

CHAPTER 3

ADVANCED ISSUES IN PARTNERSHIP ACCOUNTS

UNIT 1 : DISSOLUTION OF PARTNERSHIP FIRMS

BASIC CONCEPTS

- On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards the capital contributed by partners is repaid and, if there is still surplus, it is distributed among the partners in their profit-sharing ratio.

Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm left over are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit-sharing ratio.

On dissolution of partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

- (a) Losses including deficiencies of capital are paid, first out of profits, next out of capital and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.
- (b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order :
 - (i) in paying the debts of the firm to third parties;
 - (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;
 - (iii) in paying to each partner what is due to him on account of capital; and
 - (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

The death or retirement of a partner would not result in the dissolution of the partnership, if the partnership agreement so provides (Section 42).

- According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

The determination of capital ratio for this has been explained below. The provisions of the Indian Partnership Act are not contrary to **Garner vs. Murray rule**. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business shall not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.
- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances it is better not to transfer the amount of creditors to Realisation Account.
- Creditors may be paid the amount available including the amount contributed by the partners.

The unsatisfied portion of creditor account is transferred to Capital Accounts of the partners in the profit sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

- On dissolution
 - assets are realized and all liabilities are paid off
(if any liability remains unpaid then it is to be realized from partners in their profit sharing ratio).

➤ Piecemeal describes two methods

- Maximum loss method- each instalment realised is considered to be the final payment.
- Highest relative capital method.- the partner whose capital is greater in proportion to his profit sharing ratio is first paid off.

Question 1

A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were ₹9,600, ₹6,000 and ₹8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	₹		₹
Liability for interest on loans from :		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure. **(November,1999)**

Answer

Statement of Distribution of Cash

	Realisation	Interest on loans from partners' spouses	Interest on loans from partners	Partners' Capitals			
				A	B	C	Total
	₹	₹	₹	₹	₹	₹	₹
Balances due (1)		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	-				
		1,000	1,000				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
		-	-				
(iii) Sale of machinery	1,200						
Maximum possible loss	₹ 22,800						
(total of capitals ₹ 24,000 less cash available ₹ 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off							

against C	<u>1,800</u>	<u>840</u>	<u>(2,640)</u>	<u>—</u>
Amount paid (2)	<u>—</u>	<u>—</u>	<u>1,200</u>	<u>1,200</u>
Balances in capital accounts(1 – 2) = (3)	<u>9,600</u>	<u>6,000</u>	<u>7,200</u>	<u>22,800</u>
(iv) Sale of stock	4,000			
Maximum possible loss	<u>18,800</u>			
(₹ 22,800 – ₹ 4,000) Allocated				
to partners in the ratio 5 : 3 : 2	<u>(9,400)</u>	<u>(5,640)</u>	<u>(3,760)</u>	<u>(18,800)</u>
Amounts at credit and cash paid (4)	<u>200</u>	<u>360</u>	<u>3,440</u>	<u>(4,000)</u>
Balances in capital accounts left unpaid—Loss (3 – 4) = (5)	<u>9,400</u>	<u>5,640</u>	<u>3,760</u>	<u>18,800</u>

Question 2

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2003:

Liabilities	₹	₹	Assets	₹	₹
Capital Account:			Premises		1,20,000
Neptune	1,00,000		Furniture		40,000
Jupiter	<u>60,000</u>	1,60,000	Stock		1,00,000
General Reserve		56,000	Debtors		40,000
Capital Reserve		14,000	Cash		8,000
Sundry Creditors		20,000	Capital Overdrawn:		
Mortgage Loan		80,000	Venus	10,000	
			Pluto	<u>12,000</u>	<u>22,000</u>
		<u>3,30,000</u>			<u>3,30,000</u>

(i) The assets were realised as under:

	₹
Debtors	24,000
Stock	60,000
Furniture	16,000
Premises	90,000

(ii) Expenses of dissolution amounted to ₹ 4,000.

(iii) Further Creditors of ₹ 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray. **(November, 2003)**

Answer

Realisation Account

	₹		₹	₹
To Sundry assets A/c (transfer):		By Sundry creditors A/c		20,000
Premises	1,20,000	By Cash A/c (assets realised): Premises	90,000	
Furniture	40,000	Furniture	16,000	
Stock	1,00,000	Stock	60,000	
Sundry Debtors	40,000	Debtors	<u>24,000</u>	1,90,000
To Cash A/c (creditors paid)	32,000			
To Cash A/c (expenses)	4,000	By Loss transferred to Capital Accounts:		
		Neptune	54,000	
		Jupiter	36,000	
		Venus	18,000	
		Pluto	<u>18,000</u>	<u>1,26,000</u>
	<u>3,36,000</u>			<u>3,36,000</u>

Cash Account

		₹		₹
To Balance b/d		8,000	By Realisation A/c (creditors)	32,000
To Realisation A/c (assets realised)		1,90,000	By Realisation A/c (expenses)	4,000
To Capital A/c (realisation loss made good):			By Mortgage loan	80,000
Neptune	54,000		By Neptune's Capital A/c	1,18,857
Jupiter	36,000		By Jupiter's Capital A/c	73,143
Pluto	<u>18,000</u>	1,08,000		
To Pluto's Capital A/c		<u>2,000</u>		
		<u>3,08,000</u>		<u>3,08,000</u>

Partners' Capital Accounts

Particulars	Neptune	Jupiter	Venus	Pluto	Particulars	Neptune	Jupiter	Venus	Pluto
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d	—	—	10,000	12,000	By Balance b/d	1,00,000	60,000	—	—
To Realisation A/c (loss)	54,000	36,000	18,000	18,000	By General reserve A/c (3 : 2 : 1 : 1)	24,000	16,000	8,000	8,000
To Venus's Capital A/c (loss)	11,143	6,857	—	—	By Capital reserve A/c (3 : 2 : 1 : 1)	6,000	4,000	2,000	2,000
To Cash A/c	1,18,857	73,143	—	—	By Cash A/c (loss on realization)	54,000	36,000	—	18,000
					By Neptune's Capital A/c	—	—	11,143	—
					By Jupiter's Capital A/c	—	—	6,857	—
					By Cash A/c	—	—	—	2,000
	<u>1,84,000</u>	<u>1,16,000</u>	<u>28,000</u>	<u>30,000</u>		<u>1,84,000</u>	<u>1,16,000</u>	<u>28,000</u>	<u>30,000</u>

Question 3

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2. Following is the Balance sheet of the firm as at 31st March, 2008:

Balance Sheet as at 31st March, 2008

Liabilities	₹	Assets	₹
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	<u>3,20,000</u>		
	<u>13,10,000</u>		<u>13,10,000</u>

Partners of the firm decided to dissolve the firm on the above said date. It was found that a credit purchase of ₹ 20,000 in January, 2008 had not been recorded in the books of the firm.

Fixed assets realized ₹ 5,20,000 and book debts ₹ 4,40,000.

Stocks were valued at ₹ 2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realization amounted to ₹ 6,000.

You are required to prepare:

- Realisation account;
- Partners capital account; and
- Cash account.

(November, 2008)

Answer

(i) Realisation Account

	₹		₹
To Fixed assets	5,00,000	By Creditors	3,20,000
To Stock in trade	3,00,000	By Cash	9,60,000
		(5,20,000+4,40,000)	
To Debtors	5,00,000	By Y (Stock taken over)	2,50,000
To Cash - Expenses	6,000	By Loss transferred to partners' capital accounts	

To	Cash -Creditors (3,40,000x 95%)	3,23,000	X	44,000
			Y	33,000
			Z	<u>22,000</u>
		<u>16,29,000</u>		<u>16,29,000</u>

(ii) **Partners' Capital Accounts**

	X	Y	Z		X	Y	Z
	₹	₹	₹		₹	₹	₹
To Realisation Account	44,000	33,000	22,000	By Balance b/d	4,00,000	3,00,000	2,00,000
To Realisation Account	-	2,50,000	-	By General reserve	40,000	30,000	20,000
To Cash	<u>3,96,000</u>	<u>47,000</u>	<u>1,98,000</u>				
	<u>4,40,000</u>	<u>3,30,000</u>	<u>2,20,000</u>		<u>4,40,000</u>	<u>3,30,000</u>	<u>2,20,000</u>

(iii) **Cash Account**

		₹			₹
To	Balance b/d	10,000	By	Realisation A/c (Expenses)	6,000
To	Realisation A/c (Fixed assets and book debts realized)	9,60,000	By	Realisation A/c (Creditors)	3,23,000
			By	X	3,96,000
			By	Y	47,000
			By	Z	<u>1,98,000</u>
		<u>9,70,000</u>			<u>9,70,000</u>

Question 4

A, B and C are partners; A became insolvent on 15.4.2010. The capital account balance of partner B is on the debit side. Partner B is solvent. Should partner B bear the loss arising on account of the insolvency of partner A?
(May, 2010)

Answer

According to *Garner vs Murray* Rule, if a solvent partner is having a debit balance in his capital account, then he cannot be called upon to bear the loss on account of the insolvency of the other partner. Hence, 'B' needs not bear the loss due to insolvency of partner 'A'.

Question 5

Amar, Akbar and Antony are in partnership. The following is their Balance Sheet as at March 31, 2010 on which date they dissolved their partnership. They shared profit in the ratio of 5:3:2.

Liabilities	₹	Assets	₹
Creditors	80,000	Plant and machinery	60,000
Loan A/c – Amar	20,000	Premises	80,000
Capital A/cs - Amar	1,00,000	Stock	60,000
Akbar	30,000	Debtors	1,20,000
Antony	<u>90,000</u>		<u> </u>
	<u>3,20,000</u>		<u>3,20,000</u>

It was agreed to repay the amounts due to the partners as and when the assets were realised, viz.

April 15, 2010	₹ 60,000
May 1, 2010	₹ 1,46,000
May 31, 2010	₹ 94,000

Prepare a statement showing how the distribution should be made under maximum loss method and write up the cash account and partners' capital accounts. **(May, 2010)**

Answer

(a) Statement of Distribution of Cash by 'Maximum Loss Method'

	Creditors	Amar's Loan	Amar	Akbar	Antony
	₹	₹	₹	₹	₹
Balance due	80,000	20,000	1,00,000	30,000	90,000
15 th April 2010 realised ₹ 60,000					
Paid to creditors	<u>60,000</u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance due	20,000	20,000	1,00,000	30,000	90,000
1 st May, 2010 realised ₹ 1,46,000					
Paid to creditors ₹ 20,000	20,000	-	-	-	-
Paid to Amar's loan ₹ <u>20,000</u>	<u> </u>	<u>20,000</u>	<u> </u>	<u> </u>	<u> </u>
Balance due (1)	Nil	Nil	1,00,000	30,000	90,000
Balance ₹ <u>1,06,000</u>					
Maximum Loss (1,00,000+30,000+90,000-1,06,000) = ₹ 1,14,000 shared in Profit & Loss					

ratio 5:3:2			<u>57,000</u>	<u>34,200</u>	<u>22,800</u>
			43,000	(4,200)	67,200
Akbar's deficiency shared by Amar & Antony in capital ratio 100:90			<u>(2,210)</u>	<u>4,200</u>	<u>(1,990)</u>
Cash paid [2]			<u>40,790</u>	—	<u>65,210</u>
Balance due (3) [1-2]			59,210	30,000	24,790
31 st May 2010 realised ₹ 94,000					
Maximum Loss [59,210+30,000+24,790-94,000]= ₹ 20,000 shared in 5:3:2			<u>10,000</u>	<u>6,000</u>	<u>4,000</u>
Cash paid (4)			<u>49,210</u>	<u>24,000</u>	<u>20,790</u>
Balance/Loss* on realisation (3-4)			<u>10,000</u>	<u>6,000</u>	<u>4,000</u>

Cash Account

	₹		₹
To Realization Account	60,000	By Creditors Account	60,000
To Realization Account	1,46,000	By Creditors Account	20,000
To Realization Account	94,000	By Amar's Loan Account	20,000
		By Amar's Capital Account	40,790
		By Antony's Capital Account	65,210
		By Amar's Capital Account	49,210
		By Akbar's Capital Account	24,000
		By Antony's Capital Account	<u>20,790</u>
	<u>3,00,000</u>		<u>3,00,000</u>

Partners' Capital Accounts

	Amar	Akbar	Antony		Amar	Akbar	Antony
	₹	₹	₹		₹	₹	₹
To Cash	40,790	-	65,210	By Balance b/d	1,00,000	30,000	90,000
To Cash	49,210	24,000	20,790				

To Balance c/d							
Realization loss*	<u>10,000</u>	<u>6,000</u>	<u>4,000</u>		<u> </u>	<u> </u>	<u> </u>
	<u>1,00,000</u>	<u>30,000</u>	<u>90,000</u>		<u>1,00,000</u>	<u>30,000</u>	<u>90,000</u>

* If no further realization takes place, then Amar, Akbar and Anthony will bear loss on realization ₹ 10,000, ₹ 6,000 and ₹ 4,000 respectively.

Question 6

P, Q and R are partners sharing profits and losses in the ratio of 2 : 2 : 1. Their Balance Sheet as on 31st March, 2009 is as follows:

<i>Liabilities</i>		<i>₹</i>	<i>Assets</i>	<i>₹</i>
<i>Capital Accounts:</i>			<i>Plant & Machinery</i>	<i>1,08,000</i>
<i>P</i>	<i>1,20,000</i>		<i>Fixtures</i>	<i>24,000</i>
<i>Q</i>	<i>48,000</i>		<i>Stock</i>	<i>60,000</i>
<i>R</i>	<i>24,000</i>	<i>1,92,000</i>	<i>Sundry debtors</i>	<i>48,000</i>
<i>Reserve fund</i>		<i>60,000</i>	<i>Cash</i>	<i>60,000</i>
<i>Creditors</i>		<i><u>48,000</u></i>		<i><u> </u></i>
		<i><u>3,00,000</u></i>		<i><u>3,00,000</u></i>

They decided to dissolve the firm. The following are the amounts realized from the assets:

	<i>₹</i>
<i>Plant and Machinery</i>	<i>1,02,000</i>
<i>Fixtures</i>	<i>18,000</i>
<i>Stock</i>	<i>84,000</i>
<i>Sundry debtors</i>	<i>44,400</i>

Creditors allowed a discount of 5% and realization expenses amounted to ₹ 1,500. A bill for ₹ 4,200 due for sales tax was received during the course of realization and this was also paid.

You are required to prepare:

- Realization account*
- Partners capital account*
- Cash account.*

(November, 2009)

Answer

Realisation A/c

Particulars	Amount		Amount
	₹		₹
To Debtors	48,000	By Creditors	48,000
To Stock	60,000	By Cash (assets realised)	
To Fixtures	24,000	Plant & Machinery	1,02,000
To Plant and Machinery	1,08,000	Fixtures	18,000
To Cash (Creditors)	45,600	Stock	84,000
To Bills for Sales Tax	4,200	Debtors	<u>44,400</u>
To Realisation Expenses	1,500		2,48,400
To Profit on realisation			
P 2,040			
Q 2,040			
R <u>1,020</u>	<u>5,100</u>		
	<u>2,96,400</u>		<u>2,96,400</u>

Partners' Capital A/cs

Particulars	P	Q	R	Particulars	P	Q	R
	₹	₹	₹		₹	₹	₹
To Cash (Bal.fig.)	1,46,040	74,040	37,020	By Balance b/d	1,20,000	48,000	24,000
				By Reserve Fund	24,000	24,000	12,000
				By Realisation Profit	<u>2,040</u>	<u>2,040</u>	<u>1,020</u>
	<u>1,46,040</u>	<u>74,040</u>	<u>37,020</u>		<u>1,46,040</u>	<u>74,040</u>	<u>37,020</u>

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance c/d	60,000	By Realisation (Creditors)	45,600
To Realisation (assets realised)	2,48,400	By Realisation Expenses	1,500
		By Bills for Sales Tax	4,200
		By Partners' Capital A/cs	
		P	1,46,040

		Q	74,040
		R	<u>37,020</u>
	<u>3,08,400</u>		<u>3,08,400</u>

Question 7

A, B, C and D are sharing profits and losses in the ratio 5 : 5 : 4 : 2. Frauds committed by C during the year were found out and it was decided to dissolve the partnership on 31st March, 2010 when their Balance Sheet was as under :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital		Building	1,20,000
A	90,000	Stock	85,500
B	90,000	Investments	29,000
C	-	Debtors	42,000
D	35,000	Cash	14,500
General reserve	24,000	C	15,000
Trade creditors	47,000		
Bills payable	<u>20,000</u>		
	<u>3,06,000</u>		<u>3,06,000</u>

Following information is given to you:

- A cheque for ₹ 4,300 received from debtor was not recorded in the books and was misappropriated by C.
- Investments costing ₹ 5,400 were sold by C at ₹ 7,900 and the funds transferred to his personal account. This sale was omitted from the firm's books.
- A creditor agreed to take over investments of the book value of ₹ 5,400 at ₹ 8,400. The rest of the creditors were paid off at a discount of 2%.
- The other assets realized as follows:

Building	105% of book value
Stock	₹ 78,000
Investments	The rest of investments were sold at a profit of ₹ 4,800
Debtors	The rest of the debtors were realized at a discount of 12%
- The bills payable were settled at a discount of ₹ 400.
- The expenses of dissolution amounted to ₹ 4,900
- It was found out that realization from C's private assets would only be ₹ 4,000.

Prepare the necessary Ledger Accounts.

(November, 2010)

Answer

Realisation account

Particulars	₹	Particulars	₹
To Building	1,20,000	By Trade creditors	47,000
To Stock	85,500	By Bills payable	20,000
To Investment	29,000	By Cash	
To Debtors	42,000	Building	1,26,000
To Cash-creditors paid (W.N.1)	37,828	Stock	78,000
To Cash-expenses	4,900	Investments (W.N.2)	23,000
To Cash-bills payable (20,000-400)	19,600	Debtors (W.N. 3)	<u>33,176</u>
To Partners' Capital A/cs			2,60,176
A	171	By Debtors-unrecorded	4,300
B	171	By Investments-unrecorded	7,900
C	137		
D	<u>69</u>		
	<u>548</u>		
	<u>3,39,376</u>		<u>3,39,376</u>

Cash account

Particulars	Amount ₹	Particulars	Amount ₹
To Balance b/d	14,500	By Realisation-creditors paid	37,828
To Realisation - assets realised		By Realisation-bills payable	19,600
Building	1,26,000	By Realisation-expenses	4,900
Stock	78,000	By Capital account	
Investments	23,000	A	90,528
Debtors	<u>33,176</u>	B	90,528
	2,60,176	D	<u>35,292</u>
To C's capital A/c	<u>4,000</u>		<u>2,78,676</u>
	<u>2,78,676</u>		

Partners' Capital Accounts

Particulars	A	B	C	D	Particulars	A	B	C	D
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d			15,000		By Balance b/d	90,000	90,000	-	35,000
To Debtors-misappropriation			4,300		By General reserve	7,500	7,500	6,000	3,000
To Investment-misappropriation			7,900		By Realisation profit	171	171	137	69
To C's capital A/c (W.N. 4)	7,143	7,143		2,777	By Cash A/c			4,000	
To Cash A/c	90,528	90,528		35,292	By A's capital A/c			7,143	
					By B's capital A/c			7,143	
					By D's capital A/c			2,777	
	<u>97,671</u>	<u>97,671</u>	<u>27,200</u>	<u>38,069</u>		<u>97,671</u>	<u>97,671</u>	<u>27,200</u>	<u>38,069</u>

Working Notes:**1. Amount paid to creditors**

	₹
Book value	47,000
Less: Creditors taking over investments	<u>(8,400)</u>
	38,600
Less: Discount @ 2%	<u>(772)</u>
	<u>37,828</u>

2. Amount received from sale of investments

	₹
Book value	29,000
Less: Misappropriated by C	<u>(5,400)</u>
	23,600
Less: Taken over by a creditor	<u>(5,400)</u>
	18,200
Add: Profit on sale of investments	<u>4,800</u>
	<u>23,000</u>

3. Amount received from debtors

	₹
Book value	42,000
Less: Unrecorded receipt	<u>(4,300)</u>
	37,700
Less: Discount @ 12%	<u>(4,524)</u>
	<u>33,176</u>

4. Deficiency of C

	₹
Balance of capital as on 31 st March, 2010	15,000
Debtors-misappropriation	4,300
Investment-misappropriation	<u>7,900</u>
	27,200
Less: Realisation Profit	(137)
General reserve	(6,000)
Contribution from private assets	<u>(4,000)</u>
Net deficiency of capital	<u>17,063</u>

This deficiency of ₹ 17,063 in C's capital account will be shared by other partners A, B and D in their capital ratio of 90 : 90 : 35.

Accordingly,

A's share of deficiency = $[17,063 \times (90/215)] = ₹ 7,143$

B's share of deficiency = $[17,063 \times (90/215)] = ₹ 7,143$

D's share of deficiency = $[17,063 \times (35/215)] = ₹ 2,777$

EXERCISES

- 1 The firm of Kapil and Dev has four partners and as of 31st March, 2011, its Balance Sheet stood as follows:

Balance Sheet as on 31st March, 2011

Liabilities	₹	Assets	₹
Capital A/cs:		Land	50,000
F. Kapil	2,00,000	Building	2,50,000
S. Kapil	2,00,000	Office equipment	1,25,000
R. Dev	1,00,000	Computers	70,000
Current A/cs		Debtors	4,00,000
F. Kapil	50,000	Stocks	3,00,000
S. Kapil	1,50,000	Cash at Bank	75,000
R. Dev	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c :	
Current Liabilities	<u>70,000</u>	B. Dev	<u>87,400</u>
	13,80,000		13,80,000

The partners have been sharing profits and losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 1.4.2011 on the basis of the following understanding :

- (a) The following assets are to be adjusted to the extent indicated with respect to the book values :
- | | |
|-----------|------|
| Land | 200% |
| Building | 120% |
| Computers | 70% |
| Debtors | 95% |
| Stocks | 90% |
- (b) In the case of the loan, the lender's are to be paid at their insistence a prepayment premium of 1%.
- (c) B. Dev is insolvent and no amount is recoverable from him. His father, R.Dev, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

Assuming that the realisation of the assets and discharge of liabilities is carried out immediately, show the Cash A/c, Realisation Account and the Partners' Accounts.

(Hints: Profit on realisation: F. Kapil ₹ 9,600, S. Kapil ₹ 9,600, R. Dev ₹ 2,400., B. Dev ₹ 2,400)

2. The firm of LMS was dissolved on 31.3.2011, at which date its Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Creditors	2,00,000	Fixed Assets	45,00,000
Bank Loan	5,00,000	Cash and Bank	2,00,000
L's Loan	10,00,000		
Capital			
L	15,00,000		
M	10,00,000		
S	5,00,000		
	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	Amount in ₹
1	5,00,000
2	15,00,000
3	15,00,000
4	30,00,000
5	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

(Hints: Realization profit credited to partners L ₹ 15,66,667, M ₹ 15,66,667, S ₹ 15,66,666)

3. Ajay, Vijaya, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 2011 :

Liabilities	₹	Assets	₹
Sundry Creditors	3,00,000	Sundry Debtors	3,50,000
Capital A/cs :		Less: Doubtful Debts	50,000
Ajay	7,00,000		3,00,000
Shyam	3,00,000	Cash in hand	1,40,000
	10,00,000	Stocks	2,00,000
		Other Assets	3,10,000
		Capital A/cs:	
		Vijay	2,00,000
		Ram	1,50,000
	13,00,000		13,00,000

On 31st March, 2011, the firm is dissolved and the following points are agreed upon:

Ajay is to takeover sundry debtors at 80% of book value

Shyam is to takeover the stocks at 95% of the value and

Ram is to discharge sundry creditors.

Other assets realise ₹ 3,00,000 and the expenses of realisation come to ₹ 30,000.

Vijay is found insolvent and ₹ 21,900 is realised from his estate.

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Prepare Realisation Account and Capital Accounts of the partners. Show also the Cash A/c.

The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray.

(Hints: Vijay's deficiency will be borne by Ajay and Shyam in the ratio of 7 : 3 i.e. on opening capitals of ₹ 7,00,000 and ₹ 3,00,000. Ram will not bear any portion of the loss since at the time of dissolution he had a debit balance in his capital account. Loss on realization- Ajay ₹ 28,000, Vijay ₹ 7,000, Ram ₹ 14,000, Shyam ₹ 21,000)

4. Ram, Rahim and Auntony were in partnership sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. They decided to dissolve the partnership firm on 31.3.2011, when the Balance Sheet of the firm appeared as under :

Balance Sheet of the firm as on 31.3.2011

Liabilities	₹	Assets	₹
Sundry Creditors	5,67,000	Goodwill A/c	4,56,300
Bank Overdraft	6,06,450	Plant and Machinery	6,07,500
Joint Life Policy Reserve	2,65,500	Furniture	64,650
Loan from Mrs. Ram	1,50,000	Stock	2,36,700
Capital Accounts:		Sundry Debtors	5,34,000
Ram 4,20,000		Joint Life Policy	2,65,500
Rahim 2,25,000		Commission Receivable	1,40,550
Auntony 1,20,000	7,65,000	Cash in Hand	48,750
	<u>23,53,950</u>		<u>23,53,950</u>

The following details are relevant for dissolution :

- The joint life policy was surrendered for ₹ 2,32,500.
- Ram took over goodwill and plant and machinery for ₹ 9,00,000.
- Ram also agreed to discharge bank overdraft and loan from Mrs. Ram.
- Furniture and stocks were divided equally between Ram and Rahim at an agreed valuation of ₹ 3,60,000.
- Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.
- Commission receivable was received in toto in time.
- A bill discounted was subsequently returned dishonoured and proved valueless ₹ 30,750 (including ₹ 500 noting charges).
- Ram paid the expenses of dissolution amounting to ₹ 18,000.
- Auntony agreed to receive ₹ 1,50,000 in full satisfaction of his rights, title and interest in the firm.

You are required to show accounts relating to closing of books on dissolution of the firm.

(Hints: Profit on realization- Ram ₹ 55,800, Rahim ₹ 37,200 , Auntony ₹ 18,600 Cash paid to Ram ₹ 1,63,410, Rahim ₹ 77,640, Auntony ₹ 1,50,000 The amount of excess payments to Auntony (₹ 1,50,000 less ₹ 1,38,600 i.e., ₹ 11,400) has been debited to Ram and Rahim in the ratio of 3:2.)

UNIT 2: AMALGAMATION, CONVERSION AND SALE OF PARTNERSHIP FIRM

BASIC CONCEPTS

- Amalgamation includes

Closing the books of old firm:

- Each firm should prepare a **Revaluation Account** relating to its own assets and liabilities and transfer the balance to the partners' capital accounts in the profit-sharing ratio.
- Entries for **raising goodwill** should be passed.
- Assets and liabilities not taken over** by the new firm should be transferred to the capital accounts of partners in the ratio of their capitals.
- The **new firm** should be debited with the difference between the value of assets and liabilities taken over by it; the assets should be credited and liabilities debited.
- Partners' capital accounts** should be transferred to the new firm's account;

Opening the books of the new firm:

Debit assets taken out at the agreed values

Credit the liabilities taken over, and

Credit individual partner's capital accounts with the closing balances in the erstwhile firm.

When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.

Question 1

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 2011 stood as follows:

Liabilities	₹	Assets	₹
Capital accounts:		Stock	2,70,000
S 6,40,000		Debtors	3,65,000
T <u>6,60,000</u>	13,00,000	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, 2011. 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 ₹ 50,000, Bills payable by ₹ 11,500 and Bank overdraft by ₹ 75,000. The Joint Life policy was surrendered for ₹ 47,500 on 30th September, 2011. Stock was valued at ₹ 3,17,000 and debtors at ₹ 3,25,000 on 30th September, 2011. The other items remained the same as on 31st March, 2011.

On 30th September, 2011 the firm sold its business to ST Ltd. The value of goodwill was estimated at ₹ 5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 2011. The ST Ltd. paid the purchase consideration in equity shares of ₹ 10 each. You are required to prepare a Realization Account and Capital accounts of the partners.

(November, 2008)

Answer

Realisation Account

Particulars	₹	Particulars	₹
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
		₹	₹			₹	₹
2011				2011			
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, 2011

Liabilities	₹	Assets		₹
Sundry creditors	2,77,500	Building	9,10,000	
Bills payable	51,000	Less: Depreciation	<u>45,500</u>	8,64,500
Bank overdraft	75,000	Plant	1,72,500	
Total capital (bal. fig.)	13,40,000	Less: Depreciation	<u>8,625</u>	1,63,875
		Furniture	75,000	
		Less: Depreciation	<u>1,875</u>	73,125
		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, 2011

		₹
Total capital (of S and T) on 30 th September, 2011 (W.N.1)		13,40,000
Capital on 1 st April, 2011		
S	6,40,000	
T	<u>6,60,000</u>	<u>13,00,000</u>
Net increase (after drawings)		<u>40,000</u>

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

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

(3) Purchase consideration:

	₹
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

P, Q and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2011 is as follows:

Liabilities		₹	Assets	₹
Capital accounts			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		<u>48,000</u>		
		<u>3,00,000</u>		<u>3,00,000</u>

They decided to dissolve the business. The following are the amounts realized:

	₹
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realization expenses amounted to ₹1,500. There was an unrecorded asset of ₹6,000 which was taken over by Q at ₹4,800. A bill for ₹4,200 due for sales tax was received during the course of realization and this was also paid.

You are required to prepare:

- Realisation account.
- Partners' capital accounts.
- Cash account.

(November, 2009)

Answer

Realisation Account

Particulars	₹	Particulars	₹
To Debtors	48,000	By Creditors	48,000
To Stock	60,000	By Cash A/c (Assets realized):	

To	Fixtures	24,000	Plant and Machinery	1,02,000	
To	Plant and machinery	1,08,000	Fixtures	18,000	
To	Cash A/c (Creditors)	45,600	Stock	84,000	
To	Cash A/c (Sales tax)	4,200	Sundry Debtors	<u>44,400</u>	2,48,400
To	Cash A/c (Realisation expenses)	1,500	By Q (Unrecorded asset)*		4,800
To	Profit on Realisation				
	P	3,960			
	Q	3,960			
	R	<u>1,980</u>			
		9,900			
		3,01,200			3,01,200

Partners' Capital Accounts

Particulars	P	Q	R	Particulars	P	Q	R
	₹	₹	₹		₹	₹	₹
To Realisation A/c (unrecorded asset)		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	12,000
				By Realisation A/c (Profit)	3,960	3,960	1,980
	1,47,960	75,960	37,980		1,47,960	75,960	37,980

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Realisation A/c (Creditors)	45,600
To Realisation A/c (Assets)	2,48,400	By Realisation A/c (Expenses)	1,500
		By Realisation A/c (Sales Tax)	4,200
		By P's Capital A/c	1,47,960
		By Q's Capital A/c	71,160
		By R's Capital A/c	37,980
	3,08,400		3,08,400

* An unrecorded asset is in the nature of gain hence realization account is credited. Since this asset has been taken over by Q, therefore, his account has been debited.

Question 3

P and Q are partners of P & Co. sharing Profit and Losses in the ratio of 3:1 and Q and R are partners of R & Co., sharing profits and losses in the ratio of 2:1. On 31st March, 2009, they decide to amalgamate and form a new firm M/s PQR & Co., wherein P, Q and R would be partners sharing profits and losses in the ratio of 3:2:1. The Balance Sheets of two firms on the above date are as under:

Liabilities	P & Co. ₹	R & Co. ₹	Assets	P & Co. ₹	R & Co. ₹
Capitals:			Fixed assets:		
P	2,40,000	----	Building	50,000	60,000
Q	1,60,000	2,00,000	Plant & machinery	1,50,000	1,60,000
R	----	1,00,000	Office equipment	20,000	6,000
Reserves	50,000	1,50,000	Current assets:		
Sundry creditors	1,20,000	1,16,000	Stock-in-trade	1,20,000	1,40,000
Due to P & Co.	----	1,00,000	Sundry debtors	1,60,000	2,00,000
Bank overdraft	80,000	----	Bank balance	30,000	90,000
			Cash in hand	20,000	10,000
			Due from R & Co.	<u>1,00,000</u>	<u>-----</u>
	<u>6,50,000</u>	<u>6,66,000</u>		<u>6,50,000</u>	<u>6,66,000</u>

The amalgamated firm took over the business on the following terms:

- Building of P & Co. was valued at ₹ 1,00,000.*
- Plant and machinery of P & Co. was valued at ₹ 2,50,000 and that of R & Co. at ₹ 2,00,000.*
- All stock in trade is to be appreciated by 20%.*
- Goodwill valued of P & Co. at ₹ 1,20,000 and R & Co. at ₹ 60,000, but the same will not appear in the books of PQR & Co.*
- Partners of new firm will bring the necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.*
- Provisions for doubtful debts has to be carried forward at ₹ 12,000 in respect of debtors of P & Co. and ₹ 26,000 in respect of debtors of R & Co.*

You are required to prepare the Balance Sheet of new firm and capital accounts of the partners in the books of old firms.

(May, 2010)

Answer

Balance Sheet of M/s PQR & Co. as at 31st March, 2009

Liabilities		₹	Assets		₹
Capitals:			Building (₹ 1,00,000 + ₹ 60,000)		1,60,000
P	5,52,000		Plant & machinery (₹ 2,50,000+₹ 2,00,000)		4,50,000
Q	3,68,000		Office equipment (₹ 20,000+₹ 6,000)		26,000
R	<u>1,84,000</u>	11,04,000	Stock-in-trade (₹ 1,44,000+₹ 1,68,000)		3,12,000
Sundry creditors (₹ 1,20,000+1,16,000)		2,36,000	Sundry debtors (₹ 1,60,000+₹ 2,00,000)		3,60,000
Bank overdraft		80,000	Less: Provision for doubtful debts (₹ 12,000+₹ 26,000)		<u>(38,000)</u>
			Bank balance (₹ 30,000+₹ 90,000)		1,20,000
			Cash in hand		<u>30,000*</u>
		<u>14,20,000</u>			<u>14,20,000</u>

In the books of P & Co.

Partners' Capital Accounts

Particulars	P ₹	Q ₹	Particulars	P ₹	Q ₹
To Capital A/cs – M/s PQR & Co.	4,89,000	2,43,000	By Balance b/d	2,40,000	1,60,000
			By Reserve (3:1)	37,500	12,500
			By Profit on Realisation A/c (W.N.4)	2,11,500	70,500
	4,89,000	2,43,000		4,89,000	2,43,000

In the books of R & Co.

Partners' Capital Accounts

Particulars	Q ₹	R ₹	Particulars	Q ₹	R ₹
To Capital A/cs – M/s PQR & Co.	3,68,000	1,84,000	By Balance b/d	2,00,000	1,00,000

* ₹ 20,000+₹ 10,000+₹ 1,53,000+₹ 30,000 –₹ 1,83,000 = ₹ 30,000.

			By Reserve (2:1)	1,00,000	50,000
			By Profit on Realisation (W.N.5)	68,000	34,000
	3,68,000	1,84,000		3,68,000	1,84,000

Working Notes:
1. Computation of purchase considerations

	<i>P & Co.</i> ₹	<i>R & Co.</i> ₹
Assets:		
Goodwill	1,20,000	60,000
Building	1,00,000	60,000
Plant & machinery	2,50,000	2,00,000
Office equipment	20,000	6,000
Stock-in-trade	1,44,000	1,68,000
Sundry debtors	1,60,000	2,00,000
Bank balance	30,000	90,000
Cash in hand	20,000	10,000
Due from R & Co.	<u>1,00,000</u>	<u>-</u>
(A)	<u>9,44,000</u>	<u>7,94,000</u>
Less: Liabilities:		
Creditors	1,20,000	1,16,000
Provision for doubtful debts	12,000	26,000
Due to P & Co.	-	1,00,000
Bank overdraft	<u>80,000</u>	<u>-</u>
(B)	<u>2,12,000</u>	<u>2,42,000</u>
Purchase consideration (A-B)	<u>7,32,000</u>	<u>5,52,000</u>

2. Computation of proportionate capital

	₹
M/s PQR & Co. (Purchase Consideration) (₹ 7,32,000+ ₹ 5,52,000)	12,84,000
Less: Goodwill adjustment	<u>(1,80,000)</u>
Total capital of new firm (Distributed in ratio 3:2:1)	<u>11,04,000</u>
P's proportionate capital	5,52,000
Q's proportionate capital	3,68,000
R's proportionate capital	1,84,000

3. Computation of Capital Adjustments

	<i>P</i>	<i>Q</i>	<i>R</i>	<i>Total</i>
	₹	₹	₹	₹
Balance transferred from P & Co.	4,89,000	2,43,000		7,32,000
Balance transferred from R & Co.		3,68,000	1,84,000	5,52,000
	4,89,000	6,11,000	1,84,000	12,84,000
Less: Goodwill written off in the ratio of 3:2:1	(90,000)	(60,000)	(30,000)	(1,80,000)
Existing capital	3,99,000	5,51,000	1,54,000	11,04,000
Proportionate capital	5,52,000	3,68,000	1,84,000	11,04,000
Amount to be brought in (paid off)	1,53,000	(1,83,000)	30,000	

4. In the books of P & Co.**Realisation Account**

	₹		₹
To Building	50,000	By Creditors	1,20,000
To Plant & machinery	1,50,000	By Bank overdraft	80,000
To Office equipment	20,000	By M/s PQR & Co.	7,32,000
To Stock-in-trade	1,20,000	(purchase consideration)	
To Sundry debtors	1,60,000	(W.N.1)	
To Bank balance	30,000		
To Cash in hand	20,000		
To Due from R & Co.	1,00,000		
To Partners' capital A/cs			
P 2,11,500			
Q 70,500	2,82,000		
	<u>9,32,000</u>		<u>9,32,000</u>

5. In the books of R & Co.**Realisation Account**

	₹		₹
To Building	60,000	By Creditors	1,16,000
To Plant & machinery	1,60,000	By Due to P & Co.	1,00,000
To Office equipment	6,000	By M/s PQR & Co.	5,52,000
To Stock-in-trade	1,40,000	(purchase consideration)	
To Sundry debtors	2,00,000	(W.N.1)	
To Bank balance	90,000		
To Cash in hand	10,000		
To Partners' capital A/cs			
Q 68,000			
R 34,000	1,02,000		
	<u>7,68,000</u>		<u>7,68,000</u>