Class 12

Accountancy

Chapter 3

RETIREMENT & DEATH OF A PARTNER

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RETIREMENT

Withdrawal of a partner by himself from the business for various reasons such as old age, lack of interest in business etc.

RETIREMENT

A partner can retire from the business either as per the terms of agreement or voluntarily

RETIREMENT

On retirement he is entitled to get all the sums due to him up to the date of retirement, as well as he is liable for his share in all losses till the date of his retirement

Accounting Aspects on Retirement

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Accounting Aspects on Retirement

1) Change in Profit sharing ratio.
2) Calculation of gaining ratio.
3) Adjustment regarding goodwill.
4) Adjustment of reserves and accumulated profits/losses.
5) Revaluation of assets and liabilities.
6) Ascertainment of profit or loss up to the date of retirement.
7) Calculation of total amount due to the retiring partner.
8) Settlement of total amount due to the retiring partner.
9) Adjustment of capitals of continuing partner.

Change in Ratio

Change in Profit Sharing Ratio

While retiring a partner the profit sharing ratio of the existing partners may be revised

Change in Profit Sharing Ratio

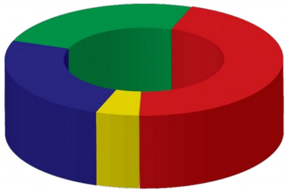
If the share of outgoing partner is acquired by the existing partners in their profit sharing ratio the profit sharing ratio among the remaining partners will not change

Change in Profit Sharing Ratio

Eg: A,B &C share profits in the ratio of 3 : 2 : 1 and B retires

Here the ratio between A and C will be 3 : 1

If they decide to be equal partners, the new ratio will be 1 : 1.



Gaining Ratio

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Gaining Ratio

The ratio in which the continuing partners share the profit of outgoing partner is called gaining ratio

GAINING RATIO = NEW RATIO – OLD RATIO

GAINING SHARE = NEW SHARE – OLD SHARE

Treatment of goodwill

A partner who is retiring from the firm is entitled to his share of goodwill, as it is created by the firm with the efforts of all the partners including the retiring partner

The accounting treatment for goodwill in such a situation depends upon whether goodwill already appears in the books or not

Treatment of Goodwill

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Treatment of goodwill

When Goodwill does not appear in the books

A. When Goodwill does not appear in the books

In this case there are four ways to treat the Goodwill:

1. **Goodwill is raised at its full value and retained in the books.**

Here **Goodwill A/c is debited** with its full value and **all partners' capital Accounts are credited** in their old ratio.

The full value of Goodwill appears in the balance of the reconstituted firm.

Goodwill is raised at its full value and retained in the books

Example: A, B and C are partners in the ratio of 3:2:1 and B retires. The goodwill of the firm is valued at Rs. 60000 and remaining partners A and C continue to share profits in 3:1.

Goodwill is raised at its full value and retained in the books

Example: A, B and C are partners in the ratio of 3:2:1 and B retires. The goodwill of the firm is valued at Rs. 60000 and remaining partners A and C continue to share profits in 3:1.

Let us see the accounting treatment (Journal Entry):

Goodwill is raised at its full value and retained in the books

Example: A, B and C are partners in the ratio of 3:2:1 and B retires. The goodwill of the firm is valued at Rs. 60000 and remaining partners A and C continue to share profits in 3:1.

Goodwill A/c	Dr	60000	
To A's Capital A/c			30000
To B's Capital A/c			20000
To C's Capital A/c			10000
(Goodwill is raised at its full value in old ratio)			

When Goodwill does not appear in the books

2. Goodwill raised at its full value and written off immediately:

The partners have decided that the goodwill is not to be shown in the books after reconstitution

Goodwill raised at its full value and written off

Example: A, B and C are partners in the ratio of 3:2:1 and B retires. The goodwill of the firm is valued at Rs. 60000 and remaining partners A and C continue to share profits in 3:1.

Let us think about the accounting treatment:

Goodwill raised at its full value and written off

Example: A, B and C are partners in the ratio of 3:2:1 and B retires. The goodwill of the firm is valued at Rs. 60000 and remaining partners A and C continue to share profits in 3:1.

Goodwill A/c Dr	60000	
To A's Capital A/c		30000
To B's Capital A/c		20000
To C's Capital A/c		10000
(Goodwill is raised at its full value in old ratio)		

A's Capital A/c Dr	45000	
C's Capital A/ Dr	15000	
To Goodwill A/c		60000
(Goodwill written off in new ratio)		

When Goodwill does not appear in the books

3. The Goodwill is raised to the extent of retired / diseased partner’s share and written off immediately:

In the above example, B’s share of goodwill is Rs. 20000

So what is the journal entry?

When Goodwill does not appear in the books

3. The Goodwill is raised to the extent of retired / diseased partner's share and written off immediately:

In the above example, B's share of goodwill is Rs. 20000

Goodwill A/c	Dr	20000	
To B's Capital A/c			20000

(Goodwill is raised to the extent of B's share)

A's Capital A/c	Dr	15000	
C's Capital A/c	Dr	5000	
To Goodwill A/c			20000

(Goodwill written off in their gaining ratio 3:1)

When Goodwill does not appear in the books

4. No Goodwill account is raised in the books of accounts

If it is decided that the goodwill account should not appear in the books, it is adjusted through partners’ capital accounts

No Goodwill account is raised in the books of accounts

Since, the outgoing partner’s share of profit is acquired by the continuing partners; they have to compensate the retiring partner in their gaining ratio

So what is the accounting treatment?

No Goodwill account is raised in the books of accounts

Since, the outgoing partner's share of profit is acquired by the continuing partners; they have to compensate the retiring partner in their gaining ratio

Continuing Partners' Capital A/c Dr

To Retiring partner's Capital Account

(Share of goodwill of the retiring/diseased partner adjusted to the continuing partners in their gaining ratio)

No Goodwill account is raised in the books of accounts

In the above example, it will be:

A's Capital A/c	Dr	15000
C's Capital A/c	Dr	5000
To B's Capital A/c		20000

(B's share of Goodwill adjusted to remaining partners' capital accounts in their gaining ratio 3:1)

In case, if any of the continuing partners sacrifice some share in profits on retirement, his capital account will also be credited along with the retiring partner’s capital account

So what is the Journal Entry?

In case, if any of the continuing partners sacrifice some share in profits on retirement, his capital account will also be credited along with the retiring partner's capital account.

Journal Entry:

Gaining Partner's Capital Account Dr

To Retiring Partner's Capital Account

To Sacrificing Partner's Capital Account

(Both the retiring partner's sacrifice and the continuing partner's sacrifice are compensated by the gaining partner)

Example: A,B and C are partners sharing profits in the ratio of 3:2:1. **C retires** from the firm and the new ratio agreed between A and B is 1:1 .

Show the accounting treatments of goodwill on the assumption that the total amount of goodwill of the firm is Rs.6000/-

Solution:

C's share of goodwill = 6000 x 1/6 = 1000

A's gain = NR – OR = 0

B's gains = 1/6

B's Capital A/c Dr 1000

To C's Capital A/c 1000

Treatment of goodwill

When Goodwill is Appearing in the Books

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B. When Goodwill is Appearing in the Books

There are three situations:

1

1. If value of Goodwill appearing in the books of the firm equals with the current value of goodwill:

No adjustment is required in this case

B. When Goodwill is Appearing in the Books

There are three situations:

2. If the book value of goodwill is lower than its current value:

In this the goodwill is raised to its present value by debiting difference amount to goodwill account and crediting all partners’ capital accounts in their old ratio.

Book value of goodwill is lower than its current value

Example: X, Y and Z are partners in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20000. Y retires and the goodwill is valued at Rs.24000.

Show the accounting treatment.

Book value of goodwill is lower than its current value

Example: X, Y and Z are partners in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20000. Y retires and the goodwill is valued at Rs.24000.

Goodwill A/c	Dr	4000	
To X's Capital A/c			2000
To Y's Capital A/c			1200
To Z's Capital A/c			800

(Increase in the value of goodwill credited to all partners capital accounts in their old ratio)

When Goodwill is Appearing in the Books

3. If the book value of goodwill is higher than its current value:

Here the difference amount is credited to goodwill account and debited to all partners’ capital accounts in their old ratio

Book value of goodwill is higher than its current value

Example: X, Y and Z are partners in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 24000. Y retires and the goodwill is valued at Rs.20000.

What is the accounting treatment in this case?

Book value of goodwill is higher than its current value

Example: X, Y and Z are partners in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 24000. Y retires and the goodwill is valued at Rs.20000.

X's Capital A/c	Dr	2000	
Y's Capital A/c	Dr	1200	
Z's Capital A/c	Dr	800	
To Goodwill A/c			4000

(Decrease in the value of goodwill debited to all partners capital accounts in their old ratio)

Hidden Goodwill

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Hidden Goodwill

In case a firm may agree to settle the retiring partner by making a lump sum payment which is more than what is due to him, the excess amount paid shall be treated as his share of goodwill, which is called hidden goodwill

Hidden Goodwill

Example: Mr. Tom is retiring from a firm and the balanc in his capital account after making all adjustments comes to Rs. 10000. But the firm agrees to pay him Rs. 12000 as full settlement.

What is the amount of hidden goodwill in this case?

Hidden Goodwill

Example: Mr. Tom is retiring from a firm and the balanc in his capital account after making all adjustments comes to Rs. 10000. But the firm agrees to pay him Rs. 12000 as full settlement.

Hidden Goodwill = 12000 – 10000 = 2000

Revaluation of Assets and Liabilities

Revaluation of Assets and Liabilities

Assets and Liabilities are to be revalued at the time of retirement as in the case of admission of a partner

It is to be done, in order to find out the appropriate share of retiring partner in the firm

Revaluation of Assets and Liabilities

It can be done through a revaluation account or profit and loss adjustment account

The profit or loss on revaluation is transferred to all the partner’s capital accounts in their old ratio

Revaluation of Assets and Liabilities

Accounting treatments are similar to admission of a partner except **Accumulated Profit or Loss**

Adjustment of Accumulated Profit or Loss

General reserve, profit and loss account credit balance and unused reserves like workmen's compensation fund (in liability side) should be transferred to all partners' capital accounts in their old ratio

Accounting treatment ?

Adjustment of Accumulated Profit or Loss

General reserve, profit and loss account credit balance and unused reserves like workmen's compensation fund (in liability side) should be transferred to all partners' capital accounts in their old ratio

General Reserve A/c	Dr
Workmen's compensation fund A/c	Dr
Profit and Loss A/c	Dr
To Partners' capital account (individually)	

Adjustment of Accumulated Profit or Loss

In case of accumulated loss (debit balance in P/L account) appearing on the assets side:

Accounting treatment ?

Adjustment of Accumulated Profit or Loss

In case of accumulated loss (debit balance in P/L account) appearing on the assets side:

Partners' Capital A/c Dr

To Profit and Loss A/c

In the above cases, Reserves or Profit and Loss account balances should not be shown in the balance sheet immediately after retirement

Adjustment of Accumulated Profit or Loss

Alternatively, only retiring partner's share in these items may be credited (if profit) or debited (if loss) to his capital account

Adjustment of Accumulated Profit or Loss

1. To transfer retiring partner's share of **reserve or accumulated profit:**

Reserve / Profit and Loss A/c Dr

To Retiring partner's capital A/c

(retiring partner's share only)

Adjustment of Accumulated Profit or Loss

2. To transfer retiring partner's share of **accumulated loss**:

Retiring partner's capital A/c Dr

To Profit and Loss A/c

(retiring partner's share only)

Adjustment of Accumulated Profit or Loss

Note: Amount of reserve and profit & loss account after deducting retiring partner's share will be shown in the balance sheet prepared immediately after retirement.

These accounts must be transferred to partner/partners' capital accounts even if the question is silent in this regard

Ascertainment of Profit or Loss up to the date of retirement

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Profit or Loss up to the date of retirement

Usually the retirement takes place on the closing day of the accounting year

If a partner retires on any day other than the closing day of the accounting year, the partner is entitled to share the profits or losses till the date of retirement

Profit or Loss up to the date of retirement

It is determined on the basis of past profits as follows:

- Take the total profits of the required number of past years.
- Calculate the average annual profit.
- Reduce the average annual profit for the period up to the date of retirement.
- Find out the share of retiring partner.

Profit or Loss up to the date of retirement

Alternatively, in practice actual profit or loss is determined by drawing interim accounts up to the date of retirement

Profit or Loss up to the date of retirement

1. In case of profit:

Profit and Loss Suspense A/c Dr

To Retiring partner's Capital Account

<u>Note:</u> P/L suspense account, being debit balance, is shown on the assets side of balance sheet.

At the end of the year it is closed by transfer to P/L account.

Profit or Loss up to the date of retirement

2. In case of loss:

Retiring partner’s capital A/c Dr

To Profit and Loss Suspense A/c

Disposal of amount due to the retiring partner

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Disposal of amount due to the retiring partner

1. Lump Sum Payment:

The total amount due to the retiring partner shown by his capital account may be paid in full at the time of retirement

The journal entry will be?

Disposal of amount due to the retiring partner

1. Lump Sum Payment:

The total amount due to the retiring partner shown by his capital account may be paid in full at the time of retirement

Retiring partner's capital account	Dr
To Cash / Bank	

Disposal of amount due to the retiring partner

2. Payment in Installments:

If the firm is not in a position to pay off the entire amount in lump sum, the amount due to him is transferred to his loan account and will be paid in installments along with the interest as per the agreement

The journal entry will be?

Disposal of amount due to the retiring partner

2. Payment in Installments:

Journal Entry:

Retiring partner’s capital a/c Dr

To Retiring partner’s loan account.

This loan amount will be shown on the liability side of the balance after retirement.

Disposal of amount due to the retiring partner

As per section 37 of the Indian Partnership Act, the outgoing partner can claim proportionate **share in the profit** earned on the amount due to him from the date of his retirement to the date of final payment **or interest @ 6%** per annum at his option

Disposal of amount due to the retiring partner

Each installment consists of Principal amount and Interest at an agreed rate.

Interest due on loan is credited to loan account and installments (principal amount plus interest) are paid at agreed intervals.

Disposal of amount due to the retiring partner

Journal entries:

1. For interest due on loan

Interest on loan A/c	**Dr**
Retired partner's loan A/c	

Disposal of amount due to the retiring partner

Journal entries:

2. For payment of installments:

Retired partner's loan A/c Dr

To Cash/Bank A/c

(Principal amount + interest)

Disposal of amount due to the retiring partner

Journal entries:

3. For closing interest on loan at the end of financial period

Profit and Loss A/c Dr

To Interest on loan A/c

Note: 1.The above entries are repeated until the loan is closed.

2. Interest on loan is calculated on the outstanding amount of loan.

Disposal of amount due to the retiring partner

3. Part payment and balance in installments:

When the retiring partner is partly paid in cash and balance amount treated as loan

The journal entry will be?

Disposal of amount due to the retiring partner

3. Part payment and balance in installments:

When the retiring partner is partly paid in cash and balance amount treated as loan

The journal entry will be?

Retiring Partner's Capital A/c	Dr
To Cash / Bank A/c	
To Retiring Partner's Loan A/c	

Adjustment of capitals of continuing partners

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Adjustment of capitals of continuing partners

In certain cases, after the retirement of a partner, the remaining partners may decide to adjust their capitals in proportion to their new profit sharing ratio

Adjustment of capitals of continuing partners

Steps:

a. Fix an amount as capital of the new firm or find out the existing capital balance after making all adjustments.

This is called adjusted capital

Adjustment of capitals of continuing partners

Steps:

b. Add the adjusted capitals of continuing partners.

This will become the total capital of the firm.

Adjustment of capitals of continuing partners

Steps:

c. Ascertain share of capital of continuing partner in the total capital in proportion to their new ratio by the following equation:

Total capital required x New profit sharing ratio of each partner

Adjustment of capitals of continuing partners

Steps:

d. If the existing capital balance of any partner after all adjustments is more than that of the new capital, he can withdraw the surplus or it may be transferred to the current account.

Whereas if there is any deficiency, it should be brought in or adjusted from his current account

Adjustment of capitals of continuing partners

Steps:

In case of excess capital.

Entry:

Partner's capital account Dr

To Cash / Current Account

Adjustment of capitals of continuing partners

Steps:

In case, if the existing capital is less than the new capital, he is required to bring the necessary amount to make good the deficit.

Entry:

Cash / Current Account Dr

To Partner's Capital Account

Death of a Partner

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Death of a Partner

A partnership will come to an end as soon as a partner dies, although the firm may continue with the remaining partners

The accounting treatments for various adjustments in case of death of a partner are similar to that of a retiring partner

Death of a Partner

Differences between retirement and death of a partner

Retirement	Death
Retirement is planned and which usually takes place at the end of the accounting period	Death may take place at any time
Partner's connection with the firm is voluntarily broken	It is automatic in the case of death.
Amount payable to the retiring partner is transferred to his loan account.	it is transferred to the Executor's account.

Death of a Partner

The amount due to the deceased partner is calculated in the same manner as in the case of retirement and the payment of deceased partner’s share in the firm will be received by his legal representatives.

Most of the accounting treatments are similar to that of retirement.

Death of a Partner

Whenever a firm is not in a position to make the full payment immediately in cash, amount due to the deceased partner is transferred to his Executor's Loan Account.

Entry:

Deceased partner's capital a/c   Dr

To Deceased partners' Executor's loan a/c

Death of a Partner

If the amount due to the deceased partner is paid in full:

Entry:

Deceased Partner's Capital A/c Dr

To Cash A/c

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