CHAPTER 2

PARTNERSHIP ACCOUNTS

UNIT - 1: DISSOLUTION OF PARTNERSHIP FIRMS

LEARNING OUTCOMES

After studying this unit, you will be able to–

- Go through the circumstances in which a partnership is dissolved.
- Understand that on dissolution of a partnership all assets are sold out and all liabilities are discharged. Learn the accounting technique relating to disposal of assets and payment of liabilities.
- Learn how to settle the partner's claims in case of surplus and how to raise money from partners in case of deficit.
- Deal with piecemeal distribution to partners of amount realised from assets net of liabilities.

UNIT OVERVIEW

Circumstances leading to Dissolution of Partnership

- where the firm is constituted for a fixed term, on the expiry of that term
- where the firm is constituted to carry out one or more adventures or undertaking, then by completion thereof
- by the death of a partner, and
- by the adjudication of a partner as an insolvent.

Methods of piecemeal distribution

Piecemeal distribution involves either of two methods

- Maximum loss method
- Highest relative capital method

1.1. INTRODUCTION

Apart from readjustment of rights of partners in the share of profit by way of change in the profit sharing ratio and admission of a new partner or for retirement/death of a partner, another important aspect of partnership accounts is how to close books of accounts in case of dissolution. In this Unit, we will discuss the circumstances leading to dissolution of a partnership firm and accounting treatment necessary to close its books of accounts. Also we will discuss the special problems relating to insolvency of partners and settlement of partnership's liabilities.

1.2 CIRCUMSTANCES LEADING TO DISSOLUTION OF PARTNERSHIP

A partnership is dissolved or comes to an end on:

(a) the expiry of the term for which it was formed or the completion of the venture for which it was entered into;

(b) death of a partner;

(c) insolvency of a partner.

However, the partners or remaining partners (in case of deathor insolvency) may continue to do the business. In such case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved.

A firm stands dissolved in the following cases:

(i) The partners agree that the firm should be dissolved;

(ii) All partners except one become insolvent;

(iii) The business becomes illegal;

(iv) In case of partnership at will, a partner gives notice of dissolution; and

(v) The court orders dissolution.

The court has the option to order dissolution of a firm in the following circumstances :

(a) Where a partner has become of unsound mind;

(b) Where a partner suffers from permanent incapacity;

(c) Where a partner is guilty of misconduct of the business;

(d) Where a partner persistently disregards the partnership agreement;

(e) Where a partner transfers his interest or share to a third party;

(f) Where the business cannot be carried on except at a loss; and

(g) Where it appears to be just and equitable.

1.3 CONSEQUENCES OF DISSOLUTION

On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, are realised. Then the amount realised, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards the capital contributed by partners is repaid and, if there is still surplus, it is distributed among the partners in their profit-sharing ratio.

Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm left over are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit-sharing ratio.

According to the provisions contained in section 48 of the Partnership Act, upon dissolution of partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

(a) Losses including deficiencies of capital are paid, first out of profits, next out of capital and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:

   (i) in paying the debts of the firm to third parties;

   (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;

   (iii) in paying to each partner what is due to him on account of capital; and

   (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

1.3.1 Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund of premium or of such part as may be reasonable, if the firm is dissolved before the term has expired.

No claim in this respect will arise if:

(1) the firm is dissolved due to the death of a partner;

(2) the dissolution is mainly due to the partner's (claiming refund) own misconduct; and

(3) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit- sharing ratio.

1.4 CLOSING OF PARTNERSHIP BOOKS ON DISSOLUTION

We will illustrate the required journal entries to be made for closing the books of a firm with the example given below:

Balance Sheet of Fast and Quick as at Dec. 31, 20X1

Liabilities		₹	***Assets***		₹
Sundry Creditors		20,000	Plant and Machinery		40,000
Fast's Loan		10,000	Patents		6,000
General Reserve		10,000	Stock		25,000
Capitals:			Sundry Debtors	19,000	
Fast	30,000		*Less:* Prov. for doubtful debts	(1,000)	18,000
Quick	25,000	55,000	Cash		6,000
		95,000			95,000

Fast and Quick share profits in the ratio of 3:2. On 1st January, 20X2 the firm was dissolved. Fast took over the patents at a valuation of ₹ 5,000. The other assets realised as under:

	₹
Goodwill	15,000
Plant and Machinery	30,000
Stock	22,000
Sundry Debtors	18,500
Total	85,500

The Sundry Creditors were paid off at a discount of 5%. The expense amounted to ₹ 3,500. The steps to close the books are given below:

I. Open a **Realisation Account** and **transfer all assets** except cash in hand or at bank at book values. Realisation Account is debited and the various assets are credited and thus closed. It should be remembered that Sundry Debtors and Provisions for Bad Debts Accounts are two separate accounts and the gross amount of debtors should be transferred. In the above example the entry will be:

		₹	₹
Realisation Account	Dr.	90,000	
To Plant and Machinery Account			40,000
To Patents Account			6,000
To Stock Account			25,000
To Sundry Debtors			19,000
(Transfer of various assets to the debit side of Realisation Account)			

II. **Transfer of liabilities** to outsiders and provisions and reserves against assets (e.g., Provision for Doubtful Debts) to the credit side of Realisation account. The accounts of the liabilities and provisions will be debited and thus closed. The entry should be at book figures. The entry will be:

		₹	₹
Sundry Creditors Account	Dr.	20,000	
Provision for Doubtful Debts Account	Dr.	1,000	
To Realisation Account			21,000
(Transfer of liabilities to outsiders and provision against debtors to Realisation Account)			

Note: Accounts denoting accumulated losses or profits should not be transferred to the Realisation Account.

III. (i) The Realisation Account should be **credited with the actual amount realised by sale of assets**. This should take no note of the book figures. of course, Cash (or Bank) Account will be debited. Thus:

		₹	₹
Cash Account	Dr.	85,500	
To Realisation Account			85,500
(Amount realised by sale of various assets)			

(ii) If a **partner takes over an asset**, his Capital Account should be debited and Realisation Account credited with the value agreed upon, Thus:

		₹	₹
Fast's Capital Account	Dr.	5,000	
To Realisation Account			5,000
(Patents taken over by Fast at ₹ 5,000)			

IV. **Expenses of dissolution** or realisation of assets are debited to the Realisation Account and credited to Cash Account. Thus

		₹	₹
Realisation Account	Dr.	3,500	
To Cash Account			3,500
(Payment of Expenses)			

V. (i) The actual amount **paid to creditors** should be debited to the Realisation Account and Cash Account is credited:

		₹	₹
Realisation Account	Dr.	19,000	
To Cash Account			19,000
(Payment of Sundry Creditors ₹ 20,000 less 5%)			

(ii) If any **liability is taken over by a partner**, his Capital Account should be credited and Realisation Account debited with the amount agreed upon.

VI. At this stage, the Realisation Account will show **profit or loss**. If the debit side is bigger, there is a loss; if the credit side is bigger, there is a profit. Profit or loss is transferred to the Capital Accounts of partners in the profit sharing ratio. In case of profit, Realisation Account is debited and Capital Accounts credited. The entry for loss is, naturally, reverse of this entry. The Realisation Account in the example given above shows a loss of ₹ 1,000 (see account below).

	₹	₹
Fast’s Capital Account Dr.	600	
Quick's Capital Account Dr.	400	
To Realisation Account		1,000
(Transfer of loss to Capital Account in the ratio of 3:2)		

VII. **Partner's Loans** if any, should now be paid. The entry is to debit the Loan Account and credit Cash Account. Thus:

		₹	₹
Fast’s Loan Account	Dr.	10,000	
To Cash Account			10,000
(Repayment of Fast’s Loan)			

VIII. Any **reserve** of accumulated profit or loss lying in the books (as shown by the Balance Sheet) should be transferred to the Capital Account in the profit sharing ratio. Thus:

		₹	₹
General Reserve	Dr.	10,000	
To Fast’s Capital Account			6,000
To Quick’s Capital Account			4,000
(General Reserve transferred to Capital Account in the ratio of 3:2)			

IX. At this stage the Capital Accounts of partners will show how much amount is due to them or from them. The partner owing money to the firm will pay; Cash Account will be debited and his Capital Account credited and thus closed. Money owing to a partner will be paid to him; his Capital Account will be debited and the Cash Account credited. This will close the Capital Accounts as well as the Cash Account. The entry in the above example is seen in the Capital Accounts below:

		₹	₹
Fast's Capital Account	Dr.	30,400	
Quick's Capital Account	Dr.	28,600	
To Cash Account			59,000
(Amount paid to partners on Capital Account)			

Ledger Accounts

Plant and Machinery Account

20X2		₹	**20X2**		₹
Jan. 1	To Balance b/d	40,000	Jan. 1	By Realisation A/c - Transfer	40,000

Patents Accounts

20X2		₹	**20X2**		₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realisation A/c - Transfer	6,000

Stock Account

20X2		₹	**20X2**		₹
Jan. 1	To Balance b/d	25,000	Jan. 1	By Realisation A/c - Transfer	25,000

Sundry Debtors Account

20X2		₹	**20X2**		₹
Jan. 1	To Balance b/d	19,000	Jan. 1	By Realisation A/c - Transfer	19,000

Provision for Doubtful Debts Account

20X2		₹	**20X2**		₹
Jan. 1	To Realisation A/c Transfer	1,000	Jan. 1	By Balance b/d	1,000

Sundry Creditors Account

20X2		₹	20X2		₹
Jan. 1	To Realisation A/c Transfer	20,000	Jan. 1	By Balance b/d	20,000

Fast's Loan Account

20X2		₹	20X2		₹
Jan. 1	To Cash Account	10,000	Jan. 1	By Balance b/d	10,000

General Reserve Account

20X2		₹		20X2		₹
Jan. 1	To Capital Accounts			Jan. 1	By Balance b/d	10,000
	Fast	6,000				
	Quick	4,000	10,000			
			10,000			10,000

Realisation Account

20X2		₹	20X2			₹
Jan.	To Sundry Assets		Jan.	By Sundry Creditors		20,000
	Plant and Machinery	40,000		By Provision for Doubtful Debts		1,000
	Patents	6,000		By Cash Account-assets realised		85,500
	Stock	25,000				
	Sundry Debtors	19,000		By Fast's Capital Account-patents taken over		5,000
	To Cash Account-Exp.	3,500				
	To Cash Account-Creditors paid	19,000		By Loss to :		
				Fast	600	
				Quick	400	1,000
		1,12,500				1,12,500

Cash Account

20 X2		₹		20 X2	₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realisation A/c-Exp.	3,500
	To Realisation b/d	85,500	Jan. 1	By Realisation A/c-Creditors	19,000
			Jan. 1	By Fast's Loan Account	10,000
			Jan. 1	By Fast's Capital A/c	30,400
			Jan. 1	By Quick's Capital A/c	28,600
		91,500			91,500

Fast's Capital Account

20 X2		₹	20 X2		₹
Jan. 1	To Realisation A/c-Patents	5,000	Jan. 1	By Balance b/d	30,000
	To Realisation A/c-Loss	600	Jan. 1	By General Reserve	6,000
	To Cash Account	30,400			
		36,000			36,000

Quick's Capital Account

20 X2		₹	20 X2		₹
Jan. 1	To Realisation A/c-loss	400	Jan. 1	By Balance b/d	25,000
	To Cash Account	28,600		By General Reserve	4,000
		29,000			29,000

Note :

(1) If any of the assets is taken over by a partner at a value mutually agreed to by the partners, debit the Partner’s Capital Account and credit Realisation Account with the price of asset taken over.

(2) Pay off the liabilities, crediting cash and debiting the liability accounts, the difference between the book figure and the amount paid being transferred to the Realisation Account.

(3) Liabilities to outsiders may also be transferred to the Realisation Account. In that case, the amount paid in respect of the liabilities in cash should be debited

to the Realisation Account, Cash Account being credited. If liability is taken over by a partner, Realisation Account should be debited and the Partners' Capital A/cs credited at the figure agreed upon.

(4) The balance of the Realisation Account will represent either the profit or loss on realisation. Divide it between the partners in the proportion in which they shared profits and losses. In the case of a loss, credit Realisation Account and debit various partners' Capital Accounts; follow the opposite course in the case of a profit.

(5) Pay off the partners' loans or advances which are separate from the capital (if any) contributed by them, after setting off against them any debit balance in the capital account of the concerned partner.

(6) The balance of the cash account at the end will be exactly equal to the balance of capital account, provided they are in credit; credit cash and debit the partners' capital account with the amount payable to them to close their accounts.

If the capital account of a partner is in debit, after his share of loss or profit has been adjusted therein, the firm will not have sufficient cash or assets to pay off the amounts due to the other partners, until the amount is repaid by the partner whose account is in debit. If however, the partner is insolvent, the amount will not be realised. In such a case, the deficiency may be borne by the solvent partners in their profit-sharing ratio or according to the principle settled in the well known case of *Garner* vs. *Murray*. In the latter case, the deficiency would be borne by the solvent partners in proportion to their capitals and not in the proportion in which they share profits and losses.

1.5 CONSEQUENCES OF INSOLVENCY OF A PARTNER

If a partner goes insolvent then the following are the consequences:

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.
2. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
3. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and

4. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

1.6 LOSS ARISING FROM INSOLVENCY OF A PARTNER

When a partner is unable to pay his debt due to the firm he is said to be insolvent and the share of loss is to be borne by other solvent partners in accordance with the decision in the English case of Garner vs. Murray.

According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

The determination of capital ratio for this has been explained below. The provisions of the Indian Partnership Act are not contrary to Garner vs. Murray rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.
- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances it is better not to transfer the amount of creditors to Realisation Account.
- Creditors may be paid the amount available including the amount contributed by the partners.
- The unsatisfied portion of creditor account is transferred to Capital Accounts of the partners in the profit sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

Illustration 1

X, Y and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4 : 3 : 2. Following is the Balance Sheet of the firm as at 31st March, 20X1 :

Balance Sheet as at 31st March, 20X1

Liabilities	**₹**	***Assets***	**₹**
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry debtors	5,00,000
Z	2,00,000	Cash in hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above said date.

Fixed assets realised ₹5,20,000 and book debts ₹4,40,000.

Stocks were valued at ₹2,50,000 and it was taken over by partner Y.

Creditors allowed discount of 5% and the expenses of realisation amounted to ₹6,000.

You are required to prepare:

(i) Realisation account;

(ii) Partners capital account; and

(iii) Cash account.

Soultion

(i) Realisation Account

		₹			₹
To	Fixed assets	5,00,000	By	Creditors	3,20,000
To	Stock in trade	3,00,000	By	Cash (5,20,000+4,40,000)	9,60,000
To	Debtors	5,00,000	By	Y (Stock taken over)	2,50,000
To	Cash - Expenses	6,000	By	Loss transferred to partners' capital accounts	
To	Cash -Creditors (3,20,000 x 95%)	3,04,000		X	35,555
				Y	26,667
				Z	17,778
		16,10,000			16,10,000

(ii) Partners' Capital Accounts

		X	Y	Z			X	Y	Z
		₹	₹	₹			₹	₹	₹
To	Realisation Account	35,555	26,667	17,778	By	Balance b/d	4,00,000	3,00,000	2,00,000
To	Realisation Account	-	2,50,000	-	By	General reserve	40,000	30,000	20,000
To	Cash	4,04,445	53,333	2,02,222					
		4,40,000	3,30,000	2,20,000			4,40,000	3,30,000	2,20,000

(iii) Cash Account

		₹			₹
To	Balance b/d	10,000	By	Realisation A/c (Expenses)	6,000
To	Realisation A/c (Fixed assets and book debts realised)	9,60,000	By	Realisation A/c (Creditors)	3,04,000
			By	X	4,04,445
			By	Y	53,333
			By	Z	2,02,222
		9,70,000			9,70,000

Illustration 2

P, Q and R were partners sharing profits and losses in the ratio of 3 : 2 : 1, no partnership salary or interest on capital being allowed. Their balance sheet on 30th June, 20X1 is as follows:

Liabilities		₹	Assets		₹
Fixed Capital			Fixed assets :		
P	20,000		Goodwill		40,000
Q	20,000		Freehold Property		8,000
R	10,000	50,000	Plant and Equipment		12,800
Current Accounts :			Motor Vehicle		700
P	500		Current Assets		
Q	9,000	9,500	Stock		3,900
Loan from P		8,000	Trade Debtors	2,000	
Trade Creditors		12,400	Less : Provision	(100)	1,900
			Cash at Bank		200
			Miscellaneous losses		
			R's Current Account		400
			Profit and Loss Account		12,000
		79,900			79,900

On 1st July, 20X1 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of ₹ 500 but no cash passed specifically in respect of this transaction. Sale of other assets realised the following amounts:

	₹
Goodwill	nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

Trade Creditors were paid ₹ 11,700 in full settlement of their debts. The costs of dissolution amounted to ₹ 1,500. The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and *was only able to bring 1/3 of the amount due.*

You are required to show:

(a) Cash and Bank Account,

(b) Realisation Account, and

(c) Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

Solution

Cash / Bank Account

	₹		₹
To Balance b/d	200	By Realisation A/c-Creditors	11,700
To Realisation A/c-		By Realisation A/c-Expenses	1,500
Freehold property	7,000	By P's Loan A/c	8,000
Plant and Equipment	5,000	By P's Capital A/c	14,200
Stock	3,000	By Q's Capital A/c	24,200
Trade Debtors	1,600		
To Capital Accounts:			
P 25,500			
Q 17,000			
R 300	42,800		
	59,600		59,600

Realisation Account

	₹			₹
To Goodwill	40,000	By Trade Creditors		12,400
To Freehold Property	8,000	By Provision for Bad Debts		100
To Plant and Equipment	12,800	By Bank :		
To Motor Vehicle	700	Freehold Property	7,000	
To Stock	3,900	Plant and Equip.	5,000	
To Sundry Debtors	2,000	Stock	3,000	
To Bank (Creditors)	11,700	Debtors	1,600	16,600

To Bank (Expenses)	1,500	By Q (Car)		500
		By Capital Accounts: (Loss)		
		P	25,500	
		Q	17,000	
		R	8,500	51,000
	80,600			80,600

Partners' Capital Accounts

	P	Q	R		P	Q	R
	₹	₹	₹		₹	₹	₹
To Current A/c (Transfer)	5,500*	—	2,400**	By Balance b/d	20,000	20,000	10,000
To Realisation A/c (Loss)	25,500	17,000	8,500	By Current A/c (Transfer)	—	5,000***	—
To Realisation A/c (Car)	—	500	—	By Bank	—	—	300
				By Bank (realisation loss)	25,500	17,000	—
To R's Capital A/c (Deficiency)	300	300	—				
To Bank	14,200	24,200	—	By P & Q (Deficiency)	—	—	600
	45,500	42,000	10,900		45,500	42,000	10,900

Note:

1. P, Q and R will bring cash to make good their share of the loss on realisation. In actual practice they will not be bringing any cash; only a notional entry will be made.
2. On following Garner Vs. Murray rule, solvent partners P and Q have to bear the loss due to insolvency of a partner R in their fixed capital ratio.

Current account balances have been arrived after adjusting profit and loss account debit balance as follows:

* ₹ 6,000 - ₹ 500 = ₹ 5,500

** ₹ 2,000 + ₹ 400 = ₹ 2,400

*** ₹ 9,000 - ₹ 4,000 = ₹ 5,000

Illustration 3

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 20X1 when the firm was dissolved:

	₹		₹
Creditors A/c	*4,800*	*Plant & Machinery*	*2,500*
Amal's Capital A/c	*750*	*Furniture*	*500*
		Debtors	*1,000*
		Stock	*800*
		Cash	*200*
		Bimal's drawings	*550*
	5,550		*5,550*

The assets realised as under:

	₹
Plant & Machinery	*1,250*
Furniture	*150*
Debtors	*400*
Stock	*500*

The expenses of realisation amounted to ₹ 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.

Show necessary ledger accounts to close the books of the firm.

Solution

In the books of M/s Amal and Bimal

Realisation Account

	₹			₹
To Sundry Assets :		By Cash A/c :		
Plant & Machinery	2,500	Plant & Machinery	1,250	
Furniture	500	Furniture	150	
Debtors	1,000	Debtors	400	

Stock	800	Stock	500	2,300
Cash A/c-expenses	175	By Partners' Capital A/c		
		Loss on realisation (Bal.fig.)		
		Amal	1,337	
		Bimal	1,338	2,675
	4,975			4,975

Cash Account

	₹		₹
March 31, 20*X1*		March 31, 20*X1*	
To Balance b/d	200	By Realisation A/c- expenses	175
To Realisation A/c		By Sundry Creditors A/c (Bal.fig.)	2,525
- Sale of sundry assets	2,300		
To Bimal's Capital A/c	200		
	2,700		2,700

Sundry Creditors Account

	₹		₹
To Cash A/c	2,525	By Balance b/d	4,800
To Deficiency A/c-transfer (bal.fig.)	2,275		
	4,800		4,800

Partners' Capital Account

	Amal	***Bimal***		***Amal***	***Bimal***
	₹	₹		₹	₹
To Balance b/f	—	550	By Balance b/f	750	—
To Realisation A/c			By Cash A/c	—	200
- loss	1,337	1,338	By Deficiency		
			A/c- transfer (bal.fig.)	587	1,688
	1,337	1,888		1,337	1,888

Deficiency Account

	₹		₹
To Partners' Capital A/c		By Sundry Creditors A/c	2,275
Amal	587		
Bimal	1,688		
	2,275		2,275

Illustration 4

A, B, C and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 20X1 when their balance sheet was as under:

Liabilities		₹	***Assets***	₹
Creditors		*15,700*	*Bank*	*535*
Employees Provident Fund		*6,300*	*Debtors*	*15,850*
Capital Accounts :-			*Stock*	*25,200*
A	*40,000*		*Prepaid Expenses*	*800*
B	*20,000*	*60,000*	*Plant & Machinery*	*20,000*
			Patents	*8,000*
			C's Capital A/c	*3,200*
			D's Capital A/c	*8,415*
		82,000		*82,000*

Following information is given to you :-

1. *One of the creditors took some of the patents whose book value was ₹ 5,000 at a valuation of ₹ 3,200. Balance of the creditors were paid at a discount of ₹ 400.*

2 *There was a joint life policy of ₹ 20,000 (not mentioned in the balance sheet) and this was surrendered for ₹ 4,500.*

3 *The remaining assets were realised at the following values:- Debtors ₹ 10,800; Stock ₹ 15,600; Plant and Machinery ₹ 12,000; and Patents at 60% of their book-values. Expenses of realisation amounted ₹ 1,500.*

D became insolvent and a dividend of 25 paise in a rupee was received in respect of the firms claim against his estate. Prepare necessary ledger accounts.

Solution

Realisation Account

		₹			₹
To Sundry Assets :-			By Creditors		15,700
Debtors	15,850		By Employee's Provident Fund		6,300
Stock	25,200				
Prepaid Expenses	800		By Bank A/c :-		
Plant & Machinery	20,000		Joint Life Policy	4,500	
Patents	8,000	69,850	Debtors	10,800	
To Bank-Creditors: (₹ 15,700 – ₹ 3,200-₹ 400)		12,100	Stock	15,600	
To Bank A/c Employee's (P.F)		6,300	Plant and Machinery	12,000	
To Bank A/c (expenses)		1,500	Patents 60% of (₹ 8,000 – ₹ 5,000)	1,800	44,700
			By Loss transferred to :		
			A's Capital A/c	9,220	
			B's Capital A/c	6,915	
			C's Capital A/c	4,610	
			D's Capital A/c	2,305	23,050
		89,750			89,750

Capital Accounts

	A ₹	B ₹	C ₹	D ₹		A ₹	B ₹	C ₹	D ₹
To Bal. b/d	—	—	3,200	8,415	By Bal. b/d	40,000	20,000	—	—
To Realisation A/c	9,220	6,915	4,610	2,305	By Bank (Realisation loss)	9,220	6,915	4,610	—
To D's Capital (Deficiency)	5,360	2,680	—	—	By Bank (Recovery)	—	—	—	2,680
To Bank	34,640	17,320	—	—	By A's Capital 2/3	—	—	—	5,360
					By B's Capital 1/3	—	—	—	2,680
					By Bank A/c		—	3,200	—
	49,220	26,915	7,810	10,720		49,220	26,915	7,810	10,720

Bank Account

	₹		₹
To Balance b/d	535	By Realisation A/c	12,100
To Realisation A/c	44,700	By Realisation A/c	6,300
To A's Capital A/c	9,220	By Realisation A/c	1,500
To B's Capital A/c	6,915	By A's Capital A/c	34,640
To D's Capital A/c	2,680	By B's Capital A/c	17,320
To C's Capital A/c (4,610 + 3,200)	7,810		
	71,860		71,860

Working Note

D's loss will be borne by A and B only because only solvent partners having credit balance has to bear the loss on account of insolvency. C will bring his share of loss in cash.

Illustration 5

M/s X, Y and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as at December 31, 20X1 :

Liabilities	₹	₹	***Assets***	₹	₹
Capital : X	*29,200*		*Fixed Assets*		*40,000*
Y	*10,800*		*Stock*		*25,000*
Z	*10,000*	*50,000*	*Book Debts*	*25,000*	
Z's Loan		*5,000*	*Less : Provision*	*(5,000)*	*20,000*
Loan from Mrs. X		*10,000*	*Cash*		*1,000*
Sundry Trade Creditors		*25,000*	*Advance to Y*		*4,000*
		90,000			*90,000*

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 20X1 and had been received but the purchase was not recorded in books.

Fixed assets realised ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on the average. The expenses of realisation come to

₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything.

Give accounts to close the books; work according to the decision in Garner vs. Murray.

Solution

Realisation Account

	₹			₹
To Sundry		By Provision for Doubtful Debts		5,000
Fixed Assets (transfer)	40,000	By Cash (20,000+21,000+20,500)		61,500
Stock	25,000	By Sundry Trade Creditors		
Book Debts	25,000	(Discount)		580
To Cash—Expenses	1,080	By Loss : X (2/5)	9,600	
		Y (2/5)	9,600	
		Z (1/5)	4,800	24,000
	91,080			91,080

Sundry Trade Creditors

	₹		₹
To Realisation A/c – Discount		By Balance b/d	25,000
@ 2% on ₹ 29,000	580	By Sundry Capital Accounts	
To Cash	28,420	(Purchase omitted)	4,000
	29,000		29,000

Z's Loan Account

	₹		₹
To Cash Account	5,000	By Balance b/d	5,000

Mrs. X's Loan Account

	₹		₹
To X's Capital A/c - transfer	10,000	By Balance b/d	10,000

Cash Account

	₹		₹
To Balance b/d	1,000	By Sundry Trade Creditors	28,420
To Realisation A/c-		By Realisation A/c - expenses	1,080
assets realised	61,500	By Z's Loan	5,000
To X's Capital A/c*	9,600	By X's Capital A/c	34,300
To Z's Capital A/c*	4,800	By Z's Capital A/c	8,100
	76,900		76,900

*X and Z bring these amounts to make good their share of the loss on realisation. In actual practice they will not be bringing any cash; only a notional entry will be made.

Capital Accounts

	X	Y	Z		X	Y	Z
	₹	₹	₹		₹	₹	₹
To Sundry Trade Creditors- omission	1,600	1,600	800	By Balance b/d	29,200	10,800	10,000
To Balance c/d	27,600	9,200	9,200				
	29,200	10,800	10,000		29,200	10,800	10,000
To Advance	-	4,000	-	By Balance b/d	27,600	9,200	9,200
To Realisation A/c- loss	9,600	9,600	4,800	By Mrs. X's Loan	10,000	-	-
To Y's Capital A/c	3,300	-	1,100	By Cash (Realisation loss)	9,600	-	4,800
				By X's Capital A/c-		3,300	
To Cash	34,300	-	8,100	By Z's Capital A/c	-	1,100	-
	47,200	13,600	14,000		47,200	13,600	14,000

Note *:* Y's deficiency comes to ₹ 4,400 (difference in the two sides of his Capital Account); this has been debited to X and Z in the ratio of 27,600 : 9,200 *i.e.,* capital standing up just before dissolution but after correction of error committed while drawing up the accounts for 20X1.

Illustration 6

Yash, Tanish and Ruchika were partners sharing Profit & Loss in ratio of 3:2:1. Balance Sheet of the firm is as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
Fixed Capital:		Fixed Assets	45,000
- Yash	50,000	Investments	15,000
- Tanish	20,000	Current Assets:	
- Ruchika	10,000	- Stock	10,000
Current Accounts:		- Debtors	27,500
- Yash	6,000	- Cash & Bank	12,500
- Ruchika	4,000	Current Account:	
Unsecured Loans	15,000	- Tanish	10,000
Current Liabilities	15,000		-
	1,20,000		1,20,000

On 1st April, 20X1 all the partners agreed to form a new company YTR Pvt. Ltd., which will take over the firm as going concern including goodwill, but excluding cash and bank balances. The following matters were also agreed upon:

(i) *Goodwill should be valued at 3 years' purchase of super profits.*

(ii) *Actual profit for the purpose of goodwill valuation will be ₹ 20,000.*

(iii) *The normal rate of return will be 17.50% per annum of Fixed Capital.*

(iv) *All other Assets and Liabilities will be taken over at book value.*

(v) *The purchase consideration will be paid partly in share of ₹ 1 each and partly in cash. Yash and Tanish to acquire interest in new company in the ratio of 3:2 at face value. Ruchika agreed to retire after taking her share in cash.*

(vi) *Realisation expenses amounted to ₹ 5,000.*

Prepare Realisation Account, Cash and Bank Account, YTR Private Limited Account and Capital Accounts of the partners.

Solution

Realisation Account

		₹		₹
To Sundry Assets			By Unsecured Loans	15,000
Fixed Assets	45,000		By Current Liabilities	15,000
Investments	15,000		By YTR Ltd. (W.N. 2)	85,500
Stock	10,000			
Debtors	27,500	97,500		
To Bank A/c (Realisation Expenses)		5,000		
To Profit on realisation transferred to				
Yash	6,500			
Tanish	4,333			
Ruchika	2,167	13,000		
		1,15,500		1,15,500

Cash and Bank Account

	₹		₹
To Balance b/d	12,500	By Realisation A/c – Expenses	5,000
To YTR(P) Ltd.	8,667	By Ruchika Capital A/c	16,167
	21,167		21,167

YTR Pvt. Ltd.

	₹		₹
To Realisation A/c	85,500	By Cash and bank A/c	8,667
		By Equity Shares in YTR Pvt. Ltd. A/c	76,833
	85,500		85,500

Partners' Capital Accounts

	Yash	Tanish	Ruchika		Yash	Tanish	Ruchika
	₹	₹	₹		₹	₹	₹
To Current A/c	-	10,000	–	By Balance b/d	50,000	20,000	10,000
To Cash and bank A/c	–	–	16,167	By Current A/c	6,000	–	4,000
				By Realisation A/c	6,500	4,333	2,167
To Equity Shares in YTR Ltd. (in 3:2)	46,100	30,733	–	By Yash's capital A/c - adjustment		16,400	–
To Tanish's capital A/c- adjustment	16,400						
	62,500	40,733	16,167		62,500	40,733	16,167

Working Notes:

1. Calculation of Goodwill

	₹
Actual profits	20,000
Less: Normal Rate of Return @ 17.5% of fixed capital worth ₹ 80,000	14,000
Super Profits	6,000
Goodwill valued at 3 years' purchase	18,000

2. Calculation of Purchase Consideration

	₹
Total value of assets as per Balance Sheet	1,20,000
Less: Cash and Bank Balances	12,500
Current account	10,000
	97,500
Add: Goodwill	18,000
	1,15,500

Less: Liabilities taken over	
Unsecured Loan	15,000
Current Liabilities	15,000
Purchase Consideration	85,500

Note: In the above answer, goodwill has not been raised but has been considered for the purpose of computation of purchase consideration.

1.7 PIECEMEAL PAYMENTS

Generally, the assets sold upon dissolution of partnership are realised only in small instalments over a period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected. Usually, the first course is adopted. In order to ensure that the distribution of cash among the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made.

1.7.1 Maximum Loss Method

Each instalment realised is considered to be the final payment *i.e.*, outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a distribution is made, following either *Garner* vs. *Murray* Rule or the profit-sharing ratio rule.

Illustration 7

The following is the Balance Sheet of A, B, C on 31st December, 20X1 when they decided to dissolve the partnership:

Liabilities	***₹***	***Assets***	***₹***
Creditors	*2,000*	*Sundry Assets*	*48,500*
A's Loan	*5,000*	*Cash*	*500*
Capital Accounts :			
A	*15,000*		
B	*18,000*		
C	*9,000*		
	49,000		*49,000*

The assets realised the following sums in instalments:

I	*1,000*
II	*3,000*
III	*3,900*
IV	*6,000*
V	*20,100[1]*
	34,000

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only.

Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1.

Solution

First of all, the following table will be constructed to show the amounts available for distribution among the various interests:

Statement showing Realisation and Distribution of Cash Payments

	Realisation ₹	***Creditors*** ₹	***Partners' Loan*** ₹	***Partners' Capitals*** ₹
1. After taking into account cash balance and amount set aside for expenses	1,000	1,000	-	-
2.	3,000	1,000	2,000	-
3.	3,900	-	3,000	900
4.	6,000	-	-	6,000
Including saving in expenses	20,100	-	-	20,100
	34,000	2,000	5,000	27,000

To ascertain the amount distributable out of each instalment realised among the partners, the following table will be constructed:

---

[1] *includes saving in expenses i.e. ₹100 (₹500 - ₹400).*

Statement of Distribution on Capital Account

(1) Calculation to determine the mode of distribution of ₹ 900

	Total	A	B	C
	₹	₹	₹	₹
Balance	42,000	15,000	18,000	9,000
Less: Possible loss, should remaining assets prove to be worthless (in their profit sharing ratio)	(41,100)	(16,440)	(16,440)	(8,220)
	+ 900	– 1,440	+ 1,560	+ 780
Deficiency of A's capital written off against those of B and C in the ratio of their capital, 18,000 : 9,000 (*Garner* vs. *Murray*)			(960)	(480)
Manner in which the first ₹ 900 should be distributed			+ 600	+ 300

(2) Distribution of ₹ 6,000

Balance after making payment of amount shown in step (1)	41,100	15,000	17,400	8,700
Less : Possible Loss assuming remaining asset to be valueless (in their profit sharing ratio)	(35,100)	(14,040)	(14,040)	(7,020)
Balance available and to be distributed	6,000	960	3,360	1,680

(3) Distribution of ₹ 20,100

Balance after making payment of amount shown in step (2)	35,100	14,040	14,040	7,020
Less : Possible loss, assuming remaining assets to be valueless (in their profit sharing ratio)	(15,000)	(6,000)	(6,000)	(3,000)
Manner of distribution of ₹ 20,100	20,100	8,040	8,040	4,020
Summary :				
Balance	42,000	15,000	18,000	9,000
Total amounts paid	27,000	9,000	12,000	6,000
Loss	15,000	6,000	6,000	3,000

1.7.2 Highest Relative Capital Method

According to this method, the partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit-sharing ratio, is first paid off. This method is also called as proportionate capital method.

For determining the amount by which the capital of each partner is in excess of his relative capital, partners' capitals are first divided by figures that are in proportion to their profit-sharing ratio; the smallest quotient will indicate the basic capital. Having ascertained the partner who has the smallest basic capital, the amount of capital of other partners proportionate to the profit-sharing ratio of the basic capital is calculated. These may be called as their hypothetical capitals. The amount of hypothetical capital of each partner is then subtracted from the amount of his actual capital; the resultant figure will be the amount of excess capital held by him. By repeating the process once or twice, as may be necessary between the partners having excess capital, the amount by which the capital of each partner is in excess will be ascertained. The partner with the largest excess capital will be paid off first, followed by payment to the other or others who rank next to him until the capitals of partners are reduced to their profit-sharing ratio.

The illustration given above is now worked out according to this method.

	A	*B*	*C*
Capital	₹ 15,000	18,000	9,000
Profit-sharing ratio	2	2	1
Capital divided by the profit-sharing ratio	7,500	9,000	9,000
Proportionate Capital of B and C, taking			
A's capital as the base	₹ 15,000	15,000	7,500
Excess of actual over proportionate capital	₹ nil	3,000	1,500

This indicates that A should not get anything till ₹ 3,000 is paid to B and ₹ 1,500 is paid to C. Since capital of B and C are already according to their mutual profit-sharing ratio (2:1), they will share the available cash in this ratio.

After paying off creditors and A's loan, the available amount will be distributed as below in this method:

	Total	A	B	C
		₹	₹	₹
Third Instalment	900	-	600	300
Fourth Instalment (*i*)	3,600	-	2,400	1,200
(*ii*)	2,400	960	960	480
Fifth Instalment	20,100	8,040	8,040	4,020
Total	27,000	9,000	12,000	6,000

Total payment made to each partner will, of course be same under both the methods.

Illustration 8

Ajay Enterprises, a Partnership firm in which A,B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. the balance sheet of the firm as on 31st December, 20X1 is as below:

Liabilities	₹	*Assets*	₹
A' s Capital	*15,000*	*Factory Building*	*24,160*
B' s Capital	*7,500*	*Plant & Machinery*	*16,275*
C' s Capital	*15,000*	*Debtors*	*5,400*
B' s Loan	*4,500*	*Stock*	*12,390*
Sundry Creditors	*16,500*	*Cash at Bank*	*275*
	58,500		*58,500*

On balance sheet date all the three partners have decided to dissolve their partnership. Since the realisation of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realised other than cash at Bank and 10% of the amount distributed to the partners.

Assets were realised piecemeal as under:

First instalment	*₹ 18,650*
Second installment	*₹ 17,320*
Third installment	*₹ 10,000*
Last instilment	*₹ 7,000*
Dissolution expenses were provided for estimated amount of	*₹ 3,000*
The creditors were settled finally for	*₹ 15,900*

Prepare a statement showing distribution of cash amongst the partners by 'Higher Relative Capital Method'.

Solution

Statement showing distribution of cash amongst the partners

		Creditors	***B's Loan***	***A(₹)***	***Capitals B(₹)***	***C(₹)***
Balance Due		16,500	4,500	15,000	7,500	15,000
On 1st Instalment amount with the firm ₹ (275 + 18,650)	18,925					
Less: Dissolution expenses provided for	(3,000)					
	15,925					
Less: C's remuneration of 1% on assets realised (18,650 x 1%)	(187)					
	15,738					
Less: Payment made to creditors	(15,738)	(15,738)				
Balance due	Nil	762				
2nd instalment realised	17,320					
Less: C's remuneration of 1% on assets realised (17,320 x 1%)	(173)					
	17,147					
Less: Payment made to creditors	(162)	(162)				
Transferred to P& L A/c		600				

Balance available	16,985					
Less: Payment for B's loan A/c	(4,500)		(4,500)			
Amount available for distribution to partners	12,485		nil			
Less: C's remuneration of 10% of the amount distributed to partners (12,485 x 10/110)	(1,135)					
Balance distributed to partners on the basis of HRCM	11,350					
Less: Paid to C (W.N.1)	(3,750)					(3,750)
	7,600					11,250
Less: Paid to A and C in 4:3 (W.N.1)	(7,600)			(4,343)	-	(3,257)
Balance due	nil			10,657	7,500	7,993
Amount of 3rd instalment	10,000					
Less: C's remuneration of 1% on assets realised (10,000 x 1%)	(100)					
	9,900					
Less: C's remuneration of 10% of the amount distributed to partners (9,900 x 10/110)	(900)					
	9,000					
Less: Paid to A and						

C in 4:3 for (₹ 8,750 – 7,600) (W.N.1)	(1,150)			(657)	-	(493)
	7,850			10,000	7,500	7,500
Less: Paid to A, B and C in 4:3:3	(7,850)			(3,140)	(2,355)	(2,355)
Balance due	nil			6,860	5,145	5,145
Amount of 4th and last instalment	7,000					
Less: C's remuneration of 1% on assets realised (7,000 x 1%)	(70)					
	6,930					
Less: C's remuneration of 10% of the amount distributed to partners (6,930 x 10/110)	(630)					
	6,300					
Less: Paid to A, B and C in 4:3:3	(6,300)			(2,520)	(1,890)	(1,890)
Loss suffered by partners				4,340	3,255	3,255

Working Note:

(i) ₹ 275 added to the first instalment received on sale of assets represents the Cash in Bank

(ii) The amount due to Creditors at the end of the utilisation of First Instalment is ₹ 762/-. However, since the creditors were settled for ₹ 15,900/- only the balance 162/- were paid and the balance ₹ 600/- was transferred to the Profit & Loss Account.

(iii) **Highest Relative Capital Basis**

	A ₹	B ₹	C ₹
Balance of Capital Accounts (A)	15,000	7,500	15,000
Profit sharing ratio	4	3	3
Capital Profit sharing ratio	3,750	2,500	5,000
Capital in profit sharing ratio taking B's Capital as base (B)	10,000	7,500	7,500
Excess of A's Capital and C's Capital (A-B) =(C)	5,000	nil	7,500
Again repeating the process			
Profit sharing ratio	4		3
Capital Profit sharing ratio	1,250		2,500
Capital in profit sharing			
ratio taking A's Capital as base (D)	5,000		3,750
Excess of C's Capital (C-D)=(E)	nil		3,750

Therefore, firstly ₹ 3,750 is to be paid to C then A and C to be paid in proportion of 4:3 upto ₹ 8,750 to bring the capital of all partners A, B and C in proportion to their profit sharing ratio. Thereafter, balance available will be paid in their profit sharing ratio 4:3:3 to all partners viz A, B and C.

Illustration 9

The firm of LMS was dissolved on 31.3.20X1, at which date its Balance Sheet stood as follows:

Liabilities	₹	***Assets***	₹
Creditors	*2,00,000*	*Fixed Assets*	*45,00,000*
Bank Loan	*5,00,000*	*Cash and Bank*	*2,00,000*
L's Loan	*10,00,000*		
Capital			
L	*15,00,000*		
M	*10,00,000*		
S	*5,00,000*		
	47,00,000		*47,00,000*

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building.

Realisations are:

S.No.	**Amount in ₹**
1	*5,00,000 (including cash and bank)*
2	*15,00,000*
3	*15,00,000*
4	*30,00,000*
5	*30,00,000*

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

Solution

In the Books of M/s LMS

Statement of Piecemeal Distribution (Under Higher Relative Capital method)

Particulars	***Amount***	***Creditors***	***Bank***	***L's loan***	***Capital A/cs***		
	Available ₹	₹	*Loan* ₹	₹	*L* ₹	*M* ₹	*S* ₹
Balance due		2,00,000	5,00,000	10,00,000	15,00,000	10,00,000	5,00,000
1st Instalment (including cash and bank balances)	5,00,000						
Less: Liquidator's Expenses and fee	(1,00,000)						
	4,00,000						
Less: Payment to Creditors and repayment of Bank Loan in the ratio of 2:5	(4,00,000)	(1,14,286)	(2,85,714)	–	–	–	–
Balance Due	–	85,714	2,14,286	10,00,000	15,00,000	10,00,000	5,00,000
2nd Instalment	15,00,000						

Less: Payment to Creditors and repayment of bank loan in full settlement	(3,00,000)	(85,714)	(2,14,286)	–	–	–	–
Balance Due	12,00,000	Nil	Nil	10,00,000	15,00,000	10,00,000	5,00,000
Less: Repayment of L's Loan	(10,00,000)			(10,00,000)	–	–	–
Balance Due	2,00,000			-	15,00,000	10,00,000	5,00,000
Less: Payment to Mr. L towards relative higher capital (W.N. 1)	(2,00,000)				(2,00,000)	–	–
Balance Due	Nil			Nil	13,00,000	10,00,000	5,00,000
3rd Instalment	15,00,000						
Less: Payment to Mr. L towards higher relative capital (W.N. 2)	(3,00,000)				(3,00,000)	–	–
Balance Due	12,00,000				10,00,000	10,00,000	5,00,000
Less: Payment to Mr. L & Mr. M towards excess capital (W.N. 1&2)	(10,00,000)				(5,00,000)	(5,00,000)	–
Balance Due	2,00,000				5,00,000	5,00,000	5,00,000
Less: Payment to all the partners equally	(2,00,000)				(66,667)	(66,667)	(66,666)
Balance due	Nil				4,33,333	4,33,333	4,33,334
4th Instalment	30,00,000						
Less: Payment to all the partners equally	(30,00,000)				(10,00,000)	(10,00,000)	(10,00,000)
Realisation profit credited to Partners					5,66,667	5,66,667	5,66,666
5th Instalment	30,00,000						
Less: payment to all partners equally	(30,00,000)				10,00,000	10,00,000	10,00,000
Realisation profit credited to partners					15,66,667	15,66,667	15,66,666

Working Notes:

(i) Scheme of payment of surplus amount of ₹ 2,00,000 out of second Instalment:

		Capital A/cs	
	L	M	S
	₹	₹	₹
Balance (i)	15,00,000	10,00,000	5,00,000
Profit sharing ratio (ii)	1	1	1
Capital taking S's Capital (iii)	5,00,000	5,00,000	5,00,000
Excess Capital (iv) = (i) – (iii)	10,00,000	5,00,000	
Profit Sharing Ratio	1	1	
Excess capital taking			
M's Excess Capital as base (v)	5,00,000	5,00,000	
Higher Relative Excess (iv) – (iv)	5,00,000		

So, Mr. L should get ₹ 5,00,000 first which will bring down his capital account balance from ₹ 15,00,000 to ₹ 10,00,000. Accordingly, surplus amounting to ₹ 2,00,000 will be paid to Mr. L towards higher relative capital.

(ii) Scheme of payment of ₹ 15,00,000 realised in 3rd Instalment:

- Payment of ₹ 3,00,000 will be made to Mr. L to discharge higher relative capital. This makes the higher capital of both Mr. L and Mr. M ₹ 5,00,000 as compared to capital of Mr. S.
- Payment of ₹ 5,00,000 each of Mr. L & Mr. M to discharge the higher capital.
- Balance ₹ 2,00,000 equally to L, M and S, i.e., ₹ 66,667 ₹ 66,667 and ₹ 66,666 respectively.

Illustration 10

Daksh Associates is a reputed firm. On account of certain misunderstanding between the partners, it was decided to dissolve the firm as on 31st December, 20X1. Their Balance Sheet as on 31st December, 20X1 was follows:

Liabilities	₹	***Assets***	₹
Capitals:		*Land and Buildings*	*7,00,000*

Daksh	3,00,000		Other Fixed Assets	3,00,000
Yash	2,00,000		Stock in Trade	2,00,000
Siddhart (Minor)	1,00,000		Debtors	4,00,000
		6,00,000	Bills Receivable	1,50,000
Trade Loans		3,00,000	Goodwill	30,000
Bank Overdraft		3,00,000	Cash	20,000
Other Loans		2,00,000		
Creditors		2,00,000		
Siddhart's Loan		2,00,000		
		18,00,000		18,00,000

It was decided that Mr. Daksh will be in-charge of Realisation. He will set apart ₹ 10,000 towards expenses. He will be paid a remuneration of 5 percent on the amounts distributed to the partners towards their contribution other than loans. Assets realised are as under:

		₹
1-1-20X2	Debtors	3,50,000
15-1-20X2	Fixed Assets	4,00,000
1-2-20X2	Debtors	50,000
15-2-20X2	Bills Receivable	1,40,000
1-3-20X2	Fixed Assets	50,000
15-3-20X2	Land and Buildings	8,00,000

Prepare a statement showing how the money received on various dates will be distributed assuming:

(a) *The actual expenses of realisation amounted to ₹ 20,005.*

(b) *The firm is solvent.*

(c) *The profit sharing ratio was as under:*

	Profit	Loss
Daksh	2	1
Yash	2	1
Siddhart	1	Nil
	5	2

(d) *The final dissolution is made on 15th March, 20X2.*

Solution

It is assumed that trade loans, bank overdraft, other loans and creditors have equal priority at the time of payment. Therefore, they all have been paid in the ratio of their dues outstanding.

Particulars		Trade Loans	Bank Overdraft	Other Loans	Creditors	Siddharth's Loan	Daksh's Capital	Yash's Capital	Siddharth's Capital
		₹	₹	₹	₹	₹	₹	₹	₹
Amount due		3,00,000	3,00,000	2,00,000	2,00,000	2,00,000	3,00,000	2,00,000	1,00,000
Cash in hand	20,000								
Less: Amount kept for realisation expenses	(10,000)								
	10,000								
Less: Distributed among outsiders (3:3:2:2)	(10,000)	(3,000)	(3,000)	(2,000)	(2,000)	-	-	-	-
Balance Due	Nil	2,97,000	2,97,000	1,98,000	1,98,000	2,00,000	3,00,000	2,00,000	1,00,000
Debtors realised on 1-1-20X2	3,50,000								
Less: Distributed among outsiders (3:3:2:2)	(3,50,000)	(1,05,000)	(1,05,000)	(70,000)	(70,000)	-	-	-	-
Balance Due	Nil	1,92,000	1,92,000	1,28,000	1,28,000	2,00,000	3,00,000	2,00,000	1,00,000
Fixed Assets realised on 15-1-20X2	4,00,000								
Less: Distributed among outsiders (3:3:2:2)	(4,00,000)	(1,20,000)	(1,20,000)	(80,000)	(80,000)	-	-	-	-
Balance Due	Nil	72,000	72,000	48,000	48,000	2,00,000	3,00,000	2,00,000	1,00,000
Debtors realised on 1-2-20X2	50,000								
Less: Distributed among outsiders (3:3:2:2)	(50,000)	(15,000)	(15,000)	(10,000)	(10,000)	-	-	-	-
Balance Due	Nil	57,000	57,000	38,000	38,000	2,00,000	3,00,000	2,00,000	1,00,000
Bills Receivable realised on 15-2-20X2	1,40,000								

Less: Distributed among outsiders (3:3:2:2)	(1,40,000)	(42,000)	(42,000)	(28,000)	(28,000)	-	-	-	-
Balance Due	Nil	15,000	15,000	10,000	10,000	2,00,000	3,00,000	2,00,000	1,00,000
Fixed Assets realised on 1-3-20X2	50,000								
Less: Distributed among outsiders (3:3:2:2)	(50,000)	(15,000)	(15,000)	(10,000)	(10,000)	-	-	-	-
Balance Due	Nil	-	-	-	-	2,00,000	3,00,000	2,00,000	1,00,000
Land and Building realised on 15-3-20X2	8,00,000								
Less: Additional payment of realisation expenses (20,005 – 10,000)	(10,005)								
	7,89,995								
Less: Payment of Siddhart's Loan	(2,00,000)					(2,00,000)	-	-	-
Amount available for partners' Capital	5,89,995					-	3,00,000	2,00,000	1,00,000
Less: Daksh's Commission (i.e. $5,89,995 \times \frac{5}{105}$)	(28,095)								
	5,61,900								
Less: Siddhart's Capital is paid first because he will not share any loss on account of being minor partner	(1,00,000)								(1,00,000)
	4,61,900						3,00,000	2,00,000	-
Less: Paid to Daksh to make his capital equal to that of Yash	(1,00,000)						(1,00,000)		

	3,61,900						2,00,000	2,00,000	-
Less: Distributed equally between Daksh and Yash	(3,61,900)						(1,80,950)	(1,80,950)	
Balance Due							19,050	19,050	Nil*

*Siddhart will get 1/5 share (i.e., share of profit) of what remains after paying ₹ 19,050 to each Daksh and Yash out of the proceeds of stock-in trade. If stock does not realise any amount, then amount unpaid to Daksh and Yash will become loss on realisation. Siddhart has been paid first because he is not to share any loss on realisation.

1.8 ISSUES RELATED TO ACCOUNTING IN LIMITED LIABILITY PARTNERSHIPS

The Limited Liability Partnerships (LLPs) in India were introduced by Limited Liability Partnership Act, 2008 which lay down the law for the formation and regulation of Limited Liability Partnerships.

Definitions :

Section 2 of the Limited Liability Partnership (LLPs) Act, 2008 defines the following terms as:

"limited liability partnership" means a partnership formed and registered under this Act;

"limited liability partnership agreement" means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership;

"foreign limited liability partnership" means a limited liability partnership formed, incorporated or registered outside India which establishes a place of business within India.

"business" includes every trade, profession, service and occupation;

"**designated partner"** means any partner designated as such pursuant to section 7 of the Act;

"partner", in relation to a limited liability partnership, means any person who becomes a partner in the limited liability partnership in accordance with the limited liability partnership agreement;

Nature of Limited Liability Partnership

(1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

(2) A limited liability partnership should have perpetual succession.

(3) Any change in the partners of a limited liability partnership should not affect the existence, rights or liabilities of the limited liability partnership.

Non-applicability of the Indian Partnership Act, 1932

Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 should not apply to a limited liability partnership.

Minimum number of partners

As per section 5 of the LLP Act, any individual or body corporate may be a partner in a limited liability partnership:

Provided that an individual should not be capable of becoming a partner of a limited liability partnership, if-

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending

As per section 6 of the LLP Act, every limited liability partnership should have at least two partners.

If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, will be liable personally for the obligations of the limited liability partnership incurred during that period.

Designated partners

As per Section 7 of the LLP Act, every limited liability partnership should have at least two designated partners who are individuals and at least one of them should be a resident in India:

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate will act as designated partners.

Explanation.-For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less 182 days during the immediately preceding one year.

Subject to the provisions of sub-section (1),

(1) if the incorporation document-

 (a) specifies who are to be designated partners, such persons should be designated partners on incorporation; or

 (b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every such partner will be a designated partner;

(2) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

(3) An individual will not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

(4) Every limited liability partnership should file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

(5) An individual eligible to be a designated partner should satisfy such conditions and requirements as may be prescribed.

Liabilities of designated partners

As per Section 8 of LLP Act, unless expressly provided otherwise in this Act, a designated partner should be-

(a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and .

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

Changes in designated partners

A limited liability partnership may appoint a designated partner within thirty days of a vacancy arising for any reason and provisions of sub-section (4) and sub-section (5) of section 7 will apply in respect of such new designated partner:

Provided that if no designated partner is appointed, or if at any time there is only one designated partner, each partner will be deemed to be a designated partner.

Distinction between an ordinary partnership firm and an LLP

	Key Elements	**Partnerships**	**LLPs**
1	Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2	Registration	Optional	Compulsory with ROC
3	Creation	Created by an Agreement	Created by Law
4	Body Corporate	No	Yes
5	Separate Legal Entity	No	Yes
6	Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
7	Number of Partners	Minimum 2 and Maximum 20 (subject to 10 for banks)	Minimum 2 but no maximum limit
8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	The LLP as an independent entity can own assets
9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the firm only and not of other partners

Formation of LLP

Two or more persons associated for the purpose of carrying on a lawful business with a view to earn profits may subscribe their names to an incorporation document and file the same with the Registrar of the state in which the Registered Office of the LLP is to be situated, in such manner with such fees as may be prescribed along with a statement in the prescribed form made either by an advocate, a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of LLP and by any one who subscribed his name to incorporation document, that all the requirements of the LLP Act 2008 and the rules made there under have been complied with.

Limitation of Liability of an LLP and its partners

- ♦ Under section 27 (3) of the LLP Act, 2008 an obligation of an LLP arising out of a contract or otherwise, will be solely the obligation of the LLP;
- ♦ The Liabilities of an LLP should be met out of the properties of the LLP;
- ♦ Under section 28 (1) a partner is not personally liable, directly or indirectly, for an obligation referred to in Section 27 (3) above, solely by reason of being a partner in the LLP;
- ♦ Section 27 (1) states that an LLP is not bound by anything done by a partner in dealing with a person, if:
  - The partner does not have the authority to act on behalf of the LLP in doing a particular act; and
  - The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
- ♦ Under section 30 (1) the liability of the LLP and the partners perpetrating fraudulent dealings will be unlimited for all or any of the debts or other liabilities of the LLP.
- ♦ Section 27(2) states that the LLP is liable if a partner of LLP is liable to any person as a result of wrongful or omission on his part in the course of business of the LLP or with his authority.

Financial Disclosures & Returns

Under section 34 (1) every LLP should maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to the double entry system of accounting and should maintain the same at its registered office for such period as may be prescribed;

Section 34 (2): Every LLP should within six months of the end of each financial year prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year, in such form as may be prescribed, and such statement should be signed by the designated partners of the LLP;

Section 34 (3): Every LLP should file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner and accompanied by such fee as may be prescribed;

Section 34 (4): The accounts of an LLP must be audited in accordance with such rules as may be prescribed.

Under Section 35 (1) of the LLP Act every LLP is required to file an Annual Return which is duly authenticated with the registrar within sixty days of the closure of its financial year in such form and manner and with such fees as may be prescribed.

Assignment and Transfer of Partnership Rights

The rights of a partner to the share of profits and losses of an LLP and to receive distribution in accordance with the LLP Agreement are transferable wholly or in part;

The transfer of any right by a partner as above does not by itself cause the disassociation of the partner or a dissolution or winding up of the LLP;

Similarly the transfer of the right as above does not entitle the transferee to participate in the management or the conduct of activities of the LLP, or give access to any information concerning the transactions of the LLP.

Conversion of firm into Limited Liability Partnership

Section 55 of LLP Act: A firm may convert into a LLP in accordance with the provisions of the Act and the Second Schedule to the Act.

Section 56 of LLP Act: A private limited company may convert into an LLP in accordance with the provisions of the Act and the Third Schedule to the Act.

Section 57 of LLP Act: An unlisted public limited company may convert into an LLP in accordance with the provisions of the Act and the Fourth Schedule to the Act.

Winding up and Dissolution

- Under section 63 of the LLP Act, 2008 an LLP may be wound up voluntarily or by the Tribunal and such LLP so wound up may be dissolved

- Under section 64 and LLP may be wound up by the Tribunal:
  - If the LLP decides that it should be wound up by the Tribunal;
  - If for a period of more than six months, the number of partners of the LLP is reduced below two;
  - If the LLP is unable to pay its debts;
  - If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;
  - If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;
  - If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

SUMMARY

- Reasons for which a partnership could be dissolved are
  - ➢ expiry of term for which its was formed
  - ➢ death of a partner
  - ➢ insolvency of a partner.
- Reasons when a firm stands dissolved
  - ➢ when partners mutually decide to dissolve
  - ➢ partners except one becomes insolvent
  - ➢ business becomes illegal
  - ➢ if partnership is at will any partner can give notice for dissolution
  - ➢ Court orders.
- On dissolution assets are realised and all liabilities are paid off

  (*if any liability remains unpaid then it is to be realised from partners in their profit sharing ratio*).
- Piecemeal distribution involves either of two methods
  - ➢ Maximum loss method
  - ➢ Highest relative capital method.

TEST YOUR KNOWLEDGE

MCQ

1. On the dissolution of partnership, profit or loss on realisation of assets and liabilities should be divided among partners
   - (a) In the ratio of their capitals.
   - (b) In the same ratio in which they share profits.
   - (c) Equally.
2. An unrecorded asset realised at the time of dissolution is credited to
   - (a) Realisation account.
   - (b) Revaluation account.
   - (c) Capital accounts.
3. A liability taken over by a partner at the time of dissolution is credited to
   - (a) Profit and loss account.
   - (b) Partners' capital accounts.
   - (c) Realisation account.
4. Realisation account is a
   - (a) Nominal account.
   - (b) Real account.
   - (c) Personal account.
5. Which of the following method/methods is adopted to ensure that distribution of cash among partners is in proportion to their interest in partnership?
   - (a) Maximum loss method.
   - (b) Highest relative capital method.
   - (c) Either (a) or (b).

THEORETICAL QUESTIONS

Question 1

State the circumstances when Garner V/S Murrary rule not applicable.

Question 2

W paid a premium to other partners of the firm at the time of his admission to the firm, with a condition that the will not be dissolved before expiry of five years. The firm is dissolved after three years. W claims refund of premium.

(i) List the criteria for the calculation of the amount of refund.

(ii) Also list any two conditions when no claim in this respect will arise.

Question 3

Can a partner be called upon to pay the liability of the LLP? If yes, under what circumstances?

Question 4

Under what circumstances, an LLP can be wound up by the Tribunal.

PRACTICAL QUESTIONS

Question 1

P, Q and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 20X1 is as follows:

Liabilities		₹	**Assets**	₹
Capital accounts			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		48,000		
		3,00,000		3,00,000

They decided to dissolve the business. The following are the amounts realised:

	₹
Plant and Machinery	1,02,000

Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realisation expenses amounted to ₹ 1,500. There was an unrecorded asset of ₹ 6,000 which was taken over by Q at ₹ 4,800. A bill for ₹ 4,200 due for sales tax was received during the course of realisation and this was also paid.

You are required to prepare:

(i) Realisation account.

(ii) Partners' capital accounts.

(iii) Cash account.

Question 2

'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1.

On 30th September, 20X1 their Balance Sheet was as follows :

Liabilities		**₹**	**Assets**	**₹**
Capital Accounts :			Premises	50,000
Thin	80,000		Fixtures	1,25,000
Short	50,000		Plant	32,500
Fat	20,000	1,50,000	Stock	43,200
Current Accounts :			Debtors	54,780
Thin	29,700			
Short	11,300			
Fat (Dr.)	(14,500)	26,500		
Sundry Creditors		84,650		
Bank Overdraft		44,330		
		3,05,480		3,05,480

'Thin' decides to retire on 30th September, 20X1 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from

30th September, 20X1. It then transpires that 'Fat' has no private assets whatsoever.

The premises are sold for ₹ 60,000 and the plant for ₹ 1,07,500. The fixtures realise ₹ 20,000 and the stock is acquired by another firm at book value less 5%. Debtors realise ₹ 45,900. Realisation expenses amount to ₹ 4,500.

The bank overdraft is discharged and the creditors are also paid in full.

You are required to write up the following ledger accounts in the partnership books following the rules in Garner vs. Murray:

(i) Realisation Account;

(ii) Partners' Current Accounts;

(iii) Partners' Capital Accounts showing the closing of the firm's books.

Question 3

A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were ₹ 9,600, ₹ 6,000 and ₹ 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	₹		₹
Liability for interest on loans from :		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

Question 4

The partners A, B and C have called you to assist them in winding up the affairs of their partnership on 30th June, 20X1. Their Balance Sheet as on that date is given below :

Liabilities	₹	**Assets**	₹
Sundry Creditors	17,000	Cash at Bank	6,000
Capital Accounts :		Sundry Debtors	22,000
A	67,000	Stock in trade	14,000

B	45,000	Plant and Equipment	99,000
C	31,500	Loan-A	12,000
		Loan-B	7,500
	1,60,500		1,60,500

(1) The partners share profit and losses in the ratio of 5:3:2

(2) Cash is distributed to the partners at the end of each month

(3) A summary of liquidation transactions are as follows:

July 20X1

- ₹ 16,500 – collected from Debtors; balance is uncollectable.
- ₹ 10,000 – received from sale of entire stock.
- ₹ 1,000 – liquidation expenses paid.
- ₹ 8,000 – cash retained in the business at the end of the month.

August 20X1

- ₹ 1,500 – liquidation expenses paid. As part payment of his Capital, C accepted a piece of equipment for ₹ 10,000 (book value ₹ 4,000).
- ₹ 2,500 – cash retained in the business at the end of the month.

September 20X1

- ₹ 75,000 – received on sale of remaining plant and equipment.
- ₹ 1,000 – liquidation expenses paid. No cash retained in the business.

Required : Prepare a schedule of cash payments as of September 30, showing how the cash was distributed under 'Highest Relative Capital Method'.

ANSWERS/ SOLUTIONS

ANSWERS TO MCQ

1. (b) **2.** (a) **3.** (b) **4.** (a) **5.** (c)

ANSWERS TO THEORETICAL QUESTIONS

Answer 1

Non-Applicability of Garner vs Murray rule:

1. When the solvent partner has a debit balance in the capital account.

Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.

2. When the firm has only two partners.

3. When there is an agreement between the partners to share the deficiency in capital account of insolvent partner.

4. When all the partners of the firm are insolvent.

Answer 2

If the firm is dissolved before the term expires, as is the case, W being a partner who has paid premium on admission will have to be repaid / refunded

The criteria for calculation of refund amount are:

(i) Terms upon which admission was made,

(ii) The time period for which it was agreed that the firm will not be dissolved,

(iii) The time period for which the firm has already been in existence.

No claim for refund will arise if:

(i) The firm is dissolved due to death of a partner,

(ii) If the dissolution of the firm is basically because of misconduct of W,

(iii) If the dissolution is through an agreement and such agreement does not have a stipulation for refund of premium.

Answer 3

Under section 27 (3) of the LLP Act, 2008, any obligation of the LLP arising out of a contract or otherwise will be the sole obligation of the LLP. The partners of an LLP in the normal course of business are not liable for the debts of the LLP. However, under section 28 (2) of the LLP Act, 2008, a partner will be liable for his own wrongful acts or commissions, but will not be liable for the wrongful acts or commissions of other partners of the LLP.

Answer 4

Under following circumstances, an LLP can be wound up by the Tribunal:

(i) If the LLP decides that it should be wound up by the Tribunal;

(ii) If for a period of more than six months, the number of partners of the LLP is reduced below two;

(iii) If the LLP is unable to pay its debts;

(iv) If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;

(v) If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;

(vi) If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

ANSWERS TO PRACTICAL QUESTIONS

Answer 1

Realisation Account

	Particulars	₹		*Particulars*	₹
To	Debtors	48,000	By	Creditors	48,000
To	Stock	60,000	By	Cash A/c (Assets realised):	
To	Fixtures	24,000		Plant and Machinery 1,02,000	
To	Plant and machinery	1,08,000		Fixtures 18,000	
To	Cash A/c (Creditors)	45,600		Stock 84,000	
To	Cash A/c (Sales tax)	4,200		Sundry Debtors 44,400	2,48,400
To	Cash A/c (Realisation expenses)	1,500	By	Q (Unrecorded asset)*	4,800
To	Profit on Realisation				
	P 3,960				
	Q 3,960				
	R 1,980	9,900			
		3,01,200			3,01,200

* An unrecorded asset is in the nature of gain hence realization account is credited. Since this asset has been taken over by Q, therefore, his account has been debited.

Partners' Capital Accounts

Particulars	*P*	*Q*	*R*	*Particulars*	*P*	*Q*	*R*
	₹	₹	₹		₹	₹	₹
To Realisation A/c (unrecorded asset)		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	12,000
				By Realisation A/c (Profit)	3,960	3,960	1,980
	1,47,960	75,960	37,980		1,47,960	75,960	37,980

Cash Account

	Particulars	₹		*Particulars*	₹
To	Balance b/d	60,000	By	Realisation A/c (Creditors)	45,600
To	Realisation A/c (Assets)	2,48,400	By	Realisation A/c (Expenses)	1,500
			By	Realisation A/c (Sales Tax)	4,200
			By	P's Capital A/c	1,47,960
			By	Q's Capital A/c	71,160
			By	R's Capital A/c	37,980
		3,08,400			3,08,400

Answer 2

Realisation Account

	₹			₹
To Premises	50,000	By Sundry Creditors		84,650
To Plant	1,25,000	By Bank :		
To Fixtures	32,500	Premises	60,000	
To Stock	43,200	Plant	1,07,500	
To Debtors	54,780	Fixtures	20,000	
To Bank (Creditors)	84,650	Stock	41,040	

To Bank (Expenses)	4,500	Debtors	45,900	2,74,440
		By Loss on Realisation		
		transferred to		
		Partners' Current A/cs		
		Thin	14,216	
		Short	14,216	
		Fat	7,108	35,540
	3,94,630			3,94,630

Partners' Current Accounts

	Thin	*Short*	*Fat*		*Thin*	*Short*	*Fat*
	₹	₹	₹		₹	₹	₹
To Balance b/d	–	–	14,500	By Balance b/d	29,700	11,300	–
To Realisation	14,216	14,216	7,108	By Capital A/c			
To Capital A/c				Transfer	–	2,916	21,608
transfer	15,484	–	–				
	29,700	14,216	21,608		29,700	14,216	21,608

Partners' Capital Accounts

	Thin	*Short*	*Fat*		*Thin*	*Short*	*Fat*
	₹	₹	₹		₹	₹	₹
To Current A/c	–	2,916	21,608	By Balance b/d	80,000	50,000	20,000
To Fat's Capital A/c				By Current A/c			
Deficiency in the				(transfer)	15,484	–	–
ratio of 8:5	990	618	–	By Bank (Realisation loss)	14,216	14,216	
To Bank	1,08,710	60,682	–	By Thin & Short			
				Capital A/cs			1,608
	1,09,700	64,216	21,608		1,09,700	64,216	21,608

Working Notes:

(i) **Bank Account**

	₹		₹
To Realisation A/c	2,74,440	By Balance b/d	44,330
To Thin's Capital A/c	14,216	By Realisation A/c (Creditors)	84,650
To Short's Capital A/c	14,216	By Realisation A/c (Expenses)	4,500
		By Thin's Capital A/c	1,08,710
		By Short's Capital A/c	60,682
	3,02,872		3,02,872

(ii) Fat's deficiency has been by borne Thin & Short in the ratio of their fixed capitals i.e., 8:5 following the rule in *Garner vs. Murray*.

Answer 3

Statement of Distribution of Cash

	Realisation	*Interest on loans from partners' spouses*	*Interest on loans from partners*	*Partners' Capitals* A	B	C	*Total*
	₹	₹	₹	₹	₹	₹	₹
Balances due (1)		2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	(1,000)	-				
		1,000	1,000				
(ii) Sale of furniture	2,000	(1,000)	(1,000)				
	-	-					
(iii) Sale of machinery	1,200						
Maximum possible loss₹ 22,800 (total of capitals ₹ 24,000 less cash available ₹ 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2				(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit				(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C				1,800	840	(2,640)	–
Amount paid (2)				–	–	1,200	1,200
Balances in capital accounts(1 – 2) = (3)				9,600	6,000	7,200	22,800
(iv) Sale of stock		4,000					

Maximum possible loss (₹ 22,800 – ₹ 4,000) Allocated	18,800				
to partners in the ratio 5 : 3 : 2		(9,400)	(5,640)	(3,760)	(18,800)
Amounts at credit and cash paid (4) (4,000)		200	360	3,440	4,000
Balances in capital accounts left unpaid—Loss (3 – 4) = (5)		9,400	5,640	3,760	18,800

Answer 4

Statement showing distribution of cash

		Creditors	Capitals		
	₹	₹	*A (₹)*	*B (₹)*	*C (₹)*
Balance Due after loan (W.N.(i))		17,000	55,000	37,500	31,500
July					
Balance available	6,000				
Realisation less expenses and cash retained	17,500				
Amount available and paid	23,500	17,000	-	-	6,500
Balance due		—	55,000	37,500	25,000
August					
Opening balance	8,000				
Expenses paid and balance carried forward	4,000				
Available for distribution	4,000				
Cash paid to 'B' and Equipment given to C.			—	4,000	10,000
(Excess paid to 'C' ₹ 7,333)			55,000	33,500	15,000
September					
Opening balance	2,500				
Amount realised less expenses	74,000				
Amount paid to partners	76,500		41,500	25,400	9,600
			13,500	8,100	5,400

Working Note:

(i) **Highest Relative Capital Basis**

	A	B	C
	₹	₹	₹
Scheme of payment for July			
Balance of Capital Accounts	67,000	45,000	31,500
Less : Loans	(12,000)	(7,500)	—
A	55,000	37,500	31,500
Profit sharing ratio	5	3	2
Capital Profit sharing ratio	11,000	12,500	15,750
Capital in profit sharing ratio, taking A's capital as base	55,000	33,000	22,000
B			
Excess of C's Capital and B's Capital (A-B)		4,500	9,500
Profit sharing ratio		3	2
Capital Profit sharing ratio		1,500	4,750
Capital in profit sharing ratio taking B's Capital as base		4,500	3,000
Excess of C's Capital over B			6,500

(ii) **Scheme of distribution of available cash:**

	A	*B*	*C*
	₹	₹	₹
Scheme of payment for September			
Balance of Capital Accounts ***(A)***	55,000	33,500	15,000
Profit sharing ratio	5	3	2
Capital/Profit sharing ratio	11,000	11,167	7,500
Capital in profit sharing ratio taking C's capital as base ***(B)***	37,500	22,500	15,000
Excess of A's capital and B's capital ***(A-B)***	17,500	11,000	-
Profit sharing ratio	5	3	
Capital in profit sharing ratio	3,500	3,667	

Capital in profit sharing ratio taking A's capital as base	17,500	10,500	-
Excess of B's capital over A's capital	–	500	–
Payment ₹ 500 **(C)**	-	(500)	-
Balance of Excess	17,500	10,500	
Payment ₹ 28,000 **(D)**	(17,500)	(10,500)	-
Balance ***[A-C-D]***	37,500	22,500	15,000
Payment (₹ 76,500 – ₹ 28,500) ₹ 48,000 **(D)**	(24,000)	(14,400)	(9,600)
Loss	13,500	8,100	5,400
Total Payment ₹ 76,500 ***[A+C+D]***	41,500	25,400	9,600