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## PARTNERSHIP ACCOUNTS

**Meaning of Goodwill:** --Goodwill is an intangible asset and an important aspect for an enterprise

**Classification of Goodwill:** -- Goodwill can be classified into two categories:

1. Purchased Goodwill; and
2. Self-generated Goodwill.

**1. Purchased Goodwill:** It is the Goodwill that is acquired by making a payment. **As per AS-26, only purchased goodwill can be shown in books of account.**

**2. Self-generated Goodwill:** It is an internally generated goodwill which arises from a number of factors (such as good location, efficient management, good quality of products, etc.) that a running business possesses due to which it is able to earn higher profit. **As per AS-26, internally generated goodwill is not to be recorded in the books of accounts.**

**Methods of Valuation of Goodwill** :- **The methods for valuing goodwill are:**

1. Average Profit Method,
2. Super Profit Method,
3. Capitalisation Method
4. Annuity method

**1. Average Profit Method:**

- (i) Simple Average Profit Method
- (ii) Weighted Average Profit Method- it is used when there is upward trend in increase of profit.

**Revision question 1.** Following profits are of COC Ltd for the year ended on 31<sup>st</sup> March:

March, 2018	90,000
March, 2019	1,60,000
March, 2020	1,80,000
March, 2021	2,20,000

Calculate goodwill by simple average profit method and weighted average profit method.

**Note:-** Number of years' purchase means for how many years the firm will earn the same amount of profit because of its past efforts after change of ownership.

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While calculating average profits (Average future maintainable profit) for the purpose of valuation of goodwill certain adjustments are made, which are as follows:

- (a) All non-recurring and abnormal expenses and losses not likely to occur in the future are added back to profits.
- (b) Non-recurring or casual income not likely to recur in future are deducted from such profits.
- (c) Expenses and losses expected to occur in future are deducted from such profits, increase in rent, managerial remuneration etc.)
- (d) All profits likely to accrue in the future are added.
- (e) All errors should be rectified.

**Super Profit Method:** Goodwill, under this method, is valued on the basis of following three values:

- (i) **Average Profits:** it is also called average future maintainable profits.
- (ii) **Normal Rate of Return:** Normal Rate of Return is the rate of return normally earned by other firms of similar nature.
- (iii) **Capital Employed:** Capital employed means capital invested in the firm to carry on business.

Capital employed may be calculated by any of the following two methods:

(a) Liabilities Side Approach:

**Capital Employed** = Capital + Reserves - Fictitious Assets (i.e. losses/unamortised expenses) - Non-trade Investments.

(b) Assets Side Approach:

**Capital Employed** = All Assets (except self generated goodwill, fictitious assets and Non-trade Investment) - outside Liabilities.

**Revision question 2.** Aaloo and Tamatar are partners in M/s Maina Enterprises. They admit Pyaj as partner w.e.f. 1<sup>st</sup> April, 2021. They decided to value goodwill at 3 years' purchase by Super Profit Method for which they decided to take average of last 5 years profits. The profits for the last five years were:

Year ended	₹
31 <sup>st</sup> March, 2017	3,00,000 (Including gain of Rs. 35,000 from sale of fixed assets)
31 <sup>st</sup> March, 2018	1,70,000 (Including abnormal loss of Rs. 40,000)
31 <sup>st</sup> March, 2019	Loss 3,10,000 (including insurance claim received Rs 30,000)
31 <sup>st</sup> March, 2020	6,30,000
31 <sup>st</sup> March, 2021	3,50,000

Capital employed in the firm is ₹ 12,00,000 and normal rate of return in similar business is 10%. The remuneration of the partners is estimated to be ₹20,000 p.a. It was also found that closing stock for the year ended on 31<sup>st</sup> march 2020 was under casted by ₹30,000. Calculate value of goodwill.

**Capitalisation Method:** Under the Capitalisation Method, goodwill can be valued either by:

- (i) Capitalisation of Average Profit Method; or
- (ii) Capitalisation of Super Profit Method.

(i) **Capitalisation of Average Profit:** Under this method, goodwill is calculated by deducting actual capital employed (i.e., Net Assets as on the date of valuation) in the business from the capitalised value of average profit.

**Net Assets** = All Assets (other than self-generated goodwill, fictitious assets and non-trade investments) at their current values minus 'outsiders' liabilities.

**Revision question 3.** A firm earned ₹ 600,000 as profit, the normal rate of return being 10%. Assets of the firm are ₹72,00,000 (excluding goodwill) and Liabilities are ₹24,00,000. Find the value of goodwill by Capitalisation of Average Profit Method.

(ii) **Capitalisation of Super Profit:** Under this method, goodwill is calculated by capitalising super profit at the normal rate of return.

**Revision question 4.** A business has earned average profit of Rs. 1,00,000 during the last few years and the normal rate of return in similar business is 10%. Find out the value of Goodwill by capitalisation of super profits.

**Annuity method:**

**Revision question 5.** Calculate the goodwill by annuity method of super profit from the following facts:

- (a) Annual maintainable profit after tax is ₹ 65,000.
- (b) Capital employed is ₹ 4,00,000.
- (c) Normal rate of return is expected at 12%p.a.
- (d) year's purchase price is 5 years.
- (e) Present value of an annuity of ₹ 1 for five years @ 12% interest is 3.604776.

Answer: goodwill ₹ 61,281

**Multiple Choice Questions**

1. Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their.....ratio.

- (a) Capital. (b) New Profit Sharing. (c) Sacrificing. (d) gaining

2. A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings ₹70,000 cash and ₹ 48,000 against goodwill. New profit-sharing ratio between A, Band C are 7:5:4. Find the sacrificing ratio of A: B.

- (a) 3:1. (b) 4:7. (c) 5:4. (d) none of the above

3. Following are the factors affecting goodwill except:

- (a) Nature of business. (b) Efficiency of management. (c) Location of the customers. (d) location of entity

4. Weighted average method of calculating goodwill is used if:

- (a) Profits has increasing trend. (b) Profits has decreasing trend. (c) Either 'a' or 'b' (d) none of the above.

5. In the absence of any provision in the partnership agreement, profits and losses are shared

- (a) In the ratio of capitals. (b) Equally. (c) In the ratio of loans given by them to the firm (d) no idea

6. The profits and losses for the last 4 years are 2007-08 2016-17 Losses ₹10,000; 2008-09 2017-18 Losses ₹ 2,500; 2009-10 2018-19 Profits ₹ 98,000 & 2019-20 Profits ₹76,000. The average capital employed in the business is ₹2,00,000. The rate of interest expected from capital invested is 12%. The remuneration of partners is estimated to be ₹ 1,000 per month not charged in the above losses/ profits. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.

- (a) ₹9,000. (b) ₹8,750. (c) ₹8,500. (d) ₹8,250.

**Answer MCQs**

<b>1.</b>	<b>2.</b>	<b>3.</b>	<b>4.</b>	<b>5.</b>	<b>6.</b>
<b>C</b>	<b>A</b>	<b>c</b>	<b>C</b>	<b>B</b>	<b>b</b>

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## Admission of partner

### Topics of revision:

- (i) Computation of new and sacrificing ratio.
- (ii) Treatment of goodwill.
- (iii) Concept of revaluation and memorandum revaluation account.
- (iv) Capital adjustments.

### Computation of new and sacrificing ratio:

**Revision question 1.** A and B are partners sharing profits in the ratio of 5:3. C is admitted for 1/4<sup>th</sup> share in the profits. Calculate new profit-sharing ratio and sacrificing ratio of the partners.

**Revision question 2.** X and Y are equal partners. They admit Z for 1/4<sup>th</sup> share. In future, profit-sharing ratio between A and B would be 2:1. Calculate new profit-sharing and sacrificing ratio.

Solution:

Partners	Old ratio	New ratio	Sacrificing ratio
X	$\frac{1}{2}$	$\frac{3}{4} \times \frac{2}{3} = \frac{6}{12}$	
Y	$\frac{1}{2}$	$\frac{3}{4} \times \frac{1}{3} = \frac{3}{12}$	
Z		$\frac{1}{4}$	

**Revision question 3.** A and B are in partnership sharing profits and losses in the ratio of 5:3. C is admitted as a partner for 1/5<sup>th</sup> share which he takes equally from A and B. Calculate new profit-sharing ratio and sacrificing ratio of the partners.

Partners	Old ratio	New ratio	Sacrificing ratio
A	$\frac{5}{8}$		$\frac{1}{5} \times \frac{1}{2} = \frac{1}{10}$
B	$\frac{3}{8}$		$\frac{1}{5} \times \frac{1}{2} = \frac{1}{10}$
C		$\frac{1}{5}$	

**Revision question 4.** A and B are partners in a firm sharing profits and losses in the ratio of 3:2. A surrenders 1/5<sup>th</sup> of his share, whereas B surrenders 2/5<sup>th</sup> of his share in favour of C, a new partner. Calculate new profit-sharing ratio and sacrificing ratio.

Partners	Old ratio	New ratio	Sacrificing ratio
A	$\frac{3}{5}$	$\frac{3}{5} - \frac{3}{25} = \frac{12}{25}$	$\frac{3}{5} \times \frac{1}{5} = \frac{3}{25}$
B	$\frac{2}{5}$	$\frac{2}{5} - \frac{4}{25} = \frac{6}{25}$	$\frac{2}{5} \times \frac{2}{5} = \frac{4}{25}$
C		$\frac{3}{25} + \frac{4}{25} = \frac{7}{25}$	

**Treatment of goodwill:**

**Revision question 5.** A, B and C are partners sharing profit in 3:2. On 1<sup>st</sup> April 2022, C was admitted as new partner for 1/4<sup>th</sup> share. He has to bring ₹2,00,000 as his capital and ₹35,000 for his share of goodwill. Make journal entries if;

**Case 1.** He paid premium for goodwill privately to the partners.

**Case 2.** He brings his share of goodwill in cash along with his capital and 80% share in goodwill were withdrawn by partners.

**Solution:**

No.	Particulars	Debit	Credit
	Cash account Dr To C's capital account To premium for goodwill a/c	2,35,000	2,00,000 35,000
	premium for goodwill a/c To A's capital account To B's Capital account	35,000	21,000 14,000
	A's capital account Dr B's Capital account Dr To cash account	16,800 11,200	28,000

**Case 3.** He could not bring his share of goodwill in cash.

**Solution:**

No.	Particulars	Debit	Credit
1.	Cash account Dr To C's capital account	2,00,000	2,00,000
2.	C's Capital a/c Dr To A's capital account To B's Capital account	35,000	21,000 14,000

**Case 4.** He could bring only 70% of his share of goodwill in cash.

**Solution:**

No.	Particulars	Debit	Credit
1.	Cash account Dr To C's capital account To premium for goodwill a/c	2,24,500	2,00,000 24,500
2.	Premium for goodwill a/c Dr C's Capital account Dr To A's capital account To B's Capital account	24,500 10,500	21,000 14,000

**Case 5.** He could not bring his share of goodwill in cash and partners decided to raise goodwill in the book of firm.

**Solution:**

No.	Particulars	Debit	Credit
	Cash account Dr To C's capital account	2,00,000	2,00,000
	Goodwill account Dr To A's capital account To B's Capital account (being goodwill raised among old partners in their old ratio)	1,40,000	84,000 56,000

Case 6. He could not bring his share of goodwill in cash and partners decided to raise and then written off goodwill from the books of firm.

**Solution:**

No.	Particulars	Debit	Credit
1.	Cash account Dr To C's capital account	2,00,000	2,00,000
2.	Goodwill account Dr To A's capital account To B's Capital account (being goodwill raised among old partners in their old ratio)	1,40,000	84,000 56,000
3.	A's capital account B's Capital account C's Capital account To goodwill account (being goodwill written off among all partners in their new ratio)	63,000 42,000 35,000	1,40,000

**Revision question 6.** A and B are partners sharing profits and losses in the ratio of 3: 2. They agree to admit C as a partner for 1/4<sup>th</sup> share. Goodwill of the firm is valued at ₹1,20,000. C brings his share of goodwill and ₹2,00,000 as his capital through cheque. Pass necessary Journal entries assuming that:

Case 1. Goodwill appears in the books at ₹50,000 and partners decided not to show goodwill in the book of firm.

**Solution:**

No.	Particulars	Debit	Credit
	A's Capital account Dr B's Capital account Dr To Goodwill account ( being old goodwill written off among old partners in their old ratio)	30,000 20,000	50,000
	Cash account Dr To D's capital account To premium for goodwill a/c	2,35,000	2,00,000 35,000
	premium for goodwill a/c To A's capital account To B's Capital account	35,000	21,000 14,000

Case 2. When goodwill appears in the books at 50,000 and partners decided to show goodwill in the book of firm at its book value.

**Solution:**

No.	Particulars	Debit	Credit
1.	Cash account Dr To D's capital account To premium for goodwill a/c	2,22,500	2,00,000 22,500
2.	premium for goodwill a/c To A's capital account To B's Capital account	22,500	13,500 9,000

### premium for goodwill brought in by C =  $(1,40,000 - 50,000) \times \frac{1}{4} = 22,500$

**Revision question 9.** (Hidden or Inferred Goodwill) Abhay and Beena are partners in a firm. They admit Chetan as a partner with 1/4th share in the profits of the firm. Chetan brings ₹2,00,000 as his share of capital. Value of the total assets of the firm is ₹5,40,000 and outside liabilities are valued at ₹1,00,000 on that date. Give necessary entry to record goodwill at the time of Chetan's admission.

### 3. REVALUATION OF ASSETS AND REASSESSMENT OF LIABILITIES:

#### Case 1. When Assets and Liabilities are to be shown in the Books at the revalued Values:-

The adjustments in the value of assets and liabilities are effected through an account called **Revaluation Account or Profit and Loss Adjustment Account**.

**Revision question 10.** Swadesh and Swaraj were partners sharing profits equally. Sambhav is admitted as a partner from 1<sup>st</sup> April, 2022 for 1/5<sup>th</sup> share in profits. Their Balance Sheet as at 31.3. 2022 was:

Liabilities	₹	Assets	₹
Creditors	50,000	Cash	12,000
Bills Payable	15,000	Cash at Bank	28,500
Outstanding Expenses	3,000	Debtors	20,000
Workmen compensation reserve	30,000	Less: Provision for Doubtful Debts	500
Investment fluctuation fund	15,000	Stock	20,000
Provident fund	5,000	Furniture	10,000
Capital A/cs:		Machinery	18,000
Swadesh	60,000	Land and Building	70,000
Swaraj	40,000	Investments (market value 22,000)	40,000
	2,18,000		2,18,000

- (i) Sambhav will bring in ₹20,000 as his capital and ₹5,000 as his share of goodwill. Goodwill brought in by Sambhav will be withdrawn by Swadesh and Swaraj.
- (ii) Provision for Doubtful Debts should be brought up to 5% on Debtors.
- (iii) A debtor whose due of ₹14,000 were written off as bad debts last year, paid ₹10,000 in full settlement.
- (iv) Machinery is undervalued by 10% and Furniture to be depreciated by 12.5%.
- (v) Stock be valued at ₹23,000.
- (vi) Cashier has misappropriated cash of ₹4,000
- (vii) Land and Building be appreciated by 20%.
- (viii) Investments of ₹2,000 which did not appear in books should be recorded.
- (viii) An item of ₹ 600 included in S. Creditors is not likely to be claimed, hence should be written back.
- (ix) There was unrecorded equipment costing ₹40,000 now estimated at ₹28,000.
- (x) out of the amount of insurance premium which was debited to profit and loss account, 5000 to be carried forward to the next year.
- (xi) liability on account of workmen were estimated at 12,000.

Record necessary Journal entries and prepare Balance Sheet of the new firm.

**Solution:****Revaluation account**

Particulars	Amount	Particulars	Amount
To provision for doubtful debts	500	By bank account	10,000
To furniture account	1,250	By machinery a/c	2,000
To cash account	4,000	By stock a/c	3,000
To investments account	3,000	By land & building a/c	14,000
To profit on revaluation:		By investment a/c	2,000
Swadesh capital 27,925		By creditors account	600
Swaraj capital <u>27,925</u>	55,850	By equipment account	28,000
		By prepaid insurance a/c	5,000
	64,600		64,600

**Partner's capital account**

Particulars	Swadesh	Swaraj	Sandesh	Particulars	Swadesh	Swaraj	Sandesh
To bank a/c	2,500	2,500	----	By balance b/d	60,000	40,000	----
				By Bank a/c	----	----	20,000
To balance c/d	96,925	76,925	20,000	By premium for g/w	2,500	2,500	----
				By W.C Reserve	9,000	9,000	----
				By revaluation a/c	27,925	27,925	----
	99,425	79,425	20,000		99,425	79,425	20,000

**Cash and bank account**

Particulars	Amount	Particulars	Amount
To balance b/d	40,500	By Swadesh' capital	2,500
To Sambhav's capital	20,000	By Swaraj capital	2,500
To premium for g/w	5,000	By revaluation a/c	4,000
To revaluation a/c	10,000	By balance c/d	66,500
	75,500		75,500

**Balance sheet**

Capital + liability	Amount	Assets	Amount
Creditors	49,400	Cash & bank	66,500
Bills payable	15,000	Debtors 20,000	
o/s expenses	3,000	- prov for D. Debts <u>-1,000</u>	19,000
Prov for workmen comp liability	12,000	Stock	23,000
Provident fund	5,000	Furniture	8,750
<u>capital account:</u>		Machinery	20,000
Swadesh	96,925	Land & building	84,000
Swaraj	76,925	Investments	24,000
Sambhav	20,000	(40,000-18,000+2,000)	
		Equipments	28,000
		Prepaid insurance	5,000

**Revision question 11.** A, B and C are partners in a firm sharing in the ratio of 3 : 2 : 1. On 1<sup>st</sup> April, 2022, their Balance Sheet is as follows:

**BALANCE SHEET OF A, B AND C as at 1<sup>st</sup> April, 2022**

Liabilities	₹	Assets	₹
Capital A/cs:		B's Current Account Land and Building	14,000
A	3,50,000	Investments	3,60,000
B	3,00,000	Bills Receivable Sundry Debtors Stock	73,000
C	<u>2,50,000</u>	Bank Goodwill	24,000
Currently A/cs:		Profit and loss account	87,000
A	8,000		2,50,000
C	<u>12,000</u>		5,14,000
Capital Reserve	30,000		60,000
Creditors	1,60,000		18,000
Bills Payable	90,000		
12% Bank loan	2,00,000		
	<u>14,00,000</u>		<u>14,00,000</u>

On the above date, D is admitted on the following terms:

- (i) D will bring ₹ 1,00,000 as his capital and will get 1/6th share in profits. He will bring necessary Cash for his share of goodwill premium. The goodwill of the firm was valued at ₹ 1,80,000.
- (ii) The new profits-sharing ratio will be 2 : 2 : 1 : 1.
- (iii) A bill Receivable of ₹ 14,000 discounted with Bank was dishonoured, which is to be recorded in The books of account.
- (iv) Debtors of ₹20,000 were found bad. Debtors to the extent of 15,000 were unrecorded. Provision for doubtful debts to be created @ 10%.
- (v) A bill for ₹12,000 for electricity expenses was not accounted.
- (vi) Interest on bank loan is outstanding for 6 months.
- (vii) There being a claim against the firm for damages, a liability to the extent of 8,000 will be created for the same.
- (viii) The value of Stock is to be reduced by 20% whereas the value of Land and Building was found overestimated/overvalued by 20%.
- (ix) Investments were taken over by C at 60,000.
- (x) B agreed to pay Bills payable at discount of 10%.
- (xi) Expenses on revaluation amount to ₹5000 paid by A.

Prepare Revaluation Account, Partners' Current Accounts, Capital Account and Balance Sheet.

**Partner's Capital adjustments:****Revision question 15.**

	X	Y
Capital account	2,00,000	3,00,000

General reserve appearing in balance sheet Rs 50,000.

Profit on revaluation Rs 20,000.

Profit ratio between X and Y is 3:1.

Z is admitted as new partner for  $\frac{1}{5}$ <sup>th</sup> share in profit and loss. He brings Rs 1,50,000 for his capital and Rs 40,000 for his share in goodwill.

After admission of Z, others partners decided to make their capital proportionate in the new firm. Any excess capital brought in or paid off should be through cash.

**Revision question 16.**

	X	Y
Capital account	2,00,000	3,00,000

General reserve appearing in balance sheet Rs 50,000.

Profit on revaluation Rs 20,000.

Profit ratio between X and Y is 3:1.

Z is admitted as new partner for  $\frac{1}{5}$ <sup>th</sup> share in profit and loss. He brings proportionate capital and Rs 40,000 for his share in goodwill.

**Revision question 17.**

	X	Y
Capital account	2,00,000	3,00,000

General reserve appearing in balance sheet Rs 50,000.

Profit on revaluation Rs 20,000.

Profit ratio between X and Y is 3:1.

Z is admitted as new partner for  $\frac{1}{5}$ <sup>th</sup> share in profit and loss. He brings  $\frac{1}{2}$  of the combined capital of X and Y and Rs 40,000 for his share in goodwill.

**Revision question 18.**

	X	Y
Capital account	2,00,000	3,00,000

General reserve appearing in balance sheet Rs 50,000.

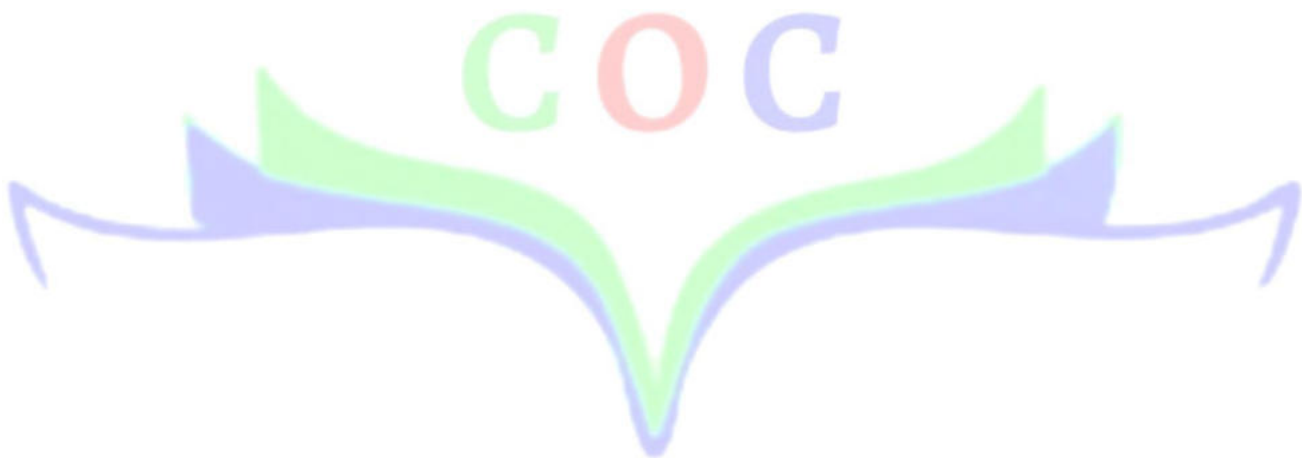
Profit on revaluation Rs 20,000.

Profit ratio between X and Y is 3:1.

Z is admitted as new partner for  $\frac{1}{5}$ <sup>th</sup> share in profit and loss. He brings proportionate capital and Rs 40,000 for his share in goodwill. Other partners also decided to make their capital proportionate. Balance, if any, will be adjusted by opening current account.

### When Assets/ Liabilities are to Appear in the Book at the Old Values

- (Memorandum Revaluation A/C):
  
  
  
  
  
  
  
  
  
  
- Must revise question number 49 of my book based on updation of balance sheet.



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## Retirement and death of a partner

### CHANGE IN THE PROFIT-SHARING RATIO:

**GAINING RATIO:** --The ratio in which the continuing partners acquire the outgoing (retired or deceased partner's share is called the Gaining Ratio.

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$$

**Revision Question 1.** A, B and C are partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5 respectively. C retires, A and B decide to share future profits and losses in the ratio of 2:1 respectively. Calculate the gaining ratio.

**Solution:**

Partners	Old ratio	New ratio	Gaining ratio
A	$\frac{2}{5}$	$\frac{2}{3}$	$\frac{2}{3} - \frac{2}{5} = \frac{4}{15}$
B	$\frac{2}{5}$	$\frac{1}{3}$	$\frac{1}{3} - \frac{2}{5} = \frac{-1}{15}$
C	$\frac{1}{5}$	-----	

**Revision Question 2.** X, Y and Z are partners sharing profits and losses in the ratio of 4:3:2. Y retires and surrenders  $\frac{1}{3}$ <sup>rd</sup> of his share in favour of X and the remaining in favour of Z. Calculate new profit-sharing ratio and the gaining ratio.

**Solution:**

Partners	Old ratio	New ratio	Gaining ratio
X	$\frac{4}{9}$		$\frac{3}{9} \times \frac{1}{3} = \frac{1}{9}$
Y	$\frac{3}{9}$		
Z	$\frac{2}{9}$	-----	$\frac{3}{9} \times \frac{2}{3} = \frac{2}{9}$

### Treatment of goodwill:

**Revision Question 3.** (When all the Remaining Partners Gain). A, B, C and D are partners in a firm sharing profit in 2:1:2:1 ratio. On the retirement of C, goodwill of the firm was valued at ₹ 72,000. A, B and D decided to share future profits equally. You are required to make adjustment entry for goodwill.

Partners	Old ratio	New ratio	Gaining ratio
A	$\frac{2}{6}$	$\frac{1}{3}$	$\frac{1}{3} - \frac{2}{6} = \frac{0}{6}$
B	$\frac{1}{6}$	$\frac{1}{3}$	$\frac{1}{3} - \frac{1}{6} = \frac{1}{6}$
C	$\frac{2}{6}$	-----	
D	$\frac{1}{6}$	$\frac{1}{3}$	$\frac{1}{3} - \frac{1}{6} = \frac{1}{6}$

**Revision Question 4.** (When one of the remaining Partners also Sacrifices in Addition to the Retiring Partner). X, Y and Z are partners sharing profits in the ratio of 3:2:1. Z retires and the new profit-sharing ratio between X and Y was 1:2. On Z's retirement, goodwill of the firm was valued at ₹ 30,000. Goodwill was appearing in the book of old firm at ₹90,000. Pass necessary Journal entries for the treatment of goodwill of the firm Z's retirement without opening the Goodwill Account.

### Concept of preparing Revaluation account and memorandum revaluation account.

- Same as discussed in admission of partner.
- **RESERVES AND ACCUMULATED (UNDISTRIBUTED) PROFITS/LOSSES** --- Reserve, Accumulated Profits and Losses are always distributed among old partners in their old ratio (even if the question does not specify).

### Adjustments in partner's capital account:

**Revision Question 5** (Capitals to be Proportionate to Profit-sharing). X, Y and Z were partners sharing profits and losses in the ratio of 4 : 3 : 2 respectively. Y retired on 1<sup>st</sup> April, 2022. On that date capitals of X,Y and Z after all necessary adjustments stood at ₹ 19,500; ₹19,800 and ₹ 9,150 respectively. The total capital of the firm as newly constituted is fixed at ₹ 28,000 between X and Z in the proportion of 5/8: 3/8. Calculate amount to be paid or to be brought by the continuing partners.

**Revision Question 6** (Capital in Future Profit-sharing Ratio). X Y and Z were partners sharing profits and losses in the ratio of 4:3:2 respectively. Y retired on 1<sup>st</sup> April, 2022 on which date the capitals of X, Y and Z after all the necessary adjustments stood at ₹ 65,800; ₹ 57,225 and ₹ 33,800 respectively. Capital of the reconstituted firm will be readjusted by bringing in or paying cash so that the future capitals of X and Z be in their future profit- sharing ratio. Calculate the amount of cash to be paid or to be brought in by the continuing partners.

**Revision Question 7.** Naresh, David Aslam are partners sharing profits in the ratio of 5:3:7. On 1<sup>st</sup> April, 2022, Naresh gave a notice to retire. David and Aslam decided to share future profits in the ratio 2:3. The adjusted Capital Accounts of David and Aslam show a balance of ₹ 33,000 and ₹ 70,500 respectively. The total amount to be paid to Naresh is ₹ 90,500. This amount is to be paid by David and Aslam in such way that their capitals become proportionate to their new profit-sharing ratio.

**Revision Question 8.** X, Y and Z were partners sharing profits in the ratio of 5:3:2 respectively. Y retired on 31<sup>st</sup> March,2022. On that date the capitals of X,Y and Z after all necessary adjustments stood at ₹ 43,000; ₹ 36,600 and ₹ 11,200 respectively. The cash and bank balance appears in balance sheet at ₹10,000. Amount payable to Y is to be brought in by X and Z in such a way as to make their capitals proportionate to their new profit-sharing ratio which was to be X  $\frac{3}{5}$  and Z  $\frac{2}{5}$ . Calculate amount of cash to be paid or to be brought in by the continuing partners assuming that a minimum cash and bank balance of ₹ 3,000 as to be maintained.

## Death of a partner

**NOTE:-** Accounting procedures on the death of a partner are similar to that of retirement of a partner.

**Computation of Amount Due to Deceased Partner:-** When a partner dies, his heirs are entitled to the amount due and the rights which a retiring partner has. The heirs of the deceased partner become entitled to the following:

- Amount standing to the credit of the deceased Partner's Capital Account and Current Account, if Capital Accounts are maintained following Fixed Capital Account Method.
- His share in the goodwill of the firm.
- His share of profit earned from beginning of the financial year to the date of death.
- His share of gain (profit) on revaluation of assets and reassessment of liabilities
- His share of accumulated profits and reserves.
- Interest on capital up to the date of his death, if allowed by the Partnership Deed. Following amounts are debited to his account :
  - His share of accumulated losses.
  - His drawings.
  - Interest on drawings.
  - Advance or loan taken by him from the firm, if any.

**Section 37 of the Indian Partnership Act, 1932:** - As per Section 37 of the Indian Partnership Act, 1932, if full or part amount of outgoing partner (retirement or death) still remains to be paid then:

- He will be entitled to interest or share in profit or nothing as has been mutually agreed among partners.
- If nothing is agreed among the partners, then outgoing partner or his representative have the choice to get either of the following till final settlement:
  - (i) Interest @ 6 % p.a. on the balance amount.
  - (ii) Share in the profit earned proportionate to his amount outstanding to total capital.

**Revision Question 9.** A, B and C were partners sharing profits and losses in the ratio of 4:3:2. C retired on 1<sup>st</sup> July, 2021 on which date the capitals of A, B and C after all necessary adjustment stood at ₹ 75,000; ₹ 65,000 and ₹ 45,000 respectively. A and B continued to carry on the business for 6 months without settling the account of C. During the period of 6 months ended 31<sup>st</sup> December, 2021, a profit of ₹ 50,000 is earned by the firm. State which of the two options available with C under Section 37 of the Indian Partnership Act, 1932 should be exercised?

**Special cases of admission cum retirement:**

**Case 1.** Admission and retirement occur on different dates.

**Case 2.** Admission and retirement occur on same date.

**Must revise question 55, 56 and 57 of my books based on admission cum retirement.**



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## Dissolution of partnership firm

### Topics to revise:

- (i) In case of solvency of partner
- (ii) In case of insolvency of one or more partner
- (iii) In case of insolvency of all partners.
- (iv) Piecemeal distribution
- (v) Sale/conversion/amalgamation of firm.

### Dissolution of Firm – when does it take place?

1. By Mutual consent of all the partners.
2. By Notice – given in writing, by any partner to all other partners if the Partnership is at will.
3. On the happening of any one of the following events : (i) expiry of the term; (ii) completion of the venture for which the firm was constituted; (iii) Death of a partner, (iv) Adjudication of a Partner as insolvent.
4. Compulsory Dissolution.
  - (i) Where all the partners 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

**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”.
- (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;
  - (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.”

**In case of solvency of partner:**

1. In realization account, we debit all assets appearing in balance sheet at their book value (except cash and bank balance).
2. In realization account, we credit all liabilities appearing in balance sheet at their book value (including bank overdraft).
3. If realized value of any asset is not given in question, we assume it has been realized at its nil value.
4. If payable value of any liability is not given in question, we assume it has been paid at its book value.
5. Unrecorded liabilities/assets are those liabilities/assets which do not appear in the balance sheet prepared just before dissolution of the firm. Such liabilities/assets are not credited/debited to the realization account but they are paid/realised as per instruction given in question.
6. Any provision/reserve/fund created on specific asset are credited to realization account but they are not paid, because they are not the liabilities of the firm. e.g. provision for doubtful debts, investment fluctuation fund, provision for depreciation e.t.c.
7. If any asset is taken over by any liability in full settlement of their claim. No entry is made for such agreements because it does not involve any cash/partner's capital account.

**Treatment of Workmen Compensation Reserve**

Question 1. X and Y were partners sharing profits in the ratio of 3 : 2. Give Journal entries under following situation at the time of dissolution of firm:

- (i) Workmen Compensation Reserve stood at ₹ 75,000 in the Balance Sheet and there was no liability towards Workmen Compensation.
- (ii) Workmen Compensation Reserve stood at ₹ 60,000 and liability for it was ascertained at ₹ 35,000.
- (iii) Workmen Compensation Reserve stood at ₹ 60,000 and liability in respect of it was ascertained at ₹ 75,000.
- (iv) Workmen Compensation Reserve stood at ₹ 60,000 and liability in respect of it was ascertained at ₹ 60,000.
- (v) There was no Workmen Compensation Reserve and firm had to pay ₹ 15,000 as compensation to the workers.

Question 2. Pass Journal entries for the following transactions:

- (i) Realisation expenses amounted to ₹ 10,000.
- (ii) Realisation expenses amounted to ₹ 5,000 were paid by a partner.
- (iii) Realisation expenses amounted to ₹ 5,000 were paid by the firm on behalf of a partner.
- (iv) A partner was paid remuneration (including expenses) of ₹ 7,500 to carry out dissolution of the firm. Actual expenses were ₹ 10,000.
- (v) Dissolution expenses were ₹ 8,000. Out of the said expenses, ₹ 3,000 were to be borne by the firm and the balance by a partner. ₹ 8,000 are paid by the firm.
- (vi) Dissolution expenses were ₹ 8,000; ₹ 3,000 were to be borne by the firm and the balance by a partner. The expenses were paid by a partner.
- (vii) Realisation expenses of ₹ 5,000 were to be borne and paid by a partner.
- (viii) X, the partner, is paid remuneration of ₹ 5,000 for dissolution of the firm. Realisation expenses of ₹ 8,000 are met by the firm.

### Difference between Revaluation Account and Realisation Account

Basis	Revaluation Account	Realisation Account
<b>1. Meaning</b>	It records the effect of revaluation of assets and reassessment of liabilities.	It records the realisation of assets and settlement of liabilities.
<b>2. Purpose</b>	It is prepared to make necessary adjustments in the value of assets and liabilities.	It is prepared for determining net profit/Loss on realisation of assets and settlement of liabilities.
<b>3. Time</b>	It is prepared at the time of admission, retirement or death of a partner.	It is prepared at the time of dissolution of a firm.
<b>4. Contents</b>	In this account, only changes in assets and liabilities are recorded.	In the account, all assets and liabilities are recorded.
<b>5. Preparation of Account</b>	This account may be prepared at a number of occasions during the life of a firm.	This account is prepared only once during the life of a firm.

**Revision Question: 3** A, B and C are partners sharing profit and losses in the ratio 2:2:1. They agreed to dissolve the firm on 31<sup>st</sup> March 2021 on which date their Balance Sheet was as under.

#### Balance Sheet as on 31 March. 2021

Liabilities		Rs.	Assets		Rs.
<b>Capital Account</b>			<b>Machine</b>		<b>4,00,000</b>
<b>A</b>	<b>3,00,000</b>		<b>Furniture</b>		<b>3,00,000</b>
<b>B</b>	<b>2,00,000</b>		<b>Building</b>		<b>8,00,000</b>
<b>C</b>	<b>1,00,000</b>	<b>6,00,000</b>	<b>Goodwill</b>		<b>2,00,000</b>
<b>General Reserve</b>		<b>80,000</b>	<b>Debtors</b>	<b>1,50,000</b>	
<b>Profit and Loss A/c</b>		<b>20,000</b>	<b>-Provision for doubtful</b>		
<b>Investment Fluctuation Fund</b>		<b>50,000</b>	<b>debt</b>	<b>10,000</b>	<b>1,40,000</b>
<b>Provision for taxation</b>		<b>1,00,000</b>	<b>Investment</b>		<b>2,20,000</b>
<b>Provident Fund</b>		<b>1,20,000</b>	<b>Stock</b>		<b>1,30,000</b>
<b>Bank Loan</b>		<b>7,00,000</b>	<b>Cash</b>		<b>20,000</b>
<b>Creditors</b>		<b>2,10,000</b>	<b>Bank</b>		<b>30,000</b>
<b>Bills Payable</b>		<b>2,50,000</b>	<b>Preliminary expenses</b>		<b>40,000</b>
<b>Outstanding salary</b>		<b>1,50,000</b>			
		<b>22,80,000</b>			<b>22,80,000</b>

During the dissolution, the following were cash and non-cash transaction:

- Machine was sold for Rs. 2,80,000
- Furniture was sold at a loss of 10%
- Building was sold for Rs. 9,00,00
- Debtors were realised in full
- Investment was taken over by A at an agreed value of Rs. 1,40,000
- Creditors were paid at a discount of 10%
- Bank loan was paid along with accrued interest of Rs. 60,000
- B agreed to pay outstanding salary of Firm
- Expenses on dissolution was Rs. 30,000 Prepare necessary account to close the books of firm.

**Revision Question 4.** X, Y and Z were partners sharing profit and losses in the ratio of 2:2:1. On 31<sup>st</sup> March 4021, they decided to dissolve their partnership firm on that date their balance sheet stood as follow:

Balance Sheet as on 31 Dec. 4021

Liabilities		Rs.	Assets		Rs.
Capital Account			Machine		6,00,000
X	2,00,000		Building		8,00,000
Y	2,00,000		Goodwill		3,00,000
Z	<u>1,00,000</u>	5,00,000	Debtor		2,50,000
Current A/C			Stock		1,50,000
X	60,000		Cash		2,00,000
Y	<u>1,40,000</u>	2,00,000	Investment		5,00,000
General reserve		3,00,000	Joint Life Policy		80,000
Bank Loan		8,00,000	Advertising Suspense		40,000
Mortgage loan(secured by building)		6,00,000	Profit & Loss A/C		60,000
Creditors		4,00,000	Z's current A/C		20,000
Bills Payable		1,00,000			
Outstanding expense		1,00,000			
		30,00,000			30,00,000

The following information are given regarding Dissolution of firm

(a) Assets realised as follow:

Machine 4,60,000

Building 9,40,000

Investment 4,00,000

(b) Stock was taken over by X at its market value of Rs. 1,80,000

(c) JLP was surrendered

(d) Debtors were assigned to creditors in full settlement of their claim

(e) Bank loan was paid at a prepayment premium of 5%

(f) There was an unrecorded typewriter worth Rs. 40,000 which was sold for Rs. 25,000

(g) An equipment worth Rs. 60,000 not recorded in the book was taken over by Z at 50,000

(h) Expenses on dissolution were Rs. 40,000 which was paid by Y.

Close the books of firm

**Revision question 5.** Satya, Shiva and Sunder have been in partnership for a number of years, sharing profit and losses in the ratio of 4:3:3 on 31 Dec. 2021, they decided to dissolve their partnership firm on that date their Balance Sheet stood as follow:

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Capital Account			Trade marks		40,000
Satya	3,00,000		Machine		2,00,000
Shiva	<u>4,00,000</u>	7,00,000	Furniture		3,00,000
General Reserve		2,10,000	Equipment		1,50,000
Provision for bad debts		10,000	Building		8,00,000
Workmen compensation fund		1,40,000	Debtors		1,40,000
Provident fund		60,000	Bank		2,00,000
Provision for depreciation on building		1,20,000	Stock		1,60,000
Mrs. Satya's Loan		80,000	Investment		40,000
Shiva's Loan		1,40,000	Sunder's Capital A/c		1,20,000
12% bank loan		2,00,000			
Creditors 1,30,000					
-Provision for discount <u>15,000</u>		1,15,000			
Bills payable		50,000			
Loan from NBFC		3,00,000			
Outstanding Rent		25,000			
		21,50,000			21,50,000

It has been agreed to dissolve the firm according to following understanding.

- i Satya agreed to take over machine for Rs. 1,60,000 and also agreed to discharge his wife's loan.
- ii An unrecorded asset estimated at Rs. 20,000 was sold for Rs. 12,000.
- iii An unrecorded tools worth Rs. 32,000 was taken over by an unrecorded liability for Rs. 40,000 in full settlement of their claim.
- iv One customer, whose account was written off as bad, now paid Rs. 2000 to the firm.
- v There was an unrecorded asset worth Rs. 80,000. Half of which was handed over to settle half of an unrecorded liability of Rs. 60,000 and balance of unrecorded liability was paid in cash. The remaining unrecorded asset was sold in the market at a loss of 10%.
- vi Sunder took the responsibility of dissolution of firm for which he was allowed Rs. 70,000. Actual expenses on dissolution Rs. 20,000 which was paid by Sunder from Firm Account.
- vii Satya agreed to discharge a hire purchase debt relating to Machine at Rs. 25,000.
- viii Shiva agreed to pay o/s rent by giving his personal motor car.
- ix Equipment was auctioned for Rs. 1,20,000. The auctioneer is entitled to a commission of 10%.
- x Debtors worth Rs. 30,000 were untraceable and remaining realized at a discount of 20%.
- xi Bills payable were due for payment one month after the date of dissolution but they were paid immediately at a discount of 12% p.a.
- xii There was a contingent liability for Rs. 16,000 which became certain liability on date of dissolution.
- xiii Other assets were realized as follow: Furniture at 120%, Building at 90% of its book value. Investment at 110%.
- xiv All other liabilities were paid at its book value. Close the books of Firm.

**Revision Question 6.** A, B and C are three partners sharing profits in the ratio of 3:1:1. On 31<sup>st</sup> March, 2021, they decided to dissolve their firm. On that date their Balance Sheet was:

Liabilities		₹	Assets		₹
Creditors		6,000	Cash		3,200
Loan		1,500	Debtors	24,200	
<u>Capital A/cs:</u>			Less : Provision for bad Debts	1,200	23,000
A	27,500		Stock – in – Trade		7,800
B	10,000		Furniture		1,000
C	7,000	44,500	Sundry Assets		17,000
		52,000			52,000

It is agreed that:

- (i) A is to take over Furniture at ₹ 800 and Debtors amounting to ₹ 20,000 at ₹ 17,200; Creditors were payable after 2 months. They were paid immediately at 10% discount.
- (ii) B is to take over all Stock-in-Trade at ₹7,000 and some of Sundry Assets at ₹7,200 (being 10% less than book value).
- (iii) C is to take over remaining Sundry Assets at 90% of the book value, less 100 as discount and assume responsibility for discharge of Loan together with accrued interest of ₹30 which has not been recorded in the books.
- (iv) The expenses of dissolution were ₹270.
- (v) The remaining Debtors were sold to a debt collecting agency for 50% of the book value.

Prepare necessary Ledger Accounts to close the books of the firm.

### Ascertaining Sundry Assets by Preparing Memorandum Balance Sheet:-

**Revision Question 7.** A and B, who were partners sharing profits and losses in the proportion of 4/7 and 3/7 respectively, decided to dissolve the partnership firm as at 31<sup>st</sup> March, 2021. At the date of the dissolution A's Capital was ₹ 1,25,030 and B's Capital was ₹ 2,070. Creditors amounted to 23,150 and Cash ₹ 4,520. Remaining assets realised ₹ 1,24,910 and the expenses of dissolution were ₹ 1,860. Both A and B were solvent. Prepare Balance Sheet of the firm as at the date of dissolution and also necessary accounts to close the books of the firm, showing final adjustment of cash between the partners.

**Let's revise INSOLVENCY OF ONE OR MORE PARTNERS:****Steps to be followed in case of insolvency of one or more partners:**

Step 1. Prepare realisation account, partner's capital account, partner's loan account and cash account.

Step 2. Transfer all items appearing in the balance sheet to the realisation account ( in the same way as in case of solvency of partners)

Step 3. Realise assets and pay off liabilities through realisation account as per instruction given in questions.

Step 4. Close realisation account. Balancing figure will be called profit/loss on realisation. Such profit or loss will be transferred to partners capital account in their profit sharing ratio.

Step 5. In case of loss on realisation, all solvent partners will bring cash into the business upto their share in loss on realisation.

Step 6. Collect cash from insolvent partner, as much as he can pay.( realised value of private assets- private liabilities paid).

Step 7. Close capital account insolvent partner. Balancing figure will be called deficiency. Such deficiency will be borne by other solvent partners as per decisions given in Garner Vs Murray case. Decision was as follow:

- (a) If capital account is fixed: deficiency will be borne by all solvent partners in the ratio of their Capital account.  
 (b) If capital account is fluctuating: deficiency will be borne by all solvent partners( having credit balance only) in the ratio of their capital standing just before date of dissolution.

**Revision question 8. (Fixed Capital)** A, B and C were partners sharing profit and losses in the ration of 2:1:1. Firm was dissolved on 31 December, 2022 due to insolvency of C. On that date their Balance Sheet was as Follow.

Balance Sheet as on 31 Dec. 2022

Liabilities	Rs.	Assets	Rs.
<b>Capital Account</b>		<b>Fixed assets</b>	<b>18,00,000</b>
A	2,00,000	Bank	2,00,000
B	3,00,000	Other current assets	6,00,000
C	<u>1,00,000</u>	Profit & Loss A/c (Dr.)	4,00,000
<b>Current A/c</b>		<b>C's current A/c</b>	<b>1,00,000</b>
A	3,00,000		
B	<u>2,00,000</u>		
<b>General Reserve</b>	<b>4,00,000</b>		
<b>Liabilities</b>	<b>16,00,000</b>		
	<b>31,00,000</b>		<b>31,00,000</b>

- I. Fixed assets realized at Rs. 11,00,000.  
 II. Other current assets were sold at Rs. 2,00,000.  
 III. C could pay only Rs. 60,000 to the firm.  
 Close the books of firm.

**Solution: Realisation account**

Particulars	Amount	Particulars	Amount
To fixed capital	18,00,000	By liabilities	16,00,000
To other current assets	6,00,000	<u>By cash account</u>	
To cash ( liabilities)	16,00,000	Fixed assets	11,00,000
		Other current assets	<u>2,00,000</u>
			13,00,000
		<u>By loss on realisation:</u>	
		A'Capital account	5,50,000
		B's Capital account	2,75,000
		C's Capital account	<u>2,75,000</u>
			11,00,000
	<b>40,00,000</b>		<b>40,00,000</b>

## Partner's capital account

Particulars	A	B	C	Particulars	A	B	C
To profit & loss	2,00,000	1,00,000	1,00,000	By balance b/d	2,00,000	3,00,000	1,00,000
To current a/c	---	---	1,00,000	By current account	3,00,000	2,00,000	---
To realisation a/c	5,50,000	2,75,000	2,75,000	By general reserve	2,00,000	1,00,000	1,00,000
To C's capital a/c	86,000	1,29,000		By cash account	5,50,000	2,75,000	---
To cash account	4,14,000	371,000		By cash account	---	---	60,000
				By A's capital a/c			86,000
				By B's capital a/c			1,29,000
	12,50,000	8,75,000	4,75,000		12,50,000	8,75,000	4,75,000

## Cash account

Particulars	Amount	Particulars	Amount
To balance b/d	2,00,000	By realisation a/c	16,00,000
To realisation a/c	13,00,000	By A's capital	4,14,000
To A's capital a/c	5,50,000	By B's capital	3,71,000
To B's Capital a/c	2,75,000		
To C's capital a/c	60,000		
	23,85,000		23,95,000

**Revision question 9. (fluctuating capital method)** A, B, C and D were partners sharing profit and loss in the ratio 2:1:1:1. Firm was dissolved due to insolvency of D. On that date Balance Sheet was as follow.

## Balance Sheet

Liabilities	Rs.	Assets	Rs.
A's Capital Account	15,00,000	Bank	3,00,000
B's Capital Account	10,00,000	Other assets	27,00,000
General reserve	2,00,000	Profit and loss A/c	5,00,000
Liabilities	13,00,000	C's Capital A/c	3,00,000
		D's Capital A/c	2,00,000
	40,00,000		40,00,000

- I. Assets realized Rs. 16,00,000.
  - II. Liabilities were paid in full.
  - III. D's private estate realized at Rs. 6,00,000 and his private liabilities were Rs. 4,20,000.
- Close the books of firm.

**Solution:**

## Realisation account

Particulars	Amount	Particulars	Amount
To other assets	27,00,000	By liabilities	13,00,000
To cash (liabilities)	13,00,000	By cash account	16,00,000
		<b>By loss on realisation:</b>	
		A'Capital account	4,40,000
		B's Capital account	2,20,000
		C's Capital account	2,20,000
		D's capital account	2,20,000
	40,00,000		11,00,000
			40,00,000

## Partner's capital account

Particulars	A	B	C	D	Particulars	A	B	C	D
To bal b/d	---	---	3,00,000	2,00,000	By bal b/d	15,00,000	10,00,000	---	---
To P & L	2,00,000	1,00,000	1,00,000	1,00,000	By G. reserve	80,000	40,000	40,000	40,000
To	4,40,000	2,20,000	2,20,000	2,20,000	By cash a/c	4,40,000	2,20,000	2,20,000	---
realisation	1,78,448	1,21,552			By cash a/c	---	---	---	1,80,000
To D's capital	12,01,552	8,18,448			(6,00,000-4,20,000)				
To cash a/c (bal fig)					By A's capital				1,78,448
					By B's capital				1,21,552
					By Cash a/c ( bal. fig)			3,60,000	
	20,20,000	12,60,000	6,20,000	5,20,000		20,20,000	12,60,000	6,20,000	5,20,000

## Cash account

Particulars	Amount	Particulars	Amount
To balance b/d	3,00,000	By realisation a/c	13,00,000
To realisation a/c	16,00,000	By A's capital	12,01,552
To A's capital a/c	4,40,000	By B's capital	8,18,448
To B's Capital a/c	2,20,000		
To C's capital a/c	2,20,000		
To D's capital a/c	1,80,000		
To C's capital a/c	3,60,000		
	33,20,000		33,20,000

## Working notes 1. Computation of ratio of capital standing just before date of dissolution:

	A	B	C	D
Capital	15,00,000	10,00,000	(3,00,000)	(2,00,000)
+ reserve	80,000	40,000	40,000	40,000
- losses	(2,00,000)	(1,00,000)	(1,00,000)	(1,00,000)
	13,80,000	9,40,000	(3,60,000)	(2,60,000)
	Will bear	Will bear	C will not bear because his capital shows negative balance	D is insolvent

Ratio : 138: 94



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## Let's revise dissolution in case of Insolvency of all partners:

### 1. sequence of payment to be followed in case of insolvency of all partners:

- (i) expenses on dissolution
- (ii) secured liabilities with fixed charge
- (iii) secured liabilities with floating charge
- (iv) unsecured liabilities
- (v) partner's loan
- (vi) partner's capital

### 2. steps to be followed in case of insolvency of all partners:

**Step i.** prepare realisation account, partner's capital account, partner's loan account and account of each liabilities separately.

- Step ii.** (a) transfer all assets( except cash and bank balance) and provisions/funds on such assets to realisation account.  
(b) transfer balances of cash and bank to the debit of cash & bank account.  
(c) transfer balances of partner's loan to the credit of partner's loan account.  
(d) transfer balances of partner's capital, current account, all reserves and losses appearing in the balance sheet to partner's capital account.  
(e) transfer balances of each liabilities to their respective account.

**Step (iii)** realise assets through realisation account. Close realisation account. Balancing figure will be called loss on realisation. Such loss will be transferred to partner's capital account in their profit-sharing ratio.

**Step (iv)** collect cash from all partners as much as they can pay.

**Step (v)** pay off claim of liabilities (in the sequence given above) as much as cash is available.

**Step (vi)** all account of remaining unpaid liabilities will be closed by transferring their balancing figure to deficiency account.

**Step (vii)** prepare deficiency account. It should get tally.

**Note :** 1. All unrecorded liabilities should be paid through realisation account.

**Note 2.** Liabilities can also be recorded in realisation account instead of opening separate account. ( Must revise question 26 and 27 of my book based on same and equation.

**Revision question 10.** A, B, and C were partners sharing profit in the ratio of 3:1:1. Partnership firm was dissolved due to insolvency of all partners. On that date their Balance Sheet was as follow:

**Balance Sheet**

Liabilities	Rs.	Assets	Rs.
Capital A/c		Machinery	4,00,000
A           2,00,000		Building Goodwill Equipment	6,00,000
B           1,00,000		Stock Debtors	2,00,000
C <u>50,000</u>	3,50,000	Profit and loss A/c	3,00,000
Bank loan (secured by building)	5,00,000		2,00,000
Mortgage loan (floating charge)	6,50,000		5,00,000
Creditors	4,00,000		3,00,000
Bills payable	2,00,000		
C's Loan	4,00,000		
	<b>25,00,000</b>		<b>25,00,000</b>

I. Assets were realized as follows:

Machinery	2,00,000
Building	5,50,000
Equipment	1,00,000
Stock	1,50,000
Debtors	3,00,000

II. Private assets and liabilities of each partners were as follow:

Particulars	Private estate	Private liabilities
A	2,00,000	2,40,000
B	3,00,000	2,60,000
C	1,00,000	1,50,000

Close the Books of Firm.

**Solution:**

Particulars	Amount	Particulars	Amount
To machinery	4,00,000	<u>By cash account:</u>	
To building	6,00,000	Machine   2,00,000	
To goodwill	2,00,000	Building   5,50,000	
To equipment	3,00,000	Equipment 1,00,000	
To stock	2,00,000	Stock       1,50,000	
To debtors	5,00,000	Debtors <u>3,00,000</u>	13,00,000
		<u>By loss on realisation:</u>	
		A'Capital account   5,40,000	
		B's Capital account   1,80,000	
		C's Capital account <u>1,80,000</u>	9,00,000
	<b>22,00,000</b>		<b>22,00,000</b>

**Partner's capital account**

Particulars	A	B	C	Particulars	A	B	C
To profit & loss a/c	1,80,000	60,000	60,000	By balance b/d	2,00,000	1,00,000	50,000
To realisation a/c	5,40,000	1,80,000	1,80,000	By cash account		40,000	----
				By deficiency a/c (bal fig)	5,20,000	1,00,000	1,90,000
	<b>7,20,000</b>	<b>2,40,000</b>	<b>2,40,000</b>		<b>7,20,000</b>	<b>2,40,000</b>	<b>2,40,000</b>

**Bank loan account**

Particulars	Amount	Particulars	amount
To cash account	5,00,000	By balance b/d	5,00,000

**Mortgage loan account**

Particulars	Amount	Particulars	amount
To cash account	6,50,000	By balance b/d	6,50,000

**Creditors account**

Particulars	Amount	Particulars	amount
To cash account	1,26,667	By balance b/d	4,00,000
To deficiency a/c	2,73,333		

**Bills payable account**

Particulars	Amount	Particulars	amount
To cash account	63,333	By balance b/d	2,00,000
To deficiency a/c	1,36,667		

**C's loan account**

Particulars	Amount	Particulars	amount
To deficiency account	4,00,000	By balance b/d	4,00,000

**Cash account**

Particulars	Amount	Particulars	amount
To balance b/d	Nil	By bank loan	5,00,000
To realisation a/c	13,00,000	By mortgage loan	6,50,000
To B's capital a/c	40,000	By creditors	126,667
		By B/P	63,333
	13,40,000		13,40,000

**Deficiency account**

Particulars	Amount	Particulars	amount
To A's capital	5,20,000	By C' loan	4,00,000
To B's capital	1,00,000	By creditors	2,73,333
To C's capital	1,90,000	By B/P	136,667
	8,10,000		8,10,000

**LET'S REVISE PIECEMEAL DISTRIBUTION:**

1. 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, O/s wages)
- (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/ conservative method/safe method

2. if method is not mentioned in question :

- (a) In case of solvency of partners: -- Follow proportionate capital method.
- (b) In case of insolvency of partners/partner --- Follow maximum possible method.

**Revision Question 11.** 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 31<sup>st</sup> December, 2021, on which date their balance sheet was as follows:

Liabilities		Rs.	Assets	Rs.
Capital accounts:East			Land and building	30,810
South	38,700		Motor car Investment	5,160
North	10,680		Stock Debtors	1,080
Loan account: North	10,680		Cash	19,530
Creditors	<u>11,100</u>	60,480		11,280
		3,000		<u>5,940</u>
		<u>10,320</u>		73,800
		73,800		

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

15 <sup>th</sup> January	2022	Rs. 10,380
20 <sup>th</sup> February	2022	27,900
23 <sup>rd</sup> March	2022	3,600
15 <sup>th</sup> April	2022	North took over investment at value of 1,260
27 <sup>th</sup> April	2022	19,200

Dissolution expenses were originally provided for an estimated amount of R. 2,700, but actual amount spent on 29<sup>th</sup> March, 2022 was Rs.1,920. The creditors were settled for Rs. 10,080. You are required to prepare a statement showing distribution of cash amongst the partners.

Solution:

Particulars	Amount	Creditors	North's loan	East	South	North
Balance		10,320	3,000	38,700	10,680	11,100
15 <sup>th</sup> Jan Cash in hand	5,940					
Assets realised	<u>10,380</u>					
	16,320					
Provision for expense	<u>(2,700)</u>					
	13,620					
Paid to creditors	<u>(10,080)</u>	(10,080)				
	3,540					
Paid to North's Loan	<u>(3,000)</u>		(3,000)			
Balance	540	Nil	Nil	38,700	10,680	11,100
Paid to East	<u>(540)</u>			(540)		
Balance	Nil	Nil	Nil	38,160	10,680	11,100
20 <sup>th</sup> Feb: Assets realised	27,900					
Paid to East	<u>-4,860</u>			-4,860		
Balance	23,040					
Paid to East and South in 3:1	23,040			-17,280		-5,760
Balance	Nil	Nil	Nil	16,020	10,680	5,340
23 <sup>rd</sup> March: Assets realised	<u>3,600</u>					
	3,600					
Paid to all partners in 3:2:1	<u>(3,600)</u>			-1,800	-1,200	-600
Balance	Nil	Nil	Nil	14,220	9,480	4,740
27 <sup>th</sup> April: Assets realised	19,200					
15 <sup>th</sup> April investment taken over	1,260					
	<u>780</u>					
Excess provision for expense	21,240					
	21,240					
Paid to all partners in 3:2:1				-10,620	-7,080	-3,540
Balance: loss on realisation				3,600	2,400	1,200

Working notes: computation of sequence of payment by proportionate capital method:

Ratio	3	2	1	
Partners	East	South	North	
Final claim	38,700	10,680	11,100	
Proportionate capital taking South capital/ his share as base	-16,020	-10,680	-5,340	32,080
Balance	22,680	Nil	5,760	
Proportionate capital taking Noth capital/ his share as base	-17,280		-5,760	23,040
Balance	5,400	Nil	Nil	5,400

Statement showing Sequence of payment to partners:

First 5,400 to East

Next 23,040 to East and North in 3:1

Next any realisation to all partners in 3:2:1

Note : How to compute final claim of partners:

Partner	A	B	C
Capital account	xxxx	xxxxx	xxxx
Add: current account	xxxx	xxxx	xxxx
Add: reserves	xxxx	xxxx	xxxx
Less: all losses	(xxxx)	(xxxx)	(xxxx)
Final claim	xxxx	xxxx	xxxx

**Revision Question 12.** Anagha , Anita and Alka were in partnership sharing profits and losses as 3:2:1 respectively. The partnership was dissolved on 30<sup>th</sup> June 2021 when the position was as follows:

Liabilities	Rs.	Rs.	Assets	Rs.
Captials: Anagha Anita	1,40,000		Cash in hand Sundry	28,000
Alka Creditors	70,000		debtors	2,94,000
	<u>14,000</u>	2,24,000	Stock-in-trade	1,12,000
		<u>2,10,000</u>		<u>4,34,000</u>
		4,34,000		

There was a bill for 10,000 due on 30<sup>th</sup> November 2021, under discount. It was agreed that the net realizations should be distributed in their due order (at the end month) but as safely as possible. The realizations and expenses were:

	Stock and debtors	Expenses
31 <sup>st</sup> July 2021	Rs, 84,000	Rs. 7,000
31 <sup>st</sup> August 2021	1,26,000	5,400
30 <sup>th</sup> September 2021	70,000	4,900
31 <sup>st</sup> October 2021	77,000	3,500
30 <sup>th</sup> November 2021	35,500	3,500

The stock was completely disposed of and amounts due from debtors were realized, the balance being irrecoverable. The acceptor of the bill under discount met the bill on the due date. Prepare a statement for piecemeal distribution of cash.

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Solution:

Particulars		Amount	Creditors	Anagha	Anita	Alka
Balance			2,10,000	1,40,000	70,000	14,000
Cash in hand		28,000				
31 <sup>st</sup> July Assets realised		<u>77,000</u>				
		1,05,000				
Provision for bill disc		<u>(10,000)</u>				
		95,000				
Paid to creditors		<u>(95,000)</u>	(95,000)			
Balance	(A)		1,15,000	1,40,000	70,000	14,000
31 <sup>st</sup> August: assets realised(net)		1,20,600				
Less: paid to creditors		<u>1,15,000</u>	1,15,000			
		5,600				
Total amount payable to partners(A)		<u>2,24,000</u>				
Maximum possible loss in 3:2:1		2,18,400		-	-72,800	-36,400
Deficiency of Anita and Alka transferred to Anagha				1,09,200	-2,800	-22,400
				30,800	+2,800	+22,400
				-2,800		
				-22,400		
Amount finally paid	(B)			5,600	Nil	Nil
Balance (A-B)	(C)			1,34,400	70,000	14,000
30 September: assets realised(net)		65,100				
Total amount payable to partners(C)		<u>2,18,400</u>				
Maximum possible loss in 3:2:1		1,53,300		-76,650	-51,100	-25,550
Deficiency of Alka transferred to Anagha and Anita in 2:1				57,750	18,900	-11,550
				-7,700	-3,850	+11,550
Amount finally paid	D			50,050	15,050	NIL
Balance (C-D)	E			84,350	54,950	14,000
31 <sup>st</sup> October assets realised(net)		73,500				
Total amount payable to partners(E)		<u>1,53,300</u>				
Maximum possible loss in 3:2:1		79,800		-39,900	-	-13,300
					26,600	
Amount finally paid	F			44,450	28,350	700
Balance (E-F)	G			39,900	26,600	13,300
30 November: assets realised(net)		32,000				
+ excess prov for bill discount		<u>10,000</u>				
		42,000				
Total amount payable to partners(G)		<u>79,800</u>				
Maximum possible loss in 3:2:1		37,800		-18,900	-12,600	-6,300
Amount finally paid	H			21,000	14,000	7,000
Balance (loss on realisation)				18,900	12,600	6,300

Note: (1) payment for outside liabilities will be same under both methods.

(2) under this method, following steps are taken to calculate amount finally paid to partners:

Step (i) calculate cash available to distribute among partners.

Step (ii) calculate total amount payable to partners.

Step (iii) deduct amount in step (i) from amount in step (ii). Balancing figure will be called maximum possible loss. Such losses should be distributed among partners in their profit sharing ratio.

Step (iv) deduct share in loss to partners from amount payable to partners individually.

Step (v) if negative balance (i.e. deficiency) comes in any partner's capital, it should be transferred to other partners in the ratio of their capital (as per Garner vs Murray case).

Step (vi) calculate final amount payable to partners after adjusting deficiency.

## Amalgamation, conversion and sale of firm to a company

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 realisation (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.**

**Revision question 13.** A and B were partners in a partnership firm 'X' sharing profits and losses in the ratio of 4:1.

**Balance sheet of firm X**

Capital + liabilities	Amount	Assets	Amount
Capital account:		Machinery	8,00,000
A 6,00,000		Building	12,00,000
B 4,00,000	10,00,000	Furniture	3,00,000
General reserve	2,00,000	cash	2,00,000
Liabilities	13,00,000		
	25,00,000		25,00,000

COC Ltd purchased their business for purchase consideration of Rs 14,00,000 payable Rs 9,00,000 in cash and Rs 5,00,000 by issue of 40,000 equity shares of Rs 10 each at Rs 12.50 per share. Close the book of firm 'X'.

**Solution:**

**Realisation account**

Particulars	Amount	Particulars	Amount
To Machinery	8,00,000	By Liabilities	13,00,000
To Building	12,00,000	By COC Ltd (p.c)	14,00,000
To Furniture	3,00,000		
To cash	2,00,000		
To profit on realization:			
A's capital 1,60,000			
B's capital 40,000	2,00,000		

**Partner's capital account**

Particulars	A	B	Particulars	A	B
To cash			By balance b/d	6,00,000	4,00,000
To equity shares in COC Ltd			By general reserve	1,60,000	40,000
			By realization a/c	1,60,000	40,000

**COC Ltd**

Particulars	Amount	Particulars	Amount
To realization account	14,00,000	By cash	9,00,000
		By equity shares in COC Ltd	5,00,000
	14,00,000		14,00,000

**Cash account**

Particulars	Amount	Particulars	Amount
To COC Ltd	9,00,000	By A's capital	7,20,000
		By B's capital	1,80,000
	9,00,000		9,00,000

**Equity shares in COC Ltd**

Particulars	Amount	Particulars	Amount
To COC Ltd	5,00,000	By A's capital	4,00,000
		By B's capital	1,00,000
	5,00,000		5,00,000

**Note 1:** if new firm/company has not taken cash and bank balance or any part there of, then such balance will not be transferred to realization account. It will be treated as opening balance of cash and bank account.

**Note 2.** Except cash and bank balance, all other assets and liabilities will always be transferred to realization account (whether taken by new company or not).

**Note 3.** If realized value /payable value of any asset/liability is not given in question, we assume they have been realized/paid at their book value.

**Note 4.** Method of computation of purchase consideration:

- (i) Net assets method
- (j) Net payment method

### In the book of new firm/ company

No	Particulars	Debit	Credit
1.	Machinery account	8,00,000	
	Building account	12,00,000	
	Furniture account	3,00,000	
	Cash account	2,00,000	
	Goodwill account ( bal fig)	2,00,000	
	To liability account		13,00,000
	To Firm X account		14,00,000
2	Firm X account	14,00,000	
	To cash account		9,00,000
	To equity share capital		4,00,000
	To security premium		1,00,000

### Note : journal entries in the book of new firm/company

- (i) **Assets of old firm account Dr** (agreed value)  
     **To liabilities of old firm account** (agreed value)  
     **To old firm account** (P.C)
- (ii) **old firm account Dr**  
     **To cash account**  
     **To equity shares account**  
     **To security premium account**
- (iii) **other entries—as per instruction given in question.**

**Revision question 14.** A and B were partners in a partnership firm 'X' sharing profits and losses in the ratio of 4:1.

Balance sheet of firm X

Capital + liabilities	Amount	Assets	Amount
<b>Capital account:</b>		<b>Machinery</b>	<b>8,00,000</b>
A 6,00,000		<b>Building</b>	<b>12,00,000</b>
B <u>4,00,000</u>	<b>10,00,000</b>	<b>Furniture</b>	<b>3,00,000</b>
<b>General reserve</b>	<b>2,00,000</b>	<b>cash</b>	<b>2,00,000</b>
<b>Liabilities</b>	<b>13,00,000</b>		
	<b>25,00,000</b>		<b>25,00,000</b>

They decided to amalgamate with Firm 'Y.' Their firm were valued at Rs 14,00,000. Close the book of firm 'X' and make opening entry in the book of new firm.

Solution:

**Solution:** Realisation account

Particulars	Amount	Particulars	Amount
To Machinery	8,00,000	By Liabilities	13,00,000
To Building	12,00,000	By Firm Y (p.c)	14,00,000
To Furniture	3,00,000		
To cash	2,00,000		
To profit on realization:			
A's capital 1,60,000			
B's capital <u>40,000</u>	2,00,000		

Partner's capital account

Particulars	A	B	Particulars	A	B
To Fir Y ( bal fig)	9,20,000	4,80,000	By balance b/d	6,00,000	4,00,000
			By general reserve	1,60,000	40,000
			By realization a/c	1,60,000	40,000

Firm Y

Particulars	Amount	Particulars	Amount
To realization account	14,00,000	By A's capital account	9,20,000
		By B's capital account	4,80,000
	14,00,000		14,00,000

**In the book of new firm/ company**

No	Particulars	Debit	Credit
1.	Machinery account	8,00,000	
	Building account	12,00,000	
	Furniture account	3,00,000	
	Cash account	2,00,000	
	Goodwill account ( bal fig)	2,00,000	
	To liability account		13,00,000
	To A's capital account		9,20,000
	To B's capital account		4,80,000





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