

CUET · ACCOUNTANCY · CLASS XII · CODE 301

Reconstitution of a Partnership Firm

CUET unit: Accounting for Partnership Firms — Reconstitution
(Retirement and Death of a Partner)

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Snapshot

- Retirement or death of a partner ends the existing partnership deed and creates a reconstituted firm with the remaining partners; accounting treatment is virtually identical for both events (NCERT §3.1, p. 107).
- Eight accounting aspects are involved: new ratio & gaining ratio, goodwill treatment, revaluation, unrecorded items, accumulated profits/losses, share of profit till date of retirement/death, capital adjustment, and final settlement (NCERT §3.1, p. 108).
- The retiring / deceased partner is entitled to capital balance, current account credit, share of goodwill, share of reserves, share of revaluation gain, share of profit till date, interest on capital and salary/commission due — and is liable for debit current balance, accumulated losses, revaluation loss, drawings and interest on drawings (NCERT §3.1, p. 107-108).
- In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 gives the outgoing partner the option of interest @ **6% p.a.** on the unpaid balance OR a proportionate share of profit earned with his money (NCERT §3.7, p. 125).
- Death differs from retirement only in (a) the amount due is credited to the deceased partner's **Executor's Account** and (b) death may occur mid-year, requiring profit till date of death to be ascertained (NCERT §3.9, p. 140-141).
- Dissolution follows in leac104.

Detailed Notes

2.1 Core concepts

Sum due to retiring / deceased partner (§3.1, p. 107). The outgoing partner is entitled to: (i) credit balance of his Capital A/c, (ii) credit balance of his Current A/c, (iii) his share of goodwill, (iv) his share of accumulated profits / reserves, (v) his share of gain on revaluation, (vi) his share of profit up to the date of retirement / death, (vii) interest on capital and (viii) salary / commission due to him. **Deductions** from his share include the debit balance of Current A/c, share of goodwill to be written off, share of accumulated losses, share of revaluation loss, drawings during the period, and interest on drawings.

New profit-sharing ratio (§ 3.2, p. 108-109). The ratio in which the remaining partners share future profits after the outgoing partner leaves. $\text{New Share} = \text{Old Share} + \text{Share Acquired from the outgoing partner}$. In the absence of information, the remaining partners are assumed to acquire the outgoing partner's share in their old ratio, so the new ratio equals their old ratio.

Gaining Ratio (§ 3.3, p. 110-112). The ratio in which continuing partners acquire the share from the retiring / deceased partner: $\text{Gaining Share} = \text{New Share} - \text{Old Share}$. It must be calculated only when the new profit-sharing ratio is specified; otherwise it equals the old ratio or the specified acquisition ratio.

Goodwill treatment (§ 3.4, p. 113-114). The retiring / deceased partner is entitled to his share of goodwill because goodwill was built by the efforts of all partners. Gaining partners compensate him in their gaining ratio: Dr Gaining Partners' Capital A/cs (individually), Cr Retiring / Deceased Partner's Capital A/c. **If goodwill already appears in the books**, it is first written off by debiting all partners' capital accounts (including the retiring) in their old profit-sharing ratio, and then the retiring partner is credited with his share of the current value of goodwill via gaining partners.

Hidden goodwill (§ 3.4.2, p. 118-119). When a lump sum is agreed to be paid in full settlement of the retiring / deceased partner, the excess of that lump sum over his adjusted capital balance is treated as his share of goodwill and adjusted via gaining partners.

Revaluation of assets and liabilities (§ 3.5, p. 120-121). A Revaluation Account is prepared; increase in assets and decrease in liabilities are credited to it; decrease in assets, increase in liabilities and unrecorded liabilities are debited; unrecorded assets are credited. The net gain / loss is transferred to all partners' capital accounts (including the retiring) in the old profit-sharing ratio, because the underlying changes relate to the period before reconstitution.

Accumulated profits and losses (§ 3.6, p. 122). General Reserve and the credit balance of P&L belong to all partners and are distributed to all partners' capital accounts in the old profit-sharing ratio. Accumulated losses are similarly distributed in the old ratio by debiting the partners.

Retirement in middle of the year (§ 3.6, p. 123-125). Share of profit for the intervening period from the last balance sheet to the date of retirement / death is computed on (a) last year's profit basis, (b) average profit basis or (c) sales basis. Journal entry: Dr Profit & Loss Suspense A/c, Cr Retiring / Deceased Partner's Capital A/c.

Disposal of amount due (§ 3.7, p. 125-126). Settled per partnership deed: (a) lump sum in cash, (b) full amount transferred to a Retiring Partner's Loan A/c, or (c) part cash + part loan. Loan A/c is shown on the liabilities side until the final instalment. Interest on loan is debited to Interest A/c and credited to Retiring Partner's Loan A/c.

Section 37 default — in the absence of any agreement, the outgoing partner may opt

for interest @ **6% p.a.** on the unpaid balance OR a proportionate share of profit earned with his money.

Adjustment of Partners' Capitals (§ 3.8, p. 134-138). Continuing partners may decide to keep their capitals in the new profit-sharing ratio. Total capital may be (i) specified by the partners, (ii) computed as the sum of their existing capital balances after all adjustments, or (iii) equal to the existing capitals of continuing partners plus the amount payable to the retiring partner. Surplus is paid off through cash / bank; shortage is brought in.

Death of a partner (§ 3.9, p. 140-141). Accounting is similar to retirement, but (a) the amount payable is transferred to the deceased partner's **Executor's Account**, and (b) death can occur mid-year, so the claim must include share of profit, interest on capital, interest on drawings and other dues from the last balance sheet date to the date of death. Three methods to compute share of profit till date of death: (i) last year's profit \times time proportion \times share, (ii) average of past few years' profit \times time proportion \times share, (iii) **Sales basis** — profit \times (sales during period \div sales of last year) \times share.

2.2 Definitions to memorise

Term	Definition	Page
New Profit Sharing Ratio	Ratio in which remaining partners share future profits; $\text{New} = \text{Old} + \text{Acquired}$ (NCERT §3.2).	108
Gaining Ratio	Ratio in which continuing partners acquire the outgoing share; $\text{Gain} = \text{New} - \text{Old}$ (NCERT §3.3).	110
Hidden Goodwill	Excess of agreed lump-sum settlement over the retiring partner's adjusted capital balance (NCERT §3.4.2).	118
Revaluation Account	Nominal account opened to record gain / loss on revaluation, reassessment and unrecorded items (NCERT §3.5).	120
Profit & Loss Suspense A/c	Account debited (or credited) to record retiring / deceased partner's share of profit (or loss) for the intervening period (NCERT §3.6, §3.9).	125, 142
Retiring Partner's Loan A/c	Liability A/c to which the unpaid balance is transferred, paid off in instalments with interest (NCERT §3.7).	125
Executor's Account	Liability A/c for the deceased partner; settled with his legal heirs (NCERT §3.9).	142
Section 37 Partnership Act	Default rule — 6% p.a. interest OR share of profit earned with his money (NCERT §3.7).	125
Adjusted Capital Balance	Capital after all adjustments — goodwill, revaluation, reserves, profit till date, drawings (NCERT §3.4.2).	118
Sales Basis Method	Profit \times (sales of intervening period \div sales of last year) \times share (NCERT §3.9).	141

Term	Definition	Page
Last Year's Profit Basis	Profit × time proportion × share (NCERT §3.9).	141
Average Profit Basis	Average of past few years × time proportion × share (NCERT §3.9).	141
Continuing Partners	Partners who remain in the firm after reconstitution (NCERT §3.1).	107
Sacrificing Continuing Partner	Continuing partner whose new share is less than his old share (NCERT Illus. 8, p. 116).	116
Gaining Continuing Partner	Continuing partner whose new share is more than his old share (NCERT §3.3, p. 110).	110
Equal Annual Instalment	Loan repayment in equal annual amounts inclusive of interest (NCERT p. 126-128).	127
Final Settlement	Total amount due to retiring / deceased partner after all adjustments (NCERT §3.1).	107
Old Profit Sharing Ratio	Ratio before reconstitution; used for reserves, revaluation, existing goodwill write-off (NCERT §3.2).	108
Revaluation Profit/Loss	Net gain / loss transferred to all partners' capitals in old ratio (NCERT §3.5).	121
Interest on Loan to Outgoing Partner	6% p.a. on unpaid balance — Section 37 default (NCERT §3.7).	125
General Reserve	Pre-reconstitution accumulated profit; distributed in old ratio (NCERT §3.6).	122
Unrecorded Asset / Liability	Asset / liability not previously in books; credited / debited to Revaluation A/c (NCERT §3.5).	120
Mid-year Death	Death occurring between two balance-sheet dates; share of profit till date of death must be computed (NCERT §3.9).	141
Loan in Instalments	Repayment of retiring partner's dues in equal yearly amounts with interest (NCERT §3.7).	126
Sacrifice during Continuance	Reduction in a continuing partner's share when continuing partners' shares are re-allocated (NCERT Illus. 8).	116

2.3 Diagrams / processes to remember

New Ratio Computation (NCERT §3.2, p. 109). Naveen-Suresh-Tarun 5:3:2 → 7:3 after Suresh's retirement. Show acquired share added to old share to derive the new ratio.

Mahinder's Loan Account variants (NCERT p. 126-128). Three variants: (a) four yearly instalments of principal + interest @12%, (b) three yearly instalments of ₹20,000

including interest, (c) four equal annual instalments including interest of ₹19,754. Memorise the structure of each.

Anil's Capital and Executor's Account (NCERT Illus. 18, p. 143). ₹57,000 due, half paid immediately, balance carried forward; demonstrates the executor's account format.

Revaluation Account Format (NCERT Illus. 10, p. 121-122). Losses on Dr side, gains on Cr side, balancing profit / loss transferred to all partners' capital in old ratio.

Three Modes of Capital Adjustment (NCERT § 3.8, p. 134-137). Specified total capital (Illus. 14), sum-of-balances method (Illus. 15), existing-capital-plus-payable method (Illus. 16).

Process — Computing the Gaining Ratio. (i) Identify each continuing partner's new share (given or derived). (ii) $\text{Gain} = \text{New} - \text{Old}$. (iii) Express the positive gains in a ratio. (iv) If any continuing partner has a negative gain (i.e., sacrifice), treat him as a sacrificing partner — see Illus. 8.

Process — Goodwill on Retirement / Death. (i) Write off existing goodwill in old ratio across all partners. (ii) Compute the retiring partner's share of (current) goodwill. (iii) Dr gaining partners in gaining ratio; Cr retiring partner. (iv) For hidden goodwill, compare agreed settlement with adjusted capital balance and treat the difference as share of goodwill.

Process — Share of profit till date of retirement / death. (i) Identify the basis stated in the deed — last year, average of past years, or sales. (ii) Apply the chosen formula. (iii) Pass Dr P&L Suspense A/c, Cr Retiring / Deceased Partner's Capital A/c. (iv) The Suspense A/c is closed against the next year's P&L.

Process — Final Settlement. Once all adjustments are passed, compute the closing balance of the retiring / deceased partner's capital. If paid immediately → Dr Capital, Cr Cash/Bank. If unpaid → Dr Capital, Cr Loan A/c (retirement) or Executor's A/c (death). Interest @ 6% p.a. accrues on unpaid balance under Section 37 (if no agreement).

2.4 Common confusions / NTA trap points

1. **Reserves and revaluation profit are distributed in OLD ratio.** Goodwill is adjusted in GAINING ratio (only gainers debited, retiring credited). Students often interchange these (NCERT §3.4-§3.6, p. 113-122).
2. **Sacrificing vs Gaining Ratio.** $\text{Gaining} = \text{New} - \text{Old}$; $\text{Sacrificing} = \text{Old} - \text{New}$. NTA loves swapped-formula distractors (NCERT §3.3, p. 110 vs leac102 §2.4).
3. **Existing goodwill write-off step is mandatory.** First write off in old ratio across all partners (including retiring) — only then credit the retiring partner with current goodwill share (NCERT §3.4 Illus. 9, p. 117).

4. **Hidden goodwill comparison.** Compare lump sum with adjusted capital balance after all adjustments (reserves, revaluation, profit till date); don't compare with the unadjusted capital (NCERT §3.4.2, p. 118).
5. **Section 37 default rate. 6% p.a.** — not 12% or 10%. NTA inserts 8%, 10%, 12% as distractors (NCERT §3.7, p. 125).
6. **Sales-basis formula.** Profit of last year \times (Sales of intervening period \div Sales of last year) \times share — not a direct percentage of sales of intervening period (NCERT §3.9, p. 141).
7. **Mid-year death requires more adjustments.** Must include interest on capital, interest on drawings and salary up to the date of death — easy to miss (NCERT §3.9, p. 141).
8. **Continuing partner can also sacrifice.** When the new ratio re-allocates among continuing partners, a continuing partner may sacrifice and be entitled to compensation from gainers — see Illus. 8 (NCERT p. 116).
9. **Executor's A/c (death) \neq Loan A/c (retirement).** The destination of unpaid balance differs (NCERT §3.7 vs §3.9).
10. **Profit & Loss Suspense A/c.** Used only for share of profit till date when actual profit cannot be computed — distinct from a regular P&L Adjustment A/c (NCERT §3.9, p. 142).
11. **Old ratio for distribution of reserves.** Even when only one partner retires, all partners (including retiring) share the reserves in old ratio (NCERT §3.6, p. 122).
12. **Adjusted capital balance for hidden goodwill.** Must include positive items (reserves, revaluation profit, profit till date) and negative items (drawings, interest on drawings, accumulated losses) (NCERT §3.4.2, p. 118).

2.5 Journal entry templates

(a) Existing goodwill written off in old ratio (NCERT § 3.4 Illus. 9, p. 117)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	Gobind's Capital A/cDr.		8,000	
	Hari's Capital A/cDr.		8,000	
	Pratap's Capital A/cDr.		8,000	
	To Goodwill A/c			24,000
	(Being existing goodwill of ₹24,000 written off in old ratio 1:1:1)			

(b) Retiring partner credited with share of current goodwill (NCERT §3.4.1, p. 114)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	A's Capital A/cDr.		15,000	
	C's Capital A/cDr.		5,000	
	To B's Capital A/c			20,000
	(Being B's share of goodwill ₹20,000 credited; debited to A and C in gaining ratio 3:1)			

(c) Distribution of General Reserve in old ratio (NCERT § 3.6, p. 122)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	General Reserve A/cDr.		60,000	
	To A's Capital A/c			30,000
	To B's Capital A/c			20,000
	To C's Capital A/c			10,000
	(Being general reserve distributed in old ratio 3:2:1)			

(d) Revaluation profit transferred to all partners (NCERT § 3.5, p. 121)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	Revaluation A/cDr.		18,000	
	To A's Capital A/c			9,000
	To B's Capital A/c			6,000
	To C's Capital A/c			3,000
	(Being revaluation profit ₹18,000 distributed in old ratio 3:2:1, including the retiring partner)			

(e) Share of profit till date of retirement via Suspense A/c (NCERT § 3.6, p. 125)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jul 31	Profit and Loss Suspense A/cDr.		10,000	
	To Champak's Capital A/c			10,000
	(Being share of profit ₹10,000 till date of retirement / death credited to outgoing partner; basis = last year's profit ₹1,00,000 × 3/12 × 4/10)			

(f) Transfer of final balance to Retiring Partner's Loan A/c (NCERT § 3.7, p. 125)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	B's Capital A/cDr.		2,50,000	
	To B's Loan A/c			2,50,000
	(Being final balance due to B transferred to his Loan A/c — to be paid in instalments)			

(g) Interest @ 6% p.a. on retiring partner's loan — Section 37 default (NCERT § 3.7, p. 125)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Interest A/cDr.		15,000	
	To B's Loan A/c			15,000
	(Being interest @ 6% p.a. on B's loan balance of ₹2,50,000 — Section 37 default)			

(h) Transfer of final balance to deceased partner's Executor's A/c (NCERT § 3.9, p. 142)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Oct 1	Anil's Capital A/cDr.		57,000	
	To Anil's Executor's A/c			57,000
	(Being final amount due to deceased partner transferred to Executor's A/c)			

 **Practice MCQs**
 **PYQ Alignment**

This chapter is a high-yield CUET zone: every CUET (UG) 2023-25 Accountancy paper has carried 4-6 direct MCQs from retirement / death of a partner, focused on (i) computing new and gaining ratios from given old ratios, (ii) calculating share of goodwill (including hidden goodwill), (iii) calculating share of profit till date of death on last-year / average / sales basis, (iv) Section 37 interest at 6%, and (v) identifying which items are distributed

in old ratio vs gaining ratio. Numerical problems on executor's claim and instalment-with-interest loan accounts also recur as case-based MCQ sets. See /pyq/accountancy for drill sets.

CUET 2025 — Actual PYQs from this chapter

Q.7 (CUET 2025) Rana, Sana and Kamana share profits 4:3:2. Rana retires; Sana and Kamana decide to share 5:3. Gaining ratio:

- A) 11 : 11 B) 11 : 21 C) 11 : 22 D) 12 : 21 Tests: §2 New Profit Sharing Ratio and Gaining Ratio on retirement. Answer: Not in extracted key

Q.18 (CUET 2025) Asha, Deepa and Lata share 3:2:1. Deepa retires. After adjustments capitals of Asha and Lata show ₹1,60,000 and ₹80,000 credit. Find the new capitals.

- A) ₹1,80,000 ; ₹1,70,000 B) ₹1,80,000 ; ₹60,000 C) ₹1,60,000 ; ₹80,000 D) ₹1,60,000 ; ₹60,000 Tests: §6 Adjustment of Capitals in proportion to the new profit-sharing ratio. Answer: Not in extracted key

Q.26 (CUET 2025) The sum due to a retiring partner includes: (A) Share of profits till retirement (B) Share of goodwill (C) Share of accumulated profits (D) Share in gain of revaluation

- A) A & B only B) A, B & C only C) A, B, C & D D) B, C & D only Tests: §5 Computation of amount due to retiring partner. Answer: Not in extracted key

Q.27 (CUET 2025) Accounting aspects on death of a partner include: (A) Adjustment of unrecorded assets and liabilities (B) Treatment of goodwill (C) Preparation of Realisation Account (D) Executor's loan account

- A) A & C only B) A, B & C only C) A, B & D only D) A, B, C & D Tests: §7 Death of a Partner — items and Executor's A/c (Realisation A/c is for dissolution, not death). Answer: Not in extracted key

CUET 2023 — Actual PYQs from this chapter

Q.3 (CUET 2023) On retirement/death, the remaining partners who have gained due to change in PSR should compensate the:

- A) No partner B) Retiring partner only C) Remaining partners only D) Gaining partners as well as retiring partner Tests: §3 Treatment of Goodwill — gaining partners compensate the retiring/deceased partner. Answer: Not in extracted key

Q.4 (CUET 2023) Lisa, Monika and Nisha share 2:2:1. Capitals: ₹50,000, ₹50,000, ₹25,000. Monika died; reserve ₹15,000, goodwill ₹30,000, revaluation profit ₹7,050. Amount transferred to Monika's Executors A/c:

- A) ₹50,820 B) ₹70,820 C) ₹8,820 D) ₹60,820 Tests: §7 Death of a partner — Executor's Account computation. Answer: Not in extracted key

Q.5 (CUET 2023) Shweta, Shreya and Shaniya share 6:3:2. Shaniya retired; capital ₹4,50,000. Shaniya took 25% furniture valued ₹52,000; balance to loan. Total value of furniture was:

- A) ₹2,58,000 B) ₹3,60,000 C) ₹3,68,000 D) ₹4,92,000 Tests: §5 Settlement of retiring partner — payment partly in kind (asset taken over). Answer: Not in extracted key

Q.28 (CUET 2023) Correct sequence during retirement of partner: (A) New Balance Sheet (B) Transfer to retiring partner loan (C) Calculation of gaining ratio (D) Partners' capital account (E) Revaluation account

- A) C, D, E, A, B B) C, E, D, B, A C) A, B, C, D, E D) C, E, B, A, D Tests: Procedural sequence on retirement — §2 → §4 → §5 → §6. Answer: Not in extracted key

Q.32 (CUET 2023) On retirement, the retiring partner's capital account will be credited with: (A) His/her Capital Balance (B) His/her share of Goodwill (C) Share of goodwill of remaining partners (D) His/her share of Reserve (E) His/her Drawings

- A) (A), (B) and (C) only B) (A), (B) and (D) only C) (B), (C) and (D) only D) (C), (B) and (D) only Tests: §5 Items credited to retiring partner's capital account. Answer: Not in extracted key