Accountancy

Not-for-Profit Organisation and Partnership Accounts

Textbook for Class XII

राष्ट्रीय शैक्षिक अनुसंधान और प्रशिक्षण परिषद्
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OFFICES OF THE PUBLICATION DIVISION, NCERT

NCERT Campus
Sri Aurobindo Marg
New Delhi 110 016 **Phone : 011-26562708**

108, 100 Feet Road
Hosdakere Halli Extension
Banashankari III Stage
Bengaluru 560 085 **Phone : 080-26725740**

Navjivan Trust Building
P.O.Navjivan
Ahmedabad 380 014 **Phone : 079-27541446**

CWC Campus
Opp. Dhankal Bus Stop
Panihati
Kolkata 700 114 **Phone : 033-25530454**

CWC Complex
Maligaon
Guwahati 781 021 **Phone : 0361-2674869**

Publication Team

Head, Publication Division : *N.K. Gupta*

Chief Editor : *Shveta Uppal*

Chief Business Manager : *Gautam Ganguly*

Chief Production Officer (I/c) : *Arun Chitkara*

Assistant Production Officer : *Atul Saxena*

Cover
Shweta Rao

Foreword

The *National Curriculum Framework* (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the *National Policy on Education* (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences Professor Hari Vasudevan and the Chief Advisor for this book, Professor R.K. Grover, (Retd.) Director, School of Management Studies (IGNOU), New Delhi for guiding the work of this committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to the systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement.

Director
National Council of Educational
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Textbook Development Committee

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Chief Advisor

R. K. Grover, *Professor, (Retd.)*, School of Management Studies, IGNOU, New Delhi

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Sudhir Sapra, *PGT (Commerce),* Kendriya Vidyalaya, Sultanpur, U.P.

Vanita Tripathi, *Lecturer,* Department of Commerce, Delhi School of Economics, Delhi

Member-coordinator

Shipra Vaidya, *Professor,* Department of Education in Social Sciences, NCERT, New Delhi.

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Contents

Accounting for Not-for-Profit Organisation — 1

LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- *Identiy the need for, and nature of accounting records relating to not-for-profit organisations;*
- *List the principal financial statements prepared by not-for-profit organisations and explain their nature;*
- *Prepare the Receipt and Payment Account from a given data;*
- *Explain the procedure of preparing the Income and Expenditure Account from a given Receipt and Payment Account and some additional information;*
- *Distinguish between the Receipt and Payment Account and the Income and Expenditure Account;*
- *Prepare Income and Expenditure Account and Balance Sheet from a given Receipt and Payment Account and the relevant additional information;*
- *Explain treatment of certain peculiar items of receipts and payments such as subscriptions from members, special funds, legacies, sale of old fixed assets, etc.*

There are certain organisations which are set up for providing *service* to its members and the public in general. Such organisations include clubs, charitable institutions, schools, religious organisations, trade unions, welfare societies and societies for the promotion of art and culture. These organisations have service as the main objective and not the *profit* as is the case of organisations *in business. Normally, t*hese organisations do not undertake any business activity, and are managed by trustees who are fully accountable to their members and the society for the utilization of the funds raised for meeting the objectives of the organisation. Hence, they also have to maintain proper accounts and prepare the financial statement which take the form of Receipt and Payment Account; Income and Expenditure Account; and Balance Sheet. at the end of for every accounting period (normally a financial year).

This is also a legal requirement and helps them to keep track of their income and expenditure, the nature of which is different from those of the business organisations. In this chapter we shall learn about the accounting aspects relating to not-for-profit organisation.

1.1 Meaning and Characteristics of Not-for-Profit Organisation

Not-for-Profit Organisations refer to the organisations that are for used for the welfare of the society and are set up as charitable institutions which function without any profit motive. Their main aim is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence they need not maintain many books of account (as the trading concerns do) and Trading and Profit and Loss Account. The funds raised by such organisations are credited to capital fund or general fund. The major sources of their income usually are subscriptions from their members donations, grants-in-aid, income from investments, etc. The main objective of keeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

The main characteristics of such organisations are:

1. Such organisations are formed for providing service to a specific group or public at large such as education, health care, recreation, sports and so on without any consideration of caste, creed and colour. Its sole aim is to provide service either free of cost or at nominal cost, and not to earn profit.
2. These are organised as charitable trusts/societies and subscribers to such organisation are called members.
3. Their affairs are usually managed by a managing/executive committee elected by its members.
4. The main sources of income of such organisations are: (i) subscriptions from members, (ii) donations, (iii) legacies, (iv) grant-in-aid, (v) income from investments, etc.
5. The funds raised by such organisations through various sources are credited to capital fund or general fund.
6. The surplus generated in the form of excess of income over expenditure is not distributed amongst the members. It is simply added in the capital fund.
7. The Not-for-Profit Organisations earn their reputation on the basis of their contributions to the welfare of the society rather than on the customers' or owners' satisfaction.
8. The accounting information provided by such organisations is meant for the present and potential contributors and to meet the statutory requirement.

1.2 Accounting Records of Not-for-Profit Organisations

As stated earlier, normally such organisations are not engaged in any trading or business activities. The main sources of their income are subscriptions from members, donations, financial assistance from government and income from investments. Most of their transactions are in *cash* or through the bank. These institutions are required by law to keep proper accounting records and keep proper control over the utilization of their funds. This is why they usually keep a cash book in which all receipts and payments are duly recorded. They also maintain a ledger containing the accounts of all incomes, expenses, assets and liabilities which facilitates the preparation of financial statements at the end of the accounting period. In addition, they are required to maintain a stock register to keep complete record of all fixed assets and the consumables.

They do not maintain any capital account. Instead they maintain capital fund which is also called general fund that goes on accumulating due to surpluses generated, life membership fee, donation, legacies, etc. received from year to year. In fact, a proper system of accounting is desirable to avoid or minimise the chances of misappropriations or embezzlement of the funds contributed by the members and other donors.

Final Accounts or Financial Statements: The Not-for-Profit Organisations are also required to prepare financial statements at the end of the each accounting period. Although these organisations are non-profit making entities and they are not required to make Trading and Profit & Loss Account but it is necessary to know whether the income during the year was sufficient to meet the expenses or not. Not only that they have to provide the necessary financial information to members, donors, and contributors and also to the Registrar of Societies. For this purpose, they have to prepare their final accounts at the end of the accounting period and the general principles of accounting are fully applicable in their preparation as stated earlier, the final accounts of a 'not-for-profit organisation' consist of the following:

(i) Receipt and Payment Account
(ii) Income and Expenditure Account, and
(iii) Balance Sheet.

The Receipt and Payment Account is the summary of cash and bank transactions which helps in the preparation of Income and Expenditure Account and the Balance Sheet. Besides, it is a legal requirement as the Receipts and Payments Account has also to be submitted to the Registrar of Societies along with the Income and Expenditure Account, and the Balance Sheet.

Income and Expenditure Account is akin to Profit and Loss Account. The Not-for-Profit Organisations usually prepare the Income and Expenditure Account and a Balance Sheet with the help of Receipt and Payment Account. However, this does not imply that they do not make a trial balance. In order to check the accuracy of the ledger accounts, they also prepare a trial balance which facilitates the preparation of accurate Receipt and Payment Account as well as the Income and Expenditure Account and the Balance Sheet.

In fact, if an organisation has followed the double entry system they must prepare a trial balance for checking the accuracy of the ledger accounts and it will also facilitate the preparation of Receipt and Payment account. Income and Expenditure Account and the Balance Sheet.

1.3 Receipt and Payment Account

It is prepared at the end of the accounting year on the basis of cash receipts and cash payments recorded in the cash book. It is a summary of cash and bank transactions under various heads. For example, subscriptions received from the members on different dates which appear on the debit side of the cash book, shall be shown on the receipts side of the Receipt and Payment Account as one item with its total amount. Similarly, salary, rent, electricity charges paid from time to time as recorded on the credit side of the cash book but the total salary paid, total rent paid, total electricity charges paid during the year appear on the payment side of the Receipt and Payment Account. Thus, Receipt and Payment Account gives summarised picture of various receipts and payments, irrespective of whether they pertain to the current period, previous period or succeeding period or whether they are of capital or revenue nature. It may be noted that this account does not show any non cash item like depreciation. The opening balance in Receipt and Payment Account represents cash in hand/cash at bank which is shown on its receipts side and the closing balance of this account represents cash in hand and bank balance as at the end of the year, which appear on the credit side of the Receipt and Payment Account. However, if it is bank overdraft at the end it shall be shown on its debit side as the last item. Let us look at the cash book of Golden Cricket Club given in the example to show how the total amount of each item of receipt and payment has been worked out.

Example 1

Golden Cricket Club
Cash Book (Columnar)

Dr. *Cr.*

Date	*Receipts*	*L.F.*	*Bank Amount (Rs.)*	*Office Amount (Rs.)*	*Date*	*Payments*	*L.F.*	*Bank Amount (Rs.)*	*Office Amount (Rs.)*
2014					*2014*				
April 1	Balance b/d		35,000	20,000	April 15	Insurance premium		15,000	
April 10	Subscriptions		1,20,000		May 12	Printing and stationery		10,750	
April 10	Entrance fees		13,000		May 20	Postage and courier fees			430
May 20	Life membership fees		12,000		June 16	Telephone expenses			810
June 12	Locker rent			42,000					
July 23	Life membership fees		8,000		July 10	Wages and salaries			22,000
					July 15	Rates and Taxes		17,000	
Aug. 20	Donation for building		60,000		July 30	Govt. securities		1,00,000	
Sept. 13	Subscriptions (2005-2006)		30,000		Aug. 13	Printing and statienary		15,000	
Sept. 13	Subscription		45,000		Aug. 15	Postage and courier service			480
					Sept. 10	Lighting		12,250	

Sept. 14	Entrance fees		10,000		Sept 13	Telephone expenses			830
Nov. 9	Subscription		35,000		Oct. 1	Wages and salaries		10,000	12,000
					Oct. 18	Printing and stationary		13,000	
Nov. 9	Subscription (2009-2010)		10,000		Oct. 31	Govt. securities		1,00,000	
2015					Dec. 31	Wages and Salaries		22,000	
Feb. 07	Subscription		25,000		*2015*				
					Jan. 21	Courier charges			240
Mar. 28	Interest on government securities		18,000		Feb. 2	Telephone expenses			960
					Mar. 10	Postage and Courier fees			850
					Mar. 27	Lighting		14,000	
					Mar. 27	Wages and Salaries		22,000	
					Mar. 31	Balance c/d		70,000	23,400
			4,21,000	**62,000**				**4,21,000**	**62,000**

Part A

Item wise Aggregation of various Receipts

Subscriptions (2014–2015)

Date	*Amount (Rs.)*
April 10, 2014	1,20,000
Sept. 13, 2014	45,000
Nov. 9, 2014	35,000
Feb. 7, 2015	25,000
Total	**2,25,000**

Subscriptions (2013–14)

Date	*Amount (Rs.)*
Sept. 13, 2014	30,000
Total	**30,000**

Subscription

Date	*Amount (Rs)*
Nov. 9, 2014	10,000
Total	**10,000**

Entrance Fees

Date	*Amount (Rs)*
April 10, 2014	13,000
Sept.14, 2014	10,000
Total	**23,000**

Locker Rent

Date	*Amount (Rs)*
April 12, 2014	42,000
Total	**42,000**

Life Membership fee

Date	*Amount (Rs)*
May 12, 2014	12,000
July 23, 2014	8,000
Total	**20,000**

Donation for Buildings

Date	*Amount (Rs)*
Aug. 20, 2014	60,000
Total	**60,000**

Interest on Government securities

Date	*Amount (Rs)*
March 28, 2015	18,000
Total	**18,000**

Part B

Item wise Aggregation of various Payments

Insurance Premium

Date	*Amount (Rs)*
April 15, 2014	15,000
Total	**15,000**

Printing and Stationery

Date	*Amount (Rs.)*
May 12, 2014	10,750
Aug. 13, 2014	15,000
Oct. 18, 2014	13,000
Total	**38,750**

Lighting

Date	*Amount (Rs.)*
Sept. 10, 2014	12,250
March 27, 2015	14,000
Total	**26,250**

Telephone Expenses

Date	*Amount (Rs.)*
June 16, 2014	810
Sept. 13, 2014	830
Feb. 12, 2015	960
Total	**2,600**

Rates and Taxes

Date	*Amount (Rs.)*
July 15, 2014	17,000
Total	**17,000**

Government Securities

Date	*Amount (Rs.)*
July 30, 2014	1,00,000
Oct. 31, 2014	1,00,000
Total	**2,00,000**

Wages and Salaries

Date	*Amount (Rs.)*
July 10, 2014	22,000
Oct. 1, 2014	22,000
Dec. 31, 2014	22,000
March 30, 2015	22,000
Total	**88,000**

Postage and Courier Service

Date	*Amount (Rs.)*
May 20, 2014	430
Aug. 15, 2014	480
Jan. 22, 2015	240
March 10, 2015	850
Total	**2,000**

The above data can also be shown in the form of the respective accounts in the ledger. A detailed illustrative list of items of receipts and payments is given in figure 1.

Figure 1

Receipts	*Payments*
1. Donations	1. Purchase of Fixed Assets
(a) General	2. Purchase of Sports Material
(b) Specific purpose	3. Investment in Securities
2. Entrance Fees	4. Printing and Stationery
3. Legacies	5. Postage and Courier Charges
4. Sale of Investments	6. Advertisements
5. Sale of Fixed Assets	7. Wages and Salary
6. Subscriptions from Members	8. Honorarium
7. Life Membership Fees	9. Telephone Charges
8. Sale of old Newspapers	10. Electricity and Water Charges
9. Sale of Old Sports Material	11. Repairs and Renewals
10. Interest on Fixed Deposits	12. Upkeep of Play Ground
11. Interest/ Dividend on Investments	13. Conveyance Charges
12. Proceed from Charity Shows	14. Subscription for Periodicals
13. Sale of Scrap	15. Audit Fees
14. Grant-in-aid	16. Entertainment Expenses
15. Interest/Dividend on Specific	17. Municipal Taxes
Fund Investments	18. Charity
16. Miscellaneous Receipts.	19. Insurance

Receipt and Payment Account is given below:

Receipt and Payment Account for the year ending ————-

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		Balance b/d (Bank overdraft)	xxx
Cash in Hand	xxx	Wages and Salaries	xxx
Cash at Bank	xxx	Rent	xxx
Subscriptions	xxx	Rates and Taxes	xxx
General Donations	xxx	Insurance	xxx
Sale of newspaper/	xxx	Printing and Stationery	xxx
periodicals/waste paper		Postage and courier	xxx
Sale of old sports materials	xxx	Advertisement	xxx
Interest on fixed deposits		Sundry expenses	xxx
Interest/Dividend on general	xxx	Telephone charges	xxx
investments		Entertainment expenses	xxx
Locker Rent	xxx	Audit fees	xxx
Sale of scraps	xxx	Honorarium	xxx
Proceeds from charity show	xxx	Repair and Renewals	xxx
Miscellaneous receipts	xxx	Upkeep of ground	xxx
Grant-in-aid**	xxx	Conveyance	xxx
Legacies	xxx	Newspapers and Periodicals	xxx
Specific Donations	xxx	Purchases of Assets	xxx
Sale of Investments	xxx	Purchase of Investments	xxx
Sale of Fixed Assets	xxx	Balance c/d	xxx

Life membership fees	xxx	Cash in hand	xxx
Entrance fees	xxx	Cash at Bank*	xxx
Receipts on account of specific purpose funds	xxx		
Interest on specific funds' investments	xxx		
Balance b/d (Bank Overdraft)*	xxx		
	xxxxx		xxxxx

Fig. 1.1: *Format of Receipt and Payment Account*

* There will be either of the two amounts i.e., each at bank or bank overdraft, not both.

It may be noted that the receipts side of the Receipt and Payment Account gives a list of revenue receipts (for past, current and future periods) as well as capital receipts. Similarly, the payments side of the Receipts and Payments Account lists the Revenue Payments (for past, current and future periods) as well as Capital Payments.

1.3.1 Salient Features

1. It is a summary of the cash book. Its form is identical with that of simple cash book (without discount and bank columns) with debit and credit sides. Receipts are recorded on the debit side while payments are entered on the credit side.
2. It shows the total amounts of all receipts and payments irrespective of the period to which they pertain . For example, in the Receipt and Payment account for the year ending on March 31, 2015, we record the total subscriptions received during 2014–15 including the amounts related to the years 2013–2014 and 2015-2016. Similarly, taxes paid during 2014–15 even if they relate to the years 2013–14 and 2015–2016.
3. It includes all receipts and payments whether they are of capital nature or of revenue nature.
4. No distinction is made in receipts/payments made in cash or through bank. With the exception of the opening and closing balances, the total amount of each receipt and payment is shown in this account.
5. No non-cash items such as depreciation outstanding expenses accrued income, etc. are shown in this account.
6. It begins with opening balance of cash in hand and cash at bank (or bank overdraft) and closes with the year end balance of cash in hand/ cash at bank or bank overdraft. In fact, the closing balance in this account (difference between the total amount of receipts and payments) which is usually a debit balance reflects cash in hand and cash at bank unless there is a bank overdraft.

1.3.2 *Steps in the preparation of Receipt and Payment Account*

1. Take the opening balances of cash in hand and cash at bank and enter them on the debit side. In case there is bank overdraft at the begining of the year, enter the same on the credit side of this account.
2. Show the total amounts of all receipts on its debit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
3. Show the total amounts of all payments on its credit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
4. None of the receivable income and payable expense is to be entered in this account as they do not involve inflow or outflow of cash.
5. Find out the difference between the total of debit side and the total of credit side of the account and enter the same on the credit side as the closing balance of cash/bank. In case, however, the total of the credit side is more than that of the total of the debit side, show the difference on the debit as bank overdraft and close the account.

From the following information based on the data assimilated from the cash book given in *example 1*, at page 4, the Receipt and Payment Account of Golden Cricket Club for the year ended on March 31, 2015 will be prepared as follows:

Summary of Cash Book

Details		*Amount (Rs.)*
Cash in hand as on April 1, 2014		20,000
Cash at bank as on April 1, 2014		35,000
Subscription:	Rs.	
2013-14	30,000	
2014-15	2,25,000	
2015-16	10,000	2,65,000
Donation for Building		60,000
Entrance fees		23,000
Life membership fee		20,000
Printing and Stationery		38,750
Lighting		26,250
Rates and Taxes		17,000
Telephone charges		2,600
Postage and courier		2,000
Wages and Salaries		88,000
Insurance Premium		15,000
Interest on government securities		18,000
Locker rent		42,000
Purchase of government securities		2,00,000
Cash in hand as on March 31, 2015		23,400
Cash at bank as on March 31, 2015		70,000

Receipt and Payment Account for the year ending March 31, 2015

Dr. *Cr.*

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Cash in hand as on April 1, 2014		20,000	Printing and Stationery	38,750
			Lighting	26,250
Cash at bank as on April 1, 2014		35,000	Rates and Taxes	17,000
			Telephone charges	2,600
Subscription:			Postage and Courier	2,000
2013–14	30,000		Wages and Salaries	88,000
2014–15	2,25,000		Insurance Premium	15,000
2015–16	10,000	2,65,000	Purchase of govt. securities	2,00,000
Donation for building		60,000	Cash in hand as on March 31, 2015	23,400
Entrance fees		23,000		
Life membership fee		20,000	Cash at bank as on March 31, 2015	70,000
Interest on investment in Government securities		18,000		
Locker rent		42,000		
		4,83,000		**4,83,000**

Illustration 1

From the following particulars relating to Silver Point, prepare a Receipt and Payment account for the year ending March 31, 2015.

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Opening cash balance		1,000	Sale of old sports materials	1,200
Opening bank balance		7,200	Donation received for pavilion	4,600
Subscriptions collected for:			Rent paid	3,000
2013-14	Rs. 500		Sports materials purchases	4,800
2014-15	Rs. 7,600		Purchase of refreshments	600
2015-16	Rs. 900	9,000	Expenses for maintenance of tennis court	2,000
Sale of refreshments		1,000		
Entrance fees received		1,000	Salary paid	2,500
			Tournament expenses	2,400
			Furniture purchased	1,500
			Office expenses	1,200
			Closing cash in hand	400

Solution

Books of Silver Point
Receipt and Payment Account
for the year ending March 31, 2015

Dr. *Cr.*

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d			Rent	3,000
Cash		1,000	Sports materials purchased	4,800
Bank		7,200	Purchase of refreshments	600
Subscriptions			Maintenance expenses for tennis court	2,000
2013-14	500			
2014-15	7,600		Salary	2,500
2015-16	900	9,000	Tournament expenses	2,400
Sale of refreshments		1,000	Furniture purchased	1,500
Entrance fees		1,000	Office expenses	1,200
Sale of old sports materials		1,200	Balance c/d	
Donation for pavilion		4,600	Cash	400
			Bank (balancing figure)	6,600
		25,000		25,000

1.4 Income and Expenditure Account

It is the summary of income and expenditure for the accounting year. It is just like a profit and loss account prepared on accrual basis in case of the business organisations. It includes only revenue items and the balance at the end represents surplus or deficit. The Income and Expenditure Account serves the same purpose as the profit and loss account of a business organisation does. All the revenue items relating to the current period are shown in this account, the expenses and losses on the expenditure side and incomes and gains on the income side of the account. It shows the net operating result in the form of surplus (i.e. excess of income over expenditure) or deficit (i.e. excess of expenditure over income), which is transferred to the capital fund shown in the balance sheet.

The Income and Expenditure Account is prepared on accrual basis with the help of Receipts and Payments Account along with additional information regarding outstanding and prepaid expenses and depreciation etc. Hence, many items appearing in the Receipts and Payments need to be adjusted. For example, as shown in Example 1, (Page No. 10) subscription amount of Rs.2, 65,000 received during the year 2014-15 appearing on the receipts side of the Receipt and Payment Account includes receipts for the periods other than the current period. But the subscription amount of Rs. 2,25,000 pertaining to the current year only will be shown as income in Income and Expenditure Account for the year 2014-15.

1.4.1 Steps in the Preparation of Income and Expenditure Account

Following steps may be helpful in preparing an Income and Expenditure Account from a given Receipt and Payment Account:

1. *Persue* the Receipt and Payment Account thoroughly.
2. Exclude the opening and closing balances of cash and bank as they are not an income.
3. Exclude the capital receipts and capital payments as these are to be shown in the Balance Sheet.
4. Consider only the revenue receipts to be shown on the income side of Income and Expenditure Account. Some of these need to be adjusted by excluding the amounts relating to the preceding and the succeeding periods and including the amounts relating to the current year not yet received.
5. Take the revenue expenses to the expenditure side of the Income and Expenditure Account with due adjustments as per the additional information provided relating to the amounts received in advance and those not yet received.
6. Consider the following items not appearing in the Receipt and Payment Account that need to be taken into account for determining the surplus/ deficit for the current year :
   (a) Depreciation of fixed assets.
   (b) Provision for doubtful debts, if required.
   (c) Profit or loss on sale of fixed assets.

Now you will observe how the income and expenditure account is prepared from the receipts and payments account given in example 1, on page 10.

Income and Expenditure Account
for the year ending on March 31, 2015

Dr. *Cr.*

Expenditure	*Amount (Rs.)*	*Income*	*Amount (Rs.)*
Printing and Stationery	38,750	Subscriptions	2,25,000
Lighting	26,250	Entrance fees	23,000
Rates and Taxes	17,000	Interest on investment	18,000
Telephone charges	2,600	in government securities	
Postage and courier charges	2,000	Locker rent	42,000
Wages and Salaries	88,000		
Insurance Premium	15,000		
Surplus (*Excess of income over expenditure*)	1,18,400		
	3,08,000		**3,08,000**

Note that-

1. Opening and closing cash/bank balances have been excluded.
2. Payment for purchase of Government securities being capital expenditure has been excluded.
3. Amount of subscriptions received for the year 2013-14 and 2014-15 have been excluded.
4. Life membership fee is an item of capital receipt and so excluded.
5. Donation for building is a receipt for a specific purpose and so excluded.

Illustration 2

From the Receipt and Payment Account given below, prepare the Income and Expenditure Account of Clean Delhi Club for the year ended March 31, 2014.

Receipt and Payment Account for the year ending March 31, 2014

Dr. *Cr.*

Receipts	*Amount (Rs.)*	*Payments*		*Amount (Rs.)*
Balance b/d (Cash in hand)	3,200	Salary		1,500
		Rent		800
Subscriptions	22,500	Electricity		3,500
Entrance Fees	1,250	Taxes		1,700
Donations	2,500	Printing and Stationery		380
Rent of hall	750	Sundry expenses		920
Sale of investments	3,000	Books purchased		7,500
		Govt. bonds purchased		10,000
		Fixed deposit with bank (on 31.03.2014)		5,000
		Balance c/d		
		Cash in hand	400	
		Cash at bank	1,500	1,900
	33,200			**33,200**

Solution

Books of Clean Delhi Club
Income and Expenditure Account for the year ending March 31, 2014

Dr. *Cr.*

Expenditure	*Amount (Rs.)*	*Income*	*Amount (Rs.)*
Salary	1,500	Subscriptions	22,500
Rent	800	Entrance fees	1,250
Electricity	3,500	Donation	2,500
Taxes	1,700	Rent of hall	750
Printing & Stationery	380		
Sundray Expenses	920		
Surplus (excess of income over expenditure)	18,200		
	27,000		**27,000**

Illustration 3

From the following Receipt and Payment Account for the year ending March 31, 2015 of Negi's Club, prepare Income and Expenditure Account for the same period:

Receipt and Payment Account for the year ending March 31, 2015

Dr. *Cr.*

Expenditure		*Amount (Rs.)*	*Income*	*Amount (Rs.)*
Balance c/d Bank		25,000	Purchase of furniture (1.7.14)	5,000
Subscriptions			Salaries	2,000
2014	1,500		Telephone expenses	300
2015	10,000		Electricity charges	600
2016	500	12,000	Postage and Stationery	150
Donation		2,000	Purchase of books	2,500
Hall rent		300	Entertainment expenses	900
Interest on bank deposits		450	Purchase of 5% government papers (1.7.14)	8,000
Entrance fees		1,000	Miscellaneous expenses	600
			Balance c/d:	
			Cash	300
			Bank	20,400
		40,750		**40,750**

The following additional information is available:

(i) Salaries outstanding – Rs. 1,500;
(ii) Entertainment expenses outstanding – Rs. 500;
(iii) Bank interest receivable – Rs. 150;
(iv) Subscriptions accrued – Rs. 400;
(v) 50 per cent of entrance fees is to be capitalised;
(vi) Furniture is to be depreciated at 10 per cent per annum.

Solution

Books of Negi's Club
Income and Expenditure Account for the year ending 31.3.2015

Dr. *Cr.*

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Salaries	2,000		Subscriptions		10,400
Add: Outstanding	1,500	3,500	Donation		2,000
Telephone expenses		300	Entrance Fees (50% of Rs. 1,000)		500
Electricity charges		600	Bank interest	450	
Postage and Stationery		150	*Add:* Outstanding interest	150	600

Entertainment expenses	900		Interest on investment	200
Add: Outstanding expenses	500	1,400	Hall rent	300
Miscellaneous expenses		600		
Depreciation on furniture		375		
Surplus (Excess of Income over Expenditure)		7,075		
		14,000		**14,000**

1.4.2 *Distinction between Income and Expenditure Account and Receipt and Payment Account*

Based upon discussion made in regard to the Receipts and Payments Account and the Income and Expenditure Account we make the distinction between Income and Expenditure Account and Receipts and Payments Account in the tabular form:

Basis of distinction Account	**Income and Expenditure**	**Receipt and Payment Account**
Nature	It is like as profit and loss account.	It is the summary of the cash book.
Nature of Items	It records income and expenditure of *revenue* nature only.	It records receipts and payments of *revenue as well as capital* nature.
Period	Income and expenditure items relate only to the current period.	Receipts and payments may also relate to preceding and succeeding periods.
Debit side	Debit side of this account records expenses and losses.	Debit side of this account records the receipts.
Credit side	Credit side of this account records income and gains.	Credit side of this account records the payments.
Depreciation	Includes depreciation.	Does not includes depreciation.
Opening Balance	There is no opening balance.	Balance in the beginning represents cash in hand /cash at bank or overdraft at the beginning.
Closing Balance	Balance at the end represents excess of income over expenditure or vice-versa.	Balance at the end represents cash in hand at the end and bank balance (or bank overdraft).

1.5 Balance Sheet

'Not-for-Profit' Organisations prepare Balance Sheet for ascertaining the financial position of the organisation. The preparation of their Balance Sheet is on the same pattern as that of the business entities. It shows assets and liabilities as at the end of the year. Assets are shown on the right hand side and the liabilities on the left hand side. However, there will be a Capital Fund or General Fund in place of the Capital and the surplus or deficit as per Income and Expenditure Account which is either added to/deducted from the capital fund, as the case may be. It is also a common practice to add some of the capitalised items like legacies, entrance fees and life membership fees directly in the capital fund.

Besides the Capital or General Fund, there may be other funds created for specific purposes or to meet the requirements of the contributors/donors such as building fund, sports fund, etc. Such funds are shown separately in the liabilities side of the balance sheet.

Some times it becomes necessary to prepare Balance Sheet as at the beginning of the year in order to find out the opening balance of the capital/general fund.

1.5.1 Preparation of Balance Sheet

The following procedure is adopted to prepare the *Balance Sheet*:

1. Take the Capital/General Fund as per the opening balance sheet and add surplus from the Income and Expenditure Account. Further, add entrance fees, legacies, life membership fees, etc. received during the year.
2. Take all the fixed assets (not sold/discarded/or destroyed during the year) with additions (from the Receipts and Payments account) after charging depreciation (as per Income and Expenditure account) and show them on the assets side.
3. Compare items on the receipts side of the Receipts and Payments Account with income side of the Income and Expenditure Account. This is to ascertain the amounts of: (a) subscriptions due but not yet received: (b) incomes received in advance; (c) sale of fixed assets made during the year; (d) items to be capitalised (i.e. taken directly to the Balance Sheet) e.g. legacies, interest on specific fund investment and so on.
4. Similarly compare, items on the payments side of the Receipt and Payment Account with expenditure side of the Income and Expenditure Account. This is to ascertain the amounts if: (a) outstanding expenses; (b) prepaid expenses; (c) purchase of a fixed asset during the year; (d) depreciation on fixed assets; (e) stock of consumable items like stationery in hand; (f) Closing balance of cash in hand and cash at bank as, and so on.

A proforma Balance Sheet is given for the proper understanding of preparing the balance sheet.

Balance Sheet of as on ....

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital fund:			
Opening Balance	......	*Cash in hand and /or Cash*	......
Add: Surplus		*at Bank*	
OR		*Outstanding Incomes*	......
Less: Deficit		*Prepaid Expenses*	......
Add: Capitalised Income of the	......	*Stock of Consumable Items*:	
Current Year on account of:		Previous Balance	
Legacies	......	*Add:* Purchases in the current	
Entrance Fees	......	period	
Life Membership Fees	......	*Less:* Value consumed during	......
Closing Balance	......	the period	
Special Fund/Donations:		Previous Balance	......
Previous Balance (If any)		*Add:* Purchases in the current	
Add: Receipts for the item		period	
during the period		*Less:* Book Value of the Asset	
Add: Income earned on		sold/disposed off	
fund/Donations'		*Closing Balance*	......
Investments			
Less: Expenses paid out of			
fund/Donations			
Net Balance	......		
Creditors for Purchases			
and/or supplies	......		
Bank Overdraft	......		
Outstanding Expenses:			
Income received in Advance	......		
	......		......

Fig. 1.2: *Proforma Balance Sheet*

Illustration 4

From the following Receipt and Payment Account and additional information relating to Excellent Cricket Club, prepare Income and Expenditure Account for the year ended March 31, 2015 and Balance Sheet as on date.

Dr. *Cr.*

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d (Cash in Hand)	18,000	Balance b/d (bank overdraft)	16,000
Member's subscriptions	2,50,000	Upkeep of field and pavilion	1,15,000
Member's admission fee	15,000	Tournament expenses	40,000
Sale of old sports materials	2,500	Rates and Insurance	10,000
Hire of ground	28,000	Telephone	3,500
Subscription for tournament	60,000	Postage and Courier charges	4,000
Life membership fee	20,000	Printing and Stationery	26,000
Donations	6,00,000	Miscellaneous expenses	4,400

		Secretary's honorarium	30,000
		Grass seeds	2,600
		Investments	6,00,000
		Purchase of sports materials	68,000
		Balance c/d	74,000
	9,93,500		**9,93,500**

Assets at the beginning of the year were:

	Rs.
Play ground	5,00,000
Cash in hand	18,000
Stock of sports materials	85,000
Printing and Stationery	11,000
Subscriptions receivable	28,000

Donations and Surplus on account of tournament are to be kept in Reserve for a permanent pavilion. Subscriptions due on March 31 , 2015 were Rs. 42,000. Write-off fifty per cent of sports materials and thirty per cent of printing and stationery.

Solution

Books of Excellent Cricket Club
Income and Expenditure Account for the year ending on March 31, 2015

Dr. *Cr.*

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Upkeep of field and pavilion		1,15,000	Subscriptions	2,50,000	
Rates and Insurance		10,000	*Add:* Outstanding		
Telephone		3,500	(closing)	42,000	
Postage and Courier charges		4,000		2,92,000	
Printing & stationery	26,000		*Less:* Outstanding		
Add: Opening stock	11,000		(opening)	28,000	2,64,000
Available for use	37,000		Admission fees		15,000
Less: Closing stock	25,900	11,100	Sale of old sports material		2,500
Stationery consumed		4,400	Rent of hall		28,000
Miscellaneous expenses		30,000			
Secretary's honorarium		2,600			
Grass seeds					
Sports materials consumed:					
Opening stock	85,000				
Add: Purchases	68,000				
	1,53,000				
Less: Closing stock	76,500	76,500			
Surplus		52,400			
(Excess of income over expenditure)					
		3,09,500			**3,09,500**

Note: Since the opening balance of the capital fund is not given, the same has been ascertained by preparing opening balance sheet.

Balance Sheet of Excellent Cricket Club as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital Fund	6,26,000		Cash in hand	74,000
Add: Surplus	52,400		Outstanding subscriptions	42,000
	6,78,400		Stock of sports materials	76,500
Add: Life membership			Stock of printing	25,900
fee	20,000	6,98,400	and stationery	
Pavilion Fund:			Investments	6,00,000
Surplus from Tournament			Play ground	5,00,000
(Rs.60,000-40,000)	20,000			
Donation	6,00,000	6,20,000		
		13,18,400		**13,18,400**

Balance Sheet of Excellent Cricket Club as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bank overdraft	16,000	Cash in hand	18,000
Capital/General fund		Outstanding subscription	28,000
(balancing figure)	6,26,000	Stock of sports materials	85,000
		Printing and Stationery	11,000
		Play ground	5,00,000
	6,42,000		**6,42,000**

Test your Understanding – I

State with reasons whether the following statements are TRUE or FALSE:

(i) Receipt and Payment Account is a summary of all capital receipts and payments.
(ii) If there appears a sports fund, the expenses incurred on sports activities will be shown on the debit side of Income and Expenditure Account.
(iii) A credit balance of Income and Expenditure Account denotes excess if expenses over incomes.
(iv) Scholarships granted to students out of funds provided by government will be debited to Income and Expenditure Account.
(v) Receipt and Payment Account records the receipts and payments of revenue nature only.
(vi) Donations for specific purposes are always capitalized.
(vii) Opening balance sheet is prepared when the opening balance of capital fund is not given.
(viii) Surplus of Income and Expenditure Account is deducted from the capital/ general fund.
(ix) Receipt and Payment Account is equivalent to profit and loss account.
(x) Receipt and Payment Account does not deference between capital and revenue receipts.

1.6 Some Peculiar Items

Final accounts of the Not-for-Profit organisations are prepared on the similar pattern as that of a business orgnisation. However, a few items of income and expenses of such orgnisations are somewhat different in nature and need special attention in their treatment in final accounts. They are peculiar to these orgnisations. Some of the common peculiar items are explained as under:

Subscriptions: Subscription is a membership fee paid by the member on annual basis. This is the main source of income of such orgnisations. Subscription paid by the members is shown as receipt in the Receipt and Payment Account and as income in the Income and Expenditure Account. It may be noted that Receipt and Payment Account shows the total amount of subscription actually received during the year while the amount shown in Income and Expenditure Account is confined to the figure related to the current period only irrespective of the fact whether it has been received or not. For example, a club received Rs. 20,000 as subscriptions during the year 2014-15 of which Rs.3,000 relate to year 2013-14 and Rs.2,000 to 2015-16, and at the end of the year 2014-15 Rs.6,000 are still receivable. In this case, the Receipt and Payment Account will show Rs.20,000 as receipt from subscriptions. But the Income and Expenditure Account will show Rs. 21,000 as income from subscriptions for the year 2014-15, the calculation of which is given as below:

	Rs.
Subscriptions received in 2014-15	20,000
Less: Subscriptions for the year 2013-14	3,000
	17,000
Less: Subscription for the year 2015-16	2,000
	15,000
Add: Subscriptions outstanding for the year 2014-15	6,000
Income from subscriptions for the year 2014-15	**21,000**

The above amount of subscriptions to be shown as income can also be ascertained by preparing the subscription account as follows:

Subscription Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d (outstanding at the beginning)		3,000		Balance b/d (received in advance during previous year)		Nil
	Income and Expenditure Account (balancing figure)		21,000		Cash (subscription received)		20,000
	Balance c/d (received in advance)		2,000		Balance c/d (outstanding at the end)		6,000
			26,000				**26,000**

Illustration 5

As per Receipt and Payment Account for the year ended on March 31, 2015, the subscriptions received were Rs. 2,50,000. Additional Information given is as follows:

1. Subscriptions Outstanding on 1.4.2014 Rs. 50,000
2. Subscriptions Outstanding on 31.3.2015 Rs.35,000
3. Subscriptions Received in Advance as on 1.4.2014 Rs.25,000
4. Subscriptions Received in Advance as on 31.3.2015 Rs.30,000

Ascertain the amount of income from subscriptions for the year 2014–15 and show how relevant items of subscriptions appear in opening and closing balance sheets.

Solution

Details	*Amount (Rs.)*
Subscriptions Received as per Receipt and Payment account	2,50,000
Add: Subscriptions outstanding on 31.3.2015	35,000
Add: Subscriptions received in advance on 1.4.2014	25,000
	3,10,000
Less: Subscriptions outstanding on 1.4.2014	50,000
	2,60,000
Less: Subscriptions received in advance on 31.3.2015	30,000
Income from subscription for the year 2014–15	**2,30,000**

Alternately, income received from subscriptions can be calculated by preparing a Subscriptions account as under.

Subscription Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d (outstanding)		50,000		Balance b/d (advance)		25,000
	Income and Expenditure Account (balancing figure)		2,30,000		Receipts and Payments A/c		2,50,000
	Balance c/d (advance)		30,000		Balance b/d (outstanding)		35,000
			3,10,000				**3,10,000**

Relevant items of subscription can be shown in the opening and closing balance sheet as under:

Balance Sheet as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Subscriptions received in advance	25,000	Subscription outstanding	50,000

*Relevant data only

Balance Sheet as on March 31, 2015

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Subscriptions received in advance	30,000	Subscriptions outstanding	35,000

*Relevant data only

Illustration 6

Extracts of Receipt and Payment Account for the year ended March 31, 2015 are given below:

Receipt	
Subscriptions	*(Rs.)*
2013-14	2,500
2014-15	26,750
2015-16	1,000
	30,250

Additional Information:
Total number of members: 230.
Annual membership fee: Rs. 125.
Subscriptions outstandings on April 1, 2013: Rs. 2,750.
Prepare a statement showing all relevant items of subscriptions viz., income, advance, outstandings, etc.

Solution

Amount of subscription due for the year 2014-15 irrespective of cash Rs. 28,750 (i.e. Rs. 125 × Rs. 230).

Details	*Amount (Rs.)*
Subscriptions received as per Receipts and Payments Account	30,250
Add: Subscriptions outstanding on March 31, 2014	2,250
Add: Subscriptions received in advance on April 1, 2013	NIL
	32,500
Less: Subscriptions outstanding on April 1, 2013	2,750
	29,750
Less: Subscriptions received in advance on March 31, 2014	1,000
Income from Subscription for the year 2014-15. (125×230)	**28,750**

Note: The amount of subscriptions outstanding as on 01-04-2014 has been ascertained as follows:

Details	(Rs.)	(Rs.)
(i) Outstanding as on 01.04.2014	2,750	
Received for 2013–14	2,500	250
(ii) Due for 2014–15 (125×230)	28,750	
Received for 2014–15	26,750	2,000
Outstanding as on 31-3-2015		**2,250**

Illustration 7

From the following extract of Receipt and Payment Account and the additional information given below, compute the amount of income from subscriptions and show as how they would appear in the Income and Expenditure Account for the year ending March 31, 2015 and the Balance Sheet.

Receipt and Payment Account for the year ending March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Subscriptions:				
2013-14	7,000			
2014-15	30,000			
2015-16	5,000	**42,000**		

Additional Information: *Rs.*

1. Subscriptions outstanding March 31, 2014 8,500
2. Total Subscriptions outstanding March 31, 2015 18,500
3. Subscriptions received in advance as on March 31, 2014 4,000

Solution

Income and Expenditure Account
for the year ending on March 31, 2015

Expenditure	*Amount (Rs.)*	*Income*	*Amount (Rs.)*
		Subscriptions	30,000
		Received for 2014-15	
		Add: Outstanding for 2014-15	17,000
		Add: Received in advance for 2014-15	4,000
			51,000

Note: Total amount of subscriptions outstanding as on 31-3-2015 are Rs. 18,500. This, includes Rs. 1,500 (Rs. 8,500 – Rs. 7,000) for subscriptions still outstanding for 2013–14. Hence, the subscriptions outstanding for 2014–15 are Rs. 17,000 (Rs. 18,500 – Rs. 1,500).

Balance Sheet (Relevant Data) as on March 31,2015

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Subscription Received in Advance for 2014-15	**5,000**	Subscription Outstanding: 2013-14 2014-15	 1,500 1,7000	**18,500**

*Relevant data only

Do it Yourself

1. Subscriptions received by the health club during the year 2013 were as under:

	Rs.
2012	3,000
2013	96,000
2014	2,000
	1,01,000

	Rs.
Subscriptions Outstanding as on 31.12.12	5,000
Subscriptions Outstanding as on 31.12.13	12,000
Subscriptions received in advance in 2012 for 2013	5,000

Calculate the amount of subscriptions to be shown on the income side of Income and Expenditure A/c.

2. During the year 2013, subscriptions received by a sports club were Rs. 80,000. These included Rs. 3,000 for the year 2010 and Rs.6,000 for the year 2014. On December 31, 2012 the amount of subscriptions due but not received was Rs.12,000. Calculate the amount of subscriptions to be shown in Income and Expenditure Account as income from subscription.

3. Subscriptions received during the year ended December 31, 2013 by Royal Club were as under:

	Rs.
2012	3,000
2013	93,000
2014	2,000
	98,000

The club has 500 members each paying @ Rs.200 as annual subscription. Subscriptions outstanding as on December 31, 2012 are Rs. 6,000. Calculate the amount of subscriptions to be shown as income in the Income and Expenditure Account for the year ended December 31, 2013 and show the relevant data in the Balance Sheet as on date.

Donations: It is a sort of gift in cash or property received from some person or organisation. It appears on the receipts side of the Receipts and Payments Account. Donation can be for specific purposes or for general purposes.

(i) *Specific Donations:* If donation received is to be utilised to achieve specified purpose, it is called Specific Donation. The specific purpose can be an extension of the existing building, construction of new computer laboratory, creation of a book bank, etc. Such donation is to be capitalised and shown on the liabilities side of the Balance Sheet irrespective of the fact whether the amount is big or small. The intention is to utilise the amount for the specified purpose only.

(ii) General Donations: Such donations are to be utilised to promote the general purpose of the organisation. These are treated as revenue receipts as it is a regular source of income hence, it is taken to the income side of the Income and Expenditure Account of the current year.

Legacies: It is the amount received as per the *will* of a deceased person. It appears on the receipts side of the Receipt and Payment Account and is directly added to capital fund/general fund in the balance sheet, because it is not of recurring nature. However, legacies of a small amount may be treated as income and shown on the income side of the Income and Expenditure Account.

Life Membership Fees: Some members prefer to pay lump sum amount as life membership fee instead of paying periodic subscription. Such amount is treated as capital receipt and credited directly to the capital/general fund.

Entrance Fees: Entrance fee also known as admission fee is paid only once by the member at the time of becoming a member. In case of organisations like clubs and some charitable institutions, is limited and the amount of entrance fees is quite high. Hence, it is treated as non-recurring item and credited directly to capital/general fund. However, for some organisations like educational institutions, the entrance fees is a regular income and the amount involved may also be small. In their case, it is customary to treat this item as a revenue receipt. However, if there is specific instruction, it is advisable to treat the entire amount as capital receipt and the relevant amount should be directly added to capital/general fund.

Sale of old asset: Receipts from the sale of an old asset appear in the Receipts and Payments Account of the year in which it is sold. But any gain or loss on the sale of asset is taken to the Income and Expenditure Account of the year. For example, if an item furniture with a book value of Rs. 800 is sold for Rs. 700, this amount of Rs. 700 will be shown as receipt in Receipts and Payments Account and Rs. 100 on the expenditure side of the Income and Expenditure Account as a loss on sale of old asset and while showing furniture in the balance sheet Rs. 800 will be deducted from its total book value.

Sale of Periodicals: It is an item of recurring nature and shown as the income side of the Income and Expenditure Account.

Sale of Sports Materials: Sale of sports materials (*used* materials like old balls, bats, nets, etc) is the regular feature with any Sports Club. It is usually shown as an income in the Income and Expenditure Account.

Payments of Honorarium: It is the amount paid to the person who is not the regular employee of the institution. Payment to an artist for giving performance at the club is an example of honorarium. This payment of honorarium is shown on the expenditure side of the Income and Expenditure Account.

Endowment Fund: It is a fund arising from a bequest or gift, the income of which is devoted for a specific purpose. Hence, it is a capital receipt and shown on the Liabilities side of the Balance Sheet as an item of a specific purpose fund.

Government Grant: Schools, colleges, public hospitals, etc. depend upon government grant for their activities. The recurring grants in the form of maintenance grant is treated as revenue receipt (i.e. income of the current year) and credited to Income and Expenditure account. However, grants such as building grant are treated as capital receipt and transferred to the building fund account. It may be noted that some Not-for-Profit organisations receive cash subsidy from the government or government agencies. This subsidy is also treated as revenue income for the year in which it is received.

Special Funds

The Not-for-Profit Organisations office create special funds for certain purposes/ activities such as 'prize funds', 'match fund' and 'sports fund', etc. Such funds are invested in securities and the income earned on such investments is added to the respective fund, not credited to Income and Expenditure Account. Similarly, the expenses incurred on such specific purposes are also deducted from the special fund. For example, a club may maintain a special fund for sports activities. In such a situation, the interest income on sports fund investments is added to the sports fund and all expenses on sports deducted therefrom. The special funds are shown in balance sheet. However, if, after adjustment of income and expenses the balance in specific or special fund is negative, it is transferred to the debit side of the Income and Expenditure Account or adjusted as per prescribed directions. (see Illustrations 8 and 9.)

Illustration 8

Show how you would deal with the following items in the financial statements of a Club:

Details	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Prize Fund		80,000
Prize Fund Investments	80,000	
Income from Prize Fund Investments		8,000
Prizes awarded	6,000	

Solution

Balance Sheet as on...........

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Prize fund	80,000		Prize Fund Investments	80,000
Add: Income from	8,000			
Investments	88,000			
Less: Prizes Awarded	6,000	82,000		

Illustration 9

(a) Show the following information in financial statements of a 'Not-for-Profit' Organisation:

Details	*Amount (Rs.)*
Match Expenses	16,000
Match Fund	8,000
Donation for Match Fund	5,000
Sale of Match tickets	7,000

(b) What will be the effect, if match expenses go up by Rs. 6,000 other things remaining the same?

Solution

(a)

Balance Sheet as on...........*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Match fund	8,000			
Add: Donation (Specific)	5,000			
Add: Sale of Match	7,000			
Tickets	20,000			
Less: Match Expenses	16,000	4,000		
		4,000		

** Only relevant data.*

(b)

If match expenses go up by Rs. 6,000, the net balance of the match fund becomes negative i.e. Debit exceeds the Credit, and the resultant debit balance of Rs. 2,000 shall be charged to the Income and Expenditure Account of that year.

Test your Understanding – II

How would you treat the following items in the case of a 'not-for-profit' organisation?

1. Tournament Fund Rs. 40,000. Tournament Expenses Rs. 14,000. Receipts from Tournament Rs. 16,000.
2. Table Tennis match expenses Rs. 4,000.
3. Prize Fund Rs. 22,000. Interest on Prize fund Investments Rs. 3,000. Prizes given Rs. 5,000. Prize fund Investments Rs. 18,000.
4. Receipts from Charity Show Rs. 7,000. Expenses on Charity Show Rs. 3,000.

Illustration 10

Extract of a Receipt and Payment Account for the year ended on March 31, 2015:

Payments:

Stationery Rs. 23,000

Additional Information:

Details	*April 1, 2014*	*March 31, 2015*
Stock of stationery	4,000	3,000
Creditors for stationery	9,000	2,500

Solution

Details	*Amount (Rs.)*
Payment made for the purchase of stationery as per Receipts and Payments account	23,000
Less: Payment for 2013-14 (i.e. creditors in the beginning)	9,000
Payment made for the year 2014-15	14,000
Add: Payment not yet made (i.e. creditors at the end)	2,500
Stationery *Purchased* for the year 2014-15	16,500
Add: Stock in the beginning	4,000
Stationery Available for consumption during 2014-15	20,500
Less: Stock at the end	3,000
Stationery Consumed during 2014-15 to be taken to the Expenditure side of the Income and Expenditure account	**17,500**

Stationery: Normally expenses incurred on stationary, a consumable items are charged to Income and Expenditure Account. But in case stock of stationery (opening and/or closing) is given, the approach would be make necessary adjustments in purchases of stationery and work out cost of stationery consumed and show that amount in Income and Expenditure Account and its stock in the balance sheet. For example, the Receipt and Payment Account shows a payment for stationery amounting to Rs. 40,000 and there is an opening and closing stationery amounting to Rs. 12,000 and Rs. 15,000. The amount of expense on stationery will be worked out as follows:

Stationery	
Purchases	40,000
Add: Opening stock	12,000
	52,000
Less: Closing stock	15,000
	37,000

In case stationery is also purchased on credit, the amount of its consumption will be worked out as given in Illustration 12.

Do it Yourself

1. Find out the cost of medicines consumed during 2014-15 from the following information:

Details	*Amount (Rs.)*
Payment for purchase of medicines	3,70,000
Creditors for medicines purchased:	
On 1.4.2014	25,000
On 31.3.2015	17,000
Stock of Medicines:	
On 1.4.2014	62,000
On 31.3.2015	54,000
Advance to suppliers of medicines:	
On 1.4.2014	11,500
On 31.3.2015	18,200

2. What amount of sports material will be posted to Income and Expenditure Account for the year ended March 31, 2014 as expenditure? :

	Amount (Rs.)
Stock of sports materials as on April 1, 2014	7,500
Creditors for sports material as on April 1, 2014	2,000
Stock of sports material as on March 31, 2015	6,200
Amount paid for sports material during the year 2014-15	17,000
Advance paid for sports material as on March 31, 2015	3,500
Creditors for sports material as on March 31, 2015	1,200

Illustration 11

Following is the Receipt and Payment Account of an Entertainment Club for the period April 1, 2015 to March 31, 2016.

Receipt and Payment Account for the year ending March 31, 2016

Receipts		*Amount (Rs.)*	*Payments*		*Amount (Rs.)*
Balance b/d			Salaries		24,000
Cash	27,500		Electric bill		21,000
Bank	60,000	87,500	Food stuff for restaurant		60,000
Member's subscriptions:			Telephone bill		35,000
2014-2015	12,500		Subscription for periodicals		14,500
2015-2016	1,00,000		Printing and stationery		13,000
2016-2017	10,000	1,22,500	Sports expenses		50,000
Sale of furniture			Secretary's honorarium		30,000
(book value: Rs. 8,000)		10,000	8% Investments (31.3.2007)		1,00,000
Sale of food stuffs		1,00,000	Balance c/d:		
Sale of old periodicals		3,200	Cash	21,500	
and newspapers			Bank	45,000	66,500
Hire of ground used		48,750			
for marriage					
Donation for sports fund		25,000			
Locker Rent		17,050			
		4,14,000			**4,14,000**

Additional Information

1. The club had 225 members, each paying an annual subscription of Rs. 500. Subscription outstanding as on 31 March 2016 Rs. 15,000.
2. Telephone bill outstanding for the year 2015-2016 is Rs. 2,000.
3. Locker Rent Rs. 3,050 outstanding for the year 2014-15 and Rs. 1,500 for 2015-16.
4. Salary outstanding for the year 2015-16 Rs. 4,000.
5. Opening Stock of Printing and stationery Rs. 2,000 and closing stock of printing and stationery is Rs. 3,000 for the year 2015-16.
6. On 1st April 2015 other balances were as under:

	Rs.
Furniture	1,00,000
Building	6,50,000
Sports fund	15,000

7. Depreciation Furniture and Building @ 12.5% and 5% respectively assuming that it is on reducing balance for the year ending March 31.2016

Prepare Income and Expenditure account and Balance Sheet as on that date.

Solution

Book of Entertainment Club
Income and Expenditure Account
for the year ending on March 31, 2016

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Salary	24,000		Subscriptions	1,00,000	
Add: Outstanding	4,000	28,000	*Add:* Outstanding	12,500	1,12,500
Electric Bill		21,000	Sale of old periodicals		3,200
Telephone Bill	35,000		Profit on sale of furniture		2,000
Add: Outstanding	2,000	37,000	Hire of ground for marriage		48,750
Subscription for periodicals		14,500	Locker rent	17,050	
Printing and Stationery	13,000		*Less:* Opening o/s	3,050	
Add: Opening Stock	2,000			14,000	
	15,000		*Add:* Closing o/s	1,500	15,500
Less: Closing stock	3,000	12,000			
Secretary's honorarium		30,000	Sale of Food Stuff	1,00,000	
Sports Expenses	50,000		Cost of food Consumed	60,000	40,000
Less: Opening Balance of sports fund	15,000				
	35,000				
Less: Donation for Sports	25,000	10,000			
Depreciation On:					
Furniture	11,500				
Building	32,500	44,000			
Surplus (Excess of Income over Expenditure)		25,450			
		2,21,950			**2,21,950**

Balance Sheet of Entertainment Club as on March 31, 2015

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sports fund	15,000	Cash in hand	27,500
Capital/General Fund (Balancing figure)	8,42,550	Cash at bank	60,000
		Outstanding subscription	15,000
		Outstanding locker Rent	3,050
		Printing & Stationery	2,000
		Furniture	1,00,000
		Buildings	6,50,000
	8,57,550		**8,57,550**

Balance Sheet of Entertainment Club as on March 31, 2016

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Subscriptions received in advanced		10,000	Cash in hand		21,500
Outstanding Telephone Bill		2,000	Cash at bank		45,000
Salary Outstanding		4,000	Outstanding subscriptions		15,000
Capital/General Fund		8,42,550	(2015 Rs 2500 and 2016 Rs 12500)		
Add: Surplus	25,450	8,68,000	Outstanding locker Rent		1,500
			Printing and Stationery		3,000
			Furniture	1,00,000	
			Less: Sales	8,000	
				92,000	
			Less: Depreciation	11,500	80,500
			Building	6,50,000	
			Less: Depreciation	32,500	6,17,500
			Investment		1,00,000
		8,84,000			**8,84,000**

Illustration 12

Prepare Income and Expenditure Account and Balance Sheet for the year ended March 31, 2015 from the following information.

Receipt and Payment Account for the year ending March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*		*Amount (Rs.)*
Balance b/d		41,000	Salaries and Wages:		
Subscriptions:			2013-14	4,800	
2013-14	7,200		2014-15	83,200	88,000
2014-15	3,37,600		Sundry expenses		37,000
2015-16	12,000	3,56,800	Freehold land		60,000
Entrance fees		16,000	Stationery		16,000
Locker rent		58,000	Rates		24,000
Revenue from refreshment		48,000	Refreshment expenses		37,500
Income from investments		56,000	Telephone charges		4,000
			Investments		2,50,000
			Audit fee		6,000
			Balance c/d		53,300
		5,75,800			**5,75,800**

The following additional information is provided to you:

1. There are 1800 members each paying an annual subscription of Rs. 200, Rs. 8,000 were in arrears for 2013-14 as on April 1, 2014.
2. On March 31, 2015 the rates were prepaid to June 2015; the charge paid every year being Rs. 24,000.
3. There was an outstanding telephone bill for Rs. 1,400 on March 31, 2015.
4. Outstanding sundry expenses as on March 31, 2014 totaled Rs. 2,800.
5. Stock of stationery as on March 31, 2014 was Rs. 2000; on March 31, 2015, it was Rs. 3,600.
6. On March 31, 2014 Building stood at Rs. 4,00,000 and it was subject to depreciation @ 2.5% p. a.
7. Investment on March 31, 2014 stood at Rs. 8,00,000.
8. On March 31, 2015, income accrued on investments purchased during the year amounted to Rs. 1,500.

Solution

Income and Expenditure Account
for the year ending on March 31, 2015

Dr. *Cr.*

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Salaries and Wages		83,200	Subscriptions		3,60,000
Sundry Expenses	37,000		Entrance fees		16,000
Less: Outstanding on			Locker rent		58,000
31.3.2014	2,800	34,200	Income from refreshment:		
Stationery : (consumed)			Revenue from	48,000	
Opening stock	2,000		refreshment		
Add: Purchases	16,000		*Less:* Refreshment	37,500	10,500
Less: Closing stock	3,600	14,400	expenses		
Rates	24,000		Income from	56,000	
Less: Paid for 2015-16	6,000		investments		
Add: Prepaid in 2014-15	6,000	24,000	*Add:* Accrued income	1,500	57,500
Telephone charges	4,000		on current year		
Add: Outstanding	1,400	5,400	investment		
audit fee		6,000			
Surplus Depreciation on building		10,000			
(excess of Income over					
expenditure)		3,24,800			
		5,02,000			**5,02,000**

Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Outstanding Telephone Expenses		1,400	Cash and Bank Balance		53,300
			Subscription in Arrears		23,200
Subscription received in Advance		12,000	Stock of Stationery		3,600
			Rates Prepaid		6,000
General Fund	12,49,400		Accrued Interest on investment:		1,500
Add: Surplus	3,24,800	15,74,200	Investments	8,00,000	
			Additions	2,50,000	10,50,000
			Building	4,00,000	
			Less: Depreciation	10,000	3,90,000
			Land		60,000
		15,87,600			**15,87,600**

Balance Sheet as on March 31, 2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Outstanding Sundry Expenses	2,800	Cash and Bank balance	41,000
Outstanding Salary and Wages	4,800	Subscription in arrears	8,000
General Fund (Balancing figure)	12,49,400	Stock of stationery	2,000
		Rates prepaid	6,000
		Investments	8,00,000
		Building	4,00,000
	12,57,000		**12,57,000**

Working Note :

Subscription Account

Dr. ***Cr.***

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Opening Balance or Balance b/d (Arrears for 2013-14)		8,000		Receipt and Payment		3,56,800
	Income and Expenditure (1800×200)		3,60,000		Balance c/d		23,200
	Balance c/d (Advance for 2015-16)		12,000				
			3,80,000				**3,80,000**

Illustration 13

Following is the Receipt and Payment Account of Friendship Club in respect of the Year on 31.3.2015.

Receipt and Payment Account for the year ending March 31, 2015.

Receipts		Amount (Rs.)	Payment	Amount (Rs.)
Opening cash in hand		10,000	Salaries	20,000
Subscription:			Stationery	4,500
2013-14	15,000		Rates and Taxes	1,500
2014-15	20,000		Telephone charges	7,500
2015-16	5,000	40,000	8% govt. securities at par	25,000
Profit from sports		17,800	Sundry expenses	500
Interest on 8% govt. securities		5,000	Courier service charges	300
			Closing cash in hand	13,500
		72,800		**72,800**

Additional Information :

1. There are 500 members, each paying an annual subscription of Rs. 50, Rs. 17,500 being in arrears for 2013-14 at the beginning of 2014-15. During 2013-14, subscriptions were paid in advance by 40 members for 2014-15.
2. Stock of stationery at March 31, 2014, was Rs. 1,500 and at March 31, 2015, Rs. 2,000.
3. At March 31, 2006, the rates and taxes were prepaid to the following January 31, the annual charge being Rs. 1,500.
4. A quarter's charge for telephone is outstanding, the amount accrued being Rs. 1,500. There is no change in quarterly charge.
5. Sundry expenses accruing at 31.3.2014 were Rs. 250 and at March 31, 2015 Rs. 300.
6. At March 31, 2014 Building stood in the books at Rs. 2,00,000 and it is required to write off depreciation @ 10% p.a.
7. Value of 8% Government Securities at March 31, 2005 was Rs. 75,000 which were purchased at that date at Par. Additional Government Securities worth Rs. 25,000 are purchased on March 31, 2015.

You are required to prepare:

(a) An Income and Expenditure Account for the year ended on 31.3.2015

(b) A Balance Sheet on that date.

Solution

Books of Friendship Club
Balance Sheet as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Outstanding Expenses:			Building	2,00,000
Telephone charges	3,000		Investment in 8% Govt. Securities	75,000
Sundry Expenses	250	3,250		
Subscription received in Advance		2,000	Stock of stationery	1,500
			Prepaid Rates and Taxes	1,250
General Fund (balancing figure)		3,00,000	Subscription outstanding	17,500
			Cash in hand	10,000
		3,05,250		**3,05,250**

Income and Expenditure Account
for the year ending on March 31, 2015

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Salaries		20,000	Profit on Sports		17,800
Stationery (paid)	4,500		Interest on 8% Govt. Securities Received	5,000	
Add: Opening stock	1,500				
	6,000		*Add:* Receivable	1,000	6,000
Less: Closing stock	2,000		Total Subscription Received during the current year	40,000	
Stationery consumed		4,000			
Rates and Taxes	1,500				

Less: Closing Prepaid	1,250		*Add:* Opening Subscription in advance	2,000	
	250				
Add: Opening Prepaid	1,250	1,500	*Add:* Outstanding at the end of the Current Year	5,500	
Telephone charges paid	7,500				
Add: Outstanding (Current Year)	1,500		(2,500+3,000)=	47,500	
	9,000				
Less: Outstanding (Previous year)	3,000	6,000	*Less:* Subscription received in Advance(Closing)	5,000	
Sundry expenses paid	500			42,500	
Add: Outstanding (Current Year)	300		*Less:* Outstanding at the start of the Current Year	17,500	25,000*
	800				
Less: Outstanding (Previous year)	250	550			
Depreciation on building		20,000	Deficit: (Excess of Expenditure over to Income)		3,550
Courier charges		300			
		52,350			**52,350**

- Verification: 500 × 50 = 25000.

Balance Sheet of Friendship Club as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Outstanding Expenses:			Building :	2,00000	
Telephone charges	1,500		*Less:* depreciation	20,000	1,80,000
Sundry Expenses	300	1,800	Investment in 8% Govt. Securities:	75,000	
Subscription received in Advance		5,000	*Add:* Purchases	25,000	1,00,000
General Fund	3,00,000		Stock of stationery		2,000
Less: Deficit	3,550	2,96,450	Interest on 8% Govt. securities Receivable		1,000
			Prepaid Rates and Taxes		1,250
			Subscription outstanding (Rs.17,500-Rs. 5,000) +Rs. 3,000= Rs.5,500		5,500
			Cash in hand		13,500
		3,03,250			**3,03,250**

1.7 Income and Expenditure Account based on Trial Balance

In case of not-for-profit organisations, normally the Income and Expenditure Account and Balance Sheet is prepared based on the Receipts and Payments Account and the additional information given. But, sometimes, the trial balance along with some additional information is given for this purpose. See Illustration 14.

Illustration 14

From the trial balance and other information given below for a school, prepare Income and Expenditure Account for the year ended on 31.3.2014 and a Balance Sheet as on that date:

Debit Balance	*Amount (Rs.)*	*Credit Balance*	*Amount (Rs.)*
Building	6,25,000	Admission fees	12,500
Furniture	1,00,000	Tuition fees received	5,00,000
Library books	1,50,000	Creditors for supplies	15,000
Investment @12%	5,00,000	Rent for the school hall	10,000
Salaries	5,00,000	Miscellaneous receipts	30,000
Stationery	40,000	Government grant	3,50,000
General expenses	18,000	General fund	10,00,000
Sports expenses	15,000	Donation for library books	62,500
Cash at bank	50,000	Sale of old furniture	20,000
Cash in hand	2,000		
	20,00,000		**20,00,000**

Additional Information:

(i) Fees yet to be received for the year are Rs. 25,000.
(ii) Salaries yet to be paid amount to Rs.30,000.
(iii) Furniture costing Rs. 40000 was purchased on October 1, 2010.
(iv) The book value of the furniture sold was Rs. 50,000 on April 1, 2013
(v) Depreciation is to be charged @ 10% p.a. on furniture, 15% p.a. on Library books, and 5% p.a. on building.

Solution

Income and Expenditure Account
for the year ending on March 31, 2014

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Loss on sale of old furniture (50,000 –20,000)		30,000	Admission fees		12,500
Salaries	5,00,000		Tuition fees	5,00,000	
Add: outstanding	30,000	5,30,000	*Add:* Outstanding	25,000	5,25,000
Stationery		40,000	Rent for the school hall		10,000
General expenses		18,000	Miscellaneous receipts		30,000
Depreciation:			Government grant		3,50,000
Furniture	3,000		Interest accrued on investments		60,000
Building	31,250				
Library books	22,500	56,750			
Sports expenses		15,000			
Surplus (excess of income over expenditure)		2,97,750			
		9,87,500			**9,87,500**

Working Notes:

1. As admission fee is a regular income of a school, so it has been taken as a revenue income of the school.
2. Depreciation on furniture has been computed as following on the assumption that furniture was sold on April 1, 2013.

	Amount (Rs.)
Book Value on March 31, 2014	1,00,000
Less: Book Value of Sold furniture	(50,000)
	50,000
Depreciation on furniture of Rs. 10,000 for one year	1,000
Depreciation on furniture of Rs. 40,000 for 6 months	2,000
Total depreciation	**3,000**

Balance Sheet as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors for Supplies		15,000	Buildings	6,25,000	
Outstanding Salaries		30,000	*Less:* Depreciation	31,250	5,93,750
Donation for Library Books		62,500	Furniture	1,00,000	
General fund	10,00,000		*Less:* Sold	50,000	
Add: Surplus	2,97,750	12,97,750		50,000	
			Less: Depreciation	3,000	47,000
			Accrued fees		25,000
			Library books	1,50,000	
			Less: Depreciation	22,500	1,27,500
			Investments @ 12%		5,00,000
			Interest accrued		60,000
			Cash at bank		50,000
			Cash in hand		2,000
		14,05,250			**14,05,250**

1.8 Incidental Trading Activity

Sometimes, trading activities such as chemist Shop, hospital, canteen, beauty parlour etc. also take place in such organisations to provide certain facilities to members or public in general. In such a situation, trading account has to be prepared to ascertain the results of such incidental activity. The profit from such commercial (trading) activities is applied to fulfill the main objectives for which the organisation was set up, and so it is transferred to the Income and Expenditure Account. It is pertinent to note the following procedure:

1. Prepare trading account to determine profit (or Loss) due to incidental commercial (trading) activity. All costs and revenues directly and exclusively

related to such activity are recorded in the trading account. Balance of trading account is transferred to the Income and Expenditure Account.

2. Income and Expenditure Account records, in addition to trading Profit (or loss), all other incomes and expenses not recorded in the Trading Account. Surplus or deficit revealed by the Income and Expenditure Account is transferred to capital/general fund.

Illustration 15

Following balances have been extracted from the books of Pleasant Club for the year ended on March 31, 2015:

Details	*Amount (Rs.)*
Capital Fund as on March 31, 2014	2,05,000
Furniture as on March 31, 2014	21,000
Additions of furniture during the year	23,500
Billiard Table and other accessories as on March 31, 2014	22,250
China glass and cutlery and Linen as on March 31, 2014	6,250
Restaurant receipts during the year	9,68,000
Restaurant stock as on March 31, 2014	9,750
Receipts from billiard Room during the year	86,000
Subscription received during the year	88,750
Interest on deposit received during the year	6,000
Honorarium paid to Secretary	80,000
Purchases for restaurant	5,59,500
Rent and Rates	87,250
Wages (restaurant Rs. 1,25,000)	2,30,750
Repairs and Renewals	44,750
Lighting	44,250
Fuel	33,500
Sundry expenses	8,000
Cash in hand as on March 31, 2014	4,375
Bank balance as on March 31, 2014	36,875
Bank deposit @10% as on March 31, 2014	1,00,000

Payment for purchases included Rs.7,500 for the year ended on March 31, 2014. Restaurant stock as on March 31, 2015 were Rs. 11,250. Amount of Subscription received included Rs. 12,000 for the previous year and Rs. 3,000 for the next year. Subscription outstanding as on March 31, 2015 were Rs. 12,500.

Depreciation should be provided as per following rate Structure:

(a) Furniture @ 10 %; (b) Billiard Table and other accessories@ 12%; (c) China glass and cutlery @ 20%.

Cost of boarding expenses of the staff is estimated at Rs. 68,750 of which Rs. 50,000 is to be charged to Restaurant.

Prepare the Receipt and Payment Account; Income and Expenditure Account and the Balance Sheet showing the working of the Restaurant separately. Cash in hand on March 31, 2015 was Rs. 8,500.

Solution

Books of Pleasant Club
Receipt and Payment Account
for the year ending on March 31, 2012

Receipts		*Amount (Rs.)*	*Payments*		*Amount (Rs.)*
Opening Balance:			Rent and Rates		87,250
Cash in hand	4,375		*Wages:*		
Cash at bank	36,875	41,250	Restaurant	1,25,000	
Subscriptions		88,750	Others	1,05,750	2,30,750
Interest on deposit		6,000	Repairs and Renewals		44,750
Restaurant receipts		9,68,000	Furniture purchased		23,500
Billiard receipts		86,000	Honorarium of Secretary		80,000
			Purchases for restaurant		5,59,500
			Lighting		44,250
			Fuel		33,500
			Sundry expenses		8,000
			Closing balance:		
			Cash in hand	8,500	
			Cash at bank (balancing figure)	70,000	78,500
		11,90,000			**11,90,000**

Trading Account
for the year ending on March 31, 2015

Details		*Amount (Rs.)*	*Details*	*Amount (Rs.)*
Opening stock		9,750	Restaurant receipts	9,68,000
Purchases	5,59,500		Cost of boarding expenses of the staff	68,750
Less: Previous year	7,500	5,52,000		
Wages		1,25,000	Closing stock	11,250
Depreciation of china glass cutlery		1,250		
Cost of boarding expenses of the staff		50,000		
Fuel		33,500		
Profit transferred to Income and Expenditure		2,76,500		
		10,48,000		**10,48,000**

Income and Expenditure Account
for the year ending on March 31, 2015

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Wages		1,05,750	Subscription Received	88,750	
Repairs and Renewals		44,750	*Add:* Outstanding	12,500	
Honorarium of Secretary		80,000	this year	1,01,250	
Lighting		44,250	*Less:* Outstanding	12,000	
Rent and Rates		87,250	previous year	89,250	
Cost of boarding			*Less:* Advance for	3,000	86,250
expenses of the staff		18,750	Next year		
Sundry expenses		8,000	Interest received	6,000	
Depreciation on:			*Add:* Accrued	4,000	10,000
Furniture	4,450		Billiard receipts		86,000
Billiard table	2,670	7,120	Profit transferred		2,76,500
Surplus: (Excess of Income			from trading Account		
over Expenditure)		62,880			
		4,58,750			**4,58,750**

Balance Sheet of Pleasant Club as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Capital Fund	2,05,000		Furniture:		
Add: Surplus	62,880	2,67,880	Opening Balance	21,000	
Subscription received		3,000	*Add:* Additions	23,500	
in Advance				44,500	
			Less: Depreciation	4,450	40,050
			Billiard Table	22,250	
			Less: Depreciation	2,670	19,580
			China glass and cutlery	6,250	
			Less: Depreciation	1,250	5,000
			Restaurant stock		11,250
			Subscription Outstanding		12,500
			Interest Accrued		4,000
			Bank deposit		1,00,000
			Cash in hand		8,500
			Cash at bank		70,000
		2,70,880			**2,70,880**

Illustration 16

Prepare Income and Expenditure Account of Entertainment Club for the year ending March 31, 2015 and Balance Sheet as on that date from the following information:

Receipt and Payment Account
For the year ending on March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		24,000	Rent and Rates	48,750
Subscriptions			Furniture purchased	40,000
2013-14	23,250		Creditors for sports materials	61,000
2014-15	3,36,000		Purchases for sports materials	10,000
2015-16	13,000	3,72,250	Cost of prizes awarded	20,750
Sale of sports materials		26,000	Match expenses	35,150
Entrance fees		40,000	Miscellaneous expenses	1,50,000
General donation		20,250	Balance c/d	1,34,050
Donation for prize fund		14,000		
Interest on prize fund				
Investments		1,500		
Miscellaneous receipts		1,700		
		4,99,700		**4,99,700**

Additional Information:

Details	*Apr. 01, 2014*	*Mar. 31, 2015*
Sports materials	20,000	25,000
Furniture	2,00,000	?
5% Prize fund investments	60,000	?
Creditors for sports materials	7,000	14,750
Subscription in arrears	23,750	?
Prize fund	60,000	?
Rent paid in advance	----	3,750
Outstanding rent	3,750	
Outstanding miscellaneous expenses	11,400	20,100
Miscellaneous expenses paid in advance	3,750	4,250
Book value of sports materials sold was Rs. 20000		
Depreciation on furniture is to be provided @ 10%.		
Half of the entrance fee is to be capitalised.		
There are 1440 members, each paying an annual subscription @ Rs. 250.		
Subscription received in advance on 1.4.2014 were Rs. 7,000.		

Solution

Books of Entertainment Club
Income and Expenditure Account
for the year ending March 31, 2015

Expenditure		*Amount (Rs.)*	*Income*		*Amount (Rs.)*
Rent	48,750		Subscriptions	3,36,000	
Less: Opening	3,750		*Add:* Received		
Outstanding			in advance		
	45,000		(2014-2015)	7,000	
Less: paid in advance	3,750	41,250	*Add:* Outstanding		
Sports Materials			(2013–2014)	17,000	3,60,000
Opening stock	20,000		(Rs.3,60,000–Rs.3,43,000)		3,60,000
Add: Payments	61,000		General donations		20,250
to creditor			Entrance fees		20,000
	81,000		Sports materials		
Add: Closing creditor	14,750		(Profit on sale)		
	95,750		(i.e. 26,000–20,000)		6,000
Add: Cash purchase	10,000		Miscellaneous receipts		1,700
	1,05,750				
Less: Opening creditor	7,000				
	98,750				
Less: Sports material	20,000				
Sold					
	78,750				
Less: Closing stock	25,000	53,750			
Match expenses		35,150			
Depreciation on furniture		24,000			
Miscellaneous expenses:					
Paid 1,50,000					
Less: Outstanding	11,400				
(2013-2014)					
	1,38,600				
Paid in advance	4,250				
(2013-2014)					
	1,34,350				
Add: Outstanding	20,100				
(2013-2014)					
	1,54,250				
Paid in advance	3,750	1,58,200			
(2012-2013)					
Surplus (Excess of		95,600			
income over expenditure)					
		4,07,950			**4,07,950**

Balance Sheet of Entertainment Club as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital Fund (Balancing figure)		2,42,350	Furniture	2,00,000
Prize fund		60,000	5% Prize Fund Investments	60,000
Creditors for Sports Materials		7,000	Subscription Receivable (i.e. outstanding)	23,750
Subscription Received in Advance Outstanding		7,000	Stock of Sports Materials	20,000
Expenses:			Miscellaneous Expenses Paid in Advance	3,750
Rent	3,750		Cash in hand	24,000
Miscellaneous Expenses	11,400	15,150		
		3,31,500		**3,31,500**

Balance Sheet of Entertainment as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Capital fund	2,42,350		*Furniture:*		
Add: Surplus	95,600		Opening balance	2,00,000	
Entrance fees	20,000	3,57,950	Additions	40,000	
Prize fund	60,000			2,40,000	
Add: Donations	14,000		*Less:* Depreciation	24,000	2,16,000
Interest received	1,500		5% Prize fund investments		60,000
Interest accrued*	1,500		Subscription receivable		
	77,000		(i.e. Outstanding):		
Less: Prizes awarded	20,750	56,250	(2013-2014)	500	
Creditors for sports materials		14,750	(2014-2015)	17,000	17,500
Subscription received in advance		13,000	Stock of sports materials		25,000
Outstanding miscellaneous expenses		20,100	Miscellaneous expenses Paid in advance		4,250
			Prepaid rent		3,750
			Accrued interest on Prize fund investments		1,500
			Cash in hand		1,34,050
		4,62,050			**4,62,050**

Note: * Interest on Prize Fund Investments @ 5% amounts to Rs. 3,000 whereas only Rs. 1,500 have been received; so the balance is treated as Accrued interest.

It is preferable to prepare separate accounts of various items involving many transactions. In this case Account for Subscription, Miscellaneous Expenses, and Sports Materials may be made as a Classroom activity.

Illustration 17

Shiv-e-Narain Education Trust provides the information in regard to Receipt and Payment Account and Income and Expenditure Account for the year ended March 31st 2015:

Receipt and Payment Account for the year ending March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Cash in hand as on April 1, 2014		3,000	Printing and Stationery	6,000
			Lighting & Water	2,600
Cash at bank as on April 1, 2014		15,000	Rent	21,000
			Advertisement	2,820
Subscription:			Miscellaneous Expenses	4,400
2013-14	12,000		Staff Salaries	85,000
2014-15	46,000		Furniture purchased	28,000
2015-16	15,600	73,600	Honorarium	15,000
Entrance fees		25,200	Books	5,000
Tuition fees:			Cash in hand as on March 31, 2015	9,180
2014-15	80,000			
2014-15	10,000	90,000	Cash at bank as on March 31, 2015	45,000
Interest on investment:				
2013-14	4,000			
2014-15	6,000	10,000		
Miscellaneous receipts		7,200		
		2,24,000		**2,24,000**

On March 31, 2015 the following balances appeared:
Investments Rs.1, 60,000; Furniture Rs.40, 000; and Books Rs.20, 000.

Income and Expenditure Account for the year ending on March 31, 2015

Expenditure	*Amount (Rs.)*	*Income*	*Amount (Rs.)*
Printing and Stationery	7,800	Subscription	46,000
Lighting & Water	2,600	Interest on investment	6,800
Rent	24,000	Miscellaneous incomes	7,200
Staff salaries	84,000	Tuition fees	90,000
Advertisement	3,200		
Honorarium	15,000		
Misc. expenses	4,400		
Depreciation on furniture	4,000		
Surplus(Excess of income over expenditure)	5,000		
	1,50,000		**1,50,000**

Prepare opening and closing balance sheet

Solution

Shiv-e-Narain Education Trust
Balance Sheet as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital/General Fund (Balancing figure)	2,54,000	Investments	1,60,000
		Furniture	40,000
		Books	20,000
		Outstanding subscription	12,000
		Accrued Interest on Invest.	4,000
		Cash in hand	3,000
		Cash at bank	15,000
	2,54,000		**2,54,000**

Balance Sheet of Shiv-e-Narain Education Trust as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Tuition fee advance		10,000	Investments		1,60,000
Rent Outstanding		3,000	Furniture	40,000	
Advertisement Outstanding		380	*Less:* Depreciation	4,000	
Printing & Stationery Outstanding		1,800		36,000	
			Add: Purchases	28,000	64,000
Advance Subscription		15,600	Books	20,000	
Capital/			*Add:* Purchases	5,000	25,000
General Fund	2,54,000		Interest Accrued		800
Add Entrance fee	25,200		Outstanding tuition fee		10,000
Add Surplus	5,000	2,84,200	Staff Salary Advance		1,000
			Cash in Hand		9,180
			Cash at Bank		45,000
		3,14,980			**3,14,980**

Note:

1. Income and Expenditure Account for the current year shows interest on investment income Rs.6,800 while Receipts and Payments Account shows the receipts of Rs.6,000 the difference of Rs.800 means interest on investment has become due but not yet receivable during the year.
2. Income and Expenditure Account shows Rs.90,000 as income from Tuition fees. However, the Receipts and Payments Account shows Rs.10,000 as tuition fees received for the year 2015-16 and Rs.80,000 for 2014-15. It implies that Rs.10,000 on account of tuition fees for the year 2014-15 are still receivable (i.e. Tuition fees are outstanding).
3. Receipt and Payment Account shows a payment of Rs.85,000 on account of staff salaries, but the Income and Expenditure Account shows expenditure

of Rs.84,000 on account of staff salaries. It means the excess of Rs.1,000 shown in the Receipt and Payment Account may either belong to the pervious year or the next year. Their is no evidence that staff salaries of Rs.1,000 was outstanding at the end of the previous year 2013-14. This is why this payment of Rs.1,000 has been considered as an advance salaries to the staff.

Terms Introduced in the Chapter

1. Not-for-Profit Organisation.
2. Receipts and Payments Account
3. Income and Expenditure Account
4. Entrance Fee
5. Life Membership
6. Special Receipts
7. Subscription
8. Donation
9. Incidental Trading Activity
10. Legacy

Summary

1. *Difference between Profit Seeking Entities and Not-for-Profit Entities:* Profit-seeking entities undertake activities such as manufacturing trading, banking and insurance to bring financial gain to the owners. Not-for-Profit entities exist to provide services to the member or to the society at large. Such entities might sometimes carry on trading activities but the profits arising therefrom are used for further the service objectives.
2. *Appreciation of the need for separate Accounting Treatment for Not-for-Profit Organisations:* Since not-for-profit entities are guided primarily by a service motive, the decisions made by their managers are different from those made by their counterparts in profit-seeking entities. Differences in the nature of decisions implies that the financial information on which they are based, must also be different in content and presentation.
3. *Explanation of the nature of the Principal Financial Statements prepare by Not-for-Profit enterprises:* Not-for-Profit Organisations that maintain accounts based on the double-entry system of accounting, generally prepare three principal statements to fulfil their information needs. These include Receipts and Payments Account, Income and Expenditure Account, and a Balance Sheet.

   The Receipts and Payments Account is a summarised cash book which records all cash Receipts and cash Payments without distinguishing between capital and revenue items, and between items relating to the current year and those relating to previous or future years.

   The Income and Expenditure Account is an income statement which is prepared to ascertain the excess of revenue income over revenue expenditure or vice versa, for a particular accounting year, as a result of the entity's overall activities. Although it is considered to be a substitute for the Trading and Profit and Loss Account of a profit-seeking entity, there are certain conceptual differences between the two statements. The Balance Sheet is prepared at the end of the entity's accounting year to depict the financial position on that date. It includes the Capital Fund or Accumulated Fund, special purpose funds, and current liabilities on the left hand or liabilities side, and fixed assets and current assets on the right hand or assets side.

4. *Difference between the Receipt and Payment Account and the Income and Expenditure Account:* Many differences exist between the Receipt and Payment Account and the Income and Expenditure Account which is evident from the nature and purpose of two statements. While the former records both capital and revenue receipts and payments relating to any accounting year, the latter records only revenue items relating to the current accounting year. Non-cash expenses such as depreciation on fixed assets and outstanding incomes and expenses are shown in the latter but omitted in the former. The Receipt and Payment Account has an opening balance while the Income and Expenditure Account does not. The closing balance of the former account represents cash and bank balances on the closing date while in the latter account it indicates surplus or deficit from the activities of the enterprise.
5. *Conversion of a Receipt and Payment Account into an Income and Expenditure Account:* This essentially involves five steps namely, (i) adjusting the revenue receipts on the debit side to include outstanding incomes and incomes relating to the current year received earlier and to exclude amounts received in arrears or in advance; (ii) adjusting revenue payments on the credit side; (iii) identifying and showing non-cash expenses and losses on the debit side of the Income and Expenditure Account; (iv) computing and showing profits/losses from trading and/or social activities on the credit/debit side of the Income and Expenditure Account; and (v) ascertaining the surplus or deficit as the closing balance of the Income and Expenditure Account.

Questions for Practice

Short Answer Questions

1. State the meaning of 'Not- for- Profit' Organisations.
2. State the meaning of Receipt and Payment Account.
3. State the meaning of Income and Expenditure Account.
4. What are the feature of Receipt and Payment Account?
5. What steps are taken to prepare Income and Expenditure Account from a Receipt and Payment Account?
6. What is subscription? How is it calculated?
7. What is Capital Fund? How is it calculated?

Long Answer Questions

1. Explain the statement: "Receipt and Payment Account is a summarised version of Cash Book".
2. "Income and Expenditure Account of a Not-for-Profit Organisation is akin to Profit and Loss Account of a business concern". Explain the statement.
3. Distinguish between Receipts and Payments Account and Income and Expenditure Account.
4. Explain the basic features of Income and Expenditure Account and of Receipt and Payment Account.
5. Show the treatment of the following items by a not-for-profit organisation:
   (i) Annual subscription
   (ii) Specific donation
   (iii) Sale of fixed assets
   (iv) Sale of old periodicals
   (v) Sale of sports materials
   (vi) Life membership fee
6. Show the treatment of items of Income and Expenditure Account when there is a specific fund for those items.
7. What is Receipt and Payment Account? How is it different from Income and Expenditure Account?

Numerical Questions

1. From the following particulars taken from the Cash Book of a health club, prepare a Receipts and Payments Account.

	Rs.
Opening balance:	
Cash in Hand	5,000
Cash at Bank	25,000
Subscriptions	1,65,000
Donations	35,000
Investment Purchased	80,000
Rent Paid	20,000
General Expenses	21,500
Postage and stationery	2,000
Courier charges	1,000
Sundry Expenses	2,500
Closing Cash in Hand	12,000

(**Ans**: Cash at Bank (balancing figure) Rs. 91,000)

2. The Receipt and Payment Account of Harimohan charitable institution is given:

Receipt and Payment Account for the year ending March 31, 2015

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		Furniture	3,000
Cash at Bank	22,000	Investments	55,000
Cash in Hand	8,800	Advance for building	20,000
Donations	32,000	Charities	60,000
Subscriptions	50,200	Salaries	10,400
Endowment fund	60,000	Rent and Taxes	4,000
Legacies	24,000	Printing	1,000
Interest on Investment	3,800	Postage	300
Interest on Deposits	800	Advertisements	1,100
Sale of old newspapers	500	Insurance	4,800
		Balance c/d:	
		Cash at bank	32,000
		Cash in hand	10,500
	2,02,100		**2,02,100**

Prepare the Income and Expenditure Account for the Year ended on March 31, 2015 after considering the following:

(i) It was decided to treat Fifty per cent of the amount received on account of Legacies and Donations as income.

(ii) Liabilities to be provided for are:
Rent Rs. 800; Salaries Rs. 1,200; advertisement Rs. 200.

(iii) Rs. 2,000 due for interest on investment was not actually received.

(Ans : Excess of income over Expenditure Rs. 2,500.)

3. From the following particulars , prepare Income and Expenditure account:

Details	*Amount (Rs.)*
Fees collected, including Rs.80,000 on account of the previous year	5,20,000
Fees for the year outstanding	30,000
Salary paid , including Rs. 5,000 on account of the previous year	68,000
Salary outstanding at the end of the year	3,000
Entertainment expenses	8,000
Tournament expenses	25,000
Meeting Expenses	18,000
Traveling Expenses	7,000
Purchase of Books and Periodicals, including Rs. 31,000 for purchase of Books	40,000
Rent	15,000
Postage, telegrams and telephones	6,000
Printing and Stationery	18,000
Donations received	25,000

(Ans : Excess of income over expenditure Rs. 3,07,000**)**

4. Following is the information given in respect of certain items of a Sports Club. Show these items in the Income and Expenditure Account and the Balance Sheet of the Club:

	Rs.
Sports Fund as on 1.4.2015	35,000
Sports Fund Investments	35,000
Interest on Sports Fund	4,000
Donations for Sports Fund	15,000
Sports Prizes awarded	10,000
Expenses on Sports Events	4,000
General Fund	80,000
General Fund Investments	80,000
Interest on General Fund Investments	8,000

(Ans : Balance of Sports Fund Rs. 40,000.**)**

5. How will you deal with the following items while preparing for the Bombay Women Cricket Club its income and expenditure account for the year ending 31.3.2015 and its Balance Sheet as on 31.3.2015:

	Rs.
(a) Donation received during the year for the construction of a permanent Pavilion	12,25,000
Expenditure incurred up to 31.3.2015 on its construction	10,80,000
The total estimated expenditure on construction of Pavilion being	25,00,000
(b) Tournament Fund:	
Balance as on 1.4.2014	10,700
Subscriptions for tournament received during the year	65,800
Expenditure incurred during the year on conducting tournaments	72,400
(c) Life Membership fee received during the year	28,000

Give reasons for your answers.

(Ans : (a) Balance of Pavilion Fund Rs. 1,45,000; (b) Balance of Tournment Fund Rs. 4,100; (c) Life Membership fee to the Capitalised).

6. From the following receipts and payments and information given below, Prepare Income and Expenditure Account and opening Balance Sheet of Adult Literacy Orgnisation as on December 31, 2015.

Receipt and Payment Account for the year ending as on December 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d			General Expenses	3,200
Cash in hand		4,000	News paper	1,850
Cash at Bank		15,550	Electricity	3,000
Subscriptions			Fixed deposit with bank	18,000
2014	1,200		(on 31.06.2015) @ 10% p.a.	
2015	26,500		Books	7,000
2016	500	28,200	Salary	3,600
Sale of old newspapers		1,250	Rent	6,500
Govt. grant		12,000	Postage charges	300
Sale of old furniture			Furniture (purchased)	10,500
(book value Rs.5000)		3,700	Balance c/d	
Interest received on FD		450	Cash in hand	3,000
			Cash at bank	8,200
		65,150		**65,150**

Information:

(i) Subscription outstanding as on 31.12.2014 Rs.2,000 and on December 31, 2015 Rs.1,500.

(ii) On December 31, 2015 Salary outstanding Rs.600, and one month Rent paid in advance.

(iii) On Jan. 01, 2014 orgnisation owned Furniture Rs.12,000, Books Rs.5,000.

(**Ans :** Surplus Rs. 22,300, Opening Capital Fund Rs.38,550, Total Balance Sheet Rs. 61,950).

7. The following is the account of cash transactions of the Nari Kalayan Samittee for the year ended December 31, 2015:

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance from last year	2,270	Rent	6,600
Subscriptions	32,500	Electric charges	3,200
Life membership fee	3,250	Lecturer's fee	730
Donation	2,500	Office expenses	1,480
Profit from entertainment	7,250	Printing and Stationery	1,050
Sale of old Books	750	Legal fee	1,870
(books value Rs.1,000)		Books	6,500
Interest	350	Furniture purchased	8,600
		Expenses on nukar drama	1,300
		Cash in hand	8,040
		Cash at bank	9,500
	48,870		**48,870**

You are required to prepare an Income and Expenditure Account after the following adjustments:

(a) Subscription still to be received are Rs.750 , but subscription include Rs.500 for the year 2014.

(b) In the beginning of the year the Sangh owned building Rs.20,000 and furniture Rs.3,000 and Books Rs.2,000.

(c) Provide depreciation on furniture @5% (including purchase), books @ 10% and building @ 5%.

(**Ans :** Surplus Rs. 24,090)

8. Following is the Receipt and Payment Account of Indian Sports Club, prepared Income and Expenditure Account, Balance Sheet as on December 31, 2015:

Receipt and Payment Account for the year ending December 31, 2015

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d	7,890	Salary	11,000
Subscriptions	52,000	Electric charges	5,500
Life member ship fee	2,200	Billiard Table	17,500
Entrance fee	3,200	Office expenses	4,100
Tournament fund	26,000	Printing & Stationery	2,300
Locker Rent	1,250	Tournament expenses	18,500
Sale of old sports goods		Repair of ground	2,000
(Costing Rs.2,200)	2,500	Furniture purchased	7,700
Sale of old newspaper	750	Sports equipments	12,000
Legacy	37,500	Cash in hand	12,690
		Cash at bank	10,000
		Fixed deposit	
		(on 1.10.2015 for 10% p.a)	30,000
	1,33,290		**1,33,290**

Other Information:

Subscription outstanding was on December 31, 2014 Rs.1,200 and Rs.3,200 on December 31, 2015. Locker rent outstanding on December 31, 2015 Rs.250. Salary outstanding on December 31, 2015 Rs.1,000.

On January 1, 2015, club has Building Rs.36,000, furniture Rs.12,000, Sports equipments Rs.17,500. Depreciation charged on these items @ 10% (including Purchase).

(**Ans :** Surplus Rs.26,300, Opening Capital fund Rs.74,590, Total of Closing Balance Sheet Rs.1,49,090)

9. From the following Receipt and Payment Account of Jan Kalyan Club, prepare Income and Expenditure Account and Balance Sheet for the year ending March 31, 2015.

Receipt and Payment Account
for the year ending March 31, 2015

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Cash in hand as on 1.4.14	6,800	Salaries	24,000
Subscription	60,200	Traveling Expenses	6,000
Donation	3,000	Stationery	2,300
Sale of furniture	4,000	Rent	16,000
(Book value Rs.6000)		Repair	700
Entrance fee	800	Books purchased	6,000
Life membership fee	7,000	Building purchased	30,000
Interest on investment	5,000	Cash in hand as 31.03.2015	1,800
(@ 5% for full year)			
	86,800		**86,800**

Additional Information:

	As on 01.04.2014	*As on 31.03.2015*
(i) Subscription received in advance	1,000	3,200
(ii) Outstanding subscription	2,000	3,700
(iii) Stock of stationery	1,200	800
(iv) Books	13,500	16,500
(v) Furniture	16,000	8,000
(vi) Outstanding rent	1,000	2,000

(**Ans :** Surplus Rs.11,100 ,Opening Capital fund Rs.1,37,000, Total of Closing Balance Sheet Rs.1,60,800]

10. Receipt and Payment Account of Shankar Sports club is given below, for the year ended March 31, 2015

Receipt and Payment Account
for the year ending March 31, 2015

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Opening Cash in hand	2,600	Rent	18,000
Entrance fees	3,200	Wages	7,000
Donation for building	23,000	Billiard table	14,000
Locker rent	1,200	Furniture	10,000
Life membership fee	7,000	Interest	2,000
Profit from entertainment	3,000	Postage	1,000
Subscription	40,000	Salary	24,000
		Cash in hand	4,000
	80,000		**80,000**

Prepare Income and Expenditure Account and Balance Sheet with help of following Information:
Subscription outstanding on March 31, 2014 is Rs.1, 200 and Rs.2, 300 on March 31, 2015, opening stock of postage stamps is Rs.300 and closing stock is Rs. 200, Rent Rs.1, 500 related to 2005 and Rs.1, 500 is still unpaid.
On April 1, 2014 the club owned furniture Rs.15, 000, Furniture valued at Rs. 22,500
On March 31, 2015, the club took a loan of Rs.20,000 (@ 10% p.a) in 2014.

(**Ans :** Deficit Rs.8,100, Opening Capital fund Deficit Rs.2,400, Total of Closing Balance Sheet Rs. 53,500)

11. Prepare Income and Expenditure Account and Balance Sheet for the year ended December 31, 2015 from the following Receipt and Payment Account and Balance Sheet of culture club:

Receipt and Payment Account
for the year ending March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Opening cash balance		12,000	Furniture	4,000
Subscription			Telephone expenses	800
2013-14	2,000		Salary	
2014-15	22,000	24,000	2013-14	1,000
Entrance fees		2,800	2014-15	4,000
Locker rent		1,000	Newspapers	700
Life membership fee		1,200	Sundry expenses	1,000
Government grant		11,000	Defence bonds	18,000
			Land	20,000
			Closing cash balance	2,500
		52,000		**52,000**

Balance Sheet for the year ending March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Advance locker rent	200	Cash in hand	12,000
Subscription received in Advance	1,000	Outstanding expenses	3,000
		Building	35,000
Outstanding salary	2,000		
Loan	10,000		
Capital fund	36,800		
	50,000		**50,000**

(**Ans :** Surplus Rs.31500, Total of Closing Balance Sheet Rs.80500)

12. From the following Receipt and Payment Account prepare final accounts of a Unity Club for the year ended March 31, 2015

Receipt and Payment Accounts for the year ending March 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		15,000	Furniture	18,000
Sale of Old furniture			Library books	10,000
(costing Rs. 6,000)		4,000	Salaries	72,000
Subscriptions:			General expenses	18,000
2014-15	18,000		Electric charges	12,000
2015-16	60,000		Newspapers	33,800
2016-17	12,000	90,000	Postage	3,000
Sale of old newspapers		10,800	Stationery	40,000
Profit from entertainment		44,000	Audit fee	8,000
Rent		84,000	Balance c/d	33,000
		2,47,800		**2,47,800**

Balance Sheet as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Outstanding Salary	6,000	Cash	15,000
Capital Fund	6,94,000	Outstanding subscription	18,000
		Library Books	30,000
		Furniture	37,000
		Land and Building	6,00,000
	7,00,000		**7,00,000**

Additional Information:

1. The Club had 500 members each paying an annual subscription of Rs. 150.
2. On 31.3.2015 salaries outstanding amounted to Rs. 1,200 and salaries paid included Rs. 6,000 for the year 2013-14.
3. Provide 5% depreciation on Land and Building.

(**Ans :** Surplus Rs.14,000 Total of Closing Balance Sheet Rs.7,27,000)

13. Following is the information in respect of certain items of a Sports Club. You are required to show them in the Income and Expenditure Account and the Balance Sheet.

Details	*Amount (Rs.)*
Sports Fund as on April 1, 2015	80,000
Sports Fund Investments	80,000
Interest on Sports Fund Investments	8,000
Donations for Sports Fund	30,000
Sports Prizes awarded	16,000
Expenses on Sports Events	7,000
General Fund	2,00,000
General Fund Investments	2,00,000
Interest on General Fund Investments	20,000

14. Receipt and Payment Account of Maitrey Sports Club showed that Rs. 68,500 were received by way of subscriptions for the year ended on March 31, 2016.

    The additional information was as under:

    1. Subscription Outstanding as on March 31, 2015 were Rs. 6,500,
    2. Subscription received in advance as on March 31, 2015 were Rs. 4,100,
    3. Subscription Outstanding as on March 31, 2016 were Rs. 5,400,
    4. Subscription received in advance as on March 31, 2016 were Rs. 2,500.

    Show how that above information would appear in the final accounts for the year ended on March 31, 2016 of Maitrey Sports Club.

    (**Ans** : Subscription credited to Income and Expenditure Account for the year ended on March 31, 2016 is Rs. 69,000. Subscription Outstanding as on 31.3.2016 is Rs. 5,400 and should be shown on the assets side of the Balance sheet as on March 31, 2016 and subscriptions of Rs. 2,500 received in advance as on March 31, 2016 on the liabilities side of the balance sheet as on March 31, 2016)

15. Following is the Receipt and Payment account of Rohatgi Trust :

Receipt and Payment Account for the year ending December 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Cash in hand		14,000	Rent	6,000
Cash at bank		60,000	Salary	12,000
Subscription:			Postage	300
2014	5,000		Electricity charges	6,000
2015	83,000		Purchase of furniture	20,000
2016	3,000	91,000	Books	3,000
Sale of investment		90,000	Defence Bonds	1,50,000
Interest on investment		2,000	Help to needy students	22,000
Sale of furniture		3,200	Cash in hand	10,900
(book value Rs.3,000)			Cash at bank	30,000
		2,60,200		**2,60,200**

Prepare Income and expenditure account for the year ended December 31, 2015, and a balance sheet as on that date after the following adjustments: Subscription for 2013, still owing were Rs. 7,000. Interest due on defence bonds was Rs.7,000, Rent still owing was Rs. 1,000. The Book value of investment sold was Rs. 80,000, Rs. 30,000 of the investment were still in hand. Subscription received in 2013 included Rs. 400 from a life member. The total furniture on January 1, 2015 was worth Rs.12,000. Salary paid for the year 2014 is Rs.2,000.

(**Ans :** Surplus Rs. 59,900, Total of Closing Balance Sheet Rs. 2,68,900)

16. Following Receipt and Payment Account was prepared from the cash book of Delhi Charitable Trust for the year ending December 31, 2015

Receipt and Payment Account for the year ending December 31, 2015

Receipts	*Amount (Rs.)*	*Payment*	*Amount (Rs.)*
Balance b/d		Charity	11,500
Cash in hand	11,500	Rent and taxes	3,200
Cash at bank	12,600	Salary	6,000
Donation	9,000	Printing	600
Subscription:	42,800	Postage	300
Legacies	18,000	Advertisements	4,500
Interest on investment	4,500	Insuranc es	2,000
Sale of old newspapers	200	Furniture	21,600
		Investment	23,000
		Balance c/d:	
		Cash in hand	9,900
		Cash at bank	16,000
	98,600		**98,600**

Prepare Income and expenditure account for the year ended December 31, 2014, and a balance sheet as on that date after the following adjustments:

(a) It was decided to treat one-third of the amount received on account of donation as income.

(b) Insurance premium was paid in advance for three months.

(c) Interest on investment Rs.1,100 accrued was not received.

(d) Rent Rs.600: salary Rs.900 and advertisement expenses Rs.1,000 outstanding as on December 31, 2015.

(**Ans :** Surplus Rs.21,500, Total of Closing Balance Sheet Rs.72,100)

17. From the following Receipt and Payment Account of a club, prepare Income and Expenditure Account for the year ended December 31, 2015 and the Balance Sheet as on that date.

Receipt and Payment Account for the year ending December 31, 2015

Receipts		*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		3,500	General expenses	900
Subscription:			Salary	16,000
2014	2,000		Postage	1,300
2015	70,000		Electricity charges	7,800
2016	3,000	75,000	Furniture	26,500
Sale of old Books		2,000	Books	13,000
(costing Rs.3,200)			Newspapers	600
Rent from use of hall		17,000	Meeting expenses	7,200
Sale of newspapers		400	T.V. set	16,000
Profit from entertainment		7,300	Balance c/d	15,900
		1,05,200		**1,05,200**

Additional Information:

(a) The club has 100 members each paying an annual subscription of Rs.900. Subscriptions outstanding on December 31, 2012 were Rs.3,600.

(b) On December 31, 2015, salary outstanding amounted to Rs.1,000, Salary paid included Rs. 1,000 for the year 2014.

(c) On January 1, 2015 the club owned land and building Rs.25,000, furniture Rs.2,600 and books Rs.6,200.

(**Ans :** Surplus Rs.79,700, Total of Closing Balance Sheet Rs.1,23,800)

18. Following is the Receipt and Payment Account of Women's Welfare Club for the year ended December 31, 2015:

Receipt and Payment Account for the year ending December 31, 2015

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d	7,250	Salary	12,500
Subscriptions	81,750	Stationery	1,700
Donations	3,000	Electricity charges	9,550
Grant from Government	15,000	Insurance	7,500
Sale of newspapers	300	Equipments	30,000
Proceeds of charity show	16,500	Petty expenses	500
Interest on investments	7,000	Expenses on charity show	12,900
@ 10% for full year		Newspapers	1,000
Sundries income	400	Lectures fee	16,500
		Honorarium to Secretary	12,000
		Balance c/d	27,050
	1,31,200		**1,31,200**

Additional Information:

	01.01.2015 *Rs.*	*31.12.2015* *Rs.*
Outstanding salaries	1,200	1,800
Insurance prepaid	700	300
Subscription outstanding	3,750	2,500
Subscription received in advanced	1,750	1,000
Electricity charges outstanding	—	1,250
Stock of stationery	2,250	700
Equipments	25,600	50,200
Building	1,20,000	1,14,000

Prepare Income and Expenditure Account for the year ended December 31, 2015 and Balance Sheet as on date.

(**Ans :** Surplus Rs.79,700, Total of Closing Balance Sheet Rs.1,23,800)

19. As at March 31, 2015 the following balances have been extrated from the books of the Indian Chartered Accountants Recreation Club and you are asked to prepare (1) Trading Account for ascertaining gross profit derived from running resturant and dining room and (2) Income and Expenditure Account for the year ended March 31, 2015 (3) and a Balance Sheet as at that date.

Debit Balances		*Credit Balances*	
	Rs.		*Rs.*
Stock-in-hand	1170	Receipts Dining Room	87,660
Purchases	24,660	Subscriptions	9,450
Dining Room	32,370	Billiard's Receipts	7,300
Rent	10,470	Sunday Receipts	410
Wages	18,690	Interest on Fixed Deposit	270
Repairs and Renewals	5,400	Sundry Credtiors	5310
Fuel and Light	5,280	Grant from Institute (permanent)	42,000
Misc. Expenses	4,050		
Cash in hand	560	Income and Exp. A/c (1.4.14)	1,380
Cash at bank	2,760		
Fixed Deposit	8,500		
Sundry Debtors	2,250		
China glass, cutlery & linen	600		
Billiard Table	2,070		
Fixtures and Fittings	870		
Furniture	4,140		
Club Premises	30,000		
	1,53,840		**1,53,840**

On March 31,2014 stock of restaurant consisted of Rs. 900 and Rs. 60 respectively. Provide depreciations Rs. 60 on fixtures and fittings, Rs. 390 on billiard table and Rs. 560 on furniture.
(Ans: Excess of income over expenditure– Rs. 2,950: Total of Balance Sheet Rs. 51,700)

Check-list to Test your Understanding

Test your Understanding – I

Ans. TRUE: (iii) (vi) (vii) (x); FALSE: (i) (ii) (iv).(v).(viii).(ix).

Test your Understanding – II

1. There is a specific tournament fund. The accounting treatment is as under:

Liabilities side of the Balance Sheet	*Amount (Rs.)*
Tournament fund	40,000
Add: Receipts from tournament	16,000
	56,000
Less: Tournament Expenses	14,000
Balance to remain on the Liabilities side of the Balance Sheet	**42,000**

2. There is no specific fund. So the amount incurred on Table Tennis match expenses Rs. 4,000 would be shown on the debit side of Income and Expenditure Account. It is the case of expenses independent of any specific fund.

3. There is a specific fund. The accounting treatment is as under:

Liabilities side of the Balance Sheet	*Amount (Rs.)*
Prize Fund	22,000
Add: Interest	3,000
	25,000
Less: Prizes Paid	5,000
Balance to remain on the Liabilities side of the Balance Sheet	20,000
Prize fund Investments would appear on the Assets Side of the Balance Sheet	**18,000**

4. There is no specific fund. Receipts from Charity Show would be shown on the credit side and expenses on charity show are deducted from the receipts and the net amount would be shown on the credit side of Income and Expenditure Account.

Accounting for Partnership : Basic Concepts 2

Learning Objectives

After studying this chapter, you will be able to :

- *Define partnership and list its essential features;*
- *Explain the meaning and list the contents of partnership deed;*
- *Identify the provisions of the Indian Partnership Act 1932 that are relevant for accounting;*
- *Prepare partners' capital accounts under fixed and fluctuating capital methods;*
- *Explain the distribution profit or loss among the partners and prepare the Profit and Loss Appropriation Account;*
- *Calculate interest on capital and drawing under various situations;*
- *Explain how guarantee for a minimum amount of profit affects the distribution of profits among the partners;*
- *Make necessary adjustments to rectify the past errors in partners capital accounts; and*
- *Prepare final accounts of a partnership firm;*

You have learnt about the preparation of final accounts for a sole proprietary concern. As the business expands, one needs more capital and larger number of people to manage the business and share its risks. In such a situation, people usually adopt the partnership form of organisation. Accounting for partnership firms has it's own peculiarities, as the partnership firm comes into existence when two or more persons come together to establish business and share its profits. On many issues affecting distribution of profits, there may not be any specific agreement between the partners. In such a situation the provisions of the Indian Partnership Act 1932 apply. Similarly, calculation of interest on capital, interest on drawings and maintenance of partners capital accounts have their own peculiarities. Not only that a variety of adjustments are required on the death of a partner or when a new partner is admitted and so on. These peculiar situations need specific treatment in accounting that need to be clarified.

The present chapter discusses some basic aspects of partnership such as distribution of profit, maintenance of capital accounts, etc. The treatment of situations like admission of partner, retirement, death and dissolution have been taken up in the subsequent chapters.

2.1 Nature of Partnership

When two or more persons join hands to set up a business and share its profits and losses, they are said to be in partnership. Section 4 of the Indian Partnership Act 1932 defines partnership as the *'relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'*.

Persons who have entered into partnership with one another are individually called 'partners' and collectively called 'firm'. The name under which the business is carried is called the 'firm's name'. A partnership firm has no separate legal entity, apart from the partners constituting it. Thus, the essential features of partnership are:

1. *Two or More Persons:* In order to form partnership, there should be at least two persons coming together for a common goal. In other words, the minimum number of partners in a firm can be two. There is however, a limit on their maximum number. If a firm is engaged in the banking business, it can have a maximum of ten partners while in case of any other business, the maximum number of partners can be twenty.
2. *Agreement:* Partnership is the result of an agreement between two or more persons to do business and share its profits and losses. The agreement becomes the basis of relationship between the partners. It is not necessary that such agreement is in written form. An oral agreement is equally valid. But in order to avoid disputes, it is preferred that the partners have a written agreement.
3. *Business:* The agreement should be to carry on some business. Mere co-ownership of a property does not amount to partnership. For example, if Rohit and Sachin jointly purchase a plot of land, they become the joint owners of the property and not the partners. But if they are in the business of purchase and sale of land for the purpose of making profit, they will be called partners.
4. *Mutual Agency:* The business of a partnership concern may be carried on by all the partners or any of them acting for all. This statement has two important implications. First, every partner is entitled to participate in the conduct of the affairs of its business. Second, that there exists a relationship of mutual agency between all the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He can bind other partners by his acts and also is bound by the acts of other partners with regard to business of the firm. Relationship of mutual agency is so important that one can say that there would be no partnership, if the element of mutual agency is absent.
5. *Sharing of Profit:* Another important element of partnership is that, the agreement between partners must be to share profits and losses of a business. Though the definition contained in the Partnership Act describes partnership as relation between people who agree to share the profits of a business, the sharing of loss is implied. Thus, sharing of profits and

losses is important. If some persons join hands for the purpose of some charitable activity, it will not be termed as partnership.

6. *Liability of Partnership:* Each partner is liable jointly with all the other partners and also severally to the third party for all the acts of the firm done while he is a partner. Not only that the liability of a partner for acts of the firm is also unlimited. This implies that his private assets can also be used for paying off the firm's debts.

2.2 Partnership Deed

Partnership comes into existence as a result of agreement among the partners. The agreement can be either oral or written. The Partnership Act does not require that the agreement must be in writing. But wherever it is in writing, the document, which contains terms of the agreement is called 'Partnership Deed'. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.

The clauses of partnership deed can be altered with the *consent of all the partners***.** The deed should be properly drafted and prepared as per the provisions of the 'Stamp Act' and preferably registered with the Registrar of Firms.

Contents of the Partnership Deed

The Partnership Deed usually contains the following details:

- Names and Addresses of the firm and its main business;
- Names and Addresses of all partners;
- Amount of capital to be contributed by each partner;
- The accounting period of the firm;
- The date of commencement of partnership;
- Rules regarding operation of Bank Accounts;
- Profit and loss sharing ratio;
- Rate of interest on capital, loan, drawings, etc;
- Mode of auditor's appointment, if any;
- Salaries, commission, etc, if payable to any partner;
- The rights, duties and liabilities of each partner;
- Treatment of loss arising out of insolvency of one or more partners;
- Settlement of accounts on dissolution of the firm;
- Method of settlement of disputes among the partners;
- Rules to be followed in case of admission, retirement, death of a partner; and
- Any other matter relating to the conduct of business.

Normally, the partnership deed covers all matters affecting relationship of partners amongst themselves. However, if there is no express agreement on certain matters, the provisions of the Indian Partnership Act, 1932 shall apply.

2.2.1 Provisions Relevant for Accounting

The important provisions affecting partnership accounts are as follows:

(a) *Profit Sharing Ratio:* If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners, irrespective of their capital contribution in the firm.

(b) *Interest on Capital:* No partner is entitled to claim any interest on the amount of capital contributed by him in the firm as a matter of right. However, interest can be allowed when it is expressly agreed to by the partners. Thus, no interest on capital is payable if the partnership deed is silent on the issue. Further the interest is payable only out of the profits of the business and not if the firm incurs losses during the period.

(c) *Interest on Drawings:* No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.

(d) *Interest on Advances:* If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall be entitled to get an interest on the amount at the rate of 6 per cent per annum.

(e) *Remuneration for Firm's Work:* No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm unless there is a provision for the same in the Partnership Deed.

Apart from the above, the Indian Partnership Act specifies that subject to contract between the partners:

(i) If a partner derives any profit for him/her self from any transaction of the firm or from the use of the property or business connection of the firm or the firm name, he/she shall account for the profit and pay it to the firm.

(ii) If a partner carries on any business of the same nature as and competing with that of the firm, he/she shall account for and pay to the firm, all profit made by him/her in that business.

Test your Understanding – I

1. Mohan and Shyam are partners in a firm. State whether the claim is valid if the partnership agreement is silent in the following matters:
   (i) Mohan is an active partner. He wants a salary of Rs. 10,000 per year;
   (ii) Shyam had advanced a loan to the firm. He claims interest @ 10% per annum;
   (iii) Mohan has contributed Rs. 20,000 and Shyam Rs. 50,000 as capital. Mohan wants equal share in profits.
   (iv) Shyam wants interest on capital to be credited @ 6% per annum.

2. State whether the following statements are true or false:
   (i) Valid partnership can be formulated even without a written agreement between the partners;

(ii) Each partner carrying on the business is the principal as well as the agent for all the other partners;
(iii) Maximum number of partners in a banking firm can be 20;
(iv) Methods of settlement of dispute among the partners can't be part of the partnership deed;
(v) If the deed is silent, interest at the rate of 6% p.a. would be charged on the drawings made by the partner;
(vi) Interest on partner's loan is to be given @ 12% p.a. if the deed is silent about the rate.

2.3 Special Aspects of Partnership Accounts

Accounting treatment for partnership firm is similar to that of a sole proprietorship business with the exception of the following aspects:

- Maintenance of Partners' Capital Accounts;
- Distribution of Profit and Loss among the partners;
- Adjustments for Wrong Appropriation of Profits in the Past;
- Reconstitution of the Partnership Firm; and
- Dissolution of Partnership Firm.

The first three aspects mentioned above have been taken up in the following sections of this chapter. The remaining aspects have been covered in the subsequent chapters.

2.4 Maintenance of Capital Accounts of Partners

All transactions relating to partners of the firm are recorded in the books of the firm through their capital accounts. This includes the amount of money brought in as capital, withdrawal of capital, share of profit, interest on capital, interest on drawings, partner's salary, commission to partners, etc.

There are two methods by which the capital accounts of partners can be maintained. These are: (i) fixed capital method, and (ii) fluctuating capital method. The difference between the two lies in whether or not the transactions other than addition/withdrawal of capital are recorded in the capital accounts of the partners.

(a) *Fixed Capital Method:* Under the fixed capital method, the capitals of the partners shall remain fixed unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners. All items like share of profit or loss, interest on capital, drawings, interest on drawings, etc. are recorded in a separate accounts, called Partner's Current Account. The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital. The partners' current account on the other hand, may show a debit or a credit balance. Thus under this method, two accounts are maintained for each partner viz., capital account and current account, While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance shall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.

The partner's capital account and the current account under the fixed capital method would appear as shown below:

Partner's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Bank (permanent withdrawal of capital)		xxx		Balance b/d (opening balance)		xxx
	Balance c/d (closing balance)		xxx		Bank (fresh capital introduced)		xxx
			xxx				xxx

Partner's Current Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d (in case of debit opening bal,)		xxx		Balance b/d (in case of credit opening balance)		xxx
	Drawings		xxx		Salary		xxx
	Interest on drawings		xxx		Commission		xxx
	Profit & Loss Appropriation (for share of loss)		xxx		Interest on capital		
	Balance c/d (in case of credit closing balance)		xxx		Profit & Loss Appropriation (share of profit)		xxx
					Balance c/d (in case of debit closing balance)		xxx
			xxxx				**xxxx**

Fig. 2.1: *Proforma of Partner's Capital and Current Account under Fixed Capital Method.*

(b) *Fluctuating Capital Method:* Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method. The proforma of capital accounts prepared under the fluctuating capital method is given below:

Partner's Capital Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings		xxx		Balance b/d		xxx
					Bank (fresh capital introduced)		xxx
	Interest on drawings		xxx		Salaries		xxx
	Profit and Loss Appropriation (for share of loss)		xxx		Interest on capital		xxx
	Balance c/d				Profit and Loss Appropriation (for share of profit)		xxx
			xxxx				**xxxx**

Fig. 2.2: *Proforma of Partner's Capital Account under Fluctuating capital Method.*

2.4.1 Distinction between Fixed and Fluctuating Capital Accounts

The main points of differences between the fixed and fluctuating capital methods can be summed up as follows:

Basis of Distinction	*Fixed Capital Account*	*Fluctuating Capital Account*
(i) Number of accounts	Under this method, two separate accounts are maintained for each partner viz. 'capital account' and ' current account'.	Each partner has one account, i.e. capital account, under this method
(ii) Adjustments	All adjustments for drawings, salary, interest on capital, etc. are made in the current accounts and not in the capital accounts.	All adjustments for drawings, salary interest on capital, etc., are made in the capital accounts,
(iii) Fixed balance	The capital account balance remain unchanged unless there is addition to or withdrawal of capital.	The balance of the capital account fluctuates from year to year
(iv) Credit balance	The capital accounts always show a credit balance.	The capital account may sometimes show a debit balance.

Illustration 1

Sameer and Yasmin are partners with capitals of Rs.15,00,000 and Rs. 10,00,000 respectively. They agree to share profits in the ratio of 3:2. Show how the following transactions will be recorded in the capital accounts of the partners in case: (i) the capitals are fixed, and (ii) the capitals are fluctuating. The books are closed on March 31, every year.

Particulars	*Sameer (Rs.)*	*Yasmin (Rs.)*
Additional capital contributed on July 1, 2014	3,00,000	2.00,000
Interest on capital	5 %	5 %
Drawings (during 2014-15)	30,000	20,000
Interest on drawings	1,800	1,200
Salary	20.000	
Commission	10,000	7,000
Share in loss for the year 2014-15	60,000	40,000

Solution

Fixed Capital Method

Partner's Capital Accounts

Dr. *Cr.*

Date	*Details*	*L.F.*	*Sameer Amount (Rs.)*	*Yasmin Amount (Rs.)*	*Date*	*Details*	*L.F.*	*Sameer Amount (Rs.)*	*Yasmin Amount (Rs.)*
	Balance c/d		18,00,000	12,00,000		Balance b/d		15,00,000	10,00,000
						(Additional capital)		3,00,000	2,00,000
			18,00,000	**12,00,000**				**18,00,000**	**12,00,000**

Partner's Current Accounts

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.) Sameer*	*Amount (Rs.) Yasmin*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.) Sameer*	*Amount (Rs.) Yasmin*
	Drawings		30,000	20,000		Interest on capital		82,500	55,000
	Interest on drawings		1,800	1,200		Partner's salary		20,000	7,000
	Profit and Loss Appropriation (Loss)		60,000	40,000		Commission		10,000	
	Balance c/d		20,700	800					
			1,12,500	**62,000**				**1,12,500**	**62,000**

Working Notes:

Calculation of interest on capitals:

		Rs.		*Rs.*
X	5% on Rs. 15,00,000 for 1 Year	$= 5 \times \frac{15,00,000}{100}$	=	75,000
	5% on Rs. 3,00,000 for 6 months	$= 5 \times \frac{3,00,000}{100} \times \frac{6}{12}$	=	7,500
				82,500
Y	5% on Rs. 10,00,000 for 1 year	$= 5 \times \frac{10,00,000}{100}$	=	50,000
	5% on Rs. 2,00,000 for 6 month	$= 5 \times \frac{2,00,000}{100} \times \frac{6}{12}$	=	5,000
				55,000

Fluctuating Capital Method

Dr, **Partner's Capital Accounts** *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.) Sameer*	*Amount (Rs.) Yasmin*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.) Sameer*	*Amount (Rs.) Yasmin*
	Drawings		30,000	20,000		Balance b/d		15,00,000	10,00,000
	Interest on Drawings		1800	1200		Bank		3,00,000	2,00,000
	Profit and Loss		60,000	40,000		Interest on capital		82,500	55,000
	Balance c/d		18,20,700	12,00,800		Salary		20,000	7000
						Commission		10,000	-
			19,12,500	**12,62,000**				**19,12,500**	**12,62,000**

Do it Yourself

1. Soumya and Bimal are partners in a firm Sharing profits and losses in the ratio of 3:2. The balance in their capital and current accounts as on April 01, 2015 were as under:

	Soumya (Rs.)	*Bimal (Rs.)*
Capital Accounts	3,00,000	2,00,000
Current Accounts (Cr.)	1,00,000	80,000

The partnership deed provides that Soumya is to be paid salary @ Rs, 500 per month where as Bimal is to get a commission of Rs. 40,000 for the year. Interest on capital is to be credited at 6% p.a. The drawings of Soumya and Bimal for the year were Rs. 30,000 and Rs. 10,000 respectively. The net profit of the firm before making these adjustment was Rs, 2,49,000. Interest on Soumya's drawings was Rs. 750 and Bimal's drawings, Rs. 250. Prepare Profit and Loss Appropriation Account and Partner's Capital and Current Accounts.

2. Soniya, Charu and Smita started a partnership firm on April 1, 2015. They contributed Rs, 5,00,000, Rs. 4,00,000 and Rs. 3,00,000 respectively as their capitals and decided to share profits and losses in the ratio of 3:2:1.

The partnership provides that Soniya is to be paid a salary of Rs. 10,000 per month and Charu a commission of Rs. 50,000. It also provides that interest on capital be allowed @6% p.a. The drawings for the year were Soniya Rs. 60,000, Charu Rs. 40,000 and Smita Rs. 20,000. Interest on drawings was charged as Rs. 2,700 on Soniya's drawings, Rs. 1,800 on Charu's drawings and Rs. 900 on Smita's drawings. The net amount of profit as per Profit and Loss Account for the year 2015-16 was Rs. 3,56,600.

(i) Record necessary journal entries.
(ii) Prepare profit and loss appropriation account
(iii) Show capital accounts of the partners.

2.5 Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.

You know that in the case of sole partnership the profit or loss, as ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and ascertain the final figure of profit and loss to be distributed among the partners, in their profit sharing ratio.

2.5.1 Profit and Loss Appropriation Account

Profit and Loss Appropriation Account is merely an extension of the Profit and Loss Account of the firm. It shows how the profits are appropriated or distributed among the partners. All adjustments in respect of partner's salary, partner's commission, interest on capital, interest on drawings, etc. are made through this account. It starts with the net profit/net loss as per Profit and Loss Account is transfered to this account. The journal entries for preparation of Profit and Loss Appropriation Account and making various adjustments through it are given as follows:

Journal Entries

1. Transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account:
   (a) If Profit and Loss Account shows a credit balance (net profit):
   Profit and Loss A/c Dr.
   To Profit and Loss Appropriation A/c
   (b) If Profit and Loss Account shows a debit balance (net loss)
   Profit and Loss Appropriation A/c Dr.
   To Profit and Loss A/c
2. Interest on Capital:
   (a) For crediting interest on capital to partners' capital account:
   Interest on Capital A/c Dr.
   To Partner's Capital/Current A/cs (individually)

(b) For transferring interest on capital to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c

3. Interest on Drawings:
(a) For charging interest on drawings to partners' capital accounts:
Partners Capital/Current A/c's (individually) Dr.
To Interest on Drawings A/c
(b) For transferring interest on drawings to Profit and Loss Appropriation Account:
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c

4. Partner's Salary:
(a) For crediting partner's salary to partner's capital account:
Salary to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring partner's salary to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Salary to Partner's A/c

5. Partner's Commission:
(a) For crediting commission to a partner, to partner's capital account:
Commission to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring commission paid to partners to Profit and Loss Appropriation Account.
Profit and Loss Appropriation A/c Dr.
To Commission to Partners Capital/Current A/c

6. Share of Profit or Loss after appropriations:
If Profit:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c's (individually)
If Loss:
Partner's Capital/Current A/c's (individually) Dr.
To Profit and Loss Appropriation A/c

The Proforma of Profit and Loss Appropriation Account is given as follows:

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Profit and Loss (if there is loss)	xxx	Profit and Loss (if there is profit)	xxx
Interest on Capital	xxx	Interest on Drawings	xxx
Salary to Partner	xxx	Partners' Capital (distribution of loss)	xxx
Commission to Partner	xxx		
Interest on Partner's Loan	xxx		
Partners' Capital Accounts (distribution of profit)	xxx		
	xxxx		**xxxx**

Fig. 2.3: *Proforma of Profit and Loss Appropriation Account*

Illustration 2

Amit, Babu and Charu set up a partnership firm on April 1, 2015. 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. Amit 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 drawings for the year were Amit Rs. 6,000, Babu Rs. 4,000 and Charu Rs. 2,000. Interest on drawings of Rs. 270 was charged on Amit's drawings, 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, 2015 was Rs. 35,660. Prepare the Profit and Loss Appropriation Account to show the distribution of profit among the partners.

Solution

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Amits' salary		12,000	Net profit		35,660
Babus' commission		5,000	Interest on drawings:		
Interest on Capitals :			Amit	270	
Amit	3,000		Babu	180	
Babu	2,400		Charu	90	540
Charu	1,800	7,200			
Share of profit transferred to Capital accounts :					
Amit	6,000				
Babu	4,000				
Charu	2,000	12,000			
		36,200			**36,200**

Illustration 3

Amitabh and Babul are partners sharing profits in the ratio of 3:2, with capitals of Rs. 50,000 and Rs. 30,000 respectively. Interest on capital is agreed @ 6% p.a. Babul is to be allowed an annual salary of Rs. 2,500. During the year 2014-15, the profits prior to the calculation of interest on capital but after charging Babul's salary amounted to Rs. 12,500. A provision of 5% of the profit is to be made in respect of commission to the Manager.

Prepare Profit and Loss Appropriation account showing the distribution of profit and the partners' capital accounts for the year ending March 31, 2015.

Solution

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Babul's salary		2,500	Net profit (before Babul's salary)	15,000
Interest on capital:				
Amitabh		3,000		
Babul		1,800		
Manager's commission (5% of Rs. 15,000)		750		
Profit transferred to partner's capital account;				
Amitabh	4,170			
Babul	2,780	6,950		
		15,000		**15,000**

Amitabh's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
2015 Mar.31	Balance c/d		57,170	2014 Apr.01	Balance b/d		50,000
				2015 Mar.31	Interest on capital		3,000
				Mar.31	Profit & Loss (share of profit)		4,170
			57,170				**57,170**

Babul's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
2015 Mar.31	Balance c/d		37,080	2014 Apr.01	Balance b/d		30,000
				2015	Salary		2,500
				Mar.31	Interest on capital		1,800
				Mar.31	Profit & Loss Appropriation (share of profit)		2,780
			37,080				**37,080**

Test your Unerstanding – II

1. Raju and Jai commenced business in partnership on April 1, 2015. *No partnership agreement was made whether oral or written.* They contributed Rs. 4,00,000 and Rs. 1,00,000 respectively as capitals. In addtion, Raju advanced Rs. 2,00,000 as loan to the firm on October 1, 2015. Raju met with an accident on July 1, 2015 and could not attend the business up to september 30, 2015. The profit for the year ended March 31, 2016 amounted to Rs, 50,600. Disputes have arisen between them on sharing the profits of the firm.

Raju Claims:

(i) He should be given interest at 10% p.a. on capital and so also on loan.
(ii) Profit should he distributed in the proportion of capitals.

Jai Claims:

(i) Net profit should be shared equally.
(ii) He should be allowed remuneration of Rs, 1,000 p.a. during the period of Raju's illness.
(iii) Interest on capital and loan should be given @ 6% p.a.
State the correct position on each issue as per the provisions of the partnership Act. 1932.

2. Reena and Raman are partners with capitals of Rs. 3,00,000 and Rs. 1,00,000 respectively. *The profit (as per Profit and Loss Account) for the year ended March 31, 2015 was Rs. 1,20,000.* Interest on capital is to be allowed at 6% p.a. Raman was entitled to a salary of Rs. 30,000 p.a. The drawings of partners were Rs. 30,000 and 20,000. The interest on drawings to be charged to Reena was Rs. 1,000 and to Raman, Rs. 500.

   Assuming that Reena and Raman are equal partners. State their share of profit after necessary appropriations.

2.5.2 Calculation of Interest on Capital

No interest is allowed on partners' capitals unless it is expressly agreed among the partners. When the Deed specifically provides for it, interest on capital is credited to the partners at the agreed rate with reference to the time period for which the capital remained in business during a financial year. Interest on capital is generally provided for in two situations: (i) when the partners contribute unequal amounts of capitals but share profits equally, and (ii) where the capital contribution is same but profit sharing is unequal.

Interest on capital is calculated with due allowance for any addition or withdrawal of capital during the accounting period. For example, Mohini, Rashmi and Navin entered into partnership, bringing in Rs. 3,00,000, Rs. 2,00,000 and Rs. 1,00,000 respectively into the business. They decided to share profits and losses equally and agreed that interest on capital will be provided to the partners

@10 per cent per annum. There was no addition or withdrawal of capital by any partner during the year. The interest on capital works out to Rs. 30,000 (10% on 30,000) for Mohini, Rs. 20,000 (10% on 2,00,000) for Rashmi, and Rs. 10,000 (10% on 1,00,000) for Navin.

Take another case of Mansoor and Reshma who are partners in a firm and their capital accounts showed the balance of Rs. 2,00,000 and Rs. 1,50,000 respectively on April 1, 2015. Mansoor introduced additional capital of Rs. 1,00,000 on August 1, 2015 and Reshma brought in further capital of Rs. 1,50,000 on October 1, 2015. Interest is to be allowed @ 6% p.a. on the capitals. It shall be worked as follows:

For Mansoor $\left(\text{Rs. } 2{,}00{,}000 \times \frac{6}{100}\right) + \left(\text{Rs. } 1{,}00{,}000 \times \frac{6}{100} \times \frac{8}{12}\right)$

= Rs. 12,000 + Rs. 4,000 = Rs. 16,000

For Reshma $\left(\text{Rs. } 1{,}50{,}000 \times \frac{6}{100}\right) + \left(\text{Rs. } 1{,}50{,}000 \times \frac{6}{100} \times \frac{6}{12}\right)$

= Rs. 9,000+Rs. 4,500= Rs. 13,500

When there are both addition and withdrawal of capital by of partners during a financial year, the interest on capital is calculated as follows:

(i) On the opening balance of the capital accounts of partners, interest is calculated for the whole year;

(ii) On the additional capital brought in by any partner during the year, interest is calculated from the date of introduction of additional capital to the last day of the financial year.

(iii) On the amount of capital withdrawn (other than usual drawings) during the year interest for the period from the date of withdrawal to the last day of the financial year is calculated and deducted from the total of the interest calculated under points: (i) and (ii) above.
Alternatively, it can be calculated with respect to the amounts remained invested for the relevant periods.

Illustration 4

Saloni and Srishti are partners in a firm. Their capital accounts as on April 01. 2015 showed a balance of Rs. 2,00,000 and Rs. 3,00,000 respectively. On July 01, 2015, Saloni introduced additional capital of Rs. 50,000 and Srishti, Rs. 60,000. On October 01 Saloni withdrew Rs. 30,000, and on January 01, 2016 Srishti withdraw, Rs. 15,000 from their capitals. Interest is allowed @ 8% p.a. Calculate interest payable on capital to both the partners during the financial year 2015–2016.

Solution

Statement Showing Calculation of Interest on Capital

For Saloni

				(Rs,)
Interest on Rs. 2,00,000 for full year	=	$\frac{\text{Rs. } 2,00,000 \times 8 \times 1}{100}$	=	16,000
Add: Interest on Rs. 50,000 for 9 months	=	$\frac{\text{Rs.}50,000 \times 9 \times 8}{12 \times 100}$	=	3,000
				19,000
Less: Interest on 30,000 for 6 months	=	$\frac{\text{Rs.}30,000 \times 8 \times 6}{12 \times 100}$	=	1,200
				17,800

Alternatively interest can be calculated on Rs. 2 lakh for 3 months, on Rs. 2,50,000 for 3 months, and on Rs. 2,20,000, for 6 months (Rs. 4,000 + Rs. 5,000 + Rs. 8,800 = Rs. 17,800).

For Srishti

				(Rs.)
Interest on Rs. 3,00,000, for full year @8%	=	$\frac{\text{Rs.}3,00,000 \times 8 \times 1}{100}$	=	24,000
Add: Interest on Rs. 60,000, for 9 months	=	$\frac{\text{Rs.}60,000 \times 8 \times 9}{100 \times 12}$	=	3,600
				27,600
Less: Interest on Rs. 15,000 for 3 months	=	$\frac{\text{Rs.}15,000 \times 8 \times 3}{100 \times 12}$	=	300
(Money withdrawn)				*27,300*

Alternatively interest can be charged on Rs. 3,00,000 for 3 months on Rs. 3,60,000 for 6 months and on Rs. 3,45,000 for 3 months (Rs. 6,000 + Rs. 14,400 + Rs. 6,900 = Rs. 27,300).

Illustration 5

Josh and Krish are partners sharing profits and losses in the ratio of 3:1. Their capitals at the end of the financial year 2015-2016 were Rs. 1,50,000 and Rs. 75,000. During the year 2015-2016, Josh's drawings were Rs. 20,000 and the drawings of Krish were Rs. 5,000, which had been duly debited to partner's capital accounts. Profit before charging interest on capital for the year was Rs. 16,000. The same had also been debited in their profit sharing ratio. Krish had brought additional capital of Rs. 16,000 on October 1, 2015. Calculate interest on capital @ 12% p.a. for the year 2015-2016.

Solution

Statement Showing Calculation of Capital at the Beginning

Particulars	*Josh Rs.*	*Krish Rs.*
Capital at the end	1,50,000	75,000
Add: Drawings during the year	20,000	5,000
	1,70,000	**80,000**
Less: Share of profit (credited)	12,000	4,000
	1,58,000	**76,000**
Less: Additional capital	—-	16,000
Capital in the beginning	1,58,000	60,000

Interest on capital will be as 19,200 (12% of Rs. 1,60,000) for Josh and Rs. 960 for krish calculated as follows:

$$\left(\text{Rs. } 60,000 \times \frac{12}{100}\right) + \left(\text{Rs. } 16,000 \times \frac{12}{100} \times \frac{6}{12}\right) = \text{Rs. } 7,200 + \text{Rs. } 960$$

$$= \text{Rs. } 8,160.$$

Sometimes opening capitals of partners may not be given. In such a situation before calculation of interest on capital the opening capitals will have to be worked out with the help of partners' closing capitals by marking necessary adjustments for the additions and withdrawal of capital, drawings, share of profit or loss, if already shown in the capital accounts the partners.

As clarified earlier, the interest on capital is allowed only when the firm has earned profit during the accounting year. Hence, no interest will be allowed during the year the firm has incurred net loss and if in a year, the profit of the firm is less than the amount due to the partners as interest on capital, the payment of interest will be restricted to the amount of profits. In that case, the profit will be effectively distributed in the ratio of interest on capital of each partner.

Illustration 6

Anupam and Abhishek are partners sharing profits and losses in the ratio of 3 : 2. Their capital accounts showed balances of Rs. 1,50,000 and Rs. 2,00,000 respectively on Jan 01, 2013. Show the treatment of interest on capital for the year ending December 31, 2015 in each of the following alternatives:

(a) If the partnership deed is silent as to the payment of interest on capital and the profit for the year is Rs. 50,000;

(b) If partnership deed provides for interest on capital @ 8% p.a. and the firm incurred a loss of Rs. 10,000 during the year;

(c) If partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 50,000 during the year;

(d) If the partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 14,000 during the year.

Solution

(a) In the absence of a specific provision in the Deed, no interest will be paid on the capital to the partners. The whole amount of profit will however be distributed among the partners in their profit sharing ratio.

(b) As the firm has incurred losses during the accounting year, no interest on capital will be allowed to any partner. The firm's loss will however be shared by the partners in their profit sharing ratio.

			Rs.
(c)	Interest to Anupam @ 8% on Rs. 2,00,000	=	16,000
	Interest to Abhishek @ 8% on Rs. 1,50,000	=	12,000
			28,000

As the profit is sufficient to pay interest at agreed rate, the whole amount of interest on capital shall be allowed and the remaining profit amounting to Rs. 22,000 (Rs. 50,000 – Rs. 28,000) shall be shared by the partners in their profit sharing ratio.

(d) As the profit for the year is Rs. 14,000, which is less than the amount of interest on capital due to partners, i.e. Rs. 28,000 (Rs. 12,000 for Anupam and Rs. 16,000 for Abhishek), interest will be paid to the extent of available profit i.e., Rs. 14,000. Anupam and Abhishek will be credited with Rs. 6,000 and Rs. 8,000, respectively. Effectively this amounts to sharing the firm's profit in the ratio of interest on capital.

Test your Understanding – III

1. Rani and Suman are in partnership with capitals of Rs, 80,000 and Rs. 60,000, respectively. During the year 2015-16, Rani withdrew Rs. 10,000 from her capital and Suman Rs. 15,000. Profits before charging interest on capital was Rs. 50,000. Ravi and Suman shared profits in the ratio of 3:2. Calculate the amounts of interest on their capitals @ 12% p.a. for the year ended March 31, 2016.
2. Priya and Kajal are partners in a firm, sharing profits and losses in the ratio of 5:3. The balance in their fixed capital accounts, on April 1, 2015 were: Priya, Rs. 6,00,000 and Kajal, Rs. 8,00,000. The profit of the firm for the year ended March 31, 2016 is Rs, 1,26,000. Calculate their shares of profits: (a) when there is no agreement in respect of interest on capital, and (b) when there is an agreement that the interest on capital will be allowed @ 12% p.a.

2.5.3 Interest on Drawings

The partnership agreement may also provide for charging of interest on money withdrawn out of the firm by the partners for their personal use. As stated earlier, no interest is charged on the drawings if there is no express agreement among the partners about it. However if the partnership deed so provides for it, the interest is charged at an agreed rate, for the period money remained outstanding from the partners during an accounting year. Charging interest on drawings discourages excessive amounts of drawings by the partners.

The calculation of interest on drawings under different situations is shown as hereunder.

When Fixed Amounts is Withdrawn Every Month

Many a times a fixed amount of money is withdrawn by the partners, at equal time interval, say each month or each quarter. While calculating the time period, attention must be paid to whether the fixed amount was withdrawn at the beginning (first day) of the month, middle of the month or at the end (last day) of the month. If withdrawn on the first day of every month, interest on total amount will be calculated for 6½ months; if withdrawn at the end at every month, it will be calculated for 5½ months, and if withdrawn during the middle of the month, it will be calculated for 6 months.

Suppose, Aashish withdrew Rs. 10,000 per month from the firm for his personal use during the year ending March 31, 2015. The calculation of average period and the interest on drawings, in different situations would be as follows:

(a) When the amount is withdrawn at the beginning of each month:

$$\text{Average Period} = \frac{\text{Total Period in Months} + 1}{2} = \frac{12+1}{2} = 6\frac{1}{2} \text{ months.}$$

$$\text{Interest on Drawings} = \frac{\text{Rs.}1,20,000 \times 8 \times 13 \times 1}{100 \times 2 \times 12} = \text{Rs. } 5,200.$$

(b) When the amount is withdrawn at the end of each month

$$\text{Average Period} = \frac{\text{Total period in Months} - 1}{2} = \frac{12-1}{2} = 5\frac{1}{2} \text{ months}$$

$$\text{Interest on Drawings} = \frac{\text{Rs.}1,20,000 \times 8 \times 11 \times 1}{100 \times 2 \times 12} = \text{Rs. } 4,400.$$

(c) When money is withdrawn in the middle of the month

When money is withdrawn in the middle of the month, nothing is added or deduced from the total period.

$$\text{Average Period} = \frac{\text{Total period in Months}}{2} = \frac{12}{2} = 6 \text{ months}$$

$$\text{Interest on Drawings} = \frac{\text{Rs.}1,20,000 \times 8 \times 6 \times 1}{100 \times 12} = \text{Rs. } 4,800.$$

When Fixed Amount is withdrawn Quarterly

When fixed amount of money is withdrawn quarterly by partners, in such a situation, for the purpose of calculation of interest, the total period of time is ascertained depending on whether the money was withdrawn at the beginning or at the end of each quarter. If the amount is withdrawn at the beginning of each quarter, the interest is calculated on the total money withdrawn during the year, for a period of seven and half months and if withdrawn at the and of each quarter it will be calculated for a period of 4½ months.

Suppose Satish and Tilak are partners in a firm, sharing profits and losses equally. During financial year 2015–2016, Satish withdrew Rs. 30,000 quarterly. If interest is to be charged on drawings @ 8% per annum, the calculation of average period and interest on drawings will be as follows:

(a) *If the amount is withdrawn at the beginning of each quarter*

Statement Showing Calculation of Interest on Drawings

Date	*Amount (Rs.)*	*Time Period*	*Interest (Rs.)*
April 1, 2015	30,000	12 months	$30,000 \times \frac{8}{100} \times 1$ = 2,400

July 1, 2015	30,000	9 months	$30{,}000 \times \frac{9}{12} \times \frac{8}{100}$ = 1,800
Oct. 1, 2015	30,000	6 months	$30{,}000 \times \frac{6}{12} \times \frac{8}{100}$ = 1,200
Jan. 1, 2016	30,000	3 months	$30{,}000 \times \frac{3}{12} \times \frac{8}{100}$ = 600
Total	**1,20,000**		**= Rs. 6,000**

Alternatively, the interest can be calculated on the total amount withdrawn during the accounting year, i.e. Rs. 1,20,000 for a period of 7½ months (12+9+6+3)/4. as follows:

Rs. $1{,}20{,}000 \times \frac{8}{100} \times \frac{15}{2} \times \frac{1}{12}$ = Rs. 6,000.

(b) *If the amount is withdrawn at the end of each quarter*

Statement Showing Calculation of Interest on Drawings

Date	*Amount (Rs.)*	*Time Period*	*Interest (Rs.)*
June 30, 2015	30,000	9 months	$30{,}000 \times \frac{9 \times 8}{12 \times 100}$ = 1,800
September 30, 2015	30,000	6 months	$30{,}000 \times \frac{6}{12} \times \frac{8}{100}$ = 1200
December 31, 2015	30,000	3 months	$30{,}000 \times \frac{3}{12} \times \frac{8}{100}$ = 6,000
March 31, 2016	30,000	0 months	
Total	**1,20,000**		**= 3,600**

Alternatively, the interest can be calculated on the total amount withdrawn during the accounting year, i.e., Rs. 1,20,000 for a period of 4½ months (9 + 6 + 3 + 0)/4 months as follows:

= Rs. $1{,}20{,}000 \times \frac{8}{100} \times \frac{9}{2} \times \frac{1}{12}$ = Rs. 3,600

When Varying Amounts are Withdrawn at Different Intervals

When the partners withdraw different amounts of money at different time intervals, the interest is calculated using the product method. Under the product method, for each withdrawal, the money withdrawn is multiplied by the period (usually expressed in months) for which it remained withdrawn during the financial year. The period is calculated from the date of the withdrawal to the last day of the accounting year. The products so calculated are totalled and interest for 1 month at the specified rate is worked out, on the total of the products. The calculation of interest can be explained with the help of an example.

Shahnaz withdrew the following amounts from her firm, for personal use during the year ending March 31, 2015. Calculate interest on drawings by product method, if the rate of interest to be charged is 7 per cent per annum.

Date	*Amount (Rs.)*
April 1, 2014	16,000
June 30, 2014	15,000
October 31, 2014	10,000
December 31, 2014	14,000
March 1, 2015	11,000

Calculation of interest on drawings will be as follows:

Statement Showing Calculation of Interest on Drawings

Date	*Amount (Rs.)*	*Time Period*	*Product (Rs.)*
April 1, 2014	16,000	12 months	1,92,000
June 30, 2014	15,000	9 months	1,35,000
Oct. 31, 2014	10,000	5 months	50,000
Dec. 31, 2014	14,000	3 months	42,000
Mar. 1, 2015	11,000	1 month	11,000
Total			**4,30,000**

$$\text{Interest} = \text{Sum of Products} \times \text{Rate} \times \frac{1}{12}$$

$$= \text{Rs. } 4{,}30{,}000 \times \frac{7}{100} \times \frac{1}{12} = \frac{30100}{12} = \text{Rs. } 2{,}508 \text{ (approx.).}$$

Illustration 7

John Ibrahm, a partner in Modern Tours and Travels withdrew money during the year ending March 31, 2015 from his capital account, for his personal use. Calculate interest in drawings in each of the following alternative situations, if rate of interest is 9 per cent per annum.

(a) If he withdrew Rs. 3,000 per month at the beginning of the month.
(b) If an amount of Rs. 3,000 per month was withdrawn by him at the end of each month.
(c) If the amounts withdrawn were : Rs. 12,000 on June 01, 2014, Rs. 8,000; on August 31, 2014, Rs. 3,000; on September 30, 2014, Rs. 7,000, on November 30, 2014, and Rs. 6,000 on January 31, 2015.

Solution

(a) As a fixed amount of Rs. 3,000 per month is withdrawn at the beginning of the month, interest on drawings will be calculated for an average period of $6\frac{1}{2}$ months.

Interest on drawings = Rs. $\frac{36,000 \times 9 \times 13 \times 1}{100 \times 2 \times 12}$ = Rs. 1,755

(b) As the fixed amount of Rs. 3,000 per month is withdrawn at the end of each month, interest on drawings will be calculated for an average period of $5\frac{1}{2}$ months.

= $\frac{\text{Rs.}36,000 \times 9 \times 11 \times 1}{100 \times 2 \times 12}$ = Rs. 1,485

(C) Statements showing Calculation of Interest on Drawings

1 *Date*	2 *Amount withdrawn (Rs.)*	3 *Period (in months)*	4 *(Interest)* *(Rs.)*
Jun. 1, 2014	12,000	10	$12,000 \times \frac{9}{100} \times \frac{10}{12} = 900$
Aug. 31, 2014	8,000	7	$8,000 \times \frac{9}{100} \times \frac{7}{12} = 420$
Sept. 30, 2014	3,000	6	$3,000 \times \frac{9}{100} \times \frac{6}{12} = 135$
Nov. 30, 2014	7,000	4	$7,000 \times \frac{9}{100} \times \frac{4}{12} = 210$
Jan. 31, 2015	6,000	2	$6,000 \times \frac{9}{100} \times \frac{2}{12} = 90$
Total Interest			**1,755**

Illustration 8

Manu, Harry and Ali are partners in a firm sharing profits and losses equally. Harry and Ali withdrew the following amounts from the firm, for their personal use, during 2015.

Date	*Harry (Rs.)*	*Ali (Rs.)*
2015		
January, 01	5,000	7,000
April, 01	8,000	4,000
September, 01	5,000	5,000
December, 01	4,000	9,000

Calculate interest on drawings if the rate of interest to be charged is 10 per cent, and the books are closed on December 31 every year.

Statement Showing Calculation of Interest on Drawings

Harry			*Ali*		
Amount (Rs.)	*Period (in months)*	*Product (Rs.)*	*Amount (Rs.)*	*Period (in months)*	*Product (Rs.)*
5000	12	60,000	7,000	12	84,000
8000	9	72,000	4,000	9	36,000
5000	4	20,000	5,000	4	20,000
4000	1	4,000	10,000	1	10,000
		1,56,000			**1,50,000**

Amount of Interest

Mannu = Rs. $\dfrac{1{,}56{,}000 \times 10 \times 1}{100 \times 12}$ = Rs. 1,300

Ali = Rs. $\dfrac{1{,}50{,}000 \times 10 \times 1}{100 \times 12}$ = Rs. 1,250

Do it Yourself

1. Govind is a partner in a firm. He withdrew the following amounts during the year 2013-14:

	(Rs.)
April 30, 2015	6,000
June 30, 2015	4,000
Sept. 30, 2015	8,000
Dec. 31, 2015	3,000
Jan. 31, 2016	5,000

The interest on drawings is to be charged @ 6% p.a. The books are closed on March 31, every year.

2. Ram and Syam are partners sharing profits/losses equally. Ram withdrew Rs. 1,000 p.m. regularly on the first day of every month during the year 2015-16 for personal expenses. If interest on drawings is charged @ 5% p.a. Calculate interest on the drawings of Ram.
3. Verma and Kaul are partners in a firm. The partnership agreement provides that interest on drawings should be charged @ 6% p.a. Verma withdraws Rs. 2,000 per month starting from April 01, 2015 to March 31, 2014. Kaul withdrew Rs, 3,000 per quarter, starting from April 01, 2015. Calculate interest on partner's drawings.

When Dates of Withdrawal are not specified

When the total amount withdrawn is given but the dates of withdrawals are not specified, it is assumed that the amount was withdrawn evenly throughout the year. *For example;* Shakila withdrew Rs. 60,000 from partnership firm during the year ending March 31, 2015 and the interest on drawings is to be charged at the rate of 8 per cent per annum. For calculation of interest, the period would be taken as six months, which is the average period assuming, that amount is withdrawn evenly in the middle of the month, throughout the year. The amount of interest on drawings works out to be Rs. 2,400 as follows:

$$\left(\text{Rs.}\,60{,}000 \times \frac{8}{100} \times \frac{6}{12}\right) = \text{Rs. } 2{,}400$$

2.6 Guarantee of Profit to a Partner

Sometimes a partner is admitted into the firm with a guarantee of certain minimum amount by way of his share of profits of the firm. Such assurance may be given by all the old partners in a certain ratio or by any of the old partners, individually to the new partner. The minimum guaranteed amount shall be paid to such new partner when his share of profit as per the profit sharing ratio is less than the guarnteed amount. For example, Madhulika and Rakshita, who are partners in a firm decide to admit Kanishka into their firm, giving her the guarantee of a minimum of Rs.25,000 as her share in firm's profits. The firm earned a profit of Rs.1,20,000 during the year and the agreed profit sharing ratio between the partners is decided as 2:3:1. As per this ratio, Madhulika's share in profit comes to Rs.40,000 (2/6 of Rs. 1,20,000); Rakshita, Rs. 60,000 (3/6 of Rs. 1,20,000) and Kanishka Rs. 20,000 (1/6 of Rs. 1,20,000). The share of Kanishka works out to be Rs.5,000 short of the guaranteed amount. This shall be borne by the guaranteeing partners Madhulika and Rakshita in their profit sharing ratio, which in this case is 2:3, Madhulika's share in the deficiency comes to Rs.2,000 (2/5 of Rs. 5,000), and that of Rakshita Rs.3,000. The total profit of the firm will be distributed among the partners as follows Madhulika will get Rs.38,000 (her share 40,000 minus share in deficiency Rs.2,000); Rakshita Rs.57,000 (60,000–3,000) and Kanishka Rs. 25,000 (Rs. 20,000 + Rs. 2,000 + Rs. 3,000).

If only one partner gives the guarantee, say in the above case, only Rakshita gives the guarantee, the whole amount of deficiency (Rs.5,000) will be borne by her only. In that case profit distribution will be Madhulika Rs.40,000, Rakshita Rs. 55,000 (60,000–5,000) and Kanishka Rs. 25,000 (Rs. 20,000 + Rs. 5,000).

Illustration 9

Mohit and Rohan share profits and losses in the ratio of 2:1. They admit Rahul as partner with 1/4 share in profits with a guarantee that his share of profit shall be at least Rs. 50,000. The net profit of the firm for the year ending March 31, 2015 was Rs. 1,60,000. Prepare Profit and Loss Appropriation Account.

Solution

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Mohit's capital			Net profit	1,60,000
(share of profit)	80,000			
Less: Share in deficiency	6,667	73,333		
Rohan's capital				
(share of profit)	40,000			
Less: Share in deficiency	3,333	36,667		
Rahul's capital				
(share of profit)	40,000			
Add: Deficiency received from:				
Mohit	6,667			
Rohan	3,333	50,000		
		1,60,000		**1,60,000**

Working Notes:

The new profit sharing ratio after admission of Rahul comes to 2:1:1. As per this ratio the share of partners in the profit comes to:

Mohit = Rs. 1,60,000 × $\frac{2}{4}$ = Rs. 80,000

Rohan = Rs. 1,60,000 × $\frac{1}{4}$ = Rs. 40,000

Rahul = Rs. 1,60,000 × $\frac{1}{4}$ = Rs. 40,000

But, since Rahul has been given a guarantee of minimum of Rs. 50,000 as his share of profit. The deficiency of Rs. 10,000 (Rs. 50,000 – Rs. 40,000) shall be borne by Mohit and Rohan in the ratio in which they share profits and losses between themselves, viz. 2:1as follows:

Mohit's share in deficiency comes to 2/3 × Rs. 10,000 = Rs. 6,667
Rohan's share in deficiency comes to 1/3 × Rs. 10,000 = Rs. 3,333

Thus Mohit will get Rs. 80,000 – Rs. 6,667 = Rs. 73,333, Rohan will get Rs. 40,000–Rs. 3,333 = Rs. 36,667 and Rahul will get Rs. 40,000 + Rs. 6,667 + Rs. 3,333 = Rs. 50,000 in the profit of the firm.

Calculation of new profit sharing ratio

The new partner Rahul's share is $\frac{1}{4}$ The remaining profit is $1 - \frac{1}{4} = \frac{3}{4}$, to be shared between Mohit and Rohan in the ratio of 2:1.

Mohit's new share = $\frac{3}{4} \times \frac{2}{3} = \frac{2}{4}$

Rohan's new share = $\frac{3}{4} \times \frac{1}{3} = \frac{1}{4}$

Thus, New profit sharing ratio comes to be $\frac{2}{4} : \frac{1}{4} : \frac{1}{4}$ or 2 : 1 :1.

Illustration 10

John and Mathew share profits and losses in the ratio of 3:2. They admit Mohanty into their firm to 1/6 share in profits. John personally guaranteed that Mohanty's share of profit, after charging interest on capital @ 10 per cent per annum would not be less than Rs. 30,000 in any year. The capital provided was as follows: John Rs. 2,50,000, Mathew Rs. 2,00,000 and Mohanty Rs. 1,50,000. The profit for the year ending March 31,2015 amounted to Rs. 1,50,000 before providing interest on capital. Show the Profit & Loss Appropriation Account if new profit sharing ratio is 3:2:1.

Solution

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Interest on capital			Net profit	1,50,000
John	25,000			
Mathew	20,000			
Mohanty	15,000	60,000		
Capital accounts:				
John	45,000			
Less: Share of deficiency	15,000	30,000		
Mathew		30,000		
Mohanty	15,000			
Add: Deficiency received from John	15,000	30,000		
		1,50,000		**1,50,000**

Working Notes:

Profit after interest on capital is Rs. 90,000, which is to be distributed in the ratio of 3:2:1 as follows: John gets Rs. 45,000 (3/6 × Rs. 90,000), Mathew Rs. 30,000, Mohanty Rs. 15,000. Deficiency of Mohanty from the guaranteed profit of Rs. 15,000 will be borne by John. John will therefore get Rs. 45,000 – Rs. 15,000 = Rs. 30,000, Mathew Rs. 30,000 and Mohanty Rs. 30,000.

Illustration 11

Mahesh and Dinesh share profits and losses in the ratio of 2:1. From January 01, 2014 they admit Rakesh into their firm who is to be given a share of 1/10 of the profits with a guaranteed minimum of Rs. 25,000. Mahesh and Dinesh continue to share profits as before but agree to bear any deficiency on account of guarantee to Rakesh in the ratio of 3:2 respectively. The profits of the firm for the year ending December 31, 2015 amounted to Rs. 1,20,000. Prepare Profit and Loss Appropriation Account.

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Capital Accounts: (for share of profit)			Net profit	1,20,000
Mahesh 6/10 × 1,20,000	72,000			
Less: Deficiency share	7,800	64,200		
Dinesh 3/10 × 1,20,000	36,000			
Less: Deficiency share	5,200	30,800		
Rakesh	12,000			
Add: Share of Deficiency from Mahesh	7,800			
Dinesh	5,200	25,000		
		1,20,000		**1,20,000**

Working Notes:

New profit sharing Ratio will be calculated as follows:

Rakesh to share $\frac{1}{10}$ of the profits. The remaining profit $\frac{9}{10}$ will be shared by Mahesh and Dinesh in the ratio of 2:1.

Mahesh's share in profit will be $\frac{2}{3} \times \frac{9}{10} = \frac{3}{10}$

Dinesh's share will be $\frac{1}{3} \times \frac{9}{10} = \frac{3}{10}$

The New ratio becomes $\frac{3}{5} : \frac{3}{10} : \frac{1}{10}$ or 6 : 3 : 1.

Mahesh's share in profit = 1,20,000 × $\frac{6}{10}$ = Rs. 72,000,
Dinesh's share in profit = Rs. 36,000,
Rakesh's share in profit = Rs. 12,000.

Deficiency of Rakesh (Rs. 13,000) will be shared by Mahesh and Dinesh in the ratio of 3:2.

Mahesh will bear 3/5 of 13,000, i.e. Rs. 7,800 and Rakesh, 2/5 of Rs. 13,000, i.e. Rs. 5,200.

Thus, the profits of the firm will be shared as follows.
Mahesh will get Rs. 72,000 – Rs. 7,800 = Rs. 64,200.
Dinesh will get Rs. 36,000 – Rs. 5,200 = Rs. 30,800
Rakesh will get Rs. 12,000 + Rs. 7,800 + Rs. 5,200 = Rs. 25,000.

Do It Yourself

Kavita and Lalit are partners sharing profits in the ratio of 2:1. They decide to admit Mohan with share in profits with a guaranteed amount of Rs. 25,000. Both Kavita and Lalita undertake to meet the liability arising out of Guaranteed amount to Mohan in their respective profit sharing ratio. The profit sharing ratio between Kavita and Lalit does not change. The firm earned profits of Rs. 76,000 for the year 2006–07.Show the distribution of profit amongst the partners.

2.7 Past Adjustments

Sometimes a few omissions or errors in the recording of transactions or the preparation of summary statements are found after the final accounts have been prepared and the profits distributed among the partners. The omission may be in respect of interest on capitals, interest on drawings, interest on partners' loan, partner's salary, partner's commission or outstanding expenses. There may also be some changes in the provisions of partnership deed or system of accounting having impact with retrospective effect. All these acts of omission and commission need adjustments for correction of their impact. Instead of altering old accounts, necessary adjustments can be made either; (a) through 'Profit and Loss Adjustment Account', or (b) directly in the capital accounts of the concerned partners. This is explained with the help of following example.

Rameez and Zaheer are equal partners. Their capitals as on April 01, 2015 were Rs. 50,000 and Rs. 1,00,000 respectively. After the accounts for the financial year ending March 31, 2016 have been prepared, it is discovered that interest at the rate of 6 per cent per annum, as provided in the partnership deed has not been credited to the partners' capital accounts before distribution of profit. In this case, the interest on capital not credited to the partners' capital accounts works out to be Rs. 3000 (6/100 × Rs. 50,000) for Rameez and Rs. 6,000 (6/100 × Rs. 1,00,000) for Zaheer. Had the interest on capital been duly provided, the firm's profit would have reduced by Rs. 9,000. By this omission, the whole amount of profit as per Profit and Loss Account (without adjustment of Rs. 9,000) has been distributed among the partners in their profit sharing ratio, and the amounts of interest on capital have not been credited to their capital accounts. This error can be rectified in any of the following ways;

(a) Through Profit and Loss Adjustment Account

(i)	Profit and Loss Adjustment A/c	Dr.	9,000	
	To Rameez's capital A/c			3,000
	To Zaheer's capital A/c			6,000
	(Interest on capital)			

(ii)	Rameez's capital A/c	Dr.	4,500	
	Zaheer's capital A/c	Dr.	4,500	
	To Profit and Loss Adjustment A/c			9,000
	(Loss on adjustment)			

(b) Directly in Partners' Capital Accounts

For direct adjustment in partners' capital accounts first a statement to ascertain the net effect of omission on partners' capital accounts will be worked out as follows and then the adjustment entries can be recorded.

Statement Showing Net Effect of Omitting Interest on Capital

Details	*Rameez (Rs.)*	*Zaheer (Rs.)*
(i) Amount which should have been credited as interest on capital	3,000	6,000
(ii) Amount actually credited by way of share of profit (Rs. 9,000 divided equally)—	4,500	4,500
Difference between (i) and (ii) (Net effect)	**Cr. 1,500 (Excess)**	**Cr. 1,500 (Short)**

The statement shows that Rameez has got excess credit of Rs. 1,500 while Zaheer's account has been credited less by Rs. 1,500. In order to rectify the error Rameez's capital account should be debited and that of Zaheer, credited with Rs. 1,500 by passing the following journal entry;
journal entry.

Rameez's Capital A/c	Dr.	1,500	
To Zaheer's Capital A/c			1,500
(Adjustment for omission of interest on capital)			

Illustration 12

Nusrat, Sonu and Himesh are partners sharing profits and losses in the ratio of 5 : 3 : 2. The partnership deed provides for charging interest on drawing's @ 10% p.a. The drawings of Nusrat, Sonu and Himesh during the year ending December 2015 amounted to Rs. 20,000, Rs. 15,000 and Rs. 10,000 respectively. After the final accounts have been prepared, it was discovered that interest on drawings has not been taken into consideration. Give necessary adjusting journal entry.

Statement showing Net Effect of Omitting Interest on Drawings

Particulars	*Nusrat (Rs.)*	*Sonu (Rs.)*	*Himesh (Rs.)*	*Total*
Amount which should have been debited by way of interest on drawings	2,000	1,500	1,000	4,500
Amount that should have been credited by way of share of profit	2,250	1,350	900	4,500
Required Adjustment	**Cr. 250 (Short)**	**Cr. 150 (Excess)**	**Cr.100 (Excess)**	

Journal Entry for adjustment of interest on drawings would be:

Sonu's Capital A/c	Dr.	150	
Himesh's Capital A/c	Dr.	100	
To Nusrat's Capital A/c			250
(Adjustment for omission of interest on drawings)			

Do it Yourself

1. Gupta and Sarin are partners in a firm sharing profits in the ratio of 3:2. Their fixed capitals are: Gupta 2,00,000, and Sarin 3,00,000. After the accounts for the year are prepared it is discovered that interest on capital @10% p.a. as provided in the partnership agreement, has not been credited in the capital accounts of partners before distribution of profits. Record adjustment entry to rectify the error.
2. Krishna, Sandeep and Karim are partners sharing profits in the ratio of 3:2:1. Their fixed capitals are: Krishan Rs. 1,20,000, Sandeep 90,000 and Karim 60,000. For the year 2014-15, interest was credited to them @ 6% p.a. instead of 5% p.a. Record adjustment entry.
3. Leela, Meera and Neha are partners and have omitted interest on capital @9% p.a. for three years ended March 31, 2013. Their fixed capitals on which interest was to be allowed throughout were: Leela Rs. 80,000, Meera Rs. 60,000 and Neha Rs. 1,00,000. Their profit sharing ratio during the last three years were:

Year	*Leela*	*Meera*	*Neha*
2015-16	2	2	2
2014-15	4	5	1
2013-14	1	2	2

Record adjustment entry.

2.8 Final Accounts

The final accounts of a partnership firm are prepared in the same way as those prepared for a sole trading concern with just one difference which relates to the distribution of profit among the partners. After preparing the Trading and Profit and Loss Account, the net profit or net loss is transferred to an account called Profit and Loss Appropriation Account as discussed earlier in this chapter. As you know, all adjustments in respect of interest on capital, interest on drawings, partner's salary, partners' share of profit and loss, interest on partner's loan, etc. are made through the Profit and Loss Appropriation Account. This is done in order to distinguish between the results of operations of business and the distribution of the profit among the owners. The preparation of final accounts and the Profit & Loss Appropriation Account is clarified with the help of Illustration 13.

Illustration 13

Kapil and Vineet were partners sharing profits and losses in the ratio of 3:2. The following balances were extracted from the books of account for the year ended March 31, 2014.

	Debit Amount (Rs.)	*Credit Amount (Rs.)*
Capitals		
Kapil	—	60,000
Vineet	—	50,000
Current accounts (on April 01, 2013)		2,800
Kapil	—	
Vineet	—	1,600
Drawings:		—
Kapil	12,000	—
Vineet	8,000	—
Stock as on 1.4.2013	11,000	
Purchases and Sales	54,000	80,000
Returns	2,000	1,500
Wages	2,500	—
Salaries	4,000	—
Printing and Stationery	500	—
Bills receivables	12,000	—
Bills payables	—	2,000
Debtors and Creditors	36,000	8,000
Discounts	1,200	1,500
Rent and Rates	800	—
Bad debts	1,400	—
Insurance	400	—
Postage and Telegrams	300	—
Salesman's commission	3,400	—
Land and Building	24,000	—
Plant and Machinery	20,000	—
Furniture	13,500	—
Overdraft	—	2,000
Trade expenses	400	—
Cash in hand	500	—
Cash at bank	1,500	—
	2,09,400	**2,09,400**

Prepare the final accounts for the year ended March 31, 2014 firm taking into consideration the following:

(a) Stock on March 31, 2014 was Rs. 18,000;
(b) Provision for doubtful debts is to be provided at 5% on debtors;
(c) Outstanding salaries were Rs. 1,000;
(d) Goods worth Rs. 8,000 were destroyed by fire on December 10, 2013. The Insurance Company agreed to pay Rs. 7,000 in full settlement of the claim;
(e) Interest on capitals is allowed at 6% per annum and interest on drawings is also charged at 6% per annum;
(f) Kapil is entitled to a Salary of Rs. 1,200 per annum;
(g) Write-off Land and buildings at 5%, Furniture at 10% and Plant and Machinery at 15%.

Solution

Trading and Profit & Loss Account for the year ending March 31, 2014

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Opening stock		11,000	Sales	80,000	
Purchases	54,000		*Less:* Returns	2,000	78,000
Less: Returns	1,500	52,500	Closing stock		18,000
Wages		2,500	Goods destroyed by fire		8,000
Gross Profit c/d		38,000			
		1,04,000			**1,04,000**
Salaries	4,000		Gross Profit b/d		38,000
Add: Outstanding	1,000	5,000	Discount received		1,500
Printing and Stationery		500			
Rent and Rates		800			
Insurance		400			
Discount allowed		1,200			
Trade expenses		400			
Postage and Telegrams		300			
Bad debts	1,400				
Add: Provision	1,800	3,200			
Salesman's commission		3,400			
Loss due to fire (Rs. 8000–Rs. 7000)		1,000			
Depreciation:					
Land and Buildings	1,200				
Furniture	1,350				
Plant and Machinery	3,000	5,550			
Net Profit transferred to Profit and Loss Appropriation		17,750			
		39,500			**39,500**

Profit and Loss Appropriation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Interest on capital:			Profit and Loss		17,750
Kapil	3,600		Interest on drawings:		
Vineet	3,000	6,600	(for 6 months)		
Salary to Kapil		1,200	Kapil	360	
Net profit (transferred to capital accounts)			Vineet	240	600
Kapil	6,330				
Vineet	4,220	10,550			
		18,350			**18,350**

Partner's Current Accounts

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Kapil (Rs.)*	*Vineet (Rs.)*	*Date*	*Particulars*	*J.F.*	*Kapil (Rs.)*	*Vineet (Rs.)*
	Drawings		12,000	8,000		Balance b/d		2,800	1,600
	Interest on drawings		360	240		Interest on capital		3,600	3,000
	Balance c/d		1,570	580		Salary		1,200	—
						Share of profit		6,330	4,220
			13,930	**8,820**				**13,930**	**8,820**
						Balance c/d		1,570	580

Balance Sheet as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Overdraft		2,000	Land and Building	24,000	
Bill payables		2,000	*Less:* Depreciation	1,200	22,800
Creditors		8,000	Plant and Machinery	20,000	
Outstanding salaries		1,000	*Less:* Depreciation	3,000	17,000
Capital:			Furniture	13,500	
Kapil	60,000		*Less:* Depreciation	1,350	12,150
Vineet	50,000	1,10,000	Stock		18,000
Current Accounts			Debtors	36,000	
Kapil	1,570		*Less:* Prov. for DD	1,800	34,200
Vineet	580	2,150	Insurance company		7,000
			Bill receivables		12,000
			Cash at bank		1,500
			Cash in hand		500
		1,25,150			**1,25,150**

Terms Introduced in the Chapter

- Partnership
- Partnership Firm
- Partnership Deed
- Fixed Capital Account
- Fluctuating Capital Account
- Profit and Loss Adjustment Account
- Interest on Capital
- Interest on Drawings
- Average Period
- Profit and Loss Appropriation Account
- Partner's Current Account

Summary

1. *Definition of partnership and its essential features:* Partnership is defined as "Relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all". The essential features of partnership are : (i) To form a partnership, there must be at least two persons; (ii) It is created by an agreement; (iii) The agreement should be for carrying on some legal business; (iv) sharing of profits and losses; and (v) relationship of mutual agency among the partners.

2. *Meaning and contents of partnership deed:* A document which contains the terms of partnership as agreed among the partners is called 'Partnership Deed'. It usually contains information about all aspects affecting relationship between partners, including objective of business, contribution of capital by each partner, ratio in which profit and losses will be shared by the partners, entitlement of partners to interest on capital, interest on loan and the rules to be followed in case of admission, retirement, death, dissolution, etc.

3. *Provisions of Partnership Act 1932 applicable to accounting:* If partnership deed is silent in respect of certain aspects, the relevant provisions of the Indian Partnership Act, 1932 become applicable. According to the Partnership Act, the partners share profits equally, no partner is entitled to remuneration, no interest on capital is allowed and no interest on drawings is charged. However, if any partner has given some loan to the firm, he is entitled to interest on such amount @ 6% per annum.

4. *Preparation of capital accounts under fixed and fluctuating capital methods:* All transactions relating to partners are recorded in their respective capital accounts in the books of the firm. There can be two methods of maintaining Capital Accounts. These are; (i) fluctuating capital method, (ii) fixed capital method. Under fluctuating capital method, all the transactions relating to a partner are directly recorded in the capital account. Under fixed capital method, however the amount of capital remains fixed, the transactions like interest on capital, drawings, interest on drawings, salary, commission, share of profit or loss are recorded in a separate account called 'Partner's Current Account'.

5. *Distribution of profit and loss:* The distribution of profits among the partners is shown through a Profit and Loss Appropriation Account, which is merely an extension of the Profit and Loss Account. It is usually debited with interest on capital and salary/commission allowed to the partners, and credited with net profit as per Profit and Loss Account and the interest on drawings. The balance being profit or loss is distributed among the partners in the profit sharing ratio and transferred to their respective capital accounts.
6. *Treatment of guarantee of minimum profit to a partner:* Sometimes, a partner may be guaranteed a minimum amount by way of his share in profits. If, in any year, the share of profits as calculated according to his profit sharing ratio is less than the guaranteed amount, the deficiency is made good by the guaranteeing partners' in the agreed ratio which usually is the profit sharing ratio. If, however, such guarantee has been given by any of them, he or they alone shall bear the amount of deficiency.
7. *Treatment of past adjustments:* If, after the final accounts have been prepared, some omission or commissions are noticed say in respect of the interest on capital, interest on drawings, partner's salary, commission, etc. necessary adjustments can be made in the partner's capital accounts through the Profit and Loss Adjustment Account, to rectify the same.
8. *Preparation of final accounts of a partnership firm:* There is not much difference in the final accounts of a sole proprietary concern and that of a partnership firm except that in case of a partnership firm an additional account called Profit and Loss Appropriation Account is prepared to show distribution of profit and loss among the partners.

Questions for Practice

Short Answer Questions

1. Define Partnership Deed.
2. Why it is considered desirable to make the partnership agreement in writing.
3. List the items which may be debited or credited in capital accounts of the partners when:
   (i) Capitals are fixed.
   (ii) Capital are fluctuating.
4. Why is Profit and Loss Adjustment Account prepared? Explain.
5. Give two circumstances under which the fixed capitals of partners may change.
6. If a fixed amount is withdrawn on the first day of every quarter, for what period the interest on total amount withdrawn will be calculated?

7. In the absence of Partnership deed, specify the rules relating to the following :
   (i) Sharing of profits and losses.
   (ii) Interest on partner's capital.
   (iii) Interest on Partner's drawings.
   (iv) Interest on Partner's loan
   (v) Salary to a partner.

Long Answer Questions

1. What is partnership? What are its chief characteristics? Explain.
2. Discuss the main provisions of the Indian Partnership Act 1932 that are relevant to partnership accounts if there is no partnership deed.
3. Explain why it is considered better to make a partnership agreement in writing.
4. Illustrate how interest on drawings will be calculated under various situations.
5. How will you deal with a change in profit sharing ratio among existing partners? Take imaginary figures to illustrate your answer?

Numerical Questions

Fixed and Fluctuating Capitals

1. Triphati and Chauhan are partners in a firm sharing profits and losses in the ratio of 3:2. Their capitals were Rs.60,000 and Rs.40,000 as on January 01, 2015. During the year they earned a profit of Rs. 30,000. According to the partnership deed both the partners are entitled to Rs. 1,000 per month as Salary and 5% interest on their capital. They are also to be charged an interest of 5% on their drawings, irrespective of the period, which is Rs. 12,000 for Tripathi, Rs. 8,000 for Chauhan. Prepare Partner's Accounts when, capitals are fixed.

   (**Ans :** Tripathi's Current account Balance Rs. 20,400,Chauhan's Current account Balance Rs.17,600)

2. Anubha and Kajal are partners of a firm sharing profits and losses in the ratio of 2:1. Their capital, were Rs.90,000 and Rs.60,000. The profit during the year were Rs. 45,000. According to partnership deed, both partners are allowed salary, Rs. 700 per month to Anubha and Rs. 500 per month to Kajal. Interest allowed on capital @ 5%p.a. The drawings at the end of the period were Rs. 8,500 for Anubha and Rs. 6,500 for Kajal. Interest is to be charged @ 5% p.a. on drawings. Prepare partners capital accounts, assuming that the capital account are fluctuating.
   (**Ans :** Anubha's Capital Account Balance Rs.1,23,975, Kajal's Capital Account Balance Rs.77,175)

Distribution of Profits

3. Harshad and Dhiman are in partnership since April 01, 2015. No Partnership agreement was made. They contributed Rs. 4,00,000 and 1,00,000 respectively as capital. In addition, Harshad advanced an amount of Rs. 1,00,000 to the firm, on October 01, 2015. Due to long illness, Harshad could not participate in business activities from August 1, to September 30, 2015. The profits for the year ended March 31, 2015 amounted to Rs. 1,80,000.
   Dispute has arisen between Harshad and Dhiman.

   Harshad Claims:
   (i) he should be given interest @ 10% per annum on capital and loan;
   (ii) Profit should be distributed in proportion of capital;

   Dhiman Claims:
   (i) Profits should be distributed equally;
   (ii) He should be allowed Rs. 2,000 p.m. as remuneration for the period he managed the business, in the absence of Harshad;
   (iii) Interest on Capital and loan should be allowed @ 6% p.a.

   You are required to settle the dispute between Harshad and Dhiman. Also prepare Profit and Loss Appropriation Account.

   (**Ans :** Harshad's share in profit Rs. 88,500, Dhiman's share in profit Rs. 88,500)

4. Aakriti and Bindu entered into partnership for making garment on April 01, 2015 without any Partnership agreement. They introduced Capitals of Rs. 5,00,000 and Rs. 3,00,000 respectively on October 01, 2015. Aakriti Advanced. Rs, 20,000 by way of loan to the firm without any agreement as to interest. Profit and Loss account for the year ended March 2016 showed profit of Rs, 43,000. Partners could not agree upon the question of interest and the basis of division of profit. You are required to divide the profits between them giving reason for your solution.

   (**Ans :** Profit shares equal Aakriti and Bindu Rs. 21,200)

5. Rakhi and Shikha are partners in a firm, with capitals of Rs. 2,00,000 and Rs, 3,00,000 respectively. The profit of the firm, for the year ended 2014-15 is Rs. 23,200. As per the Partnership agreement, they share the profit in their capital ratio, after allowing a salary of Rs. 5,000 per month to Shikha and interest on Partner's capital at the rate of 10% p.a. During the year Rakhi withdrew Rs. 7,000 and Shikha Rs. 10,000 for their personal use. You are required to prepare Profit and Loss Appropriation Account and Partner's Capital Accounts.

   (**Ans :** Loss Transferred to Rakhi Capital Rs.34,720 and Shikha Capital Rs.52,080)

6. Lokesh and Azad are partners sharing profits in the ratio 3:2, with capitals of Rs. 50,000 and 30,000, respectively. Interest on capital is agreed to be paid

@ 6% p.a. Azad is allowed a salary of Rs. 2,500 p.a. During 2013, the profits prior to the calculation of interest on capital but after charging Azad's salary amounted to Rs. 12,500. A provision of 5% of profits is to be made in respect of manager's commission. Prepare accounts showing the allocation of profits and partner's capital accounts.

(**Ans :** Profit transferred to Lokesh's Capital Rs. 4,170 and Azad's Capital Rs.2,780)

7. The partnership agreement between Maneesh and Girish provides that:
   (i) Profits will be shared equally;
   (ii) Maneesh will be allowed a salary of Rs. 400 p.m;
   (iii) Girish who manages the sales department will be allowed a commission equal to 10% of the net profits, after allowing Maneesh's salary;
   (iv) 7% interest will be allowed on partner's fixed capital;
   (v) 5% interest will be charged on partner's annual drawings;
   (vi) The fixed capitals of Maneesh and Girish are Rs. 1,00,000 and Rs. 80,000, respectively. Their annual drawings were Rs. 16,000 and 14,000, respectively. The net profit for the year ending March 31, 2015 amounted to Rs. 40,000;
   Prepare firm's Profit and Loss Appropriation Account.

   (**Ans :** Profit transferred to the Capital accounts of Maneesh and Girish, Rs.10,290)

8. Ram, Raj and George are partners sharing profits in the ratio 5 : 3 : 2. According to the partnership agreement George is to get a minimum amount of Rs. 10,000 as his share of profits every year. The net profit for the year 2013 amounted to Rs, 40,000. Prepare the Profit and Loss Appropriation Account.

   (**Ans :** Profit transferred to Ram's Capital Rs.18,750 Raj's Capital Rs.11,250 and George's Capital Rs.10,000)

9. Amann, Babita and Suresh are partners in a firm. Their profit sharing ratio is 2:2:1. Suresh is guaranteed a minimum amount of Rs. 10,000 as share of profit, every year. Any deficiency on that account shall be met by Babita. The profits for two years ending December 31, 2015 and December 31, 2016 were Rs. 40,000 and Rs. 60,000, respectively. Prepare the Profit and Loss Appropriation Account for the two years.

   (**Ans :** For the year 2015, Profits transferred to Amann's Capital, Rs.16,000; Babita's Capital Rs.14,000; Suresh's capital Rs.10,000 and for the year 2006, Profit transferred to Amann's Capital Rs.24,000, Babita's Capital Rs.24,000, Suresh's capital, Rs.12,000)

10. Simmi and Sonu are partners in a firm, sharing profits and losses in the ratio of 3:1. The profit and loss account of the firm for the year ending March 31, 2015 shows a net profit of Rs. 1,50,000. Prepare the Profit and Loss Appropriation Account by taking into consideration the following information:
    (i) Partners capital on April 1, 2014;
    Simmi, Rs. 30,000; Sonu, Rs. 60,000;

(ii) Current accounts balances on April 1, 2014;
Simmi, Rs. 30,000 (cr.); Sonu, Rs. 15,000 (cr.);

(iii) Partners drawings during the year amounted to
Simmi, Rs. 20,000; Sonu, Rs. 15,000;

(iv) Interest on capital was allowed @ 5% p.a.;

(v) Interest on drawing was to be charged @ 6% p.a. at an average of six months;

(vi) Partners' salaries : Simmi Rs. 12,000 and Sonu Rs. 9,000. Also show the partners' current accounts.

(**Ans :** Profit transferred to Simmi's Capital, Rs. 92,587 and Sonu's Capital, Rs. 30,863)

11. Ramesh and Suresh were partners in a firm sharing profits in the ratio of their capitals contributed on commencement of business which were Rs. 80,000 and Rs. 60,000 respectively. The firm started business on April 1, 2013. According to the partnership agreement, interest on capital and drawings are 12% and 10% p.a., respectively. Ramesh and Suresh are to get a monthly salary of Rs. 2,000 and Rs. 3,000, respectively.

The profits for year ended March 31, 2015 before making above appropriations was Rs. 1,00,300. The drawings of Ramesh and Suresh were Rs. 40,000 and Rs. 50,000, respectively. Interest on drawings amounted to Rs. 2,000 for Ramesh and Rs. 2,500 for Suresh. Prepare Profit and Loss Appropriation Account and partners' capital accounts, assuming that their capitals are fluctuating.

(**Ans :** Profit transferred to Ramesh's Capital Rs.16,000 and Suresh's Capital, Rs.12,000)

12. Sukesh and Vanita were partners in a firm. Their partnership agreement provides that:

(i) Profits would be shared by Sukesh and Vanita in the ratio of 3:2;

(ii) 5% interest is to be allowed on capital;

(iii) Vanita should be paid a monthly salary of Rs. 600.

The following balances are extracted from the books of the firm, on December 31, 2014.

	Sukesh (Rs.)	*Verma (Rs.)*
Capital Accounts	40,000	40,000
Current Accounts	(Cr.) 7,200	(Cr.) 2,800
Drawings	10,850	8,150

Net profit for the year, before charging interest on capital and after charging partner's salary was Rs. 9,500. Prepare the Profit and Loss Appropriation Account and the Partner's Current Accounts.

(**Ans :** Profit transferred to Sukesh's Capital, Rs.3,300 and Vanita's Capital, Rs. 2,200)

Calculation of Interest on Capital and Interest on Drawings

13. Rahul, Rohit and Karan started partnership business on April 1, 2014 with capitals of Rs. 20,00,000, Rs. 18,00,000 and Rs. 16,00,000, respectively. The profit for the year ended March 2015 amounted to Rs.1,35,000 and the partner's drawings had been Rahul Rs. 50,000, Rohit Rs. 50,000 and Karan Rs. 40,000. The profits are distributed among partner's in the ratio of 3:2:1. Calculate the interest on capital @ 5% p.a.

    (**Ans :** Rahul, Rs. 1,00,000, Rohit, Rs. 90,000, Karan Rs. 80,000)

14. Sunflower and Pink Rose started partnership business on April 01, 2014 with capitals of Rs. 2,50,000 and Rs.1,50,000, respectively. On October 01, 2014, they decided that their capitals should be Rs. 2,00,000 each. The necessary adjustments in the capitals are made by introducing or withdrawing cash. Interest on capital is to be allowed @ 10% p.a. Calculate interest on capital as on March 31, 2015.

    (**Ans :** Total interest on Sunflower's Capital Rs. 22,500 and on Pink Rose's Capital, Rs. 17,500)

15. On March 31, 2014 after the close of accounts, the capitals of Mountain, Hill and Rock stood in the books of the firm at Rs. 4,00,000,Rs.3,00,000 and Rs. 2,00,000, respectively. Subsequently, it was discovered that the interest on capital @ 10% p.a. had been omitted. The profit for the year amounted to Rs. 1,50,000 and the partner's drawings had been Mountain: Rs. 20,000, Hill Rs. 15,000 and Rock Rs. 10,000.
    Calculate interest on capital.

    (**Ans :** Interest on Capital: Mountain, Rs.37,000; Hill, Rs.26,500; Rock, Rs.16,000)

16. Following is the extract of the Balance Sheet of, Neelkant and Mahdev as on March 31, 2014:

Balance Sheet as at March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Neelkant's Capital	10,00,000	Sundry Assets	30,00,000
Mahadev's Capital	10,00,000		
Neelkant's Current Account	1,00,000		
Mahadev's Current Account	1,00,000		
Profit and Loss Apprpriation (March 2007)	8,00,000		
	30,00,000		**30,00,000**

During the year Mahadev's drawings were Rs. 30,000. Profits during 2014 is Rs. 10,00,000. Calculate interest on capital @ 5% p.a for the year ending March 31, 2014.

(**Ans :** Interest on Neelkant's Capital, Rs. 50,000 and Mahadev's Capital, Rs. 50,000)

17. Rishi is a partner in a firm. He withdrew the following amounts during the year ended March 31, 2014.

May 01, 2013	Rs. 12,000
July 31, 2013	Rs. 6,000
September 30, 2013	Rs. 9,000
November 30, 2013	Rs. 12,000
January 01, 2014	Rs. 8,000
March 31, 2014	Rs. 7,000

Interest on drawings is charged @ 9% p.a.
Calculate interest on drawings

(**Ans :** Interest on Drawing Rs. 2,295)

18. The capital accounts of Moli and Golu showed balances of Rs.40,000 and Rs. 20,000 as on April 01, 2014. They shared profits in the ratio of 3:2. They allowed interest on capital @ 10% p.a. and interest on drawings, @ 12 p.a. Golu advanced a loan of Rs. 10,000 to the firm on August 01, 2014.
During the year, Moli withdrew Rs. 1,000 per month at the beginning of every month whereas Golu withdrew Rs. 1,000 per month at the end of every month. Profit for the year, before the above mentioned adjustments was Rs.20,950. Calculate interest on drawings show distribution of profits and prepare partner's capital accounts.

(**Ans :** Interest on Drawings : Moli, Rs. 780; Golu, Rs. 660; Profits Moli, Rs. 9,594; Golu, Rs. 6,396)

19. Rakesh and Roshan are partners, sharing profits in the ratio of 3:2 with capitals of Rs. 40,000 and Rs. 30,000, respectively. They withdrew from the firm the following amounts, for their personal use:

Rakesh	*Month*	*Rs.*
	May 31, 2014	600
	June 30, 2014	500
	August 31, 2014	1,000
	November 1, 2014	400
	December 31, 2014	1,500
	January 31, 2015	300
	March 01, 2015	700
Rohan	*At the beginning of each month*	*400*

Interest is to be charged @ 6% p.a. Calculate interest on drawings, assuming that book of accounts are closed on March 31, 2015, every year.

(**Ans :** Interest on Rakesh's Drawings : Rs. 102; Rohan's Drawings Rs. 156 rounded off to nearest rupee)

20. Himanshu withdrews Rs. 2,500 at the end Month of each month. The Partnership deed provides for charging the interest on drawings @ 12% p.a. Calculate interest on Himanshu's drawings for the year ending 31st December, 2014.

(**Ans :** Interest on Drawings Rs.1,650)

21. Bharam is a partner in a firm. He withdraws Rs. 3,000 at the starting of each month for 12 months. The books of the firm closes on March 31 every year. Calculate interest on drawings if the rate of interest is 10% p.a.

    (**Ans :** Interest on Drawings, Rs.1,950)

22. Raj and Neeraj are partners in a firm. Their capitals as on April 01, 2015 were Rs. 2,50,000 and Rs. 1,50,000, respectively. They share profits equally. On July 01, 2015, they decided that their capitals should be Rs. 1,00,000 each. The necessary adjustment in the capitals were made by introducing or withdrawing cash by the partners'. Interest on capital is allowed @ 8% p.a. Compute interest on capital for both the partners for the year ending on March 31, 2016.

    (**Ans :** Raj Rs. 11,000 and Neeraj's Rs. 9,000)

23. Amit and Bhola are partners in a firm. They share profits in the ratio of 3:2. As per their partnership agreement, interest on drawings is to be charged @ 10% p.a. Their drawings during 2013 were Rs. 24,000 and Rs. 16,000, respectively. Calculate interest on drawings based on the assumption that the amounts were withdrawn evenly, throughout the year.

    (**Ans :** Interest on Amit's Drawings, Rs. 2,400 and Bhola's, Rs.800)

24. Harish is a partner in a firm. He withdrew the following amounts during the year 2015 :

	Rs.
February 01	4,000
May 01	10,000
June 30	4,000
October 31	12,000
December 31	4,000

    Interest on drawings is to be charged @ $7\frac{1}{2}$% p.a.
    Calculate the amount of interest to be charged on Harish's drawings for the year ending December 31, 2015.

    (**Ans :** Interest on Drawings, Rs.1,075)

25. Menon and Thomas are partners in a firm. They share profits equally. Their monthly drawings are Rs. 2,000 each. Interest on drawings is to be charged @ 10% p.a. Calculate interest on Menon's drawings for the year 2006, assuming that money is withdrawn: (i) in the beginning of every month, (ii) in the middle of every month, and (iii) at the end of every month.

    (**Ans :** (i) Interest on Drawings, Rs.1,300; (ii) Rs.1,200; (iii) Rs.1,100)

26. On March 31, 2015, after the close of books of accounts, the capital accounts of Ram, Shyam and Mohan showed balance of Rs. 24,000 Rs. 18,000 and Rs. 12,000, respectively. It was later discovered that interest on capital @ 5% had been omitted. The profit for the year ended March 31, 2015, amounted to Rs. 36,000 and the partner's drawings had been Ram, Rs. 3,600; Shyam, Rs. 4,500 and Mohan, Rs. 2,700. The profit sharing ratio of Ram, Shyam and Mohan was 3:2:1. Calculate interest on capital.

    (**Ans :** Interest on Ram's Capital Rs.480; Shyam's Capital, Rs.525 and Mohan's Capital, Rs.435)

Guarantee of Profit to the Partners

27. Amit, Sumit and Samiksha are in partnership sharing profits in the ratio of 3:2:1. Samiksha' share in profit has been guaranteed by Amit and Sumit to be a minimum sum of Rs. 8,000. Profits for the year ended March 31, 2015 was Rs. 36,000. Divide profit among the partners.

    (**Ans :** Profit to Amit Rs. 16,800; Sumit, Rs. 11,200; Samiksha, Rs. 8,000)

28. Pinki, Deepati and Kaku are partner's sharing profits in the ratio of 5:4:1. Kaku is given a guarantee that his share of profits in any given year would not be less than Rs. 5,000. Deficiency, if any, would be borne by Pinki and Deepti equally. Profits for the year amounted to Rs. 40,000. Record necessary journal entries in the books of the firm showing the distribution of profit.

    (**Ans :** Deficiency borne by Pinki and Deepti Rs.500 each)

29. Abhay, Siddharth and Kusum are partners in a firm, sharing profits in the ratio of 5:3:2. Kusum is guaranteed a minimum amount of Rs. 10,000 as per share in the profits. Any deficiency arising on that account shall be met by Siddharth. Profits for the years ending March 31, 2015 and 2016 are Rs. 40,000 and 60,000 respectively. Prepare Profit and Loss Appropriation Account.

    (**Ans :** year 2015 - Abhay Rs. 20,000, Siddharth Rs. 10,000, Kusum Rs. 10,000; year 2016- Abhay Rs. 30,000, Siddharth Rs. 18,000, Kusum Rs. 12,000)

30. Radha, Mary and Fatima are partners sharing profits in the ratio of 5:4:1. Fatima is given a guarantee that her share of profit, in any year will not be less than Rs. 5,000. The profits for the year ending March 31, 2015 amounts to Rs. 35,000. Shortfall if any, in the profits guaranteed to Fatima is to be borne by Radha and Mary in the ratio of 3:2. Record necessary journal entry to show distributioin of profit among partner.

    (**Ans :** Deficiency borne by Radha, Rs. 900 and Mary, Rs. 600)

31. X, Y and Z are in Partnership, sharing profits and losses in the ratio of 3 : 2 : 1, respectively. Z's share in the profit is guaranteed by X and Y to be a minimum of Rs. 8,000. The net profit for the year ended March 31, 2015 was Rs. 30,000. Prepare Profit and Loss Appropriation Account, indicating the amount finally due to each partner.

    (**Ans :** Profit to X Rs.13,200; Y Rs.8,800; Z Rs.8,000)

32. Arun, Boby and Chintu are partners in a firm sharing profit in the ratio or 2:2:1. According to the terms of the partnership agreement, Chintu has to get a minimum of Rs. 60,000, irrespective of the profits of the firm. Any Deficiency to Chintu on Account of such guarantee shall be borne by Arun. Prepare the profit and loss appropriation account showing distribution of profits among partners in case the profits for year 2015 are: (i) Rs. 2,50,000; (ii) 3,60,000.

    (**Ans :** (i) Profit to Arun Rs.90,000, Boby Rs.1,00,000 and Chintu Rs.60,000 (ii) Profit to Arun Rs.1,44,000, Boby Rs.1,44,000 and Chintu Rs.72,000)

33. Ashok, Brijesh and Cheena are partners sharing profits and losses in the ratio of 2 : 2 : 1. Ashok and Brijesh have guaranteed that Cheena share in any year shall be less than Rs. 20,000. The net profit for the year ended March 31, 2015 amounted to Rs. 70,000. Prepare Profit and Loss Appropriation Account.

    (**Ans :** Profit to Ashok Rs.25,000, Brijesh Rs. 25,000 and Cheena Rs. 20,000)

34. Ram, Mohan and Sohan are partners with capitals of Rs. 5,00,000, Rs. 2,50,000 and 2,00,000 respectively. After providing interest on capital @ 10% p.a. the profits are divisible as follows:

    Ram $1/2$, Mohan $1/3$ and Sohan $1/6$. But Ram and Mohan have guaranteed that Sohan's share in the profit shall not be less than Rs. 25,000, in any year. The net profit for the year ended March 31, 2015 is Rs. 2,00,000, before charging interest on capital.

    You are required to show distribution of profit.

    (**Ans :** Profit to Ram, Rs. 48,000, Mohan, Rs. 32,000 and Sohan, Rs. 25,000)

35. Amit, Babita and Sona form a partnership firm, sharing profits in the ratio of 3 : 2 : 1, subject to the following :
    (i) Sona's share in the profits, guaranteed to be not less than Rs. 15,000 in any year.
    (ii) Babita gives guarantee to the effect that gross fee earned by her for the firm shall be equal to her average gross fee of the proceeding five years, when she was carrying on profession alone (which is Rs. 25,000). The net profit for the year ended March 31, 2015 is Rs. 75,000. The gross fee earned by Babita for the firm was Rs. 16,000.

    You are required to show Profit and Loss Appropriation Account (after giving effect to the alone).

    (**Ans :** Profit transferred to Capital Accounts of; Amit, Rs. 41,400, Babita, Rs.27,600 and Sona, Rs.15,000)

Past Adjustment

36. The net profit of X, Y and Z for the year ended March 31, 2015 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 mentioned transactions were not recorded in the books :
    (i) Interest on Capital @ 5% p.a.
    (ii) Interest on drawings amounting to X Rs. 700, Y Rs. 500 and Z Rs. 300.
    (iii) Partner's Salary : X Rs. 1000, Y Rs. 1500 p.a.

    The capital accounts of partners were fixed as : X Rs. 1,00,000, Y Rs. 80,000 and Z Rs. 60,000. Record the adjustment entry.

    (**Ans :** X Dr. Rs.2,700 , Y credit Rs.2,600 and Z credit Rs.100]

37. The firm of Harry, Porter and Ali, who have been sharing profits in the ratio of 2 : 2 : 1, have existed for same years. Ali wants that he should get equal share in the profits with Harry and Porter and he further wishes that the change in

the profit sharing ratio should come into effect retrospectively were for the last three year. Harry and Porter have agreement on this account.

The profits for the last three years were:

	(Rs.)
2013-14	22,000
2014-15	24,000
2015-16	29,000

Show adjustment of profits by means of a single adjustment journal entry.

(**Ans :** Harry (Dr.) Rs.5,000, Porter (Dr.) Rs.5,000 and Ali (Cr.) Rs.10,000)

38. Mannu and Shristhi are partners in a firm sharing profit in the ratio of 3 : 2. Following is the balance sheet of the firm as on March 31, 2015.

Balance Sheet as at March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Mannu's Capital	30,000		Drawings :		
Shristhi's Capital	10,000	40,000	Mannu	4,000	
			Shristhi	2,000	6,000
			Other Assets		34,000
		40,000			**40,000**

Profit for the year ended March 31, 2015 was Rs. 5,000 which was divided in the agreed ratio, but interest @ 5% p.a. on capital and @ 6% p.a. on drawings was inadvertently enquired. Adjust interest on drawings on an average basis for 6 months. Give the adjustment entry.

(**Ans :** Mannu (Dr.) Rs.288 and Shrishti (Cr.) Rs.288)

39. On March 31, 2015 the balance in the capital accounts of Eluin, Monu and Ahmed, after making adjustments for profits, drawing, etc; were Rs. 80,000, Rs. 60,000 and Rs. 40,000 respectively. Subsequently, it was discovered that interest on capital and interest on drawings had been omitted.

The partners were entitled to interest on capital @ 5% p.a. The drawings during the year were Eluin Rs. 20,000; Monu, Rs. 15,000 and Ahmed, Rs. 9,000. Interest on drawings chargeable to partners were Eluin Rs, 500, Monu Rs. 360 and Ahmed Rs. 200. The net profit during the year amounted to Rs. 1,20,000. The profit sharing ratio was 3 : 2 : 1. Record necessary adjustment entries.

(**Ans :** Eluin (Dr.) Rs.570, Monu (Cr.) Rs.10 and Ahmed (Cr.) Rs.560)

40. Azad and Benny are equal partners. Their capitals are Rs. 40,000 and Rs. 80,000, respectively. After the accounts for the year have been prepared it is discovered that interest at 5% p.a. as provided in the partnership agreement, has not been credited to the capital accounts before distribution of profits. It is decided to make an adjustment entry at the beginning of the next year. Record the necessary journal entry.

(**Ans :** Azad (Dr.)1,000 and Benny (Cr.)1,000)

41. Kavita and Pradeep are partners, sharing profits in the ratio of 3 : 2. They employed Chandan as their manager, to whom they paid a salary of Rs. 750 p.m. Chandan deposited Rs. 20,000 on which interest is payable @ 9% p.a. At the end of 2001 (after the division of profit), it was decided that Chandan should be treated as partner w.e.f. Jan. 1, 1998 with $\frac{1}{6}$th share in profits. His deposit being considered as capital carrying interest @ 6% p.a. like capital of other partners. Firm's profits after allowing interest on capital were as follows:

		(Rs.)
2012	Profit	59,000
2013	Profit	62,000
2014	Loss	(4,000)
2015	Profit	78,000

Record the necessary journal entries to give effect to the above.

(**Ans :** Kavita (Dr.) 300, Pradeep (Dr.) 200 and Chandan (Cr.) 500)

42. Mohan, Vijay and Anil are partners, the balance on their capital accounts being Rs. 30,000, Rs. 25,000 and Rs. 20,000 respectively. In arriving at these figures, the profits for the year ended March 31, 2015 amounting to Rupees 24,000 had been credited to partners in the proportion in which they shared profits. During the tear their drawings for Mohan, Vijay and Anil were Rs. 5,000, Rs. 4,000 and Rs. 3,000, respectively. Subsequently, the following omissions were noticed:
(a) Interest on Capital, at the rate of 10% p.a., was not charged.
(b) Interest on Drawings: Mohan Rs. 250, Vijay Rs. 200, Anil Rs. 150 was not recorded in the books.
Record necessary corrections through journal entries.

(**Ans :** Debit Anil's Capital Account by Rs. 450 and Credit Mohan's Capital Account by Rs. 450)

43. Anju, Manju and Mamta are partners whose fixed capitals were Rs. 10,000, Rs. 8,000 and Rs. 6,000, respectively. As per the partnership agreement, there is a provision for allowing interest on capitals @ 5% p.a. but entries for the same have not been made for the last three years. The profit sharing ratio during there years remained as follows:

Year	Anju	Manju	Mamta
2013	4	3	5
2014	3	2	1
2015	1	1	1

Make necessary and adjustment entry at the beginning of the fourth year i.e. Jan. 2015.

(**Ans :** Mamta (Dr.) Rs. 200, Anju (Cr.) Rs. 100 and manju (Cr.) Rs. 100)

44. Dinker and Ravinder were partners sharing profits and losses in the ratio of 2:1. The following balances were extracted from the books of account, for the year ended December 31, 2015.

Account Name	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Capital		
Dinker		2,35,000
Ravinder		1,63,000
Drawings		
Dinker	6,000	
Ravinder	5,000	
Opening Stock	35,100	
Purchases and Sales	2,85,000	3,75,800
Carriage inward	2,200	
Returns	3,000	2,200
Stationerry	1,200	
Wages	12,500	
Bills receivables and Bills payables	45,000	32,000
Discount	900	400
Salaries	12,000	
Rent and Taxes	18,000	
Insurance premium	2,400	
Postage	300	
Sundry expenses	1,100	
Commission		3,200
Debtors and creditors	95,000	40,000
Building	1,20,000	
Plant and machinery	80,000	
Investments	1,00,000	
Furniture and Fixture	26,000	
Bad Debts	2,000	
Bad debts provision		4,600
Loan		35,000
Legal Expenses	200	
Audit fee	1,800	
Cash in hand	13,500	
Cash at Bank	23,000	
	8,91,200	**8,91,200**

Prepare final accounts for the year ended December 31,2015, with following adjustment:

(a) Stock on December 31,2015, was Rs. 42,500.
(b) A Provision is to be made for bad debts at 5% on debtors.
(c) Rent outstanding was Rs.1,600.
(d) Wages outstanding were Rs.1,200.
(e) Interest on capital to be allowed on capital @ 4% per annum and interest on drawings to be charged @ 6% per annum.
(f) Dinker and Ravinder are entitled to a Salary of Rs.2,000 per annum
(g) Ravinder is entitled to a commission Rs.1,500.

(h) Depreciation is to be charged on Building @ 4%, Plant and Machinery, 6%, and furniture and fixture, 5%.

(i) Outstanding interest on loan amounted to Rs. 350.

(**Ans :** Gross Profit Rs. 81,500, Net Profit Rs.32,200, Dinker 's Capital Rs. 2,47,627 Ravinder's Capital Rs.1,71,573, Total of Balance Sheet Rs. 5,29,350)

45. Kajol and Sunny were partners sharing profits and losses in the ratio of 3:2. The following Balances were extracted from the books of account for the year ended March 31, 2015.

Account Name	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Capital		
Kajol		1,15,000
Sunny		91,000
Current accounts [on 1-04-2005]		
Kajol		4,500
Sunny	3,200	
Drawings		
Kajol	6,000	
Sunny	3,000	
Opening stock	22,700	
Purchases and Sales	1,65,000	2,35,800
Freight inward	1,200	
Returns	2,000	3,200
Printing and Stationery	900	
Wages	5,500	
Bills receivables and Bills payables	25,000	21,000
Discount	400	800
Salaries	6,000	
Rent	7,200	
Insurance premium	2,000	
Traveling expenses	700	
Sundry expenses	1,100	
Commission		1,600
Debtors and Creditors	74,000	78,000
Building	85,000	
Plant and Machinery	70,000	
Motor car	60,000	
Furniture and Fixtures	15,000	
Bad debts	1,500	
Provision for doubtful debts		2,200
Loan		25,000
Legal expenses	300	
Audit fee	900	
Cash in hand	7,500	
Cash at bank	12,000	
	5,78,100	**5,78,100**

Prepare final accounts for the year ended March 31,2015, with following adjustments:

(a) Stock on March 31,2015 was Rs.37,500.
(b) Bad debts Rs.3,000; Provision for bad debts is to be made at 5% on debtors.
(c) Rent Prepaid were Rs.1,200.
(d) Wages outstanding were Rs.2,200.
(e) Interest on capital to be allowed on capital at 6% per annum and interest on drawings to be charged @ 5% per annum.
(f) Kajol is entitled to a Salary of Rs. 1,500 per annum.
(g) Prepaid insurance was Rs. 500.
(h) Depreciation was charged on Building, @ 4%; Plant and Machinery, @ 5%; Motor car, @ 10% and furniture and fixture, @ 5%.
(i) Goods worth Rs.7,000 were destroyed by fire on January 20, 2015. The Insurance company agreed to pay Rs.5,000 in full settlement of the claim.

(**Ans :** Gross Profits Rs. 84,900; Net Profit, Rs. 48,000; Kajol's Current account, Rs. 27,369; Sunny's Current Account, Rs. 12,931; Total of Balance Sheet, Rs. 3,72,500)

Check-list to Test your Understanding

Test your Understanding – I

1. (i) Invalid (ii) Invalid (iii) Valid (iv) Invalid
2. (i) True (ii) True (iii) True (iv) False (v) False (vi) False

Test your Understanding – II

1. (i) Interest on loan given 6% p.a.
   (ii) No interest allowed on capital and charged on drawings
   (iii) Salary and Commission not given to partner
   (iv) Profit to the shared equally
2. Profit : Reena, Rs. 3,87,500; Raman, Rs. 3,87,500

Test your Understanding – III

1. Interest on capital; Rani, Rs. 9,600; Suman, Rs. 7,200
2. (a) Profit : Priya, Rs. 78,750; Kajal, Rs. 47,250
   (b) Profit NIL. Interest on capital: Priya, Rs. 47.250; Kajal, Rs. 78,750

Reconstitution of a Partnership Firm – Admission of a Partner

3

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- *Explain the concept and the ways of reconstitution of a partnership firm;*
- *Identify the matters that need adjustments in the books of firm when a new partner is admitted;*
- *Determine the new profit sharing ratio and calculate the sacrificing ratio;*
- *Define goodwill and enumerate the factors that affect it;*
- *Explain the methods of valuation of goodwill;*
- *Describe how goodwill will be treated under different situations when a new partner is admitted;*
- *Make necessary adjustments for revaluation of assets and reassessment of liabilities;*
- *Make necessary adjustments for accumulated profits and losses;*
- *Determine the capital of each partner, if required according to the new profit sharing ratio and make necessary adjustments;*
- *Make necessary adjustments on change in the profit sharing ratio among the existing partners.*

Partnership is an agreement between two or more persons (called partners) for sharing the profits of a business carried on by all or any of them acting for all. Any change in the existing agreement amounts to reconstitution of the partnership firm. This results in an end of the existing agreement and a new agreement comes into being with a changed relationship among the members of the partnership firm and/or their composition. However, the firm continues. The partners often resort to reconstitution of the firm in various ways such as admission of a new partner, change in profit sharing ratio, retirement of a partner, death or insolvence of a partner. In this chapter we shall have a brief idea about all these and in detail about the accounting implications of admission of a new partner or an on change in the profit sharing ratio.

3.1 Modes of Reconstitution of a Partnership Firm

Reconstitution of a partnership firm usually takes place in any of the following ways:

Admission of a new partner: A new partner may be admitted when the firm needs additional capital or managerial help. According to the provisions of Partnership Act 1932 unless it is otherwise provided in the partnership deed a new partner can be admitted only when the existing partners unanimously agree for it. For example, Hari and Haqque are partners sharing profits in the ratio of

3:2. On April 1, 2015 they admitted John as a new partner with 1/6 share in profits of the firm. With this change now there are three partners of the firm and it stand reconstituted.

Change in the profit sharing ratio among the existing partners: Sometimes the partners of a firm may decide to change their existing profit sharing ratio. This may happen an account of a change in the existing partners' role in the firm. For example, Ram, Mohan and Sohan are partners in a firm sharing profits in the ratio of 3:2:1. With effect from April 1,2015 they decided to share profits equally as Sohan brings in additional capital. This results in a change in the existing agreement leading to reconstitution of the firm.

Retirement of an existing partner: It means withdrawal by a partner from the business of the firm which may be due to his bad health, old age or change in business interests. In fact a partner can retire any time if the partnership is at will. For example, Roy, Ravi and Rao are partners in the firm sharing profits in the ratio of 2:2:1. On account of illness, Ravi retired from the firm on March 31, 2015. This results in reconstitution of the firm now having only two partners.

Death of a partner: Partnership may also stand reconstituted on death of a partner, if the remaining partners decide to continue the business of the firm as usual. For example, X,Y and Z are partners in a firm sharing profits in the ratio 3:2:1. X died on March 31, 2015. Y and Z decide to carry on the business sharing future profits equally. The continuity of business by Y and Z sharing future profits equally leads to reconstitution of the firm.

3.2 Admission of a New Partner

When firm requires additional capital or managerial help or both for the expansion of its business a new partner may be admitted to supplement its existing resources. According to the Partnership Act 1932, a new partner can be admitted into the firm only with the consent of all the existing partners unless otherwise agreed upon. With the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm.

A newly admitted partner acquires two main rights in the firm–

1. Right to share the assets of the partnership firm; and
2. Right to share the profits of the partnership firm.

For the right to acquire share in the assets and profits of the partnership firm, the partner brings an agreed amount of capital either in cash or in kind. Moreover, in the case of an established firm which may be earning more profits than the normal rate of return on its capital the new partner is required to contribute some additional amount known as premium or goodwill. This is done primarily to compensate the existing partners for loss of their share in super profits of the firm.

Following are the other important points which require attention at the time of admission of a new partner:

1. New profit sharing ratio;
2. Sacrificing ratio;
3. Valuation and adjustment of goodwill;
4. Revaluation of assets and Reassessment of liabilities;
5. Distribution of accumulated profits (reserves); and
6. Adjustment of partners' capitals.

3.3 New Profit Sharing Ratio

When new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the old partners sacrifice a share of their profit in favour of the new partner. But, what will be the share of new partner and how he will acquire it from the existing partners is decided mutually among the old partners and the new partner. However, if nothing is specified as to how does the new partner acquire his share from the old partners; it may be assumed that he gets it from them in their profit sharing ratio. In any case, on admission of a new partner, the profit sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing ratio of the incoming partner. Hence, there is a need to ascertain the new profit sharing ratio among all the partners. This depends upon how does the new partner acquires his share from the old partners for which there are many possibilities. Let us understand it with the help of the following illustrations.

Illustration 1

Anil and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for 1/5 share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal and Sumit.

Solution

Sumit's share $= \frac{1}{5}$

Remaining share $= 1-\frac{1}{5} = \frac{4}{5}$

Anil's new share $= \frac{3}{5}$ of $\frac{4}{5} = \frac{12}{25}$

Vishal's new share $= \frac{2}{5}$ of $\frac{4}{5} = \frac{8}{25}$

New profit sharing ratio of Anil, Vishal and Sumit will be 12:8:5.

Note: It has been assumed that the new partner acquired his share from old partners in old ratio.

Illustration 2

Akshay and Bharati are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for 1/5th share in the future profits of the firm which he gets equally from Akshay and Bharati. Calculate new profit sharing ratio of Akshay, Bharati and Dinesh.

Solution

Dinesh's share = $\frac{1}{5}$ or $\frac{2}{10}$

Akshay's share = $\frac{3}{5} - \frac{1}{10} = \frac{5}{10}$

Bharati's share = $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

New profit sharing ratio between, Akshay, Bharati and Dinesh will be 5:3:2.

Illustration 3

Anshu and Nitu are partners sharing profits in the ratio of 3:2. They admitted Jyoti as a new partner for 3/10 share which she acquired 2/10 from Anshu and 1/10 from Nitu. Calculate the new profit sharing ratio of Anshu, Nitu and Jyoti.

Solution

Jyoti's share = $\frac{3}{10}$

Ashu's new share = $\frac{3}{5} - \frac{2}{10} = \frac{4}{10}$

Nitu's new share = Old share – Share Surrendered

= $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

The new profit sharing ratio between
Anshu, Nitu and Jyoti will be 4 : 3 : 3.

Illustration 4

Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ghanshyam as a new partner. Ram surrenders 1/4 of his share and Shyam 1/3 of his share in favour of Ghanshyam. Calculate new profit sharing ratio of Ram, Shyam and Ghanshyam.

Solution

Ram's old share	=	$\frac{3}{5}$
Share surrendered by Ram	=	$\frac{1}{4}$ of $\frac{3}{5} = \frac{3}{20}$
Ram's new share	=	$\frac{3}{5} - \frac{3}{20} = \frac{9}{20}$
Shyam's old share	=	$\frac{2}{5}$
Share surrendered by Shyam	=	$\frac{1}{3}$ of $\frac{2}{5} = \frac{2}{15}$
Shyam's new share	=	$\frac{2}{5} - \frac{2}{15} = \frac{4}{15}$
Ghanshyam's new share	=	Ram's sacrifice + Shyam's Sacrifice
	=	$\frac{3}{20} + \frac{2}{15} = \frac{17}{60}$

New profit sharing ratio among Ram, Shyam and Ghanshyam will be 27:16:17

Illustration 5

Das and Sinha are partners in a firm sharing profits in 4:1 ratio. They admitted Pal as a new partner for 1/4 share in the profits, which he acquired wholly from Das. Determine the new profit sharing ratio of the partners.

Solution

Pal's share	=	$\frac{1}{4}$
Das's new share	=	Old Share – Share Surrendered
	=	$\frac{4}{5} - \frac{1}{4} = \frac{11}{20}$
Sinha's new share	=	$\frac{1}{5}$

The new profit sharing ratio among Das, Sinha and Pal will be 11:4:5.

3.4 Sacrificing Ratio

The ratio in which the old partners agree to sacrifice their share of profit in favour of the incoming partner is called sacrificing ratio. The sacrifice by a partner is equal to :

Old Share of Profit – New Share of Profit

As stated earlier, the new partner is required to compensate the old partner's for their loss of share in the super profits of the firm for which he brings in an additional amount known as premium or goodwill. This amount is shared by the existing partners in the ratio in which they forego their shares in favour of the new partner which is called sacrificing ratio.

The ratio is normally clearly given as agreed among the partners which could be the old ratio, equal sacrifice, or a specified ratio. The difficulty arises where the ratio in which the new partner acquires his share from the old partners is not specified. Instead, the new profit sharing ratio is given. In such a situation, the sacrificing ratio is to be worked out by deducting each partner's new share from his old share. Look at the illustrations 6 to 8 and see how sacrificing ratio is calculated in such a situation.

Illustration 6

Rohit and Mohit are partners in a firm sharing profits in the ratio of 5:3. They admit Bijoy as a new partner for 1/7 share in the profit. The new profit sharing ratio will be 4:2:1. Calculate the sacrificing ratio of Rohit and Mohit.

Solution

Rohit's old share $= \frac{5}{8}$

Rohit's new share $= \frac{4}{7}$

Rohit's sacrifice $= \frac{5}{8} - \frac{4}{7} = \frac{3}{56}$

Mohit's old share $= \frac{3}{8}$

Mohit's new share $= \frac{2}{7}$

Mohit's sacrifice $= \frac{3}{8} - \frac{2}{7} = \frac{5}{56}$

Sacrificing ratio among Rohit and Mohit will be 3:5.

Illustration 7

Amar and Bahadur are partners in a firm sharing profits in the ratio of 3:2. They admitted Mary as a new partner for 1/4 share. The new profit sharing ratio between Amar and Bahadur will be 2:1. Calculate their sacrificing ratio.

Solution

Marry's share $= \frac{1}{4}$

Remaining share $= 1 - \frac{1}{4} = \frac{3}{4}$

This 3/4 share is to be shared by Amar and Bahadur in the ratio of 2:1. Therefore,

Amar's new share $= \frac{2}{3}$ of $\frac{3}{4} = \frac{6}{12}$ or $\frac{2}{4}$

Bahadur's new share $= \frac{1}{3}$ of $\frac{3}{4} = \frac{3}{12}$ or $\frac{1}{4}$

New profit sharing ratio of Amar, Bahadur and Mary will be 2:1:1.

Amar's sacrifice $= \frac{3}{5} - \frac{2}{4} = \frac{2}{20}$

Bahadur's sacrifice $= \frac{2}{5} - \frac{1}{4} = \frac{3}{20}$

Sacrificing ratio among Amar and Bahadur will be 2:3.

Illustration 8

Ramesh and Suresh are partners in a firm sharing profits in the ratio of 4:3. They admitted Mohan as a new partner. The profit sharing ratio of Ramesh, Suresh and Mohan will be 2:3:1. Calculate the gain or sacrifice of old partner.

Solution

Ramesh's old share $= \frac{4}{7}$

Ramesh's new share $= \frac{2}{6}$

Ramesh's sacrifice $= \frac{4}{7} - \frac{2}{6} = \frac{10}{42}$

Suresh's new share $= \frac{3}{6}$

Suresh's old share $= \frac{3}{7}$

Suresh's gain $= \frac{3}{6} - \frac{3}{7} = \frac{3}{42}$

Mohan's share $= \frac{1}{6}$ or $\frac{7}{42}$

Ramesh's sacrifice = Suresh's gain+Mohan's gain

$$= \frac{3}{42} + \frac{7}{42} = \frac{10}{42}$$

In this case, the whole sacrifice is by Ramesh.

Test your Understanding - I

1. A and B are partners sharing profits in the ratio of 3:1. They admit C for 1/4 share in the future profits. The new profit sharing ratio will be:

   (a) A $\frac{9}{16}$, B $\frac{3}{16}$, C $\frac{4}{16}$

   (b) A $\frac{8}{16}$, B $\frac{4}{16}$, C $\frac{4}{16}$

   (c) A $\frac{10}{16}$, B $\frac{2}{16}$, C $\frac{4}{16}$

   (d) A $\frac{8}{16}$, B $\frac{9}{16}$, C $\frac{10}{16}$

2. X and Y share profits in the ratio of 3:2. Z was admitted as a partner who sets 1/5 share. New profit sharing ratio, if Z acquires 3/20 from X and 1/20 from Y would be:

   (a) 9 : 7 : 4 (b) 8 : 8 : 4 (c) 6 : 10 : 4 (d) 10 : 6 : 4

3. A and B share profits and losses in the ratio of 3 : 1, C is admitted into partnership for 1/4 share. The sacrificing ratio of A and B is:

   (a) equal (b) 3 : 1 (c) 2 : 1 (d) 3 : 2.

3.5 Goodwill

Goodwill is also one of the special aspects of partnership accounts which requires adjustment (also valuation if not specified) at the time of reconstitution of a firm viz., a change in the profit sharing ratio, the admission of a partner or the retirement or death of a partner.

3.5.1 Meaning of Goodwill

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly set up business. In accounting, the monetary value of such advantage is known as "goodwill".

It is regarded as an intangible asset. In other words, goodwill is the value of the reputation of a firm in respect of the profits expected in future over and above the normal profits. It is generally observed that when a person pays for goodwill, he/she pays for something, which places him in the position of being able to earn super profits as compared to the profit earned by other firms in the same industry.

In simple words, goodwill can be defined as "the present value of a firm's anticipated excess earnings" or as "the capitalised value attached to the differential profit capacity of a business". Thus, goodwill exists only when the firm earns super profits. Any firm that earns normal profits or is incurring losses has no goodwill.

3.5.2 Factors Affecting the Value of Goodwill

The main factors affecting the value of goodwill are as follows:

1. *Nature of business:* A firm that produces high value added products or having a stable demand is able to earn more profits and therefore has more goodwill.
2. *Location:* If the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high.
3. *Efficiency of management:* A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of goodwill will also be high.
4. *Market situation:* The monopoly condition or limited competition enables the concern to earn high profits which leads to higher value of goodwill.
5. *Special advantages:* The firm that enjoys special advantages like import licences, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators, patents, trademarks, etc. enjoy higher value of goodwill.

3.5.3 Need for Valuation of Goodwill

Normally, the need for valuation of goodwill arises at the time of sale of a business. But, in the context of a partnership firm it may also arise in the following circumstances:

1. Change in the profit sharing ratio amongst the existing partners;
2. Admission of new partner;
3. Retirement of a partner;
4. Death of a partner; and
5. Dissolution of a firm involving sale of business as a going concern.
6. Amalgamation of partnership firms.

3.5.4 Methods of Valuation of Goodwill

Since goodwill is an intangible asset it is very difficult to accurately calculate its value. Various methods have been advocated for the valuation of goodwill of a partnership firm. Goodwill calculated by one method may differ from the goodwill calculated by another method. Hence, the method by which goodwill is to be calculated, may be specifically decided between the existing partners and the incoming partner.

The important methods of valuation of goodwill are as follows:

1. Average Profits Method
2. Super Profits Method
3. Capitalisation Method

3.5.4.1 Average Profits Method

Under this method, the goodwill is valued at agreed number of 'years' purchase of the average profits of the past few years. It is based on the assumption that a new business will not be able to earn any profits during the first few years of its operations. Hence, the person who purchases a running business must pay in the form of goodwill a sum which is equal to the profits he is likely to receive for the first few years. The goodwill, therefore, should be calculated by multiplying the past average profits by the number of years during which the anticipated profits are expected to accrue.

For example, if the past average profits of a business works out at Rs. 20,000 and it is expected that such profits are likely to continue for another three years, the value of goodwill will be Rs. 60,000 (Rs. 20,000 × 3),

Illustration 9

The profit for the five years of a firm are as follows – year 2010 Rs. 4,00,000; year 2011 Rs. 3,98,000; year 2012 Rs. 4,50,000; year 2013 Rs. 4,45,000 and year 2014 Rs. 5,00,000. Calculate goodwill of the firm on the basis of 4 years purchase of 5 years average profits.

Solution

Year	*Profit (Rs.)*
2010	4,00,000
2011	3,98,000
2012	4,50,000
2013	4,45,000
2014	5,00,000
Total	**21,93,000**

Average Profit $= \dfrac{\text{Total Profit of Last 5 Years}}{\text{No. of years}} = \text{Rs. } \dfrac{21,93,000}{5} = \text{Rs. } 4,38,600$

Goodwill = Average Profits × No. of years purchased

= Rs. 4,38,600 × 4 = Rs. 17,54,400

The above calculation of goodwill is based on the assumption that no change in the overall situation of profits is expected in the future.

The above illustration is based on simple average. Sometimes, if there exists an increasing on decreasing trend, it is considered to be better to give a higher weightage to the profits to the recent years than those of the earlier years. Hence, it is a advisable to work out weighted average based on specified weights like 1, 2, 3, 4 for respective year's profit. However, weighted average should be used only if specified. (See illustrations 10 and 11).

Illustration 10

The Profits of firm for the five years are as follows:

Year	*Profit (Rs.)*
2011–12	20,000
2012–13	24,000
2013–14	30,000
2014–15	25,000
2015–16	18,000

Calculate the value of goodwill on the basis of three years' purchase of weighted average profits based on weights 1,2,3,4 and 5 respectively.

Solution

Year Ended 31st March	*Profit (Rs.)*	*Weight*	*Product*
2011–12	20,000	1	20,000
2012–13	24,000	2	48,000
2013–14	30,000	3	90,000
2014–15	25,000	4	1,00,000
2015–16	18,000	5	90,000
		15	3,48,000

Weighted Average Profit = Rs. $\frac{3,48,000}{15}$ = Rs. 23,200

Goodwill = Rs. 23,200 × 3 = Rs. 69,600

Illustration 11

Calculate goodwill of a firm on the basis of three year' purchase of the weighted average profits of the last four years. The profit of the last four years were: 2012 Rs. 20,200; 2013 Rs. 24,800; 2014 Rs. 20,000 and 2015 Rs. 30,000. The weights assigned to each year are : 2012 – 1; 2013 – 2; 2014 – 3 and 2015 – 4.
You are supplied the following information:

1. On September 1, 2014 a major plant repair was undertaken for Rs. 6,000, which was charged to revenue. The said sum is to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on reducing balance method.
2. The Closing Stock for the year 2013 was overvalued by Rs. 2,400.
3. To cover management cost an annual charge of Rs. 4,800 should be made for purpose of goodwill valuation.

Solution

Calculation of Adjusted Profit	*2012 Rs.*	*2013 Rs.*	*2014 Rs.*	*2015 Rs.*
Given Profits *Less:* Management Cost	20,200 4,800	24,800 4,800	20,000 4,800	30,000 4,800
Add: Capital Expenditure Charged to Revenue	15,400 -	20,000 -	15,200 6,000	25,200 -
 Less: Unprovided Depreciation	15,400 -	20,000 -	21,200 200	25,200 580
 Less: over valuation of Closing Stock	15,400 -	20,000 2,400	21,000 -	24,620 -
 Add: over value of opening stock	15,400 -	17,600 -	21,000 2,400	24,620 -
Adjusted Profits	**15,400**	**17,600**	**23,400**	**24,620**

Calculation of weighted average profits:

(Rs.)

Year	*Profit*	*Weight*	*Product*
2012	15,400	1	15,400
2013	17,600	2	35,200
2014	23,400	3	70,200
2015	24,620	4	98,480
Total		**10**	**2,19,280**

Weight Average Profit $= \text{Rs.} \dfrac{2{,}19{,}280}{10} = \text{Rs. } 21{,}928$

Goodwill = Rs. 21,928 × 3 = Rs. 65,784

Notes to Solution

(i) Depreciation of 2005 = 10% of Rs. 6000 for 4 months
= Rs. 6000 × 10/100 × 4/12 = Rs. 200

(ii) Depreciation of 2006 = 10% of Rs. 6000 – Rs. 200 for one year
= Rs. 5800 × 10/100 + Rs. 580

(iii) Closing Stock of 2004 will become opening stock for the year 2005.

3.5.4.2 Super Profits Method

The basic assumption in the average profits (simple or weighted) method of calculating goodwill is that if a new business is set up, it will not be able to earn any profits during the first few years of its operations. Hence, the person who purchases an existing business has to pay in the form of goodwill a sum equal to the total profits he is likely to receive for the first 'few years'. But it is contended that the buyer's real benefit does not lie in total profits; it is limited to such amounts of profits which are in excess of the normal return on capital employed in similar business. Therefore, it is desirable to value, goodwill on the basis of the excess profits and not the actual profits. The excess of actual profits over the normal profits is termed as super profits.

$$\text{Normal Profit} = \frac{\text{Capital Employed} \times \text{Normal Rate of Return}}{100}$$

Suppose an existing firm earns Rs. 18,000 on the capital of Rs. 1,50,000 and the normal rate of return is 10%. The Normal profits will work out at Rs. 15,000 (1,50,000 × 10/100). The super profits in this case will be Rs. 3,000 (Rs. 18,000 – 15,000). The goodwill under the super profit method is ascertained by multiplying the super profits by certain number of years' purchase. If, in the above example, it is expected that the benefit of super profits is likely to be available for 5 years in future, the goodwill will be valued at Rs. 15,000 (3,000 × 5). Thus, the steps involved under the method are:

1. Calculate the average profit,
2. Calculate the normal profit on the capital employed on the basis of the normal rate of return,
3. Calculate the super profits by deducting normal profit from the average profits, and
4. Calculate goodwill by multiplying the super profits by the given number of years' purchase.

Illustration 12

The books of a business showed that the capital employed on December 31, 2014, Rs. 5,00,000 and the profits for the last five years were: 2010–Rs. 40,000: 2011-Rs. 50,000; 2012-Rs. 55,000; 2013-Rs.70,000 and 2014-Rs. 85,000. You are required to find out the value of goodwill based on 3 years purchase of the super profits of the business, given that the normal rate of return is 10%.

Solution

$$\text{Normal Profits} = \frac{\text{Capital Employed} \times \text{Normal Rate of Return}}{100}$$

$$= \text{Rs. } \frac{5,00,000 \times 10}{100} = \text{Rs. } 50,000$$

Average Profits:

Year	*Profit (Rs.)*
2010	40,000
2011	50,000
2012	55,000
2013	70,000
2014	85,000
Total	**3,00,000**

Average Profits = Rs. 3,00,000/5 = Rs. 60,000
Super Profit = Rs. 60,000 – Rs. 50,000 = Rs. 10,000
Goodwill = Rs. 10,000 × 3 = Rs. 30,000

Illustration 13

The capital of the firm of Anu and Benu is Rs. 1,00,000 and the market rate of interest is 15%. Annual salary to partners is Rs. 6,000 each. The profits for the last 3 years were Rs. 30,000; Rs. 36,000 and Rs. 42,000. Goodwill is to be valued at 2 years purchase of the last 3 years' average super profits. Calculate the goodwill of the firm.

Solution

Interest on capital $= 1,00,000 \times \frac{15}{100}$ = Rs. 15,000............(i)

Add: partner's salary = Rs. $6,000 \times 2$ = Rs. 12,000............(ii)

Normal Profit(i+ii) = Rs. 27,000

Average Profit = Rs. 30,000+Rs.36,000+Rs.42,000 = Rs. $\frac{1,08,000}{3}$

= Rs. 36,000

Super Profit = Average Profit–Normal Profit

= Rs. 36,000–Rs. 27,000

= Rs. 9,000

Goodwill = Super Profit × No of years' purchase

= Rs. 9,000 × 2

= Rs. 18,000

3.5.4.3 Capitalisation Methods

Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

(a) *Capitalisation of Average Profits:* Under this method, the value of goodwill is ascertained by deducting the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return. This involves the following steps:

(i) Ascertain the average profits based on the past few years' performance.

(ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:

Average Profits × 100/Normal Rate of Return

(iii) Ascertain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).

Capital Employed = Total Assets (excluding goodwill) – Outside Liabilities

(iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e. (ii) – (iii).

Illustration 14

A business has earned average profits of Rs. 1,00,000 during the last few years and the normal rate of return in a similar business is 10%. Ascertain the value of goodwill by capitalisation average profits method, given that the value of net assets of the business is Rs. 8,20,000.

Solution

Capitalised Value of Average Profits

Rs. $\frac{1,00,000 \times 100}{10}$ = Rs. 10,00,000

Goodwill = Capitalised value – Net Assets
= Rs. 10,00,000 – Rs. 8,20,000
= Rs.1,80,000

(b) *Capitalisation of Super Profits:* Goodwill can also be ascertained by capitalising the super profit directly. Under this method there is no need to work out the capitalised value of average profits. It involves the following steps.

(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.
(ii) Calculate normal profits on capital employed.
(iii) Calculate average profit for past years, as specified.
(ii) Calculate super profits by deducting normal profits from average profits.
(iii) Multiply the super profits by the required rate of return multiplier, that is,

Goodwill = Super Profits × 100 Normal Rate of Return

In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

For example, using the data given in illustration 14 where the average profits are Rs. 1,00,000 and the normal profits are Rs. 82,000 (10% of Rs. 8,20,000), the super profits worked out as Rs. 18,000 (Rs. 1,00,000 – Rs. 82,000), the goodwill will be Rs. 18,000 × $\frac{100}{10}$ = Rs. 1,80,000.

Illustration 15

1. The goodwill of a firm is to be worked out at three years' purchase of the average profits of the last five years which are as follows:

Years	*Profits (Loss) (Rs.)*
2012	10,000
2013	15,000
2014	4,000
2015	(5,000)
2016	6,000

2. The capital employed of the firm is Rs. 1,00,000 and normal rate of return is 8%, the average profits for last 5 years are Rs. 12,000 and goodwill is to be worked out at 3 years' purchase of super profits,
3. Rama Brothers earn an average profit of Rs. 30,000 with a capital of Rs. 2,00,000. The normal rate of return in the business is 10%. Using capitalisation of super profits method work out the value the goodwill of the firm.

Solution

1. Total Profits = Rs. 10,000 + Rs. 15,000 + Rs. 4,000 + Rs. 6,000 – Rs. 5,000 = Rs. 30,000

   Average Profits = Rs. 30,000/5 = Rs. 6,000

   Goodwill = Average Profits × 3 = Rs. 6,000 × 3 = Rs.18,000
2. Average Profit = Rs. 12,000

   Normal Profit $= \text{Rs.}1{,}00{,}000 \times \dfrac{8}{100} = \text{Rs. } 8{,}000$

   Super Profit=Average Profit – Normal profit = Rs. 12,000 – Rs. 8,000 = Rs. 4,000

   Goodwill=Super Profit × 3 = Rs. 4,000 × 3 = Rs. 12,000
3. Normal Profit= Rs. 2,00,000 × 10/100 = Rs. 20,000

   Super Profit = Average Profit – Normal Profit = Rs. 30,000 – Rs. 20,000 = Rs. 10,000

   Goodwill=Super Profit × 100/Normal Rate of Return

   = 10,000 × 100/10 = Rs. 1,00,000.

3.5.5 Treatment of Goodwill

As stated earlier, the incoming partner who acquires his share in the profits of the firm from the existing partners brings in some additional amount to compensate them for loss of their share in super profits. It is termed as his share of goodwill (also called premium). Alternatively he may agree that goodwill account be raised in the books of the firm by giving the necessary credit to the old partners. Thus, when a new partner is admitted, goodwill can be treated in two ways: (1) By Premium Method, and (2) By Revaluation Method.

3.5.5.1 Premium Method

This method is followed when the new partner pays his share of goodwill in cash. The amount of premium brought in by the new partner is shared by the existing partners in their ratio of sacrifice. If this amount is paid to the old partners directly (privately) by the new partner, no entry is made in the books of the firm. But, when the amount is paid through the firm, which is generally the case, the following journal entries are passed:

(i)	Cash A/c To Goodwill A/c (Amount brought by new partner as premium)	Dr.		
(ii)	Goodwill A/c To Existing Partners Capital A/c (Individually) (Goodwill distributed among the existing partners in their sacrificing ratio)	Dr.		

Alternatively, it is credited to the new partner's capital account and then adjusted in favour of the existing partners in their sacrificing ratio. In that case the journal entries will be as follows:

(i)	Cash A/c To New Partner's Capital A/c (Amount brought by new partner for his share of goodwill)	Dr.		
(ii)	New Partner's Capital A/c To Existing Partner's Capital A/cs (Individually) (Goodwill brought by new partners distributed among the existing partners in their sacrificing ratio)	Dr.		

If the partners decide that the amount of premium credited to their capital accounts should be retained in business, there is no need to pass any additional entry. If, however, they decide to withdraw their amounts, (in full or in part) the following additional entry will be passed:

Existing Partner's Capital A/c (Individually) Dr.
To Cash A/c
(The amount of goodwill withdrawn by the existing partners)

Illustration 16

Sunil and Dalip are partners in a firm sharing profits and losses in the ratio of 5:3. Sachin is admitted in the firm for 1/5 share of profits. He is to bring in Rs. 20,000 as capital and Rs. 4,000 as his share of goodwill. Give the necessary journal entries,

(a) When the amount of goodwill is retained in the business.
(b) When the amount of goodwill is fully withdrawn.
(c) When 50% of the amount of goodwill is fully withdrawn.

Solution

(a) When the amount of goodwill credited to existing partners is retained in business

Books of Sunil and Dalip
Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
(i)	Cash A/c	Dr.		24,000	
	To Sachin's Capital A/c				20,000
	To Goodwill A/c				4,000
	(The amount brought in by Sachin as Capital and Goodwill)				
(ii)	Goodwill A/c	Dr.		4,000	
	To Sunil's Capital A/c				2,500
	To Dalip's Capital A/c				1,500
	(Goodwill transferred to Sunil and Dalip in the ratio of 5:3)				

Alternatively, if the goodwill account is not be the brought into the books of accounts the following entries will be recorded:

(i)	Cash A/C	Dr.	24,000	
	To Sachin's Capital A/c			24,000
(ii)	Sachin's Capital A/c	Dr	4,000	
	To Sunil's Capital A/c			2,500
	To Dalip's Capital A/c			1,500

Note: It assumed that the sacrificing ratio is the same as old profit sharing ratio.

(b) When the amount of goodwill credited to existing partners is fully withdrawn.

Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
1.	Same as in (a) above				
2.	Same as in (a) above,				
3.	Sunil's Capital A/c	Dr.		2,500	
	Dalip's Capital A/c	Dr.		1,500	
	To Cash A/c				4,000
	(Cash withdrawn by Sunil and Dalip equal to their share of goodwill)				

(c) When 50% of the amount of goodwill credited to existing partners is withdrawn.

Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
1.	Same as in (a) above,				
2.	Same as in (a) above				
3.	Sunil's Capital A/c	Dr.		1,250	
	Dalip's Capital A/c	Dr.		750	
	To Cash A/c				2,000
	(Cash withdrawn for 50% of their share of goodwill)				

Illustration 17

Vijay and Sanjay are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Ajay into partnership with 1/4 share in profits. Ajay brings in Rs. 30,000 for capital and the requisite amount of premium in cash. The goodwill of the firm is valued at Rs. 20,000. The new profit sharing ratio is 2:1:1. Vijay and Sanjay withdraw their share of goodwill. Give necessary journal entries.

Solution

(a) Ajay will bring Rs. 5,000 (1/4 of Rs. 20,000) as his share of goodwill (premium)

(b) Sacrificing Ratio is 2:3 as calculated below:
For Vijay, old ratio is 3/5 and the new ratio is 2/4, hence, his sacrificing ratio is

$$= \frac{3}{5} - \frac{2}{4} = \frac{12 - 10}{20} = \frac{2}{20}$$

For Sanjay, old ratio is 2/5 and the new ratio is 1/4, hence, his sacrificing ratio is $= \frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$

Books of Vijay and Sanjay
Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
1.	Cash A/c	Dr.		35,000	
	To Ajay's Capital A/c				30,000
	To Goodwill A/c				5,000
	(The amount of capital and goodwill brought by Ajay)				
2.	Goodwill A/c	Dr.		5,000	
	To Vijay's Capital A/c				2,000
	To Sanjay's Capital A/c				3,000
	(the amount of goodwill brought by Ajay shared by Vijay and Sanjay in their sacrificing ratio)				
3.	Vijay's Capital A/c	Dr.		2,000	
	Sanjay's Capital A/c	Dr.		3,000	
	To Cash A/c				5,000
	(Cash withdrawn by Vijay and Sanjay for their share of goodwill)				

Note: Alternatively, journal entries (1) and (2) could be as follows:

Books of Vijay and Sanjay
Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1.	Cash A/c Dr. To Ajay's Capital A/c (Ajay brought in Rs. 30,000 for capital and Rs. 5,000 as goodwill)		35,000	 35,000
2.	Ajay's Capital A/c Dr. To Vijay's Capital A/c To Sanjay's Capital A/c (Amount of goodwill brought in by Ajay shared by Vijay and Sanjay in their sacrificing in the ratio of 2:3)		5,000	 2.000 3,000

When goodwill already exists in books: The above treatment of goodwill was based on the assumption that there was no goodwill account in the books of the firm. However, It is quite possible that when a new partner brings in his share of goodwill in cash, some amount of goodwill already exists in books. In that case, after crediting the old partners by the amount of goodwill brought in by the new partner, the existing goodwill must be written off by debiting the old partners in their old profit sharing ratio. But, if it is decided that the goodwill may continue to appear in the books at its old value, the amount to be brought in by new partner will have to be proportionately reduced i.e., He will be required to bring cash only for this share of the excess of the agreed value of goodwill over the amount of goodwill already appearing in books. For example,

In illustration 17, the goodwill of the firm is valued at Rs. 20,000 and Ajay who is admitted to 1/4 share in its profits, brings in Rs. 5,000 as his share of goodwill. Suppose, goodwill already appeared in books at Rs. 10,000 and there is no decision to retain it. In that case, after crediting Vijay and Sanjay for the amount of goodwill brought in by Ajay, the following additional journal entry shall be recorded for writing off the existing amount of goodwill.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
	Vijay's Capital A/c Dr. Sanjay's Capital A/c Dr. To Goodwill A/c (Goodwill written-off in old ratio)		6,000 4,000	 10,000

In case, however, the partners decide to maintain the Goodwill Account as it is, the new partner is required to bring in as his share of goodwill only in respect of the difference between its total value and the book value. In other words, Ajay will be required to bring in Rs. 2,500 only [1/4 of Rs. 10,000 (Rs 20,000 – Rs. 10,000)]. Which will be credited to old partners in their sacrificing ratio, and no entry will be recorded for writing off the existing amount of goodwill.

Illustration 18

Srikant and Raman are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Venkat into partnership with 1/3 share in the profits. Venkat brings in Rs 30,000 as his capital. He also promises to bring in the necessary amount for his share of goodwill. On the date of admission, the goodwill has been valued at Rs 24,000 and the goodwill account already appears in the books at Rs 12,000. Venkat brings in the necessary amount for his share of goodwill and agrees that the existing goodwill account be written off.

Record the necessary journal entries in the books of the firm.

Solution

Books of Srikant and Raman
Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
1.	Cash A/c	Dr.		38,000	
	To Venkat's Capital A/c				30,000
	To Goodwill A/c				8,000
	(Amount brought in by Venkat as his capital and his share of goodwill)				
2.	Goodwill A/c	Dr.		8,000	
	To Srikant's Capital A/c				4,800
	To Raman's Capital A/c				3,200
	(Goodwill brought in by Venkat shared by old partners in their ratio of sacrifice)				
3.	Srikant's Capital A/c	Dr.		7,200	
	Raman's Capital A/c	Dr.		4,800	
	To Goodwill A/c				12,000
	(Goodwill already appearing in books written-off in the old ratio)				

Note: Since nothing is given about the ratio in which the new partner acquires his share of profit from Srikant and Raman, it is implied that they sacrifice their share of profit in favour of Venkat in the old ratio i.e., 3:2.

3.5.5.2 Revaluation Method

This method is followed when the new partner does not bring in his share of goodwill in cash. In such a situation, the goodwill account is raised in the books of account by crediting the old partners in the old profit sharing ratio. When goodwill account is to be raised in the books of account there are two possibilities,

(a) No goodwill appears in books at the time of admission, and
(b) Goodwill already exists in books at the time of admission.

(a) When no goodwill exists in the books: When no goodwill exists in the books at the time of the admission of a new partner, the goodwill account must be raised at its full value. This can be done by debiting goodwill account with its full value and crediting the old partners' capital accounts in their profit sharing ratio. The journal entry will be:

Goodwill A/c Dr.
To Old Partners' Capitals A/c (individually)
(Goodwill raised at full value in the old ratio)

The goodwill thus raised shall appear in the balance sheet of the firm at its full value.

Illustration 19

Ahuja and Barua are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Chaudhary into partnership for 1/5 share of profits, which he acquires equally from Ahuja and Barua. Goodwill is valued at Rs. 30,000. Chaudhary brings in Rs. 16,000 as his capital but is not in a position to bring any amount for goodwill. No goodwill account exists in books of the firm. Goodwill account is to be raised at full value. Record the necessary journal entries.

Solution

Book of Ahuja and Barua
Journal

Date	*Particulars*	*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
1.	Cash A/c Dr. To Chaudhary's Capital A/c (Amount brought for capital)		16,000	 16,000
2.	Goodwill A/c Dr. To Ahuja's Capital A/c To Barua's Capital A/c (Goodwill raised at full value in old ratio)		30,000	 18,000 12,000

Note: Goodwill shall appear in the balance sheet at Rs. 30,000

Sometimes, a partner may bring in a part of his share of goodwill. In such a situation, after distributing the amount brought in for goodwill among the old partners in their sacrificing ratio, the goodwill account is raised in the books based on the portion of premium not brought by the new partner. For example, Pooja and Sandeep are partners sharing profits in ratio of 3:3. They admit Tushar as a new partner for $\frac{1}{3}$ share in profits. Tushar is to bring in Rs. 30,000 as his share of goodwill as the total value of goodwill is estimated at Rs. 90,000. But he brings Rs. 15,000 only (half of what is due) on this account. In this case, after due credit for Rs. 15,000 to Pooja's and Sandeep's capital accounts in their sacricifing ratio, goodwill account will be raised by Rs. 45,000 (half of its total value) by crediting their old profit sharing ratio.

(b) When goodwill already exists in the books : If the books already show some balance in the Goodwill Account, the adjustment for goodwill in the old partner's capital accounts shall be made only for the difference between the agreed value of goodwill and the amount of goodwill appearing in books.

The amount of goodwill appearing in the books may be less than its agreed value or it may be more than the agreed value. If it is less than the agreed value, the difference between the agreed value of goodwill and the amount of goodwill appearing in the books will be debited to goodwill account and credited to old partner's capital accounts in their old profit sharing ratio. If, however, it is more than the agreed value, the difference will be debited to the old partners' capital accounts in their old profits sharing ratio and credited to the goodwill account. Thus, the journal entries will be as under:

(a) When the value of goodwill appearing in the books is less than the agreed value.

Goodwill A/c Dr.
To Old Partners' Capital A/c (individually)
(Goodwill raised to its agreed value)

(b) When the value of goodwill appearing in the books is more than the agreed value.

Old Partners' Capital A/c (individually) Dr.
To Goodwill A/c
(Goodwill brought down to its agreed value)

Illustration 20

Ram and Rahim are partners in a firm sharing profits and losses in the ratio of 3:2. Rahul is admitted into partnership for 1/3 share in profits. He brings in Rs. 10,000 as capital, but is not in a position to bring any amount for his share of goodwill which has been valued at Rs. 30,000. Give necessary journal entries under each of the following situations:

(a) When there is no goodwill appearing in the books of the firm;
(b) When the goodwill appears at Rs 15,000 in the books of the firm; and
(c) When the goodwill appears at Rs. 36,000 in the books of the firm.

Solution

(a) When no goodwill appears in the books

Books of Ram and Rahim
Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
	Cash A/c	Dr.		10,000	
	To Rahul's Capital A/c				10,000
	(Amount brought by Rahul as Capital)				
	Goodwill A/c	Dr.		30,000	
	To Ram's Capital A/c				18,000
	To Rahim's Capital A/c				12,000
	(Goodwill raised at full value in the old profit sharing ratio)				

(b) When goodwill appears in the books at Rs 15,000

Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
	Cash A/c	Dr.		10,000	
	To Rahul's Capital A/c				10,000
	(Amount brought by Rahul as capital)				
	Goodwill	Dr.		15,000	
	To Ram's Capital A/c				9,000
	To Rahim's Capital A/c				6,000
	(Goodwill raised to its agree value)				

(c) When the goodwill appears in the books at Rs 36,000

Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
	Cash A/c	Dr.		10,000	
	To Rahul's Capital				10,000
	(Amount brought by Rahul as capital)				
	Ram's Capital A/c	Dr.		3,600	
	Rahim's Capital A/c	Dr.		2,400	
	To Goodwill A/c				6,000
	(Goodwill brought down to its agreed vlaue)				

Normally, when goodwill is raised in the books of the firm, it will be shown in the balance sheet at its agreed value. If, however, the partners decide that after necessary adjustments have been made in the old partners' capital accounts, the goodwill should not appear in the firm's balance sheet, then it has to be written off. This is done by crediting the goodwill account and debiting the capital accounts of all the partners (including the new partner) in the new profit sharing ratio. The net effect of such treatment will be that the new partner's capital account stands debited to the extent of his share of goodwill and the old partners capital accounts credited in the ratio of their sacrifice, and the goodwill shows nil balance.

Illustration 21

A and B are partners sharing profits and losses equally. They admit C into partnership and the new ratio is fixed as 4:3:2. C is unable to bring anything for goodwill but brings Rs 25,000 as capital. Goodwill of the firm is valued at Rs 18,000. Give the necessary journal entries assuming that the partners do not want goodwill to appear in the Balance Sheet.

Solution

Books of A and B
Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
	Cash A/c	Dr.		25,000	
	To C's Capital A/c				25,000
	(Cash brought in by C as Capital)				
	Goodwill			18,000	
	To A's Capital A/c				9,000
	To B's Capital A/c				9,000
	(Goodwill raised at its full value)				
	A's Capital A/c	Dr.		8,000	
	B's Capital A/c	Dr.		6,000	
	C's Capital A/c	Dr.		4,000	
	To Goodwill A/c				18,000
	(Goodwill written-off)				

The net effect of the entries (2) and (3) above is that C's Capital account has been debited by Rs. 4,000 and A's Capital account and B's Capital account credited in their sacrificing ratio by Rs 1,000 (credit Rs 9,000 – debit Rs 8,000) and Rs 3,000 (credit Rs 9,000 – debit Rs 6,000) respectively, and goodwill will show nil balance.

Sometimes, the partners may decide not to show goodwill account anywhere in books (not even in the journal and ledger). In that case, for adjustment of goodwill, just one entry can be passed by debiting the new partner's capital account with his share of goodwill and crediting the old partners' capital accounts in their ratio of sacrifice. If in Illustration 21 we were to treat goodwill in this manner, the entry for goodwill would have been as follows:

Date	*Particulars*	*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
	C's Capital A/c Dr.		4,000	
	To A's Capital A/c			1,000
	To B's Capital A/c			3,000
	(Adjustment for C's share of goodwill)			

The above entry has the same effect on partners' capital accounts as journal entries (2) and (3).

Box I

Accounting standard 10 (AS–10) on "Accounting for Fixed Assets" in its Para 16 states that Goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable either in cash or in shares or otherwise) which is excess of the net assets taken over, the excess is termed as goodwill'. Goodwill arises from business connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise.

As a matter of financial prudence, goodwill is written off over a period. However, many enterprises do not write off goodwill and retain it as an asset.

In view of the provision in para 16 of the Accounting Standard 10 (AS-10), some experts feel that in case of admission, retirement or death of a partner or a change in profit sharing ratio among the partners, goodwill cannot be raised in the books of the firm, and all entries relating to goodwill on such occasions should be recorded in books of the firm directly through the partners' capital accounts only. This is stretching the interpretation of AS–10 too far. What this accounting standard implies is that **normally goodwill should not be brought into books unless it is paid for, and whenever it is recorded it should be written- off over a period.** Hence, crediting goodwill account with the amount brought in by the incoming partner for his share of goodwill and then transferring it to old partners' capital accounts by debiting goodwill account is quite in order. Similarly, when the incoming partner is unable to bring in the necessary amount for his share of goodwill, raising goodwill account at its agreed value by crediting the old partners in then old profit sharing ratio and then writing it off immediately by debiting it to all the partners (including the new partner) in the new profit sharing ratio is also acceptable as effectively it is tent amount to purchase of goodwill because new partner's capital account balance stands reduced by his share of goodwill. The same logic equally implies to the adjustments made for raising the goodwill account to its goodwill account when it already appears in the balance sheet. What is important is that in the normal course of raising goodwill as an asset should be avoided of and, if and when it is brought in to books, it should be written off in the shortest possible period.

Test your Understanding – II

Choose the correct alternative –

1. At the time of admission of a new partner, general reserve appearing in the old balance sheet is transferred to:
   (a) all partner's capital account
   (b) new partner's capital account
   (c) old partner's capital account
   (d) none of the above.
2. Asha and Nisha are partner's sharing profit in the ratio of 2:1. Asha's son Ashish was admitted for 1/4 share of which 1/8 was gifted by Asha to her son. The remaining was contributed by Nisha. Goodwill of the firm in valued at Rs. 40,000. How much of the goodwill will be credited to the old partner's capital account.
   (a) Rs. 2,500 each
   (b) Rs. 5,000 each
   (c) Rs. 20,000 each
   (d) None of the above.
3. A, B and C are partner's in a firm. If D is admitted as a new partner:
   (a) old firm is dissolved
   (b) old firm and old partnership is dissolved
   (c) old partnership is reconstituted
   (d) None of the above.
4. On the admission of a new partner increase in the value of assets is debited to:
   (a) Profit and Loss Adjustment account
   (b) Assets account
   (c) Old partner's capital account
   (d) None of the above.
5. At the time of admission of a partner, undistributed profits appearing in the balance sheet of the old firm is transferred to the capital account of:
   (a) old partners in old profit sharing ratio
   (b) old partners in new profit sharing ratio
   (c) all the partner in the new profit sharing ratio.

3.5.5.3 Hidden Goodwill

Sometimes the value of goodwill is not given at the time of admission of a new partner. In such a situation it has to be inferred from the arrangement of the capital and profit sharing ratio. Suppose, A and B are partners sharing profits equally with capitals of Rs. 45,000 each. They admitted C as a new partner for one-third share in the profit. C brings in Rs. 60,000 as his capital. Based on the amount brought in by C and his share in profit, the total capital of the newly constituted firm works out to be Rs.1,80,000 (Rs. 60,000 × 3). But the actual total capital of A, B and C works out as Rs. 1,50,000 (Rs. 45,000 + Rs. 45,000 + Rs. 60,000). Hence, it can be inferred that the difference is on account of goodwill i.e., Rs. 30,000 (Rs. 1,80,000 – Rs. 1,50,000). Which is to be shared equally (old ratio) by A and B. This shall raise their capital accounts to Rs. 60,000 each and total capital of the firm to Rs. 1,80,000. Alternatively, if goodwill account is not to be raised, C's capital account can be debited by Rs. 10,000 (his share of goodwill) and A and B's Capital accounts credited by Rs. 5,000 each, and firm's total capital remains Rs. 50,000.

Illustration 22

Hem and Nem are partners in a firm sharing profits in the ratio of 3:2. Their capitals were Rs. 80,000 and Rs. 50,000 respectively. They admitted Sam on Jan. 1, 2007 as a new partner for 1/5 share in the future profits. Sam brought Rs. 60,000 as his capital. Calculate the value of goodwill of the firm and record necessary journal entries on Sam's admission.

Solution

Value of Firm's Goodwill

Sam's capital = Rs. 60,000

Sam's share = $\frac{1}{5}$

Total capital of new firm = $5 \times$ Rs.60,000 = Rs. 3,00,000

Hem's+Nem's+Sam's = Rs.80,000 + Rs. 50,000 + Rs.60,000
= Rs.1,90,000

Goodwill of the firm = Rs.1,10,000 (Rs. 3,00,000 – Rs.1,90,000)

Sam's share = $\frac{1}{5} \times$ Rs.1,10,000 = Rs. 22,000

Books of Hem, Nem and Sam
Journal

Date 2007	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
1.	Bank A/c Dr. To Sam's Capital A/c (Cash brought by Sam for his capital)		60,000	 60,000

2.	Goodwill A/c Dr.		1,10,000	
	To Hem's Capital A/c			66,000
	To Nem's Capital A/c			44,000
	(Credit given for goodwill to Hem and Nem on Sam's admission)			

Alternatively, if goodwill account is not to be raised, the second journal entry passed for goodwill shall be as fallows.

	Sam's Capital A/c Dr.		22,000	
	To Hem's Capital A/c			13,200
	To Nem's Capital A/c			8,800

Do It Yourself

1. A firm's profits for the last three years are Rs. 5,00,000; Rs. 4,00,000 and Rs. 6,00,000. Calculate value of firm's goodwill on the basis of four years' purchase of the average profits for the last three years. (**Ans :** Rs. 20,00,000)
2. A firm's profits for the last five years were Rs. 20,000, Rs. 30,000, Rs. 40,000, Rs. 50,000 and Rs. 60,000. Calculate the value of firm's goodwill on the basis of three years' purchase of weighted average profits after using weight of 1,2,3,4 and 5 respectively.
3. A firm's profits during 2013, 2014, 2015 and 2016 were Rs. 16,000; Rs. 20,000; Rs. 24,000 and Rs. 32,000 respectively. The firm has capital investment of Rs. 1,00,000. A fair rate of return on investment is 18% p.a. Compute goodwill based on three years' purchase of the average super profits for the last four years. (**Ans :** Rs. 15,000)
4. Based on the data given in the above question, calculate goodwill by capitalisation of super profits method. Will the amount of goodwill be different if it is computed by capitalisation of average profits? Confirm your answer by numerical verification.
5. Giri and Shanta are partners in a firm sharing profits equally. They admit Kachroo into partnership who, in addition to capital, brings Rs. 20,000 as goodwill for 1/5th share of profits in the firm. What shall be journal entries if:
   (a) no goodwill appears in the books of the firm.
   (b) goodwill appears in the books of the firm at Rs. 40,000.
6. A and B are partners in a firm sharing profits in the ratio of 3:2. They admit C into partnership for 1/5th share of profits in the firm. The goodwill of the firm is valued at Rs. 1,00,000. He is unable to bring in his share of goodwill. What will be the journal entries if:
   (a) Goodwill is raised at full value and then written off.
   (b) Goodwill is not raised.

3.6 Adjustment for Accumulated Profits and Losses

Sometimes a firm may have accumulated profits not yet transferred to capital accounts of the partners. These are usually in the firm of general reserve, reserve fund and/or Profit and Loss Account balance. The new partner is not entitled to have any share in such accumulated profits. These are distributed among the partners by transferring it to their capital accounts in old profit sharing ratio. Similarly, if there are some accumulated losses in the form of a debit balance of profit and loss account appearing in the balance sheet of the firm.

A remote possibility, the same should also be transferred to the old partners' capital accounts (see Illustration 23).

Illustration 23

Rajinder and Surinder are partners in a firm sharing profits in the ratio of 4:1. On April 15, 2015 they admit Narender as a new partner. On that date there was a balance of Rs. 20,000 in general reserve and a debit balance of Rs. 10,000 in the profit and loss account of the firm. Pass necessary journal entries regarding adjustment of a accumulate a profit or loss.

Solution

Books of Rajinder,Surinder and Narender
Journal

Date 2015	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Apr.15	General Reserve A/c	Dr.		20,000	
	To Rajinder's capital A/c				16,000
	To Surender's capital A/c				4,000
	(General Reserve balance transferred to the capital account of Rajinder and Surinder on Narender's admission)				
	Rajinder's Capital A/c	Dr.		8,000	
	Surender's Capital A/c	Dr.		2,000	
	To Profit and Loss A/c				10,000
	(Debit balance of Profit and Loss A/c transferred to old partners' capital accounts)				

3.7 Revaluation of Assets and Reassessment of Liabilities

At the time of admission of a new partner, it is always desirable to ascertain whether the assets of the firm are shown in books at their current values. In case the assets are overstated or understated, these are revalued. Similarly, a reassessment of the liabilities is also done so that these are brought in the books at their correct values. At times there may also be some unrecorded assets and liabilities of the firm. These also have to be brought into the books of the firm. For this purpose the firm has to prepare the Revaluation Account. The gain or loss on revaluation of each asset and liability is transferred to this account and finally its balance is transferred to the capital accounts of the old partners in their old profit sharing ratio. In other words, the revaluation account is credited with increase in the value of each asset and decrease in its liabilities because it is a gain and is debited with decrease in the value of assets and increase in its liabilities is debited to revaluation account because it is a loss. Similarly unrecorded assets are credited and unrecorded liabilities are debited to the revaluation account. If the revaluation account finally shows a credit balance then it indicates net gain and if there is a debit balance then it indicates net loss. Which will be transferred to the capital accounts of the old partners in old ratio.

The journal entries recorded for revaluation of assets and reassessment of liabilities are as follows:

(i)	For increase in the value of an asset		
	Asset A/c	Dr.	
	To Revaluation A/c		(Gain)
(ii)	For reduction in the value of an asset		
	Revaluation A/c	Dr.	
	To Asset A/c		(Loss)
(iii)	For appreciation in the amount of a liability		
	Revaluation A/c	Dr.	
	To Liability A/c		(Loss)
(iv)	For reduction in the amount of a liability		
	Liability A/c	Dr.	
	To Revaluation A/c		(Gain)
(v)	For an unrecorded asset		
	Cash A/c	Dr.	
	To Revaluation A/c		(Gain)
(vi)	For an unrecorded liability		
	Revaluation A/c	Dr.	
	To Cash A/c		(Loss)
(vii)	For transfer of gain on Revaluation if credit balance		
	Revaluation A/c	Dr.	
	To Old Partners Capital A/cs (individually)		(Old ratio)
(viii)	For transferring loss on revaluation		
	Old partner's Capital A/cs (Individually)	Dr.	(Old ratio)
	To Revaluation A/c		

Note: Entries (i), (ii), (iii) and (iv) are recorded only with the amount increase and decrease in the value of assets and liabilities.

Illustration 24

Following in Balance Sheet of A and B who share profits in the ratio of 3:2.

Balance Sheet of A and B as on April 1, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry creditors		20,000	Cash in hand	3,000
Captials			Debtors	12,000
A	30,000		Stock	15,000
B	20,000	50,000	Furniture	10,000
			Plant and Machinery	30,000
		70,000		**70,000**

On that date C is admitted into the partnership on the following terms:

1. C is to bring in Rs. 15,000 as capital and Rs. 5,000 as premium for goodwill for 1/6 share.
2. The value of stock is reduced by 10% while plant and machinery is appreciated by 10%.
3. Furniture is revalued at Rs. 9,000.
4. A provision for doubtful debts is to be created on sundry debtors at 5% and Rs. 200 is to be provided for an electricity bill.
5. Investment worth Rs. 1,000 (not mentioned in the balance sheet) is to be taken into account.
6. A creditor of Rs. 100 is not likely to claim his money and is to be written off.

Record journal entries and prepare revaluation account and capital account of partners.

Solution

Books of A, B and C
Journal

Date 2015	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
April 01	Bank A/c Dr.		20,000	
	To C's capital account			15,000
	To Goodwill A/c			5,000
	(Cash brought in by C as capital and goodwill/premium)			

02	Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c (Premium divided between A and B in sacrificing ratio 3:2)		5,000	 3,000 2,000
03	Revaluation A/c Dr. To Stock A/c To Furniture To Provision for Doubtful Debt A/c (Revaluation in the value of assets on revaluation)		3,100	 1,500 1,000 600
04	Plant and Machinery A/c Dr. Investment A/c To Revaluation A/c (Increase in the value of assets on revaluation)		3,000 1,000	 4,000
05	Revaluation A/c Dr. To Outstanding Electricity A/c (Amount provided for outstanding electricity bill)		200	 200
06	Sundry Creditors A/c Dr. To Revaluation A/c (Amount not likely to be claimed by the creditors written off)		100	 100
07	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c (Profit on revaluation of assets and re-assessment of liabilities transferred to A and B in old profit sharing ratio)		800	 480 320

Revaluation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Stock	1,500	Plant and Machinery	3,000
Furniture	1,000	Investments	1,000
Provision for Doubtful	600	Sundry Creditors	100
Outstanding Electricity	200		
Profit on Revaluation transferred to:			
A's Capital	480		
B's Capital	320		
	4,100		**4,100**

Partner's Capital Accounts

Dr. *Cr.*

Date 2015	Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Date 2015	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
Apr.01	Balance c/d	33,480	22,320	15,000	Apr.1	Balance b/d	30,000	20,000	
						Bank			15,000
						Goodwill	3,000	2,000	
						Revaluation (Profit)	480	320	
		33,480	**22,320**	**15,000**			**33,480**	**22,320**	**15,000**

Illustration 25

Given below is the Balance Sheet of A and B, who are carrying on partnership business as on March 31,2015. A and B share profits in the ratio of 2:1.

Balance Sheet of A and B as at March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bills Payable		10,000	Cash in hand	10,000
Sundry creditors		58,000	Cast at bank	40,000
Outstanding expenses		2,000	Sundry debtors	60,000
Capitals			Stock	40,000
A	1,80,000		Plant and machinery	1,00,000
B	1,50,000	3,30,000	Building	1,50,000
		4,00,000		**4,00,000**

C is admitted as a partner on the date of the balance sheet on the following terms:

1. C will bring in Rs 1,00,000 as his capital and Rs 60,000 as his share of goodwill for 1/4 share in profits.
2. Plant is to be appreciated to Rs 1,20,000 and the value of buildings is to be appreciated by 10%.
3. Stock is found overvalued by Rs 4,000.
4. A provision for doubtful debts is to be created at 5% of debtors.
5. Creditors were unrecorded to the extend of Rs 1,000.

Record revaluation Account, partners' capital accounts, and the Balance Sheet of the constituted firm after admission of the new partner.

Solution

Books of A and B
Revaluation Account

Dr. Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
Stock in hand		4,000	Plant and machinery	20,000
Provision for doubtful debts		3,000	Buildings	15,000
Creditors				
profit on revaluation		1,000		
transferred to:				
A's Capital	18,000			
B's Capital	9,000	27,000		
		35,000		**35,000**

Partners' Capital Accounts

Dr. Cr.

Date 2015	Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Date 2015	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
March 31	Balance c/d	2,38,000	1,79,000	1,00,000	March 31	Balabce b/d	1,80,000	1,50,000	
						Bank			1,00,000
						Goodwill	40,000	20,000	
						Revaluation	18,000	9,000	
		2,38,000	**1,79,000**	**1,00,000**			**2,38,000**	**1,79,000**	**1,00,000**

Balance Sheet of A, B and C as on April 01, 2015

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Bills Payable		10,000	Cash in hand		10,000
Sundry Creditors		59,000	Cash at bank		2,00,000
Outstanding Expenses		2,000	Sundry Debtors	60,000	
Capitals			Less: Provision for doubtful debts	3,000	57,000
A	2,38,000				
B	1,79,000		Stock		36,000
C	1,00,000	5,17,000	Plant and Machinery		1,20,000
			Buildings		1,65,000
		5,88,000			**5,88,000**

Do It Yourself

1. Aslam, Jackab, Hari are equal partners with capitals of Rs. 1,500, Rs. 1,750 and Rs. 2,000 respectively. They agree to admit Satnam into equal partnership upon payment in cash of Rs. 1,500 for one-fourth share of the goodwill and Rs. 1,800 as his capital, both sums to remain in the business. The liabilities of the old firm amount Rs. 3,000 and the assets, apart from cash, consist of Motors Rs. 1,200, Furniture Rs. 400, Stock Rs. 2,650, Debtors of Rs. 3,780. The Motors and Furniture were revalued at Rs. 950 and Rs. 380 respectively, and the depreciation written-off. Ascertain cash in hand and prepare the balance sheet of the firm after Satnam's admission.
2. Benu and Sunil are partners sharing profits in the ratio of 3:2 on April 1, 2003. Ina was admitted for 1/4 share who paid Rs. 2,00,000 as capital and Rs. 1,00,000 for premium in cash. At the time of admission, general reserve amounting to Rs. 1,20,000 and profit and loss account amounting to Rs. 60,000 appeared on the asset side of the balance sheet.
   Required: Record necessary journal entries to record the above transactions.
3. Ashoo and Rahul are partners sharing profits in the ratio of 5:3. Gaurav was admitted for 1/5 share and was asked to contribute proportionate capital and Rs. 4,000 for premium (goodwill). The Capitals of Ashoo and Rahul, after all adjustments relating to revaluation, goodwill etc., worked out to be Rs. 45,000 and Rs. 35,000 respectively.
   Required: Calculate New Profit sharing ratio, capital to be brought in by Gaurav and record necessary journal entries for the same.

3.8 Adjustment of Capitals

Sometimes, at the time of admission, the partners agree that their capitals should also be adjusted so as to be proportionate to their profit sharing ratio. In such a situation, if the capital of the new partner is given, the same can be used as a base for calculating the new capitals of the old partners. The capitals thus ascertained should be compared with their old capitals after all adjustments relating to goodwill reserves and revaluation of assets and liabilities, etc. have been made; and then the partner whose capital falls short, will bring in the necessary amount to cover the shortage and the partner who has a surplus, will withdraw the excess amount of capital. (See Illustration 26)

Illustration 26

A and B are partners sharing profits in the ratio of 2:1. C is admitted into the firm for 1/4 share of profits. C brings in Rs. 20,000 in respect of his capital. The capitals of old partners A and B, after all adjustments relating to goodwill, revaluation of assets and liabilities, etc., are Rs. 45,000 and Rs. 15,000 respectively. It is agreed that partners' capitals should be according to the new profit sharing ratio.

Determine the new capitals of A and B and record the necessary journal entries assuming that the partner whose capital falls short, brings in the amount of deficiency and the partner who has an excess, withdraws the excess amount.

Solution

1. Calculation of new profit sharing ratio: Assuming the new partner C quires his share from A and B in their old profit sharing ratio, i.e 2:1.,

Total Share = 1

C's Share $= \frac{1}{4}$

Remaining Shares $= 1 - \frac{1}{4} = \frac{3}{4}$

A's New Share $= \frac{3}{4} \times \frac{2}{3} = \frac{6}{12}$

B's New Share $= \frac{3}{4} \times \frac{1}{3} = \frac{3}{12}$

C's New Share $= \frac{1}{4} \times \frac{3}{3} = \frac{3}{12}$

Thus, new profit sharing ratio between A,B and C is 6:3:3 or 2:1:1.
2. Required Capital of A and B
C's capital (who has 1/4 share in profits) is Rs. 20,000. B's new share in profits 1/4. Hence his capital will also be Rs. 20,000. A's new share is 2/4 which is double of C's share. Hence his capital will be Rs. 40,000.

Alternatively, based on C's capital, the total capital of the firm works out at Rs. 80,000 (4/1 × Rs.20,000). Hence, based on their share in profits, the capital of A and B will be:

A's capital $= \frac{2}{4}$ of 80,000 = Rs. 40,000

B's capital $= \frac{1}{4}$ of 80,000 = Rs. 20,000

The capital of A and B after all adjustments have been made, are Rs. 45,000 and Rs. 15,000 respectively. Hence, A will withdraw Rs. 5,000 (Rs. 45,000–Rs.40,000) from the firm whereas B will contribute additional amount of Rs. 5,000 (Rs. 20,000–Rs.15,000). The journal entries will be :

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Anount (Rs.)*
	A's Capital A/c Dr. To Cash A/c (Excess capital withdrawn by A)		5,000	 5,000

	Cash A/c Dr. To B's Capital A/c (Deficiency made good by additional amount brought in by B)		5,000	5,000

Sometimes, the total capital of the firm may clearly be specified and it is agreed that the capital of each partner should be proportionate to his share in profits. In such a situation each partner's capital (including the new partner's capital to be brought by him) is calculated on the basis of his share in profits. By bringing in additional amount or withdrawal of excess amount, the final capital of each partner can be brought up to the required level.

It may be noted that subject to agreement among the partners, surplus or deficiency in each old partners' capital accounts can also be taken care of simply by transfer to their respective current accounts. (See Illustration 27)

Illustration 27

A, B and C are partners in a firm sharing profits the ratio of 3:2:1. D is admitted into the firm for 1/4 share in profits, which he gets as 1/8 from A and 1/8 from B. The total capital of the firm is agreed upon as Rs. 1,20,000 and D is to bring in cash equivalent to 1/4 of this amount as his capital. The capitals of other partners are also to be adjusted in the ratio of their respective shares in profits. The capitals of A, B and C after all adjustments are Rs. 40,000, Rs. 35,000 and Rs. 30,000 respectively. Calculate the new capitals of A,B and C, and record the necessary journal entries.

Solution

1. Calculation of new profit sharing ratio:

A $= \frac{1}{2} - \frac{1}{8} = \frac{3}{8}$

B $= \frac{1}{3} - \frac{1}{8} = \frac{5}{24}$

C will continue to get 1/6 as his share in the profits.
Thus, the new profit sharing ratio between A,B,C and D will be:

$\frac{3}{8} : \frac{5}{24} : \frac{1}{6} : \frac{1}{4}$ or $\frac{9}{24} : \frac{5}{24} : \frac{4}{24} : \frac{6}{24}$ or 9:5:4:6

2. Required capitals of all partners:

A's Capital = Rs. 1,20,000 $\times \frac{9}{24}$ = Rs. 45,000

B's Capital = Rs. 1,20,000 $\times \frac{5}{24}$ = Rs. 25,000

C's Capital = Rs. 1,20,000 $\times \frac{4}{24}$ = Rs. 20,000

D's Capital = Rs. 1,20,000 $\times \frac{6}{24}$ = Rs. 30,000

Hence, A will bring in Rs. 5,000 (Rs. 45,000 – Rs. 40,000), B will withdraw Rs. 10,000 (Rs. 35,000 – Rs. 25,000), C will withdraw Rs. 10,000 (Rs. 30,000 – Rs, 20,000) and D will bring in Rs. 30,000. Alternatively, the current accounts can be opened and the amounts to be brought in or withdrawn by A, B and C will be transferred to their respective current accounts subject to the agreement among the partners. The journal entries in this regard will be recorded as follows:

Books of A, B, C and D
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c	Dr.		5,000	
	To A's Capital A/c				5,000
	(Deficiency made good by additional amount brought in by A)				
	B's Capital A/c	Dr.			
	C's Capital A/c	Dr.		10,000	
	To Cash A/c			10,000	
	(Excess amounts withdrawn by B and C)				20,000
	Cash A/c	Dr.		30,000	
	To D's Capital A/c				30,000
	(Cash brought in by D as Capital)				

Alternatively, for entries (2) and (3) above shall be

Books of A, B, C and D
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	A's Current A/c	Dr.		5,000	
	To A's Capital A/c				5,000
	(Deficiency in A's capital transferred to A's Current Account)				
	B's Capital A/c	Dr.		10,000	
	C's Capital A/c	Dr.		10,000	
	To B's Current A/c				10,000
	To C's Current A/c			10,000	
	(Excess Capital of B transferred to their current account)				

Illustration 28

A and B are partners in a firm sharing profits in the ratio 2:1. C is admitted into the firm with 1/4 share in profits. He will bring in Rs. 30,000 as capital and capitals of A and B are to be adjusted in the profit sharing ratio. The Balance Sheet of A and B as on March 31, 2013 (before C's admission) was as under:

Balance Sheet of A and B as at March 31,2013

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		8,000	Cash in hand	2,000
Bills payable		4,000	Cash at bank	10,000
General Reserve		6,000	Sundry debtors	8,000
Capitals: A	50,000		Stock	10,000
B	32,000	82.,000	Furniture	5,000
			Machinery	25,000
			Building	40,000
		1,00,000		**1,00,000**

Other terms of agreement are as under:

1. C will bring in Rs. 12,000 as his share of goodwill.
2. Building was valued at Rs. 45,000 and Machinery at Rs. 23,000.
3. A provision for bad debts is to be created @ 6% on debtors.
4. The capital accounts of A and B are to be adjusted by opening current accounts.

Record necessary journal entries, show necessary ledger accounts and prepare fund's Balance Sheet after C's admission.

Books of A, B and C
Journal

Date 2013	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Anount (Rs.)*
March 1	Cash A/c	Dr.		42,000	
	To C's Capital A/c				30,000
	To Goodwill A/c				12,000
	(Amounts of capital and goodwill brought in by C)				
	Goodwill A/c	Dr.		12,000	
	To A's Capital A/c				8,000
	To B's Capital A/c				4,000
	(Goodwill brought in by C transferred to A and B in their ratio of sacrifice)				
	Revaluation A/c	Dr.		2,480	
	To Machinery A/c				2,000
	To Provision for Bad Debts A/c				480
	(Decrease in the value of machinery and creation of provision for bad debts)				

	Building A/c Dr. To Revaluation A/c (Increase in the value of building)		5,000	 5,000
	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c (Profit on revaluation distributed between A and B)		2,520	 1,680 840
	General Reserve A/c Dr. To A's Capital A/c To B's Capital A/c (Undistributed profit transferred to A and B)		6,000	 4,000 2,000
	A's Capital A/c Dr. To A's Current A/c (The excess of capital transferred to partner's current account)		3,680	 3,680
	B's Capital A/c Dr. To B's Current A/c (The excess of B's capital transferred to partner's current account)		8.840	 8,840

Revaluation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Machinery		2,000	Building	5,000
Provision for bad debts		480		
Transfer of profit on revaluation to:				
A's Capital	1,680			
B's Capital	840	2,520		
		5,000		**5,000**

Partner's Capital Accounts

Dr. *Cr.*

Date	*Particulars*	*A (Rs.)*	*B (Rs.)*	*C (Rs.)*	*Date*	*Particulars*	*A (Rs.)*	*B (Rs.)*	*C (Rs.)*
	Current Accounts	3,680	8,840			Balance b/d	50,000	32,000	
	Balance c/d	60,000	30,000	30,000		Cash			30,000
						Goodwill	8,000	4,000	
						General Reserve	4,000	2,000	
						Revaluation (transfer of profit)	1,680	840	
		63,680	38,840	30,000			63,680	38,840	30,000

Partner's Current Accounts

Dr. *Cr.*

Date	Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Date	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
	Balance c/d	3,680	8,840	-		Capital A/cs	3,680	8,840	-

Balance Sheet of A, B and C as on March 31, 2013

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		8,000	Cash in hand		44,000
Bills Payable		4,000	Cash at bank		10,000
Partners Current accounts:			Sundry Debtors	8000	
A	3,680		*Less:* Provision for	480	7,520
B	8,840	12,520	Doubtful Debts		
Capitals			Stock		10,000
A	60,000		Furniture		5,000
B	30,000		Machinery		23,000
C	30,000	1,20,000	Buildings		45,000
		1,44,520			**1,44,520**

Notes

1. New Profit Sharing Ratio

Since nothing is given as to how C acquired his share from A and B. It is assumed that A and B, between themselves continue to share the profit in the old ratio of 2:1.

C's Share of Profits $= \frac{1}{4}$

Remaining Share $= 1 - \frac{1}{4} = \frac{3}{4}$

A's New Share $= \frac{2}{3}$ of $\frac{3}{4} = \frac{6}{12} = \frac{1}{2}$

B's New Share $= \frac{1}{3}$ of $\frac{3}{4} = \frac{3}{12} = \frac{1}{4}$

Thus, new profit sharing ratio between A, B and C is 2:1:1

2. New Capitals of A and B

C's capital is Rs 30,000 and his share of profits is 1/4. Based on C's capital, the total capital of the firm will work out at Rs 1,20,000 (4/1 × 30,000) and the respective capitals of A and B will be as follows :

A's Capital $= \frac{2}{4}$ of 1,20,000 = Rs. 60,000

B's Capital $= \frac{1}{4}$ of 1,20,000 = Rs. 30,000

Illustration 29

The Balance Sheet of W and R who shared profits in the ratio of 3 : 2 was as follows on Jan. 01, 2015.

Balance Sheet of W and R as on Jan. 01, 2013

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Sundry Creditors		20,000	Cash in hand		5,000
Partner's Capital			Sundry Debtors	20,000	
W	40,000		*Less:* Provision for	700	19,300
R	30,000	70,000	doubtful debts		
			Stock		25,000
			Plant and Machinery		35,000
			Patents		5,700
		90,000			**90,000**

On this date B was admitted as a partner on the following conditions:

1. He was to get 4/15 share of profit.
2. He had to bring in Rs 30,000 as his capital.
3. He would pay cash for goodwill which would be based on 2 ½ years purchase of the profits of the past four years.
4. W and R would withdraw half the amount of goodwill premium brought by B.
5. The assets would be revalued as: Sundry Debtors at book value less a provision of 5%; Stock at Rs 20,000; Plant and Machinery at Rs 40,000; and Patents at Rs 12,000.
6. Liabilities were valued at Rs 23,000, one bill for goods purchased having been omitted from books.
7. Profit for the past four years were :

2011	15,000	2013	14,000
2012	20,000	2014	17,000

Give necessary journal entries and ledger accounts to record the above, and prepare the Balance Sheet after B's admission.

Solution

The goodwill of the firm is Rs 41,250 worked out as under :

Profits :	
Year 2011	15,000
Year 2012	20,000
Year 2013	14,000
Year 2014	17,000
	66,000

Average Profits = $\text{Rs.}\dfrac{66{,}000}{4}$ = Rs. 16,500

Goodwill at 2 ½ Years purchase = Rs .16,500 × $\dfrac{5}{2}$ = Rs. 41,250

B's share of goodwill = Rs. 41,250 × $\dfrac{4}{15}$ = Rs, 11,000.

Books of W, R and B
Journal

Date 2015	*Particulars*	*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
Jan. 01	Cash A/c Dr. To B's Capital A/c To Goodwill A/c (Sum brought in by B as his Capital and his share (4/5) of the goodwill)		41,000	 30,000 11,000
	Goodwill A/c Dr. To W's Capital A/c To R's Capital A/c (Goodwill brought by B credited to W's and R's capital accounts in old profit ratio of 3:2)		11,000	 6,600 4,400
	W's Capital A/c Dr. R's Capital A/c To Cash A/c (Amount (half of goodwill) withdrawn by the old partners)		3,300 2,200	 5,500
	Revaluation A/c Dr. To Provision for Doubtful Debts A/c To Stock A/c (Increase in provision for doubtfull debts to Rs 1,000 (5% of Rs 20,000) and decrease in value of stock)		5,300	 300 5,000
	Plant and Machinery A/c Dr. Patents A/c Dr. To Revaluation A/c (Increase in value of Plant and Machinery and Patents)		5,000 6,300	 11,300
	Revaluation A/c Dr. To Sundry Creditors A/c (Increase in liabilities)		3,000	 3,000

	Revaluation A/c Dr. To W's Capital A/c To R's Capital A/c (Being profit on adjustment transferred to partners' capital accounts)		3,000	 1,800 1,200

Cash Account

Dr. *Cr.*

Date 2015	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Amount (Rs.)*
Jan. 1	Balance b/d		5,000	Jan. 1	W's Capital		3,300
	B's Capital		30,000		R's Capital		2,200
	Goodwill		11,000		Balance c/d		40,500
			46,000				**46,000**

B's Capital Account

Dr. *Cr.*

Date 2015	*Particulars*	*J.F.*	*Anount (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Amount (Rs.)*
Jan. 1	Balance c/d		30,000	Jan. 1	Cash		30,000
			30,000				**30,000**

W's Capital Account

Dr. *Cr.*

Date 2015	*Particulars*	*J.F.*	*Anount (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Amount (Rs.)*
Jan.1	Cash		3,300	Jan. 1	Balance b/d		40,000
	Balance c/d		45,100		Goodwill		6,600
					Revaluation		1,800
			48,400				**48,400**

R's Capital Account

Dr. *Cr.*

Date 2015	*Particulars*	*J.F.*	*Anount (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Amount (Rs.)*
Jan. 1	Cash		2,200	Jan. 1	Balance b/d		30,000
	Balance c/d		33,400		Goodwill		4,400
					Revaluation		1,200
			35,600				**35,600**

Revaluation Account

Dr. *Cr.*

Particulars		*Anount (Rs.)*	*Particulars*	*Amount (Rs.)*
Provision for doubtful debts		300	Plant and Machinery	5,000
Stock		5,000	Patents	6,300
Sundry Creditors		3,000		
Profit transferred to:				
W 3/5	1,800			
R 2/5	1,200	3,000		
		11,300		**11,300**

Balance Sheet of W, R and B as on January 01, 2013

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Sundry Creditors		23,000	Cash in hand		40,500
Capitals:			Sundry debtors :	20,000	
W	45,100		*Less:* Provision for		
R	33,400		doubtful debits	1,000	19,000
B	30,000	1,08,500	Stock		20,000
			Plant & Machinery		40,000
			Patents		12,000
		1,31,500			**1,31,500**

The new profit sharing ratio will be:

$$W = (1-\frac{4}{15})\times\frac{3}{5}=\frac{11}{15}\times\frac{3}{5}=\frac{33}{75}$$

$$R = (1-\frac{4}{15})\times\frac{2}{5}=\frac{11}{15}\times\frac{2}{5}=\frac{22}{75}$$

$$B = \frac{4}{15}=\frac{20}{75}$$

The new ratio is 33 : 22 : 20.

3.9 Change in Profit Sharing Ratio among the existing Partners

Sometimes, the partners of a firm decide to change their existing profit sharing ratio without any admission or retirement of a partner. This results in a gain of additional share in future profits of the firm for some partners while a loss of a part thereof for other partners. For example, A, B and C are partners in a firm sharing profits in the ratios of 8:5:3 It is felt that A will no more be able to actively participate in the affairs of the firm. Hence, with effect from April 1, 2007, they decided that, in future they will share the profits in the ratio of 5 : 6 : 5. This results in A losing $3/16 \left(\frac{8}{16} - \frac{5}{16}\right)$ share in profits while B and C gaining $1/16 \left(\frac{6}{16} - \frac{5}{16}\right)$ and $2/16 \left(\frac{5}{16} - \frac{3}{16}\right)$. In such a situation, first of all, the loss and gain in the value of goodwill (if any) will have to be adjusted. This is done by raising goodwill at its full value in the MD profit sharing ratio and then writing it off in the new ratio. Alternatively, losing partners can be credited and gaining partners debited with appropriate amounts without goodwill account appearing in the books, as explained earlier in the context of the admission of a new partners.

Any change, in the profit sharing ratio, like admission of partner, may also involve adjustments in respect of revaluation of assets and liabilities, transfer of accumulated profit and losses to partners' capital accounts in the old profit sharing ratio and adjustment of partners' capitals, if specified, so as to make them proportionate to the new profit sharing ratio. All this is done in the same way as in case of admission of a partner.

Illustration 30

Dinesh, Ramesh and Suresh are partners in a firm sharing profits and losses in the ratio of 3:3:2. They decided to share the profits equally w.e.f. April 1, 2015. Their Balance Sheet as on March 31, 2007 was as follows :

Liabilities		*Amount Rs.*	*Assets*	*Amounts Rs.*
Sundry Creditors		1,50,000	Cash at Bank	40,000
General Reserve		80,000	Bills Receivable	50,000
Partner's Loan :			Sundry Debtors	60,000
Dinesh	40,000		Stock	1,20,000
Ramesh	30,000	70,000	Fixed Assets	2,80,000
Partners Capital :				
Dinesh	1,00,000			
Ramesh	80,000			
Suresh	70,000	2,50,000		
		5,50,000		**5,50,000**

It was also decide that :

1. The fixed assets should be valued at Rs. 3,31,000.
2. A provisions of 5% on sundry debtors be made doubtful debts.

3. The goodwill of the firm at this date be valued at $4\frac{1}{2}$ years purchase of the average net profits of last, five years which were Rs. 14,000; Rs. 17,000; Rs. 20,000; Rs. 22,000 and Rs. 27,000 respectively.
4. The value of stock be reduced to Rs. 1,12,000.
5. Goodwill was not to appear in the books. Pass the necessary journal entries and prepare the revised Balance sheet of the firm.

Solution

Books of Dinesh, Ramesh and Suresh
Journal

2015 Apr. 01	Fixed Assets A/c Dr. To Revaluation A/c (Increase in value of fixed assets)		51,000	 51,000
	Revaluation A/c Dr. To Stock A/c To Provisions for Doubtful debts A/c (Decrease in value of stock and creation of provision for doubtful debts)		11,000	 8,000 3,000
	Revaluation A/c Dr. To Dinesh's Capital A/c To Ramesh's Capital A/c To Suresh's Capital A/c (Profit on revaluation transferred to partners' capital accounts in old profit sharing ratio)		40,000	 15,000 15,000 10,000
	General Reserve A/c Dr. To Dinesh's Capital A/c To Ramesh's Capital A/c To Suresh's Capital A/c (General reserve, transferred to partners' capital accounts in old ratio)		80,000	 30,000 30,000 20,000
	Suresh's Capital A/c Dr. To Dinesh's Capital A/c To Ramesh's Capital A/c (Goodwill adjusted in partner's capital accounts in their sacrificing/gaining ratio)		7,500	 3,750 3,750

Working Notes:

1. Gain or sacrifice of partners

	Dinesh	Ramesh	Suresh
Old Share	3/8	3/8	2/8
New Share	1/3	1/3	1/3
Difference	1/24 (sacrifice)	1/24 (sacrifice)	2/24 (gain)

2. Goodwill

Total Profits : Rs. 14,000 + Rs. 17,000 + Rs. 20,000 + Rs. 22,000 + Rs. 27,000
= Rs. 1,00,000

Average Profits = Rs. 1,00,000/5
= Rs. 20,000

Goodwill = Rs. 20,000 × $4\frac{1}{2}$
= Rs. 90,000

Suresh in expected to bring in Rs. 7,500
as he gain $\frac{2}{24}$ share in profits.

Dinesh in expected to receive Rs. 3,750
as he sacrifices $\frac{1}{24}$ share in profits

Ramesh is expected to receive Rs. 3,750
as he sacrifices $\frac{1}{24}$ share in profits

Had we raised Goodwill A/c in the old ratio and written it off in the new ratio, the net effect would have been the same.

(a)	Good will A/c	Dr.		90,000	
	To Dinesh's Capital A/c				33,750
	To Ramesh's Capital A/c				33,750
	To Suresh's Capital A/c				22,500
	(Goodwill raised in old ratio)				
(b)	Dinesh's Capital A/c	Dr.		30,000	
	Ramesh's Capital A/c	Dr.		30,000	
	Suresh's Capital A/c	Dr.		30,000	
	To Goodwill A/c				90,000

3. Capital Accounts

Date	*Particulars*	*J.F.*	*Dinesh (Rs.)*	*Ramesh (Rs.)*	*Suresh (Rs.)*	*Date*	*Particulars*	*J.F.*	*Dinesh (Rs.)*	*Ramesh (Rs.)*	*Suresh (Rs.)*
	Dinesh's Account				3,750		Balance b/d		1,00,000	80,000	70,000
	Ramesh's Account				3,750		Profit on Revaluation		15,000	15,000	10,000
	Balance c/d		1,48,750	1,28,750	92,500		General Reserve		30,000	30,000	20,000
							Suresh's Account		3,750	3,750	
			1,48,750	1,28,750	1,00,000				1,48,750	1,28,750	1,00,000

Balance Sheet as on April 01, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Sundry Creditors		1,50,000	Cash at Bank		40,000
Partner's Loan :			Bills Receivable		50,000
Dinesh	40,000		Sundry Debtors	60,000	
Ramesh	30,000	70,000	Less Prov. for Doubtful		
			Debts	3,000	57,000
Capitals:			Stock		1,12,000
Dinesh	1,48,750		Fixed Assets		3,31,000
Ramesh	1,28,750				
Suresh	92,500	3,70,000			
		5,90,000			**5,90,000**

Terms Introduced in the Chapter

1. Reconstitution of Partnership Firm.
2. Revaluation of Assets.
3. Reassessment of liabilities.
4. Undistributed and accumulated profits and losses.
5. Accumulated Losses.
6. Goodwill.
7. Profit Sharing Ratio.
8. Reserves.
9. Revaluation Account.
10. Sacrificing Ratio.
11. Change in Profit Sharing Ratio.

Summary

1. *Matters requiring adjustments at the time of admission of a partner:* Various matters which need adjustments in the books of firm at the time of admission of a new partner are : goodwill, revaluation of assets and liabilities, reserves and other accumulated profits and losses and the capitals of the old partners (if agreed).
2. *Determining the new profit sharing ratio and calculating sacrificing ratio:* The new partner acquires his share in profits from the old partners. This reduces the old partner's share in profits. Hence, the problem of determining the new profit sharing ratio simply involves the determination of old partner's new share in

the profits of the reconstituted firm. Given the new partner's share in profits and the ratio, in which he acquires it from the old partners, the new share of each old partner shall be worked out by deducting his share of sacrifice from his old share in profits. The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of the new partner is called the sacrificing ratio. It is usually same as the old profit sharing ratio. However, based on the agreement it can be different also.

3. *Treatment of Goodwill:* Goodwill is an intangible asset and belonges to its owner at a point of time. On the admission of a new partner the goodwill of the firm belongs to the old partners. It means that on the admission of a new partner some adjustments must be made into the capital accounts of the old partners for goodwill so that the new partner will not acquire a share in that profit which the firm earns because of its goodwill earned before admission without making any payment for the same. The amount that the new partner pays for goodwill is called goodwill. From accounting point of view the firm may have to face different situations for the treatment of goodwill at the time of admission of a partner. The amount of premium brought in by the new partner is shared by old partners in the ratio of sacrifice. In case the new partner fails to bring his share of premium for goodwill in cash than the capital account of the new partner is debited for his share of premium of goodwill and the old partners capital accounts are credited in their sacrificing ratio.
4. *Adjustments for Revaluation of Assets and Reassessment of Liabilities:* If, at the time of admission of a partner, the assets and liabilities are revalued or some asset or liability is found unrecorded, necessary adjustments are made through the Revaluatiion Account. Any gain or loss arising from such exercise shall be distributed among the old partner's in their old profit sharing ratio.
5. *Adjustment for reserves and accumulated profits/losses:* If, at the time of admission of a partner, any reserve and accumulated profits or losses exist in books of the firm, these should be transferred to old partner's capital/current accounts in their old profit sharing ratio.
6. *Determining/Adjusting partners' capital:* If agreed, the partner's capital may be adjusted so as to be proportionate to their new profit sharing ratio. In that case, the new partner's capital is normally used as a base for determining the new capitals of the old partners and necessary adjustment made through case or by transfer to partner's current accounts. Other basis also may be available for determining capitals of the partners after admissioin of the new partner like sharing the total capital to be in the firm immeidately after admission of the new partner.
7. *Change in profit sharing ratio:* Sometimes the partners of a firm may agree to change their existing profit sharing ratio. With a result, some partners will gain in future profits while others will lose. In such a situation, the partner who gain by change in profit effecting amounts to one partner buying the share of profit from another partner. Apart from the payment for compensation, the change in profit sharing ratio also necessitates adjustment in partner's capital accounts with respect to undistributed profits and reserves, revaluation of assets and reassessment of liabilities.

Questions for Practice

Short Answer Questions

1. Identify various matters that need adjustments at the time of admission of a new partner.
2. Why it is necessary to ascertain new profit sharing ratio even for old partners when a new partner is admitted?
3. What is sacrificing ratio? Why is it calculated?
4. On what occasions sacrificing ratio is used?
5. If some goodwill already exists in the books and the new partner brings in his share of goodwill in cash, how will you deal with existing amount of goodwill?
6. Why there is need for the revaluation of assets and liabilities on the admission of a partner?

Long Answer Questions

1. Do you advise that assets and liabilities must be revalued at the time of admission of a partner? If so, why? Also describe how is this treated in the book of account?
2. What is goodwill? What factors affect goodwill?
3. Explain various methods of valuation of goodwill.
4. If it is agreed that the capital of all the partners should be proportionate to the new profit sharing ratio, how will you work out the new capital of each partner? Give examples and state how necessary adjustments will be made.
5. Explain how will you deal with goodwill when new partner is not in a position to bring his share of goodwill in cash.
6. Explain various methods for the treatment of goodwill on the admission of a new partner?
7. How will you deal with the accumulated profits and losses and reserves on the admission of a new partner?
8. At what figures the value of assets and liabilities appear in the books of the firm after revaluation has been due. Show with the help of an imaginary balance sheet.

Numerical Questions

1. A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C into the partnership with 1/6 share in the profits. Calculate the new profit sharing ratio?

   (**Ans :** 3:2:1)
2. A,B,C were partners in a firm sharing profits in 3:2:1 ratio. They admitted D for 10% profits. Calculate the new profit sharing ratio?

   (**Ans :** 9:6:3:2)
3. X and Y are partners sharing profits in 5:3 ratio admitted Z for 1/10 share which he acquired equally for X and Y. Calculate new profit sharing ratio?

   (**Ans :** 23:13:4)

4. A, B and C are partners sharing profits in 2:2:1 ratio admitted D for 1/8 share which he acquired entirely from A. Calculate new profit sharing ratio?\

   (**Ans :** 11:16:8:5)

5. P and Q are partners sharing profits in 2:1 ratio. They admitted R into partnership giving him 1/5 share which he acquired from P and Q in 1:2 ratio. Calculate new profit sharing ratio?

   (**Ans :** 3:1:1)

6. A, B and C are partners sharing profits in 3:2:2 ratio. They admitted D as a new partner for 1/5 share which he acquired from A, B and C in 2:2:1 ratio respectively. Calculate new profit sharing ratio?

   (**Ans :** 61:36:43:35)

7. A and B were partners in a firm sharing profits in 3:2 ratio. They admitted C for 3/7 share which he took 2/7 from A and 1/7 from B. Calculate new profit sharing ratio?

   (**Ans :** 11:9:15)

8. A, B and C were partners in a firm sharing profits in 3:3:2 ratio. They admitted D as a new partner for 4/7 profit. D acquired his share 2/7 from A. 1/7 from B and 1/7 from C. Calculate new profit sharing ratio?

   (**Ans :** 5:13:6:32)

9. Radha and Rukmani are partners in a firm sharing profits in 3:2 ratio. They admitted Gopi as a new partner. Radha surrendered 1/3 of her share in favour of Gopi and Rukmani surrendered 1/4 of her share in favour of Gopi. Calculate new profit sharing ratio?

   (**Ans :** 4:3:3.)

10. Singh, Gupta and Khan are partners in a firm sharing profits in 3:2:3 ratio. They admitted Jain as a new partner. Singh surrendered 1/3 of his share in favour of Jain: Gupta surrendered 1/4 of his share in favour of Jain and Khan surrendered 1/5 in favour of Jain. Calculate new profit sharing ratio?

    (**Ans :** 20:15:24:21.)

11. Sandeep and Navdeep are partners in a firm sharing profits in 5:3 ratio. They admit C into the firm and the new profit sharing ratio was agreed at 4:2:1. Calculate the sacrificing ratio?

    (**Ans :** 1:1.)

12. Rao and Swami are partners in a firm sharing profits and losses in 3:2 ratio. They admit Ravi as a new partner for 1/8 share in the profits. The new profit sharing ratio between Rao and Swami is 4:3. Calculate new profit sharing ratio and sacrificing ratio?

    (**Ans :** New Profit Ratio 4:3:1 and Sacrificing Ratio 4:1)

13. Compute the value of goodwill on the basis of four years' purchase of the average profits based on the last five years? The profits for the last five years were as follows:

	Rs.
2011	40,000
2012	50,000
2013	60,000
2014	50,000
2015	60,000

(**Ans :** Rs. 2,08,000)

14. Capital employed in a business is Rs. 2,00,000. The normal rate of return on capital employed is 15%. During the year 2015 the firm earned a profit of Rs. 48,000. Calculate goodwill on the basis of 3 years purchase of super profit?

    (**Ans :** Rs. 54,000)

15. The books of Ram and Bharat showed that the capital employed on 31.12.2016 was Rs. 5,00,000 and the profits for the last 5 years : 2015 Rs. 40,000; 2014 Rs. 50,000; 2013 Rs. 55,000; 2012 Rs. 70,000 and 2011 Rs. 85,000. Calculate the value of goodwill on the basis of 3 years purchase of the average super profits of the last 5 years assuming that the normal rate of return is 10%?

    (**Ans :** Rs. 30,000)

16. Rajan and Rajani are partners in a firm. Their capitals were Rajan Rs. 3,00,000; Rajani Rs. 2,00,000. During the year 2015 the firm earned a profit of Rs. 1,50,000. Calculate the value of goodwill of the firm assuming that the normal rate of return is 20%?

    (**Ans :** Rs. 2,50,000)

17. A business has earned average profits of Rs. 1,00,000 during the last few years. Find out the value of goodwill by capitalisation method, given that the assets of the business are Rs. 10,00,000 and its external liabilities are Rs. 1,80,000. The normal rate of return is 10%?

    (**Ans :** Rs. 1,80,000)

18. Verma and Sharma are partners in a firm sharing profits and losses in the ratio of 5:3. They admitted Ghosh as a new partner for 1/5 share of profits. Ghosh is to bring in Rs. 20,000 as capital and Rs. 4,000 as his share of goodwill premium. Give the necessary journal entries:
    a) When the amount of goodwill is retained in the business.
    b) When the amount of goodwill is fully withdrawn.
    c) When 50% of the amount of goodwill is withdrawn.
    d) When goodwill is paid privately.

19. A and B are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit C into partnership with 1/4 share in profits. C will bring in Rs. 30,000 for capital and the requisite amount of goodwill premium in cash. The goodwill of the firm is valued at Rs, 20,000. The new profit sharing ratio is 2:1:1. A and B withdraw their share of goodwill. Give necessary journal entries?

20. Arti and Bharti are partners in a firm sharing profits in 3:2 ratio, They admitted Sarthi for 1/4 share in the profits of the firm. Sarthi brings Rs. 50,000 for his

capital and Rs. 10,000 for his 1/4 share of goodwill. Goodwill already appears in the books of Arti and Bharti at Rs. 5,000. the new profit sharing ratio between Arti, Bharti and Sarthi will be 2:1:1. Record the necessary journal entries in the books of the new firm?

21. X and Y are partners in a firm sharing profits and losses in 4:3 ratio. They admitted Z for 1/8 share. Z brought Rs. 20,000 for his capital and Rs. 7,000 for his 1/8 share of goodwill. Subsequently X, Y and Z decided to show goodwill in their books at Rs. 40,000. Show necessary journal entries in the books of X, Y and Z?

22. Aditya and Balan are partners sharing profits and losses in 3:2 ratio. They admitted Christopher for 1/4 share in the profits. The new profit sharing ratio agreed was 2:1:1. Christopher brought Rs. 50,000 for his capital. His share of goodwill was agreed to at Rs. 15,000. Christopher could bring only Rs. 10,000 out of his share of goodwill. Record necessary journal entries in the books of the firm?

23. Amar and Samar were partners in a firm sharing profits and losses in 3:1 ratio. They admitted Kanwar for 1/4 share of profits. Kanwar could not bring his share of goodwill premium in cash. The Goodwill of the firm was valued at Rs. 80,000 on Kanwar's admission. Record necessary journal entry for goodwill on Kanwar's admission.

24. Mohan Lal and Sohan Lal were partners in a firm sharing profits and losses in 3:2 ratio. They admitted Ram Lal for 1/4 share on 1.1.2013. It was agreed that goodwill of the firm will be valued at 3 years purchase of the average profits of last 4 years which were Rs. 50,000 for 2012, Rs. 60,000 for 2011, Rs. 90,000 for 2010 and Rs. 70,000 for 2009. Ram Lal did not bring his share of goodwill premium in cash. Record the necessary journal entries in the books of the firm on Ram Lal's admission when:
    a) Goodwill already appears in the books at Rs. 2,02,500.
    b) Goodwill appears in the books at Rs. 2,500.
    c) Goodwill appears in the books at Rs. 2,05,000.

25. Rajesh and Mukesh are equal partners in a firm. They admit Hari into partnership and the new profit sharing ratio between Rajesh, Mukesh and Hari is 4:3:2. On Hari's admission goodwill of the firm is valued at Rs. 36,000. Hari is unable to bring his share of goodwill premium in cash. Rajesh, Mukesh and Hari decided not to show goodwill in their balance sheet. Record necessary journal entries for the treatment of goodwill on Hari's admission.

26. Amar and Akbar are equal partners in a firm. They admitted Anthony as a new partner and the new profit sharing ratio is 4:3:2. Anthony could not bring this share of goodwill Rs. 45,000 in cash. It is decided to do adjustment for goodwill without opening goodwill account. Pass the necessary journal entry for the treatment of goodwill?

27. Given below is the Balance Sheet of A and B, who are carrying on partnership business on 31.12.2006. A and B share profits and losses in the ratio of 2:1.

Balance Sheet of A and B as on December 31, 2006

Liabilites		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bills Payable		10,000	Cash in Hand	10,000
Creditors		58,000	Cash at Bank	40,000
Outstanding Expenses		2,000	Sundry Debtors	60,000
			Stock	40,000
Capitals:			Plant	1,00,000
A	1,80,000		Buildings	1,50,000
B	1,50,000	3,30,000		
		4,00,000		**4,00,000**

C is admitted as a partner on the date of the balance sheet on the following terms:

(i) C will bring in Rs. 1,00,000 as his capital and Rs. 60,000 as his share of goodwill for 1/4 share in the profits.

(ii) Plant is to be appreciated to Rs. 1,20,000 and the value of buildings is to be appreciated by 10%.

(iii) Stock is found over valued by Rs. 4,000.

(iv) A provision for bad and doubtful debts is to be created at 5% of debtors.

(v) Creditors were unrecorded to the extent of Rs. 1,000.

Pass the necessary journal entries, prepare the revaluation account and partners' capital accounts, and show the Balance Sheet after the admission of C.

(**Ans :** Gain of Revaluation Rs. 27,000. Balance Sheet Rs. 5,88,000)

28. Leela and Meeta were partners in a firm sharing profits and losses in the ratio of 5:3. On Is Jan. 2015 they admitted Om as a new partner. On the date of Om's admission the balance sheet of Leela and Meeta showed a balance of Rs. 16,000 in general reserve and Rs. 24,000 (Cr) in Profit and Loss Account. Record necessary journal entries for the treatment of these items on Om's admission. The new profit sharing ratio between Leela, Meeta and Om was 5:3:2.

29. Amit and Viney are partners in a firm sharing profits and losses in 3:1 ratio. On 1.1.2015 they admitted Ranjan as a partner. On Ranjan's admission the profit and loss account of Amit and Viney showed a debit balance of Rs. 40,000. Record necessary journal entry for the treatment of the same.

30. A and B share profits in the proportions of 3/4 and 1/4 . Their Balance Sheet on Dec. 31, 2015 was as follows:

Balance Sheet of A and B as on December 31, 2006

Liabilites	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry creditors	41,500	Cash at Bank	26,500
Reserve fund	4,000	Bills Receivable	3,000
Capital Accounts		Debtors	16,000
A	30,000	Stock	20,000
B	16,000	Fixtures	1,000
		Land & Building	25,000
	91,500		**91,500**

On Jan. 1,2016, C was admitted into partnership on the following terms:

(a) That C pays Rs. 10,000 as his capital.

(b) That C pays Rs. 5,000 for goodwill. Half of this sum is to be withdrawn by A and B.

(c) That stock and fixtures be reduced by 10% and a 5%, provision for doubtful debts be created on Sundry Debtors and Bills Receivable.

(d) That the value of land and buildings be appreciated by 20%.

(e) There being a claim against the firm for damages, a liability to the extent of Rs. 1,000 should be created.

(f) An item of Rs. 650 included in sundry creditors is not likely to be claimed and hence should be written back.

Record the above transactions (journal entries) in the books of the firm assuming that the profit sharing ratio between A and B has not changed. Prepare the new Balance Sheet on the admission of C.

(**Ans :** Gain on Revaluation Rs. 1600. Balance Sheet Total Rs. 1,05,950).

31. A and B are partners sharing profits and losses in the ratio of 3:1. On Ist Jan. 2015 they admitted C as a new partner for 1/4 share in the profits of the firm. C brings Rs. 20,000 as for his 1/4 share in the profits of the firm. The capitals of A and B after all adjustments in respect of goodwill, revaluation of assets and liabilities, etc. has been worked out at Rs. 50,000 for A and Rs. 12,000 for B. It is agreed that partner's capitals will be according to new profit sharing ratio. Calculate the new capitals of A and B and pass the necessary journal entries assuming that A and B brought in or withdrew the necessary cash as the case may be for making their capitals in proportion to their profit sharing ratio?

32. Pinky, Qumar and Roopa partners in a firm sharing profits and losses in the ratio of 3:2:1. S is admitted as a new partner for 1/4 share in the profits of the firm, whichs he gets 1/8 from Pinky, and 1/16 each from Qmar and Roopa. The total capital of the new firm after Seema's admission will be Rs. 2,40,000.

Seema is required to bring in cash equal to 1/4 of the total capital of the new firm. The capitals of the old partners also have to be adjusted in proportion of their profit sharing ratio. The capitals of Pinky, Qumar and Roopa after all adjustments in respect of goodwill and revaluation of assets and liabilities have been made are Pinky Rs. 80,000, Qumar Rs. 30,000 and Roopa Rs. 20,000. Calculate the capitals of all the partners and record the necessary journal entries for doing adjustments in respect of capitals according to the agreement between the partners?

33. The following was the Balance Sheet of Arun, Bablu and Chetan sharing profits and losses in the ratio of $\frac{6}{14}:\frac{5}{14}:\frac{3}{14}$ respectively.

Liabilites		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		9,000	Land and Buildings	24,000
Bills Payable		3,000	Furniture	3,500
Capital Accounts			Stock	14,000
Arun	19,000		Debtors	12,600
Bablu	16,000		Cash	900
Chetan	8,000	43,000		
		55,000		**55,000**

They agreed to take Deepak into partnership and give him a share of 1/8 on the following terms: a) that Deepak should bring in Rs. 4,200 as goodwill and Rs. 7,000 as his Capital; (b) that furniture be depreciated by 12%; (c) that stock be depreciated by 10% (d) that a Reserve of 5% be created for doubtful debts: (e) that the value of land and buildings having appreciated be brought upto Rs. 31,000 ;(f) that after making the adjustments the capital accounts of the old partners (who continue to share in the same proportion as before) be adjusted on the basis of the proportion of Deepak's Capital to his share in the business, i.e., actual cash to be paid off to, or brought in by the old partners as the case may be.

Prepare Cash Account, Profit and Loss Adjustment Account (Revaluation Account) and the Opening Balance Sheet of the new firm.

(**Ans :** Gain on revaluation Rs. 4,550. Balance Sheet Total Rs. 68,000))

34. Azad and Babli are partners in a firm sharing profits and losses in the ratio of 2:1. Chintan is admitted into the firm with 1/4 share in profits. Chintan will bring in Rs. 30,000 as his capital and the capitals of Azad and Babli are to be adjusted in the profit sharing ratio. The Balance Sheet of Azad and Babli as on December 31, 2015 (before Chintan's admission) was as follows:

Balance Sheet of A and B as on 31.12.2015

Liabilites		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		8,000	Cash in hand	2,000
Bills payable		4,000	Cash at bank	10,000
General reserve		6,000	Sundry debtors	8,000
Capital accounts:			Stock	10,000
Azad	50,000		Funiture	5,000
Babli	32,000	82,000	Machinery	25,000
			Buildings	40,000
		1,00,000		**1,00,000**

It was agreed that:

i) Chintan will bring in Rs. 12,000 as his share of goodwill premium.

ii) Buildings were valued at Rs. 45,000 and Machinery at Rs. 23,000.

iii) A provision for doubtful debts is to be created @ 6% on debtors.

iv) The capital accounts of Azad and Babli are to be adjusted by opening current accounts.

Record necessary journal entries, show necessary ledger accounts and prepare the Balance Sheet after admission.

(**Ans :** Gain or Revaluation Rs. 2,520. Balance Sheet Rs. 1,44,520).

35. Ashish and Dutta were partners in a firm sharing profits in 3:2 ratio. On Jan. 01, 2015 they admitted Vimal for 1/5 share in the profits. The Balance Sheet of Ashish and Dutta as on Jan. 01, 2015 was as follows:

Balance Sheet of A and B as on 1.1.2015

Liabilites	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors	15,000	Land & Building		35,000
Bills Payable	10,000	Plant		45,000
Ashish Capital	80,000	Debtors	22,000	
Dutta's Capital	35,000	Less : Provision	2,000	20,000
		Stock		35,000
		Cash		5,000
	1,40,000			**1,40,000**

It was agreed that:

i) The value of Land and Building be increased by Rs. 15,000.

ii) The value of plant be increased by 10,000.

iii) Goodwill of the firm be valued at Rs. 20,000.

iv) Vimal to bring in capital to the extent of 1/5th of the total capital of the new firm.

Record the necessary journal entries and prepare the Balance Sheet of the firm after Vimal's admission.

(**Ans :** Gain on Revaluation Rs. 25,000. Balance Sheet Total Rs. 2,25,000).

Check-list to Check your Understanding

Test your Understanding – I

1. (a), 2 (a), 3. (b).

Test your Understanding – II

1. (c), 2. (b), 3. (c), 4. (b), 5. (b).

Reconstitution of a Partnership Firm – Retirement/Death of a Partner

4

LEARNING OBJECTIVES

After Studying this chapter you will be able to:

- *calculate new profit sharing ratio and gaining ratio of the remaining partners after the retirement/death of a partner;*
- *describe the accounting treatment of goodwill in the event of retirement/ death of a partner;*
- *explain the accounting treatment for revaluation of assets and reassessment of liabilities;*
- *make the necessary entries in respect of unrecorded assets and liabilities;*
- *make necessary adjustment for accumulated profits or losses;*
- *ascertain the retiring/ deceased partner claim against the firm and explain the mode of its settlement;*
- *prepare the retiring partner's loan account, if required; and.*
- *Prepare the deceased partner's executor's account in the case of death of a partner and the balance sheet of a reconstituted firm.*

You have learnt that retirement or death of a partner also leads to reconstitution of a partnership firm. On the retirement or death of a partner, the existing partnership deed comes to an end, and in its place, a new partnership deed needs to be framed whereby, the remaining partners continue to do their business on changed terms and conditions. There is not much difference in the accounting treatment at the time of retirement or in the event of death. In both the cases, we are required to determine the sum due to the retiring partner (in case of retirement) and to the legal representatives (in case of deceased partner) after making necessary adjustments in respect of goodwill, revaluation of a assets and liabilities and transfer of accumulated profits and losses. In addition, we may also have to compute the new profit sharing's ratio among the remaining partners and so also their gaining ratio, This covers all these aspects in detail.

4.1 Ascertaining the Amount Due to Retiring/ Deceased Partner

The sum due to the retiring partner (in case of retirement) and to the legal representatives/ executors (in case of death) includes:

(i) credit balance of his capital account;
(ii) credit balance of his current account(if any);
(iii) his share of goodwill ;
(iv) his share of accumulated profits (reserves);
(v) his share in the gain of revaluation of assets and liabilities;

(vi) his share of profits up to the date of retirement/death;
(vii) interest on his capital, if involved, up to the date of retirement/death; and
(viii) salary/commission, if any, due to him up to the date of retirement/death.

The following deductions, if any, may have to be made from his share:

(i) debit balance of his current account(if any);
(ii) his share of goodwill to be written off; if necessary;
(iii) his share of accumulated losses;
(iv) his share of loss on revaluation of assets and liabilities;
(v) his share of loss up to the date of retirement/death;
(vi) his drawings up to the date of retirement/death;
(vii) interest on drawings, if involved, up to the date of retirement/death.

Thus, as in the case of admission, the various accounting aspects involved on retirement or death of a partner are as follows:

1. Ascertainment of new profit sharing ratio and gaining ratio;
2. Treatment of goodwill;
3. Revaluation of assets and liabilities;
4. Adjustment in respect of unrecorded assets and liabilities;
5. Distribution of accumulated profits and losses;
6. Ascertainment of share of profit or loss up to the date of retirement/death;
7. Adjustment of capital, if required;
8. Settlement of the amounts due to retired/deceased partner;

4.2 New Profit Sharing Ratio

New profit sharing ratio is the ratio in which the remaining partners will share future profits after the retirement or death of any partner. The new share of each of the remaining partner will consist of his own share in the firm plus the share acquired from the retiring /deceased partner.

Consider the following situations :

(a) normally, the continuing partners acquire the share of retiring or deceased partners in the old profit sharing ratio, and there is no need to compute the new profit sharing ratio among them, as it will be same as the old profit sharing ratio among them. In fact, in the absence of any information regarding profit sharing ratio in which the remaining partners acquire the share of retiring/deceased partner, it is assumed that they will acquire it in the old profit sharing ratio and so share the future profits in their old ratio. For example, Asha, Deepti and Nisha are partners in a firm sharing profits and losses in the ratio of 3:2:1. If Deepti retires, the new profit sharing ratio between Asha and Nisha will be 3:1, unless they decide otherwise.

(b) The continuing partners may acquire the share in the profits of the retiring/deceased partner in a proportion other than their old ratio, In that case, there is need to compute the new profit sharing ratio among them, and it will be equal to sum total of their respective old share and the share acquired from the retiring/deceased partner. *For example:* Naveen, Suresh and Tarun are partners sharing profits and losses in the ratio of 5:3:2. Suresh retires from the firm and his share was required by Naveen and Tarun in the ratio 2:1. In such a case, the new share of profit will be calculated as follows:

New share of Continuing Partner = Old Share + Acquired share from the Outgoing Partner

Gaining Ratio 2 : 1

Share acquired by Naveen $= \frac{2}{3}$ of $\frac{3}{10}$

$= \frac{2}{3} \times \frac{3}{10} = \frac{2}{10}$

Share acquired by Tarun $= \frac{1}{3}$ of $\frac{3}{10}$

$= \frac{1}{3} \times \frac{3}{10} = \frac{1}{10}$

Share of Naveen $= \frac{5}{10} + \frac{2}{10} = \frac{7}{10}$

Share of Tarun $= \frac{2}{10} + \frac{1}{10} = \frac{3}{10}$

Thus, the new profit sharing ratio of Naveen and Tarun will be = 7 : 3.

(c) The contributing partners may agree on a specified new profit sharing ratio: In that case the ratio so specified will be the new profit sharing ratio.

4.3 Gaining Ratio

The ratio in which the continuing partners have acquired the share from the retiring/deceased partner is called the gaining ratio. Normally, the continuing partners acquire the share of retiring/deceased partner in their old profit sharing ratio, In that case, the gaining ratio of the remaining partners will be the same as their old profit sharing ratio among them and there is no need to compute the gaining ratio, Alternatively, proportion in which they acquire the share of the retiring/deceased partner may be duly spacified. In that case, again, there is no need to calculate the gaining ratio as it will be the ratio in which they have acquired the share of profit from the retiring deceased partner. The problem of calculating gaining ratio arises primarily when the new profit sharing ratio of the continuing partners is specified. In such a situation, the gaining ratio should be calculated by, deducting the old share of each continuing partners from his new share. For example, Amit, Dinesh and Gagan are partners sharing profits in the ratio of 5:3:2.

Dinesh retires. Amit and Gagan decide to share the profits of the new firm in the ratio of 3:2. The gaining ratio will be calculated as follows :

Amit's Gaining Share $= \frac{3}{5} - \frac{5}{10} = \frac{6-5}{10} = \frac{1}{10}$

Gagan's Gaining Share $= \frac{2}{5} - \frac{2}{10} = \frac{4-2}{10} = \frac{2}{10}$

Thus, Gaining Ratio of Amit and Gagan = 1:2

This implies Amit gains $\frac{1}{3}$ and Gagan gains $\frac{2}{3}$ of Dinesh's share of profit.

Gaining share of Continuing Partner = New share – Old share

Do it Yourself

Distinguish between Gaining ratio and Sacrificing Ratio in terms of:

1. Meaning
2. Effect on Partner's Share of Profit
3. Mode of calculation
4. When to calculate

Illustration 1

Madhu, Neha and Tina are partners sharing profits in the ratio of 5:3:2. Calculate new profit sharing ratio and gaining ratio if

1. Madhu retires
2. Neha retires
3. Tina retires.

Solution

Given old ratio among Madhu : Neha : Tina as 5 : 3 : 2

1. If Madhu retires, new profit sharing Ratio between Neha and Tina will be
   Neha : Tina = 3:2 and Gaining Ratio of Neha and Tina =3:2
2. If Neha retires New profit sharing Ratio between Madhu and Tina will be
   Madhu : Tina = 5:2
   Gaining Ratio of Madhu and Tina = 5:2
3. If Tina retires, new profit sharing ratio between Madhu and Neha will be:
   Madhu : Neha = 5:3
   Gaining ratio of Madhu and Neha = 5:3

Illustration 2

Alka, Harpreet and Shreya are partners sharing profits in the ratio of 3:2:1. Alka retires and her share is taken up by Harpreet and Shreya in the ratio of 3:2. Calculate the new profit sharing ratio.

Solution

Gaining Given, Ratio of Harpreet and Shreya = 3:2 = $\frac{3}{5}:\frac{2}{5}$

Old Profit Sharing Ratio of between Alka, Harpreet and Shreya 3:2:1 = $\frac{3}{6}:\frac{2}{6}:\frac{1}{6}$

Share acquired by Harpreet = $\frac{3}{5}$ of $\frac{3}{6}$ = $\frac{9}{30}$

Share acquired by Shreya = $\frac{2}{5}$ of $\frac{3}{6}$ = $\frac{6}{30}$

New Share = Old Share + Acquired Share

Harpreet's New Share = $\frac{2}{6}+\frac{9}{30}=\frac{19}{30}$

Shreya's New Share = $\frac{1}{6}+\frac{6}{30}=\frac{11}{30}$

New Profit Sharing Ratio of Harpreet and Shreya = 19:11

Illustration 3

Murli, Naveen and Omprakash are partners sharing profits in the ratio of $\frac{3}{8}$, $\frac{1}{2}$ and $\frac{1}{8}$. Murli retires and surrenders 2/3rd of his share in favour of Naveen and the remaining share in favour of Omprakash. Calculate new profit sharing and the gaining ratio of the remaining partners.

Solution

			Naveen	*Omprakash*
(i)	Old Share		$\frac{1}{2}$	$\frac{1}{8}$
(ii)	Share Acquired by Naveen and Omprakash from Murli	=	$\frac{2}{3}$ of $\frac{3}{8}=\frac{2}{8}$	$\frac{1}{3}$ of $\frac{3}{8}=\frac{1}{8}$
(iii)	New Share = (i) + (ii)	=	$\frac{1}{2}+\frac{2}{8}$	$\frac{1}{8}+\frac{1}{8}$
		=	$\frac{6}{8}$ or $\frac{3}{4}$	= $\frac{2}{8}$ or $\frac{1}{4}$

Thus, the New profit sharing Ratio = $\frac{3}{4}:\frac{1}{4}$ or 3:1, and the

Gaining Ratio = $\frac{2}{8} : \frac{1}{8}$ or 2:1 [as calculated in (ii)].

Illustration 4

Kumar, Lakshya, Manoj and Naresh are partners sharing profits in the ratio of 3 : 2 : 1 : 4. Kumar retires and his share is acquired by Lakshya and Manoj in the ratio of 3:2. Calculate new profit sharing ratio and gaining ratio of the remaining partners.

Solution

		Lakshya	*Manoj*	*Naresh*
(i)	Old Share	$\frac{2}{10}$	$\frac{1}{10}$	$\frac{4}{10}$
(ii)	Acquired Share from Kumar	$\frac{3}{5}$ of $\frac{3}{10}$	$\frac{2}{5}$ of $\frac{3}{10}$	Nil
		$= \frac{9}{50}$	$= \frac{6}{50}$	Nil
(iii)	New share = (i) = (ii)	$\frac{2}{10} + \frac{9}{50}$	$= \frac{1}{10} + \frac{6}{50}$	$= \frac{4}{10}$ + Nil
		$= \frac{19}{50}$	$= \frac{11}{50}$	$= \frac{20}{50}$

The New Profit Sharing Ratio is 19 : 11 : 20

Gaining ratio is 3 : 2 : 0

Notes : 1. Since Lakshya and Manoj are acquiring Kumar's share of profit in the ratio of 3:2, hence, the gaining ratio will be 3:2 between Lakshya and Manoj.

2. Naresh has neither sacrificed nor gained.

Illustration 5

Ranjana, Sadhna and Kamana are partners sharing profits in the ratio 4:3:2. Ranjana retires; Sadhna and Kamana decided to share profits in future in the ratio of 5:3. Calculate the Gaining Ratio.

Solution

Gaining Share = New Share – Old Share

Sadhna's Gaining Share = $\frac{5}{8} - \frac{3}{9} = \frac{45 - 24}{72} = \frac{21}{72}$

Kamana's Gaining Share = $\frac{3}{8} - \frac{2}{9} = \frac{27 - 16}{72} = \frac{11}{72}$

Gaining Ratio between Sadhna and Kamana = 21:11.

Do it Yourself

1. Anita, Jaya and Nisha are partners sharing profits and losses in the ratio of 1 : 1 : 1 Jaya retires from the firm. Anita and Nisha decided to share the profit in future in the ratio 4:3. Calculate the gaining ratio.
2. Azad, Vijay and Amit are partners sharing profits and losses in the proportion of $\frac{1}{4}, \frac{1}{8}$ and $\frac{10}{16}$. Calculate the new profit sharing ratio between continuing partners if (a) Azad retires; (b) Vijay retires; (c) Amit retires.
3. Calculate the gaining ratio in each of the above situations.
4. Anu, Prabha and Milli are partners. Anu retires. Calculate the future profit sharing ratio of continuing partners and gaining ratio if they agree to acquire her share : (a) in the ratio of 5:3; (b) equally.
5. Rahul, Robin and Rajesh are partners sharing profits in the ratio of 3 : 2 : 1. Calculate the new profit sharing ratio of the remaining partners if (i) Rahul retires; (ii) Robin retires; (iii) Rajesh retires.
6. Puja, Priya, Pratistha are partners sharing profits and losses in the ratio of 5 : 3 : 2. Priya retires. Her share is taken by Priya and Pratistha in the ratio of 2 : 1. Calculate the new profit sharing ratio.
7. Ashok, Anil and Ajay are partners sharing profits and losses in the ratio of $\frac{1}{2}, \frac{3}{10}$ and $\frac{1}{5}$. Anil retires from the firm. Ashok and Ajay decide to share future profits and losses in the ratio of 3 : 2. Calculate the gaining ratio.

4.4 Treatment of Goodwill

The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners. Hence, at the time of retirement/death of a partner, goodwill is valued as per agreement among the partners the retiring/ deceased partner compensated for his share of goodwill by the continuing partners (who have gained due to acquisition of share of profit from the retiring/ deceased partner) in their gaining ratio.

The accounting treatment for goodwill in such a situation depends upon whether or, not goodwill already appears in the books of the firm.

4.4.1 When Goodwill does not Appear in the Books

When goodwill does not appear in the books of the firm there are four ways in which the retiring partner can be given the necessary credit for loss of his share of goodwill, these are as follows:

(a) Goodwill is raised at its full value and retained in the books as such: In this case, Goodwill Account is debited will its full value and all the partner's (including the retired/deceased partner) capital accounts are credited in the old profit sharing ratio. The full value of goodwill will appear in the balance sheet of the reconstituted firm.

(b) Goodwill is raised at it's full value and written off immediately: If it-decided that goodwill should not be refrained and shown in the balance sheet of the reconstituted firm then, after raising goodwill at its value by crediting all the partners' capital accounts (including that of the retired/ deceased partners, it should be written off by debiting the remaining partners in their new profit sharing ratio and crediting the goodwill account with its full value.

(c) Goodwill is raised to the extent of retired/deceased partner's share and written off immediately: In this case goodwill account is raised only to the extent of retired/deceased partner's share by debiting goodwill account with the proportionate amount and credited only to the retired/deceased partner's capital account. Thereafter, the remaining partners capital accounts are debited in their gaining ratio and goodwill account/credited to write it off.

(d) No goodwill account is raised at all in firm's books: If it is decided that the goodwill account should not appear in firm's books at all, in that case it is adjusted discretely through partners capital accounts by recording the following journal entry.

Continuing partners' capital A/c's	Dr.
(individually in their gaining ratio)	
To Retiring/Deceased Partner's Capital A/c	
(Retiring/deceased in the remaining partners' capital accounts into their gaining ratio)	

Let us take an example and clarity the treatment of goodwill on retirement or death of a partner using all the above alternatives. A, B. and C are partners in a firm sharing profits in the ratio of 3:2:1 B retires. The goodwill of the firm is valued at Rs. 60,000 and the remaining partners A and C continue to share profits in the ratio of 3:1. The journal entries passed under various alternatives shall be as follows:

(a) If goodwill is raised at full value and retained in books

Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all the partners in their old profit sharing ratio)			

(b) If goodwill is raised at full value and written off immediately.

(i) Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all partners in old ratio)			
(ii) A's capital A/c	Dr.	45,000	
C's capital A/c	Dr.	15,000	
To Goodwill A/c			60,000
(Goodwill written off and debited to remaining partners in the new ratio)			

(c) If goodwill is raised to the extent of retiring partner's share and written off immediately.

(i) Goodwill A/c	Dr.	20,000	
To B's capital A/c			20,000
(Goodwill raised to the extant of B's share)			
(ii) A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To goodwill A/c			20,000
(Goodwill written off by debiting remaining partners' in gaining ratio)			

(d) If goodwill is not to after in firm's books at all

A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To C's capital A/c			20,000
(B's share of goodwill adjusted to remaining partners' capital accounts in gaining ratio)			

It may also happen that as a result of decision on the new profit sharing ratio among the remaining partners, a continuing partner may also sacrifice a part of his share in future profits. In such a situation his capital account will also be credited along with the retiring/deceased partner's capital account in proportion to his sacrifice and the other continuing partners' capital accounts will be debited based on their gain in the future profit ratio.

Illustration 6

Keshav, Nirmal and Pankaj are partners sharing profits and losses in the ratio of 4 : 3 : 2. Nirmal retires and the goodwill is valued at Rs. 72,000. Keshav and Pankaj decided to share future profits and losses in the ratio of 5 : 3. Record necessary journal entries (a) when goodwill is raised at its full value and written off immediately (b) when goodwill is not to appear in firms books at all.

Solution

(a) When Goodwill is raised and written-off

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
(i)	Goodwill A/c	Dr.		72,000	
	To Keshav's Capital A/c				32,000
	To Nirmal's Capital A/c				24,000
	To Pankaj's Capital A/c				16,000
	(Goodwill raised at its full value in old profit sharing ratio)				
(ii)	Keshav's Capital A/c	Dr.		45,000	
	Pankaj's capital A/c	Dr.		27,000	
	To Goodwill A/c				72,000
	(Goodwill written off in the new profit sharing ratio)				

(b) When goodwill is not to appear in firm's books at all

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Keshav's Capital A/c	Dr.		13,000	
	Pankaj's Capital A/c	Dr.		11,000	
	To Nirmal's Capital A/c				24,000
	(Nirmal's share of goodwill adjusted to Keshav and Pankaj in their gaining ratio of 13:11)				

Working Notes

1. Vimal's share of goodwill = Rs. 72,000 $\times \frac{3}{9}$ = Rs. 24,000
2. Calculation of Gaining Ratio

   Gaining Share = New Share – Old Share

   Keshav's Gaining Share $= \frac{5}{8} - \frac{4}{9} = \frac{13}{72}$

   Pankaj's Gaining Share $= \frac{3}{8} - \frac{2}{9} = \frac{11}{72}$

   Hence, Gaining Ratio between Keshav and Pankaj is 13:11 i.e. $\frac{13}{24} : \frac{11}{24}$

Illustration 7

Jaya, Kirti, Ekta and Shewata are partners in a firm sharing profits and losses in the ratio of 2 : 1 : 2 : 1. On Jaya's retirement, the goodwill of the firm is valued at Rs. 36,000. Kirti, Ekta and Shewata decided to share future profits equally. Record the necessary journal entry for the treatment of goodwill without opening 'Goodwill Account'.

Solution

Books of Kirti, Ekta and Shewata
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Kirti's Capital A/c Dr. Shewata's Capital A/c Dr. To Jaya's Capital A/c (Jaya's share of goodwill adjusted to remaining in their gaining ratio)		6,000 6,000	 12,000

Working Notes

1. Jaya's Share of Goodwill

   = Rs. $36{,}000 \times \frac{2}{6}$ = Rs. 12,000

2. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Kirti's Gain $= \frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$

   Ekta's Gain $= \frac{1}{3} - \frac{2}{6} = \frac{2-2}{6} = \frac{0}{6}$ (Neither Gain nor Sacrifice)

   Shewata's Gain $= \frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$

   Hence, Gaining ratio between Kirti and Shewata $\frac{1}{6} : \frac{1}{6}$ = 1:1

Illustration 8

Deepa, Neeru and Shilpa were partners in a firm sharing profits in the ratio of 5 : 3 : 2. Neeru retired and the new profit sharing ratio between Deepa and Shilpa was 2 : 3. On Neeru's retirement, the goodwill of the firm was valued at Rs. 1,20,000. Record necessary journal entry for the treatment of goodwill on Neeru's retirement.

Solution

Books of Deepa and Shilpa
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Shilpa's Capital A/c Dr. To Neeru's Capital A/c To Deepa's Capital A/c (Shilpa compensated Neeru for her share of goodwill and to Deepa for the sacrifice made by her on Neeru's retirement)		48,000 36,000	 12,000

Working Notes

1. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Deepa's Gaining Share = $\frac{2}{5} - \frac{5}{10} = \frac{4-5}{10} = -\frac{1}{10} = \left(\frac{1}{10}\right)$ i.e., Sacrifice.

   Shilpa's Gaining Share = $\frac{3}{5} - \frac{2}{10} = \frac{6-2}{10} = \frac{4}{10}$ i.e., Gain

2. Hence, Shilpa will compensate both Neeru (retiring partner) and Deepa (continuing partner who has sacrificed) to the extent of their sacrifice worked out as follows:

   Deepa's Sacrifice = Goodwill of the firm × Sacrificing Share

   $$= \text{Rs. } 1,20,000 \times \frac{1}{10} = \text{Rs. } 12,000$$

   Neeru's (Retiring Partner's Sacrifice) = Rs. $1,20,000 \times \frac{3}{10}$ = Rs. 36,000.

Test your Understanding – I

Choose the correct option in the following questions:

1. Abhishek, Rajat and Vivek are partners sharing profits in the ratio of 5:3:2. If Vivek retires, the New Profit Sharing Ratio between Abhishek and Rajat will be–
   (a) 3:2
   (b) 5:3
   (c) 5:2
   (d) None of these
2. The old profit sharing ratio among Rajender, Satish and Tejpal were 2:2:1. The New Profit Sharing Ratio after Satish's retirement is 3:2. The gaining ratio is–
   (a) 3:2
   (b) 2:1
   (c) 1:1
   (d) 2:2

3. Anand, Bahadur and Chander are partners. Sharing Profit equally On Chander's retirement, his share is acquired by Anand and Bahadur in the ratio of 3:2. The New Profit Sharing Ratio between Anand and Bahadur will be–
   (a) 8:7
   (b) 4:5
   (c) 3:2
   (d) 2:3
4. In the absence of any information regarding the acquisition of share in profit of the retiring/deceased partner by the remaining partners, it is assumed that they will acquire his/her share:-
   (a) Old Profit Sharing Ratio
   (b) New Profit Sharing Ratio
   (c) Equal Ratio
   (d) None of these

Illustration 9

Hanny, Pammy and Sunny are partners sharing profits in the ratio of 3 : 2 : 1. Goodwill is appearing in the books at a value of Rs. 60,000. Pammy retires and at the time of Pammy's retirement, goodwill is valued at Rs. 84,000. Hanny and Sunny decided to share future profits in the ratio of 2:1. Record the necessary journal entries.

Solution

Books of Hanny and Sunny
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Hanny's Capital A/c	Dr.		30,000	
	Pammy's Capital A/c	Dr.		20,000	
	Sunny's Capital A/c	Dr.		10,000	
	To Goodwill A/c				60,000
	(Existing goodwill written-off in old ratio)				
	Hanny's Capital	Dr.		14,000	
	Sunny's Capital	Dr.		14,000	
	To Pammy's Capital A/c				28,000
	(Pammy's share of goodwill adjusted to Hanny's and Sunny's capital account to the extent of their gain)				

Working Notes

(i) Pammy's share of current value of goodwill $\frac{1}{3}$ of Rs. 84,000

$$= 84,000 \times \frac{1}{3} = \text{Rs. } 28,000$$

(ii) Gaining Share = New Share – Old Share

Hanny's Gaining Share = $\frac{2}{3} - \frac{3}{6} = \frac{1}{6}$

Sunny's Gaining Share = $\frac{1}{3} - \frac{1}{6} = \frac{1}{6}$

This gaining Ratio of Hanny and Sunny is $\frac{1}{6} - \frac{1}{6}$ = 1:1

4.4.2 When Goodwill is already Appearing in the Books

If value of goodwill already appearing in the books of the firm equals with the current value of goodwill, normally no adjustment is required because goodwill stands credited in the accounts of all the partners including the retiring one. In case the present value of goodwill is different from its book value, an adjustment entry is required for the difference between the value already appearing in the books (called book value) and its present value. In such a situation, there are two possibilities: (a) the book value of goodwill is lower than its current value, and (b) the book value is greater than its current value. These are discussed as follows.

(a) *If the book value of goodwill is lower than its present value :* In this case the goodwill is raised to its present value by debiting goodwill Account with the excess of its current value over the book value and crediting all partners' capital accounts in their old profit sharing ratio. For example, Deepak, Nakul and Rajesh are partners sharing profits in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20,000. Nakul retires and, on the day of Nakul's retirement, goodwill is valued at Rs. 24,000. In this case, the following journal entry will be recorded.

Books of Deepak, Nakul and Rajesh
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Goodwill A/c Dr.		4,000	
	To Deepak's Capital A/c			2,000
	To Nakul's Capital A/c			1,200
	To Rajesh's Capital A/c			800
	(Increase in the value of goodwill credited to all partners' capital accounts in their old profit sharing ratio of 5:3:2)			

(b) *If the book value of goodwill is greater than its current value:* In this case the difference between the book value of goodwill and its current value will be credited to Goodwill Account and debited to all Partners' capital accounts in their old profit sharing ratio. For example, Mohanlal, Girdharilal and Shyamlal are partners sharing profits in the ratio of 4:3:1. Shyamlal retires from the firm. On Shyamlal's retirement, goodwill has been valued at Rs. 52,000. There was a goodwill account already appearing in the books of the firm with a value of Rs. 60,000. In this case, the following journal entry will be recorded.

Books of Mohanlal, Girdharilal and Shyamlal
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Mohan Lal's Capital A/c Dr.		4,000	
	Girdhari Lal's Capital A/c Dr.		3,000	
	Shyam Lal's Capital A/c Dr.		1,000	
	To Goodwill A/c			8,000
	(Decrease in the value of goodwill adjusted among all the partners' capital accounts in their old profit sharing ratio)			

It may be noted that in all the above situations, goodwill appears in the balance sheet at its full value. In case it is decided by the partners that it should be written-off, fully or partially, it can be done by debiting the remaining partner's capital accounts in the new profit sharing ratio and crediting Goodwill Account with the respective value.

Alternatively, instead of first raising goodwill to its full value and then writing it off, if the partners so decide, we may first write off the existing goodwill as it appears in the book by debiting all partners in the old profit sharing ratio, and then give the necessary credit to the retiring/deceased partner by debiting the remaining partners capital accounts in their gaining ratio and crediting the retired/deceased partner by his share of goodwill. (See illustration 9)

4.4.3 Hidden Goodwill

If the firm has agreed to settle the retiring or deceased partner's account by paying him a lump sum amount, then the amount paid to him in excess of what is due to him, based on the balance in his capital account after making necessary adjustments in respect of accumulated profits and losses and revaluation of assets and liabilities, etc., shall be treated as his share of goodwill (known as hidden goodwill). For example, P, Q and R are partners in a firm sharing profits in the ratio of 3:2:1. R retires, and the balance in his capital account after making necessary adjustments on account of reserves, revolution of assets and liabilities works-out to be Rs. 60,000, P and Q agreed to pay him Rs. 75,000 in full settlement of his claim. It implies that Rs. 15,000 is R's share of goodwill of the firm. This will be debits to the capital accounts of P and Q in their gaining ratio (3:2 assuming no change in their own profit sharing ratio) and crediting R's capital Account as follows:

			Rs.	*Rs.*
	P's Capital A/c Dr. Q's Capital A/c Dr. To R's Capital A/c (R's share of goodwill adjusted in P's and Q's capital accounts in their gaining ratio of 3:2)		9,000 6,000	 15,000

Test your Understanding – II

Choose the correct option in the following questions:

1. On retirement/death of a partner, the retiring/deceased partner's capital account will be credited with
   (a) his/her share of goodwill.
   (b) goodwill of the firm.
   (c) shares of goodwill of remaining partners.
   (d) none of these.
2. Gobind, Hari and Pratap are partners. On retirement of Gobind, the goodwill already appears in the Balance Sheet at Rs. 24,000. The goodwill will be written-off
   (a) by debiting all partners' capital accounts in their old profit sharing ratio.
   (b) by debiting remaining partners' capital accounts in their new profit sharing ratio.
   (c) by debiting retiring partners' capital accounts from his share of goodwill.
   (d) none of these.
3. Chaman, Raman and Suman are partners sharing profits in the ratio of 5:3:2. Raman retires, the new profit sharing ratio between Chaman and Suman will be 1:1. The goodwill of the firm is valued at Rs. 1,00,000 Raman's share of goodwill will be adjusted
   (a) by debiting Chaman's Capital account and Suman's Capital Account with Rs 15,000 each.
   (b) by debiting Chaman's Capital account and Suman's Capital Account with Rs. 21,429 and 8,571 respectively.
   (c) by debiting only Suman's Capital Account with Rs. 30,000.
   (d) by debiting Raman's Capital account with Rs. 30,000.
4. On retirement/death of a partner, the remaining partner(s) who have gained due to change in profit sharing ratio should compensate the
   (a) retiring partners only.
   (b) remaining partners (who have sacrificed) as well as retiring partners.
   (c) remaining partners only (who have sacrificed).
   (d) none of these.

4.5 Adjustment for Revaluation of Assets and Liabilities

At the time of retirement or death of a partner there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm. Not only that, there may be some unrecorded assets and liabilities which need to be brought into books. As learnt in case of admission of a partner, a Revaluation Account is prepared in order to ascertain net gain (loss) on revaluation of assets and/or liabilities and bringing unrecorded items into firm's books and the same is transferred to the capital account of all partners including retiring/deceased partners in their old profit sharing ratio. the Journal entries to be passed for this purpose are as follows:

1. *For increase in the value of assets*

   Assets A/c's (Individually) Dr.
   To Revaluation A/c
   (Increase in the value of assets)

2. *For decrease in the value of assets*

   Revaluation A/c Dr.
   To Assets A/c's (Individually)
   (Decrease in the value of assets)

3. *For increase in the amount of liabilities*

   Revaluation A/c Dr.
   To Liabilities A/c (Individually)
   (Increase in the amount of liabilities)

4. *For decrease in the amount of liabilities*

   Liabilities A/c's (Individually) Dr.
   To Revaluation A/c
   (Decrease in the amount of liabilities)

5. *For an unrecorded asset*

   Assets A/c Dr.
   To Revaluation A/c
   (Unrecorded asset brought into book)

6. *For an unrecorded liability*

   Revaluation A/c Dr.
   To Liability A/c
   (Unrecorded liability brought into books)

7. *For distribution of profit or loss on revaluation*

   Revaluation A/c Dr.
   To All Partners' Capital A/c's (Individually)
   (Profit on revaluation transferred
   to partner's capital)

(or)

All Partners' Capital A/c's (Individually) Dr.
To Revaluation A/c
(Loss on revaluation transferred to partner's capital accounts)

Illustration 10

Mitali, Indu and Geeta are partners sharing profits and losses in the ratio of 3 : 2 : 1 respectively. On March 31, 2015, their Balance Sheet was as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		55,000	Goodwill	25,000
Reserve Fund		30,000	Buildings	1,00,000
Capital Accounts:			Patents	30,000
Mitali	1,50,000		Machinery	1,50,000
Indu	1,25,000		Stock	50,000
Geeta	75,000	3,50,000	Debtors	40,000
			Cash	40,000
		4,35,000		**4,35,000**

Geeta retires on the above date. It was agreed that Machinery be valued at Rs.1,40,000; Patents at Rs. 40,000; and Buildings at Rs. 1,25,000. Record the necessary journal entries and prepare the Revaluation Account.

Solution

Books of Mitali and Indu
Journal

Date 2015	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Mar. 31	Revaluation A/c	Dr.		10,000	
	To Machinery A/c				10,000
	(Decrease in the value of machinery)				
	Patents A/c	Dr.		10,000	
	Buildings A/c	Dr.		25,000	
	To Revaluation A/c				35,000
	(Increase in the value of patents and buildings)				
	Revaluation A/c	Dr.		25,000	
	To Mitali's Capital A/c				12,500
	To Indu's Capital A/c				7,500
	To Geeta's Capital A/c				5,000
	(Profit on revaluation transferred to all partner's capital accounts in old profit sharing ratio)				

Revaluation Account

Dr. *Cr.*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Machinery		10,000	Patents	10,000
Profit			Buildings	25,000
transferred to:				
Mitali's Capital A/c	12,500			
Indu's Capital A/c	7,500			
Geeta's Capital A/c	5,000	25,000		
		35,000		**35,000**

4.6 Adjustment of Accumulated Profits and Losses

Sometimes, the Balance Sheet of a firm may show accumulated profits in the form of general reserve on reserve fund and/on accumulated losses in the form of profit and loss account debit balance. The retiring/deceased partner is entitled to his/her share in the accumulated profits and is also liable to share the accumulated losses, if any. These accumulated profits or losses belong to all the partners and should be transferred to the capital accounts of all partners in their old profit sharing ratio. The following journal entries are recorded for the purpose.

(i) *For transfer of accumulated profits (reserves),*

Reserves A/c Dr.
To All Partners' Capital A/c's (Individually)
(Reserves transferred to all partners' capital account's in old profit sharing ratio).

(ii) *For transfer of accumulated losses*

All Partners' Capital A/c's (Individually) Dr.
To Profit and Loss A/c
(Accumulated loss transferred to all partners' capital accounts in their old profit-sharing ratio)

For example; Inder, Gajender and Harinder are partners sharing profits in the ratio of 3 : 2 : 1. Inder retires and the Balance Sheet of the firm on that date was as follows:

Books of Inder, Gajinder and Harinder
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		50,000	Land and Building	3,00,000
General Reserve		90,000	Stock	30,000
Capital Accounts:			Bank	10,000
Inder	1,00,000		Cash	5,000
Gajender	55,000			
Harinder	50,000	2,05,000		
		3,45,000		**3,45,000**

The journal entry to record the treatment of general reserve will be as follows :

Books of Gajender and Harinder
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2015 Mar. 31	General Reserve A/c Dr.		90,000	
	To Inder's Capital A/c			45,000
	To Gajender's Capital A/c			30,000
	To Harinder's Capital A/c			15,000
	(General Reserves transferred to all partners' capital accounts in the old ratio on Inder's retirement)			

4.7 Disposal of Amount Due to Retiring Partner

The outgoing partner's account is settled as per the terms of partnership deed i.e., in lumpsum immediately or in various instalments with or without interest as agreed or partly in cash immediately and partly in installment at the agreed intervals. In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive either interest @ 6% p.a. till the date of payment or such share of profits which has been earned with his/her money (i.e., based on capital ratio). Hence, the total amount due to the retiring partner which is ascertained after all adjustments have been made is to be paid immediately to the retiring partner. In case the firm is not in a position to make the payment immediately, the amount due is transferred to the retiring Partner's Loan Account, and as and when the amount is paid it is debited to his account. The necessary journal entries recorded are as follows.

1. *When retiring partner is paid cash in full.*

   Retiring Partner's Capital A/c Dr.
   To Cash/Bank A/c

2. *When retiring partner's whole amount is treated as loan.*

   Retiring Partner's Capital A/c Dr.
   To Retiring Partner's Loan A/c

3. *When retiring partner is partly paid in cash and the remaining amount treated as loan.*

   Retiring Partner's Capital A/c Dr. (Total Amount due)
   To Cash/Bank A/c (Amount Paid)
   To Retiring Partner's Loan A/c (Amount of Loan)

4. When Loan account is settled by paying in instalment includes principal and interest.
   a) For interest on loan
      Interest A/c Dr.
        To Retiring Partner's Loan A/c
   b) For payment of instalment
      Retiring Partner's Loan A/c Dr.
        To Cash/Bank A/c

Note:
1. The balance of the retiring partner's loan account is shown on the liabilities side of the Balance Sheet till the last instalment is paid to him/her.
2. Entry number (b) and (c), above will be repeated till the loan is paid off.

Illustration 11

Amrinder, Mahinder and Joginder are partners in a firm. Mahinder retires from the firm. On his date of retirement, Rs. 60,000 becomes due to him. Amrinder and Joginder promise to pay him in instalments every year at the end of the year. Prepare Mahinder's Loan Account in the following cases:
1. When payment is made four yearly instalments plus interest @ 12% p.a. on the unpaid balance.
2. When they agree to pay three yearly instalments of Rs. 20,000 including interest @ 12% p.a on the outstanding balance during the first three years and the balance including interest in the fourth year.
3. When payment is made in 4 equal yearly instalment's including interest @ 12% p.a. on the unpaid balance.

Solution

(a) When payment is made in four yearly instalments plus interest

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
Year-I	Bank (15,000+7,200)		22,200	Year-1	Mahinder Capital		60,000
					Interest		7,200
	Balance c/d		45,000				
			67,200				**67,200**

Year-II	Bank (15,000+5,400)		20,400	Year-II	Balance b/d		45,000
	Balance c/d		30,000		Interest		5,400
			50,400				**50,400**
Year-III	Bank (15,000+3,600)		18,600	Year-III	Balance b/d		30,000
	Balance c/d		15,000		Interest		3,600
			33,600				**33,600**
Year-IV	Bank (15,000+1,800)		16,800	Year-IV	Balance b/d		15,000
					Interest		1,800
			16,800				**16,800**

(b) When payment is made in three yearly installments of Rs. 20,000 each including interest.

Books of Amrinder, Mahinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		20,000	Year-I	Mohan's Capital		60,000
	Balance c/d		47,200		Interest		7,200
			67,200				**67,200**
Year-II	Bank		20,000	Year-II	Balance b/d		47,200
	Balance c/d		32,864		Interest		5,664
			52,864				**52,864**
Year-III	Bank		20,000	Year-III	Balance b/d		32,864
	Balance c/d		16,808		Interest		3,944
			36,808				**36,808**
Year-IV	Bank		18,825	Year-IV	Balance b/d		16,808
					Interest		2,017
			18,825				**18,825**

(c) When payment is made in four equal yearly instalments including interest @12% (Annually).

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		19,754	Year-I	Mohinder's Capital		60,000
	Balance c/d		47,446		Interest		7,200
			67,200				**67,200**
Year-II	Bank		19,754	Year-II	Balance b/d		47,446
	Balance c/d		33,386		Interest		5,694
			53,140				**53,140**
Year-III	Bank		19,754	Year-III	Balance b/d		33,386
	Balance c/d		17,638		Interest		4,006
			37,392				**37,392**
Year-IV	Bank		19,754	Year-IV	Balance b/d		17,638
					Interest		2,116
			19,754				**19,754**

Note: The annual instalment of payment in 4 years @ 12% interest works out at Rs. 19,754 (Annually of Rs. 0.329234 as per Annually Table x 60,000).

It may noted that the accounting treatment for disposal of amount due to retiring partner and deceased partner is similar with a difference that in case of death of a partner, the amount credited to him/her is transferred to his Executors' Account and the payment has to be made to him/her. This shall be taken up later in this chapter.

Do it Yourself

Vijay, Ajay and Mohan are friends. They passed B. Com. (Hons) from Delhi University in June, 2013. They decided to start the business of computer hardware.

On Ist of August, 2013, they introduced the capital of Rs. 50,000, Rs. 30,000 and Rs. 20,000 respectively and started the business in partnership at Delhi. The profit sharing ratio decided between there was 4:2:1. The business was running successfully. But on Ist February, 2016, due to certain unavoidable circumstances and family circumstances, Ajay decided to settle in Pune and decided to retire from the partnership on 31st March, 2017; with the consent of partners, Ajay retires as on 31st March, 2017, the position of assets and liabilities are as follows:

Contd...

Contd...

Balance Sheet of Vijay, Ajay and Mohan as on March 31, 2013

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital Accounts :			Goodwill	56,000
Vijay	1,80,000		Stock	90,000
Ajay	1,20,000		Debtors	66,000
Mohan	1,00,000	4,00,000	Land and Buildings	1,20,000
Bills Payable		12,000	Machinery	1,59,000
General Reserve		42,000	Motor Van	31,000
Creditors		90,000	Cash at bank	22,000
		5,44,000		**5,44,000**

On the date of retirement, the following adjustments were to be made:

1. Firm's goodwill was valued at Rs. 1,48,000.
2. Assets and Liabilities are to be valued as under: Stock Rs. 72,000; Land and Buildings Rs. 1,35,600; Debtors Rs. 63,000; Machinery Rs. 1,50,000; Creditors Rs. 84,000.
3. Vijay to bring Rs. 1,20,000 and Mohan Rs. 30,000 as additional capital.
4. Ajay was to be paid Rs. 97,200 in cash and the balance of his Capital Account to be transferred to his Loan Account Work out the amount due to Ajay and state as to how will you settle his account ?

Illustration 12

The Balance Sheet of Ashish, Suresh and Lokesh who were sharing profits in the ratio of 5 : 3 : 2, is given below as on March 31, 2015.

Balance Sheet of Ashish, Suresh and Lokesh
As on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Land	4,00,000
Shyam	7,20,000		Building	3,80,000
Gagan	4,15,000		Plant & Machinery	4,65,000
Ram	3,45,000	14,80,000	Furniture & Fittings	77,000
Reserve Fund		1,80,000	Stock	1,85,000
Sundry Creditors		1,24,000	Sundry Debtors	1,72,000
Outstanding Expresses		16,000	Cash in hand	1,21,000
		18,00,000		**18,00,000**

Suresh retires on the above date and the following adjustments are agreed upon his retirement.

1. Stock was valued at Rs. 1,72,000.
2. Furniture and fittings were valued at Rs. 80,000.

3. An amount of Rs. 10,000 due from Mr. Deepak, a debtor, was doubtful and a provision for the same was required.
4. Goodwill of the firm was valued at Rs. 2,00,000 but it was decided not to show goodwill in the books of accounts.
5. Suresh was paid Rs. 40,000 immediately on retirement and the balance was transferred to his loan account.
6. Ashish and Lokesh were to share future profits in the ratio of 3:2.

   Prepare Revaluation Account, Capital Account and Balance Sheet of the reconstituted firm.

Solution

Books of Ashish, Suresh and Lokesh
Revaluation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Stock	13,000	Furniture		3,000
Provision for Doubtful Debt	10,000	(Loss on Revaluation transferred to :		
		Ashish's capital	10,000	
		Suresh's capital	6,000	
		Lokesh's capital	4,000	20,000
	23,000			**23,000**

Partners' Capital Accounts

Dr. *Cr.*

Date 2015	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*
Mar.31	Revaluation (Loss)		10,000	6,000	4,000	Mar.31	Bal. b/d		7,20,000	4,15,000	3,45,000
	Suresh's Capital Goodwill		20,000		40,000		Reserve fund		90,000	54,000	36,000
	Cash			40,000			Ashish's Capital			20,000	
	Suresh's Loan			4,83,000			Lokesh's Capital			40,000	
	Balance c/d		7,80,000		3,37,000						
			8,10,000	**5,29,000**	**3,81,000**				**8,10,000**	**5,29,000**	**3,81,000**

Balance Sheet of Ashish and Lokesh as on April 01, 2013

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Capitals :			Land		4,00,000
Ashish	7,80,000		Buildings		3,80,000
Lokesh	3,37,000	11,17,000	Plant and Machinery		4,65,000
Suresh's Loan		4,83,000	Furniture		80,000
Sundry Creditors		1,24,000	Stock		1,72,000
Outstanding Expresses		16,000	Sundry Debtors	1,72,000	
			Less: Provision for Doubtful Debts	10,000	1,62,000
			Cash (Rs. 1,21,000–Rs. 40,000)		81,000
		17,40,000			**17,40,000**

Working Notes

1. Share Gained = New Share – Old Share

   Ashish's Gain = $\frac{3}{5} - \frac{5}{10} = \frac{6-5}{10} = \frac{1}{10}$

   Lokesh's Gain = $\frac{2}{5} - \frac{2}{10} = \frac{4-2}{10} = \frac{2}{10}$

   Gaining Ratio between Ashish and Lokesh = 1 : 2,

2. Suresh's Share of Goodwill = $\frac{3}{10}$ × Rs. 2,00,000 = Rs. 60,000

Illustration 13

Shyam, Gagan and Ram are partners sharing profit in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2015 are as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Reserves		14,500	Debtors	19,000
Capital:			Stock	42,000
Shyam	80,000		Machinery	85,000
Gagan	62,500		Building	1,22,000
Ram	75,000	2,17,500	Patents	9,000
Employees' Provident Fund		4,000		
		2,85,000		**2,85,000**

As Gagan got a very good break at an MNC, so he decided to retire on that date and it was decided that Shyam and Ram would share the future profits in the ratio of 5 : 3. Goodwill was valued at Rs. 70,000; Machinery at Rs. 78,000; Buildings at Rs. 1,52,000; stock at Rs. 30,000; and bad debts amounting to Rs. 1,550 were to be written off. Record journal entries in the books of the firm and prepare the Balance Sheet of the new firm.

Solution

Books of Shyam, Ram and Gagan
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2015	Revaluation A/c	Dr.		20,550	
Mar. 31	To Machinery A/c				7,000
	To Stock A/c				12,000
	To Debtors A/c				1,550
	(Loss on revaluation of assets recorded on Gagan's retirement)				
	Building A/c	Dr.		30,000	
	To Revaluation A/c				30,000
	(Appreciation in the value of Building on Gagan's retirement)				
	Revaluation A/c	Dr.		9,450	
	To Shyam's Capital A/c				3,780
	To Gagan's Capital A/c				3,780
	To Ram's Capital A/c				1,890
	(Profit on revaluation transferred to partners' capital accounts in the ratio of 2 : 2 : 1)				
	Reserve A/c	Dr.		14,500	
	To Shyam's Capital A/c				5,800
	To Gagan's Capital A/c				5,800
	To Ram's Capital A/c				2,900
	(Reserve transferred to partner's capital accounts)				
	Shyam's Capital A/c	Dr.		15,750	
	Ram's Capital A/c	Dr.		12,250	
	To Gagan's Capital A/c				28,000
	(Gagan's share of goodwill adjusted to Shyam and Ram in their gaining ratio of 9 : 7)				
	Gagan's Capital A/c	Dr.		1,00,080	
	To Gagan's Loan A/c				1,00,080
	(Amount payable to retiring partner transferred to his loan account)				

Balance Sheet of Shyam and Ram as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Employees' Provident Fund		4,000	Debtors	17,450
Capitals :			Stock	30,000
Shyam	73,830		Machinery	78,000
Ram	67,540	1,41,370	Building	1,52,000
Gagan's Loan		1,00,080	Patents	9,000
		2,94,450		**2,94,450**

Working Notes

Share Gained = New Share – Old Share

Shyam's Gain $= \frac{5}{8} - \frac{2}{5} = \frac{25-16}{40} = \frac{9}{40}$

Ram's Gain $= \frac{3}{8} - \frac{1}{5} = \frac{15-8}{40} = \frac{7}{40}$

Therefore, Gaining Ratio of Shyam and Ram = 9 : 7.

Revaluation Account

Dr. *Cr.*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Machinery		7,000	Building	30,000
Stock		12,000	Debtors	1,550
(Profit on Revaluation)				
Transfer to Capital				
Shyam	3,780			
Gagan	3,780			
Ram	1,890	9,450		
		30,000		**30,000**

Partners' Capital Accounts

Date 2015	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*
Mar.31	Gagan's Capital		15,750		12,250	Mar.31	Bal. b/d		80,000	62,500	75,000
	Gagan's Loan			1,00,080			Revaluation		3,780	3,780	1,890
	Bal. c/d		73,830		67,540		Profit Reserve		5,800	5,800	2,900
							Shyam's Capital			15,750	
							Ram's Capital			12,250	
			89,580	**1,00,080**	**79,790**				**89,580**	**1,00,080**	**79,790**

Note: As sufficient balance is not available to pay the due amount to Gagan, the balance in his capital account is transferred to his loan account.

4.8 Adjustment of Partners' Capitals

At the time of retirement or death of a partner, the remaining partners may decide to adjust their capital contributions in their profit sharing ratio. In such a situation, the sum of balances in the capitals of continuing partners may be treated as the total capital of the new firm, unless specified otherwise. Then, to ascertain the new capital of the continuing partners, the total capital of the firm is divided amongst the remaining partners as per the new profit sharing ratio, and the excess or deficiency of capital in the individual capital account's may be worked out. Such excess or shortage shall be adjusted by withdrawal of contribution in cash, as the case may be, for which the following journal entries will be recorded.

(i) For excess capital withdrawn by the partner :

Partners' Capital A/c Dr.
  To Cash / Bank A/c

(ii) For amount of capital to be brought in by the partner:

Cash / Bank A/c Dr.
  To Partners' Capital A/c

Consider the following situations:
The adjustment of the continuing partner's capitals may involve any one of the three ways as illustrated as follows :

1. When the capital of the new firm as decided by the partners is specified.

Illustration 14

Mohit, Neeraj and Sohan are partners in a firm sharing profits in the ratio of 2 : 1 : 1. Neeraj retires and Mohit and Sohan decided that the capital of the new firm will be fixed at Rs. 1,20,000. The capital accounts of Mohit and Sohan show a credit balance of Rs. 82,000 and Rs. 41,000 respectively after making all the adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries.

Solution

The New Profit Sharing Ratio between Mohit and Sohan = 2 : 1

	Mohit	*Sohan*
New Capital based new ratio is	80,000	40,000
Existing Capital (after adjustments) is	82,000	41,000
Cash to be brought in on (Paid off)	2,000	1,000

Books of Mohit and Sohan
Journal

Date	Particulars		L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Mohit's Capital A/c	Dr.		2,000	
	Sohan's Capital A/c	Dr.		1,000	
	To Cash A/c				3,000
	(Excess capital withdrawn by Sohan)				

2. When the total capital of new firm is not specified.

Illustration 15

Asha, Deepa and Lata are partners in a firm sharing profits in the ratio of 3 : 2 : 1. Deepa retires. After making all adjustments relating to revaluation, goodwill and accumulated profit etc., the capital accounts of Asha and Lata showed a credit balance of Rs. 1,60,000 and Rs. 80,000 respectively. It was decided to adjust the capitals of Asha and Lata in their new profit sharing ratio. You are required to calculate the new capitals of the partners and record necessary journal entries for bringing in or withdrawal of the necessary amounts involved.

Solution

a. Calculation of new capitals of the existinging partners

Balance in Asha's Capital (after all adjustments)	= 1,60,000
Balance in Lata's Capital	= 80,000
Total Capital of the New Firm	= 2,40,000

Based on the new profit sharing ratio of 2:1

Asha's New Capital = Rs. 2,40,000 $\times \frac{3}{4}$ = 1,80,000

Lata's New Capital = Rs. 2,40,000 $\times \frac{1}{4}$ = 60,000

Note :The total capital of the new firm is based on the sum of the balance in the capital accounts of the continuing partners.

b. Calculation of cash to be brought in or withdrawn by the continuing partners :

	Asha (Rs.)	Lata (Rs.)
New Capitals	1,80,000	60,000
Existing Capitals	1,60,000	80,000
c. Cash to be brought in on (paid off)	20,000	20,000

Books of Asha and Lata
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c Dr. To Asha Capital A/c (Cash brought by Asha)		20,000	 20,000
	Lata's Capital A/c Dr. To Cash A/c (Surplus capital withdrawn by Lata)		20,000	 20,000

3. When the amount payable to retiring partner will be contributed by continuing partners in such a way that their capitals are adjusted proportionate to their new profit sharing ratio:

Illustration 16

Lalit, Pankaj and Rahul are partners sharing profits in the ratio of 4 : 3 : 3. After all adjustments, on Lalit's retirement with respect to general reserve, goodwill and revaluation etc., the balances in their capital accounts stood at Rs. 70,000, Rs. 60,000 and Rs. 50,000 respectively. It was decided that the amount payable to Lalit will be brought by Pankaj and Rahul in such a way as to make their capitals proportionate to their profit sharing ratio. Calculate the amount to be brought by Pankaj and Rahul and record necessary journal entries for the same. Also record necessary entry for payment to Lalit.

After Lalit's retirement, the new profit sharing ratio between Pankaj and Rahul is 3 : 3, i.e. 1 : 1.

Solution

a. *Calculation of total capital of the new firm*

Balance in Pankaj's Capital account (after adjustment) = 60,000
Balance in Rahul's Capital account (after adjustment) = 50,000
Amount payable to Lalit (Retiring partner) = 70,000
Total capital of new firm (i) + (ii) + (iii) = 1,80,000

b. *Calculation of new capitals of the continuing partners*

Pankaj's New Capital = Rs. 1,80,000 $\times \frac{1}{2}$ = Rs. 90,000

Rahul's New Capital = Rs. 1,80,000 $\times \frac{1}{2}$ = Rs. 90,000 *c. Calculation of the amounts to be brought in or withdrawn by the continuing partners*

	Pankaj (Rs.)	*Rahul (Rs.)*
New Capital (Rs. 1,80,000 in the ratio of 1 : 1)	90,000	90,000
Existing capital (after adjustment)	60,000	50,000
Cash to be brought in	30,000	40,000

Books of Pankaj and Rahul
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c	Dr.	70,000	
	To Pankaj's Capital A/c			30,000
	To Rahul's Capital A/c			40,000
	(Amounts brought by Pankaj and Rahul)			
	Lalit's Capital A/c	Dr.	70,000	
	To Cash A/c			70,000
	(Amount paid to Lalit on retirement)			

Illustration 17

The Balance Sheet of Mohit, Neeraj and Sohan who are partners in a firm sharing profits according to their capitals as on March 31, 2015 was as under:

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors	21,000	Buildings		1,00,000
Mohit's Capital	80,000	Machinery		50,000
Neeraj's Capital	40,000	Stock		18,000
Sohan's Capital	40,000	Debtors	20,000	
General Reserve	20,000	*Less:* Provision for Bad Debt	1,000	19,000
		Cash at bank		14,000
	2,01,000			**2,01,000**

On that date, Neeraj decided to retire from the firm and was paid for his share in the firm subject to the following:

1. Buildings to be appreciated by 20%.
2. Provision for Bad debts to be increased to 15% on Debtors.
3. Machinery to be depreciated by 20%.
4. Goodwill of the firm is valued at Rs. 72,000 and the retiring partner's share is adjusted through the capital accounts of remaining partners.

5. The capital of the new firm be fixed at Rs. 1,20,000.

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

Solution

Revaluation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Provision for Doubtful Debt		2,000	Building	20,000
Machinery		10,000		
Capital (Profit on Revaluation)				
Mohit	4,000			
Neeraj	2,000			
Sohan	2,000	8,000		
		20,000		**20,000**

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

Date 2015	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*	*Date 2015*	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*
Mar.31	Neeraj's		12,000		6,000	Mar.31	Bal. b/d		80,000	40,000	40,000
	Balance c/d		82,000	65,000	41,000		General Reserve		10,000	5,000	5,000
							Revaluation (Profit)		4,000	2,000	2,000
							Mohit's Capital			12,000	
							Sohan's Capital			6,000	
			94,000	**65,000**	**47,000**				**94,000**	**65,000**	**47,000**
	Bank			65,000			Bal. b/d		82,000	65,000	41,000
	Bank		2,000		1,000						
	Bal. c/d (1)		80,000		40,000						
			82,000	**65,000**	**41,000**				**82,000**	**65,000**	**41,000**

Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		21,000	Building		1,20,000
Bank overdraft		54,000	Machinery		40,000
Capital			Stock		18,000
Mohit	80,000		Debtors	20,000	
Sohan	40,000	1,20,000	*Less:* Provision for Doubtful Debts (1,000+2,000)	3,000	17,000
		1,95,000			**1,95,000**

Working Notes

1. **Bank Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		14,000		Mohit's Capital		2,000
	Balance c/d (overdraft)		54,000		Sohan's Capital		1,000
					Neeraj's Capital		65,000
			68,000				**68,000**

2. It is assumed that bank overdraft is taken to pay the retiring partners.
3. Cash to be brought in or withdrawn by Mohit and Sohan :

		Mohit (Rs.)	*Sohan (Rs.)*
(a)	New capitals (Rs.1,20,000 in the ratio of 2:1)	80,000	40,000
(b)	Existing capital (after adjustments) as calculated	82,000	41,000
	Cash to be brought (paid off)	2,000	1,000

Do it Yourself

1. The Balance Sheet of A, B and C who were sharing the profits in proportion to their capitals stood as on March 31, 2015.

Balance Sheet as on March 31, 2015

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable	6,250	Land and Building		12,000
Sundry Creditors	10,000	Debtors	10,500	
Reserve Fund	2,750	*Less* Provision for bad debts	500	10,000
Capitals				
A 20,000		Bill receivables		7,000
B 15,000		Stock		15,500
C 15,000	50,000	Plant and Machinery		11,500
		Cash at bank		13,000
	69,000			69,000

B retired on the date of Balance Sheet and the following adjustments were to be made:
(a) Stock was depreciated by 10%.
(b) Factory building was appreciated by 12%.
(c) Provision for doubtful debts to be created up to 5%.
(d) Provision for legal charges to be made at Rs.265.
(e) The goodwill of the firm to be fixed at Rs.10,000.
(f) The capital of the new firm to be fixed at Rs.30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3:2.

Work out the final balances in capital accounts of the firm, and the amounts to be brought in and/or withdrawn by A and C to make their capitals proportionate to then new profit sharing ratio.

2. R, S and M were carrying on business in partnership sharing profits in the ratio of 3:2:1, respectively. On March 31, 2015, Balance Sheet of the firm stood as follows :

Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Building	23,000
Capitals:			Debtors	7,000
R	20,000		Stock	12,000
S	7,500		Patents	8,000
M	12,500	40,000	Bank	6,000
		56,000		**56,000**

Shyam retired on the above mentioned date on the following terms :
(a) Buildings to be appreciated by Rs.8,800.
(b) Provision for doubtful debts to be made @ 5% on debtors.
(c) Goodwill of the firm to be valued at Rs.9,000.
(d) Rs.5,000 to be paid to S immediately and the balance due to him to be treated as a loan carrying interest @ 6% per annum.

Prepare the balance sheet of the reconstituted firm.

4.9 Death of a Partner

As stated earlier, the accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any) from the date of the last Balance Sheet to the date of his death of these, the main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet and the date of the partner's death. Since, it is considered cumbersome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

For example, Bakul, Champak and Darshan were partners in a firm sharing profits in the ratio of 5:4:1. The profit of the firm for the year ending on March 31, 2016 was Rs.1,00,000. Champak dies on June 30, 2015. Champak's share of profit for the period from April 1 to June 30, 2015, shall be calculated as follows:

Total profit for the year ending on 31st March, 2016 = Rs.1,00,000

Champak's share of profit :

Proceeding Year's Profit × Proportionate Period × Share of Deceased Partner

$$= \text{Rs. } 1,00,000 \times \frac{3}{12} \times \frac{4}{10} = \text{Rs. } 10,000$$

The journal entry will be recorded as follows :

Profit & Loss Suspense A/c	Dr.	10,000	
To Champak's Capital A/c			10,000
(Champak's share of profit transferred to his capital account)			

Alternatively, if Champak's share of profit was to be calculated on the basis of average profits of the last three years, which were Rs. 1,36,000 for 2012-13, Rs. 1,54,000 for 2013-14 and Rs. 1,00,000 for 2015-16; Chambers share of profits for the period from April 7, 2015 to June 30, 2015 shall be calculated on the basis of average profit based on profits for the last year calculation as follows:

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of years}} = \frac{\text{Rs. } 1,36,000 + \text{Rs. } 1,54,000 + \text{Rs. } 1,00,000}{3}$$

$$= \frac{\text{Rs. } 3,90,000}{3} = \text{Rs. } 1,30,000$$

$$\text{Champak's share of profit} = \text{Rs. } 1,30,000 \times \frac{3 \text{ months}}{12 \text{ months}} \times \frac{4}{10}$$

$$= \text{Rs. } 13,000$$

In case, the agreement provides, that share of profit of the deceased partner will be worked out on the basis of sales, and it is specified that the sales during the year 2014-15 were Rs. 8,00,000 and the sales from April 1, 2015 to June

30, 2015 were Rs. 1,50,000 Champak's share of profits for the period from April 1, 2015 to June 30, 2015 shall be calculated as follows.

If sale is Rs.8,00,000, the profit	= Rs.1,00,000
If sale is Rs.1, the profit	$= \frac{1,00,000}{8,00,000}$
If sale is Rs.1,50,000, the profit	$= \frac{1,00,000}{8,00,000} \times 1,50,000$
	= Rs. 18,750
Champak's share of profit	= Rs. 7,500

For being deceased partner's share of profits for the intervening period to books of account, the following journal entry is recorded.

Profit and Loss Account

Profit and Loss (Supense) A/c Dr.
 To Deceased Partner's Capital A/c
(Share of profit for the intervening period)

Illustration 18

Anil, Bhanu and Chandu were partners in a firm sharing profits in the ratio of 5:3:2. On March 31, 2014, their Balance Sheet was as under:

Books of Anil, Bhanu and Chandu
Balance Sheet as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		11,000	Buildings	20,000
Reserve Fund		6,000	Machinery	30,000
Anil's Capital	30,000		Stock	10,000
Bhanu's Capital	25,000		Patents	11,000
Chandu's Capital	15,000	70,000	Debtors	8,000
			Cash	8,000
		87,000		**87,000**

Anil died on October 1, 2014. It was agreed between his executors and the remaining partners that :

(a) Goodwill to be valued at $2\frac{1}{2}$ year's purchase of the average profits of the previous four years which were :

Year 2009-10 – Rs.13,000, Year 2010-11 – Rs. 12,000,
Year 2011-12 – Rs.20,000, Year 2012-13 – Rs.15,000

(b) Patents be valued at Rs.8,000; Machinery at Rs.28,000; and Building at Rs.25,000.
(c) Profit for the year 2013-14 be taken as having accrued at the same rate as that of the previous year.
(d) Interest on capital be provided at 10% p.a.
(e) Half of the amount due to Anil be paid immediately.

Prepare Anil's Capital Account and Anil's Executor's Account as on October 1, 2013.

Solution

Books of Anil, Bhanu and Chander
Anil's Capital Account

Dr. *Cr.*

Date 2013	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2013*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Anil's Executors		57,000	April,1	Balance b/d		30,000
				Oct. 1	Reserve Fund		3,000
					Bhanu's Capital		11,250
					Chandu's Capital		7,500
					Profit & Loss (Suspense)		3,750
					Interest on Capital		1,500
			57,000				**57,000**

Anil's Executor's Account

Dr. *Cr.*

Date 2013	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2013*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Bank		28,500	Oct.1	Anil's Capital		57,000
	Balance c/d		28,500				
			57,000				**57,000**

Working Notes

1. **Revaluation Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Patents		3,000		Building		5,000
	Machinery		2,000				
			5,000				**5,000**

2. Goodwill = 2½ years' purchase × Average Profit

$$\text{Average Profit} = \frac{\text{Rs. } 13{,}000 + \text{Rs.}12{,}000 + \text{Rs.}20{,}000 + \text{Rs.}15{,}000}{4}$$

$$= \frac{\text{Rs. } 60{,}000}{4} = \text{Rs. } 15{,}000$$

$$\text{Goodwill} = \frac{5}{2} \times \text{Rs. } 15{,}000$$

$$= \text{Rs. } 37{,}500$$

$$\text{Anil's Share of Goodwill} = \frac{5}{10} \times \text{Rs. } 37{,}500$$

$$= \text{Rs. } 18{,}750$$

3. Profit from the date of last balance sheet to date of death (April 1, 2014 to October 1, 2014) = 6 months

$$\text{Profit for 6 months} = \text{Rs. } 15{,}000 \times \frac{6}{12} = \text{Rs. } 7{,}500$$

$$\text{Anil's share of profit} = \text{Rs. } 7{,}500 \times \frac{5}{10} = \text{Rs. } 3{,}750$$

4. Interest on Capital (April 1, 2007 to October 1, 2014)

$$= \text{Rs. } 30{,}000 \times \frac{10}{100} \times \frac{6}{12}$$

$$= \text{Rs. } 1{,}500$$

Illustration 19

You are given the Balance Sheet of Mohit, Sohan and Rahul who are partners sharing profits in the ratio of 2 : 2 : 1, as on March 31, 2014.

Books of Mohit, Sohan and Rahul
Balance Sheet as on March 31, 2012.

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		40,000	Goodwill	30,000
Reserve Fund		25,000	Fixed assets	60,000
Capitals:			Stock	10,000
Mohit	30,000		Sundry Debtors	20,000
Sohan	25,000		Cash at bank	15,000
Rahul	15,000	70,000		
		1,35,000		**1,35,000**

Sohan died on June 15, 2014. According to the Deed, his legal representatives are entitled to:

(a) Balance in Capital Account;
(b) Share of goodwill valued on the basis of thrice the average of the past 4 years' profits.

(c) Share in profits up to the date of death on the basis of average profits for the past 4 years.

(d) Interest on capital account @ 12% p.a.

Profits for the years ending on March 31 of 2010, 2011, 2012, 2013 respectively were Rs. 15,000, Rs. 17,000, Rs. 19,000 and Rs. 13,000.

The firm had taken a Joint Life Policy of Rs. 1,25,000, the annual premium being charged to profit & loss account every year.

Sohan's legal representatives were to be paid the amount due. Mohit and Rahul continued as partner by taking over Sohan's share equally. Work out the amount payable to Sohan's legal representatives.

Solution

Books of Mohit, Sohan and Rahul
Sohan's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2007*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Goodwill		12,000	Apr. 1	Balance b/d		25,000
	Sohan's Executor		94,158	Jun.15	Reserve Fund		10,000
					Mohit's Capital		9,600
					Rahul's Capital		9,600
					Profit & Loss (Suspense)		1,333
					Joint life policy		50,000
					Interest on Capital		625
			1,06,158				**1,06,158**

Working Notes

1. Sohan's Share of Goodwill

$$= \text{Goodwill of the Firm} \times \frac{2}{5}$$

$$= \text{Rs. } 48{,}000 \times \frac{2}{5} = \text{Rs. } 19{,}200$$

Goodwill of the Firm $= 3 \times$ Average Profit

$$= 3 \times \frac{\text{Rs. } 64{,}000}{4} = \text{Rs. } 48{,}000$$

2. Profit and Loss (Suspense)
(Share of Profit from the date of last Balance Sheet to the date of death) $2\frac{1}{2}$ months.

$$= \frac{\text{Rs. } 64{,}000}{4} \times \frac{2}{5} \times \frac{2.5}{12}$$

= Rs. 1,333

3. Joint Life Policy = Rs. 1,25,000

Sohan's Share $= \frac{2}{5} \times$ Rs. 1,25,000

= Rs. 50,000

4. Interest on Capital $= \text{Rs. } 25{,}000 \times \frac{12}{100} \times \frac{2.5}{12}$

= Rs. 625

Do it Yourself

On December 31, 2015, the Balance Sheet of Pinki, Qureshi and Rakesh showed as under :

Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		25,000	Buildings	26,000
Reserve Fund		20,000	Investments	15,000
Capitals:			Debtors	15,000
Pinki	15,000		Bills Receivables	6,000
Qureshi	10,000		Stock	12,000
Rakesh	10,000	35,000	Cash	6,000
		80,000		**80,000**

The partnership deed provides that the profit be shared in the ratio of 2:1:1 and that in the event of death of a partner, his executors be entitled to be paid out :

(a) The capital of his credit at the date of last Balance Sheet.

(b) His proportion of reserves at the date of last Balance Sheet.

(c) His proportion of profits to the date of death based on the average profits of the last three completed years, plus 10%, and

(d) By way of goodwill, his proportion of the total profits for the three preceding years. The net profit for the last three years were :

	(Rs.)
2013	16,000
2014	16,000
2015	15,400

Rakesh died on April 1, 2015. He had withdrawn Rs.5,000 to the date of his death. The investment were sold at par and R's Executors were paid off. Prepare Rakesh's Capital Account that of his executors.

Terms Introduced in the Chapter

- Retirement of a Partner.
- Death of a Partner.
- Gaining Ratio
- Executors of deceased Partner
- Executor's Account.

Summary

1. *New Profit Sharing Ratio:* New profit sharing ratio is the ratio in which the remaining partner will share future profits after the retirement or death of any partner.

   New Share = Old Share + Acquired Share from the Outgoing partner
2. *Gaining Ratio:* Gaining ratio is the ratio in which the continuing partners have acquired the share from the retiring deceased partner.
3. *Treatment of Goodwill:* The basic rule is that gaining partner(s) shared compensate the sacrificing partner to the extent of their gain for the respective share of goodwill.

   If goodwill already appears in the books, it will be written off by debiting all partner's capital account in their old profit sharing ratio.
4. *Revaluation of Assets and Liabilities*: At the time of retirement/death of a partner, there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm.

   Besides this, there may be unrecorded assets and liabilities which have to be recorded.
5. *Accumulated Profits or Losses:* The reserves (Accumulated profits) or losses belong to all the partners and should be transferred to capital account of all partners.

   6. Retiring partner/deceased partner may be paid in one lump sum or installments with interest.
7. At the time of retirement/death of a partner, the remaining partner may decide to keep their capital contributions in their profit sharing ratio.

Question for Practice

Short Answer Questions

1. What are the different ways in which a partner can retire from the firm.
2. Write the various matters that need adjustments at the time of retirement of a partners.
3. Distinguish between sacrificing ratio and gaining tab.

4. Why do firm revaluate assets and reassers their liabilities on retirement or on the event of death of a partner.
5. Why a retiring/deceased partner is entitled to a share of goodwill of the firm.

Long Answer Questions

1. Explain the modes of payment to a retiring partner.
2. How will you compute the amount payable to a deceased partner?
3. Explain the treatment of goodwill at the time of retirement or on the event of death of a partner?
4. Discuss the various methods of computing the share in profits in the event of death of a partners.

Numerical Questions

1. Aparna, Manisha and Sonia are partners sharing profits in the ratio of 3 : 2 : 1. Manisha retires and goodwill of the firm is valued at Rs. 1,80,000. Aparna and Sonia decided to share future in the ratio of 3 : 2. Pass necessary journal entries.

   (**Ans :** Dr. Aparna's Capital A/c by Rs. 18,000, Dr. Sonia's Capital A/c by Rs. 42,000, Dr. Manisha's Capital A/c by Rs. 60,000).
2. Sangeeta, Saroj and Shanti are partners sharing profits in the ratio of 2 : 3 : 5. Goodwill is appearing in the books at a value of Rs. 60,000. Sangeeta retires and goodwill is valued at Rs. 90,000. Saroj and Shanti decided to share future profits equally. Record necessary journal entries.
3. Himanshu, Gagan and Naman are partners sharing profits and losses in the ratio of 3 : 2 : 1. On March 31, 2007, Naman retires.

   The various assets and liabilities of the firm on the date were as follows:

   Cash Rs. 10,000, Building Rs. 1,00,000, Plant and Machinery Rs. 40,000, Stock Rs. 20,000, Debtors Rs. 20,000 and Investments Rs. 30,000.

   The following was agreed upon between the partners on Naman's retirement:
   (i) Building to be appreciated by 20%.
   (ii) Plant and Machinery to be depreciated by 10%.
   (iii) A provision of 5% on debtors to be created for bed and doubtful debts.
   (iv) Stock was to be valued at Rs. 18,000 and Investment at Rs. 35,000.

   Record the necessary journal entries to the above effect and prepare the revaluation account.
4. Naresh, Raj Kumar and Bishwajeet are equal partners. Raj Kumar decides to retire. On the date of his retirement, the Balance Sheet of the firm showed the following: General Reserves Rs. 36,000 and Profit and Loss Account (Dr.) Rs. 15,000.
   Pass the necessary journal entries to the above effect.

5. Digvijay, Brijesh and Parakaram were partners in a firm sharing profits in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2015 was as follows:

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors	49,000	Cash	8,000
Reserves	18,500	Debtors	19,000
Digvijay's Capital	82,000	Stock	42,000
Brijesh's Capital	60,000	Buildings	2,07,000
Parakaram's Capital	75,500	Patents	9,000
	2,85,000		**2,85,000**

Brijesh retired on March 31, 2015 on the following terms:

(i) Goodwill of the firm was valued at Rs. 70,000 and was not to appear in the books.

(ii) Bad debts amounting to Rs. 2,000 were to be written off.

(iii) Patents were considered as valueless.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of Digvijay and Parakaram after Brijesh's retirement.

(**Ans :** Loss on Revaluation Rs. 11,000, Balance of Capital Accounts: Digvijay Rs. 66,333 and Parakaram Rs. 67,667, Balance Sheet Total Rs. 2,74,000).

6. Radha, Sheela and Meena were in partnership sharing profits and losses in the proportion of 3:2:1. On April 1, 2015, Sheela retires from the firm. On that date, their Balance Sheet was as follows:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Trade Creditors		3,000	Cash-in-Hand	1,500
Bills Payable		4,500	Cash at Bank	7,500
Expenses Owing		4,500	Debtors	15,000
General Reserve		13,500	Stock	12,000
Capitals:			Factory Premises	22,500
Radha	15,000		Machinery	8,000
Sheela	15,000		Losse Tools	4,000
Meena	15,000	45,000		
		70,500		**70,500**

The terms were:

a) Goodwill of the firm was valued at Rs. 13,000.

b) Expenses owing to be brought down to Rs. 3,750.

c) Machinery and Loose Tools are to be valued at 10% less than their book value.

d) Factory premises are to be revalued at Rs. 24,300.

Prepare:

1. Revaluation account
2. Partner's capital accounts and
3. Balance sheet of the firm after retirement of Sheela.

(**Ans :** Profit on Revaluation Rs. 1,350, Balance of Capital Accounts: Radha Rs. 19,050 and Meena Rs. 16,350, Balance Sheet Total = Rs. 71,100).

7. Pankaj, Naresh and Saurabh are partners sharing profits in the ratio of 3 : 2 : 1. Naresh retired from the firm due to his illness. On that date the Balance Sheet of the firm was as follows:

Books of Pankaj, Naresh and Saurabh
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
General Reserve		12,000	Bank		7,600
Sundry Creditors		15,000	Debtors	6,000	
Bills Payable		12,000	*Less:* Provision for Doubtful Debt	400	5,600
Outstanding Salary		2,200			
Provision for Legal Damages		6,000	Stock		9,000
Capitals:			Furniture		41,000
Pankaj	46,000		Premises		80,000
Naresh	30,000				
Saurabh	20,000	96,000			
		1,43,200			**1,43,200**

Additional Information

(i) Premises have appreciated by 20%, stock depreciated by 10% and provision for doubtful debts was to be made 5% on debtors. Further, provision for legal damages is to be made for Rs. 1,200 and furniture to be brought up to Rs. 450.

(ii) Goodwill of the firm be valued at Rs. 42,000.

(iii) Rs. 26,000 from Naresh's Capital account be transferred to his loan account and balance be paid through bank; if required, necessary loan may be obtained form Bank.

(iv) New profit sharing ratio of Pankaj and Saurabh is decided to be 5 : 1.

Give the necessary ledger accounts and balance sheet of the firm after Naresh's retirement.

(**Ans :** Profit or Revaluation Rs. 18,000, Balance of Capital Account of Pankaj, Rs. 47,000 and of Saurabh, Rs. 25,000).

(Total Amount at Credit in Naresh's Capital = Rs. 54,000, Balance Sheet Total = Rs. 1,54,800).

8. Puneet, Pankaj and Pammy are partners in a business sharing profits and losses in the ratio of 2 : 2 : 1 respectively. Their balance sheet as on March 31, 2007 was as follows:

Books of Puneet, Pankaj and Pammy
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		1,00,000	Cash at Bank	20,000
Capital Accounts:			Stock	30,000
Puneet	60,000		Sundry Debtors	80,000
Pankaj	1,00,000		Investments	70,000
Pammy	40,000	2,00,000	Furniture	35,000
Reserve		50,000	Buildings	1,15,000
		3,50,000		**3,50,000**

Mr. Pammy died on September 30, 2015. The partnership deed provided the following:

(i) The deceased partner will be entitled to his share of profit up to the date of death calculated on the basis of previous year's profit.

(ii) He will be entitled to his share of goodwill of the firm calculated on the basis of 3 years' purchase of average of last 4 years' profit. The profits for the last four financial years are given below:
for 2010–11; Rs. 80,000; for 2011–12, Rs. 50,000; for 2012–13, Rs. 40,000; for 2013–14, Rs. 30,000.
The drawings of the deceased partner up to the date of death amounted to Rs. 10,000. Interest on capital is to be allowed at 12% per annum.
Surviving partners agreed that Rs. 15,400 should be paid to the executors immediately and the balance in four equal yearly instalments with interest at 12% p.a. on outstanding balance.
Show Mr. Pammy's Capital account, his Executor's account till the settlement of the amount due.

(**Ans :** Total amount due is Rs. 75,400)

9. Following is the Balance Sheet of Prateek, Rockey and Kushal as on March 31, 2015.

Books of Prateek, Rockey and Kushal
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Bills Receivable	16,000
General Reserve		16,000	Furniture	22,600
Capital Accounts:			Stock	20,400
Prateek	30,000		Sundry Debtors	22,000
Rockey	20,000		Cash at Bank	18,000
Kushal	20,000	70,000	Cash in Hand	3,000
		1,02,000		**1,02,000**

Rockey died on June 30, 2015. Under the terms of 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% per annum.
c) Share of goodwill on the basis of twice the average of the past three years' profit and
d) Share of profit from the closing date of the last financial year to the date of death on the basis of last year's profit.

Profits for the year ending on March 31, 2013, March 31, 2014 and March 31, 2015 were Rs. 12,000, Rs. 16,000 and Rs. 14,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up Rockey's capital account to be rendered to his executor.

(**Ans :** Sony's Executor Account is Rs. 33,821)

10. Narang, Suri and Bajaj are partners in a firm sharing profits and losses in proportion of $1/2$, $1/6$ and $1/3$ respectively. The Balance Sheet on April 1, 2015 was as follows:

Books of Suri and Bajaj
Balance Sheet as on April 1, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		12,000	Freehold Premises		40,000
Sundry Creditors		18,000	Machinery		30,000
Reserves		12,000	Furniture		12,000
Capital Accounts:			Stock		22,000
Narang	30,000		Sundry Debtors	20,000	
Suri	20,000		*Less:* Reserve for Bad	1,000	19,000
Bajaj	28,000	88,000	Debt		
			Cash		7,000
		1,30,000			**1,30,000**

Bajaj retires from the business and the partners agree to the following:

a) Freehold premises and stock are to be appreciated by 20% and 15% respectively.
b) Machinery and furniture are to be depreciated by 10% and 7% respectively.
c) Bad Debts reserve is to be increased to Rs. 1,500.
d) Goodwill is valued at Rs. 21,000 on Bajaj's retirement.
e) The continuing partners have decided to adjust their capitals in their new profit sharing ratio after retirement of Bajaj. Surplus/deficit, if any, in their capital accounts will be adjusted through current accounts.

Prepare necessary ledger accounts and draw the Balance Sheet of the reconstituted firm.

(**Ans :** Profit on Revaluation, Rs. 6,960; Balance in Capital Accounts of Narang, Rs. 49,230; and that of Suri, Rs. 16,410. Amount at Credit in Bajaj Capital is Rs. 41,320).

11. The Balance Sheet of Rajesh, Pramod and Nishant who were sharing profits in proportion to their capitals stood as on March 31, 2015:

Books of Rajesh, Pramod and Nishant
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		6,250	Factory Building		12,000
Sundry Creditors		10,000	Debtors	10,500	
Reserve Fund		2,750	*Less:* Reserve	500	10,000
Capital Accounts:			Bills Receivable		7,000
Rajesh	20,000		Stock		15,500
Pramod	15,000		Plant and Machinery		11,500
Nishant	15,000	50,000	Bank Balance		13,000
		69,000			**69,000**

Pramod retired on the date of Balance Sheet and the following adjustments were made:

a) Stock was valued at 10% less than the book value.
b) Factory buildings were appreciated by 12%.
c) Reserve for doubtful debts be created up to 5%.
d) Reserve for legal charges to be made at Rs. 265.
e) The goodwill of the firm be fixed at Rs. 10,000.
f) The capital of the new firm be fixed at Rs. 30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3 : 2.

Pass journal entries and prepare the balance sheet of the reconstituted firm after transferring the balance in Pramod's Capital account to his loan account.

(**Ans :** Loss on Revaluation, Rs. 400 ; Balance in Capital Accounts of Rajesh, Rs. 18,940; and of Nishant, Rs. 14,705; Pramod's Loan Rs. 18,705, Balance Sheet Total = Rs. 65,220).

12. Following is the Balance Sheet of Jain, Gupta and Malik as on March 31, 2002.

Books of Jain, Gupta and Malik
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		19,800	Land and Building	26,000
Telephone bills		300	Bonds	14,370
Outstanding		8,950	Cash	5,500
Accounts Payable		16,750	Bills Receivable	23,450
Accumulated profits			Sundry Debtors	26,700
Capitals :			Stock	18,100
Jain	40,000		Office Furniture	18,250
Gupta	60,000		Plants and Machinery	20,230
Malik	20,000	1,20,000	Computers	13,200
		1,65,800		**1,65,800**

The partners have been sharing profits in the ratio of 5:3:2. Malik decides to retire from business on April 1, 2015 and his share in the business is to be calculated as per the following terms of revaluation of assets and liabilities :
Stock, Rs.20,000; Office furniture, Rs.14,250; Plant and Machinery Rs.23,530; Land and Building Rs.20,000.
A provision of Rs.1,700 to be created for doubtful debts. The goodwill of the firm is valued at Rs.9,000.
The continuing partners agreed to pay Rs.16,500 as cash on retirement of Malik, to be contributed by continuing partners in the ratio of 3:2. The balance in the capital account of Malik will be treated as loan.
Prepare Revaluation account, capital accounts, and Balance Sheet of the reconstituted firm.

13. Arti, Bharti and Seema are partners sharing profits in the proportion of 3:2:1 and their Balance Sheet as on March 31, 2016 stood as follows :

Books of Arti, Bharti and Seema
Balance Sheet as on March 31, 2016

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bills Payable		12,000	Buildings	21,000
Creditors		14,000	Cash in Hand	12,000
General Reserve		12,000	Bank	13,700
Capitals:			Debtors	12,000
Arti	20,000		Bills Receivable	4,300
Bharti	12,000		Stock	1,750
Seema	8,000	40,000	Investment	13,250
		78,000		**78,000**

Bharti died on June 12, 2016 and according to the deed of the said partnership, her executors are entitled to be paid as under :

(a) The capital to her credit at the time of her death and interest thereon @ 10% per annum.
(b) Her proportionate share of reserve fund.
(c) Her share of profits for the intervening period will be based on the sales during that period, which were calculated as Rs.1,00,000. The rate of profit during past three years had been 10% on sales.
(d) Goodwill according to her share of profit to be calculated by taking twice the amount of the average profit of the last three years less 20%. The profits of the previous years were :
    2014 – Rs.8,200
    2015 – Rs.9,000
    2016 – Rs.9,800

The investments were sold for Rs.16,200 and her executors were paid out. Pass the necessary journal entries and write the account of the executors of Bharti.

14. Nithya, Sathya and Mithya were partners sharing profits and losses in the ratio of 5:3:2. Their Balance Sheet as on December 31, 2015 was as follows :

Books of Nithya, Sathya and Mithya
Balance Sheet at December 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		14,000	Investments	10,000
Reserve Fund		6,000	Goodwill	5,000
Capitals:			Premises	20,000
Nithya	30,000		Patents	6,000
Sathya	30,000		Machinery	30,000
Mithya	20,000	80,000	Stock	13,000
			Debtors	8,000
			Bank	8,000
		1,00,000		**1,00,000**

Mithya dies on May 1, 2015. The agreement between the executors of Mithya and the partners stated that :

(a) Goodwill of the firm be valued at $2\frac{1}{2}$ times the average profits of last four years. The profits of four years were : in 2011, Rs.13,000; in 2012, Rs.12,000; in 2013, Rs.16,000; and in 2014, Rs.15,000.
(b) The patents are to be valued at Rs.8,000, Machinery at Rs.25,000 and Premises at Rs.25,000.
(c) The share of profit of Mithya should be calculated on the basis of the profit of 2002.
(d) Rs.4,200 should be paid immediately and the balance should be paid in 4 equal half-yearly instalments carrying interest @ 10%.

Record the necessary journal entries to give effect to the above and write the executor's account till the amount is fully paid. Also prepare the Balance Sheet of Nithya and Sathya as it would appear on May 1, 2002 after giving effect to the adjustments.

Check-list to Test your Understanding

Test your understanding – I

1. (b), 2. (c), 3. (b), 4. (a).

Test your understanding – II

1. (a), 2. (a), 3. (c), 4. (b).

Dissolution of Partnership Firm

5

> **LEARNING OBJECTIVES**
>
> *After studying this chapter you will be able to :*
>
> - *State the meaning of dissolution of partnership firm;*
> - *Differentiate between dissolution of partnership and dissolution of a partnership firm;*
> - *Describe the various modes of dissolution of the partnership firm;*
> - *Explain the rules relating to the settlement of claims among all partners;*
> - *Prepare Realisation Account;*
> - *Record journal entries and prepare the necessary ledger accounts to close the books of the firm and settlement of partners' claim.*

You have learnt about the reconstitution of a partnership firm which takes place on account of admission, retirement or death of a partner. In such a situation while the existing partnership is dissolved, the firm may continue under the same name if the partners so decide. In other words, it results in the dissolution of a partnership but not that of the firm. According to Section 39 of the partnership Act 1932, the dissolution of partnership between all the partners of a firm is called the dissolution of the firm. That means the Act recognises the difference in the breaking of relationship between all the partners of a firm and between some of the partners; and it is the breaking or discontinuance of relationship between all the partners which is termed as the dissolution of partnership firm. This brings an end to the existence of firm, and no business is transacted after dissolution except the activities related to closing of the firm as the affairs of the firm are to be wound up by selling firm's assets and paying its liabilities and discharging the claims of the partners.

5.1 Dissolution of Partnership

As stated earlier dissolution of partnership changes the existing relationship between partners but the firm may continue its business as before. The dissolution of partnership may take place in any of the following ways:

(1) Change in existing profit sharing ratio among partners;
(2) Admission of a new partner;

(3) Retirement of a partner;
(4) Death of a partner;
(5) Insolvency of a partner;
(6) Completion of the venture, if partnership is formed for that; and
(7) Expiry of the period of partnership, if partnership is for a specific period of time;

5.2 Dissolution of a firm

Dissolution of a partnership firm may take place without the intervention of court or by the order of a court, in any of the ways specified later in this section. It may be noted that dissolution of the firm necessarily brings in dissolution of the partnership.

Dissolution of a firm takes place in any of the following ways:

1. *Dissolution by Agreement:* A firm is dissolved :
   (a) with the consent of all the partners or
   (b) in accordance with a contract between the partners.
2. *Compulsory Dissolution:* A firm is dissolved compulsorily in the following cases:
   (a) when all the partners or all but one partner, become insolvent, rendering them incompetent to sign a contract;
   (b) when the business of the firm becomes illegal; or
   (c) when some event has taken place which makes it unlawful for the partners to carry on the business of the firm in partnership, e.g., when a partner who is a citizen of a country becomes an alien enemy because of the declaration of war with his country and India.
3. *On the happening of certain contingencies:* Subject to contract between the partners, a firm is dissolved :
   (a) if constituted for a fixed term, by the expiry of that term;
   (b) if constituted to carry out one or more ventures, by the completion thereof;
   (c) by the death of a partner;
   (d) by the adjudication of a partner as an insolvent.
4. *Dissolution by Notice:* In case of partnership at will, the firm may be dissolved if any one of the partners gives a notice in writing to the other partners, signifying his intention of seeking dissolution of the firm.
5. *Dissolution by Court:* At the suit of a partner, the court may order a partnership firm to be dissolved on any of the following grounds:
   (a) when a partner becomes insane;
   (b) when a partner becomes permanently incapable of performing his duties as a partner;
   (c) when a partner is guilty of misconduct which is likely to adversely affect the business of the firm;

(d) when a partner persistently commits breach of partnership agreement;
(e) when a partner has transferred the whole of his interest in the firm to a third party;
(f) when the business of the firm cannot be carried on except at a loss; or
(g) when, on any ground, the court regards dissolution to be just and equitable.

Distinction between Dissolution of Partnership and Dissolution of Firm

Basis	*Dissolution of Partnership*	*Dissolution of Firm*
1. Termination of business	The business is not terminated.	The business of the firm is closed.
2. Settlement of assets and liabilities	Assets and liabilities are revalued and new balance sheet is drawn.	Assets are sold and liabilities are paid-off.
3. Court's intervention	Court does not intervene because partnership is dissolved by mutual agreement.	A firm can be dissolved by the court's order.
4. Economic relationship	Economic relationship between the partners continues though in a changed form.	Economic relationship between the partners comes to an end.
5. Closure of books	Does not require because the business is not terminated.	The books of account are closed.
6. Other dissolution	It may or may not involve dissolution of the firm.	It necessarily involves dissolution of partnership.

Test your Understanding – I

State giving reasons, which of the following statements are true or false:
1. Dissolution of a partnership is different from dissolution of a firm,
2. A partnership is dissolved when there is a death of a partner,
3. A firm is dissolved when all partners give consent to it.
4. A firm is compulsorily dissolved when a partner decide to retire.
5. Dissolution of a firm necessarily involves dissolution of partnership.
6. A firm is compulsorily dissolved when all partners or when all except one partner become involvent.
7. Court can order a firm to be dissolved when a partner becomes insane.
8. Dissolution of partnership can not take place without intervention of the court.

5.3 Settlement of Accounts

In case of dissolution of a firm, the firm ceases to conduct business and has to settle its accounts. For this purpose, it disposes off all its assets for satisfying all the claims against it. In this context it should be noted that, subject to agreement among the partners, the following rules as provided in Section 48 of the Partnership Act 1932 shall apply.

(a) *Treatment of Losses*

Losses, including deficiencies of capital, shall be paid :

(i) first out of profits,
(ii) next out of capital of partners, and
(iii) lastly, if necessary, by the partners individually in their profits sharing ratio.

(b) *Application of Assets*

The assets of the firm, including any sum contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

(i) In paying the debts of the firm to the third parties;
(ii) In paying each partner proportionately what is due to him/her from the firm for advances as distinguished from capital (i.e. partner' loan);
(iii) In paying to each partner proportionately what is due to him on account of capital; and
(iv) the residue, if any, shall be divided among the partners in their profit sharing ratio.

Thus, the amount realised from assets along with contribution from partners, if required, shall be utilised first to pay off the outside liabilities of the firm such as creditors, loans, bank overdraft, bill payables, etc. (it may be noted that secured loans have precedence over the unsecured loans); the balance should be applied to repay loans and advances made by the partners to the firm. (in case the balance amount is not adequate enough to pay off such loans and advances, they are to be paid propartionately); and surplus, if any is to be utilised in settlement of the capital account balances, after adjusting all profits and losses.

Private Debts and Firm's Debts: Where both the debts of the firm and private debts of a partner co-exist, the following rules, as stated in Section 49 of the Act, shall apply.

(a) The property of the firm shall be applied first in the payment of debts of the firm and then the surplus, if any, shall be divided among the partners as per their claims, which can be utilised for payment of their private liabilities.
(b) The private property of any partner shall be applied first in payment of his private debts and the surplus, if any, may be utilised for payment of the firm's debts, in case the firm's liabilities exceed the firm's assets.

It may be noted that the private property of the partner does not include the personal properties of his wife and children. Thus, if the assets of the firm are not adequate enough to pay off firm's liabilities, the partners have to contribute out of their net private assets (private assets minus private liabilities).

Inability of a Partner to Contribute Towards Deficiency

In the context of settlement of accounts among the partners there is still another important aspect to be noted, i.e., when a partner is unable to contribute towards the deficiency of his capital account (the account finally showing a debit balance), he/she is said to be insolvent, and the sum not recoverable is treated as capital loss for the firm. In the absence of any agreement, to the contrary, such a capital loss is to be borne by the remaining solvent partners in accordance with the principle laid down in Garner vs. Murray case, which states that the solvent partners have to bear such loss in the ratio of their capitals as on the date of dissolution. However, the accounting treatment relating to dissolution of partnership on account of insolvency of partners is not being taken up at this stage.

5.4 Accounting Treatment

When the firm is dissolved, its books of account are to be closed and the profit or loss arising on realisation of its assets and discharge of liabilities is to be computed. For this purpose, a Realisation Account is prepared to ascertain the net effect (profit or loss) of realisation of assets and payment of liabilities which may be is transferred to partner's capital accounts in their profit sharing ratio. Hence, all assets (other than cash in hand bank balance and fictitious assets, if any), and all external liabilities are transferred to this account. It also records the sale of assets, and payment of liabilities and realisation expenses. The balance in this account is termed as profit or loss on realisation which is transferred to partners' capital accounts in thier profit sharing ratio (see figure 5.1)

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

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Land and Building	xxx	Sundry creditors	xxx
Plant and Machinery	xxx	Bills payables	xxx
Furniture and Fittings	xxx	Bank overdraft	xxx
Bills receivables	xxx	Outstanding expenses	xxx
Sundry debtors	xxx	Provision for doubtful debts	xxx
Cash/Bank (payment of liabilities)	xxx	Cash/Bank (sale of assets)	xxx
Cash/Bank (payment of unrecorded liabilities)	xxx	Partner's capital account (assets taken by the partner)	xxx
Partner's capital account (liability assumed by the partner)	xxx	Loss (transferred to partners capital accounts)	xxx
Profit (transferred to partners' capital account's in their profit sharing ratio)	xxx		
Total	**xxxxx**	**Total**	**xxxxx**

Fig. 5.1: *Format of Realisation Account*

Illustration 1

Supriya and Monika are partners, who share profit in the ratio of 3:2. Following is the balance sheet as on March 31, 2014.

Balance Sheet of Supriya and Monika as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Supriya's Capital	32,500	Cash and Bank		40,500
Monika's Capital	11,500	Stock		7,500
Sundry Creditors	48,000	Sundry debtors	21,500	
Reserve fund	13,500	*Less:* Provision for doubtful debts	500	21,000
		Fixed Assets		36,500
	1,05,500			**1,05,500**

The firm was dissolved on March 31, 2014. Close the books of the firm with the following information:

(i) Debtors realised at a discount of 5%,
(ii) Stock realised at Rs.7,000,
(iii) Fixed assets realised at Rs.42,000,
(iv) Realisation expenses of Rs.1,500,
(v) Creditors are paid in full.

Prepare necessary ledger accounts.

Solution

Books of Supriya and Monika
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Assets transferred:			Provision for doubtful debts		500
Stock		7,500	Sundry creditors		48,000
Sundry debtors		21,500	Bank		
Fixed assets		36,500	Debtors	20,425	
Bank			Stock	7,000	
Creditors		48,000	Fixed assets	42,000	69,425
Realisation expenses		1,500			
Profit transferred to:					
Supriya Capital	1,755				
Monika Capital	1,170	2,925			
		1,17,925			**1,17,925**

Partners Capital Accounts

Dr. Cr.

Date	Particulars	J.F.	Supriya (Rs.)	Monika (Rs.)	Date	Particulars	J.F.	Supriya (Rs.)	Monika (Rs.)
	Bank		42,355	18,070		Balance b/d		32,500	11,500
						Reserve fund		8,100	5,400
						Realisation (Profit)		1,755	1,170
			42,355	**18,070**				**42,355**	**18,070**

Cash and Bank Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		40,500		Realisation		48,000
	Realisation		69,425		Realisation		1,500
					Supriya's Capital		42,355
					Monika's Capital		18,070
			1,09,925				**1,09,925**

5.4.1 Journal Entries

1. *For trnasfer of assets*

   All asset accounts excluding cash, bank and the fictitious assets, if any are closed by transfer to the debit of Realisation Account at their book values. It may be noted that sundry debtors are transferred at gross value and the provision for doubtful debts is transferred to the credit side of Realisation Account along with liabilities. The same thing will apply to fixed assets, if provision for depreciation account is maintained.

   Realisation A/c Dr.
   To Assets (Individually) A/c

2. *For transfer of liabilities*

   All external liability accounts including provisions, if any, are closed by transferring them to the credit of Realisation account.

   Liabilities (individually) Dr.
   To Realisation A/c

3. *For sale of assets*

   Bank A/c Dr.
   To Realisation A/c

4. *For an asset taken over by a partner*

   Partner's Capital A/c Dr.
   To Realisation A/c

5. *For payment of liabilities*

    Realisation A/c Dr.
    To Bank A/c

6. *For a liability which a partner takes responsibility to discharge*

    Ralisation A/c Dr.
    To Partner's Capital A/c

7. For settlement with the creditor through transfer of assets when a creditor accepts an asset in full and final settlement of his account, journal entry needs to be recorded. But, if the creditor accepts an asset only as part payment of his/her dues, the entry will be made for cash payment only. For example, a creditor to whom Rs. 10,000 was due accepts office equipment worth Rs. 8,000 and is paid Rs. 2,000 in cash, the following entry shall be made for the payment of Rs. 2,000 only.

    Realisation A/c Dr.
    To Bank A/c

However, when a creditor accepts an asset whose value is more than the amount due to him, he/she will pay cash to the frim for the difference for which the entry will be:

    Bank A/c Dr.
    To Realisation A/c

8. *For payment of realisation expenses*

(a) When some expenses are incurred and paid by the firm in the process of realisation of assets and payment of liabilities:

    Realisation A/c Dr.
    To Bank A/c

(b) When realisation expenses are paid by a partner on behalf of the firm:

    Realisation A/c Dr.
    To Partner's Capital A/c

(c) When a partner has agreed to undertake the dissolution work for an agreed remuneration bear the realisation expenses:

(i) if payment of realisation expenses is made by the firm

    Partner's Capital A/c Dr.
    To Bank A/c

(ii) if the partner himself pays the realisation expenses, no entry is required

(iii) For agreed remuneration to such partner

    Realisation A/c Dr.
    To Partner's Capital A/c

9. *For realisation of any unrecorded assets including goodwill, if any*

Bank A/c Dr.
To Realisation A/c

10. *For settlement of any unrecorded liability*

Realisation A/c Dr.
To Bank A/c

11. *For transfer of profit and loss on realisation*

(a) In case of profit on realisation

Realisation A/c Dr.
To Partners' Capital A/c (individually) A/c

(b) In case of loss on realisation

Partners' Capital A/c (individually) Dr.
To Realisation A/c

12. *For transfer of accumulated profits in the form of reserve fund or general reserve:*

Reserve Fund/General Reserve A/c Dr.
To Partners' Capital A/c (individually)

13. *For transfer of fictitious assets, if any, to partners' capital accounts in their profit sharing ratio:*

Partners' Capital A/c (individually) Dr.
To Fictitious Asset A/c

14. *For payment of loans due to partners*

Partner's Loan A/c Dr.
To Bank A/c

15. *For settlement of partners' accounts*

If the partner's capital account shows a debit balance, he brings in the necessary cash for which the entry will be:

Bank A/c Dr.
To Partner's Capital A/c

The balance is paid to partners whose capital accounts show a credit balance and the following entry is recorded.

Partners' Capitals A/cs (individually) Dr.
To Bank A/c

It may be noted that the aggregate amount finally payable to the partners must equal to the amount available in bank and cash accounts. Thus, all accounts of a firm are closed in case of dissolution.

Test your Understanding – II

Tick (✓) the Correct Answer

1. On dissolution of a firm, bank overdraft is transferred to :
   (a) Cash Account
   (b) Bank Account
   (c) Realisation Aaccount
   (d) Partner's capital Account.
2. On dissolution of a firm, partner's loan account is transferred to:
   (a) Realisation Account
   (b) Partner's Capital Account
   (c) Partner's Current Account
   (d) None of the above.
3. After transferring liabilities like creditors and bills payables in the Realisation Account, in the absence of any information regarding then payment, such liabilities are treated as:
   (a) Never paid
   (b) Fully paid
   (c) Partly paid
   (d) None of the above.
4. When realisation expenses are paid by the firm on behalf of a partner, such expenses are debited to:
   (a) Realisation Account
   (b) Partner's Capital Account
   (c) Partner's Loan Account
   (d) None of the above.
5. Unrecorded assets when taken over by a partner are shown in :
   (a) Debit of Realisation Account
   (b) Debit of Bank Account
   (c) Credit of Realisation Account
   (d) Credit of Bank Account.
6. Unrecorded liabilities when paid are shown in:
   (a) Debit of Realisation Account
   (b) Debit of Bank Account
   (c) Credit of Realisation Account
   (d) Credit of Bank Account.
7. The accumulated profits and reserves are transferred to :
   (a) Realisation Account
   (b) Partners' Capital Accounts
   (c) Bank Account
   (d) None of the above.
8. On dissolution of the firm, partner's capital accounts are closed through:
   (a) Realisation Account
   (b) Drawings Account
   (c) Bank Account
   (d) Loan Account.

Illustration 2

Sita, Rita and Meeta are partners sharing profit and losses in the ratio of 2:2:1 Their balance sheet as on March 31, 2015 is as follows:

Balance Sheet of Sita, Rita and Meeta as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Reserve fund		2,500	Cash at bank	2,500
Creditors		2,000	Stock	2,500
Capitals:			Furniture	1,000
Sita	5,000		Debtors	2,000
Rita	2,000		Plant and Machinery	4,500
Meeta	1,000	8,000		
		12,500		**12,500**

They decided to dissolve the business. The following amounts were realised: Plant and Machinery Rs.4,250, Stock Rs.3,500, Debtors Rs.1850, Furniture 750.

Sita agreed to bear all realisation expenses. For the service Sita is paid Rs.60.

Actual expenses on realisation amounted to Rs.450.Creditors paid 2% less. There was an unrecorded assets of Rs.250, which was taken over by Rita at Rs.200.

Prepare the necessary accounts to close the books of the firm.

Solution

Books of Sita, Rita and Meeta

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

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Creditors		2,000
Stock		2,500	Rita's capital		200
Furniture		1,000	[Unrecorded assets]		
Debtors		2,000	Bank [assets realised]:		
Plant and Machinery		4,500	Plant and Machinery	4,250	
Bank [Creditors]		1,960	Debtors	1,850	
Sita's capital		60	Stock	3,500	
(realisation expenses]			Furniture	750	10,350
Profit transferred to:					
Sita's capital	212				
Rita's capital	212				
Meeta's capital	106	530			
		12,550			**12,550**

Dr. **Partner's Capital Accounts** *Cr.*

Date	*Particulars*	*J.F.*	*Sita (Rs.)*	*Rita (Rs.)*	*Meeta (Rs.)*	*Date*	*Particulars*	*J.F.*	*Sita (Rs.)*	*Rita (Rs.)*	*Meeta (Rs.)*
	Bank		450				Balance b/d		5,000	2,000	1,000
	Realisation (asset)			200			Reserve fund		1,000	1,000	500
	Bank		5,822	3,012	1,606		Realisation [profit]		212	212	106
							Realisation (expenses)		60	—	—
			6,272	**3,212**	**1,606**				**6,272**	**3,212**	**1,606**

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

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		2,500		Realisation (Creditor)		1,960
	Realisation (assets realised)		10,350		Sita's Capital [expenses]		450
					Sita's Capital		5,822
					Rita's Capital		3,012
					Meeta's capital		1,606
			12,850				**12,850**

llustration 3

Nayana and Arushi were partners sharing profits equally Their Balance Sheet as on March 31, 2015 was as follows:

Balance Sheet of Nayana and Arushi as on March 31, 2012

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Bank	30,000
Nayana	1,00,000		Debtors	25,000
Arushi	50,000	1,50,000	Stock	35,000
Creditors		20,000	Furniture	40,000
Arushi's current account		10,000	Machinery	60,000
Workmen Compensation Fund		15,000	Nayana's current account	10,000
Bank overdraft		5,000		
		2,00,000		**2,00,000**

The firm was dissolved on the above date:

1. Nayana took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realised for Rs.30,000 and Rs.50,000 respectively;
2. There was an unrecorded investment which was sold for Rs. 25,000;

3. Debtors realised 90% only and Rs.1,200 were recovered for bad debts written-off last year;
4. There was an outstanding bill for repairs which had to be paid for Rs.2,000.

Record necessary journal entries and prepare ledger accounts to close the books of the firm.

Solution

Books of Nayana and Arushi
Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Realisation A/c Dr.		1,60,000	
	To Debtors			25,000
	To Stock A/c			35,000
	To Furniture A/c			40,000
	To Machinery A/c			60,000
	(Assets transferred to Realisation Account)			
	Creditors A/c Dr.		20,000	
	Bank overdraft A/c Dr.		5,000	
	To Realisation A/c			25,000
	(Liabilities transferred to Realisation Account)			
	Realisation A/c Dr.		27,000	
	To Bank A/c			27,000
	(Creditors, Bank overdraft, Outstanding repair bill paid)			
	Bank A/c Dr.		1,57,825	
	To Realisation A/c			1,57,825
	(Assets sold and bad debts recovered)			
	Nayana's Capital A/c Dr.		15,750	
	To Realisation A/c			15,750
	(Half stock take over by Nayana at 10% less)			
	Realisation A/c Dr.		15,575	
	To Nayana's Current A/c			5,788
	To Arushi's Current A/c			5,787
	(Realisation profit transferred to partner's current account)			
	Workman Compensation Fund A/c Dr.		15,000	
	To Nayana's Current A/c			7,500
	To Arushi's Current A/c			7,500
	(Compensation fund transfered to partners' Current account)			

	Arushi Current A/c Dr. To Arushi's Capital A/c (Current account balance transferred to Capital account)		23,287	23,287
	Nayana Capital A/c Dr. To Nayana's Current A/c (Current account balance transferred to Capital account)		12,462	12,462
	Nayana's Capital A/c Dr. Arushi's Capital A/c Dr. To Bank A/c (Final amounts due to partners paid)		87,538 73,287	1,60,825

Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Creditors		20,000
Debtors	25,000		Bank overdraft		5,000
Stock	35,000		Bank:		
Furniture	40,000		Investment	25,000	
Machinery	60,000	1,60,000	Furniture	30,000	
Bank:			Machinery	50,000	
Creditors	20,000		Debtors (90%)	31,500	
Bank overdraft	5,000		Stock :	20,125	
Outstanding bill	2,000	27,000	Bad debts		
Profit transferred to :			recovered	1,200	1,57,825
Nayana's capital	5,788		Nayana's capital		
Arushi's capital	5,787	11,575	(stock taken over)		15,750
		1,98,575			**1,98,575**

Partners' Current Accounts

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Nayana (Rs.)*	*Arushi (Rs.)*	*Date*	*Particulars*	*J.F.*	*Nayana (Rs.)*	*Arushi (Rs.)*
	Balance b/d		10,000			Balance b/d			10,000
	Realisation		15,750			Workmen Compensation Fund		7,500	7,500
	Arushi's capital			23,287		Realisation (profit)		5,788	5,787
						Nayana's Capital		12,462	
			25,750	**23,287**				**25,750**	**23,287**

Partner's Current Accounts

Dr. *Cr.*

Date	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)	Date	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)
	Nayana's current account		12,462			Balance b/d		1,00,000	50,000
						Arushi's current account			23,287
	Bank		87,538	73,287					
			1,00,000	**73,287**				**1,00,000**	**73,287**

Bank Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		30,000		Realisation		27,000
	Realisation		1,57,825		Nayana's capital		87,538
					Arushi's capital		73,287
			1,87,825				**1,87,825**

Test your Understanding – III

Fill in the Correct Word(s):

1. All assets (except cash/bank and fictitious assets) are transferred to the ———— (Debit/Credit) side of ———— Account (Realisation/Capital).
2. All ———— (internal/external) liabilities are transferred to the ———— (Debit/Credit) side of ————acccount (Bank/Realisation).
3. Accumulated losses are transferred to ———— (Current/Capital Accounts) in ———— (equal ratio/profit sharing ratio).
4. If a liability is assumed by a partner, such Partner's Capital Account is ———— (debited/credited).
5. If a partner takes over an asset, such (Partner's Capital Account) is ———— (debited/credited).
6. No entry is required when a ———— (partner/creditor) accepts a fixed asset in payment of his dues.
7. When creditor accepts an asset whose value is more than the amount due to him, he will ———— (pay/not pay) the excess amount which will be credited ———— Account.
8. When the firm has agreed to pay the partner a fixed amount for realisation work irrespective of the actual amount spent, such fixed amount is debited to (Realisation/Capital) Account and Credited to (Capital/Bank) Account.
9. Partner's loan is ———— (recorded/not recorded) in the (Realisation Account).
10. Partner's current accounts are transferred to respective ———— Partners' (Loan/Capital) Accounts.

Illustration 4

Following is the Balance Sheet of Ashwani and Bharat on March 31, 2014.

Balance Sheet Ashwani and Bharat as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		76,000	Cash at bank		17,000
Mrs.Ashwani's loan		10,000	Stock		10,000
Mrs.Bharat loan		20,000	Investments		20,000
Investment fluctuation fund		2,000	Debtors	40,000	
Reserve fund		20,000	*Less:* Provision		
Capitals:			for doubtful debts	4,000	36,000
Ashwani	20,000		Buildings		70,000
Bharat	20,000	40,000	Goodwill		15,000
		1,68,000			**1,68,000**

The firm was dissolved on that date. The following was agreed transactions took place.

(i) Aswhani promised to pay Mrs. Ashwani's loan and took away stock for Rs.8,000.

(ii) Bharat took away half of the investment at 10% less. Debtors realised for Rs.38,000. Creditor's were paid at less of Rs.380. Buildings realised for Rs.1,30,000, Goodwill Rs.12,000 and the remaining Investment were sold at Rs.9,000. An old typewriter not recorded in the books was taken over by Bharat for Rs. 600. Realisation expenses amounted to Rs. 2,000.

Prepare Realisation Account, Partner's Capital Account and Bank Account.

Solution

Books of Ashwani and Bharat

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

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Investment	20,000		Provision for doubtful debts		4,000
Debtors	40,000		Creditors		76,000
Buildings	70,000		Mrs. Ashwani loan		10,000
Stock	10,000		Mrs. Bharat loan		20,000
Goodwill	15,000	1,55,000	Investment fluctuation fund		2,000
Ashwani's Capital (Mrs.Ashwani's loan}		10,000	Ashwani's Capital[stock]		8,000
			Bharat's capital (Typewriter)		600
Bank (Mrs. Bharat's loan)		20,000	Bharat's capital (Investment)		9,000
Bank (creditors)		75,620	Bank:		
Bank (realisation expenses)		2,000	Investment	9,000	
Profit transferred to:			Debtors	38,000	
Ashwani's Capital	27,990		Buildings	1,30,000	
Bharat's Capital	27,990	55,980	Goodwill	12,000	1,89,000
		3,18,600			**3,18,600**

Partner's Capital Accounts

Dr. *Cr.*

Date	Particulars	J.F.	Ashwani (Rs.)	Bharat (Rs.)	Date	Particulars	J.F.	Ashwani (Rs.)	Bharat (Rs.)
	Realisation (stock)		8,000	—		Balance b/d		20,000	20,000
	Realisation [sale of typewriter]			600		Reserve fund		10,000	10,000
	Realisation [investment]			9,000		Realisation [Mrs. Ashwini's loan]		10,000	—
	Bank		59,990	48,390		Realisation (profit)		27,990	27,990
			67,990	**57,990**				**67,990**	**57,990**

Bank Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		17,000		Realisation [creditors]		75,620
	Realisation		1,89,000		Realisation [expenses]		2,000
					Realisation (Mrs.Bharat's loan)		20,000
					Ashwani's capital		59,990
					Bharat's capital		48,390
			2,06,000				**2,06,000**

Do it Yourself

Give the journal entry(ies) to be recorded for the following, in case of the dissolution of a partnership firm.

1. For closure of assets accounts.
2. For closure of liabilities accounts.
3. For sale of assets.
4. For settlement of a creditor by transfer of fixed assets to him.
5. For expenses of realisation when actual expenses are paid by the partner on behalf of the firm.
6. When a partner discharges the liability of the firm.
7. For payment of partner's loan.
8. For settlement of capital accounts.

Illustration 5

Sonia, Rohit and Udit are partners sharing profits in the ratio of 5:3:2. Their Balance Sheet as on March 31, 2014 was as follows:

Balance Sheet of Sonia, Rohit and Udit as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		30,000	Buildings	2,00,000
Bills payable		30,000	Machinery	40,000
Bank loan		1,20,000	Stock	1,60,000
Sonia's husband's loan		1,30,000	Bills receivable	1,20,000
General reserve		80,000	Furniture	80,000
Capitals:			Cash at bank	60,000
Sonia	70,000			
Rohit	90,000			
Udit	1,10,000	2,70,000		
		6,60,000		**6,60,000**

The firm was dissolved on that date. Close the books of the firm with following information:

1. Buildings realised for Rs.1,90,000, Bills receivable realised for Rs.1,10,000; Stock realised Rs.1,50,000; and Machinery sold for Rs.48,000 and furniture for Rs. 75,000,
2. Bank loan was settled for Rs.1,30,000. Creditors and Bills payable were settled at 10% discount,
3. Rohit paid the realisation expenses of Rs.10,000 and he was to get a remuneration of Rs.12,000 for completing the dissolution process.

Prepare necessary ledger accounts.

Solution

Books of Sonia, Rohit and Udit

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

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Buildings	2,00,000		Creditors		30,000
Machinery	40,000		Bills payable		30,000
Stock	1,60,000		Bank loan		1,20,000
Bills receivable	1,20,000		Sonia's husband's loan		1,30,000
Furniture	80,000	6,00,000	Bank:		
Bank (Bank Loan)		1,30,000	Buildings	1,90,000	
Bank			Bills receivable	1,10,000	
[creditors and Bills payable]		54,000	Stock	1,50,000	
Bank [Sonia's husbands loan]		1,30,000	Machinery	48,000	
Rohit's capital		12,000	Furniture	75,000	5,73,000
(reslisation expenses)			Loss transferred to capital accounts:		
			Sonia	21,500	
			Rohit	12,900	
			Udit	8,600	43,000
		9,26,000			**9,26,000**

Partner's Capital Accounts

Dr. Cr.

Date	Particulars	J.F.	Sonia (Rs.)	Rohit (Rs.)	Udit (Rs.)	Date	Particulars	J.F.	Sonia (Rs.)	Rohit (Rs.)	Udit (Rs.)
	Realisation (Loss)		21,500	12,900	8,600		Balance b/d		70,000	90,000	1,10,000
	Bank		88,500	1,13,100	1,17,400		Realisation (expenses)		—	12,000	—
							General reserve		40,000	24,000	16,000
			1,10,000	**1,26,000**	**1,26,000**				**1,10,000**	**1,26,000**	**1,26,000**

Bank Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		60,000		Realisation [bank loan]		1,30,000
	Realisation (assets realised)		5,73,000		Realisation [creditors and bills payable]		54,000
					Realisation (Sonia's husband loan)		1,30,000
					Sonia's capital		88,500
					Rohit's capital		1,13,100
					Udit's capital		1,17,400
			6,33,000				**6,33,000**

Note: No entry has been recorded in firm's books for the actual realisation expenses incurred by Rohit because he gets Rs. 12,000 as his remuneration which has been duly accounted for.

Illustration 6

Romesh and Bhawan were in partnership sharing profit and losses as 3:2. Their Balance Sheet as on March 31, 2014, was as follows:

Balance Sheet of Romesh and Bhawan as on March 31, 2014

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Bank loan		60,000	Cash at bank	30,000
Creditors		80,000	Debtors	70,000
Bills payables		40,000	Stock	2,00,000
Bhawan loan		20,000	Investments	1,40,000
Capitals:			Buildings	60,000
Romesh	1,00,000			
Bhawan	2,00,000	3,00,000		
		5,00,000		**5,00,000**

They decided to dissolve the firm. The following information is available:

1. Debtors were recovered 5% less. Stock was realised at books value and building was sold for Rs.51,000,
2. It is found that investment not recorded in the books amounted to Rs.10,000. The same were accepted by one creditor for this amount and other Creditors were paid at a discount of 10%. Bills payable were paid full,
3. Romesh took over some of the Investments at Rs.8,100 (book value less 10%). The remaining investment were taken over by Bhawan at 90% of the book value less Rs.900 discount,
4. Bhawan paid bank loan along with one year interest at 6% p.a,
5. An unrecorded liability of Rs.5,000 paid.

Close the books of the firm and prepare necessary ledger accounts.

Solution

Books of Romesh and Bhawan
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Bank loan		60,000
Debtors	70,000		Creditors		80,000
Stock	2,00,000		Bills payable		40,000
Investments	1,40,000		Romesh's Capital (investment)		8,100
Buildings	60,000	4,70,000	Bhawan's Capital (investment)		1,17,000
Bank (bills payable)		40,000	Bank:		
Bank (creditors)		63,000	Debtors	66,500	
Bhawan's capital		63,600	Stock	2,00,000	
(loan with interest)			Buildings	51,000	3,17,500
Bank (unrecorded liabilities)		5,000	Loss transferred to :		
			Romesh capital	11,400	
			Bhawan capital	7,600	19,000
		6,41,600			**6,41,600**

Partner's Capital Accounts

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Romesh (Rs.)*	*Bhawan (Rs.)*	*Date*	*Particulars*	*J.F.*	*Romesh (Rs.)*	*Bhawan (Rs.)*
	Realisation [investment]		8,100	1,17,000		Balance b/d		1,00,000	2,00,000
	Realisation [loss]		11,400	7,600		Realisation [bank loan]			63,600
	Bank		80,500	1,39,000					
			1,00,000	**2,63,600**				**1,00,000**	**2,63,600**

Bank Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		30,000		Realisation[creditor]		63,000
	Realisation (assets realised)		3,17,500		Realisation [unrecorded liability]		5,000
					Bhawan loan		20,000
					Realisation (bills payable]		40,000
					Romesh's capital		80,500
					Bhawan's capital		1,39,000
			3,47,500				**3,47,500**

Note: No entry has been made for acceptance of unrecorded investments by a creditor as part payment of his dues as per rules.

Illustration 7

Sonu and Ashu sharing profits as 3:1 and they agree upon dissolution. The Balance Sheet as on March 31, 2014 is as under:

Balance Sheet of Sonu and Ashu as on March 31, 2012

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Loan		12,000	Cash at bank	25,000
Creditors		18,000	Stock	45,000
Capital			Furniture	16,000
Sonu	1,10,000		Debtors	70,000
Ashu	68,000	1,78,000	Plant and Machinery	52,000
		208,000		**2,08,000**

Sonu took over plant and machinery at an agreed value of Rs.60,000. Stock and Furniture were sold for Rs.42,000 and Rs.13,900 respectively. Debtors were took over by Ashu at Rs.69,000. Creditors were paid subject to discount of Rs.900. Sonu agrees to pay the loans. Realisation expenses were Rs.1,600.

Prepare Realisation Account, Bank Account and Capital Accounts of the Partners.

Solution

Books of Sonu and Ashu
Realisation Account

Dr. Cr.

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
Stock		45,000	Loan		12,000
Furniture		16,000	Creditors		18,000
Debtors		70,000	Sonu's capital (plant& machinery)		60,000
Plant and Machinery		52,000	Ashu's capital (debtors)		69,000
Bank (creditors)		17,100	Bank:		
Sonu's capital (loan)		12,000	Stock	42,000	
Bank (realisation expenses)		1,600	Furniture	13,900	55,900
Profit transferred to :					
Sonu's capital	900				
Ashu's capital	300	1,200			
		2,14,900			**2,14,900**

Partners Capital Accounts

Dr. Cr.

Date	Particulars	J.F.	Sonu (Rs.)	Ashu (Rs.)	Date	Particulars	J.F.	Sonu (Rs.)	Ashu (Rs.)
	Realisation [plant and machinery]		60,000			Balance b/d		1,10,000	68,000
						Realisation [loan]		12,000	
	Realisation [debtors]			69,000		Realisation [profit]		900	300
						Bank			700
	Bank		62,900						
			1,22,900	**69,000**				**1,22,900**	**69,000**

Bank Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		25,000		Realisation [creditor]		17,100
	Realisation (assets realised)		55,900		Realisation [expenses]		1,600
	Ashu's capital		700		Sonu's capital		62,900
			81,600				**81,600**

Illustration 8

Anju, Manju and Sanju sharing profit in the ratio of 3:1:1 decided to dissolve their firm. On March 31, 2014 their position was as follows:

Balance Sheet Anju, Manju and Sanju as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		60,000	Cash at bank		35,000
Loan		15,000	Stock		83,000
Capitals:			Furniture		12,000
Anju	2,75,000		Debtors	2,42,000	
Manju	1,10,000		*Less:* Provision for		
Sanju	1,00,000	4,85,000	doubtful debts	12,000	2,30,000
			Buildings		2,00,000
		5,60,000			**5,60,000**

It is agreed that:

1. Anju takes over the Furniture at Rs.10,000 and Debtors amounting to Rs.2,00,000 at Rs.1,85,000. Anju also agrees to pay the creditors,
2. Manju is to take over Stock at book value and Buildings at book value less 10%,
3. Sanju is to take over remaining Debtors at 80% of book value and responsibility for the discharge of the loan,
4. The expenses of dissolution amounted to Rs.2,200.

Prepare Realisation Account, Bank Account and Capital Accounts of the partners.

Solution

Books of Anju, Manju and Sanju

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

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Provision for doubtful debts		12,000
Stock	83,000		Creditors		60,000
Furniture	12,000		Loan		15,000
Debtors	2,42,000		Anju's capital :		
Buildings	2,00,000	5,37,000	Furniture	10,000	
Anju capital (creditors)		60,000	Debtors	1,85,000	1,95,000
Sanju capital (loan)		15,000	Manju's capital :		
Bank (realisation expenses)		2,200	Stock	83,000	
			Buildings	1,80,000	2,63,000
			Sanju's capital : (remaning debtors less 20% of book value)		33,600
			Loss transferred to :		
			Anju's capital	21,360	
			Manju's capital	7,120	
			Sanju's capital	7,120	35,640
		6,14,200			**6,14,240**

Dr. **Partner's Capital Accounts** *Cr.*

Date	Particulars	J.F.	Anju (Rs.)	Manju (Rs.)	Sanju (Rs.)	Date	Particulars	J.F.	Anju (Rs.)	Manju (Rs.)	Sanju (Rs.)
	Realisation (assets)		1,95,000	2,63,000	33,600		Balance b/d		2,75,000	1,10,000	1,00,000
	Realisation (loss)		21,360	7,120	7,120		Realisation (creditors)		60,000		
	Bank		1,18,640		74,280		Realisation (loan)				15,000
							Bank			1,60,120	
			3,35,000	**2,70,120**	**1,15,000**				**3,35,000**	**2,70,120**	**1,15,000**

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

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		35,000		Realisation (expenses)		2,200
	Manju's capital		1,60,120		Anju's capital		1,18,640
					Sanju's capital		74,280
			1,95,120				**1,95,120**

Illustration 9

Sumit, Amit and Vinit are partners sharing profit in the ratio of 5:3:2. Their Balance Sheet as on March 31, 2014 was as follows:

Balance Sheet of Sunit, Amit and Vinit as on March 31, 2012

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Capitals:			Machinery	80,000
Sumit	40,000		Investments	1,50,000
Amit	50,000		Stock	10,000
Vinit	60,000	1,50,000	Debtors	35,000
Profit and Loss		10,000	Cash at bank	15,000
Mrs. Amit's loan		40,000		
Sundry creditors		90,000		
		2,90,000		**2,90,000**

The firm was dissolved on that date. Amit took over his wife's loan. One of the Creditors for Rs.2,600 was not claim the amount. Other assets realised as follows:

1. Machinery was sold for Rs.70,000,
2. Investments with book value of Rs.1,00,000 were given to Creditors in full settlement of their account. The remaining Investments were took over by Vinit at an agreed value of Rs.45,000,

3. Stock was sold for Rs.11,000 and Debtors for Rs.3,000 proved to be bad,
4. Realisation expenses were Rs.1,500.

Prepare ledger accounts to close the books of the firm.

Solution

Books of Amit, Sumit and Vinit
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Machinery	80,000		Sundry creditors		90,000
Investments	1,50,000		Mrs.Amit's loan		40,000
Stock	10,000		Bank :		
Debtors	35,000	2,75,000	Machinery	70,000	
Amit's Capital (wife's loan)		40,000	Stock	11,000	
Bank (realisation expenses)		1,500	Debtors	32,000	1,13,000
			Vinit's capital (investment)		45,000
			Loss transferred to :		
			Amit's capital	14,250	
			Sumit's capital	8,550	
			Vinit's capital	5,700	28,500
		3,16,500			**3,16,500**

Partners Capital Accounts

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amit (Rs.)*	*Sumit (Rs.)*	*Vinit (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amit (Rs.)*	*Sumit (Rs.)*	*Vinit (Rs.)*
	Realisation (assets)				45,000		Balance b/d		40,000	50,000	60,000
	Realisation (loss)		14,250	8,550	5,700		Realisation (Mrs. Vinit's loan)		40,000		
	Bank		70,750	44,450	11,300		Profit and Loss		5,000	3,000	2,000
			85,000	**53,000**	**62,000**				**85,000**	**53,000**	**62,000**

Bank Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		15,000		Realisation (expenses)		1,500
	Realisation (assets realised)		1,13,000		Amit's capital		70,750
					Sumit's capital		44,450
					Vinit's capital		11,300
			1,28,000				**1,28,000**

Note: No entry has been made for the investments taken over by the creditors as per rules.

Illustration 10

Meena and Tina are partners in a fir m and sharing profit as 3:2. They decided to dissolve their firm on March 31, 2014 when their Balance Sheet was a follows:

Balance Sheet Meena and Tina as on March 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital :			Machinery	70,000
Meena	90,000		Investments	50,000
Tina	80,000	1,70,000	Stock	22,000
Sundry creditors		60,000	Sundry Debtors	1,03,000
Bills payable		20,000	Cash at bank	5,000
		2,50,000		**2,50,000**

The assets and liabilities were disposed off as follows :

(a) Machinery were given to creditors in full settlement of their account and Stock were given to bills payable in full settlement.

(b) Investment wer e took over by Tina at book value. Sundry debtors of book value Rs. 50,000 took over by Meena at 10% less and remaining debtors realised Rs. 51,000.

(c) Realisation expenses amount to Rs. 2,000.

Prepare necessary ledger accounts to close the book of the firm.

Solution

Books of Meena and Tina – Realisation Account

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Assets transferred :			Sundry creditors		60,000
Machinery	70,000		Bills payable		20,000
Investments	50,000		Tina's Capital (investment)		50,000
Stock	22,000		Meena's Capital (debtors of		45,000
Sundry debtors	1,03,000	2,45,000	books value Rs. 50,000		
Bank (realisation expenses)		2,000	less 10%)		
			Bank		
			Debtors		51,000
			Loss transferred to :		
			Meena's capital	12,600	
			Tena's capital	8,400	21,000
		2,47,000			**2,47,000**

Partner's Capital Accounts

Dr. *Cr.*

Particulars	*Mena (Rs.)*	*Tina (Rs.)*	*Particulars*	*Meena (Rs.)*	*Tina (Rs.)*
Realisation (investment)		50,000	Balance b/d	90,000	80,000
Realisation (debtors)	45,000				
Realisation (loss)	12,600	8,400			
Bank	32,400	21,600			
	90,000	**80,000**		**90,000**	**80,000**

Bank Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Balance b/d	5,000	Realisation (expenses)	2,000
Realisation (assets realised)	51,000	Mena's capital	32,400
		Tina's capital	21,600
	56,000		**56,000**

Terms Introduced in the Chapter

1. Dissolution of Partnership
2. Dissolution of Partnership Firm
3. Partnership at Will
4. Compulsory Dissolution
5. Dissolution by Notice
6. Realisation Expenses
7. Realisation Account

Summary

1. *Dissolution of Partnership Firm :* The dissolution of a firm implies the discontinuance of partnership business and separation of economic relations between the partners. In the case of a dissolution of a firm, the firm closes its business altogether and realises all its assets and pays all its liabilities. The payment is made to the creditors first out of the assets realised and, if necessary, next out of the contributions made by the partners in their profit sharing ratio. When all accounts are settled and the final payment is made to the partners for the amounts due to them, the books of the firm are closed.
2. *Dissolution of Partnership :* A partnership gets terminated in case of admission, retirement death, etc. of a partner. This does not necessarily involve dissolution of the firm.
3. *Realisation Account :* The Realisation Account is prepared to record the transactions relating to sale and realisation of assets and settlement of creditors. Any profit or loss arising act of this process is shared by partners' in their profit sharing ratio. Partners' accounts are also settled and the Cash or Bank account is closed.

Questions for Practice

Short Answer Questions

1. State the difference between dissolution of partnership and dissolution of partnership firm.
2. State the accounting treatment for:
   i. Unrecorded assets ii. Unrecorded liabilities
3. On dissolution, how will you deal with partner's loan if it appears on the (a) assets side of the balance sheet, (b) liabilities side of balance sheet.

4. Distinguish between firm's debts and partner's private debts.
5. State the order of settlement of accounts on dissolution.
6. On what account realisation account differs from revaluation account.

Long Answer Questions

1. Explain the process dissolution of partnership firm?
2. What is a Realisation Account?
3. Reproduce the format of Realisation Account.
4. How deficiency of crditors is paid off?

Numerical Questions

1. Journalise the following transactions regarding realisation expenses :
   [a] Realisation expenses amounted to Rs.2,500.
   [b] Realisation expenses amounting to Rs.3,000 were paid by Ashok, one of the partners.
   [c] Realisation expenses Rs.2,300 borne by Tarun, personally.
   [d] Amit, a partner was appointed to realise the assets, at a cost of Rs.4,000. The actual amount of realisation amounted to Rs.3,000.
2. Record necessary journal entries in the following cases:
   [a] Creditors worth Rs.85,000 accepted Rs.40,000 as cash and Investment worth Rs.43,000, in full settlement of their claim.
   [b] Creditors were Rs.16,000. They accepted Machinery valued at Rs.18,000 in settlement of their claim.
   [c] Creditors were Rs.90,000. They accepted Buildings valued Rs.1,20,000 and paid cash to the firm Rs.30,000.
3. There was an old computer which was written-off in the books of accounts in the pervious year. The same has been taken over by a partner Nitin for Rs.3,000. Journalise the transaction, supposing. That the firm has been dissolved.
4. What journal entries will be recorded for the following transactions on the dissolution of a firm:
   [a] Payment of unrecorded liabilities of Rs.3,200.
   [b] Stock worth Rs.7,500 is taken by a partner Rohit.
   [c] Profit on Realisation amounting to Rs.18,000 is to be distributed between the partners Ashish and Tarun in the ratio of 5:7.
   [d] An unrecorded asset realised Rs.5,500.
5. Give journal entries for the following transactions :
   1. To record the realisation of various assets and liabilities,
   2. A Firm has a Stock of Rs. 1,60,000. Aziz, a partner took over 50% of the Stock at a discount of 20%,
   3. Remaining Stock was sold at a profit of 30% on cost,
   4. Land and Buildging (book value Rs. 1,60,000) sold for Rs. 3,00,000 through a broker who charged 2%, commission on the deal,
   5. Plant and Machinery (book value Rs. 60,000) was handed over to a Creditor at an agreed valuation of 10% *less* than the book value,
   6. Investment whose face value was Rs. 4,000 was realised at 50%.

6. How will you deal with the realisation expenses of the firm of Rashim and Bindiya in the following cases:
   1. Realisation expenses amounts to Rs. 1,00,000,
   2. Realisation expenses amounting to Rs. 30,000 are paid by Rashim, a partner.
   3. Realisation expenses are to be borne by Rashim for which he will be paid Rs. 70,000 as remuneration for completing the dissolution process. The actual expenses incurred by Rashim were Rs. 1,20,000.

7. The book value of assets (other than cash and bank) transferred to Realisation Account is Rs. 1,00,000. 50% of the assets are taken over by a partner Atul, at a discount of 20%; 40% of the remaining assets are sold at a profit of 30% on cost; 5% of the balance being obsolete, realised nothing and remaining assets are handed over to a Creditor, in full settlement of his claim.

   You are required to record the journal entries for realisation of assets.

8. Record necessary journal entries to record the following unrecorded assets and liabilities in the books of Paras and Priya:
   1. There was an old furniture in the firm which had been written-off completely in the books. This was sold for Rs. 3,000,
   2. Ashish, an old customer whose account for Rs. 1,000 was written-off as bad in the previous year, paid 60%, of the amount,
   3. Paras agreed to takeover the firm's goodwill (not recorded in the books of the firm), at a valuation of Rs. 30,000,
   4. There was an old typewriter which had been written-off completely from the books. It was estimated to realize Rs. 400. It was taken away by Priya at an estimated price less 25%,
   5. There were 100 shares of Rs. 10 each in Star Limited acquired at a cost of Rs. 2,000 which had been written-off completely from the books. These shares are valued @ Rs. 6 each and divided among the partners in their profit sharing ratio.

9. All partners wishes to dissolve the firm. Yastin, a partner wants that her loan of Rs. 2,00,000 must be paid off before the payment of capitals to the partners. But, Amart, another partner wants that the capitals must be paid before the payment of Yastin's loan. You are required to settle the conflict giving reasons.

10. What journal entries would be recorded for the following transactions on the dissolution of a firm after various assets (other than cash) on the third party liabilities have been transferred to Reliasation account.
    1. Arti took over the Stock worth Rs. 80,000 at Rs. 68,000.
    2. There was unrecorded Bike of Rs. 40,000 which was taken over By Mr. Karim.
    3. The firm paid Rs. 40,000 as compensation to employees.
    4. Sundry creditors amounting to Rs. 36,000 were settled at a discount of 15%.
    5. Loss on realisation Rs. 42,000 was to be distributed between Arti and Karim in the ratio of 3:4.

11. Rose and Lily shared profits in the ratio of 2:3. Their Balance Sheet on March 31, 2014 was as follows:

Balance Sheet of Rose and Lily as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors	40,000	Cash		16,000
Lily's loan	32,000	Debtors	80,000	
Profit and Loss	50,000	*Less*: Provision for		
Capitals:		doubtful debts	3,600	76,400
Lily	1,60,000	Inventory		1,09,600
Rose	2,40,000	Bills receivable		40,000
		Buildings		2,80,000
	5,22,000			**5,22,000**

Rose and Lily decided to dissolve the firm on the above date. Assets (except bills receivables) realised Rs. 4,84,000. Bills Receivable were taken over by Rose at Rs. 30,000. Creditors agreed to take Rs. 38,000. Cost of realisation was Rs. 2,400. There was a Motor Cycle in the firm which was bought out of the firm's money, was not shown in the books of the firm. It was now sold for Rs. 10,000. There was a contingent liability in respect of outstanding electric bill of Rs. 5,000 Bill Receivable taken over by Rose at Rs. 33,000.

Show Realisation Account, Partners Capital Acount, Loan Account and Cash Account.

(**Ans :** Realisation Profit Rs. 15,600, Total of Cash Account Rs. 5,10,000)

12. Shilpa, Meena and Nanda decided to dissolve their partnership on March 31,2014. Their profit sharing ratio was 3:2:1 and their Balance Sheet was as under:

Balance Sheet of Shilpa, Meena and Nanda as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:		Land	81,000
Shilpa	80,000	Stock	56,760
Meena	40,000	Debtors	18,600
Bank loan	20,000	Nanda's capital	23,000
Creditors	37,000	Cash	10,840
Provision for doubtful debts	1,200		
General reserve	12,000		
	1,90,200		**1,90,200**

The stock of value of Rs. 41,660 are taken over by Shilpa for Rs. 35,000 and she agreed to discharge bank loan. The remaining stock was sold at Rs. 14,000 and debtors amounting to Rs. 10,000 realised Rs. 8,000. land is sold for Rs. 1,10,000. The remaining debtors realised 50% at their book value. Cost of realisation amounted to Rs. 1,200. There was a typewriter not recorded in the books worth Rs. 6,000 which were taken over by one of the Creditors at this value. Prepare Realisation Account.
(**Ans :** Profit on Realisation Rs. 20,940, Total of Cash Account Rs. 1,64,650)

13. Surjit and Rahi were sharing profits (losses) in the ratio of 3:2, their Balance Sheet as on March 31, 2014 is as follows:

Balance Sheet of Surjit and Rahi as on March 31, 2014

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors	38,000	Bank	11,500
Mrs. Surjit loan	10,000	Stock	6,000
Reserve	15,000	Debtors	19,000
Rahi's loan	5,000	Furniture	4,000
Capital's:		Plant	28,000
Surjit	10,000	Investment	10,000
Rahi	8,000	Profit and Loss	7,500
	86,000		**86,000**

The firm was dissolved on March 31, 2014 on the following terms:
1. Surjit agreed to take the investments at Rs. 8,000 and to pay Mrs. Surojit's loan.
2. Other assets were realised as follows:
   Stock Rs. 5,000
   Debtors Rs. 18,500
   Furniture Rs. 4,500
   Plant Rs. 25,000
3. Expenses on realisation amounted to Rs. 1,600.
4. Creditors agreed to accept Rs. 37,000 as a final settlement.
   You are required to prepare Realisation account, Partner's Capital account and Bank account.

(**Ans :** Loss on Realisation Rs. 6,600, Total of Cash Account Rs. 64,500)

14. Rita, Geeta and Ashish were partners in a firm sharing profits/losses in the ratio of 3:2:1. On March 31, 2014 their balance sheet was as follows:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Cash	22,500
Rita	80,000		Debtors	52,300
Geeta	50,000		Stock	36,000
Ashish	30,000	1,60,000	Investments	69,000
Creditors		65,000	Plant	91,200
Bills payable		26,000		
General reserve		20,000		
		2,71,000		**2,71,000**

On the date of above mentioned date the firm was dissolved:

1. Rita was appointed to realise the assets. Rita was to receive 5% commission on the rate of assets (except cash) and was to bear all expenses of realisation,
2. Assets were realised as follows:

	Rs.
Debtors	30,000
Stock	26,000
Plant	42,750

3. Investments were realised at 85% of the book value,
4. Expenses of realisation amounted to Rs. 4,100,
5. Firm had to pay Rs. 7,200 for outstanding salary not provided for earlier,
6. Contingent liability in respect of bills discounted with the bank was also materialised and paid off Rs. 9,800,

   Prepare Realisation account, Capital Accounts of Partner's and Cash Account.

(**Ans :** Loss on Realisation Rs. 1,29,455, Total of Cash Account Rs. 1,65,705)

15. Anup and Sumit are equal partners in a firm. They decided to dissolve the parntership on December 31, 2014. When the balance sheet is as under :

Balance Sheet of Anup and Sumit as on December 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		27,000	Cash at bank	11,000
Reserve fund		10,000	Sundry Debtors	12,000
Loan		40,000	Plants	47,000
Capital			Stock	42,000
Anup	60,000		Lease hold land	60,000
Sumit	60,000	1,20,000	Furniture	25,000
		1,97,000		**1,97,000**

The Assets were realised as follows :

	Rs.
Lease hold land	72,000
Furniture	22,500
Stock	40,500
Plant	48,000
Sundry Debtors	10,5000

The Creditors were paid Rs. 25,500 in full settlement. Expenses of realisation amount to Rs. 2,500.

Prepare Realisation Account, Bank Account, Partners Capital Accounts to close the books of the firm.

(**Ans :** Realisation Profit Rs. 46,500)

16. Ashu and Harish are partners sharing profit and losses as 3:2. They decided to dissolve the firm on December 31, 2014. Their balance sheet on the above date was:

Balance Sheet of Ashu and Harish as on December 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Building	80,000
Ashu	1,08,000		Machinery	70,000
Harish	54,000	1,62,000	Furniture	14,000
Creditors		88,000	Stock	20,000
Bank overdraft		50,000	Investments	60,000
			Debtors	48,000
			Cash in hand	8,000
		3,00,000		**3,00,000**

Ashu is to take over the building at Rs. 95,000 and Machinery and Furniture is take over by Harish at value of Rs. 80,000. Ashu agreed to pay Creditor and Harish agreed to meet Bank overdraft. Stock and Investments are taken by both partner in profit sharing ratio. Debtors realised for Rs. 46,000, expenses of realisation amounted to Rs. 3,000. Prepare necessary ledger account.

(**Ans :** Loss on Realisation Rs. 14,000, Cash/Bank Total Rs. 59,600)

17. Sanjay, Tarun and Vineet shared profit in the ratio of 3:2:1. On December 31,2012 their balance sheet was as follows :

Balance Sheet of Sanjay, Tarun and Vineet as on December 31, 2012

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Plant	90,000
Sanjay	1,00,000		Debtors	60,000
Tarun	1,00,000		Furniture	32,000
Vineet	70,000	2,70,000	Stock	60,000
Creditors		80,000	Investments	70,000
Bills payable		30,000	Bills receivable	36,000
			Cash in hand	32,000
		3,80,000		**3,80,000**

On this date the firm was dissolved. Sanjay was appointed to realise the assets. Sanjay was to receive 6% commission on the sale of assets (except cash) and was to bear all expenses of realisation.
Sanjay realised the assets as follows : Plant Rs. 72,000, Debtors Rs. 54,000, Furniture Rs. 18,000, Stock 90% of the book value, Investments Rs. 76,000 and Bills receivable Rs.31,000. Expenses of realisation amounted to Rs.4,500. Prepare Realisation Account, Capital Accounts and Cash Account

(**Ans :** Loss on Realisation Rs.61,300, Total of Cash Account Rs.3,37,000)

18. The following is the Balance Sheet of Gupta and Sharma as on December 31,2014:

Balance Sheet of Gupta and Sharma as on December 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		38,000	Cash at bank	12,500
Mrs.Gupta's loan		20,000	Sundry Debtors	55,000
Mrs.Sharma's loan		30,000	Stock	44,000
Reserve fund		6,000	Bills receivable	19,000
Provision of doubtful debts		4,000	Machinery	52,000
Capital			Investment	38,500
Gupta	90,000		Fixtures	27,000
Sharma	60,000	1,50,000		
		2,48,000		**2,48,000**

The firm was dissolved on December 31, 2014 and asset realised and settlements of liabilities as follows:

(a) The realisation of the assets were as follows:

	Rs.
Sundry Debtors	52,000
Stock	42,000
Bills receivable	16,000
Machinery	49,000

(b) Investment was taken over by Gupta at agreed value of Rs.36,000 and agreed to pay of Mrs. Gupta's loan.

(c) The Sundry Creditors were paid off *less* 3% discount.

(d) The realisation expenses incurred amounted to Rs.1,200.

Journalise the entries to be made on the dissolution and prepare Realisation Account, Bank Account and Partners Capital Accounts.

(**Ans :** Loss on Realisation Rs.19,660, Total of Cash Account Rs.1,88,500)

19. Ashok, Babu and Chetan are in partnership sharing profit in the proportion of 1/2, 1/3, 1/6 respectively. They dissolve the partnership of the December 31, 2014, when the balance sheet of the firm as under:

Balance Sheet of Ashok, Babu and Chetan as on December 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		20,000	Bank	7,500
Bills payable		25,500	Sundry Debtors	58,000
Babu's loan		30,000	Stock	39,500
Capital's :			Machinery	48,000
Ashok	70,000		Investment	42,000
Babu	55,000		Freehold property	50,500
Chetan	27,000	1,52,000		
Current accounts :				
Ashok	10,000			
Babu	5,000			
Chetan	3,000	18,000		
		2,45,500		**2,45,500**

The Machinery was taken over by Babu for Rs.45,000, Ashok took over the Investment for Rs.40,000 and Freehold property took over by Chetan at Rs.55,000. The remaining Assets realised as follows: Sundry Debtors Rs.56,500 and Stock Rs.36,500. Sundry Creditors were settled at discount of 7%. A Office computer, not shown in the books of accounts realised Rs.9,000. Realisation expenses amounted to Rs.3,000.

Prepare Realisation Account, Partners Capital Account, Bank Account.

(**Ans :** Profit on Realisation Rs.1,200, Total of Cash Account Rs.1,34,100)

20. The following is the Balance sheet of Tanu and Manu, who shares profit and losses in the ratio of 5:3, On December 31,2014:

Balance Sheet of Tanu and Manu as on December 31, 2014

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		62,000	Cash at bank	16,000
Bills payable		32,000	Sundry Debtors	55,000
Bank loan		50,000	Stock	75,000
Reserve fund		16,000	Motor car	90,000
Capital			Machinery	45,000
Tanu	1,10,000		Investment	70,000
Manu	90,000	2,00,000	Fixtures	9,000
		3,60,000		**3,60,000**

On the above date the firm is dissolved and the following agreement was made: Tanu agree to pay the bank loan and took away the sundry debtors. Sundry creditors accepts stock and paid Rs.10,000 to the firm. Machinery is taken over by Manu for Rs.40,000 and agreed to pay of bills payable at a discount of 5%.. Motor car was taken over by Tanu for Rs.60,000. Investment realised Rs.76,000 and fixtures Rs.4,000. The expenses of dissolution amounted to Rs.2,200.

Prepare Realisation Account, Bank Account and Partners Capital Accounts.

(**Ans :** Loss on Ralisation Rs.37,600, Total of Cash Account Rs.1,06,000)

Check-list to Check your Understanding

Test your Understanding – I

1. True, 2 True, 3. True, 4. False, 5. True, 6. True, 7. True, 8. False.

Test your Understanding – II

1. (c), 2. (d), 3. (b), 4. (d), 5. (c), 6. (a), 7. (b), 8. (c)

Test your Understanding – III

1. Debit, Realisaton, 2. External, Credit, Realisation, 3. Capital Accounts, Profit sharing ratio. 4. Credited, 5. Debited, 6. Creditor, 7. Pay, Realisation, 8. Realisation, Capital, 9. Not recorded, 10. Capital.