

## PARTNERSHIP ACCOUNTS

**Definition:** The partnership Act 1932 defines partnership as the relationship between person who has agreed to share the profit of a business carried on by all or any of them acting for all.

**Partnership deed:** It is a written document which contains the terms and conditions regarding the conduct of partnership business.

It may include the name of the firm, the nature of business, the amount of capital and the partners share, the amount a partner can drawn, share of profit and loss, interest on capital, duration of the firm, terms and condition for admission, retirement or death of partner, salary payable to partners, how to prepare annual accounts of the firm, loan extended by partners in addition to capital, what is to be done in the case of insolvency, in case of dispute how it should be settled and other clause.

**Rules as per Act:** In case, if the firm doesn't have any deed, then the provisions as provided in the Partnership Act 1932 should be followed. Accordingly,

Profit and losses of the firm must be shared equally

Interest on capital normally not allowed, if allowed only out of profits

If any partner extended loan in addition to capital, then 6% interest can be paid.

No salary or remuneration to partners.

Every partner must participate in the management of the business

No person shall be admitted without the consent of all existing partners

The partnership accounts are to be kept at the place of business of the firm and every member may have access to and inspect copy of them.

**Profit and loss appropriation account:**

As the partnership Act says interest on capital and other things are to be provided out of profit only, it is necessary to prepare the profit and loss appropriation account to give effect for

Interest on capital, interest on drawings, salary to partners and share of profit among partners equally or according to the agreed ratio.

**Capital Account:** In case of partnership firm, the capital account of the partners may be either fixed or fluctuating capital.

**Fixed capital:** In this case, the capital of the partners should be kept as it is and all the other adjustment such as interest on capital, interest drawings, etc will be done in a separate account called current account.

**Fluctuating capital:** All adjustment regarding profit, share of other income, interest on drawings and interest on capital will be recorded in one capital account.

On 1<sup>st</sup> January 2006, A,B and C enter into partnership contributing Rs.250000, Rs.130000 and Rs.120000 respectively and sharing profit in the ratio of 5:3:2. B and C entitled to a salary of Rs.16000 and Rs.14500 respectively per year. Interest on capitals is to be allowed at 5% per annum. 10% interest is to be charged on drawings. During the year A withdrew Rs.40000 on 01/04/06, B Rs.25000 on 01/07/06 and C Rs.15000 on 01/10/06. Profit before above



To Drawing	40000	25000	15000	By interest on Capital	12500	6500	6000
To interest on drawing	2000	1250	750	By salary		16000	14500
To B c/d	---	2250	8750	By profit	10000	6000	4000
				By Bc/d	19500	---	---
	42000	28500	24500		42000	28500	24500

**Minor partner:** A minor can be admitted into the firm with the consent of all partners. A minor partner is not personally liable for the firm's debt but his share in the partnership property and profit can be utilized to set off the losses of firm. Within six months of attaining the age of major, he must give public notice that he doesn't want to continue as a partner otherwise he will be deemed to have elected as partner and held liable personally for the losses of the firm.

**Guaranteed profit:** Sometime, a partner may be admitted with a guaranteed profit. The guaranteed profit will be paid even if there are no profits or his share of profit falls short of the guaranteed amount. The guarantee may be given by one of the existing partners or the entire existing partners.

In case of partnership firm, the final accounts are prepared in the following manner:

- 1] Trading account
- 2] Profit and loss account
- 3] Profit and loss appropriation account
- 4] Partners capital account – fluctuating - capital account  
Fixed – capital account and current account
- 5] Balance sheet.

**Change in the partnership firm:** Over a period of time, there may be lot of changes in the partnership firm. It may be in the form of admission of new partner, retirement of existing partners or any partner may expired or by any other reason whatsoever. Hence, it is important to give effect to the above change in the books of accounts which is the ultimate challenges in the partnership accounts.

### **ADMISSION OF NEW PARTNER**

A partner may be newly admitted into existing firm to bring further capital or new talent or managerial skill. The terms on which a new partner is admitted must be fair to both new and existing partner. When a person is newly admitted he acquires - right in the share of the profits of the business  
Right in the assets and liabilities of the business.

Therefore, when a new partner is admitted the following adjustments are needed to be carried out

- 1] Calculation of new profit ratio
- 2] Revaluation of assets and liabilities
- 3] Goodwill
- 4] Adjustment for undistributed profits and losses and
- 5] Adjustment in the capital.

1] **Calculation of new profit ratio:** When a new partner is admitted, there is change in the profit sharing ratio of the partner, as the same profit is going to be shared among more person than before the admission. In this case, either one of the existing partner or all the existing partners sacrifice some of their profit, therefore, in case of admission, it is necessary to prepare new ratio and sacrificing ratio.

Aravind and Balu are partners sharing profits and losses in proportion of 2:1. They admitted Chandran a new partner whom they give  $\frac{1}{6}$ <sup>th</sup> share in the profits. What is the new profit sharing ratio?

David and Eswar are partners sharing profits and losses in the proportion of 7:5. They agree to admit Fazil into partnership who is to get  $\frac{1}{6}$ <sup>th</sup> profits. He acquires this share  $\frac{1}{24}$ <sup>th</sup> from David and  $\frac{1}{8}$ <sup>th</sup> from Eswar. What is the new profit sharing ratio?

Ganesh and Hari are partners sharing profits and losses in the ratio of 3:1. They agreed to admit Isaac into the partnership firm. Isaac is given  $\frac{1}{4}$ <sup>th</sup> share of future profits which he acquires in the ratio of 2:1 from the old partners. What is the new profit sharing ratio?

**Sacrificing ratio:** It is that portion of profit sacrificed by the existing partners in favour of the new partner. Technically, it is the difference between old ratio and new ratio. **SR = OR – NR.**

John and Kannan are in partnership sharing profits and losses in the ratio of 3:2. They admitted Latif into partnership firm for  $\frac{1}{5}$ <sup>th</sup> share. What is the new ratio and sacrificing ratio?

2] **Revaluation of assets and liabilities:** When a new partner is admitted, it is obvious that neither he should be benefited from any appreciation in the value of assets or suffer from any depreciation in the value of assets. Same treatment should be given for liabilities also.

Therefore, the of assets and liabilities should be revalued at the time of admission by opening a revaluation account and any profit or loss on revaluation should be transferred to existing partners capital account in the old profit sharing ratio.

For increase in the value of assets Assets A/c. To Revaluation A/c.	For decrease in the value of assets Revaluation A/c. To Assets A/c
For decrease in the value of liabilities Liabilities A/c. To Revaluation A/c.	For Increase in the value of liabilities Revaluation A/c. To Liabilities A/c.
For loss on revaluation Partners' capital A/c.	For profit on revaluation Revaluation A/c.

To Revaluation A/c.	To Partners capital A/c.
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**Memorandum revaluation account:** Sometimes, the partner may agree to show the assets and liabilities in its original value and also don't want give share to the new partner either in the appreciation or depreciation in the value of assets and liabilities. In that case, instead of revaluation account, memorandum revaluation accounts is prepared and in that account the changes in the value of assets and liabilities are recorded first and then reverse entries (i.e. by debiting what credited and by crediting what debited)are passed but no change will be made in the value of assets and liabilities in Balance sheet.

For profit on memo revaluation Memo. Revaluation A/c. To Old partners capital A/c(OR)	For reverse entry All partners Capital A/c. (including new partners in new ratio) To memo. Revaluation A/c.
For loss on memo revaluation Old partners capital A/c(OR) To memo. Revaluation A/c.	For reverse entry Memo. Revaluation A/c. To All partners capital A/c. (including new partners in new ratio)

### Valuation of Goodwill

**Average profit method:** under this method, the average of the profits last few years is computed and which is multiplied by the number of years in which the anticipated profit will be available.

The following particulars are available in respect of the business carried on by a firm: 2006 loss Rs.5000, 2007 loss Rs.10000, 2008 profit Rs.75000 and 2009 Profit Rs.60000 Compute the value of goodwill on the basis of 5 years purchase of average profit of the business.

Good will = Average profit x no of years of profit

$$AP = -5000 + (-10000) + 75000 + 60000 / 4 = 30000 \times 5 = 150000$$

**Super profit method:** Super profit means the excess profit that can be earned by a firm over and above the normal profit usually earned by similar firms under similar circumstances. Goodwill is computed by multiplying the super profit by certain number of years.

The profits and losses for the last years are 2002 loss Rs.10000, 2003 loss Rs.2500 2003 profit Rs.98000 and 2004 Profit Rs.76000. The average capital employed in the business is Rs.200000. The rate of interest expected from capital invested is 12%. The remuneration of partners is estimated to be Rs.1000 per month. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.

Goodwill = super profit x no of years of purchase

$$\text{Average profit} = -10000 + (-2500) + 98000 + 76000 / 4 = 40375$$

$$\text{Normal return in the business} = 200000 \times 12/100 = 24000$$

$$\text{Super profit} = \text{profit} - \text{normal return} = 40375 - 24000 = 16375 \times 2 = 32750/-$$

**Capitalisation method:** under this method, the average profits are capitalized taking into consideration the normal rate of return in the industry.

The profits for the last three years are 2003 Rs.42500, 2004 Rs.56000 and 2005 Rs.68000. The total liabilities of the firm are Rs.1000000 of which outsiders liabilities is Rs.500000. The rate of interest expected from capital invested is 10%. Calculate the value of goodwill on Capitalisation basis.

Average profit =  $42500+56000+68000/3=166500/3=55500$

$55500/10 \times 100=5,55,000$  – capital employed 500000 = 55000 goodwill

**Treatment of goodwill:** The goodwill amount will be treated in the following manner in case of admission of a partner.

**A]** When the amount for goodwill is paid privately by new partner to old partners, In such cases, it will not be recorded in the books.

**B]** When goodwill is received in cash and retained in the business. If the new partner brought the money for goodwill then it will be distributed among old partners in their sacrificing ratio.

For cash brought by new partner Cash A/c. To new partner Capital A/c	When transferred to old partner in SR New partner capital A/c. To Old partners capital A/c.
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**C]** When goodwill is received in cash and withdrawn by old partners. In this case, first the amount brought in by new partner for goodwill is recorded and transferred to the old partners' capital account in sacrificing ratio. When money withdrawn by them it will also be recorded.

For cash brought by new partner Cash A/c. To New partner capital Ac/.	When money transferred to old partners A/c. New partner capital A/c. Old partner capital A/c.
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For money withdrawn by old partners Old partners' capital A/c. Cash A/c.
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**D]** When goodwill raised fully in the books of accounts: in this case, goodwill account is recorded in the books of accounts by passing following journal entry  
Goodwill A/c.

To Old partners capital A/c. old ratio.

When goodwill is already appearing in the books of accounts then if there is any decrease in the value of goodwill, it will be adjusted in the capital account of old partners by debiting their account and if there is any increase in the value of goodwill, the partners capital account will be credited in their old ratio.

Sunil and Dalip are partners in a firm sharing profits and losses in the ratio of 5:3. Sachin is admitted in the firm for 1/5 share of profits. He is to bring in Rs.20000 as capital and Rs.4000 as his share of goodwill. Give the necessary Journal entries (a) when the amount of goodwill is retained in the business (B) When the amount of goodwill is fully withdrawn and (C) when 50% of the amount of goodwill is fully withdrawn

New Ratio Sachin 1/5 then balance 4/5 Sunil New share  $4/5 \times 5/8 = 20/40$

Dalip's new share  $4/5 \times 3/8 = 12/40$  Sachin = 8/40 20:12:8 or 5:3:2

Old ratio 5:3 SR = OR – NR Sunil  $5/8-5/10= 25-20=5$  Dalip  $3/8-3/10= 12-9 =3$

Cash A/c.	24000	
To Sachin capital A/c. (20000+4000)		24000

**(a) When goodwill retained in the business**

Sachin capital A/c.	4000	
To Sunil capital A/c.		2500
To Dalip capital A/c.		00
Amount brought by new partner for goodwill is shared by old partners in SR		

**(b) When amount of goodwill fully withdrawn**

Sachin capital A/c.	4000	
To Sunil capital A/c.		2500
To Dalip capital A/c.		1500
Amount brought by new partner for goodwill is shared by old partners in SR		

Sunil capital A/c.	2500	
Dalip capital A/c.	1500	
To Cash A/c.		4000

**[c] When 50% of the amount of goodwill is fully withdrawn**

Sachin capital A/c.	4000	
To Sunil capital A/c.		2500
To Dalip capital A/c.		1500
Amount brought by new partner for goodwill is shared by old partners in SR		

Sunil capital A/c.	1250	
Dalip capital A/c.	750	
To Cash A/c.		2000

Hem and Nem are partners in a firm sharing profits in the ratio of 3:2. Their capitals were Rs.80000 and Rs.50000 respectively. They admitted Sam on 01/01/2007 as a new partner for 1/5 share in the future profits. Sam brought Rs.60000 as his capital. Calculate the value of goodwill of the firm and record necessary journal entries on Sam's admission.

New ratio = 12:8:5 Sam share is 1/5 balance 1-1/5 = 4/5

Hem new ratio = 4/5 x 3/5 = 12/25 Nem New ratio = 4/5 x 2/5 = 8/25

If Hem and Nem capital (80000+50000) is 130000/20(12+8) for a share of 20 then Sam capital for 5 share should be 130000/20 x 5= 32500 He brings Rs.60000 as his capital i.e. means the extra amount of Rs.27500(60000-32500) is his share of goodwill.

Rs.27500 is for 5 share then the total value of goodwill is 27500/5x25=137500

Cash A/c.	60000	
To Sam capital A/c. (32500+27500)		60000

**4] Adjustment of undistributed profit and losses:** at the time of admission of new partners, if there is any undistributed profit kept in the name of general reserve or profit and loss account, it should be transferred to capital account of the old partners in their old ratio. In case if there is any loss which should also be transferred to partners' capital account.

For profit, general reserve (transfer ) General reserve A/c. To Old partners capital Ac.	For accumulated loss Old partners' capital A/c. To Accumulated losses A/c.
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The following is the balance sheet of Ram and Mohan (who share profits in the ratio of 3:2) as on 1<sup>st</sup> January 2009

Liabilities		Assets	
Sundry creditors	15000	Buildings	18000
Ram's capital	20000	Plant and machinery	15000
Mohan's capital	25000	Stock	12000
General reserve	15000	Debtors	10000
		Investments	15000
		Bank	5000
	75000		75000

On this date shyam was admitted on the following:

He is to pay Rs.25000 as his capital and Rs.10000 as his share of goodwill for one fifth share of profits.

The assets are revalued as building 25000, Plant and machinery 12000 stock 12000, debtors 9500.

It was found that there was a liability for 1500 for good received but not recorded in books. Prepare new balance after the admission of Shyam.

New profit sharing ratio = Shyam 1/5 balance 1-1/5= 4/5

Ram's new ratio =  $4/5 \times 3/5 = 12/25$  Mohan's New ratio =  $4/5 \times 2/5 = 8/25$

New Ratio = 12:8:5

Old Ratio = 3:2

Sacrificing ratio for Ram = OR – NR  $3/5 - 12/25 = 15 - 12 = 3$

Sacrificing ratio for Mohan = OR – NR  $2/5 - 8/25 = 10 - 8 = 2$

Cash A/c.	25000	
To Shyam's capital A/c.		25000

Cash A/c.	10000	
To Shyam's capital A/c.		10000

Shyam, capital A/c.	10000	
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To Ram's capital A/c.		6000
To Mohan's capital A/c.		4000
Amount brought by new partner for goodwill is shared by old partners in SR		

General Reserve A/c.	15000	
To Ram's capital A/c.		9000
To Mohan's capital A/c.		6000

Building A/c.	7000	
To Revaluation A/c.		7000

Revaluation A/c.	3000	
To Plant and machinery A/c.		3000

Revaluation A/c.	500	
To Debtors A/c.		500

Revaluation A/c.	1500	
To liability A/c.		1500

#### Revaluation Account

To Debtors A/c.	500	By Building A/c	7000
To plant and machinery A/c.	3000		
To liability A/c.	1500		
To Ram's capital A/c. 1200	2000		
To Mohan's capital A/c. 800			
	7000		7000

#### Partners Capital Account

	Ram	Mohan	Shyam		Ram	Mohan	Shyam
To Ram	---	---	6000	By B b/d	20000	25000	---
To Mohan	---	---	4000	By Cash			35000
To B c/d	36200	35800	25000	By G. Reserve	9000	6000	---
				By Revaluation	1200	800	---
				By Mohan	6000	4000	---
	272500	158500	144500		36200	35800	35000

#### Balance sheet (after the admission of Shyam)

Liabilities		Assets	
Sundry creditors	15000	Buildings	25000
Ram's capital	36200	Plant and machinery	12000
Mohan's capital	35800	Stock	12000
Sham's Capital	25000	Debtors	9500

Liability not recorded	1500	Investments	15000
		Bank(5000+35000)	40000
	113500		113500

### 5. Adjusting capital in proportion to profit sharing ratio

The following is the balance of A, B and C sharing profits and losses in the proportion of 6:5:3 respectively

Liabilities		Assets	
Sundry creditors	18900	Cash	1890
Bills payable	6300	Debtors	26460
General reserve	10500	Stock	29400
A's capital	35400	Furniture	7350
B's Capital	29850	Land and building	45150
C's Capital	14550	Goodwill	5250
	115500		115500

They agreed to take D into partnership and give him 1/8<sup>th</sup> share on the following terms:

Furniture to be depreciated by 920, Stock to be depreciated 10%, Value of land and building appreciated to 59850, value of goodwill brought upto Rs.14070  
D should then bring in Rs.14700 as his capital.

That after making the above adjustments the capital accounts of the old partners be adjusted on the basis of the proportion of D's capital to his share in the business i.e. actual cash to paid off or bought in by the old partners as the case may be. Prepare revaluation account, partners' capital account and balance sheet of the new firm.

D's share = 1/8 Balance 1-1/ = 7/8

New ratio A= 7/8 x 6/14= 42/112 B=7/8 x 5/14 = 35/112 C = 7/8 x 3/14 =21/112

D's share convert to 112 =14/112 New Ratio = 42:35:21:14 or 6:5:3:2

Cash A/c.	14700	
To D's capital A/c.		14700

General Reserve A/c.	10500	
To A's capital A/c.		4500
To B's capital A/c.		3750
To C's Capital A/c.		2250

Land and Building A/c.	14700	
Goodwill A/c.	8820	
To Revaluation A/c.		23520

Revaluation A/c.	3860	
To Furniture A/c.		920
To Stock A/c.		2940

#### Revaluation Account

To Furniture A/c.	920	By land and Building A/c	14700
To Stock A/c.	2940	By Goodwill A/c.	8820

To A's capital A/c.	8426	19660		
To B's capital A/c.	7021			
To c's capital A/c.	4213			
		23520		23520

### Partners Capital Account

	A	B	C	D		A	B	C	D
To cash	4226	3871			By B b/d	35400	29850	14550	---
To B b/d	44100	36750	22050	14700	By cash A/c.	---	---	---	14700
					By G. Res.	4500	3750	2250	---
					By Revalu.	8426	7021	4213	---
					By Cash A/c.	---	---	1037	---
						48326	40621	22050	14700

D's Capital = 14700 for 2 share of profit. Accordingly  
A's capital would be  $14700/2 \times 6 = 44100$  actual capital is 48326  
Excess capital of Rs. 4226(48326-44100), that A may withdrawn from business  
B's capital would be  $14700/2 \times 5 = 36750$  actual capitals is 40621  
Excess capital of Rs. 3871(40621-36750), that B may withdrawn from business  
C's capital would be  $14700/2 \times 3 = 22050$  actual capitals is 21013  
Shortage capital of Rs. 1037(22050-21013), that C has to bring to business

### Cash Account

To Balance b/d.	1890	By A's capital A/c	4226
To D's capital A/c.	14700	By B's capital A/c	3871
To C's Capital A/c.	1037	By Balance C/d.	9530
	17627		17627

### Balance sheet (after the admission of D)

Liabilities		Assets	
Sundry creditors	18900	Land and Buildings	59850
Bills payable	6300	Goodwill	14070
A's capital	44100	Furniture(7350-920)	6430
B's capital	36750	Stock(29400-2940)	26460
C's Capital	22050	Debtors	26460
D's Capital	14700	Cash	9530
	142800		142800

### RETIRMENT OF A PARTNER

When a partner retires from the firm due to ill health or old age, as per the agreement, it is necessary to make adjustments in the books of account for the following:

- Revaluation of assets and liabilities
- Treatment of goodwill and calculation of gaining ratio
- Treatment of undistributed profit and losses
- Calculation of amount payable to the retiring partner

Adjustment of capital accounts

Settlement of the total amount due to the retiring partner.

**Treatment of good will:**

1] when raised in the books at full value Goodwill A/c. To all partners capital A/c.	
2a] When raised in the books Goodwill A/c. To all partners capital A/c.	2b] For writing off the goodwill Remaining partners' capital A/c.(GR) To Goodwill A/c.
3a] raised only for share of retiring partner Goodwill A/c. To Retiring partners capital A/c.	3b] When written off Remaining partners' capital A/c.(GR) To Goodwill A/c.

**Gaining ratio:** After retirement of a particular partner, the profit is going to be shared by the remaining partners only. If suppose, there are three partners and one retire means, the remaining two will have to share the profits. Naturally the remaining partners gaining something and if that is represented in the form of ratio, it is called gaining ratio.

Gaining ratio **(GR)** = New ratio **(NR)** – Old ratio **(OR)**

**Settlement of amount due to retiring partner:** If necessary funds available in the business, his amount may be settled immediately after retirement. If no sufficient funds available, then the amount payable to the retiring partner may be transferred to his loan account for which the firm has to be pay interest.

On 31<sup>st</sup> march 2005, the balance sheet of M/s. A, B and C sharing profits and losses in proportion to their capitals, stood as follows

Liabilities		Assets	
Sundry creditors	100000	Land and buildings	200000
Capital accounts A	200000	Machinery	300000
Capital accounts B	300000	Stock	100000
Capital accounts C	200000	Sundry debtors	100000
		Cash and bank balances	100000
	800000		800000

On 31<sup>st</sup> march 2005, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the assets and liabilities on that date on the following basis

Land and building be appreciated by 30%, machinery be depreciated by 20% closing stock to be valued at Rs.75000, provision for bad debts to be made at 5% Old credit balances of sundry creditors Rs.20000 to be written back.

Joint life policy of the partners surrendered and cash obtained Rs.80000

Goodwill of the entire firm be valued at Rs.140000 and A share of the goodwill be adjusted in the accounts of B and C who share the future profits equally. No goodwill account being raised.

After retirement A's account is settled as 50% on retirement and 50% within one, year.

Prepare revaluation account, partners' capital account and balance sheet after retirement.

Old Ratio = 2:3:2 New Ratio = 1:1

Land and Building A/c.	60000	
To Revaluation A/c.		60000

Revaluation A/c.	170000	
To Machinery A/c.		60000
To Stock A/c.		25000
To Provision for Bad debts A/c.		5000
To Sundry Creditors A/c.(old)		80000

Cash A/c.	80000	
To JLP A/c.		80000

JLP A/c.	80000	
To A's Capital A/c.		22857
To B's Capital A/c.		34286
To C's Capital A/c.		22857

A's share of goodwill =  $140000/7 \times 2 = 40000$

To be borne by B and C in their gaining ratio

Gaining Ratio (G) = NR – OR for B =  $\frac{1}{2} - \frac{3}{7} = \frac{7-6}{14} = \frac{1}{14}$  C =  $\frac{1}{2} - \frac{2}{7} = \frac{7-4}{14} = \frac{3}{14}$

$40000/4 \times 1 = 10000$  for B and  $40000/4 \times 3 = 30000$  for C

B's Capital A/c	10000	
C's Capital A/c.	30000	
To A's Capital A/c.		40000

#### Revaluation Account

To Machinery A/c.	60000	By Land and Building A/c	60000
To Stock A/c.	25000	By A's capital A/c.	31429
To Provision for Bad debts A/c.	5000	By B's capital A/c.	47143
To Sundry Creditors A/c.(old)	80000	By C's capital A/c.	110000
	170000		170000

#### Partners Capital Account

	A	B	C		A	B	C
To Revaluation	31429	47143	31428	By B b/d	200000	300000	200000
To A's A/c.	---	10000	30000	By B's	10000	---	---

				A/c.			
To Cash	115714	---	---	By C's A/c.	30000	---	---
To A's loan	115714	---	---	By JLP A/c.	22857	34286	22857
To Balance	---	277683	161429		---	---	---
	262857	334826	222857		262857	334826	222857

### Balance sheet (after the Retirement of A)

Liabilities		Assets	
Sundry creditors (100000+80000)	180000	Land and Buildings (200000+60000)	260000
A's Loan Account	115714	Machinery(300000-60000)	240000
B's capital	277683	Stock	75000
C's Capital	161429	Debtors(100000-5000)	95000
		Cash (100000+80000-115714)	64286
	734286		734286

## DISSOLUTION OF PARTNERSHIP

There is a difference between dissolution of firm and dissolution of partnership. Dissolution of partnership means one partner may resign, or retire or died or become insolvent, in that case the relationship between partners is dissolved and new relationship may emerge if they admit new partner.

Dissolution of firm means complete breakdown of the partnership firm and there is no more business. In such case, all the assets of the business should be sold and all the liabilities should be settled and the accounts in the firm should be closed.

### Modes of dissolution

There are different ways in which a firm may be dissolved.

- 1] Dissolution by agreement
- 2] Dissolution on the happening of contingencies – expiry of term, job, etc
- 3] Dissolution by notice of partnership at will
- 4] Compulsory dissolution or dissolution by the operation of law
- 5] Dissolution by the court.

**Accounting treatment:** When there is dissolution, the assets of the business should be sold first and amount due to creditors to be paid and if there exist any surplus which will be paid and if there is any shortage that should be settled by the partners. For this purpose, we have to prepare Realisation of account, partners' capital account and cash account.

For closing the assets except cash Realisation A/c.	For closing the liabilities account Liabilities A/c
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To Assets A/c. (Book Value)	To Realisation A/c.
If any assets taken over by partners Partners' capital A/c. To Assets A/c.	If any liabilities taken over by partners Liabilities A/c. To partners capital A/c.
For realizing the assets ( by selling) Cash A/c. To Realisation A/c.	For payment of liabilities Realisation A/c. To cash A/c.
Expenses on Realisation Realisation A/c. To Cash A/c.	If expenses borne by the partners Realisation A/c. To partners capital A/c.
For profit on realisation Realisation A/c. To Partners capital A/c.	For loss on realisation Partners' capital A/c. To Realisation A/c.

**Order of settlement:** First outside liabilities, then partners' loan account, if excess fund available then partners capital account

Jyothi and vikas was equal partner in a manufacturing business. On June 30 2006, they dissolved the firm on which date their balance sheet was as follows:

Liabilities		Assets	
Creditors 28000 Less reserve 1000	27000	Debtors Less: 2000	42000 Provision 40000
Reserve for contingencies	5000	Stock	32000
Mrs. Vikas loan	10000	Furniture	3500
Reserve fund	15000	Plant and machinery	25000
Jyothi loan	8000	Prepaid expenses	1000
Capital account Jyothi	21000	Advance to vikas	5000
Capital account vikas	23000	Cash and bank	2500
	109000		109000

Stock, debtors, plant and machinery and goodwill realised Rs.27000, Rs.38000, Rs.20000 and Rs.5000 respectively. Furniture did not realise any value. An amount of Rs.6000 was paid on account of contingent liabilities. The expenses of realisation were Rs.1000

The firm had previously made some investments in share of a joint stock company and had written off this investment on finding it useless. The investment now realised Rs.1500.

Show necessary accounts and close the books.

Creditors A/c.	28000	
Mrs. Vikas Loan A/c.	10000	

To Realisation A/c.		38000
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Provision for Debtors A/c.	2000	
To Realisation A/c.		2000

Realisation A/c.	103500	
To Debtors		42000
To Stock		32000
To Furniture		3500
To Plant and machinery		25000
To Prepaid expense		1000

Realisation A/c.	1000	
To Reserve on creditors A/c.		1000

Realisation A/c.	7000	
To Cash A/c. (6000+1000)		7000

Cash A/c. (27000+38000+20000+5000+1500)	91500	
To Realisation A/c.		91500

Reserve fund A/c.	15000	
Reserve for contingencies A/c.	5000	
To Joythi's Capital A/c.		10000
To Vikas's capital A/c.		10000

Jyothi's Loan A/c.	8000	
To Cash A/c.		8000

Jyothi's Capital A/c.	41000	
Vikas's Capital A/c.	38000	
To Cash A/c.		79000

### Realisation Account

To Machinery A/c.	25000	By Creditors A/c	28000
To Stock A/c.	32000	By Mrs. Vikas loan A/c.	10000
To Debtors A/c.	42000	By Provision for debtors	2000
To Furniture A/c.	3500	By Cash A/c.	91500
To Prepaid expenses A/c.	1000		
To Reserve for creditors	1000		
To cash A/c.	7000		
To Joythi's Capital 10000	20000		
To Vikas's Capital 10000			



131500	1315000
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### Partners Capital Account

	Joythi	Vikas		Joythi	Vikas
To Advance to vikas		5000	By B b/d	21000	23000
To cash A/c.	41000	38000	By Realisation A/c.	10000	10000
			By Reserve fund	10000	10000
	41000	43000		41000	43000

### Cash Account

To Balance b/d.	2500	By Realisation A/c	7000
To Realisation A/c	91500	By Jyothi's loan A/c	8000
		By Jyothi's capital A/c.	41000
		By Vikas's Capital A/c.	38000
	94000		94000

P,Q and R are partners in a firm, sharing profits and losses in the ratio of 2:2:1. The firm's balance sheet as on 31/03/2009 was as follows:

Liabilities		Assets	
Creditors	48000	Debtors	48000
Reserve fund	60000	Stock	60000
Capital Account P	120000	Fixtures	24000
Capital Account Q	48000	Plant and machinery	108000
Capital Account R	24000	Cash	60000
	3000000		300000

The partners have decided to dissolve the firm and realised the following amounts realised from the assets: Plant and machinery 102000, Fixtures 18000, stock 84000 and sundry debtors 44400.

Creditors allowed a discount of 5% and realisation expenses amounted to Rs.1500. A bill for Rs.4200 on account of sales tax due was received during the course of realisation and was paid.

Prepare realisation account, partners capital and cash account

Creditors A/c.	48000	
To Realisation A/c.		48000

Realisation A/c.	240000	
To Debtors		48000
To Stock		60000
To Fixtures		24000
To Plant and machinery		108000

Realisation A/c.	51300	
To Cash A/c. (48000 x 95%=45600+1500+4200)		51300

Cash A/c. (102000+18000+84000+44400)	248400	
To Realisation A/c.		248400

Reserve fund A/c.	60000	
To P's capital A/c.		24000
To Q's capital A/c.		24000
To R's capital A/c.		12000

Cash A/c.	257100	
To P's capital A/c.		146040
To Q's capital A/c.		74040
To R's capital A/c.		37020

#### Realisation Account

To Machinery A/c.	108000	By Creditors A/c	48000
To Stock A/c.	60000	By Cash A/c.	248400
To Debtors A/c.	48000		
To Fixtures A/c.	24000		
To cash A/c.	51300		
To P's Capital			
2040			
To Q's Capital			
2040			
To R's Capital	5100		
1020			
	296400		296400

#### Partners Capital Account

	P	Q	R		P	Q	R
To Cash	146040	74040	37020	By B b/d	120000	48000	24000
				By Realis A/c.	2040	2040	1020
				By Reserve	24000	24000	12000
					---	---	---
	146040	74040	37020		146040	74040	37020

#### Cash Account

To Balance b/d.	60000	By Realisation A/c	51300
To Realisation A/c	248400	By P's Capital A/c.	146040

		By Q's capital A/c.	74040
		By R's Capital A/c.	37020
	308400		308400

**Insolvency of partner:** If the firm at the time of dissolution has enough funds to settle all dues then insolvency a particular partner doesn't have much impact. But when the firm has to be settle the accounts of outsiders and any partner become insolvent, then it is necessary to follow Garner Vs. Murray rule.

Accordingly, if any partner is insolvent and then the deficiency caused by the insolvent partners has to be borne by the remaining solvent partner in proportion to the capital before dissolution.

The following is the balance sheet of a firm as on 31/12/2007

Liabilities		Assets	
Creditors	204800	Bank	11000
P Loan A/c.	60000	Debtors	192120
Q loan A/c.	24000	Stock	128000
P Current A/c.	42400	Plant and machinery	57200
Q Current A/c.	5000	Land	168000
Capital account P	120000	R's current account	19880
Capital account Q	80000		
Capital account R	40000		
	576200		576200

It was decided to close the firm on that date. The assets (with the exception of bank balance) realised for Rs.453600/-. The firm had to pay Rs.3000 for an outstanding bill not recorded in the books. R becomes insolvent and Rs.2000 is realised from his estate. Realisation expenses Rs.2500. Prepare necessary accounts in the books of the firm.

Creditors A/c.	204800	
To Realisation A/c.		204800

Realisation A/c.	545320	
To Debtors		192120
To Stock		128000
To land		168000
To Plant and machinery		57200

Realisation A/c.	210300	
To Cash A/c. (204800+2500+3000)		210300

Cash A/c.	11000	
To Bank A/c.		11000

Cash A/c.	453600	
To Realisation A/c.		453600

Cash A/c.	2000	
To R's Capital A/c.		2000

P's capital A/c.	32407	
Q's capital A/c.	32407	
R's capital A/c.	32406	
To Realisation A/c.		97220

P's Loan A/c.	60000	
Q's Loan A/c.	24000	
To Cash A/c.		84000

P's capital A/c.	6172	
Q's capital A/c.	4114	
To R's capital A/c.		10286

P's capital A/c.	123821	
Q's capital A/c.	48479	
To Cash A/c.		172300

### Realisation Account

To Machinery A/c.	57200	By Creditors A/c	204800
To Stock A/c.	128000	By Cash A/c.	453600
To Debtors A/c.	192120	To P's Capital	
		32407	
To land A/c.	168000	To Q's Capital	
		32407	
To cash A/c.	210300	To R's Capital	97220
		32406	
	775620		775620

### Partners Current Account

	P	Q	R		P	Q	R
To B b/d	---	---	19880	By B b/d	42400	5000	---
To P's Capital	42400	---	---	By R.s Capital	---	---	19880
To Q's Capital	---	5000	---				
	42400	5000	19880		42400	5000	19880

### Partners Capital Account

	P	Q	R		P	Q	R
To R's current	---	---	19880	By B b/d	120000	80000	40000
To Realisation	32407	32407	32406	By P's current	42400	---	---
To R's Capital	6172	4114	---	By Q's current	---	5000	---
To cash	123821	48479	---	By cash			2000

				By P 's capital	---	---	6172
				By Q 's capital	---	---	4114
	162400	85000	52286		162400	85000	52286

**Bank Account**

To Balance b/d.	11000	By cash A/c	11000
	308400		308400

**Cash Account**

To Bank	11000	By Realisation A/c	210300
To Realisation A/c	453600	By P's Loan A/c.	60000
To R's capital A/c.	2000	By Q's Loan A/c.	24000
		By P's capital A/c.	123821
		By Q's Capital A/c.	48479
	466600		466600

