Adjustment of Capital

3/4 Marks Questions

1. Nandan, John and Rosa are partners sharing profits in the ratio of 4 : 3: 2. On 1st April, 2012, John gave a notice to retire from the firm. Nandan and Rosa decided to share future profits in the ratio of 1 : 1. The capital accounts of Nandan and Rosa after all adjustments showed a balance of Rs. 43,000 and Rs. 80,500 respectively. The total amount to be paid to John was Rs. 95,500. This amount was to be paid by Nandan and Rosa in such a way that their capitals become proportionate to their new profit sharing ratio. Pass necessary journal entries in the books of the firm for the above transactions. Show your working clearly. (All India 2013)

Ans.

JOURNAL

Date	Particulars		LF	Amt (Dr)	Amt (Cr)
2012					
Apr 1	Cash A/c	Dr		95,500	
	To Nandan's Capital A/c				66,500
	To Rosa's Capital A/c				29,000
	(Being cash to be paid to John brought in by Nandan and Rosa)				
Apr 1	John's Capital A/c	Dr		95,500	
	To Cash A/c				95,500
	(Being cash paid to John for his capital)				

Working Note

Adjusted capitals of Nandan and Rosa (43,000 + 80,500)	1,23,500
(+) Amount to be paid to John	95,500
Total capital of new firm	2,19,000

Amount to be Brought in or Withdrawn

Particulars	Nandan (₹)	Rosa (₹)
New Firm's Capital (2,19,000) in New Ratio i.e. 1:1	1,09,500	1,09,500
(–) Existing Capitals	43,000	80,500
Cash to be Brought in	66,500	29,000

2. X, Y and Z are partners in a firm sharing profits in the ratio of 3 : 2 : 1. On 1st April, 2009, X retires from the firm, Y and Z agrees that the capital of the new firm shall be fixed Rs. 2,10,000 in the profit sharing ratio. The capital accounts of Y and Z after all adjustment on the date of retirement showed balances of Rs. 1,45,000 and Rs. 63,000 respectively. State the amount of actual cash to be brought in or to be paid to the partners. (Delhi 2010)

to the partners. (Delhi 2010)

Ans. **Calculation of Cash to be Brought In or Paid Out**

Particulars	Y	Z
Capital After All Adjustments	1,45,000	63,000
(–) New Capital Share (2,10,000 in 2 : 1)	(1,40,000)	(70,000)
Amount of Cash Adjustment	5,000	(7,000)

It means Y will take ₹ 5,000 and Z will bring ₹ 7,000 to make their capital in new ratio.

3. X, Y and Z are partners in a firm sharing profits in the ratio of 3 : 2 : 1. On 1st April, 2009, Y retires form the firm. X and Z agree that the capital of the new firm shall be fixed at Rs.2,10,000 in the profit sharing ratio. The capital accounts of X and Z after all adjustments on the date of retirement showed balances of Rs. 1,45,000 and Rs. 63,000 respectively. State the amount of actual cash to be brought in or to be paid of partners. (All India 2010)

Ans. **Calculation of Cash to be Brought In or Paid Out**

Particulars	X	Z
Capital After All Adjustments	1,45,000	63,000
(–) New Capital Share (2,10,000 in 3 : 1)	(1,57,500)	(52,500)
Amount of Cash Adjustment	(12,500)	10,500

Therefore, X will bring ₹ 12,500 and Z will take away ₹ 10,500 to make their capital in new ratio.

8 Marks Questions

4. L, M and N were partners in a firm sharing profits in the ratio of 2 : 1 :1. On 1st April, 2013 their balance sheet was as follows.

Balance Sheet
as at 1st April, 2013

Liabilities		Amt (₹)	Assets		Amt (₹)
Capital A/cs			Land		8,00,000
L	6,00,000		Building		6,00,000
M	4,80,000		Furniture		2,40,000
N	4,80,000	15,60,000	Debtors	4,00,000	
General Reserve		4,40,000	(–) Provision for Doubtful Debts	(20,000)	3,80,000
Workmen's Compensation Fund		3,60,000	Stock		4,40,000
Creditors		2,40,000	Cash		1,40,000
		26,00,000			26,00,000

On the above date, N retired. The following were agreed
(i) Goodwill of the firm was valued at Rs. 6,00,000.
(ii) Land was to be appreciated by 40% and building was to be depreciated by Rs. 1,00,000.
(iii) Furniture was to be depreciated by Rs. 30,000.
(iv) The liabilities for workmen's compensation fund was determined at Rs. 1,60,000.
(v) Amount payable to N was transferred to his loan account.
(vi) Capitals of L and M were to be adjusted in their new profit sharing ratio and for this purpose current accounts of the partners will be opened.
Prepare revaluation account, partner's capital accounts and the balance sheet of the new firm. (All India 2014)

Ans. **Revaluation Account**

Particulars		Amt (₹)	Particulars	Amt (₹)
To Building A/c		1,00,000	By Land A/c	3,20,000
To Furniture A/c		30,000		
To Profit Transferred to Capital A/cs				
L	95,000			
M	47,500			
N	47,500	1,90,000		
		3,20,000		3,20,000

Partner's Capital Accounts

Particulars	L	M	N	Particulars	L	M	N
To N's Capital A/c	1,00,000	50,000	—	By Balance b/d	6,00,000	4,80,000	4,80,000
To N's Loan A/c	—	—	8,37,500	By General Reserve	2,20,000	1,10,000	1,10,000
To M's Current A/c (Balancing Figure)	—	1,20,000	—	By Revaluation A/c	95,000	47,500	47,500
				By L's Capital A/c	—	—	1,00,000
To Balance c/d	10,35,000	5,17,500	—	By M's Capital A/c	—	—	50,000
				By Workmen's Compensation Fund A/c	1,00,000	50,000	50,000
				By L's Current A/c (Balancing Figure)	1,20,000	—	—
	11,35,000	6,87,500	8,37,500		11,35,000	6,87,500	8,37,500

Balance Sheet

as at ...

Liabilities		Amt (₹)	Assets		Amt (₹)
Capital A/cs			Land	8,00,000	
L	10,35,000		(+) Appreciation	3,20,000	11,20,000
M	5,17,500	15,52,500	Buiding	6,00,000	
Liabilities for Workmen Compensation Fund		1,60,000	(–) Depreciation	(1,00,000)	5,00,000
Creditors		2,40,000	Furniture	2,40,000	
L's Current Account		1,20,000	(–) Depreciation	(30,000)	2,10,000
N's Loan Account		8,37,500	Debtors	4,00,000	
			(–) Provision for Doubtful Debts	(20,000)	3,80,000
			Stock		4,40,000
			M's Current A/c		1,20,000
			Cash		1,40,000
		29,10,000			29,10,000

Working Note

(*i*) **Calculation of Gaining Ratio**

Gaining Ratio = New Ratio – Old Ratio

$$L = \frac{2}{3} - \frac{2}{4} = \frac{8-6}{12} = \frac{2}{12}; \qquad M = \frac{1}{3} - \frac{1}{4} = \frac{4-3}{12} = \frac{1}{12}$$

Gaining ratio = 2 : 1

(*ii*) Firm's goodwill = 6,00,000

N's share of goodwill $= 6,00,000 \times \frac{1}{4} = 1,50,000$

L's Capital A/c	Dr	1,00,000	
M's Capital A/c	Dr	50,000	
To N's Capital A/c			1,50,000

(Being N's share of goodwill adjusted among L and M in their gaining ratio) (*iii*) **Calculation of Proportionate's Capital**

L's capital after all adjustment = 9,15,000

M's capital after all adjustment = 6,37,500

Total capital of new firm = 15,52,500

$$\text{L's new capital} = 15,52,500 \times \frac{2}{3} = 10,35,000$$

$$\text{M's new capital} = 15,52,500 \times \frac{1}{3} = 5,17,500$$

5. A, B and C were in partnership sharing profits in proportion to their capitals. Their balance sheet on 31st March, 2008 was as follows

Balance Sheet

as at 31st March, 2008

Liabilities		Amt (₹)	Assets		Amt (₹)
Creditors		15,600	Cash		16,000
Reserve		6,000	Debtors	20,000	
Capital A/cs			(--) Provision for Doubtful Debts	(400)	19,600
A	90,000		Stock		18,000
B	60,000		Machinery		48,000
C	30,000	1,80,000	Buildings		1,00,000
		2,01,600			2,01,600

On the above date B retired owing to ill health and the following adjustments were agreed upon

(i) Buildings to be appreciated by 10%.
(ii) Provision for doubtful debts to be increased to 5% of debtors.
(iii) Machinery to be depreciated by 15%.
(iv) Goodwill of the firm be valued at Rs. 36,000 and be adjusted into the capital accounts of A and C who will share profits in future in the ratio of 3 : 1.
(v) A provision to be made for outstanding repairs bill of Rs. 3,000.
(vi) Included in the value of creditors is Rs. 1,800 for an outstanding legal claim, which is not likely to arise.

(vii) Out of the insurance premium paid Rs. 2,000 is for the next year. The amount was debited to profit and loss account.
(viii) The partners decide to fix the capital of the new firm as Rs. 1,20,000 in the profit sharing ratio.
(ix) B to be paid Rs. 9,000 in cash and balance to be transferred to his loan account.
Prepare the revaluation account, partners' capital account and the balance sheet of the new firm after B[1] s retirement. (Delhi; All India; Foreign 2009)

Ans. Dr **Revaluation Account** Cr

Particulars		Amt (₹)	Particulars	Amt (₹)
To Provision For Doubtful Debts A/c		600	By Building A/c	10,000
To Machinery A/c		7,200	By Creditors A/c	1,800
To Outstanding Repair A/c		3,000	By Prepaid Insurance A/c	2,000
To Profit Transferred to				
A's Capital A/c	1,500			
B's Capital A/c	1,000			
C's Capital A/c	500	3,000		
		13,800		13,800

Dr **Partners' Capital Account** Cr

Particulars	A	B	C	Particulars	A	B	C
To B's Capital A/c	9,000	—	3,000	By Balance b/d	90,000	60,000	30,000
To Cash A/c	—	9,000	—	By Reserve A/c	3,000	2,000	1,000
To B's Loan A/c	—	66,000	—	By Revaluation A/c (Profit)	1,500	1,000	500
To Balance c/d	90,000	—	30,000	By A's Capital A/c	—	9,000	—
				By C's Capital A/c	—	3,000	—
				By Cash (Balancing Figure)	4,500	—	1,500
	99,000	75,000	33,000		99,000	75,000	33,000

Balance Sheet
as at 31st March, 2008

Liabilities		Amt (₹)	Assets		Amt (₹)
Outstanding Repairs		3,000	Building		1,10,000
Creditors		13,800	Debtors	20,000	
Capital A/cs			(–) Provision for Doubtful Debts	(1,000)	19,000
A	90,000		Machinery		40,800
C	30,000	1,20,000	Prepaid Insurance		2,000
B's Loan A/c		66,000	Stock		18,000
			Cash		13,000
		2,02,800			2,02,800

Working Note

(*i*) **Calculation of Gaining Ratio**

Old ratio ⇒ 3 : 2 : 1 New ratio ⇒ 3 : 1

Gaining Ratio = New Ratio – Old Ratio

$$A = \frac{3}{4} - \frac{3}{6} = \frac{9-6}{12} = \frac{3}{12}, \qquad C = \frac{1}{4} - \frac{1}{6} = \frac{3-2}{12} = \frac{1}{12}$$

Gaining ratio = 3 : 1

(*ii*) **Calculation of B's Share of Goodwill**

Firm's goodwill = 36,000

B's share of goodwill = $36{,}000 \times \frac{2}{6}$ = ₹ 12,000, to be contributed by A and C in their gaining ratio. i.e. 3 : 1.

(*iii*) Dr **Cash Account** Cr

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	16 ,000	By B's Capital A/c	9,000
To A's Capital A/c	4,500	By Balance c/d	13,000
To C's Capital A/c	1,500		
	22,000		22,000

6. The balance sheet of A, B and C on 31st March, 2007 was as follows

Balance Sheet
as at 31st March, 2007

Liabilities		Amt (₹)	Assets	Amt (₹)
Creditors		50,000	Profit and Loss A/c	30,000
Capital A/cs			Land and Buildings	80,000
A	80,000		Plant and Machinery	56,000
B	80,000		Motor Car	54,000
C	60,000	2,20,000	Debtors	48,000
			Cash	2,000
		2,70,000		2,70,000

The following terms were agreed upon for As retirement
(i) Goodwill to be valued at Rs. 42,000 and not to be shown in the books of the firm after A's retirement.
(ii)Land and building to be appreciated by Rs. 20,000.
(iii) Plant and machinery to be reduced to Rs. 46,000.
(iv) Provision for doubtful debts to be created at 5% on debtors.
(v) Create a provision of Rs. 1,400 for discount on creditors.
(vii) The sum payable to A to be brought in by B and C in such a manner that their capitals are in proportion to their new profit sharing ratio.
Prepare the revaluation account, partners' capital account and the balance sheet of the new firm to give effect to the above terms. (All India 2008)

Ans. Dr **Revaluation Account** Cr

Particulars		Amt (₹)	Particulars	Amt (₹)
To Plant and Machinery A/c		10,000	By Land and Buildings A/c	20,000
To Provision for Doubtful Debts A/c		2,400	By Discount on Creditors A/c	1,400
To Profit Transferred to				
A's Capital A/c	3,000			
B's Capital A/c	3,000			
C's Capital A/c	3,000	9,000		
		21,400		21,400

Dr **Partners' Capital Account** Cr

Particulars	A	B	C	Particulars	A	B	C
To Profit and Loss A/c	10,000	10,000	10,000	By Balance b/d	80,000	80,000	60,000
To A's Capital A/c	—	7,000	7,000	By B's Capital A/c	7,000	—	—
To Cash A/c	87,000	—	—	By C's Capital A/c	7,000	—	—
To Balance c/d	—	99,500	99,500	By Revaluation A/c (Profit)	3,000	3,000	3,000
				By Cash A/c	—	33,500	53,500
	97,000	1,16,500	1,16,500		97,000	1,16,500	1,16,500

Balance Sheet
as at 31st March, 2007

Liabilities		Amt (₹)	Assets		Amt (₹)
Creditors		48,600	Land and Building (80,000 + 20,000)		1,00,000
Capital A/cs			Plant and Machinery		46,000
B	99,500		Debtors	48,000	
C	99,500	1,99,000	(–) Provision for Doubtful Debts	(2,400)	45,600
			Motor Car		54,000
			Cash		2,000
		2,47,600			2,47,600

Working Note

(*i*) Dr **Cash Account** Cr

Particulars	Amt (₹)	Particulars	Amt (₹)
To Balance b/d	2,000	By A's Capital A/c	87,000
To B's Capital A/c	33,500	By Balance c/d	2,000
To C's Capital A/c	53,500		
	89,000		89,000

(*ii*) **Calculation of A' Share of Goodwill**

Firm's goodwill = 42,000

A's share of goodwill = $42{,}000 \times \frac{1}{3} =$ ₹ 14,000, to be contributed by B and C in their gaining ratio i.e. 1 : 1

(*iii*) **Calculation of New Capital of B and C**

A's capital after all adjustment	=	87,000
B's capital after all adjustment	=	66,000
C's capital after all adjustment	=	46,000
		₹ 1,99,000

To be the capital of new firm

B's share of new capital = $1{,}99{,}000 \times \frac{1}{2} =$ ₹ 99,500

C's share of new capital = $1{,}99{,}000 \times \frac{1}{2} =$ ₹ 99,500

(*iv*) **Calculation of Cash to be Brought In or Withdrawn**

Cash to be brought in by B = 99,500 − 66,000	= 33,500
Cash to be brought in by C = 99,500 − 46,000	= 53,500
Amount of cash to be paid to B.	₹ 87,000