## 1. Details of Module and its structure

| Module Detail | |
|---|---|
| Subject Name | Accountancy |
| Course Name | Accountancy 03 (Class XII, Semester - 1) |
| Module Name/Title | Reconstitution of Partnership Firm-Retirement of a Partner – Part 1 |
| Module Id | leac_10401 |
| Pre-requisites | Basic knowledge of Partnership – Fundamentals, Admission of Partnership. |
| Objectives | After going through this lesson, the learners will be able to understand recording of business transactions in the journal.<br>• Meaning of Reconstitution- Retirement<br>• New Ratio &Gaining Ratio and their Calculation<br>• Amount due to Retiring Partner |
| Keywords | Reconstitution, Retirement, New & Gaining Ratio, Amount due to Retiring Partner |

## 2. Development Team

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**Introduction**

Retirement/Death of the partner is also one of the modes of Reconstitution of partnership firm. In case of Retirement/Death, the old partnership will come to an end and a new partnership comes into existence among remaining partners. Retirement can be

- With the consent of All other partners.
- By giving notice if Partnership is at will.

The following points are to be considered at the time of retirement/death of a partner:

(a) Adjustment of New profit and Gaining ratio.
(b) Calculation of total amount due to Retiring partner or Deceased partner.
(c) Treatment of Goodwill.
(d) Revaluation of Assets and Liabilities
(e) Distribution of undistributed Reserves, Profits/Losses
(f) Adjustment of Capital.

But in this video, we will be concentrating on the first two points only- Ratios and Amount due to Retiring or Deceased Partner

So, let us begin with the First one

**1. Change in profit sharing ratio—new and gaining ratio**

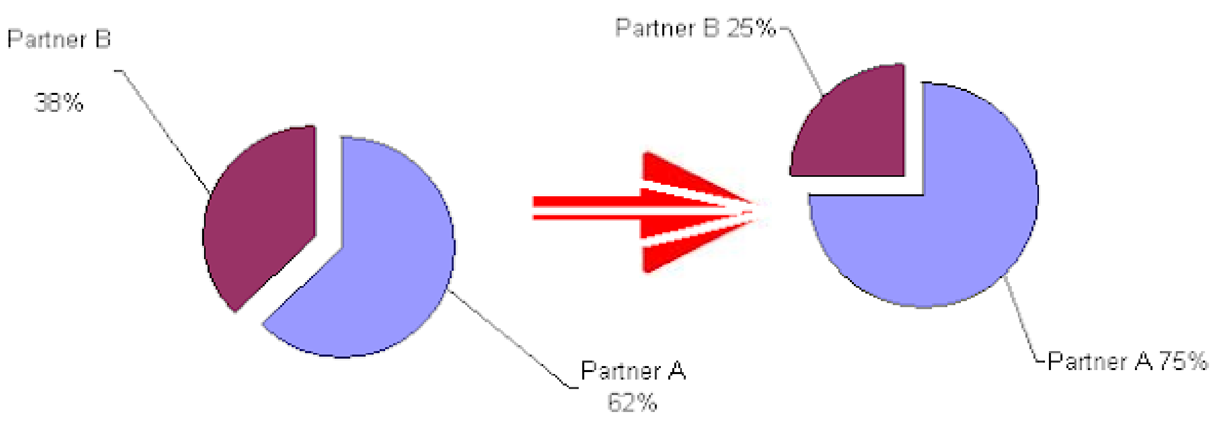


Image-1

**New profit sharing ratio** is the ratio in which the remaining partners agree to share the future profits after the retirement or death of any partner i.e., in the newly constituted firm.

Calculation of the new profit sharing ratio is important because the remaining partners may gain some of the retiring or deceased partner's share. New Ratio can be calculated as under:

**New Profit Sharing Ratio = Old Share + The Gain.**

**Following situations can arise**

**I. When only old profit ratio is given**.

Unless anything is mentioned, it is always assumed that the Remaining partners will acquire the share of Retiring partners in their old profit sharing ratio so their future profits is the same ratio.

**Example** X, Y and Z are partners sharing profits and losses in the ratio 3:2: 1. Calculate new profit sharing ratio if:

(a) X retires OR (b)Y dies

**Solution:**

This is a very simple case, where nothing else is mentioned. We are only told about which Partner is Retiring. The new ratio in each of the case, can be calculated just by striking out the share of retiring partner:

**(a) If X retires**, the new ratio between Y and Z will be Y: Z = 2:1

**Alternatively, even if you want to Verify, then let us do the calculation-**

X's share is taken over by Y and Z in the ratio of 2: 1

Y will gain 2/3 of 3/6 = 6/18 Hence Y's new share = 2/6 + 6/18 = 12/18

Similarly, Z will gain 1/3 of 3/6 = 3/18 Hence Z's new share = 1/6 + 3/18 = 6/18

So, New Ratio of Y and Z will be = 12/18 : 6/18 = 2 : 1. So, the conclusion is if nothing mentioned except which partner leaving, it’s same ratio between others remaining.

**(b) If Y dies**, then new ratio between X and Z will be X:Z =3:1

**Alternatively, if you want to Verify, then let us do the calculation-**

Y's share is taken over by X and Z in the ratio of 3 : 1

X will gain 3/4 of 2/6 = 6/24 Hence X's new share = 3/6 + 6/24 =18/24

Z will gain 1/4 of 2/6 = 2/24 Hence Z's new share = 1/6 + 2/24 = 6/24

New Ratio of X and Z will be = 18/24 : 6/24 = 3 : 1

**2. If retiring partner's share is taken over by the remaining partners in some other ratio.**

In this case,we have to first calculate the share proportion taken and then that proportion to be added to remaining partners' share.

**Example** X, Y and Z are partners sharing profits and losses equally. Calculate new profit sharing ratio if Z retires and his share is acquired by X and Y in the ratio 2:1.

**Solution:**

**Here we need to do some calculations regarding Gain of X & Y and then Add in their share**

X's gain = 1/3 × 2/3 = 2/9

Y's gain = 1/3 × 1/3 = 1/9

Now, this will be added to their old ratio and now the New Ratio will be :

X's new share = 1/3 + 2/9 = 5/9 and Y's share = 1/3 + 1/9 = 4/9

New profit sharing ratio of X and Y = 5 : 4

**Now, let us talk about gaining ratio**

Gaining ratio is the ratio in which the remaining partners acquire the outgoing partner's share. The objective of calculating the gaining ratio is to find out how much compensation to be paid by remaining partners to the retiring partner in the form of Goodwill. Gaining Ratio can be calculated as under:

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

As explained earlier, Generally the Remaining partners acquire the share of Retiring/Deceased partner in their old profit sharing ratio. In that case, gaining ratio is same as their Old profit sharing ratio.

But when the ratio in which the Remaining partners acquire the share of Retiring/Deceased partner is Different, the gaining ratio will be that ratio which is calculated as per the information given in the question.

However, in case new ratio of the remaining partners is given, then in that case the gaining ratio is required to be calculated as per the formula. [Gaining = New- Old]

**Example** X, Y and Z share profit and losses in the ratio 6 :4 : 5. Z retires and surrenders 1/5th of his share in favour of Y and remaining in favour of X. Calculate new profit sharing ratio and gaining ratio.

**Solution: Calculation of New Profit Sharing Ratio by calculating the Gain First & then adding it to the respective Partner share.**

X's gain = 4/5 x 5/15 = 4/15

Y's gain = 1/5 × **5/15 = 1/15**

X's new share = 6/15 + 4/15 = 10/15

Y s new share = 4/15 + 1/15 = 5/15

New ratio of X and Y = 10:5

**Let us now calculate Gaining Ratio and Verify.**

Gaining Ratio = New Ratio – Old Ratio

X's Gaining Share = 10/15 – 6/15 = 4/15

Y's Gaining Share = 5/15 – 4/15 = 1/15

Thus, gaining ratio of X and Y = 4:1 which is the Ratio we earlier calculated.

Let us take an Example where one Partner retires and his share is shared by some of the existing partners and not All.

**Example** A, B, C and D are partners sharing profits in the ratio of 4 : 2 : 3 : 1. A retires and her share is acquired by C and D in the ratio 4:1. Calculate new profit sharing ratio and gaining ratio of the remaining partners.

**Solution:**

**Here B is not getting anything, so his share will remain the same.**

B old share= 2/10 + Gain (Nil)= B New Share = 2/10=10/50

C old share= 3/10 + Gain (16/50)= C New Share = 31/50

D old share= 1/10 + Gain (4/50 )= D New Share = 9/50

So, The New Profit Sharing Ratio is 10 : 31 : 9 and Gaining Ratio of C and D is 4 : 1

Let us examine another Interesting Case where One Partner retires and instead of his share taken in some Ratio, New ratio is specified. Then what we have to do is to Ignore the retiring partner ratio and concentrate on what Old and New Ratios are.

**Example** A, B, C and D are sharing profits and losses in the ratio 4 : 3 : 2 : 1. C retires and A, B, D share future profits equally. Calculate Gaining Ratio.

**Solution:**

**Gaining ratio= new-old**

A's gain = 1/3 – 4/10 = (2/30) sacrifice

B's gain = 1/3 – 3/10 = 1/30

D's gain = 1/3 – 1/10 = 7/30

Thus, A is sacrificing to the extent of 2/30, whereas B and D are gaining in the ratio of 1: 7.

**If you just want to verify????**

**1/30+7/30-2/30=6/30. Right, this was C share which he left. HAPPY.**

**Let us see another different type of problem. (With a twist)**

**Example**

X, Y and Z are partners sharing profits and losses in the ratio of 3:2:1. Y retires and he gifted 1/2 of his share to X and remaining 1/2 share to X and Z in the ratio of 1:2. Find out gaining ratio and new ratio.

**Solution:**

Y's Share = 2/6 or 1/3.Y gifts 1/2 of his share to X, means X will get = 1/2 x 1/3 = 1/6. Remaining 1/2 of Y's share that is 1/6 (1/2 x 1/3 = 1/6) is given to X and Z in the ratio of 1:2, i.e. 1/3 of 1/6 = 1/18 is acquired by X and 2/3 of 1/6= 2/18 is acquired by Z.

| | |
|---|---|
| X's Gain | 1/6+1/18=4/18 or 2/9 |
| Gaining Ratio | 2:1 |
| X's New Share | 3/6+2/9=13/18 |
| Z's New Share | 1/6+1/9=5/18 |
| New Ratio | 13:5 |

**Let us see the difference between sacrificing ratio and gaining ratio**

| **Basis of Different** | **Sacrificing Ratio** | **Gaining Ratio** |
|---|---|---|
| **Meaning** | The ratio of sacrifice by old partners in favour of new partner is called Sacrificing Ratio. | The ratio of gain by remaining partners of the outgoing partner's share is called Gaining Ratio. |
| **Time to Calculate** | Sacrificing Ratio is calculated at the time of admission of a partner. | Gaining Ratio is calculated at the time of retirement /death of partner |
| **Method / formula** | Sacrificing Ratio = Old – New Ratio | Gaining Ratio = New – Old Ratio |

| | | |
|---|---|---|
| **Need** | To distribute the amount of premium brought in by new partner amongst sacrificing partners. | To find the amount of premium to be paid by the remaining partners to retiring partner. |
| **Accounting Treat.** | Old Partners' Capital Account are credited for adjustment of goodwill. | Remaining Partners' Capital A/cs are debited for adjusting goodwill. |

**Liability of a Retiring Partner (As per partnership act)**

**(i) Liability for the Firm's acts before his Retirement**: The retiring partner continues to be liable for all the acts of the firm up to the date of his retirement. However, he may be discharged from his liability by an agreement between himself, third party and the remaining partners.

**(ii) Liability for the Firm's acts after Retirement**: The retiring partner continues to be liable for acts of the firm **even after his retirement until public notice** of his retirement has been given either by himself or by other partners.

**2. Payment to the retiring or excecutors of deceased partner**

Image-2

The amount due to the Retiring or Executors of deceased partner has to be calculated after incorporating all adjustments relating to Revaluation of assets/liabilities, Accumulated profit/losses, Reserves, Goodwill and some assets or some liability taken over, etc. is settled in a manner prescribed in the partnership deed.

The amount due is either immediately paid off in full or(LOAN) paid in installments with interest.

In the absence of any agreement, to the contrary in this regards, the retiring or executors of deceased partner, at their option, are entitled to receive either a share in theprofit which has been earned by using the amount due to them OR interest @ 6% per annum till the amount is paid off. (Section 37 of Indian Partnership Act)

**On the Retirement / Death of a partner, the amount dueis payable to him or his legal representatives. Let us see, how to calculate this Amount.**

***Calculation of Total amount due to the Retiring / Representatives of the deceased partner***

On the Retirement / Death of a partner, accounts in the books of the firm are maintained in the same way as on the retirement of a partner. Thus the Retiring Partner or Legal representatives of the deceased partner are entitled to claim the following amounts, **which are credited to 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. (Upto Date of Retirement/ Death)
4. His share of Profit on the Revaluation of assets and liabilities.
5. His share of the Undistributed profits or Reserves.
6. His share of Life Policy. (**Surrender Value**- Retirement case or **Full Policy**-Death case)
7. His share of profit upto the date of his Retirement / Death.

The following amounts will be **debited to the account** of the Retiring / Deceased partner:

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 Account.
5. His share of the reduction in the value of goodwill.

**Settlement of account**

When the amount due to the retiring partner is determined after all adjustments, then it is either paid out in cash or transferred to his loan account.

There can be three situations:

1. **When the amount due is fully paid in cash or by cheque**:
   Journal Entry passed is:

Retiring Partner's Capital, A/c

To Cash / Bank A/c

(Being the amount due to the retiring partner paid)

2. **When the amount due is transferred to his loan account**:

The total amount due will be transferred to 'Retiring Partner's Loan Account' and it will appear as a liability in the Balance Sheet of reconstituted Firm, till it is paid off.

Journal Entry passed is:

Retiring Partner's Capital, A/c

To Retiring Partner's Loan A/c

(Being the amount payable to the retiring partner transferred to his loan account)

3. **When amount due is partly paid in cash and balance transferred to loan account**:

Journal Entry passed is:

Retiring Partner's Capital, A/c

To Cash / Bank A/c

To Retiring Partner's Loan A/c

(Being amount due to partner settled partly in cash and balance transferred to his loan account)

**Important Note**: If the question is silent on the settlement of claim of the retiring partner, then the amount due to him MUST be transferred to 'Retiring Partner's Loan Account'.