CHAPTER – 4

Quick Revision Notes

RECONSTITUTION OF A PARTNERSHIP FIRM – RETIREMENT/DEATH OF A PARTNER

ACCOUNTING TREATMENT OF GOODWILL

The Retiring Partner is also responsible for bringing the firm to the level of enjoying reputation or goodwill and earning super or extra profits. When he retires from the firm, he surrenders his share of future normal and super profits to the other partners. Thus, retiring partner along with his share in the profits or losses is entitled to his share of goodwill of the firm. Retiring partner's share of goodwill is calculated as follows:-

Value of firm's goodwill X Retiring partner's Share of profit

As regards the accounting treatment of goodwill, it should be adjusted through partners' capital accounts it is also known as capital transfer. In this case, no doubt, adjustment is made to extent of the retiring partner's share of goodwill and the same is written back to the capital account of remaining continuing partners in their gaining ratio. In this case, following journal entry is recorded:-

Continuing Partners' Capital/Current A/cs Dr. (in gaining ratio)
To Retiring Partners' Capital/Current A/cs
(Share of goodwill)

Notes:-(i) If goodwill account already appears in the old Balance Sheet, it is to be written off by making the following entry:

All Partners' Capital/current A/cs Dr.
To Good will A/c
(For existing goodwill written off in old ratio)

(ii) If any of the remaining partner has also agreed to sacrifice some share in the profits of the firm on retirement of a partner, the following entry should be recorded;

Continuing Partners' Capital/Current A/cs Dr.(Who have gained)
To Retiring Partners' Capital/Current A/cs (Who have sacrificed)
To Continuing Partners' Capital/Current A/cs (Who have sacrificed)

Settlement of the Amount Due to the Retiring Partner

The amount due to a retiring partner has to be paid to him or transferred to his Loan Account. The retiring partners' loan account will appear in the books of the new firm as a liability until it is paid off. The entry will be as follows:

(i) *If the amount is paid in cash or by cheque:*

Retiring Partner's capital A/c Dr.
To Cash/Bank A/c

(ii) *If the amount is not paid in cash:*

Retiring Partner's capital A/c
To retiring Partners' Loan A/c Dr.

Notes: If nothing is given in the question about the payment, it will be transferred to retiring partner's loan account.

Adjustment of Partner's Capital in New Profit Sharing Ratio

After the retirement of a partner, sometimes, the remaining partners may wish to adjust their capitals in accordance with their new profit share ration or on some other agreed basis. For the purpose of adjustment, the final adjusted closing capital balances of remaining partners have to be found out. After that, these final balances in their capital accounts have to be compared their new capitals (or their required capitals); the partner whose capital falls short will bring in cash required capital or transferred to his current account and the partner who has surplus capital will withdraw excess amount of capital return in cash or transferred to his current account. For this purpose, the following entries will be passed:-

(i) *If capital of remaining partner falls short, bring in cash:*

Cash/Bank A/c Dr.

To Remaining Partner's Capital A/c

(ii) *If capital or remaining partner has a surplus, withdraw cash:*

Remaining Partner's Capital A/c Dr.

To Cash/Bank A/c

OR

(i) *If the deficit in their capital accounts is adjusted by transferring to their current accounts:*

Remaining Partner's Capital A/c Dr.

To Cash/Bank A/c

(ii) If the surplus in their capital accounts is adjusted by transferring to their current accounts:

Remaining Partner's Capital A/c Dr.

To Remaining Partner's Current A/c

Note:- Unless agreed, otherwise any surplus or deficiency should be adjusted in cash and not by transferring it to partner's current account.

Format of Revaluation A/c

Dr. **Revaluation A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Decrease in value of assets (Loss) To Increase in value of Liabilities (Loss) To Unrecorded Liabilities (at an agreed value) To Profit transferred to All Partner's Capital/Current A/c (in old ratio) Total	....	By Increase in value of assets (Profit) By Decrease in value of Liabilities(Profit) By Unrecorded Assets (at an agreed value) By Loss transferred to All Partner's Capital/Current A/c (in old ratio) Total	....

Format of Partners' Capital A/c (Suppose C is retiring partner)

Particulars	A	B	C	Particulars	A	B	C
To Revaluation loss	xx	xx	xx	By balance b/d	xx	xx	xx
To P & L A/c (Dr.)	xx	xx	xx	By gaining partner's			xx
To Advertisement Suspense A/c	xx	xx	xx	capital A/c (goodwill)			
To Sacrificing/retiring partner's	xx	xx		By revaluation	xx	xx	xx
capital A/c (goodwill)				Profit			
To old goodwill	xx	xx		By Reserves/workmen	xx	xx	xx
To cash A/c (if some cash paid			xx	compensation reserve/			
to retiring partner)				Investment fluctuation	xx	xx	xx
To retiring partner's loan A/c			xx	fund	xx	xx	xx
To balance c/d	xx	xx		By P & L A/c (Cr.)			
	xx	xx	xx		xx	xx	xx

DEATH OF A PARTNER

Calculation of share of profit up to date of death

(i) On the basis of time

(ii) On the basis of turnover

(i) On the basis of time: If the time basis is used, the profit will be assumed to have uniformity over the year. According to this method, profit may estimated by any one of the following two methods:

(a) On the basis of the last year's profit:- In this case, last year's profit is given in the question and on this basis, the profit of the period between the date of preparing last final accounts to the date of death is calculated. After that proportionate share of outgoing partner will be calculated.

(b) On the basis of average profits: In certain cases. Partners may agree to calculate deceased partner's share of profit on the basis of average profit. This is worked out as follows: Total Profits / No. of years In such a case average profit is used instead of year's profit. In the form of formula:

Formula: Decease Partner's share of Profit = Previous year's profit or Average Profits x Time till death/ 12 or 365 X Deceased partner's proportion of Profit

(ii) On the basis of turnover (or sales): If profits till the date of death are to be calculated on the basis of turnover, on such arrangement last year's profit and sales are given together with the sale of the current year up to the date of death of the partner. The profit is ascertained proportionately and the share of profit of deceased partner is calculated. In the form of formula:

Formula: Deceased partner's share of profit= Last year's Profit/ Last year's Sale X Sales till death X Deceased partner's Profit Share

Ascertainment of the Amount due to the Deceased Partner

Deceased Partner's Capital A/c

	Rs.		Rs.
To Undistributed Losses	-	By Balance b/d	-
(Advertisement suspense/ P & L Dr.)	-	By Interest on Capital A/c	-
(Share in such losses)		By salary and Commission A/c	-
To Revaluation A/c (Share in loss)	-	By Undistributed Profits(Reserves/	-
To Goodwill A/c written off (share in	-	workmen compensation reserve/	-
old goodwill)	-	Investment fluctuation fund/P & L) (share	-
To Drawing A/c		in such profits)	-
To Interest on Drawing A/c	-	By Revaluation A/c (share in profit)	-
To Profit & Loss Suspense A/c (Share		By Gaining Partner's Capital A/c (share of	
in loss till death)		goodwill)	
To Deceased Partner's Executor's A/C		By Joint Life Policy A/c (share of J.L.P.)	
(Bal. Fig.)		By Profit & Loss suspense A/c (Share in	
		profits till death)	

(i) If the amount is paid in cash, the entry will be:

Deceased Partner's Executor A/c Dr.

To Cash/Bank A/c

(ii) When the settlement is made in installments, the following entries are recorded :

(a) For Interest due:

Interest on deceased Partner's Executor's A/c Dr.

To Deceased Partner's Executor's A/c

(b) For Payment of installment including interest:

Deceased Partner's Executor's A/c Dr.

To Cash/Bank A/c