ગુજરાત રાજ્યના શિક્ષણવિભાગના પત્ર-ક્રમાંક
મશબ/1215/178/છ, તા. 24-11-2016–થી મંજૂર

ELEMENTS OF ACCOUNTS

(Part 1)

Standard 12

PLEDGE

India is my country.

All Indians are my brothers and sisters.

I love my country and I am proud of its rich and varied heritage.

I shall always strive to be worthy of it.

I shall respect my parents, teachers and all my elders and treat everyone with courtesy.

I pledge my devotion to my country and its people.

My happiness lies in their well-being and prosperity.

રાજ્ય સરકારની વિનામૂલ્યે યોજના હેઠળનું પુસ્તક

તમસો મા જ્યોતિર્ગમય

Gujarat State Board of School Textbooks
'Vidyayan', Sector 10-A, Gandhinagar-382010

Subject Adviser
Shri R. H. Vyas

Authors
Dr H. C. Sardar (Convener)
Shri Pankajbhai C. Raval
Dr Dipak R. Raste
Dr R. K. Patel
Dr Jayesh A. Thakkar
Shri Sureshchandra J. Sahu
Shri Raghubhai T. Socha

Translators
Dr H. C. Sardar
Shri Pankajbhai C. Raval
Dr Dipak R. Raste
Dr R. K. Patel

Reviewers
Dr Bharat J. Acharya
Shri Neel A. Shastri
Shri Philomina L. Solanki
Shri Arvind B. Acharya
Shri Maulik B. Shah
Shri Parul M. Divan
Dr Manoj D. Shah
Shri Soham S. Desai
Shri Aliasgar T. Bookwala

Language Reviewer
Dr Bharti G. Dave

Co-ordinator
Dr Chirag N. Shah
(Subject Co-ordinator : Commerce)

Preparation and Planning
Shri Haren Shah
(Dy. Director : Academic)

Lay-out and Planning
Shri Haresh S. Limbachiya
(Dy. Director : Production)

PREFACE

The Gujarat Secondary and Higher Secondary Board has prepared new syllabi in accordance with the syllabi at the national level. These syllabi are approved by the Government of Gujarat.

The Gujarat State Board of School Textbooks takes pleasure in presenting this textbook to the students. It is prepared according to the new syllabus of **Elements of Accounts (Part 1)** for **Standard 12**.

This textbook is written and reviewed by expert teachers and professors. This textbook is published after incorporating the necessary changes suggested by the reviewers.

The Board has taken ample care to make this textbook interesting, useful and free of errors. However, suggestions are welcome to improve the quality of this book from persons taking interest in education.

P. bharathi (IAS)
Director
Executive President
Date : 13-12-2019
Gandhinagar

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FUNDAMENTAL DUTIES

It shall be the duty of every citizen of India*:

(a) to abide by the Constitution and respect its ideals and institutions, the National Flag and the National Anthem;

(b) to cherish and follow the noble ideals which inspired our national struggle for freedom;

(c) to uphold and protect the sovereignty, unity and integrity of India;

(d) to defend the country and render national service when called upon to do so;

(e) to promote harmony and the spirit of common brotherhood amongst all the people of India transcending religious, linguistic and regional or sectional diversities; to renounce practices derogatory to the dignity of women;

(f) to value and preserve the rich heritage or our composite culture;

(g) to protect and improve the natural environment including forests, lakes, rivers and wild life, and to have compassion for living creatures;

(h) to develop the scientific temper, humanism and the spirit of inquiry and reform;

(i) to safeguard public property and to abjure violence;

(j) to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement;

(k) to provide opportunities for education by parent, the guardian, to his child, or a ward between the age of 6 to 14 years as the case may be.

* Constiution of India : Section 51-A

CONTENTS

●

1

Introduction to Partnership

1. Introduction

The partnership firm is emerged from capital and managerial limitations of sole proprietor firm. Following are the reasons for the emergence of partnership firm.

(i) An individual has sufficient funds but does not have required skill. (ii) An individual has required skill but does not have sufficient funds. (iii) To distribute business risk.

More than one person, additional capital, skill and managerial ability are required to run a business at a large level and for the expansion of any business. In these circumstances, more than one person gather and become the supplement to each other and commence a business; this form of business organisation means a partnership firm.

2. Meaning and Definition of Partnership

Section 4 of the Indian Partnership Act 1932, defines partnership as, "Partnership is the relation between the persons who have agreed to share the profit of a business carried on by all or any one of them acting for all."

The person who enter into such relationship are individually called 'partners' and collectively a 'firm'.

From the above definition it can be said that two or more persons who are competent to undertake a contract to earn profit from a legal business, the business is termed as partnership.

The business run collectively in partnership by two or more persons is known as partnership firm.

3. Characteristics of Partnership

(1) **Creation by Contract :** Partnership emerge through agreement. Partnership agreement can be in written or oral form. But written form is desirable and advisable.

(2) **Profit Objective :** Partnership firm forms to earn and distribute profit. The distribution of profit or loss is done amongst partners in their predetermined proportion. As per partnership act profit or loss is distributed in equal proportion if no provision is made in the contract.

(3) **Legal Business :** Partnership firm is formed to do a legal business.

(4) **Agent of Each other :** The business of partnership firm is run by all the partners or any one of them for all or more than one partner. Thus each partner is an agent of each other.

(5) **Number of Partners :** The section 464 of the companies Act, 2013 empowers the government to prescribe maximum number of partners in a firm subject to maximum of 100. The government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the companies (miscellaneous) Rules, 2014.

(6) **Unlimited Liabilities :** As per partnership Act partners are responsible to pay business obligation from their personal property when the firm does not have sufficient assets to pay liabilities of the business. Every partner individually and collectively is responsible to the partnership firm. Therefore the liability of each partner is unlimited.

(7) **Ownership and Management of Firm :** Partners are owners of business and they do the management of business. The management of business is done either by all the partners or by one partner or by more than one partner.

4. Partnership Deed

The emergence of partnership is from the agreement. Partners undertake agreement within the provisions of partnership act. Partnership deed acceptable to all the partners is prepared at the time of the commencement of a partnership firm. The partnership agreement can be written or oral. A written agreement of partnership is known as a partnership deed. A written partnership deed is desirable and advisable, so that the solution of any misunderstanding or dispute in future can be obtained on the basis of the provisions of the partnership deed. The partnership deed is a administrative constitution of partnership firm, where all provisions pertaining to firms' administration are included. Generally, the following content is included in the partnership deed.

(1) **Details of Partners :** The information about name, address and other details of patners is included.

(2) **Details of Firm :** The details like name and address of the firm are included.

(3) **Type of Business :** The information about the type of business is also included here.

(4) **Commencement of Partnership :** The information about the commencement date of the partnership firm is also covered in the deed.

(5) **Capital :** The amount of capital introduced by each partner is mentioned in the deed. It is not mandatory to bring a capital by each partner.

(6) **Interest on Capital :** Whether interest on capital is to be paid or not ? If yes, than what percentage ? These points are mentioned in the partnership deed. If no provision is made in partnership deed, no interest on capital is paid to the partners.

(7) **Drawings :** What maximum amount can be withdrawn by each partner is also mentioned in the partnership deed.

(8) **Interest on Drawings :** At what rate interest is to be charged on drawings made by the partner during the year is also mentioned in the partnership deed. There is no provision in the partnership act for the interest on drawings. But if necessary such provision can be included in the partnership deed.

(9) Distribution of Profit and Loss : In which proportion profit or loss of business will be distributed among the partners is provided in the partnership deed. If no provision is made in partnership deed, as per the partnership act profit or loss is distributed in equal proportion.

(10) Salary, Bonus, Commission and Remuneration to the Partners : There is no provision in partnership act for the payment of salary, bonus, commission and remuneration to the partners. If any partner takes active participation in the management of the partnership firm, a provision is made in the partnership deed for the payment of salary, bonus, commission and remuneration to the partners.

(11) Interest on Loan Provided by Partner to Firm : The rate of interest is to be mentioned in the partnership deed, when any partner has lended a loan to the firm. If no provision is made in the partnership deed, as per the partnership act, 6 % p.a. interest will be paid on the loan given by the partner to the firm. Interest on partners' loan is treated as an expense of business. Thus, it is debited to the profit and loss account.

(12) Goodwill : The computation to determine the value of goodwill at the time of the admission of a new partner and at the time of retirment or death of a partner is also mentioned in the partnership deed.

(13) Admission - Retirement : The provisions pertaining to admission of a new partner and the retirement or death of a partner is also mentioned in the partnership deed.

(14) Dissolution of Firm : In what circumstances firm will be dissolved ? What procedure will be adopted ? etc. These points are mentioned in the partnership deed.

The payment of salary, bonus, commission, remuneration or any other payment only to active partners of a partnership firm is available as deduction as per section 40(b) of Income Tax Act, 1961.

As stated in section 40(b) of Income Tax, any interest payable to partners will be disallowed, if no provision is made in the partnership deed. Therefore it is desirable to mention it in the partnership deed. As per section 40(b)(iv) of Income Tax Act, interest payment more than 12 % to the partners will not be given as deduction. As per partnership deed interest more than 12 % can be paid but deduction will be allowed, upto 12 %.

***Note :** Sections of Income Tax Act are given for the better understanding of students. It is not for examination purpose.

5. Provisions of Indian Partnership Act 1932, Pertaining to Accounting Treatments in the Absence of Partnership Deed

The following provisions of partnership Act 1932, will be applicable if no partnership deed is prepared or no clarification is made in the partnership deed.

(1) Each partner contributes capital in the firm by mutual agreement. There is no restriction in the act in this regard. It is not mandatory to bring a capital for each partner.

(2) Interest on the capital of partner cannot be paid.

(3) The distribution of profit and loss would remain in equal proportion.

(4) Interest on drawings of the partner can not be charged.

(5) Salary, bonus, commission or remuneration can not be paid to the partners.

(6) 6 % p.a. interest is payable for the loan given by any partner to the firm.

(7) In case of any reasonable expense incurred by the partner for the firm the partner has the right to reimburse it.

6. Capital Accounts of Partners

A capital account of each partner is prepared in the books of partnership firm to record the individual transactions done by the partner with the partnership firm.

An initial capital introduced by the partner and addition in capital in any means are recorded at the credit side of the capital account and transactions which reduce the capital are recorded at the debit side of the capital account.

There are two methods to maintain capital accounts in the books of partnership firm.

(1) Fluctuating Capital Account Method (2) Fixed Capital Account Method

(1) **Fluctuating Capital Account Method :** A method in which the opening balance of the capital account and the closing balance of the capital account of any partner is reported fluctuated (flexible) is known as fluctuating or temporary capital account method. Under this method to record all the transactions related to the partners, only one capital account is prepared in the books of firm.

Opening capital, additional capital introduced during the year, interest on capital, salary, bonus, commission, remuneration, interest on loan given by the partner, share of partner in divisible profit are credited at the credit side of the capital account. Drawings, interest on drawings, share of partner in divisible loss are debited at the debit side of the capital account. To record these transactions partners' capital account are debited or credited keeping in mind the nature of transaction. Consequently, during the year there is either increase or decrease in the opening balance of the capital account. So the balance of capital account of any partner keeps on changing every year. Thus, this method is known as fluctuating or temporary capital account.

All transactions between the partners and the partnership firm are recorded in the partners capital account. Under this method balance of partners' capital is either credit or debit. If there is credit balance in capital account it would appear at the liability side of the balance sheet and the debit balance would appear at the asset side of the balance sheet. A specimen of partners' capital accounts under fluctuating account method is as under :

Partners' Capital Accounts

Dr Cr

Date	**Particular**	**A Amt. (₹)**	**B Amt. (₹)**	**Date**	**Particular**	**A Amt. (₹)**	**B Amt. (₹)**
*	To Balance b/d (Opening debit balance of capital A/c)	....	....	*	By Balance b/d (Opening credit balance of capital A/c)	....	....
	To Drawings A/c (Cash/bank/any other asset A/c)	....	....		By Cash/bank/any other assets A/c	....	....
	To Interest on drawings A/c	....	....		By Interest on capital A/c	....	....
					By Salary A/c	....	....
					By Bonus A/c	....	....
					By Commission A/c	....	....
**	To Profit and loss appropriation A/c (Divisible loss)	....	....		By Remuneration A/c	....	....
***	To Balance c/d (Closing credit balance of capital account)	....	....	**	By Profit and loss appropriation A/c (Divisible profit)	....	....
				***	By Balance c/d (Closing debit balance of capital A/c)	....	....
		....	....			....	....

* Balance b/d can be either debit balance or credit balance.

** There can be either divisible loss or divisible profit.

*** Balance c/d can be either debit balance or credit balance.

(2) Fixed Capital Account Method : A method of partners' capital under which no change is reported in opening balance and closing balance in the partners' capital account is known as fixed capital account method. Under this method to record all the transactions of the partners with the partnership firm, two accounts are maintained in the books.

(A) Partners' Capital Account

(B) Partners' Current Account

(A) Partners' Capital Account : Generally, under this method opening balance and closing balance of partners' capital account remains identical. There can be change in opening balance and closing balance of partners' capital account, if either additional capital is introduced or capital is withdrawn by the partners on the permanent basis. Under this method balance of partners' capital account remains credit balance. The credit balance of capital account is shown at the Capital-liability side of the balance sheet. Transactions other than permanent capital are recorded in the current account. A specimen of partners' capital accounts under fixed capital account method is as under.

Partners' Capital Account

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
....	To Cach/bank/any other asset (with-drawal of capital)	....	....	....	By Balance b/d (Opening credit balance)	....	....
....	To Balance c/d (Closing credit balance)	....	....	....	By Cash/bank/any other assets' A/c (Additional capital)	....	....
		....	....			....	....

(B) Partners' Current Account : Under fixed capital account method the account prepared to record the transactions of the partner with the partnership firm, other than permanent capital is known as current account. At the credit side of the current account, opening credit balance of current account, interest on capital, interest on credit balance of current account, salary, bonus, commission, remuneration and shares in divisible profit are recorded. At the debit side of current account, opening debit balance of current account, drawings, interest on drawings, interest on debit balance of current account and share in divisible loss are recorded. The closing balance of current account can be either debit or credit balance. If closing balance of current account is credit balance it is shown at the capital and the liability side of the balance sheet and debit balance is shown at the asset side. The specimen partners' current accounts is as shown on page no. 6.

Partners' Current Account

Dr | Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
....	To Balance b/d (Opening debit balance of current account)	....	....	....	By Balance b/d (Opening credit balance of current account)	....	....
	To Drawings A/c (cash/bank/any other asset A/c)	....	....		By Interest on capital A/c	....	....
	To Interest on drawings A/c	....	....		By Interest on credit balance of current account	....	....
	To Interest on debit balance of current A/c	....	....		By Salary A/c	....	....
	To Profit-loss Appropriation A/c (Divisible loss A/c)	....	....		By Bonus A/c	....	....
	To Balance c/d (Closing credit balance of current account)	....	....		By Commission A/c	....	....
					By Remuneration A/c	....	....
					By Profit-loss appropriation A/c (By Divisible profit)	....	....
					By Balance c/d (Closing debit balance of current A/c)	....	....
		....	....			....	....

Note : When current accounts of partners are not given in the question and no specification is given pertaining to the capital account, in this case capital accounts are maintained under fluctuating capital account method :

7. Difference Between Fixed Capital Account Method and Fluctuating Capital Account Method

Points of Difference	Fixed Capital Account Method	Fluctuating Capital Account Method
(1) Meaning	Where the opening balance and the closing balance of the partners' capital accounts is reported unchanged is known as fixed capital account method.	Where the opening balance and the closing balance of the partners' capital account is reported flexible is known as fluctuating capital account method.
(2) Accounts	To record all the transactions of the partners with the firm, two accounts are opened in the books of the firm : (i) capital account and (ii) current account.	To record all the transactions of the partners with the firm only capital account is opened in the books of the firm.

Points of Difference	Fixed Capital Account Method	Fluctuating Capital Account Method
(3) **Treatments of transactions**	In 'capital account', capital and changes in capital are recorded. Transactions other than permanent capital are recorded in the current account.	All transactions of capital and other than capital are recorded in the 'capital account'.
(4) **Interest on capital**	Generally, the amount of capital remains unchanged, therefore interest on capital remains constant.	The amount of capital keeps on changing, consequently interest on capital also keeps on changing.
(5) **Balance of account**	Balance of fixed capital account is always a credit balance. While current account can have a debit or credit balance.	Generally, balance of capital account is a credit balance. But under this method, there can be debit balance of capital account.
(6) **Treatment in balance-sheet**	Since fixed capital account has credit balance, it will be shown at the capital liability side of balance sheet. If current account has credit balance, it will be shown at the capital-liability side of balance sheet and debit balance at the asset side.	If capital account has a credit balance, it will be shown at the capital-liability side of the balance sheet and the debit balance at the asset side.

8. Drawing Accounts of Partners

When partners withdraw cash, goods or assets from the partnership firm for his personal use, this amount is known as drawings of partners. Withdrawn done by the partner from the partnership firm is debited to the drawing account. If provision is made, then interest on drawings is also debited to the drawing account. At the end of the year, in fluctuating capital account method drawing account is closed and the balance is transferred to the partners' capital account. In the fixed capital method it is debited to the partners' current account. Journal entry is passed as follows in this regard.

	Partners' Capital/Current A/c Dr To Partners' drawings A/c [Being partners' drawings account is closed and transfer it to partners' capital / current account.]	......	....	....

The specimen of drawings account is as follows :

Partners' Drawings Account

Dr Cr

Date	Particular	Amt. (₹)	Date	Particular	Amt. (₹)
	To Cash A/c To Bank A/c To Goods/assets A/c (Drawings done during the year)	....		By Capital/Current A/c (Closing balance is transferred to Capital/Current account)	....
*	To Interest on drawings A/c	....			
		....			....

Note : *When interest on drawing is debited to drawings account, it will not be debited to the capital/current account.

9. Profit-Loss Appropriation Account

To distribute profit and loss amongst the partners profit-loss appropriation account is prepared after the preparation of the profit-loss account in final accounts of the partnership firm. Profit-loss appropriation is a part of the profit-loss account. A separate preparation of this account is not mandatory.

Credit side of profit-loss appropriation account : At the credit side of the profit-loss appropriation account, net profit transferred from the profit-loss account, interest on drawings done by the partners, interest on debit balance of current accounts of partners are credited.

Debit side of profit-loss appropriation account : At the debit side of the profit-loss appropriation account net loss transferred from the profit-loss account, interest on partners' capital account, interest on credit balance of the current accounts of partners, salary-bonus, commission, remuneration to the partners, amount transferred to general reserve account are debited.

Allocation of profit-loss : After deduction of the total of the debit side of the profit-loss appropriation from the total of the credit side of profit-loss appropriation, difference (profit) is credited to partners' capital/current account in their profit-loss sharing ratio. After the deduction of the total of the credit side of profit-loss appropriation from the total of the debit side of the profit-loss appropriation, difference (loss) is debited to the partners' capital/current account in their profit-loss sharing ratio.

Profit-Loss Appropriation Account for the year ending ....
of Partnership firm of A, B and C

Dr | | | Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Profit & Loss A/c (Net loss)	....	By Profit & Loss A/c (Net profit)	....
To Interest on partners' capital A/c		By Interest on partners' drawings A/c	
A		**A**	
B		**B**	
C	....	**C**	....
To Interest on credit balance of current accounts of partner	....	By Interest on debit balance of current accounts of partner	....
To Partners' salary A/c	....	By Partners' capital A/c (Divisible loss)	
To Partners' bonus, commission, remuneration A/c	....	**A**	
To General reserve A/c	....	**B**	
To Partners' capital A/c (Divisible profit)		**C**	....
A			
B			
C	....		
	....		....

Note : Commission to manager and interest on loan given by the partner are treated as the expense of the firm. Thus both are recorded at the debit side of the profit-loss account. The principle of matching concept is applicable to both of these, hence are debited to profit and loss account. A detailed information for interest on drawings, interest on capital and interest on loan of partners is given subsequently.

The interest on partners' loan is not mentioned in the partners' capital/current account. It's accounting effect is given separately. The partner's loan is the liability of a business. Outstanding interest on the loan also will be shown as liability in the balance sheet.

10. Difference Between Profit-Loss Account and Profit-Loss Appropriation Account

Points of difference	Profit-Loss Account	Profit-Loss Appropriation Account
(1) **Meaning**	After the preparation of the trading account, the account which is prepared to know the net profit or loss of the business is known as profit and loss account.	After the preparation of the profit and loss account, account which is prepared to distribute profit or loss amongst the partners, is known as profit and loss appropriation account.
(2) **Prepared by**	All business entities prepare profit and loss account.	Generally, partnership firm prepares profit and loss appropriation account.
(3) **Opening entry of account**	Gross profit or gross loss determined under trading account is shown as the opening entry of the profit and loss account.	Net profit or net loss determined under profit and loss account is shown as the opening entry of the profit and loss appropriation account.
(4) **Debit side**	At the debit side of this account, expenses other than purchase are recorded for e.g. administrative expenses, sales expenses, financial expenses, depreciation, interest on loan of partner, commission of manager, provision and other expenses and loss.	At the debit side of this account interest on capital, interest on credit balance of current account, salary, bonus, commisison and remuneration to the partners are recorded.
(5) **Credit side**	At the credit side of this account different revenues of business are recorded.	At the credit side of this account interest on drawings, interest on debit balance of current account are recorded.
(6) **Result of Account**	From this account net profit or net loss of the firm is ascertained.	From this account divisible profit or divisible loss of the firm is ascertained.
(7) **Balance of Account**	The balance of this account is transferred to the profit and loss appropriation account.	The ascertained divisible profit/loss is distributed among the partners.

Explanation and Journal Entries for Special Issues :

Particular	Journal Entry
(1) **Interest on Capital**	(i) When interest on capital is payable Interest on capital A/c ...Dr To partners' capital/current A/c (ii) To close interest on capital account and transfer it to profit and loss appropriation A/c Profit and loss appropriation A/c ...Dr To interest on capital A/c

Particular	Journal Entry
(2) Salary, Bonus, Commission, Remuneration to the Partners	(i) When salary, bonus, commission, remuneration are payable to partners Partners' salary, bonus, commission, remuneration A/c ...Dr To partners' capital/current A/c (ii) To close salary, bonus, commission, remuneration and transfer them to profit and loss appropriation A/c Profit and loss appropriation A/c ...Dr To partners' salary, bonus, commission, remuneration A/c
(3) Interest on Drawings	(i) When interest on drawings is charged Partners' capital/current A/c ...Dr To interest on drawings A/c (ii) To close interest on drawings A/c, Interest on drawings A/c ...Dr To profit and loss appropriation A/c
(4) Profit Transfered to General Reserve	(i) When profit is transfered to general reserve A/c Profit and loss appropriation A/c ...Dr To general reserve A/c
(5) Profit or Loss of Profit-Loss Appropriation A/c	When profit or loss of profit and loss appropriation is distributed among partners in their profit sharing ratio : (i) In case of profit Profit and loss appropriation A/c ...Dr To partners' capital/current A/c (ii) In case of loss Partners' capital/current A/c ...Dr To profit and loss appropriation A/c
(6) Interest on Loan of Partners	(i) When interest on loan is paid Interest on loan A/c ...Dr To cash A/c (ii) When interest on loan is outstanding Interest on loan A/c ...Dr To outstanding interest on loan A/c (iii) To close interest on loan A/c Profit and loss A/c ...Dr To interest on loan

Note : There can be combined journal entry for the above stated transactions no. 1 to 3.

Interest on Partners' Capital Account :

There can be different provisions for the interest on capital in the partnership deed. Interest on capital can be paid to the partners as per the following provisions of the partnership deed.

Provisions in Partnership Deed	Interest on Capital
(1) When there is no provision for interest on capital in the partnership deed.	Interest on capital cannot be paid.
(2) When the provision for interest on capital is made in the partnership deed but no clarification is provided to consider interest on capital as a charge or appropriation of profit.	(i) In case of loss, interest on capital cannot be paid. (ii) If profit is equal to interest of amount or more than that, in this case interest on capital can be paid as per the prescribed rate. (iii) If profit is less than interest on capital, amount equal to profit can be paid as interest on capital to the partners' in their capital proportion.
(3) When interest on capital is considered as a charge as per the partnership deed. (In case of either profit or loss interest will be paid.)	Whether profit is unsufficient or there is loss, interest on capital can be paid as per the prescribed rate. (In this circumstances profit and loss appropriation account would show the divisible loss.)

A and B are partners sharing profit-loss in the proportion of 4:1. Their capital as on 1-4-2016 is ₹ 4,00,000 and ₹ 2,00,000 respectively. Prepare profit and loss appropriation account or profit and loss account whichever is necessary for the year ending on 31-3-2017 under the following provisions pertaining to interest on capital if prescribed in the partnership deed.

(1) If a firm has a profit for the year ₹ 40,000 and no provision is made for interest on capital in partnership deed.

(2) If a firm has a profit for the year ₹ 80,000 and 10 % p.a. interest on capital is payable as per the provision of partnership deed.

(3) If a firm has a profit for the year ₹ 30,000 and 10 % p.a. interest on capital is payable as per the provision of partnership deed.

(4) If a firm has a profit for the year ₹ 30,000 and 10 % p.a. interest on capital is payable and interest on capital is considered as charge as per the provision of the partnership deed.

(5) If a firm has a loss for the year ₹ 10,000 and 10 % p.a. interest on capital is payable and interest on capital is considered as charge as per the provision of the partnership deed.

Ans.

(1) If no provision is made for interest on capital in partnership deed.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Partners' capital A/c			By Profit and loss A/c (Net profit)	40,000
A :	32,000			
B :	8000	40,000		
		40,000		**40,000**

(2) If provision in partnership deed is made to pay 10 % interest on capital.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)	80,000
A :	40,000			
B :	20,000	60,000		
To Partners' capital A/c				
A :	16,000			
B :	4000	20,000		
		80,000		**80,000**

(3) If provision in partnership deed is made to pay 10 % interest on capital.

Profit and Loss Appropriation Account for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)	30,000
A :	20,000			
B :	10,000	30,000		
		30,000		**30,000**

Note : Payable interest at 10 % to A ₹ 40,000 and to B ₹ 20,000 : total ₹ 60,000. While net profit is ₹ 30,000. Thus, interest on capital will be paid to the extent of net profit available. Interest on capital, equal to net profit ₹ 30,000 will be paid to the partners in their ratio of capital 2:1 (₹ 20,000 : ₹ 10,000).

(4) If provision in partnership deed is made to pay 10 % interest on capital and treated interest as charge.

Dr **Profit and Loss Appropriation Account for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on partners' capital A/c			By Profit and loss A/c (Net profit)		30,000
A :	40,000		By Partners' capital A/c		
B :	20,000	60,000	(Net divisible loss (4:1)) :		
			A :	24,000	
			B :	6000	30,000
		60,000			**60,000**

(5) If provision in partnership deed is made to pay 10 % interest on capital and treated interest as a charge - when firm has net loss.

Dr **Profit and Loss Appropriation Account for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Net loss)		10,000	By Partners' capital A/c		
To Interest on partners' capital A/c			(Net divisible loss (4:1)) :		
A :	40,000		A :	56,000	
B :	20,000	60,000	B :	14,000	70,000
		70,000			**70,000**

Difference Between Charge Against Profit and Appropriation of Profit and Loss :

Points of Difference	Charge Against Profit	Appropriation of Profit and Loss
(1) Principle of Matching Concept	The principle of matching concept is applicable.	The principle of matching concept is not applicable.
(2) Entry	Charge against profit is recorded at the debit side of profit and loss account.	Appropriation of profit is recorded at debit side of profit and loss appropriation account.
(3) When to record	In all circumstances irrespective of profit or loss full amount is recorded.	Only in circumstances of profit, appropriation is recorded, no recording in case of loss.
(4) Priority	Expenses are recorded before appropriation of profit.	Appropriation is done after recording of all expenses.
(5) Illustration	Interest on partners' loan, rent payable to partner, commission to manager.	Interest on capital, commission to partner, transfer profit to general reserve.

Note : Above mentioned different provisions and illustrations for interest on capital of partners as well as the difference between charge against profit and appropriation of profit are explained for a better understanding of students in this regard. Questions and problems pertaining to these are not expected for examination.

11. Exclusive Illustrations :

Illustration 1 : Hiral, withdraws ₹ 500 in the beginning of every month. If 10 % p.a. interest is chargeable on drawings, determine annual drawings and interest on drawings.

Ans. : Total annual drawings = 500 × 12 = ₹ 6000

Interest on drawings = I = $\frac{PRN}{100}$

$= 500 \times \frac{10}{100} \times \frac{78}{12}$

= ₹ 325

where, I = Interest P = Principal amount

R = Rate of interest N = Number of years

Explanation :

Table Showing Computation of Interest of Monthly Drawings

Month	Drawings in the beginning of every month	Drawings at the end of every month
1	12	11
2	11	10
3	10	9
4	9	8
5	8	7
6	7	6
7	6	5
8	5	4
9	4	3
10	3	2
11	2	1
12	1	0
Interest of total months	**78**	**66**

From the above table it can be ascertained that :

(i) If drawings is done in the beginning of every month, interest will be calculated for 78 months.

$\therefore \quad N = \frac{78}{12}$

(ii) If drawings is done at the end of every month, interest will be calculated for 66 months.

$\therefore \quad N = \frac{66}{12}$

Above stated interest on drawings under product method will be calculated as under :

The computation of above mentioned illustration can be done as follows :

Date of Drawing	Amount × Months = Principal Under .... Method
01-04-2016	500 × 12 = 6000
01-05-2016	500 × 11 = 5500
01-06-2016	500 × 10 = 5000
01-07-2016	500 × 9 = 4500
01-08-2016	500 × 8 = 4000
01-09-2016	500 × 7 = 3500
01-10-2016	500 × 6 = 3000
01-11-2016	500 × 5 = 2500
01-12-2016	500 × 4 = 2000
01-01-2017	500 × 3 = 1500
01-02-2017	500 × 2 = 1000
01-03-2017	500 × 1 = 500
Total	**= 39,000**

Interest on drawings $= 39{,}000 \times \frac{10}{100} \times \frac{1}{12}$

$= ₹\ 325$

Note : Problem pertaining to drawings in the beginning or at the end of the month are expected, no other computations are expected.

Illustration 2 : Hansa, Hitesh and Vijay are partners of a firm. Their capital proportion is 3:2:1. Hitesh is entitled to receive commission 10 % of net profit after deduction of his such share. What amount will be received by Hitesh, When profit of the firm is ₹ 1,65,000 at the end of the year.

Ans. : Assume profit after commission is ₹ 100, where commission is ₹ 10. Thus, profit before commission will be ₹ 110 (100 + 10), where commission is ₹ 10.

$$\text{Commission} = \text{Profit} \times \frac{\text{\% of commission}}{100 + \text{\% of commission}}$$

$\therefore$ Commission $= \frac{1{,}65{,}000 \times 10}{110}$

$= ₹\ 15{,}000$

$\therefore$ Profit after commission (Divisible profit) = Total profit − Commission

= 1,65,000 − 15,000

= 1,50,000

This will be distributed between partners in equal proportion. The share of Hitesh in profit ₹ 50,000.

$\therefore$ Total amount received by Hitesh = ₹ 50,000 Profit + ₹ 15,000 Commission

= ₹ 65,000

Explanation : (1) In the question proportion of partners' capital is given. Profit loss sharing ratio is not given. Thus, profit-loss will be distribuited between partners in equal proportion.

(2) Commission can be paid in two forms :

(i) Certain percentage of commission on profit before deduction of such commission.

(ii) Certain percentage of commission on profit after deduction of such commission.

(i) If commission is to be paid on profit before deduction of such commission, the computation of commission will be done as follows :

$$\text{Commission} = \text{Net profit} \times \frac{\text{\% of commission}}{100}$$

e.g., X and Y are partners sharing profit-loss in the proportion of 3:2. The profit of the firm for the year is ₹ 1,65,000. If 10 % commission on profit is payable to X, compute the amount of commission.

$$\text{Commission} = ₹\ 1{,}65{,}000 \times \frac{10}{100}$$

$$= ₹\ 16{,}500$$

Here, commission is to be calculated on the net profit. No specification is given whether commission is to be paid either before deduction of such commission or after that. Thus, commission will be computed from profit before deduction of such commission (on net profit).

(ii) If commission is payable from profit after deduction of such commission, the computation of commission will be done as follows :

In the above illustration X is entitled to get 10 % commission on profit after deducting such commission. It is computed as follows :

$$\text{Commission} = \text{Net profit} \times \frac{\text{\% of commission}}{100 + \text{\% of commission}}$$

$$= ₹\ 1{,}65{,}000 \times \frac{10}{110}$$

$$= ₹\ 15{,}000$$

Illustration 3 : The profit-loss sharing ratio of Jayesh, Suresh and Pankaj is 6:2:3. A manager has received his commission of ₹ 6600, at 10 % after deduction of such commission from profit. Ascertain distribution of profit amongst the partners.

Ans. : Profit and loss distribution proportion of Jayesh, Suresh and Pankaj = 6:2:3

Manager receives commission at 10 % from profit after deduction of his commission.

∵ ₹ 10 commission = ₹ 100 Divisible profit

∴ ₹ 6600 " (?) "

$$= \frac{6600 \times 100}{10}$$

= ₹ 66,000 Divisible profit

The profit-loss sharing ratio of partners is 6:2:3, distribution of profit will be as follows :

Jayesh : ₹ 66,000 × $\frac{6}{11}$ = ₹ 36,000

Suresh : ₹ 66,000 × $\frac{2}{11}$ = ₹ 12,000

Pankaj : ₹ 66,000 × $\frac{3}{11}$ = ₹ 18,000

Illustration 4 : Sheela, Surbhi and Seema are partners sharing profit-loss in the ratio of 5:7:9. Manager Sanket is entitled to receive 10 % commission from profit after deduction of his such commission. Surbhi receives share in profit ₹ 7000. Determine the amount of commission of Sanket. Also determine amount of profit before the commission of manager.

Ans. : (i) Manager is entitled to get commission from the profit after the deduction of his own commission. It means commission will be calculated on divisible profit.

Surbhi receives ₹ 7000 of divisible profit for her share of $\frac{7}{21}$. Assume total profit of the firm is 1.

Thus, $\frac{7}{21}$ share of Surbhi = Total profit of firm = ₹ 1

∴ ₹ 7000 share of Surbhi = Total profit (?)

$$= \frac{1}{1} \times \frac{7000 \times 21}{7}$$

= ₹ 21,000 divisible profit

(ii) Manager Sanket is entitled to get 10 % commission from the divisible profit

$$= ₹\ 21{,}000 \times \frac{10}{100}$$

= ₹ 2100

(iii) Profit before commission of manager = Divisible profit + Commission of manager

= ₹ 21,000 + ₹ 2100

= ₹ 23,100

Illustration 5 : Riya, Dilip and Kirtan are partners of a partnership firm. The share of Kirtan is $\frac{1}{5}$th of share of Dilip and share of Riya is double of share of Kirtan. Determine the amount of profit of each partner, if the profit of the firm at the end of the year was ₹ 1,92,000.

Ans. : Assume : Dilip's share of profit ₹ 1.

Share of Kirtan is $\frac{1}{5}$ of Dilip means $\frac{1}{5}$ of 1 = $\frac{1}{5}$. While share of Riya is double of the share of Kirtan, double of $\frac{1}{5}$ i.e. $\frac{1}{5} \times \frac{2}{1} = \frac{2}{5}$.

∴ Share of Riya $\frac{2}{5}$, Dilip $\frac{1}{1}$ and Kirtan $\frac{1}{5}$.

Thus, proportion of distribution of profit between partners :

Riya : Dilip : Kirtan

2 : 5 : 1

The distribuition of profit will be as follows :

Profit of Riya	$= 1{,}92{,}000 \times \frac{2}{8} =$	₹ 48,000
Profit of Dilip	$= 1{,}92{,}000 \times \frac{5}{8} =$	₹ 1,20,000
Profit of Kirtan	$= 1{,}92{,}000 \times \frac{1}{8} =$	₹ 24,000

Illustration 6 : Milin, Hemant and Rasik have distributed profit of the firm of ₹ 1,89,000 in equal proportion, instead of distributing it in 1:2:4 proportion. To rectify this mistake what treatment will be given to the capital account ?

Ans. :

Particular	Milin (₹)	Hemant (₹)	Rasik (₹)
Correct distribution of profit in the proportion of 1:2:4	+ 27,000	+ 54,000	+ 1,08,000
Incorrect distribution of profit in the proportion of 1:1:1	− 63,000	− 63,000	− 63,000
Amount of difference	**− 36,000 Debit**	**− 9000 Debit**	**+ 45,000 Credit**

Rectification of Error : An excess credit to Milin's and Hemant's account is ₹ 36,000 and ₹ 9000 respectively, and ₹ 45,000 are less credited to Rasik's Account. So, Rasik's account will be credited and Milin's and Hemant's capital account will be debited.

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Milin's Capital/Current A/c Dr		36,000	
	Hemant's Capital/Current A/c Dr		9000	
	To Rasik's Capital/Current A/c			45,000
	[Being profit credited in wrong proportion is corrected.]			

Illustration 7 : Ram, Laxman and Sita are partners of a firm. On 1-4-2016 their capital was ₹ 40,000, ₹ 30,000 and ₹ 80,000 respectively. At the end of the year after distribution of profit it was realised that charging of interest on capital at 12 % is missed out. Write journal entry for rectification.

Ans. :

Particular	Ram (₹)	Laxman (₹)	Sita (₹)	Total (₹)
Interest on capital at 12 %	+ 4800	+ 3600	+ 9600	+ 18,000
Reduction in profit equal to amount of interest (₹ 18,000) In equal proportion (1:1:1)	− 6000	− 6000	− 6000	− 18,000
Accounting treatment of difference to Capital Account	**− 1200 Debit**	**− 2400 Debit**	**+ 3600 Credit**	−

Rectification of Error : ₹ 1200 and ₹ 2400 will be debited to Ram's and Laxman's capital account respectively and ₹ 3600 will be credited to Sita's capital account.

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Ram's Capital/Current A/c Dr		1200	
	Laxman's Capital/Current A/c Dr		2400	
	To Sita's Capital/Current A/c			3600
	[Being the computation of interest on capital at 12 % was missed out, is rectified.]			

Explanation : Total interest on capital is payable ₹ 18,000. So the same amount of ₹ 18,000 has to be reduced from the capital account of the partners, which will be debited in their profit-loss sharing ratio. Since profit-loss sharing is not given, amount will be debited in equal proportion.

Illustration 8 : Bhalchandra, Darshana and Ankit are partners sharing profit-loss in the ratio of 5:3:2. At the end of the year after the preparation of final account it is realised that, computation of interest on drawings is missed out. Interest on drawings were ₹ 1000, ₹ 800 and ₹ 600 respectively. Write journal entry for rectifications.

Ans. :

Particular	Bhalchandra (₹)	Darshana (₹)	Ankit (₹)	Total (₹)
Increase in profit equal to amount of interest on drawings (5:3:2) Interest on drawings	+ 1200 − 1000	+ 720 − 800	+ 480 − 600	+ 2400 − 2400
Accounting treatment of difference to the Capital Account	**+ 200 Credit**	**− 80 Debit**	**− 120 Debit**	**−**

Rectification of Error :

Date	Particular	L.F.No.	Debit (₹)	Credit (₹)
	Darshana's Capital/current A/c Dr		80	
	Ankit's Capital/current A/c Dr		120	
	To Bhalchandra's Capital/Current A/c			200
	[Being computation of interest on drawings was missed out, is rectified.]			

Explanation : Total interest on drawings is ₹ 2400 (₹ 1000, ₹ 800 and ₹ 600), due to this profit would increase. This is to be credited to partners' capital account in their profit-loss sharing ratio. Thus in the proportion of 5:3:2 ₹ 1200, ₹ 720 and ₹ 480 will be credited respectively to the capital account of Bhalchandra, Darshana and Ankit. Interest on drawings will be debited to the capital account of respective partners.

Illustration 9 : Yusuf, Harun and Kodawala are partners sharing profit-loss in the proportion of 3:2:1. Yusuf and Harun have given assurance to Kodawala to give minimum ₹ 36,000 from profit. If for the year ending on 31-3-16 total profit of the firm was ₹ 1,80,000, how profit will be distributed among the partners ?

Ans. : Distribution of profit :

Yusuf : ₹ 1,80,000 $\times \frac{3}{6}$ = ₹ 90,000 Harun: ₹ 1,80,000 $\times \frac{2}{6}$ = ₹ 60,000

Kodawala : ₹ 1,80,000 $\times \frac{1}{6}$ = ₹ 30,000

It was assured by Yusuf and Harun to Kodawala that he will receive atleast ₹ 36,000 from profit. But deficit to Kodawala is ₹ 6000 (₹ 36,000 − ₹ 30,000) will be given to Kodawala by Yusuf and Harun in their profit-loss sharing ratio.

Amount of profit to be given to Kodawala : Yusuf : ₹ 6000 $\times \frac{3}{5}$ = ₹ 3600

Harun : ₹ 6000 $\times \frac{2}{5}$ = ₹ 2400

Amount of distributable profit amongst the partners :

Particular	Yusuf (₹)	Harun (₹)	Kodawala (₹)	Total (₹)
Distribution of profit in the profit-loss sharing ratio (3:2:1) Payable and receivable amount	90,000 − 3600	60,000 − 2400	30,000 + 6000	1,80,000 −
Actual distribution of profit	**86,400**	**57,600**	**36,000**	**1,80,000**

Illustration 10 : The closing capital of a partner Girish is ₹ 96,000 after giving effect of drawings of ₹ 6000 and divisible profit of ₹ 9000. Calculate 8 % p.a. interest on capital.

Ans. : Interest on capital is always calculated on the opening balance. Here, closing capital is provided. From that opening capital will be ascertained as follows :

Opening capital = Closing capital + Drawings − Profit

	Closing capital	₹	96,000
+	Drawings	₹	6000
		₹	1,02,000
−	Profit	₹	9000
	Opening capital	₹	93,000

∴ Interest on capital $= ₹\ 93{,}000 \times \frac{8}{100} = ₹\ 7440$

or

Dr **Girish's Capital Account** Cr

Particular	Amt. (₹)	Particular	Amt. (₹)
To Drawings A/c	6000	By Balance b/d (Opening capital)	93,000
To Balance c/d (Closing capital)	96,000	By Profit and Loss A/c (profit)	9000
	1,02,000		**1,02,000**

∴ Interest on capital = ₹ 7440

Illustration 11 : Jennet, Akshra and Sapna are partners sharing profit-loss in equal proportion. Their total capital is of ₹ 3,00,000. The proportion of their capital is 2:3:5. Firm pays 6 % interest p.a. on the capital. Partner Akshra received ₹ 45,400 including interest on capital. Compute what amount inclusive of interest is received by Jennet and Sapna ?

Ans. :

Particular	Jennet (₹)	Akshra (₹)	Sapna (₹)
Capital in the proportion of 2:3:5	60,000	90,000	1,50,000
Interest on capital at 6 % p.a. Divisible profit (1:1:1)	3600 + 40,000	5400 + 40,000	9000 + 40,000
Profit including interest on capital	**43,600**	**45,400**	**49,000**

∴ Including interest on capital Jennet would receive total ₹ 43,600 and Sapna ₹ 49,000.

Explanation : Akshra received ₹ 45,400 with interest on capital.

∴ Akshra has received ₹ 40,000 (₹ 45,400 − ₹ 5400) towards share of profit.

All three partners are sharing profit-loss in equal proportion. Therefore Jennet and Sapna each of them has received ₹ 40,000 from profit.

Illustration 12 : Sharda and Jamna are partners of a firm. Their capital as on 1-4-2016 was ₹ 30,000 and ₹ 40,000 respectively. During the year Sharda has withdrawn ₹ 6000 on 1-4-2016 while Jamna ₹ 8000 on 1-1-2017. The provisions of partnership deed are as follows :

(1) Provide interest on capital at 10 % p.a.

(2) Provide interest on drawings 12 % p.a.

(3) Monthly salary of ₹ 500 is payable to Sharda for her active participation in business. An annual commission of ₹ 3000 is payable to Jamna.

On 1-10-2016 Sharda has given loan of ₹ 6000 to the firm. There is no provision in partnership deed for interest on loan. Sharda demands interest at 10 % p.a. on loan.

Profit for the year ending on 31-3-2017 before consideration of above provision and interest on loan of Sharda of the firm is ₹ 39,820.

From the above information prepare profit and loss appropriation account and partners' capital accounts of the firm.

Ans. :

Profit and Loss Appropriation Account for the Year Ending on 31-3-2017 of Firm of Sharda and Jamna

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c			By Profit and loss A/c (Net profit)		39,820
Sharda :	3000		By Interest on capital A/c		
Jamna :	4000	7000	Sharda :	720	
To Salary (Sharda)		6000	Jamna :	240	960
To Commission (Jamna)		3000			
To Partners' capital A/c (Divisible profit) :					
Sharda :	12,390				
Jamna :	12,390	24,780			
		40,780			**40,780**

Partners' Capital Accounts

Dr Cr

Date	Particular	Sharda (₹)	Jamna (₹)	Date	Particular	Sharda (₹)	Jamna (₹)
1-4-16	To Drawings A/c	6000	–	1-4-16	By Balance b/d	30,000	40,000
1-1-17	To Drawings A/c	–	8000	31-3-17	By Interest on capital A/c	3000	4000
31-3-17	To Interest on drawings A/c	720	240	31-3-17	By Salary A/c	6000	–
31-3-17	To Balance c/d	44,670	51,150	31-3-17	By Commission A/c	–	3000
				31-3-17	By Profit and loss appropriation A/c (Divisible profit)	12,390	12,390
		51,390	**59,390**			**51,390**	**59,390**

Explanation : (1) No clarification pertaining to capital account method is given in the problem, thus capital accounts are prepared on the basis of fluctuating capital account method. (2) No clarification is made in the partnership deed for interest on loan of Sharda, as per partnership act interest at 6 % p.a. is calculated for six month (from 1-10-2016 to 31-3-2017). It is debited to profit and loss account and will be shown at the liability side of balance sheet. (3) To determine interest on drawings, date of drawings is considered. (4) No clarification is made for profit-loss sharing ratio between the partners, profit is distributed amongst the partners in equal proportion.

Illustration 13 : Sudhanshu and Sarvesh are partners of a firm. Their profit-loss sharing ratio is 3:2. The capital of partners as on 1-4-2016 was ₹ 90,000. This is fixed capital. Capital of partners is in the proportion of 5:4. Drawings of the partners during the year was as follows :

Sudhanshu : ₹ 6000 on 1-7-2016

Sarvesh : ₹ 4000 on 1-10-2016

There is provision in partnership deed to pay interest on capital at 8 % p.a. and to charge interest on drawings at 12 % p.a. On 1-4-2016 balances in current accounts of partners ₹ 3000 credit balance and ₹ 2000 debit balance respectively for Sudhanshu and Sarvesh. Interest at 6 % p.a. on opening balance of current account is to be calculated. Sudhanshu is to be paid 5 % commission on profit after deduction of his commission from profit.

Before considering the above mentioned adjustments, profit of the firm for the year ending on 31-3-2017 is ₹ 37,770. From this information prepare a profit and loss appropriation account, partners' capital accounts and current accounts.

Ans. :

Profit and Loss Appropriation Account for the Year Ending on 31-3-2017 of Firm of Sudhanshu and Sarvesh

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		37,770
Sudhanshu :	4000		By Interest on drawings A/c :		
Sarvesh :	3200	7200	Sudhanshu :	540	
To Interest on current A/c (Sudhanshu)		180	Sarvesh :	240	780
To Commission A/c (Sudhanshu)		1490	By Interest on current A/c (Survesh)		120
To Partners' current A/c :					
(Divisible profit)					
Sudhanshu	17,880				
Sarvesh	11,920	29,800			
		38,670			**38,670**

Partners' Capital Accounts

Dr | Cr

Date	Particular	Sudhanshu (₹)	Sarvesh (₹)	Date	Particular	Sudhanshu (₹)	Sarvesh (₹)
31-3-17	To Balance c/d	50,000	40,000	1-4-16	By Balance b/d	50,000	40,000
		50,000	**40,000**			**50,000**	**40,000**

Partners' Current Accounts

Dr | | | | | | | Cr

Date	Particular	Sudhanshu (₹)	Sarvesh (₹)	Date	Particular	Sudhanshu (₹)	Sarvesh (₹)
1-4-16	To Balance b/d	–	2000	1-4-16	By Balance b/d	3000	–
1-7-16	To Drawings A/c	6000	–	31-3-17	By Interest on capital A/c	4000	3200
1-10-16	To Drawings A/c	–	4000				
31-3-17	To Interest on current A/c	–	120	31-3-17	By Interest on current A/c	180	–
31-3-17	To Interest on drawings A/c	540	240	31-3-17	By Commission A/c	1490	–
				31-3-17	By Profit and loss appropriation A/c	17,880	11,920
31-3-17	To Balance c/d	20,010	8760				
		26,550	**15,120**			**26,550**	**15,120**

Explanation : (1) The opening total capital of partners is ₹ 90,000, it is in the proportion of 5:4, so capital of Sudhanshu is of ₹ 50,000 and ₹ 40,000 of Sarvesh. This capital is considered as fixed capital and interest on capital is calculated on these amounts. (2) Interest on drawings : Sudhanshu for 9 months from 1-7-2016 to 31-3-2017, Sarvesh for 6 months from 1-10-2016 to 31-3-2017. (3) 5 % commission on profit is payable to Sudhanshu, but after deduction of such commission from profit.

Assume, profit after commission is ₹ 100 where commission will be ₹ 5. Therefore profit before deduction of commission will be ₹ 105 (100 + 5), where ₹ 5 commission are included.

∴ Commission of Sudhanshu = $\frac{31,290 \times 5}{105}$ (Total of credit side of profit and loss appropriation account is ₹ 38,670 – (Interest on capital ₹ 7200 + interest on current account ₹ 180) = ₹ 31,290)

= ₹ 1490

(4) Profit after commission (Divisible profit) = ₹ 29,800 (₹ 31,290 – ₹ 1490) will be distributed amongst the partners in the ratio of 3:2.

Divisble profit of Sudhanshu = ₹ 29,800 × $\frac{3}{5}$

= ₹ 17,880

Divisble profit of Sarvesh = ₹ 29,800 × $\frac{2}{5}$

= ₹ 11,920

Illustration 14 : Saksham, Samarth and Shrey are partners of firm. Their capital on 1-4-2016 was ₹ 1,00,000, ₹ 60,000 and ₹ 40,000 respectively. As per partnership deed : (1) Provide interest on capital at 8 % p.a. on capital of partners. (2) 10 % p.a. interest is chargeable to drawings. (3) Monthly salary of ₹ 600 is payable to Samarth. (4) Partners would share half profit in equal proportion and remaining half profit they will share in their opening capital proportion.

On 1-1-2017 Saksham and Shrey have withdrawn ₹ 5000 and ₹ 4000 respectively.

Partners have unanimously decided to transfer 10 % of divisible profit to general reserve. Before recording of above mentioned adjustments profit of the firm for the year ending on 31-3-2017 was ₹ 34,975.

From the above information prepare profit and loss appropriation account of the partnership firm for the year ending on 31-3-2017 and partners capital accounts.

Ans. :

Profit and Loss Appropriation Account for the year ending on 31-3-2017 of Partnership firm of Saksham, Samarth and Shrey

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		34,975
Saksham :	8000		By Interest on drawings A/c		
Samarth :	4800		Saksham :	125	
Shrey :	3200	16,000	Shrey :	100	225
To Salary (Samarth)		7200			
To General reserve A/c (10 % of divisible profit)		1200			
To Partners capital A/c (Divisible profit)					
Saksham :	4500				
Samarth :	3420				
Shrey :	2880	10,800			
		35,200			**35,200**

Partners' Capital Accounts

Dr Cr

Date	Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)	Date	Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)
1-1-17	To Drawings A/c	5000	–	4000	1-4-16	By Balance b/d	1,00,000	60,000	40,000
					31-3-17	By Interest on capital	8000	4800	3200
31-3-17	To Interest on drawings A/c	125	–	100	31-3-17	By Salary A/c	–	7200	–
31-3-17	To Balance c/d	1,07,375	75,420	41,980	31-3-17	By P & L Appropriation A/c (Divisible profit)	4500	3420	2880
		1,12,500	**75,420**	**46,080**			**1,12,500**	**75,420**	**46,080**

Explanation :

(1) Before distribution of divisible profit, amount is to be transferred to general reserve. Total of credit side of profit and loss appropriation account is ₹ 35,200 (₹ 34,975 + ₹ 225) and total of debit side is ₹ 23,200 (₹ 16,000 + ₹ 7200).

$\therefore$ Divisible profit = ₹ 35,200 – ₹ 23,200 = ₹ 12,000

$\therefore$ General reserve = 10 % of divisible profit = $12,000 \times \frac{10}{100}$ = ₹ 1200

(2) Surplus of divisible profit after transfer of ₹ 1200 to general reserve is = ₹ 12,000 – ₹ 1200 = ₹ 10,800.

Divisible profit will be distributed as follows :

Particular	Saksham (₹)	Samarth (₹)	Shrey (₹)	Total (₹)
$\frac{1}{2}$ of ₹ 10,800 in equal proportion ₹ 5400 (1:1:1)	1800	1800	1800	5400
Remaining ₹ 5400 in the proportion of opening capital (5:3:2)	2700	1620	1080	5400
Share of each partner in total Divisible Profit	**4500**	**3420**	**2880**	**10,800**

Illustration 15 : Shruti, Kashvi and Mary are partners of a firm. Total balance of their fixed capital on 1-4-2016 was ₹ 2,50,000. It was in the proportion of 2:2:1. Balances of their current accounts were as follows. Shruti ₹ 24,000 (credit), Kashvi ₹ 18,000 (debit) and Mary ₹ 12,000 (credit).

Provisions of partnership deed were as follows :

(1) $\frac{3}{5}$ of profit to be distributed in the proportion of 3:2:1 and remaining in the proportion of their opening capital.

(2) Provide p.a. 10 % interest on capital.

(3) Provide p.a. 8 % interest on opening balance of current account.

(4) Monthly salary of ₹ 500 is payable to Kashvi.

(5) 12 % p.a. interest is chargeable to drawings of partners.

Shruti has withdrawn ₹ 18,000 on 1-2-2017, Kashvi ₹ 12,000 on 30-11-2016 and Mary ₹ 20,000 on 1-10-2016.

Mary has introduced additional capital ₹ 24,000 on 1-1-2017. 5 % amount of net profit is to be transferred to the development fund (but not more than ₹ 6000). Than after 10 % commission on net profit is payable to Mary, but from profit after deduction of such her commission. Profit of the firm for the year ending on 31-3-2017, after credit of interest on drawings but before incorporation of other adjustments was ₹ 1,71,040. From the above information prepare profit and loss appropriation account for the year ending 31-3-2017 and partners' capital accounts and current accounts under fixed method.

Ans. : Profit and Loss Appropriation Account for the year ending on 31-3-2017 of Partnership firm of Shruti, Kashvi and Merry

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c			By Profit and loss A/c (Net profit)		1,69,000
Shruti :	10,000		By Interest on drawings :		
Kashvi :	10,000		Shruti :	360	
Mary :	5600	25,600	Kashvi :	480	
To Interest on current A/c :			Mary :	1200	2040
Shruti :	1920		By Interest on current A/c (Kashvi)		1440
Mary :	960	2880			
To Salary A/c (Kashvi)		6000			
To Development fund A/c		6000			
To Commission A/c (Mary)		12,000			
To Partners' current A/c (Divisible profit)					
Shruti :	55,200				
Kashvi :	43,200				
Mary :	21,600	1,20,000			
		1,72,480			**1,72,480**

Partners' Capital Accounts

Dr | | | | | | | | | Cr

Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)
31-3-17	To Balance c/d	1,00,000	1,00,000	74,000	1-4-16	By Balance b/d	1,00,000	1,00,000	50,000
					1-1-17	By Cash A/c	–	–	24,000
		1,00,000	**1,00,000**	**74,000**			**1,00,000**	**1,00,000**	**74,000**

Partners' Current Accounts

Dr | | | | | | | | | Cr

Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Date	Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)
1-4-16	To Balance c/d	–	18,000	–	1-4-16	By Balance b/d	24,000	–	12,000
1-10-16	To Drawings A/c	–	–	20,000	31-3-17	By Interest on capital A/c	10,000	10,000	5600
30-11-16	To Drawings A/c	–	12,000	–	31-3-17	By Interest on current A/c	1920	–	960
1-2-17	To Drawings A/c	18,000	–	–	31-3-17	By Salary A/c	–	6000	–
					31-3-17	By Commission A/c	–	–	12,000
31-3-17	To Interest on drawings A/c	360	480	1200	31-3-17	By P & L Appropriation A/c (Divisible profit)	55,200	43,200	21,600
31-3-17	To Interest on current A/c	–	1440	–					
31-3-17	To Balance c/d	72,760	27,280	30,960					
		91,120	**59,200**	**52,160**			**91,120**	**59,200**	**52,160**

Explanation :

(1) Profit of the firm for the year ending on 31-3-17 (after credit of interest on drawings) ₹ 1,71,040. Total interest on drawings of all partners ₹ 2040 (₹ 360 + ₹ 480 + ₹ 1200) deduct it from ₹ 1,69,000 (₹ 1,71,040 – ₹ 2040) and so net profit will be ₹ 1,69,000. This is shown at credit side of profit and loss appropriation account.

(2) Interest on capital of Mary : $I = \frac{PRN}{100}$

Interest on opening capital on ₹ 50,000 = ₹ $\frac{50,000 \times 10 \times 1}{100}$ = ₹ 5000

Interest on additional capital on ₹ 24,000. Interest for 3 months (1-1-17 to 31-3-17)

$= 24,000 \times \frac{10}{100} \times \frac{3}{12}$ = ₹ 600

Total interest of capital = ₹ 5000 + ₹ 600 = ₹ 5600

(3) Development Fund : Profit before development fund and commission of Mary is ₹ 1,38,000. Total of the credit side of the profit and loss appropriation A/c is ₹ 1,72,480 − Total of the debit side ₹ 34,480 (₹ 25,600 + ₹ 2880 + ₹ 6000).

∴ Development Fund $= 1,38,000 \times \frac{5}{100}$

$= ₹\ 6900$

But this amount can not exceed to ₹ 6000.

∴ ₹ 6000 are transferred to the development fund.

(4) Commission to Mary : A surplus of profit after transferring of ₹ 6000 to the development fund is ₹ 1,32,000 (1,38,000 − 6000).

Assume profit after commission is ₹ 100 + commission ₹ 10

∴ Profit before commission ₹ 110

∴ Commission $= ₹\ 1,32,000 \times \frac{10}{110}$

$= ₹\ 12,000$

(5) Divisible profit $= ₹\ 1,32,000 - ₹\ 12,000$

$= ₹\ 1,20,000$

Computation of divisible profit :

Particular	Shruti (₹)	Kashvi (₹)	Mary (₹)	Total (₹)
$\frac{3}{5}$ of ₹ 1,20,000 in equal proportion ₹ 72,000 (3:2:1)	36,000	24,000	12,000	72,000
Remaining ₹ 48,000 in the proportion of opening capital (2:2:1)	19,200	19,200	9600	48,000
Share of each partner in total Divisible Profit	**55,200**	**43,200**	**21,600**	**1,20,000**

Illustration 16 : On 1-4-2016 Ranjana, Sushma and Joseph introduced capital of ₹ 1,28,000, ₹ 96,000 and 80,000 respectively and commenced a business. Sushma has withdrawn ₹ 8000 on 1-10-2016. While Ranjana has withdrawn ₹ 1200 at the end of each month.

As per the partnership deed :

(1) Provide 5 % p.a. interest on capital and charge 10 % p.a. interest on drawings.

(2) Profit-loss sharing ratio among partner is 5:3:2.

After incorporation of the above mentioned adjustment 2 % bonus is to be paid to Ranjana from the surplus of profit. On 31-3-2017 partners have decided that total capital of the firm, after the incorporation of the above mentioned adjustments, will be of ₹ 3,00,000. Their credit balance of capital accounts will be in the ratio of 2:2:1. For this adjustment necessary amount will be introduced or withdrawn by the partners.

Net loss of the firm for the year ending on 31-3-2017 was of ₹ 45,860. From the above information prepare profit and loss appropriation account for the year ending on 31-3-2017 as well as partners' capital accounts and drawings accounts.

Ans. : **Profit and Loss Appropriation Account for the year ending on 31-3-2017 of partnership firm of Ranjana, Sushma and Joseph**

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Net loss)		45,860	By Interest on drawings :		
To Interest on capital :			Ranjana :	660	
Ranjana :	6400		Sushma :	400	1060
Sushma :	4800		By Partners' capital A/c (divisible loss)		
Joseph :	4000	15,200	Ranjana :	30,000	
			Sushma :	18,000	
			Joseph :	12,000	60,000
		61,060			**61,060**

Dr **Partners' Capital Accounts** Cr

Date	Particular	Ranjana (₹)	Sushma (₹)	Joseph (₹)	Date	Particular	Ranjana (₹)	Sushma (₹)	Joseph (₹)
31-3-17	To Drawings A/c	15,060	8400	–	1-4-16	By Cash A/c	1,28,000	96,000	80,000
31-3-17	To P & L Appropriation A/c (Divisible loss)	30,000	18,000	12,000	31-3-17	By Interest on capital A/c	6400	4800	4000
31-3-17	To Cash A/c	–	–	12,000	31-3-17	By Cash A/c	30,660	45,600	–
31-3-17	To Balance c/d	1,20,000	1,20,000	60,000					
		1,65,060	**1,46,400**	**84,000**			**1,65,060**	**1,46,400**	**84,000**

Dr **Partners' Drawings Accounts** Cr

Date	Particulars	Ranjana (₹)	Sushma (₹)	Date	Particulars	Ranjana (₹)	Sushma (₹)
30-4-16	To Cash A/c	1200	–	31-3-17	By Capital A/c	15,060	8400
31-5-16	To Cash A/c	1200	–				
30-6-16	To Cash A/c	1200	–				
31-7-16	To Cash A/c	1200	–				
31-8-16	To Cash A/c	1200	–				
30-9-16	To Cash A/c	1200	–				
1-10-16	To Cash A/c	–	8000				
31-10-16	To Cash A/c	1200	–				
30-11-16	To Cash A/c	1200	–				
31-12-16	To Cash A/c	1200	–				
31-1-17	To Cash A/c	1200	–				
28-2-17	To Cash A/c	1200	–				
31-3-17	To Cash A/c	1200	–				
31-3-17	To Interest on drawings	660	400				
		15,060	**8400**			**15,060**	**8400**

Explanation :

(1) Interest on drawings of Ranjana $= 1200 \times \frac{10}{100} \times \frac{66}{12}$

$= ₹\ 660$

(2) There is divisible loss at the end of the year, so Ranjana will not get bonus.

(3) Total closing capital ₹ 3,00,000 is to be maintained in the ratio of 2:2:1 which is ₹ 1,20,000, ₹ 1,20,000 and ₹ 60,000 respectively. To maintain this capital Ranjana and Sushma will bring deficit of ₹ 30,660 and 45,600 in cash respectively. (It will be recorded in the credit side of capital account.) While Joseph will withdraw excess capital of ₹ 12,000. (It will be recorded in the debit side of the capital account.)

Limited Liability Partnership :

As per the Partnership Act 1932, the business liability of the partners of the firm is unlimited. The Limited Liability Partnership Act 2008, has been introduced as a new scheme to mobilize the small scale and medium scale industries of India; as well as to eliminate the limitation of unlimited liability of partners of a partnership firm. This form of business has the characteristics similar to partnership firms and companies. In this form of business the liability of partners is similar to the liabilities of the shareholders in the companies. In this form of business there should be minimum number of partners. Each partner of such business would be same as the agent of LLP (Limited Liability Partnership) but its scope will not be treated as the agent of other partner. The registration of LLP is mandatory.

This information is provided for better understanding of the students. It is not expected in the examination.

Exercise

1. Select appropriate option for each question :

(1) What is the interest on partners' capital for a partner ?

(a) An expense (b) Liability

(c) Income (d) Loss

(2) Under which method, the interest on capital keeps on changing during the year due to the changes in the capital ?

(a) Fluctuating capital accounts method (b) Fixed capital accounts method

(c) Current accounts method (d) None of the above

(3) In which account and on which side the share of partners' share profit is recorded under the fluctuating capital account method ?

(a) Debit to capital account (b) Credit to capital account

(c) Debit to current account (d) Credit to current account

(4) At the end of the year where will you transfer drawings account, in fixed capital account method ?

(a) To capital account (b) To current account

(c) To profit and loss account (d) To profit and loss appropriation account

(5) How would you consider the interest on debit balance of partners' current account for firm ?

(a) An expense (b) Liability

(c) Income (d) Loss

(6) What is the interest on drawings of partners for a partner ?

(a) An expense (b) Liability

(c) Income (d) Loss

(7) Debit balance of profit and loss appropriation account means ....

(a) gross profit (b) gross loss

(c) divisible profit (d) divisible loss

(8) What percentage of interest will be paid, when no provision is made pertaining to interest on capital in the partnership deed ?

(a) 6 % (b) 9 %

(c) 12 % (d) No interest

(9) What percentage of interest will be paid on the loan lent by the partner to the firm, when no such provision is made in the partnership deed ?

(a) 6 % (b) 9 %

(c) 12 % (d) No interest

(10) The capital proportion of A, B and C is 3:2:1 respectively. The divisible profit is ₹ 66,000. What will be the amount of profit of C ?

(a) ₹ 11,000 (b) ₹ 22,000

(c) ₹ 33,000 (d) ₹ 66,000

2. Answer the following questions in one sentence :

(1) What is partnership ?

(2) What is maximum and minimum limit of partners to constitute a partnership firm ?

(3) What is a partnership deed for a firm ?

(4) Describe the objectives to prepare a partnership deed.

(5) How are the administrative problems solved, when no written agreement is signed between the partners ?

(6) Describe partners' capital account methods of a partnership firm.

(7) Profit of a partner is credited to which account under fixed capital account method ?

(8) Additional capital introduced by partner on permanent basis is credited to which account in the fixed capital accounts method ?

(9) The debit balance of current account of partners' is shown on which side of balance sheet ?

(10) Write a journal entry to transfer drawings account to the capital account, at the end of the year.

(11) Profit and loss appropriation account is a part of which account ?

3. Answer the following questions in brief :

(1) A partner withdraws identical amount at the end of each month from the firm. At the end of the year total annual drawings is ₹ 12,000. 12 % p.a. interest is chargeable on drawings. Determine the amount of interest on drawings of the year.

(2) Amruta and Divya are the partners of a firm. Their capital ratio is 3:2. Amruta is to be paid 8 % comission on net profit, after deduction of such commission. What amount will be received by Amruta if profit of the year is ₹ 96,876.

(3) Vismay, Abhijit and Kunal are partners sharing profit-loss in the proportion of 3:2:4. Manager is to be paid 10 % commission on profit but after the deduction of his such share. The share of profit of Abhijit is ₹ 30,000. Determine the commission of manager.

(4) The profit-loss sharing ratio of Rajkumar, Kaushik and Sharma is 15:10:9. The total profit of the year of the firm is ₹ 68,000. Determine the share in profit of each partner.

(5) Mehta receives his share four times of Pandya. While Bajpai receives half of share of Mehta. Profit of firm at the end of the year is ₹ 87,500. Determine the share in profit of each partner.

(6) Profit of the partnership firm of Sheela, Surbhi and Sanket is ₹ 1,35,000. They have shared profit in the ratio 2:1:3 instead of 3:2:3. What accounting treatment is to be given to the capital account to rectify this error ?

(7) Ram, Rahim and Ishu are partners of a partnership firm. Their capital as on 1-4-2016 was ₹ 60,000, ₹ 40,000 and ₹ 50,000 respectively. After the distribution of the profit of the year, it was realised that charging of 6 % interest on partners' capital accounts was missed out. Write an entry for the rectification of error.

(8) Lata, Geeta and Pravina are partners of a partnership firm. After distribution of the profit of the year it was realised that charging of interest on partners' drawings account respectively ₹ 2700, ₹ 1200 and ₹ 1500 was missed out. Write an entry for the rectification of error.

(9) Mukesh, Dhaval and Vinod are the partners of a partnership firm. Their capital proportion is 4:2:3. Dhaval and Vinod has given assurance to Mukesh that he will get minimum ₹ 35,000 from the profit. The profit of the year is ₹ 90,000. How would you distribute the profit among the partners ?

(10) The closing capital of Raghuvir is ₹ 80,000. In which ₹ 12,500 drawings of current year and profit of ₹ 17,800 are recorded. What will be the interest at 6 % p.a. on the opening capital ?

(11) A, B and C are the partners sharing profit-loss in equal proportion. Their total capital is of ₹ 4,50,000. Their proportion of capital is 1:3:2. Firm pays interest on capital at 9 % p.a. Partner C has received ₹ 73,500 including interest on capital. Determine the amount payable including interest on the capital of A and B ?

4. Answer the following questions to the point :

(1) Explain the meaning of partnership.

(2) Describe the characteristics of partnership.

(3) Describe the accounting provisions of partnership act 1932, in absense of a partnership deed.

(4) What is profit-loss appropriation account ? Which items are disclosed in it ?

5. Write short-notes :

(1) Partnership deed

(2) Fluctuating capital accounts of partners

(3) Fixed capital accounts of partners

(4) Current accounts of partners

(5) Drawing accounts of partners

6. Distinguish between :

(1) Fixed capital accounts method and fluctuating capital accounts method

(2) Profit and loss account and profit and loss appropriation account

7. X and Y are partners of a partnership firm. They have not prepared partnership deed. There is difference of opinion between the partners. Please give legal advice to the partners.

(1) X demands 6 % p.a. interest on drawings of partners.

(2) Y is an active partner of the firm. He claims for remuneration and commission.

(3) X demands interest on capital of partners.

(4) X has lent loan of ₹ 20,000 to the firm. He demands interest on loan.

(5) Firm has lent loan of ₹ 25,000 to Y. X demands to charge interest on the loan.

(6) X demands to share profit between the partners in the proportion of capital.

8. Harpal and Chirag are the partners of a firm. On 1-4-2016 their capital is ₹ 60,000 and ₹ 1,00,000 respectively. During the year on 1-4-2016 Harpal has withdrawn ₹ 15,000 and Chirag has withdrawn ₹ 20,000 on 1-1-2017. Provisions of partnership deed are as follows :

(1) Provide 12 % p.a. interest on capital.

(2) Charge 9 % p.a. interest on drawings.

(3) ₹ 1000 per month are payable to Harpal for his active role in the firm, while 5 % commission of divisible profit is payable to Chirag.

On 1-12-2016 Harpal has given loan of ₹ 30,000 to the firm. There is no provision for interest on loan in the partnership deed. He claims 11 % interest on his loan. The profit to the firm on 31-3-2017 was ₹ 79,400, before above mentioned provisions but after charging interest on loan of Harpal.

From the above information prepare profit and loss appropriation account and partners capital accounts.

9. Bhadresh and Hiral are the partners of a firm. Their profit-loss sharing ratio is 3:2. On 1-4-2016 total capital of partners was ₹ 4,20,000. The proportion of their fixed capital is 4:3. On this day, balances of their current accounts are as follows : Bhadresh ₹ 36,000 (credit), Hiral 24,000 (debit).

As per partnership deed per annum 12 % interest is payable on the capital of the partners. Provide per annun 10 % interest on opening balances of the current accounts. Per annum 12 % interest is to be charged on drawings. ₹ 2400 per month as a salary are payable to Bhadresh for his active role in the firm.

On 1-10-2016 Bhadresh has withdrawn ₹ 36,000 and on 1-1-2017 Hiral has withdrawn ₹ 48,000. 10 % commission on net profit is payable Hiral, from net profit, but after deduction of his such share from net profit.

Before consideration of above mentioned adjustments the profit for the year ending on 31-3-2017 of the firm was ₹ 4,06,800.

From the above information prepare profit and loss appropriation account and partners capital account and current accounts as per the fixed method.

10. Sharda, Jamna and Ganesh are the partners of a firm. On 1-4-2016 their capital was ₹ 72,000, ₹ 48,000 and ₹ 24,000 respectively.

As per the partnership deed :

(1) 5 % per annum interest is payable on opening capital of partners.

(2) 8 % per annum interest will be charged on drawings.

(3) Monthly salary of ₹ 700 is payable to Sharda.

(4) Half profit will be distributed amongst the partners in equal proportion and remaining half profit in the proportion of their opening capital.

On 31-12-2016 Ganesh has withdrawn ₹ 6000 from the firm for his personal use.

Profit of the firm for the year ending on 31-3-2017 after charging interest on drawings but before consideration of above mentioned adjustment was ₹ 81,600. Before the distribution of the profit to the partners but after consideration of above mentioned adjustments from surplus of profit 20 % (but not less than ₹ 18,000) are to be transferred to the general reserve.

From the above information for the year ending on 31-3-2017, prepare profit-loss appropriation account and partners' capital accounts.

11. Isha, Saraswati and Laxmi are the partners sharing profit-loss in the proportion of opening capital. On 1-4-2016 balances of their fixed capital accounts were ₹ 40,000, ₹ 40,000 and ₹ 20,000 respectively. On the same day balance of their current accounts were as under :

Isha ₹ 5000 (credit), Saraswati ₹ 4000 (credit), Laxmi ₹ 3000 (debit)

Total drawings of partners during the year is ₹ 20,000. It is in the proportion of 2:1:2. On 30-6-2016 Isha has lent ₹ 3000 and on 1-10-2016 ₹ 2000 to the firm in the form of loan. On 30-11-2016 Laxmi has introduced addition capital of ₹ 12,000.

As per the partnership deed :

(1) Provide 10 % p.a. interest on capital.

(2) Respectively ₹ 800, ₹ 500 and ₹ 700 are to be recovered as interest on drawings.

(3) Provide 8 % p.a. interest on opening capital of current accounts.

(4) From 1-11-2016 monthly salary of ₹ 800 is payable to Isha for her active role in the firm.

(5) ₹ 3500 of divisible profit are to be transferred to building fund account.

Profit for the year ending on 31-3-2017 before incorporation of above mentioned adjustment but after incorporation of effect of interest on Isha's loan was ₹ 20,880.

Prepare profit and loss appropriation account, capital accounts and current accounts of partners.

12. Prerna, Paras and Jaishri are the partners of a firm. On 1-4-2016 their capital was ₹ 1,50,000, ₹ 90,000 and ₹ 60,000 respectively. Their drawings were as follows :

Prerna ₹ 15,000 on 1-7-2016 and Paras ₹ 24,000 on 30-10-2016.

They distribute half profit in the capital proportion and remaining in the ratio of 2:2:1. Jaishri has lent out loan of ₹ 30,000 on 1-10-2016 to the firm. As per partnership deed per annum 5 % interest on capital, per annum 12 % interest on drawings is to be calculated. Paras is to be paid annual salary of ₹ 18,000 for his active role in the firm. 10 % commission is to be given to Prerna from surplus of profit after providing for above mentioned provisions and after deduction of her such commission. For the year ending on 31-3-2017 profit of the firm before incorporation of the above mentioned adjustments but after charging interest on loan of Jaishri was ₹ 1,29,450.

It was decided that after the consideration of above mentioned adjustments and transfer of profit-loss to capital account, total capital of the firm would be identical to the opening capital, which should be in the proportion of 2:2:1. For this purpose required amount will be introduced by the partners and excess amount will be withdrawn by the partners.

Prepare profit and loss appropriation account, partners' capital accounts for the year ending on 31-3-2017.

●

2

Final Accounts (Financial Statements) of Partnership Firm

1. Introduction

Similar to the sole proprietor, the partnership firms also prepare its final accounts from the trial balance with the consideration of the adjustments at the end of the year to know the earned profit or incurred losses as well as the financial status of the business.

In the final accounts of a partnership firm, trading account, profit and loss account, profit and loss appropriation account, partners' capital accounts/current accounts and balance sheets are prepared.

2. Objectives of Final Accounts of Partnership Firm

(1) **To ascertain gross profit or loss :** A partnership firm can ascertain gross profit or loss through the preparation of trading account.

(2) **To ascertain net profit or loss :** A partnership firm can ascertain net profit or loss through the preparation of profit and loss account. The profitability of the firm can be seen from the profit and loss account.

(3) **To ascertain divisible profit or loss :** All personal transactions and provisions of the partners with the firm can be ascertained through the preparation of profit and loss appropriation account.

(4) **To know financial status of the firm :** To know the financial status of the firm balance sheet is prepared. It provides information about assets, receivables, payables and capital of the firm.

(5) **For taxation purpose :** To know the taxable income of the firm final accounts are prepared.

3. Final Accounts of Partnership Firm :

Annual financial statements of the firm are prepared as follows with the consideration of balances recorded in the trial balance at the end of the accounting year and adjustments.

(1) **Trading Account :** Transactions pertaining to receipt and issue of goods, purchase of goods and production related expenses are recorded in the trading account. To ascertain gross profit or loss on the basis of these transactions account which is prepared is known as the trading account.

At the debit side of the trading account opening stock, purchase minus purchase return, as well as outward of goods due to other reason like withdrawal of goods, goods destroyed by fire, goods distributed as sample, goods given for donation are recorded. Purchase expenses like wages, carriage inward, frieght and production expenses like factory expenses, rent, taxes, electricity, fuel, coal, gas, royalty, depreciation on plant etc are also disclosed.

At the credit side of trading account sales minus sales return, sale of scrap and closing stock of goods are disclosed.

When trading account is closed and if total of credit side of trading account is more than debit side, difference is shown at debit side which is considered as gross profit. This gross profit is transferred to the credit side of profit and loss account. If total of debit side is more than credit side, difference is shown at credit side which is considered as gross loss. This gross loss is transferred to debit side of profit and loss account.

Specimen of Trading Account

Trading for the period ending on .... of ....

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		✓	By Sales	✓	
To Purchase	✓		Less : Sales return	✓	✓
Less : Purchase return	✓		By Sale of scrap A/c		✓
Less : Outward of goods	✓	✓	By Closing stock		✓
To Purchase expenses :			By Profit and loss A/c (Gross loss)		✓
Wages		✓			
Carriage inward		✓			
Railway Freight		✓			
Transportation cartage		✓			
Port charge		✓			
Demurrage		✓			
Wharfaje		✓			
To Production expenses :					
Production wages		✓			
Royalty		✓			
Factory expense (rent, taxes, electricity, fuel, coal, gas)		✓			
Consumable stores (oil, grease)		✓			
To Factory depreciation A/c		✓			
To Plant-machinery depreciation A/c		✓			
To Profit and loss (gross profit)		✓			
		✓			✓

(2) **Profit and Loss Account :** To ascertain net profit or loss, profit and loss account is prepared. At the debit of profit and loss account, gross loss transferred from trading account, administrative, expenses, sales-distribution expenses, financial expenses, depreciation on assets, sundry expenses and other losses of the firm are shown. While at the credit side, gross profit transferred from the trading account, incomes of business like interest received, rent received, commission received, dividend, brokerage, bad debts return, profit on sale of asset and other incomes are shown.

When profit and loss account is closed and if the total of credit side is more than the debit side, difference is shown at the debit side which is considered as the net profit. This net profit is transferred at the credit side of the profit and loss appropriation account. When the total of debit side is more than the credit side, difference is shown at the credit side, which is considered as the net loss. This net loss is transferred to the debit side of the profit and loss appropriation account.

Specimen of Profit and Loss Account

Profit and Loss Account for the Period Ending on .... of ....

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Trading A/c (Gross loss)		✓	**By Trading A/c (Gross profit)**	✓
To Administrative expenses :			**By Incomes :**	
Trading expenses		✓	Discount received	✓
Salary, allowances, bonus		✓	Rent received	✓
Rent		✓	Commission received	✓
Insurance Premium		✓	Brokerage received	✓
Taxes		✓	Consignment commission received	✓
Postage		✓	Interest on investment	✓
Printing and Stationery		✓	Interest on loan lent	✓
Legal charges		✓	Bad debts return	✓
Audit fees		✓	Profit on sale of asset	✓
Electricity expense		✓	Sale of old newspapers	✓
Contribution to provident fund			Income from scrap	✓
To Sales-Distribution Expense :		✓	Sundry income	✓
Carriage outward		✓	By Profit and loss appropriation A/c	✓
Salesman salary - commission		✓	(Net loss)	
Advertisement expenses		✓		
Discount allowed		✓		
Discount reserve		✓		
Expenses of show-room		✓		
Godown expense		✓		
Packing expense				
To Financial Expenses :		✓		
Interest on partners' loan		✓		
Interest on bank overdraft		✓		
Interest on borrowed loan		✓		
Bank charges commission		✓		
Manager commission				
To Other Expenses-Loss :		✓		
Donation expense		✓		
office-Assets depreciation				
Bad debts (TB)	✓			
+ Bad debts (Adj.)	✓			
+ Bad debts reserve (Adj.)	✓			
	✓	✓		
Less : Bad debts reserve (TB)	✓	✓		
Loss due to fire		✓		
Loss due to theft		✓		
Loss on sale of asset		✓		
Provision for expense/loss		✓		
To Profit and loss appropriation A/c				
(Net profit)		✓		
		✓		✓

(3) **Profit and Loss Appropriation Account :** To disclose the distribution of profit & Loss between the partners, profit and loss appropriation account is prepared in a partnership firm. Profit and loss appropriation account is a part of profit and loss account only. The separate preparation of it is not mandatory.

At the debit side of the profit and loss appropriation account, net loss transferred from profit and loss account, interest on partners' capital, interest on credit balance of current accounts, bonus, commission, salary and remuneration to partners' amount transferred to general reserve account are shown.

At the credit of profit and loss appropriation account, net profit transferred from profit and loss account, interest on drawings of partners, interest on debit balance of current accounts etc. are shown.

When profit and loss appropriation account is closed and if the total of credit side of it is more than the debit side, the difference is recorded at the debit side and it is considered as the divisible profit. This divisible profit is credited to partners' capital accounts or to partners current accounts when fixed capital account is maintained, in their profit-loss sharing ratio.

While total of debit side is more than difference is recorded at the credit side, which is considered as the divisible loss. This divisible loss is debited to partners' capital accounts or current account in their profit-loss sharing ratio.

Note : When separate profit and loss appropriation account is not prepared, to ascertain divisible profit or loss, all items of profit and loss appropriation account are shown in profit and loss account. This divisible profit or loss is transferred to partners' capital accounts. This is explained as a optional treatment. Not to be asked in examination.

Specimen of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account for the year ending on .... of ....

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Net loss (From profit and loss A/c)		✓	By Net profit(From profit and loss A/c)		✓
To Interest on partners' capital A/c			To Interest on partners' drawings A/c		
A	✓		A	✓	
B	✓	✓	B	✓	✓
To Interest on credit balance of current account of partner A/c		✓	By Interest on debit balance of current account of partner A/c		✓
To Salary, bonus, commission, remuneration to partner A/c		✓	By Partners' capital or current A/c (Divisible loss)		
To General reserve A/c		✓	A	✓	
To Partners' capital or current A/c (Divisible profit)			B	✓	✓
A	✓				
B	✓	✓			
		✓			✓

(4) **Partners' Capital Accounts :** Partners of a partnership firm undertake personal transactions with the firm. To record such transactions capital account of each partner is prepared in the books of the firm. Transactions which increase the capital of partner are recorded at the credit side and transactions which reduce the capital of partner are recorded at the debit side of the capital account.

First of all the opening capital of a partner is written at the credit side of the capital account and subsequently if additional capital introduced it also credited.. At debit side, capital returned to the partner is recorded. When partners capital accounts are closed the total of credit side generally remains more, thus difference is written at the debit side. This is known as the closing balance. This balance is shown at the capital-liability side as a permanent capital.

Specimen of Partners' Capital Accounts :

Partners' Capital Accounts

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
–	To Cash/bank/other asset A/c (Withdrawal of capital)	✓	✓	1-4	By Balance b/d (Opening capital)	✓	✓
31-3	To Balance c/d (Closing credit balance)	✓	✓	–	By Cash/bank/other asset A/c (Additional capital)	✓	✓
		✓	✓			✓	✓

(5) **Partners' Current Accounts :** There are personal transactions between partners and partnership firm other than the permanent capital. To record these transactions, accounts which are prepared are known as partners' current accounts.

At the credit side of partners' current accounts, opening credit balance of current account, interest on capital, interest on credit balance of current accounts, salary, bonus, commission and bonus to partners', share in divisible profit etc are recorded. On the debit side of the current account, opening debit balance of current account (if any), drawings, interest on drawings, interest on debit balance of current accounts, share in divisible loss etc are recorded.

When current account is closed and if the total of credit side is more than the debit side, difference is shown at the debit side. This is known as the closing balance. This balance is shown at the the Capital-liability side of the balance sheet. If the total of debit side is more, difference is shown at credit side. This is also known as the closing balance. But this balance is shown at Asset side of the balance sheet.

Specimen of Partners' Current Accounts :

Partners' Current Accounts

Dr Cr

Date	Particular	A Amt. (₹)	B Amt. (₹)	Date	Particular	A Amt. (₹)	B Amt. (₹)
1-4	To Balance b/d (Opening debit balance of current A/c)	✓	✓	1-4	By Balance b/d (Opening credit balance)	✓	✓
–	To Drawings A/c	✓	✓	31-3	By Interest on capital A/c	✓	✓
31-3	To Interest on drawings A/c	✓	✓	31-3	By Interest on credit balance of current A/c	–	✓
31-3	To Interest on debit balance of current A/c	✓	–	31-3	By Salary, bonus, commission, remuneration A/c	✓	✓
31-3	To Divisible loss	✓	✓	31-3	By Divisible profit	✓	✓
31-3	To Balance c/d (Closing credit balance)	✓	✓	31-3	By Balance c/d (Closing debit balance)	✓	✓
		✓	✓			✓	✓

Note : All items of the current accounts will be shown in the capital accounts when current accounts are not given in a question.

(6) **Balance Sheet :** To know the financial status of the firm balance sheet is prepared at the end of an accounting year. Balance sheet is a statement. Where on one side of it, amount of capital and liabilities and on another side amount of assets are disclosed.

At capital and liability side of balance sheet of the partnership firm the balance of permanent capital accounts, credit balances of current accounts, creditors, bills payable, bank overdraft, expenses outstanding, incomes received in advance, loan borrowed, partners' loan, interest outstanding on partners' loan are disclosed. Besides, general reserve and other reserves etc are also disclosed.

At the asset side of the balance sheet fixed assets, investments, current and liquid assets like closing stock, debtors, cash balance, bank balance, bills receivables, incomes due but not received, prepaid expenses, loan lent, deffered revenue expenses, debit balance of current accounts etc are disclosed.

Specimen Balance Sheet :

Balance Sheet as at .... of ....

Capital-Liabilities	Amt. (₹)	Assets	Amt. (₹)
Fixed Capital Accounts :		**Non-Current Assets :**	
A	✓	**Fixed Assets :**	
B	✓	**Tangible Assets :**	
Current Accounts (Credit Balance) :		Land	✓
A	✓	Building	✓
B	✓	Leasehold properties	✓
Reserves :		Vehicles	✓
General reserve	✓	Machines	✓
Capital reserve	✓	Furniture and Fittings	✓
Other reserve	✓	**Intangible Assets :**	
Non-Current Liabilities :		Patent	✓
Loan from bank	✓	Trademark	✓
Loan from financial institutions	✓	Copyright	✓
Loan from friends	✓	Goodwill	✓
Partners' loan	✓	**Investments :**	
Current Liabilities :		Investments in government	
Bank overdraft	✓	securities	✓
Sundry creditors	✓	Investments of providend fund	✓
Bills payable	✓	**Other Non-Current Assets :**	
Expenses outstanding	✓	Deffered revenue expense	✓
Income received in advance	✓	**Current Assets :**	
Taxation provision	✓	Closing stock	✓
Provident fund	✓	Sundry debtors	✓
Interes outstanding on		Cash balance	✓
on partners' loan	✓	Bank balance	✓
		Incomes due	✓
		Loan lent	✓
		Bills receivable	✓
		Prepaid expenses	✓
		Current Accounts :	
		(In case of debit balance)	
		A	✓
		B	✓
	✓		✓

4. Adjustments of Final Accounts of Partnership Firm

At the end of an accounting year, to give complete shape to accounts, adjustments and adjustment entries are recorded. Adjustment entries and their accounting effect in an annual account of a firm is as under :

Adjustments, Adjustment Entries and their Effect in Annual Accounts

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(1)	Closing stock	Closing stock A/c ...Dr To trading A/c	(1) Asset side of balance sheet (2) Credit side of trading A/c
(2)	Outstanding expense	Respective expense A/c ...Dr To outstanding expense A/c	(1) Debit side of trading / P & L A/c add it to respective expense (2) Capital & liability side of balance sheet
(3)	Prepaid expense	Prepaid expense A/c ...Dr To respective expense A/c	(1) Asset side of balance sheet (2) Debit side of trading/P & L A/c deduct it from respective expense
(4)	Receivable income	Receivable income A/c ...Dr To respective income A/c	(1) Credit side of P & L A/c add it to respective income (2) Assets side of balance sheet
(5)	Income received in advance	Respective income A/c ...Dr To income received in advance A/c	(1) Liability side of balance sheet (2) Credit side of P & L A/c deduct from respective income
(6)	Depreciation on assets	Depreciation A/c ...Dr To respective asset A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet, deduct from respective asset
(7)	Bad debts written off (new/additional)	Bad debts A/c ...Dr To debtors A/c	(1) Debit side of P & L A/c, add it old bad debts (2) Asset side of balance sheet, deduct from debtors
(8)	Bad debts reserve	Profit and loss A/c ...Dr To bad debts reserve A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct from debtors
(9)	Discount reserve on debtors	Profit and loss A/c ...Dr To discount reserve on debtors A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct from debtors

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(10)	For unrecorded credit purchase	Purchase A/c ...Dr To creditors A/c	(1) Debit side of trading A/c add it to purchase (2) Liability side of balance sheet add it to creditors
(11)	For unrecorded credit sales	Debtors A/c ...Dr To sales A/c	(1) Asset side of balance sheet add it to debtors (2) Credit side of trading A/c add it to sales
(12)	For unrecorded credit purchase return	To creditors A/c ...Dr To purchase return A/c	(1) Liability side of balance sheet, deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase
(13)	For unrecorded credit sales return	Sales return A/c ...Dr To debtors A/c	(1) Credit side of trading A/c, deduct it from sales (2) Asset side of balance sheet, deduct it from debtors
(14)	Purchase return recorded to sales book	(1) Sales A/c ...Dr To debtors A/c (2) Creditors A/c ...Dr To purchase return A/c	(1) Credit side of trading A/c, deduct it from sales (2) Asset side of balance sheet deduct it from debtors (3) Liability side of balance sheet deduct it from creditors (4) Debit side of trading A/c deduct it from purchase A/c
(15)	Sales return recorded to purchase book	(1) Creditors A/c ...Dr To purchase A/c (2) Sales return A/c ...Dr To debtors A/c	(1) Liability side of balance sheet deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase (3) Credit side of trading A/c, deduct it from sales (4) Asset side of balance sheet, deduct it from debtors

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(16)	Credit purchase recorded to sales book	(1) Sales A/c ...Dr To debtors A/c (2) Purchase A/c ...Dr To creditors A/c	(1) Debit side of trading A/c, deduct from sales (2) Asset side of balance sheet, deduct from debtors (3) Debit side of trading A/c, add it to purchase (4) Liability side of balance sheet add it to creditors
(17)	Credit sales recorded to purchase book	(1) Creditors A/c ...Dr To purchase A/c (2) Debtors A/c ...Dr To sales A/c	(1) Liability side of balance sheet, deduct it from creditors (2) Debit side of trading A/c, deduct it from purchase (3) Asset side of balance sheet, add it to debtors (4) Credit side of trading A/c, add it to sales
(18)	Interest on capital	Interest on capital A/c ...Dr To capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Liability side of balance sheet, add it to capital A/c
(19)	Interest on drawings	Drawings A/c ...Dr To interest on drawings A/c	(1) Liability side of balance sheet, add it to drawings (2) Credit side of profit and loss appropriation A/c
(20)	Salary to partners	Partners' salary A/c ...Dr To partners capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of partners current/ capital A/c
(21)	Interest on credit balance of current a/c of partners	Interest on partners current A/c ...Dr To partners current A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of partners current A/c
(22)	Interest on debit balance of current a/c of partners	Partners current A/c ...Dr To interest on partners current A/c	(1) Debit side of partners current A/c (2) Credit side of profit and loss appropriation A/c
(23)	Outstanding interest on partners' loan	Interest on loan A/c ...Dr To outstanding interest on partners' loan A/c	(1) Debit side of P & L A/c (2) Liability side of balance sheet,

No.	Adjustment	Adjustment Entry	Effect in Annual Accounts
(24)	Transfer to general reserve	P & L Appropriation A/c ...Dr To general reserve A/c	(1) Debit side of profit and loss appropriation A/c (2) Liability side of balance sheet, add it to general reserve
(25)	Commission payable to partners	Partners commission A/c ...Dr To partners capital A/c	(1) Debit side of profit and loss appropriation A/c (2) Credit side of current or capital A/c of partners
(26)	Interest on advanced loan	Outstanding interest on loan A/c...Dr To interest on loan A/c	(1) Asset side of balance sheet, A/c (2) Credit side of P & L A/c
(27)	Amortization of intangible assets like goodwill, patent, trademark, copy-right	Profit and loss A/c ...Dr To intangible asset A/c	(1) Debit side of P & L A/c (2) Asset side of balance sheet deduct it from intangible asset
(28)	Unrecorded goods withdrawn for personal use	Drawings A/c ...Dr To purchase A/c	(1) Liability side of balance sheet, add it to drawings (2) Debit side of trading A/c deduct it from purchase
(29)	Goods issued for free sample	Advertisment A/c ...Dr To purchase A/c	(1) Debit side of P & L A/c (2) Debit side of trading A/c deduct it from purchase
(30)	Stationery stock	Stationery stock A/c ...Dr To stationery expense A/c	(1) Asset side of balance sheet (2) Debit side of P & L A/c, deduct it from stationery expense
(31)	Writting off lease-hold property	Profit and loss A/c ...Dr To leasehold property A/c	(1) Debit side of P & L A/c (2) Asset side, deduct it from lease hold property
(32)	Receivable Interest/ dividend on shares and other investments	Receivable interest/dividend A/c ...Dr To interest / dividend A/c	(1) Asset side of balance sheet (2) Credit side of profit and loss A/c
(33)	Personal asset introduced by partner	Assets A/c ...Dr To partners capital A/c	(1) Asset side of balance sheet (2) Liability side of balance sheet, add it to capital of partner

Note : With an objective to maintain equal distribution of marks to each chapter and also to make it convenient for the students to understand each topic, it is mandatory to provide 24 to 30 items in a trial balance for the question of final accounts in the examination. Total adjustments should be limited to 5. Not more than two effects of adjustments should be introduced in an adjustment. To explain all types of transactions with minimum questions in illustration and exercise, more transactions are covered in illustrations and exercise.

Illustration 1 : Ram and Shyam are partners of a firm sharing profit - loss in the ratio 6:4. From the following trial balance dated 31-3-2017 and adjustments, prepare annual accounts of the firm.

Trial Balance of Partnership Firm of Ram and Shyam as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital :**	
Ram	18,000	Ram	80,000
Shyam	16,000	Shyam	70,000
Debtors	45,000	Creditors	35,000
Stock (1-4-2016)	25,000	Purchase return	1500
Sales return	1000	Bank overdraft	8000
Cash balance	10,000	Sales	78,150
Purchase	60,000	Bad debts reserve	700
Discount allowed	500	Outstanding wages	1000
Bad debts	400	8 % Geeta's loan (1-10-2016)	15,000
Machines (office)	18,250	Bills payable	200
Depreciation on machines	1750		
Furniture	8000		
Sundry expenses	1500		
Leasehold building (For four years)	7000		
Goodwill	40,000		
Trading expense	1250		
Rent and taxes	5000		
Carriage inward	400		
Bank interest	500		
Insurance premium	800		
Salary	15,000		
Wages	14,000		
Prepaid insurance	200		
	2,89,550		**2,89,550**

Adjustments : (1) Closing stock value ₹ 45,000, it's market value is 10 % more. (2) 5 % interest on partners capital is chargeable and on drawings 10 % interest is recoverable. (3) Provide 10 % depreciation on machine and 5 % on furniture. (4) Provide 5 % Bad debts reserve on debtors. (5) Outstanding expenses : salary ₹ 500, Sundry expense ₹ 150 and rent ₹ 150. (6) As per partnership agreement interest on capital is payable even in loss.

Ans. : Trading account of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		25,000	By Sales	78,150	
To Purchase	60,000		− Sales return	1000	77,150
− Purchase return	1500	58,500	By Closing stock		45,000
To Wages A/c		14,000			
To Carriage inward A/c		400			
To Profit and loss A/c (gross profit)		24,250			
		1,22,150			**1,22,150**

P & L account of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administration Expense :			By Trading A/c (Gross profit)	24,250
To Salary	15,000		By Profit and loss appropriation A/c	7800
+ Outstanding	500	15,500	(Net loss)	
To Sundry expense	1500			
+ Outstanding	150	1650		
To Trading expense A/c		1250		
To Rent & taxes	5000			
+ Outstanding	150	5150		
To Insurance premium		800		
Selling-Distribution Expense :				
To Discount allowed		500		
Financial Charges :				
To Bank interest		500		
To Interest on Geeta's loan		600		
Other Expense-Loss :				
To Bad debts (old)	400			
+ To Bad debts reserve (new)	2250			
	2650			
− By Bad debts reserve (old)	700	1950		
To Depreciation :				
Machinery (office)	2000			
+ Furniture	400	2400		
To Leasehold building (written off)		1750		
		32,050		**32,050**

P & L appropriation a/c of partnership firm of Ram and Shyam for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Profit and loss A/c (Gross loss)		7800	By Interest on drawings A/c :		
To Interest on capital :			Ram	1800	
Ram	4000		Shyam	1600	3400
Shyam	3500	7500	By Partners capital A/c (loss) :		
			Ram	7140	
			Shyam	4760	11,900
		15,300			**15,300**

Partners Capital A/c

Dr | Cr

Date	Particular	Ram (₹)	Shyam(₹)	Date	Particular	Ram (₹)	Shyam(₹)
31-3-17	To Drawings A/c	18,000	16,000	1-4-16	By Balance b/d	80,000	70,000
31-3-17	To Interest on drawings A/c	1800	1600	31-3-17	By Interest on capital A/c	4000	3500
31-3-17	To P & L appro. A/c (Divisible loss)	7140	4760				
31-3-17	To Balance c/d	57,060	51,140				
		84,000	**73,500**			**84,000**	**73,500**
				1-4-17	By Balance b/f	57,060	51,140

Balance Sheet of partnership firm of Ram and Shyam as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital :			**Non-Current Assets :**		
Ram	57,060		**Fixed Assets :**		
Shyam	51,140	1,08,200	**Tangible Assets :**		
Non-Current Liabilities :			Machines	20,000	
8 % Geeta's loan		15,000	− Depreciation	2000	18,000
Current Liabilities :			Furniture	8000	
Bank overdraft		8000	− Depreciation	400	7600
Interest on Geeta's loan		600	Leasehold property	7000	
Creditors		35,000	− Written off	1750	5250
Outstanding expenses :			Non-tangible assets : Goodwill		40,000
Salary	500		**Current Assets :**		
Sundry expense	150		Closing stock		45,000
Rent-taxes	150	800	Debtors	45,000	
Outstanding wages		1000	− Bad debts reserve	2250	42,750
Bills payable		200	Cash balance		10,000
			Prepaid insurance		200
		1,68,800			**1,68,800**

Note : (1) Interest for 6 months will be calculated at the rate of 8 % on Gita's loan

$= 15,000 \times \frac{8}{100} \times \frac{6}{12} = ₹ 600$

(2) Leasehold property is acquired for 4 years for ₹ 7000, therefore during current year $7000 \div 4 = ₹ 1750$ will be amortised.

(3) Depreciated price ₹ 18,250 + depreciation ₹ 1750 = ₹ 20,000 pre depreciation price.

Calculated depreciation $= \frac{1750}{20,000} \times 100 = 8.75$ %

Now, ₹ 2000 depreciation will be calculated at the rate of 10 % on ₹ 20,000.

Illustration 2 : The following is the trial balance as at 31-3-2017 of Jay and Vijay. Prepare revised Trading account, Profit and loss account, Current accounts and Balance sheet with consideration of necessary adjustments :

Trial Balance of Partnership Firm of Jay and Vijay as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital A/c :		
Jay		80,000
Vijay		60,000
Current A/c :		
Jay		20,000
Vijay	5000	
Closing stock	27,300	
Trading A/c		30,900
Cash on hand	280	
Current A/c with bank	7000	
Fixed deposit with bank	40,000	
Debtors	18,400	
Salary	18,500	
Freehold land	60,000	
Machines (office)	20,000	
Furniture and fixtures	5000	
Factory on lease (Lease will be ended on 31-3-2021)	30,000	
Loan of partner Vijay (On 1-10-2016)		30,000
Discount reserve on debtors		380
Bad debt reserve		1000
Insurance premium	1000	
Printing and stationery	600	
Creditors / Suppliers		12,000
Bad debts	200	
Advertisment expense	600	
Travelling expense	400	
	2,34,280	**2,34,280**

Adjustments : (1) Prepaid insurance ₹ 200. (2) Jay withdrawn goods of ₹ 2000 from business for his personal use. (3) Goods of ₹ 4000 purchased on credit on 28-3-2017, which is not recorded in the books. (4) Write off ₹ 400 as bad debts and provide 5 % bad debts reserve. (5) There is no need of discount reserve on debtors. (6) Provide 20 % depreciation on plant and machines and 5 % on furniture and fittings.

Note : Credit balance of trading A/c is given in the trial balance. To incorporate the effect of adjustments and to ascertain revised gross profit, revised trading account will be prepared.

Ans. : Revised Trading Account of partnership firm of Jay and Vijay as on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Unrecorded purchase	4000		By Trading A/c (as per trail balance)	
− Drawings of goods	2000	2000	(Gross profit)	30,900
To leasehold property written off		6000		
To P & L A/c (Revised gross profit)		22,900		
		30,900		**30,900**

Profit and Loss Account of partnership firm of Jay and Vijay as on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
Administrative Expense :			By Trading A/c (Revised gross profit)		22,900
To Salary		18,500	By Discount reserve on debtors		380
To Insurance primium	1000		By Partners current A/c (Divisible loss)		
− Prepaid	200	800	Jay	1635	
To Bad debts (old)	200		Vijay	1635	3270
+ To Bad debts (new)	400				
+ To Bad debts reserve (new)	900				
	1500				
− To Bad debts reserve (old)	1000	500			
To Printing and stationery		600			
To Travelling expense		400			
To Advertisement expense		600			
Depreciation :					
To Machinery (office)	4000				
+ To Furniture	250	4250			
To Interest on Vijay's loan		900			
		26,550			**26,550**

Dr **Partners' Current Accounts** Cr

Date	Particular	Jay (₹)	Vijay (₹)	Date	Particular	Jay (₹)	Vijay (₹)
1-4-16	To Balance b/d	–	5000	1-4-16	By Balance b/d	20,000	–
31-3-17	To Drawings A/c	2000	–	31-3-17	By Balance c/d	–	6635
31-3-17	To P & L A/c (Divisible loss)	1635	1635				
31-3-17	To Balance c/d	16,365	–				
		20,000	**6635**			**20,000**	**6635**

Balance Sheet of Partnership firm of Jay and Vijay as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Jay	80,000		**Fixed Assets :**		
Vijay	60,000	1,40,000	**Tangible Assets :**		
Current A/c : Jay		16,365	Freehold land		60,000
Non-Current Liabilities :			Machines (office)	20,000	
Vijay's loan		30,000	– Depreciation	4000	16,000
Creditors	12,000		Furniture	5000	
+ Unrecorded purchase	4000	16,000	– Depreciation	250	4750
Outstanding interest on loan of Vijay		900	Lease hold factory	30,000	
			– written off	6000	24,000
			Non-Tangible Assets :		–
			Investments :		–
			Current Assets :		
			Closing stock		27,300
			Cash on hand		280
			Current A/c with bank		7000
			Fixed deposit with bank		40,000
			Debtors	18,400	
			– Bad debts (Adj.)	400	
				18,000	
			– Bad debts reserve (Adj.)	900	17,100
			Prepaid insurance premium		200
			Current A/c : Vijay		6635
		2,03,265			**2,03,265**

Note : (1) No profit-loss sharing is given. Thus loss is distributed in equal proportion. (2) Rate of interest on loan of partner Vijay is not given. Thus as per the provision of partnership act 1932 interest will be paid at 6 % for 6 months.

$= 30{,}000 \times \frac{6}{100} \times \frac{6}{12} = ₹\ 900$

Vijay's loan ₹ 30,000 will be disclosed as non-current liabilities in the balance sheet and outstanding interest of loan ₹ 900 as a current liability in the balance sheet.

Illustration 3 : Trial balance of partnership firm of Yash and Jash as on 31-3-2017 is as follows :

Trial Balance of partnership firm of Yash and Jash as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital A/c :**	
Yash	8000	Yash	50,000
Jash	4000	Jash	40,000
Stock (1-4-2016)	24,000	Suppliers	16,400
Customers	29,000	Sales	2,04,000
Purchase	1,30,800	Bills payable	8000
Wages	2000	Interest on investment	300
Bills receivables	6000	Bank overdraft	24,260
6 % Investments (1-4-16)	10,000	Goods returned	2800
Salary	12,000	Rent received	600
Cash balance	3500	Discount received	400
Discount allowed	1400	Bad debts reserve	2000
Goods returned	2400	Goods withdrawn for personal use	740
Bad debts	400	Outstanding wages	500
Stationery expense	800		
Office expense	2300		
Motor car	52,000		
Building	60,200		
Prepaid office expense	1200		
	3,50,000		**3,50,000**

Adjustments : (1) Interest at 5 % on capital and at 10 % on drawings for 6 months. (2) Closing stock ₹ 15,000, having market value ₹ 12,000. (3) Outstanding stationery expense ₹ 500. (4) Prepaid wages ₹ 400. (5) Rent received in advance ₹ 200 and discount is receivable ₹ 40. (6) From debtors written off ₹ 1000 as bad debts, provide 5 % bad debts reserve and 2 % discount on reserve on debtors. (7) Provide 10 % depreciation on motor car. (8) Goods worth ₹ 2000 destroyed by fire, insurance company has admitted claim of 80 % (9) 10 % commission is payable to Jash from profit after deduction of commission from profit.

Prepare annual accounts of partnership firm.

Trading Account of Partnership firm of Yash and Jash as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		24,000	By Sales	2,04,000	
To Purchase	1,30,800		− Sales return	2400	2,01,600
− Purchase return	2800		By Closing stock		12,000
	1,28,000				
− Goods withdrawn for personal use	740				
	1,27,260				
− Goods destroyed by fire	2000	1,25,260			
To wages	2000				
− Prepaid	400	1600			
To profit and loss A/c (Gross profit)		62,740			
		2,13,600			**2,13,600**

Profit and Loss Account of Partnership firm of Yash and Jash as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
Administrative expenses :			By Trading A/c (Gross profit)		62,740
To Salary		12,000	By Interest on investment	300	
To Stationery expense	800		+ Outstanding	300	600
+ outstanding	500	1300	By Rent	600	
To Office expense		2300	− Received in advance	200	400
Selling & distribution expense :			By Discount received	400	
To Discount allowed	1400		+ Outstanding	40	440
+ To Discount reserve on debtors (Adj.)	532	1932			
Other expenses-loss :					
To Bad debts (old)	400				
+ To Bad debts (new)	1000				
+ To Bad debts reserve (new)	1400				
	2800				
− To Bad debts reserve (old)	2000	800			
Depreciation : Motor car		5200			
To Loss on goods destroyed by fire		400			
To P & L App. A/c (Net profit)		40,248			
		64,180			**64,180**

Dr **P & L Appropriation A/c of Partnership firm of Yash and Jash as year ending on 31-3-17** Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Interest on capital A/c :			By Profit and loss A/c (Net profit)		40,248
Yash	2500		Interest on drawings :		
Jash	2000	4500	Yash	400	
To Jash's commission A/c		3304	Jash	200	600
To Partners' capital A/c (Divisible profit)					
Yash	16,522				
Jash	16,522	33,044			
		40,848			**40,848**

Note : (1) Profit-loss sharing ratio is in equal proportion.

(2) Jash's commission $= 36{,}348 \times \frac{10}{110}$ = ₹ 3304.36 = ₹ 3304

Dr **Partners Capital Accounts** Cr

Date	Particular	Yash (₹)	Jash (₹)	Date	Particular	Yash (₹)	Jash (₹)
31-3-17	To Drawings A/c	8000	4000	1-4-16	By Balance b/d	50,000	40,000
31-3-17	To Interest on drawings A/c	400	200	31-3-17	By Interest on capital A/c	2500	2000
31-3-17	To Balance c/d	60,622	57,626	31-3-17	By Commission A/c	–	3304
				31-3-17	By P & L App. A/c (Divisible profit)	16,522	16,522
		69,022	**61,826**			**69,022**	**61,826**

Balance Sheet of partnership firm of Yash and Jash as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Yash	60,622		**Fixed Assets :** Building		60,200
Jash	57,626	1,18,248	Motar car	52,000	
Non-Current Liabilities :			– Depreciation	5200	46,800
Current Liabilities :			6 % investments		10,000
Bank overdraft		24,260	**Current Assets :** Closing stock		12,000
Bills payables		8000	Customers	29,000	
Suppliers		16,400	– Bad debts (Adj.)	1000	
Outstanding wages		500		28,000	
Outstanding stationery expense		500	– Bad debts reserve(Adj.)	1400	
Rent received in advance		200		26,600	
			– Discount reserve	532	26,068
			Cash balance		3500
			Discount receivable		40
			Bills receivable		6000
			Prepaid office expense		1200
			Prepaid wages		400
			Receivable interest on investments		300
			Insurance Co. (Claim amount)		1600
		1,68,108			**1,68,108**

Illustration 4 : Following is the trial balance of partnership firm of Ganga and Jamna as on 31-3-2017.

Trial Balance of partnership firm of Ganga and Jamna as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital :**	
Ganga	12,000	Ganga	30,000
Jamna	12,000	Jamna	36,000
Purchase	1,04,000	**Current Accounts :**	
Goods return	1600	Ganga	3000
Stock of goods (1-4-16)	16,000	Jamna	2400
Salary	18,000	Sales	1,84,000
Office expense	9000	Goods returned	1200
Carriage inward	3000	Bad debts reserve	6000
Carriage outward	4500	Bank loan	13,500
Bad debts	1400	Creditors	36,000
Debtors	67,000	Bills payable	1800
Bills receivable	2000	Loan borrowed	4000
Cash on hand	3400	General reserve	9600
Bank balance	5600		
Investments	14,000		
Machinery (office)	30,000		
Building	24,000		
	3,27,500		**3,27,500**

Adjustments : (1) Value of closing stock ₹ 28,600, but market value of 20 % goods is 10 % more than book value. (2) 5 % interest is payable on capital to partners and annual bonus of ₹ 2000 payable to each partner. (3) Bad debts reserve is to be maintained of ₹ 3000 and provide 5 % discount reserve on debtors. (4) Provide 10 % depreciation on building and machines. (5) Purchase of ₹ 4000 is not recorded but included in the closing stock. (6) Receivable commission is of ₹ 2000 and outstanding office expense is ₹ 200. (7) The value of investment is determined at ₹ 12,000 and adjustment of difference is to be transferred to general reserve. (8) Loan of ₹ 600 was given to an employee, but debited to salary account. (9) Profit-loss sharing of partners is 3:7. Prepare annual accounts of partnership firm.

Trading Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		16,000	By Sales	1,84,000	
To Purchase	1,04,000		− Sales return	1600	1,82,400
+ Unrecorded	4000		By Closing stock		28,600
	1,08,000				
− Purchase returned	1200	1,06,800			
To Carriage inward A/c		3000			
To profit and loss A/c (Gross profit)		85,200			
		2,11,000			**2,11,000**

Profit and Loss Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expenses :			By Trading A/c (Gross profit)	85,200
To Salary	18,000		Outstanding commission	2000
− Loan to employee	600	17,400	By Bad debts reserve	1600
To Office expense	9000		(Transfered from debit side)	
+ Outstanding	200	9200		
Selling-Distribution Expenses :				
To Carriage outward		4500		
Other Expenses-Loss :				
To Bad debts (old)	1400			
+ To Bad debts reserve (adj.)	3000			
	4400			
− To Bad debts reserve (old)	6000			
Transferred at credit side	−1600			
Discount reserve to debtors		3200		
Depreciation :				
Mechines	3000			
Building	2400	5400		
To Profit and loss appropriation A/c (Net profit)		49,100		
		88,800		**88,800**

Profit and Loss Appropriation Account of partnership firm of Ganga and Jamna for the year ending on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on capital :			By Profit and loss A/c (Net profit)	49,100
Ganga	1500			
Jamna	1800	3300		
To Bonus to partners :				
Ganga	2000			
Jamna	2000	4000		
To Partners' current A/c(Divisible profit)				
Ganga	12,540			
Jamna	29,260	41,800		
		49,100		**49,100**

Partners Capital Accounts

Dr | Cr

Date	Particular	Ganga (₹)	Jamna(₹)	Date	Particular	Ganga (₹)	Jamna(₹)
31-3-17	To Drawings A/c	12,000	12,000	1-4-16	By Balance b/d	3000	2400
31-3-17	To Balance c/d	7040	23,460	31-3-17	By Interest on capital A/c	1500	1800
				31-3-17	By Bonus A/c	2000	2000
				31-3-17	By P & L App.A/c (Divisible profit)	12,540	29,260
		19,040	**35,460**			**19,040**	**35,460**

Note : (1) Book value of investment is ₹ 14,000, but its value is determined at ₹ 12,000. Adjustment is to be recorded to general reserve. So ₹ 2000 will be deducted from general reserve A/c.

(2) Distributed profit : Ganga : $41,800 \times \frac{3}{10}$ = ₹ 12,540

Jamna : $41,800 \times \frac{7}{10}$ = ₹ 29,260

Balance Sheet of partnership firm of Ganga and Jamna as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital A/c :			**Non-Current Assets :**		
Ganga		30,000	**Fixed Assets :**		
Jamna		36,000	Building	24,000	
Current A/c :			− Depreciation	2400	21,600
Ganga		7040	Machines	30,000	
Jamna		23,460	− Depreciation	3000	27,000
Reserves :			**Investments :**		
General reserve	9600		Investments	14,000	
− Investments written off	2000	7600	− Written off	2000	12,000
Non-Current Liabilities :			**Current Assets :**		
Bank loan		13,500	Closing stock		28,600
Loan borrowed		4000	Debtors	67,000	
Current liabilities :			− Bad debts reserve (Adj.)	3000	
Bills payable		1800		64,000	
Creditors	36,000		− Discount reserve (Adj.)	3200	60,800
+ Unrecorded purchase	4000	40,000	Cash on hand		3400
Outstanding office expense		200	Bank balance		5600
			Outstanding commission		2000
			Bills receivable		2000
			Loan to employee		600
		1,63,600			**1,63,600**

Illustration 5 : Shiv and Shankar are partners of a firm sharing profit-loss in the equal proportion. From the following trial balance as on dated 31-3-2017 and adjustments prepare final accounts of the firm.

Trial Balance of partnership firm of Shiv and Shankar as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital and Drawings :		
Shiv	10,000	1,00,000
Shankar	20,000	1,20,000
Opening stock	60,000	
Purchase and sales	61,000	80,000
Carriage inward	20,000	
Weighing machine charges / Tolai4	1000	
Providend fund and contribution to providend fund	1000	4000
Dead stock	22,000	
Salary-wages	12,000	
Loan of Shiv (From 1-7-2016)		20,000
Mahajan Lago	2000	
Factory building	1,00,000	
Depreciation on factory building	10,000	
Insurance premium	1200	
Prepaid insurance	600	
Demurrage	200	
Cash and bank	6000	18,000
Bills	30,000	14,000
Customers and traders	20,000	16,000
Professional tax	1000	
Outstanding salary		1400
Bad debts and bad debts reserve	1400	6000
Total	**3,79,400**	**3,79,400**

Adjustments : (1) The value of closing is ₹ 40,000, but market value is 20 % less than book value. (2) Goods was received of ₹ 1000, but invoice is not recorded in the purchase book. (3) 10 % interest is payable on capital and 5 % interest is chargeable on drawings. (4) Provide bad debts reserve of ₹ 3000 and keep 10 % discount reserve on debtors. (5) Shiv has withdrawn goods of ₹ 1000 and Shankar has withdrawn goods of ₹ 2000 for personal use recorded in sales book as credit sales. (6) As per partnership deed, interest on capital is payable, even if there is loss.

Trading Account of partnership firm of Shiv and Shankar for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		60,000	By Sales	80,000	
To Purchase	61,000		− Wrongly recorded	3000	77,000
+ Unrecorded	1000		withdrawal		
	62,000		Closing stock		32,000
− Withdrawal of goods	3000	59,000	By Profit and loss A/c (Gross loss)		43,200
(1000 + 2000)					
To Depreciation on factory building		10,000			
To Carriage inward		20,000			
To Weighing charges		1000			
To Mahajan Lago		2000			
To Demurrage		200			
		1,52,200			**1,52,200**

Profit and Loss Account of partnership firm of Shiv and Shankar for the year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Trading A/c (Gross loss)		43,200	By Bad debts reserve A/c	1600
Administrative Expenses :			(Transfered from debit side)	
To Salary-wages		12,000	By Profit and loss Appropriation A/c	
To Professional tax		1000	(Net loss)	59,100
To Insurance premium		1200		
To Contribution in PF		1000		
Selling and Distribution Expenses :				
Discount reserve on debts		1400		
Other Expenses - Loss :				
To Bad debts (trial balance)	1400			
+ Bad debts reserve (Adj.)	3000			
	4400			
− To Bad debts reserve	6000			
(trial balance)				
Transfered to credit side	−1600	−		
To Interest on Shiv's loan		900		
(At 6 % for 9 months)				
		60,700		**60,700**

Dr **P & L App. A/c of partnership firm of Shiv and Shankar for the year ending on 31-3-2017** Cr

Particular		**Amt. (₹)**	**Particular**		**Amt. (₹)**
To Profit and Loss A/c (Net loss)		59,100	By Interest on partners' drawings :		
Toi Interest on partners' capital :			Shiv	500	
Shiv	10,000		Shankar	1000	1500
Shankar	12,000	22,000	By Partners' capital A/c (Divisible loss)		
			Shiv	39,800	
			Shankar	39,800	79,600
		81,100			**81,100**

Balance Sheet as on 31-3-17 of Partnership Firm of Shiv and Shankar

Capital-Liabilities			**Amt. (₹)**	**Assets-Debts**		**Amt. (₹)**
Shiv		1,00,000		**Non-Current Assets :**		
+ Interest on capital		10,000		**Fixed Assets :**		
		1,10,000		Factory building		1,00,000
− Loss		39,800		**Current Assets :**		
		70,200		Customers	20,000	
− Drawings	10,000			− Wrong recorded	3000	
+ Goods withdrawal	1000				17,000	
+ Int. on drawings	500	11,500	58,700	− Bad debts reserve (Adj.)	3000	
Shankar :		1,20,000			14,000	
+ Interest on capital		12,000		− Discount reserve	1400	12,600
		1,32,000		Bill receivable		30,000
− Loss		39,800		Cash balance		6000
		92,200		Dead stock		22,000
− Drawings	20,000			Closing stock		32,000
+ Goods withdrawal	2000			Prepaid insurance		600
+ Int. on drawings	1000	23,000	69,200			
Non-Current Liabilities :						
Shiv's loan			20,000			
Current Liabilities :						
Provident fund			4000			
Outstanding salary			1400			
Outstanding interest on Shiv's loan			900			
Bank overdraft			18,000			
Traders		16,000				
+ Unrecorded purchase		1000	17,000			
Bills payable			14,000			
			2,03,200			**2,03,200**

Illustration 6 : Govind and Gopal had started partnership firm on 1-4-2016. Partners are entitled for 5 % interest on capital. 10 % commission is payable to Gopal on profit, after deduction of commission from the profit. Partners sharing profit-loss in the proportion of 3:2. There are several mistakes in the Trading Account and Profit-Loss Account prepared by an unexperienced accountant. You are asked to prepare revised annual accounts from the given trading account, profit-loss account and list of assets and liabilities and other information.

Trading Account and Profit and Loss Account as on 31-3-17

Dr | | | | | | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Purchase	2,48,600		By Sales	3,32,400	
+ Goods returned credit	2400		− Goods returned debit	600	3,31,800
	2,51,000		By Interest	600	
+ Closing stock	50,000	3,01,000	+ Discount received	800	1400
To Wages		11,200	By Net loss		27,200
To Carriage inward	8000				
− To carriage outward	4000	4000			
To Salary		18,000			
To Rent		12,000			
To Postage expense		600			
To Sundry expense		1200			
To Telephone expense		1600			
To Govind's drawing		6000			
To Gopal's drawing		4800			
		3,60,400			**3,60,400**

The position of assets and liabilities as on 31-3-2017 was as follows :

Assets : Stock ₹ 50,000, debtors ₹ 1,00,000, furniture ₹ 20,000, building ₹ 50,000, cash on hand ₹ 6000, bank balance ₹ 24,000

Liabilities : Creditors ₹ 40,000, bills payable ₹ 14,000, capital of Govind ₹ 1,00,000, capital of Gopal ₹ 30,000

Adjustments : (1) Write off bad debts of ₹ 2800. (2) Provide 2 % discount reserve on debtors. (3) Maintain bad debts reserve of ₹ 7200. (4) Provide 5 % depreciation on furniture and building.

Ans. : **Revised Trading Account of Govind and Gopal's Partnership Firm for the year ending on 31-3-2017**

Dr | | | | | | Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Purchase	2,48,600		By Sales	3,32,400	
− Goods returned	600	2,48,000	− Goods returned	2400	3,30,000
To Wages		11,200	By Closing stock		50,000
To Carriage inward		8000			
To Profit and loss A/c (Gross profit)		1,12,800			
		3,80,000			**3,80,000**

Profit and Loss Account of Govind and Gopal's Partnership Firm

Dr **for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative expenses :			By Trading A/c (Gross profit)	1,12,800
To Salary		18,000	By Interest received	600
To Rent		12,000	By Discount received	800
To Postage expense		600		
To Sundry expense		1200		
To Telephone expense		1600		
Sales-distribution expenses :				
To Carriage outward		4000		
To Discount reserve - debtors		1800		
Other expense-loss :				
To Bad debts (Adj.)	2800			
+ Bad debts reserve (Adj.)	7200	10,000		
Depreciation :				
To Furniture	1000			
+ To Building	2500	3500		
Profit and Loss App. A/c (Net profit)		61,500		
		1,14,200		**1,14,200**

Profit and Loss Appropriation Account of Govind and Gopal's Partnership Firm

Dr **for the year ending on 31-3-2017** Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital :			By Profit and loss A/c (Net profit)	61,500
Govind	5000			
Gopal	1500	6500		
To Gopal's commission 10 %		5000		
To Partners capital A/c (Divisible profit)				
Govind	30,000			
Gopal	20,000	50,000		
		61,500		**61,500**

Partners' Capital Accounts

Dr Cr

Date	Particular	Govind(₹)	Gopal (₹)	Date	Particular	Govind(₹)	Gopal (₹)
31-3-17	To Drawings A/c	6000	4800	1-4-16	By Balance b/d	1,00,000	30,000
31-3-17	To Balance c/d	1,29,000	51,700	31-3-17	By Int. on capital A/c	5000	1500
				31-3-17	By Commission A/c	–	5000
				31-3-17	By P & L App. A/c	30,000	20,000
		1,35,000	**56,500**			**1,35,000**	**56,500**

Balance Sheet as on 31-3-17 of Partnership Firm of Govind and Gopal

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital :			**Non-Current Assets :**		
Govind	1,29,000		**Fixed Assets :**		
Gopal	51,700	1,80,700	Furniture	20,000	
Non-current liabilities :		–	– Depreciation	1000	19,000
Current liabilities :			Building	50,000	
Creditors		40,000	– Depreciation	2500	47,500
Bills payable		14,000	**Current Assets :**		
			Debtors	1,00,000	
			– Bad debts (Adj.)	2800	
				97,200	
			– Bad debts reserve (Adj.)	7200	
				90,000	
			– Discount reserve (Adj.)	1800	88,200
			Cash on hand		6000
			Bank balance		24,000
			Closing stock		50,000
		2,34,700			**2,34,700**

Illustration 7 : From the following Trial Balance dated 31-3-2017 and adjustments prepare final account of partnership firm of Parekh and Mehta.

Trial Balance as on 31-3-2017 of Partnership Firm of Parekh and Mehta

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Opening stock	30,000	**Capital :**	
Purchase	4,00,000	Parekh	50,000
Debtors	1,50,000	Mehta	50,000
Cash and Bank	12,000	Creditors	50,000
Rent-taxes	3000	Sales	6,00,000
Insurance premium	9000		
Salary	42,000		
Carriage inward	18,000		
Carriage outward	21,000		
Recoverable claims	5000		
Advertisement suspense A/c	9000		
Furniture and fittings (C.P. ₹ 30,000)	23,000		
Office equipments (C.P. ₹ 15,000)	10,000		
Tender deposit (From 1-10-16)	6000		
Bills receivables	6000		
Bad debts	4000		
Electricity expense	2000		
	7,50,000		**7,50,000**

Adjustments : (1) Closing stock was ₹ 1,05,000. (2) A purchase bill of ₹ 15,000 is received from creditors, but not recorded. (3) Recoverable claims from insurance co. settled for ₹ 2000. (4) From the advertisement suspense account, written off 50 % as a advertisment expense of current year. (5) Provide depreciation at 5 % on furniture and fittings and office equipments as per straight line method. (6) ₹ 1000 paid in advance for insurance premium. (7) 12 % interest is receivable on tender deposit. (8) A discounted bill of ₹ 2000 was dishonored on 30-3-2017, which was earliar discounted in the bank. (9) Provide 2 % bad debts reserve on debtors.

Ans. : Trading Account of Parenership of Parekh and Mehta for Year Ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Opening stock		30,000	By Sales	6,00,000
To Purchase	4,00,000		By Closing stock	1,05,000
+ Unrecorded	15,000	4,15,000		
To Carriage inward		18,000		
To Profit and loss A/c (Gross profit)		2,42,000		
		7,05,000		**7,05,000**

Profit and Loss Account of Parenership of Parekh and Mehta for year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative expense :			By Trading A/c (Gross profit)	2,42,000
To Insurance premium	9000		By Outstanding interest on	
− Prepaid	1000	8000	tender deposit	360
To Salary		42,000		
To Electricity expense		2000		
To Rent and taxes		3000		
Sales-distribution expense :				
To Carriage outward		21,000		
To Advertisement suspense - 50 %		4500		
Other expense-loss :				
To Loss on recoverable claim		3000		
Depreciation :				
Furniture and fittings	1500			
+ Office equipments	750	2250		
To Bad debts (Trial balance)	4000			
+ To Bad debts reserve (Adj.)	3040	7040		
To Capital A/c (Divisible profit) :				
Parekh	74,785			
Mehta	74,785	1,49,570		
		2,42,360		**2,42,360**

Note : No transactions pertaining to partners capital are given, like interest on capital, interest on drawings and other personal transactions of partners. Thus profit and loss appropriation account is not opened.

Balance Sheet of partnership firm of Parekh and Mehta as on 31-3-17

Capital-Liabilities		**Amt. (₹)**	**Assets-Debts**		**Amt. (₹)**
Parekh	50,000		**Fixed Assets :**		
+ Divisible profit	74,785	1,24,785	Furniture and fittings	23,000	
Mehta	50,000		− Depreciation	1500	21,500
+ Divisible profit	74,785	1,24,785	Office equipments	10,000	
Liabilities :			− Depreciation	750	9250
Creditors	50,000		**Current Assets :**		
+ Unrecorded purchase	15,000	65,000	Debtors	1,50,000	
			+ Dishonored bill	2000	
				1,52,000	
			− Bad debts reserve 2 %	3040	1,48,960
			Tender deposit		6000
			Advertisement suspense A/c	9000	
			− 50 % written off	4500	4500
			Bills receivables		6000
			Closing stock		1,05,000
			Cash-bank	12,000	
			+ Insurance Co.'s settlement	2000	
				14,000	
			− Dishonored bill	2000	12,000
			Prepaid insurance		1000
			Outstanding interest on tender deposit		360
		3,14,570			**3,14,570**

Note : (1) Under straight line method of depreciation, depreciation is calculated on the cost price of furniture and fittings and office equipments. (2) On tender deposit 6 months interest at 12 % is calculated.

Illustration 8 : Radha and Mira are partners sharing profit-loss in proportion of 3:2. Their Trial Balance as on 31-3-2017 was as shown on page number 65 :

Trial Balance of partnership firm of Radha and Mira as on 31-3-17

Particular	Debit (₹)	Credit (₹)
Capital Account :		
Radha	–	20,000
Mira	–	10,000
Current Account :		
Radha	5000	–
Mira	–	1000
Purchase and sales	15,000	32,000
Receivables and Payables	16,000	9800
Motor car	12,000	–
Goods returned	1000	500
Sundry expense	800	–
Provident fund and contribution to provident fund	200	4000
Bank and cash	2500	19,847
Opening stock	9000	–
Bank interest	142	–
Building	12,950	–
Stationery stock (1-4-16)	200	–
Stationery purchase	1000	–
Bad debts return	–	700
Sale of old newspapers	–	1000
Professional tax	800	–
Patent	4000	–
Trademark	5000	–
Carriage inward	200	–
Discount	125	325
Machines (office)	8325	–
Depreciation on machines	675	–
Depreciation on motor car	2000	–
Freight	350	–
Discount reserve	–	250
Bad debt reserve	–	1000
Investments of provident fund	4000	–
Interest on provident fund investments	–	240
9 % Kanaiya's loan (1-6-16)	–	7000
Interest on loan	315	–
Insurance premium (Out of which premium of ₹ 400 is for the year ending on 30-6-2017)	600	–
Salary and wages	3730	–
Furniture	1500	–
Dead stock	150	–
Demurrage	100	–
Total	**1,07,662**	**1,07,662**

Adjustments : (1) Value of closing stock is ₹ 15,000, out of which 10 % and 15 % goods have market value less than book value by 12 % and 20 % respectively. (2) Stationery stock as on 31-3-17 ₹ 500. (3) A furniture of ₹ 600, sold to Kishan for ₹ 400 on 1-10-2016, which is recorded in the sales book. (4) Increase in the rate of depreciation to 10 % on Machines. (5) Provide 5 % depreciation on furniture. (6) Write off ₹ 600 from debtors as bad debts and provide bad debts reserve 5 %. (7) Provide 2 % discount reserve on debtors. (8) Goods of ₹ 3000 withdrawn by Mira for personal use on 1-1-17, it is recorded in the sales book. (9) Calculate 10 % p.a. interest on capital of partners. (10) ₹ 2000 annual salary will be given to Radha for her active participation in business.

Ans. : Trading Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Opening stock		9000	By Sales	32,000	
To Purchase	15,000		− Sales returned	1000	
− Purchase returned	500			31,000	
	14,500		− Sales of furniture (Kishan)	400	
− Goods withdrawn (Mira)	3000	11,500		30,600	
To Demurrage		100	− Wrongly recorded drawings	3000	27,600
To Carriage inward A/c		200	By Closing stock		14,370
To Freight		350			
To Profit and loss A/c (Gross profit)		20,820			
		41,970			**41,970**

Profit and Loss Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expense :			By Trading A/c (Gross profit)	20,820
To Insurance premium	600		By Discount received	325
− Prepaid	100	500	By Bad debts returned	700
To Stationery expense :			By Sale of old newspapers	1000
Opening stock	200			
+ Purchase	1000			
	1200			
− Closing stock	500	700		
To Professional tax		800		
To Salary-wages		3730		
To Sundry expense		800		
To Contribution to PF		200		

Financial Expense :					
Interest on Loan (Kanaiya) :					
Interest paid		315			
+ Outstanding		210	525		
To Bank interest			142		
Sales-Distribution Expense :					
To Discount (Trial balance)		125			
+ Discount reserve (Adj.)		228			
		353			
− Discount reserve (Trial bal.)		250	103		
Other Expenses-Loss :					
Depreciation :					
Motor car		2000			
+ Machinery	675				
+ Addition	225	900	2900		
To Furniture :					
Furniture sold		15			
Remaining		45	60		
To Loss on sale of furniture			185		
To Bad debts (Adj.)		600			
+ Bad debts reserve (Adj.)		600			
		1200			
− Bad debts reserve (Trial bal.)		1000	200		
To Profit and loss Appropriation A/c (Net profit)			12,000		
			22,845		**22,845**

Profit and Loss Appropriation Account of partnership firm of Radha and Mira for the year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on Capital :			By Profit and loss A/c (Net profit)	12,000
Radha	2000			
Mira	1000	3000		
To Radha's salary A/c		2000		
To Partners' capital A/c (Divisible profit 3:2) :				
Radha	4200			
Mira	2800	7000		
		12,000		**12,000**

Dr **Partners Capital Accounts** Cr

Date	Particular	Radha (₹)	Mira (₹)	Date	Particular	Radha (₹)	Mira (₹)
1-4-16	To Balance b/d	5000	–	1-4-16	By Balance b/d	–	1000
31-3-17	To Drawings A/c	–	3000	31-3-17	Int. on capital A/c	2000	1000
31-3-17	To Balance c/d	3200	1800	31-3-17	By Salary A/c	2000	–
				31-3-17	By P&L App. A/c (Divisible profit)	4200	2800
		8200	**4800**			**8200**	**4800**

Balance Sheet of partnership firm of Radha and Mira as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Accounts :			**Non-Current Assets :**		
Radha	20,000		**Fixed Assets : Tangible Assets :**		
Mira	10,000	30,000	Furniture	1500	
Current Accounts :			− Sale	600	
Radha	3200			900	
Mira	1800	5000	− Depreciation	45	855
Non-Current Liabilities :			Motor car		12,000
Loan of Kanaiya		7000	Building		12,950
Provident fund	4000		Machines	8325	
+ Interest	240	4240	+ Depreciation (Trial bal.)	675	
Current Liabilities :				9000	
Bank overdraft		19,847	− Depreciation 10 % (Adj.)	900	8100
Creditors		9800	**Intangible Assets :**		
Outstanding interest of loan		210	Patent		4000
			Trademark		5000
			PF investment		4000
			Current Assets :		
			Dead stock		150
			Closing stock of goods		14,370
			Stationery stock		500
			Debtors	16,000	
			− Sale of furniture	400	
				15,600	
			− Wrongly recorded draiwngs of Mira	3000	
				12,600	
			− Bad debts (Adj.)	600	
				12,000	
			− Bad debts reserve (Adj.)	600	
				11,400	
			− Discount reserve 2 %	228	11,172
			Kishan's A/c (debtors)(furniture's sale)		400
			Prepaid insurance		100
			Cash balance		2500
		76,097			**76,097**

Explanation of adjustments :

(1) **Closing stock :**

₹ 15,000

10 %	15 %	75 %
₹ 1500	₹ 2250	₹ 11,250
− 12 % 180	− 20 % 450	−
₹ 1320	₹ 1800	₹ 11,250 = ₹ 14,370

(2) **Depreciation and sale of furniture :**

Balance as per trial balance	₹ 1500
− Sale of furniture	₹ 600
Balance of furniture	₹ 900

Depreciation and loss on sale of furniture :

Opening balance of sale of furniture	₹ 600
− Depreciation : 6 months, 5 %	₹ 15
	₹ 585
− Selling price	₹ 400
Loss on sale of furniture	₹ 185

(To be shown debit side of profit and loss account)

Balance of furniture ₹ 900 $\times \frac{5}{100}$ =	₹ 45	Depreciation
+ Depreciation on sale of furniture	₹ 15	
To be shown debit side of P & L A/c	₹ 60	

Deduct ₹ 45 from the balance of furniture of balance sheet.

(3) **Calculation of interest on Kanaiya's loan :**

$7000 \times \frac{9}{100} \times \frac{10}{12}$ =	₹ 525	Total interest
− Interest paid	₹ 315	
	₹ 210	Outstanding interest

(4) **Depreciation on Machinery :**

Balance as per trial balance	₹ 8325
+ Depreciation charged	₹ 675
Value before depreciation	₹ 9000
− Depreciation 10 %	900
Value after depreciation	8100
Depreciation charged	₹ 675
Outstanding	₹ 225
Total depreciation	₹ 900

Rate of depreciation = $\frac{675}{9000} \times 100 = 7.5$ %

New depreciation rate = 10 % ∴ 9000 × 10 %

New depreciation	= 900	10 %
− Old depreciation	= 675	7.5 %
Yet to be recovered	= 225	

(To be shown debit side of profit and loss A/c)

(5) Furniture sold to Kishan on credit, thus it would appear in balance sheet at assets side.

Illustration 9 : Mahi and Rahi are partners sharing profit-loss in the proportion of 6:4. From the given trial balance dated 31-3-2017 and adjustments, prepare final accounts of partnership firm.

Trial Balance of partnership firm of Mahi and Rahi as on 31-3-2017

Debit Balances		Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :			**Capital Accounts :**	
Mahi	3000		Mahi	20,000
Rahi	2000	5000	Rahi	12,500
Opening stock		1750	Sales	2,00,000
Purchase		1,38,750	Purchase return	1250
Travelling expense :			Discount and allowance	1250
Rahi		3000	Dividend on share of SBI	50
Salesman		5250	Bank A/c	3000
Salary : Accountant		2500	Creditors	1250
Collection clerk		1250	Loan borrowed from friend	2500
Shop rent		900		
Debtors		5000		
Carriage (goods)		7500		
Advertisement expense		10,000		
Prepaid rent of shop (1-4-16)		75		
Discount and allowance		4250		
Donation expense		10,000		
Income tax		12,500		
Professional tax		125		
Bank overdraft interest		6000		
Bank commission		250		
Share of SBI		500		
Fixed assets		1250		
Fixed assets maintenance		500		
Cash balance		450		
Goodwill		25,000		
		2,41,800		**2,41,800**

Adjustments : (1) Provide 12 % interest on capital of partners and 5 % on drawings. (2) 3 % commission on sales is payable to Mahi. (3) Every month ₹ 300 is payable to Rahi for travelling expense done for business. (4) ₹ 50 interest is outstanding on loan of friend. (5) Shop rent is paid for 12 months for the year ending on 30-4-2017. (6) Provide 20 % depreciation on fixed assets. (7) There is doubtful recovery of ₹ 250. (8) Closing stock ₹ 19,025.

Ans. : Trading Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Opening stock		1750	By Sales	2,00,000
To Purchase	1,38,750		By Closing stock	19,025
− Purchase return	1250	1,37,500		
To Carriage (Goods)		7500		
To Profit and loss A/c (Gross profit)		72,275		
		2,19,025		**2,19,025**

Profit and Loss Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
Administrative Expense :			By Trading A/c (Gross profit)	72,275
To Salary of accountant		2500	By Discount allowance A/c	1250
To Professional tax		125	By Dividend on share of SBI	50
To Shop rent	900			
+ Prepaid of 2017 (1-4-16)	75			
	975			
− Prepaid of 2018 (1-4-17)	75	900		
Sales-Distribution Expense :				
To Salary of collection clerk		1250		
Advertisement expense A/c		10,000		
To Salesman travelling expense		5250		
To Discount - allowance A/c		4250		
To Other Expenses-Loss A/c :				
To Bank overdraft interest A/c		6000		
To Bank commission A/c		250		
To Fixed assets maintenance A/c		500		
To Outstanding int. on loan of friend		50		
To Donation expense A/c		10,000		
To Depreciation on fixed assets A/c		250		
To Bad debts reserve A/c		250		
To Income tax A/c		12,500		
P & L Appropriation A/c (Net profit)		19,500		
		73,575		**73,575**

Profit and Loss Appropriation Account of partnership firm of Mahi and Rahi for year ending on 31-3-2017

Dr Particular		Amt. (₹)	Particular		Amt. (₹) Cr
Interest on capital :			By Profit and loss A/c (Net profit)		19,500
Mahi	2400		**Interest on drawings :**		
Rahi	1500	3900	Mahi	150	
To Travelling expense A/c			Rahi	100	250
Rahi	3000				
+ Outstanding	600	3600			
To Mahi's commission A/c 3 %		6000			
To Partners' capital A/c(Divisible profit)					
Mahi	3750				
Rahi	2500	6250			
		19,750			**19,750**

Partners' Capital Accounts

Dr Date	Particular	Mahi (₹)	Rahi (₹)	Date	Particular	Mahi (₹)	Rahi (₹) Cr
31-3-17	To Drawings A/c	3000	2000	1-4-16	By Balance b/d	20,000	12,500
31-3-17	To Interest on drawing A/c	150	100	31-3-17	By Int. on capital	2400	1500
				31-3-17	By Travelling exp.	–	600
31-3-17	To Balance c/d	29,000	15,000	31-3-17	By Commission A/c	6000	–
				31-3-17	By P&L App. A/c (Divisible profit)	3750	2500
		32,150	**17,100**			**32,150**	**17,100**

Balance Sheet of partnership firm of Mahi and Rahi as on 31-3-17

Capital-Liabilities	Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Account :		**Non-Current Assets :**		
Mahi	29,000	**Fixed Assets :**		
Rahi	15,000	**Tangible Assets :**		
Non-Current Liabilities :		Fixed assets	1250	
Loan borrowed from friend	2500	– Depreciation	250	1000
Current Liabilities :		**Intangible Assets :** Goodwill		25,000
Bank A/c	3000	**Investments :**		
Creditors	1250	Shares of SBI		500
Interest outstanding of friend's loan	50	**Current Assets :**		
		Closing stock		19,025
		Debtors	5000	
		– Bad debts reserve (Adj.)	250	4750
		Cash balance		450
		Prepaid rent		75
	50,800			**50,800**

Note : (1) Outstanding shop rent as per trial balance ₹ 900
+ Paid in previous year of current year (1-4-16) ₹ 75
₹ 975
− Paid in current year of Next year (30-4-17) ₹ 75
[900 ÷ 12 = 75] ₹ 900

(2) Income tax is expense of partnership firm. Thus disclosed the at debit side of P & L A/c.

Illustration 10 : Following are the annual accounts of partnership firm of Labh and Subh.

Profit and Loss Account of partnership firm of Labh and Shubh as on 31-3-17

Dr | Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Cost of goods sold A/c		1,16,000	By Sales A/c	1,96,000
To Office expenses A/c		20,000	By Sundry income A/c	2000
To Sales expenses A/c		16,000		
To Financial expenses A/c		4000		
To Sundry expenses A/c		4000		
To Partners' capital A/c (Net profit)				
Labh	22,800			
Subh	15,200	38,000		
		1,98,000		**1,98,000**

Balance Sheet of partnership firm of Labh and Shubh as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts	Amt. (₹)
Capital :			**Non-Current Assets :**	
Labh	40,000		**Tangible Assets :**	
+ Net profit	22,800		Fixed assets	60,000
	62,800		Investments	12,000
− Drawings	12,000	50,800	Current assets (with debtors)	28,000
Shubh	30,000			
+ Net profit	15,200			
	45,200			
− Drawings	6000	39,200		
Liabilities		8000		
Suspense A/c		2000		
		1,00,000		**1,00,000**

After preparation of annual accounts the following adjustments are reported : (1) 5 % interest on capital is not calculated. (2) 10 % depreciation on fixed assets is to be provided. (3) Prepaid rent is ₹ 200. (4) Interest on investment is not received ₹ 400. (5) Maintain Bad debts reserve of ₹ 600. (6) Total of sales book is under cast by ₹ 2000. (7) Purchase of ₹ 800 is not recorded in the books. Write adjustment entries and prepare revised final accounts from the above information.

Adjustments

Date	Particular	LF No.	Debit (₹)	Credit (₹)
(1)	Interest on capital A/c Dr		3500	
	To Labh's capital A/c			2000
	To Shubh's capital A/c			1500
	(Being 5 % interest on capital is charged to partners.)			
(2)	Depreciation A/c Dr		6000	
	To fixed assets A/c			6000
	(Being depreciation is charged at 10 % on fixed assets.)			
(3)	Prepaid rent A/c Dr		200	
	To rent A/c			200
	(Being prepaid rent is adjusted.)			
(4)	Outstanding intrest on investment A/c Dr		400	
	To interest on investment A/c			400
	(Being interest on investment is not received.)			
(5)	Profit and Loss A/c Dr		600	
	To Bad debts reserve A/c			600
	(Being provided bad debts reserve.)			
(6)	Suspense A/c Dr		2000	
	To sales A/c			2000
	(Being total of sales book was under cost.)			
(7)	Purchase A/c Dr		800	
	To creditors A/c			800
	(Being entry passed for unrecorded purchase.)			

Trading Account of partnership firm of Labh and Shubh for year ending of 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular		Amt. (₹)
To Cost of goods sold A/c	1,16,000		By Sales	1,96,000	
+ Unrecorded purchase	800	1,16,800	+ From suspense A/c	2000	1,98,000
To Profit and loss A/c (Gross profit)		81,200			
		1,98,000			**1,98,000**

Revised Profit and Loss Account of partnership firm of Labh and Shubh for year ending on 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Office expense	20,000		By Trading A/c (Gross profit)	81,200
– Prepaid rent	200	19,800	By Sundry income A/c	2000
To Sales expense		16,000	By Interest on investment A/c	400
To Financial expenses A/c		4000		
To Sundry expenses A/c		4000		
To Depreciation on fixed assets		6000		
To Bad dabts reserve		600		
To P & L App. A/c (Net profit)		33,200		
		83,600		**83,600**

Revised Profit and Loss Appropriation Account of partnership firm of Labh and Shubh for year ending of 31-3-17

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To Interest on partners' capital :			By Profit and loss A/c (Net profit)	33,200
Labh	2000			
Shubh	1500	3500		
To partners' capital A/c (Divisible profit):				
Labh	17,820			
Shubh	11,880	29,700		
		33,200		**33,200**

Partners' Capital Accounts

Dr Cr

Date	Particular	Labh (₹)	Shubh (₹)	Date	Particular	Labh (₹)	Shubh (₹)
31-3-17	To Drawings A/c	12,000	6000	1-4-16	By Balance b/d	40,000	30,000
31-3-17	To Balance c/d	47,820	37,380	31-3-17	By Interest on capital A/c	2000	1500
				31-3-17	By P&L App. A/c (Divisible profit)	17,820	11,880
		59,820	**43,380**			**59,820**	**43,380**

Balance Sheet of partnership firm of Labh and Shubh as on 31-3-17

Capital-Liabilities	Amt. (₹)	Assets-Debts		Amt. (₹)
Capital Accounts :		**Non-Current Assets :**		
Labh	47,820	Fixed assets	60,000	
Shubh	37,380	− Depreciation 10 %	6000	54,000
Liabilities	8000	Investments		12,000
Unrecorded purchase	800	**Current Assets :**		
		Debtors	28,000	
		− Bad dabts reserve	600	27,400
		Interest outstanding on investments		400
		Prepaid rent		200
	94,000			**94,000**

Note : (1) Total of sales book is under cast by ₹ 2000. Thus it is added to sales and debited to suspense account. Consequently sales would increase by ₹ 2000 and suspense account will be closed. (2) Old profit shared by partner Labh and Shubh is ₹ 22,800 and ₹ 15,200 respectively. So total profit is ₹ 38,000. Proportion will be determined as follows :

$\frac{22800}{38000} \times 100 = 60\ \% : 3$

$\frac{15200}{38000} \times 100 = 40\ \% : 2$

∴ Labh and Subh would get in the proportion of 3:2. Divisible profit is calculated as per this proportion.

Revised devisible profit ₹ 29,700 will be shared as follows :

Labh $= 29{,}700 \times \frac{3}{5}$

$= 17{,}820$

Shubh $= 29{,}700 \times \frac{2}{5}$

$= 11{,}880$ are shown in the profit and loss appropriation account.

Exercise

1. Select appropriate option for each question :

(1) In which year partnership act was implemented in India ?

(a) 1923 (b) 1932

(c) 1947 (d) 1956

(2) In which proportion profit-loss will be shared between the partners if no provision is made in the partnership deed ?

(a) Capital proportion (b) Gaining ratio

(c) Sacrificing ratio (d) Equal proportion

(3) Credit balance of trading account represents ....

(a) gross profit (b) net profit

(c) gross loss (d) net loss

(4) Goods returned debit means ....

(a) purchase (b) purchase return

(c) sales (d) sales return

(5) Goods returned credit means ....

(a) purchase return (b) sales return

(c) purchase (d) sales

(6) Which balance is represented by bank overdraft ?

(a) Debit balance (b) Credit balance

(c) Debit and Credit (d) None of the above

(7) Where will you disclose the credit balance of profit and loss account which is shown in the trial balance ?

(a) Trading A/c (b) Profit and loss A/c

(c) Profit and loss appropriation A/c (d) Capital/current A/c

(8) Which transaction is shown at the debit side of the profit and loss appropriation account ?

(a) Interest on drawings (b) Interest on debit balance of current A/c

(c) Net profit (d) Amount to be transferred to general reserve

(9) Generally, which balance is maintained by current account ?

(a) debit (b) credit

(c) debit or credit (d) None of the above

(10) The financial position of business is disclosed by ....

(a) Trial balance (b) Trading A/c

(c) Balance sheet (d) Profit and loss A/c

2. Describe the objectives of the preparation of final accounts of a partnership firm.

3. Explain in brief, the method of the preparation of final accounts of a partnership firm.

4. State list of tangible and intangible assets.

5. Where will you disclose the following items given in a trial balance during the preparation of a final account of a partnership firm : (1) Bad debts returned (2) Depreciation : factory's building (3) Wages and salary (4) Providend fund investments (5) Bills payable (6) Goods withdrawn as drawings (7) Goods return credit (8) Goods return debit (9) Loan given to firm by a partner (10) Interest on investments of providend fund.

6. Where will you disclose the effects of the following adjustments during the preparation of final accounts of a partnership firm :

(1) Closing stock of stationery (2) Unrecorded credit sales (3) Commission payable to partner on net profit (4) Goods withdrawn by partner for personal use. (5) Interest on debit balance of Partners' current account (6) Certain amount is written off from leasehold property (7) Receivable income (outstanding income) (8) Prepaid expenses (9) Discount reserve on debtors.

7. **Write adjustment entries for the following adjustments :**

(1) Book value of stock is ₹ 40,000, but its market value is 20 % less than the book value.

(2) Salary outstanding ₹ 1000.

(3) Mahendra lended loan of ₹ 25,000 to the firm, but 10 % for 6 months is outstanding on it.

(4) Interest received in advance ₹ 500.

(5) Provide depreciation at 8 % for 8 months on a building of ₹ 5,00,000.

(6) Closing stock of stationery at the end of the accounting period is ₹ 250.

(7) Closing balance at the end of accounting period, of debtors of business is ₹ 50,000, out which written off ₹ 4500 as bad debts. Provide 10 % bad debts reserve on debtors.

(8) One partner has withdrawn goods of ₹ 5000 for personal use, this transaction is not recorded.

(9) Goods of ₹ 3000 destroyed by fire. Insurance company has admitted the the claim of 80 %.

8. Brahma and Vishnu are partners of a firm sharing profit-loss in the proportion 3:2. From the trial balance dated 31-3-2017 and adjustments, prepare annual accounts of the firm :

Trial Balance of Partnership Firm of Brahma and Vishnu as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Brahma	5000	**Capital Accounts :** Brahma	55,000
Vishnu	5000	Vishnu	45,000
Leasehold building		Loan of Brahma (from 1-7-2016)	50,000
(from 1-4-16 for 10 years)	60,000	Discount received	400
Machinery (Office)	50,000	Creditors	25,000
Discount allowed	350	Commission	2500
Debtors	40,000	Bills payable	5000
Carriage outward	1200	Trading A/c	97,250
Furniture-fixtures	5000		
Salary	7500		
Bad debts	1200		
Bills receivable	20,000		
Trading expense	5900		
Cash balance	6000		
Stock (31-3-17)	73,000		
	2,80,150		**2,80,150**

Adjustments : (1) Provide depreciation 6 % on machinery and 20 % on furniture fixtures. (2) Written off ₹ 500 from debtors as bad debts. (3) Annual salary of ₹ 5000 and ₹ 4000 payable to Brahma and Vishnu respectively. (4) Commission ₹ 500 is receivable. (5) Outstanding salary ₹ 3000.

9. Parthiv and Priya are the partners of a partnership firm. From the Trial balance dated 31-3-2017 and adjustments, prepare final accounts of a partnership firm.

Trial Balance of Partnership Firm of Parthiv and Priya as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Parthiv	4800	**Capital Accounts :** Parthiv	24,000
Priya	3200	Priya	16,000
*Net cost of purchase	1,06,000	Sales	2,00,000
Stock of goods (31-3-17)	28,000	Payables	30,000
Receivables	48,000	Goods distribute as sample	2000
Wages-salary	10,000	Bank overdraft	14,000
Trading expense	16,000		
Building	50,000		
Furniture-fittings	10,000		
Office equipments	4000		
Packing material stock	4000		
Cash balance	2000		
	2,86,000		**2,86,000**

***Note :** Net cost of purchase means adjusted purchase.

Adjustments :

(1) Provide interest 8 % on capital and 12 % on drawings. Parthiv had withdrawn ₹ 400 at the end of each month and Priya had withdrawn on 1-10-16.

(2) Credit sales of ₹ 10,000 is not recorded and total of sales book of March is overcast by ₹ 2000.

(3) Write off additional bad debts of ₹ 2000 and provide 5 % bad debts reserve on debtors.

(4) Furniture of ₹ 4000 became obsolete, which is not recorded in the books.

(5) A court has finalised claim of ₹ 4000, for not meeting agreement to provide goods to a customer.

(6) Outstanding wages of ₹ 2000 is recorded to wages account but outstanding wages account is not recorded in the trial balance.

10. Luv and Kush are partners of a partnership firm. They distribute 60 % profit in the ratio of 3:2 and remaining in the proportion of 2:1. From the trial balance of the firm dated 31-3-17 and adjustments prepare profit and loss appropriation account, current accounts of partners and balance sheet of the firm.

Trial Balance of Partnership Firm of Luv and Kush as on 31-3-2017

Particular	Debit balance (₹)	Credit balance (₹)
Luv's capital - drawings	40,000	1,20,000
Kush's capital - drawings	12,000	80,000
Current accounts : Luv	–	8000
Kush	12,000	–
Profit and loss A/c	–	80,000
Stock (31-3-2017)	72,000	–
Prepaid insurance premium	3200	–
Building	1,60,000	–
Debtors and creditors	80,000	28,000
Cash and bank balance	4800	20,000
Bills payable	–	14,000
Mortgage loan	–	1,00,000
Goodwill	40,000	–
Outstanding wages	–	2800
Receivable rent	1600	–
Commission received in advance	–	800
Bad debts reserve	–	8000
Patents	12,000	–
Furniture	24,000	–
	4,61,600	**4,61,600**

Adjustments : (1) Provide interest on capital at 6 % and on drawings at 10 %. (2) Provide 10 % interest on opening balance of current accounts. (3) Monthly salary of ₹ 1800 is outstanding, payable to Kush. (4) After information of above mentioned adjustments, on remaining profit 10 % commission is payable to Kush.

11. From the Trial Balance and adjustments of partnership firm of Salim and Shabana, prepare final accounts of partnership firm.

Trial Balance of Partnership Firm of Salim and Shabana as on 31-3-2017

Particular	Debit balance (₹)	Credit balance (₹)
Capital Account : Salim	–	1,60,000
Shabana	–	1,20,000
Current Account : Shabana	10,000	–
Salim	–	40,000
Stock of goods (31-3-17)	54,600	–
Cash balance	560	–
Current account with bank	14,000	–
Fixed deposit of SBI	80,000	–
Debtors - creditors	36,800	24,000
Salary	37,000	–

Land-building	1,20,000	–
machinery (office)	40,.000	–
Furniture	10,000	–
Insurance premium	2000	–
Leasehold machinery (from 1-4-16 for 5 years)	60,000	–
Stationery and printing	1200	–
Bad debts - bad debts reserve	400	2000
Advertisement expense	1200	–
Travelling expense	800	–
Trading A/c	–	61,800
Loan of Shabana (from 1-10-16)	–	60,000
Discount reserve	–	760
	4,68,560	**4,68,560**

Adjustments :

(1) Salim withdrew goods of ₹ 4000 for personal use. It is not recorded in the books.

(2) Goods of ₹ 8000 purchased at the end of the accounting year, which is not recorded.

(3) Prepaid insurance is ₹ 400.

(4) From debtors ₹ 800 is not recoverable. Provide 5 % bad debts reserve on debtors.

(5) Discount reserve on debtors is not required.

(6) Provide depreciation on machinery at 20 % and on furniture at 5 %.

12. Dhara and Mira are partners sharing profit-loss in the proportion of 3:2. Final accounts of their partnership firm are as follows :

Trading Account and Profit and Loss Account of partnership firm of Dhara and Mira for year ending on 31-3-2017

Dr Cr

Particular		Amt. (₹)	Particular	Amt. (₹)
To cost of goods sold		4,64,000	By sales	7,84,000
To office expense		80,000	By sundry income	7000
To show-room rent		10,000	By bad debts returned	1000
To packing expense		12,000		
To bad debts		8000		
To advertisement expense		14,000		
To selling-distribution expense		20,000		
To financial expense		6000		
To sundry expense		16,000		
To salary		8000		
To tax-insurance		2000		
Net profit : Dhara	91,200			
Mira	60,800	1,52,000		
		7,92,000		**7,92,000**

Balance Sheet of Partnership Firm of Dhara and Mira as on 31-3-17

Capital-Liabilities		Amt. (₹)	Assets-Debts	Amt. (₹)
Dhara :			**Non-current assets :**	
Capital	1,60,000		**Fixed assets :**	
+ Net profit	91,200		Building	2,40,000
	2,51,200		Machinery	20,000
− Drawings	48,000	2,03,200	Furniture	20,000
Mira :			Investments	24,000
Capital	1,20,000		**Current assets :**	
+ Net profit	60,800		Cash balance	10,000
	1,80,800		Bank balance	25,000
− Drawings	24,000	1,56,800	Bills receivable	5000
Creditors		32,000	Debtors	56,000
Bills payable		8000		
		4,00,000		**4,00,000**

After preparation of annual accounts, it is found that :

(1) 5 % interest on capital is not calculated. (2) 10 % depreciation on building is to be provided. (3) Prepaid salary is of ₹ 400. (4) Interest on investments not received ₹ 800. (5) Bad debts reserve of ₹ 1200 is to be maintained. (6) Credit purchase of ₹ 1600 is not recorded.

Prepare revised Trading account, Profit and loss a/c, Profit and loss appropriation a/c and Balance sheet.

13. Harsha and chhaya are partners of a partnership firm. From the following information prepare final accounts :

Trial Balance of Partnership Firm of Harsha and Chhaya as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Harsha (1-10-16)	5000	Capital accounts : Harsha	20,000
Chhaya (1-1-17)	10,000	Chhaya	30,000
Current account : Harsha	6000	Current account : Chhaya	4000
Interest on capital : Harsha	700	Interest on drawings : Harsha	100
Chhaya	1000	Chhaya	50
Machinery (office)	40,000	Loan of Harsha (from 1-10-2016)	10,000
Interest on loan	200	Rent	12,000
Salary (Monthly ₹ 1000)	13,000	Creditors	5000
Salary of Chhaya	5500	Trading account	24,700
Debtors	15,000	Bank balance	5450
Receivable rent	2000	Interest on current account : Harsha	100
Bad debts	1300	Suspense account	300
Stock of goods (31-3-17)	10,000		
Insurance pre. (Out of which ₹ 1200 is for the year ending on 30-6-17)	2000		
	1,11,700		**1,11,700**

Adjustments :

(1) Provide interest 5 % on capital, 6 % on drawings and 10 % on opening balance of current a/c.

(2) Provide 10 % depreciation on machines.

(3) Monthly salary of Chhaya is ₹ 500.

(4) Total of sales book is under cast by ₹ 300.

(5) ₹ 1700 are to be transferred to general reserve.

14. Dharma and Karma are partners sharing profit-loss in their capital ratio. From the following information prepare their final accounts.

Trial Balance of Partnership Firm of Dharma and Karma as on 31-3-2017

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings : Dharma	7500	Capital accounts : Dharma	1,40,000
Karma	5000	Karma	1,20,000
Opening stock	15,000	Sales	1,20,000
Purchase	80,000	Goods return debit	2000
Goods return credit	3000	Payables	79,000
Receivables	27,400	Salary outstanding	700
Salary (upto 28-2-17)	13,200	Loan of Dharma	30,000
Machinery (office)	71,760	Discount received	6600
Depreciation on machine	6240	Bank overdraft	2800
Building	80,000	Current account : Karma	14,000
Wages	1600		
Insurance premium	1800		
Discount allowed	3200		
Interest on loan	1200		
Furniture	87,000		
Stationery expense	7000		
Advertisement expense	36,000		
Cash balance	51,200		
Current account : Dharma	17,000		
	5,15,100		**5,15,100**

Adjustments :

(1) Closing stock is of ₹ 21,000, in which stock of stationery of ₹ 2000 is included.

(2) On machinery, depreciation rate is to be increased upto 10 %.

(3) Credit sales of ₹ 1000, is recorded in the purchase return book by mistake.

(4) $\frac{1}{4}$ share of advertisement expense is to be carry forwarded to the next year.

15. With consideration of following trial balance and adjustments of Harsh and Yesha, prepare final accounts for the year ending on 31-3-17 of their firm.

Trial Balance of Partnership Firm of Harsh and Yesha as on 31-3-2017

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings :		
Harsh	5000	35,000
Yesha	2500	15,000
Goodwill	5000	–
Patent and Trade-mark	2700	–
Receivables and payables	31,000	25,000
Accounts of goods	40,000	89,250
Machines (office)	15,000	–
Opening stock	6000	–
Furniture	3000	–
Goods return accounts	7500	5000
Wages	4000	–
Depreciation on furniture	300	–
Stationery and printing	1550	–
Building	46,000	–
Legal charges	6500	–
Cash balance	300	–
Railway frieght	600	–
Insurance premium	1150	–
Bills	4000	2500
Postage expense	2000	–
Bad debts and bad debts reserve	1500	2000
Discounts	750	1500
Stamps on hand and bad debts return	150	1250
12 % HDFC loan (1-7-16)	–	10,000
	1,86,500	**1,86,500**

Adjustments :

(1) Closing stock ₹ 10,000 out of which 50 % has no market value.

(2) Legal charges included of legal charges of building purchase ₹ 4000.

(3) Provide 5 % bad debts reserve on debtors.

(4) Provide depreciation 10 % on furniture and 5 % on building.

(5) $\frac{1}{3}$ share of patent and trade mark is to be written off.

16. Neela and Sheela are partners of partnership firm sharing profit-loss in capital proportion. From the following trial balance and adjustments prepare final accounts of the firm.

Trial balance of Partnership Firm of Neela and Sheela as on 31-3-17

Name of Accounts	Debit balances (₹)	Credit balances (₹)
Neela's capital and drawings	20,000	1,00,000
Sheela's capital and drawings	14,000	50,000
Suppliers and customers	90,000	60,000
Goods returned	2000	3000
Bills	15,000	20,800
Cash and Bank	1000	14,000
Bad debts and bad debts reserve	400	1300
Purchase and sales	1,40,000	2,60,500
Wages and outstanding wages	35,000	2000
Machinery (office)	36,500	–
Depreciation on machinery	3500	–
Furniture	12,000	–
Opening stock	46,100	–
Prepaid insurance	200	–
Salary	23,000	–
Insurance premium	2000	–
Rent-taxes	12,000	–
Advertisement expenses	2900	–
Goodwill	72,000	–
Leasehold building (from 1-10-14 for 5 years)	14,000	–
8 % Leela's loan (1-11-16)	–	30,000
Total	**5,41,600**	**5,41,600**

Adjustments :

(1) Closing stock ₹ 1,10,000 and having market value 20 % more than book value.

(2) Per annum 6 % interest is payable on Partners' capital.

(3) Interest on drawings recoverable from partners : Neela ₹ 900, Sheela ₹ 600.

(4) Provide 5 % bad debt reserve on debtors.

(5) Outstanding expenses at the end of accounting year : rent ₹ 300 and salary ₹ 950.

(6) Provide depreciation : 10 % on machinery and 5 % on furniture.

17. Man and Mohan are partners of a firm sharing profit and loss in the proportion of 1:1. From the given below trial balance and adjustments prepare final accounts for the year ending on 31-3-2017.

Trial Balance of Patnership Firm of Man and Mohan as on 31-3-17

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings :		
Man	3000	2,80,000
Mohan	4500	2,20,000
Purchase-sales	80,000	1,20,000
Advertisment expense	7000	–
Carriage outward	850	–
Machines (office)	1,50,000	–
Purchase of office machine (1-4-16)	40,000	–
Building	2,50,000	–
Office salary	15,000	–
Customers - Suppliers	25,000	35,000
Goods returned	16,000	14,000
Weight charges	450	–
Loan of Man	–	10,000
Carriage inward	1300	–
Goods stock (1-4-16)	42,000	–
Trading expense	1300	–
Wages and outstanding wages	750	2600
Commission paid in advance	350	–
Bank account and cash account	20,700	3000
Interest on loan	400	–
Investment in 8 % govt. security	30,000	–
Current accounts :		
Man	8000	–
Mohan	–	12,000
Total	**6,96,600**	**6,96,600**

Adjustments :

(1) The value of closing stock is ₹ 80,000. It's market value is 10 % more.

(2) Provide depreciation at 10 % on machines and building.

(3) Debtor of ₹ 10,000 became insolvent. 50 % amount will be received as per instructions of his receiver. Provide 5 % bad debt reserve.

(4) 10 % interest is outstanding on bank overdraft.

(5) Goods of ₹ 2000 is missed out to record in sales return book.

18. Sant and Mahant are partners of a firm sharing profit and loss in the proportion of 3:2. From the trial balance of 31-3-2017 and adjustments prepare final accounts of the partnership firm.

Trial Balance of Partnership Firm of Sant and Mahant as on 31-3-17

Debit Balances	Amt. (₹)	Credit Balances	Amt. (₹)
Drawings :		**Capital accounts :**	
Sant	7000	Sant	80,000
Mahant	3000	Mahant	40,000
Plant and Machines	33,300	Creditors	48,000
Addition in plant and machines	24,000	Sale of plants and machines	4800
(from 1-7-2016)		(on 1-4-16, book value ₹ 6900)	
Furniture-fittings	2560	Sales	2,68,000
Debtors	64,940	5 % loan from Gyani (from 1-10-16)	10,000
Advertisment expense	13,248	Commission	800
Cash-bank balance	8496		
Purchases	1,81,168		
Productive wages	45,272		
Electricity expense (Factory)	4296		
Rent-taxes (Office)	872		
Rent-taxes (Factory)	9384		
Technical expense	400		
Opening stock	33,696		
Factory expense	1780		
Office salary	8780		
Discount allowed	4800		
Carriage inward	1700		
Bad debts	836		
Office expenses	2072		
	4,51,600		**4,51,600**

Adjustments :

(1) There was stock of ₹ 85,500.

(2) Provide 15 % depreciation on plant and machines and 7.5 % on furniture and fittings.

(3) Provide bad debts reserve of ₹ 2000 on debtors.

(4) 6 % interest is payable on capital of partners.

(5) Outstanding expenses : Productive wages ₹ 784, advertisement expense ₹ 312, office salary ₹ 400, technical expense ₹ 320.

19. Jay and Prafulla are partners of a partnership firm sharing profit and loss in equal proportion. From the trial balance dated 31-3-17 and additional information, prepare financial accounts of the firm.

Trial Balance of Partnership Firm of Jay and Prafulla as on 31-3-17

Name of Accounts	Debit balance (₹)	Credit balance (₹)
Capital and drawings : Jay	12,000	1,00,000
Prafulla	16,000	1,40,000
Current accounts : Jay	12,000	–
Prafulla	–	4000
Good stock (1-4-16)	60,000	–
Purchase and sales	2,00,000	3,80,000
Goods returned	7000	12,000
Cash and bank	3700	15,750
Bills	18,000	14,000
Rent (upto February 2017)	22,000	–
Building	1,20,000	–
Currents year's depreciation on building	12,000	–
Freight	5300	–
Furniture	84,600	–
Sale of furniture (1.4.16)	–	14,600
Debtors and creditors	48,000	16,800
Salary	20,000	–
Insurance premium (Including ₹ 3600 for the year ending on 30-6-17)	5700	–
Bad debts and bad debt reserve	1000	2000
Loan of Prafulla (from 1-10-16)	–	20,000
Waves	11,000	–
Discount	650	850
Trading expenses	1050	–
Advertisement expenses	8000	–
(Office) Machines (Addition of ₹ 12,000 on 31-12-16)	52,000	–
	7,20,000	**7,20,000**

Adjustments : (1) The value of closing stock is ₹ 60,000. Out of which the market value of 10 % goods is 20 % less and the market value of 20 % goods is 10 % less. The remaining goods of ₹ 42,000 is valued at 25 % less then book value. (2) Provide 10 % interest on capital, 9 % on balance of current accounts and 12 % on drawings. (3) Monthly salary of ₹ 700 is payable to Jay. He has withdrawn salary of 4 months which is included in salary. (4) Prafulla has introduced additional capital of ₹ 20,000 on 1-1-17. (5) Jay has withdrawn ₹ 1000 per month on the last date of each month. Prafulla has withdrawn on 1-10-2016. (6) Calculate depreciation at 9 % on machines and 5 % on furniture. (7) Prafulla has withdrawn goods of ₹ 2000 on 1-12-2016, which is recorded in the sales book at ₹ 2400. (8) One debtor of ₹ 2400 became insolvent and 40 paise per rupee dividend is receivable.

●

3

Valuation of Goodwill

1. Introduction

In practical reconstruction of a partnership firm as per the circumstances, assets and liabilities are revalued at the time of the reconstruction of a partnership. Issue of valuation of goodwill is taken place with revaluation of assets and liabilities. In this chapter, we will study about goodwill and its several aspects.

Firm has two types of assets : (1) Non-current assets (2) Current assets.

Intangible assets, fixed assets and long-term investment are included in non-current assets. Goodwill, patent, trademark, copyright etc. are included in intangible assets. These type of assets can not seen, but they have a value in the market. Goodwill is also an intangible asset which can not be seen but it has its value.

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections, which benefits the business. In accounting, monetary value of such advantage is known as 'Goodwill'.

2. Meaning of Goodwill

In simple words, "Goodwill is an intangible asset which shows the reputation of a firm in the market."

"Goodwill is the value of the reputation of a firm in respect to the profit earning over and above the expected profit."

A firm has a goodwill which has the capacity to earn more profit than a common firm and it is due to its own reputation, specific stable customer and other reasons. Value of goodwill depends on the profit earning capacity of a firm. In short we can say that goodwill does not exist in those businesses which earn normal profit or incur loss. Goodwill is shown in the balance sheet on the assets side under the head of non-current assets as intangible assets.

3. Factors Affecting Valuation of Goodwill

The valuation of goodwill depends on the earning ability of a firm. Business location, business period, types of business, competitiveness of business etc. are the factors that affect the business profit. Therefore, the same reasons also affect the valuation of goodwill. Following are the factors that affect the valuation of goodwill.

(1) Nature of business : Goodwill exists when a firm earns more profit than the expected profit, it earns profit due to a high value added product, it has more profit margin due to stable sales or it earns more profit due to some other reasons.

(2) Location of business : Often, the profit earning capacity of the business depends upon the business location. If the business is centrally located or it is at a place having heavy customer traffic then more profit earning can be seen in the business. The value of goodwill is high at such centrally located businesses. Thus, business location also affects the value of goodwill.

(3) **Period of business :** Generally, older the firm, higher the reputation in the market. Because majority of the customers are familiar and they have very close and long term relations with that particular business unit. Consequently, the value of such business is bound to be high. Thus, the period of business also has an impact on the value of goodwill.

(4) **Market situation :** The monopoly condition or limited competition enables the concerned firm earn to high profit. Therefore the value of goodwill is high in such business. Thus, the value of goodwill also depends on the situation of the business in the market.

(5) **Efficiency of managers :** The efficient management of a business increase the productivity and decreases the cost of a firm. Due to it, profit increase, which increase the value of goodwill.

(6) **Other special benefits :** Goodwill exists when a company enjoys special benefits and the overall profitability increases. For e.g. if a company can acquire license, patent or trademark or earn more profit or has been earning more profit, it is valued of having higher goodwill.

Apart from the above given factors, services after sales, past achievements of a firm, good labour relations etc. also become the reasons to earn more profit. Due to which the goodwill comes into existence.

4. Necessity for Goodwill Valuation

Normally, the need for valuation of goodwill arises at the time of the sale of a business. In the context of a company, the need for valuation of goodwill arises at the time of amalgamation and absorption. In the context of a partnership firm it may also arise in the following circumstances :

(1) Change in the profit sharing ratio amongst the existing partners

(2) Admission of new partner

(3) Retirement of a partner from existing partners

(4) Death of a partner from existing partners

(5) Conversion of partnership firm into a company

(6) Amalgamation of a partnership firm

Amalgamation means two partnership firm join to start a new firm.

5. Methods of Valuation of Goodwill

Since goodwill is an intangible asset, there are specific methods to determineits value. Valuation of goodwill depends on a profit earning capacity of a firm or a business. Prospective earning capacity means future maintainable profit. However, while determining the future maintainable profit, past year's profits are considered as the base. Various methods are available for the valuation of a goodwill. Generally, following methods are used for the valuation of a goodwill.

(1) Average profit method

(2) Weighted average profit method

(3) Super profit method

(4) Capitalization of profit method

(1) **Average Profit Method :** Under this method, the average of the past certain years are taken into consideration. Average profit is to be multiplied by the certain number of years for the valuation of goodwill. It is based on the assumption that a new business will take certain number of

years to earn the same profit. Therefore, the business purchaser is ready to pay the value of goodwill equal to the number of years of average profit. Generally, the multiplication of average profit and the number of years during which the anticipated profits are expected is known as goodwill.

(1) Average profit $= \dfrac{\text{Total profit of given years}}{\text{No. of years}}$

(2) Goodwill = Average profit × No. of years of purchase (defined years)

For example, if the past five years average profits of a business is ₹ 1,20,000. Three years are required to earn ₹ 1,20,000 annual profit for a new businessman. Under this method the value of goodwill is ₹ 1,20,000 × 3 = 3,60,000. Thus, profit receivable after three years is started from the current year.

Illustration 1 : Determine the value of goodwill based on 3 years purchase of last 5 years average profit, from the following information of a partnership firm of Nilesh and Nikunj. Last five years' profit information is as under :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000

Ans. :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000
Total	**10,35,000**

Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$

$= \dfrac{10{,}35{,}000}{5}$

Average profit = 2,07,000

Goodwill = Average profit × No. of years purchased

= 2,07,000 × 3

Goodwill = 6,21,000

Illustration 2 : Hasu and Vasu are partners of a firm. They contemplate to change their profit and loss distribution ratio from 2:1 to 1:1. Therefore, it is determined for valuation of goodwill. From the following information, determine the value of the firm's goodwill. As per the agreement of the partnership, the value of goodwill is to be computed at 5 years purchase of the average profit of last 4 years.

Year	Profit/Loss (₹)
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000

Ans. : Here loss is incurred in the year 2014-15. We must take the loss into consideration while calculating the average profit.

Note : Amount mentioned in (   ) is '–' means loss indication. In account whenever amount is mentioned in (   ) then it is called '–'.

Year	Profit
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000
Total	**2,40,000**

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{2,40,000}{4}$$

Average profit = 60,000

Goodwill = Average profit × No. of years purchased

= 60,000 × 5

Goodwill = 3,00,000

In simple average method, calculation of goodwill is based on the assumption that no change in the overall situation of profit is expected in future. This method does not consider the increasing and decreasing trends of profits. Capital employed is also not considered. To eliminate these limitations, various methods are used.

(2) **Weighted Average Profit Method :** We have seen that in simple average method the trend of profit is neglected. Sometimes, it can be seen that there is continuous increasing trend in profit. Under such circumstances, we should give more weightage to the profit of recent years and give comparatively less weightage to the profits of previous years. Generally the weightage of different year's profit are numbered as 1, 2, 3, 4,...

Average workout after giving weightage to different year's profit, it is called weightage average profit. If the computation of goodwill is made on the basis of weighted average profit then it is called weighted average method of goodwill.

If specific instruction is given that compute as per weighted average method or every year profit increasing or decreasing trend then compute goodwill as per the weighted average method.

As per this method, computation of goodwill should be done as shown on page number 93.

Step No. 1 : To prepare table.

Statement Showing Weighted Average Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	✓	1	✓
2013-14	✓	2	✓
2014-15	✓	3	✓
2015-16	✓	4	✓
		10	✓
		↑ Total weight	↑ Total profit (product)/weighted

Step No. 2 : Weightage average profit = $\frac{\text{Total weighted profit}}{\text{Total weight}}$

Step No. 3 : Goodwill = Weightage average profit × No. of years of purchase

Note : Average or weightage average method for computation of goodwill should be specified clearly.

Illustration 3 : From the following information find out weighted average profit.

Year	Profit
2013-14	40,000
2014-15	50,000
2015-16	60,000
2016-17	70,000

Ans. : In this illustration it can be seen that every year profit is increasing, it means the trend of profit is increasing. It can be also estimated that profit will be increased in future. In this type of circumstances, weightage average method for valuation of goodwill is a proper method. Here, the highest weight will be given to recent year (2016-17) or the highest profit is in this year. Gradually less weight will be given to the previous years.

It means 1 weight to year 2013-14, 2 wieght to year 2014-15, 3 weight to year 2015-16 and 4 weight to year 2016-17 will be given.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2013-14	40,000	1	40,000
2014-15	50,000	2	1,00,000
2015-16	60,000	3	1,80,000
2016-17	70,000	4	2,80,000
	Total	**10**	**6,00,000**

Step No. 2 : Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$$= \frac{6,00,000}{10}$$

Weighted average profit = 60,000

Illustration 4 : From the following information compute the value of goodwill of Mina and Bhadresh's firm at three years' purchase of weighted average profit on the basis of last five years.

Year	Profit
2012-13	80,000
2013-14	1,20,000
2014-15	1,40,000
2015-16	1,60,000
2016-17	1,70,000

Ans. : Here, the profit of last five years has upward trend, therefore the application of weighted average method for the computation of goodwill is relevant. Though, weighted average method for valuation of goodwill is specified in the example.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	80,000	1	80,000
2013-14	1,20,000	2	2,40,000
2014-15	1,40,000	3	4,20,000
2015-16	1,60,000	4	6,40,000
2016-17	1,70,000	5	8,50,000
	Total	**15**	**22,30,000**

Step No. 2 : Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$$= \frac{22,30,000}{15}$$

Weighted average profit = 1,48,666.67

= ₹ 1,48,667

Step No. 3 : Goodwill = Weighted average profit × No. of years purchase

= 1,48,667 × 3

Goodwill = 4,46,001

(3) **Super Profit Method :** In this method, capital employed by business, expected rate of return, expected profit, average profit etc. are used for super profit. The excess of average profit over the expected profit is called 'Super profit'. So, when a business earns excess profit over average profit,

then the amount of excess profit is called super profit. On the basis of this super profit, valuation of goodwill is made.

(1) Capital employed = Total assets ✓

− Total external liabilities ✓

✓

(2) Expected rate of return (It is given in example.)

(3) Expected profit $= \dfrac{\text{Capital employed} \times \text{Expected rate of return}}{100}$

(4) Average profit = (After adjustment)

(5) Super profit = Average profit − Expected profit

(6) Goodwill = Super profit × No. of years of purchase

Note : Capital employed is also known as net assets.

Illustration 5 : Pratibha and Pushpa are the partners of a firm. They want to change the profit and loss sharing ratio from 3:2 to 1:1. They decided to determine the valuation of goodwill.

On the basis of the firm's profit and other information, determine the valuation of goodwill on the basis of three years purchase of super profit.

Assets	₹ 12,00,000
Liabilities	₹ 4,00,000
Expected rate of return	10 %

Actual profit

Year	Profit (₹)
2014-15	1,30,000
2015-16	1,10,000
2016-17	1,20,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed : Total assets = 12,00,000 − Total liabilities 4,00,000 Net assets / capital employed 8,00,000 →	8,00,000
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 10 %	80,000
(4)	Average profit : **Year** **Profit (₹)** 2014-15 1,30,000 2015-16 1,10,000 2016-17 1,20,000 **3,60,000**	1,20,000

	Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$	
	$= \dfrac{3,60,000}{3}$	
	Average profit = 1,20,000	
(5)	Super profit = Average profit − Expected profit	40,000
	= 1,20,000 − 80,000	
	= 40,000	
(6)	Goodwill = Super profit × No. of years of purchase	1,20,000
	= 40,000 × 3	
	Goodwill = 1,20,000	

Illustration 6 : Pooja and Prarthna's firm capital is ₹ 8,00,000 and expected rate of return is 12 %. Last three year's profit are ₹ 1,00,000, ₹ 1,40,000 and ₹ 90,000 respectively. Determine the value of goodwill of the firm on the basis of 2 yeras purchase of last three years average super profit.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	8,00,000
(2)	Expected rate of return (Interest rate in the market)	12 %
(3)	Expected profit = Capital employed × Expected rate of return	96,000
	= 8,00,000 × 12 %	
(4)	Average profit :	1,10,000
	Year — **Profit**	
	1 — 1,00,000	
	2 — 1,40,000	
	3 — 90,000	
	3,30,000	
	Average profit $= \dfrac{\text{Total profit}}{\text{No. of years}}$	
	$= \dfrac{3,30,000}{3}$	
	Average profit = 1,10,000	
(5)	Super profit = Average profit − Expected profit	14,000
	= 1,10,000 − 96,000	
	= 14,000	
(6)	Goodwill = Super profit × No. of years of purchase	28,000
	= 14,000 × 2	
	Goodwill = 28,000	

(4) **Capitalization of Profit Method :** In this method, average profit of a business is computed and it is used to determine its capitalised value on the basis of normal / expected rate of return of the business. This type of profit received is called capitalisation of profit. Thus, capitalised profit means capitalised value of average profit on the basis of the expected rate of return.

$$\text{Capitalised profit} = \frac{\text{Expected profit}}{\text{Expected rate of return}} \times 100 \textbf{ or } = \frac{\text{Average profit}}{\text{Expected rate of return \%}}$$

e.g. Average profit of business is ₹ 90,000 and expected rate of return is 10 %. Capitalised profit will be found as under.

$$\text{Capitalised profit} = \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$$

$$= \frac{90{,}000}{10} \times 100$$

Capitalised profit = ₹ 9,00,000

Capitalised profit is compared with the capital employed in the business. If capitalised profit amount is more than the capital employed, then the difference amount is called goodwill. If capitalised amount is equal to the capital employed or less, then there is no goodwill of the business.

Goodwill = Capitalised profit − Capital employed

e.g. Capital employed is ₹ 7,00,000 and capitalised profit is ₹ 9,00,000, then goodwill is ₹ 2,00,000.

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 7,00,000

Goodwill = ₹ 2,00,000

Following explanation is not expected for exam.

Capitalised profit means how much net assets (capital employed) is required to earn average profit on the basis of expected rate of return. In this question expected rate of return is 10 %. Average profit is ₹ 90,000. So ₹ 9,00,000 net assets (capital employed) is required to earn ₹ 90,000 on the basis of 10 %. But actual net assets are ₹ 7,00,000. So ₹ 70,000 profit must be received on ₹ 7,00,000 at 10 %.

₹ 90,000 × $\frac{100}{10}$ = ₹ 9,00,000 net assets required

− ₹ 70,000 × $\frac{100}{10}$ = ₹ 7,00,000 actual net assets

₹ 20,000 × $\frac{100}{10}$ = ₹ 2,00,000 difference of asset is called goodwill

(a) If capital employed is ₹ 9,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 9,00,000

Goodwill = 0

(b) If capital employed is ₹ 10,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 10,00,000

Goodwill = −1,00,000

There is no goodwill in (a) and (b). Capital employed and capitalised profit both are equal in (a). There is no goodwill in (b) because capital employed is more than capitalised profit.

In short, following steps are used for the computation of the valuation of the goodwill as per the capitalisation profit method.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	✓
	Total assets ✓	
	− Total liabilities ✓	
	Net assets / capital employed ✓	
(2)	Expected rate of return	✓
(3)	Average profit	✓
(4)	Capitalised profit $= \dfrac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	✓
(5)	Goodwill = Capitalised profit − Capital employed	✓

Note : If answer of step no. 5 is '0' (zero) or negative then no goodwill exists in that business.

Illustration 7 : From the following information of Manoj and Harish's firm, determine the value of goodwill by capitalised average profit method.

Year	Profit (₹)
2012-13	90,000
2013-14	1,00,000
2014-15	1,10,000
2015-16	1,30,000
2016-17	1,50,000

Additional information : (1) Assets of business ₹ 13,40,000 (2) Liabilities of business ₹ 3,40,000 (3) Normal expected rate of return of business is 10 %.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	10,00,000
	Assets = 13,40,000	
	− Liabilities 3,40,000	
	Net assets / capital employed 10,00,000	
(2)	Expected rate of return	10 %
(3)	Weighted average profit (As per note no. 1)	1,26,000
(4)	Capitalised profit $= \dfrac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	12,60,000
	$= \dfrac{1,26,000}{10} \times 100 = \mathbf{12,60,000}$	

(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 10,00,000 **Goodwill = 2,60,000**	2,60,000

Note no. 1 : Calculation of weighted average profit

In this example, profit is continuously increasing since last five years. Therefore, average profit will be computed as per the weighted average method.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,00,000	2	2,00,000
2014-15	1,10,000	3	3,30,000
2015-16	1,30,000	4	5,20,000
2016-17	1,50,000	5	7,50,000
	Total	**15**	**18,90,000**

$$\text{Weighted average profit} = \frac{\text{Total weighted profit}}{\text{Total weight}}$$

$$= \frac{18{,}90{,}000}{15}$$

Weighted average profit = ₹ 1,26,000

Super profit capitalization method : Super profit can be capitalised directly and can determine the value of goodwill. It is not required to capitalised the average profit under this method. Following computation should be done to determining value of goodwill.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed : Total assets ✓ − Total liabilities ✓ Capital employed ✓	✓
(2)	Expected rate of return	✓
(3)	Expected profit = Capital employed × Expected Rate of return	✓
(4)	Average profit	✓
(5)	Super profit (Average profit − Expected profit)	✓
(6)	Goodwill = $\frac{\text{Super profit}}{\text{Expected rate of return}} \times 100$	✓

Note : If super profit is zero or negative (−), then it is no goodwill exists in the business.

Illustration 8 : Determine the value of goodwill of Virat and Anushka's firm as per the capitalisation of super profit method.

(1) Capital employed = 7,80,000

(2) Expected rate of return = 12 %

(3) Last 5 years profit :

Year	Profit (₹)
2012-13	2,00,000
2013-14	2,70,000
2014-15	2,40,000
2015-16	2,50,000
2016-17	2,30,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	7,80,000
(2)	Expected rate of return	12 %
(3)	Expected profit = Capital employed × Expected rate of return = 7,80,000 × 12 % = 93,600	93,600
(4)	Average profit : **Year** **Profit** 2012-13 2,00,000 2013-14 2,70,000 2014-15 2,40,000 2015-16 2,50,000 2016-17 2,30,000 **11,90,000** Average profit = $\frac{\text{Total profit}}{\text{No. of years}} = \frac{11,90,000}{5} = 2,38,000$	2,38,000
(5)	Super profit = Average profit − Expected profit = 2,38,000 − 93,600 = 1,44,400	1,44,400
(6)	Goodwill = $\frac{\text{Super profit}}{\text{Expected rate of return}} = \frac{1,44,400}{12\ \%} = 12,03,333.33$ Goodwill = 12,03,333	12,03,333

Special Illustration :

Illustration 9 : Harpal, Rajesh and Jayesh's firm's information is as under :

(1) Business assets : ₹ 10,00,000

(2) Business liabilities : ₹ 2,00,000

(3) Expected rate of return : 10 %

(4) Firm's last five years profit are as under :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000

From the above information, determine the value of goodwill of the firm.

(1) Calculate the goodwill of the firm equal to five years average profit.

(2) On the basis of 3 years purchase of average profit.

(3) On the basis of 2 years purchase of weighted average profit.

(4) On the basis of 4 years purchase of super profit (Weighted average basis).

(5) As per capitalisation profit method. (Weighted average basis).

(6) As per capitalisation of super profit. (Weighted average basis).

Ans. :

(1) As per last five years average profit method :

Goodwill :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000
	5,90,000

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{5,90,000}{5}$$

Average profit = 1,18,000

Goodwill = Average profit

∴ $\boxed{\textbf{Goodwill = 1,18,000}}$

(2) Goodwill is equal to 3 years purchase of average profit :

Average profit = 1,18,000 [5,90,000 / 5]

(As per previous calculation)

Goodwill = Average profit × No. of years of purchase

= 1,18,000 × 3

Goodwill = 3,54,000

(3) **Goodwill as per weighted average profit method :**

Statement Showing Computation of Weighted Average Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,10,000	2	2,20,000
2014-15	1,20,000	3	3,60,000
2015-16	1,30,000	4	5,20,000
2016-17	1,40,000	5	7,00,000
	Total	**15**	**18,90,000**

Weighted average profit $= \dfrac{\text{Total weighted profit}}{\text{Total weight}}$

$= \dfrac{18,90,000}{15}$

Weighted average profit = ₹ 1,26,000

Goodwill = Weighted average profit × No. of years of purchase

= 1,26,000 × 2

Goodwill = 2,52,000

(4) **On the basis of 4 years purchase of super profit :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	8,00,000
	Total assets 10,00,000	
	− Total external liabilities 2,00,000	
	Capital employed 8,00,000	
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return	80,000
	= 8,00,000 × 10 % = 80,000	
(4)	Average profit : (Weighted average profit)	1,26,000
	Note : Here, weighted average profit ₹ 1,26,000 will be calculated as per previous method.	
(5)	Super profit = Average profit − Expected profit	46,000
	= 1,26,000 − 80,000 = 46,000	

(6)	Goodwill = Super profit × No. of years of purchase = 46,000 × 4 Goodwill = 1,84,000	1,84,000

(5) **Profit capitalisation method :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Average profit (Weighted average) (As per previous method)	1,26,000
(4)	Capitalised profit $= \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$ $= \frac{1,26,000}{10} \times 100 = \mathbf{12,60,000}$	12,60,000
(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 8,00,000 **Goodwill = 4,60,000**	4,60,000

(6) **Super profit capitalisation method :**

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 10 % = 80,000	80,000
(4)	Average profit (Weighted average) (As per previous method)	1,26,000
(5)	Super profit = Average profit − Expected profit = 1,26,000 − 80,000 = 46,000	46,000
(6)	Goodwill $= \frac{\text{Super profit}}{\text{Expected rate of return}} \times 100 = \frac{46,000}{10} \times 100$ Goodwill = 4,60,000	4,60,000

Note : (1) Value of goodwill is zero where super profit is zero or negative (–), it means no existence of goodwill. (2) If there is loss in business, then there is no existence of goodwill.

EXERCISE

1. Select the correct answer for each question :

(1) 'Goodwill' is which type of asset ?

(a) Tangible asset (b) Intangible asset

(b) Current asset (d) Fictitious asset

(2) Goodwill depends on which aspect ?

(a) On employee of business enterprise

(b) On management of business enterprise

(c) On assets of business enterprise

(d) On future maintainable profit

(3) Goodwill is a financial value of ....

(a) investment (b) prestige of business enterprise

(c) fixed assets (d) competition

(4) Goodwill is .... where individual skill is important.

(a) more (b) less

(c) zero (d) negative

(5) Which method is appropriate for the computation of goodwill when every year profit is increasing ?

(a) Simple average (b) Weighted average

(c) Annual growth rate (d) Compound growth rate

(6) Expected profit = ...

(a) Capital employed × Expected rate of return

(b) Average profit × Expected rate of return

(c) Weighted average profit × Expected rate of return

(d) Assets × Expected rate of return

(7) Super profit means ....

(a) Capital employed – Expected profit (b) Expected profit – Capital employed

(c) Average profit – Expected profit (d) Expected profit – Average profit

2. Answer the following questions in one sentence :

(1) What is goodwill ?

(2) What is revaluation of goodwill ?

(3) Which type of asset is 'goodwill' ?

(4) Under which head goodwill is shown in the balance sheet ?

(5) What is capitalised profit ?

(6) What is super profit ?

(7) What is average profit ?

(8) What is weighted average profit ?

3. Answer the following questions :

(1) Give the meaning of goodwill and explain the factors affecting to its valuation.

(2) Explain the nature of goodwill.

(3) Explain the simple average method for the valuation of goodwill.

(4) Explain the weighted average method for the valuation of goodwill.

(5) Explain the super profit method for the valuation of goodwill.

(6) Explain the profit capitalisation method for the valuation of goodwill.

4. From the following information of Bhavesh and Vipul's firm, compute the value of goodwill on the basis of 4 years purchase of last five years average profit. Information of last five years profit is as under :

Year	Profit (₹)
2011-12	1,00,000
2012-13	1,10,000
2013-14	1,80,000
2014-15	2,00,000
2015-16	1,50,000

5. Mahendra and Pravin are partners of a firm sharing profit and loss in the ratio of 3:2. They want to change their profit-loss sharing ratio to 1:1. Therefore, they decided to make valuation of goodwill. As per partnership agreement, value of goodwill to be determine on the basis of 5 years purchase of last 4 years average profit.

Year	Profit (₹)
2013-14	60,000
2014-15	80,000
2015-16	(20,000)
2016-17	30,000

6. From the following information find out weighted average profit :

Year	Profit (₹)
2013-14	60,000
2014-15	70,000
2015-16	90,000
2016-17	1,10,000

7. From the following information of Babulal and Kantilal's firm, determine the value of goodwill on the basis of 3 years purchase of last five years weighted average profit :

Year	Profit (₹)
2012-13	40,000
2013-14	60,000
2014-15	75,000
2015-16	90,000
2016-17	1,20,000

8. Pushpa, Pratibha and Bhavna are partners of a partnership firm. They decided to change their profit-loss sharing ratio from 3:2:1 to 1:1:1. Therefore they decided to make the valuation of goodwill. On the basis of partnership firm's profit and other information, determine the value of goodwill on the basis of three years purchase of super profit.

Assets : ₹ 6,00,000; Liabilities : ₹ 2,50,000; Expected rate of return : 10 %

Actual profit :

Year	Profit (₹)
2014-15	80,000
2015-16	70,000
2016-17	90,000

9. Capital of Meena and Manju's firm is ₹ 4,00,000 and expected rate of return is 10 %. Last three year's profits are ₹ 1,20,000, ₹ 1,10,000 and ₹ 1,00,000 respectively. Compute the value of goodwill two times of super profit on the basis weighted average method..

10. From the following information of Nairutva and Rutvik's firm determine the value of goodwill of partnership firm on the basis of capitalisation of weighted average profit method.

Year	Profit (₹)
2012-13	45,000
2013-14	50,000
2014-15	65,000
2015-16	75,000
2016-17	90,000

Additional information :

(1) Business assets : ₹ 6,00,000 (2) Business liabilities : ₹ 1,70,000

(3) Normal expected return of business is 10 %.

11. Determine the value of goodwill of Prabha and Prabhu's firm on the basis of capitalised super profit method.

(1) Capital employed : ₹ 9,00,000 (2) Expected rate of return : 12 %

(3) Last five years profit :

Year	Profit (₹)
2012-13	1,00,000
2013-14	1,40,000
2014-15	1,30,000
2015-16	1,50,000
2016-17	1,80,000

12. Rajesh and Harish are partners of a partnership firm. On the basis of their partnership firm's profit and other information, determine the value of goodwill on the basis of two years purchase of super profit.

(1) Capital employed : ₹ 8,00,000 (2) Expected rate of return : 12 %

(3) Previous years profit :

Year	Profit (₹)
2014-15	1,20,000
2015-16	90,000
2016-17	1,50,000

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 :

$$\textbf{Sacrifice = Old share − New share}$$

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

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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.

●

5

Admission of a Partner

1. Introduction

Admission of a partner means reconstitution of the partnership. With the admission of a partner, the existing agreement comes to an end and a new agreement among all the partners including the new partner comes into existence. The capital contribution by the new partner, his share of profit, goodwill and other conditions are agreed upon. The new partner, on joining becomes liable for the liabilities of the firm and he is also entitled to have a share in the assets and profits of the firm.

Section 31 of the Indian Partnership Act, 1932 provides that a new partner shall not be admitted in the firm without the consent of all the existing partners, unless it has been agreed otherwise by the partners in the partnership agreement.

A new partner may be admitted in a continuing firm because of the following reasons :

(1) When the continuing firm needs additional capital

(2) When the continuing firm requires additional managerial ability

(3) When any continuing partner retires or dies

(4) When skilled and efficient employees of the firm need to continued in the firm, therefore he is admitted by the firm as a partner

(5) For the distribution of risk of the partnership firm

The share of future profits which the incoming partner receives is equal to the sacrifice of profit made by the existing partners of the firm. The new partner compensates the partner or partners who sacrifice their share in profits. The amount he pays against this sacrifice is called goodwill or premium for goodwill. Besides the goodwill or premium for goodwill, he also brings in capital to get right in the assets of the firm and brings goodwill to get right in the profits. Amount of capital remains in the firm while amount of goodwill is distributed among the old partners in their sacrificing ratio.

2. Effects of Admission of a New Partner

The effects of admission of a new partner are as follows :

(1) The old partnership comes to an end and new partnership comes into existence.

(2) New partner becomes entitled to share future profits of the firm and therefore the combined share of the old partners' profit gets reduced.

(3) New partner contribnutes an agreed amount of capital in cash or in kind and acquires right on the assets of the firm.

(4) Balances of accumulated profits and losses, reserves and fictitious assets appearing in the books on the date of admission is distributed to the old partners in their old profit sharing ratio.

(5) Assets are revalued and liabilities are reassessed and net change is adjusted in the old partners' capital accounts.

(6) The goodwill of the firm is revalued and new partner contributes his share of goodwill in a cash or kind and its accounting effect is given.

(7) Accounting effect is also given for maintaining agreed capital in the new firm among the old partners, if decided in the new partnership agreement.

Thus, at the time of admission of a new partner following adjustments are required to be made :

(1) Calculation of new profit and loss sharing ratio and old partners' sacrificing ratio.

(2) Accounting effects relating to goodwill.

(3) Accounting effect of profits/losses arising from revaluation of assets and reassessement of liabilities.

(4) Accounting effect of accumulated profits, losses and reserves

(5) Adjustment of change in capital.

Let us now discuss each of the above cases :

3. Change in Profit Sharing Ratio

The new partner acquires some share out of the future profit of the firm, which is sacrificed by the old partners. Consequently new profit sharing ratio of all the partners and sacrificing ratio of old partners come into existence after the admission of a new partner. Thus following two ratios are required to be calculated at the time of admission of a new partner.

(A) Calculation of new profit-loss sharing ratio

(B) Calculation of sacrificing ratio

Now let us discuss the computation of both the proportion in detail.

Calculation of new profit-loss sharing ratio and sacrificing ratio :

New profit sharing ratio means ratio in which all partners including the new partner decide to share future profit or loss of the firm.

New profit-loss sharing ratio can be calculated as per the following circumstances :

(1) When sacrificing share or sacrificing ratio of old partners is not given (In other words, when old ratio of old partners and profit share to be given to the old partner is given) :

When old profit-loss sharing ratio of old partners and profit share of new partner is given it is asumed that the remaining profit after giving share in profit to new partner will be distributed among old partners in their old profit-loss sharing ratio.

Illustration 1 : A and B are the partners in a firm sharing profit & loss in the ratio of 3:2. C is admitted for $\frac{1}{4}$th share in the profit. Calculate the new profit sharing ratio.

Ans. : Old sharing ratio of A and B = 3:2

Let the total share of profit = 1

C's share = $\frac{1}{4}$, after giving $\frac{1}{4}$th share to C,

Remaining share of A and B = Total profit − Share of new partner

$$= 1 - \frac{1}{4}$$

$$= \frac{4-1}{4}$$

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

Remaining share for A and B is $\frac{3}{4}$ which is to be distributed in their old sharing ratio 3:2.

New share of old partners = Remaining share of profit × Share in old ratio

A's new share = $\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$

B's new share = $\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$

C's new share = $\frac{1}{4}$, Making denominator equal $\frac{1}{4} \times \frac{5}{5} = \frac{5}{20}$

∴ New profit sharing ratio of A, B and C = 9:6:5

Explanation : Here it is assumed that the old partners will maintain their relative old ratio even after the admission of a new partner. It means profit share to be given to the new partners will be sacrificed by the old partners in their old ratio only. Therefore, Relative old ratio = Sacrificing ratio = New ratio.

Sacrificing ratio of old partners can be calculated in illustration 1 as under :

	A		B		C
Old ratio	3	:	2	:	–
Old share	$\frac{3}{5}$	:	$\frac{2}{5}$	:	–
New ratio	9	:	6	:	5
New share	$\frac{9}{20}$	:	$\frac{6}{20}$	:	$\frac{5}{20}$

Sacrifice = Old share − New share

$$A = \frac{3}{5} - \frac{9}{20} = \frac{12-9}{20} = \frac{3}{20}$$

$$B = \frac{2}{5} - \frac{6}{20} = \frac{8-6}{20} = \frac{2}{20}$$

So, sacrificing ratio of A and B = 3:2.

Note : When sacrificing share or sacrificing ratio is not given and the old ratio of old partners and new partners' share is given, relative old ratio of old partners will be their sacrificing ratio.

(2) When the old ratio of old partners, share of new partner and the new ratio of old partners are given :

Illustration 2 : A and B are the partners of a firm sharing profit in the ratio of 2:1. C is admitted for $\frac{1}{5}$ share in the profit. In future, the profit sharing ratio of A and B would be 2:3.

Calculate the new profit sharing ratio.

Ans. : Assume that total share of profit = 1

Remaining share for A and B = Total share − New partners' share

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

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

$= \frac{4}{5}$

Remaining share of A and B is $\frac{4}{5}$ which will be distributed by A and B in their new ratio, that is 2:3.

New share of old partners = Remaining share of profit × Share in new ratio

A's new share = $\frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$

B's new share = $\frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$

C's new share = $\frac{1}{5}$, Making denominator equal, $\frac{5}{25}$

∴ New profit-loss sharing ratio of A, B and C = 8:12:5

(3) When a new partner acquires specific share from old partners :

When sacrifice made by old partners is given, new share of old partners can be obtained by substracting sacrificing share from old share.

Thus, new share of old partners = Old share − Sacrifice

Illustration 3 : A and B are the partners in a firm sharing profits and losses in the ratio of 4:3. They admitted C as a new partner with $\frac{1}{7}$ share. C obtained $\frac{2}{21}$ share from A, and $\frac{1}{21}$ from B. Calculate the new profit sharing ratio.

Ans. : Old profit sharing of A and B = 4:3 means $\frac{4}{7} : \frac{3}{7}$

Share of C = $\frac{1}{7}$

C obtains $\frac{2}{21}$ share from A and $\frac{1}{21}$ share from B.

∴ A's sacrifice = $\frac{2}{21}$ (from their own share)

B's sacrifice = $\frac{1}{21}$ (from their own share)

New share = Old share − Sacrifice

A's new share = $\frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$

B's new share = $\frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$

C's new share = $\frac{1}{7}$, Making denominator equal, $\frac{3}{21}$

∴ New profit-loss sharing ratio of A, B and C = 10:8:3

Explanation : (1) C's $\frac{1}{7}$th share must be equal to the sacrifice of A and B. It means,

$$\text{C's share} = \text{A's sacrifice} + \text{B's sacrifice}$$

$$= \frac{2}{21} + \frac{1}{21}$$

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

$$= \frac{1}{7}$$

(2) A's sacrifice is $\frac{2}{21}$ and B's sacrifice is $\frac{1}{21}$. If the sacrificing ratio of A and B is to be ascertained, it will be $\frac{2}{21} : \frac{1}{21}$ it means 2:1.

Thus, sacrifice and sacrificing ratio are two different things. In the above illustration, sacrificing ratio is given instead of sacrifice of A and B, means it is given that A and B will sacrifice C's $\frac{1}{7}$th share in the ratio of 2:1, it is first necessary to calculate the sacrifice of A and B.

Sacrifice = New partners' share × Sacrificing ratio of old partners

$$\text{A's new share} = \frac{1}{7} \times \frac{2}{3} = \frac{2}{21}$$

$$\text{B's new share} = \frac{1}{7} \times \frac{1}{3} = \frac{1}{21}$$

New profit-loss sharing ratio can be ascertained only after calculating sacrificing share.

New share = Old share − Sacrifice

$$\text{A's new share} = \frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$$

$$\text{B's new share} = \frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$$

C's new share = $\frac{1}{7}$, Making denominator equal, $\frac{3}{21}$

∴ New profit-loss sharing ratio of A, B and C = 10:8:3

(4) **When sacrificing ratio of old partners is given :**

When sacrificing ratio of old partners is given, sacrificing share of old partners is to be ascertained first with the help of the following formula :

Sacrifice of old partners = Share of new partner × Sacrificing ratio of old partner

After calculating the sacrifice of old partners, new profit-loss sharing ratio of all partners is to be ascertained with the help of the following formula :

New share = Old share − Sacrifice

Illustration 4 : A and B are the partners of a firm sharing profits and loss in the ratio of 5:3. They admit C, a new partner, who acquires $\frac{1}{4}$th share in the firm. C obtains his share from A and B in the ratio of 3:1. Find out new profit-loss sharing ratio.

Ans. : Old profit sharing ratio of A and B = 5:3 means $\frac{5}{8} : \frac{3}{8}$.

C's share = $\frac{1}{4}$, C obtains his share from A and B in the ratio of 3:1.

Sacrifice of old partners = New partners' share × Sacrificing ratio of old partner

$\therefore$ A's sacrifice $= \frac{1}{4} \times \frac{3}{4} = \frac{3}{16}$

B's sacrifice $= \frac{1}{4} \times \frac{1}{4} = \frac{1}{16}$

New share of old partners = Old share − Sacrifice

$\therefore$ A's new share $= \frac{5}{8} - \frac{3}{16} = \frac{10-3}{16} = \frac{7}{16}$

B's new share $= \frac{3}{8} - \frac{1}{16} = \frac{6-1}{16} = \frac{5}{16}$

and C's new share $= \frac{1}{4}$, Making denominator equal, $\frac{4}{16}$

$\therefore$ New profit-loss sharing ratio of A, B and C = 7:5:4

(5) When old partners sacrifice particular fraction of their share in favour of the new partner :

Illustration 5 : A and B are partners. They admit C as a new partner. 'A' sacrifices $\frac{1}{5}$th of his share and B sacrifices $\frac{1}{4}$th of his share in favour of C. Calculate new profit and loss sharing ratio and sacrificing ratio.

Ans. : Old profit sharing ratio of A and B = 1:1 means $\frac{1}{2} : \frac{1}{2}$

A sacrifices $\frac{1}{5}$th of his share to C

$\therefore$ A's sacrifice = A's old share × Share of his sacrifice

$\therefore$ A's sacrifice $= \frac{1}{2} \times \frac{1}{5} = \frac{1}{10}$

B sacrifices $\frac{1}{4}$th of his share to C.

$\therefore$ B's sacrifice = B's old share × Share of his sacrifice

$\therefore$ B's sacrifice $= \frac{1}{2} \times \frac{1}{4} = \frac{1}{8}$

New share = Old share − Sacrifice

$\therefore$ A's new share $= \frac{1}{2} - \frac{1}{10} = \frac{5-1}{10} = \frac{4}{10}$

B's new share $= \frac{1}{2} - \frac{1}{8} = \frac{4-1}{8} = \frac{3}{8}$

A and B sacrifice some of their share in favour of C. Therefore share of A and B will reduce, which is received by C. Sacrifice of A and B will be deducted from their old share and sacrifice of A and B will be received by C.

C's new share $= \frac{1}{10} + \frac{1}{8} = \frac{4+5}{40} = \frac{9}{40}$

$\therefore$ New profit-loss sharing ratio of A, B and C $= \frac{4}{10} : \frac{3}{8} : \frac{9}{40}$; Making denominator equal,

$= \frac{16}{40} : \frac{15}{40} : \frac{9}{40} = 16 : 15 : 9$

Now, ascertainment of sacrificing ratio of A and B,

$\therefore$ A's sacrifice $= \frac{1}{10}$

B's sacrifice $= \frac{1}{8}$

$\therefore$ Sacrificing ratio of A and B $= \frac{1}{10} : \frac{1}{8}$; Making denominator equal $= \frac{4}{40} : \frac{5}{40}$

$= 4 : 5$

(6) When old partners sacrifice some share out of their share in favour of the new partner :

Illustration 6 : A and B are the partners of a firm sharing profit-loss in the ratio of 2:1. C is admitted as a new partner from 1-4-2017.

'A' sacrifices $\frac{1}{12}$ from his share while 'B' sacrifices $\frac{1}{6}$ from his share to C.

Determine the sacrificing ratio and the new profit-loss sharing ratio.

Ans. : Sacrificing ratio :

A's sacrifice = $\frac{1}{12}$ and B's; sacrifice = $\frac{1}{6}$. Making denominator equal, $\frac{1}{12}$ and $\frac{2}{12}$.

$\therefore$ Sacrificing ratio is 1:2

C's share (A's sacrifice + B's sacrifice)

$\therefore$ $\frac{1}{12} + \frac{1}{6} = \frac{1}{4}$

New profit-loss sharing ratio :

A's old share $\frac{2}{3}$ − share of sacrifice $\frac{1}{12} = \frac{8-1}{12} = \frac{7}{12}$

B's old share $\frac{1}{3}$ − share of sacrifice $\frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$ Making denominator equal,

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

New ratio of A, B and C = 7 : 2 : 3

(7) When one partner from old partners retains his old share after the admission of a new partner :

Illustration 7 : A, B and C are the partners of a firm. Their profit sharing ratio is $\frac{1}{2}$, $\frac{3}{10}$ and $\frac{1}{5}$ respectively. They admit D, as a new partner for $\frac{1}{6}$th share. C would retain his original share after D's admission. Calculate new profit-loss sharing ratio.

Ans. : Old ratio of A, B and C $= \frac{1}{2} : \frac{3}{10} : \frac{1}{5}$

= 5:3:2 (Making denominator equal)

New partner D's share $= \frac{1}{6}$

After admission of D, share of C = $\frac{1}{5}$ will be maintained

$\therefore$ Remaining share for A and B = Total share − C's share − D's share

$\therefore$ Remaining share for A and B $= 1 - \frac{1}{5} - \frac{1}{6}$ or $1 - \left(\frac{1}{5}+\frac{1}{6}\right)$

$= \frac{30-6-5}{30} = \frac{19}{30}$ or $\frac{30-(6+5)}{30} = \frac{19}{30}$

A and B will acquire remaining share $\frac{19}{30}$ in their relative ratio of 5:3.

$\therefore$ A's new share $= \frac{19}{30} \times \frac{5}{8} = \frac{95}{240}$

$$\left.\begin{array}{l} \text{B's new share} = \frac{19}{30} \times \frac{3}{8} = \frac{57}{240} \\ \text{C's new share} = \frac{1}{5} = \frac{48}{240} \\ \text{D's new share} = \frac{1}{6} = \frac{40}{240} \end{array}\right| \text{(Making denominator equal)}$$

$\therefore$ New ratio of profit and loss = 95 : 57 : 48 : 40

(8) When sacrifice made by some old partners is given and sacrifice made by other old partners is not given :

Illustration 8 : A and B are partners sharing in the ratio of 3:2. They admitted C for $\frac{1}{5}$th of the profits. Out of which he takes $\frac{1}{20}$th from A and remaining share from B. Calculate new profit and loss sharing ratio.

Ans. : B's sacrifice = C's share − A's sacrifice

(C's share is $\frac{1}{5}$ out of which he acquires $\frac{1}{20}$ from A and remaining B's sacrifice.)

$$= \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$$

New share = Old share − Sacrifice

$\therefore$ A's new share $= \frac{3}{5} - \frac{1}{20} = \frac{12-1}{20} = \frac{11}{20}$

B's new share $= \frac{2}{5} - \frac{3}{20} = \frac{8-3}{20} = \frac{5}{20}$

C's new share $= \frac{1}{5} = \frac{4}{20}$

$\therefore$ New ratio of profit and loss = 11 : 5 : 4

Illustration 9 : A and B are the partners in a firm sharing profit-loss in the ratio of 4:1. C is admitted as a new partner for $\frac{1}{4}$th share in the firm. 'A' sacrificed $\frac{1}{4}$th of his share in favour of C. While 'B' sacrificed remaining share of C's share. Calculate new profit & loss sharing ratio.

Ans. : Old profit sharing ratio of A and B = 4:1 or $\frac{4}{5} : \frac{1}{5}$

Share of new partner C = $\frac{1}{4}$

'A' sacrificed $\frac{1}{4}$th of his share in favour of C.

$\therefore$ A's sacrifice $= \frac{4}{5} \times \frac{1}{4} = \frac{4}{20} = \frac{1}{5}$

(C's share is $\frac{1}{4}$, C receives $\frac{1}{5}$ from A, So, remaining share of $\frac{1}{4}$th, he will received from B)

$\therefore$ B's sacrifice = C's share − A's sacrifice

$$= \frac{1}{4} - \frac{1}{5} = \frac{5-4}{20} = \frac{1}{20}$$

New share = Old share − Sacrifice

$\therefore$ A's new share $= \frac{4}{5} - \frac{1}{5} = \frac{3}{5}$

B's new share $= \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$

C's new share $= \frac{1}{4}$

$\therefore$ New profit-loss sharing ratio $= \frac{3}{5} : \frac{3}{20} : \frac{1}{4}$

$$= \frac{12}{20} : \frac{3}{20} : \frac{5}{20}$$

$$= 12 : 3 : 5$$

4. Accounting Treatment of Goodwill as per Accounting Standard-26

Goodwill is an intangible asset. When a firm earns higher profit than normal profit, which is earned by its competitors, super profit arises. Goodwill arises due to the super profit earned by the firm. Goodwill arises in the firm because of the efforts made by old partners in past. On the admission of a new partner, old partners sacrifice some of their profit share in favour of the new partner. To compensate the profit share acquired by the new partner, he is required to give his share in goodwill of the firm, which is called as premium for goodwill. Premium for goodwill is distributed among the old partners in the sacrificing ratio.

Sometimes, on the admission of a new partner :

(i) If profit sharing ratio of an old partner does not change, even after the admission of a new partner, it means that he does not sacrifice and therefore he will not receive any amount for goodwill.

(ii) If new profit share of an old partner is more than the old profit share, he gains some profit share. On the other hand, other old partner sacrifices in favour of new partner as well as old partner. Therefore the old partner who gains will have to give goodwill by his share of gain which is calculated by taking new partners' share in goodwill as base. The sacrificing partners' capital account is credited and gaining partners' capital account is debited.

Now, let us discuss accounting treatments of goodwill on the admission of a new partner.

Before studying accounting treatment of goodwill at the time of the admission of a new partner, it is very important to refer , the accounting standard 26. Accounting standard for intangible assets, issued by the Institute of Chartered Accountants of India.

According to para 35 of accounting standard-26, ''Internally generated goodwill should not be recognised as an asset.'' Which means that internally generated goodwill should not be shown in the books of accounts.

As per para 36 of this Accounting Standard, ''Internally generated goodwill is not recognised as an asset because it is not an identifiable resource.'' (i.e. It is not separable nor does it arise from contractual or other legal rights.) It is controlled by the entity that can be measured reliably at cost.)

Reference : resource.cdn.icai.org/27292 abs-as-26 pdf.

Thus as per AS-26, internally generated goodwill does not arise due to a contract or any legal rights which are controlled by the firm and its cost can be decided specifically. Thus AS-26 specifies clearly that goodwill should be shown as an asset in the books only when some consideration is paid for goodwill. Internally generated goodwill should not be shown in the books of accounts.

At the time of the admission of a partner, goodwill is valued on the basis of internal resources of the firm like profit, capital employed; expected rate of return etc. Therefore, goodwill can not be shown as an asset in the balance sheet of the firm. Looking to this fact, old goodwill appearing in the balance sheet of the old firm must be written off among old partners in their old profit sharing ratio because old partnership is dissolved and a new partnership is reconstituted (reconstructed).

From the accounting point of view goodwill is a compensation for the profit sacrificed by old partners in favour of new partner. Therefore new partners' share in goodwill is received by old partners in their sacrificing ratio, and if any goodwill appears in the balance sheet of the old firm it must be written off in old profit-loss sharing ratio among the old partners.

From the accounting point of view, there may be different situations relating to treatment of goodwill. These are :

(1) When goodwill is paid privately by the new partner.

(2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business.

(3) When premium of goodwill is brought in cash by the new partner and it is withdrawn by the old partners fully or partly.

(4) When the new partner does not bring his share in goodwill in cash.

(5) When the new partner brings his share in goodwill partly in cash.

(6) When valuation of goodwill is made on the basis of partners' capital (hidden goodwill)

Let us study all these different situations related to the treatment of goodwill in detail.

(1) When the goodwill premium is paid privately by the new partner :

When the goodwill premium is paid privately by the new partner to the old partners, no entry is recorded in the books of accounts of the firm.

(2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business :

The amount of goodwill brought in cash or kind by the new partner is shared by the sacrificing partners (old partners) in their sacrificing ratio.

Accounting entries :

(1) When premium for goodwill brought in cash by the new partner :

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

To Premium for goodwill A/c

(2) (i) **When premium for goodwill brought in by the new partner i.e. personal land, building, motor car brought in firm as a goodwill :**

Land and building A/c ....Dr

Motor car A/c ....Dr

Other assets A/c ....Dr

To Premium for goodwill A/c

Note : Instead of above two entries, we can pass one combined entry :

Cash/Bank A/c ....Dr

Land/Building A/c ....Dr

Motor car A/c ....Dr

Other assets A/c ....Dr

To Premium for goodwill A/c

(ii) **For the distribution of premium for goodwill among the partners in their sacrificing ratio :**

Premium for goodwill A/c ....Dr

To Old partners capital/current A/c

OR

If out of old partners, any partner gains in new profit-loss sharing ratio compared to old profit-loss sharing ratio, i.e. if sacrifice of an old partner is negative, he is also required to give goodwill by his share of gain to other sacrificing partners. Under this situation following journal entry is passed.

Premium for goodwill A/c ....Dr

Old partners' (gaining partners') capital/current A/c ....Dr

To Old partners' (sacrificing partners') capital/current A/c

Note : Goodwill appearing in the books (Balance sheet) of old partners is written off among the old partners in their old profit-loss sharing ratio for which following journal entry is passed :

Old partners' capital/current A/c ....Dr

To Goodwill A/c (shown in old balance sheet)

Note : (1) In every situation of accounting treatment of goodwill, old goodwill shown in the books of old firm is written off by debiting old partners capital / current accounts because old partnership comes to an end and new goodwill is valued for which accounting treatment is given as per AS-26.

(2) If it is specifically mentioned that capital accounts of partners are maintained on fixed capital accounts method, goodwill should be transferred to partners' current account. If it is not mentioned specifically, it is assumed that the partners maintain their capital accounts by fluctuating capital method and the effect of goodwill should be given to partners' capital account only.

When sacrificing share or sacrificing ratio of old partners is not given (old ratio of old partners and new partners' profit share are given) :

Illustration 10 : Aahna and Amina are partners sharing profit-loss in the ratio of 3:2. They admitted Aman as a new partner for $\frac{1}{4}$th share. The goodwill of the firm is valued at ₹ 1,20,000. Aman has to bring ₹ 50,000 as capital and his share of premium for goodwill in cash. Pass journal entries regarding goodwill.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		80,000	
	To Aman's capital A/c			50,000
	To Premium for Goodwill A/c			30,000
	[Being cash brought by Aman for capital and for premium for goodwill.]			
(2)	Premium for goodwill A/c Dr		30,000	
	To Aahna's capital A/c			18,000
	To Amina's capital A/c			12,000
	[Being premium for goodwill distributed by old partners in their sacrificing ratio of 3:2.]			

Explanation (1) New profit-loss sharing ratio :

Suppose total share of profit = 1

Share of Aman = $\frac{1}{4}$

$\therefore$ Remaining share of Aahna and Amina = $1 - \frac{1}{4} = \frac{4-1}{4} = \frac{3}{4}$

Remaining share of $\frac{3}{4}$ is distributed between Aahna and Amina in the ratio of 3:2.

$\therefore$ New share of Aahna = $\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$

New share of Amina = $\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$

New share of Aman = $\frac{1}{4} = \frac{5}{20}$

$\therefore$ New profit-loss sharing ratio = 9:6:5

(2) Sacrificing ratio :

Sacrifice = Old share − New share

Aahna = $\frac{3}{5} - \frac{9}{20} = \frac{12-9}{20} = \frac{3}{20}$

Amina = $\frac{2}{5} - \frac{6}{20} = \frac{8-6}{20} = \frac{2}{20}$

$\therefore$ Sacrificing ratio = 3:2

Note : When new sharing ratio or sacrificing ratio is not given, sacrificing ratio will be the old profit sharing ratio.

Share of goodwill of Aman = ₹ 1,20,000 $\times \frac{1}{4}$

= ₹ 30,000

Capital of Aman ₹ 50,000 and goodwill ₹ 30,000, total cash ₹ 80,000.

(3) Distribution of premium for goodwill in sacrificing ratio :

Aahna : ₹ 30,000 $\times \frac{3}{5}$ = ₹ 18,000

Amina : ₹ 30,000 $\times \frac{2}{5}$ = ₹ 12,000

When old ratio of old partners, new partners' share and profit-loss sharing ratio of all partners are given.

Illustration 11 : Aayush and Aaditya are the partners sharing profit and loss in the ratio of 5:3. They admitted Parth as a new partner in the firm for $\frac{1}{4}$th share. Parth brings land and building worth ₹ 1,00,000, motor car ₹ 50,000 and cash ₹ 30,000 for his capital and premium for goodwill. Goodwill of the firm is valued ₹ 1,60,000. The new profit and loss ratio is decided at 2:1:1. Give necessary journal entry.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land and building A/c Dr		1,00,000	
	Motor car A/c Dr		50,000	
	Cash A/c Dr		30,000	
	To Parth's capital A/c			1,40,000
	To Premium for Goodwill A/c			40,000
	[Being Parth brought in the firm land-building, motor car and cash as capital and premium for goodwill.]			
(2)	Premium for goodwill A/c Dr		40,000	
	To Aayush's capital A/c			20,000
	To Aaditya's capital A/c			20,000
	[Being premium for goodwill distributed between old partners in their sacrificing ratio 1:1.]			

Explanation (1) Sacrificing ratio :

Old profit-loss sharing ratio of Aayush and Aaditya = 5:3

New profit-loss sharing ratio of Aayush, Aaditya and Parth = 2:1:1

Sacrifice = Old share − New share

Aayush $= \frac{5}{8} - \frac{2}{4} = \frac{5-4}{8} = \frac{1}{8}$

Aaditya $= \frac{3}{8} - \frac{1}{4} = \frac{3-2}{8} = \frac{1}{8}$

∴ Sacrificing ratio = 1:1

(2) Share of Parth in goodwill :

Parth's share in goodwill = ₹ 1,60,000 $\times \frac{1}{4}$ = ₹ 40,000

(3) Capital brought by Parth :

Parth's share in capital =	Land and building	₹ 1,00,000
	Motor car	₹ 50,000
	Cash	₹ 30,000
	Total	₹ 1,80,000
Less : Amount of premium for goodwill brought by Parth		₹ 40,000
∴ Capital brought by Parth		₹ 1,40,000

(4) Distribution of premium for goodwill in sacrificing ratio :

Aayush : ₹ 40,000 $\times \frac{1}{2}$ = 20,000

Aaditya : ₹ 40,000 $\times \frac{1}{2}$ = 20,000

When old partners sacrifice some part of their share :

Illustration 12 : X and Y are the partners of a firm. They admitted Z as a new partner on 1 April, 2016. X sacrificed $\frac{1}{2}$ of his share and Y sacrificed $\frac{3}{4}$th of his share in favour of Z. X and Z maintain their accounts as per fixed capital method. Z brought in ₹ 60,000 for his capital and ₹ 20,000 for his share of premium for goodwill in cash. Goodwill appeared in the books of the firm at ₹ 30,000 as on 31-3-2016. Give necessary journal entries at the time of Z's admission.

Ans. : **Journal Entries**

Date/No.	Particulars		L.F.	Debit (₹)	Credit (₹)
(1)	X's current A/c	Dr		15,000	
	Y's current A/c	Dr		15,000	
	To Goodwill A/c				30,000
	[Being old goodwill written off among old partners in their old profit-loss ratio.]				
(2)	Cash A/c	Dr		80,000	
	To Z's capital A/c				60,000
	To Premium for Goodwill A/c				20,000
	[Being Z brought cash as goodwill and capital.]				
(3)	Premium for goodwill A/c	Dr		20,000	
	To X's current A/c				8000
	To Y's current A/c				12,000
	[Being premium for goodwill distributed between X and Y in their sacrificing ratio.]				

Explanation : Sacrificing ratio :

Old sharing ratio of X and Y = 1:1 (X sacrificed $\frac{1}{2}$ this share while Y sacrificed $\frac{3}{4}$ his share)

Sacrifice of X = $\frac{1}{2} \times \frac{1}{2} = \frac{1}{4} \times \frac{2}{2} = \frac{2}{8}$ (Making denominator equal)

Sacrifice of Y = $\frac{1}{2} \times \frac{3}{4} = \frac{3}{8}$

$\therefore$ Sacrificing ratio of X and Y = $\frac{1}{4} : \frac{3}{8}$ = 2:3 Goodwill will be distributed between X and Y in this ratio.

When an old partner gains due to the admission of a new partner :

Illustration 13 : X and Y are the partners in a firm sharing profit and loss in the ratio of 4:3. They admitted Z as a new partner on 1 April 2016. At the time of admission of Z, balance of capital of X and Y are ₹ 30,000 and ₹ 40,000 respectively. They decide their new profit sharing ratio at 2:4:1. Z brought ₹ 50,000 as his capital and share of his goodwill in cash. On the date of admission of Z, goodwill of the firm was valued at ₹ 84,000. Goodwill appeared in the balance sheet of X and Y at ₹ 35,000.

Pass necessary journal entries and prepare all three partners' capital accounts.

Ans. :

Journal Entries

Date/No.	Particulars		L.F.	Debit (₹)	Credit (₹)
(1)	X's capital A/c	Dr		20,000	
	Y's capital A/c	Dr		15,000	
	To Goodwill A/c				35,000
	[Being old goodwill is written off among old partners A and B in their old ratio.]				
(2)	Cash/Bank A/c	Dr		62,000	
	To Z's capital A/c				50,000
	To Premium for goodwill A/c				12,000
	[Being Z, the new partner brought his capital and goodwill in cash.]				
(3)	Premium for goodwill A/c	Dr		12,000	
	Y's capital A/c	Dr		12,000	
	To X's capital A/c				24,000
	[Being the goodwill premium of Z and share in goodwill of Y's gain debited to their capital accounts and credited to X's capital account.]				

Capital Accounts of Partners

Dr Cr

Date	Particulars	X (₹)	Y (₹)	Z (₹)	Date	Particulars	X (₹)	Y (₹)	Z (₹)
1-4-16	To Goodwill A/c	20,000	15,000	–	1-4-16	By Balance b/d	30,000	40,000	–
1-4-16	To X's capital A/c	–	12,000	–	1-4-16	By Cash A/c	–	–	50,000
1-4-16	To Balance c/f	34,000	13,000	50,000	1-4-16	By Premium for goodwill A/c	12,000	–	–
					1-4-16	By Y's capital A/c	12,000	–	–
		54,000	**40,000**	**50,000**			**54,000**	**40,000**	**50,000**

Old and new profit-loss sharing ratios are given. Premium for goodwill is distributed in sacrificing ratio by deducting new share from old share.

Due to the admission of Z, sacrifice of X is $\frac{2}{7}$, while Y gains instead of sacrifice. Therefore Y's share in goodwill is debited to his capital account. Premium for goodwill and Y's share in goodwill, both will be credited to X's capital account.

Explanation (1) Sacrificing ratio :

Old profit sharing ratio of X and Y = 4:3

New profit sharing ratio of X, Y and Z = 2:4:1

Sacrifice = Old share − New share

X's sacrifice = $\frac{4}{7} - \frac{2}{7} = \frac{2}{7}$

Y's sacrifice = $\frac{3}{7} - \frac{4}{7} = -\frac{1}{7}$ (ratio of gain)

(2) Distribution of premium for goodwill :

Z's share in goodwill = ₹ 84,000 × $\frac{1}{7}$ = 12,000

Y gains in new profit-loss ratio, therefore Y will also give goodwill to X by his share of gain.

Goodwill payable by Y = 84,000 × $\frac{1}{7}$ = 12,000

(3) Goodwill receivable by X :

X's sacrifice = $\frac{2}{7}$

Goodwill receivable by X = $\frac{2}{7}$ × 84,000 = 24,000

(4) Old goodwill will be written off among old partners in their old ratio :

X : ₹ 35,000 × $\frac{4}{7}$ = 20,000

Y : ₹ 35,000 × $\frac{3}{7}$ = 15,000

(3) When new partner brings his share of goodwill premium in cash and it is withdrawn by the old partners :

When premium of goodwill is brought in cash by a new partner and it is withdrawn by the old partners, following journal entries are passed in the books of the firm :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When old goodwill of the firm appears in the balance sheet of the firm, it is written off between old partners' capital A/c in their old profit sharing ratio :			
	Old partners' capital A/c Dr		....	
	To Goodwill A/c			....
	[Being old goodwill written off between old partner in their old profit sharing ratio.]			
(2)	When new partner brings his share of goodwill and his capital in cash :			
	Cash A/c Dr		....	
	To New partners' capital A/c			....
	To Premium for goodwill A/c			....
	[Being new partner brought cash for his share of goodwill and capital.]			

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(3)	When premium for goodwill is distributed between old partners in their sacrificing ratio :			
	Premium for goodwill A/c Dr		....	
	To Old partners' capital A/c			....
	[Being premium for goodwill distributed between old partners' in their sacrificing ratio.]			
(4)	When premium for goodwill fully or partly withdrawn by old partners in cash :			
	Old partners' capital A/c Dr		....	
	To Cash A/c			....
	[Being old partners' withdrew their share of premium for goodwill fully or partly in cash.]			

Illustration 14 : A, B and C are partners sharing profit and losses in the ratio of 3:2:1. They admitted D as a new partner. D brought ₹ 80,000 as capital and ₹ 60,000 as goodwill in cash. New profit sharing ratio of A, B, C and D is decided at 4:3:2:3. Old partners withdrew 50 % of their share of goodwill in cash. Pass necessary journal entries. Partners maintain their capital accounts by fixed capital method.

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		1,40,000	
	To D's capital A/c			80,000
	To Premium for goodwill A/c			60,000
	[Being D brought his share of goodwill and capital in cash.]			
(2)	Premium for goodwill A/c Dr		60,000	
	To A's current A/c			40,000
	To B's current A/c			20,000
	[Being premium for goodwill is distributed between old partners in their sacrificing ratio.]			
(3)	A's current A/c Dr		20,000	
	B's current A/c Dr		10,000	
	To Cash A/c			30,000
	[Being 50 % goodwill withdrawn by old partners in cash.]			

Explanation :

Old and new profit-loss sharing ratio is given, therefore goodwill will be distributed in the sacrificing ratio by deducting new share from old share.

Sacrificing ratio :

Old profit sharing ratio of A, B and C = 3:2:1

New profit sharing ratio of A, B, C and D = 4:3:2:3

Sacrifice = Old share – New share

$A = \frac{3}{6} - \frac{4}{12} = \frac{6-4}{12} = \frac{2}{12}$

$B = \frac{2}{6} - \frac{3}{12} = \frac{4-3}{12} = \frac{1}{12}$

$C = \frac{1}{6} - \frac{2}{12} = \frac{2-2}{12} = 0$

$\therefore$ Sacrificing ratio of A and B = 2:1

(4) When the new partner is not able to bring his share of premium for goodwill in cash :

If a new partner does not bring his share of goodwill in cash, the new partners' capital account is debited by his share of goodwill and the sacrificing partners' capital accounts are credited in their sacrificing ratio. The following journal entries are recorded.

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When new partner brings his capital in cash : Cash A/c Dr To New partners' capital A/c [Being new partner brought his capital in cash.]		....	....
(2)	When new partners' share of goodwill is debited to his capital A/c and distributed between old partners in their sacrificing ratio : New partners' capital A/c Dr To Old partners' capital A/c [Being new partners' capital A/c debited by his share of goodwill and old partners' capital accounts are credited in their sacrificing ratio.] **Note :** There is no difference in journal entries for old goodwill written off and withdrawn in cash.		....	....

Illustration 15 : A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for $\frac{1}{6}$th share of profit. C brought ₹ 1,00,000 in cash as capital. But he is not able to bring in his share of goodwill. The goodwill of the firm is valued at ₹ 3,00,000 at the time of admission of a new partner. Pass necessary journal entries.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr		1,00,000	
	To C's capital A/c			1,00,000
	[Being C brought cash as his capital.]			
(2)	C's capital A/c Dr		50,000	
	To A's capital A/c			30,000
	To B's capital A/c			20,000
	[Being C's share in goodwill distributed to A and B in their sacrificing ratio.]			

Explanation : (1) : C's share in goodwill = $\frac{1}{6} \times 3,00,000$ = ₹ 50,000

(2) : C's share of goodwill received by A and B in their sacrificing ratio :

A : $50,000 \times \frac{3}{5}$ = ₹ 30,000

B : $50,000 \times \frac{2}{5}$ = ₹ 20,000

Note : Here, old ratio = Sacrificing ratio = 3:2

(5) When only a part of the premium for goodwill is brought by a new partner in cash :

When only part of the premium for goodwill is brought by a new partner in cash the premium for goodwill account is credited for the amount of premium brought in cash by him. Thereafter his capital account is debited by the amount of goodwill not brought in cash and premium for goodwill account is debited by the amount of goodwill brought in cash and total share of new partner in goodwill is credited to old partners' capital accounts in their sacrificing ratio. Journal entries for old goodwill to write off and goodwill withdrawn by old partners will remain the same as in the earlier cases. Journal entries for new partners' share in goodwill in this situation are as follows :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When part of share in goodwill and his capital brought in by new partner in cash :			
	Cash A/c Dr		....	
	To New partners' capital A/c			....
	To Premium for goodwill A/c			....
	(Goodwill brought in cash)			
	[Being new partner brought capital and his share of goodwill in cash.]			

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	Premium for goodwill A/c Dr (Goodwill brought in cash) New partners' capital A/c Dr (Goodwill not brought in cash) To Old partners' capital A/c [Being new partners' goodwill is distributed between old partners in their sacrificing ratio.] **Note :** There is no change in writting off old goodwill among old partners in their old profit-loss sharing ratio.		.... 	 ....

Illustration 16 : A and B are the partners in a firm sharing profit and loss in the ratio of 2:1. They admitted C as a new partner for $\frac{1}{3}$rd share in the profit of the firm. C brought ₹ 70,000 as capital and ₹ 30,000 as premium for goodwill in cash. Goodwill of the firm valued at ₹ 1,20,000 at the time of admission of a new partner. Goodwill appeared in the balance sheet of A and B at ₹ 60,000. New profit sharing ratio of all three partners is to be 1:1:1.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	A's capital A/c Dr B's capital A/c Dr To Goodwill A/c [Being old goodwill written off between old partners in the old ratio.]		40,000 20,000	 60,000
(2)	Cash A/c Dr To C's capital A/c To Premium for goodwill A/c [Being C brought part of his share of goodwill and capital in cash.]		1,00,000	 70,000 30,000
(3)	Premium for goodwill A/c Dr C's capital A/c Dr To A's capital A/c [Being C's share of goodwill credited to A's capital A/c.]		30,000 10,000	 40,000

Explanation (1) : C's share of goodwill = $1{,}20{,}000 \times \frac{1}{3} = 40{,}000$

Goodwill not brought in cash by C

= ₹ 40,000 − ₹ 30,000 brought in cash

= ₹ 10,000

(2) : Sacrificing ratio :

Old profit sharing ratio of A and B = 2:1

New profit sharing ratio of A, B and C = 1:1:1

Sacrifice = Old share − New share

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

B : $\frac{1}{3} - \frac{1}{3} = 0$

Only A will receive goodwill brought by C.

(6) When goodwill is valued on the basis of net worth or capital of patners (Hidden goodwill)

When the amount of goodwill is not given, at the time of admission of a partner, goodwill of the firm is valued on the basis of net worth of the firm or capital of partners. For example, A and B whose capitals in the firm are at ₹ 50,000 and ₹ 30,000 respectively. They admit C as a new partner for $\frac{1}{5}$th share of profits and he brings in ₹ 40,000 as his share of capital. The sacrificing ratio of A and B is equal. In this case, the total capital of the firm should be ₹ 2,00,000 by taking C's capital as base.

($\frac{1}{5}$th share = ₹ 40,000 capital

1 share = ?

= ₹ 40,000 × 5 = ₹ 2,00,000)

But the combined capital of all three partners or net worth is ₹ 1,20,000.

(₹ 50,000 + ₹ 30,000 + ₹ 40,000)

Goodwill of the firm = Net worth of firm on the basis of new partner C's capital − New worth of the firm excluding goodwill

= ₹ 2,00,000 − ₹ 1,20,000

= ₹ 80,000

C's share of goodwill = ₹ 80,000 × $\frac{1}{5}$

= ₹ 16,000

C's share of goodwill ₹ 16,000 will be distributed between A and B in equal proportion, i.e. in their sacrificing ratio.

Illustration 17 : A and B are the partners sharing profit and loss in the ratio of 3:2. Their capital is ₹ 1,00,000 and ₹ 1,50,000 respectively as on 31-3-2016. On that day the balance sheet of the firm shows general reserve of ₹ 30,000. They admitted C as a new partner for $\frac{1}{4}$th share in profit on 1-4-2016. C brings ₹ 1,20,000 as a capital. Pass journal entries for goodwill. Show necessary calculation.

Ans. :

Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr To C's capital A/c [Being C brought capital in cash.]		1,20,000	1,20,000

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	C's capital A/c Dr To A's capital A/c To B's capital A/c [Being C's share of goodwill distributed between A and B in their sacrificing ratio.]		20,000	 12,000 8000

Explanation (1) : Calculation of goodwill of the firm :

Net wroth of the firm (including goodwill) on the basis of C's capital

$\frac{1}{4}$ = ₹ 1,20,000

1 = (?)

= ₹ 1,20,000 × 4 = ₹ 4,80,000

Net worth of the firm (excluding goodwill) = Old partners' capital + General reserve + New partner's capital

= ₹ 1,00,000 + ₹ 1,50,000 + ₹ 30,000 + ₹ 1,20,000

= 4,00,000

Goodwill of the firm = ₹ 4,80,000 – ₹ 4,00,000

= ₹ 80,000

C's share of goodwill = ₹ 80,000 × $\frac{1}{4}$

= ₹ 20,000

(2) : Distribution of C's goodwill :

C's share of goodwill will be distributed between A and B in their sacrificing ratio 3:2. (Old ratio = Sacrificing ratio = 3:2)

Goodwill receivable by A = ₹ 20,000 × $\frac{3}{5}$ = ₹ 12,000

Goodwill receivable by B = ₹ 20,000 × $\frac{2}{5}$ = ₹ 8000

5. Revaluation of Assets and Reassessment of Liabilities and its Accounting Effects

Fixed assets are recorded in the books of the firm at cost less depreciation. Book value of assets at the time of the admission of a new partner may be more or less than its market value. Some assets may not have been recorded in the books. Same thing is possible in the case of liabilities. Actual amount payable may be more or less than its book values. New partner is not entitled to receive any share in the profit due to the change in the values of assets and liabilities till the date of his admission. He will also not share such losses. Therefore, assets and liabilities are revalued at the time of the admission of a partner. To record the change in the values of assets and liabilities on account of their revaluation, an account called "Revaluation Account" is opened. It is also called as profit and loss adjustment A/c. Changes in the values of assets and liabilities are recorded in this account. Net profit or net loss of revaluation account is distributed among the old partners in their old profit sharing ratio.

Revaluation of assets and liabilities are recorded by two methods :

(1) When assets and liabilities are to be shown in the books of the new firm at their new values (Revaluation account)

(2) When assets and liabilities are to be shown in the books at their old values (Memorandum revaluation account)