மனோன்மணியம் சுந்தரனார் பல்கலைக்கழகம்

Manonmaniam Sundaranar University

Reaccredited with 'A' Grade (CGPA 3.13 Out of 4.0) by NAAC (3rd Cycle)

Tirunelveli - 627 012, Tamilnadu, India.

DIRECTORATE OF DISTANCE

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CONTINUING EDUCATION

ADVANCED FINANCIAL ACCOUNTING

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TIRUNELVELI

II B. COM (III SEMESTER) UNDER CBCS

PART III-MAJOR CORE-5

ADVANCED FINANCIAL ACCOUNTING

Unit 1 :

Branch Accounting – Debtor's system -Invoice Price Method (excluding stock and Debtor's system) – Departmental accounts -Department trading, profit and loss accounts – Departmental transfers.

Unit 2 :

Partnership – Past adjustment and guarantee – admission of a partner – Revaluation account – adjustment regarding goodwill -Adjustment regarding capital.

Unit 3

Retirement -Death of a Partner – Retirement and admission -Death of Partner – Retiring Partner's loan – joint life policy.

Unit 4

Dissolution of partnership – Accounting Procedure – Insolvency of a partner, two partners and all partners – Garner Vs Murray rule

Unit 5

Amalgamation of firms – sale to a company – Gradual realisation of assets and piecemeal Distribution – Maximum loss method -amalgamation of firms

Text &Reference Books

1. S.P Jain & K.L Narang ,Advance Accountancy ,Kalyani Publishers,New Delhi.
2. R.L Gupta and M.Radhaswamy ,Advanced Accountancy ,Sultan Chand & Sons,New Delhi
3. M.C.Shukal and T.S.Grewal ,Advanced accountancy ,Himalaya Publishing House ,Mumbai
4. T .S Reddy & A.Murthy,Advance Accountancy ,Margham ,Publications,Chennai.

ACCOUNTING FOR BRANCHES

INTRODUCTION

A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office;for there can be no branch without a head office - the principal place of business. From the accounting point of view, branches may be classified as follows:

Inland Branches which can be further classified as:

Independent Branches which maintain independent accounting records

Dependent Branches for which whole accounting records are kept at Head Office

Foreign Branches

DISTINCTION BETWEEN BRANCH ACCOUNTS AND DEPARTMENTALACCOUNTS

Basis of difference	Branch	Departmental
1. place	Branch are established by separating them from the head office	Departments are run by attaching them with the main organization under a single roof.
2. Geography	Branches are geographically separated.	Departments are not separated rather existed under a same roof.
3. objective	Branches are the outcome of touch competition and expansion of business	Department are the result of fast human life.
4. Types	Branches are different types like dependent, independent and foreign.	There is no such classification in department because all are common under the same roof.
5. Common cost	Allocation of branch common expenses does not arise.	Allocation of departmental common expenses is a touch job.
6. reconciliation	Reconciliation is necessary for final result of departments.	No reconciliation is necessary because there is a central account division.

DEPENDENT BRANCHES

When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it the branch is described as Dependent branch. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch. Some of the significant types of branches that are operated in this manner are described below:

A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;

A branch established at a commercial center for the sale of goods supplied by the head office, and under its direction all collections are made by the H.O.; and

A branch for the retail sale of goods, supplied by the head office.

Accounting in the case of first two types is simple. Only a record of expenses incurred at the branch has to be maintained.

But however, a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorized, also on credit to approved customers. Generally, cash collected is deposited into a local bank tothe credit of the head office and the head office issues cheques thereon for meeting the expenses of the branch. In addition, the Branch Manager is provided with a ‘float’ for petty expenses which is replenished from time to time on animprest basis. If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

METHODS OF CHARGING GOODS TO BRANCHES

Goods may be invoiced to branches (1) at cost; or (2) at selling price; or (3) in caseof retail branches, at wholesale price; or (4) arbitrage price.

Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit. The arbitrary price method is usually adopted if the selling price is not known or when it is not considered desirable to disclose to the branch manager the profit made by the branch.

ACCOUNTING FOR DEPENDENT BRANCHES

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches in any of the following methods:

Methods of maintaining accounts of Dependent Branches

- *If Goods are invoiced at cost or selling price*: Debtors Method; Stock and Debtors Method; Trading and profit and loss account method (Final Accounts method)
- *If Goods are invoiced at wholesale price*: Whole Sale branch method

When goods are invoiced at cost

If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods: **(i) Debtors Method,** (ii)**Stock and Debtors method, (iii) Trading and Profit and Loss Account (Final Accounts) Method**.

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office. On the basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

Debtors method

This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch. The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office,*e.g.,* salaries, rent, insurance, etc., are also debited to it. Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited. At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch accounton the credit side and then the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and *vice versa*. If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply tothe head office a copy of the Cash Account, showing details of cash collections and disbursements. To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

Proforma Branch Account

Particulars	Amount	Particular	Amount
To Balance b/d		By Bank A/c (Cash remitted)	
Cash		By Return to H.O.	
Stock			
Debtors		By Balance c/d	
Petty Cash		Cash	
Fixed Assets		Stock	
Prepaid Expenses		Debtors	
To Goods sent to Branch		Petty Cash	
To Bank A/c		Fixed Assets	
Salaries		Prepaid Expenses	
Rent			
Sundry Expenses		By Profit and Loss A/c—Loss	
To Profit & Loss A/c—Profit		(if debit side is larger)	
(if credit side is larger)			

Note:

1.Having credited the Branch Account by the actual cash received from debtors, it would be wrong to debit the Branch Account, in respect of discount or allowances to debtors.

2.The accuracy of the trading results as disclosed by the Branch Account, so maintained, if considered necessary, can be proved by preparing a Memorandum Branch Trading and Profit & Loss Account, in the usual way, from the balances of various items of income and expenses contained in the Branch Account.

Illustration 1

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost totheir branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

	`		`
Opening balance (1-1-20X1) Imprest Cash	*2,000*	*Bad Debts*	*1,000*
Sundry Debtors	*25,000*	*Discount to Customers*	*2,000*
Stock: Transferred from H.O.	*24,000*	*Remittances to H.O.*	
Direct Purchases	*16,000*	*(recd. by H.O.)*	*1,65,000*
Cash Sales	*45,000*	*remittances to H.O.*	
Credit Sales	*1,30,000*	*(not recd. by H.O. so far)*	*5,000*

Direct Purchases	*45,000*	*Branch Exp. directly paid by H.O.*	*30,000*
Returns from Customers	*3,000*	*Closing Balance (31-12-20X1)*	
Goods sent to branch from H.O.	*60,000*	*Stock: Direct Purchase*	*10,000*
Transfer from H.O. for Petty cash expeses	*4,000*	*Transfer from H.O.*	*15,000*
		Debtor	*?*
		Imprest cash	*?*
		Petty cash expensed	*4000*

Solution

In the Books of Buckingham Bros, Bombay Nagpur Branch Account

		`				`
To	Opening Branch Assets		By	Bank – Remittances received from branch		
	Stock (24,000+16,000)	40,000		Cash Sales	45,000	
	Debtors	25,000		Cash from Debtors	1,20,000	
	Imprest Cash	2,000		Cash from Debtors in transit	5,000	1,70,000
To	Goods sent to Branch A/c	60,000	By	Stock:		15,000
				Transfer from H.O.		
To	Creditors (Direct Purchases)	45,000				
To	Bank (Sundry exp.)	30,000		Direct Purchase		10,000
To	Bank (Petty cash exp.)	4,000	By	Sundry Debtors (W.N. 2)		24,000
To	Net Profit transferred to General Profit & Loss A/c	15,000	By	Imprest Cash (W.N. 3)		2,000
		2,21,000				2,21,000

Working Notes:

Collections from debtors:

	`
Total remittances (` 1,65,000 + ` 5,000)	1,70,000
Less: Cash sales	(45,000)
	1,25,000

Calculation of Sundry Debtors closing Balance:

	`
Opening Balance	25,000
Add: Credit Sales	1,30,000
	1,55,000
Less: Returns, Discount, Bad debts & collections (3,000 + 2,000 + 1,000 + 1,25,000)	(1,31,000)
Closing balance	24,000

Calculation of closing balance of Imprest Cash

	`
Opening Balance	2,000
Add: Transfer from H.O.	4,000
	6,000
Less: Expenses	(4,000)
Closing balance	2,000

When goods are invoiced at selling price

It would be obvious that if Branch Account is debited with the sales price of goods and subsequent to the debit being raised there is a change in the sale price, the amount of debit either has to be increased or reduced on aconsideration of the quantity of unsold stock that was there at the branch at the time the change took place. Such an adjustment will be necessary as often as the change in sale price occurs.

Moreover the amount of anticipatory profit, included in the value of unsold stockwith the branch at the close of the year will have to be **eliminated** before the accounts of the branch are incorporated with that of the head office. This will be done by creating a reserve.

It may also be necessary to adjust the value of closing stock on account of the physical losses of stock due to either pilferage or wastages which may have occurred during the year. The last mentioned adjustments are made by debitingthe cost of the goods to Goods Lost Account and the amount of loading (included in the lost goods), to the Branch Adjustment Account.

Illustration 2

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 20X1:

		`
Cost of goods sent to Branch at cost		*2,00,000*
Goods received by Branch till 31-12-20X1 at invoice price		*2,20,000*
Credit Sales for the year @ invoice price		*1,65,000*
Cash Sales for the year @ invoice price		*59,000*
Cash Remitted to head office		*2,22,500*
Expenses paid by H.O.		*12,000*
Bad Debts written off		*750*
Balances as on	*1-1-20X1*	*31-12-20X1*
	`	`
Stock	*25,000 (Cost)*	*28,000 (invoice price)*
Debtors	*32,750*	*26,000*
Cash in Hand	*5,000*	*2,500*

Show necessary ledger accounts in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December, 20X1.

Solution

Books of Harrison Branch Stock Account

	`		`
To Balance b/d	30,000	By Branch Debtors	1,65,000
To Goods Sent to Branch A/c	2,40,000	By Branch Bank	59,000
To Branch Adjustment A/c	2,000	By Balance c/d	
(Excess of sale		Goods in Transit	
over invoice price)		(` 2,40,000 – ` 2,20,000)	20,000
		Stock at Branch	28,000
	2,72,000		2,72,000

Branch Debtors Account

	`		`
To Balance b/d	32,750	By Bad debts written off	750
To Branch Stock	1,65,000	By Branch Cash-collection (bal. fig.)	1,71,000
		By Balance c/d	26,000

	1,97,750		1,97,750

Branch Cash Account

	`		`
To Balance b/d To Branch Stock To Bank (as per contra) To Branch Debtors	5,000 59,000 12,000 1,71,000	By Bank Remit to H.O. By Branch profit & loss A/c (exp. paid by H.O.) By Branch profit & loss A/c [Bal. fig. (exp. paid by Branch)] By Balance c/d	2,22,500 12,000 10,000 2,500
	2,47,000		2,47,000

Branch Adjustment Account

	`		`
To Stock Reserve (on closing stock (48,000 × 1/6) To Gross Profit c/d	8,000 39,000	By Stock Reserve opening (25000 × 20%) By Goods sent to Branch A/c By Branch Stock A/c	5,000 40,000 2,000
	47,000		47,000

Branch Profit and Loss Account

	`		`
To Branch Expenses (paid by HO: ` 12,000 and paid by Branch ` 10,000) To Branch Debtors-Bad debts To Net Profit	22,000 750 16,250	By Gross Profit b/d	39,000
	39,000		39,000

Goods Sent to Branch Account

	`		`
To Branch Adjustment A/c To Purchase A/c - Transfer	40,000 2,00,000	By Branch to Stock A/c	2,40,000
	2,40,000		2,40,000

Debtors Method

Under this method, the principal accounts that will be maintained are:

The Branch Account;

The Goods Sent to Branch Account; and

The Stock Reserve Account.

Entries in these accounts will be made in the following manner:

	Transaction	Account debited	Account credited
(*a*)	Goods sent to Branch at selling price	Branch A/c	Goods Sent to Branch A/c
(*b*)	'Loading being the difference between selling price and cost of goods	Goods Sent to Branch A/c	Branch A/c
(*c*)	Returns to H.O. at selling price	Goods Sent to Branch A/c	Branch A/c
(*d*)	'Loading' in respect of goods returned to H.O.	Branch A/c	Goods Sent to Branch A/c
(*e*)	'Loading' included in the opening stock to reduce it	Stock Reserve A/c	Branch A/c
(*f*)	Closing stock at selling price	Branch Stock A/c	Branch A/c
(*g*)	'Loading' included in closing stock to reduce it to cost	Branch A/c	Stock Reserve A/c

It will be observed that entries in the Branch Account in respect of goods sent to a branch or returned by it, as well as those for the opening and closing stock, will be at selling price. In consequence, the Branch Account is maintained at selling price.

Hence the Branch Account will not correctly show the trading profit of the Branch unless these amounts are adjusted to cost. Such an adjustment is effected by making contra entries in 'Goods Sent to Branch A/c' and 'Stock Reserve Account'. In respect of closing stock at branch for the purpose of disclosure in the Balance Sheet, the credit balance in the 'Stock Reserve Account' at the end of the year will be deducted from the value of the closing stock, so as to reduce it to close; it will be carried forward as a separate balance to the following year, for being transferred to the credit of the Branch Account.

Illustration 3

Harrison of Chennai has a branch at New Delhi to which goods are sent @ 20% above cost. The branch makes both cash and credit sales. Branch expenses are met partly from H.O. and partly by the branch. The statement of expenses incurred by the branch every month is sent to head office for recording.

Following further details are given for the year ended 31st December, 20X1:

	`
Cost of goods sent to Branch at cost	2,00,000
Goods received by Branch till 31-12-20X1 at invoice price	2,20,000
Credit Sales for the year @ invoice price	1,65,000

Cash Sales for the year @ invoice price		59,000
Cash Remitted to head office		2,22,500
Expenses paid by H.O.		12,000
Bad Debts written off		750
Balances as on	1-1-20X1 `	31-12-20X1 `
Stock	25,000 (Cost)	28,000 (invoice price)
Debtors	32,750	26,000
Cash in Hand	5,000	2,500

Show necessary ledger accounts in the books of the head office and determine the Profit and Loss of the Branch for the year ended 31st December, 20X1.

Solution

Books of Harrison New Delhi Branch Account

	`		`
To Balance b/d		By Balance b/d	
Stock	30,000	Stock Reserve	5,000
Debtors	32,750	By Goods Sent to Branch A/c	40,000
Cash	5,000	By Bank-Remittance	
To Goods Sent to Branch A/c (2,00,000 + 20% of 2,00,000)	2,40,000	received from the Branch:	
To Bank (Exp. paid by H.O.)	12,000	Cash sales 59,000	
To Net Profit Transferred to H.O. Profit and Loss A/c	16,250	Debtors Collection 1,63,500 (W.N.1) (Net of expense)	2,22,500
To Balance c/d (Stock reserve on closing stock)	8,000	By Balance c/d	
		Stock (including Transit) (W.N.2)	48,000
		Debtors	26,000
		Cash	2,500
	3,44,000		3,44,000

Working Note:

Collection from debtors = Total collection – Cash sales

= 2,22,500 – 59,000 = 1,63,500

Closing stock = Stock at branch + Goods sent by H.O. – Goods received by Branch

= 28,000 +2,40,000 – 2,20,000 = 48,000

DEPARTMENTAL ACCOUNTING

Department:

Department refers to activity center (profit or cost center) usually located in the same roof but carrying distinct type of activities.

Departmental Accounting:

Department accounting or departmental accounting is a system of financial accounting which is used in the organizations whose all works are done through their different departments or departmental stores. Departmental accounts are prepared separately for each department and trial balance will also be prepared. Departmental P&L Account is prepared to ascertain the profit or loss of each department separately and at the end of the year it is transferred to General profit and loss account of the whole organisation.

Objectives of departmental accounting

The main objectives of departmental accounting are:

a)To have comparison of the results of a particular department with previous year and also with the other departments of

the same concern;

b)To help the proprietor in formulating policy to expand the business on proper lines so as to optimize the profits of the

concern;

c)To allow departmental managers' commission on the basis of the profits of their departments; and

d)To generate information, which may be helpful for planning, control, and evolution of performance of each department and for taking various managerial decisions.

Advantages of Department Accounts:

The main advantages of Departmental accounting are as follows:

a)It provides an idea about the affairs of each department.

b)It helps to evaluate the performance of each department.

c) It helps to reward the Departmental mangers and staff on the basis of performance.

d)It facilitates control over the working of each department.

e)It helps to compare the result of one department with those of other departments.

f) It helps the management to formulate the right business policies for the various departments.

g) It will help in the preparation of departmental budgets.

h) It helps to calculate stock turnover ratio of each department.

There are two methods that are used in departmental accounting: –

1. Where a separate set of books is maintained for every department.
2. Where all departmental accounts maintain columnar-wise collectively.

E. Methods of Departmental Accounting:

Where individual set of books is maintained

It is method under which every branch of an organization is regarded as separate unit and therefore individual book of accounts are prepared and maintained for every unit. At the end, financial result of every department is calculated and consolidated to find the overall performance and net result of whole organization.

This method of departmental accounting involves huge costs and is preferred only by large scale organizations or where is required by the law. Companies involved in insurance business are the one which are compulsorily required to implement this system of accounting.

Where all departmental accounts are maintained columnar-wise collectively

Under this technique of departmental accounting, accounts of all branches are maintained collectively in columnar form by central accounts department. In this method for every department a departmental trading and profit and loss account is opened in columnar way altogether. There is a separate column for "Total" for finding out the results of different departments both on individual and collective basis. Balance sheet is however prepared in a combining form.

For incorporation of purchase and sale of goods, a subsidiary book of accounts is prepared with different columns for different departments. Various subsidiary books prepared are Purchase book, Sales book, Purchase return and Sales return book. Cash book with separate columns of cash purchase and cash sale is also maintained in case of large volumes of purchase and sales done on cash basis.

INTER-DEPARTMENTAL TRANSFERS:

Inter-departmental transfers are made on the following basis:

INTER-DEPARTMENTAL TRANSFER AT COST PRICE

The price at which one department supplies goods to another department or when some services are rendered by department to the another department is known as Transfer Price. It refers to the charge made for goods and services sold internally. It may be market price if one is available. The transfer price is adjusted with the following amounts:

- Cash discount
- Selling costs (not in internal transfers)
- Margin of profit
- Standard costs.

Recording inter-departmental transfers helps the management in setting up profit centres, fixing responsibility on departmental managers and eventually, evaluates the performance and efficiency of the concerned departments.

STANDARD COST BASED TRANSFER PRICE

Under this method of pricing the prices may be based on the actual cost or total cost or standard cost or marginal cost. Standard cost is preferred to actual cost as the efficiency of one department is not allowed to pass to another department. When goods are transferred at cost, the fixed cost of supplying department becomes the variable cost of the receiving department.

INTER-DEPARTMENTAL TRANSFER AT SALE OR INVOICE PRICE

The goods may also be transferred from one department to another at sale or invoice price. The department which transfers the goods is known as Transferor department and the department to which goods are transferred is known as Transferee department. In this case, the transferor department retains the normal profit and does not allow the transferee department to increase its profit at the cost of the transferor.

When the goods received are sold out, the load or profit retained by the transferor department becomes the actual profit realized.

But if the goods remain unsold, then there will be unrealized profit in the closing stock. Unrealized profit is the difference between transfer price and the cost price of unsold stock. These reserves are created as follows:

FOR CLOSING STOCK

General Profit and Loss A/c Dr.

To stock reserve A/c

AT THE BEGINNING OF THE YEAR

Stock reserve A/c Dr.

To General profit and loss A/c

Illustration No 1

Z & Co. has two departments. They maintain separate records for each department. You are requested to prepare the Trading A/c and Profit & Loss A/c of each department and a Balance Sheet for the year ended on 31st March, 1989 on the basis of the following information

	Dept.I	Dept. II	Other Balances
Opening Stock (1.4.88) ,	25,000	20,000	
Purchases	2,30,000	1,90,000	
Purchase Returns	2,000	1,000	
Sales	6,33,000	4,92,000	
Sales Returns	3,000	2,000	
Wages & Salaries	1,80,000	1,60.000	
Miscellaneous Charges	35,000	32,000	
Closing Stock on 31.3.89	26,000	24,000	
Sundry Debtors			1,90,000
Sundry Creditors			1.73,000
Plant & Machinery			2.40.000
Leasehold Land			80,000

Buildings			1,20,000
Furniture & Fittings			48,000
Selling Expenses and other overheadexpenses			1,28,000
Cash in hand on 31.3.89			8,000
Cash at Bank on 31.3.89			1,10,000
Proprietors Capital A/c			5,00,000

Depreciate Plant & Machinery by 33— 3 %, Building by 5% and Furniture & Fittings by 10%. All unallocated expenses are to be allocated on the basis of net sales of each department.

Solution 1

In the books of Z & Co					
Departmental Trading and P&L Account for the year ended 31-03-1989					
Dr			**Cr**		
Particulars	**Dept 1**	**Dept 2**	**Particulars**	**Dept 1**	**Dept 2**
To Opening Stock	25000	20000	By sales	630000	490000
To Purchases	228000	189000			
To wages and Salries	180000	160000			
To Gross Profit	223000	145000	By Closing Stock	26000	24000
Total	**656000**	**514000**	**Total**	**656000**	**514000**
			By Gross Profit	223000	145000
To S&D Expense	72000	56000			
To Misc. Expenses	35000	32000			
To Depn on Building	3375	2625			
To Depn on P&M	45000	35000			
To Depn on Furniture	2700	2100			
To General P&L	64925	17275			
Total	**223000**	**145000**		**223000**	**145000**

In the books of Z & Co					
Balance Sheet as on 31st March 1989					
Liabilities	**Amount(₹)**	**Amount (₹)**	**Assets**	**Amount(₹)**	**Amount(₹)**
Capital	500000		Leasehold Land		80000
Add: Net Profit			Building	120000	
Dept-1	64925		Less: Depriciation	6000	114000
Dept-2	17275	582200			
			Plant & Macinery	240000	
			Less: Depriciation	80000	160000
Sundry Creditors		173000			
			Furniture & Fittings	48000	
			Less: Depriciation	4800	43200

			Stock		50000
			Sundry Debtors		190000
			Cash-at-Bank		110000
			Cash-in-Hand		8000
Total		**755200**	**Total**		**755200**

Question 2. S Brothers are leading paper merchants and book sellers. Their wholesale business isin- paper and their retail show room -conducts business in stationery, books and magazines. The following balances are abstracted from their books at the end of their financial year, 3Ist March, 1997.

	₹		₹
Capital	300000	Rent	60000
Stock (1-4-1996)		Lighting	24000
Paper	200000	Showroom Maintenance	18000
Stationary	50000	Showroom Fittings	180000
Books	100000	Sundry Debtors (for Paper)	100000
Magazines	25000	Sundry Creditors	150000
Purchases:		Salaries:	
Paper	800000	showroom staff	36000
Stationary	300000	Wholesale Business Staff	12000
Books	350000	Showroom Cashier	12000
Magazines	300000	General Office Expenses	44000
Sales:		General Office Salaries	11000
Paper	1000000	Cash and Bank Balances	8000
Stationary	360000		
Books	420000		
Magazines	420000		

You arc requested by the firm to prepare their Departmental Trading and Profit & Loss Account for the financial year under reference with help of the following additional information:

Closing balance at the end of the year in the various departments were: Paper Z 1, 80,000; Stationery Z 40,000; Books Z 1, 20,000 and Magazines T 30,000.

Rent and Lighting are for premises taken on lease, General Office accommodation is negligible.Wholesale department uses 1,500 sq. ft. The balance of 1,500 sq., feet is occupied by the showroomwith equal division among stationery, books and magazines.

Showroom fittings are to be depreciated by 10% p.a.

In the Books of S. Brothers									
Departmental Trading and Profit & Loss									
Particulars	**Paper**	**Stationary**	**Books**	**Magazine**	**Particulars**	**Paper**	**Stationary**	**Books**	**Magazine**
To op Stock	200000	50000	100000	25000	By Sales	1000000	360000	420000	420000
To purchases	800000	300000	350000	300000	By cl. Stock	180000	40000	120000	30000

To Gross Profit	180000	50000	90000	125000					
Total	**1180000**	**400000**	**540000**	**450000**	**Total**	**1180000**	**400000**	**540000**	**450000**
					By Gross Profit	180000	50000	90000	125000
To Rent (3:1:1:1)	30000	10000	10000	10000					
To lighting (floor area)	12000	4000	4000	4000					
To showroomMaintenance		6000	6000	6000					
To depreciation		6000	6000	6000					
To salaries showroom		10800	12600	12600					
To Salaries Wholesale	12000								
To salaries Cashier		3600	4200	4200					
To General Office	5000	1800	2100	2100					
To General officeExpenses	20000	7200	8400	8400					
To Net Profit	101000	600	36700	71700					
Total	**180000**	**50000**	**90000**	**125000**	**Total**	**180000**	**50000**	**90000**	**125000**

Question 3. M/s ABC carried on business as Departmental Stores in Calcutta. The partners A, B, C were in charge of Departments X, Y and Z respectively. The partners are entitled to aremuneration equal to 50 % of the profits (without taking the partners remuneration into consideration) of the respective departments of which they are in-charge and the balance of the profits are to be distributed among A, B and C in the ratio of 5:3:2. The following are balance of the revenue items in the books for the year 31.3.1994:

	Departments		
Particulars	**X (₹)**	**Y (₹)**	**Z (₹)**
Opening Stock	151560	96000	80000
Purchases	562800	332400	177600
Sales	720000	540000	360000
Closing Stock	180320	69920	96360
Other Revenue Items:			
Salaries and Wages	192000		
Discount Allowed	5400		
Advertising	9000		
Discount Received	3200		
Rent	43200		
Sundry Expenses	48600		
Depreciation on Furniture & Fittings	3000		

Prepare the Departmental Trading and Profit & Loss Account for the year ended 31.3.94.

Show the distribution of profits amongst the partners after taking into account the following:

Goods having a transfer price of ₹42800 and ₹2400 were transferred from Department X and Y respectively to department Z. The inter-departmental transfers are made at 125%of the cost.

The various items shall be apportioned amongst the three Departments in the followingproportions:

	Departments		
Particulars	**X**	**Y**	**Z**
Rent	2	2	5
Salaries	1	1	1
Depreciation	1	1	1
Discount Received	8	5	3

All other expenses: on the basis of sales (excluding inter-departmental transfers) of each department. The opening stock of Department Z does not include goods transferred from other Department but the Closing Stock include ₹34200 valued at the inter-departmental transfer prices.

Solution 4

In the books of M/S ABC							
Departmental trading and Profit& Loss Account for the year 31-03-1994							
Dr							**Cr**
Particulars	**Dept. X (₹)**	**Dept. Y (₹)**	**Dept. Z(₹)**	**Particulars**	**Dept. X (₹)**	**Dept. Y (₹)**	**Dept. Z(₹)**
To opening Stock	151560	96000	80000	By Sales	720000	540000	360000
To Purchases	562800	332400	177600	By Dept Z	42800		
To Dept Z			42800	By Dept Z		2400	
Dept X			2400				
DeptY				By Closing Stock	180320	69920	86360
To Gross Profit c/d	228760	183920	143560				
Total	**943120**	**612320**	**446360**	**Total**	**943120**	**612320**	**446360**
				By Gross Profit b/d	228760	183920	143560
To Salaries & Wages	64000	64000	64000	By Discount Received	1600	1000	600
To Rent	9600	9600	24000				
To Depreciation	1000	1000	1000				
To Discount Allowed	2400	1800	1200				
To Advertising	4000	3000	2000				
To sundry Expenses	21600	16200	10800				
To General P&L	127760	89320	41160				
Total	**230360**	**184920**	**144160**	**Total**	**230360**	**184920**	**144160**

PARTNERSHIP FIRMS

According to Section -4 of the Indian Partnership Act, 1932:"Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all"

Kinds of Partners

***Active Partners*:** These are the persons who actively take part in the business,i.e., they are involved in day-to-day affairs of business. They take all the decisions.

Sleeping Partners: Sleeping partners are those partners who are not actively involved in the business, i.e., they do not take part in the day-to-day affairs of the business. But they do contribute capital and share profits and losses of the business-like other partners.

***Nominal Partner**:* He neither contributes capital nor takes part in the conduct of the business. He is a person with good reputation in the market and lends his name to the firm and makes outsiders believe that he is a partner of the firm.

Partner in Profits Only: He only shares profit but not the losses. The objective of having such partner is to make use of his capital and goodwill.

Partner by Estoppel: He is not a partner of a firm in actual. He neither contributesany capital nor share profits or losses of the business. He also does not take partin the conduct of the business. His role is to make the outsiders believe that he is a partner of the firm.

Secret Partner: As the name suggests, his name is not disclosed to the outsiders as a partner.

Minor Partners: According to Indian Partnership Act 1932, a minor, i.e., person below the age of 18 years cannot be a partner of the firm. However, with the mutual consent of all the partners, he can be admitted into the partnership for the benefits of the firm.

Rights and Obligations of Partners

All the rights and duties should be clearly defined in the Partnership Deed. If in anycase, Partnership Deed is silent on some points, then in that case rights and obligationsof the partners are governed by Partnership Act's provisions.

Rights of the Partners

1. Right to take part in the day-to-day affairs or management of the partnership.2. If Partnership Deed is silent on the rate of interest on partner's loan, then the

partner is entitled to the interest @ 6%.

Every partner of the firm has the right to check the books of accounts andrecords of business.

A partner has the right to be indemnified for the expenditure incurred by himto protect the firm from the loss.

A partner can use the property of the firm for the purpose of firm's business. 6. Right to retire from the firm in accordance with the terms and conditions of the Partnership Deed.

Every partner has the right to continue in the firm unless expelled according tothe provisions of the deed.

On retirement, right to share profits in the firm earned with the help of partner’sshare in the firm or interest @ 6% p.a. until the amount due to retired partner is paid off.

Right to be consulted before taking important decisions.

Right to share the profits equally, in the absence of any agreement. 11. Right to receive interest on capital, if there are sufficient profits.

Every partner is co-owner of the firm.

Right to act independently in emergency situation to protect the firm from loss.

Right to inspect the entry of new partner.

Right to dissolve the firm with the consensus, i.e., mutual consent of all the partners. But in case, if partnership is at will, any partner can dissolve the firm by giving notice to other partners.

Duties and Obligations of Partners

Every partner of the partnership firm must act in the maximum interest of thefirm.

Every partner must have mutual trust and confidence in other partners andthey should act in faithful manner to each other and the firm.

Duty to render true accounts to fellow partners.

Duty to compensate the firm for the loss arising out of breach of trust andwillful negligence.

A partner should not compete with the firm’s business by starting his ownbusiness.

Obligation to share the loss equally in the absence of any agreement betweenthe partners.

A partner must not apply firm’s property for the accomplishment of his personaltasks.

Every partner must act within the scope of their authority.

A partner must not transfer his share without the mutual consent of his fellowpartners.

Every partner must disclose any secret profit made by them.

A partner must not make secret profits by using firm’s property, if he does so,he must surrender it to the firm.

In the absence of any previous contract between the partners, no partner isentitled to the salary.

Features of Partnership

1. Two or more persons: There must be at least two persons to form a valid partnership. The maximum number of partners cannot exceed the number of partners prescribed by Companies Act, 2013 which is 50 in any business whether banking or non- banking.

2. Agreement: Partnership comes into existence by an agreement (either written or oral among the partners. The written agreement among the partners is called Partnership Deed.

3. Existence of business and profit motive: A partnership can be formed for the purpose of carrying on legal business with the intention of earning profits. A joint ownership of some property by itself cannot be called a partnership.

4. Sharing of Profits: An agreement between the partners must be aimed at sharing the profits. If some persons join hands to run some charitable activity, it will not be called partnership. Further, if a partner is deprived of his right to share the profits of the business, he cannot be called as partner.

5. Business carried on by all or any of them acting for all: It means that each partner can participate in the conduct of business and each partner is bound by the acts of other partners in respect to the business of the firm.

6. **Relationship of Principal and Agent:** Each partner is an agent ad well as a partner of the firm. An agent, because he can bind the other partners by his acts and principal, because he himself can be bound by the acts of the other partners.

Partnership Deed

Since partnership is the outcome of an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions may be either written or oral. The law does not make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

The partnership deed is a written agreement among the partners which contains the terms of agreement. It is also called ‘ Articles of Partnership’. A partnership deed should contain the following points:

Name and address of the firm as well as partners.

Name and addresses of the partners.

Nature and place of the business.

Duration, if any of partnership.

Capital contribution by each partner.

Interest on capital.

Drawings and interest on drawings.

Profit sharing ratio.

Interest on loan.

Partner’s Salary/commission etc.

Method for valuation of goodwill and assets.

Accounting period of the firm and duration of partnership

Rights and duties of partners how disputes will be settled.

Decisions taken if some partner becomes insolvent.

Opening of Bank Account – whereas it will be in the name of firm or partners.

Rules to be followed in case of admission & Settlement of accounts or retirement or death of partner.

Revaluation of assets & liabilities, if any to be done.

Method of recording of firm’s accounts

Auditing

Date of commencement of partnership

Benefits of Partnership Deed

(1) It regulates the rights, duties and liabilities of each partner.

(2) It helps to avoid any misunderstanding amongst the partners because all the terms and conditions of partnership have been laid down beforehand in the deed.

(3) Any dispute amongst the partners may be settled easily as the partnership deed may be readily referred to.

Hence, it is always best course to have a written partnership deed duly signed by all the partners and registered under the Act.

Rules applicable in the absence of partnership deed

Profit sharing Ratio	Equal, irrespective of capital contribution.
Interest on Capital	No Interest on Capital is to be allowed to any Partner
Interest on Drawings	No interest on Drawings is to be charged to any partner
Salary or Commission to a Partner	Not allowed to any partner
Interest on loan by a Partner	Interest is allowed @ 6% per annum.

Distribution of Profits among Partners

Transactions of the partnership firm are recorded according to the principles of Double-entry book keeping system, and as in the case of a sole proprietorship concern a partnership firm will also prepare Trading account, Profit & Loss account and Balance Sheet at the end of every year. The only difference between accounting of a sole trader and partnership firm is that the profits of the partnership firm are divided amongst the partners.

A Profit and Loss Appropriation Account is prepared to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of profit and Loss Account. It is nominal account. It records entries for interest on capital, Interest on Drawings, Salary to the partner, and division of profits among the partners.

The Journal Entries regarding Profit and Loss Appropriation Account are as follows:

1.For transfer of balance of Profit and Loss Account

Profit and Loss A/cDr.

To Profit and Loss Appropriation A/c

2.For Interest on Capital

For allowing Interest on capital

1. Interest on Capital A/c

To Partner's Capital/Current A/cs

(Being interest on capital allowed @ % p.a.)

2. For transferring Interest on Capital to p&L appropriation A/c.

Profit and Loss Appropriation A/cDr.

To Interest on Capital A/c.

(Being interest on capital transferred to p&L Appropriation A/c)

3. For Salary or Commission payable to a partner

i. For allowing Salary or Commission to a partner:

Partners Salary/Commission A/cDr.

To Partner's Capital/Current A/cs

(Being salary/commission payable to a partner)

ii. For transferring Partner's Salary/Commission A/c to Profit and Loss Appropriation A/s:

Profit and Loss Appropriation A/cDr.

To Partner's Salary/Commission A/c

4. For transfer of Reserves:

Profit and Loss Appropriation A/cDr.

To Reserve A/c

(Being reserve created)

5. For Interest on Drawings:

1.For charging interest on a partner's drawings:

Partner's Capital/Current A/c.Dr.

To Interest on Drawings A/c

(Being interest on drawings charged @ % p.a.)

2. For transferring interest on drawings to Profit and Loss Appropriation A/c

Interest on Drawings A/cDr.

To Profit and Loss Appropriation A/c

(Being interest on drawings transferred to P&L appropriation A/c)

6. For transfer to Profit (i.e. Credit Balance of Profit and Loss Appropriation Account

Profit and Loss Appropriation A/cDr.

To Partners Capital/Current A/cs

(Being profits distributed among partners)

SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Profit and Loss Appropriation Account

For the year ending on ___________________

Particulars	Rs.	Particulars	Rs.
To Interest on Capital: A B To Partner's Salary/Commission To Reserves To Profits transferred to capital A/cs of: A B		By Profit and Loss A/c (Net Profits transferred from P & L A/c) By Interest on drawings: A B	

Partner's Capital Accounts

Partner's Capital Accounts: It is an account which represents the partners interest in the business. In case of partnership business, a separate capital account is mainted for each partner. The capital accounts of partners may be maintained by any of the following two methods.

1. Fixed Capital Accounts
2. Fluctuating Capital Accounts

1. Fixed Capital Accounts

Under this method the original capitals invested by the partners remain constant, unless additional capital is introduced by an agreement. All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account whihc is called as Current Account. Thus the following two accounts are maintained when capitals are fixed.

(i) Capital Account

This account will always show a credit balance: Balance of Capital account remains fixed, it does not change every year that is why it is called fixed capital method and only the following two transactions are recorded in the Fixed Capital Accounts:
Permanent·Additional Capital Introduced

·Permanent Capital Withdrawn or Drawings out of Capital only

Partner's Capital A/Cs

Particulars	X(Rs.)	Y(Rs.)	Particulars	X(Rs.)	Y(Rs.)
To Cash/Bank A/c (Capital Withdrawn)			By Balance b/d (Opening Cr. Balance)		
To Balance c/d (Closing balance)			By Cash/Bank A/c (Additional Capital Introduced)		

(ii) Current Account

The Current account may show a debit or credit balance. All the usual adjustments such as interest on Capital, partner's salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account.All the Current Year's adjustments are recorded in this account, that is why it is called Current account.

Partner's Current A/Cs

Particulars	X(Rs.)	Y(Rs.)	Particulars	X(Rs.)	Y(Rs.)
To Balance b/d (Opening Dr. Balance)			By Balance b/d (Opening Cr. Balance)		
To Drawings (out of Profits)			By Interest on Capital		
To Interest on Drawings			By Partner's Salary or Commission		
To Profit and Loss A/c (Share in losses)			By Profit and Loss Appropriation A/c (Share in Profits)		
To Balance c/d (Closing credit Balance)			By Balance c/d (Closing Dr. Balance)		

Note :

1. Debit balance of Current Account is shown in Assets side of Balance Sheet.

2. Credits balance of Current Account A/c is shown in Liabilities side of balance Sheet.

3.Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet as it will be always be credit balance.

Fluctuating Capital Accounts
In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustment such as interest on capital interest on drawings etc, are recorded in this account under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account.In this method the capitals are not fixed.

In the absence of information, the Capital Accounts should be prepared by this method.

Partner's Capital

Particulars	X(Rs.)	Y(Rs.)	Particulars	X(Rs.)	Y(Rs.)
To Balance b/d (Opening Dr. Balance) To Cash/Bank A/c (Capital Withdrawn) To Drawings (out of profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d (Closing credit Balance)			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c (Additional Capital Introduced) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c (Share in Profits) By Balance c/d (Closing Dr. Balance)		

INTEREST ON CAPITAL

Interest on partners capital will be allowed only when it has been specifically mentioned in the partnership deed. If interest on capital is to be allowed as per the agreement, it should be calculated with respect to the time, rate of interest and the amount of capital. Interest on Capital can be treated as either:

a. An Appropriation of profit; or

b. A charge against profit.

A. Interest on Capital: An Appropriation of Profits:

In case of Losses	Interest on Capital is NOT ALLOWED
In cases of Sufficient Profits	Interest on Capital is ALLOWED IN FULL

In case of Insufficient Profits	Interest will be restricted to the amount of profit. Hence, profit will be distributed in the ratio of interest on capital of each partner.

B. Interest on Capital: As a Charge against Profits:
Interest on Capital is always allowed in full irrespective of amount of profits of losses.

Note:
Interest on Capital is always calculated on the OPENING CAPITAL.
Il' Opening Capital is not given in the question, it should be ascertained as follows:

Particulars	(Rs.)
Capital at the End	____________
Add: **1.** Drawingxxxxxx **2.** Interest on Drawingsxxxxxx **3.** Losses during the year xxxxxx Less: **1.** Additional Capital Introduced (xxxxxx) **2.** Profits during the year (xxxxxx) 3. Any salary/commission received Opening Capital ……………	……………

INTEREST ON DRAWINGS

Interest on drawing is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn. There are two cases in which calculation of interest on drawings may arise:

Case 1: When Rate of Interest on Drawings is given in %

Interest on Drawings is calculated on flat rate irrespective of period.

Case 2: When Rate of Interest on Drawings is given in % p.a.

1. When date of Drawing is not given

Interest on Drawing = $Total\ Drawings \times \frac{Rate}{100} \times \frac{6}{12}$

Note: Interest is calculated for a period of 6 months, we assume drawings have been done evenly during the year, that is why we take average six months tenure.

2. When date of Drawings is given

Interest on Drawing = $Total\ Drawings \times \frac{Rate}{100} \times \frac{Time\ left\ after\ drawings\ (in\ months)}{12}$

Case 3: When different amount are withdrawn on different dates:

We have the following two methods to calculate the amount of interest on Drawing:

1. Simple Interest Method
In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn till the close of accounting period.

2. Product Method

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period;Thereafter the products are added and interest is calculated on the total of products so arrived at for one month. The advantage of this system is that separate calculations are not required each time.

We can explain the above mentioned two methods with the help of an example.

Month	**Date**	**Drawings Amount**
May	1	12000
July	31	6000
September	30	9000
November	30	12000
Janurary	1	8000
March	31	7000

Interest on drawings is to be charged @ 9% p.a

SIMPLE METHOD

DATE	**AMOUNT**	**PERIOD**	**INTEREST @9%**
1 MAY	12000	11	990
31 JULY	6000	8	360
30 SEP	9000	6	405
30 NOV	12000	4	360
1 JAN	8000	3	180
31 MAR	7000	0	00
TOTAL	**54000**		**2295**

PRODUCT METHOD

DATE	AMOUNT	PERIOD	PRODUCTS
1 MAY	12000	11	132000
31 JULY	6000	8	48000
30 SEP	9000	6	54000
30 NOV	12000	4	48000
1 JAN	8000	3	24000
31 MAR	7000	0	00
TOTAL	**54000**		**306000**

Interest = Total of products * 9/100* 1/12= 306000*9/100*1/12 = Rs 2295/-.

Case 4: When an equal amount is withdrawn regularly
Interest on Drawing can be calculated using either Product Method or Direct Method (i.e. Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:

1. Amount should be same throughout the period
2. Date of Drawings should be same throughout the period
3. Drawings should be made regularly without any gap.

4. Interest on Drawing = $Total\ Drawings \times \frac{Rate}{100} \times \frac{T}{12}$
T = Time (in months) for which interest is to be charged $T = \frac{Time\,left\,after\,first\,drawing + Time\,left\,after\,last\,drawing}{2}$
Value of T under Different circumstances will be as under:

	Monthly Drawings for 12 Months	Quarterly Drawings for 12 Months	Half yearly Drawings for 12 Months	Monthly Drawings for 06 Months (last 6 months)
	6.5(beginning of the month)	**7.**5 (beginning of every quater)	9 (beginning of every month for six month in the beginning of 6 months)	**3.**5(beginning of the month for last six month)
	6(middle of very month)	6(middle of every quater)	6	3(middle of the month for last six month)

			middle of every month for six month in the beginning of 6 months)	
	5.5(end of every month)	**4.**5(end of every quater)	3 (end of every month for six month in the beginning of 6 months)	**2.**5(end of the month for last six month)

PAST ADJUSTMENTS
If, after preparation of Final Accounts of firm, it is found that some errors or commission in accounts has occurred than such errors or omissions are rectified in the next year by passing an adjustment entry.

A statement is prepared to ascertain the net effect of such errors or omissions on partner's capital/current accounts in the following manner.

Statement showing adjustment

Particulars	A (Rs.)	B (Rs.)	C (Rs.)
A Amount to be given credited Interest on Capital (Not allowed or provided at a lower rate) Partner's Salary or Commission etc. (Omitted to be recorded) Actual Profits (To be distributed in correct ratio)			
Total A			
B. Amount already given to be taken back now debited * Interest on Capital (If given at a higher rate) * Interest on Drawings (If not charged)			

* Profits already distributed in wrong ratio (debited now)			
Total B			
Net Effect (A-B)	+/-	+/-	+/-

+ Indicates Amount to be Credited to Partner's Capital Account – Indicates Amount to be Debited to Partners Capital Account
Journal

Date	Particulars	LF.	Debit(Rs.)	Debit(Rs.)
	Partners Capital A/C Dr. (Amount to be Debited) To Partners' Capital A/c (Amount to be Credited) (Being adjustment entry passed)			

During Past Adjustment it is not compulsory that capital accounts of all partners are affected. More than one partners Capital Account may be debited or credited but amount of debit & credit should be equal.

GUARANTEE OF PROFITS TO A PARTNER

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be or as may have been decided by a n a agreement.

Note:

Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum share in profits, then the actual profits will be allowed to the partner.

Case: **1.** When guarantee is given by FIRM (i.e. by all the Partners of the firm)

1. If share in actual profits is less than the guaranteed amount then. Guaranteed amount to a partner is first written off against the profits and then,

2. Remaining profits are distributed among the remaining partners in the remaining ratio.

Case: **2.** When guarantee is given by a partner or partners to another partner.

1. Calculate the share in profits for the partner to whom guarantee is given.

2. If share in profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.

3. If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as deficiency.

Deficiency is contributed by the partner or partners who guaranteed in certain ratio and subtracted from his or their respective shares.

ADMISSION OF A PARTNER

Admission of a Partner

A new partner can be admitted only with the concent of all the existing partners. A new partner is not liable for any profit or loss occured before his admission. Such a partner is called a new partner or incoming partner.

Purpose of Admission of a Partner:

1. For additional capital
2. For progress of the firm
3. For acquiring additional managerial skill4. For

reducing compitition

Effect of Admission of a Partner: Admission of a new partner is a major event in a partnership business. A new admission can take place only with the unanimous consent of all the existing partners. New partners are admitted for several reasons. Additional capital contribution, fresh ideas more contacts etc. are some of the advantages in admittinga new partner. Following are the most important accounting aspects to be considered at the time of admission of a new partner.

1. Change in profit sharing ratio,
2. Accounting treatment of Goodwill,3.

Revaluation of assets and liabilities,

4. Treatment of reserves and accumulated profits/losses and5. Adjustment

of Capital Accounts.

1. Change in Profit Sharing Ratio: When a new partner comes into the business, old partner have to adjust his profit share from their portion. Thus, change in profit sharing ratio is the first accounting aspect to be considered on admission of a new partner.In academic accounting, change in profit sharing ratio can be presented in various ways:

The New Partner's Share is Mentioned without Specifying the Old Partner's Profit Sharing Arrangement. In this case, it is to be assumed that the profit available after payingthe new partner's share is to be divided by the old partner's share in their old profit sharing ratio. In other words, even though the overall profit sharing ratio changes, the old ratio is still maintained between the old partners, within the new ratio.

Sacrificing Ratio

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

Old Share of Profit – New Share of Profit

2. Accounting Treatment of Goodwill: As stated earlier, the new partner is requiredto compensate the old partners 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 amountis 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 theold ratio, equal sacrifice, or a specified ratio. The difficulty arises where the ratio in whichthe 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.

3. Revaluation of Assets and Liabilities: Revaluation of assets and liabilities is another major step prior to admission or retirement. Revaluation is important, as there are hidden profits or losses in the difference between book value and actual market
value of assets or liabilities. Revaluation is necessary whenever there is a change in profitsharing ratio, even without admission or retirement. The hidden profits or losses should be distributed in the ratio prior to change (old ratio). Revised values of assets and liabilitiesare brought into books by opening a temporary account called 'Revaluation account'. The purpose of revaluation account is to summarise effect of revaluation of assets and liabilities. Revaluation account represents the combined capital account of partners. Anygain on revaluation of asset or liabilities, which are to be credited to partners, will be credited in revaluation account. Similarly, any loss on revaluation will be debited in revaluation account instead of capital accounts. The revaluation account is closed by transferring its net balance to partner's capital

accounts in the profit sharing ratio.

4. Treatment of Reserves and Accumulated Profits: Accumulated profits such as general reserve, credit balance in Profit & Loss account etc. will be transferred to the capital accounts of old partners in the old profit sharing ratio. Similarly, accumulated losses shall be transferred to the debit side of old partner's capital accounts. Therefore, these items will not appear in the new balance sheet.

5. Adjustment of Capital Accounts: When the partners change their profit sharing ratio at admission, retirement or any other reason, they also rearrange their capital accounts. Capital contribution is not essentially the basis of profit sharing. However, in most partnerships, capital contribution is considered as the major factor in determining profit sharing ratio. At the time of admission, capital contribution will be raised as an important condition. When a new partner is admitted for a certain share of profit for a certain amount of capital contribution, he would naturally expect the other also to maintain a capital balance matching with their profit share. Admission of a partner is notthe only situation when a capital rearrangement is considered. Retirement, death or any other change in profit sharing ratio would prompt rescheduling the capital balances. The basic purpose of following 'Fixed capital method' is to maintain a steady capital ratio.

When capital is readjusted on the basis of new partner's capital contribution, the first step is to determine the revised capital balances of each partner. Readjustment in capital account is usually done by bringing in or taking out cash. Sometimes, in place of cash transactions, old partners may adjust their capital balances by transferring the excessor deficit in the capital accounts to their current accounts as a temporary measure. Once the capital balances are adjusted, current accounts can be settled in due course.

What are Partners and Their Kinds?

Meaning: Minimum of 2 persons are required to form a partnership and maximum of 10 persons in case of banking and 20 in case of others. These persons are individually known as 'Partners' and collectively known as 'Firm'.

Kinds of Partners

1. *Active Partners*: These are the persons who actively take part in the business,i.e., they are involved in day-to-day affairs of business. They take all the decisions.
2. *Sleeping Partners:* Sleeping partners are those partners who are not actively involved in the business, i.e., they do not take part in the day-to-day affairs of the business. But they do contribute capital and share profits and losses of the business like other partners.
3. *Nominal Partner:* He neither contributes capital nor takes part in the conduct of the business. He is a person with good reputation in the market and lends his name to the firm and makes outsiders believe that he is a partner of the firm.
4. *Partner in Profits Only:* He only shares profit but not the losses. The objective of having such partner is to make use of his capital and goodwill.
5. *Partner by Estoppel:* He is not a partner of a firm in actual. He neither contributesany capital nor share profits or losses of the business. He also does not take partin the conduct of the business. His role is to make the outsiders believe that he is a partner of the firm.
6. *Secret Partner:* As the name suggests, his name is not disclosed to the outsiders as a partner.
7. *Minor Partners:* According to Indian Partnership Act 1932, a minor, i.e., person below the age of 18 years cannot be a partner of the firm. However, with the mutual consent of all the partners, he can be admitted into the partnership for the benefits of the firm.

Rights and Obligations of Partners

All the rights and duties should be clearly defined in the Partnership Deed. If in anycase, Partnership Deed is silent on some points, then in that case rights and obligationsof the partners are governed by Partnership Act's provisions.

Rights of the Partners

1. Right to take part in the day-to-day affairs or management of the partnership.2. If Partnership

Deed is silent on the rate of interest on partner's loan, then the
partner is entitled to the interest @ 6%.

3. Every partner of the firm has the right to check the books of accounts andrecords of business.

4. A partner has the right to be indemnified for the expenditure incurred by himto protect the firm from the loss.
5. A partner can use the property of the firm for the purpose of firm's business.
6. Right to retire from the firm in accordance with the terms and conditions of the Partnership Deed.
7. Every partner has the right to continue in the firm unless expelled according tothe provisions of the deed.
8. On retirement, right to share profits in the firm earned with the help of partner'sshare in the firm or interest @ 6% p.a. until the amount due to retired partner is paid off.
9. Right to be consulted before taking important decisions.
10. Right to share the profits equally, in the absence of any agreement.
11. Right to receive interest on capital, if there are sufficient profits.
12. Every partner is co-owner of the firm.
13. Right to act independently in emergency situation to protect the firm from loss.
14. Right to inspect the entry of new partner.
15. Right to dissolve the firm with the consensus, i.e., mutual consent of all the partners. But in case, if partnership is at will, any partner can dissolve the firm by giving notice to other partners.

Duties and Obligations of Partners

1. Every partner of the partnership firm must act in the maximum interest of thefirm.
2. Every partner must have mutual trust and confidence in other partners andthey should act in faithful manner to each other and the firm.
3. Duty to render true accounts to fellow partners.
4. Duty to compensate the firm for the loss arising out of breach of trust andwillful negligence.
5. A partner should not compete with the firm's business by starting his ownbusiness.
6. Obligation to share the loss equally in the absence of any agreement betweenthe partners.
7. A partner must not apply firm's property for the accomplishment of his personaltasks.
8. Every partner must act within the scope of their authority.
9. A partner must not transfer his share without the mutual consent of his fellowpartners.
10. Every partner must disclose any secret profit made by them.
11. A partner must not make secret profits by using firm's property, if he does so,he must surrender it to the firm.
12. In the absence of any previous contract between the partners, no partner isentitled to the salary.

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.

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 anticipatedexcess earnings" or as "the capitalised value attached to the differential profit capacity ofa business". Thus, goodwill exists only when the firm earns super profits. Any firm that earns normal profits or is incurring losses has no goodwill.

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 astable 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 customertraffic, 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.

Methods of Valuation of Goodwill

1. Average Profits Method2. Super Profits Method
3. Capitalisation Method.

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 inthe form of goodwill a sum which is equal to the profits he is likely to receive for the firstfew 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 ` 20,000 and it is expected that such profits are likely to continue for another three years, the value of goodwill will be ` 60,000 (` 20,000 × 3).

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 beable 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 thetotal 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.

Normal Profit: Capital Employed × Normal Rate of Return/100

Suppose an existing firm earns ` 18,000 on the capital of ` 1,50,000 and the normal rate of return is 10%. The Normal profits will work out at ` 15,000 (1,50,000 × 10/100). The super profits in this case will be ` 3,000 (` 18,000 – ` 15,000). The goodwill under the super profit method is ascertained by multiplying the super profits by certain numberof 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 ` 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 normalrate 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 ofyears' purchase.

Capitalisation Methods: Under this method, the goodwill can be calculated in twoways: (a) by capitalising the average profits, or (b) by capitalising the super profits.

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 capitalised 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) Capitalise the average profits on the basis of the normal rate of return to ascertainthe 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 liabilitiesfrom 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).

Illustrations 1: A and B are partners is a firm sharing profit in the ration of 4 : 3.They admitted 'C' as a new partner. C brought ` 10,000 towards goodwill premium and ` 30,000 as capital. New Ratio for profit sharing will be 3 : 2 : 2 for A, B and C respectively Pass necessary journal entries assuming that goodwill is retained in Business.

Solution

Date	Particulars	Dr. `	Cr. `
	Bank A/c Dr. To C's Capital A/c To Premium for Goodwill A/c (Being the amount of capital and goodwill/premium brought in cash)	40,000	 30,000 10,000
	Premium for Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c (Being the amount of goodwill transferred to old partners in sacrificing ratio)	10,000	 5,000 5,000

Working Note: Calculation of sacrificing ratio:

Sacrificing ratio = Old ratio – New ratio Thus, A's sacrifice ratio = 4/7 – 3/7 = 1/7 B's sacrifice ratio = 3/7 – 2/7 = 1/7

As, C has not made any sacrifice, therefore he will not be entitled to any amount ofgoodwill brought in by new partner.

A and B have sacrificed in equal proportion, therefore they will get equal share inthe goodwill brought in by D.

Illustrations 2: The Balance sheet of Krishna and Suresh is given below. They shareprofits and losses in the ratio of 3 : 2.

Liabilities	`	**Assets**	`
Capital:		Plant	30,000
Krishna	30,000	Patent	5,000
Suresh	20,000	Furniture	3,000
General Reserve	5,000	Stock	16,000
Creditors	15,000	Debtors	15,000
Joint Life Policy	7,000	Joint Life Policy Investment	7,000
		Cash	1,000
77,000		**77,000**	

They take Mohan into partnership on following terms:

(i) Mohan shall bring ` 14,000 in cash for goodwill share and capital for future1/5th share in profits.

(ii) Depreciation on plant and machinery amounted to ` 5,000.

(iii) Patents were appreciated by ` 8,000.

(iv) Valuation of goodwill of the firm was to be made at twice the average profit oflast 4 years and profits were ` 10,000, ` 9,000, ` 8,000 and ` 13,000.

V)Prepare Revaluation Account, Partner's Capital Account and Opening Balance Sheetfor the firm.

Solution:

Revaluation Account

Particulars		**Amt**	**Particulars**	**Amt**
To Plant		5,000	By Patents	8,000
To Profit Transferred to				
Capital Account:				
Krishna	1,800			
Suresh	1,200	3,000		
		8,000		8,000

Capital Account

Particulars	**Krishna**	**Suresh**	**Mohan**	**Particulars**	**Krishna**	**Suresh**	**Mohan**
To Bal c/d	41,400	27,600	10,000	By Bal b/d	30,000	20,000	10,000

				By Reserves	3,000	2,000	
				By Revaluation A/c	1,800	1,200	
				By Joint Life Policy	4,200	2,800	
				By Cash A/c (Goodwill)	2,400	1,600	
	41,400	27,600	10,000		41,400	27,600	10,000

Opening Balance Sheet

Liabilities		Amount	Assets	Amount
Creditors		15,000	Plant & Machinery	25,000
Capital:			Patents	13,000
Krishna	41,400		Furniture	3,000
Suresh	27,600		Stock	16,000
Mohan	10,000	79,000	Debtors	15,000
			Joint Life Policy	7,000
			Cash	15,000
		94,000		94,000

Working Notes:

1. Valuation of Goodwill:

Average profit = (10,000 + 9,000 + 8,000 + 13,000)/4 = ` 10,000 Goodwill at 2 years purchase = 10,000 * 2 = ` 20,000Mohan's share of goodwill = 20,000 * 1/5 = ` 4,000 Mohan's capital = 14,000 – 4,000 = 10,000

2. Entry for joint life policy:

Joint Life Policy A/c	Dr.	7,000	
To Krishna's Capital A/c			4,200
To Suresh's Capital A/c			2,800

Illustration 3: A and B are partners sharing in the ratio of 2/3 and 1/3. BalanceSheet of their firm is as below:

Balance sheet

Liabilities		`	Assets		`
Capital:			Debtors	40,000	
A	40,000		*Less:* R.D.D.	3,600	36,400
	30,000				

B	70,000	Stock	20,000
Reserve Fund	12,000	Building	25,000
Creditors	20,000	Machinery	31,000
Bank Overdraft	15,000	Typewriter	2,600
		Patent	2,000
	1,17,000		1,17,000

Mr. C was admitted as partner on the following terms:

(i) **He will get 1/6th share in future profit for which he brings goodwill in cash ` 10,000.**

(ii) **R.D.D. is reduced to ` 1,600 whereas machinery was appreciated by ` 2,600.**

(iii) **Patents were fully written off.**

(iv) **Discount on creditors were provided at ` 400.**

Prepare Revaluation A/c, Partner's Capital A/c and Opening Balance Sheet for the firm.

Revaluation Account

Particulars	Amt (`)	Particulars	Amt (`)
To Patents	2,000	By Provision for Doubtful Debts	2,000
To Profit Transferred to:A		By Machinery	2,600
B	2,000 1,000	By Provision for Discount on Creditors	400
	5,000		5,000

Capital Account

Particulars	A (`)	B (`)	C (`)	Particulars	A (`)	B (`)	C (`)
				By Balance b/d	40,000	30,000	
				By Reserve Fund	8,000	4,000	
				By Revaluation A/c	2,000	1,000	
				By Premium for Goodwill A/c	10,000		
To Balance c/d	60,000	35,000	19,000	By Bank			19,000
	60,000	35,000	19,000		60,000	35,000	19,000

Opening Balance Sheet

Liabilities	Amt (`)	Assets	Amt (`)

Sundry Creditors	20,000		Bank		14,000
Less: Provision:	400	19,600	Sundry Debtors	40,000	
Capitals:			*Less:* Provision:	1,600	38,400
A		60,000	Stock		20,000
B		35,000	Building		25,000
C		19,000	Machinery		33,600
			Typewriter		2,600
		1,33,600			1,33,600

Working Notes:

1. Sacrifice Ratio = Old Ratio – New Ratio Sacrifice by A = old 2/3 – new 3/6 = 1/6 Sacrifice by B = old 1/3 – new 2/6 = 0

Since B has not made any sacrifice, the ratio amount of premium for goodwill brought in by C will be credited to A.

1. C's capital is not given in the question. He will bring in capital proportionate tohis share of profits. C is given 1/6th share of profits, balance 5/6th is shared by A and B. Total capital of A and B after all adjustments is ` 60,000 + 35,000 = 95,000.

Thus, for 5/6th share of profits, the capital = 95,000. Then total capital of the firm = 95,000 * 6/5 = ` 1,14,000.

Therefore, C's capital for 1/6th share profits = 1,14,000 * 1/6 = ` 19,000.

2. Calculation of balance at bank:

Amount of cash brought in by C as goodwill =10,000Amount of cash brought in by C as capital = 19,000

	29,000
(-) Bank overdraft	15,000
Balance at bank	14,000

Illustration 4: A, B, C and D are the partners sharing profits and losses in 6 : 5 : 3ratio. Balance Sheet is given as below

Liabilities	**Amt (`)**	**Assets**	**Amt (`)**
Creditors	18,900	Debtors	26,460
Bills Payable	6,300	Land & Building	45,150
General Reserve	10,500	Furniture	7,350
Capital:		Stock	29,400
A	35,400	Cash	7,140
B	29,850		
C	14,550		

	1,15,500		1,15,500

D was admitted as partner on the following terms:

(i) He shall get 1/8th share is business future profit for which he should bringgoodwill ` 14,070 and capital ` 14,700 in cash.

(ii) Debtors are raised by ` 2,000 whereas provision for repairs were made at ` 1,320.

(iii) Furniture were depreciated by ` 920.

(iv) Partners decided to write of goodwill from book amounting to ` 5,250 as wellas to withdraw cash amounting to ` 7,060.

Prepare Revaluation Account, Partner's Capital Account and Opening Balance Sheetfor the firm. Also pass necessary journal entries.

Journal

	Particulars		**Amt. Dr. `**	**Amt. Cr. `**
(i)	General Reserve A/c	Dr.	10,500	
	To A's Capital A/cTo			4,500
	B's Capital A/cTo C's			3,750
	Capital A/c			2,250
	(Being general reserve transferred to Old Partner's Capital A/cs)			
(ii)	Revaluation A/c	Dr.	2,240	
	To Furniture A/c			920
	To Provision for Repairs A/c			1,320
	(Being reduction in the value of assets and a provision made for o/s repair bills)			
(iii)	Debtors A/c	Dr.	2,000	
	To Revaluation A/c			2,000
	(Being amount receivable from an old customer)			
(iv)	Land & Building A/c	Dr.	9,760	
	To Revaluation A/c			9,760
	(Being increase in the value of land and building)			
(v)	Revaluation A/c	Dr.	9,520	
	To A's Capital A/cTo			4,080
	B's Capital A/cTo C's			3,400
	Capital A/c			2,040
	(Being transfer of profit on revaluation to Old Partner's Capital A/cs)			

(vi)	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c (Being goodwill appearing in the books written off)	2,250 1,875 1,125	 5,250
(vii)	Cash A/c Dr. To D's Capital A/c To Premium for Goodwill A/c (Being the amount brought in cash by D being ` 14,700 for capital and ` 14,070 for goodwill)	28,770	 14,070 14,700
(viii)	Premium for Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being goodwill brought in by 'D' credited to old partners capital A/c)	14,070	 6,030 5,025 3,015
(ix)	A's Capital A/c Dr. B's Capital A/c Dr. To Cash A/c (Being cash withdrawn by A and B)	3,660 3,400	 7,060
(x)	Cash A/c Dr. To C's Capital A/c (Being cash brought in by C)	1,320	 1,320

Revaluation Account

Particulars		Amt (`)	Particulars	Amt (`)
To Furniture A/c		920	By Debtor's A/c	2,000
To Provision for Repairs		1,320	By Land and Building A/c	9,760
To Profit Transferred to Capital A/c:				
A	4,080			
B	3,400			
C	2,040	9,520		
		11,760		11,760

Capital Account

Particulars	A (`)	B (`)	C (`)	D (`)	Particulars	A (`)	B (`)	C (`)	D (`)
To Goodwill	2,250	1,875	1,125	14,700	By Balance b/d	35,400	29,850	14,550	14,700
To Balance c/d	47,760	40,150	20,730		By General Reserve A/c	4,500	3,750	2,250	
					By Revaluation A/c	4,080	3,400	2,040	
					By Cash A/c	6,030	5,025	3,015	
					By Premium for Goodwill A/c				
	50,010	42,025	21,855	14,700		50,010	42,025	21,855	14,700

To Cash A/c	3,660	3,400	22,050	14,700	By Balance c/d	47,760	40,150	20,730	14,700
To Balance c/d	44,100	36,750			By Cash A/c (Balancing Fig.)			1,320	
	47,760	40,150	22,050	14,700		47,760	40,150	22,050	14,700

Balance Sheet as on

Liabilities		Amt (`)	Assets	Amt (`)
Creditors		18,900	Cash	24,920
Bills Payable		6,300	Debtors	28,460
Provision for Repairs		1,320	Stock	29,400
Capital:			Furniture	6,430
A	44,100		Land and Building	54,910
B	36,750			
C	22,050			
D	14,700	1,17,600		
		1,44,120		1,44,120

New profit sharing ratio will be calculated as under:

Share given to D = 1/8

Balance of profits = 1 – 1/8 = 7/8A's

new share = 7/8 * 6/14 = 3/8 B's new

share = 7/8 * 5/14 = 5/16C's new

share = 7/8 * 3/14 = 3/16D's share =

1/8

A : B : C : D = 3/8 : 5/16 : 3/16 : 1/8 = 6/16 : 5/16 : 3/16 : 2/16

D brought in ` 14,700 as capital according to his 1/8th share of profit. Therefore, according to D's capital, the total capital of the new firm will be:

= 14,700 * 8/1 = ` 1,17,600

Therefore, A's Capital in new firm = 1,17,600 * 6/16 = ` 44,100B's

Capital in new firm = 1,17,600 * 5/16 = ` 36,750

C's Capital in new firm = 1,17,600 * 3/16 = ` 22,050D's

Capital in new firm = 1,17,600 * 2/16 = ` 14,700

Illustration 5 (Dr. Balance in P & L A/c: R.D.D. adjusted in General Reserve): The Balance Sheet of Sohan and Madan as on 31st Dec. 2006 is set out below. They share Profits and Losses in the ratio of 2 : 1.

Balance Sheet

Liabilities	Amt (`)	Assets	Amt (`)
Sohan's Capital	40,000	Building	20,000
Madan's Capital	30,000	Furniture	6,000
General Reserve	24,000	Stock	12,000
Creditors	16,000	Debtors	60,000
		Cash	6,000
		Profit & Loss A/c	6,000
	1,10,000		1,10,000

UNIT – III

RETIREMENT AND DEATH OF A PARTNER

If you look around, you must have noticed people in your relation and in your neighborhoods running business in partnership. You must have seen people quitting partnership firm or a person dies while in partnership. These are the events that take place during the lifetime of a partnership firm. Some issues arise on the happening of these events involving finance. Some assets and liabilities may need revaluation, goodwill is to be treated and amount of joint life policy is distributed and some accounting adjustment have to be made. Whenever such events take place, the firm has to calculate the dues of a partner leaving the firm or that of the deceased. In this lesson you will learn the accounting treatment in the books of the firm in these two cases i.e. retirement of a partner and death of a partner.

RETIREMENT – MEANING, CALCULATION OF NEW PROFIT-SHARING RATIO AND GAINING RATIO

When one or more partners leave the firm and the remaining partners continue todo the business of the firm, it is known as retirement of a partner. Amit, Sunil and Ashu are partners in a firm. Due to some family problems, Ashu wants to leave thefirm. The other partners decide to allow him to withdraw from the partnership. Thus,due to some reasons like old age, poor health, strained relations etc., an existing partner may decide to retire from the partnership. Due to retirement, the existingpartnership comes to an end and the remaining partners form a new agreement andthe partnership firm is reconstituted with new terms and conditions. At the time ofretirement the retiring partner's claim is settled.

A partner retires either :

(i) with the consent of all partners, or

(ii) as per terms of the agreement; or

(iii) at his or her own will.

The terms and conditions of retirement of a partner are normally provided in thepartnership deed. If not, they are agreed upon by the partners at the time of retirement.The old partnership comes to an end and a new partnership is formed among theremaining partners. At the time of retirement the following accounting issues are dealt with :

(a) New profit sharing ratio and gaining ratio.

(b) Goodwill.

(c) Adjustment of changes in the value of Assets and liabilities.

(d) Treatment of reserve and accumulated profits.

(e) Settlement of retiring partners dues.

f) New capital of the continuing partners

New Profit Sharing Ratio and Gaining Ratio

As soon as a partner retires the profit sharing ratio of the continuing partners getchanged. The share of the retiring partner is distributed amongst the continuingpartners. In the absence of information, the continuing partners take the retiringpartner's share in their profit sharing ratio or in an agreed ratio. The ratio in whichretiring partner's share is distributed amongst continuing partners is known as gaining ratio. Gain of a partner is

New Ratio – Existing Ratio

Gain of an exising partner = His New Share - His Existing (old) ShareVarious cases

of new ratio and gaining ratio are illustrated as follows :

Retiring Partner's Share Distributed in Existing Ratio

In this case, retiring partner's share is distributed in existing ratio amongst the remainingpartners. The remaining partners continue to share profits and losses in the existingratio. The following example illustrates this :

Tanu, Manu and Rena are partners sharing profits and losses in the ratio of4 : 3 : 2. Tanu retires and remaining partners decide to take Tanu's share in the existingratio i.e. 3 : 2. Calculate the new ratio of Manu and Rena.

Existing Ratio between Manu and Rena = 3/9 and 2/9Tanu's Share

(retiring partner) = 4/9

Tanu's share taken by the Manu and Rena in the ratio of 3 : 2Manu's Gain = 4/9 ×

3/5 = 12/45

Manu's New Share = 3/9 + 12/45 = 27/45Rena's Gain = 4/9

× 2/5 = 8/45

Rena's New Share = 2/9 + 8/45 = 18/45

New ratio of Manu and Rena is 27/45 : 18/45 = 27 : 18 = 3 : 2.Gain of a

Partner = New Share – Existing Share

Manu's Gain = 27/45 – 3/9 = 12/45

Rena's Gain = 18/45 – 2/9 = 8/45

Gaining Ratio = 12/45 : 8/45 OR 3 : 2

You may note that the new ratio is similar to existing ratio that existed between Manuand Rena before Tanu's retirement.

Note: In absence of any information in the question, it will be presumed that retiring partner's share has been distributed among the remains partners in existing (old) ratio.

Retiring partner's share distributed in Specified proportion

Sometimes the remaining partners purchase the share of the retiring partner in specifiedratio. The share purchased by them is added to their old share and the new ratiois arrived at. The following example illustrates this:

A, B and C are partners in the firm sharing profits in the ratio of 3 : 2 : 1. B retiredand his share was divided equally between A and C. Calculate the new profit sharingratio of A and C.

B's Share = 2/6

B's share is divided between A and C in the ratio of 1 : 1.

A's Gain 1/2 of 2/6 = 2/6 × 1/2 = 1/6

A's New Share = 3/6 + 1/6 = 4/6

C's Gain 1/2 of 2/6 = 2/6 × 1/2 = 1/6

C's New share = 1/6+1/6 = 2/6

Thus new, ratio of A and C will be 2 : 1

Retiring Partner's share is taken by one of the partners

The retiring partner's share is taken up by one of the remaining partners. In this case,the retiring partner's share is added to that of existing partner's share. Only his/her share changes. The other partners continue to share profit in the existing ratio. An example illustrating this point is given below:

Anuj, Babu and Rani share profit in the ratio of 5 : 4 : 2. Babu retires and his shareis taken by Rani, So

Rani's share is 2/11 + 4/11 = 6/11, Anuj share will remainunchanged i.e, 5/11. Thus, the new profit sharing ratio of Anuj and Rani is 5 : 6.

Illustration 1

Neru, Anu and Ashu are partners sharing profit in the ratio of 4 : 3 : 2. Ashu retires. Find the new ratio of Neru and Anu if terms for retirement provide the following :

(i) Ratio is not given

(ii) Equal distribution of Ashu's share

(iii) Ashu's share is taken by Neru and Anu in the ratio of 2 : 1

(iv) Anu takes over the share of Ashu.

Solution :

(i) New profit sharing ratio of Neru and Anu is 4 : 3.

(ii) Ashu's share = 2/9

Neru's Gain = 1/2 of 2/9 = 2/9 × 1/2 = 1/9Neru's New

share = 4/9 + 1/9 = 5/9

Anu's Gain = 1/2 of 2/9 = 2/9 × 1/2 = 1/9Anu's New

Share = 3/9 + 1/9 = 4/9

New profit sharing ratio of Neru and Anu is 5/9 : 4/9 or 5 : 4Gaining ratio

is equal 1/9 : 1/9 = 1 : 1

(iii) Ashu's Share = 2/9

Neru's Gain = 2/3 of 2/9 = 2/9 × 2/3 = 4/27Neru's new

share = 4/9 + 4/27 = 16/27 Anu's Gain = 1/3 of 2/9 =

2/9 × 1/3 = 2/27 Anu's new share = 3/9 + 2/27 =

11/27

New profit sharing ratio of Neru and Anu is 16 : 11.Gaining

ratio is 4/27 : 2/27 = 4 : 2 = 2 : 1

$$\left[i.e. \frac{16}{27} - \frac{4}{9} = \frac{4}{27}, \frac{11}{27} - \frac{3}{9} = \frac{2}{27} \right]$$

(i) Anu takes over Ashu share fully. Ashu's share = 2/9

Retirement and Death of a Partner

Anu's Gain = 2/9

Anu's new share = 3/9 + 2/9 = 5/9

New profit sharing ratio of Neru and Anu is 4 : 5Only Anu gains.

Illustration 2

Ashish, Barmon, and Chander are partners sharing profits and losses in the ratio of2 : 1 : 2 respectively. Chander retires and Ashish and Barman decide to share theprofits and losses equally in future. Calculate the gaining ratio.

Solution :

Gain of a Partner = New Share – Existing (old) Share

Hence, Ashish's Gain	= 1/2 – 2/5	=	1/10
Barman's Gain	= 1/2 – 1/5	=	3/10

Gaining ratio between Ashish and Barman is 1 : 3

TREATMENT OF GOODWILL

The retiring partner is entitled to his/her share of goodwill at the time of retirementbecause the goodwill is the result of the efforts of all partners including the retiringone in the past. The retiring partner is compensated for his/her share of goodwill. As per Accounting Standard 10 (AS-10), goodwill is recorded in the books only whensome consideration in money is paid for it. Therefore, goodwill is recorded in thebooks only when it is purchased and the goodwill account cannot be raised on itsown.

Therefore, in case of retirement of a partner, the goodwill is adjusted through partner's capital accounts. The retiring partner's capital account is credited with. his/her shareof goodwill and remaining partner's capital account is debited in their gaining ratio.The journal entry is made as under:

Remaining Partners' Capital A/c Dr. (individually)

To Retiring Partner's Capital A/c

(Retiring partner's share of goodwill adjusted toremaining partners in the gaining ratio)

Illustration 3

Mitu, Udit and Sunny are partners sharing profit equally. Sunny retires and the goodwill of the firm is valued at ` 54,000. No goodwill account appears in the books of thefirm. Mitu and Udit share future profit in the ratio of 3 : 2. Make necessary journalentry for goodwill.

Solution :

Date	Particulars	L.F.	Debit Amount (`)	Credit Amount (`)
	Mitu's Capital A/c Dr		14,400	
	Udit's Capital A/c Dr.		3,600	
	To Sunny's Capital A/c (Sunny's share of goodwill adjusted to remaining partners in their gaining ratio 4 : 1]			18,000

Note : Sunny's share of goodwill = ` 54,000 × 1/3 = `18,000 Gain of a Partner

= New Share – Existing Share

Mitu Gains = 3/5 – 1/3 = 9/15 – 5/15 = 4/15

Udit Gains = 2/5 - 1/3 = 6/15 – 5/ 15 = 1/15

Gaining Ratio between Mitu and Udit = 4 : 1

When the Goodwill Account already appears in the Books

Normally the goodwill is not shown in the books of the firm. If at the time of retirement/death of a partner, goodwill appears in the Balance Sheet of the firm, it will be writtenoff by debiting all the partners' capital accounts in their existing profit sharing ratio and crediting the goodwill account. In such a case, the following journal entry is made:

Partners' Capital A/c Dr (including retiring partner's capital A/c)

To Goodwill A/c (Existing goodwill written-off)

Illustration 4

Tanu, Priya and Mayank are partners' sharing profit in the ratio of3 : 2 : l. Priya retires and on the date of Priya's retirement goodwill is valued at `90,000. Goodwill already appears in the books at a value of ` 48,000. New ratioof Tanu and Mayank is 3 : 2. Make the necessary journal entries.

Solution :

Journal

Date	Particulars	L.F.	Debit Amount (`)	Credit Amount (`)
	Tanu's Capital A/c Dr. Priya's Capital A/c Dr. Mayank's Capital A/c Dr. To Goodwill A/c (Existing goodwill written-off from the books)		24,000 16,000 8,000	 48,000
	Tanu's Capital A/c Dr. Mayank's Capital A/c Dr. To Priya's Capital A/c (Priya's share of goodwill adjusted to remaining partners in their gaining ratio 3 : 7)		9,000 21,000	 30,000

Note : Priya's share of goodwill = `90,000 × 2/6 = `30,000

Gaining of a Partner's = New Share – Existing Share,

Tanu's Gain = 3/5 – 3/6 = 18/30 – 15/30 = 3/30 Mayank's Gain = 2/5 – 1/6 = 12/30 – 5/30 = 7/30 Gaining Ratio between Tanu and Mayank = 3 : 7

REVALUATION OF ASSETS AND REASSESSMENT OF LIABILITIES

At the time of retirement of a partner the assets of the firm are revalued and liabilities are reassessed. Revaluation Account is prepared in the same way as in case of admission of a partner. This is done to adjust the changes in value of assets and liabilities at the time of retirement/death of a partner. Any gain or loss due to revaluation is divided amongst all the partners including retiring/deceased in their existing profit sharing ratio. Following journal entries are made for this purpose:

For increase in value of assets:

Assets A/c Dr. (Individually)

To Revaluation A/c

(Increase in the value of assets)

For decrease in value of assets:

Revaluation A/c Dr.

To Assets A/c (Individually)

(Decrease in the value of asset)

For increase in value of Liabilities:

Revaluation A/c Dr.

To Liabilities A/c (Individually)

(Increase in the value of liabilities)

For decrease in value of Liabilities:

Liabilities A/c Dr. (Individually)

To Revaluation A/c

(Decrease in the value of liabilities)

Revaluation account is prepared to record the change in the value of assets or liabilities. It will reveal profit or loss on revaluation. This profit or loss is divided amongst all partners including the retiring/deceased partner in existing profit-sharing ratio.

For Profit on Revaluation:

Revaluation A/c Dr. (Individually)

To Partner's Capital A/c

(Profit on revaluation divided amongst all partners in their existing profit-sharing ratio)

For loss on Revaluation:

Partner's Capital A/c Dr. (Individually)

To Revaluation A/c

(Loss on revaluation borne by all partnersin their existing profit-sharing ratio)

Solution :

JOURNAL

Date	Particulars	L.F.	Debit Amount (`)	Credit Amount (`)
	Machinery A/c Dr.		25,000	
	Investments A/c Dr.		2,000	
	Provision for Outstanding Bill Dr.		1,000	
	To Revaluation A/c (Increase in value of Assets i.e. Machinery and investment and reduction in provision)			28,000
	Revaluation A/c Dr.		12,000	
	To Land and Building A/c (Decrease in value of assets)			12,000
	Revaluation A/c Dr.		16,000	

To Mudit's Capital A/c To Mohit's Capital A/c To Sonu's Capital A/c (Gain on revaluation credited to all partners capital A/c in old profit sharing ratio i.e. 3 : 2 : 1)			8,000 5,333 2,667

Revaluation Account

Particulars	Amount (`)	Particulars	Amount (`)
Land and Building	12,000	Machinery	25,000
Profit transferred to :		Investments	2,000
Mudit Capital 8,000		Provision for	1,000
Mohit Capital 5,333		Outstanding Bill	
Sonu Capital 2,667	16,000		
	28,000		28,000

TREATMENT OF ACCUMULATED RESERVES AND UNDISTRIBUTED PROFIT

All the balances of Accumulated Reserves, funds and undistributed amount of Profitor Loss appearing in the balance sheet of the firm on the date of retirement/death isdistributed amongst all partners including retiring/deceased partner in their old profitsharing ratio, The following entries are made:

For distribution of undistributed profit and reserve.

Reserves A/c Dr
Profit & Loss A/c (Profit) Dr.
To Partners' Capital A/c (individually)(Reserves and
Profit & Loss (Profit)
transferred to all partners capitals A/cin existing profit
sharing ratio)

For distribution of undistributed loss

Partners' Capital A/c Dr. (individually)To Profit & Loss A/c (Loss)

(Profit & Loss (loss) transferred to all partners Capitals A/c in old profitsharing ratio)

DEATH OF A PARTNER

On the death of a partner, the accounting treatment regarding goodwill, revaluation of assets and reassessment of liabilities, accumulated reserves and undistributed profitare similar to that of the retirement of a partner. On the death of partner, the amount payable to him/her is paid to his/her legal representatives. The legal representativesare entitled to the followings:

(a) The amount standing to the credit of the capital account of the deceased partner.

(b) Interest on capital, if provided in the partnership deed upto the date of death.

(c) Share of goodwill of the firm.

(d) Share of undistributed profit or reserves.

(e) Share of profit on the revaluation of assets and liabilities.

(f) Share of profit upto the date of death.

(g) Share of Joint Life Policy.

The following amounts are debited to the account of the deceased partner's legalrepresentatives:

(i) Drawings

(ii) Interest on drawings

(iii) Share of loss on the revaluation of assets and liabilities;

(iv) Share of loss that have occurred till the date of his/her death.

The above adjustments are made in the capital account of the deceased partner andthen the balance in the capital account is transferred to an account opened in the nameof his/her executor.

The payment of the amount of the deceased partner depends on the agreement. Inthe absence of an agreement, the legal representative of a deceased partner is entitledto interest @ 6% p.a. on the amount due from the date of death till the date of finalpayment.

Calculation of Profit upto the Date of Death of a Partner

If the death of a partner occurs during the year, the representatives of the deceasedpartner are entitled to his/her share of profits earned till the date of his/her death. Suchprofit is ascertained by any of the following methods:

(i) Time Basis; (ii) Turnover or Sales Basis

Time Basis

In this case, it is assumed that profit has been earned uniformly through out the year.For example:

The total profit of previous year is ` 2,25,000 and a partner dies three months afterthe close of previous year, the profit of three months is ` 31,250 i.e. ` 1,25,000 × 3/12. If the deceased partner took 2/10 share of profit, his/her share of profit tillthe date of death is ` 6,250 i.e. ` 31,250 × 2/10

Turnover or Sales Basis

In this method, we have to take into consideration the profit and the total sales ofthe last year. Thereafter the profit upto the date of death is estimated on the basisof the sale of the last year. Profit is assumed to be earned uniformly at the same rate.

Illustration 12

Arun, Tarun and Neha are partners sharing profits in the ratio of 3 : 2 : 1 Neha dieson 31st May 2014. Sales for the year 2013-2014 amounted to ` 4,00,000 and theprofit on sales is ` 60,000. Accounts are closed on 31 March every year. Sales fromlst April 2014 to 31st May 2014 is ` 1,00,000.

Calculate the deceased partner's share in the profit up to the date of death.

Solution :

Profit from 1st April 2014 to 31st May 2014 on the basis of sales:If sales are `

4,00,000, profit is ` 60,000

If the sales are ` 1,00,000 profit is : ` 60,000/` 4,00,000 × ` 1,00,000

= `15,000

Neha's share = ` 15,000 × 1/6 = ` 2,500

Alternatively, profit is calculated as

Rate of profit = 60000/400000*100 =15%

Sale up to date of death = 100000

Profit = 100000 * 15/100 = 150

Illustration 13

Nutan, Sumit and Shiba are partners in a firm sharing profits in the ratio 5 : 3 : 2.On 31st December 2014 their Balance Sheet was as under:

Liabilities		Amount (`)	Assets	Amount (`)
Creditors		52,000	Building	60,000
Reserve Fund		15,000	Plant	50,000
Capitals :			Stock	27,000
Nutan	60,000		Debtors	25,000
Sumit	45,000		Cash	10,000
Shiba	30,000	1,35,000	Bank	30,000
		2,02,000		2,02,000

Nutan died on 1 July 2015. It was agreed between her executor and the remaining partners that:

Goodwill to be valued at 2½ years purchase of the average profits of the lastFour years, which were: 2011 ` 25,000; 2012 ` 20,000; 2013 `40,000 and 2014 `35,000.

(i) Building is valued at ` 70,000; Plant at `46,000 and Stock at ` 32,000.

(ii) Profit for the year 2015 be taken as having accrued at the same rate as thatof the previous year.

(iii) Interest on capital is provided at 9% p.a.

(iv) On 1 July 2015 her drawings account showed a balance of `.20,000.

(v) ` 25,950 are to be paid immediately to her executor and the balance istransferred to her Executors Loan Account.

Prepare Nutan's Capital Account and Nutan's Executor's Account as on 1st July2015

Solution :

Valuation of Goodwill:

Total Profit = ` 25,000 + ` 20,000 + ` 40,000 + ` 35,000

= ` 1,20,000

Average Profit = ` 1,20,000/4 = ` 30,000

Hence, Goodwill at 2½ year's purchase = ` 30,000 × 2½ = ` 75,000Nutan's share of goodwill = ` 75,000 × 5/10 = ` 37,500

It is adjusted into the Capital Accounts of Sumit and Shiba in the gaining ratioof 3 : 2 i.e. ` 22,500 and ` 15000 respectively.

(i) Share of Profit payable to Nutan [upto the date of death]
= ` 35,000 × 6/12 × 5/10
= ` 8,750

(ii) Nutan's Share of Reserve Fund = ` 15,000 × 5/10
= ` 7,500

(iii) Interest on Nutan's Capital = ` 60,000 × 9/100 × 6/12
= ` 2,700

Revaluation Account

Particulars		*Amount (`)*	*Particulars*	*Amount (`)*
Plant		4,000	Building	10,000
Profit transferred to			Stock	5,000
Nutan Capital	5,500			
Sumit Capital	3,300			
Shiba Capital	2,200	11,000		
		15,000		15,000

Nutan's Capital Account

Particulars	*Amount (`)*	*Particulars*	*Amount (`)*
Drawings	20,000	Balance b/d	60,000
Nutan's Executor's	1,01,950	Reserve fund	7,500
		Sumit's Capital (Goodwill)	15,000
		Shiba's Capital (Goodwill)	22,500

		Profit & Loss (Suspense)	8,750
		Revaluation A/c	5,500
		Interest on Capital	2,700
	1,21,950		1,21,950

Nutan's Executor's Accounts

Particulars	*Amount (`)*	*Particulars*	*Amount (`*
Bank	25,950	Nutan's Capital	1,01,950
Nutan's Executor's Loan A/c (Transfer)	76,000		
	1,01,950		1,01,950

UNIT-V

DISSOLUTION OF PARTNERSHIP FIRM WITH INSOLVENCY

Dissolution of firm – The dissolution of partnership between all the partners of a firm is called the dissolution of the firm. In the case of dissolution of a firm, the business of the firms is closed down and its affairs are wound up. The assets are realized and the liabilities are paid off.

Model of dissolution of firm –

Dissolution without the intervention of the court

a) Dissolution by agreement
b) Compulsory dissolution
c) Dissolution on the happening of certain contingencies.
d) Dissolution by notice Dissolution by the court
e) Insanity
f) Permanent incapacity
g) Misconduct
h) Breach of agreement
i) Transfer of interest
j) Loss in business
k) Just and equitable

Steps in the dissolution process –

Step 1	Prepare a balance sheet of the firm as on the date of the dissolution of the firm.
Step 2	Realize the non-cash assets which are not acceptable for distribution in their present form, pay the debts of the firm to third parties. Realization account is prepared to calculate the loss or profit on realization of assets and settlement of liabilities. Loss or profit on realization of assets and settlement of liabilities is transferred to partners' capital accounts.
Step 3	Pay the amount due to each partner ratably for advances (or Loan)
Step 4	Pay the available cash to the partners.

Accounting treatment on dissolution of firm –

In case of dissolution of firm the following accounts are prepared to close the books of the firm –

1) Realisation Account
2) Partners' loan account
3) Parnters' capital account
4) Cash or bank account

1) **Realization account –** This is a special type of account. It is a nominal account. The purpose of preparing this account is to find out the result of realization of assets and discharge of liabilities. The following steps involved in preparing this account.

Step 1. For Transfer of all accounts given in the balance sheet

For transfer of assets – All the assets except cash in hand, cash at bank, debit balance of current accounts of partners and fictitious assets are transferred to debit of this account at book values as under –

Realisation A/c Dr.

To Various assets (individually)

(For transfer of various assets to realization a/c)

a. **For transfer of outside liabilities –** All the external liabilities including partners loan are transferred to the credit of realization account at book value as under –

Various Liabilities A/c Dr.

To Realisation A/c

(For transfer of various liabilities to realisation a/c)

Note: Liabilities have got credit balance, so debiting to close them.

Step 2. Disposal of assets For sale of assets

Cash / Bank A/c Dr.

To Realisation A/c(For assets realised in cash)

Asset taken over by partner

Partner's Capital A/c Dr.

To Relisation A/c

(For assets taken over by a partner)

Step 3. Entry for payment of dissolution expenses

a. For cash payment

Realisation A/c Dr.

To Cash / Bank A/c

(For payment of dissolution expenses)

b. For payment made by a partner

Realisation A/c Dr.

To Partner's Capital A/c

(For dissolution expenses paid by a partner)

Note : if any partner is to bear all expenses of realisation, no journal entry is required in the books of the firm but in this case if the partner is paid the realisation expenses, the following entry will be made :

Partner's Capital A/c Dr.

To Cash / Bank A/c

(For dissolution expenses paid on behalf of a partner.)

Step 4. Entry for payment of outside liabilities :

a. For cash payment

Realisation A/c Dr.

To Cash / Bank A/c

(For payment to outside liabilities)

b. For liabilities taken over by a partner

Realisation A/c Dr.

To Partner's Capital A/c
(For liabilities taken over by
a partner)

Step 5. Entry for closing realisation account

a. In case of profit
Realisation A/c Dr.
To Partners' Capital A/c
(For profit on realisation transferred to partner's capital a/cs in their profit sharing ratio)

b. In case of loss
Partners' capital A/cs Dr.
To Realisation A/c
(For loss on realisation transferred to partners' capital a/cs in their profit sharing ratio)

Note : (1) Intangible assets such as goodwill, patents, copyrights, prepaid expense are normally value less in case of dissolution. So if a question is silent it should be presumed that nothing could be realised from such assets. (2) If question is silent about the realisation of tangible assets it is presumed that their book values have been realised.

2) **Partner's loan Account –** This are transferred to the credit side of realization account and the payments there of are shown on debit side of realization account. Alternatively the payment can be credited directly to cash account.

3) **Partner's capital accounts –** All the reserved and undivided profit or loss, realization profit orloss, balance of current accounts. Now the difference is adjusted in cash if there is credit balance it is surplus to be withdrawn by the concerned partner from their personal resources. Entry for surplus withdrawn or deficiency brought in by the concerned partner from their personal resources. Entry for surplus withdrawn or deficiency brought in are as under –

a. Cash/Bank A/c Dr.
To Partner's capital A/c
(For deficit amount of capital brought in cash)
Partner's Capital A/c

To cash/Bank A/c

(For final payment made to a partners)

Cash account – At first opening balance is written. Then cash at bank is also transferred to this account. Amount realized from assets and deficiency brought in by partners is debited to this account and payment of liabilities, realization expenses and surplus withdrawn by partners are credited. Now both side of cash account will be equal. The agreement of both the sides of cash account is the cross checks of accounting and arithmetical accuracy.

Formate of Accounts Realisation A/c

Particulars	Amount	Particulars	Amount
To land and Building A/c		By Creditors a/c	
To Plant Machinery A/c		By B/P A/c	
To furniture A/c		By Bad Debts Reserve A/c	
To investment A/c		By Bank Loan A/c	
To stock A/c		By Bank Overdraft A/c	
To Debtors a/c		By Loan A/c	
To B/R A/c		By Cash A/c (Assets Realised)	
To cash A/c (Payment of Liabilities)		By Capital A/c (Assets taken)	
To Capital A/c (Liab. Taken by Partners)		By Capital A/cs (Loss):	
To Cash A/c (Realization Exps.)			
To Capital A/cs (Profit):			

Partner's Capital A/cs

Particulars				Particulars			
To Balance b/d				By Balance b/dBy current A/c			
To Current A/c				By P & L A/c (Profit)			
To P & L A/c (Loss)				By General Reserve A/c			
To Realisation A/c (Assetstaken)				By Realisation (Liab. Taken)By Realisation A/c (Profit)			
To Realisation A/c (Loss)				By Cash A/c (Deficiency) (Bal.fig)			
To cash A/c (Surplus) (Bal. fig)							

Cash A/c

Particulars	Amount	Particulars	Amount
To Balance b/d (cash in hand)		By Realisation A/c (Paymnet of Liab.)	
To Bank A/c (Cash at bank)		By Realisation A/c (Exp.)	
To Realisation A/c (Assets Realised)		By Capital A/c (Surplus Refund)	
To Capital A/c (Deficiency brought)			

Insolvency of Partners

At the time of dissolution of a partnership firm, the capital account of a partner may show a debit balance after his share of realization loss or profit and accumulated profits or losses etc. have been transferred to his capital account. In such a case, the partner is a debtor of the firm to the extent of debitbalance in his capital account and he has to bring in the necessary cash to make up the deficiency in his capital account. If the partner is unable to bring in the necessary cash, e.g. when he cannot pay in full the amount of debit balance in the capital account, he is said to be insolvent. The solvent partners have to bear the capital deficiency of the insolvent partner. There is no provision in the Indian

Partnership Act., 1932 regarding this matter. Therefore, if there is a provision regarding this matter in the partnership deed it would be decisive. The partners may provide in partnership deed that loss due to insolvency of a partner will be shared by the solvent partners in their profit-sharing ratio or any other ratio. But the problem arises when there is no provision in the partnership deed regarding this matter.

Decision in Garner V/s Murray

In this case Garner, Murray and Wilkins were equal partners in England. Their capitals were unequal. The Balance Sheet of the firm after satisfying all the liabilities were as follows:

Balance Sheet

Liabilities	Rs	Asset	Rs
Capital		Cash	1,916
Accounts:	2,500	Wilkins— Overdrawn	263
Garner	314	Deficiency (Realisation loss)	635
Murray	2,814		2,814

Wilkins was insolvent and unable to pay anything. Thus the assets of the firm were not sufficient to repay the capitals in full. There was a dispute between the solvent partners regarding the method of sharing of loss due to insolvency of Wilkings. Justice Joyce held in 1904 as follows:

"The solvent partners are only liable to make good their share of the deficiency, and that the remaining assets should be divided among them in proportion to their capitals,"

In other words, the learned judge held as follows:

The solvent partners should bring in cash their share of the realisation loss.

The loss due to insolvency of a partner should be borne by the solvent partners in proportion totheir last agreed capitals.

It should noted that a partner having a debit balance or nil balance, will not have to bear the loss due toinsolvency of a partner.

The decision in the above case has taken into consideration only the book capital of the partners. It ignores the private estate of the solvent partners.

Meaning of last agreed capitals

In case of fixed capital method, the expression, "Last Agreed Capitals" means the fixed capital. In case of fluctuating capital method, it means the capitals after malting adjustment for accumulated profits and losses, drawings, interest on capital, salary to a partner etc. to the date of dissolution but before transferring realisation loss or profit.

Applicability of Garner V/s Murray to India

It is reasonable to assume that Garner v. Murray case will also apply to India as S. 48 of the Indian Partnership Act., 1932 is almost identical with S.44 of the English Partnership Act and there has been no case law which has examined the question of sharing of loss due to the insolvency of a partner. However, some Accountants contend that the above decision is not inconformity with S.48 (a) of the Indian Partnership Act., 1932. The students, in an examination problem, should indicate whether or notthe ruling in Garner v. Murray has been applied.

Piecemeal distribution of cash

It has been presumed so far that all the assets are realised on the date of dissolution and all the liabilities are also simultaneously discharged on the same day itself. But usually this is not true in practice. In actual practice, assets are realised gradually and liabilities are paid gradually depending upon the amount realised from the sale of assets. Therefore, the realsiation loss or profit can be ascertained only after the realisation of all assets and payment of all liabilities. Available cash is used in the following order:

1. Payment of realisation expenses or a provision is made for realisation expenses.
2. Payment of outside liabilities i.e., bank loan, sundry creditors, bills payable, outstanding expenses etc. It must be noted here that a secured creditor has priority whenever an asset provided by way of security to the concerned creditor is realised. After satisfying the claim of the secured creditor the surplus, if any, is paid to unsecured creditors. Amount realised from an asset which is not charged or mortgaged is used to pay all the creditors, whether secured or unsecured in the ratio of their claims.
3. Payment of partners' loan in the ratio of their respective loans.
4. Payment of partners capitals.

If there is any contingent liability an account of bills discounted, a provision should be made in the beginning for the same and when provision is no longer required, the amount should be distributed.

Basis of distribution of cash among partners

The following are the two basis of distribution of cash among partners:

1. Proportionate or surplus capital method
2. Maximum loss method

Proportionate or surplus capital method

Under this method, the partner who have contributed more capital than his proportionate share are paid off first. In other words, the partners who have surplus capital are given the payment first. The following procedure should be adopted for calculation of surplus:

Step 1 Calculate adjusted capitals of all the partner after making adjustment for accumulated profits and losses and transfer of balances of current accounts etc.

Step 2 Divide the adjusted capitals of all partners by their respective profit sharing ratio and treat the smallest quotient as base capital.

Step 3 Calculate proportionate capitals by multiplying base capital and profit shaft ratio.

Step 4 Calculate surplus capitals by subtracting proportionate capital (step 3)from adjusted capital (Step 1)

Step 5 If there is only one partner having surplus capital make payment to that partner first to the extent of surplus capital. If there are two or more partner having surplus capitals and surplus capitals are in profit sharing ratio, distribute cash among such partners to the extent of surplus capitals in the profit sharing ratio. If there are two or more partners having surplus capitals and the surplus capitals are not in profit sharing ratio, go to the next step.

Step 6 Divide surplus capital of the concerned partners (Step 4) by their profit sharing ratio and treat the smallest quotient as revised base capital.

Step 7 Calculate the proportionate surplus by multiplying the revised base capital (Step 6).

Step 8 Calculate the excess surplus capital by subtracting revised proportionate surplus (Step 7) from surplus capital (Step 4)

Step 9 See step 5 and repeat the process until there is only one partner having excess surplus.

The partner or partners having excess surplus are paid off first to the extent of excess surplus and after that payment is made to the partners having surplus capitals to the extent of surplus capitals and lastly payment is made to all the partners in the profit sharing ratio.

Maximum Loss Method

Under this method, it is assumed that every installment realised is a final realisation, i.e., the remaining assets will realise nothing. The following procedure is adopted for distribution of cash among the partners after the payment has been made for outside liabilities and partners' loan :

Step 1. Calculate the adjusted capitals of the partners after making adjustments for accumulated profits and losses, transfer of balance of current accounts etc.

Step 2. Calculate the maximum possible loss assuming that the remaining assets are worthless. Maximum possible loss is calculated by subtracting cash available from the total of the balances of adjusted capital accounts.

Step 3. Distribute the maximum possible loss among the partners in their profit sharing ratio.

Step 4. Calculate the balances of capital accounts of partners after distribution of maximum possible loss.

Step 5. If the balances of capital accounts of all the partners (Step 4) show positive balances, distribute the available cash among the partners equal to their respective balances of capital accounts (Step 4). Onthe other hand, if balance of capital account of any partner (Step 4) shows a negative balance, transfer the negative balance of that partner to the capital accounts of other partners having positive balances inthe ratio of capitals just before dissolution assuming the partner having negative balance as insolvent. Ifthe capitals are fixed the negative balance should be transferred in the fixed capital ratio and in case of fluctuating capitals after adjusting for accumulated profits and losses. This process is repeated till the negative balance is completely transferred. Distribute the available cash to the partners whose capital balances after transfer of negative balance, show positive balances and the amount paid

will be equal totheir respective balances of capital accounts.
Step 6. Calculate the balances due after subtracting the amount paid (Step 5) from the adjusted capitals (Step 2)
Step 7. Calculate the maximum possible loss at the time of next realisation. Maximum possible loss at this stage will be calculated by subtracting the available cash at this stage from the balances due (Step 6)
Step 8. Go to Step 5.

Step 9. Calculate the balance due at this stage after subtracting the amount paid (Step 8) from the balances due (Step 6) and repeat the process till the final realisation.
This method is suitable when a partner is insolvent or is likely to be insolvent.

Illustration 1

Sita, Rita and Meeta are partners sharing profit and losses in the ratio of 2:2:1 Their balance sheet as on March 31, 2017 is as follows:

Balance Sheet of Sita, Rita and Meeta as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
General Reserve		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 paid by the firm expenses. For the service

Sita is paid Rs.60.Actual expenses on realisation paid by the firm 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**

Partner's Capital Accounts

Date 2017	Particulars	J.F.	Sita (Rs.)	Rita (Rs.)	Meeta (Rs.)	Date 2017	Particulars	J.F.	Sita (Rs.)	Rita (Rs.)	Meeta (Rs.)
Mar.	Bank		450			Mar.	Balance b/d		5,000	2,000	1,000
31	Realisation (asset)			200		31	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

Bank Account

Date 2017	Particulars	J.F.	Amount (Rs.)	Date 2017	Particulars	J.F.	Amount (Rs.)
Mar.	Balance b/d		2,500	Mar.	Realisation (Creditor)		1,960
31	Realisation			31	Sita's Capital		450
	(assets realised)		10,350		[expenses]		
					Sita's Capital		5,822
					Rita's Capital		3,012
					Meeta's capital		1,606
			12,850				12,850

Illustration 3

Record journal entries at the time of dissolution of a partnership firm of Vibha, Shobha and Anubha in the following cases:

a) Dissolution expenses amounted to Rs. 6,500.

b) Dissolution expenses Rs. 7,800 were paid by Anubha.

c) Vibha was appointed to look after the dissolution process for which she was given a remuneration of Rs. 12,000

d) Shobha was appointed to look after the dissolution work for which she was allowed a remuneration of Rs.15,000. She agreed to bear dissolution expenses. Actual dissolution expenses paid by her amounted to Rs. 11,800.

e) Anubha was to look after the dissolution process for which she was allowed a remuneration of Rs. 12,000 she also agreed to bear dissolution expenses. Actual expenses Rs. 9,500 were paid by the firm.

f) Anubha looked after the dissolution work for remuneration of Rs. 8,500 and agreed to bear dissolution expenses upto Rs. 6,000. Actual expenses paid by her were Rs. 7,600.

g) Vibha was appointed to look after the dissolution work for which she was allowed a remuneration of Rs. 14,000. She agreed to take over investment

h) of the book value of Rs. 13,000 towards payment of her remuneration. Investments have already been transferred to realisation Account.

Book of Vibha, Shobha and Anubha

Date 2017	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
(a)	Realisation A/c Dr. To Cash / Bank A/c (Dissolution expense paid by the firm)		6,500	6,500
(b)	Realisation A/c Dr. To Anubha's Capital A/c (Dissolution Expenses paid by Anubha)		7,800	7,800
(c)	Realisation A/c Dr. To Vibha's Capital A/c (Remuneration given to Vibha)		12,000	12,000
(d)	Realisation A/c Dr. To Shobha's Capital A/c (Remuneration allowed to Shobha forlooking after dissolution work)		15,000	15,000
(e)	(i) Realisation A/c Dr. To Anubha's Capital A/c (Remuneration allowed to Anubha)		12,000	12,000
	(ii) Anubha's Capital A/c Dr.		9,500	

	To Cash /Bank A/c (Dissolution expenses paid by the firmand borne by Annubha)			9,500
(f)	(i) Realisation A/c Dr. To Anubha's Capital A/c (Remuneration payable to Anubha)		8,500	8,500
	(ii) Realisation A/c Dr. To Anubha's Capital A/c (Dissolution expenses paid by Anubhaon behalf of the firm)		1,600	1,600
(g)	No Entry			

llustration 4

Nayana and Arushi were partners sharing profits equally Their Balance Sheet as on March 31, 2020 was as follows:

Balance Sheet of Nayana and Arushi as on March 31, 2017

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 Reserv	e 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 Machineryrealised for Rs.30,000 and Rs.50,000 respectively;
2. There was an unrecorded investment which was sold for Rs. 34,000;
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 thebooks of the firm.

Books of Nayana and ArushiJournal

Date 2017	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 Current 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/cTo Arushi's				5,788
	Current A/c				5,787
	(Realisation profit transferred to partner's current account)				
	Workman Compensation Reserve A/cTo Nayana's Current A/c	Dr.		15,000	7,500
	To Arushi's Current A/c				7,500
	(Compensation fund transfered to partners'Current account)				
	Arushi Current A/c	Dr.		23,287	
	To Arushi's Capital A/c				23,287
	(Current account balance transferred toCapital account)				
	Nayana Capital A/c	Dr.		12,462	
	To Nayana's Current A/c				12,462
	(Current account balance transferred to Capitalaccount)				
	Nayana's Capital A/c	Dr.		87,538	
	Arushi's Capital A/c	Dr.		73,287	
	To Bank A/c				1,60,825
	(Final amounts due to partners paid)				

Realisation Account

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
Debtors	25,000		Creditors		20,000
Stock	35,000		Bank overdraft		5,000
Furniture	40,000		Bank:		
Machinery	60,000	1,60,000	Investment	34,000	
Bank:			Furniture	30,000	
Creditors	20,000		Machinery	50,000	
Bank overdraft	5,000		Debtors (90%)	22,500	
Outstanding bill	2,000	27,000	Stock :	20,125	
Profit transferred to :			Bad debts recovered	1,200	1,57,825
Nayana's capital	5,788		Nayana's capital (stock taken over)		15,750
Arushi's capital	5,787	11,575			
		1,98,575			**1,98,575**

Partners' Current Accounts

Date 2017	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)	Date 2017	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)
	Balance b/d		10,000			Balance b/d			10,000
	Realisation		15,750			Workmen Compensation Reserve		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 Capital Accounts

Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)
Nayana's current account		12,462		Balance b/d		1,00,000	50,000
Bank		87,538	73,287	Arushi's current account			23,287
		1,00,000	**73,287**			**1,00,000**	**73,287**

Bank Account

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**

UNIT V

Amalgamation of Partnership Firms

Meaning of Amalgamation of Partnership Firms :

Amalgamation means to merge or to combine two or more business units carrying on same type of business and form a new business unit. Amalgamation of partnership firms means merger of two or more partnership firms withone another and form a new partnership firm. When two or more existing partnership firms, carrying on same type of business, come together end their separate entity and form a new firm it is called as amalgamation of partnership firms.

Amalgamation may be formed with any one of the following ways :

- Merging of two or more existing sole proprietors into each another and form a newpartnership firm.
- Merging one existing partnership firm with one existing sole proprietor and form a new partnership firm.
- Absorbing one existing partnership firm by another existing partnership firm.
- Merging two or more existing partnership firms with one another and form a newpartnership firm.

Objectives of Amalgmation of Partnership firms :

Amalgamation of partnership firm is done to achive the following objectives :

- To avoid the cut-throat competition.
- To minimize the common expenses of business.
- To get advantage of large scale business.
- To strengthen the capital position.
- To get advantage of expertise of different people, etc.

Accounting Procedure for Amalgamation of Partnership Firms :

Accounting for amalgamation of partnership firms includes closing the books of accountsof amalgamating / old firms and opening the books of accounts of amalgamated / new firm. There are two methods used for closing the books of accounts

1. Revaluation Method, and 2. Realization Method.

In Revaluation Method, a Revaluation or Profit & Loss Adjustment A/c is prepared to record the effect of increase or decrease in the value of assets and liabilities. In Realisation Method, the purchase price is calculated and all assets and outsider liabilities are transferred to Realisation A/c at book values. In this unit the Revaluation Method is followed. As per this method, for closing the books of accounts of old firms journal entries are to be passed taking into consideration the following points :

i) Revaluation of Assets and liabilities.

ii) Creation of Goodwill.

iii) Close Reserves and other Profit Accounts.

iv) Close Loss Account.

v) Close Assets and Liabilities Accounts which are not taken over by the new firm.

vi) Transfer / close Assets and Liabilities Accounts which are taken over by the new firm.

vii) Close Capital Accounts of the partners.

To open the books of accounts of the New Firm the journal entries are to be passed takinginto consideration the following points :

i) Assets of the old firm taken over by the new firm.

ii) Liabilities of the old firm taken over by the new firm.

iii) Capitals of the partners of the old firm taken over by the new firm.

iv) Adjustment of Goodwill.

v) Adjustment of Capitals of the Partners.

1.2 Journal Entries and Ledger Accounts for Amalgamation of Partnership Firms :In the amalgamation of partnership firms closing entries and opening entries are to be passed. The closing entries are to be passed to close the books of accounts of amalgamating / old firms and the opening entries are to be passed to open the books of accounts of amalgamated/ new firm.

Journal Entries in the Books of Old Firms (Closing Entries) :

i) For Revaluation of Assets and Liabilities : Assets and Liabilities of the old firms may be revalued at the time of amalgamation. There may be increase or decrease in the valuesof assets and liabilities which shows profit or loss. To record this profit or loss a Profit & Loss Adjustment A/c or Revaluation A/c is to be opened. The net profit or loss on this account is tobe transferred to Partner's Capital A/c in the old profit sharing ratio. For this purpose following journal entries are to be passed.

a) For increase in the value of asset and decrease in the value of Liability, which shows revalution profit.

Particular Asset / Liability A/c ....Dr.

To Profit & Loss Adjustment A/c / Revaluation A/c

b) For decrease in the value of asset and increase in the value of liability which shows revaluation losss.

Profit & Loss Adjustment A/c / Revaluation A/c.......... Dr.

Particular Asset / Liability A/c

c) For closing the Profit & Loss Adjustment A/c / Revaluation A/c and transferring profit. Profit &

Loss Adjustment A/c / Revaluation A/c. .... Dr.

To Partner's Capital A/cs

(If there is a loss, a reverse entry will be passed)

ii) For Creation of Goodwill : If there is no goodwill account in the books of the old firmand if it is to be created the following entry will be passed,

Goodwill A/c........................ Dr.

To Partner's Capital A/cs

(Goodwill is to be transferred in the old profit sharing ratio)

iii) For closing Reserves and Profit Accounts : The balance on these accounts is to be transferred to Partiner's Capital A/cs in the old profit sharing ratio.

Reserves A/c .... Dr.

Profit & Loss A/c (Cr. Balance) .... Dr.

To Partner's Capital A/cs

iv) For closing Loss Account : The Profit & Loss A/c showing Dr. balance is a loss account It appears on the asset side of the Balance sheet. The balance on this account also transferred to Partner's Capital A/cs in the old profit sharing ratio.

Partner's Capital A/cs ....Dr.

To Profit & Loss A/cs

v) For closing Assets and Liabilities A/cs which are not taken over by the NewFirm : Those assets and Liabilities which are not taken over by the new firm will be either sold

away / paid off by the old firm or transferred to Partner / Partner's Capital A/cs in the capital ratio. The profit or loss on such transaction will be transferred to P & L Adjustment A/c or directly to Partner's Capital A/cs in the old profit sharing ratio. For this purpose following journal entries are to be passed.

a) If an asset is sold away for cash

Cash / Bank A/c .... Dr.

To Particular Asset A/c

b) If an asset is taken over by the partner / partnersPartner/s

Capital A/c .... Dr.

To Particular Asset A/c

c) If a liability is paid off

Particular Liability A/c .... Dr.

To Cash / Bank A/c

d) If a liability is taken over by the partner/ partnersParticular

Liability A/c .... Dr.

To Partner/s Capital A/c

vi) For closing Assets and Liabilities which are taken over by the New Firm : The accounts of assets and liabilities which are taken over by the new firm will be closed by transferring them to the New Firm A/c at agreed values.

a) For closing Assets

New Firm A/c...................Dr

To Assets A/c

b) For closing Liabilities

Liabilities A/c ....Dr

To New Firm A/c

vii) For closing Partner's Caital A/cs : Partner's Capital A/cs of the old firm are to be closed with the net balance by transferring them to the New Firm A/c

Partner's Capital A/c .... Dr

To New Firm A/c

Ledger Accounts if the Books of the Old Firms :

Form the above journal entries the follwing important ledger accounts will be prepared inthe books of old firms.

i) Profit & Loss Adjustment A/c / Revaluation A/c

ii) Partner's Caital A/cs

iii) New Firm A/c

iv) Good will A/c

v) Partner's Current A/c, etc.

Journal Entries in the Books of the New Firm (Opening Entries) :

i) For Assets, Liabilities and Capitals of the Partners of the old firm taken overby the New Firm :

Assets A/c .... Dr. (at agreed values)To Labilities

A/c (at agreed values)

To Partner's Capital A/cs (at transferred balance)

ii) For Adjustment of Goodwill : The good will transferred from the old firm to the newfirm may be maintained as it is or may be written off or may be reduced by the New Firm. If the goodwill is written off or reduced the entry will be as follows :

All Partner's Capital A/cs .... Dr.

To Goodwill A/c

(All partner's capital A/c are debited in the new profit sharing ratio)

iii) For Adjustment of Capitals : If the capitals of the partners in the nw firm are changed as per the new profit sharing ratio or as per the agreement, there is a need to pass journal entries for the adjustment of capitals. The adjustments of capital may be made in cashor through current A/cs.

a) For cash brought in or through current A/c for adjustment of shortage of capitalCash / Bank

A/c .... Dr.

Particular Partner Current A/c. ....Dr.

To Particular Partner Capital A/c

b) For cash paid or through current a/c for adjustment of excess capitalParticular

Partner Capital A/c. ....Dr.

To Cash / Bank A/c

To Particular Partner Current A/c

Ledger Accounts in the Books of New Firm : From the above journal entries the Opening Balance Sheet of the new firm is to be prepared. Also, the Partner's Capital A/s, Cash/Bank A/c may be prepared.

Illustrations :

Illustration 1 : The following were the Balance Sheets of two firms M/s P and Q and M/s R and S.

Balance Sheets as at 31/03/2012

Liabilities	P & Q Rs.	R & S Rs.	Assets	P & Q Rs.	R & S Rs.
Sundry Creditors	20000	25000	Cash at Bank	5600	6700
Mrs. P's Loan	5000	-	Stock	20400	18300
Capitals - P	40000	-	Debtors	15000	20000
Q	20000	-	Furniture	4000	5000
R	-	24000	Premises	40000	-
S	-	16000	Investment	-	15000
	85000	65000		85000	65000

The two firms decided to amalgamate their business as from 1st January, 2013 under the name Bharat Traders. For this purpose, it was agreed that Mrs. P's Loan should be repaid andthe Investment of M/s. R & S be not taken over by the new firm.

Goodwill of P & Q was fixed at Rs. 8000 and that of R & S at Rs. 10000. Premises wererevalued at Rs. 50000, but the stock of P & Q was found overvalued by Rs. 4000. The stock ofR & S was undervalued by Rs. 2000. A reserve for bad debts was created at 5% of both firms.

The total capital of Bharat Traders was to be 80000 and it was shared by the P, Q, R & Sin their new profit sharing ratio which was 3 : 2 : 3 : 2 respectively.

Pass necessary journal entries to close the books of M/s P & Q and M/s R & S also passopening entries in the books of Bharat Traders. Prepare necessary accounts in the books of all the firms.

Solution :

Journal Entries in the Books of M/s P & Q (old Firm)(Closing Entries)

Date	Particulars	L.F. No.	Dr. Rs.	Cr. Rs.
1-1-2013	Premises A/c Dr.		10000	-
	To Profit & Loss Adjustment A/c		-	10000

	or		
	To Revaluation A/c		
	(Being increase in value of premises)		
	Profit & Loss Adjustment A/c Dr.	4750	
	or		
	Revaluation A/c Dr.		
	To Stock A/c		4000
	To Provision for Bad Debts A/c		750
	(Being decrease in value of stock & debtors)		
	Goodwill A/c Dr.	8000	
	To P's Capital A/c		4000
	To Q's Capital A/c		4000
	(Being creation of goodwill)		
	Mrs. P's Loan A/c Dr.	5000	
	To Bank A/c		5000
	(Being Mrs. P's Loan A/c paid)		
	Profit & Loss Adjustment A/c Dr.	5250	
	or		
	Revaluation A/c Dr.		
	To P's Capital A/c		2625
	To Q's Capital A/c		2625
	(Being revaluation profit transferred)		
	Bharat Traders A/c Dr.	94000	
	To Cash at bank A/c		600
	To stock A/c To		16400 15000

	Debtors A/c		4000
	To Furniture A/c		50000
	To Premises A/c		8000
	To Goodwill A/c		
	(Being assets transferred to new firm)	20000	
	Sundry Creditors A/c Dr.	750	
	Provision for Bad Debts A/c Dr.		20750
	To Bharat Traders A/c		
	(Being Liabilities transferred to new firm)	46625	
	P's Capital A/c Dr.	26625	
	Q's Capital A/c Dr.		73250
	To Bharat Traders A/c		
	(Being partners capital a/cs closed)		

Ledger Accounts in the Books of M/s P & Q (old firm)

(Closing Accounts)

Profit & Loss Adjustment A/cor

Dr. Revaluation A/c Cr.

Date	Particulars	J.F. No.	Rs.	Date	Particulars	J.F. No.	Rs.
	To Stock A/c		4000		By Premises A/c		10,000
	To Provision for Bad Debts A/c		750				
	To P's Capital A/c		2625				
	To Q's Capital A/c		2625				
			10,000				10,000

Dr. Partner's Capital A/c Cr.

Particulars	P Rs.	Q Rs.	Particulars	P Rs.	Q Rs.
To Bharat Traders A/c	46625	26625	By Balance b/d By P & L Adjustment A/c By Goodwill A/c	40000 2625 4000	20000 2625 4000
	46625	26625		46625	26625

Bharat Traders A/c (New Firm) Cr.

Particulars	Rs.	Particulars	Rs.
To Cash at Bank A/c	600	By Sundry Creditors A/c	20000
To stock A/c	16400	By Provision for Bad Debts A/c	750
To Debtors A/c	15000	By P's Capital A/c 46625	
To Furniture A/c	4000	By Q's Capital A/c 26625	73250
To Premises A/c	50000		
To Goodwill A/c	8000		
	94000		94000

Dr. Cash at Bank A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bid	5600	By Mrs P's Loan A/c	5000
		By Bharat Traders A/c	600
	5600		5600

Dr. Mrs P's Loan A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Cash at Bank A/c	5000	By Balance bld	5000
	5000		5000

Dr. Goodwill A/c Cr.

Particulars	Rs.	Particulars	Rs.
To P's Capital A/c To Q's Capital A/c	4000 4000	By Bharat Traders A/c	8000
	8000		8000

Journal Entries in the Books of M/s R & S (old firm)(Closing Entries)

Date	Particulars	L.F. No.	Dr. Rs.	Cr. Rs.
	Stock A/c Dr.		2000	
	To Profit & Loss Adjustment A/c			2000
	(Being increase in value of stock)			
	Profit & Loss Adjustmennt A/c Dr.		1000	
	To Provision for Bad Debts A/c			1000
	(Being decrease in value of debtors)			
	Profit & Loss Adjustment A/c Dr.		1000	
	To R's Capital A/c			500
	To S's Capital A/c			500

	(Being profit transferred)		
	Goodwill A/c Dr.	10000	
	To R's Capital A/c		5000
	To S's Capital A/c		5000
	(Being goodwill created)		
	Bank A/c Dr.	15000	
	To Investment A/c		15000
	(Being investment sold)		
	Bharat Traders A/c Dr.	77000	
	To Cash at Bank A/c		21700
	To Stock A/c		20300
	To Debtors A/c		20000
	To Furniture A/c		5000
	To Goodwill A/c		10000
	(Being assets transferred)		
	Sundry Creditors A/c Dr.	25000	
	Provision for Bad Debts A/c Dr.	1000	
	To Bharat Traders A/c		26000
	(Being Liabilities transferred)		
	R's Capital A/c Dr.	29500	
	S's Capital A/c Dr.	21500	
	To Bharat Traders A/c		51000
	(Being Partners Capital A/cs closed)		

Ledger Accounts in the Books of M/s R & S (old firm)

(Closing Accounts)

Dr. Profit & Loss Adjustment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Provision for Bad Debts A/c To R's Capital A/c To S's Capital A/c	1000 500 500	By Stock A/c	2000
	2000		2000

Dr. Partner's Capital A/c Cr.

Particulars	R Rs.	S Rs.	Particulars	R Rs.	S Rs.
To Bharat Traders A/c	29500	21500	By Balance bld	24000	16000
			By Profit & Loss Adjustment A/c	500	500
			By Goodwill A/c	5000	5000
	29500	21500		29500	21500

Dr. Bharat Traders A/c (New Firm) Cr.

Particulars	Rs.	Particulars	Rs.
To Cash at Bank A/c	21700	By Sundry Creditors A/c	25000
To Stock A/c	20300	By Provision for Bad Debts A/c	1000
To Debtors A/c	20000	By R's Capital A/c 29500	
To Furniture A/c	5000	By S's Capital A/c 21500	51000
To Goodwill A/c	10000		
	77000		77000

Dr. Cash at Bank A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bld To Investment A/c	6700 15000	By Bharat Traders A/c	21700
	21700		21700

Dr. Investment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bld	15000	By Bank A/c	15000
	15000		15000

Dr. Goodwill A/c Cr.

Particulars	Rs.	Particulars	Rs.
To R's Capital A/c To S's Capital A/c	5000 5000	By Bharat Traders A/c	10000
	10000		10000

Note : Investment of M/s R & S is not taken over by the new firm. It is treated as soldby the old firm at book value.

Journal Entries in the Books of Bharat Traders (New Firm)(Opening Entries)

Date	Particulars		L.F. No.	Dr. Rs.	Cr. Rs.
	Cash at Bank A/c	Dr.		600	
	Stock A/c	Dr.		16400	
	Debtors A/c	Dr.		15000	
	Furniture A/c	Dr.		4000	
	Premises A/c	Dr.		50000	
	Goodwill A/c	Dr.		8000	
	To Sundry Creditors A/c				20000
	To Provision for Bad Debts A/c				750
	To P's Capital A/c				46625
	To Q's Capital A/c				26625
	(Being assets, Liabilities & Partners Capitals of M/s P & Q taken over)				
	Cash at Bank A/c	Dr.		21700	
	Stock A/c	Dr.		20300	
	Debtors A/c	Dr.		20000	
	Furniture A/c	Dr.		5000	
	Goodwill A/c	Dr.		10000	
	To Sundry Creditors A/c				25000
	To Provision for Bad Debts A/c				1000
					29500

	To R's Capital A/c To S's Capital A/c		21500
	(Being assets, Liabilities & partners capitals of M/s R & S taken over)		
	P's Capital A/c Dr.	22625	
	Q's Capital A/c Dr.	10625	
	R's Capital A/c Dr.	5500	
	S's Capital A/c Dr.	5500	
	To cash at Bank A/c		44250
	(Being extra capital amount paid in cash)		

Note : The total capital of Bharat Traders (New Firm) is fixed at Rs. 80000 and shared by all partners in the ratio 3 : 2 : 3 : 2 . It is treated as the extra capital is paid in cash.

Ledger Posting in the Books of Bharat Traders (New Firm)

Balance Sheet of Bharat Tradersas on 1st

January, 2013 (Opening Balance Sheet)

Liabilites	Rs.	Assets	Rs.
Capital A/cs		Stock A/c	36700
P	24000	Debtors A/c 35000	
		Less - Provision for Bad Debts 1750	33250
Q	16000	Furniture A/c	9000
R	24000	Premises A/c	50000
S	16000	Goodwill A/c	18000
Sundry Creditors A/c	45000		
Bank Loan A/c	21950		
(44250 - 600 + 21700)			
	146950		146950

Dr.

Partner's Capital A/c Cr.

Particulars	P Rs.	Q Rs.	R Rs.	S Rs.	Particulars	P Rs.	Q Rs.	R Rs.	S Rs.
To Cash at Bank A/c (Bank Loan)	22625	10625	5500	5500	By M/s P & Q	46625	26625	-	-
					By M/s R & S	-	-	29500	21500
To Balance cld (New Capital)	24000	16000	24000	16000					
	44625	26625	29500	21500		46625	26625	29500	21500
					By Balance bld	24000	16000	24000	16000

Illustration 2 : The Balance Sheets of M/s A & B and M/s C & D as on 31st December,2012 were as follows :

Liabilities	A & B Rs.	C & D Rs.	Assets	A & B Rs.	C & D Rs.
Capital A/cs			Land & Building	10000	12000
A	10000	-	Machinery	7000	8000
B	10000	-	Furniture	3000	3500
C	-	10000	Debtors	6000	8500
D	-	10000	Stock	8000	10000
Creditors	15000	10000	Cash & Bank	3000	1000
Loan	-	10000			
Outstanding Expenses	2000	3000			
	37000	43000		37000	43000

The two firms decided to amalgmate and form into A B & Co. with effect from 1st January, 2013. Partners would share profit and losses equally between themselves as they were doing prior to amalgamation and they agreed to following revaluation of assets and Liabilities.

Particulars	A & B Rs.	C & D Rs.
Land & Building	10000	10000
Machindry	7000	8000
Furniture	2500	2500
Debtors	5500	7000
Stock	8000	8000
Outstanding Expenses	2000	3500

In addition to above it was decided :

a) That the new firm would not take over the loan of C and D.

b) That the goodwill of A and B and C and D were valued at Rs. 10000 and Rs. 5000 respectively in the first instant but for the purpose of the Balance Sheet of the new firm, the combined goodwill would be valued at Rs. 12000, and

C) The reconstructed capitals of partners should be Rs. 14000 each, partners introducing cash if necessary.

You are required to prepare : Journal entries in the books of A & B

i) Profit & Loss Adjustment A/c, Partners Capital A/c and A B & Co. A/c in the books of C & D.

ii) Journal entries and Opening Balance Sheet in the books of A B & Co.

Solution :

Journal Entries in the Books of A & B (Old Firm)(Closing Entries)

	Particulars		Debit Rs.	Credit Rs.
1.	Profit & Loss Adjustment A/c	Dr.	1000	
	To Furniture A/c			500
	To Debtors A/c			500
	(Being decrease in value of assets)			
2.	A's Capital A/c	Dr.	500	
	B's Capital A/c	Dr.	500	
	To Profit & Loss Adjustment A/c			1000
	(Being loss transferred)			
3.	Goodwill A/c	Dr.	10000	
	To A's Capital A/c			5000
	To B's Capital A/c			5000
	(Being goodwill created)			
4.	A B & Co. A/c	Dr.	46000	
	To Land & Building A/c			1000
	To Machinery A/c			7000
	To Furniture A/c			2500
	To Debtors A/c			5500
	To Stock A/c			8000
	To Cash & Bank A/c			3000
	To Goodwill A/c			10000
	(Being assets transferred)			
5.	Creditors A/c	Dr.	15000	

	Outstanding Expenses A/c Dr.		2000	
	To A B & Co. A/c			17000
	(Being Liabilities transferred)			
6.	A's Capital A/c	Dr.	14500	
	B's Capital A/c	Dr.	14500	
	To A B & Co. A/c			29000
	(Being Partner's Capital A/cs closed)			

Ledger Accounts in the Books of C & D (Old Firm)(Closing Accounts)

Dr. Profit & Loss Adjustment A/c Cr.

Particulars	Rs.	Particulars	Rs.	Rs.
To Land & Building A/c To Furniture A/c To Debtors A/c To Stock A/c To Outstanding Expenses A/c	2000 1000 1500 2000 500	By C's Capital A/c By D's Capital A/c	3500 3500	 7000
	7000			7000

Dr. Partner's Capital A/c Cr.

Particulars	C Rs.	D Rs.	Particulars	C Rs.	D Rs.
To Profit & Loss Adju-stment A/c	3500	3500	By Balance bld	10000	10000
			By Goodwill A/c	2500	2500
			By Loan A/c	5000	5000
To A B & A/c	14000	14000			
	17500	17500		17500	17500

Dr.	A B & Co. A/c (New Firm)		Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
To Land & Building A/c	10000	By Creditors A/c	10000
To Machinery A/c	8000	By Outstanding Expenses A/c	3500
To Furniture A/c	2500	By C's Capital A/c	14000
To Debtors A/c	7000	By D's Capital A/c	14000
To Stock A/c	8000		
To Cash & Bank A/c	1000		
To Goodwill A/c	5000		
	41500		41500

Note : Loan of the C & D is not taken over by the new firm. It is treated as taken over bypartners in the old firm.

Journal Entries in the Books of A B & Co. (New Firm)(Opening Entries)

	Particulars		Debit Rs.	Credit Rs.
1.	Land & Building A/c	Dr.	10000	
	Machinery A/c	Dr.	7000	
	Furniture A/c	Dr.	2500	
	Debtors A/c	Dr.	5500	
	Stock A/c	Dr.	8000	
	Cash & Bank A/c	Dr.	3000	
	Goodwill A/c	Dr.	10000	
	To Creditors A/c			15000
	To Outstanding Expenses A/c			2000
	To A's Capital A/c			14500
	To B's Capital A/c			14500
	(Being assets, liabilities and Capitals taken over)			
2.	Land & Building A/c	Dr.	10000	
	Machinery A/c	Dr.	8000	
	Furniture A/c	Dr.	2500	

	Debtors A/c	Dr.	7000	
	Stock A/c	Dr.	8000	
	Cash & Bank A/c	Dr.	1000	
	Goodwill A/c	Dr.	5000	
	To Creditors A/c			10000
	To Outstanding Expenses A/c			3500
	To C's Capital A/c			14000
	To D's Capital A/c			14000
	(Being assets, liabilities & Capitals tavenover)			
3.	A's Capital A/c	Dr.	750	
	B's Capital A/c	Dr.	750	
	C's Capital A/c	Dr.	750	
	D's Capital A/c	Dr.	750	
	To Goodwill A/c			3000
	(Being goodwill reduced)			
4.	Cash & Bank A/c	Dr.	2000	
	To A's Capital A/c			250
	To B's Capital A/c			250
	To C's Capital A/c			750
	To D's Capital A/c			750
	(Being Cash brought in by partners)			

Dr. Balance Sheet of AB & Co. Cr.

Liabilities	Rs.	Assets	Rs.
Capitals - A	14000	Land & Building	20000
B	14000	Machinery	15000
C	14000	Furniture	5000
D	14000	Debtors	12500
Creditors	25000	Stock	16000
Outstanding Expenses	5500	Cash & Bank	6000
		Goodwill	12000

	86500		86500

Illustration 3 : Ajay and Vijay were in partnership sharing profits & loses in the ratio 3 : 2. They agreed to amalgamate their business with that of Sanjay and form a new firm on March31, 2011. As on that date their Balance Sheets were as follows :

Liabilities	Ajay & Vijay Rs.	Sanjay Rs.	Assets	Ajay & Vijay Rs.	Sanjay Rs.
Capitals - Ajay	100000	-	Freehold Premises	80000	-
Vijay	80000	-	Furniture	24000	15000
Sanjay	-	60000	Investments	-	30000
Current A/cs			Stock	60000	45000
Ajay	34000	-	Debtors 24000		
Vijay	28000	-	Provision 2000	22000	18000
Sanjay	-	8000	Bank	82000	-
Loan from Mahesh	-	20000			
Creditors	26000	16000			
Bank Overdraft	-	4000			
	268000	108000		268000	108000

The two firms were amalgamated on the following terms :

i) Profits & losses were to be shared : Ajay 2/5, Vijay 2/5 & Sanjay 1/5.

ii) An account for goodwill is to be maintained in the books of new firm, agreed values of goodwill of each firm being : Ajay & Vijay Rs. 120000 and Sanjay Rs. 40000.

iii) Assets of Ajay & Vijay were valued as Freehold Premises Rs. 110000, FurnitureRs.21000, Stock Rs. 69000, Debtors Rs. 23200.

iv) Investment of Sanjay was sold by him for Rs. 46000 and out of this sum he dischargedthe loan to Mahesh and bank overdraft, the balance being taken over by the new firm.

You are required to prepare important accounts in the books of Ajay & Vijay and also inthe books of Sanjay and prepare Balance Sheet in the books of New Firm assuming that capitalof new firm was to be Rs. 400000 countribted in their new ratio and any difference being adjusted through their current accounts.

Solution : Ledger Accounts in the Books of Ajay & Vijay.

Dr. Profit & Loss Adjustment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Furniture	3000	By Freehold Bemises A/c	30000
To Ajay's Capital A/c 22320		By Stock A/c	9000
To Vijay's Capital A/c 14880		By Debtors A/c	1200

	37,200		
	40,200		40,200

Dr. Partner's Current A/c Cr.

Particulars	Ajay Rs.	Vijay Rs.	Particulars	Ajay Rs.	Vijay Rs.
To Partner's Capital A/c	128320	90880	By Balance bld By P & L Adjustment A/c By Goodwill A/c	34000 22320 72000	28000 14880 48000
	128320	90880		128320	90880

Dr. New Firm A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Freehold Premises A/c To Furniture A/c To Stock A/c To Debtors A/c To Bank A/c To Goodwill A/c	110000 21000 69000 23200 82000 120000	By Creditors A/c By Ajay's Capital A/c By Vijay's Capital A/c	26000 228320 170880
	425200		425200

Dr. Partner's Capital A/c Cr.

Particulars	Ajay Rs.	Vijay Rs.	Particulars	Ajay Rs.	Vijay Rs.
To New Firm A/c	228320	170880	By Balance bld By Partner's Current A/c	100000 128320	80000 90880
	228320	170880		228320	170880

Ledger Accounts in the Books of Sanjay

Dr. Profit & Loss Adjustment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Sanjay's Current A/c	16000	By Investment A/c	16000
	16000		16000

Dr. Sanjay's Capital A/c Cr.

Particulars	Rs.	Particulars	Rs.
To New Firm A/c	124000	By Balance bld	60000
		By Sanjay's Current A/c	64000
	124000		124000

Dr. Sanjay's Current A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Sanjay's Capital A/c	64000	By Balance bld	8000
		By P & L Adjustment A/c	16000
		By Goodwill A/c	40000
	64000		64000

Dr. New Firm A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Furniture A/c	15000	By Creditors A/c	16000
To Stock A/c	45000	By Sanjay's Capital A/c	124000
To Debtors A/c	18000		
To Bank A/c	22000		
To Goodwill A/c	40000		
	140000		140000

Dr. Bank A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Investment A/c	46000	By Loan From Mahesh A/c By Bank Overdraft A/c By New Firm A/c	20000 4000 22000
	46000		46000

Dr. Investment A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bld To P & L Adjustment A/c	30000 16000	By Bank A/c	46000
	46000		46000

In the Books of New FirmBalance
Sheet

Liabilities	Rs.	Assets	Rs.
Capital A/cs		Freehold Premises	1,10,000
Ajay	160000	Furniture	36000
Vijay	160000	Stock	114000
Sanjay	80000	Debtors	41200
Current A/cs		Bank	104000
Ajay	68320	Goodwill	160000
Vijay	10880		
Sanjay	44000		
Creditors	42000		
	565200		565200

Illustration 4 : Two firms P & Q and R & S agreed to amalgamate their businesses. Their positions as on 31st December 2012 were as follows :

Liabilities	P & Q Rs.	R & S Rs.	Assets	P & Q Rs.	R & S Rs.
Creditors	104000	52000	Bank	156000	65000
General Reserve	62000	6000	Debtors	130000	104000
Capitals			stock	42000	26000
P / R	150000	90000	Office Building	78000	-
Q / S	100000	60000	Furniture	10000	13000
	416000	208000		416000	208000

Creditors and Debtors of both the firms were not taken over by the new firm P Q R S. Office Building was taken over by P & Q. Goodwill created Rs. 40000 and Rs. 20000 respectivelyof P & Q and R & S.

Prepare necessary accounts to close the books of P & Q and R & S and open Balance Sheet in the books of P Q R S.

Solution : In the Books of P & Q.

Dr. Partner's Capital A/c Cr.

Particulars	P Rs.	Q Rs.	Particulars	P Rs.	Q Rs.
To Office Building A/c	46800	31200	By Balance bld	150000	100000
To PQRS A/c	154200	119800	By General Reserve	31000	31000
(New Firm)			By Goodwill A/c	20000	20000
	201000	151000		201000	151000

Dr. P Q R S A/c (New Firm) Cr.

Particulars	Rs.	Particulars	Rs.
To Stock A/c	42000	By P's Capital A/c	154200
To Furniture A/c	10000	By Q's Capital A/c	119800
To Goodwill A/c	40000		
To Bank A/c	182000		
	274000		274000

Dr. Bank A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bld To Debtors A/c	156000 130000	By Creditors A/c By PQRS A/c	104000 182000
	286000		286000

Notes :

1. There is no need to prepare P & L Adjustment A/c because no change in the values ofassets & liabilities.

2. Office Building is taken over by P & Q. It is in the capital ratio.

3. Creditors and Debtors are not taken over by the new firm. It is treated that thesetransactions are made in cash.

In the Books of R & S

Dr. Partner's Capital A/c Cr.

Particulars	P Rs.	Q Rs.	Particulars	P Rs.	Q Rs.
To P Q R S A/c (New Firm)	103000	73000	By Balance bld By General Reserve bld By Goodwill A/c	90000 3000 10000	60000 3000 10000
	103000	73000		103000	73000

Dr. Bank A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Balance bld To Debtors A/c	65000 104000	By Creditors A/c By PQRS A/c	52000 117000
	169000		169000

Dr. P Q R S A/c (New Firm) Cr.

Particulars	Rs.	Particulars	Rs.
To Stock A/c To Furniture A/c To Goodwill A/c	26000 13000 20000	By R's Capital A/c By S's Capital A/c	103000 73000

To Bank A/c	117000		
	176000		176000

In the Books of P Q R S (New Firm)Balance Sheet

Liabilities	Rs.	Assets	Rs.
Capital A/cs		Stock	68000
P	154200	Furniture	23000
Q	119800	Bank	299000
R	103000	Goodwill	60000
S	73000		
	450000		450000