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ISSUES IN PARTNERSHIP ACCOUNTS

BASIC CONCEPTS

- Partnership is defined as the relationship between persons who have agreed to share the profit or loss of a business carried on by all or any of them acting for all.
- Two methods of accounting
  - Fixed capital method
  - Fluctuating capital method.
- Goodwill is the value of reputation of a firm in respect of profits expected in future over and above the normal rate of profits.
- Necessity for valuation of goodwill in a firm arises in the following cases:
  - When the profit sharing ratio amongst the partners is changed;
  - When a new partner is admitted;
  - When a partner retires or dies, and
  - When the business is dissolved or sold.
- Methods for valuation of goodwill:-

(1) Average profit basis :

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{Number of years}}$$

Goodwill = Average Profit x No. of Years' purchased

The profits taken into consideration are adjusted with abnormal losses, abnormal gains, errors, return on non-trade investments and errors.

(2) Super profit basis :

Calculate Capital Employed

Assets …….

Less: Liability …….

Capital Employed ....

- Find the normal Rate of Return(NRR)
- Find Normal Profit=Capital Employed X Normal rate of Return
- Find Average Actual Profit
- Find Super Profit=Average Actual Profit-Normal Profit
- Find Goodwill=Super Profit X **Number** of Years Purchased

(3) Annuity basis :

Goodwill=Super Profit X Annuity Number

(4) Capitalization basis :

$$\textbf{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}}$$

Question 1

A, B and C were partners of a firm sharing profits and losses in the ratio of 3 : 4 : 3. The Balance Sheet of the firm, as at 31st March, 2010 was as under :

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Accounts :			Fixed Assets		1,00,000
A	48,000		Current Assets :		
B	64,000		Stock	30,000	
C	48,000	1,60,000	Debtors	60,000	
Reserve		20,000	Cash and Bank	30,000	1,20,000
Creditors		40,000			
		2,20,000			2,20,000

The firm had taken a Joint Life Policy for Rs. 1,00,000; the premium periodically paid was charged to Profit and Loss Account. Partner C died on 30th September, 2010. It was agreed between the surviving partners and the legal representatives of C that :

(i) *Goodwill of the firm will be taken at Rs. 60,000.*

(ii) *Fixed Assets will be written down by Rs. 20,000.*

(iii) *In lieu of profits, C should be paid at the rate of 25% per annum on his capital as on 31st March, 2010.*

Policy money was received and the legal heirs were paid off. The profits for the year ended 31st March, 2011, after charging depreciation of Rs. 10,000 (depreciation upto 30th September was agreed to be Rs. 6,000) were Rs. 48,000.

Partners' Drawings Accounts showed balances as under :

A Rs. 18,000 (drawn evenly over the year)

B Rs. 24,000 (drawn evenly over the year)

C (up-to-date of death) Rs. 20,000

On the basis of the above figures, please indicate the entitlement of the legal heirs of C, assuming that they had not been paid anything other then the share in the Joint Life Policy.

(November, 2000)

Answer

Computation of entitlement of legal heirs of C

(1) Profits for the half year ended 31st March, 2011

	Rs.
Profits for the year ended 31st March, 2011 (after depreciation)	48,000
Add : Depreciation	10,000
Profits before depreciation	58,000
Profits for the first half (assumed : evenly spread)	29,000
Less : Depreciation for the first half	6,000
Profits for the first half year (after depreciation)	23,000
Profits for the second half (i.e., 1st October, 2010 to 31st March, 2011)	29,000
Less : Depreciation for the second half	4,000
Profits for the second half year (after depreciation)	25,000

(2) Capital Accounts of Partners as on 30th September, 2010

Dr. Cr.

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Fixed Assets (loss on revaluation)	6,000	8,000	6,000	By Balance b/d	48,000	64,000	48,000
				By Reserve	6,000	8,000	6,000
				By Goodwill	18,000	24,000	18,000
To Drawings	9,000	12,000	20,000	By P & L Appropriation A/c			
To C Executor's A/c			52,000				

To Balance c/d	57,000	76,000	–	(Interest on Rs. 48,000 @ 25% for 6 months)	—	—	6,000
	72,000	96,000	78,000		72,000	96,000	78,000

(3) Application of Section 37 of the Partnership Act

Legal heirs of C have not been paid anything other than the share in joint life policy. The amount due to the deceased partner carries interest at the mutually agreed upon rate. In the absence of any agreement, the representatives of the deceased partner can receive at their option interest at the rate of 6% per annum or the share of profit earned for the amount due to the deceased partner.

Thus, the representatives of C can opt for

Either,

(i) Interest on Rs. 52,000 for 6 months @ 6% p.a. = Rs. 1,560

Or

(ii) Profit earned out of unsettled capital (in the second half year ended 31st March, 2011)

$$\text{Rs. } 25{,}000 \times \frac{52{,}000}{57{,}000 + 76{,}000 + 52{,}000} = \text{Rs. } 7{,}027 \text{ (approx.)}$$

In the above case, it would be rational to assume that the legal heirs would opt for Rs. 7,027.

(4) Amount due to legal heirs of C

	Rs.
Balance in C's Executor's account	52,000
Amount of profit earned out of unsettled capital [calculated in (3)]	7,027
Amount due	59,027

Question 2

A, B and C were partners, sharing Profits and Losses in the ratio of 5 : 3 : 2 respectively. On 31st March, 2011 their Balance Sheet stood as follows :

Liabilities	*Rs.*	*Assets*	*Rs.*
A's capital	*7,79,000*	*Plant and Machinery*	*13,62,000*
B's capital	*7,07,800*	*Furniture and Fittings*	*2,36,000*
C's capital	*6,86,200*	*Stock*	*7,02,000*
Creditors	*4,91,000*	*Debtors*	*1,91,000*
		Cash at Bank	*1,73,000*
	26,64,000		*26,64,000*

On 31st July, 2011 A died. According to partnership deed, on the death of a partner, the capital account of the deceased partner was to be credited with :

(i) his share of profit for the relevant part of the year of death calculated on the basis of profit earned during the immediately preceding accounting year, and

(ii) his share of goodwill

Goodwill was to be valued at two years' purchase of the average profits of immediately preceding three accounting years. The profits, as per books of account were as follows:

	Rs.
For accounting year ended 31st March, 2009	*3,29,000*
For accounting year ended 31st March, 2010	*3,46,000*
For accounting year ended 31st March, 2011	*3,78,000*

However, while going through the books of account on A's death, it came to light that Rs. 30,000 worth of wages were spent on installation of a new machinery, but the same was not capitalized; the machinery was put into operation on 1st October, 2010. Depreciation was provided on the machinery @ 20% per annum.

On 1st October, 2011 A's son D was admitted into partnership with immediate effect on the following terms :

(a) D would get one-fourth share in the profit of the firm, while the relative profit sharing ratio between B and C would remain unchanged.

(b) The final balance of A's capital account would be credited to D's capital account

(c) An adjustment would be made in the Capital Accounts for D's share of goodwill. The basis of valuation of firm's goodwill would be the same as was adopted at the time of the death of his father.

On 31st March, 2012 the Profit and Loss Account of the firm showed that the firm had earned a profit of Rs. 4,16,000 for the year. The respective drawings accounts showed that while B and C had withdrawn Rs. 60,000 each during the year, D's drawings totalled Rs. 30,000. The Drawings Accounts are closed at the end of the year by transfer to respective capital accounts.

You are required to :

(i) Prepare a statement showing distribution of profits for the accounting year ended 31st March, 2012; and

(ii) Pass journal entries for all the transactions relating to death of the partner. D's admission into partnership, and at the end of the year relating to transfer of Drawings Accounts and distribution of profit for the year. ***(May, 2001)***

Answer

(i) Statement Showing distribution of profits for the accounting year ended 31st March, 2012

		Rs.	Rs.
Net profit for the year ended 31.03.2012			4,16,000
A's share			
(Profit distributed to deceased partner A & his executor)			
(a)	Profit for 4 months (1.4.2011 – 31.7.2011) (W.N.1)	67,500	
(b)	Application of Sec. 37 (1.8.2011 – 30.9.2011) (W. N. 5)	28,021	95,521
	B's share		
(a)	Profit for 4 months (1.4.2011 – 31.7.2011) (W. N. 3)	42,700	
(b)	Profit for 2 months (1.8.2011 – 30.9.2011) (W. N. 6)	24,787	
(c)	Profit for 6 months (1.10.2011 – 31.3.2012) (W. N. 10)	93,600	1,61,087
	C's share		
(a)	Profit for 4 months (1.4.2011 – 31.7.2011) (W. N. 3)	28,467	
(b)	Profit for 2 months (1.8.2011 – 30.9.2011) (W. N. 6)	16,525	
(c)	Profit for 6 months (1.10.2011 – 31.3.2012) (W. N. 10)	62,400	1,07,392
	D's share		
(a)	Profit for 6 months (1.10.2011 – 31.3.2012) (W. N. 10)	52,000	52,000
			4,16,000

(ii) Journal Entries

Year 2011			*Dr.* *Rs.*	*Cr.* *Rs.*
July 31	Machinery A/c	Dr	27,000	
	To A's Capital A/c			13,500
	To B's Capital A/c			8,100
	To C's Capital A/c			5,400
	(Wages spent on installation of new machinery capitalised and credited to partners' capital accounts after providing depreciation for six months ended 31st March, 2011)			
	Profit and Loss Suspense A/c	Dr.	67,500	

	To A's Capital A/c			67,500
	(A's share of profit for four months as calculated in W. N. 1 credited to his capital account)			
	Goodwill A/c	Dr.	7,20,000	
	To A's Capital A/c			3,60,000
	To B's Capital A/c			2,16,000
	To C's Capital A/c			1,44,000
	(Goodwill raised in the books and credited to partners in the old profit sharing ratio 5 : 3 : 2)			
	A's Capital A/c	Dr.	12,20,000	
	To A's Executor's A/c			12,20,000
	(Balance due to A transferred to his executor's account)			
	Profit & Loss Suspense A/c	Dr.	28,021	
	To A's Executor's A/c			28,021
	(Profit earned out of the unsettled capital credited to A's executor's account as per W. N. 5)			
Oct. 1	A's Executor's A/c	Dr.	12,48,021	
	To D's Capital A/c			12,48,021
	(Final balance of A's executor's account transferred to D's capital account)			
	B's Capital A/c	Dr.	3,24,000	
	C's Capital A/c	Dr.	2,16,000	
	D's Capital A/c	Dr.	1,80,000	
	To Goodwill			7,20,000
	(Goodwill written off and debited to partners in the new profit sharing ratio 9 : 6 : 5)			
March 31	B's Capital A/c	Dr.	60,000	
	C's Capital A/c	Dr.	60,000	
	D's Capital A/c	Dr.	30,000	
	To B's Drawings A/c			60,000
	To C's Drawings A/c			60,000
	To D's Drawings A/c			30,000
	(Drawings debited to partners' capital accounts)			

March 31	Profit and Loss Appropriation A/c	Dr.	4,16,000	
	To Profit and loss suspense A/c (Rs. 67,500 + 28,021)			95,521
	To B's Capital A/c			1,61,087
	To C's Capital A/c			1,07,392
	To D's Capital A/c			52,000
	(Division of profits as shown in statement of distribution of profits and balance of profit & loss suspense account transferred to profit and loss appropriation account)			

Working Notes:

(1) Computation of A's share in profit for the period 1.4.2011 – 31.7.2011

A's share in profit for the period of 1st April, 2011 to 31st July, 2011 is to be calculated on the basis of profit earned during the immediately previous accounting year i.e. year ended on 31st March, 2011

	Rs.
Profit for the year ended 31st March, 2011	3,78,000
Add : Capital expenditure of wages spent on installation of new machinery, treated as revenue expenditure	30,000
	4,08,000
Less : Depreciation on Rs. 30,000 (being the value of machinery @ 20% p.a. for 6 months)	3,000
Correct profit for the year ended 31st March, 2011	4,05,000

Profit for 4 months on the basis of last year's profit = Rs. $4{,}05{,}000 \times \frac{4}{12} = 1{,}35{,}000$

A's share in profit = $1{,}35{,}000 \times \frac{5}{10} = 67{,}500$

(2) Valuation of Goodwill

	Rs.
Profit for the year ended 31st March, 2009	3,29,000
Profit for the year ended 31st March, 2010	3,46,000
Profit for the year ended 31st March, 2011	4,05,000
Total Profit	10,80,000

Average Profit = Rs. $\frac{10,80,000}{3}$ = Rs. 3,60,000

Goodwill (two years' purchase) = Rs. 3,60,000 × 2 = Rs. 7,20,000

(3) Distribution of profit for 4 months ended 31st July, 2011

	Rs.
Net Profit (Rs. 4,16,000 × $\frac{4}{12}$)	1,38,667
A's share (W. N. 1)	67,500
B's share (Rs. 71,167 × $\frac{3}{5}$)	42,700
C's share (Rs. 71,167 × $\frac{2}{5}$)	28,467

(4) Partners' Capital Accounts as on 31st July, 2011

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Drawings		20,000	20,000	By Balance b/d	7,79,000	7,07,800	6,86,200
To A's Executor's A/c	12,20,000	9,54,600	8,44,067	By Plant & Machinery	13,500	8,100	5,400
To Balance c/d		–	–	By Goodwill	3,60,000	2,16,000	1,44,000
				By Share in Profit (W. N. 3)	67,500	42,700	28,467
	12,20,000	9,74,600	8,64,067		12,20,000	9,74,600	8,64,067

(5) Application of section 37 of the Partnership Act

Either

(i) Interest of Rs. 12,20,000 × $\frac{6}{100} \times \frac{2}{12}$ = Rs. 12,200

Or

(ii) Profit earned out of unsettled capital

Rs. 4,16,000 × $\frac{2}{12} \times \frac{\text{Rs. } 12,20,000}{\text{Rs. } (12,20,000 + 9,54,600 + 8,44,067)}$ = Rs. 28,021 (approx.)

In the absence of specific agreement amongst partners on the above subject matter, the representatives of the deceased partner can receive at their option, interest at the rate of 6% p.a. or share of profit earned for the amount due to the deceased partner.

In the above case, it would be rational to assume that A's representatives would opt for Rs. 28,021.

(6) Distribution of profit for 2 months ended 31st Oct, 2011

		Rs.
Net profit	(Rs. 4,16,000 × $\frac{2}{12}$)	69,333
A's executor's share (W. N. 5)		28,021
B's share	(Rs. 41,312 × $\frac{3}{5}$)	24,787
C's share	(Rs. 41,312 × $\frac{2}{5}$)	16,525

(7) A's Executor's Account

	Rs.		Rs.
To D's Capital A/c	12,48,021	By A's capital A/c	12,20,000
		By Share in profit (W. N. 6)	28,021
	12,48,021		12,48,021

(8) Partner's Capital Accounts (1st August, 2011 to 30th Sept., 2011)

Dr.	*B*	*C*		*B*	*C*
	Rs.	*Rs.*		*Rs.*	*Rs.*
To Drawings	10,000	10,000	By Balancd b/d	9,54,600	8,44,067
To Balance c/d	9,69,387	8,50,592	By P & L A/c	24,787	16,525
	9,79,387	8,60,592		9,79,387	8,60,592

(9) Computation of new profit sharing ratio between B, C & D

D is admitted for ¼ share

B's new ratio	= 3/4 × 3/5	= 9/20
C's new ratio	= 3/4 × 2/5	= 6/20
D's new ratio	= 5/20	
New profit sharing ratio	= 9 : 6 : 5	

(10) Distribution of profit for 6 months ended 31st March, 2012

	Rs.
Net profit (Rs. 4,16,000 × $\frac{6}{12}$)	2,08,000

B's share (Rs. 2,08,000 × $\frac{9}{20}$)	93,600
C's share (Rs. 2,08,000 × $\frac{6}{20}$)	62,400
D's share (Rs. 2,08,000 × $\frac{5}{20}$)	52,000

(11) Partner's Capital Accounts as on 31st March, 2012

	B	C	D		B	C	D
	Rs.	*Rs.*	*Rs.*		*Rs.*	*Rs.*	*Rs.*
To Goodwill	3,24,000	2,16,000	1,80,000	By Balance b/d	9,69,387	8,50,592	
To Drawings	30,000	30,000	30,000	By A's Executor's A/c			12,48,021
To Balance c/d	7,08,987	6,66,992	10,90,021	By Share of profit			
				(W. N. 10)	93,600	62,400	52,000
	10,62,987	9,12,992	13,00,021		10,62,987	9,12,992	13,00,021

Notes:

1. It is assumed that profit was earned uniformly throughout the year. Although notional profit was calculated for the first four months, it is to be transferred from the current year's profit (as calculated in working note 3). The question requires that A's share of profit for this period is to be calculated on the basis of profit earned during year ended 31st March. 2011. The balance amount after calculating his share has been credited to B and C in ratio 3 : 2.
2. It is assumed that drawings were made evenly throughout the year. However, single entry has been given at year end in the main solution relating to transfer of drawings and distribution of profit but the Partners' capital accounts shown in the working notes include the entries of drawings and distribution of profit of respective dates within the year.

Question 3

M/s Neptune & Co.'s Balance Sheet as at 31st March, 2011:

Liabilities		*Rs.*	*Assets*		*Rs.*
Bank overdraft (State Bank)		*54,000*	*Cash at Bank of India*		*800*
Sundry Creditors		*1,56,000*	*Sundry Debtors*		*2,80,000*
Capital Accounts :			*Stock*		*1,00,000*
Mr. A			*Motor Cars cost as per last B/S*	*1,60,000*	
Balance as per last B/S	*4,02,000*		*Less : Depreciation till date*	*54,000*	*1,06,000*

Add : Profits for the year	*95,400*		*Machinery :*		
	4,97,400		*Cost as per last B/S*	*3,00,000*	
Less : Drawings	*40,000*	*4,57,400*	*Less : Depreciation till date*	*1,40,000*	*1,60,000*
Mr. B			*Land and Building*		*2,40,000*
Balance as per last B/s	*2,00,000*				
Add : Profit for the year	*95,400*				
	2,95,400				
Less : Drawings	*76,000*	*2,19,400*			
		8,86,800			*8,86,800*

You have examined the foregoing Draft of the Balance Sheet and have ascertained that the following adjustments are required to be carried out :

(i) *Land and Buildings are shown at cost less Rs. 60,000 being the proceeds of the sale during the year of premises costing Rs. 70,000.*

(ii) *Machinery having a net book value of Rs. 4,300 had been scrapped during the year. The original cost was Rs. 12,300.*

(iii) *Rs. 2,000 paid for the Licence fees for the year ending 30th September, 2011 had been written off.*

(iv) *Debts amounting to Rs. 10,420 were considered to be bad and further debts amounting to Rs. 5,400 were considered doubtful and required 100% provision. Provision for doubtful debts had previously been made for Rs. 10,000.*

(v) *An item in the Inventory was valued at Rs. 37,400, but had a realisable value of Rs. 26,000 only. Scrap Material having a value of Rs. 6,600 had been omitted from the stock valuation.*

(vi) *The cashier had misappropriated Rs. 700.*

(vii) *The cash-book for the year ending 31st March, 2011 included payments amounting to Rs. 6,924, the cheques having been made out, but not despatched to suppliers until April 2011.*

(viii) *Interest is to be allowed on the Partners' opening Capital Account balances less drawings during the year at 9%.*

You are required to prepare:

(a) *Profit & Loss Adjustment Account for the year.*

(b) *Capital Accounts of the Partners.* **(November, 2001)**

Answer

(a) **M/s Neptune & Co.**

Profit and Loss Adjustment Account

for the year ended 31st March, 2011

		Rs.			Rs.
To Land & Building (Loss on sale		10,000	By Partner's Capital Accounts :		
To Machinery (Loss on scrapping)4,300			Mr. A	95,400	
To Provision for Doubtful Debts		5,820	Mr. B	95,400	1,90,800
(Working note)					
To Stock Adjustment (Fall in the		11,400	By Prepaid expenses (Licence		1,000
Market value)			fee)		
To Cash (Misappropriated)		700	By Stock Adjustment (items		6,600
To Interest on Capital			omitted)		
Mr. A	32,580				
Mr. B	11,160	43,740			
To Profit transferred to Capital					
Accounts:					
Mr. A	61,220				
Mr. B	61,220	1,22,440			
		1,98,400			1,98,400

(b) **Partners' Capital Accounts**

As on 31st March, 2011

	Mr. A	Mr. B		Mr. A	Mr. B
31.3.2011	Rs.	Rs.	*31.3.2010*	Rs.	Rs.
To Drawings	40,000	76,000	By Balance b/d	4,02,000	2,00,000
To Profit & Loss			31.3.2011		
Adjustment Account	95,400	95,400	By Profit & Loss A/c	95,400	95,400
To Balance c/d	4,55,800	1,96,380	By Profit & Loss		
			Adjustment A/c:		
			Interest on capital	32,580	11,160
			Profit for the year	61,220	61,220
	5,91,200	3,67,780		5,91,200	3,67,780

Working Notes :

(1) Provision for doubtful debts charged to profit and loss adjustment account

Provision for Doubtful Debts Accounts

	Rs.		Rs.
To Bad Debts	10,420	By Balance b/d	10,000
To Balance c/d (required)	5,400	By Profit & Loss Adjustment A/c	
		(balancing figure)	5,820
	15,820		15,820

(2) Interest on Capitals

Mr. A Rs. 3,62,000 × 9% p.a. = Rs. 32,580

Mr. B Rs. 1,24,000 × 9% p.a. = Rs. 11,160

Note : Misappropriation by cashier may be debited to cashier also. In that case, Rs. 700 will not be debited to Profit and Loss Adjustment Account and profit transferred to partners will be Rs. 1,23,140.

Question 4

Manish, Jatin and Paresh were partners sharing Profits/ Losses in the ratio of Manish 40 percent, Jatin 35 percent, and Paresh 25 percent. The draft Balance Sheet of the partnership as on 31st December, 2011 was as follows :

		Rs.			Rs.
Sundry Creditors		*30,000*	*Cash on hand and at Bank*		*67,000*
Bills payable		*8,000*	*Stock*		*42,000*
Loan from Jatin		*30,000*	*Sundry Debtors*	*34,000*	
Current Accounts :			*Less : Provision for*		
Manish	*12,000*		*Doubtful Debts*	*6,000*	*28,000*
Jatin	*8,000*		*Plant and Machinery*		
Paresh	*6,000*	*26,000*	*(at cost)*	*80,000*	
Capital Accounts :			*Less : Depreciation*	*28,000*	*52,000*
Manish	*90,000*		*Premises (at cost)*		*75,000*
Jatin	*50,000*				
Paresh	*30,000*	*1,70,000*			
		2,64,000			*2,64,000*

Jatin retired on 31st December, 2011. Manish and Paresh continued in partnership sharing Profits/ Losses in the ratio of Manish 60 percent and Paresh 40 percent. 50 percent of Jatin's Loan was repaid on 1.1.2012 and it was agreed that of the amount then remaining due to him a sum of Rs. 80,000 should remain as loan to partnership and the balance to be carried *forward as ordinary trading liability. The following adjustments were agreed to be made to the above mentioned Balance Sheet:*

(i) Rs. 10,000 should be written off from the premises.

(ii) Plant and Machinery was revalued at Rs. 58,000.

(iii) Provision for doubtful debts to be increased by Rs. 1,200

(iv) Rs. 5,000 due to creditors for expenses had been omitted from the books of account.

(v) Rs. 4,000 to be written off on stocks.

(vi) Provide Rs. 1,200 for professional charges in connection with revaluation.

As per the deed of partnership, in the event of the retirement of a partner, goodwill was to be valued at an amount equal to one year's purchase of the average profits of the preceding three years on the date of retirement. Before determining the said average profits a notional amount of Rs. 80,000 should be charged for remuneration to partners. The necessary profits before charging such remuneration were:

Year ending 30.12.2009	*Rs. 1,44,000*	
Year ending 31.12.2010	*Rs. 1,68,000*	
Year ending 31.12.2011	*Rs. 1,88,200*	*(As per draft accounts)*

It was agreed that, for the purpose of valuing goodwill, the amount of profit for the year 2011 be recomputed after charging the loss on revaluation in respect of premises and stock, the unprovided expenses (except professional expenses) and increase in the provision for doubtful debts. The continuing partners decided to eliminate goodwill account from their books.

You are required to prepare:

(i) Revaluation Account:

(ii) Capital Accounts (merging current accounts therein):

(iii) Jatin's Accounts showing balance due to him; and

(iv) Balance Sheet of Manish and Paresh as at 1st January, 2012. ***(May, 2002)***

Answer

(i) **Revaluation Account**

	Rs		*Rs.*
To Premises	10,000	By Plant and Machinery	6,000
To Provision for Doubtful Debts	1,200	By Loss on revaluation transferred	

To Outstanding Expenses	5,000	to Capital Accounts:		
To Stocks	4,000	Manish (40%)	6,160	
To Provision for Professional Charges	1,200	Jatin (35%)	5,390	
		Paresh (25%)	3,850	15,400
	21,400			21,400

(ii) **Capital Accounts of Partners**

	Manish	Jatin	Paresh		Manish	Jatin	Paresh
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Revalutation A/c (loss)	6,160	5,390	3,850	By Balance b/d	90,000	50,000	30,000
To Goodwill (written off in new Profit sharing ratio)	48,000	–	32,000	By Current A/c	12,000	8,000	6,000
To Personal A/c (Balance transferred)		80,610	–	By Goodwill (old profit sharing)	32,000	28,000	20,000
To Balance c/d	79,840		20,150				
	1,34,000	86,000	56,000		1,34,000	86,000	56,000

(iii) **Jatin's Personal Account**

	Rs.		Rs.
To Bank Account (50% of old loan)	15,000	By Capital Accounts (Balance transferred)	80,610
ToLoan Account (transferred)	80,000	By Loan Account (old loan)	30,000
To Balance c/d	15,610		
	1,10,610		1,10,610

(iv) **Balance Sheet of Manish and Paresh as on 1st January, 2012**

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Accounts			Fixed Assets		
Manish	79,840		Plant and Machinery	86,000	
Paresh	20,150	99,990	Less: Depreciation	28,000	58,000
Jatin's Loan A/c		80,000	Premises	75,000	
Current Liabilities			Less: Written off	10,000	65,000
and Provisions			Current Assets		
Bills Payable	8,000		Cash in hand & at Bank		

Sundry Creditors	35,000		(67,000–15,000)		52,000
(30,000+5,000)			Sundry Debtors	34,000	
Jatin's dues	15,610		Less: Provision for		
Provision for			doubtful debts	7,200	26,800
Professional charges	1,200	59,810	Stock in trade		38,000
		2,39,800			2,39,800

Working Notes :

(1) Profit for the Year ending 31st December, 2011

		Rs.
As per draft accounts		1,88,200
Less: Premises written off	10,000	
Provision for Doubtful debts	1,200	
Outstanding Expenses	5,000	
Stock	4,000	20,200
		1,68,000

(2) Valuation of Goodwill

Profit for the year ending 31st Dec.2011 (adjusted)	1,68,000
Profit for the year ending 31st Dec. 2010	1,68,000
Profit for the year ending 31st Dec. 2009	1,44,000
	4,80,000
Average Profits before partners' salaries	1,60,000
Less: Partners' Salaries (notional)	80,000
Super Profit and Goodwill (one year's purchase)	80,000

Question 5

Ram, Rahim and Robert are partners, sharing Profits and Losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2011 and in his place Richard would be admitted as a partner with new profit sharing ratio between Ram, Rahim and Richard at 3 : 2 : 1.

Balance Sheet of Ram, Rahim and Robert as at 31.3.2011:

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		*Cash in hand*	*20,000*
Ram	*1,00,000*	*Cash in Bank*	*1,00,000*
Rahim	*1,50,000*	*Sundry Debtors*	*5,00,000*

Robert	*2,00,000*	*Stock in Trade*	*2,00,000*
General Reserve	*2,00,000*	*Plant & Machinery*	*3,00,000*
Sundry Creditors	*8,00,000*	*Land & Building*	*5,30,000*
Loan from Richard	*2,00,000*		
	16,50,000		*16,50,000*

Retirement of Robert and admission of Richard is on the following terms:

(a) Plant & Machinery to be depreciated by Rs. 30,000.

(b) Land and Building to be valued at Rs. 6,00,000.

(c) Stock to be valued at 95% of book value.

(d) Provision for doubtful debts @ 10% to be provided on debtors.

(e) General Reserve to be apportioned amongst Ram, Rahim and Robert.

(f) The firm's goodwill to be valued at 2 years purchase of the average profits of the last 3 years. The relevant figures are:

Year ended 31.3.2008	–	*Profit Rs. 50,000*
Year ended 31.3.2009	–	*Profit Rs. 60,000*
Year ended 31.3.2010	–	*Profit Rs. 55,000*

(g) Out of the amount due to Robert Rs. 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.

(h) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare:

(i) Capital accounts of the partners; and

(ii) Balance Sheet of the reconstituted firm. ***(November, 2005)***

Answer

Partners' Capital Accounts

Dr.											*Cr.*
		Ram	*Rahim*	*Robert*	*Richard*			*Ram*	*Rahim*	*Robert*	*Richard*
		Rs.	*Rs.*	*Rs.*	*Rs.*			*Rs.*	*Rs.*	*Rs.*	*Rs.*
To	Revaluation A/c (W.N.1)	10,000	6,000	4,000	–	By	Balance b/d	1,00,000	1,50,000	2,00,000	–
To	Loan from Robert A/c			2,00,000		By	General reserve	1,00,000	60,000	40,000	–

To	Bank			58,000		By	Goodwill (W.N. 2)	55,000	33,000	22,000	–
To	Balance c/d	2,45,000	2,37,000	–	–						
		2,55,000	2,43,000	2,62,000	–			2,55,000	2,43,000	2,62,000	–
To	Goodwill*	55,000	36,667	–	18,333	By	Balance b/d	2,45,000	2,37,000	–	–
						By	Loan A/c – transfer	–	–	–	2,00,000
To	Balance c/d	1,90,000	2,00,333	–	1,95,167	By	Bank	–	–	–	13,500
		2,45,000	2,37,000	–	2,13,500			2,45,000	2,37,000	–	2,13,500

Balance Sheet as at 31.3.2011

after the admission of Richard

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts:		Land and Building	6,00,000
Ram	1,90,000	Plant and Machinery	2,70,000
Rahim	2,00,333	Stock	1,90,000
Richard	1,95,167	Debtors	4,50,000
Sundry Creditors	8,00,000	Cash at Bank (W.N. 3)	55,500
Loan from Robert	2,00,000	Cash in hand	20,000
	15,85,500		15,85,500

Working Notes:

(1) **Revaluation Account**

		Rs.				*Rs.*
To	Plant and Machinery	30,000	By	Land and Building		70,000
To	Stock	10,000	By	Partners Capital A/cs:		
To	Debtors	50,000		Ram	10,000	
				Rahim	6,000	
				Robert	4,000	20,000
		90,000				90,000

* As per para 36 of AS 10, 'Accounting for Fixed Assets', goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill raised at the time of retirement of Robert is to be written off in new ratio among remaining partners including new partner – Richard.

(2) **Calculation of Goodwill:**

Profit for the year ended 31.3.2008	50,000
Profit for the year ended 31.3.2009	60,000
Profit for the year ended 31.3.2010	55,000
	1,65,000

$$\text{Average profit} = \frac{1,65,000}{3} = \text{Rs. } 55,000$$

Goodwill = Rs. 55,000 × 2 years = Rs. 1,10,000.

(3) **Bank Account**

		Rs.			Rs.
To	Balance b/d	1,00,000	By	Robert's Capital A/c	58,000
To	Richard's Capital A/c	13,500	By	Balance c/d	55,500
		1,13,500			1,13,500

Question 6

The following was the Balance Sheet of 'A' and 'B', who were sharing profits and losses in the ratio of 2:1 on 31.12.2011:

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts		*Plant and machinery*	*12,00,000*
A	*10,00,000*	*Building*	*9,00,000*
B	*5,00,000*	*Sundry debtors*	*3,00,000*
Reserve fund	*9,00,000*	*Stock*	*4,00,000*
Sundry creditors	*4,00,000*	*Cash*	*1,00,000*
Bills payable	*1,00,000*		
	29,00,000		*29,00,000*

They agreed to admit 'C' into the partnership on the following terms:

(i) The goodwill of the firm was fixed at Rs.1,05,000.

(ii) That the value of stock and plant and machinery were to be reduced by 10%.

(iii) That a provision of 5% was to be created for doubtful debts.

(iv) That the building account was to be appreciated by 20%.

(v) There was an unrecorded liability of Rs.10,000.

(vi) Investments worth Rs.20,000 (Not mentioned in the Balance Sheet) were taken into account.

(vii) *That the value of reserve fund, the values of liabilities and the values of assets other than cash are not to be altered.*

(viii) *'C' was to be given one-fourth share in the profit and was to bring capital equal to his share of profit after all adjustments.*

Prepare Memorandum Revaluation Account, Capital account of the partners and the Balance Sheet of the newly reconstituted firm. ***(November, 2007)***

Answer

Memorandum Revaluation Account

		Rs.			Rs.
To	Stock	40,000	By	Building	1,80,000
To	Plant & machinery	1,20,000	By	Investments	20,000
To	Provision for doubtful debts	15,000			
To	Unrecorded liability	10,000			
To	Profit transferred to Partners' Capital A/cs (in old ratio)				
	A = 10,000				
	B = 5,000	15,000			
		2,00,000			2,00,000
To	Building	1,80,000	By	Stock	40,000
To	Investments	20,000	By	Plant & machinery	1,20,000
			By	Provision for doubtful debts	15,000
			By	Unrecorded liability	10,000
			By	Loss transferred to Partners' Capital A/cs (in new ratio)	
				A = 7,500	
				B = 3,750	
				C = 3,750	15,000
		2,00,000			2,00,000

Partners' Capital Accounts

		A	B	C			A	B	C
To	Loss on Revaluation	7,500	3,750	3,750	By	Balance b/d	10,00,000	5,00,000	-
To	Reserve Fund	4,50,000	2,25,000	2,25,000	By	Reserve Fund	6,00,000	3,00,000	-
To	A (W.N.3)	-	-	17,500	By	C (W.N.3)	17,500	8,750	-
To	B (W.N.3)	-	-	8,750	By	Profit on Revaluation	10,000	5,000	

To	Balance c/d (Refer W.N.2)	11,70,000	5,85,000	5,85,000	By	Cash (Bal. Fig.)			8,40,000
		16,27,500	8,13,750	8,40,000			16,27,500	8,13,750	8,40,000

Balance Sheet of newly reconstituted firm as on 31.12.2011

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Accounts		Plant & Machinery	12,00,000
A	11,70,000	Building	9,00,000
B	5,85,000	Sundry Debtors	3,00,000
C	5,85,000	Stock	4,00,000
Reserve Fund	9,00,000	Cash (1,00,000 + 8,40,000)	9,40,000
Sundry Creditors	4,00,000		
Bills Payable	1,00,000		
	37,40,000		37,40,000

Working Notes:

1. Calculation of new profit and loss sharing ratio

C will get 1/4 th share in the new profit sharing ratio.

Therefore, remaining share will be 1-1/4 =3/4

Share of A will be 3/4 x 2/3 = 2/4 i.e. 1/2

Share of B will be 3/4 x 1/3 = 1/4

New ratio will be

A : B : C

1/2 : 1/4 : 1/4

2 : 1: 1

2. Calculation of closing capital of C

Closing capitals of A & B after all adjustments are:

A = Rs.11,70,000

B = Rs. 5,85,000

Since B's capital is less than A's capital, therefore B's capital is taken as base.

Hence, C's closing capital should be Rs.5,85,000 i.e. at par with B (as per new profit and loss sharing ratio)

3. Adjustment entry for goodwill*

Partners	Goodwill as per old ratio	Goodwill as per new ratio	Effect	
A	70,000	52,500	+ 17,500	-
B	35,000	26,250	+ 8,750	-
C	-	26,250	-	-26,250
	1,05,000	1,05,000	26,250	26,250

Adjustment entry will be:

C's Capital A/c	Dr.	26,250	
To A's Capital A/c			17,500
To B's Capital A/c			8,750

Question 7

P, Q, R are three doctors who are running a Polyclinic. Their capital on 31st March, 2009 was ₹ 1,00,000 each. They agreed to admit X, Y and Z as partners w.e.f. 1st April 2009. The terms for sharing profits & losses were as follows:

(a) 70% of the visiting fee is to go to the specialist concerned.

(b) 50% of the chamber fee will be payable to the individual specialist.

(c) 40% of operation fee and fee for pathological reports, X-rays and ECG will accrue in favour of the doctor concerned.

(d) Balance of profit or loss is shared equally.

(e) All the partners are entitled for 6% interest on capital employed.

They further agreed that:

(i) X, Y and Z brought in ₹ 20,000 each as goodwill. Goodwill is shared by the existing partners equally.

(ii) X, Y and Z brought in ₹ 50,000 each as capital. Each of the original partners also contributed ₹ 50,000 by way of capital.

The receipts for the year after admission of new partners were:

Name of doctors	*Particulars*	*Visiting Fees (₹)*	*Chambers Fees (₹)*	*Fees for reports, operation etc. (₹)*
P	*General Physician*	*1,50,000*	*2,00,000*	*-*

* As per para 36 of AS 10, 'Accounting for fixed Assets,' goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill raised at the time of admission of C is to be written off in new ratio among all partners including new partner, C.

Q	Gynecologist	25,000	1,75,000	1,00,000
R	Cardiologist	-	1,00,000	75,000
X	Child Specialist	1,00,000	1,50,000	-
Y	Pathologist	-	-	1,00,000
Z	Radiologist	-	40,000	2,00,000
	Total	2,75,000	6,65,000	4,75,000

Expenses for the year were as follows:

Particulars	₹
Medicines, injections and other consumables	1,00,000
Printing and stationery	5,000
Telephone expenses	5,000
Rent	42,000
Power and light	10,000
Nurses salary	20,000
Attendants wages	20,000
Total	2,02,000
Depreciation:	
X-Ray machines	15,000
ECG equipments	5,000
Furniture	5,000
Surgical equipments	5,000
Total Depreciation	30,000

You are requested to:

(i) Pass necessary journal entries on admission of partners.

(ii) Prepare the Profit and Loss Account of the polyclinic for the year ended 31st March, 2010.

(iii) Prepare capital accounts of all the partners at the end of the financial year 2009-10. Also show the distribution of profit among partners. **(November, 2010)**

Answer

(i) Journal Entries (on admission of partners)

Date	Particulars		Debit (₹)	Credit (₹)
1st April, 2009	X's capital A/c	Dr.	20,000	
	Y's capital A/c	Dr.	20,000	

	Z's capital A/c Dr.	20,000	
	To P's capital A/c		20,000
	To Q's capital A/c		20,000
	To R's capital A/c		20,000
	(Being goodwill adjusted through capital accounts)		
	Bank A/c Dr.	2,10,000	
	To X's capital A/c (20,000 + 50,000)		70,000
	To Y's capital A/c (20,000 + 50,000)		70,000
	To Z's capital A/c (20,000 + 50,000)		70,000
	(Being goodwill and capital brought in by new partners)		
	Bank A/c Dr.	1,50,000	
	To P's capital A/c		50,000
	To Q's capital A/c		50,000
	To R's capital A/c		50,000
	(Being capital brought in by existing partners)		

(ii) **Profit & Loss Account**

for the year ended 31st March, 2010

Particulars	(₹)	Particulars	(₹)
To Medicines, injections and other consumables	1,00,000	By Visiting fee	2,75,000
To Printing and stationery	5,000	By Chamber fee	6,65,000
To Telephone expenses	5,000	By Fee for report, operation etc.	4,75,000
To Rent	42,000		
To Power and light	10,000		
To Nurses salary	20,000		
To Attendants wages	20,000		
To Depreciation			
X-ray machine 15,000			
ECG equipment 5,000			

	Furniture 5,000	30,000		
	Surgical equipment 5,000			
To	Interest on capital (W.N.3)	39,600		
To	Net profit transferred to partners' capital accounts	11,43,400		
		14,15,000		14,15,000

(iii)

Partners' Capital Accounts

for the year ended 31st March, 2010

Debit side

Particulars	*P*	*Q*	*R*	*X*	*Y*	*Z*
	₹	₹	₹	₹	₹	₹
To P, Q & R A/cs (Goodwill)	-	-	-	20,000	20,000	20,000
To Balance c/d	4,56,600	3,96,600	3,31,600	2,69,400	1,64,400	2,24,400
	4,56,600	3,96,600	3,31,600	2,89,400	1,84,400	2,44,400

Credit side

Particulars	*P* ₹	*Q* ₹	*R* ₹	*X* ₹	*Y* ₹	*Z* ₹
By Balance b/d	1,00,000	1,00,000	1,00,000	-	-	-
By X, Y & Z A/cs (Goodwill)	20,000	20,000	20,000	-	-	-
By Bank	50,000	50,000	50,000	70,000	70,000	70,000
By Interest on capital (W.N.3)	10,200	10,200	10,200	3,000	3,000	3,000
By Fee (share) (W.N.1)	2,05,000	1,45,000	80,000	1,45,000	40,000	1,00,000
By Profit (share) (W.N.2)	71,400	71,400	71,400	71,400	71,400	71,400
	4,56,600	3,96,600	3,31,600	2,89,400	1,84,400	2,44,400

Working Notes:

1. **Statement showing distribution of fee among partners**

Partner Name	*Visiting fees (70%) (₹.)*	*Chamber fees (50%) (₹)*	*Operations fees (40%) (₹)*	*Total (₹)*
P	1,05,000	1,00,000	-	2,05,000
Q	17,500	87,500	40,000	1,45,000
R	-	50,000	30,000	80,000

X	70,000	75,000	-	1,45,000
Y	-	-	40,000	40,000
Z	-	20,000	80,000	1,00,000
	1,92,500	3,32,500	1,90,000	7,15,000

2. **Statement showing distribution of profit among partners**

	₹
Profits as per profit and loss account	11,43,400
Less: Fee payable to partners	(7,15,000)
Profit to be divided equally among partners	4,28,400

Share of each partner in remaining profit = ₹ 4,28,400/6 = ₹71,400.

3. **Interest on capital employed**

	P ₹	Q ₹	R ₹	X ₹	Y ₹	Z ₹
Opening balance	1,00,000	1,00,000	1,00,000	-	-	-
Add: Premium for goodwill shared equally by old partners	20,000	20,000	20,000	-	-	-
Add: Capital brought in cash	50,000	50,000	50,000	50,000	50,000	50,000
	1,70,000	1,70,000	1,70,000	50,000	50,000	50,000
Interest @ 6%	10,200	10,200	10,200	3,000	3,000	3,000

Total interest = ₹ 39,600.

Note: It is assumed that amount of premium for goodwill brought in by new partners X, Y and Z has not been withdrawn by old partners P, Q and R and it is still kept in the business.

Question 8

The Balance Sheet of Amitabh, Abhishek and Amrish as at 31.12.2008 stood as follows:

Liabilities		*Amount Rs.*	*Assets*	*Amount Rs.*
Capital:			*Land & Buildings*	*74,000*
Amitabh	*60,000*		*Investments*	*10,000*

Abhishek	40,000		Goodwill		37,800
Amrish	40,000	1,40,000	Life Policy (at surrender value):		
Creditors		25,800	Amitabh		2,500
General Reserve		8,000	Abhishek		2,500
Investment Fluctuation Reserve		2,400	Amrish		1,000
			Stock		20,000
			Debtors	20,000	
			Less: Provision for doubtful debts	1,600	18,400
			Cash & bank balance		10,000
		1,76,200			1,76,200

Amrish died on 31 March, 2009, due to this reason the following adjustments were agreed upon:

(i) *Land and Buildings be appreciated by 50%.*

(ii) *Investment be valued at 6% less than the cost.*

(iii) *All debtors (except 20% which are considered as doubtful) were good.*

(vi) *Stock to be reduced to 94%.*

(v) *Goodwill to be valued at 1 year's purchase of the average profits of the past five years.*

(vi) *Amrish's share of profit to the date of death be calculated on the basis of average profits of the three completed years immediately preceeding the year of death.*

The profits of the last five years are as follows:

Year	Rs.
2004	23,000
2005	28,000
2006	18,000
2007	16,000
2008	20,000
	1,05,000

The life policies have been shown at their surrender values representing 10% of the sum assured in each case. The annual premium of Rs.1,000 is payable every year on 1st August.

Give the necessary Journal Entries in the books of account and prepare the Balance Sheet of the reconstituted firm. **(June, 2009)**

Answer

Journal Entries

Particulars			*Amount*	*Amount*
1.	Insurance Company's A/c	Dr.	10,000	
	To Life Policy A/c			10,000
	(Being the policy on the life of Amrish matured on his death)			
2.	Life Policy A/c	Dr.	9,000	
	To Amitabh's Capital A/c			3,000
	To Abhishek's Capital A/c			3,000
	To Amrish's Capital A/c			3,000
	(Being the transfer of balance in life policy account to all partners' capital accounts)			
3.	Amitabh's Capital A/c	Dr.	12,600	
	Abhishek's Capital A/c	Dr.	12,600	
	Amrish's Capital A/c	Dr.	12,600	
	To Goodwill A/c			37,800
	(Being goodwill standing in the books written off fully)			
4.	Land & Buildings A/c	Dr.	37,000	
	To Revaluation A/c			37,000
	(Being an increase in the value of assets recorded)			
5.	Investment Fluctuation Reserve A/c	Dr.	600	
	To Investment A/c			600
	(Being reduction in the cost of investment adjusted through Investment Fluctuation Reserve)			
6.	Revaluation A/c	Dr.	3,600	
	To Stock A/c			1,200
	To Provision for Doubtful Debts A/c			2,400
	(Being the fall in value of assets recorded)			
7.	Amitabh's Capital A/c	Dr.	3,500	
	Abhishek's Capital A/c	Dr.	3,500	
	To Amrish's Capital A/c			7,000
	(Being the share of Amrish's revalued goodwill adjusted through capital accounts of the remaining partners)			

8.	Profit & Loss Suspense Account	Dr.	1,500	
	To Amrish's Capital A/c			1,500
	(Being Amrish's Share of profit to date of death credited to his account)			
9.	Revaluation A/c	Dr.	33,400	
	To Amitabh's Capital A/c			11,133
	To Abhishek's Capital A/c			11,133
	To Amrish's Capital A/c			11,134•
	(Being the transfer of profit on revaluation)			
10.	General Reserve A/c	Dr.	8,000	
	Investment Fluctuation Reserve A/c (Rs. 2,400 - Rs. 600)	Dr.	1,800	
	To Amitabh's Capital A/c			3,267
	To Abhishek's Capital A/c			3,267
	To Amrish's Capital A/c			3,266
	(Being the transfer of accumulated profits to capital accounts)			
11.	Amrish's Capital A/c	Dr.	53,300	
	To Amrish's Executor's A/c			53,300
	(Being the transfer of Amrish's Capital A/c to his Executor's A/c)			

Balance Sheet

as at 31st March, 2009

Liabilities	*Amount*	*Assets*		*Amount*
Amithabh's Capital Account	61,300	Land & Building		1,11,000
Abhishek's Capital Account	41,300	Life Policy: Amitabh	2,500	
Amrish's Executor's Account	53,300	Abhishek	2,500	5,000
Sundry Creditors	25,800	Investments		9,400
		Stock		18,800
		Debtors	20,000	
		Less: Provisions	4,000	16,000
		Insurance Company		10,000
		Cash & Bank Balance		10,000
		Profit and loss Suspense A/c		1,500
	1,81,700			1,81,700

• Rounded off.

Working Notes:

(i) Calculation of Amrish's Share of Profit

Total profit for last three years	Rs. 18,000+16,000+20,000= Rs.54,000
Average profit 54,000/3	= 18,000
Profit for 3 months = 18,000 x 3/12	= 4,500
Amrish's share of Profit = 4,500 x 1/3	= 1,500

(ii) Calculation of Goodwill

Total profits for last five years	Rs.1,05,000
Average profit 1,05,000/5	= 21,000
Goodwill at one year's purchase	Rs. 21,000 x 1 =Rs. 21,000

Question 9

A, B and C run a business sharing profits and losses in proportion of 2:2:1. On 1st January, 2008 their respective capitals were Rs.96,000, Rs.90,000 and Rs.84,000. On 30th June, 2008 the following was the position:

	Rs.
Creditors	*30,000*
Furniture	*9,000*
Book debts	*1,80,000*
Stock	*90,000*
Cash in hand and at bank	*36,000*

The drawings of the partners respectively were Rs.12,000, Rs.9,000 and Rs.6,000 during the half-year. Each partner is entitled to an interest at the rate of 5% p.a. on capital. Interest on drawings was calculated as Rs.600 for A, Rs.450 in case of B and Rs.300 in case of C.

You are required to prepare:

(i) A statement of affair as on 30th June, 2008.

(ii) Calculate the profits for the half-year ending on 30th June, 2008 and allocate the same amongst the partners. Also calculate capital of each partner as on 30th June, 2008.

(November, 2009)

Answer

(i) Statement of Affairs of A, B & C

As on 30th June, 2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital (Bal. Fig.)	2,85,000	Furniture	9,000
Creditors	30,000	Stock	90,000
		Book debts	1,80,000
		Cash in hand and at bank	36,000
	3,15,000		3,15,000

(ii) Statement showing Profit and Loss of partners A, B and C for six months ending on 30th June, 2008

Particulars	*Rs.*
Capital as on 30th June, 2008	2,85,000
Add: Drawings of A, B and C (Rs.12,000 + Rs.9,000 + Rs.6,000)	27,000
Add: Interest on drawings of A, B and C (Rs.600 + Rs.450 + Rs.300)	1,350
	3,13,350
Less: Interest on capital of A, B and C (Rs.2,400+Rs.2,250+Rs.2,100)	(6,750)
	3,06,600
Less: Capital as on 1st January, 2008 of A, B and C (Rs.96,000 + Rs.90,000 + Rs.84,000)	(2,70,000)
Net Profit	36,600

Statement showing allocation of profits and other adjustments in the capital accounts of A, B and C

Particulars	*A (Rs.)*	*B (Rs.)*	*C (Rs.)*
Capital as on 1st January, 2008	96,000	90,000	84,000
Add: Net profit in the ratio of 2:2:1	14,640	14,640	7,320
Add: Interest on capital @ 5% p.a. for 6 months	2,400	2,250	2,100

		1,13,040	1,06,890	93,420
Less:	Drawings	(12,000)	(9,000)	(6,000)
Less:	Interest on drawings	(600)	(450)	(300)
Capital as on 30th June, 2008		1,00,440	97,440	87,120

Question 10

'A' and 'B' are partners sharing Profits and Losses in the ratio of 3:1. Their capitals were Rs.3,00,000 and Rs.2,00,000 respectively. As from 1st April, 2009, it was agreed to change the profit sharing ratio to 3:2. According to the partnership deed, goodwill should be valued at two years' purchase of the average of three years' profits. The profits of the previous three years ending 31st March were:

2007-Rs.1,50,000; 2008-Rs.2,00,000 and 2009-Rs.2,50,000. Pass the necessary journal entry to give effect to the above arrangement in the capital accounts of the partners.

(November, 2009)

Answer

Journal Entry

		Rs.	*Rs.*
B's Capital A/c	Dr.	60,000	
To A's Capital A/c			60,000
(Being the adjusting entry for goodwill, passed due to change in profit and loss sharing ratio, through capital accounts of partners)			

Working Notes:

1. Calculation of Goodwill

	Rs.
Profit for the year 2007	1,50,000
Profit for the year 2008	2,00,000
Profit for the year 2009	2,50,000
Total profit of 3 years	6,00,000

Average Profit = $\frac{6,00,000}{3}$ =Rs.2,00,000

Goodwill = Rs.2,00,000 × 2 = Rs.4,00,000

2. Effect of change in Profit Sharing Ratio

Old ratio of A and B = 3 : 1

New ratio of A and B = 3 : 2

Gaining Ratio = New Ratio – Old Ratio

For A = $\frac{3}{5} - \frac{3}{4} = \frac{12-15}{20} = \frac{3}{20}$ i.e. A loses by $\frac{3}{20}$

For B = $\frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$ i.e. B gains by $\frac{3}{20}$

3. Amount of compensation payable by B to A

$\frac{3}{20} \times \text{Rs.}4,00,000 = \text{Rs.}60,000$

EXERCISES

1. X, Y Ltd. and Z Ltd. are partners of X & Co. The partnership deed provided that :

(a) The working partner Mr. X is to be remunerated at 15% of the net profits after charging his remuneration, but before charging interest on capital and provision for taxation;

(b) Interest is to be provided on capital at 15% per annum;

(c) Balance profits after making provision for taxation, is to be shared in the ratio of 1 : 2 : 2 by the three partners.

During the year ended 31st March, 2011 :

(i) the net profit before tax and before making any payment to partners amounted to Rs. 6,90,000;

(ii) interest on capitals at 15% per annum amounted to :

(iii) Rs. 60,000 for X; Rs. 1,50,000 for Y Ltd. and Rs. 1,80,000 for Z Ltd. The capitals have remained unchanged during the year;

provision for tax is to be at 40% of "total income" of the firm. The total income has been computed at Rs. 1,95,000.

You are asked by :

(a) the firm to pass closing entries in relation to the above;

(b) Y Ltd. to pass journal entries in its books pertaining to its income from the firm and show the investment in partnership account as it would appear in its ledger;

(c) Z Ltd. to show, how the above information will appear in its financial statements for the year;

(d) Shri X to show the working, if any, in relation to the above.

(Hints: Investment in partnership with Shri X and Z Ltd. Rs. 12,02,800)

2. *Avinash, Basuda Ltd. and Chinmoy Ltd. were in partnership sharing profits and losses in the ratio of 9 : 4 : 2. Basuda Ltd. retired from the partnership on 31st March, 2011, when the firm's balance sheet was as under :*

Rs. in thousand

Sundry creditors		600	*Cash and bank*	284
Capital accounts :			*Sundry debtors*	400
Avinash	2,700		*Stock*	800
Basuda Ltd.	1,200		*Furniture*	266
Chinmoy Ltd.	600	4,500	*Plant*	850
			Land and building	2,500
		5,100		5,100

Basuda Ltd.'s share in goodwill and capital was acquired by Avinash and Chinmoy Ltd. in the ratio of 1 : 3, the continuing partners bringing in the necessary finance to pay off Basuda Ltd. The partnership deed provides that on retirement or admission of a partner, the goodwill of the firm is to be valued at three times the average annual profits of the firm for the four years ended on the date of retirement or admission. The profits of the firm during the four years ended 31st March, 2011 in thousands of rupees were:

	Rs. in thousand
2007-2008	450
2008-2009	250
2009-2010	600
2010-2011	700

The deed further provided that goodwill account is not to appear in the books of accounts at all. The continuing partners agreed that with effect from 1st April, 2011, Ghanashyam, son of Avinash is to be admitted as a partner with 25% share of profit.

Avinash gifts to Ghanashyam, by transfer from his capital account, an amount sufficient to cover up 12.5% of capital and goodwill requirement. The balance 12.5% of capital and goodwill requirement is purchased by Ghanashyam from Avinash and Chinmoy Ltd. in the ratio of 2 : 1.

The firm asks you to:

(i) Prepare a statement showing the continuing partners' shares;

(ii) Pass journal entries including for bank transactions; and

(iii) Prepare the balance sheet of the firm after Ghanashyam's admission

(Hints: New ratio 11:7:6; Total of Balance Sheet Rs.66,00,000)