4

Reconstruction of Partnership

1. Introduction

We have studied about the nature of a partnership firm and its final accounts in the previous chapter. In this chapter we will study about the "Reconstruction (Reconstitution) of partnership". i.e. Changes in partnership due to several reasons.

Reasons for changes in partnership : Following are three reasons for the changes in a partnership.

Reasons for changes in a partnership

The change in the ratio of profit and loss sharing between the continuing partners	Admission of existing partnership firm	Retirement or death of a partner of an existing partnership firm

In this chapter, we will discuss in detail about the change in profit and loss sharing ratio or distribution ratio between the existing partners. The detailed discussion on the admission of a new partner and the retirement or death of a partner has been made in the next chapter.

2. The Changes in Profit and Loss Sharing or Distributing Ratio Between the Continuing (Present) Partners

Generally, profit and loss sharing ratio between the partners in a partnership is not changed once it is agreed. e.g. profit and loss sharing ratio between A and B is 3:2. Generally this ratio is not changed. But if it is required, then it can be changed with the consent of all existing partners.

There may be following reasons for the change in profit and loss distribution ratio :

(1) When a partner in charge of the firm is not able to manage the firm on the grounds of illness or incapability or some personal reasons.

(2) When a partner can not devote enough time to run a business, the other partner has to substitute him and run the business.

(3) Due to retirement or death of a partner.

(4) Due to new partners' admission.

Explanation or Understanding with Illustration : Let us understand the above information (particulars) with an illustration.

Virat and Vaman are the partners in a firm sharing profit and loss in proportion of 1:1. Due to his illness, Vaman is not able to spare enough time for business. Therefore, they have decided to share the profit and loss in the ratio of 2:1.

After making changes in the profit and loss sharing ratio Virat will get $\frac{2}{3}$ part of the profit and Vaman will get $\frac{1}{3}$.

Prior to the above distribution, both used to get $\frac{1}{2}$ part of profit. From this we can say that the portion of share of profit for Virat is increased and that of Vaman is decreased. The same can be shown by the following calculation :

Changes in profit share = Old share − New share

In the above formula if the answer is '+' (positive) then it is called decrease in profit (sacrifice) sharing and if the answer is '−' (negative) then it is called increase in profit sharing (gain).

Changes in profit received by Virat = Old share − New share

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

$$= \frac{3-4}{6}$$

$$= -\frac{1}{6}$$

Increase in profit ratio received by Virat $= -\frac{1}{6}$ (Gain)(As per above explanation)

Changes in profit received by Vaman = Old share − New share

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

$$= \frac{3-2}{6}$$

$$= \frac{1}{6}$$

Decrease in profit ratio received by Vaman $= \frac{1}{6}$ (Sacrifice)(As per above explanation)

From the above calculation, it can be seen that the share of profit of Virat is increased by $\frac{1}{6}$ and Vaman lost the share of profit by $\frac{1}{6}$. i.e. $\frac{1}{6}$ share of profit, which is lost by Vaman, is gained by Virat. In this way, the increase in the share of profit of Virat is called 'gain' and decrease in the share of profit of Vaman is called 'sacrifice'. In this example Vaman's 'sacrifice' turns out to be 'gain' for Virat.

Generally, when there is a change in profit sharing ratio of the existing partner, then some partners have to sacrifice certain portion of their profit which will be the gain for the other partner. So at the time of the reconstruction of a partnership, two important points are to be noted :

(1) Sacrificing ratio (2) Gaining ratio

(1) Sacrificing Ratio :

When there is a change in the ratio of profit and loss sharing of existing partners, a portion of profit of certain partners is reduced. i.e. they get less share as compared to what they used to get before. This reduced share of profit of a partners is called "Sacrificing ratio".

In case of admission of a new partner in an existing partnership firm, old partners have to give certain share of profit in favour of the new partner. At that time, it is also required to calculate sacrificing ratio of old partners. The detailed discussion of admission of a new partner will be made in Chapter no. 5.

Sacrificing ratio depends on the changes in the old profit and loss sharing ratio of the parnters. In the existing partnership firm, sacrificing ratio is a difference between the old share and the new share of profit of one or more partners who have, sacrificed. As per the mathematical method,

Sacrificing ratio of a partner = Old share − New share

From the above formula we can say that if a partners' old share of profit is higher than the new share, it means that the partner has sacrified his share. Let us try to understand the sacrifice made by a partner through the following example.

- **When sacrifice is done by one partner :**

Illustration 1 : Ram, Shyam and Ghanshyam are the partners in a firm sharing profit and loss equally. They decided to share profit and loss in the ratio of 3:2:1 in future. In these circumstances, calculate which partner has sacrified and how much ?

Ans. :

	Ram		Shyam		Ghanshyam	Total
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	3	:	2	:	1	6
New share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	

Now let's calculate sacrifice ratio by partners.

Sacrifice by partner = Old share − New share

(1) Ram's sacrifice $= \frac{1}{3} - \frac{3}{6}$

$= \frac{2-3}{6}$

Ram's sacrifice $= \frac{-1}{6}$ (Gain)

Here, $\frac{-1}{6}$ share in sacrifice formula, it means Ram is gaining $\frac{1}{6}$ shares.

(2) Shyam's sacrifice $= \frac{1}{3} - \frac{2}{6}$

$= \frac{2-2}{6}$

$= \frac{0}{6}$

Shyam's sacrifice $= 0$ (No gain, no sacrifice)

From the above calculation sacrifice ratio of Shyam = 0. i.e. Shyam has sacrificed nothing, as his share of profit remains the same.

Old ratio $= \frac{1}{3}$

New ratio $= \frac{2}{6} = \frac{1}{3}$

(3) Ghanshyam's sacrifice $= \frac{1}{3} - \frac{1}{6}$

$= \frac{2-1}{6}$

Ghanshyam's sacrifice $= \frac{1}{6}$ (Sacrifice)

From the above illustration, the benefit to Ram of $\frac{1}{6}$ share is due to the sacrifice given by Ghanshyam of $\frac{1}{6}$ share.

From the above illustration we can say that while calculating the sacrificing ratio, if the answer is negative (–), then it is benefit to the partner and not sacrifice. i.e. Gain ratio = New profit sharing ratio – Old profit sharing ratio

Ram	Shyam	Ghanshyam	
$-\frac{1}{6}$	0	$\frac{1}{6}$	0
(Gain)		(Sacrifice)	

Note : Total of sacrifice share and total of gain share is always equal.

- **When more than one partner is sacrificing :**

Illustration 2 : Bhavesh, Vipul and Hiral are the partners in a firm sharing profit and loss in the ratio of 2:2:1. They decided to share profits and losses in the ratio of 3:2:1 in future. From this information, calculate the sacrificing ratio.

Ans. :

	Bhavesh		**Vipul**		**Hiral**	**Total**
Old ratio	2	:	2	:	1	5
Old share	$\frac{2}{5}$		$\frac{2}{5}$		$\frac{1}{5}$	
New ratio	3	:	2	:	1	6
New share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	

Share of sacrifice = Old share – New share

(1) Bhavesh's sacrifice $= \frac{2}{5} - \frac{3}{6}$

$= \frac{12-15}{30}$

$= \frac{-3}{30}$

Bhavesh's sacrifice $= \frac{-1}{10}$ (Gain)

(2) Vipul's sacrifice $= \frac{2}{5} - \frac{2}{6}$

$= \frac{12-10}{30}$

Vipul's sacrifice $= \frac{2}{30}$ (Sacrifice)

(3) Hiral's sacrifice $= \frac{1}{5} - \frac{1}{6}$

$= \frac{6-5}{30}$

Hiral's sacrifice $= \frac{1}{30}$ (Sacrifice)

From the above calculation it can be seen that the sacrifice by Vipul and Hiral is received by Bhavesh in the form of gain / benefit. Vipul sacrificed $\frac{2}{30}$ and Hiral sacrificed $\frac{1}{30}$. So sacrifice ratio between Vipul and Hiral is $\frac{2}{30} : \frac{1}{30}$ respectively. i.e. sacrificing ratio of Vipul and Bhavesh is 2:1.

As per the earlier discussion, some partners' sacrifice turns out to be a benefit for the other partners'. In the above illustration sacrifice by Vipul and Hiral become a gain for Bhavesh. The calculation is as under :

Vipul's sacrifice $= \frac{2}{30}$

Hiral's sacrifice $= \frac{1}{30}$

$\therefore$ Vipul and Hiral's total sacrifice $= \frac{2}{30} + \frac{1}{30}$

$= \frac{2+1}{30}$

$= \frac{3}{30}$

Vipul and Hiral's total sacrifice $= \frac{1}{10}$

Bhavesh's gain $= \frac{1}{10}$

So, from the above calculation, it can be seen that the benefit of $\frac{1}{10}$ received by Bhavesh, is in the ratio of 2:1 from Vipul and Hiral respectively.

- **Sacrifice by one partner and gain by more than one partners :**

Illustration 3 : Poonam, Dhaval and Komal are the partners in a firm. Their profit and loss sharing ratio is 3:2:1. All the partners have decided to change the profit and loss ratio and it is 1:2:2. Calculate the sacrificing ratio of partners.

Ans. :

	Poonam		Dhaval		Komal	Total
Old ratio	3	:	2	:	1	6
Old share	$\frac{3}{6}$		$\frac{2}{6}$		$\frac{1}{6}$	
New ratio	1	:	2	:	2	5
New share	$\frac{1}{5}$		$\frac{2}{5}$		$\frac{2}{5}$	

The calculation of sacrifice by the partner :

Sacrifice = Old share − New share

(1) Poonam's sacrifice = Old share − New share

$= \frac{3}{6} - \frac{1}{5}$

$= \frac{15-6}{30}$

Poonam's sacrifice $= \frac{9}{30}$

(2) Dhaval's sacrifice = Old share − New share

$= \frac{2}{6} - \frac{2}{5}$

$= \frac{10-12}{30}$

Dhaval's sacrifice $= \frac{-2}{30}$ (Gain)

(3) Komal's sacrifice = Old share − New share

$= \frac{1}{6} - \frac{2}{5}$

$= \frac{5-12}{30}$

Komal's sacrifice $= \frac{-7}{30}$ (Gain)

As per the above calculation answers of Dhaval and Komal are negative (−). i.e. Dhaval and Komal have sacrificied nothing, but they received benefit of $\frac{2}{30}$ and $\frac{7}{30}$.

The benefit by Dhaval and Komal is due to Poonam's sacrifice. The calculation is as under :

Poonam's sacrifice $= \frac{9}{30}$

Dhaval's gain $= \frac{2}{30}$

Komal's gain $= \frac{7}{30}$

$\therefore$ Dhaval and Komal's gain $= \frac{2}{30} + \frac{7}{30} = \frac{9}{30}$

Here, the sacrifice of $\frac{9}{30}$ by Poonam, is equal to the total benefit of Dhaval and Komal.

Dhaval and Komal received the benefit of $\frac{2}{30}$ and $\frac{7}{30}$ respectively. i.e. the gain ratio between Dhaval and Komal is 2:7 which is received from Pooman.

Now, we try to understand the calculation of the gain ratio.

(2) **Gaining Ratio :**

When there is a change in profit and loss sharing ratio of partners, share of profit of some partners reduces and other partners share of profit increases. So some partners' share of profit is higher than the prior one. The higher share of profit of partners is called 'gaining ratio'.

If any partner retired or if there is death of any partner in the existing firm, share of profit of the retired or deceased partner will be received by the existing partners. At that time also, it becomes necessary to calculate the gaining ratio. The detailed discussion of retirement or death of an existing partner will be made in chapter 6.

If the new profit-loss sharing ratio is more compared to the old profit-loss sharing ratio then it is called gain. Gaining ratio is a difference between new profit-loss sharing ratio and old profit-loss sharing ratio received by the partners. As per the mathematical method,

Gain = New share − Old share

Let us try to understand the gaining ratio of partners with an illustration.

- **When any one partner is gaining :**

Illustration 4 : Dhruvil, Gopi and Mukund are partners the in a partnership firm. Their profit and loss sharing ratio is 1:1:1. All partners have decided to change the profit and loss sharing ratio in future to 1:2:3. Calculate the gain ratio.

Ans. :

	Dhuvil		Gopi		Mukund	Total
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	1	:	2	:	3	6
New share	$\frac{1}{6}$		$\frac{2}{6}$		$\frac{3}{6}$	

Now, let's calculate the gaining ratio of the partners.

Partner's gain = New share − Old share

(1) Dhruvil's gain $= \frac{1}{6} - \frac{1}{3}$

$= \frac{1-2}{6}$

Dhruvil's gain $= \frac{-1}{6}$ (Sacrifice)

(2) Gopi's gain $= \frac{2}{6} - \frac{1}{3}$

$= \frac{2-2}{6}$

$= \frac{0}{6}$

Gopi's gain $= 0$ (Zero)

(3) Mukund's gain $= \frac{3}{6} - \frac{1}{3}$

$= \frac{3-2}{6}$

Mukund's gain $= \frac{1}{6}$

As per the above calculation of gain, Dhruvil's gain answer is negative (–) which shows that actually Dhruvil does not receive any benefit but he has to sacrifice his share because of the change in profit and loss sharing ratio. Gopi has neither sacrificed nor gained due to the change in profit and loss sharing ratio as there is no change in her profit and loss sharing ratio. Her new profit-loss sharing ratio $\frac{2}{6} = \frac{1}{3}$ and her old ratio is also $\frac{1}{3}$. Actually, gain by Mukund is due to Dhruvil's sacrifice.

From the above illustration, it can be seen that while calculating the gain ratio if the answer is negative (–) then it is a sacrifice and not a gain.

- **When more than one partner are gaining :**

Illustration 5 : Dhyey, Siddhi and Prapti are the partners in a firm sharing profits and losses in the ratio of 1:1:1. All partners have decided to share profit and loss in the new ratio of 1:3:3. From the above information, find out the gain ratio.

Ans. :

	Dhyey		**Siddhi**		**Prapti**	**Total**
Old ratio	1	:	1	:	1	3
Old share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	
New ratio	1	:	3	:	3	7
New share	$\frac{1}{7}$		$\frac{3}{7}$		$\frac{3}{7}$	

Gain = New share – Old share

(1) Gain to Dhyey $= \frac{1}{7} - \frac{1}{3}$

$= \frac{3-7}{21}$

Gain to Dhyey $= \frac{-4}{21}$ (Sacrifice)

(2) Gain to Siddhi $= \frac{3}{7} - \frac{1}{3}$

$= \frac{9-7}{21}$

Gain to Siddhi $= \frac{2}{21}$

(3) Gain to Prapti $= \frac{3}{7} - \frac{1}{3}$

$= \frac{9-7}{21}$

Gain to Prapti $= \frac{2}{21}$

As per the above calculation, while calculating the gain to Dhyey, answer is negative (−), so Dhyey is not gaining anything but he has sacrificed $\frac{4}{21}$ share of profit. Gain to Siddhi and Prapti is $\frac{2}{21}$ and $\frac{2}{21}$ respectively.

So, gain ratio between Siddhi and Prapti is $\frac{2}{21} : \frac{2}{21}$ i.e. 1:1 (2:2).

- **When more than one partner scrifices and gain is to any one partner :**

Illustration 6 : Sagar, Sarita and Palak are the partners in a firm sharing profits and losses in the ratio of 3:3:2. All partners have decided to change their profit and loss ratio to 1:1:1. Calculate gain and sacrifice by the partners.

Ans. :

	Sagar		**Sarita**		**Palak**	**Total**
Old ratio	3	:	3	:	2	8
Old share	$\frac{3}{8}$		$\frac{3}{8}$		$\frac{2}{8}$	
New ratio	1	:	1	:	1	3
New share	$\frac{1}{3}$		$\frac{1}{3}$		$\frac{1}{3}$	

(1) Explanation with gain formula :

Gain = New share − Old share

(1) Gain to Sagar $= \frac{1}{3} - \frac{3}{8}$

$= \frac{8-9}{24}$

Gain to Sagar $= \frac{-1}{24}$ (Sacrifice)

(2) Gain to Sarita $= \frac{1}{3} - \frac{3}{8}$

$= \frac{8-9}{24}$

Gain to Sarita $= \frac{-1}{24}$ (Sacrifice)

(3) Gain to Palak $= \frac{1}{3} - \frac{2}{8}$

$= \frac{8-6}{24}$

Gain to Palak $= \frac{2}{24}$

As per the above calculation, Sagar and Sarita have sacrificed $\frac{1}{24}$ and $\frac{1}{24}$ respectively and Palak received the gain of $\frac{2}{24}$.

Gain to Palak $=$ Sacrifice by Sagar $+$ Sacrifice by Sarita

$= \frac{1}{24} + \frac{1}{24}$

$= \frac{1+1}{24}$

Gain to Palak $= \frac{2}{24}$

(2) Explanation with sacrifice formula :

Sacrifice = Old share − New share

(1) Sagar's sacrifice $= \frac{3}{8} - \frac{1}{3}$

$= \frac{9-8}{24}$

Sagar's sacrifice $= \frac{1}{24}$

(2) Sarita's sacrifice $= \frac{3}{8} - \frac{1}{3}$

$= \frac{9-8}{24}$

Sarita's sacrifice $= \frac{1}{24}$

(3) Palak's sacrifice $= \frac{2}{8} - \frac{1}{3}$

$= \frac{6-8}{24}$

Palak's sacrifice $= \frac{-2}{24}$ (Gain)

As per the above calculation, Sagar and Sarita have sacrificed and the benefit is received by Palak.

Gain to Palak $=$ Sagar's sacrifice $+$ Sarita's sacrifice

$= \frac{1}{24} + \frac{1}{24}$

$= \frac{1+1}{24}$

Gain to Palak $= \frac{2}{24}$

As per the above calculation we can say that the answer will remain same both in gain formula and sacrifice formula. In this way, whenever there is a change in profit and loss sharing ratio between the existing partners necessary calculation can be made by sacrifice or gain formula.

In short, whenever calculation is made by gain formula and if the answer is positive (+) then it is a gain and if the answer is negative (−) then it is a sacrifice.

Whenever calculation is made by the sacrifice formula and if the answer is positive (+) then it is a sacrifice and if the answer is negative (−) then it is a gain.

Difference Between Sacrifice Ratio and Gaining Ratio :

Sacrifice Ratio	Gaining Ratio
(1) **Meaning :** Old partners giving their profit share in favour of the new partners, OR changes in existing partners' profit-loss ratio due to the reconstruction of a partnership firm where any partners gives its profit share in favour of other partners is called sacrifice.	(1) Share of retiring partners received by existing partners, OR changes in existing partners' profit-loss sharing ratio, where some partner's sacrifice is received by existing partners is called gain ratio.
(2) **When is it computed ? :** At the time of admission of new partner and reconstruction of partnership firm, sacrifice ratio of old partners is computed.	(3) At the time of the retirement of a partner and at the time of the reconstruction of partnership, gaining ratio of existing partners is found.
(3) **Formula :** Sacrifice = Old share − New share	(3) Gain = New share − Old share
(4) **Why is it found ?** Sacrifice ratio is found to distribute the goodwill which is broughts in a new partner for his share and to give by adjustments of goodwill at the time of the reconstruction of a partnership firm.	(4) Gaining ratio is found for the share of goodwill to the retiring partner by the existing partners in their gain ratio and to give adjustment of goodwill due to the reconstruction of a partnership firm.

Now let us discuss another important point regarding the reconstruction of partnership.

3. Revaluation Accounts of Assets and Liabilities of a Partnership Firm and its Accounting Effects

The book value of assets and liabilities recorded in the books of a partnership firm when brought at present value it is called revaluation of assets. It means, recorded assets and liabilities are shown at new value which is called revaluation of assets and liabilities. Recorded assets and liabilities may be higher or lesser than its actual or real value. It may be possible that, with the passage of time, the price of fixed assets such as land and building may go up. In the same manner, there may not be any provision for reserve on debtors or bills receivable. In the same manner, it may be possible that liabilities increase or decrease or the liabilities remain unrecorded. Due to all these reasons if the partners have decided to revalue the assets and liabilities of the firm then its accounting effects are given.

- **Accounting effects of revaluation of assets and liabilities of a partnership firm :**

A special account is opened in the books of a partnership firm to record the accounting effects of the revaluation of assets and liabilities. This account is called the 'Revaluation Account'. Generally, whenever there is reconstruction of a partnership firm (changes in profit and loss sharing ratio), assets and liabilities of the firm are revalued. So assets and liabilities can be recorded at their real value in the firm's accounts and there is no possibility that any partner has to suffer because of the reconstruction of a partnership. For the same reasons, at the time of admission of a new partner in the existing partnership firm or at the time of retirement or death of a partner of the existing firm, assets and liabilities are revalued.

At the time of giving the accounting effect of revaluation, following rules should be remembered.

(1) If there is increase in assets-receivable then it is called profit.

(2) If there is decrease in assets-receivable then it is called loss.

(3) If there is increase in liabilities-provisions then it is called loss.

(4) If there is decrease in liabilities-provisions then it is called profit.

(5) If unrecorded assets are brought to books then it is a profit.

(6) If unrecorded liabilities are brought to books then it is a loss.

In above circumstances, when profit arise then respective account is debited and revaluation account is credited and when loss arise then the revaluation account is debited and the respective account is credited.

Balance of assets is always debit. Therefore, if assets value increases then assets account will be debited and revaluation account will be credited as it is a profit. On the contrary, if assets value decreases then revaluation account will be debited and assets account will be credited.

Balance of liabilities is always credit. Therefore if the liabilities value increases then the realisation account will be debited and the liabilities account will be credited, as it is a loss. On the contrary if the liabilities value decreases then the liabilities account will be debited and revaluation account will be credited.

Effect of changes (effect of adjustments) in the value of assets and liabilities are given in the revaluation account. So, it is also known, as profit and loss adjustment account.

At the time of revaluation of assets and liabilities, following journal entries are passed in the books of firm.

Journal Entry

	Particulars	**L.F.**	**Debit (₹)**	**Credit (₹)**
(1)	When there is an increase in the value of assets then :			
	Respective assets A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the assets value increase is recorded due to revaluation.]			
(2)	When there is decrease in the value of assets then :			
	Revaluation assets A/c Dr		✓	
	To Respective assets A/c			✓
	[Being the assets value decreased due to revaluation is recorded.]			
(3)	When there is a provision for doubtful debt or discount reserve etc. on debtor then :			
	Revaluation A/c Dr		✓	
	To Bad debt reserve A/c			✓
	To Discount reserve on debtors A/c			✓
	[Being the provision made for bad debts reserve and discount reserve on debtors.]			

	Particulars	L.F.	Debit (₹)	Credit (₹)
(4)	If there is an unrecorded assets, accrued income or prepaid expenses then :			
	Respective assets A/c Dr		✓	
	Accrued income A/c Dr		✓	
	Prepaid expenses A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the unrecorded assets, income receivable, and prepaid expenses are recorded.]			
(5)	If there is an increase in amount of liability then :			
	Revaluation A/c Dr		✓	
	To Respective liability A/c			✓
	[Being the liability amount increased due to revaluation.]			
(6)	If there is a decrease in amount of liability then :			
	Respective liability A/c Dr		✓	
	To Revaluation A/c			✓
	[Being the liability amount decreased to due to revaluation.]			
(7)	When an entry made for unrecorded liability in the books then :			
	Revaluation A/c Dr		✓	
	To Outstanding liability			✓
	[Being the unrecorded liability is recorded.]			
(8)	When revaluation account is closed then :			
	(A) If profit of revaluation account :			
	Revaluation A/c Dr		✓	
	To Partner's capital/current A/c			✓
	[Being due to revaluation, profit is distributed between partners in the ratio of profit-loss.]			
	(B) If loss of revaluation account :			
	Partners' capital/current A/c Dr		✓	
	To Revaluation A/c			✓
	[Being due to revaluation, loss is distributed between partners in the ratio of profit-loss.]			

- **Specimen/proforma of revaluation account is as under :**

Dr | Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Assets A/c (2)	✓	By Assets A/c (1)	✓
(Decrease in assets value)		(Increase in assets value)	
To Bad debt reserve A/c (3)	✓	By Assets A/c (4)	✓
To Discount reserve on debtors A/c (3)	✓	(Unrecorded assets)	
To Liabilities (Increase in liabilities) (5)	✓	By Accrued income A/c (4)	✓
To Outstanding liability A/c	✓	By Prepaid expenses A/c (4)	✓
(Increase in liability value) (7)		By Liability A/c (6)	✓
To Partners' capital A/c : Profit (8A)	✓	(Decrease in value)	
		By Partners' capital A/c : Loss (8B)	✓
	✓		✓

Note : The figure in the bracket shows No./Index of journal entries. It means revaluation account is a posting of journal entries of revaluation.

The above journal entry no. 8 will be passed after the preparation of the revaluation account. If the balance of revaluation account is credited then it is called profit and if it is a debit balance then it is called loss. The profit or loss is transferred to the present partners' capital accounhts in their old profit and loss sharing ratio, as the profit or loss has been increased before the changes made in the profit-loss sharing ratio.

Illustration 7 : Bhavna, Bharat and Bhumesh are the partners in a partnership firm sharing profit and loss in the ratio of 2:1:1. The following is their balance sheet as on 31-3-2017.

Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Land	5,00,000
Bhavna	6,00,000		Building	8,00,000
Bharat	6,00,000		Machinery	4,00,000
Bhumesh	5,40,000	17,40,000	Furniture	50,000
Creditors		2,00,000	Investment	50,000
Bills payable		60,000	Debtors	1,00,000
			Bills receivable	30,000
			Cash balance	20,000
			Bank balance	50,000
		20,00,000		**20,00,000**

Partners have decided to revaluate the assets and liabilities on the date of the above balance-sheet.

(1) The value of land is ₹ 7,00,000.

(2) The value of building is increased by ₹ 1,00,000.

(3) The market-value of machine is ₹ 2,50,000 which is to be recorded in the books.

(4) Provision for doubtful debts at 20 % on debtors.

(5) Creditors amounting to ₹ 10,000, are not required to be paid.

(6) Income receivable amounted to ₹ 5000 and outstanding expenses amounted to ₹ 3000 which are to be recorded.

From the above information, write journal-entry in the books of partnership firm for revaluation and prepare revaluation A/c.

Ans. : Journal Entry in the Books of Partnership Firm of Bhavna, Bharat and Bhumesh

Date	Particulars	L.N.	Debit (₹)	Credit (₹)
(1)	Land A/c Dr		2,00,000	
	To Revaluation A/c			2,00,000
	[Being due to revaluation, there is an increase in price of land ₹ 2,00,000.]			
(2)	Building A/c Dr		1,00,000	
	To Revaluation A/c			1,00,000
	[Being due to revaluation there is an increase in price of building ₹ 1,00,000.]			
(3)	Revaluation A/c Dr		1,50,000	
	To Machinery A/c			1,50,000
	[Being due to revaluation, there is decrease in price of machinery ₹ 1,50,000.]			
(4)	Revaluation A/c Dr		20,000	
	To Bad debt reserve A/c			20,000
	[Being the provision for doubtful debts ₹ 20,000 on ₹ 1,00,000 debtors @ 10 %.]			
(5)	Creditors A/c Dr		10,000	
	To Revaluation A/c			10,000
	[Being an amount of ₹ 10,000 not to be paid to creditors.]			
(6)	Receivable income A/c Dr		5000	
	To Revaluation A/c			5000
	[Being the unrecorded receivable income is recorded.]			
(7)	Revaluation A/c Dr		3000	
	To Outstanding expenses A/c			3000
	[Being the unrecorded outstanding expense is recorded.]			
	Total carry forward		4,88,000	4,88,000

Date	Particulars	L.N.	Debit (₹)	Credit (₹)
	Total bring forward		4,88,000	4,88,000
(8)	Revaluation A/c Dr		1,42,000	
	To Bhavna's capital A/c			71,000
	To Bharat's capital A/c			35,500
	To Bhumesh's capital A/c			35,500
	[Being the profit due to revaluation distributed among the partners in their profit sharing ratio.]			
	Total		**6,30,000**	**6,30,000**

Revaluation Account as on 31-3-2017 (Profit-loss adjustment A/c)

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		1,50,000	By Land A/c	2,00,000
To Bad debt reserve A/c		20,000	By Building A/c	1,00,000
To Outstanding expense A/c		3000	By Creditors A/c	10,000
Profit : To partners' capital A/c (2:1:1)			By Income receivable A/c	5000
Bhavna	71,000			
Bharat	35,500			
Bhumesh	35,500	1,42,000		
		3,15,000		**3,15,000**

Explanation :

Particulars	Old	New	Increased	Decreased	Profit	Loss	Revaluation A/c
Land	5,00,000	7,00,000	2,00,000	–	2,00,000	–	Credit
Building	8,00,000	9,00,000	1,00,000	–	1,00,000	–	Credit
Machinery	4,00,000	2,50,000	–	1,50,000	–	1,50,000	Debit
Bad debt reserve	–	20,000	20,000	–	–	20,000	Debit
Creditors	2,00,000	1,90,000	–	10,000	10,000	–	Credit
Income Receivable	–	5000	5000	–	5000	–	Credit
Outstanding Expenses	–	3000	3000	–	–	3000	Debit
					3,15,000	**1,73,000**	

Illustration 8 : Harish, Dhruvil and Manoj are the partners of a partnership firm. Their profit-loss sharing ratio is 3:2:1. Balance-sheet of the firm as on 31-3-2017 is as given on page no. 123.

Harish, Dhruvil and Manoj's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital account :			Land	3,00,000
Harish	3,65,000		Building	4,80,000
Dhruvil	3,00,000		Machinery	2,00,000
Manoj	1,00,000	7,65,000	Investment	1,20,000
Bank loan		4,50,000	Debtors	80,000
Creditors		1,00,000	Bills receivables	20,000
Bills payable		32,000	Bank balance	1,00,000
Outstanding expenses		18,000	Cash balance	40,000
			Income receivables	10,000
			Closing stock	15,000
		13,65,000		**13,65,000**

As on above balance sheet date, profit-loss sharing ratio is changed to 1:3:2 and also decided for revaluation of assets and liabilities of business as follows :

(1) Land value is increased upto ₹ 3,50,000 and building value is increased by ₹ 70,000.

(2) Machinery value keeps upto ₹ 1,50,000.

(3) Investment value decreased 20 %.

(4) Provide 10 % for bad debts reserve and 5 % for discount reserve on debtors.

(5) 50 % stock value decreased by 10 %.

(6) Unrecorded outstanding expense is amounted to ₹ 2000.

(7) Unrecorded prepaid rent ₹ 3000.

From the above information, write journal entries and prepare revaluation account in the books of partnership firm.

Ans. :

Journal Entries in the books of Harish, Dhruvil and Manoj's firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land A/c Dr		50,000	
	Building A/c Dr		70,000	
	To Revaluation A/c			1,20,000
	[Being increase in the value of land and building due to revaluation is recorded.]			
(2)	Revaluation A/c Dr		50,000	
	To Machinery A/c			50,000
	[Being decrease in the value of machinery due to revaluation is recorded.]			
	Total carry forward		1,70,000	1,70,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		1,70,000	1,70,000
(3)	Revaluation A/c Dr To Investment A/c [Being decrease in the value of investment due to revaluation is recorded.]		24,000	 24,000
(4)	Revaluation A/c Dr To Bad debt reserve A/c To Discount reserves on debtors A/c [Being the provision made for bad debt reserves on ₹ 80,000 debtors at 10 %. ₹ 8000 and ₹ 3600 discount reserves at 5 % on ₹ 72,000 (₹ 80,000 – ₹ 8000) are recorded.]		11,600	 8000 3600
(5)	Revaluation A/c Dr To Stock A/c [Being the stock value decreased due to revaluation is recorded.]		750	 750
(6)	Revaluation A/c Dr To Outstanding exp. A/c [Being the unrecorded outstanding expense is recorded in the book.]		2000	 2000
(7)	Prepaid rent A/c Dr To Revaluation A/c [Being the unrecorded prepaid rent is recorded.]		3000	 3000
(8)	Revaluation A/c Dr To Harish's capital A/c To Dhruvil's capital A/c To Manoj's capital A/c [Being the profit due to revaluation is distributed between partners as per their old profit-loss sharing ratio (3:2:1)]		34,650	 17,325 11,550 5775
	Total		**2,46,000**	**2,46,000**

Revaluation Account as on 31-3-2017 (Profit-loss Adjustment A/c)

Dr | | | | | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		50,000	By Land A/c	50,000
To Investment A/c		24,000	By Building A/c	70,000
To Bad debt reserve A/c		8000	By Outstanding rent A/c	3000
To Discount reserve on debtors A/c		3600		
To Stock A/c		750		
To Outstanding expense A/c		2000		
Profit : To partners' capital A/c :				
Harish	17,325			
Dhruvil	11,550			
Manoj	5775	34,650		
		1,23,000		**1,23,000**

Note : (1) Land value increased upto ₹ 3,50,000 means revaluation value is ₹ 3,50,000. Therefore, land value increased ₹ 50,000 due to revaluation (3,50,000 − 3,00,000 = ₹ 50,000 increased).

(2) Machinery value decreased upto ₹ 1,50,000 means revaluation value is ₹ 1,50,000. Therefore, machinery value decreased ₹ 50,000 due to revaluation (2,00,000 − 1,50,000 = ₹ 50,000 decreased).

Illustration 9 : Hardik and Alpesh are the partners of a partnership firm. Their profit-loss sharing ratio is 5:3. They want to change their profit-loss sharing ratio to 3:2. Therefore, they decided to have the revaluation of firm's assets and liabilities. From the following information prepare revaluation account and balance-sheet after revaluation in the books of firm.

Hardik and Alpesh's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land-building		2,00,000
Hardik	1,10,000		Machinery		80,000
Alpesh	90,000	2,00,000	Furniture		40,000
Current accounts :			Investments		60,000
Hardik	1,55,000		Closing stock		45,000
Alpesh	1,00,000	2,55,000	Debtors	30,000	
Creditors		35,000	− Bad debt reserves	1500	28,500
Bank overdraft		90,000	Bills receivables		15,000
Outstanding expenses		3500	Income receivable		5000
			Cash balance		1,10,000
		5,83,500			**5,83,500**

Additional information :

(1) Land and building value is to be increased by 25 %.

(2) Furniture value is to be decreased upto 90 %.

(3) Market value of machinery is ₹ 72,000.

(4) Book value of closing stock is ₹ 10,000, less than its market value.

(5) To keep total bad debt reserve ₹ 3600 on debtors.

(6) Creditor amounted to ₹ 5000 out of the total creditors are not to be paid.

(7) Unrecorded interest on bank overdraft is ₹ 4500.

Ans. :

Revaluation Account as on 31-3-2017

Dr | Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Furniture A/c		4000	By Land-building A/c	50,000
To Machinery A/c		8000	By Closing stock A/c	10,000
To Bad debt reserve A/c		2100	By Creditors A/c	5000
To Outstanding bank overdraft interest A/c		4500		
Profit : To partners' current A/c : (5:3)				
Hardik	29,000			
Alpesh	17,400	46,400		
		65,000		**65,000**

Note : (1) Furniture value decreased upto 90 % means 10 % decrease. (100 % – 90 %)

(2) Book value of closing stock is less than market value means ₹ 10,000 market value is high.

(3) Partners' fixed capital accounts and current are separately given in balance sheet. Therefore, profit of revaluation account is transferred to the partners' current account.

Hardik and Alpesh's Partnership Firm's Balance Sheet After Revaluation

Liabilities			Amt. (₹)	Assets		Amt. (₹)
Capital accounts :				Land-building	2,00,000	
Hardik		1,10,000		+ 25 % increased	50,000	2,50,000
Alpesh		90,000	2,00,000	Machinery	80,000	
Current accounts :				− Decreased	8000	72,000
Hardik	1,55,000			Furniture	40,000	
+ Profit	29,000	1,84,000		− Decreased 10 %	4000	36,000
Alpesh	1,00,000			Investments		60,000
+ Profit	17,400	1,17,400	3,01,400	Closing stock	45,000	
Creditors			30,000	+ Increased	10,000	55,000
Bank overdraft		90,000		Debtors	30,000	
+ Outstanding interest		4500	94,500	− Bad debt reserve	3600	26,400
Outstanding expenses			3500	Bills receivables		15,000
				Income receivable		5000
				Cash balance		1,10,000
			6,29,400			**6,29,400**

4. Distribution of Reserves and Accumulated Profits Among the Partners :

Free Reserves created from the divisible profit of a partnership firm, and the balance of the accumulated profit (if any) are of current partners of the firm. General reserves, workers' accident compensation fund etc. are called reserve fund and credit balance of profit and loss account is called the accumulated profit. At the time of the reconstruction of a partnership firm reserve funds and the balance of accumulated profit are distributed amongst the existing (current) partners in their old profit-loss sharing ratio.

If there is debit balance (loss) of profit-loss account then it is also distributed among the existing partners in their old profit-loss sharing ratio. The same distribution is also made before the admission of a new partner. At the time of retirement or death of a partner also, balance of reserve fund and profit-loss account is distributed amongst the old partners in the old profit-loss sharing ratio.

Following journal entry is passed in the books of the firm for distributing reserve fund and accumulated profit.

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
	Profit-loss A/c (Profit)	Dr		✓	
	General reserves A/c	Dr		✓	
	Capital reserves A/c	Dr		✓	
	Reserve fund A/c	Dr		✓	
	Contingency reserves A/c	Dr		✓	
	Worker's accident compensation fund A/c	Dr		✓	
	Investment fluctuation fund A/c	Dr		✓	
	To Old partners' capital/Current A/c				✓

Note : If there is debit balance (loss) of profit-loss account and other defferred revenue expenditures in the book of a firm then the following journal entry is passed.

	Particulars		L.F.	Debit (₹)	Credit (₹)
	Old partners' current/capital A/c	Dr		✓	
	To profit-loss A/c (loss)				✓
	To advertisement campaign A/c				✓
	To research development expense A/c				✓
	To other non-written off revenue expenditure A/c				✓

Note : Fluctuating capital account method has no current account so reserve fund and profit-loss account are transferred to the capital account and in fixed capital account method they are transferred to the partners' current account.

Illustration 10 : Ram and Rahim are the partners of a partnership firm. Profit-loss sharing ratio between them is 4:3. The following are the balances in the books of the firm as on 31-3-2017.

Profit-loss A/c (debit balance)	₹ 14,000
Reserve fund	₹ 42,000
Workers' profit sharing fund	₹ 21,000
Workers' accident compensation fund	₹ 26,000

On the above date, Ram and Rahim decided on a new profit sharing ratio of 1:1. A claim of ₹ 5000 is outstanding against the workers' accident compensation fund. Pass journal entries showing distribution of accumulated profit or losses in the books of the firm.

Ans. : Here, partners have made a change in their profit-loss sharing ratio. Therefore, accumulated profit or loss and reserves will be distributed in the old profit-loss sharing ratio.

Debit balance of profit-loss account ₹ 14,000

(4:3)

Ram 8000 | Rahim 6000

Reserve fund = 42,000

Workers' accident compensation fund = 21,000

(₹ 26,000 – ₹ 5000 claim)

63,000

(4:3)

Ram 36,000 | Rahim 27,000

Note : (1) Workers' profit sharing fund is a liability for a firm, therefore, it is not distributed. (2) Total workers' accident compensation fund is ₹ 26,000, but ₹ 5000 claim is outstanding against it, therefore ₹ 5000 workers' accident compensation fund will be continued as a liability in the balance-sheet while balance ₹ 21,000 will be distributed between the old partners.

Journal entry in the books of Ram and Rahim's firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Ram's capital A/c Dr		8000	
	Rahim's capital A/c Dr		6000	
	To Profit-loss A/c			14,000
	[Being the profit-loss debit balance is distributed between existing partners in their old profit-loss sharing ratio.]			
(2)	Reserve fund A/c Dr		42,000	
	Workers' accident compensation fund A/c Dr		21,000	
	To Ram's capital A/c			36,000
	To Rahim's capital A/c			27,000
	[Being the balance of reserve fund and workman compensation fund are distributed between existing partners in their old profit sharing ratio.]			
	Total		**77,000**	**77,000**

Note : Above journal entry no. 2 is combined. Instead of it following separate journal entry will be passed.

(1)	Reserve fund A/c Dr		42,000	
	To Ram's capital A/c $(42{,}000 \times \frac{4}{7})$			24,000
	To Rahim's capital A/c $(42{,}000 \times \frac{3}{7})$			18,000
	[Being the balance of reserve fund is distributed between existing partners in their old profit-loss sharing ratio.]			
(2)	Workers' accident compensation fund A/c Dr		21,000	
	To Ram's capital A/c $(21{,}000 \times \frac{4}{7})$			12,000
	To Rahim's capital A/c $(21{,}000 \times \frac{3}{7})$			9,000
	[Being the workman's accident compensation fund is distributed between existing partners in their old profit-loss sharing ratio.]			

Note : Above journal entry no. 2 is combined.

(1) Maximum 10 adjustments can be included in a question if both journal entries and the revaluation accounts are asked to prepare.

(2) Maximum 5 adjustments can be included if journal entries, necessary accounts and balance sheet are asked to prepare.

This information has to be implemented also in the chapter on Reconstruction of partnership, Admission of partners and Retirement or death of partner.

Illustration 11 : From the following information, pass necessary journal entries and prepare a revaluation account and a balance-sheet after the effects of revaluation in the books of Rajesh and Jagdish.

Rajesh and Jagdish are the partners sharing profit-loss in the ratio of 3:2. Balance sheet of the firm as on 31-3-2017 is as below :

Rajesh and Jagdish's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land - building		1,00,000
Rajesh	1,40,000		Machinery		80,000
Jagdish	60,000	2,00,000	Furniture		20,000
General reserve		10,000	Investment (Market value ₹ 25,000)		30,000
Profit and Loss A/c		15,000	Debtors	60,000	
Creditors		95,000	– Bad debt reserve	3000	57,000
			Stock		23,000
			Cash balance		10,000
		3,20,000			**3,20,000**

Partners have decided for the revaluation of assets and liabilities of the firm and the future profit distribution ratio is 1:1. Information for the same is as under :

(1) Land-building value is to be increased by 20 %.

(2) The value of machinery and furniture is to be decreased by 20 %.

(3) Now, bad debts reserves is not required.

(4) ₹ 3000 repairing expense is required in stock.

(5) An amount of ₹ 5000 among creditors is now not to be paid, which is to be recorded.

(6) Outstanding expenses ₹ 6000 and income receivable ₹ 8000.

(7) The investment is to be shown at market value.

Ans. :

Journal Entries in the Books of Rajesh and Jagdish Firm

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land - building A/c Dr		20,000	
	To Revaluation A/c			20,000
	[Being increase in the value of land building on their revaluation is recorded.]			
	Total carry forward		20,000	20,000

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		20,000	20,000
(2)	Revaluation A/c Dr		20,000	
	To Machinery A/c			16,000
	To Furniture A/c			4000
	[Being decrease in the value of machinery and furniture on their revaluation are recorded.]			
(3)	Bad debt reserves A/c Dr		3000	
	To Revaluation A/c			3000
	[Being the bad debt reserve is not required, due to its revaluation is recorded.]			
(4)	Revaluation A/c Dr		3000	
	To Stock A/c			3000
	[Being the repairing expenses for stock is recorded.]			
(5)	Creditors A/c Dr		5000	
	To Revaluation A/c			5000
	[Being the amount of ₹ 5000 is not payable to creditors recorded.]			
(6)	Revaluation A/c Dr		6000	
	To Outstanding expense A/c			6000
	[Being the unpaid expenses not recorded is recorded due to revaluation.]			
(7)	Income receivable A/c Dr		8000	
	To Revaluation A/c			8000
	[Being the income receivable due to revaluation is recorded.]			
(8)	Revaluation A/c Dr		5000	
	To Investment A/c			5000
	[Being the market value of investment decrease due to revaluation is recorded.]			
	Total carry forward		70,000	70,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		70,000	70,000
(9)	General reserve A/c Dr		10,000	
	To Rajesh's capital A/c			6000
	To Jagdish's capital A/c			4000
	[Being the general reserve distributed between existing partners in their old profit-loss sharing ratio.]			
(10)	Profit-loss A/c Dr		15,000	
	To Rajesh's capital A/c			9000
	To Jagdish's capital A/c			6000
	[Being the credit balance of profit-loss account is distributed between existing partners in their old profit-loss sharing ratio.]			
(11)	Revaluation A/c Dr		2000	
	To Rajesh's capital A/c			1200
	To Jagdish's capital A/c			800
	[Being the profit on revaluation is distributed between existing partners in their old profit-loss sharing ratio.]			
	Total		**97,000**	**97,000**

Revaluation account (Profit-loss adjustment A/c) of
Partnership firm of Rajesh and Jagdish as on 31-3-2017

Dr Cr

Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Machinery A/c		16,000	By Land-building A/c	20,000
To Furniture A/c		4000	By Bad debt reserve A/c	3000
To Stock A/c		3000	By Creditors A/c	5000
To Outstanding expenses A/c		6000	By Income receivable A/c	8000
To Investment A/c		5000		
To Partners' capital A/c (Profit) :				
Rajesh's capital A/c	1200			
Jagdish's capital A/c	800	2000		
		36,000		**36,000**

Partners' Capital Account

Dr Cr

Particular	Rajesh(₹)	Jagdish(₹)	Particular	Rajesh(₹)	Jagdish(₹)
To Balance c/d	1,56,200	70,800	By Balance b/d	1,40,000	60,000
			By General reserve A/c	6000	4000
			By Profit-loss A/c	9000	6000
			By Revaluation A/c	1200	800
	1,56,200	**70,800**		**1,56,200**	**70,800**

Rajesh and Jagdish's partnership firm's balance sheet after revaluation

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			Land-building	1,00,000	
Rajesh :	1,40,000		+ Increase (20 %)	20,000	1,20,000
+ General reserves	6000		Machinery	80,000	
+ Profit-loss A/c	9000		− Decrease (20 %)	16,000	64,000
+ Revaluation profit	1200	1,56,200	Furniture	20,000	
Jagdish :	60,000		− Decrease (20 %)	4000	16,000
+ General reserves	4000		Investment (Market value)		25,000
+ Profit-loss A/c	6000		Debtors		60,000
+ Revaluation profit	800	70,800	Stock	23,000	
Creditors		90,000	− Decrease	3000	20,000
Outstanding expenses		6000	Cash balance		10,000
			Income receivables		8000
		3,23,000			**3,23,000**

Note : In above balance sheet, effects of general reserves, profit-loss account and revaluation account are given in the balance of capital account. Instead of it, capital accounts can be prepared and balance of capital account can be shown in the balance sheet as under :

Illustration 12 : Pushpa, Pratibha and Bhavna are the partners of a partnership firm, profit-loss sharing in the ratio of 3:2:1. Balance-sheet of a partnership firm as on 31-3-2017 is as given on page no. 134 :

Balance Sheet of Pushpa, Pratibha and Bhavna's Partnership Firm as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Pushpa	2,64,000		Land-building		1,80,000
Pratibha	1,20,000		Machinery		1,60,000
Bhavna	80,000	4,64,000	Furniture		40,000
General reserve		18,000	Investments		30,000
Worker's accident compensation fund		6000	**Current assets :**		
Non-current liabilities :			Debtors	1,60,000	
12 % bank loan		1,00,000	− Bad debts	10,000	
Current liabilities :				1,50,000	
Creditors		56,000	− Bad debts reserves	7500	1,42,500
Bills payable		6000	Bills receivables		7000
Bank overdraft		15,000	Stock		30,500
			Cash balance		63,000
			Profit-loss account		12,000
		6,65,000			**6,65,000**

As on above balance sheet date, partners have decided to change the profit-loss sharing ratio to 1:1:1 and have decided to revalue the assets and liabilities of the business. Following revaluation account is prepared for the revaluation of the business, assets and liabilities.

Revaluation Account

Dr Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	60,000	By Land-building A/c		40,000
To Furniture A/c	5000	By Creditors A/c		6000
To Investment A/c	3000	By Income receivables A/c		4000
To Bad debt reserve A/c	7500	Partners' capital A/c (Loss) :		
To Stock A/c	2500	Pushpa	18,000	
To Outstanding expenses A/c	8000	Pratibha	12,000	
		Bhavna	6000	36,000
	86,000			**86,000**

From the above information pass necessary journal entries, partners' capital accounts and balance-sheet after the revaluation in the books of the partnership firm.

Ans. : Revaluation account is already given in the example. It means posting of revaluation of liabilities- assets transactions are given. Therefore, journal entries of revaluation will be passed on the basis of the posting.

Effect of general reserves, workers' accident compensation fund and profit-loss account (debit balance) are given in the partners' capital accounts. Therefore, they are not in the revaluation accounts, but it's journal entries will be passed.

Separate journal entry can be passed for each transaction from the revaluation account, but here the revaluation account is given, therefore three journal entries can be passed for the effect of particulars mentioned in the revaluation account.

(1) Profit due to revaluation of assets-liabilities (2) Loss due to revaluation of assets-liabilities

(3) Profit-loss of revaluation account is distributed between the existing partners in their old profit-loss sharing ratio

Journal Entries in the Books of Pushpa, Pratibha and Bhavna's Firm

	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Revaluation A/c Dr		86,000	
	To Machinery A/c			60,000
	To Furniture A/c			5000
	To Investment A/c			3000
	To Bad debt reserve A/c			7500
	To Stock A/c			2500
	To Outstanding expense A/c			8000
	[Being the changes in the value of assets liabilities due to revaluation are recorded.]			
(2)	Land-building A/c Dr		40,000	
	Creditors A/c Dr		6000	
	Income receivables A/c Dr		4000	
	To Revaluation A/c			50,000
	[Being the changes in the value of assets-liabilities due to revaluation are recorded.]			
(3)	Pushpa's capital A/c Dr		18,000	
	Pratibha's capital A/c Dr		12,000	
	Bhavna's capital A/c Dr		6000	
	To Revaluation A/c			36,000
	[Being the loss of revaluation is distributed between existing partners in their old profit-loss sharing ratio.]			
(4)	General reserve A/c Dr		18,000	
	To Pushpa's capital A/c			9000
	To Pratibha's capital A/c			6000
	To Bhavna's capital A/c			3000
	[Being the balance of general reserves is distributed between existing partners in their old profit-loss sharing ratio.]			
(5)	Workers' accident compensation fund A/c Dr		6000	
	To Pushpa's capital A/c			3000
	To Pratibha's capital A/c			2000
	To Bhavna's capital A/c			1000
	[Being the balance of workers' accident compensation fund is distributed between existing partners in their old profit-loss sharing ratio.]			
	Total carry forward		1,96,000	1,96,000

	Particulars	L.F.	Debit (₹)	Credit (₹)
	Total bring forward		1,96,000	1,96,000
(6)	Pushpa's capital A/c Dr		6000	
	Pratibha's capital A/c Dr		4000	
	Bhavna's capital A/c Dr		2000	
	To Profit-loss A/c			12,000
	[Being the debit balance of profit-loss account is distribnuted between existing partners in their old profit-loss sharing ratio.]			
	Total		**2,08,000**	**2,08,000**

Dr **Partners' Capital A/c** Cr

Particulars	Pushpa (₹)	Pratibha (₹)	Bhavna (₹)	Particulars	Pushpa (₹)	Pratibha (₹)	Bhavna (₹)
To Profit-loss A/c	6000	4000	2000	By Balance b/d	2,64,000	1,20,000	80,000
To Revaluation A/c	18,000	12,000	6000	By General reserve A/c	9000	6000	3000
To Balance c/d	2,52,000	1,12,000	76,000	By Workers accident compensation fund A/c	3000	2000	1000
	2,76,000	**1,28,000**	**84,000**		**2,76,000**	**1,28,000**	**84,000**

Pushpa, Pratibha and Bhavna's Partnership Firm's Balance Sheet After Revaluation

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Pushpa	2,52,000		Land-building	1,80,000	
Pratibha	1,12,000		+ Increased	40,000	2,20,000
Bhavna	76,000	4,40,000	Machinery	1,60,000	
Non-current liabilities :					
12 % bank loan		1,00,000	− Decreased	60,000	1,00,000
Current liabilities :			Furniture	40,000	
Creditors	56,000		− Decreased	5000	35,000
− Decreased	6000	50,000	Investment	30,000	
Bills payable		6000	− Decreased	3000	27,000
Outstanding expenses		8000	**Current assets :**		
Bank overdraft		15,000	Debtors	1,50,000	
			− Bad debt reserve	15,000	1,35,000
			Bills receivables		7000
			Stock	30,500	
			− Decreased	2500	28,000
			Cash balance		63,000
			Income receivables		4000
		6,19,000			**6,19,000**

5. Goodwill

At the time of the reconstruction of a partnership firm, the problem of determining the value of 'goodwill' of the firm also arises. Meaning of goodwill, its nature, factors affecting its valuation and methods of valuation of goodwill are discussed at length in the previous chapter.

EXERCISE

1. Select appropriate option for each question :

(1) At the time of the reconstruction of a partnership firm .... is prepared.

(a) trading account
(b) revaluation account
(c) realisation account
(d) profit-loss appropriation account

(2) Where are the effects given when the value of assets increase at the time of the reconstruction of a partnership firm ?

(a) Addition in assets value and the revaluation account will be credited.
(b) Addition in assets value and the revaluation account will be debited.
(c) Subtract from assets value and the revaluation account will be credited.
(d) Subtract from assets value and the revaluation account will be debited.

(3) Where are the effects given when the value of liabilities decrease at the time of the reconstruction of a partnership firm ?

(a) Subtract from such liabilities and the revaluation account will be credited.
(b) Subtract from such liabilities and the revaluation account will be debited.
(c) Addition in such liabilities and the revaluation account will be credited.
(d) Addition in such liabilities and the revaluation account will be debited.

(4) Revaluation account is also known as ....

(a) Capital reserves account
(b) Profit-loss appropriation account
(c) Profit-loss adjustment account
(d) Profit-loss account

(5) In which ratio profit or loss of revaluation account is distributed between the partners ?

(a) Sacrifice ratio
(b) Gain ratio
(c) New profit-loss ratio
(d) Old profit-loss ratio

(6) Where is the accumulated profit as per the balance sheet is shown at the time of the reconstruction of a partnership firm ?

(a) Credit side of revaluation account
(b) Credit side of profit-loss appropriation account
(c) Credit side of partners' capital account
(d) Debit side of partners' capital account

(7) In the reconstruction of partnership firm, sacrifice = ...

(a) New profit-loss share × Old profit-loss share
(b) New profit-loss share – Old profit-loss share
(c) Old profit-loss share – New profit-loss share
(d) Old capital share – New capital share

(8) In the reconstruction of a partnership firm, gain ratio = ...

(a) New profit-loss share – Old profit-loss share

(b) Old profit-loss share – New profit-loss share

(c) New capital ratio – Old capital ratio

(d) Old capital ratio – New capital ratio

(9) At the time of the reconstruction of a partnership firm, investments are shown at .... value in the balance-sheet after the revaluation.

(a) Book value - market value (b) Cost value

(c) Market value (d) Face value

(10) Where is the worker profit sharing fund shown in balance sheet at the time of the reconstruction of a partnership firm ?

(a) Credit side of revaluation account

(b) Liabilities of balance sheet after reconstruction

(c) Credit side of partners' capital account

(d) Debit side of partners' capital account

2. Answer the following questions in one sentence :

(1) What is reconstruction of a partnership firm ?

(2) What is revaluation account ?

(3) What is sacrifice ratio ?

(4) What is gain ratio ?

(5) How is the consolidated profit distributed ?

(6) In which account revaluation account's profit-loss is transferred ?

(7) At which value assets-liabilities are shown in the balance sheet after revaluation ?

(8) Which is the other name known for the revaluation account ?

3. Answer the following questions :

(1) Explain the meaning of a partnership reconstruction and the circumstances for reconstruction.

(2) Explain the sacrifice ratio with illustration.

(3) Explain the gain ratio with illustration.

(4) What is the revaluation of assets and liabilities ? Prepare specimen of revaluation account.

(5) Write specimen journal entries for revaluation in following circumstances :

(a) When assets' value are increased and decreased.

(b) When liabilities' value are increased and decreased.

(6) Write specimen journal entry for the distribution of reserve fund and accumulated profit of a partnership firm.

(7) Write journal for the following assets-liabilities revaluation :

Assets and Liabilities	Book value	Revaluation Value
Machinery	1,00,000	80,000
Land	3,00,000	5,00,000
Creditors	1,00,000	95,000
Outstanding expenses	–	3000
Income receivables	–	2000

(8) Difference between sacrifice ratio and gain ratio.

4. Amar and Akbar are the partners of a firm distributing profits-losses of the firm in equal proportion. They decided to change their profit-loss sharing proportion to 3:2 for future. Under this circumstances, calculate what sacrifice has been made by which partner.

5. Komal, Krupa and Karishma are the partners' of a partnership firm. They distribute profit-loss in the ratio of 3:2:1. All the partners have decided to change the profit-loss sharing ratio to 5:3:2 for future. From this information calculate the sacrifice ratio.

6. Sachin, Rahul and Rohit are the partners of a partnership firm. Profit-loss sharing ratio is 1:2:2 between them. All partners have decided to change profit-loss sharing ratio to 3:2:1. Calculate the sacrifice ratio of partners.

7. Dipak, Nilesh and Pratik are the partners of a partnership firm. Their profit-loss sharing ratio is 1:2:3, which is decided to change to 2:2:1 respectively for future. Under these circumstances, calculate what gain is received by which partners ?

8. Raju, Hasu and Sanju are the partners of a partnership firm. Their profit-loss sharing ratio is 5:4:3. All the partners have decided to change their profit-loss sharing ratio to 2:2:1. From this information find out gain the ratio.

9. Pravin, Mahendra and Arvind are the partners of a partnership firm. Their profit-loss sharing ratio is 5:2:2. All the partners have decided to change the profit-loss sharing ratio to $\frac{2}{9}$, $\frac{3}{9}$ and $\frac{4}{9}$ as new ratio. From this information find out what sacrifice has been made by which partner by using sacrifice formula.

   From above information, by using gain formula find out what sacrifice has been made by which partner.

10. Rajesh, Pushpa and Pratibha are the partners of a "Shreenathji Traders" partnership firm. Their profit-loss sharing ratio is 2:3:1. Their firms' balance sheet as on 31-3-2017 is as under :

Shreenathji Traders' Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets	Amt. (₹)
Capital : Rajesh	2,00,000		**Non-current assets :** Land	1,80,000
Pushpa	1,00,000		Building	3,00,000
Pratibha	2,00,000	5,00,000	Machinery	1,20,000
Non-current liabilities :			Investments	40,000
10 % bank loan		80,000	**Current assets :**	
Current liabilities : Creditors		1,70,000	Debtors	50,000
Bills payable		40,000	Bills receivables	10,000
Workers' profit sharing fund		29,000	Closing stock	35,000
Outstanding expenses		10,000	Bank balance	60,000
			Cash balance	30,000
			Income receivables	4000
		8,29,000		**8,29,000**

As on above date of the balance sheet, partners decided to change profit-loss sharing ratio to 1:1:1. On this date they decided to revalue the assets and liabilities for which information is as under :

(1) The value of land is to be increased upto ₹ 2,50,000 and building value is to be increased by ₹ 50,000.

(2) The value of machinery is to be decreased upto ₹ 80,000.

(3) The value of investments is to be reduced 30 %.

(4) Provision for bad debt reserve at 20 % and discount reserve of 5 % is to be made on debtors.

(5) The stock value of ₹ 15,000 is to be reduced by 20 %.

(6) An amount of ₹ 20,000 is not to be paid to creditors.

(7) ₹ 3000 for outstanding expenses and ₹ 2000 for income receivable are not recorded in the books.

Form the above information, write journal entries in the books of the partnership firm and also prepare the revaluation account.

11. Manju, Prabha and Meena are the partners of a partnership firm. Their profit-loss sharing ratio is 5:3:2. They want to change their profit-loss sharing ratio to 3:2:1. Therefore, they decided to revalue the assets-liabilities of the firm. From the following information prepare revaluation account and balance sheet after revaluation.

Manju, Prabha and Meena's Partnership Firm's Balance Sheet as on 31-3-2017

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital :			**Non-current assets :**		
Manju	1,50,000		Land-building		1,00,000
Prabha	40,000		Machinery		50,000
Meena	30,000	2,20,000	Furniture		30,000
Current accounts :			Investments		50,000
Manju	10,000		**Current assets :**		
Prabha	20,000		Closing stock		40,000
Meena	9000	39,000	Debtors	25,000	
Non-current liabilities :			− Bad debt reserves	1000	24,000
12 % Bank loan		30,000	Bills receivables		5000
Current liabilities :			Cash balance		40,000
Creditors		40,000			
Bills payable		10,000			
		3,39,000			**3,39,000**

Additional information :

(1) The value of land-building is to be increased by 25 %.

(2) The value of furniture is to be reduced by 10 %.

(3) The value of machinery is to be kept 80 %.

(4) The book value of closing stock is ₹ 5000 more than its market value.

(5) Total amount of ₹ 2500 is to be kept for bad debts reserve on debtors.

(6) An amount of ₹ 3000 among the creditors is now not to be paid.

(7) Interest on bank loan for last three month is outstanding.

12. Alay and Sanket are the partners of a partnership firm. Profit-loss sharing ratio among them is 2:1. As on 31-3-2017, the following are the balances in the books of firm.

Profit-loss account (Debit balance)	₹ 18,000
Reserve fund	₹ 27,000
Workers' profit sharing fund	₹ 33,000
Workers' accident compensation fund	₹ 21,000

On the above date, Alay and Sanket decided to change their profit-loss sharing ratio to 1:1. A claim of ₹ 6000 is outstanding payable to workers against workers accident compensation fund. Pass journal entries showing distribution of accumulated profit-loss in the books of firm.

13. From the following information, pass necessary journal entries and prepare a revaluation account and a balance sheet after revaluation in the books of Sajan and Nirmi.

Sajan and Nirmi are the partners sharing profit-loss in the ratio of 5:3. Their firm's balance sheet as on 31-3-2017 is as under :

Balance Sheet as on 31-3-2017 of Sajan and Nirmi's Firm

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital account :			**Non-current assets :**		
Sajan	80,000		Land-building		1,40,000
Nirmi	50,000	1,30,000	Machinery		80,000
General reserve		80,000	Furniture		30,000
Profit-loss account		48,000	Investments (Market value ₹ 18,000)		20,000
Non-current liabilities :			**Current assets :**		
12 % bank loan		70,000	Debtors	40,000	
Current liabilities :			− Bad debts reserve	1500	38,500
Creditors		32,000	Stock		31,500
Bills payable		10,000	Cash balance		30,000
		3,70,000			**3,70,000**

Partners decided to revalue the assets and liabilities of the firm and to distribute profit in the ratio of 1:1 for future.

(1) The value of land-building is to be increased by 10 %.

(2) The value of machinery and furniture is to be reduced by 40 %.

(3) ₹ 1000 bad debts reserve on debtors is not required.

(4) ₹ 1500 repairing expense is required for stock.

(5) ₹ 1500 out of creditors is now not to be paid which is to be recorded in the books.

(6) Outstanding expenses is ₹ 10,000 and income receivable is ₹ 2000.

(7) Investment is to be shown at its market value.

14. Dattu, Daya and Tarak are the partners of a partnership firm sharing profit-losses in the ratio of 4:3:2. Their firm's balance sheet as on 31-3-2017 is as under :

Balance sheet as on 31-3-2017 of Dattu, Daya and Tarak's firm

Liabilities		Amt. (₹)	Assets		Amt. (₹)
Capital accounts :			**Non-current assets :**		
Dattu	1,00,000		Land-building		90,000
Daya	50,000		Machinery		80,000
Tarak	50,000	2,00,000	Furniture		20,000
Reserves :			Investments		15,000
General reserve		36,000	**Current assets :**		
Workers accident compensation fund		23,000	Debtors	80,000	
Non-current liabilities :			− Bad debts	4000	
9 % bank loan		40,000		76,000	
Current-liabilities :			− Bad debts reserve	6000	70,000
Creditors		50,000	Bills receivable		5000
Bills payable		20,000	Stock		15,000
Bank overdraft		8000	Cash balance		55,000
			Profit-loss account		27,000
		3,77,000			**3,77,000**

As on above balance sheet date, partners changed profit-loss sharing ratio to 1:1:1 and the following revaluation account is prepared for the revaluation of assets and liabilities.

Revaluation Account

Dr Cr

Particulars	Amt. (₹)	Particulars		Amt. (₹)
To Machinery A/c	35,000	By Land-building A/c		10,000
To Furniture A/c	5000	By Creditors A/c		6000
To Investment A/c	3000	By Income receivables A/c		3000
To Bad debts reserve A/c	10,000	By Partners' capital A/c (Loss) :		
To Stock A/c	3000	Dattu	18,000	
To Outstanding expenses A/c	2000	Daya	13,500	
To Bank overdraft interest A/c	1500	Tarak	9000	40,500
	59,500			**59,500**

A claim of ₹ 5000 was against workers accident compensation fund.

From the above information write journal entries and prepare partners' capital account and balance sheet after revaluation.

●