

CHAPTER- 4

RETIREMENT AND DEATH OF PARTNER

- ❖ Retirement and death of a partner leads to discontinuation of old partnership and a change in the existing partnership deed.
- ❖ The following are the different ways in which a partner can retire from a partnership firm.
 - With the consent of all other partners
 - With an express agreement by all the partners
 - By giving a written notice
- ❖ The following are the various items that need adjustments at the time of retirement and death of partner.
 - New ratio of the remaining partners.
 - Gaining ratio of the remaining partners.
 - Calculation of goodwill of the new firm and its accounting treatment.
 - Revaluation of assets and liabilities of the new firm.
 - Distribution of accumulated profits and losses and reserves among all the partners (including the retiring partner).
 - Treatment of Joint Life Policy
 - Settlement of the amount due to the retiring partner
 - Adjustment of capital accounts of the remaining partners in their new profit sharing ratio.

❖ Calculation of New Profit Sharing Ratio

In the case of retirement or death of a partner, generally, there exist the following two cases for calculation of new profit sharing ratio.

- **Case-1:** When new profit sharing ratio of the remaining partners is **not mentioned** in the question.
Example: If A, B and C are partners sharing profits and losses in the ratio 3:2:1. If B retires, then the new profit sharing ratio between A and C becomes 3:1.
- **Case-2:** When the share of the retiring or deceased partner **is purchased in a particular ratio** by the remaining partners.
Example: If A, B and C are partners sharing profits and losses in the ratio 3:2:1. B retires and his share is purchased by A and C in the ratio 2:1.

$$\text{B's share taken by A} = \frac{2}{6} \times \frac{2}{3} = \frac{4}{18}$$

$$\text{New share of A} = \frac{3}{6} + \frac{4}{18} = \frac{13}{18}$$

$$\text{B's share taken by C} = \frac{2}{6} \times \frac{1}{3} = \frac{2}{18}$$

$$\text{New share of C} = \frac{1}{6} + \frac{2}{18} = \frac{5}{18}$$

Thus, the New Profit Share of A and C is 13:5

❖ **Gaining Ratio**

It is the ratio in which the remaining (or continuing) partners acquire the share of profit of the outgoing partner.

Algebraically,

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$$

❖ **Difference between Sacrificing Ratio and Gaining Ratio**

Basis of Difference	Sacrificing Ratio	Gaining Ratio
Meaning	It is the ratio in which the old partners agree to sacrifice their share of profit in favour of new partner.	It is the ratio in which the continuing partners acquire the share of profit from outgoing partner.
Calculation	Sacrificing Ratio = Old Ratio – New Ratio	Gaining Ratio = New Ratio – Old Ratio
Time	It is calculated at the time of admission of new partner.	It is calculated at the time of retirement/death of old partner.
Objective	It is calculated to ascertain the share of profit and loss given up by the existing partners in favour of new partner.	It is calculated to ascertain the share of profit and loss acquired by the remaining partners from the retiring or deceased partner.
Effect	It reduces the profit share of the existing partners.	It increases the profit share of the remaining partners.

❖ Treatment of Goodwill

At the time of retirement or at the event of death of a partner, the goodwill is adjusted among the remaining partners in the gaining ratio with the share of goodwill of the retiring or the deceased partner. The following are the two probable cases on which the treatment of goodwill rests.

- **Situation 1: If goodwill already appears in the books of the firm at the time of retirement/death of partner**

Step 1: Write-off the existing goodwill

First of all, we need to write-off the existing goodwill among all the partners of the firm (including the retiring or the deceased partner) in their old profit sharing ratio. The following Journal entry is passed to write-off the existing goodwill.

All Partners' Capital A/c	Dr.
To Goodwill A/c	
(Goodwill written off among all the partners in their old ratio)	

Step 2: Adjusting goodwill through Partner's Capital Account

After writing-off the existing goodwill, we need to adjust the goodwill through the Remaining Partners' Capital Account with the share of the Retiring or the Deceased Partner's goodwill.

Remaining Partners' Capital A/c	Dr.
To Retiring/Deceased Partner's Capital A/c	
(Gaining Partner's Capital A/c is debited in their gaining share and retiring/deceased Partner's Capital Account is credited with his share of goodwill)	

- **Situation 2: If no goodwill appears in the books of the firm at the time of retirement/death of partner.**

As no goodwill appears in the books of the firm, so the goodwill is adjusted through the Remaining Partners' Capital Account with the share of the goodwill of the Retiring or the Deceased Partner.

Remaining Partners' Capital A/c	Dr.
To Retiring/Deceased Partner's Capital A/c	

(Gaining Partner's Capital A/c is debited in their gaining share and retiring/deceased Partner's Capital Account is credited with his share of goodwill)

Note: In both the above cases, if any of the remaining (or continuing) partner/s is/are sacrificing instead of gaining, then the Journal entry for adjusting the goodwill becomes.

Remaining Partner's Capital A/c	Dr. (Gaining Partner)
To Retiring/Deceased Partner's Capital A/c	(Retiring or Deceased Partner)
To Remaining Partner's Capital A/c	(Sacrificing Partner)

❖ **Treatment of JLP (in case of Retirement)**

The treatment of JLP depends on the following two situations.

- **Situation 1: If no JLP appears in the Old Balance Sheet, but the continuing partners decided to show JLP in the New Balance Sheet**

In this case, the surrender value of JLP will be distributed among all the partners (including the retiring partner) in their old profit sharing ratio. Also, JLP will be shown at its surrender value on the Assets side of the Balance Sheet of the new firm.

JLP A/c	Dr. (With the surrender value in the Old Ratio)
To All Partner's Capital A/c	

- **Situation 2: If no JLP appears in the Old Balance Sheet, but the continuing partners decided not to show JLP in the New Balance Sheet.**

In this case, JLP will be written-off with the share of the surrender value of JLP of the retiring partner in the gaining ratio among the remaining partners in the gaining ratio. In this case, no JLP will be shown on the Assets side of the new Balance Sheet.

Remaining Partner's Capital A/c	Dr. With the share of surrender value of JLP of the retiring partner (<i>in gaining ratio</i>)
To Retiring Partner's Capital A/c	

- **Situation 3: If JLP already appears in the Old Balance Sheet**

In this case, JLP is treated as an asset and any increase or decrease in its surrender value is credited (or debited) to the Revaluation Account. Also, JLP will be shown on the Assets side of the New Balance Sheet at its final surrender value (i.e. net of increase or decrease).

❖ **Treatment of JLP (in case of Death)**

The treatment of JLP in case of death of a partner depends on the following two situations.

- **Situation 1: If the surrender value of JLP is not appearing in the Old Balance Sheet.**

In this case, Insurance Company pays amount against the claim for the death of a partner.

Insurance Company A/c	Dr.	With the full value of the policy
To Life Policy A/c		
Life Policy A/c	Dr.	With the full value of the policy
To All Partner's Capital Account		(In Old Ratio)
(Insurance claim credited to all partners)		
Remaining Partners' Capital A/c	Dr.	(In Gaining Ratio)
To Deceased Partner's Capital A/c		With the share of the deceased partner in the surrender value of the policy

- **Situation 2: If the surrender value of JLP is already appearing in the Old Balance Sheet.**

In this case, the amount received from the Insurance Company will be credited to the *all partners' Capital Accounts net of the surrender value*.

Insurance Company A/c	Dr.	With the full value of the policy
To Life Policy A/c		
Life Policy A/c	Dr.	(Full value – Surrender Value of the policy)
To All Partner's Capital Account		(In Old Ratio)
(Insurance claim credited to all partners)		

No entry is to be passed for recording the surrender value of the continuing partners, as their surrender value is already appearing on the Assets side of the Old Balance Sheet.

❖ **Revaluation of Assets and Liabilities**

Revaluation A/c			
Dr.			Cr.
Particulars	Amount Rs	Particulars	Amount Rs
Decrease in Value of Assets		Increase in Value of Assets	
Increase in Value of Liabilities		Decrease in Value of Liabilities	
Unrecorded Liabilities		Unrecorded Assets	
Outstanding Expenses (e.g. Salaries)		Prepaid Expenses	
Income Received in Advance		Income Earned but not yet received	
Revaluation Profit*		Revaluation Loss •	
A		A	
B		B	
(Transferred to the Credit side of All Partners' Capital A/c in Old Ratio)		(Transferred to the Debit side of All Partners' Capital A/c in Old Ratio)	

* If Credit side > Debit Side

• If Credit side < Debit Side

❖ Partners' Capital Account- Continuing and Retiring (or Deceased) Partner's Capital Account

Partners' Capital A/c

Dr.							Cr.
Particulars	A	B	C	Particulars	A	B	C
Profit and Loss (Debit Balance)	—	—	—	Balance b/d	—	—	—
Deferred Revenue Expenditure (Advertisement Expenditure)	—	—	—	General Reserve	—	—	—
Revaluation Loss	—	—	—	Profit and Loss (Credit Balance)	—	—	—
Assets (Taken over by Partners’)	—	—	—	Revaluation Profit	—	—	—
Cash/Bank/Partner’s Loan			—	Workmen’s Compensation Fund*	—	—	—
Goodwill A/c	—	—		Investment Fluctuation Fund*	—	—	—
Profit and Loss Suspense Account (up to date loss of retired/deceased partner)			—	Contingency Reserve*	—	—	—
Balance c/d (If Cr. Side > Dr. side)	—	—		Liabilities (If taken over by Partners’)	—	—	—
				Profit and Loss Suspense Account (up to date profit of retired/deceased partner)			—
				Balance c/d (If Dr. side > Cr. Side)	—	—	—
							—

* Workmen's Compensation Fund, Investment Fluctuation Fund and Contingency Reserve are transferred to All Partners' Capital A/c (Credit side) only with the excess amount. For example, if WCF appears on the Liabilities side of the Old Balance Sheet at Rs 6,000 and if in the adjustment, an amount of Rs 4,000 for Workmen's Compensation Claim is given, then the excess amount of Rs 2,000 (i.e. Rs 6,000 – Rs 4,000) will be transferred to the credit side of All Partners' Capital Account in their old ratio. The amount of claim i.e. Rs 4,000 will be shown on the Liabilities side of the New Balance Sheet.

- This represents the amount of existing goodwill that is already appearing on the Assets side of the Old Balance sheet. It has to be written-off by debiting All Partners' Capital A/c in their old profit sharing ratio.

Note:

1) If in the question, there are ***no adjustments related to WCF, IFF, Contingency Reserve***, then these are transferred to the Partners' Capital Account (with full value given in the question) among all the partners (including the retiring/deceased partner) in their profit sharing ratio.

2) Reserves such as, Employees' Provident Fund, Provision for Tax, Taxation Reserve, JLP Reserve and Depreciation Reserve are ***not*** transferred to the Partners' Capital Account and are shown on the Liabilities side of the New Balance Sheet.

❖ **Modes of Payment to the Retiring and Deceased Partner**

The retired/deceased partner may either be paid in cash or through loan (in instalments) or partly in cash and partly through loan.

Modes of Payment to Retiring or Deceased Partner	Journal Entries
If the retired/deceased partner is paid in <u>Cash</u>	Retiring/Deceased Partner's Capital A/c Dr. To Cash/Bank A/c
If the retired/deceased partner is paid through <u>Loan (in instalments)</u>	Retiring/Deceased Partner's Capital A/c Dr. To Retiring/Deceased Partner's Loan A/c
If the retired/deceased partner is paid <u>partly in Cash and partly through Loan</u>	Retiring/Deceased Partner's Capital A/c Dr. To Cash/Bank A/c To Retiring/Deceased Partner's Loan A/c

Note: *If nothing is mentioned in the question regarding the mode of the payment to the retiring or the deceased partner, then it is assumed to be paid through loan. The capital account of the retiring or the deceased partner is closed by transferring the balancing figure to the credit side of the Retiring/Deceased Partner's Loan A/c. The Retiring/Deceased Partner's Loan A/c will be shown on the Liabilities side of the New Balance Sheet*

❖ **Loan Account- Retiring and Deceased Partner**

The question may ask to prepare Retiring Partner's Loan Account or Deceased Partner's Executors' Loan Account for one year or for more than one year.

For one year

Retiring Partner's Loan Account
or
Deceased Partner's Executors' Loan Account

Dr.			Cr.		
Date	Particulars	Amount Rs	Date	Particulars	Amount Rs
End of Year	Cash/Bank A/c	–	Date of Death/ Retirement For the Year	Retiring/Deceased Partner's Capital/Executor's A/c Interest A/c	–

For more than one year

Retiring Partner's Loan Account
or
Deceased Partner's Executors' Loan Account

Dr.			Cr.		
Date	Particulars	Amount Rs	Date	Particulars	Amount Rs
1 st Year	Cash A/c (Interest + first year instalment) Balance c/d	–	Date of Death/ Retirement	Retiring/Deceased Partner's Capital/Executors' A/c Interest A/c	–
					–
2 nd Year	Cash A/c (Interest + second year instalment) Balance c/d	–	2 nd Year	Balance b/d Interest A/c	–
		–			–
Last Year	Cash A/c (Interest + last year instalment)	–	Last Year	Balance b/d Interest A/c	–
					–

❖ Adjustment of Capital Balances of the Remaining Partners

- **Total Capital of New Firm is Mentioned in the Question**

If in the question, the total capital of the new firm after the retirement or death of a partner is mentioned, then following are the steps involved in the adjustment of capital.

Step1: Calculate Cr. – Dr. Balances (Old capital) of the remaining partners, after all adjustments.

Step 2: Calculate the individual new capital of the remaining partners by the following formula.

$$\text{New Capital of one of the Remaining Partners} = \frac{\text{Total Capital of the Firm After Retirement / Death}}{\times \text{New Profit Share of Remaining Partner}}$$

Step 3: If the amount calculated in the Step 1 (old capital after all adjustments) exceeds the amount calculated in the Step 2 (new capital), then the difference amount (surplus) is paid to the partner in cash or through bank, i.e. debited to the Partners' Capital Account. On the other hand, if the amount calculated in the Step 2 exceeds the amount calculated in the Step 1, then the difference amount (shortage) is to be brought in by the partner, i.e. credited to the Partners' Capital Account.

Step 4: The retiring (or deceased) partner's balance (i.e. Cr. – Dr.) is transferred to his Loan Account or paid in cash (or transferred to the Executors' Account in case of death of a partner).

- **Total Capital of New Firm is not Mentioned in the Question**

If in the question, the total capital of the new firm after the retirement or death of a partner is not mentioned, then following are the steps involved in the adjustment of capital.

Step1: Calculate Cr. – Dr. Balances (Old capital) of the remaining partners, after all adjustments.

Step 2: Calculate the total capital of the new firm using the following formula.

Total Capital of the New Firm = Add Cr. – Dr. balances of remaining partners

Step 3: Calculate the new capital for each of the continuing partners by the following formula.

$$\text{New Capital of one of the Remaining Partners} = \frac{\text{Total Capital of the Firm After Retirement / Death}}{\times \text{New Profit Share of Remaining Partner}}$$

Step 4: If the amount calculated in the Step 1 (old capital after all adjustments) exceeds the amount calculated in the Step 3 (new capital), then the difference amount (i.e. surplus) is paid to the partner in cash or through bank, i.e. debited to the Partners' Capital Account. On the other hand, if the amount calculated in the Step 3 exceeds the amount calculated in the Step 1, then the difference amount (shortage) is to be brought in by the partner, i.e. credited to the Partners' Capital Account.

Step 5: The retiring (or the deceased) partner's balance (i.e. Cr. – Dr.) is transferred to his Loan Account or paid in cash (or Executors' Account in case of death of a partner).

- ***Amount Payable to Retiring Partner is Contributed by Remaining Partners***

If the question specifies that the amount payable to the retiring partner is to be contributed by the remaining partners such that their capitals become proportionate in their new profit sharing ratio, then following are the steps involved in the adjustment of capital.

Step 1: Calculate Cr. – Dr. Balances (Old capital) of the remaining partners, after all adjustments

Step 2: Calculate the total capital of the new firm using the following formula.

$$\text{Total Capital of the New Firm} = \text{Add Cr. – Dr. balances of Remaining Partners} \\ + \text{Amount Payable to Retiring Partner}$$

Step 3: Calculate the new capital for each of the continuing partners by the following formula.

$$\text{New Capital of one of the Remaining Partners} = \frac{\text{Total Capital of the Firm After Retirement / Death}}{\times \text{New Profit Share of Remaining Partner}}$$

Step 4: If the amount calculated in the Step 1 (old capital after all adjustments) exceeds the amount calculated in the Step 3 (new capital), then the difference amount (i.e. surplus) is paid to the partner in cash or through bank, i.e. debited to the Partners' Capital Account. On the other hand, if the amount calculated in the Step 3 exceeds the amount calculated in the Step 1, then the difference amount (shortage) is to be brought in by the partner, i.e. credited to the Partners' Capital Account.

Step 5: The retiring (or the deceased) partner's balance (i.e. Cr. – Dr.) is transferred to his Loan Account or paid in cash (or Executors' Account in case of death of a partner).

- ***Adjustment of Capital by Maintaining a Minimum Cash/Bank Balance***

If the question specifies that the capital of the remaining partners has to be adjusted in their new profit ratio in such a manner that after the payment to the retiring or the deceased partner, a minimum cash balance of Rs _____ is maintained. The following are the various steps involved in the calculation of the new capitals of the remaining partners.

Step 1: Calculate Cr. – Dr. Balances (Old capital) of all the partners, after all adjustments (including the retiring or the deceased partner).

Step 2: Calculate the total capital of the new firm using the following formula.

$$\begin{aligned}\text{Total Capital of the New Firm} &= \text{Add Cr. – Dr. balances of all partners} \\ &\quad + \text{Required (New) Cash Balance} \\ &\quad - \text{Old Cash Balance (given in the Balance Sheet)}\end{aligned}$$

Step 3: Calculate the new capital for each of the continuing partners by the following formula.

$$\begin{aligned}\text{New Capital of one of the Remaining Partners} &= \text{Total Capital of the Firm After Retirement / Death} \\ &\quad \times \text{New Profit Share of Remaining Partner}\end{aligned}$$

Step 4: If the amount calculated in the Step 1 (old capital after all adjustments) exceeds the amount calculated in the Step 3 (new capital), then the difference amount (i.e. surplus) is paid to the partner in cash or through bank, i.e. debited to the Partners' Capital Account. On the other hand, if the amount calculated in the Step 3 exceeds the amount calculated in the Step 1, then the difference amount (shortage) is to be brought in by the partner, i.e. credited to the Partners' Capital Account.

Step 5: The retiring (or the deceased) partner's balance (i.e. Cr. – Dr.) is transferred to his Loan Account or paid in cash (or Executors' Account in case of death of a partner).

Step 6: The closing balance of the Cash/Bank Account (i.e. Balance c/d) will reveal the same amount as required to be the minimum amount of Cash (as stated in the question).

❖ **Retirement or Death during an Accounting Period (other than Jan. 01, Dec. 31, March 31 and April 01)**

In case a partner is seeking retirement or death of a partner occurs during an accounting year, then the treatment of all the above items (such as, accumulated reserves and losses, Profit and Loss A/c, treatment of goodwill, JLP, etc.) remain the same. In addition to this, we need to calculate the profit/loss for the period for which the partner remained in the business during the retiring (current) year. For example, if B died on Oct. 01, then we need to calculate the profit or loss for the period April to September, if the accounting period is April to March. It is calculated on the following two bases.

- **Time Basis**

According to this approach, the up-to-date profit of the retiring (or deceased) partner is calculated as:

$$\begin{aligned} \text{Up to Date Profit of Retiring (Deceased) Partner} &= \text{Average Profits} \\ &\times \frac{\text{Number of Months Partner Remained}}{12} \\ &\times \text{Share of the Retiring (Deceased) Partner} \end{aligned}$$

where,

$$\text{Average Profits} = \frac{\text{Sum of Profits of Last Years} - \text{Loss (if any)}}{\text{Total Number of Years}}$$

- **Sales or Turnover Basis**

According to this approach, the up-to-date profit of the retiring (or deceased) partner is calculated as:

$$\begin{aligned} \text{Up to Date Profit of Retiring (Deceased) Partner} &= \frac{\text{Previous Year's Profit}}{\text{Previous Year's Sales}} \\ &\times \text{Sales till the Date of Retirement or Death of Partner} \\ &\times \text{Share of the Retiring (Deceased) Partner} \end{aligned}$$

The profit (or loss) whether calculated by Time Basis or Sales Basis is transferred to the credit (or debit) side of the retiring or deceased Partner's Capital Account as '*Profit and Loss Suspense Account*'.

❖ **Executors' Account**

In case of death of a partner, the Deceased Partner's Capital Account is closed by transferring its balance after all adjustments (i.e. Cr. – Dr.) to the Executors' Account. The Executors' Account is closed by either paying him/her cash or in instalments or partly in cash and partly through loan.

(a) When payment is made in Cash

Deceased Partner's Executors' Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount Rs	Date	Particulars	J.F.	Amount Rs
Year				Year			
Date of Payment	Bank		–	Date of Death	Deceased Partner's Capital A/c		–
			–				–

(b) When amount due is transferred to Executors' Loan A/c

Deceased Partner's Executors' Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount Rs	Date	Particulars	J.F.	Amount Rs
Year				Year			
Date of Death	Deceased Partner's Executors' Loan A/c		–	Date of Death	Deceased Partner's Capital A/c		–
			–				–

Note: The preparation of Deceased Partner's Executors' Loan A/c has been covered above (under the topic 'Loan Account- Retiring and Deceased Partner').

❖ **Cash Account**

Cash Account							
Dr.				Cr.			
Date	Particulars	J.F.	Amount Rs	Date	Particulars	J.F.	Amount Rs
	Balance b/d		—		Deceased Partner's Executors' Account (payment to retiring /deceased partner)		—
	Partners' Capital Account (if deficiency any brought in by partner)		—		Partners' Capital Account (if surplus any paid to partner)		
					Balance c/d (to be shown on the Assets side of Balance Sheet)		—
			—				—

❖ **Balance Sheet**

Format of Balance Sheet			
Dr.		Cr.	
Liabilities	Amount Rs	Assets	Amount Rs
Bank Overdraft		Cash in Hand	
Creditors		Cash at Bank	
General Reserve		Debtors	
Contingency Reserve		Less: Provision	
Depreciation Reserve		Bills Receivable	
Workmen's Compensation Fund		Stock	
Investment Fluctuation Fund		Land and Building	
Machinery Replacement Reserve		Plant and Machinery	
Employees' Provident Fund		JLP	
Provision for Tax		Profit and Loss Suspense	

JLP Reserve Bills Payable Executors' Loan Account (or Retiring Partner's Loan Account) Capitals: A: B:		Account (up to date profit of retired/deceased partner) Capitals: A: B:	
	**		○○

Note: The equality of ** and ○○ ensures the arithmetical accuracy of the solution.