CHAPTER 6

RETIREMENT/DEATH OF A PARTNER

Retirement of a Partner	Retirement of a partner means ceasing to be partner of the firm. A partner may retire 1. If there is Agreement to this effect 2. All Partners' give consent 3. At Will by giving written notice
Amount due to Retiring/ Deceased Partner	1. Credit Balance of his capital. 2. Credit Balance of his current account (if any). 3. Share of Goodwill. (To be given by gaining partners) 4. Share of Reserves or Undistributed Profits. 5. His share in the profit on revaluation of assets and reassessment of liabilities. 6. If retirement is during the year, the retiring partner will be given. Share in profits up to the date of retirement. 7. Interest on capital if involved. 8. Salary if any up to the date of Retirement/Death Deductions from the above Sum (To be Debited to the Capital Account) 1. Debit balance of his current account (if any) 2. Share of existing Goodwill to be written off. 3. Share of Accumulated loss. 4. Drawings and interest on drawings (if any). 5. Share of loss on account of Revaluation of assets and liabilities. 6. His share of business loss up to the date of Retirement/Death (To P & L suspense A/c)
Gaining Ratio	The ratio in which the continuing partners have acquired the share from the retiring/deceased Partner is called Gaining Ratio.

Sacrificing Ratio v/s Gaining Ratio	
Why the Retiring or Deceased Partner is entitled to his share of Goodwill at the time of Retirement/ Death?	Because the Goodwill has been earned by the firm with the efforts of the existing partners, hence at the time of retirement/death of a partner it is valued as per agreement.
Hidden Goodwill	If the firm has agreed to settle the retiring or deceased partner by paying a lump sum amount, then the amount paid to him in access of what is due shall be treated as his share of goodwill and known as hidden goodwill
Disposal Amount due to Retiring partner	The outgoing partners' account is settled as per the terms of partnership deed i.e. 1. In lump sum immediately 2. In various instalments with or without interest as agreed 3. Partly in cash immediately and partly in instalments at the agreed intervals
What are the provisions if the Retiring Partner is not paid fully at the time of Retirement	In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive 1. Either Interest @ 6% till the date of payment 2. Such share of Profits which has been earned with his/her money

Deceased Partner share of profit may be calculated	1. On the basis of last years profit (On Average Basis) 2. On the basis of sales

Points to remember -

1. When the question is silent about the amount payable to retiring partner, then the whole amount payable is transferred to his/her loan account.
2. In case of death of a partner, Capital Account of the Deceased Partner is closed by transferring the whole amount to the executors of the deceased Partner.
3. Any payment to the executors of the deceased partner is made through executor's account, not through the deceased partners' capital account.
4. Goodwill already appeared in the books must be written off in old PSR.
5. All accumulated profits and all accumulated losses are to be distributed among old partners in their old PSR.
6. In case of specific fund, like investment fluctuation fund, market value of the investment must be considered. For workman compensation fund, actual liabilities must be considered (to be deducted from fund).
7. Revaluation profit/loss is to be distributed in old PSR.

Accounting Treatment

1. Calculation of new profit-sharing ratio and gaining ratio
2. Treatment of goodwill.
3. Revaluation account preparation with the adjustment in respect of unrecorded assets/liabilities.
4. Distribution of reserves and accumulated profits/loss.
5. Ascertainment of share of profit/loss till the date of retirement/death.
6. Adjustment of capital if required.
7. Settlement of the Accounts due to Retired/Deceased partner.

1. New Profit Sharing Ratio & Gaining Ratio

Calculation of the two ratios.

Following situations may arise

(i) When no information about new ratio or gaining ratio is given in the question

> In this case it is considered that the share of the retiring partner is acquired by the remaining partners in the old ratio. Then no need to calculate the new ratio/gaining ratio as it will be the same as before.

(ii) Gaining ratio is given which is different from the old ratio in this case,

> **New share of continuing partner = old share + share gained from the outgoing partner.**

(iii) If the new ratio is given

> **Gaining ratio = New Ratio - Old ratio**

2. Treatment Of Goodwill.

Steps to be followed

1. When old goodwill appears in the books then first of all this is written off in the old ratio. Remember **Old Goodwill in Old Ratio.**
   All Partner's capital A/c Dr.
   To Goodwill A/c
2. After written off old goodwill, adjustment of retiring partner's share of goodwill will be made through the following journal entry
   Gaining Partner's Capital A/c Dr. (in gaining ratio)
   To Retiring / Deceased Partner's Current A/c (if any)
   To Retiring/Deceased Partners' Capital A/c

OR

Alternative entry with raising of goodwill of its value and written off:-

1. Journal entries passed are : -

   Goodwill A/c Dr. (Current value of goodwill)

   To all partners capital A/c

   (Being the goodwill raised is current value) (In old profit sharing ratio)

2. Counting partners capitals A/c Dr. (In new profit sharing ratio)

   To goodwill A/c

   (Being the goodwill written of)

3. Revaluation of Assets and Reassessment of Liabilities

Revaluation A/c is prepared in the same way as in the case of admission of a new partner. Profit and loss on revaluation is transferred among all the partners in old ratio.

4. Adjustment of Reserves and Surplus (Profits)

(Appearing in the Balance Sheet - Liability Side)

(a) General Reserve A/c Dr.
Reserve Fund A/c Dr.
Profit & Loss A/c (Credit Balance) Dr.
To all partners' Capital/Current A/c (in old ratio)

(b) Specific Funds - if the specific funds such as workmen's compensation fund or investment fluctuation fund are in excess of actual requirement, the excess will be transferred to the Capital A/c in old ratio.

Workmen Compensation Fund A/c Dr.

Investment Fluctuation Funds A/c Dr

To All Partner's Cap A/c's (in old Ratio)

(c) For distributing accumulated losses (P & A/c Dr. Balance)

All partner's Capital/Current A/c Dr. (in old ratio) To P & L A/c

5. Adjustment of Capitals

At the time of retirement /death, the remaining partners may decide to adjust their capitals in their new profit sharing Ratio. Then following situation may arise

Case 1 . When the total capital of the new firm is not given in the question

- Then the sum of their adjusted capitals of remaining partners' will be treated as the total capital of the new firm which will be divided in their New Profit Sharing Ratio.

- Excess or Deficiency of capital in the individual capital A/c is calculated.
- Such excess or shortage is adjusted by withdrawal or contribution in cash or transferring to Partner's current A/cs.

Journal Entries

(a) For excess Capital withdrawn by the partners

Partner's Capital A/c Dr.

To Cash/Bank A/c / Partner's Current A/c

(b) For deficiency, cash will be brought in by the partner

Cash/Bank A/c /Partner's Current A/c Dr.

To Partner's Capital A/c

Case 2. When the capital of the new firm as decided by the partners is specified, divide the capital in new profit sharing ratio and make adjustments accordingly.

Case 3. When the amount payable to retiring partner will be contributed by continuing partners in such a way that their capitals are adjusted proportionate to their new profit sharing ratio then calculations will be as under

> Total capital of the new firm = balance in capital accounts of remaining partners + amount payable to retiring/deceased partner

DEATH OF A PARTNER

Accounting treatment in the case of death is same as in the case of retirement except the following:

1. The deceased partners claim is transferred to his executer's account.
2. Normally the retirement takes place at the end of the Accounting Period but the death may occur at any time. Hence the claim of deceased partner shall also include his share of profit or loss, interest on capital and drawings if any from the date of the last balance sheet to the date of his death.

- Calculation of Profits/ Loss for the intervening Period

  It is calculated by any one of the two methods given below:

a. On Time Basis: In this method proportionally profit for the time period is calculated either on the basis of last year's profit or on the basis of average profits of last few years and then deceased partner's share is calculated based on his share of profits.

b. On Turnover or Sales Basis: in this method the profits up to the date of death for the current year are calculated on the basis of current year's sales up to the date of death by using the formula.

   Profits for the current year up to the date of death =

   Sales of the current year up to the date of death/total sales of last year x Profit for the last year.

   Then from this profit the deceased partner's share of profit is calculated.

> If the remaining partners decides to change their profit sharing ratio in new firm, then the adjustment entry for deceased partners' share in current year's profit will be passed.

Payment for retiring deceased partner :-

a. When payment is made in full

   retiring deceased partners capitals A/c to bank Dr.

b. When Payment is made in instalments. When payment is made in instalments interest is paid on instalments at agreed price or @ 6% per annum. Journal entries are

(i) When interest is allowed

Interest A/c Dr.

To Deceased Partner's Executor or retiring partner loan A/c

(ii) When instalment is paid

retiring partners loan A/c or Desease partners executor a = A/c Dr.

To Bank A/c (interest & instalment amount)

Illustration 1: A, B and C are partners sharing profit and loss in the ratio of 3:2:1 then on retirement of a partner; the gaining ratio/new ratio will be

On A's Retirement ratio between B and C will be 2: 1

On B's Retirement ratio between A and C will be 3: 1

On C's Retirement ratio between A and B will be 3: 2

Illustration 2: A, B & C share profit and losses in the ratio 3:2:1. On C's death his share is taken by A and B in the ratio of 2:1 Calculate new ratio.

Solution: In this case gaining ratio = 2:1 (given)

A's old share = 3/6, B's old share = 2/6 & C's share = 1/6

A's gain = 2/3 of C's share 2/3* 1/6 = 2/18

B's gain = 1/3 of C's share = 1/3* 1/6 = 1/18

A's new share = A's old + A's gain

= 3/6 + 2/18 = 11/18

B's new share = B's old share + B's gain

= 2/6 + 1/18 = 7/18

New ratio = 11:7

Illustration 3 : A, B and C are partners in the ratio of 3:2:1. C retires and A & B decide to share future profit in the ratio of 5:3. Calculate Gaining ratio of A and B.

Solution: A's Gain = 5/8- 3/6=3/24

B's Gain = 3/8-2/6 = 1/24

Gaining ratio = 3:1

Illustration 4: A, B and C are partners sharing profits and losses in the ratio of 3:2:1. B retires and gifted $\frac{1}{2}$ of his share in favour of A and sells remaining share to A and C in the ratio of 1:2. Find out gaining ratio and new ratio.

Solution:

B's share = $\frac{2}{6} = \frac{1}{3}$; gifted to A = $\frac{1}{3} \times \frac{1}{2} \times \frac{1}{6}$

Remaining shares of B = $\frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}$

A's gain = Gifted share of B + Share sold by B

Share sold by B to A = $\frac{1}{6} \times \frac{1}{3} = \frac{2 \times 1}{6} = \frac{1}{6}$

A's gain = $\frac{1}{6} + \frac{1}{18} = \frac{3+1}{18} - \frac{4}{18}$ or $\frac{2}{9}$

C's gain = $\frac{1}{6} \times \frac{2}{3} = \frac{2}{18}$ or $\frac{1}{9}$

Gaining ratio = $\frac{2}{9} : \frac{1}{9}$ or 2 : 1

A's new share = $\frac{3}{6} + \frac{2}{9} = \frac{9+4}{18} = \frac{13}{18}$

C's new share = $\frac{1}{6} + \frac{1}{9} = \frac{3+2}{18} = \frac{5}{8}$

New profit sharing ratio of A and C is $\frac{13}{18} : \frac{5}{18}$ or 13 : 5

Illustration 5: A, B and C were partners sharing profits in the ratio of 6:4:5. On 1st April, 2016, B retired from the firm and the new profit sharing ratio between A and C was decided as 11:4. On B's retirement, the goodwill of the firm valued at Rs. 1,80,000. Pass journal entry for treatment of goodwill on B's retirement.

(CBSE Delhi)

Solution:

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Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2016 April,1	A's Capital A/c Dr.		60,000	
	To B's Capital A/c			48,000
	To C's Capital A/c			12,000
	(Being adjustment of goodwill made on B's retirement)			

Working Notes:

Gaining Ratio = A's gain = $\frac{11}{15} - \frac{6}{11} = \frac{11-6}{15} = \frac{5}{15}$

C's gain = $\frac{4}{15} \times \frac{5}{15} = -\frac{1}{15}$ (sacrificed)

B's share is goodwill = 1,80,000 × $\frac{4}{15}$ = Rs. 48,000

A will compensate C to the extent of sacrifice made by C i.e. 1,80,000 × $\frac{1}{15}$
= Rs. 12,000

Illustration 6: M. N. & P are partners in a firm. P retires & the goodwill of the firm is valued at Rs. 30,000. M & N decide to share future profits in the ratio of 3:2. Pass necessary

1. If goodwill A/c already appears in the books at Rs. 18,000
2. When goodwill account raised and written books.

Solution:

Old ratio of M, N & P = 1:1:1 (since profit sharing ratio is not given it is treated as equal) New ratio = 3:2

M's gain = 3/5 - 1/3 = 4/15

N's gain = 2/5 - 1/3 = 1/15

Gaining ratio = 4 : 1

Ps share of goodwill = 30,000 ×1/3

= Rs. 10,000

Case 1. If goodwill A/c appears in the books at ₹ 18,000.

Journal

Date	Particulars		LF.	Debit (₹)	Credit (₹)
1.	M's Capital A/c	Dr.		6,000	
	N's Capital A/c	Dr.		6,000	
	P's Capital A/c	Dr.		6,000	
	To Goodwill A/c				18,000
	(Being the existing goodwill written off in old ratio i.e. 1:1:1)				
2.	Goodwill			30,000	
	To M's Capital A/c	Dr.			10,000
	To N's Capital A/c	Dr.			10,000
	To P's Capital A/c				
	(Being adjustment made for goodwill on retirement in gaining ratio i.e. 4:1)				
3.	M's Capital A/c	Dr.		18,000	
	N's Capital A/c	Dr.		12,000	
	To Goodwill				
	(Goodwill writting off immidatly with				30,000
	new right storng ratio 3.2)				

Case 2. When no goodwill account appears in the book entry as 2 above.

Illustration 7 : R, S & T are partners in a firm sharing profit & loss in the ratio of 2:2:1. T Retires and his balance in capital a/c after adjustment for reserve &

revaluation of assets & liabilities comes out to be Rs. 50,000. R &S agree to pay him Rs. 60,000. Give journal entry for the adjustment of goodwill.

Solution:

New ratio between R & S = gaining ratio = 2:2 or 1:1

T's share of goodwill (hidden) = 60,000 – 50,000 = 10,000

Hence adjustment entry is

Journal

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	R's capital A/c Dr.		5,000	
	S's capital A/C Dr.		5,000	
	To T's capital A/c			10,000
	(T's share of goodwill adjusted in gaining ratio i.e. 1:1			

Illustration 8: X, Y and Z are partners sharing profits in the ratio of 3:2:1. Y retires selling his share to X and Z for Rs. 36,000; Rs. 24,000 being paid by X and Rs. 12,000 by Z. The profit after Y's retirement is Rs. 63,000.

Pass necessary journal entries to

(i) Record the sale of Y's share to X and Z and

(ii) Distribute the profit between X and Z.

Solution:

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Date	Particulars	L.F.	Debit (₹)	Credit (₹)
(i)	X's Capital A/c Dr.		24,000	
	Z's Capital A/c Dr.		12,000	
	To Y's Capital A/c			36,000
	(Being Y's share is purchase by X and Z on his retirement)			
	Profit & Loss Appropriation A/c Dr.		63,000	
	To X's Capital A/c			45,500
	To Y's Capital A/c			17,500
(ii)	(Being profit distributed between X and Z in new profit sharing ratio			

Working Notes:

Gaining ratio= 24000:12000 = 2:1

Y's share = $\frac{2}{6}$

X's gaining share = $\frac{2}{6} \times \frac{2}{3} = \frac{4}{18}$

Z's gaining share = $\frac{2}{6} \times \frac{1}{3} = \frac{2}{18}$

X's new share is = $\frac{3}{6} \times \frac{4}{18} = \frac{9+4}{18} = \frac{13}{18}$

Z's new share is = $\frac{90,000}{2,10,000} \times 42,000$

New Profit sharing Ratio between X and Z = 13: 5

Q. 9. A,B and C are partner sharing profits in the ration of 3:2:1 . A dies on 31st July 2015. The profits of the firm for the year ending 31st March 2015, were 42,000. Calculate as share of profit :-

A). On time Basis from 1 April to 31st July 2015 on the basis of Last year's Profrit

(B). On sales basis Sales for the last year ₹ 2,10,000 and for current year upto 31st July are Rs. 90,000?

Solution

(A). A's Profit = Preceding year's profit × Proportionate Period × Share of A

= Rs. 42,000 × 4/12 × 3/6

= Rs. 7,000

Journal Entries

Date	Particulars	L.F	Debit (Rs)	Credit (Rs.)
2015 July 31	Profit and Loss Suspense A/c Dr. To A's Capital A/c (A's share of profit transferred to his capital A/c)		7,000	 7,000

(B).

$$= \frac{90,000}{2,10,000} \times 42,000$$

= Rs. 18,000

A's share = Rs. 18,000×3/6

= Rs. 9,000

Illustration 10: (Death of a partner) M, N and O were partners in a firm sharing profits and losses equally.

Their Balance Sheet on 31-12.2014 was as follows:

Liabilities		(Rs)	Assets	Rs.
Capitals:			Plant and machinery	60,000
M	70,000		Stock	30,000
N	70,000		Sundry Debtors	95,000
O	70,000	2,10,000	Cash at Bank	40,000
General Reserve		30,000	Cash in Hand	35,000
Creditors		20,000		
		2,60,000		2,60,000

N died on 14th March, 2015. According to the Partnership Deed, executers of the deceased partner are entitling to:

(i) Balance of partner's capital A/c

(ii) Interest on capital @ 5% p.a.

(ii) Share of goodwill calculated on the basis of twice the average of past three years' profits.

(iv) Share of profits from the closure of the last accounting year till the date of death on the basis of twice the average of three completed year's profits before death. Profits for 2012, 2013 and 2014 were Rs. 80,000, Rs. 90,000, Rs. 1,00,000 respectively. Show the working for deceased partner's share of goodwill and profits till the date of his death. Pass the necessary journal entries and prepare N's Capital A/c to be rendered to his executers.

(CBSE 2011 Modified)

Solution

Journal

Date	Particulars	L.F.	Debit (`)	Credit (`)
2015 March, 14th	General Reserve A/c Dr. To N's Capital A/c (Being transfer of N's share of general reserve of his Capital A/c)		10,000	10,000
	Interest on Capital A/c Dr. To N's Capital A/c (Being interest 5% p.a. credited to N's Capital A/c upto 14.03.2010)		700	700
	M's Capital A/c Dr. O's Capital A/c Dr. To N's Capital A/c (Being goodwill adjusted in gaining ratio i.e. 1:1)		30,000 30,000	60,000
	Profit and Loss Suspense A/c Dr. To N's Capital A/c (Being the transfer of N's share of profit to his capital A/c)		12,000	12,000
	N's Capital A/c Dr. To N's Executor A/c (Being the transfer of amount due to N's executor A/c)		1,52,700	1,52,700

N's Capital A/c

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To N's Executors A/c	1,52,700	By Balance b/d	70,000
		By General Reserve A/c	10,000
		By Interest on Capital A/c	
		(70,000*5/100*73/365)	700
		By M's Capital A/c	30,000
		By O's Capital A/c	30,000
		By Profit & Loss	
		Suspense A/c	
		(90,000*2*73/365*1/3)	12,000
	1,52,700		**1,52,700**

Working Note:

1. Calculation of Goodwill

   Average profit for 3 years

   (₹ 80,000 + 90,000 + 1,00,000)/3 = ₹ 90,000

   Goodwill of the firm=Average Profit × No. of years of Purchase

   = 90,000 × 2 = ₹ 1,80,000

   N's Share in Goodwill = 1,80,000 × 1/3 = 60,000

2. Time from the date of last balance Sheet (31st December, 2014) to the date of death (14th March, 2015)

   = 31 days of January + 28 days of Feb (2015 is not a leap year) + 14 days of March = 73 days

Illustration 11: The balance sheet of P, Q & R as at 31st Dec.2014 was as follows.

Liabilities	Rs.	Assets	Rs.
Bills Payable	20,000	Cash at Bank	1,58,000
Employees Provident Fund	50,000	Bills Receivable	8,000
Workmen compensation	90,000	Stock	90,000
reserve		Sundry Debtors	1,60,000
Loan	1,71,000	Furniture	20,000
Capital Accounts		Plant & Machinery	65,000
P 2,27,500		Building	3,00,000
Q 1,52,500		Advertisement	
R1,20,000	5,00,000	Suspense	30,000
	8,31,000		**8,31,000**

The profit ratio was 3:2:1 R died on 30th April 2015. The partnership deed provides that:

a. Goodwills is to be calculated on the basis of 3 years purchase of preceding 5 years' average profits. The profits were 2014. ₹ 2,40,000, 2013 ₹ 1,60,000, 2012 ₹ 2,00,000, 2011 ₹ 1,00,000 and 2010 - ₹ 50,000.

b. Deceased partner should be given share of profits upto the date of death on the basis of previous year profits.

c. The assets have been revalued as under
Stock Rs. 1,00,000, Debtors Rs. 1,50,000, Furniture Rs. 15,000. Plant and Machinery Rs. 50,000, Building Rs. 3,50,000. A bill for Rs. 6000 was found worthless.

d. A sum of Rs. 72,333 was paid immediately to R's executor & balance is paid in two equal instalments (annual) with interest of 10% p.a. On outstanding amount. Ist instalment was paid on 30th April 2016.
Prepare Revolution account & R's executor account till it is finally settled. Accounts are closed on 31st December each year.

Solution:

Revaluation Account

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Debtors A/c	10,000	By Stock A/c	10,000
To Furniture A/c	5,000	By Building A/c	50,000
To Plant & Machinery A/c	15,000		
To Bill Receivable A/c	6,000		
To profits transferred to			
P's capital A/c 12,000			
Q's Capital A/c 8,000			
R's Capital A/c 4000	24,000		
	60,000		60,000

R's Capital Account

Dr. Cr.

Date	**Particular**	**Rs.**	**Date**	**Particular**	**Rs.**
2013	To Advertisement		2013	By balance b/d	1,20,000
30th	Suspense A/c		30th April	By Workmen	15,000
April	(30,000 × 1/6)	5,000	30th April	Compensation	
			30th April	reserve	
			30th April	By Revaluation	4,000
30th	To R's Executor	2,22,333		A/c	
April	A/c		30th April	By P's Capital A/c	45,000
				(Goodwill)	
			30th April	By Q's capital A/c	30,000
				(Goodwill)	
			30th April	By P&L Suspense	13,333
				A/c	
		2,27,333			**2,27,333**

R's Executor Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particular	Rs.
30.4.15	To Bank A/c	72,333	30.4.15	By R's capital A/c	2,22.333
31.12.15	To Balance c/d	1,60,000	31.12.15	By interest A/c	
				(10% on 1,50,000× $\frac{8}{12}$)	10,000
		2,32,333			**2,32,333**
30.4.16	To Bank A/c 75000		1.1.16	By Balance b/d	1,60,000
	15000	90,000	30.4.16	By Interest A/c	
30.12.16	To Balance c/d	80,000		($\frac{10}{100}$×1,50,000×$\frac{4}{12}$)	5,000
			31.12.16	($\frac{10}{100}$×75,000×$\frac{8}{12}$)	5,000
		1,70,000			**1,70,000**
				By Balance b/d	80,000
30.4.17	To Bank A/c 80,000		1.1.17	By interest A/c	
	Add Interest 2,500	82,500	30.4.17	($\frac{10}{100}$×75,000×$\frac{4}{12}$)	2,500
		82,500			**82,500**

Working Note:

Average Profit = 2,40,000 + 1,60,000 + 2,00,000 + 1,00,000 + 50,000/5

= Rs. 1,50,000Goodwill = Rs. 1,50,000 × 3 = Rs. 4,50,000

R's share = 4, 50, 000× $\frac{1}{6}$ = Rs. 75,000

contribution by P&Q in ratio 3:2

P's share = $\frac{3}{5}$ ×75000 = Rs. 45000 Q's share $\frac{2}{5}$ × 75,000 = Rs. 30,000

R's share of profits = 2, 40, 000 × $\frac{4}{12}$×$\frac{1}{6}$ = ₹ 13,333