

Chapter 11

Unit 1: Introduction to Partnership Accounts

Question 1

Laurel and Hardy are partners of the firm LH & Co., from 1.4.2003. Initially both of them contributed Rs.1,00,000 each as capital. They did not contribute any capital thereafter. They maintain accounts of the firm on mercantile basis. They were sharing profits and losses in the ratio of 5:4. After the accounts for the year ended 31.3.2007 were finalized, the partners decided to share profits and losses equally with effect from 1.4.2003.

It was also discovered that in ascertaining the results in the earlier years certain adjustments, details of which are given below, had not been noted.

Year ended 31 st March	2004	2005	2006	2007
	Rs.	Rs.	Rs.	Rs.
Profit as per accounts prepared and finalized	1,40,000	2,60,000	3,20,000	3,60,000
Expenses not provided for (as at 31 st March)	30,000	20,000	36,000	24,000
Incomes not taken into account (as at 31 st March)	18,000	15,000	12,000	21,000

The partners decided to admit Chaplin as a partner with effect from 1.4.2007. It was decided that Chaplin would be allotted 20% share in the firm and he must bring 20% of the combined capital of Laurel and Hardy.

Following is the Balance sheet of the firm as on 31.3.2007 before admission of Chaplin and before adjustment of revised profits between Laurel and Hardy.

Balance Sheet of LH & Co. as at 31.3.2007

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Plant and machinery	60,000
Laurel	2,11,500	Cash on hand	10,000
Hardy	1,51,500	Cash at bank	5,000
Sundry creditors	2,27,000	Stock in trade	3,10,000
		Sundry debtors	2,05,000
	<u>5,90,000</u>		<u>5,90,000</u>

You are required to prepare:

- (i) Profit and Loss Adjustment account;
- (ii) Capital accounts of the partners; and
- (iii) Balance Sheet of the firm after the admission of Chaplin.

(20 Marks) (May, 2007)

Answer**(i)****Profit and Loss Adjustment Account***

	Rs.		Rs.
To Expenses not provided for (years 2004-2007)	1,10,000	By Income not considered (for years 2004-2007)	66,000
		By Partners' capital accounts (loss)	
		Laurel	22,000
		Hardy	<u>22,000</u>
	<u>1,10,000</u>		<u>1,10,000</u>

(ii)**Partners' Capital Accounts**

	Laurel Rs.	Hardy Rs.	Chaplin Rs.		Laurel Rs.	Hardy Rs.	Chaplin Rs.
To P & L Adjustment A/c	22,000	22,000	-	By Balance b/d	2,11,500	1,51,500	-
To Hardy	60,000			By Laurel	-	60,000	-
To Balance c/d	<u>1,29,500</u>	<u>1,89,500</u>	<u>63,800</u>	By Cash	<u>-</u>	<u>-</u>	<u>63,800</u>
	<u>2,11,500</u>	<u>2,11,500</u>	<u>63,800</u>		<u>2,11,500</u>	<u>2,11,500</u>	<u>63,800</u>
				By Balance b/d	1,29,500	1,89,500	63,800

(iii)

**Balance Sheet of LH & Co.
as on 1.4.2007
(After admission of Chaplin)**

Liabilities	Rs.	Assets	Rs.
Capital accounts:		Plant and machinery	60,000
Laurel	1,29,500	Sundry debtors	2,05,000
Hardy	1,89,500	Stock in trade	3,10,000
Chaplin	63,800	Accrued income	66,000
Sundry creditors	2,27,000	Cash on hand (10,000 + 63,800)	73,800
Outstanding expenses	<u>1,10,000</u>	Cash at bank	<u>5,000</u>
	<u>7,19,800</u>		<u>7,19,800</u>

* It is assumed that expenses and incomes not taken into account in earlier years were fully ignored.

Working Notes:**1. Computation of Profit and Loss distributed among partners**

		Rs.
Profit for the year ended	31.3.2004	1,40,000
	31.3.2005	2,60,000
	31.3.2006	3,20,000
	31.3.2007	<u>3,60,000</u>
Total Profit		<u>10,80,000</u>

	<i>Laurel</i>	<i>Hardy</i>	<i>Total</i>
	Rs.	Rs.	Rs.
Profit shared in old ratio i.e 5:4	6,00,000	4,80,000	10,80,000
Profit to be shared as per new ratio i.e. 1:1	<u>5,40,000</u>	<u>5,40,000</u>	10,80,000
Excess share	<u>60,000</u>		
Deficit share		<u>(60,000)</u>	

Laurel to be debited by Rs.60,000 and Hardy to be credited by Rs.60,000.

2. Capital brought in by Chaplin

Capital to be brought in by Chaplin must be equal to 20% of the combined capital of Laurel and Hardy

	Rs.
Capital of Laurel (2,11,500 – 22,000 – 60,000)	1,29,500
Capital of Hardy (1,51,500 – 22,000 + 60,000)	<u>1,89,500</u>
Combined Capital	<u>3,19,000</u>
20% of the combined capital brought in by Chaplin (20% of Rs. 3,19,000)	<u>63,800</u>

Question 2

A and B are equal partners. They admit C and D as partners with 1/5 and 1/6 share respectively. What is the profit sharing ratio of all the partners?

(2 Marks) (May, 2007)

Answer

Let total profits or losses of the firm be 1

Shares of C and D is $\frac{1}{5}$ and $\frac{1}{6}$ respectively.

Balance remaining: $1 - \left(\frac{1}{5} + \frac{1}{6}\right) = 1 - \frac{11}{30} = \frac{19}{30}$

$\frac{19}{30}$ to be shared equally by A and B as $\frac{9.5}{30} : \frac{9.5}{30}$

New profit sharing ratio will be A: B: C: D

$$\left[\frac{9.5}{30} \times \frac{2}{2} \right] : \left[\frac{9.5}{30} \times \frac{2}{2} \right] : \left[\frac{1}{5} \times \frac{12}{12} \right] : \left[\frac{1}{6} \times \frac{10}{10} \right]$$

Thus new profit sharing ratio of all the partners will be 19:19:12:10.

Question 3

X and Y are partners sharing profits and losses in the ratio of 3:2. On 30th September, 2006 they admitted Z as a partner. The new profit sharing ratio agreed was 2:2:1.

At the time of admission Z brought in a fixture valued at Rs. 6,000 and a machinery worth Rs.24,000. No accounting entry was passed for the fixture brought in by partner Z in the books of the firm.

Also at the time of admission the valuation of goodwill was made. The value of goodwill of X and Y was decided at Rs. 40,000 and value of goodwill of partner Z was fixed at Rs. 20,000. No effect was given to the goodwill value in the books of the firm.

On 31.3.2007, it was decided that partner X would retire and the other partners viz., Y and Z would continue the business of the firm by converting it into a company called YZ Ltd., with equal shareholding in the company.

The partners agreed as below:

- (i) The goodwill of the firm shall be fixed at Rs.80,000. Necessary effect for goodwill value not recorded earlier shall be given. The present goodwill value being Rs.80,000 shall be reflected in the books of the company.*
- (ii) All the assets and liabilities of the firm shall be taken over by the company.*
- (iii) Partner X would take motor car of the firm at a value of Rs.7,400.*
- (iv) A plant owned by the firm is sold for Rs.6,000.*
- (v) The profit of the firm upto 30.9.2006 was Rs.44,000.*
- (vi) Partner X agreed to leave Rs.90,000 as loan with the firm in return for 12% interest per annum.*

Following is the Trial Balance of the firm as on 31.3.2007:

Particulars	Dr. Rs.	Cr. Rs.
<i>Capital Account:</i>		
X	-	80,000
Y	-	50,000
Z	-	24,000
<i>Drawings Account:</i>		
X	22,000	-
Y	20,000	-
Z	9,600	-

Sundry Debtors	70,000	-
Sundry Creditors	-	32,000
Plant (Book value of plant sold Rs.8,000)	46,000	-
Fixtures	14,000	-
Stock	24,000	-
Motor car	5,400	-
Cash at bank	34,600	-
Profit and Loss A/c (for the year)	<u> </u>	<u>59,600</u>
	<u>2,45,600</u>	<u>2,45,600</u>

You are required to prepare:

- (i) Goodwill Adjustment Account
- (ii) Profit and Loss Appropriation Account
- (iii) Partners' Capital Accounts
- (iv) Balance Sheet of YZ Ltd. after conversion.

(20 Marks) (November, 2007)

Answer

(i) Goodwill Adjustment Account					
Rs.			Rs.		
30.9.07	To	Partners' Capital A/cs (in old ratio)	30.9.06	By	Partners' Capital A/cs (in new ratio)
		X 24,000			X 24,000
		Y 16,000			Y 24,000
		Z 20,000			Z 12,000
31.3.07	To	Partners' Capital A/cs	31.3.07	By	Goodwill A/c
		X 32,000			(Goodwill raised in the book) 80,000
		Y 32,000			
		Z <u>16,000</u>			
		<u>1,40,000</u>			<u>1,40,000</u>

(ii) Profit and Loss Appropriation Account					
To	Plant - Loss on sale of plant	2,000	By	Motor Car	2,000
To	Partners' Capital A/cs		By	Profit and Loss A/c	59,600
	X	32,640			

Y	23,840	
Z	<u>3,120</u>	
	<u>61,600</u>	<u>61,600</u>

Calculation of profit apportionment:

	<i>Total</i>	<i>X</i>	<i>Y</i>	<i>Z</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Upto 30.9.2006	44,000	26,400	17,600	NIL
From 01.10.2006 to 31.3.2007	<u>15,600</u>	<u>6,240</u>	<u>6,240</u>	<u>3,120</u>
	<u>59,600</u>	<u>32,640</u>	<u>23,840</u>	<u>3,120</u>

(iii)

Partners' Capital Accounts

		<i>X</i>	<i>Y</i>	<i>Z</i>			<i>X</i>	<i>Y</i>	<i>Z</i>
		<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>			<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
30.9.06	To Goodwill Adjustment A/c	24,000	24,000	12,000	30.9.06	By Balance	80,000	50,000	-
31.7.07	To Motor car	7,400	-	-		By Plant & machinery	-	-	24,000
	To Drawings	22,000	20,000	9,600		By Fixtures	-	-	6,000
	To 12% Loan	90,000	-	-		By Goodwill Adjustment A/c	24,000	16,000	20,000
	To Bank	25,240	-	-		By Profit upto 30.9.06	26,400	17,600	-
	To Balance c/d	-	77,840	47,520	31.7.07	By Profit for 6 months ended 31.3.07	6,240	6,240	3,120
						By Goodwill Adj. A/c	<u>32,000</u>	<u>32,000</u>	<u>16,000</u>
		<u>1,68,640</u>	<u>1,21,840</u>	<u>69,120</u>			<u>1,68,640</u>	<u>1,21,840</u>	<u>69,120</u>
31.7.07	To Bank		15,160	-	31.7.07	By Balance b/d		77,840	47,520
	To Share capital		<u>62,680</u>	<u>62,680</u>		By Bank			15,160
			<u>77,840</u>	<u>62,680</u>				<u>77,840</u>	<u>62,680</u>

(iv)

Balance Sheet of YZ Ltd.

Liabilities	Rs.	Assets	Rs.
Share capital	1,25,360	Goodwill	80,000
12% Loan	90,000	Plant (46,000 – 8,000)	38,000
Sundry creditors	32,000	Fixtures (14,000 + 6,000)	20,000
		Stock	24,000
		Sundry debtors	70,000
		Cash at bank	<u>15,360</u>
	<u>2,47,360</u>		<u>2,47,360</u>

Bank A/c

	Rs.		Rs.
To Balance b/d	34,600	By X's Capital A/c	25,240
To Plant (sold) A/c	6,000	By Y's Capital A/c	15,160
To Z's capital A/c	<u>15,160</u>	By Balance c/d	<u>15,360</u>
	<u>55,760</u>		<u>55,760</u>

Total capital of the firm before conversion:

Y	77,840
Z	<u>47,520</u>
	<u>1,25,360</u>

As Y and Z would continue with equal shareholding, therefore, share capital of Y and Z would be Rs.1,25,360 / 2 = Rs.62,680 each.

	Rs.
Z should bring cash Rs.(62,680 – 47,520) =	15,160
Y should withdraw cash Rs.(77,840 – 62,680) =	15,160

Question 4

A, B, and C are partners sharing profits and losses in the ratio of 3:2:1. B retired from the firm. Partners A and C decided to take his share in 3:1 ratio. What is the new ratio of the partners A and C?

(2 Marks) (November, 2007)

Answer

Calculation of new profit and loss sharing ratio of partners A and C

1/3rd share of B taken by oartners A & C in 3:1 i.e.

$$\Rightarrow \text{A will receive from B} = \frac{1}{3} \times \frac{3}{4} = \frac{1}{4}$$

$$\Rightarrow C \text{ will receive from B} = \frac{1}{3} \times \frac{1}{4} = \frac{1}{12}$$

Total share of A and C will be:

$$A = \frac{3}{6} + \frac{1}{4} = \frac{12+6}{24} = \frac{18}{24} \text{ or } \frac{3}{4}$$

$$C = \frac{1}{6} + \frac{1}{12} = \frac{2+1}{12} = \frac{3}{12} \text{ or } \frac{1}{4}$$

Therefore, new profit and loss sharing ratio of A and C will be 3:1.

Question 5

A, B and C are partners of the firm ABC & Co., sharing profits and losses in the ratio of 5:3:2. Following is the Balance Sheet of the firm as at 31.3.2008:

Balance Sheet as at 31.3.2008

Liabilities	Rs.	Assets	Rs.
Partners' capital accounts:		Goodwill	1,00,000
A	4,50,000	Building	10,50,000
B	1,30,000	Machinery	6,50,000
C	1,70,000	Furniture	2,15,000
Investment fluctuation reserve	1,00,000	Investments (market value Rs.75,000)	60,000
Contingency reserve	75,000	Stock	6,50,000
Long-term loan	15,00,000	Sundry debtors	6,95,000
Bank overdraft	2,20,000	Advertisement suspense	25,000
Sundry creditors	<u>8,00,000</u>		
	<u>34,45,000</u>		<u>34,45,000</u>

It was decided that B would retire from the partnership on 1.4.2008 and D would be admitted as a partner on the same date. Following adjustments are agreed amongst the partners for the retirement/admission:

- (i) Goodwill is to be valued at Rs.5,00,000, but the same will not appear as an asset in the books of the firm.
- (ii) Building and machinery are to be revalued at Rs.10,00,000 and Rs.5,20,000 respectively.
- (iii) Investments are to be taken over by B at the market value.
- (iv) Provision for doubtful debts to be maintained at 20% on sundry debtors.
- (v) The capital of the reconstituted firm will be Rs.10,00,000 to be contributed by the partners A, C and D in their new profit sharing ratio of 2 : 2 : 1.
- (vi) Surplus funds if any will be used to pay the bank overdraft.
- (vii) Amount due to retiring partner B will be transferred to his loan account.

Prepare:

- (i) Revaluation Account;
- (ii) Capital Accounts of the partners; and
- (iii) Balance Sheet of the firm after reconstitution.

(20 Marks) (May, 2008)

Answer

(i)

Revaluation Account

	Rs.		Rs.
To Building	50,000	By Investments	15,000
To Machinery	1,30,000	By Partners' capital A/cs (Loss on revaluation)	
To Provision for doubtful debts	1,39,000	A	1,52,000
		B	91,200
		C	<u>60,800</u>
	<u>3,19,000</u>		<u>3,04,000</u>
			<u>3,19,000</u>

(ii)

Partners' Capital Accounts

	A	B	C	D		A	B	C	D
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Revaluation A/c	1,52,000	91,200	60,800	-	By Balance b/d	4,50,000	1,30,000	1,70,000	-
To Goodwill (W.N.2)	50,000	30,000	20,000	-	By Contingency Reserve	37,500	22,500	15,000	-
To A and B (W.N.3)	-	-	1,00,000	1,00,000	By Investment fluctuation Reserve	50,000	30,000	20,000	-
To Investments	-	75,000	-	-					
To Advertisement suspense	12,500	7,500	5,000	-	By C and D (W.N.3)	50,000	1,50,000	-	-
To B's Loan A/c (Bal. fig.)	-	1,28,800	-	-	By Bank (Bal.fig.)	27,000	-	3,80,800	3,00,000
To Balance c/d (W.N.4)	<u>4,00,000</u>	<u>-</u>	<u>4,00,000</u>	<u>2,00,000</u>					
	<u>6,14,500</u>	<u>3,32,500</u>	<u>5,85,800</u>	<u>3,00,000</u>		<u>6,14,500</u>	<u>3,32,500</u>	<u>5,85,800</u>	<u>3,00,000</u>

(iii)

Balance Sheet as at 01.04.2008**(After retirement of B and admission of D)**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Partners' capital accounts (W.N.4)		Building	10,00,000
A	4,00,000	Machinery	5,20,000
C	4,00,000	Furniture	2,15,000
D	2,00,000	Stock	6,50,000
Long term loan	15,00,000	Debtors	6,95,000
B's loan	1,28,800	Less: Provision for doubtful debts	<u>1,39,000</u> 5,56,000
Sundry creditors	<u>8,00,000</u>	Cash at bank (W.N.1)	<u>4,87,800</u>
	<u>34,28,800</u>		<u>34,28,800</u>

Working Notes:**1. Bank Account**

	<i>Rs.</i>		<i>Rs.</i>
To A's capital A/c	27,000	By Balance (Overdraft)	b/d 2,20,000
To C's capital A/c	3,80,800	By Balance (Bal. fig.)	c/d 4,87,800
To D's capital A/c	<u>3,00,000</u>		
	<u>7,07,800</u>		<u>7,07,800</u>

2. Goodwill, already shown in the Balance Sheet of Rs. 1,00,000, is firstly written off and then an adjusting entry is passed for revalued goodwill of Rs. 5,00,000 in sacrificing and gaining ratio of partners. This treatment is given based on the para 36 of AS 10, which states that goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it.

3. Calculation of sacrificing and gaining ratio

<i>Partners</i>	<i>New share</i>	<i>Old share</i>	<i>Share Sacrificed</i>	<i>Share Gained</i>
A	$\frac{2}{5}$	$\frac{5}{10}$	$\frac{2}{5} - \frac{5}{10} =$	$\frac{1}{10}$
B		$\frac{3}{10}$		$\frac{3}{10}$
C	$\frac{2}{5}$	$\frac{2}{10}$		$\frac{2}{5} - \frac{2}{10} = \frac{1}{5}$
D	$\frac{1}{5}$			$\frac{1}{5}$

Adjusting Entry

		Rs.	Rs.
C's Capital A/c	Dr.	1,00,000	
D's Capital A/c	Dr.	1,00,000	
	To A's Capital A/c		50,000
	To B's Capital A/c		1,50,000

4. Capitals of A, C and D as per new ratio

		Rs.
Total Capital of the firm after admission		<u>10,00,000</u>
A's share =	$10,00,000 \times \frac{2}{5}$	4,00,000
C's share =	$10,00,000 \times \frac{2}{5}$	4,00,000
D's share =	$10,00,000 \times \frac{1}{5}$	2,00,000

Question 6

P, Q and R share profit and losses in the ratio of 4:3:2 respectively. Q retires and P and R decide to share future profits and losses in the ratio of 5:3. Then immediately H is admitted for $\frac{3}{10}$ share of profits half of which was gifted by P and the remaining share was taken by H equally from P and R. Calculate the new profit sharing ratio after H's admission and gaining ratio of P and R after Q's retirement.

(2 Marks) (November, 2008)

Answer

(a) Calculation of new profit sharing ratio after H's admission:

$$\begin{aligned} P &= \frac{5}{8} - \left[\frac{3}{10} \times \frac{1}{2} \right] - \left[\frac{3}{10} \times \frac{1}{4} \right] \\ &= \frac{5}{8} - \frac{3}{20} - \frac{3}{40} \\ &= \frac{25-6-3}{40} = \frac{16}{40} \end{aligned}$$

$$\begin{aligned} R &= \frac{3}{8} - \left[\frac{3}{10} \times \frac{1}{4} \right] \\ &= \frac{3}{8} - \frac{3}{40} = \frac{15-3}{40} = \frac{12}{40} \end{aligned}$$

$$H = \frac{3}{10} \text{ or } \frac{3}{10} \times \frac{4}{4} = \frac{12}{40}$$

Hence,

New Ratio of P : R : H

16:12:12

Or 4 : 3 : 3

(b) Calculation of gaining ratio of P and R after Q's retirement:

$$P = \frac{5}{8} - \frac{4}{9} = \frac{45-32}{72} = \frac{13}{72}$$

$$R = \frac{3}{8} - \frac{2}{9} = \frac{27-16}{72} = \frac{11}{72}$$

Question 7

A and M are partners, sharing profits and losses in the ratio of 3:2. G is admitted for $\frac{1}{4}$ th share. Thereafter, N enters the partnership for 20 Paise in a Rupee. Compute new profit sharing ratio.

(2 Marks) (June, 2009)

Answer

Let the total share be = 1

$$\text{Share of new partner G} = \frac{1}{4}$$

$$\text{Remaining share of profit} = 1 - \frac{1}{4} = \frac{3}{4}$$

$$\text{New ratio of (A)} = \frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$$

$$\text{New ratio of (M)} = \frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$$

$$\text{New ratio of A:M:G} = 9:6:5$$

Again, let the total share at the time of admission of N = 1

$$\text{Share of new partner N is 20\% i.e. } \frac{1}{5}$$

$$\text{Remaining share} = 1 - \frac{1}{5} = \frac{4}{5}$$

$$\text{New ratio of A} = \frac{4}{5} \times \frac{9}{20} = \frac{9}{25}$$

$$\text{New ratio of M} = \frac{4}{5} \times \frac{6}{20} = \frac{6}{25}$$

$$\therefore \text{New ratio of G} = \frac{4}{5} \times \frac{5}{20} = \frac{5}{25}$$

$$\text{New ratio of A:M:G:N} = 9:6:5:5$$

Question 8

P, N and T are equal partners. They decided to change their profit sharing ratio into 5:4:3. They raised the goodwill in the books to the extent of Rs.2,40,000 and it is to be written off immediately. Show Journal entries with narration to be passed for raising the goodwill and for its subsequent write off.

(2 marks) (November, 2009)

Answer

Journal Entries

	<i>Dr. (Rs.)</i>	<i>Cr. (Rs.)</i>
Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the value of goodwill raised in the books, in old profit sharing ratio)	2,40,000	80,000 80,000 80,000
A's Capital A/c Dr. B's Capital A/c Dr, C's Capital A/c Dr. To Goodwill A/c (Being the value of goodwill written off from the books of the firm, in new profit sharing ratio)	1,00,000 80,000 60,000	2,40,000

Note: 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 valued at the time of change in profit and loss sharing ratio is to be adjusted through capital accounts of the partners directly. The journal entries for raising goodwill and then writing it off is not in accordance with the said standard but have been given due to the requirement of the question.

Alternatively, Capital accounts of partner A and partner C may be adjusted to give net effect to the above entries.

The Adjusting Journal entry would be

	<i>Rs.</i>	<i>Rs.</i>
A's Capital A/c Dr. To C's Capital A/c (Being adjusting entry passed for goodwill, due to change in profit and loss sharing ratio)	20,000	20,000

Unit 2: Dissolution of Partnership Firms

Question 1

X, Y and Z are partners. X became insolvent on 15.4.2007. The Capital account balance of partner Y is on the debit side. Partner Y is solvent. Should partner Y bear the loss arising on account of the insolvency of partner X?

(2 Marks) (May, 2007)

Answer

If some partner is having debit balance in his capital account and is not insolvent, then he cannot be called upon to bear the loss on account of the insolvency of the other partner.

Hence, Y need not bear the loss due to insolvency of partner X.

Question 2

Explain Garner v/s Murray rule applicable in the case of partnership firms. State, when is this rule not applicable.

(2 Marks) (May, 2008)

Answer

In the case of dissolution of a partnership firm due to insolvency, Garner vs Murray rule is applicable at the time of any partner becoming insolvent. It requires -

1. That the solvent partners should bear the loss arising due to insolvency of a partner in their capital ratio after making adjustments for past accumulated reserves, profits or losses, drawings, interest on drawings/capitals, remuneration to partners etc., to the date of dissolution but before making adjustment for profit or loss on realization in case of fluctuating capital. In case of fixed capital no such adjustments are required.
2. That the solvent partners should bring in cash equal to their respective shares of the loss on realization.

This rule is not applicable when:

1. Only one partner is solvent.
2. All partners are insolvent.
3. The partnership deed provides for a specific method to be followed in case of insolvency of a partner, and then the conditions given in the deed would prevail.

Unit 3: Amalgamation, Conversion and Sale of Partnership Firm

Question 1

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 2008 stood as follows:

Liabilities	Rs.	Assets	Rs.
Capital accounts:		Stock	2,70,000
S	6,40,000	Debtors	3,65,000
T	<u>6,60,000</u>	Furniture	75,000
Creditors	3,27,500	Joint life policy	47,500
Bank overdraft	1,50,000	Plant	1,72,500
Bills payable	<u>62,500</u>	Building	<u>9,10,000</u>
	<u>18,40,000</u>		<u>18,40,000</u>

The operations of the business were carried on till 30th September, 2008. S and T both withdrew in equal amounts half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by Rs. 50,000, Bills payable by Rs. 11,500 and Bank overdraft by Rs. 75,000. The Joint Life policy was surrendered for Rs. 47,500 on 30th September, 2008. Stock was valued at Rs. 3,17,000 and debtors at Rs. 3,25,000 on 30th September, 2008. The other items remained the same as on 31st March, 2008.

On 30th September, 2008 the firm sold its business to ST Ltd. The value of goodwill was estimated at Rs.5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2008. The ST Ltd. paid the purchase consideration in equity shares of Rs.10 each. You are required to prepare a Realization Account and Capital accounts of the partners.

(8 Marks) (November, 2008)

Answer

Realisation Account

Particulars	Rs.	Particulars	Rs.
To Sundry assets:		By Creditors	2,77,500
Stock	3,17,000	By Bills payables	51,000
Debtors	3,25,000	By Bank overdraft	75,000
Plant	1,63,875	By Shares in ST Ltd. (W.N. 3)	18,80,000
Building	8,64,500		
Furniture	73,125		
To Profit:			
S	2,70,000		
T	<u>2,70,000</u>		
	<u>5,40,000</u>		
	<u>22,83,500</u>		<u>22,83,500</u>

Partners' Capital Accounts

Date	Particulars	S	T	Date	Particulars	S	T
2008				2008			
April 1	To Cash – Drawings (W.N. 2)	20,000	20,000	April 1	By Balance b/d	6,40,000	6,60,000
Sept. 30	To Shares in ST Ltd.	9,30,000	9,50,000	Sept. 30	By Profit (W.N.2)	40,000	40,000
					By Realisation A/c (Profit)	<u>2,70,000</u>	<u>2,70,000</u>
		<u>9,50,000</u>	<u>9,70,000</u>			<u>9,50,000</u>	<u>9,70,000</u>

Working Notes:

(1) Ascertainment of total capital:

Balance Sheet

as at 30th September, 2008

Liabilities	Rs.	Assets	Rs.
Sundry creditors	2,77,500	Building	9,10,000
Bills payable	51,000	Less: Depreciation	<u>45,500</u>
Bank overdraft	75,000	Plant	1,72,500
Total capital (bal. fig.)	13,40,000	Less: Depreciation	<u>8,625</u>
		Furniture	75,000
		Less: Depreciation	<u>1,875</u>
		Stock	3,17,000
		Debtors	<u>3,25,000</u>
	<u>17,43,500</u>		<u>17,43,500</u>

(2) Profit earned during six months to 30 September, 2008

Total capital (of S and T) on 30 th September, 2008 (W.N.1)	Rs.
Capital on 1 st April, 2008	
S	6,40,000
T	<u>6,60,000</u>
Net increase (after drawings)	<u>40,000</u>

Since drawings are half of profits therefore, actual profit earned is Rs.40,000 x 2 = Rs.80,000 (shared equally by partners S and T).

Half of the profits, has been withdrawn by both the partners equally i.e. drawings Rs. 40,000 (Rs.80,000 x ½) withdrawn by S and T in 1:1 (i.e. Rs.20,000 each).

(3) Purchase consideration:	Rs.
Total assets (W.N.1)	17,43,500
Add: Goodwill	<u>5,40,000</u>
	22,83,500
Less: Liabilities (2,77,500 + 51,000 + 75,000)	<u>4,03,500</u>
Purchase consideration	<u>18,80,000</u>

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

Question 2

XYZ & Co. is a partnership firm consisting of Mr. X, Mr. Y and Mr. Z who share profits and losses in the ratio of 2:2:1 and ABC Ltd. is a company doing similar business.

Following is the Balance Sheet of the firm and that of the company as at 31.3.2009:

Liabilities	XYZ & Co. Rs.	ABC Ltd. Rs.		XYZ & Co. Rs.	ABC Ltd. Rs.
Equity share capital:			Plant & machinery	5,00,000	16,00,000
Equity shares of Rs.10 each		20,00,000	Furniture & fixture	50,000	2,25,000
Partners capital:			Stock in trade	2,00,000	8,50,000
X	2,00,000		Sundry debtors	2,00,000	8,25,000
Y	3,00,000		Cash at bank	10,000	4,00,000
Z	1,00,000		Cash in hand	40,000	1,00,000
General reserve	1,00,000	7,00,000			
Sundry creditors	<u>3,00,000</u>	<u>13,00,000</u>			
	<u>10,00,000</u>	<u>40,00,000</u>		<u>10,00,000</u>	<u>40,00,000</u>

It was decided that the firm XYZ & Co. be dissolved and all the assets (except cash in hand and cash at bank) and all the liabilities of the firm be taken over by ABC Ltd. by issuing 50,000 shares of Rs.10 each at a premium of Rs.2 per share.

Partners of XYZ & Co. agreed to divide the shares issued by ABC Ltd. in the profit sharing ratio and bring necessary cash for settlement of their capital.

The creditors of XYZ & Co. includes Rs.1,00,000 payable to ABC Ltd. An unrecorded liability of Rs.25,000 of XYZ & Co. must also be taken over by ABC Ltd.

Prepare:

- Realisation account, Partners' capital accounts and Cash in hand/Bank account in the books of XYZ & Co.
- Pass journal entries in the books of ABC Ltd. for acquisition of XYZ & Co. and draw the Balance Sheet after the takeover.

(16 Marks)(November, 2009)

Answer

(i)

In the books of XYZ & Co.**Realisation Account**

	Rs.		Rs.
To Plant & Machinery	5,00,000	By Sundry Creditors	3,00,000
To Furniture & Fixture	50,000	By ABC Ltd. (Refer W.N.)	6,00,000
To Stock in trade	2,00,000	By Partners' Capital Accounts (loss):	
To Sundry Debtors	2,00,000	X's Capital A/c	20,000
		Y's Capital A/c	20,000
		Z's Capital A/c	<u>10,000</u>
	<u>9,50,000</u>		<u>9,50,000</u>

Partners' Capital Accounts

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
To Realisation A/c	20,000	20,000	10,000	By Balance b/d	2,00,000	3,00,000	1,00,000
To Shares in ABC Ltd.	2,40,000	2,40,000	1,20,000	By General Reserve	40,000	40,000	20,000
To Cash A/c	<u>-</u>	<u>80,000</u>	<u>-</u>	By Cash A/c	<u>20,000</u>	<u>-</u>	<u>10,000</u>
	<u>2,60,000</u>	<u>3,40,000</u>	<u>1,30,000</u>		<u>2,60,000</u>	<u>3,40,000</u>	<u>1,30,000</u>

Cash and Bank Account

	Cash Rs.	Bank Rs.		Cash Rs.	Bank Rs.
To Balance b/d	40,000	10,000	By Cash A/c (Contra)*		10,000
To Bank A/c (Contra)*	10,000		By Y	80,000	
To X	20,000				
To Z	<u>10,000</u>				
	<u>80,000</u>	<u>10,000</u>		<u>80,000</u>	<u>10,000</u>

(ii)

In the Books of ABC Ltd.**Journal Entries**

		Dr. (Rs.)	Cr. (Rs.)
1.	Business Purchase Account Dr. To XYZ & Co.	6,00,000	6,00,000

* It is assumed that cash at bank has been withdrawn to pay Rs.80,000 to partner Y. However, payment to Y of Rs. 80,000 can also be made by cash Rs.70,000 & by cheque Rs.10,000.

	(Being business of XYZ & Co. purchased and payment due)			
2.	Plant and Machinery Account	Dr.	5,00,000	
	Furniture and Fixture Account	Dr.	50,000	
	Stock in Trade Account	Dr.	2,00,000	
	Sundry Debtors Account	Dr.	2,00,000	
	To Sundry Creditors Account			3,00,000
	To Unrecorded Liability Account			25,000
	To Business Purchase Account			6,00,000
	To Capital Reserve Account (Bal.Fig.)			25,000
	(Being take over of all assets and liabilities)			
3.	XYZ & Co.	Dr.	6,00,000	
	To Equity Share Capital Account			5,00,000
	To Securities Premium Account			1,00,000
	(Being purchase consideration discharged in the form of shares of Rs. 10 each issued at a premium of Rs. 2 each)			
4.	Sundry Creditors Account	Dr.	1,00,000	
	To Sundry Debtors Account			1,00,000
	(Being mutual owings eliminated)			

Balance Sheet of ABC Ltd. (After take over of XYZ & Co.)

as at 31.3.2009

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital :		Plant and Machinery (5,00,000+16,00,000)	21,00,000
2,50,000, Equity shares of Rs.10 each fully paid up (out of which 50,000 shares has been issued for consideration other than cash)	25,00,000	Furniture and fixture (50,000+2,25,000)	2,75,000
Securities Premium	1,00,000	Stock in trade (2,00,000+8,50,000)	10,50,000
Capital Reserve	25,000	Sundry Debtors (2,00,000+8,25,000-1,00,000)	9,25,000
General Reserve	7,00,000	Cash at Bank	4,00,000
Sundry Creditors (3,00,000 + 13,00,000 - 1,00,000)	15,00,000	Cash in hand	1,00,000
Unrecorded Liability	<u>25,000</u>		
	<u>48,50,000</u>		<u>48,50,000</u>

Working Note:

Computation of purchase consideration:

50,000, Equity shares of Rs.12 (10+2) each = Rs.6,00,000

Equity shares distributed among partners:

Partner X	=	20,000 shares @ Rs.12	= Rs.2,40,000
Partner Y	=	20,000 shares @ Rs.12	= Rs.2,40,000
Partner Z	=	10,000 shares @ Rs.12	= Rs.1,20,000
			Rs.6,00,000