Reconstitution Of A Partnership Firm Retirement Death Of A Partner

Accountancy : Partnership Accounts

- Retirement of a Partner
- Death of a Partner
- Gaining Ratio
- Accounting Treatment of Goodwill
- Revaluation of Assets and Liabilities
- Adjustment of Accumulated Profits and Reserves
- Determination and Payment of Amount Payable to Retiring Partner
- Adjustment of Capital Accounts
- Share of Profit of the Deceased Partner
- Partner's Capital Account Ledger

Retirement of a Partner

Meaning: Retirement of a partner means a partner leaving or separating from a partnership firm due to certain reasons. On retirement, the old partnership agreement ends and a new agreement is formed among the remaining partners.

Preconditions (Section 32(1) of Indian Partnership Act, 1932):

- Dispute with other partners
- No interest in business activities
- Old age, illness, or physical weakness
- Desire to do other work or profitable business
- Other reasons

Note: A partner can be removed due to fraudulent or illegal behavior.

Practice Set

- Explain the legal conditions under which a partner may retire.
- Discuss the difference between retirement and removal of a partner.
- Case Study: A partner wants to retire due to old age. What steps should the firm take?

Answer Key

- Section 32(1) lists valid reasons for retirement.
- Removal is due to misconduct; retirement is voluntary.
- Firm must dissolve old agreement and form a new one among remaining partners.

Quick Reference

- Retirement ends old agreement
- New agreement formed
- Legal reasons specified

Glossary

- **Retirement:** Voluntary exit of a partner
- **Removal:** Forced exit due to misconduct

Death of a Partner

Meaning: Partnership ends with death of a partner but firm may continue with new agreement. Legal representative of deceased partner has rights over capital, profit till death, salary, commission, interest, goodwill, reserves, and funds.

Accounting Treatment: Similar to retirement except date of death is uncertain. Accounts settled by legal executor.

Amount Payable to Legal Executor:

- Credit balance of capital and current account
- Salary, commission, interest up to death
- Proportionate share in profit till death
- Share in goodwill, undistributed profits, reserves
- Share in profit on revaluation

Debited Items:

- Capital balance
- Drawings and interest on drawings
- Goodwill written off

- Loss on revaluation
- Undistributed loss

Payment Methods: Lump sum or instalments.

Legal Provisions (Section 37):

- Payment as per partnership deed
- If no instructions, immediate cash payment
- If not possible, interest @ 6% p.a. or share in profit earned on amount due

Practice Set

- List the rights of legal executor of deceased partner.
- Explain the difference in accounting treatment between death and retirement.
- Numerical: Calculate amount payable to executor given capital and profit share.

Answer Key

- Legal executor entitled to capital, profit share, goodwill, reserves.
- Death date uncertain; accounts settled by executor.
- Calculation involves capital + profit share + goodwill - drawings etc.

Quick Reference

- Death ends partnership
- Executor settles accounts
- Payment as per deed or law

Glossary

- **Legal Executor:** Person authorized to settle deceased partner's accounts
- **Goodwill:** Intangible asset representing firm's reputation

Gaining Ratio

Meaning: Ratio in which continuing partners receive the share of retiring/deceased partner. Calculated as difference between new and old profit sharing ratios.

Calculation:

- If new and old ratios given: *Gaining Ratio = New Ratio - Old Ratio*
- If new ratio not given: Remaining partners share old ratio as gaining ratio.

Example: X, Y, Z share profits 3:2:1. X retires, surrenders 1/4 share to Y and rest to Z.

New shares: Y = 2/6 + (1/4 × 3/6) = 11/24; Z = 1/6 + (3/4 × 3/6) = 13/24

Gaining ratio: Y = 11/24 - 2/6 = 3/24; Z = 13/24 - 1/6 = 9/24 = 1:3

Practice Set

- Calculate gaining ratio when new and old ratios are given.
- Explain gaining ratio when new ratio is not given.
- Case: Partner retires, calculate new profit sharing and gaining ratio.

Answer Key

- Subtract old share from new share for each partner.

- Assume old ratio as gaining ratio if new ratio unknown.
- Apply formula and simplify ratio.

Quick Reference

- Gaining Ratio = New Ratio - Old Ratio
- Used to compensate retiring partner's share

Glossary

- **Gaining Ratio:** Share gained by continuing partners
- **Profit Sharing Ratio:** Ratio of profit distribution among partners

Accounting Treatment of Goodwill

Context: Retiring/deceased partner claims share of goodwill as compensation for their contribution.

Cases:

1. **Goodwill not in books:** Credit retiring partner's capital account; debit gaining partners' capital accounts in gaining ratio.
2. **Goodwill in books:** Write off old goodwill among all partners in old ratio; then debit gaining partners and credit retiring partner in gaining ratio.

Journal Entries:

Situation	Entry
Goodwill not in books	Gaining Partners Capital A/c Dr. To Retiring/Deceased Partner's Capital

	A/c
Goodwill in books (i) Write off old goodwill	All Partners Capital A/c Dr. To Goodwill Account
Goodwill in books (ii) Adjust retiring partner's share	Gaining Partners Capital A/c Dr. To Retiring/Deceased Partner's Capital A/c

Hidden Goodwill: If retiring partner is paid more than adjusted capital, excess is treated as goodwill and debited to gaining partners in gaining ratio.

Practice Set

- Pass journal entries for goodwill when not appearing in books.
- Explain treatment when goodwill appears in books.
- Calculate hidden goodwill given payment and capital balances.

Answer Key

- Debit gaining partners, credit retiring partner for goodwill share.
- Write off old goodwill first, then adjust retiring partner's share.
- Hidden goodwill = Payment - Adjusted capital.

Quick Reference

- Goodwill compensates retiring partner
- Entries depend on goodwill presence in books

Glossary

- **Goodwill:** Value of firm's reputation
- **Hidden Goodwill:** Excess payment over capital

Revaluation of Assets and Liabilities

Purpose: To show assets and liabilities at current values during retirement/death.

Process: Prepare Revaluation Account to record gains or losses on assets and liabilities.

Effect: Net gain or loss transferred to partners' capital accounts in old profit sharing ratio including retiring/deceased partner.

Note: Profit & Loss Adjustment Account may be used instead. Memorandum Revaluation Account used if old values retained.

Practice Set

- Explain why revaluation is necessary on retirement.
- Prepare Revaluation Account for given asset and liability changes.
- Pass journal entries for net gain/loss distribution.

Answer Key

- Reflects true financial position.
- Record increase/decrease in assets/liabilities.
- Transfer net result to partners' capital accounts.

Quick Reference

- Revalue assets/liabilities
- Prepare Revaluation Account
- Distribute gain/loss in old ratio

Glossary

- **Revaluation Account:** Account showing asset/liability adjustments
- **Profit & Loss Adjustment Account:** Alternative to Revaluation Account

Adjustment of Accumulated Profits and Reserves

Meaning: Accumulated profits or losses shown in balance sheet are adjusted among partners' capital accounts in old profit sharing ratio.

Procedure:

- Credit partners' capital accounts for accumulated profits
- Debit partners' capital accounts for accumulated losses

Practice Set

- Explain treatment of accumulated profits on retirement.
- Pass journal entries for accumulated losses adjustment.

Answer Key

- Distribute profits or losses in old ratio.
- Adjust capital accounts accordingly.

Quick Reference

- Acc. profits credited
- Acc. losses debited

Glossary

- **Accumulated Profits:** Profits retained in firm
- **Reserves:** Funds set aside for contingencies

Determination and Payment of Amount Payable to Retiring Partner

Determination: Includes capital and current account balances, interest, salary, commission, share in goodwill, undistributed profits/losses, revaluation profit/loss, and share of profit/loss till retirement date.

Payment Methods:

- **Lump-sum:** Immediate payment in cash or bank; may require cash brought in by remaining partners or bank loan.
- **Instalments:** Amount treated as loan; paid with interest (usually 6% p.a.) in agreed instalments; loan balance shown as liability.

Journal Entries for Instalment System:

- Transfer payable amount to loan account
- Payment against loan account
- Interest on loan account
- Transfer interest to Profit & Loss Account

Practice Set

- Calculate amount payable to retiring partner given data.
- Pass journal entries for lump-sum payment.

- Pass journal entries for instalment payment system.

Answer Key

- Sum all components for payable amount.
- Debit retiring partner's capital account; credit cash/bank.
- Debit capital account; credit loan account; record interest and payments accordingly.

Quick Reference

- Payable amount includes all dues
- Payment by lump-sum or instalments

Glossary

- **Lump-sum Payment:** One-time full payment
- **Instalment Payment:** Payment in parts over time

Adjustment of Capital Accounts

Meaning: Remaining partners adjust their capital balances to new agreed amounts after retirement.

Process:

- Compare final capital balances with new required capitals
- Partners with deficit bring in cash or transfer from current account
- Partners with surplus withdraw cash or transfer to current account

Journal Entries:

- If capital falls short: Cash/Bank A/c Dr. To Partner's Capital A/c
- If capital surplus: Partner's Capital A/c Dr. To Cash/Bank A/c
- Transfer surplus to current account: Partner's Capital A/c Dr. To Partner's Current A/c
- Transfer deficit from current account: Partner's Current A/c Dr. To Partner's Capital A/c

Practice Set

- Explain why capital adjustment is necessary.
- Pass journal entries for capital adjustment scenarios.

Answer Key

- Ensures capitals reflect new profit sharing and business needs.
- Entries depend on surplus or deficit situations.

Quick Reference

- Adjust capitals to new agreed amounts
- Use cash or current accounts for adjustment

Glossary

- **Capital Account:** Partner's investment account
- **Current Account:** Account for partner's drawings and adjustments

Share of Profit of the Deceased Partner

Meaning: Deceased partner's successor is entitled to share of profit from start of year till date of death.

Methods to Calculate:

1. **On basis of time:** Proportionate estimated profit based on previous years' profit or average profit.
2. **On basis of sales/turnover:** Profit to sales ratio applied to sales till date of death.

Interest on Capital: May be given as per partnership deed till date of death.

Practice Set

- Calculate deceased partner's share of profit using time method.
- Calculate share using sales method.
- Explain interest on capital for deceased partner.

Answer Key

- Use proportion of time or sales to estimate profit.
- Apply partner's profit share ratio.
- Interest credited as per deed or agreement.

Quick Reference

- Profit share till death calculated
- Methods: time or sales
- Interest on capital may apply

Glossary

- **Profit Share:** Partner's portion of firm profit
- **Interest on Capital:** Return on partner's investment

Partner's Capital Account Ledger

Purpose: To record all transactions affecting a partner's capital in the firm.

Debit Side (Reduces Capital): Drawings, losses, goodwill written off, share of loss on revaluation.

Credit Side (Increases Capital): Opening balance, salary, commission, share of profit, interest on capital, share of goodwill, revaluation gain.

Special Accounts: Deceased Partner's Executor's Account and Profit & Loss Suspense Account used for settlement and temporary balancing.

Practice Set

- Identify debit and credit items in capital account.
- Prepare capital account ledger for a partner given transactions.

Answer Key

- Debit: Drawings, losses; Credit: Profits, capital introduced.
- Ledger balances must tally.

Quick Reference

- Debit reduces capital

- Credit increases capital
- Balance shows net capital

Glossary

- **Capital Account:** Partner's investment record
- **Drawings:** Withdrawals by partner