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 4
Module Id	leac_10404
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. • Meaning of Reconstitution- Retirement • New Ratio &Gaining Ratio and their Calculation • Amount due to Retiring Partner
Keywords	Profits on Retirement, Payment to Retiring / Deceased Partner, Payment in Instalments (Loan Account)

2. Development Team

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1. Adjustments of Accumulated Profits on Retirement
2. Payment to Retiring / Deceased Partner
3. Payment in Instalments (Loan Account)

First of all, let us see the Objectives of our discussion

After going through this video tutorial you will be able to understand:

1. Accounting Treatment of Accumulated Profits on Retirement/ Death
2. Payment to Retiring / Deceased Partner (Full / Instalments)

1. Adjustment of accumulated profits and reserves

Sometimes a firm may have **Accumulated profits** (existing in the Balance sheet) . It means they are not yet transferred to capital accounts of the partners. These are in the form of general reserve, reserve fund and/or Profit and Loss Account (Credit balance).

Since these profits were earned with the contribution/Efforts of the Retiring or Deceased partner also, so he is also entitled to share in such profits.

So, very correctly, these are distributed among the old partners in their capital accounts in **old profit sharing ratio**.

General Reserve A/c	Dr.
Profit and Loss A/c	Dr.
Investment Fluctuation Reserve A/c	Dr.
Contingency Reserve A/c	Dr.
Workmen Compensation Reserve A/c	Dr.
To Old Partners' Capital A/c	

(Being distribution of accumulated profits among old partners in old ratio)

Similarly, if there are some **Accumulated losses** in the form of a debit balance of profit and loss account appearing in the balance sheet of the firm, the same are transferred to the Debit side of old partners' capital accounts in **old ratio,** as these also belongs to them. In this case, being a loss, the Old partners' capital accounts will be debited. The entry will be:

Old Partners' Capital A/c Dr.

To Profit and Loss, A/c

To Advertisement Suspense A/c

To Deferred Revenue Expenditure A/c (Being distribution of undistributed losses)

Example

X, Y and Z are partners sharing profit and losses in the ratio of 2 : 2 : 1. Y retires from the firm on 31st March 2020. On the date of Y's retirement, the following balances appeared in the books of the firm:

Profit and Loss Account (Dr)	80,000
General Reserve	50,000
Workmen's Compensation Reserve	20,000

Pass the necessary journal entries for the adjustment of these items on Y's retirement

Solution

In this Particular Question, General Reserve 50,000 + Workmen Compensation 20.000 that is 70,000 is Profit to be credited, And P/L a/c (Dr) 80,000 is Loss to be Debited to Old Partners in Old Ratio.

Books of X, Y and Z

JOURNAL

Date	**Particulars**			**Debit** (Rs.)	**CrediT**(Rs.)
March 31	General Reserve A/c	Dr.		50,000	
2020	Workmen's Compensation Reserve A/c	Dr.		20,000	
	To X's Capital A/c				28,000
	To Y's Captial A/c				28,000
	To Z's Capital A/c				14,000
	(Being the General Reserve and Workmen's Compensation transferred to Capital Accounts)				
March 31	X's Capital A/c	Dr.		32,000	

	Y's Capital A/c	Dr.		32,000	
	Z's Capital A/c	**Dr.**		16,000	
	To Profit & Loss A/c				80,000
	(Being the amount of accumulated loss transferred to Capital Accounts on Y's retirement)				

2. Payment to the retiring or executors of deceased partner

In the case of retirement, after all the adjustments relating to Goodwill, Revaluation, Accumulated Profits, etc., the sum due is **paid to the Retiring partner** and if Full Amount is not Paid, then the **balance is transferred to his Loan account**.

Similarly, in the case of death of the Partner, after all the above adjustments in capital account of the deceased partner, his balance in the capital account is transferred to Partner's Executor Account and from here, Final payments are made, which depend upon the agreement or partnership deed.

In the absence of any agreement, the provision of the **Section 37** of the Partnership Act, 1932 will apply. According to which, the Legal representatives (Executors) are entitled to opt for either of the following option:

(i) Interest @ 6% p.a. on the amount due, from the date of death till the payment is made. OR

(ii) Portion of profit, which has been earned by the firm with the help of amount payable to the executors of the deceased partner.

Let us now see what Journal Entries are made at the time of Payment, In case of Full Payment OR Partial Payment along with a Loan.

<u>CASE (A) When the amount due is paid off immediately in full or partially and the Rest is kept in his loan account</u>

Retiring Partners' Capital, A/c Dr. (Total amount due)

To Cash/Bank A/c (Amount actually paid)

To Partner's Loan A/c (Amount left as loan)

<u>CASE (B) When the amount due is paid off in instalments</u>

Here, instalment to be paid is equal to Principal plus Interest. Interest is paid on balance of Loan outstanding after the end of each year.

But sometime a Fixed amount is paid which include principal and interest, Both. However, at the end, the Remaining balance is paid in lump sum.

Journal entries on transfer, interest and payment (loan account)

(a) When final amount due is transferred from capital account to retiring or deceased partner's loan A/c

Retiring/Deceased Partner's Capital A/c Dr.

To Retiring/Executor's Partner's Loan A/c

Here, whatever was due to the retiring Partner in his Capital account on account of his Capital, Goodwill, Revaluation Profit / Loss, Accumulated Profits / Losses, etc. will be transferred to his Loan Account.

(b) When interest becomes due on the Balance

Interest, being an expense, will be debited and Retiring/Executor's Partner's Loan A/c will be credited, as it is a liability. The entry will be:

Interest A/c Dr.

To Retiring/Executor's Partner's Loan A/c

(c) When instalment is paid

Retiring/Executor's Partner's Loan A/c Dr.

To Cash/Bank A/c

NOTE:

1. The balance of the Retiring/ Deceased partner's loan account will be 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 Last instalment of loan is paid off.
3. Instalment consist of Principal and the interest up to that date on the Unpaid Balance.

CASE (C) If the Remaining Partners agree to take over in the Retiring partner's share

In this case, the Amount due to the Retiring Partner will be paid off by the Remaining Partners. The entry for this will be:

Retiring Partners' Capital, A/c Dr.

To Remaining Partners' Capital A/c

Let us do one question to understand all the above points along with a Loan Account

Question

X, Y and Z were in partnership sharing profits and losses in the proportion of 3 :2:1. Their Balance Sheet as at 31.3.2020 was as under.

BALANCE SHEET as at 31.3.2020

Liabilities		Rs.	**Assets**	Rs.
Creditors		27,000	Cash in hand / Bank	2,250
Bills Payable		15,000	Goodwill	9,000
General Reserve		12,000	Debtors	20,000
Profit and Loss A/c		6,000	Stock	10,800
Capital Accounts:			Buildings	50,000
X	40,000		Machinery	24,000
Y	20,000		Equipment's	5,750
Z	**10.000**	70,000	Furniture	8,200
		1,30,000		1,30,000

On the same date, Y died and the following terms were agreed upon:

(i) Goodwill for the firm is valued at Rs. 12,000.

(ii) Machinery and Equipment's are to be valued at 20% less than their book value.

(iii) The Buildings be decreased to Rs. 40,000.

(iv) Furniture to be appreciated by 15%, and Creditors to be reduced by Rs. 620

(v) Rs. 1,300 to be paid to Y immediately and the balance to be transferred to his loan account, carrying interest at 10% per annum (Payable in three instalments along with Interest)

You are required to prepare Revaluation Account, the Capital Accounts of the Partners, Executor Loan account of Y (till finally paid off) and the Balance Sheet of the firm as at 31.3.2020.

Solution:

Let us start with point no. 1, Goodwill. Existing Goodwill 9,000 will be written off in Old Ratio. And then as of Now, when Y is retiring, Value of Goodwill is Rs. 12,000, out of which Y's share = 2/6x12,000=4,000 which will be ultimately borne by X & Z in their Gaining Ratio 3:1, as nothing else is Mentioned, so it will be the same Old Ratio among them. **See Working Note 1.**

Working Notes:1. TREATMENT OF GOODWILL

Date	**Particulars**		**LF.**	**Debit**	**Credit**
	P's Capital A/c	Dr.		4,500	
	Q's Capital A/c	Dr.		3,000	

	R's Capital A/c Dr.		1,500	
	To Goodwill A/c			9,000
	(Being old goodwill written off among all partners in their old ratio)			
	P's Capital A/c Dr.		3,000	
	R's Capital A/c Dr.		1,000	
	To Q's Capital A/c			4,000
	(Being Q's share of goodwill adjusted among P and R in their gaining ratio)			

For Point no. 2, Machinery 24,000 and Equipment's 5,750 are to be valued at 20% less than their book values. Which means Assets value being decreased (Loss). So, Revaluation will be Debited with 24,000 *20% = Rs. 4,800 and **20% of 5,750 = Rs. 1,150.**

And as regards Point no. 3, Building is valued down by 10,000. Assets value being decreased (Loss). So, Revaluation will again be Debited by Rs. 10,000.

As Regards Point no. 4, Furniture to be appreciated by 15% of 8,200= 1,230, and Creditors to be reduced by Rs. 620. Assets value being increased (Profit) as well as Liability value being Decreased, again a Profit So, Revaluation will be Credited for Both

For Point no. 5, We will pay1,300 to Y Immediately And Rest Loan to be paid in three instalments, along with Interest. As we will see in Y's Capital Account balance, that Rs. 1,300 will be paid and the Remaining Rs. 21,000 will be paid in three instalments of Rs. 7,000 with Interest.

Let's Now make the Accounts to see the Final Picture

Books of X, Y and Z

Dr. REVALUATION ACCOUNT Cr.

Particulars	**Rs.**	**Particulars**		
To Machinery A/c	4,800	By Furniture A/c		1,230
To Equipment A/c	1,150	By Creditors A/c		620
To Buildings A/c	10,000	By Loss transferred to :		
		X's Capital A/c	7,050	
		Y's Capital A/c	4,700	
		Z's Capital A/c	2.350	14,100
	15,950			15,950

Dr. **PARTNERS'CAPITAL ACCOUNTS** **Cr.**

Particulars	X Rs.	Y Rs.	Z Rs.	**Particulars**	X Rs.	Y Rs.	Z Rs.
To Rev. A/c(Loss)	7,050	4,700	2,350	By Balance b/d	40,000	20,000	10,000
To Goodwill A/c	4,500	3,000	1,500	By General Res.	6,000	4,000	2,000
To Y's Capital A/c	3,000	—	1,000	By P/L a/c	3,000	2,000	1,000
To Cash A/c	—	1,300	—	By X's Capital A/c	—	3,000	—
To Y's Loan A/c	—	21,000	—	By Z's Capital A/c	—	1,000	—
To Balance c/d	34,450	—	8,150	By Balance b/d			
	49,000	30,000	13,000		49,000	30,000	13,000
					34,450	—	8,150

BALANCE SHEET as at 31.3.2020

Liabilities	Rs.	**Assets**	Rs.
Creditors	26,380	Furniture	9,430
Bills Payable	15,000	Cash at bank	950
Y's Loan @ 10% p.a.	21,000	Debtors	20,000
X's Capital	34,450	Stock	10,800
Z's Capital	8,150	Machinery	19,200
		Equipment	4,600
		Buildings	40,000
	1,04,980		1,04,980

Dr **Y's LOAN ACCOUNT** **Cr.**

Date	**Particulars**	Rs.	**Date**	**Particulars**	**Rs.**
Mar.31 2021	To Bank A/c (Rs. 7,000 + 2,100)	9,100	April.1 2020	By Y's Capital A/c	21,000
Mar.31	To Balance c/d	14,000	Mar.31	By Interest(21,000 x10%)	2,100
		23,100			23,100
Mar.31	To Bank A/c	8,400	April 1	By Balance b/d	14,000
2022	(Rs.7,000 + 1,400)		Mar.31	By Interest A/c	1,400
Mar.31	To Balance c/d	7,000		(Rs. 14,000x10%)	
		15,400			15,400
2023			2022		
Mar.31	To Bank A/c	7,700	April 1	By Balance b/d	7,000
	(Rs. 7,000 +700)		Mar.31 2023	By Interest 7,000 x 10%)	700
		7,700			7,700