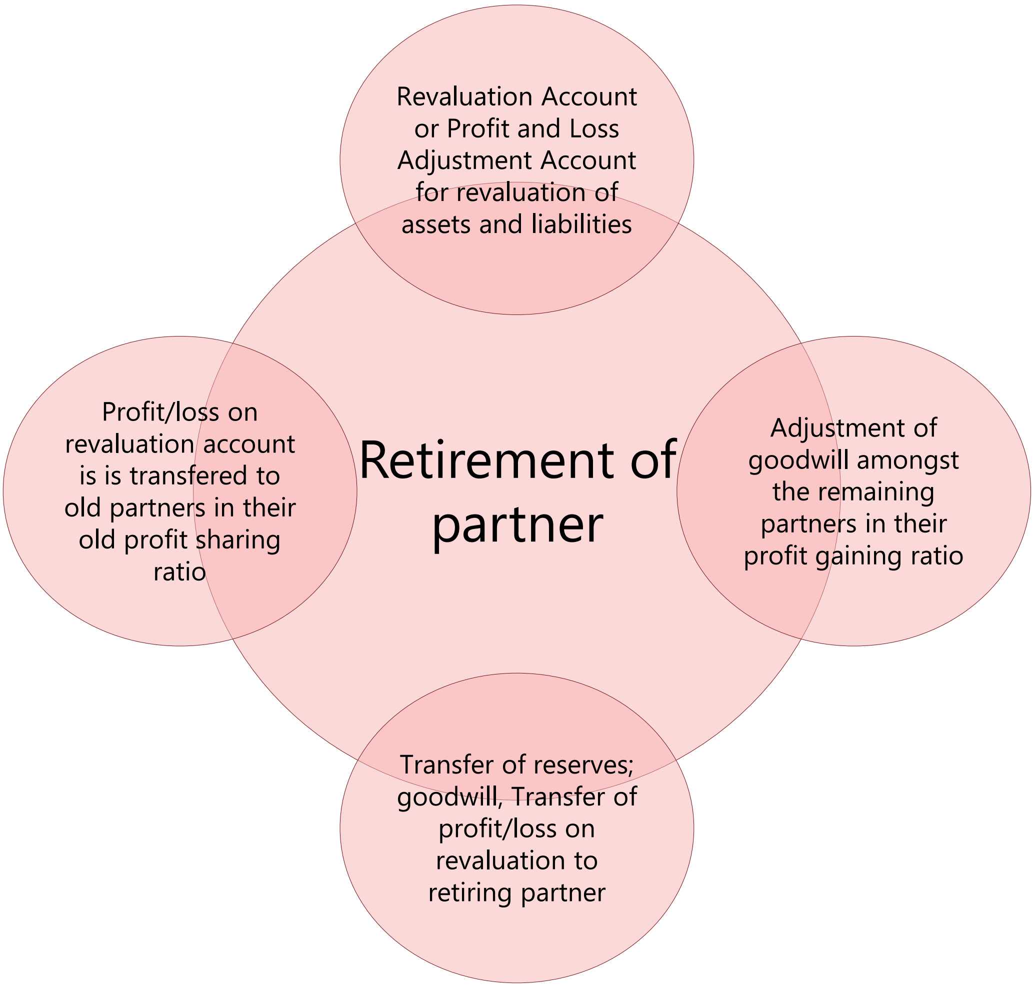
UNIT – 4: RETIREMENT OF A PARTNER

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Learn how to compute the gaining ratio and observe the use of such gaining ratio.
- Be familiar with the accounting treatment in relation to revaluation of assets and liabilities.
- Learn the accounting entries to be passed for transfer of reserves standing in the balance sheet to partners' capital accounts in a manner already discussed for admission of a partner in unit 3 of the chapter.
- Learn the technique of keeping records if the balance due to the retiring partner is transferred to loan account.
- Familiarize with the term Joint Life Policy.
- Learn how to keep records for payment of premium in relation to Joint Life Policy. Also observe the accounting treatment in relation to such Joint Life Policy in case of retirement of a partner.

UNIT OVERVIEW



4.1 INTRODUCTION

A partner may retire from the partnership firm because of old age, illness, etc. Generally, the business of the partnership firm may not come to an end when one of the partners retires. Other partners may continue to run the business of the firm. Readjustment takes place in case of retirement of a partner likewise the case of admission of a partner. Whenever a partner retires, the continuing partners make gain in terms of profit sharing ratio. Therefore, the remaining partners arrange for the amount to be paid to discharge the claims of the retiring partners. Assets and liabilities are revalued, value of goodwill is raised and surrender value of joint life policy, if any, is taken into account. Revaluation profit and reserves are transferred to capital or current accounts of partners. Lastly, final amount due to the retiring partner is determined and discharged.

4.2 CALCULATION OF GAINING RATIO

On retirement of a partner, the continuing partners will gain in terms of profit sharing ratio. For example, if A, B and C were sharing profits and losses in the ratio of 5:3: 2 and B retires, then A and C have to decide at which ratio they will share profits and losses in future. If it is decided that the continuing partners will share profits and losses in future at the ratio of 3:2, then A gains 1/10th [(3/5)-(5/10)] and C gains 2/10 [(2/5)-(2/10)]. So the gaining ratio between A and C is 1:2. If A and C decide to continue at the ratio 5:2, this indicates that they are dividing the gained share in the previous profit sharing ratio.

Example: Amir, Jamir and Samir are in partnership sharing profits and losses at the ratio of 3:2:1. Now Amir wants to retire and Jamir and Samir want to continue at the ratio of 3:2. In this case, Jamir gains 8/30th of share of partnership (3/5 less 2/6) whereas Samir gains 7/30th (2/5 less 1/6) share of the partnership. So gaining ratio between Jamir and Samir is 8:7. On the other hand, if Jamir and Samir would decide to continue sharing profits and losses at the ratio of 2:1, then Jamir would gain 2/6th share of partnership i.e. [(2/3)–(2/6)], and Samir would gain 1/6th share of partnership i.e. [(1/3)–(1/6)]. So it appears that in such a case gaining ratio of Jamir and Samir would be 2:1. i.e., the existing profit sharing ratio between them.

Thus, on the retirement or death of a partner, his share in the profit would be taken by the remaining partners. In other words, they get additional share which is obviously a gain or benefit. The calculation of gaining ratio or benefit ratio is done as follows:

(i) When the new ratio is given, gaining ratio is calculated by deducting their new share of profits from the old share.

(ii) When the new profit sharing ratio is not given and the remaining partners share the future profits in the same ratio as before, the gaining ratio would be the old profit sharing ratio.

Observe the following table:

Ratio between Remaining Partners

		New Ratio	Gaining or Benefit Ratio
1.	When new ratio is given	As given in the examination problem	New Ratio minus Old ratio
2.	When the new Ratio is not given	The same old ratios between them	The same old ratios between them
3.	When gaining or benefit ratio is given	Old ratio + Gaining ratio	As given in the question

Calculation of New Profit Sharing Ratio

Case 1 When nothing is given about the new profit sharing ratio of the remaining partners: Under this situation the calculation of new ratio is done by striking out the share of the retiring partner.

Example : Alok, Bhaskar and Chetan are partners sharing in the ratio 3:2:1. Calculate new ratio if:

(a) If Alok retires.

(b) If Bhaskar retires.

(c) If Chetan retires.

Solution

Old Profit ratio = 3:2:1

(a) If Alok retires new profit ratio will be 2:1

(b) If Bhaskar retires new profit ratio will be 3:1

(c) If Chetan retires new profit ratio will be 3:2

Case 2: When gains of the continuing partners are specifically given in the question: In such a case, the new shares of the continuing partners are calculated by adding their respective gain to their old share.

New share = Old share + Gain

Example

Aarav, Banta and Chunmun are partners sharing in the ratio 3:2:1. Aarav retires and his share is taken over by the remaining partners as follow

Banta takes 2/6th from Aarav.

Chunmun takes 1/6th from Aarav.

Calculate new ratio.

Solution

Banta's New Share = Banta's old share + Banta's gain = 2/6 + 2/6 = 4/6

Chunmun's New Share = Chunmun's old share + Chunmun's gain = 1/6 + 1/6 = 2/6

So the new share = 4/6: 2/6 = 2:1

Case 3: When the ratio in which the remaining partners acquire the share of the outgoing partner is given:

Example

Deepu, Tasha and Honey are partners sharing profits in the ratio 3:2:1. Tasha retires and his share was acquired by deepu and honey in the ratio 2:1. Calculate new ratio.

Solution

Share acquired by Deepu = 2/6 × 2/3 = 4/18

Share acquired by Honey = 2/6 × 1/3 = 2/18

Deepu's new Share = Deepu 's old share + Deepu's gain = 3/6 + 4/18 = 13/18

Honey's new Share = Honey's old share + Honey's gain = 1/6+ 2/18 = 5/18

New Ratio = 13:5

Calculation of Gaining Ratio

Case – 1

A, B and C are partners sharing profits and losses in the ratio of 1/2, 3/10 and 1/5 respectively. B retires from the firm and A&C decide to share future profits and losses in the ratio of 3:2.

		A	C
Their new shares	(a)	3/5	2/5
Their old shares	(b)	1/2	1/5
Difference being gain		(a –b)	1/10
2/10			

Gaining ratio of A and C = 1/10 : 2/10 = 1 : 2

Case – 2

W, A , B and C are partners sharing profits and losses in the ratio of 1/3, 1/6, 1/3 and 1/6 respectively. B retires and W, A and C decide to share future profits and losses equally.

		W	A	C
Their new shares	(a)	1/3	1/3	1/3
Their old shares	(b)	1/3	1/6	1/6
Difference being gain		(a –b)		-
1/6	1/6			

Gaining ratio of A and C = 1/6 : 1/6 = 1 : 1

Case – 3

A, B and C are partners sharing profits and losses in the ratio of 25:15:9. B retires and it is decided that profit sharing ratio between A&C will be the same as existing between B and C.

Ratio of B and C = 15 : 9 = 5 : 3

Therefore new ratio of A and C should be 5 : 3

		A	C
Their new shares	(a)	5/8	3/8
Their old shares	(b)	25/49	9/49
Difference being gain	(a–b)	45/392	75/392

Gaining ratio of A and C = 45 : 75 = 3 : 5

Case – 4

A, B and C are partners sharing profits and losses in the ratio of 4/9, 1/3 and 2/9. B retires and surrenders 1/9th of his share in favour of A and remaining in favour of C.

		A	C
Their existing shares	(a)	4/9	2/9
Share surrendered by B	(b)	1/9 X 1/3 = 1/27	8/9 X 1/3 = 8/27
New share of remaining partner	(a + b)	13/27	14/27

New ratio of A and C = 13 : 14

Gaining ratio = 1/27 : 8/27 = 1 : 8

Case – 5

A, B & C are partners sharing profits and losses in the ratio of 1/2 , 3/10 and 1/5 respectively. B retires and his share is taken by A and C in the ratio of 2:1. Then immediately W is admitted for 1/4th share of profit, half of which was gifted by A and remaining share was taken by W equally from A and C.

		A	C
Their existing shares	(a)	1/2	1/5
Share acquired by remaining partners	(b)	2/3 x 3/10 = 2/10	1/3 x 3/10 = 1/10
New shares of remaining partners	(c= a + b)	7/10	3/10
Share gifted by A	(d)	1/2 x 1/4 = 1/8	-

Share acquired by W (other than gift) (e)		1/2 x 1/8 = 1/16	1/2 x 1/8 = 1/16
New Shares	(c – d - e)	41/80	19/80

New ratio of A , C and W = 41/80 : 19/80 : 20/80 = 41 : 19 : 20

4.3 REVALUATION OF ASSETS AND LIABILITIES ON RETIREMENT OF A PARTNER

On retirement of a partner, it is required to revalue assets and liabilities just as in the case of admission of a partner. If there is revaluation profit, then such profit should be distributed amongst the existing partners including the retiring partner at the existing profit sharing ratio. On the other hand, if there is loss on revaluation that is also to be distributed to all the partners including the retiring partner at the existing profit sharing ratio. To arrive at, profit or loss on revaluation of assets and liabilities, a Revaluation Account or Profit and Loss Adjustment Account is opened. Revaluation Account or Profit and Loss Adjustment Account is closed automatically by transfer of profit or loss balance to the Partners' Capital Accounts.

If it is decided that revalued figures of assets and liabilities will not appear in the balance sheet of the continuing partners, then a journal entry should be passed with the amount payable or chargeable to the retiring partner which the continuing partners will share at the ratio of gain. In the first instance, the journal entry for distribution of profit or loss on revaluation which will appear in the balance sheet also is as follows:

	Revaluation A/c	Dr.
	To Partners' Capital A/cs	
	(For profit on revaluation)	
Or	Partners' Capital A/c's	Dr.
	To Revaluation A/c	
	(For loss on revaluation)	

Now see how to deal with a situation where revalued figures will not appear in the Balance Sheet.

If A, B & C share profits and losses equally and there is a revaluation profit of ₹ 30,000 calculated on A's retirement, then ₹ 10,000 becomes due to A which is to be borne by B and C equally. So the journal entry will be as follows:

		₹	₹
B's Capital A/c	Dr.	5,000	
C's Capital A/c	Dr.	5,000	
To A's Capital A/c			10,000

Alternatively, it is possible to account for the increase in the value of assets or decrease in the value of liabilities by debiting the appropriate asset account or liability account and crediting partners' capital account at the existing profit sharing ratio. Simultaneously the partners capital accounts are to be debited for such gain at the new profit sharing ratio and the respective assets and liabilities account is to be credited again. So the following journal entries are necessary for ₹ 10,000 increase in sundry fixed assets and ₹ 2,000 decrease in trade payables:

			₹	₹
1)	Sundry Fixed Assets A/c	Dr.	10,000	
	Trade payables A/c	Dr.	2,000	
	To A's Capital A/c			4,000
	To B's Capital A/c			4,000
	To C's Capital A/c			4,000
	(Distribution of Revaluation Profit amongst the existing partners in the old profit sharing ratio)			
2)	B's Capital A/c	Dr.	6,000	
	C's Capital A/c	Dr.	6,000	
	To Sundry Fixed Assets A/c			10,000
	To Trade payables A/c			2,000
	(Being revalued assets and liabilities are not required to be shown in the Balance Sheet)			

In this case it is not necessary to open a separate Revaluation Account. However, the above effect can also be given through Memorandum Revaluation Account as discussed in the case of admission of a partner in unit 3.

4.4 RESERVE

On the retirement of a partner any undistributed profit or reserve standing at the Balance Sheet is to be credited to the Partners' Capital Accounts in the old profit sharing ratio. Alternatively, only the retiring partner's share may be transferred to his Capital Account if the others continue at the same profit sharing ratio.

For example, A, B and C were in partnership sharing profits and losses at the ratio 5:3: 2. A retired and B and C agreed to share profits and losses at the ratio of 3:2. Reserve balance was ₹ 10,000. In this case either of the following journal entries can be passed:

			₹	₹
1)	Reserve A/c	Dr.	10,000	
	To A's Capital A/c			5,000
	To B's Capital A/c			3,000
	To C's Capital A/c			2,000
	(Transfer of reserve to Partners' Capital A/cs in 5 : 3 : 2 on A's retirement)			
2)	Reserve A/c	Dr.	5,000	
	To A's Capital A/c			5,000
	(Transfer of A's share of Reserve to the Capital Account on his retirement)			

Note that alternative (2) has the same implications because B and C continued at the same ratio 3: 2 as they did before A's retirement.

Take another example: X, Y and Z were equal partners. Z decided to retire. X and Y decided to continue at the ratio of 3: 2. Reserve standing at the date of retirement of Z was ₹ 9,000. In this case adjustment of Z's share was not sufficient since the relationship between X and Y was also changed.

X's gain: $\frac{3}{5}-\frac{1}{3}=\frac{9-5}{15}=\frac{4}{15}$

Y's gain: $\frac{2}{5}-\frac{1}{3}=\frac{6-5}{15}=\frac{1}{15}$

Gaining Ratio: X: Y

4: 1

This is different from 1: 1. So alternative (1) is to be followed in this case.

		₹	₹
Reserve A/c	Dr.	9,000	
To X's Capital A/c			3,000
To Y's Capital A/c			3,000
To Z's Capital A/c			3,000
(Transfer of Reserve on Z's retirement)			

If the continuing partners want to show reserve in the Balance Sheet, the journal entry will be:

		₹	₹
X's Capital A/c	Dr.	2,400	
Y's Capital A/c	Dr.	600	
To Z's Capital A/c			3,000
(Adjustment entry for Z's share in reserve)			

4.5 FINAL PAYMENT TO A RETIRING PARTNER

The following adjustments are necessary in the Capital A/c:

(i) Transfer of reserve,

(ii) Transfer of goodwill,

(iii) Transfer of profit/loss on revaluation.

After adjustment of the above mentioned items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him.

The continuing partners may discharge the whole claim at the time of retirement. Then the journal entry will appear as follows:

Retiring Partner's Capital A/c Dr.

To Bank A/c

Sometimes the retiring partner agrees to retain some portion of his claim in the partnership as loan. The journal entry will be as follows:

Retiring partner's Capital A/c Dr.

To Retiring Partner's Loan A/c

To Bank A/c

As a rule, the payment is made according to terms of partnership agreement which might provide one of the following alternatives:

(a) Repayment may be made in instalments over a period of time and the interest is paid on outstanding balance which will be treated as a loan of the outgoing partner.

(b) The amount due may be treated as a loan to the firm and in return the firm will either pay interest at a fixed rate or share of the profit of the firm.

(c) An annuity may be paid to a retired partner for life or for an agreed number of years for the life of some dependent.

ILLUSTRATION 1

A and B are partners in a business sharing profit and losses as A-3/5th and B-2/5th. Their balance sheet as on 1st January, 2022 is given below:

Liabilities		₹	***Assets***	₹
Capital Accounts			*Plant and Machinery*	*20,000*
A	*20,000*		*Inventories*	*16,000*
B	*15,000*	*35,000*	*Trade receivables*	*15,000*
Reserve Account		*15,000*	*Balance at Bank*	*6,000*
Trade payables		*7,500*	*Cash in hand*	*500*
		57,500		*57,500*

B retires from the business owing to illness and A takes it over. The following revaluation was made:

(1) The goodwill of the firm is valued at ₹ 25,000.

(2) Depreciate Plant & Machinery by 7.5% and Inventories by 15%.

(3) Doubtful debts provision is raised against trade receivables at 5% and a discount reserve against trade payables at 2%.

Required:

Journalize the above transactions in the books of the firm and close the Partners' Accounts as on 1st January 2022. Give also the opening Balance Sheet of A.

SOLUTION

Journal Entries

2022		Dr. (₹)	Cr. (₹)
Jan 1.	A's Capital Account Dr.	10,000	
	To B's Capital Account		10,000
	(The amount of share of goodwill adjusted on B's retirement)		
	Reserve Account Dr.	15,000	
	To A's Capital Account		9,000
	To B's Capital Account		6,000
	(Transfer of reserve to A's Capital Account and B's Capital Account in the profit sharing ratio)		
	Profit and Loss Adjustment Account Dr.	4,650	
	To Plant and Machinery Account		1,500
	To Inventory Account		2,400
	To Provision for Doubtful Debts Account		750
	(Reduction in the values, assets and creation of provision for doubtful debts as per agreement with B)		
	Reserve for Discount on Trade payables A/c Dr.	150	
	To Profit and Loss Adjustment Account		150
	(Creation of reserve for discount on trade payables at 2%)		
	A's Capital Account Dr.	2,700	
	B's Capital Account Dr.	1,800	
	To Profit and Loss Adjustment Account		4,500
	(Transfer of loss on revaluation of assets and liabilities to Capital Accounts of A and B in the profit sharing ratio)		
	B's Capital Account Dr.	29,200	
	To B's Loan Account		29,200
	(Transfer of B's Capital Account to his Loan A/c)		

Note: Here it is assumed that amount payable to B is transferred to his loan a/c.

Balance Sheet of A as on 1st January, 2022

Liabilities	₹	₹	Assets	₹	₹
A's Capital Account		16,300	Plant and Machinery		18,500
B's Loan Account		29,200	Inventories		13,600
Trade payables	7,500		Trade receivables	15,000	
Less: Reserve for Discount	(150)	7,350	*Less*: Prov. for Bad Debts	(750)	14,250
			Balance at Bank		6,000
			Cash		500
		52,850			52,850

ILLUSTRATION 2

F, G and K were partners in LLP sharing profits and losses at the 2:2: 1. K wants to retire on 31.12.2022. Given below is the Balance Sheet of the partnership as well as other information:

Balance Sheet as on 31.12.2022

Liabilities	₹	*Assets*	₹
Capital A/cs		*Sundry Fixed Assets*	*1,50,000*
F	*1,20,000*	*Inventories*	*50,000*
G	*80,000*	*Trade receivables*	*70,000*
K	*60,000*	*(Including Bills Receivable 20,000)*	
Reserve	*10,000*	*Bank*	*50,000*
Trade payables	*50,000*		
	3,20,000		*3,20,000*

F and G agree to share profits and losses at the ratio of 3: 2 in future. Value of Goodwill is taken to be ₹ 50,000. Sundry Fixed Assets are revalued upward by ₹ 30,000 and Inventories by ₹ 10,000. Bills Receivable dishonoured ₹ 5,000 on 31.12.2022 but not recorded in the books. Dishonour of bill was due to insolvency of the customer. F and G agree to bring sufficient cash to discharge claim of K and to make their capital proportionate. Also they wanted to maintain ₹ 75,000 bank balance for working capital.

Required:

Pass necessary journal entries and draft the Balance Sheet of M/s F & G LLP. Also prepare capital accounts of partners and draft the Balance Sheet of Ms/ F & G after K's retirement.

SOLUTION

Journal Entries

			₹	₹
(1)	F's Capital A/c	Dr.	10,000	
	To K's Capital A/c			10,000
	(Being the adjustment for goodwill on K's retirement) - Refer W.N.			
(2)	Reserve A/c	Dr.	10,000	
	To F's Capital A/c			4,000
	To G's Capital A/c			4,000
	To K's Capital A/c			2,000
	(Transfer of Reserve to Partners' Capital A/cs on K's retirement)			
(3)	Sundry Fixed Assets A/c	Dr.	30,000	
	Inventory A/c	Dr.	10,000	
	To Profit and Loss Adjustment A/c			40,000
	(Increase in the value of Sundry Fixed Assets and inventory recorded)			
(4)	Profit and Loss Adjustment A/c	Dr.	5,000	
	To Trade Receivable A/c			5,000
	(Loss arising out of dishonoured bill recorded)			
(5)	Profit and Loss Adjustment A/c	Dr.	35,000	
	To F's Capital A/c			14,000
	To G's Capital A/c			14,000
	To K's Capital A/c			7,000
	(Profit on revaluation transferred to Partners' Capital A/cs on K's retirement)			
(6)	Bank A/c	Dr.	1,04,000	
	To F's Capital A/c			70,000
	To G's Capital A/c			34,000
	(Cash brought in by F and G as per agreement)			
(7)	K's Capital A/c	Dr.	79,000	
	To Bank A/c			79,000
	(Payment made to K on retirement)			

Working Note:

Adjusting entry for goodwill

Partner	Old Share	New Share	Gain	Sacrifice
F	$\frac{2}{5}$	$\frac{3}{5}$	$\frac{1}{5}$	–
G	$\frac{2}{5}$	$\frac{2}{5}$	–	–
K	$\frac{1}{5}$	–	–	$\frac{1}{5}$

Adjusting entry:

	₹	₹
F's Capital A/c (50,000 x 1/5) Dr.	10,000	
To K's Capital A/c		10,000

Balance Sheet (after K's retirement)

Liabilities	₹	Assets	₹
Capital A/cs:		Sundry Fixed Assets	1,80,000
F	1,98,000	Inventories	60,000
G	1,32,000	Trade receivables	65,000
Trade payables	50,000	Bank	75,000
	3,80,000		3,80,000

Partners' Capital Accounts

	F	G	K		F	G	K
	₹	₹	₹		₹	₹	₹
To K's Capital A/c	10,000	–	–	By Balance b/d	1,20,000	80,000	60,000
To Balance c/d	1,28,000	98,000	79,000	By F's Capital A/c			10,000
				By P & L Adj. A/c	14,000	14,000	7,000
				By Reserve	4,000	4,000	2,000
	1,38,000	98,000	79,000		1,38,000	98,000	79,000
To Bank	–	–	79,000	By Balance b/d	1,28,000	98,000	79,000
To Balance c/d	1,98,000	1,32,000	–	By Bank	70,000	34,000	–
	1,98,000	1,32,000	79,000		1,98,000	1,32,000	79,000

Working Notes:

1.	**Total Capital**	₹
	Sundry Fixed Assets (₹ 1,50,000 + ₹ 30,000)	1,80,000
	Inventory (₹ 50,000 + ₹ 10,000)	60,000
	Trade receivables	65,000
	(Including Bill Receivable of ₹ 15,000)	
	Bank	75,000
		3,80,000
	Less: Sundry Creditors	(50,000)
		3,30,000
	F's share (3,30,000 × 3/5)	1,98,000
	G's share (3,30,000 × 2/5)	1,32,000

2. **Bank Account**

	₹		₹
To Balance b/d	50,000	By K's Capital A/c	79,000
To F's Capital A/c	70,000	By Balance c/d	75,000
To G's Capital A/c	34,000		
	1,54,000		1,54,000

ILLUSTRATION 3

A, B & C were in partnership sharing profits in the proportions of 5:4:3. The balance sheet of the firm as on 31st March, 2022 was as under:

Liabilities	₹	***Assets***	₹
Capital accounts:		*Fixtures*	*8,200*
A	*1,35,930*	*Inventories*	*1,57,300*
B	*95,120*	*Trade receivables*	*93,500*
C	*61,170*	*Cash*	*74,910*
Trade payables	*41,690*		
	3,33,910		*3,33,910*

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore, entered into as on 31st March, 2022, the terms of which were as follows:

(i) *The profit and loss account for the year ended 31st March, 2022 which showed a net profit of ₹ 48,000 was to be re-opened. B was to be credited with ₹ 4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing was to be revised from 1st April, 2021, as 3:4:4.*

(ii) *Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The fixtures were to be valued by an independent valuer. The valuations arising out of the above agreement were goodwill ₹ 56,800 and fixtures ₹ 10,980. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.*

B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to retain the fixtures on the books at the revised value, and to increase the provision for doubtful debts to 6%.

Required:

Submit the journal entries necessary to give effect to the above arrangements and to draw up the capital account of the partners after carrying out all adjusting entries as stated above.

SOLUTION

Journal Entries

Particulars		**Dr. (₹)**	**Cr. (₹)**
A's Capital Account	Dr.	20,000	
B's Capital Account	Dr.	16,000	
C's Capital Account	Dr.	12,000	
To Profit and Loss Adjustment Account			48,000
(Profit written back for making adjustments)			
Profit and Loss Adjustment Account	Dr.	4,000	
To B's Capital account			4,000
(Bonus Credited to B's Capital Account)			
Profit and Loss Adjustment Account	Dr.	44,000	
To A's Capital Account			12,000
To B's Capital Account			16,000
To C's Capital Account			16,000
(Distribution of profits in the new ratio)			
Fixtures Account	Dr.	2,780	
To Provision for Doubtful debts Account @ 2%			1,870

To A's Capital Account			248
To B's Capital Account			331
To C's Capital Account			331
(Revaluation of assets on A's retirement)			
A's Capital Account	Dr.	1,43,669	
To A's Loan Account			1,43,669
(Transfer of A's Capital Account to his Loan Account)			
B's Capital Account	Dr.	2,244	
C's Capital Account	Dr.	1,496	
To Provision for Doubtful Debts Account			3,740
(Raising provision for bad debts)			
B's Capital Account	Dr.	13,425	
C's Capital Account	Dr.	2,066	
To A's Capital Account			15,491
(Adjusting entry of goodwill passed through partners' capital accounts in gaining/sacrificing ratio)			

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To Profit and Loss Adjustment A/c	20,000	16,000	12,000	By Balance b/d	1,35,930	95,120	61,170
				By Profit and Loss Adjustment A/c	–	4,000	–
To A's Loan A/c	1,43,669	–	–				
To Provision for Doubtful Debts A/c	–	2,244	1,496	By Profit and loss Adjustment A/c	12,000	16,000	16,000
To A	–	13,425	2,066	By Fixtures Less provision for Doubtful Debts A/c	248	331	331
To Balance c/d	–	83,782	61,939	By B	13,425		
				By C	2,066		
	1,63,669	1,15,451	77,501		1,63,669	1,15,451	77,501

Note: The balance of A's Capital Account has been transferred to A's Loan Account.

Working Note:

Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
A	$\frac{3}{11}$	–	–	$\frac{3}{11}$
B	$\frac{4}{11}$	$\frac{3}{5}$	$\frac{13}{55}$	–
C	$\frac{4}{11}$	$\frac{2}{5}$	$\frac{2}{55}$	–

ILLUSTRATION 4

K, L & M are partners sharing profits and losses in the ratio 5:3:2. Due to illness, L wanted to retire from the firm on 31.3.2022 and admit his son N in his place.

Balance Sheet of K, L and M as on 31.3.2022

Liabilities	₹	₹	***Assets***	₹
Capital:			*Furniture*	*20,000*
K	*40,000*		*Trade receivables*	*50,000*
L	*60,000*		*Inventory in Trade*	*50,000*
M	*30,000*	*1,30,000*	*Cash and Bank balances*	*80,000*
Reserve		*50,000*		
Trade payables		*20,000*		
		2,00,000		*2,00,000*

On retirement of L assets were revalued: Furniture ₹ 10,000 and Inventory in trade ₹ 30,000. 50% of the amount due to L was paid off in cash and the balance was retained in the firm as capital of N. On admission of the new partner, goodwill was valued at ₹ 50,000. Partners are being paid off their extra balances to make capital proportionate by keeping N's capital as base.

You are required to give:

(i) Necessary journal entries; (ii) balance sheet of M/s K, M and N as on 1.4.2022; (iii) capital accounts of partners.

SOLUTION

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
31.3.2022	Profit and Loss Adjustment A/c	Dr.	30,000	
	To Furniture A/c			10,000
	To Inventory in Trade A/c			20,000
	(Being revaluation of Furniture and inventory in trade recorded)			
	K's Capital A/c	Dr.	15,000	
	L's Capital A/c	Dr.	9,000	
	M's Capital A/c	Dr.	6,000	
	To Profit and Loss Adjustment A/c			30,000
	(Being net revaluation loss debited to capital accounts of K, L and M in the ratio 5 : 3 : 2)			
	Reserve A/c	Dr.	50,000	
	To K's Capital A/c			25,000
	To L's Capital A/c			15,000
	To M's Capital A/c			10,000
	(Being reserve transferred to capital accounts, K, L and M)			
	N's Capital A/c	Dr.	15,000	
	To L's Capital A/c			15,000
	(Being adjusting entry for goodwill passed in gaining/ sacrificing ratio)			
	L's Capital A/c	Dr.	81,000	
	To Cash and Bank A/c			40,500
	To N's Capital A/c			40,500
	(Being 50% of the amount due to L was paid off in cash and balance was retained in the firm as capital of N)			

	K's Capital A/c	Dr.	7,500	
	M's Capital A/c	Dr.	17,000	
	To Cash and Bank A/c			24,500
	(Being amount paid to K and M to make their capital proportionate)			

Working Note:

1. Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
K	$\frac{5}{10}$	$\frac{5}{10}$	–	–
L	$\frac{3}{10}$	–	–	$\frac{3}{10}$
M	$\frac{2}{10}$	$\frac{2}{10}$	–	–
N	–	$\frac{3}{10}$	$\frac{3}{10}$	–

2. Calculation of excess capital paid off to M to make capital proportionate.

Partner	Capital Balance	P/L Ratio	Excess Capital Paid Off
K	50,000	5	7,500
N	25,500	3	–
M	34,000	2	17,000

Partners' Capital Accounts

	K ₹	L ₹	M ₹	N ₹		K ₹	L ₹	M ₹	N ₹
To Profit and Loss Adjustment A/c	15,000	9,000	6,000		By Balance b/d By Reserve	40,000 25,000	60,000 15,000	30,000 10,000	
To Cash & Bank A/c	-	40,500	-	-	By L's Capital A/c	-	-	-	40,500
To N's Capital A/c	-	40,500	-	-	By N's Capital A/c	-	15,000	-	-
To L's Capital A/c	-	-	-	15,000					
To Cash & Bank A/c									

(Balancing figure)	7,500	-	17,000	-					
To Balance c/d	42,500	-	17,000	25,500					
	65,000	90,000	40,000	40,500		65,000	90,000	40,000	40,500
					By Balance b/d	35,000	–	14,000	25,500

Balance Sheet of M/s K, M & N

as on 1st April, 2022

Liabilities	₹	₹	Assets	₹
Capital Accounts:			Furniture	10,000
K	42,500		Trade receivables	50,000
M	17,000		Inventory in Trade	30,000
N	25,500	85,000	Cash and Bank balance	15,000
Trade payables		20,000		
		1,05,000		1,05,000

ILLUSTRATION 5

Dowell llp. with partners Mr. A, Mr. B and Mr., C, are sharing profits and losses in the ratio of 10:6:4. The balance sheet of the firm as at 31st March, 2022 is as under:

Liabilities		₹	Assets	₹
Capitals :			*Land*	*10,000*
Mr. A	*80,000*		*Buildings*	*2,00,000*
Mr. B	*20,000*		*Plant and Machinery*	*1,30,000*
Mr. C	*30,000*	*1,30,000*	*Furniture*	*43,000*
Reserves			*Investments*	*12,000*
(un-appropriated profit)		*20,000*	*Inventories*	*1,30,000*
Long Term Debt		*3,00,000*	*Trade receivables*	*1,39,000*
Bank Overdraft		*44,000*		
Trade payables		*1,70,000*		
		6,64,000		*6,64,000*

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2022. For this purpose, the following adjustments are to be made:

(a) *Goodwill is to be valued at ₹ 1 lakh but the same will not appear as an asset in the books of the reconstituted firm.*

(b) *Buildings and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at ₹ 15,000. Provision of 20% is to be made on Trade receivables to cover doubtful debts.*

(c) *In the reconstituted firm, the total capital will be ₹ 2 lakhs which will be contributed by Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2:2:1.*

(i) *The surplus funds, if any, will be used for repaying bank overdraft.*

(ii) *The amount due to retiring partner shall be transferred to his loan account.*

Required:

Prepare

(a) *Revaluation account;*

(b) *Partners' capital accounts;*

(c) *Bank account; and*

(d) *Balance sheet of the reconstituted firm as on 1st April, 2022.*

SOLUTION

Revaluation Account

	₹				₹
To Buildings A/c	10,000	By Investments A/c			3,000
To Plant and Machinery A/c	26,000	By Loss to Partners:			
To Provision for Doubtful Debts A/c	27,800		A	30,400	
			B	18,240	
			C	12,160	60,800
	63,800				63,800

A's Capital Account

	₹		₹
To Revaluation A/c	30,400	By Balance b/d	80,000
To Balance c/d	80,000	By Reserves A/c	10,000
		By C and D's Capital A/c	10,000
		By Bank A/c (balancing figure)	10,400
	1,10,400		1,10,400

B's Capital Account

	₹		₹
To Revaluation A/c	18,240	By Balance b/d	20,000
To Investments A/c	15,000	By Reserves A/c	6,000
To B's Loan A/c	22,760	By C and D's Capital A/c	30,000
	56,000		56,000

C's Capital Account

	₹		₹
To Revaluation A/c	12,160	By Balance b/d	30,000
To A and B's Capital A/c	20,000	By Reserves A/c	4,000
To Balance c/d	80,000	By Bank A/c (balancing figure)	78,160
	1,12,160		1,12,160

D's Capital Account

	₹		₹
To A and B's Capital A/cs	20,000	By Bank A/c	60,000
To Balance c/d	40,000		
	60,000		60,000

Bank Account

	₹		₹
To A's Capital A/c	10,400	By Bank Overdraft A/c	44,000
To C's Capital A/c	78,160	By Balance c/d	1,04,560
To D's Capital A/c	60,000		
	1,48,560		1,48,560

Balance Sheet of Dowell llp.

as at 1st April, 2022

Liabilities		₹	**Assets**		₹
Capital Accounts:			Land		10,000
A	80,000		Buildings		1,90,000
C	80,000		Plant and Machinery		1,04,000
D	40,000	2,00,000	Furniture		43,000
Long Term Debts		3,00,000	Inventories		1,30,000
Trade payables		1,70,000	Trade receivables	1,39,000	

B's Loan Account		22,760	*Less*: Provision for Doubtful Debts)	(27,800)	1,11,200
			Balance at Bank		1,04,560
		6,92,760			6,92,760

Note: Even though the problem says goodwill ₹ 1,00,000 to appear in new Balance Sheet, it is written off so as to company with Accounting Standard. Net entry for goodwill is:

C's capital	Dr.	20,000	
D's capital	Dr.	20,000	
To A's capital			10,000
To B's capital			30,000

4.6 PAYING A PARTNER'S LOAN IN INSTALMENT

Strictly speaking, paying a partner's loan is only a matter of arranging finance. However, sometimes it is stated that the loan is to be paid off in so many equal instalments and that the balance is to carry interest. In such case, what should be done is that the loan should be divided into equal parts. The interest for the period should be calculated and the payment should consist of the instalment on account of the loan plus interest for the period. Suppose a partner's loan stands at ₹ 30,000 and that it has to be paid in four annual equal instalments and that the loan is to carry interest at 6% per annum. The annual instalment on account of loan comes to ₹ 7,500. For the first year the first interest is ₹ 1,800 i.e. 6% on ₹ 30,000. In the first year the amount to be paid will be ₹ 9,300. Balance of ₹ 22,500 will now be left. Next year the interest will be ₹ 1,350. The amount to be paid therefore will be ₹ 7,500 plust interest viz., ₹ 8,850. The loan account will appear in the books as under.

Retiring Partner's Loan Account

		₹			₹
I Year	To Cash (7,500 + 1,800)	9,300	I Year	By Capital A/c	30,000
	To Balance c/d	22,500		By Interest A/c	1,800
		31,800			31,800
II Year	To Cash (7,500 + 1,350)	8,850	II Year	By Balance b/d	22,500
	To Balance c/d	15,000		By Interest A/c	1,350

				(6% on ₹ 22,500)	
		23,850			23,850
III Year	To Cash	8,400	III Year	By Balance b/d	15,000
	To Balance c/d	7,500		By Interest Account	900
		15,900			15,900
IV Year	To Cash	7,950	IV Year	By Balance b/d	7,500
				By Interest A/c	450
		7,950			7,950

ILLUSTRATION 6

M/s X is a partnership firm with the partners A, B and C sharing profits and losses in the ratio of 3:2:5. The balance sheet of the firm as on 30th June 2022, was as under:

Balance Sheet of M/s. X as on 30.06.2022

Liabilities	₹	***Assets***	₹
A's Capital A/c	*1,04,000*	*Land*	*1,00,000*
B's Capital A/c	*76,000*	*Building*	*2,00,000*
C's Capital A/c	*1,40,000*	*Plant and Machinery*	*3,80,000*
Long Term Loan	*4,00,000*	*Investments*	*22,000*
Bank Overdraft	*44,000*	*Inventories*	*1,16,000*
Trade payables	*1,93,000*	*Trade receivables*	*1,39,000*
	9,57,000		*9,57,000*

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st July, 2022. For this purpose, the following adjustments are to be made:

(a) Goodwill of the firm is to be valued at ₹ 2 lakhs due to the firm's locational advantage but the same will not appear as an asset in the books of the reconstituted firm.

(b) Buildings and plant and machinery are to be valued at 90% and 85% of the respective balance sheet values. Investments are to be taken over by the retiring partner at ₹ 25,000. Trade receivables are considered good only upto 90% of balance sheet figure. Balance be considered bad.

(c) *In the reconstituted firm, the total capital will be ₹ 3 lakhs, which will be contributed by A, C and D in their new profit sharing ratio, which is 3:4:3.*

(d) *The amount due to retiring partner shall be transferred to his loan account.*

Required:

Prepare Revaluation Account and Partners' Capital Accounts.

SOLUTION

Revaluation Account

2022		₹	2022			₹
July 1	To Building	20,000	July 1	By Investments		3,000
	To Plant and Machinery	57,000		(25,000 - 22,000)		
	To Bad Debts	13,900		By Partners' Capital A/cs		
				(Loss on revaluation)		
				A (3/10)	26,370	
				B (2/10)	17,580	
				C (5/10)	43,950	87,900
		90,900				90,900

Partners' Capital Accounts

	A	B	C	D		A	B	C	D
	₹	₹	₹	₹		₹	₹	₹	₹
To Revaluation A/c	26,370	17,580	43,950	–	By Balance b/d	1,04,000	76,000	1,40,000	-
To B's and C's Capital A/cs	–	–	–	60,000	By D's Capital A/c (W.N.1)	–	40,000	20,000	–
To Investments A/c	–	25,000	–	–	By Bank A/c	12,370	–	3,950	1,50,000
To B's Loan A/c	–	73,420	–	–					
To Balance c/d (W.N. 2)	90,000	-	1,20,000	90,000					
	1,16,370	1,16,000	1,63,950	1,50,000		1,16,370	1,16,000	1,63,950	1,50,000

Working Notes:

1. Adjustment of goodwill

Goodwill of the firm is valued at ₹ 2 lakhs

Sacrificing ratio:

A	3/10-3/10	= 0
B	2/10-0	= 2/10
C	5/10-4/10	= 1/10

Hence, sacrificing ratio of B and C is 2:1. A has not sacrificed any share in profits after retirement of B and admission of D in his place.

Adjustment of D's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio:

					₹
B :	₹	60,000 x 2/3	=	40,000	
C :	₹	60,000 x 1/3	=	20,000	60,000

2. Capital of partners in the reconstituted firm :

	₹
Total capital of the reconstituted firm (given)	3,00,000
A (3/10)	90,000
B (4/10)	1,20,000
C (3/10)	90,000

4.7 JOINT LIFE POLICY

A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners. The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier. The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.

The accounting treatment for the premium paid and the Joint Life Policy may be on any of the following ways:

1. **When premium paid is treated as an expense:** When premium is treated as an expense then it is closed every year by transferring to profit and loss account. In this case complete amount received from the insurance company either on a surrender of policy or on the death of the partner becomes a gain.

   Accounting entries are:

   (a) On payment of premium

   Joint Life Policy Insurance Premium A/c Dr.

To Bank A/c

(b) On charging to Profit and Loss Account

Profit and Loss Account Dr.

To Joint Life Policy Insurance Premium A/c

(c) On maturity of the Policy

Insurance Company/ Bank Account Dr.

To Partners' Capital A/cs (individually)

(Including the account of the representative of a deceased partner)

2. **When premium paid is treated as an asset:** In this case insurance premium paid is first debited to life policy account and credited to bank account. At the end of the year the amount in excess of surrender value is treated as a loss and is transferred to Profit and Loss Account. In this case the amount received from the insurance company in excess of the surrender value results in a gain at the time of receipt of such amount which is transferred to Capital Accounts of the partners in the profit sharing ratio.

3. **Creation of Joint Policy Reserve Account:** Under this method, premium paid is debited to policy account and credited to bank account. At the end of the year, amount equal to premium is transferred from Profit and Loss Appropriation Account to Policy Reserve Account. After this, policy account is brought down to its surrender value by debiting the life policy reserve account with amount which exceeds the surrender value of the policy. Thus, in this method, policy account appears on the assets side and policy reserve account appears on the liabilities side of the Balance Sheet until it is realized. Both these accounts appear in the Balance Sheet at the surrender value of the policy. This method is different from the method discussed in (2) above only in respect of reserve account.

   On the death of a partner Joint Life Policy Reserve Account is transferred to Joint Life Policy Account and then the balance is transferred to Partners' Capital Accounts.

ILLUSTRATION 7

Red, White and Black shared profits and losses in the ratio of 5:3:2. They took out a joint life Policy in 2018 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil; 2019 ₹ 900; 2020 ₹ 2,000; 2021 ₹ 3,600. Black retires on 15th April, 2022.

Required

Prepare ledger accounts assuming no Joint Life Policy Account is maintained.

SOLUTION

Joint Life Policy Premium Account

		₹			₹
10th June, 2018	To Bank A/c	3,000	31st Dec., 2018	By Profit and Loss A/c	3,000
10th June, 2019	To Bank A/c	3,000	31st Dec., 2019	By Profit and Loss A/c	3,000
10th June, 2020	To Bank A/c	3,000	31st Dec., 2020	By Profit and Loss A/c	3,000
10th June, 2021	To Bank A/c	3,000	31st Dec., 2021	By Profit and Loss A/c	3,000

Profit and Loss Account

		₹		₹
31st Dec., 2018	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2019	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2020	To Joint Life Policy Premium A/c	3,000		
31st Dec., 2021	To Joint Life Policy Premium A/c	3,000		

Joint Life Policy Account

		₹			₹
15th April, 2022	To Capital A/cs:		15th April, 2022	By Bank A/c	3,600
	(Transfer)				
	Red 5/10	1,800			
	White 3/10	1,080			
	Black 2/10	720			
		3,600			3,600

ILLUSTRATION 8

Red, White and Black shared profits and losses in the ratio of 5: 3: 2. They took out a Joint Life Policy in 2018 for ₹ 50,000, a premium of ₹ 3,000 being paid annually on 10th June. The surrender value of the policy on 31st December of various years was as follows: 2018 nil; 2019 ₹ 900: 2020 ₹ 2,000; 2021 ₹ 3,600.

Black retires on 15th April, 2022.

Required:

Prepare ledger accounts assuming Joint Life Policy Account is maintained on surrender value basis.

SOLUTION

Joint Life Policy Account

		₹			₹
10th June, 2018	To Bank A/c	3,000	31st Dec., 2018	By Profit and Loss A/c	3,000
10th June, 2019	To Bank A/c	3,000	31st Dec., 2019	By Profit and Loss A/c	2,100
				By Balance c/d	900
		3,000			3,000
1st January, 2020	To Balance b/d	900	31st Dec., 2020	By Profit and Loss A/c	1,900
10th June, 2020	To Bank A/c	3,000		By Balance c/d	2,000
		3,900			3,900
1st January, 2021	To Balance b/d	2,000	31st Dec., 2021	By Profit and Loss A/c	1,400
10th June, 2021	To Bank A/c	3,000		By Balance c/d	3,600
		5,000			5,000
1st January, 2022	To Balance b/d	3,600	15th April, 2022	By Bank	3,600
		3,600			3,600

Profit and Loss Account

		₹			₹
31st Dec., 2018	To Joint Life Policy A/c	3,000			
31st Dec., 2019	To Joint Life Policy A/c	2,100			
31st Dec., 2020	To Joint Life Policy A/c	1,900			
31st Dec., 2021	To Joint Life Policy A/c	1,400			

ILLUSTRATION 9

A, B and C are in partnership sharing profits and losses at the ratio of 5:3: 2. The balance sheet of the firm on 31.12.2021 was as follows:

Balance Sheet

Liabilities	*₹*	***Assets***	*₹*
Capital A/cs:		*Sundry Fixed Assets*	*80,000*
A	*50,000*	*Inventories*	*50,000*
B	*40,000*	*Trade receivables*	*30,000*
C	*30,000*	*Joint Life Policy*	*20,000*
Bank Loan	*40,000*	*Bank*	*10,000*
Trade payables	*30,000*		
	1,90,000		*1,90,000*

On 1.1.2022, A wants to retire, B and C agreed to continue at 2:1. Joint Life Policy was taken on 1.1.2017 for ₹ 1,00,000 and its surrender value as on 31.12.2021 was ₹ 25,000. For the purpose of A's retirement goodwill was raised for ₹ 1,00,000. Sundry Fixed Assets was revalued for ₹ 1,10,000. But B and C did not prefer to show such an increase in assets in the balance sheet. Also they agreed to bring necessary cash to discharge 50% of the A's claim, to make the bank balance ₹ 25,000 and to make their capital proportionate.

Required:

Prepare necessary journal entries to give the effect in capital accounts of partners.

SOLUTION

Journal Entries

			₹	₹
1.	B's Capital A/c	Dr.	49,500	
	C's Capital A/c	Dr.	18,000	
	To A's Capital A/c			67,500
	(Share of memorandum revaluation profit ₹ 67,500 including good will due to A borne by B and C at the gaining ratio 11 : 4)			
2.	A's Capital A/c	Dr.	1,17,500	
	To A's Loan A/c			58,750
	To Bank A/c			58,750
	(Settlement of A's claim on his retirement by payment of 50% in case and transferring the balance to his Loan A/c).			

3.	Bank A/c	Dr.	73,750	
	To B's Capital A/c			60,333
	To C's Capital A/c			13,417
	(Cash brought in by the continuing partners).			

Working Notes:

1. Memorandum Revaluation Profit

	₹
Goodwill	1,00,000
Sundry Fixed Assets	30,000
Joint Life Policy	5,000
	1,35,000

A's Share ₹ 1,35,000 × 5/10 = ₹ 67,500.

2. Gaining Ratio

B : 2/3 – 3/10 = 11/30

C : 1/3 – 2/10 = 4/30

Gaining Ratio :	B	:	C
	11	:	4

3. Total Capital

		₹
Assets as per Balance Sheet		1,90,000
Additional Bank Balance		15,000
		2,05,000
Less : Bank Loan	40,000	
Sundry Creditors	30,000	
A's Loan	58,750	(1,28,750)
		76,250
B's Share		50,833
C's Share		25,417

4.8 SEPARATE LIFE POLICY

Instead of life policy taken jointly on the name of all the partners, all the partners may take individual life policies for each of them by paying the premium from the firm. In the event of retirement, the retired partner is entitled for the proportionate amount of the life policies of all the partners.

Example: Sona, Gabbu and Amit are partners Profit sharing ratio is 3:1:1

	SONA	GABBU	AMIT
Policy	1,00,000	2,00,000	3,00,000
Surrender Value	10,000	20,000	30,000

If Amit retires, then, Amit will get ₹ 60,000 × 1/5 = 12,000

ILLUSTRATION 10

Aarav, Nirav and Purav are partners in LLP sharing profits and losses in the ratio of 3:2:1. Their Balance Sheet as on 31st March, 2022 was as follows:

Balance Sheet as on 31st March, 2022

Liabilities	₹	*Assets*	₹
Capital : Aarav	*80,000*	*Building*	*50,000*
Nirav	*50,000*	*Machinery*	*67,500*
Purav	*35,000*	*Debtors*	*65,000*
General Reserve	*60,000*	*Stock*	*80,000*
Trade Creditors	*50,000*	*Bank*	*12,500*
	2,75,000		*2,75,000*

Purav retired from the business on 1st April 2022 on the following terms:

1. *Goodwill was to be valued at 2 years purchase of average profit of past 3 years.*

   31st March, 2020 ₹ 41,000

   31st March, 2021 ₹ 50,000

   31st March, 2022 ₹ 55,000

2. *Goodwill was not to be raised in the books of accounts.*
3. *Provision for Doubtful Debts was to be created on debtors at 5%. Machinery is to be depreciated by 10% and stock is revalued at ₹ 71,000.*

5. *Building to be appreciated by 20%.*
6. *Aarav and Nirav to bring in additional capital of ₹ 35,000 and ₹ 25,000 respectively.*
7. *Balance payable to Purav must be paid immediately.*

You are required to prepare:

1. *Revaluation account*
2. *Partners capital accounts.*
3. *Bank account.*
4. *Balance Sheet after retirement.*

SOLUTION

In The Books of Aarav Nirav and Purav
Revaluation A/c

Particulars	₹	Particulars		₹
To Provision for Doubtful Debts	3,250	By Building		10,000
To Machinery	6,750	By Loss on revaluation		
To Stock	9,000	Aarav	4,500	
		Nirav	3,000	
		Purav	1,500	9,000
	19,000			19,000

Partners Capital A/c

Particulars	Aarav	Nirav	Purav	Particulars	Aarav	Nirav	Purav
To Loss on Revaluation	4,500	3,000	1,500	By Balance b/d	80,000	50,000	35,000
To Bank			60,500	By General Reserve	30,000	20,000	10,000
To Purav capital	10,200	6,800		By Aarav, Nirav capital			17,000
To Balance c/d	1,30,300	85,200		By Bank	35,000	25,000	
	1,45,000	95,000	62,000		1,45,000	95,000	62,000

Bank A/c

Particulars	₹	Particulars	₹
To Balance b/d	12,500	By Purav's Capital	60,500
To Aarav's Capital	35,000	By Balance c/d	12,000

To Nirav's Capital	25,000		
	72,500		72,500

Balance Sheet as on April 1st, 2022

Liabilities			₹	Assets		₹
Capital :	Aarav	1,30,300		Building		60,000
	Nirav	85,200	2,15,500	Machinery		60,750
Trade Creditors			50,000	Debtors	65,000	
				Less: Provision for doubtful Debts	3,250	61,750
				Stock		71,000
				Bank		12,000
			2,65,500			2,65,500

Working note :

Valuation of Goodwill (as per weight average method)

31st March 2020	₹ 41,000 X 1 = 41,000
31st March 2021	₹ 50,000 X 2 = 1,00,000
31st March 2022	₹ 55,000 X 3 = 1,65,000
Total	₹ 3,06,000

Weighted average profit (3,06,000/6) = 51,000

Goodwill (2 years purchase) = 2 x 51,000 = ₹ 1,02,000

Purav's share = 1/6th = 1,02,000/6 = 17,000

Journal entry for adjustment of goodwill

Aarav capital A/c	Dr.	10,200	
Nirav capital	Dr.	6,800	
To Purav capital			17,000

ILLUSTRATION 11

Satyam, Shivam & Sundaram are partners of M/s. Great Stationers sharing profits and losses in the ratio of 1:1:2.

On 31st March, 2022 their Balance Sheet was as under :

Liabilities		₹	***Assets***	₹
Capitals :			*Building*	*2,50,000*
Satyam	*1,95,000*		*Plant*	*1,60,000*
Shivam	*1,48,000*		*Investments*	*85,000*
Sunderam	*1,12,000*	*4,55,000*	*Stock*	*45,280*
General Reserve		*80,000*	*Trade Receivable*	*68,000*
Loan from Satyam		*94,000*	*Bank*	*95,720*
Sundry Creditors		*75,000*		
		7,04,000		*7,04,000*

On 1st April 2022 Shivam retired on the following terms:

1. *Goodwill is to be valued at ₹ 1,20,000 but the same will not appear as an asset in the books of the reconstituted firm.*
2. *Buildings is to be appreciated by 20% and Plant is to be depreciated by 10 %.*
3. *Investments are to be taken over by the Satyam in full settlement of his loan.*
4. *Provision of 5% is to be made on trade receivables to cover doubtful debts.*
5. *In the reconstituted firm, the total capital will be ₹ 3,00,000/- which will be contributed by Satyam and Sunderam in their new profit sharing ratio, which is 2:3.*
6. *The amount due to retiring partner shall be transferred to his loan account.*

You are required to give journal entries to record above adjustments and also prepare Balance Sheet thereafter.

SOLUTION

In the books of Satyam Shivam & Sundaram

Journal entries

Sr No	Particulars		Dr. ₹	Cr. ₹
1	General Reserve A/c	Dr.	80,000	
	To Satyam Capital A/c			20,000
	To Shivam Capital A/c			20,000
	To Sunderam Capital A/c			40,000
	(Being General reserve distributed among old partners)			
2.	Satyam Capital A/c	Dr.	18,000	

	Sunderam Capital A/c Dr. To Shivam Capital A/c (Being adjustment entry for goodwill passed)	12,000	 30,000
3.	Building A/c Dr. To Revaluation A/c (Being Building appreciated)	50,000	 50,000
4.	Satyam loan A/c Dr. To Revaluation A/c To Investments A/c (Being investments taken over by Satyam)	94,000	 9,000 85,000
5.	Revaluation A/c Dr. To Plant To Provision for Doubtful Debts (Being Assets revalued)	19,400	 16,000 3,400
6.	Revaluation A/c Dr. To Satyam Capital A/c To Shivam capital A/c To Sundaram Capital A/c (Being profit on Revaluation distributed)	39,600	 9,900 9,900 19,800
7	Shivam Capital A/c Dr. To Shivam loan a/c (Being amount payable to Shivam transferred to his Loan A/c)	2,07,900	 2,07,900
8.	Satyam Capital A/c Dr. To Bank A/c (Being Capital accounts adjusted in Profit sharing ratio)	86,900	 86,900
9.	Bank A/c To Sunderam Capital A/c (Being Capital accounts adjusted in Profit sharing ratio)	20,200	 20,200

Balance Sheet as on April 1st, 2022

Liabilities		₹	Assets		₹
Capitals :			Building		3,00,000
Satyam	1,20,000		Plant		1,44,000
Sunderam	1,80,000	3,00,000	Stock		45,280
Shivam loan A/c		2,07,900	Trade Receivable	68,000	
Sundry Creditors		75,000	*Less*: Provision for Doubtful Debts	3,400	64,600
			Bank		29,020
		5,82,900			5,82,900

Working Note:

Revaluation A/c

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts		3,400	By building	50,000
To Plant		16,000	By Investments	9,000
To Revaluation profit				
Satyam	9,900			
Shivam	9,900			
Sunderam	19,800	39,600		
		59,000		59,000

Bank A/c

Particulars	₹	Particulars	₹
To Balance b/d	95,720	By Satyam Capital	86,900
To Sundaram Capital	20,200	By Balance c/d	29,020
	1,15,920		1,15,920

Partners Capital A/c

Particulars	Satyam	Shivam	Sundaram	Particulars	Satyam	Shivam	Sundaram
				By Balance b/d	1,95,000	1,48,000	1,12,000
To Shivam	18,000		12,000	By Satyam and Sunderam		30,000	
To Shivam loan A/c		2,07,900		By General Reserve	20,000	20,000	40,000

				By Revaluation	9,900	9,900	19,800
To bank	86,900			By bank			20,200
To balance c/d	1,20,000		1,80,000				
	2,24,900	2,07,900	1,92,000		2,24,900	2,07,900	1,92,000

Partner	Old Share		New share		Gain Share
Satyam	1/4	-	2/5	=	3/20
Shivam	1/4	-	-	=	(5/20)
Sunderam	2/4	-	3/5	=	2/20

SUMMARY

- Re-adjustment takes place in case of retirement of a partner likewise the case of admission of a partner. Whenever a partner retires, the continuing partners make gain in terms of profit sharing ratio. So they arrange for the amount to be paid to discharge the claims of the retiring partners.
- On retirement of a partner, it is required to revalue assets and liabilities just as in the case of admission of a partner. If there is revaluation profit/loss, then such profit/loss should be distributed amongst the existing partners including the retiring partner at the existing profit sharing ratio.
- On the retirement of a partner any undistributed profit or reserve standing at the Balance Sheet is to be credited to the Partners' Capital Accounts in the old profit sharing ratio.
- Following adjustments are necessary in the Capital A/c of a retiring partner at the time of final payment:

  (i) Transfer of reserve,

  (ii) Transfer of goodwill,

  (iii) Transfer of profit/loss on revaluation.
- There are three methods for treating premium paid on Joint Life Policy: firstly, it can be shown as an expense; alternatively it can be shown as an asset to the extent of surrender value and the balance as an expense; Thirdly, a joint Life Policy reserve can be created; On retirement of a partner, the surrender value of the Joint Life Policy is to be raised in the books of accounts if it is not shown already as an asset. If the surrender value is more than the value of joint Life Policy shown in the Balance Sheet, only the excess amount should be transferred to revaluation account.

TEST YOUR KNOWLEDGE

True and False

1. *Business of a partnership has to be closed if any one of the partners retires.*
2. *At the time of retirement of a partner no special treatment is required for any reserves appearing in the Balance Sheet.*
3. *After retirement of a partner, profit sharing ratio of continuing partners remains the same.*
4. *If any partner wants to retire from the business, he must retire on 1st day of the accounting year.*
5. *Retiring partner has to forego his share of goodwill in the firm.*
6. *If a partner retires in between the accounting year then he is not entitled to any profit from the date of beginning of the year till his date of retirement.*
7. *If the firm has taken any joint life policy then it is to be surrendered at the time of retirement of a partner.*
8. *Any joint life policy reserve appearing in the Balance Sheet is credited to all the partners in their old profit sharing ratio.*
9. *No revaluation account is necessary on retirement of a partner.*
10. *Profit on revaluation is credited to continuing partners, retiring partner is not entitled to any profit on revaluation.*

Multiple Choice Questions

1. *C, D and E are partners sharing profits and losses in the proportion of 1/2, 1/3 and 1/6. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of ₹ 12,000 is divided among the partners in the ratio:*

   (a) ₹ 2,000: ₹ 4,000: ₹ 6,000.

   (b) ₹ 5,000: ₹ 5,000: ₹ 2,000.

   (c) ₹ 6,000: ₹ 4,000: ₹ 2,000.

2. *A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement, A and C decides to share profits equally. They had taken a Joint Life Policy of ₹ 2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?*

(a) ₹ 50,000 credited to all the partners in old ratio.

(b) ₹ 2,50,000 credited to all the partners in old ratio.

(c) ₹ 2,00,000 credited to all the partners in old ratio.

3. *A, B and C take a Joint Life Policy, after five years, B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of ₹ 2,50,000 with the surrender value ₹ 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at the surrender value?*

   (a) ₹ 50,000 credited to all the partners in old ratio.

   (b) ₹ 2,50,000 credited to all the partners in old ratio.

   (c) No treatment is required.

4. *A, B and C are partners sharing profits in the ratio 2:2:1. On retirement of B, goodwill was valued as ₹ 30,000. Find the contribution of A and C to compensate B.*

   (a) ₹ 20,000 and ₹ 10,000.

   (b) ₹ 8,000 and ₹ 4,000.

   (c) They will not contribute anything.

5. *A, B and C were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of ₹ 50,000 for A and B, for C ₹ 25,000. B declared to retire from the firm and balance in reserve on the date was ₹ 15,000. If goodwill of the firm was valued as ₹ 30,000 and profit on revaluation was ₹ 7,050 then what amount will be transferred to the loan account of B.*

   (a) ₹ 70,820.

   (b) ₹ 50,820.

   (c) ₹ 25,820.

6. *A, B and C are partners sharing profits and losses in the ratio of 3:2:1. C retires on a decided date and Goodwill of the firm is to be valued at ₹ 60,000. Find the amount payable to retiring partner on account of goodwill.*

   (a) ₹ 30,000.

   (b) ₹ 20,000.

   (c) ₹ 10,000.

7. *A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at ₹ 24,000. What will be the treatment for goodwill?*

   (a) *Credited to Revaluation Account at ₹ 24,000.*

   (b) *Adjusted through partners' capital accounts in gaining/sacrificing ratio.*

   (c) *Only A's capital account credited with ₹ 12,000.*

8. *Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A - ₹ 2,00,000; B - ₹ 3,00,000 and C - ₹ 2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at ₹ 1,40,000 and no Goodwill account being raised.*

   (a) *Credit Partner's Capital Account with old profit sharing ratio for ₹ 1,40,000.*

   (b) *Credit Partner's Capital Account with new profit sharing ratio for ₹ 1,40,000.*

   (c) *Credit A's Account with ₹ 40,000 and debit B's Capital Account with ₹ 10,000 and C's Capital Account with ₹ 30,000.*

Theoretical questions

1. *Write short notes on:*

   (i) *Calculation of gaining ratio.*

   (ii) *Final payment of a retiring partner.*

2. *What is joint life policy? What is the objective of taking such a policy?*

Practical questions

1. *On 31st March, 2022, the balance sheet of M/s Ram, Rahul and Rohit sharing profits and losses in proportion to their capital, stood as follows:*

Liabilities	₹	₹	***Asset***	₹
Capital accounts:			*Land & building*	*2,00,000*
Ram	*3,00,000*		*Machinery*	*2,00,000*
Rahul	*2,00,000*		*Closing stock*	*1,00,000*
Rohit	*1,00,000*	*6,00,000*	*Sundry debtors*	*2,00,000*
Sundry creditors		*2,00,000*	*Cash and bank balances*	*1,00,000*
		8,00,000		*8,00,000*

On 31st March, 2022, Ram desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis:-

1. *Land and buildings be appreciated by 30%.*
2. *Machinery be depreciated by 20%.*
3. *Closing stock to be valued at ₹ 80,000.*
4. *Provision for bad debts be made at 5%.*
5. *Old credit balances of sundry creditors ₹ 10,000 be written off.*
6. *Joint life policy of the partners surrendered and cash obtained ₹ 60,000.*
7. *Goodwill of the entire firm be valued at ₹ 1,80,000 and Ram's share of the goodwill be adjusted in the accounts of Rahul and Rohit who share the future profits equally. No goodwill account being raised.*
8. *The total capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.*
9. *Amount due to Ram is to be settled as 50% on retirement and the balance 50% within one year.*

Prepare revaluation account, capital account of partners: Rahul & Rohit, loan account of Ram, cash account and balance sheet as on 1.4.2022 of M/s Rahul and Rohit.

2. *A, B, C were in partnership sharing profits and losses in the ratio of 3:2:1. The balance sheet of the firm as on 31.2.2022 was as under:*

Liabilities		₹	**Assets**	₹
Capital accounts:				
A	1,50,000		Fixtures	30,000
B	1,00,000		Stock	1,70,000
C	50,000	3,00,000	Sundry debtors	90,000
Sundry creditors		40,000	Cash	50,000
		3,40,000		3,40,000

A, on account of ill-health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered as on 31.3.2022, the terms of which were as follows:

(a) *The profit and loss account for the year ended 31.3.2022, which showed a net profit of ₹ 42,000 was to be re-opened. B was to be credited with ₹ 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio is to be 2:3:1 as and from 1st April 2021.*

(b) *Goodwill was to be valued at two years' purchase of the simple average profits of five years. Profits for these five years ending on 31st March were as under:*

	₹
31.3.2018	*15,000*
31.3.2019	*23,000*
31.3.2020	*25,000*
31.3.2021	*35,000*
31.3.2022	*42,000*

(c) *Fixtures are to be valued at ₹ 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.*

(d) *That the amount payable to A shall be paid by B.*

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3:1 and decided to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6 %. Total capital of the firm will be ₹ 3 lakhs as before to be maintained in the new ratio as between B and C.

You are required to give the necessary entries to give effect to the above arrangements. Prepare capital accounts of partners, cash account and balance sheet of B and C after giving effect to the above arrangements on the retirement of A.

ANSWERS/HINTS

True and False

1. False: Business of a partnership is not closed if any one of the partners retires, remaining partners continue to carry on the business.

2. False: At the time of retirement of a partner all the reserves appearing in the balance sheet are transferred to all the partners in their old profit sharing ratio.

3. False: After retirement of a partner, profit sharing ratio of continuing partners does not remain the same.

4. False: A partner can retire on any day as per his own wish.

5. False: Retiring partner is entitled to his share of goodwill in the firm.

6. False: If a partner retires in between the accounting year then he is certainly entitled to the profit from the date of beginning of the year till his date of retirement.

7. True: The firm is eligible for the surrender value on the Joint Life Policy taken on the partners at the time of their retirement.

8. True: As per the surrender policy method, the JLP reserve is distributed to the partners in their profit sharing ratio through capital account.

9. False: Revaluation account is necessary on retirement of a partner.

10. False: Profit on revaluation is credited to all the partners in their profit sharing ratio.

Multiple Choice Questions

1.	(c)	**2.**	(a)	**3.**	(c)	**4.**	(b)	**5.**	(a)	**6.**	(c)
7.	(b)	**8.**	(c)								

Theoretical Questions

1. **(a)** On retirement of a partner, the continuing partners will gain in terms of profit sharing ratio. For example, if A, B and C were sharing profits and losses in the ratio of 5:3: 2 and B retires, then A and C have to decide at which ratio they will share profits and losses in future. If it is decided that the continuing partners will share profits and losses in future at the ratio of 3:2, then A gains 1/10th [(3/5)-(5/10)] and C gains 2/10 [(2/5)-(2/10)]. So the gaining ratio between A and C is 1:2. If A and C decide to continue at the ratio 5:2, this indicates that they are dividing the gained share in the previous profit sharing ratio.

   (b) The following adjustments are necessary in the Capital A/c: (i) Transfer of reserve, (ii) Transfer of goodwill, (iii)Transfer of profit/loss on revaluation. After adjustment of these items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him. The continuing partners may discharge the whole claim at the time of retirement.

2. A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners. The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier. The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.

Practical Questions

1. **Revaluation Account**

		₹		₹
To Machinery A/c		40,000	By Land and Buildings A/c	60,000
To Closing Stock A/c		20,000	By Sundry Creditors A/c	10,000
To Provision for Bad Debts A/c		10,000	By Cash and Bank A/c– Joint Life policy surrendered	60,000
To Partners' Capital A/cs:				
Ram	30,000			
Rahul	20,000			
Rohit	10,000	60,000		
		1,30,000		1,30,000

Partners' Capital Accounts

			Rahul	Rohit				Rahul	Rohit
			₹	₹				₹	₹
31.3.2022	To	Ram's Capital A/c	30,000	60,000	31-3-2022	By	Balance b/d	2,00,000	1,00,000
	To	Balance c/d	3,00,000	3,00,000		By	Revaluation A/c	20,000	10,000
						By	Cash & bank A/c – cash brought in by Rahul and Rohit	1,10,000	2,50,000
			3,30,000	3,60,000				3,30,000	3,60,000
					1-4-2022	By	Balance b/d	3,00,000	3,00,000

Ram's Loan Account

		₹			₹
31-3-2022	To Balance c/d	2,10,000	31-3-2022	By Ram's Capital A/c	2,10,000
		2,10,000			2,10,000
			1-4-2022	By Balance b/d	2,10,000

Cash and Bank Account

		₹			₹
31-3 2022	To Balance b/d	1,00,000	31-3-2022	By Ram's capital A/c	2,10,000
	To Revaluation A/c- joint life policy surrendered	60,000		By Balance c/d	3,10,000
	To Rahul's Capital A/c	1,10,000			
	To Rohit's Capital A/c	2,50,000			
		5,20,000			5,20,000
1-4-2022	To Balance b/d	3,10,000			

M/s Rahul & Rohit
Balance Sheet as on 1st April, 2022

Liabilities	₹	₹	**Assets**	₹	₹
Capital accounts:			Land and buildings		2,60,000
Rahul	3,00,000		Machinery		1,60,000
Rohit	3,00,000	6,00,000	Closing stock		80,000
Ram's loan account		2,10,000	Sundry debtors	2,00,000	
Sundry creditors		1,90,000	*Less:* Provision for bad debts	(10,000)	1,90,000
			Cash and bank balances		3,10,000
		10,00,000			10,00,000

Working Notes:

1. **Gaining ratio of existing partners:**

   Rahul 1/2-1/3=1/6

   Rohit 1/2-1/6=2/6

2. **Total goodwill of firm is ₹ 1,80,000**

   Ram's share (1/2 x ₹ 1,80,000)=₹ 90,000

   Ram's share of goodwill is to be borne by Rahul and Rohit in their gaining ratios i.e.

   Rahul=1/3 x ₹ 90,000= ₹ 30,000

   Rohit = 2/3 x ₹ 90,000=₹ 60,000

3. Ram's Capital Account

		₹			₹
31-3-2022	To Cash and Bank A/c	2,10,000	31-3-2022	By Balance b/d	3,00,000
	To Ram's Loan A/c -Transfer	2,10,000		By Revaluation A/c	30,000
				By Rahul's Capital A/c - Goodwill	30,000
				By Rohit's Capital A/c-Goodwill	60,000
		4,20,000			4,20,000

2. Journal Entries

		₹	₹
1.	A's Capital account Dr.	21,000	
	B's Capital account Dr.	14,000	
	C's Capital account Dr.	7,000	
	To Profit and loss adjustment account		42,000
	(Profit written back for making adjustments)		
2.	Profit and loss adjustment account Dr.	6,000	
	To B's Capital account		6,000
	(Bonus credited to B's capital account)		
3.	Profit and loss adjustment account Dr.	36,000	
	To A's Capital account		12,000
	To B's Capital account		18,000
	To C's Capital account		6,000
	(Distribution of profits in the new ratio)		
4.	Fixtures account Dr.	9,800	
	To Provision for bad debts account		1,800
	To A's Capital account		2,667
	To B's Capital account		4,000
	To C's Capital account		1,333
	(Revaluation of assets on A's retirement)		
5.	B's capital account Dr.	2,700	
	C's capital account Dr.	900	
	To Provision for bad debts account		3,600
	(Raising provision for bad debts)		

6.	A's capital account Dr.		1,62,334	
	To B's Capital account			1,62,334
	(Amount payable to A paid by B)			
7.	B's Capital account	Dr.	14,000	
	C's Capital account	Dr.	4,667	
	To A's Capital account			18,667
	(Adjusting entry of goodwill passed through partners' capital accounts in gaining/sacrificing ratio)			

Partners' Capital Accounts

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
To P & L adjustment A/c	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
To Provision for bad debts A/c	-	2,700	900	By P & L adjustment account	-	6,000	-
To B's Capital A/c	1,62,334	-	-	By P & L adjustment account	12,000	18,000	6,000
To Cash A/c	-	34,634	-	By Fixtures A/c	2,667	4,000	1,333
To A's Capital A/c		14,000	4,667	By A's capital A/c	-	1,62,334	-
				By B and C's capital A/c	18,667		
To Balance c/d	-	2,25,000	75,000	By Cash A/c			30,234
	1,83,334	2,90,334	87,567		1,83,334	2,90,334	87,567

Cash Account

	₹		₹
To Balance b/d	50,000	By B's capital A/c	34,634
To C's capital A/c	30,234	By Balance b/d	45,600
	80,234		80,234

Balance Sheet of B and C

as on 31st March, 2022 (after retirement of A)

Liabilities		₹	Assets	₹	₹
Capital accounts:			Fixtures		39,800
B	2,25,000		Stock		1,70,000

C	75,000	3,00,000	Sundry debtors	90,000	
Sundry creditors		40,000	*Less*: Provision for bad debts	(5,400)	84,600
			Cash		45,600
		3,40,000			3,40,000

Working Notes:

Calculation of goodwill:

1. Average of last five year's profit

Year ended on	**Profit** ₹
31.3.2018	15,000
31.3.2019	23,000
31.3.2020	25,000
31.3.2021	35,000
31.3.2022	42,000
	1,40,000

2. Goodwill at two years' purchase

₹ 28,000 x 2=₹ 56,000

3. Calculation for adjustment of Amount of Goodwill

Partner	Old Share	New Share	Gain	Sacrifice
A	$\frac{2}{6}$	–	–	$\frac{2}{6}$
B	$\frac{3}{6}$	$\frac{3}{4}$	$\frac{3}{12}$	–
C	$\frac{1}{6}$	$\frac{1}{4}$	$\frac{1}{12}$	–