4. RETIREMENT / DEATH OF A PARTNER

4.1 Amounts due to a Retiring / Deceased Partner

Retirement from Partnership means ceasing to be a Partner in a Firm. The Firm continues as such, and the Retiring Partner is entitled to the following amounts –

1. Balance in his Capital / Current Accounts (net of Drawings and Interest on Drawings, if any),
2. Share of Goodwill,
3. Share in Gain / Loss of Revaluation of Assets and Liabilities,
4. Share of Accumulated Profits / Reserves and Losses, if any,
5. Share in Profits of the current year (till the date of retirement / death), and
6. Interest on Capital, Salary, etc. if any, due to him till the date of his retirement / death.

Note: As per Section 37 of the Partnership Act, 1932, the representatives of a Deceased Partner are entitled to receive, at their option – (a) interest at the rate of 6% p.a, or (b) share of profits earned, for the amount due to the Deceased Partner, till the amount is settled in full.

4.2 Accounting issues in case of Retirement of a Partner

The accounting issues in case of retirement of Partner are –

1. Change in Profit Sharing Ratio,
2. Treatment of Goodwill on Retirement,
3. Revaluation of Assets and Liabilities, and distribution of such profit / loss,
4. Transfer of Reserves and Accumulated Losses, if any, as per Balance Sheet,
5. Adjustment of Capitals, if any.
6. Joint Life Policy, if any.

4.3 Compute of the New PSR of Continuing Partners in case of Retirement of Partner

New Share = Old Share + Acquired Share. So, the Continuing Partners may acquire the share of the Retiring Partner, in any of the following manner –

1. In a specified / agreed ratio.
2. In the Old Profit Sharing Ratio itself.

4.4 Journal Entries in connection with Retirement / Death of a Partner.

	Transaction / Issue involved	Journal Entry
1.	Old Goodwill, if any, appearing in B/Sheet	All Partner's Capital (Individually in Old PSR) Dr. To Goodwill A/c
2.	Goodwill credited to Retiring Partner / Sacrificing Partners, and borne by Gaining Partners in Gain Ratio	Gaining Partners' A/c(Individually in Gain Ratio) Dr. To Retiring / Deceased Partners' A/c To Sacrificing Partners' A/c (if any of the Continuing Partners also make a sacrifice)
3.	Recording – (a) increase in value of Assets, and (b) reduction in amount of Liabilities	Assets (Individually) A/c Dr. Liabilities (Individually) A/c Dr. To Revaluation A/c
4.	Recording – (a) decrease in value of Assets, and (b) increase in amount of Liabilities	Revaluation A/c Dr. To Assets (Individually) A/c To Liabilities (Individually) A/c

	Transaction / Issue involved	Journal Entry
5.	Recording Unrecorded Assets	Assets (Individually) A/c Dr. To Revaluation A/c
6.	Recording Unrecorded Liabilities	Revaluation A/c Dr. To Liabilities (Individually) A/c
7.	Transfer of Revaluation Gain	Revaluation A/c Dr. To All Partner's Capital (Individually in Old PSR)
8.	Transfer of Revaluation Loss, if any	All Partner's Capital (Individually in Old PSR) Dr. To Revaluation A/c
9.	Distribution of Reserves and Surplus as per Balance Sheet	Reserves A/c (Individually) Dr. To All Partner's Capital (Individually in Old PSR)
10.	Transfer of Reserves, if Continuing Partners want to show the Reserves in the B/Sheet	Gaining Partners' A/c(Individually in Gain Ratio) Dr. To Retiring / Deceased Partners' A/c To Sacrificing Partners' A/c (if any of the Continuing Partners also make a sacrifice)
11.	Distribution of Accumulated Losses, Deferred Revenue Expenditure, as per B/Sheet	Old Partner's Capital (Individually in Old PSR) Dr. To Accumulated Losses / Deferred Rev.Exp.
12.	Share of Profit of Deceased Partner	Profit and Loss Suspense A/c Dr. To Deceased Partners' Capital A/c
13.	Settlement of Amount due to Retiring Partner / Transfer to Loan A/c, etc.	Retiring Partners' Capital A/c Dr. To Cash / Bank (to the extent settled) To Bills Payable (if B/E accepted for amt due) To ...... Loan A/c (unpaid amt tfr to Loan a/c) To Deceased Partners' Executors' A/c (in case of Deceased Partners' A/c tfr to Executor's A/c)

Note: In Entries 3 to 8 above, the Account can also be called as "Profit and Loss Adjustment A/c", instead of the head "Revaluation A/c".

4.5 Payment of Retiring Partners' Loan Amount in instalments.

The amount due to a Retiring Partner is settled to him based on the funds position of the Firm. Sometimes, it may be agreed that the amount due to him be settled in certain number of equal instalments. In such case, the amount paid every year = Principal Due + Interest on Unpaid Portion for that year.

Example: If the amount due to a Retiring Partner is ₹ 30,000, to be paid in four annual equal instalments and the loan is to carry interest at 6% per annum, the payment every year is as under –

Year	Principal	Interest	Total
1	7,500	30,000 × 6% = ₹ 1,800	7,500 + 1,800 = ₹ 9,300
2	7,500	(30,000 – 7,500) × 6% = ₹ 1,350	7,500 + 1,350 = ₹ 8,850
3	7,500	(22,500 – 7,500) × 6% = ₹ 900	7,500 + 900 = ₹ 8,400
4	7,500	(15,000 – 7,500) × 6% = ₹ 450	7,500 + 450 = ₹ 7,950

4.6 Joint life Policy – Retirement / Death

1. **Purpose:** A Partnership Firm may take a Joint Life Insurance Policy (JLP) on the lives of all its Partners. The objective of taking out a JLP is to provide sufficient funds in case of settlement due to Retiring Partner or Legal Representatives of a Deceased Partner.

2. **Operation:** The Firm pays the Premium Amount on the JLP. The amount of policy is payable to the Firm upon death of any Partner, or maturity of the policy, whichever falls earlier.

3. **Accounting Treatment:**

Method	**Method 1**	**Method 2**	**Method 3**
Transaction	**Premium paid is treated as an Expense**	**Premium paid is treated as an Asset**	**Creation of Joint Policy Reserve Account**
Premium paid every year	JLP Premium A/c Dr. To Bank A/c	Joint Life Policy A/c Dr. To Bank A/c	Joint Life Policy A/c Dr. To Bank A/c
Transfer of Premium to Profit & Loss A/c	Profit and Loss A/c Dr. To JLP Premium (Premium written off)	Profit and Loss A/c Dr. To Joint Life Policy A/c (Tfr Amt = Premium Paid **less** Surrender Value)	P&L Approp. A/c Dr. To JLP Reserve A/c (Tfr Amt = Premium Paid)
Adjustment to bring JLP to Surrender Value	Not Applicable	This aspect is already considered in the earlier entry.	JLP Reserve A/c Dr. To Joint Life Policy A/c (Tfr Amt = Premium Paid **less** Surrender Value)
Receipt of Policy amount	Bank A/c Dr. To Joint Life Policy A/c	Bank A/c Dr. To Joint Life Policy A/c To Profit on JLP A/c	Bank A/c Dr. To Joint Life Policy A/c
Excess Amount received over Surrender Value	–	–	Joint Life Policy A/c Dr. To JLP Reserve A/c
Tfr to Partners' Capital A/cs	Joint Life Policy A/c Dr. To All Partners' Cap. A/c	Profit on JLP A/c Dr. To All Partners' Cap. A/c	JLP Reserve A/c Dr. To All Partners' Cap.A/c

Illustration 1: Retirement – Computation of New PSR and Gain Ratio

X, Y and Z are Partners sharing profits in the ratio of 5/10 : 4/10 : 1/10. Find out the New Ratio of the Remaining Partners if (a) X retires, (b) Y retires, and (iii) Z retires.

Solution: Unless otherwise specified, the New Ratio of the Remaining Partners will be taken by striking out the share of the Outgoing Partner. So,

1. If X retires, then the ratio between Y and Z is 4 : 1.
2. If Y retires, then the ratio between X and Z is 5 : 1.
3. If Z retires, then the ratio between X and Y is 5 : 4.

Note: In each case, the Gain Ratio is the same as the Old Ratio between the Continuing Partners.

Illustration 2: Retirement – Computation of New PSR

A, B and C are sharing profits and losses in the ratio of 5:3:2. B retires. His share is taken by A and C in the ratio of 2:1. Calculate the New Profit Sharing Ratio.

Solution:

Particulars	**A**	**B (Retiring)**	**C**
1. Old PSR	5/10	3/10	2/10
2. Gain / Sacrifice	Gain = 2/3 of 3/10 = 2/10	– 3/8 Sacrifice	Gain = 1/3 of 3/10 = 1/10
3. New PSR (1+2)	5/10 + 2/10 = 7/10	Nil	2/10 + 1/10 = 3/10

Hence, **New PSR is 7: 3**, and **Gain Ratio is 2 : 1** (Given)

Illustration 3: Retirement – Computation of New PSR

A, B and C are Partners sharing in the ratio of 2:2:1. B retires and his share is taken by C. Compute New Ratio of A & C.

Solution:

Particulars	**A**	**B (Retiring)**	**C**
1. Old PSR	2/5	2/5	1/5
2. Gain / Sacrifice	Nil	– 2/5 Sacrifice	+ 2/5 Gain
3. New PSR (1+2)	2/5	Nil	1/5 + 2/5 = 3/5

Hence, **New PSR is 2: 3.**

Illustration 4: Retirement – Computation of Gain Ratio

A, B and C are Partners sharing profits and losses in the ratio of ½, 3/10 and 1/5. B retires from the Firm and A and C decide to share future profits and losses in the ratio of 3 : 2. Calculate the Gaining Ratio.

Solution:

Particulars	A	B (Retiring)	C
1. Old PSR	½ = 5/10	3/10	1/5 = 2/10
2. New PSR (given)	3/5	Nil	2/5
3. (Gain) / Sacrifice (1 – 2)	–1/10 Gain	3/10 Sacrifice	– 2/10 Gain

Hence, **New PSR is 3 : 2** (given) and **Gain Ratio is 1:2.**

Illustration 5: Retirement – Computation of New PSR and Gain Ratio

A, B and C are partners with capitals of ₹ 1,00,000, ₹ 75,000 and ₹ 50,000 respectively. On C's retirement, his share is acquired by A and B in the ratio 3: 2. Ascertain the new Profit–Sharing Ratio and the Gaining Ratio.

Solution:

Particulars	A	B	C (Retiring)
1. Old PSR (equal Partners)	1/3	1/3	1/3
2. Gain / Sacrifice	3/5 of 1/3 = 3/15	2/5 of 1/3 = 2/15	– 1/3 Sacrifice
3. New PSR (1+2)	1/3 + 3/15 = 8/15	1/3 + 2/15 = 7/15	Nil

Hence, **New PSR is 8 : 7** and **Gain Ratio is 3:2** (given).

Illustration 6: Retirement – Computation of New PSR, Payment of Profits to Retiring Partner

A, B and C are Partners sharing Profits and Losses in the ratio 4 : 3 : 1. B retires, selling his share of Profits to A and C for ₹ 8,100, ₹ 3,600 paid by A and ₹ 4,500 by C. The Profits for the year after B's retirement was ₹ 10,500.

(a) Calculate New Profit–Sharing Ratio, and distribute the Profits between A and C, who bring the necessary cash.

(b) Give the necessary Journal entries to record the above said sale of B's share to A and C.

Solution: **1. Computation of New PSR and Gain Ratio**

It is given that A and C paid ₹ 8,100 to B,in the ratio of ₹ 3,600 and ₹ 4,500, i.e. 4:5. Hence, they will divide B's share between themselves in the ratio of 4:5.

Particulars	A	B (Retiring)	C
1. Old PSR	4/8	3/8	1/8
2. Gain / Sacrifice	4/9 of 3/8 = 4/24	– 3/8 Sacrifice	5/9 of 3/8 = 5/24
3. New PSR (1+2)	4/8 + 4/24 = 16/24	Nil	1/8 + 5/24 = 8/24

Hence, **New PSR is** 16: 8 or **2: 1**, and **Gain Ratio is 4 : 5** (Given)

2. Journal Entries

	Particulars		Dr.	Cr.
1.	Cash A/c	Dr.	8,100	
	To A's Capital A/c			3,600
	To C's Capital A/c			4,500
	(Being the amount brought in by A and C to pay B on his retirement)			
2.	B's Capital A/c	Dr.	8,100	
	To Cash A/c			8.100
	(Being the amount paid to B on his retirement for selling his share)			
3.	Profit and Loss Appropriation A/c	Dr.	10,500	
	To A's Capital A/c			7,000
	To C's Capital A/c			3,500
	(Being Profit distributed to A & C after B's retirement in New Ratio 2 : 1)			

Note: It is given that first A and C bring in cash for acquiring B's share and after that cash is given to B for purchasing his share.

Illustration 7: New PSR and Gain Ratio, Treatment of Goodwill

A, B, C and D are Partners in a Firm sharing profits in 2 : 1 : 2 : 1 ratio. On the retirement of C, the Goodwill was valued at ₹ 72,000. A, B and D decided to share future profits equally. You are required to – (a) compute New PSR, and (b) make adjustments entries for Goodwill.

Solution: **1. Computation of New PSR and Gain Ratio**

Particulars	A	B	C (Retiring)	D
1. Old PSR	2/6	1/6	2/6	1/6
2. New PSR (given)	1/3	1/3	Nil	1/3
3. (Gain) / Sacrifice (1 – 2)	Nil	– 1/6 Gain	2/6 Sacrifice	– 1/6 Gain

Hence, **New PSR is 1 : 1 : 1 : 1**, and **Gain Ratio is** 1 : 1 (between B and D only)

2. Treatment of Goodwill

C is entitled to 2/6th Share of Goodwill, i.e. ₹ 72,000 × 2/6 = ₹ 24,000. This will be debited to the Continuing Partners' Capital Accounts in the Gaining Ratio.	B's Capital A/c	Dr.	12,000
	D's Capital A/c	Dr.	12,000
	To C's Capital A/c		24,000

Illustration 8: New PSR and Gain Ratio, Treatment of Goodwill

X, Y and Z are Partners sharing Profits in the ratio 2:3:5. Goodwill appears in their books at a value of ₹ 50,000 . X retires and on the day of X's retirement, Goodwill is valued at ₹ 45,000. Y and Z decided to share the future profits equally. Compute Gain Ratio, and pass the necessary Journal entries for Goodwill.

Solution: **1. Computation of New PSR and Gain Ratio**

Particulars	X (Retiring)	Y	Z
1. Old PSR	2/10	3/10	5/10
2. New PSR (given)	Nil	½	½
3. (Gain) / Sacrifice (1 – 2)	2/10 Sacrifice	– 2/10 Gain	Nil

Hence, **New PSR is 1 : 1**, and there is no Gain Ratio, since Y gains fully consequent to X's retirement.

2. Journal Entries

	Particulars		Dr.	Cr.
1.	X's Capital A/c	Dr.	10,000	
	Y's Capital A/c	Dr.	15,000	
	Z's Capital A/c	Dr.	25,000	
	To Goodwill A/c			50,000
	(Being Goodwill appearing in the books written off in the Old Ratio)			
2.	Y's Capital A/c	Dr.	9,000	
	To X's Capital A/c (2/10 of ₹ 45,000)			9,000
	(Being X's share of G/w debited to Y's a/c, due to gain on X's retirement)			

Illustration 9: Sacrifice by Retiring Partner and Continuing Partner – G/w Adjustment

X, Y and Z were Partners in a Firm sharing Profits in the ratio of 3:2:1. Z retired and the new Profit Sharing Ratio between X and Y was 1:2. On Z's retirement the Goodwill of the Firm was valued at ₹ 30,000. Compute Gain Ratio, and pass the necessary Journal entries for Goodwill.

Solution: **1. Computation of New PSR and Gain Ratio**

Particulars	X	Y	Z (Retiring)
1. Old PSR	3/6	2/6	1/6
2. New PSR (given)	1/3	2/3	Nil
3. (Gain) / Sacrifice (1 – 2)	1/6 Sacrifice	– 2/6 Gain	1/6 Sacrifice

Hence, **New PSR is 1 : 2** (given). Y gains from both X and Z, upon reconstitution of Firm.

2. Treatment of Goodwill: Here, Y, the Gaining Partner has to compensate both X and Z for their sacrifice.

Particulars		Dr.	Cr.
Y's Capital A/c (2/6th of ₹ 30,000)	Dr.	10,000	
To X's Capital A/c (1/6th of ₹ 30,000)			5,000
To Z's Capital A/c (1/6th of ₹ 30,000)			5,000
(Being compensation of Y to X and Z for Share in Goodwill, for the sacrifice made by them on Z's retirement)			

Illustration 10: Sacrifice by Retiring Partner and Continuing Partner – G/w Adjustment

P, Q, R and S are Partners sharing profits in the ratio of 3 : 2 : 3 : 2. On the retirement of R, Goodwill was valued at ₹ 2,40,000. R's Share of Goodwill will be given by adjusting it into the Capital Accounts of P, Q and S. Give the necessary entries for the treatment of Goodwill, if the new Profit–Sharing Ratio is 3 : 1 : 6.

Solution: **1. Computation of Gain / Sacrifice**

Particulars	P	Q	R (Retiring)	S
1. Old PSR	3/10	2/10	3/10	2/10
2. New PSR (given)	3/10	1/10	–	6/10
3. (Gain) / Sacrifice (1 – 2)	Nil	1/10 Sacrifice	3/10 Sacrifice	– 4/10 Gain

Hence, Q and R have sacrificed in favour of S, upon retirement of R from the Firm.

2. Treatment of Goodwill

Here, S, the Gaining Partner has to compensate both Q and S for the sacrifice made by them.

Particulars		Dr.	Cr.
S's Capital A/c (4/10th of ₹ 2,40,000)	Dr.	96,000	
To Q's Capital A/c (1/10th of ₹ 2,40,000)			24,000
To R's Capital A/c (3/10th of ₹ 2,40,000)			72,000
(Being compensation of S to Q and R for Share in Goodwill, for the sacrifice made by them on R's retirement)			

Illustration 11: Retirement – Hidden Goodwill

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 Profits on Revaluation stands at ₹ 2,20,000. A and B agreed to pay him ₹ 2,50,000 in full settlement of his claim. Record the necessary Journal Entry for the treatment of Goodwill, if the new profit–sharing ratio is decided at 1 : 3.

Solution: **1. Computation of Gain / Sacrifice**

Particulars	A	B	C (Retiring)
1. Old PSR	1/6	2/6	3/6
2. New PSR (given)	¼	¾	–
3. (Gain) / Sacrifice (1 – 2)	– 2/24 Gain	– 10/24 Gain	3/6 = 12/24 Sacrifice

Hence, **New PSR is 1: 3** (given), and **Gain Ratio** is 2 : 10 or **1 : 5.**

2. Treatment of Goodwill

Hidden Goodwill on Retirement = Amount paid to Retiring Partner less Amount due to him as per Books

= ₹ 2,50,000 – Rs2,20,000 = ₹ **30,000.**

Particulars		Dr.	Cr.
A's Capital A/c	Dr.	5,000	
B's Capital A/c	Dr.	25,000	
To C's Capital A/c			30,000
(Being Goodwill due to C on retirement, adjusted in Gain Ratio 1:5)			

Illustration 12: Retirement – G/w Treatment and Revaluation of Assets and Liabilities

X, Y and Z were Partners sharing profits as 3:2:1. Their Balance Sheet on 31st March stood as follows:

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		17,500
X	20,000		Buildings		22,500
Y	15,000		Motor Vans		4,000
Z	12,500	47,500	Stock		12,500
Reserve Fund		6,000	Debtors	8,000	
Creditors		9,500	Less: Provision	250	7,750
Bills Payable		2,500	Cash at bank		1,250
Total		**65,500**	**Total**		**65,500**

Y retired on that date subject to the following conditions:

1. **Goodwill of the Firm be valued at ₹ 9,000 and Y's share of the Goodwill adjusted in the accounts of X and Z.**
2. **Machinery to be depreciated by 10% and Motor Vans by 15%**
3. **Stock to be appreciated by 20% and Building by 10%**
4. **Provision for Doubtful Debts be increased by ₹ 975.**
5. **Provision for Workmen's Compensation to the extent of ₹ 825 to be created.**

It was agreed that X and Z will share Profits in future in the ratio of 3:2 respectively. Prepare the Revaluation A/c, Capital Accounts of the Partners and the Balance Sheet of the Firm after retirement of Y.

Solution:

1. Revaluation Account

Particulars		₹	Particulars	₹
To Bad Debts A/c		975	By Stock A/c	2,500
To Machinery A/c		1,750	By Buildings A/c	2,250
To Motor Vans A/c		600		
To Provision for Workmen's Compensation		825		
To Profit on Revaluation transferred to:				
X's Capital A/c	300			
Y's Capital A/c	200			
Z's Capital A/c	100	600		
Total		**4,750**	**Total**	**4,750**

2. Partners' Capital Accounts

Particulars	X	Y	Z	Particulars	X	Y	Z
To Y's Capital A/c	900	–	2,100	By Balance b/d	20,000	15,000	12,500
To Y's Loan A/c (Note)	–	20,200	–	By Revaluation A/c – Profit	300	200	100
To Balance c/d	22,400	–	11,500	By X's Capital A/c	–	9,00	–
				By Z's Capital A/c	–	2,100	–
				By Reserve Fund	3,000	2,000	1,000
Total	**23,300**	**20,200**	**13,600**	**Total**	**23,300**	**20,200**	**13,600**

Note: Since the question is silent about payment to Y, the amount due to him is transferred to his Loan A/c.

3. Balance Sheet of X and Z as on 31st March

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		15,750
X	22,400		Buildings		24,750
Y	11,500	33,900	Motor Vans		3,400
Y's Loan A/c		20,200	Stock		15,000
Provision for Workmen's Compensation		825	Debtors	8,000	
Creditors		9,500	**Less:** Provision	1,225	6,775
Bills Payable		2,500	Cash at Bank		1,250
Total		**66,925**	**Total**		**66,925**

Illustration 13: Retirement – G/w Treatment and Revaluation of Assets and Liabilities

X, Y and Z were in a Firm sharing profits as 3:2:1. Their Balance Sheet on 31st March was as follows –

Liabilities	₹	Assets		₹
X's Capital	68,000	Goodwill		6,000
Y's Capital	32,000	Patents		10,000
Z's Capital	21,000	Machinery		50,000
Investment Fluctuation Fund	6,000	Investment (Market Value ₹ 17,600)		15,000
Workmen's Compensation	12,000	Stock		37,650
Trade Creditors	21,000	Debtors	40,000	
Employee's Provident Fund	6,000	Less: Provision for Doubtful Debts	2,000	38,000
		Cash at Bank		5,750
		Advertisement Expenditure		3,600
Total	**1,66,000**	**Total**		**1,66,000**

Z retired on the above date on the following terms –

1. **Goodwill of the Firm was valued at ₹ 30,000**
2. **Value of Patents was to be reduced by 20% and that of Machinery to 90%.**
3. **Provision for Doubtful Debts was to be raised to 6%.**
4. **Liability on account of Provident Fund was only ₹ 3,000.**
5. **Liability for Workmen Compensation to the extent of ₹ 6,000 is to be created.**
6. **Z took over the investment at Market Value.**
7. **Amount due to Z is to be settled on the following basis – 50% on retirement, 50% of the balance within one year and the balance by a bill of exchange (without interest) at 3 months.**

Required: (a) Show entries for the treatment of Goodwill, (b) Prepare the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of X and Y after Z's retirement.

Solution: **1. Journal Entries for treatment of Goodwill**

	Particulars		Dr.	Cr.
1.	X's Capital A/c	Dr.	3,000	
	Y's Capital A/c	Dr.	2,000	
	Z's Capital A/c	Dr.	1,000	6,000
	To Goodwill A/c			
	(Being existing Book Value of Goodwill written off in Old Ratio)			
2.	X's Capital A/c	Dr.	3,000	
	Y's Capital A/c	Dr.	2,000	
	To Z's Capital A/c			5,000
	(Being Z's Share of G/w credited to him, from Other Partners in Gain Ratio 3:2)			

2. Revaluation Account

Particulars	₹	Particulars		₹
To Patents	2,000	By Investments (₹ 17,600 – ₹ 15,000)		2,600
To Machinery	5,000	By Provident Fund		3,000
To Provision for Doubtful Debts	400	By Loss on Revaluation transferred to:		
		X's Capital A/c	900	
		Y's Capital A/c	600	
		Z's Capital A/c	300	1,800
Total	**7,400**	**Total**		**7,400**

3. Partners' Capital Accounts

Particulars	X	Y	Z	Particulars	X	Y	Z
To Goodwill A/c	3,000	2,000	1,000	By balance b/d	68,000	32,000	21,000
To Z's Capital A/c	3,000	2,000		By Workmen Compen. Fund	3,000	2,000	1,000
To Revaluation A/c – Loss	900	600	300				
To Advertisement Expenses	1,800	1,200	600	By Investment Fluctuation Fund	3,000	2,000	1,000
To Investment A/c	–	–	17,600				
To Bank A/c (Note)	–	–	4,250	By X's Capital A/c	–	–	3,000
To Z's Loan A/c (Note)	–	–	2,125	By Y's Capital A/c	–	–	2,000
To Bills Payable A/c (Note)	–	–	2,125				
To balance c/d	65,300	30,200					
Total	**74,000**	**36,000**	**28,000**	**Total**	**74,000**	**36,000**	**28,000**

Note:

- Amount Due to Z (by balancing his account initially) = Cr. Side Items Less Debit Side Items = ₹ (21,000+1,000+1,000+3,000+2,000) – ₹ (1,000+300+600+17600) = ₹ 8,500
- Amount paid to Z on his Retirement = 50% of ₹ 8,500 = ₹ 4,250
- Amount to be paid as Loan within one year = 50% of (₹ 8,500 – ₹ 4,250) = ₹ 2,125
- Hence, Bills Payable (balance amount due)= ₹ 2,125

4. Balance Sheet of X and Y as on 31st March, 2008

Liabilities	₹	Assets		₹
X's Capital	65,300	Patents		8,000
Y's Capital	30,200	Machinery		45,000
Z's Loan	2,125	Stock		37,650
Liab. for Workmen's Compensation	6,000	Debtors	40,000	
Trade Creditors	21,000	**Less:** Provision for Doubtful Debts	2,400	37,600
Employee's Provident Fund	3,000	Cash at Bank (₹ 5,750 – ₹ 4,250)		1,500
Bills Payable	2,125			
Total	**1,29,750**	**Total**		**1,29,750**

Illustration 14: Retirement – Comprehensive Illustration

The Balance Sheet of A, B, and C, who are Partners in a Firm sharing Profits as per their Capitals at 31st March was as under –

Liabilities		₹	Assets		₹
Capital A/cs:			**Buildings**		**1,00,000**
A	**80,000**		**Machinery**		**50,000**
B	**40,000**		**Stock**		**18,000**
C	**40,000**	**1,60,000**	**Debtors**	**20,000**	
General Reserve		**20,000**	**Less: Provision for Bad Debts**	**1,000**	**19,000**
Creditors		**21,000**	**Cash at Bank**		**14,000**
Total		**2,01,000**	**Total**		**2,01,000**

On that date, B decided to retire from the Firm and was paid for his share in the Firm subject to the following terms:

- **Buildings to be appreciated by 20%**
- **Provision for Bad Debts to be increased to 15% on Debtors.**
- **Machinery to be depreciated by 20%**
- **Goodwill of the Firm is valued at ₹ 72,000 and the Retiring Partner's share is adjusted through the Capital Accounts of the Remaining Partners.**
- **The Capital of the new Firm be fixed at ₹ 1,20,000.**

Prepare Revaluation Account, Capital Accounts of the Partners and the Balance Sheet after retirement of B.

Solution:

1. Revaluation Account

Particulars		₹	Particulars	₹
To Provision for Bad Debts A/c		2,000	By Buildings A/c	20,000
To Machinery A/c		10,000		
To Profit on Revaluation transferred to:				
A's Capital A/c	4,000			
B's Capital A/c	2,000			
C's Capital A/c	2,000	8,000		
Total		**20,000**	**Total**	**20,000**

2. Partners' Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
To Bank A/c	–	65,000	–	By balance b/d	80,000	40,000	40,000
To B's Captl A/c – G/w	12,000	–	6,000	By General Reserve	10,000	5,000	5,000
To balance c/d	82,000	–	41,000	By A's Capital A/c	–	12,000	–
(before Capital Adjt)				By C's Capital A/c	–	6,000	–
				By Revaluation A/c – Profit	4,000	2,000	2,000
Total	**94,000**	**65,000**	**47,000**	**Total**	**94,000**	**65,000**	**47,000**
To Bank A/c **(bal. fig)**	2,000	–	1,000	By balance b/d	82,000	–	41,000
To balance c/d	80,000	–	40,000				
(₹ 1,20,000 in 2 : 1)							
Total	**82,000**	**–**	**41,000**	**Total**	**82,000**	**–**	**41,000**

Note: B's Share of Goodwill ₹ 72,000 × ¼ = ₹ 18,000 is adjusted between A and C in Gaining Ratio.

3. Bank Account

Particulars	₹	Particulars	₹
To balance b/d	14,000	By A's Capital A/c	2,000
		By B's Capital A/c	65,000
To balance c/d **(Balancing Figure)**	54,000	By C's Capital A/c	1,000
Total	**68,000**	**Total**	**68,000**

4. Balance Sheet as on 31st March

Liabilities		₹	Assets		₹
Capital A/cs:			Machinery		40,000
X	80,000		Buildings		1,20,000
Y	40,000	1,20,000	Debtors	20,000	
Bank Overdraft		54,000	Less: Provision	3,000	17,000
Bills Payable		21,000	Stock		18,000
Total		**1,95,000**	**Total**		**1,95,000**

Illustration 15: Retirement – Rectification of Errors, Revaluation, Goodwill **M 02**

Meena, Jamba and Punya were partners sharing Profit and Losses in the ratio of Meena – 40%, Jamba – 35% and Punya – 25%. The Balance Sheet of the Partnership as on 31st December was as follows:

Capital and Liabilities			₹	Properties and Assets			₹
Current Accounts:				**Non–Current Assets:**			
– **Meena**		**12,000**			**Premises (at Cost)**		**75,000**
– **Jamba**		**8,000**			**Plant & Machinery (Cost)**	**80,000**	
– **Punya**		**6,000**	**26,000**		**Less: Depreciation**	**(28,000)**	**52,000**
Capital Accounts:				**Current Assets:**			
– **Meena**		**90,000**			**Sundry Debtors**	**34,000**	
– **Jamba**		**50,000**		**Less:**	**Provision for Doubtful Debts**	**(6,000)**	**28,000**
– **Punya**		**30,000**	**1,70,000**		**Stock**		**42,000**
Non–Current Liabilities:	**Loan from Jamba**		**30,000**		**Cash on Hand and at Bank**		**67,000**
Current Liabilities:	**Sundry Creditors**		**30,000**				
	Bills Payable		**8,000**				
Total			**2,64,000**	**Total**			**2,64,000**

Jamba retired from the Firm on 31st December. Meena and Punya continued in Partnership, sharing Profits and Losses in the ratio of Meena – 60% and Punya – 40%. 50% of Jamba Loan was repaid on 1st January (immediately on retirement) and it was agreed that, of the amount then remaining due to her, a sum of ₹ 80,000 should remain as Loan to Partnership, and the balance to be carried forward as ordinary trading liability.

The following adjustments were agreed to be made to the above–mentioned Balance Sheet.

1. **₹ 10,000 should be written off from the Premises.**
2. **Plant and Machinery was revalued at ₹ 58,000.**
3. **Provision for Doubtful Debts to be increased by ₹ 1,200.**
4. **₹ 5,000 due to Creditors for Expenses had been omitted from the Books of Account.**
5. **₹ 4,000 to be written off on Stocks.**
6. **Provide ₹ 1,200 for Professional Charges in connection with revaluation.**

As per the Deed of Partnership, in the event of the retirement of a Partner, Goodwill is to be valued at an amount equal to one year's purchase of the Average Profits of the preceding three years on the date of retirement. Before determining the said Average Profits, a Notional Amount of ₹ 80,000 should be charged for Remuneration to Partners. The necessary Profits before charging such Remuneration were: ₹ 1,44,000, ₹ 1,68,000, and ₹ 1,88,200 for the past three years (as per Draft Accounts).

It was agreed that, for the purpose of valuing Goodwill, the amount of profit for the last year be re–computed after charging the loss on revaluation in respect of Premises and Stock, the Unprovided Expenses (except Professional Expenses) and increase in the Provision for Doubtful Debts. The Continuing Partners decided to eliminate Goodwill Account from their books.

Prepare: (1) Revaluation A/c, (2) Capital A/c (merging Current Accounts therein), (3) Jamba A/c showing Balance due to her, and (4) Balance Sheet of Meena and Punya as at 1st January.

Solution:

1. Computation of Adjusted Profit for the year ending 31st December

	Particulars	₹	₹
	Profit as per Draft Accounts		1,88,200
Less:	Premises – amount written off	10,000	
	Provision for Doubtful debts	1,200	
	Outstanding Expenses provided	5,000	
	Stock – reduction in value	4,000	(20,200)
	Adjusted Profit for the Year		**1,68,000**

Note: Professional Charges, being retirement–related one–time expenses, is not considered above.

2. Valuation of Goodwill

	Particulars	₹
	Total Profits for last three years (1,44,000 + 1,68,000 + 1,68,000) after adjustment	4,80,000
	Average Profits before Partners' Remuneration (Total Profits ₹ 4,80,000 ÷ 3 Years)	1,60,000
Less:	Partners' Salaries (Notional)	(80,000)
	Super Profit and Goodwill (one year's purchase)	**80,000**

3. Revaluation Account

Particulars	₹	Particulars		₹
To Premises – amount written off	10,000	By Plant and Machinery		6,000
To Provision for Doubtful Debts	1,200	By Capital Accounts – Loss Transferred (old PSR)		
To Outstanding Expenses	5,000	– Meena (40% × ₹ 15,400)	6,160	
To Stocks – reduction in value	4,000	– Jamba (35% × ₹ 15,400)	5,390	
To Provision for Professional charges	1,200	– Punya (25% × ₹ 15,400)	3,850	15,400
Total	**21,400**	**Total**		**21,400**

4. Partners' Capital Account

Particulars	Meena	Jamba	Punya	Particulars	Meena	Jamba	Punya
To Realisation Loss	6,160	5,390	3,850	By balance b/d	90,000	50,000	30,000
To G/w (New PSR 60:40)	48,000	–	32,000	By Current a/c	12,000	8,000	6,000
To Jamba A/c – Tfrd.	–	80,610	–	By G/w (40:35:25)	32,000	28,000	20,000
To balance c/d	**79,840**	–	**20,150**				
Total	**1,34,000**	**86,000**	**56,000**	**Total**	**1,34,000**	**86,000**	**56,000**

5. Jamba's Account (Personal)

Particulars	₹	Particulars	₹
To Bank (50% of Old Loan) – settlement	15,000	By Capital A/c – transfer of amount due	80,610
To Loan A/c (Transferred) – New Loan	80,000	By Loan A/c (Old Loan) – transfer	30,000
To balance c/d – Trading Liability	**15,610**		
Total	**1,10,610**	**Total**	**1,10,610**

6. Balance Sheet of Meena and Punya as at 1st January (after Jamba's retirement)

Capital and Liabilities		₹	Properties and Assets		₹
Capital Accounts:			**Non–Current Assets:**		
– Meena	79,840		Plant and Machinery	86,000	
– Punya	20,150	99,990	**Less:** Depreciation	(28,000)	58,000
Non–Current Liabilities: Jamba Loan A/c		80,000	Premises	75,000	
Current Liabilities:			**Less:** Written off	(10,000)	65,000
Creditors (30,000 +5,000)	35,000		**Current Assets:**		
Jamba (Creditors) A/c	15,610		Stock in Trade		38,000
Bills Payable	8,000		Sundry Debtors	34,000	
Professional Charges P'ble	1,200	59,810	**Less:** Provision for Doubtful Debts	(7,200)	26,800
			Cash & Bank (67,000 – 15,000)		52,000
Total		**2,39,800**	**Total**		**2,39,800**

Illustration 16: Admission–cum–Retirement – Revaluation, Goodwill Adjustment, Capital Adjustment **N 05**

Ram, Rahim and Robert are Partners, sharing Profits and Losses in the ratio of 5:3:2. It was decided that Robert would retire on 31.3.2017 and in his place Richard would be admitted as a Partner with New Profit Sharing ratio between Ram, Rahim and Richard at 3:2:1.

Balance Sheet of Ram, Rahim and Robert as at 31st March 2017

Capital and Liabilities			₹	Properties and Assets		₹
Capital	Ram	1,00,000		Non–Current Assets: Plant and Machinery		3,00,000
	Rahim	1,50,000			Land and Building	5,30,000
	Robert	2,00,000	4,50,000	Current Assets:	Stock in Trade	2,00,000
General Reserve			2,00,000		Sundry Debtors	5,00,000
Non–Current Liabilities: Loan from Richard			2,00,000		Cash in Hand	20,000
Current Liabilities: Sundry Creditors			8,00,000		Cash at Bank	1,00,000
Total			16,50,000	Total		16,50,000

Retirement of Robert and admission of Richard is on the following terms:

1. **Plant and Machinery to be depreciated by ₹ 30,000**
2. **Land and Building to be valued at ₹ 6,00,000**
3. **Stock to be valued at 95% of Book Value.**
4. **Provision for Doubtful Debts at 10% to be provided on Debtors.**
5. **General Reserve to be apportioned amongst Ram, Rahim and Robert.**
6. **The Firm's Goodwill to be valued at 2 years purchase of the average profits of the last 3 years. The relevant figures are – 2015 – ₹ 50,000, 2016 – ₹ 60,000 and 2017 – ₹ 55,000 respectively.**
7. **Out of the amount due to Robert, ₹ 2,00,000 is retained as Loan by the Firm, and the balance will be settled immediately.**
8. **Richard's Capital should be equal to 50% of the Combined Capital of Ram and Rahim.**

Prepare: Capital Accounts of the Partners, and Balance Sheet of the Reconstituted Firm.

Solution: **1. Revaluation Account**

Particulars	₹	Particulars		₹
To Plant & Machinery	30,000	By Land & Building (6,00,000 – 5,30,000)		70,000
To Stock (5% on ₹ 2,00,000)	10,000	By Capital Accounts – Loss transferred (Old PSR)		
To Debtors (10% on ₹ 5,00,000)	50,000	– Ram (20,000 ÷ 5 / 10)	10,000	
		– Rahim (20,000 ÷ 3 / 10)	6,000	
		– Robert (20,000 ÷ 2 / 10)	4,000	20,000
Total	**90,000**	**Total**		**90,000**

2. Partners' Capital Account

Details	Ram	Rahim	Robert	Richard	Details	Ram	Rahim	Robert	Richard
To Revaln	10,000	6,000	4,000	–	By bal.b/d	1,00,000	1,50,000	2,00,000	–
To Loan	–	–	2,00,000	–	By Genl. Res.(5:3:2)	1,00,000	60,000	40,000	–
To Cash (bal. paid)	–	–	**58,000**	–	By G/w (5:3:2)	55,000	33,000	22,000	–
To G/w (3:2:1)	55,000	36,667	–	18,333	By Loan	–	–	–	2,00,000
To bal. c/d **(Note2)**	**1,90,000**	**2,00,333**	–	1,95,167	By Bank **(bal. fig.)**	–	–	–	**13,500**
Total	**2,55,000**	**2,43,000**	**2,62,000**	**2,13,500**	**Total**	**2,55,000**	**2,43,000**	**2,62,000**	**2,13,500**

Note:

1. Goodwill $= 2 \times$ Average of Last 3 Years Profit $= 2 \times \frac{(50{,}000 + 60{,}000 + 55{,}000)}{3 \text{ years}}$ = ₹ 1,10,000. This is credited to Ram, Rahim and Robert in Old PSR and written off / debited to Ram, Rahim and Richard in new PSR (3:2:1)

2. Computation of Capital Account Balances is as under –

- Capital Accounts of Ram & Rahim are balanced first to derive Closing Balance ₹ 1,90,000 & ₹ 2,00,333 respectively.
- Required Capital of Richard = 50% of (1,90,000 + 2,00,333) = ₹ 1,95,167
- Richard's Account is then balanced to derive Additional Capital Contribution as balancing figure.

3. Balance Sheet of the Firm as at 31.3.2017 (after re–constitution)

Capital and Liabilities		₹	Properties and Assets	₹
Partner's Capital A/c			**Non–Current Assets:**	
– Ram	1,90,000		Plant and Machinery	2,70,000
– Rahim	2,00,333		Land and Building	6,00,000
– Richard	1,95,167	5,85,500	**Current Assets:**	
Non–Current Liabilities:			Stock in Trade	1,90,000
Loan from Robert		2,00,000	Debtors	4,50,000
Current Liabilities:			Bank (1,00,000 + 13,500 – 58,000)	55,500
Sundry Creditors		8,00,000	Cash in Hand	20,000
Total		**15,85,500**	**Total**	**15,85,500**

Illustration 17: Admission cum Retirement – Subsequent Admission **N 09**

E, F and G were Partners sharing Profits and Losses in the ratio of 5:3:2 respectively. On 31st March, the Balance Sheet of the Firm stood as follows –

Capital and Liabilities		₹	Properties and Assets		₹
Capital Accounts:			**Non–Current Assets:**	**Building**	**55,000**
– E	50,000			**Furniture**	**25,000**
– F	40,000		**Current Assets:**	**Stock**	**42,000**
– G	28,000	1,18,000		**Debtors**	**20,000**
Current Liabilities: Creditors		33,500		**Cash at Bank**	**11,200**
Outstanding Expenses		1,700			
Total		1,53,200	Total		1,53,200

On the above date 31st March, E decided to retire, and F and G decided to continue as equal Partners. Other terms were as follows –

(a) Building is appreciated by 20%, Furniture be depreciated by 10% and a Provision of 5% be created on Debtors.

(b) Goodwill is valued at two year's purchase of profit for the latest accounting year. The Firm's Profit for the year ended 31st March 2013 was ₹ 25,000. No Goodwill account is to be raised in the books of account.

(c) Fresh Capital be introduced by F and G to the extent of ₹ 10,000 and ₹ 35,000 respectively.

(d) Out of sum payable to Retiring Partner E, a sum of ₹ 45,000 be paid immediately and the balance be transferred to his Loan Account bearing interest at 12% per annum. The Loan is to be paid off by 31st March of next financial year.

One month after E's retirement, F and G agreed to admit E's son H as a Partner with one–fourth share in Profit/Losses. E agreed that the balance in his Loan A/c be converted into H's Capital. E also agreed to forego one month's interest on his loan.

It was also agreed that H will bring in his share of Goodwill through book adjustment, valued at the price on the date of E's retirement. No Goodwill Account is to be raised in the books. You are requested to pass necessary Journal Entries to give effect to above transactions, and prepare Partner's Capital Accounts.

Solution:

1. Computation of Partners' Shares consequent to Retirement and Admission

Particulars	E	F	G	H
Ratio before Retirement of E	5/10	3/10	2/10	–
Ratio after Retirement of E	–	½	½	–
Ratio after Admission of H	–	¾ × ½ = 3/8	¾ × ½ = 3/8	¼

So, Profit Sharing Ratio among F:G:H is 3:3:2

2. Computation of Goodwill and Adjustment upon retirement of "E"

Amount of Goodwill = 2 Yrs Purchase × Latest Year profit = 2 × ₹ 25,000 = ₹ 50,000. It is distributed as follows –

Goodwill	E	F	G
Raised in the ratio of 5:3:2	50,000 × 5/10 = 25,000	50,000 × 3/10 = 15,000	50,000 × 2/10 = 10,000
Written Off in New ratio of 1:1	–	50, 000 × 1/2 = 25,000	50,000 × 1/2 = 25,000
Net Effect	**25,000 Cr.**	**10,000 Dr.**	**15,000 Dr.**

3. Revaluation Account (on Retirement)

Particulars		₹	Particulars		₹
To Furniture A/c	(25000 × 10%)	2,500	By Building A/c	(55,000 × 20%)	11,000
To Provision for Doubtful Debts	(20,000 × 5%)	1,000			
To Capital Accounts – Profit Transferred (old PSR)					
– E	3,750				
– F	2,250				
– G	1,500	7,500			
Total		**11,000**	**Total**		**11,000**

4. Computation of Goodwill and Adjustment upon admission of "H"

Goodwill Value on the date of retirement of E = ₹ 50,000. It is distributed as follows –

Goodwill	F	G	H
Raised in the ratio of 1:1	50,000 × ½ = 25,000	50,000 × ½ = 25,000	–
Written Off in New Ratio of 3:3:2	50,000 × ⅜ = 18,750	50,000 × ⅜ = 18,750	50,000 × 2/8 = 12,500
Net Effect	**6,250 Cr.**	**6,250 Cr.**	**12,500 Dr.**

5. Journal Entries in the books of the Firm

S.No.	Particulars	Dr.	Cr.
1.	Building A/c Dr. To Revaluation A/c (Being value of Building appreciated by 20% on ₹ 55,000)	11,000	11,000

S.No.	Particulars		Dr.	Cr.
2.	Revaluation A/c	Dr.	3,500	
	To Provision for Doubtful Debts A/c			1,000
	To Furniture A/c			2,500
	(Being Furniture depreciated at 10% on ₹ 25,000 and Provision for Doubtful Debts created at 5% on ₹ 20,000)			
3.	Revaluation A/c	Dr.	7,500	
	To E's Capital A/c			3,750
	To F's Capital A/c			2,250
	To G's Capital A/c			1,500
	(Being profit on revaluation transferred in Old PSR 5:3:2)			
4.	Bank A/c	Dr.	45,000	
	To F's Capital A/c			10,000
	To G's Capital A/c			35,000
	(Being Capital brought in by the Partners)			
5.	F's Capital A/c	Dr.	10,000	
	G's Capital A/c	Dr.	15,000	
	To E's Capital A/c			25,000
	(Being Adjustment of Goodwill upon retirement of Partner E, without raising Goodwill in the Books) **(WN 2)**			
6.	E's Capital A/c	Dr.	78,750	
	To E's Loan A/c			33,750
	To Bank A/c			45,000
	(Being of the amount due to E, Rs.45000 paid immediately and balance as Loan)			
7.	E's Loan A/c	Dr.	33,750	
	To H's Capital A/c			33,750
	(Being of the Loan amount transferred to H's Capital after admission)			
8.	H's Capital A/c	Dr.	12,500	
	To F's Capital A/c			6,250
	To G's Capital A/c			6,250
	(Being adjustment of Goodwill upon admission of H) **(WN 4)**			

6. Partners' Capital Account

Particulars	E	F	G	H	Particulars	E	F	G	H
To E's Capital	–	10,000	15,000	–	By balance b/d	50,000	40,000	28,000	–
To Bank	45,000				By Revaluation	3,750	2,250	1,500	–
To E's Loan **(b/f)**	**33,750**				By F & G's Capital	25,000	–	–	–
To F & G's Capital	–	–	–	12,500	By Bank	–	10,000	35,000	–
To balance c/d	–	48,500	55,750	21,250	By E's Loan	–	–	–	33,750
					By H's Capital	–	6,250	6,250	–
Total	**78,750**	**58,500**	**70,750**	**33,750**	**Total**	**78,750**	**58,500**	**70,750**	**33,750**

Illustration 18: Death – Computation of Amount due to Executors

Following is the Balance Sheet of Black, Brown and White as on 31st March –

Liabilities		₹	Assets	₹
Capital A/cs;			**Plant and Machinery**	**1,00,000**
Black	**1,00,000**		**Stock**	**40,000**
Brown	**50,000**		**Sundry Debtors**	**60,000**
White	**50,000**	**2,00,000**	**Cash at Bank**	**50,000**
Reserve Fund		**32,000**	**Cash in Hand**	**2,000**
Sundry Creditors		**20,000**		
Total		**2,52,000**	**Total**	**2,52,000**

White died on 30th June. Under the Partnership Deed, the Executors of a Deceased Partner were entitled to –

(a) Amount standing to the credit of the Partner's Capital Account.

(b) Interest on Capital at 5% p.a.

(c) Share of Goodwill on the basis of twice the average of the past three years' profits.

(d) Share of Profits from the closing of last financial year to the date of death, on the basis of the last year's profits.

- **White's Share of Goodwill will be adjusted to the accounts of Black and Brown who will maintain a Profit–Sharing Ratio of 2:1 in the new Firm. They decide not to raise any Goodwill Account.**
- **Profits for 2005, 2006 and 2007 were ₹ 80,000 ₹ 90,000 and ₹ 1,00,000 respectively. Profits were shared in the ratio of capitals.**

Pass the necessary Journal Entries and draw up White's Account to be rendered to his Executors.

Solution:

1. Computation of Gain Ratio

Particulars	Black	Brown	White (Expired)
1. Old PSR (Capital Ratio)	2/4	¼	¼
2. New PSR (given)	2/3	1/3	–
3. (Gain) / Sacrifice (1 – 2)	– 2/12 Gain	– 1/12 Gain	1/4 = 3/12 Sacrifice

Hence, **New PSR is 2: 1** (given), and **Gain Ratio** is **2 : 1.**

$$2.\ \text{Average Profits} = \frac{₹\,80{,}000 + ₹\,90{,}000 + ₹\,1{,}00{,}000}{3} = ₹\,90{,}000$$

So, Goodwill = Average Profits × 2 years = ₹ 90,000 × 2 = ₹ **1,80,000**

White's Share in G/w = ₹ 1,80,000 × ¼ = ₹ 45,000, to be borne by Black and Brown in Gain Ratio 2: 1.

3. Journal Entries

	Particulars		Dr.	Cr.
1.	Reserve Fund A/c To White's Capital A/c (Being the transfer of White's Share of Reserve Fund to his Capital A/c)	Dr.	8,000	8,000
2.	Interest A/c To White's Capital A/c (Being Interest on Capital at 5% p.a. upto 30th June, credited to White)	Dr.	625	625
3.	Black's Capital A/c Brown's Capital A/c To White's Capital A/c (Being adjustment of Goodwill due to White, adjusted in Gain Ratio 2:1)	Dr. Dr.	30,000 15,000	45,000
4.	Profit and Loss Suspense A/c To White's Capital A/c (₹ 1,00,000 × 3/12 × ¼) (Being transfer of White's share of Profit upto 30th June, to his Capital A/c)	Dr.	6,250	6,250
5.	White's Capital A/c To White's Executor's A/c (Being the transfer of amount due to Executor's Account)	Dr.	1,09,875	1,09,875

4. White's Capital Account

Particulars	₹	Particulars	₹
To White's Executor's A/c (transfer)	1,09,875	By balance b/d	50,000
		By Reserve Fund	8,000
		By Interest A/c	625
		By Black's Capital A/c	30,000
		By Brown's Capital A/c	15,000
		By Profit and Loss Suspense A/c	6,250
Total	**1,09,875**	**Total**	**1,09,875**

Illustration 19: Application of Partnership Act Provisions

A, B and C were Partners sharing profits and losses in the ratio of 4:3:2. C expired on 1st July, on which date the capital of A, B and C after all necessary adjustments 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 on 31st December, the Firm made a Profit of ₹ 50,000.

State which of the two options available under Section 37 of the Indian Partnership Act, 1932 should be exercised by the Executors of C.

Solution:

Option 1: Interest at 6% on the use of his balance = ₹ 45,000 × 6/12 × 6/100 = ₹ 1,350

Option 2: Share in subsequent Profits attributable to the use of his balance =

$$= ₹\ 50{,}000 \times \frac{₹45{,}000}{₹1{,}85{,}000} = ₹\ \mathbf{12{,}162}$$ [**Note:** Total Funds = 75,000 + 65,000 + 45,000 = ₹ 1,85,000]

The Executors of C should exercise **Option 2** since the amount payable under Option 2 is more than Option 1.

Illustration 20: Death of Partners – Sec.37, Profit Sharing, Goodwill, Revaluation **N 00**

Akash, Badri and Charu were Partners of a Firm, sharing Profits and Losses in the ratio of 3:4:3. The Balance Sheet of the Firm as at 31st March 2017 as under:

Capital and Liabilities		₹	Properties and Assets	₹
Capital Accounts:	Akash	48,000	Non–Current Assets: Fixed Assets	1,00,000
	Badri	64,000	Current Assets:	
	Charu	48,000	Stock	30,000
Reserve		20,000	Debtors	60,000
Current Liabilities:	Creditors	40,000	Cash & Bank	30,000
Total		2,20,000	Total	2,20,000

The Firm had taken a Joint Life Policy for ₹ 1,00,000. The premium periodically paid was charged to P&L A/c. Partner Charu died on 30th September 2017. It was agreed between the surviving Partners, and the legal representatives of Charu that –

1. **Goodwill of the Firm will be taken at ₹ 60,000.**
2. **Fixed Assets will be written down by ₹ 20,000.**
3. **In lieu of profits, Charu should be paid at the rate of 25% p.a. on his Capital as on 31st March 2017.**

Policy Money was received and the legal heirs were paid off. The Profits for the year–ended 31st March 2018 after charging Depreciation of ₹ 10,000 (Depreciation up to 30th September was agreed to be ₹ 6,000) were ₹ 48,000.

Partners Drawings Accounts showed balances as under: (1) Akash – ₹ 18,000 (drawn evenly over the year), (2) Badri – ₹ 24,000 (drawn evenly over the year), and (3) Charu – ₹ 20,000 (upto date of death)

On the basis of the above figures, indicate the entitlement of the legal heirs of Charu, assuming that they had not been paid anything other than the share in the Joint Life Policy.

Solution:

1. Partners' Capital A/c (6 months upto 30.9.2017)

Particulars	Akash	Badri	Charu	Particulars	Akash	Badri	Charu
To FA (Rev. Loss) (in 3:4:3)	6,000	8,000	6,000	By balance b/d	48,000	64,000	48,000
To Drawings (½ yr for A & B)	9,000	12,000	20,000	By Reserve	6,000	8,000	6,000
To Charu Executor's A/c	–	–	**52,000**	By Goodwill	18,000	24,000	18,000
To Goodwill (w/off in 3:4)	25,714	34,286	–	By P & L Appn. A/c	7,286	9,714	6,000
To balance c/d	**38,572**	**51,428**	–	(Pft Share **WN 2**)			
Total	**79,286**	**1,05,714**	**78,000**	**Total**	**79,286**	**1,05,714**	**78,000**

2. Distribution of Profit to Partners and Application of Sec.37

Profit before Depreciation for whole year = ₹ 48,000 + ₹ 10,000 = ₹ **58,000**

Upto date of Death 30.09.2017 (i.e. 6 months period)

	Particulars	₹
	Pft before Deprn = ₹ 58,000 × 6/12	29,000
Less:	Depreciation (given)	6,000
		23,000
Less:	Charu's Share 25% of 48,000 × 6/12	6,000
	Profit distributed in New PSR 3:4	**17,000**

Akash (3/7th) ₹ 7,286 — Badri (4/7th) ₹ 9,714

Balance Period (i.e. 6 months period)

	Particulars	₹
	Pft before Deprn = ₹ 58,000 × 6/12	29,000
Less:	Depreciation (10,000 – 6,000)	4,000
	Balance Profit	25,000
Less:	To Charu's Executor **(Note below)**	9,155
	Profit distributed in New PSR 3:4	**15,845**

Akash (3/7th) ₹ 6,791 — Badri (4/7th) ₹ 9,054

Note: Right of Claim u/s 37 = Higher of the following –

(a) 6% Interest on Unsettled Capital for 6 months = ₹ 52,000 × 6% × 6/12 = ₹ **1,560**

(b) Profit earned out of Unsettled Capital = ₹ 25,000 × $\frac{\text{Charu } 52{,}000}{\text{Charu } 52{,}000 + \text{Akash } 38{,}572 + \text{Badri } 51{,}428}$ = ₹ **9,155**

(Note: Capital Balances are obtained from **WN 1**, after crediting Share of Profit upto date of death as per **WN 2.)**

3. Amount due to Legal Heirs of Charu = from Capital ₹ 52,000 + Sec. 37 ₹ 9,155 = ₹ **61,155.**

Illustration 21: Death of a Partner – Sec.37, Goodwill Adjustment, Revaluation **N 10**

Ramu, Shamu and Raju were Partners sharing profits and losses in the ratio of 3:2:2. Their Balance Sheet as on 01.01.2017 was as follows –

Capital and Liabilities			₹	Properties and Assets	₹
Capital Accounts				**Non–Current Assets: Fixed Assets**	
– Ramu		30,000		**Current Assets:**	80,000
– Shamu		20,000		**Stock**	15,000
– Raju		20,000	70,000	**Debtors**	12,000
Reserves			14,000	**Cash & Bank**	1,951
Current Liabilities:	**Creditors**		24,951		
Total			1,08,951	**Total**	1,08,951

On 1st October 2017, Ramu died. His heirs agreed that –

(a) Goodwill of the Firm be valued at 2 years' purchase of Average Profit of past three years. Profits for the year 2010, 2011 and 2012 were ₹ 30,000, ₹ 40,000 and ₹ 47,600 respectively.

(b) Fixed Assets be revalued at ₹ 1,01,000.

(c) Profit to be shared, earned in subsequent period after death of Ramu, till settlement of his Executors' Claim.

Ramu's Heirs Account was settled on 31.12.2017 by bringing in required cash by Remaining Partners in equal proportion, leaving cash balance of ₹ 1,234. Each Partner had drawn at ₹ 1,000 per month for personal use.

Profit for the current year after charging depreciation of ₹ 9,000 (₹ 6,000 for first three quarters and ₹ 3,000 for last quarter) was ₹ 46,600 earned evenly through–out the year.

Prepare Profit & Loss Appropriation A/c, Cash & Bank A/c, Ramu's Executor's A/c and Partner's Capital Accounts for the year ended on 31.12.2017 assuming Remaining Partners' decided not to retain Goodwill in the books.

Solution:

1. Goodwill = 2 years of purchase of 3 years Average Profits = $\frac{30{,}000 + 40{,}000 + 47{,}600}{3 \text{ years}} \times 2$ = ₹ **78,400.**

This is credited to all Partners in old PSR (3:2:2) and debited to Remaining Partners Shamu & Raju in new PSR (2:2)

2. Partners' Capital A/c from 01.01.2017 to 01.10.2017 (9 Months)

Particulars	Ramu	Shamu	Raju	Particulars	Ramu	Shamu	Raju
To Drawings (9 Months)	9,000	9,000	9,000	By Balance b/d	30,000	20,000	20,000
To Goodwill (1:1) **(WN 1)**	–	39,200	39,200	By Reserves (3:2:2)	6,000	4,000	4,000
To Ramu's Executor's A/c **(bal. fig.)**	**84,900**	–	–	By Revaluation Gain **(Note)**	9,000	6,000	6,000
				By Goodwill (3:2:2) **(WN 1)**	33,600	22,400	22,400
To balance c/d	–	**14,400**	**14,400**	By P&L Appropriation	15,300	10,200	10,200
Total	**93,900**	**62,600**	**62,600**	**Total**	**93,900**	**62,600**	**62,600**

Note: Gain on Revaluation of Fixed Asset (1,01,000 – 80,000) = ₹ 21,000, distributed in old PSR 3:2:2.

3. Distribution of Profit to Partners and Application of Sec.37

Profit before Depreciation for whole year = ₹ 46,600 + ₹ 9,000 = ₹ **55,600**

Upto date of Death 30.09.2017
(i.e. 9 months period)

Particulars	₹
Pft before Deprn = ₹ 55,600 × 9/12	41,700
Less: Depreciation (given)	6,000
Profit distributed in Old PSR 3:2:2	**35,700**

Ramu (3/7th) ₹ 15,300 | Shamu (2/7th) ₹ 10,200 | Raju (2/7th) ₹ 10,200

Balance Period
(i.e. 3 months period)

Particulars	₹
Pft before Deprn = ₹ 55,600 × 3/12	13,900
Less: Depreciation (given)	3,000
Balance Profit	10,900
Less: To Ramu's Executor **(Note below)**	8,139
Profit distributed in New PSR 2:2	**2,761**

Shamu (50%) ₹ 1,380 | Raju (50%) ₹ 1,381 (R/off)

Note: Right of Claim u/s 37 = Higher of the following –

(a) 6% Interest on Unsettled Capital for 3 months = ₹ 84,900 × 6% × 3/12 = ₹ **1,274**

(b) Profit earned out of Unsettled Capital = ₹ 10,900 × $\frac{\text{Ramu } 84{,}900}{\text{Ramu } 84{,}900 + \text{Shamu } 14{,}400 + \text{Raju } 14{,}400}$ = ₹ **8,139**

(Note: Capital Balances are obtained from **WN 2**, , after crediting Share of Profit upto date of death as per **WN 3.)**

4. Profit & Loss Appropriation A/c

Particulars	₹	Particulars	₹
To Ramu's Capital **(WN 2)**	15,300	By Profit & Loss A/c (Given)	46,600
To Shamu's Capital (₹ 10,200 + ₹ 1,380) **(WN 6)**	11,580		
To Raju's Capital (₹ 10,200 + ₹ 1,381) **(WN 6)**	11,581		
To Ramu's Executor's A/c **(WN 5)**	8,139		
Total	**46,600**	**Total**	**46,600**

5. Ramu's Executor A/c

Particulars	₹	Particulars	₹
To Bank	93,039	By Ramu's Capital – transfer	84,900
		By P&L Appropriation A/c	8,139
Total	**93,039**	**Total**	**93,039**

6. Cash and Bank A/c

Particulars		₹	Particulars	₹
To balance b/d		1,951	By Ramu's Executor's A/c (Settlement)	93,039
To Shamu's Capital	62,661		By Drawings (12,000 + 12,000 + 9,000)	33,000
To Raju's Capital	62,661	**1,25,322**	By balance c/d (Given)	1,234
Total		**1,27,273**	**Total**	**1,27,273**

7. Partners' Capital A/c from 01.10.2017 to 31.12.2017 (3 Months)

Particulars	Shamu	Raju	Particulars	Shamu	Raju
To Drawings	3,000	3,000	By balance b/d	14,400	14,400
To balance c/d	75,441	75,442	By P&L Appropriation	1,380	1,381
			By Cash and Bank	62,661	62,661
Total	**78,441**	**78,442**	**Total**	**78,441**	**78,442**

Illustration 22: Death of Partner, Sec.37 Profit Sharing, Subsequent Admission

A, B and C were Partners, sharing Profits in the ratio of 5:3:2 respectively. On 31st March 2017, their B/ Sheet stood as follows –

Capital and Liabilities	₹	Properties and Assets	₹
A's Capital	7,79,000	Plant and Machinery	13,62,000
B's Capital	7,07,800	Furniture and Fittings	2,36,000
C's Capital	6,86,200	Stock	7,02,000
Creditors	4,91,000	Debtors	1,91,000
		Cash at Bank	1,73,000
Total	26,64,000	Total	26,64,000

On 31st July 2017, A died. According to Partnership Deed, on the Death of a Partner, the Capital Account of the deceased Partner was to be credited with –

(a) His Share of Profit for the relevant part of the year of death, calculated on the basis of Profit earned during the immediately preceding accounting year, and

(b) His Share of Goodwill.

Goodwill was to be valued at two year's purchase of the Average Profits of immediately preceding three Accounting Years. The Profits as per Books of Accounts, for the preceding accounting years were –

For the accounting year ending on	31.03.2015	31.03.2016	31.03.2017
Profits	₹ 3,29,000	₹ 3,46,000	₹ 3,78,000

However, while going through the Books of Accounts on A's death, it came to light that ₹ 30,000 worth of Wages were spent on installation of a New Machinery, but the same was not capitalised, the Machinery was put into operation on 1st October 2016. Depreciation was provided on the Machinery @ 20% p.a.

On 1st October 2017, A's Son D was admitted into Partnership with immediate effect on the following terms –

(a) D would get one–fourth Share in the Profit of the Firm, while the relative Profit Sharing Ratio between B and C would remain unchanged.

(b) The Final Balance of A's Capital Account would be Credited to D's Capital Account.

(c) An adjustment would be made in the Capital Accounts for D's Share of Goodwill. The basis of valuation of Firm's Goodwill would be the same as was adopted at the time of the death of his Father.

On 31st March 2018, the Profit and Loss Account of the Firm showed that the Firm had earned a Profit of ₹ 4,16,000 for the year. The respective Drawings Accounts showed that while B and C had withdrawn ₹ 60,000 each during the year, D's Drawings totalled ₹ 30,000. The Drawings Accounts are closed at the end of the year by transfer to respective Capital Accounts.

You are required to:

1. **Prepare a Statement showing distribution of Profits for the Accounting year ended 31st March 2018, and**
2. **Pass Journal Entries for all the transactions relating to death of a Partner, D's admission into Partnership, and at the end of the year relating to transfer of Drawings Accounts and distribution of Profit for the year.**

Solution: 1. Computation of A's Share of Profit for the period 01.04.2017 to 31.07.2017

	Particulars	₹
	Profit for year ended 31.03.2017 (**Note:** A's Share in Profit for 01.04.2017 to 31.07.2017 is to be calculated based on Profit earned during immediately **previous** year, i.e. year ended 31.03.2017.)	3,78,000
Add:	Wages spent on installation of New M/c, treated as Revenue Expenditure, added back	30,000
	Sub–Total	4,08,000
Less:	Depreciation on ₹ 30,000 (Addition to Machinery, at 20% p.a. for 6 months)	(3,000)
	Correct Profit for the year ended 31.03.2017	**4,05,000**

Profit for 4 months on the Basis of above adjusted Profit = ₹ 4,05,000 × $\frac{4}{12}$ = ₹ 1,35,000.

A's Share in above Profit = ₹ 1,35,000 × $\frac{5}{10}$ = **₹ 67,500.**

2. Valuation of Goodwill

(a) Average Annual Profit (of 3 years) = $\frac{3,29,000 + 3,46,000 + 4,05,000}{3 \text{ years}}$ = ₹ 3,60,000

(b) Goodwill = Two year's Purchase = ₹ 3,60,000 × 2 = **₹ 7,20,000**

3. Partners' Capital A/c from 01.04.2017 to 31.07.2017 (4 Months)

Particulars	A	B	C	Particulars	A	B	C
To Drawings	–	20,000	20,000	By Balance b/d	7,79,000	7,07,800	6,86,200
To A's Executor A/c	12,20,000	–	–	By Plant & Machinery	13,500	8,100	5,400
To balance c/d	–	9,54,600	8,44,067	By Goodwill	3,60,000	2,16,000	1,44,000
				By Share in Pft **(WN 4)**	67,500	42,700	28,467
Total	**12,20,000**	**9,74,600**	**8,64,067**	**Total**	**12,20,000**	**9,74,600**	**8,64,067**

4. Distribution of Profit to Partners and Application of Sec.37

Profit for whole year = ₹ **4,16,000 (See Note 2 below)**

Upto date of death 31.07.2017 (i.e. 4 months)

Particulars	₹
Pft for 4 mths = ₹ 4,16,000 × 4/12	1,38,667
Less: A's Share as per **WN 1**	67,500
Pft share of B&C in Old PSR 3:2	**71,167**

B ($3/5^{th}$) ₹ 42,700

C ($2/5^{th}$) ₹ 28,467

Next 2 months (i.e. upto date of settlement)

Particulars	₹
Pft for 8 mths = ₹ 4,16,000 × 2/12	69,333
Less: To A's Executor **(See Note 1 below)**	28,021
Balance to B&C in Old PSR 3:2	41,312

B ($3/5^{th}$) ₹ 24,787

C ($2/5^{th}$) ₹ 16,525

Note 1: Right of Claim u/s 37 = Higher of the following –

(Computation is made from date of death till date of settlement, i.e. 01.08.2017 to 30.09.2017, i.e. **2 months period**)

(a) 6% Interest on Unsettled Capital for 3 months = ₹ 12,20,000 × 6% × 2/12 = ₹ **12,200**

(b) Profit earned out of Unsettled Capital = ₹ 4,16,000 × $\frac{2}{12}$ × $\frac{A\ 12,20,000}{A\ 12,20,000 + B\ 9,54,600 + C\ 8,44,067}$ = **₹ 28,021**

Note 2: Profit from date of admission of D, i.e. 01.10.2017 to 31.03.2018, i.e. 6 months is shared in New PSR, as under –

Particulars	B	C	D	Total
New PSR	$3/4^{th}$ of 3/5 = 9/20	$3/4^{th}$ of 2/5 = 6/20	$1/4^{th}$ Share = 5/20	**9 : 6 : 5**
Profit for 6 months = ₹ 4,16,000 × 6/12 = ₹ 2,08,000, shared in 9:6:5	93,600	62,400	52,000	**2,08,000**

5. A's Executor's Account

Date	Particulars	₹	Date	Particulars	₹
01.10.2017	To D's Capital A/c	12,48,021	31.07.2017	By A's Capital A/c	12,20,000
			30.09.2017	By Share in Profit **(WN 4)**	28,021
	Total	**12,48,021**		**Total**	**12,48,021**

6. Partners' Capital Account from 01.08.2017 to 30.09.2017 (upto D's admission)

Particulars	B	C	Particulars	B	C
To Drawings	10,000	10,000	By balance b/d	9,54,600	8,44,067
To balance c/d	9,69,387	8,50,592	By Share in Profit **(WN 4)**	24,787	16,525
Total	**9,79,387**	**8,60,592**	**Total**	**9,79,387**	**8,60,592**

7. Partners' Capital Account from 01.10.2017 to 31.03.2018 (last 6 months)

Particulars	B	C	D	Particulars	B	C	D
To Goodwill	3,24,000	2,16,000	1,80,000	By Balance b/d	9,69,387	8,50,592	6,86,200
To Drawings	30,000	30,000	30,000	By A's Executor's A/c	13,500	8,100	5,400
To balance c/d	**7,08,987**	**6,66,992**	**10,90,021**	By Share in Pft **(WN 4)**	93,600	62,400	52,000
Total	**10,62,987**	**9,12,992**	**13,00,021**	**Total**	**10,62,987**	**9,12,992**	**13,00,021**

8. Journal Entries

Note: It is assumed that Drawings were made evenly throughout the year. However, a single Journal Entry (**JE 8 & 9**) has been given at year–end relating to transfer of Drawings and Distribution of Profit, but the Partners' Capital Accounts shown in the earlier workings include the entries of Drawings and Distribution of Profit of respective dates within the year.

S.No	Particulars		Dr. (₹)	Cr. (₹)
1.	Machinery A/c	Dr.	27,000	
	To A's Capital A/c			13,500
	To B's Capital A/c			8,100
	To C's Capital A/c			5,400
	(Being Wages spent on installation of new Machinery capitalised and credited to Partners' Capital Accounts after providing Depreciation for 6 months ended 31.03.2017)			
2.	Profit and Loss Suspense A/c **(WN 1)**	Dr.	67,500	
	To A's Capital A/c			67,500
	(Being A's Share of Profit for 4 months credited to his Capital Account) **(WN 2)**			
3.	Goodwill A/c	Dr.	7,20,000	
	To A's Capital A/c			3,60,000
	To B's Capital A/c			2,16,000
	To C's Capital A/c			1,44,000
	(Being Goodwill credited to Partners in the Old Profit Sharing Ratio 5:3:2)			
4.	A's Capital A/c	Dr.	12,20,000	
	To A's Executor's Account A/c			12,20,000
	(Being balance due to A, transferred to his Executor's Account)			
5.	Profit and Loss Suspense A/c	Dr.	28,021	
	To A's Executor's Account A/c			28,021
	(Being Profit earned out of Unsettled Capital credited to A's Executor's A/c) **(WN 4)**			
6.	A's Executor's Account A/c	Dr.	12,48,021	
	To D's Capital A/c			12,48,021
	(Being Final Balance of A's Executor's Account transferred to D's Capital Account)			
7.	B's Capital A/c	Dr.	3,24,000	
	C's Capital A/c	Dr.	2,16,000	
	D's Capital A/c	Dr.	1,80,000	
	To Goodwill A/c			7,20,000
	(Being Goodwill written off and debited to Partners in New Profit Sharing Ratio 9:6:5)			
8.	B's Capital A/c	Dr.	60,000	
	C's Capital A/c	Dr.	60,000	
	D's Capital A/c	Dr.	30,000	
	To B's Drawings A/c			60,000
	To C's Drawings A/c			60,000
	To D's Drawings A/c			30,000
	(Being Drawings debited to Partner's Capital Accounts)			

S.No	Particulars		Dr. (₹)	Cr. (₹)
9.	Profit and Loss Appropriation A/c	Dr.	4,16,000	
	To Profit and Loss Suspense A/c (₹ 67,500 + ₹ 28,021)			95,521
	To B's Capital A/c			1,61,087
	To C's Capital A/c			1,07,392
	To D's Capital A/c			52,000
	(Being Division of Profits as shown in statement of distribution of Profits and Balance of Profit and Loss Suspense A/c transferred to Profit and Loss Appropriation A/c)			

Illustration 23: Accounting for Partnership: Death **N 19**

Arup and Swarup were partners. The partnership deed provides inter alia:

(i) That the annual accounts be balanced on 31st December each year,

(ii) That the profits be allocated as follows:

Arup: One–half, Swarup: One–third and Carried to reserve account: One Sixth,

(iii) That in the event of death of a partner, his executor will be entitled to the following:

(1) The capital to his credit at the date of death:

(2) His proportionate share of profit to date of death based on the average profits of the last three completed years, and

(3) His Share of goodwill based on three years' purchase of the average profits for the three preceding completed years

Trial Balance as on 31st December 2018

Particulars	Debit (₹)	Credit (₹)
Arup's Capital		**90,000**
Swarup's Capital		**60,000**
Reserve		**45,000**
Bills receivable	**50,000**	
Investment	**55,000**	
Cash	**1,10,000**	
Trade payables		**20,000**
Total	**2,15,000**	**2,15,000**

The profits for the three year were 2016: ₹ 51,000, 2017: ₹ 39,000 and 2018: ₹ 45,000. Swarup died on 1st May 2019.

Show the calculation of Swarup (A) Share of profits, (B) Share of Goodwill, (C) Draw up Swarup's Executors Account as would appear in the firm's ledger transferring the amount to the Loan amount.

Solution:

1. Computation of (Sacrifice)/Gain Ratio

Particulars	Anup	Swarup	Reserves
1. Old PSR (Given)	3/6	2/6	1/6

Profit sharing Ratio of Anup and Swarup is 3:2 for which Swarup on death sacrifices 2/5 and Anup gains 2/5 on Swarup's death

2. Average Profits = $\frac{₹51{,}000 + ₹39{,}000 + ₹45{,}000}{3}$ = ₹ 45,000

So, Goodwill = Average Profits × 3 years = ₹ 45,000 x 3 years = ₹ **1,35,000**

Swarup's Share in G/w = ₹ 1,35,000 × 2/5 = ₹54,000, to be borne by Anup.

So, Share of Profits of Swarup = Average of Last 3 Completed Years Profits x No. of Months / 12 x PSR of Swarup

= 45,000 x 5/12 x 2/5

= ₹ 7,500

3. Swarup's Capital Account

Particulars	₹	Particulars	₹
To Swarup's Executor's A/c (transfer)	1,39,500	By balance b/d	60,000
		By Reserves (45,000 x 2/5)	18,000
		By Anup's Capital A/c (Goodwill)	54,000
		By Profit and Loss Suspense A/c	7,500
Total	**1,39,500**	**Total**	**1,39,500**

3. Swarup's Executor Account

Particulars	₹	Particulars	₹
To Swarup's Executor's Loan A/c (transfer)	1,39,500	By Swarup's Capital A/c	1,39,500
Total	**1,39,500**	**Total**	**1,39,500**

Additional Questions

Illustration 1: Retirement of Partner – Revaluation, Part Settlement, etc.

Atul, Balbir and Chatur were carrying on a business in Partnership sharing Profits in the ratio of 5:3:2 respectively. On 31st March 2016, their Balance Sheet stood as follows:

Capital and Liabilities	₹	Properties and Assets		₹
Atul's Capital	**6,25,000**	**Goodwill**		**80,000**
Balbir's Capital	**3,75,000**	**Land and Buildings**		**7,00,000**
Chatur's Capital	**2,50,000**	**Furniture**		**1,65,000**
General Reserve	**1,00,000**	**Stock**		**2,86,000**
Trade Creditors	**2,10,000**	**Trade Debtors**	**1,80,000**	
		Less: Provision for Bad Debts	**(3,600)**	**1,76,400**
		Cash at Bank		**1,52,600**
Total	**15,60,000**	**Total**		**15,60,000**

Atul retired on the above mentioned date and Partners agreed that:

(i) The Current Value of Goodwill be taken to be equal to the Book Value of the Asset.

(ii) Land and Buildings be considered worth ₹ 9,00,000.

(iii) The Provision for Bad Debts on Trade Debtors be raised to 5%.

(iv) Provision be made for compensation of ₹ 5,000 to an ex–employee.

(v) Half of the amount due to Atul be paid immediately in cash, and balance be treated as 10% Loan, repayable within 3 years.

In order to facilitate cash payment to Atul, Balbir and Chatur brought in ₹ 3,00,000 in the ratio of 3:2 respectively.

Prepare Revaluation Account, the Capital Account of all the Partners and Bank Account. Also, draw the Initial Balance Sheet of Balbir and Chatur, immediately after Atul's retirement.

Solution:

1. Revaluation Account

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts (5% of 1,80,000 – 3,600)		5,400	By Land & Buildings	2,00,000
To Provision for Compensation		5,000	(9,00,000 – 7,00,000)	
To Capital Account (tfr in new PSR 5 : 3 : 2)				
– Atul	94,800			
– Balbir	56,880			
– Chatur	37,920	**1,89,600**		
Total		**2,00,000**	**Total**	**2,00,000**

2. Partners' Capital Account

Particulars	Atul	Balbir	Chatur	Particulars	Atul	Balbir	Chatur
To Goodwill (5:3:2)	40,000	24,000	16,000	By balance b/d	6,25,000	3,75,000	2,50,000
To Cash A/c	3,84,900	–	–	By General Reserve	50,000	30,000	20,000
To 10% Loan	**3,84,900**	–	–	By Revaluation A/c	94,800	56,880	37,920
To A's Capital	–	24,000	16,000	By B & C's Capital A/c	40,000	–	–
To balance c/d **(b/f)**	–	**5,93,880**	**3,95,920**	By Cash A/c	–	1,80,000	1,20,000
Total	**8,09,800**	**6,41,880**	**4,27,920**	**Total**	**8,09,800**	**6,41,880**	**4,27,920**

3. Balance Sheet as at 31.03.2016 (after Atul's retirement)

Capital and Liabilities	₹	Properties and Assets			₹
Capital Account:		**Non–Current Assets:**	Land & Buildings		9,00,000
– Balbir	5,93,880		Furniture		1,65,000
– Chatur	3,95,920	**Current Assets:**			
10% Loan A/c	3,84,900	Stock			2,86,000
Current Liabilities:			Sundry Debtors	1,80,000	
Sundry Creditors	2,10,000	**Less:**	Provision for Doubtful Debts	(9,000)	1,71,000
Provision for Compensation	5,000	Cash at Bank **(Note)**			67,700
Total	**15,89,700**	**Total**			**15,89,700**

Note: Balance at Bank = 1,52,600 + 1,80,000 + 1,20,000 – 3,84,900 = ₹ **67,700**

Illustration 2: Retirement cum Admission – Revaluation, Goodwill Adjustment, Capital Adjustment

A, B and C are Partners of the Firm ABC & Co. sharing Profits and Losses in the ratio of 5:3:2. Following is the Balance Sheet of the Firm as at 31.03.2016:

Capital and Liabilities		₹	Properties and Assets	₹
Partners' Capital Accounts:			**Non–Current Assets:**	
– A		4,50,000	Goodwill	1,00,000
– B		1,30,000	Building	10,50,000
– C		1,70,000	Machinery	6,50,000
Investment Fluctuation Reserve		1,00,000	Furniture	2,15,000
Contingency Reserve		75,000	Investments (Market Value ₹ 75,000)	60,000
Non–Current Liabilities: Long–Term Loan		15,00,000	**Current Assets:**	
			Stock	6,50,000
Current Liabilities:	Sundry Creditors	8,00,000	Sundry Debtors	6,95,000
	Bank Overdraft	2,20,000	Advertisement Suspense	25,000
Total		**34,45,000**	**Total**	**34,45,000**

It was decided that B retire from the Partnership on 1.4.2016, and D would be admitted as a Partner on the same date.

The following adjustments are agreed amongst the Partners for the Retirement / Admission:

- **Goodwill is to be valued at ₹ 5,00,000, but the same will not appear as an asset in the books of the Firm.**
- **Building and Machinery are to be revalued at ₹ 10,00,000 and ₹ 5,20,000 respectively.**
- **Investments are to be taken over by B at their Market Value.**
- **Provision for Doubtful Debts to be maintained at 20% on Sundry Debtors.**
- **The Capital of the reconstituted Firm will be ₹ 10,00,000 to be contributed by the Partners A, C and D in their new profit sharing ratio 2:2:1.**
- **Surplus funds if any will be used to pay the Bank Overdraft.**
- **Amount due to Retiring Partner B will be transferred to his Loan Account.**

Prepare – (1) Revaluation Account, (2) Capital Accounts of the Partners, and (3) Balance Sheet of the Firm after reconstitution.

Solution: **1. Goodwill Adjustment** (Amount ₹ 5,00,000 given)

Note: Existing Balance Sheet Goodwill ₹1,00,000 is written off in the Capital Account **(See WN 3)** and the new agreed amount of Goodwill ₹ 5,00,000 is adjusted in Capital Account, as shown below.

Particulars	**A**	**B**	**C**	**D**
New Goodwill credited in Old PSR (5:3:2)	2,50,000 Cr.	1,50,000 Cr.	1,00,000 Cr.	–
New Goodwill written off in New PSR (2:2:1)	2,00,000 Dr.	–	2,00,000 Dr.	1,00,000 Dr.
Net Effect in Capital A/c for New G/W	**50,000 Cr.**	**1,50,000 Cr.**	**1,00,000 Dr.**	**1,00,000 Dr.**

2. Revaluation Account

Particulars		₹	**Particulars**		₹
To Building (10,50,000 – 10,00,000)		50,000	By Investments (75,000 – 60,000)		15,000
To Machinery (6,50,000 – 5,20,000)		1,30,000	By Capital Accounts – Loss transferred (old PSR)		
To Provision for Doubtful Debts		1,39,000	– A	1,52,000	
(20% on 6,95,000)			– B	91,200	
			– C	60,800	3,04,000
Total		**3,19,000**	**Total**		**3,19,000**

3. Bank Account (See Partners' Capital A/c below)

Particulars	₹	**Particulars**	₹
To A's Capital A/c	27,000	By balance b/d (Overdraft)	2,20,000
To C's Capital A/c	3,80,800	By balance c/d **(bal. fig)**	**4,87,800**
To D's Capital A/c	3,00,000		
Total	**7,07,800**	**Total**	**7,07,800**

4. Partners' Capital Accounts

Details	**A**	**B**	**C**	**D**	**Details**	**A**	**B**	**C**	**D**
To Revaln	1,52,000	91,200	60,800	–	By bal.b/d	4,50,000	1,30,000	1,70,000	–
To Goodwill w/off**(WN1)**	50,000	30,000	20,000	–	By Contin. Reserve	37,500	22,500	15,000	–
To A and B **(WN 1)**	–	–	1,00,000	1,00,000	By InvtFluc.Reserve	50,000	30,000	20,000	–
To Invts	–	75,000	–	–	By C and D **(WN 1)**	50,000	1,50,000	–	–0
To AdvtSusp	12,500	7,500	5,000	–	By Bank	**27,000**	–	**3,80,800**	**3,00,000**
To B's Loan **(bal. fig.)**	–	**1,28,800**	–	–	**(bal. fig.)**				
To bal. c/d **(Note)**	4,00,000	–	4,00,000	2,00,000					
Total	**6,14,500**	**3,32,500**	**5,85,800**	**3,00,000**	**Total**	**6,14,500**	**3,32,500**	**5,85,800**	**3,00,000**

Note: Required Closing Capital (given) = ₹ 10,00,000, to be maintained in new PSR 2:2:1.

5. Balance Sheet as at 01.04.2016(After retirement of B and admission of D)

Capital and Liabilities	₹	**Properties and Assets**		₹
Partner's Capital Accounts **(WN 3)**		**Non–Current Assets:**		
– A	4,00,000	Building		10,00,000
– C	4,00,000	Machinery		5,20,000
– D	2,00,000	Furniture		2,15,000
Non–Current Liabilities:		**Current Assets:**		
Long–Term Loan	15,00,000	Stock		6,50,000
B's Loan	1,28,800	Debtors	6,95,000	
Current Liabilities:		**Less:** Provn for Doubtful Debts	(1,39,000)	5,56,000
Sundry Creditors	8,00,000	Cash at Bank **(WN 4)**		4,87,800
Total	**34,28,800**	**Total**		**34,28,800**

Illustration 3: Admission cum Retirement – Adjustment for Goodwill

Pathak, Quereshi and Ranjeet were Partners sharing Profits in the ratio of 7:5:3 respectively. On 31st March 2016, Quereshi retired when the Firm's Balance Sheet was as follows:

Capital and Liabilities	₹	Properties and Assets		₹
Capital Account:		Land & Building		10,00,000
– Pathak	8,50,000	Plant & Machinery		4,65,000
– Quereshi	6,20,000	Furniture, Fixture & Fittings		2,30,100
– Ranjeet	3,70,000	Stock		1,82,200
General Reserve	2,25,000	Trade Debtors	2,00,000	
Trade Creditors	1,13,000	Less: Provision for Bad Debts	6,000	1,94,000
		Cash at Bank		1,06,700
Total	21,78,000	Total		21,78,000

It was agreed that:

(i) Land & Buildings be appreciated by 20%.

(ii) Plant & Machinery be depreciated by 10%.

(iii) Provision for Bad Debts be made equal to 4% of Trade Debtors.

(iv) Outstanding Repairs Bill amounting to ₹ 1,500 be recorded in the books of account.

(v) Goodwill of the Firm be valued at ₹ 3,00,000, and Quereshi's Capital Account be credited with his share of goodwill without raising Goodwill Account.

(vi) Half of the amount due to Quereshi be immediately paid to him by means of a cheque, and the balance be treated as a Loan bearing interest @ 12% per annum.

After Quereshi's retirement, Pathak and Ranjeet admitted Swamy as new Partner with effect from 1st April 2015. Pathak, Ranjeet and Swamy agreed to share profits in the ratio of 2 : 1 : 1 respectively.

Swamy brought Patents valued at ₹ 20,000 and ₹ 3,80,000 in cash including payment for his share of Goodwill as valued by the Old Firm. The entire amount of ₹ 4,00,000 was credited to Swamy's Capital Account. Adjustments were made in the Capital Account for Swamy's share of goodwill.

(a) Pass Journal Entries for all the above transactions without any narration, and

(b) Prepare the Capital Account of all the Partners.

Solution:

Journal Entries

S.No	Particulars		Dr. (₹)	Cr. (₹)
1.	Land and Building A/c (10,00,000 × 20%)	Dr.	2,00,000	
	To Revaluation A/c			2,00,000
	(Being Land and Buildings appreciated by 20%)			
2.	Revaluation A/c	Dr.	46,500	
	To Plant & Machinery A/c (4,65,000 × 10%)			46,500
	(Being Plant and Machinery depreciated by 10%)			
3.	Revaluation A/c	Dr.	2,000	
	To Provision for Bad Debts A/c (4% of ₹ 2,00,000 – 6,000)			2,000
	(Being Provision for Bad Debts made equal to 4% of Debtors)			
4.	Revaluation A/c	Dr.	1,500	
	To Outstanding Repair Bills A/c			1,500
	(Being Outstanding Repair Bills recorded in the Books of Accounts)			
5.	Revaluation A/c **(WN 2)**	Dr.	1,50,000	
	To Pathak's Capital A/c			70,000
	To Quereshi's Capital A/c			50,000
	To Ranjeet's Capital A/c			30,000
	(Being Gain on Revaluation transferred to Partner's Capital A/c)			
	Note: Net Gain on Revaluation as per Effect of Journal Entries 1,2,3 & 4 = 2,00,000 (–) 46,500 (–) 2,000 (–) 1,500 = ₹ 1,50,000. Alternatively, Revaluation Account can be prepared to ascertain the Net Gain.			

S.No	Particulars		Dr. (₹)	Cr. (₹)
6.	Pathak's Capital A/c	Dr.	10,000	
	Ranjeet's Capital A/c	Dr.	15,000	
	Swamy's Capital A/c	Dr.	75,000	
	To Quereshi's Capital A/c **(WN 1)**			1,00,000
	(Being Adjustment made for Goodwill)			
7.	General Reserve A/c (Distribution in 7:5:3)	Dr.	2,25,000	
	To Pathak's Capital A/c			1,05,000
	To Quereshi's Capital A/c			75,000
	To Ranjeet's Capital A/c			45,000
	(General Reserve transferred to the Old Partners in Old Profit Sharing Ratio)			
8.	Quereshi's Capital A/c	Dr.	8,45,000	
	To Bank A/c			4,22,500
	To Quereshi's Loan A/c			4,22,500
	(Being settlement made to Quereshi and Balance treated as Loan)			
9.	Patents A/c	Dr.	20,000	
	Cash A/c	Dr.	3,80,000	
	To Swamy's Capital A/c			4,00,000
	(Being Capital Brought in by the new Partner)			

Partners' Capital Accounts

Details	Pathak	Quereshi	Ranjeet	Swamy	Details	Pathak	Quereshi	Ranjeet	Swamy
To Quereshi's Capital A/c	10,000	–	15,000	75,000	By bal.b/d	8,50,000	6,20,000	3,70,000	
					By General Reserve	1,05,000	75,000	45,000	
To Bank A/c		4,22,500			By Cap A/c – Pathak		10,000		
					– Ranjeet		15,000		
To Quereshi's Loan A/c		4,22,500			– Swamy		75,000		
					By Revln.	70,000	50,000	30,000	
To bal c/d	10,15,000	–	4,30,000	3,25,000	By Patents				20,000
					By Cash A/c				3,80,000
Total	**10,25,000**	**8,45,000**	**4,45,000**	**4,00,000**	**Total**	**10,25,000**	**8,45,000**	**4,45,000**	**4,00,000**

Working Notes

1. Adjustment for Goodwill

Particulars	Pathak	Quereshi	Ranjeet	Swamy
Creation of Goodwill (7:5:3)	1,40,000 Cr.	1,00,000 Cr.	60,000 Cr.	–
Goodwill Written Off (2:1:1)	1,50,000 Dr.	–	75,000 Dr.	75,000 Dr.
Net Effect	**10,000 Dr.**	**1,00,000 Cr.**	**15,000 Dr.**	**75,000 Dr.**

Illustration 4: Retirement cum Admission – Revaluation, Goodwill, Capital Adjustment

P, Q and R were Partners sharing Profits and Losses in the ratio of 2: 2: 1. R wants to retire from Partnership on 31.03.2016 and S wants to join the Partnership on the same date, to which both P & Q agreed. The Balance Sheet of the Partnership Firm as on 31.03.2016 and other information were as detailed below:

Capital and Liabilities			₹	Properties and Assets	₹
Capital Accounts:				Non–Current Assets: Fixed Assets	6,00,000
– P		4,80,000		Current Assets:	
– Q		3,20,000		Stock in Hand	2,00,000
– R		2,40,000	10,40,000	Sundry Debtors	2,80,000
General Reserve			40,000	Cash at Bank	1,60,000
Current Liabilities:	Sundry Creditors		2,00,000	Cash in Hand	40,000
Total			12,80,000	Total	12,80,000

P, Q and S agree to share Profits and Losses in equal ratio in future. Value of Goodwill is taken to be ₹ 1,80,000. Fixed Assets are revalued upwards by ₹ 1,20,000 and Stock by ₹ 40,000. A Debtor from whom ₹ 20,000 was due, become insolvent. No amount will be received from him in future and same is not recorded in the books and Balance Sheet as above. Claim of R will be settled in full. P, Q and S agree to make their Capital proportionate to their New Profit Sharing Ratio. Balance amount receivable from / payable to Partners will be paid to Partners / brought in by Partners immediately. All these transactions viz., claim of R and amount receivable / payable to Partners will be routed through Bank only. New Partners also want to maintain ₹ 3,20,000 Bank Balance for Working Capital requirement. However, they do not want to show Goodwill in the books of accounts.

Prepare:

(i) Revaluation Account,

(ii) Capital Accounts of Partners, and

(iii) Balance Sheet of the Firm as newly constituted.

Solution:

1. Revaluation Account

Particulars		₹	Particulars	₹
To Sundry Debtors		20,000	By Fixed Assets	1,20,000
To Partners' Capital – Profit transferred (old PSR)			By Stock	40,000
– P	56,000			
– Q	56,000			
– R	28,000	**1,40,000**		
Total		**1,60,000**	**Total**	**1,60,000**

2. Adjustment of Goodwill

Particulars	P	Q	R	S	Total
Goodwill credited to Old Partners in Old PSR (2:2:1)	72,000 Cr.	72,000 Cr.	36,000 Cr.	–	1,80,000
Goodwill debited to New Partners in New PSR (1:1:1)	60,000 Dr.	60,000 Dr.	–	60,000 Dr.	1,80,000
Net Effect	**12,000 Cr.**	**12,000 Cr.**	**36,000 Cr.**	**60,000 Dr.**	**Nil**

3. Computation of Capital to be maintained

Particulars	₹
(a) Total Assets of Reconstituted Firm = = Revalued FA 7,20,000 + Revalued Stock 2,40,000 + Revised Debtors 2,60,000 + Reqd Bank 3,20,000 + Cash 40,000 (given)	15,80,000
(b) External Liabilities = Creditors	2,00,000
(c) Net Assets, i.e. represented by Equity (i.e. Capital) = (a – b) to be maintained in New PSR (1:1:1)	**13,80,000**

Required Capital = ₹ 13,80,000

		P ($1/3^{rd}$)	Q ($1/3^{rd}$)	S ($1/3^{rd}$)
	Amount of Capital to be maintained	4,60,000 Cr.	4,60,000 Cr.	4,60,000 Cr.
Less:	Existing Capital after adjustments (refer below)	5,64,000 Cr.	4,04,000 Cr.	60,000 Dr.
	Amount to be brought in / (paid off)	**(1,04,000)**	**56,000**	**5,20,000**

4. Partners' Capital

Details	P	Q	R	S	Details	P	Q	R	S
To Goodwill	–	–	–	60,000	By bal.b/d	4,80,000	3,20,000	2,40,000	–
To Bank **(bal. fig.)**	–	–	**3,12,000**	–	By General Res.(2:2:1)	16,000	16,000	8,000	–
To Bank **(bal. fig.)**	**1,04,000**	–	–	–	By Revaln A/c	56,000	56,000	28,000	–
To bal.c/d	4,60,000	4,60,000	–	4,60,000	By G/w	12,000	12,000	36,000	
					By Bank **(bal. fig.)**	–	**56,000**	–	**5,20,000**
Total	**5,64,000**	**4,60,000**	**3,12,000**	**5,20,000**	**Total**	**5,64,000**	**4,60,000**	**3,12,000**	**5,20,000**

5. Bank Account

Particulars	₹	Particulars	₹
To balance b/d	1,60,000	By R's Capital	3,12,000
To Q's Capital	56,000	By P's Capital	1,04,000
To S's Capital	5,20,000	By balance c/d (given)	3,20,000
Total	**7,36,000**	**Total**	**7,36,000**

6. Balance Sheet of the Firm as on 31.03.2016 (after Reconstitution)

Capital and Liabilities		₹	Properties and Assets	₹
Partner's Capital A/c			**Non–Current Assets:**	
– P	4,60,000		Fixed Assets (6,00,000 + 1,20,000)	7,20,000
– Q	4,60,000		**Current Assets:**	
– S	4,60,000	13,80,000	Stock in Trade (2,00,000 + 40,000)	2,40,000
Current Liabilities:			Sundry Debtors (2,80,000 – 20,000)	2,60,000
Sundry Creditors		2,00,000	Cash at Bank (given)	3,20,000
			Cash in Hand	40,000
Total		**15,80,000**	**Total**	**15,80,000**

Appendix: Limited Liability Partnerships – An Overview

Salient Features of LLP

1. **Hybrid of Corporate Entity and Partnership Firm:** LLP assimilates the features of the Company and Partnership form of Business Entity. As the name suggests the limited liability of Partners is the key feature of the LLP Act, 2008.
2. **Definition of LLP:** A Limited Liability Partnership is a **Body Corporate** formed and incorporated under the LLP Act. Every LLP shall have atleast 2 **Designated Partners** who are Individuals, and atleast one of them shall be a **Resident** in India. [**Note:** Resident = Person who has stayed in India for ≥ 182 days during the immediately preceding 1 year.]
3. **Below Minimum:** If at any time the number of partners of a LLP is reduced below 2 and the LLP carries on business for > 6 Months while the number is so reduced, the Person, who is the only Partner of the LLP during the time that it so carries on business after those 6 Months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.
4. **Persons not capable of becoming Designated Partners [Rule 9]:** A person shall **not** be capable of being appointed as a Designated Partner of a LLP, if he –
   (a) has at any time within the preceding 5 years been **adjudged insolvent**, or
   (b) suspends, or has at any time within the preceding 5 years **suspended payment to his Creditors** and has not at any time within the preceding 5 years made, a composition with them, or
   (c) has been **convicted by a Court** for any **offence involving moral turpitude** and sentenced in respect thereof to imprisonment for not less than 6 months, or
   (d) has been convicted by a Court for an **offence involving Sec.30** of the Act.
5. **LLP Agreement:** Any written Agreement between the Partners of the LLP or between the LLP and its Partners which determines the mutual rights and duties of the Partners and their rights and duties in relation to that LLP – is the LLP Agreement. The significance of LLP is that –
   (a) the mutual rights and duties of the Partners of a LLP, $\xrightarrow{\text{Shall be governed}}$ (a) between the Partners, or
   (b) the mutual rights and duties of a LLP and its Partners, by LLP Agreement (b) between LLP and its Partners.
6. **Perpetual Succession:** The duration or life of the LLP does not depend upon the Partnership Deed. The LLP continues till it is wound up in accordance with the process established by law.
7. **Separate Legal Entity:** LLP is a separate legal entity, a concept hitherto known to Corporate Entities only. Thus, an LLP enjoys the right to enter agreements in its own name and is entitled to sue and be sued in its own name.
8. **Flexible Management Structure:** The LLP can have flexible management structure and flexible Profit Distribution of the Partnership Firm Concept. The flexibility of management means that there are no mandatory Board Meetings or General Meetings and there are few legal and procedural requirements to be followed by LLP.
9. **Indian Partnership Act, 1932 does not apply:** The provisions of the Indian Partnership Act, 1932 do not apply to LLP's. The LLP Act, 2008 has not superseded the Indian Partnership Act, 1932 and Partnership Firms can continue to be formed and governed under the said Act.
10. **Formation:** The LLP can be formed by any Individual and/or a Body Corporate provided the individual is of sound mind and is neither an undischarged insolvent nor has applied to be adjudicated as an insolvent. A Body Corporate can also be a Partner of LLP.
11. **Unique Identity Number:** Upon incorporation, every LLP is allocated a Unique Identity Number called as Limited Liability Partnership Identity Number (LLPIN), similar to Corporate Identity Number allotted upon registration / incorporation of a Company. Every Designated Partner of LLPs are liable to obtain Unique Identification Number called as Designated Partner Identification Number (DPIN).
12. **Designated Partner:** The Designated Partner has a major role to play in LLP. The Designated Partner is responsible for doing all acts, matters and things as are required to be done by LLP as per the Act or as specified in LLP Agreement. The Designated Partner is liable for all penalties imposed on LLP for any contravention of the provisions of the Act or LLP Agreement.
13. **Conversion of an Entity to LLP:** The Act also contains the provisions to convert a Partnership Firm, Private Limited Company, or an Unlisted Public Limited Company into a LLP. The continuation of the activities of such a Firm, Private Limited Company and Unlisted Public Company is not affected.
14. **Compromise and Arrangements:** The Act also provides the facility of Merger, Amalgamation and Arrangement of LLPs. The power to order Merger lies with the National Company Law Tribunal as defined under the Companies Act. Further, a LLP may be wound up voluntarily or compulsorily by the Tribunal. The compulsory winding up may be ordered by the Tribunal, interalia, on the ground of inability to pay debts or on just and equitable ground. The Registrar has the power to strike off defunct LLPs.

Comparison between Company, Partnership Firm and LLP

Features	Company	Partnership	LLP
Registration	Compulsory registration required with ROC. Certificate of Incorpo–ration is conclusive evidence.	Not compulsory.Unregistered Partnership Firms have some disadvantages.	Compulsory registration required with the ROC
Name	Name of a Public Company to end with the word "Limited" and a Private Company with the words "Private Limited".	No guidelines, but there are certain restrictions on use of some words as a part of name of the Firm.	Name to end with "**LLP**" " Limited Liability Partnership" but restrictions on use of some words as a part of name of the Firm.
Creation	Created by Law.	Created by Agreement	Created by Law & Agreement.
Legal Entity	Separate Legal Entity.	**Not** a Separate Legal Entity.	Separate Legal Entity.
Owning Assets	Company can own Assets in its own name.	In reality, the Partners own the Assets of the Firm.	LLP can own Assets in its own name.
Body Corporate	It is a Body Corporate	**Not** a Body Corporate.	It is a Body Corporate.
Perpetual Succession	Company has perpetual succession.	Firm does not have perpetual succession.	LLP has perpetual succession.
Liability	Limited to the extent of Unpaid Capital.	Unlimited, can extend to the Personal Assets of the Partners.	Limited to the extent of the Contribution to the LLP, except in case of intentional fraud or wrongful act by a Partner.
No. of Share–holders / Partners	Minimum 2. In a Private Company, maximum of 50 Shareholders.	2–20 Partners	Minimum of 2. No maximum limit
Agency Relationship	Shareholders and Company are not Agents of one another.	Partners are Agents of the Firm and of each other.	Partners are Agents of the Firm only, and not of other Partners.
Foreign Nationals	Foreign Nationals can be Shareholders. There is no express restriction.	Foreign Nationals cannot form Partnership Firm as such.	Foreign Nationals can be Partners. No specific restriction.
Meetings	Quarterly Board of Directors meeting, Annual Shareholders Meeting is mandatory.	Not required.	Not required.
Annual Return	Annual Accounts and Annual Return to be filed with ROC.	Annual Returns or Accounts need not be filed with the Registrar of Firms.	Annual Statement of Accounts and Solvency & Annual Return have to be filed with ROC.
Audit	Compulsory, irrespective of Share Capital and Turnover.	Not mandatory as such.	Required, if the Contribution is above ₹ 25 Lakhs or if Annual Turnover is above ₹ 40 Lakhs.
Source of funding	Own Funds in case of Private Company. A Public Company can raise funds from public through IPO / Deposits.	Public Funds cannot be raised.	Public Funds cannot be raised.
Dissolution	Very procedural. Voluntary or by Order of National Company Law Tribunal.	By agreement of the Partners, Insolvency or by Court Order.	Less procedural compared to Company. Voluntary or by Order of National Company Law Tribunal.
Whistle blowing	No provision as to whistle–blowing or protection of employees	No provision as to whistle–blowing or protection of employees	Protection provided to Employees and Partners who provide useful information during investigation.

State with reasons, whether the following statements are True or False

Statements	T / F	Hint Answer / Reference
Limited Liability Partnership (LLP) is governed by Indian Partnership Act, 1932. **[M 19]**	False	Limited Liability Partnership (LLP) is governed by Limited Liability Partnership Act,1932
A partnership firm cannot own any Assets. **[N 19]**	True	A partnership firm cannot own any assets. However, the partners own the asset of the firm.