

LESSON-24 RETIERMENT AND DEATH OF A PARTNER

SUMMARY

Sometime people quitting partnership firm or a person dies while in partnership. These are the events that take place during the lifetime of a partnership firm. Some issues arise on the happening of these events involving finance. Some assets and liabilities may need revaluation, goodwill is to be treated and amount of joint life policy is distributed and some accounting adjustment have to be made. Whenever such events take place, the firm has to calculate the dues of a partner leaving the firm or that of the deceased.

RETIREMENT – MEANING, CALCULATION OF NEW PROFIT SHARING RATIO AND GAINING RATIO

When one or more partners leave the firm and the remaining partners continue to do the business of the firm, it is known as retirement of a partner. At the time of retirement the retiring partner's claim is settled.

A partner retires either :

- (i) with the consent of all partners, or
- (ii) as per terms of the agreement; or
- (iii) at his or her own will

At the time of retirement the following accounting issues are dealt with :

- (a) New profit sharing ratio and gaining ratio.
- (b) Goodwill.
- (c) Adjustment of changes in the value of Assets and liabilities.
- (d) Treatment of reserve and accumulated profits.
- (e) Settlement of retiring partners dues.
- (f) New capital of the continuing partners.

New Profit Sharing Ratio and Gaining Ratio

As soon as a partner retires the profit sharing ratio of the continuing partners get changed. Various cases of new ratio and gaining ratio are illustrated as follows:

(i) Retiring Partner's Share Distributed in Existing Ratio

(ii) Retiring partner's share distributed in Specified proportion

(iii) Retiring Partner's share is taken by one of the partners

TREATMENT OF GOODWILL

The retiring partner is entitled to his/her share of goodwill at the time of retirement because the goodwill is the result of the efforts of all partners including the retiring one in the past. The retiring partner is compensated for his/her share of goodwill.

REVALUATION OF ASSETS AND REASSESSMENT OF LIABILITIES

At the time of retirement of a partner the assets of the firm are revalued and liabilities are reassessed. Revaluation Account is prepared in the same way as in case of admission of a partner. This is done to adjust the changes in value of assets and liabilities at the time of retirement/death of a partner.

TREATMENT OF ACCUMULATED RESERVES AND UNDISTRIBUTED PROFIT

All the balances of Accumulated Reserves, funds and undistributed amount of Profit or Loss appearing in the balance sheet of the firm on the date of retirement/death is distributed amongst all partners including retiring/deceased partner in their old profit sharing ratio, The following entries are made:

- (i) *For distribution of undistributed profit and reserve.*
- (ii) *For distribution of undistributed loss*

SETTLEMENT OF RETIRING PARTNER'S CLAIM

The amount due to the retiring partner is paid according to the terms of partnership agreement. The retiring partners' claim consists of-

- (a) The credit balance of Capital Account;
- (b) His/her share in the Goodwill of the firm;

- (c) His/her share in the Gain/Profit on Revaluation;
- (d) His/her share in General Reserve and Accumulated Profit and
- (f) Interest on Capital

ADJUSTMENT OF REMAINING PARTNER'S CAPITAL ACCOUNT AFTER RETIREMENT

After retirement of a partner the remaining partners may decide to adjust their capital. Often the remaining partners determine the total amount of capital of the reconstituted firm and decide to keep their respective capital accounts in proportion to the new profit sharing ratio. The total capital of the firm may be more or less than the total of their capital at the time of retirement.

DEATH OF A PARTNER

On the death of a partner, The legal representatives are entitled to the followings :

- (a) The amount standing to the credit of the capital account of the deceased partner.
- (b) Interest on capital, if provided in the partnership deed upto the date of death.
- (c) Share of goodwill of the firm.
- (d) Share of undistributed profit or reserves.
- (e) Share of profit on the revaluation of assets and liabilities.
- (f) Share of profit upto the date of death.
- (g) Share of Joint Life Policy.