1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 03 (Class XII, Semester - 1)
Module Name/Title	Reconstitution of Partnership Firm-Retirement of a Partner – Part 5
Module Id	leac_10405
Pre-requisites	Basic knowledge of Partnership – New & Gaining Ratios, Treatment of Goodwill, Hidden Goodwill, Adjustment of Accumulated profits, Payment to Retiring partner
Objectives	After going through this lesson, the learners will be able to understand: • Adjustments of Capitals on various basis
Keywords	Adjustments of Capitals

2. Development Team

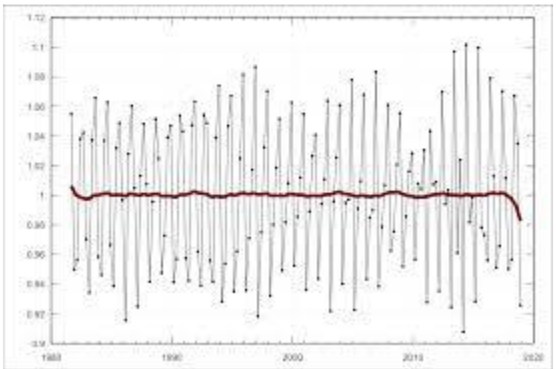
Role	Name	Affiliation
National MOOC Coordinator	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Rejaul Karim Barbhuiya	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Prof. Shipra Vaidya	DESS, NCERT New Delhi
Course Co-Coordinator / Co-PI	Dr. Nidhi Gusain	CIET, NCERT, New Delhi
Subject Matter Expert (SME)	Ms. Deepti Madhura	Amity Institute of Education, New Delhi
Review Team	Ms. Preeti Sharma Mr. Vinay Setia	Kendirya Vidyalaya, Sec 24, Noida Indraprastha Global School, New Delhi
Technical Team	Mr. Shobit Saxena Ms. Khushboo Sharma	CIET, NCERT, New Delhi CIET, NCERT, New Delhi

Table of Contents:

First of all, let us see the Objectives of our discussion

After going through this video tutorial you will be able to understand:

1. Accounting Treatment of Various type of Capital Adjustments.



Adjustment of Capitals

In case of Retirement or Death of a partner, remaining partners may decide to re-adjust their capitals on the basis of their profit sharing ratio. So, this amount required as Capital is then compared with the existing balance in the Capital account after making all necessary adjustments like Goodwill, Revaluation, JLP, etc. Then, the Excess amount is withdrawn or credited to their respective Current accounts, And, in case of Deficit, the required amount is brought in or debited to their respective Current accounts.

Let us see the steps to be followed in different cases.

CASE I- When the capital of the new firm is fixed (already specified) and capital of remaining partners to be in their new profit sharing ratio.

Following steps should be taken:

Step 1. Calculate adjusted capitals (Actual)of remaining partners.

Step 2. Ascertain the final proportionate capital on the basis of total capital of the new firm and new profit sharing ratio.

Step 3. Put the proportionate capital of remaining partners in their respective capital accounts as closing balances. (Balance c/d)

Step 4. Any Excess or Deficit to be adjusted by transferring the remaining balance in account to Cash / Bank Account OR their respective Partners' Current Accounts.

Example. A, B and C were partners sharing profits in the ratio of 3:2:1. B retires, A and C have agreed that the capital of the new firm will be fixed at Rs. 3,00,000 in the profit sharing ratio. The Capital Accounts of A and C shows a balance of Rs. 2,40,000 and Rs. 65,000 respectively on the date of retirement after making all the adjustments.

Show the adjustment of Capital Account in Both cases if

(a) excess/deficit amount may be paid off or brought in by the remaining partners or

(b) adjustment is to be made by opening Current Accounts.

Solution: In this question, Agreed Capital of the entire new firm = Rs. 3,00,000

And The New ratio between A and C =3:1

A's adjusted Capital should be = Rs. 3,00,000 × 3/4 = Rs.2,25,000 and right now existing capital of A is 2,40,000. So, the excess Rs. 15,000 has to be returned to A, so as to restrict his Capital balance to Rs. 2,25,000. The journal entry to be passed will be:

A's Capital A/c Dr. Rs. 15,000

To Cash A/c Rs. 15,000

Similarly, C's adjusted Capital should be = Rs. 3,00,000 × 1/4 = Rs.75,000. And the Existing capital of C is 65,000. So the remaining deficiency of Rs. 10,000 will be brought in cash by C as his additional capital. The required journal entry to be passed will be as under:

Cash A/c Dr. Rs. 10,000

To C's Capital A/c Rs. 10,000

(Being additional capital brought by C)

Case (a)Excess/Deficit amount paid off or brought in by the remaining partners

Dr. **PARTNERS' CAPITAL ACCOUNTS** **Cr.**

Particulars	A	C	**Particulars**	A	C
To Cash A/c(Bal.fig)	15,000	—	By Balance b/d	2,40,000	65,000
To Balance c/d	2,25,000	75,000	By Cash A/c (Bal.fig)	—	10,000

Case (b)Adjustment is to be made by opening Current Accounts

In these questions, the only difference will be that instead of Cash brought or paid, it will be transferred to their respective Current accounts.

Dr. **PARTNERS' CAPITAL ACCOUNTS** **Cr.**

Particulars	A	C	**Particulars**	A	C
To A Current A/c(Bal.fig)	15,000	—	By Balance b/d	2,40,000	65,000
To Balance c/d	2,25,000	75,000	By C Curr. A/c (Bal.fig)	—	10,000
	1,67,500	50,000		2,40,000	75,000

So, the only Change we note is that Instead of Cash, we have transferred it to the CURRENT ACCOUNT. The surplus capital of Rs. 15,000 in case of A has been transferred to his Current Account. Journal entry will be:

A's Capital A/c Dr. Rs. 15,000

To A's Current A/c Rs. 15,000

(Being A's surplus capital transferred to his Current Account)

Similarly, C's deficiency to the extent of Rs. 10,000 has also been transferred to his Current Account. Journal entry will be:

C's Current A/c Dr. Rs. 10,000

To C's Capital A/c Rs. 10,000

(Being transfer of C's deficiency to his Current Account)

Now, A's current A/c will be shown on the Liabilities side of the Revised New Balance Sheet with Rs. 15,000 being a Liability (credit balance).

And C's current A/c showing a will be shown on the Assets side of the Revised New Balance Sheet with Rs. 10,000 being an Asset. (debit balance)

Let us understand this in the Following Question.

<u>CASE I- When the capital of the new firm is fixed (already specified) and capital of remaining partners to be in their new profit sharing ratio</u>

Question. The Balance Sheet of A, B and C sharing profit in 5:3:2, stood as follows on 31/12/20:

	Rs.			**Rs.**
Sundry Creditors	6,900	Cash at Bank		5,500
Capital Accounts :		Sundry Debtors	5,000	

	A			Less : Provision	(100)	4,900
20,000		20,000				
	B			Stock		8,000
15,000		15,000				
	C		45,000	Computers		8,500
10,000		10,000				
				Land and Building		25,000
			51,900			51,900

B retired on the above date and the following was agreed upon:

(i) That stock be depreciated by 10%.

(ii) That the Provision for Doubtful Debts be brought up to 300.

(iii) That Land and building be appreciated by 20%.

(iv) That a provision of Rs.700 be made in respect of outstanding legal charges.

(v) Computer to be appreciated by 20%

(vi) B a/c to be transferred to Loan a/c.

(vii) That the entire capital of the firm as newly constituted be fixed at Rs. 36,000 between A and C in the proportion of 5: 4 (Actual cash to be brought in or paid off, as the case may be).

Pass Journal entries and show the Balance Sheet after transferring B's share to a separate Loans Account in his name.

Solution:

Books of A, **B and** C

Dr. **REVALUATION ACCOUNT** **Cr**

Particulars	Rs.	**Particulars**	Rs.
To Stock A/c	800	By Land &Building A/c	5,000
To Prov.B/D (300-100)	200	By Computers	1,700
To Prov. For Legal charges	700		
To Profits transferred to -			
A's Capital A/c 2,500			
B's Capital A/c 1,500			
C's Capital A/c 1,000	5,000		
	6,700		6,700

Dr. **PARTNERS'CAPITAL ACCOUNTS** **Cr**

Particulars	A	B	C	**Particulars**	A	**B**	C
To Loan a/c		16,500		By Balance b/d	20,000	15,000	10,000
To Bank A/c(Bal.)	2,500			By Revaluation A/c	2,500	1,500	1,000
To Balance c/d	20,000		16,000	By Bank A/c(Bal.)			5,000
	22,500	16,500	16,000		22,500	16,500	16,000

BALANCE SHEET as at 31.12.2020

Liabilities	Rs.	Assets	Rs.
Creditors	6,900	Bank	8,000
Prov. For Legal charges	700	Debtors (5000-300)	4,700
C's Loan	16,500	Land &Building	30,000
A's Capital	20,000	Computers (8500+1700)	10,200
B's Capital	16,000	Stock (8000-800)	7,200
	60,100		60,100

Working Notes:

(i) Calculation of Total Capital of New Firm.

Total Capital of new firm = Rs. 36,000

A's new Capital =- 5/9 × 36,000 = Rs.20,000B's new Capital = 4/9 × 36,000 = Rs. 16,000

Dr. BANK ACCOUNT Cr.

Particulars	Rs.	Particulars	***Rs.***
To Balance b/d	5,500	By A's Capital A/c	2,500
To C's Capital A/c	5,000	By Balance c/d	8,000
	10,500		10,500

CASE II – When the adjusted capital of the remaining partners should be in their profit sharing ratio. (total capital remaining the same)

In fact, this is to be called **"Readjustment of Capital"**

Following steps should be taken:

Step 1. Calculate Adjusted capitals of remaining partners.

Step 2. Now this is the Total Capital of the new firm = Aggregate of Total of Adjusted capital of remaining partners.

Step 3. Calculate the Proportionate capital as per their new profit sharing ratio.

Step 4. Put this as closing balance in their respective capital accounts as (To Bal. c/d)

Step 5. Any excess or deficit (Balancing figure) be adjusted by transferring to Cash/Bank account or Partners' Current / Loan Accounts. (As the Question specify)

Example.

Sanjay, Paras and Dipanshu are partner sharing profits and losses in the ratio 3:3:1. On Sanjay's retirement, capital of Paras and Dipanshu were Rs.85,000 and Rs. 1,15,000 respectively. They decided that from now onwards their Capitals should be in the new profit sharing ratio.3:2 Show the adjustment of capital.

SOLUTION: Calculation of Capitals of New Partners' as per New Profit Sharing Ratio 3:2

Adjusted Capital of Paras = Rs. 85,000

Adjusted Capital of Dipanshu = Rs. 1,15,000

Total Capital of New Firm = Rs. 2,00,000. Now this is going to be the same.

We just have to Re-adjust Only.

So, Paras new Capital will be = Rs.2,00,000 × 3/5 = Rs. 1,20,000

And Dipanshu new Capital will be = Rs.2,00,000 × 2/5 = Rs. 80,000

Working Notes:

Statement Showing Adjustment of Capitals

Particulars	**Paras**	**Dipanshu**
Old Capital	85,000	1,15,000
New Capital	1,20,000	80,000
Adjustment	+35,000 (BRING)	-35,000 (Take Back)

Paras will introduce Rs. 35,000 and Dipanshu will withdraw Rs.35,000, so as to make their Capital in their new profit sharing ratio which is 3:2

<u>CASE III- When the amount payable to retiring partners is to be brought in by remaining partners and their capital should also be in the required ratio</u>.

Example X, Z and C are partners sharing profits in the ratio of 3 : 2 : 1. Their capitals after all the necessary adjustments were Rs.2,00,000 , Rs. 1,50,000 and Rs. 2,50,000 respectively. B decides to retire. It was decided that the entire sum payable to B should be brought in by A and C in such a manner that their capital should be in the ratio of 2 : 1.

Solution:

Following steps should be taken:

Step 1. Calculate Adjusted capitals of the remaining partners.Either by making Capital accounts or May be **Given in the question**.[2,00,000+2,50,000= 4,50,000]

Step 2. Calculate the total capital to be Maintained by the new firm as under:

Capital of the remaining partners as in Step 1 *Add:* Amount payable to Retiring Partner To be brought (By Remaining partners)	4,50,000 1,50,000
Total capital of the new firm to be maintained	6,00,000

Step 3. Now, calculate the proportionate capital of each remaining partners

(As per their new profit sharing ratio).

A's new capital should be Rs. 6,00,000 × 2/3 = Rs. 4,00,000

C's new capital should be Rs.6,00,000x1/3 = Rs. 2,00,000

Step 4. Put this as closing capitals of the remaining partners in their respective capital account (To Balance c/d)

Step 5. Any excess or deficit (Balancing figure) be adjusted by transferring the to Cash/Bank account or Partners' Current / Loan Accounts. (As the Question specify)

A should bring Rs. 2,00,000 { 4,00,000 Reqd.-2,00,000 Existing}

C should take back Rs. 50,000 { 2,50,000 Existing - 2,00,000 Reqd.}

Question Based on CASE (III)

X, Y and Z were partners sharing profits and losses in the ratio of 5/10, Y – 3/10 and Z – 2/10. They had taken out a ***Joint Life Policy*** of the face value of Rs.20,000. On 31st December,2020, its surrender value was Rs.4,000.

On this date the balance sheet of the firm stood as under:

Liabilities		**Rs.**	**Assets**	**Rs.**
Sundry Creditors		5,300	Fixed Assets	25,000
Expenses Outstanding		700	Stock	11,000
Reserve		3,000	Books debts	9,000
Capital :			Cash at bank	2,000
X	20,000			
Y	10,000			
Z	8,000	38,000		
		47,000		47,000

On this date Y decided to retire and the purpose:

a) Goodwill on this date was valued at Rs.15,000

b) Fixed assets were valued at Rs.30,000

c) Stock was considered as worth Rs.10,000.

d) Y to be paid through cash brought by X and Z in such a way to make their capitals proportionate to their new profits sharing ratio which was to be X 3/5 and Z 2/5.

e) Goodwill was to be passed through the books without raising a Goodwill account.

f) Joint life policy was also not to appear in the balance sheet.

Draw all relevant Accounts and Re-constituted New Balance Sheet of New Firm.

Solution:

Books of X, Y and Z

Dr. REVALUATION ACCOUNT Cr

Particulars	**Rs.**	**Particulars**	Rs.
To Stock A/c	1,000	By Fixed Asset A/c	5,000
To Profits transferred to -			
X's Capital A/c 2,000			
Y's Capital A/c 1,200			
Z's Capital A/c 800	4,000		
	5,000		5,000

Dr. PARTNERS'CAPITAL ACCOUNTS Cr

Particulars	X	Y	Z	**Particulars**	X	**Y**	Z
To J.L.P a/c	2,400		1,600	By Balance b/d	20,000	10,000	8,000
To Y (Goodwill)	1,500		3,000	By Revaluation A/c	2,000	1,200	800
To Bank (Bal. Fig)		17,800		By Reserves	1,500	900	600
				By J.L.P	2,000	1,200	800
				By X (Goodwill)		1,500	
				By Z (Goodwill)		3,000	
To Balance c/d	27,000		18,000	By Bank A/c(Bal.)	5,400		12,400
	30,900	17,800	22,600		30,900	17,800	22,600

BALANCE SHEETas at 31.12.2020

Liabilities	Rs.	Assets	Rs.
Creditors	5,300	Bank	2,000
Expenses O/S	700	Debtors	9,000
X's Capital	27,000	Fixed Assets	30,000
Z's Capital	18,000	Stock	10.000
	51,000		51,000

Working Notes:

(i) Gaining Ratio

X= 3/5- 5/10= 1/10Z= 2/5- 2/10= 2/10

(ii) Y share of Goodwill= 15,000x3/10= 4,500 to be shared by X & Z in Gaining ratio of 1:2

X=1,500 and Z= 3,000

(iii) Calculation of Total Capital of New Firm.

X Capital (Before Adjustment) = 21,600

Z Capital (Before Adjustment) = 5,600

Payment to Y (By X and Z) = 17,800 45,000 (Firm Capital)

So, X's new Capital = 3/5 × 45,000 = Rs. **27,000** & Z's new Capital = 2/5 × 45,000 = Rs. **18,000**

Therefore, X will Bring = 27,000- 21,600 = **5,400** AND Z Will Bring = 18,000 – 5,600 = **12,400**

Dr. **BANK ACCOUNT** **Cr.**

Particulars	Rs.	Particulars	***Rs.***
To Balance b/d	2,000	By Y's Capital A/c	17,800
To X's Capital A/c	5,400	By Balance c/d	2,000
To Z’s Capital A/c	12,400		
	19,800		19,800