19

ADMISSION OF A PARTNER

Kapil and Krish are running a partnership firm dealing in toys. They are one of the most successful businessmen in the locality. They now decide to start manufacturing toys that are electronically operated to diversify their busmess. For this they need more capital and also technical expertise. Mohit; their friend is an electronic engineer and has capital also. They have persuaded him to join their firm. In case, he joins the partnership firm, this will be a case of admission of a partner. As a result, he may need to bring in capital and share of goodwill. In this lesson, you will learn about goodwill and other ajustments at the time of admission of a partner. Mohit will bring in capital and share of goodwill. Some changes in the value of some assets and liabilities of the existing firm are need to bring them at their realistic value, on his admission. There may be other issues involing finance on his admission. All this need accounting treatment. In this lesson you will learn accounting treatment and adjustments to be made on the admission of a partner.

OBJECTIVES

After studying this lesson, you will be able to :

- state the meaning of admission of a partner;
- calculate new profit sharing ratio and sacrificing ratio;
- state the meaning and factors affecting goodwill;
- explain the methods of valuation of goodwill;
- describe accounting treatment of goodwill;
- explain the need for revaluation of assets and reassessment of liabilities;

- illustrate the accounting treatment of changes arising from revaluation of assets and reassessment of liabilities;
- describe accounting treatment of undistributed profits and reserves;
- explain the treatment of various adjustments in partners' capitals ;
- prepare Revaluation Account, Partners' Capital Accounts and balance sheet of the reconstituted firm.

19.1 ADMISSION OF A PARTNER

Meaning, New Profit Sharing Ratio and Sacrificing Ratio

Meaning

An existing partnership firm may take up expansion/diversification of the business. In that case it may need managerial help or additional capital. An option before the partnership firm is to admit partner/partners, when a partner is admitted to the existing partnership firm, it is called admission of a partner.

> According to the Partnership Act 1932, a person can be admitted into partnership only with the consent of all the existing partners unless otherwise agreed upon.

On admission of a new partner, the partnership firm is reconstituted with a new agreement. For example, Rekha and Nitesh are partners sharing profit in the ratio of 5:3. On April 1, 2006 they admitted Nitu as a new partner with 1/4th share in the profit of the firm. In this case, with the admission of Nitu as partner, the firm stands reconstituted.

On the admission of a new partner, the following adjustments become necessary:

(i) Adjustment in profit sharing ratio;
(ii) Adjustment of Goodwill;
(iii) Adjustment for revaluation of assets and reassessment of liabilities;
(iv) Distribution of accumulated profits and reserves; and
(v) Adjustment of partners' capitals.

Adjustment in Profit sharing Ratio

When a new partner is admitted he/she acquires his/her share in profit from the existing partners. As a result, the profit sharing ratio in the new firm is decided mutually between the existing partners and the new partner. The incoming partner acquires his/her share of future profits either incoming from one or more existing partner. The existing partners sacrifice a share of their profit in the favour of new partner, hence the calculation of new profit sharing ratio becomes necessary.

Sacrificing Ratio

At the time of admission of a partner, existing partners have to surrender some of their share in favour of the new partner. The ratio in which they agree to sacrifice their share of profits in favour of incoming partner is called sacrificing ratio. Some amount is paid to the existing partners for their sacrifice. The amount of compensation is paid by the new partner to the existing partner for acquiring the share of profit which they have surrendered in the favour of the new partner.

Sacrificing Ratio is calculated as follows:

Sacrificing Ratio = Existing Ratio – New Ratio

Following cases may arise for the calculation of new profit sharing ratio and sacrificing ratio:

(i) Only the new partner's share is given

In this case, it is presumed that the existing partners continue to share the remaining profit in the same ratio in which they were sharing before the admission of the new partner. Then, existing partner's new ratio is calculated by dividing remaining share of the profit in their existing ratio. Sacrificing ratio is calculated by deducting new ratio from the existing ratio.

Illustration 1

Deepak and Vivek are partners sharing profit in the ratio of 3 : 2. They admit Ashu as a new partner for 1/5 share in profit. Calculate the new profit sharing ratio and sacrificing ratio.

Solution:

Calculation of new profit sharing ratio:

Let total Profit = 1

New partner's share = 1/5

Remaining share = 1 – 1/5 = 4/5

Deepak's new share = 3/5 of 4/5 i.e. 12/25

Vivek's new share = 2/5 of 4/5 i.e. 8/25

Ashu's Share = 1/5

The new profit sharing ratio of Deepak, Vivek and Ashu is :

= 12/25 : 8/25 : 1/5 = 12 : 8 : 5/25 = 12 : 8 : 5

So Deepak Sacrificed = 3/5 – 12/25 = 15 – 12/25 = 3/25

Vivek Sacrificed = 2/5 – 8/25 = 10 – 8/25 = 2/25

Sacrificing Ratio = 3 : 2

Sacrificing ratio of the existing partners is same as their existing ratio.

(ii) The new partner purchases his/her share of the profit from the Existing partner in a particular ratio.

In this case : the new profit sharing ratio of the existing partners is to be ascertained after deducting the sacrifice agreed from his share. It means the incoming partner has purchased some share of profit in a particular ratio from the existing partners.

Illustration 2

Neha and Parteek are partners, sharing profit in the ratio of 5 : 3. They admit Nisha as a new partner for 1/6 share in profit. She acquires this share as 1/8 from Neha and 1/24 share from Parteek. Calculate the new profit sharing ratio and sacrificing ratio.

Solution

Neha's and Parteek existing ratio is 5 : 3

Neha's new share = 5/8-1/8 = 4/8 or 12/24

Parteek's new share = 3/8-1/24 = 8/24

Nisha's share = 1/8+1/24 =4/24

The new profit sharing ratio of Neha, Parteek and Nisha is

12/24 : 8/24 : 4/24

= 12 : 8 : 4 = 3 : 2 : 1

(ii) Sacrifice ratio = 1/8 : 1/24 or 3 : 1

(iii) Existing partners surrender a particular portion of their share in favour of a new partner.

In this case, sacrificied share of the each partner is to be ascertained. This ascertained by multiplying the existing partner share in the ratio of their

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sacrifice. The share sacrificed by the existing partners should be deducted from his existing share. Therefore, the new share of the existing partners is determined. The share of the incoming partner is the sum of sacrifice by the existing partners.

Illustration 3

Him and Raj shared profits in the ratio of 5:3. Jolly was admitted as a partner. Him surrendered 1/5 of his share and Raj 1/3 of his share in favour of Jolly. Calculate the new profit sharing ratio.

Solution :

Him surrenders 1/5 of his share, i.e., = 1/5 of 5/8 = 1/8

Raj surrenders 1/3 of his share, i.e., = 1/3 of 3/8 = 1/8

So, sacrificing ratio of Him and Raj is 1/8 : 1/8 or equal.

Him's new share = 5/8 – 1/8 = 4/8

and Raj's new share = 3/8 – 1/8 = 2/8

Jolly's New share = 1/8 + 1/8 = 2/8

New profit sharing ratio of Him's, Raj's and Jolly's is

= 4/8 : 2/8 : 2/8 or 4 : 2 : 2 or 2 : 1 : 1.

INTEXT QUESTIONS 19.1

I. Fill in the blanks with appropriate word/words :

(i) Sacrificing ratio is calculated by deducting .... share of profit from .... share of profit of the existing partners.

(ii) On admission of a new partner, the partnership firm is ....

(iii) The ratio in which partners surrender their profits is known as ....

(iv) The new ratio of existing partners is calculated by dividing remaining share of the profit in their ....

II. If Tarun and Nisha are partners sharing profits in the ratio of 5:3. What will be their sacrificing ratio if Rahul is admitted for 1/8 share of profit in the firm?

19.2 GOODWILL : MEANING, FACTORS AFFECTING GOODWILL AND VALUATION

Meaning of Goodwill

Over a period of time, a business firm develops a good name and reputation among the customers. This help the business earn some extra profits as compared to a newly set up business. In accounting capitalised value of this extra profit is known as goodwill. For example, your firm earns say Rs 1200 and the normal profit was expected from your firm Rs 700. The rate of return is @ 10%. In this case goodwill is ascertained as under :

Step 1 : Excess profit = Actual profit – Desired normal profit

$1200 - 700 = 500$

Step 2 : Goodwill $= 500 \times \frac{100}{10}$ = Rs 5000

In other words, goodwill is the value of the reputation of a firm in respect of the profit earned in future over and above the normal profit. It may also be defined as the present value of the capacity to earn future profits. This means that a firm can be said to have goodwill only if it has capacity to earn profit in future. A firm earning only normal profits like similar firms cannot claim to have any goodwill.

Factors affecting the Goodwill

The factors affecting goodwill are as follows:

1. **Location :** If the firm is located at a central place, resulting in good sale, the goodwill tends to be high.
2. **Nature of Business :** A firm that produces high value products or having a stable demand is able to earn more profits and therefore has more goodwill.
3. **Efficient management :** A well managed firm earns higher profit and so the value of goodwill will also be high.
4. **Quality :** If a firm is known for the quality of its products the value of goodwill will be high.
5. **Market Situation :** The monopoly condition to earn high profits which leads to higher value of goodwill.
6. **Special Advantages :** The firm has special advantages like importing licenses, long term contracts for supply of material, patents, trademarks, etc. enjoy higher value of goodwill.

Methods of valuation of Goodwill

The methods of valuation of goodwill are generally decided by the partners among themselves while preparing partnership deed. The following are the important methods of valuing the goodwill of a firm :

(i) Average Profit Method

(ii) Super Profit Method

(iii) Capitalisation Method

Let us learn about these methods.

1. **Simple Average Profit Method :** Under this method, average of the profits of certain given years is calculated. The value of the goodwill is calculated at an agreed number of years purchase of the average profit. Thus the goodwill is calculated as follows :

   Value of goodwill = Average Profit × Number of year of purchase

   For example, the average profits of a firm of say 3 years and the goodwill is to be calculated at 2 years purchase of the average profits works out at Rs.25,000 and it is assumed that the same profits will be the value of the goodwill will be Rs.50,000[Rs.25,000 × 2]. Thus the goodwill is calculated as goodwill = average profits × Number of years purchase.

Illustration : 4

The profit for the last five years of a firm were as follows Year 2001 Rs. 1,20,000: Year 2002 Rs.1,50,000: Year 2003 Rs.1,70,000: Year 2004 Rs.1,90,000: Year 2005 Rs.2,00,000. Calculate goodwill of the firm on the basis of 3 years purchases of 5 years average profits.

Solution :

Year	Profit (Rs.)
2001	1,20,000
2002	1,50,000
2003	1,70,000
2004	1,90,000
2005	2,00,000
Total	**8,30,000**

Average Profit = Total Profit/No. of Years

= Rs.8,30,000/5 = Rs.1,66,000

Goodwill = Average Profits × No. of years purchased

= Rs.1,66,000 × 3 = Rs.4,98,000

2. **Super Profit Method** : Super profits is the excess of actual profit over the normal profits. If a new business earns certain percentage of the capital employed, it is called 'normal profit'. The value of the goodwill is calculated at an agreed number of years purchase is multiplied by the Super profit. Normal profit is that profit which is, earned by other business unit of the same business. Normal profit will be calculated as follows:

Normal profit = Capital employed × normal rate of return/100

Actual Profit : These are the profit earned during the year or it is also taken as the average of the last few years profit.

Super Profit = Actual Profit – Normal Profit

For example, A firm earns profit of Rs.65,000 on a capital of Rs.4,80,000 and the normal rate of return in similar business is 10%. Then the normal profit is Rs.48,000[10% of the Rs.4,80,000]. The actual profit is Rs.65,000. Thus,

Super profit = Actual profit – Normal profit

= Rs.65,000 – Rs.48,000

= Rs.17,000

If value of Goodwill is calculated by 3 years' purchase of super profit then goodwill is equal to Rs.51,000[Rs.17,000 × 3].

(b) **Weighted average method :** This method is a modified version of average profit method. In this method each year profit is assigned a weight i.e. 1, 2, 3, 4 etc. Thereafter each year profit is multiplied by the weight and find product. The total of products is divided by the total of weight. As a result we find the weighted average profit. After this the value of goodwill is calculated to multiplied the weight average profit into the agreed number of year's purchase. Thus the goodwills calculated as follows

$$\text{Weighted average profit} = \frac{\text{Total product of profit}}{\text{Total of weights}}$$

Value of goodwill = Weighted average profit × number of year of purchase

(Note : This method is used when we observe that there is a tendency to increase the annual profits. Latest year profit is assigned the highest weight.

Illustration : 5

The profit of firm for past years were as follow :

	Profit Rs.
2002	80,000
2003	85,000
2004	90,000
2005	1,00,000
2006	1,10,000

The weight to be used are 1, 2, 3, 4, and 5 for the years from 2002- 2006.

Calculate the value of goodwill on the basis of two year's purchase of weighted average profit.

Solution

Year	Profit	Weight	Products
2002	80,000	1	80,000
2003	85,000	2	170000
2004	90,000	3	270000
2005	1,00,000	4	400000
2006	1,10,000	5	550000
		15	1470000

$$\text{Weighted Average Profit} = \frac{14{,}70{,}000}{15} = \text{Rs } 98{,}000$$

Goodwill = Rs 98000 × 2 = Rs 1,96,000

Illustration : 6

A firm earned the following net profits during the last 4 years

	Rs.
2003	90,000
2004	1,20,000
2005	1,60,000
2006	1,80,000

Capital employed in the firm is Rs.10,00,000. The normal rate of profit is 10%. Calculate the value of the goodwill on the basis of 4 year purchase.

Solution:

Total profit of 4 years = Rs. 90,000 + Rs. 1,20,000 + Rs. 1,60,000 + Rs. 1,80,000

= Rs.5,50,000

Average annual profit = Rs.5,50,000/4

= Rs.1,37,500

Normal Profit = Rs.10% of Rs.10,00,000 = Rs.10,00,000 × 10/ 100

= Rs.1,00,000

Super profit = Rs. 1,37,500 – Rs. 1,00,000

= Rs.37,500

Value of goodwill at 4 years' of purchase = Rs. 37,500 × 4 = Rs. 1,50,000

3. **Capitalisation Method :** In this method, goodwill is the amount of capital saved. Normally businessmen invest capital to operate business activities, and earn profit with the efficient utilisation of capital. If the business earns more profit by investing lesser amount of capital as compared to other business, who earned same amount of profit with more amount of capital, the saved amount is assumed to be goodwill.

   Under this method, the Goodwill is calculated in two ways:

   1. Capitalisation of Average profit
   2. Capitalisation of Super profit

1. Capitalisation of Average profit

In this method, the value of goodwill is assumed to be excess of the capital value of average profit over the actual capital employed.

Following formula is applied for Calculation of capital employed:

> Capital employed = Total assets – outsider liabilities
>
> Following formula is applied for calculation of capitalised value of profit:
>
> Capitalised value of profit = Average Profit × 100/ Normal rate of profit
>
> Goodwill = Capitalised value of profits – Capital cimployed

Illustration : 7

A firm earned average profit during the last few years is Rs.40,000 and the normal rate of return in similar business is 10%. The total assets is Rs.3,60,000 and outside liabilities is Rs.50,000. Calculate the value of goodwill with the help of Capitalisation of Average profit method.

Solution:

Capital employed = Total assets - Outside liabilities

= Rs.3,60,000 - Rs.50,000

= Rs.3,10,000

Capitalised value of average profit = Average Profit × 100/ Normal rate of profit

= Rs. 40,000 × 100/10

= Rs. 4,00,000

Goodwill = Capitalised value – Capital employed

= Rs. 4,00,000 – Rs. 3,10,000

= Rs. 90,000

Illustration : 8

The capital invested in a firm is Rs.4,60,000 and the rate of return in the similar business is 12%. The firm earns the following profit in the last 4 years:

2003	Rs. 60,000	2005	Rs. 80,000
2004	Rs. 70,000	2006	Rs. 90,000

Calculate the value of goodwill by Capitalisation method.

Solution

Total Profit = Rs.60,000 + Rs.70,000 + Rs.80,000 + Rs.90,000/4

Average Profit = Rs.3,00,000/4

= Rs.75,000

Capitalised Value = Average profit × 100/12

= Rs.75,000x100/12

= Rs.6,25,000

Goodwill = Capitalised value – Capital employed

= Rs.6,25,000 – Rs.4,60,000

= Rs.1,65,000

2. Capitalisation of Super profit

In this method, the value of goodwill is calculated on the basis of super profit method. Following formula is applied for Calculation of capital employed:

Goodwill = Super profit × 100/normal rate of profit

Illustration : 9

A firm earns a profit of Rs.26,000 and has invested capital amounting to Rs.2,20,000. In the same business normal rate of earning profit is 10%. Calculate the value of goodwill with the help of Capitalisation of super profit method.

Solution

Actual profit = Rs. 26,000

Normal profit = Rs. 2,20,000 x 10/ 100 = Rs.22,000

Super Profit = Actual Profit – Normal Profit

= Rs. 26,000 – Rs.22,000

= Rs. 4,000

Goodwill = Super profit × 100/normal rate of profit

= Rs. 4,000 × 100/10

= Rs. 40,000

Notes

INTEXT QUESTIONS 19.2

I. Fill in the blanks with appropriate word/words :

(i) Goodwill is an .... asset.

(ii) The amount of goodwill is generally brought in by .... Partner.

(iii) Super Profit = Actual Profit – ....

(iv) The methods of calculating goodwill are .... and ....

(v) Capital employed = Total assets minus ....

II. (a) From the following information, Calculate average profit : year

Year	Profit (Rs)	Loss (Rs)
2001	80,000	
2002	90,000	
2003	—	30,000
2004	1,10,000	

Average Profit = Rs.

(b) Calculate value of goodwill at two year's purchase of average profit, ascertained in 2(a) above.

19.5 TREATMENT OF GOODWILL

The new partner acquires his/her share profit from the existing partners. This will result in the reduction of the share of existing partners. Therefore, he/she compensates the existing partners for the sacrifices. He/she compensates them by making payment in cash or in kind. The payment is equal to his/her share in the goodwill.

As per Accounting Standard 10(AS-10) that goodwill should be recorded in the books only when some consideration in money has been paid for it. Thus, if a new partner does not bring necessary cash for goodwill, no goodwill account can be raised in the books. He/she should pay for goodwill in addition to his/her contribution for capital.

If, he/she does not pay for goodwill, then amount equal to his/her share of goodwill will be deducted from the capital. The amount brought in by him/her as goodwill or amount of goodwill deducted from his/her capital and divided between the existing partners in their sacrificing ratio. At the time of admission of a new partner any goodwill appearing in the books, will be written off in existing ratio among the existing partners.

There are different situations relating to treatment of goodwill at the time of admission of a new partner. These are discussed as under:

1. When the amount of goodwill is paid privately by the new partner.
2. When the new partner brings his/her share of goodwill in cash.
3. When the new partner does not bring his/her share of goodwill in cash.

1. The amount of goodwill is paid privately by the new partner

If the amount of goodwill is paid by the new partner to the existing partner privately, no journal entries are made in the books of the firm.

2. The new partner brings his/her share of goodwill in cash and the amount of goodwill is retained in the Business:

When, the new partner brings his/her share of goodwill in cash. The amount brought in by the new partner is transferred to the existing partner in the sacrificing ratio. If there is any goodwill account in the balance sheet of existing partner, it will be written off immediately in existing ratio among the partners. The journal entries are as follows:

(i) The existing goodwill in the books of the firm will be written off in existing profit ratio as;

Existing Partners Capital A/c Dr. [individually]
    To Goodwill A/c
(Existing goodwill written off)

(ii) For bringing cash for Capital and goodwill

Cash/Bank A/c Dr.
    To Goodwill A/c
    To New partner's Capital A/c
(Cash brought in for capital and goodwill)

(iii) For amount of goodwill transferred to existing partner capital account:

Goodwill A/c Dr.
    To Existing Partner's Capital/current A/c [individually]
(The amount of goodwill credited to existing partner's capitals in sacrificing ratio)

Notes

Illustration : 10

Tanaya and Sumit are partners in a firm sharing profit in the ratio 5 : 3. They admitted Gauri as a new partner for 1/4th share in the profit. Gauri brings Rs. 30,000 for her share of goodwill and Rs.1,20,000 for capital. Make journal entries in the books of the firm after the admission of Gauri. The new profit sharing ratio will be 2 : 1 : 1.

Solution :

Books of Tanaya, Sumit and Gauri

Date	Particulars	LF	Debit Amount (Rs)	Credit Amount (Rs)
1.	Bank A/c Dr.		1,50,000	
	To Goodwill A/c			30,000
	To Gauri's Capital A/c			1,20,000
	(cash brought by Gauri for her share of goodwill and capital)			
	Goodwill A/c Dr.			
	To Tanaya's Capital A/c		30,000	
	To Sumit's Capital A/c			15,000
	(Goodwill transferred to existing partners capital account in their profit sharing ratio)			15,000

Working Note:

Calculation of sacrificing ratio [existing ratio – new ratio]

Partners	Existing ratio	New ratio	Sacrifice	Sacrificing ratio
Tanaya	5/8	2/4	5/8 – 2/4 = 1/8	Tanaya : Sumit
Sumit	3/8	1/4	3/8 – 1/4 = 1/8	1 : 1

The amount of goodwill is withdrawn by the existing partners:

(iv) Existing Partners Capital/current A/c Dr. [individually]

To Cash/Bank A/c

(The amount of goodwill withdrawn by the existing partners)

It is to be noted that sometimes partner's withdraw only 50% or 25% amount of goodwill. In such a case, entry will be made for the withdrawn amount only.

I1lustration : l1

In previous illustration, it is assumed that the full amount of goodwill is withdrawn by the Tanaya and Sumit . Make journal entry in the books of the firm.

Solution:

Books of Tanaya, Sumit and Gauri

Date	Particulars		LF	Debit amount Rs	Credit amount Rs
	Tanaya's Capital A/c	Dr.		15,000	
	Sumit's Capital A/c	Dr.		15,000	
	To Bank A/c				30,000
	(Amount of Goodwill is withdrawn by them)				

3. New partner does not bring his/her share of goodwill in cash:

When the goodwill of the firm is calculated and the new partner is not able to bring his/her share of goodwill in cash, goodwill will be adjusted through new partner's capital accounts. In this case new partner's capital account is debited for his/her share of goodwill and the existing partner's capital accounts are credited in their sacrificing ratio. The journal entry is as under:

New Partner's Capital A/c	Dr.
To Existing Partner's Capital A/c	[individually in sacrificing ratio]

(New partner's share in goodwill credited to exisitng partner's in sacrificing ratio)

Goodwill appears in the books of the firm and new partner does not bring his/her share of goodwill in cash:

If the goodwill account appears in the books of the firm, and the new partner is not able to bring goodwill in cash. In this case, the amount of goodwill existing in the books is written off by debiting the capital account of existing partners in their existing profit sharing ratio.

Illustration 12

Ashmita and Sahil are partners sharing profit in the ratio of 3 : 2. They agree to admit Charu for 1/5 share in future profit. Charu brings Rs. 2,50,000 as capital and enable to bring her share of goodwill in cash, the goodwill of

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the firm to be valued at Rs. 1,80,000. At the time of admission goodwill existed in the books of the firm at Rs.80,000. Make necessary journal entries in the books of the firm.

Solution:

Books of Ashmita, Sahil and Charu

Date	Particulars		LF	Debit amount Rs	Credit amoun Rs
	Bank A/c	Dr.		2,50,000	
	To Charu's Capital A/c				2,50,000
	[Cash brought by Charu for her capital]				
	Ashmita's Capital A/c	Dr.		48,000	
	Sahil's Capital A/c	Dr.		32,000	
	To Goodwill A/c				80,000
	[Goodwill written off before Charu's admission]				
	Charu's Capital A/c	Dr.		36,000	
	To Ashmita's Capital A/c				21,600
	To Sahil's Capital A/c				14,400
	[Existing partners capital a/c credited for goodwill on Charu's admission in sacrificing ratio]				

Working Note :

Ashmita and Sahil sacrifice their profit in favour of Charu in their existing profit sharing ratio i.e. 3 : 2. Therefore, the sacrificing ratio is 3 : 2.

Value of Goodwill = Rs.1,80,000

Charu's share in Profit = 1/5

Charu's share of Goodwill = Rs. 1,80,000 × 1/5 = Rs. 36,000

New partner brings in only a part of his share of goodwill

When new partner is not able to bring the full amount of his/her share of goodwill in cash and brings only a part of cash. In this case, the amount of goodwill brought by him is credited to goodwill account. At the time of goodwill transferred to capital account of existing partner's, new partner's capital account is debited with his unpaid share of goodwill besides debiting goodwill account with the amount of goodwill is paid by him. The journal entries is as

Bank A/c	Dr.
To Goodwill A/c	
[Part Amount of goodwill brought by new partnerI	
Goodwill A/c	Dr.
New Partner's Capital A/c	Dr.
To Existing Partner's Capital A/c	[individually in sacrificing ratio]
[Credit given to sacrificing partner by new partner's in full share of goodwill]	

Illustration 13

Tanu and Puneet are partners sharing profit in the ratio of 5 : 3. They admit Tarun into the firm for 1/6 share in profit which he takes 1/ 18 from Tanu and 2/ 18 from Puneet. Traun brings Rs.9,000 as goodwill out of his share of Rs. 12,000. No goodwill account appears in the books of the firm. Make necessary journal entries in the books of the firm.

Solution:

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Date	Particulars		LF	Debit Amount Rs	Credit Amount Rs
	Bank A/c	Dr		9,000	
	To Goodwill A/c				9,000
	[A part of his share of goodwill brought in by Tarun]				
	Goodwill A/c	Dr.		9,000	
	Tarun Capital A/c	Dr.		3,000	
	To Tanu's Capital A/c				4,000
	To Puneet's Capital A/c				8,000
	[Goodwill credited to Tanu and Puneet in their sacrificing ratio i.e 1 : 2]				

Notes

INTEXT QUESTIONS 19.3

1. Fill in the blanks with appropriate word/words

   (a) When Goodwill is paid privately, ... will be made.

   (b) If the new partner brings amount of goodwill, the amount of goodwill brought by him is .... to goodwill account.

   (c) The amount brought in by the new partner is transferred to the existing partner in the .... ratio

   (d) Goodwill appearing in the books of the firm is .... at the time of admission of a new partner.

   (e) If the new partner is not able to bring his share of goodwill, The new partner's capital account is .... for his share of goodwill

2. Match the appropriate entry of Column B with that of Column A. by writing the correct numbers of the column B in the space provided.

Column A	Column B
1. Goodwill is paid privately	I. Existing Partners Capital A/c To Goodwill A/c
2. New partner is not able to bring cash for Goodwill.	II Goodwill A/c Dr. To Existing partner's Capital A/c
3. At the time of admission the goodwill appearing in the books is written off.	III New Partner's Capital A/c Dr To Existing Partner's Capital A/c To Existing Partner's Capital A/c
4. At the time of admission the amount of goodwill brought by the new partner is transferred to Capital A/c existing partners capital	IV No Entry

19.6 REVALUATION OF ASSETS AND LIABILITIES

On admission of a new partner, the firm stands reconstituted and consequently the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner. If the values of the assets are raised, gain will increase the capital of the existing partners. Similarly, any decrease in the value of assets, i.e. loss will decrease the capital of the existing partners. For this purpose a 'Revaluation Account' is prepared. This account is credited with all increases in the value of assets and decrease in the value of liabilities. It is debited with decrease on account of value of assets and increase in the value of liabilities. The balance of this account shows a gain or loss on revaluation which is transferred to the existing partner's capital account in existing profit sharing ratio The following journal entries made for this purpose are:

(i) For increase in the value of assets:

Asset A/c Dr. (individually)

To Revaluation A/c

(ii) For decrease in the value of Asset

Revaluation A/c Dr. (individually)

To Asset A/c

[Decrease in the value of assets]

(iii) For increase in the value of Liabilities:

Revaluation A/c Dr. (individually)

To Liabilities A/c

[Increase in the value of Liabilities]

(iv) For decrease in the value of Liabilities:

Liabilities A/c Dr.

To Revaluation A/c

[Decrease in the value of Liabilities]

(v) For unrecorded Assets

Asset A/c [unrecorded] Dr.

To Revaluation A/c

[Unrecorded asset recorded at actual value]

(vi) For unrecorded Liability :

Revaluation A/c Dr.

To Liability A/c [unrecorded]

[Unrecorded Liability recorded at actual value]

(vii) For transfer of gain on revaluation:

Revaluation A/c Dr.

To Existing Partner's Capital/Current A/c

[Profit on revaluation transferred to capital account in existing ratio] (viii)For transfer of loss on revaluation:

Existing Partner's Capital/Current A/c Dr.

To Revaluation A/c

[Loss on revaluation transferred to capital account in existing ratio]

Proforma of Revaluation account is given as under:

Revaluation account

Dr. Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Assets		Assets	
[decrease in value]		[Increase in value]	
Liabilities		Liabilities	
[increase in value]		[Decrease in value]	
Liabilities[unrecordcd]		Assets [unrecorded]	
Profit transferred to		Loss transferred to	
Capital A/c		Capital A/c	
[Individually in existing ratio]		[Individually in existing ratio]	

Illustration 14

Karan and Tarun are partners sharing profit and losses in the ratio of 2 : 1. Their Balance Sheet was as follows:

Balance Sheet of Karan and Tarun as on December 31,2006

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	10,000	Cash in hand	7,000
Bills payable	7,000	Debtors	26,000
Building 20,000			
Capitals:		Investment	15,000
Karan 40,000		Machinery	13,000
Tarun 30,000		Stock	6,000
	70,000		
	87,000		87,000

Nikhil is admitted as a partner and assets are revalued and liabilities reassessed as follows:

(i) Create a Provision for doubtful debt on debtors at Rs.800.

(ii) Building and investment are appreciated by 10%.

(iii) Machinery is deprecated at 5%

(iv) Creditors were overestimated by Rs.500.

Make journal entries and Prepare revaluation account before the admission of Nikhil.

Solution

Journal

Date	Particulars		LF	Debit Amount (Rs.)	Credit Amount (Rs.)
	Revaluation A/c	Dr.		800	
	To Provision for Doubtful Debts				800
	[Provision made for doubtful debts]				
	Building A/c	Dr.			
	Investment A/c	Dr.		2,000	
	To Revaluation A/c			1,500	
	[Increase in the value of Building &				3,500
	Investment]				
	Revaluation A/c	Dr.		650	
	To Machinery A/c				650
	[Decrease in the value of machinery]				
	Creditor A/c	Dr.		500	
	To Revaluation A/c				500
	[Value of creditors reduced by Rs.500]				

Revaluation account

Dr. Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Provision for		Building	2,000
Doubtful Debts	800	Investment	1,500
Machinery	650	Creditors	500
Profit transferred to			
Karan's Capital 1,700			
Tarun's Capital 850			
	2,550		
	4,000		4,000

Notes

19.7 ADJUSTMENTS OF RESERVES AND ACCUMULATED PROFIT OR LOSSES

Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner, is credited in the existing partner's capital account in existing profit sharing ratio. If there is any loss, the same will be debited to the existing partner in the existing ratio. For this purpose the following journal entries are made as:

(i) For distribution of undistributed profit and reserve.

Reserves A/c	Dr	
Profit & Loss A/c(Profit)	Dr.	
To Partner's Capital A/c		[individually]
[Reserves and Profit & Loss (Profit) transferred to all partners capitals A/c in existing profit sharing ratio]		

(ii) For distribution of loss

Partner's Capital A/c	Dr.	[individually]
ToProfit and Loss A/c [Loss]		
[Profit & Loss (loss) transferred to all partners capitals A/c in existing profit sharing ratio]		

Illustration 15

Rohit and Soniya are partners sharing profit in the ratio of 4:3. On lst April 2006 they admit Meena as as new partner for 1/4 shares in profits. On that date the balance sheet of the firm shows a balance of Rs.70,000 in general reserve and debit balance of Profit and Loss A/c of Rs.21,000. make the necessary journal entries.

Solution

Journal

Date	Particulars		LF	Debit Amount (Rs.)	Credit Amount (Rs.)
	General Reserve	Dr		70,000	
	To Rohit's Capital A/c				40,000
	To Soniya's Capital A/c				30,000
	[Transfer of general reserve to the existing partner's capital accounts]				
	Rohit's Capital A/c	Dr.		12,000	
	Soniya's Capital A/c	Dr.		9,000	
	To Profit & Loss A/c				21000
	[transfer of accumulated Loss to existing partner's capital A/c]				

Notes

Illustration : 16

Bhanu and Etika are partners sharing profit and losses in the ratio of 3:2 respectively. Their Balance Sheet as on March 31, 2006 was as under:

Balance Sheet of Bhanu and Etika as on December 31,2006

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
Creditors		28,000	Cash in hand	3,000
Capitals:			Cash at Bank	23,000
Bhanu	70,000		Debtors	19,000
Etika	70,000	1,40,000	Buildings	65,000
			Furniture	15,000
			Machinery	13,000
			Stock	30,000
		1,68,000		1,68,000

On that date, they admit Deepak into partnership for 1/3 share in future profit on the following terms:

(i) Furniture and stock are to be depreciated by 10%.

(ii) Building is appreciated by Rs.20,000.

(iii) 5% provision is to be created on Debtors for doubtful debts.

(iv) Deepak is to bring in Rs.50,000 as his capital and Rs.30,000 as goodwill.

Make necessary ledger account and balance sheet of the new firm.

Solution :

Revaluation account

Dr. Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
Provision for Doubtful Debts		950	Building	20,000
Furniture		1,500		
Stock		3,000		
Profit transferred to				
Bhanu's Capital A/c	8,730			
Etika's Capital A/c	5,820	14,550		
		20,000		20,000

Capital account

Dr. Cr.

Particulars	Bhanu (Rs)	Etika (Rs)	Deepak (Rs)	Particulars	Bhanu (Rs)	Etika (Rs)	Deepak (Rs)
Balance c/d (closing)	96,730	87,820	50,000	Balance b/d (closing)	70,000	70,000	—
				Revaluation (Profit)	8,730	5,820	—
				Bank A/c	—	—	50,000
				Goodwill A/c	18,000	12,000	—
	96,730	87,820	50,000		96,730	87,820	50,000

Balance Sheet of Bhanu , Etika and Deepak
as on December 31, 2006

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Creditors		28,000	Cash in hand		3,000
Capitals:			Cash at Bank		1,03,000
Bhanu	96,730		Debtors	19,000	
Etika	87,820		Less Provision	950	18,050
Deepak	50,000	2,34,550	Stock		27,000
			Furniture		13,500
			Machinery		13,000
			Building		85,000
		2,62,550			2,62,550

Illustration: 17

Ashu and Pankaj are partners sharing profit in the ratio of 3 : 2, their Balance sheet on March 31, 2007 was as follows:

Balance Sheet of Ashu and Pankaj
as on March 31,2007

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Creditors		38,000	Cash in hand	15,000
Bills Payable		40,000	Cash at Bank	62,000
Salaries outstanding		5,000	Debtors	58,000
Profit & Loss		40,000	Stock	85,000
Capitals:			Machinery	1,45,000
Ashu	1,50,000		Goodwill	38,000
Pankaj	1,30,000	2,80,000		
		4,03,000		4,03,000

They admitted Gurdeep into partnership on the following terms on March 31, 2007.

(a) New profit sharing ratio is agreed as 3 : 2 : 1.

(b) He will bring in Rs.1,00,000 as his shared capital and Rs.30,000 as his share of goodwill.

(c) Machinery is appreciated by 10%

(d) Stock is valued at Rs. 87,000.

(e) Creditors are unrecorded to the extent of Rs.6,000.

(f) A provision for doubtful debts is to be created by 4% on debtors.

Prepare Revaluation account, Capital Accounts, Bank account and Balance Sheet of the new firm after admission of Gurdeep.

Solution

Revaluation account

Dr. Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
Provision for Doubtful Debts		2,320	Machinery	14,500
Creditors	6,000		Stock	2,000
Profit transferred to				
Ashu's Capital A/c	4,908			
Pankaj's Capital A/c	3,272	8,180		
		16,500		16,500

Capital account

Dr. Cr.

Particulars	Ashu (Rs)	Pankaj (Rs)	Gurdeep (Rs)	Particulars	Ashu (Rs)	Pankaj (Rs)	Gurdeep (Rs)
Goodwill A/c	22,800	15,200	—	Balance b/d	1,50,000	1,30,000	—
Balance c/d	1,74,108	1,46,072	1,00,000	Profit & Loss A/c	24,000	16,000	—
				Revaluation A/c (Profit)	4,908	3,272	
				Bank A/c	—	—	1,00,000
				Goodwill A/c	18,000	12,000	—
	1,96,908	1,61,272	50,000		1,96,908	1,61,272	1,00,000

Balance Sheet of Ashu Pankaj and Gurdeep as on March 31,2007

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Creditors		44,000	Cash in hand		15,000
Bills Payable		40,000	Cash at Bank		1,92,000
Salaries outstanding		5,000	Debtors	58,000	
Capitals:			Less Provision	(2,320)	
Ashu	1,74,108		of doubtful debts		55,680
Pankaj	1,46,072		Stock		87,000
Gurdeep	1,00,000	4,20,180	Machinery		1,59,500
		5,09,180			5,09,180

Bank account

Dr | Cr

$\frac{18-15}{30}=\frac{3}{30}$

Particulars	Amount (Rs}	Particulars	Amount (Rs)
Balance b/d	62,000	Balance c/d	1,92,000
Gurdeep's Capital A/c	1,00,000		
Goodwill A/c	30,000		
	1,92,000		1,92,000

Working Note:

Sacrificing Ratio = Existing Ratio – New Ratio

Partners	Existing ratio	New ratio	sacrifice	Sacrificing ratio
Ashu	3/5	3/6		Ashu:Pankaj
Pankaj	2/5	2/6	$\frac{12-10}{30}=\frac{2}{30}$	3 : 2

Illustration: 18

Himani and Harsha are partners in a firm. Their Balance Sheet on March 31, 2006 was as follows:

Balance Sheet of Himani and Harsha
as on March 31,2006

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Provision for Doubtful Debts		3,000	Cash	20,000
			Sundry Debtors	90,000
Creditors		36,000	Stock	45,000
Bills Payable		15,000	Machinery	41,000
Outstanding Expenses		2,000	Building	1,10,000
Capitals:			Goodwill	40,000
Himani	1,70,000			
Harsha	1,20,000	2,90,000		
		3,46,000		3,46,000

On April 1, 2006 they admitted Charu as a Partner on the following terms:

(i) Charu brings Rs.90,000 as her share of capital and she is unable to bring any amount for goodwill.

(ii) Goodwill is valued at 2 Years purchase of the average profit of last 4 years. The Profit of last 4 years amounted to Rs.20,000: Rs.30,000: Rs.30,000: Rs.40,000 Respectively.

(iii) New Profit sharing ratio between Himani's, Harsha's and Charu are 3 : 2 : 1.

(iv) Outstanding Expenses to be brought down to Rs.500.

(v) The provision for doubtful debts is to be increased upto 5% on Debtors.

(vi) Machinery is depreciated by 10% and Stock is valued at Rs.47,000.

Prepare Revaluation Account, Partners Capital account and opening Balance sheet of the New firm.

Notes

Solution:

Revaluation account

Dr. Cr.

Particulars	Amount (Rs.)	Particulars		Amount (Rs.)
Provision for Doubtful Debts	1,500	Outstanding Expenses		1,500
		Stock		2,000
Machinery	4,100	Loss on revaluation transferred to		
		Himani's Capital A/c	1,050	
		Harsha's Capital A/c	1,050	2,100
	5,600			5,600

Capital account

Dr. Cr.

Particulars	Himani (Rs)	Harsha (Rs)	Charu (Rs)	Particulars	Himani (Rs)	Harsha (Rs)	Charu (Rs)
Goodwill A/c	20,000	20,000	—	Balance b/d	1,70,000	1,20,000	—
Revaluation A/c	1,050	1,050		Charu's Capital A/c	—	10,000	—
(loss)				Bank A/c	—	—	90,000
Harsha,s Capital			10,000				
Balance c/d	1,48,950	1,08,950	80,000				
	1,70,000	1,30,000	90,000		1,70,000	1,30,000	90,000

Balance Sheet of Himani,Harsha and Charu as on March 31,2007

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Provision for Doubtful Debts		4,500	Cash	70,000
			Bank	90,000
			Sundry Debtors	90,000
Creditors		36,000	Stock	47,000
Bills Payable		15,000	Machinery	36,900
Outstanding Expenses		500	Building	1,10,000
Capitals:				
Himani	1,48,950			
Harsha	1,08,950			
Charu	80,000	2,90,000		
		3,93,900		3,93,900

Working Note:

(i) Valuation of Goodwill:

Total Profit = Rs.20,000 + Rs.30,000 + Rs.30,000 + Rs.40,000

Average Profit = Rs.1,20,000/4 = Rs.30,000

Goodwill = Rs.30,000 × 2 = Rs.60,000

Charu's Share of Goodwill = Rs.60,000 × 1/6 = Rs.10,000

(ii) Sacrificing Ratio = Existing Ratio – New Ratio

Himani's = $\frac{3-3}{6} = 0$

Harsha's =

Only Harsha sacrificed his share of profit.

INTEXT QUESTIONS 19.4

$\frac{3-2}{6} = \frac{1}{6}$

Fill in the blanks with suitable word/words :

(i) Revaluation account is debited for an increase in the value of ....

(ii) Revaluation account is credited for an increase in the value of ....

(iii) Revaluation account is credited for an decrease in the value of ....

(iv) Revaluation account is debited for an decrease in the value of ....

(v) Profit on revaluation is transferred to the .... of the partners' capital account.

(vi) Reserve should be distributed amongst the existing partners in ....

(vii) Accumulated Losses are .... in the existing partner's capital account in existing profit sharing ratio.

19.8 ADJUSTMENT OF PARTNER'S CAPITAL

Sometime, at the time of admission, the partners' agree that their capitals be adjusted in proportion to their profit sharing ratio. For this purpose, the capital accounts of the existing partners are prepared, making all adjustments, on account of goodwill, general-reserve, revaluation of assets and resettlement of liabilities. The actual capital so adjust will be compared with the amount of capital that should be kept in the business after the admission of the new partner. The excess if any, of adjusted actual capital over the proportionate capital will either be withdrawn or transferred to current account and vice versa.

The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital account balances.

1. Adjustment of existing partner's capital on the basis of the capital of the new partner:

If the capital of the new partner is given, the entire capital of the new firm will be determined on the basis of the new partner's capital and his profit sharing ratio. Therefore the capital of other partners is ascertained by dividing the total capital as per his profit sharing ratio.

If the existing capital of the partner after adjustment is in excess of his new capital, the excess amount is withdrawn by partner or transferred to the credit of his current account. If the existing capital of the partner is less than his new capital, the partner brings the short amount or makes transfer to the debit of his current account. The journal entries are made as under:

(i) when excess amount is withdrawn by the partner or transferred to current account.

Existing Partner's Capital A/c Dr.

To Bank A/c or Partner Current A/c

(Excess amount is withdrawn by the partner or transferred to current account]

(ii) For bringing in the Deficit amount or Balance transferred to current account.

Bank A/c or Partner Current A/c Dr.

To Existing Partner's Capital A/c

(Bringing the Deficit amount or Balance transferred to current account)

Illustration 19

Asha and Boby are partners sharing profit in the ratio of 5:3 with capital of Rs.80,000 and Rs.70,000 respectively. They admit a new partner Nitin. The new profit sharing ratio of Asha, Boby and Nitin is 5:3:2 respectively. Ntin brings Rs.40,000 as capital. The profit on revaluation of assets and reassessment of liabilities is Rs.6,400. it is agreed that capitals of the partner's should be in the new profit sharing ratio. Calculate new capital of each partner.

Solution:

Actual Capital of Asha and Boby

	Asha (Rs.)	Boby (Rs.)
Balance in Capital A/c	80,000	70,000
Add Profit on Revaluation (5 : 3)	4,000	2,400
Capital after Adjustment	84,000	72,400

Calculation of new capital of the firm and existing partner's capital

Nitin's Share in the firm = 2/10

Nitin's brings 40,000 for 2/10 Share

Total capital of the new firm in terms of Nitin's capital

$$= 40{,}000 \times 10/2$$

$$= \text{Rs.}2{,}00{,}000$$

Asha's share in New Capital = 2,00,000 × 5/10 = Rs.1,00,000

Boby's share in New Capital = 2,00,000 × 3/10 = Rs.60,000

On comparing Asha's adjusted capital with the new capital we find that the Asha brings Rs.16,000 [Rs.1,00,000 - Rs.84,000] or the amount may be debited to her current account.

On comparing the Boby's adjusted capital with the new capital, we find that the Boby is to withdraw Rs. 12,400 [Rs.72,400 - Rs.60,000] or the amount may be credited to his current account.

2. **When the capital of the new partner is calculated in proportion to the total capital of the new firm.**

Sometimes the capital of the new partner is not given. He/she is required to bring an amount proportionate to his/her share of profit. In such a case,

Notes

new partner's capital will be calculated on the basis of adjusted capital of the existing partners.

For example, the capital account of Sumit and Anu show the balance after all adjustments and revaluation are Rs.90,000 and Rs.60,000 respectively. They admit Rohit as a new partner for 1/4 share in the profits. Rohit's capital is calculated as follows:

Total share = 1

Rohit's share in the profit = 1/4

Remaining share = 1 – 1/4 = 3/4

3/4 share of profit combined capital of Sumit and Anu

= Rs.90,000+Rs.60,000 = Rs.1,50,000

Total Capital of the firm = Rs.1,50,000 × 4/3

= Rs.2,00,000

Rohit's capital for 1/4 share of profits = Rs.2,00,000 × 1/4 = Rs.50,000

Rohit brings in Rs.50,000 as his Capital

Illustration : 20

Manoj and Hema are partner sharing profit and losses in the ratio of 7 : 3. On March 31,2006, their Balance Sheet was as follows:

Balance Sheet of Manoj and Hema
as on March 31,2006

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Capital :			Bank	12,000
Manoj	88,00		Sundry Debtors	45,000
Hema	64,00	1,52,000	Bills Receivable	30,000
Sundry creditors		32,000	Stock	35,000
Bills Payable		38,000	Investment	13,000
Reserve		18,000	Machinery	40,000
			Building	45,000
			Goodwill	20,000
		2,40,000		2,40,000

They admit Tarun into partnership on the following terms:

(i) Stock is revalued at Rs.40,000.

Notes

(ii) Building, Machinery and Investment are depreciated by 12%.

(iii) Prepaid Insurance is Rs. 1,000.

(iv) Tarun brings Rs.40,000 as his capital and Rs. 12,000 for goodwill for 1/6 share of profit of the firm.

(v) Capital of the partners shall be proportionate to their profit sharing ratio. Adjustment of Capitals to be made by Cash.

Prepare Revaluation Account, Partners' Capital Account , Cash Account and Balance Sheet of the new firm.

Solution:

Revaluation account

Dr. Cr.

Particulars	Amount (Rs.)	Particulars		Amount (Rs.)
Building	5,400	Stock		5,000
Machinery	4,800	Prepaid Insurance		1,000
Investment	1,560	Loss transferred to		
		Manoj's Capital	4,032	
		Hema's Capital	1,728	5,760
	11,760			11,760

Capital account

Dr. Cr.

Particulars	Manoj (Rs)	Hema (Rs)	Tarun (Rs)	Particulars	Manoj (Rs)	Hema (Rs)	Tarun (Rs)
Goodwill	14,000	6,000	—	Balance b/d	88,000	64,000	—
Revaluation A/c (loss)	4,032	1,728	—	General Reserve	12,600	5,400	—
(loss)				Goodwill A/c	8,400	3,600	
Bank A/c	—	5,272	—	Bank A/c	—	—	40,000
Balance c/d	1,40,000	60,000	40,000	Bank A/c (Profit)	49,032	—	—
	1,58,032	73,000	90,000		1,58,032	73,000	90,000

**Balance Sheet of Manoj, Hema and Tarun
as on March 31, 2006**

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable		38,000	Bank	1,07,760
Sundry creditors		32,000	Bills Receivable	30,000
Capitals A/c:			Sundry Debtors	45,000
Manoj	1,40,000		Stock	40,000
Hema	60,000		Investment	11,440
Tarun	40,000	2,40,000	Prepaid Insurance	1,000
			Machinery	35,200
			Building	39,600
		3,10,000		3,10,000

Bank account

Dr Cr

Particulars	Amount (Rs)	Particulars	Amount (Rs)
Balance b/d	12,000	Hema's Capital A/c	5,272
Manoj's Capital A/c	49,032	Balance c/d	1,07,760
Goodwill A/c	12,000		
Tarun's Capital A/c	40,000		
	1,13,032		1,13,032

Working Note:

(a) Calculation of New profit Sharing Ratio:

Total Profit = 1

Tarun gets = 1/6

Remaining Profit = 1 – 1/6 = 5/6 share by Manoj and Hema in their existing profit sharing ratio.

Manoj's new share = 5/6 × 7/10 = 7/12

Hema's new shares = 5/6 × 3/10 = 3/12

New profit sharing ratio of Manoj, Hema and Tarun

= 7/12 : 3/12 : 1/6 or 7 : 3 : 2.

(b) Adjustment of Capital:

Tarun brought capital for 1/6 share = Rs.40,000

Total Capital of the firm = Rs. 40,000 × 6/1 = Rs.2,40,000

Manoj's Capital = Rs. 2,40,000 × 7/12 = Rs. 1,40,000

Hema's Capital = Rs. 2,40,000 × 3/12 = Rs.60,000

Tarun's Capital = Rs. 2,40,000 × 2/12 = Rs.40,000

INTEXT QUESTIONS 19.5

Tanu and Anu are partner's sharing profit in the ratio 3:2. They admit Sumit as a new partner of 1/5 share in the profit and brings Rs.50,000 for his capital. The Capital of Tanu and Anu after all the adjustments are Rs.95,000 and 90,000 respectively. Calculate the total capital of the new firm and capital of the each partner on the basis of the new partner's capital.

WHAT YOU HAVE LEARNT

Admission of a partner – Meaning

When a partner so admitted to the existing partnership firm, it is called admission of a partner.

On the admission of a new partner, the following adjustments become necessary:

(i) Adjustment in profit sharing ratio;

(ii) Adjustment of Goodwill;

(iii) Adjustment for revaluation of assets and reassessment of liabilities;

(iv) Distribution of accumulated profits and reserves; and

(v) Adjustment of partners' capitals.

Adjustment in Profit sharing Ratio

When new partner is admitted he/she acquires his/her share in profit from the existing partners. As a result, the profit sharing ratio in the new firm is decided mutually between the existing partners and the new partner.

Sacrificing Ratio

At the time of admission of an incoming partner, existing partners have to surrender some of their share in favour of the new partner. The ratio in which they surrender their profits is known as sacrifice ratio.

Meaning of Goodwill:

A established firm develops wide business connections. This helps the firm to earn more profits as compared to a new firm. The monetary value of such advantage is known as "Goodwill".

Methods of valuation of Goodwill

(i) Average Profit Method

(ii) Super Profit Method

(iii) Capitalisation Method

Revaluation of assets and liabilities

On admission of a new partner, the firm is reconstituted and the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner.

Adjustments of reserves and accumulated profit or losses

Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner, are credited in the existing partner's capital account in existing profit sharing ratio. If there is any loss, the same will be debited to the existing partner in the existing ratio.

Adjustment of partner's capital

Sometime, at the time of admission, the partners' agreed that their capitals are adjusted to the proportionate to their profit sharing ratio. The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital accounts.

TERMINAL QUESTIONS

1. State the meaning of Sacrificing Ratio.
2. State the meaning of Goodwill.
3. Explain the methods of valuation of goodwill.
4. Explain 'Revaluation Account'. Why assets are liabilities are revalued at the time of admission of a new partner?

5. Explain the treatment of accumulated profit or losses and Reserves at the time of admission of a new partner.

6. Explain the calculation of the proportionate capital of the new partner in case of admission of a partner.

7. A and B are partners sharing profit in the ratio of 5 : 3 is admitted to the partnership for 1/4 share of future profit . Calculate the new profit sharing ratio and sacrificing ratio.

8. Rohit and Meena are partners sharing and losses in the ratio of 7 : 3. Rohit surrenders 1/7 of his share and Meena surrenders 1/3 of his share in favour of Teena,a new partner. Calculate the new profit sharing ratio.

9. A firm has earned Rs.3,00,000 as average profit for the last few year. Normal rate of return in the class of business is 15%. Find out goodwill according to Capitalisation of Super profit, if the value of net assets amounted to Rs. 16,00,000.

10. The following is the Balance Sheet of Tarun and Ashima sharing profit and losses in the ratio of 2 : 1.

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Capitals:			Cash	12,000
Tarun	50,000		Sundry Debtors	60,000
Ashima	40,000	90,000	Stock	12,000
Sundry creditors	20,000		Furniture	6,000
			Building	20,000
		1,10,000		1,10,000

They agreed to admit Sunita into partnership on the following terms:

(i) Sunita tp pay Rs.9,000 as Goodwill.

(ii) Sunita bring Rs. 11,000 as her Capital for 1/4 share of profit in the business.

(iii) Building and furniture to be depreciated at 5%. Stock is reduced by Rs. 1,600 and Bad Debt Reserve Rs.1,300 to be provided for.

Prepare necessary ledge account and balance sheet after admission.

11. A and B are partner in a firm sharing profit in the ratio 2 : 1. C is admitted into the firm with 1/4 share in profits. He will bring in Rs.60,000 as capital and capital of A and B are to be adjusted in the profit sharing ratio. The Balance sheet of A and B as on March 31, 2006 was as under:

Notes

Balance Sheet of A and B as on March 31,2006

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors		16,000	Cash in Hand	4,000
Bills Payable		8,000	Cash at Bank	20,000
General Reserve	12,000		Sundry Debtors	16,000
Capitals:			Stock	20,000
A	1,00,000		Furniture	10,000
B	64,000	1,64, 000	Machinery	50,000
			Building	80,000
		2,00,000		2,00,000

Other terms of agreement are as under:

1. C will bring in Rs.24,000 as his share of Goodwill.
2. Building was valued at Rs.90,000 and Machinery at Rs.46,000
3. A provision for bad debts is to be created @ 6% on Debtors.
4. The capital account of A and B are to be adjusted through cash.

Prepare necessary account and Balance Sheet after C's admission.

ANSWERS TO INTEXT QUESTIONS

Intext Questions 19.1

I. (i) New, Existing (ii) reconstituted (iii) sacrifice ratio
(iv) existing ratio

II. Sacrificing ratio 5 : 3.

Intext Questions 19.2

I. (i) intangible (ii) incoming (iii) Normal Profit
(iv) Average profit, super profit and Capitalisation
(v) Outsider liabilities

II. (a) Rs. 62,500 (b) Rs.1,25,000

Intext Questions 19.3

I. (i) no entry (ii) credited (iii) sacrificing
(iv) debited (v) debited

II. 1. IV 2. III 3. I 4. II.

Notes

Intext Questions 19.4

(i) Liabilities, (ii) Assets, (iii) Liabilities,

(iv) Assets, (v) Credit side. (vi) Existing ratio

(vi) debited

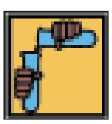
Intext Questions 19.5

Total Capital of the new firm Rs.2,50,000

Capital of Tanu's Rs.1,20,000, capital of Anu's Rs.80,000

Answers to Practical Terminal Questions

7. New profit sharing ratio 15 : 9 : 8, Sacrificing ratio 5 : 3.
8. New profit sharing ratio 3 : 1 : 1
9. Goodwill Rs. 4,00,000
10. Loss on Revaluation Rs. 4,200, Total of Balance Sheet Rs. 1,25,800
11. Profit on Revaluation Rs. 5,040, Capital of A Rs. 1,20,000, B & C Rs.60,000 each, Balance sheet Total Rs. 2,64,000



***Activity* :** Talk to the owners of five such business organisations which are doing good business and have built up good reputation in the market. Write against each firm the factor that have contributed to its goodwill

Name of the firm	Nature of Business	Factors contributing to the goodwill of the firm