ACCOUNTANCY THEORY NOTES

CBSE – GRADE 12

CHAPTER – II
PARTNERSHIP ACCOUNTING

1. INTRODUCTION TO PARTNERSHIP ACCOUNTING (FUNDAMENTALS)

1. Define partnership.

When two or more persons enter into an agreement to carry on business and share its profit and losses, it is a case of partnership. The Indian partnership Act, 1031, defines Partnership as follows :

"Partnership is the relation between persons and who have agreed to share the profits of a business carried on by all or any of them acting for all.

2. What do you understand by 'partners', 'firm' and 'firms' name ?

The persons who have entered in to a Partnership with one another are individually called 'Partners' and collectively 'a firm' and the name under which the business is carried is called 'the firm's name'.

3. Write any four main features of partnership.

Essential elements or main features of Partnership:

i) Two or more persons: Partnership is an association of two or more persons.

ii) Agreement: The Partnership is established by an agreement either oral or in writing.

iii) Lawful Business: A Partnership formed for the purpose of carrying a business, it must be a legal business.

iv) Profit sharing: Profit of the firm is share by the partners in an agreed ration, if the ratio is not agreed then equally. Profit also includes loss.

4. What is the minimum and maximum number of partners in all partnership?

There should be at least two persons to form a Partnership. The maximum number of Partners in a firm carrying an banking business should not exceed ten and in any other business should not exceed ten and in any other business it should not exceed twenty.

5. What is the status of partnership from an accounting viewpoint?

From an accounting viewpoint, partnership is a separate business entity. From legal viewpoints, however, a Partnership, like a sole proprietorship, is not separate from the owners.

6. What is meant by partnership deed?

Partnership deed is a written agreement containing the terms and conditions agreed by the Partners.

7. State any four contents of a partnership deed.

i) The date of formation and the duration of the Partnership

ii) Name and address of the Partners

iii) Name of the firm.

iv) Interest on Partners capital and drawings

v) Ratio in which profit or losses shall be shared

8. In the absence of a partnership deed, how are mutual relations of partners governed?

In the absence of Partnership deed, mutual relations are governed by the Partnership Act, 1932.

9. Give any two reason in favour of having a partnership deed.

i. In case of any dispute or doubt, Partnership deed is the guiding document.

ii) It can specify the duties and powers of each Partner.

10. State the provision of 'Indian partnership Act 1932' relating to sharing of profits in absence of any provision in the partnership deed.

In the absence of any provision in the Partnership deed, profit or losses are share by the Partners equally.

11. Why is it important to have a partnership deed in writing ?

Partnership deed is important Since it is a document defining relationship of among Partners, thus is a assistance in settlement of disputes, if any and also avoid possible disputes : it is a good evidence in the court.

12. What do you understand by fixed capital of partners?

Partners' capital is said to be fixed when the capital of Partners remain unaltered except in the case where further capital is introduced or capital is withdrawn permanently.

13. What do you understand by fluctuating capital of partners ?

Partners capital is said to be fluctuating when capital alters with every transaction in the capital account. For example, drawing, credit of interest, etc

14. Give two circumstances in which the fixed capital of partners may change.

Two circumstances in which the fixed capital of Partners may change are :

i) When additional capital is introduced by the Partners.

ii) When a part of the capital is permanently withdrawn by the Partners.

15. List the items that may appear on the debit side and credit side of a partner's fluctuating capital account.

On debit side : Drawing, interest on drawing, share of loss, closing credit balance of the capital.

On credit side : Opening credit balance of capital, additional capital introduced, share of profit, interest on capital, salary to a Partner, commission to a Partner.

16. How will you show the following in case the capitals are

i) Fixed and ii) Fluctuating

. a) Additional capital introduced

b) Drawings

c) Withdrawal of capital

d) Interest on capital and

e) Interest on loan by a partners ?

<u>i) In case, capitals are fixed :</u>

a) on credit side of capital (b) on debit side of current A/c (c) on debit side of capital A/c (d) on credit side of current A/c (e) on credit side of loan from partner's A/c

17. If the partners capital accounts are fixed, where will you record the following items :

i) Salary to a partners

ii) Drawing by a partners

iii) Interest on capital and

iv) Share of profit earned by a partner ?

ANSWER:

i) Credit side of Partner's current A/c
ii) Debit side of Partner's current A/c
iii) Credit side of Partners current A/c
iv) Credit side of Partners current A/c

18. How would you calculate interest on drawings of equal amounts drawn on the Last day of every month ?

When a partners draws a fixed amount at the beginning of each month, interest on total drawing would be on the amount withdraw for 6.5 months at the agreed rate of interest per annum. Apply the following formula.

Interest on drawing = total drawing x $\frac{Rate}{100} \times \frac{6.5}{12}$

19. How would you calculate interest on drawing of equal amounts drawn on the last day of every month ?

When drawing of fixed amounts are made at regular monthly intervals on the day of every month, Interest would be charged on the amount withdrawn at the agreed rate of interest for 5.5 months. Apply the following formula. :

Interest on drawing = Total drawing x $\frac{Rate}{100} \times \frac{5.5}{12}$

20. Ramesh, a partner in the firm has advanced a loan of a Rs. 1,00,000 to the firm and has demanded on interest @ 9% per annum. The partnership deed is silent on the matter. How will you deal with it ?

Since the Partnership deed is silent on payment of interest, the provisions of the Partnership Act, 1932 will apply. Accordingly, Ramesh is entitled to interest @ 6% p.a.

21. The partnership deed provides that Anjali, the partner will get Rs. 10,000 per month as salary. But, the remaining partners object to it. How will this matter be resolved?

No, he is not entitled to the salary because it is not so, Provided in the Partnership deed and according to the Partnership act, 1932 if the Partnership deed does not provided for payment of salary to Partners, he will not be entitled to it.

22. Distinction between Profit and loss and profit and loss appropriation account :

	Profit & Loss A/c		Profit & Loss Appropriation A/c
i)	Profit and Loss A/c is prepared to ascertain net profit or net loss of the business for an accounting year.	i)	In case of partnership firms, profit and loss appropriation A/c is prepared to appropriate / distribute the profit of the year among partners.
ii)	It is prepared by all the business firms.	ii)	Only partnership firms and companies prepare profit and loss appropriation A/c

SHORT HINTS

- Partnership deed : It is a document which contains the terms and conditions of Partnership agreement either oral or written.
- Profit and Loss Appropriation Account : After the preparation of Profit and Loss account, entries pertaining to Interest on Capital, Drawings , Salaries among the partners are shown separately in a newly opened Profit and Loss Appropriation Account.
- Rules applicable in the absence of Partnership Deed :

  a) Profit sharing ratio will be equal

  b) No Interest on Capital and Drawings

  c) No Remuneration or Salary to the partners.

  d) Interest on Loan advanced by the partner @6% p.a.
- Fixed and Fluctuating Capital Accounts :

  When the Capitals are fixed, the Current account of the partners will be maintained.

2. RECONSTITUTION OF PARTNERSHIP FIRM

ADMISSION OF PARTNER

1. State the two financial rights acquired by a new Partner?

New partner is admitted to the partnership if it provided in the partnership deed or all the existing partners agree to admit the new partner. Section 31 of the Indian Partnership Act Provides that a person may be admitted as a new partner into a partnership firm with the consent of all the Partners.

2. Give the name of the compensation which is paid by a new Partner to sacrificing Partners for sacrificing their share of profits.

. When a partner joins the firm, he gets the following two rights along with others :

i) Right to share future profit of the firm and

ii) Right to share the assets of the firm.

3. Enumeration the matters that need adjustment at the time of admission of a new Partner.

The matter that needs adjustment of the time of admission of a new partner are:

i) Adjustment in profit sharing ratio and adjustment of capital
ii) Adjustment for goodwill
iii) Adjustment of Profit / Loss arising from the Revolution of Assets and Reassessment of Liabilities.
iv) Adjustment of accumulated profits, reserves and losses.

4. Give two circumstances in which sacrificing Ratio may be applied.

Circumstances in which sacrificing Ratio may be applied are:

i) At the time of admission of a new partner for distributing goodwill brought in by the new partner.

ii) For adjustment goodwill in case of change in Profit - sharing ratio of existing partners.

5. Why is it necessary to revalue assets and reassess liabilities of a firm in case of admission of a new partner?

The assets are revalued and liabilities of a firm are reassess, at the time of admission of a partner because the new partner should; neither benefit nor suffer because change in the value of assets and liabilities as on the date of admission.

6. What are the accumulated profit and accumulated losses?

The profit accumulated over the years and have not been credited to partners' capital A/c are known as accumulated Profit or undistributed profit, e.g. the General Reserve, Profit and Loss A/c (credit balance).

The losses which have not yet been written off to the debit of Partners' Capital A/c are known as accumulated Losses, e.g. the Profit and Loss A/c appearing on the assets side of Balance Sheet, etc.

7. Explain the treatment of goodwill in the books of a firm on the admission of a new Partner when goodwill already appears in the Balance sheet at its full value and the new partner brings his share of good will in cash.

By following Accounting Standard – 10 (AS-10), the existing goodwill (i.e. goodwill appearing in the Balance Sheet) is written off to the old partners Capital a/c in their old profit sharing ratio.

Old partners' capital A/c Dr.	XXX	
To Goodwill A/c	XXX	[in old Ratio]
[Being the existing g/w written off in the old ratio.]		

8. Under what circumstances the premium for goodwill paid by the incoming Partner will not recorded in the books of Accounts ?

When the premium for goodwill is paid by the incoming partner privately, it is not recorded in the books of A/c as it is as a matter outside the business.

SHORT HINTS

1. Goodwill is the monetary value of business reputation. It is an intangible asset.
2. Goodwill may be of two types:
   a. Purchased goodwill
   b. Non-purchased goodwill
3. When existing firm faces problem of limited financial resources and man power then one new additional partner enters into firm.
4. There are three methods of valuation of goodwill:
   a. Average Profit Method
   b. Super Profit method
   c. Capitalisation Method
5. When new partner is admitted into existing partnership then existing partners have to sacrifice in favour of new partner, it is called sacrificing ratio.
6. Share of goodwill of new partner will be credited to sacrificing partners into their sacrificing ratio.
7. At the admission of new partner Profit & Loss on revaluation of assets and liabilities and balances of accumulated profits & losses will be distributed among old partners (only) in old ratio.

RETIREMENT OF PARTNER

1. What is meant by retirement of a partner?

Retirement of a partner is one of the modes of reconstituting the firm in which old partnership comes to an end and a new partner among the continuing (remaining) partners (i.e., partners other than the outgoing partner) comes into existence.

2. 'How can a partner retire from the firm?

A partner may retire from the firm;

i) In accordance with the terms of agreement; or

ii) With the consent of all other partners; or

iii) Where the partnership is at will, by giving a notice in writing to all the partners of his intention to retire.

3. *What do you understand by 'Gaining Ratio*?*

Gaining Ratio means the ratio by which the share in profit stands increased. It is computed by deducting old ratio from the new ratio.

4. *What do you understand by 'Gaining Partner'?*

Gaining Partner is a partner whose share in profit stands increased as a result of change in partnership.

5. *Give two circumstances in which gaining ratio is computed.*

Gaining Ratio is computed in the following circumstances:

(i) When a partner retires or dies.

(ii) When there is a change in profit-sharing ratio.

6. Why is it necessary to revalue assets and reassess liabilities at the time of retirement of a partner?

At the time of retirement or death of a partner, assets are revalued and liabilities are reassessed so that the profit or loss arising on account of such revaluation upto the date of retirement or death of a partner may be ascertained and adjusted in all partners' capital accounts in their old profit-sharing ratio.

7. Why is it necessary to distribute Reserves Accumulated, Profits and Losses at the time of retirement or death of a partner?

Reserves, accumulated profits and losses existing in the books of account as on the date of retirement or death are transferred to the Capital Accounts (or Current Accounts) of all the partners (including outgoing or deceased partner) in their old profit-sharing ratio so that the due share of an outgoing partner in reserves, accumulated profits/losses gets adjusted in his Capital or Current Account.

8. What are the adjustments required on the retirement or death of a partner?

At the time of the retirement or death of a partner, adjustments are made for the following:

(i) Adjustment in regard to goodwill.
(ii) Adjustment in regard to revaluation of assets and reassessment of liabilities.
(iii) Adjustment in regard to undistributed profits.
(iii) Adjustment in regard to the Joint Life Policy and individual policies.

9. X wants to retire from the firm. The profit on revaluation of assets on the date of retirement is Rs. 10,000. X is of the view that it be distributed among all the partners in their profit-sharing ratio whereas Y and Z are of the view that this profit be divided between Y and Z in new profit-sharing ratio. Who is correct in this case?

X is correct because according to the Partnership Act a retiring partner is entitled to share the profit up to the date of his retirement. Since the profit on revaluation arises before a partner retires, he is entitled to the profit.

10. How is goodwill adjusted in the books of a firm -when a partner retires from partnership?

When a partner retires (or dies), his share of profit is taken over by the remaining partners. The remaining partners then compensate the retiring or deceased partner in the form of goodwill in their gaining ratio. The following entry is recorded for this purpose:

Remaining Partners' Capital A/c Dr. XXX [Gaining Ratio]
To Retiring/Deceased Partner's Capital A/c XXX [With his share of goodwill]

If goodwill (or Premium) account already appears in the old Balance Sheet, it should be written off by recording the following entry :

All Partners' Capital/Current A/c Dr. XXX [Old Ratio]
To Goodwill (or Premium) A/c XXX

SHORT HINTS

1. An existing partner may wish to withdraw from a firm for various reasons.
2. The amount due to a retiring partner will be the total of :-
   a. his capital in the firm
   b. His share in firm's accumulated profits and losses.
   c. His share of profit or loss on revaluation of assets and liabilities
   d. ;his share of profits till the date of retirement
   e. His remuneration and interest on capital.
   f. His share in firm's goodwill.
3. The ratio in which the continuing (remaining) partners have acquired the share from the outgoing partner is called gaining ratio.
4. Share of goodwill of outgoing partner will be debited to gaining partners in their gaining ratio.
5. At the retirement of a partner Profit & Loss on Revaluation of Assets and liabilities and balances of accumulated Profits and losses will be distributed among all partners (including outgoing partner) in their old ratio.
6. The outstanding balance of outgoing partner's capital A/C may be settled by fully or Partly payment and (or) transferring into his loan account.

DEATH OF PARTNER

- Gaining Ratio: When the partner retires or dies, his share of profit is taken over by the remaining partners.
- Gaining ratio is applied for the purpose of calculating Goodwill to be paid off to the deceased partner.

❖ The deceased partner s share of profit till the date of death will be calculated by preparing Profit and Loss Suspense account on the date of Death.

1. What adjustments are required to be made at the time of retirement of a partner?

The following adjustments are made at the time of retirement of a partner:

- Calculations of New Profit Sharing Ratio and Gaining Ratio of remaining partners.
- Distribution of Reserves and Undistributed Profits/Losses.
- Revaluation of Assets and Liabilities.
- Treatment of Goodwill.
- Calculation of amount payable to retiring partner.
- Adjustment of Capital.

2. Discuss the accounting treatment of Goodwill at the time of retirement of a partner.

The accounting treatment of goodwill at the time of retirement is as follows:

1) Calculate retiring partner's share of Goodwill.
2) Calculate gaining ratio of remaining partners.

Pass an adjusting entry in the following manner:

Remaining Partner's Capital A/c Dr	**XXX**
To Retiring Partner's Capital A/c	**XXX**

<u>Condition</u>: No goodwill should already appear in the books. In case goodwill already appears in the books it should be written off in old ratio.

3. Difference between sacrificing ratio and gaining ratio

Sacrificing Ratio	Gaining Ratio
1. Sacrificing Ratio is a ratio in which the old partners have agreed to surrender their share of profit in favour of new partner.	1. Gaining Ratio is a ratio in which remaining partners' gain the retiring partner's share.
2. The main purpose to calculate the sacrificing ratio is to ascertain the compensation to be paid by incoming partner to the sacrificing partner's in the form of goodwill.	2. The main purpose to calculate the gaining ratio is to find out the compensation to be paid by the gaining partner's to the retiring partner.
3. Sacrificing Ratio is calculated at the time of admission of a new partner.	3. Gaining Ratio is calculated at the time of retirement of a partner.
4. Sacrificing Ratio = Old Ratio – New Ratio	4. Gaining Ratio = New Ratio – Old Ratio

DISSOLUTION OF PARTNERSHIP FIRM

1. Distinguish between Dissolution of Partnership and Dissolution of Partnership firm

Dissolution of Partnership	Dissolution of partnership firm
a)The Partnership is dissolved but the business continues. The Business is not terminated	a)The firm winds up the business.
b)Assets and liabilities are revalued through revaluation account and the Balance sheet is prepared	b)Assets are sold and the liabilities are paid off through Realisation account.
c) The Books of accounts are not closed as the business is not terminated.	d) The Books of accounts are closed.

2. State the provisions of Section 48 of the Partnership Act 1932 regarding settlement of Accounts during the Dissolution of Partnership firm.

According to section 48—

a)Losses including the deficiencies of Capitals are to be paid---

i) First out of profits

ii) Next out of Capitals of the partners

iii) Lastly if required, by the partners individually in their profit sharing ratio(as their liability is unlimited)

b)The Assets of the firm and the amount contributed by the partners to make up the deficiency of capital shall be applied for –

i) First to pay the debts of the firm to the third parties.

ii) Next, Partners Loan(Partner has advanced to the firm)

iii) Partners capitals

iv) The residue, if any shall be distributed among the partners in their profit sharing ratio.

3. Distinguish between Realisation account and Revaluation account

Realisation Account	Revaluation Account
a) It is prepared in the case of Dissolution of Partnership firm.	a)It is prepared in the case of Dissolution of Partnership.
b)This account is prepared to realise the assets & pay off the liabilities .	b) This Account is prepared to revalue the assets and liabilities during Admission, Retirement and Death of the partner.

****** SHORT HINTS *******

- **Dissolution:** Dissolution of the firm is different from Dissolution of Partnership.
- **Realisation account :** It is prepared to realize the various assets and pay off the liabilities.
- **Closure of the Books of Accounts :** When the firm is dissolved, finally all the books of accounts are closed through Bank Account.

BOARD EXAM THEORY QUESTIONS
(OLD QUESTIONS)

1. BASIC CONCEPTS:

1. The partnership deed is silent on payment of salary to partners. Anita, a partner, claimed that, since she managed the business, she should get a monthly salary of Rs 10,000. Is she entitled for the salary? Give reason. (Compartment 2014)

No, Anita is not entitled for the salary. Since, the partnership deed is silent on the payment of salary to partners, in that case provisions of Partnership Act will be followed, which prohibit payment of remuneration of any kind to the partners.

2. State the provisions of Indian Partnership Act, 1932 regarding the payment of remuneration to a partner for the services rendered. (Delhi 2012)

Ans. In the absence of partnership deed, a partner is not entitled to get any remuneration from the firm.

3. What share of profit would a 'sleeping partner', who has contributed 75% of the total capital, get in the absence of a deed? (Delhi 2011; hots)

Ans. In the absence of partnership deed, sleeping partner will get equal share of profit, no matter how much share of total capital he has contributed.

4. Is a sleeping partner liable for the acts of other partners? (Delhi 2011)

Ans. Yes, a sleeping partner is also liable for the acts of other partners.

5. Would a 'charitable dispensary' run by 8 members be deemed a partnership firm? Give reason in support of your answer. (All India 2011)

Ans. No, a 'charitable dispensary' run by 8 members cannot be deemed to be a partnership firm because:
(i) For partnership, there must be a business.
(ii) There must be sharing of profits among the partners from such business.
In this case, there is no business and no sharing of profits.

6.What is meant by a partnership deed? (Delhi 2011,2010; All India 2010)

Ans. Partnership deed is a document which contains the terms and conditions of partnership agreement.

7.Why should a firm have a partnership deed? (All India 2011; Delhi 2009)

Ans. A firm should have a partnership deed because:
(i) It regulates the rights, duties and liabilities of the partners.
(ii) It avoids disputes in future by acting as a proof.

8.What is meant by 'unlimited liability of a partner'? (Delhi 2010)

Ans. Unlimited liability of a partner means that each partner is liable jointly and also severally with all the other partners to the third party for all the acts of the firm done, while he is a partner. His private assets can also be used for paying off the firm's debts.

9.A, B and C decided that interest on capitals will be provided to each partner @ 5% per annum, but after one year C wants that no interest on capital is to be provided to any partner. State how 'C' can do this? (Delhi 2010)

Ans. C can do this only when all partners agree to it or if there is no partnership deed.

10. State the provisions of Indian Partnership Act, 1932 regarding interest on partners' capital and interest on partners' loan when there is no partnership deed.(All-India-2010)

Ans. According to Indian Partnership Act, 1932, in the absence of partnership deed no interest on' partners' capital is allowed and interest on partners' loan will be allowed @ 6% per annum.

11. Can a partner be exempted from sharing the losses in a firm? If yes, under what circumstances? (All India 2009; Foreign 2009)

Ans. As per Indian Partnership Act, 1932, if a partner is a minor then he is exempted from sharing the losses of a firm.

12. State two elements of the partnership deed. (All India 2009)

Ans. Two elements of the partnership deed are:

(i) Amount of capital contributed by each partner.
(ii) Ratio in which profits or losses are to be shared.

13. Do all firms need a deed and registration? (Foreign 2009)
Ans. No, it is not compulsory to have a deed and registration.

14. A and B are partners in a firm without a partnership deed. A is an active partner and claims a salary of Rs 18,000 per month. State with reasons whether the claim is valid or not. (Delhi 2008)
Ans. According to Indian Partnership Act, 1932, no salary is allowed to partners in the absence of partnership deed. So, the claim of A for salary of 7 18,000 per month is not valid.

15. Suresh and Ramesh are partners in a firm with capitals of Rs. 3,00,000 and Rs. 4,00,000 respectively. They do not have a partnership deed. Ramesh wants to share the profits in the ratio of capitals. State with reason whether the claim is valid. (Delhi 2008; All India 2008)
Ans. According to Indian Partnership Act, 1932, in the absence of partnership deed profits are shared equally among the partners. So, the claim of Ramesh to share the profits in the ratio of capitals is not valid.

16.R, S and T entered into a partnership for manufacturing and distributing educational CDs on 1st April, 2006. R looked after the business development, S content development and T financed the project. At the end of the year (31st March, 2007), R wanted a salary of Rs. 5,000 per month for the additional work he did. The other partners were not inclined to this. How would you reduce this within the ambit of the Indian Partnership Act, 1932? **Ans.** According to Indian Partnership Act, 1932, 'No salary for the additional work will be allowed to R in the absence of partnership deed'.

17. A partnership deed provides for the payment of interest on capital but there was a loss instead of profit during the year 2010-2011. At what rate will the interest on capital be allowed? (All India 2012)
Ans. No interest on capital will be allowed as there was loss in the firm.

18. Give the average period in months for charging interest on drawings for the same amount withdrawn at the beginning of each quarter. (All India 2011)
Ans. The average period for charging interest on drawings for the same amount withdrawn at the beginning of each quarter is 7 1/2 months which can be computed as follows = 12+3 /2=15/2=7.5
Interest on Drawings =Total Drawings x Rate/100 x 7 1/2 /12

19. How is interest on drawings calculated, if the drawings are made at regular intervals, as on the first day of each month? (Delhi 2009)
Ans. If the drawings are made regularly on the first day of each month, the interest on drawings will be calculated for 6-^ months which can be computed as follows:
= 12+1 /2 = 13/2 =6.5

20. Name the accounts which are maintained for the partners when capitals of the partners are fixed. (Compartment 2014)
Ans. When capitals of the partners are fixed, following accounts are required to be maintained:
(i) Partner's fixed capital accounts (ii) Partner's current capital accounts.

21. Distinguish between fixed and fluctuating capital accounts.
(Compartment 2014) (Delhi; All India 2011)
Ans. Difference between fixed and fluctuating capital accounts

S.No.	Fixed capital account	Fluctuating capital account
(i)	Each partner has two accounts i.e. capital account and current account.	Each partner has only one account i.e. capital account.
(ii)	Capital account always shows a credit balance.	Sometimes capital account may show a debit balance due to huge drawings or losses.

22. When the partners' capitals are fixed, where the drawings made by a partner will be recorded? (Delhi; All India 2013)

Ans. When the partners' capitals are fixed, the drawings made by a partner will be recorded in partners' current account (debit side).

23. State the conditions under which the capital balances may change under the system of fixed capital account.(All India 2009,2008; Delhi 2009 c)

Ans. The conditions under which the capital balances may change under the system of a fixed capital ' accounts are:

(i) When additional capital is introduced.

(ii) When capital is withdrawn.

24. The firm XYZ earned a profit of Rs. 2,75,000 during the year ending on 31st March, 2009. 10% of this profit was to be transferred to general reserve. Pass necessary journal entry for the same. (Delhi 2010c)

Ans. **JOURNAL**

Date	Particulars		LF	Amt (Dr)	Amt (Cr)
	Profit and Loss Appropriation A/c	Dr		27,500	
	To General Reserve A/c				27,500
	(Being 10% of profit transferred to general reserve account)				

25. How does the nature of business affect the value of goodwill of a firm? (All India 2011)

Ans. The firm that produces high value products and has stabilised demand, will be able to earn more profit and more goodwill.

26. What are super profits? (Delhi 2011c)

Ans. Super profit is the excess of actual average profit over the normal profit.

i.e. Super Profit = Actual Profit – Normal Profit

27. How does the factor 'quality of product' affect the goodwill of a firm? (Delhi 2010)

Ans. If the firm enjoys good reputation for its product quality, there will be higher sales and the value of its goodwill will increase.

28. How does the factor 'efficiency of management' affect the goodwill of a firm? (All India 2010)

Ans. When the management of a firm is capable and competent, the firm will earn higher profits therefore the 'efficiency of management' surely will affect or increase the goodwill.

29. How does the factor location affect the goodwill of a firm? (Delhi 2010)

Ans. The value of business will be more, if it is located in a convenient or prominent locality.

30. Define goodwill? (All India 2008)

Ans. Goodwill means the good name or reputation earned by a businessman through his hard work and honesty. This helps the business to earn more profit.

31. Explain any two methods for valuation of goodwill. (Delhi 2008C)
Ans. The two methods for valuation of goodwill are as follows

(i) Average Profit Method of Valuation of Goodwill Under average profit method, goodwill is valued on the basis of simple average or weighted average profits of the firm, multiplied by the number of years' of purchase.
Average Profit =Total Profit (after adjustments) / Number of Years
Goodwill = Average Profit x Number of Years' of Purchase.

(ii) **Valuation of Goodwill by Capitalisation of Super Profit Method** Under this method, goodwill is the capitalised value of super profits. For calculating goodwill, the following steps are followed
(a) Ascertain the average profits based on the past few years' performance.
(b) Calculate normal profit on capital employed by applying normal rate of return.
(c) Calculate super profits by deducting normal profit from average profits.

Goodwill = Super Profit x 100 / Normal Rate of Return

2. RECONSTITUTION OF PARTNERSHIP

1. Give the meaning of 'reconstitution of a partnership firm'. (AllIndia; Delhi2014)
Ans Change in the existing agreement of partnership is considered as reconstitution of a partnership firm. Due to this, existing agreement comes to an end and the new agreement comes into existence and the firm continues.

2. State the ratio in which the partners share the accumulated profits when there is a change in the profit sharing ratio amongst existing partners. (All India 2013)
Ans. Accumulated profits are distributed in old profit sharing ratio, at the time of change in profit sharing ratio amongst the existing partners.

3. State the ratio in which the partners share profits or losses on revaluation of assets and liabilities, when there is a change in profit sharing ratio amongst existing partners. (Delhi 2013)
Ans. Revaluation profits or losses are distributed in old profit sharing ratio, at the time of change in profit sharing ratio amongst the existing partners.

4. State any two occasions on which a firm can be reconstituted.
(Delhi 2012,2008; All India 2011)
Ans. A firm can be reconstituted on the following occasions (Any two)
(i) When there is a change in the profit sharing ratio of existing partners.
(ii) When a new partner is admitted.
(iii) When an existing partner retires.
(iv) When an existing partner dies.

5. Why are 'reserves and surplus' distributed at the time of reconstitution of the firm? (Delhi, All India 2010)
Ans. At the time of reconstitution of the firm, reserves and surplus should be transferred to old partners' capital/current accounts in their old profit sharing ratio because the new partner is not entitled to any share in such undistributed profits or losses as these are earned/accrued by the old partners.

6. State the right acquired by a newly admitted partner. (All India 2014,2009; Delhi 2008)

Ans. The right acquired by a newly admitted partner is (Any one):
(i) Share in the future profits of the firm.
(ii) Share in the assets of the firm.

7. What is meant by sacrificing ratio? (Compartment 2014)
or
State the meaning of sacrificing ratio. (All India 2011)

Ans. It is the ratio in whicfi the old partners have agreed to sacrifice their share of profits in favour of new or incoming partner.
Sacrificing Ratio = Old Ratio – New Ratio

8. List any two items that need adjustments in the books of accounts of a firm at the time of admission of a partner. (Compartment 2014)

Ans. Two items that need adjustment at the time of admission are:
(i) Goodwill of the firm.
(ii) Reserves and accumulated profits/losses.

9. X and Y are partners. Y wants to admit his son K into business. Can K become the partner of the firm? Give reason. (Compartment 2014)

Ans. K can be admitted as a partner with the consent of X, and that to if he is a major.

10. State any one purpose for admitting a new partner in a firm. (All India 2012)

Ans. A new partner may be admitted for the following purpose (Any one)
(i) For procuring additional capital.
(ii) For acquiring additional managerial skills.

11. How is a new partner admitted to a firm?

Ans. A new partner is admitted to a firm with the consent of all the existing partners.

12. State the other rights which a newly admitted partner acquires besides the right to share the profits of the firm. (All India 2009)

Ans. The rights that a newly admitted partner acquires besides the right to share the profits of the firm are: (Any two)
(i) Right to share in the assets of the firm.
(ii) Right to take part in the business.
(iii) Right to inspect the books of account.

13. Under what circumstances will the premium for goodwill paid by the incoming partner not be recorded in the books of accounts. (Compartment 2014)

Ans. When the incoming partner pays his share of goodwill privately to the sacrificing partners, outside the business, then no entry is passed in the books of the firm.

14. State the need for treatment of goodwill on admission of a partner. (Delhi 2010)

Ans. When a new partner is admitted, his share in future profits of the firm is equal to the sacrifice of profit by an existing partner or partners of the firm. The amount he pays to compensate this sacrifice, is in the form of goodwill. Therefore, it is important to treat goodwill at the time of admission of a partner.

15. Why are assets and liabilities revalued at the time of admission of a partner? (Compartment 2014)

Ans. Assets and liabilities are revalued at the time of admission of a partner, so that profit or loss arising on account of revaluation, may be adjusted among old partners in their old profit sharing ratio, since it belongs to them.

16. State any two reasons for the preparation of revaluation account on the admission of a partner. (All India 2008)

Ans. At the time of admitting a new partner, revaluation account is prepared for the below stated reasons:
(i) An incoming partner will not likely to suffer any loss relating to the period prior to his admission.
(ii) Old partners will not like to share the gain relating to the period prior to his admission.

17. What is a revaluation account? (All India 2008)

Ans. The account which is prepared to record changes in the value of assets and liabilities at the time of admission, retirement, death and change in profit sharing ratio is called revaluation account.

18. X, Y and Z are partners sharing profits in the ratio of 1/2, 2/5 and 1/10. Find the new ratio of remaining partners, if Z retires. (Delhi 2014)

Ans. Old ratio of X: V : Z = 1/2: 2/5: 1/10 or 5/10: 4/10: 1/10 or 5:4:1
Z retires, after striking of the retiring partner's ratio, remaining ratio will be new profit sharing ratio, i.e. 5 :4.

19. Why heirs of a retiring/deceased partner are entitled to a share of goodwill of the firm? (Delhi 2014)

Ans. The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm at the time when he was a partner.

20. X, Y and Z were partners sharing profits in the ratio of 1/2, 3/10, and 1/5. X retired from the firm. Calculate the gaining ratio of the remaining partners. (All India 2014)

Ans. Old ratio of X:Y:Z =1/2: 3/10 :1/5 or 5/10 : 3/10 : 2/10= 5:3:2

X retired, after striking of the retiring partner's ratio, remaining ratio will be new profit sharing ratio,i.e. 3:2
New profit sharing ratio = Y : Z = 3:2
Gaining Ratio = New Ratio – Old Ratio
Y = 3/5-3/10 = 6-3/10=3/10;   Z=2/5-2/10 =4-2/10 =2/10
Gaining ratio = 3:2

21. Ram, Mohan and Sohan were partners in a firm sharing profits in the ratio of 4:3:2. Mohan retired. His share was taken over equally by Ram and Sohan. In which ratio will the profit or loss on revaluation of assets and liabilities on the retirement of Mohan be transferred to the capital accounts of the partners? (Delhi 2010C)

Ans. The profit or loss on revaluation of assets and liabilities on the retirement of Mohan will be transferred to the capital accounts of the partners in their old ratio, i.e. 4:3:2.

22. How can a partner retire from a firm? (Foreign 2009)

Ans. A partner can retire

(i) With the consent of all the partners.
(ii) By giving notice in writing, in case of partnership at will.

23. A, B and C were partners in a firm sharing profits in the ratio of 8 : 4 :3. B retires and his share is taken up equally by A and C. Find the new profit sharing ratio. (Delhi 2009)

24. Define gaining ratio. (Delhi 2008)

Ans. The ratio in which the continuing partners have acquired the share from the retiring partner's share of the profit is termed as gaining ratio.

25. A, B and C are partners sharing profits in the ratio of 3 : 2 :1. B retires and new profit sharing ratio between A and C is 3 : 1. State the gaining ratio. (All India 2008)

Ans. Old ratio among A, B and C = 3 : 2 : 1

New profit sharing ratio between A and C = 3 : 1

Gaining Ratio = New Ratio – Old Ratio

$$\text{A gains} = \frac{3}{4} - \frac{3}{6} = \frac{9-6}{12} = \frac{3}{12},$$

$$\text{C gains} = \frac{1}{4} - \frac{1}{6} = \frac{3-2}{12} = \frac{1}{12}$$

Gaining ratio of A and C = 3:1

26. P, Q and R were partners in a firm sharing profits in the ratio of 5 : 4 : 3 respectively. Their capitals were Rs. 50,000, Rs. 40,000 and Rs. 30,000 respectively. State the ratio in which the goodwill of the firm, amounting to Rs. 6,00,000, will be adjusted in the capital accounts of the remaining partners on the retirement of Q. (Compartment 2014)

Ans. The goodwill will be adjusted in the gaining ratio of the continuing partners.

27.. Give the journal entry to distribute 'workmen compensation reserve' of Rs. 60,000 at the time of retirement of Sajjan, when there is no claim against it. The firm has three partners Rajat, Sajjan and Kavita. (Delhi 2013)

Ans. **JOURNAL**

Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Workmen Compensation Reserve A/c Dr		60,000	
	To Rajat's Capital A/c			20,000
	To Sajjan's Capital A/c			20,000
	To Kavita's Capital A/c			20,000
	(Being workmen compensation reserve distributed to old partners in old ratio)			

NOTE Since, the profit sharing ratio is not given, it is distributed equally.

28. Give the journal entry to distribute workmen compensation reserve of Rs. 70,000 at the time of retirement of Neeti when there is a claim of Rs. 25,000 against it. The firm has three partners

Raveena, Neeti and Rajat. (All India 2013)

Ans. JOURNAL

Date	Particulars		LF	Amt (Dr)	Amt (Dr)
	Workmen Compensation Reserve A/c	Dr		70,000	
	To Liability for Workmen Compensation A/c				25,000
	To Raveena's Capital A/c				15,000
	To Neeti's Capital A/c				15,000
	To Rajat's Capital A/c				15,000
	(Being workmen compensation reserve distributed to old partners in old ratio)				

NOTE Since, the profit sharing ratio is not given, it is distributed equally.

29. For which share of goodwill a partner is entitled at the time of his retirement? (Delhi 2012)

Ans. At the time of retirement, a partner is entitled to get an amount equal to his share out of firm's goodwill.

30. P, Q and R were partners in a firm sharing profits in the ratio of 5 : 4 :3. Their capitals were Rs. 40,000, Rs. 50,000 and Rs.1,00,000 respectively. State the ratio in which the goodwill of the firm amounting to Rs.1,20,000 will be adjusted on the retirement Of R. (All India 2010,2008C)

Ans. R's share of goodwill, i.e. Rs. 30,000 (1,20,000 x 3/12) will be contributed by P and Q in their gaining ratio, i.e. 5 : 4.

31. A, T and R were partners in a firm sharing profits in the ratio of 5 : 6 : 7 respectively. Their capitals were Rs. 5,00,000; Rs. 6,00,000 and Rs. 7,00,000 respectively. State the ratio in which the goodwill of the firm amounting to Rs. 16,00,000 will be adjusted in the capital accounts of A and T in case of R's death. (Compartment 2014)

Ans. Goodwill of the firm, at the time of R's death, will be adjusted among A and T in gaining ratio.

32. At what rate is interest payable on the amount remaining unpaid to the executor of deceased partner? (All India 2013; hots)

Ans. Interest is payable @ 6% per annum on the amount remaining unpaid to the executor of deceased partner.

Ans. JOURNAL

Date	Particulars		LF	Amt (Dr)	Amt (Cr)
	A's Capital A/c	Dr		4,000	
	C's Capital A/c	Dr		2,000	
	To B's Capital A/c				6,000
	(Being retiring partner's amount of goodwill adjusted)				

Working Note

Firm's goodwill = ₹ 18,000

B's share of goodwill = $18{,}000 \times \frac{3}{9}$ = ₹ 6,000, to be contributed by A and C in their gaining ratio, i.e. 4 : 2 or 2 : 1.

33. Name the account which is opened to credit the share of profit of the deceased partner, till the time of his death to his capital account. (Delhi 2013; HOTS)

Ans. 'Profit and loss suspense account' is opened, to credit the share of profit of the deceased partner.

34. State any two deductions that may have to be made from the amount payable to the legal representative of a deceased partner. (All India 2009)

Ans. (i) Deceased partner's share of loss on revaluation of assets and liabilities.
(ii) Drawings made by deceased partner till the date of death.

35.Distinguish between 'dissolution of partnership' and 'dissolution of partnership firm' on the basis of Court's intervention. (All India 2014)

Ans.

Difference between dissolution of firm and dissolution of partnership are:

Basis	Dissolution of firm	Dissolution of partnership
Court's intervention	It can be either voluntarily by the partners or compulsorily by the order of the court.	It is always voluntarily.

36.Distinguish between 'dissolution of partnership' and 'dissolution of partnership firm' on the basis of closure of books. (Delhi 2014)

Ans.

Difference between dissolution of firm and dissolution of partnership are:

Basis	Dissolution of firm	Dissolution of partnership
Closure of books	Books of accounts of the firm are closed.	Books of accounts of the firm need not be closed.

37.Identify a situation, under which court may order for dissolution of a partnership firm. (Compartment 2014)

Ans. A court may order for dissolution of a partnership firm on insanity of a partner.

38. Identify a situation for compulsory dissolution of a partnership firm.(Compartment 2014)

Ans. A firm is compulsorily dissolved on the insolvency of all the partners.

39. Name the asset that is not transferred to the debit side of realisation account, but brings certain amount of cash against its disposal at the time of dissolution of the firm. (Compartment 2014)

Ans. Unrecorded asset.

40. Name the liability which is not shown in the balance sheet, but paid at the time of dissolution of the firm. (Compartment 2014)

Ans. Unrecorded liability.

41. When an asset is taken over by a partner, why is his capital account debited? (Delhi 2012)

Ans. When an asset is taken over by a partner, his capital account is debited because the value of the asset

42.When a liability is to be discharged by a partner, why is his capital account credited? (All india 2011)

Ans. When a liability is to be discharged by a partner, his capital account is credited because the partner's claim is increased over the firm by the amount of liability discharged by him, thus his capital account is increased.

43. In case of dissolution of a firm, which liabilities are to be paid first? (Delhi 2011c)

Ans. The debts of the firm to the third parties are to be paid first.

44. In case of dissolution of a firm, which item on the liabilities side are to be paid last? (Delhi 2011)

Ans. In case of dissolution of firm, partner's capital are paid at last after all external liabilities are paid and all profit and losses are adjusted in capital account.

45. A and B are partners in a firm sharing profits in the ratio of 3 : 2. Mrs A has given a loan of Rs 20,000 to the firm and the firm also obtained a loan of Rs 10,000 from B. The firm was dissolved and its assets were realised for Rs 25,000. State the order of payment of Mrs A's loan and B's loan with reason, if there were no creditor of the firm. (Delhi 2010 c)

Ans. According to Section 48 of The Indian Partnership Act, 1932, first of all the payment of Rs 20,000 will be made for Mrs A's loan as she is an outsider, then remaining Rs 5,000 will be paid to B against his loan of Rs 10,000.