3RD SEMESTER SUB CC3.1CH/ CHAPTER-5- RETIREMENT OF PARTNER

1. **INTRODUCTION**-------As per section 32 of partnership Act 1932 a partner may retire 1/ with the consent of all the existing partner or 2/ in accordance with an express agreement by the partners or3/ by giving written notice to all other partners of his intention to retire in case of Partnership at will.

2. **ACCOUNTING TREATMENT------** When an existing partner retire from a firm , the existing partners may decide to continue the business. But, It brings the partnership between the existing partners to an end and marks the beginning of new partnership even though the firm continues. This requires certain adjustment to be made in the books of accounts of the existing partners like below :-

a. Calculation of new profit sharing ratio (including gaining ratio) ---When an existing partner retires from a firm , the share of profit of the retiring partner gets distributed over the other continuing partner .This result in a gain in the share of other continuing partners. As such ,it is required to determine a ratio of profit sharing in the event of such retirement of retiring partner. This leads to calculation of new profit sharing ratio.

b. Distribution of reserve, profit or any fund appropriated out of profit… It is distributed among all partners in the old ratio.

c. Revaluation of asset and liabilities---It should be done for unearthing the secret profit and the loss and the profit or loss on revaluation is to be distributed among old partners in the old profit ratio.

d. Adjustment of goodwill----it is to be treated either in the gaining ratio or by the way of raising and written off or capital adjustment basis as the case may be.

e. Adjustment of life policy—the surrender value may be distributed among all partners in the old ratio.

f. Adjustment for interim period's profit----Usually the retirement of a partner is planned at the end of accounting period .this is because on that date the operating result of the firm for the period is ascertained and incorporated in the capital account. However ,in certain situation ,an existing partner may decide to retire during the continuance of an accounting period. In that case for determining the amount due to retiring partner, the profit /loss of accounting period till the date of retirement is to be considered. For this purpose profit /loss of the firm for the interim period up to the date of retirement may be estimated . A new account Profit and loss suspense account for the share of interim profit of the retiring partner is debited against the credit of Retiring partner' capital account. At the end of year this P/L suspense a/c gets closed by transfer to profit and loss A/c. Or alternatively share of interim profit of retiring partner may be adjusted through capital adjustment between the existing partners.

g. Settlement of final balance of retiring partner—after the ascertainment the due to the retiring partner, the firm should decide upon a mode of settling the same either by mutual agreement or any specific mode if so mentioned. In the case of immediate settlement it may be settled in one shot or it may be by the way of deferred settlement by opening a loan account in the name of retiring partner and sometimes interest is charged @6% as per section 37 of partnership Act. Adjustment of existing partners' capital accounts.

EXAMPLE 1— A, B, C are partners sharing profit and loss in the ratio 3:2;1. The balance sheet of the firm as on 31.3.2020:-

Balance sheet as on 31/03/2020

Capital A+B+C=45000+35000+25000)		Building	50000
Reserve	105000	Furniture	4000
Profit and loss	15000	Plant	40000
creditors	12000	Stock	25000
	20500	Debtors	30000
		Cash at bank	3500
	152500		152500

C retired on 31/3/20 subject to the condition :i. Goodwill of the firm is to be valued 36000 ii. plant and furniture is to be depreciated by 10% & 15% respectively iii. Building is to be appreciated by 20 % iv) provision is to be created for doubtful debt at 5% v . A & B are to bring in cash , in their profit sharing ratio to pay off Mr .C' dues on retirement and leave a sum of Rs.10000 as working capital vi. New profit sharing ratio of A & B 2:1. Prepare Revaluation account , Capital A/c and Balance Sheet 1/4/2020.

SOL

Revaluation A/c

To Plant (10%bof 40000)	4000	By building 20% of 50000)	10000
To Furniture (15% of 4000)	600		
To provision for doubtful debt 5%	1500		
To partners capital A/c:			
A=3/6*3900,B=2/6*3900,C=1/6*3900	3900		
(A=1950,B=1300,C=650)	10000		10000

Partners' Capital account

To C' capital (goodwill)	6000			By Balance b/f	45000	35000	25000
To Bank A/c (final Payment)			36150	By Reserve	7500	5000	2500
To Balance c/d	82883	59517		By profit & loss	6000	4000	2000
				By A' capital (goodwill)	-	-	6000
				By revaluation	1950	1300	650
				By Bank (amount brought in)	28433	14217	
	88883	**59517**	36150		88883	59517	36150

Balance sheet as on 1/4/2020

Capital- A B Creditors	 82883 59517	 142400 20500	Building [50000x120] Plant [40000x90%] Furniture[4000x15%] Stock Debtors Less provision 5% Cash at bank	 30000 -1500	60000 36000 3400 25000 28500 10000
		162900			162900

WORKING—1---Goodwill adjustment

Right to goodwill before retirement C [3/2/1] Right to goodwill after retirement C [2;1]	36000 36000 nil	18000 24000 +6000	12000 12000 0	6000 - -6000

Working-2 Amount to be brought in----Final payment= 36150

Add : credit balance to be kept 10000

Less opening balance -3500

Balance 42650

42650 to be brought in by A=2/3x42650=28433

B=1/3x42650=14217

EXAMPLE 2— A,B, and C are partners of firm sharing profits and losses in the ratio 2;2;1. Their balance is as follows:

Balance Sheet as on 31/3/20

Capital-A B C General reserve Creditors	65600 43700 32200	 141500 22000 18000	Land &building Machinery Furniture Motor car Stock Sundry debtors\essprovison1500 Cash at bank	72000 35500 10400 18000 19800 22200 3600
		181500		181500

B retires on 31/3/20 but A & C continue the business sharing profit 3:2 with the following terms:-

a. Goodwill is to be valued at 2yrs purchase of average annual profit of the 3 yrs and it would not be shown in the books. Profit for 3years for 2017,2018 and 2019 =12100 , 8480, 10920 respectively

b. the value of Land & Building is to be appreciated by 20%, Machinery to be valued at 32000 and provision for doubtful debt to be maintained at 1800.

c. Furniture costing 3000 purchased In sept 2018 but was debited to purchase a/c. This asset is to be taken into account after charging depreciation @10% p.a straight line method.

d.. Annual premium of Rs.1200 paid in sept,30,19 has been entirely charged to p &l a/c.

e. B will take over Motor car with Rs.16000 and a bank loan Rs.50000 is to be arranged for the balance amount payable to him on his retirement.

f. Capital of new firm will be readjusted by bringing in or paying of cash so that the capital of A & C is in the new profit sharing ratio, Prepare necessary accounts.

<u>SOL:</u> **Working -1**, Value of goodwill after rectification of profit-

Profit for 2018=8480 plus wrong debit in purchase A/c 3000 less depreciation not yet charged on furniture @10% on 3000 for ½ yr.=8480+3000-150=11330.

Average profit= 12100+11330+10920/3 =34350/3=11450 .**Goodwill for 2 years purchsae = <u>11450x2=22900</u>**

Working-2 Adjustment of goodwill treatment-

Right to goodwill before B' retirement (2;2;1)=	22900	9160	9160	4580
Right to goodwill after B' retirement (3;2) =	- 22900	13740	-	9160
Balance gain[+]/loss[-]		+4580	-9160	+4580

Revaluation Account

To Machinery		3500	By land & building		14400
To provision for doubtful debt		300	By furniture [3000-150-300] [From sept 18 to march20]		2550
To Motor car		2000	By prepaid insurance 1200/2		600
To partners' capital					
A=2/5x11750=	4700				
B=2/5x 11750=	4700				
C=1/5x11750=	<u>2350</u>	<u>11750</u>			
		<u>17550</u>			17550

Partners' capital account

To motorcar (taken)		16000		By balance b/f	65600	43700	32200
To B' capital		-		By General	8800	8800	4400
(goodwill)	4580		4580	Reserve	4700	4700	2350
				By Revaluation		9160	
To balance c/d	74520		34370	By A & C'	79100	66360	38950
To Bank –payment	79100	50360	38950	capital			
To bank-					74520		34370
(withdrawn-balance)	9186						9186
To Balance c/d	65334		43556	By balance b/d			
			43556	By bank (			
	74520	66360		balance)			

Working: Total capital as per closing balance of capital account of A &C=74520+34370=108890 to be shared between A & C I.e A=108890x3/5=65334 C= 2/5 x108890=43556.

Balance sheet as on 1/4/2020

Capital			Land & building		86400
A—	65334		Furniture[10400+2550]		12950
C---	43556	108890	Machinery		32000
Bank loan		50000	Stock		19800
Creditors		18000	Prepaid insurance		600
			s/debtors		21900
			[less provision 1800]		
			cash at bank [3600+50000-50360+9186-9186]		3240
		176890			176890

Nominal a/c like depreciation, prepaid insurance is corrected through revaluation a/c . ----x-----