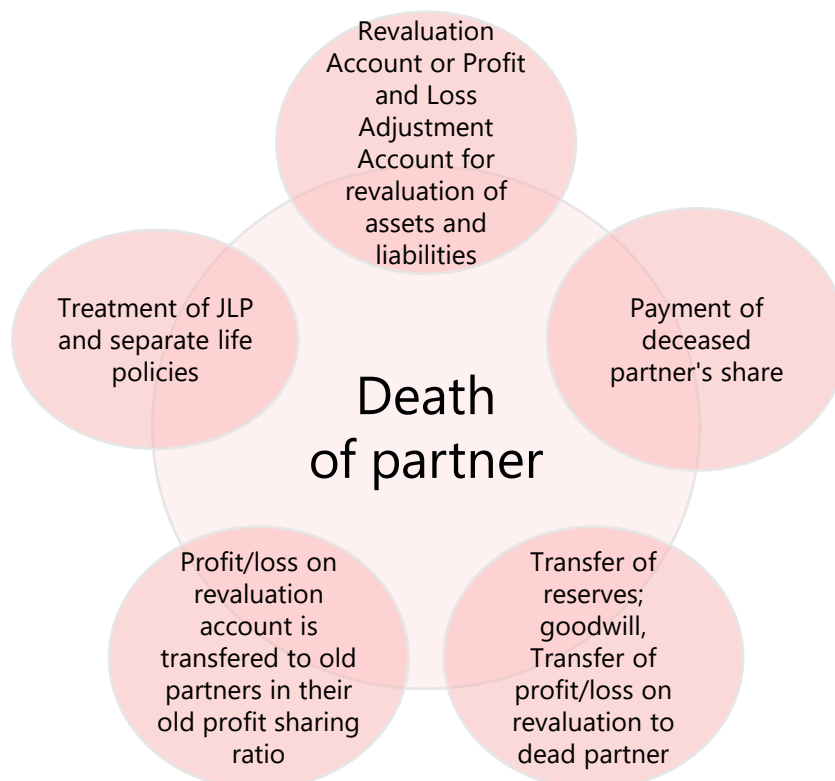


UNIT – 5 DEATH OF A PARTNER

LEARNING OUTCOMES

After studying this unit, you would be able to:

- ◆ Understand the implication of the excess money received on death of a partner from a joint life policy from the insurance company in the accounts of the partnership. Learn the journal entries required to record this transaction.
- ◆ Understand the accounting implications if death of a partner takes place at any date during the accounting period. Learn to record this transaction and how to record payment of profit to the Executor of the deceased partner for part of the accounting year.
- ◆ Be familiar with other accounting treatments in case of death of partner which are similar to the explained in case of retirement of a partner.

UNIT OVERVIEW**5.1 INTRODUCTION**

Business of a partnership firm may not come to an end due to death of a partner as it is known as Reconstitution of Partnership. Other partners shall continue to run the business of the firm. The problems arising on the death of a partner are similar to those arising on retirement. Assets and liabilities have to be revalued and the resultant profit or loss has to be transferred to the capital accounts of all partners including the deceased partner. Goodwill is dealt with exactly in the way already discussed in the case of retirement in the earlier unit. Treatment of joint life policy will also be same as in the case of retirement. However, in case of death of a partner, the firm would get the joint policy value.



5.2 RIGHT OF OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS

As per provisions of Section 37 of the Indian Partnership Act., "Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

Provided that whereby contract between the partners an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section. This way, the outgoing partner has the option to receive, interest at the rate of 6% p.a. or the share of profit earned on the unsettled amounts for the period till his dues are settled by the firm in the absence of any contract made to the contrary".

It may be noted that the outgoing partner is not bound to make election until the share of the profit that would be payable to him has been ascertained.

For example, A, B and C are in a partnership business-sharing profits and losses equally. C died on 31st October, 20X1. The capitals of the partners, after all necessary adjustments stood at ₹ 50,000, ₹75,000 and ₹ 1,20,000 respectively. A and B continued to carry on the business further without settling the accounts of C. Final payment to C is made on February 1, 20X2. The profit made during the period of three months amounts to ₹ 28,000.

Under Section 37 of the Partnership Act, C can exercise any of the following two options.

- (i) Share in subsequent profits of firm:

Profit made—₹ 28,000

$$C's \text{ share} = 28,000 \times \frac{1,20,000}{2,45,000} = ₹ 13,714$$

- (ii) Interest at 6% p.a.

$$1,20,000 \times \frac{6}{100} \times \frac{3}{12} = ₹ 1,800$$

Since, (i) option is beneficial for C, he will necessarily go for his proportionate share in profits.



5.3 AMOUNT PAYABLE TO LEGAL REPRESENTATIVES OF DEAD PARTNER

When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings:

- (a) The amount standing to the credit to 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.

Legal representatives are liable for:

- (i) Drawings
- (ii) Interest on drawings
- (iii) Share of loss on the revaluation of assets and liabilities;
- (iv) Share of loss that have occurred till the date of his/her death.

Calculation of profit upto the date of death of a partner.

Such Profit is calculated through P&L Suspense account. After ascertaining the amount due to the deceased partner, it should be credited to his Executor's Account.

If the death of a partner occurs during the year, the representatives of the deceased partner are entitled to his/her share of profits earned till the date of his/her death. Such profit is ascertained by any of the following methods:

- (i) Time Basis
- (ii) Turnover or Sales Basis

(i) Time Basis

In this case, it is assumed that profit has been earned uniformly throughout the year. For example:

The total profit of previous year is ₹ 2,25,000 and a partner dies three months after the close of previous year, the profit of three months is ₹ 31,250 i.e. $1,25,000 \times 3/12$, if the deceased partner took $2/10$ share of profit, his/her share of profit till the date of death is ₹ 6,250 i.e. $₹ 31,250 \times 2/10$

(ii) Turnover or Sales Basis

In this method, we have to take into consideration the profit and the total sales of the last year. Thereafter the profit up to the date of death is estimated on the basis of the sale of the last year. Profit is assumed to be earned uniformly at the same rate.

Example

Arun, Tarun and Neha are partners sharing profits in the ratio of 3:2:1. Neha dies on 31st May 20X2. Sales for the year 20X1-20X2 amounted to ₹ 4,00,000 and the profit on sales is ₹ 60,000. Accounts are closed on 31 March every year. Sales from 1st April 20X2 to 31st May 20X2 is ₹ 1,00,000. The deceased partner's share in the profit upto the date of death will be as follows.

Profit from 1st April 20X2 to 31st May 20X2 on the basis of sales:

If sales are ₹ 4,00,000, profit is ₹ 60,000

If the sales are ₹ 1,00,000 profit is: $60,000/4,00,000 \times 1,00,000 = ₹ 15,000$

Neha's share = $15,000 \times 1/6 = ₹ 2,500$

Alternatively profit is calculated as

$$\text{Rate of profit} = \frac{60,000}{4,00,000} \times 100 = 15\%$$

Sale upto date of death = 1,00,000

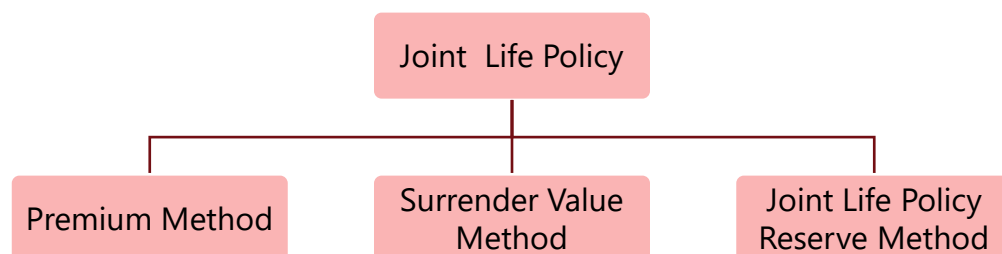
Profit = $1,00,000 \times 15/100 = ₹ 15,000$

The above adjustments are made in the capital account of the deceased partner and then the balance in the capital account is transferred to an account opened in the name of his/her executor. The payment of the amount of the deceased partner depends on the agreement. In the absence of an agreement, the legal representative of a deceased partner is entitled to interest @ 6% p.a. on the amount due from the date of death till the date of final payment



5.4 SPECIAL TRANSACTIONS IN CASE OF DEATH: JOINT LIFE POLICY

In case of Partnership, Partners generally get Joint Life Policy (JLP) in name of all partners. If partner expires, then partners are entitled for share in JLP.



Method 1: If Joint Life Policy does not appear in the Balance Sheet, then the firm will gain on the death of a partner. For example, A, B and C are in partnership sharing profits and losses at the ratio of 5:3:2. They took a Joint Life Policy of ₹ 1,00,000. Now, if A dies, the firm will receive ₹ 1,00,000 from the insurance company.

The journal entries will appear as follows:

		₹	₹
(i) Bank A/c	Dr.	1,00,000	
To Joint Life Policy A/c			1,00,000
(Policy value received from the insurance company on A's death)			
(ii) Joint Life Policy A/c	Dr.	1,00,000	
To A's Capital A/c			50,000
To B's Capital A/c			30,000
To C's Capital A/c			20,000
(Joint Life Policy written off and credited to old partners in Profit Sharing Ratio)			

Method 2: If Joint Life Policy appears in the Balance Sheet at surrender value, then the firm will gain on the death of a partner. For example, A, B and C are in partnership sharing profits and losses at the ratio of 5:3:2. They took a Joint Life Policy of ₹ 1,00,000 which is appearing in the Balance Sheet at the surrender value of ₹ 10,000. Now, if A dies, the firm will receive ₹ 1,00,000 from the insurance company.

The journal entries will appear as follows:

		₹	₹
(i)	Bank A/c Dr. To Joint Life Policy A/c (Policy value received from the insurance company on A's death)	1,00,000	1,00,000
(ii)	Joint Life Policy A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Joint Life Policy written off and credited to old partners in Profit Sharing Ratio)	90,000	45,000 27,000 18,000

Method 3:

If Joint Life Policy appears in the Balance Sheet at surrender value along with Joint Life Policy Reserve, then the firm will gain on the death of a partner and reserve will be distributed among partners. For example, A, B and C are in partnership sharing profits and losses at the ratio of 5:3:2. They took a Joint Life Policy of ₹ 1,00,000 which is appearing in the Balance Sheet at the surrender value of ₹ 10,000, along with JLP reserve. Now, if A dies, the firm will receive ₹ 1,00,000 from the insurance company.

The journal entries will appear as follows:

		₹	₹
(i)	Bank A/c Dr. To Joint Life Policy A/c (Policy value received from the insurance company on A's death)	1,00,000	1,00,000
(ii)	Joint Life Policy A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Joint Life Policy written off and credited to old partners in Profit Sharing Ratio)	90,000	45,000 27,000 18,000
(iii)	Joint Life Policy Reserve A/c Dr. To A's Capital A/c	10,000	5,000

To B's Capital A/c		3,000
To C's Capital A/c		2,000
(Joint Life Policy reserved written off and credited to old partners in Profit Sharing Ratio)		



5.5 SPECIAL TRANSACTIONS IN CASE OF DEATH: SEPARATE LIFE POLICY

Instead of taking one joint life policy in the names of all the partners, the partners may take individual policies on the lives of respective partners. The premium paid is charged to profit and loss account. On the death of a partner then only the amount for which the deceased partner was insured would be recovered from the insurance company. The policies of the surviving partners will continue to survive but the surrender value of the policies of the surviving partners would also be taken into account for the purpose of calculating the amount payable to the legal representatives of the deceased partner. In other words the legal representatives would be entitled to receive share in surrender value equivalent to the profit sharing ratio of the deceased.

Separate Life Policy of Deceased Partner A/c Dr. (Assured value)
 Separate Life Policy of Remaining Partners A/c Dr. (Surrender value)
 To Executor's A/c (Total value distributed in profit sharing ratio)
 To Remaining partners A/c (Total value distributed in profit sharing ratio)

(Being the total of assured value of deceased partner's life policy and surrender value of other partners' life policy(s) distributed in the profit and loss sharing ratio)

Bank A/c Dr. (Assured value)
 To Separate Life Policy of Deceased partner A/c

(Policy value received on death of a partner)

Example: Sona, Gabbu and Amit are partners sharing profits in the ratio of 3:1:1.

	SONA	GABBU	AMIT
Policy	1,00,000	2,00,000	3,00,000
Surrender Value	10,000	20,000	30,000

If Amit dies, then, Amit's executives will get $3,00,000 \times \frac{1}{5}$ and $\frac{1}{5}(10,000+20,000)$
 $= 60,000+6,000 = 66,000$



5.6 SPECIAL TRANSACTIONS IN CASE OF DEATH: PAYMENT OF DECEASED PARTNER'S SHARE

The basic distinction between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition, the executor of the deceased partner is entitled to share of profit upto the date of death.

For example, A, B and C are in partnership sharing profits and losses at the ratio of 2:2:1. A died on 15th April, 20X2. The firm closes its books of account as on 31st December every year. So the executor of A is entitled for 3½ months profit. If A's share is immediately paid off then profit for 20X1 can be taken as base for calculating 3½ months profits in the year, 20X2. If M/s. A, B & C earned ₹ 96,000 in year 20X1, then 3½ months profit is ₹ 28,000. A's share comes to ₹ 28,000 × 2/5 i.e. ₹ 11,200.

Journal entry is:

Profit and Loss Suspense A/c *	Dr.	₹ 11,200	
To A's Capital A/c			₹ 11,200
(Share of A 3½ months profit in 20X2 is transferred to his Capital Account on death)			

*At the end of the year 20X2, the Profit & Loss Suspense A/c will be transferred to Profit and Loss A/c.

ILLUSTRATION 1

The following was the Balance Sheet of Om & Co. in which X, Y, Z were partners sharing profits and losses in the ratio of 1:2:2 as on 31.3.20X3. Mr. Z died on 31st December, 20X3. His account has to be settled under the following terms.

Balance Sheet of Om & Co. as on 31.3.20X3

Liabilities	₹	₹	Assets	₹
Trade payables		20,000	Building	1,20,000
Bank loan		50,000	Computers	80,000
General reserve		30,000	Inventories	20,000
Capital accounts:			Trade receivables	20,000
X	40,000		Cash at bank	50,000
Y	80,000		Investments	10,000
Z	80,000	2,00,000		
		3,00,000		3,00,000

Goodwill is to be calculated at the rate of two years purchase on the basis of simple average of three years' profits and losses. The profits and losses for the three years were detailed as below:

Year ending on	profit/loss
31.3.20X3	30,000
31.3.20X2	20,000
31.3.20X1	(10,000) Loss

Profit for the period from 1.4.20X3 to 31.12.20X3 shall be ascertained proportionately on the basis of average profits and losses of the preceding three years.

During the year ending on 31.3.20X3 a car costing ₹ 40,000 was purchased on 1.4.20X2 and debited to traveling expenses account on which depreciation is to be calculated at 20% p.a. at written down value method. This asset is to be brought into account at the depreciated value.

Other values of assets were agreed as follows:

Inventory at ₹ 16,000, building at ₹ 1,40,000, computers at ₹ 50,000; investments at ₹ 6,000. Trade receivables were considered good.

Required:

- Calculate goodwill and Z's share in the profits of the firm for the period 1.4.20X3 to 31.12.20X3.
- Prepare revaluation account assuming that other items of assets and liabilities remained the same.
- Prepare partners' capital accounts and balance sheet of the firm Om & Co. as on 31.12.20X3.

SOLUTION

(i) Calculation of goodwill and Z's share of profit

(a)	Adjusted profit for the year ended 31.3.20X3:	₹	₹
	Profit (Given)		30,000
	Add: Cost of car wrongly written off	40,000	
	Less: Depreciation for the year 20X2-X3 (20% on 40,000)	(8,000)	32,000
			62,000
(b)	Average of last three year's profits and losses	Profit/(loss)	

	Year ended on	₹	
	31.3.20X1	(10,000)	
	31.3.20X2	20,000	
	31.3.20X3	62,000	
		72,000	
	Average profit (72,000/3)	24,000	
(c)	Goodwill at 2 years' purchase		
	₹ 24,000 x 2 = ₹ 48,000		
(d)	Z's share of profits from the period 1.4.20X3 to 31.12.20X3		
	₹ 24,000 x 9/12 x 2/5 = ₹ 7,200		

(ii)

Revaluation Account

	₹		₹
To Inventory account	4,000	By Building account	20,000
To Computers account	30,000	By Car (32,000-4,800)	27,200
To Investments account	4,000		
To Profit transferred to			
X 1,840			
Y 3,680			
Z <u>3,680</u>	9,200		
	47,200		47,200

Partners' Capital Accounts

	X ₹	Y ₹	Z ₹		X ₹	Y ₹	Z ₹
To Z's Executor's A/c			1,22,080	By Balance b/d	40,000	80,000	80,000
To Z	6,400	12,800	–	By General reserve	6,000	12,000	12,000
To Balance c/d	41,440	82,880		By X and Y	–	–	19,200
				By Revaluation A/c	1,840	3,680	3,680
				By Profit and Loss suspense A/c	–	–	7,200
	47,840	95,680	1,22,080		47,840	95,680	1,22,080

Balance Sheet of Om & Co. as at 31st December, 20X3

Liabilities	₹	Assets	₹
Trade payables	20,000	Building	1,40,000
Bank loan	50,000	Car	27,200
Capital accounts:		Inventories	16,000
X	41,440	Computers	50,000
Y	82,880	Investments	6,000
Z's Executor's account	1,22,080	Trade receivables	20,000
		Cash at bank	50,000
		Profit and Loss suspense Account	7,200
	3,16,400		3,16,400

Working Note:

Goodwill calculated at the time of death of partner Z ₹ 48,000

Partner	Old Share	New Share	Gain	Sacrifice
X	$\frac{1}{5}$	$\frac{1}{3}$	$\frac{2}{15}$	—
Y	$\frac{2}{5}$	$\frac{2}{3}$	$\frac{4}{15}$	—
Z	$\frac{2}{5}$	—	—	$\frac{2}{5}$

Adjusting entry:

X's Capital Account	Dr.	6,400	
Y's Capital Account	Dr.	12,800	
To Z's Capital Account			19,200

(Adjustment for goodwill on the death of Z on the basis of gaining ratio)

ILLUSTRATION 2

The partnership agreement of a firm consisting of three partners - A, B and C (who share profits in proportion of $\frac{1}{2}$, $\frac{1}{4}$ and $\frac{1}{4}$ and whose fixed capitals are ₹ 10,000; ₹ 6,000 and ₹ 4,000 respectively) provides as follows:

- (a) That partners be allowed interest at 10 per cent per annum on their fixed capitals, but no interest be allowed on undrawn profits or charged on drawings.

- (b) That upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.
- (c) That an insurance policy of ₹ 10,000 each to be taken in individual names of each partner, the premium is to be charged against the profit of the firm.
- (d) Upon the death of a partner, he is to be credited with his share of the profits, interest on capitals etc. calculated upon 31st December following his death.
- (e) That the share of the insurance policy and goodwill be credited to the deceased partner as on 31st December following his death.
- (f) That the partnership books be closed annually on 31st December.

A died on 30th September 20X4, the amount standing to the credit of his current account on 31st December, 20X3 was ₹ 450 and from that date to the date of death he had withdrawn ₹ 3,000 from the business.

An unrecorded liability of ₹ 2,000 was discovered on 30th September, 20X4. It was decided to record it and be immediately paid off.

The trading result of the firm (before charging interest on capital) had been as follows: 20X1 Profit ₹ 9,640; 20X2 Profit ₹ 6,720; 20X3 Profit ₹ 7,640; 20X4 Profit ₹ 3,670.

Assuming the surrender value of the policy to be 20 percent of the sum assured.

Required

Prepare an account showing the amount due to A's legal representative as on 31st December, 20X4.

SOLUTION

A's Capital Account

20X4		₹	20X4		₹
Sep. 30	To Current A/c (3,000 - 450)	2,550	Jan. 1	By Balance b/d	10,000
			Dec. 31	By Profit and Loss app A/c :	
Dec. 31	To Profit and Loss Adj. (Unrecorded Liability)	1,000		Interest on Capital	1,000
	To Balance Transferred to A's Executor's A/c	21,285		Share of Profit	835
		24,835		B & C (Goodwill)	6,000
				Insurance Policies A/c	7,000
					24,835

Working Notes:**(i) Valuation of Goodwill**

Year	Profit before Interest on fixed capital	Interest	Profit after interest
	₹	₹	₹
20X1	9,640	2,000	7,640
20X2	6,720	2,000	4,720
20X3	7,640	2,000	5,640
	24,000	6,000	18,000
			₹
Average			6,000
Goodwill at two years purchase of average net profits			12,000
Share of A in the goodwill			6,000
(ii) Profit on Separate Life Policy			
A's policy			10,000
B and C's policy @ 20%			4,000
			14,000
Share of A (1/2)			7,000
(iii) Share in profit for 20X4			
Profit for the year			3,670
Less : Interest on capitals			(2,000)
			1,670
A's share in profit (1/2)			835

- (iv) As unrecorded liability of ₹ 2,000 has been charged to Capital Accounts through Profit and Loss Adjustment Account, no further adjustment in current year's profit is required.
- (v) Profits for 20X1, 20X2 and 20X3 have not been adjusted (for valuing goodwill) for unrecorded liability for want of precise information.

ILLUSTRATION 3

The following is the Balance Sheet of M/s. ABC LLP as at 31st December, 20X1.

Balance Sheet as at 31st December, 20X1

Liabilities	₹	Assets	₹
Capital		Machinery	5,000
A	4,100	Furniture	2,800

B	4,100	Fixture		2,100
C	4,500	Cash		1,500
General Reserve	1,500	Inventories		950
Trade payables	2,350	Trade receivables	4,500	
		Less: Provision for Doubtful debts	300	4,200
	16,550			16,550

C died on 3rd January, 20X2 and the following agreement was to be put into effect.

- Assets were to be revalued: Machinery to ₹ 5,850; Furniture to ₹ 2,300; Inventory to ₹ 750.
- Goodwill was valued at ₹ 3,000 and was to be credited with his share, without using a Goodwill Account
- ₹ 1,000 was to be paid away to the executors of the dead partner on 5th January, 20X2.

Required

- The Journal Entry for Goodwill adjustment.
- The Revaluation Account and Capital Accounts of the partners.
- Which account would be debited and which account credited if the provision for doubtful debts in the Balance Sheet was to be found unnecessary to maintain at the death of C.

SOLUTION

(i) Journal Entry in the books of the firm

Date	Particulars		₹	₹
Jan 3, 20X2	A's Capital A/c Dr.		500	
	B's Capital A/c Dr.		500	
	To C's Capital A/c			1,000
	(Being the required adjustment for goodwill through the partner's capital accounts)			

(ii) Revaluation Account

Particulars	₹	Particulars	₹
To Furniture A/c (₹ 2,800 – 2,300)	500	By Machinery A/c (₹ 5,850 – 5,000)	850
To Inventory A/c (₹ 950 – 750)	200		
To Partners' Capital A/cs (A – ₹ 50, B – ₹ 50, C – ₹ 50)	150		
	850		850

Partners' Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To C (Goodwill)	500	500	–	By Balance b/d	4,100	4,100	4,500
To Cash A/c	–	–	1,000	By General Reserve A/c	500	500	500
To Executors A/c	–	–	5,050	By Revaluation A/c (Profit)	50	50	50
To Balance C/d	4,150	4,150	–	By A (Goodwill)	–	–	500
				By B (Goodwill)	–	–	500
	4,650	4,650	6,050		4,650	4,650	6,050

- (iii) Provision for Doubtful Debts Account is a credit balance. To close, this account is to be debited. It becomes a gain for the partners. Therefore, either Partners' Capital Accounts (including C) or Revaluation Account is to be credited.

Working Note:**Statement showing the Required Adjustment for Goodwill**

Particulars	A	B	C
Right of goodwill before death	1/3	1/3	1/3
Right of goodwill after death	1/2	1/2	–
Gain/(Sacrifice)	(+) 1/6	(+) 1/6	(-) 1/3

Profit sharing ratio is equal before or after the death of C because nothing has been mentioned in respect of profit-sharing ratio.

ILLUSTRATION 4

B and N were partners. The partnership deed provides inter alia:

- (i) *That the accounts be balanced on 31st December each year.*
- (ii) *That the profits be divided as follows:*
B: One-half; N: One-third; and carried to Reserve Account: One-sixth
- (iii) *That in the event of death of a partner, his executor will be entitled to the following:*
 - (a) *the capital to his credit at the date of death; (b) his proportion of profit to date of death based on the average profits of the last three completed years; (c) his share of goodwill based on three years' purchases of the average profits for the three preceding completed years.*

Trial Balance on 31st December, 20X3

Particulars	Dr. (₹)	Cr. (₹)
B's Capital		90,000
N's Capital		60,000
Reserve		30,000
Bills receivable	50,000	
Investments	40,000	
Cash	1,10,000	
Trade payables		20,000
Total	2,00,000	2,00,000

The profits for the three years were 20X1: ₹ 42,000; 20X2: ₹ 39,000 and 20X3: ₹ 45,000. N died on 1st May, 20X4. Show the calculation of N (i) Share of Profits; (ii) Share of Goodwill; (iii) Draw up N's Executors Account as would appear in the firms' ledger transferring the amount to the Loan Account.

SOLUTION

(i)	Ascertainment of N's Share of Profit		(ii)	Ascertainment of Value of Goodwill	
	20X1	42,000		20X1	42,000
	20X2	39,000		20X2	39,000
	20X3	45,000		20X3	45,000
	Total Profit	1,26,000		Total Profit for 3 years	1,26,000
	Average Profit	42,000		Average Profit	42,000
	4 months' Profit	14,000		Goodwill - 3 years	
				Purchase of Average Profit	1,26,000
	N's Share in Profit (2/5th* of ₹ 14,000)	5,600		N's Share of goodwill (2/5 of ₹ 1,26,000)	50,400

* Profit sharing ratio between B and N = 1/2; 1/3; = 3: 2, Therefore N's share of Profit = 2/5

N's Executors Account

Date	Particulars	₹	Date	Particulars	₹
20X4 May 1,	To N's Loan A/c	1,28,000	20X4 Jan. 1	By Capital A/c	60,000
			May 1	By Reserves (2/5th of ₹ 30,000)	12,000

			May 1	By B's Capital A/c (Share of goodwill)	50,400
			May 1	By P/L Suspense A/c (Share of Profit)	5,600
		1,28,000			1,28,000

ILLUSTRATION 5

Diya, Riya & Kiya are partners of M/s. DRK Fabrics sharing profits and losses in the ratio of 2:1:2. On 31st March 20X5 their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capitals :		Land & Building	1,65,000
Diya	1,50,000	Furniture	75,000
Riya	1,80,000	Joint life Policy	60,000
Kiya	70,000	Inventory	88,740
General Reserve	1,40,000	Trade Receivable	96,750
Trade payables	60,000	Bank	1,14,510
	6,00,000		6,00,000

Kiya died on 30th September, 20X5.

The partnership deed provides as follows:

- That partners be allowed interest at 12% p.a. on their capitals, but no interest be charged on drawings.
- Upon the death of a partner, the goodwill of the firm be valued at one years' purchase of the average net profits (after charging interest on capital) for the four years to 31st March preceding the death of a partner. The profits of the firm before charging interest on capitals were:

20X1-X2 1,62,000

20X2-X3 1,99,000

20X3-X4 1,87,000

20X4--X5 1,96,000

Average capital during preceding four years may be assumed as ₹ 3,00,000.

- Profits till the date of death to be ascertained on the basis of average profit of previous four years.

- (d) Upon the death of a partner, she is to be credited with her share of the profits, interest on capitals etc. calculated till the date of death.

After the death of Kiya

1. ₹ 2,00,000 was received from insurance company against Joint life Policy.
2. Land & Building was appreciated by 20%, Furniture to be depreciated by 10%, inventory to be revalued at ₹ 80,000. Bad debts amounted ₹ 1760.
3. Amount payable to Kiya was paid through bank.

You are required to prepare

1. Revaluation A/c
2. Partners' Capital A/c
3. Balance Sheet as on 30th September 20X5, assuming other Assets and liabilities remaining the same.

SOLUTION

Revaluation A/c

Particulars	₹	Particulars	₹
To Furniture	7,500	By Land & Building	33,000
To Inventory	8,740		
To Bad Debts	1,760		
To Profit on Revaluation			
Diya 6,000			
Riya 3,000			
Kiya <u>6,000</u>	15,000		
	33,000		33,000

Partners Capital A/c

Particulars	Diya ₹	Riya ₹	Kiya ₹	Particulars	Diya ₹	Riya ₹	Kiya ₹
To Kiya capital	40,000	20,000		By Balance b/d	1,50,000	1,80,000	70,000
To Bank			2,79,800	By General Reserve	56,000	28,000	56,000
To Balance c/d	2,28,000	2,19,000		By Joint life Policy	56,000	28,000	56,000

				By Interest on Capital			4,200
				By revaluation	6,000	3,000	6,000
				By Diya & Riya capital			60,000
				By Profit & loss suspense A/c			27,600
	2,68,000	2,39,000	2,79,800		2,68,000	2,39,000	2,79,800

Bank A/c

Particulars	₹	Particulars	₹
To Balance B/d	1,14,510	By Kiya's Capital	2,79,800
To Joint Life Policy	2,00,000	By Balance c/d	34,710
	3,14,510		3,14,510

Balance Sheet as on 30th September, 20X5

Liabilities	₹	Assets	₹
Capitals :		Land & Building	1,98,000
Diya	2,28,000	Furniture	67,500
Riya	2,19,000	Inventory	80,000
		Trade Receivable	94,990
Trade payables	60,000	Bank	34,710
		Profit and loss Suspense (27,600+4,200)	31,800
	5,07,000		5,07,000

Working Notes:

1. Goodwill valuation

20X1-X2 1,62,000

20X2-X3 1,99,000

20X3-X4 1,87,000

20X4-X5 1,96,000Total 7,44,000

Average = 7,44,000/4 = 1,86,000

Less: Interest on Capital 3,00,000 X 12% = 36,000

Adjusted Average Profit = 1,50,000

Goodwill (1 year's purchase) = 1,50,000

Kiya's share (2/5) = 60,000

2. Journal entry for adjustment of goodwill

Particulars		₹	₹
Diya's Capital A/c	Dr.	40,000	
Riya's Capital A/c	Dr.	20,000	
To Kiya's Capital A/c			60,000
(Share of goodwill adjusted)			

3. Kiya's share of profit till the date of death

Average profit for full year before interest on capital = 1,86,000

6 month's profit = 93,000

Less: interest on capital $4,00,000 \times 12\% \times 6/12$ = 24,000

Adjusted profit till the date of death = 69,000

Kiya's share 2/5th = 27,600

4. The Joint life policy in this question is based on the surrender value method- where in the amount shown in the balance sheet shall be deducted from the JLP proceeds received from insurance co, on the death of a partner.

₹ 2,00,000- 60,000 (Balance Sheet value) = ₹ 1,40,000 (divided in profit sharing ratio between the partners.)

NOTE: The ICAI through guidance note has recommended the formats of financial statements for Limited Liability Partnerships (LLPs). This would enable these entities to communicate their financial performance and financial position in standardised formats thereby enhancing their consistency and comparability. The said format of financial statements is being given as Annexure – II at the end of the chapter for awareness of students. It may be noted that this format does not form part of syllabus and has been given here for the knowledge of students only.

SUMMARY

- ♦ The problems arising on the death of a partner are similar to those arising on retirement. Assets and liabilities have to be revalued and the resultant profit or loss has to be transferred to the Capital Accounts of all partners including the deceased partner. Goodwill is dealt with exactly in the way already discussed in the case of retirement.

- ◆ Treatment of joint life policy will also be same as in the case of retirement. However, in case of death of a partner, the firm would get the joint policy value. The only additional point is that as death may occur on any day, the representatives of the deceased partner will be entitled to the partner's share of profit from the beginning of the year to the date of death. After ascertaining the amount due to the deceased partner, it should be credited to his Executor's Account.
- ◆ If the death takes place during the accounting period, the Executor of the deceased partner is entitled to have a share of profit upto the date of death based on the profit earned in the immediately preceding year or some other agreed basis. For this purpose, the deceased partners' Capital Accounts is credited and Profit & Loss Suspense Account is debited.

TEST YOUR KNOWLEDGE

True and False

1. *Business of partnership comes to an end on death of a partner.*
2. *Legal heir of a deceased partner automatically becomes partner in the firm.*
3. *A revaluation account is opened in the books of accounts on death of a partner.*
4. *Any reserve appearing in the balance sheet on the date of death of a partner is transferred to all partners capital account in their profit sharing ratio.*
5. *Legal heirs of a deceased partner are entitled to his capital account balance only.*
6. *It is not necessary to adjust goodwill on death of a partner.*
7. *On death of a partner continuing partners can agree to change their capital contribution and profit sharing ratio.*
8. *On death of a partner, the firm gets surrender value of the joint life policy.*
9. *Only legal heirs of deceased partner are entitled to amount received from joint life policy.*

Multiple Choice Questions

1. *In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in*
 - (a) *Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.*
 - (b) *Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.*

- (c) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.
- (d) Interest on drawings, share in secret reserves, and future profits.
2. A, B and C are the partners sharing profits and losses in the ratio 2:1:1. Firm has a joint life policy of ₹ 1,20,000 and in the balance sheet it is appearing at the surrender value i.e. ₹ 20,000. On the death of A, how this JLP will be shared among the partners.
- (a) ₹ 50,000: ₹ 25,000: ₹ 25,000.
- (b) ₹ 60,000: ₹ 30,000: ₹ 30,000.
- (c) ₹ 40,000: ₹ 35,000: ₹ 25,000.
- (d) ₹ 10,000: ₹ 5,000: ₹ 5,000.
3. R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 20X6. It was decided to value the goodwill on the basis of three year's purchase of last five years average profits. If the profits are ₹ 29,600; ₹ 28,700; ₹ 28,900; ₹ 24,000 and ₹ 26,800. What will be D's share of goodwill?
- (a) ₹ 20,700.
- (b) ₹ 27,600.
- (c) ₹ 82,800.
- (d) ₹ 16,800.
4. R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 20X2 and profits for the accounting year 20X1-20X2 were ₹ 24,000. How much share in profits for the period 1st April 20X2 to 30th June 20X2 will be credited to D's Account.
- (a) ₹ 6,000.
- (b) ₹ 1,500.
- (c) ₹ 2,000.
- (d) ₹ 3,000.
5. Revaluation account is prepared at the time of
- (a) Admission and retirement of a partner
- (b) Death of a partner
- (c) Dissolution of a partner
- (d) Both (a) and (b)

6. If three partners A, B & C are sharing profits as 5:3:2, then on the death of a partner A, how much B & C will pay to A's executer on account of goodwill. Goodwill is to be calculated on the basis of 2 years purchase of last 3 years average profits. Profits for last three years are: ₹ 3,29,000; ₹ 3,46,000 and ₹ 4,05,000.
- (a) ₹ 2,16,000 & ₹ 1,42,000.
- (b) ₹ 2,44,000 & ₹ 2,16,000.
- (c) ₹ 2,16,000 & ₹ 1,44,000.
- (d) ₹ 1,80,000 & ₹ 1,20,000.

Theoretical Questions

1. Explain distinction between retirement and death of a partner as relating to finalisation of amount payable.
2. What amount is payable to legal representatives of dead partner?

Practical Questions

1. The Balance Sheet of Seed, Plant and Flower as at 31st December, 20X4 was as under :

Liabilities		₹	Assets	₹
Trade payables		20,000	Fixed Assets	40,000
General Reserve		5,000	Debtors	10,000
Capital:			Bills Receivable	4,000
Seed	25,000		Inventories	16,000
Plant	15,000		Cash at Bank	10,000
Flower	15,000	55,000		
		80,000		80,000

The profit sharing ratio was: Seed 5/10, Plant 3/10 and Flower 2/10. On 1st May, 20X4 Plant died. It was agreed that:

- (a) Goodwill should be valued at 3 years purchase of the average profits for 4 years. The profits were:
- | | | | |
|------|----------|------|----------|
| 20X1 | ₹ 10,000 | 20X3 | ₹ 12,000 |
| 20X2 | ₹ 13,000 | 20X4 | ₹ 15,000 |
- (b) The deceased partner to be given share of profits upto the date of death on the basis of the previous year.

- (c) Fixed Assets were to be depreciated by 10%. A bill for ₹ 1,000 was found to be worthless. These are not to affect goodwill.
- (d) A sum of ₹ 7,750 was to be paid immediately, the balance was to remain as a loan with the firm at 9% p.a. as interest.

Seed and Flower agreed to share profits and losses in future in the ratio of 3: 2.

Give necessary journal entries.

2. Peter, Paul and Prince were partners sharing profits and losses in the ratio 2:1:1. It was provided in the partnership deed that in the event of retirement /death of a partner he/his legal representatives would be paid:

- (i) The balance in the capital Account
- (ii) His share of goodwill of the firm valued at two years purchase of normal average profits (after charging interest on fixed capital) for the last three years to 31st December preceding the retirement or death.
- (iii) His share of profits from the beginning of the accounting year to the date of retirement or death, which shall be taken on proportionate basis of profits of the previous year as increased by 25%
- (iv) Interest on fixed capital at 10% p.a. though payable to the partners will not be payable in the year of death or retirement to the deceased or retiring partner.
- (v) All the asset are to be revalued on the date of retirement or death and the profit and loss be debited/credited to the Capital Accounts in the profit sharing ratio.

Peter died on 30th September, 20X4. The books of Account are closed on calendar year basis from 1st January to 31st December.

The balance in the Fixed Capital Accounts as on 1st January, 20X4 were Peter ₹ 10,000, Paul ₹ 5,000 and Prince ₹ 5,000. The balance in the Current Account as on 1st January, 20X4 were Peter ₹ 20,000, Paul ₹ 10,000 and Prince ₹ 7,000. Drawings of Peter till 30th September, 20X4 were ₹ 10,000. The profits of the firm before charging interest on capital for the calendar years 20X1, 20X2 and 20X3 were ₹ 1,00,000, ₹ 1,20,000 and ₹ 1,50,000 respectively. The profits include the following abnormal items of credit:

	20X1 ₹	20X2 ₹	20X3 ₹
Profit on sale of assets	5,000	7,000	10,000
Insurance claim received	3,000	-	12,000

The firm has taken out a Joint Life Policy for ₹ 1,00,000. Besides the partners had severally insured their lives for ₹ 50,000 each, the premium in respect thereof being charged to the Profit and Loss account. The surrender value of the Policies were 30% of the face value. On 30th June, 20X4 the firm received notice from the insurance company that the insurance premium in respect of fire policy had been undercharged to the extent of ₹ 6,000 in the year 20X3 and the firm has to pay immediately. The revaluation of the assets indicates an upward revision in value of assets to the extent of ₹ 20,000. Prepare an account showing the amount due to Peter's Legal representatives as on 30th September, 20X4 along with necessary workings.

ANSWERS/HINTS

True and False

1. False: The business of partnership may not end on death of a partner if the partnership deed provides clause for continuation of the business by the surviving partners.
2. False: Legal heirs of deceased partners are entitled to dues of the deceased partner.
3. True: To find out the actual values of the assets and liabilities, revaluation account is prepared.
4. True: reserves belong to the partners in the same manner the capital contributed by them. Hence it is distributed to them through the capital account.
5. False: Legal heirs of a deceased partner are entitled to all the dues of deceased partner.
6. False: It is very much necessary to adjust goodwill on death of a partner.
7. True: Yes, it can be continued in the earlier share or in new share- in either case it leads to computing a new profit sharing ratio
8. False: On death of a partner the firm gets full value of sum assured of the joint life policy.
9. False: All the partners are entitled to amount received from joint life policy.

Multiple Choice Questions

1.	(c)	2.	(a)	3.	(a)	4.	(b)	5.	(d)	6.	(c)
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Theoretical Questions

1. The basic distinction between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition,

the executor of the deceased partner is entitled to share of profit upto the date of death

2. When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings :
- The amount standing to the credit to the capital account of the deceased partner;
 - Interest on capital, if provided in the partnership deed upto the date of death;
 - Share of goodwill of the firm;
 - Share of undistributed profit or reserves;
 - Share of profit on the revaluation of assets and liabilities;
 - Share of profit upto the date of death;
 - Share of Joint Life Policy.

Practical Questions

1. Journal Entries

			₹	₹
May 1	General Reserve Account	Dr.	5,000	
	To Seed's Capital Account			2,500
	To Plant's Capital Account			1,500
	To Flower's Capital Account			1,000
	(General Reserve transferred to Capital Account on the death of Plant)			
	Seed's Capital Account	Dr.	3,750	
	Flower's Capital Account	Dr.	7,500	
	To Plant's Capital Account			11,250
	(Adjustment for goodwill on the death of Plant on the basis of gaining ratio) (Value = $3 \times (10,000 + 13,000 + 12,000 + 15,000)/4$)			
	Revaluation Account	Dr.	5,000	
	To Fixed Assets Account			4,000

To Bills Receivable Account (Depreciation of fixed assets @ 10% and writing off of one bill for ₹1,000 on Plant's death)			1,000
Seed's Capital Account	Dr.	2,500	
Plant's Capital Account	Dr.	1,500	
Flower's Capital Account	Dr.	1,000	
To Revaluation Account (Loss on Revaluation transferred to capital accounts)			5,000
Profit and Loss Suspense Account	Dr.	1,500	
To Plant's Capital Account (Plant's share of four month's profit based on the previous year)			1,500
Plant's Capital Account	Dr.	27,750	
To Plant's Executor's Account (Amount standing to the credit of Plant's Capital Account transferred to the credit of his Executor's Account)			27,750
Plant's Executor's Account	Dr.	7,750	
To Bank Account (Amount paid to Plant's Executors)			7,750

2. In the books of M/s Paul and Prince

Executors of Peter Account

	₹		₹
To Balance c/d	2,91,125	By Peter's capital A/c (W.N.6)	20,000
		By Peter's Current A/c (W.N.7)	2,71,125
	2,91,125		2,91,125

Working Notes:

		20X1 ₹	20X2 ₹	20X3 ₹
1. Valuation of Goodwill:				
Profit as per Profit and loss A/c		1,00,000	1,20,000	1,50,000
Less: Interest on capital @ 10%		2,000	2,000	2,000

	Abnormal Items:			
	Profit on sale of asset	5,000	7,000	10,000
	Insurance claim received	3,000	-	12,000
	Insurance premium undercharged	-	-	6,000
		90,000	1,11,000	1,20,000
	Total profit of three years		3,21,000	
	Average profit		1,07,000	
	Goodwill (2 x Average profit)		2,14,000	
	Peter's share of goodwill (2/4)		1,07,000	
2.	Peter's share of profit:		₹	
	Profit for the year 20X3		1,50,000	
	Less: Insurance premium undercharged		(6,000)	
			1,44,000	
	Add: 25% increase thereof		36,000	
	Estimated profit for 20X4		1,80,000	
	Less: Interest on capital *		(1,000)	
	Estimated profit for 20X4		1,79,000	
	Estimated profit upto 30.9.X4		1,34,250	
	Peter's Share (2/4)		67,125	

Since Peter was not entitled to interest on capital in the year of death, interest is payable only to the remaining two partners.

3. Profit on revaluation of assets:

	₹
Upward revision in the value of assets	20,000
Peter's share (2/4)	10,000

4. Peter's share in insurance premium undercharged:

Insurance premium undercharged in 20X3	6,000
Peter's share	3,000

5. Share of life policy:

Joint life policy	1,00,000
Maturity value of Peter's individual life policy	50,000
Surrender value of individual life policies of Paul & Prince (30 % of face value)	30,000
	1,80,000
Peter's share (2/4)	90,000

6. Peter's Capital Account

		₹			₹
30.9.X4	To Executors of Peter A/c (Transfer)	20,000	1.1.X4 30.9.X4	By Balance b/d By Profit on revaluation of assets	10,000 10,000*
		20,000			20,000

* This is generally transferred to Peter's current account. But as per the requirement of adjustment No. (v) of question, it is transferred to capital account.

7. Peter's Current Account

		₹			₹
30.9.X4	To Drawings	10,000	1.1.X4	By Balance b/d	20,000
	To Insurance premium undercharged	3,000	30.9.X4	By Share of goodwill	1,07,000
	To Executor's of Peter's Account (balance transferred)	2,71,125		By share of profit	67,125
		2,84,125		By Share of life policy By Paul & Prince	75,000 15,000
					2,84,125

Note: The share of goodwill given to peter would be borne by remaining partners in their gaining ratio, so that goodwill account does not appear in the balance sheet.