ACCOUNT OF JOINT LIFE POLICY
B.Com Sem.-1
Financial Accounting-1

Prepared by :

Dr.Dhaval Ardeshana

[M.Com./M.Phil/Ph.D]

Assistant Professor

B.Com English Medium Department

Gurukul Mahila College- Porbandar.

Introduction

- Death is certain for a human being. But when it will come is absolutely uncertain. In a partnership firm, due to death of any partner, the firm has to pay total amount to the successor of deceased partner and in that case the firm may have to face financial crisis. As a solution, to this situation, Joint Life Policy is the best remedy.

Accounting treatment of premium of Joint Life Policy, paid by firm:

- (2 – A): When Premium is considered as Revenue Expenditure:
- (2 – B): When premium is considered as Capital Expenditure:
- (2 – C): When policy is shown at surrender value and amount of difference is debited to Profit & Loss A/c. (mixture of A & B)
- (2 – D): Policy shown at surrender value with the help of J.L.P. Reserve A/c.:

(2 – A): When Premium is considered as Revenue Expenditure:

- In this method, like other administrative expenses, premium is considered as revenue expenses of the firm and therefore, premium A/c is closed by debiting Profit & Loss A/c at the end of accounting year. In short, premium is treated as general expenses of the firm and debited to Profit & Loss A/c.
- Journal entries in this method are as under:

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1. When premium is paid:

   Premium A/c Dr. …

   To Bank A/c …

2. At the end of the accounting year, to close the premium A/c:

   Profit & Loss A/c Dr. …

   To Premium A/c …

- Every year these two journal entries are passed, till premium is paid. On maturity of policy or in case of death of any partner, when amount is received from Insurance Co. following journal entries will be written.

3. Bank A/c Dr. (Policy Amt. with benefit)

To J. L. Policy A/c (Policy Amt. + Bonus)

4. Joint Life Policy A/c Dr.

To Capital A/c of Partner 1 Partner 2 Partner 3	Balance of Policy A/c credited to capital A/c in Profit Sharing Ratio.

(2 – B): When premium is considered as Capital Expenditure:

- In this method premium is paid by the firm on Joint Life Policy is considered as Capital expenditure and not revenue expense. So when premium is paid, Joint Life Policy A/c is debited instead of premium A/c or Profit & Loss A/c and balance of Joint Life Policy A/c is shown as an asset in Balance Sheet. Balance of Joint Life Policy A/c is increased every year.

1. When premium is paid:

Joint Life Policy A/c Dr. …

To Bank A/c …

2. Policy Amount together with bonus:

Bank A/c Dr. …

To J. L. P. A/c …

3. Joint Life Policy A/c Dr. …

To Partner No. 1 A/c …

To Partner No. 2 A/c …

To Partner No. 3 A/c …

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(2 – C): When policy is shown at surrender value and amount of difference is debited to Profit & Loss A/c. (mixture of A & B)

- In this method, when premium is paid, Joint Life Policy A/c is debited and Bank A/c is credited.
- But at the end of the year, to show the policy at surrender value, the difference between the amount of premium and surrender value is debited to Profit & Loss A/c, considering that portion as revenue expenditure.
- Thus, this method is mixture of first two methods discussed above and tries to rectify the defects of first two methods. In the first method, premium is wholly treated as revenue expenditure which is not fair, while in the second method, premium is fully treated as capital expenditure, which is also not fair and reasonable.

- In this method premium is partly considered as capital expenditure (to the extent of surrender value) and partly as revenue expenditure.

- In this method, on maturity of policy or in the event of death of a partner, when amount is received from insurance company Bank A/c is debited and Joint Life Policy A/c is credited and the credit balance of Joint Life Policy A/c is treated as profit of the policy and is credited to each partner's capital A/c in their profit sharing proportion.

Following journal entries are passed every year in this method:

1. When premium is paid to Ins. Co.

Joint Life Policy A/c	Dr.	…	
To Bank A/c			…

2. At the end of accounting year when certain amount of premium is written off to show the policy at surrender value:

Profit and Loss A/c	Dr.	…	
To Joint Life Policy A/c			…

3. When Insurance Co. pays the dues:

Bank A/c	Dr.	…	
To Joint Life Policy A/c			…

4. When credit balance of Joint Life Policy is distributed among the partners in their profit sharing ratio:

Joint Life Policy A/c	Dr.	…	
To Partner 1 Capital A/c			…
To Partner 2 Capital A/c			…
To Partner 3 Capital A/c			…

(2 – D): Policy shown at surrender value with the help of J.L.P. Reserve A/c.:

- This method is similar to the method discussed above in 2 – C. The only difference is that in this method Joint Life Policy Reserve A/c is opened and policy is shown at its surrender value in Balance Sheet.

Following journal entries are written:

1. When Premium is paid:

   Joint Life Policy A/c   Dr.   …

   To Bank or Cash A/c   …

2. When amount equal to premium is appropriated against Profit and Loss A/c.:

   Profit and Loss A/c   Dr.   …

   To Joint Life Policy A/c   …

3. Last journal entry will bring down the value of policy to its surrender value:

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

To Joint Life Policy A/c ...

- Here amount will be Amount of Premium less increase in surrender value. This amount will vary every year
- Joint Life Policy A/c and Joint Life Policy Reserve A/c will show similar balance i.e. surrender value.

In the event of death of a partner or on maturity of policy, following journal entries are passed:

1. When received from insurance company:

Bank A/c Dr. …

To Joint Life Policy A/c

…

2. To close the Joint Life Policy Reserve A/c

Joint Life Policy Reserve A/c Dr. …

To Joint Life Policy A/c

…

The credit balance of policy A/c is distributed to partners in their profit sharing ratio. For this following journal entry will be written:

3. Joint Life Policy A/c	Dr.	…
To Partner No. 1 A/c		…
To Partner No. 1 A/c		…
To Partner No. 1 A/c		…

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Main features of this method are as under:

- This method is combination of first two methods: i.e. to consider premium as revenue expenditure and to consider premium as capital expenditure.
- In method (2 – C) the amount written off in profit and loss A/c varies every year. This method removes this drawback also. In this method, Profit and Loss A/c is debited by amount of annual premium. So the Profit and Loss A/c shows the true and fair financial condition.

- Policy A/c is shown at surrender value, in Balance Sheet which is right and reasonable method. Balance Sheet reflects the true and fair situation.
- Only maturity or death of a partner, amount of policy less last year premium is treated as profit of the policy and this amount is credited to the partner's capital A/c in their profit sharing ratio and J. L. P. Reserve A/c is closed by making cross entry in J. L. P. Policy A/c.
- In short, among the four methods discussed above, the fourth method is logical, reasonable and fulfilling the accounting principles. So this method is very popular and widely used.

Amount payable to Successor of Deceased Partner:

- When a partner of the firm dies, it becomes necessary to calculate the amount payable to his widow or successor. Apart from his credit balance in capital A/c, he is also entitled to get his share in goodwill, profit of the year, interest on capital and his share in amount of policy.
- This calculation is necessary and important. With the help of following illustration, we shall try to understand the calculation of amount payable to deceased partner's widow or successor.

Summary: Key points of the chapter:

- To overcome financial crisis, on event of death of a partner, firm may take joint life policy for all partners.
- Premium of Joint Life Policy is paid by firm.
- Premium thus paid can be considered as:
  - When premium is considered as revenue expenditure, whole amount of policy is treated as profit and credited to partner's capital A/c in their profit sharing ratio.

- When premium is considered as capital expenditure, amount of policy less total premium paid is treated as profit and credited to partner's capital A/c in their profit sharing ratio.
- When policy is shown at surrender value without opening J. L. P. Reserve A/c, amount of policy is less last surrender value is considered as profit and given credit to capital A/cs of partners in their profit sharing proportion.
- When J. L. P. A/c and J. L. P. Reserve A/c, both are operative, the debit balance of policy A/c is equal to credit balance of Reserve A/c. This balance reflects the surrender value of policy.

- On maturity or in event of partner's death, Reserve A/c Balance is transferred to Policy A/c to close the account.
- The balance of J. L. Policy A/c is then distributed among partners in their profit sharing proportion.
- When policy of partners are individual, amount of deceased partner's policy together with surrender value of existing partner's policy is distributed among partners in their profit sharing ratio and respective capital A/cs are credited.

- While calculating amount of payable to widow or successor of deceased partner, following factors are to be considered:
  - Credit Balance of capital A/c of deceased partner.
  - His share of Goodwill.
  - His share of proportionate profit of the business, for the year in which he died.
  - His share of policy amount.
  - Interest on capital, if there is provision for interest.

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