Goenka College of Commerce and Business Administration
B.Com (H) Semester Three
Paper CC3.1CG: Financial Accounting – II

Unit 1: Partnership Account – I

Treatment of Life Policy

A partnership business is run by many partners. When a partner dies, the firm has to pay the due amount to his/her legal heir. As this is a huge amount, it may cause disruption in the usual company operation. Hence, the firm may take life policies on the life of the partner. The policy may be taken in the individual name of the partner or jointly on all the partners. The premium is paid by the firm only. The value/ proportionate value of the policy are to be paid to the partner(s) at their expiry or after a particular period. Since, the policy is the property of the company, the proportionate value of the property is to be calculated after change in partnership agreement with respect to admission, retirement, and change in PSR or death.

If the insured surrenders the policy before its maturity period, then the value paid by the insurance company to the insured is called surrender value. It is the fair value of the policy which increases over time.

Life policies may be of two types:

(a) Individual life policy
(b) Joint life policy

Individual Life Policy

If life policies are taken on the lives of individual partners, it is called individual life policies. Number of such policies depends on the number of partners. If the policy is taken by the partners themselves, then they have to pay the premium and it will never be accounted in the books of the firm. However, if the policies are taken by the firm, then it will pay the premium and it will be considered as a property of the firm. At the event of death of a particular partner or maturity of the particular policy, the maturity values of the policies are to be paid to the respective partner. However, at that time, the surrender values of the policies of the other partners are also considered. At the event of any significant event (admission, retirement, change in PSR) the surrender value of policies of all the partners are to be considered.

Accounting Entries

On payment of premium	Individual policy premium A/c …Dr. To Bank A/c.	Amount of premium paid	
Transfer of premium to PL	P/L A/c ….Dr. To Individual policy premium A/c	Do	
Death of a partner			
Maturity value of a policy received on the event of death of a partner or at the end of maturity period	Bank A/c….Dr. To ILP Receivable A/c.	Maturity value	
Maturity value of one partner is distributed among other partners as the policy was taken by the firm	ILP Receivable A/c….Dr. To Partners' capital A/c	Maturity value	
Method 1: Raising the ILPs in the books			
Significant event	ILP A/c…..Dr. To Existing Partners' Capital A/c.	Surrender value of all partners	ILP is shown in the post constitution balance sheet
Death of a partner	ILP A/c….Dr. To Existing Partners' capital A/c.	Surrender value of the surviving partners	Do
Method 2: Raising and writing off			
Significant event	ILP A/c…..Dr. To Existing partners' capital A/c. (old PSR) Continuing partners' capital A/c…Dr.	Surrender value of all partners	

	To ILP A/c.		
Death of a partner	ILP A/c…..Dr. To Existing partners' capital A/c. (old PSR) Continuing partners' capital A/c…Dr. To ILP A/c.	Surrender value of the surviving partners	
Method 3: Capital adjustment			
Significant event	Gaining partners' capital A/c…..Dr. Sacrificing partners' capital A/c.	Surrender value of all partners	
Death of a partner	Gaining partners' capital A/c…..Dr. Sacrificing partners' capital A/c.	Surrender value of the surviving partners	

Problem

- **Partners A, B, C**
- **PSR: equally**
- **Sum assured: A (Rs. 100000); B (Rs. 70000); C (Rs. 60000)**
- **Premium paid: A (Rs. 6000); B (Rs. 4000); C (Rs. 3000).**
- **Premium paid on 1.4.17 for the year 2017-18**
- **C died on 31.7.17. On the date surrender value of other 2 partners were 1/5th of sum assured.**
- **Pass journal entries.**

Joint Life Policy

The nature of accounting of JLP depends upon the treatment of JLP

(a) JLP is not considered as an asset
(b) JLP is considered as an asset

Option A

When JLP is not considered as an asset, it is treated as revenue expenditure. Hence, it is not necessary to raise JLP in the balance sheet. It is to be debited in the P/L A/c.

Accounting Entries

Payment of JLP insurance premium	JLP Insurance Premium A/c….Dr. To Bank A/c
Transfer of JLP to P/L	P/L A/c ………….Dr. To JLP Insurance Premium A/c
Change in constitution of the firm (admission, retirement, change in PSR)	
Apportioning surrender value of JLP in old PSR	JLP A/c….Dr. To Existing Partners' Capital A/c.
Writing of JLP among continuing partners in new PSR	Continuing Partners' Capital A/c….Dr. To JLP A/c
Death of a partner	
Sum assured of JLP receivable apportioned among the partners in old PSR	JLP Receivable A/c….Dr. Existing Partners' Capital A/c
Sum assured received	Bank A/c…Dr. To JLP Receivable A/c.

Option B

Here payment of JLP insurance premium is treated as a capital expenditure and JLP is treated as an investment in asset. JLP should appear in the balance sheet at its surrender value. However, as the total amount of premium paid till date is more than its surrender value, we have to make sure that the difference between premium paid and surrendered value are written off and the JLP appears in the balance sheet at its surrender value only.

There are 2 methods of accounting in this option:

(a) Surrender value method
(b) JLP reserve method

Process 1: Surrender Value Method
In this method, only one ledge account is maintained – JLP A/c. Premium paid is passed through JLP A/c as it is considered as an asset. Difference between total premium paid and surrender value is transferred to P/L A/c.

Process 2: JLP Reserve Method
In this method, two ledger accounts are maintained – JLP A/c and JLP Reserve A/c. JLP Reserve is an appropriation from partners' profit of the amount of premium. The difference between premium paid and surrender value is passed through adjusting these two accounts.

Accounting Entries

Payment of JLP premium	JLP A/c. ……….Dr. To Bank A/c.	JLP A/c…..Dr. To Bank A/c
Creation of reserve	NA	P/L Appropriation A/c….Dr. To JLP Reserve A/c.
Transfer of balance of excess surrender value	P/L A/c…..Dr. To JLP A/c	JLP Reserve A/c……Dr. To JLP A/c.
Change in constitution of the firm	NA (JLP is already raised in the books with due credit to its partner. No further entry is required)	JLP Reserve A/c….Dr. To Existing Partners' Capital A/c. (in old PSR) (If the partners decide not to maintain JLP Reserve A/c.) Continuing Partners' Capital A/c……Dr. To JLP Reserve A/c. (in new PSR) (If the partners decide to maintain JLP Reserve A/c.)
Death of a partners		
Maturity of the JLP	JLP Receivable A/c….Dr. To JLP A/c. (maturity value)	JLP Receivable A/c….Dr. To JLP A/c. (maturity value)
On receipt of maturity value	Bank A/c…..Dr. To JLP Receivable A/c. (maturity value)	Bank A/c…..Dr. To JLP Receivable A/c. (maturity value)
Closing JLP reserve by transferring to JLP A/c	NA	JLP Reserve A/c…Dr. To JLP A/c (with last recorded JLP value)
Closing JLP A/c	JLP A/c…Dr To All Partners' Capital A/c. [Maturity value – (last recorded surrendered value + current year premium) in old PSR	JLP A/c…Dr To All Partners' Capital A/c. [Maturity value – current year premium] in old PSR

Problem:
1. **Partners: A, B, C**
2. **PSR: 3:2:1**
3. **JLP of Rs. 600000 on 1.1.14**
4. **Annual premium Rs. 40000 payable on Jan. 1 every year.**
5. **Closure of books Dec. 31 every year.**
6. **Surrender values of the policy on Dec. 31 every year:**
    a) **2014: nil**
    b) **2015: Rs. 15000**
    c) **2016: Rs. 42000**
    d) **2017: Rs. 65000**
7. **C died on Jan 20, 2018.**
8. **Claim accepted on February 5, 2018**
9. **Claim paid on February 15, 2018**
10. **Prepare necessary accounts under 3 methods**

Death of a Partner
In the course of partnership business, any one of the partners may expire. The business may not dissolve in such situation, if the existing partners desire to continue to by changing the partnership deed (Sec. 35 of Partnership Act 1932). In that case, the dues to the expired partner are to be paid to his legal heir/ executor.

Accounting treatment:

- Adjustment for interim period's profit/ loss
- Settlement of final balance

Adjustment for Interim Period's Profit/ Loss

Interim period refers to the period between the date of last balance sheet and date of expiry of the partner.

Ascertainment

Profit/ loss for the interim period may be ascertained by preparing the final accounts for the period. However, always it may not be possible. Hence, the profit for the interim period is ascertained based on profit of the last year or average of the last few years on the following basis:

(a) *Time*: Profit of the last year or average of last few years is ascertained and apportioned among pre-death and post-death period. The theory assumes that profits of different years are correlated and profit is evenly distributed over the year.

(b) *Sales*: determine the rate of profit for last year (s) [profit for last year (s)/ sales for last year (s)]. Calculate interim profit by applying this rate on sale of the interim period.

Share of the deceased partner in the interim period profit/ loss is calculated based on old PSR.

Accounting

Mode	Entry	Remarks
Creating P/L suspense A/c	P/L suspense A/c Dr. To Decease partner's capital A/c (in case of profit) In case of loss, pass reverse entry	The share of the deceased partner is transferred to the P/L suspense A/c. Later, that account is closed by transferring it to P/L A/c.
Capital adjustment	Continuing Partner's Capital A/c….Dr. To Decease Partner's Capital A/c	The share of the deceased partner is to be shared among the continuing partners in the new PSR

Total Amount Payable to the Deceased Partner

Amount payable = Balance of deceased partner's current A/c ± deceased partner's share in accumulated profit/ loss or reserves + decease partner's share of goodwill + deceased partner's share of life policy ± deceased partner's share of revaluation profit/ loss ± deceased partner's share of interim period's profit/ loss

Mode of settlement is usually decided by the deed. In the absence of any deed, it may be decided by the partners.

Settlement of Final Balance

Accounting Entries

Time	Mode	Entry	Remarks
Immediate	Cash payment	Executor's A/c…Dr. To Bank A/c.	Total amount due may be paid from the business fund. It may sometimes incorporate some assets as well.
Immediate	Capital adjustments	Executors A/c….Dr. To Continuing Partners' Capital A/c	Deceased partner's share is purchased by the continuing partners in some agreed ratio
Deferred (in installments)	Loan A/c without interest	Executor A/c…Dr. To Executors Loan A/c Executors Loan A/c….Dr. To Bank A/c.	Only the amount due is paid over a agreed number of installments
Deferred (in installments)	Loan A/c with interest	Executor A/c…Dr. To Executors Loan A/c Interest on Loan A/c…Dr.	Amount is paid off over agreed installments with a rate of interest charged on the due

		To Executors Loan A/c Executors Loan A/c….Dr. To Bank A/c.	

In case the firm continues without settling the claim of the deceased partner, then as per Section 37 of the act, the legal heir can claim the higher of the following:

(a) Share of profit of the deceased partner calculated on the adjusted capital of the partner on the present date

(b) Total dues to the decease partner + Interest @ 6% p.a. up to the date of settlement.

Change in PSR

The ratio at which the partners agree to share profit/loss among them in a partnership business is called PSR. Change in PSR occurs in case of admission, retirement, retirement-cum-admission, death, etc. In all these cases, partners either sacrifice their share or gain their share based whether a partner goes out of the firm or joins the firm. However, change in PSR may happen due to change in constitution of the firm because of unequal amounts of capital contribution by the partners; levels of responsibilities shared, etc. Whenever change in PSR happens, it is actually end of the old partnership and start of a new one as it calls for change in the constitution. Hence, it requires changes in books too.

Calculation of New PSR

Partners agree to change their PSR. Some partners will sacrifice their shares, while some other will gain it. Partners who sacrifices are called sacrificing partners and the ratio in which they sacrifice their part is called sacrificing ratio. It is ascertained by taking the difference between old and new PSR. Partners who gains are called gaining partners and the ratio in which they gain is called gaining ratio. It is calculated the same way as that of sacrificing ratio.

Distribution of Reserves, Accumulated Profits and Loss

Any reserve on the date of change of PSR should be credited to Partner's Capital A/c or Current A/c. in old PSR. However, any reserves required to be made after change is to be done through Partners' Capital A/c.
Reserves A/c….Dr.
To Partners' Capital A/c.

Revaluation of Assets and Liabilities

In case of change in PSR, certain assets and liabilities are required to be revalued to their fair values to ensure that any secret profit gets distributed among partners in old PSR. Revaluation of assets and liabilities are to be done through a nominal account Revaluation A/c and resultant profit/ loss to be shared among partners in old PSR. It is the alteration of values of assets and liabilities in the old PSR. Sometimes assets and liabilities are revalued only for the purpose of change in constitution. Such change is not reflected in the books. In that case the revaluation profit is distributed among partners in old PSR and the same is again distributed in new PSR among new partners.

Adjustment of Goodwill

- Involving Goodwill A/c
- Without involving Goodwill A/c (Capital Adjustment)

Adjustment for Life Policy

Individual Life Policy

Surrender values of individual policies of existing partners are accounted for in the books by raising and writing off ILP A/c or by adjusting the Partner's Cap A/c.

Joint Life Policy

1. JLP is treated as expense: the surrender value of the JLP is to be raised and written off as JLP A/c (old PSR) or by adjusting the Partner's Cap A/c (new PSR)
2. JLP is treated as assets under surrender value method: no treatment of account is required
3. JLP is treated as asset under JLP reserve method: both JLP A/c and JLP Reserve A/c appear in the books at surrender value. If the partners decide not to maintain JLP Reserve A/c JLP Reserve A/c is to

be written back and distributed among partners in the old PSR. If the partners decide to keep the JLP Reserve A/c, the adjustment is required to be made through Partner's Cap A/c.

Adjustment in Partner's Cap A/c
After necessary adjustments, partners may decide to maintain capital in the new ratio. In that situation, they may introduce new capital or withdraw capital.

References

1. Hanif & Mukherjee, Financial Accounting, Vol II, McGraw Hill
2. Sukla, Grewal, Gupta: Advanced Accountancy Vol. I & II, S Chand
3. Mukherjee & Mukherjee, Financial Accounting II, Oxford University Press.
4. Maheshwari & Maheshwari, Advanced Accountancy Vol. I & II, Vikash Publishing House Pvt. Ltd.