Reconstitution of a Partnership Firm – Retirement/Death of a Partner

4

Learning Objectives

After studying this chapter you will be able to:

- *calculate new profit sharing ratio and gaining ratio of the remaining partners after the retirement/death of a partner;*
- *describe the accounting treatment of goodwill in the event of retirement/ death of a partner;*
- *make the necessary entries in respect of unrecorded assets and liabilities;*
- *make necessary adjustment for accumulated profits or losses;*
- *ascertain the retiring/ deceased partner claim against the firm and explain the mode of its settlement;*
- *prepare the retiring partner's loan account, if required; and*
- *prepare the deceased partner's executor's account in the case of death of a partner and the balance sheet of a reconstituted firm.*

You have learnt that retirement or death of a partner also leads to reconstitution of a partnership firm. On the retirement or death of a partner, the existing partnership deed comes to an end, and in its place, a new partnership deed needs to be framed whereby, the remaining partners continue to do their business on changed terms and conditions. There is not much difference in the accounting treatment at the time of retirement or in the event of death. In both the cases, we are required to determine the sum due to the retiring partner (in case of retirement) and to the legal representatives (in case of deceased partner) after making necessary adjustments in respect of goodwill, revaluation of a assets and liabilities and transfer of accumulated profits and losses. In addition, we may also have to compute the new profit sharing's ratio among the remaining partners and so also their gaining ratio, This covers all these aspects in detail.

4.1 Ascertaining the Amount Due to Retiring/ Deceased Partner

The sum due to the retiring partner (in case of retirement) and to the legal representatives/ executors (in case of death) includes:

(i) credit balance of his capital account;
(ii) credit balance of his current account (if any);
(iii) his share of goodwill;
(iv) his share of accumulated profits (reserves);
(v) his share in the gain of revaluation of assets and liabilities;

(vi) his share of profits up to the date of retirement/death;
(vii) interest on his capital, if involved, up to the date of retirement/death; and
(viii) salary/commission, if any, due to him up to the date of retirement/death.

The following deductions, if any, may have to be made from his share:

(i) debit balance of his current account (if any);
(ii) his share of goodwill to be written off, if necessary;
(iii) his share of accumulated losses;
(iv) his share of loss on revaluation of assets and liabilities;
(v) his share of loss up to the date of retirement/death;
(vi) his drawings up to the date of retirement/death;
(vii) interest on drawings, if involved, up to the date of retirement/death.

Thus, as in the case of admission, the various accounting aspects involved on retirement or death of a partner are as follows:

1. Ascertainment of new profit sharing ratio and gaining ratio;
2. Treatment of goodwill;
3. Revaluation of assets and liabilities;
4. Adjustment in respect of unrecorded assets and liabilities;
5. Distribution of accumulated profits and losses;
6. Ascertainment of share of profit or loss up to the date of retirement/death;
7. Adjustment of capital, if required;
8. Settlement of the amounts due to retired/deceased partner;

4.2 New Profit Sharing Ratio

New profit sharing ratio is the ratio in which the remaining partners will share future profits after the retirement or death of any partner. The new share of each of the remaining partner will consist of his own share in the firm plus the share acquired from the retiring /deceased partner.

Consider the following situations :

(a) normally, the continuing partners acquire the share of retiring or deceased partners in the old profit sharing ratio, and there is no need to compute the new profit sharing ratio among them, as it will be same as the old profit sharing ratio among them. In fact, in the absence of any information regarding profit sharing ratio in which the remaining partners acquire the share of retiring/deceased partner, it is assumed that they will acquire it in the old profit sharing ratio and so share the future profits in their old ratio. For example, Asha, Deepti and Nisha are partners in a firm sharing profits and losses in the ratio of 3:2:1. If Deepti retires, the new profit sharing ratio between Asha and Nisha will be 3:1, unless they decide otherwise.

(b) The continuing partners may acquire the share in the profits of the retiring/deceased partner in a proportion other than their old ratio, In that case, there is need to compute the new profit sharing ratio among them.

For example: Naveen, Suresh and Tarun are partners sharing profits and losses in the ratio of 5:3:2. Suresh retires from the firm and his share was required by Naveen and Tarun in the ratio 2:1. In such a case, the new share of profit will be calculated as follows:

New share of Continuing Partner = Old Share + Acquired share from the Outgoing Partner

Gaining Ratio 2 : 1

Share acquired by Naveen $= \frac{2}{3} \text{ of } \frac{3}{10}$

$= \frac{2}{3} \times \frac{3}{10} = \frac{2}{10}$

Share acquired by Tarun $= \frac{1}{3} \text{ of } \frac{3}{10}$

$= \frac{1}{3} \times \frac{3}{10} = \frac{1}{10}$

Share of Naveen $= \frac{5}{10} + \frac{2}{10} = \frac{7}{10}$

Share of Tarun $= \frac{2}{10} + \frac{1}{10} = \frac{3}{10}$

Thus, the new profit sharing ratio of Naveen and Tarun will be = 7 : 3.

(c) The contributing partners may agree on a specified new profit sharing ratio: In that case the ratio so specified will be the new profit sharing ratio.

4.3 Gaining Ratio

The ratio in which the continuing partners have acquired the share from the retiring/deceased partner is called the gaining ratio. Normally, the continuing partners acquire the share of retiring/deceased partner in their old profit sharing ratio, In that case, the gaining ratio of the remaining partners will be the same as their old profit sharing ratio among them and there is no need to compute the gaining ratio, Alternatively, proportion in which they acquire the share of the retiring/deceased partner may be duly spacified. In that case, again, there is no need to calculate the gaining ratio as it will be the ratio in which they have acquired the share of profit from the retiring deceased partner. The problem of calculating gaining ratio arises primarily when the new profit sharing ratio of the continuing partners is specified. In such a situation, the gaining ratio should be calculated by, deducting the old share of each continuing partners from his new share. For example, Amit, Dinesh and Gagan are partners sharing profits in the ratio of 5:3:2.

Dinesh retires. Amit and Gagan decide to share the profits of the new firm in the ratio of 3:2. The gaining ratio will be calculated as follows :

Amit's Gaining Share $= \frac{3}{5} - \frac{5}{10} = \frac{6-5}{10} = \frac{1}{10}$

Gagan's Gaining Share $= \frac{2}{5} - \frac{2}{10} = \frac{4-2}{10} = \frac{2}{10}$

Thus, Gaining Ratio of Amit and Gagan = 1:2

This implies Amit gains $\frac{1}{3}$ and Gagan gains $\frac{2}{3}$ of Dinesh's share of profit.

Gaining share of Continuing Partner = New share – Old share

Do it Yourself

Distinguish between Gaining Ratio and Sacrificing Ratio in terms of:

1. Meaning
2. Effect on Partner's Share of Profit
3. Mode of calculation
4. When to calculate

Illustration 1

Madhu, Neha and Tina are partners sharing profits in the ratio of 5:3:2. Calculate new profit sharing ratio and gaining ratio if

1. Madhu retires
2. Neha retires
3. Tina retires.

Solution

Given old ratio among Madhu : Neha : Tina as 5 : 3 : 2

1. If Madhu retires, new profit sharing Ratio between Neha and Tina will be
   Neha : Tina = 3:2 and Gaining Ratio of Neha and Tina =3:2
2. If Neha retires new profit sharing Ratio between Madhu and Tina will be
   Madhu : Tina = 5:2
   Gaining Ratio of Madhu and Tina = 5:2
3. If Tina retires, new profit sharing ratio between Madhu and Neha will be:
   Madhu : Neha = 5:3
   Gaining ratio of Madhu and Neha = 5:3

Illustration 2

Alka, Harpreet and Shreya are partners sharing profits in the ratio of 3:2:1. Alka retires and her share is taken up by Harpreet and Shreya in the ratio of 3:2. Calculate the new profit sharing ratio.

Solution

Gaining Given, Ratio of Harpreet and Shreya = 3:2 = $\frac{3}{5}:\frac{2}{5}$

Old Profit Sharing Ratio of between Alka, Harpreet and Shreya 3:2:1 = $\frac{3}{6}:\frac{2}{6}:\frac{1}{6}$

Share acquired by Harpreet = $\frac{3}{5}$ of $\frac{3}{6}$ = $\frac{9}{30}$

Share acquired by Shreya = $\frac{2}{5}$ of $\frac{3}{6}$ = $\frac{6}{30}$

New Share = Old Share + Acquired Share

Harpreet's New Share = $\frac{2}{6}+\frac{9}{30}=\frac{19}{30}$

Shreya's New Share = $\frac{1}{6}+\frac{6}{30}=\frac{11}{30}$

New Profit Sharing Ratio of Harpreet and Shreya = 19:11

Illustration 3

Murli, Naveen and Omprakash are partners sharing profits in the ratio of $\frac{3}{8}$, $\frac{1}{2}$ and $\frac{1}{8}$. Murli retires and surrenders 2/3rd of his share in favour of Naveen and the remaining share in favour of Omprakash. Calculate new profit sharing and the gaining ratio of the remaining partners.

Solution

			Naveen	*Omprakash*
(i)	Old Share		$\frac{1}{2}$	$\frac{1}{8}$
(ii)	Share Acquired by Naveen and Omprakash from Murli	=	$\frac{2}{3}$ of $\frac{3}{8}=\frac{2}{8}$	$\frac{1}{3}$ of $\frac{3}{8}=\frac{1}{8}$
(iii)	New Share = (i) + (ii)	=	$\frac{1}{2}+\frac{2}{8}$	$\frac{1}{8}+\frac{1}{8}$
		=	$\frac{6}{8}$ or $\frac{3}{4}$	= $\frac{2}{8}$ or $\frac{1}{4}$

Thus, the New profit sharing Ratio = $\frac{3}{4}:\frac{1}{4}$ or 3:1, and the

Gaining Ratio = $\frac{2}{8} : \frac{1}{8}$ or 2:1 [as calculated in (ii)].

Illustration 4

Kumar, Lakshya, Manoj and Naresh are partners sharing profits in the ratio of 3 : 2 : 1 : 4. Kumar retires and his share is acquired by Lakshya and Manoj in the ratio of 3:2. Calculate new profit sharing ratio and gaining ratio of the remaining partners.

Solution

		Lakshya	*Manoj*	*Naresh*
(i)	Old Share	$\frac{2}{10}$	$\frac{1}{10}$	$\frac{4}{10}$
(ii)	Acquired Share from Kumar	$\frac{3}{5}$ of $\frac{3}{10}$	$\frac{2}{5}$ of $\frac{3}{10}$	Nil
		$= \frac{9}{50}$	$= \frac{6}{50}$	Nil
(iii)	New share = (i) = (ii)	$\frac{2}{10} + \frac{9}{50}$	$= \frac{1}{10} + \frac{6}{50}$	$= \frac{4}{10}$ + Nil
		$= \frac{19}{50}$	$= \frac{11}{50}$	$= \frac{20}{50}$

The New Profit Sharing Ratio is 19 : 11 : 20

Gaining ratio is 3 : 2 : 0

Notes : 1. Since Lakshya and Manoj are acquiring Kumar's share of profit in the ratio of 3:2, hence, the gaining ratio will be 3:2 between Lakshya and Manoj.

2. Naresh has neither sacrificed nor gained.

Illustration 5

Ranjana, Sadhna and Kamana are partners sharing profits in the ratio 4:3:2. Ranjana retires; Sadhna and Kamana decided to share profits in future in the ratio of 5:3. Calculate the Gaining Ratio.

Solution

Gaining Share = New Share – Old Share

Sadhna's Gaining Share $= \frac{5}{8} - \frac{3}{9} = \frac{45-24}{72} = \frac{21}{72}$

Kamana's Gaining Share $= \frac{3}{8} - \frac{2}{9} = \frac{27-16}{72} = \frac{11}{72}$

Gaining Ratio between Sadhna and Kamana = 21:11.

Do it Yourself

1. Anita, Jaya and Nisha are partners sharing profits and losses in the ratio of 1 : 1 : 1 Jaya retires from the firm. Anita and Nisha decided to share the profit in future in the ratio 4:3. Calculate the gaining ratio.
2. Azad, Vijay and Amit are partners sharing profits and losses in the proportion of $\frac{1}{4}, \frac{1}{8}$ and $\frac{10}{16}$. Calculate the new profit sharing ratio between continuing partners if (a) Azad retires; (b) Vijay retires; (c) Amit retires.
3. Calculate the gaining ratio in each of the above situations.
4. Anu, Prabha and Milli are partners. Anu retires. Calculate the future profit sharing ratio of continuing partners and gaining ratio if they agree to acquire her share : (a) in the ratio of 5:3; (b) equally.
5. Rahul, Robin and Rajesh are partners sharing profits in the ratio of 3 : 2 : 1. Calculate the new profit sharing ratio of the remaining partners if (i) Rahul retires; (ii) Robin retires; (iii) Rajesh retires.
6. Puja, Priya, Pratistha are partners sharing profits and losses in the ratio of 5 : 3 : 2. Priya retires. Her share is taken by Priya and Pratistha in the ratio of 2 : 1. Calculate the new profit sharing ratio.
7. Ashok, Anil and Ajay are partners sharing profits and losses in the ratio of $\frac{1}{2}, \frac{3}{10}$ and $\frac{1}{5}$. Anil retires from the firm. Ashok and Ajay decide to share future profits and losses in the ratio of 3 : 2. Calculate the gaining ratio.

4.4 Treatment of Goodwill

The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners. Hence, at the time of retirement/death of a partner, goodwill is valued as per agreement among the partners the retiring/ deceased partner compensated for his share of goodwill by the continuing partners (who have gained due to acquisition of share of profit from the retiring/ deceased partner) in their gaining ratio.

The accounting treatment for goodwill in such a situation depends upon whether or, not goodwill already appears in the books of the firm.

4.4.1 When Goodwill does not Appear in the Books

When goodwill does not appear in the books of the firm there are four ways in which the retiring partner can be given the necessary credit for loss of his share of goodwill, these are as follows:

(a) Goodwill is raised at its full value and retained in the books as such: In this case, Goodwill Account is debited will its full value and all the partner's (including the retired/deceased partner) capital accounts are credited in the old profit sharing ratio. The full value of goodwill will appear in the balance sheet of the reconstituted firm.

(b) Goodwill is raised at its full value and written off immediately: If it decided that goodwill should not be refrained and shown in the balance sheet of the reconstituted firm then, after raising goodwill at its value by crediting all the partners' capital accounts (including that of the retired/deceased partners, it should be written off by debiting the remaining partners in their new profit sharing ratio and crediting the goodwill account with its full value.

(c) Goodwill is raised to the extent of retired/deceased partner's share and written off immediately: In this case goodwill account is raised only to the extent of retired/deceased partner's share by debiting goodwill account with the proportionate amount and credited only to the retired/deceased partner's capital account. Thereafter, the remaining partners capital accounts are debited in their gaining ratio and goodwill account/credited to write it off.

(d) No goodwill account is raised at all in firm's books: If it is decided that the goodwill account should not appear in firm's books at all, in that case it is adjusted discretely through partners capital accounts by recording the following journal entry.

Continuing partners' capital A/c's	Dr.
(individually in their gaining ratio)	
To Retiring/Deceased Partner's Capital A/c	
(Retiring/deceased in the remaining partners' capital accounts into their gaining ratio)	

Let us take an example and clarity the treatment of goodwill on retirement or death of a partner using all the above alternatives. A, B. and C are partners in a firm sharing profits in the ratio of 3:2:1 B retires. The goodwill of the firm is valued at Rs. 60,000 and the remaining partners A and C continue to share profits in the ratio of 3:1. The journal entries passed under various alternatives shall be as follows:

(a) *If goodwill is raised at full value and retained in books*

Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all the partners in their old profit sharing ratio)			

(b) *If goodwill is raised at full value and written off immediately.*

(i) Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all partners in old ratio)			
(ii) A's capital A/c	Dr.	45,000	
C's capital A/c	Dr.	15,000	
To Goodwill A/c			60,000
(Goodwill written off and debited to remaining partners in the new ratio)			

(c) *If goodwill is raised to the extent of retiring partner's share and written off immediately.*

(i) Goodwill A/c	Dr.	20,000	
To B's capital A/c			20,000
(Goodwill raised to the extant of B's share)			
(ii) A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To goodwill A/c			20,000
(Goodwill written off by debiting remaining partners' in gaining ratio)			

(d) *If goodwill is not to appear in firm's books at all*

A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To C's capital A/c			20,000
(B's share of goodwill adjusted to remaining partners' capital accounts in gaining ratio)			

It may also happen that as a result of decision on the new profit sharing ratio among the remaining partners, a continuing partner may also sacrifice a part of his share in future profits. In such a situation his capital account will also be credited along with the retiring/deceased partner's capital account in proportion to his sacrifice and the other continuing partners' capital accounts will be debited based on their gain in the future profit ratio.

Illustration 6

Keshav, Nirmal and Pankaj are partners sharing profits and losses in the ratio of 4 : 3 : 2. Nirmal retires and the goodwill is valued at Rs. 72,000. Keshav and Pankaj decided to share future profits and losses in the ratio of 5 : 3. Record necessary journal entries (a) when goodwill is raised at its full value and written off immediately (b) when goodwill is not to appear in firms books at all.

Solution

(a) When Goodwill is raised and written-off

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
(i)	Goodwill A/c Dr.		72,000	
	To Keshav's Capital A/c			32,000
	To Nirmal's Capital A/c			24,000
	To Pankaj's Capital A/c			16,000
	(Goodwill raised at its full value in old profit sharing ratio)			
(ii)	Keshav's Capital A/c Dr.		45,000	
	Pankaj's capital A/c Dr.		27,000	
	To Goodwill A/c			72,000
	(Goodwill written off in the new profit sharing ratio)			

(b) When goodwill is not to appear in firm's books at all

Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Keshav's Capital A/c Dr.		13,000	
	Pankaj's Capital A/c Dr.		11,000	
	To Nirmal's Capital A/c			24,000
	(Nirmal's share of goodwill adjusted to Keshav and Pankaj in their gaining ratio of 13:11)			

Working Notes

1. Vimal's share of goodwill = Rs. $72{,}000 \times \frac{3}{9}$ = Rs. 24,000
2. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Keshav's Gaining Share = $\frac{5}{8} - \frac{4}{9} = \frac{13}{72}$

   Pankaj's Gaining Share = $\frac{3}{8} - \frac{2}{9} = \frac{11}{72}$

   Hence, Gaining Ratio between Keshav and Pankaj is 13:11 i.e. $\frac{13}{24} : \frac{11}{24}$

Illustration 7

Jaya, Kirti, Ekta and Shewata are partners in a firm sharing profits and losses in the ratio of 2 : 1 : 2 : 1. On Jaya's retirement, the goodwill of the firm is valued at Rs. 36,000. Kirti, Ekta and Shewata decided to share future profits equally. Record the necessary journal entry for the treatment of goodwill without opening 'Goodwill Account'.

Solution

Books of Kirti, Ekta and Shewata
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Kirti's Capital A/c	Dr.		6,000	
	Shewata's Capital A/c	Dr.		6,000	
	To Jaya's Capital A/c				12,000
	(Jaya's share of goodwill adjusted to remaining in their gaining ratio)				

Working Notes

1. Jaya's Share of Goodwill

   $= \text{Rs. } 36{,}000 \times \frac{2}{6} = \text{Rs. } 12{,}000$

2. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Kirti's Gain $= \frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$

   Ekta's Gain $= \frac{1}{3} - \frac{2}{6} = \frac{2-2}{6} = \frac{0}{6}$ (Neither Gain nor Sacrifice)

   Shewata's Gain $= \frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$

   Hence, Gaining ratio between Kirti and Shewata $\frac{1}{6} : \frac{1}{6} = 1:1$

Illustration 8

Deepa, Neeru and Shilpa were partners in a firm sharing profits in the ratio of 5 : 3 : 2. Neeru retired and the new profit sharing ratio between Deepa and Shilpa was 2 : 3. On Neeru's retirement, the goodwill of the firm was valued at Rs. 1,20,000. Record necessary journal entry for the treatment of goodwill on Neeru's retirement.

Solution

Books of Deepa and Shilpa
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Shilpa's Capital A/c Dr.		48,000	
	To Neeru's Capital A/c		36,000	
	To Deepa's Capital A/c			12,000
	(Shilpa compensated Neeru for her share of goodwill and to Deepa for the sacrifice made by her on Neeru's retirement)			

Working Notes

1. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Deepa's Gaining Share $= \frac{2}{5} - \frac{5}{10} = \frac{4-5}{10} = -\frac{1}{10} = \left(\frac{1}{10}\right)$ i.e., Sacrifice.

   Shilpa's Gaining Share $= \frac{3}{5} - \frac{2}{10} = \frac{6-2}{10} = \frac{4}{10}$ i.e., Gain

2. Hence, Shilpa will compensate both Neeru (retiring partner) and Deepa (continuing partner who has sacrificed) to the extent of their sacrifice worked out as follows:
   Deepa's Sacrifice = Goodwill of the firm $\times$ Sacrificing Share

   $$= \text{Rs. } 1,20,000 \times \frac{1}{10} = \text{Rs. } 12,000$$

   Neeru's (Retiring Partner's Sacrifice) = Rs. $1,20,000 \times \frac{3}{10}$ = Rs. 36,000.

Test your Understanding – I

Choose the correct option in the following questions:

1. Abhishek, Rajat and Vivek are partners sharing profits in the ratio of 5:3:2. If Vivek retires, the New Profit Sharing Ratio between Abhishek and Rajat will be–
   (a) 3:2
   (b) 5:3
   (c) 5:2
   (d) None of these
2. The old profit sharing ratio among Rajender, Satish and Tejpal were 2:2:1. The New Profit Sharing Ratio after Satish's retirement is 3:2. The gaining ratio is–
   (a) 3:2
   (b) 2:1
   (c) 1:1
   (d) 2:2

3. Anand, Bahadur and Chander are partners. Sharing Profit equally On Chander's retirement, his share is acquired by Anand and Bahadur in the ratio of 3:2. The New Profit Sharing Ratio between Anand and Bahadur will be–
   (a) 8:7
   (b) 4:5
   (c) 3:2
   (d) 2:3
4. In the absence of any information regarding the acquisition of share in profit of the retiring/deceased partner by the remaining partners, it is assumed that they will acquire his/her share:-
   (a) Old Profit Sharing Ratio
   (b) New Profit Sharing Ratio
   (c) Equal Ratio
   (d) None of these

Illustration 9

Hanny, Pammy and Sunny are partners sharing profits in the ratio of 3 : 2 : 1. Goodwill is appearing in the books at a value of Rs. 60,000. Pammy retires and at the time of Pammy's retirement, goodwill is valued at Rs. 84,000. Hanny and Sunny decided to share future profits in the ratio of 2:1. Record the necessary journal entries.

Solution

Books of Hanny and Sunny
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Hanny's Capital A/c	Dr.		30,000	
	Pammy's Capital A/c	Dr.		20,000	
	Sunny's Capital A/c	Dr.		10,000	
	To Goodwill A/c				60,000
	(Existing goodwill written-off in old ratio)				
	Hanny's Capital	Dr.		14,000	
	Sunny's Capital	Dr.		14,000	
	To Pammy's Capital A/c				28,000
	(Pammy's share of goodwill adjusted to Hanny's and Sunny's capital account to the extent of their gain)				

Working Notes

(i) Pammy's share of current value of goodwill $\frac{1}{3}$ of Rs. 84,000

$$= 84{,}000 \times \frac{1}{3} = \text{Rs. } 28{,}000$$

(ii) Gaining Share = New Share – Old Share

Hanny's Gaining Share = $\frac{2}{3} - \frac{3}{6} = \frac{1}{6}$

Sunny's Gaining Share = $\frac{1}{3} - \frac{1}{6} = \frac{1}{6}$

This gaining Ratio of Hanny and Sunny is $\frac{1}{6} : \frac{1}{6} = 1:1$

4.4.2 When Goodwill is already Appearing in the Books

If value of goodwill already appearing in the books of the firm equals with the current value of goodwill, normally no adjustment is required because goodwill stands credited in the accounts of all the partners including the retiring one. In case the present value of goodwill is different from its book value, an adjustment entry is required for the difference between the value already appearing in the books (called book value) and its present value. In such a situation, there are two possibilities: (a) the book value of goodwill is lower than its current value, and (b) the book value is greater than its current value. These are discussed as follows.

(a) *If the book value of goodwill is lower than its present value :* In this case the goodwill is raised to its present value by debiting goodwill Account with the excess of its current value over the book value and crediting all partners' capital accounts in their old profit sharing ratio. For example, Deepak, Nakul and Rajesh are partners sharing profits in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20,000. Nakul retires and, on the day of Nakul's retirement, goodwill is valued at Rs. 24,000. In this case, the following journal entry will be recorded.

Books of Deepak, Nakul and Rajesh
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Goodwill A/c Dr.		4,000	
	To Deepak's Capital A/c			2,000
	To Nakul's Capital A/c			1,200
	To Rajesh's Capital A/c			800
	(Increase in the value of goodwill credited to all partners' capital accounts in their old profit sharing ratio of 5:3:2)			

(b) *If the book value of goodwill is greater than its current value:* In this case the difference between the book value of goodwill and its current value will be credited to Goodwill Account and debited to all Partners' capital accounts in their old profit sharing ratio. For example, Mohanlal, Girdharilal and Shyamlal are partners sharing profits in the ratio of 4:3:1. Shyamlal retires from the firm. On Shyamlal's retirement, goodwill has been valued at Rs. 52,000. There was a goodwill account already appearing in the books of the firm with a value of Rs. 60,000. In this case, the following journal entry will be recorded.

Books of Mohanlal, Girdharilal and Shyamlal
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Mohan Lal's Capital A/c	Dr.		4,000	
	Girdhari Lal's Capital A/c	Dr.		3,000	
	Shyam Lal's Capital A/c	Dr.		1,000	
	To Goodwill A/c				8,000
	(Decrease in the value of goodwill adjusted among all the partners' capital accounts in their old profit sharing ratio)				

It may be noted that in all the above situations, goodwill appears in the balance sheet at its full value. In case it is decided by the partners that it should be written-off, fully or partially, it can be done by debiting the remaining partner's capital accounts in the new profit sharing ratio and crediting Goodwill Account with the respective value.

Alternatively, instead of first raising goodwill to its full value and then writing it off, if the partners so decide, we may first write off the existing goodwill as it appears in the book by debiting all partners in the old profit sharing ratio, and then give the necessary credit to the retiring/deceased partner by debiting the remaining partners capital accounts in their gaining ratio and crediting the retired/deceased partner by his share of goodwill. (See illustration 9)

4.4.3 Hidden Goodwill

If the firm has agreed to settle the retiring or deceased partner's account by paying him a lump sum amount, then the amount paid to him in excess of what is due to him, based on the balance in his capital account after making necessary adjustments in respect of accumulated profits and losses and revaluation of assets and liabilities, etc., shall be treated as his share of goodwill (known as hidden goodwill). For example, P, Q and R are partners in a firm sharing profits in the ratio of 3:2:1. R retires, and the balance in his capital account after making necessary adjustments on account of reserves, revaluation of assets and liabilities workout to be Rs. 60,000, P and Q agreed to pay him Rs. 75,000 in full settlement of his claim. It implies that Rs. 15,000 is R's share of goodwill of the firm. This will be debits to the capital accounts of P and Q in their gaining ratio (3:2 assuming no change in their own profit sharing ratio) and crediting R's capital Account as follows:

			Rs.	*Rs.*
	P's Capital A/c Dr. Q's Capital A/c Dr. To R's Capital A/c (R's share of goodwill adjusted in P's and Q's capital accounts in their gaining ratio of 3:2)		9,000 6,000	 15,000

Test your Understanding – II

Choose the correct option in the following questions:

1. On retirement/death of a partner, the retiring/deceased partner's capital account will be credited with
   (a) his/her share of goodwill.
   (b) goodwill of the firm.
   (c) shares of goodwill of remaining partners.
   (d) none of these.
2. Gobind, Hari and Pratap are partners. On retirement of Gobind, the goodwill already appears in the Balance Sheet at Rs. 24,000. The goodwill will be written-off
   (a) by debiting all partners' capital accounts in their old profit sharing ratio.
   (b) by debiting remaining partners' capital accounts in their new profit sharing ratio.
   (c) by debiting retiring partners' capital accounts from his share of goodwill.
   (d) none of these.
3. Chaman, Raman and Suman are partners sharing profits in the ratio of 5:3:2. Raman retires, the new profit sharing ratio between Chaman and Suman will be 1:1. The goodwill of the firm is valued at Rs. 1,00,000 Raman's share of goodwill will be adjusted
   (a) by debiting Chaman's Capital account and Suman's Capital Account with Rs 15,000 each.
   (b) by debiting Chaman's Capital account and Suman's Capital Account with Rs. 21,429 and 8,571 respectively.
   (c) by debiting only Suman's Capital Account with Rs. 30,000.
   (d) by debiting Raman's Capital account with Rs. 30,000.
4. On retirement/death of a partner, the remaining partner(s) who have gained due to change in profit sharing ratio should compensate the
   (a) retiring partners only.
   (b) remaining partners (who have sacrificed) as well as retiring partners.
   (c) remaining partners only (who have sacrificed).
   (d) none of these.

4.5 Adjustment for Revaluation of Assets and Liabilities

At the time of retirement or death of a partner there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm. Not only that, there may be some unrecorded assets and liabilities which need to be brought into books. As learnt in case of admission of a partner, a Revaluation Account is prepared in order to ascertain net gain (loss) on revaluation of assets and/or liabilities and bringing unrecorded items into firm's books and the same is transferred to the capital account of all partners including retiring/deceased partners in their old profit sharing ratio. the Journal entries to be passed for this purpose are as follows:

1. *For increase in the value of assets*

   Assets A/c's (Individually) Dr.
   To Revaluation A/c
   (Increase in the value of assets)

2. *For decrease in the value of assets*

   Revaluation A/c Dr.
   To Assets A/c's (Individually)
   (Decrease in the value of assets)

3. *For increase in the amount of liabilities*

   Revaluation A/c Dr.
   To Liabilities A/c (Individually)
   (Increase in the amount of liabilities)

4. *For decrease in the amount of liabilities*

   Liabilities A/c's (Individually) Dr.
   To Revaluation A/c
   (Decrease in the amount of liabilities)

5. *For an unrecorded asset*

   Assets A/c Dr.
   To Revaluation A/c
   (Unrecorded asset brought into book)

6. *For an unrecorded liability*

   Revaluation A/c Dr.
   To Liability A/c
   (Unrecorded liability brought into books)

7. *For distribution of profit or loss on revaluation*

   Revaluation A/c Dr.
   To All Partners' Capital A/c's (Individually)
   (Profit on revaluation transferred
   to partner's capital)

(or)

All Partners' Capital A/c's (Individually) Dr.
To Revaluation A/c
(Loss on revaluation transferred to partner's capital accounts)

Illustration 10

Mitali, Indu and Geeta are partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On March 31, 2017, their Balance Sheet was as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		55,000	Goodwill	25,000
Reserve Fund		30,000	Buildings	1,00,000
Capital Accounts:			Patents	30,000
Mitali	1,50,000		Machinery	1,50,000
Indu	1,25,000		Stock	50,000
Geeta	75,000	3,50,000	Debtors	40,000
			Cash	40,000
		4,35,000		**4,35,000**

Geeta retires on the above date. It was agreed that Machinery be valued at Rs.1,40,000; Patents at Rs. 40,000; and Buildings at Rs. 1,25,000. Record the necessary journal entries and prepare the Revaluation Account.

Solution

Books of Mitali and Indu
Journal

Date 2017	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Mar. 31	Revaluation A/c Dr.		10,000	
	To Machinery A/c			10,000
	(Decrease in the value of machinery)			
	Patents A/c Dr.		10,000	
	Buildings A/c Dr.		25,000	
	To Revaluation A/c			35,000
	(Increase in the value of patents and buildings)			
	Revaluation A/c Dr.		25,000	
	To Mitali's Capital A/c			12,500
	To Indu's Capital A/c			7,500
	To Geeta's Capital A/c			5,000
	(Profit on revaluation transferred to all partner's capital accounts in old profit sharing ratio)			

Revaluation Account

Dr. Cr.

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Machinery		10,000	Patents	10,000
Profit transferred to:			Buildings	25,000
Mitali's Capital A/c	12,500			
Indu's Capital A/c	7,500			
Geeta's Capital A/c	5,000	25,000		
		35,000		**35,000**

4.6 Adjustment of Accumulated Profits and Losses

Sometimes, the Balance Sheet of a firm may show accumulated profits in the form of general reserve on reserve fund and/on accumulated losses in the form of profit and loss account debit balance. The retiring/deceased partner is entitled to his/her share in the accumulated profits and is also liable to share the accumulated losses, if any. These accumulated profits or losses belong to all the partners and should be transferred to the capital accounts of all partners in their old profit sharing ratio. The following journal entries are recorded for the purpose.

(i) *For transfer of accumulated profits (reserves),*

Reserves A/c Dr.
  To All Partners' Capital A/c's (Individually)
(Reserves transferred to all partners' capital account's in old profit sharing ratio).

(ii) *For transfer of accumulated losses*

All Partners' Capital A/c's (Individually) Dr.
  To Profit and Loss A/c
(Accumulated loss transferred to all partners' capital accounts in their old profit-sharing ratio)

For example; Inder, Gajender and Harinder are partners sharing profits in the ratio of 3 : 2 : 1. Inder retires and the Balance Sheet of the firm on that date was as follows:

Books of Inder, Gajinder and Harinder
Balance Sheet as on March 31, 2017

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Creditors		50,000	Land and Building	3,00,000
General Reserve		90,000	Stock	30,000
Capital Accounts:			Bank	10,000
Inder	1,00,000		Cash	5,000
Gajender	55,000			
Harinder	50,000	2,05,000		
		3,45,000		**3,45,000**

The journal entry to record the treatment of general reserve will be as follows :

Books of Gajender and Harinder
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017 Mar. 31	General Reserve A/c Dr. To Inder's Capital A/c To Gajender's Capital A/c To Harinder's Capital A/c (General Reserves transferred to all partners' capital accounts in the old ratio on Inder's retirement)		90,000	 45,000 30,000 15,000

4.7 Disposal of Amount Due to Retiring Partner

The outgoing partner's account is settled as per the terms of partnership deed i.e., in lumpsum immediately or in various instalments with or without interest as agreed or partly in cash immediately and partly in installment at the agreed intervals. In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive either interest @ 6% p.a. till the date of payment or such share of profits which has been earned with his/her money (i.e., based on capital ratio). Hence, the total amount due to the retiring partner which is ascertained after all adjustments have been made is to be paid immediately to the retiring partner. In case the firm is not in a position to make the payment immediately, the amount due is transferred to the retiring Partner's Loan Account, and as and when the amount is paid it is debited to his account. The necessary journal entries recorded are as follows.

1. *When retiring partner is paid cash in full.*

   Retiring Partner's Capital A/c Dr.
   To Cash/Bank A/c

2. *When retiring partner's whole amount is treated as loan.*

   Retiring Partner's Capital A/c Dr.
   To Retiring Partner's Loan A/c

3. *When retiring partner is partly paid in cash and the remaining amount treated as loan.*

   Retiring Partner's Capital A/c Dr. (Total Amount due)
   To Cash/Bank A/c (Amount Paid)
   To Retiring Partner's Loan A/c (Amount of Loan)

4. When Loan account is settled by paying in instalment includes principal and interest.

   a) For interest on loan
      Interest A/c Dr.
        To Retiring Partner's Loan A/c

   b) For payment of instalment
      Retiring Partner's Loan A/c Dr.
        To Cash/Bank A/c

Note:

1. The balance of the retiring partner's loan account is shown on the liabilities side of the Balance Sheet till the last instalment is paid to him/her.
2. Entry number (a) and (b), above will be repeated till the loan is paid off.

Illustration 11

Amrinder, Mahinder and Joginder are partners in a firm. Mahinder retires from the firm. On his date of retirement, Rs. 60,000 becomes due to him. Amrinder and Joginder promise to pay him in instalments every year at the end of the year. Prepare Mahinder's Loan Account in the following cases:

1. When payment is made four yearly instalments plus interest @ 12% p.a. on the unpaid balance.
2. When they agree to pay three yearly instalments of Rs. 20,000 including interest @ 12% p.a on the outstanding balance during the first three years and the balance including interest in the fourth year.
3. When payment is made in 4 equal yearly instalment's including interest @ 12% p.a. on the unpaid balance.

Solution

(a) When payment is made in four yearly instalments plus interest

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank (15,000+7,200)		22,200	Year-1	Mahinder Capital		60,000
	Balance c/d		45,000		Interest		7,200
			67,200				**67,200**

Year-II	Bank (15,000+5,400)		20,400	Year-II	Balance b/d		45,000
					Interest		5,400
	Balance c/d		30,000				
			50,400				**50,400**
Year-III	Bank (15,000+3,600)		18,600	Year-III	Balance b/d		30,000
					Interest		3,600
	Balance c/d		15,000				
			33,600				**33,600**
Year-IV	Bank (15,000+1,800)		16,800	Year-IV	Balance b/d		15,000
					Interest		1,800
			16,800				**16,800**

(b) When payment is made in three yearly installments of Rs. 20,000 each including interest.

Books of Amrinder, Mahinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		20,000	Year-I	Mohan's Capital		60,000
	Balance c/d		47,200		Interest		7,200
			67,200				**67,200**
Year-II	Bank		20,000	Year-II	Balance b/d		47,200
	Balance c/d		32,864		Interest		5,664
			52,864				**52,864**
Year-III	Bank		20,000	Year-III	Balance b/d		32,864
	Balance c/d		16,808		Interest		3,944
			36,808				**36,808**
Year-IV	Bank		18,825	Year-IV	Balance b/d		16,808
					Interest		2,017
			18,825				**18,825**

(c) When payment is made in four equal yearly instalments including interest @12% (Annually).

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		19,754	Year-I	Mohinder's Capital		60,000
	Balance c/d		47,446		Interest		7,200
			67,200				**67,200**
Year-II	Bank		19,754	Year-II	Balance b/d		47,446
	Balance c/d		33,386		Interest		5,694
			53,140				**53,140**
Year-III	Bank		19,754	Year-III	Balance b/d		33,386
	Balance c/d		17,638		Interest		4,006
			37,392				**37,392**
Year-IV	Bank		19,754	Year-IV	Balance b/d		17,638
					Interest		2,116
			19,754				**19,754**

Note: The annual instalment of payment in 4 years @ 12% interest works out at Rs. 19,754 (Annually of Rs. 0.329234 as per Annually Table x 60,000).

It may noted that the accounting treatment for disposal of amount due to retiring partner and deceased partner is similar with a difference that in case of death of a partner, the amount credited to him/her is transferred to his Executors' Account and the payment has to be made to him/her. This shall be taken up later in this chapter.

Do it Yourself

Vijay, Ajay and Mohan are friends. They passed B. Com. (Hons) from Delhi University in June, 2016. They decided to start the business of computer hardware.

On Ist of August, 2016, they introduced the capital of Rs. 50,000, Rs. 30,000 and Rs. 20,000 respectively and started the business in partnership at Delhi. The profit sharing ratio decided between there was 4:2:1. The business was running successfully. But on Ist February, 2017, due to certain unavoidable circumstances and family circumstances, Ajay decided to settle in Pune and decided to retire from the partnership on 31st March, 2017; with the consent of partners, Ajay retires as on 31st March, 2017, the position of assets and liabilities are as follows:

Contd...

Contd...

Balance Sheet of Vijay, Ajay and Mohan as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital Accounts :			Goodwill	56,000
Vijay	1,80,000		Stock	90,000
Ajay	1,20,000		Debtors	66,000
Mohan	1,00,000	4,00,000	Land and Buildings	1,20,000
Bills Payable		12,000	Machinery	1,59,000
General Reserve		42,000	Motor Van	31,000
Creditors		90,000	Cash at bank	22,000
		5,44,000		**5,44,000**

On the date of retirement, the following adjustments were to be made:

1. Firm's goodwill was valued at Rs. 1,48,000.
2. Assets and Liabilities are to be valued as under: Stock Rs. 72,000; Land and Buildings Rs. 1,35,600; Debtors Rs. 63,000; Machinery Rs. 1,50,000; Creditors Rs. 84,000.
3. Vijay to bring Rs. 1,20,000 and Mohan Rs. 30,000 as additional capital.
4. Ajay was to be paid Rs. 97,200 in cash and the balance of his Capital Account to be transferred to his Loan Account Work out the amount due to Ajay and state as to how will you settle his account ?

Illustration 12

The Balance Sheet of Ashish, Suresh and Lokesh who were sharing profits in the ratio of 5 : 3 : 2, is given below as on March 31, 2017.

Balance Sheet of Ashish, Suresh and Lokesh
As on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Land	4,00,000
Shyam	7,20,000		Building	3,80,000
Gagan	4,15,000		Plant & Machinery	4,65,000
Ram	3,45,000	14,80,000	Furniture & Fittings	77,000
Reserve Fund		1,80,000	Stock	1,85,000
Sundry Creditors		1,24,000	Sundry Debtors	1,72,000
Outstanding Expresses		16,000	Cash in hand	1,21,000
		18,00,000		**18,00,000**

Suresh retires on the above date and the following adjustments are agreed upon his retirement.

1. Stock was valued at Rs. 1,72,000.
2. Furniture and fittings were valued at Rs. 80,000.

3. An amount of Rs. 10,000 due from Mr. Deepak, a debtor, was doubtful and a provision for the same was required.
4. Goodwill of the firm was valued at Rs. 2,00,000 but it was decided not to show goodwill in the books of accounts.
5. Suresh was paid Rs. 40,000 immediately on retirement and the balance was transferred to his loan account.
6. Ashish and Lokesh were to share future profits in the ratio of 3:2.

   Prepare Revaluation Account, Capital Account and Balance Sheet of the reconstituted firm.

Solution

Books of Ashish, Suresh and Lokesh
Revaluation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Stock	13,000	Furniture		3,000
Provision for Doubtful Debt	10,000	(Loss on Revaluation transferred to :		
		Ashish's capital	10,000	
		Suresh's capital	6,000	
		Lokesh's capital	4,000	20,000
	23,000			**23,000**

Partners' Capital Accounts

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*
Mar.31	Revaluation (Loss)		10,000	6,000	4,000	Mar.31	Bal. b/d		7,20,000	4,15,000	3,45,000
	Suresh's Capital		20,000		40,000		Reserve fund		90,000	54,000	36,000
	Cash			40,000			Ashish's Capital			20,000	
	Suresh's Loan			4,83,000			Lokesh's Capital			40,000	
	Balance c/d		7,80,000		3,37,000						
			8,10,000	**5,29,000**	**3,81,000**				**8,10,000**	**5,29,000**	**3,81,000**

Balance Sheet of Ashish and Lokesh as on April 01, 2017

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Capitals :			Land		4,00,000
Ashish	7,80,000		Buildings		3,80,000
Lokesh	3,37,000	11,17,000	Plant and Machinery		4,65,000
Suresh's Loan		4,83,000	Furniture		80,000
Sundry Creditors		1,24,000	Stock		1,72,000
Outstanding Expresses		16,000	Sundry Debtors	1,72,000	
			Less: Provision for Doubtful Debts	10,000	1,62,000
			Cash (Rs. 1,21,000–Rs. 40,000)		81,000
		17,40,000			**17,40,000**

Working Notes

1. Gaining Share = New Share – Old Share

   Ashish's Gain $= \frac{3}{5} - \frac{5}{10} = \frac{6-5}{10} = \frac{1}{10}$

   Lokesh's Gain $= \frac{2}{5} - \frac{2}{10} = \frac{4-2}{10} = \frac{2}{10}$

   Gaining Ratio between Ashish and Lokesh = 1 : 2,

2. Suresh's Share of Goodwill = $\frac{3}{10} \times$ Rs. 2,00,000 = Rs. 60,000

Illustration 13

Shyam, Gagan and Ram are partners sharing profit in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2017 are as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Reserves		14,500	Debtors	19,000
Capital:			Stock	42,000
Shyam	80,000		Machinery	85,000
Gagan	62,500		Building	1,22,000
Ram	75,000	2,17,500	Patents	9,000
Employees' Provident Fund		4,000		
		2,85,000		**2,85,000**

As Gagan got a very good break at an MNC, so he decided to retire on that date and it was decided that Shyam and Ram would share the future profits in the ratio of 5 : 3. Goodwill was valued at Rs. 70,000; Machinery at Rs. 78,000; Buildings at Rs. 1,52,000; stock at Rs. 30,000; and bad debts amounting to Rs. 1,550 were to be written off. Record journal entries in the books of the firm and prepare the Balance Sheet of the new firm.

Solution

Books of Shyam, Ram and Gagan
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2017	Revaluation A/c	Dr.		20,550	
Mar. 31	To Machinery A/c				7,000
	To Stock A/c				12,000
	To Debtors A/c				1,550
	(Loss on revaluation of assets recorded on Gagan's retirement)				
	Building A/c	Dr.		30,000	
	To Revaluation A/c				30,000
	(Appreciation in the value of Building on Gagan's retirement)				
	Revaluation A/c	Dr.		9,450	
	To Shyam's Capital A/c				3,780
	To Gagan's Capital A/c				3,780
	To Ram's Capital A/c				1,890
	(Profit on revaluation transferred to partners' capital accounts in the ratio of 2 : 2 : 1)				
	Reserve A/c	Dr.		14,500	
	To Shyam's Capital A/c				5,800
	To Gagan's Capital A/c				5,800
	To Ram's Capital A/c				2,900
	(Reserve transferred to partner's capital accounts)				
	Shyam's Capital A/c	Dr.		15,750	
	Ram's Capital A/c	Dr.		12,250	
	To Gagan's Capital A/c				28,000
	(Gagan's share of goodwill adjusted to Shyam and Ram in their gaining ratio of 9 : 7)				
	Gagan's Capital A/c	Dr.		1,00,080	
	To Gagan's Loan A/c				1,00,080
	(Amount payable to retiring partner transferred to his loan account)				

Balance Sheet of Shyam and Ram as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Employees' Provident Fund		4,000	Debtors	17,450
Capitals :			Stock	30,000
Shyam	73,830		Machinery	78,000
Ram	67,540	1,41,370	Building	1,52,000
Gagan's Loan		1,00,080	Patents	9,000
		2,94,450		**2,94,450**

Working Notes

Share Gained = New Share – Old Share

Shyam's Gain = $\frac{5}{8} \quad \frac{2}{5} \quad \frac{25 \quad 16}{40} \quad \frac{9}{40}$

Ram's Gain = $\frac{3}{8} \quad \frac{1}{5} \quad \frac{15 \quad 8}{40} \quad \frac{7}{40}$

Therefore, Gaining Ratio of Shyam and Ram = 9 : 7.

Revaluation Account

Dr. *Cr.*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Machinery		7,000	Building	30,000
Stock		12,000		
Debtors		1,550		
(Profit on Revaluation)				
Transfer to Capital				
Shyam	3,780			
Gagan	3,780	9,450		
Ram	1,890	**30,000**		**30,000**

Partners' Capital Accounts

Date 2017	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*
Mar.31	Gagan's Capital		15,750		12,250	Mar.31	Bal. b/d		80,000	62,500	75,000
	Gagan's Loan			1,00,080			Revaluation		3,780	3,780	1,890
	Bal. c/d		73,830		67,540		Profit Reserve		5,800	5,800	2,900
							Shyam's Capital			15,750	
							Ram's Capital			12,250	
			89,580	**1,00,080**	**79,790**				**89,580**	**1,00,080**	**79,790**

Note: As sufficient balance is not available to pay the due amount to Gagan, the balance in his capital account is transferred to his loan account.

4.8 Adjustment of Partners' Capitals

At the time of retirement or death of a partner, the remaining partners may decide to adjust their capital contributions in their profit sharing ratio. In such a situation, the sum of balances in the capitals of continuing partners may be treated as the total capital of the new firm, unless specified otherwise. Then, to ascertain the new capital of the continuing partners, the total capital of the firm is divided amongst the remaining partners as per the new profit sharing ratio, and the excess or deficiency of capital in the individual capital account's may be worked out. Such excess or shortage shall be adjusted by withdrawal of contribution in cash, as the case may be, for which the following journal entries will be recorded.

(i) For excess capital withdrawn by the partner :

Partners' Capital A/c Dr.
  To Cash / Bank A/c

(ii) For amount of capital to be brought in by the partner:

Cash / Bank A/c Dr.
  To Partners' Capital A/c

Consider the following situations:
The adjustment of the continuing partner's capitals may involve any one of the three ways as illustrated as follows :

1. When the capital of the new firm as decided by the partners is specified.

Illustration 14

Mohit, Neeraj and Sohan are partners in a firm sharing profits in the ratio of 2 : 1 : 1. Neeraj retires and Mohit and Sohan decided that the capital of the new firm will be fixed at Rs. 1,20,000. The capital accounts of Mohit and Sohan show a credit balance of Rs. 82,000 and Rs. 41,000 respectively after making all the adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries.

Solution

The New Profit Sharing Ratio between Mohit and Sohan = 2 : 1

	Mohit	*Sohan*
New Capital based new ratio is	80,000	40,000
Existing Capital (after adjustments) is	82,000	41,000
Cash to be brought in on (Paid off)	2,000	1,000

Books of Mohit and Sohan
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Mohit's Capital A/c Dr. Sohan's Capital A/c Dr. To Cash A/c (Excess capital withdrawn by Sohan)		2,000 1,000	 3,000

2. When the total capital of new firm is not specified.

Illustration 15

Asha, Deepa and Lata are partners in a firm sharing profits in the ratio of 3 : 2 : 1. Deepa retires. After making all adjustments relating to revaluation, goodwill and accumulated profit etc., the capital accounts of Asha and Lata showed a credit balance of Rs. 1,60,000 and Rs. 80,000 respectively. It was decided to adjust the capitals of Asha and Lata in their new profit sharing ratio. You are required to calculate the new capitals of the partners and record necessary journal entries for bringing in or withdrawal of the necessary amounts involved.

Solution

a. Calculation of new capitals of the existinging partners

Balance in Asha's Capital (after all adjustments)	= 1,60,000
Balance in Lata's Capital	= 80,000
Total Capital of the New Firm	= 2,40,000

Based on the new profit sharing ratio of 3:1

Asha's New Capital = Rs. $2,40,000 \times \frac{3}{4}$ = 1,80,000

Lata's New Capital = Rs. $2,40,000 \times \frac{1}{4}$ = 60,000

Note :The total capital of the new firm is based on the sum of the balance in the capital accounts of the continuing partners.

b. Calculation of cash to be brought in or withdrawn by the continuing partners :

	Asha (Rs.)	*Lata (Rs.)*
New Capitals	1,80,000	60,000
Existing Capitals	1,60,000	80,000
c. Cash to be brought in on (paid off)	20,000	20,000

Books of Asha and Lata
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c Dr. To Asha Capital A/c (Cash brought by Asha)		20,000	 20,000
	Lata's Capital A/c Dr. To Cash A/c (Surplus capital withdrawn by Lata)		20,000	 20,000

3. When the amount payable to retiring partner will be contributed by continuing partners in such a way that their capitals are adjusted proportionate to their new profit sharing ratio:

Illustration 16

Lalit, Pankaj and Rahul are partners sharing profits in the ratio of 4 : 3 : 3. After all adjustments, on Lalit's retirement with respect to general reserve, goodwill and revaluation etc., the balances in their capital accounts stood at Rs. 70,000, Rs. 60,000 and Rs. 50,000 respectively. It was decided that the amount payable to Lalit will be brought by Pankaj and Rahul in such a way as to make their capitals proportionate to their profit sharing ratio. Calculate the amount to be brought by Pankaj and Rahul and record necessary journal entries for the same. Also record necessary entry for payment to Lalit.

After Lalit's retirement, the new profit sharing ratio between Pankaj and Rahul is 3 : 3, i.e. 1 : 1.

Solution

a. *Calculation of total capital of the new firm*

Balance in Pankaj's Capital account (after adjustment)	=	60,000
Balance in Rahul's Capital account (after adjustment)	=	50,000
Amount payable to Lalit (Retiring partner)	=	70,000
Total capital of new firm (i) + (ii) + (iii)	=	1,80,000

b. *Calculation of new capitals of the continuing partners*

Pankaj's New Capital $= \text{Rs. } 1{,}80{,}000 \times \frac{1}{2}$ = Rs. 90,000

Rahul's New Capital $= \text{Rs. } 1{,}80{,}000 \times \frac{1}{2}$ = Rs. 90,000 *c. Calculation of the amounts to be brought in or withdrawn by the continuing partners*

	Pankaj (Rs.)	*Rahul (Rs.)*
New Capital (Rs. 1,80,000 in the ratio of 1 : 1)	90,000	90,000
Existing capital (after adjustment)	60,000	50,000
Cash to be brought in	30,000	40,000

Books of Pankaj and Rahul
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c	Dr.	70,000	
	To Pankaj's Capital A/c			30,000
	To Rahul's Capital A/c			40,000
	(Amounts brought by Pankaj and Rahul)			
	Lalit's Capital A/c	Dr.	70,000	
	To Cash A/c			70,000
	(Amount paid to Lalit on retirement)			

Illustration 17

The Balance Sheet of Mohit, Neeraj and Sohan who are partners in a firm sharing profits according to their capitals as on March 31, 2017 was as under:

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors	21,000	Buildings		1,00,000
Mohit's Capital	80,000	Machinery		50,000
Neeraj's Capital	40,000	Stock		18,000
Sohan's Capital	40,000	Debtors	20,000	
General Reserve	20,000	*Less:* Provision for Bad Debt	1,000	19,000
		Cash at bank		14,000
	2,01,000			**2,01,000**

On that date, Neeraj decided to retire from the firm and was paid for his share in the firm subject to the following:

1. Buildings to be appreciated by 20%.
2. Provision for Bad debts to be increased to 15% on Debtors.
3. Machinery to be depreciated by 20%.
4. Goodwill of the firm is valued at Rs. 72,000 and the retiring partner's share is adjusted through the capital accounts of remaining partners.

5. The capital of the new firm be fixed at Rs. 1,20,000.

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

Solution

Revaluation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Provision for Doubtful Debt		2,000	Building	20,000
Machinery		10,000		
Capital (Profit on Revaluation)				
Mohit	4,000			
Neeraj	2,000			
Sohan	2,000	8,000		
		20,000		**20,000**

Dr. **Partners' Capital Accounts** *Cr.*

Date 2017	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*
Mar.31	Neeraj's Capital		12,000		6,000	Mar.31	Bal. b/d		80,000	40,000	40,000
	Balance c/d		82,000	65,000	41,000		General Reserve		10,000	5,000	5,000
							Revaluation (Profit)		4,000	2,000	2,000
							Mohit's Capital			12,000	
							Sohan's Capital			6,000	
			94,000	**65,000**	**47,000**				**94,000**	**65,000**	**47,000**
	Bank			65,000			Bal. b/d		82,000	65,000	41,000
	Bank		2,000		1,000						
	Bal. c/d (1)		80,000		40,000						
			82,000	**65,000**	**41,000**				**82,000**	**65,000**	**41,000**

Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		21,000	Building		1,20,000
Bank overdraft		54,000	Machinery		40,000
Capital			Stock		18,000
Mohit	80,000		Debtors	20,000	
Sohan	40,000	1,20,000	*Less:* Provision for Doubtful Debts (1,000+2,000)	3,000	17,000
		1,95,000			**1,95,000**

Working Notes

1. **Bank Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		14,000		Mohit's Capital		2,000
	Balance c/d (overdraft)		54,000		Sohan's Capital		1,000
					Neeraj's Capital		65,000
			68,000				**68,000**

2. It is assumed that bank overdraft is taken to pay the retiring partners.
3. Cash to be brought in or withdrawn by Mohit and Sohan :

		Mohit (Rs.)	*Sohan (Rs.)*
(a)	New capitals (Rs.1,20,000 in the ratio of 2:1)	80,000	40,000
(b)	Existing capital (after adjustments) as calculated	82,000	41,000
	Cash to be brought (paid off)	2,000	1,000

Do it Yourself

1. The Balance Sheet of A, B and C who were sharing the profits in proportion to their capitals stood as on March 31, 2017.

Balance Sheet as on March 31, 2017

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable	6,250	Land and Building		12,000
Sundry Creditors	10,000	Debtors	10,500	
Reserve Fund	2,750	*Less* Provision for bad debts	500	10,000
Capitals		Bill receivables		7,000
A 20,000		Stock		15,500
B 15,000		Plant and Machinery		11,500
C 15,000	50,000	Cash at bank		13,000
	69,000			69,000

B retired on the date of Balance Sheet and the following adjustments were to be made:
(a) Stock was depreciated by 10%.
(b) Factory building was appreciated by 12%.
(c) Provision for doubtful debts to be created up to 5%.
(d) Provision for legal charges to be made at Rs.265.
(e) The goodwill of the firm to be fixed at Rs.10,000.
(f) The capital of the new firm to be fixed at Rs.30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3:2.

Work out the final balances in capital accounts of the firm, and the amounts to be brought in and/or withdrawn by A and C to make their capitals proportionate to then new profit sharing ratio.

2. R, S and M were carrying on business in partnership sharing profits in the ratio of 3:2:1, respectively. On March 31, 2017, Balance Sheet of the firm stood as follows :

Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Building	23,000
Capitals:			Debtors	7,000
R	20,000		Stock	12,000
S	7,500		Patents	8,000
M	12,500	40,000	Bank	6,000
		56,000		**56,000**

Shyam retired on the above mentioned date on the following terms :
(a) Buildings to be appreciated by Rs.8,800.
(b) Provision for doubtful debts to be made @ 5% on debtors.
(c) Goodwill of the firm to be valued at Rs.9,000.
(d) Rs.5,000 to be paid to S immediately and the balance due to him to be treated as a loan carrying interest @ 6% per annum.

Prepare the balance sheet of the reconstituted firm.

4.9 Death of a Partner

As stated earlier, the accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any) from the date of the last Balance Sheet to the date of his death of these, the main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet and the date of the partner's death. Since, it is considered cumbersome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

For example, Bakul, Champak and Darshan were partners in a firm sharing profits in the ratio of 5:4:1. The profit of the firm for the year ending on March 31, 2017 was Rs.1,00,000. Champak dies on June 30, 2017. Champak's share of profit for the period from April 1 to June 30, 2017, shall be calculated as follows:

Total profit for the year ending on 31st March, 2017 = Rs.1,00,000

Champak's share of profit :

Proceeding Year's Profit $\times$ Proportionate Period $\times$ Share of Deceased Partner

$$= \text{Rs. } 1,00,000 \times \frac{3}{12} \times \frac{4}{10} = \text{Rs. } 10,000$$

The journal entry will be recorded as follows :

Profit & Loss Suspense A/c	Dr.	10,000	
To Champak's Capital A/c			10,000
(Champak's share of profit transferred to his capital account)			

Alternatively, if Champak's share of profit was to be calculated on the basis of average profits of the last three years, which were Rs. 1,36,000 for 2014-15, Rs. 1,54,000 for 2015-16 and Rs. 1,00,000 for 2016-17; Champahs share of profit for the period from April 7, 2017 to June 30, 2017 shall be calculated on the basis of average profit based on profits for the last year calculation as follows:

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of years}} = \frac{\text{Rs. } 1,36,000 + \text{Rs. } 1,54,000 + \text{Rs. } 1,00,000}{3}$$

$$= \frac{\text{Rs. } 3,90,000}{3} = \text{Rs. } 1,30,000$$

$$\text{Champak's share of profit} = \text{Rs. } 1,30,000 \times \frac{3 \text{ months}}{12 \text{ months}} \times \frac{4}{10}$$

$$= \text{Rs. } 13,000$$

In case, the agreement provides, that share of profit of the deceased partner will be worked out on the basis of sales, and it is specified that the sales during the year 2015-16 were Rs. 8,00,000 and the sales from April 1, 2017 to June

30, 2017 were Rs. 1,50,000 Champak's share of profits for the period from April 1, 2017 to June 30, 2017 shall be calculated as follows.

If sale is Rs.8,00,000, the profit = Rs.1,00,000

If sale is Rs.1, the profit $= \frac{1,00,000}{8,00,000}$

If sale is Rs.1,50,000, the profit $= \frac{1,00,000}{8,00,000} \times 1,50,000$

= Rs. 18,750

Champak's share of profit = Rs. 7,500

For being deceased partner's share of profits for the intervening period to books of account, the following journal entry is recorded.

Profit and Loss Account

Profit and Loss (Supense) A/c Dr.
To Deceased Partner's Capital A/c
(Share of profit for the intervening period)

Illustration 18

Anil, Bhanu and Chandu were partners in a firm sharing profits in the ratio of 5:3:2. On March 31, 2017, their Balance Sheet was as under:

Books of Anil, Bhanu and Chandu
Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		11,000	Buildings	20,000
Reserve Fund		6,000	Machinery	30,000
Anil's Capital	30,000		Stock	10,000
Bhanu's Capital	25,000		Patents	11,000
Chandu's Capital	15,000	70,000	Debtors	8,000
			Cash	8,000
		87,000		**87,000**

Anil died on October 1, 2017. It was agreed between his executors and the remaining partners that :

(a) Goodwill to be valued at $2\frac{1}{2}$ year's purchase of the average profits of the previous four years which were :

Year 2013-14 – Rs.13,000, Year 2014-15 – Rs. 12,000,
Year 2015-16 – Rs.20,000, Year 2016-17 – Rs.15,000

(b) Patents be valued at Rs.8,000; Machinery at Rs.28,000; and Building at Rs.25,000.
(c) Profit for the year 2017-18 be taken as having accrued at the same rate as that of the previous year.
(d) Interest on capital be provided at 10% p.a.
(e) Half of the amount due to Anil be paid immediately.

Prepare Anil's Capital Account and Anil's Executor's Account as on October 1, 2017.

Solution

Books of Anil, Bhanu and Chander
Anil's Capital Account

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Anil's Executors		57,000	April,1	Balance b/d		30,000
				Oct. 1	Reserve Fund		3,000
					Bhanu's Capital		11,250
					Chandu's Capital		7,500
					Profit & Loss (Suspense)		3,750
					Interest on Capital		1,500
			57,000				**57,000**

Anil's Executor's Account

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Bank		28,500	Oct.1	Anil's Capital		57,000
	Balance c/d		28,500				
			57,000				**57,000**

Working Notes

1. **Revaluation Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Patents		3,000		Building		5,000
	Machinery		2,000				
			5,000				**5,000**

2. Goodwill = 2½ years' purchase × Average Profit

$$\text{Average Profit} = \frac{\text{Rs. } 13{,}000 + \text{Rs.}12{,}000 + \text{Rs.}20{,}000 + \text{Rs.}15{,}000}{4}$$

$$= \frac{\text{Rs. } 60{,}000}{4} = \text{Rs. } 15{,}000$$

$$\text{Goodwill} = \frac{5}{2} \times \text{Rs. } 15{,}000$$

$$= \text{Rs. } 37{,}500$$

$$\text{Anil's Share of Goodwill} = \frac{5}{10} \times \text{Rs. } 37{,}500$$

$$= \text{Rs. } 18{,}750$$

3. Profit from the date of last balance sheet to date of death (April 1, 2017 to October 1, 2017) = 6 months

$$\text{Profit for 6 months} = \text{Rs. } 15{,}000 \times \frac{6}{12} = \text{Rs. } 7{,}500$$

$$\text{Anil's share of profit} = \text{Rs. } 7{,}500 \times \frac{5}{10} = \text{Rs. } 3{,}750$$

4. Interest on Capital (April 1, 2017 to October 1, 2017)

$$= \text{Rs. } 30{,}000 \times \frac{10}{100} \times \frac{6}{12}$$

$$= \text{Rs.} 1{,}500$$

Illustration 19

You are given the Balance Sheet of Mohit, Sohan and Rahul who are partners sharing profits in the ratio of 2 : 2 : 1, as on March 31, 2017.

Books of Mohit, Sohan and Rahul
Balance Sheet as on March 31, 2017.

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		40,000	Goodwill	30,000
Reserve Fund		25,000	Fixed assets	60,000
Capitals:			Stock	10,000
Mohit	30,000		Sundry Debtors	20,000
Sohan	25,000		Cash at bank	15,000
Rahul	15,000	70,000		
		1,35,000		**1,35,000**

Sohan died on June 15, 2017. According to the Deed, his legal representatives are entitled to:

(a) Balance in Capital Account;

(b) Share of goodwill valued on the basis of thrice the average of the past 4 years' profits.

(c) Share in profits up to the date of death on the basis of average profits for the past 4 years.

(d) Interest on capital account @ 12% p.a.

Profits for the years ending on March 31 of 2014, 2015, 2016, 2017 respectively were Rs. 15,000, Rs. 17,000, Rs. 19,000 and Rs. 13,000.

The firm had taken a Joint Life Policy of Rs. 1,25,000, the annual premium being charged to profit & loss account every year.

Sohan's legal representatives were to be paid the amount due. Mohit and Rahul continued as partner by taking over Sohan's share equally. Work out the amount payable to Sohan's legal representatives.

Solution

Books of Mohit, Sohan and Rahul
Sohan's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Goodwill		12,000	Apr. 1	Balance b/d		25,000
	Sohan's Executor		94,158	Jun.15	Reserve Fund		10,000
					Mohit's Capital		9,600
					Rahul's Capital		9,600
					Profit & Loss suspense		1,333
					Joint life policy		50,000
					Interest on Capital		625
			1,06,158				**1,06,158**

Working Notes

1. Sohan's Share of Goodwill

$$= \text{Goodwill of the Firm} \times \frac{2}{5}$$

$$= \text{Rs. } 48{,}000 \times \frac{2}{5} = \text{Rs. } 19{,}200$$

Goodwill of the Firm $= 3 \times$ Average Profit

$$= 3 \times \frac{\text{Rs. } 64{,}000}{4} = \text{Rs. } 48{,}000$$

2. Profit and Loss
(Share of Profit from the date of last Balance Sheet to the date of death) $2\frac{1}{2}$ months.

$$= \frac{\text{Rs. } 64,000}{4} \times \frac{2}{5} \times \frac{2.5}{12}$$

= Rs. 1,333

3. Joint Life Policy = Rs. 1,25,000

Sohan's Share $= \frac{2}{5} \times$ Rs. 1,25,000

= Rs. 50,000

4. Interest on Capital $= \text{Rs. } 25,000 \times \frac{12}{100} \times \frac{2.5}{12}$

= Rs. 625

Do it Yourself

On December 31, 2015, the Balance Sheet of Pinki, Qureshi and Rakesh showed as under :

Balance Sheet as on December 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		25,000	Buildings	26,000
Reserve Fund		20,000	Investments	15,000
Capitals:			Debtors	15,000
Pinki	15,000		Bills Receivables	6,000
Qureshi	10,000		Stock	12,000
Rakesh	10,000	35,000	Cash	6,000
		80,000		**80,000**

The partnership deed provides that the profit be shared in the ratio of 2:1:1 and that in the event of death of a partner, his executors be entitled to be paid out :

(a) The capital of his credit at the date of last Balance Sheet.
(b) His proportion of reserves at the date of last Balance Sheet.
(c) His proportion of profits to the date of death based on the average profits of the last three completed years, plus 10%, and
(d) By way of goodwill, his proportion of the total profits for the three preceding years. The net profit for the last three years were :

	(Rs.)
2013	16,000
2014	16,000
2015	15,400

Rakesh died on April 1, 2015. He had withdrawn Rs.5,000 to the date of his death. The investment were sold at par and R's Executors were paid off. Prepare Rakesh's Capital Account that of his executors.

Terms Introduced in the Chapter

- Retirement of a Partner.
- Death of a Partner.
- Gaining Ratio
- Executors of deceased Partner
- Executor's Account.

Summary

1. *New Profit Sharing Ratio:* New profit sharing ratio is the ratio in which the remaining partner will share future profits after the retirement or death of any partner.

   New Share = Old Share + Acquired Share from the Outgoing partner

2. *Gaining Ratio:* Gaining ratio is the ratio in which the continuing partners have acquired the share from the retiring deceased partner.
3. *Treatment of Goodwill:* The basic rule is that gaining partner(s) shared compensate the sacrificing partner to the extent of their gain for the respective share of goodwill.

   If goodwill already appears in the books, it will be written off by debiting all partner's capital account in their old profit sharing ratio.

4. *Revaluation of Assets and Liabilities*: At the time of retirement/death of a partner, there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm.

   Besides this, there may be unrecorded assets and liabilities which have to be recorded.

5. *Accumulated Profits or Losses:* The reserves (Accumulated profits) or losses belong to all the partners and should be transferred to capital account of all partners.

   6. Retiring partner/deceased partner may be paid in one lump sum or installments with interest.

7. At the time of retirement/death of a partner, the remaining partner may decide to keep their capital contributions in their profit sharing ratio.

Questions for Practice

Short Answer Questions

1. What are the different ways in which a partner can retire from the firm.
2. Write the various matters that need adjustments at the time of retirement of a partners.
3. Distinguish between sacrificing ratio and gaining tab.

4. Why do firm revaluate assets and reassers their liabilities on retirement or on the event of death of a partner.
5. Why a retiring/deceased partner is entitled to a share of goodwill of the firm.

Long Answer Questions

1. Explain the modes of payment to a retiring partner.
2. How will you compute the amount payable to a deceased partner?
3. Explain the treatment of goodwill at the time of retirement or on the event of death of a partner?
4. Discuss the various methods of computing the share in profits in the event of death of a partner.

Numerical Questions

1. Aparna, Manisha and Sonia are partners sharing profits in the ratio of 3 : 2 : 1. Manisha retires and goodwill of the firm is valued at Rs. 1,80,000. Aparna and Sonia decided to share future in the ratio of 3 : 2. Pass necessary journal entries.

   (**Ans :** Dr. Aparna's Capital A/c by Rs. 18,000, Dr. Sonia's Capital A/c by Rs. 42,000, Cr. Manisha's Capital A/c by Rs. 60,000).
2. Sangeeta, Saroj and Shanti are partners sharing profits in the ratio of 2 : 3 : 5. Goodwill is appearing in the books at a value of Rs. 60,000. Sangeeta retires and goodwill is valued at Rs. 90,000. Saroj and Shanti decided to share future profits equally. Record necessary journal entries.
3. Himanshu, Gagan and Naman are partners sharing profits and losses in the ratio of 3 : 2 : 1. On March 31, 2017, Naman retires.

   The various assets and liabilities of the firm on the date were as follows:

   Cash Rs. 10,000, Building Rs. 1,00,000, Plant and Machinery Rs. 40,000, Stock Rs. 20,000, Debtors Rs. 20,000 and Investments Rs. 30,000.

   The following was agreed upon between the partners on Naman's retirement:
   (i) Building to be appreciated by 20%.
   (ii) Plant and Machinery to be depreciated by 10%.
   (iii) A provision of 5% on debtors to be created for bad and doubtful debts.
   (iv) Stock was to be valued at Rs. 18,000 and Investment at Rs. 35,000.

   Record the necessary journal entries to the above effect and prepare the revaluation account.
4. Naresh, Raj Kumar and Bishwajeet are equal partners. Raj Kumar decides to retire. On the date of his retirement, the Balance Sheet of the firm showed the following: General Reserves Rs. 36,000 and Profit and Loss Account (Dr.) Rs. 15,000.
   Pass the necessary journal entries to the above effect.

5. Digvijay, Brijesh and Parakaram were partners in a firm sharing profits in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2017 was as follows:

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors	49,000	Cash	8,000
Reserves	18,500	Debtors	19,000
Digvijay's Capital	82,000	Stock	42,000
Brijesh's Capital	60,000	Buildings	2,07,000
Parakaram's Capital	75,500	Patents	9,000
	2,85,000		**2,85,000**

Brijesh retired on March 31, 2017 on the following terms:

(i) Goodwill of the firm was valued at Rs. 70,000 and was not to appear in the books.

(ii) Bad debts amounting to Rs. 2,000 were to be written off.

(iii) Patents were considered as valueless.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of Digvijay and Parakaram after Brijesh's retirement.

(**Ans :** Loss on Revaluation Rs. 11,000, Balance of Capital Accounts: Digvijay Rs. 66,333 and Parakaram Rs. 67,667, Balance Sheet Total Rs. 2,74,000).

6. Radha, Sheela and Meena were in partnership sharing profits and losses in the proportion of 3:2:1. On April 1, 2017, Sheela retires from the firm. On that date, their Balance Sheet was as follows:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Trade Creditors		3,000	Cash-in-Hand	1,500
Bills Payable		4,500	Cash at Bank	7,500
Expenses Owing		4,500	Debtors	15,000
General Reserve		13,500	Stock	12,000
Capitals:			Factory Premises	22,500
Radha	15,000		Machinery	8,000
Sheela	15,000		Losse Tools	4,000
Meena	15,000	45,000		
		70,500		**70,500**

The terms were:

a) Goodwill of the firm was valued at Rs. 13,500.

b) Expenses owing to be brought down to Rs. 3,750.

c) Machinery and Loose Tools are to be valued at 10% less than their book value.

d) Factory premises are to be revalued at Rs. 24,300.

Prepare:

1. Revaluation account
2. Partner's capital accounts and
3. Balance sheet of the firm after retirement of Sheela.

(**Ans :** Profit on Revaluation Rs. 1,350, Balance of Capital Accounts: Radha Rs. 19,050 and Meena Rs. 16,350, Balance Sheet Total = Rs. 71,100).

7. Pankaj, Naresh and Saurabh are partners sharing profits in the ratio of 3 : 2 : 1. Naresh retired from the firm due to his illness. On that date the Balance Sheet of the firm was as follows:

Books of Pankaj, Naresh and Saurabh
Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
General Reserve		12,000	Bank		7,600
Sundry Creditors		15,000	Debtors	6,000	
Bills Payable		12,000	*Less:* Provision for Doubtful Debt	400	5,600
Outstanding Salary		2,200			
Provision for Legal Damages		6,000	Stock		9,000
Capitals:			Furniture		41,000
Pankaj	46,000		Premises		80,000
Naresh	30,000				
Saurabh	20,000	96,000			
		1,43,200			**1,43,200**

Additional Information

(i) Premises have appreciated by 20%, stock depreciated by 10% and provision for doubtful debts was to be made 5% on debtors. Further, provision for legal damages is to be made for Rs. 1,200 and furniture to be brought up to Rs. 45,000.

(ii) Goodwill of the firm be valued at Rs. 42,000.

(iii) Rs. 26,000 from Naresh's Capital account be transferred to his loan account and balance be paid through bank; if required, necessary loan may be obtained form Bank.

(iv) New profit sharing ratio of Pankaj and Saurabh is decided to be 5 : 1.

Give the necessary ledger accounts and balance sheet of the firm after Naresh's retirement.

(**Ans :** Profit or Revaluation Rs. 18,000, Balance of Capital Account of Pankaj, Rs. 47,000 and of Saurabh, Rs. 25,000).

(Total Amount at Credit in Naresh's Capital = Rs. 54,000, Balance Sheet Total = Rs. 1,54,800).

8. Puneet, Pankaj and Pammy are partners in a business sharing profits and losses in the ratio of 2 : 2 : 1 respectively. Their balance sheet as on March 31, 2017 was as follows:

Books of Puneet, Pankaj and Pammy
Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		1,00,000	Cash at Bank	20,000
Capital Accounts:			Stock	30,000
Puneet	60,000		Sundry Debtors	80,000
Pankaj	1,00,000		Investments	70,000
Pammy	40,000	2,00,000	Furniture	35,000
Reserve		50,000	Buildings	1,15,000
		3,50,000		**3,50,000**

Mr. Pammy died on September 30, 2017. The partnership deed provided the following:

(i) The deceased partner will be entitled to his share of profit up to the date of death calculated on the basis of previous year's profit.

(ii) He will be entitled to his share of goodwill of the firm calculated on the basis of 3 years' purchase of average of last 4 years' profit. The profits for the last four financial years are given below:
for 2013–14; Rs. 80,000; for 2014–15, Rs. 50,000; for 2015–16, Rs. 40,000; for 2016–17, Rs. 30,000.
The drawings of the deceased partner up to the date of death amounted to Rs. 10,000. Interest on capital is to be allowed at 12% per annum.
Surviving partners agreed that Rs. 15,400 should be paid to the executors immediately and the balance in four equal yearly instalments with interest at 12% p.a. on outstanding balance.
Show Mr. Pammy's Capital account, his Executor's account till the settlement of the amount due.

(**Ans :** Total amount due is Rs. 75,400)

9. Following is the Balance Sheet of Prateek, Rockey and Kushal as on March 31, 2017.

Books of Prateek, Rockey and Kushal
Balance Sheet as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Bills Receivable	16,000
General Reserve		16,000	Furniture	22,600
Capital Accounts:			Stock	20,400
Prateek	30,000		Sundry Debtors	22,000
Rockey	20,000		Cash at Bank	18,000
Kushal	20,000	70,000	Cash in Hand	3,000
		1,02,000		**1,02,000**

Rockey died on June 30, 2017. Under the terms of the partnership deed, the executors of a deceased partner were entitled to:

a) Amount standing to the credit of the Partner's Capital account.
b) Interest on capital at 5% per annum.
c) Share of goodwill on the basis of twice the average of the past three years' profit and
d) Share of profit from the closing date of the last financial year to the date of death on the basis of last year's profit.

Profits for the year ending on March 31, 2015, March 31, 2016 and March 31, 2017 were Rs. 12,000, Rs. 16,000 and Rs. 14,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up Rockey's capital account to be rendered to his executor.

(**Ans :** Sony's Executor Account is Rs. 33,821)

10. Narang, Suri and Bajaj are partners in a firm sharing profits and losses in proportion of $1/2$, $1/6$ and $1/3$ respectively. The Balance Sheet on April 1, 2015 was as follows:

Books of Suri and Bajaj
Balance Sheet as on April 1, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		12,000	Freehold Premises		40,000
Sundry Creditors		18,000	Machinery		30,000
Reserves		12,000	Furniture		12,000
Capital Accounts:			Stock		22,000
Narang	30,000		Sundry Debtors	20,000	
Suri	30,000		*Less:* Reserve for Bad	1,000	19,000
Bajaj	28,000	88,000	Debt		
			Cash		7,000
		1,30,000			**1,30,000**

Bajaj retires from the business and the partners agree to the following:

a) Freehold premises and stock are to be appreciated by 20% and 15% respectively.
b) Machinery and furniture are to be depreciated by 10% and 7% respectively.
c) Bad Debts reserve is to be increased to Rs. 1,500.
d) Goodwill is valued at Rs. 21,000 on Bajaj's retirement.
e) The continuing partners have decided to adjust their capitals in their new profit sharing ratio after retirement of Bajaj. Surplus/deficit, if any, in their capital accounts will be adjusted through current accounts.

Prepare necessary ledger accounts and draw the Balance Sheet of the reconstituted firm.

(**Ans :** Profit on Revaluation, Rs. 6,960; Balance in Capital Accounts of Narang, Rs. 49,230; and that of Suri, Rs. 16,410. Amount at Credit in Bajaj Capital is Rs. 41,320).

11. The Balance Sheet of Rajesh, Pramod and Nishant who were sharing profits in proportion to their capitals stood as on March 31, 2015:

Books of Rajesh, Pramod and Nishant
Balance Sheet as on March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		6,250	Factory Building		12,000
Sundry Creditors		10,000	Debtors	10,500	
Reserve Fund		2,750	*Less:* Reserve	500	10,000
Capital Accounts:			Bills Receivable		7,000
Rajesh	20,000		Stock		15,500
Pramod	15,000		Plant and Machinery		11,500
Nishant	15,000	50,000	Bank Balance		13,000
		69,000			**69,000**

Pramod retired on the date of Balance Sheet and the following adjustments were made:

a) Stock was valued at 10% less than the book value.
b) Factory buildings were appreciated by 12%.
c) Reserve for doubtful debts be created up to 5%.
d) Reserve for legal charges to be made at Rs. 265.
e) The goodwill of the firm be fixed at Rs. 10,000.
f) The capital of the new firm be fixed at Rs. 30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3 : 2.

Pass journal entries and prepare the balance sheet of the reconstituted firm after transferring the balance in Pramod's Capital account to his loan account.

(**Ans :** Loss on Revaluation, Rs. 400 ; Balance in Capital Accounts of Rajesh, Rs. 18,940; and of Nishant, Rs. 14,705; Pramod's Loan Rs. 18,705, Balance Sheet Total = Rs. 65,220).

12. Following is the Balance Sheet of Jain, Gupta and Malik as on March 31, 2016.

Books of Jain, Gupta and Malik
Balance Sheet as on March 31, 2016

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		19,800	Land and Building	26,000
Telephone bills Outstanding		300	Bonds	14,370
Accounts Payable		8,950	Cash	5,500
Accumulated profits		16,750	Bills Receivable	23,450
Capitals :			Sundry Debtors	26,700
			Stock	18,100
Jain	40,000		Office Furniture	18,250
Gupta	60,000		Plants and Machinery	20,230
Malik	20,000	1,20,000	Computers	13,200
		1,65,800		**1,65,800**

The partners have been sharing profits in the ratio of 5:3:2. Malik decides to retire from business on April 1, 2016 and his share in the business is to be calculated as per the following terms of revaluation of assets and liabilities : Stock, Rs.20,000; Office furniture, Rs.14,250; Plant and Machinery Rs.23,530; Land and Building Rs.20,000.

A provision of Rs.1,700 to be created for doubtful debts. The goodwill of the firm is valued at Rs.9,000.

The continuing partners agreed to pay Rs.16,500 as cash on retirement of Malik, to be contributed by continuing partners in the ratio of 3:2. The balance in the capital account of Malik will be treated as loan.

Prepare Revaluation account, capital accounts, and Balance Sheet of the reconstituted firm.

13. Arti, Bharti and Seema are partners sharing profits in the proportion of 3:2:1 and their Balance Sheet as on March 31, 2016 stood as follows :

Books of Arti, Bharti and Seema
Balance Sheet as on March 31, 2016

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bills Payable		12,000	Buildings	21,000
Creditors		14,000	Cash in Hand	12,000
General Reserve		12,000	Bank	13,700
Capitals:			Debtors	12,000
Arti	20,000		Bills Receivable	4,300
Bharti	12,000		Stock	1,750
Seema	8,000	40,000	Investment	13,250
		78,000		**78,000**

Bharti died on June 12, 2016 and according to the deed of the said partnership, her executors are entitled to be paid as under :

(a) The capital to her credit at the time of her death and interest thereon @ 10% per annum.

(b) Her proportionate share of reserve fund.

(c) Her share of profits for the intervening period will be based on the sales during that period, which were calculated as Rs.1,00,000. The rate of profit during past three years had been 10% on sales.

(d) Goodwill according to her share of profit to be calculated by taking twice the amount of the average profit of the last three years less 20%. The profits of the previous years were :

2013 – Rs.8,200
2014 – Rs.9,000
2015 – Rs.9,800

The investments were sold for Rs.16,200 and her executors were paid out. Pass the necessary journal entries and write the account of the executors of Bharti.

14. Nithya, Sathya and Mithya were partners sharing profits and losses in the ratio of 5:3:2. Their Balance Sheet as on March 31, 2015 was as follows :

Books of Nithya, Sathya and Mithya
Balance Sheet at March 31, 2015

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		14,000	Investments	10,000
Reserve Fund		6,000	Goodwill	5,000
Capitals:			Premises	20,000
Nithya	30,000		Patents	6,000
Sathya	30,000		Machinery	30,000
Mithya	20,000	80,000	Stock	13,000
			Debtors	8,000
			Bank	8,000
		1,00,000		**1,00,000**

Mithya dies on August 1, 2015. The agreement between the executors of Mithya and the partners stated that :

(a) Goodwill of the firm be valued at $2\frac{1}{2}$ times the average profits of last four years. The profits of four years were : in 2011-12, Rs.13,000; in 2012-13, Rs.12,000; in 2013-14, Rs.16,000; and in 2014-15, Rs.15,000.

(b) The patents are to be valued at Rs.8,000, Machinery at Rs.25,000 and Premises at Rs.25,000.

(c) The share of profit of Mithya should be calculated on the basis of the profit of 2014-15.

(d) Rs.4,200 should be paid immediately and the balance should be paid in 4 equal half-yearly instalments carrying interest @ 10%.

Record the necessary journal entries to give effect to the above and write the executor's account till the amount is fully paid. Also prepare the Balance Sheet of Nithya and Sathya as it would appear on August 1, 2015 after giving effect to the adjustments.

Check-list to Test your Understanding

Test your understanding – I

1. (b), 2. (c), 3. (b), 4. (a).

Test your understanding – II

1. (a), 2. (a), 3. (c), 4. (b).

Dissolution of Partnership Firm

5

> **Learning Objectives**
>
> *After studying this chapter you will be able to :*
>
> - *State the meaning of dissolution of partnership firm;*
> - *Differentiate between dissolution of partnership and dissolution of a partnership firm;*
> - *Describe the various modes of dissolution of the partnership firm;*
> - *Explain the rules relating to the settlement of claims among all partners;*
> - *Prepare Realisation Account;*

You have learnt about the reconstitution of a partnership firm which takes place on account of admission, retirement or death of a partner. In such a situation while the existing partnership is dissolved, the firm may continue under the same name if the partners so decide. In other words, it results in the dissolution of a partnership but not that of the firm. According to Section 39 of the partnership Act 1932, the dissolution of partnership between all the partners of a firm is called the dissolution of the firm. That means the Act recognises the difference in the breaking of relationship between all the partners of a firm and between some of the partners; and it is the breaking or discontinuance of relationship between all the partners which is termed as the dissolution of partnership firm. This brings an end to the existence of firm, and no business is transacted after dissolution except the activities related to closing of the firm as the affairs of the firm are to be wound up by selling firm's assets and paying its liabilities and discharging the claims of the partners.

5.1 Dissolution of Partnership

As stated earlier dissolution of partnership changes the existing relationship between partners but the firm may continue its business as before. The dissolution of partnership may take place in any of the following ways:

(1) Change in existing profit sharing ratio among partners;

(2) Admission of a new partner;

(3) Retirement of a partner;
(4) Death of a partner;
(5) Insolvency of a partner;
(6) Completion of the venture, if partnership is formed for that; and
(7) Expiry of the period of partnership, if partnership is for a specific period of time;

5.2 Dissolution of a firm

Dissolution of a partnership firm may take place without the intervention of court or by the order of a court, in any of the ways specified later in this section. It may be noted that dissolution of the firm necessarily brings in dissolution of the partnership.

Dissolution of a firm takes place in any of the following ways:

1. *Dissolution by Agreement:* A firm is dissolved :
   (a) with the consent of all the partners or
   (b) in accordance with a contract between the partners.
2. *Compulsory Dissolution:* A firm is dissolved compulsorily in the following cases:
   (a) when all the partners or all but one partner, become insolvent, rendering them incompetent to sign a contract;
   (b) when the business of the firm becomes illegal; or
   (c) when some event has taken place which makes it unlawful for the partners to carry on the business of the firm in partnership, e.g., when a partner who is a citizen of a country becomes an alien enemy because of the declaration of war with his country and India.
3. *On the happening of certain contingencies:* Subject to contract between the partners, a firm is dissolved :
   (a) if constituted for a fixed term, by the expiry of that term;
   (b) if constituted to carry out one or more ventures, by the completion thereof;
   (c) by the death of a partner;
   (d) by the adjudication of a partner as an insolvent.
4. *Dissolution by Notice:* In case of partnership at will, the firm may be dissolved if any one of the partners gives a notice in writing to the other partners, signifying his intention of seeking dissolution of the firm.
5. *Dissolution by Court:* At the suit of a partner, the court may order a partnership firm to be dissolved on any of the following grounds:
   (a) when a partner becomes insane;
   (b) when a partner becomes permanently incapable of performing his duties as a partner;
   (c) when a partner is guilty of misconduct which is likely to adversely affect the business of the firm;

(d) when a partner persistently commits breach of partnership agreement;
(e) when a partner has transferred the whole of his interest in the firm to a third party;
(f) when the business of the firm cannot be carried on except at a loss; or
(g) when, on any ground, the court regards dissolution to be just and equitable.

Distinction between Dissolution of Partnership and Dissolution of Firm

Basis	*Dissolution of Partnership*	*Dissolution of Firm*
1. Termination of business	The business is not terminated.	The business of the firm is closed.
2. Settlement of assets and liabilities	Assets and liabilities are revalued and new balance sheet is drawn.	Assets are sold and liabilities are paid-off.
3. Court's intervention	Court does not intervene because partnership is dissolved by mutual agreement.	A firm can be dissolved by the court's order.
4. Economic relationship	Economic relationship between the partners continues though in a changed form.	Economic relationship between the partners comes to an end.
5. Closure of books	Does not require because the business is not terminated.	The books of account are closed.
6. Other dissolution	It may or may not involve dissolution of the firm.	It necessarily involves dissolution of partnership.

Test your Understanding – I

State giving reasons, which of the following statements are true or false:
1. Dissolution of a partnership is different from dissolution of a firm,
2. A partnership is dissolved when there is a death of a partner,
3. A firm is dissolved when all partners give consent to it.
4. A firm is compulsorily dissolved when a partner decide to retire.
5. Dissolution of a firm necessarily involves dissolution of partnership.
6. A firm is compulsorily dissolved when all partners or when all except one partner become involvent.
7. Court can order a firm to be dissolved when a partner becomes insane.
8. Dissolution of partnership can not take place without intervention of the court.

5.3 Settlement of Accounts

In case of dissolution of a firm, the firm ceases to conduct business and has to settle its accounts. For this purpose, it disposes off all its assets for satisfying all the claims against it. In this context it should be noted that, subject to agreement among the partners, the following rules as provided in Section 48 of the Partnership Act 1932 shall apply.

(a) *Treatment of Losses*

Losses, including deficiencies of capital, shall be paid :

(i) first out of profits,
(ii) next out of capital of partners, and
(iii) lastly, if necessary, by the partners individually in their profits sharing ratio.

(b) *Application of Assets*

The assets of the firm, including any sum contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

(i) In paying the debts of the firm to the third parties;
(ii) In paying each partner proportionately what is due to him/her from the firm for advances as distinguished from capital (i.e. partner' loan);
(iii) In paying to each partner proportionately what is due to him on account of capital; and
(iv) the residue, if any, shall be divided among the partners in their profit sharing ratio.

Thus, the amount realised from assets along with contribution from partners, if required, shall be utilised first to pay off the outside liabilities of the firm such as creditors, loans, bank overdraft, bill payables, etc. (it may be noted that secured loans have precedence over the unsecured loans); the balance should be applied to repay loans and advances made by the partners to the firm. (in case the balance amount is not adequate enough to pay off such loans and advances, they are to be paid propartionately); and surplus, if any is to be utilised in settlement of the capital account balances, after adjusting all profits and losses.

Private Debts and Firm's Debts: Where both the debts of the firm and private debts of a partner co-exist, the following rules, as stated in Section 49 of the Act, shall apply.

(a) The property of the firm shall be applied first in the payment of debts of the firm and then the surplus, if any, shall be divided among the partners as per their claims, which can be utilised for payment of their private liabilities.
(b) The private property of any partner shall be applied first in payment of his private debts and the surplus, if any, may be utilised for payment of the firm's debts, in case the firm's liabilities exceed the firm's assets.

It may be noted that the private property of the partner does not include the personal properties of his wife and children. Thus, if the assets of the firm are not adequate enough to pay off firm's liabilities, the partners have to contribute out of their net private assets (private assets minus private liabilities).

Inability of a Partner to Contribute Towards Deficiency

In the context of settlement of accounts among the partners there is still another important aspect to be noted, i.e., when a partner is unable to contribute towards the deficiency of his capital account (the account finally showing a debit balance), he/she is said to be insolvent, and the sum not recoverable is treated as capital loss for the firm. In the absence of any agreement, to the contrary, such a capital loss is to be borne by the remaining solvent partners in accordance with the principle laid down in Garner vs. Murray case, which states that the solvent partners have to bear such loss in the ratio of their capitals as on the date of dissolution. However, the accounting treatment relating to dissolution of partnership on account of insolvency of partners is not being taken up at this stage.

5.4 Accounting Treatment

When the firm is dissolved, its books of account are to be closed and the profit or loss arising on realisation of its assets and discharge of liabilities is to be computed. For this purpose, a Realisation Account is prepared to ascertain the net effect (profit or loss) of realisation of assets and payment of liabilities which may be is transferred to partner's capital accounts in their profit sharing ratio. Hence, all assets (other than cash in hand bank balance and fictitious assets, if any), and all external liabilities are transferred to this account. It also records the sale of assets, and payment of liabilities and realisation expenses. The balance in this account is termed as profit or loss on realisation which is transferred to partners' capital accounts in thier profit sharing ratio (see figure 5.1)

Dr. **Realisation Account** *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Land and Building	xxx	Sundry creditors	xxx
Plant and Machinery	xxx	Bills payables	xxx
Furniture and Fittings	xxx	Bank overdraft	xxx
Bills receivables	xxx	Outstanding expenses	xxx
Sundry debtors	xxx	Provision for doubtful debts	xxx
Cash/Bank (payment of liabilities)	xxx	Cash/Bank (sale of assets)	xxx
Cash/Bank (payment of unrecorded liabilities)	xxx	Partner's capital account (assets taken by the partner)	xxx
Partner's capital account (liability assumed by the partner)	xxx	Loss (transferred to partners capital accounts)	xxx
Profit (transferred to partners' capital account's in their profit sharing ratio)	xxx		
Total	**xxxxx**	**Total**	**xxxxx**

Fig. 5.1: *Format of Realisation Account*

Illustration 1

Supriya and Monika are partners, who share profit in the ratio of 3:2. Following is the balance sheet as on March 31, 2017.

Balance Sheet of Supriya and Monika as on March 31, 2017

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Supriya's Capital	32,500	Cash and Bank		40,500
Monika's Capital	11,500	Stock		7,500
Sundry Creditors	48,000	Sundry debtors	21,500	
Reserve fund	13,500	*Less:* Provision for doubtful debts	500	21,000
		Fixed Assets		36,500
	1,05,500			**1,05,500**

The firm was dissolved on March 31, 2017. Close the books of the firm with the following information:

(i) Debtors realised at a discount of 5%,
(ii) Stock realised at Rs.7,000,
(iii) Fixed assets realised at Rs.42,000,
(iv) Realisation expenses of Rs.1,500,
(v) Creditors are paid in full.

Prepare necessary ledger accounts.

Solution

Books of Supriya and Monika
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Assets transferred:			Provision for doubtful debts		500
Stock		7,500	Sundry creditors		48,000
Sundry debtors		21,500	Bank		
Fixed assets		36,500	Debtors	20,425	
Bank			Stock	7,000	
Creditors		48,000	Fixed assets	42,000	69,425
Realisation expenses		1,500			
Profit transferred to:					
Supriya Capital	1,755				
Monika Capital	1,170	2,925			
		1,17,925			**1,17,925**

Partners Capital Accounts

Dr. *Cr.*

Date	Particulars	J.F.	Supriya (Rs.)	Monika (Rs.)	Date	Particulars	J.F.	Supriya (Rs.)	Monika (Rs.)
	Bank		42,355	18,070		Balance b/d		32,500	11,500
						Reserve fund		8,100	5,400
						Realisation (Profit)		1,755	1,170
			42,355	**18,070**				**42,355**	**18,070**

Cash and Bank Account

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		40,500		Realisation		48,000
	Realisation		69,425		Realisation		1,500
					Supriya's Capital		42,355
					Monika's Capital		18,070
			1,09,925				**1,09,925**

5.4.1 Journal Entries

1. *For trnasfer of assets*

All asset accounts excluding cash, bank and the fictitious assets, if any are closed by transfer to the debit of Realisation Account at their book values. It may be noted that sundry debtors are transferred at gross value and the provision for doubtful debts is transferred to the credit side of Realisation Account along with liabilities. The same thing will apply to fixed assets, if provision for depreciation account is maintained.

Realisation A/c Dr.
  To Assets (Individually) A/c

2. *For transfer of liabilities*

All external liability accounts including provisions, if any, are closed by transferring them to the credit of Realisation account.

Liabilities (individually) Dr.
  To Realisation A/c

3. *For sale of assets*

Bank A/c Dr.
  To Realisation A/c

4. *For an asset taken over by a partner*

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

5. *For payment of liabilities*

   Realisation A/c Dr.
   To Bank A/c

6. *For a liability which a partner takes responsibility to discharge*

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

7. For settlement with the creditor through transfer of assets when a creditor accepts an asset in full and final settlement of his account, journal entry needs to be recorded. But, if the creditor accepts an asset only as part payment of his/her dues, the entry will be made for cash payment only. For example, a creditor to whom Rs. 10,000 was due accepts office equipment worth Rs. 8,000 and is paid Rs. 2,000 in cash, the following entry shall be made for the payment of Rs. 2,000 only.

   Realisation A/c Dr.
   To Bank A/c

However, when a creditor accepts an asset whose value is more than the amount due to him, he/she will pay cash to the frim for the difference for which the entry will be:

   Bank A/c Dr.
   To Realisation A/c

8. *For payment of realisation expenses*

   (a) When some expenses are incurred and paid by the firm in the process of realisation of assets and payment of liabilities:

   Realisation A/c Dr.
   To Bank A/c

   (b) When realisation expenses are paid by a partner on behalf of the firm:

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

   (c) When a partner has agreed to undertake the dissolution work for an agreed remuneration bear the realisation expenses:

   (i) if payment of realisation expenses is made by the firm

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

   (ii) if the partner himself pays the realisation expenses, no entry is required

   (iii) For agreed remuneration to such partner

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

9. *For realisation of any unrecorded assets including goodwill, if any*

    Bank A/c Dr.
    To Realisation A/c

10. *For settlement of any unrecorded liability*

    Realisation A/c Dr.
    To Bank A/c

11. *For transfer of profit and loss on realisation*

    (a) In case of profit on realisation
    Realisation A/c Dr.
    To Partners' Capital A/c (individually) A/c

    (b) In case of loss on realisation
    Partners' Capital A/c (individually) Dr.
    To Realisation A/c

12. *For transfer of accumulated profits in the form of reserve fund or general reserve:*

    Reserve Fund/General Reserve A/c Dr.
    To Partners' Capital A/c (individually)

13. *For transfer of fictitious assets, if any, to partners' capital accounts in their profit sharing ratio:*

    Partners' Capital A/c (individually) Dr.
    To Fictitious Asset A/c

14. *For payment of loans due to partners*

    Partner's Loan A/c Dr.
    To Bank A/c

15. *For settlement of partners' accounts*

    If the partner's capital account shows a debit balance, he brings in the necessary cash for which the entry will be:

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

    The balance is paid to partners whose capital accounts show a credit balance and the following entry is recorded.

    Partners' Capitals A/cs (individually) Dr.
    To Bank A/c

It may be noted that the aggregate amount finally payable to the partners must equal to the amount available in bank and cash accounts. Thus, all accounts of a firm are closed in case of dissolution.

Test your Understanding – II

Tick (✓) the Correct Answer

1. On dissolution of a firm, bank overdraft is transferred to :
   (a) Cash Account
   (b) Bank Account
   (c) Realisation Aaccount
   (d) Partner's capital Account.
2. On dissolution of a firm, partner's loan account is transferred to:
   (a) Realisation Account
   (b) Partner's Capital Account
   (c) Partner's Current Account
   (d) None of the above.
3. After transferring liabilities like creditors and bills payables in the Realisation Account, in the absence of any information regarding then payment, such liabilities are treated as:
   (a) Never paid
   (b) Fully paid
   (c) Partly paid
   (d) None of the above.
4. When realisation expenses are paid by the firm on behalf of a partner, such expenses are debited to:
   (a) Realisation Account
   (b) Partner's Capital Account
   (c) Partner's Loan Account
   (d) None of the above.
5. Unrecorded assets when taken over by a partner are shown in :
   (a) Debit of Realisation Account
   (b) Debit of Bank Account
   (c) Credit of Realisation Account
   (d) Credit of Bank Account.
6. Unrecorded liabilities when paid are shown in:
   (a) Debit of Realisation Account
   (b) Debit of Bank Account
   (c) Credit of Realisation Account
   (d) Credit of Bank Account.
7. The accumulated profits and reserves are transferred to :
   (a) Realisation Account
   (b) Partners' Capital Accounts
   (c) Bank Account
   (d) None of the above.
8. On dissolution of the firm, partner's capital accounts are closed through:
   (a) Realisation Account
   (b) Drawings Account
   (c) Bank Account
   (d) Loan Account.

Illustration 2

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

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

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Reserve fund		2,500	Cash at bank	2,500
Creditors		2,000	Stock	2,500
Capitals:			Furniture	1,000
Sita	5,000		Debtors	2,000
Rita	2,000		Plant and Machinery	4,500
Meeta	1,000	8,000		
		12,500		**12,500**

They decided to dissolve the business. The following amounts were realised: Plant and Machinery Rs.4,250, Stock Rs.3,500, Debtors Rs.1850, Furniture 750.

Sita agreed to bear all realisation expenses. For the service Sita is paid Rs.60.

Actual expenses on realisation amounted to Rs.450.Creditors paid 2% less. There was an unrecorded assets of Rs.250, which was taken over by Rita at Rs.200.

Prepare the necessary accounts to close the books of the firm.

Solution

Books of Sita, Rita and Meeta

Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Creditors		2,000
Stock		2,500	Rita's capital		200
Furniture		1,000	[Unrecorded assets]		
Debtors		2,000	Bank [assets realised]:		
Plant and Machinery		4,500	Plant and Machinery	4,250	
Bank [Creditors]		1,960	Debtors	1,850	
Sita's capital		60	Stock	3,500	
(realisation expenses]			Furniture	750	10,350
Profit transferred to:					
Sita's capital	212				
Rita's capital	212				
Meeta's capital	106	530			
		12,550			**12,550**

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

Date	Particulars	J.F.	Sita (Rs.)	Rita (Rs.)	Meeta (Rs.)	Date	Particulars	J.F.	Sita (Rs.)	Rita (Rs.)	Meeta (Rs.)
	Bank		450				Balance b/d		5,000	2,000	1,000
	Realisation (asset)			200			Reserve fund		1,000	1,000	500
	Bank		5,822	3,012	1,606		Realisation [profit]		212	212	106
							Realisation (expenses)		60	—	—
			6,272	**3,212**	**1,606**				**6,272**	**3,212**	**1,606**

Dr. **Bank Account** *Cr.*

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

llustration 3

Nayana and Arushi were partners sharing profits equally Their Balance Sheet as on March 31, 2017 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 Fund		15,000	Nayana's current account	10,000
Bank overdraft		5,000		
		2,00,000		**2,00,000**

The firm was dissolved on the above date:

1. Nayana took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realised for Rs.30,000 and Rs.50,000 respectively;
2. There was an unrecorded investment which was sold for Rs. 25,000;

3. Debtors realised 90% only and Rs.1,200 were recovered for bad debts written-off last year;
4. There was an outstanding bill for repairs which had to be paid for Rs.2,000.

Record necessary journal entries and prepare ledger accounts to close the books of the firm.

Solution

Books of Nayana and Arushi
Journal

Date 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 Capital A/c	Dr.		15,750	
	To Realisation A/c				15,750
	(Half stock take over by Nayana at 10% less)				
	Realisation A/c	Dr.		15,575	
	To Nayana's Current A/c				5,788
	To Arushi's Current A/c				5,787
	(Realisation profit transferred to partner's current account)				
	Workman Compensation Fund A/c	Dr.		15,000	
	To Nayana's Current A/c				7,500
	To Arushi's Current A/c				7,500
	(Compensation fund transfered to partners' Current account)				

	Arushi Current A/c Dr. To Arushi's Capital A/c (Current account balance transferred to Capital account)		23,287	23,287
	Nayana Capital A/c Dr. To Nayana's Current A/c (Current account balance transferred to Capital account)		12,462	12,462
	Nayana's Capital A/c Dr. Arushi's Capital A/c Dr. To Bank A/c (Final amounts due to partners paid)		87,538 73,287	1,60,825

Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Creditors		20,000
Debtors	25,000		Bank overdraft		5,000
Stock	35,000		Bank:		
Furniture	40,000		Investment	25,000	
Machinery	60,000	1,60,000	Furniture	30,000	
Bank:			Machinery	50,000	
Creditors	20,000		Debtors (90%)	31,500	
Bank overdraft	5,000		Stock :	20,125	
Outstanding bill	2,000	27,000	Bad debts		
Profit transferred to :			recovered	1,200	1,57,825
Nayana's capital	5,788		Nayana's capital		
Arushi's capital	5,787	11,575	(stock taken over)		15,750
		1,98,575			**1,98,575**

Partners' Current Accounts

Dr. *Cr.*

Date 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 Fund		7,500	7,500
	Arushi's capital			23,287		Realisation (profit)		5,788	5,787
						Nayana's Capital		12,462	
			25,750	**23,287**				**25,750**	**23,287**

Partner's Current Accounts

Dr. *Cr.*

Date 2017	Particulars	J.F.	Nayana (Rs.)	Arushi (Rs.)	Date 2017	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

Dr. *Cr.*

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d		30,000		Realisation		27,000
	Realisation		1,57,825		Nayana's capital		87,538
					Arushi's capital		73,287
			1,87,825				**1,87,825**

Test your Understanding – III

Fill in the Correct Word(s):

1. All assets (except cash/bank and fictitious assets) are transferred to the ———— (Debit/Credit) side of ———— Account (Realisation/Capital).
2. All ———— (internal/external) liabilities are transferred to the ———— (Debit/Credit) side of ————acccount (Bank/Realisation).
3. Accumulated losses are transferred to ———— (Current/Capital Accounts) in ———— (equal ratio/profit sharing ratio).
4. If a liability is assumed by a partner, such Partner's Capital Account is ———— (debited/credited).
5. If a partner takes over an asset, such (Partner's Capital Account) is ———— (debited/credited).
6. No entry is required when a ———— (partner/creditor) accepts a fixed asset in payment of his dues.
7. When creditor accepts an asset whose value is more than the amount due to him, he will ———— (pay/not pay) the excess amount which will be credited ———— Account.
8. When the firm has agreed to pay the partner a fixed amount for realisation work irrespective of the actual amount spent, such fixed amount is debited to (Realisation/Capital) Account and Credited to (Capital/Bank) Account.
9. Partner's loan is ———— (recorded/not recorded) in the (Realisation Account).
10. Partner's current accounts are transferred to respective ———— Partners' (Loan/Capital) Accounts.

Illustration 4

Following is the Balance Sheet of Ashwani and Bharat on March 31, 2017.

Balance Sheet Ashwani and Bharat as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		76,000	Cash at bank		17,000
Mrs.Ashwani's loan		10,000	Stock		10,000
Mrs.Bharat loan		20,000	Investments		20,000
Investment fluctuation fund		2,000	Debtors	40,000	
Reserve fund		20,000	*Less:* Provision		
Capitals:			for doubtful debts	4,000	36,000
Ashwani	20,000		Buildings		70,000
Bharat	20,000	40,000	Goodwill		15,000
		1,68,000			**1,68,000**

The firm was dissolved on that date. The following was agreed transactions took place.

(i) Aswhani promised to pay Mrs. Ashwani's loan and took away stock for Rs.8,000.

(ii) Bharat took away half of the investment at 10% less. Debtors realised for Rs.38,000. Creditor's were paid at less of Rs.380. Buildings realised for Rs.1,30,000, Goodwill Rs.12,000 and the remaining Investment were sold at Rs.9,000. An old typewriter not recorded in the books was taken over by Bharat for Rs. 600. Realisation expenses amounted to Rs. 2,000.

Prepare Realisation Account, Partner's Capital Account and Bank Account.

Solution

Books of Ashwani and Bharat

Dr. **Realisation Account** *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Investment	20,000		Provision for doubtful debts		4,000
Debtors	40,000		Creditors		76,000
Buildings	70,000		Mrs. Ashwani loan		10,000
Stock	10,000		Mrs. Bharat loan		20,000
Goodwill	15,000	1,55,000	Investment fluctuation fund		2,000
Ashwani's Capital (Mrs.Ashwani's loan}		10,000	Ashwani's Capital[stock]		8,000
			Bharat's capital (Typewriter)		600
Bank (Mrs. Bharat's loan)		20,000	Bharat's capital (Investment)		9,000
Bank (creditors)		75,620	Bank:		
Bank (realisation expenses)		2,000	Investment	9,000	
Profit transferred to:			Debtors	38,000	
Ashwani's Capital	27,990		Buildings	1,30,000	
Bharat's Capital	27,990	55,980	Goodwill	12,000	1,89,000
		3,18,600			**3,18,600**

Partner's Capital Accounts

Dr. *Cr.*

Date 2017	Particulars	J.F.	Ashwani (Rs.)	Bharat (Rs.)	Date 2017	Particulars	J.F.	Ashwani (Rs.)	Bharat (Rs.)
	Realisation (stock)		8,000	—		Balance b/d		20,000	20,000
	Realisation [sale of typewriter]			600		Reserve fund		10,000	10,000
	Realisation [investment]			9,000		Realisation [Mrs. Ashwini's loan]		10,000	—
	Bank		59,990	48,390		Realisation (profit)		27,990	27,990
			67,990	**57,990**				**67,990**	**57,990**

Bank Account

Dr. *Cr.*

Date 2017	Particulars	J.F.	Amount (Rs.)	Date 2017	Particulars	J.F.	Amount (Rs.)
	Balance b/d		17,000		Realisation [creditors]		75,620
	Realisation		1,89,000		Realisation [expenses]		2,000
					Realisation (Mrs.Bharat's loan)		20,000
					Ashwani's capital		59,990
					Bharat's capital		48,390
			2,06,000				**2,06,000**

Do it Yourself

Give the journal entry(ies) to be recorded for the following, in case of the dissolution of a partnership firm.

1. For closure of assets accounts.
2. For closure of liabilities accounts.
3. For sale of assets.
4. For settlement of a creditor by transfer of fixed assets to him.
5. For expenses of realisation when actual expenses are paid by the partner on behalf of the firm.
6. When a partner discharges the liability of the firm.
7. For payment of partner's loan.
8. For settlement of capital accounts.

Illustration 5

Sonia, Rohit and Udit are partners sharing profits in the ratio of 5:3:2. Their Balance Sheet as on March 31, 2017 was as follows:

Balance Sheet of Sonia, Rohit and Udit as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		30,000	Buildings	2,00,000
Bills payable		30,000	Machinery	40,000
Bank loan		1,20,000	Stock	1,60,000
Sonia's husband's loan		1,30,000	Bills receivable	1,20,000
General reserve		80,000	Furniture	80,000
Capitals:			Cash at bank	60,000
Sonia	70,000			
Rohit	90,000			
Udit	1,10,000	2,70,000		
		6,60,000		**6,60,000**

The firm was dissolved on that date. Close the books of the firm with following information:

1. Buildings realised for Rs.1,90,000, Bills receivable realised for Rs.1,10,000; Stock realised Rs.1,50,000; and Machinery sold for Rs.48,000 and furniture for Rs. 75,000,
2. Bank loan was settled for Rs.1,30,000. Creditors and Bills payable were settled at 10% discount,
3. Rohit paid the realisation expenses of Rs.10,000 and he was to get a remuneration of Rs.12,000 for completing the dissolution process.

Prepare necessary ledger accounts.

Solution

Books of Sonia, Rohit and Udit

Dr. **Realisation Account** *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Buildings	2,00,000		Creditors		30,000
Machinery	40,000		Bills payable		30,000
Stock	1,60,000		Bank loan		1,20,000
Bills receivable	1,20,000		Sonia's husband's loan		1,30,000
Furniture	80,000	6,00,000	Bank:		
Bank (Bank Loan)		1,30,000	Buildings	1,90,000	
Bank			Bills receivable	1,10,000	
[creditors and Bills payable]		54,000	Stock	1,50,000	
Bank [Sonia's husbands loan]		1,30,000	Machinery	48,000	
Rohit's capital		12,000	Furniture	75,000	5,73,000
(reslisation expenses)			Loss transferred to		
			capital accounts:		
			Sonia	21,500	
			Rohit	12,900	
			Udit	8,600	43,000
		9,26,000			**9,26,000**

Partner's Capital Accounts

Dr. Cr.

Date 2017	Particulars	J.F.	Sonia (Rs.)	Rohit (Rs.)	Udit (Rs.)	Date 2017	Particulars	J.F.	Sonia (Rs.)	Rohit (Rs.)	Udit (Rs.)
	Realisation (Loss)		21,500	12,900	8,600		Balance b/d		70,000	90,000	1,10,000
							Realisation (expenses)		—	12,000	—
	Bank		88,500	1,13,100	1,17,400						
							General reserve		40,000	24,000	16,000
			1,10,000	**1,26,000**	**1,26,000**				**1,10,000**	**1,26,000**	**1,26,000**

Bank Account

Dr. Cr.

Date 2017	Particulars	J.F.	Amount (Rs.)	Date 2017	Particulars	J.F.	Amount (Rs.)
	Balance b/d		60,000		Realisation [bank loan]		1,30,000
	Realisation (assets realised)		5,73,000		Realisation [creditors and bills payable]		54,000
					Realisation (Sonia's husband loan)		1,30,000
					Sonia's capital		88,500
					Rohit's capital		1,13,100
					Udit's capital		1,17,400
			6,33,000				**6,33,000**

Note: No entry has been recorded in firm's books for the actual realisation expenses incurred by Rohit because he gets Rs. 12,000 as his remuneration which has been duly accounted for.

Illustration 6

Romesh and Bhawan were in partnership sharing profit and losses as 3:2. Their Balance Sheet as on March 31, 2017, was as follows:

Balance Sheet of Romesh and Bhawan as on March 31, 2014

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Bank loan		60,000	Cash at bank	30,000
Creditors		80,000	Debtors	70,000
Bills payables		40,000	Stock	2,00,000
Bhawan loan		20,000	Investments	1,40,000
Capitals:			Buildings	60,000
Romesh	1,00,000			
Bhawan	2,00,000	3,00,000		
		5,00,000		**5,00,000**

They decided to dissolve the firm. The following information is available:

1. Debtors were recovered 5% less. Stock was realised at books value and building was sold for Rs.51,000,
2. It is found that investment not recorded in the books amounted to Rs.10,000. The same were accepted by one creditor for this amount and other Creditors were paid at a discount of 10%. Bills payable were paid full,
3. Romesh took over some of the Investments at Rs.8,100 (book value less 10%). The remaining investment were taken over by Bhawan at 90% of the book value less Rs.900 discount,
4. Bhawan paid bank loan along with one year interest at 6% p.a,
5. An unrecorded liability of Rs.5,000 paid.

Close the books of the firm and prepare necessary ledger accounts.

Solution

Books of Romesh and Bhawan
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Bank loan		60,000
Debtors	70,000		Creditors		80,000
Stock	2,00,000		Bills payable		40,000
Investments	1,40,000		Romesh's Capital (investment)		8,100
Buildings	60,000	4,70,000	Bhawan's Capital (investment)		1,17,000
Bank (bills payable)		40,000	Bank:		
Bank (creditors)		63,000	Debtors	66,500	
Bhawan's capital		63,600	Stock	2,00,000	
(loan with interest)			Buildings	51,000	3,17,500
Bank (unrecorded liabilities)		5,000	Loss transferred to :		
			Romesh capital	11,400	
			Bhawan capital	7,600	19,000
		6,41,600			**6,41,600**

Partner's Capital Accounts

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Romesh (Rs.)*	*Bhawan (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Romesh (Rs.)*	*Bhawan (Rs.)*
	Realisation [investment]		8,100	1,17,000		Balance b/d		1,00,000	2,00,000
	Realisation [loss]		11,400	7,600		Realisation [bank loan]			63,600
	Bank		80,500	1,39,000					
			1,00,000	**2,63,600**				**1,00,000**	**2,63,600**

Bank Account

Dr. *Cr.*

Date 2017	Particulars	J.F.	Amount (Rs.)	Date 2017	Particulars	J.F.	Amount (Rs.)
	Balance b/d		30,000		Realisation[creditor]		63,000
	Realisation (assets realised)		3,17,500		Realisation [unrecorded liability]		5,000
					Bhawan loan		20,000
					Realisation (bills payable]		40,000
					Romesh's capital		80,500
					Bhawan's capital		1,39,000
			3,47,500				**3,47,500**

Note: No entry has been made for acceptance of unrecorded investments by a creditor as part payment of his dues as per rules.

Illustration 7

Sonu and Ashu sharing profits as 3:1 and they agree upon dissolution. The Balance Sheet as on March 31, 2017 is as under:

Balance Sheet of Sonu and Ashu as on March 31, 2017

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Loan		12,000	Cash at bank	25,000
Creditors		18,000	Stock	45,000
Capital			Furniture	16,000
Sonu	1,10,000		Debtors	70,000
Ashu	68,000	1,78,000	Plant and Machinery	52,000
		208,000		**2,08,000**

Sonu took over plant and machinery at an agreed value of Rs.60,000. Stock and Furniture were sold for Rs.42,000 and Rs.13,900 respectively. Debtors were took over by Ashu at Rs.69,000. Creditors were paid subject to discount of Rs.900. Sonu agrees to pay the loans. Realisation expenses were Rs.1,600.

Prepare Realisation Account, Bank Account and Capital Accounts of the Partners.

Solution

Books of Sonu and Ashu
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Stock		45,000	Loan		12,000
Furniture		16,000	Creditors		18,000
Debtors		70,000	Sonu's capital (plant& machinery)		60,000
Plant and Machinery		52,000	Ashu's capital (debtors)		69,000
Bank (creditors)		17,100	Bank:		
Sonu's capital (loan)		12,000	Stock	42,000	
Bank (realisation expenses)		1,600	Furniture	13,900	55,900
Profit transferred to :					
Sonu's capital	900				
Ashu's capital	300	1,200			
		2,14,900			**2,14,900**

Partners Capital Accounts

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Sonu (Rs.)*	*Ashu (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Sonu (Rs.)*	*Ashu (Rs.)*
	Realisation [plant and machinery]		60,000			Balance b/d		1,10,000	68,000
						Realisation [loan]		12,000	
	Realisation [debtors]			69,000		Realisation [profit]		900	300
						Bank			700
	Bank		62,900						
			1,22,900	**69,000**				**1,22,900**	**69,000**

Bank Account

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		25,000		Realisation [creditor]		17,100
	Realisation (assets realised)		55,900		Realisation [expenses]		1,600
					Sonu's capital		62,900
	Ashu's capital		700				
			81,600				**81,600**

Illustration 8

Anju, Manju and Sanju sharing profit in the ratio of 3:1:1 decided to dissolve their firm. On March 31, 2014 their position was as follows:

Balance Sheet Anju, Manju and Sanju as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		60,000	Cash at bank		35,000
Loan		15,000	Stock		83,000
Capitals:			Furniture		12,000
Anju	2,75,000		Debtors	2,42,000	
Manju	1,10,000		*Less:* Provision for		
Sanju	1,00,000	4,85,000	doubtful debts	12,000	2,30,000
			Buildings		2,00,000
		5,60,000			**5,60,000**

It is agreed that:

1. Anju takes over the Furniture at Rs.10,000 and Debtors amounting to Rs.2,00,000 at Rs.1,85,000. Anju also agrees to pay the creditors,
2. Manju is to take over Stock at book value and Buildings at book value less 10%,
3. Sanju is to take over remaining Debtors at 80% of book value and responsibility for the discharge of the loan,
4. The expenses of dissolution amounted to Rs.2,200.

Prepare Realisation Account, Bank Account and Capital Accounts of the partners.

Solution

Books of Anju, Manju and Sanju

Dr. **Realisation Account** *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
			Provision for doubtful debts		12,000
Stock	83,000		Creditors		60,000
Furniture	12,000		Loan		15,000
Debtors	2,42,000		Anju's capital :		
Buildings	2,00,000	5,37,000	Furniture	10,000	
Anju capital (creditors)		60,000	Debtors	1,85,000	1,95,000
Sanju capital (loan)		15,000	Manju's capital :		
Bank (realisation expenses)		2,200	Stock	83,000	
			Buildings	1,80,000	2,63,000
			Sanju's capital :		
			(remaning debtors less		
			20% of book value)		33,600
			Loss transferred to :		
			Anju's capital	21,360	
			Manju's capital	7,120	
			Sanju's capital	7,120	35,640
		6,14,200			**6,14,240**

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

Date 2017	*Particulars*	*J.F.*	*Anju (Rs.)*	*Manju (Rs.)*	*Sanju (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Anju (Rs.)*	*Manju (Rs.)*	*Sanju (Rs.)*
	Realisation (assets)		1,95,000	2,63,000	33,600		Balance b/d		2,75,000	1,10,000	1,00,000
	Realisation (loss)		21,360	7,120	7,120		Realisation (creditors)		60,000		
	Bank		1,18,640		74,280		Realisation (loan)				15,000
							Bank			1,60,120	
			3,35,000	**2,70,120**	**1,15,000**				**3,35,000**	**2,70,120**	**1,15,000**

Dr. **Bank Account** *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		35,000		Realisation (expenses)		2,200
	Manju's capital		1,60,120		Anju's capital		1,18,640
					Sanju's capital		74,280
			1,95,120				**1,95,120**

Illustration 9

Sumit, Amit and Vinit are partners sharing profit in the ratio of 5:3:2. Their Balance Sheet as on March 31, 2017 was as follows:

Balance Sheet of Sunit, Amit and Vinit as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Machinery	80,000
Sumit	40,000		Investments	1,50,000
Amit	50,000		Stock	10,000
Vinit	60,000	1,50,000	Debtors	35,000
Profit and Loss		10,000	Cash at bank	15,000
Mrs. Amit's loan		40,000		
Sundry creditors		90,000		
		2,90,000		**2,90,000**

The firm was dissolved on that date. Amit took over his wife's loan. One of the Creditors for Rs.2,600 was not claim the amount. Other assets realised as follows:

1. Machinery was sold for Rs.70,000,
2. Investments with book value of Rs.1,00,000 were given to Creditors in full settlement of their account. The remaining Investments were took over by Vinit at an agreed value of Rs.45,000,

3. Stock was sold for Rs.11,000 and Debtors for Rs.3,000 proved to be bad,
4. Realisation expenses were Rs.1,500.

Prepare ledger accounts to close the books of the firm.

Solution

Books of Amit, Sumit and Vinit
Realisation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Machinery	80,000		Sundry creditors		90,000
Investments	1,50,000		Mrs.Amit's loan		40,000
Stock	10,000		Bank :		
Debtors	35,000	2,75,000	Machinery	70,000	
Amit's Capital (wife's loan)		40,000	Stock	11,000	
Bank (realisation expenses)		1,500	Debtors	32,000	1,13,000
			Vinit's capital (investment)		45,000
			Loss transferred to :		
			Amit's capital	14,250	
			Sumit's capital	8,550	
			Vinit's capital	5,700	28,500
		3,16,500			**3,16,500**

Dr. **Partners Capital Accounts** *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amit (Rs.)*	*Sumit (Rs.)*	*Vinit (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amit (Rs.)*	*Sumit (Rs.)*	*Vinit (Rs.)*
	Realisation (assets)				45,000		Balance b/d		40,000	50,000	60,000
	Realisation (loss)		14,250	8,550	5,700		Realisation (Mrs. Vinit's loan)		40,000		
	Bank		70,750	44,450	11,300		Profit and Loss		5,000	3,000	2,000
			85,000	**53,000**	**62,000**				**85,000**	**53,000**	**62,000**

Bank Account

Dr. *Cr.*

Date 2017	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2017*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		15,000		Realisation (expenses)		1,500
	Realisation (assets realised)		1,13,000		Amit's capital		70,750
					Sumit's capital		44,450
					Vinit's capital		11,300
			1,28,000				**1,28,000**

Note: No entry has been made for the investments taken over by the creditors as per rules.

Illustration 10

Meena and Tina are partners in a firm and sharing profit as 3:2. They decided to dissolve their firm on March 31, 2017 when their Balance Sheet was a follows:

Balance Sheet Meena and Tina as on March 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital :			Machinery	70,000
Meena	90,000		Investments	50,000
Tina	80,000	1,70,000	Stock	22,000
Sundry creditors		60,000	Sundry Debtors	1,03,000
Bills payable		20,000	Cash at bank	5,000
		2,50,000		**2,50,000**

The assets and liabilities were disposed off as follows :

(a) Machinery were given to creditors in full settlement of their account and Stock were given to bills payable in full settlement.

(b) Investment were took over by Tina at book value. Sundry debtors of book value Rs. 50,000 took over by Meena at 10% less and remaining debtors realised Rs. 51,000.

(c) Realisation expenses amount to Rs. 2,000.

Prepare necessary ledger accounts to close the book of the firm.

Solution

Books of Meena and Tina – Realisation Account

Particulars		*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Assets transferred :			Sundry creditors		60,000
Machinery	70,000		Bills payable		20,000
Investments	50,000		Tina's Capital (investment)		50,000
Stock	22,000		Meena's Capital (debtors of		45,000
Sundry debtors	1,03,000	2,45,000	books value Rs. 50,000		
Bank (realisation expenses)		2,000	less 10%)		
			Bank		
			Debtors		51,000
			Loss transferred to :		
			Meena's capital	12,600	
			Tena's capital	8,400	21,000
		2,47,000			**2,47,000**

Partner's Capital Accounts

Dr. *Cr.*

Particulars	*Mena (Rs.)*	*Tina (Rs.)*	*Particulars*	*Meena (Rs.)*	*Tina (Rs.)*
Realisation (investment)		50,000	Balance b/d	90,000	80,000
Realisation (debtors)	45,000				
Realisation (loss)	12,600	8,400			
Bank	32,400	21,600			
	90,000	**80,000**		**90,000**	**80,000**

Bank Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Balance b/d	5,000	Realisation (expenses)	2,000
Realisation (assets realised)	51,000	Mena's capital	32,400
		Tina's capital	21,600
	56,000		**56,000**

Terms Introduced in the Chapter

1. Dissolution of Partnership
2. Dissolution of Partnership Firm
3. Partnership at Will
4. Compulsory Dissolution
5. Dissolution by Notice
6. Realisation Expenses
7. Realisation Account

Summary

1. *Dissolution of Partnership Firm :* The dissolution of a firm implies the discontinuance of partnership business and separation of economic relations between the partners. In the case of a dissolution of a firm, the firm closes its business altogether and realises all its assets and pays all its liabilities. The payment is made to the creditors first out of the assets realised and, if necessary, next out of the contributions made by the partners in their profit sharing ratio. When all accounts are settled and the final payment is made to the partners for the amounts due to them, the books of the firm are closed.
2. *Dissolution of Partnership :* A partnership gets terminated in case of admission, retirement death, etc. of a partner. This does not necessarily involve dissolution of the firm.
3. *Realisation Account :* The Realisation Account is prepared to record the transactions relating to sale and realisation of assets and settlement of creditors. Any profit or loss arising act of this process is shared by partners' in their profit sharing ratio. Partners' accounts are also settled and the Cash or Bank account is closed.

Questions for Practice

Short Answer Questions

1. State the difference between dissolution of partnership and dissolution of partnership firm.
2. State the accounting treatment for:
   i. Unrecorded assets ii. Unrecorded liabilities
3. On dissolution, how will you deal with partner's loan if it appears on the (a) assets side of the balance sheet, (b) liabilities side of balance sheet.

4. Distinguish between firm's debts and partner's private debts.
5. State the order of settlement of accounts on dissolution.
6. On what account realisation account differs from revaluation account.

Long Answer Questions

1. Explain the process dissolution of partnership firm?
2. What is a Realisation Account?
3. Reproduce the format of Realisation Account.
4. How deficiency of crditors is paid off?

Numerical Questions

1. Journalise the following transactions regarding realisation expenses :
   [a] Realisation expenses amounted to Rs.2,500.
   [b] Realisation expenses amounting to Rs.3,000 were paid by Ashok, one of the partners.
   [c] Realisation expenses Rs.2,300 borne by Tarun, personally.
   [d] Amit, a partner was appointed to realise the assets, at a cost of Rs.4,000. The actual amount of realisation amounted to Rs.3,000.
2. Record necessary journal entries in the following cases:
   [a] Creditors worth Rs.85,000 accepted Rs.40,000 as cash and Investment worth Rs.43,000, in full settlement of their claim.
   [b] Creditors were Rs.16,000. They accepted Machinery valued at Rs.18,000 in settlement of their claim.
   [c] Creditors were Rs.90,000. They accepted Buildings valued Rs.1,20,000 and paid cash to the firm Rs.30,000.
3. There was an old computer which was written-off in the books of accounts in the pervious year. The same has been taken over by a partner Nitin for Rs.3,000. Journalise the transaction, supposing. That the firm has been dissolved.
4. What journal entries will be recorded for the following transactions on the dissolution of a firm:
   [a] Payment of unrecorded liabilities of Rs.3,200.
   [b] Stock worth Rs.7,500 is taken by a partner Rohit.
   [c] Profit on Realisation amounting to Rs.18,000 is to be distributed between the partners Ashish and Tarun in the ratio of 5:7.
   [d] An unrecorded asset realised Rs.5,500.
5. Give journal entries for the following transactions :
   1. To record the realisation of various assets and liabilities,
   2. A Firm has a Stock of Rs. 1,60,000. Aziz, a partner took over 50% of the Stock at a discount of 20%,
   3. Remaining Stock was sold at a profit of 30% on cost,
   4. Land and Buildging (book value Rs. 1,60,000) sold for Rs. 3,00,000 through a broker who charged 2%, commission on the deal,
   5. Plant and Machinery (book value Rs. 60,000) was handed over to a Creditor at an agreed valuation of 10% *less* than the book value,
   6. Investment whose face value was Rs. 4,000 was realised at 50%.

6. How will you deal with the realisation expenses of the firm of Rashim and Bindiya in the following cases:
    1. Realisation expenses amounts to Rs. 1,00,000,
    2. Realisation expenses amounting to Rs. 30,000 are paid by Rashim, a partner.
    3. Realisation expenses are to be borne by Rashim for which he will be paid Rs. 70,000 as remuneration for completing the dissolution process. The actual expenses incurred by Rashim were Rs. 1,20,000.

7. The book value of assets (other than cash and bank) transferred to Realisation Account is Rs. 1,00,000. 50% of the assets are taken over by a partner Atul, at a discount of 20%; 40% of the remaining assets are sold at a profit of 30% on cost; 5% of the balance being obsolete, realised nothing and remaining assets are handed over to a Creditor, in full settlement of his claim.

    You are required to record the journal entries for realisation of assets.

8. Record necessary journal entries to record the following unrecorded assets and liabilities in the books of Paras and Priya:
    1. There was an old furniture in the firm which had been written-off completely in the books. This was sold for Rs. 3,000,
    2. Ashish, an old customer whose account for Rs. 1,000 was written-off as bad in the previous year, paid 60%, of the amount,
    3. Paras agreed to takeover the firm's goodwill (not recorded in the books of the firm), at a valuation of Rs. 30,000,
    4. There was an old typewriter which had been written-off completely from the books. It was estimated to realize Rs. 400. It was taken away by Priya at an estimated price less 25%,
    5. There were 100 shares of Rs. 10 each in Star Limited acquired at a cost of Rs. 2,000 which had been written-off completely from the books. These shares are valued @ Rs. 6 each and divided among the partners in their profit sharing ratio.

9. All partners wishes to dissolve the firm. Yastin, a partner wants that her loan of Rs. 2,00,000 must be paid off before the payment of capitals to the partners. But, Amart, another partner wants that the capitals must be paid before the payment of Yastin's loan. You are required to settle the conflict giving reasons.

10. What journal entries would be recorded for the following transactions on the dissolution of a firm after various assets (other than cash) on the third party liabilities have been transferred to Reliasation account.
    1. Arti took over the Stock worth Rs. 80,000 at Rs. 68,000.
    2. There was unrecorded Bike of Rs. 40,000 which was taken over By Mr. Karim.
    3. The firm paid Rs. 40,000 as compensation to employees.
    4. Sundry creditors amounting to Rs. 36,000 were settled at a discount of 15%.
    5. Loss on realisation Rs. 42,000 was to be distributed between Arti and Karim in the ratio of 3:4.

11. Rose and Lily shared profits in the ratio of 2:3. Their Balance Sheet on March 31, 2017 was as follows:

Balance Sheet of Rose and Lily as on March 31, 2017

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors	40,000	Cash		16,000
Lily's loan	32,000	Debtors	80,000	
Profit and Loss	50,000	*Less*: Provision for		
Capitals:		doubtful debts	3,600	76,400
Lily	1,60,000	Inventory		1,09,600
Rose	2,40,000	Bills receivable		40,000
		Buildings		2,80,000
	5,22,000			**5,22,000**

Rose and Lily decided to dissolve the firm on the above date. Assets (except bills receivables) realised Rs. 4,84,000. Creditors agreed to take Rs. 38,000. Cost of realisation was Rs. 2,400. There was a Motor Cycle in the firm which was bought out of the firm's money, was not shown in the books of the firm. It was now sold for Rs. 10,000. There was a contingent liability in respect of outstanding electric bill of Rs. 5,000 Bill Receivable taken over by Rose at Rs. 33,000.

Show Realisation Account, Partners Capital Acount, Loan Account and Cash Account.

(**Ans :** Realisation Profit Rs. 15,600, Total of Cash Account Rs. 5,10,000)

12. Shilpa, Meena and Nanda decided to dissolve their partnership on March 31,2017. Their profit sharing ratio was 3:2:1 and their Balance Sheet was as under:

Balance Sheet of Shilpa, Meena and Nanda as on March 31, 2017

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:		Land	81,000
Shilpa	80,000	Stock	56,760
Meena	40,000	Debtors	18,600
Bank loan	20,000	Nanda's capital	23,000
Creditors	37,000	Cash	10,840
Provision for doubtful debts	1,200		
General reserve	12,000		
	1,90,200		**1,90,200**

The stock of value of Rs. 41,660 are taken over by Shilpa for Rs. 35,000 and she agreed to discharge bank loan. The remaining stock was sold at Rs. 14,000 and debtors amounting to Rs. 10,000 realised Rs. 8,000. land is sold for Rs. 1,10,000. The remaining debtors realised 50% at their book value. Cost of realisation amounted to Rs. 1,200. There was a typewriter not recorded in the books worth Rs. 6,000 which were taken over by one of the Creditors at this value. Prepare Realisation Account.
(**Ans :** Profit on Realisation Rs. 20,940, Total of Cash Account Rs. 1,64,650)

13. Surjit and Rahi were sharing profits (losses) in the ratio of 3:2, their Balance Sheet as on March 31, 2017 is as follows:

Balance Sheet of Surjit and Rahi as on March 31, 2017

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors	38,000	Bank	11,500
Mrs. Surjit loan	10,000	Stock	6,000
Reserve	15,000	Debtors	19,000
Rahi's loan	5,000	Furniture	4,000
Capital's:		Plant	28,000
Surjit	10,000	Investment	10,000
Rahi	8,000	Profit and Loss	7,500
	86,000		**86,000**

The firm was dissolved on March 31, 2017 on the following terms:
1. Surjit agreed to take the investments at Rs. 8,000 and to pay Mrs. Surojit's loan.
2. Other assets were realised as follows:
   Stock Rs. 5,000
   Debtors Rs. 18,500
   Furniture Rs. 4,500
   Plant Rs. 25,000
3. Expenses on realisation amounted to Rs. 1,600.
4. Creditors agreed to accept Rs. 37,000 as a final settlement.
   You are required to prepare Realisation account, Partner's Capital account and Bank account.

(**Ans :** Loss on Realisation Rs. 6,600, Total of Cash Account Rs. 64,500)

14. Rita, Geeta and Ashish were partners in a firm sharing profits/losses in the ratio of 3:2:1. On March 31, 2017 their balance sheet was as follows:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Cash	22,500
Rita	80,000		Debtors	52,300
Geeta	50,000		Stock	36,000
Ashish	30,000	1,60,000	Investments	69,000
Creditors		65,000	Plant	91,200
Bills payable		26,000		
General reserve		20,000		
		2,71,000		**2,71,000**

On the date of above mentioned date the firm was dissolved:

1. Rita was appointed to realise the assets. Rita was to receive 5% commission on the rate of assets (except cash) and was to bear all expenses of realisation,
2. Assets were realised as follows:

	Rs.
Debtors	30,000
Stock	26,000
Plant	42,750

3. Investments were realised at 85% of the book value,
4. Expenses of realisation amounted to Rs. 4,100,
5. Firm had to pay Rs. 7,200 for outstanding salary not provided for earlier,
6. Contingent liability in respect of bills discounted with the bank was also materialised and paid off Rs. 9,800,

   Prepare Realisation account, Capital Accounts of Partner's and Cash Account.

(**Ans :** Loss on Realisation Rs. 1,15,970, Total of Cash Account Rs. 1,65,705)

15. Anup and Sumit are equal partners in a firm. They decided to dissolve the parntership on December 31, 2017. When the balance sheet is as under :

Balance Sheet of Anup and Sumit as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		27,000	Cash at bank	11,000
Reserve fund		10,000	Sundry Debtors	12,000
Loan		40,000	Plants	47,000
Capital			Stock	42,000
Anup	60,000		Lease hold land	60,000
Sumit	60,000	1,20,000	Furniture	25,000
		1,97,000		**1,97,000**

The Assets were realised as follows :

	Rs.
Lease hold land	72,000
Furniture	22,500
Stock	40,500
Plant	48,000
Sundry Debtors	10,500

The Creditors were paid Rs. 25,500 in full settlement. Expenses of realisation amount to Rs. 2,500.

Prepare Realisation Account, Bank Account, Partners Capital Accounts to close the books of the firm.

(**Ans :** Realisation Profit Rs. 6,500)

16. Ashu and Harish are partners sharing profit and losses as 3:2. They decided to dissolve the firm on December 31, 2017. Their balance sheet on the above date was:

Balance Sheet of Ashu and Harish as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Building	80,000
Ashu	1,08,000		Machinery	70,000
Harish	54,000	1,62,000	Furniture	14,000
Creditors		88,000	Stock	20,000
Bank overdraft		50,000	Investments	60,000
			Debtors	48,000
			Cash in hand	8,000
		3,00,000		**3,00,000**

Ashu is to take over the building at Rs. 95,000 and Machinery and Furniture is take over by Harish at value of Rs. 80,000. Ashu agreed to pay Creditor and Harish agreed to meet Bank overdraft. Stock and Investments are taken by both partner in profit sharing ratio. Debtors realised for Rs. 46,000, expenses of realisation amounted to Rs. 3,000. Prepare necessary ledger account.

(**Ans :** Loss on Realisation Rs. 6,000, Cash/Bank Total Rs. 59,600)

17. Sanjay, Tarun and Vineet shared profit in the ratio of 3:2:1. On December 31,2017 their balance sheet was as follows :

Balance Sheet of Sanjay, Tarun and Vineet as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Plant	90,000
Sanjay	1,00,000		Debtors	60,000
Tarun	1,00,000		Furniture	32,000
Vineet	70,000	2,70,000	Stock	60,000
Creditors		80,000	Investments	70,000
Bills payable		30,000	Bills receivable	36,000
			Cash in hand	32,000
		3,80,000		**3,80,000**

On this date the firm was dissolved. Sanjay was appointed to realise the assets. Sanjay was to receive 6% commission on the sale of assets (except cash) and was to bear all expenses of realisation.
Sanjay realised the assets as follows : Plant Rs. 72,000, Debtors Rs. 54,000, Furniture Rs. 18,000, Stock 90% of the book value, Investments Rs. 76,000 and Bills receivable Rs.31,000. Expenses of realisation amounted to Rs.4,500. Prepare Realisation Account, Capital Accounts and Cash Account

(**Ans :** Loss on Realisation Rs.61,300, Total of Cash Account Rs.3,37,000)

18. The following is the Balance Sheet of Gupta and Sharma as on December 31,2017:

Balance Sheet of Gupta and Sharma as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		38,000	Cash at bank	12,500
Mrs.Gupta's loan		20,000	Sundry Debtors	55,000
Mrs.Sharma's loan		30,000	Stock	44,000
Reserve fund		6,000	Bills receivable	19,000
Provision of doubtful debts		4,000	Machinery	52,000
Capital			Investment	38,500
Gupta	90,000		Fixtures	27,000
Sharma	60,000	1,50,000		
		2,48,000		**2,48,000**

The firm was dissolved on December 31, 2017 and asset realised and settlements of liabilities as follows:

(a) The realisation of the assets were as follows:

	Rs.
Sundry Debtors	52,000
Stock	42,000
Bills receivable	16,000
Machinery	49,000

(b) Investment was taken over by Gupta at agreed value of Rs.36,000 and agreed to pay of Mrs. Gupta's loan.

(c) The Sundry Creditors were paid off *less* 3% discount.

(d) The realisation expenses incurred amounted to Rs.1,200.

Journalise the entries to be made on the dissolution and prepare Realisation Account, Bank Account and Partners Capital Accounts.

(**Ans :** Loss on Realisation Rs.36,560, Total of Cash Account)

19. Ashok, Babu and Chetan are in partnership sharing profit in the proportion of 1/2, 1/3, 1/6 respectively. They dissolve the partnership of the December 31, 2017, when the balance sheet of the firm as under:

Balance Sheet of Ashok, Babu and Chetan as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		20,000	Bank	7,500
Bills payable		25,500	Sundry Debtors	58,000
Babu's loan		30,000	Stock	39,500
Capital's :			Machinery	48,000
Ashok	70,000		Investment	42,000
Babu	55,000		Freehold property	50,500
Chetan	27,000	1,52,000		
Current accounts :				
Ashok	10,000			
Babu	5,000			
Chetan	3,000	18,000		
		2,45,500		**2,45,500**

The machinery was taken over by Babu for Rs.45,000, Ashok took over the Investment for Rs.40,000 and Freehold property took over by Chetan at Rs.55,000. The remaining Assets realised as follows: Sundry Debtors Rs.56,500 and Stock Rs.36,500. Sundry Creditors were settled at discount of 7%. A Office computer, not shown in the books of accounts realised Rs.9,000. Realisation expenses amounted to Rs.3,000.

Prepare Realisation Account, Partners Capital Account, Bank Account.

(**Ans :** Profit on Realisation Rs.2,400, Total of Cash Account Rs.1,34,100)

20. The following is the Balance sheet of Tanu and Manu, who shares profit and losses in the ratio of 5:3, On December 31,2017:

Balance Sheet of Tanu and Manu as on December 31, 2017

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		62,000	Cash at bank	16,000
Bills payable		32,000	Sundry Debtors	55,000
Bank loan		50,000	Stock	75,000
Reserve fund		16,000	Motor car	90,000
Capital			Machinery	45,000
Tanu	1,10,000		Investment	70,000
Manu	90,000	2,00,000	Fixtures	9,000
		3,60,000		**3,60,000**

On the above date the firm is dissolved and the following agreement was made: Tanu agree to pay the bank loan and took away the sundry debtors. Sundry creditors accepts stock and paid Rs.10,000 to the firm. Machinery is taken over by Manu for Rs.40,000 and agreed to pay of bills payable at a discount of 5%.. Motor car was taken over by Tanu for Rs.60,000. Investment realised Rs.76,000 and fixtures Rs.4,000. The expenses of dissolution amounted to Rs.2,200.

Prepare Realisation Account, Bank Account and Partners Capital Accounts.

(**Ans :** Loss on Ralisation Rs.37,600, Total of Cash Account Rs.1,06,000)

Check-list to Check your Understanding

Test your Understanding – I

1. True, 2 True, 3. True, 4. False, 5. True, 6. True, 7. True, 8. False.

Test your Understanding – II

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

Test your Understanding – III

1. Debit, Realisaton, 2. External, Credit, Realisation, 3. Capital Accounts, Profit sharing ratio. 4. Credited, 5. Debited, 6. Creditor, 7. Pay, Realisation, 8. Realisation, Capital, 9. Not recorded, 10. Capital.