Retirement of a Partner

LEARNING OBJECTIVES:

After studying this lesson, we are confident; you should be competent enough to:

- Identify adjustments arising due to retirement of a partner.
- Calculate new and gaining ratio.
- Make accounting treatment of goodwill in different cases.
- Make accounting treatment of the revaluation of assets and liabilities and distribution of profit or loss on revaluation among partners.
- Make accounting treatment of undistributed profit or loss.
- Determine the amount payable to retiring partner and make payment as per agreement and provisions of law.
- Make adjustment of partners' capital account

Salient Points:-

1. An existing partner may wish to withdraw from a firm for various reasons.
2. The amount due to a retiring partner will be the total of :-
   a. his capital in the firm
   b. His share in firm's accumulated profits and losses.
   c. His share of profit or loss on revaluation of assets and liabilities
   d. ;his share of profits till the date of retirement
   e. His remuneration and interest on capital.
   f. His share in firm's goodwill.
3. The ratio in which the continuing (remaining) partners have acquired the share from the outgoing partner is called gaining ratio.
4. Share of goodwill of outgoing partner will be debited to gaining partners in their gaining ratio.
5. At the retirement of a partner Profit & Loss on Revaluation of Assets and liabilities and balances of accumulated Profits and losses will be distributed among all partners (including outgoing partner) in their old ratio.
6. The outstanding balance of outgoing partner's capital A/C may be settled by fully or partly payment and (or) transferring into his loan account.

Q.1 What is meant by retirement of a partner?

Ans. Retirement of a partner is one of the modes of reconstituting the firm in which old partnership comes to an end and a new partner among the continuing (remaining) partners (i.e., partners other than the outgoing partner) comes into existence.

Q.2 'How can a partner retire from the firm?

Ans. A partner may retire from the firm;

i) In accordance with the terms of agreement; or

ii) With the consent of all other partners; or

iii) Where the partnership is at will, by giving a notice in writing to all the partners of his intention to retire.

Q.3 What do you understand by 'Gaining Ratio?

Ans. Gaining Ratio means the ratio by which the share in profit stands increased. It is computed by deducting old ratio from the new ratio.

Q.4 What do you understand by 'Gaining Partner'?

Ans Gaining Partner is a partner whose share in profit stands increased as a result of change in partnership.

Q.5 Give two circumstances in which gaining ratio is computed.

Ans. Gaining Ratio is computed in the following circumstances: (i) When a partner retires or dies. (ii) When there is a change in profit-sharing ratio.

Q.6 Why is it necessary to revalue assets and reassess liabilities at the time of retirement of a partner?

Ans. At the time of retirement or death of a partner, assets are revalued and liabilities are reassessed so that the profit or loss arising on account of such revaluation up to the date of retirement or death of a partner may be ascertained and adjusted in all partners' capital accounts in their old profit-sharing ratio.

Q.7 Why is it necessary to distribute Reserves Accumulated, Profits and Losses at the time of retirement or death of a partner?

Ans. Reserves, accumulated profits and losses existing in the books of account as on the date of retirement or death are transferred to the Capital Accounts (or Current Accounts) of all the partners (including outgoing or deceased partner) in their old profit-sharing ratio so that the due share of an outgoing partner in reserves, accumulated profits/losses gets adjusted in his Capital or Current Account.

Q.8 What are the adjustments required on the retirement or death of a partner?

Ans. At the time of the retirement or death of a partner, adjustments are made for the following:

(i) Adjustment in regard to goodwill.

(ii) Adjustment in regard to revaluation of assets and reassessment of liabilities.

(iii) Adjustment in regard to undistributed profits.

(iv) Adjustment in regard to the Joint Life Policy and individual policies.

Q.9 X wants to retire from the firm. The profit on revaluation of assets on the date of retirement is Rs. 10,000. X is of the view that it be distributed among all the partners in their profit-sharing ratio whereas Y and Z are of the view that this profit be divided between Y and Z in new profit-sharing ratio. Who is correct in this case?

Ans. X is correct because according to the Partnership Act a retiring partner is entitled to share the profit up to the date of his retirement. Since the profit on revaluation arises before a partner retires, he is entitled to the profit.

Q.10 How is goodwill adjusted in the books of a firm -when a partner retires from partnership?

Ans. When a partner retires (or dies), his share of profit is taken over by the remaining partners. The remaining partners then compensate the retiring or deceased partner in the

Q.13 State the ratio in which profit or loss on revaluation will be shared by the partners when a partner retires. ;

Ans. Profit or loss on revaluation of assets/liabilities will be shared by the partners (including the retiring partner) hi their old profit-sharing ratio.

Q.14 How is the account of retiring partner settled?

Ans. The retiring partner account is settled either by making payment in cash or by promising the retiring partner to pay in installments along with interest or by making payment partly in call and partly transferring to his loan account. The -following Journal entry is passed:

Retiring Partner's Capital A/c ...Dr.

To Cash* [If paid in cash] Or

To Retiring Partner's Loan [If transferred to loan]

6 to 8 marks questions

Q.1 The Balance Sheet of A, B and C on 31st December 2007 was as under :

BALANCE SHEET
as at 31.12.2007

Liabilities	Amount	Assets	Amount
A's Capital	400,00	Buildings	20,000
B's Capital	30,000	Motor Car	18,000
C's Capital	20,000	Stock	20,000
General Reserve	17,000	Investments	1,20,000
Sundry Creditors	1,23,000	Debtors	40,000
		Patents	12,000
	2,30,000		**2,30,000**

The partners share profits in the ratio of 8 : 4 : 5. C retires from the firm on the same date subject to the following term S and conditions:

i) 20% of the General Reserve is to remain' as a reserve for bad and doubtful debts.

;

ii) Motor)r Car is to be decreased by 5%.

iii) Stock is to be revalued at Rs.17, 500.

iv) Goodwill is valued at' 2 ½ years purchase of the average profits of last 3 years.

Profits were; 2001: Rs.11,000; 200l: Rs. 16,000 and 2003: Rs.24,000.

C. was paid in July A and B borrowed the necessary amount from the Bank on the security of Motor Car and stock to payoff C.

Prepare Revaluation Account, Capital Accounts and Balance Sheet of A and B.

Ans.2 SOLUTION

REVALUATION ACCOUNT

Particulars	Rs.	Particulars	Rs.
To Motor Cars A/C	900	By Loss transferred to	
To Stock A/C	2,500	A's Capital A/c Rs.	1,600
		B's Capital A/c Rs.	800
		C's Capital A/c Rs.	1,000
	3,400		**3,400**

PARTNERS CAPITAL ACCOUNT

Particulars	ARs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To C's Capital A/c	8,334	4,166	-	By Balance b/d	40,000	30,000	20,000
To Revaluation A/c (Loss)	1,600	800	1,000	By General Reserve A/c	6,400	3,200	4,000
To Bank A/c	-	-	35,500	By A's Capital A/c	-	-	8,334
Balance c/d	36,466	28,234	-	By B's Capital A/c	-	-	4,166
	46,400	**33,200**	**36,500**		**46,400**	**33,200**	**36,500**
				By Balance b/d	**36,466**	**28,234**	**-**

BALANCE SHEET OF A AND B

Liabilities	Rs.	Assets	Rs.
Sundry creditors	1,23,000	Building	20,000
Bank Loan	35,500	Motor Card	17,100

Capital A	36,466		Stock	17,500
B	28,234	64,700	Investment	1,20,000
			Debtors	36,600
			Patents	12,000
		2,23,200		**2,23,200**

Q.3 A, Band C were partners in a firm sharing profits equally: Their Balance Sheet on.31.12.2007 stood as:

BALANCE SHEET AS AT 31.12.07

Liabilities		Rs.	Assets		Rs.
A	Rs. 30,000		Goodwill		18,000
B	Rs. 30,000		Cash		38,000
C	Rs. 25,000	85,000	Debtors	. 43,000	
Bills payable		20,000	Less: Bad Debt provision	3,000	40,000
Creditors		18,000	Bills Receivable		25,000
Workers Compensation Fund		8,000	Land and Building		60,000
Employees provide4nt Fund		60,000	Plant and Machinery		40,000
General Reserve		30,000			
		2,21,000			**2,21,000**

It was mutually agreed that C will retire from partnership and for this purpose following terms were agreed upon.

i) Goodwill to be valued on 3 years' purchase of average profit of last 4 years which were 2004 : Rs.50,000 (loss); 2005 : Rs. 21,000; 2006: Rs.52,000; 2007 : Rs.22,000.

ii) The Provision for Doubtful Debt was raised to Rs. 4,000.

iii) To appreciate Land by 15%.

iv) To decrease Plant and Machinery by 10%.

v) Create provision of Rs;600 on Creditors.

vi) A sum of Rs.5,000 of Bills Payable was not likely to be claimed.

vii) The continuing partners decided to show the firm's capital at 1,00,000 which would be in their new profit sharing ratio which is 2:3. Adjustments to be made in cash

Make necessary accounts and prepare the Balance Sheet of the new partners.

Ans.3 REVALUATION ACCOUNT

Particulars		Rs.	Particulars	Rs.
To Provision for Debts A/c		1,000	By Land A/c	9,000
To Plant & Machinery A/c		4,000	By Provision on Creditors A/c	600
To Profit transferred to			By Bills Payable A/c	5,000
A's Capital A/c	Rs. 3,200			
B's Capital A/c	Rs. 3,200			
C's Capital A/c	Rs. 3,200	9,600		
		14,600		**14,600**

PARTNER'S CAPITAL ACCOUNTS

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To Goodwill A/c	6,000	6,000	6,000	By Balance b/d	30,000	30,000	25,000
To C's Capital A/c	2,250	9,000	-	By General Reserve	10,000	10,000	10,000
To C's Loan A/c	-	-	46,116	By Workmen A/c Compensation Fund	2,667	2,667	2,666
To Balance c/d	40,000	60,000	-	By Revalu A/c (profit)	3,200	3,200	3,200
				By A's Capital A/c	-	-	2,250
				By B's Capital A/c	-	-	9,000
				By Cash A/c (Deficiency)	2,383	29,133	-

	48,250	**75,000**	**52,116**		**48,250**	**75,000**	**52,116**
				By Balance b/d	**40,000**	**60,000**	**-**

BALANCE SHEET

as at 31.12.07

Liabilities		Rs.	Assets		Rs.
Bills Payable		15,000	Debtors	Rs. 43,000	
Creditors		17,400	Less: Provision	Rs. 4,000	39,000
Employees Provident Fund		60,000	Bills Receivables		25,000
C's Loan		46,116	Land & Buildings		69,000
A's Capital	40000		Plant & Machinery		36,000
B'S Capital	60000	1,00,000	Cash		69,516
		2,38,516			**2,38,516**

DEATH OF A PARTNER

Learning Objectives:

After studying this Unit, students will be able to understand and prepare:

a) Deceased partners capital account
b) Deceased partners Executor account
c) Executors loan account
d) Calculation of share of profit and Goodwill of the deceased partner.

SALIENT POINTS:

- ❖ Gaining Ratio: When the partner retires or dies, his share of profit is taken over by the remaining partners.
- ❖ Gaining ratio is applied for the purpose of calculating Goodwill to be paid off to the deceased partner.
- ❖ The deceased partner s share of profit till the date of death will be calculated by preparing Profit and Loss Suspense account on the date of Death.

SHORT QUESTIONS--- (3-4 MKS)

1. A, B and C are partners sharing profits and losses in the ratio of 5:4:1. The profit for the year ending 31, March, 2010 was Rs 1, 00,000. B died on 30th June 2010. Calculate C's share of profit till the date of death and pass necessary journal entry.

Profit and Loss suspense a/c – Dr B's Capital Account	10,000	 10,000
(Being B's share of profit transferred to his		

capital account)	

C’s share of profit = 1, 00,000 X 4/10 X 3/12 = 10,000

2. X, Y and Z are partners in a firm sharing profits and losses in the ratio of 5:4:1.The Partnership agreement provides that the share of profit of the deceased partner will be worked out on the basis of sales. The sales for the year 2009-10 was Rs 8,00,000 and the sales from April 1, 2010 to June 30, 2010 was Rs 1,50,000. The profit for the year ended 31st March 2010 amounted to Rs 1,00,000. Y died on 30th June 2010. Calculate his share of profit and pass necessary journal entry.

Profit and Loss suspense a/c – Dr Y’s Capital Account	7500	 7500
(Being Y’s share of profit transferred to his capital account		

Sales for the year 2009-10 ----8, 00,000 Profit for the year 2009-10 -----1,00,000
Sales from April 1,2010 to 30th June 2010 -----1,50,000 Profit upto 30th June 2010----?
C’s share of profit = 1,00,000/8,00,000 X 1,50,000 = 18750 X 4/10 = 7500.

3. Ram, Mohan and Sohan were partners sharing profits and losses in the ratio of 5:3:2. On 31st March, 2006 their Balance Sheet was as under:

Liabilities	Rs	Assets	Rs
Capitals		Leasehold	1,25,000
Ram	1,50,000	Patents	30,000
Mohan	1,25,000	Machinery	1,50,000
Sohan	75,000	Stock	1,90,000
Workmen’s Compensation Reserve	30,000	Cash at Bank	40,000
Creditors	1,55,000		
	5,35,000		5,35,000

Sohan died on 1st August, 2006. It was agreed that :
(i) Goodwill of the firm is to be valued at Rs. 1,75,000.
(ii) Machinery be valued at Rs. 1,40,000; Patents at Rs. 40,000; Leasehold at Rs. 1,50,000 on this date.
(iii) For the purpose of calculating Sohan’s share in the profits of 2006-07, the profits should be taken to have accrued on the same scale as in 2005-06, which were Rs. 75,000.
Prepare Sohan’s Capital Account and Revaluation Account. (6)

Revaluation Account

Particulars	Amt	Particulars	Amt
Machinery	10,000	Leasehold	25000
Capital Accounts		Patents	10,000
Ram	12500		
Mohan	7500		

Sohan	5000		
	35000		35000

Sohan's capital Account

Particulars	Rs	Particulars	Rs
		Balance b/d	75000
Sohan's Executor's account	1,26,000	Revaluation a/c	5000
		Ram's Capital a/c	21875
		Mohan's capital a/c	13125
		P & L Suspense A/c	13125
		Workmen's Compensation reserve a/c	6000
	1,26,000		1,26,000

Working Note :
a)Total Goodwill of the firm = 1,75,000
Sohan's share of goodwill = 1,75,000 X 2/10 = 35000 (to be divided in the ratio of 5:3 i.e gaining ratio)
b) Sohan's share of profit = 75000 X 4/12 x 2/10 = Rs 5000
4. Following is the Balance sheet of P , Q and R as on 31st December 2010 sharing profits in the ratio of 5:3:2.

Particulars	Rs	Particulars	Rs
Capital Accounts		Cash	13000
P	30000	Debtors	8000
Q	25000	Machinery	30000
R	15000	Stock	10000
Creditors	7000	Patents	6000
Reserve Fund	10000	Building	20000
	87000		87000

P died on 1st July 2011 on the following terms-

i) Patents are to be valued at Rs 8000, Machinery at Rs 28000 and Building at Rs 30,000.
ii) Interest on Capital is to be provided at 10% p.a.
iii) Goodwill of the firm is valued at 2 years purchase of the average profits of the last five years which were-
2006 - Rs 15,000 2007 – Rs 13000 2008 – Rs 12,000
2009—15,000 and 2010--- Rs 20,000
iv) Profit for the year 2011 has been accrued on the same scale as in 2010.
v) P's Executor is to be paid Rs 11,500 and balance transferred to his loan account.

Prepare Revaluation Account, P's Capital account and P's executors account. Also pass necessary journal entries.

Revaluation Account

Particulars	Rs	Particulars	Rs
Machinery	2000	Patents	2000
Capital Accounts-		Buildings	10000
P	5000		
Q	3000		
R	2000		
	12000		12000

P's Capital Account

Particulars	Rs	Particulars	Rs
P's Executors a/c	61500	Balance b/d	30000
		Reserve fund	5000
		Q's Capital a/c	9000
		R's Capital a/c	6000
		Revaluation a/c	5000
		Interest on capital	1500
	61500		61500

P's Executor's account

Particulars	Rs	Particulars	Rs
Bank/cash a/c	11500	P's Capital a/c	61500
P's Executor's Loan a/c	50000		
	61500		61500

Working Note :

a) Interest on Capital : 30,000 X 10/100 X 6/12 = Rs 1500

b) Reserve fund = 10,000 X 5/10 = Rs 5000

c) P's Share of profits = 20,000 X 5/10 X 6/12 = Rs 5000.(for 6 months)

d) Total Goodwill of the firm =
Average profits = 75000/5 = Rs 15000
Goodwill = 15000 X 2 = 30,000
P's share of Goodwill = 30,000 X 5/10 = 15000(to be divided in Gaining ratio 3:2)

Journal

SN	Particulars	LF	Amt	Amt
1	Revaluation a/c ----Dr Machinery a/c (Being machinery revalued)		2000	 2000
2	Patents a/c --Dr Building a/c - Dr Revaluation a/c (Being Assets revalued)		2000 10000	 12000
3	Revaluation a/c --- Dr P's Capital a/c Q's Capital a/c		10000	 5000 3000

	R's Capital a/c (Being Revaluation profit distributed)			
4	Reserve fund a/c –Dr P's Capital a/c (Being reserve distributed)		5000	5000
5	Q's Capital a/c ---Dr R's Capital a/c ---Dr P's capital a/c (Being deceased partner 's account credited by his share of goodwill contributed by the gaining partners)		9000 6000	15000
6	Interest on capital a/c – Dr P's Capital a/c (Being Interest on capital provided to the deceased partner)		1500	1500
7	P's Capital a/c ---Dr P's executor's a/c (Being P's balance due transferred to his executor's a/c)		61500	61500
8	P's executor's a/c --Dr Cash a/c P's executor's loan a/c (Being amount paid to the executor and balance transferred to his loan account)		61500	11500 50000

5. X, Y and Z are partners sharing profits and losses in the ratio of 2:2:1 respectively. Their Balance Sheet as on 31st march 2007 was as follows—

Balance Sheet as on 31/03/10

Liabilities	Rs	Assets	Rs
Sundry Creditors	1,00,000	Cash at bank	20,000
Capital Accounts		Stock	30,000
X	60,000	Sundry Debtors	80,000
Y	1,00,000	Investments	70,000
Z	40,000	Furniture	35,000
General Reserve	50,000	Buildings	1,15,000
	3,50,000		3,50,000

Z died on 30th September 2007 and the following was provided—

a) "Z" will be entitled to his share of profit upto the date of death based on last year's profit.
b) Z's share of Goodwill will be calculated on the basis of 3 years purchase of average profits of last four years . The profits of the last four years was as follows—
   Year I – 80,000, Year II –Rs 50,000 Year III – Rs 40,000 and Year IV –Rs 30,000
c) Interest on Capital was provided at 12% p.a.
d) Drawings of the deceased partner upto the date of death was Rs 10,000.
e) Rs 15,400 should be paid immediately to the executor of the deceased partner and the balance in four equal yearly instalments with interest at 12% on remaining balance.
   Prepare Z's capital account and Z's executors account till the account is finally closed.

Z’s Capital Account

Particulars	Rs	Particulars	Rs
Drawings	10,000	Balance b/d	40,000
Z’s Executor’s a/c	75,400	General Reserve	10,000
		Profit &Loss Suspense a/c	3,000
		Interest on capital	2400
		X’s Capital a/c	15,000
		Y’s capital a/c	15,000
	85400		85400

Z's Executor's Account

Date	Particulars	Rs	Date	Particulars	Rs.
30/09/07	Bank a/c	15400	30/09/07	Z's Capital a/c	75400
31/03/08	Balance c/d	63600	31/03/08	Interest on Loan (on Rs 60,000@12% for 6 months)	3600
		79000			79000
30/09/08	Bank a/c (15000+ 7200)	22,200	1/04/08	Balance b/d	63600
31/03/09	Balance c/d	47,700	30/09/08	Interest on Loan(On Rs 60,000 @ 12% for 6 months)	3600
			31/03/09	Interest on Loan(on Rs 45000 @12% for 6 months)	2700
		69900			69900
30/09/09	Bank a/c (15000+5400)	20,400	1/04/09	Balance b/d	47,700
31/03/10	Balance c/d	31800	30/09/09	Interest on loan(on Rs 45000 @ 12% for 6 months)	2700
			31/03/10	Interest on loan (on Rs 30,000@12% for 6 months)	1800
		52200			52200
30/09/10	Bank a/c(15000 + 3600)	18600	1/4/10	Balance b/d	31800
31/03/11	Balance c/d	15900	30/09/10	Interest on loan(on Rs 30,000 @12% for 6 months)	1800
			31/03/11	Interest on Loan(on Rs 15000 @12% for 6 months)	900
		34500			34500
30/09/11	Bank a/c (15000+1800)	16800	1/04/11	Balance b/d	15900
			30/09/11	Interest on loan(on Rs 15000 @12% for 6 months)	900
		16800			16800

6 Anil, Jatin and Ramesh were sharing profit in the ratio of 2:1:1. Their Balance Sheet as at 31.12.2001 stood as follows:-

Liabilities	**Rs**	**Assets**	**Rs**
Creditors	24,400	Cash	**1,00,000**
Bank Loan	10,000	Debtors 20000 Less : Provision 1600	18,400
Profit and Loss A/c	18,000	Stock	10,000
Bills Payable	2,000	Building	20,000
Anil's Capital	50,000	Investment	14,000
Jatin's Capital	40,000	Goodwill	22,000
Ramesh's Capital	40,000		
	1,84,400		1,84,400

Ramesh died on 31st March 2002. The following adjustments were agreed upon-

(a) Building be appreciated by Rs. 2,000

(b) Investments be valued at 10% less than the book value.

(c) All debtors (except 20% which are considered as doubtful) were good.

(d) Stock be increased by 10 %

(e) Goodwill be valued at 2 years' purchase of the average profit of the past five years.

(f) Ramesh's share of profit to the death be calculated on the basis of the profit of the preceding year. profit for the years 1997, 1998, 1999 and 2000 were Rs. 26,000, Rs. 22,000, Rs. 20,000 and Rs. 24,000 respectively.

Prepare revaluation account, partner's capital Account, Ramesh 's Executors' Account and Balance sheet immediately after Ramesh's death assuming that Rs. 18, 425 be paid immediately to his executors and balance to b left to the Ramesh's Executor's Account

Revaluation Account

Particulars	**Rs**	Particulars	**Rs**
Investment A/c	1,400	Building A/c	2,000
Provision for doubtful debt A/c	2,400	Stock A/c	1,000
		Loss transferred to	
		Anil's Capital A/c	400
		Jatin's Capital A/c	200
		Ramesh's Capital A/c	200
	3800		3800

Partners Capital Accounts

Particulars	**Anil**	**Jatin**	**Ramesh**	**Particulars**	**Anil**	**Jatin**	**Ramesh**
Goodwill A/c	11000	5500	5500	By Balance b/d	50000	40000	40000
Ramesh Capital A/c	7333	3667		Profit and Loss A/c	9000	4500	4500
Revaluation A/c (Loss)	400	200	200	Profit &Loss Susp A/c			1125
Ramesh's Executor's A/c			50925	Anil's Capital A/c			7333
Balance c/d	40,267	35,133	----	Jatin's Capital A/c			3667
	59,000	41,500	56,625		59,000	41,500	56,625

Ramesh's Executor's account

Particulars	**Rs**	**Particulars**	**Rs**
Cash Account	18425	Ramesh's Capital account	50925
Balance c/d	32500		
	50925		50925

Balance sheet

Liabilities	Rs	Assets	Rs
Bank Loan	10, 000	Cash	81,575
Creditors	20,400	Debtors 20000 Less Provision 4000	16000
Bills Payable	2,000	Stock	11000
Ramesh's Executor's Loan	32,500	Building	22000
Anil's Capital	40,267	Investments	12600
Jatin's Capital	35,133	Profit &Loss Suspense A/c	1125
	1,44,300		1,44,300