Shri J. H. Bhaldoia Women's College – Rajkot
B.Com. Sem. – II
Financial Accounting – 2
Conversion of Partnership Firm into Company

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Introduction : As per Act of partnership firm, the membership of the firm is limited. Minimum 2 and maximum 20 persons can start a business in partnership firm. In case of banking business, this limit is minimum 2 and maximum 10. The liability of partners of partnership firm is unlimited. To remove and solve the limitation of partnership firm like numbers of members, capital investment, risk of insolvency, scarcity of capital, the firm establishes a company of it's own existing business or sells the current business to new company or existing company and both the parties follow the legal procedure. **It's called a conversion of partnership firm into a company.**

Purchase Consideration [PC] of Business

Purchase consideration (PC) means the price which is paid by the purchaser to the vendor. In the case of conversion of the firm into a company or sale of the firm's business, Purchaser is the purchasing company and vender is the firm.

PC is calculated through any one of the following method :

[A] Net Asset Method [Net Assets = Total Assets – Total Liabilities] and
[B] Purchase Consideration Method

[A] Net Asset Method

According to this method purchasing company agrees to take over those assets whose total price is taken. From this purchasing company agrees to pay off. The liabilities total will be deducted and the amount that remains is called net assets and it is to be consideration, "**Purchase Consideration of Business".**

Purchase Consideration = Agreed price of assets by purchasing company – Agreed price of liabilities by purchasing company

- When purchasing company agrees to pay purchase consideration more than net assets of the firm, this excess amount is called **"Goodwill.".**

[Good Will = Purchase consideration – Net Assets]

- But when purchasing company agrees to pay purchase consideration less than the net assets, this amount is called **"Capital Reserve."** This amount is a capital gain for the company. So it is recorded as capital reserve in its book.

[Capital Reserve = Net Assets – Purchase Consideration]

[B] Purchase Consideration Method

Purchasing Company purchases the assets & liabilities of firm's business and in exchange of which is liable to pay is known as purchase price. For this the accepted consideration by both the parties and its financial value is called purchase consideration, these included the shares and debentures, cash and bank etc. of the company.

For the calculation of the purchase price under this method, it is required to make the total of each individual consideration.

Purchase price = Shares given by company + Debentures given by company + Cash and bank given by company

Necessary Accounts in the books of the firm

1) **Realisation Account**
2) **Partner's Capital Account**
3) **Cash/Bank Account**
4) **New Company Account**
5) **New Co.'s Equity Shares Account**
6) **New Co.'s Preference Account**
7) **New Co.'s Debentures Account**

Steps to solve Practical Problems as per Conversion Process in the books of Partnership Firm.

1) Calculate purchase price according to calculating method or instruction given in the question.
2) Open required accounts for closing firm's books.
3) Transfer the balance of assets and liabilities from B/s, to Realisation account.
4) Distribute owners reserve, general reserves and credit balance of Profit and Loss account of partners in their profit sharing ratio.
5) Transfer the credit and debit balance of current accounts to partner's capital accounts.
6) If separate information is given to pay partner's loan, open partner's loan account and show balance on credit side.
7) If company has not taken bank/cash then open bank/cash account by showing its balance on debit side.
8) Debit the amount of PC on purchasing company (New Co's) account and credit realisation account.
9) Assets not taken over by the company are sold out and amount realized is to be debited to cash/bank account and credited to realisation account. If any assets are taken over by partners, debit partners account and credit realisation account.

10) If the firm has paid off any my liabilities which is not taken by the company, debit it to realisation account and credit to cash/bank account, otherwise in the case of any partner being paid off the same amount, debit it to realisation account but credit it to partner's capital account.
11) Pass the entry for dissolution expense as per given instruction.
12) Record profit or loss realized from sale of Share received as purchase consideration, to realisation account.
13) Distribute shares, debentures received from purchasing company as per instruction, otherwise distribute among partners in their closing capital balance ratio.
14) Close the partner's capital account. If there is difference of any balance, then transfer it to cash account.
15) Finally cash/bank account will be tallied.

Practical Problems

1. **Radha** and **Shyam** were the partners in a firm sharing profits and losses in the ratio of 2 : 3 respectively. The balance sheet of their firm as on 31/3/2010 was as under:

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital Accounts :		Goodwill	25,000
Radha 80,000		Building	1,20,000
Shyam 1,00,000	1,80,000	Machinery	23,000
Profit and Loss Account	10,000	Investment in the Bonds of Narmada Nigam	15,000
12 % Gopal's Loan	50,000	Debtors 75,000	
Creditors	60,000	-Bad Debts 5,000	70,000
		Stock	35,000
		Cash-bank balance	12,000
	3,00,000		3,00,000

- On 1/4/2010 the firm was converted into **"Radheshyam Co. Ltd."**. Conditions of conversion and other information are as under :

1) The company has to take all the assets and creditors of the firm.
2) The goodwill of the firm is to be valued at twice the average profit of last three years. The total profit of the last three years amounted to Rs. 1,20,000.
3) The building and machinery are to be valued at Rs. 1,50,000 and Rs. 25,000 respectively. The investments are to be valued at Rs. 20,000.
4) Debtors are to be taken subjects to 10 % bad debts reserve.
5) The remaining assets are to be taken as per book value.
6) Against purchase price, the company has to give 10,000 equity shares of Rs. 10 each at a premium of 10 %, Debentures of Rs. 1,00,000 at a discount of 5% and the remaining amount in cash.
7) Shyam paid up Gopal's loan, alongwith accrued interest there on for one year.
8) The firm paid dissolution expenses of Rs. 4,000.

- The shares and debentures received from the company are to be shared by the partners in their profit sharing ratio and the balance payment is to be made in cash.
- From the above information prepare.

a) Resolution A/c
b) Partners' Capital A/c
c) Cash A/c **[Guj. Uni. 1999]**

2. **Mahendra, Devendra** and **Ravi** were partners sharing profit –loss in the ratio of 3 : 2 : 1. On 31/3/2010 the firm has decided to sell its business to **ABC Ltd**. Position of the firm on that date was as follows:

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital Accounts :			Land & Building	20,000
Mahendra	20,000		Machinery	22,000
Devendra	10,000		Debtors	18,000
Ravi	10,000	40,000	Stock	13,000
Creditors		22,000	Cash	7,000
Loan		18,000		
		80,000		80,000

- The company has taken following assets at given price.
- Land-Building Rs. 24,000, Machinery Rs. 21,000, Debtors Rs. 17,000, Stock Rs. 13,000 and Goodwill Rs. 4,000.
- The company has not accepted the loan, but agreed to pay creditors.
- The company issued 3,000 equity shares of Rs. 10 each and paid remaining amount in cash for purchase price. Dissolution expense amounted to Rs. 1,000. Partners have distributed shares in their profit and loss ratio. Prepare necessary accounts in the books of the firm.

[Sau. Uni. 2006 and 2007]

3. **Bansari, Murali** and **Bina** are partners and sharing profit and loss in the ratio of 5 : 3 : 2. The balance sheet of firms on 31/3/2010 is as follows :

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital Accounts :			Land & Building	1,28,000
Bansari	75,000		Machinery	60,000
Murali	45,000		Investments	12,000
Bina	65,000	1,85,000	Bills receivable	5,200
Creditors		45,000	Stock	9,000
Bills payable		6,500	Cash-Bank	12,800
Outstanding expenses		500	Advertisement	
Reserve Fund		5,000	Campaign	15,000
		2,42,000		2,42,000

- The business of Firm sold to Rhythm Ltd. on following conditions:

1) Revaluated assets are Machinery – Rs. 80,000, Stock-Rs.12,000 and Land-Building – Rs. 62800.

2) Other assets (except cash-bank and investment) and liabilities to be considered as on book value.
3) The company agreed to pay Rs. 40,000 as goodwill.
4) The company paid 10,000 equity shares of Rs. 10 each for purchase price and remaining amount was paid in cash.
5) Partners sold investment at Rs. 10,000 and sold 7,000 equity shares at Rs. 12 and for remaining shares; they took away at their profit and loss ratio.

- **Prepare :** [1] Realisation Account [2] partners' Capital account [3] Cash-Bank Account [4] New Co.'s Account and [5] New Co.'s equity shares account . For preparation of A/c No. (4) and (5).

[Sau. Uni. April-2010 and Bhav. Uni. 2010]

4. **Dharti** and **Shilpa** are partners in a firm sharing profits and losses in the ratio of 3 : 1. The **Shital Co. Ltd.** Was incorporated to purchase business of the firm with authorized capital of 10,000 equity shares of Rs. 10 each. The balance sheet of the firm as on 31/3/2010 was as follows:

Balance Sheet

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Capital :		Land & Building	40,000
Dharti 75,000		Machinery	20,000
Shilpa 25,000	1,00,000	Investments	25,000
General reserve	12,000	Debtors 37,000	
Creditors	22,000	-B.D. 3,000	34,000
Bank over draft	10,000	Bills receivable	6,000
Bills payable	9,000	Cash	3,000
	1,53,000		1,53,,000

- Conditions for selling their business were as follows :

1) Goodwill of the firm to be valued at Rs. 20,000.
2) Land-Building, Stock and Debtors at Rs. 50,000, Rs. 20,000 and Rs. 30,000 respectively and other assets (except cash and machinery) to be taken over at book value.
3) All the liabilities except Bank overdraft are accepted by the company. Dissolution expense of the firm will be borne by the company.
4) Purchase consideration is to be paid in 6,000 fully paid up equity shares of Rs. 10 each at 20 % premium, 10 % Debentures of the Co. worth Rs. 40,000 and rest amount in cash.
5) Partners have distributed share in their profit-loss sharing ratio. Difference ar to adjusted in cash.
6) The firm sold machinery at Rs. 19,000 and paid off bank overdraft Dissolution expenses amounted to Rs. 1,000.

- Prepare necessary accounts in the books of firm.

[Guj. Uni. April-2005 Same ; Sau. Uni. April-2004]

5. Ravindra, Surendra and **Mahendra** are the partners sharing Profits-Losses in the ratio of 3 : 2 : 1. The balance sheet of the firm was as under on 31st December,2010.

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital :		Goodwill	1,00,000
Ravindrar 2,00,000		Land-Building 2,00,000	
Surendera 1,20,000		-Depreciation 20,000	1,80,000
Mahendra 80,000	4,00,000	Machinery 2,00,000	
Profit and Loss Account	1,20,000	-Depreciation 20,000	1,80,000
Worker's Comp. Fund	60,000	Furniture	60,000
Worker's Profit sharing fund	90,000	Investments	1,00,000
Investment Fluctuation fund	20,000	Stock	90,000
Creditors	1,00,000	**Debtors 1,00,000**	
Bills payable	30,000	-Bad Debts 10,000	
Outstanding Expenses	5,000	-BDR 7,000	
		-Reserve for Disc. 3,000	80,000
		Bills receivable	14,000
		Bank	15,000
		Advt. Suspense A/c	6,000
	8,25,000		8,25,000

- **Harendra Ltd.** Purchased all real assets except Bank and all Liabilities except Bills payable on 1-1-2011 with the following conditions :

1) The company agreed to pay 10 % more for Land & Building and 20 % more for furniture.
2) Rs. 81,000 is to be paid for stock.
3) Other real assets are to be taken over at book value.
4) The Company took liability at took value.
5) Mahendra accepted to pay bills payable.

- The company agreed to pay 3,000 equity shares of Rs. 100 each at 10 % premium, 1200 debentures of Rs. 200 each of 5 % discount and the rest in bank.
- The partners distributed Equity shares and Debentures in profit sharing ratio.
- From the above information, prepare :
  [1] Realisation A/c, Partners' Capital A/c and Bank A/c.
  [2] Write journal entries for the transactions regarding purchase consideration and receiving the amount for the same. **[S.G.Uni. March-2006]**

6. Varsha and **Bina** were in partnership sharing profits and losses inn ratio of 2 : 1. The balance sheet of the firm as on 31-3-2010 was as under:

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital :		Fixed Assets	70,000
Varsha 50,000		**Current Assets :**	
Bina 40,000	90,000	Stock 35,000	
Current Account : Varsha	20,000	Debtors 65,000	
Bina's Loan	30,000	Bank 15,000	1,15,000
Creditors	55,000	Current Account : Bina	10,000
	1,95,000		1,95,000

- The fixed assets included two Motor cars, having book value of Rs. 8,000 and Rs. 6,000 respectively. The firm sold their business to **Prakash Textiles Ltd**. Purchasing Company acquires the stock and fixed assets other than the motor cars.
- Purchasing consideration is to be paid by Rs. 56,000 in cash, 900 equity shares of Rs. 100 each and 400, 5 % preference shares of Rs. 100 each.
- Rs. 61,000 were received from debtors. Rs. 51,000 were paid to creditors partners agreed on the following maner:

1) One car will be taken over by Varsha at Rs. 12,000 and Bina will take over the other car at Rs. 8,000.
2) Bina to be allotted preference share against her loan the remainder to be allotted to Varsha.
3) Both partners will be distributed equity share in their fixed capital ratio.
4) Remaining amount to be settled in cash.

- Market price of equity shares and preference shares to be considered at the value of Rs. 80 per share. Prepare necessary accounts in the books of the firm.

[Guj. Uni. April-1995]

7. Balance sheet of the firm of **"Abhi"** and **"Dabbu"** as on 1-4-2010 is as under:

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital :			Land & Building	1,12,500
Abhi	75,000		Machinery	30,000
Dabbu	75,000	1,50,000	Furniture	15,000
General Reserve		15,000	Debtors	97,500
Loan from Abhi		75,000	Stock	60,000
Creditors		75,000	Bank	30,000
Bills payable		30,000		
		3,45,000		3,45,000

- **Harsh Ltd.** Was incorporated for conversion of the firm into a company, authorized capital of which was 3,000 Equity Shares each of Rs. 100 and 13 % 1500 Preference Shares each of Rs. 100. Conditions for conversion from partnership firm to company were as under:

1) Harsh Ltd. took over all the assets as under :
Machines Rs. 37,500, Land and Building Rs. 1,80,000, Goodwill Rs. 97,500 and remaining assets at their book value.
2) Harsh Ltd. also took over all the liabilities other than Abhi's loan.
3) 12 % Debentures of Harsh Ltd. of Rs. 7,500 (which were later on given to Abhi for his loan A/c by the firm) and for the balance equity share and preference shares of Harsh Ltd. were given to the firm in the ratio of 2 : 1 being purchase consideration of the firm. Prepare accounts in the books of the firm.
4) Prepare necessary accounts in the books of firm:
[1] Realisation A/c [2] Partners Capital A/c [3] Abhi's Loan A/c [4] Harsh Ltd. 's A/c [5] Harsh Ltd.'s Equity shares A/c [6] Harsh Ltd's Preference share A/c [7] Harsh Ltd.'s 12 % Debentures A/c.

[Sau. Uni. F.Y.B.Com. April-2001 and April-2009]

8. Balance Sheet of **Irfan** and **Munaf** as on 1-4-2010 is as under :

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital Accounts :		Land & Building	2,80,000
Irfan 1,80,000		Machinery	1,40,000
Munaf 1,80,000	3,60,000	Furniture	40,000
General Reserve	40,000	Debtors	1,10,000
Loan from Irfan	1,80,000	Stock	80,000
Creditors	90,000	Bank	50,000
Bills payable	30,000		
	7,00,000		7,00,000

- **Patel Ltd.** was incorporated for conversion of the firm into a company, authorized capital of which was 5000 Equity shares each of Rs. 100 and 15 % 2,500, Preference shares each of Rs. 100.

- **Conditions for conversion from partnership firm to a company were as under:**

  1) Patel Ltd. took over all the assets as under :

  Land-building Rs. 3,20,000
  Machinery Rs. 1,50,000
  Goodwill Rs. 1,20,000 (as per new value) and remaining Assets at their book value.

  2) Patel Ltd. also took over all the liabilities other than Irfan's Loan.

  3) 12 % Debentures of Patel Ltd. of Rs. 1,80,000 (which were later on given to Irfan for his loan by the firm) and for the balance equity and Preference shares of Patel Ltd. were given to the firm in the ratio of 2 : 1 being purchased consideration of the frim.

  4) Prepare accounts in the books of the firm as under :

  a) Realisation A/c
  b) Partners' Capital A/c
  c) Patel Ltd. A/c
  d) Irfan's Loan A/c
  e) Patel Ltd.'s Equity shares A/c
  f) Patel Ltd.'s 15 % Preference shares A/c
  g) Patel Ltd.'s 12 % Debenture A/c

- **Required calculations are to be shown.**

**Never wish Life easier,
Wish that you were better**

– Jim Rohn