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Reconstitution Retirement/Death of a Partner

Question 1:

Explain the modes of payment to a retiring partner.

ANSWER:

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 the

retiring 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)

Question 2:

How will you compute the amount payable to a deceased partner?

ANSWER:

The legal executer of the deceased partner is entitled for the balancing figure of the deceased partner's capital account. The balancing figure of the deceased partner's capital account is derived after posting the below mentioned items in Step 1 and Step 2.

Step 1: The following items are posted in the debit side of the deceased partner's capital account.

a) Credit balance of the deceased partner's capital account and/or current account.

b) Deceased partner’s share of profit up to the date of his/her death.

c) Deceased partner’s share of goodwill.

d) Deceased partner’s share in accumulated reserves and profit account.

e) Deceased partner’s share in gain on revaluation of assets and liabilities.

f) Deceased partner’s share of Joint Life Policy.

g) Interest on capital, if any, up to the date of the death.

h) Salary or commission, if any, up to the date of the death.

Step 2: The following items are posted in the credit side of the deceased partner's capital account.

a) Debit balance of the deceased partner's capital account and/or current account.

b) Amount withdrawn in the form of drawings up to the date of death of the partner.

c) Interest on drawings, if any, up to the date of the death.

d) Deceased partner’s share in loss on revaluation of assets and liabilities.

e) Deceased partner’s share of loss up to the date of the death.

f) Deceased partner’s share in the accumulated losses of the firm.

The legal executor is entitled for the balancing figure that is the excess of the credit side over the debit side of the deceased partner's capital account.

Deceased Partner's Capital Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount Rs	Date	Particulars	J.F.	Amount Rs
	Revaluation A/c (Loss)				Balance b/d		
	Profit and Loss Suspense A/c				Profit and Loss Suspense A/c		
	(Share of loss up to the date of the death)				(Share of profit up to the date of the death)		
					Goodwill		
	Accumulated Losses A/c				Reserves and Profits		
	Goodwill A/c (Written off)				Revaluation A/c (gain)		
	Partner Executor's A/c				Joint Life Policy A/c		
	(*Balancing Figure*)				Interest on Capital A/c		

				Salary A/c Commission A/c			

Question 3:

Explain the treatment of goodwill at the time of retirement or on the event of death of a partner?

ANSWER:

At the time of retirement or at the event of death of a partner, the goodwill is adjusted among the partners in gaining ratio with the share of goodwill of the retiring or the deceased partner. As per Para 16 of Accounting Standard 10, it is mandatory to record goodwill in the books only when consideration in money or money's worth has been paid for it.

In case of retirement and death of a partner, goodwill account cannot be raised. There are namely two probable situations on which the treatment of goodwill rests.

1. If ***goodwill already appears*** in the books of the firm.
2. If ***no goodwill appears*** in the books of the firm.

Situation 1: If goodwill <u>already appears</u> in the books of the firm.

Step 1: Write off the existing goodwill

If goodwill already appears in the old balance sheet of the firm (if mentioned in the question), then first of all, this goodwill should be written off and should be distributed among all the partners of the firm including the retiring or the deceased partner in their old profit sharing ratio. The following Journal entry is passed to write off the old/existing goodwill.

All Partners' Capital A/c Dr.

To Goodwill A/c

(Goodwill written of among all the partners in their

old ratio)

Step 2: Adjusting goodwill through partner's capital account.

After writing off the old goodwill, the goodwill need to be adjusted through the partner's capital account with the share of the goodwill of the retiring or the deceased partner. The following Journal entry is passed.

Remaining Partner's Capital A/c Dr.

To Retiring/Deceased Partner's Capital A/c

(Gaining Partner's Capital A/c is debited in their

gaining share and retiring/deceased partner's capital

account in credited for their share of goodwill)

Situation 2: If <u>no goodwill appears</u> in the books of the firm.

As no goodwill appears in the books of the firm, so the goodwill is adjusted through the partner's capital account with the share of the goodwill of the retiring or the deceased partner. The following Journal entry is passed.

Remaining Partner's Capital A/c Dr.

To Retiring/Deceased Partner's Capital A/c

(Gaining partner's capital account is debited in their gaining

share and retiring/deceased partner's capital account in

credited for their share of goodwill)

Question 4:

Discuss the various methods of computing the share in profits in the event of death of a partner.

ANSWER:

In case of death of a partner during the year, his/her executer is entitled for share of profit up to the date of death of the partner.

The share of profit can be calculated by one of the two methods.

1) **On time basis:** Under this method, profit up to the date of the death of the partner is calculated on the basis of the last year's/years' profit or average profit of last few years. In this approach, it is assumed that the profit will be uniform throughout the current year. The deceased partner will be entitled for the share of the profit proportionately up to the date of his/her death.

Share of Deceased Partner in Profit =

$$\text{Previous Year /Average Profit} \times \frac{\text{Time period from date of balance sheet till death}}{\text{12 months / 52 weeks / 365 days}} \times \text{Profit Share of deceased partner}$$

Example- A, B and C are equal partners. The profit of the firm for the years 2008, 2009 and 2010 are Rs 10,00,000, Rs 7,00,000 and Rs 13,00,000 respectively. C dies on April 30, 2011. The share of C in the firm's profit will be calculated on the basis of average profit of last three years. Firm closes its books every year on December 31.

In this case, C's share in the profits will be calculated for four months, i.e. from January 01, 2011 to April 30, 2011.

$$\text{Average Profit} = \frac{10,00,000 + 7,00,000 + 13,00,000}{3} = \text{Rs } 10,00,000$$

$$\text{C's share of profit} = 10,00,000 \times \frac{4}{12} \times \frac{1}{3} = \text{Rs } 1,11,111 \text{ approx.}$$

2) **On the sale basis:** Under this method, profit is calculated on the basis of last year's sale. In this situation, it is assumed that the net profit margin of the current year's sale is similar to that of the last year's.

Share of Deceased Partner's Profit = $\frac{\text{Previous Year's Profit}}{\text{Previous Year's Sales}}$ ×Sales from the beginning of the current year up to the date of death × Share of deceased partner

Example- X Y and Z are equal partners. The last year's sales and profit were Rs 25,00,000 and Rs 2,50,000. Z died on the April 30, 2011. Sales of the current year till the date of Z's death amounts to Rs 12,00,000. Firm closes its books on December 31 every year.

$$\text{Z's share of profit} = \frac{2,50,000}{25,00,000} \times 12,00,000 \times \frac{1}{3} = \text{Rs } 40,000$$