Retirement and Death of a Partner

Q.1 What is meant by retirement of a partner?

Ans. Retirement of a partner is one of the modes of reconstituting the firm in which old partnership comes to an end and a new partner among the continuing (remaining) partners (i.e., partners other than the outgoing partner) comes into existence.

Q.2 How can a partner retire from the firm?

Ans. A partner may retire from the firm;

i) in accordance with the terms of agreement; or

ii) with the consent of all other partners; or

iii) where the partnership is at will, by giving a notice in writing to all the partners of his intention to retire.

Q.3 What do you understand by ‘Gaining Ratio’?

Ans. Gaining Ratio means the ratio by which the share in profit stands increased. It is computed by deducting old ratio from the new ratio.

Q.4 What do you understand by ‘Gaining Partner’?

Ans. Gaining Partner is a partner whose share in profit stands increased as a result of change in partnership.

Q.5 Distinguish between Sacrificing Ratio and Gaining Ratio.

Ans. Distinction between Sacrificing Ratio and Gaining Ratio
Q.6 Give two circumstances in which gaining ratio is computed. Ans. Gaining Ratio is computed in the following circumstances: (i) When a partner retires or dies. (ii) When there is a change in profit-sharing ratio.

Q.7 Why is it necessary to revalue assets and reassess liabilities at the time of retirement of a partner?

Ans. At the time of retirement or death of a partner, assets are revalued and liabilities are reassessed so that the profit or loss arising on account of such revaluation up to the date of retirement or death of a partner may be ascertained and adjusted in all partners' capital accounts in their old profit-sharing ratio.

Q.8 Why is it necessary to distribute Reserves Accumulated, Profits and Losses at the time of retirement or death of a partner?

Ans. Reserves, accumulated profits and losses existing in the books of account as on the date of retirement or death are transferred to the Capital Accounts (or Current Accounts) of all the partners (including outgoing or deceased partner) in their old profit-sharing ratio so that the due share of an outgoing partner in reserves, accumulated profits/losses gets adjusted in his Capital or Current Account.

Q.9 What are the adjustments required on the retirement or death of a partner?

Ans. At the time of the retirement or death of a partner, adjustments are made for the following:

(i) Adjustment in regard to goodwill.

(ii) Adjustment in regard to revaluation of assets and reassessment of liabilities.

(iii) Adjustment in regard to undistributed profits.
(iv) Adjustment in regard to the Joint Life Policy and individual policies.

Q.10 X wants to retire from the firm. The profit on revaluation of assets on the date of retirement is Rs. 10,000. X is of the view that it be distributed among all the partners in their profit-sharing ratio whereas Y and Z are of the view that this profit be divided between Y and Z in new profit-sharing ratio. Who is correct in this case?

Ans. X is correct because according to the Partnership Act a retiring partner is entitled to share the profit upto the date of his retirement. Since the profit on revaluation arises before a partner retires, he is entitled to the profit.

Q.11 How is goodwill adjusted in the books of a firm -when a partner retires from partnership?

Ans. When a partner retires (or dies), his share of profit is taken over by the remaining partners. The remaining partners then compensate the retiring or deceased partner in the form of goodwill in their gaining ratio. The following entry is recorded for this purpose:

Remaining Partners’ Capital A/cs ...Dr. [Gaining Ratio]

To Retiring/Deceased Partner’s Capital A/c [With his share of goodwill]

If goodwill (or Premium) account already appears in the old Balance Sheet, it should be written off by recording the following entry :

All Partners’ Capital/Current A/cs ...Dr. [Old Ratio]

To Goodwill (or Premium) A/c

Q.12 X, V and Z are partners sharing profits and losses in the ratio of 3 : 2 :1. Z retires and the following Journal entry is passed in respect of Goodwill:

Y’s Capital A/c ...Dr. 20,000
To X’s Capital A/c  
10,000  
To Z’s Capital A/c  
10,000  

The value of goodwill is Rs. 60,000. What is the new profit-sharing ratio between X and Y?  

Ans. Without calculating the gaining ratio, the amount to be adjusted in respect of goodwill can be calculated directly with the help of following statement:  

**STATEMENT SHOWING THE REQUIRED ADJUSTMENT FOR GOODWILL**  

<table>
<thead>
<tr>
<th>Particulars</th>
<th>X (Rs.)</th>
<th>V (Rs.)</th>
<th>Z (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right of goodwill before retirement (3:2:1)</td>
<td>30,000</td>
<td>20,000</td>
<td>10,000</td>
</tr>
<tr>
<td>(Old Ratio) Right of goodwill after retirement</td>
<td>20,000</td>
<td>40,000</td>
<td>—</td>
</tr>
<tr>
<td>(Balancing Figure) (New Ratio)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Adjustment</td>
<td>(-) 10,000</td>
<td>(+) 20,000</td>
<td>(-) 10,000</td>
</tr>
</tbody>
</table>

The new ratio between X and Y is 1 : 2.  

Q.13 State the ratio in which profit or loss on revaluation will be shared by the partners when a partner retires.  

Ans. Profit or loss on revaluation of assets/liabilities will be shared by the partners (including the retiring partner) in their old profit-sharing ratio.  

Q.14 How is the account of retiring partner settled?  

Ans. The retiring partner account is settled either by making payment in cash or by promising the retiring partner to pay in installments along with
interest or by making payment partly in call and partly transferring to his loan account. The following Journal entry is passed:

Retiring Partner’s Capital A/c ...Dr.

To Cash* [If paid in cash]

Or

To Retiring Partner’s Loan [If transferred to loan]

Q.15  What is Joint Life Policy?

Ans.  Joint Life Policy is an insurance policy taken on the lives of the partners jointly. Premium of the policy is paid by the firm.

Q.16  What is the objective of taking a Joint Life Policy by a partnership firm?

Ans.  A partnership firm takes a Joint Life Policy with the objective of receiving sufficient amount in cash and thereby enabling itself to pay the amount payable to the retiring partner or to the representatives of the deceased partner, without adversely affecting the financial position and working of the business.

Q.17  When does the Joint Life Policy become due?

Ans.  Joint Life Policy becomes due for payment by the Insurance Company either on the death of any partner or on its maturity, whichever is earlier. The policy may also be surrendered before its maturity.

Q.18  What is Surrender Value?

Ans.  Surrender Value is the value of the insurance policy that the insurance company pays on the surrender of a policy before the date of its maturity.

Q.19  How is the share of profit of a deceased partner calculated from the date of last balance sheet to the date of death?
Ans. If a partner dies on any date after the date of balance sheet; then his share of profit is calculated from the beginning of the year to the date of death on the basis of average profits or last year's profit. It is calculated on either of the following two bases:

(i) On the Basis of Time: In this method, it is assumed that the profits had accrued uniformly in the previous year. On the basis of time, deceased partner's share in the profits till the date of death is calculated as follows:

Share of Deceased Partner

\[ = \text{Average Profits} \times \text{Proportion of Deceased Partner} \]

(ii) On the Basis of Sales: Deceased partner's share in profit till the date of death shall be:

\[ = \text{Sales for the period}^* \times \text{Proportion of Deceased Partner} \]

*Period = from the beginning of the year to the date of death.

Q.20 How is amount payable to the representative of a deceased partner calculated?

Ans. In the case of death of a partner, the legal representatives of a deceased partner are entitled to the following:

(i) The amount standing to the credit of the deceased partner's capital account.

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

(iii) His share of profit on the revaluation assets and reassessment of liabilities. (iv) His share of reserves and accumulated profits.

(v) His share of profits earned from the date of last balance sheet of the date of death.
(vi) Interest on capital provided in the partnership agreement.

(vii) His share of the proceeds of Joint Life Policy.

The following amounts will be debited to his account:

(i) His share in the reduction in the value of goodwill, if any.

(ii) His share of loss on revaluation of assets and reassessment of liabilities.

(iii) His drawings.

(iv) Interest on drawings, if provided in the partnership deed.

(v) His share of loss from the date of last balance sheet to the date of death.

The balance in the capital account is transferred to his Executor’s Account.

Q.21 Can an outgoing partner or Legal Representative of Deceased Partner share in the subsequent profits?

Or

What will happen if deceased or retired partner’s dues are not settled immediately?

Ans. As per the provisions of Section 37 of the Partnership Act, 1932 if full or part amount of outgoing partner still remains to be paid then

(i) He will be entitled to interest or share in profit or nothing as has been mutually agreed among partners.

(ii) If nothing is agreed among the partners, then outgoing partner or his representatives have the choice to get either of the following till final settlement:
(a) Interest @ 6% per annum on the balance amount.

(b) Share in the profit earned proportionate to their amount outstanding to total capital.

Share in Profit =

Normally he will opt for the better of (a) or (b).