Accountancy Notes

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Chapter- 4

Reconstitution of a Partnership Firm: Retirement/Death of a Partner

Introduction and New Profit Sharing Ratio/Gaining Ratio

1. Meaning of Retirement

Retirement of a partner means ceasing to be a partner of the firm.
The different ways by which a partner can retire from the firm are:
(i) With the consent of all the partners.
(ii) By giving notice in writing to all other partners of his intention to retire, in case of partnership at will.
(iii) In accordance with the terms of agreement between the partners.

2. Liability of a Partner

Liability of the Firm for the Acts before Retirement [Section 32(2)] A retiring partner remains liable for all the acts of the firm up to the date of his retirement. However, a retiring partner may be discharged from his liability by an agreement between himself, third party and the continuing partners.
Liability of the Firm for the Acts after Retirement [Section 32 (3)] A retiring partner also continues to be liable to third parties for the acts of the firm even after his retirement until a public notice of his retirement is given.

Various matters that need accounting adjustment at the time of retirement are:
(i) Determination of new profit sharing ratio
(ii) Determination of gaining ratio
(iii) Treatment of goodwill
(iv) Revaluation of assets and liabilities
(v) Adjustment of accumulated profits and losses
(vi) Adjustment of capital
(vii) Determination of the amount payable to the retiring partner

3. New Profit Sharing Ratio

The ratio in which the continuing partners will share profits and losses is called the new profit sharing ratio. It is the sum total of his old share and the ratio in which the outgoing partner's share of profit is acquired.

New Ratio = Old Ratio + Gaining Ratio

4. Gaining Ratio

The ratio in which the remaining i.e. continuing partners have acquired the share from the retiring partner is called the gaining ratio.

Gaining Ratio = New Ratio – Old Ratio

5. Difference between Sacrificing Ratio and Gaining Ratio

Basis	Sacrificing Ratio	Gaining Ratio
Meaning	The portion of profits/ losses sacrificed by the existing partner in favor of a new partner.	The portion of profits/ losses acquired by the remaining partners on leave of retired or died partner.
Why should we calculate	To ascertain the ratio of profits/ losses sacrificed by the existing partner on account of a new partner.	To ascertain the ratio of profits/losses acquired by the remaining partners on account of retirement or death of the old partner.
When to be calculated	At the time of Admission of new partners.	At the time retirement or death of partners.
How to calculate	SR = Old ratio – New ratio.	GR = New ratio – Old ratio.
Its effect on respective partners.	The profit-sharing ratio of the existing partners is reduced.	The profit-sharing ratio of the existing partners is increased.

Treatment of Goodwill and Revaluation of Assets and Re-assessment of Liabilities

1. Treatment of Goodwill

Goodwill is a compensation paid to an outgoing partner payable by remaining partners in their gaining ratio.

Adjustment for retiring partner's share of goodwill will be made through the following journal entry

Gaining Partners' Capital A/c Dr [Continuing partners] [in gaining ratio]
To .Sacrificing Partner's Capital A/c [Retiring partner]

If goodwill already appears in the old balance sheet, then it is to be written-off in the old ratio.

All Partners' Capital/Current A/c Dr
To Goodwill A/c

2. Revaluation of Assets and Reassessment of Liabilities

Revaluation of assets and reassessment of liabilities are to be done in the same way as in the case of admission of a new partner.

3. Adjustment for reserves and accumulated profits/losses

Adjustment for reserves and accumulated profits/losses are to be done in the same way as in the case of admission of a partner.

Settlement of Amount Due to Retiring Partner

1. Calculation of Amount Payable to Retiring/Deceased Partner

The amount due to a retiring partner is ascertained by preparing retiring partner's capital account, after taking into account the following

Items to be Credited

(i) Opening balance of capital and current account of retiring partner.
(ii) His share in the profit of the revaluation account.
(iii) His share of reserve and accumulated profit.
(iv) His share of goodwill of the firm.
(v) His share of profit till the date of his retirement.
(vi) His salary and/or interest on capital due to the retiring partner till the date of his retirement.

Items to be Debited

(i) Drawings and interest thereon.
(ii) Share in the accumulated losses of past year/years.
(iii) Share in the loss of revaluation account.

2. Settlement of the Amount Due to the Retiring Partner

The amount due to the retiring partner is either paid off immediately or is transferred to his loan account. The retiring partner's loan account will appear in the books of the new firm as a liability until it is paid off finally.

Journal Entries

The following journal entries are passed in this regard
(i) If the Amount is Immediately Paid off
Retiring Partner's Capital A/c Dr
To Cash/ Bank A/c

(ii) In Case the Amount is Not Immediately Paid
(a) For amount due, transferred to retiring partner's loan account
Retiring Partner's Capital A/c Dr
To Retiring Partner's Loan A/c

(b) On interest being provided
Interest on Loan A/c Dr
To Retiring Partner's Loan A/c

(c) On payment of instalment with interest
Retiring Partner's Loan A/c Dr
To Cash/Bank A/c

(iii) If Payment is Partly Paid in Cash and the Remaining Amount is to be Treated as Loan
Retiring Partner's Capital A/c Dr
To Cash/Bank A/c To Retiring Partners' Loan A/c

Adjustment of Capital

At the time of retirement of a partner, the remaining partners may decide to adjust their capital contributions in their profit sharing ratio.

The capitals of the continuing partners may be required to be adjusted in the following three cases:

Case I When the total capital of the new firm is given
The various steps involved in adjusting the capitals of the partners are given below:
Step 1 Calculate the adjusted old capitals of continuing partners (i.e. after all other adjustments).
Step 2 Calculate the new capitals of continuing partners.
Step 3 Calculate the surplus/deficit capital by comparing steps 2 and 3.

Case II When the total capital of the new firm is not given
The various steps involved in adjusting the capitals of the partners are given below:
Step 1 Calculate the adjusted old capitals of continuing partners after all other adjustments.
Step 2 Calculate total capital of the new firm.
Step 3 Calculate the new capitals of continuing partners.
Step 4 Calculate the surplus/deficit capital by comparing steps 2 and 3.

Case III When the outgoing partner is to be paid through cash brought by the continuing partners in such a way as to make their capitals proportionate to their new profit sharing ratio

Steps involved in adjusting the capitals of partners are given below:
Step 1 Calculate the adjusted old capitals of continuing partners after all other adjustments.
Step 2 Calculate total capital of the new firm.
Step 3 Calculate the new capital of continuing partners.
Step 4 Calculate the surplus/deficit by comparing steps 2 and 3 above.

Death of a Partner

1. Death of A Partner

The partnership comes to an end immediately, whenever a partner dies although the firm may continue with the remaining partners.
The deceased partner is entitled to get his share in the firm as per the provision of a partnership agreement. His share in the firm is calculated in the same manner as in the case of a retiring partner.

2. Accounting Treatment of Deceased Partners' Share in Profits

If a partner dies on any date after the date of the balance sheet, then his share of profit is calculated from the beginning of the year to the date of death on the basis of time or sales. When the share of profit is calculated on the basis of time, it may be on the basis of previous year's profit or average profit of past years.

(A) On the basis of time :

$$\text{Profit of the firm till the date of death of partner} = \frac{\text{Previous Year Profit or Average profit of a given number of past years}}{12} \times \text{No's of months from last Balance Sheet to the date of death}$$

$$\text{Share of deceased partner} = \text{Profit of the firm till the date of death} \times \text{Deceased partner share}$$

(B) On the basis of turnover (sale basis) :

$$\text{Profit of the firm till the date of death of partner} = \frac{\text{Average profit of a given numbers of years or Profit of previous year} \times \text{Sale from the date of last Balance Sheet till the date of death}}{\text{Sale of last year}}$$

3. Ascertainment of the Amount Due to the Deceased Partner

The deceased partner's share is also calculated in the same manner as in the case of the retiring partner. Amount due to a deceased partner shown by his capital account is transferred to his executors' account by passing the following journal entry

Deceased Partner's Capital A/c Dr

    To Deceased Partner's Executors A/c

4. Settlement of Deceased Partners' Executor Account

(i) If Payment is Made in Full/Lump Sum

Deceased Partner's Executor's A/c Dr

    To Cash/ Bank A/c

(ii) If Payment is Made in Installment

(a) Deceased Partner's Executor's A/c Dr

    To Deceased Partner's Executor's Loan A/c

(b) Interest A/c Dr

    To Deceased Partner's Executor's Loan A/c, Interest is generally paid to deceased partner's executor's @ 6% per annum.

5. Format of Deceased Partner's Capital Account

Dr **Deceased Partners' Capital Account** Cr

Date	Particulars	JF	Amt. (₹)	Date	Particulars	JF	Amt. (₹)
	To Revaluation A/c (Loss)				By Balance b/d		
	To Profit and Loss Suspense A/c (Share of loss up to the date of the death)				By Profit and Loss Suspense A/c (Share of profit up to the date of the death)		
	To Accumulated Losses A/c				By Goodwill		
	To Goodwill A/c (Written off)				By Reserves and Profits		
	To Partner Executor's A/c (Payment due) (Balancing Figure)				By Revaluation A/c (gain)		
					By Joint Life Policy A/c		
					By Interest on Capital A/c		
					By Salary A/c		
					By Commission A/c		

Note *In the above capital account, the legal executor will be entitled for the balancing figure that is the excess of the credit side over the debit side of the deceased partner's capital account*

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