ACCOUNTANCY

Part I ACCOUNTING

No.	Name of unit and Focus Areas
1	**Accounting for Not-for-Profit Organisation**
	Meaning and Characteristics of Not-for-Profit Organisation
	Accounting Records of Not-for-Profit Organisations
	Receipt and Payment Account
	Income and Expenditure Account
	Distinction between Income and Expenditure A/c and Receipt and Payment A/c
	Treatment of Subscription in the financial statements of Not for profit organisation
2	**Accounting for Partnership – Basic Concepts**
	Nature of partnership
	Partnership deed
	Provisions of Partnership Act Relevant for Accounting
	Maintenance of Capital Accounts of Partners
	Distinction between Fixed and Fluctuating Capital Accounts
	Profit & Loss Appropriation Account
	Calculation of Interest on capital
3	**Reconstitution of Partnership – Admission of a Partner**
	Modes of Reconstitution of a Partnership Firm
	Admission of a New Partner
	New profit sharing ratio & Sacrificing ratio
	Goodwill – Factors Affecting the Value of Goodwill
	Methods of valuation of goodwill (Average Profit)
	Treatment of goodwill (When the new Partner brings goodwill in cash.)
	Adjustment for Accumulated Profits and Losses
	Revaluation of Assets and Reassessment of Liabilities
	Preparation of Revaluation account, Partners Capital Account & Balance sheet
4	**Reconstitution of Partnership -Retirement & Death of a partner**
	New profit sharing ratio & Gaining ratio
	Adjustment for Revaluation of Assets and Liabilities
	Adjustment of Accumulated Profits and Losses
	Disposal of Amount Due to Retiring Partner
	Preparation Partner's Loan Account
	Death of a partner – Calculation of amount due to the deceased partner
5	**Dissolution of Partnership Firm**
	Dissolution of Partnership
	Dissolution of a Firm
	Distinction between Dissolution of partnership and dissolution of firm
	Preparation of Realisation A/c

Part III
COMPUTERISED ACCOUNTING

No. Name of unit and Focused Areas

1 Overview of Computerised accounting system

Features of CAS
Components of CAS
Grouping of Accounts
Codification of Accounts
Merits and Demerits of CAS.

2 Spread Sheet

Features of LibreOffice Calc
Components of LibreOffice Calc
Spread Sheet Operations
Cell references
Functions (Date and Time, Statistical, Logical and Mathematical)

3 Use of spreadsheet in Business Applications

Payroll Accounting
Asset Accounting

4 Graphs and Charts for Business Data

Column chart, Bar chart, Pie Chart, Doughnut chart
Advantages of Graphs and Charts

5 Accounting Software Packge - GNUKhata

Creation of organisation
Ledger Creation
Voucher entry

6 Database Management System

Components of DBMS
Preparation of Table in design view

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Chapter-1
Accounting for Not-For Profit Organisation

(Focused Area Only)

Chapter-1 Focused Area

1. **Meaning and Characteristics of Not-For Profit Organisation**
2. **Accounting Records of Not-for-profit Organisation**
3. **Receipt and Payment Account**
4. **Preparation of Income and Expenditure Account**
5. **Distinction between Income and Expenditure Account and Receipt and Payment Account**
6. **Treatment of Subscription in the financial statements of Not-For Profit Organisation**

Meaning and Characteristics of Not-For profit Organisations

Not-For Profit Organizations are those type of organizations established for the purpose of rendering service. They are not expected to earn profit, but are organized mainly for social, cultural, educational, religious and charitable purposes. They are formed for the promotion of education, science, culture and religion. Sports and arts clubs, hospitals, libraries, charitable institutions like orphanages, old age homes, trade union, educational institutions, religious institutions etc come under this group.

Normally, these organizations do not undertake any business activity, and are managed by trustees who are fully accountable to their members for the utilization of the funds raised for meeting the objectives of the organization. Hence, they also have to maintain proper accounts and prepare the financial statement which takes the form of Receipt and payment account, Income and Expenditure Account and Balance Sheet.

Characteristics of Not-For Profit Organisations

1. Their main objective is to **render service** and is not expected to earn profit.
2. These organisations are generally organized as **charitable trusts/ societies** and subscribers to such organization are called **members.** They are **managed by managing committee.**
3. They **do not usually engage in trading activities**.
4. Usually, these organizations **not entertain credit** transactions.
5. Not for profit organizations **keep Cash Book** to record all daily receipt and payments, it help to prepare Receipt and payment Account.
6. They usually maintain a ledger containing the accounts of all incomes, expenses, assets and liabilities which facilitates the preparation of financial statements at the end of the accounting period.
7. The **main sources of income** of such organizations are **subscription from members, donations, legacies, grant, income from investment** etc.
8. The funds raised by such organizations through various sources are credited to **capital fund** or general fund.

9 The **surplus** generated in the form of excess of income over expenditure is **not distributed amongst the members**. It is simply **added to capital fund**. They do not maintain capital account, instead they maintain capital fund.
10 Not for profit organization earn their reputation on the basis of their contributions to the welfare of the society.

Accounting Records Not-For Profit Organisations

Not-For Profit Organisations are required to prepare financial statements at the end of each accounting period. They required to provide necessary financial information to members, donors, contributors, Registrar of Societies. It is also necessary to know whether the income during the year is sufficient to meet the expenses or not. The final accounts of a Not-For Profit Organisations consists of the following:

1. **Receipts and Payment Account**
2. **Income and Expenditure Account**
3. **Balance Sheet**

1 Receipts and Payment Account

Receipt and payment account is the summary of cash and bank transactions under various heads. It is prepared at the end of an accounting year on the basis of cash receipts and payments recorded in the cash book. Receipt and payment account record all cash receipts and all cash payments, irrespective of whether they relate to the current period, previous period succeeding period or whether they are of capital or revenue nature. Receipt and payment account never record non-cash items like depreciation, outstanding expenses, accrued incomes etc. The opening balance in Receipt and payment account represents cash in hand/cash at bank which is shown on its receipts side and the closing balance of this accounts represents cash in hand/cash at bank as at the end of the year, which appear on the credit side of the Receipt and payment account.

In Receipts and Payments Account

Items	Record/Not
Current year's receipts	Record
Previous year's receipts	Record
Succeeding year's receipts	Record
Capital receipts	Record
Revenue receipts	Record
Outstanding receipts/payments	Not record
Non cash items like depreciation	Not record

The Not-for-Profit Organization usually prepare the income and expenditure Account and balance Sheet with the help of Receipt and Payment Account.

Receipt and payment account for the year ending……………

Receipts	Amount	Payments	Amount
Balance b/d		Balance b/d (Bank o/d)	XXX
Cash in hand	XXX	Wages and salaries	XXX
Cash at bank Subscriptions	XXX	Rent	XXX
General donations	XXX	Rent and rates	XXX
Sale of old news papers	XXX	Insurance	XXX
Sale of scraps	XXX	Printing and stationery	XXX
Locker rent	XXX	Postage and courier	XXX
Interest on investment	XXX	Advertisement	XXX
Proceeds from charity show	XXX	Sundry expenses	XXX
Miscellaneous receipts	XXX	Telephone charges	XXX
Grant-in –aid	XXX	Entertainment expenses	XXX
Legacies	XXX	Audit fee	XXX
Specific donations	XXX	Honorarium	XXX
Sale of investments	XXX	Repair and rewards	XXX
Sale of Fixed Assets	XXX	Upkeep of grounds	XXX
Life Membership Fees	XXX	Conveyance	XXX
Entrance Fees	XXX	News papers and periodicals	XXX
Receipts on account of spec		Purchase of assets	XXX
purpose funds	XXX	Purchase of investments	XXX
Interest on specific fund investment		Balance c/d	
Balance b/d (Bank Overdraft)	XXX	Cash in hand	XXX
		Cash at bank	XXX
	XXX		XXX

Note:

Capital Receipt: The non recurring receipt of the organization is called s Capital Receipts. It is never considered as an income.

Example: Specific donations, Life Membership Fees, Sale of investments, sale proceeds of fixed assets ,Loans from banks etc. Capital receipt should be shown on the liabilities side of the Balance Sheet. Decrement

Revenue Receipt: Receipts which are recurring in nature and which are available for meeting all day to day expenses (revenue expenditure) of a concern are known as "Revenue receipts", e.g. Subscriptions, interest on investment received, sale of old news paper, General Donations, Profit on sale of Assets, locker rent, commission received, rent received, dividend received etc.

Capital expenditure: Any expenditure which is incurred in acquiring or increasing the value of fixed assets is termed as capital expenditure. Such expenditure yields benefit over a long period and hence treated as an asset. Eg.Purchase of Fixed Assets,Books,Investments etc.

Revenue expenditure: Revenue expenses are shorter-term expenses and the full benefit of which is received during one accounting period. Such expenditure does not result in an increase in the earning capacity of the business but only helps to maintaining the existing earning capacity.

Examples: Salaries, Telephone Expenses, Electricity Charges, Postage and Stationery, Depreciation, Audit fees. Loss on sale of machinery, Advertisements, Insurance, sports expenses.

Salient features of Receipt and payment account

- It is a **real account**.
- It is a **summary of cash book**.
- It is **prepared at the end of an accounting year on the basis of cash book**.
- It is **debited with all cash receipts and credited with all cash payments**.
- It is prepared on **cash basis** (records only actual cash receipts and payments).
- **It records all receipts and payments of current year, previous and succeeding years**. (For example, in the Receipt and payment account for the year ending 31/12/2015, we record the total subscriptions received during 2015 including the amounts related to the years 2014 and 2016.)
- **It records all receipts and payments whether they are of capital and revenue nature**.
- **Non cash items** like depreciation, outstanding expenses, accrued income etc are **never recorded** in this account.
- It **begins with opening cash in hand/at bank and ends with closing cash in hand/at bank**.

Useful Note: ***Steps in the preparation of receipts and payments account***

1. Take the opening balances of cash in hand and at bank and enter the same on the debit side.(In case there is bank over draft at the beginning it should be entered on the credit side)
2. Show the total amounts of all receipts on its debit side irrespective of their nature (i.e capital or revenue) and period (i.e current year.previour or succeeding years)
3. Show the total amounts of all payments on its credit side irrespective of their nature and period.
4. Accrued incomes and outstanding expenses etc not to be entered in this account as they do not involve inflow or out flow of cash.
5. Find out the difference between the total of the debit side and the total of the credit side of the account and if the total of the debit side is more than the total of the credit side, it is 'closing cash in hand/bank'.

2 Income and expenditure account

It is just **like a profit and loss account** prepared by trading concern. It is prepared on **accrual basis**. It **records only revenue items of current year** and the **balance at the end of the year represents surplus or deficit. All revenue expenditure and losses** relating to the **current year are recorded** in the debit side and all revenue incomes and gains relating to current year are recorded in the credit side. It is **necessary to adjust**

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outstanding and prepaid expenses/income in this account as this account records only current year's revenue items. **Non cash items like depreciation also recorded** in it.

Salient features of Income and Expenditure account

- It is a **nominal** account
- It is a summary of income and expenditure for the accounting year.
- It **records only the revenue incomes and revenue expenses of the current year**.
- Non cash items like depreciation, outstanding expenses, accrued incomes etc are shown in this account.
- It **never records capital receipts or payments**.
- It **never starts with a balance**.
- Its closing balance will be surplus or deficit. Surplus is added to Capital fund and deficit is deducted from it.

Income and Expenditure Account

Expenditure	Amount	Income	Amount
Salaries	XXXX	Subscription	XXXX
Honorarium	XXXX	General Donation	XXXX
Rent, rates and taxes	XXXX	Entrance Fee (Not Capitalized)	XXXX
Postage	XXXX	Hall rent	XXXX
Printing and stationery	XXXX	Locker Rent	XXXX
Telephone charges	XXXX	Sale of old news papers	XXXX
Charities	XXXX	Sale of grass	XXXX
Wages	XXXX	Interest received	XXXX
Upkeep of grounds	XXXX	Sale of refreshments	XXXX
Insurance	XXXX	Profit on sale of F.Assets	XXXX
Electricity charges	XXXX	Miscellaneous receipts	XXXX
Interest	XXXX	**Deficit** (Excess of expenditure over income)	XXXX
General exp	XXXX		
Entertainment Exp	XXXX		
Bank Charges	XXXX		
Conveyance	XXXX		
Repairs	XXXX		
Newspapers &periodicals	XXXX		
Loss on sale of F. Assets	XXXX		
Depreciation on F.Assets	XXXX		
Surplus (Excess of income over expenditure)	XXXX		XXXX

Useful Note: Steps in the preparation of income and expenditure account

1.Carefully read the Receipts and Payments account given in the question.

2.Exclude the opening and closing balances given in the Receipts and Payments Account.

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3.Exclude the capital receipts and capital payments, as they are to be shown in the balance sheet.

4.Identify the revenue incomes relating to the current year from the debit side of Receipts and Payment Account and record it in the income side. Any accrued income must be added and income received in advance must be deducted.

5. Identify revenue expenses to the expenses relating to the current year from the credit side of Receipts and Payments Account and record it in the expenditure side. Any outstanding expenses must be added and prepaid expenses must be deducted.

6.Consider the following items which are not appearing in the receipt and payment account but required to consider in Income and Expenditure a/c for determining the surplus/deficit for the current year:

- Depreciation of fixed assets
- Provision for doubtful debts
- Profit or loss on sale of fixed assets.

Difference between Income and Expenditure Account and Receipts and Payments Account

Basis	Income and expenditure account	Receipts and payments account
Nature of account	It is like a profit and loss account	It is a summary of the cash book
Nature of items	It records income and expenditure of revenue nature only	It records receipts and payments of revenue as well as capital nature
Period	It records revenue items relate to the current year only	It records receipts and payments relate to the current year previous year and succeeding year
Type of Account	Nominal Account	Real Account
Depreciation	Record depreciation	Never record depreciation
Debit side	Debit side of this account records expenses and losses	Debit side of this account records cash receipts
Credit side	Credit side of this account records incomes and gain	Credit side of this account Records cash payments
Opening balance	There is no opening balance	Balance in the beginning represents cash in hand/at bank (or bank o/d)
Closing balance	Balance at the end represents surplus or deficit	Balance at the end represents closing cash in hand/at bank (or bank over draft)

Subscription:

Subscription is the membership fees paid by the members on annual/monthly basis. It is the main source of income of a not for profit organization. Subscriptions received from members during the year are recorded as receipt in the receipt and payment account and subscriptions for the current year

are recorded as income in the income and expenditure account. It may be noted that receipt and payment account records **actual subscription received during the year, it may include current year's subscription, previous year's subscription and succeeding years subscription**. But the amount of subscription to be shown in the income and expenditure account is **restricted to the figure related to the current year only irrespective of the fact whether it is received or not**.

(For eg:a club had received Rs.20000 as subscription during the year 2014 of which Rs. 3000 relate to year 2013 and Rs. 2000 relates to year 2015, and at the end of the year 2014, Rs.6000 still receivable. In this case Receipt and Payment account will show Rs.20000 as receipt from subscriptions. But in the income and expenditure account subscription amount for 2014 will be Rs.21000. [20,000(actual receipts) – (3,000 relates to previous year +2000 relates to next year) + 6000(current year outstanding)]

20000 –5000 + 6000= **21000**

Treatment of Subscription in the financial statements of Not-For Profit Organisation

Current year's Subscription

Calculation of subscription to be shown in Income and Expenditure A/C

Subscription received during the year		xxxx
Add:		
Closing out standing	xxxx	
Opening pre-received	xxxx	xxxx
		xxxx
Less:	xxxx	
Opening out standing	xxxx	xxxxx
Closing pre-received		
Income from subscription during the current year (shown in the I &E a/c)		xxxxx

OR

Subscription Account

Date	Particulars	Amount	Date	Particulars	Amount
	Opening outstanding	XXXX		Opening pre-received	XXXX
	Income and expendit a/c(subscription for the current year)	?		Receipts and payment account (cash received during year)	XXXX
	Closing pre received	XXXX		Closing outstanding	XXXX
		XXXX			XXXX

Balance sheet

Not-For Profit Organizations' prepares balance sheet to display the financial position of the organization. The preparation of the balance sheet is on the same pattern as that in the case of a profit organizations. However, in Not-for-Profit organization there is capital fund in place of capital in profit organization and the surplus or deficit should be added to or deducted from capital fund, as the case may be. Capitalized portion of legacies, entrance fees, life membership fees etc.directly added to the capital fund. Specific purposes funds like building fund, sports fund, etc. are shown separately in the liability side of the balance sheet.

Some Peculiar Items

1. **Donation**

It is a sort of gift in cash or property received from some person or organization. It appears on the receipts side of the receipts and payment account. Donation can be for specific purpose or for general purpose.

a. **Specific purpose donation**: If donation received is to be utilized only for specific purpose, it is called specific donation. The specific purpose may be to an extension of the existing building, construction of a new computer lab, etc. Such donation is to be capitalized(capital receipts) and should be shown on the liability side of the balance sheet irrespective of the fact whether the amount is big or small. It is a capital receipt so it can't be recorded in the Income and expenditure account.
b. **General donations**: such donations are to be utilized to promote the general purpose of the organization. These are treated as revenue receipts as it is a regular source of income hence so it should be taken to the income side of the income and expenditure account. It will not be shown on the balance sheet.

2. **Legacies:**

It is the amount received as per the will of a deceased person. It appears on the receipt side of the receipts and payment account and is **directly added to the capital fund** in the balance sheet, because it is **not a recurring nature**.

However, legacies of a small amount may be treated as income and should be shown on the income side of the income and expenditure account.

3. **Life membership fees:**

Some members prefer to pay lump sum amount as life membership fee instead of paying periodic subscription. Such amount is treated as capital receipt and added directly to the capital fund in the balance sheet.

4. **Entrance Fees:**

Entrance fee also known as admission fee is paid only once by the member at the time of becoming a member. In clubs and some charitable institutions the membership is limited and the amount of entrance fee is quite high. Hence, **it is treated as non-recurring item and added directly to capital fund.**

However, for some organizations like educational institutions the entrance fees is a regular income and the amount involved may also be small. In this case, it is customary to treat this item as a revenue receipt. However, if there is specific instruction, it is advisable to treat the amount as capital receipt and the amount should be directly added to capital fund.

5. **Sale of old asset**

Receipts from the sale of an old asset will appear in the **receipts side of the receipts and payments account** of the year in which it is sold. But any **gain or loss on the sale of asset is taken to the income and expenditure account of the year.**

(For example, suppose, furniture with a book value of Rs.800 is sold for Rs.700 and the sale price of Rs.700 should be shown as receipts in the in the receipts and payment account and Rs.100,loss on sale of furniture should be shown in the expenditure side of the income and expenditure account as loss on sale of furniture and in balance sheet book value,Rs.800 will be deducted from total book value of furniture).

Treatment:

1.Amount received on sale of furniture (here Rs.700) – Rs.700 recorded on the Receipts side of

R & P Account.

2.Book value (value of asset recorded in the last balance sheet) of the asst is Rs.800.But ,here it is sold for Rs.700,i.e there is a loss on sale of asset **Rs.100**(800-700)-**Loss on sale of asset should be shown on the expenditure side of I & E Account.**

3. Due to this transaction there is a reduction in the value of furniture to the extent of Rs. 800. So **book value Rs.800 deducted from the value of asset in balance sheet**.

6. **Sale of periodicals**

It is an item of recurring nature and shown as the income side of the income and expenditure account.

7. **Sale of old sports materials**

Sale of used sports materials like old balls, bats, net, etc is the regular feature with any sports club. It is usually treated as an income and should be credited in the income and expenditure account.

8. **Payment of honorarium**

It is the amount paid to the person who is not a regular employee of the institution. Payment to an artist for giving performance at the club is an example of honorarium. This is shown on the expenditure side of the income and expenditure account.

9. **Endowment fund**

It is a fund arising from an inheritance or gift, the income of which is devoted for a specific purpose. Hence, it is a capital receipt and should be shown on the liability side of the balance sheet as an item of a specific purpose fund.

10. Government grant

Schools, colleges, public hospitals etc depend upon government grant for their activities. The recurring grant in the form of maintenance grant is treated as revenue receipt and is credited to income and expenditure account. However, special purpose grant like building grant is treated as capital receipt and transferred to the building fund account and should be shown on the liability side of the balance sheet.

It may be noted that some not-for profit organizations receive cash subsidy from the government or government agencies. This subsidy is treated as revenue income and shown on the income side of the income and expenditure account.

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Chapter-2

Accounting for Partnership-Basic Concepts

(Focused Area Only)

Chapter-2 Focused Area

1. **Nature of Partnership**
2. **Partnership Deed**
3. **Provision for Partnership Act Relevant for accounting**
4. **Maintenance of Capital Accounts of Partners**
5. **Distinction between fixed and Fluctuating Capital Accounts**
6. **Profit and Loss Appropriation Account**
7. **Calculation of interest on capital**

Partnership

Partnership is a form of business organization in which two or more competent persons join together to carry on any lawful business after entering into an agreement to share the profit and loss of the business. Persons who have entered into partnership are individually called **partners** and collectively known as **firm**.

Definition

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 one of them acting for all".

Nature of partnership

The essential features of partnership are:

1 **Number of persons:** In order to form a partnership, there must be at least ***two*** persons. Maximum limit is **100**.(*The new Companies Act 2013 has prescribed the maximum number of members in case of a partnership firm should not be more than 100 in case of partnerships. As per the previous Companies Act 1956, the maximum limit in case of partnerships was 10 and 20 for banking business and other businesses respectively*.)

2 **Agreement:** In order to form a partnership, there must be an agreement. The agreement may be oral or written.
Note: It is not necessary that such an agreement is in written form. An oral agreement is equally valid. But in order to avoid disputes, it is preferred that the partners have written agreement. The written agreement is known as **partnership deed**.

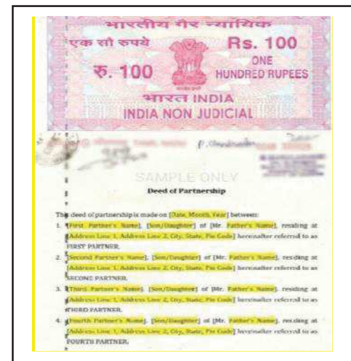
1 **Always to conduct a business:** The agreement should be to carry on some lawful business.

2 **Unlimited liability:** In partnership the liability of each partner is unlimited. It is joint and several.

3 **No separate legal existence:** A partnership is not a legal entity. It has no separate legal existence apart from its members. It can't purchase property on its own name.
4 **Sharing of profit/ loss:** The profit should be shared by the partners in an agreed ratio. If there is no specific agreement in this regard, the partners will share the profit equally.
5 **Mutual agency:** Each partner can participate in the conduct of a business and act for the firm. Similarly, each partner is bound by the acts of other partners. Thus a partner is both an agent and a principal. He is an agent when he makes the other partners liable for his acts. He is the principal when the other partners make him liable for their acts.

Partnership Deed/Articles of partnership

To form a partnership there must be an agreement between partners. The agreement may be oral or written. The written agreement between partners, containing the terms and conditions of partnership called '***partnership deed***'.



Contents of partnership deed

1 Name of the firm.
2 Names and addresses of all partners.
3 Nature and places of business.
4 Date of commencement of partnership.
5 Duration of partnership, if any.
6 Rules regarding operation of bank accounts.
7 Amount of capital contributed by each partner.
8 Profit sharing ratio between partners, if any.
9 Interest on partner's loan to the firm, if any.
10 Interest on partner's capital and drawings, if any.
11 Salary, commission, if any, payable to a partner.
12 Method of computation and treatment of goodwill on the reconstitution of a firm.
13 Mode of settlement of accounts at the time of admission, retirement, death and dissolution of firms.

Provision for Partnership Act Relevant for accounting (Rules applicable in the absence of Partnership Deed)

In the absence of partnership deed or if the deed is silent on any matter, provisions of the partnership act will automatically apply in the following way:

1. The partners are entitled to share **profit** and **losses equally i**rrespective of their capital contribution.
2. The partners are **not entitled to get interest on their capitals**.
3. **No interest will be charged on drawings** of the partners.
4. **No partner is entitled to get salary or any other remuneration** for any extra work done for the firm.
5. **Partners are entitled to get Interest @ 6%p.a on loans** granted by partners to the firm.
6. Partner's capital shall be fluctuating (Fluctuating Capital Method).

Maintenance of capital accounts of partners

All transactions relating to the partners of the firm are recorded in their capital accounts. This includes the amount of money brought in as capital, additional capital introduced withdrawal of capital, share of profit, interest on capital, interest on drawings, partner's salary, partner's commission etc. Partner's capital account is a **personal** account. Partner's capital account can be maintained in two ways: -

1. Fixed Capital Method

Under fixed capital method, two accounts are prepared for each partner, i.e Partner's Capital Account and Partner's Current Account. Adjustments like drawings, interest on drawings, interest on capital, partner's salary, commission, share of profit or loss etc are not recorded in capital account, but in a separate account known as partner's current account. Original capital investment, additional capital contribution and capital withdrawals only are recorded in partner's current account. In this case capital Account balance will remain unaltered unless additional capital introduced or withdrawn.

Format: - Capital account under Fixed Capital method

Partners capital account and Current Account

(i) Capital account

Dr **Partners' Capital Account** Cr

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Cash/Bank A/c (Capital withdrawn)			By Balance b/d (Opening credit balance)		
To Balance c/d (Closing balance)			By Cash/Bank A/c (Additional capital introduced)		

(ii) Current account

Dr **Partners' Current Account** Cr

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance b/d (Opening debit balance)			By Balance b/d (Opening credit balance)		
To Drawings A/c (Out of profits)			By Interest on Capital A/c		
To Interest on Drawings A/c			By Partner's Salary or Commission A/c		
To Profit and Loss A/c (Share in losses)			By Profit and Loss Appropriation A/c (Share in profits)		
To Balance c/d (Closing credit balance)			By Balance c/d (Closing debit balance)		

Note: 1. It may be noted that capital accounts of partners will be shown at the same balance from year to year unless some amount of capital is introduced or withdrawn.

Note: 2. At the end of the year **current account** should be balanced which may show **debit or credit** balance. If it shows a **debit** balance it should be shown on the **asset** side of the balance sheet. If it is a **credit** balance it should be shown on the **liability** side of the balance sheet.

Note:3. In fixed capital method **both capital and current** account balance should be shown separately in Balance Sheet .

2. Fluctuating Capital Method

Under fluctuating capital method, there is only one account, i.e. the capital account of each partner is maintained. All adjustments like drawings, interest on drawings, interest on capital, salary, commission, share of profit or loss etc are recorded directly in capital account itself. As a result, the capital balance of a partner at the end of the year will be different from that at the beginning of the year. So it is called fluctuating capital method. In the absence of any instruction, the capital account should always be fluctuating.

Format: - **Capital account [Fluctuating Capital method]**

Dr **Partners' Capital Account** Cr

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance b/d (Opening debit balance)			By Balance b/d (Opening credit balance)		
To Cash/Bank A/c (Capital withdrawn)			By Cash/Bank A/c (Additional capital introduced)		
To Drawings A/c (Out of profits)			By Interest on Capital A/c		
To Profit and Loss A/c (Share in losses)			By Partners' Salary or Commission A/c		
To Balance c/d (Closing credit balance)			By Profit and Loss Appropriation A/c (Share in profits)		
			By Balance c/d (Closing debit balance)		

Items usually appears on the debit and credit side of the capital account

Debit Side	Credit Side
Drawings	**Opening Capital Balance**
Interest on Drawings	**Additional capital introduced**
Share of Loss	**Interest on capital**
	Salary to partner
	Commission to partner
	Share of profit

Difference between fixed capital method and fluctuating capital method

Basis	Fixed Capital Method	Fluctuating Capital Method
Number of Accounts	Under this method two accounts are maintained for each partner viz.capital account and current account.	Under this method there is only one account for each partner, i.e capital account.
Adjustments	All adjustments are recorded in a separate account known as current account.	All adjustments are recorded in the capital account itself.
Fixed Balance	The capital account balance remains unchanged unless there is addition to or withdrawal of capital.	The balance of the capital account fluctuates from year to year.
Credit Balance	The capital accounts always show a credit balance.	The capital account sometimes shows debit balance.
Appearance in the Balance Sheet	Both capital and current account balance will appear	Only capital account balance appears.

Distribution of profit/ loss among partners

In case of sole trading concern, profits or losses disclosed in the profit and loss account can be transferred to his capital account directly. The reason is that, there is no other person to share profit/loss. But the net profit reflected in the profit and loss account of the partnership needs some adjustments. In partnership there are tw or more partners and there may be some agreement between partners with regard to interest on capital, interest on drawings, partner's salary, partner's commission etc. All these adjustments/**appropriations** are made in a separate account known as profit and loss appropriation account.

Profit and Loss Appropriation Account

Profit and Loss Appropriation account is a nominal account and it is prepared to show how the net profit has been distributed among the partners. It is an extension of profit and loss account. It is opened with net profit/ net loss brought forward from profit and Loss Account. It is credited with interest on drawings and it is debited with interest on capital, partners salary, partners commission and amount transferred to reserve (if any).The net profit or net loss after making the above adjustments can be divided among the partners in their profit sharing ratio by transferring it to their capital accounts or current accounts as the case may be.

Format: - **P &L Appropriation account**

Particulars	Amount	Particulars	Amount
To Partner's Salary	**XXXXX**	**By Profit and Loss,A/C**	XXXXX
To Partner's Commission	**XXXXX**	**(Net Profit)**	
To Interest on capital	**XXXXX**	**By Interest on Drawings**	XXXXX
To Amount transferred to reserve(if any)	**XXXXX**		
To Partners capital account (b/f)	**XXXXX**		
(***Divisible Profit*** *distributed among partners in their ratio)*			
	XXXXX		XXXXX

Journal Entries in connection with P & L Appropriation Account:

1. *For transfer of **Net profit** from P & L A/C:-* **P & L Account Dr** **To P & L Appropriation A/c** **(Net profit transferred to P & L Appropriation Account)**	xxxxx	xxxxx
2.*For transfer of Net loss from P & L A/C:-* **P & L Appropriation A/c Dr** **To P & L Account** **(Net loss transferred to P & L Appropriation Account)**	xxxxx	Xxxxx
3(a).*For charging interest on drawings:-* **Partner's Capital A/C Dr** **To interest on Drawings** **(Interest on drawings charged)** ***Interest on drawings is an income to the firm***	xxxxx	xxxxx
3(b).*To close interest on drawings account* **Interest on Drawings A/C Dr** **To P & L appropriation A/C** **(Int on drawings A/C closed by transfer it to P & L Appropriation A/C)**	xxxxx	xxxxx
4(a) *When interest on capital due:-* **Interest on Capital A/C Dr** **To Partner's Capital A/C** **(Interest on capital due)** ***Interest on capital is an expense to the firm***	xxxxx	xxxxx
4(b) *To close interest on capital account:-* **P &L Appropriation A/C Dr** **To Interest on Capital A/C** (Interest on capital A/C closed by transfer it to P &L Appropriation A/C)	xxxxx	xxxxx

5 (a) *When partner's salary due:-* **Partners's Salary A/C Dr** **To Partner's Capital A/C** **(Salary due)**	xxxxx	 xxxxx
5 (b) *To close salary account* **P & L Appropriation A/C Dr** **To Partners Salary A/C** **(Salary account closed)**	xxxxx	 xxxx
6 *To transfer amount to reserve:-* **P & L Appropriation A/C Dr** **To Reserve A/C** **(Amount transferred to reserve)**	xxxxx	 xxxxx
7 (a) To transfer balance of P &L Appropriation account to Partner's capital account (If credit balace/Prtofit) **P & L appropriation A/C Dr** **To Partner's Capital A/C** **(Divisible profit distributed among partners in their ratio)**	xxxxx	 xxxxx
7 (b) To transfer balance of P &L Appropriation account to Partner's capital account (If debit balace/loss) **Partner's Capital A/C** **To P & L appropriation A/C Dr** **(Share of loss distributed among partners in their ratio)**	xxxxx	 xxxxx

Profit and Loss Account (with imaginary figures)

For the year ended……..

Particulars	Amount	Particulars	Amount
Rent	2,000	Gross Profit b/d	80,000
Interest	4,000		
Stationery	3,000		
Depreciation	1,000		
Net profit c/d	70,000		
	80,000		80,000

Profit and Loss Appropriation Account

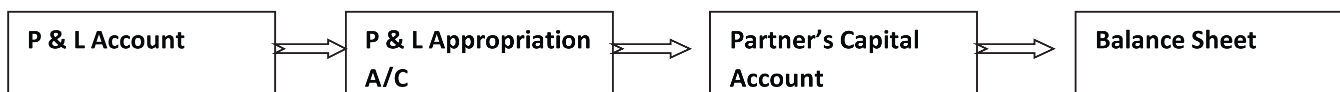
For the year ended………

Particulars		Amount	Particulars		Amount
To Interest on Capital			Net Profit b/d(P & L A/C)		70,000
A	4000		Interest on Drawings		
			A	400	
B	2000	6,000	B	200	600
To Partner's Salary					
A		3,000			
To Partner's Commission					
A	1000				
B	2000	3,000			
To A's Capital	35160				
(58600 x 3/5)					
To B's Capital	23440	58,600			
(58600 x 2/5)					
		70,600			70,600

Partners Capital Account

Particulars	A	B	Particulars	A	B
To Drawings	20,000	10,000	By Balance b/d	2,00,000	1,00,000
To Interest on Drawings	400	200	By Interest on capital	4,000	2,000
			By Salary	3,000	
To Balance c/d	2,22,760	1,17,240	By Commission	1,000	2,000
			By P&L Appropriation	35,160	23,440
			(Closing balance of P & L Appropriation A/C)		
	2,43,160	1,27,440		2,43,160	1,27,440

Order (flow) preparing accounts in partnership:



Interest on Capital

Interest on capital is paid to partners as a compensation for their capital contribution to the firm. Interest on capital is an expense to the firm and a gain to partner's individually. No interest is allowed on partners' capital unless it is agreed between partners. Interest is generally calculated on the opening capital and is credited to capital account. If some additional capital is introduced during the year, the interest on additional amount should be calculated based on the time for which the amount remains in the business. It is an appropriation of profit and it should be noted that no interest on capital is payable if the firm is working at a loss.

Interest on capital=Capital of the partner x Rate x period for which amount remained in the business.

Calculation of interest on capital

Case-1

Calculation of Interest on Capital-When there is no Addition or Withdrawal of capital

Interest on capital=**Opening capital X rate X period for which amount remained in business.**

Q.Amal and Bimal entered into partnership business on 01-01-2019 by bringing in Rs.300000 and Rs.200000 respectively. They decided to share profit and losses equally and agreed that the interest on capital will be provided to the partners @ 10% per annum. There was no addition or withdrawal of capital by any partner during the year. Calculate interest on capital of Amal for the year?

Ans: Interest on capital of Amal=3,00,000 x 10/100 x12/12

OR

=300000 x10% =**30000**

Case-2

Calculation of Interest on Capital-When there is additional capital introduced during the accounting year.

a) **On opening capital** interest for **full** year
b) **On the additional capital** interest **from the date of contribution** to the **end** of the period

Q. Anna and Maria are partners in a firm. Anna's capital account showed a balance of Rs.50,000 on 01-01-2019.During the year 2017 Anna introduced an additional capital of Rs.10,000 on 1st August 2019.The Interest on capital allowed @ 8% p.a. Accounts are closed on December 31st every year. Calculate interest on capital to be allowed to Anna during the year 2019?

Ans:
For Anna's opening capital, interest for full year,i.e. 50,000 x8% =4,000

For Anna's additional capital, interest from the date of contribution (1-8-2019) to the end of the period (31-12-2019) 5 months ,i.e.10000 x 8% x 5/12 =333

Total Interest on capital of Anna = 4000 + 333 = **4333**

Case-3

Calculation of interest on capital – When there is withdrawal out of capital during the year

i. On opening capital interest is calculated for full year **(1)**
ii. On amount of capital withdrawn during the year, interest for the period from the date of withdrawal to the closing date and deduct it from the above **(1)**

Q. Sneha and Varsha are partners in a firm. Their capital accounts as on 1-04-2017 showed a balance of Rs.2,00,000 and Rs.3,00,000 respectively. On October 1st 2017.Sneha withdraw Rs.30,000 from her capital. Interest is allowed @8% p.a. Calculate interest on capital of Sneha for the financial year 2017-2018?

On opening capital for full year, i.e.2, 00,000 x 8% =16,000 **(1)**
Calculate interest on the amount of capital withdraw for the period from the date of withdraw to the closing date,
i.e 30,000 x 8% x 6/12 = 1200 **(2)**
Interest on capital **(1-2)** = 16000 – 1200
= **14,800**

Case-4

Calculation of interest on capital– When there is both addition and withdrawal of capital by partners during the year

i. On opening capital interest is calculated for full year **(1)**
ii. On additional capital from the date of contribution to the end of the period **(2)**
iii. On the amount of capital withdrawn during the year interest for the period from the date of withdrawal to the closing day and deducted from the total of the interest calculated under point **(1)** and point **(2).**

Q.Tomy and George are partners in a firm. Their capital account balance as on 1-4-2017 showed a balance of Rs.5,00,000 and Rs.2,00,000 respectively. On June 1st ,Tomy introduced additional capital of Rs.20,000.On November 1st Tomy withdraw Rs.30,000 from his capital. Interest on capital is allowed @10% p.a. Calculate interest on capital

Ans.
On opening capital (5, 00,000) Interest on capital for whole year
i.e, 5, 00,000 x 10% =50000 **(1)**
On additional capital from the date of contribution (1-6-2017) to the closing date (31-3-2018)
i.e. 20,000 x 10% x 10/12 =1667 **(2)**
On the amount of capital withdrawn for the period from the date of withdrawal (1-11-2017) to the closing day (31-3-2018)
i.e. 30,000 x 10% x 5/12 = 1250 **(3)**
Net interest on capital = **(1) + (2) – (3)**
i.e, 50,000 + 1667 - 1250 =**50417**

Calculation of opening capital when closing capital is given

Closing capital		xxxx
Add:		
Drawings	xxxxx	
Interest on drawings	xxxxx	
Share of loss(if any)	xxxxx	xxxxx
		xxxxx
Less:		
Partners salary	xxxxx	
Partners commission	xxxxx	
Share of profit(if any)	xxxxx	xxxx
Opening capital		xxxxx

Interest on capital is always calculated on opening capital

3. Provision for Partnership Act Relevant for accounting
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Chapter-3

Reconstitution of Partnership Firm-Admission of a partner

Focused Area- Chapter-3

1. **Modes of Reconstitution of a partnership firm**
2. **Admission of a new partner**
3. **New profit-sharing ratio and sacrificing ratio**
4. **Goodwill- factors affecting the value of goodwill**
5. **Methods of valuation of goodwill (Average profit)**
6. **Treatment of Goodwill (When the new partner brings goodwill in cash)**
7. **Adjustment for accumulated profit and loss**
8. **Revaluation of assets and reassessment of liabilities**
9. **Preparation of revaluation account, partner's capital Account and Balance sheet**

Partnership is a voluntary association of two or more persons who on the basis of an agreement pool together their financial and managerial resources and jointly start a lawful business. Any change in the relationship among partners may lead to reconstitution of the partnership firm. A change in the partnership agreement brings to an end to the existing agreement. Thus in reconstitution the existing agreement comes to an end and the firm may continue its business with a new agreement.

Modes of Reconstitution/ Occasions when reconstitution of a firm take place

Reconstitution of a partnership firm is usually taking place in any of the following ways:

1. Change in the profit sharing ratio among the existing partners
2. Admission of a partner
3. Retirement of an existing partner
4. Death of a partner
5. Amalgamation of two partnership firms

1. Change in the profit sharing ratio among the existing partners

Sometimes partners of an existing firm may decide to change their existing profit sharing ratio. The change in profit sharing ratio may lead to increase or decrease partner's share

in the firm. In other words, certain partner may gain others will lose. The sacrificing partners must be compensated by the gaining partner. The amount of compensation is calculated on the basis of the value of goodwill of the firm (Goodwill is the value of reputation of a firm; It is the extra earning capacity of a business compared to other business).

Example: Anna and Maria are partners, sharing profit and loss in the ratio of 3:1.Now they decided to share profit equally (old ratio 3:1, New ratio 1:1:1).

2. Admission of a new partner

Inclusion of a person as a partner to an existing partnership firm is called admission of a partner. When a firm requires additional capital or managerial help or both for the expansion of its business, a firm can admit a person as a partner to an existing firm. The new person admitted is called as incoming partner. On admission, old partnership agreement comes to an end and with a new agreement the business will continue. A person can be admitted as a partner only with the consent of all partners. A minor can be admitted as a partner for the benefit of partnership. In that case minor's liability is limited to the capital contributed by him.

Example: Rajan and Mohan were equal partners. They admit Sunil as a partner by giving him an equal share. In this case agreement will change and reconstitution takes place.

3. Retirement of a partner

Retirement means withdrawal of a partner from an existing business. Retirement may be due to his bad health, old age or change in business interests.

Example: A, B and C are partners sharing in the ratio of 3:2:1.After C's retirement A and B decided to continue the business with a profit sharing ratio of 3:2.This results in reconstitution of the firm.

4. Death of a partner

Death of a partner will also result in the change of relationship between surviving partners. Their profit sharing ratio will change and it leads to reconstitution.

5. Amalgamation of two firms

Sometimes two firms amalgamate in order to avoid competition and reduce administrative cost. This arrangement brings new relationship among partners of two firms. A new

agreement is signed .New profit sharing arrangements takes palce.Here also reconstitution occurred.

As such, any change in the partnership agreement due to change in the ratio of existing partners or admission or retirement or death of a partner or amalgamation of partnership firm is known as **Reconstitution** of Partnership.

Admission of a new partner

When a firm requires additional capital or managerial help or both for the expansion of its business, a new partner may be admitted to supplement its existing resources. According to the **partnership Act 1932**, a new partner can be admitted into the firm only with the consent of all the existing partners unless otherwise agreed upon.

An incoming partner acquires two main **rights** in the firm:-

1. Right to share the assets of the partnership firm.

2. Right to share the profit of the partnership firm.

For the **right to acquire share in the assets** and profit of the partnership firm, the partner brings adequate (agreed) amount of **capital** either in cash or kind. For the **right to share future profit of an established firm** the new partner is required to bring some additional amount known **as his share of goodwill or premium**. This is necessary to compensate the existing partners for their sacrifice a part of their share of profit in favour of the incoming partner.

Accounting treatment required at the time of admission of a partner

1. Recording capital contributed by the new partner

2. Calculation of new profit sharing ratio and sacrificing ratio

3. Treatment of goodwill

4. Revaluation of assets and liabilities

5. Distribution of accumulated profits and losses

6. Adjustment of partner's capital account

1. **Record the capital contributed by the new partner**

   When the new partner brings agreed amount or assets for capital:

   Cash / Assets A/C Dr

   To New Partner's Capital A/C

   (Amount brought in for capital)

2. **Calculation of New profit sharing ratio and sacrificing ratio**

   The new profit sharing ratio is mutually decided by partners. Admission of a partner to the existing firm means reduction in the share of old partner or partners.

   New ratio = Old Share – Sacrificing Share

   Sacrificing Ratio

   On admission of a partner, the old partners have to give up a certain portion of their profits in favour of the new partner. In other words, sacrificing ratio is the ratio in which the old partners agree to sacrifice their share of profit in favour of the new partner.

   Sacrificing Ratio = Old Share – New Share

   Reason for calculation of sacrificing ratio:

   The new partner is required to compensate the old partners for their loss of share in the super profits of the firm. To compensates the sacrificing partners; the incoming partner brings in an additional amount known as **premium or goodwill.** This amount is shared by the old partners in the ratio in which they sacrifice their in favour of the new partner. Thus sacrificing ratio is calculated **to share goodwill**.

Calculation of new ratio and sacrificing ratio in different situations

Case-1 When new partner acquires his share from the old partners in their old ratio (when the new share of the incoming partner is given without mentioning the details of sacrifice made by the old partners)

Case-2 When the new partner acquires his share of profit in any other agreed ratio from the old partners (When the new share of the incoming partner and how he acquires the share from the old partners are given)

Case–3 when old ratio of the old partners and the new ratio of all the partners are given.

Case–4 when old partners surrendered a part of their share in favour of the new partner.

Case–5 when new partner's share and new profit sharing ratio between old partners are given

Case–1 When new partner acquires his share from the old partners in their old ratio (when the new share of the incoming partner is given without mentioning the details of sacrifice made by the old partners)

Note: **In this case sacrificing ratio is same as old ratio**–the reason is that in this case, the incoming partner acquires his share from old partners in their **old ratio**. So old partner's sacrifice for the new partner is same as their old ratio.

Calculation of New share:

Total Share of all partners (100%) = **1/1** or **1**.On admission old partners admit a person as a partner by giving a portion of share in the business.

So remaining share for old partners = Total share i.e 1 –New Partner's Share

New Share of old partner's = Remaining Share x Old Share

Q. Anil and Sunil are partners sharing profits and losses in the ratio of 3:2.They admits Mahesh for ¼ shares. Calculate new ratio and sacrificing ratio.

Sacrificing ratio = Old share – New share

Old ratio of Anil and Sunil =3:2

Mahesh Share = 1/4

Remaining portion = 1 – 1/4 =3/4 (1/1 – 1/4 or 4/4 – 1/4)

This 3/4 portion is remaining for Anil and Sunil.It is to be shared by Anil and Sunil in their old ratio.Hence there new share will be

Anil's new share = Remaining portion X Anil's old ratio

= 3/4 X 3/5 =9/20

Sunil's new share=Remaining portion X Mohan's old ratio

3/5 – 9/20, to deduct it, we want to equalize the denominators (here we want to change the denominator 5 to 20).For this we required to multiply numerator and denominator with 4 ie 3/5 *4 or 3 * 4 and 5* 4.Then we will get **12/20**.It is the easiest way. There are other ways like cross multiplication, calculate L.C.M etc.

=3/4 X2/5 =6/20

Mahesh share= 1/4 or 5/20

The new ratio between Anil,Sunil and Mahesh = 9/20:6/20:5/20

Sacrificing Ratio = Old Share – New Share

Anil's Sacrifice =Anil's old share – Anil's New Share

= 3/5 –9/20 or **12/20**–9/20 =3/20

Sunil's Sacrifice = Sunil's Old Share – Sunil's New Share

=2/5 – 6/20 or 8/20 – 6/20 =2/20

Sacrificing ratio of Anil and Sunil = 3/20:2/20 or 3:2

In this case sacrificing ratio is same as old ratio.

Note: When the new share of the incoming partner is given without mentioning the details of sacrifice made by the old partners, in such a case it is assumed that the old partners make their sacrifice in the old profit sharing ratio. In this case sacrificing ratio is same as old ratio. So in this case, students should not waste their time in calculating sacrificing ratio.

Q. P and Q are partners sharing profit and losses in the ratio of 1:1.They admits R for a third share. Calculate new ratio and sacrificing ratio?

Here,P & Q decided to admit R as a new partner by giving a third share.i.e,1/3 .There is no further explanation about the new ratio of old partners.

So new profit sharing ratio will be **1:1:1**

In this case, as the relative ratio between the old partners is not changed, the old ratio and sacrificing ratio of the old partners are the same, i.e **1:1.** So in this case, students should not waste their time in calculating sacrificing ratio.

No need for calculoation, only to prove it:–

Old ratio of P & Q=1:1

New ratio of P, Q & R = 1:1:1

Sacrificing Ratio = Old Share – New Share

P's Sacrifice = 1/2 – 1/3 or 3/6 – 2/6 =1/6

Q's Sacrifice =1/2 – 1/3 or 3/6 – 2/6 =1/6

Sacrificing ratio =**1:1**

Q. X and Y are partners sharing profits in the ratio of 3:2.They admits Z for a sixth (1/6) share. The new ratio and sacrificing ratio are as follows. Calculate new ratio and sacrificing ratio.

Here, we can easily calculate new ratio as**–3:2:1**

In this case, as the relative ratio between the old partners is not changed, the old ratio and sacrificing ratio of the old partners are the same, i.e **3:2**

Case–2 When the new partner acquires his share of profit in any other agreed ratio from the old partners (When the new share of the incoming partner and how he acquires the share from the old partners are given)

In this case also, there is no need to calculate sacrificing ratio, which is already mentioned in the question itself.

Q. A & B are partners sharing profit and losses in the ratio of 4:3. They admit C into partnership for 2/7 share, which acquires equally (2/7 * 1/2= 2/14 or 1/7) from A & B.Calculate new ratio and sacrificing ratio.

Old ratio of A & B =4:3

C's Share=2/7 which he acquires equally, i.e 1/7 from A and 1/7 from B.

So A's new share = A's old share – A's share acquired by C

=4/7 – 1/7 =3/7

B's new share = B's old share – B's share acquired by C

=3/7 – 1/7 =2/7

C's share =2/7

So new ratio of A,B and C=3:2:2

Sacrificing ratio of A & B (In this problem C acquires his share 2/7 equally from A & B,so there sacrifice is 1:1)

Sacrificing Ratio = Old Share – New Share

A's Sacrifice = A's old share– A's new share

=4/7 –3/7= 1/7

B's Sacrifice = B's old share– B's new share

=3/7 –2/7 = 1/7

Sacrificing ratio of A & B = 1:1

Q. Arun & Varun are partners sharing profit and losses in the ratio of 7:5. They admit Tharun into partnership for 1/6 share, which he acquires 1/24 from Arun and 1/8 from Varun.Find out the new ratio and sacrificing ratio.

Old ratio of Arun and Tharun =7:5

Tharun's share = 1/6 which he acquires 1/24 from Arun and 1/8 from Tharun

Arun's new share = 7/12 – 1/24 or 14/24 –1/24 =13/24

Varun's new share =5/12 – 1/8 or 10/24 –3/24 =7/24

Tharun's share = 1/6 or4/24

New ratio of Arun,Varun and Tharun =13:7:4

Sacrificing ratio of Arun and Varun

Sacrificing Ratio = Old Share – New Share

Arun's sacrifice = 7/12 – 13/24 or 14/12 –13/24 =1/24

Varun's sacrifice =5/12 –7/24 or 10/24 – 7/24 = 3/24

Sacrificing ratio =**1:3**

Q.A &B are partners in a firm sharing profits and losses in the ratio of 4:1.C is admitted into the partnership with ¼ shares in profits which he acquires wholly from A. Calculate the new profit sharing ratio of partners and sacrificing ratio of A & B.

Old ratio of A & B =4:1

C's share = ¼ which he acquires wholly from A

So A's new share = A's old share – A's share acquired by C

=4/5 – 1/4 or 16/20 – 5/20 = 11/20

B,s new share =1/5 or 4/20 (No change)

C's share =1/4 or 5/20

New ratio of A,B and C = 11:4:5

Sacrificing Ratio = Old Share – New Share

A's sacrifice =4/5 – 11/20 or 16/20 –11/20 =5/20

B's sacrifice = 1/5 –4/20 or 4/20–4/20 = 0

In this case A made the complete sacrifice. Ratio is 5/20:0/20 or 5:0

Case-3 When old ratio of the old partners and the new ratio of all the partners are given.

Sacrificing Ratio = Old Share – New Share

Q. P and Q are partners in a firm sharing profits in the ratio of 5:3.They admits R as a new partner for 1/7 share in profit. The new profit sharing ratio will be 4:2:1.Calculate the sacrificing ratio of P and Q.

Old ratio of P and Q = 5:3

New ratio of P, Q and R =4:2:1

Sacrificing Ratio = Old Share – New Share

Sacrificing ratio of P = 5/8 –4/7 or 35/56 –32/56 =3/56

Sacrificing ratio of Q = 3/8 – 2/7 or 21/56 – 16/56 =5/56

Sacrificing ratio of P and Q = **3:5**

Q.Arjun and Karnan are partners in a firm sharing profits in the ratio of 4:3.They admitted Soman as a new partner.The profit sharing ratio of Arjun,Karnan and Mohan will be 2:3:1. Calculate sacrificing ratio.

Old ratio of Arjun and Karnan = 4:3

New ratio of Arjun,Karnan and Soman = 2:3:1

Sacrificing Ratio = Old Share – New Share

Arjun's sacrifice = 4/7 – 2/6 or 24/42 – 14/42 = 10/42

Karnan's sacrifice = 3/7 – 3/6 or 18/42 – 21/42 = (–) 3/42 (Gain)

Mahesh share = 1/6 or 7/42

Arjun's sacrifice = Karnan's gain + Mahesh's gain

= 3/42 + 7/42 =10/42

In this case all sacrifice is made by Arjun.

Case –4 when old partners surrender a part of their share in favour of the new partner.

In this case, it is necessary to find out new ratio and sacrificing ratio. Here old partners surrender a portion of their share in favour of the new partner. Surrendered portion of each partner is ascertained by multiplying their old share with ratio of their sacrifice. The new profit sharing ratio of existing partner's is determined by deducting sacrificed portion from old share.

Surrendered portion = Old Share x Ratio of sacrifice

Old Partner's new share = Old Share – Surrendered portion

Sacrificing Ratio = Old Share – New Share

Q. A and B are partners sharing profits equally. They took C into partnership. A surrendered 1/3 of his share and B surrendered ¼ of his share in favour of C.Calculate new profit sharing ratio and sacrificing ratio.

Old ratio of A & B = 1:1

A surrendered 1/3 of his share in favour of C,i.e, 1/2 X 1/3 =1/6

So A's new share = Old share – Surrendered portion

=1/2 – 1/6 or 3/6 – 1/6 = 2/6

B surrendered 1/4 of his share in favour of C,i.e, 1/2 X 1/4 = 1/8

So, B's new share = 1/2 –1/8 or 4/8 –1/8 = 3/8

C's share = Surrendered portion of A + surrendered portion of B

= 1/6 + 1/8 or 8/48 +6/48 = 14/48

A's new share=2/6 or 16/48, B's new share=3/8 or 18/48, C's share =14/48

New ratio of A,B and C =16:18:14 or 8:9:7

Sacrificing Ratio = Old Share – New Share

A's sacrifice = 1/2 – 8/24 or 12/24 –8/24 = 4/24

B's sacrifice = 1/2 –9/24 or 12/24 –9/24 =3/24

Sacrificing ratio = **4:3**

Case–5 when new partner's share and new profit sharing ratio between old partners are given

In this case also, it is necessary to find out new ratio and sacrificing ratio. In this case incoming partners share directly given. Old partner's old ratio and their proportionate new ratio are referred here.

1. Find out remaining portion (1 – New partner's share)

2. Calculate new ratio of old partners = Remaining portion x New proportionate ratio between old partners.

3. Find out the new ratio of **all** partners

4. Calculate Sacrificing Ratio = New Share – Old Share

Q.Veeran and Velu are partners in a firm sharing profits and losses in the ratio of 3:2.They admitted Vijay as a new partner for 1/4 share. The new profit sharing ratio between Veeran and Velu will be 2:1.Calculate new profit sharing ratio and sacrificing ratio.

Old ratio of Veeran and Velu = 3:2

Whole (full) share for all partners = 1/1 i.e 100%

Vijay's share =1/4

Remaining portion =1−1/4 =3/4

New profit sharing ratio between Veeran and Velu = 2:1

New ratio of Veeran = Remaing portion X new ratio of Veeran

= 3/4 X 2/3 = 6/12

New ratio of Velu = 3/4 X 1/3 = 3/12

Vijay's share = 1/4 or 3/12

So New ratio of Veeran,Velu and Vijay =6:3:3 or 2:1:1

Sacrificing Ratio = Old Share − New Share

Veeran's sacrifice = 3/5 − 2/4 or 12/20 − 10/20 = 2/20

Velu's sacrifice = 2/5 − 1/4 or 8/20 − 5/20 =3/20

Sacrificing ratio of Veeran and Velu =**2:3**

Goodwill

Goodwill the value of reputation of a firm in respect of the profits expected in future over and above the normal profits earned by other similar firms belonging to the same industry. Such excess of future profit over the normal profit is known as super profit.Thus, goodwill exists only when the firm earns super profit. Goodwill is shown as fixed asset of the business because it increases profit earning capacity of the business.

In simple words, goodwill can be defined as" the present value of a firm's anticipated excess earnings".

Nature of Goodwill

- It is an intangible asset
- A firm that earns only normal profit or is incurring lossess has no goodwill
- Sometimes Goodwill has more value than the tangible asset

Factors affecting the value of goodwill

The main factors that affect the value of goodwill of a firm are the following:

1. **Favorable location** – If the business is centrally located, it will attract more customers. It increases the profitability and also the value of goodwill.
2. **Nature of business** – A firm that produces high value added products or dealing goods having stable demand is able to earn more profits and therefore has more goodwill.
3. **Efficiency of management** – A well managed concern enjoys the advantages of high productivity and profitability. Hence; its goodwill will be more.
4. **Market situation** – The monopoly condition or limited competition enables the business to earn more profits and so the value of goodwill will be high.
5. **Special advantages** – A firm which enjoys special advantages like import licencing, low rate and assured supply of electricity, trade mark, well known collaborations, patents etc. enjoy higher value of goodwill.
6. **Time Factor** – A business concern running profitably for a long period will have more goodwill.

Methods of Valuation of Goodwill

Since goodwill is an intangible asset it is very difficult accurately calculate its value. Various methods have been advocated for the valuation of goodwill of a partnership firm. The important methods for valuation of goodwill are as follows:

A. Average Profit Method
B. Super Profit Method
C. Capitalisation Method

I. Average profit method

Under this method, the goodwill is valued at agreed number of year's purchase of the average profit of the past few years.

Steps to be followed:

Step –1 Calculate normal past business profits for each year(deducting abnormal gain and adding abnormal losses).

Step –2 Sums up the normal profit calculated above

Step–3 Calculate Average profit = Total Profit / Number of Years

Step–4 Calculate Goodwill

Goodwill = Average profit X Agreed number of years purchase

Q. Calculate the value of goodwill on the basis of three year's purchase of the average profits based on the last 5 years. The profits of the last five years were as follows:

2014	40000
2015	60000
2016	30000
2017	50000
2018	28000

If any loss, it should be deducted

Ans:

Total Normal Profit = 40000+60000+30000+50000+28000 =2,08,000

Average Profit = Total normal profit / Number of years

=2,08,000 / 5 =41,600

Goodwill = Three year's purchase of average profit of last 5 years

=41,600 X 3 =1,24,800

Q.The following were the profits/loss of a firm for the last six years

Year	Profit (Rs.)
2012	250000 (Including abnormal gain Rs.30000)

2013	200000 (After charging abnormal loss of Rs.40000)
2014	325000 (Excluding Rs.20000 payable on the insurance of Plant)
2015	100000 (Including profit on sale of land Rs.70000)
2016	80000
2017	(−)60000 (Loss)

Calculate the value of firm's goodwill on the basis of two years purchase of average profit for the last 6 years.

Ans:Calculate average maintainable profit

Year	Profit
2012(2, 50,000 − 30,000)	2, 20,000
2013 (2,00,000 + 40,000)	2,40,000
2014 (3,25,000 − 20,000)	3,05,000
2015 (1,00,000 − 70,000)	30,000
2016	80,000
2017	(−) 60,000
Total	8, 15,000

Average Profit = Total normal profit / Number of years

= 8,15,000 / 6 =135833

Goodwill = Two year's purchase of average profit of last 6 years

= 135833 X 2 =271666

Average profit method-important assumptions

a) This method is based on the assumption that a new business will not be able to earn any profit during the first few years of its operations. Hence, a person who purchases the share of a running business must pay in the form of goodwill a sum which is equal to the profits he is likely to receive for the first few years.

b) In this method calculation of goodwill is based on the assumption that no change in the overall situation of profit is expected in the future.

Treatment of Goodwill

On admission, the incoming partner who acquires his share of profit from the existing partners has to bring in some additional amount to compensate them for the loss of their share in super profits. It is termed as his share of goodwill or premium.This premium amount is shared by old partners in the ratio in which they make their sacrifice. From the accounting point of view, there may be different situations related to treatment of goodwill and these are:

Treatment of goodwill-Various cases

Case-1 When the goodwill (premium) is paid privately (i.e., outside the business) by the new partner to the old partners, no entry is recorded in the books of account.

Case-2 When the new partner brings in his share of goodwill in cash and the same retained in the business

Case-3 When the new partner brings in his share of goodwill in cash and the same fully or partly withdrawn by old partners.

Case -4 when the new partner brings his share of goodwill in kind (in the form of assets)

Case-5 When the new partner is unable to bring in his share of goodwill in cash or kind

Case-6 When new partner brings in only a portion of the goodwill in cash

Treatment of Goodwill

Case-2 When the new partner brings in his share of goodwill in cash and the same retained in the business

Journal Entry -1 When cash brought in as goodwill

Cash A/C Dr

To Premium

(Cash brought in by the new partner as goodwill)

Journal entry –2 when goodwill distributed among old partners

Premium A/C Dr

To Old partner's capital A/C (sacrificing ratio)

(Goodwill distributed among old partners)

Note: Alternatively, the cash premium brought in by the new partner may be directly credited to old partner's capital account. If so, instead of two journal entries (1) and (2) in the above two cases, a single journal entry would sufficient (Cancel premium debit and credit balance)

Single Journal entry when the new partner brings in his share of goodwill in cash and the same retained in the business

Cash A/C Dr

To old partners capital A/C (Sacrificing ratio)

(Cash brought in by the new partner as goodwill)

Q.A and B are partners sharing profits and losses in the ratio of 5:3.They admitted C as a new partner 1/4 share in the profits. C brought in Rs.30, 000 for 1/4 share in the profits as premium for goodwill. Record necessary journal entries in the book of the firm on C's admission.

Note: In this case sacrificing ratio will be same as old ratio, i.e, 5:3

C's share of goodwill for 1/4 share = 30,000

Single journal entry:

Cash A/C Dr		30000	
To A's Capital	A/C		18750
To B's Capital	A/C		11250

(Cash brought in by C as goodwill and the transferred to old partners capital account

In their sacrificing ratio)

Case-3 When the new partner brings in his share of goodwill in cash and the same fully or partly withdrawn by the old partners.

The following journal entries are passed in the books:

(a) When cash brought in as goodwill

Cash A/C Dr

To old partners capital A/C

(Cash brought in by the new partner as goodwill)

(b) When goodwill amount withdrawn by old partners from business

Old partners' capital A/C Dr

To Cash

(The amount of goodwill withdrawn by old partners)

Q.Santhosh and Antony are partners in a firm.They sharing profit and losses in the ratio of 5:3.They admits Biju into partnership who pays Rs.50, 000 for his capital and 18,000 as his share of goodwill. Half of the goodwill is withdrawn by the partners. They agree to share profit and losses in the ratio of 4:2:1.

Ans:New partner's share of goodwill should be shared by old partners in their sacrificing ratio. So here,we want to calculate sacrificing ratio (S.R)

Sacrificing ratio = Old ratio – New ratio

Old ratio of Santhosh and Antony =5 :3

New ratio of Santhosh, Antony and Biju = 4:2:1

Santhosh's Sacrifice = 5/8 – 4/7 or 35/56 – 32/56 =3/56

Antony's Sacrifice = 3/8 – 2/7 or 21/56 –16/56 =5/56 .Sacrificing Ratio = 3:5

Biju's share of goodwill =18,000

Journal entry to record capital :

Cash A/C Dr 50000

To Biju's Capital 50000

(Being cash brought in as capital)

Journal entry when cash brought in as goodwill

Cash A/C Dr 18000

To Santhosh's capital A/C 6750

To Antony's capital A/C 11250

(Being goodwill brought in by Biju credited to old partner's capital account in their S.R)

Journal entry when goodwill (here half) withdrawn by old partners

Snathsh's capital A/C Dr(9000 X3/8) 3375

Anton's capital A/C Dr(9000 X 5/8) 5625

To Cash A/C 9000

(Being half of the goodwill withdrawn by old partners in their S.R)

4. Revaluation of assets and liabilities

At the time of admission of a partner, assets and liabilities of a firm must be revalued. It is necessary because actual realizable value of assets and actual liabilities may be different from their book values. The outcome of revaluation may be revaluation profit or loss. Profit or loss arising on account of such revaluation up to the date of admission of a new partner may be ascertained and adjusted in the old partners' capital accounts in their old profit sharing ratio since it belongs to the old partners and not to the new partner. Effect of revaluation can be ascertained by preparing a revaluation account.

Revaluation Account

Revaluation account is a nominal account prepared to bring the assets and liabilities of the firm to their true (market) values and to find out profit or loss on revaluation of assets and reassessment of liabilities. Revaluation account is credited with increase in the value of assets, decrease in the amount of liabilities and unrecorded assets. Revaluation account is debited with decrease in the value of assets, increase in the value of liabilities and unrecorded liabilities. The balance of Revaluation account represents the profit or loss on revaluation and is transferred to the old partners' capital accounts in their old profit sharing ratio.

Note: Revaluation account records only changes in values of assets and liabilities, not book value or real value.

Revaluation Account

Particulars	Amount	Particulars	Amount
To Assets Decrease (-) To Liability Increase (+) To Unrecorded Liability (+) To Old partners 'Capital Accounts (Profit, old ratio)	XXXX XXXX XXXX XXXX	By Assets Increase (+) By Liabilities Decrease (-) By Unrecorded Assets (+) By Old partners 'Capital Accounts (Loss, old ratio)	XXXX XXXX XXXX XXXX
	XXXX		XXXX

Journal Entry –Revaluation of Assets and Liabilities

Particulars	Journal Entry
Increase in the value of Assets	**Assets A/c Dr** **To Revaluation A/C**
Decrease in the value of Assets	**Revaluation A/C Dr** **To Assets**
Increase in the value of Liability	**Revaluation A/C Dr** **To Liabilities**
Decrease in the value of Liability	**Liabilities A/C Dr** **Revaluation A/C**
Un Recorded Assets	**Assets A/C Dr** **To Revaluation**
Unrecorded Liabilities	**Revaluation A/C Dr** **To Liabilities**
For Distribution of Revaluation Profits	**Revaluation A/C Dr** **To Old Partners' Capital A/c**
For Distribution of Revaluation Loss	**Old Partner's Capital A/C Dr** **To Revaluation**

5. (A) Distribution of accumulated profits and losses

If, at the time of admission of a partner, any reserve or accumulated profits/losses exists in the books of the firm, these should be transferred to old partners' Capital accounts (if capitals are fluctuating) or Current Accounts (If capitals are fixed) in their old profit sharing ratio since the reserves, accumulated profits/losses up to the date of admission of a new partner belong to the old partners and not to the new partner.

General Reserve A/C Dr

Profit & Loss A/C Dr

To Old Partners Capital A/C (Old ratio, individually)

(Accumulated profit transferred to old partners capital A/C in their old ratio)

5. (B) Distribution of Accumulated Losses

Old Partners' Capital A/C Dr

To Profit & Loss A/C

(Accumulated Loss transferred to old partner's capital A/C in their old ratio)

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Chapter-4

Reconstitution of a Partnership Firm – Retirement/Death of a Partner

Focused Area- Chapter-4

1. New profit-sharing ratio and gaining ratio
2. Adjustment for revaluation of assets and liabilities
3. Adjustment of accumulated profits and losses
4. Disposal of amount due to the retiring partner
5. Preparation of Partner's Loan Account
6. Death of partner- Calculation of amount due to the deceased partner.

Withdrawal of a partner from the partnership with the consent of other partners or as per the provisions of the partnership deed or by giving notice of retirement is termed as retirement of a partner. A partner who cut his connection with the firm is called a retiring partner or outgoing partner. Retirement of a partner leads to reconstitution of a partnership firm as the original agreement between the partners comes to an end. The business may continue with a new agreement with the remaining partners. When a partner retires, his share in the firm is to be correctly ascertained and settled.

A retiring partner is entitled to get his share of capital, interest on capital, revaluation profit, share of profit etc. up to the date of his retirement. Similarly he is liable for his share in all the losses like accumulated loss, revaluation loss, Drawings, interest on drawings, share of current year's loss up to the date of retirement, drawings, interest on drawings etc. till the date of his retirement. He is not liable for any loss incurred by the firm after his retirement.

Adjustments/Accounting treatment required at the time of retirement of a partner

1. Calculation of new profit sharing ratio and gaining ratio
2. Treatment of goodwill
3. Treatment of accumulated profit and losses
4. Revaluation of assets and liabilities
5. Ascertainment of profit and loss upto the date of retirement
6. Calculation of total amount due to the retiring partner
7. Settlement of total amount due to the retiring partner
8. Adjustment of capitals of the continuing partners

I. Calculation of New profit-sharing ratio and gaining ratio

At the time of retirement of a partner, the business continues with the remaining partners. They need to decide among themselves what will be the new profit sharing ratio in the in the future.

New Ratio: The ratio, in which the continuing partners decide to share the future profits and losses, is known as new profit sharing ratio.

Gaining Ratio

The ratio in which the continuing partners acquire the outgoing partner's share is called gaining ratio. This ratio is calculated by taking out the difference between new profit share and old profit share. Gaining ratio is calculated when a partner retires or dies from a firm. It is called gaining ratio because the continuing partners stand to gain by acquiring the retiring partner's share in profits.

Gaining Ratio = New Share – Old Share

Difference between Gaining Ratio and sacrificing Ratio

Basis	**Gaining Ratio**	**Sacrificing Ratio**
When to calculate	It is calculated at the time of retirement/death of a partner and change in profit sharing ratio	It is calculated at the time of admission of a partner and change in profit sharing ratio
Meaning	The ratio in which the continuing partners acquire the outgoing partner's share is called gaining ratio.	The ratio in which the old partners sacrifice their share of profit in favour of the new partner
Objective	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner in the form of goodwill	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners in the form of goodwill
Equation	New Share-Old Share	Old Share – New Share

Calculating Gaining Ratio - Different Cases

Case-1 Relative Ratio between remaining partners unchanged

Case-2 When the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

Case-3 When the continuing partners acquire (Purchase) the retiring partner's share of profit in an agreed ratio.

Case-4 When entire share of the retiring partner is taken by only one continuing partner

Case-1 Relative Ratio between remaining partners unchanged

If the continuing partners maintain their relative ratio, the gaining ratio and the new ratio will be the same.

In this case there is no need to calculate gaining ratio, new ratio and gaining ratio will be the same

Q. A,B and C were sharing profits in the ratio of 4:3:2. B retires from the firm. Calculate the gaining ratio of A and C.

Ans:

Old Ratio of A,B and C = 4:3:2 or 4/9 :3/9 :2/9

New ratio of A and C is calculated by striking out the share of retiring partner and by finding out the denominator of the remaining ratio

So New ratio of A and C = 4:2 or 4/6 : 2/6

Gaining Ratio = New Share – Old Share

A's Gain = A's New Share – A's Old Share

=4/6 – 4/9 or 36/54 – 24/54 =12/54

C's Gain =C's New Share – C's Old Share

=2/6 – 2/9 or 18/54 – 12/54 =6/54

Gaining ratio of A and C = 12:6 or **2:1**

Q.X,Y and Z are partners sharing profits in the ratio of 1/2,3/10,1/5 or (**5/10:3/10:2/10**).Calculate the new ratio and sacrificing ratio if X retires.

Old ratio of X,Y and Z = 5:3:2

New ratio of Y and Z = 3:2

Gaining Ratio = New share – Old share

Y's Gain = 3/5 – 3/10 or 6/10 – 3/10 =3/10

Z's Gain = 2/5 – 2/10 or 4/10 – 2/10 = 2/10

Gaining ratio of Y and Z = **3:2**

Case-2 When the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

If the continuing partners decide to share future profits in some other ratio, the gaining ratio will also change.

In this case it is necessary to calculate gaining ratio.

Gaining Ratio = New Share – Old Share

Q.A,B and C were sharing profits in the ratio of 3:2:1.C retires from the firm. A and B decided to share future profits in the ratio of 7:5.Calculate gaining ratio.

Old ratio of A,B and C = 3:2:1

New ratio of A and B = 7:5

Gaining Ratio = New Share – Old Share

A's Gain = 7/12 – 3/6 or 7/12 -6/12 =1/12

B's Gain = 5/12 – 2/6 or 5/12 – 4/12 =1/12

Gaining ratio = **1:1**

Q.X,Y and Z are partners sharing profits and losses in the ratio of 2/5,2/5 and 1/5 respectively.Z retires and X and Y decides to share the future profits and losses in the ratio of 2:1 respectively. Calculate gaining ratio.

Old ratio of X,Y and Z = 2:2:1

New ratio of X and Y = 2:1

Gaining Ratio = New Share – Old Share

X's Gain = 2/3 – 2/5 or 10/15 – 6/15 = 4/15

Y's Gain 1/3 – 2/5 or 5/15 – 6/15 = (1/15) (Sacrifice)

X's Gain =**4/15,** Y's Sacrifice= **1/15**

Note: In this case has also sacrificed his share to the extent of 1/15 in favour of X who is required to compensate Y for such loss.

Case-3 When the continuing partners acquire (Purchase) the retiring partner's share of profit in an agreed ratio.

Here new ratio is to be calculated. In this case there is no need to calculate Gaining Ratio. The ratios in which remaining partners acquire retiring partner's share constitute the gaining ratio. We can easily ascertain it from the question itself.

Q.A,B and C are partners sharing profits in the ratio of 3:2:1.A retires and his share is taken up (acquired) by B and C in the ratio of 3:2.Calculate the new profit sharing ratio and gaining ratio.

Old ratio of A,B and C = 3:2:1

A's share =3/6

Shares acquired by B and C from A in the ratio of 3:2

A's share acquired by B = 3/5 of 3/6 = 3/5 X3/6 = 9/30

A's share acquired by C = 2/5 of 3/6 = 2/5 X 3/6 =6/30

B's new share = B's old share + A's Share acquired by B

=2/6 +9/30 or 10/30+9/30 = 19/30

C's New Share = C's old share + A's share acquired by C

=1/6 +6/30 or 5/30+6/30 =11/30

New ratio of B and C = 19:11

Gaining Ratio = New Share – Old Share

B's Gain = 19/30 -2/6 or 19/30 -10/30 = 9/30

C's gain = 11/30 – 1/6 or 11/30 – 5/30 = 6/30

Gaining ratio = **9:6 or 3:2**

Q.P,Q and R are partners sharing profits in the ratio of 3:4:1.P retires from the firm and surrenders 2/3 of his share to Q and the remaining share 1/3 to R .Calculate new profit sharing ratio and gaining ratio.

Old Ratio of P,Q and R = 3:4:1

P Retires, P's share =3/8

P's share acquired by Q = 2/3 of 3/8 or 2/3 X 3/8 =6/24 or 2/8

P's share acquired by R = 1/3 of 3/8 or 1/3 X 3/8 = 3/24 or 1/8

Q's new share =Q's old Share + P's share acquired by Q = 4/8 +2/8 =6/8

R's new share = R's old share + P's share acquired by R =1/8 +1/8 =2/8

New ratio of Q and R =6:2 or **3:1**

In this, there is no need to calculate gaining ratio, it is already mentioned in the question, i.e. 2/3:1/3 or 2:1

Case-4 When entire share of the retiring partner is taken by only one continuing partner

Q. A,B and C are partners sharing profits in the ratio of 2:2:1.B retires and his share is entirely taken by C.Calculate new Ratio

Old Ratio of A,B and C =2:2:1

B retires and B's share is entirely taken over by C

B's share =2/5

A's new share =2/5 (Unchanged)

C's new share = C's old share + B's share acquired by C

1/5 + 2/5 =3/5

New ratio of A and C = 2/5 : 3/5 or **2:3**

Gaining Ratio = New Share – Old Share

A's Gain = 2/5 – 2/5 = 0

C's Gain = 3/5 – 1/5 = 2/5

II Treatment of goodwill

When an existing partner of a firm decides to retire from the business, the continuing partners will gain in future profits. The continuing partner who gains by acquiring an additional right to share future profits must compensate the retiring partner who sacrifices his right to share future profits. The amount of compensation will be equal to the proportionate amount of firm's goodwill.

Retiring partner's share of goodwill = **Goodwill of the Firm X Retiring partner's Share**

Note:

As per Accounting Standard 10(AS-10) **goodwill is recorded in the books only when some consideration in money is paid for it**. So goodwill can be recorded only when it is purchased. So as per AS-10 goodwill account can't be raised in the books. Therefore, goodwill is to be adjusted through partners' capital account on retirement.

As per AS-10 Goodwill can't be raised and therefore retiring partner's share of goodwill is adjusted by debiting **Gaining partner's** capital Account and crediting **Retiring Partner's** capital Account & **Sacrificing Partner's** Capital Account (**If any**)

Journal Entry to adjust goodwill of the retiring partner:

Remaining Partners Capital A/C Dr.(Individually, gaining ratio)

To Retiring Partner's Capital A/C (Retiring partner's share of goodwill)

(Retiring partner's share of goodwill adjusted by debiting remaining partners in their G.R)

Q.A,B and C are partners in a firm sharing profits in the ratio of 5:3:2.A retires from the firm and goodwill of the firm is valued at Rs.1,20,000.New profit sharing ratio of the continuing partners will be equal. Record necessary Journal entry regarding goodwill

Old ratio of A, B and C =5:3:2

New ratio of B and C = 1:1

Gaining Ratio New Share – Old Share

B's Gain = 1/2 – 3/10 or 5/10 – 3/10 =2/10

C's Gain =1/2 – 2/10 or 5/10 – 2/10 =3/10

Gaining ratio of B and C =**2:3**

Goodwill of the firm = 1,20,000

A's Share of Goodwill = 1,20,000 X 5/10 =60,000

Journal entry to adjust A's Share of Goodwill :

B's Capital A/C Dr.(60000 *2/5)	**24,000**
C's Capital A/C Dr (60000* 3/5)	**36,000**
To A's Capital	**60,000**

(A's share of goodwill adjusted by debiting gaining partners capital account)

Q. P,Q and R were partners sharing profits and losses in the ratio of 4:3:2.Q retires from partnership and his share of goodwill is valued at Rs.9,600.Q's share of goodwill is credited to his capital account. Their future profit sharing ratio is 5:3.Give necessary journal entries in the books of the firm regarding goodwill.

Old Ratio of P,Q and R = 4:3:2

New Ratio of P and R = 5:3

Gaining Ratio = New Share – Old Share

P's Gain = 5/8 – 4/9 or 45/72 – 32/72 = 13/72

R’s Gain = 3/8 – 2/9 or 27/72 – 16/72 = 11/72

Gaining Ratio = **13:11**

Q’s Share of goodwill = 9600

Journal entry to adjust Q’s Share of Goodwill :

P’s Capital A/C Dr (9600*13/24) **5200**

R’s Capital A/C Dr (9600*13/24) **4400**

To Q’s Capital 9,600

(retiring partner’s goodwill adjusted by gaining partners P and R)

Q.A,B,C and D are partners sharing profits and losses in the ratio of 4:3:2:1.C retires from the firm and the continuing partners decided to share profits and losses equally. Goodwill of the firm was valued at Rs.60, 000.Pass necessary for goodwill treatment.

Old Ratio of A,B ,C and D =4:3:2:1

New ratio of A ,B and D = 1:1:1

Gaining Ratio = New Share – Old Share

A’s Gain =1/3 – 4/10 or 10/30 – 12/30 = (-2/30) Sacrifice

B’s Gain = 1/3 – 3/10 or 10/30 – 9/30 = 1/30

At the time of retirement, retiring partner, here,C sacrifice his share in favour of gaining partners.

So C’s sacrifice =2/10 or 6/30

D’s Gain = 1/3 – 1/10 or 10/30 – 3/30 = 7/30

Note:

Sacrificing partner has the right to get compensation in the form of share of goodwill and at the same time gaining partner is liable to pay compensation for his gain. Compensation is adjusted by debiting gaining partner’s capital account and crediting sacrificing partner’s capital account

Goodwill of the firm = 60,000

A’s sacrifice adjusted by crediting his capital account to the extent of:-

=Goodwill of the firm X A’s Sacrifice

=60000 x 2/30 =4000

C's sacrifice adjusted by crediting his capital account to the extent of:-

=Goodwill of the firm X C's Sacrifice

=60000 x 6/30 = 12000

B's gain adjusted by debiting his capital account to the extent of:-

=Goodwill of the firm X B's Gain

=60000 x 1/30 =2000

D's gain adjusted by debiting his capital account to the extent of:-

=Goodwill of the firm X D's Gain

=60000 x 7/30 = 14000

B's Capital A/C Dr 2000

D's Capital A/C Dr 14000

To A's Capital A/C 4000

To C's Capital A/C 12000

(Goodwill adjusted by crediting sacrificing partners capital account and debiting gaining partners capital account)

Q. P,Q and R are partners sharing profits in the ratio of 3:2:1. R retires from the business. The balance in C's capital after making all adjustments shows a credit balance of Rs.1, 30,000. P and Q agreed to pay R Rs. 1, 70,000 in full settlement of C's account. Calculate the value of goodwill and write the journal entry for the same.

Hidden Goodwill = Settlement Amount – Amount due to the retiring partner after all adjustments

=1,70,000 – 1,30,000 = 40,000

Gaining Ratio = 3:2

Journal Entry:

P's Capital A/C Dr (40000 x 3/5) 24,000

Q's Capital A/C Dr (40000 x 2/5) 16,000

To R's Capital A/C 40000

(Being R's share of goodwill adjusted by P and Q in their gaining ratio 3:2)

III.Treatment of accumulated profit and losses

(a) In Case of Accumulated Profit:

General reserve, P &L Account **credit** balance, unused reserves like work men's compensation fund etc should be transferred to the credit side of the all partners capital account in their old ratio.

Journal Entry:

General Reserve A/C Dr

P & L A/C Dr

Workmen's Compensation Fund A/C Dr (Excess of reserve over liability)

Investment Fluctuation Fund A/C Dr (Excess of reserve over difference between book value and market value)

To All Partners Capital A/C (Individually, old ratio)

(Being accumulated profit distributed among all partners in their old ratio)

(b) In case of Accumulated loss:

Accumulated losses like **debit** balance of P & L Account (appearing on the asset side of the Balance sheet) should be written off by transferring such losses to the debit side of all partners capital account in their old profit sharing ratio.

Journal Entry:

All Partners' Capital A/C (Individually,Old Ratio)

To P & L Account

To Deferred Revenue expenditure A/C

(Being accumulated loss distributed among all partners in their old ratio)

IV Revaluation of Assets and Liabilities

The assets and liabilities should be revalued on the same basis as is done in case of admission of a partner. A revaluation account or profit and loss adjustment account is prepared for this purpose. The profit or loss on revaluation is transferred to **all** the partners' capital accounts in their old profit sharing ratio.

Journal entry If Revaluation Profit:

Revaluation A/C Dr

To All Partners Capital A/C (Individually, Old Ratio)

(Being revaluation profit distributed among all partners)

If Revaluation Loss:

All Partners Capital A/C Dr

To Revaluation A/C

(Being Revaluation loss distributed among all partners)

V Ascertainment of profit and loss upto the date of retirement

Where the retirement occurs on the last date of the financial year, determination of profit or loss of the firm is not a problem.But,where the retirement takes place **during the course of an accounting year**, the actual profit obtained or loss incurred from the last balance sheet to the date of retirement is to be ascertained. Generally it may be ascertained on the basis of last year's profit ,on the basis of the average profit of a certain number of year's etc.Such derived amount is only an estimate. Hence the journal entry for the same would be:

In case of profit:

Profit and Loss Suspense A/C Dr.

Retiring Partner's Capital A/C

(Being Retiring partner's share of profit upto the date of retirement)

Note: In this case, Profit and Loss Suspense A/C will show debit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the **asset side of the Balance sheet**

In Case of Loss:

Retiring Partner's Capital A/C Dr

Profit and Loss Suspense A/C

(Being Retiring partner's share of Loss upto the date of retirement)

Note: In this case, Profit and Loss Suspense A/C will show credit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the **Liability side of the Balance sheet.**

VI Calculation of Total Amount Due to the Retiring Partner

The total amount due to the retiring partner is determined by preparing his capital account on the date of retirement.

Retiring partner's capital account shall have the following items on the credit side:

- Capital on the date of last balance sheet
- Interest on capital, salary, commission etc.payable to him from the date of last balance sheet to the date of retirement.
- His share of goodwill of the firm
- His share of undistributed profits and reserves
- His share in revaluation profit
- His share in joint life policy surrender value
- His share in profit up to the date of retirement, since the last balance sheet

Retiring partner's capital account shall have the following items on the credit side:

- His share of accumulated losses
- His share of revaluation loss
- His drawings during the period
- His interest on drawings
- His share of loss till the date of retirement since the last Balance Sheet, if any

Retiring Partner's Capital Account (Specimen)

Particulars	Amount	Particulars	Amount
To Drawings	XXXX	By Balance b/d	XXXX
To Interest on Drawings	XXXX	By Gaining partners Capital(Retiring partner's share of goodwill)	XXXX
To Revaluation Loss (If any)	XXXX	By Reserves/ P & L A/C	XXXX
To Retiring Partner's Loan (B/F)	**XXXX**	By Revaluation Account (Profit)	XXXX
OR		By Joint life policy(Share of surrender value)	XXXX
To Cash/Bank (B/F)	**XXXX**		
	XXXX		XXXX

VII Settlement of total amount due to the retiring partner

The amount due to the retiring partner is settled as per the provisions of the partnership deed. It may be paid in full at the time of retirement. Sometimes, the firm may not be ina position to pay the amount due to him in lumpsum.In such a case, the amount due is transferred to retiring partner's loan account and is paid in instalments together with interest.

Note: According to section 37 of the Indian Partnership Act,1932,the outgoing(Retiring) Partner has an option to receive either interest **@ 6 % p.a** till the date of payment or such share of profit which has been earned with his money(based on capital ratio).

<u>Journal Entry-When retiring partner is paid cash in full (Lump Sum):</u>

Retiring Partner's Capital A/C Dr

To Cash/Bank

(Amount due to the retiring partner paid off)

<u>Journal Entry-When the retiring partner's whole amount is transferred to his loan account</u>

Retiring Partner's Capital A/C Dr

To retiring Partner's Loan A/C

(Amount due to the retiring partner transferred to his Loan A/C)

<u>Journal Entry-When the retiring partner is partly paid in cash and the remaining amount transferred to his loan account</u>

Retiring Partner's Capital A/C Dr (Total Amount Due)

To Cash/Bank (Amount paid)

To Retiring Partner's Loan (Amount transferred to loan)

(Amount due to the retiring partner is settled)

Loan account of the Rating Partner

Journal Entry: 1. When the amount due to the retiring partner is transferred to his loan account

Retiring Partner's Capital A/C Dr

To retiring Partner's Loan A/C

(Amount due to the retiring partner transferred to his Loan A/C)

2. When yearly interest due

Interest Account Dr (Interest of the current year)

Retiring Partner's Loan account

(Interest due)

3. For payment of yearly instalment (yearly Principal amount + Yearly interest)

Retiring Partner's Loan A/C Dr

To Cash/Bank

(Being yearly instalment paid)

Note: 1. Balance of retiring partner's loan account is shown on the liability side of the balance sheet.

2.Journal entry (2) and (3) above will be repeated till the loan is paid off.

Q.P,Q and R are partners in a firm .Q retires from the firm on 1-1-2014.On his date of retirement,Rs.1,20,000 is due to him and R promise to pay **four** equal annual instalments together with interest at 10% per annum.Prepare Q's Loan Account for the 4 Years.

Repayment period =4 yers

Amount of equal yearly instalment = 1,20,000/4 = 30,000

Total amount to be repaid each year = 30000 + Yearly interest

R's Loan Account

Date	Particulars	Amount	Date	Particulars	Amount
31-12-14	To cash (30,000+12,000)	42,000	1-1-14	By R's Capital A/C	1,20,000
31-12-14	To Balance c/d	90,000	31-12-14	By Interest (1,20,000*10%)	12,000
		1,32,000			1,32,000
31-12-15	To Cash (30,000 +9,000)	39,000	1-1-15	By Balance b/d	90,000
31-12-15	To Balance c/d	60,000	31-12-15	By Interest (90,000 *10%)	9,000
		99,000			99,000
31-12-16	To Cash (30,000 +6,000)	36,000	1-1-16	By Balance b/d	60,000
31-12-16	To Balance c/d	30,000	31-12-16	By Interest (60,000 *10%)	6,000
		66,000			66,000
31-12-17	To Cash (30,000 + 3,000)	33,000	1-1-17	By Balance b/d	30,000
			31-12-17	By Interest (30,000 *10%)	3,000
		33,000			**33,000**

Journal Entry for First Year:

Journal

Date	**Particulars**	**LF**	**Debit**	**Credit**
1-1-14	When Amount due to R transferred to his loan A/C **R's Capital A/C Dr** **To R's Loan A/C** (R's capital A/C closed by transfer it to R's Loan A/C)		**1,20,000**	**1,20,000**
31-12-14	When interest due at the end of the year: **Interest A/C Dr** **To R's Loan A/C** (Loan interest due for one year)		**12,000**	**12,000**

31-12-14	When first instalment paid (Interest +1st instalment of Principal amount) **R's Loan A/C Dr** **To Cash** (First instalment paid)		**42,000**	**42,000**

Note: 2nd and 3rd will be repeated for 3 more years.

Ascertainment of deceased partner's share of profit and loss upto the date of Death

Where the death occurs on the last date of the financial year, determination of profit or loss of the firm is not a problem.But,where the death takes place during the course of an accounting year, the actual profit obtained or loss incurred from the last balance sheet to the date of death is to be ascertained. Generally it may be ascertained on the basis of last year's profit ,on the basis of the average profit of a certain number of year's etc.Such derived amount is only an estimate.Hence the journal entry for the same would be:

In case of profit:

Profit and Loss Suspense A/C Dr.

Deceased Partner's Capital A/C

(Being deceased partner's share of profit upto the date of death)

Note: In this case, Profit and Loss Suspense A/C will show debit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the asset side of the Balance sheet

In Case of Loss:

Deceased Partner's Capital A/C Dr

Profit and Loss Suspense A/C

(Being deceased partner's share of Loss upto the date of death)

Note: In this case, Profit and Loss Suspense A/C will show credit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the Liability side of the Balance sheet.

Calculation of interest on deceased partner's capital (If any)

Example:

If the balance of deceased partner's capital as on 1-1-2013 is Rs.50,000.He dies on 31-03-2013 and interest is allowed @10%.The interest for 3 months, the life time of the deceased partner during the current year will be calculated as under.

Interest on capital = 50000 x 10/100 x 3/12 =1250

Journal Entry

Interest on Capital A/c Dr 1250

To deceased Partner's capital A/c 1250

Settlement of Amount due to the deceased partner

(1) When the amount due to the deceased partner is transferred to his Executor's Loan A/C

Deceased Partner's Capital A/C Dr

Deceased Partner's Executor's Loan A/C

(Amount due to the deceased partner is transferred to his executors loan A/C)

(2) When the balance appearing in the Executor's Loan Account is paid off

Deceased Partner's Executor's Loan A/C

To cash

(Being deceased partner's executor's loan paid off)

Joint Life Policy

When a partner dies, his legal representatives are to be paid a large sum of money. If some arrangement is not made, it may affect the financial position as well as working of the partnership firm. So in order to generate such funds, generally, a joint life policy on the lives of partners is taken by the firm. If any of the partner dies, the insurance company pays the sum assured.

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Chapter-5

Dissolution of Partnership Firm

Focused Area- Chapter-5

1. Dissolution of Partnership
2. Dissolution of a firm
3. Distinction between dissolution of partnership and dissolution of firm
4. Preparation of realization Account

Dissolution of Firm is entirely different from Dissolution of Partnership. Dissolution of Firm leads to complete closure of a partnership business. In case of dissolution of partnership, the business may continue with a new agreement, but in dissolution of firm, business will not continue.

Dissolution of Partnership

Any change in the relation between partners leads to dissolution of partnership. At the time of change in profit sharing ratio between partners, admission, retirement, death etc. of partners cause change in the relationship between partners. In all these cases dissolution of partnership takes place. At the time of dissolution of partnership, the business can continue with a new agreement.

Situations (reasons) of Dissolution of Partnership

1) Admission of a new partner
2) Retirement/death of an existing partner
3) Change in profit sharing ratio among partners
4) Amalgamation of firms

In all the above cases the firm can continue its business with a new agreement, there is no need to close (Dissolution of Firm) the firm.

Dissolution of a Firm

Dissolution of Firm means complete closure of the business. Dissolution of a firm also known as winding up of a firm, results in termination of relationship between all partners and stoppage of business. At the time of dissolution of firms, all assets of the firm are sold, cash realized and with that cash liabilities are to be paid off. If there is any cash, balance left, it will be distributed among the partners as per their ratio.

Distinguish between Dissolution of Partnership and Dissolution of Firm

Basis	Dissolution of Partnership	Dissolution of Firm
Meaning	Relation of partnership among different partners changes	Partnership between all the partners of a firm comes to an end
Termination of business	Business is not terminated, it can continue with new agreement	On dissolution of firm, business will not continue.
Settlement of Assets & Liabilities	Assets and Liabilities are revalued	Assets are realized and liabilities are paid off
Economic relationship among partners	Economic relationship often changes	Economic relationship comes to an end
Preparation of Balance Sheet	Assets and liabilities are revalued and new balance sheet prepared	There is no scope for balance sheet as the accounts of assets and liabilities are closed

Modes of Dissolution of a Firm

Dissolution of a firm takes place in the following ways:

I. Dissolution by Agreement
II. Compulsory Dissolution
III. On the happening of certain contingencies
IV. Dissolution by notice
V. Dissolution by court

I. Dissolution by agreement

A firm is dissolved

a) With the consent of all the partners
b) As per the terms of the partnership agreement

II. Compulsory Dissolution

A firm is dissolved compulsorily in the following cases:

a) When the business of the firm becomes illegal
b) When all the partners or all except one become insolvent
c) When all the partners or all except one decide to retire from the firm
d) When all the partners or all except one die

III. On the happening of certain contingencies

In the absence of an agreement to the contrary, a firm will be dissolved in the following cases:

a) If the constituted for a fixed period, by the expiry of that term
b) If constituted to carry out one or more ventures, by the completion thereof;
c) By the death of a partner

d) By the declaration of a partner as an insolvent

IV. **Dissolution by notice**

In case of a partnership at will, the firm may be dissolved if any one of the partners gives a notice in writing to the other partners, signifying his intention to dissolve the firm.

V. **Dissolution by court**

At the suit of a partner, the court may order a partnership firm to be dissolved on any of the following ground:

a) When a partner becomes of unsound mind
b) When a partner becomes permanently incapable of performing his duties as a partner
c) When the partner transfers whole of his interest in the firm to a third party
d) When the business of the firm is can't be carried on at a loss.
e) When the partner commits breach of agreement relating to the management of the firm
f) When, on any ground, the court regards dissolution to be just and equitable.

Accounting Treatment

On dissolution of a firm, the firm ceases (stop) to conduct business and has to settle its accounts. So at the time of dissolution of a firm, books of accounts are to be closed, assets realized, liabilities are to be paid off and balance if any, distributed among partners according to their ratio. In this process the following accounts are prepared:

i. Realisation Account
ii. Partners Capital Account
iii. Bank/Cash Account

Realisation Account

Realisation account is a nominal account. It is prepared at the time of dissolution of a firm.Realisation account is prepared to close the accounts of assets and liabilities and to find out profit or loss on realization of assets and repayment of liabilities.

All assets except cash, bank and fictitious assets are closed by transfer it to the debit side of the realization account at its book values and all external liabilities are closed by transfer it to the credit side of the realization account at its book value. Any provision relating to asset/liability must also be transferred to the realization account. Amounts realized are credited and liabilities settled are debited to this account.Realisation expense is debited to this account. At last this account is closed by transferring the realization profit or loss to partner's capital accounts.

Journal Entries in connection with Realisation Account

1.To close assets: All assets except cash, bank and fictitious assets (P&l account debit balance) are closed by transferring it to the debit side of the realization account at their book value. **Note-1**:Cash/bank account balance opened in Cash/Bank account. **Note-2**:Sundry debtors should be transferred to realization account at its full value(without deducting provision, if any)	**Realisation A/C Dr** **To Assets (Individually)** (Being assets closed)
2.To close external liabilities: All external liabilities are closed by transferring it to the credit side of the realization account at its book value ***Example for external liabilities:*** Creditors, bills payable, bank over draft, outstanding liabilities, partners wife's loan etc.	**External Liabilities A/C Dr** **To Realisation A/C** (Being liabilities closed)
3.To close provision against various assets like provision for doubtful debts, provision for depreciation etc.(Provision against asset is a liability)	**Provision for doubtful debts A/C Dr** **Provision for depreciation A/C Dr** **Joint life policy reserve A/C Dr** **Contingency Reserve A/C Dr** **Investment fluctuation fund A/C Dr** **To Realisation A/C** (Being provision against to assets closed)
4. To close provision against various liabilities like provision for discount on creditors.(Provision against liability is an asset)	**Realisation A/C Dr** **To Provision for discount on creditors** (Being provision for discount on creditors closed)
5.When closed assets realized(Sold)	**Cash/Bank A/C Dr** **To Realisation A/C** (Being assets sold)

6.When closed assets taken over by a partner	**Particular Partner's Capital A/C Dr** **To Realisation A/C** (Being assets taken over by a partner)
7.When closed liabilities paid off	**Realisation A/C Dr** **To Cash** (Being liabilities paid off)
8.When closed liabilities taken over by a partner	**Realisation A/C Dr** **To Particular partner's Capital A/C** (Being liabilities taken over by a partner)
9.When realization expense paid	**Realisation A/C Dr** **To Cash/Bank** (Being realization expense paid)
10.When realization expense taken over by a partner	**Realisation A/C dr** **To Particular Partner's Capital A/C** (Being realization expense taken over by……)
11.For the amount realized from unrecorded assets	**Cash/Bank A/C Dr** **To Realisation A/C** (Being cash realized on unrecorded assets)
12.When unrecorded assets taken over by a partner	**Particular partner's capital A/C Dr** **To realization A/c** (Being unrecorded assets taken over by a partner)
13.When payment of an unrecorded liability	**Realisation A/C Dr** **To Cash/ Bank** (Unrecorded liability paid off)
14.When unrecorded liability taken over by a partner	**Realisation A/C Dr** **To Particular partner's capital A/C** (Being unrecorded liability taken over by…..)
15.Settlement with outside liabilities like creditors through assets/unrecorded assets	When creditor(a liability)accepts an asset in full and final settlement,No **Entry is required** The reason is that, the liability(here creditors) has already been closed by crediting it to realization account. The **particular asset account** is also closed by

	transferring it to the debit side of the realization accont.Some times, the creditor may accept the part of his payment in cash and part of his payment by taking over an asset. In this case, the entry will be made for the cash payment only.
16.For Closing Realisation Account: ***(a)If Realisation Profit:-***	**Realisation A/C Dr** **To Partners' Capital A/C** (Being Realisation profit distributed among partners)
16. For Closing Realisation Account: ***(b)If Realisation Loss:-***	**Partners' Capital A/C Dr** **To Realisation A/C** (Being Realisation loss distributed among partners)
17.Payment of partner's loan **Note:** Partner's loan directly paid off. (Never transferred to Realisation A/C)	**Partner's Loan A/C Dr** **To Cash** (Being partners loan paid off)
18.Receipt of partner's loan **Note:** Sometimes, firm advances some amount to partner(It is an asset to the firm).It is directly collected from partner's, not transferred to realization account	**Cash/Bank A/C Dr** **To Partner's Loan A/C** (Cash received against patrtner's loan)
19.For closing of current account: ***If it show credit balance:***	**Partner's Current A/C Dr** **To Partner's capital A/C** (Being current account is closed by transfer it to his capital account)
20.For closing of current account: ***If it show debit balance:***	**Partner's Capital A/C Dr** **To Partner's Current A/C** (Being current account is closed by transfer it to his capital account)
21.For closing capital A/C (If it shows credit balance and cash paid off in final settlement)	**Partner's Capital A/C Dr** **To Cash/Bank** (Being capital Account closed)

22.For closing capital A/C (If it shows debit balance and balance brought in by the new partner in final settlement)	**Cash/Bank A/C Dr** **To Partnere's Capital A/C** (Being capital Account closed)

Treatment of goodwill:-On dissolution of Firm, goodwill is treated like an ordinary asset. No special treatment is required. If it appears in the Balance Sheet, it is closed by transferring it to the debit side of the realization account at its book value. If any amount is realized for goodwill, the amount is credited to realization Account

Proforma of Realisation Account

Particulars	Amount	Particulars	Amount
To Assets (To close assets)	XXX	**By Liability Account** (To close external liabilities)	XXX
To Provision against Assets	XXX	**By Provision against asset**	XXX
To Cash (Payment of liabilities)		**By Cash** (Assets realized)	XXX
To Partner's Capital (Liability taken over by a partner)	XXX	**By Partner's capital** (Assets taken over)	XXX
To Cash (Realisation expense paid)	XXX	**By Cash** (Realised from unrecorded assets)	XXX
To Partner's capital (Realisation expense taken over by a partner)	XXX	**By Partner's capital** (Unrecorded asset taken over by a partner)	XXX
To Cash(Payment of unrecorded liability)	XXX	**By Partners Capital A/C** (Loss on realization,if any)	XXX
To partner's capital (when unrecorded liability discharged by a partner)	XXX		
To partners capital A/C(Profit on realization)	XXX		
	XXXX		**XXXX**

Difference between Revaluation account and Realisation account

Revaluation Account	Realisation Account
Revaluation account is prepared at the time of admission,retirement,death or change in profit sharing ratio of a partner	Realisation account is prepared at the time of Dissolution of Firm
It records only changes in values of assets and liabilities	Assets and liabilities are shown at the book values
Revaluation account is prepared to find out profit or loss on revaluation of assets and reassessment of liabilities	It is prepared to find out profit or loss on realization of assets and payment of liabilities.

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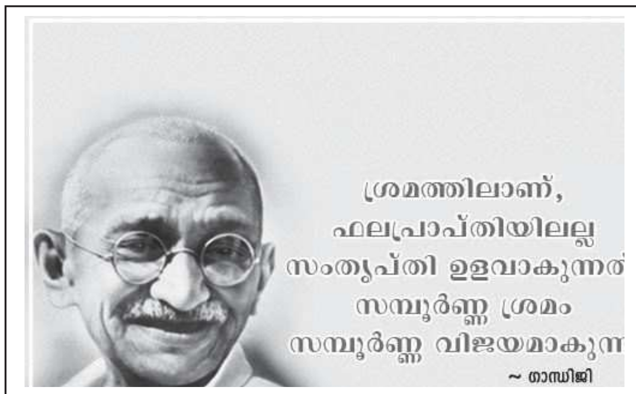

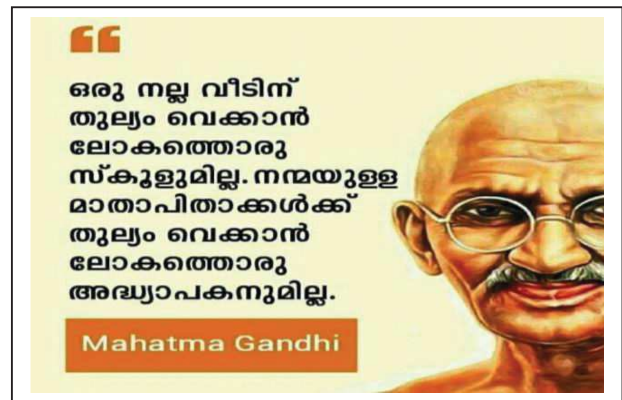

Work hard to achieve your goal. Wish you all success and bright future………………

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