

Revision Notes for CBSE Class 12 Accountancy Chapter 3, Reconstitution of a Partner- Retirement/Death of a Partner

Accounting Aspects Involved on Retirement or Death of a Partner

When a partner retires or dies, the following aspects of accounting are relooked at and changed:

- a) Ascertainment of new profit sharing ratio and gaining ratio
- b) Treatment of goodwill
- c) Revaluation of assets and liabilities
- d) Adjustment in respect of unrecorded assets and liabilities
- e) Distribution of accumulated profits and losses
- f) Ascertainment of share of profit or loss up to the date of retirement/death
- g) Adjustment of capital, if required
- h) Settlement of the amounts due to retired/deceased partner

New Profit Sharing Ratio

The ratio in which the remaining partners will share future profits after the retirement or death of any partner. Post retirement or death of a partner, the profit share of the existing partner will include his profit share along with the share gained from the profit of the deceased or retired partner.

New Profit Sharing Ratio of the Continuing Partner = Old Share + Acquired share from the Outgoing Partner

What is Gaining Ratio?

The ratio in which the continuing partners have acquired the share from the retiring/deceased partner is called the gaining ratio. Usually, the profit sharing ratio of he deceased partner is divided similarly to the old profit sharing ratio of the partners. In such a scenario, there is no need to calculate the gaining ratio. Mathematically,

Gaining Ratio = New Share - Old Share

Hidden Goodwill

The amount of goodwill given to the retired/deceased partner by paying him an excess of what his capital account holds is called as hidden goodwill. It is given by making necessary adjustments in respect of accumulated profits and losses and revaluation of assets and liabilities.

Treatment of Goodwill

Since goodwill is built by the joint effort of all the partners in a firm, the goodwill is compensated for the deceased/retiring partner int heir old profit sharing ratio.

When goodwill does not appear in the books

When goodwill does not appear in the books of the firm, credit is given to the retiring partner for the share in goodwill by debiting the goodwill account to gaining partners capital accounts (individually) in their gaining ratio.

Gaining Partners Capital A/c

Dr. (Individually)

To Retiring Partners Capital A/c

(Share in goodwill of retiring partner adjusted)

Adjustment for Revaluation of Assets and Liabilities

Sometimes it may happen that the assets of the retiring/deceased partner might not be written at their current values or the liabilities might not be written at the obligations fulfilled by the company or some assets/liabilities might have not made it to the journal. In all these cases, a revaluation account is prepared to keep a track of the missing assets/liabilities or calculate the revalued assets/liabilities, the same of which is transferred to the capital account of all the partners. Various journal entries passed in different situations are as follows:

• For increase in the value of assets

Assets A/c's (Individually) Dr.
To Revaluation A/c

(Increase in the value of assets)

For decrease in the value of assets

Revaluation A/c Dr.
To Assets A/c's (Individually)
(Decrease in the value of assets)

• For increase in the amount of liabilities

Revaluation A/c Dr.
To Liabilities A/c (Individually)

(Increase in the amount of liabilities)

For decrease in the amount of liabilities

Liabilities A/c's (Individually)

To Revaluation A/c
(Decrease in the amount of liabilities)

For an unrecorded asset

Assets A/c Dr.
To Revaluation A/c
(Unrecorded asset brought into book)

For an unrecorded liability

Revaluation A/c Dr.
To Liability A/c
(Unrecorded liability brought into books)

For distribution of profit or loss on revaluation

All Partners' Capital A/c's (Individually)

To Revaluation A/c

(Loss on revaluation transferred to partner's capital accounts)

Revaluation A/c

To All Partners' Capital A/c's (Individually)

(Profit on revaluation transferred to partner's capital)

Adjustment of Accumulated Profits and Losses

In case there is accumulated profits and losses, it has to be shared by all the partners including the retired/deceased partner in their old profit sharing ratio. The journal entries in this case are:

For transfer of accumulated profits (reserves)

Reserves A/c

To All Partners' Capital A/c's (Individually)
(Reserves transferred to all partners'
capital account's in old profit sharing ratio).

For transfer of accumulated losses

All Partners' Capital A/c's (Individually) Dr.
To Profit and Loss A/c
(Accumulated loss transferred to all partners' capital accounts in their old profit-sharing ratio)

When Partner Retires in the Middle of the Year

In this case the claim shall include share of profit or loss, interest on capital, interest on drawings if any, from the date of last balance sheet to the date of retirement

Disposal of Amount Due to Retiring Partner

The disposal of amount in the retiring account's partner is transferred as per the partnership deed in various installments or in a lump sum amount. In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive either interest @ 6% p.a. till the date of payment or such share of profits which has been earned with his/her money (i.e., based on capital ratio). Journal entries in this case are:

When retiring partner is paid cash in full

Retiring Partners' Capital A/c Dr. To Cash/Bank A/c

When retiring partner's whole amount is treated as loan

Retiring Partners' Capital A/c

Dr.

To Retiring Partners' Loan A/c

 When retiring partner is partly paid in cash and the remaining amount treated as loan

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Retiring Partners' Capital A/c	Dr.	(Total Amount due)
To Cash/Bank A/c		(Amount Paid)
To Retiring Partners' Loan A/c		(Amount of Loan)

When loan account is settled by paying in installment includes principal and interest

Dr.

a) For interest on loan

Interest A/c

To Retiring Partner's Loan A/c

b) For payment of instalment

Retiring Partner's Loan A/c Dr.

To Cash/Bank A/c

Adjustment of Partners' Capitals

During the retirement or death of a person, the continuing partners might decide to adjust their capital contributions in their profit sharing ratio. In such a situation, the sum of balances in the capitals of continuing partners may betreated as the total capital of the new firm, unless specified otherwise.

• For excess capital withdrawn by the partner

Partners' Capital A/c

Dr.

Dr.

To Cash / Bank A/c

 For amount of capital to be brought in by the partner Cash / Bank A/c
 Dr.

To Partners' Capital A/c

Death of a Partner

The accounting takes place in similar manner as retiring partner. However, the only difference between the two is that while the retirement normally takes place at the end of an accounting period, the death of apartner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any)from the date of the last Balance Sheet to the date of his death of these.

For being deceased partner's share of profits for the intervening period to books of account, the following journal entry is recorded.

(i) Profit and Loss (Supense) A/c
To Deceased Partner's Capital A/c
(Share of profit for the intervening period)

Later Profit and Loss Suspense account is closed by transferring the account to Gaining Partners' Capital Account in their gaining ratio. The journal entry is:

(ii) Gaining Partners Capital A/c [In gaining ratio] To Profit and Loss Suspense A/c (P&L Suspense account transferred).

Alternatively the following journal entry can also be passed in Place of (i) & (ii)

(ii) Gaining Partners' Capital A/c Di To Deceased Partner Capital A/c (share of profit of Deceased Partner credited)