UNIT 6

RETIREMENT AND DEATH OF A PARTNER

Contents

Points to recall

The following points are to be recalled before learning retirement and death of a partner:

- Meaning and features of partnership firm
- Partnership deed
- Partners' capital accounts
- Valuation of goodwill

Learning objectives

To enable the students to

- Understand the accounting treatment at the time of retirement and death of a partner.
- Prepare the partnership accounts on retirement and death of a partner.

Key terms to know

- Retirement of a partner
- Gaining ratio
- Executor's account

RETIREMENT OF A PARTNER

6.1 Introduction

Student activity 6.1

Think of any three reasons for a partner for leaving a partnership firm.

When a partner leaves from a partnership firm, it is known as retirement. The reasons for the retirement of a partner may be illness, old age, better opportunity elsewhere, disagreement with other partners, etc. On retirement of a partner, existing agreement comes to an end. The firm is reconstituted and other partners continue the partnership firm with a new agreement. A partner who retires from the firm is called an outgoing partner or a retiring partner.

Section 32(1) of The Indian Partnership Act, 1932 states that a partner may retire from the firm

(a) with the consent of all the other partners,

(b) in accordance with an express agreement by the partners, or

(c) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

The retiring partner is liable for all the acts of the firm up to the date of his retirement. It is necessary for the retiring partner to give a public notice of his retirement from the firm to get relieved from the liabilities to the third parties for the acts of the firm after the retirement. The remaining partners must settle the amount due to the retiring partner.

6.2 Adjustments required on retirement of a partner

On retirement of a partner, generally the mutual rights of the continuing partners change. The retiring partner is liable for all the acts which are carried out by the firm until the date of his retirement from the firm. Hence, the accumulated profits, losses and reserves upto the date of his retirement is to be distributed to all the partners. Assets and liabilities have to be revalued and the profit or loss on revaluation is to be distributed to all the partners. The following adjustments are necessary at the time of retirement of a partner:

(1) Distribution of accumulated profits, reserves and losses

(2) Revaluation of assets and liabilities

(3) Determination of new profit sharing ratio and gaining ratio

(4) Adjustment for goodwill

(5) Adjustment for current year's profit or loss upto the date of retirement

(6) Settlement of the amount due to the retiring partner

Tutorial note: All these adjustments are similar to the adjustments to be done on admission of a partner except determination of profit sharing ratio and settlement of the amount due to the retiring partner.

6.3 Distribution of accumulated profits, reserves and losses

Profits and losses of previous years which are not distributed to the partners are known as accumulated profits and losses. Reserve includes general reserve, reserve fund, workmen compensation fund and investment fluctuation fund. As the accumulated profits and losses belong to all the partners, these should be distributed to all the partners in the old profit sharing ratio. Incase of workmen compensation fund, the excess amount after providing for anticipated claim is to be transferred. Following are the journal entries to be passed:

(a) For transferring accumulated profits and reserves

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Profit and loss Appropriation A/c	Dr.		xxx	
	General reserve A/c	Dr.		xxx	
	Reserve fund A/c	Dr.		xxx	
	Workmen compensation fund A/c	Dr.		xxx	
	Investment fluctuation fund A/c	Dr.		xxx	
	To All partners' capital / current A/c (in the old ratio)				xxx

(b) For transferring accumulated loss

Date	Particulars		L.F	Debit ₹	Credit ₹
	All partners' capital / current A/c	Dr.		xxx	
	To Profit and loss A/c (in old ratio)				xxx

Illustration 1

Vivin, Hari and Joy are partners sharing profits and losses in the ratio of 3:2:1. On 31.3.2017, Hari retired. On the date of retirement, the books of the firm showed a general reserve of ₹ 60,000. Pass the journal entry to transfer the general reserve.

Solution

Journal entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017	General reserve A/c	Dr.		60,000	
March 31	To Vivin's capital A/c (60,000 × 3/6)				30,000
	To Hari's capital A/c (60,000 × 2/6)				20,000
	To Joy's capital A/c (60,000 × 1/6)				10,000
	(General reserve transferred to all partners' capital account in the old profit sharing ratio)				

Ilustration 2

Mary, Meena and Mariam are partners of a firm sharing profits and losses equally. Mary retired from the partnership on 1.1.2019. On that date, their balance sheet showed accumulated loss of ₹ 75,000 on the asset side of the balance sheet. Give the journal entry to distribute the accumulated loss.

Solution

Journal entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2019	Mary's capital A/c	Dr.		25,000	
January 1	Meena's capital A/c	Dr.		25,000	
	Mariam's capital A/c	Dr.		25,000	
	To Profit and loss a/c				75,000
	(Accumulated loss transferred to all partners' capital account in the old profit sharing ratio)				

Illustration 3

Prince, Dev and Sasireka are partners in a firm sharing profits and losses in the ratio of 2:4:1. Their balance sheet as on 31st March, 2019 is as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts			Buildings	40,000
Prince	30,000		Plant	50,000
Dev	50,000		Furniture	10,000
Sasireka	20,000	1,00,000	Stock	15,000
Profit and loss appropriation A/c		10,000	Debtors	20,000
General reserve		15,000	Cash at bank	15,000
Workmen compensation fund		17,000		
Sundry creditors		8,000		
		1,50,000		1,50,000

Solution

Journal entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2019	Profit and loss appropriation A/c	Dr.		10,000	
March 31	General reserve A/c	Dr.		15,000	
	Workmen compensation fund A/c	Dr.		17,000	
	To Prince's capital A/c (42,000 × 2/7)				12,000
	To Dev's capital A/c (42,000 × 4/7)				24,000
	To Sasireka's capital A/c (42,000 × 1/7)				6,000
	(Accumulated profits and reserve transferred to all partners' capital account in the old profit sharing ratio)				

6.4 Revaluation of assets and liabilities

When a partner retires from the partnership firm, the assets and liabilities are revalued as the current value may differ from the book value. There are two ways in which the revaluation of assets and liabilities may be dealt with in the accounts.

(a) Revised value of assets and liabilities are shown in the books

(b) Revised value of assets and liabilities are not shown in the books

(a) When revised value of assets and liabilities are shown in the books:

Under this method, the assets and liabilities are shown at their revised values in the books and in the balance sheet which is prepared immediately after the retirement of a partner. A revaluation account is opened to record the increase or decrease in the value of assets and liabilities. Revaluation account which is otherwise called profit and loss adjustment account is a nominal account. Revaluation account is credited with increase in value of assets and decrease in the value of liabilities. It is debited with decrease in value of assets and increase in the value of liabilities. Unrecorded assets if any are credited and unrecorded liabilities if any are debited to the revaluation account. The profit or loss arising therefrom is transferred to the capital accounts of all the partners in the old profit sharing ratio.

Following are the journal entries to be passed to record the revaluation of assets and liabilities:

Date	Particulars		L.F.	Debit ₹	Credit ₹
	1. For increase in the value of asset				
	Concerned asset A/c	Dr.		xxx	
	To Revaluation A/c				xxx
	2. For decrease in the value of asset				
	Revaluation A/c	Dr.		xxx	
	To Concerned asset A/c				xxx
	3. For increase in the amount of liabilities				
	Revaluation A/c	Dr.		xxx	
	To Concerned liability A/c				xxx
	4. For decrease in the amount of liability				
	Concerned liability A/c	Dr.		xxx	
	To Revaluation A/c				xxx
	5. For recording an unrecorded asset				
	Concerned asset A/c	Dr.		xxx	
	To Revaluation A/c				xxx
	6. For recording an unrecorded liability				
	Revaluation A/c	Dr.		xxx	
	To Concerned liability A/c				xxx
	7. For transferring the balance in revaluation A/c				
	(a) For profit on revaluation				
	Revaluation A/c	Dr.		xxx	
	To All partners' capital A/c (individually in old profit sharing ratio)				xxx
	(b) For loss on revaluation				
	All partner's capital A/c (individually in old profit sharing ratio)	Dr.		xxx	
	To Revaluation A/c				xxx

Format of revaluation account is as follows:

Dr. **Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Concerned asset A/c (net decrease)	xxx	By Concerned asset A/c (net increase)	xxx
To Concerned liability A/c (net increase)	xxx	By Concerned liability A/c (net decrease)	xxx
To All partners' capital A/c (profit on revaluation shared in old ratio) *	xxx	By All partners' capital A/c (loss on revaluation shared in old ratio)*	xxx
	xxx		xxx

*There will be either profit or loss on revaluation.

Illustration 4

Ramya, Sara and Thara are partners sharing profits and losses in the ratio of 5:3:2. On 1st April 2018, Thara retires and on retirement, the following adjustments are agreed upon:

(i) Increase the value of premises by ₹ 40,000.

(ii) Depreciate stock by ₹ 3,000 and machinery by ₹ 6,500.

(iii) Provide an outstanding liability of ₹ 500

Pass journal entries and prepare revaluation account.

Solution

Journal Entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
2018 April 1	Premises A/c To Revaluation A/c (Value of premises increased)	Dr.		40,000	 40,000
,,	Revaluation A/c To Stock A/c To Machinery A/c To Outstanding liability A/c (Decrease in value of assets and outstanding liability recorded)	Dr.		10,000	 3,000 6,500 500
,,	Revaluation A/c To Ramya's capital A/c To Sara's capital A/c To Thara's capital A/c (Profit on revaluation distributed)	Dr.		30,000	 15,000 9,000 6,000

Dr. **Revaluation account** Cr.

Particulars	₹	₹	Particulars	₹
To Stock A/c		3,000	By Premises A/c	40,000
To Machinery A/c		6,500		
To Outstanding liability A/c		500		
To Profit on revaluation				
transferred to				
Ramya's capital A/c (5/10)	15,000			
Sara's capital A/c (3/10)	9,000			
Thara's capital A/c (2/10)	6,000	**30,000**		
		40,000		40,000

Student activity 6.2

Write any four transactions that may increase the profit on revaluation .

Illustration 5

Prabu, Ragu and Siva are partners sharing profits and losses in the ratio of 3:2:1. Prabu retires from partnership on 1st April 2017. The following adjustments are to be made:

(i) Increase the value of building by ₹ 12,000

(ii) Reduce the value of furniture by ₹ 8,500

(iii) A provision would also be made for outstanding salary for ₹ 6,500.

Give journal entries and prepare revaluation account.

Journal entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017	Building A/c	Dr.		12,000	
April 1	To Revaluation A/c				12,000
	(Increase in the value of building accounted)				
,,	Revaluation A/c	Dr.		15,000	
	To Furniture A/c				8,500
	To Outstanding salary A/c				6,500
	(Reduction in the value of furniture and outstanding salary accounted)				
,,	Prabu's capital A/c	Dr.		1,500	
	Ragu's capital A/c	Dr.		1,000	
	Siva's capital A/c	Dr.		500	
	To Revaluation A/c				3,000
	(Loss on revaluation transferred to capital accounts)				

Dr. **Revaluation Account** Cr.

Particulars	₹	Particulars		₹
To Furniture A/c	8,500	By Building A/c		12,000
To Outstanding salary A/c	6,500	By Loss on revaluation transferred to		
		Prabu's capital A/c (3/6)	1,500	
		Ragu's capital A/c (2/6)	1,000	
		Siva's capital A/c (1/6)	500	**3,000**
	15,000			15,000

Illustration 6

John, James and Raja are partners in a firm sharing profits and losses equally. Their balance sheet as on 31st March, 2019 is as follows:

Liabilities		₹	Assets		₹
Capital accounts:			Office equipment		70,000
John	80,000		Machinery		1,40,000
James	60,000		Sundry debtors	52,000	
Raja	1,00,000	2,40,000	Less: Provision for		
Sundry creditors		1,20,000	doubtful debts	2,000	50,000
			Stock		60,000
			Cash at bank		40,000
		3,60,000			3,60,000

Raja retired on 31st March, 2019 subject to the following conditions:

(i) Machinery is valued at ₹ 1,30,000

(ii) Value of office equipment is brought down by ₹ 2,000

(iii) Provision for doubtful debts should be increased to ₹ 3,000

(iv) Investment of ₹ 25,000 not recorded in the books is to be recorded now

Pass necessary journal entries and prepare revaluation account.

Solution

Journal entries

Date	Particulars	L.F.	Debit ₹	Credit ₹
2019	Revaluation A/c Dr.		13,000	
March 31	To Machinery A/c			10,000
	To Office equipment A/c			2,000
	To Provision for doubtful debts A/c			1,000
	(Depreciation on machinery and furniture and provision made for doubtful debts adjusted)			

,,	Investments A/c	Dr.		25,000	
	To Revaluation A/c				25,000
	(Unrecorded investments brought into accounts)				
,,	Revaluation A/c	Dr.		12,000	
	To John's capital A/c				4,000
	To James's capital A/c				4,000
	To Raja's capital A/c				4,000
	(Profit on revaluation transferred to capital accounts)				

Dr. **Revaluation Account** **Cr.**

Particulars	₹	₹	Particulars	₹
To Machinery A/c		10,000	By Investments A/c	25,000
To Office equipment A/c		2,000		
To Provision for doubtful debts		1,000		
To Profit on revaluation transferred to				
John's Capital A/c (1/3)	4,000			
James Capital A/c (1/3)	4,000			
Raja's Capital A/c (1/3)	4,000	**12,000**		
		25,000		25,000

(b) When revised values of assets and liabilities are not shown in the books:

Under this method, the assets and liabilities are shown at their original values and not at the revised values in the books and in the balance sheet which is prepared immediately after the retirement of a partner. The net result of revaluation is adjusted through the capital accounts of the partners. A Memorandum revaluation account which is a temporary account is opened when the revised values are not to be shown in the books of accounts.

6.5 Determination of new profit sharing ratio and gaining ratio

6.5.1 New profit sharing ratio

It is necessary to determine the new profit sharing ratio at the time of retirement of a partner because the continuing partners acquire the retiring partner's share of profit. New profit sharing ratio is the agreed proportion in which future profit will be distributed to the continuing partners. If the new profit sharing ratio is not agreed, the continuing partners will share the profits and losses equally.

6.5.2 Gaining ratio

The continuing partners may gain a portion of the share of profit of the retiring partner. The gain may be shared by all the partners or some of the partners. Gaining ratio is the proportion of the profit which is gained by the continuing partners. The purpose of finding the gaining ratio is to bear the goodwill to be paid to the retiring partner. The share gained is calculated as follows:

Share gained = New share – Old share

Gaining ratio = Ratio of share gained by the continuing partners

Tutorial note: When the new profit sharing ratio is not given in the problem, it is to be calculated based on the information given in the problem.

Calculation of gaining ratio and new profit sharing ratio under different situations

1. When new profit sharing ratio is given

When new profit sharing ratio is given, only gaining ratio has to be calculated as follows:

Gaining ratio = Ratio of share gained by the continuing partners

Share gained = New share – Old share

Illustration 7

Kiran, Vinoth and Vimal are partners sharing profits in the ratio of 5:3:2. Kiran retires and the new profit sharing ratio between Vinoth and Vimal is 2:1. Calculate the gaining ratio.

Solution

Share gained = New share – Old share

Vinoth $= \frac{2}{3} - \frac{3}{10} = \frac{20-9}{30} = \frac{11}{30}$

Vimal $= \frac{1}{3} - \frac{2}{10} = \frac{10-6}{30} = \frac{4}{30}$

Therefore, the gaining ratio of Vinoth and Vimal is $\frac{11}{30} : \frac{4}{30}$, that is, 11:4

2. When new profit sharing ratio is not given

(a) Only one partner gains the retiring partner's share

When new profit sharing ratio is not given and only one continuing partner gains the entire share of the retiring partner, new profit sharing ratio is calculated as follows:

New share of continuing partner = Old share + Share gained

Illustration 8

Arya, Benin and Charles are partners sharing profits and losses in the ratio of 3:3:2. Charles retires and his share is taken up by Arya. Calculate the new profit sharing ratio and gaining ratio of Arya and Benin.

Share gained by Arya $= \frac{2}{8}$

Gaining ratio $= \frac{2}{8}$: 0 that is, $\frac{1}{4}$: 0 or 1:0

New share of continuing partner = Old share + Share gained

Arya $= \frac{3}{8}+\frac{2}{8}=\frac{5}{8}$

Benin $= \frac{3}{8}+0=\frac{3}{8}$

Therefore, new profit sharing ratio of Arya and Benin is $\frac{5}{8}:\frac{3}{8}$ that is 5:3.

(b) More than one partner gains the retiring partner's share

(i) Proportion of share gained on retiring partner's share is given

When new profit sharing ratio is not given, but the proportion of share gained on retiring partner's share is given, new profit sharing ratio is calculated as follows:

New share of continuing partners = Old share + Share gained

Share gained = Retiring partner's share × Proportion of share gained

Illustration 9

Rahul, Ravi and Rohit are partners sharing profits and losses in the ratio of 5:3:2. Rohit retires and the share is taken by Rahul and Ravi in the ratio of 3:2. Find out the new profit sharing ratio and gaining ratio.

Solution

Rohit's share $\frac{2}{10}$

Share gained = Retiring partner's share × Proportion of share gained

Rahul $= \frac{2}{10}\times\frac{3}{5}=\frac{6}{50}$

Ravi $= \frac{2}{10}\times\frac{2}{5}=\frac{4}{50}$

Gaining ratio $= \frac{6}{50}:\frac{4}{50}$ that is, 3:2

New share of continuing partners = Old share + Share gained

Rahul $= \frac{5}{10}+\frac{6}{50}=\frac{25+6}{50}=\frac{31}{50}$

Ravi $= \frac{3}{10}+\frac{4}{50}=\frac{15+4}{50}=\frac{19}{50}$

The new profit sharing ratio of Rahul and Ravi is $\frac{31}{50}:\frac{19}{50}$ that is 31:19.

Illustration 10

Kumar, Kesavan and Manohar are partners sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. Manohar retires and his share is taken up by Kumar and Kesavan equally. Find out the new profit sharing ratio and gaining ratio.

Solution

Gaining ratio is 1:1 as Manohar's share is taken up by Kumar and Kesavan equally.

Manohar's share $= \frac{1}{6}$

Share gained = Retiring partner's share × Proportion of share gained

Kumar $= \frac{1}{6} \times \frac{1}{2} = \frac{1}{12}$

Kesavan $= \frac{1}{6} \times \frac{1}{2} = \frac{1}{12}$

Therefore, gaining ratio of Kumar and Kesavan is $\frac{1}{12} : \frac{1}{12}$ that is 1:1.

New share of continuing partners = Old share + Share gained

Kumar $= \frac{1}{2} + \frac{1}{12} = \frac{6+1}{12} = \frac{7}{12}$

Kesavan $= \frac{1}{3} + \frac{1}{12} = \frac{4+1}{12} = \frac{5}{12}$

Therefore, new profit sharing ratio of Kumar and Kesavan is $\frac{7}{12} : \frac{5}{12}$ that is 7:5.

(ii) Proportion of share gained is not given

When new profit sharing ratio, share gained and the proportion of share gained is not given, the new share is calculated by assuming that share gained is the proportion of the old share. Therefore, the new profit sharing ratio and the gaining ratio among the continuing partners is their old profit sharing ratio between them.

Illustration 11

Raja, Roja and Pooja are partners sharing profits in the ratio of 4:5:3. Roja retires from the firm. Calculate the new profit sharing ratio and gaining ratio.

Solution

Since, new profit sharing ratio, share gained and the proportion of share gained is not given, the new share is calculated by assuming that the share gained is in the proportion of old ratio. Therefore, the new profit sharing ratio and the gaining ratio between the continuing partners, Raja and Pooja is their old profit sharing ratio, that is 4:3.

6.5.3 Differences between the sacrificing ratio and the gaining ratio

Basis	Sacrificing ratio	Gaining ratio
1. Meaning	It is the proportion of the profit which is sacrificed by the old partners in favour of a new partner.	It is the proportion of the profit which is gained by the continuing partners from the retiring partner.
2. Purpose	It is calculated to determine the amount to be adjusted towards goodwill for the sacrificing partners.	It is calculated to determine the amount to be adjusted towards goodwill for the gaining partners.
3. Time of calculation	It is calculated at the time of admission of a new partner.	It is calculated at the time of retirement of a partner.
4. Method of calculation	It is the difference between the old ratio and the new ratio Sacrificing ratio = Old profit sharing ratio – New profit sharing ratio	It is the difference between the new ratio and the old ratio. Gaining ratio = New profit sharing ratio - Old profit sharing ratio

6.6 Adjustment for goodwill

Reputation built up by a firm has an impact on the present and future profit to be earned by the firm. At the time of retirement of a partner, the continuing partners gain part of retiring partner's share of profit. Hence, the retiring partner's share of goodwill is to be valued and adjusted through the capital accounts of the gaining partners. The following journal entry is passed.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Continuing partners' capital / current A/c (in gaining ratio) Dr.		xxx	
	To Retiring partner's capital / current A/c			xxx

Illustration 12

Suresh, Senthamarai and Raj were partners in a firm sharing profits and losses in the ratio of 3:2:1. Suresh retired from partnership. The goodwill of the firm on the date of retirement was valued at ₹ 36,000. Pass necessary journal entries for goodwill on the assumption that the fluctuating capital system is followed.

Solution

As the new profit sharing ratio and gain made by the continuing partners is not mentioned, it is assumed that they gain in their old profit sharing ratio of 2:1. Therefore, gaining ratio is 2:1.

Suresh's share of goodwill = $36,000 \times \frac{3}{6}$ = ₹ 18,000

Journal Entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Senthamari's capital A/c (18,000 × 2/3)	Dr.		12,000	
	Raj's capital A/c (18,000 × 1/3)	Dr.		6,000	
	To Suresh's capital A/c				18,000
	(Suresh's share of goodwill adjusted)				

6.6.1 Existing goodwill

If goodwill already appears in the balance sheet, at the time of retirement if the partners decide, it can be written off by transferring it to all the partners' capital account / current account in the old profit sharing ratio. The following journal entry is to be passed:

Journal entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
	All partners' capital / current A/c (in old ratio)	Dr.		xxx	
	To Goodwill A/c				xxx
	(Existing goodwill written off)				

Illustration 13

Naresh, Mani and Muthu are partners in a firm sharing profits and losses in the ratio of 2:2:1. On 31st March 2019, Muthu retires from the firm. On the date of Muthu's retirement, goodwill appeared in the books of the firm at ₹ 40,000. By assuming fluctuating capital method, pass the necessary journal entry if the partners decide to

(a) write off the entire amount of existing goodwill

(b) write off half of the amount of existing goodwill.

Solution

(a) Write off the entire amount of existing goodwill

Journal entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2019	Naresh's capital A/c (40,000 × 2/5)	Dr.		16,000	
March 31	Mani's capital A/c (40,000 × 2/5)	Dr.		16,000	
	Muthu's capital A/c (40,000 × 1/5)	Dr.		8,000	
	To Goodwill A/c				40,000
	(Existing goodwill written off)				

(b) Write off half of the amount of existing goodwill, that is ₹ 20,000

Journal entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2019	Naresh's capital A/c (20,000 × 2/5) Dr.		8,000	
March 31	Mani's capital A/c (20,000 × 2/5) Dr.		8,000	
	Muthu's capital A/c (20,000 × 1/5) Dr.		4,000	
	To Goodwill A/c			20,000
	(Half of the existing goodwill written off)			

6.7 Adjustment for current year's profit or loss upto the date of retirement

When a partner retires in between in an accounting year, his share of the current year's profit or loss upto the date of retirement has to be distributed to him. It may be estimated based on the current year's turnover. Previous year's profit or the average of the past years' profit may also be taken as the base to estimate the current year's profit. The following journal entry is passed.

Date	Particulars	L.F.	Debit ₹	Credit ₹
	Profit and loss Suspense A/c Dr.		xxx	
	To Retiring partner's capital / current A/c			xxx
	(Retiring partner's current year share of profit credited to his capital account)			

Note: If there is loss the reverse entry is passed.

Profit and loss suspense account is closed by transferring to the profit and loss account at the end the accounting period.

DO YOU KNOW?

Profit and loss suspense account is a temporary account opened to transfer the share of retiring or deceased partner's share in current year's profit or loss upto the date of retirement or death.

Illustration 14

Justina, Navi and Rithika are partners sharing profits and losses equally. On 31.3.2019, Rithika retired from the partnership firm. Profits of the preceding years is as follows:

2016: ₹ 5,000; 2017: ₹ 10,000 and 2018: ₹ 30,000

Find out the share of profit of Ritika for the year 2019 till the date of retirement if

(a) Profit is to be distributed on the basis of the previous year's profit

(b) Profit is to be distributed on the basis of the average profit of the past 3 years

Also pass necessary journal entries by assuming that partners' capitals are fluctuating.

Solution

(a) If profit is to be distributed on the basis of the previous year's profit:

Ritika's share of profit for 3 months $= 30,000 \times \frac{3}{12} \times \frac{1}{3}$ = ₹ 2,500

Date	Particulars		L.F.	Debit ₹	Credit ₹
2019 March 31	Profit and loss Suspense A/c	Dr.		2,500	
	To Rithika's capital A/c				2,500
	(Rithika's current year share of profit credited to her capital account)				

(b) If profit is to be distributed on the basis of the average profit of the past 3 years:

Average profit $= \frac{5,000 + 10,000 + 30,000}{3}$

$= 15,000$

Ritika's share of profit for 3 months $= 15,000 \times \frac{3}{12} \times \frac{1}{3}$ = ₹ 1,250

Date	Particulars		L.F.	Debit ₹	Credit ₹
2019 March 31	Profit and loss Suspense A/c	Dr.		1,250	
	To Rithika's capital A/c				1,250
	(Rithika's current year share of profit credited to her capital account)				

6.8 Settlement of the amount due to the retiring partner

The amount due to the retiring partner from the partnership firm is the balance of his capital account after making adjustments for goodwill, accumulated profits and losses, profit or loss on revaluation, remuneration due, etc. The settlement is to be done in the manner prescribed in the partnership deed. The amount due to the retiring partner may be settled in one of the following ways:

(i) Paying the entire amount due immediately in cash

(ii) Transfer the entire amount due, to the loan account of the partner

(iii) Paying part of the amount immediately in cash and transferring the balance to the loan account of the partner

The journal entries to be made are as follows:

(a) When the amount due is paid in cash immediately

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Retiring partner's capital A/c	Dr.		xxx	
	To Cash / Bank A/c				xxx

(b) When the amount due is not paid immediately in cash

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Retiring partner's capital A/c	Dr.		xxx	
	To Retiring partner's loan A/c				xxx

(c) When the amount due is partly paid in cash immediately

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Retiring partner's capital A/c	Dr.		xxx	
	To Cash / Bank A/c (amount paid)				xxx
	To Retiring partner's loan A/c				xxx

Retiring partner's loan account will appear on the liabilities side of the balance sheet prepared after retirement till it is completely settled.

Student activity 6.3

A partner retires from a partnership firm. The final amount due to him on his retirement from the partnership firm is ₹ 25,000. He receives ₹ 15,000 immediately and the balance is left with the firm. What impact will it have in the books of accounts after his retirement?

DO YOU KNOW?

If the amount due to the retiring/deceased partner is not paid in cash immediately and if there is no contract entered into concerning settlement of account, then provisions of Section 37 of the Indian Partnership Act, 1932 will apply.

As per section 37, the retiring partner or the representatives of the retiring or deceased partner is entitled to choose any of the following options:

(a) Share of profits attributable to the use of his share of property of the firm or

(b) Interest at the rate of 6 per cent per annum on the amount of his share on the property of the firm.

Illustration 15

Kavitha, Kumudha and Lalitha are partners sharing profits and losses in the ratio of 5:3:3 respectively. Kumudha retires from the firm on 31st December, 2018. On the date of retirement, her capital account shows a credit balance of ₹ 2,00,000. Pass journal entries if:

(i) The amount due is paid off immediately by cheque.

(ii) The amount due is not paid immediately.

(iii) ₹ 70,000 is paid immediately by cheque.

Solution

Journal entries

Date	Particulars	L.F.	Debit ₹	Credit ₹
2018 Dec. 31	(i) Kumudha's capital A/c Dr.		2, 00,000	
	To Bank A/c			2, 00,000
	(Amount due paid immediately)			
,,	(ii) Kumudha's capital A/c Dr.		2,00,000	
	To Kumudha's loan A/c			2,00,000
	(Amount due transferred to loan account)			
,,	(iii) Kumudha's capital A/c Dr.		2,00,000	
	To Bank A/c			70,000
	To Kumudha's loan A/c			1,30,000
	(₹ 70,000 paid and the balance transferred to loan account)			

Illustration 16

Mani, Rama and Devan are partners in a firm sharing profits and losses in the ratio of 4:3:3. Their balance sheet as on 31st March, 2019 is as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Buildings	80,000
Mani	50,000		Stock	20,000
Rama	50,000		Furniture	70,000
Devan	50,000	1,50,000	Debtors	20,000
Sundry creditors		20,000	Cash in hand	10,000
Profit and loss A/c		30,000		
		2,00,000		2,00,000

Mani retired from the partnership firm on 31.03.2019 subject to the following adjustments:

(i) Stock to be depreciated by ₹ 5,000

(ii) Provision for doubtful debts to be created for ₹ 1,000.

(iii) Buildings to be appreciated by ₹ 16,000

(iv) The final amount due to Mani is not paid immediately

Prepare revaluation account and capital account of partners after retirement.

Solution

Dr. **Revaluation Account** **Cr.**

Particulars	₹	₹	Particulars	₹
To Stock A/c		5,000	By Buildings A/c	16,000
To Provision for doubtful debts A/c		1,000		
To Profit on revaluation transferred to				
Mani's capital A/c (4/10)	4,000			
Rama's capital A/c (3/10)	3,000			
Devan's capital A/c (3/10)	3,000	**10,000**		
		16,000		16,000

Dr. **Capital Account** **Cr.**

Particulars	**Mani** ₹	**Rama** ₹	**Devan** ₹	**Particulars**	**Mani** ₹	**Rama** ₹	**Devan** ₹
To Mani's loan A/c	**66,000**			By Balance b/d	50,000	50,000	50,000
To Balance c/d		**62,000**	**62,000**	By Revaluation A/c	4,000	3,000	3,000
				By Profit and loss A/c	12,000	9,000	9,000
	66,000	62,000	62,000		66,000	62,000	62,000
				By Balance b/d		62,000	62,000

Comprehensive problems

Illustration 17

Charles, Muthu and Sekar are partners, sharing profits in the ratio of 3:4:2. Their balance sheet as on 31st December, 2018 is as under:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Furniture	20,000
Charles	30,000		Stock	40,000
Muthu	40,000		Debtors	30,000
Sekar	20,000	90,000	Cash at bank	42,000
Workmen compensation fund		27,000	Profit and loss A/c (loss)	18,000
Sundry creditors		33,000		
		1,50,000		1,50,000

On 1.1.2019, Charles retired from the partnership firm on the following arrangements.

(i) Stock to be appreciated by 10%

(ii) Furniture to be depreciated by 5%

(iii) To provide ₹ 1,000 for bad debts

(iv) There is an outstanding repairs of ₹ 11,000 not yet recorded

(v) The final amount due to Charles was paid by cheque

Prepare revaluation account, partners' capital account and the balance sheet of the firm after retirement.

Solution

Dr. **Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹	₹
To Furniture A/c	1,000	By Stock A/c		4,000
To Provision for bad debts A/c	1,000	By Loss on revaluation transferred to		
To Outstanding repairs	11,000	Charles capital A/c (3/9)	3,000	
		Muthu's capital A/c (4/9)	4,000	
		Sekar's capital A/c (2/9)	2,000	**9,000**
	13,000			13,000

Dr.				Capital Account			Cr.
Particulars	**Charles ₹**	**Muthu ₹**	**Sekar ₹**	**Particulars**	**Charles ₹**	**Muthu ₹**	**Sekar ₹**
To Profit and loss A/c	6,000	8,000	4,000	By Balance b/d	30,000	40,000	20,000
To Revaluation A/c (loss)	3,000	4,000	2,000	By Workmen's compensation fund	9,000	12,000	6,000
To Bank	30,000	-	-				
To Balance c/d		**40,000**	**20,000**				
	39,000	52,000	26,000		39,000	52,000	26,000
				By Balance b/d	-	40,000	20,000

Balance Sheet as on 1st January 2019

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Furniture	20,000	
Muthu	40,000		Less: Depreciation	1,000	19,000
Sekar	20,000	60,000	Stock	40,000	
Sundry creditors		33,000	Add: Appreciation	4,000	44,000
Outstanding repairs		11,000	Debtors	30,000	
			Less: Provision for bad debts	1,000	29,000
			Cash at bank	42,000	
			Less: Amount paid to Charles	30,000	12,000
		1,04,000			1,04,000

Illustration 18

Raghu, Ravi and Ramesh are partners in a firm sharing profits and losses in the ratio of 2:3:1. Their balance sheet as on 31st March, 2019 was as follows:

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Buildings		60,000
Raghu	30,000		Machinery		70,000
Ravi	40,000		Stock		20,000
Ramesh	20,000	90,000	Debtors	18,000	
Reserve fund		36,000	Less Provision for		
Sundry creditors		50,000	bad debts	1,000	17,000
			Cash at bank		9,000
		1,76,000			1,76,000

Ramesh retires on 31.3.2019 subject to the following conditions:

(i) Goodwill of the firm is valued at ₹ 24,000

(ii) Machinery to be depreciated by 10%

(iii) Buildings to be appreciated by 20%

(iv) Stock to be appreciated by ₹ 2,000

(v) Provision for bad debts to be raised by ₹ 1,000

(vi) Final amount due to Ramesh is not paid immediately

Prepare the necessary ledger accounts and show the balance sheet of the firm after retirement.

Solution

Dr. Revaluation Account Cr.

Particulars	₹	₹	Particulars	₹
To Machinery A/c		7,000	By Buildings A/c	12,000
To Provision for bad debts A/c		1,000	By Stock A/c	2,000
To Profit on revaluation transferred to				
Raghu's capital A/c (2/6)	2,000			
Ravi's capital A/c (3/6)	3,000			
Ramesh capital A/c (1/6)	1,000	**6,000**		
		14,000		14,000

Dr. Capital Account Cr.

Particulars	Raghu ₹	Ravi ₹	Ramesh ₹	Particulars	Raghu ₹	Ravi ₹	Ramesh ₹
To Ramesh's capital A/c	1,600	2,400	-	By Balance b/d	30,000	40,000	20,000
				By Reserve fund A/c	12,000	18,000	6,000
To Ramesh's loan A/c			31,000	By Revaluation A/c	2,000	3,000	1,000
To Balance c/d	**42,400**	**58,600**	-	By Raghu's capital A/c	-	-	1,600
				By Ravi's capital A/c	-	-	2,400
	44,000	61,000	31,000		44,000	61,000	31,000
				By Balance b/d	42,400	58,600	-

Balance sheet as on 31st March 2019

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Buildings	60,000	
Raghu	42,400		Add: Appreciation	12,000	72,000
Ravi	58,600	1,01,000	Machinery	70,000	
Ramesh's loan		31,000	Less: Depreciation	7,000	63,000
Sundry creditors		50,000	Stock	20,000	
			Add: Appreciation	2,000	22,000
			Debtors	18,000	
			Less: Provision for bad debts	2,000	16,000
			Cash at bank		9,000
		1,82,000			1,82,000

Tutorial note

1. As new profit sharing ratio and proportion of gain is not given, it is assumed that the continuing partners gain in their old profit sharing ratio of 2:3.

2. Ramesh share of goodwill = $24,000 \times \frac{1}{6}$ = ₹ 4,000

   Goodwill of Ramesh to be borne by

   Raghu: 4,000 × 2/5 = ₹ 1,600

   Ravi : 4,000 × 3/5 = ₹ 2,400

Illustration 19

Muthu, Murali and Manoj are partners in a firm and sharing profits and losses in the ratio 3:1:2. Their balance sheet as on 31st December, 2018 is given below:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Machinery	45,000
Muthu	20,000		Furniture	5,000
Murali	25,000		Debtors	30,000
Manoj	20,000	65,000	Stock	20,000
General reserve		6,000		
Creditors		29,000		
		1,00,000		1,00,000

Manoj retires on 31st December, 2018 subject to the following conditions:

(i) Muthu and Murali will share profits and losses in the ratio of 3:2

(ii) Assets are to be revalued as follows:
Machinery ₹ 43,000, stock ₹ 27,000, debtors ₹ 28,000.

(iii) Goodwill of the firm is valued at ₹ 30,000

(iv) The final amount due to Manoj is not paid immediately

Prepare necessary ledger accounts and the balance sheet immediately after the retirement of Manoj.

Solution

Dr. **Revaluation Account** **Cr.**

Particulars	₹	₹	Particulars	₹
To Machinery A/c		2,000	By Stock A/c	7,000
To Debtors A/c		2,000		
To Profit on revaluation transferred to				
Muthu's capital A/c	1,500			
Murali's capital A/c	500			
Manoj's capital A/c	1,000	**3,000**		
		7,000		7,000

Dr. **Capital Account** **Cr.**

Particulars	Muthu ₹	Murali ₹	Manoj ₹	Particulars	Muthu ₹	Murali ₹	Manoj ₹
To Manoj's capital A/c	3,000	7,000	-	By Balance b/d	20,000	25,000	20,000
To Manoj's loan A/c			33,000	By General reserve A/c	3,000	1,000	2,000
To Balance c/d	**21,500**	**19,500**		By Revaluation A/c (profit)	1,500	500	1,000
				By Muthu's capital A/c			3,000
				By Murali's capital A/c			7,000
	24,500	26,500	33,000		24,500	26,500	33,000
				By Balance b/d	21,500	19,500	

Note:

(i) Computation of gaining ratio

Share gained = New share – old share

Muthu $= \frac{3}{5} - \frac{3}{6} = \frac{18-15}{30} = \frac{3}{30}$

Murali $= \frac{2}{5} - \frac{1}{6} = \frac{12-5}{30} = \frac{7}{30}$

Therefore, the gaining ratio of Muthu and Murali is 3:7

(ii) Adjustment for goodwill

Goodwill of the firm = ₹ 30,000

Share of goodwill to Manoj = $30{,}000 \times \frac{2}{6}$ = ₹ 10,000

It is to be adjusted in the capital accounts of Muthu and Murali in the gaining ratio of 3:7

That is,

Muthu : $10{,}000 \times \frac{3}{10}$ = ₹ 3,000

Murali : $10{,}000 \times \frac{7}{10}$ = ₹ 7,000

Balance Sheet as on 31st December, 2018

Liabilities	₹	₹	Assets	₹	₹
Capital accounts			Machinery	45,000	
Muthu	21,500		Less: Depreciation	2,000	43,000
Murali	19,500	41,000	Furniture		5,000
Manoj's loan A/c		33,000	Debtors	30,000	
Creditors		29,000	Less: Provision for bad debts	2,000	28,000
			Stock	20,000	
			Add: Appreciation	7,000	27,000
		1,03,000			1,03,000

DEATH OF A PARTNER

6.9 Adjustments required on the death of a partner

When a partner dies, there is dissolution or reconstitution of partnership. The following adjustments are made on the death of a partner:

(1) Distribution of accumulated profits, reserves and losses
(2) Revaluation of assets and liabilities
(3) Determination of new profit sharing ratio and gaining ratio
(4) Adjustment for goodwill
(5) Adjustment for current year's profit or loss upto the date of death
(6) Settlement of the amount due to the deceased partner

The adjustments to be done in the accounts incase of death of a partner is the same as in the case of retirement of a partner except settlement of the amount due to the deceased partner.

Incase of retirement, the amount due from the firm is paid to the partner himself. But, when a partner dies the amount due from the firm is paid to the executor or legal representative of the deceased partner. The following journal entries are passed for settlement of the amount due to the deceased partner:

(i) To transfer the amount due to the deceased partner to the executor or legal representative of the deceased partner.

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Deceased partner's capital A/c	Dr.		xxx	
	To Deceased partner's executor A/c				xxx

(ii) For payment made

(a) When the amount due is paid in cash immediately

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Deceased partner's executor A/c	Dr.		xxx	
	To Cash / Bank A/c				xxx

(b) When the amount due is not paid immediately in cash

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Deceased partner's executor A/c	Dr.		xxx	
	To Deceased partner's executor loan A/c				xxx

(c) When the amount due is partly paid in cash immediately

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Deceased partner's executor A/c	Dr.		xxx	
	To Cash / Bank A/c (amount paid)				xxx
	To Deceased partner's executor loan A/c				xxx

Illustration: 20

Rathna, Baskar and Ibrahim are partners sharing profits and losses in the ratio of 2:3:4 respectively. Rathna died on 31st December, 2018. Final amount due to her showed a credit balance of ₹ 1,00,000. Pass journal entries if,

(a) The amount due is paid off immediately by cheque.

(b) The amount due is not paid immediately.

(c) ₹ 60,000 is paid immediately by cheque.

Solution

Journal entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
	(a) Rathna's Executor A/c	Dr.		1,00,000	
	To Bank A/c				1,00,000
	(Amount due paid immediately)				
	(b) Rathna's Executor A/c	Dr.		1,00,000	
	To Rathna's Executor loan A/c				1,00,000
	(Amount due transferred to loan account)				
	(c) Rathna's Executor A/c	Dr.		1,00,000	
	To Bank A/c				60,000
	To Rathna's Executor loan A/c				40,000
	(₹ 60,000 paid and the balance transferred to loan account)				

DO YOU KNOW?

Life policies may be taken on the life of the partners in a partnership firm. The life policy may be individual policy or joint life policy. Incase of individual policy, if a partner dies, his policy alone matures and the policy amount is received from the insurance company.

Incase of joint life policy, one policy is taken on the lives of all partners. When any one of the partners dies, the policy matures and the policy amount is received. In both types of policies, the insurance premium is paid by the partnership firm. The policy amount received from the insurance company is used to settle the amount due to the deceased partner.

Illustration: 21

Sundar, Vivek and Pandian are partners, sharing profits in the ratio of 3:2:1. Their balance sheet as on 31st December, 2018 is as under:

Balance Sheet as on 31st December, 2018

Liabilities	₹	₹	Assets	₹
Capital accounts:			Land	80,000
Sundar	50,000		Stock	20,000
Vivek	40,000		Debtors	30,000
Pandian	10,000	1,00,000	Cash at bank	14,000
General reserve		36,000	Profit and loss A/c (loss)	6,000
Sundry creditors		14,000		
		1,50,000		1,50,000

On 1.1.2019, Pandian died and on his death the following arrangements are made:

(i) Stock to be depreciated by 10%

(ii) Land is to be appreciated by ₹ 11,000

(iii) Reduce the value of debtors by ₹ 3,000

(iv) The final amount due to Pandian was not paid

Prepare revaluation account, partners' capital account and the balance sheet of the firm after death.

Solution

Dr. **Revaluation Account** **Cr.**

Particulars	₹	₹	Particulars	₹
To Stock A/c		2,000	By Land A/c	11,000
To Debtors A/c		3,000		
To Profit on revaluation transferred to				
Sundar's capital A/c (3/6)	3,000			
Vivek's capital A/c (2/6)	2,000			
Pandian's capital A/c (1/6)	1,000	**6,000**		
		11,000		11,000

Dr. **Capital Account** **Cr.**

Particulars	Sundar ₹	Vivek ₹	Pandian ₹	Particulars	Sundar ₹	Vivek ₹	Pandian ₹
To Profit and loss A/c	3,000	2,000	1,000	By Balance b/d	50,000	40,000	10,000
To Pandian's Executor A/c			16,000	By General reserve	18,000	12,000	6,000
				By Revaluation A/c (profit)	3,000	2,000	1,000
To Balance c/d	**68,000**	**52,000**					
	71,000	54,000	17,000		71,000	54,000	17,000
				By Balance b/d	68,000	52,000	

Balance Sheet as on 1st January, 2019

Liabilities	₹	₹	Assets		₹
Capital account:			Land	80,000	
Sundar	68,000		Add: Appreciation	11,000	91,000
Vivek	52,000	1,20,000	Stock	20,000	
Pandian's Executor A/c		16,000	Less: Decrease	2,000	18,000
Sundry creditors		14,000	Debtors	30,000	
			Less: Decrease	3,000	27,000
			Cash at bank		14,000
		1,50,000			1,50,000

Illustration 22

Ramesh, Ravi and Akash are partners who share profits and losses in their capital ratio. Their balance sheet as on 31.12.2017 is as follows:

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital account:			Plant and machinery		45,000
Ramesh	30,000		Stock		22,000
Ravi	30,000		Debtors		15,000
Akash	20,000	80,000	Cash at bank		10,000
General reserve		8,000	Cash in hand		4,000
Creditors		8,000			
		96,000			96,000

Akash died on 31.3.2018. On the death of Akash, the following adjustments are made:

(i) Plant and machinery is to be valued at ₹ 54,000

(ii) Stock is to be depreciated by ₹ 1,000

(iii) Goodwill of the firm is valued at ₹ 24,000

(iv) Share of profit of Akash is to be calculated from the closing of the last financial year to the date of death on the basis of the average of the three completed years' profit before death. Profit for 2015, 2016 and 2017 were ₹ 66,000, ₹ 60,000 and ₹ 66,000 respectively.

Prepare the necessary ledger accounts and the balance sheet immediately after the death of Akash.

Solution

Dr. **Revaluation Account** **Cr.**

Particulars	₹	₹	Particulars	₹
To Stock A/c		1,000	By Plant and Machinery A/c	9,000
To Profit on revaluation transferred to				
Ramesh's capital A/c (3/8)	3,000			
Ravi's capital A/c (3/8)	3,000			
Akash's capital A/c (2/8)	2,000	**8,000**		
		9,000		9,000

Dr. **Capital Account** **Cr.**

Particulars	Ramesh ₹	Ravi ₹	Akash ₹	Particulars	Ramesh ₹	Ravi ₹	Akash ₹
To Akash's capital A/c	3,000	3,000		By Balance b/d	30,000	30,000	20,000
				By General reserve	3,000	3,000	2,000
				By Revaluation A/c (profit)	3,000	3,000	2,000
To Akash's Executor A/c			**34,000**	By Profit and loss suspense A/c			4,000
To Balance c/d	**33,000**	**33,000**		By Ramesh's capital A/c			3,000
				By Ravi's capital A/c			3,000
	36,000	36,000	34,000		36,000	36,000	34,000
				By Balance b/d	33,000	33,000	

Balance Sheet as on 31st December, 2018

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Plant and machinery	45,000	
Ramesh	33,000		Add: Appreciation	9,000	54,000
Ravi	33,000	66,000	Stock	22,000	
Akash's Executor's A/c		34,000	Less: Depreciation	1,000	21,000
Sundry creditors		8,000	Debtors		15,000
			Cash at bank		10,000
			Cash in hand		4,000
			Profit and loss suspense A/c		4,000
		1,08,000			1,08,000

Working notes:

(i) Profit sharing ratio

Profit sharing ratio = Capital ratio = 30,000: 30,000: 20,000 that is, 3:3:2

Gaining ratio between Ramesh and Ravi = Old profit sharing ratio = 3:3 that is 1:1

(ii) Calculation of Akash's share of current year's profit

$$\text{Average profit} = \frac{66,000+60,000+66,000}{3} = \frac{1,92,000}{3} = ₹\ 64,000$$

Current year's profit upto the date of death = 64,000 × 3/12 = ₹ 16,000

Akash's share of current year's profit = 16,000 × 2/8 = ₹ 4,000

(iii) Akash's share of goodwill = 24,000 × 2/8 = ₹ 6,000

It is to be borne by Ramesh and Ravi in the gaining ratio of 1:1

Points to remember

- On retirement of a partner, existing agreement comes to an end. The firm is reconstituted and other partners continue the partnership firm with a new agreement.
- The retiring partner is liable for all the acts which are carried out by the firm until the date of his retirement from the firm.
- At the time of retirement of a partner the accumulated profits and losses and reserves upto the date of retirement is to be distributed to all the partners in the old profit sharing ratio.
- When a partner retires from the partnership firm, the assets and liabilities are to be revalued and the profit or loss on revaluation is to be distributed to all the partners in the old profit sharing ratio.
- At the time of retirement of a partner, the continuing partners gain part of retiring partner's share of profit. Hence the retiring partner's share of goodwill is to be valued and adjusted through the capital accounts of the gaining partners.
- Gaining ratio is the proportion of the profit which is gained by the continuing partners. The share gained is new share minus old share.
- The amount due to the retiring partner may be settled by paying the entire amount due immediately in cash, or transfer the entire amount due to the loan account of the partner or by paying part of the amount immediately in cash and transferring the balance to the loan account of the partner.
- when a partner dies the amount due from the firm is paid to the executor or legal representative of the deceased partner.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. A partner retires from the partnership firm on 30th June. He is liable for all the acts of the firm up to the

(a) End of the current accounting period

(b) End of the previous accounting period

(c) Date of his retirement

(d) Date of his final settlement

2. On retirement of a partner from a partnership firm, accumulated profits and losses are distributed to the partners in the

(a) New profit sharing ratio
(b) Old profit sharing ratio

(c) Gaining ratio
(d) Sacrificing ratio

3. On retirement of a partner, general reserve is transferred to the

(a) Capital account of all the partners

(b) Revaluation account

(c) Capital account of the continuing partners

(d) Memorandum revaluation account

4. On revaluation, the increase in liabilities leads to

(a) Gain
(b) Loss

(c) Profit
(d) None of these

5. At the time of retirement of a partner, determination of gaining ratio is required

(a) To transfer revaluation profit or loss

(b) To distribute accumulated profits and losses

(c) To adjust goodwill

(d) None of these

6. If the final amount due to a retiring partner is not paid immediately, it is transferred to

(a) Bank A/c
(b) Retiring partner's capital A/c

(c) Retiring partner's loan A/c
(d) Other partners' capital A/c

7. 'A' was a partner in a partnership firm. He died on 31st March 2019. The final amount due to him is ₹ 25,000 which is not paid immediately. It will be transferred to

(a) A's capital account
(b) A's current account

(c) A's Executor account
(d) A's Executor loan account

8. A, B and C are partners sharing profits in the ratio of 2:2:1. On retirement of B, goodwill of the firm was valued as ₹ 30,000. Find the contribution of A and C to compensate B:

(a) ₹ 20,000 and ₹ 10,000 (b) ₹ 8,000 and ₹ 4,000

(c) ₹ 10,000 and ₹ 20,000 (d) ₹ 15,000 and ₹ 15,000

9. A, B and C are partners sharing profits in the ratio of 4:2:3. C retires. The new profit sharing ratio between A and B will be

(a) 4:3 (b) 3:4 (c) 2:1 (d) 1:2

10. X, Y and Z were partners sharing profits and losses equally. X died on 1st April 2019. Find out the share of X in the profit of 2019 based on the profit of 2018 which showed ₹ 36,000.

(a) ₹ 1,000 (b) ₹ 3,000 (c) ₹ 12,000 (d) ₹ 36,000

Answers

1 (c)	**2(b)**	**3(a)**	**4(b)**	**5 (c)**	**6(c)**	**7(d)**	**8(b)**	**9(c)**	**10(b)**

II. Very short answer questions

1. What is meant by retirement of a partner?
2. What is gaining ratio?
3. What is the purpose of calculating gaining ratio?
4. What is the journal entry to be passed to transfer the amount due to the deceased partner to the executor of the deceased partner?

III Short answer questions

1. List out the adjustments made at the time of retirement of a partner in a partnership firm.
2. Distinguish between sacrificing ratio and gaining ratio.
3. What are the ways in which the final amount due to an outgoing partner can be settled?

IV Exercises

Retirement of a partner

Distribution of accumulated profits, reserves and losses

1. Dheena, Surya and Janaki are partners sharing profits and losses in the ratio of 5:3:2. On 31.3.2018, Dheena retired. On the date of retirement, the books of the firm showed a reserve fund of ₹ 50,000. Pass journal entry to transfer the reserve fund.

(Answer: Reserve fund: Dheena: ₹ 25,000(Cr.); Surya: ₹ 15,000 (Cr.); Janaki: ₹ 10,000 (Cr.))

2. Rosi, Rathi and Rani are partners of a firm sharing profits and losses equally. Rathi retired from the partnership on 1.1.2018. On that date, their balance sheet showed accumulated loss of ₹ 45,000 on the asset side of the balance sheet. Give the journal entry to distribute the accumulated loss.

(Answer: Rosi: ₹ 15,000(Dr.); Rathi: ₹15,000 (Dr.); Rani: ₹ 15,000 (Dr.))

3. Akash, Mugesh and Sanjay are partners in a firm sharing profits and losses in the ratio of 3:2:1. Their balance sheet as on 31st March, 2017 is as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Buildings	1,10,000
Akash	40,000		Vehicle	30,000
Mugesh	60,000		Stock in trade	26,000
Sanjay	30,000	1,30,000	Debtors	25,000
Profit and loss appropriation A/c		12,000	Cash in hand	15,000
General reserve		24,000		
Workmen compensation fund		18,000		
Bills payable		22,000		
		2,06,000		2,06,000

Pass journal entry to transfer accumlatetd Profit and prepare the capital account of the partners

(Answer: Akash's capital: ₹ 67,000(Cr.); Mugesh's capital: ₹78,000 (Cr.); Sanjay's capital: ₹ 39,000 (Cr.))

Revaluation of assets and liabilities

4. Roja, Neela and Kanaga are partners sharing profits and losses in the ratio of 4:3:3. On 1st April 2017, Roja retires and on retirement, the following adjustments are agreed upon.

(i) Increase the value of building by ₹ 30,000.

(ii) Depreciate stock by ₹ 5,000 and furniture by ₹ 12,000.

(iii) Provide an outstanding liability of ₹ 1,000

Pass journal entries and prepare revaluation account.

(Answer: Revaluation profit: ₹ 12,000)

5. Vinoth, Karthi and Pranav are partners sharing profits and losses in the ratio of 2:2:1. Pranav retires from partnership on 1st April 2018. The following adjustments are to be made.

(i) Increase the value of land and building by ₹ 18,000

(ii) Reduce the value of machinery by ₹15,000

(iii) A provision would also be made for outstanding expenses for ₹ 8,000.

Give journal entries and prepare revaluation account.

(Answer: Revaluation loss: ₹ 5,000)

6. Chandru, Vishal and Ramanan are partners in a firm sharing profits and losses equally. Their balance sheet as on 31st March, 2018 is as follows:

Liabilities		₹	Assets		₹
Capital accounts:			Furniture		60,000
Chandru	60,000		Machinery		1,20,000
Vishal	70,000		Sundry debtors	33,000	
Ramanan	70,000	2,00,000	Less: Provision for		
Bills payable		80,000	doubtful debts	3,000	30,000
			Bills receivable		50,000
			Cash at bank		20,000
		2,80,000			2,80,000

Ramanan retired on 31st March 2019 subject to the following conditions:

(i) Machinery is valued at ₹ 1,50,000

(ii) Value of furniture brought down by ₹ 10,000

(iii) Provision for doubtful debts should be increased to ₹ 5,000

(iv) Investment of ₹ 30,000 not recorded in the books is to be recorded now.

Pass necessary journal entries and prepare revaluation account.

(Answer: Revaluation profit: ₹ 48, 000)

New profit sharing ratio and gaining ratio

7. Kayal, Mala and Neela are partners sharing profits in the ratio of 2:2:1. Kayal retires and the new profit sharing ratio between Mala and Neela is 3:2. Calculate the gaining ratio.

(Answer: Gaining ratio: 1:1)

8. Sunil, Sumathi and Sundari are partners sharing profits in the ratio of 3:3:4. Sundari retires and her share is taken up entirely by Sunil. Calculate the new profit sharing ratio and gaining ratio.

(Answer: Gaining ratio: 4:0; New ratio: 7:3)

9. Ramu, Somu, Gopu are partners sharing profits in the ratio of 3:5:7. Gopu retires and the share is purchased by Ramu and Somu in the ratio of 3:1. Find the new profit sharing ratio and gaining ratio.

(Answer: Gaining ratio: 3:1; New ratio: 11:9)

10. Navin, Ravi and Kumar are partners sharing profits in the ratio of 1/2, 1/4 and 1/4 respectively. Kumar retires and his share is taken up by Navin and Ravi equally. Calculate the new profit sharing ratio and gaining ratio.

(Answer: New ratio 5:3; Gaining ratio 1:1)

11. Mani, Gani and Soni are partners sharing the profits and losses in the ratio of 4:5:6. Mani retires from the firm. Calculate the new profit sharing ratio and gaining ratio.

(Answer: New profit sharing ratio and gaining ratio is 5:6)

Adjustment for goodwill

12. Rajan, Suman and Jegan were partners in a firm sharing profits and losses in the ratio of 4:3:2. Suman retired from partnership. The goodwill of the firm on the date of retirement was valued at ₹ 45,000. Pass necessary journal entries for goodwill on the assumption that the fluctuating capital method is followed.

(Answer: Suman's share of goodwill: ₹ 15,000; Rajan's capital: ₹ 10,000 (Dr.); Jegan's capital: ₹ 5,000 (Dr.))

13. Balu, Chandru and Nirmal are partners in a firm sharing profits and losses in the ratio of 5:3:2. On 31st March 2018, Nirmal retires from the firm. On the date of Nirmal's retirement, goodwill appeared in the books of the firm at ₹ 60,000. By assuming fluctuating capital account, pass the necessary journal entry if the partners decide to
    (a) write off the entire amount of existing goodwill
    (b) write off half of the existing goodwill.

(Answer: (a) Balu's capital: ₹ 30,000 (Dr.); Chandru's capital: ₹18,000 (Dr.); Nirmal's capital: ₹ 12,000 (Dr.)(b) Balu's capital: ₹ 15,000 (Dr.); Chandru's capital: ₹9,000 (Dr.); Nirmal's capital: ₹6,000 (Dr.))

Adjustment for current year's profit or loss upto the date of retirement

14. Rani, Jaya and Rathi are partners sharing profits and losses in the ratio of 2:2:1. On 31.3.2018, Rathi retired from the partnership. Profit of the preceding years is as follows: 2014: 10,000; 2015: ₹ 20,000; 2016: ₹ 18,000 and 2017: ₹ 32,000

Find out the share of profit of Rathi for the year 2018 till the date of retirement if

(a) Profit is to be distributed on the basis of the previous year's profit

(b) Profit is to be distributed on the basis of the average profit of the past 4 years

Also pass necessary journal entries by assuming partners capitals are fluctuating.

(Answer: (a) Rathi's share of profit: ₹ 1,600); (b) Rathi's share of profit: ₹ 1,000)

Settlement of amount due to the retiring partner

15. Kavin, Madhan and Ranjith are partners sharing profits and losses in the ratio of 4:3:3 respectively. Kavin retires from the firm on 31st December, 2018. On the date of retirement, his capital account shows a credit balance of ₹ 1,50,000. Pass journal entries if:

(a) The amount due is paid off immediately.

(b) The amount due is not paid immediately.

(c) ₹ 1,00,000 is paid and the balance in future.

(Answer: (a) Kavin's loan: Nil; (b) Kavin's loan: ₹ 1,50,000; (c) Kavin's loan: ₹ 50,000)

16. Manju, Charu and Lavanya are partners in a firm sharing profits and losses in the ratio of 5:3:2. Their balance sheet as on 31st March, 2018 is as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Buildings	1,00,000
Manju	70,000		Furniture	80,000
Charu	70,000		Stock	60,000
Lavanya	70,000	2,10,000	Debtors	40,000
Sundry creditors		40,000	Cash in hand	20,000
Profit and loss A/c		50,000		
		3,00,000		3,00,000

Manju retired from the partnership firm on 31.03.2018 subject to the following adjustments:

(i) Stock to be depreciated by ₹ 10,000

(ii) Provision for doubtful debts to be created for ₹ 3,000.

(iii) Buildings to be appreciated by ₹ 28,000

Prepare revaluation account and capital accounts of partners after retirement.

(Answer: Revaluation profit: ₹15, 000; Manju's loan account: ₹1,02,500(Cr.), Capital account: Charu: ₹89,500(Cr.); Lavanya: ₹ 83,000(Cr.))

Comprehensive problems

17. Kannan, Rahim and John are partners in a firm sharing profit and losses in the ratio of 5:3:2. The balance sheet as on 31st December, 2017 was as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Buildings	90,000
Kannan	1,00,000		Machinery	60,000
Rahim	80,000		Debtors	30,000
John	40,000	2,20,000	Stock	20,000
Workmen compensation			Cash at bank	50,000
fund		30,000	Profit and loss A/c (loss)	20,000
Creditors		20,000		
		2.70,000		2,70,000

John retires on 1st January 2018, subject to following conditions:

(i) To appreciate building by 10%

(ii) Stock to be depreciated by 5%.

(iii) To provide ₹1,000 for bad debts

(iv) An unrecorded liability of ₹8,000 have been noticed.

(v) The retiring partner shall be paid immediately.

Prepare revaluation account, partners' capital account and the balance sheet of the firm after retirement.

(Answer: Revaluation loss: ₹ 1,000; Capital account: Kannan: ₹ 1,04,500, Rahim: ₹ 82,700, Amount paid to John ₹41,800; Balance sheet total: ₹ 2,15,200)

18. Saran, Arun and Karan are partners in a firm sharing profits and losses in the ratio of 4:3:3. Their balance sheet as on 31.12.2016 was as follows:

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Buildings		60,000
Saran	60,000		Machinery		40,000
Arun	50,000		Investment		20,000
Karan	40,000	1,50,000	Stock		12,000
General reserve		15,000	Debtors	25,000	
			Less: Provision		
Creditors		35,000	Provision for bad debts	1000	24,000
			Cash at bank		44,000
		2,00,000			2,00,000

Karan retires on 1.1.2017 subject to the following conditions:

(i) Goodwill of the firm is valued at ₹ 21,000

(ii) Machinery to be appreciated by 10%

(iii) Building to be valued at ₹ 80,000

(iv) Provision for bad debts to be raised to ₹ 2,000

(v) Stock to be depreciated by ₹ 2,000

(vi) Final amount due to Karan is not paid immediately

Prepare the necessary ledger accounts and show the balance sheet of the firm after retirement.

(Answer: Revaluation profit: ₹ 21,000; Capital A/c: Saran: ₹ 70,800; Arun: ₹ 58,100; Karan's loan account: ₹ 57,100; Balance sheet total: ₹ 2,21,000)

19. Rajesh, Sathish and Mathan are partners sharing profits and losses in the ratio of 3:2:1 respectively. Their balance sheet as on 31.3.2017 is given below.

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Premises		4,00,000
Rajesh	4,00,000		Machinery		4,20,000
Sathish	3,00,000		Debtors		1,60,000
Mathan	2,50,000	9,50,000	Stock		3,00,000
General reserve		1,20,000	Cash at bank		20,000
Creditors		50,000			
Bills payable		1,80,000			
		13,00,000			13,00,000

Mathan retires on 31st March, 2017 subject to the following conditions:

(i) Rajsh and Sathish will share profits and losses in the ratio of 3:2

(ii) Assets are to be revalued as follows:
Machinery ₹ 3,90,000, Stock ₹ 2,90,000, Debtors ₹ 1,52,000.

(iii) Goodwill of the firm is valued at ₹ 1,20,000

Prepare necessary ledger accounts and the balance sheet immediately after the retirement of Mathan.

(Answer: Revaluation loss: ₹ 48,000; Mathan loan: A/c ₹ 2,82,000;
Rajesh's capital A/c: ₹ 4,24,000; Sathish capital A/c: ₹ 3,16,000;
Balance sheet total: ₹ 12,52,000)

Death of a partner

20. Janani, Janaki and Jamuna are partners sharing profits and losses in the ratio of 3:3:1 respectively. Janaki died on 31st December, 2017. Final amount due to her showed a credit balance of ₹ 1,40,000. Pass journal entries if,

(a) The amount due is paid off immediately.

(b) The amount due is not paid immediately.

(c) ₹ 75, 000 is paid and the balance in future.

21. Varsha, Shanthi and Madhuri are partners, sharing profits in the ratio of 5:4:3. Their balance sheet as on 31st December 2017 is as under:

Balance Sheet as on 31st December 2017

Liabilities	₹	₹	Assets	₹
Capital accounts:			Premises	1,20,000
Varsha	80,000		Stock	40,000
Shanthi	60,000		Debtors	50,000
Madhuri	20,000	1,60,000	Cash at bank	18,000
General reserve		48,000	Profit and loss A/c (loss)	12,000
Sundry creditors		32,000		
		2,40,000		2,40,000

On 1.1.2018, Madhuri died and on her death the following arrangements are made:

(i) Stock to be depreciated by ₹ 5,000

(ii) Premises is to be appreciated by 20%

(iii) To provide ₹4,000 for bad debts

(iv) The final amount due to Madhuri was not paid

Prepare revaluation account, partners' capital account and the balance sheet of the firm after death.

(Answer: Revaluation profit: ₹ 15,000;
Varsha's capital A/c: ₹ 1,01,250; Santhi's capital account: ₹ 77,000;
Madhuri's executors account: ₹ 32,750; Balance sheet total: ₹ 2,43,000)

22. Vijayan, Sudhan and Suman are partners who share profits and losses in their capital ratio. Their balance sheet as on 31.12.2018 is as follows:

Balance Sheet as on 31.12.2018

Liabilities	₹	₹	Assets	₹
Capital accounts:			Building	80,000
Vijayan	70,000		Stock	45,000
Sudhan	50,000		Debtors	25,000
Suman	30,000	1,50,000	Cash at bank	20,000
General reserve		18,000	Cash in hand	15,000
Creditors		17,000		
		1,85,000		1,85,000

Suman died on 31.3.2019. On the death of Suman, the following adjustments are made:

(i) Building is to be valued at ₹ 1,00,000

(ii) Stock to be depreciated by ₹ 5,000

(iii) Goodwill of the firm is valued at ₹ 36,000

(iv) Share of profit from the closing of the last financial year to the date of death on the basis of the average of the three completed years' profit before death.

Profit for 2016, 2017 and 2018 were ₹ 40,000, ₹ 50,000 and ₹ 30,000 respectively.

Prepare the necessary ledger accounts and the balance sheet immediately after the death of Suman.

(Answer: Revaluation profit ₹ 15,000;Vijayan's capital A/c: ₹ 81,200;
Sudhan's capital account: ₹ 58,000; Suman's executor's account: ₹ 45,800;
Balance sheet total: ₹ 2,02,000)

CASE STUDY Arun, Balu and Charan are partners in a partnership firm. After few years, Charan wanted to leave the firm because of his illness. The other two partners agreed on this. After making adjustments for reserves and revaluation of assets and liabilities, Charan's capital account showed a balance of ₹ 1,40,000. But, Arun and Balu paid ₹ 1,65,000 to Charan. After his retirement, one of the firm's customers filed a case against the firm, for the bad service provided by the firm.

Discuss on the following:

1. Apart from illness, what other reasons can be there for retirement?
2. What are the adjustments to be made in the accounts when Charan leaves the firm?
3. What could have been the cause for paying ₹ 1,65,000, instead of ₹ 1,40,000, to Charan?
4. If the firm did not have enough money to settle the amount due to Charan, what can be done?
5. Is Charan liable for the case filed by the customer?

To explore further

After a partner's death, if the remaining partners agreed to close down the partnership firm, what should be done?

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