Learning Objectives

The students would be able to understand:-

1. Admission of a partner
2. Effects of Admission of a partner
3. Meaning and Calculation of New Profit-Sharing Ratio
4. Meaning and Calculation of Sacrificing Ratio
5. Valuation and Adjustment of Goodwill as per AS-26
6. Revaluation of Assets and Reassessment of Liabilities
7. Accounting Treatment of Reserves and Accumulated Profits or Losses

Topics covered in this chapter

1. Admission of a partner
2. Effects of Admission of a partner
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Admission of a Partner

Admission of a partner is one of the modes of reconstituting the firm, because with the admission of a partner, existing agreement ends and new agreement among partners comes into force.

According to Section 31 of the Indian Partnership Act, 1932 a person can be admitted as a new partner:-

(i) If it is so agreed in the Partnership Deed, or

(ii) In the absence of the above, if all the partners agree for the admission

After admission, the new partner gets following two rights

1. Right to share future profits of the firm, and
2. Right to share in the assets of the firm.

At the same time, he becomes liable for the liability of the business and any loss incurred by the firm after admission.

Effects of Admission of a Partner

The effect of admission of a new partner are:-

1. Old partnership comes to an end and new partnership comes into existence.
2. New partner becomes entitled to share future profits of the firm and the combined share of the old partners gets reduced.
3. New partner brings in an agreed amount of capital in the firm.
4. New partner acquires right on the assets and also becomes liable for the liability of the firm.
5. Adjustment is made for reserves, accumulated profits and losses.
6. Assets are revalued and liabilities are reassessed.
7. Goodwill of the firm is valued and is paid to sacrificing partners for their sacrificed share by the new partner or gaining partner.

New Ratio=

Old Ratio- Sacrificing Ratio

Sacrificing Ratio=

Old Ratio- New Ratio

SACRIFICING RATIO- **Sacrificing ratio** refers to the **ratio** in which the old partners surrender their share of profit in favor of new partner.

New Profit Sharing Ratio

New profit sharing ratio is the ratio in which all partners, (including new partner) will share future profits and losses of the firm.

New partner may acquire his share from old partners through any of the following mode:-

1. **In their old profit sharing ratio**
2. **In a particular ratio**
3. **In a particular fraction from old partners**

1. When new partner acquires his share from old partners in their old profit sharing ratio

There may be two cases:-

(i) When new partner's share and old ratio is given

(ii) When new partner's share and new profit sharing ratio of old partner is given

(i) When new partner's share and old ratio is given

Ratan and Gautam are partners sharing profits equally. They admitted Anil for $\frac{1}{4}$ share. Calculate new profit sharing ratio.

Solution:- Let Total Profit=1

$$Anil's\ share\ of\ profit = \frac{1}{4}$$

$$Remaining\ share = 1 - \frac{1}{4} = \frac{4-1}{4} = \frac{3}{4}$$

$$Ratan's\ new\ share = \frac{3}{4} \times \frac{1}{2} = \frac{3}{8}$$

$$Gautam's\ new\ share = \frac{3}{4} \times \frac{1}{2} = \frac{3}{8}$$

$$New\ profit\ sharing\ ratio = \frac{3}{8} : \frac{3}{8} : \frac{1}{4} = \frac{3:3:2}{8} = 3:3:2$$

(ii) When new partner's share and new profit sharing ratio of old partner is given

Ratan and Gautam are partners sharing profits equally. They admitted Anil for $\frac{1}{4}$ share. In future profit sharing ratio of Ratan and Gautam would be 2:1. Calculate new profit sharing ratio.

Solution:- Let Total Profit=1

$$Anil's\ share\ of\ profit = \frac{1}{4}$$

$$Remaining\ share = 1 - \frac{1}{4} = \frac{4-1}{4} = \frac{3}{4}$$

$$Ratan's\ new\ share = \frac{3}{4} \times \frac{2}{3} = \frac{2}{4}$$

$$Gautam's\ new\ share = \frac{3}{4} \times \frac{1}{3} = \frac{1}{4}$$

$$New\ profit\ sharing\ ratio = \frac{1}{4} : \frac{1}{4} : \frac{1}{4} = 2:1:1$$

2. When new partner acquires his share from old partners in a particular ratio

Naresh and Ramesh are partners sharing profits in the ratio of 2:1. They admitted Suresh for $\frac{1}{4}$ share. Suresh acquires his share from old partners in the ratio of 3:2. Calculate new profit sharing ratio.

Solution:-

$$Suresh\ gets\ from\ Naresh = \frac{1}{4} \times \frac{3}{5} = \frac{3}{20}$$

$$Suresh\ gets\ from\ Ramesh = \frac{1}{4} \times \frac{2}{5} = \frac{2}{20}$$

$$Naresh's\ new\ share = \frac{2}{3} - \frac{3}{20} = \frac{40-9}{60} = \frac{31}{60}$$

$$Ramesh's\ new\ share = \frac{1}{3} - \frac{2}{20} = \frac{20-6}{60} = \frac{14}{60}$$

$$New\ Profit\ Sharing\ Ratio = \frac{31}{60} : \frac{14}{60} : \frac{1}{4} = \frac{31:14:15}{60} = 31:14:15$$

3. When new partner acquires his share from old partners in a particular fraction

A and B are partners in a firm sharing profits and losses in the ratio of 3:2. A surrenders $\frac{1}{5}th$ of his share, whereas B surrenders $\frac{2}{5}th$ of his share in favour of C, the new partner. Calculate new profit-sharing ratio.

Solution:- $C\ gets\ from\ A = \frac{3}{5} \times \frac{1}{5} = \frac{3}{25}$ $C\ gets\ from\ B = \frac{2}{5} \times \frac{2}{5} = \frac{4}{25}$

$$A's\ new\ share = \frac{3}{5} - \frac{3}{25} = \frac{15-3}{25} = \frac{12}{25}$$

$$B's\ new\ share = \frac{2}{5} - \frac{4}{25} = \frac{10-4}{25} = \frac{6}{25}$$

$$C's\ share = \frac{3}{25} + \frac{4}{25} = \frac{3+4}{25} = \frac{7}{25}$$

$$New\ Profit\ Sharing\ Ratio = \frac{12}{25} : \frac{6}{25} : \frac{7}{25}$$

3. When new partner acquires his share from old partners in a particular fraction

Jack and Goerge are partners in a firm sharing profits and losses in the ratio of 5:3. They admit Stalin in the firm. Stalin gets his share from Jack $\frac{5}{40}$ and from Goerge $\frac{3}{40}$ .Calculate the new profit sharing ratio.

Solution:-

$$Jack's\ new\ share = \frac{5}{8} - \frac{5}{40} = \frac{25-5}{40} = \frac{20}{40}$$

$$George's\ new\ share = \frac{3}{8} - \frac{3}{40} = \frac{15-3}{40} = \frac{12}{40}$$

$$Stalin's\ share = \frac{5}{40} + \frac{3}{40} = \frac{5+3}{40} = \frac{8}{40}$$

$$New\ Profit\ Sharing\ Ratio = \frac{20}{40} : \frac{12}{40} : \frac{8}{40} = 20:12:8 = 5:3:2$$

Learning Objectives

The students would be able to understand:-

1. Admission of a partner
2. Effects of Admission of a partner
3. Meaning and Calculation of New Profit-Sharing Ratio
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5. Valuation and Adjustment of Goodwill as per AS-26
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7. Accounting Treatment of Reserves and Accumulated Profits or Losses

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Valuation and Accounting treatment of Goodwill

As per AS-26 'Intangible Assets' prescribes that goodwill should be recorded in the books only when consideration in money or money's worth is paid for it or say goodwill purchased.

Goodwill is an intangible asset which enables a firm to earn higher profit than the normal profit earned by the other firm. It is due to efforts made by the existing partners in the past and this goodwill is known as self-generated goodwill.

At the time of admission, new partner compensate sacrificing partners by paying them an amount, termed as goodwill or premium of goodwill.

Accounting treatment of Goodwill at the time of Admission of a Partner

There can be following situation relating to accounting treatment of goodwill at the time of admission of a partner:-

1. Goodwill is paid privately
2. Goodwill is brought in cash or by cheque or brought in kind by new partner
3. Goodwill not brought in full or a part by the new partner in cash

1. When goodwill is paid privately

No Entry

2. When Goodwill is brought in cash or by cheque or brought in kind by new partner

There can be two cases:-

(a) When Goodwill is retained in the business

(b) When Goodwill is withdrawn by sacrificing partners fully or partly

(a) When Goodwill is retained in the business

The following journal entries will be made:-

1. When premium for goodwill is brought in cash by new partner	Cash or Bank A/c Dr. To Premium for Goodwill A/c (for premium for goodwill brought in cash)
2. When premium for goodwill is shared by sacrificing partners	Premium for Goodwill A/c Dr. To Sacrificing Partner's Cap. A/c (for premium for goodwill transferred to sacrificing partners' capital account)

(b) When Goodwill is withdrawn by sacrificing partners fully or partly

The following journal entries will be made:-

1. When premium for goodwill is brought in cash by new partner	Cash or Bank A/c Dr. To Premium for Goodwill A/c (for premium for goodwill brought in cash)
2. When premium for goodwill is shared by sacrificing partners	Premium for Goodwill A/c Dr. To Sacrificing Partner's Cap. A/c (for premium for goodwill brought in cash)
3. When premium for goodwill is withdrawn by sacrificing partners	Sacrificing Partners' Capital A/c Dr. To Cash/Bank A/c (for amount of goodwill withdrawn by sacrificing partners)

3. Goodwill not brought in full or a part by the new partner

The following journal entries will be made:-

1. When premium for goodwill is not brought in full in cash by new partner	New Partner's Capital A/c Dr. To Sacrificing Partners' Cap. A/c (for sacrificing partners' capital A/c credited by share of goodwill of new partner)
2. When premium for goodwill is not brought in a part in cash by new partner	Premium for Goodwill A/c Dr. New Partner's Current A/c Dr. To Sacrificing Partner's Cap. A/c (for new partner's share of goodwill transferred to sacrificing partners' capital account)

Note:-

In case the new partner does not bring his share of premium for goodwill in cash, it may be adjusted by debiting his capital account.

But in case of capitals of the existing partners are to be adjusted on the basis of the capital of new partner or new partner will bring proportionate capital of the firm, then, the amount of goodwill not brought is adjusted by debiting his current account

P and Q are partners sharing profits and losses in the ratio of 3:2. They admitted R into partnership for 1/4th share, which he acquires 1/6th from P and 1/12th from Q. Goodwill already appears in the books Rs.20,000. R brings Rs.18,000 as goodwill out of his share of Rs.30,000. It was decided that shortfall in amount shall be debited in R's Current Account

Journal Entries

Date	Particulars	L.F.	Dr. Amt.	Cr. Amt.
	P's Capital A/c Dr. Q's Capital A/c Dr. To Goodwill A/c (for existing goodwill written off in 3:2)		12,000 8,000	 20,000
	Cash/Bank A/c Dr. To Premium for Goodwill A/c (for goodwill brought in by R in cash)		18,000	 18,000
	Premium for Goodwill A/c Dr. R's Current A/c Dr. To P's Capital A/c To Q's Capital A/c (for goodwill credited to the sacrificing partners in their sacrificing ratio)		18,000 12,000	 20,000 10,000

Learning Objectives

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Revaluation of Assets and Reassessment of Liabilities

Assets are revalued and liabilities are reassessed at the time of admission of a partner to calculate gain or loss on revaluation of assets and reassessment of liabilities.

If there is increase in the value of asset and decrease in the amount of liability then there is a gain.

If there is decrease in the value of asset and increase in the amount of liability then there is a loss.

The gain or loss should be share by the old partners in their old profit sharing ratio.

The partner may decide:-

(i) Record revised (changed) values of assets and liabilities in books of accounts of the firm.

(ii) Not to record the revised (changed) values of assets and liabilities in the books of accounts of the firm.

When revised (changed) values of assets and liabilities are to be recorded

Revaluation of assets and reassessment of liabilities are recorded in an account called Revaluation Account or Profit and Loss Adjustment Account. Increase in the value of assets and decrease in the amount of liabilities are credited and decrease in the value of assets and increase in the amount of liabilities are debited in this account.

Journal Entries

1.	For increase in the value of Assets	Assets A/c Dr. To Revaluation A/c (For assets increased)
2.	For decrease in the value of Assets	Revaluation A/c Dr. To Assets A/c (For assets decreased)
3.	For increase in the amount of liability	Revaluation A/c Dr. To Liability A/c (For liability increased)
4.	For decrease in the amount of liability	Liability A/c Dr. To Revaluation A/c (For liability decreased)
5.	For recording an unrecorded asset	Assets A/c Dr. To Revaluation A/c (For unrecorded assets recorded)
6.	For recording an unrecorded liability	Revaluation A/c Dr. To Liability A/c (For unrecorded liability recorded)

For transfer of Balance in Revaluation Account

(a) If credit side of Revaluation Account is more than debit side

Revaluation A/c Dr.

To Partners' Capital A/c

(For profit on revaluation transferred to partners' capital account in their old ratio)

(b) If debit side of Revaluation Account is more than credit side

Partners' Capital A/c Dr.

To Revaluation A/c

(For loss on revaluation transferred to partners' capital account in their old ratio)

Format of Revaluation Account

Particualrs	Rs.	Particulars	Rs.
To Assets (decrease in assets) To Liability (increase in liability) To Unrecorded Liability To Profit (transfer to partners' Capital/Current A/c)	------ ------ ------ ------ ------- =====	By Assets (increase in assets) By Liability (decrease in liability) By Unrecorded Assets By Loss (transferred to partners' Capital/current A/c)	------ ------ ------- ------- ------- =====

Raman, Rahul are partners sharing profits in the ratio of 2:1. Their Balance Sheet as at 31st March, 2019 was as follows:

Liabilities		Rs.	Assets		Rs.
Creditors		2,40,000	Bank Balance		1,25,000
Salaries Payable		60,000	Bills Receivable		11,000
Capitals:-			Stock		2,00,000
Raman	3,60,000		Sundry Debtors	1,00,000	
Rahul	2,40,000	6,00,000	Less: Provision	10,000	90,000
			Furniture		50,000
			Computers		3,00,000
			Air Conditioners		1,00,000
			Goodwill		24,000
		9,00,000			9,00,000

They admitted Ramesh as a new partner for 1/4th share. He brings in Rs. 1,00,000 as his capital. They agreed to the following:-

(i) Stock to be increased to Rs.2,20,000 and Furniture to be reduced by 20% and Computers to be reduced to Rs.2,70,000.

(ii) Provision for Doubtful Debts to be reduced by Rs.2,000.

(iii) Goodwill of the firm is valued at Rs.1,20,000.

Prepare Revaluation A/c, Partner's Capital A/c and revised Balance Sheet of the reconstituted firm.

Revaluation A/c

Particulars	Rs.	Particulars		Rs.
To Furniture	10,000	By Stock		20,000
To Computers	30,000	By Provision for D/D		2,000
		By Loss transferred to partners' capitals:-		
		Raman	12,000	
		Rahul	6,000	18,000
	40,000			40,000

Capital A/c

Particulars	Raman	Rahul	Ramesh	Particulars	Raman	Rahul	Ramesh
To Revaluation	12,000	6,000		By Balance b/d	3,60,000	2,40,000	
To Goodwill	16,000	8,000		By Ramesh's Cap	20,000	10,000	
To Raman's Cap.			20,000	By Bank A/c			1,00,000
To Rahul's Cap.			10,000				
To Balance c/d	3,52,000	2,36,000	70,000				
	3,80,000	2,50,000	1,00,000		3,80,000	2,50,000	1,00,000

Balance Sheet
As at 31st March, 2019

Liabilities		Rs.	Assets		Rs.
Creditors		2,40,000	Bank Balance		2,25,000
Salaries Payable		60,000	Bills Receivable		11,000
Capitals:-			Stock		2,20,000
Raman	3,52,000		Sundry Debtors	1,00,000	
Rahul	2,36,000		Less: Provision	8,000	92,000
Ramesh	70,000	6,58,000	Furniture		40,000
			Computers		2,70,000
			Air Conditioners		1,00,000
		9,58,000 =======			9,58,000 ======

$Old\ Ratio = 2:1$ $\qquad$ $Ramesh's\ share = \frac{1}{4}$

$$Ramesh's\ \text{share of goodwill} = 1{,}20{,}000 \times \frac{1}{4} = Rs.\,30{,}0000$$

$Rs.$ 30,000 will be shared by Raman and Rahul in their sacrificing ratio.

Journal Entry

Ramesh's Capital A/c Dr.	30,000	
To Raman's Capital A/c		20,000
To Rahul's Capital A/c		10,000

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Accounting Treatment of Reserves and Accumulated Profits or Losses

If at the time of Admission of a Partner, reserves and accumulated profits or losses are given in the books of the firm, they will be transferred to the old/existing partners' capital or current account in their old profit sharing ratio.

Journal Entries:-

1. **For transfer of Reserve and Accumulated Profits:-**

Reserve A/c	Dr.
Contingency Reserves A/c	Dr.
Profit and Loss A/c (Cr. Balance)	Dr.
Workmen Compensation Reserve A/c	Dr.
Investment Fluctuation Reserve A/c	Dr.
To Old Partners' Capital/Current A/c	

2. **For transfer of Accumulated losses:-**

Old Partner's Capital A/c	Dr
To Profit and Loss A/c (Dr. Balance)	
To Deferred Revenue Expenditure A/c	

Workmen Compensation Reserve

This is a reserve set aside out of firm's profits to meet possible liability to pay compensation to employees, if it arises. The claim may or may not arise. Excess of Workmen Compensation Reserve over the workmen compensation liability is credited to old partner's capital account in their old profit sharing ratio.

Account Treatment of Workmen Compensation Reserve

(A) If no claim against Workmen Compensation Reserve Exists:-

Workmen Compensation Reserve A/c Dr.

To Old Partner's Capital/Current A/c

(For the amount of Workmen Compensation Reserve Transferred to Old Partners' Capital/Current A/c in old profit sharing ratio)

(B) If claim for Workmen Compensation Exists:-

There can be three possible situation:

(i) **If the claim is less then the amount of Workmen Compensation Reserve**

(ii) **If the claim is equal to the amount of Workmen Compensation Reserve**

(iii) **If the claim is more than the amount of Workmen Compensation Reserve**

(i) If the claim is less then the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To Provision for Worker's Claim A/c

To Old Partner's Capital/Current A/c

(For provision for estimated claim is made and balance transferred to old partners' capital account in old ratio)

(ii) If the claim is equal to the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To Provision for Worker's Claim A/c

(For provision for estimated claim is made)

(iii) If the claim is more than the amount of Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To Revaluation A/c Dr.

To Provision for Worker's Claim A/c

(For the amount of claim debited to Workmen Compensation Reserve and Revaluation A/c)

Old Partners' Capital A/c Dr.

To Revaluation A/c

(For loss on revaluation transferred to Capital/Current A/c in old ratio)

Investment Fluctuation Reserve

Investment Fluctuation Reserve is created out of profit to meet the fall in the market value of investment. At the time of admission of a partner, the accounting treatment of Investment Fluctuation Reserve is as follows:-

(i) If book value is equal to market value

(ii) If market value is less than the book value

(iii) If market value is more than the book value

(i) If book value is equal to market value

Investment Fluctuation Reserve A/c Dr.

To Old Partners' Capital/Current A/c

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

(ii) If market value is less than the book value

Investment Fluctuation Reserve A/c Dr.

To Investment A/c

To Old Partners' Capital/Current A/c

(For fall in the value of investment is meet out and balance is transferred to Capital/Current A/c in old ratio)

(iii) If market value is more than the book value

Investment Fluctuation Reserve A/c Dr.

To Old Partners' Capital/Current A/c

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in their old ratio)

Investment A/c Dr.

To Revaluation A/c

(For increase in the value of investment)

Revaluation A/c Dr.

To Old Partners' Capital A/c

(For profit on revaluation transferred to old partners' capital account in their old ratio)

Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Sacrificing Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated profit

Sacrificing Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Learning Objectives

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Illustration

Manohar, Mahesh and Mukesh are partners sharing profits and losses in the ratio of 4:3:2, decided to admit Amit as a partner for 1/5th share in the firm with effect from 1st April, 2018. An extract of their Balance Sheet as at 31st March, 2018 is:

Liabilities	Rs.	Assets	Rs.
Workmen Compensation Reserve	90,000		

Show the accounting treatment of Workmen Compensation Reserve on the admission of Amit under following alternatives:-

1. **If there is no other information.**
2. **If claim on account of workmen compensation is estimated at Rs.45,000.**
3. **If claim on account of workmen compensation is estimated at Rs.99,000.**

Account Treatment of Workmen Compensation Reserve

1. If no claim against Workmen Compensation Reserve Exists:-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**	
To Manohar's Capital A/c			**40,000**
To Mahesh's Capital A/c			**30,000**
To Mukesh's Capital A/c			**20,000**

(For the amount of Workmen Compensation Reserve Transferred to Old Partners' Capital/Current A/c in old profit sharing ratio)

2. If claim on account of Workmen Compensation is estimated Rs.45,000:-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**	
To Worker's Claim A/c			**45,000**
To Manohar's Capital A/c			**20,000**
To Mahesh's Capital A/c			**15,000**
To Mukesh's Capital A/c			**10,000**

(For the amount of surplus Workmen Compensation Reserve Transferred to Old Partners' Capital/Current A/c in old profit sharing ratio)

3. If claim on account of Workmen Compensation is estimated Rs.45,000 :-

Workmen Compensation Reserve A/c	**Dr.**	**90,000**	
Revaluation A/c	**Dr.**	**9,000**	
To Provision for Workmen Compensation claim			**99,000**

(For the provision created and shortfall charged to revaluation account)

Illustration

Manohar, Mahesh and Mukesh are partners sharing profits and losses in the ratio of 4:3:2, decided to admit Amit as a partner for 1/5th share in the firm with effect from 1st April, 2018. An extract of their Balance Sheet as at 31st March, 2018 is:

Liabilities	Rs.	Assets	Rs.
Investment Fluctuation Reserve	18,000	Investment	2,00,000

Show the accounting treatment of Workmen Compensation Reserve on the admission of Amit under following alternatives:-

1. **If there is no other information.**
2. **If the market value of Investment is Rs.2,00,000.**
3. **If the market value of Investment is Rs.1,91,000**
4. **If the market value of Investment is Rs.1,73,000**
5. **If the market value of Investment is Rs.2,18,000.**

1. If there is no other information

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
To Manohar's Capital A/c			**8,000**
To Mahesh's Capital A/c			**6,000**
To Mukesh's Capital A/c			**4,000**

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

2. If the market value of Investment is Rs.2,00,000

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
To Manohar's Capital A/c			**8,000**
To Mahesh's Capital A/c			**6,000**
To Mukesh's Capital A/c			**4,000**

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

3. If the market value of Investment is Rs.1,91,000

Investment Fluctuation Reserve A/c	**Dr.**	**18,000**	
To Investment A/c			**9,000**
To Manohar's Capital A/c			**4,000**
To Mahesh's Capital A/c			**3,000**
To Mukesh's Capital A/c			**2,000**

(For the surplus amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

4. If the market value of Investment is Rs.1,73,000

Investment Fluctuation Reserve A/c	Dr.	18,000	
Revaluation A/c	Dr.	9,000	
To Investment A/c			27,000

(For excess fall in value than the balance of Investment Fluctuation Reserve transferred to Revaluation A/c)

Manohar's Capital A/c		4,000	
Mahesh's Capital A/c		3,000	
Mukesh's Capital A/c		2,000	
To Revaluation A/c			9,000

(For the loss on revaluation transferred to old partner's capital account)

5. If the market value of Investment is Rs.2,18,000

Investment Fluctuation Reserve A/c	Dr.	18,000	
To Manohar's Capital A/c			8,000
To Mahesh's Capital A/c			6,000
To Mukesh's Capital A/c			4,000

(For the amount of Investment Fluctuation Reserve transferred to old partners' capital account in old ratio)

Investment A/c	Dr.	18,000	
To Revaluation A/c			18,000

(For increase in the value of investment)

Revaluation A/c	Dr.	18,000	
To Manohar's Capital A/c			8,000
To Mahesh's Capital A/c			6,000
To Mukesh's Capital A/c			4,000

(For profit on revaluation transferred to old partners' capital account in their old ratio)

Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Sacrificing Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated profit

Sacrificing Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Learning Objectives

The students would be able to understand:-

1. Admission of a partner
2. Effects of Admission of a partner
3. Meaning and Calculation of New Profit-Sharing Ratio
4. Meaning and Calculation of Sacrificing Ratio
5. Valuation and Adjustment of Goodwill as per AS-26
6. Revaluation of Assets and Reassessment of Liabilities
7. Accounting Treatment of Reserves and Accumulated Profits or Losses

Topics covered in this chapter

1. Admission of a partner
2. Effects of Admission of a partner
3. Meaning and Calculation of New Profit-Sharing Ratio
4. Meaning and Calculation of Sacrificing Ratio
5. Valuation and Adjustment of Goodwill as per AS-26
6. Revaluation of Assets and Reassessment of Liabilities
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Accounting treatment of Accumulated Profits, Reserves and Losses through an Adjustment Entry

(i) In case of net accumulated profit

Gaining Partners' Capital/Current A/c Dr.

To Sacrificing Partners' Capital/Current A/c

(For adjustment entry is made for accumulated profits)

(ii) In case of net accumulated profit

Sacrificing Partners' Capital/Current A/c Dr.

To Gaining Partners' Capital/Current A/c

(For adjustment entry is made for accumulated losses)

Illustration

Nishant, Manish and Vishal are partners sharing profits and losses in the ratio of 6:3:1, decided to admit Bhavesh as a partner in the firm with effect from 1st April, 2018. The new profit sharing ratio of Nishant, Manish, Vishal and Bhavesh will be 3:3:3:1. They also decided to record the effect of the following without affecting their book values, by passing a single adjustment entry:-

	Book Value (Rs.)
General Reserve	1,80,000
Contingency Reserve	30,000
Profit and Loss A/c (Cr.)	90,000
Advertisement Suspense A/c (Dr.)	1,20,000

Pass necessary journal adjustment entry.

Step 1

Calculate the net effect of Accumulated Profits, Losses and Reserves:-

	Rs.
General Reserve	1,80,000
Add: Contingencies Reserves	30,000
Profit and Loss A/c (Cr.)	90,000
	3,00,000
Less: Advertisement Suspense A/c	1,20,000
Net Effect	**1,80,000**

Step 2

Calculate sacrificing or gain share of each partners:-

Old Ratio = 6:3:1

New Ratio = 3:3:3:1

$$Nishant = \frac{6}{10} - \frac{3}{10} = \frac{6-3}{10} = \frac{3}{10}\ (Sacrify)$$

$$Manish = \frac{3}{10} - \frac{3}{10} = \frac{3-3}{10} = \frac{0}{10}$$

$$Vishal = \frac{1}{10} - \frac{3}{10} = \frac{1-3}{10} = -\frac{2}{10} = \frac{2}{10}\ (Gain)$$

$$Bhavesh = \frac{1}{10}\ (Gain)$$

Step 3

Calculate share of Gaining partner and Sacrificing partner in the net effect of Accumulated Profits, Losses and Reserves:-

$$Nishant = 1,80,000 \times \frac{3}{10} = 54,000\ (Sacrify)$$

$$Vishal = 1,80,000 \times \frac{2}{10} = 36,000 (Gain)$$

$$Bhavesh = 1,80,000 \times \frac{1}{10} = 18,000 (Gain)$$

Step 4

Pass the adjustment entry:-

Particulars		Dr.	Cr.
Vishal’s Capital A/c	Dr.	3,600	
Bhavesh’s Capital A/c	Dr.	1,800	
To Nishant’s Capital A/c			5,400
(For adjustment entry is made for accumulated profits)			

Raman, Rahul are partners sharing profits in the ratio of 2:1. Their Balance Sheet as at 31st March, 2019 was as follows:

Liabilities		Rs.	Assets		Rs.
Creditors		1,60,000	Bank Balance		1,25,000
Salaries Payable		30,000	Bills Receivable		61,000
Reserves		80,000	Stock		2,00,000
Profit and Loss A/c		30,000	Sundry Debtors	1,00,000	
Capitals:-			Less: Provision	10,000	90,000
Raman	3,60,000		Furniture		50,000
Rahul	2,40,000	6,00,000	Computers		3,00,000
			Advertisement Suspense A/c		50,000
			Goodwill		24,000
		9,00,000			9,00,000

They admitted Ramesh as a new partner for 1/4th share. He brings in Rs. 2,00,000 as his capital. They agreed to the following:-

(i) Stock to be increased to Rs.2,20,000 and Furniture to be reduced by 20% and Computers to be reduced to Rs.2,70,000.

(ii) Provision for Doubtful Debts to be reduced by Rs.2,000.

(iii) Goodwill of the firm is valued at Rs.1,20,000.

(iv) They decided not to share Reserves, Credit balance of P &L A/c and Advertisement Suspense A/c.

Prepare Revaluation A/c, Partner's Capital A/c and revised Balance Sheet of the reconstituted firm.

Revaluation A/c

Particulars	Rs.	Particulars		Rs.
To Furniture	10,000	By Stock		20,000
To Computers	30,000	By Provision for D/D		2,000
		By Loss transferred to partners' capitals:-		
		Raman	12,000	
		Rahul	6,000	18,000
	40,000			40,000

Capital A/c

Particulars	Raman	Rahul	Ramesh	Particulars	Raman	Rahul	Ramesh
To Revaluation	12,000	6,000		By Balance b/d	3,60,000	2,40,000	
To Goodwill	16,000	8,000		By Ramesh's Cap	30,000	15,000	
To Raman's Cap.			30,000	By Bank A/c			2,00,000
To Rahul's Cap.			15,000				
To Balance c/d	3,62,000	2,41,000	1,55,000				
	3,90,000	2,55,000	2,00,000		3,90,000	2,55,000	2,00,000

Balance Sheet
As at 31st March, 2019

Liabilities		Rs.	Assets		Rs.
Creditors		1,60,000	Bank Balance		3,25,000
Salaries Payable		30,000	Bills Receivable		61,000
Reserves		80,000	Stock		2,20,000
Profit and Loss A/c		30,000	Sundry Debtors	1,00,000	
Capitals:-			Less: Provision	8,000	92,000
Raman	3,62,000		Furniture		40,000
Rahul	2,41,000		Computers		2,70,000
Ramesh	1,55,000	7,58,000	Advertisement Suspense A/c		50,000
		10,58,000			10,58,000
		=======			======

Working Note:-

$Old\ Ratio = 2:1$ $\quad\quad$ $Ramesh's\ share = \frac{1}{4}$

	Rs.
General Reserve	**80,000**
Add: New Goodwill	**1,20,000**
Profit and Loss A/c (Cr.)	**30,000**
	2,30,000
Less: Advertisement Suspense A/c	**50,000**
Net Effect	**1,80,000**

$$Ramesh's\ \text{share in Net Effect} = 1{,}80{,}000 \times \frac{1}{4} = Rs.\,45{,}000$$

$Rs.$ 45,000 will be shared by Raman and Rahul in their sacrificing ratio.

Journal Entry

Ramesh's Capital A/c Dr.	45,000	
To Raman's Capital A/c		30,000
To Rahul's Capital A/c		15,000

(For adjustment entry is made for Reserve, Profit & Loss A/c, Goodwill and Advertisement Suspense A/c)