

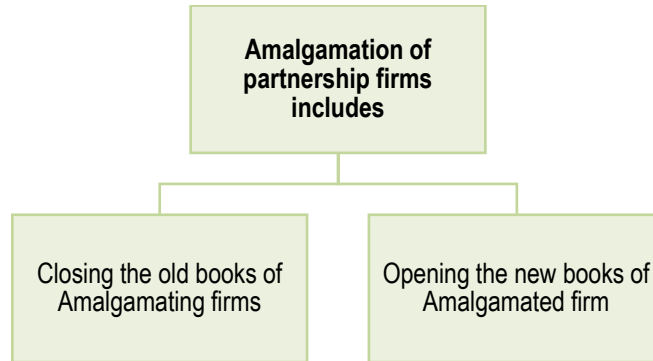
UNIT - 2: AMALGAMATION, CONVERSION AND SALE OF PARTNERSHIP FIRMS

LEARNING OUTCOMES

After studying this unit, you will be able to–

- ❑ Understand the procedure for amalgamation of partnership firms.
- ❑ Learn the accounting treatment when a partnership firm is converted in the form of a company.
- ❑ Distribute the shares received as purchase consideration among the partners.

UNIT OVERVIEW



2.1 AMALGAMATION OF PARTNERSHIP FIRMS

When two or more partnership firms are amalgamated, the books of old firm are closed and books of the new firm are opened.

The accounting procedures for the same are:

2.1.1 Closing the books of old firm

- Each firm should prepare a **Revaluation Account** relating to its own assets and liabilities and transfer the balance to the partners' capital accounts in the profit-sharing ratio.
- Entries for **raising goodwill** should be passed.
- Assets and liabilities not taken over** by the new firm should be transferred to the capital accounts of partners in the ratio of their capitals.
- The **new firm** should be debited with the difference between the value of assets and liabilities taken over by it; the assets should be credited and liabilities debited.
- Partners' capital accounts** should be transferred to the new firm's account;

2.1.2 Opening the books of the new firm

Debit assets taken out at the agreed values

Credit the liabilities taken over, and

Credit individual partner's capital accounts with the closing balances in the erstwhile firm.

When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.

Illustration 1

B and S are partners of S & Co. sharing profits and losses in the ratio of 3:1. S and T are partners of T & Co. sharing profits and losses in the ratio of 2:1.

On 31st October, 20X1, they decided to amalgamate and form a new firm M/s. BST & Co. wherein B, S and T would be partners sharing profits and losses in the ratio of 3:2:1.

Their balance sheets on that date were as under:

| Liabilities | S & Co. | T & Co. | Assets | S & Co. | T & Co. |
|-----------------|----------|----------|------------------|----------|----------|
| | ₹ | ₹ | | ₹ | ₹ |
| Due to X & Co. | 40,000 | – | Cash in hand | 10,000 | 5,000 |
| Due to S & Co. | – | 50,000 | Cash at bank | 15,000 | 20,000 |
| Other Creditors | 60,000 | 58,000 | Due from T & Co. | 50,000 | – |
| Reserves | 25,000 | 50,000 | Due from X & Co. | – | 30,000 |
| Capitals | | | Other Debtors | 80,000 | 1,00,000 |
| B | 1,20,000 | – | Stock | 60,000 | 70,000 |
| S | 80,000 | 1,00,000 | Furniture | 10,000 | 3,000 |
| T | – | 50,000 | Vehicles | – | 80,000 |
| | | | Machinery | 75,000 | – |
| | | | Building | 25,000 | – |
| | 3,25,000 | 3,08,000 | | 3,25,000 | 3,08,000 |

The amalgamated firm took over the business on the following terms :

- Goodwill of S & Co. was worth ₹ 60,000 and that of T & Co. ₹ 50,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.*
- Building, machinery and vehicles were taken over at ₹ 50,000, ₹ 90,000 and ₹ 1,00,000 respectively.*
- Provision for doubtful debts has to be carried forward at ₹ 4,000 in respect of debtors of S & Co. and ₹ 5,000 in respect of debtors of T & Co.*

You are required to:

- (i) Compute the adjustments necessary for goodwill.
- (ii) Pass the journal entries in the books of BST & Co. assuming that excess/deficit capital (taking T's Capital as base) with reference to share in profits are to be transferred to current accounts.

Solution

(i) Adjustment for raising & writing off of goodwill:

| | Raised in old profit sharing ratio | | | | Written off in new ratio | | Difference | |
|---|------------------------------------|---------|----------|-----|--------------------------|-----|------------|-----|
| | S & Co. | T & Co. | Total | | | | | |
| | 3:1 | 2:1 | ₹ | | 3:2:1 | | ₹ | |
| B | 45,000 | - | 45,000 | Cr. | 55,000 | Dr. | 10,000 | Dr. |
| S | 15,000 | 33,333 | 48,333 | Cr. | 36,666 | Dr. | 11,667 | Cr. |
| T | - | 16,667 | 16,667 | Cr. | 18,334 | Dr. | 1,667 | Dr. |
| | 60,000 | 50,000 | 1,10,000 | | 1,10,000 | | | |

Books of BST & Co. Journal Entries

| 20X1 | | Dr. ₹ | Cr. ₹ |
|---------|---------------------------------|------------|----------|
| Oct. 31 | Cash Account | Dr. 10,000 | |
| | Bank Account | Dr. 15,000 | |
| | T & Co. | Dr. 50,000 | |
| | Sundry Debtors | Dr. 80,000 | |
| | Stock Account | Dr. 60,000 | |
| | Furniture Account | Dr. 10,000 | |
| | Machinery Account | Dr. 90,000 | |
| | Building Account | Dr. 50,000 | |
| | To Provision for Doubtful debts | | 4,000 |
| | To X & Co. | | 40,000 |
| | To Sundry Creditors | | 60,000 |
| | To B's Capital Account | | 1,65,750 |

| | | | |
|--|-----|----------|----------|
| To S's capital Account (Sundry assets and liabilities of M/s S & Co. taken over at the values stated as per agreement dated.....) | | | 95,250 |
| Cash Account | Dr. | 5,000 | |
| Bank Account | Dr. | 20,000 | |
| X & Co. Account | Dr. | 30,000 | |
| Sundry Debtors A/c | Dr. | 1,00,000 | |
| Stock Account | Dr. | 70,000 | |
| Furniture Account | Dr. | 3,000 | |
| Vehicles Account | Dr. | 1,00,000 | |
| To Provision for Doubtful Debts | | | 5,000 |
| To S & Co. | | | 50,000 |
| To Sundry Creditors | | | 58,000 |
| To S's Capital Account | | | 1,43,333 |
| To T's Capital Account | | | 71,667 |
| (Sundry assets and liabilities of M/s T & Co. taken over at the values stated as per agreement dated...) | | | |
| B's Capital Account | Dr. | 10,000 | |
| T's Capital Account | Dr. | 1,667 | |
| To S's Capital Account | | | 11,667 |
| (Adjustment in capital accounts consequent on raising goodwill of S & Co. for ₹ 60,000, T & Co. for ₹ 50,000 and writing off the same in the new ratio between B,S,T as per agreement) | | | |
| S & Co. | | 50,000 | |
| To T Co. | | | 50,000 |
| (Mutual indebtedness of S & Co. and T & Co., cancelled on taking over of the two firms) | | | |
| B's Current Account | Dr. | 54,250 | |
| To B's Capital Account | | | 54,250 |
| (Amount credited to B's Capital to bring capital in profit-sharing ratio) | | | |

| | | | |
|--|-----|----------|----------|
| S's Capital Account To S's Current Account (Excess amount in S's Capital Account transferred to S's current account to reduce the balance in capital accounts in accordance with the profit sharing ratio) | Dr. | 1,10,250 | 1,10,250 |
|--|-----|----------|----------|

Working Notes :

(i) Balance of Capital Accounts on transfer of business to M/s BST & Co.

| (a) | S & Co. | | B's Capital | S's Capital |
|-----|-------------------------------------|---------|-------------|-------------|
| | | ₹ | ₹ | ₹ |
| | As per Balance Sheet | | 1,20,000 | 80,000 |
| | Credit for Reserve | | 18,750 | 6,250 |
| | Profit on Revaluation | 40,000 | | |
| | Less : Provision for doubtful debts | (4,000) | 27,000 | 9,000 |
| | | | 1,65,750 | 95,250 |

| (b) | T & Co. | | S's Capital | T's Capital |
|-----|-------------------------------------|---------|-------------|-------------|
| | | ₹ | ₹ | ₹ |
| | As per Balance Sheet | | 1,00,000 | 50,000 |
| | Credit for Reserve | | 33,333 | 16,667 |
| | Profit on Revaluation | 20,000 | | |
| | Less : Provision for doubtful debts | (5,000) | 10,000 | 5,000 |
| | | | 1,43,333 | 71,667 |

(ii) Capital in the new firm

| | B ₹ | | S ₹ | | T ₹ |
|-----------------------|----------|--|-----------------|--|---------------|
| Balance as taken over | 1,65,750 | | 95,250 | | |
| | — | | <u>1,43,333</u> | | <u>71,667</u> |
| | 1,65,750 | | 2,38,583 | | 71,667 |

| | | | | | |
|---|-----------------|-------|-----------------|-------|---------------|
| Adjustment for Goodwill | <u>-10,000</u> | | <u>+11,667</u> | | <u>-1,667</u> |
| | 1,55,750 | | 2,50,250 | | 70,000 |
| Total capital, ₹ 4,20,000* in the new ratio of 3:2:1, taking T's Capital as the basis | <u>2,10,000</u> | | <u>1,40,000</u> | | <u>70,000</u> |
| Transfer to Current Account | 54,250 | (Dr.) | 1,10,250 | (Cr.) | — |

*T's Capital is ₹ 70,000 and it is 1/6 of total. The total therefore is ₹ 4,20,000.

Illustration 2

On 31st March 20X2, Sri Raman acquires on payment of ₹ 80,000 the business of M/s Gupta and Singh taking over at book value the following assets and liabilities :

| | |
|-----------|--------|
| | ₹ |
| Debtors | 35,000 |
| Furniture | 3,000 |
| Stock | 46,000 |
| Creditors | 10,000 |

There was no change between 1st January, 20X2 and 31st March, 20X2 in the book value of the assets and liabilities not taken over.

The same set of books has been continued after the acquisition and no entries of the acquisition have been passed except for the payment of ₹ 80,000 made by Sri Raman.

From the following balance sheet and trial balance prepare Business Purchase Account, Profit and Loss Account for the year ended 31st December, 20X2 and Balance Sheet at that date.

Balance Sheet as at December, 20X1

| Liabilities | | ₹ | Assets | ₹ |
|------------------|--------|--------|------------------|--------|
| Capital Accounts | | | Furniture | 3,000 |
| Sri Gupta | 30,000 | | Investments | 5,000 |
| Sri Singh | 20,000 | 50,000 | Insurance Policy | 2,000 |
| Bank Loan | | 18,000 | Stock | 40,000 |
| Creditors | | 12,000 | Debtors | 30,000 |
| | | 80,000 | | 80,000 |

On 31st December 20X2 the trial balance is:

| | ₹ | ₹ |
|---------------------------|----------|----------|
| Stock | 40,000 | |
| Furniture | 3,000 | |
| Investment | 5,000 | |
| Insurance Policy | 2,000 | |
| Business Purchase Account | 80,000 | |
| Bank Loan | | 18,000 |
| Capital : | | |
| Gupta | | 30,000 |
| Singh | | 20,000 |
| Raman | | 30,000 |
| Bank | 3,000 | |
| Debtors | 48,000 | |
| Creditors | | 15,000 |
| Purchases | 3,20,000 | |
| Expenses | 12,000 | |
| Sales | | 4,00,000 |
| | 5,13,000 | 5,13,000 |
| Closing Stock ₹ 50,000 | | |

Solution

Business Purchase Account

| 20X2 | ₹ | 20X2 | ₹ |
|---------------------|--------|--|--------|
| Dec. 31 | | | |
| To Balance b/d | 80,000 | By Bank Loan | 18,000 |
| To Investments | 5,000 | By Gupta's Capital A/c | 30,000 |
| To Insurance Policy | 2,000 | By Singh's Capital A/c | 20,000 |
| | | By Goodwill | 6,000 |
| | | By Profit & Loss A/c | 13,000 |
| | | (Balancing figure, profit upto 31st March, 20X2) | |
| | 87,000 | | 87,000 |

Profit & Loss Account of Raman for the year ended 31st December, 20X2

| | ₹ | | ₹ |
|--|----------|------------------|----------|
| To Opening Stock | 40,000 | By Sales | 4,00,000 |
| To Purchases | 3,20,000 | By Closing Stock | 50,000 |
| To Expenses | 12,000 | | |
| To Business Purchase (Profit upto 31st March) | 13,000 | | |
| To Net Profit | | | |
| Raman's Capital A/c | 65,000 | | |
| | 4,50,000 | | 4,50,000 |

Balance Sheet of Raman as on 31st December, 20X2

| Liabilities | ₹ | Assets | ₹ |
|----------------------------|----------|----------------|----------|
| Raman's Capital A/c 30,000 | | Goodwill | 6,000 |
| Add : Profit <u>65,000</u> | 95,000 | Furniture | 3,000 |
| Sundry Creditors | 15,000 | Stock in trade | 50,000 |
| | | Sundry Debtors | 48,000 |
| | | Cash at Bank | 3,000 |
| | 1,10,000 | | 1,10,000 |

Working Notes :(1) *Goodwill*

| | ₹ |
|-----------------------------|----------|
| Value of Assets taken over | |
| Stock | 46,000 |
| Debtors | 35,000 |
| Furniture | 3,000 |
| | 84,000 |
| Less : Creditors | (10,000) |
| Net assets | 74,000 |
| Goodwill (Balancing figure) | 6,000 |
| Purchase Consideration | 80,000 |

(2) Increase in net assets upto 31st March 20X2 :

| | as on 1st January | as on 31st March |
|-------------------------------|------------------------------|-----------------------------|
| | ₹ | ₹ |
| Debtors | 30,000 | 35,000 |
| Stock | 40,000 | 46,000 |
| Furniture | 3,000 | 3,000 |
| | 73,000 | 84,000 |
| Less : Creditors | (12,000) | (10,000) |
| | 61,000 | 74,000 |
| Profit, equal to net increase | 13,000 | – |
| | 74,000 | 74,000 |

Illustration 3

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5 : 3.

On 31st March, 20X1 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.20X1

| Liabilities | X & Co. | Y & Co. | Assets | X & Co. | Y & Co. |
|--------------------|--------------------|--------------------|-------------------|--------------------|--------------------|
| | ₹ | ₹ | | ₹ | ₹ |
| <i>Capital:</i> | | | Cash in hand/bank | 40,000 | 30,000 |
| A | 1,50,000 | --- | Debtors | 60,000 | 80,000 |
| B | 1,00,000 | 75,000 | Stock | 50,000 | 20,000 |
| C | --- | 50,000 | Vehicles | --- | 90,000 |
| Reserve | 50,000 | 40,000 | Machinery | 1,20,000 | --- |
| Creditors | 1,20,000 | 55,000 | Building | 1,50,000 | --- |
| | 4,20,000 | 2,20,000 | | 4,20,000 | 2,20,000 |

The following were the terms of amalgamation:

- (i) Goodwill of X & Co., was valued at ₹ 75,000. Goodwill of Y & Co. was valued at ₹ 40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.
- (ii) Building, Machinery and Vehicles are to be taken over at ₹ 2,00,000, ₹ 1,00,000 and ₹ 74,000 respectively.
- (iii) Provision for doubtful debts at ₹ 5,000 in respect of X & Co. and ₹ 4,000 in respect of Y & Co. are to be provided.

You are required to:

- (i) Show, how the Goodwill value is adjusted amongst the partners.
- (ii) Prepare the Balance Sheet of XY & Co. as at 31.3.20X1 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current accounts.

Solution

(i) Adjustment for raising and writing off of goodwill

| | Raised in old profit sharing ratio | | Total | Written off in new ratio | Difference |
|---|------------------------------------|---------------|-----------------|--------------------------|------------|
| | X & Co. | Y & Co. | | | |
| | 3:2 | 5:3 | | 4:5:1 | |
| | ₹ | ₹ | ₹ | ₹ | ₹ |
| A | 45,000 | --- | 45,000 Cr. | 46,000 Dr. | 1,000 Dr. |
| B | 30,000 | 25,000 | 55,000 Cr. | 57,500 Dr. | 2,500 Dr. |
| C | --- | 15,000 | 15,000 Cr. | 11,500 Dr. | 3,500 Cr. |
| | <u>75,000</u> | <u>40,000</u> | <u>1,15,000</u> | <u>1,15,000</u> | <u>Nil</u> |

(ii) Balance Sheet of XY & Co. (New firm) as on 31.3.20X1

| Liabilities | ₹ | Assets | ₹ |
|-------------------|----------|-----------|----------|
| Capital Accounts: | | Vehicle | 74,000 |
| A | 1,72,000 | Machinery | 1,00,000 |
| B | 2,15,000 | Building | 2,00,000 |
| C | 43,000 | Stock | 70,000 |
| Current Accounts: | | Debtors | 1,31,000 |

| | | | |
|-----------|-----------------|-------------|-----------------|
| A | 22,000 | Cash & Bank | 70,000 |
| C | 18,000 | | |
| Creditors | <u>1,75,000</u> | | <u> </u> |
| | <u>6,45,000</u> | | <u>6,45,000</u> |

Working Notes:

1. Balance of Capital Accounts at the time of amalgamation of firms

| | A's Capital ₹ | B's Capital ₹ |
|--|-----------------|-----------------|
| X & Co. Profit and loss sharing ratio 3:2 | | |
| Balance as per Balance Sheet | 1,50,000 | 1,00,000 |
| Add: Reserves | 30,000 | 20,000 |
| Revaluation profit (Building) | 30,000 | 20,000 |
| Less: Revaluation loss (Machinery) | (12,000) | (8,000) |
| Provision for doubtful debt | (3,000) | (2,000) |
| | <u>1,95,000</u> | <u>1,30,000</u> |
| | B's Capital | C's Capital |
| Y & Co. Profit and loss sharing ratio 5:3 | ₹ | ₹ |
| Balance as per Balance sheet | 75,000 | 50,000 |
| Add: Reserves | 25,000 | 15,000 |
| Less: Revaluation (vehicle) | (10,000) | (6,000) |
| Provision for doubtful debts | (2,500) | (1,500) |
| | <u>87,500</u> | <u>57,500</u> |

2. Balance of Capital Accounts in the balance sheet of the new firm as on 31.3.20X1

| | A | B | C |
|-------------------------|-------------------|-----------------|---------------|
| | ₹ | ₹ | ₹ |
| Balance b/d: X & Co. | 1,95,000 | 1,30,000 | -- |
| Y & Co. | <u> --</u> | <u>87,500</u> | <u>57,500</u> |
| | 1,95,000 | 2,17,500 | 57,500 |
| Adjustment for goodwill | <u>(1,000)</u> | <u>(2,500)</u> | <u>3,500</u> |
| | <u>1,94,000</u> | <u>2,15,000</u> | <u>61,000</u> |

| | | | |
|---|----------|----------|--------|
| Total capital ₹ 4,30,000 (B's capital* i.e. ₹ 2,15,000 x 2) to be contributed in 4:5:1 ratio. | 1,72,000 | 2,15,000 | 43,000 |
| Transfer to Current Account | 22,000 | --- | 18,000 |

2.2 Conversion of Partnership Firm into a Company

At times partnerships also are reconstructed like joint stock companies, with the help of creditors if they are satisfied that if by taking of further risk or forgoing a part of the debt, the chances of recovery of their loan and capital would improve.

It usually entails preparation of Reconstruction Account for determining the past losses which belong to old partners and writing them off to the debit of their capital accounts. If a creditor agrees to join as a partner the whole or only a part of the account standing to the credit of his loan account is transferred to his capital account. For the further development of the business, usually some fresh capital/loan is required. The amount of loan is placed to the credit of the party contributing the same on such terms and conditions as may have been agreed upon.

When the partnership firm is converted into a company, then the financial statements of the new company will be prepared according to Schedule III to the Companies Act, 2013. The general instructions for preparation of Balance sheet and the Statement of Profit and Loss of the company are given in Schedule III to the Companies Act, 2013.

Illustration 4

The following is the Balance Sheet of Messers A and B as on 31st March 20X5 :

| Liabilities | | ₹ | Assets | | ₹ |
|--------------------|---------------|-----------------|-------------------------|--|-----------------|
| A's Capital | 40,000 | | Land and Buildings | | 50,000 |
| B's Capital | <u>50,000</u> | 90,000 | Stock | | 30,000 |
| A's Loan | | 10,000 | Debtors | | 20,000 |
| General Reserve | | 10,000 | Investment | | |
| Liabilities | | 20,000 | 6% Debentures in X Ltd. | | 20,000 |
| | | | Cash | | 10,000 |
| | | <u>1,30,000</u> | | | <u>1,30,000</u> |

It was agreed that Mr. C is to be admitted for a fifth share in the future profits from 1st April 20X5. He is required to contribute cash towards goodwill and ₹ 10,000 towards

* B's Capital ` 21,500 being one-half of the total capital of the firm.

capital.

The following further information is furnished :

- (i) The partners A and B shared the profits in the ratio 3:2.
- (ii) Mr. A was receiving a salary of ₹ 500 p.m. from the very inception of the firm in 20YY in addition to share of profit.
- (iii) The future profit ratio between A, B and C will be 3:1:1. Mr. A will not get any salary after the admission of Mr. C.
- (iv) (a) The goodwill of the firm should be determined on the basis of 2 years' purchase of the average profits from business of the last 5 years. The particulars of the profits are as under :

| | | | ₹ |
|------------|---------|--------|--------|
| Year ended | 31-3-X1 | Profit | 20,000 |
| Year ended | 31-3-X2 | Loss | 10,000 |
| Year ended | 31-3-X3 | Profit | 20,000 |
| Year ended | 31-3-X4 | Profit | 25,000 |
| Year ended | 31-3-X5 | Profit | 30,000 |

The above profits and losses are after charging the salary of Mr. A. The profit of the year ended 31st March 20X1 included an extraneous profit of ₹ 30,000 and the loss of the year ended 31st March 20X2 was on account of loss by strike to the extent of ₹ 20,000.

- (b) It was agreed that the value of the goodwill of the firm should appear in the books of the firm.
- (v) The trading profit for the year ended 31st March, 20X6 was ₹ 40,000 before depreciation.
- (vi) The partners had drawn each ₹ 1,000 p.m. as drawings.
- (vii) The value of the other assets and liabilities as on 31st March, 20X6 were as under :

| | ₹ |
|--------------------------------|--------|
| Building (before depreciation) | 60,000 |
| Stock | 40,000 |
| Debtors | Nil |

| | |
|-------------|--------|
| Investment | 20,000 |
| Liabilities | Nil |

(viii) Provide depreciation at 5% on land and buildings on the closing balance and interest at 6% on A's loan.

(ix) They applied for conversion of the firm into a Private Limited Company i.e. ABC Pvt. Ltd.. Certificate received on 1-4-20X6. They decided to convert Capital A/cs of the partners into share capital in the ratio of 3 : 1 : 1 on the basis of total Capital as on 31-3-20X6. If necessary, partners have to subscribe to fresh capital or withdraw.

Prepare the Statement of Profit and Loss for the year ended 31st March, 20X6 and the Balance Sheet of the company.

Solution

Messers A, B and C

Statement of Profit & Loss for the year ended on 31st March, 20X6

| | ₹ | | ₹ |
|--|--------|---------------------------|--------|
| To Dep. Building (60,000x5%) | 3,000 | By Trading Profit | 40,000 |
| To Interest on A's loan (10,000 x 6%) | 600 | By Interest on Debentures | 1,200 |
| To Net Profit to : | | | |
| A's Capital A/c | 22,560 | | |
| B's Capital A/c | 7,520 | | |
| C's Capital A/c | 7,520 | | |
| | 41,200 | | 41,200 |

Balance Sheet of the ABC Pvt Ltd. as on 1-4-20X6

| | | Notes No. | ₹ |
|---|-------------------------------|-----------|----------|
| I | Equity and Liabilities | | |
| | Shareholders funds | | 1,59,120 |
| | Non-current liabilities | | |
| | Long term borrowings | 1 | 10,600 |
| | Total | | 1,69,720 |

| | | |
|---------------------------|--------------|-----------------|
| Assets | | |
| Non-current assets | | |
| Fixed assets | | |
| Tangible assets | 2 | 57,000 |
| Intangible assets | 3 | 39,600 |
| Non-current investments | | 20,000 |
| Current assets | | |
| Inventories | | 40,000 |
| Cash and cash equivalents | | 13,120 |
| | Total | 1,69,720 |

Notes to Accounts

| | | ₹ |
|----|------------------------------------|--------|
| 1. | Long term borrowings | |
| | Loan from A | 10,600 |
| 2. | Tangible asset, net | |
| | Land and Building (60,000 – 3,000) | 57,000 |
| 3. | Intangible asset | |
| | Goodwill | 39,600 |
| 4. | Other income | |
| | Interest on debentures | 1,200 |
| 5. | Finance cost | |
| | Interest on A's loan | 600 |

Working Notes:

1.

Calculation of goodwill:

Year ended March, 31

| | 20X1 ₹ | 20X2 ₹ | 20X3 ₹ | 20X4 ₹ | 20X5 ₹ |
|--|-----------|-----------|-----------|-----------|-----------|
| Book Profits | 20,000 | (10,000) | 20,000 | 25,000 | 30,000 |
| Adjustment for extraneous profit 20X1 and abnormal loss 20X2 | (30,000) | 20,000 | — | — | — |
| | (10,000) | 10,000 | 20,000 | 25,000 | 30,000 |
| Add Back: Remuneration of A | 6,000 | 6,000 | 6,000 | 6,000 | 6,000 |

| | | | | | |
|---|---------|---------|---------|---------|----------|
| | (4,000) | 16,000 | 26,000 | 31,000 | 36,000 |
| Less : Debenture Interest being non-operating income* | (1,200) | (1,200) | (1,200) | (1,200) | (1,200) |
| | (5,200) | 14,800 | 24,800 | 29,800 | 34,800 |
| Total Profit from 20X2 to 20X5 | | | | | 1,04,200 |
| Less : Loss for 20X1 | | | | | (5,200) |
| | | | | | 99,000 |
| Average Profit | | | | | 19,800 |
| Goodwill equal to 2 years' purchase | | | | | 39,600 |
| Contribution from C, equal to 1/5 | | | | | 7,920 |

2. Partners' Capital Accounts

| | A | B | C | | A | B | C |
|----------------|--------|--------|--------|----------------------|--------|--------|--------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To Drawings | 12,000 | 12,000 | 12,000 | By Balance b/d | 40,000 | 50,000 | — |
| To Balance c/d | 80,320 | 65,360 | 13,440 | By General Reserve | 6,000 | 4,000 | — |
| | | | | By Goodwill | 23,760 | 15,840 | — |
| | | | | By Bank | — | — | 17,920 |
| | | | | By Profit & Loss A/c | 22,560 | 7,520 | 7,520 |
| | 92,320 | 77,360 | 25,440 | | 92,320 | 77,360 | 25,440 |

3. Balance Sheet as on 31st March, 20X6

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|----------------|--------|----------|-------------------------|---------|----------|
| A's Capital | | 80,320 | Goodwill | | 39,600* |
| B's Capital | | 65,360 | Land & Building | 60,000 | |
| C's Capital | | 13,440 | Less : Dep. | (3,000) | 57,000 |
| A's Loan | 10,000 | | Investments | | 20,000 |
| Add : Int. due | 600 | 10,600 | Stock-in-trade | | 40,000 |
| | | | Cash (Balancing figure) | | 13,120** |
| | | 1,69,720 | | | 1,69,720 |

4. Conversion into Company

| | | ₹ |
|-------------------------|---------|----------|
| Capital : | A | 80,320 |
| | B | 65,360 |
| | C | 13,440 |
| Share Capital | | 1,59,120 |
| Distribution of share : | A (3/5) | 95,472 |
| | B (1/5) | 31,824 |
| | C (1/5) | 31,824 |

A should subscribe shares of ₹ 15,152 (₹ 95,472 – ₹ 80,320) and C should subscribe shares of ₹ 18,384 (₹ 31,824 – ₹ 13,440) B withdraws ₹ 33,536 (₹ 65,360 – ₹ 31,824) subscribing to shares worth ₹ 31,824.

* It is shown in the books of the firm only to determine the closing capital of partners inclusive of goodwill before conversion.

** Also the closing cash balance can be derived as shown below :

| | ₹ | ₹ |
|---|--------|---------------|
| Trading profit (assume realised) | | 40,000 |
| <i>Add:</i> Debenture Interest | | 1,200 |
| <i>Add:</i> Decrease in Debtors Balance | | <u>20,000</u> |
| | | 61,200 |
| <i>Less:</i> Increase in stock | 10,000 | |
| <i>Less:</i> Decrease in Liabilities | 20,000 | (30,000) |
| Cash Profit | | 31,200 |
| <i>Add:</i> Opening cash balance | | 10,000 |
| <i>Add:</i> Cash brought in by C | | 17,920 |
| | | 59,120 |
| <i>Less:</i> Drawings | 36,000 | |
| <i>Less:</i> Additions to Building | 10,000 | (46,000) |
| | | 13,120 |

Illustration 5

Hari, Lal and Jay have been in partnership for a number of years, sharing profits/losses in the ratio of 2:2:1 as wholesale stationers trading under the name 'Hari Brothers'. They decide to convert their partnership into a limited company (with effect from 1st January, 20X2) to be known as Hari Ltd.

Immediately prior to this conversion the balance sheet of partnership as at 31st December 20X1 was as follows:

Balance Sheet
As on 31st December 20X1

| Liabilities | ₹ | ₹ | Assets | ₹ |
|-----------------------|--------|----------|-------------------------|----------|
| Capital accounts | | | Fixed assets | |
| Hari | 70,000 | | (at written down value) | |
| Lal | 30,000 | | Land & Buildings | 50,000 |
| Jay | 20,000 | 1,20,000 | Plant & Machinery | 30,000 |
| Current accounts | | | Motor vehicles | 20,000 |
| Hari | 7,000 | | Current Assets: | |
| Lal | 5,000 | | Inventories | 60,000 |
| Jay | 3,000 | 15,000 | Debtors | 25,000 |
| Current liabilities | | | Axis Bank account | 5,000 |
| Creditors | 25,000 | | | |
| Dena Bank account | 20,000 | 45,000 | | |
| Long-term liabilities | | | | |
| Loan-Hari | 3,000 | | | |
| Loan-Gopi Ltd. | 7,000 | 10,000 | | |
| | | 1,90,000 | | 1,90,000 |

The terms of conversion are that Hari Ltd. is to take over the assets and liabilities of Hari Brothers as follows:

| | Valuation for take-over |
|---------------------|--------------------------------|
| | ₹ |
| Land and Building | 96,000 |
| Plant and Machinery | 28,000 |

| | |
|----------------|--------|
| Motor vehicles | 15,000 |
| Inventories | 60,000 |
| Debtors | 24,000 |
| Creditors | 25,000 |
| Goodwill | 10,000 |

The closing balance in Axis Bank account is to be transferred to Dena Bank account before all the other dissolution entries are effected in the partnership ledgers.

Lal took over one of the motor vehicles at an agreed amount of ₹ 2,000. All other liabilities were paid from the Dena Bank account.

The purchase consideration is discharged by an issue at par of ₹ 60,000 10% Debentures (fully paid) to the partners in their capital account proportions as shown in the above balance sheet plus equity shares in Hari Ltd. of ₹ 1 each (fully paid to make up the balance due to each partner).

You are required to

- (i) prepare (a) Realisation Account (b) Partners' Capital Accounts (c) Bank account of Axis Bank and Dena Bank in the books of Hari Brothers;
- (ii) 'Business purchase account' and 'Hari Brothers' account in Hari Ltd.'s books.

Solution

(i) (a) In the books of Hari Brothers

Realisation Account

| | ₹ | ₹ | | ₹ |
|-------------------------------|--------|----------|-----------------------|----------|
| To Land and buildings | | 50,000 | By Creditors | 25,000 |
| To Plant and machinery | | 30,000 | By Lal's capital A/c | 2,000 |
| To Motor vehicles | | 20,000 | By Dena Bank A/c | 25,000 |
| To Inventories | | 60,000 | By Hari Ltd. (W.N.ii) | 1,83,000 |
| To Debtors | | 25,000 | | |
| To Partners' capital accounts | | | | |
| Hari (2/5) | 20,000 | | | |
| Lal (2/5) | 20,000 | | | |
| Jay (1/5) | 10,000 | 50,000 | | |
| | | 2,35,000 | | 2,35,000 |

(b) Partners' Capital Accounts

| Particulars | Hari | Lal | Jay | Particulars | Hari | Lal | Jay |
|--|--------|--------|--------|---------------------------|--------|--------|--------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To Realisation A/c (motor vehicle takeover) | | 2,000 | | By Balance b/d | 70,000 | 30,000 | 20,000 |
| To 10% Debentures* | 35,000 | 15,000 | 10,000 | By Current A/c | 7,000 | 5,000 | 3,000 |
| To Equity shares | 62,000 | 38,000 | 23,000 | By Realisation A/c Profit | 20,000 | 20,000 | 10,000 |
| | 97,000 | 55,000 | 33,000 | | 97,000 | 55,000 | 33,000 |

* Debentures have been issued in proportion of capital account balances i.e. in ratio of 7:3:2.

(c) Bank Account

| Particulars | Axis Bank | Dena Bank | Particulars | Axis Bank | Dena Bank |
|--------------------|-----------|-----------|---------------------|-----------|-----------|
| | ₹ | ₹ | | ₹ | ₹ |
| To Balance b/d | 5,000 | - | By Balance b/d | - | 20,000 |
| To Axis Bank | - | 5,000 | By Loan (Gopi Ltd.) | - | 7,000 |
| To Realisation A/c | - | 25,000 | By Loan-Hari | - | 3,000 |
| | | | By Dena Bank | 5,000 | |
| | 5,000 | 30,000 | | 5,000 | 30,000 |

**(ii) In the books of Hari Ltd.
Business Purchase Account**

| | | ₹ | | | ₹ |
|----|--------------------------|----------|----|---------------------|----------|
| To | Creditors | 25,000 | By | Land and buildings | 96,000 |
| To | Dena Bank (overdraft) | 25,000 | By | Plant and Machinery | 28,000 |
| To | Hari Brothers | 1,83,000 | By | Motor Vehicles | 15,000 |
| | | | By | Inventories | 60,000 |
| | | | By | Debtors | 24,000 |
| | | | By | Goodwill | 10,000 |
| | | 2,33,000 | | | 2,33,000 |

Hari Brothers Account

| | ₹ | | ₹ |
|-----------------------------|----------|----------------------|----------|
| To 10% Debentures A/c | 60,000 | By Business purchase | 1,83,000 |
| To Equity share capital A/c | 1,23,000 | | |
| | 1,83,000 | | 1,83,000 |

Partnership-Sale to a Company

Illustration 6

A and B were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.20X1 was:

| Liabilities | | ₹ | Assets | | ₹ |
|--------------------|----------|----------|--------------------|--------|----------|
| Sundry Creditors | | 60,000 | Stock | | 60,000 |
| Bank overdraft | | 35,000 | Machinery | | 1,50,000 |
| Capital A/cs: | | | Debtors | | 70,000 |
| A | 1,40,000 | | Joint Life Policy | | 9,000 |
| B | 1,30,000 | 2,70,000 | Leasehold Premises | | 34,000 |
| | | | Profit & Loss A/c | | 26,000 |
| | | | Drawings Accounts: | | |
| | | | A | 10,000 | |
| | | | B | 6,000 | 16,000 |
| | | 3,65,000 | | | 3,65,000 |

The business was carried on till 30.6.20X2. The partners withdrew in equal amounts half the amount of profits made during the period of six months after charging depreciation at 10% p.a. on machinery and after writing off 5% on leasehold premises. In the half year, sundry creditors were reduced by ₹ 10,000 and bank overdraft by ₹ 15,000.

On 30.6.20X2, stock was valued at ₹ 75,000 and Debtors at ₹ 60,000; the Joint Life Policy had been surrendered for ₹ 9,000 before 30.6.20X2 and other items remained the same as at 31.12.20X1.

On 30.6.20X2, the firm sold the business to a Limited Company. The value of goodwill was fixed at ₹ 1,00,000 and the rest of the assets were valued on the basis of the

Balance Sheet as at 30.6.20X2. The company paid the purchase consideration in Equity Shares of ₹ 10 each.

You are required to prepare: (a) Balance Sheet of the firm as at 30.6.20X2; (b) The Realisation Account; (c) Partners' Capital Accounts showing the final settlement between them.

Solution

(a) Balance Sheet as on 30.6.20X2

| Liabilities | ₹ | ₹ | Assets | ₹ | ₹ |
|-----------------------------|----------------|----------|-------------------------------|----------------|----------|
| Capital Accounts: | | | Machinery | 1,50,000 | |
| A's balance as on 1.1.20X2 | 1,17,000 | | Less: Depreciation @ 10% p.a. | <u>(7,500)</u> | 1,42,500 |
| Add: Profit for 6 months | 11,800 | | Leasehold premises | 34,000 | |
| | 1,28,800 | | Less: Written-off @5% | <u>(1,700)</u> | 32,300 |
| Less: Drawings for 6 months | <u>(5,900)</u> | 1,22,900 | Stock | | 75,000 |
| B's balance as on 1.1.20X2 | 1,11,000 | | Sundry Debtors | | 60,000 |
| Add: Profit for 6 months | 11,800 | | | | |
| | 1,22,800 | | | | |
| Less: Drawings for 6 months | <u>(5,900)</u> | 1,16,900 | | | |
| Sundry Creditors | | 50,000 | | | |
| Bank overdraft | | 20,000 | | | |
| | | 3,09,800 | | | 3,09,800 |

(b) Realisation Account

| | Particulars | ₹ | | Particulars | ₹ |
|----|------------------------|----------|----|-----------------------------|----------|
| To | Machinery A/c | 1,42,500 | By | Sundry Creditors A/c | 50,000 |
| To | Leasehold Premises A/c | 32,300 | By | Bank Overdraft A/c | 20,000 |
| To | Stock A/c | 75,000 | By | Limited Company A/c (W.N.2) | 3,39,800 |
| To | Sundry Debtors A/c | 60,000 | | | |

| | | | | | |
|----|-----------------|----------|--|--|----------|
| To | A's Capital A/c | 50,000 | | | |
| To | B's Capital A/c | 50,000 | | | |
| | | 4,09,800 | | | 4,09,800 |

(c) Partners' Capital Accounts

| Date | Particulars | A | B | Date | Particulars | A | B |
|---------|----------------------------------|----------|----------|---------|------------------------------------|----------|----------|
| | | ₹ | ₹ | | | ₹ | ₹ |
| 1.1.X2 | To Profit & Loss A/c | 13,000 | 13,000 | 1.1.X2 | By Balance b/d | 1,40,000 | 1,30,000 |
| | To Drawings A/c | 10,000 | 6,000 | | | | |
| 29.6.X2 | To Balance c/d | 1,17,000 | 1,11,000 | | | | |
| | | 1,40,000 | 1,30,000 | | | 1,40,000 | 1,30,000 |
| 30.6.X2 | To Drawings A/c | 5,900 | 5,900 | 30.6.X2 | By Balance b/d | 1,17,000 | 1,11,000 |
| | To Shares in Limited Company A/c | 1,72,900 | 1,66,900 | 30.6.X2 | By Profit & Loss Appropriation A/c | 11,800 | 11,800 |
| | | | | | By Realisation A/c | 50,000 | 50,000 |
| | | 1,78,800 | 1,72,800 | | | 1,78,800 | 1,72,800 |

Working Notes:**(1) Ascertainment of profit for the 6 months ended 30th June, 20X2**

| Closing Assets: | ₹ | ₹ |
|-------------------------------------|--------|-----------|
| Stock | | 75,000 |
| Sundry Debtors | | 60,000 |
| Machinery less depreciation | | 1,42,500 |
| Leasehold premises less written off | | 32,300 |
| | | 3,09,800 |
| Less: Closing liabilities: | | |
| Sundry Creditors | 50,000 | |
| Bank overdraft | 20,000 | (70,000) |
| Closing Net Assets | | 2,39,800 |

| | | |
|--|----------|------------|
| Less: Opening combined capital: | | |
| A – ₹ (1,40,000 – 13,000 – 10,000) | 1,17,000 | |
| B – ₹ (1,30,000 – 13,000 – 6,000) | 1,11,000 | (2,28,000) |
| Profit before adjustment of drawings | | 11,800 |
| Add: Combined drawings during the 6 months (equal to profit) | | 11,800 |
| Profit for 6 months | | 23,600 |

(2) Ascertainment of purchase consideration:

Closing net assets (as above) ₹ 2,39,800 + Goodwill ₹ 1,00,000 = ₹ 3,39,800.

Illustration 7

A, B and C were in partnership sharing profits and losses 3:2:1. There was no provision in the agreement for interest on capitals or drawings.

A died on 31.12.20X0 and on that date, the partners' balance were as under:

Capital Account : A – ₹ 60,000; B- ₹ 40,000; C- ₹ 20,000

Current Account: A – ₹ 29,000; B – ₹ 20,000; C – ₹ 5,000 (Dr.).

By the partnership agreement, the sum due to A's estate was required to be paid within a period of 3 years, and minimum instalment of ₹ 20,000 each were to be paid, the first such instalment falling due immediately after death and the subsequent instalments at half-yearly intervals. Interest @ 5% p.a. was to be credited half-yearly.

In ascertaining his share, goodwill (not recorded in the books) was to be valued at ₹ 60,000 and the assets, excluding the Joint Endowment Policy (mentioned below), were valued at ₹ 36,000 in excess of the book values.

No Goodwill Account was raised and no alteration was made to the book values of fixed assets. The Joint Assurance Policy shown in the books at ₹ 20,000 matured on 1.1.20X1, realising ₹ 26,000; payments of ₹ 20,000 each were made to A's Executors on 1.1.20X1, 30.6.20X1 and 31.12.20X1. B and C continued trading on the same terms as previously and the net profit for the year to 31.12.20X1 (before charging the interest due to A's estate) amounted to ₹ 32,000. During that period, the partners drawings were: B- ₹ 15,000; and C- ₹ 8,000.

On 1.1.20X2, the partnership was dissolved and an offer to purchase the business as a going concern for ₹ 1,40,000 was accepted on that day. A cheque for that sum was received on 30.6.20X2.

The balance due to A's estate, including interest, was paid on 30.6.20X2 and on that day, B and C received the sums due to them.

You are required to write-up the Partners' Capital and Current Accounts from 1.1.20X1 to 30.6.20X2. Show also the account of the executors of A.

Solution

Partners' Current Accounts

| Particulars | A | B | C | Particulars | A | B | C |
|---|--------|--------|--------|--|--------|--------|--------|
| 1.1.20X1 | ₹ | ₹ | ₹ | 1.1.20X1 | ₹ | ₹ | ₹ |
| To Balance b/d | --- | --- | 5,000 | By Balance b/d | 29,000 | 20,000 | -- |
| To A's Current A/c – goodwill (W.N.1) | - | 20,000 | 10,000 | By B's Current A/c – goodwill | 20,000 | -- | -- |
| To A's Current A/c – Revaluation Profit (W.N.2) | - | 12,000 | 6,000 | By C's Current A/c – goodwill | 10,000 | - | - |
| To A's Capital A/c – transfer | 80,000 | - | - | By B's Current A/c – Revaluation profit | 12,000 | - | - |
| | | | | By C's Current A/c – Revaluation profit | 6,000 | | |
| | | | | By Joint Life Policy A/c (₹ 26,000 – ₹ 20,000) | 3,000 | 2,000 | 1,000 |
| | | | | By Balance c/d | | 10,000 | 20,000 |
| | 80,000 | 32,000 | 21,000 | | 80,000 | 32,000 | 21,000 |
| 1.1.20X1 | | | | 31.12.20X1 | | | |
| To Balance b/d | | 10,000 | 20,000 | By Profit & Loss Appropriation A/c | | 17,617 | 8,808 |
| 31.12.20X1 | | | | By Balance c/d | | 7,383 | 19,192 |
| To Drawings A/c | | 15,000 | 8,000 | | | 25,000 | 28,000 |
| | | 25,000 | 28,000 | | | | |
| 1.1.20X2 | | | | 30.6.20X2 | | | |
| To Balance b/d | | 7,383 | 19,192 | By Realisation A/c – profit | | 12,573 | 6,287 |
| To B's Capital A/c – transfer | | | | By C's Capital A/c – transfer | | --- | 12,905 |
| | | 5,190 | --- | | | 12,573 | 19,192 |
| | | 12,573 | 19,192 | | | | |

Partners' Capital Accounts

| Particulars | A | B | C | Particulars | A | B | C |
|-------------------------------|----------|--------|--------|-------------------------------|----------|--------|--------|
| 1.1.20X1 | ₹ | ₹ | ₹ | 1.1.20X1 | ₹ | ₹ | ₹ |
| To A's Executors A/c | 1,40,000 | ---- | --- | By Balance b/d | 60,000 | 40,000 | 20,000 |
| To Balance c/d | --- | 40,000 | 20,000 | By A's Current A/c | 80,000 | -- | -- |
| | 1,40,000 | 40,000 | 20,000 | | 1,40,000 | 40,000 | 20,000 |
| 31.12.20X1 | | | | 1.1.20X1 | | | |
| To Balance c/d | | 40,000 | 20,000 | By Balance b/d | | 40,000 | 20,000 |
| | | 40,000 | 20,000 | | | 40,000 | 20,000 |
| 30.6.20X2 | | | | 1.1.20X2 | | | |
| To C's Current A/c – transfer | | --- | 12,905 | By Balance b/d | | 40,000 | 20,000 |
| To Bank A/c | | 45,190 | 7,095 | 30.6.20X2 | | | |
| | | | | By B's Current A/c – transfer | | 5,190 | -- |
| | | | | | | | - |
| | | 45,190 | 20,000 | | | 45,190 | 20,000 |

A's Executors Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|------------|----------------|----------|------------|--------------------|----------|
| 1.1.20X1 | To Bank A/c | 20,000 | 1.1.20X1 | To A's Capital A/c | 1,40,000 |
| 1.1.20X1 | To Balance c/d | 1,20,000 | | | |
| | | 1,40,000 | | | 1,40,000 |
| 30.6.20X1 | To Bank A/c | 20,000 | 1.1.20X1 | By Balance b/d | 1,20,000 |
| 30.6.20X1 | To Balance c/d | 1,03,000 | 30.6.20X1 | By Interest A/c | 3,000 |
| | | 1,23,000 | | | 1,23,000 |
| 31.12.20X1 | To Bank A/c | 20,000 | 1.7.20X1 | By Balance b/d | 1,03,000 |
| 31.12.20X1 | To Balance c/d | 85,575 | 31.12.20X1 | By Interest A/c | 2,575 |
| | | 1,05,575 | | | 1,05,575 |
| 30.6.20X2 | To Bank A/c | 87,715 | 1.1.20X2 | By Balance b/d | 85,575 |
| | | 87,715 | 30.6.20X2 | By Interest A/c | 2,140 |
| | | | | | 87,715 |

Working Notes:**(1) Adjustment in regard to Goodwill**

| Partners | | A | B | C |
|--------------------------------|-----|----------|--------|--------|
| Share of goodwill before death | (₹) | 30,000 | 20,000 | 10,000 |
| Share of goodwill after death | (₹) | - | 40,000 | 20,000 |
| Gain (+)/Sacrifice (-) | (₹) | (30,000) | 20,000 | 10,000 |
| | | Cr. | Dr. | Dr. |

(2) Adjustment in regard to revaluation of assets

| Partners | | A | B | C |
|---|-----|----------|--------|--------|
| Share of profit on revaluation credited to all the partners | (₹) | 18,000 | 12,000 | 6,000 |
| Debited to the continuing partners | (₹) | - | 24,000 | 12,000 |
| | (₹) | (18,000) | 12,000 | 6,000 |
| | | Cr. | Dr. | Dr. |

(3) Ascertainment of Profit for the year ended 31.12.20X1

| | ₹ | ₹ |
|---|-------|---------|
| Profit before charging interest on balance due to A's executors | | 32,000 |
| Less: Interest payable to A's executors: | | |
| from 1.1.20X1 to 30.6.20X1 | 3,000 | |
| From 1.7.20X1 to 31.12.20X1 | 2,575 | (5,575) |
| Balance of profit to be shared by B and C | | 26,425 |

(4) Balance Sheet as at 31.12.20X1

| Liabilities | ₹ | Assets | ₹ |
|---------------------|----------|----------------------------------|----------|
| Capital Account – B | 40,000 | Sundry Assets (balancing figure) | 1,19,000 |
| Capital Account – C | 20,000 | Partners' Current A/cs –B | 7,383 |
| A's Executors A/c | 85,575 | Partners' Current A/cs- C | 19,192 |
| | 1,45,575 | | 1,45,575 |

(5) Realisation Account

| | | ₹ | | | ₹ |
|----|------------------------------|----------|----|-----------------------------------|----------|
| To | Sundry Assets A/c | 1,19,000 | By | Bank A/c (purchase consideration) | 1,40,000 |
| To | Interest A/c – A's Executors | 2,140 | | | |
| To | Partners' Capital A/cs – B | 12,573 | | | |
| To | Partners' Capital A/cs – C | 6,287 | | | |
| | | 1,40,000 | | | 1,40,000 |

2.2.1 Apportionment of shares amongst the partners

Sometime an examination problem may require the students to suggest equitable basis for division of shares between the vendors, when they are partners, so as to preserve the rights as previously existed between them, that is, to maintain the same profit-sharing ratio and to preserve the priority in regard to repayment of capital.

Suppose A, B and C share profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their capitals on 31st December, 20X1 were: A ₹ 50,000, B ₹ 30,000 and C ₹ 20,000. On 1st January, 20X2 the business was converted into a limited company and was valued at ₹ 1,30,000. A scheme of capitalisation, whereby the mutual interest of partners may remain intact as far as possible is suggested below:

The total capital being ₹ 1,00,000 and the value placed on the business being ₹ 1,30,000 there is goodwill of ₹ 30,000 to be shared by the partners in the ratio of 3:2:1 or A ₹ 15,000, B ₹ 10,000 and C ₹ 5,000. The capital will now be: A ₹ 65,000, B ₹ 40,000 and C ₹ 25,000.

Taking B's capital as the basis, A's capital should be ₹ 60,000, i.e. $40,000 \times \frac{3}{2}$ and C's capital should be ₹ 20,000. Both A and C have ₹ 5,000 excess. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to A & C for ₹ 5,000 each and the remaining amount of ₹ 1,20,000 can be in the form of equity shares to be divided among A, B and C in the ratio of 3 : 2 : 1. They will then share the company's profit in the ratio of 3 : 2 : 1 after allowing preference dividend.

Illustration 8

Prabhu & Co. is a partnership firm consisting of Mr. Prabhu, Mr. Bhola and Mr. Shiv who share profits and losses in the ratio of 2:2:1 and Bhagwan Ltd. is a company doing similar business.

Following is the Balance sheet of the firm and that of the company as at 31.3.20X1:

| Liabilities | Prabhu & Co. | Bhagwan Ltd. | | Prabhu & Co. | Bhagwan Ltd. |
|----------------------------|-------------------------|---------------------|---------------------|-------------------------|----------------------|
| | ₹ | ₹ | | ₹ | ₹ |
| Equity share Capital: | | | Plant & machinery | 2,50,000 | 8,00,000 |
| Equity shares of ₹ 10 each | | 10,00,000 | Furniture & fixture | 25,000 1,00,000 | 1,12,500 4,25,000 |
| Partners' capital: | | | Stock in trade | | |
| Prabhu | 1,00,000 | | Sundry debtors | 1,00,000 | 4,12,500 |
| Bhola | 1,50,000 | | Cash at bank | 5,000 | 2,00,000 |
| Shiv | 50,000 | | Cash in hand | 20,000 | 50,000 |
| General reserve | 50,000 | 3,50,000 | | | |
| Sundry creditors | 1,50,000 | 6,50,000 | | | |
| | 5,00,000 | 20,00,000 | | 5,00,000 | 20,00,000 |

It was decided that the firm Prabhu & Co. be dissolved and all the assets (except cash in hand and cash at bank) and all the liabilities of the firm be taken over by Bhagwan Ltd. by issuing 25,000 shares of ₹ 10 each at a premium of ₹ 2 per share.

Partners of Prabhu & Co. agreed to divide the shares issued by Bhagwan Ltd. in the profit sharing ratio and bring necessary cash for settlement of their capital.

The creditors of Prabhu & Co. includes ₹ 50,000 payable to Bhagwan Ltd. An unrecorded liability of ₹ 12,500 of Prabhu & Co. must also be taken over by Bhagwan Ltd.

Prepare:

- (i) *Realisation account, Partners' capital accounts and Cash in hand/Bank account in the books of Prabhu & Co.*
- (ii) *Pass journal entries in the books of Bhagwan Ltd. for acquisition of Prabhu & Co.*

Solution**(i) In the books of Prabhu & Co.
Realisation Account**

| | ₹ | | ₹ |
|------------------------|-----------------|------------------------------|-----------------|
| To Plant & Machinery | 2,50,000 | By Sundry Creditors | 1,50,000 |
| To Furniture & Fixture | 25,000 | By Bhagwan Ltd. (Refer W.N.) | 3,00,000 |
| To Stock in trade | 1,00,000 | By Partners' Capital | |
| To Sundry Debtors | 1,00,000 | Accounts (loss): | |
| | | Prabhu's Capital A/c | 10,000 |
| | | Bhola's Capital A/c | 10,000 |
| | | Shiv's Capital A/c | 5,000 |
| | <u>4,75,000</u> | | <u>4,75,000</u> |

Partners' Capital Accounts

| | Prabhu | Bhola | Shiv | | Prabhu | Bhola | Shiv |
|-----------------------------------|-----------------|-----------------|---------------|--------------------|-----------------|-----------------|---------------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To Realisation A/c | 10,000 | 10,000 | 5,000 | By Balance b/d | 1,00,000 | 1,50,000 | 50,000 |
| To Shares in Bhagwan Ltd. (W.N.1) | 1,20,000 | 1,20,000 | 60,000 | By General Reserve | 20,000 | 20,000 | 10,000 |
| To Cash | - | 40,000 | - | By Cash | 10,000 | - | 5,000 |
| | <u>1,30,000</u> | <u>1,70,000</u> | <u>65,000</u> | | <u>1,30,000</u> | <u>1,70,000</u> | <u>65,000</u> |

Cash and Bank Account

| | ₹ | ₹ | | ₹ | ₹ |
|-----------------------|---------------|--------------|-----------------------|---------------|--------------|
| To Balance b/d | 20,000 | 5,000 | By Cash A/c (Contra)* | | 5,000 |
| To Bank A/c (Contra)* | 5,000 | | By Bhola | 40,000 | |
| To Prabhu | 10,000 | | | | |
| To Shiv | <u>5,000</u> | <u> </u> | | | |
| | <u>40,000</u> | <u>5,000</u> | | <u>40,000</u> | <u>5,000</u> |

* It is assumed that cash at bank has been withdrawn to pay to Partner Bhola.

(ii) **In the Books of Bhagwan Ltd.
Journal Entries**

| | | | Dr. (₹) | Cr. (₹) |
|----|---|--------------------------|--|--|
| 1. | Business Purchase Account To Liquidators of Prabhu & Co. (Being business of Prabhu & Co. purchased and payment due) | Dr. | 3,00,000 | 3,00,000 |
| 2. | Plant and Machinery A/c Furniture and Fixture A/c Stock in Trade A/c Sundry Debtors A/c To Sundry Creditors To Unsecured Liability To Business Purchase Account To Capital Reserve (B.F.) (Being take over of all assets and liabilities) | Dr. Dr. Dr. Dr. | 2,50,000 25,000 1,00,000 1,00,000 | 1,50,000 12,500 3,00,000 12,500 |
| 3. | Liquidators of Prabhu & Co. To Equity Share Capital Account To Securities Premium Account (Being purchase consideration discharged in the form of shares of ₹ 10 each issued at a premium of ₹ 2 each) | Dr. | 3,00,000 | 2,50,000 50,000 |
| 4. | Sundry Creditors Account To Sundry Debtors Account (Being mutual owing eliminated) | Dr. | 50,000 | 50,000 |

Working Note:

Computation of purchase consideration:

25,000 Equity shares of ₹ 12 each = ₹ 3,00,000

Equity shares to be given to partners :

| | | |
|--------|---|-----------------------------------|
| Prabhu | = | 10,000 Shares @ ₹ 12 = ₹ 1,20,000 |
| Bhola | = | 10,000 shares @ ₹ 12 = ₹ 1,20,000 |
| Shiv | = | 5,000 shares @ ₹ 12 = ₹ 60,000 |

Illustration 9

P and Q were carrying on business sharing profits and losses equally. The firm's Balance Sheet as at 31.12.20X1 was:

| Liabilities | ₹ | Assets | ₹ |
|----------------------|----------|-------------------|----------|
| Capital Accounts: | | Plant | 1,60,000 |
| P 1,50,000 | | Building | 48,000 |
| Q <u>1,30,000</u> | 2,80,000 | Debtors | 75,000 |
| Sundry Creditors | 80,000 | Stock | 70,000 |
| Bank Overdraft | 45,000 | Joint Life Policy | 6,000 |
| | | Profit & Loss A/c | 30,000 |
| | | Drawings Account: | |
| | | P 9,000 | |
| | | Q <u>7,000</u> | 16,000 |
| | 4,05,000 | | 4,05,000 |

The operations of the business were carried on till 30.06.20X2. P and Q both withdrew in equal amount half the amount of profit made during the current period of six months after charging depreciation at 10% per annum on plant and after writing off 5% on building.

During the current period of six months, creditors were reduced by ₹ 20,000 and bank overdraft by ₹ 5,000.

The joint life policy was surrendered for ₹ 6,000 before 30th June 20X2. Stock was valued at ₹ 84,000 and debtors at ₹ 68,000 on 30th June 20X2. The other items remained the same as at 31.12.20X1.

On 30.06.20X2, the firm sold its business to PQ Ltd. The value of goodwill was estimated at ₹ 1,30,000 and the remaining assets were valued on the basis of the balance sheet as on 30.06.20X2.

PQ Ltd. paid the purchase consideration in equity shares of ₹ 10 each.

You are required to prepare:

- (a) *Balance sheet of the firm as at 30.06.20X2,*
- (b) *Realisation account,*
- (c) *Partners' Capital Accounts showing the final settlement between them.*

Solution**(a) Balance sheet of the firm as at 30.06.20X2**

| Liabilities | ₹ | Assets | ₹ |
|--------------------------|-----------------|--------------------------|-----------------|
| Capital Accounts: | | Plant : | |
| P's Capital | 1,33,800 | Opening Balance | 1,60,000 |
| Q's Capital | 1,15,800 | Less: Depreciation @ 10% | <u>8,000</u> |
| Creditors | 60,000 | Building: | |
| Bank Overdraft | 40,000 | Opening Balance | 48,000 |
| | | Less: Written-off @ 5% | <u>2,400</u> |
| | | Debtors | 68,000 |
| | | Stock | 84,000 |
| Total | 3,49,600 | Total | 3,49,600 |

(b) Realisation Account

Dr.

Cr.

| Particulars | Amount | Particulars | Amount |
|--------------------|-----------------|--------------------|-----------------|
| To Sundry Assets: | | By Creditors | 60,000 |
| Plant | 1,52,000 | By Bank Overdraft | 40,000 |
| Building | 45,600 | By PQ Limited A/c | 3,79,600 |
| Stock | 84,000 | (working note 2) | |
| Debtors | 68,000 | | |
| To Profit: | | | |
| P's Capital A/c | 65,000 | | |
| Q's Capital A/c | 65,000 | | |
| | <u>4,79,600</u> | | <u>4,79,600</u> |

(c) Partner's Capital Accounts

| Date | Particulars | P (₹) | Q (₹) | Date | Particulars | P (₹) | Q (₹) |
|-------------|-------------------------|--------------|--------------|-------------|---------------------|--------------|--------------|
| 01.01.X2 | To Profit & Loss A/c | 15,000 | 15,000 | 1.1.X2 | By Balance b/d | 1,50,000 | 1,30,000 |
| 01.01.X2 | To Drawing A/c | 9,000 | 7,000 | 30.06.X2 | By Profit (W. N. 1) | 15,600 | 15,600 |
| 30.06.X2 | To Drawing A/c (W. N.1) | 7,800 | 7,800 | | | | |

| | | | | | | | |
|----------|-------------------------|----------|----------|----------|-----------------------------|----------|----------|
| 30.06.X2 | To Balance c/d | 1,33,800 | 1,15,800 | | | | |
| | Total | 1,65,600 | 1,45,600 | | Total | 1,65,600 | 1,45,600 |
| 30.06.X2 | To Shares in PQ Limited | 1,98,800 | 180,800 | 30.06.X2 | By Balance b/d | 1,33,800 | 1,15,800 |
| | | 1,98,800 | 1,80,800 | 30.06.X2 | By Realisation A/c (Profit) | 65,000 | 65,000 |
| | | | | | | 1,98,800 | 1,80,800 |

Working Notes

(1) Ascertainment of profit for the period of 6 Months ended 30.06.20X2

| | Amount (₹) |
|---|-----------------------|
| Closing Assets: | |
| Stock | 84,000 |
| Debtors | 68,000 |
| Plant Less Depreciation | 1,52,000 |
| Building Less Written off | 45,600 |
| Total | 3,49,600 |
| Less: Closing Liabilities: | |
| Creditors | 60,000 |
| Bank Overdraft | <u>40,000</u> |
| Closing Net Assets | 2,49,600 |
| Less: Opening adjusted Capitals | |
| P (₹1,50,000 – ₹15,000 – ₹9,000) | 1,26,000 |
| Q (₹1,30,000 – ₹15,000 – ₹7,000) | <u>1,08,000</u> |
| Profit Net of drawings | 15,600 |
| Actual Profit for Six Months before drawings(half of profit) = 15,600 x 2 | 31,200 |
| Combined Drawing during six months (half of profit) | 15,600 |

(2) Ascertainment of purchase consideration

| | ₹ |
|-------------------------------|-----------------|
| Closing Net Assets (As above) | 2,49,600 |
| Add: Goodwill | <u>1,30,000</u> |
| Total Purchase Consideration | <u>3,79,600</u> |

SUMMARY

- Amalgamation of partnership firms includes
 - Closing the old books of Amalgamating firms
 - Opening the new books of Amalgamated firm
- When one firm is merged with another existing firm, entries will be in the pattern of winding up in the books of the firm which has ceased to exist. The other firm will record the transaction as that of a business purchase.
- Creditors play an important role in conversion of partnership firm into company.

TEST YOUR KNOWLEDGE

MCQs

1. When one firm is merged with another existing firm, entries will be made for
 - (a) Winding up in the books of firm which will cease to exist.
 - (b) Business purchase in the books of other firm.
 - (c) Both (a) and (b).
2. In case of amalgamation of firms, profit/ loss on sale of the firm is ascertained by
 - (a) Realisation account.
 - (b) Revaluation account.
 - (c) New firm's account.
3. Liabilities not taken over by the new firm (at the time of amalgamation) will be transferred to
 - (a) Capital accounts.
 - (b) Revaluation account.
 - (c) New firm's account.

THEORETICAL QUESTIONS

1. Describe the accounting procedure involved in amalgamation of two or more partnership firms.

PRACTICAL QUESTIONS

Question 1

P and Q are partners of P & Co. sharing Profit and Losses in the ratio of 3:1 and Q and R are partners of R & Co., sharing profits and losses in the ratio of 2:1. On 31st March, 20X1, they decide to amalgamate and form a new firm M/s PQR & Co., wherein P, Q and R would be partners sharing profits and losses in the ratio of 3:2:1. The Balance Sheets of two firms on the above date are as under

| Liabilities | P & Co. | R & Co. | Assets | P & Co. | R & Co. |
|------------------|----------|----------|-------------------|----------|----------|
| | ₹ | ₹ | | ₹ | ₹ |
| Capitals: | | | Fixed assets: | | |
| P | 2,40,000 | ---- | Building | 50,000 | 60,000 |
| Q | 1,60,000 | 2,00,000 | Plant & machinery | 1,50,000 | 1,60,000 |
| R | ---- | 1,00,000 | Office equipment | 20,000 | 6,000 |
| Reserves | 50,000 | 1,50,000 | Current assets: | | |
| Sundry creditors | 1,20,000 | 1,16,000 | Stock-in-trade | 1,20,000 | 1,40,000 |
| Due to P & Co. | ---- | 1,00,000 | Sundry debtors | 1,60,000 | 2,00,000 |
| Bank overdraft | 80,000 | ----- | Bank balance | 30,000 | 90,000 |
| | | | Cash in hand | 20,000 | 10,000 |
| | | | Due from R & Co. | 1,00,000 | ---- |
| | | | | | - |
| | 6,50,000 | 6,66,000 | | 6,50,000 | 6,66,000 |

The amalgamated firm took over the business on the following terms:

- Building of P & Co. was valued at ₹ 1,00,000.*
- Plant and machinery of P & Co. was valued at ₹ 2,50,000 and that of R & Co. at ₹ 2,00,000.*
- All stock in trade is to be appreciated by 20%.*
- Goodwill valued of P & Co. at ₹ 1,20,000 and R & Co. at ₹ 60,000, but the same will not appear in the books of PQR & Co.*
- Partners of new firm will bring the necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.*
- Provisions for doubtful debts has to be carried forward at ₹ 12,000 in respect of debtors of P & Co. and ₹ 26,000 in respect of debtors of R & Co.*

You are required to prepare the Balance Sheet of new firm and capital accounts of the partners in the books of old firms.

Question 2

'S' and 'T' were carrying on business as equal partner. Their Balance Sheet as on 31st March, 20X1 stood as follows:

| Liabilities | | ₹ | Assets | | ₹ |
|--------------------|-----------------|------------------|-------------------|--|------------------|
| Capital accounts: | | | Stock | | 2,70,000 |
| S | 6,40,000 | | Debtors | | 3,65,000 |
| T | <u>6,60,000</u> | 13,00,000 | Furniture | | 75,000 |
| Creditors | | 3,27,500 | Joint life policy | | 47,500 |
| Bank overdraft | | 1,50,000 | Plant | | 1,72,500 |
| Bills payable | | 62,500 | Building | | 9,10,000 |
| | | <u>18,40,000</u> | | | <u>18,40,000</u> |

The operations of the business were carried on till 30th September, 20X1. S and T both withdrew in equal amounts half the amount of profits made during the current period of 6 months after 10% per annum had been written off on building and plant and 5% per annum written off on furniture. During the current period of 6 months, creditors were reduced by ₹ 50,000, Bills payable by ₹ 11,500 and Bank overdraft by ₹ 75,000. The Joint Life policy was surrendered for ₹ 47,500 on 30th September, 20X1. Stock was valued at ₹ 3,17,000 and debtors at ₹ 3,25,000 on 30th September, 20X1. The other items remained the same as on 31st March, 20X1.

On 30th September, 20X1 the firm sold its business to ST Ltd. The value of goodwill was estimated at ₹ 5,40,000 and the remaining assets were valued on the basis of the Balance Sheet as on 30th September, 20X1. The ST Ltd. paid the purchase consideration in equity shares of ₹ 10 each. You are required to prepare a Realisation Account and Capital accounts of the partners.

Question 3

X, Y and Z were in partnership sharing profits and losses 3:2:1. There was no provision in the agreement for interest on capital or drawings.

X died on 31.3.20X1 and on that date, the partners' balance were as under:

Capital Account: X - ₹ 60,000, Y - ₹ 40,000, Z - ₹ 20,000.

Current Account: X - ₹ 40,000 (Cr.), Y - ₹ 30,000 (Cr.), Z - ₹ 10,000 (Dr.)

By the partnership agreement, the sum due to X's estate was required to be paid within a period of 3 years, and minimum installment of ₹ 30,000 each were to be paid, the first such installment falling due immediately after death and the subsequent installments at half-yearly intervals. Interest @ 6% p.a. was to be credited half yearly.

In ascertaining his share, goodwill (not recorded in the books) was to be valued at ₹ 90,000 and the assets, excluding the Joint Endowment Policy (mentioned below), were valued at ₹ 60,000 in excess of the book values.

No Goodwill Account was raised and no alteration was made to the book values of fixed assets. The Joint Assurance Policy shown in the books at ₹ 40,000 matured on 1.4.20X1, realising ₹ 52,000; payments of ₹ 30,000 each were made to X's Executors on 1.4.20X1, 30.9.20X1 and 31.3.20X2. Y and Z continued trading on the same terms as previously and the net profit for the year ending 31.3.20X2 (before charging the interest due to X's estate) amounted to -- ₹ 52,000. During that period, the partners' drawings were Y - ₹ 15,000; and Z - ₹ 8,000.

On 1.4.20X2, the partnership was dissolved and an offer to purchase the business as a going concern for ₹ 1,80,000 was accepted on that day. A cheque for that sum was received on 30.6.20X2.

The balance due to X's estate, including interest, was paid on 30.6.20X2 and on that day, Y and Z received the sums due to them.

You are required to write-up the Partners' Capital and Current Accounts from 1.4.20X1 to 30.6.20X2. Show also the account of the executors of X.

Question 4

Ramesh, Roshan and Rohan were partners of the firm '3R Enterprises' sharing profits and losses in the ratio of 3:2:1 respectively. On 31st March, 20X1 their Balance Sheet stood as follows:

| Liabilities | ₹ | Assets | ₹ |
|----------------------|-----------|--------------------|-----------|
| Ramesh's Capital A/c | 16,80,000 | Land and Buildings | 14,00,000 |
| Roshan's Capital A/c | 11,60,000 | Machinery | 11,00,000 |
| Rohan's Capital A/c | 6,70,000 | Furniture | 6,10,000 |
| General Reserve | 6,30,000 | Stock | 8,40,000 |
| Creditors | 6,00,000 | Debtors | 6,00,000 |
| | | Cash at Bank | 1,90,000 |
| | 47,40,000 | | 47,40,000 |

On the above-mentioned date, the partners decided to convert their firm into a private limited company and named it '3R Enterprises (Private) Ltd.'. The company took over all the assets including cash at bank and all the creditors for ₹ 42,00,000 payable in the form of fully paid equity shares of ₹ 10 each. It recorded in its books, land and buildings at ₹ 16,40,000, machinery at ₹ 9,90,000 and created a provision for bad debts @ 5% on debtors. The expenses of the take-over came to ₹ 23,000 which were paid and borne by the company.

The expenses of getting the company incorporated were ₹ 57,000.

The partners distributed the company's shares amongst themselves in their profit sharing ratio. They settled their accounts by paying or receiving cash.

Prepare Realisation Account and all the partners' capital accounts in the firm's ledger and pass journal entries in the books of the company for all of its transactions mentioned above.

ANSWERS/ SOLUTIONS

ANSWERS TO MCQs

1. (c) 2. (a) 3. (a)

ANSWRS TO THEORETICAL QUESTIONS

1. Amalgamation includes:

Closing the books of old firm

- (a) Each firm should prepare a **Revaluation Account** relating to its own assets and liabilities and transfer the balance to the partners' capital accounts in the profit-sharing ratio.
- (b) Entries for **raising goodwill** should be passed.
- (c) **Assets and liabilities not taken over** by the new firm should be transferred to the capital accounts of partners in the ratio of their capitals.
- (d) The **new firm** should be debited with the difference between the value of assets and liabilities taken over by it; the assets should be credited and liabilities debited.
- (e) **Partners' capital accounts** should be transferred to the new firm's account.

Opening the books of the new firm

Debit assets taken out at the agreed values

Credit the liabilities taken over **at the agreed values**, and

Credit individual partner's capital accounts with the closing balances in the erstwhile firm.

ANSWERS TO PRACTICAL QUESTIONS**Answer 1****Balance Sheet of M/s PQR & Co. as at 31st March, 20X1**

| Liabilities | | ₹ | | Assets | | ₹ | |
|---|-----------------|-----------|------------------|--|-----------------|---|------------------|
| Capitals: | | | | Building (₹ 1,00,000 + ₹ 60,000) | | | 1,60,000 |
| P | 5,52,000 | | | Plant & machinery (₹ 2,50,000+₹ 2,00,000) | | | 4,50,000 |
| Q | 3,68,000 | | | Office equipment (₹ 20,000+₹ 6,000) | | | 26,000 |
| R | <u>1,84,000</u> | 11,04,000 | | Stock-in-trade (₹ 1,44,000+₹ 1,68,000) | | | 3,12,000 |
| Sundry creditors (1,20,000+1,16,000) | | | 2,36,000 | Sundry debtors (₹ 1,60,000+₹ 2,00,000) | 3,60,000 | | |
| Bank overdraft | | | 80,000 | Less: Provision for doubtful debts (₹ 12,000+₹ 26,000) | <u>(38,000)</u> | | 3,22,000 |
| | | | | Bank balance (₹ 30,000+ ₹ 90,000) | | | 1,20,000 |
| | | | | Cash in hand | | | 30,000* |
| | | | <u>14,20,000</u> | | | | <u>14,20,000</u> |

**In the books of P & Co.
Partners' Capital Accounts**

| Particulars | P ₹ | Q ₹ | Particulars | P ₹ | Q ₹ |
|----------------------------------|---------------|---------------|---------------------------------|---------------|---------------|
| To Capital A/cs M/s PQR & Co. | 4,89,000 | 2,43,000 | By Balance b/d | 2,40,000 | 1,60,000 |
| | | | By Reserve (3:1) | 37,500 | 12,500 |
| | | | By Profit on Realisation A/c | | |

* ₹ 20,000+₹ 10,000+₹ 1,53,000+₹ 30,000 – ₹ 1,83,000 = ₹ 30,000.

| | | | | | |
|--|----------|----------|---------|----------|----------|
| | | | (W.N.4) | 2,11,500 | 70,500 |
| | 4,89,000 | 2,43,000 | | 4,89,000 | 2,43,000 |

**In the books of R & Co.
Partners' Capital Accounts**

| <i>Particulars</i> | <i>Q</i> ₹ | <i>R</i> ₹ | <i>Particulars</i> | <i>Q</i> ₹ | <i>R</i> ₹ |
|----------------------------------|---------------|---------------|-------------------------------------|---------------|---------------|
| To Capital A/cs M/s PQR & Co. | 3,68,000 | 1,84,000 | By Balance b/d | 2,00,000 | 1,00,000 |
| | | | By Reserve (2:1) | 1,00,000 | 50,000 |
| | | | By Profit on Realisation (W.N.5) | 68,000 | 34,000 |
| | 3,68,000 | 1,84,000 | | 3,68,000 | 1,84,000 |

Working Notes:

1. Computation of purchase considerations

| | <i>P & Co.</i> ₹ | <i>R & Co.</i> ₹ |
|------------------------------|-------------------------|-------------------------|
| <i>Assets:</i> | | |
| Goodwill | 1,20,000 | 60,000 |
| Building | 1,00,000 | 60,000 |
| Plant & machinery | 2,50,000 | 2,00,000 |
| Office equipment | 20,000 | 6,000 |
| Stock-in-trade | 1,44,000 | 1,68,000 |
| Sundry debtors | 1,60,000 | 2,00,000 |
| Bank balance | 30,000 | 90,000 |
| Cash in hand | 20,000 | 10,000 |
| Due from R & Co. | 1,00,000 | - |
| | (A) 9,44,000 | 7,94,000 |
| <i>Liabilities:</i> | | |
| Creditors | 1,20,000 | 1,16,000 |
| Provision for doubtful debts | 12,000 | 26,000 |
| Due to P & Co. | - | 1,00,000 |
| Bank overdraft | 80,000 | - |
| | (B) 2,12,000 | 2,42,000 |
| Purchase consideration (A-B) | 7,32,000 | 5,52,000 |

2. Computation of proportionate capital

| | ₹ |
|---|------------|
| M/s PQR & Co. (Purchase Consideration) (₹ 7,32,000+ ₹ 5,52,000) | 12,84,000 |
| Less: Goodwill adjustment | (1,80,000) |
| Total capital of new firm (Distributed in ratio 3:2:1) | 11,04,000 |
| P's proportionate capital | 5,52,000 |
| Q's proportionate capital | 3,68,000 |
| R's proportionate capital | 1,84,000 |

3. Computation of Capital Adjustments

| | P ₹ | Q ₹ | R ₹ | Total ₹ |
|--|----------|------------|----------|------------|
| Balance transferred from P & Co. | 4,89,000 | 2,43,000 | | 7,32,000 |
| Balance transferred from R & Co. | | 3,68,000 | 1,84,000 | 5,52,000 |
| | 4,89,000 | 6,11,000 | 1,84,000 | 12,84,000 |
| Less: Goodwill written off in the ratio of 3:2:1 | (90,000) | (60,000) | (30,000) | (1,80,000) |
| Existing capital | 3,99,000 | 5,51,000 | 1,54,000 | 11,04,000 |
| Proportionate capital | 5,52,000 | 3,68,000 | 1,84,000 | 11,04,000 |
| Amount to be brought in (paid off) | 1,53,000 | (1,83,000) | 30,000 | |

**4. In the books of P & Co.
Realisation Account**

| | ₹ | | ₹ |
|---------------------------|----------|--------------------------|----------|
| To Building | 50,000 | By Creditors | 1,20,000 |
| To Plant & machinery | 1,50,000 | By Bank overdraft | 80,000 |
| To Office equipment | 20,000 | By M/s PQR & Co. | 7,32,000 |
| To Stock-in-trade | 1,20,000 | (purchase consideration) | |
| To Sundry debtors | 1,60,000 | (W.N.1) | |
| To Bank balance | 30,000 | | |
| To Cash in hand | 20,000 | | |
| To Due from R & Co. | 1,00,000 | | |
| To Partners' capital A/cs | | | |
| P | 2,11,500 | | |

| | | | |
|---|---------------|----------|----------|
| Q | <u>70,500</u> | 2,82,000 | |
| | | 9,32,000 | 9,32,000 |

**5. In the books of R & Co.
Realisation Account**

| | ₹ | | ₹ |
|---------------------------|-----------------|--------------------------|-----------------|
| To Building | 60,000 | By Creditors | 1,16,000 |
| To Plant & machinery | 1,60,000 | By Due to P & Co. | 1,00,000 |
| To Office equipment | 6,000 | By M/s PQR & Co. | 5,52,000 |
| To Stock-in-trade | 1,40,000 | (purchase consideration) | |
| To Sundry debtors | 2,00,000 | (W.N.1) | |
| To Bank balance | 90,000 | | |
| To Cash in hand | 10,000 | | |
| To Partners' capital A/cs | | | |
| Q | 68,000 | | |
| R | <u>34,000</u> | | |
| | 1,02,000 | | |
| | <u>7,68,000</u> | | <u>7,68,000</u> |

Note: The adjustments in the Capital Accounts of P, Q and R (both for Goodwill and the amounts paid to Q by P and R) can be shown in their Capital Accounts in the Books of P & Co and R & Co respectively. In such a case the Capital Account of the partners carried to PQR & Co will be the same amounts as shown in the Balance Sheet of PQR & Co.

Answer 2

Realisation Account

| <i>Particulars</i> | ₹ | <i>Particulars</i> | ₹ |
|--------------------|----------|----------------------|-----------|
| To Sundry assets: | | By Creditors | 2,77,500 |
| Stock | 3,17,000 | By Bills payables | 51,000 |
| Debtors | 3,25,000 | By Bank overdraft | 75,000 |
| Plant | 1,63,875 | By Shares in ST Ltd. | 18,80,000 |
| | | (W.N.3) | |
| Building | 8,64,500 | | |
| Furniture | 73,125 | | |
| To Profit: | | | |

| | | | |
|---|----------|-----------|-----------|
| S | 2,70,000 | | |
| T | 2,70,000 | 5,40,000 | |
| | | 22,83,500 | 22,83,500 |

Partners' Capital Accounts

| Date | Particulars | S ₹ | T ₹ | Date | Particulars | S ₹ | T ₹ |
|----------|-----------------------------|----------|----------|----------|-----------------------------|----------|----------|
| 20X1 | | | | 20X1 | | | |
| April 1 | To Cash – Drawings (W.N. 2) | 20,000 | 20,000 | April 1 | By Balance b/d | 6,40,000 | 6,60,000 |
| Sept. 30 | To Shares in ST Ltd. | 9,30,000 | 9,50,000 | Sept. 30 | By Profit (W.N.2) | 40,000 | 40,000 |
| | | | | | By Realisation A/c (Profit) | 2,70,000 | 2,70,000 |
| | | 9,50,000 | 9,70,000 | | | 9,50,000 | 9,70,000 |

Working Notes:

(1) Ascertainment of total capital:

Balance Sheet as at 30th September, 20X1

| <i>Liabilities</i> | ₹ | <i>Assets</i> | | ₹ |
|---------------------------|-----------|--------------------|----------|-----------|
| Sundry creditors | 2,77,500 | Building | 9,10,000 | |
| Bills payable | 51,000 | Less: Depreciation | (45,500) | 8,64,500 |
| Bank overdraft | 75,000 | Plant | 1,72,500 | |
| Total capital (bal. fig.) | 13,40,000 | Less: Depreciation | (8,625) | 1,63,875 |
| | | Furniture | 75,000 | |
| | | Less: Depreciation | (1,875) | 73,125 |
| | | Stock | | 3,17,000 |
| | | Debtors | | 3,25,000 |
| | 17,43,500 | | | 17,43,500 |

(2) Profit earned during six months to 30 September, 20X1

| | ₹ |
|--|-----------|
| Total capital (of S and T) on 30 th September, 20X1 (W.N.1) | 13,40,000 |

| | | |
|--|----------|-----------|
| Capital on 1 st April, 20X1 | | |
| S | 6,40,000 | |
| T | 6,60,000 | 13,00,000 |
| Net increase (after drawings) | | 40,000 |

Since drawings are half of profits therefore, actual profit earned is ₹ 40,000 x 2 = ₹ 80,000 (shared equally by partners S and T).
Half of the profits, has been withdrawn by both the partners equally i.e. drawings ₹ 40,000 (₹ 80,000 x ½) withdrawn by S and T in 1:1 (i.e. ₹ 20,000 each).

(3) Purchase consideration:

| | |
|--|------------|
| | ₹ |
| Total assets (W.N.1) | 17,43,500 |
| Add: Goodwill | 5,40,000 |
| | 22,83,500 |
| Less: Liabilities (2,77,500 + 51,000 + 75,000) | (4,03,500) |
| Purchase consideration | 18,80,000 |

Note: The above solution is given on the basis that reduction in bank overdraft is after surrender of Joint life policy.

Answer 3**Partners' Current Accounts**

| <i>Particulars</i> | <i>X</i> | <i>Y</i> | <i>Z</i> | <i>Particulars</i> | <i>X</i> | <i>Y</i> | <i>Z</i> |
|---|----------|----------|----------|---|----------|----------|----------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| 31.3.20X1 | | | | 31.3.20X1 | | | |
| To Balance b/d | --- | ---- | 10,000 | By Balance b/d | 40,000 | 30,000 | -- |
| To X's Current A/c – goodwill (W.N.1) | - | 30,000 | 15,000 | By Y's Current A/c – goodwill (W.N.1) | 30,000 | -- | -- |
| To X's Current A/c – Revaluation Profit (W.N.2) | - | 20,000 | 10,000 | By Z's Current A/c – goodwill (W.N.1) | 15,000 | - | - |
| To X's Capital A/c – transfer | 1,21,000 | - | - | By Y's Current A/c – Revaluation profit (W.N.2) | 20,000 | - | - |
| | | | | By Z's Current A/c – Revaluation | 10,000 | | |

| | | | | | | | |
|-------------------------------|----------|--------|--------|------------------------------------|----------|--------|--------|
| | | | | profit (W.N.2) | | | |
| | | | | By Joint assurance policy | 6,000 | 4,000 | 2,000 |
| | | | | By Balance c/d | | 16,000 | 33,000 |
| | 1,21,000 | 50,000 | 35,000 | | 1,21,000 | 50,000 | 35,000 |
| 1.4.X1 | | | | 31.3.X2 | | | |
| To Balance b/d | | 16,000 | 33,000 | By Profit & Loss Appropriation A/c | | 29,136 | 14,568 |
| 31.3.X2 | | | | By Balance c/d | | 1,864 | 26,432 |
| To Drawings A/c | | 15,000 | 8,000 | | | 31,000 | 41,000 |
| | | 31,000 | 41,000 | | | | |
| 1.4.X2 | | | | 1.4.X2 | | | |
| To Balance b/d | | 1,864 | 26,432 | By Realisation A/c -profit | 31,674 | | 15,837 |
| To Y's Capital A/c - transfer | | 29,810 | --- | By Z's Capital A/c - transfer | | --- | 10,595 |
| | | 31,674 | 26,432 | | 31,674 | 26,432 | |

Partners' Capital Accounts

| Particulars | X | Y | Z | Particulars | X | Y | Z |
|-------------------------------|----------|--------|--------|-------------------------------|----------|--------|--------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| 31.3.X1 | | | | 31.3.X1 | | | |
| To X's Executors A/c | 1,81,000 | ---- | --- | By Balance b/d | 60,000 | 40,000 | 20,000 |
| To Balance c/d | --- | 40,000 | 20,000 | By X's Current A/c | 1,21,000 | -- | -- |
| | 1,81,000 | 40,000 | 20,000 | | 1,81,000 | 40,000 | 20,000 |
| 31.3.X2 | | | | 1.4.X1 | | | |
| To Balance c/d | | 40,000 | 20,000 | By Balance b/d | | 40,000 | 20,000 |
| | | 40,000 | 20,000 | | | 40,000 | 20,000 |
| 1.4.X2 | | | | 1.4.X2 | | | |
| To Z's Current A/c - transfer | | --- | 10,595 | By Balance b/d | | 40,000 | 20,000 |
| 30.6.X2 | | | | 1.4.X2 | | | |
| To Bank A/c | | 69,810 | 9,405 | By Y's Current A/c - transfer | | 29,810 | --- |
| | | 69,810 | 20,000 | | | 69,810 | 20,000 |

X's Executor's Account

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|-----------|----------------|----------|-----------|--------------------|----------|
| 1.4.20X1 | To Bank A/c | 30,000 | 31.3.20X1 | By X's Capital A/c | 1,81,000 |
| 31.3.20X1 | To Balance c/d | 1,51,000 | | | |
| | | 1,81,000 | | | 1,81,000 |
| 30.9.20X1 | To Bank A/c | 30,000 | 1.4.20X1 | By Balance b/d | 1,51,000 |
| 30.9.20X1 | To Balance c/d | 1,25,530 | 30.9.20X1 | By Interest A/c | 4,530 |
| | | 1,55,530 | | | 1,55,530 |
| 31.3.20X2 | To Bank A/c | 30,000 | 1.10.20X1 | By Balance b/d | 1,25,530 |
| | To Balance c/d | 99,296 | 31.3.20X2 | By Interest A/c | 3,766 |
| | | 1,29,296 | | | 1,29,296 |
| 30.6.20X2 | To Bank A/c | 1,00,785 | 1.4.20X2 | By Balance b/d | 99,296 |
| | | 1,00,785 | 30.6.20X2 | By Interest A/c | 1,489 |
| | | | | | 1,00,785 |

Working Notes:**(1) Adjustment in regard to Goodwill**

| Partners | | X | Y | Z |
|--------------------------------|-----|----------|--------|--------|
| Share of goodwill before death | (₹) | 45,000 | 30,000 | 15,000 |
| Share of goodwill after death | (₹) | - | 60,000 | 30,000 |
| Gain (+)/Sacrifice (-) | (₹) | (45,000) | 30,000 | 15,000 |
| | | Cr. | Dr. | Dr. |

(2) Adjustment in regard to revaluation of assets

| Partners | | X | Y | Z |
|---|-----|----------|--------|--------|
| Share of profit on revaluation credited to all the partners | (₹) | 30,000 | 20,000 | 10,000 |
| Debited to the continuing partners | (₹) | - | 40,000 | 20,000 |
| | (₹) | (30,000) | 20,000 | 10,000 |
| | | Cr. | Dr. | Dr. |

(3) Ascertainment of Profit for the year ended 31.3.X2

| | ₹ | ₹ |
|---|---|--------|
| Profit before charging interest on balance due to X's executors | | 52,000 |

| | | |
|--|-------|---------|
| Less: Interest payable to X's executors: | | |
| From 1.4.X1 to 30.9.X1 | 4,530 | |
| From 1.10.X1 to 31.3.X2 | 3,766 | (8,296) |
| Balance of profit to be shared by Y and Z in 2:1 | | 43,704 |

(4) Ascertainment of Sundry Assets as on 31.3.X2

| Liabilities | ₹ | Assets | ₹ |
|---------------------|----------|----------------------------------|----------|
| Capital Account – Y | 40,000 | Sundry Assets (balancing figure) | 1,31,000 |
| Capital Account – Z | 20,000 | Partner's Current A/c – Y | 1,864 |
| X's Executors A/c | 99,296 | Partner's Current A/cs Z | 26,432 |
| | 1,59,296 | | 1,59,296 |

(5) Realisation Account

| | ₹ | | ₹ |
|---------------------------------|----------|--------------------------------------|----------|
| To Sundry Assets A/c | 1,31,000 | By Bank A/c (purchase consideration) | 1,80,000 |
| To Interest A/c – X's Executors | 1,489 | | |
| To Partner's Capital A/c – Y | 31,674 | | |
| To Partner's Capital A/c – Z | 15,837 | | |
| | 1,80,000 | | 1,80,000 |

(6) Bank Account

| | ₹ | | ₹ |
|---------------------------|----------|----------------------|----------|
| To Purchase consideration | 1,80,000 | By X's Executors A/c | 1,00,785 |
| | | By Y | 69,810 |
| | | By Z | 9,405 |
| | 1,80,000 | | 1,80,000 |

Answer 4

**In the books of 3R Enterprises
Realisation Account**

| | ₹ | | ₹ |
|-----------------------|-----------|-----------------------------------|-----------|
| To Land and Buildings | 14,00,000 | By Creditors | 6,00,000 |
| To Machinery | 11,00,000 | By 3R Enterprises (Pvt.) Ltd. A/c | 42,00,000 |
| To Furniture | 6,10,000 | | |

| | | |
|---------------------|-----------|-----------|
| To Stock | 8,40,000 | |
| To Debtors | 6,00,000 | |
| To Cash at Bank | 1,90,000 | |
| To Ramesh's capital | 30,000 | |
| To Roshan's capital | 20,000 | |
| To Rohan's capital | 10,000 | |
| | 48,00,000 | 48,00,000 |

Partners' Capital Accounts

| | Ramesh ₹ | Roshan ₹ | Rohan ₹ | | Ramesh ₹ | Roshan ₹ | Rohan ₹ |
|---|-------------|-------------|------------|-----------------------------|-------------|-------------|------------|
| To Shares in 3R Enterprises (Pvt.) Ltd. A/c | 21,00,000 | 14,00,000 | 7,00,000 | By Balance b/d | 16,80,000 | 11,60,000 | 6,70,000 |
| To Bank A/c (Settlement) | - | - | 85,000 | By General Reserve | 3,15,000 | 2,10,000 | 1,05,000 |
| | | | | By Realisation A/c (Profit) | 30,000 | 20,000 | 10,000 |
| | | | | By Bank A/c (Settlement) | 75,000 | 10,000 | - |
| | 21,00,000 | 14,00,000 | 7,85,000 | | 21,00,000 | 14,00,000 | 7,85,000 |

In the Books of 3R Enterprises (Private) Ltd Journal Entries

| | | ₹ | ₹ |
|----|---|---|---------------------------------|
| 1. | Business Purchase A/c To M/s 3R Enterprises (Consideration payable for business purchased) | Dr. 42,00,000 | 42,00,000 |
| 2. | Land and Buildings A/c Machinery A/c Furniture A/c Stock A/c Debtors A/c Bank A/c To Creditors A/c To Provision for doubtful debts A/c To Business Purchase A/c | Dr. 16,40,000 Dr. 9,90,000 Dr. 6,10,000 Dr. 8,40,000 Dr. 6,00,000 Dr. 1,90,000 | 6,00,000 30,000 42,00,000 |

| | | | | |
|----|---|-----|-----------|-----------|
| | To Capital Reserve A/c (balancing figure) (Assets and liabilities taken over for ₹ 42,00,000; balance credited to capital reserve) | | | 40,000 |
| 3. | Capital reserve A/c (Expenses of takeover) To Bank A/c (Expenses for take over debited to capital reserve) | Dr. | 23,000 | 23,000 |
| 4. | M/s 3R Enterprises A/c To Equity share capital A/c (Allotment of fully paid equity shares to discharge consideration for business) | Dr. | 42,00,000 | 42,00,000 |
| 5. | Preliminary expenses A/c* To Bank A/c (Expenses incurred to get the company incorporated) | Dr. | 57,000 | 57,000 |

- * As per Accounting Standards, preliminary expense is charged to Profit and Loss account in the year it is incurred.