Introduction to Partnership Accounts

Question 1

Laurel and Hardy are partners of the firm LH & Co., from 1.4.2003. Initially both of them contributed Rs.1,00,000 each as capital. They did not contribute any capital thereafter. They maintain accounts of the firm on mercantile basis. They were sharing profits and losses in the ratio of 5:4. After the accounts for the year ended 31.3.2007 were finalized, the partners decided to share profits and losses equally with effect from 1.4.2003.

It was also discovered that in ascertaining the results in the earlier years certain adjustments, details of which are given below, had not been noted.

Year ended 31st March	2004	2005	2006	2007
	Rs.	Rs.	Rs.	Rs.
Profit as per accounts prepared and finalized	1,40,000	2,60,000	3,20,000	3,60,000
Expenses not provided for (as at 31st March)	30,000	20,000	36,000	24,000
Incomes not taken into account (as at 31st March)	18,000	15,000	12,000	21,000

The partners decided to admit Chaplin as a partner with effect from 1.4.2007. It was decided that Chaplin would be allotted 20% share in the firm and he must bring 20% of the combined capital of Laurel and Hardy.

Following is the Balance sheet of the firm as on 31.3.2007 before admission of Chaplin and before adjustment of revised profits between Laurel and Hardy.

Balance Sheet of LH & Co. as at 31.3.2007

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Plant and machinery	60,000
Laurel	2,11,500	Cash on hand	10,000
Hardy	1,51,500	Cash at bank	5,000
Sundry creditors	2,27,000	Stock in trade	3,10,000
		Sundry debtors	2,05,000
	5,90,000		5,90,000

You are required to prepare:

(i) Profit and Loss Adjustment account;

(ii) Capital accounts of the partners; and

(iii) Balance Sheet of the firm after the admission of Chaplin.

(20 Marks) (May, 2007)

Answer

(i) Profit and Loss Adjustment Account*

		Rs.			Rs.
To	Expenses not provided for (years 2004-2007)	1,10,000	By	Income not considered (for years 2004-2007)	66,000
			By	Partners' capital accounts (loss)	
				Laurel	22,000
				Hardy	22,000
		1,10,000			1,10,000

(ii) Partners' Capital Accounts

		Laurel Rs.	Hardy Rs.	Chaplin Rs.			Laurel Rs.	Hardy Rs.	Chaplin Rs.
To	P & L Adjustment A/c	22,000	22,000	-	By	Balance b/d	2,11,500	1,51,500	-
To	Hardy	60,000			By	Laurel	-	60,000	-
To	Balance c/d	1,29,500	1,89,500	63,800	By	Cash	-	-	63,800
		2,11,500	2,11,500	63,800			2,11,500	2,11,500	63,800
					By	Balance b/d	1,29,500	1,89,500	63,800

(iii) Balance Sheet of LH & Co.
as on 1.4.2007
(After admission of Chaplin)

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital accounts:		Plant and machinery	60,000
Laurel	1,29,500	Sundry debtors	2,05,000
Hardy	1,89,500	Stock in trade	3,10,000
Chaplin	63,800	Accrued income	66,000
Sundry creditors	2,27,000	Cash on hand (10,000 + 63,800)	73,800
Outstanding expenses	1,10,000	Cash at bank	5,000
	7,19,800		7,19,800

* It is assumed that expenses and incomes not taken into account in earlier years were fully ignored.

Working Notes:

1. Computation of Profit and Loss distributed among partners

		Rs.
Profit for the year ended	31.3.2004	1,40,000
	31.3.2005	2,60,000
	31.3.2006	3,20,000
	31.3.2007	3,60,000
Total Profit		10,80,000

	Laurel	*Hardy*	*Total*
	Rs.	*Rs.*	*Rs.*
Profit shared in old ratio i.e 5:4	6,00,000	4,80,000	10,80,000
Profit to be shared as per new ratio i.e. 1:1	5,40,000	5,40,000	10,80,000
Excess share	60,000		
Deficit share		(60,000)	

Laurel to be debited by Rs.60,000 and Hardy to be credited by Rs.60,000.

2. Capital brought in by Chaplin

Capital to be brought in by Chaplin must be equal to 20% of the combined capital of Laurel and Hardy	*Rs.*
Capital of Laurel (2,11,500 – 22,000 – 60,000)	1,29,500
Capital of Hardy (1,51,500 – 22,000 + 60,000)	1,89,500
Combined Capital	3,19,000
20% of the combined capital brought in by Chaplin (20% of Rs. 3,19,000)	63,800

Question 2

A and B are equal partners. They admit C and D as partners with 1/5 and 1/6 share respectively. What is the profit sharing ratio of all the partners?

(2 Marks) (May, 2007)

Answer

Let total profits or losses of the firm be 1

Shares of C and D is $\frac{1}{5}$ and $\frac{1}{6}$ respectively.

Balance remaining: $1 - (\frac{1}{5} + \frac{1}{6}) = 1 - \frac{11}{30} = \frac{19}{30}$

$\frac{19}{30}$ to be shared equally by A and B as $\frac{9.5}{30} : \frac{9.5}{30}$

New profit sharing ratio will be A: B: C: D

$$\left[\frac{9.5}{30}\times\frac{2}{2}\right]:\left[\frac{9.5}{30}\times\frac{2}{2}\right]:\left[\frac{1}{5}\times\frac{12}{12}\right]:\left[\frac{1}{6}\times\frac{10}{10}\right]$$

Thus new profit sharing ratio of all the partners will be 19:19:12:10.

Question 3

X and Y are partners sharing profits and losses in the ratio of 3:2. On 30th September, 2006 they admitted Z as a partner. The new profit sharing ratio agreed was 2:2:1.

At the time of admission Z brought in a fixture valued at Rs. 6,000 and a machinery worth Rs.24,000. No accounting entry was passed for the fixture brought in by partner Z in the books of the firm.

Also at the time of admission the valuation of goodwill was made. The value of goodwill of X and Y was decided at Rs. 40,000 and value of goodwill of partner Z was fixed at Rs. 20,000. No effect was given to the goodwill value in the books of the firm.

On 31.3.2007, it was decided that partner X would retire and the other partners viz., Y and Z would continue the business of the firm by converting it into a company called YZ Ltd., with equal shareholding in the company.

The partners agreed as below:

(i) The goodwill of the firm shall be fixed at Rs.80,000. Necessary effect for goodwill value not recorded earlier shall be given. The present goodwill value being Rs.80,000 shall be reflected in the books of the company.

(ii) All the assets and liabilities of the firm shall be taken over by the company.

(iii) Partner X would take motor car of the firm at a value of Rs.7,400.

(iv) A plant owned by the firm is sold for Rs.6,000.

(v) The profit of the firm upto 30.9.2006 was Rs.44,000.

(vi) Partner X agreed to leave Rs.90,000 as loan with the firm in return for 12% interest per annum.

Following is the Trial Balance of the firm as on 31.3.2007:

Particulars	*Dr.*	*Cr.*
	Rs.	*Rs.*
Capital Account:		
X	-	*80,000*
Y	-	*50,000*
Z	-	*24,000*
Drawings Account:		
X	*22,000*	-
Y	*20,000*	-
Z	*9,600*	-

Sundry Debtors	*70,000*	-
Sundry Creditors	-	*32,000*
Plant (Book value of plant sold Rs.8,000)	*46,000*	-
Fixtures	*14,000*	-
Stock	*24,000*	-
Motor car	*5,400*	-
Cash at bank	*34,600*	-
Profit and Loss A/c (for the year)		*59,600*
	2,45,600	*2,45,600*

You are required to prepare:

(i) *Goodwill Adjustment Account*

(ii) *Profit and Loss Appropriation Account*

(iii) *Partners' Capital Accounts*

(iv) *Balance Sheet of YZ Ltd. after conversion.*

(20 Marks) (November, 2007)

Answer

(i) Goodwill Adjustment Account

				Rs.					Rs.
30.9.07	To	Partners' Capital A/cs (in old ratio)			30.9.06	By	Partners' Capital A/cs (in new ratio)		
			X	24,000				X	24,000
			Y	16,000				Y	24,000
			Z	20,000				Z	12,000
31.3.07	To	Partners' Capital A/cs			31.3.07	By	Goodwill A/c		
			X	32,000			(Goodwill raised in the book)		80,000
			Y	32,000					
			Z	16,000					
				1,40,000					1,40,000

(ii) Profit and Loss Appropriation Account

To	Plant - Loss on sale of plant		2,000	By	Motor Car	2,000
To	Partners' Capital A/cs			By	Profit and Loss A/c	59,600
		X	32,640			

Y	23,840		
Z	3,120		
	61,600		61,600

Calculation of profit apportionment:	*Total*	*X*	*Y*	*Z*
	Rs.	*Rs.*	*Rs.*	*Rs.*
Upto 30.9.2006	44,000	26,400	17,600	NIL
From 01.10.2006 to 31.3.2007	15,600	6,240	6,240	3,120
	59,600	32,640	23,840	3,120

(iii) **Partners' Capital Accounts**

			X	*Y*	*Z*				*X*	*Y*	*Z*
			Rs.	*Rs.*	*Rs.*				*Rs.*	*Rs.*	*Rs.*
30.9.06	To	Goodwill Adjustment A/c	24,000	24,000	12,000	30.9.06	By	Balance	80,000	50,000	-
31.7.07	To	Motor car	7,400	-	-		By	Plant & machinery	-	-	24,000
	To	Drawings	22,000	20,000	9,600		By	Fixtures	-	-	6,000
	To	12% Loan	90,000	-	-		By	Goodwill Adjustment A/c	24,000	16,000	20,000
	To	Bank	25,240	-	-		By	Profit upto 30.9.06	26,400	17,600	-
	To	Balance c/d	-	77,840	47,520	31.7.07	By	Profit for 6 months ended 31.3.07	6,240	6,240	3,120
							By	Goodwill Adj. A/c	32,000	32,000	16,000
			1,68,640	1,21,840	69,120				1,68,640	1,21,840	69,120
31.7.07	To	Bank		15,160	-	31.7.07	By	Balance b/d		77,840	47,520
	To	Share capital		62,680	62,680		By	Bank			15,160
				77,840	62,680					77,840	62,680

(iv) **Balance Sheet of YZ Ltd.**

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital	1,25,360	Goodwill	80,000
12% Loan	90,000	Plant (46,000 – 8,000)	38,000
Sundry creditors	32,000	Fixtures (14,000 + 6,000)	20,000
		Stock	24,000
		Sundry debtors	70,000
		Cash at bank	15,360
	2,47,360		2,47,360

Bank A/c

		Rs.			*Rs.*
To	Balance b/d	34,600	By	X's Capital A/c	25,240
To	Plant (sold) A/c	6,000	By	Y's Capital A/c	15,160
To	Z's capital A/c	15,160	By	Balance c/d	15,360
		55,760			55,760

Total capital of the firm before conversion:

Y	77,840
Z	47,520
	1,25,360

As Y and Z would continue with equal shareholding, therefore, share capital of Y and Z would be Rs.1,25,360 / 2 = Rs.62,680 each.

	Rs.
Z should bring cash Rs.(62,680 – 47,520) =	15,160
Y should withdraw cash Rs.(77,840 – 62,680) =	15,160

Question 4

A, B, and C are partners sharing profits and losses in the ratio of 3:2:1. B retired from the firm. Partners A and C decided to take his share in 3:1 ratio. What is the new ratio of the partners A and C?

(2 Marks) (November, 2007)

Answer

Calculation of new profit and loss sharing ratio of partners A and C

1/3rd share of B taken by oartners A & C in 3:1 i.e.

=> A will receive from B = $\frac{1}{3} \times \frac{3}{4} = \frac{1}{4}$

=> C will receive from B = $\frac{1}{3} \times \frac{1}{4} = \frac{1}{12}$

Total share of A and C will be:

A = $\frac{3}{6} + \frac{1}{4} = \frac{12+6}{24} = \frac{18}{24}$ or $\frac{3}{4}$

C = $\frac{1}{6} + \frac{1}{12} = \frac{2+1}{12} = \frac{3}{12}$ or $\frac{1}{4}$

Therefore, new profit and loss sharing ratio of A and C will be 3:1.

Question 5

A, B and C are partners of the firm ABC & Co., sharing profits and losses in the ratio of 5:3:2. Following is the Balance Sheet of the firm as at 31.3.2008:

Balance Sheet as at 31.3.2008

Liabilities	*Rs.*	*Assets*	*Rs.*
Partners' capital accounts:		*Goodwill*	*1,00,000*
A	*4,50,000*	*Building*	*10,50,000*
B	*1,30,000*	*Machinery*	*6,50,000*
C	*1,70,000*	*Furniture*	*2,15,000*
Investment fluctuation reserve	*1,00,000*	*Investments (market value Rs.75,000)*	*60,000*
Contingency reserve	*75,000*	*Stock*	*6,50,000*
Long-term loan	*15,00,000*	*Sundry debtors*	*6,95,000*
Bank overdraft	*2,20,000*	*Advertisement suspense*	*25,000*
Sundry creditors	*8,00,000*		
	34,45,000		*34,45,000*

It was decided that B would retire from the partnership on 1.4.2008 and D would be admitted as a partner on the same date. Following adjustments are agreed amongst the partners for the retirement/admission:

(i) Goodwill is to be valued at Rs.5,00,000, but the same will not appear as an asset in the books of the firm.

(ii) Building and machinery are to be revalued at Rs.10,00,000 and Rs.5,20,000 respectively.

(iii) Investments are to be taken over by B at the market value.

(iv) Provision for doubtful debts to be maintained at 20% on sundry debtors.

(v) The capital of the reconstituted firm will be Rs.10,00,000 to be contributed by the partners A, C and D in their new profit sharing ratio of 2 :2 : 1.

(vi) Surplus funds if any will be used to pay the bank overdraft.

(vii) Amount due to retiring partner B will be transferred to his loan account.

Prepare:

(i) Revaluation Account;

(ii) Capital Accounts of the partners; and

(iii) Balance Sheet of the firm after reconstitution.

(20 Marks) (May, 2008)

Answer

(i) Revaluation Account

		Rs.				Rs.
To	Building	50,000	By	Investments		15,000
To	Machinery	1,30,000	By	Partners' capital A/cs (Loss on revaluation)		
To	Provision for doubtful debts	1,39,000		A	1,52,000	
				B	91,200	
				C	60,800	3,04,000
		3,19,000				3,19,000

(ii) Partners' Capital Accounts

	A	B	C	D		A	B	C	D
	Rs.	*Rs.*	*Rs.*	*Rs.*		*Rs.*	*Rs.*	*Rs.*	*Rs.*
To Revaluation A/c	1,52,000	91,200	60,800	-	By Balance b/d	4,50,000	1,30,000	1,70,000	-
To Goodwill (W.N.2)	50,000	30,000	20,000	-	By Contingency Reserve	37,500	22,500	15,000	-
To A and B (W.N.3)	-	-	1,00,000	1,00,000	By Investment fluctuation Reserve	50,000	30,000	20,000	-
To Investments	-	75,000	-	-					
To Advertisement suspense	12,500	7,500	5,000	-	By C and D (W.N.3)	50,000	1,50,000	-	-
To B's Loan A/c (Bal. fig.)	-	1,28,800	-	-	By Bank (Bal.fig.)	27,000	-	3,80,800	3,00,000
To Balance c/d (W.N.4)	4,00,000	-	4,00,000	2,00,000					
	6,14,500	3,32,500	5,85,800	3,00,000		6,14,500	3,32,500	5,85,800	3,00,000

(iii) **Balance Sheet as at 01.04.2008**

(After retirement of B and admission of D)

Liabilities	*Rs.*	*Assets*		*Rs.*
Partners' capital accounts (W.N.4)		Building		10,00,000
A	4,00,000	Machinery		5,20,000
C	4,00,000	Furniture		2,15,000
D	2,00,000	Stock		6,50,000
Long term loan	15,00,000	Debtors	6,95,000	
B's loan	1,28,800	*Less:* Provision for doubtful debts	1,39,000	5,56,000
Sundry creditors	8,00,000	Cash at bank (W.N.1)		4,87,800
	34,28,800			34,28,800

Working Notes:

1. **Bank Account**

		Rs.				*Rs.*
To	A's capital A/c	27,000	By	Balance (Overdraft)	b/d	2,20,000
To	C's capital A/c	3,80,800	By	Balance (Bal. fig.)	c/d	4,87,800
To	D's capital A/c	3,00,000				
		7,07,800				7,07,800

2. Goodwill, already shown in the Balance Sheet of Rs. 1,00,000, is firstly written off and then an adjusting entry is passed for revalued goodwill of Rs. 5,00,000 in sacrificing and gaining ratio of partners. This treatment is given based on the para 36 of AS 10, which states that goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it.

3. **Calculation of sacrificing and gaining ratio**

Partners	*New share*	*Old share*	**Share Sacrificed**		**Share Gained**	
A	$\frac{2}{5}$	$\frac{5}{10}$	$\frac{2}{5} - \frac{5}{10} =$	$\frac{1}{10}$		
B		$\frac{3}{10}$		$\frac{3}{10}$		
C	$\frac{2}{5}$	$\frac{2}{10}$			$\frac{2}{5} - \frac{2}{10}$	$\frac{1}{5}$
D	$\frac{1}{5}$					$\frac{1}{5}$

Adjusting Entry

		Rs.	Rs.
C's Capital A/c	Dr.	1,00,000	
D's Capital A/c	Dr.	1,00,000	
To A's Capital A/c			50,000
To B's Capital A/c			1,50,000

4. Capitals of A, C and D as per new ratio

		Rs.
Total Capital of the firm after admission		10,00,000
A's share =	$10,00,000 \times \frac{2}{5}$	4,00,000
C's share =	$10,00,000 \times \frac{2}{5}$	4,00,000
D's share =	$10,00,000 \times \frac{1}{5}$	2,00,000

Question 6

P, Q and R share profit and losses in the ratio of 4:3:2 respectively. Q retires and P and R decide to share future profits and losses in the ratio of 5:3. Then immediately H is admitted for 3/10 share of profits half of which was gifted by P and the remaining share was taken by H equally from P and R. Calculate the new profit sharing ratio after H's admission and gaining ratio of P and R after Q's retirement.

(2 Marks) (November, 2008)

Answer

(a) Calculation of new profit sharing ratio after H's admission:

$$P = \frac{5}{8} - \left[\frac{3}{10} \times \frac{1}{2}\right] - \left[\frac{3}{10} \times \frac{1}{4}\right]$$

$$= \frac{5}{8} - \frac{3}{20} - \frac{3}{40}$$

$$= \frac{25-6-3}{40} = \frac{16}{40}$$

$$R = \frac{3}{8} - \left[\frac{3}{10} \times \frac{1}{4}\right]$$

$$= \frac{3}{8} - \frac{3}{40} = \frac{15-3}{40} = \frac{12}{40}$$

$$H = \frac{3}{10} \text{ or } \frac{3}{10} \times \frac{4}{4} = \frac{12}{40}$$

Hence,

New Ratio of P : R : H

16:12:12

Or 4 : 3 : 3

(b) Calculation of gaining ratio of P and R after Q's retirement:

P = $\frac{5}{8}-\frac{4}{9}=\frac{45-32}{72}=\frac{13}{72}$

R = $\frac{3}{8}-\frac{2}{9}=\frac{27-16}{72}=\frac{11}{72}$

Question 7

A and M are partners, sharing profits and losses in the ratio of 3:2. G is admitted for 1/4th share. Thereafter, N enters the partnership for 20 Paise in a Rupee. Compute new profit sharing ratio.

(2 Marks) (June, 2009)

Answer

Let the total share be = 1

Share of new partner G = $\frac{1}{4}$

Remaining share of profit = 1- $\frac{1}{4}$ = $\frac{3}{4}$

New ratio of (A) = $\frac{3}{4}\times\frac{3}{5}=\frac{9}{20}$

New ratio of (M) = $\frac{3}{4}\times\frac{2}{5}=\frac{6}{20}$

New ratio of A:M:G = 9: 6: 5

Again, let the total share at the time of admission of N = 1

Share of new partner N is 20% i.e. $\frac{1}{5}$

Remaining share = 1- $\frac{1}{5}$ = $\frac{4}{5}$

New ratio of A = $\frac{4}{5}\times\frac{9}{20}=\frac{9}{25}$

New ratio of M = $\frac{4}{5}\times\frac{6}{20}=\frac{6}{25}$

$\therefore$ New ratio of G = $\frac{4}{5}\times\frac{5}{20}=\frac{5}{25}$

New ratio of A:M:G:N = 9:6:5:5

Question 8

P, N and T are equal partners. The decided to change their profit sharing ratio into 5:4:3. They raised the goodwill in the books to the extent of Rs.2,40,000 and it is to be written off immediately. Show Journal entries with narration to be passed for raising the goodwill and for its subsequent write off.

(2 marks) (November, 2009)

Answer

Journal Entries

	Dr. (Rs.)	*Cr. (Rs.)*
Goodwill A/c Dr.	2,40,000	
To A's Capital A/c		80,000
To B's Capital A/c		80,000
To C's Capital A/c		80,000
(Being the value of goodwill raised in the books, in old profit sharing ratio)		
A's Capital A/c Dr.	1,00,000	
B's Capital A/c Dr,	80,000	
C's Capital A/c Dr.	60,000	
To Goodwill A/c		2,40,000
(Being the value of goodwill written off from the books of the firm, in new profit sharing ratio)		

Note: As per para 36 of AS 10, 'Accounting for fixed Assets,' goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Therefore, the goodwill valued at the time of change in profit and loss sharing ratio is to be adjusted through capital accounts of the partners directly. The journal entries for raising goodwill and then writing it off is not in accordance with the said standard but have been given due to the requirement of the question.

Alternatively, Capital accounts of partner A and partner C may be adjusted to give net effect to the above entries.

The Adjusting Journal entry would be

	Rs.	*Rs.*
A's Capital A/c Dr.	20,000	
To C's Capital A/c		20,000
(Being adjusting entry passed for goodwill, due to change in profit and loss sharing ratio)		