Date 02-07-23

ADMISSION of PARTNER

- **Admission of Partner**: It is one of the modes of reconstitution of a partnership firm under which existing agreement comes to an end and new one comes into existence.

→ According to Section 31(1) of Indian Partnership Act, a new partner can be admitted only.

- **Rights of new partner**

(i) Right to share future profits of the firm.
(ii) Right to share in the assets of the firm.

- **Sometimes a new partner is needed into the business due to the following reasons:**

1> When more capital is needed for the expansion of the business.
2> When experienced person is needed for the efficient running of the business.
3> To increase the goodwill or reputation of business by taking reputed person into the partnership.
4> To encourage a capable employee by taking him into the partnership.

Page
Date

• Following adjustments are needed at the time of admission of a new partner:

1) Calculation of new profit sharing ratio.
2) Accounting treatment of goodwill
3) Accounting treatment ~~of~~ for revalution of assets and liabilities.
4) Accounting treatment of reserves and accumulated profits.
5) Adjustment of capitals on the basis of new profit sharing ratio.

1) CALCULATION OF NEW PROFIT SHARING RATIO

Illustration 2.

(a) Share of Gopi $= \frac{1}{6}$

Share acquired by Gopi from Ram $= \frac{1}{2} \times \frac{1}{6} = \frac{1}{12}$

Share acquired by Gopi from Shyam $= \frac{1}{2} \times \frac{1}{6} = \frac{1}{12}$

$\therefore$ Ram's New share $= \frac{7}{12} - \frac{1}{12} = \frac{6}{12}$

Shyam's new share $= \frac{5}{12} - \frac{1}{12} = \frac{4}{12}$

Gopi share $= \frac{1}{12} + \frac{1}{12} = \frac{2}{12}$

$\Rightarrow$ New profit share ratio $= \boxed{6:4:2}$ or $\boxed{3:2:1}$

Date

(b) $A : B : C \Rightarrow 3:2:1$

A's new share $= \frac{3}{6}$

B's new share $= \frac{2}{6} - \frac{1}{16} = \frac{16-3}{48} = \frac{13}{48}$

C's new share $= \frac{1}{6} - \frac{1}{16} = \frac{8-3}{48} = \frac{5}{48}$

D's share $= \frac{1}{8}$

New Share's of $A:B:C:D$

$= \frac{3\times8}{6\times8} : \frac{13}{48} : \frac{5}{48} : \frac{1\times6}{8\times6}$

$\boxed{= 24:13:5:6}$

- When no base is provided for calculation of New Ratio:

Step 1: Let the profit of the firm be 1.

Step 2: Remaining profits = Step 1 (1) − new partner's profit share

Step 3: New ratio = old ratio × step 2

Illustration 14.

Sacrificing ratio = OR − NR.

$A = \frac{5}{10} - \frac{3}{10} = \frac{2}{10}$

$B = \frac{3}{10} - \frac{2}{10} = \frac{1}{10}$

Page
Date

$C = \frac{2}{10} - \frac{2}{10} = 0$

As C has not sacrificed any share of profit.

$\therefore$ Sacrifice ratio of A and B $= \frac{2}{10} : \frac{1}{10}$

$\boxed{= 2:1}$

2) ACCOUNTING TREATMENT OF GOODWILL

Ⓐ Transactions	Journal entry
Ⓐ When new partner pays amount of premium privately.	No entry.
Ⓑ When new partner brings cash for his share of premium (goodwill)	(i) Cash / Bank A/C Dr. To premium A/C (Being premium introduced in cash) (ii) Premium A/C Dr. To sacrificing partner (in sacrificing ratio) (Being premium transferred to old partners)
Ⓒ When new partner brings premium in cash and amount is withdrawn by old partners.	(i) Cash / Bank A/C Dr. To premium A/C (ii) Premium A/C Dr. To sacrificing partner (iii) Sacrificing partners capital A/C Dr. To cash / bank A/C (premium withdrawn by sacrificing partners)

(D) When new partner is not bringing his share of premium in cash.	(ii) New partner's current A/C Dr. (always a gainer) To sacrificing partner capital A/C
(E) When new partner brings his share of/or premium in kind [by any other assets except cash]	(i) Sundary assets A/C Dr. To premium A/C (ii) Premium A/C Dr. To sacrificing partner.

NOTE

★ Sacrificing ratio will be calculated only when old and new ratio both are given. If new ratio is not given, then goodwill is distributed amoung old partners in old ratio.

★ When nothing is written in question about withdrawal amount by partners. We assume entire amount is withdrawal.

Calculation of SR. = OR − NR.

$X = \frac{5}{8} - \frac{4}{9} = \frac{45-32}{72} = \frac{13}{72}$

$Y = \frac{3}{8} - \frac{3}{9} = \frac{27-24}{72} = \frac{3}{72}$

$\boxed{\Rightarrow 13:3}$

③ ★ REVALUATION OF ASSETS AND LIABILITIES

- Revaluation Account : It is prepared to find out the profit or loss on revaluation of assets and liabilities at the time of reconstitution of the firm.

→ This account is also called as 'Profit and Loss Account'.

→ This account is a nominal account in nature.

Dr. REVALUATION ACCOUNT Cr.

Particulars	₹	Particulars	₹
To decrease in assets	xxx	By increase in asset	xxx
To increase in liability	xxx	By decrease in liability	xxx
To unrecorded liability	xxx	By unrecorded assets	xxx
To profit on revaluation	xxx	By loss on revaluation	xxx
	xxx		xxx

Illustration 50.

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Stock A/C	Dr.		6000	
	To revaluation A/C				6000
	(Increase in value of stock)				
(ii)	Revaluation A/C	Dr.		6000	
	To Stock				6000
	(Decrease in value of stock)				
(iii)	Land & building A/C	Dr.		100000	
	To revaluation A/C				100000
	(Increase in land and building)				
(iv)	Land and building A/C	Dr.		500000	
	To revaluation A/C				500000
	(Increase in land & building)				
(v)	(a) Bank A/C	Dr.		30000	
	To bad-debt recovered				30000
	(Bad-debt recovered)				
	(b) Bad-debts recovered A/C	Dr.		30000	
	To revalution A/C				30000
	(bad-debt transferred to revaluation A/C)				
(vi)	Sundry Debtors A/C	Dr.		15000	
	To revaluation A/C				15000
	(Increase in sundry debtors)				
(vii)	Creditors A/C	Dr.		20000	
	To bank A/C				16000
	To revaluation A/C				4000
	(Claim of ₹20000 settled at ₹16000)				
(viii)	Office equipment A/C	Dr.		34200	
	To revaluation A/C				34200
	(Computer wrongly debited to office expenses brought into account)				

Page
Date

(4) ★ ACCOUNTING TREATMENT OF RESERVES AND ACCUMULATED PROFITS OR LOSSES.

(i) For distributing reserves and accumulated profits

General reserve A/C Dr.
Reserve fund A/C Dr.
Profit & loss A/C (Cr. bal.) Dr.
To old partner's capital/ current A/C.

(ii) For distributing losses and Dr. balance of P&L A/C, Advertisement Suspense A/C, deferred payments, etc.

Old partner's capital / current A/C Dr.
To P&L A/C (Dr. bal.)
To Advertisement suspense A/C
To deferred revenue expenditure A/C.

(iii) For distributing surplus of specific reserves

Workmen's compensation reserve A/C Dr.
Investment fluctuation reserve A/C Dr.
To old partner's capital/ current A/C

★ - Entries for transferring the reserves & accumulated profits & losses must be passed even if the question is silent on this point.

Date

Illustration 57.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2021 April 1 Case 1	Investment fluctuation reserve A/C Dr.		30000	
	To A's capital A/C			15000
	To B's capital A/C			10000
	To C's capital A/C			5000
	(IFR credited to partner's capital A/c in old profit sharing ratio			
Case 2.	Investment fluctuation reserve A/C Dr.		30000	
	To A's capital A/C			15000
	To B's capital A/C			10000
	To C's capital A/C			5000
	(IFR credited to partner's capital in old ratio)			
Case 3	Investment fluctuation reserve A/C Dr.		30000	
	To investment			18000
	To A's capital A/C			6000
	To B's capital A/C			4000
	To C's capital A/C			2000
	(Excess IFR credited to partners capital in old ratio)			
Case 4	Investment fluctuation reserve A/C Dr.		30000	
	Revaluation A/C Dr.		15000	
	To investment A/C			45000
	(Fall in book value of investment Cr. to investment A/C & excess fall in to charge revaluation A/C)			
	A's capital A/C Dr.		7500	
	B's capital A/C Dr.		5000	
	C's capital A/C Dr.		2500	
	To revaluation A/C			15000
	(Loss in revaluation Dr. to capital A/C in old ratio)			

Page
Date

Case 5.	Investment fluctuation reserve A/C Dr.	30000	
	To A's capital A/C		15000
	To B's capital A/C		10000
	To C's capital A/C		5000
	(IFR credited to capital A/C in their old profit sharing ratio)		
	Investment A/C Dr.	24000	
	To revaluation A/C		24000
	(Value of investment brought up to market value)		
	Revaluation A/C Dr.	24000	
	To A's capital A/C		12000
	To B's capital A/C		8000
	To C's capital A/C		4000
	(Profit on revaluation Cr. to capital A/C in old ratio)		

Illustration 68.

Dr. Revaluation A/C Cr.

Particulars	₹	Particulars	₹
To stock	4000	By unrecorded assets	20000
To furniture	5000	By prepaid insurance	2000
To outstanding rent	15000	By loss	
To creditors	10000	A - 7200	
		B - 4800	12000
	34000		34000

Date

Dr. Capital A/C Cr.

Particulars	A	B	C	Particulars	A	B	C
To revalution A/C	7200	4800	—	By bal. b/d	150000	80000	—
To goodwill	18000	12000	—	By premium	6000	8000	—
To bal. c/d	136800	79200	100000	By C's current	6000	8000	—
				By bank	—	—	100000
	162000	96000	100000		162000	96000	100000

Balance Sheet
as at 1st april, 2021

Liabilities	₹	Assets	₹
Creditors	80000	Bank	154000
Outstanding rent	15000	Debtors	120000
Capital A/C		Stock	56000
A - 136800		Furniture	45000
B - 79200		Prepaid insurance	2000
C - 100000	316000	Unrecorded asset	20000
		C's current A/C	14000
	4,11,000		4,11,000

★ **HIDDEN GOODWILL** : when the value of goodwill of the firm is not given but has to be inferred on the basis of net worth of the firm, it is called hidden goodwill.

• Calculation of Hidden Goodwill

Step 1: Find total capital of the firm

$$\boxed{= \text{New partner's capital} \times \text{reciprocal of his share}}$$

Page
Date

Step 2: Find the capital of existing / old partners

$\boxed{= \text{sum of net worth / combined capital} + \text{capital of new partner}}$

Step 3 Goodwill of the firm

$\boxed{= \text{Step 1} - \text{Step 2}}$

Step 4: New partner's goodwill

$\boxed{= \text{Firm's goodwill} \times \text{his share}}$

Illustration 73.

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2018 April 1	A's capital A/C	Dr.		40000	
	B's capital A/C	Dr.		20000	
	To goodwill A/C				60000
	(existing g/w written off in old ratio 2:1)				
April 1	C's current A/C	Dr.		1,05,000	
	To A's capital A/C				70000
	To B's capital A/C				35000
	(C's share of goodwill cr. to sacrificing partners in 2:1)				

Calculation of hidden goodwill.

Total capital $= 320000 \times \frac{4}{1} = 12,80,000$

Net worth of firm = 300000 + 200000 + 70000 + 50000 − 60000 − 20000 = 5,40,000

Capital of C's (new partner) = 3,20,000

Goodwill of firm = 12,80000 − (540000 + 320000)
= 12,80,000 − 860000
$\boxed{= 4,20,000}$

C's share of goodwill = $420000 \times \frac{1}{4}$
$\boxed{= 1,05,000}$

5) CAPITAL ADJUSTMENTS

CASE-1: When 'new partner's' capital is to be calculated, on the basis of old partner's capitals.

OR

When new partner's brings proportionate capital.

CASE-2: When 'old partner's' capital are to be adjusted on the basis of new partner's capital.

Case 1: (i) Let assume the share of whole firm = 1
(ii) Remaining share = 1 − new partner's share.
(iii) Combined capital of old partner's × reciprocal of remaining share
⇑
Total capital of the firm
(iv) New partner's capital = Total capital of firm × his share of profits.

Page
Date

Case-2: Adjustment of Old Partner's capital A/C on the basis of new partner's capital :

Step 1: Total capital = New partner's capital × Reciprocal of his share

Step 2: Divide the above total capital among partners in NEW RATIO.

Step 3: Any balance (credit / debit) is transferred to Cash A/C or Current A/C as specifies in the questions.

★ If question is silent then use "Cash A/C".

(i) If the existing capital of any partner is in excess of his newly calculated capital:

Old partner's capital A/C Dr.
To cash A/C / current A/C (withdraw)

(ii) If the existing capital of any partner is less than his newly calculated capital :

Cash A/C / Current A/C Dr. (introduce)
To old partner's capital A/C