



RETIREMENT AND DEATH OF A PARTNER

If you look around, you must have noticed people in your relation and in your neighbourhood running business in partnership. You must have seen people quitting partnership firm or a person dies while in partnership. These are the events that take place during the lifetime of a partnership firm. Some issues arise on the happening of these events involving finance. Some assets and liabilities may need revaluation, goodwill is to be treated and amount of joint life policy is distributed and soon accounting adjustment are required to be made. Whenever such events take place, the firm has to calculate the dues of a partner leaving the firm or that of the deceased. In this lesson you will learn the accounting treatment in the books of the firm in these two cases i.e. retirement of a partner and death of a partner.



OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of retirement/death of a partner;
- calculate new profit sharing ratio and gaining ratio;
- make adjustments relating to goodwill, accumulated reserves and undistributed profits at the time of retirement/death of a partner;
- explain the need for revaluation of assets and reassessment of liabilities at the time of retirement/death;
- prepare the revaluation account relating to retirement/death of a partner;
- illustrate the various methods of settling the claim of retiring partner and the related accounting treatment;
- illustrate the accounting treatment of partners capital and its adjustment;
- ascertain profit up to the date of death of a partner;
- prepare the account of the deceased partner's executor.



Notes

20.1 RETIREMENT – MEANING, CALCULATION OF NEW PROFIT SHARING RATIO AND GAINING RATIO

When one or more partners leaves the firm and the remaining partners continue to do the business of the firm, it is known as retirement of a partner. Amit, Sunil and Ashu are partners in a firm. Due to some family problems, Ashu wants to leave the firm. The other partners decide to allow him to withdraw from the partnership. Thus, due to some reasons like old age, poor health, strained relations etc., an existing partner may decide to retire from the partnership. Due to retirement, the existing partnership comes to an end and the remaining partners form a new agreement and the partnership firm is reconstituted with new terms and conditions. At the time of retirement the retiring partner's claim is settled.

A partner retires either :

- (i) with the consent of all partners, or
- (ii) as per terms of the agreement; or
- (iii) at his or her own will.

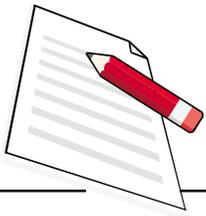
The terms and conditions of retirement of a partner are normally provided in the partnership deed. If not, they are agreed upon by the partners at the time of retirement. At the time of retirement the following accounting issues are dealt :

- (a) New profit sharing ratio and gaining ratio.
- (b) Goodwill
- (c) Adjustment of changes in the value of Assets and liabilities
- (d) Treatment of reserve and accumulated profits.
- (e) Settlement of retiring partners dues,
- (f) New capital of the continuing partners.

New profit sharing ratio and gaining ratio

As soon as a partner retires the profit sharing ratio of the continuing partners get changed. The share of the retiring partner is distributed amongst the continuing partners. In the absence of information, the continuing partners take the retiring partner's share in their profit sharing ratio or in an agreed ratio. The ratio in which retiring partner's share is distributed amongst continuing partners is known as gaining ratio. It is

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Existing Ratio}$$



Notes

Various cases of new ratio and gaining ratio are illustrated as follows:

(i) Retiring partner's share distributed in Existing Ratio :

In this case, retiring partner's share is distributed in existing ratio amongst the remaining partners. The remaining partners continue to share profits and losses in the existing ratio. The following example illustrates this :

Tanu, Manu and Rena are partners sharing profits and losses in the ratio of = 4 : 3 : 2. Tanu retires and remaining partners decide to take Tanu's share in the existing ratio i.e. 3 : 2. Calculate the new ratio of Manu and Rena.

Existing Ratio between Manu and Rena = $\frac{3}{9}$ and $\frac{2}{9}$

Tanu's Ratio (retiring partner) = $\frac{4}{9}$

Tanu's share taken by the Manu and Rena in the ratio of 3 : 2

Manu's gets = $\frac{4}{9} \times \frac{3}{5} = \frac{12}{45}$

Manu's New Share = $\frac{3}{9} + \frac{12}{45} = \frac{27}{45}$

Rena's gets = $\frac{4}{9} \times \frac{2}{5} = \frac{8}{45}$

Rena's New Share = $\frac{2}{9} + \frac{8}{45} = \frac{18}{45}$

New ratio between Manu and Rena is $\frac{27}{45} : \frac{18}{45} = 27 : 18 = 3 : 2$.

Gaining Ratio = New Ratio – Existing Ratio

Manu Gain = $\frac{27}{45} - \frac{3}{9} = \frac{12}{45}$

Rena Gain = $\frac{18}{45} - \frac{2}{9} = \frac{8}{45}$

$\frac{12}{45} : \frac{8}{45}$

3 : 2

You may note that the new ratio is similar to existing ratio that existed between Manu and Rena before Tanu's retirement.

Note: In absence of any information in the question, it will be presumed that retiring partner's share has been distributed in existing ratio.

(ii) Retiring partner's share distributed in Specified proportions:

Sometimes the remaining partners purchase the share of the retiring partner in specified ratio. The share purchased by them is added to their old share and the new ratio is arrived at. The following example illustrates this:



A, B and C are partners in the firm sharing profits in the ratio of 3 : 2 : 1. B retired and his share was divided equally between A and C. Calculate the new profit sharing ratio of A and C.

$$\text{B's Share} = 2/6$$

B's share is divided between A and C in the ratio of 1 : 1.

$$\text{A gets } 1/2 \text{ of } 2/6 = 2/6 \times 1/2 = 1/6$$

$$\text{A's New Share} = 3/6 + 1/6 = 4/6$$

$$\text{C's gets } 1/2 \text{ of } 2/6 = 2/6 \times 1/2 = 1/6$$

$$\text{C's New share} = 1/6 + 1/6 = 2/6$$

Gaining Ratio

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Existing, Ratio}$$

$$\text{Gain of A} = 4/6 - 3/6 = 1/6$$

$$\text{Gain of C} = 2/6 - 1/6 = 1/6$$

$$1/6 : 1/6$$

1 : 1 i.e, equal.

(iii) Retiring Partner's share is taken by one of the partners

The retiring partner's share is taken up by one of the remaining partners. In this case, the retiring partner's share is added to that of partner's existing share. Only his/her share changes. The other partners continue to share profit in the existing ratio. An example illustrating this point is given below:

Anuj, Babu and Rani share profit in the ratio of 5 : 4 : 2. Babu retires and his share is taken by Rani, So Rani's share is $2/11 + 4/11 = 6/11$, Anuj share will remain unchanged i.e, $5/11$. Thus, the new profit sharing ratio of Anuj and Rani is 5 : 6.

Illustration 1

Neru, Anu and Ashu are partners sharing profit in the ratio of 4 : 3 : 2. Ashu retires. Find the new ratio of Neru and Anu if terms for retirement provide the following :

- (i) ratio is not given
- (ii) equal distribution of Ashu's share

Notes



Notes

- (iii) Ashu's share is taken by Neru and Anu in the ratio of 2 : 1
- (iv) Anu take over the share of Ashu.

Solution:

- (i) New profit sharing ratio of Neru and Anu is 4 : 3.

- (ii) Ashu's share = $\frac{2}{9}$

$$\text{Neru gets} = \frac{1}{2} \text{ of } \frac{2}{9} = \frac{2}{9} \times \frac{1}{2} = \frac{1}{9}$$

$$\text{Neru's New share} = \frac{4}{9} + \frac{1}{9} = \frac{5}{9}$$

$$\text{Anu gets} = \frac{1}{2} \text{ of } \frac{2}{9} = \frac{2}{9} \times \frac{1}{2} = \frac{1}{9}$$

$$\text{Anu's New Share} = \frac{3}{9} + \frac{1}{9} = \frac{4}{9}$$

New profit sharing ratio of Neru and Anu is $\frac{5}{9} : \frac{4}{9}$ or 5 : 4

$$\text{Gaining ratio is equal } \frac{1}{9} : \frac{1}{9} = 1 : 1 \left[\text{i.e. } \frac{5}{9} - \frac{4}{9} = \frac{1}{9}; \frac{4}{9} - \frac{3}{9} = \frac{1}{9} \right]$$

- (iii) Ashu's Share = $\frac{2}{9}$

$$\text{Neru gets} = \frac{2}{3} \text{ of } \frac{2}{9} = \frac{2}{9} \times \frac{2}{3} = \frac{4}{27}$$

$$\text{Neru's new share} = \frac{4}{9} + \frac{4}{27} = \frac{16}{27}$$

$$\text{Anu gets} = \frac{1}{3} \text{ of } \frac{2}{9} = \frac{2}{9} \times \frac{1}{3} = \frac{2}{27}$$

$$\text{Anu's new share} = \frac{3}{9} + \frac{2}{27} = \frac{11}{27}$$

New profit sharing ratio of Neru and Anu is 16 : 11.

$$\text{Gaining ratio is } \frac{4}{27} : \frac{2}{27} = 4 : 2 = 2 : 1$$

$$\left[\text{i.e. } \frac{16}{27} - \frac{4}{9} = \frac{4}{27}; \frac{11}{27} - \frac{3}{9} = \frac{2}{27}; 4 : 2 = 2 : 1 \right]$$

- (iv) Anu takes over Ashu share fully.

$$\text{Ashu's share} = \frac{2}{9}$$

$$\text{Anu gets} = \frac{2}{9}$$

$$\text{Anu's new share} = \frac{3}{9} + \frac{2}{9} = \frac{5}{9}$$

New profit sharing ratio of Neru and Anu is 4 : 5

Only Anu gains.



Illustration 2

Ashish, Barmon, and Chander are partners sharing profits and losses in the ratio of 2 : 1 : 2 respectively. Chander retires and Ashish and Barman decide to share the profits and losses equally in future. Calculate the gaining ratio.

Solution:

$$\begin{aligned} \text{Gaining ratio} &= \text{New Ratio} - \text{Existing Ratio} \\ \text{Hence, Ashish gets} &= 1/2 - 2/5 \\ &= 1/10 \\ \text{Barman gets} &= 1/2 - 1/5 \\ &= 3/10 \end{aligned}$$

Gaining ratio between Ashish and Barman is 1 : 3



INTEXT QUESTIONS 20.1

- I. Give any three circumstances under which a partner may retire from partnership.
 - (a)
 - (b)
 - (c)
- II. New ratio of remaining partner
- III. Gaining Ratio = New Ratio – ?
- IV. A B and C were sharing profit in the ratio of 3 : 2 : 1 and A retires. His share is taken by B and C in the ratio of 2 : 1. Which of the following is the new ratio of B and C after A's retirement?

(a) 3 : 2	(b) 2 : 1	(c) 1 : 2
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20.2 TREATMENT OF GOODWILL

The retiring partner is entitled to his/her share of goodwill at the time of retirement because the goodwill is the result of the efforts of all partners including the retiring one in the past. The retiring partner is compensated for his/her share of goodwill. As per Accounting Standard 10 (AS-10), goodwill is recorded in the books only when some consideration in money is paid for it. Therefore, goodwill is recorded in the books only when it is purchased and the goodwill account cannot be raised on its own.

Therefore, in case of retirement of a partner, the goodwill is adjusted through partner's capital accounts. The retiring partner's capital account is

Notes



in their existing profit sharing ratio and crediting the goodwill account. In such a case, the following journal entry is made:

Partners' Capital A/c	Dr	(including retiring partner's capital A/c)
To Goodwill A/c		
(Existing goodwill written-off)		

Notes

Illustration 4

Tanu, Priya and Mayank are partners' sharing profit in the ratio of 3 : 2 : 1. Priya retires and on the date of Priya's retirement goodwill is valued at Rs.90,000. Goodwill already appears in the books at a value of Rs.48,000. New ratio of Tanu and Mayank is 3 : 2. Make the necessary journal entries.

Solution:

Journal

Date	Particulars	LF	Debit Amount (Rs.)	Credit Amount (Rs.)
	Tanu's Capital A/c Dr		24,000	
	Priya's Capital A/c Dr		16,000	
	Mayank's Capital A/c Dr		8,000	
	To Goodwill A/c			48,000
	(Existing goodwill written-off in the books)			
	Tanu's Capital A/c Dr		9,000	
	Mayank's Capital A/c Dr		21,000	
	To Priya's Capital A/c			30,000
	(Priya's share of goodwill adjusted to remaining partners in their gaining ratio 3 : 7)			

Note : Priya's share of goodwill = Rs.90,000 × 2/6 = Rs.30,000

Gaining Ratio = New Ratio – Existing Ratio,

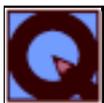
Tanu Gains = $3/5 - 3/6 = 18 - 15/30 = 3/30$

Mayank Gains = $2/5 - 1/6 = 12 - 5/30 = 7/30$

Gaining Ratio between Tanu. and Mayank = 3 : 7



Notes



INTEXT QUESTIONS 20.2

State whether the following statements are True or False :

- (i) Retiring partner’s share of goodwill is debited to his/her capital account at the time of retirement.
- (ii) Goodwill is recorded in the books only when it is purchased.
- (iii) The retiring partner’s capital account is debited with his/her share of goodwill and remaining partner’s capital account is credited in their gaining ratio.
- (iv) In case goodwill account is written off the capital account of all partners is credited.

20.3 REVALUATION OF ASSETS AND LIABILITIES

At the time of retirement of a partner the assets and liabilities of the firm are revalued and Revaluation Account is prepared in the same way as in case of admission of a partner. This is done to adjust the changes in value of assets and liabilities at the time of retirement/death of a partner. Any profit or loss due to revaluation is divided amongst all the partners including retiring/deceased in their existing profit sharing ratio. Following journal entries are made for this purpose :

- (i) For increase in value of assets:

Assets A/c	Dr.	[Individually]
To Revaluation A/c		
(Increase in the value of assets)		

- (ii) For decrease in value of assets:

Revaluation A/c	Dr.	
To Assets A/c		(Individually)
(decrease in the value of asset)		

- (iii) For increase in value of Liabilities:

Revaluation A/c	Dr.	
To Liabilities A/c		[Individually]
(Increase in the value of liabilities)		



Notes

Solution

Date	Particulars	LF	Debit Amount (Rs.)	Credit Amount (Rs.)
	Machinery A/c Dr. Investments A/c Dr. Provision for Outstanding Bill Dr. To Revaluation A/c (Increase in value of Assets i.e. Machinery and investment and reduction in provision)		25,000 2,000 1,000	28,000
	Revaluation A/c Dr. To Land and Building A/c (Decrease in value of assets)		12,000	12,000
	Revaluation A/c Dr. To Mudit's Capital A/c To Mohit's Capital A/c To Sonu's Capital A/c (Profit on revaluation credited to all partners capital A/c in old profit sharing ratio i.e. 3 : 2 : 1)		16,000	8,000 5,333 2,667

Revaluation account

Dr		Cr	
Particulars	Amount (Rs)	Particulars	Amount (Rs)
Land and Building	12,000	Machinery	25,000
Profit transferred to :		Investments	2,000
Mudit Capital 8,000		Provision for	1,000
Mohit Capital 5,333		Outstanding Bill	
Sonu Capital 2,667	16,000		
	28000		28000

Treatment of accumulated reserves and undistributed profit

All the balances of Accumulated Reserves, funds and undistributed amount of Profit or Loss appearing in the balance sheet of the firm on the date of retirement/death is distributed amongst all partners including retiring/deceased partner in their old profit sharing ratio, The following entries are made:



Notes

- (i) For distribution of undistributed profit and reserve.

Reserves A/c	Dr	
Profit & Loss A/c (Profit)	Dr.	
To Partners' Capital A/c		(individually)

(Reserves and Profit & Loss (Profit) transferred to all partners capitals A/c in existing profit sharing ratio)

- (ii) For distribution of undistributed loss

Partners' Capital A/c	Dr.	(individually)
To Profit & Loss A/c (Loss)		

(Profit & Loss (loss) transferred to all partners Capitals A/c in old profit sharing ratio)



INTEXT QUESTIONS 20.3

- I. Fill in the blanks with suitable word or words:

- (a) The credit balance of Revaluation account shows
- (b) Reserve shown in the Balance sheet are transferred to the side of at the time of retirement of a partner.
- (c) The value of the assets has been decreased at the time of retirement of a Partner Account will be debited and account will be credited with the decrease.

- II. There was an increase in the value of a creditor at the time of retirement of a partner. What will be the journal entry for the above?

20.4 SETTLEMENT OF RETIRING PARTNER'S CLAIM

The amount due to the retiring partner is paid according to the terms of partnership agreement. The retiring partners' claim consists of

- (a) The credit balance of Capital Account;



Notes

- (b) His/her share in the Goodwill of the firm;
- (c) His/her share in the Revaluation Profit:
- (d) His/her share in General Reserve and Accumulated Profit;
- (f) Interest on Capital

But, the following deductions are made from his/her Capital Account on account of :

- (a) His/her share in the Revaluation loss;
- (b) His/her Drawings and Interest on Drawings up to the date of retirement
- (c) His/her share of any accumulated losses
- (d) Loan taken from the firm.

The total amount so calculated is the claim of the retiring partner. He/she is interested in receiving the amount at the earliest. Total payment may be made immediately after his/her retirement. However, the resources of the firm may not be adequate to make the payment to the retiring partner in lumpsum. The firm makes payment to retiring partner in instalments.

(i) Payment in Lump Sum

Retiring partners' claim is paid either out of the funds available with the firm or out of funds brought in by the remaining partners.

The following journal entry is made for disposal of-the amount payable to the retiring partner :

On payment of cash in lump sum.

Retiring Partner's Capital A/c	Dr.
To Cash/Bank A/c	
(Amount paid to the retiring partner)	

Illustration 6

Om, Jai and Jagdish are partners sharing profit in the ratio of 3 : 2 : 1. Their balance sheet as on December 31st 2006 is as under :



Balance sheet as on December 31st, 2006

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	80,000	Building	1,80,000
Bills Payable	26,000	Plant	1,40,000
General reserve	24,000	Motor Car	40,000
Capital :		Stock	1,00,000
Om	1,60,000	Debtors	63,000
Jai	1,20,000	Less Provision	3,000
Jagdish	1,20,000	for Bad debts	
		Cash at Bank	10,000
	5,30,000		5,30,000

Notes

Jai retires on that date on the following terms:

- (a) The Goodwill of the firm is valued at Rs.60,000.
- (b) Stock and Building to be appreciated by 10%.
- (c) Plant is depreciated by 10%
- (d) Provision for Bad debts is increased upto Rs.5,000.
- (e) Jai's share of goodwill adjusted through remaining partners capital account,

The amount due to Jai is paid out of the fund brought in by Om and Jagdish for that purpose in their new profit sharing ratio. Jai is paid full amount.

Prepare Revaluation Account and Partner's Capital account.

Solution :

It is assumed that Om and Jagdish gaining ratio remains 3 : 1.

- (a) Gaining ratio = 3 : 1.

$$\text{Om gets} = \frac{2}{6} \times \frac{3}{4} = \frac{1}{4}$$

$$\text{Om's new share} = \frac{3}{6} + \frac{1}{4} = \frac{3}{4}$$

$$\text{Jagdish gets} = \frac{2}{6} \times \frac{1}{4} = \frac{1}{12}$$

$$\text{Jagdish's new share} = \frac{1}{6} + \frac{1}{12} = \frac{3}{12} = \frac{1}{4}$$

$$\text{New profit sharing ratio between Om and Jagdish is } \frac{3}{4} : \frac{1}{4} = 3 : 1.$$



Notes

Illustration 7

Taking the figures of the pervious illustration, assuming that he is paid 40% of the amount due immediately and the balance in three equal yearly instalments. The interest payable is 12% p.a.

Solution:

The amount due to Jai = Rs.1,52,000

Amount paid immediately = Rs.1,52,000 × 40/100
= Rs.60,800

Amount of three equal instalments = Rs.1,52,000 – Rs.60,800 × 3
= Rs.91,200 ÷ 3 = Rs.30,400

1st Instalment at the end of 1st Year = Rs.30,400 + Rs. 10,944
= Rs.41,344

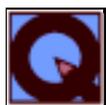
Interest @ 12% pa. = Rs.91,200 × 12/100
= Rs.10,944

2nd Instalment at the end of 2nd Year = Rs.30,400 + Rs.7,296
= Rs.37,344

Interest @ 12% pa. = Rs.60,800 × 12/ 100
= Rs.7,296

3rd Instalment at the end of 3rd Year = Rs.30,400 + Rs.3,648
= Rs.34,048

Interest @ 12% pa. = Rs.30,400 × 12/100
= Rs.3,648



INTEXT QUESTIONS 20.4

I. List the various claims of a retiring partner:

1. 2. 3. 4.

II. Mention the modes of settling the total claims of the retiring partner:

1. 2.



III. Find the total amount due to Munish, who is retiring as a partner:

1. Credit balance in Munish capital account Rs.20,000.
2. Munish's share of goodwill Rs.7,000
3. General reserve balance shown in Balance sheet Rs.10,000
4. Profit on Revaluation of Assets /liabilities Rs.3,000
5. Interest on drawings Rs.5,00.
6. Munish share in the profit of the firm $\frac{1}{2}$

Notes

20.5 ADJUSTMENT OF REMAINING PARTNER'S CAPITAL ACCOUNT AFTER RETIREMENT

After retirement of a partner the remaining partners may decide to adjust their capital. Often the remaining partners determine the total amount of capital of the reconstituted firm and decide to keep their respective capital accounts in proportion to the new profit sharing ratio. The total capital of the firm may be more or less than the total of their capital at the time of retirement. The new capitals of the partners are compared with the balance standing to the credit of respective partner's capital account. If there is a surplus in the capital account, the amount is withdrawn by the concerned partner. The partner brings cash in case the balance in the capital account is less than the calculated amount.

Illustration 8

Roopa, Sunder and Shalu are partners sharing profit in the ratio of 5 : 3 : 2. Roopa retired, when their capitals were: Rs.46,000, Rs.42,000 and Rs.38,000 respectively after making all adjustments on retirement. Sunder and Shalu decided to have a total capital of the firm at Rs.84,000 in the proportion of 7 : 5. Calculate actual cash to be paid or brought in by each partner and make necessary journal entries.

Solution:

Total Capital of the New firm	= Rs.84,000
Sunder's share in the new capital	= Rs.84,000 \times $\frac{7}{12}$
	= Rs.49,000
Shalu's share in the new capital	= Rs.84,000 \times $\frac{5}{12}$
	= Rs.35,000



Notes

On comparing Sunder's share in the new capital of the firm with the amount standing to the credit of his capital, It is observed that he has to bring Rs.7,000 the deficit amount (Rs.49,000 – 42,000) in Cash.

Similarly, Shalu's share in the new capital of the firm is Rs.35,000 while Rs.38,000 stands credited to her capital account. So she is allowed to withdraw Rs.3,000, the surplus amount (Rs.38,000 – Rs.35,000) from the firm so as to make her capital in proportion to her new profit share ratio.

journal

Date	Particulars	LF	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr. To Sunder's Capital A/c (The deficit amount brought in by the partner)		7,000	7,000
	Shalu's Capital A/c Dr. To Bank A/c (The surplus amount withdrawn by the partner)		3,000	3,000

Adjustment of remaining partner's capital in their profit sharing ratio, when the total capital of the new firm is not pre-determined.

In this case the total amount of adjusted capital of the remaining partners is rearranged as per agreed proportion in which they share profit of the reconstituted firm. The following steps may be adopted:

- (i) Add the balance standing to the credit of the remaining partners' capital accounts.
- (ii) The total so obtained is the total capital of the firm.
- (iii) This capital is divided according to the new profit sharing ratio.

Illustration 9

Sumit, Amit and Neha are partners sharing profit in the ratio of 4 : 3 : 1. when Amit retired , their adjusted capitals were Rs.76,000: Rs.45,000 and Rs.34,000 respectively. Sumit and Neha decided to have their total capital of the firm in the ratio of 3 : 2. The necessary adjustments were to be made in cash only. Calculate actual cash to be paid off or brought in by each partner.



Solution:

Total of the adjusted capitals of the remaining partners.

Sumit = Rs. 76,000

Neha = Rs. 34,000

Total = Rs.110,000

Total capital of the firm which is divided in the new ratio of 3 : 2.

New capital of Sumit = $1,10,000 \times \frac{3}{5} = \text{Rs. } 66,000$

New Capital of Neha = $1,10,000 \times \frac{2}{5} = \text{Rs.}44,000$

Sumit's share in the new capital of the firm is Rs.66,000 while Rs.76,000 stands credited to his capital account. So he will withdraw Rs.10,000 (Rs.76,000 – Rs.66,000) from the firm so as to make his capital in proportion to his new profit sharing ratio.

Similarly, Neha's share in the new capital of the firm is Rs.44,000 while Rs.34,000 stands credited to her capital account, She has to bring Rs,10,000 (Rs,44,000 – 34,000) in Cash to make up the deficit in the capital account.

Illustration 10

The Balance Sheet of Rohit, Nisha and Sunil who are partners in a firm sharing profits according to their capitals as on 31st March 2006 was as under:

Liabilities	Amount (Rs.)	As.sets	Amount (Rs.)
Creditors	25,000	Machinery	40,000
Bills Payable	13,000	Building	90,000
General Reserve	22,000	Debtors 30,000	
Capital		Less Provision for 1,000	29,000
Rohit 60,000		Bad debts	
Nisha 40,000		Stocks	23,000
Sunil 40,000	1,40,000	Cash at Bank	18,000
	<u>2,00,000</u>		<u>2,00,000</u>

On the date of Balance Sheet, Nisha retired from the firm, and following adjustments were made:

Notes



Notes

- (i) Building is appreciated by 20%.
- (ii) Provision for bad debts is increased to 5% on Debtors.
- (iii) Machinery is depreciated by 10%.
- (iv) Goodwill of the firm is valued at Rs.56,000 and the retiring partner's share is adjusted.
- (v) The capital of the new firm is fixed at Rs.1,20,000.

Prepare Revaluation Account, Capital Accounts of the partner and Balance sheet of the new firm after Nisha's retirement.

Solution:

Revaluation Account

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Provision for Bad debt A/c	500	Building A/c	18,000
Machinery A/c	4,000		
Profit transferred to Capital Accounts (3 : 2 : 2)			
Rohit	5,786		
Nisha	3,857		
Sunil	3,857		
	13,500		
	18,000		18,000

Capital account

Dr.				Cr.			
Particulars	Rohit (Rs)	Nisha (Rs)	Sunil (Rs)	Particulars	Rohit (Rs)	Nisha (Rs)	Sunil (Rs)
Sunil Capital	9,600	—	6,400	Balance b/d	60,000	40,000	40,000
Bank		66,143		General : Reserve	9,428	6,286	6,286
Balance c/d	72,000	—	48,000	Revaluation (Profit)	5,786	3,857	3,857
				Rohit Capital	—	9,600	—
				Sunil Capital		6,400	
				Bank	6,386		4,257
	81,600	66,143	54,400		81,600	66,143	54,400



Balance Sheet as on 31st March 2006

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	25,000	Building	1,08,000
Bank overdraft	37,500	Machinery	36,000
Bills Payable	13,000	Debtors	30,000
Capital:		Less Provision for	1,500
Rohit	72,000	Bad debts	
Sunil	48,000	Stock	23,000
	1,20,000		
	1,95,500		1,95,500

Notes

Working Notes :

(i) (a) Profit sharing ratio is 60,000:40,000:40,000 i.e. = 3:2:2

(b) Gaining Ratio: Rohit = $3/5 - 3/7 = 21/35 - 15/35 = 6/35$

Sunil = $2/5 - 2/7 = 14/35 - 10/35 = 4/35$

= $6/35 : 4/35$

= 6 : 4 = 3 : 2

(c) Nisha Share of Goodwill = $56,000 \times 2/7 = \text{Rs.}16,000$.

Share of Goodwill in the gaining ratio by the existing partner, i.e.

Rohit = $16,000 \times 3/5 = \text{Rs.}9,600$

Sunil = $16,000 \times 2/5 = \text{Rs.}6,400$

The journal entry is

Rohit's Capital A/c Dr 9,600

Sunil's Capital A/c Dr 6,400

To Nisha's Capital A/c 16,000

(Share of Goodwill divided into gaining ratio)

Bank account

Dr		Cr	
Particulars	Amount (Rs)	Particulars	Amount (Rs)
Balance b/d	18,000	Nisha's Capital A/c	66,143
Rohit's Capital A/c	6,386		
Sunil's Capital A/c	4,257		
Balance c/d (Bank overdraft)	37,500		
	66,143		66,143

Notes

(ii) Bank overdraft is taken to pay the retiring partner amount.

(iv) New Capital of the firm is fixed at Rs.1,20,000.

	Rohit (Rs.)	Sunil (Rs.)
New Capital (Rs.1,20,000 in the ratio of 3 : 2)	72,000	48,000
Existing Capital (After Adjustments) i.e. partner capitals	65,614	43,743
Cash to be brought by the remaining partners	6,386	4,257

Illustration 11

Chauhan Triphati and Gupta are partners in a firm sharing profit and losses in the ratio of 1/2, 1/6 and 1/3 respectively. The Balance Sheet on March 31, 2006 was as follows :

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	36,000	Freehold Premises	80,000
Bills Payable	24,000	Machinery	60,000
General Reserve	24,000	Furniture	24,000
Capitals:		Debtors	40,000
Chauhan	60,000	Less Provision for	2,000
Triphati	60,000	Bad debts	38,000
Gupta	56,000	Stock	44,000
	1,76,000	Cash	14,000
	2,60,000		2,60,000


Notes

Gupta retires from the business and the partners agree to the following revaluation:

- Freehold premises and stock are to be appreciated by 20% and 15% respectively
- Machinery and furniture are to be depreciated by 10% and 7% respectively
- Bad debts reserve is to be increased to Rs.3,000.
- On Gupta retirement, the goodwill is valued at Rs.42,000.
- The remaining partners have decided to adjust their capitals in their new profit sharing ratio after retirement of Gupta. Surplus/deficit, if any in their capital account will be adjusted through cash.

Prepare necessary ledger accounts and Balance Sheet of reconstituted firm.

Solution:
Revaluation Account

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Provision for Bad debts	1,000	Freehold Premises	16,000
Machinery	6,000	Stock	6,600
Furniture	1,680		
Profit transferred to Capital Accounts:			
Chauhan	6,960		
Triphati	2,320		
Gupta	4,640		
	13,920		
	22,600		22,600

Capital Account

Dr.				Cr.			
Particulars	Chauhan (Rs)	Triphati (Rs)	Gupta (Rs)	Particulars	Chauhan (Rs)	Triphati (Rs)	Gupta (Rs)
Gupta Capital	10,500	3,500	—	Balance b/d	60,000	60,000	56,000
Gupta Loan			82,640	General Reserve	12,009	4,000	8,000
Cash		30,000		Revaluation (Profit)	6,960	2,320	4,640
Balance c/d	98,460	32,820		Chauhan Capital	—	—	10,500
				Tirphati Capital			3,500
				Cash	30,000		
	1,08,960	66,320	82,640		1,08,960	66,320	82,640



Notes

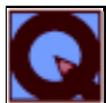
Balance Sheet as on March 31, 2006

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	36,000	Freehold Premises	96,000
Bills Payable	24,000	Machinery	54,000
Gupta's Loan	82,640	Furniture	22,320
Capital:		Debtors	40,000
Chauhan	98,460	Less Provision for	3,000
Tirphati	32,820	Bad debts	37,000
	1,31,280	Stock	50,600
		Cash	14,000
			2,73,920
	2,73,920		2,73,920

Working Note:

- (a) In the absence of agreement, retiring partner's capital account is transferred to his loan account.
- (b) In the absence of agreement, existing ratio of remaining partners is gaining ratio i.e. 3 : 1
- (c) Calculation of Cash brought in (or paid off) by remaining partner.

	Chauhan	Tirphati
(a) Total Capital of Chauhan and Tirphati		
(Rs.68,460 + 62,820 = Rs.1,31,280 in the ratio of 3 : 1)	98,460	32,820
Adjusted existing Capital	68,460	62,820
Excess or Deficit	(Excess) 30,000	(Deficit) 30,000



INTEXT QUESTION 20.5

- I. Surinder, Mahinder and Tarun are partners in a firm. After Surinder's retirement, the profit sharing ratio between Mahinder and Tarun is 5 : 3.

They also decide to fix the firm's capital at Rs.80,000. Find the individual capitals of Mahinder and Tarun.

Mahinder's Capital Rs

Tarun Capitals Rs



- II. Sohan, Amisha and Neena are partners sharing profit in the ratio of 3 : 2 : 1. when Sohan retired, their adjusted capitals were Rs.90,000, Rs.60,000 and Rs.70,000 respectively. Amisha and Neena decided to have their total capital of the firm in the ratio of 5 : 3. Find the capital of each partner and the total capital of firm.

Amisha Capital Rs Neena Capital Rs

Notes**20.6 DEATH OF A PARTNER**

On the death of a partner, the accounting treatment regarding goodwill, revaluation of assets and reassessment of liabilities, accumulated reserves and undistributed profit are similar to that of the retirement of a partner, When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings :

- (a) The amount standing to the credit to the capital account of the deceased partner
- (b) Interest on capital, if provided in the partnership deed upto the date of death:
- (c) Share of goodwill of the firm;
- (d) Share of undistributed profit or reserves;
- (e) Share of profit on the revaluation of assets and liabilities;
- (f) Share of profit upto the date of death;
- (g) Share of Joint Life Policy.

The following amounts are debited to the account of the deceased partner's legal representatives:

- (i) Drawings
- (ii) Interest on drawings
- (iii) Share of loss on the revaluation of assets and liabilities;
- (iv) Share of loss that have occurred till the date of his/her death.

The above adjustments are made in the capital account of the deceased partner and then the balance in the capital account is transferred to an account opened in the name of his/her executor.

The payment of the amount of the deceased partner depends on the agreement. In the absence of an agreement, the legal representative of a deceased partner is entitled to interest @ 6% p.a. on the amount due from the date of death till the date of final payment.



Notes

Calculation of profit upto the date of death of a partner.

If the death of a partner occurs during the year, the representatives of the deceased partner are entitled to his/her share of profits earned till the date of his/her death. Such profit is ascertained by any of the following methods:

- (i) Time Basis
- (ii) Turnover or Sales Basis

(i) Time Basis

In this case, it is assumed that profit has been earned uniformly throughout the year. For example:

The total profit of previous year is Rs. 2,25,000 and a partner dies three months after the close of previous year, the profit of three months is Rs. 31,250 i.e. $1,25,000 \times 3/12$, if the deceased partner took 2/10 share of profit, his/her share of profit till the date of death is Rs. 6,250 i.e. $31,250 \times 2/10$

(ii) Turnover or Sales Basis

In this method, we have to take into consideration the profit and the total sales of the last year. Thereafter the profit upto the date of death is estimated on the basis of the sale of the last year. Profit is assumed to be earned uniformly at the same rate.

Illustration 12

Arun, Tarun and Neha are partners sharing profits in the ratio of 3 : 2 : 1 Neha dies on 31st May 2006. Sales for the year 2005-2006 amounted to Rs.4,00,000. and the profit on sales is Rs.60,000. Accounts are closed on 31 March every year. Sales from 1st April 2006 to 31st May 2006 is Rs.1,00,000.

Calculate the deceased partner's share in the profit upto the date of death.

Solution :

Profit from 1st April 2006 to 31st May 2006 on the basis of sales:

If sales are Rs.4,00,000, profit is Rs.60,000

If the sales are Rs.1,00,000 profit is : $60,000/4,00,000 \times 1,00,000$

$$= \text{Rs.}15,000$$

$$\text{Neha's share} = 15,000 \times 1/6 = \text{Rs.}2,500$$



Alternatively profit is calculated as

$$\text{Rate of profit} = \frac{60000}{400000} \times 100 = 15\%$$

$$\text{Sale upto date of death} = 1,00,000$$

$$\text{Profit} = 1,00,000 \times \frac{15}{100} = \text{Rs } 15000$$

Notes
Illustration 13

Nutan, Sumit and Shiba are partners in a firm sharing profits in the ratio 5 : 3 : 2. On 31st December 2006 their Balance Sheet was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	52,000	Building	60,000
Reserve Fund	15,000	Plant	50,000
Capitals :		Stock	27,000
Nutan 60,000		Debtors	25,000
Sumit 45,000		Cash	10,000
Shiba 30,000	1,35,000	Bank	30,000
	2,02,000		2,02,000

Nutan died on 1 July 2007. It was agreed between her executor and the remaining partners that:

- (i) Goodwill to be valued at 2½ years purchase of the average profits of the last Four years, which were: 2003 Rs. 25,000; 2004 Rs.20,000; 2005 Rs.40,000 and 2006 Rs.35,000.
- (ii) Building is valued at Rs.70,000; Plant at Rs.46,000 and Stock at Rs.32,000.
- (iii) Profit for the year 2006 be taken as having accrued at the same rate as that of the previous year.
- (iv) Interest on capital is provided at 9% p.a.
- (v) On 1 July 2007 her drawings account showed a balance of Rs.20,000.
- (vi) Rs.25,950 are to be paid immediately to her executor and the balance is transferred to her Executors Loan Account.

Prepare Nutan's Capital Account and Nutan's Executor's Account as on 1st July 2007.

Solution

- (i) Valuation of Goodwill:

$$\begin{aligned} \text{Total Profit} &= \text{Rs.}25,000 + \text{Rs.}20,000 + \text{Rs.}40,000 + \text{Rs.}35,000 \\ &= \text{Rs. } 1,20,000 \end{aligned}$$



Notes

Average Profit = $1,20,000/4 = \text{Rs.}30,000$

Hence, Goodwill at $2\frac{1}{2}$ year's purchase = $\text{Rs.}30,000 \times 2\frac{1}{2} = \text{Rs.}75,000$

Nutan's share of goodwill = $75,000 \times 5/10 = \text{Rs.}37,500$

It is adjusted into the Capital Accounts of Sumit and Shiba in the gaining ratio of 3 : 2 i.e. Rs 22,500 and Rs 15000 respectively.

(ii) Share of Profit payable to Nutan [upto the date of death]

$$= \text{Rs.}35,000 \times 6/12 \times 5/10$$

$$= \text{Rs.}8,750$$

(iii) Nutan's Share of Reserve Fund = $\text{Rs.}15,000 \times 5/10$

$$= \text{Rs.}7,500$$

(iv) Interest on Nutan's Capital = $60,000 \times 9/100 \times 6/12$

$$= \text{Rs.}2,700$$

Revaluation account

Dr		Cr	
Particulars	Amount (Rs)	Particulars	Amount (Rs)
Plant	4,000	Building	10,000
Profit transferred to		Stock	5,000
Nutan Capital	5,500		
Sumit Capital	3,300		
Shiba Capital	2,200		
	11,000		
	15,000		15,000

Nutan's Capital account

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Drawings	20,000	Balance b/d	60,000
Nutan's Executor's	1,01,950	Reserve fund	7,500
		Sumit's Capital (Goodwill)	15,000
		Shiba's Capital (Goodwill)	22,500
		Profit & Loss (Suspense)	8,750
		Revaluation A/c	5,500
		Interest on Capital	2,700
	1,21,950		1,21,950



Nutan's Executor's accounts

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Bank	25,950	Nutan's Capital	1,01,950
Nutan's Executor's Loan Transfer	76,000		
	1,01,950		1,01,950

Notes



INTEXT QUESTION 20.6

- I. Fill in the blanks with suitable words :
- The Executor is entitled to all the right of a
 - Share of goodwill of the deceased partner is to his capital account.
 - In case of death of a partner, the profit may be estimated on the basis of and
 - The balance in the capital account of the deceased partner is transferred to his account.
 - Interest on drawing due from deceased partner till the date of the death is to his capital account.



WHAT YOU HAVE LEARNT

I. Retirement

- Due to some reasons like old age, poor health, strained relations etc., an existing partner may decide to retire from the partnership. Due to retirement, the existing partnership comes to an end and the remaining partners form a new agreement and the partnership firm is reconstituted with new terms and conditions.
- At the time of retirement the following accounting issues are dealt:
 - New profit sharing ratio and gaining ratio.

**Notes**

- (b) Goodwill
- (c) Adjustment of changes in the value of Assets and liabilities
- (d) Treatment of reserve and accumulated profits.
- (e) Settlement of retiring partner's dues,
- (f) New capital of the continuing partners.

II. Death

1. When the partner dies, the amount payable to him is paid to his/her legal representatives.
2. The representatives of deceased partner is entitled to the followings:
 - (a) The amount standing to the credit to the capital account and the deceased partner.
 - (b) Interest on capital, if provided in the partnership deed, upto the date of death:
 - (c) share of the value of goodwill of the firm;
 - (d) share of undistributed profit or reserves;
 - (e) share of profit on the revaluation of assets and liabilities;
 - (f) share of profit upto the date of death;
 - (g) share of Joint Life Policy.

The following amounts are debited to the account of the deceased partner's legal representatives:

- (i) Drawings
 - (ii) Interest on drawings
 - (iii) share of loss on the revaluation of assets and liabilities;
 - (iv) share of loss that have occurred till the date of his/her death
3. Calculation of Profit upto the date of death Two Methods
 - (i) Time basis
 - (ii) Sales basis



TERMINAL QUESTIONS



Notes

1. What is meant by retirement of a partner?
2. Explain the gaining Ratio.
3. Explain the accounting treatment of goodwill on retirement of a partner.
4. What problems arise when a partner dies? How would you deal with them as an accountant?
5. Seema, Mohit and Meenakshi were partners in a firm sharing profit in the ratio of 7 : 6 : 7. Mohit retired and his share was divided equally between Seema and Meenakshi. Calculate the new profit sharing ratio of Seema and Meenakshi.
6. Ashu, Ashmita and Metu are partners sharing profits in the ratio of 4 : 3 : 2. Ashu retires, assuming Ashmita and Metu will share profits in future in the ratio 5 : 3, determine the gaining ratio.
7. Anu Beena and Chander are partners in a firm, sharing profit in the ratio of 3 : 2 : 1. Their Balance Sheet as on March 31, 2006 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	3,200	Cash in hand	1,200
General Reserve	12,000	Cash at Bank	2,000
Capitals:		Debtors	18,000
Anu 20,000		Stocks	14,000
Beena 20,000		Machinery	12,000
Chander 20,000	60,000	Building	28,000
	75,200		75,200

On the date of Balance Sheet Chander retires from firm. It is agreed to adjust the value of assets as follows:

- (a) Provide a reserve of 5% on Sundry Debtors for Doubtful Debts.
- (b) Building to be revalued at Rs.30,200.
- (c) Depreciate stock by 5% and Machinery by 10%.

Prepare Revaluation account, Partners Capital account and Balance Sheet of Anu and Beena.

MODULE - 4

Partnership Accounts

Retirement and Death of a Partner



Notes

8. Ashok, Babu and Chinu are partners sharing profit and losses in the ratio of 3 : 2 : 1 respectively. The firm's Balance Sheet on March 31, 2006 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	38,000	Plant & Machinery	70,000
Bills Payable	10,000	Building	90,000
General Reserve	24,000	Motor Car	16,000
Capitals:		Debtors	32,000
Ashok	80,000	Less Provision for <u>1,000</u>	31,000
Babu	60,000	Bad debts	
Chinu	<u>50,000</u>	Stock	50,000
	1,90,000	Cash	5,000
	<u>2,62,000</u>		<u>2,62,000</u>

Babu retires on that date, subject to the following adjustments:

- The Goodwill of the firm to be valued at Rs.36,000.
- Plants and Machinery to be depreciated by 10% and Motor Car by 15%.
- Stock to be appreciated by 20% and Building by 10%.
- Provision for Doubtful debts to be increased by Rs.3,900.

Prepare Revaluation account and Babu's Capital account.

9. Dhruv, Raja and Lela are partners sharing profit and losses in the ratio of 3 : 2 : 1 respectively. The Balance Sheet as on March 31, 2006 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	31,200	Plant & Machinery	37,600
Dhruv Loan	10,000	Building	24,000
Capitals:		Debtors	24,800
Dhruv	51,840	Less Provision for <u>2,400</u>	22,400
Raja	27,360	Bad debts	
Lela	<u>14,240</u>	Stock	18,400
	93,440	Cash	32,240
	<u>1,34,640</u>		<u>1,34,640</u>


Notes

Dhruv retired on March 31, 2006 and Raja and Lela continued in partnership sharing profits and losses in the ratio of 2 : 1. Dhruv was repaid Rs 20000 on 1.4.2006 and it was agreed that the remaining balance due to him should be kept as his loan to the firm,

For the purpose of Dhruv's retirement it was agreed that

- (a) Building be revalued at Rs.48,000 and Plant and Machinery at Rs.31,600.
- (b) The provision for bad debts was to be increased by Rs.800.
- (c) A provision of Rs.1,000 included in creditor was no longer required.
- (d) Rs.2,400 was to be written off from the stock in respect of damaged items included therein.
- (e) A provision of Rs. 8,480 made in respect of outstanding legal charges.
- (f) The goodwill of the firm to be valued at Rs. 28,800.

Prepare Revaluation Account, Capital A/c of partners and Balance sheet of the reconstituted firm.

10. Sunny Honey and Rupesh are partners in a firm. Their Balance sheet as on December 31,2005 is as under:

liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	20,000	Plant & Machinery	40,000
General Reserve	20,000	Furniture & Fittings	5,000
Capitals:		Debtors	30,000
Sunny	40,000	Stock	21,000
Honey	30,000	Investment	24,000
Rupesh	10,000		
	80,000		
	1,20,000		1,20,000

Honey died on 30.06.2006. The partnership deed provides that the representative of the deceased partner shall be entitled to:

- (i) Balance of the capital account of deceased partner.
- (ii) Interest on Capital at 8% p.a. upto date of death.



- II. 1. Lumpsum 2. Instalments
 III. Rs.33,000.

Intext Questions 20.5

- I. Mahinder's Capital Rs.50,000, Tarun's Capital Rs.30,000
 II. Amisha Capital Rs.1,37,500, Neena Capital Rs.82,500 Total Capital Rs.2,20,000.

Intext Questions 20.6

1. (a) Deceased partner, (b) credited, (c) Time, Sales,
 (d) Executor's (e) debited

Answers to Practical Terminal Questions

5. New Ratio 1 : 1
 6. Gaining Ratio 21 : 11
 7. Loss on Revaluation Rs.600
 Total of Balance Sheet Rs.74,600
 8. Profit on Revaluation Rs.5,700,
 Balance of Babu Capital Account Rs.81,900.
 9. Profit on Revaluation Rs.7,320
 Total of Balance Sheet Rs.1,22,680.
 10. Amount payable to Honney's Executor Rs. 44,534.

Notes



Do you know?

Can a person get HIV from a swimming pool?

One cannot get HIV infection from a swimming pool. It is important to know that chlorine, which is widely used to treat the water in swimming pools, is an extremely effective way of destroying HIV.

Any common household bleach mixed in water is also an effective antiseptic. For example, one part of bleaching power/liquid mixed with nine parts of water or hydrogen peroxide can be effective. However, low-level disinfectants such as Dettol and Lysol do not kill HIV.

