Centre for Distance and online Education

Punjabi University, Patiala

Class: B.COM-Part-I Semester: I

Paper: BC 103 (Financial Accounting) Unit: II

Medium: English

LESSON NO.

Department website: www.pbidde.org

Updated on – 16 may, 2023

Partnership Accounts -
Introduction and Admission of Partners

2.1.1 Objective

The objective of this lesson is to:

i. Accounting treatment of items such as interest on capital, interest on drawings, loan by partners.
ii. This lesson elaborate accounting treatment of reserves, revaluation of assets and liabilities and goodwill.
iii. This lesson explains the methods of calculation of goodwill in detail.

2.1.2 Partnership-An Introduction :

Section 4 of the Indian Partnership Act, 1932 defines partnership as the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually partners and collectively as a firm and the name under which the partners carry on their business is called the firm's name.

2.1.3 IMPORTANT TERMS IN PARTNERSHIP:

2.1.3.1Number of Partners :

The minimum number required to constitute a partnership firm is two, the maximum can be 10 in the case of firm engaged in banking business and 20 in other kinds of business.

2.13.2Liability of a Partner :

In a Partnership firm, the liability of the Partner is unlimited. In the event of dissolution of the firm the Partners may have to pay, in case of exigency, even out of their personal assets for the debts of the firm. As long as a person is a Partner, he is liable jointly as well as severally, for all the acts of the firm.

2.1.3.3 Capital Formation :

The Partnership Act does not insist that partners should bring capital in equal or in any stated proportions. The decision in this regard rests completely with the partners. Partners can raise their capital contributions from time to time either by further contribution or by not withdrawing their share of profits.

The proportion of capital contribution by the Partners are originally determined can be altered by the mutual consent of all the Partners.

2.1.3.4 Fluctuating Capital Accounts :

When the capital of the Partners are fluctuating, then all adjustments pertaining to distribution of profits or loss, drawings, interest on capital and drawing, salary of commission are made in the capital accounts. As a result of this, the capital of the partner at the end is different from what it was at the commencement of the period.

2.1.3.5 Fixed Capital Accounts :

The partners can agree that the amount of capital contributed by them will remain fixed and will not be reduced or increased during their term of Partnership. If such an agreement is arrived at, capital accounts are said to be fixed. When the capital accounts remains fixed no adjustment is made in it. The balance of each partner continues to be same from year to year representing the original capital contribution. In such cases, a separate current account is opened for each partner.

2.13.6 Current Account :

When it is desired to maintain a Fixed Capital Account, it is necessary, to have current account for all the partners. All operations relating to the personal accounts of the partners such as drawings, profits of loss, interest on capital and drawings, salary, commission, etc. are entered in the current accounts. At the close of the accounting period the current accounts are adjusted and balanced. Current Account is not integrated with the capital account of the partners, but shown distinct from it, in the Balance Sheet.

2.1.3.7 Drawings :

The Partnership deed may contain a clause which permits partners to withdraw a sum for their personal use. This is done in anticipation of their share in profits. In this case, a separate Drawings Accounts of each partner is opened.

2.1.3.8 Interest on Capital :

Partners are not entitled to claim interest on capital in the absence of any agreement to his effect. Interest on capital is allowed only when the partners have agreed on a stipulated rate of interest. It is generally allowed when partners do not share profits in proportion to their Capital contribution.

2.1.3.9 Interest on Drawings :

There is no provision in the Partnership Act to charge interest on drawings. Where interest is allowed on capital it does not necessarily follow that interest on drawings should also be charged. If it is found desirable to charge interest on drawings, then there should be a specific mention of this decision in the agreement. Interest is to be charged at an agreed rate on the amount of drawings. When the partner's drawings are unequal it helps towards adjusting the partner's accounts in an equitable manner.

2.1.3.10 Loan by a partner :

In order to expand the business or to provide working capital, a partner can advance a loan to the firm from his personal account. This is in addition to the capital contributed by him. For the loan advanced, he is entitled to receive interest. If the rate of interest is not stipulated, 6% p.a. is considered to be the effective rate, the Loan Account of the partner by separately shown form his Capital Account in the Balance Sheet.

2.1.3.11 Sharing Profits and Losses :

The profit/losses of a partnership firm are divided among the partners in a given ratio according to agreement entered into by them, in the absence of any specific mention in the agreement regarding the distribution of profits/losses, they should divide the profits equally between themselves.

The Profits-Loss ratio is not a constant entity. It can be changed with the mutual consent of all the partners.

2.1.4 self check exercise

a) fixed capital account

b) accounting treatment of interest on capital and interest on drawings.

2.13.12 Accounting Procedures :

(1) For Capital Contribution of Partners :

Cash/Bank Account - Dr

To Partner's Capital A/c

(2) For Drawings :

Partner's Capital/Current A/c -Dr

To Cash/Bank A/c

(Being cash withdrawn by banks)

(3) For interest on Capital :

Interest on Capital A/c -Dr

To Partner's capital/Current A/c

(Being interest on capital)

(4) For Interest on Drawings :

Partner's Capital/Current A/c -Dr

To Interest on drawings A/c

(Being Interest on drawings)

{5) For Partner's salary, commission, etc.

Partner's salary/commission A/c -Dr

To Partner's Capital/ Current A/c

(Being partner's salary/commission adjusted to Partner's capital/ Current account)

(6) For Adjusting Net Profit :

Profit & Loss Appropriation A/c -Dr

To Partner's Capital/Current A/c

(Being profit adjusted to Partner's capital Current account)

(7) For Adjusting Net Loss :

Partner's capital/Current A/c -Dr

To Profit & Loss Appropriation A/c

(Being net loss adjusted to partner's Capital/Current account)

(8) When a loan is advanced by a partner :

Cash/Bank Account -Dr

To Partner's Loan A/c

` (Being loan advanced by a partner)

(9) When a Interest on Loan in paid in cash :

Interest on Loan Account -Dr

To Cash/Bank Account

(Being interest on loan of the partner paid in cash)

(10) When Interest on Loan is adjusted to loan Account:

Interest on Loan A/c -Dr

To Partner's Loan Account

(Being interest on loan adjusted to partner's loan account)

Illustration :

On Ist Jan., 1996 A, B and C enter into partnership contributing Rs. 2,50,000, Rs. 1,30,000 and Rs.1,20,000 respectively and sharing profit in the ratio of 5:3:2 B and

C are entitled to a salary of Rs.16,000 and Rs.14,500 respectively per year. Interest on capital is to be allowed at 5 % per annum. 5% interest is to be charged on drawings. During the year A withdraw Rs. 40,000 B Rs. 25,000 and C Rs. 15,000 interest being A Rs. 2,250, B Rs. 1,125 and C Rs. 725 Profit in 1996 before the above mentioned adjustments was Rs. 71,400. Show how the profits is distributed and also prepare the capital accounts (a) if they are fluctuating and (b) if they are fixed.

Solution :

PROFIT AND LOSS APPROPRIATION ACCOUNT

To Interest on Captial (Rs.)		Rs.	By Net Profit (Rs)	(Rs)	
			By Interest on Drawing	71,400	
A	12,500		A	2,250	
B	6,500		B	1,125	
C	6,000	25,000	C	725	4,100
To Partners Salary					
B	16,000				
C	14,500	30,500			
To Net Profit Transferred to:					
A	10,000				
B	6,000				
C	4,000	20,000			
		75,500		75,500	

Capital are fluctuating

CAPITAL ACCOUNTS

	A	B	C		A	B	C
To Drawings	40,000	25,000	15,000	By Bank	2,25,000	1,30,000	1,20,000
To Interest				By Interest			
on Drawing	2,250	1,125	725	On Capital	12,500	6,500	6,000
To Balance c/d	2,30,250	1,32,375	1,28,775	By Salary	16,000	14,500	
				By P & L	10,000	6,000	4,000
				App.A/c			
	2,72,500	1,58,500	1,44,500		2,72,500	15,850	1,44,500

(b) If the capitals are fixed

CAPITAL ACCOUNTS

	A	B	C		A	B	C
To Balance c/d	2,50,000	1,30,000	1,20,000	By Bank	2,50,000	1,30,000	1,20,000

CURRENT ACCOUNTS

	A	B	C		A	B	C
To Drawings	40,000	25,000	15,000	By Interest on Capital	12,500	6,500	6,000
To Intt.on Drawings	2,250	1,125	725	By Salary		16,000	14,500
				By P & L Appropriation			
To Bal,c/d		2,375	8,775				
				By Bal.c/d	19,750	-	-
	42,250	28,500	24,500		42,250	28,500	24,500

2.1.6 Admission of Partner

A New partner can be admitted with the consent of all existing partners. The various reasons for admission of a new partner may be requirement of more capital, influence of special skill etc.

When a new partner is admitted, the amount brought in by him as his capital is credited to a newly opened capital Account in the name of the new partner. The new partner may contribute to the capital of the firm in the form of assets other than cash also.

Illustration:

X and Y are carrying on business in partnership. Z is admitted as a new partner who brings Rs. 8,000 in cash and trademarks and patents valued at Rs.2,000. Pass the Journal Entry.

Solution:

Cash A/c	-Dr	8,000	
Patents & Trade Mark A/c	-Dr	2,000	
To Z's capital A/c			10,000
(Capital brought in by Z in the form of cash patents and trade mark)			

2.1.6.1 Reserves :

Reserves created out of profits of balances in Profit and Loss Account at the time of admission of a new partner be transferred to the Capital Account of the old partners in the old profit sharing ratio. In case there is no partner admitted, but the partners agree on a change in the profit sharing ratio. the existing reserves should be credited to the capital accounts in the old profit sharing ratio.

Similarly, accumulated loss should be transferred to the Capital Accounts of the old partners in the old profit sharing ratio. The Journal Entry will be.

Old Partner's Capital A/c	-Dr
To Profit and Loss A/c	

2.1.6.2 Revaluation of Assets and Liabilities :

A new partner is not to be benefited by any appreciation in the values of assets of the firm or by any decrease in the values placed on liabilities of the firm. Similarly, he is not to bear any part of the loss that is due to decrease in the values of the assets or increase in the values of the liabilities of the firm till the date of his admission. Therefore before a new partner is admitted, the assets and liabilities of the firm are revalued if any profit or loss resulting from such a revaluation is transferred to old partner's. Capital Accounts in the old profit sharing ratio. For this purpose, the following three entries should be remembered:-

(1) Revaluation Account or Profit & Loss
Adjustment A/c -Dr
To Assets (Individually)
To Liabilities (Individually)
(To record decrease in the book value of assets and increase in the book values of liabilities as agreed upon on admission of the new partner)

(2) Assets (individual) - Dr
Liabilities (Individually) - Dr
To revaluation Account
(To record increase in the book values of assets and decrease in the book values of liabilities as agreed upon on admission of new partner)

(3) Revaluation Account - Dr
To Old Partner's capital A/c (Individually)
(Transfer of profit on revaluation to old partner's capital accounts in their old profit sharing ratio)

Sometimes the book values of assets and liabilities are not to be changed but suitable adjustment entries have to be passed to ensure that only the old partners are benefited by any profit on revaluation and they alone bear any loss arising out of such revaluation. In such a case the profit or loss on revaluation is calculated without actually debiting or crediting any assets or liability. If there is a profit, the following entries are passed:-

Memorandum Revaluation Account -Dr
To Old Partner's Capitals Account (individually)
(Profit on revaluation transferred to old partner's capital accounts in old profit sharing ratio)

All the partner's (including news) Capital Account individually) -Dr
To Memorandum Revaluations Account
(Transfer of Memorandum Revaluations Account to All Partners (including the new Partners) Capital Accounts

on the new profit sharing ratio)

2.1.6.3 New Profit Sharing Ratio

When the new profit sharing is not specially mentioned but only the share given to the new partner is mentioned, the assumption is that the old partners among themselves continue to share profits in the same relative ratio in which they were sharing profits to admission of new partner. In such the share given to the new partner should be deducted from I and then remainder should be divided among the old ratio.

2.1.6.4 Ratio of Sacrifice/ Sacrificing Ratio

In order to ascertain the ratio in which the old partners make sacrifice of profits, the new share of old partners should be deducted from their respective old shares of profits.

Example:

If X and Y share profits in the ratio of 5:3 and on admission of Z the new ratio between X,Y and Z is agreed upon 7:5:4 respectively, the ratio of sacrifice will be calculated as below:-

$$\text{Sacrifice by X} = \frac{5}{8} - \frac{7}{16} = \frac{3}{16}$$

$$\text{Sacrifice by Y} = \frac{3}{8} - \frac{5}{16} = \frac{1}{16}$$

Hence, Sacrifice Ratio between X and Y is 3:1

2.1.6.5 Goodwill

Goodwill is value of reputation attached to a business firm which enables it to earn super profits, i.e. profits in excess of what is considered to be a fair return on the amount of capital invested in business. Whenever a new partner is admitted, he is generally expected to pay cash to old partners for his share of goodwill for the right he acquires to share is super profits of the firm in future. It is not necessary that the new partner must bring cash or his share of goodwill, only adjustment may be made for goodwill.

Treatment of Goodwill

(1) When the goodwill brought in by the incoming partner and amount in retained in the business-

In such a case following journal entries are passed :-

(a) Cash/bank Account -Dr

To Goodwill Account

(Being amount of goodwill brought by the new partner)

(b) Goodwill Account -Dr

To Old Partner's Capital A/c

(Being the amount of goodwill shared by the old partners in the sacrificing ratio)

(2) when the goodwill brought in by the new partner and this amount is immediately withdrawn by the old partners:-

The entry for withdrawal would be:-

Old partner's Capital Accounts -Dr

To Bank Account

(Being the amount of goodwill brought in by new partner withdrawn by the old partners)

(3) When the new partner pays amount of goodwill privately to the old partners-

In this case, no entry is passed in the books of account of the firm.

(4) When the new partner may not bring anything for goodwill-

In this case goodwill account may be raised in the books of the firm at the full value of goodwill of the firm. the entry in this case is -

Goodwill Account -Dr

To Old Partner Capital Account (Individually)

(Being total value of goodwill of the firm credited to old partners in their old profit sharing ratio and raised at its full value)

However, if the goodwill account already appears in the Balance Sheet, the above entry will be passed by the excess value of goodwill as agreed upon on admission of a new partner. If the book value is higher than the value agreed upon, a reverse entry will be passed with the difference to bring down the book value of goodwill to the figure agreed upon.

(5) When the incoming new partner cannot bring anything for goodwill and no good will is to appear in the books of the firm.

In this case, the goodwill is raised in the books first and thereafter it is written off. And the entry in this case would be:-

(a) Goodwill Account -Dr

To Old Partner's Capital Accounts

(b) All Partner's Capital Account -Dr

To Goodwill Account

(Being the goodwill amount written off in the books of the firm)

(6) When the new partner brings a portion of the required amount for goodwill.

In this case the amount brought in by new partner will be shared by old partners in sacrificing ratio and for the portion of amount of goodwill not brought in by new partner, it will be raised in the books of the firm.

2.1.6.6 Calculation of Goodwill

(i) Average Profit Method:

Under this method, the average profit of a certain number of years has been calculated and this amount of average profit is the basis of the goodwill.

For example: If it is agreed on the admission of a new partner that goodwill of the firm be valued at three years purchases of average profits for the last five years. And the average profit of the firm for the last 5 years in 20,000 then amount of goodwill is -

Rs. 20,000 x 3= Rs. 60,000

(ii) Super Profit Method:

Under this method, the super profit of the business firm are taken as the basis of calculating the value of goodwill, the super profit of a business are the excess of average profit of the business firm over and above the fair return on the net capital employed.

(iii) Capitalisation Method:

The formula for calculating goodwill under this method is :

$$\text{Value of goodwill} = \frac{\text{Average Annual earnings} \times 100}{\text{Fair Return}} - \text{Net Tangible Assets}$$

Example: Average Profit of the Firm is Rs. 48,000

The Rate of capitalisation is 12%

Assets =6,00,000

Liabilities =Rs. 5,00,000

$$\text{Value of goodwill} = \frac{(48{,}000 \times 100) - (6{,}00{,}000 - 5{,}00{,}000)}{12}$$

=Rs. 4,00,000-1,00,000

=Rs 3,00,000

Illustration :

X and Y are partners in a firm sharing profit in the ratio of 3:1. The balance sheet of the firm on 31 Dec., 2005 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	1,800	Bank	1,000
Workmen			
Compensation Fund	1,200	Bill receivable	2,500
		Debtors 4,000	
General reserve	2,100	Less : Provision 500	3,500
Capital		Stock	3,000
X	6,000	Investments	5,000
Y	4,900	Goodwill	1,000
	16,000		16,000

On the above date Z is admitted for 2/5th share in the profits of the firm and the following revaluations were made :

(i) Accrued income not appearing in the books Rs. 100

(ii) Market value of investments is Rs. 4,500

(iii) Claim on account of workmen compensation is estimated at Rs. 150

(iv) A, an old customer, whose account was written off as bad, has promised to pay Rs. 350 in settlement of his full debt.

(v) Z is required to bring Rs. 8,000 as capital and Rs. 2,000 as goodwill. His share of goodwill was calculated at Rs. 2,400 Partners decide to show the goodwill in the Balance Sheet at Rs. 4,000.

You are required to prepare Revaluation Account, partners' Capital Account and initial Balance sheet of the new firm.

Solution :

REVALUATION ACCOUNT

To Investments	500	By Accrued Income	100
To Capital A/c		By Workmen Compensation fund A/c (1200-150)	1,050
X 750			
Y 250	1,000	By A	350
	1,500		1,500

CAPITAL ACCOUNTS

	X	Y	Z		X	Y	Z
	(Rs)	(Rs)	(Rs)		(Rs)	(Rs)	(Rs)
To Goodwill A/c	750	250	-	By balance b/d	6,000	4,900	-
To Goodwill A/c (9:3:8)	900	300	800	By General Reserve	1,575	525	
To balance c/d	11,175	6,625	9,200	By cash A/c	-	-	10,000
				By goodwill A/c	4,500	1,500	-
	12,825	7,175	10,000		12,825	7,175	10,000

BALANCE SHEET OF M/S X, Y & Z

Liabilities		Amt.Rs	Assets		Amt.R
Creditors		1,800	Bank		11,000
Workmen Compensation Fund		150	Bills Receivable		2,500
Capital A/c:			Debtors	4,350	
			Less: Provision	500	3,850
X	11,175				3,000
Y	6,625		Investment		4,500
Z	9,200	27,000	Accrued Income		100
			Goodwill		4,000
		28,950			28,950

2.1.7 self check exercise2

a) how sacrifice ratio is calculated?

b) what is the treatment of reserves at admission of partner.

2.1.8 Summary:

After going through this chapter we have learnt about important terms in partnership such as, fixed capital account, current capital account, fluctuating capital account, interest on capital, interest on drawings loan by partners sharing of profits and losses. This lesson has elaborated accounting procedure at the time of admission of a partner in detail. Calculation of new profit sharing ratio and sacrifice or gaining ratio is elaborated in this lesson. Accounting treatment of goodwill at the time of admission of partner. Methods of calculating goodwill are also elaborated in this lesson.

2.1.9 Glossary

Gaining ratio = new profit sharing ratio- old profit sharing ratio

Sacrificing ratio= old profit sharing ratio- new profit sharing ratio

2.1.10 Answers to self check exercise

1 a) see para 2.1.3.5

b) see para 2.1.3.8 & 2.1.3.9

2 a) see para 2.1.6.3

b) see para 2.16.1

2.1.11 exercise:

Write short notes on:

1. treatment of goodwill at the time of admission of partner
2. fluctuating capital account
3. Current account
4. Capital formation

Long questions

Q.1 What is the accounting procedure at the event of the admission of partner?

Q.2 what is goodwill? Write down methods of calculating goodwill. What is the accounting treatment of goodwill at the admission of partner.

2.1.12 Suggested readings

1. Advanced Accountancy - S.P. Jain & K.L. Narang
2. Advanced Accountancy - M.C.Shukla
3. Advanced Accountancy - R.L. Gupta & M.Radhaswamy

LESSON NO. 2.2

RETIREMENT AND DEATH OF A PARTNER

2.2.0 objective

The objective of this lesson is to explain accounting procedure of revaluation of assets and liabilities, valuation and treatment of goodwill, adjustment of reserves and calculation of profit and loss sharing ratio. This lesson explains in detail the accounting treatment of joint life policy at the death of a partner and repayment of amount to deceased partner.

2.2.1 Introduction

According to section 32 (1) of the Partnership Act, a partner may retire-

(a) With the consent of all partners.

(b) In accordance with an express agreement by the partners

(c) Where a partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

When a partner retires, the total amount due to him is either paid out to him in cash or the same in transferred to a Loan Account in his name. It is also possible that a part of the sums due to him is paid out in cash and the balance is transferred to his Loan Account. In any case, the Capital Account of the retiring partner is closed and it signifies retirement.

2.2.2 Accounting Procedure

The following are some of the accounting procedure involved in a partnership firm when one of the partners retires and the remaining partners continue to manage the business.

(a) Revaluation of Assets and Liabilities.
(b) Valuation and Treatment of Goodwill
(c) Adjustment of Reserves and Undistributed Profits
(d) Calculation of Profit-Loss Sharing Ratio.
(e) Mode of payment to the retiring partner.

2.2.2.1Revaluation of Assets and Liabilities

Before a partner retires all the assets and liabilities of the firm are revalued and any profit or loss resulting from such revaluation is transferred to all the partner's Capital Account in their profit sharing ratios. A Revaluation Account or Profit and Loss Adjustment Account is opened which is debited for all decreases in the book value of assets and all increase in liabilities and is credited for all increase in the value of assets and all decreases in liabilities. The balance transferred to the Capital accounts of all the partners.

If adjustments have to be made for profit or loss on revaluation without altering the values of assets and liabilities, a Memorandum Revaluation Account is opened. The profit and loss on revaluation is calculated without actually debiting or crediting any assets or liabilities, if there is a profit, the following entries are passed:

Memorandum Revaluation Account -Dr

To All the Partner's Capital Accounts

(i.e. including the retiring partners)

(Profit on revaluation transferred to all the partner's capital account in their profit-sharing ratio)

On retirement of the partner. the following entry is passed :-

Remaining Partners Capital Account -Dr

To Memorandum Revaluation Account

(Transfer of memorandum revaluation account to the remaining partner's capital accounts in the new profit sharing ratio).

If there is a loss of revaluation, first all the partners capital accounts are debited and Memorandum Revaluation Account is credited with the amount of such a loss. Then after the retirement has taken place. Memorandum revaluation Account is closed by transfer of the amount to the remaining partners capital accounts in the new profit sharing ratio.

2.2.2.2 Calculation of new Profit & Loss Sharing Ratio :

When a partner retires, the remaining partners has to carry on the business and their profit-loss sharing ratio changes. The change may take place under two situations-

(a) The remaining partners may decide to continue with their old profit-loss sharing ratio.

(b) The remaining partners may agree to have a new profit-loss sharing ratio. This may mean that they are changing their old contract of sharing the profit/ loss on certain consideration. It may be noted that the remaining partners may agree to purchase the share of the retired partner in a different ratio. Therefore, the profit-loss sharing ratio is to be altered according to the changed situation.

2.2.2.3 Valuation and Treatment of Goodwill:

In case of retirement of a partner, goodwill is valued in the same manner in which it is valued in case of admission of partner. There are a number of ways in which it may be treated on retirement.

In case there is no Goodwill Account appearing in the books of the firm, a Goodwill Account may be raised at its full value debiting Goodwill Account and crediting. All the Partners' Capital Account in their profit sharing ratio. If there is already a Goodwill Account, the above entry will be passed only with the excess of value of goodwill over the book value of goodwill. However, if the value of goodwill as agreed upon at the time of retirement is less than the balance of Goodwill Account as already appearing in the books of account, a reserve entry will be passed for the difference. Goodwill Account may be written off after the retirement of the partner by transfer to remaining partners' Capital accounts in the new profit sharing ratio,

If there is no Goodwill Account in the firm's ledger it is not necessary that it must be raised at its full value. Goodwill may be debited and the retiring partner's Capital Account may be credited with the retiring partner's share of goodwill.

It is also not necessary that Goodwill Account must be opened, only capital accounts of the partners may be debited with necessary amounts. If entries are to be made with full value of goodwill, the amount of the goodwill should be credited to all partners capital accounts in the old profit sharing ratio should be debited to the remaining partners' capital accounts in the new profit sharing ratio.

2.2.2.4 Adjustment of Revenue and Undistributed Profits

Before a partner retires. Reserves created out of profits or balance in profit and loss account must be transferred to the Capital Accounts of all the partners (i.e including the retiring partner) in the old profit sharing ratio (i.e. the ratio in which all the partners including the retiring are sharing profits and losses at the time of retirement), it is done so that the retiring partner may get his share of accumulated profits and may contribute his share of the loss that has not been transferred to capital accounts so far. Alternatively, only the share of the retiring partner be credited to his capital accounts for his share of profit. The journal Entry will be :

Reserves on Proft & Loss -Dr

To All Partners' Capital A/cs

(Reserves/balance in profits and loss account transferred to the capital accounts of all partners in old profit sharing ratio.)

The alternative entry will be :

Reserves on Profit and Loss A/c -Dr

To Retiring Partner's Capital A/c

(Reserves/balances in profit and loss account transferred to the capital account of retiring partner, his share only)

2.2.2.5 Mode of Payment to the retiring partner

The payment to the retiring partner is made in three different ways-

(a) A separate account called the Annuity Account is created by debiting the retiring partner's account. Payment is made regularly from this account. When payment is made, the Annuity Account is debited to the cash account. Interest is paid at an agreed rate on the balance in the Annuity Account. Every year for which the interest Account is debited to the Annuity Account. This account will appear on the liabilities side of the Balance-Sheet and the balance in this account will be reduced as and when annual instalments are paid to the retired partner.

(b) The second way of setting the dues of the retired partner is to buy an annuity from a Life Insurance office by paying a fixed amount. In this case, the Capital Account of the retiring partner is closed by transfer to the remaining partners' Capital Account in their profit-loss sharing proportions.

(c) The Third way of setting the retired partner's dues is to debit his Capital

Account and credit the Capital Accounts of the remaining partners in their profit-loss sharing proportions. The amount to be paid to the retiring partner on instalment basis every year is debited to the profit and Loss account treating is as a business expense.

2.2.3 Self check exercise 1

a) revaluation of assets and liabilities

b) calculation of profit and loss sharing ratio

Illustration :

A,B and C are partnership sharing profits and losses in the proportion of their capitals. Their Balance Sheet on December 31,2015 is given below :

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	5,000	Cash at Bank	1,000
Capital Accounts:		Sundry Debtors 10,000	
A 30,000		Less : Reserve 1,000	9,000
B 40,000	1,00,000	Stock	8,000
C 30,000		Furniture	10,000
		Plant & Machinery	25,000
General Reserve	10,000	Land & Building	62,000
	1,15,000		1,15,000

C wants to retire and the partners agree to settle his accounts on the following terms :

(a) The goodwill of the firm should be fixed at Rs. 20,000. The share of C should be adjusted into the accounts of A and B in the profit -loss sharing ratio of 3:2 which they decide to have in future.

(b) The value of furniture and plant and machinery should be depreciated at the rate of 15% and 20% respectively.

(c) The Stock was revalued at Rs. 6500.

(d) The value of land and building should be appreciated by 20%.

(e) The amount of capital of B after adjustment should remain the same and A has to adjust his capital in the new profit-loss sharing ratio.

Make necessary accounts in the books of the firm to give effect to these arrangements and also prepare the Balance Sheet of the new firm.

Solution:

Revaluation Account

Particulars		L.F. Amount Rs.	Particulars	L.F. Amount Rs.
To Stock		1,500	By Land & Building	12,400
To Furniture		1,500	By General Reserves	
10,000				
To Plant & Machinery		5,000		
To Capital Accounts:				
A	4,320			
B	5,760			
C	4,320	14,400		
		22,400		22,400

Calculation of A's Capital

New Profit-Loss sharing ratio of A and B =3:2

Capital of B after adjustment =Rs.43,360

This capital is 2/5 of the total capital

Then Total Capital is =43,360 x 5/2 = Rs. 1,08,400

A's share of capital will be 3/5 of total capital, i.e.

Rs. 1,08,400 x 3/5 =Rs. 65,040

A's capital after adjustment =Rs. 34,320-3,600=Rs. 30,720

So, A has to bring an additional capital of Rs.65,040-30,720=Rs. 34,320

CAPITAL ACCOUNTS

Particulars	A	B	C	Particulars	A	B	C
To C's Capital	3,600	2,400	-	By Bal.b/d	30,000	40,000	30,000
To Loan of C	-	-	40,320	By Revaluation	4,320	5,760	4,320
To Bal.c/d	65,040	43,360	-	By A and B's Capital	-	-	6,000
				By Bank (Balancing fig.)	34,320		
	68,640	45,760	40,320		68,640	45,760	40,320
				By bal. b/d	65,040	43,360	-

Balance Sheet of A and B after the Retirement of C

Balance Sheet

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)	
S.Creditors	5,000	Cash at Bank	1,000	
Loan of C	40,320	Add:Amount brought by A	34,320	
35,320				
Capital Accounts:		S.Debtors	10,000	
A 65,040		Less: Reserves	1,000	9,000
B 43,360	1,08,400	Stock		6,500
		Furniture		8,500
		Plant & Machinery		20,000
		Land & Building		74,400
	1,53,720			1,53,720

2.2.4DEATH OF A PARTNER

All the problems which arise on the retirement of a partner also arise on the death of a partner. However, there are a few additional points which have to be noted.

If the balance of deceased partner's capital account is not immediately paid in cash, the amount should be transferred to the deceased partner's Executors Account and not to any Loan Account.

A partner usually retires at the close of an accounting period when his capital account is credited with his state of profits for the year. But death is uncertain and a partner's death may take place any day. Partnership deed may provide that in case of death of a partner during an accounting period, the deceased partner's capital account will be credited with his share of profits for the period for which he remained alive during the year on the basis of profits of the year preceding the year in which death takes place.

2.2.5 Joint Life Policy

Partner's often take out a joint life policy to provide funds for setting the claims of the deceased partner. Annual premium is paid by the firm and on the death of a partner, the amount of the policy is received from the insurance company. There are three ways to treat the joint life policy in the books of account.

(1) When premium paid is treated as an expense

Under this method, the annual premium is treated as an expense and debited to the profit & Loss Account. On death of a partner, the amount in the Policy received by the aim is credited to Joint Life Policy Account. The amount in the Joint Policy Account is transferred to all the partner's capital accounts in the profits sharing ratio.

The Journal entries will be as under :

(i) For payments of premium of the Joint Life Policy

(a) Joint Life insurance Premium A/c -Dr
    To Bank A/c
(Being amount of premium paid on Joint Life Policy)

(b) Profit & Loss A/c -Dr
    To Joint Life Insurance Premium A/c
    (Being the amount of premium charged to Profit & Loss A/c)

(ii) For receipt of the Policy Money
    Bank A/c -Dr
        To all Partner's Capitals A/cs
    (Being the policy money distributed among all the partners in the profit sharing ratio)

(2) When Premium paid is treated as an Asset and Surrender Value is taken into Account :

Under this method Joint Life Policy account is debited with the amount of premium as and when paid. At the end of the year the book value of the Policy is adjusted to surrender value by transferring to Profit & Loss Account. The balance in Life Policy account is shown as an asset in the balance-sheet. The amount received on maturity of policy in excess of surrender value will be net gain and will be divided among all the partners in their profit sharing ratio.

The Journal entries will be as under :

(i) Joint Life Policy A/c-Dr

To Bank A/c

(Being the premium paid on policy)

(ii) Profit & Loss A/c -Dr

To Joint Life Policy A/c

(Being the adjustment of book value with the surrender value i.e. excess of life policy over the surrender value)

(iii) Bank A/c -Dr

To Joint Life Policy A/c

(Being amount received on maturity of policy)

(iv) Joint Life Policy A/c-Dr

To All Partner's Capital A/c

(Being the amount received minus the surrender value on that date distributed among the partners)

(3) When Premium paid is treated as an Asset and Life Policy Reserve Account maintained :

Under this method, whenever premium is paid, the amount of the premium is debited to Joint Life Policy Account. At the end of the year profit & loss account is debited and Joint Life Policy Reserve Account is credited with the amount of the premium paid for the year. Then in order to reduce the balances of Joint Life Policy Account and Joint Life Policy Reserve Account to the figure of surrender value of the policy Joint Life Policy Reserve Account is debited and Joint Life Policy Account is credited with the difference between balance of Joint Life Account and surrender value of the policy. The entries are repeated every year. On maturity of the policy, the amount received from insurance company is credited to Joint Life Policy Account, Joint Life Policy Reserve Account is transferred to Joint Life Policy Account and the balance in Joint Life Policy Account is transferred to all partner's capital accounts in their profit sharing ratio.

The Journal entries will be as under :

(i) Joint Life Policy A/c-Dr

To bank A/c

(Being the amount of premium paid on joint life policy)

(ii) Profit & Loss A/c -Dr

To Joint Life Policy Reserve A/c

(Being the amount transferred to joint life policy Reserve Account)

(iii) Joint Life Policy Reserve A/c -Dr

To Joint Life Policy A/c

(Being excess of premium over surrender value adjusted)

(iv) Bank A/c

To Joint Policy A/c

(Being the amount received of joint life policy on maturity)

(v) Joint Life Policy Reserve A/c -Dr

To Joint Life Policy A/c

(Being the credit balance of joint life policy reserve account transferred)

(vi) Joint Life Policy Reserve A/c -Dr

To All partner's Reserve A/c

(Being the final balance is transferred to capital accounts in the old profit sharing ratio of all the partners)

2.2.6 Repayment of the amount due to Deceased Partner

On death of a partner, the amount due to his legal representatives will have to be paid. It may not be possible to pay the whole amount in lump sum. As a rule the payment is made according terms of partnership agreement. The various courses available may be :-

(i) Repayment in instalments over a period of time and interest is paid on outstanding balance.

(ii) The amount may be treated as a loan to the firm. The firm may pay interest at an agreed rate or share of profit of the time.

(iii) An annuity may be paid for the life of some dependent.

2.2.7 Illustration :

(a) A and B are partners in a firm. On April Ist, 2005 they took out a joint life policy without profits for Rs. 30,000 upon which an annual premium of Rs. 1,400 is payable. A and B share profits and losses in the ratio of 2:1. On March 31, 2006, B died and Rs. 30,000 is received from the insurance company.

Journalise the above transactions. Premium is to be taken as expense.

(b) A and B who shared profits in the ratio of 3:2 took a joint life policy on May, 1, 2002 for Rs. 30,000. The annual premium was Rs. 1,300. The surrender value of the policy was :

2002, Nil; 2003, Rs. 400, 2004, Rs. 900, 1996, Rs. 1,450. B died on Sept., 15, 2005 and the amount of the policy was received on Dec. 31, 2005. The books are closed on 31st, Dec., every year.

Show the Joint Life Account and Joint Life Policy Reserve Account assuming that premium are written off through Joint Policy Reserve Account (a) From the particulars given in (b) prepare Joint Life Policy Account when surrender value is to be treated as an asset.

(a) JOURNAL ENTRIES

2005 Apr. 1	Joint Life Policy Premium A.c -Dr To Bank (Being annual Premium paid)	1,400	 1,400
2006 Mar. 31	Profit and Loss A.c -Dr To Joint Life Policy Premium A/c (Being premium charged to P & L A/c	1,400	 1,400
2006 Mar. 31	Insurance Company A/c -Dr To Joint Life Policy A/c (Beinf the amount of J & P due from Insurance Company)	30,000	 30,000
2006 Mar. 31	Bank A/c -Dr To Insurance Company (Being the receipt of claim form insurance company)	30,000	 30,000
2006 Mar. 31	Joint Life Policy A/c -Dr To A's Capital A/c To B's Capital A/c (Being the amount of Policy distributed among the partners)	30,000	 20,000 10,000

(b) JOINT LIFE POLICY ACCOUNT

2002		(Rs.)	2002		Rs.
May Ist	To Bank	1,300	Dec. 31	By Joint Life Policy	
1,300					
				Reserve A/c	
2003			2003		
May 1	To Bank	1,300	Dec. 31	By Joint Life Policy	900
				Reserve A/c	400
		1,300		By Balance c/d	1,300
2004			2004	1994	
Jan. 1	To Bal. b/d	400	Dec. 31	By J.L.P Reserve A/c	800
May 1	To Bank	1,300	Dec. 31	By Balance c/d	900
		1,700			1,700
2005			2005		
Jan. 1	To Bal.b/d	900	Dec. 31	By Bank	30,000
May 1	To Bank	1,300	Dec. 31	By J.P.L Reserve A/c	900
Dec. 31	To Capital A/c				
	A	17,220			
	B	11,480			
		30,900			30,900

JOINT LIFE POLICY RESERVE ACCOUNT

2002	(Rs.)		2002		(Rs.)
Dec.31	To J.L.P. A/c	1,300	Dec.31	By P & L A/c	1,300
2003			2003		
Dec.31	To J.P A/c	900	Dec.31	By P & L A/c 1,300	
		400			
		1300			1300
2004			2004		
Dec.31	To J.P. A/c	800	Jan.1	By balance b/d	400
Dec.31	To Bal. c/d	900	Dec.31	By P & L A/c	1,300
		1,700			1,700
2005			2005		
Dec.31	To Bal. c/d	900	Jan.1	By Balance b/d	900

(e) JOINT LIFE POLICY A/C

2002	Rs.				Rs.
May 1	To Bank	1,300	Dec.31	By P & L A/c	1300
2003				2003	
May 1	To Bank	1,300	Dec.31	By P & L A/c	900
				By Balance c/d	400
2004		1,300			
Jan.1	To Bal.b/d	400	Dec.31	By P & L A/c 8	00
May 1	To Bank	1,300	Dec.31	By Balance b/d	900
					1,700
1,700					
2005				2005	
Jan.1	To Bal b/d	900	Dec.31	By Bank	
30,000					
May 1	To Bank	1,300			
Dec.31	To A's Capital	16,680			
Dec.31	To B's Capital	11,120			
		30,000			30,0000

Illustrations:

X.Y. and Z are partners sharing profits and losses in the ratio of 5:3:2. The Balance Sheet the end of the Year 2008 was as follows:

Liabilities	(Rs.)	Assets	(Rs.)
Capital Accounts			
X	2,00,000	Goodwill	1,00,000
		Machinery	1,00,000
Y	1,50,000	Debtors	3,00,000
Z	1,00,000	Stock	2,00,000
Reserves	50,000	Cash at Bank	50,000
Creditors	2,50,000		
	7,50,000		7,50,000

Profit upto the date of death is estimated at Rs.9,00,000 without considering any depreciation. One Joint Life Policy of Rs.1,50,000 (without profit) was taken in the year 2007. Premium of Rs.10,000 was written off to ptofit and Loss Account. Each of the current assets (except cash and Bank) is estimated to bank gone up by 20 %. Creditors have increased by Rs.20,000. Goodwill is to be calculated at 2 years purchase of average profit of three. The profit was Rs.1,80,000 Rs.2,00,000 and Rs.2,20,000. Dues to deceased partners representations were to be settled on receipt of insurance claim to the extent possible. Balance was to carry 10 % interest from the date of death and was to be paid after one year. Machinery was valued at Rs. 80,000. Prepare necessary accounts and a Balance Sheet immediately after A's death.

Solution :

REVALUATION ACCOUNT

	(Rs.)		(Rs.)
To Machinery	20,000	By Debtors	60,000
To Creditors	20,000	By Stock	40,000
To Capital			
X 30,000			
Y 18,000			
Z 12,000	60,000		
	1,00,000		1,00,000

CAPITAL ACCOUNTS

	X	Y	Z		X	Y	Z
	(Rs)	(Rs)	(Rs)		(Rs)	(Rs)	(Rs)
To X's Executors A/c	5,25,000	-	-	By Balanceb/d	2,20,000	1,50,000	1,00,000
To Balance C/d	-	31,800	2,12,000	By Reserves	25,000	15,000	10,000
				By Goodwill	1,50,000	90,000	60,000
				By Revaluation	30,000	18,000	12,000
				By JLPA/c	75,000	45,000	30,000
				By P & L Suspense A/c	45,000	-	-
	5,25,000	3,18,000	2,12,000		5,25,000	3,18,000	2,12,000

BALANCE SHEET OF M/S Y & Z
(after death of X)

Liabilities		Rs.	Assets	Rs.
Creditors		2,70,000	Goodwill	40,000
X's Executors A/c		5,25,000	Machinery	80,000
Capital Accounts :			Debtors	3,40,000
Y	3,18,000		Stock	2,60,000
Z	2,12,000	5,30,000	Cash at Bank	50,000
			Policy Account Due	1,50,000
			P & L Suspense A/c	45,000
		13,25,000		13,25,000

2.2.8 Self check exercise2
a) treatment of joint life policy
b) death of partner

2.2.9 Summary
After going through this chapter we have understood about accounting procedure involved at retirement of partner. This chapter elaborate in detail the revaluation of assets and liabilities, valuation and treatment of goodwill, adjustment of reserves and undistributed profits, calculation of profit and loss sharing ratio and mode of payment to retiring partner. This lesson also explains in detail the accounting treatment of joint life policy at the death of a partner.

2.2.10 Glossary
Revaluation of assets and liabilities: assets and liabilities are revalued by preparing revaluation account and profit or loss arising from revaluation is distributed among partners in their profit sharing ratio before retirement of partner.
New profit sharing ratio= old profit sharing + gaining ratio

2.2.11 Answers to self check exercises
1 a) see para 2.2.2.1
b) see para 2.2.24
2. a) see para 2.2.5
b) see para 2.2.4

2.2.11 Exercise
Write short notes on
1, revaluation of assets and liabilities
2.valuation and treatment of goodwill
3.adjustment of reserves and undistributed profits
Long questions
Q.1 write down accounting procedure involved at the time of retirement of partner.
Q.3 write down treatment of joint life policy at the death of the partner.

2.2.12 Suggested readings

Advanced Accountancy - S.P. Jain & K.L. Narang
Advanced Accountancy - M.C.Shukla
Advanced Accountancy - R.L. Gupta & M.Radhaswamy

LESSON NO. 2.3

DISSOLUTION OF PARTNERSHIP

2.3.0 Objective

The objective of this chapter is to explain accounting treatment and settlement of accounts at event of dissolution of partnership. This lesson also elaborate sale of partnership to a company and purchase consideration in detail.

2.3.1 Introduction

Dissolution of a firm means that the business of the firm is put to an end, assets are disposed off, liabilities are paid off and accounts of all the partners are also settled. Dissolution of a firm differs from dissolution of a partnership. When a partnership is formed for a specific venture, it is dissolved on the expiry of the term or on the completion of the specified venture, but the partners may decide to continue to run the business for another term on the another venture. Similarly, death, retirement or insolvency of a partner dissolves the partnership but the remaining partners may continue to run the business. Thus, dissolution of a partnership need not necessary lead to dissolution of the firm. However, dissolution of a firm involves dissolution of partnership as well.

2.3.2 Dissolution of firm

A firm is dissolved when :

(i) the partners of the firm decide to dissolve it;

(ii) all the partners or all the partners except one become insolvent ;

(iii) the business of the firm is declared illegal;

(iv) in case partnership at will, a partner gives notice of dissolution;

(v) the court orders dissolution of the firm which may happen in the following circumstances :-

(a) where a partner has become of unsound mind;

(b) where a partner suffers from permanent incapacity;

(c) where a partner is guilty of misconduct affecting the business.

(d) where there is presistent disregard of partnership agreement by a partner;

(e) where a partner transfers his interest of share to a third person;

(f) where a business cannot be carried on except at a loss; and

(g) where a dissolution appears to the court to be just and equitable on may other ground.

2.3.3 Settlement of Accounts

On dissolution of the firm, the assets of the firm are sold out the proceeds are applied in the following order:-

(1) in paying debts due to third parties;

(2) in paying rateably the loans advances by partners to the firm, and

(3) in paying to the partners the sums due to them on account of capital.

If there is a surplus, it has to be distributed among the partners in the profit sharing ratio. On the other hand, if there is a loss of dissolution, it has to be made up first out of past accumulated profits, then out of capitals of the partners and lastly out of contributions from private estates of the partners in the profit sharing ratio.

2.3.4 Firms debts Vs. Private debts

An important principle to remember is that the private property of a partner is to be used first to pay his private debts and only the surplus, if any, can be used to pay firm's liabilities. Similarly, firm's assets are first used to pay firm's liabilities. A partner can use only his share of the surplus to pay his private liabilities. Another priniciple to remember is that the liability of partners is joint and several. It means that if a partner is unable to bring in his share of loss, the other partners have to make up his share of loss also.

2.3.5 Accounting Procedure

Preparation of Realisation Account:

At the of dissolution all assets are to be disposed off and all liabilities discharged with a view to closing the books of the firm. In this process, some profit or loss is likely to occur and profits of loss ascertained is transferred to partners' capital accounts in their profit-loss sharing ratio. Assets are realised and liabilities are discharged through a common account called the Realisation Account.

Following are the Journal entries relating to the preparation of the Realisation Account :

(a) When all realisable assets are transferred at their book-value:

  Realisation Account -Dr
  To All Assets Account
  (Being transfer of assets at books values)

(b) When all liabilities of the third parties are transferred :

  Liabilities Account -Dr
    To Realisation Account
  (Being transfer of liabilities to Realisation Account)

(c) When Reserve for Bad and Doubtful Debts is transferred:

  Reserve for Bad and Doubtful Debts A/c -Dr
    To Realisation Account
  (Being transfer of reserve for bad and doubtful)

(d) When assets are realised in cash-

  Cash Account-Dr
    To Realisation Account
  (Being realisation of assets for cash)

(e) When some of the assets are taken overby the partners:

  Partner's Capital Account -Dr

To Realisation Account

(Being the asets taken over by the partner)

(f) When expenses are incurred on dissolution :

Realisation Account-Dr

To Cash Account

(Being expenses incurred on dissolution)

(g) When third party's liabilities are discharged :

Realisation account -Dr

To cash Account

(Being payment made to third parties)

(h) When any liability is taken over by a partner at an agreed value :

Realisation Account-Dr

To Partner's Capital Account

(Being liability taken over by the partner at an agreed value)

(i) When profits are earned on realisation :

Realisation Account-Dr

To Partner's Capital Account

(Being profits earned on realisation transferred to Partner's Capital account in their profit-loss sharing ratio)

(j) When losses are incurred on realisation ;

Partner's Capital Accounts -Dr

To Realisation Account

(Being losses incurred on realisation transferred to partners capitalaccounts in their profit-loss sharing ratio)

Other Accounting Entries to Finalise the process of Dissolution :

(a) When the loan of partner is repaid :

Partner's Loan Account -Dr

To Cash Account

(Being partner's loan repaid)

(b) When undistributed profits or reserve are transferred to the accounts of all partners :

Profits/Reserves Account -Dr

To All Partner's Capital A/cs

(Being transfer of undistributed profits of reserves to all partner capital accounts in their profit-loss sharing ratio)

(c) When accumulated losses of the firm are transferred to the partners capital accounts :

Partner's Capital Accounts -Dr

To Profit & Loss Account

(Being transfer of accumulated losses to the capital account of fall the partners in their profit -loss sharing ratio)

(d) When cash is brought by the partners to meet their capital requirements:

Cash Account -Dr

To Partners' Capital Account

(Being cash brought in to meet the capital requirements of the partners)

(e) When accounts of the partner are settled by making payments to them:

Partner's capital Account -Dr

To Cash Account

(Being final Settlement made to the partner in cash)

Example:

On December 31,1995, the following was the balance sheet of X,Y and Z when the firm was dissolved :

BALANCE SHEET

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capital Accounts		Goodwill	10,000
X 30,000		Plant & Machinery	20,000
Y 30,000		Furniture	8,000
Z 30,000	90,000	Investment	10,000
General Reserve	9,000	Stock	51,060
Y's Loan	5,000	Debtors 23,600	
Mrs. X's Loan	5,000	Less:Provision	
		for Bad Debts 1,020	22,580
Current Accounts:		Bills Receivable	5,000
X 2,860		Cash at Bank	2,760
Y 1,240	4,100	Unexpired Insurance	125

Investment were taken over by X for Rs. 13,000 whereas bills receivable were taken over by Y for Rs. 4,800, fixed assets fetched Rs. 17,000 whereas stock realised Rs.60,000. All the debtors paid the amounts due from them. Total rebate of Rs. 110 was received on retiring all bills payable immediately. Expenses of realisation came to Rs. 1,441.

Pass journal entries to close the books of the firm and show Realisation Account, Bank Account, Current and Capital Accounts of all the partners.

Journal Entries

Realisation A/c -Dr	1,27,785	
To Goodwill		
10,000		
To Plant & Machinery		
20,000		
To Furniture		8,000
To Investments		
10,000		
To Stock		51,060
To Debtors		23,600
To Bill Receivable		5,000
To Unexpired Insurance		125
(Being Transfer of assets to realisation Account)		
Provision for Bad debts -Dr	1,020	
Mrs. X's Loan -Dr	5,000	
Bills Payable -Dr	10,000	
Sundry Creditors -Dr	6,035	
To Realisation A/c		
22,550		
(Being transfer liabilities to realisation account)		
Bank A/c -Dr		1,00,600
To Realisation A/c		
1,00,600		
(Being sale proceeds of fixed assets and stock and amount received from debtors)		
X's Current A/c -Dr		
13,000 Y's Current A/c	-Dr	
4,800		
To Realisation A/c		
17,800		
(For investments taken over by X for Rs. 13,000 and bills receivable taken by Y for Rs.4,800		
Realisation A/c -Dr		
21,420		
To Bank A/c		21,420
(Being payment made to pay liabilities to		

outsiders)			
Realisation A/c	-Dr		1,441
To Bank A/c			1,441
(Expenses of realisation amounting to Rs. 1,141)			
X's Current A/c	-Dr	3,232	
Y's Current A/c	-Dr	3,232	
Z's Current A/c	-Dr	3,232	
To Realisation A/c			9,696
(Transfer of loss realisation)			
General Reserve	-Dr		
Y's Loan A/c	-Dr	5,000	
To Bank A/c			5,000
(Payment of Y's Loan)		9,000	
X's Capital Account	-Dr		
To X's Current A/c			3,000
To Y's Current A/c			3,000
To Z's Current A/c			3,000
(Transfer of General Reserve)		10,372	
Y's Capital Account	-Dr	5,137	
Z's Current A/c	-Dr		
To X's Current A/c			10,372
To Y's Current A/c			5,137
(Transfer of debit balances of current accounts of X and Y to their accounts			
X's Capital A/c	-Dr	1,008	
To Z's Capital A/c			1,008
(Being transfer of credit balance in Z's current account to Z's capital account			
Y's Capital A/c	-Dr	19,628	
Z's Capital A/c	-Dr	24,863	
To Bank A/c		31,008	75,499
(Payment to partners)			

REALISATION ACCOUNT

To Sundry Assets :	(Rs.)		(Rs.)
Goodwill	10,000	By Provision for Bad	1,020

		Debts	
Plant & Machinery	20,000	By Mrs. X's Loan	5,000
Furniture	8,000	By Bills Payable	10,000
Investments	10,000	By Sundry Creditors	6,530
Stocks	51,060	By Bank	
1,00,000			
Debtors	23,600	By X'a Current A/c	
13,000			
Bills receivable	5,000	(Investment)	
Unexpired insurance	125	By Y's Current A/c Bills receivable	4,800
To Bank (Liabilities)	21,420	By X,s Current A/c (1/3rd Loss)	3,232
To Bank (Expenses)	1,441	By Y's Current A/c (1/3rd Loss)	3,232
		By Z's current A/c (1/3rd loss)	3,232
	1,50,646		1,50,646

Bank Account

To Bal B/f	2,760	By Realisation (Liabilities)	
21,420			
To Realisation	1,00,600	By Realisation (Expenses)	1,441
(Sale proceess of asset)		By Y's Loan A/c	5,000
		By X's Capital A/c	
19,628			
		By Y's Capital A/c	
24,863			
		By Z's Capital A/c	
31,008			
	1,30360		1,30,360

CAPITAL ACCOUNTS

	X	Y	Z		X	Y	Z
To X's Current A/c	10,732			By Bal. b/f	30,000	30,000	30,000
To Y's Current A/c		5,137		By Z's Current A/c			1,008
To Bank	19,628	24,863	31,008				
	30,000	30,000	31,008		30,000	30,000	31,008

CURRENT ACCOUNTS

	X	Y	Z		X	Y	Z
To Bal. b/f			105	By Bal.b/f	2,860		1,240
To Realisation	13,000	4,800		By General Reserve	3,000	3,000	3,000
To Realisatio (Loss)	3,232	3,232	3,232	By Y's Capital A/c		5,137	
To Z's capital A/c			1,008				
	16,232	8,137	4,240		16,232	8,137	4,240

2.3.6 Sale to a Company

Sometimes the business of a partnership firm is sold an existing joint stock company or to a joint stock company newly started to table over the business of the firm. In such a case Realisation Account is opened in the books of the firm and all the assets are transferred to it usual. Even cash in hand and cash at bank are transferred if the same have also been taken over by the company. However, as regards liabilities, only those liabilities are transferred to Realisation Account which have been taken over by the joint stock company, and is therefore sold by the firm, the sale proceeds are credited to Realisation Account. Realisation Account is also creditors with purchase consideration payable by the company for the business purchased by it, debit being given to the company. If expense are incurred by the firm, they are debited to Realisation Account. If they are paid by the firm but are recoverable from the purchasing company, payment for such expenses is debited to the company. If the company itself is to pay and bear such expenses, no entry is required in the books of the firm for such expenses. Profit or loss revealed by Realisation Account is transferred to partners capital in profit sharing ratio.

Usually the company discharges the amount due from it in the form of cash, shares and debentures. Separate accounts will be opened to record the receipt of shares and debentures. If different types of share are received, the firm will debit the agreed values of different types of share to separate share accounts.

In the absence of an agreement of the contrary, shares and debentures should be distributed among the partners in the ratio of their final claims, i.e. in the ratio of capitals standing after all other adjustments (e.g. for profit or loss on realisation, for past undistributed profit or losses or for any other asset or liabilities taken over by a partner of partners) have been made. It must be remembered that no fraction of a share or debenture can be issued. Hence, the nearest, whole number of shares and debentures should be given to partners, the necessary adjustment being made in cash. Finally cash is paid to partners to close all the accounts.

2.3.7 Purchase Consideration

There are different ways in which purchase consideration may be computed. There is no question if the purchase consideration is stated as a lump sum. But sometimes the values at which different assets and liabilities are taken over by the company may be given. In such a case, agreed values of the assets taken over by should be totaled and from such a total, the total of values at which different liabilities have been taken over should be deducted to find the purchase consideration. Alternatively, agreed values of shares and debentures issued by the company and cash paid by the company in discharge of purchase consideration may be mentioned. Total of such value and cash will be the purchase consideration.

Example: ABC Co. Ltd. took over the business of X and Y, two equal partners and agreed to issue 1,000 Equity shares of Rs. 10 each at an agreed value of Rs. 11 each, 1008% preference shares of Rs. 100 each, at par , Rs. 5000 of 5 % Debentures at a discount of 5 % and Rs. 1500 in cash.

Solution:

Agreed Value of 1,000 Equity Shares = Rs. 11 X 1,000=Rs. 11,000

Agreed Value of 100 8 % Preference Shares= Rs. 10 x 100 = Rs. 1,000

Agreed Value of Rs. 5,000

5% Debentures at a discount of 5 % $= \text{Rs. } \dfrac{5{,}000 \times 95}{100} = \text{Rs. } 4{,}750$

Cash = Rs. 1,500

Total Purchase Consideration = Rs. 18,250

2.3.8 self -check exercise

1. dissolution of partnership
2. purchase consideration
3. sale to a company

2.3.9 Summary

In this chapter dissolution of partnership is explained in detail. Accounting procedure and settlement of accounts are explained in detail. Sale of partnership to a company and calculation of purchase consideration are elaborated in this chapter. Journal entries to be passed at the time of dissolution are explained in this lesson.

2.3.10 Glossary

Dissolution = the partnership firm discontinue the business by selling the assets and paying off liabilities.

Sal e to a company= the sale of partnership to a joint stock company or a company take over the business of partnership firm.

2.3.11 Exercise

Write short notes on

1. dissolution of partnership
2. sale to a company
3. purchase consideration

Long questions

Q.1 what do you mean by dissolution of partnership? What is the accounting procedure on the event of dissolution of partnership?

Q,2 what is sale to a company? How purchase consideration is calculated?

2.3.12 Suggested readings

Advanced Accountancy - S.P. Jain & K.L. Narang

Advanced Accountancy - M.C.Shukla

Advanced Accountancy - R.L. Gupta & M.Radhaswamy

Lesson No. 2.4 Author : J.S. PASRICHA

Amalgamation of Firms

2.4.0 Objectives

After studying this lesson you should be able to :

- explain the concept and objectives of amalgamation.
- understand various aspects to be dealt with at the time of amalgamation.
- understand the accounting procedure to be followed to close the books of the firms being amalgamated.

2.4.1 Introduction

Due to changed environment under new economic policy pursued in the recent past by Government of India, amalgamations, mergers and acquisitions have become quite common in the country. Due to opening up of the economy under policies of liberalisation, competition from multinational companies has grown considerably. To cope up with the situation, a number of amalgamations, mergers and acquisitions have already taken place and many are in the pipe line.

2.4.2 Meaning and objectives of Amalgamation

When two or more than two firms doing similar business combine together and form a new firm, such a combination is called amalgamation. That is, if two firms A & Co. and B & Co. decide to amalgamate, then these two firms will cease to function as separated business entities and a new firm, say, C & Co. shall come into existence taking over the business of both the firms.

The main objectives of amalgamation are :-

1. To eliminate or reduce competition.
2. To achieve economies of scale (both external and internal) due to increase in the size of the business.
3. To reduce business expenses by eliminating duplication of activities.

2.4.3 Issues in Amalgamation :

When two or more firms decide to amalgamate with each other, it is essentially a case of existing firms selling their business to the new firm. When the existing firms are sold to the new one, the following issues may generally be faced with :

(a) The new firms may not take over all the assets and liabilities of the existing firms.

(b) The new firm may take over some assets and liabilities at book value and some assets and liabilities at revised values.

(c) The new firms may pay to the existing firms some amount for goodwill which may be more or less than the amount of goodwill, if any, already appearing in balance - sheets.

2.4.4 Steps in Amalgamation

The following steps may be taken to close the books of the existing firms.

1. All the assets and liabilities of the amalgamated firms are revalued. This revaluation is done through Revaluation Account in the same manner as is done at the time of admission or retirement of a partner. The Revaluation Account is closed by transferring profit/loss on revaluation to partner's Capital accounts in their profit sharing ratio.
2. All reserves, profits and losses appearing in the balance sheets of the existing firms shall be transferred to the partner's capital accounts in their profit sharing ratio.
3. The assets not taken over by the new firm shall be transferred to the capital accounts of the partners in their capital ratio.
4. The liabilities not taken over by the new firm shall be either paid off or transferred to the capital accounts of the partners in their capital ratio.
5. The assets and liabilities taken over by the new firm shall be closed by transferring them to the new firm.
6. The capital accounts of the partners and the account of the new firm shall be closed by debiting capital accounts of partners (with final balance outstanding) and crediting the new firm's account.

2.4.5 Self Check Exercise :

State whether the following statements are true or false :

1. All assets including cash must be transferred to Revaluation Account

2. Any balance in the goodwill account at the time of amalgamation must be transferred to capital accounts.
3. Unrecorded liability paid at the time of amalgamation of the firm is to be debited to Revaluation Account. ( )
4. The balance in the Revaluation Account is transferred to partner's capital account in their profit sharing ratio. ( )

2.4.6 Accounting Entries

2.4.6 (a) Accounting Entries in the books of Amalgamated firms :-

1. The journal entries for revaluation of assets and liabilities and transfer of reserves/profits and losses would be same as in the case of admission or retirement of a partner.
2. Assets not taken over by the New Firm.

   Partner's Capital Accounts Dr.

   To Various Assets A/c.
3. Liabilities not taken over by the New firm.

   Various Liabilities Accounts Dr.

   To Cash/Bank A/c.

   To Partners Capital A/c.
4. Assets and Liabilities taken over by the New firm.

   Liabilities Accounts Dr.

   New Firm Account Dr.

   To Assets A/c.
5. For closing Partners 'Capital Accounts

   Partners' Capital Account Dr.

   To New Firm's A/c.

2.4.6 (b) Accounting Entries in the books of the New Firm :

Books of the new firm shall be opened by passing the following journal entry :

Various Assets A/c. (taken over) Dr.

To Various Liabilities A/c. (taken over)

To Partners' Capital A/c.

2.4.7 Illustration

Following were the Balance Sheets as at 31st December, 2000 of two firms M/s. A and B and M/s C & D.

	A & B	C & D		A & B	C & D
Creditors	30000	250000	Stock	500000	750000

Bills Payable	60000	- - -	Debtors	300000	450000
Bank overdraft	- - -	103000	Premises	200000	- - -
			Plant & Machinery	50000	200000
A	500000		Bank	15000	- - -
B	500000		Furniture	5000	3000
C		525000	Defence		
D		525000	Bonds	20000	- - -
	10,90,000	14,03,000		10,90,000	14,03,000

The two firms decided to amalgamate their business and form a new firm ABCD & Co. as from Ist January, 2001. For this purpose, it was agreed that the Premises and Plant and Machinery belonging to A & B should be taken over by the new firm at Rs. 250000 and Rs. 100000 respectively. C & D were to be credited with Rs. 50000 for the value of certain patent rights they possessed, which became the property of the partnership and which were not included in their Balance Sheet. All the other assets were taken over at the values stated in the respective Balance Sheets, except the Defence Bonds belonging to A & B, which were not taken over. Both firms undertook to discharge their own liabilities, and it was agreed that A & B should introduce cash to make their capitals equal to that of C & D.

Pass the necessary Journal entries in the books of the old firms and the opening entries in the books of the new firm. Also, prepare Balance Sheet of the new firm.

Solution :

Books of M/s. A and B
Journal Entries

		Rs.	Rs.
Plant& Machinery Account	Dr.	50,000	
Premises Account	Dr.	50,000	
To Revaluation Account			1,00000
(Being appreciation in the value of Plant & Machinery and Premises)			
Revaluation Account	Dr.	1,00000	
To A's Capital Account			50,000
To B's Capital Account			50,000
(Being distribution of profit on			

revaluation between A and B)

Creditors Accounts	Dr.	30,000	
Bills Payable Accounts	Dr.	60,000	
To A's Capital Account			45,000
To B's Capital Account			45,000
(Being transfer of liabilities not taken over by the new firm to the Capital Account of A and B)			
A's Capital Account	Dr.	10,000	
B's Capital Accont	Dr.	10,000	
To Defence Bonds A/c			20,000
(Being transfer of asset not taken over by the new firm to the Capital Accounts of A and B)			
M/s. ABCD & Co.	Dr.	11,70,000	
To Bank			15,000
To Stock			5,00,000
To Debtors			3,00,000
To Premises			2,50,000
To Plant & Machinery			1,00,000
To Furniture			5,000
(Being taking over of various assets by the new firm)			
A's Capital A/c	Dr.	5,85,000	
B's Capital A/c	Dr.	5,85,000	
To M/s ABCD & Co.			11,70,000
(Being transfer of capital to new firm)			

Books of M/s C and D
Journal Entries

Patent Rights A/c	Dr.	50,000	
To Revaluation			50,000

(Being patent rights brought into accounts)
Revaluation A/c Dr. 50,000
To C's Capital A/c
25,000
To D's Capital A/c
25,000
(Being distribution of balance of
revaluation between C and D)
Creditors A/c Dr. 2,50,000
Bank Overdraft A/c Dr. 1,03,000
To C's Capital A/c
1,76,500
To D's Capital A/c 1,76,500
(Being transfer of liabilities not taken
over to the Capital Accounts of C and D.)
M/s ABCD & Co. Dr. 14,53,000
To Stock
7,50,000 To Debtors
4,50,000 To Plant and Machinery
2,00,000
To Patents
50,000
To Furniture 3,000
(Being taking over of various assets by the new
firm M/s ABCD & Co.)
C's Capital A/c Dr. 72650
D's Capital A/c Dr. 72650
To M/s ABCD & Co. 1453000
(Being transfer of Capital Accounts to new firm)

Books of M/s ABCD & Co
Journal Entries.

Bank A/c Dr. 15,000
Stock A/c Dr. 5,00,000
Debtors A/c Dr. 3,00,000
Premises A/c Dr. 2,50,000
Plant and Machinery A/c Dr. 1,00,000

Furniture A/c	Dr.	5,000	
To A's Capital A/c			5,85,000
To B's Capital A/c			5,85,000
(Being taking over of Assets of A and B)			
Stock A/c	Dr.	7,50,000	
Debtors A/c	Dr.	4,50,000	
Plant and Machinery A/c	Dr.	50,000	
Patents A/c	Dr.	2,00,000	
Furniture A/c	Dr.	3,000	
To C's Capital A/c			
7,26,500			
To D's Capital A/c			
7,26,500			
(Being taking over of Assets of C and D)			
Bank A/c	Dr.	2,83,000	
To A's Capital A/c			
1,41,500			
To B's Capital A/c			
1,41,500			
(Being introduction of cash by A and B to make their capitals equal to C and D)			

Balance Sheet of M/s ABCD & Co.
as on Ist January, 2001

Liabilicies	Rs.	Assets	Rs.
Capital Accounts		Cash at Bank	298000
A	726500	Sundry Debtors	750000
B	726500	Stock	1250000
C	726500	Patents Rights	50000
D	726500	Furniture and fixture	8000
		Plant & Machinery	300000
		Premises	250000
	2906000		2906000

2.4.8 Summary

In order to avoid cut-throat competition and to achieve economies of scale, amalgamations among business entities are quite common. When two or more firms decide to amalgamate, their books of accounts would be closed by transferring various assets and liabilities either to the new firm or to the capital accounts of the partners. The other accounts such as, reserves, profits and losses accounts shall be transferred to partners' capital accounts. The partner's capital accounts shall be closed by transferring them to the new firm.

2.4.9 Glossary

Amalgamation = The amalgamation of company is the process of combination of two or more businesses to create large single entity.

Types of amalgamation = amalgamation in the nature of merger, amalgamation in the nature of purchase

2.4.10 exercise

Write short notes on

1. Amalgamation
2. steps in Amalgamation

Long questions

Q.1 what do you mean by amalgamation? What are the steps in amalgamation?

Q2. What do you mean by amalgamation? What journal entries are passed in the books of amalgamating company?

2.3.11 suggested readings

Advanced Accountancy	-	S.P. Jain & K.L. Narang
Advanced Accountancy	-	M.C.Shukla
Advanced Accountancy	-	R.L. Gupta & M.Radhaswamy

2.3.12 answer self -check exercise

1. false
2. true
3. true
4, true

Lesson No. 2.5 Author : Dr. J.S. PASRICHA

Sale of a Firm to a Company and Conversion of a Firm into a Company

2.5.0 Objectives

After studying this lesson, you should be able to understand:

- The reasons for conversion of a firm into a company
- The special features in this type of dissolution of firm.
- Accounting procedure to be followed when a firm is converted into a company or is sold to a company.

2.5.1 Introduction

In many cases. when the business of a partnership firm expands, it may get itself converted into a company. Sometimes, a partnership firm may convert itself into a limited company to get the benefits of limited liability and some other concessions, such as low rate of income tax. Still in some other cases, the business of the firm may be acquired by an existing company. In all such cases, the firm is dissolved and the business carried on by the firm is acquired either by a newly formed company or an existing company. Technically, this is referred to as Sale of a firm to a company.

2.5.2 Special Features

Although this is essentially a case of dissolution of partnership, still, there are some peculiar features in this type of dissolution. These are-

1. Generally, all assets including cash balance unless stated otherwise, and

liabilities are transferred to the company.

2. In some cases, however, certain assets may not be taken over by the company. These assets may be sold in the market or taken over by the partners. Likewise, liabilities not taken over, if say, may be settled by partners either by paying them off taking over by themselves.
3. The business of the firm is sold to the company for a price known as 'purchase consideration'. Purchase consideration is worked out on the basis of values of assets and liabilities agreed upon between the firm and the company. The purchasing company may pay for goodwill, as well, which should also be taken into account in computing purchase consideration.
4. The purchase consideration is generally paid by the company partly in cash and partly by allotment of its shares and debentures.

2.5.3 Procedure

The following procedure may be followed to close the books of the firm selling its business to a company or converting itself into a company.

1. All the assets and liabilities are transferred to the Realisation Account at their book value.
2. Assets not taken over by the company are disposed off by the firm itself and the amount realised is credited to the Realisation Account. Similarly, liabilities not taken over by the company are paid off by the firm itself and the amount paid is debited to the Realisation Account.
3. The Realisation Account is credited with the amount of purchase consideration payable by the company and the balance of the Realisation Account, being profit or loss on realisation, shall be transferred to the partners' capital account in their profit sharing ratio.
4. All reserves, profits losses appearing in the balance sheet of the firm shall be transferred to the partners' capital account in their profit sharing ratio.
5. Partner's loan accounts are not transferred to Realisation Account. Payment on account of loan is debited to loan account itself.
6. Shares and debentures received from the purchasing company are distributed among partners in the capital final balance outstanding ratio or in the proportion agreed upon by the partners. These will be distributed to the nearest whole number because fraction of a share or debenture cannot be allotted.

2.5.4 Self check Exercise

State whether the following statements are true or false

1. Shares and debentures received from the purchasing company are distributed to the partners in the profit sharing ratio.
2. The assets and liabilities not taken over by the purchasing company are transferred to capital accounts of the partners.
3. Purchase consideration on sale of a firm to a company is calculated by taking

book value of assets.

4. In the case of sale of a firm to a company, profit or loss in sale is ascertained through Revaluation Account.

2.5.5 Accounting Entries

2.5.5.1 Accounting Entries in the books of the Firm

The following journal entries are passed in the books of the firm selling its business or converting itself into a company :

1. For transfer of assets to Realisation Account

   Realisation Account Dr.

   To Various Assets A/c.

2. For transfer of liabilities to Realisation Account

   Various Liabilities A/c. Dr.

   To Realisation A/c.

3. For purchase consideration receivable from the company

   Purchasing Company's A/c Dr.

   To Realisation Account A/c

4. For assets not taken over by the company, disposed off by the firm itself

   Cash/Bank A/c Dr

   To Realisation Account

5. For liabilities not taken over by the company, piad off by the firm itself

   Realisation A/c Dr.

   To Cash/Bank A/c

6. For realisation expenses incurred by the Firm

   Realisation A/c Dr.

   To cash/Bank A/c

7. For Profit on Realisation

   Realisation A/c Dr.

   To Partners' Capital A/c

   Note: In case of loss on realisation, reverse entry shall be passed.

8. For receipt of purchase consideration

   Cash A/c Dr.

   Shares in Purchasing Co. Dr.

   Debentures in Purchasing Co. Dr.

   To Purchase Co. A/c

9. For distribution of shares, debentures and cash among partners.

   Partners' Capital A/c Dr.

   To Shares in Purchasing Co.

   To Debentures in Purchasing Co.

   To Cash/Bank A/c

2.5.5.2 Accounting Entries in the books of the Purchasing Company

1. Various Assets A/c Dr.
   To Various Liabilities A/c
   To Selling Firm's A/c
   To Capital Reserve A/c (Balancing Figure)
2. Selling Firm's A/c Dr.
   To Equity/ Preference share capital A/c
   To Debentures A/c
   To Cash/ Bank A/c

2.5.6 Illustration :

A and B traded in partnership sharing profits and losses 2/3rd and 1/3rd respectively, and on 30th September, 2001 their Balance Sheet was as follows:-

Sundry Creditors	190000	Cash in hand	1500
Bills Payable	50000	Bills Receivable	25000
A's Loan	100000	Sundry Debtors	300000
A's Capital	150000	Less: Provision for	
B/s Capital	100000	Doubtful debts	15000
Reserve Fund	30000		285000
		Stock in trade	219500
		Plant and Machinery	100000
	630000		630000

On that date they agreed to sell business to X Ltd., and the company to take over the assets at the valuation shown below:

Plant and Machinery Rs. 80000, Stock in trade Rs.175000, Sundry Debtors Rs. 253500, Bills Receivable Rs. 25000 and Good will Rs. 30000.

The company also agreed to pay the creditors which were agreed at Rs.195000. The expenses of realisation amounted to Rs. 1500. The firm received Rs. 190000 of the purchase price in Rs. 10 fully equity shares in the Limited company and Rs. 168500 in cash.

Prepare necessary ledger Accounts in the books of the firm.

Realisation Account

2001 (Sept. 30)		2001 (Sept. 30)	
To Bills Receivable	25000	By Provision for Doubtful Debts	15000
To Sundry Debtors	300000	By Sundry Creditors	190000
To Stock in trade	219500	By Bills Payable	50000
To Plant &n Machinery	100000	By X Ltd. Account	368500
To Cash (Expenses)	1500	By Loss on Realisation	
To Cash (Bills Payable Paid)	50000	A's Capital -2/3 41,000	
		B.s Capital -1/3 19500	61500
	695000		695000

X Limited Account

2001		2001	
Sept.30		Sept.30	
To Realisation Account		By Shares in X Ltd	190000
(Purchase Consideration)	368500	By Cash	168500
	368500		368500

Cash Account

2001		2001	
Sept.30		Sept.30	
To Balance b/d	1500	By Realisation A/c (Exp.)	1500
To X Limited's A/c	168500	By Realisation A/c (Bills payable paid)	50000
		By A's Loan A/c	100000
		By A's Capital	
10919			
		By B's Capital A/c	7580
	170000		170000

Shares in X Limited Account

2001		2001	
Sept.30		Sept.30	
To X Limited 's A/c	190000	By A's Capital A/c	119080
		By B's Capital A/c	81919
	190000		190000

A's Loan Account

2001		2001	
Sept.30		Sept.30	
To Cash Account	100000	By Balance b/d	100000
	100000		100000

A's Captial Account

2001		2001	
Sept.30		Sept.30	
To Realisation A/c (Loss)	41000	By Balance b/d	150000
To Shares in X Ltd's A/c	118080	By Reserve Fund	19000
To Cash Account	10919		
	170000		170000

B's Captial Account

2001 Sept.30		2001 Sept.30	
To Realisation A/c (Loss)	19500	By Balance b/d	100000
To Shares in Ltd. Co.	81919	By Reserve Fund	10000
To Cash Account	7580		
	110000		110000

Working Notes:

1. Calculation of Purchase Consideration :

Plant & Machinery	80000	
Stock in trade		175000
Sundry Debtors		253500
Bills Receivable		25000
Goodwill		30000
		56,3500
Less: Creditors		19,5000
		368500

2. Total number of shares receive from the Limited Company are 19000 (Rs. 190000/10). These have been divided between A and B in the ratio of 129000 : 89500 i.e.., in the ratio of the amount finally due to partners.

A gets, $20000x \frac{129000}{218500} = 11808$ shares or Rs. 118080

B gets, $2000x \frac{-89500}{218500} = 8192$ shares or Rs. 81919

Fraction of share cannot be issued, so the nearest whole number of shares have been given to partners.

2.5.7 Summary

Many a times, partnership firms get themselves converted into a company either to cope with the expansion needs of the business or to take benefit of the limited liability and certain other concessions admissible to companies. Sometimes, the business of a firm may be taken over by a company. In all such cases, firm's books are to be closed by transferring various assets and liabilities to Realisation Account. Realisation Account will be credited with the amount of purchase consideration receivable from the company and the balance in this account, being profit or loss on realisation, shall be transferred to partners capital accounts. Various other accounts appearing in the balance sheet, such as reserves, profits and losses accounts will be closed by transferring them to partners capital accounts. Finally partners capital accounts will be settled by distributing among them shares debentures and cash received from the purchasing company.

2.5.8 Glossary

1. Sale of firm to a company= transfer of ownership of partnership to a joint stock company
2. Procedure at conversion of firm into company = all the assets and liabilities are transferred to realization account. All the reserves and profits& losses are transferred to partners. Loan account of partners are transferred to realization account. Shares and debentures received from company are transferred to partners in their capital final balance outstanding ratio or ratio agreed by partners.

2.5.9 Exercise

Write short notes on

1. conversion of partnership into company
2. procedure of conversion of partnership into company

Long questions

Q.1 what accounting entries are passed at the time of conversion of partnership into a company?

2.5.10 Suggested Readings

Advanced Accountancy	-	S.P. Jain & K.L. Narang
Advanced Accountancy	-	M.C.Shukla
Advanced Accountancy	-	R.L. Gupta & M.Radhaswamy

2.5.11 Answers to Self-Check Exercise

1.	True	3.	False
2.	False	4.	False

Lesson No. : 2.6 Author : Dr. J.S. PASRICHA

Gradual and Piecemeal Distribution

2.6.0 Objectives

After studying this lesson, you should be able to

- Know about the circumstances for gradual realisation of cash from assets.
- Understand the method of piece mealdistribution.

2.6.1 Introduction

In various problems relating to dissolution of firm (discussed earlier), it has been assumed that all assets are realised immediately on the date of dissolution and the accounts of the creditors and partners are settled on the same date. This assumption, is, however, quite unrealistic because in actual practice there may be a gap of even a few months between the realisation of two assets and realisation of all assets may take very long time. Under such circumstances, cash is distributed to creditors and partners as and when it is realised. When assets are realised gradually, the following order is adopted for distribution or realised amounts:

(i) Creditors and other external liabilities are paid first. Secured creditors are to be paid out of the amount realised from assets kept with them as security. For the unpaid balance, if any, they are paid as unsecured creditors.

(ii) After payment to creditors, partners' loan is to be paid. When the loans of more than one partner are due, the cash available shall be paid reteably.

(iii) After making the above payments, the remaining amount realised is utilised for payment of the partner's capitals.

2.6.2 Methods of Piecemeal Distribution

Cash realised from the assets (after payment of outside liabilities and partners' loans) has to be distributed among partners in such a manner that final unpaid balances of capital accounts, which represent loss on realisation, are exactly in the profit and loss sharing ratio of the partners. To achieve this, two methods are available, which are discussed below :

2.6.2.1 Proportionate Capital Method (Higher Relative Capital Method)

Under this method, if capitals of partners are in their profit sharing ratio then they are paid according to their capital ratio at each distribution. However, if capitals of the partners are not in their profit sharing ratio, then cash available for distribution among partners should, first of all, be paid to those partners whose capitals are more than their profit sharing ratio to bring their capitals to the level determine according to profit sharing ratio. After this, the cash available is distributed among all the partners according to their profit sharing ratio. Thus, the balance if any, remaining unpaid in the capital accounts would also be in the profit sharing ratio.

Illustration 1:

P.Q and R share profits of a firm in the proportion of 1/2, 1/4 and 1/4 respectively. On the date of dissolution their Balance Sheet stood as follows:

Liabilities	Rs.	Assets.	Rs.
Creditors	100000	Sundry Assets	600000
P's Loan	50000	Cash in Hand	10000
Q's Loan	30000		
P's Capital	190000		
Q's Capital	150000		
R's Capital	80000		
	610000		610000

The assets realised Rs. 450000 which were received in instalments of Rs. 150000, Rs. 160000 and Rs.140000. Show how the proceeds should be distributed as and when received by following the Proportionate Capital Method.

STATEMENTS SHOWING DISTRIBUTION OF CASH

Particulars	Creditors	P's Loan	Q's Loan	P's Capital	Q's Capital	R's Capital
Amount due as given in B/S Less : Cash in hand paid to Creditors	100000	50000	30000	190000	150000	80000
	10000	-	-	-	-	-
Balance due	90000	50000	30000	190000	150000	80000
First Realisation- Rs.150000 Cash paid to Creditors	90000	-	-	-	-	-
Balance of Rs. 60000 used to discharge in the ratio of partners loans	90000	50000	30000	190000	150000	80000
i.e. Rs.50000:30000	-	37500	22500	-	-	-
Second Realisation -Rs 160000	-	12500	7500	190000	150000	80000
Paid Partners Loan	-	12500	7500	-	-	-
	-	-	-	190000	150000	80000
Amount Paid to Q - to make his capital equal to his profit sharing ratio with P	-	-	-	-	50000	-
				190000	100000	80000
Amount Paid to P and Q to make their capitals in accordance with their profit sharing arrangement with R				40000	19000	-
Balance paid to P,Q and R in their profit ratio 1/2:1/4:1/4				1,60,000	80,000	80,000
				15000	7500	7500

Third Realisation-Rs 140000	145000	72500	72500
distributed in the ratio of 1/2: 1/4:1/4	70000	35000	35000
Amount unpaid or loss on realisation	75000	37500	37500

2.6.2.2 Maximum Loss Method

This method is comparatively a safe method of piecemeal distribution of cash to partners and is also consistent with the principle laid down in Garner vs Murray. Under this method, cash available for distribution among partners is compared with the total of capitals payable to partners and assuming that in future assets will not realise anything, the maximum possible loss is calculated. The loss so determined is divided among partners is their sharing ratio and deducted from the capitals of the partners. The balance left in the partners capital accounts after deducting the maximum possible loss will be the amount which would be paid to each partner. However, if a partner's share of maximum possible loss is more than the amount standing to the credit of his capital account, he should be considered as insolvent and as per Garner Vs Murray rule, his deficiency should be debited to the capital accounts of the other partners in their cpiaial ratio on the date of dissolution. When all final balances are left as credit balances, then they are paid out. And, again balance is struck by deducting the amount paid from the total amount to be paid. The same procedure is repeated on each realisation till all the assets are disposed off.

Illustration 2

A.B and C share profits and losses in the proportion of 1/2,1/3 and 1/6, Their Balance Sheet is as follows:

A's Capital	30000	Assets less Liabilities	Rs.80000
B's Capital	30000		
C's Capital	19000		
	80000		80000

The partnership is dissolved, and the assets are realised as follows :

Ist Realisation	Rs.	10000
2nd Realisation		15000
3rd and Final Realisation		25000

The partners desire to withdraw immediately such cash as is available for division among them rather than wait until all the assets have been sold.

Prepare statements showing how the distribution should be made and prepare Partner's Capital Accounts by following the Maximum Loss Method.

STATEMENTS SHOWING DISTRIBUTION OF CASH

Particulars	Rs.	A's Capital	B's Capital	C's Capital
	Rs.	Rs.	Rs.	Rs.
Ist Realisation	10000	30000	30000	19000
Maximum Loss is Rs. 70,000 (30000+30000+19000-10000) allocated to Partners in their profit sharing ratio of 3:2:1		35000	23333	11667
		-5000	6667	8000
A's Deficiency borne by B and C in proportion to their capitals i.e. 3:2		+5000	-3000	-1900
			3667	6333
Repaid to B and C			3667	6333
Balance due		30000	26333	13667
2nd Realisation	15000			
Maximum Loss is 55000 (30000+26333+13667-15000) allocated to partners in the ratio of 3:2:1		27500	19333	9167
		2500	8000	4500
Repaid to A, B and C		2500	8000	4500
Balance due to partners		27500	19333	9167
3rd Realisation	25000			
Maximum Loss is Rs.30000 (2,500+19333+9167-25000) allocated to partners in the ratio 3:2:1		15000	10000	5000
		12500	8333	4167
Repaid to A, B and C		12500	8333	4167
Balance Unpaid or Loss to Partners		15000	10000	5000

PARTNER'S CAPTIAL ACCOUNTS

	A	B	C		A	B	C
	Rs	Rs	Rs		Rs	Rs	Rs
To Bank	-	3667	6333				
To Bank	2500	8000	450	By balance b/d	30,000	30,000	19,000
To Bank	12500	8333	4167				
To Realisation Loss	15000	10000	5000				
	30000	30000	19000		30,000	30,000	19,000

2.6.3 Self-Check Exercise

State whether the following statements are true or False.

1. As per decision in Garner Vs. Murray, a solvent partner who has overdrawn the capital will not be called upon to share the loss arising due to capital deficiency of in solvent partner. ( )
2. In piecemeal distribution of cash on the dissolution of a firm, cash is distributed to partners in the profit sharing ratio. ( )
3. Partner's loan is treated in the same manner as outside liabilities at the time of dissolution of partnership. ( )
4. The distribution of cash to partners under Maximum Loss Method is considered consistent with the requirements of Garner Vs Murray. ( )

2.6.4 Summary

When assets are realised gradually in case of dissolution of partnership, then cash available is used, first of all, to pay creditors and outside liabilities, then to pay loans of partners and finally to pay balances of partner's capital accounts. However. the cash available for distribution among partners has to be distributed in such a manner that final unpaid balances of capital accounts are in the profit/loss sharing ratio of the partners. For this purpose, either of the two-proportionate Capital Method of Maximum Loss Method may be used.

2.6.5 Key Words

(i) Piecemeal Distribution : Piecemeal distribution refers to distribution of cash to various claimants in stages. This happens when assets are realised gradually and amount is received in instalments.

(ii) Secured Creditors: Secured creditors are those creditors who have given loans against the security of some assets. If the realisable value of assets given as security is more than the amount of loan, then such creditors are known as fully secured creditors. However, if the realisable values of such asset is less than the amount of loan, then for the balance amount they are considered as unsecured creditors.

2.6.6 Exercise

Write short notes on

1. Proportionate Capital Method
2. Maximum Loss Method

Long question

Q.1 what is Piecemeal Distribution? Explain methods of piecemeal distribution?

2.6.7 Suggested Readings

(1)	Advances Accountancy	-	M.C. Shukla
(ii)	Advance Accountancy	-	R.L. Gupta

2.6.8 Answers to Self-Check Exercise

1.	True	2.	False
3.	False	4.	True

Mandatory Student Feedback Form

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