CHAPTER – 4

RETIREMENT & DEATH OF A PARTNER

RETIREMENT

Retirement of a partner means the withdrawal of a partner himself from the business for various reasons such as old age, lack of interest in business etc. A partner can retire from the business either as per the terms of agreement or voluntarily, on retirement he is entitled to get all the sums due to him up to the date of retirement, as well as he is liable for his share in all losses till the date of his retirement.

Accounting Aspects on Retirement

1. Change in Profit sharing ratio.
2. Calculation of gaining ratio.
3. Adjustment regarding goodwill.
4. Adjustment of reserves and accumulated profits/losses.
5. Revaluation of assets and liabilities.
6. Ascertainment of profit or loss up to the date of retirement.
7. Calculation of total amount due to the retiring partner.
8. Settlement of total amount due to the retiring partner.
9. Adjustment of capitals of continuing partner.

Change in Profit Sharing Ratio

While retiring a partner the profit sharing ratio of the existing partners may be revised. The share of outgoing partner is often acquired by the existing partners in their profit sharing ratio itself, unless otherwise agreed upon ie; the profit sharing ratio among the remaining partners will not change. Suppose, A,B &C share profits in the ratio of 3 : 2 : 1 and B retires, the ratio between A and C will be 3 : 1, whereas if they decide to be equal partners, the new ratio will be 1 : 1.

Gaining Ratio

The ratio in which the continuing partners share the profit of outgoing partner is called gaining ratio.

GAINING RATIO = NEW RATIO – OLD RATIO

:. GAINING SHARE = NEW SHARE – OLD SHARE

Revaluation of Assets and Liabilities

Assets and Liabilities are to be revalued at the time of retirement as in the case of admission of a partner. It is to be done, in order to find out the appropriate share of retiring partner in the firm. It can be done through a revaluation account or profit and loss adjustment account and the profit or loss on revaluation is transferred to all the partner's capital accounts in their old ratio.

Accounting treatment – similar to admission of a partner

Adjustment of Accumulated Profits / Losses

General reserve, profit and loss account credit balance and unused reserves like workmen's compensation fund (in liability side) should be transferred to all partner's capital accounts in their old ratio. Accounting treatment:

General Reserve A/c	Dr
Workmen's compensation fund A/c	Dr
Profit and Loss A/c	Dr
To Partners' capital account (individually)	

In case of accumulated loss (debit balance in P/L account) appearing on the assets side;

Partner's Capital A/c	Dr
To Profit and Loss A/c	

Note: In the above cases, Reserves or Profit and Loss account balances should not be shown in the balance sheet prepared immediately after retirement.

Alternatively, only retiring partner's share in these items may be credited (if profit) or debited (if loss) to his capital account.

1. To transfer retiring partner's share of reserve or accumulated profit:

Reserve / Profit and Loss A/c	Dr	
To Retiring partner's capital A/c		(retiring partner's share only)

2. To transfer retiring partner's share of accumulated loss:

Retiring partner's capital A/c	Dr	
To Profit and Loss A/c		(retiring partner's share only)

Note: Amount of reserve and profit and loss account after deducting retiring partner's share will be shown in the balance sheet prepared immediately after retirement.

These accounts must be transferred to partner/partners' capital accounts even if the question is silent in this regard.

Ascertainment of Profit or Loss up to the date of retirement

Usually the retirement takes place on the closing day of the accounting year. If a partner retires on any day other than the closing day of the accounting year, the partner is entitled to share the profits or losses till the date of retirement. It is determined on the basis of past profits as follows:

a. Take the total profits of the required number of past years.
b. Calculate the average annual profit.
c. Reduce the average annual profit for the period up to the date of retirement.
d. Find out the share of retiring partner.

Alternatively, in practice actual profit or loss is determined by drawing interim accounts up to the date of retirement.

1. In case of profit:

    Profit and Loss Suspense A/c Dr
        To Retiring partner's Capital Account

Note: P/L suspense account, being debit balance, is shown on the assets side of balance sheet. At the end of the year it is closed by transfer to P/L account.

2. In case of loss:
    Retiring partner's capital A/c Dr
        To Profit and Loss Suspense A/c

Disposal of amount due to the retiring partner

1. **Lump Sum Payment:** The total amount due to the retiring partner shown by his capital account may be paid in full at the time of retirement, the entry will be:

    Retiring partner's capital account Dr
        To Cash / Bank

2. **Payment in Installments:** If the firm is not in a position to pay off the entire amount in lump sum, the amount due to him is transferred to his loan account and it will be paid in installments along with the interest as per the agreement.

Entry:
    Retiring partner's capital a/c Dr
        To Retiring partner's loan account.

Note: This loan amount will be shown on the liability side of the balance after retirement.

When the retiring partner is partly paid in cash and balance amount treated as loan, the accounting treatment is as follows:

    Retiring Partner's Capital A/c Dr
        To Cash / Bank A/c
        To Retiring Partner's Loan A/c

As per section 37 of the Indian Partnership Act, the outgoing partner can claim proportionate share in the profit earned on the amount due to him from the date of his retirement to the date of final payment or interest @ 6% per annum at his option.

Each installment consists of Principal amount and Interest at an agreed rate. Interest due on loan is credited to loan account and installments (principal amount plus interest) are paid at agreed intervals.

Journal entries:

a. For interest due on loan
    Interest on loan A/c Dr

Retired partner's loan A/c

b. For payment of installments:

Retired partner's loan A/c Dr
To Cash/Bank A/c (Principal amount + interest)

c. For closing interest on loan at the end of financial period

Profit and Loss A/c Dr
To Interest on loan A/c

Note: 1.The above entries are repeated until the loan account is closed.
2. Interest on loan is calculated on the outstanding amount of loan.
3. **Part payment and balance in installments:** In this case, a part payment is made to the retiring partner and the balance amount in the capital account is transferred to retiring partner's loan account.

Entry:

Retiring partner's capital A/c Dr (Total amount due)
To bank A/c (Part payment made)
To Retiring partner's loan A/c (Balance amount as loan)

Adjustment of capitals of continuing partners

In certain cases, after the retirement of a partner, the remaining partners may decide to adjust their capitals in proportion to their new profit sharing ratio as follows:

Steps:

a. Fix an amount as capital of the new firm or find out the existing capital balance after making all adjustments. This is called adjusted capital.
b. Add the adjusted capitals of continuing partners. This will become the total capital of the firm.
c. Ascertain share of capital of continuing partner in the total capital in proportion to their new ratio by the following equation:

Total capital required x New profit sharing ratio of each partner

d. If the existing capital balance of any partner after all adjustments is more than that of the new capital, he can withdraw the surplus or it may be transferred to the current account. Whereas if there is any deficiency, it should be brought in or adjusted from his current account.

In case of excess capital.

Entry:

Partner's capital account Dr
To Cash / Current Account

In case, if the existing capital is less than the new capital, he is required to bring the necessary amount to make good the deficit.

Entry:

Cash / Current Account Dr
To Partner's Capital Account

DEATH OF A PARTNER

A partnership will come to an end as soon as a partner dies, although the firm may continue with the remaining partners. The accounting treatments for various adjustments in case of death of a partner are similar to that of a retiring partner. However there are some differences between retirement and death.

1. Retirement is planned and which usually takes place at the end of the accounting period. Death may take place at any time.
2. Partner's connection with the firm is voluntarily broken in the case of retirement. It is automatic in the case of death.
3. Amount payable to the retiring partner is transferred to his loan account. But in case of death it is transferred to the Executor's account.

The amount due to the deceased partner is calculated in the same manner as in the case of retirement and the payment of deceased partner's share in the firm will be received by his legal representatives. Most of the accounting treatments are similar to that of retirement.

Whenever a firm is not in a position to make the full payment immediately in cash, amount due to the deceased partner is transferred to his Executor's Loan Account.

Entry:
Deceased partner's capital a/c Dr
To Deceased partners' Executor's loan a/c If

the amount due to the deceased partner is paid in full:

Entry:
Deceased Partner's Capital A/c Dr
To Cash A/c

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