

5. Death of the partner

The accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner. The basic differences between the two situations are:

That the retirement of a partner may be planned to be effective from a particular date Which usually the date on which the final accounts of the firm are prepared whereas the death of a partner may occur any time during the year.

Amount payable to the retiring partner is transferred to his loan account. On death, the amount due to the deceased partner is transferred to his Executor's Account.

In the case of death of a partner, Partnership will come to an end immediately. In such a case Remaining partners may continue the business. All amounts due to the Deceased partner will be paid to his legal heirs. The legal heir or executor of the deceased partner may also be added as a partner in the business by the remaining partners.

Who is an Executor?

Executor is the person who is entitled to all rights or amounts due to the deceased partner. The Executor will be entitled to the balance of capital account (Capital Balance, share of profit, Interest on capital, Reserves and Accumulated profits etc. , and he will be debited for Drawings and Interest on drawings)

On the death of a partner, the amount payable to him is to be paid to his legal representatives

Following amounts will be credited his capital account:

- 1) The amount standing to the credit of his capital A/c.
- 2) His share of the increase in the value of goodwill of the firm.
- 3) Interest on capital, if provided in the partnership deed.
- 4) His share of profit on the revaluation of assets and liabilities.
- 5) His share of undistributed profits or reserves.
- 6) His share of life policy.
- 7) His share of profit up to the date of his death.

Following amounts will be debited to the account of the deceased partner for ascertaining the amount due to his legal representatives:

- 1) Drawings.
- 2) Interest on drawings.
- 3) His share of loss on the revaluation of assets and liabilities.
- 4) His share of undistributed loss, such as debit balance of profit and loss A/c.
- 5) His share of the reduction in the value of goodwill.

Accounting Treatment

At the time of reconstitution of firm due to Death of a partner, the right, duties and obligation of partners are necessary to be change then following accounting adjustment to be required in the books of firm

- (1) Determination of New profit sharing Ratio and gaining ratio of remaining partners
- (2) Calculation of Profit till the death of a Partner
- (3) Valuation of goodwill and Accounting for goodwill.
- (4) Accounting treatment of reserves and accumulated profits.
- (5) Accounting for revaluation of assets and liabilities.
- (6) Treatment of Joint Life Policy
- (7) Calculation of Total Amount Payable to Executors of deceased partner
- (8) Settlement of Executors of deceased Partners Account
- (9) Adjustment of capitals.

Calculation of New profit sharing ratio and gaining ratio

At the time of Death of a partner, the business continues with the remaining partners. They need to decide among themselves what will be the new profit sharing ratio in the in the future.

New Ratio: The ratio, in which the continuing partners decide to share the future profits and losses, is known as new profit sharing ratio.

Gaining Ratio

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

This ratio is calculated by taking out the difference between new profit share and old profit share. Gaining ratio is calculated when a partner retires or dies from a firm. It is called gaining ratio because the continuing partners stand to gain by acquiring the retiring partner's share in profits.

$$\text{Gaining Ratio} = \text{New Share} - \text{Old Share}$$

Calculating New Ratio and Gaining Ratio under Different Cases

Case-1 Relative Ratio between remaining partners unchanged or nothing is mentioned about the new ratio between the remaining partners

Case-2 when the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

Case-3 when the continuing partners acquire (Purchase) the deceased partner's share of profit in an agreed ratio.

Case-4 when entire share of the deceased partner is taken by only one continuing partner

Case-1 Relative Ratio between remaining partners unchanged or Nothing is mentioned about the new ratio between the remaining partners:- When nothing is mentioned about the new ratio or gaining ratio, it is presumed that remaining partners continue to share profits as between themselves in the old ratio

It means that remaining partners acquire deceased partners share in their old profit sharing ratio and mutual profit sharing ratio of remaining partners will no change

If the continuing partners maintain their relative ratio, the gaining ratio and the new ratio will be the same.

In this case there is no need to calculate gaining ratio, new ratio and gaining ratio will be the same

Q. A, B and C were sharing profits in the ratio of 4:3:2. B died on 28 february. Calculate the New ratio and gaining ratio of A and C.

Ans:

Old Ratio of A,B and C = 4:3:2 or $\frac{4}{9} : \frac{3}{9} : \frac{2}{9}$

New ratio of A and C is calculated by striking out the share of retiring partner and by finding out the denominator of the remaining ratio

So New ratio of A and C = 4:2 or $\frac{4}{6} : \frac{2}{6}$

Gaining Ratio = New Share - Old Share

A's Gain = A's New Share - A's Old Share

$$= \frac{4}{6} - \frac{4}{9} \text{ or } \frac{36}{54} - \frac{24}{54} = \frac{12}{54}$$

C's Gain = C's New Share - C's Old Share

$$= \frac{2}{6} - \frac{2}{9} \text{ or } \frac{18}{54} - \frac{12}{54} = \frac{6}{54}$$

Gaining ratio of A and C = 12:6 or **2:1**

Q. X, Y and Z are partners sharing profits in the ratio of $\frac{1}{2}, \frac{3}{10}, \frac{1}{5}$ or $(\frac{5}{10} : \frac{3}{10} : \frac{2}{10})$. Calculate the new ratio and sacrificing ratio if X retires.

Old ratio of X,Y and Z = 5:3:2

New ratio of Y and Z = 3:2

Gaining Ratio = New share - Old share

$$Y's \text{ Gain} = \frac{3}{5} - \frac{3}{10} \text{ or } \frac{6}{10} - \frac{3}{10} = \frac{3}{10}$$

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$$Z's \text{ Gain} = 2/5 - 2/10 \text{ or } 4/10 - 2/10 = 2/10$$

Gaining ratio of Y and Z = 3:2

Case-2 when the continuing partners acquire (Purchase) the deceased partner's share of profit in an agreed ratio. In this case new ratio of remaining partners to be determined from following formula

New share = old share of remaining partners + acquired share or gain share

In this case, new ratio has to be calculated. Gaining ratio need not be calculated. In this case the ratio in which they acquire the retiring partner's share forms the gaining ratio

Q. A, B and C are partners sharing profits in the ratio of 3:2:1. A died on 1st march and his share is taken up (acquired) by B and C in the ratio of 3:2. Calculate the new profit sharing ratio and gaining ratio.

Old ratio of A, B and C = 3:2:1

A's share = $\frac{3}{6}$

Shares acquired by B and C from A in the ratio of 3:2

A's share acquired by B = $\frac{3}{5}$ of $\frac{3}{6} = \frac{3}{5} \times \frac{3}{6} =$

$\frac{9}{30}$ A's share acquired by C = $\frac{2}{5}$ of $\frac{3}{6} = \frac{2}{5} \times \frac{3}{6} =$

$\frac{6}{30}$ B's new share = B's old share + A's Share

acquired by B

$$= \frac{2}{6} + \frac{9}{30} \text{ or } \frac{10}{30} + \frac{9}{30} = \frac{19}{30}$$

C's New Share = C's old share + A's share acquired by C

$$= \frac{1}{6} + \frac{6}{30} \text{ or } \frac{5}{30} + \frac{6}{30} = \frac{11}{30}$$

New ratio of B and C = 19:11

Gaining Ratio = New Share - Old Share

B's Gain = $\frac{19}{30} - \frac{2}{6}$ or $\frac{19}{30} - \frac{10}{30} = \frac{9}{30}$

C's gain = $\frac{11}{30} - \frac{1}{6}$ or $\frac{11}{30} - \frac{5}{30} = \frac{6}{30}$

Gaining ratio = **9:6 or 3:2**

Q. P, Q and R are partners sharing profits in the ratio of 3:4:1. P died on 28 February from the firm and surrenders $\frac{2}{3}$ of his share to Q and the remaining share $\frac{1}{3}$ to R. Calculate new profit sharing ratio and gaining ratio.

Old Ratio of P, Q and R = 3:4:1

P Retires, P's share = $\frac{3}{8}$

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P's share acquired by Q = $\frac{2}{3}$ of $\frac{3}{8}$ or $\frac{2}{3} \times \frac{3}{8} = \frac{6}{24}$ or

$\frac{2}{8}$ P's share acquired by R = $\frac{1}{3}$ of $\frac{3}{8}$ or $\frac{1}{3} \times \frac{3}{8} = \frac{3}{24}$

or $\frac{1}{8}$

Q's new share = Q's old Share + P's share acquired by Q = $\frac{4}{8} + \frac{2}{8} = \frac{6}{8}$

R's new share = R's old share + P's share acquired by R = $\frac{1}{8} + \frac{1}{8} = \frac{2}{8}$

New ratio of Q and R = $6:2$ or **3:1**

In this, there is no need to calculate gaining ratio, it is already mentioned in the question, i.e. $\frac{2}{3}:\frac{1}{3}$ or $2:1$

Case-3 when entire share of the retiring partner is taken by only one continuing partner: -

In such case the profit sharing ratio of the partner who acquires the deceased partner share would be affected. The profit sharing ratio all other remaining partners would continue to be same.

The new profit sharing ratio of the gaining partner would be ascertain by adding the gain ratio from retiring partner to his old ratio.

New Ratio = old Ratio + Gaining Ratio
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Q. A, B and C are partners sharing profits in the ratio of 2:2:1. B died on 1st April and his share is entirely taken by C. Calculate new Ratio

Old Ratio of A, B and C = $2:2:1$

B death and B's share is entirely taken over by C

B's share = $\frac{2}{5}$

A's new share = $\frac{2}{5}$ (Unchanged)

C's new share = C's old share + B's share acquired by C

$\frac{1}{5} + \frac{2}{5} = \frac{3}{5}$

New ratio of A and C = $\frac{2}{5}:\frac{3}{5}$ or **2:3**

Case-4 when the profit sharing ratio between continuing partners is changed/the new ratio between remaining partners is given

If the continuing partners decide to share future profits in some other ratio, the gaining ratio will also change.

In this case it is necessary to calculate gaining ratio.

Gaining Ratio = New Share - Old Share

Q. A, B and C were sharing profits in the ratio of 3:2:1. C died on 1st April from the firm. A and B decided to share future profits in the ratio of 7:5. Calculate gaining ratio.

Old ratio of A, B and C = $3:2:1$

New ratio of A and B = $7:5$

Gaining Ratio = New Share - Old Share

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A's Gain = $7/12 - 3/6$ or $7/12 - 6/12 = 1/12$

B's Gain = $5/12 - 2/6$ or $5/12 - 4/12 = 1/12$

Gaining ratio = 1:1

Calculation of Profit till the death of a Partner

In case of death of a partner during the year, his/her executor is entitled for share of profit up to the date of death of the partner. The share of profit can be calculated by one of the two methods.

(1) On the basis of Time

(2) On the basis of Turnover or sales

(1) On time basis: Under this method, profit up to the date of the death of the partner is calculated on the basis of the last year's/years' profit or average profit of last few years. In this approach, it is assumed that the profit will be uniform throughout the current year. The deceased partner will be entitled for the share of the profit proportionately up to the date of his/her death.

$$\frac{\text{Share of Deceased Partner in Profit} = \text{Previous Year/Average Profit} \times \frac{\text{Alive Period}}{12 \text{ or } 365 \text{ or } 52} \times \text{Share in Profit}}$$

Example- A, B and C are equal partners. The profit of the firm for the years 2012, 2013 and 2014 are Rs 10, 00,000, Rs 7, 00,000 and Rs 13, 00,000 respectively. C dies on April 30, 2015. The share of C in the firm's profit will be calculated on the basis of average profit of last three years. Firm closes its books every year on December 31. In this case, C's share in the profits will be calculated.

2) On the sale basis: Under this method, profit is calculated on the basis of last year's sale. In this situation, it is assumed that the net profit margin of the current year's sale is similar to that of the last years

Share of Deceased Partner's Profit = $\frac{\text{Previous Year's Profit}}{\text{Previous Year's Sales}} \times \text{Sales from the beginning of the current year up to the date of death} \times \text{Share of deceased partner.}$

Example- X Y and Z are equal partners. The last year's sales and profit were Rs 25, 00,000 and Rs 2, 50,000. Z died on the April 30, 2018. Sales of the current year till the date of Z's death amounts to Rs 12, 00,000. Firm closes its books on December 31 every year.

Accounting Treatment

Where the death occurs on the last date of the financial year, determination of profit or loss of the firm is not a problem. But, where the death takes place during the course of an accounting

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year, the actual profit obtained or loss incurred from the last balance sheet to the date of death is to be ascertained. Generally it may be ascertained on the basis of last year's profit; on the basis of the average profit of a certain number of year's etc. Such derived amount is only an estimate. Hence the journal entry for the same would be:

In case of profit:

Profit and Loss Suspense A/C Dr.

Deceased Partner's Capital A/C

(Being deceased partner's share of profit up to the date of death)

Note: In this case, Profit and Loss Suspense A/C will show debit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the asset side of the Balance sheet

In Case of Loss:

Deceased Partner's Capital A/C Dr

Profit and Loss Suspense A/C

(Being deceased partner's share of Loss up to the date of death)

Note: In this case, Profit and Loss Suspense A/C will show credit balance. At the end of the year it will be closed by transferring it to P & L Account. Until the date, it will appear on the Liability side of the Balance sheet.

Treatment of goodwill

When an existing partner of a firm decides to retire from the firm, the continuing partners will gain in future profits. The continuing partner who gains by acquiring an additional right to share future profits must compensate the Deceased partner who sacrifices his right to share future profits. The amount of compensation will be equal to the proportionate amount of firm's goodwill.

Deceased partner's share of goodwill = Goodwill of the Firm X deceased partner's Share

Note: As per Accounting Standard 10(AS-10) goodwill is recorded in the books only when some consideration in money is paid for it. So goodwill can be recorded only when it is purchased. So as per AS-10 goodwill account can't be raised in the books. Therefore, goodwill is to be adjusted through partners' capital account on retirement.

In case of death of a partner, goodwill account cannot be raised. There are namely two probable situations on which the treatment of goodwill rests.

- 1. If goodwill already appears in the books of the firm.**
- 2. If no goodwill appears in the books of the firm.**

Situation 1: If goodwill already appears in the books of the firm.

Step 1: Write off the existing goodwill

If goodwill already appears in the old balance sheet of the firm (if mentioned in the question), then first of all, this goodwill should be written off and should be distributed among all the

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partners of the firm including the deceased partner in their old profit sharing ratio. The following Journal entry is passed to write off the old/existing goodwill.

All Partners' Capital A/c Dr.
 To Goodwill A/c
(Goodwill written off among all the partners in their old ratio)

Step 2: Adjusting goodwill through partner's capital account.

After writing off the old goodwill, the goodwill needs to be adjusted through the partner's capital account with the share of the goodwill of the deceased partner. The following Journal entry is passed.

Remaining Partner's Capital A/c Dr.
 To Deceased Partner's Capital A/c

(Gaining Partner's Capital A/c is debited in their gaining share and retiring/deceased partner's capital account is credited for their share of goodwill)

Situation 2: If no goodwill appears in the books of the firm.

As no goodwill appears in the books of the firm, so the goodwill is adjusted through the partner's capital account with the share of the goodwill of the retiring or the deceased partner. The following Journal entry is passed.

Remaining Partner's Capital A/c Dr.
 To Deceased Partner's Capital A/c

(Gaining partner's capital account is debited in their gaining share and retiring/deceased partner's capital account is credited for their share of goodwill)

Hidden Goodwill

Sometimes, a firm may agree to settle the deceased partner by making a lump sum payment. The amount paid may be more than what is due to him based on his capital account after making all adjustments like share of revaluation, share of accumulated profits etc. Then the excess paid shall be treated as deceased partner's share of goodwill (Hidden goodwill)

Accounting Adjustment of accumulated Reserve and profits/ losses

At the time of Death of a partner, any reserve or accumulated profits/losses exists in the books of the firm, these should be transferred to All partners' Capital accounts (if capitals are fluctuating) or Current Accounts (If capitals are fixed) in their old profit sharing ratio.

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(A) Distribution of Accumulated Reserve and Profit

General Reserve A/C Dr

Profit & Loss A/C Dr

To All Partners Capital A/C (Old ratio, individually)

(Being Accumulated profit transferred to All partners capital A/C in their old ratio)

(B) Distribution of Accumulated Losses

All Partners' Capital A/C..... Dr

To Profit & Loss A/C

(Being Accumulated Loss transferred to

All partners' capital A/C in their old ratio)

Revaluation of Assets and Liabilities

The assets and liabilities should be revalued on the same basis as is done in case of admission of a partner. A revaluation account or profit and loss adjustment account is prepared for this purpose. The profit or loss on revaluation is transferred to **all** the partners' capital accounts in their old profit sharing ratio.

Journal entry: - If Revaluation Profit:

Revaluation A/C Dr

To All Partners Capital A/C (Individually, Old Ratio)

(Being revaluation profit distributed among all partners)

If Revaluation Loss:

All Partners Capital A/C Dr

To Revaluation A/C

(Being Revaluation loss distributed among all partners)

Insurance Policy

A firm may take a policy covering the lives of partners jointly or individually thus, there are two types of policies:

- Joint Life Policy
- Individual Life Policy

Joint Life Policy – Accounting Treatment

Joint Life Policy (JLP) is a policy which is decided by the partners of the firm on the joint lives of other partners. The purpose of the joint life policy is to reduce the financial burden on the firm at the time of payment of a large sum to the legal representative of the deceased partner. The insurer receives the payout when after the death of his insure partner.

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The firm pays the premium on the Joint Life Policy. The Insurance Company pays the amount of the Joint Life Policy on the maturity of the policy or the death of a partner, whichever is earlier.

Meaning of Surrender value: Surrender value refers to the realization value of an insurance policy of the joint life policy is surrendered to the insurance company before the date of maturity

The surrender value at the time of the death of a partner is distributed among the remaining partners and the legal representative of the deceased partner.

Joint Life Policy Accounting Treatment Methods

The accounting treatment for Joint Life Policy at the time of the death of a partner is as follows:

- (1) Premium Method
- (2) Surrender Value Method
- (3) Joint Life Policy Reserve Method

1. Premium Method or Premium Paid is treated as Revenue Expenditure

When the partners decide to treat the premium on Joint Life Policy as an expense and debit the Premium A/c to the Profit and Loss A/c every year, the Joint Life Policy will not appear in the Balance Sheet.

In this situation, the full amount of policy received in the event of the death of a partner from the Insurance Company becomes a gain

1. When Claim Admitted By Insurance Company

Insurance Company A/C.....Dr

To Joint Life Policy A/c

(Being claim made on death of a partner)

2. Insurance claim received on death

Bank A/c.....Dr

To Joint Life Policy A/c

(Being insurance claim received against the Joint Life Policy on the death of a partner)

3. Gain distributed

Joint Life Policy A/c.....Dr

To Partners Capital A/c (Individually)

(Being the amount received on Joint Life Policy treated as gain and distributed among the partners)

2. Surrender Value Method or Premium Paid is treated as Capital Expenditure

The partners may decide to record the Joint Life Policy at the surrender value in the books. In this case, it will appear on the assets side of the Balance Sheet. The Journal entries will be:

➤ When Claim Admitted By Insurance Company

Insurance Company A/C.....Dr

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To Joint Life Policy A/c

(Being claim made on death of a partner)

➤ **Insurance claim received on death**

Bank A/c.....Dr

To Joint Life Policy A/c

(Being insurance claim received against the Joint Life Policy on the death of a partner)

➤ **When Balance amount of Joint Life Policy A/c distributed Among All the Partners in old Ratio(Amount of JLP less Surrender Value)**

Joint Life Policy A/c (balance amount).....Dr

To Partners Capital A/c (Individually)

(Being the balance amount in the Joint Life Policy A/c distributed among the partners)

3. Joint Life Policy Reserve Method

The partners may maintain the Joint Life Policy A/c as well as the Joint Life Policy Reserve A/c. Thus, under this method, both Joint Life Policy A/c and Joint Life Policy Reserve A/c appear at surrender value on the Assets and Liabilities side of the Balance Sheet, respectively. At the time of the death of a partner, the journal entries are:

➤ **When Claim Admitted By Insurance Company**

Insurance Company A/C.....Dr

To Joint Life Policy A/c

(Being claim made on death of a partner)

➤ **Insurance claim received on death**

Bank A/c.....Dr

To Joint Life Policy A/c

(Being insurance claim received against the Joint Life Policy on the death of a partner)

➤ **When Amount of JLP Transfer In to JLP Reserve Account**

Joint Life Policy Reserve A/cDr

To Joint Life Policy A/c

(Being Transfer of JLP Reserve to JLP Account)

➤ **When Balance Of JLP distribution among All partners**

Joint Life Policy A/c (balance amount).....Dr

To Partners Capital A/c (Individually)

(Being the balance amount in the Joint Life Policy A/c distributed among the partners)

Individual Life Policy

It is also a life insurance policy taken by the firm in the name of individual partner of the firm. Individual life policy matures only after the expiry of period or in the event of death of insured partner.

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The executors of the deceased partner is entitled to deceased partner's share in the maturity value of his individual policy and surrender value of the individual policy of other partners

Calculation of Total Amount Payable to Executors of deceased partner

The total amount Payable to Executors' of the deceased partner is determined by preparing his capital account on the date of Death.

Performa of Deceased partners capital A/c

Particulars	Amount	Particulars	Amount
To Accumulated losses	xxxx	By Balance b/d	xxxx
To Goodwill A/c	xxxx	By Revaluation A/c(profit)	xxxx
To Interest on Drawings	xxxx	By Interest on Capital	xxxx
To Drawings	xxxx	By Accumulated profits/Reserves	xxxx
To Revaluation loss (if any)	xxxx	By Commission/ Salary	xxxx
To P/L Suspense A/c (Loss)	xxxx	By P/L Suspense A/c (Profit)	xxxx
		By Joint life policy	xxxx
To Executor A/c (Bal.figure)	xxxx	By Remaining partners capital(goodwill share)	xxxx

Settlement of Executors of deceased Partners Account

The amount due to the Executors' of deceased partner is settled as per the provisions of the partnership deed. It may be paid in full Amount at the time of Death. Sometimes, the firm may not be in a position to pay the amount due to him in lump sum. In such a case, the amount due is transferred to Deceased partners executors Loan account and is paid in instalments together with interest.

It should be noted that under section 37 of the Partnership Act, the executors would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment or to that portion of profit which is earned by the firm with the help of the amount due to the deceased partner.

Journal Entries

- **When balance of Deceased partners capital account Transfer to Deceased partners Executors' account**

Deceased Partners Capital A/cDr
 To Deceased Partners Executors' Account
(Being amount Transfer In to Executors' account)

- **When Deceased partner Executors' is paid cash in full (Lump Sum):**

Deceased Partner's Executors A/C..... Dr
To Cash/Bank
(Amount due to the retiring partner paid off)

- When the Deceased partner Executors' balance is partly paid in cash and the remaining amount transferred to his loan account

Deceased Partner's Executors' A/C Dr (Total Amount Due)

To Cash/Bank (Amount paid)

To Deceased Partner's Executors Loan (Amount transferred to loan)

(Amount due to the Deceased partner Executors is settled)

Loan account of the Deceased Partner's Executors

1. When the amount due to the Deceased partner is transferred to his Executors Loan account

Deceased Partner's Capital A/C Dr

To Deceased Partner's Executors' Loan A/C

(Amount due to the Deceased partner transferred to his Executors Loan A/C)

2. When yearly interest due

Interest Account Dr (Interest of the current year)

To Deceased Partner's Executors' Loan account

(Interest Amount due)

3. For payment of yearly installment (yearly Principal amount + Yearly interest)

Deceased Partner's Executors' Loan A/C Dr

To Cash/Bank

(Being yearly installment paid)

Note: 1. Balance of Deceased partner's Executors loan account is shown on the liability side of the balance sheet.

1. Journal entry (2) and (3) above will be repeated till the loan is paid off.