

Retirement

When a partner ceases to be a partner of the firm but the firm continues, Partner it is known as retirement of a partner.

Gaining Ratio

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

New Profit-sharing Ratio The ratio in which the continuing partners (*i.e.*, partners other than retiring Ratio partner) decide to share future profits and losses, is known as new profit sharing ratio.

Meaning of Retirement of a Partner: When a partner ceases to be partner of the firm but firm continues, it is termed as retirement of a partner

How can a Partner Retire:

A partner may retire from the firm:

- (i) With the consent of all other partners;
- (ii) In accordance with an express agreement by the partners; or
- (iii) By giving a written notice to the remaining partners of his intention to retire, in case of '*Partnership at will*'.

Adjustments at the Time of Retirement of a Partner: Accounting problems that arise and settled are:

calculation of the new profit-sharing ratio and gaining ratio, revaluation of assets and reassessment of liabilities, adjustment of goodwill, adjustment of reserves, accumulated profits and losses, computation of share of the retiring partner in profit or loss till the date of retirement.

New Profit-sharing Ratio: The ratio in which the continuing partners, *i.e.*, partners other than the retiring partner decide to share future profits and losses, is known as the new profit-sharing ratio.

$$\text{New Share} = \text{Old Share} + \text{Acquired Share}$$

•**Gaining Ratio:** The ratio in which the continuing partners acquire the retiring partner's profit share is known as the gaining ratio.

$$\text{Gain of a Partner} = \text{New Share} - \text{Old Share}$$

Accounting Treatment of Goodwill: When a partner retires, his share of profit is taken by the remaining partners. The remaining partners then compensate the retiring partner in the form of goodwill in their gaining ratio.

The following entry is recorded for this purpose:

Remaining Partners' Capital/Current* A/cs ...Dr. [In gaining ratio]
To Retiring Partner's Capital/Current* A/c [Retiring Partner's Share of Goodwill]

MEANING OF KEY TERMS USED IN THIS CHAPTER

If goodwill already appears in the old Balance Sheet, it is written off by recording the following entry:

All Partners' Capital/Current* A/cs ...Dr. [In old ratio]
To Goodwill A/c
*In case of Fixed Capitals

Revaluation of Assets and Reassessment of Liabilities: At the time of retirement of a partner, assets are

revalued and liabilities are reassessed; the difference is recorded in the Revaluation Account. The balance in the Revaluation Account is transferred to the Capital Accounts of all the partners (including the retiring partner) in their old profit-sharing ratio.

- Adjustment of Reserves, Accumulated Profits and Losses: At the time of retirement of a partner balances of reserves, accumulated profits and losses are transferred to Capital Accounts of all partners in their old ratio.

However, if partners decide to record the net effect of reserves, accumulated profits and losses without affecting their old values, an adjustment entry is passed through Capital Accounts of gaining partners and sacrificing partners.

- Amount Due to a Retiring Partner: The total amount due to a retiring partner may include:

- (i) Capital on the date of the last Balance Sheet.
- (ii) Loan by the Partner to the firm.
- (iii) Interest or salary, if any, payable to him.
- (iv) Share of profit or loss till the date of retirement.
- (v) Share in the gain (profit) or loss on revaluation of assets and reassessment of liabilities.
- (vi) Share in the goodwill of the firm.

(vii) Share in the General Reserve or Profit and Loss Account appearing in the Balance Sheet.

Out of the total of (i) to (vii), the amount of Loan to the partner, drawings and interest on drawings till the date of retirement are deducted.

The net amount payable will be settled by paying him through cash/bank or by transferring it to a separate Loan Account.