Financial Accounting

Prof. Vaishali Apte

Chartered Accountant

Prof. Suresh Bhirud

Ex-Head, Department of Commerce,
Mahatma Phule College, Pimpri.

Prof. Bhaskar Naphade

Ex-Head, Department of Accountancy,
Bharatratna Dr. Babasaheb Ambedkar College, Aundh.

Diamond Publications

Financial Accounting

Prof. Vaishali Apte, Prof. Suresh Bhirud, Prof. Bhaskar Naphade

First Edition : June 2013

ISBN 978-81-8483-529-8

© Diamond Publications

Cover Page :
Sham Bhalekar

Printing :
Madhuraj Printers & Publications Pvt.Ltd.,
Pune-411041

Published by :
Diamond Publications
264/3 Shaniwar Peth, 302 Anugrah Apartment
Near Omkareshwar Temple, Pune - 411 030
☎ 020-24452387, 24466642

info@diamondbookspune.com
www.diamondbookspune.com

Sole Distributor :
Diamond Book Depot
661 Narayan Peth
Appa Balwant Chowk
Pune 411 030
Tel. - 24480677, 66020282

All rights reserved. No part of this book may be reproduced or utilised in any form and by any means, electronic or mechanical, including photocopying, recording or by any information storage or retrieval system, without permission in writing from the publisher.

University of Pune
(2013 - 14)
F.Y. B.Com.
Compulsory Paper
Subject Name -: Financial Accounting.

Objectives -:

1. To impart the knowledge of various accounting concepts
2. To instill the knowledge about accounting procedures, methods and techniques.
3. To acquaint them with practical approach to accounts writing by using software package.

Term I

Unit No.	Topic
1.	**Piecemeal Distribution of Cash** Meaning and Introduction, Surplus Capital Method and Maximum Loss Method
2.	**Amalgamation of Partnership Firms:-** Meaning and Introduction, Objectives, Methods of accounting
3.	**Conversion of a partnership firm into a limited company** Meaning and introduction, objectives, effects, methods of calculation of purchase consideration (Net Asset and Net Payment method), accounting procedure in the books of the firm and balance sheet of new company
4.	**Computerized Accounting Environment** Meaning and Introduction, application of accounting software package, Voucher entry through software package.

Term II

Unit No.	Topic
5.	**Introduction and Relevance of Accounting Standards** Overview of Accounting Standards in India-Concept, Need, Scope and Importance. Study of AS- 1, AS- 2, AS- 4 and AS- 9

6.	**Royalty Accounts [excluding sub-lease]:** Royalty, Minimum Rent, Short Workings, Recoupment of Short Working, Lapse of Short Working. Journal Entries and Ledger Accounts in the Books of Landlord and Lessee.
7.	**Hire Purchase and Installment System:** **[Excluding H. P. Trading]** Basic Concepts and Distinction, Calculation of Interest and Cash Price, Journal Entries And Ledger Accounts in The Books of Purchaser and Seller.
8.	**Departmental Accounts** Meaning and Introduction, Methods and Techniques, Allocation of expenses, Inter Departmental Transfers, Provision for unrealized profits

Contents

Part I

Chapter - 1	Piecemeal Distribution of Cash	1
Chapter - 2	Amalgamation of Partnership Firms	50
Chapter - 3	Conversion of a partnership firm into a limited company	120
Chapter - 4	Computerised Accounting Environment	164

Part - II

Chapter - 5	Introduction and Relevance of Accounting Standards	183
Chapter - 6	Royalty Accounts [Excluding sub-lease]	208
Chapter - 7	Hire Purchase and Installment System: [Excluding H. P. Trading]	263
Chapter - 8	Departmental Accounts	344

Chapter 1

Piecemeal Distribution of Cash

1.1 Introduction
1.2 Settlement of Accounts
1.3 Methods of Piecemeal Distribution
1.3.1 Surplus Capital Method
1.3.2 Illustrations
1.4 Maximum Loss Method
1.4.1 Illustration
1.5 Exercises

1.1 Introduction :

We have earlier studied the admission, retirement of a partner and dissolution of partnership firm. When the partnership firm comes to end due to death, retirement or insolvency of the partners, the partnership firm is to be dissolved. The dissolution of partnership firm means closing the business of the firm. A firm ceases to exist after the dissolution of the partnership. The partnership firm cannot remain in existence after the firm gets dissolved. In case of dissolution of the partnership firm, it is assumed that all the assets are to be realised on the date of dissolution and all liabilities are also to be paid on the same date. But in actual practice, it is not possible to realise all assets and make payments of all the liabilities on the date of dissolution. The above assumption is unrealistic. The realisation of assets takes a long time to fetch better price. In order to get better price, the assets are to be sold, when they have heavy demand in the market. In short, the assets are sold gradually to get better prices for them and the cash available is immediately paid to the rightful claimant or claimants.

Meaning of Piecemeal Distribution :

According to Partnership Act 1932 cash made available by gradual realisation should be distributed among the rightful claimants. It should not be retained with the firm till all the assets are sold or realised. So **"The process of distribution of cash in accordance with availability is called piecemeal distribution."**

In short, in piecemeal distribution assets are sold or realised in pieces, then only they fetch better price and liabilities like creditors, bills payable, partners' loan and capital of partners are also paid in pieces. Therefore, this method of distribution is called as 'Piecemeal Distribution.'

1.2 Settlement of Accounts and Order of Payment :

At the time of dissolution of the firm, we prepare Realisation Account and partners' capital account and assume that all assets are realised on the date of dissolution and payment of liabilities are also made on the same date. But this is not true. At the time of payment of liabilities, the question arises, "To whom the payment is to be made and what should be the order of payment?" This problem is solved by the Partnership Act 1932. The Partnership Act 1932 (Section 48) lays down the rules and regulations regarding the priority of payments. The liabilities are paid off in the following preferential order with the available cash.

1) Realisation Expense
2) Preferential Creditors
3) Secured Creditors
4) Unsecured Creditors
5) Partner's Loan
6) Partner's Capital

(1) Realisation Expenses/Dissolution Expenses :

Realisation Expenses are paid or become payable out of the cash available. These expenses include legal expenses, commission or brokerage to selling agent, repairs to assets etc. Out of the available cash, realisation expenses are paid first. If, in the initial stage, actual realisation expenses are not known, the provision for realisation can be deducted from available cash. When the amount of actual expenses is known, they are paid off and if the expenses incurred are less than provision, the remaining cash is added in the respective instalment of realisation and used for payment of liabilities. If the provision falls short than actual expenses, the remaining amount is paid from asset realised on that date.

(2)(a) Preferential Creditors :

After the payment of realisation expenses, preferential creditors are to be paid. Preferential Creditors are these creditors, who have preference in respect of payment of their dues over other creditors. Government or local body dues income tax, sales tax etc. are the examples of preferential creditors.

(b) Contingent Liability :

Contingent Liability means the liability which may or may not arise. For example Bill discounted with the bank. If the acceptor dishonours the bill on due date, the party discounts the bill has to pay the amount of bill to the bank. Hence, it becomes the liability and it is called contingent liability.

If there is contingent liability the amount for such liability is set aside before paying cash to any other party. If such liability arises, the amount set aside will be paid to claimant and if it does not arises the amount set aside is used for other claimant.

(3) Secured Creditors :

If any creditor is secured by the particular asset of the firm, the creditor is called as secured creditor. The secured creditor has a right to sell the asset and recover his dues. After the recovery of his dues, if there is any surplus it can be used for other secured creditors. On the other hand, if there is any deficit, the balance left unpaid will be treated as unsecured creditor and will be paid with other unsecured creditors.

(4) Unsecured Creditors/Third Party Liability :

After making the above payments, the available cash is paid to unsecured creditors/third party claimants. These creditors are not given any security, hence they are called unsecured creditors. They include sundry creditors, bills payable, bank overdraft, loans from outsiders etc. (Loan taken from the wife of the partner is also treated as third party liability). If the cash is sufficient to settle the claim of above unsecured creditors, then there is no problem. But if the cash is insufficient to settle the claim, the available cash will be distributed between/among partners to their proportion of dues. For example, suppose the third party liabilities (unsecured creditors) are sundry creditors, Rs.15,000, bills payable Rs.10,000 and bank overdraft Rs.5,000 and cash available is Rs.9,000. Then Rs.9,000 will be

distributed among the creditors in their loan ratio of 15,000, 10,000, 5,000 i.e.3:2:1. So the available cash (Rs.9,000) will be distributed among creditors in the ratio of 3:2:1. Thus, the creditors would receive Rs.4,500, bills payable Rs.3,000 and bank Rs.1,500.

(5) Partner's Loan :

After the payment to third party liabilities, partners' loan rank for the repayment. If loans are advanced by two or more partners and the available cash is sufficient, it will be distributed among the partners. But if the cash available is insufficient, the loan will be repaid among the partners in proportion of loan. For example, if available cash is 3000 and loans from partners are A-Rs.4000 B- Rs.3000 and C-Rs.2000. Then cash will be distributed among partners in the ratio of 4:3:2.

(6) Partner's Capital :

Partners rank last for refund of their capitals. Once all other liabilities are paid, the partners shall start getting the payment. Sometimes, partners may not get full amount of capital contributed by them. In such a case, they have to forgo some portion of the capital. It is called as realisation loss.

While repaying the capitals, whether profit sharing ratio or capital ratio is used at the time of dissolution, the final unpaid balances (i.e. Realisation loss) may not be in profit sharing ratio. So, piecemeal distribution of cash is made in such a way that (i) no partner receives over payment or is put to heavy loss and (ii) the final unpaid balances on capital are in profit sharing ratio. To achieve this, the following methods of distribution of cash are applied.

1.3 (1) Surplus Capital Method
(2) Maximum Loss Method

1.3.1 Surplus Capital Method :

This method is also called as Excess Capital Method/ Proportionate Capital Method or Highest Relative Capital Method. Under this method, the capitals of the partners are brought proportionate to their profit sharing ratio by paying surplus capital of a partner/partners. So, first of all, we have to find out the surplus captial of the partners.

For the calculation of surplus capital, 'A statement showing surplus capital or excess capital' is to be prepared. This statement is prepared as under -

1. Find out capital per unit of profit of each partner by dividing his capital by his share of profit.

2. The partner whose capital per unit of profit is lowest or minimum is taken as a base and it is multiplied by profit sharing ratio of each partner.

3. Thus, calculate expected captials of all partners. Such amount of capitals are known as 'proportionate capitals'.

4. Deduct the proportionate capital of respective partner from actual amount of capital.

5. Determine the excess figure which is known as surplus capital.

The same method is to be followed again and again to find out absolute surplus, if there are more than two partners or number of partners.

The above process will be clear from the following illustration.

Illustration :

A, B and C are the partners sharing profits and losses in the ratio of 3:2:1. Their capitals were Rs.30000, Rs.24000 and Rs.15000 respectively, when the firm was dissolved.

From the above, calculate surplus capital.

Statement showing surplus capital.

Particulars	Capital Accounts		
	'A' Rs.	'B' Rs.	'C' Rs.
Capital Balances as per B/S.	(i) 30,000	24,000	15,000
profit sharing ratio	3	2	1
Capital per unit of profit A' is having lowest capital per share of profit, hence taken as a base and it is multiplied by profit sharing ratio of each partner.	$\frac{30000}{3}$ = 10000 10000 x 3 = (ii) 30000	$\frac{24000}{2}$ = 12000 10000 x 2 = 20000	$\frac{15000}{1}$ = 15000 10000 x 1 = 10000

Particulars	Partner's Capital		
	'A' Rs.	'B' Rs.	'C' Rs.
Surplus or excess capital (i-ii)	(ii) (Nil)	4,000	5,000
Profit sharing ratio of remaining partners capital per unit of profit 'B' is having lowest capital per share of profit, hence taken as base and it is multiplied by p.s. ratio of remaining partners.		2 $\frac{4000}{2} = 2000$ 2000 x 2 = 4000	1 $\frac{5000}{1} = 5000$ 2000 x 1 = 2000
Absolute surplus capital.		(Nil)	3000

Payment of surplus capital to partner :

While making the payment of surplus capital to partners, the reverse order is to be followed. The absolute surplus capital is paid off first. Then the surplus capital is paid. Thereafter the remaining capital of all partners is paid in their profit sharing ratio.

In above example the priority of payment will be as under-

1. First of all the absolute surplus of 'c' i.e. Rs.3000 will be paid.

2. Secondly the surplus capital of B and C will be paid. At this stage, Rs.4000 and Rs.2000 (5000-3000) will be paid to B and C.

3. Remaining cash will be paid to all partners in their profit sharing ratio.

Note : If there is General Reserve or Credit Balance of Profit and Loss Account, it should be distributed among the partners in their profit sharing ratio and added to original capital balances. On the other hand, if there is debit balance in P & L A/c (loss) it is deducted from the capital balances at the beginning in profit sharing ratio at the time of preparing statement of surplus capital.

Distribution of cash

Suppose that the assets of the firm are realised gradually and cash received as follows- Ist instalment Rs.15,000 and IInd instalment Rs.24,000.

Statement showing Distribution of Cash

Date	Particulars	Cash Available Rs	Capital Accounts 'A' Rs.	'B' Rs.	'C' Rs.
	Capital Balance		30,000	24,000	15,000
	Ist Instalment	15000			3000
	Paid to 'C' (Absolute surplus)	-3000			
	Balance Due	12000	30,000	24,000	12,000
	Paid to 'B' and 'C' (surplus capital)	- 6000		4,000	2,000
	Balance Due	6000	30,000	20,000	10,000
	Paid the remaining balance i.e. Rs.6000 among partners in their profit sharing ratio (3:2:1)		3,000	2,000	1,000
	Balance Due		27,000	18,000	9,000
	IInd Instalment Rs.	24000			
	Paid to all partners in their profit sharing ratio. i.e.ratio i.e. 3:2:1		12,000	8,000	4,000
	Realisation loss.		15,000	10,000	5,000

Note :- Realisation loss generally comes in profit sharing ratio of the partners.

Illustration 1

A, B and c carried on business as a partners sharing profit and losses in the ratio of 2:2:1 respectively. Their balance sheet was as follows :

Balance sheet on 31st Dec 2012.

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		15,000	Cash in Hand	6,000
Capital Accounts			Sundry Debtors	10,000
A	28000		Plant & Machinery	12,000
B	25000		Land & Building	50,000
C	10000	63,000		
		78,000		78,000

The partnership was dissolved and the amounts realised from the sale of assets were as follows :

First instalment	Rs. 8000
Second instalment	Rs.14000
Third instalment	Rs.16000
Realisation expenses were	Rs. 1000

Draw up detail statement showing distribution of cash.

Solution :

Statement showing surplus capital

Particulars	'A' Rs.	'B' Rs.	'C' Rs.
Capital Balances	28,000	25,000	10,000
Profit sharing Ratio	2	2	1
Capital per unit	28,000	25,000	10,000
	2	2	1
	14,000	12,500	10,000
C's capital is lowest hence taken as base and multiplied by profit sharing ratio	-20,000	-20,000	-10,000
Surplus	8,000	5,000	-
Profit sharing Ratio	2	2	
Capital per unit	4,000	2500	
Taking B's capital as base	-5000	-5000	
Surplus capital	3,000	-	

Repayment of capital

1) First Rs.3000 paid to A
2) Next 5000 + 5000 paid to A and b respectively
3) Remaining cash paid to all partners in their profit sharing ratio.

Statement showing distribution of cash

Illustration 2

Date	Particulars	Cash Available Rs	Creditors	Capital Accounts A	B	C
	Balances		15,000	28,000	25,000	10,000
	Cash Balance	6000				
	- Realisation Expenses	-1000				
		5000				
	Paid to creditors	-5000	-5000			
	Balances	-	10,000	28,000	25,000	10,000
	Ist Instalment	8000				
	Paid to Creditors	-8000	-8000			
	Balances	-	2000	28,000	25,000	10,000
	IInd Instalment	14000				
	Paid to Creditors	-2000	-2000			
		12000	-	28,000	25,000	10,000
	Paid to Mr A	- 3000		-3000		
	Balances	9000		25,000	25,000	10,000
	Paid to Mr A & Mr B in their P.S. Ratio (i.e. 2:2)	-9000		-4500	-4500	-
	Balances	-		20,500	20,500	10,000
	III Instalment	16,000				
	Paid to Mr A and Mr B in their P.S. Ratio (i.e. 2:2)	- 1000		-500	-500	-
	Balances	15,000		20,000	20,000	10,000
	Paid to A,B and C in their P.S. Ratio i.e. 2:2:1	-15000		-6000	-6000	3000
	Realisation Loss			14,000	14,000	7,000

P, Q and R were partners in a firm sharing profits and losses in the ratio equally. They decided to dissolve the firm on 31-6-2012. when their balance sheet was as follows -

Balance sheet as on 31-6-2012

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	20,000	Fixed Assets	50,000
Income Tax	2,000	Current Assets	15,000
General Reserve	18,000	Cash at Bank	10,000
Capital Accounts			
P 20000			
Q 10000			
R 5000	35,000		
	75,000		75,000

As per discussion with the bank, it was decided to withdraw Rs.4000 immediately and the balance after 1st Sep.2012. The assets were realised as under -

Date	Fixed Assets (Rs.)	Current Assets
31st July 12	15,000	5,000
31st Aug. 12	25,000	7,000
30th Sept.12	11,000	600

The partners kept aside Rs.1000 to meet probable expenses of realisation but actually they amounted to Rs.600.

Prepare statement showing surplus capital and distribution of cash.

Solution :

Statement showing surplus capital .

Particulars	Capital Accounts		
	'P' Rs.	'Q' Rs.	'R' Rs.
Capital Balance	20,000	10,000	5,000
+ Reserve Fund equally distributed	6,000	6,000	6,000
Final capital Balance	26,000	16,000	11,000
Profit sharing Ratio	1	1	1
Per unit capital	26,000	16,000	11,000
R's. capital is lowest hence taken as base	-11000	-11000	-11,000
Surplus capital	15,000	5000	-
P.S. Ratio (equal)	1	1	
Per unit capital	15,000	5000	
Q's capital is lowest hence taken as base	-5000	-5000	
Surplus capital	10,000	-	

Repayment of capital

1) First Rs.10000 paid to P

2) Next Rs.5000 + 5000 paid to P and Q respectively.

3) Remaining cash paid to P, Q and R in their profit sharing ratio.

Statement showing distribution of cash

Date	Particulars	Cash Available Rs	Income Tax	Creditors	Capital Accounts		
					P	Q	R
	Final Balances		2,000	20,000	26,000	16,000	11,000
	Cash withdrawn	4000					
	- Realisation Exp.	- 1000					
		- 3000					
	Paid Income Tax	- 2000	-2000				
		1000	-	20,000	26,000	16,000	11,000
	Paid to Creditors	-1000		-1000			
	Balances			19,000	26,000	16,000	11,000

Statement showing distribution of cash (contd.)

Date	Particulars	Cash Available Rs	Income Tax	Creditors	Capital Accounts A	B	C
	Ist Instalment			19,000	26,000	16,000	11,000
	Fixed Assets	15000					
	Current Assets	+ 5000					
		20,000					
	Paid to creditors -	19000	-2000	-19000			
	Balances	1000	-		26,000	16,000	11,000
	Paid to Mr. P.	1000			-1,000		
		-			25,000	16,000	11,000
	IInd Instalment						
	Fixed Assets	25000					
	Current Asset	+ 7000					
		32000					
	Paid to Mr. P.	-9000			-9,000		
		23000			16,000	16,000	11,000
	Paid to Mr. P & Q equally	- 10000			-5000	-5000	-
		13000			11000	11,000	11,000
	Paid to P,Q,R	13000			-4333	-4333	-4334
	Balance	-			6667	6667	6666
	Cash withdrawn from Bank	6000					
	Paid to P,Q,R (equally)	- 6000			-2000	-2000	-2000
	Balances				4,667	4667	4666
	III Instalment						
	Fixed Assets	11000					
	Current Assets	+ 600					
		11600					
	Refund of Realisation expenses	+ 400					
		12,000					
	Paid to P,Q and R (equally)	-12000			-4000	-4000	-4000
	Realisation Loss	-			667	667	666

Illustration 3

A, B and C were in partnership sharing profit and losses in the ratio of 2:1:1. They decided to dissolve the business on 31st Dec, 2012, on which date their Balance Sheet was as under-

Balance sheet

Liabilities		Rs.	Assets	Rs.
Capitals			Cash	10,000
A -	1,00,000		Debtors	90,000
B -	55,000		Stock	85,000
C -	25,000	1,80,000	Plant & Machinery	65,000
General Reserve		20,000	Land & Buildings	1,55,000
Income Tax		10,000		
Creditors		1,17,000		
Bills Payable		78,000		
		4,05,000		4,05,000

The assets were realised on piecemeal as follows.

on 1-1-2013 Rs. 15,000
on 31-1-2013 Rs. 2,11000
on 20-2-2013 Rs. 82,000
on 31-3-2013 Rs. 58,000

It was agreed that the cash should be distributed as and when realised. Dissolution expenses were originally provided for an estimated of Rs.5,000. The actual expenses amounted to Rs.4,000 spent on 31st March 2013.

Statement showing surplus capital

Particulars	'P' Rs.	'Q' Rs.	'R' Rs.
Capital Balances	1,00,000	55,000	25,000
+ General Reserve (2 : 1 : 1)	10,000	5000	5,000
Final capital Balances	1,10,000	60,000	30,000
Profit sharing Ratio	2	1	1
Per unit capital	55,000	60,000	30,000
C's capital is lowest			
hence it is taken as base and multiplied			
by P.S. ratio	-60,000	-30,000	-30,000
Surplus capital	50,000	30,000	
Profit sharing ratio	2	1	
Per unit capital	25,000	30,000	
as A's capital is lowest it is taken as base			
and multiplied by P.S. Ratio.	-50,000	-25,000	
Surplus capital	-	5,000	

Statement Showing Piecemeal Distribution of Cash

Date	Particulars	Cash Available Rs	Income Tax	Creditors Rs.	Bill Payable	Capital Accounts A Rs.	B Rs.	C Rs
	Balances	10000	10,000	1,17,000	78,000	1,10,000	60,000	30,000
	- Provision for realisation Expenses	5000	-5000					
		5000	5,000	1,17,000	78,000	1,10,000	60,000	30,000
	- Income Tax	-5000	-5000					
		-						
	Balances		5,000					
	Ist Realisation							
	Assets Realised	15000						
	- Income Tax	-5000	-5000					
		10000	-	1,17,000	78,000	1,10,000	60,000	30,000
	Paid to Crs. and B.P. in their Ratio 3:2 -	- 10000		-6000	-4000			
		-		1,11,000	74,000	1,10,000	60,000	30,000
	IInd Realisation							
	Assets Realised	2,11,000						
	Paid to Crs. and B.P. (3:2)	1,85,000		-1,11,000	-74000			

Date	Particulars	Cash Available Rs	Income Tax	Creditors Rs.	Bill Payable	Capital Accounts A Rs.	B Rs.	C Rs
	Balances	26000	-	-	-	1,10,000	60,000	30,000
	Paid to B	- 5000					-5000	
	(Surplus capital Balances)	21000				1,10,000	55,000	30,000
	Paid to A and B in the ratio 2:1	21000				-14000	-7000	-
	Balances	-				96,000	48,000	30,000
	IIIrd Realisation							
	Assets Realised	82000						
	- Paid to A and B in their P.S. Ratio 2:1	54000				-36000	-18000	-
	Balances	28,000				60,000	30,000	30,000
	Paid to A,B & C in P.S. Ratio 2:1:1 -	28000				-14000	-7000	-7000
	Balances	–				46,000	23,000	23,000
	IVth realisation							
	Assets Realised	58000						
	+ Provision of realisation Expenses	+1000						
		59000						
	Paid to A, B and C in P.S. Ratio 2:1:1	59000				-29500	-14750	-14750
	Realisation Loss					16,500	8250	8,250

Illustration 4

Asha, Usha and Nisha were in partnership with a capital of Rs.60000 originally contributed in the proportion of 1/2, 1/3 and 1/4 respectively sharing profits and losses in the same proportion. The partnership was dissolved on 31st Dec 2012. The balance sheet on which date was as follows-

Balance sheet as on 31-12-2012

Liabilities		Rs.	Assets	Rs.
Capitals			Cash	8000
Asha -	40000		Debtors	84000
Usha -	20000		Stock	32000
Nisha -	4000	64,000		

Liabilities		Rs.	Assets	Rs.
Loans				
Asha	12000			
Usha	8000	20,000		
Bank Overdraft		40,000		
		1,24,000		1,24,000

It was agreed that net realisations should be distributed in their due order at the end of each calendar month. The realisations and expenses were-

Month	Debtors (Rs.)	Stock (Rs.)	Current Assets
January	16,000	8,000	2000
February	20,000	2,000	1000
March	18,000	16,000	2000
April	20,000	2,000	800
May	4,000	6,000	1000

The stock has been completely disposed off. It was agreed that Nisha should take over the remaining debtors at Rs.1200.

Prepare statement of surplus capital and statement of distribution of cash.

Solution

Statement Showing Surplus Capital

Particulars	Asha	Usha	Nisha
Capital Balances	40,000	20,000	4000
Profit sharing Ratio	3	2	1
Per unit capital	13333.33	10,000	4,000
As Nisha's capital is lowest, it is taken as base and multiplied by P.S. Ratio	-12,000	-8,000	-4000
Surplus Capital	28,000	12,000	-
Profit Sharing Ratio	3	2	
Per unit capital	9333.33	6000	
As Usha's capital is lowest it is taken as base and multiplied by P.S. ratio.	-18,000	-12,000	
Surplus Capital	10,000	-	

Statement Showing Distribution of Cash

Date	Particulars	Cash Available Rs	Bank O/D	Loan		Capital Accounts		
				Asha Rs.	Usha Rs.	Asha	Usha	Nisha
	Balances	8000	40,000	12,000	8,000	40,000	20,000	4000
	Paid to Bank	-8000	-8000					
	(Bank overdraft)	-	32,000	12,000	8,000	40,000	20,000	4000
	Ist Instalment							
	Debtors	16000						
	Stock	+ 8000						
		24000						
	Expenses	- 2000						
		22,000						
	Paid to Bank	-22000	-22000					
	(Bank overdraft)							
	Balances		10,000	12000	8,000	40,000	20,000	4000
	IInd Instalment							
	Debtors	20000						
	Stock	+ 2000						
		22000						
	- Expenses	- 1000						
		21000						
	Paid to Bank	- 10000	-10000					
		11000	-	12000	8,000	40,000	20,000	4000
	Paid loan of Asha							
	and usha (3:2)	- 11000		-6600	-4400			
				5400	3600	40,000	20,000	4000
	IIIrd Instalment							
	Debtors	18000						
	Stock	+16000						
		34000						
	Expenses	-2000						
		32000						
	Paid loan of							
	Asha & Usha	-9000		-5400	-3600			
	Balances	23000		—	—	40,000	20,000	4,000
	Paid to Asha	-10000				-		
	Balances	13000				10000	20,000	4,000
	Paid to Asha &					30,000		
	Usha (3:2)	13000					-	
	Balances	-				-7800	5200	4000
						22200	14800	

Date	Particulars	Cash Available Rs	Bank O/D	Loan		Capital Accounts		
				Asha Rs.	Usha Rs.	Asha	Usha	Nisha
	IVth Realisation			1,10,000	1,10,000			30,000
	Debtors	20000						
	+Stock	2000						
		22000						
	- Expenses	800						
		21200						
	Paid to Asha &	-17000				-10200	-6800	
	Usha (3:2 :1)							
	Balances	4200				12000	8000	4000
	Paid to Asha Usha & Nisha							
	(3:2:1)	-4200				-2100	-1400	-700
	Vth Realisation	—				9900	6600	3300
	Debtors	4000						
	Stock	+ 6000						
		10000						
	Expenses	-1000						
	+Debtors	9000						
	Collected	1200						
		10200						
	Paid to Asha							
	Usha & Nisha							
	(3 : 2 : 1)	-10200				-5100	-3400	-1700
	Realisation Loss					4800	3200	1600

Repayment of capital

Note : 1) First Rs.10000 paid to Asha.

2) Next Rs.18000+12000 paid to Asha and Usha.

3) Remaining cash paid to all partners in their profit sharing ratio.

4) It is assumed that amount paid to Nisha on 31st May 2013 includes Rs.1200 for Debtors and Rs.500 cash.

Illustraion 5

Anita, Sunita and Nita were in partnership sharing profits and losses in the ratio of 1/2, 1/4 and 1/4 respectively. The following was their Balance Sheet on 31-12-2012 on which day they decided to dissolve the firm.

Balance sheet as on 31-12-2012

Liabilities		Rs.	Assets	Rs.
Creditors		30,000	Cash	18,000
Income Tax		8,000	Stock	80,000
Loan from Bank		60,000	Debtors	1,20,000
(Secured by pledge of			Furniture	72,000
Stock)			Motor Car	50,000
Sunita's loan		13,200		
Nita's Loan		8,800		
Capitals				
Anita	80000			
Sunita	80000			
Nita	60000	2,20,000		
		3,40,000		3,40,000

Adjustments :

(1) Bank could realise only Rs.50000 on disposal of stock

(2) A sum of Rs.6000 was spent for repairs of furniture to get better price.

(3) Other assets were realised as follows :

Jan 2013 Rs.24000
Feb 2013 Rs.30000
March 2013 Rs.20000
April 2013 Rs.60000
May 2013 Rs.100000

Prepare a statement showing distribution of cash as per proportionate capital method.

Statement Showing Surplus Capital

Particulars	Anita	Sunita	Nita
Capital Balances	80,000	80,000	60,000
Profit sharing Ratio	2	1	1
Per unit capital	40,000	80,000	60,000
As Anita's capital is lowest it is taken as base and multiplied by P.S. Ratio	-80,000	-40000	-40000
Surplus Capital	-	40,000	20,000
Profit Sharing Ratio		1	1
Per unit capital		40,000	20,000
As Nita's capital is lowest it is taken as base and multiplied by P.S. ratio.		-20,000	-20000
Surplus Capital		20,000	-

Repayment of capital

Note (1) First Rs.20000 paid to Sunita.

(2) Next Rs.20000+20000 paid to Sunita and Nita.

(3) Remaining cash to all partners in their profit sharing ratio.

Statement Showing Distribution of Cash

Date	Particulars	Cash Avail.Rs	Income Tax	Creditors		Partner's Loan		Capital Accounts		
				Creditor	Bank od	Sunita	Nita	Anita	Sunita	Nita
	Balances		8000	30000	60000	13200	8800	80000	80000	60000
	Paid to Bank (Secured				-50000					
	Loan) (Stock Realised)		8000	30000	10000	13200	8800	80000	80000	60000
	Cash Balance	18000								
	Paid for repairs of furniture	-6000								
		12000								
	Paid Income Tax	-8000	-8000							
	Balances	4000	-	30000	10000	13200	8800	80000	80000	60000
	Paid to Crs Bank Loan in the ratio of 3:1	4000		-3000	-1000					
	Balances			27000	9000	13200	8800	80000	80000	60000

(contd.)

Date	Particulars	Income	Creditors		Partner's Loan		Capital Accounts		
	Cash Avail.Rs	Tax	Creditor	Bank od	Sunita	Nita	Anita	Sunita	Nita
	Ist Realisation 24000								
	Paid to Crs. & Bank								
	Loan (3:1) -24000		-18000	-6000					
	Balances -		9000	3000	13200	8800	80000	80000	60000
	IInd Realisation 30000								
	Paid to Crs. & Bank								
	loan (3:1) -12000		-9000	-3000					
	Balances 18000		-	-	13200	8800	80000	80000	60000
	Paid loan of Sunita & Nita								
	(3:2) 18000				-10800	-7200			
	-								
	Balances				2400	1600	80000	80000	60000
	III Realisation 20000								
	Paid loan of Sunita & Nita								
	(3:2) -4000				-2400	-1600			
	Balances 16000				-	-	80000	80000	60000
	Paid Sunita's capital							-	
	-16000							16000	
	(surplus capital) -						80000	64000	60000
	IVth Realisation 60000								
	Paid Sunita's								
	surplus capital 4000							-4000	
	56000						80000	60000	600000
	Paid Sunita's & Nita's								
	Surplus capital -40000							-	-
	Balances 16000						80000	20000	20000
	Paid Anita Sunita & Nita							40000	40000
	in P.S.Ratio (2:1:1)								
	-16000						-8000		
	Balances -						72000	-4000	-4000
	Vth Realisation 100000							36000	36000
	Paid to Anita, Sunita &								
	Nita (2:1:1) -100000						-	-	-
	Realisation Loss						50000	25000	25000
							22000	11000	11000

Notes : 1) Repairs to furniture as an expenses (preferential) deducted from cash balance.

2) Income tax being preferential creditors paid first

3) Bank recovers Rs.50000 from stock given as a security. The unsecured balance (60000-50000) Rs.10000 treated as unsecured and hence paid along with other creditors.

Illustration 6

X, Y and Z were in partnership, sharing profit and losses in the ratio of 2:2:1. They decided to dissolve the firm on 31st December 2012 when their Balance Sheet was as under -

Balance Sheet as on 31st Dec. 2012

Liabilities		Rs.	Assets	Rs.
Creditors		30,000	Fixed Assets	70,000
Loans : X	8000		Current Asset	32,000
Y	4000	12,000	Profit & Loss A/c	20,000
Reserve Fund		10,000	Cash at Bank	20,000
Capitals	X	20,000		
	Y	40,000		
	Z	30,000		
		1,42,000		1,42,000

As per agreement with the bank the partners were entitled to withdraw Rs.5000 immediately and Rs 15200 after 25th March 2013.

The Assets were realised gradually as follows :

Date	Gross Amount	Expenses Rs.
15th Jan. 2013	43,000	3,000
15th Feb. 2013	32,000	2,000
15th March 2013	24,000	4,000

Sundry creditors were settled at 5% discount show the distribution of each instalment as per surplus capital method.

Solution

Statement Showing Surplus Capital.

Particulars	X Rs	Y Rs	Z Rs
Capital Balances (original)	20,000	40,000	30,000
Add Reserve Fund (2:2:1)	4,000	4,000	2,000
	24,000	44,000	32,000
Less Profit & Loss A/c (Loss) (2:2:1)	8,000	8,000	4,000
Final capital balances	16,000	36,000	28,000
Profit sharing ratio	2	2	1
Per unit capital	8,000	18,000	14,000
as X's capital is lowest it is taken as base and multiplied by P.S. ratio.	-16,000	-16,000	-8000
Surplus capital	-	20,000	20,000
Profit sharing ratio.		2	1
Per unit capital		10,000	20,000
As Y's capital is lowest it is taken as base and multiplied by P.S. ratio.		-20,000	-10,000
Surplus capital		-	10,000

Statement Showing Distribution of Cash

Date	Particulars	Cash Avail.Rs	Credi-tors	Partner's Loan		Capital Accounts		
				X Rs.	Y Rs.	X Rs.	Y Rs.	Z Rs.
	Final Balance		Rs.	8000	4000	16000	36000	28000
	- Discount on Creditors 5% on 30000		30,000					
	Balances		-1500	8000	4000	16000	36000	28000
	Withdrawn from Bank	5000	28500					
	Paid to Crs.	-5000						
	Balances	-	-5000	8000	4000	16000	36000	28000
			23500					

Contd.

(Distribution of Cash contd.)

Date	Particulars	Cash Available Rs.	Credi-tors	Partner's Loan		Capital Accounts		
				X Rs.	Y Rs.	X Rs.	Y Rs.	Z Rs.
	Ist Realisation Gross Assets		Rs.	8000	4000	16000	36000	28000
		43000						
	Expenses	3000						
		40000				16000	36000	28000
	Paid to Crs.	-23500						
	Balances	16500	-23500	8000	4000	16000	36000	28000
	Paid loan of X & Y	-12000	-	-8000	-4000			
	Balances	4500		-	-	16000	36000	28000
	Paid Surplus capital of Z	-4500						-4500
	IInd Realisation Gross Assets					16000	36000	23500
		32000						
	- Expenses	2000						
		30000						
	Paid Surplus of 'Z' remaining	-5500						5,500
		24500				16000	36000	18,000
	Paid to Y & Z (Surplus capital) (2:1)	-24500					-16334	8166
	Balances	-				16000	19666	9834
	III Realisation							
	Gross Asset	24000						
	- Expenses	4000						
		20000						
	Paid to Y & Z surplus capital (2:1)	5500					-3666	-1834
		14500				16000	16000	8000
	Paid to X,Y and Z in P.S. ratio (2:2:1)	-14500				-5800	-5800	-2900
		–				10200	10200	5100
	Withdrawn from Bank	15000						
	Paid to X, Y & Z in P.S. ratio (2:2:1)	15000				-6000	-6000	-3000
	Realisation Loss	-				4200	4200	2100

1.4 Maximum Loss Method

Maximum loss method is another method of piecemeal distribution. This is an alternative to surplus capital method. There is no difference between this method and surplus capital method in relation to the payments to preferential creditors secured creditors, contingent liability, third party liabilities and partners loan. This method differs from the first method only in respect of repayment of capitals.

In refunding the amount due to partners on piecemeal baris, great care has to be exercised that no partner will get more than for what he is entitled to.

If surplus capital method is adopted for repayment of capital, there is a risk that one or more of the partners may get overpaid, since the final amount due to each partner cannot be known until realisation is completed. Hence, if a partner who has received more than what would be due to him becomes insolvent, the excess payment may not be recovered and other partners may be put to a loss. To avoid this discrepancy the maximum loss method is adopted.

In this method, every realisation is treated as last realisation and it is presumed that remaining unrealised assets are worthless and no more cash will be realised thereafter and hence maximum possible loss is transferred to the capital accounts of the partners in their profit sharing ratio. In short, under maximum loss method the following procedure is adopted.

1) After the payment to third party liability and partners loan, maximum loss or notional loss is calculated. It is calculated as under.

Maximum loss = Total unpaid capital - cash available

2) Distribute the maximum loss or notional loss among the partners in their profit sharing ratio.

3) Find out the balance of partners capital Account.

4) If any partners' capital account shows debit balance, he is to be presumed as insolvent and his deficiency is transferred to capital accounts of the solvent partners in their profit sharing ratio (If Garner V/s Murray principle is not followed) or in proportion of capital balances (if Garner V/s Murray principle is followed.)

5) After the above step, if any other partner is capital account shows a debit balance, his deficiency is also transferred to solvent partner's capital account. If some amount is recovered from the private estate of insolvent partner, his deficiency should be reduced by the amount.

6) After completing the above step, the balance to the credit of partners capital account will be equal to the cash available for distribution.

7) Then pay the cash available to the partners equal to the balances.

8) After the payment of cash, balances on capitals are brought down and the same process is repeated upto last realisation. The loss at last is the real realisation loss.

Deficiency of Capital Account

After the distribution of maximum or notional loss among the partners, if the share of loss of a partner is more than his capital, the partner is treated as insolvent partner. The deficiency of a partner is distributed among the partners either by following two method.

1) Profit sharing ratio method.

2) Capital ratio method (Garner V/s Murray Rule)

1) Profit Sharing Ratio Method -

According to this method the deficiency of partners is distributed among the partners in their profit sharing ratio.

2) Capital Ratio Method -

According to this method, the deficiency of the partner is distributed among other partners in their capital ratio. capital ratio method is used in England because in the judgement of Garner V/s Murray case, the judge had given a decision that the deficiency of an insolvent partner should be distributed among the partners in the proportion of capital ratio of solvent partners. Hence, this method is also called as Garner V/s Murray rule or principle.

Note : - If nothing is mentioned in the problem the student can use any one of the above method, at the time of solving the problem on distribution of cash.

1.4.1 Illustrations -

Illustration 1

North, South and East sharing profits and losses in the ratio of 2:1:1 decided to dissolve their partnership as on 31st December 2012. Following is their balance sheet.

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Capital Accounts			Cash in Hand	12,000
North	1,00,000		Investment	8,000
South	54,000	1,54,000	Plant & Machinery	1,63,000
Current Accounts			South's Current	
North		4,000	Account	2,000
East		2,000		
Sundry Liabilities		25,000		
		1,85,000		1,85,000

The Assets are realised as follow :

Jan 2013 Rs.52,000

Feb 2013 Rs.72,000

March 2013 Rs.17,600

Prepare the statement of distribution of cash as per maximum loss method.

Solution :

Statement Showing Distribution of Cash

Date	Particulars	Cash Available Rs.	Sundry Liabilities	Capital Accounts		
				North	South	East Rs.
	Balances	12000	Rs.	Rs.	Rs.	-
	Partners Current Accounts		25000	1,00,000	54000	+2000
	Final Balances	12000		+4000	-2000	2000
	Paid for Liabilities	12000	25000	1,04,000	52000	
			-12000			2000
	Ist Realisation	52000	13,000	1,04,000	52000	
	Paid for Liabilities	13000				
		39000	-13000			2000
	Maximum Loss = Total Capital - cash = 1,58,000-39,000 = 1,19,000 (Loss)		-	104000	52000	
	Loss shared by all partners in their profit sharing ratio 2:1:1					-29750
	Deficiency of East is shared by			-59500	-29750	-27750
	North and South in their profit			44500	22250	
	sharing ratio (2:1)			-18500	-9250	+27750
				26000	13000	2,000
	Cash paid to North and South	39000		26000	13000	
	Balance Due	-				
	IInd Realisation	72000		78000	39000	2000
	maximum loss = Total capital - cash = 119000-72,000 = 47000 (Loss shared by all partners in their profit sharing ratio (2:1:1)					
	Deficiency of East is shared by			-23500	-11750	-11750
	North and South in their profit			54500	27250	-9750
	sharing ratio (2:1)					
	Balance due			-6500	-3250	
	Paid cash to			48000	24000	-9250
	North and South	72000				-
	Balance Due	-		-48000	-24000	
				30000	15000	2000

(contd.)

Date	Particulars	Cash Available Rs.	Sundry Liabilities	Capital Accounts		
				North Rs.	South Rs.	East Rs.
	IIIrd Realisation	17600	Rs.			
	Maximum loss = total capital -cash = 47000-17600 = 29400 (Loss)					
	Loss shared by all partners in their profit sharing ratio (2:1:1)			-14700	-7350	-7350
	Balances			15300	7650	-5350
	Deficiency of East is shared by North and South in their profit sharing ratio i.e. 2:1			-3567	-1783	+5350
				11733	5867	-
	Paid to North and South	17600		-11733	-5867	
	Realisation Loss			18267	9133	2000

Note : - In this problem the deficiency of insolvent partners is divided in the profit sharing ratio of solvent partners as it is not specifically told to apply Garner V/s Murray principle.

Illustration 2

Sourabha, Sujeet and Sachin were in partnership sharing profits and losses in the ratio 1/2,1/3 and 1/6 respectively. The partnership was dissolved on 31st Dec.2012, when the position was as follows.

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Creditors	38,000	Sundry Assets	1,44,000
Capital Accounts		Cash in Hand	6,000
Sourabha	67,000		
Sujeet	33,000		
Sachin	6,000		
Reserve Fund	6,000		
	1,50,000		1,50,000

Dissolution expenses amounted Rs.6000.

The assets were gradually realised and the distributions were made as and when cash become available. The realisations were as follows.

1st Instalment Rs.54,000
2nd Instalment Rs.45,000
3rd Instalment Rs.15,000
4th Instalment Rs.24,000

Prepare the statement showing the division of net proceeds among the partners so that the effect may be given to ruling in Garner V/s Murray at each distribution stage assuming that nothing further will be realised after that date.

Solution :

Statement Showing Distribution of Cash

Date	Particulars	Cash Available Rs.	Creditors Rs.	Capital Accounts		
				Sourbh	Sujeet	Sachin
	Balances	6000	38000	67000	33000	6000
	Add Reserve Fund (3:2:1) Rs.6000					
	Final Balances	6000	38000	3000	2000	1000
	Paid dissolution expenses	- 6000				
	-		38000	70000	35000	7000
	Ist Instalment	54000				
	Paid to creditors	- 38000	-38000	70000	35000	7000
	Balance Due	16000	-	70000	35000	7000
	Maximum loss = Total capital - cash = 112,000-16000 = 96000 (loss)					
	Loss shared by all partners in their P.S. ratio i.e. 3:2:1			-48000	-32000	-16000
	Deficiency of Sachin is shared by Sourabh and Sujeet in capital ratio (i.e.2:1)			22000 -6000	3000 -3000	-9000 +9000
	Paid cash to Sourabh	16000		16000	-	-
	-	-		-16000		
	Balance Due			54000	35000	7000
	IInd Instalment	45000				
	Maximum loss = total capital -cash = 96000-45000= 51000 (Loss shared by all partners in their profit sharing ratio i.e. 3:2:1			-25500	-17000	-8500
	Deficiency of Sachin is allocated to Sourabh and Sujeet in their capital ratio i.e.2:1			28500 -1000	18000 -500	-1500 +1500
	Paid cash to Sourabh and Sujeet	-45000		27500 -27500	17500 -17500	-
	Balance Due			26500	17500	7000

(Distribution of Cash contd.)

Date	Particulars	Cash Available Rs.	Creditors Rs.	Capital Accounts		
				Sourbh	Sujeet	Sachin
	IIIrd Instalment	15000				
	Maximum loss = total capital - cash = 51000-15000 = 36000 (Loss)					
	Loss shared by all partners in their profit sharing ratio (i.e.3:2:1)			-18000	-12000	-6000
	Balances			8500	5500	1000
	Cash paid to all partners	15000				
	-	-		-8500	-5500	-1000
	Balance Due			18,000	12000	6000
	IVth Instalment	24000				
	Maximum loss = total capital - cash = 36000-24000 = 12000(Loss)					
	Loss sharing by all partners in their profit sharing ratio (i.e. 3:2:1)			-6000	-4000	-2000
				12000	8000	4000
	Paid cash to all partners	24000		12000	8000	4000
		-				
	Realisation Loss			6000	4000	2000

Illustration 3

Sudhakar, Madhukar and Subhash who shared profits and losses in the ratio of 3:2:1 dissolved their partnership on 30th April 2012. The Balance Sheet on that date was as follows.

Balance Sheet as on 30th April 2012

Liabilities		Rs.	Assets	Rs.
Creditors		20,000	Sundry Assets	1,40,000
Reserve Fund		6,000		
Capital A/c's				
Sudhakar	6,600			
Madhukar	35,800			
Subhash	71,600	1,14,000		
		1,40,000		1,40,000

The assets were realised piecemeal and the distribution was made as cash became available. The realisation after deducting expenses were as follows.

Date	Book value	Net Proceed
	Rs.	Rs.
May 2012	26000	20,000
June 2012	12000	9,000
July 2012	30000	33,000
Sept.2012	72000	54,000

Sudhakar was insolvent and only Rs.1800 could be recovered from his private estate on 30th Sept. 2012.

Prepare a statement showing distribution of cash giving effect to the ruling in Garner V/s Murray at every realisation.

Solution :

Statement Showing Distribution of Cash

Date	Particulars	Creditors Rs.	Capital Accounts		
			Sudhakar	Madhukar	Subhash
30th April 2012	Balances	20000	6600	35800	71600
	Add : Reserve Fund (3:2:1)		3000	2000	1000
	Final Balances	20000	9600	37800	72600
May 2012	**Ist Instalment** 20000				
	Paid to Creditors -20000	-20000			
	Balances Dues -	-	9600	37800	72600
June 2012	**IInd Instalment** 9000				
	Maximum loss = total capital - cash = 120000-9000 = 111000 (loss)				
	Loss shared by partner's in their P.S. ratio i.e. 3:2:1		-55500	-37000	-18500
	Balances		-45900	800	54100
	Sudhakar's deficiency is shared by Mudhakar and Subhash in the capital ratio. i.e. 1:2		+45900	-15300	-30600
	Sudhakar's deficiency is shared by Subhash.			-14500	23,500
				+14500	-14500
					9000
					-9000
	Cash paid to Subhash 9000				
	Balance Due -		9600	37800	63600
July 2012	**III Instalment** 33000				
	Maximum loss = total capital - cash = 111000-33000 = 78000 (loss)				
	Loss shared by all partners in their P.S. ratio (3:2:1)		-39000	-26000	-13000
	Balances		-29400	11800	50600
	Sudhakar's deficiency is shared by Madhukar and Subhash in their capital ratio i.e. 2:1		+29400	-9800	-19600