Partnership Accounts

Fundamentals Of Accounting

Goodwill

Computation and Accounting

METHOD FOR GOODWILL VALUATION

There are four methods for valuation of goodwill

1) Average profit basis,

2) Super profit basis,

3) Annuity basis, and

4) Capitalisation basis

Illustration 1

Lee and Lawson are in equal partnership. They agreed to take Hicks as one-fourth partner. For this it was decided to find out the value of goodwill. M/s. Lee and Lawson earned profits during 2002-2005 as follows:

Year	**Profits (Rs.)**
2002	1,20,000
2003	1,25,000
2004	1,30,000
2005	1,50,000

Continued

On 31.12.2005 capital employed by M/s. Lee and Lawson was Rs. 5,00,000. Rate of normal profit is 20%.

Find out the value of goodwill following various methods.

Solution

Year		Profit	Weight Rs.	Weighted Profit Rs.
2002		1,20,000	1	1,20,000

Method (1) : Average Profit

2003		1,25,000	2	2,50,000
2004		1,30,000	3	3,90,000
2005		1,50,000	4	6,00,000
			10	13,60,000

Weighted Average Profit Rs. = 1,36,000

Assumption : Goodwill is valued at 3 year's purchase

Value of Goodwill :

Rs. 1,36,000 x 3 = Rs. 4,08,000

Method (2) : Super Profit Basis

Average Profit	Rs. 1,36,000
Less : Normal Profit	
20% on Rs. 5,00,000	Rs. 1,00,000
	Rs. 36,000

Assumption : Goodwill is valued at 3 years purchase.

Value of Goodwill:Rs. 36,000 x 3 = Rs. 1,08,000

Method (3) : Annuity Basis

Assumptions:

(a) Interest rate is equivalent to normal profit rate i.e. 20% p.a.

(b) Goodwill is valued at 3 years purchases

Valuation of Goodwill :

Rs. 36,000 x 2.1065 = Rs. 75,834

Method (4) : Capitalisation Basis

Normal Value of Capital employed :

$$\frac{1{,}36{,}000}{20} \times 100 = \text{Rs. } 6{,}80{,}000$$

Capital Employed in M/s. Lee and Lawson	=	Rs. 5,00,000
Goodwill	=	Rs. 1,80,000

Illustration 2

The following particulars are available in respect of the business carried on by Rathore

			Rs.
(1)	Capital Invested		1,50,000
(2)	Trading Results :		
	2002	Profit	40,000
	2003	Profit	36,000

Continued

2004	Loss	6,000
2005	Profit	50,000

(3) Market Rate of Interest on investment 10%

(4) Rate of risk return on capital invested in business 2%

(5) Remuneration from alternative employment of the proprietor Rs. 6000

(if not engaged in business). per annum

Continued

You are requested to compute the value of goodwill on the basis of 5 years' purchase of super profit of the business calculated on the average profits of the last four years.

Solution

Average maintainable profits		*Rs.*
Trading profit during	2002	40,000
	2003	36,000
	2005	50,000

Continued

	1,26,000
Less: Loss during 2004	6,000
Total	1,20,000
Average Profits (Total ¼)	30,000
Less: Remuneration for the proprietor	6,000
Average maintainable Profit	24,000

Continued

Normal Profit (12% on capital employed)	18,000
Super Profit	6,000
Goodwill at 5 year's purchase of super Profit	30,000

Example 1

A, B & C are in partnership sharing profits and losses in the ratio 2:2:1. They want to admit D into partnership with one-fifth share. D brings in Rs. 30,000 as capital and Rs. 10,000 as premium for goodwill.

The necessary journal entry will be:

Bank A/c	Dr.	Rs. 40,000	
To A’s Capital A/c			Rs. 4,000
To B’s Capital A/c			Rs, 4,000

Continued

To C’s Capital A/c	Rs. 2,000
To D’s Capital A/c	Rs. 30,000

(Amount brought in by D,
Premium for goodwill credited
to existing partners’ capital
accounts in profit sacrificing ratio)

Example 2

A & B are equal partners. They wanted to take C as a third partner and for this purpose goodwill was valued at Rs. 1,20,000. The journal entry for adjustment of value of goodwill through partner's capital accounts will be:

C's Capital A/c	Dr.	Rs. 40,000	
To A's Capital A/c			Rs. 20,000
To B's Capital A/c			Rs. 20,000

(Adjustment for goodwill)

Continued

The net effect in partner capital accounts is shown on the basis of profit sacrificing ratio:

A = 1/6 x Rs. 1,20,000 = Rs. 20,000 (Cr.)

B = 1/6 x Rs. 1,20,000 = Rs. 20,000 (Cr.)

C = 1/3 x Rs. 1,20,000 = Rs. 40,000 (Dr.)

Example 3

A & B are equal partners. They wanted to admit C as 1/6th partner who brought Rs. 60,000 as goodwill. The new profit sharing ratio is 3:2:1. Profit sacrificing ratio is to be computed as follows:

Old share – New Share = Share Sacrificed

A = 1/2 less 3/6 = 0

B = 1/2 less 2/6 = 1/6

Continued

So the entire goodwill should be credited to B's Capital A/c.

Cash A/c	Dr.	Rs.	60,000
To B's Capital A/c			Rs. 60,000

(Goodwill brought in by C credited to B's Capital A/c)

Example 4

A, B & C are equal partners. They decided to take D who brought in Rs. 36,000 as goodwill. The new profit sharing ratio is 3:3:2:2.

Old Share – New Share = Share Sacrificed

A = 1/3 less 3/10 = 1/30

B = 1/3 less 3/10 = 1/30

C = 1/3 less 2/10 = 4/30

Continued

So goodwill should be shared in the ratio 1:1:4

Cash A/c	Dr.	Rs.	36,000
To A's Capital Account		Rs.	6,000
To B's Capital Account		Rs.	6,000
To C's Capital Account		Rs.	24,000

(Goodwill brought in by D credited to old partner's accounts in their profit sacrificing ratio 1:1:4)

Note:

Instead of adjusting the value of goodwill of the firm through partner's capital accounts without raising goodwill account in the books, another practice is also followed. The practice is to first raise the goodwill account in the books by crediting the value of goodwill to existing partner's capital accounts in old profit sharing ratio and then immediately writing off the value of goodwill by debiting all partner capital accounts in new profit sharing ratio.

Illustration 3

A,B & C are equal partners. They wanted to change the profit sharing ratio into 4:3:2. They raised the goodwill Rs. 90,000 but they want to immediately write it off. Make the necessary journal entries.

Solution

Journal Entry

		Rs.	Rs.
A's Capital	Dr.	10,000	
To C's Capital A/c			10,000

In this case due to change in profit sharing ratio

Continued

A's gain is = 4/9 less 1/3 = 1/9

B's gain is = 1/3 less 1/3 = 0

C's loss is = 1/3 less 2/9 = 1/9

So, A should compensate C to the extent of 1/9th of goodwill i.e.

Rs. 90,000 x 1/9 = Rs. 10,000

Illustration 4

Wise, Clever and Dull were trading in partnership sharing profits and losses 4:3:3 respectively. The accounts of the firm are made upto 31st December every year.

The partnership provided, inter alia, that:

On the death of a partner the goodwill was to be valued at three years' purchase of average profits of the three years upto the date of the

Continued

Death after deducting interest @ 8 per cent on capital employed and a fair remuneration of each partner. The profits are assumed to be earned evenly throughout the year.

On 30th June, 2005, Wise died and it was agreed on his death to adjust goodwill in the capital accounts without showing any amount of goodwill in the Balance Sheet.

Continued

It was agreed for the purpose of valuation of goodwill that the fair remuneration for work done by each partner would be Rs. 15,000 per annum and that the capital employed would be Rs. 1,56,000. Clever and Dull were to continue the partnership, sharing profits and losses equally after the death of Wise.

The following were the amounts of profits of earlier years before charging interest on capital employed.

Continued

	Rs.
2002	67,200
2003	75,600
2004	72,000
2005	62,400

You are requested to compute the value of goodwill and show the adjustment thereof in the books of the firm.

Solution

Computation of the value of goodwill:

(i) Average Profit for three years, ending 30th June; before death:

	Rs.	Rs.
Year ending 30th June, 2003:		
1/2 of 2002 profits	33,600	
1/2 of 2003 profits	37,800	71,400

Continued

Year ending 30th June, 2004:		
1/2 of 2003	37,800	
1/2 of 2004 Profits	36,000	73,800
Year ending 30th June, 2005:		
1/2 of 2004	36,000	
1/2 of 2005 Profits	31,200	67,200
Total		2,12,400
Average		70,800

Continued

(ii) Super Profit:

Average profit earned		70,800
Less: Partner's remuneration	45,000	
Less: 8% on capital employed	12,480	57,480
Super Profits:		13,320

Continued

(iii) Goodwill @ three years' purchase

Adjustment entries for Goodwill

Journal

		Dr. Rs.	Cr. Rs.
Clever's Capital Account	Dr.	7,992	
Dull's Capital Account	Dr.	7,992	
To Wise's Capital Account			15,984

Continued

(Adjusting entry passed for share of goodwill of wise through remaining partners' capital account in gaining ratio)

Working Note:

Partner	*New Share*		*Old Share*		*Difference*
Wise	-	-	$\frac{4}{10}$	=	$-\frac{4}{10}$
Clever	½	-	$\frac{3}{10}$	=	$\frac{2}{10}$
Dull	½	-	$\frac{3}{10}$	=	$\frac{2}{10}$

MULTIPLE CHOICE QUESTIONS

On GOODWILL

MCQ 1

1. The profits of last five years are Rs. 85,000; Rs. 90,000; Rs. 70,000; Rs. 1,00,000 and Rs. 80,000. Find the value of goodwill, if it is calculated on average profits of last five years on the basis of 3 years of purchase.

   (a) Rs. 85,000 (b) Rs. 2,55,000

   (c) Rs. 2,75,000 (d) Rs. 2,85,000

MCQ 2

2. The profits of last three years are Rs. 42,000; Rs. 39,000 and Rs. 45,000. Find out the goodwill of two years purchase.

   (a) Rs. 42,000 (b) Rs. 84,000

   (c) Rs. 1,26,000 (d) Rs. 36,000

MCQ 3

3. The capital of A and B sharing profits and losses equally are Rs. 90,000 and Rs. 30,000 respectively. They value the goodwill of the firm at Rs. 84,000, which was not recorded in the books. If goodwill is be raised now, by what amount each partner's capital account will be debited:

(a) Rs. 21,000 and Rs. 63,000.

(b) Rs. 42,000 and Rs. 42,000.

(c) Rs. 63,000 and Rs. 21,000.

(d) Rs. None of the above.

MCQ 4

4. Find the goodwill of the firm using capitalization method from the following information: Total Capital Employed in the firm Rs. 8,00,000

Reasonable Rate of Return 15%

Profits for the year Rs. 12,00,000

(a) Rs. 82,00,000 (b) Rs. 12,00,000

(c) Rs. 72,00,000 (d) Rs. 42,00,000

MCQ 5

5. The capital of B and D are Rs. 90,000 and Rs. 30,000 respectively with the profit sharing ratio 3:1. The new ratio, admissible after 01.04.2006 is 5:3. Goodwill valued on 02.04.2006 as Rs. 84,000 will be credited to B and D's capital by Rs………..and Rs…….

a. 63,000 and 21,000. b. 50,000 and 34,000.

c. 52,500 and 31,500. d. 60,000 and 24,000.

MCQ 6

6. The capital of B and D are Rs. 90,000 and Rs. 30,000 respectively with the profit sharing ratio 3:1. The new ratio, admissible after 01.04.2006 is 5:3. The goodwill is valued Rs. 80,000 as on that date. Amount payable by a gaining partner to a scarifying partner is:

(a) B will pay to D Rs. 10,000

(b) D will pay to B Rs. 10,000

(c) B will pay to D Rs. 80,000

(d) D will pay to B Rs. 80,000

MCQ 7

7. A, B and C are equal partners. D is admitted to the firm for one-fourth share. D brings Rs. 20,000 capital and Rs. 5,000 being half of the premium for goodwill. The value of goodwill of the firm is

(a) Rs. 10,000 (b) 40,000

(c) Rs. 20,000 (d) None of the above

MCQ 8

8. The profits for 1998-99 are Rs. 2,000; for 1999-2000 is Rs. 26,100 and for 2000-01 is Rs. 31,200. Closing stock for 1999-2000 and 2000-01 includes the defective items of Rs. 2,200 and Rs. 6,200 respectively which were considered as having market value NIL. Calculate goodwill on average profit method.

(a) Rs. 23,700. (b) Rs. 17,700

(c) Rs. 13,700 (d) Rs. 17,300

MCQ 9

9. A and B are partners with capitals of Rs. 10,000 and Rs. 20,000 respectively and sharing profits equally. They admitted C as their third partner with one-fourth profits of the firm on the payment of Rs. 12,000. The amount of hidden goodwill is

(a) 6,000 (b) 10,000

(c) 8,000 (d) None of the above

MCQ 10

10. X and Y share profits and losses in the ratio of 2:1. They take Z as a partner and the new profit sharing ratio becomes 3:2:1. Z brings Rs. 4,500 as premium for goodwill. The full value of goodwill will be

(a) Rs. 4,500 (b) Rs. 18,000

(c) Rs. 27,000 (d) Rs. 24,000

ADMISSION – Issues

- Ratios – Sacrificing and New ratio
- Revaluation A/c
- Accumulated Reserves and Surplus
- Goodwill
- Capital Adjustment

Illustration 1

A and B are partners in a firm, sharing profits and losses in the ratio of 3:2. The Balance Sheet of A and B as on 1.1.2006 was as follows:

Liabilities		Amount Rs	Assets	Rs	Amount
Sundry Creditors		12,900	Building		26,000
Bills Payable		4,100	Furniture		5,800
Bank overdraft		9,000	Stock-in-trade		21,400
Capital accounts:			Debtors	35,000	
A	44,000		Less Provision	200	34,800
B	36,000	80,000	Investment		2,500
			Cash		15,500
		1,06,000			1,06,000

‘C’ was admitted to the firm of the above date on the following terms:

1. He is admitted for 1/6 share in the future profits and to introduce a capital of Rs 25,000.
2. The new profit sharing ratio of A,B and C will be 3:2:1 respectively.
3. ‘C’ is unable to bring in cash for his share of good will,

partners therefore, decided to raise goodwill accounts in the books of the firm. They further decide to calculate goodwill on the basis of C’s share in the profits and the capital contribution made by him to the firm.

4. Furniture is to be written down by Rs 870 and stock to be depreciated by 5% .

A provision is required for debtors @ 5% for bad debts. A provision would also be made for outstanding wages for Rs 1560. The Value of buildings having appreciated be brought upto Rs. 29,200. The value of investments is increased by Rs 450.

5. It is found that the creditors included a sum of Rs.1,400, which is not to be paid off prepare the following:

(i) Revaluation accounts.

(ii) Partners' capital accounts

Solution

Revolution Accounts

Dr.	Rs		Cr. Rs
To furniture	870	By building	3,200
To Stock	1,070	By Sundry Creditors	1,400
To Provision for			
Doubtful debts		By Investment	450
(Rs1,750-Rs200)	1,550		
To Outstanding			
wages	1,560		
	5,050		5,050

Partner Capital Accounts

	A Rs	B Rs	C Rs		A Rs	B Rs.	C Rs
To balance b/d	71,000	54,000	25,000	By balance b/d	44,000	36,000	-
				By cash A/c	-	-	25,000
				By Goodwill A/c			25,000
				(Working note)	27,000	18,000	-
	71,000	54,000	25,000		71,000	54,000	25,000

Working Note

Calculation of goodwill:.

C's contribution of Rs. 25,000 consists of only 1/6th of capital. Therefore, total capital of firm should be Rs. 25,000 x 6 =Rs 1,50,000 But combined capital of A,B,C amount Rs. 44,000 + 36,000 +25,000 = Rs1,05,000 Thus, the hidden goodwill is Rs 45,000 (Rs. 150,000- Rs 1,05,000)

Illustration 2

A and B are in the partnership sharing profits and losses in the proportion of three-fourth and one—fourth respectively. Their balance sheet as on 31st March 2005 was as follows:

Cash Rs. 1,000; sundry debtors Rs. 25000; stock Rs 22,000: plant and machinery Rs 4,000; sundry creditors Rs 12,000; bank overdraft Rs 15,000; A's capital Rs 15,000; B's capital Rs 10,000.

Continued

on 1st April, 2005, they admitted C into partnership on the following terms:

(i) C to purchase one-third of t he goodwill for Rs. 2,000 and provide Rs. 10,000 as capital Goodwill not to appear in books.

(ii) Further profits and losses are to be shared by A,B and C equally.

Continued

(iii) Plants and machinery is to be reduced by 10% and Rs 500 is to be provided for estimated bad debts. Stock is to be taken at a valuation of Rs. 24,940.

(iv) By bringing in or withdrawing cash and capitals of A and B are to e make proportionate to that of V on their profit-sharing basis.

Solution

		Dr (Rs)	Cr. (Rs)
Revaluation Account	Dr	900	
To plant and machinery account			400
To Provision for bad debts accounts			500
(Plants & machinery reduced by 10%			
And Rs. 500 provided for bad debts)			

Stock Account	Dr	2940	
To Revaluation Accounts			2,940
(Value of stock increased by Rs.2940)			
Revaluation Account	Dr	2,040	
To A's capital Account			1,530
To B's capital Account			510
(Profit on revaluation transferred)			

Cash Account	Dr	10,000	
To C's capital Account			10,000
(Cash brought in by C as his capital)			
Cash Account	Dr	2,000	
B's capital Account	Dr	500	
To A's capital Account			2,500
(Entry for goodwill purchased by B and C)			

A’s capital Account	Dr.	9,030	
B’s capital Account	Dr.	10	
To Cash Account			9,040

(Excess amount of capital withdrawn)

	A Rs	B Rs	C Rs		A Rs	B Rs	C Rs
To A's capital		500		By Balance b/d	15,000	10,000	-
To Cash	9,030	10		By Revaluation A/c	1,530	510	-
To Balance b/d	10,000	10,000	10,000	By Cash By B's capitals A/c	2,000 500	-	10,000
	19,030	10,510	10,000		19,030	10,510	10,000

Working Note

Calculation of goodwill

C pays Rs. 2,000 on account of goodwill for 1/3rd share of profit/ loss. Total goodwill is Rs. 2,000 x 3 =Rs. 6,000.

Gaining ratio:

B:1/3-1/4 = 1/12

C: 1/3

Continued

Goodwill to be paid to A:

By B Rs. 6,000 x 1/12 =	Rs. 500.
By C Rs. 6,000 x 1/3 =	Rs 2,000
Total	Rs. 2,500

MULTIPLE CHOICE QUESTIONS

ADMISSION

MCQ 1

1. A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?

   a. 35:42:17.
   b. 35:21:24.
   c. 49:22:29.
   d. 34:20:12

MCQ 2

2 A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5th share from A and 1/10th from B, new profit sharing ratio will be

a. 5:6:3. b. 2:4:6

c. 18:24:38 d. 17:11:12

3 C was admitted in a firm with 1/4th share of the profit of the profits of the firm. C contributes Rs. 15,000 as his capital. A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A and B, if capital should be in profit sharing ratio taking C's as base capital.

A. Rs. 27,000 and Rs 16,000 for A and B respectively.
B. Rs. 27,000 and Rs. 18,000 for A and B respectively.
C. Rs. 32,000 and Rs. 26,000 for A and B respectively.
D. Rs. 31,000 and Rs.26,000 for A and B respectively.

MCQ 4

4 A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take D into partnership for 1/8th share of profits. Find the new profit sharing ratio.

a. 12;27:36:42 b. 14:7:7:4.

c. 1:2:3:4. d. 7:5:3:1

MCQ 5

5 X and Y are partners sharing in the ratio 5:3. They admitted Z for 1/5th share of profits, for which he paid Rs. 1,20,000 against capital and Rs. 60,000 against goodwill. Find the capital balance for each partner taking Z's capital as base capital.

a. 3,00,000; 1,20,000 and 1,20,000.

b. 3,00,000; 1,20,000 and 1,80,000.

c. 3,00,000; 1,80,000 and 1,20,000.

d. 3,00,000; 1,80,000 and 1,80,000

MCQ 6

6 A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is Rs. and B's Capital is Rs 15,000). They admitted C agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?

a. Rs. 9,000. b. Rs 12,000.

c. Rs. 14,500. d. Rs. 11,250.

7 A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who bring in Rs. 25,000 against capital and Rs. 10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.

a. 8,000:2,000.

b. 5,000:5,000.

c. Old partners will not get any share in the goodwill bought in by C.

d. 6,000:4,000.

8 A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs.25,000 against capital and Rs. 10,000 against goodwill. New profit sharing ratio is 1:1:1. C is able to bring Rs. 30,000 only. How this will be treated in the books of the firm.

a. A and B will share goodwill bought by C as 4,000:1,000.
b. Goodwill will be raised to Rs. 15,000 in old profit sharing ratio.
c. Both.
d. None

9 A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs. 25,000 against capital and Rs. 10,000 against goodwill. New profit sharing ratio is 1:1:1. C is able to bring only his share of capital. How this will be treated in the books of the firm.

a. A and B will share goodwill bought by C as 4,000:1,000.

b. Goodwill will be raised to Rs. 30,000 in old profit sharing ratio.

c. Both.

d. None

10. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs 25,000 against capital and Rs. 10,000 against goodwill. New profit sharing ratio is 1:1:1. C bought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm

a. Cash bought in by C will only be credited to his capital account.
b. Goodwill will be raised to full value in old ratio.
c. Goodwill will be raised to full value in new ratio.
d. Cash bought by C will be credited to his account and debited with his share of goodwill, which will be debited to A and B's account in sacrificing ratio.

PARTNERSHIP

RETIREMENT

Illustration 1

F,G, and K were partners sharing profit and losses at the 2:2:1. K wants to retire on 31.12.2005. Given below is the Balance Sheet of the partnership as well as other information:

Balance sheet as on 31.12.2005

Liabilities	Rs.	Assets	Rs.
Capital A/C's		Sundry Fix Assets	1,50,000
F			
G	1,20,000		50,000
K	80,000	Stock	50,000
Reserve	60,000	Debtors	20,000
Sundry	10,000	Bills Receivable	50,000
Creditors	50,000	Bank	
	3,20,000		3,20,000

F and G agree to share profits and losses at the ratio at the ratio of 3:2 in future. Value of Goodwill is taken to be Rs. 50,000. Sundry Fixed Assets are revalued upward by Rs. 30,000 and stock by Rs. 10,000. Bills Receivable dishonoured Rs. 5,000 on 31.12.2005 but not recorded in the books. Dishonour of bill was due to insolvency of the customer. F and G agree to bring sufficient cash to discharge claim of K and make their capital proportionate. Also they wanted to maintain Rs. 75,000 bank balance for working capital. However they did not want to show goodwill in the books of accounts. Pass necessary journal entries and draft the Balance Sheet of Ms/ F & G.

	Rs.	Rs.
(1) F's Capital A/c Dr	10,000	
To K's Capital A/c		10,000
(Being the adjustment for goodwill		
on K's Retirement)- Refer W.N		
(2) Reserve A/c Dr	10,000	
To F's Capital A/c		4,000
To G's Capital A/c		4,000
To K's Capital A/c		2,000
(Transfer of Reserve to Partners'		
Capital A/cs on K's retirement)		

	Rs.	Rs.
(3) Sundry Fixed Assets A/c Dr.	30,000	
Stock A/c Dr.	10,000	
To Profit and Loss Adjustment A/c		40,000
(Increase in the value of Sundry Fixed Assets and Stock recorded)		
(4) Profit and Loss Adjustment A/c Dr.	5,000	5,000
To Bills Receivable A/c		
(Loss arising out of dishonoured bill recorded)		

	Rs.	Rs.
(5) Profit and Loss Adjustment A/c Dr	35,000	
To F's Capital A/c		14,000
To G's Capital A/c		14,000
To K's Capital A/c		7,000
(Profit on revaluation transferred to Partners' Capital A/cs on K's retirement)		

	Rs.	Rs.
(6) Bank A/c Dr	1,04,000	
To F's Capital A/c		70,000
To G's Capital A/c		34,000
(Cash brought in by F and G as per agreement)		

	Rs.	Rs.
(7) K's Capital A/c Dr.	79,000	
To Bank A/c		79,000
(Payment made to K on retirement)		

Working Note:

Adjusting entry for goodwill

Partner	*Old Share*	*New Share*	*Gain*	*Sacrifice*
F	$\frac{2}{5}$	$\frac{3}{5}$	$\frac{1}{5}$	-
G	$\frac{2}{5}$	$\frac{2}{5}$	-	-
K	$\frac{1}{5}$	-	-	$\frac{1}{5}$

Continued

Adjusting entry:

F's Capital A/c (50,000x 1/5)	Dr	10,000
To K's Capital A/c		10,000

Illustration 2

Dowell & co. is a partnership firm with partners Mr. A, Mr. B and Mr. C, sharing profits and loss in the ratio of 10:6:4. The balance sheet of the firm as at 31st March, 2006 is as under.

	Rs.		Rs.
Capital		Land	10,000
Mr. A 80,000		Buildings	2,00,000
Mr. B 20,000		Plant and machinery	1,30,000
Mr. C 30,000	1,30,000		
Reserves (unappropriated profit)	20,000	Furniture	43,000
		Investments	12,000
Long Term Debt	3,00,000	Stock	1,30,000
Bank Overdraft	44,000	Debtors	1,39,000
Trade Creditors	1,70,000		
	6,64,000		6,64,000

Continued

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1^{st} April, 2006. For this purpose, the following adjustments are to be made.

(a) Goodwill is to be valued at Rs. 1 lakh but the same will not appear as an asset in the books of the reconstituted firm.

(b) Building and plant and machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at Rs. 15,000. Provision of 20% is to be made on debtors to cover doubtful debts.

(c) In the reconstituted firm, the total capital will be Rs. 2 lakhs which will be contributed by Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2:2:1

a. The surplus funds, if any, will be used for repaying bank overdraft.
b. The amount due to retiring partner shall be transferred to his loan account.

(a) Revaluation account;

(b) Partners' capital accounts;

(c) Bank account; and

(d) Balance sheet of the reconstituted firm as on 1st April, 2006.

Solution

Revaluation Account

Dr.	Rs.		Cr. Rs.
To Building A/c	10,000	By investment A/c	3,000
To Plant and Machinery A/c	26,000	By Loss to partners:	
To Provision for Doubtful Debts A/c	27,800	A 30,400	
		B 18,240	
		C 12,160	60,800
	63,800		63,800

A's Capital

Dr	Rs		Cr Rs
To Revaluation A/c	30,400	By Balance b/d	80,000
To Balance c/d	80,000	By Reserves A/c	10,000
		By C and D's Capital A/c	10,000
		By Bank A/c (balancing figure)	10,400
	1,10,400		1,10,400

B’s Capitals

Dr	Rs		Cr Rs
To Revaluation A/c	18,240	By Balance b/d	20,000
To Investments c/d	15,000	By Reserves A/c	6,000
By B’s Loan A/c	22,760	By C and D’s Capital A/c	30,000
	56,000		56,000

C’s Capital Account

Dr	Rs		Cr Rs
To Revaluation A/c	12,160	By Balance b/d	30,000
		By Reserves A/c	4,000
To A and B’s Capital A/c	20,000	By Bank A/c (balancing figure)	78,160
To Balance c/d	80,000		
	1,12,160		1,12,160

D’s Capital Account

Dr	Rs		Cr Rs
To A and B’s Capital A/cs	20,000	By Bank A/c	60,000
To Balance c/d	40,000		
	60,000		60,000

MULTIPLE CHOICE QUESTIONS

RETIREMENT

MCQ 1

1. Retiring or outgoing partner:
   a. To be liable for firm's liabilities.
   b. Not liable for any liabilities of the firm.
   c. Is liable for obligation incurred before his retirement.
   d. Is liable for obligation incurred with his consent only.

MCQ 2

2. A, B and C are partners with profits sharing ratio 4:3:2. b retires and Goodwill Rs. 10,800 shown in books of account. If A & C share profits of B in 5:3, then find the new profit sharing ratio.

   a. 13:11.

   b. 17:11.

   c. 31:11.

   d. 14:21.

MCQ 3

3. A, B and C are partners with profits sharing ratio 4:3:2. b retires and Goodwill Rs. 10,800 was shown in books of account. If A & C shares profits of B in 5:3, then find the value of goodwill shared between A and C.

a. Rs. 1,850 and Rs. 1,950.
b. Rs. 1,650 and Rs. 1,750.
c. Rs. 2,000 and Rs. 1,600.
d. Rs. 1,950 and Rs. 1,650.

MCQ 4

4. C, D and E are partners sharing profits and losses in the proportion of ½ , 1/3 and 1/6. D retired and the new profit sharing ratio between C and E is 3:2 and the Reserve of Rs. 12,000 is divided amount the partners in the ratio.

a. 2000:4000:6000.
b. 5000:5000:2000.
c. 4000:6000:2000.
d. 6000:4000:2000

MCQ 5

5. The capitals of A, B and C are Rs. 1,00,000; Rs. 75,000 and 50,000, profits are shared in the ratio of 3:2:1. B retires on the basis that his shares is purchased by other partners keeping the total capital intact. The new ratio between A and C is 3:1. Find the capital of A and C after purchasing B's share.

a. Rs. 1,50,000 and Rs. 1,00,000.

b. Rs. 1,46,250 and Rs.42,000.

c. Rs. 1,56,250 and Rs. 68,750

d. Rs. 86,250 and Rs. 46,250

MCQ 6

6. Outgoing partner is compensated for parting with firm's future profits in favour of remaining partners. In what ratio do the remaining partners contribute to such compensation amount?

   a. Gaining Ratio.

   b. Capital Ratio.

   c. Sacrificing Ratio.

   d. Profit Sharing Ratio

MCQ 7

7. Joint Life Policy is taken by the firm on the life(s) of ………

   a. All the partners jointly.

   b. All the Partners severely.

   c. On the life of all the partners and employees of the firm.

   d. ‘a’ and ‘b”

MCQ 8

8. At the time of retirement of partner, firm gets…….from the insurance company against the joint Life Policy taken jointly for all the partners.

   a. Policy Amount .
   b. Surrender Value
   c. Policy Value for the retiring partner and Surrender Value for the rest.
   d. Surrender Value for all the partners.

MCQ 9

9. At the time of retirement of partner, firm gets….. from the insurance company against the joint Life Policy taken severely for each partner.

   a. Policy Amount .

   b. Surrender Value

   c. Policy Value for the retiring partner and Surrender Value for the rest.

   d. Surrender Value for all the partners

MCQ 10

10. A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of Rs. 2,50,000 with the surrender value Rs. 50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life premium is fully charged to revenue as and when paid?

Continued

a. Rs. 50,000 credited to all the partners in old ratio.
b. Rs. 2,50,000 credited to all the partners in old ratio.
c. Rs. 2,00,000 credited to all the partners in old ratio.
d. No treatment is required

PARTNERSHIP

DEATH

Illustration 1

The following was the Balance sheet of Om and Co. in which X,Y,Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.2005. Mr Z died on 31st December, 2005. His account has to be settled under the following terms

Balance Sheet of Om & Co. as on 31.03.205

Liabilities *Rs*	*Rs*	*Assets*	*Rs*
Sundry creditors	20,000	Goodwill	30,000
Bank Loan	50,000	Building	1,20,000
General Reserve	30,000	Computers	80,000
Capital Accounts;		Stock	20,000
X 40,000		Sundry debtors	20,000
Y 80,000		Cash at bank	20,000
Z 80,000	2,00,000	Investments	10,000
	3,00,000		
			3,00,000

Goodwill is to be calculated at the rate of tow years purchase on the basis of average of three years' profits and losses. The profits and losses for the three years were as detailed below:

Year ending on	Profit/ Loss
31.3.2005	30,000
31.3.2004	20,000
31.3.2003	(10,000) Loss

Profit for the period from 1.4.2005 to 31.12.2005 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31.3.2005 a car costing Rs. 40,000 was purchased on 1.4.2004 and debited to traveling expenses account on which depreciation is to be calculated at 20& p.a. This asset is to be brought into account at the depreciated value.

Other value of assets were agreed ad follows: Stock at Rs. 16,000, building at Rs. 1,40,000, computers at Rs. 50,000; investments at Rs. 6,000. Sundry debtors were considered good.

Your are required to:

(i) Calculate goodwill and Z's share in the profits of the firm for the period 1.4.2005 to 31.12.2005.

(ii) Prepare revaluation account assuming that other items of assets and liabilities remained the same.

Solution

(i) Calculation of goodwill and Z's share of profit

(a) *Adjust profit for the year ended 31.3.2005:*	Rs	Rs
Profit (Given)		30,000
Add: Cost of car wrongly written off	40,000	
Less: Depreciation for the Year 2004-05 (20% on Rs. 40,000)	8,000	32,000
		62,000

(b) *Average of last three years profits and losses*	Rs
Years ended on	Profit/(Loss) Rs.
31.3.2003	(10,000)
31.3.2004	20,000
31.3.2005	62,000
	72,000
Average profit (72,000/3)	24,000

(c) Goodwill at 2 years' purchase

Rs. 24,000 x 2 = Rs. 48,000

(d) Z's share of profits from the period

1.4.2005 to 31.12.2005

Rs. 24,000 x 9/12 x 2/5 = Rs.7,200

(ii) Revaluation Accounts

Dr.	Rs.		Cr. Rs.
To stock account	4,000	By Building Account	20,000
To Computer account	30,000	By Loss transferred to	
To Investments account	4,000	X 3,600	
		Y 7,200	
		Z 7,200	
			18,000
	38,000		38,000

Illustration 2

On the basis of illustration 1, prepare partners capital accounts and balance sheet of the firm Om and Co. ad on 31.12.2005.

Solution

Partners' Capital Accounts

Dr	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs	Cr Z Rs.
To Revaluation A/c To Z's Executor's To G/w A/c	3,600 6,000	7,200 12,000	7,200 1,12,000 12,000 -	By Bal. b/d By Gen. reserve By X and Y	40,000 6,000	80,000 12,000 -	80,000 12,000 19,200

Dr	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs	Cr Z Rs.
To Z	6,400	12800					
To Balance c/d	36,400	72,800		By Car A/c	6,400	12,800	12,800
				By Profit and loss suspense A/c			7,200
	52,400	1,04,800	1,31,200		52,400	1,04,800	1,31,200

Balance Sheet of Om & Co. as 31.12.2005

Liabilities	Rs.	Assets	Rs
Sundry creditors	20,000	Building	1,40,000
Bank Loan	50,000	Car	32,000
Capital accounts:		Stock	16,000
X	36,400	Computers	50,000
Y	72,800	Investments	6,000
Z's Executor's accounts	1,12,000	Sundry debtors	20,000
		Cash at bank	20,000
		Profit and Loss suspense Accounts	7,200
	2,91,200		2,91,200

Goodwill calculated at the time of death of partner Z (See W .N. c of solution 2)

Partner	Old Share	New Share	Gain	Sacrifice
X	$\frac{1}{5}$	$\frac{1}{3}$	$\frac{2}{15}$	-
Y	$\frac{2}{5}$	$\frac{2}{3}$	$\frac{5}{15}$	-
Z	$\frac{2}{5}$	-	-	$\frac{2}{5}$

Adjusting entry

X's Capital	Dr	6,400
Y's Capital	Dr.	12,800
To Z's Capital Account		19,200

(Adjustment for goodwill on the death of Z on the basis of gaining ratio)

MULTIPLE CHOICE QUESTIONS

DEATH

1. On death of partner, his executor is paid the share of profits of the dying partner for the relevant period. This payment is recoded in Profit & loss…… Account.

a. Adjustment.
b. Appropriation.
c. Suspense
d. Reserve.

2. Revaluation account is prepared at the time of

   a. Admission of partner
   b. Retirement of a partner
   c. Death of a partner
   d. All of the above

3. In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner’s share in the following items.

a. Profits till date, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities

b. Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.

c. Capital, Profits till date, goodwill, interest on capital, share in revalued assets and liabilities.

d. Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

4. As per Section 37 of the Indian Partnership Act, 1932, the executors would be entitled at their choice to the interest calculated from the date of death till the date of payment on the final amount due to the dead partner at……… percentage per annum.

   a. 7.
   b. 4.
   c. 6.
   d. 12

5. A,B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of Rs. 1,20,000 and in the balance sheet it is appearing at the surrender value i.e. Rs 20,000. On the death of A, how this JLP will be shared among the partners.

   a. 50,000:25,000:25,000
   b. 60,000:30,000:30,000
   c. 40,000:35,000:25,000
   d. Whole of Rs. 1,20,000 will be paid to A

THE END

Partnership Accounts