

Death of a Partner

MEANING OF KEY TERMS USED IN THE CHAPTER

1. Death of a Partner

Death of a partner leads to reconstitution of the firm. The firm may continue its business with the remaining partners.

2. Revaluation of Assets

Revaluation of Assets means change in the value of assets, *i.e.*, present value being different from the book value of the assets.

3. Reassessment of Liabilities

Reassessment of Liabilities means reassessing the liabilities and determining the change, *i.e.*, whether the liability is more or less than that shown in the books of account.

4. Gaining Ratio

Ratio in which the continuing partners acquire deceased partner's share is called **gaining ratio**.

5. New Profit-sharing Ratio

Ratio in which the continuing partners (*i.e.*, partners other than deceased partner) decide to share future profits and losses, is known as **new profit-sharing ratio**.

6. Profit and Loss Suspense Account

It is the account which is debited to adjust the share of profit of deceased partner between the date of last Balance Sheet and the date of death, when profit-sharing ratio of continuing partners does not change.

SUMMARY OF THE CHAPTER

- **Adjustment on Death of a Partner:** At the time of death of a partner, few accounting issues arise and are settled, *e.g.*, calculation of the new profit-sharing ratio and the gaining ratio, revaluation of assets and liabilities, treatment of goodwill, accumulated profits, reserves and surplus, share in profits or losses of the outgoing partner up to the date of retirement.

- **New Profit-sharing Ratio:** The ratio in which the continuing partners (*i.e.*, partners other than the deceased one) decide to share the future profits and losses, is known as the '**New Profit-sharing Ratio**'.

$$\text{New Share} = \text{Old Share} + \text{Acquired Share}$$

Unless agreed otherwise, it is presumed that the continuing partners acquire the deceased partner's share in their old profit-sharing ratio.

- **Gaining Ratio:** The ratio in which the continuing partners acquire the deceased partner's share is known as the '**Gaining Ratio**'.

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$$

$$\text{Gain of a Partner} = \text{New Share} - \text{Old Share}$$

- **Adjustment with regard to Goodwill:** When a partner dies his share of profit is taken by the remaining partners. *The remaining partners then compensate the deceased partner in the form of goodwill in their gaining ratio.* The following entry is recorded for this purpose:

Gaining Partners' Capital/Current A/cs ...Dr. [In gaining ratio]
 To Deceased Partner's Capital A/c [With his share of goodwill]

If Goodwill Account appears in the old Balance Sheet, it is written off by passing the following entry:

All Partners' Capital/Current A/cs ...Dr. [In old ratio]
 To Goodwill A/c

- **Revaluation of Assets and Reassessment of Liabilities:** At the time of death of a partner, assets are revalued and liabilities are reassessed; the increase or decrease in value of each asset/liability is recorded in the Revaluation Account. The net balance in the Revaluation Account is transferred to the Capital Accounts of all the partners (including the deceased partner) in their old profit-sharing ratio.
- **Adjustment for Reserves and Accumulated Profits/Losses:** For the past undistributed profits or reserves, the amount is credited to all the partners in the old profit-sharing ratio.
- *Excess of Workmen Compensation Reserve over the Workmen Compensation Liability is credited to all Partners in their Old Profit-sharing Ratio.*
- *Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value is credited to all Partners in their Old Profit-sharing Ratio.*
- **Amount Due to a Deceased Partner:** Amount due to a deceased partner includes:
 - (i) Capital on the date of last Balance Sheet.
 - (ii) Interest or salary, if any, payable to him.
 - (iii) Share of profit or loss till the date of death.
 - (iv) Share in the gain (profit) or loss on revaluation of assets and reassessment of liabilities.
 - (v) Share in the goodwill of the firm.
 - (vi) Share in the General Reserve or Profit and Loss Account appearing in the Balance Sheet.

Out of the total of (i) to (vi), the amount of drawings and interest on drawings till the date of death is deducted. The net amount payable will be settled by paying him cash or by transferring it to deceased partner's executor's account.

- **Share of Profit up to the Date of Death:** If a partner dies on any date after the date of Balance Sheet; his share of profit is calculated from the beginning of the accounting year to the date of death on the basis of average profits or last year's profit. It is calculated on the basis of time; or on the basis of sales.

Journal Entry for both the basis:

Profit and Loss Suspense A/c ...Dr.
 To Deceased Partner's Capital A/c

Note: The balance of Profit and Loss Suspense Account is shown in the interim Balance Sheet, *i.e.*, Balance Sheet after retirement.

Deceased Partner's share of profit will be credited to his Capital Account and debited to the continuing Partners' Capital Accounts in the **Gaining Ratio** when the profit-sharing ratio of the continuing partners, in between them, changes.

Gaining Partners' Capital/Current A/cs ...Dr. [in Gaining Ratio]
 To Deceased Partner's Capital A/c

- **Amount Due to Deceased Partner:** The deceased partner's share is also calculated in the same way as in the case of retiring partner's share. Amount due to a deceased partner shown by his Capital Account is transferred to his Executor's Account. The entry will be:

Deceased Partner's Capital A/c ...Dr.
 To Deceased Partner's Executor's A/c

- **Settlement of Deceased Partner's Executor's Account:** If the amount is paid in cash or in instalment, the entry will be:

Deceased Partner's Executor's A/c ...Dr.
 To Cash/Bank A/c

- In the absence of an agreement, the outgoing partner at his option is entitled to receive *either interest @ 6% p.a.* till the amount is paid off or *a share of the profit* which has been earned by using the amount due to him. [Section 37 of Indian Partnership Act, 1932]

Solved Questions

Illustration 1.

X, Y and Z were partners in a firm sharing profits in the ratio of 2 : 2 : 1. On 31st March, 2018, their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Cash at Bank	90,000
Bills Payable	40,000	Stock	70,000
General Reserve	30,000	Debtors	40,000
Capital A/cs:		Land and Building	5,00,000
X	3,00,000	Profit and Loss A/c	1,60,000
Y	3,00,000	(Loss for the year ended 31st March, 2018)	
Z	1,30,000		
	7,30,000		
	8,60,000		8,60,000

Y died on 30th June, 2018. The Partnership Deed provided for the following on the death of a partner:

- (i) Goodwill of the business was to be calculated on the basis of 2 times the average profits of the past 5 years. The profits for the years ended 31st March, 2017, 31st March, 2016, 31st March, 2015 and 31st March, 2014 were ₹ 50,000; ₹ 80,000; ₹ 1,10,000 and ₹ 2,20,000 respectively.
- (ii) Y's share of profit or loss from 1st April, 2018 till his death was to be calculated on the basis of the profit or loss for the year ended 31st March, 2018.

You are required to calculate the following:

- (a) Goodwill of the firm and Y's share of goodwill at the time of his death.
- (b) Y's share in the profit or loss of the firm till the date of his death.
- (c) Prepare Y's Capital Account at the time of his death to be presented to his executors.

Solution:

$$(a) \text{ Firm's Goodwill} = \frac{(\text{₹ } 50,000 + \text{₹ } 80,000 + \text{₹ } 1,10,000 + \text{₹ } 2,20,000 - \text{₹ } 1,60,000)}{5} \times 2$$

$$= \text{₹ } 1,20,000.$$

Y's Share of Goodwill = ₹ 1,20,000 × 2/5 = ₹ 48,000, which is contributed by X and Z in their Gaining Ratio of 2 : 1.

$$(b) \text{ Y's Share in Loss} = \text{₹ } 1,60,000 \times \frac{3}{12} \times \frac{2}{5} = \text{₹ } 16,000.$$

(c)

Dr.	Y'S CAPITAL ACCOUNT		Cr.
Particulars	₹	Particulars	₹
To Profit and Loss A/c (₹ 1,60,000 × 2/5)	64,000	By Balance b/d	3,00,000
To Profit and Loss Suspense A/c	16,000	By General Reserve A/c (₹ 30,000 × 2/5)	12,000
To Y's Executors' A/c	2,80,000	By X's Capital A/c (Goodwill)	32,000
(Balancing Figure)		By Z's Capital A/c (Goodwill)	16,000
	3,60,000		3,60,000
	3,60,000		3,60,000

Illustration 2.

Albert, Boris and Cyril are partners sharing profits and losses in the ratio of 3 : 2 : 1 and their Balance Sheet as at 31st March, 2018 stood as under:

Liabilities	₹	Assets	₹
Albert's Capital	50,000	Building	70,000
Boris's Capital	50,000	Machinery	25,000
Cyril's Capital	50,000	Stock	32,000
Creditors	17,000	Debtors	15,000
		Bank	25,000
	1,67,000		1,67,000

Albert died on 1st July, 2018 and the following decisions were taken by the surviving partners. According to the Partnership Deed, his executors were entitled to:

- The deceased partner's capital as appearing in the last Balance Sheet and interest thereon @ 6% p.a. up to the date of death.
- His share of profit for the period he was alive based on the figure of 31st March, 2018.
- Goodwill according to his share of profit to be calculated by taking twice the amount of the average profit of the last three years. The profits of the previous years were:

31st March, 2018—₹ 11,000

31st March, 2017—₹ 15,000

31st March, 2016—₹ 10,000

- Assets were to be revalued:

Building—₹ 80,000,

Stock—₹ 30,000,

Provision for Doubtful Debts @ 10%.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet as at 1st July, 2018.

(All calculations are to be made to the nearest rupee.)

(ISC 2000, Modified)

Solution:

REVALUATION ACCOUNT			
Dr.	₹	Cr.	₹
Particulars		Particulars	
To Stock A/c	2,000	By Building A/c	10,000
To Provision for Doubtful Debts A/c	1,500		
To Gain (Profit) transferred to Capital A/cs:			
Albert (3/6)	3,250		
Boris (2/6)	2,167		
Cyril (1/6)	1,083		
	6,500		
	10,000		10,000

Dr.				PARTNERS' CAPITAL ACCOUNTS				Cr.			
Particulars	Albert ₹	Boris ₹	Cyril ₹	Particulars	Albert ₹	Boris ₹	Cyril ₹				
To Albert's Capital A/c (Goodwill) (WN 3)	...	8,000	4,000	By Balance <i>b/d</i>	50,000	50,000	50,000				
To Albert's Executors' A/c (Transfer)	67,375	...	...	By Profit and Loss Suspense A/c —Share of Profit (WN 2)	1,375	...	...		
To Balance <i>c/d</i>	...	44,167	47,083	By Interest on Capital A/c (WN 1)	750	...	...		
				By Boris's Capital A/c (WN 3)	8,000	...	...		
				By Cyril's Capital A/c (WN 3)	4,000	...	...		
				By Revaluation A/c —Gain	3,250	2,167	1,083				
	67,375	52,167	51,083		67,375	52,167	51,083				

BALANCE SHEET
as at 1st July, 2018

Liabilities	₹	Assets	₹
Capital A/cs:		Building	80,000
Boris	44,167	Machinery	25,000
Cyril	47,083	Stock	30,000
Albert's Executors' A/c	67,375	Debtors	15,000
Creditors	17,000	Less: Provision for Doubtful Debts	1,500
		Bank	25,000
		Profit and Loss Suspense A/c*	2,125
	1,75,625		1,75,625

*Share of Profit + Interest on Capital = ₹ 1,375 + ₹ 750 = ₹ 2,125.

Working Notes:

- Interest on Albert's Capital for 3 months up to date of his death: ₹ 50,000 × 6/100 × 3/12 = ₹ 750.
- Albert's share of Profit up to the date of his death = ₹ 11,000 × 3/12 × 3/6 = ₹ 1,375.
- Albert's Share of Goodwill:

Average Profit of last 3 years = $1/3 \times ₹ (11,000 + 15,000 + 10,000) = ₹ 12,000$.

Albert's Share of Average Profit = $3/6 \times ₹ 12,000 = ₹ 6,000$.

Value of his Share of Goodwill = $2 \times ₹ 6,000 = ₹ 12,000$.

Albert's Share of Goodwill credited to his Capital Account which is to be contributed by Boris and Cyril in their Gaining Ratio. (As the profit-sharing ratio of Boris and Cyril remains the same in the new firm, gaining ratio is the new ratio.)

Illustration 3.

Bina and Anita are partners.

Their partnership agreement provides for the following:

- Accounts are to be balanced on 31st December each year.
- Profits are to be divided as follows:

Bina: one-half; Anita: one-third and carried to Reserve: one-sixth.

- (iii) That in the event of death of a partner, her executors will be entitled to the following:
- Capital to her credit at the date of death.
 - Proportionate profit to date of death based on the average profits of the last three completed years.
 - Share of Goodwill based on three years' purchases of the average profits for the three preceding completed years.

Profits for the three years were: 2005—₹ 42,000; 2006—₹ 39,000 and 2007—₹ 45,000.

On 31st December, 2007, Anita's Capital stood at ₹ 60,000 and firm's General Reserve stood at ₹ 30,000. Anita expired on 1st May, 2008.

From the above, prepare Anita's Executors' Account as would appear in the firm's ledger transferring the amount to her Loan Account with proper working notes. (ISC 2009)

Solution:

ANITA'S EXECUTORS' ACCOUNT			
Dr.		Cr.	
Particulars	₹	Particulars	₹
To Anita's Executors' Loan A/c	1,28,000	By Anita's Capital A/c	60,000
		By General Reserve A/c (₹ 30,000 × 2/5)	12,000
		By Bina's Capital A/c (Goodwill) (WN 2)	50,400
		By Profit and Loss Suspense A/c (WN 3)	5,600
	1,28,000		1,28,000

Working Notes:

- Reserves, Goodwill and Share in Profit up to 1st May, 2008 will be shared in the ratio of 3 : 2.
- Goodwill is valued as follows:

$$= \frac{(\text{₹ } 42,000 + \text{₹ } 39,000 + \text{₹ } 45,000)}{3} \times 3 = \text{₹ } 1,26,000$$

Anita's Share = ₹ 1,26,000 × 2/5 = ₹ 50,400.

- Anita's Share in Profit up to 1st May, 2008:

	₹
(i) Average Profit of last 3 years	42,000
(ii) Profit for 4 months	14,000
(iii) Anita's Share (2/5 of ₹ 14,000)	5,600

Illustration 4.

The Balance Sheet of X, Y and Z who are sharing profits in the ratio of 2 : 3 : 1, as at 31st March, 2018 is given below:

Liabilities	₹	Assets	₹
X's Capital A/c	2,00,000	Goodwill	24,000
Y's Capital A/c	4,00,000	Land and Building	5,00,000
Z's Capital A/c	6,00,000	Investments	1,00,000
Workmen Compensation Reserve	40,000	(Market Value ₹ 92,000)	
Investments Fluctuation Reserve	20,000	Stock	1,60,000
Provision for Doubtful Debts	20,000	Debtors	6,00,000
Creditors	7,20,000	Bank	5,92,000
		Advertisement Suspense A/c	24,000
	20,00,000		20,00,000

Z died on 30th September, 2018 and X and Y decided to share future profits and losses in the ratio of 3 : 2 and 50% of the amount payable to legal representatives of Z is to be paid immediately and the balance in two equal instalments together with interest @ 10% p.a.

Other Information:

- (i) Goodwill is to be valued at 2 years' purchase of average profits of last three completed years. The profits were—2015–16 ₹ 90,000; 2016–17 ₹ 1,80,000; 2017–18 ₹ 2,70,000.
- (ii) Land and Building was found undervalued by ₹ 1,70,000 and Stock was found overvalued by ₹ 16,000.
- (iii) Provision for Doubtful Debts is to be made equal to 5% of the Debtors.
- (iv) Claim on account of Workmen Compensation is ₹ 16,000.
- (v) Profit for the current year is to be valued on the basis of last year's profit.

Prepare necessary Ledger Accounts and Balance Sheet of the new firm.

Solution:

Dr. REVALUATION ACCOUNT Cr.			
Particulars	₹	Particulars	₹
To Stock A/c	16,000	By Land and Building A/c	1,70,000
To Provision for Doubtful Debts A/c	10,000		
To Gain (Profit) on Revaluation transferred to:			
X's Capital A/c	48,000		
Y's Capital A/c	72,000		
Z's Capital A/c	24,000		
	1,70,000		1,70,000

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.							
Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Goodwill A/c	8,000	12,000	4,000	By Balance b/d	2,00,000	4,00,000	6,00,000
To Y's Capital A/c	36,000	...	...	By X's Capital A/c	...	36,000	60,000
To Z's Capital A/c	60,000	...	...	By Revaluation A/c	48,000	72,000	24,000
To Adv. Susp. A/c	8,000	12,000	4,000	By Work. Com. Res. A/c	8,000	12,000	4,000
To Z's Capital A/c	22,500	...	...	By Inv. Fluc. Res. A/c	4,000	6,000	2,000
To Z's Executor's A/c	...	...	7,04,500	By X's Capital A/c	...	...	22,500
To Balance c/d	1,25,500	5,02,000	...	(Share of Profit)			
	2,60,000	5,26,000	7,12,500		2,60,000	5,26,000	7,12,500

Dr. Z'S EXECUTOR'S ACCOUNT Cr.			
Particulars	₹	Particulars	₹
To Bank A/c	3,52,250	By Z's Capital A/c	7,04,500
To Balance c/d	3,52,250		
	7,04,500		7,04,500

BALANCE SHEET as at 30th September, 2018

Liabilities	₹	Assets	₹
X's Capital A/c	1,25,500	Land and Building	6,70,000
Y's Capital A/c	5,02,000	Investments	92,000
Z's Executors' A/c	3,52,250	Stock	1,44,000
Creditors	7,20,000	Debtors	6,00,000
Workmen Compensation Claim	16,000	Less: Provision for Doubtful Debts	30,000
		Bank ₹ (5,92,000 – 3,52,250)	2,39,750
	17,15,750		17,15,750

Working Notes:

1. Calculation of Gain/(Sacrifice) of Share:

	New Share	Old Share	Difference
X	3/5	2/6	3/5 – 2/6 = 8/30 (Gain)
Y	2/5	3/6	2/5 – 3/6 = – 3/30 (Sacrifice)

2. Calculation of Goodwill:

$$(i) \text{ Average Profit} = \frac{\text{₹ } 90,000 + \text{₹ } 1,80,000 + \text{₹ } 2,70,000}{3} = \text{₹ } 1,80,000$$

$$(ii) \text{ Firm's Goodwill} = \text{₹ } 1,80,000 \times 2 = \text{₹ } 3,60,000.$$

Z's share in goodwill = ₹ 3,60,000 × 1/6 = ₹ 60,000. In this question Y is also sacrificing his 3/30 share of profit. He should also be compensated by ₹ 36,000 (i.e., ₹ 3,60,000 × 3/30).

- Excess Investments Fluctuation Reserve and Workmen Compensation Reserve have been transferred directly to Partners' Capital Accounts.
- As per the terms, 50% of the amount payable to Z is to be paid immediately. Since, Z has died, 50% of the amount due to Z will be paid to his executors.
- Z's Share of Profit till the date of death = ₹ 2,70,000 × 6/12 × 1/6 = ₹ 22,500, it should be adjusted through X's Capital Account (being a gaining partner).

Illustration 5.

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2018, their Balance Sheet stood as under:

Liabilities	₹	Assets	₹
Sundry Creditors	1,55,000	Goodwill	25,000
Workmen Compensation Reserve	10,000	Leasehold	1,00,000
Reserve Fund	20,000	Patents	30,000
Capital A/cs:		Machinery	1,50,000
A	1,50,000	Stock	50,000
B	1,25,000	Debtors	1,40,000
C	75,000	Cash at Bank	40,000
	3,50,000		
	5,35,000		5,35,000

C died on 1st August, 2018. It was agreed that:

- Goodwill of the firm is to be valued at 2½ years' purchase of the average of annual profits of the last 4 years. The profits for the four preceding years were ₹ 65,000, ₹ 60,000, ₹ 80,000 and ₹ 75,000.
- Machinery be valued at ₹ 1,40,000. Patents be valued at ₹ 40,000. Leasehold be valued at ₹ 1,25,000 on 1st August, 2018.

(iii) For the purpose of calculating C's share in the profits of 2018–19, the profits in 2018–19 should be taken to have accrued on the same scale as in 2017–18.

(iv) A sum of ₹ 21,000 to be paid immediately to the executors of C and the balance to be paid in four equal half-yearly instalments together with interest @ 10% p.a.

Prepare C's Capital Account and C's Executors' Account for 2018–19.

Note: Firm closes its accounts on 31st March every year.

Solution:

Dr.		C'S CAPITAL ACCOUNT				Cr.
Date	Particulars	₹	Date	Particulars	₹	
2018			2018			
Aug. 1	To Goodwill A/c	5,000	April 1	By Balance <i>b/d</i>	75,000	
Aug. 1	To C's Executors' A/c (Balancing Figure)	1,21,000	Aug. 1	By Revaluation A/c (Profit)	5,000	
				By A's Capital A/c (Goodwill) (WN 1)	21,875	
				By B's Capital A/c (Goodwill) (WN 1)	13,125	
				By Profit and Loss Suspense A/c (WN 2)	5,000	
				By Workmen Compensation Reserve A/c	2,000	
				By Reserve Fund A/c	4,000	
		1,26,000			1,26,000	

Dr.		C'S EXECUTORS' ACCOUNT				Cr.
Date	Particulars	₹	Date	Particulars	₹	
2018			2018			
Aug. 1	To Bank A/c	21,000	Aug. 1	By C's Capital A/c	1,21,000	
2019			2019			
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 5,000)	30,000	Jan. 31	By Interest A/c (₹ 1,00,000 × 10/100 × 6/12)	5,000	
Jan. 31	To Balance <i>c/d</i>	75,000				
		1,26,000			1,26,000	
2019			2019			
March 31	To Balance <i>c/d</i>	76,250	Feb. 1	By Balance <i>b/d</i>	75,000	
			March 31	By Interest A/c (₹ 75,000 × 10/100 × 2/12)	1,250	
		76,250			76,250	

Working Notes:

- Calculation of Goodwill:

	₹
(i) Total Profits for last 4 years (₹ 65,000 + ₹ 60,000 + ₹ 80,000 + ₹ 75,000)	2,80,000
(ii) Average Profit (₹ 2,80,000/4)	70,000
(iii) Goodwill (₹ 70,000 × 2½)	1,75,000
(iv) C's Share of Goodwill (₹ 1,75,000 × 2/10)	35,000

C's Share of Goodwill ₹ 35,000 will be adjusted between A and B in their Gaining Ratio, i.e., 5 : 3.
- C's Share of Profit up to the date of death = ₹ 75,000 × 4/12 × 2/10 = ₹ 5,000.

Illustration 6.

X, Y and Z were partners in a partnership firm sharing profits in the ratio of 4 : 3 : 1. Y died on 30th June, 2015. The firm's profits for the past 5 years were:

Year	2010-11	2011-12	2012-13	2013-14	2014-15
Profit (₹)	8,22,225	7,00,000	2,50,000	Loss: (50,000)	5,00,000

X and Z decided to share future profits in the ratio of 3 : 1. Goodwill is to be valued on the basis of Y's share of 2 year's profits calculated on the average of 5 completed years' profits immediately proceeding the year of death less 10%.

Solution: $X's\ Gain = \frac{3}{4} - \frac{4}{8} = \frac{2}{8};$

$$Z's\ Gain = \frac{1}{4} - \frac{1}{8} = \frac{1}{8};$$

$$\text{Gaining Ratio of X and Z} = \frac{2}{8} : \frac{1}{8} = 2 : 1.$$

Valuation of Goodwill:

$$\text{Average Profit} = \frac{₹\ 8,22,225 + ₹\ 7,00,000 + ₹\ 2,50,000 - ₹\ 50,000 + ₹\ 5,00,000}{5} = ₹\ 4,44,445$$

$$2\ \text{years' Average Profit} = ₹\ 4,44,445 \times 2 = ₹\ 8,88,890$$

$$Y's\ \text{Share of 2 years' Average Profit} = ₹\ 8,88,890 \times \frac{3}{8} = ₹\ 3,33,334$$

$$\text{Firm's Goodwill} = ₹\ 3,33,334 - 10\% \text{ of } ₹\ 3,33,334 = ₹\ 3,00,000$$

$$Y's\ \text{Share of Goodwill} = ₹\ 3,00,000 \times \frac{3}{8} = ₹\ 1,12,500.$$

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	X's Capital A/c ...Dr. Z's Capital A/c ...Dr. To Y's Capital A/c (Being Y's share of goodwill credited to Y and debited to X and Z in their gaining ratio)		75,000 37,500	1,12,500

Illustration 7.

X, Y and Z were partners in a firm sharing profits in the ratio of 2 : 2 : 1. On 31st March, 2018, their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Bank	90,000
Expenses Owning	2,500	Stock	70,000
Workmen Compensation Reserve	40,000	Debtors	40,000
General Reserve	27,500	Land and Building	5,00,000
Capital A/cs:		Profit and Loss A/c	1,60,000
X	3,00,000	(Loss for the year ended 31st March, 2018)	
Y	3,00,000		
Z	1,30,000		
	8,60,000		8,60,000

Y died on 30th June, 2018. Partnership Deed provided for the following on death of a partner:

- (i) Goodwill of the firm was to be valued at 2 years' purchase of the average profit of last 5 years. The profits for the past four years were ₹ 50,000; ₹ 80,000; ₹ 1,10,000 and ₹ 2,20,000 respectively.
- (ii) Share of profit or loss till the date of his death was to be calculated on the basis of the profit or loss for the year ended 31st March, 2018.
- (iii) X and Z decide to record the effect of Workmen Compensation Reserve and General Reserve without affecting their book figures.

Prepare Y's Capital Account at the time of his death to be presented to his executors.

Solution:

Y'S CAPITAL ACCOUNT			
Dr.		Cr.	
Particulars	₹	Particulars	₹
To Profit and Loss A/c (₹ 1,60,000 × 2/5)	64,000	By Balance b/d	3,00,000
To Profit and Loss Suspense A/c (WN 2)	16,000	By X's Capital A/c (Goodwill)	32,000
To Y's Executors' A/c (Balancing Figure)	2,95,000	By Z's Capital A/c (Goodwill)	16,000
		By X's Capital A/c (WN 3)	18,000
		By Z's Capital A/c (WN 3)	9,000
	3,75,000		3,75,000

Working Notes:

1. Calculation of Y's Share of Goodwill:

$$\text{Firm's Goodwill} = \frac{(\text{₹ } 50,000 + \text{₹ } 80,000 + \text{₹ } 1,10,000 + \text{₹ } 2,20,000 - \text{₹ } 1,60,000)}{5} \times 2 = \text{₹ } 1,20,000$$

Y's Share of Goodwill = 1,20,000 × 2/5 = ₹ 48,000, which is contributed by X and Z in their gaining ratio of 2 : 1.

Thus, X's contribution = ₹ 48,000 × 2/3 = ₹ 32,000, and Z's contribution = ₹ 48,000 × 1/3 = ₹ 16,000.

2. Y's share in loss from the date of last Balance Sheet up to date of death = ₹ 1,60,000 × 2/5 × 3/12 = ₹ 16,000.

3. Y's share in Workmen Compensation Reserve and General Reserve = 2/5 (₹ 40,000 + ₹ 27,500) = ₹ 27,000, which is contributed by X and Z in their gaining ratio of 2 : 1.

X's contribution = ₹ 27,000 × 2/3 = ₹ 18,000; Z's contribution = ₹ 27,000 × 1/3 = ₹ 9,000.

Illustration 8.

A, B and C are partners in a firm. Their Balance Sheet as at 31st March, 2017 is given below:

Liabilities		Assets	
	₹		₹
Creditors	10,000	Plant and Machinery	20,000
General Reserve	10,000	Furniture and Fixtures	2,500
A's Capital	20,000	Stock	10,500
B's Capital	15,000	Debtors	15,000
C's Capital	5,000	Investments	12,000
	60,000		60,000

B died on 30th September, 2017. The Partnership Deed provides that the representatives of the deceased partner shall be entitled to:

- (i) Deceased Partner's Capital as appearing in last Balance Sheet.
- (ii) Interest on Capital @ 6% p.a. up to the date of death.

- (iii) His share of profit up to the date of death on the average of last three years' profit.
 (iv) His share of any undistributed profits and losses as per last Balance Sheet.
 (v) Interest on his Drawings up to the date of death will be charged @ 10% p.a.

Profits for the last three financial years were ₹ 65,000; ₹ 64,000 and ₹ 69,000. B's drawings up to the date of death amounting to ₹ 10,000. Ascertain the amount payable to the legal representative of B (Goodwill excluded).
 (ISC 1996, Modified)

Solution: CALCULATION OF THE AMOUNT PAYABLE TO THE LEGAL REPRESENTATIVE OF B

Particulars	₹
Capital as per last Balance Sheet	15,000
Interest on Capital for 6 months @ 6% p.a.	450
Share of Profit for 6 months:	
Average Profit: $1/3 \times ₹ (65,000 + 64,000 + 69,000) = ₹ 66,000$	
Profit for 6 months: $1/2 \times ₹ 66,000 = ₹ 33,000$	
B's Share: $1/3 \times ₹ 33,000$	11,000
Share of General Reserve: $1/3 \times ₹ 10,000$	3,333
	29,783
Less: Drawings	10,000
Interest on Drawings ($₹ 10,000 \times 10/100 \times 3/12$)	250
Total Amount Payable	19,533

Note: In the absence of actual dates of drawings, interest thereon has been calculated for the average period of 3 months on the assumption that the drawings were made evenly during the period of 6 months.

Illustration 9.

Mandeep, Randeep and Sandeep are in partnership sharing profits equally. Sandeep died on 30th June, 2018. Balance Sheet of the firm as at 31st March, 2018 was as follows:

Liabilities	₹	Assets	₹
Creditors	33,250	Cash	2,500
General Reserve	9,000	Bank	10,000
Investments Fluctuation Reserve	3,000	Debtors	25,000
Capital A/cs:		Less: Provision for Doubtful Debts	2,000
Mandeep	75,000	Stock	25,000
Randeep	50,000	Investments (At Cost)	12,500
Sandeep	50,000	Land and Building	1,00,000
	1,75,000	Goodwill	47,250
	2,20,250		2,20,250

In order to determine the balance due to Sandeep it was mutually agreed that:

- (i) Land and Building be valued at ₹ 1,25,000.
 (ii) Investments Fluctuation Reserve be brought down to ₹ 1,350.
 (iii) All Debtors were good.
 (iv) Stock is valued at ₹ 23,500.
 (v) Goodwill be valued at one year's purchase of the average profit of the past five years.
 (vi) Sandeep's share of profit till the date of death be calculated on the basis of average profit of the preceding three years.

Death of a Partner

5.13

Profits of preceding five years ending 31st March, were: 2014—₹ 28,750; 2015—₹ 35,000; 2016—₹ 22,500; 2017—₹ 20,000 and 2018—₹ 25,000.

You are required to show Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm as at 30th June, 2018.

Solution:

REVALUATION ACCOUNT			
Dr.			Cr.
Particulars	₹	Particulars	₹
To Stock A/c	1,500	By Land and Building A/c	25,000
To Gain (Profit) on Revaluation transferred to:		By Provision for Doubtful Debts A/c	2,000
Mandeep's Capital A/c	8,500		
Randeep's Capital A/c	8,500		
Sandeep's Capital A/c	8,500		
	25,500		
	27,000		27,000

PARTNERS' CAPITAL ACCOUNTS							
Dr.							Cr.
Particulars	Mandeep ₹	Randeep ₹	Sandeep ₹	Particulars	Mandeep ₹	Randeep ₹	Sandeep ₹
To Goodwill A/c (WN 2)	15,750	15,750	15,750	By Balance b/d	75,000	50,000	50,000
To Sandeep's Capital A/c (WN 2)	4,375	4,375	...	By Revaluation A/c (Gain or Profit)	8,500	8,500	8,500
To Sandeep's Executor's A/c	...	...	56,925	By Investments Fluctuation Reserve (WN 1)	550	550	550
To Balance c/d	66,925	41,925	...	By General Reserve A/c	3,000	3,000	3,000
				By Mandeep's Capital A/c (WN 2)	...	...	4,375
				By Randeep's Capital A/c (WN 2)	...	...	4,375
				By Profit and Loss Suspense A/c (WN 3)	...	...	1,875
	87,050	62,050	72,675		87,050	62,050	72,675
	87,050	62,050	72,675		87,050	62,050	72,675

BALANCE SHEET OF MANDEEP AND RANDEEP
as at 30th June, 2018

Liabilities	₹	Assets	₹
Creditors	33,250	Cash	2,500
Investments Fluctuation Reserve	1,350	Bank	10,000
Sandeep's Executor's A/c	56,925	Debtors	25,000
Capital A/cs:		Stock	23,500
Mandeep	66,925	Land and Building	1,25,000
Randeep	41,925	Investments (At Cost)	12,500
		Profit and Loss Suspense A/c	1,875
	2,00,375		2,00,375
	2,00,375		2,00,375

Working Notes:

- Investments Fluctuation Reserve is created to meet fall in the market value of the investments. At the time of death of Sandeep, Investments Fluctuation Reserve is required to the extent of ₹ 1,350 only. Therefore, the balance of ₹ 1,650 is credited to Partners' Capital Accounts in their old profit-sharing ratio.
- Ascertainment of Goodwill:**
 - Total profits of last 5 years = ₹ 28,750 + ₹ 35,000 + ₹ 22,500 + ₹ 20,000 + ₹ 25,000 = ₹ 1,31,250.
 - Average Profit = ₹ 1,31,250/5 = ₹ 26,250.
 - Goodwill = Average Profit × Number of Years' Purchase
= ₹ 26,250 × 1 = ₹ 26,250.

STATEMENT SHOWING THE ADJUSTMENT FOR GOODWILL

Particulars	Mandeep (₹)	Randeep (₹)	Sandeep (₹)
Share of Goodwill before Sandeep's death (equally)	8,750	8,750	8,750
Share of Goodwill after Sandeep's death (equally)*	13,125	13,125	...
Gain (+)/Sacrifice (-)	(+)4,375	(+)4,375	(-)8,750

*Profit-sharing ratio is equal before or after the death of Sandeep, because nothing has been mentioned in respect of new profit-sharing ratio.

Adjustment Entry:

		₹	₹
Mandeep's Capital A/c	...Dr.	4,375	
Randeep's Capital A/c	...Dr.	4,375	
To Sandeep's Capital A/c			8,750

3. **Ascertainment of Sandeep's Share of Profit from 1st April, 2018 to 30th June, 2018:**

- Average Profit of preceding three years = $\frac{₹ 22,500 + ₹ 20,000 + ₹ 25,000}{3} = ₹ 22,500$.
- Profit for 3 months = ₹ 22,500 × 3/12 = ₹ 5,625.
- Sandeep's Share of Profit = ₹ 5,625 × 1/3 = ₹ 1,875.

Master Questions

Illustration 10.

The Balance Sheet of Hari, Sonu and Zubin who were sharing profits in the ratio of 5 : 3 : 2 as at 31st March, 2020 is as below:

Liabilities	₹	Assets	₹
Creditors	50,000	Cash at Bank	40,000
Employees' Provident Fund	10,000	Sundry Debtors	1,00,000
Profit and Loss A/c	85,000	Stock	80,000
Workmen Compensation Reserve	10,000	Fixed Assets (Tangible)	60,000
Capital A/cs:		Goodwill	5,000
Hari	40,000	Advertisement Suspense A/c	5,000
Sonu	62,000		
Zubin	33,000		
	1,35,000		
	2,90,000		2,90,000

Hari died on 1st April, 2020 and Sonu and Zubin decided to share profits in future in the ratio of 2 : 3 respectively.

The other terms on death of a partner were as follows:

- (i) Goodwill of the firm is to be valued at ₹ 80,000.
- (ii) Fixed Assets (Tangible) are to be reduced to ₹ 57,500.
- (iii) Provide Provision for Doubtful Debts at 5% on Sundry Debtors.
- (iv) A claim, included in Creditors for ₹ 10,000, is settled at ₹ 8,000.
- (v) Deceased partner will be entitled to his share in profit for the year calculated on the basis of average profit of past three years which were as follows for the years ended 31st March, 2020—₹ 85,000, 2019—₹ 80,000 and 2018—₹ 60,000.

The amount to be paid to Hari's Executor by Sonu and Zubin in such a way that their capitals are proportionate to their profit-sharing ratio and leave a balance of ₹ 15,000 in the Bank Account.

Prepare Revaluation Account and Partners' Capital Accounts.

Solution:

Dr.		REVALUATION ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Fixed Assets A/c	2,500	By Creditors A/c	2,000		
To Provision for Doubtful Debts A/c	5,000	By Loss on Revaluation transferred to:			
		Hari's Capital A/c	2,750		
		Sonu's Capital A/c	1,650		
		Zubin's Capital A/c	1,100		5,500
	7,500				7,500

Dr.		PARTNERS' CAPITAL ACCOUNTS						Cr.	
Particulars	Hari (₹)	Sonu (₹)	Zubin (₹)	Particulars	Hari (₹)	Sonu (₹)	Zubin (₹)		
To Revaluation A/c (Loss)	2,750	1,650	1,100	By Balance b/d	40,000	62,000	33,000		
To Hari's Capital A/c	...	8,000	32,000	By Workmen Compensation Reserve A/c	5,000	3,000	2,000		
To Goodwill A/c	2,500	1,500	1,000	By Sonu's Capital A/c	8,000	...	...
To Advertisement Suspense A/c	2,500	1,500	1,000	By Zubin's Capital A/c	32,000	...	...
To Bank A/c	1,19,750	...	...	By Profit and Loss A/c	42,500	25,500	17,000		
To Balance c/d (WN 3)	...	79,000	1,18,500	By Bank A/c	...	1,150	1,01,600		
				(Balancing Figure)					
	1,27,500	91,650	1,53,600		1,27,500	91,650	1,53,600		

Working Notes:

1. **Gain/Sacrifice** = New Share – Old Share

$$\text{Sonu's Gain} = \frac{2}{5} - \frac{3}{10} = \frac{1}{10}; \quad \text{Zubin's Gain} = \frac{3}{5} - \frac{2}{10} = \frac{4}{10}$$

Gaining Ratio = 1 : 4.

2. Hari's Share of Goodwill = ₹ 80,000 × $\frac{5}{10}$ = ₹ 40,000 to be contributed by Sonu and Zubin in their gaining ratio.

3. **Total Capital of the New Firm** = Adjusted Capital of All Partners – Cash Available for Payment

$$\begin{aligned} \text{Hari's Adjusted Capital} &= ₹ 40,000 + ₹ 5,000 + ₹ 8,000 + ₹ 32,000 + ₹ 42,500 - ₹ 2,750 - ₹ 2,500 - ₹ 2,500 \\ &= ₹ 1,19,750. \end{aligned}$$

$$\begin{aligned} \text{Sonu's Adjusted Capital} &= ₹ 62,000 + ₹ 3,000 + ₹ 25,500 - ₹ 1,650 - ₹ 1,500 - ₹ 1,500 - ₹ 8,000 \\ &= ₹ 77,850. \end{aligned}$$

$$\begin{aligned} \text{Zubin's Adjusted Capital} &= ₹ 33,000 + ₹ 2,000 + ₹ 17,000 - ₹ 1,100 - ₹ 32,000 - ₹ 1,000 - ₹ 1,000 \\ &= ₹ 16,900. \end{aligned}$$

$$\text{Cash Available for Payment} = ₹ 40,000 - ₹ 8,000 - ₹ 15,000 = ₹ 17,000$$

$$\text{Total Capital of New Firm} = ₹ 1,19,750 + ₹ 77,850 + ₹ 16,900 - ₹ 17,000 = ₹ 1,97,500$$

$$\text{Sonu's New Capital} = ₹ 1,97,500 \times \frac{2}{5} = ₹ 79,000$$

$$\text{Zubin's New Capital} = ₹ 1,97,500 \times \frac{3}{5} = ₹ 1,18,500.$$

4. Dr. BANK ACCOUNT Cr.			
Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Creditors A/c	8,000
To Sonu's Capital A/c	1,150	By Hari's Capital A/c	1,19,750
To Zubin's Capital A/c	1,01,600	By Balance c/d	15,000
	1,42,750		1,42,750

Illustration 11.

Micky, Ricky and Vicky were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2019 their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	55,000	Goodwill	25,000
Investment Fluctuation Reserve	17,500	Patents	1,30,000
Workmen Compensation Reserve	17,500	Machinery	1,56,000
Capital A/cs:		Investments	15,000
Micky	3,37,500	Stock	50,000
Ricky	2,37,500	Sundry Debtors	62,000
Vicky	1,85,000	Less: Provision for Doubtful Debts	2,000
	7,60,000	Loan to Vicky	5,000
		Cash at Bank	29,000
		Advertisement Expenditure	5,000
		Profit and Loss A/c (2018-19)	3,75,000
	8,50,000		8,50,000

Vicky died on 1st August, 2019. Vicky had withdrawn ₹ 25,000 during 2019-20. It was agreed between his executors and the remaining partners that—

- Goodwill be valued at 2½ years' purchase of average of four completed years' profits which were: 2015-16 ₹ 5,05,000; 2016-17 ₹ 70,000; 2017-18 ₹ 80,000.
- Vicky's Share of profit from the closure of last accounting year till date of death be calculated on the basis of the average of three completed years' profits before death.
- Patents undervalued by ₹ 85,000; Machinery overvalued by ₹ 16,000.

Death of a Partner

5.17

- (iv) Claim on account of Workmen Compensation is ₹ 10,000.
- (v) Investments be sold for ₹ 21,000 and a sum of ₹ 24,000 be paid to Vicky's Executors immediately. The remainder to be paid in four equal half-yearly instalments together with interest @ 10% p.a.

You are required:

- (a) to give the necessary Journal entries to be passed on Vicky's death;
- (b) to prepare the Capital Accounts of all the partners;
- (c) to prepare the Balance Sheet of Micky and Ricky immediately after Vicky's death;
- (d) to prepare Vicky's Executor's Account till it is finally settled.

Solution:

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2019				
Aug 1	Micky's Capital A/c ...Dr. Ricky's Capital A/c ...Dr. Vicky's Capital A/c ...Dr. To Goodwill A/c (Being the existing goodwill written off)		12,500 7,500 5,000	25,000
	Micky's Capital A/c (₹ 35,000 × 5/8) ...Dr. Ricky's Capital A/c (₹ 35,000 × 3/8) ...Dr. To Vicky's Capital A/c (₹ 1,75,000 × 2/10) (Being Vicky's share of goodwill adjusted)		21,875 13,125	35,000
	Vicky's Capital A/c ...Dr. To Profit and Loss Suspense A/c (Being Vicky's share of loss to date of death recorded)		5,000	5,000
	Investment Fluctuation Reserve A/c ...Dr. To Micky's Capital A/c To Ricky's Capital A/c To Vicky's Capital A/c (Being the transfer of Investment Fluctuation Reserve)		17,500	8,750 5,250 3,500
	Workmen Compensation Reserve A/c ...Dr. To Workmen Compensation Claim A/c To Micky's Capital A/c To Ricky's Capital A/c To Vicky's Capital A/c (Being the transfer of Workmen Compensation Reserve)		17,500	10,000 3,750 2,250 1,500
	Micky's Capital A/c ...Dr. Ricky's Capital A/c ...Dr. Vicky's Capital A/c ...Dr. To Advertisement Expenditure A/c (Being the transfer of Advertisement Expenditure)		2,500 1,500 1,000	5,000
	Micky's Capital A/c ...Dr. Ricky's Capital A/c ...Dr. Vicky's Capital A/c ...Dr. To Profit and Loss A/c (Being the transfer of Accumulated Loss)		1,87,500 1,12,500 75,000	3,75,000

Revaluation A/c To Machinery A/c (Being the decrease in value of asset recorded)	...Dr.	16,000	16,000
Patents A/c To Revaluation A/c (Being the increase in value of asset recorded)	...Dr.	85,000	85,000
Bank A/c To Investment A/c To Revaluation A/c (Being the investment sold)	...Dr.	21,000	15,000 6,000
Revaluation A/c To Micky's Capital A/c To Ricky's Capital A/c To Vicky's Capital A/c (Being the transfer of gain (profit) on revaluation)	...Dr.	75,000	37,500 22,500 15,000
Vicky's Capital A/c To Loan to Vicky (Being the transfer of Loan to Vicky to his Capital Account)	...Dr.	5,000	5,000
Vicky's Capital A/c To Vicky's Executor's A/c (Being the transfer of Vicky's Capital Account to his Executor's Account)	...Dr.	1,24,000	1,24,000
Vicky's Executor's A/c To Bank A/c (Being the partial payment made to Vicky's Executor)	...Dr.	24,000	24,000

Dr.				PARTNERS' CAPITAL ACCOUNTS				Cr.
Particulars	Micky ₹	Ricky ₹	Vicky ₹	Particulars	Micky ₹	Ricky ₹	Vicky ₹	
To Bank A/c (Drawings)	...	...	25,000	By Balance b/d	3,37,500	2,37,500	1,85,000
To Goodwill A/c	12,500	7,500	5,000	By Revaluation A/c	37,500	22,500	15,000	
To Profit and Loss A/c	1,87,500	1,12,500	75,000	By Micky's Capital A/c	...	...	21,875
To Vicky's Capital A/c	21,875	13,125	...	By Ricky's Capital A/c	...	...	13,125
To Profit and Loss Suspense A/c	...	...	5,000	By Investment Fluctua- tion Reserve A/c	8,750	5,250	3,500
To Loan to Vicky A/c	...	...	5,000	By Workmen Compen- sation Reserve A/c	3,750	2,250	1,500
To Advertisement Expenditure A/c	2,500	1,500	1,000					
To Vicky's Executor's A/c	...	...	1,24,000				
To Balance c/d	1,63,125	1,32,875	...					
	3,87,500	2,67,500	2,40,000		3,87,500	2,67,500	2,40,000	

BALANCE SHEET OF MICKY AND RICKY
as at 1st August, 2019

Liabilities	₹	Assets	₹
Sundry Creditors	55,000	Patents	2,15,000
Vicky's Executor's A/c	1,00,000	Machinery	1,40,000
Profit and Loss Suspense A/c	5,000	Stock	50,000
Workmen Compensation Claim	10,000	Sundry Debtors	62,000
Micky's Capital	1,63,125	Less: Provision for Doubtful Debts	2,000
Ricky's Capital	1,32,875	Cash at Bank	1,000
	4,66,000		4,66,000

Dr. VICKY'S EXECUTOR'S ACCOUNT Cr.					
Date	Particulars	₹	Date	Particulars	₹
2019			2019		
Aug. 1	To Bank A/c	24,000	Aug. 1	By Vicky's Capital A/c	1,24,000
2020			2020		
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 5,000)	30,000	Jan. 31	By Interest A/c (₹ 1,00,000 × 6/12 × 10/100)	5,000
Mar. 31	To Balance c/d (₹ 75,000 + ₹ 1,250)	76,250	Mar. 31	By Interest A/c (Accrued) (₹ 75,000 × 2/12 × 10/100)	1,250
		1,30,250			1,30,250
2020			2020		
July 31	To Bank A/c (₹ 25,000 + ₹ 1,250 + ₹ 2,500)	28,750	April 1	By Balance b/d	76,250
			July 31	By Interest A/c (₹ 75,000 × 4/12 × 10/100)	2,500
2021			2021		
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 2,500)	27,500	Jan. 31	By Interest A/c (₹ 50,000 × 10/100 × 6/12)	2,500
Mar. 31	To Balance c/d (₹ 25,000 + ₹ 417)	25,417	Mar. 31	By Interest A/c (₹ 25,000 × 10/100 × 2/12)	417
		81,667			81,667
2021			2021		
July 31	To Bank A/c (₹ 25,000 + ₹ 417 + ₹ 833)	26,250	April 1	By Balance b/d	25,417
			July 31	By Interest A/c (₹ 25,000 × 10/100 × 4/12)	833
		26,250			26,250

Working Notes:**1. Vicky's Share of Goodwill:**

$$\text{Firm's Goodwill} = \frac{\text{₹ } 5,05,000 + \text{₹ } 70,000 + \text{₹ } 90,000 - \text{₹ } 3,75,000}{4} \times 2.5 = \text{₹ } 1,75,000$$

$$\text{Vicky's Share of Goodwill} = \text{₹ } 1,75,000 \times \frac{2}{10} = \text{₹ } 35,000.$$

2. Vicky's Share of Profit (Loss) till date of death:

$$\text{Average Profit (Loss) of last three years} = \frac{\text{₹ } 70,000 + \text{₹ } 80,000 - \text{₹ } 3,75,000}{3} = \text{₹ } 75,000 \text{ (Loss)}$$

$$\text{Vicky's Share of Loss} = \text{₹ } 75,000 \times \frac{2}{10} \times \frac{4}{12} = \text{₹ } 5,000.$$

5.20

Double Entry Book Keeping (Section A) – ISC XII

3. Dr.		BANK ACCOUNT		Cr.
Particulars	₹	Particulars	₹	
To Balance <i>b/d</i>	29,000	By Vicky's Drawings A/c	25,000	
To Investment A/c	21,000	By Vicky's Executor's A/c	24,000	
		By Balance <i>c/d</i>	1,000	
	50,000		50,000	

Illustration 12.

Karun, Som and Mehar were partners sharing profits and losses in the ratio of 5 : 3 : 2. On 31st March, 2019 their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Trade Creditors	1,35,000	Goodwill	25,000
Employees' Provident Fund	20,000	Patents	1,30,000
Investment Fluctuation Reserve	17,500	Machinery	1,56,000
Workmen Compensation Reserve	17,500	Investments	15,000
Capital A/cs:		Stock	50,000
Karun	3,37,500	Sundry Debtors	62,000
Som	2,37,500	Less: Provision for Doubtful Debts	2,000
Mehar	1,85,000	Loan to Mehar	5,000
	7,60,000	Cash at Bank	1,29,000
		Advertisement Expenditure	5,000
		Profit and Loss A/c (2018-19)	3,75,000
	9,50,000		9,50,000

Mehar died on 1st August, 2019. Mehar had withdrawn ₹ 25,000 during 2019-20. It was agreed between his executors and the remaining partners that:

- Goodwill be valued at 2½ years' purchase of average of four completed years' profits which were: 2015-16 ₹ 5,05,000; 2016-17 ₹ 60,000; 2017-18 ₹ 90,000.
- Mehar's Share of profit from the closure of last accounting year till the date of death be calculated on the basis of the average of three completed years' profits before death.
- Patents were undervalued by ₹ 70,000; Stock was overvalued by ₹ 20,000.
- Machinery was to be valued at ₹ 1,75,000.
- Provision of ₹ 5,000 be made in respect of Outstanding Legal charges.
- Out of the amount of Insurance Premium which was debited to Profit and Loss Account, ₹ 5,000 be carried forward as an unexpired Insurance.
- Included in Trade Creditors was an item of ₹ 1,100 which was not to be paid, therefore, had to be written back.
- Provision for Doubtful Debts is to be maintained at 5% of Sundry Debtors.
- Claim on account of Workmen Compensation is ₹ 10,000.
- Investments were sold for ₹ 21,000 and a sum of ₹ 24,000 be paid to Mehar's Executors immediately. The remainder to be paid in four equal half-yearly instalments together with interest @ 10% p.a.

You are required:

- to give necessary Journal entries to be passed on Mehar's death;
- to prepare the Capital Accounts of all the partners;
- to prepare the Balance Sheet of Karun and Som immediately after Mehar's death;
- to prepare Mehar's Executor's Account till it is finally settled.

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2019				
Aug. 1	Karun's Capital A/c ...Dr. Som's Capital A/c ...Dr. Mehar's Capital A/c ...Dr. To Goodwill A/c (Being the existing goodwill written off)		12,500 7,500 5,000	25,000
	Karun's Capital A/c (₹ 35,000 × 5/8) ...Dr. Som's Capital A/c (₹ 35,000 × 3/8) ...Dr. To Mehar's Capital A/c (₹ 1,75,000 × 2/10) (Being the Mehar's share of goodwill adjusted)		21,875 13,125	35,000
	Mehar's Capital A/c ...Dr. To Profit and Loss Suspense A/c (Being the Mehar's share of loss till date of death recorded)		5,000	5,000
	Investment Fluctuation Reserve A/c ...Dr. To Karun's Capital A/c To Som's Capital A/c To Mehar's Capital A/c (Being the transfer of Investment Fluctuation Reserve)		17,500	8,750 5,250 3,500
	Workmen Compensation Reserve A/c ...Dr. To Workmen Compensation Claim A/c To Karun's Capital A/c To Som's Capital A/c To Mehar's Capital A/c (Being the transfer of Workmen Compensation Reserve)		17,500	10,000 3,750 2,250 1,500
	Karun's Capital A/c ...Dr. Som's Capital A/c ...Dr. Mehar's Capital A/c ...Dr. To Advertisement Expenditure A/c (Being the transfer of Advertisement Expenditure)		2,500 1,500 1,000	5,000
	Karun's Capital A/c ...Dr. Som's Capital A/c ...Dr. Mehar's Capital A/c ...Dr. To Profit and Loss A/c (Being the transfer of Accumulated Loss)		1,87,500 1,12,500 75,000	3,75,000
	Bank A/c ...Dr. To Investment A/c To Revaluation A/c (Being the investment sold)		21,000	15,000 6,000
	Patents A/c ...Dr. Machinery A/c ...Dr. Unexpired Insurance A/c ...Dr. Trade Creditors A/c ...Dr. To Revaluation A/c (Being the increase in assets and decrease in liabilities recorded)		70,000 19,000 5,000 1,100	95,100
	Revaluation A/c ...Dr. To Stock A/c To Provision for Outstanding Legal Charges A/c To Provision for Doubtful Debts A/c (Being the decrease in assets and increase in liabilities recorded)		26,100	20,000 5,000 1,100

Revaluation A/c	...Dr.	75,000	
To Karun's Capital A/c			37,500
To Som's Capital A/c			22,500
To Mehar's Capital A/c			15,000
(Being the transfer of gain (profit) on revaluation)			
Mehar's Capital A/c	...Dr.	5,000	
To Loan to Mehar A/c			5,000
(Being the transfer of Loan to Mehar to his Capital Account)			
Mehar's Capital A/c	...Dr.	1,24,000	
To Mehar's Executor's A/c			1,24,000
(Being the transfer of Mehar's Capital Account to his Executor's Account)			
Mehar's Executor's A/c	...Dr.	24,000	
To Bank A/c			24,000
(Being the partial payment made to Mehar's Executor)			

Dr.				PARTNERS' CAPITAL ACCOUNTS				Cr.
Particulars	Karun ₹	Som ₹	Mehar ₹	Particulars	Karun ₹	Som ₹	Mehar ₹	
To Bank A/c (Drawings)	...	...	25,000	By Balance b/d	3,37,500	2,37,500	1,85,000
To Goodwill A/c	12,500	7,500	5,000	By Revaluation A/c	37,500	22,500	15,000	
To Profit and Loss A/c	1,87,500	1,12,500	75,000	By Karun's Capital A/c	...	...	21,875
To Mehar's Capital A/c	21,875	13,125	...	By Som's Capital A/c	...	...	13,125
To Profit and Loss Suspense A/c	...	...	5,000	By Investment Fluctua- tion Reserve A/c	8,750	5,250	3,500
To Loan to Mehar A/c	...	...	5,000	By Workmen Compen- sation Reserve A/c	3,750	2,250	1,500
To Advertisement Expenditure A/c	2,500	1,500	1,000					
To Mehar's Executor's A/c	...	...	1,24,000				
To Balance c/d	1,63,125	1,32,875	...					
	<u>3,87,500</u>	<u>2,67,500</u>	<u>2,40,000</u>		<u>3,87,500</u>	<u>2,67,500</u>	<u>2,40,000</u>	

BALANCE SHEET OF KARUN AND SOM as at 1st August, 2019

Liabilities	₹	Assets	₹
Trade Creditors	1,33,900	Unexpired Insurance	5,000
Mehar's Executor's A/c	1,00,000	Patents	2,00,000
Profit and Loss Suspense A/c	5,000	Machinery	1,75,000
Employees' Provident Fund	20,000	Stock	30,000
Provision for Outstanding Legal Charges	5,000	Sundry Debtors	62,000
Workmen Compensation Claim	10,000	Less: Provision for Doubtful Debts	<u>3,100</u>
Karun's Capital	1,63,125	Cash at Bank	1,01,000
Som's Capital	1,32,875		
	<u>5,69,900</u>		<u>5,69,900</u>

Death of a Partner

5.23

Dr.			MEHAR'S EXECUTOR'S ACCOUNT			Cr.		
Date	Particulars	₹	Date	Particulars	₹			
2019			2019					
Aug. 1	To Bank A/c	24,000	Aug. 1	By Mehar's Capital A/c	1,24,000			
2020			2020					
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 5,000)	30,000	Jan. 31	By Interest A/c (₹ 1,00,000 × 6/12 × 10/100)	5,000			
Mar. 31	To Balance c/d (₹ 75,000 + ₹ 1,250)	76,250	Mar. 31	By Interest A/c (Accrued) (₹ 75,000 × 2/12 × 10/100)	1,250			
		1,30,250			1,30,250			
2020			2020					
July 31	To Bank A/c (₹ 25,000 + ₹ 1,250 + ₹ 2,500)	28,750	April 1	By Balance b/d	76,250			
			July 31	By Interest A/c (₹ 75,000 × 4/12 × 10/100)	2,500			
2021			2021					
Jan. 31	To Bank A/c (₹ 25,000 + ₹ 2,500)	27,500	Jan. 31	By Interest A/c (₹ 50,000 × 10/100 × 6/12)	2,500			
Mar. 31	To Balance c/d (₹ 25,000 + ₹ 417)	25,417	Mar. 31	By Interest A/c (₹ 25,000 × 10/100 × 2/12)	417			
		81,667			81,667			
2021			2021					
July 31	To Bank A/c (₹ 25,000 + ₹ 417 + ₹ 833)	26,250	April 1	By Balance b/d	25,417			
			July 31	By Interest A/c (₹ 25,000 × 10/100 × 4/12)	833			
		26,250			26,250			

Working Notes:

1. Mehar's Share of Goodwill:

$$\text{Firm's Goodwill} = \frac{\text{₹ } 5,05,000 + \text{₹ } 70,000 + \text{₹ } 90,000 - \text{₹ } 3,75,000}{4} \times 2.5 = \text{₹ } 1,75,000$$

$$\text{Mehar's Share of Goodwill} = \text{₹ } 1,75,000 \times \frac{2}{10} = \text{₹ } 35,000.$$

2. Mehar's Share of Profit (Loss) till date of death:

$$\text{Average Profit (Loss) of last three years} = \frac{\text{₹ } 70,000 + \text{₹ } 80,000 - \text{₹ } 3,75,000}{3} = \text{₹ } 75,000 \text{ (Loss)}$$

$$\text{Mehar's Share of Loss} = \text{₹ } 75,000 \times \frac{2}{10} \times \frac{4}{12} = \text{₹ } 5,000.$$

Dr.		BANK ACCOUNT		Cr.	
Particulars	₹	Particulars	₹		
To Balance b/d	1,29,000	By Mehar's Drawings A/c	25,000		
To Investment A/c	21,000	By Mehar's Executor's A/c	24,000		
		By Balance c/d	1,01,000		
	1,50,000		1,50,000		

Unsolved Questions

1. X, Y and Z are in partnership sharing profits equally. X dies on 30th June, 2017 and the Partnership Deed provided *inter alia* that:
- (i) The share of deceased partner's Capital Account shall be taken at the balance of the Capital Accounts as on the date of the last financial year, *less* the withdrawals, if any, made to the date of death.
 - (ii) His share of profit to the date of death be calculated on the basis of the average profits of the three preceding years.
 - (iii) Goodwill of the firm shall be taken at one year's purchase of the average profits of the preceding five years.
 - (iv) The firm's Freehold property shall be taken at an independent valuation.

The firm's Balance Sheet as at 31st March, 2017 was as under:

Liabilities	₹	Assets	₹
Capital A/cs:		Goodwill	56,700
X	90,000	Freehold Property	1,20,000
Y	60,000	Stock	45,000
Z	60,000	Debtors	30,000
Creditors	56,700	Bank	13,500
	2,66,700	Cash	1,500
	2,66,700		2,66,700

Freehold property was valued at ₹ 1,74,000.

The profits for five years ended 31st March were:

2012-13—₹ 34,500; 2013-14—₹ 42,000; 2014-15—₹ 27,000; 2015-16—₹ 24,000 and 2016-17—₹ 30,000.

Prepare X's Capital Account to be rendered to his representatives.

2. In the partnership agreement between Sajan, Arjan and Dharam who were sharing profits 4 : 2 : 2. Goodwill was to be valued on the death of any partner on the basis of such partner's share of 2 years' profits calculated on the average of 5 years' profits immediately preceding the year of death *less* 10%. Profits for the years ended 31st March, 2014, 2015, 2016, 2017 and 2018 were ₹ 15,000, ₹ 25,000, ₹ 40,000, ₹ 5,000 (Loss) and ₹ 2,000 respectively.

The deceased partner's share of profits for the period of his life-time in the year of death was to be based on the average of the profits of the previous 3 years *plus* 10%.

Sajan died on 31st August, 2018. His Capital Account showed a credit of ₹ 10,000 on 1st April, 2018 and he had drawn ₹ 1,500 since that date.

Show amount of Goodwill and the share of profits payable to him.

GUIDE TO ANSWERS

1. Transfer to X's Executor's Account—₹ 1,01,850.
2. Amount payable to Sajan's Executors—₹ 24,161 (approx.); Share of Goodwill of Sajan—₹ 13,140 (approx.); Share of Profit of Sajan—₹ 2,521 (approx.).