Reconstitution of a Partnership Firm – Retirement/Death of a Partner

4

LEARNING OBJECTIVES

After Studying this chapter you will be able to:

- *calculate new profit sharing ratio and gaining ratio of the remaining partners after the retirement/death of a partner;*
- *describe the accounting treatment of goodwill in the event of retirement/death of a partner;*
- *explain the accounting treatment for revaluation of assets and reassessment of liabilities;*
- *make the necessary entries in respect of unrecorded assets and liabilities;*
- *make necessary adjustment for accumulated profits or losses;*
- *ascertain the retiring/deceased partner claim against the firm and explain the mode of its settlement;*
- *prepare the retiring partner's loan account, if required; and.*
- *Prepare the deceased partner's executor's account in the case of death of a partner and the balance sheet of a reconstituted firm.*

You have learnt that retirement or death of a partner also leads to reconstitution of a partnership firm. On the retirement or death of a partner, the existing partnership deed comes to an end, and in its place, a new partnership deed needs to be framed whereby, the remaining partners continue to do their business on changed terms and conditions. There is not much difference in the accounting treatment at the time of retirement or in the event of death. In both the cases, we are required to determine the sum due to the retiring partner (in case of retirement) and to the legal representatives (in case of deceased partner) after making necessary adjustments in respect of goodwill, revaluation of a assets and liabilities and transfer of accumulated profits and losses. In addition, we may also have to compute the new profit sharing's ratio among the remaining partners and so also their gaining ratio, This covers all these aspects in detail.

4.1 Ascertaining the Amount Due to Retiring/ Deceased Partner

The sum due to the retiring partner (in case of retirement) and to the legal representatives/ executors (in case of death) includes:

(i) credit balance of his capital account;
(ii) credit balance of his current account(if any);
(iii) his share of goodwill ;
(iv) his share of accumulated profits (reserves);
(v) his share in the gain of revaluation of assets and liabilities;

(vi) his share of profits up to the date of retirement/death;
(vii) interest on his capital, if involved, up to the date of retirement/death; and
(viii) salary/commission, if any, due to him up to the date of retirement/death.

The following deductions, if any, may have to be made from his share:

(i) debit balance of his current account(if any);
(ii) his share of goodwill to be written off; if necessary;
(iii) his share of accumulated losses;
(iv) his share of loss on revaluation of assets and liabilities;
(v) his share of loss up to the date of retirement/death;
(vi) his drawings up to the date of retirement/death;
(vii) interest on drawings, if involved, up to the date of retirement/death.

Thus, as in the case of admission, the various accounting aspects involved on retirement or death of a partner are as follows:

1. Ascertainment of new profit sharing ratio and gaining ratio;
2. Treatment of goodwill;
3. Revaluation of assets and liabilities;
4. Adjustment in respect of unrecorded assets and liabilities;
5. Distribution of accumulated profits and losses;
6. Ascertainment of share of profit or loss up to the date of retirement/death;
7. Adjustment of capital, if required;
8. Settlement of the amounts due to retired/deceased partner;

4.2 New Profit Sharing Ratio

New profit sharing ratio is the ratio in which the remaining partners will share future profits after the retirement or death of any partner. The new share of each of the remaining partner will consist of his own share in the firm plus the share acquired from the retiring /deceased partner.

Consider the following situations :

(a) normally, the continuing partners acquire the share of retiring or deceased partners in the old profit sharing ratio, and there is no need to compute the new profit sharing ratio among them, as it will be same as the old profit sharing ratio among them. In fact, in the absence of any information regarding profit sharing ratio in which the remaining partners acquire the share of retiring/deceased partner, it is assumed that they will acquire it in the old profit sharing ratio and so share the future profits in their old ratio. For example, Asha, Deepti and Nisha are partners in a firm sharing profits and losses in the ratio of 3:2:1. If Deepti retires, the new profit sharing ratio between Asha and Nisha will be 3:1, unless they decide otherwise.

(b) The continuing partners may acquire the share in the profits of the retiring/deceased partner in a proportion other than their old ratio, In that case, there is need to compute the new profit sharing ratio among them, and it will be equal to sum total of their respective old share and the share acquired from the retiring/deceased partner. *For example:* Naveen, Suresh and Tarun are partners sharing profits and losses in the ratio of 5:3:2. Suresh retires from the firm and his share was required by Naveen and Tarun in the ratio 2:1. In such a case, the new share of profit will be calculated as follows:

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

Gaining Ratio 2 : 1

Share acquired by Naveen $= \frac{2}{3} \text{ of } \frac{3}{10}$

$= \frac{2}{3} \quad \frac{3}{10} = \frac{2}{10}$

Share acquired by Tarun $= \frac{1}{3} \text{ of } \frac{3}{10}$

$= \frac{1}{3} \quad \frac{3}{10} = \frac{1}{10}$

Share of Naveen $= \frac{5}{10} + \frac{2}{10} = \frac{7}{10}$

Share of Tarun $= \frac{2}{10} + \frac{1}{10} = \frac{3}{10}$

Thus, the new profit sharing ratio of Naveen and Tarun will be = 7 : 3.

(c) The contributing partners may agree on a specified new profit sharing ratio: In that case the ratio so specified will be the new profit sharing ratio.

4.3 Gaining Ratio

The ratio in which the continuing partners have acquired the share from the retiring/deceased partner is called the gaining ratio. Normally, the continuing partners acquire the share of retiring/deceased partner in their old profit sharing ratio, In that case, the gaining ratio of the remaining partners will be the same as their old profit sharing ratio among them and there is no need to compute the gaining ratio, Alternatively, proportion in which they acquire the share of the retiring/deceased partner may be duly spacified. In that case, again, there is no need to calculate the gaining ratio as it will be the ratio in which they have acquired the share of profit from the retiring deceased partner. The problem of calculating gaining ratio arises primarily when the new profit sharing ratio of the continuing partners is specified. In such a situation, the gaining ratio should be calculated by, deducting the old share of each continuing partners from his new share. For example, Amit, Dinesh and Gagan are partners sharing profits in the ratio of 5:3:2.

Dinesh retires. Amit and Gagan decide to share the profits of the new firm in the ratio of 3:2. The gaining ratio will be calculated as follows :

Amit's Gaining Share $= \frac{3}{5} \quad \frac{5}{10} \quad \frac{6 \quad 5}{10} \quad \frac{1}{10}$

Gagan's Gaining Share $= \frac{2}{5} \quad \frac{2}{10} \quad \frac{4 \quad 2}{10} \quad \frac{2}{10}$

Thus, Gaining Ratio of Amit and Gagan = 1:2

This implies Amit gains $\frac{1}{3}$ and Gagan gains $\frac{2}{3}$ of Dinesh's share of profit.

Gaining share of Continuing Partner = New share – Old share

Do it Yourself

Distinguish between Gaining ratio and Sacrificing Ratio in terms of:

1. Meaning
2. Effect on Partner's Share of Profit
3. Mode of calculation
4. When to calculate

Illustration 1

Madhu, Neha and Tina are partners sharing profits in the ratio of 5:3:2. Calculate new profit sharing ratio and gaining ratio if

1. Madhu retires
2. Neha retires
3. Tina retires.

Solution

Given old ratio among Madhu : Neha : Tina as 5 : 3 : 2

1. If Madhu retires, new profit sharing Ratio between Neha and Tina will be
   Neha : Tina = 3:2 and Gaining Ratio of Neha and Tina =3:2
2. If Neha retires New profit sharing Ratio between Madhu and Tina will be
   Madhu : Tina = 5:2
   Gaining Ratio of Madhu and Tina = 5:2
3. If Tina retires, new profit sharing ratio between Madhu and Neha will be:
   Madhu : Neha = 5:3
   Gaining ratio of Madhu and Neha = 5:3

Illustration 2

Alka, Harpreet and Shreya are partners sharing profits in the ratio of 3:2:1. Alka retires and her share is taken up by Harpreet and Shreya in the ratio of 3:2. Calculate the new profit sharing ratio.

Solution

Gaining Given, Ratio of Harpreet and Shreya = 3:2 = $\frac{3}{5}:\frac{2}{5}$

Old Profit Sharing Ratio of between Alka, Harpreet and Shreya 3:2:1 = $\frac{3}{6}:\frac{2}{6}:\frac{1}{6}$

Share acquired by Harpreet = $\frac{3}{5}$ of $\frac{3}{6}$ = $\frac{9}{30}$

Share acquired by Shreya = $\frac{2}{5}$ of $\frac{3}{6}$ = $\frac{6}{30}$

New Share = Old Share + Acquired Share

Harpreet's New Share = $\frac{2}{6}$ $\frac{9}{30}$ $\frac{19}{30}$

Shreya's New Share = $\frac{1}{6}$ $\frac{6}{30}$ $\frac{11}{30}$

New Profit Sharing Ratio of Harpreet and Shreya = 19:11

Illustration 3

Murli, Naveen and Omprakash are partners sharing profits in the ratio of $\frac{3}{8}$, $\frac{1}{2}$ and $\frac{1}{8}$. Murli retires and surrenders 2/3rd of his share in favour of Naveen and the remaining share in favour of Omprakash. Calculate new profit sharing and the gaining ratio of the remaining partners.

Solution

			Naveen	*Omprakash*
(i)	Old Share		$\frac{1}{2}$	$\frac{1}{8}$
(ii)	Share Acquired by Naveen and Omprakash from Murli	=	$\frac{2}{3}$ of $\frac{3}{8}$ $\frac{2}{8}$	$\frac{1}{3}$ of $\frac{3}{8}$ $\frac{1}{8}$
(iii)	New Share = (i) + (ii)	=	$\frac{1}{2}$ $\frac{2}{8}$	$\frac{1}{8}$ $\frac{1}{8}$
		=	$\frac{6}{8}$ or $\frac{3}{4}$	= $\frac{2}{8}$ or $\frac{1}{4}$

Thus, the New profit sharing Ratio = $\frac{3}{4}:\frac{1}{4}$ or 3:1, and the

Gaining Ratio = $\frac{2}{8}:\frac{1}{8}$ or 2:1 [as calculated in (ii)].

Illustration 4

Kumar, Lakshya, Manoj and Naresh are partners sharing profits in the ratio of 3 : 2 : 1 : 4. Kumar retires and his share is acquired by Lakshya and Manoj in the ratio of 3:2. Calculate new profit sharing ratio and gaining ratio of the remaining partners.

Solution

		Lakshya	*Manoj*	*Naresh*
(i)	Old Share	$\frac{2}{10}$	$\frac{1}{10}$	$\frac{4}{10}$
(ii)	Acquired Share from Kumar	$\frac{3}{5}$ of $\frac{3}{10}$	$\frac{2}{5}$ of $\frac{3}{10}$	Nil
		$= \frac{9}{50}$	$= \frac{6}{50}$	Nil
(iii)	New share = (i) = (ii)	$\frac{2}{10} \quad \frac{9}{50}$	$= \frac{1}{10} \quad \frac{6}{50}$	$= \frac{4}{10}$ Nil
		$= \frac{19}{50}$	$= \frac{11}{50}$	$= \frac{20}{50}$

The New Profit Sharing Ratio is 19 : 11 : 20

Gaining ratio is 3 : 2 : 0

Notes : 1. Since Lakshya and Manoj are acquiring Kumar's share of profit in the ratio of 3:2, hence, the gaining ratio will be 3:2 between Lakshya and Manoj.

2. Naresh has neither sacrificed nor gained.

Illustration 5

Ranjana, Sadhna and Kamana are partners sharing profits in the ratio 4:3:2. Ranjana retires; Sadhna and Kamana decided to share profits in future in the ratio of 5:3. Calculate the Gaining Ratio.

Solution

Gaining Share = New Share – Old Share

Sadhna's Gaining Share = $\frac{5}{8} \quad \frac{3}{9} \quad \frac{45 \quad 24}{72} = \frac{21}{72}$

Kamana's Gaining Share = $\frac{3}{8} \quad \frac{2}{9} = \frac{27 \quad 16}{72} = \frac{11}{72}$

Gaining Ratio between Sadhna and Kamana = 21:11.

Do it Yourself

1. Anita, Jaya and Nisha are partners sharing profits and losses in the ratio of 1 : 1 : 1 Jaya retires from the firm. Anita and Nisha decided to share the profit in future in the ratio 4:3. Calculate the gaining ratio.
2. Azad, Vijay and Amit are partners sharing profits and losses in the proportion of $\frac{1}{4}, \frac{1}{8}$ and $\frac{10}{16}$. Calculate the new profit sharing ratio between continuing partners if (a) Azad retires; (b) Vijay retires; (c) Amit retires.
3. Calculate the gaining ratio in each of the above situations.
4. Anu, Prabha and Milli are partners. Anu retires. Calculate the future profit sharing ratio of continuing partners and gaining ratio if they agree to acquire her share : (a) in the ratio of 5:3; (b) equally.
5. Rahul, Robin and Rajesh are partners sharing profits in the ratio of 3 : 2 : 1. Calculate the new profit sharing ratio of the remaining partners if (i) Rahul retires; (ii) Robin retires; (iii) Rajesh retires.
6. Puja, Priya, Pratistha are partners sharing profits and losses in the ratio of 5 : 3 : 2. Priya retires. Her share is taken by Priya and Pratistha in the ratio of 2 : 1. Calculate the new profit sharing ratio.
7. Ashok, Anil and Ajay are partners sharing profits and losses in the ratio of $\frac{1}{2}, \frac{3}{10}$ and $\frac{1}{5}$. Anil retires from the firm. Ashok and Ajay decide to share future profits and losses in the ratio of 3 : 2. Calculate the gaining ratio.

4.4 Treatment of Goodwill

The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners. Hence, at the time of retirement/death of a partner, goodwill is valued as per agreement among the partners the retiring/ deceased partner compensated for his share of goodwill by the continuing partners (who have gained due to acquisition of share of profit from the retiring/ deceased partner) in their gaining ratio.

The accounting treatment for goodwill in such a situation depends upon whether or, not goodwill already appears in the books of the firm.

4.4.1 When Goodwill does not Appear in the Books

When goodwill does not appear in the books of the firm there are four ways in which the retiring partner can be given the necessary credit for loss of his share of goodwill, these are as follows:

(a) Goodwill is raised at its full value and retained in the books as such: In this case, Goodwill Account is debited will its full value and all the partner's (including the retired/deceased partner) capital accounts are credited in the old profit sharing ratio. The full value of goodwill will appear in the balance sheet of the reconstituted firm.

(b) Goodwill is raised at it's full value and written off immediately: If it-decided that goodwill should not be refrained and shown in the balance sheet of the reconstituted firm then, after raising goodwill at its value by crediting all the partners' capital accounts (including that of the retired/deceased partners, it should be written off by debiting the remaining partners in their new profit sharing ratio and crediting the goodwill account with its full value.

(c) Goodwill is raised to the extent of retired/deceased partner's share and written off immediately: In this case goodwill account is raised only to the extent of retired/deceased partner's share by debiting goodwill account with the proportionate amount and credited only to the retired/deceased partner's capital account. Thereafter, the remaining partners capital accounts are debited in their gaining ratio and goodwill account/credited to write it off.

(d) No goodwill account is raised at all in firm's books: If it is decided that the goodwill account should not appear in firm's books at all, in that case it is adjusted discretely through partners capital accounts by recording the following journal entry.

Continuing partners' capital A/c's	Dr.
(individually in their gaining ratio)	
To Retiring/Deceased Partner's Capital A/c	
(Retiring/deceased in the remaining partners' capital accounts into their gaining ratio)	

Let us take an example and clarity the treatment of goodwill on retirement or death of a partner using all the above alternatives. A, B. and C are partners in a firm sharing profits in the ratio of 3:2:1 B retires. The goodwill of the firm is valued at Rs. 60,000 and the remaining partners A and C continue to share profits in the ratio of 3:1. The journal entries passed under various alternatives shall be as follows:

(a) If goodwill is raised at full value and retained in books

Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all the partners in their old profit sharing ratio)			

(b) If goodwill is raised at full value and written off immediately.

(i) Goodwill A/c	Dr.	60,000	
To A's capital A/c			30,000
To B's capital A/c			20,000
To C's capital A/c			10,000
(Goodwill raised at full value and credited to all partners in old ratio)			
(ii) A's capital A/c	Dr.	45,000	
C's capital A/c	Dr.	15,000	
To Goodwill A/c			60,000
(Goodwill written off and debited to remaining partners in the new ratio)			

(c) If goodwill is raised to the extent of retiring partner's share and written off immediately.

(i) Goodwill A/c	Dr.	20,000	
To B's capital A/c			20,000
(Goodwill raised to the extant of B's share)			
(ii) A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To goodwill A/c			20,000
(Goodwill written off by debiting remaining partners' in gaining ratio)			

(d) If goodwill is not to after in firm's books at all

A's capital A/c	Dr.	15,000	
C's capital A/c	Dr.	5,000	
To C's capital A/c			20,000
(B's share of goodwill adjusted to remaining partners' capital accounts in gaining ratio)			

It may also happen that as a result of decision on the new profit sharing ratio among the remaining partners, a continuing partner may also sacrifice a part of his share in future profits. In such a situation his capital account will also be credited along with the retiring/deceased partner's capital account in proportion to his sacrifice and the other continuing partners' capital accounts will be debited based on their gain in the future profit ratio.

Illustration 6

Keshav, Nirmal and Pankaj are partners sharing profits and losses in the ratio of 4 : 3 : 2. Nirmal retires and the goodwill is valued at Rs. 72,000. Keshav and Pankaj decided to share future profits and losses in the ratio of 5 : 3. Record necessary journal entries (a) when goodwill is raised at its full value and written off immediately (b) when goodwill is not to appear in firms books at all.

Solution

(a) When Goodwill is raised and written-off

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
(i)	Goodwill A/c	Dr.		72,000	
	To Keshav's Capital A/c				32,000
	To Nirmal's Capital A/c				24,000
	To Pankaj's Capital A/c				16,000
	(Goodwill raised at its full value in old profit sharing ratio)				
(ii)	Keshav's Capital A/c	Dr.		45,000	
	Pankaj's capital A/c	Dr.		27,000	
	To Goodwill A/c				72,000
	(Goodwill written off in the new profit sharing ratio)				

(b) When goodwill is not to appear in firm's books at all

Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Keshav's Capital A/c	Dr.		13,000	
	Pankaj's Capital A/c	Dr.		11,000	
	To Nirmal's Capital A/c				24,000
	(Nirmal's share of goodwill adjusted to Keshav and Pankaj in their gaining ratio of 13:11)				

Working Notes

1. Vimal's share of goodwill = Rs. 72,000 $\frac{3}{9}$ = Rs. 24,000
2. Calculation of Gaining Ratio

   Gaining Share = New Share – Old Share

   Keshav's Gaining Share = $\frac{5}{8}$ $\frac{4}{9}$ $\frac{13}{72}$

   Pankaj's Gaining Share = $\frac{3}{8}$ $\frac{2}{9}$ $\frac{11}{72}$

   Hence, Gaining Ratio between Keshav and Pankaj is 13:11 i.e. $\frac{13}{24} : \frac{11}{24}$

Illustration 7

Jaya, Kirti, Ekta and Shewata are partners in a firm sharing profits and losses in the ratio of 2 : 1 : 2 : 1. On Jaya's retirement, the goodwill of the firm is valued at Rs. 36,000. Kirti, Ekta and Shewata decided to share future profits equally. Record the necessary journal entry for the treatment of goodwill without opening 'Goodwill Account'.

Solution

Books of Kirti, Ekta and Shewata
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Kirti's Capital A/c	Dr.		6,000	
	Shewata's Capital A/c	Dr.		6,000	
	To Jaya's Capital A/c				12,000
	(Jaya's share of goodwill adjusted to remaining in their gaining ratio)				

Working Notes

1. Jaya's Share of Goodwill

   = Rs. 36,000 $\frac{2}{6}$ = Rs. 12,000

2. Calculation of Gaining Ratio
   Gaining Share = New Share – Old Share

   Kirti's Gain = $\frac{1}{3}$ $\frac{1}{6}$ $\frac{2 \quad 1}{6}$ $\frac{1}{6}$

   Ekta's Gain = $\frac{1}{3}$ $\frac{2}{6}$ $\frac{2 \quad 2}{6}$ $\frac{0}{6}$ (Neither Gain nor Sacrifice)

   Shewata's Gain = $\frac{1}{3}$ $\frac{1}{6}$ $\frac{2 \quad 1}{6}$ $\frac{1}{6}$

   Hence, Gaining ratio between Kirti and Shewata $\frac{1}{6}:\frac{1}{6}$ = 1:1

Illustration 8

Deepa, Neeru and Shilpa were partners in a firm sharing profits in the ratio of 5 : 3 : 2. Neeru retired and the new profit sharing ratio between Deepa and Shilpa was 2 : 3. On Neeru's retirement, the goodwill of the firm was valued at Rs. 1,20,000. Record necessary journal entry for the treatment of goodwill on Neeru's retirement.

Solution

Books of Deepa and Shilpa
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Shilpa's Capital A/c Dr. To Neeru's Capital A/c To Deepa's Capital A/c (Shilpa compensated Neeru for her share of goodwill and to Deepa for the sacrifice made by her on Neeru's retirement)		48,000	36,000 12,000

Working Notes

1. Calculation of Gaining Ratio

   Gaining Share = New Share – Old Share

   Deepa's Gaining Share = $\frac{2}{5}$ $\frac{5}{10}$ $\frac{4\quad 5}{10}$ $\frac{1}{10}$ $\frac{1}{10}$ i.e., Sacrifice.

   Shilpa's Gaining Share = $\frac{3}{5}$ $\frac{2}{10}$ $\frac{6\quad 2}{10}$ $\frac{4}{10}$ i.e., Gain

2. Hence, Shilpa will compensate both Neeru (retiring partner) and Deepa (continuing partner who has sacrificed) to the extent of their sacrifice worked out as follows:

   Deepa's Sacrifice = Goodwill of the firm Sacrificing Share

   = Rs. 1,20,000 $\frac{1}{10}$ = Rs. 12,000

   Neeru's (Retiring Partner's Sacrifice) = Rs. 1,20,000 $\frac{3}{10}$ = Rs. 36,000.

Test your Understanding – I

Choose the correct option in the following questions:

1. Abhishek, Rajat and Vivek are partners sharing profits in the ratio of 5:3:2. If Vivek retires, the New Profit Sharing Ratio between Abhishek and Rajat will be–
   (a) 3:2
   (b) 5:3
   (c) 5:2
   (d) None of these
2. The old profit sharing ratio among Rajender, Satish and Tejpal were 2:2:1. The New Profit Sharing Ratio after Satish's retirement is 3:2. The gaining ratio is–
   (a) 3:2
   (b) 2:1
   (c) 1:1
   (d) 2:2

3. Anand, Bahadur and Chander are partners. Sharing Profit equally On Chander's retirement, his share is acquired by Anand and Bahadur in the ratio of 3:2. The New Profit Sharing Ratio between Anand and Bahadur will be–
   (a) 8:7
   (b) 4:5
   (c) 3:2
   (d) 2:3
4. In the absence of any information regarding the acquisition of share in profit of the retiring/deceased partner by the remaining partners, it is assumed that they will acquire his/her share:-
   (a) Old Profit Sharing Ratio
   (b) New Profit Sharing Ratio
   (c) Equal Ratio
   (d) None of these

Illustration 9

Hanny, Pammy and Sunny are partners sharing profits in the ratio of 3 : 2 : 1. Goodwill is appearing in the books at a value of Rs. 60,000. Pammy retires and at the time of Pammy's retirement, goodwill is valued at Rs. 84,000. Hanny and Sunny decided to share future profits in the ratio of 2:1. Record the necessary journal entries.

Solution

Books of Hanny and Sunny
Journal

Date	*Particulars*		*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Hanny's Capital A/c	Dr.		30,000	
	Pammy's Capital A/c	Dr.		20,000	
	Sunny's Capital A/c	Dr.		10,000	
	To Goodwill A/c				60,000
	(Existing goodwill written-off in old ratio)				
	Hanny's Capital	Dr.		14,000	
	Sunny's Capital	Dr.		14,000	
	To Pammy's Capital A/c				28,000
	(Pammy's share of goodwill adjusted to Hanny's and Sunny's capital account to the extent of their gain)				

Working Notes

(i) Pammy's share of current value of goodwill $\frac{1}{3}$ of Rs. 84,000

$$= 84,000 \times \frac{1}{3} = \text{Rs. } 28,000$$

(ii) Gaining Share = New Share – Old Share

Hanny's Gaining Share = $\frac{2}{3} \quad \frac{3}{6} \quad \frac{1}{6}$

Sunny's Gaining Share = $\frac{1}{3} \quad \frac{1}{6} \quad \frac{1}{6}$

This gaining Ratio of Hanny and Sunny is $\frac{1}{6} \quad \frac{1}{6} \quad 1:1$

4.4.2 When Goodwill is already Appearing in the Books

If value of goodwill already appearing in the books of the firm equals with the current value of goodwill, normally no adjustment is required because goodwill stands credited in the accounts of all the partners including the retiring one. In case the present value of goodwill is different from its book value, an adjustment entry is required for the difference between the value already appearing in the books (called book value) and its present value. In such a situation, there are two possibilities: (a) the book value of goodwill is lower than its current value, and (b) the book value is greater than its current value. These are discussed as follows.

(a) *If the book value of goodwill is lower than its present value :* In this case the goodwill is raised to its present value by debiting goodwill Account with the excess of its current value over the book value and crediting all partners' capital accounts in their old profit sharing ratio. For example, Deepak, Nakul and Rajesh are partners sharing profits in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20,000. Nakul retires and, on the day of Nakul's retirement, goodwill is valued at Rs. 24,000. In this case, the following journal entry will be recorded.

Books of Deepak, Nakul and Rajesh
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Goodwill A/c Dr.		4,000	
	To Deepak's Capital A/c			2,000
	To Nakul's Capital A/c			1,200
	To Rajesh's Capital A/c			800
	(Increase in the value of goodwill credited to all partners' capital accounts in their old profit sharing ratio of 5:3:2)			

(b) *If the book value of goodwill is greater than its current value:* In this case the difference between the book value of goodwill and its current value will be credited to Goodwill Account and debited to all Partners' capital accounts in their old profit sharing ratio. For example, Mohanlal, Girdharilal and Shyamlal are partners sharing profits in the ratio of 4:3:1. Shyamlal retires from the firm. On Shyamlal's retirement, goodwill has been valued at Rs. 52,000. There was a goodwill account already appearing in the books of the firm with a value of Rs. 60,000. In this case, the following journal entry will be recorded.

Books of Mohanlal, Girdharilal and Shyamlal
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Mohan Lal's Capital A/c Dr.		4,000	
	Girdhari Lal's Capital A/c Dr.		3,000	
	Shyam Lal's Capital A/c Dr.		1,000	
	To Goodwill A/c			8,000
	(Decrease in the value of goodwill adjusted among all the partners' capital accounts in their old profit sharing ratio)			

It may be noted that in all the above situations, goodwill appears in the balance sheet at its full value. In case it is decided by the partners that it should be written-off, fully or partially, it can be done by debiting the remaining partner's capital accounts in the new profit sharing ratio and crediting Goodwill Account with the respective value.

Alternatively, instead of first raising goodwill to its full value and then writing it off, if the partners so decide, we may first write off the existing goodwill as it appears in the book by debiting all partners in the old profit sharing ratio, and then give the necessary credit to the retiring/deceased partner by debiting the remaining partners capital accounts in their gaining ratio and crediting the retired/deceased partner by his share of goodwill. (See illustration 9)

4.4.3 Hidden Goodwill

If the firm has agreed to settle the retiring or deceased partner's account by paying him a lump sum amount, then the amount paid to him in excess of what is due to him, based on the balance in his capital account after making necessary adjustments in respect of accumulated profits and losses and revaluation of assets and liabilities, etc., shall be treated as his share of goodwill (known as hidden goodwill). For example, P, Q and R are partners in a firm sharing profits in the ratio of 3:2:1. R retires, and the balance in his capital account after making necessary adjustments on account of reserves, revolution of assets and liabilities works-out to be Rs. 60,000, P and Q agreed to pay him Rs. 75,000 in full settlement of his claim. It implies that Rs. 15,000 is R's share of goodwill of the firm. This will be debits to the capital accounts of P and Q in their gaining ratio (3:2 assuming no change in their own profit sharing ratio) and crediting R's capital Account as follows:

			Rs.	*Rs.*
	P's Capital A/c Dr. Q's Capital A/c Dr. To R's Capital A/c (R's share of goodwill adjusted in P's and Q's capital accounts in their gaining ratio of 3:2)		9,000 6,000	 15,000

Test your Understanding – II

Choose the correct option in the following questions:

1. On retirement/death of a partner, the retiring/deceased partner's capital account will be credited with
   (a) his/her share of goodwill.
   (b) goodwill of the firm.
   (c) shares of goodwill of remaining partners.
   (d) none of these.
2. Gobind, Hari and Pratap are partners. On retirement of Gobind, the goodwill already appears in the Balance Sheet at Rs. 24,000. The goodwill will be written-off
   (a) by debiting all partners' capital accounts in their old profit sharing ratio.
   (b) by debiting remaining partners' capital accounts in their new profit sharing ratio.
   (c) by debiting retiring partners' capital accounts from his share of goodwill.
   (d) none of these.
3. Chaman, Raman and Suman are partners sharing profits in the ratio of 5:3:2. Raman retires, the new profit sharing ratio between Chaman and Suman will be 1:1. The goodwill of the firm is valued at Rs. 1,00,000 Raman's share of goodwill will be adjusted
   (a) by debiting Chaman's Capital account and Suman's Capital Account with Rs 15,000 each.
   (b) by debiting Chaman's Capital account and Suman's Capital Account with Rs. 21,429 and 8,571 respectively.
   (c) by debiting only Suman's Capital Account with Rs. 30,000.
   (d) by debiting Raman's Capital account with Rs. 30,000.
4. On retirement/death of a partner, the remaining partner(s) who have gained due to change in profit sharing ratio should compensate the
   (a) retiring partners only.
   (b) remaining partners (who have sacrificed) as well as retiring partners.
   (c) remaining partners only (who have sacrificed).
   (d) none of these.

4.5 Adjustment for Revaluation of Assets and Liabilities

At the time of retirement or death of a partner there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm. Not only that, there may be some unrecorded assets and liabilities which need to be brought into books. As learnt in case of admission of a partner, a Revaluation Account is prepared in order to ascertain net gain (loss) on revaluation of assets and/or liabilities and bringing unrecorded items into firm's books and the same is transferred to the capital account of all partners including retiring/deceased partners in their old profit sharing ratio. the Journal entries to be passed for this purpose are as follows:

1. *For increase in the value of assets*

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

2. *For decrease in the value of assets*

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

3. *For increase in the amount of liabilities*

   Revaluation A/c Dr.
   To Liabilities A/c (Individually)
   (Increase in the amount of liabilities)

4. *For decrease in the amount of liabilities*

   Liabilities A/c's (Individually) Dr.
   To Revaluation A/c
   (Decrease in the amount of liabilities)

5. *For an unrecorded asset*

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

6. *For an unrecorded liability*

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

7. *For distribution of profit or loss on revaluation*

   Revaluation A/c Dr.
   To All Partners' Capital A/c's (Individually)
   (Profit on revaluation transferred to partner's capital)

(or)

All Partners' Capital A/c's (Individually) Dr.
To Revaluation A/c
(Loss on revaluation transferred to partner's capital accounts)

Illustration 10

Mitali, Indu and Geeta are partners sharing profits and losses in the ratio of 3 : 2 : 1 respectively. On March 31, 2012, their Balance Sheet was as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		55,000	Goodwill	25,000
Reserve Fund		30,000	Buildings	1,00,000
Capital Accounts:			Patents	30,000
Mitali	1,50,000		Machinery	1,50,000
Indu	1,25,000		Stock	50,000
Geeta	75,000	3,50,000	Debtors	40,000
			Cash	40,000
		4,35,000		**4,35,000**

Geeta retires on the above date. It was agreed that Machinery be valued at Rs.1,40,000; Patents at Rs. 40,000; and Buildings at Rs. 1,25,000. Record the necessary journal entries and prepare the Revaluation Account.

Solution

Books of Mitali and Indu
Journal

Date 2012	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
Mar. 31	Revaluation A/c Dr.		10,000	
	To Machinery A/c			10,000
	(Decrease in the value of machinery)			
	Patents A/c Dr.		10,000	
	Buildings A/c Dr.		25,000	
	To Revaluation A/c			35,000
	(Increase in the value of patents and buildings)			
	Revaluation A/c Dr.		25,000	
	To Mitali's Capital A/c			12,500
	To Indu's Capital A/c			7,500
	To Geeta's Capital A/c			5,000
	(Profit on revaluation transferred to all partner's capital accounts in old profit sharing ratio)			

Revaluation Account

Dr. *Cr.*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Machinery		10,000	Patents	10,000
Profit transferred to:			Buildings	25,000
Mitali's Capital A/c	12,500			
Indu's Capital A/c	7,500			
Geeta's Capital A/c	5,000	25,000		
		35,000		**35,000**

4.6 Adjustment of Accumulated Profits and Losses

Sometimes, the Balance Sheet of a firm may show accumulated profits in the form of general reserve on reserve fund and/on accumulated losses in the form of profit and loss account debit balance. The retiring/deceased partner is entitled to his/her share in the accumulated profits and is also liable to share the accumulated losses, if any. These accumulated profits or losses belong to all the partners and should be transferred to the capital accounts of all partners in their old profit sharing ratio. The following journal entries are recorded for the purpose.

(i) *For transfer of accumulated profits (reserves),*

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

(ii) *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)

For example; Inder, Gajender and Harinder are partners sharing profits in the ratio of 3 : 2 : 1. Inder retires and the Balance Sheet of the firm on that date was as follows:

Books of Inder, Gajinder and Harinder
Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		50,000	Land and Building	3,00,000
General Reserve		90,000	Stock	30,000
Capital Accounts:			Bank	10,000
Inder	1,00,000		Cash	5,000
Gajender	55,000			
Harinder	50,000	2,05,000		
		3,45,000		**3,45,000**

The journal entry to record the treatment of general reserve will be as follows :

Books of Gajender and Harinder
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2007 Mar. 31	General Reserve A/c Dr. To Inder's Capital A/c To Gajender's Capital A/c To Harinder's Capital A/c (General Reserves transferred to all partners' capital accounts in the old ratio on Inder's retirement)		90,000	 45,000 30,000 15,000

4.7 Disposal of Amount Due to Retiring Partner

The outgoing partner's account is settled as per the terms of partnership deed i.e., in lumpsum immediately or in various instalments with or without interest as agreed or partly in cash immediately and partly in installment at the agreed intervals. 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). Hence, the total amount due to the retiring partner which is ascertained after all adjustments have been made is to be paid immediately to the retiring partner. In case the firm is not in a position to make the payment immediately, the amount due is transferred to the retiring Partner's Loan Account, and as and when the amount is paid it is debited to his account. The necessary journal entries recorded are as follows.

1. *When retiring partner is paid cash in full.*

   Retiring Partner's Capital A/c Dr.
   To Cash/Bank A/c

2. *When retiring partner's whole amount is treated as loan.*

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

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

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

4. When Loan account is settled by paying in instalment includes principal and interest.

   a) For interest on loan
      Interest A/c Dr.
        To Retiring Partner's Loan A/c
   b) For payment of instalment
      Retiring Partner's Loan A/c Dr.
        To Cash/Bank A/c

Note:
1. The balance of the retiring partner's loan account is shown on the liabilities side of the Balance Sheet till the last instalment is paid to him/her.
2. Entry number (b) and (c), above will be repeated till the loan is paid off.

Illustration 11

Amrinder, Mahinder and Joginder are partners in a firm. Mahinder retires from the firm. On his date of retirement, Rs. 60,000 becomes due to him. Amrinder and Joginder promise to pay him in instalments every year at the end of the year. Prepare Mahinder's Loan Account in the following cases:
1. When payment is made four yearly instalments plus interest @ 12% p.a. on the unpaid balance.
2. When they agree to pay three yearly instalments of Rs. 20,000 including interest @ 12% p.a on the outstanding balance during the first three years and the balance including interest in the fourth year.
3. When payment is made in 4 equal yearly instalment's including interest @ 12% p.a. on the unpaid balance.

Solution

(a) When payment is made in four yearly instalments plus interest

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank (15,000+7,200)		22,200	Year-1	Mahinder Capital		60,000
	Balance c/d		45,000		Interest		7,200
			67,200				**67,200**

Year-II	Bank (15,000+5,400)		20,400	Year-II	Balance b/d		45,000
					Interest		5,400
	Balance c/d		30,000				
			50,400				**50,400**
Year-III	Bank (15,000+3,600)		18,600	Year-III	Balance b/d		30,000
					Interest		3,600
	Balance c/d		15,000				
			33,600				**33,600**
Year-IV	Bank (15,000+1,800)		16,800	Year-IV	Balance b/d		15,000
					Interest		1,800
			16,800				**16,800**

(b) When payment is made in three yearly installments of Rs. 20,000 each including interest.

Books of Amrinder, Mahinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		20,000	Year-I	Mohan's Capital		60,000
	Balance c/d		47,200		Interest		7,200
			67,200				**67,200**
Year-II	Bank		20,000	Year-II	Balance b/d		47,200
	Balance c/d		32,864		Interest		5,664
			52,864				**52,864**
Year-III	Bank		20,000	Year-III	Balance b/d		32,864
	Balance c/d		16,808		Interest		3,944
			36,808				**36,808**
Year-IV	Bank		18,825	Year-IV	Balance b/d		16,808
					Interest		2,017
			18,825				**18,825**

(c) When payment is made in four equal yearly instalments including interest @12% (Annually).

Books of Amrinder and Joginder
Mahinder's Loan Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
Year-I	Bank		19,754	Year-I	Mohinder's Capital		60,000
	Balance c/d		47,446		Interest		7,200
			67,200				**67,200**
Year-II	Bank		19,754	Year-II	Balance b/d		47,446
	Balance c/d		33,386		Interest		5,694
			53,140				**53,140**
Year-III	Bank		19,754	Year-III	Balance b/d		33,386
	Balance c/d		17,638		Interest		4,006
			37,392				**37,392**
Year-IV	Bank		19,754	Year-IV	Balance b/d		17,638
					Interest		2,116
			19,754				**19,754**

Note: The annual instalment of payment in 4 years @ 12% interest works out at Rs. 19,754 (Annually of Rs. 0.329234 as per Annually Table x 60,000).

It may noted that the accounting treatment for disposal of amount due to retiring partner and deceased partner is similar with a difference that in case of death of a partner, the amount credited to him/her is transferred to his Executors' Account and the payment has to be made to him/her. This shall be taken up later in this chapter.

Do it Yourself

Vijay, Ajay and Mohan are friends. They passed B. Com. (Hons) from Delhi University in June, 2013. They decided to start the business of computer hardware.

On Ist of August, 2013, they introduced the capital of Rs. 50,000, Rs. 30,000 and Rs. 20,000 respectively and started the business in partnership at Delhi. The profit sharing ratio decided between there was 4:2:1. The business was running successfully. But on Ist February, 2019, due to certain unavoidable circumstances and family circumstances, Ajay decided to settle in Pune and decided to retire from the partnership on 31st March, 2020; with the consent of partners, Ajay retires as on 31st March, 2020, the position of assets and liabilities are as follows:

Contd...

Contd...

Balance Sheet of Vijay, Ajay and Mohan as on March 31, 2013

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital Accounts :			Goodwill	56,000
Vijay	1,80,000		Stock	90,000
Ajay	1,20,000		Debtors	66,000
Mohan	1,00,000	4,00,000	Land and Buildings	1,20,000
Bills Payable		12,000	Machinery	1,59,000
General Reserve		42,000	Motor Van	31,000
Creditors		90,000	Cash at bank	22,000
		5,44,000		**5,44,000**

On the date of retirement, the following adjustments were to be made:

1. Firm's goodwill was valued at Rs. 1,48,000.
2. Assets and Liabilities are to be valued as under: Stock Rs. 72,000; Land and Buildings Rs. 1,35,600; Debtors Rs. 63,000; Machinery Rs. 1,50,000; Creditors Rs. 84,000.
3. Vijay to bring Rs. 1,20,000 and Mohan Rs. 30,000 as additional capital.
4. Ajay was to be paid Rs. 97,200 in cash and the balance of his Capital Account to be transferred to his Loan Account Work out the amount due to Ajay and state as to how will you settle his account ?

Illustration 12

The Balance Sheet of Ashish, Suresh and Lokesh who were sharing profits in the ratio of 5 : 3 : 2, is given below as on March 31, 2013.

Balance Sheet of Ashish, Suresh and Lokesh
As on March 31, 2013

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capitals:			Land	4,00,000
Shyam	7,20,000		Building	3,80,000
Gagan	4,15,000		Plant & Machinery	4,65,000
Ram	3,45,000	14,80,000	Furniture & Fittings	77,000
Reserve Fund		1,80,000	Stock	1,85,000
Sundry Creditors		1,24,000	Sundry Debtors	1,72,000
Outstanding Expresses		16,000	Cash in hand	1,21,000
		18,00,000		**18,00,000**

Suresh retires on the above date and the following adjustments are agreed upon his retirement.

1. Stock was valued at Rs. 1,72,000.
2. Furniture and fittings were valued at Rs. 80,000.

3. An amount of Rs. 10,000 due from Mr. Deepak, a debtor, was doubtful and a provision for the same was required.
4. Goodwill of the firm was valued at Rs. 2,00,000 but it was decided not to show goodwill in the books of accounts.
5. Suresh was paid Rs. 40,000 immediately on retirement and the balance was transferred to his loan account.
6. Ashish and Lokesh were to share future profits in the ratio of 3:2.
   Prepare Revaluation Account, Capital Account and Balance Sheet of the reconstituted firm.

Solution

Books of Ashish, Suresh and Lokesh
Revaluation Account

Dr. *Cr.*

Particulars	*Amount (Rs.)*	*Particulars*		*Amount (Rs.)*
Stock	13,000	Furniture		3,000
Provision for Doubtful Debt	10,000	(Loss on Revaluation transferred to :		
		Ashish's capital	10,000	
		Suresh's capital	6,000	
		Lokesh's capital	4,000	20,000
	23,000			**23,000**

Partners' Capital Accounts

Dr. *Cr.*

Date 2013	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*	*Date 2013*	*Particulars*	*J.F.*	*Ashish (Rs.)*	*Suresh (Rs.)*	*Lokesh (Rs.)*
Mar.31	Revaluation (Loss)		10,000	6,000	4,000	Mar.31	Bal. b/d		7,20,000	4,15,000	3,45,000
	Suresh's Capital Goodwill		20,000		40,000		Reserve fund		90,000	54,000	36,000
	Cash			40,000			Ashish's Capital			20,000	
	Suresh's Loan			4,83,000			Lokesh's Capital			40,000	
	Balance c/d		7,80,000		3,37,000						
			8,10,000	**5,29,000**	**3,81,000**				**8,10,000**	**5,29,000**	**3,81,000**

Balance Sheet of Ashish and Lokesh as on April 01, 2013

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Capitals :			Land		4,00,000
Ashish	7,80,000		Buildings		3,80,000
Lokesh	3,37,000	11,17,000	Plant and Machinery		4,65,000
Suresh's Loan		4,83,000	Furniture		80,000
Sundry Creditors		1,24,000	Stock		1,72,000
Outstanding Expresses		16,000	Sundry Debtors	1,72,000	
			Less: Provision for Doubtful Debts	10,000	1,62,000
			Cash (Rs. 1,21,000–Rs. 40,000)		81,000
		17,40,000			**17,40,000**

Working Notes

1. Share Gained = New Share – Old Share

   Ashish's Gain $= \frac{3}{5} - \frac{5}{10} = \frac{6-5}{10} = \frac{1}{10}$

   Lokesh's Gain $= \frac{2}{5} - \frac{2}{10} = \frac{4-2}{10} = \frac{2}{10}$

   Gaining Ratio between Ashish and Lokesh = 1 : 2,

2. Suresh's Share of Goodwill = $\frac{3}{10} \times$ Rs. 2,00,000 = Rs. 60,000

Illustration 13

Shyam, Gagan and Ram are partners sharing profit in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2013 are as under:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Reserves		14,500	Debtors	19,000
Capital:			Stock	42,000
Shyam	80,000		Machinery	85,000
Gagan	62,500		Building	1,22,000
Ram	75,000	2,17,500	Patents	9,000
Employees' Provident Fund		4,000		
		2,85,000		**2,85,000**

As Gagan got a very good break at an MNC, so he decided to retire on that date and it was decided that Shyam and Ram would share the future profits in the ratio of 5 : 3. Goodwill was valued at Rs. 70,000; Machinery at Rs. 78,000; Buildings at Rs. 1,52,000; stock at Rs. 30,000; and bad debts amounting to Rs. 1,550 were to be written off. Record journal entries in the books of the firm and prepare the Balance Sheet of the new firm.

Solution

Books of Shyam, Ram and Gagan
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
2013 Mar. 31	Revaluation A/c Dr.		20,550	
	To Machinery A/c			7,000
	To Stock A/c			12,000
	To Debtors A/c			1,550
	(Loss on revaluation of assets recorded on Gagan's retirement)			
	Building A/c Dr.		30,000	
	To Revaluation A/c			30,000
	(Appreciation in the value of Building on Gagan's retirement)			
	Revaluation A/c Dr.		9,450	
	To Shyam's Capital A/c			3,780
	To Gagan's Capital A/c			3,780
	To Ram's Capital A/c			1,890
	(Profit on revaluation transferred to partners' capital accounts in the ratio of 2 : 2 : 1)			
	Reserve A/c Dr.		14,500	
	To Shyam's Capital A/c			5,800
	To Gagan's Capital A/c			5,800
	To Ram's Capital A/c			2,900
	(Reserve transferred to partner's capital accounts)			
	Shyam's Capital A/c Dr.		15,750	
	Ram's Capital A/c Dr.		12,250	
	To Gagan's Capital A/c			28,000
	(Gagan's share of goodwill adjusted to Shyam and Ram in their gaining ratio of 9 : 7)			
	Gagan's Capital A/c Dr.		1,00,080	
	To Gagan's Loan A/c			1,00,080
	(Amount payable to retiring partner transferred to his loan account)			

Balance Sheet of Shyam and Ram as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		49,000	Cash	8,000
Employees' Provident Fund		4,000	Debtors	17,450
Capitals :			Stock	30,000
Shyam	73,830		Machinery	78,000
Ram	67,540	1,41,370	Building	1,52,000
Gagan's Loan		1,00,080	Patents	9,000
		2,94,450		**2,94,450**

Working Notes

Share Gained = New Share – Old Share

Shyam's Gain $= \frac{5}{8} - \frac{2}{5} = \frac{25 - 16}{40} = \frac{9}{40}$

Ram's Gain $= \frac{3}{8} - \frac{1}{5} = \frac{15 - 8}{40} = \frac{7}{40}$

Therefore, Gaining Ratio of Shyam and Ram = 9 : 7.

Revaluation Account

Dr. *Cr.*

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Machinery		7,000	Building	30,000
Stock		12,000	Debtors	1,550
(Profit on Revaluation)				
Transfer to Capital				
Shyam	3,780			
Gagan	3,780			
Ram	1,890	9,450		
		30,000		**30,000**

Partners' Capital Accounts

Date 2013	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*	*Date 2013*	*Particulars*	*J.F.*	*Shyam (Rs.)*	*Gagan (Rs.)*	*Ram (Rs.)*
Mar.31	Gagan's Capital		15,750		12,250	Mar.31	Bal. b/d		80,000	62,500	75,000
	Gagan's Loan			1,00,080			Revaluation		3,780	3,780	1,890
	Bal. c/d		73,830		67,540		Profit Reserve		5,800	5,800	2,900
							Shyam's Capital			15,750	
							Ram's Capital			12,250	
			89,580	**1,00,080**	**79,790**				**89,580**	**1,00,080**	**79,790**

Note: As sufficient balance is not available to pay the due amount to Gagan, the balance in his capital account is transferred to his loan account.

4.8 Adjustment of Partners' Capitals

At the time of retirement or death of a partner, the remaining partners may 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 be treated as the total capital of the new firm, unless specified otherwise. Then, to ascertain the new capital of the continuing partners, the total capital of the firm is divided amongst the remaining partners as per the new profit sharing ratio, and the excess or deficiency of capital in the individual capital account's may be worked out. Such excess or shortage shall be adjusted by withdrawal of contribution in cash, as the case may be, for which the following journal entries will be recorded.

(i) For excess capital withdrawn by the partner :

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

(ii) For amount of capital to be brought in by the partner:

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

Consider the following situations:
The adjustment of the continuing partner's capitals may involve any one of the three ways as illustrated as follows :

1. When the capital of the new firm as decided by the partners is specified.

Illustration 14

Mohit, Neeraj and Sohan are partners in a firm sharing profits in the ratio of 2 : 1 : 1. Neeraj retires and Mohit and Sohan decided that the capital of the new firm will be fixed at Rs. 1,20,000. The capital accounts of Mohit and Sohan show a credit balance of Rs. 82,000 and Rs. 41,000 respectively after making all the adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries.

Solution

The New Profit Sharing Ratio between Mohit and Sohan = 2 : 1

	Mohit	*Sohan*
New Capital based new ratio is	80,000	40,000
Existing Capital (after adjustments) is	82,000	41,000
Cash to be brought in on (Paid off)	2,000	1,000

Books of Mohit and Sohan
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Mohit's Capital A/c Dr. Sohan's Capital A/c Dr. To Cash A/c (Excess capital withdrawn by Sohan)		2,000 1,000	 3,000

2. When the total capital of new firm is not specified.

Illustration 15

Asha, Deepa and Lata are partners in a firm sharing profits in the ratio of 3 : 2 : 1. Deepa retires. After making all adjustments relating to revaluation, goodwill and accumulated profit etc., the capital accounts of Asha and Lata showed a credit balance of Rs. 1,60,000 and Rs. 80,000 respectively. It was decided to adjust the capitals of Asha and Lata in their new profit sharing ratio. You are required to calculate the new capitals of the partners and record necessary journal entries for bringing in or withdrawal of the necessary amounts involved.

Solution

a. Calculation of new capitals of the existinging partners

Balance in Asha's Capital (after all adjustments)	= 1,60,000
Balance in Lata's Capital	= 80,000
Total Capital of the New Firm	= 2,40,000

Based on the new profit sharing ratio of 2:1

Asha's New Capital = Rs. $2,40,000 \times \frac{3}{4}$ = 1,80,000

Lata's New Capital = Rs. $2,40,000 \times \frac{1}{4}$ = 60,000

Note :The total capital of the new firm is based on the sum of the balance in the capital accounts of the continuing partners.

b. Calculation of cash to be brought in or withdrawn by the continuing partners :

	Asha (Rs.)	*Lata (Rs.)*
New Capitals	1,80,000	60,000
Existing Capitals	1,60,000	80,000
c. Cash to be brought in on (paid off)	20,000	20,000

Books of Asha and Lata
Journal

Date	*Particulars*	*L.F.*	*Debit Amount (Rs.)*	*Credit Amount (Rs.)*
	Cash A/c Dr. To Asha Capital A/c (Cash brought by Asha)		20,000	 20,000
	Lata's Capital A/c Dr. To Cash A/c (Surplus capital withdrawn by Lata)		20,000	 20,000

3. When the amount payable to retiring partner will be contributed by continuing partners in such a way that their capitals are adjusted proportionate to their new profit sharing ratio:

Illustration 16

Lalit, Pankaj and Rahul are partners sharing profits in the ratio of 4 : 3 : 3. After all adjustments, on Lalit's retirement with respect to general reserve, goodwill and revaluation etc., the balances in their capital accounts stood at Rs. 70,000, Rs. 60,000 and Rs. 50,000 respectively. It was decided that the amount payable to Lalit will be brought by Pankaj and Rahul in such a way as to make their capitals proportionate to their profit sharing ratio. Calculate the amount to be brought by Pankaj and Rahul and record necessary journal entries for the same. Also record necessary entry for payment to Lalit.

After Lalit's retirement, the new profit sharing ratio between Pankaj and Rahul is 3 : 3, i.e. 1 : 1.

Solution

a. *Calculation of total capital of the new firm*

Balance in Pankaj's Capital account (after adjustment)	=	60,000
Balance in Rahul's Capital account (after adjustment)	=	50,000
Amount payable to Lalit (Retiring partner)	=	70,000
Total capital of new firm (i) + (ii) + (iii)	=	1,80,000

b. *Calculation of new capitals of the continuing partners*

Pankaj's New Capital $= \text{Rs. } 1,80,000 \times \frac{1}{2}$ = Rs. 90,000

Rahul's New Capital $= \text{Rs. } 1,80,000 \times \frac{1}{2}$ = Rs. 90,000

c. *Calculation of the amounts to be brought in or withdrawn by the continuing partners*

	Pankaj (Rs.)	Rahul (Rs.)
New Capital (Rs. 1,80,000 in the ratio of 1 : 1)	90,000	90,000
Existing capital (after adjustment)	60,000	50,000
Cash to be brought in	30,000	40,000

Books of Pankaj and Rahul
Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Cash A/c	Dr.	70,000	
	To Pankaj's Capital A/c			30,000
	To Rahul's Capital A/c			40,000
	(Amounts brought by Pankaj and Rahul)			
	Lalit's Capital A/c	Dr.	70,000	
	To Cash A/c			70,000
	(Amount paid to Lalit on retirement)			

Illustration 17

The Balance Sheet of Mohit, Neeraj and Sohan who are partners in a firm sharing profits according to their capitals as on March 31, 2007 was as under:

Liabilities	Amount (Rs.)	Assets		Amount (Rs.)
Creditors	21,000	Buildings		1,00,000
Mohit's Capital	80,000	Machinery		50,000
Neeraj's Capital	40,000	Stock		18,000
Sohan's Capital	40,000	Debtors	20,000	
General Reserve	20,000	*Less:* Provision for Bad Debt	1,000	19,000
		Cash at bank		14,000
	2,01,000			**2,01,000**

On that date, Neeraj decided to retire from the firm and was paid for his share in the firm subject to the following:

1. Buildings to be appreciated by 20%.
2. Provision for Bad debts to be increased to 15% on Debtors.
3. Machinery to be depreciated by 20%.
4. Goodwill of the firm is valued at Rs. 72,000 and the retiring partner's share is adjusted through the capital accounts of remaining partners.

5. The capital of the new firm be fixed at Rs. 1,20,000.

Prepare Revaluation Account, Capital Accounts of the partners, and the Balance Sheet after retirement of B.

Solution

Revaluation Account

Dr. *Cr.*

Particulars		*Amount (Rs.)*	*Particulars*	*Amount (Rs.)*
Provision for Doubtful Debt		2,000	Building	20,000
Machinery		10,000		
Capital (Profit on Revaluation)				
Mohit	4,000			
Neeraj	2,000			
Sohan	2,000	8,000		
		20,000		**20,000**

Dr. **Partners' Capital Accounts** *Cr.*

Date 2007	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*	*Date 2007*	*Particulars*	*J.F.*	*Mohit (Rs.)*	*Neeraj (Rs.)*	*Sohan (Rs.)*
Mar.31	Neeraj's		12,000		6,000	Mar.31	Bal. b/d		80,000	40,000	40,000
	Balance c/d		82,000	65,000	41,000		General Reserve		10,000	5,000	5,000
							Revaluation (Profit)		4,000	2,000	2,000
							Mohit's Capital			12,000	
							Sohan's Capital			6,000	
			94,000	**65,000**	**47,000**				**94,000**	**65,000**	**47,000**
	Bank			65,000			Bal. b/d		82,000	65,000	41,000
	Bank		2,000		1,000						
	Bal. c/d (1)		80,000		40,000						
			82,000	**65,000**	**41,000**				**82,000**	**65,000**	**41,000**

Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Creditors		21,000	Building		1,20,000
Bank overdraft		54,000	Machinery		40,000
Capital			Stock		18,000
Mohit	80,000		Debtors	20,000	
Sohan	40,000	1,20,000	*Less:* Provision for Doubtful Debts (1,000+2,000)	3,000	17,000
		1,95,000			**1,95,000**

Working Notes

1. **Bank Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d		14,000		Mohit's Capital		2,000
	Balance c/d (overdraft)		54,000		Sohan's Capital		1,000
					Neeraj's Capital		65,000
			68,000				**68,000**

2. It is assumed that bank overdraft is taken to pay the retiring partners.
3. Cash to be brought in or withdrawn by Mohit and Sohan :

		Mohit (Rs.)	*Sohan (Rs.)*
(a)	New capitals (Rs.1,20,000 in the ratio of 2:1)	80,000	40,000
(b)	Existing capital (after adjustments) as calculated	82,000	41,000
	Cash to be brought (paid off)	2,000	1,000

Do it Yourself

1. The Balance Sheet of A, B and C who were sharing the profits in proportion to their capitals stood as on March 31, 2007.

Balance Sheet as on March 31, 2007

Liabilities	*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable	6,250	Land and Building		12,000
Sundry Creditors	10,000	Debtors	10,500	
Reserve Fund	2,750	*Less* Provision for bad debts	500	10,000
Capitals		Bill receivables		7,000
A 20,000		Stock		15,500
B 15,000		Plant and Machinery		11,500
C 15,000	50,000	Cash at bank		13,000
	69,000			69,000

B retired on the date of Balance Sheet and the following adjustments were to be made:

(a) Stock was depreciated by 10%.

(b) Factory building was appreciated by 12%.

(c) Provision for doubtful debts to be created up to 5%.

(d) Provision for legal charges to be made at Rs.265.

(e) The goodwill of the firm to be fixed at Rs.10,000.

(f) The capital of the new firm to be fixed at Rs.30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3:2.

Work out the final balances in capital accounts of the firm, and the amounts to be brought in and/or withdrawn by A and C to make their capitals proportionate to then new profit sharing ratio.

2. R, S and M were carrying on business in partnership sharing profits in the ratio of 3:2:1, respectively. On March 31, 2011, Balance Sheet of the firm stood as follows :

Balance Sheet as on March 31, 2011

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Building	23,000
Capitals:			Debtors	7,000
R	20,000		Stock	12,000
S	7,500		Patents	8,000
M	12,500	40,000	Bank	6,000
		56,000		**56,000**

Shyam retired on the above mentioned date on the following terms :

(a) Buildings to be appreciated by Rs.8,800.

(b) Provision for doubtful debts to be made @ 5% on debtors.

(c) Goodwill of the firm to be valued at Rs.9,000.

(d) Rs.5,000 to be paid to S immediately and the balance due to him to be treated as a loan carrying interest @ 6% per annum.

Prepare the balance sheet of the reconstituted firm.

4.9 Death of a Partner

As stated earlier, the accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner 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, the main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet and the date of the partner's death. Since, it is considered cumbersome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

For example, Bakul, Champak and Darshan were partners in a firm sharing profits in the ratio of 5:4:1. The profit of the firm for the year ending on March 31, 2006 was Rs.1,00,000. Champak dies on June 30, 2006. Champak's share of profit for the period from April 1 to June 30, 2006, shall be calculated as follows:

Total profit for the year ending on 31st March, 2006 = Rs.1,00,000

Champak's share of profit :

Proceeding Year's Profit $\times$ Proportionate Period $\times$ Share of Deceased Partner

$$= \text{Rs. } 1{,}00{,}000 \times \frac{3}{12} \times \frac{4}{10} = \text{Rs. } 10{,}000$$

The journal entry will be recorded as follows :

Profit & Loss Suspense A/c	Dr.	10,000	
To Champak's Capital A/c			10,000
(Champak's share of profit transferred to his capital account)			

Alternatively, if Champak's share of profit was to be calculated on the basis of average profits of the last three years. Which were Rs. 1,36,000 for 2003-04, Rs. 1,54,000 for 2004-05 and Rs. 1,00,000 for 2005-06; Chambers share of profits for the period from April 7, 2006 to June 30, 2006 shall be calculated on the basis of average profit based on profits for the last year calculation as follows:

$$\text{Average Profit} = \frac{\text{Total Profit}}{\text{No. of years}} = \frac{\text{Rs. } 1{,}36{,}000 + \text{Rs. } 1{,}54{,}000 + \text{Rs. } 1{,}00{,}000}{3}$$

$$= \frac{\text{Rs. } 3{,}90{,}000}{3} = \text{Rs. } 1{,}30{,}000$$

$$\text{Champak's share of profit} = \text{Rs. } 1{,}30{,}000 \times \frac{3 \text{ months}}{12 \text{ months}} \times \frac{4}{10}$$

$$= \text{Rs. } 13{,}000$$

In case, the agreement provides, that share of profit of the deceased partner will be worked out on the basis of sales, and it is specified that the sales during the year 2005-06 were Rs. 8,00,000 and the sales from April 1, 2006 to June

30, 2006 were Rs. 1,50,000 Champak's share of profits for the period from April 1, 2006 to June 30, 2006 shall be calculated as follows.

If sale is Rs.8,00,000, the profit	= Rs.1,00,000
If sale is Rs.1, the profit	$= \dfrac{1,00,000}{8,00,000}$
If sale is Rs.1,50,000, the profit	$= \dfrac{1,00,000}{8,00,000} \times 1,50,000$
	= Rs. 18,750
Champak's share of profit	= Rs. 7,500

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

Profit and Loss Account

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

Illustration 18

Anil, Bhanu and Chandu were partners in a firm sharing profits in the ratio of 5:3:2. On March 31, 2012, their Balance Sheet was as under:

Books of Anil, Bhanu and Chandu
Balance Sheet as on March 31, 2012

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		11,000	Buildings	20,000
Reserve Fund		6,000	Machinery	30,000
Anil's Capital	30,000		Stock	10,000
Bhanu's Capital	25,000		Patents	11,000
Chandu's Capital	15,000	70,000	Debtors	8,000
			Cash	8,000
		87,000		**87,000**

Anil died on October 1, 2012. It was agreed between his executors and the remaining partners that :

(a) Goodwill to be valued at $2\frac{1}{2}$ year's purchase of the average profits of the previous four years which were :

Year 2003-04 – Rs.13,000, Year 2004-05 – Rs. 12,000,
Year 2005-06 – Rs.20,000, Year 2006-07 – Rs.15,000

(b) Patents be valued at Rs.8,000; Machinery at Rs.28,000; and Building at Rs.25,000.
(c) Profit for the year 2007-08 be taken as having accrued at the same rate as that of the previous year.
(d) Interest on capital be provided at 10% p.a.
(e) Half of the amount due to Anil be paid immediately.

Prepare Anil's Capital Account and Anil's Executor's Account as on October 1, 2012.

Solution

Books of Anil, Bhanu and Chander
Anil's Capital Account

Dr. *Cr.*

Date 2012	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2012*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Anil's Executors		57,000	April,1	Balance b/d		30,000
				Oct. 1	Reserve Fund		3,000
					Bhanu's Capital		11,250
					Chandu's Capital		7,500
					Profit & Loss (Suspense)		3,750
					Interest on Capital		1,500
			57,000				**57,000**

Anil's Executor's Account

Dr. *Cr.*

Date 2012	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2012*	*Particulars*	*J.F.*	*Amount (Rs.)*
Oct.1	Bank		28,500	Oct.1	Anil's Capital		57,000
	Balance c/d		28,500				
			57,000				**57,000**

Working Notes

1. **Revaluation Account**

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Patents		3,000		Building		5,000
	Machinery		2,000				
			5,000				**5,000**

2. Goodwill = 2½ years' purchase × Average Profit

$$\text{Average Profit} = \frac{\text{Rs. } 13{,}000 + \text{Rs.}12{,}000 + \text{Rs.}20{,}000 + \text{Rs.}15{,}000}{4}$$

$$= \frac{\text{Rs. } 60{,}000}{4} = \text{Rs. } 15{,}000$$

$$\text{Goodwill} = \frac{5}{2} \times \text{Rs. } 15{,}000$$

$$= \text{Rs. } 37{,}500$$

$$\text{Anil's Share of Goodwill} = \frac{5}{10} \times \text{Rs. } 37{,}500$$

$$= \text{Rs. } 18{,}750$$

3. Profit from the date of last balance sheet to date of death (April 1, 2007 to October 1, 2007) = 6 months

$$\text{Profit for 6 months} = \text{Rs. } 15{,}000 \times \frac{6}{12} = \text{Rs. } 7{,}500$$

$$\text{Anil's share of profit} = \text{Rs. } 7{,}500 \times \frac{5}{10} = \text{Rs. } 3{,}750$$

4. Interest on Capital (April 1, 2007 to October 1, 2007)

$$= \text{Rs. } 30{,}000 \times \frac{10}{100} \times \frac{6}{12}$$

$$= \text{Rs.} 1{,}500$$

Illustration 19

You are given the Balance Sheet of Mohit, Sohan and Rahul who are partners sharing profits in the ratio of 2 : 2 : 1, as on March 31, 2012.

Books of Mohit, Sohan and Rahul
Balance Sheet as on March 31, 2012.

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		40,000	Goodwill	30,000
Reserve Fund		25,000	Fixed assets	60,000
Capitals:			Stock	10,000
Mohit	30,000		Sundry Debtors	20,000
Sohan	25,000		Cash at bank	15,000
Rahul	15,000	70,000		
		1,35,000		**1,35,000**

Sohan died on June 15, 2012. According to the Deed, his legal representatives are entitled to:

(a) Balance in Capital Account;

(b) Share of goodwill valued on the basis of thrice the average of the past 4 years' profits.

(c) Share in profits up to the date of death on the basis of average profits for the past 4 years.

(d) Interest on capital account @ 12% p.a.

Profits for the years ending on March 31 of 2009, 2010, 2011, 2012 respectively were Rs. 15,000, Rs. 17,000, Rs. 19,000 and Rs. 13,000.

The firm had taken a Joint Life Policy of Rs. 1,25,000, the annual premium being charged to profit & loss account every year.

Sohan's legal representatives were to be paid the amount due. Mohit and Rahul continued as partner by taking over Sohan's share equally. Work out the amount payable to Sohan's legal representatives.

Solution

Books of Mohit, Sohan and Rahul
Sohan's Capital Account

Dr. *Cr.*

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date 2007*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Goodwill		12,000	Apr. 1	Balance b/d		25,000
	Sohan's Executor		94,158	Jun.15	Reserve Fund		10,000
					Mohit's Capital		9,600
					Rahul's Capital		9,600
					Profit & Loss (Suspense)		1,333
					Joint life policy		50,000
					Interest on Capital		625
			1,06,158				**1,06,158**

Working Notes

1. Sohan's Share of Goodwill

$$= \text{Goodwill of the Firm} \times \frac{2}{5}$$

$$= \text{Rs. } 48,000 \times \frac{2}{5} = \text{Rs. } 19,200$$

Goodwill of the Firm $= 3 \times$ Average Profit

$$= 3 \times \frac{\text{Rs. } 64,000}{4} = \text{Rs. } 48,000$$

2. Profit and Loss (Suspense)

(Share of Profit from the date of last Balance Sheet to the date of death) $2\frac{1}{2}$ months.

$= \frac{\text{Rs. } 64{,}000}{4} \times \frac{2}{5} \times \frac{2.5}{12}$

= Rs. 1,333

3. Joint Life Policy = Rs. 1,25,000

Sohan's Share $= \frac{2}{5} \times$ Rs. 1,25,000

= Rs. 50,000

4. Interest on Capital $= \text{Rs. } 25{,}000 \times \frac{12}{100} \times \frac{2.5}{12}$

= Rs. 625

Do it Yourself

On December 31, 2007, the Balance Sheet of Pinki, Qureshi and Rakesh showed as under :

Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		25,000	Buildings	26,000
Reserve Fund		20,000	Investments	15,000
Capitals:			Debtors	15,000
Pinki	15,000		Bills Receivables	6,000
Qureshi	10,000		Stock	12,000
Rakesh	10,000	35,000	Cash	6,000
		80,000		**80,000**

The partnership deed provides that the profit be shared in the ratio of 2:1:1 and that in the event of death of a partner, his executors be entitled to be paid out :

(a) The capital of his credit at the date of last Balance Sheet.
(b) His proportion of reserves at the date of last Balance Sheet.
(c) His proportion of profits to the date of death based on the average profits of the last three completed years, plus 10%, and
(d) By way of goodwill, his proportion of the total profits for the three preceding years. The net profit for the last three years were :

	(Rs.)
2005	16,000
2006	16,000
2007	15,400

Rakesh died on April 1, 2007. He had withdrawn Rs.5,000 to the date of his death. The investment were sold at par and R's Executors were paid off. Prepare Rakesh's Capital Account that of his executors.

Terms Introduced in the Chapter

- Retirement of a Partner.
- Death of a Partner.
- Gaining Ratio
- Executors of deceased Partner
- Executor's Account.

Summary

1. *New Profit Sharing Ratio:* New profit sharing ratio is the ratio in which the remaining partner will share future profits after the retirement or death of any partner.

   New Share = Old Share + Acquired Share from the Outgoing partner
2. *Gaining Ratio:* Gaining ratio is the ratio in which the continuing partners have acquired the share from the retiring deceased partner.
3. *Treatment of Goodwill:* The basic rule is that gaining partner(s) shared compensate the sacrificing partner to the extent of their gain for the respective share of goodwill.

   If goodwill already appears in the books, it will be written off by debiting all partner's capital account in their old profit sharing ratio.
4. *Revaluation of Assets and Liabilities*: At the time of retirement/death of a partner, there may be some assets which may not have been shown at their current values. Similarly, there may be certain liabilities which have been shown at a value different from the obligation to be met by the firm.

   Besides this, there may be unrecorded assets and liabilities which have to be recorded.
5. *Accumulated Profits or Losses:* The reserves (Accumulated profits) or losses belong to all the partners and should be transferred to capital account of all partners.

   6. Retiring partner/deceased partner may be paid in one lump sum or installments with interest.
7. At the time of retirement/death of a partner, the remaining partner may decide to keep their capital contributions in their profit sharing ratio.

Question for Practice

Short Answer Questions

1. What are the different ways in which a partner can retire from the firm.
2. Write the various matters that need adjustments at the time of retirement of a partners.
3. Distinguish between sacrificing ratio and gaining tab.

4. Why do firm revaluate assets and reassers their liabilities on retirement or on the event of death of a partner.
5. Why a retiring/deceased partner is entitled to a share of goodwill of the firm.

Long Answer Questions

1. Explain the modes of payment to a retiring partner.
2. How will you compute the amount payable to a deceased partner?
3. Explain the treatment of goodwill at the time of retirement or on the event of death of a partner?
4. Discuss the various methods of computing the share in profits in the event of death of a partners.

Numerical Questions

1. Aparna, Manisha and Sonia are partners sharing profits in the ratio of 3 : 2 : 1. Manisha retires and goodwill of the firm is valued at Rs. 1,80,000. Aparna and Sonia decided to share future in the ratio of 3 : 2. Pass necessary journal entries.

   (**Ans :** Dr. Aparna's Capital A/c by Rs. 18,000, Dr. Sonia's Capital A/c by Rs. 42,000, Dr. Manisha's Capital A/c by Rs. 60,000).
2. Sangeeta, Saroj and Shanti are partners sharing profits in the ratio of 2 : 3 : 5. Goodwill is appearing in the books at a value of Rs. 60,000. Sangeeta retires and goodwill is valued at Rs. 90,000. Saroj and Shanti decided to share future profits equally. Record necessary journal entries.
3. Himanshu, Gagan and Naman are partners sharing profits and losses in the ratio of 3 : 2 : 1. On March 31, 2007, Naman retires.

   The various assets and liabilities of the firm on the date were as follows:

   Cash Rs. 10,000, Building Rs. 1,00,000, Plant and Machinery Rs. 40,000, Stock Rs. 20,000, Debtors Rs. 20,000 and Investments Rs. 30,000.

   The following was agreed upon between the partners on Naman's retirement:
   (i) Building to be appreciated by 20%.
   (ii) Plant and Machinery to be depreciated by 10%.
   (iii) A provision of 5% on debtors to be created for bed and doubtful debts.
   (iv) Stock was to be valued at Rs. 18,000 and Investment at Rs. 35,000.

   Record the necessary journal entries to the above effect and prepare the revaluation account.
4. Naresh, Raj Kumar and Bishwajeet are equal partners. Raj Kumar decides to retire. On the date of his retirement, the Balance Sheet of the firm showed the following: General Reserves Rs. 36,000 and Profit and Loss Account (Dr.) Rs. 15,000.

   Pass the necessary journal entries to the above effect.

5. Digvijay, Brijesh and Parakaram were partners in a firm sharing profits in the ratio of 2 : 2 : 1. Their Balance Sheet as on March 31, 2007 was as follows:

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors	49,000	Cash	8,000
Reserves	18,500	Debtors	19,000
Digvijay's Capital	82,000	Stock	42,000
Brijesh's Capital	60,000	Buildings	2,07,000
Parakaram's Capital	75,500	Patents	9,000
	2,85,000		**2,85,000**

Brijesh retired on March 31, 2007 on the following terms:

(i) Goodwill of the firm was valued at Rs. 70,000 and was not to appear in the books.

(ii) Bad debts amounting to Rs. 2,000 were to be written off.

(iii) Patents were considered as valueless.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of Digvijay and Parakaram after Brijesh's retirement.

(**Ans :** Loss on Revaluation Rs. 11,000, Balance of Capital Accounts: Digvijay Rs. 66,333 and Parakaram Rs. 67,667, Balance Sheet Total Rs. 2,74,000).

6. Radha, Sheela and Meena were in partnership sharing profits and losses in the proportion of 3:2:1. On April 1, 2007, Sheela retires from the firm. On that date, their Balance Sheet was as follows:

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Trade Creditors		3,000	Cash-in-Hand	1,500
Bills Payable		4,500	Cash at Bank	7,500
Expenses Owing		4,500	Debtors	15,000
General Reserve		13,500	Stock	12,000
Capitals:			Factory Premises	22,500
Radha	15,000		Machinery	8,000
Sheela	15,000		Losse Tools	4,000
Meena	15,000	45,000		
		70,500		**70,500**

The terms were:

a) Goodwill of the firm was valued at Rs. 13,000.

b) Expenses owing to be brought down to Rs. 3,750.

c) Machinery and Loose Tools are to be valued at 10% less than their book value.

d) Factory premises are to be revalued at Rs. 24,300.

Prepare:
1. Revaluation account
2. Partner's capital accounts and
3. Balance sheet of the firm after retirement of Sheela.

(**Ans :** Profit on Revaluation Rs. 1,350, Balance of Capital Accounts: Radha Rs. 19,050 and Meena Rs. 16,350, Balance Sheet Total = Rs. 71,100).

7. Pankaj, Naresh and Saurabh are partners sharing profits in the ratio of 3 : 2 : 1. Naresh retired from the firm due to his illness. On that date the Balance Sheet of the firm was as follows:

Books of Pankaj, Naresh and Saurabh
Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
General Reserve		12,000	Bank		7,600
Sundry Creditors		15,000	Debtors	6,000	
Bills Payable		12,000	*Less:* Provision for Doubtful Debt	400	5,600
Outstanding Salary		2,200			
Provision for Legal Damages		6,000	Stock		9,000
Capitals:			Furniture		41,000
Pankaj	46,000		Premises		80,000
Naresh	30,000				
Saurabh	20,000	96,000			
		1,43,200			**1,43,200**

Additional Information

(i) Premises have appreciated by 20%, stock depreciated by 10% and provision for doubtful debts was to be made 5% on debtors. Further, provision for legal damages is to be made for Rs. 1,200 and furniture to be brought up to Rs. 450.

(ii) Goodwill of the firm be valued at Rs. 42,000.

(iii) Rs. 26,000 from Naresh's Capital account be transferred to his loan account and balance be paid through bank; if required, necessary loan may be obtained form Bank.

(iv) New profit sharing ratio of Pankaj and Saurabh is decided to be 5 : 1.

Give the necessary ledger accounts and balance sheet of the firm after Naresh's retirement.

(**Ans :** Profit or Revaluation Rs. 18,000, Balance of Capital Account of Pankaj, Rs. 47,000 and of Saurabh, Rs. 25,000).

(Total Amount at Credit in Naresh's Capital = Rs. 54,000, Balance Sheet Total = Rs. 1,54,800).

8. Puneet, Pankaj and Pammy are partners in a business sharing profits and losses in the ratio of 2 : 2 : 1 respectively. Their balance sheet as on March 31, 2007 was as follows:

Books of Puneet, Pankaj and Pammy
Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		1,00,000	Cash at Bank	20,000
Capital Accounts:			Stock	30,000
Puneet	60,000		Sundry Debtors	80,000
Pankaj	1,00,000		Investments	70,000
Pammy	40,000	2,00,000	Furniture	35,000
Reserve		50,000	Buildings	1,15,000
		3,50,000		**3,50,000**

Mr. Pammy died on September 30, 2007. The partnership deed provided the following:

(i) The deceased partner will be entitled to his share of profit up to the date of death calculated on the basis of previous year's profit.

(ii) He will be entitled to his share of goodwill of the firm calculated on the basis of 3 years' purchase of average of last 4 years' profit. The profits for the last four financial years are given below:
for 2003–04; Rs. 80,000; for 2004–05, Rs. 50,000; for 2005–06, Rs. 40,000; for 2006–07, Rs. 30,000.
The drawings of the deceased partner up to the date of death amounted to Rs. 10,000. Interest on capital is to be allowed at 12% per annum.
Surviving partners agreed that Rs. 15,400 should be paid to the executors immediately and the balance in four equal yearly instalments with interest at 12% p.a. on outstanding balance.
Show Mr. Pammy's Capital account, his Executor's account till the settlement of the amount due.

(**Ans :** Total amount due is Rs. 75,400)

9. Following is the Balance Sheet of Prateek, Rockey and Kushal as on March 31, 2007.

Books of Prateek, Rockey and Kushal
Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		16,000	Bills Receivable	16,000
General Reserve		16,000	Furniture	22,600
Capital Accounts:			Stock	20,400
Prateek	30,000		Sundry Debtors	22,000
Rockey	20,000		Cash at Bank	18,000
Kushal	20,000	70,000	Cash in Hand	3,000
		1,02,000		**1,02,000**

Rockey died on June 30, 2007. Under the terms of the partnership deed, the executors of a deceased partner were entitled to:

a) Amount standing to the credit of the Partner's Capital account.

b) Interest on capital at 5% per annum.

c) Share of goodwill on the basis of twice the average of the past three years' profit and

d) Share of profit from the closing date of the last financial year to the date of death on the basis of last year's profit.

Profits for the year ending on March 31, 2005, March 31, 2006 and March 31, 2007 were Rs. 12,000, Rs. 16,000 and Rs. 14,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up Rockey's capital account to be rendered to his executor.

(**Ans :** Sony's Executor Account is Rs. 33,821)

10. Narang, Suri and Bajaj are partners in a firm sharing profits and losses in proportion of 1/2, 1/6 and 1/3 respectively. The Balance Sheet on April 1, 2007 was as follows:

Books of Suri and Bajaj
Balance Sheet as on April 1, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		12,000	Freehold Premises		40,000
Sundry Creditors		18,000	Machinery		30,000
Reserves		12,000	Furniture		12,000
Capital Accounts:			Stock		22,000
Narang	30,000		Sundry Debtors	20,000	
Suri	20,000		*Less:* Reserve for Bad Debt	1,000	19,000
Bajaj	28,000	88,000	Cash		7,000
		1,30,000			**1,30,000**

Bajaj retires from the business and the partners agree to the following:

a) Freehold premises and stock are to be appreciated by 20% and 15% respectively.

b) Machinery and furniture are to be depreciated by 10% and 7% respectively.

c) Bad Debts reserve is to be increased to Rs. 1,500.

d) Goodwill is valued at Rs. 21,000 on Bajaj's retirement.

e) The continuing partners have decided to adjust their capitals in their new profit sharing ratio after retirement of Bajaj. Surplus/deficit, if any, in their capital accounts will be adjusted through current accounts.

Prepare necessary ledger accounts and draw the Balance Sheet of the reconstituted firm.

(**Ans :** Profit on Revaluation, Rs. 6,960; Balance in Capital Accounts of Narang, Rs. 49,230; and that of Suri, Rs. 16,410. Amount at Credit in Bajaj Capital is Rs. 41,320).

11. The Balance Sheet of Rajesh, Pramod and Nishant who were sharing profits in proportion to their capitals stood as on March 31, 2007:

Books of Rajesh, Pramod and Nishant
Balance Sheet as on March 31, 2007

Liabilities		*Amount (Rs.)*	*Assets*		*Amount (Rs.)*
Bills Payable		6,250	Factory Building		12,000
Sundry Creditors		10,000	Debtors	10,500	
Reserve Fund		2,750	*Less:* Reserve	500	10,000
Capital Accounts:			Bills Receivable		7,000
Rajesh	20,000		Stock		15,500
Pramod	15,000		Plant and Machinery		11,500
Nishant	15,000	50,000	Bank Balance		13,000
		69,000			**69,000**

Pramod retired on the date of Balance Sheet and the following adjustments were made:

a) Stock was valued at 10% less than the book value.
b) Factory buildings were appreciated by 12%.
c) Reserve for doubtful debts be created up to 5%.
d) Reserve for legal charges to be made at Rs. 265.
e) The goodwill of the firm be fixed at Rs. 10,000.
f) The capital of the new firm be fixed at Rs. 30,000. The continuing partners decide to keep their capitals in the new profit sharing ratio of 3 : 2.

Pass journal entries and prepare the balance sheet of the reconstituted firm after transferring the balance in Pramod's Capital account to his loan account.

(**Ans :** Loss on Revaluation, Rs. 400 ; Balance in Capital Accounts of Rajesh, Rs. 18,940; and of Nishant, Rs. 14,705; Pramod's Loan Rs. 18,705, Balance Sheet Total = Rs. 65,220).

12. Following is the Balance Sheet of Jain, Gupta and Malik as on March 31, 2002.

Books of Jain, Gupta and Malik
Balance Sheet as on March 31, 2002

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Sundry Creditors		19,800	Land and Building	26,000
Telephone bills		300	Bonds	14,370
Outstanding		8,950	Cash	5,500
Accounts Payable		16,750	Bills Receivable	23,450
Accumulated profits			Sundry Debtors	26,700
Capitals :			Stock	18,100
Jain	40,000		Office Furniture	18,250
Gupta	60,000		Plants and Machinery	20,230
Malik	20,000	1,20,000	Computers	13,200
		1,65,800		**1,65,800**

The partners have been sharing profits in the ratio of 5:3:2. Malik decides to retire from business on April 1, 2002 and his share in the business is to be calculated as per the following terms of revaluation of assets and liabilities :
Stock, Rs.20,000; Office furniture, Rs.14,250; Plant and Machinery Rs.23,530; Land and Building Rs.20,000.
A provision of Rs.1,700 to be created for doubtful debts. The goodwill of the firm is valued at Rs.9,000.
The continuing partners agreed to pay Rs.16,500 as cash on retirement of Malik, to be contributed by continuing partners in the ratio of 3:2. The balance in the capital account of Malik will be treated as loan.
Prepare Revaluation account, capital accounts, and Balance Sheet of the reconstituted firm.

13. Arti, Bharti and Seema are partners sharing profits in the proportion of 3:2:1 and their Balance Sheet as on March 31, 2003 stood as follows :

Books of Arti, Bharti and Seema
Balance Sheet as on March 31, 2003

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Bills Payable		12,000	Buildings	21,000
Creditors		14,000	Cash in Hand	12,000
General Reserve		12,000	Bank	13,700
Capitals:			Debtors	12,000
Arti 20,000			Bills Receivable	4,300
Bharti	12,000		Stock	1,750
Seema	8,000	40,000	Investment	13,250
		78,000		**78,000**

Bharti died on June 12, 2003 and according to the deed of the said partnership, her executors are entitled to be paid as under :

(a) The capital to her credit at the time of her death and interest thereon @ 10% per annum.
(b) Her proportionate share of reserve fund.
(c) Her share of profits for the intervening period will be based on the sales during that period, which were calculated as Rs.1,00,000. The rate of profit during past three years had been 10% on sales.
(d) Goodwill according to her share of profit to be calculated by taking twice the amount of the average profit of the last three years less 20%. The profits of the previous years were :
    2001 – Rs.8,200
    2002 – Rs.9,000
    2003 – Rs.9,800

The investments were sold for Rs.16,200 and her executors were paid out. Pass the necessary journal entries and write the account of the executors of Bharti.

14. Nithya, Sathya and Mithya were partners sharing profits and losses in the ratio of 5:3:2. Their Balance Sheet as on December 31, 2002 was as follows :

Books of Nithya, Sathya and Mithya
Balance Sheet at December 31, 2002

Liabilities		*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Creditors		14,000	Investments	10,000
Reserve Fund		6,000	Goodwill	5,000
Capitals:			Premises	20,000
Nithya	30,000		Patents	6,000
Sathya	30,000		Machinery	30,000
Mithya	20,000	80,000	Stock	13,000
			Debtors	8,000
			Bank	8,000
		1,00,000		**1,00,000**

Mithya dies on May 1, 2002. The agreement between the executors of Mithya and the partners stated that :

(a) Goodwill of the firm be valued at $2\frac{1}{2}$ times the average profits of last four years. The profits of four years were : in 1998, Rs.13,000; in 1999, Rs.12,000; in 2000, Rs.16,000; and in 2001, Rs.15,000.

(b) The patents are to be valued at Rs.8,000, Machinery at Rs.25,000 and Premises at Rs.25,000.

(c) The share of profit of Mithya should be calculated on the basis of the profit of 2002.

(d) Rs.4,200 should be paid immediately and the balance should be paid in 4 equal half-yearly instalments carrying interest @ 10%.

Record the necessary journal entries to give effect to the above and write the executor's account till the amount is fully paid. Also prepare the Balance Sheet of Nithya and Sathya as it would appear on May 1, 2002 after giving effect to the adjustments.

Check-list to Test your Understanding

Test your understanding – I

1. (b), 2. (c), 3. (b), 4. (a).

Test your understanding – II

1. (a), 2. (a), 3. (c), 4. (b).