
Retirement
Stocks, 16

Learning Objectives

The students would be able to understand:-

1. Meaning of Retirement of a Partner
2. Calculation of New Profit Sharing Ratio of the remaining partners after retirement or death of a partner
3. Calculation of Gaining Ratio of remaining partners
4. Valuation and Adjustment of Goodwill on retirement or death
5. Revaluation of Assets and Reassessment of Liabilities
6. Accounting Treatment of Reserves and Accumulated Profits or Losses
7. Death of a Partner

Retirement of a Partner

Retirement of a partner means retiring from the firm. It is also the reconstitution of the partnership under which partnership comes to an end and new partnership among continuing partners, comes into existence.

A partner may retire from the firm:-

(i) If there is an agreement to that effect;

(ii) If all the partners are agree to his retirement, or

(iii) If the partnership is at will, by giving a written notice to the remaining partners of his decision of retire.

Adjustment required on Retirement of a Partner

1. Determining New Profit Sharing Ratio and Gaining Ratio
2. Valuation and Adjustment of Goodwill on retirement or death
3. Revaluation of Assets and Reassessment of Liabilities
4. Accounting Treatment of Reserves and Accumulated Profits or Losses
5. Computation of amount due to Retiring Partner

New Profit Sharing Ratio

New profit sharing ratio on retirement of a partner is the ratio in which the remaining partners decide to share future profits and losses.

For Calculation of New Profit Sharing Ratio there may be following situations:-

1. When one partner retires and the new profit sharing ratio among the remaining partner is not given
2. When the remaining partners acquire share of the retiring partner in specified ratio

1. When one partner retires and the new profit sharing ratio among the remaining partner is not given

In this case the old ratio of the remaining partners will be the new profit sharing ratio of remaining partners.

No Change in the ratio of Continuing partners

Illustration

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. Calculate New Profit Sharing Ratio, If

(a) A retires

(b) B retires

(c) C retires

Solution

(a) New Ratio of B and C will be 3:2

(b) New Ratio of A and C will be 4:2 or 2:1

(c) New Ratio of A and B will be 4:3

2. When the remaining partners acquire share of the retiring partner in specified ratio

X, Y and Z are partners sharing profits and losses in the ratio of 5:3:2. Y retires and his share is taken by X and Z in the ratio of 2:1. Calculate new profit sharing ratio.

Solution:-

$$X\ gets\ \text{from Y} = \frac{3}{10} \times \frac{2}{3} = \frac{2}{10}$$

$$Z\ gets\ from\ Y = \frac{3}{10} \times \frac{1}{3} = \frac{1}{10}$$

$$X's\ \text{new share} = \frac{5}{10} + \frac{2}{10} = \frac{5+2}{10} = \frac{7}{10}$$

$$Z's\ \text{new share} = \frac{2}{10} + \frac{1}{10} = \frac{2+1}{10} = \frac{3}{10}$$

$$New\ profit\ sharing\ ratio = \frac{7}{10} : \frac{3}{10} = 7:3$$

Gaining Ratio

The Ratio in which the continuing partners acquire the retiring partner's share is called the gaining ratio.

$$\boldsymbol{Gaining\ Ratio = New\ share - old\ share}$$

For Calculation of Gaining Ratio there may be following situations:-

1. **When there is no agreement exists**
2. **When new profit sharing ratio is given**

1. When there is no agreement exist

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. Calculate gaining ratio, If

(a) A retires

(b) B retires

(c) C retires

Solution

(a) Gaining Ratio of B and C will be 3:2

(b) Gaining Ratio of A and C will be 4:2 or 2:1

(c) Gaining Ratio of A and B will be 4:3

2. When New Profit Sharing Ratio is Given

P, Q and R are partners sharing profits and losses in the ratio of 2:2:1. R retires, P and Q decide to share future profits and losses in the ratio of 2:1 respectively. Calculate the gaining ratio

Solution:- $Gaining\ Ratio = New\ share - Old\ share$

$$P's\ Gain = \frac{2}{3} - \frac{2}{5} = \frac{10-6}{15} = \frac{4}{15}$$

$$Q's\ Gain = \frac{1}{3} - \frac{2}{5} = \frac{5-6}{15} = -\frac{1}{15} = \frac{1}{15}\ (Sacrify)$$

Valuation and Accounting treatment of Goodwill

As per AS-26 ‘Intangible Assets’ prescribes that goodwill should be recorded in the books only when consideration in money or money’s worth is paid for it or say goodwill purchased.

Goodwill is an intangible asset which enables a firm to earn higher profit than the normal profit earned by the other firm. It is due to efforts made by the existing partners in the past and this goodwill is known as self-generated goodwill.

At the time of retirement of a partner goodwill may be adjusted through capital accounts of the partners or Goodwill Account may be opened and immediately written off..

Accounting treatment of Goodwill at the time of Retirement of a Partner

Accounting treatment of goodwill at the time of retirement of a partner will be:-

1. **When Goodwill does not appear in the books**
2. **When Goodwill appears in the books**

1. When goodwill does not appears in the books

When goodwill is not given in the Balance Sheet of the partnership firm, there may be three ways in which the retiring partner is credited for his share of goodwill:-

(a) Goodwill Account is not raised in the books of account

(b) Goodwill is raised at its full value and written off

(c) Goodwill is raised to the extent of retiring or deceased partner's share and written off.

(a) Goodwill Account is not raised in the books of account

The following journal entries will be made:-

Gaining Partner's Capital A/c Dr.
To Retiring or Deceased Partner's Capital A/c
(for the share of goodwill credited to retiring or deceased partner's capital account in gaining ratio)

P, Q, R and S are partners sharing profits and losses in the ratio of 2:1:2:1. On the retirement of R, goodwill was valued at Rs.72,000. P, Q and S decided to share future profits equally. Pass necessary adjustment entry for goodwill without opening Goodwill Account.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	Q's Capital A/c Dr. S's Capital A/c Dr. To R's Capital A/c (for the share of goodwill credited to retiring or deceased partner's capital account in gaining ratio)		12,000 12,000	 24,000

Goodwill of the firm$= \boldsymbol{Rs.72,000}$

R's share of Goodwill$= \mathbf{72,000 \times \frac{2}{6} = 24,000}$

P's Gain$= \mathbf{\frac{1}{3} - \frac{2}{6} = \frac{2-2}{6} = \frac{0}{6}}$

Q's Gain$= \mathbf{\frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}}$

S's Gain$= \mathbf{\frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}}$

(b) Goodwill is raised at its full value and written off

The following journal entries will be made:-

Goodwill A/c Dr.
To All Partner's Capital A/c (in old ratio)
(for the goodwill raised at its current value)

Continuing Partner's Capital A/c Dr.
To Goodwill A/c (in new ratio)
(for the goodwill account written off in new profit sharing ratio)

Azim, Nusli and Sunil are partners sharing profits in the ratio of 3:2:1. Sunil retires from the firm on 1st April, 2019 on which date goodwill of the firm was valued at Rs.2,40,000. Azim and Nusli decided to share future profits equally from that date. Pass necessary journal entries for the goodwill on retirement of Sunil when goodwill is raised at its current value.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
2019 1 April	GoodwillA/c Dr. To Azim's Capital A/c To Nusli's Capital A/c To Sunil's Capital A/c (for goodwill account is raised with its current value)		2,40,000	 1,20,000 80,000 40,000
	Azim's Capital A/c Dr. Nusli's Capital A/c Dr. To Goowill A/c (for goodwill written off by debiting the continuing partners capital account)		1,20,000 1,20,000	 2,40,000

(c) Goodwill is raised to the extent of retiring or deceased partner's share and written off.

The following journal entries will be made:-

Goodwill A/c Dr.
To Retiring or Deceased Partner's Capital A/c
(for the goodwill raised with the share of retiring or deceased partner in current value of Goodwill)

Gaining Partner's Capital A/c Dr. (in gaining ratio)
To Goodwill A/c
(for the goodwill account written off in gaining ratio)

Shiv, Kumar and Savitri are partners sharing profits in the ratio of 3:2:1. Savitri retired from the firm on 1st April, 2020 on which date goodwill of the firm was valued at Rs.1,80,000. Shiv and Kumar decided to share future profits equally from that date. Pass necessary journal entries raising goodwill for Savitri's share in current value of goodwill.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
2020 1 April	GoodwillA/c Dr. To Savitri's Capital A/c (for goodwill account is raised with Savitri's share current value)		30,000	30,000
	Kumar's Capital A/c Dr. To Goowill A/c (for goodwill written off by debiting the gaining partners' capital account)		30,000	30,000

Savitri's share in goodwill= $1{,}80{,}000 \times \frac{1}{6} = 30{,}000$

$$Shiv's\ gain = \frac{1}{2} - \frac{3}{6} = \frac{3-3}{6} = \frac{0}{6}; \qquad Kumar's\ gain = \frac{1}{2} - \frac{2}{6} = \frac{3-2}{6} = \frac{1}{6}$$

2. When goodwill appears in the books

Goodwill appears in the books means it is purchased goodwill, because self generated goodwill is not recorded in the books of accounts. The following journal entry will be made for goodwill appeared in the books:-

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	All Partner's Capital A/c Dr. To Goodwill A/c (for the existing goodwill written off)			

Pankaj, Kiran and Ravi are partners sharing profits in the ratio of 2:3:5. Goodwill is appearing in the books at a value of Rs.50,000. Pankaj retires and on the day of Pankaj's retirement, goodwill valued at Rs.45,000. Kiran and Ravi decided to share future profits in the ratio of 3:2. Pass necessary journal entries.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	Pankaj's Capital A/c Dr. Kiran's Capital A/c Dr. Ravi's Capital A/c Dr. To Goodwill A/c (for goodwill appearing in the books written off)		10,000 15,000 25,000	 50,000
	Kiran's Capital A/c Dr. To Pankaj's Capital A/c To Ravi's Capital A/c (for goodwill is adjusted for the retiring and sacrificing partners)		13,500	 9,000 4,500

Pankaj's share in goodwill= $45{,}000 \times \frac{2}{10} = 9{,}000$

Kiran's gain $= \frac{3}{5} - \frac{3}{10} = \frac{6-3}{10} = \frac{3}{10}$; $\quad Ravi's\ gain = \frac{2}{5} - \frac{5}{10} = \frac{4-5}{10} = \frac{1}{10} (sacrify)$

Ravi's share in goodwill for 1/10th share= $45{,}000 \times \frac{1}{10} = 4{,}500$

Hidden Goodwill

Goodwill appears in the books means it is purchased goodwill, because self generated goodwill is not recorded in the books of accounts. The following journal entry will be made for goodwill appeared in the books:-

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	All Partner's Capital A/c Dr. To Goodwill A/c (for the existing goodwill written off)			

Revaluation of Assets and Reassessment of Liabilities

At the time of retirement or death of a partner, assets of the firm are revalued and liabilities are reassessed with a purpose that the retiring partner is not at an advantage or disadvantage because of the change in the values after retirement or death. So, to give effect to the change in value of assets and liabilities a Revaluation Account is prepared.

If there is increase in the value of asset and decrease in the amount of liability then there is a gain.

If there is decrease in the value of asset and increase in the amount of liability then there is a loss.

The gain or loss should be share by the old partners in their old profit sharing ratio.

The partner may decide:-

(i) Record revised (changed) values of assets and liabilities in books of accounts of the firm.

(ii) Not to record the revised (changed) values of assets and liabilities in the books of accounts of the firm.

When revised (changed) values of assets and liabilities are to be recorded

Revaluation of assets and reassessment of liabilities are recorded in an account called Revaluation Account or Profit and Loss Adjustment Account. Increase in the value of assets and decrease in the amount of liabilities are credited and decrease in the value of assets and increase in the amount of liabilities are debited in this account.

Journal Entries

1.	For increase in the value of Assets	Assets A/c Dr. To Revaluation A/c (For assets increased)
2.	For decrease in the value of Assets	Revaluation A/c Dr. To Assets A/c (For assets decreased)
3.	For increase in the amount of liability	Revaluation A/c Dr. To Liability A/c (For liability increased)
4.	For decrease in the amount of liability	Liability A/c Dr. To Revaluation A/c (For liability decreased)
5.	For recording an unrecorded asset	Assets A/c Dr. To Revaluation A/c (For unrecorded assets recorded)
6.	For recording an unrecorded liability	Revaluation A/c Dr. To Liability A/c (For unrecorded liability recorded)

For transfer of Balance in Revaluation Account

(a) If credit side of Revaluation Account is more than debit side

Revaluation A/c Dr.

To Partners' Capital A/c

(For profit on revaluation transferred to partners' capital account in their old ratio)

(b) If debit side of Revaluation Account is more than credit side

Partners' Capital A/c Dr.

To Revaluation A/c

(For loss on revaluation transferred to partners' capital account in their old ratio)

Format of Revaluation Account

Particualrs	Rs.	Particulars	Rs.
To Assets	------	By Assets	------
(decrease in assets)		(increase in assets)	
To Liability	------	By Liability	------
(increase in liability)		(decrease in liability)	
To Unrecorded Liability	------	By Unrecorded Assets	-------
To Profit	------	By Loss	-------
(transfer to partners'		(transferred to partners'	
Capital/Current A/c)		Capital/current A/c)	
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	======		======

Raman, Rahul and Rakesh are partners sharing profits in the ratio of 5:3:2. Their Balance Sheet as at 31st March, 2019 was as follows:

Liabilities		Rs.	Assets		Rs.
Creditors		15,000	Cash at Bank		27,000
Capitals:-			Stock		12,800
Raman	46,000		Sundry Debtors	16,000	
Rahul	34,000		Less: Provision	800	15,200
Rakesh	25,000	1,05,000	Plant and Machinery		35,000
			Land and Building		30,000
		1,20,000			1,20,000

Rahul retires from the firm on 1st April, 2019. Raman and Rakesh decided to share future profits and losses in the ratio of 3:1. Following adjustments are agreed:-

(i) An amount of Rs.1,100 included in Debtors be written off as it is no longer receivable.

(ii) Provision for Doubtful Debts be maintained at the existing rate.

(iii) Stock be written down by Rs.1,055; Land and Building be written up by Rs.11,000; Plant & Machinery be reduced to Rs.34,000 and a provision for Rs.600 be made for repairs.

(iv) An amount of Rs.700 included in Sundry Creditors be written off as no longer payable.

(v) An old computer previously written off was sold for Rs.2,000 as scrap

Pass necessary journal entries and also prepare Revaluation Account.

Journal Entries

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2019 1 April	Bad Debts A/c Dr. To Debtors A/c (For the bad debts written off)		1,100	 1,100
1 April	Provision for Doubtful Debts A/c Dr. Revaluation A/c (1100-800) Dr. To Bad Debts A/c (For the balance of bad debts transfer to revaluation account)		800 300	 1,100
1 April	Revaluation A/c Dr To Provision for D/D A/c (For provision for doubtful debts created on 16000-1100=14900 @ 5%)		745	 745

Journal Entries

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2019 1 April	Revaluation A/c Dr. To Stock A/c To Plant and Machinery A/c (For decrease in Stock and Plant and Machinery)		2,055	 1,055 1,000
1 April	Land and Building A/c Dr. Creditors A/c Dr. To Revaluation A/c (For increase in Land & Building and decrease in Creditors)		11.000 700	 11,700
1 April	Revaluation A/c Dr. To Provision for Repairs A/c (For unrecorded liability recorded)		600	 600

Journal Entries

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1 April	Bank A/c Dr. To Revaluation A/c (For old Computer sold, previously written off)		2.000	 2,000

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
1 April	Revaluation A/c Dr To Raman's Capital A/c To Rahul's Capital A/c To Rakesh's Capital A/c (For profit on revaluation transferred to partners' capital account)		10,300	 5,150 3,090 2,060

Revaluation Account

Particualrs		Rs.	Particulars	Rs.
To Bad Debts		300	By Land and Building	11,000
To Provision for D/D		745	By Creditors	700
To Stock		1,055	By Bank A/c	2,000
To Plant and Machinery		1,000		
To Provision for Repairs		600		
To Profit				
(transfer to partners' Capital A/c)				
Raman	5,150			
Rahul	3,090			
Rakesh	2,060	10,300		
		13,700		13,700

Accounting Treatment of Reserves and Accumulated Profits or Losses

If at the time of Retirement or Death of a Partner, reserves and accumulated profits or losses are given in the books of the firm, they will be transferred to the all partners' capital or current account in their old profit sharing ratio.

Journal Entries:-

1. **For transfer of Reserve and Accumulated Profits:-**

Reserve A/c	Dr.
Contingency Reserves A/c	Dr.
Profit and Loss A/c (Cr. Balance)	Dr.
Workmen Compensation Reserve A/c	Dr.
Investment Fluctuation Reserve A/c	Dr.
To All Partners' Capital/Current A/c	

2. **For transfer of Accumulated losses:-**

All Partner's Capital A/c	Dr
To Profit and Loss A/c (Dr. Balance)	
To Deferred Revenue Expenditure A/c	

Workmen Compensation Reserve

This is a reserve set aside out of firm's profits to meet possible liability to pay compensation to employees, if it arises. The claim may or may not arise. Excess of Workmen Compensation Reserve over the workmen compensation liability is credited to all partner's capital account in their old profit sharing ratio.

Account Treatment of Workmen Compensation Reserve

(A) If no claim against Workmen Compensation Reserve Exists:-

Workmen Compensation Reserve A/c Dr.

To All Partner's Capital/Current A/c

(For the amount of Workmen Compensation Reserve Transferred to All Partners' Capital/Current A/c in old profit sharing ratio)

(B) If claim for Workmen Compensation Exists:-

There can be three possible situation:

(i) If the claim is less then the amount of Workmen Compensation Reserve

(ii) If the claim is equal to the amount of Workmen Compensation Reserve

(iii) If the claim is more than the amount of Workmen Compensation Reserve

(i) If the claim is less then the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To Provision for Worker's Claim A/c

To All Partner's Capital/Current A/c

(For provision for estimated claim is made and balance transferred to all partners' capital account in old ratio)

(ii) If the claim is equal to the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To Provision for Worker's Claim A/c

(For provision for estimated claim is made)

(iii) If the claim is more than the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

Revaluation A/c Dr.

To Provision for Worker's Claim A/c

(For the amount of claim debited to Workmen Compensation Reserve and Revaluation A/c)

All Partners' Capital A/c Dr.

To Revaluation A/c

(For loss on revaluation transferred to Capital/Current A/c in old ratio)

Investment Fluctuation Reserve

Investment Fluctuation Reserve is created out of profit to meet the fall in the market value of investment. At the time of admission of a partner, the accounting treatment of Investment Fluctuation Reserve is as follows:-

(i) If book value is equal to market value

(ii) If market value is less than the book value

(iii) If market value is more than the book value

(i) If book value is equal to market value

Investment Fluctuation Reserve A/c Dr.

To All Partners' Capital/Current A/c

(For the amount of Investment Fluctuation Reserve transferred to all partners' capital account in old ratio)

(ii) If market value is less than the book value

Investment Fluctuation Reserve A/c Dr.

To Investment A/c

To All Partners' Capital/Current A/c

(For fall in the value of investment is meet out and balance is transferred to Capital/Current A/c in old ratio)

(iii) If market value is more than the book value

Investment Fluctuation Reserve A/c Dr.

To All Partners' Capital/Current A/c

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in their old ratio)

Investment A/c Dr.

To Revaluation A/c

(For increase in the value of investment)

Revaluation A/c Dr.

To All Partners' Capital A/c

(For profit on revaluation transferred to all partners' capital account in their old ratio)

Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Retiring/Deceased Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated losses

Retiring/Deceased Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Methods of Amount due to the Retiring Partner

The amount due to retiring partner can be settled in the following two ways:-

(i) Payment of Full Amount in Lump Sum

(ii) Transfer of Balance of Retiring Partner in his Loan Account and Payment in Installments

(i) Payment in Full Amount in Lump Sum

If the amount payable to the retiring partner is paid in full at the time of retirement following entry is passed:-

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

To Cash/Bank A/c

(For balance of retiring partner is paid)

(ii) Transfer of Balance of Retiring Partner in his Loan Account and Payment in Installments

It may be agreed that the amount payable to the retiring partner will be paid in installment. In such a case, balance in his capital account is transferred to his loan account and interest is credited to the loan account on the basis of the amount outstanding in the beginning of the year and installment amount is paid with interest.

Retiring Partners' Capital/Current A/c Dr.

To Retiring Partner's Loan A/c

(For balance of retiring partner is transferred to his loan account)

Illustration

A, B and C are partners sharing profits and losses in the ratio of 4:3:2, A decided to get retire from the partnership firm on 31st March, 2018. An extract of their Balance Sheet as at 31st March, 2018 is:

Liabilities	Rs.	Assets	Rs.
Workmen Compensation Reserve	90,000		

Show the accounting treatment of Workmen Compensation Reserve on the retirement of A, under following alternatives:-

1. **If there is no other information.**
2. **If claim on account of workmen compensation is estimated at Rs.45,000.**
3. **If claim on account of workmen compensation is estimated at Rs.99,000.**

Account Treatment of Workmen Compensation Reserve

1. If no claim against Workmen Compensation Reserve Exists:-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**	
To A's Capital A/c			**40,000**
To B's Capital A/c			**30,000**
To C's Capital A/c			**20,000**

(For the amount of Workmen Compensation Reserve Transferred to All Partners' Capital/Current A/c in old profit sharing ratio)

2. If claim on account of Workmen Compensation is estimated Rs.45,000:-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**	
To Worker's Claim A/c			**45,000**
To A's Capital A/c			**20,000**
To B's Capital A/c			**15,000**
To C's Capital A/c			**10,000**

(For the amount of surplus Workmen Compensation Reserve Transferred to All Partners' Capital/Current A/c in old profit sharing ratio)

3. If claim on account of Workmen Compensation is estimated Rs.99,000 :-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**
Revaluation A/c	**Dr.**	**9,000**
To Provision for Workmen Compensation claim		**99,000**

(For the provision created and shortfall charged to revaluation account)

Illustration

Ram, Rehman and Francis are partners sharing profits and losses in the ratio of 4:3:2. Rehman decided to get retire from the partnership on 31st March, 2018. An extract of their Balance Sheet as at 31st March, 2018 is:

Liabilities	Rs.	Assets	Rs.
Investment Fluctuation Reserve	18,000	Investment	2,00,000

Show the accounting treatment of Workmen Compensation Reserve on the retirement of Rehman under following alternatives:-

1. **If there is no other information.**
2. **If the market value of Investment is Rs.2,00,000.**
3. **If the market value of Investment is Rs.1,91,000**
4. **If the market value of Investment is Rs.1,73,000**
5. **If the market value of Investment is Rs.2,18,000.**

1. If there is no other information

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
To Ram's Capital A/c			**8,000**
To Rehman's Capital A/c			**6,000**
To Francis's Capital A/c			**4,000**

(For the amount of Investment Fluctuation Reserve transferred to all partners' capital account in old ratio)

2. If the market value of Investment is Rs.2,00,000

Investment Fluctuation Reserve A/c	Dr.	18,000	
To Ram's Capital A/c			8,000
To Rehman's Capital A/c			6,000
To Francis's Capital A/c			4,000

(For the amount of Investment Fluctuation Reserve transferred to all partners' capital account in old ratio)

3. If the market value of Investment is Rs.1,91,000

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
To Investment A/c			**9,000**
To Ram's Capital A/c			**4,000**
To Rehman's Capital A/c			**3,000**
To Francis's Capital A/c			**2,000**

(For the surplus amount of Investment Fluctuation Reserve transferred to all partners' capital account in old ratio)

4. If the market value of Investment is Rs.1,73,000

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
Revaluation A/c	**Dr.**	**9,000**	
To Investment A/c			**27,000**

(For excess fall in value than the balance of Investment Fluctuation Reserve transferred to Revaluation A/c)

Ram's Capital A/c	**Dr.**	**4,000**	
Rehman's Capital A/c	**Dr.**	**3,000**	
Francis's Capital A/c	**Dr.**	**2,000**	
To Revaluation A/c			**9,000**

(For the loss on revaluation transferred to all partner's capital account)

5. If the market value of Investment is Rs.2,18,000

Investment Fluctuation Reserve A/c	Dr.	18,000	
To Manohar's Capital A/c			8,000
To Mahesh's Capital A/c			6,000
To Mukesh's Capital A/c			4,000

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

Investment A/c	Dr.	18,000	
To Revaluation A/c			18,000

(For increase in the value of investment)

Revaluation A/c	Dr.	18,000	
To Manohar's Capital A/c			8,000
To Mahesh's Capital A/c			6,000
To Mukesh's Capital A/c			4,000

(For profit on revaluation transferred to old partners' capital account in their old ratio)

Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Retiring Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated losses

Retiring Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Sacrificing Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated losses

Sacrificing Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Illustration

Nishant, Manish and Vishal are partners sharing profits and losses in the ratio of 6:3:1, Nishant decided to retire from the partnership firm on 31st March, 2019. The remaining partners decided to record the effect of the following without affecting their book values, by passing a single adjustment entry:-

	Book Value (Rs.)
General Reserve	1,80,000
Contingency Reserve	30,000
Profit and Loss A/c (Cr.)	90,000
Advertisement Suspense A/c (Dr.)	1,20,000

Pass necessary journal adjustment entry.

Step 1

Calculate the net effect of Accumulated Profits, Losses and Reserves:-

	Rs.
General Reserve	**1,80,000**
Add: Contingencies Reserves	**30,000**
Profit and Loss A/c (Cr.)	**90,000**
	3,00,000
Less: Advertisement Suspense A/c	**1,20,000**
Net Effect	**1,80,000**

Step 2

Calculate sacrificing or gain share of each partners:-

Old Ratio = 6:3:1

New Ratio = 3:1

$$\boldsymbol{Manish} = \frac{\mathbf{3}}{4} - \frac{\mathbf{3}}{\mathbf{10}} = \frac{15 - \mathbf{6}}{20} = \frac{\mathbf{9}}{20}\ (gain)$$

$$\boldsymbol{Vishal} = \frac{\mathbf{1}}{4} - \frac{\mathbf{1}}{\mathbf{10}} = \frac{5 - \mathbf{2}}{\mathbf{20}} = \frac{\mathbf{3}}{\mathbf{10}}\ (\boldsymbol{Gain})$$

$$\text{Gaining Ratio} = \frac{\mathbf{9}}{\mathbf{20}} : \frac{\mathbf{3}}{\mathbf{20}} = 9:3 = 3:1$$

Step 3

Calculate share of Gaining partner and Sacrificing partner in the net effect of Accumulated Profits, Losses and Reserves:-

$$\boldsymbol{Nishant} = \mathbf{1,80,000} \times \frac{\mathbf{6}}{\mathbf{10}} = 1{,}08,\mathbf{000}\ (\boldsymbol{Sacrify})$$

Nishant's share of goodwill Rs.1,08,000 will be paid be Manish and Vishal in their sacrificing ratio 3:1

$$\text{Manish} = \mathbf{1,08,000} \times \frac{\mathbf{3}}{4} = \mathbf{81,000}(\boldsymbol{Gain})$$

$$\text{Vishal} = \mathbf{1,08,000} \times \frac{\mathbf{1}}{4} = 27,\mathbf{000}(\boldsymbol{Gain})$$

Step 4

Pass the adjustment entry:-

Particulars		Dr.	Cr.
Manish's Capital A/c	Dr.	81,000	
Vishal's Capital A/c	Dr.	27,000	
To Nishant's Capital A/c			1,08,000
(For adjustment entry is made for accumulated profits)			

Raman, Rahul and Ramesh are partners sharing profits in the ratio of 3:2:1. Their Balance Sheet as at 31st March, 2019 was as follows:

Liabilities		Rs.	Assets		Rs.
Creditors		1,60,000	Bank Balance		1,25,000
Salaries Payable		30,000	Bills Receivable		61,000
Reserves		80,000	Stock		2,00,000
Profit and Loss A/c		30,000	Sundry Debtors	1,00,000	
Capitals:-			Less: Provision	10,000	90,000
Raman	3,00,000		Furniture		50,000
Rahul	2,00,000		Computers		3,00,000
Ramesh	1,00,000	6,00,000	Advertisement Suspense A/c		50,000
			Goodwill		24,000
		9,00,000			9,00,000

Ramesh retired on 31st March, 2019. They agreed to the following:-

(i) Stock to be increased to Rs.2,20,000 and Furniture to be reduced by 20% and Computers to be reduced to Rs.2,70,000.

(ii) Provision for Doubtful Debts to be reduced by Rs.2,000.

(iii) Goodwill of the firm is valued at Rs.1,20,000.

(iv) They decided not to share Reserves, Credit balance of P &L A/c and Advertisement Suspense A/c.

Prepare Revaluation A/c, Partner’s Capital A/c and revised Balance Sheet of the reconstituted firm.

Revaluation A/c

Particulars	Rs.	Particulars	Rs.
To Furniture	10,000	By Stock	20,000
To Computers	30,000	By Provision for D/D	2,000
		By Loss transferred to partners' capitals:-	
		Raman 9,000	
		Rahul 6,000	
		Ramesh 3,000	18,000
	40,000		40,000

Capital A/c

Particulars	Raman	Rahul	Ramesh	Particulars	Raman	Rahul	Ramesh
To Revaluation	9,000	6,000	3,000	By Balance b/d	3,00,000	2,00,000	1,00,000
To Ramesh's Cap	18,000	12,000		By Raman's Cap			20,000
To Goodwill.	12,000	8,000	4,000	By Rahul's Cap			10,000
To Ramesh, Loan			1,23,000				
To Balance c/d	2,61,000	1,74,000					
	3,00,000	2,00,000	1,30,000		3,00,000	2,00,000	1,30,000

Balance Sheet
As at 31st March, 2019

Liabilities		Rs.	Assets		Rs.
Creditors		1,60,000	Bank Balance		1,25,000
Salaries Payable		30,000	Bills Receivable		61,000
Reserves		80,000	Stock		2,20,000
Profit and Loss A/c		30,000	Sundry Debtors	1,00,000	
Ramesh's Loan A/c		1,23,000	Less: Provision	8,000	92,000
Capitals:-			Furniture		40,000
Raman	2,61,000		Computers		2,70,000
Rahul	1,74,000	4,35,000	Advertisement Suspense A/c		50,000
		8,58,000			8,58,000

Working Note:-

$Old\ Ratio = 3:2:1 \qquad New\ Ratio = 3:2$

		Rs.
General Reserve		**80,000**
Add:	**New Goodwill**	**1,20,000**
	Profit and Loss A/c (Cr.)	**30,000**
		2,30,000
Less: Advertisement Suspense A/c		**50,000**
	Net Effect	**1,80,000**

$$Ramesh's\text{ share in Net Effect} = 1{,}80{,}000 \times \frac{1}{6} = Rs.\,30{,}000$$

$Rs.$ 30,000 will be shared by Raman and Rahul in their gaining ratio.

Journal Entry

Raman's Capital A/c	Dr.	18,000	
Rahul's Capital A/c	Dr.	12,000	
To Ramesh's Capital A/c			30,000

(For adjustment entry is made for Reserve, Profit & Loss A/c, Goodwill and Advertisement Suspense A/c)

Valuation and Accounting treatment of Goodwill

As per AS-26 ‘Intangible Assets’ prescribes that goodwill should be recorded in the books only when consideration in money or money’s worth is paid for it or say goodwill purchased.

Goodwill is an intangible asset which enables a firm to earn higher profit than the normal profit earned by the other firm. It is due to efforts made by the existing partners in the past and this goodwill is known as self-generated goodwill.

At the time of retirement of a partner goodwill may be adjusted through capital accounts of the partners or Goodwill Account may be opened and immediately written off..

Accounting treatment of Goodwill at the time of Retirement of a Partner

Accounting treatment of goodwill at the time of retirement of a partner will be:-

1. **When Goodwill does not appear in the books**
2. **When Goodwill appears in the books**

1. When goodwill does not appears in the books

When goodwill is not given in the Balance Sheet of the partnership firm, there may be three ways in which the retiring partner is credited for his share of goodwill:-

(a) Goodwill Account is not raised in the books of account

(b) Goodwill is raised at its full value and written off

(c) Goodwill is raised to the extent of retiring or deceased partner’s share and written off.

(a) Goodwill Account is not raised in the books of account

The following journal entries will be made:-

Gaining Partner's Capital A/c Dr.
To Retiring or Deceased Partner's Capital A/c
(for the share of goodwill credited to retiring or deceased partner's capital account in gaining ratio)

P, Q, R and S are partners sharing profits and losses in the ratio of 2:1:2:1. On the retirement of R, goodwill was valued at Rs.72,000. P, Q and S decided to share future profits equally. Pass necessary adjustment entry for goodwill without opening Goodwill Account.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	Q's Capital A/c Dr. S's Capital A/c Dr. To R's Capital A/c (for the share of goodwill credited to retiring or deceased partner's capital account in gaining ratio)		12,000 12,000	 24,000

Goodwill of the firm$= \boldsymbol{Rs. 72,000}$

R's share of Goodwill$= \mathbf{72,000 \times \frac{2}{6} = 24,000}$

P's Gain$= \mathbf{\frac{1}{3} - \frac{2}{6} = \frac{2-2}{6} = \frac{0}{6}}$

Q's Gain$= \mathbf{\frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}}$

S's Gain$= \mathbf{\frac{1}{3} - \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6}}$

(b) Goodwill is raised at its full value and written off

The following journal entries will be made:-

Goodwill A/c Dr.
To All Partner's Capital A/c (in old ratio)
(for the goodwill raised at its current value)

Continuing Partner's Capital A/c Dr.
To Goodwill A/c (in new ratio)
(for the goodwill account written off in new profit sharing ratio)

Azim, Nusli and Sunil are partners sharing profits in the ratio of 3:2:1. Sunil retires from the firm on 1st April, 2019 on which date goodwill of the firm was valued at Rs.2,40,000. Azim and Nusli decided to share future profits equally from that date. Pass necessary journal entries for the goodwill on retirement of Sunil when goodwill is raised at its current value.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
2019 1 April	GoodwillA/c Dr. To Azim's Capital A/c To Nusli's Capital A/c To Sunil's Capital A/c (for goodwill account is raised with its current value)		2,40,000	 1,20,000 80,000 40,000
	Azim's Capital A/c Dr. Nusli's Capital A/c Dr. To Goowill A/c (for goodwill written off by debiting the continuing partners capital account)		1,20,000 1,20,000	 2,40,000

(c) Goodwill is raised to the extent of retiring or deceased partner’s share and written off.

The following journal entries will be made:-

Goodwill A/c Dr.
To Retiring or Deceased Partner’s Capital A/c
(for the goodwill raised with the share of retiring or deceased partner in current value of Goodwill)

Gaining Partner’s Capital A/c Dr. (in gaining ratio)
To Goodwill A/c
(for the goodwill account written off in gaining ratio)

Shiv, Kumar and Savitri are partners sharing profits in the ratio of 3:2:1. Savitri retired from the firm on 1st April, 2020 on which date goodwill of the firm was valued at Rs.1,80,000. Shiv and Kumar decided to share future profits equally from that date. Pass necessary journal entries raising goodwill for Savitri's share in current value of goodwill.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
2020 1 April	GoodwillA/c Dr. To Savitri's Capital A/c (for goodwill account is raised with Savitri's share current value)		30,000	30,000
	Kumar's Capital A/c Dr. To Goowill A/c (for goodwill written off by debiting the gaining partners' capital account)		30,000	30,000

Savitri's share in goodwill= $1{,}80{,}000 \times \frac{1}{6} = 30{,}000$

$$Shiv's\ gain = \frac{1}{2} - \frac{3}{6} = \frac{3-3}{6} = \frac{0}{6};\qquad Kumar's\ gain = \frac{1}{2} - \frac{2}{6} = \frac{3-2}{6} = \frac{1}{6}$$

2. When goodwill appears in the books

Goodwill appears in the books means it is purchased goodwill, because self generated goodwill is not recorded in the books of accounts. The following journal entry will be made for goodwill appeared in the books:-

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	All Partner's Capital A/c Dr. To Goodwill A/c (for the existing goodwill written off)			

Pankaj, Kiran and Ravi are partners sharing profits in the ratio of 2:3:5. Goodwill is appearing in the books at a value of Rs.50,000. Pankaj retires and on the day of Pankaj's retirement, goodwill valued at Rs.45,000. Kiran and Ravi decided to share future profits in the ratio of 3:2. Pass necessary journal entries.

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	Pankaj's Capital A/c Dr. Kiran's Capital A/c Dr. Ravi's Capital A/c Dr. To Goodwill A/c (for goodwill appearing in the books written off)		10,000 15,000 25,000	 50,000
	Kiran's Capital A/c Dr. To Pankaj's Capital A/c To Ravi's Capital A/c (for goodwill is adjusted for the retiring and sacrificing partners)		13,500	 9,000 4,500

Pankaj's share in goodwill= $45{,}000 \times \frac{2}{10} = 9{,}000$

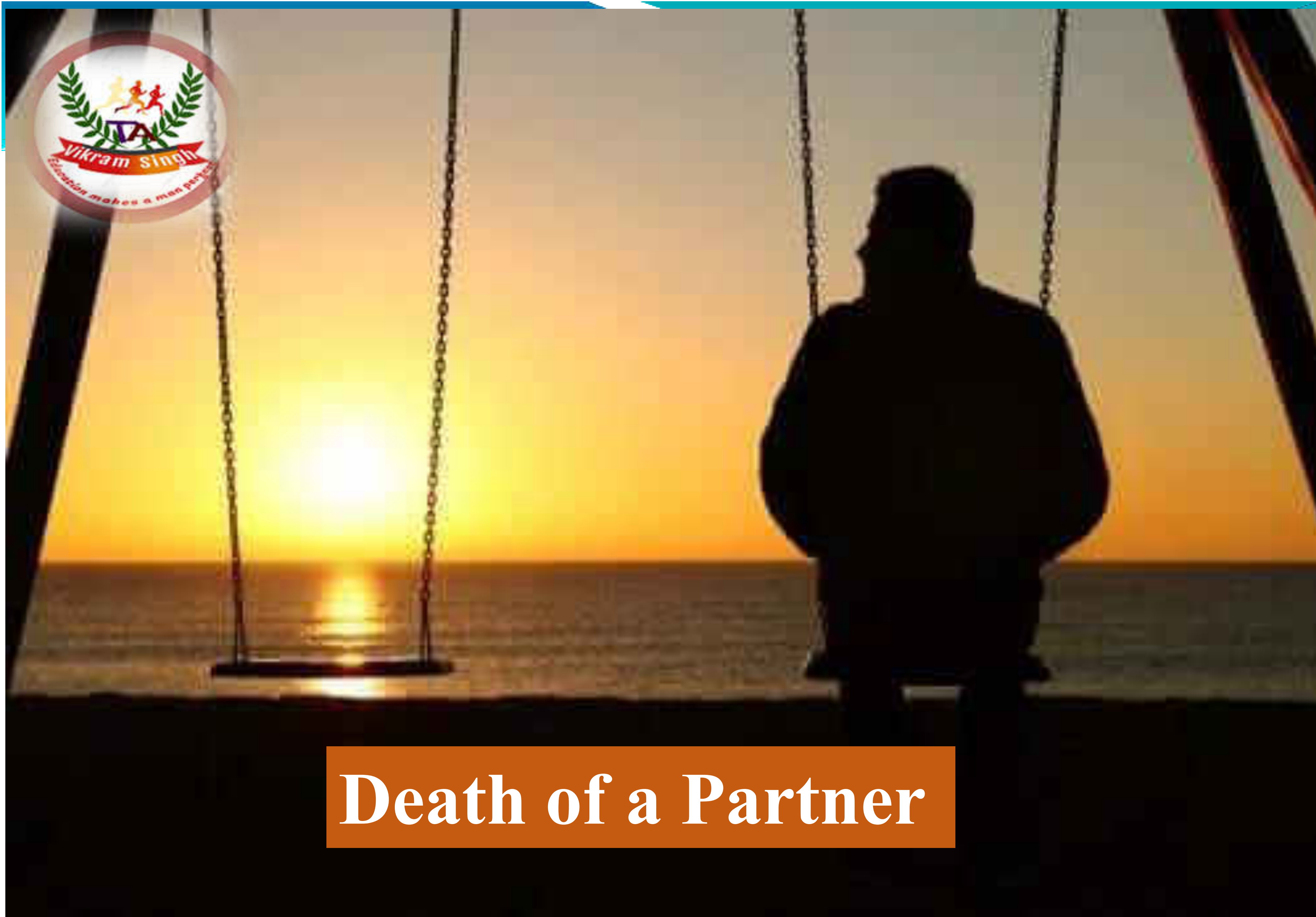
Kiran's $gain = \frac{3}{5} - \frac{3}{10} = \frac{6-3}{10} = \frac{3}{10}$; $Ravi's\ gain = \frac{2}{5} - \frac{5}{10} = \frac{4-5}{10} = \frac{1}{10}(sacrify)$

Ravi's share in goodwill for 1/10th share= $45{,}000 \times \frac{1}{10} = 4{,}500$

Hidden Goodwill

Goodwill appears in the books means it is purchased goodwill, because self generated goodwill is not recorded in the books of accounts. The following journal entry will be made for goodwill appeared in the books:-

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	All Partner's Capital A/c Dr. To Goodwill A/c (for the existing goodwill written off)			



Death of a Partner

Death of Partner

Accounting procedure on the death of a partner is similar to that of retirement of a partner. Accounting treatment of goodwill, reserves, accumulated profits or losses and revaluation of assets and reassessment of liabilities are same like retirement of a partner,

Computation of Amount due to Deceased Parnter

When a partner dies, his heirs/successors/nominees are entitled to the amount due and the right which a retiring partner has. The heir of deceased partner is entitled to the following:-

(a) Amount of capital given in the balance sheet.

(b) His share in the goodwill of the firm.

(c) His share of profit on revaluation account.

(d) His share of accumulated profits and reserves.

(e) Interest on capital upto the date of death, if provided.

(f) His Salary or commission upto the date death, if provided.

The following amount is debited to his account:-

(a) His share of loss on revaluation account.

(b) His share of accumulated losses.

(c) His drawings

(d) Interest on drawings upto the date of death, if provided.

(e) Advance or loan taken by him from the firm, if any.

The journal Entry will be:-

Deceased Partner's Capital A/c Dr.
To Deceased Partner's Executors' A/c
(for deceased partner's capital is transferred to his executors account)

Deceased Partner's Capital A/c

Particualrs	Rs.	Particulars	Rs.
To Current A/c (Dr. Balance)	------	By Balance b/d	------
To Revaluation A/c (Loss)	------	By Current A/c (Cr.)	------
To Profit & Loss A/c (Dr.)	------	By P&L Suspense A/c	------
To Drawing A/c	------	By Revaluation A/c	------
To Interest on Drawing A/c	------	By P & L A/c (Cr.)	-------
To Goodwill written off	------	By Reserves A/c	-------
To deceased partner's Executor A/c	------	By Interest on Capital	------
		By Salary or Commission	------
	-------		-------
	=====		=====

Calculation of Share of Profit of Deceased Partner

There are two methods to calculate the share of profit of deceased partner:-

- **Time Basis**
- **Turnover or Sales Basis**

1. Time Basis

If this method is used, the profits are assumed to have arisen uniformly over the years. In this the profit is calculated on the basis of previous year or average of previous years profit up to the date of death of a partner.

Question:- A, B and C are partners in a firm C died on 30th September, 2019. His share of profit from the closure of the last accounting year till the date of death was to be calculated on the basis of the average last three years profits. Profits for 2016, 2017 and 2018 were Rs.8,000; Rs.9,000 and Rs.10,000 respectively. Calculate C's share in profit till the date of death.

Solution:-

Average Profit $= \frac{8{,}000+9{,}000+10{,}000}{3} = \frac{27{,}000}{3} = Rs.\,9{,}000$

C's share in Profit$= 9{,}000 \times \frac{6}{12} \times \frac{1}{3} = Rs.\,1{,}500$

Journal Entry:-

Profit and Loss Suspense A/c	Dr.	1,500	
To C's Capital A/c			1,500
(for share in profit of C till the date of death is credited)			

Question:- A, B and C are partners in a firm C died on 30th September, 2019. His share of profit from the closure of the last accounting year till the date of death was to be calculated on the basis of the average last three years profits. Profits for 2016, 2017 and 2018 were Rs.8,000; Rs.9,000 and Rs.10,000 respectively. The profit sharing ratio of A and B is 3:2. Calculate C's share in profit till the date of death.

Solution:-

Average Profit $= \frac{8{,}000+9{,}000+10{,}000}{3} = \frac{27{,}000}{3} = Rs.\, 9{,}000$

C's share in Profit$= 9{,}000 \times \frac{6}{12} \times \frac{1}{3} = Rs.\, 1{,}500$

Journal Entry:-

A's Capital A/c	Dr.	1,200	
B's Capital A/c	Dr.	300	
To C's Capital A/c			1,500
(for share in profit of C till the date of death is credited)			

2. Turnover or Sales Basis

For calculating the share in profits of deceased partner by using this method, three things are require:-

- Sales for the previous accounting year
- Profit of the previous year
- Sale of the current year upto the date of death of partner

Question:- X,Y and Z are partners sharing profits in the ratio of 2:2:1. Y died on 30th June, 2020. Accounts are closed on 31st March each year. Sales for the year ended 31st March, 2020 was Rs.6,00,000. Sales of Rs.2,00,000 amounted between the period from 1st April to 30th June, 2020. The profit for the year ended 31st March, 2020 was Rs.60,000. Calculate deceased partner's share in the profit of the firm.

Solution:-

Profit up to the death of Y $= \frac{60,000}{6,00,000} \times 2,00,000 = Rs. 20,000$

Y's share in Profit$= 20,000 \times \frac{2}{5} = Rs. 8,000$

Journal Entry:-

Profit and Loss Suspense A/c	Dr.	8,000	
To Y's Capital A/c			8,000
(for share in profit of Y till the date of death is credited)			

A, B and C are partners sharing profits in the ratio of 2:2:1. On 31st March, 2020, their Balance Sheet was as follows:

Liabilities		Rs.	Assets	Rs.
Creditors		1,20,000	Bank Balance	1,50,000
Bills Payable		80,000	Stock	1,00,000
Reserves		60,000	Debtors	80,000
Capitals:-			Land and Building	5,00,000
A	2,50,000		Profit and Loss A/c	1,60,000
B	2,50,000		(loss for the year ended	
C	2,30,000	7,30,000	31.3.2020)	
		9,90,000		9,90,000

B died on 30th June, 2020. The Partnership Deed provides for the following to the following:-

(i) Stock to be increased to Rs.1,30,000 and Land and Building to be reduced by 5% .

(ii) Provision for Doubtful Debts to be created at 5% on debtors.

(iii) Goodwill of the firm was valued at Rs.1,20,000.

(iv) B's share of profit from 1st April, 2020 to till his death was to be calculated on the basis of profit or loss of the previous years profit or loss .

Prepare Partner's Capital Account and Balance Sheet of new firm.

Revaluation A/c

Particulars	Rs.	Particulars	Rs.
To Land & Building	25,000	By Stock	30,000
To Provision for D/D	4,000		
To Profit transfer to partner's capital account			
A 400			
B 400			
C 200	1,000		
	30,000		30,000

Capital A/c

Particulars	A	B	C	Particulars	A	B	C
To P & L A/c	64,000	64,000	32,000	By Balance b/d	2,50,000	2,50,000	2,30,000
To P & L Sus. A/c		16,000		By Reserve	24,000	24,000	12,000
To B's Cap A/c	32,000		16,000	By Revaluation	400	400	200
To B's Executor				By A's Cap A/c		16,000	
Loan A/c		2,42,400		By C's Cap A/c			
To Balance c/d	1,78,400		1,94,200				
	2,74,400	3,22,400	2,42,200		2,74,400	3,22,400	2,42,200

Balance Sheet
As at 31st March, 2019

Liabilities		Rs.	Assets		Rs.
Creditors		1,20,000	Bank Balance		1,50,000
Bills Payable		80,000	Stock		1,30,000
Profit & Loss Suspense A/c		16,000	Debtors	80,000	
B's Executor's Loan A/c		2,42,400	Less: Provision	4,000	76,000
Capitals:-			Land and Building		475,000
A	1,78,400				
C	1,94,200	3,72,600			
		8,31,000			8,31,000
		=======			======