III PARTNERSHIP ACCOUNTS – ADMISSION OF PARTNERS – RETIREMENT OF A PARTNER – DEATH OF A PARTNER

Partnership: Meaning

Partnership is the relation which subsists between two or more persons carrying on business in common with a view of profit. Persons who have entered into partnership with one another are individually called as partners and collectively "a firm".

Definition

According to Sec.4 of the Indian partnership Act 1932, partnership is defined as "the relationship between person who have agreed to share the profits of a business carried on by all or any of them acting for all"

Partnership Agreement

Partnership is the result of agreement between two or more persons to carry on a business jointly for the benefit of all. The document that contains the agreement among partners is known as partnership Deed.

1. Name of the firm and nature of business
2. Name and address of partners
3. The duration if any of partnership firm
4. The total capital of the firm and share of each partner
5. The profit-sharing ratio
6. Whether the capitals are to be fixed or fluctuating
7. Rate of interest on advances
8. The amount which each partner can draw for personal purpose and interest on drawings if any
9. Salary payable to partner if any
10. The period after which the final account is to be prepared
11. Agreement relating to admission of new partner, retirement, insolvency etc., of partners
12. The ascertainment of goodwill at the time of admission, death and retirement of partners
13. Whether decision in the case of Garner Vs. Murray is apply in the case of insolvency of partners.

ADMISSION OF PARTNER

With the consent of existing partners, new partner can be admitted into partnership firm. At the time of admission of new partner, the following accounting adjustments are necessary.

i) Revalue the assets and liabilities of partnership firm

ii) Adjustment of reserves and accumulated profits

iii) Adjustment of capital

iv) Adjustment of goodwill

v) Adjustment in profit sharing ratio

Sacrificing Ratio:

At the time of admission of a new partner, old partners have to surrender some of their old share in favour of the new partner. The surrendered shares of old partners formed a ratio and it is called as sacrificing ratio.

Sacrificing ration = Old Ratio – New Ratio

Capital Account

A partner's contribution to the business of the firm is called his capital. Capital accounts may be prepared under any one of the methods.

I) Fixed Capital Method

Under fixed capital method there will be two accounts for each partner.

a) Fixed capital account: Recording only capital of the partner. Partners fixed capital account is credited only when fresh for further capital is introduced or debited when the capital is withdrawn.

Capital a/c

	X	Y	Z		X	Y	Z
To bal., c/d				By bal. b/d			
				By cash (additional capital)			

b) **Current account (Fluctuating capital account)** :- All the transactions relating to drawings, interest on capital, commission, salary, share of profit or loss are recorded in this account. The balance in capital account keeps on changing or fluctuating every time.

	X	Y	Z		X	Y	Z
				By bal. b/d			
To drawings				By Interest on capital			

To Interest on drawings				By commission			
To loss				By salary			
				By profit and loss a/c			
To bal., c/d							

Problem:

A and B are partners sharing profits in the ratio 3:2 with capital of Rs.12,000 and 5,400 respectively. C is admitted as a new partner for 1/3 share of profits with a capital of Rs.7,500. Adjust the capitals of them in the new profit sharing ratio. Give the necessary journal entries.

Solution:

Le the total share be 1
C‘s share 1/3
Remaining share 1-1/3= 2/3   New ratio A:6; B:4; C:5
A‘s share 3/5x2/3= 6/15
B’s share 2/5x2/3=4/15
C’s share 1x5/3x5= 5/15
Capital for 1/3 = 7,500 Total capital of new firm 3/1x7500=22,500
A’s share of capital 22,500/15 x 6 = 9000
B’s share of capital 22,500/15x4 = 6000
C’s share of capital 22,500/15x 5 = 7500

Capital a/c

	A	B	C		A	B	C
To current a/c	3000			By bal. c/d	12,000	5,400	--
				By cash	---	---	7,500
To bal., c/d	9000	6000	7500	By current a/c		600	
	12000	6000	7500		12000	6000	7500

A’s capital a/c Dr.   3000
To A’s current A/C   3000
(Excess capital of A transferred to his current a/c)

B’s current a/c Dr. 600
To B’s capital a/c   600
(Shortage in B’s capital a/c transferred to his capital a/c)

Goodwill

Goodwill is the benefit and advantage of the good name, reputation and connection of a business. It is an intangible asset. Goodwill arises because the firm is able to earn more than the normal return on the capital invested.

Methods of calculating goodwill:

i) Average profit method: Under this method, the profits of some past years are taken and adjusted in the light of future possibilities.

Average profit=Total profit/No., of years

Goodwill = Average profit x No., of years purchase

Super Profit:

Super profit means the profit earned by the firm over and above the normal profit earned.

Normal profit = Capital employed x Normal rate of return

Super profit = Actual profit – Normal profit

Goodwill = super profit x No., of years purchase

Capitalisation Method

Under this method the actual profit is divided by the normal profit in order to get the total amount which should have been invested as capital. This amount compared with the net assets of the business in order to find out the value of goodwill.

Capitalised value of profit= Adjusted average profit/Normal Rate of Returnx100

Net tangible assets = Total realisable assets – Liabilities to outsiders

Value of goodwill = Capitalised value of profit - Net tangible assets

Treatment of Goodwill at the time of Admission of a partner

Revaluation Method: Under this method the new partner does not bring cash for his share of goodwill. In this case, the old partners raise goodwill at its full value and share in the old profit sharing ratio.

Goodwill a/c Dr.

To Old partners capital a/c

Sometimes goodwill may be overstated or understated. But we have to record correct value of goodwill in the books. So overstated or understated value of goodwill should be adjusted.

i) When the goodwill is understated

Goodwill a/c (Difference between the new value

and old value)

To Old partners capital a/c

ii) When the goodwill is overstated

Old partners’ capital a/c Dr.

To Goodwill a/c (To the extend of overstated value)

Problem:

A, B and c are partners sharing profits in the ratio of 5:5:4.D is admitted as a partner. D introduced Rs. 40,000 as capital for his 1/4th share. Goodwill of the firm is to be valued at 2 years purchase of 3 years profit which have been Rs.15,000, Rs.26,000 and Rs.22,000. Give journal entries if:

a) There is no goodwill in the books of the firm

b)The goodwill a/c appears at Rs.14,000

c) The goodwill already standing in the books is Rs.56,000

Solution:

Average profit = 15000+26,000+22000/3=63,000/3=21,000
Goodwill = Average profit x No. of years purchase = 21,000x2=42,000

a))Cash /c Dr. 40,000

To D’s capital a/c 40,000

ii) Goodwill a/c Dr. 42,000

To A’s capital a/c 15,000

To B’s capital a/c 15,000

To C’s capital a/c 12,000

a) I)Cash /c Dr. 40,000

To D’s capital a/c 40,000

ii) Goodwill a/c Dr. 28,000 (42,000-14000)

To A’s capital a/c 10,000

To B’s capital a/c 10,000

To C’s capital a/c 8,000

a) Cash /c Dr. 40,000

To D’s capital a/c 40,000

ii) A’s capital a/c Dr 5,000

B’s capital a/c Dr 5,000

C's capital a/cDr 4000

To Goodwill a/c 14,000 (56000-42000)

Memorandum Revaluation Method

In this method also, the new partner does not bring any cash as goodwill. The goodwill is raised at its full value and shared between the old partners in the old ratio as per revaluation method and thereafter it has to be written off among ALL partners in the new profit sharing ratio

When the goodwill is raised

Goodwill a/c Dr.

To old partners capital a/c (Old profit sharing Ratio)

For writing off goodwill

All partners capital a/c Dr. (New Ratio)

To Goodwill a/c

When the goodwill is raised

Goodwill a/c Dr.

To old partners capital a/c (Old profit sharing Ratio)

For writing off goodwill

All partners capital a/c Dr. (New Ratio)

To Goodwill a/c

Hidden goodwill

In this case, total value of goodwill is hidden which is to be calculated with reference to the total capital of the firm.

Problem:

A and B are partners with the capital of 10,000 and 20,000 respectively and sharing profit and losses equally. C admitted into partnership with ¼ in profit and contributed 12,000 as his capital. Calculate goodwill.

Solution:

Z's share of capital $1/4^{th}$ share =15,000

Total capital of the firm 15,000x1/4=60,000

Actual total capital of all the partners (20,000+20,000+15,000)=55,000

Goodwill = (60,000-55,000)= 5000

Goodwill a/c Dr. 5,000

To X's capital a/c 2,500

To Y's capital a/c 2,500

total capital should be 4/1x12000= 48000

But actual capital of partners 10,000+20,000+12,000= 42,000

Difference 48,000-42,000 =6000 (Must be treated as goodwill)

Problem:

X and Y are equal partners with capitals of Rs.20,000 each. They admit Z into the firm for ¼ share in the profits of the firm. Z brings Rs.15,000 as his capital. No goodwill account at present appears in the books of the firm. Give journal entry for goodwill.

A and B are partners in a firm, sharing profits and losses in the ratio of 5:3. They admit A into the firm on 1st April 1999, when their Balance sheet was as follows.

Liabilities	Rs.	Assets	Rs.
B's capital	32,000	Goodwill	8,000
C's capital	34,000	Machinery	38,000
General reserve	8,000	Furniture	5,000
Bank loan	6,000	Debtors	23,000
Creditors	6,000	Stock	7,000
		Bank	5,000
	86,000		86,000

Terms of A's admission were as follows:

i) A will bring Rs.30,000 through cheque, as his share of capital and will be entitled to 1/3rd share in the profits.
ii) A is not to bring goodwill in cash. B and C raise the goodwill in the books which is valued on the basis of 2 years purchase of the average profits of the last three years.
iii) Average profits of the last three years are Rs.6,000
iv) Machinery and stock are valued at Rs.45,000 and Rs.8,000 respectively.
v) Goodwill is not be shown in the books of the new firm.

Prepare Revaluation a/c and partners capital a/c incorporating the above adjustments and also the Balance sheet of the firm after the above adjustments.

Solution:

Workings :

Goodwill = Average profit x No., of years purchase

6,000x2 = 12,000 Goodwill given in the Balance sheet 8,000 (understated by 4,000 (12,000-8,000)

Goodwill a/c Dr. 4,000

To B's capital a/c 2,500

To C's capital a/c 1,500

A's capital a/c 5,000

B's Capital a/c 3,000

C's Capital a/c 4,000

To Goodwill a/c 12,000

Revaluation a/c

To B's capital a/c 5,000		By machinery a/c	7,000
To C's capital a/c 3,000		By stock a/c	1,000
	8,000		
	8,000		8,000

Capital a/c

	B	C	A		B	C	A
To goodwill	5,000	3,000	4,000	By bal.b/d	32,000	34,000	-
To bal. b/d	39,500	38,500	26,000	By general reserve	5,000	3,000	
				By Bank	--	--	30,000
				By goodwill	2,500	1,500	---
				By revaluation	5,000	3,000	---
	44,500	41,500	30,000		44,500	41,500	30,000

Revised Balance sheet after Admission

Liabilities	Rs.	Assets	Rs.
B's capital	39,500	Machinery	45,000
C's capital	38,500	Furniture	5,000
A's capital a/c	26,000	Debtors	23,000
Bank loan	6,000	Stock	8,000
Creditors	6,000	Bank	35,000
	1,16,000		1,16,000

Memorandum Revaluation account

Problem:

Ramu and Gopu are partners sharing profits in the ratio of 2:1. Following is the Balance sheet of the firm as on 31.12.93.

Liabilities	Rs.	Assets	Rs.
Ramu's capital	60,000	Cash in hand	22,000
Gopu's capital	35,000	Cash at bank	2,000
Wage due	5,000	Debtors 30,000 Less; Provision 2,000	28,000
Creditors	48,000	Bills Receivable	12,000
		Stock	18,000
		Investment	12,000
		Furniture	4,000
		Buildings	50,000
	1,48,000		1,48,000

On 1.1.94 Somu was admitted as a partner. Somu brings in Rs.25,000 as capital for 1/4th share in profits.

i) Provision for doubtful debts be increased to Rs.3,500
ii) Furniture be reduced to Rs.3,500
iii) Buildings be increased by Rs.10,000
iv) An investment of Rs.1,500 not recorded in the books, now brought into account.
v) A contingent liability of Rs.800 has become a certain liability. It has been agreed among the partners that assets and liabilities are to be shown at old values.

Prepare Memorandum Revaluation a/c and New Balance sheet after admission.

Solution:

Memorandum Revaluation Method

To provision for doubtful debts	1,500	By Building	10,000
To furniture	500	By Investment	1,500
To liability	800		
To Ramu's capital a/c 5,800 To Gopu's capital a/c 2,900	8,700		
	11,500		**11,500**
By Building	10,000	By provision for doubtful debts	1,500
By Investment	1,500	By furniture	500
		By liability	800
		By Ramu's capital a/c 8,700x2/4 4,350 By Gopu's capital a/c 8,700x1/4 2,175 By Somu's capital a/c 8,700x1/4 2,175	8,700

	11,500		11,500

Capital a/c s

	Ramu	Gopu	Somu		Ramu	Gopu	Somu
To Revaluation	4,350	2,175	2,175	By bal.b/d	60,000	35,000	-
	61,450	35,725	22,825	By cash	--	--	25,000
				By Revaluation	5,800	2,900	
	65,800	**37,900**	**25,000**		**65,800**	**37,900**	**25,000**

Balance sheet after admission

Liabilities	Rs.	Assets	Rs.
Ramu's capital	61,450	Cash in hand (22,000+25000)	47,000
Gopu's capital	35,725	Cash at bank	2,000
Somu's capital	22,825	Debtors 30,000 Less; Provision 2,000	28,000
Wage due	5,000	Bills Receivable	12,000
Creditors	48,000	Stock	18,000
		Investment	12,000
		Furniture	4,000
		Buildings	50,000
	1,73,000		1,73,000

REITIREMENT OF A PARTNER

A Partner may leave the firm by taking retirement. Normally the retirement takes place by consent of all the partners and / or by other mode of communication by the intended partner to all other partners. In case of retirement, for paying off the retiring partner(s) some adjustment are required to be done in the books of accounts.

Steps for Adjustments / Books of Accounts:

Following steps to be taken and books of accounts to be prepared to calculate the due of retiring partner.

1. **Revaluation of Assets and liabilities**.

This is required for giving the share of net assets of the firm. Treatments are:

Profit or loss on revaluation to be transferred to all the partners in old Profit Sharing ratio.

If the remaining partners decide not to alter the book value of assets or liabilities then the profit or loss on revaluation as distributed earlier should be reversed through remaining partner's capital account in new profit sharing ratio. We shall have to prepare Memorandum Revaluation Account.

2. **Undistributed profit or loss**.

Any undistributed profit or loss including reserve is to be transferred in old profit sharing ratio.

Journal entries :
In case of undistributed profit or reserves:

Profit & Loss A/c Dr.

Reserve A/c Dr.

To Old Partners Capital A/c (In old P.S.R)
In case of undistributed Loss

Old Partners Capital A/c Dr.

To Profit & Loss A/c

(1) **Adjustment regarding goodwill**:

At the time of retirement the retiring partner is also eligible for share of goodwill of the firm. This can be made in the following ways:

(a) Raising of goodwill : (If goodwill is already existing in the Balance sheet the difference shall be raised)

(b) Goodwill A/c Dr.

To All Partners Capital A/c (Old P.S.R)

(c) Goodwill raised and written off :

(i) Raise goodwill as discussed above.

(ii) Write off goodwill

Existing partners Capital A/c Dr.

To Goodwill A/c

Settlement of Dues to the Retiring Partner:

The retiring partner becomes entitled to get back his dues from the firm which consists of the following :

(i) Balance of his capital and current account at the time of retirement.
(ii) Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities.
(iii) Salary, commission, interest on capital, if any and all other dues till the date of retirement.
(iv) Any adjustment in drawings and interest thereon.

Payment of dues.

(i) Payment at a time. Subject to availability of the fund, the payment may be made at a time. Journal entry :

Retiring Partner's Capital A/c Dr.
To Bank A/c

(ii) If part payment be made by giving assets :

Retiring Partner's Capital A/c Dr.
To Assets A/c

(iii) If the dues are transferred to Loan account.

Retiring Partner's Capital A/c Dr.
To Retiring partners' Loan A/c

(iv) If the existing partners bring in cash for making payment :

Bank/Cash A /c Dr.
To Existing Partners' Capital A/c

(v) For interest due on Retiring Partners Loan A/c

Interest on Retiring Partner's Loan A/c Dr.
To Retiring Partner's Loan account.

Problem:

X, Y, & Z were equal partners. Their Balance Sheet as on 31.12.12 was as follows:

Partners' Capital			Land & Freehold Property	1,00,000
X	1,00,000		Plant & Machinery	2,00,000
Y	1,00,000		Furniture & Equipment	50,000
Z	2,00,000		Stock in-trade	1,00,000
Partner's Current A/c :		4,00,000	Sundry Debtors	1,00,000
X	50,000		Balance with Bankers	1,50,000
Y	75,000			
Z	25,000	1,50,000		
Sundry Creditors		1,50,000		
		7,00,000		7,00,000

On 1.1.13 X retired and it was agreed that he should be paid all his dues in full on that date. For this purpose, goodwill was to be calculated on the basis of 3 years purchase of past 3 years profits which amounted to Rs. 1,00,000, Rs. 1,40,000 and Rs.1,20,000 respectively.

In order to meet his obligation, a bank loan was arranged on 1.1.13 for Rs. 2,00,000 pledging the fixed assets as security. Further, to compensate a loyal manager Q, it was agreed between Y and Z that Q should be admitted as a partner, who should bring in, over and above a capital of ` 1,00,000, his share of Goodwill in cash to serve as working capital. Y and Z agreed to forego 1/3rd of their individual share of profits to Q. Prepare the opening Balance Sheet of the firm as on 1.1.13.

Solution:

Working Notes:

Valuation of Goodwill

Average Annual Profits = 1,20,000 = 1,40,000 + 1,00,000/3

Goodwill = 3 × 1,20,000 = 3,60,000

Premium to be paid by Q = 1/3 of 3,60,000 = 1,20,000 and to be shared by Y and Z equally.
Similarity X should be provided 1,20,000 by Y and Z equally.

Journal Entries

(a) Y's Current A/c Dr. 60,000
Z's Current A/c Dr. 60,000
To X's Current A/c 1,20,000
(Being X's share of goodwill adjusted against existing partners Y & Z in their gaining ratio 1:1)

(b) Cash A/c Dr. 1,00,000
To Q's Capital A/c 1,00,000
(Being Capital contributed by C)

(c) Cash A/c Dr. 1,20,000
To Y's Current 60,000
To Z's Current A/c 60,000
(Being Q's share of premium for goodwill share between Y & Z in their sacrificing ratio)

(d) Bank A/c Dr. 2,00,000
To Bank Loan A/c 2,00,000
(Being loan taken from Bank against hypothecation of fixed assets)

Partner Capital Accounts

Particulars	**X**	**Y**	**Z**	**Q**	**Particulars**	**X**	**Y**	**Z**	**Q**
To Cash A/c (Final Settlement)	2,70,000	-	-	-	By Balance b/d	1,00,000	1,00,000	2,00,000	-
					By X's Current A/c (Transfer)	1,70,000	-	-	-
To Balance c/d	-	1,00,000	2,00,000	1,00,000	By Cash A/c (capital introduced)	-	-	-	1,00,000
	2,70,000	**1,00,000**	**2,00,000**	**1,00,000**		**2,70,000**	**1,00,000**	**2,00,000**	**1,00,000**

Partners Current Account

Particulars	X	Y	Z	**Particulars**	X	Y	Z
To X's Capital A/c	1,70,000	-	-	By Balance b/d	50,000	75,000	25,000
To X's Current A/c	-	60,000	60,000	By Y's Current A/c	60,000	-	-

To Balance c/d	-	75,000	25,000	By Z’s Current A/c	60,000	-	-
				By Cash A/c	-	60,000	60,000
	1,70,000	**1,35,000**	**85,000**		**1,70,000**	**1,35,000**	**85,000**

Balance Sheet

Liabilities	**Amount**	**Amount**	**Assets**	**Amount**	**Amount**
Partners’ Capital A/cs :			Land and Freehold Property		1,00,000
			Plant & Machinery		2,00,000
Y	1,00,000		Furniture & Equipment		50,000
Z	2,00,000		Stock		1,00,000
Q	1,00,000	4,00,000	Debtors		1,00,000
			Cash at Bank (W5)		3,00,000
Partner’s Current A/c s :					
Y	75,000				
Z	25,000	1,00,000			
Bank loan		2,00,000			
(Secured) Sundry Creditors		1,50,000			
		8,50,000			8,50,000

Bank a/c

Particulars	**Amount** `	**Particulars**	**Amount** `
To Balance b/d	1,50,000	By X’s Capital A/c	2,70,000
To Bank Loan A/c	2,00,000	By Balance c/d	3,00,000
To Cash A/c (Premium for goodwill)	1,20,000		
To Q’s capital A/c	1,00,000		
	5,70,000		5,70,000

DEATH OF A PARTNER

The accounting procedure involved is similar to that followed in case of retirement of a partner.

Total Amount Payable includes:

(i) The deceased partner’s Capital and / Current Accounts last Balance.

(ii) His share of undistributed profit/loss.

(iii) His share of revaluation profit/loss

(iv) His share of goodwill.

(v) His share of Joint Life Policy, if any and

(vi) His share of profit/loss made by the firm between the last year ending and the date of his death.

Problem

The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1 : 2 : 2 as on 31st December, 2012.

Sundry Creditors		10,000	Goodwill		15,000
Capital A/c :			Debtors		10,000
A	10,000		Machinery		20,000
B	20,000		Buildings		30,000
C	20,000	50,000	Stock		10,000
General Reserve		5,000	Cash at Bank		5,000
Investment Fluctuation Fund		3,000	Investments		10,000
Bad Debts Reserve		2,000			
Bank Loan		30,000			
		1,00,000			1,00,000

C died on 31st March, 2013. His account is to be settled under the following terms:

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March' 13 is to be calculated proportionately on the average profit of 3 years. The profits were: 2008 Rs.3,000, 2009 Rs.7,000, 2010 Rs.10,000, 2011 Rs.14,000, 2012 loss Rs.12,000. During 2012 a Moped costing Rs. 4,000 was purchased and debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are: Stock Rs.12,000, Building Rs.35,000, Machinery Rs.25,000 and Investments Rs.8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Solution:

Working Notes :

1. **Adjusted profit for 2012**

Loss (12,000)

Add : Cost of Moped

Wrongly treated as Travelling Expense 4,000

Less : Depreciation not charged on Moped @25% on Rs.4,000 (1,000)

Adjusted Loss (9,000)

2. **Valuation of Goodwill**

Total Profit/Loss for the last 5 years = 3,000 + 7,000 +10,000 + 14,000 – 9,000 = Rs.25,000

Average Profit = Rs.25,000/5 = Rs.5,000; Goodwill = 2 × Rs.5,000 = Rs.10,000

But Goodwill is appearing at Balance Sheet at Rs.15,000. Over valuation of Goodwill Rs.5,000 should be written off among A, B & C as 1 : 2 : 2.

The balance of Goodwill between A & B in the ratio 1 : 2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years [2010, 2011 & 2012] = (10,000 + 14,000 – 9,000)/3 = Rs.5,000

Estimated Profit for 3 months [Jan to March, '13] = Rs.5,000 × 3/12 = Rs.1,250

C's share of profit = Rs.1,250 × 2/5 = Rs.500

Journal Entries

Date	Particulars	Amount `	Amount `
	Stock A/c Dr. Buildings A/c Dr. Machinery A/c Dr. Moped A/c [4,000 – Depr. 1,000]Dr. To Revaluation A/c [Values of assets increased on revaluation]	2,000 5,000 5,000 3,000	15,000
	General Reserve A/c Dr. Investment Fluctuation Fund A/c Dr. Bad Debts Reserve A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c [Transfer of Reserves etc. to Partners Capitals in 1 : 2 : 2]	5,000 3,000 2,000	2,000 4,000 4,000
	Revaluation A/c Dr. To Investment A/c [Value of investments reduced]	2,000	2,000

	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being profit on revaluation shared in 1 : 2 : 2)	13,000	 2,600 5,200 5,200
	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Goodwill A/c [Value of Goodwill reduced]	1,000 2,000 2,000	 5,000
	Profit & Loss Suspense A/c Dr. To C's Capital A/c [Estimated share of Profit till his date of death transferred to the decreased partner's Capital]	500	 500
	C's Capital A/c Dr. To C's Executors A/c [Total dues to the deceased partner transferred to his Executor's A/c]	27,700	 27,700

Capital Accounts

Date 2011	Particulars	A `	B `	C `	Date 2011	Particulars	A `	B `	C `
31.3	To Goodwill A/c	1,000	2,000	2,000	31.3	By Balance b/d	10,000	20,000	20,000
	To Goodwill A/c	3,333	6,667	-		” Revaluation A/c	2,600	5,200	5,200
	To C's Executors A/c (Balance transferred)			27,700		” Sundry Reserves A/c	2,000	4,000	4,000
	To Balance c/d	10,267	20,533	-		” P & L Suspense A/c	-	-	500
		14,600	29,200	29,700			14,600	29,200	29,700

Balance Sheet as at 31.3.2013

Liabilities	Amount `	Amount `	Assets	Amount `	Amount `
Capital A/cs :			Buildings		35,000
A	10,267		Machinery		25,000
B	20,533	30,800	Moped		3,000
C's Executor's A/c		27,700	(cost less depreciation)		
Bank Loan		30,000	Investments		8,000
Sundry Creditors		10,000	Stock		12,000
			Debtors		10,000

			Bank Profit & Loss Suspense A/c (Dr.)		5,000 500
		98,500			98,500

Joint Life Policy

At the time of death of a partner, the partnership firm has to pay a lumpsum amount to his legal representative. If so, the liquidity of the firm is affected, and firm will be disturbed by shortage of fund. In order to protect the firm, the joint life policy is taken by partnership firm. Every year, premium amount is paid by partnership firm. The insurance company will pay the policy amount at the time of death of any partner and the amount will be used by the firm for pay off the amount due to the deceased partner.

Accounting Treatment:

i. When the premium paid is treated as an expense:

In this case, the premium paid is treated as an expense and debited to profit and loss account. At the time of death of a partner, the policy amount received and credited to capital account of all partners (except newly admitted partner) in the profit sharing ratio.

For the Premium paid

Joint Life Policy Premium a/c Dr.

To Bank a/c

For transferring premium to profit and loss a/c

Profit and loss a/c Dr.

To Joint Life policy premium a/c

For the amount received at the time of death of a partner

Bank a/c Dr.

To Joint Life Policy a/c

For distributing the policy amount among the partners

Joint Life Policy a/c Dr.

To Partners' capital a/c

ii) When the premium is treated as an asset:

Under this method, Joint life policy is treated as an asset. The joint life policy has surrender value. The book value of joint life policy is adjusted at the end of each year to its surrender value by transferring the difference between the book value and the surrender value of joint life policy. The joint life policy is shown as an asset and calculated on the basis of its surrender value.

For the Premium paid

Joint Life Policy a/c Dr.

To Bank a/c

For recording the difference between the book value and surrender value of joint life policy

Profit and loss a/c Dr.

To Joint Life policy a/c

For the amount received at the time of death of a partner

Bank a/c Dr.

To Joint Life Policy a/c

For distributing the policy amount among the partners

Joint Life Policy a/c Dr.

To Partners' capital a/c

iii) When premium paid is treated as an asset and reserve is maintained

Under this method also premium paid is debited to life policy a/c and credited to bank account. At the end of every year joint life policy reserve account is credited and debited the profit and loss account. In order to record the joint life policy at its surrender value, the difference between the joint life policy and its surrender value is debited with Joint life policy reserve account and credited with joint life policy account.

For the Premium paid

Joint Life Policy a/c Dr.

To Bank a/c

For transferring the premium

Profit and loss appropriation a/c Dr.

To Joint Life policy reserve/c

For recording the difference between the book value and surrender value of joint life policy

Joint Life policy Reserve a/c Dr.

To joint life policy a/c

For the amount received at the time of death of a partner

Bank a/c Dr.

To Joint Life Policy a/c

For distributing the policy amount among the partners

Joint Life Policy a/c Dr.

To Partners' capital a/c

Problem:

A and B sharing profits in the ration of 3:2 took out a joint life policy on 1st January 1989 of Rs. 20000 for 20 years paying annual premium of Rs. 1000. The surrender values were 1989-Nil; 1990-Rs.200; 1992-Rs.500; 1992-Rs.970. B died on 8th March, 1992 and claim was received on 30th April. Show the necessary accounts.

I Method

Premium paid is treated as an expense

1989	Joint Life Policy Premium a/c	Dr.	**1000**	
31st Dec.,	To Bank			**1000**
	(Joint Life Policy premium is paid)			

	Profit and Loss a/c Dr.	**1000**	
	To Joint Life policy premium a/c		**1000**
	(Joint life policy premium transferred to Profit and loss a/c		
1990	Joint Life Policy Premium a/c Dr.	**1000**	
31st Dec.,	To Bank		**1000**
	(Joint Life Policy premium is paid)		
	Profit and Loss a/c Dr.	**1000**	
	To Joint Life policy premium a/c		**1000**
	(Joint life policy premium transferred to Profit and loss a/c		
1991	Joint Life Policy Premium a/c Dr.	**1000**	
31st Dec.,	To Bank		**1000**
	(Joint Life Policy premium is paid)		
	Profit and Loss a/c Dr.	**1000**	
	To Joint Life policy premium a/c		**1000**
	(Joint life policy premium transferred to Profit and loss a/c		
31 March 1992	Bank a/c Dr.	**20000**	
	To joint Life policy		**20000**
	Joint Life Policy a/c **Dr**	**20000**	
	To Partner's Capital a/c		**20000**

II Method

Joint Life Policy Account

Particulars	Rs.	Particulars	Rs.

1989 Jan. 1	To Bank (Premium Paid)	1000	1989 Dec. 31	By Profit and Loss A/c (since surrender value is nil)	1000
		1000			1000
1990 Jan. 1	To Bank	1000	1990 Dec. 31	By Profit and Loss A/c (Balancing figure)	800
				By Balance c/d (surrender value)	200
		1000			1000
1991 Jan. 1	To Balance b/d	200	1991 Dec. 31	By Profit and Loss A/c (Balancing figure)	650
	To Bank	1000		By Balance c/d (surrender value)	550
		1200			1200
	To Bank b/d	550			
1992 Jan. 1	To Bank	1000	1992 April 30	By Bank (Claim received)	20000
	To A 3/5 11070				
	To B 2/5 <u>7380</u>	18450			
		20000			20000

III Method

Joint Life Policy Account

	Particulars	Rs.		Particulars	Rs.
1989 Jan. 1	To Bank	1000	1989 Dec. 31	By Joint life policy reserve	1000
		1000			1000

1990 Jan. 1	To Bank	1000	1990 Dec. 31	By Joint life policy reserve	800
				By Balance c/d	200
		1000			1000
1991 Jan. 1	To Balance b/d	200	1991 Dec. 31	By Joint life policy reserve	650
	To Bank	1000		By Balance c/d	550
		1200			1200
	To Bank b/d	550			
1992 Jan. 1	To Bank	1000	1992 April 30	By Bank	20000
	To A 3/5 11070				
	To B 2/5 7380	18450			
		20000			20000

Joint Life Policy Reserve Account

	Particulars	Rs.		Particulars	Rs.
1989 Dec. 31	To Joint Life Policy account	1000	1989 Dec. 31	By Profit and Loss appropriation a/c	1000
1990 Dec. 31	To Joint Life Policy Account	800	1990 Dec. 31	By Profit and Loss appropriation a/c	1000
	To Balance c/d	200			
		1000			1000
1991 Dec. 31	To Joint Life Policy Account	650	1991 Jan. 1	By Balance b/d	200
	To Balance c/d	550	Dec. 31	By Profit and Loss appropriation a/c	1000
		1200			1200

1992 April 30	To A 3/5 330		1992 Jan. 1	By Balance c/d	550
	To B 2/5 220	550			
		550			550

IV DISSOLUTION OF A FIRM: INSOLVENCY OF A PARTNER – GARNER VS. MURRAY RULE – PIECEMEAL DISTRIBUTION

DISSOLUTION OF A FIRM

Dissolution means discontinuance. After dissolution no business will be transferred by the firm. All the assets and liabilities of the firm should be transferred to realisation account; assets are realised then outsiders liabilities are discharged with the help of the amount realised then the loss on realisation transferred to capital account in the profit sharing ratio.

Realization Account

	Rs.		Rs.
To Assets (transferring assets		By Liabilities (transferring liabilities)	
To bank- (Discharging liabilities)		By Loss transferring capital account)	
To bank-Expenses			
To Profit transferred to Capital Accounts			

Problem:

The balance sheet of a firm on 31st March, 1990 was as follows:

Liabilities	Rs.	Rs.	Assets	Rs.
X's Capital	5,000		Furniture	8,000
Y's Capital	4,000		Stock	2,000
Z's Capital	3,000	12,000	Book Debts	1,000

		Cash at Bank	3,000
Sundry Creditors	2,000		
	14,000		14,000

The partnership was dissolved as on 31st March, 1990. The Sundry creditors were paid at a discount of 5%. X agreed to take over the furniture at Rs. 9,000, Y the stock at 1,500 and Z the book debts at Rs. 600. The expenses of realization came to Rs. 110. Close the books of the firm.

Solution:

Realization Account

		Rs.		Rs.
To furniture		8,000	By Sundry Creditors	2,000
To stock		2,000	By X's Capital Account-Furniture	9,000
To book debts		1,000	By Y's Capital Account-Stock	1,500
To bank-Sundry Creditors		1,900	By Z's Capital Account-Book Debts	600
To bank-Expenses		110		
To Profit transferred to Capital Accounts	Rs.			
X	30			
Y	30			
Z	30	90		
		13,100		13,100

Bank Account

	Rs.		Rs.
To Balance b/fd	3,000	By Realisation Account-Sundry	1,900

To X's Capital Account-Settlement	3,970		
		By Realization Account-Expenses	110
		By Y's Capital Account-Settlement	2,530
		By Z's Capital Account-Settlement	2,430
	6,970		6,970

Capital Accounts

	X	Y	Z		X	Y	Z
To Realization Account	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
				By balance b/fd	5,000	4,000	3,000
-Furniture	9,000			By Realization Account			
-Stock		1,500		-Profit	30	30	30
-Book Debts			600	By Bank-Settlement	3,970	-	-
To Bank-Settlement		2,530	2,430				
	9,000	4,030	3,030		9,000	4,030	3,030

Garner Vs. Murray

When a partner is unable to pay his debt due to the firm he is said to be insolvent and share of loss is borne by the other solvent partners in accordance with the decision in Garner Vs. Murray. According to the decision, the solvent partners should bring in cash equal to their share of loss on realisation. The solvent partners have to bear the loss due to insolvency of a partner in the capital ratio.

Partners are free to have either fixed or fluctuating capital in the firm. When the partners adopt fixed capital, the loss of insolvent partners shared by the solvent partners in the ratio of fixed capital. In the case of fluctuating capital, transactions relating to drawings, accumulated profits and reserves, interest are transferred to capital account and capital ratio of solvent partners is found to transfer the loss of insolvent partners. Loss on realisation of profit will not be taken into account for calculating capital ratio.

Problem:

The following is the Balance sheet of X, Y and Z on 31-3-94

Liabilities	Rs	Assets	Rs
Capital A/c's		Furniture	40,000
X	50,000	Plant and Machinery	20,000
Y	30,000	Stock	40,000
General Reserve	30,000	Sundry Debtors	20,000
Sundry Creditors	40,000	Cash at Bank	12,000
		Z's Capital	18000
	1,50,000		**1,50,000**

Z is insolvent but his estate pays Rs. 4,000. It is decided to dissolve the partnership. The assets realised as follows:

Sundry Debtors: Rs. 15,000; Furniture: Rs. 28,000;

Stock: Rs. 32,000; Plant & Machinery: Rs. 14,000.

Dissolution expenses amount to Rs. 5,000.

Give Accounts to close the books of the firm if the capitals are fluctuating:

Solution:

Realisation Account

	Rs.			Rs.
To Furniture	40,000	By Sundry Creditors		40,000
To Plant and Machinery	20,000	By Bank (assets sold)		89,000
To Stock	40,000	By Loss to capital A/c's		
To Sundry Debtors	20,000	X	12,000	
To Bank (expenses)	5,000	Y	12,000	
To Bank (Creditors)	40,000	Z	12,000	36,000

	1,65,000		1,65,000

Z's Capital A/c

	Rs.		Rs.
To Balance b/d	18,000	By General Reserve	10,000
To Realisation (loss)	12,000	By Cash	4,000
		By X's Capital and Y's Capital	
		X: $16{,}000 \times \frac{3}{5} =$	9,600
		Y: $16{,}000 \times \frac{2}{5} =$	6,400
	30,000		30,000

Note:
Deficiency in Z's Capital to be shared by X and Y (solvent partners) in the Capital Ratio of 3:2

Capital ratio is determined as follows: (Capital+ All Reserves and accumulated profits but before adjusting profit or loss on realisation)

Capital Accounts of X and Y

	X	Y		X	Y
	Rs.	Rs.		Rs.	Rs.
To Realisation (loss)	12,000	12,000	By Balance b/d	50,000	30,000
To Z's Capital	9,600	6,400	By General Reserve	10,000	10,000
(Deficiency in Z's Capital shared in the ratio of 3:2)					
To Cash (Bal. fig)	50,400	33,600	By Cash (Realisation loss brought in cash)	12,000	12,000
	72,000	**52,000**		**72,000**	**52,000**

Cash at Bank A/c

	Rs.		Rs.
To Balance b/d	12,000	By Realization (expenses)	5,000
To Realisation (Assets sold)	89,000	By Realisation (creditors)	40,000
To Z's Capital	4,000	By X's Capital	50,400
To X's Capital	12,000	By Y's Capital	33,600
To Y's Capital	12,000		
	1,29,000		**1,29,000**

Problem:

The Balance sheet of Marna, Govindan and Ramu as on 31.12.2002 is given below:

Liabilities	Rs	Assets	Rs.
Creditors	80,000	Bank	2,000
Maran's Loan	20,000	Stock	48,000
Maran's capital	10,000	Debtors	40,000
Govindan's capital	6,000	Furniture	6,000
		Ramu's capital	20,000
	1,16,000		**1,16,000**

The firm is dissolved. Govindan and Ramu cannot pay anything. Maran can contribute only Rs.3,000 from his private estate. Stock realises Rs.30,000. Debtors realise Rs.32,000 and furniture is sold for Rs.2,000. Expenses amount to Rs.6,000. Prepare accounts to close the books of the firm.

Solution

Realisation a/c

To stock	48,000	By Bank (Assets realised)	64,000

To Debtors	40,000	By Maran's capital a/c	12,000
To furniture	6,000	By Govindan's capital a/c	12,000
To Bank (expenses)	6,000	By Ramu's capital a/c	12,000
	1,00,000		**1,00,000**

Capital A/c

	Maran	Govindan	Ramu		Maran	Govindan	Ramu
To Bal. b/d	--	---	20,000	By Bal., b/d	10,000	6,000	-
ToRealisation a/c	12,000	12,000	12,000	By Maran Loan a/c	20,000	--	--
To Deficiency	21,000	--	--	By cash	3,000	--	--
				By Deficiency	--	6,000	32,000
	33,000	**12,000**	**32,000**		**33,000**	**12,000**	**32,000**

Creditors A/c

To cash	63,000	By bal., b/d	80,000
To Deficiency (Bal., fig.,)	17,000		
	80,000		**80,000**

Deficiency A/c

To Govindan's capital a/c	6,000	By Maran's capital a/c	21,000
To Ramu's capital a/c	32,000	By creditors	17,000
	38,000		**38,000**

Bank A/c

To bal., b/d	2,000	By Realisation	6,000
To Realisation (Assets Realised)	64,000	By creditors	63,000

To Maran's capital	**3,000**	
	69,000	**69,000**

Piecemeal Distribution

At the time of dissolution of a firm, assets are realised and liabilities due to outsiders are settled and the losses of dissolution of partnership shared among partners in profit sharing ration. But in reality, realisation of assets is done gradually and settlements of liabilities are also done as and when the assets are realised. Settlement is done either on the basis of capital proportion method or Maximum loss method.

Proportionate Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital(determinedonthebasisofminimumcapitalperunitofprofit)todeterminesurpluscapitalofthepartners. Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio.

Maximum Loss Method

The Maximum loss is calculated after outside creditors and loans of partners have been paid off. The loss is transferred to capital account of partners then amount payable to partners are known. If share of loss of a partner is more than the capital he will be treated as insolvent and applying Garner Vs. Murray rule the loss will be transferred to the other partners in ratio of capital just before dissolution. The amount to partners' credit will be equal to the cash available and it will be distributed among the partners according the amount shown.

Steps

(1) Prepare a statement showing distribution ofcash

(2) Pay off the external Liabilities

(3) After all the payment is made for the external liabilities,

the partners will be paid off.

Total Due of Partners	xxx
Less : Net/Balance of Realisation	(xxx)
Maximum Loss	xxx

(4) The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.

(5) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.

(6) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner Vs. Murray Rule.

(7) Repeat the steps (3) to (6) till final realisation.

Problem

A partnership firm has three partners S, Y and Z with capitals as X Rs.20,000 Y Rs. 10,000 and Z Rs.10,000. The creditors amounted to Rs.20,000 and sundry assets to Rs.60,000. On dissolution, the assets realized as follows.

1st instalment Rs.20,000; 2nd instalment Rs.20,000 and final realization Rs.10,000. The partners share profits and losses in the ratio of 3:2:1/ Show the piecemeal distribution of the realization on i)proportionate capital method ii) Maximum loss method.

Solution

i) Proportionate Capital Method

	Creditors	**X**	**Y**	**Z**
First instalment Rs.20,000 paid	20,000 20,000	20,000 -----	10,000 -----	10,000 ----
Balance due II instalment 20,000 Less: paid to Z 3,334	Nil	20,000 ----	10,000 ----	10,000 3,334
Balance 16,666 Less: paid to X and Y 6,667		20,000 5,000	10,000 -----	6,666 1,666
Balance 10000 Less: paid to X, Y, Z 10000		15000 5000	10000 3334	5000 1666
Balance due Final instalment 10000 Less: paid to X,Y,Z 10000		10000 5000	6666 3334	3334 1666
Loss to be borne by X,Y,Z		5000	3332	1668

ii) Maximum Loss Method

	Creditors	**X**	**Y**	**Z**
First instalment Rs.20,000 paid	20,000 20,000	20,000 -----	10,000 -----	10,000 ----
Balance due II instalment 20,000 Maximum loss Rs. 20000 shared by X,Y, Z in profit sharing	Nil	20,000 10000	10,000 6666	10,000 3,334
 Second Instalment Rs. 20000 paid		10000 10000	3334 3334	6666 6666
Balance due Final instalment 10000		10000	6666	3334

Max. Loss Rs.10000 shared by partners in 3:2:1		5000	3334	1666
Rs.10000 paid		5000	3334	1666
Amount unpaid, i.e., loss on realisation to be borne by partners		5000	3332	1668

Problem

X and Y are two partners having capital of Rs.20,000 and Rs.10,000 and sharing profits in the ratio of 3:2 and assets realise i)R. 4,000 ii) Rsw.2,000 and iii) Rs.1,000 then the distribution will be as under:

Partners	**X**	**Y**
Capitals	20,000	10,000
Taking Y as the basis X's (according to his share in the profits) capital should be Rs.10,000/2x3)	15,000	10,000
Excess capital	5,000	

Solution

Piecemeal Distribution under Capital Proportion Method

	X	Y
Capitals	20,000	10,000
First instalment paid to X	-4,000	--
Second Instalment of Rs. 2,000. First Rs. 1,000 will be paid to X	16,000	10,000
Next Rs. 1,000 will be paid in the profit sharing ratio 3:2	-600	-400
	14,400	9,600
Third instalment Rs. 1,000 paid to X and Y in 3:2 ratio	-600	-400
Balance Unpaid	13,800	9,200

V INSOLVENCY : INSOLVENCY OF AN INDIVIDUAL – STATEMENT OF AFFAIRS AND DEFICIENCY ACCOUNT

Insolvent is a person who is unable to pay his debts when they are due to others. A person who is legally be declared as an insolvent when an order of adjudication is passed against him by a court.

Unsecured Creditors: Sundry creditors, Bills payable, Bank overdraft (unsecured), Loan from Wife out of her Stridhan, Private liabilities not given in balance sheet, Contingent liabilities (Example bills discounted expected to be dishonoured), outstanding expenses excess of the legal limits.

Fully secured creditors: These creditors extended loan on the basis of some securities and the securities have realisable value more than the loan amount.

Partly secured creditors: The loan amount is more than the realisable value of securities possessed by the partly secured creditors as security**.**

Preferential Creditors: The following are the outstanding expenses treated as preferential and that vary according to the provisions of the Presidency Towns Insolvency Act 1909 and Provincial Insolvency Act, 1920.

Creditors	**Presidency Towns Insolvency Act, 1909 (Applicable to persons in Mumbai, Calcutta and Chennai)**	**Provincial Insolvency Act, 1920 (Applicable to person living in other areas)**
Amount due to State, Central and Local Government	Fully preferential	Fully preferential
Salaries	4 months salary or Rs.300 whichever is less for each person is preferential	Rs.20 flat for each person is preferential
Wages	4 months wages or Rs.100 whichever is less for each person is preferential	Rs.20 flat for each person is preferential
Rent payable to Landlord	One month's rent whatever is the amount of preferential	----01324 1

Property as per list E: All assets and private assets and properties given up by wife.

Debtors: Good debtors have realisable value at the fullest; Doubtful debts realisable part only; Bad debts will not have realisable value.

Bills of Exchange: Bills Receivable at hand must be taken for preparing Statement of Affairs Account

. **Difference between Statement of Affairs and Balancesheet:**

STATEMENT OF AFFAIRS	**BALANCE SHEET**
Assets are recorded both in book value and realisable value	Assets are recorded at Book value
Prepaid expenses and goodwill are not recorded	Fictitious assets are included
Capital, Drawings, profit or loss, interest on capital are not included	Capital, Drawings, profit or loss, interest on capital are included.
Deficiency amount is shown in the statement of affairs.	There is no deficiency is Balance sheet.
It is prepared when the order of adjudication is passed	It is prepared at the end of the accounting period.
It is prepared as the rules of Insolvency Act.	Balance sheet is prepared regularly at the end of the accounting period to know the financial position
It includes personal assets and liabilities also.	It includes only the assets and liabilities of the business concern.
It includes contingent liabilities.	In Balance sheet contingent liabilities are

	shown as a foot note and not included as liability.

Statement of Affairs

Gross Liabilities	**Liabilities**	**Rs.**	**Expected to rank**	**Assets**	**Book value**	**Estimated to produce Rs.**
	Unsecured Creditors as per list A			**Property as per list E:** Cash in hand Cash at Bank Investment Stock Machinery		
	Fully secured creditors as per list B **Less:** Estimated value of security **Less:** Amount carried down to list C Surplus as per contra					
	Partly secured creditors as per list C **Less:** Estimated value of security			**Book debts as per list F** Good Doubtful Bad		
	Preferential creditors as per list D **Less**: Deducted as per contra			**Bills of Exchange as per list G** Surplus from securities in the hands of secured creditors as per contra Less: Preferential creditors as per list D as per contra		
				Deficiency as per list H		

Deficiency Account:

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
Excess of Assets over Liabilities			Excess liabilities over assets		
Net profit from carrying on business			Net loss from carrying on business		
Income or profit from other sources			Bad debts as per list F		
Deficiency as per Statement of Affairs			Expenses other than usual business		
			Other loss (Loss on realisation)		

Problem

What are preferential creditors in the following liabilities of insolvent according to Presidency Towns Insolvency Act and Provincial Insolvency Act?

	Rs.
3 Month's salary for 10 clerk	3,600
One month wages of 12 labourers	1,600
Sales Tax	400
3 months rent of landlord	600
Income tax	1,000
Wages of four servants	1,400
Salaries	1,000
Municipal tax	400
Wages	6,000

Solution:

Amount in Rs.	Liabilities	Preferential	
	Particulars	Under Provincial insolvency Act	Under presidency Towns Insolvency Act
3,600	Salary of 10 clerks	200 (20x10)	3000 (300x10)
1,600	Wages of 12 labourers	240 (12x20)	1200 (100x12)
400	Sales tax	400	400
600	Rent to landlord for 3 months	----	200
1,000	Income tax	1000	1000
1,400	Wages of 4 servants	80 (4x20)	400(4x100)
400	Municipal tax	400	400
6,000	Wages	6000	6000
1,000	salaries	1000	1000

16000 **-------**		**9320** **-------**	**13600** **--------**
Unsecured Creditors as per List A		**16000-9320=6680**	**16,000-13600=2400**

Problem:

Mr. DX filed a petition of insolvency on 31st December 1994. The details of outstanding expenses are as follows.

i) Salaries of 8 clerks @150 per month for each clerk for 3 months

ii) Wages of a labourer for the month of August 1994 Rs.120

iii) Wages of 8 labourers for the month of September 1994 @ Rs.110 per labourer.

IV) Rent of landlord for the month of November and December 1994 Rs.800

v) Amount due to the Municipality for Rs.1, 000, to the income tax department Rs,.2,000 and to the sales tax department Rs.2,000

vi) Salaries of two clerks for the month of July 1993 Rs.500 each. You are required to find out the amount of preferential and non-preferential creditors according to Presidency Towns Insolvency Act.

Solution:

Particulars	Total Amount	Presidency Towns Insolvency Act	
		Preferential Creditors	Non-preferential creditors
i) Amount due to the Government or any local Authority			
i) Income Tax Department ii)Sales Tax Department iii) Municipal Dues	2,000 2,000 1,000	2,000 2,000 1,000	---
2. Salaries or wages due to clerks or labourers			
i) Salaries of 8 clerks for 3 months @ 150 p.m	3,600	2,400	1,200
ii) Wages of a labourer for the month of August 1994	120	100	20
iii) Wages of 8 labourers for the month of Sept., 1994 @Rs.110 per labourer	880	800	80
iv) Salaries of two clerks	1000	----	1000
3) Rent due to landlord (for two months)	800	400	400
	11,400	**8,700**	**2,700**

Problem

Prabu filed a petition in bankruptcy on 31.6.91. Prepare statement of affairs account and deficiency accounting by using the following balances.

Capital		3,320
Cash in hand	20	
Fixtures and fittings (estimate to produce Rs.160)	500	
Stock in trade (estimated to produce Rs.2400)	3,600	
Bank overdraft		2,400
Trade creditors		4,000
Bills payable		4,000
Mrs.Prabu		400
Sundry Debtors Good Doubtful (estimated at 50%) Bad	 2,000 4,000 4,000	
	14,120	14,120

Liability on bills discounted Rs.1,000, expected to rank Rs.200. The amount due to Mrs.prabu was a loan out of money given to her by Prabu. His household furniture etc., was valued at Rs.500. He owned a house valued at Rs. 1,500 having a mortgage on it Rs.1,200 at 4%. Interest paid upto the preceding 31st December. Preferential creditors amounted to Rs.70 (included in sundry creditors) and Rs.30 for rates on the house.

Solution

Gross Liabilities	**Liabilities**	**Expected to rank Rs.**	**Assets**	**Book value**	**Estimated to produce Rs.**
11,730	Unsecured Creditors as per list A	**10,530**	**Property as per list E:** Cash in hand Stock in trade Fixtures & Fittings **Household furniture**	 **20** **3,600** **500** **----**	 **20** **2,400** **160** **500**
1,224	Fully secured creditors as per list B 1,224 **Less:** Estimated value of security **1,500** **Less:** Amount ------ carried down to list C Surplus as per contra 276				
	Partly secured creditors as per list C		**Book debts as per list F**		

	Less: Estimated value of security		Good Doubtful Bad **Surplus as per contra**	**2,000** **4,000** **4,000** **-----**	**2,000** **2,000** **276**
	Preferential creditors as per list D 100 **Less**: Deducted as per contra 100		**Bills of Exchange as per list G** Surplus from securities in the hands of secured creditors as per contra Less: Preferential creditors as per list D as per contra	**-----** **----** **14,120**	**7,356**
			Deficiency as per list H		**3,274**
		10,530			**10,530**

Deficiency as per List H

Particulars	Rs.	Particulars	Rs.
Excess of Assets over Liabilities i.e. Capital	3,320	Bad debts as per list F	6,000
Surplus from prabu's estate Household furniture house 1,500 Less:Rates 30 ---- Less: Mortgage together with interest 1,224 -------	246	Other losses: Loss on realisation of : Fixtures & fittings 340 Stock in trade 1,200 -------	1,500
Exemption from Mrs.prabu's loan	400	Loss on Bills discounted	200
Deficiency as per Statement of Affairs	3,274		
	7,740		**7,740**

Problem

Mr.chandran of Calcuta finds himself insolvent on 31.12.93. His position was as follows:
Leasehold property Rs.10, 000 (estimated to realise Rs.9, 000)
Plant and machinery Rs.4, 000 (estimated to realise Rs.3, 000)
Stock in trade Rs.2, 000 (estimated to realise Rs.1, 400)

Book Debts: Good R.6, 000
Doubtful Debts Rs.500 (estimated to realise 50%)
Bad debts Rs.1, 400
Bills in hand Rs.375
Life policy for Rs.2, 500 whose surrender value is Rs.500 is held by insurance company against a loan of Rs.200.
Household furniture Rs.360; household debt Rs.290
Bills discounted Rs.600 (Rs.200 likely to be dishonoured)
Loan on Mortgage of leasehold Rs.5, 000
Cash in hand Rs.10
Bank overdraft secured by personal guarantee of Chandra's brother and second mortgage on leasehold Rs.5, 000.
Unsecured creditors Rs.15, 000
Loan from Nathan Rs.250 secured by second charge on life policy
Ground Rent on leasehold for three months accrued Rs.25
He could not pay his office clerk's (two in number).
Salaries for six months, Rs.150 and also rates and taxes amounting to Rs.150
Prepare a statement of affairs.
Solution:

Gross Liabilities	**Liabilities**	**Expected to rank**	**Assets**	**Book value**	**Estimated to produce Rs.**
15,957	Unsecured Creditors as per list A	**15,557**			
5,450	Fully secured creditors as per list B 5,450 **Less:** Estimated value of security **9,500** ------ **Surplus** **4050** **Less:** Amount carrieddown 4,000 to list C ------ Surplus as per contra 50		**Property as per list E:** Cash in hand Stock Machinery Furniture	 10 2,000 4,000 360	 10 1,400 3,000 360
	Partly secured creditors as per list C 5,000 **Less:** Estimated value of security 4,000 -------	**1,000**	**Book debts as per list F** Good Doubtful Bad	 6,000 500 1,400	 6,000 250 ----
	Preferential creditors		**Bills of Exchange as per list G**	**375**	**375**

	as per list D 258 **Less**: Deducted 258 as per contra -----	**Nil**	Surplus from securities in the hands of secured creditors as per contra Less: Preferential creditors as per list D as per contra	**--** **14,645**	**50** **11,445** **258** **11,187**
			Deficiency as per list H		**5,370**
		16,557			**16,557**

Working Notes

i) Calculation of Unsecured creditors as per list A

Unsecured Creditors	15,000
Bills discounted likely to be dishonoured	200
Household debts	290
Salary of two clerks (150x2/6)	50
Outstanding rent (25/3x2	17
	15,557 **-------**

ii) Calculation of fully secured creditors:

Loan on mortgage on lease holds	5,000
Insurance company	200
Mr.Nathan	250
	5,450

iii) Preferential Creditors

Outstanding Rent (25x1/3)	8
Clerk's salaries (150x4/6)	100
Outstanding taxes	150
	258

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