 SUBJECT : Accounts

CLASS XII

Guidelines

• Refer to the content given below and view the links

• These notes will help you to understand the concept and complete the assignment

that follows

• The assignment is to be done in the Accounts notebook

• Please read the TS Grewal book before you begin answering

Instructional Aids / Resources

Learning Outcomes

Each student will be able to :

1. Students will able to learn How to Rectify the error with one adjustment entry

2. Introduction the concept of Guarantee of Profits

 LESSON DEVELOPMENT

Chapter 2 FUNDAMENTAL OF ACCOUNTING

**TOPIC 1**

According to Section -4 of the Indian Partnership Act, 1932:

“Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all”

### **Features of Partnership**

**1.** **Two or more persons:**There must be at least two persons to form a valid partnership. The maximum number of partners cannot exceed the number of partners prescribed by Companies Act, 2013 which is 50 in any business whether banking or non- banking.

**2.** **Agreement:**Partnership comes into existence by an agreement (either written or oral among the partners. The written agreement among the partners is called Partnership Deed.

**3.** **Existence of business and profit motive:**A partnership can be formed for the purpose of carrying on legal business with the intention of earning profits. A joint ownership of some property by itself cannot be called a partnership.

**4.** **Sharing of Profits:**An agreement between the partners must be aimed at sharing the profits. If some persons join hands to run some charitable activity, it will not be called partnership. Futher, if a partner is deprived of his right to share the profits of the business, he cannot be called as partner.

**5.** **Buiness carried on by all or any of them acting for all:**It means that each partner can participate in the conduct of business and each partner is bound by the acts of other partners in respect to the business of the firm.

**6.** **Relationship of Principal and Agent:** Each partner is an agent ad well as a partner of the firm. An agent, because he can bind the other partners by his acts and principal, because he himself can be bound by the acts of the other partners.

### **Partnership Deed**

Since partnership is the outcome of an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions mat be either written or oral. The law does not make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

### **The partnership deed is a written agreement among the partners which contains the terms of agreement. It is also called ‘ Articles of Partnership’. A partnership deed should contain the following points:**

1. Name and address of the firm as well as partners.
2. Name and addresses of the partners.
3. Nature and place of the business.
4. Duration, if any of partnership.
5. Capital contribution by each partner.
6. Interest on capital.
7. Drawings and interest on drawings.
8. Profit sharing ratio.
9. Interest on loan.
10. Partner’s Salary/commission etc.
11. Method for valuation of goodwill and assets.
12. Accounting period of the firm and duration of partnership
13. Rights and duties of partners how disputes will be settled.
14. Decisions taken if some partner becomes insolvent.
15. Opening of Bank Account – whereas it will be in the name of firm or partners.
16. Rules to be followed in case of admission & Settlement of accounts or retirement or death of partner.
17. Revaluation of assets & liabilities, if any to be done.
18. Method of recording of firm’s accounts
19. Auditing
20. Date of commencement of partnership

### **Benefits of Partnership Deed**

(1) It regulates the rights, duties and liabilites of each partner.

(2) It helps to avoid any misunderstanding amongst the partners because all the terms and conditions of partnership have been laid down beforehand in the deed.

(3) Any dispute amongst the partners may be settled easily as the partnership deed may be readily referred to.

### **Rules applicable in the absence of partnership deed**

|  |  |
| --- | --- |
| Profit sharing Ratio | Equal, Irrespective of capital contribution. |
| Interest on Capital | No Interest on Capital is to be allowed to any Partner |
| Interest on Drawings | No interest on Drawings is to be charged to any partner |
| Salary or Commission to a Partner | Not allowed to any partner |
| Interest on loan by a Partner | Interest is allowed @ 6% per annum. |

Topic 2

### **Distribution of Profits among Partners**

Transactions of the partnerhsip firm are recorded according to the principles of Double-entry book keeping system, and as in the case of a sole proprietorship concern a partnership firm will also prepare Trading account, Profit & Loss account and Balance Sheet at the end of every year. The only difference between accounting of a sole trader and partnership firm is that the profits of the partnership firm ar divided amongst the partners.

A Profit and Loss Appropriation Account is prepared to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of profit and Loss Account. It is nominal account. It records entries for interest on capital, Interest on Drawings, Salary to the partner, and division of profits among the partners.

### **The Journal Entries regarding Profit and Loss Appropriation Account are as follows:**

**1.For transfer of balance of Profit and Loss Account**

Profit and Loss A/cDr.

To Profit and Loss Appropriation A/c

**2.For Interest on Capital**

For allowing Interest on capital

**1.** Interest on Capital A/c

To Partner’s Capital/Current A/cs

(Being interest on capital allowed @ % p.a.)

**2.** For transferring Interest on Capital to p&L appropriation A/c.

Profit and Loss Appropriation A/cDr.

To Interest on Capital A/c.

(Being interest on capital transferred to p&L Appropriation A/c)

**3. For Salary or Commission payable to a partner**

i. For allowing Salary or Commission to a partner:

Partners Salary/Commission A/cDr.

To Partner’s Capital/Current A/cs

(Being salary/commission payable to a partner)

ii. For transferring Partner’s Salary/Commission A/c to Profit and Loss

Appropriation A/s:

Profit and Loss Appropriation A/cDr.

To Partner’s Salary/Commission A/c

**4. For transfer of Reserves:**

Profit and Loss Appropriation A/cDr.

To Reserve A/c

(Being reserve created)

**5. For Interest on Drawings:**

**1.**For charging interest on a partner’s drawings:

Partner’s Capital/Current A/c.Dr.

To Interest on Drawings A/c

(Being interest on drawings charged @ % p.a.)

**2.** For transferring interest on drawings to Profit and Loss Appropriation A/c

Interest on Drawings A/cDr.

To Profit and Loss Appropriation A/c

(Being interest on drawings transferred to P&L appropriation A/c)

**6. For transfer to Profit (i.e. Credit Balance of Profit and Loss Appropriation Account**

Profit and Loss Appropriation A/cDr.

To Partners Capital/Current A/cs

(Being profits distributed among partners)

### **SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT**

**Profit and Loss Appropriation Account**

**For the year ending on \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs. | Particulars | Rs. |
| To Interest on Capital:ABTo Partner’s Salary/CommissionTo ReservesTo Profits transferred to capital A/cs of:AB |  | By Profit and Loss A/c (Net Profits transferred from P & L A/c)By Interest on drawings:AB |  |
|  |  |

### Topic 3

### Partner’s**Capital Accounts**

Partner’s**Capital Accounts:**It is an account which represents the partners interest in the business.

In case of partnership business, a separate capital account is mainted for each partner. The capital accounts of partners may be maintained by any of the following two methods.

**1.** Fixed Capital Accounts

**2.** Fluctuating Capital Accounts

**1. Fixed Capital Accounts**

Under this method the original capitals invested by the partners remain constant, unless additional capital is introduced by an agreement. All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account whihc is called as Current Account. Thus the following two accounts are maintained when capitals are fixed.

**(i) Capital Account**

**This account will always show a credit balance:**Balance of Capital account remains fixed, it does not change every year that is why it is called fixed capital method and only the following two transactions are recorded in the Fixed Capital Accounts:

Permanent·Additional Capital Introduced

·Permanent Capital Withdrawn or Drawings out of Capital only

### **Partner’s Capital A/Cs**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | X(Rs.) | Y(Rs.) | Particulars | X(Rs.) | Y(Rs.) |
| To Cash/Bank A/c(Capital Withdrawn)To Balance c/d(Closing balance) |  |  | By Balance b/d(Opening Cr. Balance)By Cash/Bank A/c(Additional Capital Introduced) |  |  |
|  |  |  |  |

**(ii) Current Account**

The Current account may show a debit or credit balance. All the usual adjustments such as interest on Capital, partner’s salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account.All the Current Year’s adjustments are recorded in this account, that is why it is called Current account.

### **Partner’s Current A/Cs**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | X(Rs.) | Y(Rs.) | Particulars | X(Rs.) | Y(Rs.) |
| To Balance b/d(Opening Dr. Balance)To Drawings(out of Profits)To Interest on DrawingsTo Profit and Loss A/c(Share in losses)To Balance c/d(Closing credit Balance) |  |  | By Balance b/d(Opening Cr. Balance)By Interest on CapitalBy Partner’s Salary or CommissionBy Profit and LossAppropriation A/c(Share in Profits)By Balance c/d(Closing Dr. Balance) |  |  |
|  |  |  |  |

**Note :**

**1.** Debit balance of Current Account is shown in Assets side of Balance Sheet.

**2.** Credits balance of Current Account A/c is shown in Liabilities side of balance Sheet.

**3.** Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet as it will be always be credit balance.

**2. Fluctuating Capital Accounts**

In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustment such as interest on capital interest on drawings etc, are recorded in this account under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account.In this method the capitals are not fixed. **In the absence of information, the Capital Accounts should be prepared by this method.**

### **Partner’s Capital**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | X(Rs.) | Y(Rs.) | Particulars | X(Rs.) | Y(Rs.) |
| To Balance b/d(Opening Dr. Balance)To Cash/Bank A/c(Capital Withdrawn)To Drawings(out of profits)To Interest on DrawingsTo Profit and Loss A/c(Share in losses)To Balance c/d(Closing credit Balance) |  |  | By Balance b/d(Opening Cr. Balance)By Cash/Bank A/c(Additional Capital Introduced)By Interest on CapitalBy Partner’s Salary or CommissionBy Profit and LossAppropriation A/c(Share in Profits)By Balance c/d(Closing Dr. Balance) |  |  |
|  |  |  |  |

### **INTEREST ON CAPITAL**

Interest on partners capital will be allowed only when it has been specifically mentioned in the partnership deed. If interest on capital is to be allowed as per the agreement, it should be calculated with respect to the time, rate of interest and the amount of capital. Interest on Capital can be treated as either:

a. An Appropriation of profit; or

b. A charge against profit.

**A. Interest on Capital: An Appropriation of Profits:**

|  |  |
| --- | --- |
| In  case of Losses | Interest on Capital is NOT ALLOWED |
| In cases of Sufficient Profits | Interest on Capital is ALLOWED IN FULL |
| In  case of Insufficient Profits | Interest will be restricted to the amount of profit. Hence, profit will be distributed in the ratio of interest on capital of each partner. |

**B. Interest on Capital: As a Charge against Profits:**

Interest on Capital is always allowed in full irrespective of amount of profits of losses.

**Note:**

**Interest on Capital is always calculated on the OPENING CAPITAL.**

Il’ Opening Capital is not given in the question, it should be ascertained as follows:

|  |  |
| --- | --- |
| Particulars | (Rs.) |
| Capital at the EndAdd: **1.** Drawingxxxxxx**2.** Interest on Drawingsxxxxxx**3.** Losses during the year xxxxxxLess: **1.** Additional Capital Introduced (xxxxxx)**2.** Profits during the year (xxxxxx)3. Any salary/commission receivedOpening Capital …………… | \_\_\_\_\_\_\_\_\_\_\_\_ |
| …………… |

### **INTEREST ON DRAWINGS**

Interest on drawing is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn. There are two cases in which calulation of interest on drawings may arise:

**Case 1: When Rate of Interest on Drawings is given in %**

Interest on Drawings is calculated on flat rate irrespective of period.

**Case 2: When Rate of Interest on Drawings is given in % p.a.**

Interest on Drawing =

Note: Interest is calculated for a period of 6 months, we assume drawings have been done evenly during the year, that is why we take average six months tenure.

**2. When date of Drawings is given**

Interest on Drawing =

**Case 3: When different amount are withdrawn on different dates:**

We have the following two methods to calculate the amount of interest on Drawing:

**1. Simple Interest Method**

In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn till the close of accounting period.

**2. Product Method**

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period;Thereafter the products are added and interest is calculated on the total of products so arrived at for one month. The advantage of this system is that separate calculations are not required each time.

We can explain the above mentioned two methods with the help of an example.

| Month | Date | Drawings Amount |
| --- | --- | --- |
|  May |  1 |  12000 |
| July | 31 | 6000 |
| September | 30 | 9000 |
| November | 30 | 12000 |
| Janurary | 1 | 8000 |
| March | 31 | 7000 |

Interest on drawings is to be charged @ 9% p.a

### **SIMPLE METHOD**

| DATE | AMOUNT | PERIOD | INTEREST @9% |
| --- | --- | --- | --- |
| 1 MAY | 12000 |  11 |   990 |
|  31 JULY |  6000 |  8 |   360 |
|   30 SEP |   9000 |   6 |   405 |
|  30 NOV |  12000 |  4 |   360 |
|  1 JAN |  8000 |  3 |   180 |
|  31 MAR |  7000 |  0 |   00 |
| **TOTAL** |   **54000** |  |  **2295** |

**PRODUCT METHOD**

| DATE | AMOUNT | PERIOD |  PRODUCTS |
| --- | --- | --- | --- |
| 1 MAY | 12000 |  11 |   132000 |
|  31 JULY |  6000 |  8 |   48000 |
|   30 SEP |   9000 |   6 |   54000 |
|  30 NOV |  12000 |  4 |   48000 |
|  1 JAN |  8000 |  3 |   24000 |
|  31 MAR |  7000 |  0 |      00 |
| **TOTAL** |   **54000** |  |  **306000** |

Interest = Total of products \* 9/100\* 1/12= 306000\*9/100\*1/12 = Rs 2295/-.

**Case 4: When an equal amount is withdrawn regularly**

Interest on Drawing can be calculated using either Product Method or Direct Method (i.e. Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:

**1.** Amount should be same throughout the period

**2.** Date of Drawings should be same throughout the period

**3.** Drawings should be made regularly without any gap.

**4.** Interest on Drawing =

T = Time (in months) for which interest is to be charged

Value of T under Different circumstances will be as under:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Monthly Drawings for 12 Months | Quarterly Drawings for 12 Months | Half yearly Drawings for 12 Months | Monthly Drawings for 06 Months (last 6 months) |
|  | **6.**5(beginning of the month) | **7.**5(beginning of every quater) | 9(beginning of every month for six month in the beginning of 6 months) | **3.**5(beginning of the month for last six month) |
|  | 6(middle of very month) | 6(middle of every quater) | 6middle of every month for six month in the beginning of 6 months) | 3(middle of the month for last six month) |
|  | **5.**5( end of every month) | **4.**5(end of every quater) | 3  (end of every month for six month in the beginning of 6 months) | **2.**5(end of the month for last six month) |

### **Topic 4**

### **INTEREST ON PARTNERS LOAN**

If a partner has given loan to the firm, he is entittled to receive interest on such loan at an agreed rate.

**It is a charge against profits. It is provided irrespective of profits or loss. It will also be provided in the absence of Partnership Deed @ 6% per annum.**

The following entries are passed to record the interest on partner’s loan

**1.** For allowing Interest on loan:

Interest on Partner’s Loan A/cDr.

To Partner’s Loan A/c

(Being interest on loan allowed @ % p.a.)

**2.** For transferring Interest on Loan to Profit and Loss A/c:

Profit and Loss A/cDr.

To Interest on Loan A/c

(Being Interest on loan transferred to P & L A/c)

**It is always DEBITED to Profit and Loss A/c**

**Rent Paid to Partner**.

**Rent paid to a partner is also a charge against profits and it will also be**

**DEBITED to Profit and Loss A/c**

**Note:**

Interest on A’s Loan =

= =Rs. 5,000

**PAST ADJUSTMENTS**

If, after preparation of Final Accounts of firm, it is found that some errors or commission in accounts has occurred than such errors or omissions are rectified in the next year by passing an adjustment entry.

A statement is prepared to ascertain the net effect of such errors or omissions on partner’s capital/current accounts in the following manner.

### **Statement showing adjustment**

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | A (Rs.) | B (Rs.) | C (Rs.) |
| A Amount to be given creditedInterest on Capital(Not allowed or provided at a lower rate)Partner’s Salary or Commission etc.(Omitted to be recorded)Actual Profits(To be distributed in correct ratio) |  |  |  |
| Total A |  |  |  |
| B. Amount already given to be taken back now debited\* Interest on Capital(If given at a higher rate)\* Interest on Drawings(If not charged)\* Profits already distributed in wrong ratio(debited now) |  |  |  |
| Total B |  |  |  |
| Net Effect (A-B) | +/- | +/- | +/- |

**+ Indicates Amount to be Credited to Partner’s Capital Account – Indicates Amount to be Debited to Partners Capital Account**

**Journal**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Date | Particulars | LF. | Debit(Rs.) | Debit(Rs.) |
|  | Partners Capital A/C Dr.(Amount to be Debited)To Partners’ Capital A/c(Amount to be Credited)(Being adjustment entry passed) |  |  |  |

During Past Adjustment it is not compulsory that capital accounts of all partners are affected. More than one partners Capital Account may be debited or credited but amount of debit & credit should be equal.

Topic 5

**GUARANTEE OF PROFITS TO A PARTNER**

**Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be or as may have been decided bya na agreement.**

**Note:**

Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum share in profits, then the actual profits will be allowed to the partner.

Case: **1.** When guarantee is given by FIRM (i.e. by all the Partners of the firm)

**1.** If share in actual profits is less than the guaranteed amount then. Guaranteed amount to a partner is first written off against the profits and then,

**2.** Remaining profits are distributed among the remaining partners in the remaining ratio.

Case: **2.** When guarantee is given by a partner or partners to another partner.

**1.** Calculate the share in profits for the partner to whom guarantee is given.

**2.** If share in profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.

**3.** If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as deficiency.

Deficiency is contributed by the partner or partners who guaranteed in certain ratio and subtracted from his or their respective shares.

Assignment 1

1. Explain the feature of Accounting
2. What is a partnership dead?
3. Explain the feature of partnership.
4. Bat and Ball are partners sharing the profits in the ratio of 2 : 3 with capitals of ₹ 1,20,000 and ₹ 60,000 respectively. On 1st October, 2018, Bat and Ball gave loans of ₹ 2,40,000 and ₹ 1,20,000 respectively to the firm. Bat had allowed the firm to use his property for business for a monthly rent of ₹ 5,000. The loss for the year ended 31st March, 2019 before rent and interest amounted to ₹ 9,000. Show distribution of profit/loss.
5. A and B are partners. A's Capital is ₹ 1,00,000 and B's Capital is ₹ 60,000. Interest on capital is payable @ 6% p.a. B is entitled to a salary of ₹ 3,000 per month. Profit for the current year before interest and salary to B is ₹ 80,000.
Prepare Profit and Loss Appropriation Account.
6. Anita and Ankita are partners sharing profits equally. Their capitals, maintained following Fluctuating Capital Accounts Method, as on 31st March, 2018 were ₹ 5,00,000 and ₹ 4,00,000 respectively. Partnership Deed provided to allow interest on capital @ 10% p.a. The firm earned net profit of ₹ 2,00,000 for the year ended 31st March, 2019.
Pass the Journal entry for interest on capital
7. P and Q were partners in a firm sharing profits and losses equally. Their fixed capitals were ₹ 2,00,000 and ₹ 3,00,000 respectively. The Partnership Deed provided for interest on capital @ 12% per annum. For the year ended 31st March, 2016, the profits of the firm were distributed without providing interest on capital.
Pass necessary adjustment entry to rectify the error.
8. Azad and Benny are equal partners. Their capitals are ₹ 40,000 and ₹ 80,000 respectively. After the accounts for the year had been prepared, it was noticed that interest @ 5% p.a. as provided in the Partnership Deed was not credited to their Capital Accounts before distribution of profits. It is decided to pass an adjustment entry in the beginning of the next year. Record the necessary Journal entry
9. Ram, Shyam and Mohan were partners in a firm sharing profits and losses in the ratio of 2 : 1 : 2. Their capitals were fixed at ₹ 3,00,000, ₹ 1,00,000, ₹ 2,00,000. For the year ended 31st March, 2019, interest on capital was credited to them @ 9% instead of 10% p.a. The profit for the year before charging interest was ₹ 2,50,000.
Show your working notes clearly and pass necessary adjustment entry.
10. Mohan, Vijay and Anil are partners, the balances of their Capital Accounts being ₹ 30,000, ₹ 25,000 and ₹ 20,000 respectively. In arriving at these amounts profit for the year ended 31st March, 2019, ₹ 24,000 had already been credited to partners in the proportion in which they shared profits. Their drawings were ₹ 5,000 (Mohan), ₹ 4,000 (Vijay) and ₹ 3,000 (Anil) during the year. Subsequently, the following omissions were noticed and it was decided to rectify the errors:
(a) Interest on capital @ 10% p.a.
(b) Interest on drawings: Mohan ₹ 250, Vijay ₹ 200 and Anil ₹ 150.
Make necessary corrections through a Journal entry and show your workings clearly.
11. Ankur, Bhavns and Disha are partners in a firm. On 1st April, 2017, the balance in their Capital Accounts stood at ₹ 14,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. They shared profits in the proportion of 7 : 3 : 2 respectively. Partners are entitled to interest on capital @ 6% per annum and salary to Bhavna @ ₹ 50,000 p.a. and a commission of ₹ 3,000 per month to Disha as per the provisions of the partnership Deed. Bhavna's share of profit (excluding interest on capital) is guaranteed at not less than ₹ 1,70,000 p.a. Disha's share of profit (including interest on capital but excluding commission) is guaranteed at not less than ₹ 1,50,000 p.a. Any deficiency arising on that account shall be met by Ankur. The profit of the firm for the year ended 31st March, 2018 amounted to ₹ 9,50,000.
Prepare Profit and Loss Appropriation Account for the year ended 31st March, march 2018

Chapter 3

Change in profit sharing ratio

Topic 1

**Meaning of Reconstruction**

**Any change in agreement of partnership or profit sharing ratio is called reconstitution**

**of partnership firm.**In following circumstances a partnership firm may be reconstituted:

**1.**Change in Profit Sharing Ratio

**2.**Admission of a partner

**3.**Retirement/Death of a partner.

**CHANCE IN PROFIT SHARING RATIO AMONG THE EXISTING PARTNERS**

Meaning: A Change in profit sharing ratio means one or more partners acquires interest form another partner or partners. Here it share of profit of one or more partners increases then share of one or more partner decreases to same extent.

When all the partners of a firm agree to change their profit sharing ratio. the ratio may be changed

New profit sharing ratio: The ratio in which the partners are to share the profits in future on reconstitution is known as New profit sharing ratio.

Gaining Ratio : It is the ratio in which the profit sharing ratio of gaining partners increases. It is calculated by taking difference between New profit sharing ratio and old profit sharing ratio.

Sacrificing Ratio: It is the ratio in which the profit sharing ratio of sacrificing partners decreases. It is calculated by taking difference between old profit sharing ratio and new profit sharing ratio.

Note : If old ratio-new ratio is positive it means sacrifice and if it is negative it means gain.

Topic 2

**Accounting Treatment of Goodwill**

In case of change in profit sharing ratio, the gaining partner must components the sacrificing partner by paying the proportionate amount of goodwill.

**Note :**

**(i)** Increase in the value of an Asset and decrease in the value of a liability result in profit.

Assets A/cDr.

To Revaluation

**(ii)** Decrease in the value of any asset and increase in the value of a liability gives loss.

Revaluation A/cDr.

To Assets A/c

**(iii)** For increase in the value of liabilities.

Revaluation A/cDr.

To Liabilities A/c

(Increase in value of Liability)

**(iv)** For decrease in the value of Liabilities

Liabilities A/cDr.

To Revaluation A/c

(Decrease in the value of Liabilities)

**(v)** When Revaluation account shows profit

Revaluation A/cDr.

To Partner’s Capital A/c

(Profit credited to Partner’s Capital A/c in old ratio)

**(vi)** In case of Revaluation Loss

Partner’s Capital A/c’sDr.

To Revaluation A/c

(Loss debited to Partner’s Capital A/cs in old ratio)

**Meaning of Reconstruction**

**Any change in agreement of partnership or profit sharing ratio is called reconstitution**

**of partnership firm.**In following circumstances a partnership firm may be reconstituted:

**1.**Change in Profit Sharing Ratio

**2.**Admission of a partner

**3.**Retirement/Death of a partner.

**CHANCE IN PROFIT SHARING RATIO AMONG THE EXISTING PARTNERS**

Meaning: A Change in profit sharing ratio means one or more partners acquires interest form another partner or partners. Here it share of profit of one or more partners increases then share of one or more partner decreases to same extent.

When all the partners of a firm agree to change their profit sharing ratio. the ratio may be changed

New profit sharing ratio: The ratio in which the partners are to share the profits in future on reconstitution is known as New profit sharing ratio.

Gaining Ratio : It is the ratio in which the profit sharing ratio of gaining partners increases. It is calculated by taking difference between New profit sharing ratio and old profit sharing ratio.

Sacrificing Ratio: It is the ratio in which the profit sharing ratio of sacrificing partners decreases. It is calculated by taking difference between old profit sharing ratio and new profit sharing ratio.

Note : If old ratio-new ratio is positive it means sacrifice and if it is negative it means gain.

**Accounting Treatment of Goodwill**

In case of change in profit sharing ratio, the gaining partner must components the sacrificing partner by paying the proportionate amount of goodwill.

**Note :**

**(i)** Increase in the value of an Asset and decrease in the value of a liability result in profit.

Assets A/cDr.

To Revaluation

**(ii)** Decrease in the value of any asset and increase in the value of a liability gives loss.

Revaluation A/cDr.

To Assets A/c

**(iii)** For increase in the value of liabilities.

Revaluation A/cDr.

To Liabilities A/c

(Increase in value of Liability)

**(iv)** For decrease in the value of Liabilities

Liabilities A/cDr.

To Revaluation A/c

(Decrease in the value of Liabilities)

**(v)** When Revaluation account shows profit

Revaluation A/cDr.

To Partner’s Capital A/c

(Profit credited to Partner’s Capital A/c in old ratio)

**(vi)** In case of Revaluation Loss

Partner’s Capital A/c’sDr.

To Revaluation A/c

(Loss debited to Partner’s Capital A/cs in old ratio)

**Topic 3**

**SPECCIMEN/PROFORMA OF REVALUATION ACCOUNT**

**Revaluation Account**

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | (Rs.) | Particulars | (Rs.) |
| To Assets (individually)Decrease in valueTo Liabilities increaseOn revaluationTo Unrecorded LiabilityTo profits transferred toPartner’s capital A/c(in old ratio) |  | By Assets (individually)Increase in value of AssetBy Liabilities (individually)Decrease on revaluationBy Unrecorded assetBy Loss transferred to partnersCapital A/c (in old ratios) |   |

Assignment 2

1. Annual profit shown by a business is Rs.20,000. Normal rate of return 10%. Total assets of the business firm Rs.2,40,000 and liabilities Rs.80,000. Value of Goodwill will be:
	1. Rs.40,000
	2. Rs.30,000
	3. Rs.20,000
	4. No Goodwill of Business
2. The partner whose share has increased as a result of change is called
	1. Gaining partner
	2. Sacrificing partner
	3. Sacrificing ratio
	4. Gaining ratio
3. AK, BK and CK are sharing profits in the ratio of 2:1:1. They have decided to share future profits in the ratio of 3:2:1. Find out the gainer partner.
	1. Both AK is the gainer partner and CK is the gainer partner
	2. CK is the gainer partner
	3. BK is the gainer partner
	4. AK is the gainer partner
4. If Assets are increasing but liabilities decreasing; in such a case Revaluation A/c will show\_\_\_\_\_
	1. Do not prepare Revaluation A/c
	2. Neither Gain or Loss
	3. Profit
	4. Net loss
5. A, B and C are partners sharing profits in the ratio of capitals (old 5:3:2 and new 2:3:5).Their capital after adjustment in new capital ratio are ` 20,000, ` 30000, ` 50000. Who will bring the amount of actual cash for adjustment?
	1. None of these
	2. C
	3. B
	4. A
6. P and Q are sharing profit and losses equally .With effects from current year they decided to share profits in the ratio of 4:3.Calculate individual partner’s gain and Sacrifice
	1. P gains 1/12th share and Q sacrifices 1/14th share
	2. P gains 1/14th share and Q sacrifices 1/14th share
	3. P gains 1/10th share and Q sacrifices 1/14th share
	4. P gains 1/15th share and Q sacrifices 1/14th share
7. State any two occasions on which a firm can be reconstituted.
8. What is meant by change in Profit-Sharing Ratio?
9. What do you understand by New Profit-Sharing Ratio?
10. Define Investment Fluctuation Reserve.
11. A and B are sharing profits and losses equally. With effect from 1st April, 2019, they agree to share profits in the ratio of 4 : 3. Calculate the individual partner’s gain or sacrifice due to the change in ratio.
12. X,Y and Z share profits as 5 : 3 : 2. They decide to share their future profits as 4 : 3 : 3 with effect from April 1, 2019,. On this date the following revaluations have taken place:

|  |  |  |
| --- | --- | --- |
|  | **Book Value (Rs.)** | **Revised Value (Rs.)** |
| Investments | 22,000 | 25,000 |
| Plant and Machinery | 25,000 | 20,000 |
| Land and Building | 40,000 | 50,000 |
| Outstanding Expenses | 5,600 | 6,000 |
| Sundry Debtors | 60,000 | 50,000 |
| Trade Creditors | 70,000 | 60,000 |

1. Pass necessary adjustment entry to be made because of the above changes in the values of assets and liabilities. However old values will continue in the books.
2. X and Y are partners in a firm sharing profits in the ratio of 3:2. They decided to share future profits equally. On the date of change in the profit-sharing ratio, the Profit and Loss Account showed a debit balance of Rs 50,000. Pass the necessary Journal entry for the distribution of the balance in the Profit and Loss Account immediately before the change in the profit-sharing ratio.
3. Anant, Gulab and Khushbu were partners in a firm sharing profits in the ratio of 5 : 3 : 2. From 1st April, 2014, they decided to share the profits equally. For this purpose, the goodwill of the firm was valued at 2,40,000.
Pass necessary journal entry for the treatment of goodwill on change in the profit sharing ratio of Anant, Gulab and Khushbu.
4. Ram, Shyam and Hari were in partnership sharing profits in the ratio of 3 : 2 : 1. The Balance Sheet as at 31.3.2013 was as follows :

**BALANCE SHEET**
**as at 31.3.2013**

| Liabilities |  | (Rs) | Assets | (Rs) |
| --- | --- | --- | --- | --- |
| Bills Payable |  | 20,000 | Cash | 40,000 |
| Creditors |  | 20,000 | Bills Receivable | 5,000 |
| General Reserve |  | 30,000 | Debtors | 15,000 |
| Capitals |  |  | Stock | 50,000 |
| Ram | 50,000 |  | Furniture | 20,000 |
| Shyam | 30,000 |  | Machinery | 30,000 |
| Hari | 25,000 | 1,05,000 | Goodwill | 15,000 |
|  |  | 1,75,000 |  | 1,75,000 |

On 1.4.2013 partners decided to share profits equally. For this purpose it was further agreed that.

* 1. Goodwill of the firm should be valued at Rs 30,000.
	2. Furniture and Machinery is to be revalued at Rs 25,000 and Rs 35,000 respectively.
	3. Value of Stock is to be reduced by Rs 4,000.

You are required to give necessary journal entries to give effect to the above arrangement and prepare Revaluation Account, Partners’ Capital Accounts and Balance Sheet of the firm after reconstitution.