtors	20,000
Y	80,000		Cash at Bank	20,000
Z	80,000	2,00,000	Investments	10,000
Total		**3,00,000**	**Total**	**3,00,000**

Goodwill is to be calculated at the rate of two years' purchase on the basis of average of last three years profits and losses. The profits and losses for the three years were as detailed below:

Year ending on	**Profit / Loss (Rs.)**
31.3.2018	30,000
31.3.2017	20,000
31.3.2016	10,000 (Loss)

Profit for the period from 1.4.2018 to 31.12.2018 shall be ascertained proportionately on the basis of average profit and losses of the preceding three years.

During the year ending on 31.3.2018 a car costing Rs. 40,000 which was purchased on 1.4.2017 and debited to travelling expenses account on which depreciation is to be calculated at 20% p.a. This asset is to be brought into account at the depreciated value as on 31st March 2018..

Other values of assets were agreed as follows:

Stock at Rs. 16,000, Building at Rs. 1,40,000; Computers at Rs. 50,000; Investments at Rs. 6,000. Sundry Debtors were considered good.

You are asked to prepare Partners' Capital Accounts and Balance Sheet of the firm Om & Co. as on 31.12.2018 assuming that other items of assets and liabilities remained the same.

Q18. Accounting of Joint Life Policy **REG. PAGE NO.**

A, B and C were partners sharing profits and losses in the ratio of 5: 3: 2 took out a Joint Life Policy for Rs. 3,00,000 paying an annual premium of Rs. 15,000 starting from 1st January, 2014. The surrender value of the policy was as follows-

2014 - Rs. 3,000, 2015- Rs. 5,000, 2016 - Rs. 10,000, 2017 - Rs. 25,000

B died on November, 15th 2017 and the L.I.C. paid on 15th December, 2017. Show accounting treatments of Joint Life Policy.

"Experience is counted with repetition in a year and not years of repetition".

- Anshul A. Agrawal