PARTNERSHIP - FUNDAMENTAL

According to Sec. 4 of the Indian Partnership Act, partnership means " the relationship between persons who have agreed to shares profits of a business carried on by all or any of them acting for all." Person who have entered into partnership with one another are individually called 'partners' and collectively 'a firm' and the name under which their business is carried on is called the 'firm name'.

There are two types of firms.

(1) Registered partnership firm
(2) Non- Registered partnership firm

In the absence of partnership deed the following rules are applicable as per Partnership Act 1932.

(1) Profits and losses should be divided equally.
(2) No, interest on capital will be allowed on partner's capital.
(3) No, interest on drawings will be charged on partner's drawing.
(4) No, Salaries, Bonus and Commission will be allowed to any partner.
(5) Interest on partner's loan is to be allowed @6% p.a. only.

Interest on capital:-it is clear that interest on partner's capital is not allowed unless the partnership deed so provides, it means there must be a definite provision in the partnership deed about it. But if the partnership deed provides for interest on capital but does not stipulate the effect in case of loss, no such interest on capital is allowed.

(1) **Interest on opening capital:-** Interest on capital is allowed only on opening capital

$$\textbf{Interest on capital} = \frac{\text{Opening Capital X Rate}}{100}$$

(2) Interest on additional capital:- interest on additional capital will be allowed for the period of investment in the business.

$$\textbf{Interest on capital} = \frac{\text{Additional Capital X Rate X months}}{100 \text{ X } 12}$$

Interest on Drawings:- if interest on capital is allowed to the partners, it is fair that interest on drawings should be charged. The rate at which interest should be charged is laid down in the Partnership Deed.

Method 1:-

(i) If date of drawing is not given:- Interest on Drawings will be calculated on an average basis:

$$\textbf{Interest on drawings} = \frac{\text{Drawings X RateX 1}}{100 \text{ X } 2}$$

(ii) If date of drawing and interest rate p.a. is not given:- interest will be calculated as follows:-

Interest on drawings = $\frac{\text{Drawings X Rate}}{100}$

(iii) **If average rate of interest is given:- interest will be calculated as follows**

Interest on drawings = $\frac{\text{Drawings X Average Rate}}{100}$

Method 2:-

If date of drawing is given:- interest on drawings will be calculated for the actual period of drawings

Interest on drawings = $\frac{\text{Drawings X RateX Months}}{100 \text{ X } 12}$

Method3:- if drawings are made on monthly basis

(a) If drawings at the beginning of the month (Product Methods)

Date	Drawings	Time	Product
1^{st} Jan	100	12	1200
1^{st} Feb	100	11	1100
1^{st} March	100	10	1000
1^{st} April	100	09	900
1^{st} May	100	08	800
1^{st} June	100	07	700
1^{st} July	100	06	600
1^{st} August	100	05	500
1^{st} September	100	04	400
1^{st} October	100	03	300
1^{st} November	100	02	200
1^{st} December	100	01	100
	1200		7800

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{100 \text{ X } 12}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 6.5}}{100 \text{ X } 12}$

(a) If drawings at the end of the month (Product Methods)

Date	Drawings	Time	Product
31^{st} Jan	100	11	1100
28^{th} Feb	100	10	1000
31^{st} March	100	09	900
30^{th} April	100	08	800
31^{st} May	100	07	700

30th June	100	06	600
31st July	100	05	500
31st August	100	04	400
30th September	100	03	300
31st October	100	02	200
30th November	100	01	100
31st December	100	0	000
	1200		6600

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{\text{100 X 12}}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 5.5}}{\text{100 X 12}}$

(a) If drawings at the middle of the month (Product Methods)

Date	Drawings	Time	Product
15th Jan	100	11.5	1150
15th Feb	100	10.5	1050
15th March	100	09.5	950
15th April	100	08.5	850
15th May	100	07.5	750
15th June	100	06.5	650
15th July	100	05.5	550
15th August	100	04.5	450
15th September	100	03.5	350
15th October	100	02.5	250
15th November	100	1.5	150
15th December	100	0.5	50
	1200		7200

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{\text{100 X 12}}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 6.5}}{\text{100 X 12}}$

Method 4:-

(a) If drawings at the beginning of the quarter (Product Methods)

Date	Drawings	Time	Product
1st Jan	100	12	1200
1st April	100	09	900
1st July	100	06	600

1st October	100	03	300
	400		3000

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{\text{100 X 12}}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 7.5}}{\text{100 X 12}}$

(a) If drawings at the end of the quarter (Product Methods)

Date	Drawings	Time	Product
31st March	100	9	900
30th June	100	6	600
30th September	100	3	300
31st December	100	0	000
	400		1800

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{\text{100 X 12}}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 4.5}}{\text{100 X 12}}$

(a) If drawings at the middle of the quarter (Product Methods)

Date	Drawings	Time	Product
15th Feb	100	10.5	1050
15th May	100	07.5	750
15th August	100	04.5	450
15th November	100	1.5	150
	400		2400

Interest on Drawings = $\frac{\text{Sum of products X Rate X 1}}{\text{100 X 12}}$

Shortcut Method:- Interest on Drawings = $\frac{\text{Sum of drawings X Rate X 6}}{\text{100 X 12}}$

PROFIT AND LOSS APPROPRIATION A/C

PARTICULAR	AMOUNT	PARTICULAR	AMOUNT
To Interest on Capital		By Profit b/d ✓	
A ✓		Less- interest on	
B ✓	✓	loan ✓	✓
To Salary		By interest on Drawings	
A ✓		A ✓	
B ✓	✓	B ✓	✓
To Bonus			
A ✓			
B ✓	✓		
To Commission			
A ✓			
B ✓	✓		
To Transfer to general reserve	✓		
To Share of Profit	✓		
A ✓			
B ✓	✓		
	✓		✓

FIXED CAPITAL

PARTICULAR	A	B	PARTICULAR	A	B
To Bank	✓	✓	BY Balance b/d	✓	✓
To balance c/d	✓	✓	By Bank	✓	✓
	✓	✓		✓	✓

Current Account

PARTICULAR	A	B	PARTICULAR	A	B
To balance b/d	✓	✓	BY Balance b/d	✓	✓
To drawings	✓	✓	By Interest on Capital	✓	✓
To interest on Drawings	✓	✓	By Salary	✓	✓
To P&L Appropriation	✓	✓	By Bonus	✓	✓
			By Commission	✓	✓
To balance c/d	✓	✓	By Share of Profit	✓	✓
	✓	✓		✓	✓

CAPITAL ACCOUNT

PARTICULAR	A	B	PARTICULAR	A	B
To balance b/d	✓	✓	BY Balance b/d	✓	✓
To drawings	✓	✓	By Bank (additional capital)	✓	✓
To interest on Drawings	✓	✓	By Interest on Capital	✓	✓
To P&L Appropriation (loss)	✓	✓	By Salary	✓	✓
To balance c/d	✓	✓	By Bonus	✓	✓
			By Commission	✓	✓
			By Share of Profit (profit)	✓	✓
	✓	✓		✓	✓

ADMISSION OF A PARTNER

When the existing partner firm needs more finance for extension and development and technical skill, it appoints a new partner, of course with the consent of all partners. Due to admission of a partner existing agreement comes to an end and a new agreement comes into existence with new partner.

According to Sec 31(1) of Indian Partnership Act, 1932, " A person can be admitted as a new partner only with the consent of the existing partners unless otherwise agreed upon."

At the time of admission, new partner brings his capital and his share of goodwill and old partner given a profit sharing to new partner out of his share.

At the time of admission of a partner the following accounts will be prepared.

(1) Revaluation Account.
(2) Partners Capital Account
(3) Cash or Bank Account
(4) Balance Sheet of new firm

At the time of admission of a partner it is need to make the following adjustment.

1. Calculation of profit sharing ratio.
2. Valuation of Goodwill.
3. Treatment of Goodwill.
4. Revaluation of Assets and liability.
5. Adjustment of Accumulated profit / losses, Reserves and funds.
6. Adjustment of Capital (if new and old partners agreed).

Ratio

- Old Ratio
- New Ratio
- Sacrificing Ratio = Old Ratio – New Ratio
  Gaining Ratio = New Ratio - Old Ratio

Old ratio :- means profit sharing ratio of old partner before change in the constitution of the firm.
If A and B are partner in a firm with sharing ratio 3:2. They admitted C as a partner for 1/4thshare
It means old ratio of A and B is 3:2.

New Ratio:- means profit sharing of partners after the change in the constitution of the firm.
If A and B are partner in a firm with sharing ratio 3:2. They admitted C as a partner and after admission profit sharing ratio of A , B and C are 2:2:1.
It means newratio of A, B and C are 2 :2 : 1.

Example -1. A and B are partner in a firm sharing profit and losses in the ratio of 3:2. They admitted C as a partner for 1/4th share in the profits. Calculate the new profit sharing ratio and the sacrificing ratio.
Solution:-

Profit sharing ratio of old partner A and B = 3:2

Let the profit be = 1

C's share in profit= $\frac{1}{4}$

Remaining share = 3/4[th]

So, remaining profit will be distributed between A and B in the ratio 3:2 .

A's new ratio $= \frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$

B's new ratio $= \frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$

C's new ratio $== \frac{1}{4}$

New ratio of A , B and C = $\frac{9}{20}$: 6/20 : 1/4 or 9 : 6 : 5.

Sacrificing ratio = old ratio – new ratio

A's = $\frac{3}{5} - \frac{9}{20} =$

Goodwill

A business establishes some reputation in course of time. Goodwill is the value of this reputation which the business builds up due to efficient serve to its customers, quality of a products, etc. This reputations enables the business to earn more than the normal profits earned by the other businesses. If the new partner is therefore, admitted into the firm which enjoys some goodwill in the market, it is fair that he brings in some amount in addition to his capital. It is a real assets but intangible since it has no physical existence.

The factors on which the value of goodwill depends are:

1. The locations of the business
2. The nature of the firm's product or the reputations of the product.
3. The personal reputations of the partners.
4. The possession of trademarks, patents or well-known business name.
5. Continuance of advertising campaigns.

The value of goodwill may be ascertained in a partnership firm under any one of the following circumstances.

(a) Admission of a partner
(b) Change in the profit sharing ratio
(c) Retirement or death of a partner
(d) Dissolution or sale of the business

Method of valuation of goodwill

Valuation of goodwill is not an easy thing. The valuation of goodwill is normally mentioned in the partnership deed. There are different methods of its valuation they are:

1. Average Profit Method:
   (a) Simple Average profit method:

In this case, goodwill is valued on the basis of last few years average profits which is multiply by number of years agreed by partners to arrive at the value of goodwill.

$$\text{Average Profit} = \frac{\text{Total profits of the year}}{\text{Numbers of years}}$$

Goodwill = Average profit X No. of years purchases

Illustration 1.A, B and C are partners in a firm. They share profits and losses in the ratio of 3:2:1. They admitted D as a partner for 1/6th share and goodwill is valued on the basis of 3 years purchase of the last 4years average profits.

Ist year- 20000 IIndyear- 15000 IIIrd Year- 17000 IVth year-28000

Compute the value of the goodwill of the firm.

Solution:

$$\text{Average Profit} = \frac{\text{Total profits of the year}}{\text{Numbers of years}}$$

$$= \frac{20000 + 15000 + 17000 + 28000}{4}$$

$$= 20000$$

Goodwill = Average profit X No. of years purchases

= 20000 X 3

= 60000

(b) Weighted Average Profit Method:

Under this method, the profit of the past few years is multiplied by the respective weights for ascertaining product.

$$\text{Average Profit} = \frac{\text{Sum of products}}{\text{sum of years}}$$

Illustration: A and B are partners with sharing ratio 3:2. They admitted C as a partner for 1/4th share. On C 's admission goodwill will be valued on the basis of 3 years purchase of last 4 years weighted average profits. Profit Ist year – 10'000, IInd year – 20,000, IIIrdyaer – 30,000 and IVth year- 40,000.

Year	Profit	Weight	Product
Ist	10'000	1	10,000
IInd	20,000	2	40,000
IIIrd	30,000	3	90,000
IVth	40,000	4	160,000
		10	3,00,000

$$\text{Weighted average profit} = \frac{\text{sum of product}}{\text{Sum of Weight}}$$

Goodwill = Weighted average Profit X No. of Years purchased
= 3,00,00 X 3
= Rs. 90,000

Super Profit Method :-Super profit means the profit earned by a firm more than expected profit earned by other firm in the same business. Under this method these three steps will be followed.

1. Normal Profit = $\frac{\textbf{Capital Employed} \times \textbf{Normal rate of return}}{\textbf{100}}$
2. Super Profit = $Actual\ Average\ Profit - Normal\ Profits$
3. $Goodwill = Super\ Profit \times No.of\ years\ purchese$

Illustration: A and B are partner with capital of Rs.60,000& Rs.40,000 respectively. Normal rate of return in such type of business is 10% of capital employed. The average profit of a business over the last 5 years was Rs. 12,000.

Find out the value of the goodwill of the business if it is based on 4 years purchase of the average super profits of the last 5 years.

Solution: Average profit of last 5 years = Rs. 12,000
Less- $Normal\ Profit(@\ 10\%\ 0f\ Rs.60,000 + 40,000) = Rs.10,000$
Super profit =Rs. $\boxed{2,000}$

1. V$alue\ of\ Goodwill = Super\ Profit \times No.of\ years\ purchese$
$= Rs.2,000 \times 4$
$= Rs.8,000$

Capitalization Method: under this method ,the capital invested by the partner in the business is assumed to earn normal or reasonable profit, if the earning more than this normal profit, the excess capital which would have been needed to earn this extra profit is the value of goodwill. There are two methods

1. Capitalize value of average profit method:
Capitalize value$= Actual\ average\ profit \times \frac{100}{Normal\ rate\ of\ return}$

Illustration: A and B are partner with capital of Rs.60,000& Rs.40,000 respectively. Normal rate of return in such type of business is 10% of capital employed. The actual profit of a business at the end of the years was Rs. 12,000. Calculate goodwill.

2. Capitalize value of Super profit method:
Goodwill $= \frac{Super\ profit}{Normal\ rate\ of\ return} \times 100$

Illustration: A and B are partner with capital of Rs.60,000& Rs.40,000 respectively. Normal rate of return in such type of business is 10% of capital employed. The actual profit of a business at the end of the years was Rs. 12,000. Calculate goodwill.

Hidden goodwill method: some time goodwill is hidden and will be calculated with the help of total capital .for example, A and B are partner with capital of Rs. 60,000 and Rs. 40,000 respectively. Theyadmitted C as a partner for $\frac{1}{4}th$share of profit. He brings Rs.40,000 as his capital. Find out goodwill.
Solution:

C paid for $\frac{1}{4}th$ share, capital of. = Rs40,000

For total capitalof the firm $= \text{Rs. } 40{,}000 \times \frac{4}{1}$

$= Rs. 1{,}60{,}000$

$Less - \ Actual\ capital\ of\ the\ firm\ including\ c\ s\ capital = Rs. 1{,}40{,}000$

Goodwill = $Rs. 20{,}000$

TREATMENT OF GOODWILL

Method 1:- Premium privately brought in cash by the new partner

No entry is required

Method 2.Premium brought in cash by the new partner

Example: A and B are partner with profit sharing ratio 3:2. They admitted C as a partner for 1/4th share. He paid Rs. 50,000 as his capital and Rs. 30,000 as his share of premium.

Bank A/c	Dr.	80,000	
To C's Capital A/c			50,000
To Premium A/c			30,000

(Being capital and premium brought in cash by new partner)

Premium A/c	Dr.	30,000	
To A's Capital A/c			Sacrificing Ratio
To B's Capital A/c			Sacrificing Ratio

(Being premium distributed in old partner in sacrificing ratio)

A's Capital A/c	Dr.		
B's Capital A/c	Dr.		
To Bank A/c			

(Being his share of premium withdrawn by old partner)

*A & B will be debited with the same amount as they are credited with in the above entry no.3

Method 3.Goodwill appears in old Balance Sheet and Premium brought in cash by the new partner.

Example: **Balance Sheet**

LIABILITIES	AMOUNTS	ASSETS	AMOUNTS
		Goodwill	10,0000

Adjustment- A and B are equal partner. They admitted C as a partner for 1/4th share and he paid Rs. 50,000 as Capital and Rs. 30,000 as his share of premium.

Solution:

A's Capital A/c	Dr.	6,000	
B's Capital A/c	Dr.	4,000	
To Goodwill A/c			10,000
(Being goodwill written off in old partner old ratio)			

Bank A/c	Dr.	80,000	
To C's Capital A/c			50,000
To Premium A/c			30,000
(Being capital and premium brought in cash by new partner)			

Premium A/c	Dr.	30,000	
To A's Capital A/c			Sacrificing Ratio
To B's Capital A/c			Sacrificing Ratio
(Being premium distributed in old partner in sacrificing ratio)			

A's Capital A/c	Dr.		
B's Capital A/c	Dr.		
To Bank A/c			
(Being his share of premium withdrawn by old partner)			

*A & B will be debited with the same amount as they are credited with in the above entry No. 4

Method 4: Goodwill (Premium) partly paid in cash by the new partner

Example: A and B are partner with profit sharing ratio 3:2. They admitted C as a partner for 1/4th share. He paid Rs. 50,000 as his capital and Rs. 10,000 out of his share Rs.30000 for premium .

Bank A/c	Dr.	60,000	
To C's Capital A/c			50,000
To Premium A/c			10,000
(Being capital and premium brought in cash by new partner)			

Premium A/c	Dr.	10,000	
C's Current A/c	Dr.	3,000	
To A's Capital A/c			Sacrificing Ratio
To B's Capital A/c			Sacrificing Ratio

(Being premium distributed in old partner in sacrificing ratio)

A's Capital A/c	Dr.		
B's Capital A/c	Dr.		
To Bank A/c			

(Being his share of premium withdrawn by old partner)

*A & B will be debited with the same amount as they are credited with in the above entry No. 4

Method 5.Goodwill appears in old Balance SheetGoodwill(Premium) partly paid in cash by the new partner.

Example: **Balance Sheet**

LIABILITIES	AMOUNTS	ASSETS	AMOUNTS
		Goodwill	10,0000

Adjustment- A and B are equal partner. They admitted C as a partner for 1/4th share and he paid Rs. 50,000 as Capital and Rs. 30,000 as his share of premium.

Example: A and B are partner with profit sharing ratio 3:2. They admitted C as a partner for 1/4th share. He paid Rs. 50,000 as his capital and Rs. 10,000 out of his share Rs.30000 for premium .

Solution:

A's Capital A/c	Dr.	6,000	
B's Capital A/c	Dr.	4,000	
To Goodwill A/c			10,000

(Being goodwill written off in old partner old ratio)

Bank A/c	Dr.	60,000	
To C's Capital A/c			50,000
To Premium A/c			10,000

(Being capital and premium brought in cash by new partner)

Premium A/c	Dr.	10,000	
C's Current A/c	Dr.	3,000	
To A's Capital A/c			Sacrificing Ratio
To B's Capital A/c			Sacrificing Ratio

(Being premium distributed in old partner in sacrificing ratio)

A's Capital A/c	Dr.	
B's Capital A/c	Dr.	
To Bank A/c		

(Being his share of premium withdrawn by old partner)

*A & B will be debited with the same amount as they are credited with in the above entry No. 4

Method 6: when premium and capital brought in kinds by the new partner

Example : A and B are partner with sharing ratio 3:2. They admitted C as a Partner for 1/4th share , he brings Rs. 30,000 as cash, Stock worth Rs. 20,000 and Furniture worth Rs. 10000 for his Capital and for share of premium.

Cash A/c	**Dr.**	**30,000**	
Stock A/c	**Dr.**	**20,000**	
Furniture A/c	**Dr.**	**10,000**	
To C's Capital A/c			
To Premium A/c			

(BeingCapital and Premium brought in kinds by the new partner)

Method : 7 No Goodwill (Premium) brought in cash by the new partner

Example: A and B are Partner with sharing ratio 3:2. They admitted C as a partner for 1/4th share and he pays Rs. 50,000 as capital but unable to pay anything for goodwill. Goodwill is valued at Rs. 40,000 at the time of Admission.

Solution :

Bank A/c	Dr.	50,000	
To C's Capital A/c			50,000

(Being capital and brought in cash by new partner)

C's Current a/c	Dr.	10,000	
To A's Capital A/c			sacrificing ratio
To B's capital A/c			sacrificing ratio

(Being share of goodwill adjusted between old partner
In sacrificing ratio)

Revaluation Accounts

Particular		Amounts	Particular		Amounts
To Decrease in value of Assets		✓	By Increase in value of assets		✓
To Increase in value of Liabilities		✓	ByDecrease in value of Liabilities		✓
To Provision for Bad-Debts		✓	By Provision for Creditors		✓
To Provision for discount on debtors		✓	By Provision for discount on creditors		✓
To Outstanding expanses		✓	By Prepaid expanses		✓
To Unaccrued Income		✓	By Accrued income		✓
To Unrecorded Liabilities		✓	By Unrecorded Assets		✓
To Profit-			By loss- (if any)-		
A	✓		A	✓	
B	✓	✓	B	✓	✓
		✓			✓

FIXED CAPITAL

PARTICULAR	A	B	C	PARTICULAR	A	B	C
To Bank A/c	✓	✓	✓	BY Balance b/d	✓	✓	✓
To balance c/d	✓	✓	✓	By Bank A/c	✓	✓	✓
	✓	✓			✓	✓	✓

Current Account

PARTICULAR	A	B	C	PARTICULAR	A	B	C
To balance b/d	✓	✓		BY Balance b/d	✓	✓	
To Goodwill	✓	✓		By Bank (additional capital)	✓	✓	
To P&L A/c	✓	✓		By General reserve	✓	✓	
To Advertisement Suspense a/c	✓	✓		By Workman compensation fund	✓	✓	
To Revaluation a/c (loss)	✓	✓		By Profit and Loss A/c	✓	✓	
To Bank	✓	✓		By Contingent reserve	✓	✓	
				By Investment fluctuion fund	✓	✓ ✓	
To balance c/d	✓	✓	✓	By Revaluation A/c (Share of Profit)	✓	✓	
				By Bank a/c			✓

				By Premium A/c	✓	✓	
	✓	✓	✓		✓	✓	✓

CAPITAL ACCOUNT (floating capital)

PARTICULAR	A	B	C	PARTICULAR	A	B	C
To balance b/d	✓	✓		BY Balance b/d	✓	✓	✓
To Goodwill	✓	✓		By Bank (additional capital)	✓	✓	✓
To P&L A/c	✓	✓		By General reserve	✓	✓	✓
To Advertisement Suspense a/c	✓	✓		By Workman compensation fund	✓	✓	✓
To Revaluation a/c (loss)	✓	✓		By Profit and Loss A/c	✓	✓	✓
To Bank	✓	✓		By Contingent reserve	✓	✓	✓
				By Investment fltion fund	✓	✓	✓
				By Share of Profit (profit)	✓	✓	✓
				By Bank A/c			✓
To balance c/d	✓	✓	✓	By Premium	✓	✓	

Retirement of a Partner

When a partner decides to retire from a partnership firm. A partner may retire from a firm

(1) With the consent of all the other partner of the firm (with express or implied consent)
(2) In accordance with the express agreement of the partners, or
(3) Where the partnership is at will, by given notice in writing to all the other partners of his intention to retire.

Amount payable to the Retiring partner

The Retiring partner has a right to get his capital and others accumulated profits and losses on the date of retirement .

On the retirement of a partner from the firm, the following points usually arise :

For calculation of total amount payable to the retiring partner. The amount payable to him includes :

(a) capital on the date of last Balance Sheet.
(b) Share in accumulated profit appearing in Balance Sheet .
(c) Share in losses appearing in last balance sheet assets side.
(d) Share in the goodwill of the firm.
(e) Share in Revaluation of Assets and Liabilities.
(f) Interest and Salary, if any Payable to him to the date of retirement.

1. Settlement of the retiring partner's accounts .
2. Calculation of new profit sharing ratio.
3. Adjustment of capital of the continuing partners.

REVALUATION OF ASSETS AND LIABILITIES

The retiring partner has a right to get a share in the profit arising on the revaluation of assets and liabilities. If there is a loss on such revaluation, he must bear his share of loss. In order to ascertain profit and loss on revaluation of assets and liabilities, Revaluation Accounts is prepared in exactly the same manner in case of a new partner. Any profit and loss by this account is transferred to the Capital Accounts of all the partners in their profit sharing ratio. The assets and liabilities will appear in the new Balance Sheet (prepared after retirement of a partner) at the revised value or adjusted value.

When the revised and adjusted value values are not to be shown in the new balance sheet , in this case **Memorandum Revaluation Accounts** is prepared.

GOODWILL

The value of goodwill at the time of the retirement of a partner is calculated as per the terms of the agreement amongst the partners. When the value of goodwill is ascertained, it can be dealt with in the books of account in the following manners

The following accounts are prepared at the time of retirement of a partner.

1. Revaluation Account
2. Partners Capital Accounts
3. Partners Loan Accounts
4. Cash or Bank Accounts
5. New Balance Sheet

Revaluation Accounts

Particular	Amounts	Particular	Amounts
To Decrease in value of Assets	✓	By Increase in value of assets	✓
To Increase in value of Liabilities	✓	ByDecrease in value of Liabilities	✓
To Provision for Bad-Debts	✓	By Provision for Creditors	✓
To Provision for discount on debtors	✓	By Provision for discount on creditors	✓
To Outstanding expanses	✓	By Prepaid expanses	✓
To Unaccrued Income	✓	By Accrued income	✓
To Unrecorded Liabilities	✓	By Unrecorded Assets	✓
To Profit-		By loss- (if any)-	
A ✓		A ✓	
B ✓	✓	B ✓	✓
	✓		✓

FIXED CAPITAL

PARTICULAR	A	B	PARTICULAR	A	B
To Bank	✓	✓	BY Balance b/d	✓	✓
To balance c/d	✓	✓	By Bank	✓	✓
	✓	✓		✓	✓

Current Account

PARTICULAR	A	B	PARTICULAR	A	B
To balance b/d	✓	✓	BY Balance b/d	✓	✓
To Goodwill	✓	✓	By Bank (additional	✓	✓
To P&L A/c	✓	✓	capital)	✓	✓
To Advertisement	✓	✓	By General reserve		✓
Suspense a/c			By Workman	✓	
To Drawings			compensation fund		✓
To interest on Drawings	✓	✓	By Profit and Loss A/c	✓	✓
To Revaluation a/c (loss)	✓	✓	By Contingent reserve	✓	✓
To C's capital a/c	✓	✓	By Investment fltion fund	✓	✓
To Bank	✓	✓	By Share of Profit (profit)	✓	✓
To C's loan a/c	✓	✓	By A's Capital	✓	✓
			By B's Capital	✓	✓
To balance c/d	✓	✓	By Joint Life Policy		
			By Profit and loss	✓	✓
			Suspense a/c	✓	✓
			By Interest on Capital	✓	✓

CAPITAL ACCOUNT (floting capital)

PARTICULAR	A	B	C	PARTICULAR	A	B	C
To balance b/d	✓	✓		BY Balance b/d	✓	✓	✓
To Goodwill	✓	✓		By Bank (additional	✓	✓	✓
To P&L A/c	✓	✓		capital)			
To Advertisement	✓	✓		By General reserve	✓	✓	✓
Suspense a/c				By Workman	✓	✓	✓
To Drawings	✓	✓		compensation fund			
To interest on Drawings	✓	✓		By Profit and Loss A/c	✓	✓	✓
To Revaluation a/c (loss)	✓	✓		By Contingent reserve	✓	✓	✓
To C's capital a/c	✓	✓		By Investment fltion fund	✓	✓	✓
To Bank	✓	✓		By Share of Profit (profit)	✓	✓	✓
To C's loan a/c	✓	✓		By A's Capital	✓	✓	✓
				By B's Capital	✓	✓	✓
To balance c/d	✓	✓		By Joint Life Policy	✓	✓	✓

				By Profit and loss Suspense a/c By Interest on Capital	✓ ✓	✓ ✓	✓ ✓
	✓	✓			✓	✓	✓

Treatment of Goodwill

1. **If Goodwill already appears in old Balance sheet.**

Liabilties	Amounts	Assets	Amounts
		Goodwill	12000

Goodwill is valued at the time of retirement was Rs. 30,0000.

Solution:-

(i)	**A's capital a/c**	**Dr.**	**Old Ratio**	
	B's capital a/c	**Dr.**	**Old Ratio**	
	C's capital a/c	**Dr.**	**Old Ratio**	
	To goodwill a/c			**12,000**

(Being old goodwill written off in old partner in old ratio)

(ii)	**A's capital a/c**	**Dr.**	**Gaining ratio**	
	B's capital a/c	**Dr.**	**Gaining ratio**	
	To C's capital a/c			**30000 x his share**

(Being c's share of goodwill adjusted in old partner in Gaining ratio)

2. **If no goodwill appears in old Balance Sheet.**

A's capital a/c	**Dr.**	**Gaining ratio**	
B's capital a/c	**Dr.**	**Gaining ratio**	
To C's capital a/c			**30000 x his share**

(Being c's share of goodwill adjusted in old partner in Gaining ratio)

Treatment of profit upto date of Retirement
Balance Sheet as on 31december 2012

Liabilties	Amounts	Assets	Amounts

C retired from the firm as on 1st April 2013 and his share of profitupto the date of retirement will be calculated on the basis of last 3years average profit.
Ist Year- (Profit) 15000 , IInd Year – (Profit) 20,000, and in IIIrd Year- (Profit) 10,000.

Solution:-

$$Average\ Profi = \frac{15,000 + 20,000 + 10,000}{3}$$

= 15,000

Profit from 1st January 2013 To 31st March 2013

$$3 \text{ months Profit } = \frac{15000\ X\ 3}{12} = 3{,}750$$

C's share in profit = $\frac{3750\ X\ 1}{3} = 1250$

Profit & loss Suspense a/c	Dr.	1250	
To C's capital a/c			1250
(Being share of profit upto date of retirement credited to partner account)			

Treatment of Interest of capital upto date of retirement

$$\boldsymbol{Interest\ on\ Capital = \frac{Capital\ X\ Interest\ Rate\ X\ Months}{100\ X\ 12}}$$

Interest on capital A/c	**Dr.**	✓	
To C's Capital A/c			✓
(Being Interest on capital due upto retirement)			

Settelement of Retiring Partners Capital Account

1. **Full amount paid in cash**
   Retiring partners capital A/c Dr.
   To Cash A/c

2. **Full amount transfer to his loan A/c**
   Retiring partners capital A/c Dr.
   To Retiring partnersLoan A/c

3. **Partly paid in cash and remaining to his loan A/c.**
   Retiring partners capital A/c Dr.
   To Cash A/c
   To Retiring partnersLoan A/c

DEATH OF A PARTNER

IN CASE OF DEATH OF A PARTNER THE FOLLOWING ACCOUNTS WILL BE PREPARED

1. Revaluation Account
2. Partner's capital Accounts
3. Partner's Executers Accounts
4. Partner's Executers loan Accounts
5. Cash or Bank Accounts
6. Balance sheet after death

Revaluation Accounts

Particular	Amounts	Particular	Amounts

To Decrease in value of Assets	✓	By Increase in value of assets	✓
To Increase in value of Liabilities	✓	ByDecrease in value of Liabilities	✓
To Provision for Bad-Debts	✓	By Provision for Creditors	✓
To Provision for discount on debtors	✓	By Provision for discount on creditors	✓
To Outstanding expanses	✓	By Prepaid expanses	✓
To Unaccrued Income	✓	By Accrued income	✓
To Unrecorded Liabilities	✓	By Unrecorded Assets	✓
To Profit-		By loss- (if any)-	
A ✓		A ✓	
B✓	✓	B ✓	✓
	✓		✓

FIXED CAPITAL

PARTICULAR	A	B	PARTICULAR	A	B
To Bank	✓	✓	BY Balance b/d	✓	✓
To balance c/d	✓	✓	By Bank	✓	✓
	✓	✓		✓	✓

Current Account

PARTICULAR	A	B	PARTICULAR	A	B
To balance b/d	✓	✓	BY Balance b/d	✓	✓
To Goodwill	✓	✓	By Bank (additional capital)	✓	✓
To P&L A/c	✓	✓	By General reserve	✓	✓
To Advertisement Suspense a/c	✓	✓	By Workman compensation fund	✓	✓
To Drawings			By Profit and Loss A/c	✓	✓
To interest on Drawings	✓	✓	By Contingent reserve	✓	✓
To Revaluation a/c (loss)	✓	✓	By Investment fltion fund	✓	✓
To C's Executer a/c	✓	✓	By Share of Profit (profit)	✓	✓
To balance c/d	✓	✓	By A's Capital	✓	✓
			By B's Capital	✓	✓
			By Joint Life Policy	✓	✓
			By Profit and loss Suspense a/c	✓	✓
			By Interest on Capital	✓	✓

	✓	✓		✓	✓

CAPITAL ACCOUNT (floting capital)

PARTICULAR	A	B	C	PARTICULAR	A	B	C
To balance b/d	✓	✓		BY Balance b/d	✓	✓	✓
To Goodwill	✓	✓		By Bank (additional capital)	✓	✓	✓
To P&L A/c	✓	✓		By General reserve	✓	✓	✓
To Advertisement Suspense a/c	✓	✓		By Workman compensation fund	✓	✓	✓
To Drawings	✓	✓		By Profit and Loss A/c	✓	✓	✓
To interest on Drawings	✓	✓		By Contingent reserve	✓	✓	✓
To Revaluation a/c (loss)	✓	✓		By Investment fltion fund	✓	✓	✓
To C's Executer a/c	✓	✓		By Share of Profit (profit)	✓	✓	✓
To balance c/d	✓	✓		By A's Capital	✓	✓	✓
				By B's Capital	✓	✓	✓
				By Joint Life Policy	✓	✓	✓
				By Profit and loss Suspense a/c	✓	✓	✓
				By Interest on Capital	✓	✓	✓

Partner's Executer Accounts

PARTICULAR	Amounts	PARTICULAR	Amounts
To Bank A/c To Executer's loan A/c	✓ ✓	By partners capital A/c	✓
	✓		✓

Treatment of Goodwill

3. **If Goodwill already appears in old Balance sheet.**

Liabilties	Amounts	Assets	Amounts
		Goodwill	12000

Goodwill is valued at the time of retirement was Rs. 30,0000.

Solution:-

(i)	**A's capital a/c**	**Dr.**	**Old Ratio**	
	B's capital a/c	**Dr.**	**Old Ratio**	
	C's capital a/c	**Dr.**	**Old Ratio**	
	To goodwill a/c			**12,000**

(Being old goodwill written off in old partner in old ratio)

(ii)	**A's capital a/c**	**Dr.**	**Gaining ratio**	
	B's capital a/c	**Dr.**	**Gaining ratio**	
	To C's capital a/c			**30000 x his share**

(Being c's share of goodwill adjusted in old partner in Gaining ratio)

4. If no goodwill appears in old Balance Sheet.

A's capital a/c	**Dr.**	**Gaining ratio**	
B's capital a/c	**Dr.**	**Gaining ratio**	
To C's capital a/c			**30000 x his share**

(Being c's share of goodwill adjusted in old partner in Gaining ratio)

Treatment of profit upto date of Retirement
Balance Sheet as on 31december 2012

Liabilties	Amounts	Assets	Amounts

C retired from the firm as on 1st April 2013 and his share of profitupto the date of retirement will be calculated on the basis of last 3years average profit.
Ist Year- (Profit) 15000 , IInd Year – (Profit) 20,000, and in IIIrd Year- (Profit) 10,000.

Solution:-

$$Average\ Profi = \frac{15,000 + 20,000 + 10,000}{3}$$

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Profit from 1st January 2013 To 31st March 2013

$$3 \text{ months Profit} = \frac{15000\ X\ 3}{12} = 3{,}750$$

C's share in profit = $\frac{3750\ X\ 1}{3} = 1250$

Profit & loss Suspense a/c	Dr.	1250	
To C's capital a/c			1250
(Being share of profit upto date of retirement credited to partner account)			

Treatment of Interest of capital upto date of retirement

$$\boldsymbol{Interest\ on\ Capital = \frac{Capital\ X\ Interest\ Rate\ X\ Months}{100\ X\ 12}}$$

Interest on capital A/c	**Dr.**	✓	
To C's Capital A/c			✓
(Being Interest on capital due upto retirement)			

<u>Settelement of Retiring Partners Capital Account</u>

4. **Full amount paid in cash**
   Retiring partners capital A/c Dr.
   To Cash A/c

5. **Full amount transfer to his loan A/c**
   Retiring partners capital A/c Dr.
   To Retiring partnersLoan A/c

6. **Partly paid in cash and remaining to his loan A/c.**
   Retiring partners capital A/c Dr.
   To Cash A/c
   To Retiring partnersLoan A/c

DISSOLUTION OF FIRM

with consent of all the partners a firm may be dissolved. There is a difference between “dissolution of partnership” and “Dissolution of firm”. If there is some change in existing partnership due to admission, retirement and death of a partner is called “dissolution of partnership” and when all the partners decide to close the business of the firm permanently is known as “Dissolution of firm”. It means complete breakdown of partnership relation between all the partners.

In this condition there are six steps-

1. To find out Assets.
2. To find out Liabilities.
3. Realization from assets.
4. Payment of Liabilities
5. Payment of realization expenses and
6. Settlement of partners’ capital accounts

Dissolution takes place in the following conditions

1. Dissolution by agreement
2. Dissolution by notice of partnership at will.
3. Dissolution by court .

In case of dissolution of the firm the following accounts will be prepared

1. Realization Accounts
2. Partners capital Accounts
3. Partners Loan Accounts
4. Cash and Bank Accounts

Realisation Accounts

PARTICULAR	**Amounts**	**PARTICULAR**	**Amounts**
To Assets-(Except cash &Bank)		By Provision for Bad- debts	
Goodwill		By investment fluctuation fund	
Plant & Machinery		By joint life policy reserve	
Land & Building		By- Liabilities- (outside)	
Furniture & Fixture		Creditors	
Investment		Bills payable	
Joint life policy		Outstanding expenses	
Closing Stock		Partner's relative's loan	
Debtors		Bank overdraft	
Prepaid Expenses			
		By Bank / cash - (Sale of Assets)	
To Bank /Cash–			
(Liabilities Paid)		By Partner's Capital A/c	
To Partner's Capital A/c		(Assets taken over by partners)	
(liabilities taken over by			
partners)		By Loss- (if any)	
To Bank / Cash-		A	
(Realization Expenses Paid)		B	
To Partner's Capital A/c			
(Realization Expenses Paid by			
partner)			
To Profit-			
A			
B			

PARTNER'S CAPITAL ACCOUNTS

PARTICULAR	A	B	PARTICULAR	A	B
To Realization A/c (Assets taken)	✓	✓	By Balance b/d	✓	✓
To Realization A/c (loss sharing)	✓	✓	By Realization A/c (Liabilities taken)	✓	✓
To Bank A/c (final settlement)			By Realization A/c (expenses paid)	✓	✓
			By Realization A/c (Profit sharing)	✓	✓
	✓	✓		✓	✓

PARTNER'S LOAN ACCOUNTS

PARTICULAR	Amounts	PARTICULAR	Amounts
To Bank A/c	✓	By Balance b/d	✓
	✓		✓

BANK OR CASH ACCOUNTS

PARTICULAR	Amounts	PARTICULAR	Amounts
To Balance b/d	✓	By Realization A/c (Liabilities paid)	✓
To Realization A/c (Assets sold)	✓	By Realization A/c (Expenses paid)	✓
		By A's capital A/c	✓
		By B's capital A/c	✓
	✓		✓