**Reconstitution of a partnership firm:-**

**Retirement or Death of a partner**

**\*A Partner has the right to retire from the firm after giving due notice in advance.**

**A new partnership comes into existence between the remaining partners.**

**\*A retiring partner is entitled to get the following:**

**1)      Share in goodwill; Goodwill of the firm is valued and the retiring partners share of goodwill is credited to his capital account.**

**2)      Share in Reserves: Reserves are the undistributed profits and it is also credited to the capital account of retiring partner.**

**3)      Share in revaluation of assets and liabilities: Assets and liabilities are revalued on the date of retirement and retiring partner’s share of profit is credited or the loss is debited to his capital account.**

**\*Accounting problems:**

**1)      Calculation of new profit sharing ratio and gaining ratio of the continuing partners.**

**2)      Treatment of goodwill.**

**3)      Accounting treatment for revaluation of assets and liabilities.**

**4)      Accounting treatment of reserves, accumulated profits and losses.**

**5)      Accounting treatment of joint life policy.**

**6)      Payment to retiring partner.**

**7)      Adjustment of capitals in proportion to profit sharing ratios.**

**\*Calculation of new profit sharing ratio:**

**1) If  the new profit sharing ratios of the remaining partners are not given in the question ,it will be assumed that the remaining partners continue to share profits and losses in the old ratio.**

**2) Sometimes the remaining partners purchase the share of retiring partner in some specified proportion .In such cases the fraction of shares purchased by them is added to their old share and the new ratio is calculated as follows:-**

**New ratio = old ratio + gain**

**\*Calculation of Gaining Ratio:**

**-          Meaning of Gaining Ratio:  Gaining ratio is the ratio in which the remaining partners will pay the amount of goodwill to the retiring partners.**

**-          Calculation of Gaining Ratio:**

**1)      If the new profits sharing ratios of the remaining partners are not given in the question, it will be assumed that the remaining partners continue to gain in the old ratio.**

**2)      If the new profit sharing ratio of the remaining partners is given in the question, gaining ratio is calculated by deducting old ratio from the new ratio.**

**Gaining Ratio = New Ratio – Old Ratio**

**\*Difference between sacrificing Ratio and Gaining Ratio:**

|  |  |  |
| --- | --- | --- |
| **Basis** | **Sacrificing Ratio** | **Gaining Ratio** |
| **1) Meaning:** | **The ratio in which the old partners surrender a part of their share in favour** **of a new partner.** | **The ratio in which the remaining partner’s acquire the outgoing partners share.** |
| **2)When calculated** | **Calculated at the time of the admission of a new partner.** | **Calculated at the time of the retirement or death of a partner.** |
| **3)Formula for calculation** | **Sacrificing Ratio=Old Ratio-New Ratio** | **Gaining Ratio=New Ratio-Old Ratio** |
| **4) Purpose** | **New partners share of goodwill is divided between the old partners in sacrificing ratio.** | **Goodwill paid to retiring partner is paid by the remaining partners in their gaining ratio.** |

**\*Accounting Treatment of Goodwill:**

**1)  Remaining partner’s capital A/c       Dr.       (In gaining ratio)**

**To Retiring/Deceased partner’s capital A/c  ( with his share of goodwill)**

**2) When the goodwill A/c is already appearing in the books:**

**i) All partner’s capital A/c      Dr.( in old ratio )**

**To Goodwill A/c          (goodwill existing in the books)**

**ii) Remaining partner’s capital A/c       Dr.    (in the gaining ratio)**

**To Retiring/Deceased partner’s capital A/c**

**\*Adjustment of Accumulated profits and reserves:**

**1) For distributing reserves and accumulated profits- For distributing surplus of specific funds**

**General Reserve  A/c       Dr.**

**Reserve Fund      A/c        Dr.**

**Profit and loss A/c (cr.)      Dr.**

**Workmen compensation fund A/c        Dr.**

**Investment fluctuation fund  A/c         Dr**

**To All partners capital or current A/c  (in old ratio)**

**2) For distributing accumulated losses:**

**All partner’s capital or current A/c         Dr. (in old ratio)**

**To Profit and loss A/c**

**.**

**\*Adjustment of joint life policy  on retirement of a partner:**

**1)   when premium paid has been considered as revenue expenditure:**

**-     Joint life policy A/c          Dr. (surrender value on the date of retirement)**

**To All partner’s capital A/c  (in old ratio)**

**2)   when remaining partners decide not to show Joint life policy in books:**

**Remaining partner’s capital A/c       Dr.   (in new profit sharing ratio)**

**To Joint life policy   A/c**

**3)      when premium paid has been considered as capital expenditure:  No further treatment required**

**if remaining partners decide  not to show Joint life policy in books-**

**Remaining partner’s capital  A/c (in new ratio)**

**To Joint life policy A/c**

**Payment to retiring partner**

**a)    If the amount is paid in cash or by cheque to retiring partner:**

**Retiring partner’s capital  A/c    Dr.**

**To cash/Bank A/c     (His share paid off)**

**b)   If the amount is not paid in cash, the amount due to him will be transferred to his loan A/c:**

**Retiring partner’s capital A/c      Dr.**

**To Retiring partner’s loan A/c**

**\* Death of a partner :**

**On the death of a partner, the amount payable to him is to be paid to his legal representatives**

**  following amounts will be his capital account:**

**1)      The amount standing to the credit of his capital A/c.**

**2)      His share of the increase in the value of goodwill of the firm.**

**3)      Interest on capital, if provided in the partnership deed.**

**4)      His share of profit on the revaluation of assets and liabilities.**

**5)      His share of undistributed profits or reserves.**

**6)      His share of life policy.**

**7)      His share of profit upto the date of his death.**

**  Following amounts will be debited to the account of the deceased partner for ascertaining the amount due to his legal representatives:**

**1)      Drawings.**

**2)   Interest on drawings.**

**3)   His share of loss on the revaluation of assets and liabilities.**

**4)   His share of undistributed loss, such as debit balance of profit and loss A/c.**

**5)   His share of the reduction in the value of goodwill.**

**\*Calculation of profit :    If the death of a partner occurs on any day during the year , the executors of the deceased partner will also be entitled to the share of profits earned by the firm from the beginning of the year till the date of his death.**

**  Two methods to ascertain profit:**

**A)  On Time Basis:  In this method , we have to take into consideration the profit of the last year and the time for which he remained a partner during the current year.**

**Firm’s Profit = Average Profit X Number of months**

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**Share of deceased person in profit = Firms profit X Share of deceased person**

**B) On Turnover or sales Basis:**

**= Profit of pervious year/Sales of previous year X Sales of current year**

Individual life policy:

- Instead of taking only one joint life policy, the firm may take individual policies on the lives of partners.

  Accounting Treatment :

(1)   **When surrender values are not appearing in the** **books**,

         For amount received from the insurance company on maturity or death of a partner,

Insurance company A/c     Dr.

        To life policy A/c

Life policy A/c                  Dr.

        To All partners capital A/c             (in old ratio)

         For recording the deceased partners share in the surrender value of surviving partners policies,

Surviving partner’s capital A/c       Dr.(in gaining ratio)

       To Deceased partner’s capital A/c

**(2)   When surrender values are already appearing in the books,**

         For amount received from the insurance company on maturity or death of a partner,

Insurance company  A/c         Dr.

     To life policy A/c

Life policy A/c                       Dr.(amount received minus surrender value

                                                          Appearing in the balance sheet)

                                              To All partners capital A/c        (in old ratio)

                                >     Entry for recording the surrender value of surviving partner’s policies will not be passed in this case since they are already appearing in the balance sheet.   The following are the modes of payment to a retiring partner.

1. If the amount due to the retiring partner is to be paid in lump sum on the day of his/her retirement then the following Journal entry need to be passed.

|  |  |
| --- | --- |
| Retiring Partner's Capital A/c | Dr. |
|   | To Cash/Bank A/c |   |
| (Retiring partner paid in cash) |   |
|  |  |  |

2) If the amount due to the retiring partner is to be paid in installments then the balancing figure of his/her capital account is transferred to his/her loan account. In this case, the retiring partner receives equal installments along with the interest on the amount outstanding. The following necessary Journal entry is to be passed.

|  |  |
| --- | --- |
| Retiring Partner's Capital A/c | Dr. |
|   | To Retiring Partner's Loan A/c |   |
| (Retiring partner capital account transferred to theretiring partner's loan account @ -------- % p.a.). |   |
|  |  |  |

3) If the amount due to the retiring partner is to be paid partly in cash and partly in equal  installments then a certain amount is paid in cash to the retiring partner on the date of the retirement and the rest amount due to him/her is transferred to his/her loan account. The following necessary Journal entry is to be passed.

|  |  |
| --- | --- |
| Retiring Partner's Capital A/c (with the total amount due to the retiring partner) | Dr. |
|   | To Retiring Partner's Loan A/c (with the amount transferred to the partner's loan account) |   |
|   | To Cash A/c (with the amount paid in cash immediately on the date of the retirement) |   |
| (Retiring partner partly paid in cash and balance transferred to the partner's loan account) |   |

**1.A, B and C were partners in a firm sharing profits in the ratio of 2:2:1. Their Balance Sheet as on March 31, 2017 was as follows:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **Amount****Rs** | **Assets** | **Amount****Rs** |
| **Creditors** | **49,000** | **Cash** | **8,000** |
| **Reserves** | **18,500** | **Debtors** | **19,000** |
| **A Capital** | **82,000** | **Stock** | **42,000** |
| **B Capital** | **60,000** | **Buildings** | **2,07,000** |
| **C Capital** | **75,500** | **Patents** | **9,000** |
|  | **2,85,000** |  | **2,85,000** |
|  |  |  |  |

**B retired on March 31, 2017 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 A and C after B”s retirement.**

|  |  |
| --- | --- |
| **Books of Digvijay and Parakaram****Revaluation Account** |   |
| **Dr.** |  | **Cr.** |   |
| **Particular** | **Amount****Rs** | **Particular** | **Amount****Rs** |
| Bad Debts | 2,000 |   |   |
| Patents | 9,000 | Loss transferred to Capital Account: |   |
|   |   | Digvijay | 4,400 |
|   |   | Brijesh | 4,400 |
|   |   | Parakaram | 2,200 |
|   |   |   |   |
|   | 11,000 |   | 11,000 |
|   |   |   |  |  |
| **Partners’ Capital Account** |   |
| **Dr.** |  | **Cr.** |   |
| **Particularss** | **Digvijay** | **Brijesh** | **Parakaram** | **Particularss** | **Digvijay** | **Brijesh** | **Parakaram** |
| Brijesh’s Capital A/c | 18,667 |   | 9,333 | Balance b/d | 82,000 | 60,000 | 75,500 |
| Revaluation (Loss) | 4,400 | 4,400 | 2,200 | Digvijay’s Capital A/c |   | 18,667 |   |
| Brijesh’s Loan |   | 91,000 |   | Parakaram’s Capital A/c |   | 9,333 |   |
| Balance c/d | 66,333 |   | 67,667 | Reserves | 7,400 | 7,400 | 3,700 |
|   | 89,400 | 95,400 | 79,200 |   | 89,400 | 95,400 | 79,200 |
|   |   |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |   |   |   |

|  |
| --- |
| **Balance Sheet as on March 31, 2017**  |
| **Liabilities** | **Amount****Rs** | **Assets** | **Amount****Rs** |
| Creditors | 49,000 | Cash | 8,000 |
| Brijesh’s Loan | 91,000 | Debtors | 19,000 |   |
|   |   | *Less*: Bad Debts | 2,000 | 17,000 |
| Digvijay’s Capital A/c | 66,333 | Stock | 42,000 |
| Parakaram’s Capital A/c | 67,667 | Buildings | 2,07,000 |
|   | 2,74,000 |   | 2,74,000 |
|   |   |   |   |
|   |   |   |   |   |   |

**Note**: As sufficient balance is not available to pay the amount due to Brijesh, the balance of his Capital Account transferred to his Loan Account.

**Working Note**:

1. Brijesh’s Share of Goodwill

Total goodwill of the firm  Retiring Partner’s Share 

2. Gaining Ratio = New Ratio – Old Ratio

Digvijay’s Share

Parakaram’s Share

Gaining ratio between Digvijay and Parakaram = 4 : 2 or 2 : 1