

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

Withdrawal of a partner from the partnership with the consent of other partners or as per the provisions of the partnership deed or by giving notice of retirement is termed as retirement of a partner. A partner who cut his connection with the firm is called a retiring partner or outgoing partner. Retirement of a partner leads to reconstitution of a partnership firm as the original agreement between the partners comes to an end. The business may continue with a new agreement with the remaining partners. When a partner retires, his share in the firm is to be correctly ascertained and settled.

A retiring partner is entitled to get his share of capital, interest on capital, revaluation profit, share of profit etc. up to the date of his retirement. Similarly he is liable for his share in all the losses like accumulated loss, revaluation loss, Drawings, interest on drawings, share of current year's loss up to the date of retirement, drawings, interest on drawings etc. till the date of his retirement. He is not liable for any loss incurred by the firm after his retirement.

Adjustments/Accounting treatment required at the time of retirement of a partner

1. Calculation of new profit sharing ratio and gaining ratio
2. Treatment of goodwill
3. Treatment of accumulated profit and losses
4. Revaluation of assets and liabilities
5. Ascertainment of profit and loss upto the date of retirement
6. Calculation of total amount due to the retiring partner
7. Settlement of total amount due to the retiring partner
8. Adjustment of capitals of the continuing partners

I. Calculation of New profit sharing ratio and gaining ratio

At the time of retirement of a partner, the business continues with the remaining partners. They need to decide among themselves what will be the new profit sharing ratio in the future.

New Ratio: The ratio, in which the continuing partners decide to share the future profits and losses, is known as new profit sharing ratio.

Gaining Ratio

The ratio in which the continuing partners acquire the outgoing partner's share is called gaining ratio. This ratio is calculated by taking out the difference between new profit share and old profit share. Gaining ratio is calculated when a partner retires or dies from a firm. It is called gaining ratio because the continuing partners stand to gain by acquiring the retiring partner's share in profits.

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

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Difference between Gaining Ratio and sacrificing Ratio

Basis	Gaining Ratio	Sacrificing Ratio
When to calculate	It is calculated at the time of retirement/death of a partner and change in profit sharing ratio	It is calculated at the time of admission of a partner and change in profit sharing ratio
Meaning	The ratio in which the continuing partners acquire the outgoing partner's share is called gaining ratio.	The ratio in which the old partners sacrifice their share of profit in favour of the new partner
Objective	It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the outgoing partner in the form of goodwill	It is calculated to determine the amount of compensation to be paid by the incoming partner to the sacrificing partners in the form of goodwill
Equation	New Share - Old Share	Old Share – New Share

Calculating Gaining Ratio - Different Cases

Case-1 Relative Ratio between remaining partners unchanged

Case-2 When the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

Case-3 When the continuing partners acquire (Purchase) the retiring partner's share of profit in an agreed ratio.

Case-4 When entire share of the retiring partner is taken by only one continuing partner

Case-1 Relative Ratio between remaining partners unchanged

If the continuing partners maintain their relative ratio, the gaining ratio and the new ratio will be the same.

In this case there is no need to calculate gaining ratio, new ratio and gaining ratio will be the same

Q. A, B and C were sharing profits in the ratio of 4:3:2. B retires from the firm. Calculate the gaining ratio of A and C.

Ans:

Old Ratio of A, B and C = 4:3:2 or $\frac{4}{9} : \frac{3}{9} : \frac{2}{9}$

New ratio of A and C is calculated by striking out the share of retiring partner and by finding out the denominator of the remaining ratio

So New ratio of A and C = 4:2 or $\frac{4}{6} : \frac{2}{6}$

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Gaining Ratio = New Share – Old Share

A's Gain = A's New Share – A's Old Share

$$= 4/6 - 4/9 \text{ or } 36/54 - 24/54 = 12/54$$

C's Gain = C's New Share – C's Old Share

$$= 2/6 - 2/9 \text{ or } 18/54 - 12/54 = 6/54$$

Gaining ratio of A and C = 12:6 or **2:1**

Q. X, Y and Z are partners sharing profits in the ratio of $1/2, 3/10, 1/5$ or **(5/10:3/10:2/10)**. Calculate the new ratio and sacrificing ratio if X retires.

Old ratio of X, Y and Z = 5:3:2

New ratio of Y and Z = 3:2

Gaining Ratio = New share – Old share

$$Y's \text{ Gain} = 3/5 - 3/10 \text{ or } 6/10 - 3/10 = 3/10$$

$$Z's \text{ Gain} = 2/5 - 2/10 \text{ or } 4/10 - 2/10 = 2/10$$

Gaining ratio of Y and Z = **3:2**

Case-2 When the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

If the continuing partners decide to share future profits in some other ratio, the gaining ratio will also change.

In this case it is necessary to calculate gaining ratio.

Gaining Ratio = New Share – Old Share

Q. A, B and C were sharing profits in the ratio of 3:2:1. C retires from the firm. A and B decided to share future profits in the ratio of 7:5. Calculate gaining ratio.

Old ratio of A, B and C = 3:2:1

New ratio of A and B = 7:5

Gaining Ratio = New Share – Old Share

$$A's \text{ Gain} = 7/12 - 3/6 \text{ or } 7/12 - 6/12 = 1/12$$

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$$B's \text{ Gain} = 5/12 - 2/6 \text{ or } 5/12 - 4/12 = 1/12$$

Gaining ratio = **1:1**

Q. X, Y and Z are partners sharing profits and losses in the ratio of 2/5, 2/5 and 1/5 respectively. Z retires and X and Y decide to share the future profits and losses in the ratio of 2:1 respectively. Calculate gaining ratio.

Old ratio of X, Y and Z = 2:2:1

New ratio of X and Y = 2:1

Gaining Ratio = New Share – Old Share

$$X's \text{ Gain} = 2/3 - 2/5 \text{ or } 10/15 - 6/15 = 4/15$$

$$Y's \text{ Gain} = 1/3 - 2/5 \text{ or } 5/15 - 6/15 = (1/15) \text{ (Sacrifice)}$$

$$X's \text{ Gain} = \mathbf{4/15}, Y's \text{ Sacrifice} = \mathbf{1/15}$$

Note: In this case Y has also sacrificed his share to the extent of 1/15 in favour of X who is required to compensate Y for such loss.

Case-3 When the continuing partners acquire (Purchase) the retiring partner's share of profit in an agreed ratio.

In this case, new ratio has to be calculated. Gaining ratio need not be calculated. In this case the ratio in which they acquire the retiring partner's share forms the gaining ratio

Q. A, B and C are partners sharing profits in the ratio of 3:2:1. A retires and his share is taken up (acquired) by B and C in the ratio of 3:2. Calculate the new profit sharing ratio and gaining ratio.

Old ratio of A, B and C = 3:2:1

$$A's \text{ share} = 3/6$$

Shares acquired by B and C from A in the ratio of 3:2

$$A's \text{ share acquired by B} = 3/5 \text{ of } 3/6 = 3/5 \times 3/6 = 9/30$$

$$A's \text{ share acquired by C} = 2/5 \text{ of } 3/6 = 2/5 \times 3/6 = 6/30$$

$$B's \text{ new share} = B's \text{ old share} + A's \text{ Share acquired by B}$$

$$= 2/6 + 9/30 \text{ or } 10/30 + 9/30 = 19/30$$

$$C's \text{ New Share} = C's \text{ old share} + A's \text{ share acquired by C}$$

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$$=1/6 + 6/30 \text{ or } 5/30 + 6/30 = 11/30$$

New ratio of B and C = 19:11

Gaining Ratio = New Share – Old Share

$$B's \text{ Gain} = 19/30 - 2/6 \text{ or } 19/30 - 10/30 = 9/30$$

$$C's \text{ gain} = 11/30 - 1/6 \text{ or } 11/30 - 5/30 = 6/30$$

Gaining ratio = **9:6 or 3:2**

Q. P, Q and R are partners sharing profits in the ratio of 3:4:1. P retires from the firm and surrenders $\frac{2}{3}$ of his share to Q and the remaining share $\frac{1}{3}$ to R. Calculate new profit sharing ratio and gaining ratio.

Old Ratio of P, Q and R = 3:4:1 P Retires, P's

share = $\frac{3}{8}$

$$P's \text{ share acquired by Q} = \frac{2}{3} \text{ of } \frac{3}{8} \text{ or } \frac{2}{3} \times \frac{3}{8} = \frac{6}{24} \text{ or } \frac{2}{8}$$

$$P's \text{ share acquired by R} = \frac{1}{3} \text{ of } \frac{3}{8} \text{ or } \frac{1}{3} \times \frac{3}{8} = \frac{3}{24} \text{ or } \frac{1}{8}$$

$$Q's \text{ new share} = Q's \text{ old Share} + P's \text{ share acquired by Q} = \frac{4}{8} + \frac{2}{8} = \frac{6}{8}$$

$$R's \text{ new share} = R's \text{ old share} + P's \text{ share acquired by R} = \frac{1}{8} + \frac{1}{8} = \frac{2}{8}$$

New ratio of Q and R = 6:2 or **3:1**

In this, there is no need to calculate gaining ratio, it is already mentioned in the question, i.e. $\frac{2}{3}:\frac{1}{3}$ or 2:1

Case-4 When entire share of the retiring partner is taken by only one continuing partner

Q. A, B and C are partners sharing profits in the ratio of 2:2:1. B retires and his share is entirely taken by C. Calculate new Ratio

Old Ratio of A, B and C = 2:2:1

B retires and B's share is entirely taken over by C

$$B's \text{ share} = \frac{2}{5}$$

$$A's \text{ new share} = \frac{2}{5} \text{ (Unchanged)}$$

$$C's \text{ new share} = C's \text{ old share} + B's \text{ share acquired by C}$$

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$$1/5 + 2/5 = 3/5$$

New ratio of A and C = $2/5 : 3/5$ or **2:3**

II Treatment of goodwill

When an existing partner of a firm decides to retire from the firm, the continuing partners will gain in future profits. The continuing partner who gains by acquiring an additional right to share future profits must compensate the retiring partner who sacrifices his right to share future profits. The amount of compensation will be equal to the proportionate amount of firm's goodwill.

Retiring partner's share of goodwill = **Goodwill of the Firm X Retiring partner's Share**

Note:

As per Accounting Standard 10(AS-10) **goodwill is recorded in the books only when some consideration in money is paid for it**. So goodwill can be recorded only when it is purchased. So as per AS-10 goodwill account can't be raised in the books. Therefore, goodwill is to be adjusted through partners' capital account on retirement.

Journal Entry to adjust goodwill of the retiring partner:

Remaining Partners Capital A/C Dr. (Individually, gaining ratio)

To Retiring Partner's Capital A/C (Retiring partner's share of goodwill)

(Retiring partner's share of goodwill adjusted by debiting remaining partners in their G.R)

If the share of continuing partner becomes lesser(Sacrifice) after retirement

Some times at the time of retirement, as per new ratio some of the remaining partners share may also be lost. In such a case, such remaining partner's Capital A/C will also be credited for the share lost by him. The journal entry will be:

Gaining Partners' Capital A/C Dr (Gaining Ratio)

To Retiring Partner's Capital A/C (Retiring partner's share of goodwill)

To Sacrificing Partner's Capital (Goodwill of the firm X Sacrificing Share)

(Being adjustment of goodwill for shares gained and lost by partner)

Q. A, B and C are partners in a firm sharing profits in the ratio of 5:3:2. A retires from the firm and goodwill of the firm is valued at Rs. 1,20,000. New profit sharing ratio of the continuing partners will be equal. Record necessary Journal entry regarding goodwill

Old ratio of A, B and C = 5:3:2

New ratio of B and C = 1:1

Gaining Ratio New Share – Old Share

B's Gain = $\frac{1}{2} - \frac{3}{10}$ or $\frac{5}{10} - \frac{3}{10} = \frac{2}{10}$

C's Gain = $\frac{1}{2} - \frac{2}{10}$ or $\frac{5}{10} - \frac{2}{10} = \frac{3}{10}$

Gaining ratio of B and C = **2:3**

Goodwill of the firm = 1,20,000

A's Share of Goodwill = $1,20,000 \times \frac{5}{10} = 60,000$

Journal entry to adjust A's Share of Goodwill :

B's Capital A/C Dr. (60000 * 2/5)	24,000
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C's Capital A/C Dr (60000 * 3/5)	36,000
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To A's Capital	60,000
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(A's share of goodwill adjusted by debiting gaining partners capital account)

Q. P, Q and R were partners sharing profits and losses in the ratio of 4:3:2. Q retires from partnership and his share of goodwill is valued at Rs. 9,600. Q's share of goodwill is credited to his capital account. Their future profit sharing ratio is 5:3. Give necessary journal entries in the books of the firm regarding goodwill.

Old Ratio of P, Q and R = 4:3:2

New Ratio of P and R = 5:3

Gaining Ratio = New Share – Old Share

P's Gain = $\frac{5}{8} - \frac{4}{9}$ or $\frac{45}{72} - \frac{32}{72} = \frac{13}{72}$

R's Gain = $\frac{3}{8} - \frac{2}{9}$ or $\frac{27}{72} - \frac{16}{72} = \frac{11}{72}$

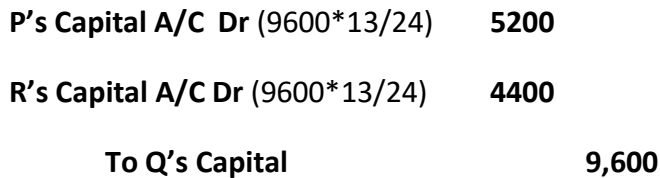
Gaining Ratio = **13:11**

Q's Share of goodwill = 9600

Journal entry to adjust Q's Share of Goodwill :

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Example- If the share of continuing partner becomes lesser after retirement

$$= 48,000 \times \frac{1}{6} = 8000$$

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C's Capital A/C Dr. 24000 (Total of the credited figures / Goodwill of the firm *Total gain i.e 3/6)

To B's Capital 16,000

To A's Capital 80000

(Being adjustment of goodwill on B's retirement)



Q. A, B, C and D are partners sharing profits and losses in the ratio of 4:3:2:1. C retires from the firm and the continuing partners decided to share profits and losses equally. Goodwill of the firm was valued at Rs. 60,000. Pass necessary for goodwill treatment.

Old Ratio of A, B, C and D = 4:3:2:1

New ratio of A, B and D = 1:1:1

Gaining Ratio = New Share – Old Share

A's Gain = $1/3 - 4/10$ or $10/30 - 12/30 = (-2/30)$ Sacrifice

B's Gain = $1/3 - 3/10$ or $10/30 - 9/30 = 1/30$

At the time of retirement, retiring partner, here, C sacrifice his share in favour of gaining partners.

So C's sacrifice = $2/10$ or $6/30$

D's Gain = $1/3 - 1/10$ or $10/30 - 3/30 = 7/30$

Note:

Sacrificing partner has the right to get compensation in the form of share of goodwill and at the same time gaining partner is liable to pay compensation for his gain. Compensation is adjusted by debiting gaining partner's capital account and crediting sacrificing partner's capital account

Goodwill of the firm = 60,000

A's sacrifice adjusted by crediting his capital account to the extent of:-

= Goodwill of the firm X A's Sacrifice

= $60000 \times 2/30 = 4000$

C's sacrifice adjusted by crediting his capital account to the extent of:-

= Goodwill of the firm X C's Sacrifice

= $60000 \times 6/30 = 12000$

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B's gain adjusted by debiting his capital account to the extent of:-

=Goodwill of the firm X B's Gain

=60000 x 1/30 =2000

D's gain adjusted by debiting his capital account to the extent of:-

=Goodwill of the firm X D's Gain

=60000 x 7/30 = 14000

B's Capital A/C Dr 2000

D's Capital A/C Dr 14000

To A's Capital A/C 4000

To C's Capital A/C 12000

(Goodwill adjusted by crediting sacrificing partners capital account and debiting gaining partners capital account)

Sometimes Goodwill already appearing in the books

Sometimes Goodwill may be existing in the business. It may be appearing at the assets side of the Balance Sheet or may be separately mentioned. While solving such problems the first step will be to write off the existing goodwill among all partners including the retiring partner in their old ratio. Then the retiring partner's share of goodwill is ascertained and the same is adjusted to the capital accounts of partners as usual.

Journal entry to write off existing goodwill:

All Partners Capital A/C Dr (Old Ratio)

To Goodwill (Goodwill existing in the books)

(Being Existing goodwill written off)

Q. Antony, Bisoy and Clement are partners in a firm sharing profits and losses in the ratio of 3:2:1. Bisoy retires from the firm on which date there appears a goodwill account in the books at Rs.90,000. But it is agreed to be worth Rs.2,40,000 for the purpose of retirement. Antony and Clement decide to share future profits in the same relative proportions as before.

Old ratio of Antony, Bisoy and Clement = 3:2:1

New ratio of Antony and Clement = 3:1 (Same relative proportions)

In this case Gaining ratio = New ratio, i.e, **3:1**

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To solve this problems, there are two steps, in the first step we want to write off the existing goodwill. In the second step retiring partner's share of goodwill is ascertained and the same is adjusted to the capital accounts of partners .

1. Write off existing goodwill

Antony's capital A/C DR (90000 x 3/6)	45,000
Bisoy's capital A/C Dr (90000 x 2/6)	30000
Clement's capital A/C Dr (90000 x 1/6)	15000
To Goodwill	90,000



(Being existing goodwill written off among all partners in their old ratio)

2. Adjust Retiring partner's /sacrificing partner's share of goodwill

Goodwill of the firm = 2,40,000

Bisoy's share of goodwill = $2,40,000 \times \frac{2}{6} = 80,000$

Antony's Capital A/C Dr ($80000 \times \frac{3}{4}$)	60,000
Clement's Capital A/C Dr ($80000 \times \frac{1}{4}$)	20,000
To Bisoy's Capital	80,000

(Retiring partner's share of goodwill adjusted by gaining partners in their gaining ratio)

Hidden Goodwill

Sometimes, a firm may agree to settle the retiring partner by making a lump sum payment. The amount paid may be more than what is due to him based on his capital account after making all adjustments like share of revaluation, share of accumulated profits etc. Then the excess paid shall be treated as retiring partner's share of goodwill (Hidden goodwill)

Q. P, Q and R are partners sharing profits in the ratio of 3:2:1. R retires from the business. The balance in C's capital after making all adjustments shows a credit balance of Rs. 1, 30,000. P and Q agreed to pay R Rs. 1, 70,000 in full settlement of C's account. Calculate the value of goodwill and write the journal entry for the same.

Hidden Goodwill = Settlement Amount – Amount due to the retiring partner after all adjustments

$$= 1,70,000 - 1,30,000 = 40,000$$

Gaining Ratio = 3:2

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Journal Entry:

P's Capital A/C Dr (40000 x 3/5)	24,000
Q's Capital A/C Dr (40000 x 2/5)	16,000
To R's Capital A/C	40000

(Being R's share of goodwill adjusted by P and Q in their gaining ratio 3:2)

III. Treatment of accumulated profit and losses

(a) In Case of Accumulated Profit:

General reserve & L Account **credit** balance, unused reserves like work men's compensation fund etc should be transferred to the credit side of the all partners capital account in their old ratio.

Journal Entry:

General Reserve A/C Dr

P & L A/C Dr

Workmen's Compensation Fund A/C Dr (Excess of reserve over liability)

Investment Fluctuation Fund A/C Dr (Excess of reserve over difference between book value and market value)

To All Partners Capital A/C (Individually, old ratio)

(Being accumulated profit distributed among all partners in their old ratio)

(b) In case of Accumulated loss:

Accumulated losses like **debit** balance of P & L Account (appearing on the asset side of the Balance sheet) should be written off by transferring such losses to the debit side of all partners capital account in their old profit sharing ratio.

Journal Entry:

All Partners' Capital A/C (Individually, Old Ratio)

To P & L Account

To Deferred Revenue expenditure A/C

(Being accumulated loss distributed among all partners in their old ratio)

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IV Revaluation of Assets and Liabilities

The assets and liabilities should be revalued on the same basis as is done in case of admission of a partner. A revaluation account or profit and loss adjustment account is prepared for this purpose. The profit or loss on revaluation is transferred to **all** the partners' capital accounts in their old profit sharing ratio.

Journal entry If Revaluation Profit:

Revaluation A/C Dr

To All Partners Capital A/C (Individually, Old Ratio)

(Being revaluation profit distributed among all partners)

If Revaluation Loss:

All Partners Capital A/C Dr

To Revaluation A/C

(Being Revaluation loss distributed among all partners)

V Ascertainment of profit and loss upto the date of retirement

Where the retirement occurs on the last date of the financial year, determination of profit or loss of the firm is not a problem. But, where the retirement takes place **during the course of an accounting year**, the actual profit obtained or loss incurred from the last balance sheet to the date of retirement is to be ascertained. Generally it may be ascertained on the basis of last year's profit, on the basis of the average profit of a certain number of year's etc. Such derived amount is only an estimate. Hence the journal entry for the same would be:

In case of profit:

Profit and Loss Suspense A/C Dr.

Retiring Partner's Capital A/C

(Being Retiring partner's share of profit upto the date of retirement)

Note: In this case, Profit and Loss Suspense A/C will show debit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the **asset side of the Balance sheet**

In Case of Loss:

Retiring Partner's Capital A/C Dr

Profit and Loss Suspense A/C

(Being Retiring partner's share of Loss upto the date of retirement)

Note: In this case, Profit and Loss Suspense A/C will show credit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the **Liability side of the Balance sheet.**

VI Calculation of Total Amount Due to the Retiring Partner

The total amount due to the retiring partner is determined by preparing his capital account on the date of retirement.

Retiring partner's capital account shall have the following items on the credit side:

- Capital on the date of last balance sheet
- Interest on capital, salary, commission etc.payable to him from the date of last balance sheet to the date of retirement.
- His share of goodwill of the firm
- His share of undistributed profits and reserves
- His share in revaluation profit
- His share in joint life policy surrender value
- His share in profit up to the date of retirement, since the last balance sheet

Retiring partner's capital account shall have the following items on the credit side:

- His share of accumulated losses
- His share of revaluation loss
- His drawings during the period
- His interest on drawings
- His share of loss till the date of retirement since the last Balance Sheet, if any

Retiring Partner's Capital Account (Specimen)

Particulars	Amount	Particulars	Amount
To Drawings	XXXX	By Balance b/d	XXXX
To Interest on Drawings	XXXX	By Gaining partners Capital(Retiring partner's share of goodwill)	XXXX
To Revaluation Loss (If any)	XXXX	By Reserves/P & L A/C	XXXX
To Retiring Partner's Loan (B/F)	XXXX	By Revaluation Account (Profit)	XXXX
OR		By Joint life policy(Share of surrender value)	XXXX
To Cash/Bank (B/F)	XXXX		
	XXXX		XXXX

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VII Settlement of total amount due to the retiring partner

The amount due to the retiring partner is settled as per the provisions of the partnership deed. It may be paid in full at the time of retirement. Sometimes, the firm may not be in a position to pay the amount due to him in lumpsum. In such a case, the amount due is transferred to retiring partner's loan account and is paid in instalments together with interest.

Note: According to section 37 of the Indian Partnership Act, 1932, the outgoing (Retiring) Partner has an option to receive either interest @ 6 % p.a till the date of payment or such share of profit which has been earned with his money (based on capital ratio).

Journal Entry-When retiring partner is paid cash in full (Lump Sum):

Retiring Partner's Capital A/C Dr

To Cash/Bank

(Amount due to the retiring partner paid off)

Journal Entry-When the retiring partner's whole amount is transferred to his loan account

Retiring Partner's Capital A/C Dr

To retiring Partner's Loan A/C

(Amount due to the retiring partner transferred to his Loan A/C)

Journal Entry-When the retiring partner is partly paid in cash and the remaining amount transferred to his loan account

Retiring Partner's Capital A/C Dr (Total Amount Due)

To Cash/Bank (Amount paid)

To Retiring Partner's Loan (Amount transferred to loan)

(Amount due to the retiring partner is settled)

Loan account of the Retiring Partner

Journal Entry: 1. When the amount due to the retiring partner is transferred to his loan account

Retiring Partner's Capital A/C Dr

To retiring Partner's Loan A/C

(Amount due to the retiring partner transferred to his Loan A/C)

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2. When yearly interest due

Interest Account Dr (Interest of the current year)

Retiring Partner's Loan account

(Interest due)

3. For payment of yearly instalment (yearly Principal amount + Yearly interest)

Retiring Partner's Loan A/C Dr

To Cash/Bank

(Being yearly instalment paid)

Note: 1. Balance of retiring partner's loan account is shown on the liability side of the balance sheet.

2. Journal entry (2) and (3) above will be repeated till the loan is paid off.

Q. P, Q and R are partners in a firm. Q retires from the firm on 1-1-2014. On his date of retirement, Rs. 1,20,000 is due to him and R promise to pay **four** equal annual instalments together with interest at 10% per annum. Prepare Q's Loan Account for the 4 Years.

Repayment period = 4 yrs

Amount of equal yearly instalment = $1,20,000/4 = 30,000$

Total amount to be repaid each year = 30000 + Yearly interest

R's Loan Account

Date	Particulars	Amount	Date	Particulars	Amount
31-12-14	To cash (30,000+12,000)	42,000	1-1-14	By R's Capital A/C	1,20,000
31-12-14	To Balance c/d	90,000	31-12-14	By Interest (1,20,000*10%)	12,000
		1,32,000			1,32,000
31-12-15	To Cash (30,000 + 9,000)	39,000	1-1-15	By Balance b/d	90,000
31-12-15	To Balance c/d	60,000	31-12-15	By Interest (90,000 * 10%)	9,000
		99,000			99,000
31-12-16	To Cash (30,000 + 6,000)	36,000	1-1-16	By Balance b/d	60,000
31-12-16	To Balance c/d	30,000	31-12-16	By Interest (60,000 * 10%)	6,000
		66,000			66,000
31-12-17	To Cash (30,000 + 3,000)	33,000	1-1-17	By Balance b/d	30,000
			31-12-17	By Interest (30,000 * 10%)	3,000
		33,000			33,000

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Journal Entry for First Year:

Journal

Date	Particulars	LF	Debit	Credit
1-1-14	When Amount due to R transferred to his loan A/C R's Capital A/C Dr To R's Loan A/C (R's capital A/C closed by transfer it to R's Loan A/C)		1,20,000	1,20,000
31-12-14	When interest due at the end of the year: Interest A/C Dr To R's Loan A/C (Loan interest due for one year)		12,000	12,000
31-12-14	When first instalment paid (Interest +1 st instalment of Principal amount) R's Loan A/C Dr To Cash (First instalment paid)		42,000	42,000

Note: 2nd and 3rd will be repeated for 3 more years.

IIX Adjustment of Capitals

The capitals of the continuing partners may be required to be adjusted in any one of the following three ways:-

Case-I when the total capital of the new firm is given

Case-II when the total capital of the new firm is not given

Case-III When the retiring partner is to be paid through cash brought in by the continuing partners in such a way as to make their capitals proportionate to their new profit sharing ratio

Case-I when the total capital of the new firm is given

The various steps involved in adjusting the capitals of the partners are given below:

Step-1 Calculate the adjusted old capitals of continuing partners (i.e after all other adjustments)

Step-2 Calculate the new capital of remaining partners by dividing the total capital in their new profit sharing ratio.

Step-3 Calculate the surplus/deficiency in each of the remaining partners' capital accounts by comparing the new capitals with the adjusted old capitals.

Step-4 Adjust the surplus by paying off or by transfer to the credit of current account and adjust the deficiency by asking the concerned partner to bring in the necessary amount or by transfer to the debit of his current account

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In case the adjusted old capital is less than new capital:

Cash/Particular Partner's Current A/C Dr

To Particular Partner's Capital A/C

(Being the shortage brought in/adjusted by the partner)

In case the adjusted old capital is more than the new capital:

Particular Partner's Capital A/C Dr

To Cash/Particular Partner's Current A/C

(Being the excess capital withdrawn/adjusted by the partner)



Q. P, Q and R were partners sharing profits and losses in the ratio of 4:3:2 respectively. Q retired on 31-3-2019 when the capitals of P, Q & R after all necessary adjustments show a credit balance of Rs.19,000, Rs.20,000 and Rs.9,000 respectively. **The entire capital of the newly constituted firm is fixed at Rs.30,000 between P and R in proportion of 5/8 and 3/8 after** passing entries in their accounts for adjustments. Calculate the actual cash to be paid off or to be brought in by the remaining partners and pass necessary journal entries.

New capital of the firm = 30,000

New Ratio of P and R = 5:3

	P	R
1. New (Required) Capital of P & R (30,000 x5:3)	18,750	11,250
2. Adjusted Old Capital	19,000	9,000
Cash to be brought in or paid off (1 -2)	(-250)(Excess)	2250 (Deficiency)

Journal Entry:

In case of P, there is excess capital. He can withdraw the same

P's Capital A/C Dr 250

To Cash 250

(Being the excess capital withdrawn by P)

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In case of R, there is deficiency of capital; he required to bring the same

Cash A/C Dr 2250

To R's Capital 2250

(Being the shortage brought in by R)



Case-II when the total capital of the new firm is not given

The various steps involved in adjusting the capitals of the partners are given below:

Step-1 Calculate the adjusted old capitals of remaining partners after all other adjustments

Step-2 Calculate the Total Capital of the new firm:

Total Capital of the new firm = Combined adjusted capitals of remaining partners.

Step-3 Calculate new capital of remaining partners as per new ratio

Step-4 Calculate the surplus/deficiency in each of the remaining partners' capital accounts by comparing the new capitals with the adjusted old capitals.

Step-5 Adjust the surplus by paying off or by transfer to the credit of current account and adjust the deficiency by asking the concerned partner to bring in the necessary amount or by transfer to the debit of his current account

Q A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. B retires. After making all adjustments relating to revaluation, goodwill and accumulated profits etc. the capital accounts of A and C showed a credit balance of Rs. 1,55,000 and 75,000 respectively. It was **decided to adjust the capitals of A and C 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 withdrawals of the necessary amounts involved.

New ratio of A and C = 3:1

Adjusted capital of A = 1,55,000

Adjusted Capital of C = 75,000

Total Capitals of the new firm = 1,55,000 + 75,000 = 2,30,000

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	A	C
1. New (Required) Capital of A & C (2,30,000 x3:1)	1,72,500	57,500
2. Adjusted Old Capital	1,55,000	75,000
Cash to be brought in or paid off (1 -2)	17,500(Deficiency)	(-17,500)(Excess)

In case of A, there is deficiency of capital; he is required to bring the same

Cash A/C Dr 17,500

To A's Capital 17,500

(Being the shortage brought in by A)

In case of P, there is excess capital. He can withdraw the same

C's Capital A/C Dr 17,500

To Cash

17,500

(Being the excess capital withdrawn by C)



Case-III When the retiring partner is to be paid through cash brought in by the continuing partners in such a way as to make their capitals proportionate to their new profit sharing ratio

The various steps involved in adjusting the capitals of the partners are given below:

Step-1 Calculate the adjusted old capitals of remaining partners after all other adjustments

Step-2 Calculate the required amount payable to the retiring partner

Step-3 Calculate Total Capital of the new firm as follows

Total Capital of the new firm = Combined adjusted capitals of remaining partners + Shortage of cash to be brought in by continuing partners in order to make payment to retiring partner

Step-4 Calculate new capital of remaining partners as per new ratio

Step-5 Calculate the surplus/deficiency in each of the remaining partners' capital accounts by comparing the new capitals with the adjusted old capitals.

Step-6 Adjust the surplus by paying off or by transfer to the credit of current account and adjust the deficiency by asking the concerned partner to bring in the necessary amount or by transfer to the debit of his current account

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Q. L, M and N are partners sharing profits in the ratio of 4:3:3. After all adjustments, on L's retirement with respect to general reserve, goodwill, revaluation etc. the balance 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 L will be brought in by M and N in such a way as to make their capitals proportionate to their profit sharing ratio. Calculate the amount to be brought in by M and N and record necessary journal entries for the same. Also record necessary entry for payment of L.

New ratio of M and N = 3:3 or 1:1

Adjusted capital of M = 60,000

Adjusted Capital of N = 50,000

Amount Payable to L (Retiring partner) = 70,000

Total Capital of the new firm = 60,000 + 50,000 + 70,000 = 1,80,000

	M	N
1. New (Required) Capital of M & N ($1,80,000 \times 1:1$)	90,000	90,000
2. Adjusted Old Capital	60,000	50,000
Cash to be brought in or paid off (1 - 2)	30,000 (Deficiency)	40,000 (Deficiency)

In case of M and N required to bring capital

Cash A/C Dr 70,000

To M's Capital 30,000

To N's Capital 40,000



(Being the shortage brought in by M and N)

Journal Entry to pay off L

L's Capital A/C Dr. 70,000

To Cash 70,000

(Amount due to L paid off)

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Death of a partner

The accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner. The basic differences between the two situations are:

(a) That the retirement of a partner may be planned to be effective from a particular date whereas the death of a partner may occur any time during the year.

(b) Amount payable to the retiring partner is transferred to his loan account. On death, the amount due to the deceased partner is transferred to his Executor's Account.

Ascertainment of deceased partner's share of profit and loss upto the date of Death

Where the death occurs on the last date of the financial year, determination of profit or loss of the firm is not a problem. But, where the death takes place during the course of an accounting year, the actual profit obtained or loss incurred from the last balance sheet to the date of death is to be ascertained. Generally it may be ascertained on the basis of last year's profit, on the basis of the average profit of a certain number of year's etc. Such derived amount is only an estimate. Hence the journal entry for the same would be:

In case of profit:

Profit and Loss Suspense A/C Dr.

Deceased Partner's Capital A/C

(Being deceased partner's share of profit upto the date of death)

Note: In this case, Profit and Loss Suspense A/C will show debit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the asset side of the Balance sheet

In Case of Loss:

Deceased Partner's Capital A/C Dr

Profit and Loss Suspense A/C

(Being deceased partner's share of Loss upto the date of death)

Note: In this case, Profit and Loss Suspense A/C will show credit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the Liability side of the Balance sheet.



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Calculation of interest on deceased partner's capital (If any)

Example:

If the balance of deceased partner's capital as on 1-1-2013 is Rs.50,000. He dies on 31-03-2013 and interest is allowed @10%. The interest for 3 months, the life time of the deceased partner during the current year will be calculated as under.

Interest on capital = $50000 \times 10/100 \times 3/12 = 1250$

Journal Entry

Interest on Capital A/c Dr 1250

To deceased Partner's capital A/c 1250

Settlement of Amount due to the deceased partner

(1) When the amount due to the deceased partner is transferred to his Executor's Loan A/C

Deceased Partner's Capital A/C Dr

Deceased Partner's Executor's Loan A/C

(Amount due to the deceased partner is transferred to his executors loan A/C)

(2) When the balance appearing in the Executor's Loan Account is paid off

Deceased Partner's Executor's Loan A/C

To cash

(Being deceased partner's executor's loan paid off)

Joint Life Policy

When a partner dies, his legal representatives are to be paid a large sum of money. If some arrangement is not made, it may affect the financial position as well as working of the partnership firm. So in order to generate such funds, generally, a joint life policy on the lives of partners is taken by the firm. If any of the partner dies, the insurance company pays the sum assured.



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