Foreword

After learning the basics of accounting in class XI the students now face application of the basic accounting skills to specific events that take place in partnership and joint stock companies. The students shall be using their knowledge of recording (journal entries); classifying (preparing ledger accounts); and summarizing (profit & loss appropriation Account and balance sheet). They shall also be using the skill to rectify the past mistakes, particularly in division of profits.

The last phase of accounting process is analyzing and interpreting the results as shown in single set of financial statements. This is also covered in the syllabus of class xii. The students are supposed to have arithmetical skills of adding, subtracting, multiplying, dividing, interest calculation, ratio calculations. Often the marks are deducted for such mistakes.

Accountancy students are supposed to learn the art of being focused and alert in their work as an error in accounts is easy to do but difficult to trace from sea of data in real life situation. Consequences of error can sometimes be grave to the organization. Accountancy questions are framed to test the student on this need of the profession. For scoring high percentage of marks there is a need for arithmetical accuracy and correct application of basic logic of accountancy i.e. rules of debit/ credit.

There is no scope of success on the basis of memorizing the accounting treatment and it is advised to make a decision of debit/ credit in the ledger or journal on the basis of basic rules. In accountancy, the more you practice the better you are.

This academic window can be used for additional practice which is needed for success in accountancy. Good luck!

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Syllabus Plan for: ACCOUNTANCY - CLASS XII

(Break-up of Topics as per CBSE Guidelines)

PART A: Accounting for Partnership Firms and Companies

Unit 1. Accounting for Partnership firms – Fundamentals (10 Marks)

• Partnership: features, Partnership deed.

• Provisions of the Indian Partnership Act 1932 in the absence of partnership deed.

• Fixed v/s fluctuating capital accounts, division of profit among partners, guarantee of profits, Past adjustments (relating to interest on capital, interest on drawing, salary and profit sharing Ratio), preparation of P&L Appropriation account.

• Goodwill: nature, factors affecting and methods of valuation - average profit, super profit And capitalization

Unit 2. Accounting for Partnership firms - Reconstitution and Dissolution (25 Marks)

• Change in the Profit Sharing Ratio among the existing partners - sacrificing ratio, gaining ratio. Accounting for revaluation of assets and re-assessment of liabilities and distribution of reserves and accumulated profits.

• Admission of a partner - effect of admission of a partner on change in the profit sharing ratio, treatment of goodwill (as per AS 26), treatment for revaluation of assets and re-assessment of liabilities, treatment of reserves and accumulated profits, adjustment of capital accounts and preparation of balance sheet.

• Retirement and death of a partner: effect of retirement /death of a partner on change in profit sharing ratio, treatment of goodwill, treatment for revaluation of assets and re - assessment of liabilities, adjustment of accumulated profits and reserves. calculation of deceased partner's share of profit till the date of death. Preparation of deceased partner's capital account, executor's account and preparation of balance sheet

• Dissolution of partnership firms: types of dissolution of firm. Settlement of accounts - preparation of realization account, and other related accounts (excluding piecemeal distribution, sale to a company and insolvency of partner's firm) .

Unit 3. Accounting for share Capital (18 Marks)

• Share and share capital : nature and types

• Accounting for share capital: issue and allotment of equity shares, private placement of shares, Public subscription of shares - over subscription and under subscription of shares; Issue at par and at premium, calls in advance and arrears, issue of shares for consideration other than cash.

• Accounting treatment of forfeiture and re-issue of shares.

• Disclosure of share capital in company's Balance Sheet only.

Unit 4. Accounting for Debentures (7 Marks)

• Debentures: Issue of debentures at par, `at premium and at discount. Issue of debentures for consideration other than cash, debentures as collateral security, interest on debentures

• Redemption of debentures: Lump sum, draw of lots and conversion.

PART B: Financial Statement Analysis

Unit5. Analysis of financial Statements (12 Marks)

• Financial statements of a company: balance sheet of a company in the prescribed form with major headings and sub headings (as per schedule VI to the Companies Act 1956).

• Financial Statement Analysis: objectives and limitations.

• Tools for Financial Statement Analysis: comparative statements, common size statements, cash flow analysis, ratio analysis.

• Accounting Ratios: objectives and classification.

• Liquidity ratios: current ratio and quick ratio.

• Solvency Ratios: Debt to Equity Ratio, Total Asset to Debt Ratio, Proprietary Ratio, Interest Coverage Ratio.

• Activity ratios: Stock Turnover Ratio, Debtors Turnover Ratio, Creditors Turnover Ratio, Working Capital Turnover Ratio.

• Profitability Ratios : Gross Profit Ratio, Operating Ratio, Operating Profit Ratio, Net Profit Ratio and Return on Investment.

Unit 6. Cash Flow Statement (8 Marks)

• Meaning, objectives and preparation (as per AS 3 revised) (Indirect Method)

Unit7. Project work (20 Marks)

• Kindly refer to the Guidelines published by the CBSE.

Unit – 1: **Accounting for Partnership firms – Fundamentals**

Chapter .1

Accounting for partnership firm

Marks: 10 out of 80 in main exam

Synopsis:

- ✓ Partnership is relation between persons who have agreed to share profits of a business carried on by all or any of them acting for all.
- ✓ Partnership deed is a document which contains the terms of partnership as agreed by the partners.
- ✓ In absence of partnership deed the provisions of Indian Partnership Act, 1932 are applicable. In such a case no remuneration is payable to any partner; no interest on capital is allowed; no interest on drawings is charged; in case partner has given loan to the firm 6% interest is allowed; and profits & losses are to be shared equally.
- ✓ Partner's capital accounts can be prepared by 'fixed capital accounts' and 'fluctuating capital accounts' methods. When all the entries are made in one capital account it is called 'fluctuating type capital account'. In case of fixed capital account method the amount of permanent capital is kept in capital account and all day to changes are recorded in partner's current account. Students should gain the skill of making capital account by both the methods.
- ✓ Division of profit is carried out in an account called 'profit & loss appropriation account' according to the terms of partnership deed. Student should have the skill to pass journal entries for division of profits; preparing profit & loss appropriation account; and partners' capital accounts by both the methods.
- ✓ The division of profits requires correct calculation of interest on capital and drawings. It will help the students to know the short cut method of calculating interest. For example if the same amount is drawn every month throughout the year we can calculate 6 months interest on total amount drawn when the amount is drawn on mid of every month; 6.5 months interest when drawing is on beginning of every month; and 5.5 months when the drawings are at the end of every month.

- ✓ The division of profit may require fulfilling a guarantee to one of the partners that his or her minimum share of profits will not be less than a given amount. Student should first divide the profit as per agreement and keep the amounts in the inner column keeping space between the entries for adjusting for guarantee. Deficiency if any is added to the share of partner who is given guarantee and subtracted from the share of partners who have given guarantee.

- ✓ Past adjustments are another important skill required for this chapter. The past year books of accounts are already closed and there is mistake in division of profits. Students are required to correct the mistake by passing one journal entry. The logic of rectification is debit the account of partner who gained from the mistake and credits the account of the partner who suffered due to mistake. This requires the calculation of net impact of the mistake by preparing a statement of adjustment needed. In this statement we undo the wrong and do the right and see the net impact of mistake and its rectification on the partners.

One Mark Questions:

1. Define partnership as per section 4 of Indian Partnership Act, 1932.
2. Give any four features of partnership.
3. Define partnership deed.
4. Give any four provisions affecting the accounting treatment in the absence of partnership deed.
5. A and B share profits in the ratio of 3:2. A is entitled to annual salary of Rs.6000. Profit for the year is Rs.56000. How much of this total profit will be received by A.
6. B's drawings during the year were Rs.5000. Calculate interest on drawings @6% per annum.
7. C withdrew Rs.200 at the end of each month for personal use. Calculate interest on drawings @ 10% p.a.
8. Give journal entries for allowing interest on capital.
9. Give journal entries for allowing interest on drawings.
10. How fixed and fluctuating capital accounts are different on the basis of number of accounts?

11. Give four items that appear on debit side of partners' capital account when it is fluctuating type.
12. If partners' capital accounts are fixed, where will you record the drawings mad by partner?
13. Alka, Barkha and Charu are partners in a firm having no partnership agreement. Alka, Barkha and Charu contributed Rs.200000, Rs.300000 and Rs.100000 respectively. Alka and Barkha desire that the profits should be divided in the ratio of capital contribution. Charu does not agree to this. How will you settle the dispute?
14. Mention two points of difference between the legal provision regarding interest on loan and interest on drawings.
15. P and Q are partners without a partnership deed. How should they divide the profit of Rs100000 earned during the year?
16. Abhinav withdrew Rs60000 during the year. Calculate interest on drawings assuming that he withdrew this amount at the end of each quarter.
17. What is the rule of debit credit for partners' capital account?
18. How would you calculate interest on drawings of equal amounts drawn in the middle of every month?
19. How would you calculate interest on drawings of equal amounts drawn in the middle of every month?
20. What is meant by Partnership?
21. List any two points from accounting point of view which must be incorporated in a partnership deed.
22. State the difference between fixed and fluctuating capital on the basis of change in balance.
23. Distinguish between Fixed Capital method and Fluctuating Capital method.
24. Give 2 benefits of having a partnership deed.
25. When the profit ratio changes, who should compensate whom?

Four Marks Questions:

1. Q 1 A, B and C are partners in a firm. They have omitted interest on capital @ 10% p.a. for three years ended 31st March, 2007. Their fixed capitals on which interest was to be calculated throughout were: A Rs.100000, B Rs.80000 and C Rs.70000. Give the necessary adjusting journal entry with working notes.

2. Q 2 A, B and C are partners in the ratio of 3:2:1. A had given guarantee to both B and C that there share of profit after salary shall not be less than Rs.20000 each. The total profit was Rs.330000 before allowing salary to all the partners @ Rs.5000 per month. Show division of profit by preparing Profit & Loss Appropriation Account

3. Q 3 Calculate interest on drawings @ 6% in following cases:
4. Rs.2000 is drawn in the beginning of every month throughout the year.
5. Rs. 1000 is drawn at the end of every month throughout the year.

6. Q 4 What journal entries will be recorded in the books of partnership in the following cases?
7. Interest on drawings A Rs.650 and B RS.450.
8. Profit before commission is Rs.220000. A is entitled to commission @ 10% of profit after charging such commission.

9. Q 5 X and Y started business on 1st January, 2002 with capitals of Rs.80000 and Rs.60000 respectively. During the year their capital was changed as under:
10. On 1st April Y introduced further capital Rs.10000, while X withdrew capital of Rs.20000. On 1st July X introduced a capital of Rs.20000, while Y withdrew capital of Rs.10000. On 1st September Y withdrew capital of Rs.37500. Partners decided to distribute profit in the ratio of their (effective) capitals. Find their profit sharing ratio and pass journal entry for division of their profit for the year Rs.200000.

11. Pappu and Munna are partners in a firm sharing profits in the ratio of 3:2. The partnership deed provided that Pappu was to be paid salary of Rs.2500 per month and Munna was to get commission of Rs.10000 per annum. Interest on Pappu's drawings

was Rs.1250 and on Munna's drawings Rs.425. Capitals of the partners were Rs.200000 and Rs.150000 respectively and were fixed. The firm earned a profit of Rs.90575 for the year ended 31st March, 2004. Prepare Profit & Loss Appropriation Account of the firm.

12. A, B and C are partners sharing profits in the ratio 5:4:1. C is given a guarantee that his share of profits in any given year would not be less than Rs.5000. Deficiency if any will be borne by A and B equally. The profit for they year 2006 amounted to Rs.40000. Pass Journal entries for division of profits and prepare Profit & Loss Appropriation Account.

13. A, B and C were partners in a firm sharing profits in the ratio of 2:1:1.. On 1st January, 2005 their capitals stood at Rs. 100000, Rs.50000 and Rs.50000 respectively. As per the provisions of partnership deed C was entitled to salary of Rs.1500 per month and interest on capital @ 5% was to be allowed. The profit during 2005 before these adjustments Rs.90000 was divided equally amongst the partners. Pass journal entry to rectify this error.

14. A, B and C the partners of a firm distributed the profits for the year ended 31st March, 2003, Rs.140000 in the ratio of 2:2:1 without providing the following adjustments:
A and B were entitled to a salary of Rs.1500 per quarter.
C was entitled to a commission of Rs.8000.
A and C had guaranteed a minimum profit of Rs.50000 per annum to B.
Profits were to be shared in the ratio of 3:3:2.
Pass necessary journal entry for the above adjustments in the books of the firm.

15. Malti, Pare and Arti are partners in a firm having fixed capitals of Rs.80000, Rs.40000 and Rs.50000 respectively sharing profits as 7:6:4. The rate of interest on capital was agreed at 10% per annum, but was wrongly credited to them as 12% per annum. Give the necessary adjustment entry to adjust the balances of partners capital accounts.

16. Ram and Manohar are partners in a firm sharing profits and losses in the ratio of 7:3. According to the partnership deed, Ram was to be paid salary of Rs.5000 per month and

Manohar was to get a bonus of Rs.40000 per annum. Interest on capital was to be allowed @ 10% per annum and interest on drawings was to be charged @ 8% per annum. Interest on Ram's drawings was Rs.3000 and on Manohar's drawings was RS.2000. Their fixed capitals were Rs.400000 and Rs.100000 respectively. The firm earned a profit of Rs.250000 for the year ended 31st March, 2004. Prepare Profit & Loss Appropriation Account.

17. Ram and Gopal were partners in a firm sharing profits in the ratio of 3:2. On 1st January, 2001 their fixed capitals were Rs.100000 and Rs.150000 respectively. On 31st March, 2001 they decided that their capital (fixed) should be Rs.300000 in their profit sharing ratio. Accordingly they introduced or withdrew the necessary capital. The partnership deed provided the following:
Interest on capital @ 12% per annum.
Interest on drawings @ 18% per annum.
Monthly salary to Ram @ Rs.2000 per month and to Gopal @ Rs.3000 per month. The drawings of Ram and Gopal during the year were as follows:
On July 1, 2001 Ram Rs.10000 and Gopal Rs.12000; On September 30, 2001 Ram Rs.15000 and Gopal Rs.12000. The profit for the year 2001 was Rs.200000.

Prepare Profit & Loss Appropriation Account.

18. Nadeem and Yash are partners in a firm. Nadeem is entitled to a salary of Rs.8000 per month and a commission of 10% of Net profit before charging any commission. Yash is entitled to a salary of Rs.20000 per annum and a commission of 10% on net profit after charging all commissions. Net profit before charging any commission for the year ended 31st December, 2007 was Rs.132000. Pass necessary journal entries for distribution of profit amongst the partners.

19. Karan and Ankur are partners sharing profits in the ratio of 3:7 with capitals of Rs.100000 and Rs.200000 respectively. Show the distribution of profits in each of the following cases:

If partnership deed is silent as to interest on capital and the profit for the year is Rs. 90000.

If the partnership deed allowed interest on capital @ 10% per annum and the profits for the year are:

Rs.90000.

Rs.18000.

Rs.90000. (Loss)

If interest @ 10% is to be allowed, irrespective of profits and profits are Rs.18000.

20. A, B and C are partners in a firm. They agree to distribute profit up to Rs. 30,000 equally and above it as 50%, 30% and 20% respectively. Their respective capitals on 1st January, 2009 were Rs. 50,000, Rs. 80,000 and Rs. 70,000.

    a. The terms of partnership are as follows : –

        i) Interest on capital is to be allowed @ 10% p.a.

        ii) A and B are to get a monthly salary of Rs. 1000 and Rs. 500 respectively.

        iii) Interest on drawings is to be charged @ 6% p.a.

        iv) C is to be allowed a commission @ 10% on Net Profit after charging such commission.

The profit for the year ended 31st December, 2008 after charging B's salary but before charging other provisions amounted to Rs. 1,26,000. Their drawings during the year were Rs. 20,000, Rs. 18,000 and Rs. 12,000 respectively.

Prepare Profit and loss appropriation Account.

21. Ram and Shyam are partners sharing profits and losses in the ratio of 3:2. Ram is a non working partner and has contributed Rs 15,00,000 as his capital. Shyam is a working partner. The partnership deed provides for interest on capital @ 10% p.a. and salary of Rs 7,500 per month to the working partner. The net profit for the year ended 31st December, 2008 (before charging manager commission @ 10% on net profit) was Rs 1,60,000.

    a. Show the distribution of profits.

22. The net profit of X,Y and Z for the year ended March 31,2006 was Rs.60,000 and the same was distributed among them in their agreed ratio of 3:1:1.It was subsequently discovered that the under mention transactions were not recorded in the books.

    (a) Salary to X Rs.5,000,Y Rs.4,000 and Z Rs.3,000
    (b) Interest on drawings X Rs.700,Y Rs.500 and Z Rs.300
    (c) Commission to X Rs.1,000, Y Rs.1,500 p.a.

    Pass an adjusting entry

23. R, K and S agreed to share profits or losses as follows :

    - First 90,000 to K and the balance in the ratio of 2:2:1.

    The profit for the year 2008 was Rs. 2,40,000 which was distributed by all the partners equally without providing Interest on capital @ 10% p.a. The capitals of the partners on 1st January, 2009 were R Rs. 1,00,000, K Rs. 1,50,000 and S Rs. 50,000.

    b. Give an adjustment entry for above.

24. A, B and C are partners with capitals of Rs.40000, Rs.30000 and Rs.20000 respectively. B and C are entitled to annual salary of Rs.2000 and Rs.3000 respectively payable before division of profits. Interest on capital is allowed @ 5% per annum, but interest is not charged on drawings. Of the first Rs.12000 divisible as profit in a year, A is entitled to 50%, B to 30% and C to 20%. Balance profit in excess of Rs,12000 us divisible equally. Profit before salary and interest was Rs.26000. Prepare Profit & Loss Appropriation Account to show the division of profit.

25. Amith Babu and Charu set up a partnership firm on April 1, 2006. They contributed Rs. 50,000, Rs. 40,000 and Rs. 30,000 respectively as their capitals and agreed to share profits and losses in the ratio of 3:2:1. Amith is to be paid a salary of Rs. 1,000 per month and Babu, a Commission of Rs. 5,000. It is also provided that interest to be allowed on capital at 6% p.a. The drawing fr the year were Amith Rs. 6,000, Babu Rs. 4,000 and Charu Rs. 2,000. Interest on drawings of Rs. 270 was charged on Amith’s drawing, Rs. 180 on Babu’s drawings and Rs. 90, on Charu’s drawings. The net profit as per Profit and Loss account for the year ending March 31, 2006 was Rs. 35,660.Prepare the Profit and Loss Appropriation Account to show the distribution of profit among the partners.

26. Q 21 A,B and C were partners sharing profits in the ratio 5:3:2.They had capital of Rs. 1,00,000 each at the beginning of the year. During the year, the firm earned a net profit of

Rs. 12,000. It was later discovered that interest on capital @ 10% p.a. has been omitted. Pass the necessary adjustment entry assuming that minimum profits guaranteed to A were Rs.5,000.

27. Q 22 X, Y and Z are partner sharing profits and losses in the ratio of 3:2:1. After the final accounts have been prepared, it was discovered that interest on drawings @5% pa has not been taken into consideration. The drawings of the partners were : X=Rs.1,50,000 ; Y= Rs.1,26,000 and Z= Rs.1,20,000.

    Pass necessary journal entry.

Valu, A, B and C are partners in a firm having fixed capital of Rs.5lacs, 3lacs and 2lacs respectively. Firm earned profits of Rs.1, 50,000 during the year ending 31st march, 2011. These profits were divided in capital ratio instead of 2:2:1.

Pass adjustment entry for the above and also state which value is being reflected through this question?

(a) A and B are partners in a firm. A manages all business as a representative of firm. For execution of a sales order a valuable customer A incurred Rs. 5,000 for delivery in quick time. B does not agree to reimburse the above expenses from the firm's accounts. **Explain the treatment of above expense and describe which value is violated by the partners.**

(b) Ram is a graduate in Business Administration. After completing B.B.A., he tried very hard for a job but he didn't get any opportunity to work due to recession in the economy. Then he realized that he should start his own business at the ground floor of his house lying vacant. Since he didn't have sufficient funds to invest in the business, he cannot start the business alone. Ram contacted one of his friends, Anuj and convinced him to start a business with him in partnership. Anuj decided to invest in the business and to form a partnership with Ram but Anuj wants to get the firm registered. State the values that are being reflected in the above case.

Chapter - 2

Goodwill: Nature and Its Valuation:

Synopsis:

- ✓ Goodwill of a business refers to the good name or reputation enjoyed business due to which it is able to get repeated orders and earn above normal profits. Goodwill of the business is an asset for the business. It is an intangible asset but not a fictitious asset. Its value keeps changing with changing performance of the business. Its value is realizable only when entire business is sold to someone.

- ✓ Factors affecting the valuation of goodwill are nature of business; favorable location of business; efficiency of management; market situation (competition); and availability of incentives.

- ✓ There is need for valuation of goodwill of the firm and carry out its accounting treatment because accounting standards do not allow to debit goodwill account until and unless we are paying for it or incurring expenditure to create it. Also there is need to record or give accounting treatment of unrecorded profits or losses or past undistributed profits.

- ✓ There are three methods of valuation of goodwill.

- First is number of year's purchase of average profits where we first find the average of given past profits and multiply that average with the number of years purchase.

- Second method is number of year's purchase of super profits. Super profits are actual profits less normal profits. Normal profits are calculated by multiplying the capital employed with the normal rate of earning. Goodwill is found by multiplying the super profits so calculated with the number of years purchase.

- Third method is capitalization method in which goodwill is excess of capitalized value of business over actual capital employed in the business. Capitalized value of the business is found by multiplying average or actual profits with inverse of normal rate of return of earning. Same answer is possible by multiplying super profits with inverse of normal rate of return.

- ✓ Accounting treatment of goodwill in all the cases covered by reconstitution of partnership can be understood by one simple logic. Debit the partner who gains in goodwill for his gain and credit the capital of the partner who sacrifices in goodwill for his share of sacrifice.

Multiple Choice Questions:

1. Goodwill is

(a) Fictitious assets

(b) Current assets

(c) Wasting assets

(d) Intangible assets

2. Goodwill of the firm calculated at 3 years purchase of average profits is Rs.60, 000. The average profits are:

(a) Rs.180000

(b) Rs. 20000

(c) Rs. 200000

(d) None of the above.

3. Assets of the firm are Rs.10,00,000 and liabilities are 20% of assets. Normal rate of income is 10% and actual profit 120000. What should be goodwill of the firm?

(a) Rs.8,80,000

(b) Rs. 2,00,000

(c) Rs.4,00,000

(d) Rs. 10,00,000

4. Goodwill valued at 3 years purchase of super profits is Rs.180000. Capital of the firm is Rs.10, 00,000 and normal rate of return is 10%. What is the actual profit?

(a) Rs.18,000

(b) Rs.11,80,000

(c) Rs.1,00,000

(d) Rs.1,60,000

One Mark Questions

1 According to accounting standard 10 when can goodwill be recorded in accounts books?

2 Define goodwill.

3 Give any four factors affecting goodwill.

4 Define super profit.

5 Average profits are Rs.60000, gross profit Rs.150000, Super profit Rs.40000, find normal profits.

6 A and B who were sharing profits in the ratio of 3:2 decided to share future profits in the ratio of 5:2. Name the gaining partner and magnitude of his gain.

7 Super profits are Rs.50000, normal rate of return is 12%, find goodwill.

8 Why Goodwill is considered an 'Intangible Assets' but not a 'Fictitious Assets'?

Four Marks Question:

Q 1 On 1st April 2007 an existing firm had total assets of Rs.150000, including cash of Rs.10000. Its creditors amounted to Rs.10000 on that date. The firm had reserve fund of Rs.20000 while partner's capital accounts showed a balance of Rs.120000. If the normal rate of return is 20% and the goodwill of the firm is valued at Rs.48000 at 4 years purchase of super profits, find the average profits per year of the existing firm.

Q 2. The average net profit expected in future by ABC firm is Rs.3,60,000 per year. The average capital employed in the business by the firm is Rs.20,00,000. The rate of return expected from the capital invested in this class of business is 10%. The remuneration of partners is estimated Rs.60,000 pa. What will be the value of goodwill on the basis of 2 years purchase of super profit?

Ans: Super profit = 1,00,000 Goodwill = 1,00,000 x 2 = 2,00,000

Q 3. X,Y and Z are partners sharing profits in the ratio of 3:2:1 respectively. From 1st April 2015, they decided to share profits in the ratio of 2:3:1. For this purpose, the goodwill of the firm is to be valued at 3 years purchase of average profit of last 5 years. The profits and losses of the preceding 5 years are:

Year	2010-11	2011-12	2012-13	2013-14	2014-15
Profit/Loss	?	6,00,000 (profit)	6,80,000(profit)	7,60,000(profit)	2,80,000(Loss)

Journal entry for change in profit sharing ratio.

Y's capital a/c………….. Dr. 2,00,000

To X's capital a/c 2,00,000

Calculate the profit for 2010-11

Ans: X= 3/6 – 2/6 = 1/6

Y= 2/6 – 3/6 = -1/6

Z= 1/6 – 1/6 = 0

Compensation payable by Y to X for 1/6th share= Rs.2,00,000

Firms goodwill = Rs.2,00,000 x 6/1 = 12,00,000 Average profit= 12,00,000/3 = 4,00,000

Profit for the year 2010-11 = P 4,00,000 = P + 6,00,000 + 6,80,000 + 7,60,000 – 2,80,000 / 5 =2,40,000

Q4 X and Y are partners in a firm sharing profits and losses in the ratio 3:2. Their firm is manufacturing handicrafts and khadi items. They decided to admit C into partnership for 1/6th share of future profits, goodwill, valued at 4 times average super profit of the firm, was Rs.18,000. The firm had asses worth Rs.15,00,000 and liabilities rs.12,00,000. The normal rate of return of such firms is 10% pa. Find the average profit earned by the firm during the last 4 years.

Ans: Capital= Assets- liabilities = 15,00,000 – 12,00,000 = 3,00,00 Normal profit= 30,000

Goodwill = 18,000 Super profit = 18,000/4 = 4,500 Average profit= Rs.34,500

Q5 Jalesh and Kishore are partners in a firm. Their capitals are : Jalesh Rs. 3,00,000 and Kishore Rs.2,00,000. During the year ended 31st 2016 the firm earned a profit of Rs. 1,50,000. Assuming that the normal rate of return is 20%. Calculate the value of goodwill of the firm:

1) By Capitalisation Method and
2) By Super Profit Method if the goodwill is valued at 2 years purchase of super profits.

Ans: **1) Capitalised Value of the firm = 7,50,000**

Goodwill = 7,50,000 – 5,00,000 = 2,50,000.

2) Super Profits = Av. Profit – Normal Profit

1,50,000 – 1,00,000 = 50,000

Goodwill = 50,000 x 2 = 1,00,000

Q6 Average Profits of the firm is Rs. 1,50,000. Total Tangible assets in the firm are Rs. 14,00,000 and Outside liabilities are Rs. 4,00,000. In the same type of business the normal rate of return is 10% of the capital employed.

Calculate value of goodwill by capitalisation of Super profit Method.

Capital emp. = 14,00,000 - 4,00,000 = 10,00,000
Normal Profit = Cap.Emp. x Normal Rate of Return
= 10,00,000 x 10/100 = 1,00,000
Super Profit = Average Profit – Normal Profit
= 1,50,000 – 1,00,000 = 50,000
Goodwill = Super Profit x 100/Normal Rate of Return
= 50,000 x 100/10 = 5,00,000.

Unit – 2- Accounting for Partnership Firm – Reconstitution and Dissolution

Chapter -3

Changes in Profit Sharing Ratio among the existing partners

Marks 25 out of 80

(Pattern of questions as per CBSE sample papers 1+1+4+6+8)

- ✓ Reconstitution of partnership takes place when the economic relationship amongst the partners changes i.e. when the share future profits in a different profit sharing ratio than earlier.

- ✓ This happens when there is admission, retirement, death of a partner or when they mutually agree to change the profit sharing ratio. In all these cases old partnership comes to an end and new partnership comes into existence.

- ✓ For handling the questions on reconstitution of partnership the students must possess following skills:

- Ability to value goodwill and carry out its accounting treatment.
- Ability to calculate new profit sharing ratio, gaining ratio and sacrificing ratio of the partners.
- Ability to prepare revaluation account to carry out accounting treatment of revaluation of assets and reassessment of liabilities.
- Ability to transfer undistributed profits and losses to partners before the event.
- Ability to make the capitals of the partners proportionate according to instructions given in the question.
- Ability to prepare partners capital account.
- Ability to prepare retiring partner's loan account and deceased partner's executor's account till it is paid off.
- Ability to prepare new balance sheet after carrying out the changes that took place during the process of reconstitution.

- Existing partners decide to share future profits in new profit sharing ratio. When profit sharing ratio changes in this way a partner's gain will be other partner's sacrifice.
- It should be noted that all the past profit till the point of time of change in ratio belongs to the partners in old profit sharing ratio. Either it should be recorded and transferred to partners in old ratio or capital of gaining partner should reduce and that of sacrificing partner increase for their respective gain/ sacrifice.
- Gain = New share – Old share (a negative answer would mean sacrifice)
- Sacrifice = Old share – New share (a negative answer would mea

- n gain) Partner's new share = Old share + gain - sacrifice
- Transfer revaluation profit or loss to partners in old ratio when the questions allow changing the values. When the question does not allow changing values then working our total profit or loss at stake and debiting the gaining partner for fraction gain in profit and credit sacrificing partner for fraction sacrifice in profits.
- In accounting treatment of goodwill we write off already existing goodwill in old ratio. Debit the gaining partner for fraction gain in goodwill and credit the sacrificing partner for fraction sacrifice in goodwill.
- Undistributed profits are transferred to the partners in old ratio.

Four Marks Questions:

Q1. E and F are partners in a firm sharing profits in the ratio 3:1. They admitted G as a new partner on 1.3.2005 for $1/3^{rd}$ share. It was decided that E, F and G will share future profits equally. G brought Rs.50000 in cash and machinery worth Rs.70000 for his share of profit as premium for goodwill. Showing your calculations clearly, pass necessary journal entries in the books of the firm.

Q2. Hari, Ravi and Kavi were partners in a firm sharing profits in the ratio of 3:2:1. They admitted Guru as a new partner for $1/7^{th}$ share in the profits. The new profit sharing ratio will be 2:2:2:1 respectively. Guru brought Rs 3, 00,000 for his capital and 45,000 for his $1/7^{th}$ share of goodwill. Showing your workings clearly, pass necessary journal entries in the books of the firm.

Q3. Ram and Mohan were partners in a firm sharing profits in the ratio 4:1. On 1.3.2015 they admitted Sohan as new partner for $1/3^{rd}$ share in the profits of the firm. They fixed the new profit sharing ratio as 4:2:3. On the date of Sohan's admission, the firm had a contingency reserve balance of Rs 20,000. Profit and loss account balance of Rs 32,000 debit. The firm also had a reserve of Rs 100,000. Sohan is to bring RS 6,000 as premium for his share of goodwill. Showing your calculations clearly, pass necessary journal entries to record the above transactions.

Q4. X, Y and Z were sharing profits and losses in the ratio of 5:3:2. They decided to share future profits and losses in the ratio of 2:3:5 with effect from 1.4.2007. They decided to record the effect of the following, without affecting their books values: *Pr*ofit and Loss Account Rs.24000 and Advertisement Suspense Account Rs.12000.

Q 5. Pass necessary adjusting entry X and Y shared profits and losses in the ratio of 3:2. With effect from 1st January 2007 they agreed to share profits equally. The goodwill of the firm was valued at Rs.30000. Give necessary single adjusting entry

What value is highlighted above problem?

Q6. A, B and C partners sharing profits in the ratio 5:3:2. They decided to change the pprofit sharing ratio to 4:1:3.

For this purpose goodwill was valued at Rs. 40,000. There existed a debit balance of Rs. 10,000 in the profit and loss account. Differed advertising account stood at Rs. 10,000. Pass the journal entry if balance sheet is not to be disturbed.

Q7. A, B and C are partners sharing profits in the ratio of 3:2:1. On April 1, 2007, they decided to share the profit equally. On that date there was a credit balance of Rs.1,20,000 in their profit and loss account and a balance of Rs.60,000 on General reserve. Record the necessary journal entry in the books of firm. The partners decided to distribute the profits and losses and the General reserve before bringing the new profit sharing ratio into force.**8 Markers:**

LIABILITIES	**AMOUNT**	**ASSETS**	**AMOUNT**
Sr. creditors	25,000	**Cash**	**1,800**
Bills payables	**5,000**	**Bank**	**13,000**
Capital A/C A 80,000 B 60,000	**1,40,000**	**Debtors30,500** **Less PDD(300)**	**30,200**
		Stock	**25,000**

		Plant	**40,000**
		Building	**60,000**
	1,70,000		**1,70,000**

agreed to admit C into partnership with effect from April 1st 2014 on the following terms:a) C to bring capital equal to 1/8th of the total capital of the new firm after all adjustments b) Buildings to be appreciated by Rs 7,000 and plant depreciated by Rs 3,500 c) The provision for doubtful debts on debtors to be raised to Rs 650 d) The goodwill of the firm to be valued at rs 28,000 and C to bring his share of premium in cash. Prepare revaluation a/c, partner's capital a/c and the Balance Sheet on C's admission.

Q2) Alpha and Beta were partners in a firm. They were trading in artificial limbs. On 1st April, 2013, they admitted Gama, a good friend of Beta into the partnership. Gama lost his one hand in a an accident Alpha and Beta decided to give one artificial hand free of cost to Gama. The balance sheet of Alpha and Beta as at 31st march 2013 is as follows:

Liabilities	AMOUNTS	ASSETS	AMOUNTS
Provision of Doubtful debts	**40,000**	Cash	**1,00,000**
Workmen's compensation	**56,000**	Sundry Debtors	**8,00,000**
Outstanding expenses	**30,000**	Stock	**2,00,000**
Capitals:		Machinery	**3,86,000**
Alpha 500000		Profit and Loss A/C	**40,000**
Beta 600000	**11,00,000**		
	15,26,000		**15,26,000**

Gama was admitted in the firm on the following terms:

- Gama will bring in RS 400000 as his share of capital, but he was unable to bring any amount for goodwill.\

- The new profit sharing ratio between Alpha, Beta and Gama will be 3:2:1
- Claim on account of workmen's compensation was RS30,000.
- To write off bad debts, amounted to RS 40,000
- Creditors were to be paid Rs 20,000 more
- Outstanding expenses be brought down to Rs 12,000
- Rs 20,000 to be provided for an unforeseen liabilities
- Goodwill of the firm was valued at Rs. 1,80,000

Prepare Revaluation a/c, capital a/cs of partners and the opening balance sheet of the new firm.

Also, identify any one value which the partners wanted to communicate to the society

Q3) A and B are partners with capitals of Rs 2,60,000 and Rs 2,20,000. They admit C as a partner with 1/4th share in the profits of the firm. Fill in the missing figures to record capital and goodwill:

DATE	PARTICULARS	LF	Dr.	Cr.
	Cash A/C Dr.		2,60,000	
	To C's Capital A/c			……………
	(For amount of capital brought in cash by C)			
	C'………………. A/c		…………	
	To………………..A/c			…………….
	To………………...A/c			…………….
	(For C's share of goodwill credited to sacrificing partner's A/Cs in their sacrificing ratio)			

Chapter -4-Admission of a new partner

Synopsis:

- ✓ Admission of new partner is possible only when there is consent of all the partners.
- ✓ The purpose of admitting new partner may be for procuring additional capital for expansion of the business and/ or also to get additional managerial skill for efficient running of the business.
- ✓ The share of new partner is created from the sacrifice by old partners in favor of new partner. Sacrificing ratio of the old partners is either given or can be calculated when new profit sharing ratio is given. Otherwise the old profit sharing ratio is taken as sacrificing ratio (it is assumed that partner's sacrificed in their mutual ratio)
- ✓ Before carrying out accounting treatment of goodwill any amount of goodwill already appearing in the balance sheet should be written off debiting to old partners in old profit sharing ratio. (New partner will compensate old partners only when goodwill is not appearing in the books of account).
- ✓ Student should understand the required journal entries and how to post them in partner's capital accounts when goodwill is paid privately; new partner brings premium for goodwill in cash to be

retained in business; new partner brings premium for goodwill to be withdrawn by old partners; and new partner is not able to bring goodwill in full or in part.

- ✓ Undistributed profits are transferred to old partners in their old profit sharing ratio.
- ✓ Revaluation account is prepared by crediting for increase in value of assets and decrease in the value of liabilities; debiting for decrease in the value of assets and increase in the value of liabilities; and resultant profit or loss is transferred to the capital accounts of old partners in old profit sharing ratio.
- ✓ Partner's capital account is prepared by following the ledger posting procedure and can be cross checked on the logic of debit credit rule for capital, liabilities and income (i.e. credit for increase and debit for decrease)
- ✓ When capitals are to be made proportionate on the basis of new partner's capital we first find the total capital by multiplying new partner's capital by inverse of his or her share and then find required capital of old partner using new profit sharing ratio (which if not given means that their combined share in total capital is divided in their old mutual ratio). Required capital of the partner is compared to his or her actual capital after all adjustments and any deficiency or surplus is dealt according to the instruction given in the question.
- ✓ Sometimes the new partner is to bring proportionate capital which can be calculated by first finding the combined capital of old partners after carrying out all adjustments and then multiplying it with the combined share of old partners. This gives us total capital of new firm and we can find the capital brought by new partner by multiplying this total capital with his or share.
- ✓ Student should read the questions carefully and look for confusion deliberately created by the examiner. For example provision for bad debts is increased to 500 or increased by 500 does not mean the same thing.

One Marks Questions

1. A and B are partners sharing profits in the ratio of 2:1, C joins for one-fourth share. Find A's new share.

2. P and Q are partners in the ratio 2:1, C joins for one-fourth share. P surrenders 3/8th of his share in favor of C. What is Q's sacrifice?
3. Give any two points of difference between sacrificing ratio and gaining ratio.
4. Pawan and Jayshree are partners. Bindu is admitted for 1/4th share. What is the ratio in which Pawan and Jayshree will sacrifice their share in favor of Bindu?
5. New partner C acquires his 1/4th share equally from old partners D and E. Goodwill of the firm is Rs.40000 and C cannot bring his share of goodwill. Give necessary journal entry.

Four Marks Questions:

Q 1 A and B are partners with capitals of Rs.5000 each. They admit C as a partner with one-fourth share in the profits of the firm. C brings Rs.8000 as his share of capital. The profit and loss account showed a credit balance of Rs.4000 as on the date of admission of C. Give necessary Journal Entry to record Goodwill

Eight Marks Questions:

Q 1 L and M share profits of a business in the ratio of 5:3. They admit N into the firm for a fourth share in the profits to be contributed equally by L and M. On the date of admission, the Balance Sheet of L and M is as follows:

Liabilities	Rupees	Assets	Rupees
L's Capital	30000	Machinery	26000
M's Capital	20000	Furniture	18000
Reserve Fund	4000	Stock	10000
Bank Loan	12000	Debtors	8000
Creditors	2000	Cash	6000
	68000		68000

Terms of N's admission were N will bring Rs.25000 as his capital. Goodwill of the firm is to be valued at 4 years' purchase of the average profits of the last three years. Average profits of the last three years are Rs.20000; while the normal profits that can be earned on the capital employed are Rs.12000.   Furniture is the be appreciated to Rs.24000 and the value of stock to be reduced by 20%. Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after admission of N.

Q 2 The following is the Balance Sheet of A and B who had been sharing profits in the ratio of three-fourth and one-fourth, on 31st December, 2006.

Liabilities	Amount	Assets	Amount
Creditors	30000	Cash at Bank	22500
Employee Provident fund	7500	Bills Receivable	7000
General Reserve	6000	Debtors	16000
A's Capital	33000	Stock	20000
B's Capital	17000	Office Furniture	1000
		Land & Building	25000
		Profit & Loss Account	2000
	93500		93500

They agreed to take C into partnership as on 1st January 2007 on the following terms:

C pays Rs.10000 as his capital for one-fifth share. Goodwill is valued at Rs.20000 and C brings his share of goodwill. Stock and furniture to be reduced by 10% and 5% provision for doubtful debts be created on debtors. Value of land and building be appreciated by 20%. Partners decide to readjust their capitals on the basis of new partner's capital. Prepare Revaluation Account, Partners Capital Accounts and Balance Sheet of the new firm.

Value based question:

(a) Ram, Gurdeep and Fathima are partners dealing in manufacturing of electric power saver machine. They share profits and losses in the ratio of 5:3:2. They admitted Mathew for 2/10th share. Fathima is a single parent of two small kids. On the admission of Mathew, Fathima requested to Ram and Gurdeep that she does not want to change her profit share and wants to retain her original (old) share.

a) Find out the new profit sharing ratio of Ram, Gurdeep and Mathew.

b) What values you can identify in the above problem?

Ans:

a). *New profit sharing ratio= 30: 18: 16: 16 or 15: 9: 8:8*

b).Following values are identified in the above problem:

i. Conservation of natural resources

ii. Empowering women entreneurship

iii. Secularism

(b) *Support to the needy person.*

(c) Deepa and Shweta are friends and after completion of their study they started a business of readymade Garments by constituting a partnership firm with a profit sharing ratio as 3:2 respectively. Their partnership firm earns huge profits during few years. **They decided to start a scholarship of ` 10,000 p.a. for meritorious and poor students.** On January 1, 2012 they admit Joney, their manager as a new partner with 1/5th share in future profits. The value of goodwill of the form is ` 3,50,000 and Joney is not able to bring his share of goodwill in cash. Joney belongs to a Religious minority community and isexpert in business management. He contributes ` 50,000 as his capital and old partners want to pass an adjusting entry for the treatment of goodwill.

(c) **Identify the value is involved in this question** and pass the journal entries on admission of Joney. Also calculate the new profit sharing ratio. Amar and Bashir are sharing profits in the ratio of 3:2 respectively. They admit their friend Chandni with one fourth share in the future profits. Chandni belongs to economic weaker section of the society and not able to bring her share of goodwill. Goodwill of the firm is valued at ` 20,000. Chandni contributes ` 30,000 as her share of capital.

Identify the value involved in this question. Give Journal entries in the books of the firm to record the above transactions.

Chapter - 5

Retirement/Death of a Partner

Synopsis:

- ✓ Retirement of a partner takes place when a partner leaves the partnership and remaining partners continue the business. The reason for retirement can be old age, change of resident, ill health, development of mistrust with other partners etc. Here the old partnership comes to an end and new partnership comes into existence.
- ✓ Accounting treatment of goodwill requires debiting the remaining partners for their gain in goodwill and crediting the retiring partner for his or her sacrifice in goodwill. (Goodwill already appearing in the books of account should be first written off by debiting old partners in old profit sharing ratio).
- ✓ Revaluation of assets and reassessment of liabilities is carried out in the same manner as in case of admission and net profit or loss transferred to old partners in old profit sharing ratio.
- ✓ Undistributed profits are also transferred to old partners in old ratio.
- ✓ The final dues of the retiring partner are worked out by giving him or her share in undistributed profits, share in revaluation profits or losses, share of goodwill by transfer from continuing partners. Some payment may be made in cash and unpaid balance is transferred to the loan account of the retiring partner.

- ✓ Some of the questions say the retiring partner is paid off by the money brought by continuing partner in such a way that their capitals are proportionate after leaving a certain bank balance.

- In such a case we first find the money payable to retiring partner after all adjustments. Then find the cash that can be used from the cash box for payment to retiring partner (this is cash in hand less minimum cash balance required). The money the continuing partners need bring in cash is equal to total money payable to retiring partner less cash available from cash box)

- The total capital of new firm will be the combined capital of continuing partners after all adjustments plus money to be brought by them. Divide this total capital into new profit sharing ratio (which if not given is assumed to be their old mutual ratio) and you get required capital of the continuing partners. Cash to be brought by a partner is equal to required capital less actual capital.

- ✓ The questions sometimes may inform that total capital of the new firm is to be a particular amount. Find required capital and pass the entry for cash adjustment.

One Marks Questions

1 A, B and C were partners in the ratio 3:2:1. C retires and all his share of goodwill is paid by A. What is B's new share?

2 Kanjli, Manjhli and Savanli are three partners sharing profits in the ratio of 4:3:2. Kanjli retires, Manjli and Savanli decided to share profits in the ratio of 5:3. Calculating the gaining ratio.

Four Marks Questions:

Q 1. A, B and C are partners sharing profits in the ratio of 1:2:3. C retires and his capital, after making adjustments for reserves and profit on revaluation stands at Rs.2,20,000. A and B agreed to pay him Rs.2,50,000 in full settlement of his claim. Record necessary journal entry for the treatment of goodwill if the new profit sharing ratio is decided at 1:

Eight Marks Questions:

Q 1 On 31st December, 2006 the balance sheet of A, B and C, who were sharing profits and losses in proportion of their capitals, stood as follows:

Liabilities	Rupees	Assets		Rupees
Creditors	10800	Cash at Bank		8000
A's Capital	45000	Debtors	Rs.10000	
B's Capital	30000	Less Provision	200	9800
C's Capital	15000	Stock		9000
		Machinery		24000
		Land and Buildings		50000
	100800			100800

B retires and the following readjustments of assets and liabilities have been agreed upon before the ascertainment of amount payable to B:

(i) That Land and Building be appreciated by 12%

(ii) That provision for Doubtful Debts be brought upto 5% of debtors.

(iii) That Provision of Rs.3900 be made in respect of a bill for repairs.

(iv) That Goodwill of entire firm be fixed at Rs.18000 and B's share of the same be adjusted into the accounts of A and C, who are going to share future profits in the proportion of 3/4th and 1/4th respectively.

(v) That B be paid Rs.5000 immediately and the balance to be transferred to his Loan Account Prepare Revaluation Account, Capital Accounts of Partners and the Balance Sheet of the firm of A and C.

(vi) What value highlighted in above problem.

Q 2 The Balance Sheet of **X ,Y** and **Z** who were sharing profit ratio of 5: 3: 2as at March31,2007:

Liabilities	**Rs.**	**Assets**	**Rs.**

Creditors	**50,000**	**Cash at Bank**	**40,000**
Employees fund	**10,000**	**Sundry Creditors**	**1,00,000**
Profit & Loss A/c	**85,000**	**Stock**	**80,000**
Capital Accounts:		**Fixed Assets**	**60,000**
X 40,000			
Y 62,000			
Z 33,000			
	1,35,000		
	2,80,000		**2,80,000**

X retired on March, 31 2007, Y and **Z** decided to share profits in future in the ratio of 2: 3 respectively.

The other terms on retirement were as follows:

(1) Goodwill of the firm is to be valued at Rs 80,000.

(2) Fixed Assets are be depreciated to Rs 57,500

(3) Make a provision for doubtful debts at 5% on debtors.

(4) A liability for claim, included in creditors for Rs 10,000 is settled at Rs 8,000

(5) The amount to be paid X by **Y** and **Z** in such a way that their Capitals are proportionate to their profits sharing ratio and leave a balance of Rs 15,000 in the Bank account.

Prepare Profit and Loss Adjustment account and Partners Capital Accounts.

Q 3. X, Y and Z are sharing profits and losses in proportion to their capitals, stood as follows:

Balance Sheet as at

Liabilities		Rs.	Assets		Rs.
Creditors		10,800	Cash at Bank		8,000
Capital:			Debtors	10,000	
X	45,000		Less: Prov.	200	9,800
Y	30,000		Stock		9,000
Z	15,000	90,000	Machinery		24,000
			Land and Building		50,000
		1,00,800			1,00,800

Y retires and the following readjustments of assets and liabilities have been agreed upon before the ascertainment of the amount payable to Y:

1. That land and Buildings be appreciated by 12%.
2. That Provision for Doubtful Debts be brought up to 5% of Debtors.
3. That a provision of Rs. 3,900 be made in respect of an outstanding bill for repairs.
4. That Goodwill of the entire firm be fixed at Rs. 18,000 and Y's Share of the same be adjusted into the accounts of X & Z, who are going to share future profits in the proportion of ¾th and ¼th respectively.
5. That Y is paid Rs. 5,000 immediately and the balance to be transferred to his loan a/c.

Prepare revaluation a/c, Capital a/c and the Balance Sheet of the firm of X and Z.

Chapter – 5 (Continue)

Death of Partner

Synopsis:

- ✓ Death of the partner brings existing partnership to an end and remaining partners may continue the business. Retirement of the partner can be planned but death is sudden any time during the year beyond anybody's control. Often the partners provide in the partnership deed about the method to calculate deceased partner dues payable to legal representatives called 'Executors'.
- ✓ The accounting concept explained in case of retirement of partner is applicable to the case of death of the partner. (i.e. treatment of goodwill, undistributed profits, revaluation account, partner's capital accounts, and capitals to be proportionate)
- ✓ Death requires calculation of share of deceased partner in current year's estimated profits (which can be taken as last year profits or average of last few years as per the language of the question). This can be done on time basis (i.e. estimated profit X fraction of the year partner was alive X share of the partner) or on turnover basis (i.e. estimated profit X sales/ estimated sales X share of deceased partner). We debit profit & loss suspense account and credit the decease partner for this amount.
- ✓ The question may also require allowing interest on capital; charging interest on drawings; and recovering drawings till the date of death from the account of the deceased partner.
- ✓ The final balance in deceased partner capital account is transferred to that partner's executor's account. This account is a liability in the balance sheet.
- ✓ The legal representatives of deceased partner are entitled to interest @6% on balance due till the date it is paid off or share in profits earned by the firm on the amount outstanding.

One Marks Questions

1 X, Y and Z were partners in the ratio 5:2:3. Z died on 30th June, 2007. What is Z's share of profit when profit for the year ending 31st December, 2007 is estimated to be Rs.60000?

Four Marks Question:

Q 1. X, Y and Z were in partnership sharing profits and losses in the ratio of 5:3:2. It was provided in the deed on the death of any partner the Goodwill will be valued at 4 times of his share in the average profit of 4 years preceding his death. The profit upto the death will be based on 10% margin of sales up to the date of death. Z died on 15th of May 2004. Total sales up to date of death were Rs 1,01,5000. Profit s for the last four years ending March 31, were as follows: 2000-01, Rs 70,000; 2001-02, Rs 1,00,000; 2002-03, Rs 90,000; 2003-04, Rs 1,40,000.

Calculate Z's share of Goodwill and his share of profit till the date of his death.

Six Marks Question:

Q 1 Ram, Mohan and Sohan were partners sharing profits and losses in the ratio of 5:3:2. On 31st March, 2006 their Balance Sheet was as under:

Liabilities	Rupees	Assets	Rupees
Ram's Capital	150000	Leasehold	125000
Mohan's Capital	125000	Patents	30000
Sohan's Capital	75000	Machinery	150000
Creditors	155000	Stock	190000

Workmen's Compensation Reserve	30000	Cash at Bank	40000
Total	535000	Total	535000

Sohan died on 1st August, 2006. It was agreed that:

(i) Goodwill of the firm is to be valued at Rs.175000.

(ii) Machinery be valued at Rs.140000; Patents at Rs.40000; Leasehold at Rs.150000 on this date.

(iii) For the purpose of calculating Sohan's share in the profits of 2006-07, the profits

(iv) Should be taken to have accrued on the same scale as in 2005-06, which were Rs.75000.

Prepare Sohan's Capital Account and Revaluation Account.

Q 2 In the partnership agreement among Angle, Border and Circle, who were sharing profits as 2:1:1, the goodwill was to be valued on the death of any partner on the basis of such partner's share of 2 years profits, calculated on the average of 5 years profits immediately preceding the year of death less 10%. The firms profits were Rs.15000 in 2001, Rs.25000 in 2002, Rs.40,000 in 2003, and a loss of Rs.5000 in 2004 and Rs.2000 in 2005. The deceased partner's share of profit for the period of his life time in the year of death was to be based on the average of the profits of the previous 3 years plus 10%.

Angle died on March 14, 2006. His capital account showed a credit of Rs.20000 on January 1, 2006 and he had drawn Rs.3000 since that date.

Show the amount of goodwill and the share of profits payable to him. Prepare Angle's Capital Account to be rendered to his executors.

Q 3 X, Y and Z carried on business in partnership, sharing profits and losses in proportion of 1:2:3. Their capitals were as under as per the Balance Sheet as at 30th June, 2007 were X Rs.15000, Y Rs.20000 and Z Rs.30000.

On 31st March, 2008 X died, and you are instructed to prepare an account for presentation to his executors having regard to the following facts:

(i) Capitals carried interest @ 12% per annum.

(ii) X's drawings from 1st July 2007 to the date of his death amounted to Rs.4500.

(iii) X's share of profits for the portion of the current financial year which he lived was to be taken at the sum calculated on the average of last three completed years and the goodwill was to be valued on the basis of two years purchase of the average profit of those three years.

(iv) The annual profits of preceding three years were Rs.17500, Rs.16000 and Rs.19000 respectively.

Pass the necessary journal entries and show the account of the deceased partner to be rendered to his executors.

Q 4. Rhino, Rat and Rabbit were partners sharing profits and losses in the ratio of 5:3:2. On 31st March 2006 their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Capitals:		Leasehold	1,25,000
Rhino		Patents	30,000
1,50,000		Machinery	1,50,000
Rat	3,50,000	Stock	1,90,000
1,25,000	1,55,000	Cash at	40,000
Rabbit		Bank	
75,000	30,000		
Creditors	5,35,000		5,35,000
Workmen's			
Compensation			
Reserve			

Rabbit died on 1st August 2006. It was agreed that:

1. Goodwill of the firm is to be valued at Rs. 1,75,000
2. Machinery to be valued at Rs. 1,40,000, Patents at Rs. 40,000, Leasehold at Rs. 1,50,000 on this date
3. For the purpose of calculating Rabbit's Share in the profits of 2006-07, the profits should be taken to have accrued on the same scale as in 2005-06, which were Rs. 75,000.

Prepare Rabbit's Capital Account and Revaluation A

Q 5. Dutta, Khana and Govil are partners sharing in the ratio of 2:2:1.The Balance Sheet of the firm was as under 31st Dec.2004.

Liabilities	Rs.	Assets	Rs.
Sundry creditors	5,000	Cash at Bank	1,000
Biils payable	2,000	Bills receivable	1,500
Reserves	3,000	Stock	12,500
Capitals:		Debtors	15,000
Dutta 10,000		Furniture	5,000
Khana 8,000			
Govil 7,000	25, 000		
	35,000		35,000

Govil died on 1-2-2004.His legal heirs were entitled for the following:

(a) His capital on the date of death. (b) His share of profit to the date of death calculated on the basis of previous year's profits.(c) His share of goodwill – the total of the business was valuated at two years purchase of the average profits of the last three completed years. The profits were Rs 8,000;Rs 13,000; and Rs 15,000 respectively.(d) Share in the profit or loss arising out of the revaluation of assets and liabilities. The assets were revaluated as under: Stock at Rs 12,000; Furniture at Rs 4,000 and provision for bad debts was made at 5% on debtors.

Prepare revaluation A/c, Partnership capital A/c and ascertain the share of the executors of the deceased partner.

What value is highlighted above problem?

Chapter - 6

Dissolution of a Partnership Firm

Synopsys:

- ✓ Dissolution means discontinuance. Dissolution of firm means dissolution of partnership between all the partners of the firm. Dissolution of partnership firm may take place due to mutual agreement or by order of court in certain cases.

- ✓ Assets of the firm are disposed off for cash or a partner takes over an asset or an asset may be given to a creditor in settlement of their dues. When the assets realize at an amount different from book value which would mean profit or loss. If liabilities are settled at an amount different from book value that also results in profit or loss.

- ✓ Realization account is prepared to work out such profit of loss due to realization of assets and payment of liabilities and realization expenses. This is done in five steps:

- First we transfer all assets other than cash and bank to the debit side of realization account by debiting realization account and crediting the respective assets at book value. The related provision or reserve or fund of asset being transferred is also transferred to the credit side of realization account by debiting such provisions or reserves or funds and crediting realization account.

- Second all external liabilities are transferred to the credit side of realization account by debiting the concerned liability and crediting realization account at book value of those external liabilities. (Note that the partner's loan is not an external liability and is not transferred to credit of realization account.)

- Third realization account is credited with realized value of the assets and cash or bank account is debited when sold for cash and partner's capital account is debited when partner takes over the asset. (No entry is passed when the asset is given in settlement of liability, but only balance amount if any of that liability is paid.)

- Fourth realization account is debited for the settlement amount of the external liabilities and cash or bank is credited when paid in cash or by cheque. In case where partner takes over the liability the capital account of that partner is credited.

- Fifth the realization account is debited for expenses of realization and cash or bank is credited when paid. If partner pays or there is agreement with the partner then capital account that partner's capital account is credited.

- The realization account is balanced and profit or loss is transferred to partner's capital account.

✓ All undistributed profits and losses are transferred to partner's capital accounts in the profit sharing ratio of the partners.

✓ We prepare all partners capital accounts crediting with opening balance, share in profits, and for liabilities taken over; debiting with share in losses and assets taken over; the balance is deficiency is recovered in cash and is payable is paid in cash. There is no balance carried forward as business and books are closed down.

✓ Last we prepare cash or bank account with opening balance and cash received entries on debit side and payment of expenses, external liabilities, partner's loan and final amount due to partners on credit side. Zero balance in cash account proves the arithmetic accuracy of the working.

✓ Sometimes the question does not give the balance sheet on the date of dissolution and rather informs about the balance of capital and external liabilities and may be one asset. In such a case there is need for preparing memorandum balance sheet by putting the liabilities and give asset on respective side of the balance sheet. The balancing figure on assets side can be called sundry assets or other assets. After this step it becomes a normal question.

✓ Students should also be strong in passing journal entries for transactions relating to dissolution of partnership (because many a times the question asked is to pass journal entries for given transactions in case of dissolution of partnership)

One Marks Questions

Q 1 What journal entry will you pass when an asset is given away to any of the firm's creditor for his dues?

Q 2 What is memorandum balance sheet?

Q 3 What is the proof of arithmetical accuracy in solving the dissolution of partnership firm question?

Q 4 Give any two grounds on which the court can order dissolution of partnership firm.

Q 5 Give journal entry for settlement of creditors of 50,000 by transferring firm's car at agreed value of Rs.38,000 and goods worth 12,000.

Four Marks Questions:

Q 1 Pass necessary journal entries for the following transaction at the time of dissolution of the firm.

A. Loan of Rs. 10,000 advanced by a partner Mr.Abu was refunded.

B. Undistributed balance (Dr.) of profit & loss A/c Rs. 30,000. The firm has three partners, Abu, Balu and Chinu.

C. Balu who undertakes to carry out dissolution proceedings is paid Rs.2,000 for the same.

D. Sales of assets for Rs.50,000

Q 2 Pass necessary journal entries for the following transaction at the time of dissolution of the firm of A and B who share profits and losses in the ratio of 5:3.

(a) Credit balance in General reserve Rs.160000.

(b) Unrecorded typewriter sold for Rs.1500.

(c) Joint life policy surrendered for Rs.8,000

(d) B clears the deficiency shown by his account Rs.4000.

Q 3 X and Y were partners in the ratio of 3:2 and they decided to dissolve the firm. On that date their capitals were showing the balance of X Rs.80,000 and Y Rs.60,000 while creditors amounted to Rs.48,000. The assets realized Rs.1,77,000. Creditors of Rs.32,000 were taken over by X at Rs.28,000. Remaining creditors were paid Rs.15,000. The expenses were Rs.1,000.

Prepare necessary accounts.

Eight Marks Questions:

1. X and Y were partners sharing profit in the ratio of 3:2. In spite of the repeated reminders by the government authorities they kept dumping hazardous waste material into the nearby

river. The court ordered for the dissolution of their partnership firm on 31st March 2014. Their balance sheet as at 31st March 2014 was as follows:

Balance Sheet

Liabilities		`	Assets		`
Mrs. X's Loan		20,000	Cash		40,000
Creditors		1,00,000	Debtors	1,84,000	
C's Loan		80,000	Less Provision	4,000	1,80,000
General Reserve		30,000	Inventory		1,20,000
Capitals:		50,000	Furniture		60,000
X	3,60,000	6,00,000	Building		3,80,000
Y	2,40,000				
		7,80,000			**7,80,000**

On the above the firm dissolved under the following terms:

i) X was appointed to realise the assets and pay off the liabilities. He had to bear the realisation expenses for which he was paid `3,000.
ii) A Motor Bike (which was bought out of firm's money) was not shown in the books of the firm. It was taken over by Y for `10,000.
iii) X agreed to pay his wife's loan along with the interest of `1,000.
iv) The Creditors were due on an average basis of one month after the date of dissolution but they were paid immediately at a discount of `500.
v) Inventory was taken over by X at 10 % less.
vi) Furniture was taken over by Y at 10 % more.
vii) The Building realised at `50,000 more.
viii) The Realisation expenses amounted to ` 1,000.

Prepare Realisation Account and identify the value being conveyed in the question

2. A,B and C are partners sharing profits in the ratio of 3:2:1. The Balance sheet of the firm on 31st December 200 was as follows:

Liabilities		**Assets**	
Creditors	65,000	Cash	22,500
B/P	20,000	Debtors	52,300
President fund	12,000	Stock	36,000
Investment fund	6,000	Investment	15,000
Commission received		Plant	91,200
In advance	8,000	Profit & Loss A/c	54,000
Capital A	80,000		
B	50,000		
C	30,000		
	2,71,000		2,71,000

On this date the firm was dissolved Mr. A was appointed to realize the assets Mr. A was to receive 5% commission on sale of assets. (except cash) and was to bear all expenses of realization. A realized the assets as follows.
Debtors – Rs.30,000, stock – Rs.26,000, Investment – 75% of the book value, plant – Rs.42,750. Expenses of – Rs.4,100.
Commission received in advance was returned to customers after deducting Rs.3,000. The firm had to pay Rs.7,100 for outstanding salary not employees amounted to Rs.9,800. This liability was not provided for in the above balance sheet. Rs.25,000 had to be paid for provident fund.

3. Dipali and Rajashri are partners in a firm sharing profits and losses in the ratio of 3:2. They decided to dissolve their firm on 31st December, 1994 when their Balance Sheet was as under:

Balance Sheet

Liabilities	Amount	Assets	Amount
Capital Accounts:		Freehold Property	16,000
Dipali 17,500		Investments	4,000
Rajashri 10,000	27,500	Sundry Debtors	2,000
Sundry Creditors	2,000	Stock	3,000
Profit & Loss Account	1,500	Bank	2,000
		Cash	4,000
	31,000		31,000

Dipali took over the investments at an agreed value of Rs.3,800, other assets were realised as follows:
Freehold property Rs.18,000; Sundry Debtors Rs.1,800 and Stock Rs.2,800.
Creditors of the firm agreed to accept 5% less. Expenses of realisation amounted to rs.400. There was a typewriter in the firm bought out of the firm's money, but the same has not been shown in the above Balance Sheet. The typewriter is now sold for Rs.10,000.
Close the firm's books of accounts by preparing a Realisation Account, Partner's Capital Accounts and Cash Account.