ADMISSION OF A NEW PARTNER

Admission of a Partner means entry of a person in the firm as owner, as a result of this the number of members are increased. In other words, when a new person is admitted into partnership firm as an owner, it is called *Admission of New Partner*. According to *Section 31(1)* of Partnership Act 1932- *'A New Partner can be admitted into partnership firm with the consent of the existing Partners"*. When a Partner is admitted into Partnership firm, the firm gets reconstituted, as a result of this old relations among Partners come to an end and new relation comes to existence. After admission, he becomes responsible for all the acts committed by the firm but he is not responsible for the acts committed by the firm prior to his admission.

Need for Admission of a New Partner

A New Partner is admitted in firm for the following reasons:-

- When more capital is needed for the expansion of the business and existing partners considered themselves incapable to meet this requirement.
- When there is need for a competent and experienced person for the management and working for the firm.
- When the reputation of the firm is to be enhanced by admitting influential & reputed person into the firm.
- When it is considered desirable to admit any competent and dedicated employees as partner of the firm.

Effect of Admission of New Partner.

- After admission of a new partner there is change in existing relation of the partners, as a result of this the firm gets reconstituted.
- The number of partners increase in the firm.
- The capital base of firm also increases and the firm is in position to get the benefits of experienced person in management.
- The firm reputation is also enhanced by admitting influential and reputed person into the firm.
- New Partner acquires right of sharing in future profit of a firm as a result of this combined share of the old partners gets reduced and for this he is required to bring his share of goodwill.
- The New Partner acquires right of sharing in the assets of the firm and for this he brings the amount of Capital in Cash or in Kind.

Adjustment required on Admission of a New Partner.

- Computation of New Profit Sharing Ratio.
- Calculation of Sacrificing Ratio.
- Accounting treatment Goodwill (As Per AS- 26).
- Accounting treatment for Revaluation of Assets & Liabilities.
- Accounting treatment for Reserves, Accumulated Profits/Accumulated Losses.
- Adjustment of Capital.

Calculation of New Profit Sharing Ratio.

New Profit Sharing Ratio: After Admission of a New Partner, he gets a share of Profit from the firm for which old partners sacrifice from their existing shares. As a result of this, the profit sharing ratio of the old partners change. That's why, it becomes necessary to calculate the new profit sharing ratio. *The ratio in which all partners (including new partner) share the future profit or losses is called New Profit Sharing Ratio.*

New Share= Old Share- Sacrificed Share

New Profit Sharing Ratio is calculated in different ways in different conditions:

Case (i) When Share of New Partner is given: When the share of New Partner is given in question and no other information regarding Sacrifice of old Partners are given, in such a case it is assumed that old Partners will sacrifice in their old profit sharing ratio. Following steps are taken in this regard:

- First of all, total profit of the firm is assumed as 1.
- After that the share of new partner is deducted from 1. The remaining share are of old partners.
- Now, Remaining Shares are distributed among all the partners in their old profit sharing ratio. The obtained share is treated as new share of old partners.
- At last, New Profit Sharing Ratio is calculated.

Case (ii) When New Partner purchases his share from other partners in a Particular Ratio: In such a case, the new profit sharing ratio is calculated by deducting the sacrificed share of a partner from his existing share of profit i.e., from old Shares . The Remaining Share of old Partner will be their New Shares.

New Share of old Partners = Old Share- Sacrificing Share.

Case (iii) When the old Partners surrender a particular fraction of their shares in favour of New Partner: In such a case for calculation of new profit sharing ratio, the following steps are taken:

- First of all, Surrender Share of old Partners is calculated.
- After that, the Surrender Share is deducted from the Share of old Partners to find out their New Share.
  New Share of old Partners = Old Share- Sacrificing Share.
- At last, New Profit Sharing Ratio is calculated.

Note: *The Share of the New Partner will be equivalent to the total of Sacrificed Share.*

Case (iv) When the New Partner acquires his entire share from one Partner only:

In such case for calculating of New Profit Sharing Ratio the following steps are taken :-

- First of all, the Share of Sacrificing Partner is deducted from the share sacrificed for new partner. The Remaining Share of old Partners will be the New Share.

New Share of old Partners = Old Share- Sacrificing Share.

- The Share of other Partners will be as usual it means there will be no change.
- At last, New Profit Sharing Ratio is calculated.

Sacrificing Ratio: After admission of a New Partner, he gets a share of profit from the firm, this share of profit is sacrificed by old Partners. *The Ratio in which old Partners sacrifice their share of profit in favour of New Partner is known as Sacrificing Ratio.*

Sacrificing Ratio = Old ratio – New ratio.

Sacrificing Ratio is calculated essentially because the amount of Premium brought by new Partner is distributed among old Partners in their Sacrificing Ratio. So, those Partners who sacrifice for New Partner get share in goodwill and those partners who don't sacrifice for new partner they don't get share in goodwill.

Calculation of Sacrificing ratio: Sacrificing ratio is calculated in different ways according to different conditions:-

1. *When the Share of New Partner is given in question without mentioning the details of sacrifice made by old Partners*, in such a case it is assumed that old Partners sacrifice in their old Profit Sharing Ratio.

2. *When old ratio of the old Partners and new ratio of all Partners are given in question*, in such a case sacrificing ratio is calculated by applying the following formula.
   ***Sacrificing Ratio** = Old Ratio – New Ratio .*
3. *When Sacrificing Ratio is different from old Profit Sharing Ratio*, in such a case the Sacrificing Ratio will be calculated by applying following steps :-

- First of all, Sacrifice made by each Partner is calculated.
- After that Sacrificing ratio is calculated on the basis of share surrendered or sacrificed.

4. *When new partner acquires his share equally from old Partner*:- In such a case Sacrificing Ratio will be equally (1:1).

DIFFERENCE BETWEEN SACRIFICING RATIO AND NEW PROFIT SHARING RATIO

Sacrificing Ratio	New Profit Sharing Ratio
• Sacrificing Ratio is the ratio in which the old partners sacrifice/ surrender a share of profit in favour of a new partner.	• New Profit Sharing Ratio is the ratio in which all Partners (old + new) share the future profit of the firm.
• Sacrificing Ratio is required for the purpose of distributing the goodwill brought by the new Partner among the old Partner.	• New Profit Sharing Ratio is required for the purpose of distributing the future profit of the firm among all the Partners.
• Sacrificing Ratio = Old Ratio – New Ratio	• New Profit Sharing Ratio = Old Ratio – Sacrificing Ratio.
• This ratio is related to the old Partners.	• This ratio is related to all the Partners.

Accounting treatment of Goodwill (AS- 26) :-

When a new Partner is admitted into Partnership firm he brings the amount of capital in cash but besides capital, he is told to bring the amount of 'Premium for goodwill' also because he gets a share of profit in the firm.

When he brings the amount of capital, following journal entry is passed.

- **When amount of capital is brought by new partner in cash.**

Bank/Cash A/c- Dr.
To New partner's Capital A/c

(For amount of capital brought in Cash)

- **When amount of Capital brought in Assets.**

Cash in hand A/c- Dr.
Cash at bank A/c- Dr.
Stock A/c- Dr.
Debtors A/c- Dr.
Machinery A/c- Dr.
Furniture A/c- Dr.
To New Partner's Capital A/c

(For amount of capital brought by new Partner in assets.)

Note: As Goodwill of the firm is the result of efforts made by the existing partners in the past. Therefore, at the time of admission, as the new partner acquires in future profit of the firm he has to compensate to the existing partners (who have sacrificed their existing share of profit in the favour of new partner) in the form of goodwill or premium.

Methods of bringing the amount of goodwill by New Partner.

When a New Partner is admitted into Partnership Firm, he has to bring the amount of Premium for Goodwill besides Capital. The following are the different methods of bringing goodwill by New Partner:

Case (I) When the New Partner brings the amount of goodwill in cash and gives to old partners privately.

No Entry.

Case (II) When the New Partner brings the amount of goodwill in cash and gives to old partners. The old Partners distribute it in their Sacrificing Ratio and don't withdraw it.

(i) For bringing the amount of Premium for goodwill in cash.

Bank/Cash A/c- Dr.
To Premium for Goodwill A/c
(For amount of goodwill brought in cash)

(ii) For Distribution the amount of Premium for Goodwill.

Premium for Goodwill A/c- Dr.
To Sacrificing Partner's Capital A/c
(For amount of Premium for goodwill credited to old Partner's Capital A/c in Sacrificing Ratio.)

Case (III) When the New Partner brings the amount of goodwill in cash and old Partners distribute in their Sacrificing ratio and they withdraw it later on from firm.

- **For bringing the amount of Premium for goodwill in cash.**
  Bank/ Cash A/c- Dr.
  To Premium for Goodwill A/c
  (For amount of premium for goodwill brought in cash)
- **For Distribution of Goodwill.**
  Premium for Goodwill A/c Dr.
  To Sacrificing Partner's Capital A/c
  (For amount of Premium for goodwill credited to old Partner's Capital A/c in Sacrificing Ratio.)
- **For Withdrawal of the amount of Goodwill.**
  Old Partner's Capital A/c- Dr.
  To Bank/ Cash A/c
  (For amount of goodwill withdrawn by old Partners.)

Case (IV) When New Partner does not bring the amount of Premium for goodwill in cash: In such case adjustment entry is made for goodwill in books. **The following journal entry made in books:-**

New Partner's Current A/c- Dr.
(Share of New Partner in Goodwill)
To Sacrificing Partner's Capital A/c
(In Sacrificing Ratio)
(For Adjustment entry made for goodwill)

Case (V) When the New Partner brings a part of Goodwill in cash.

- **When goodwill is brought in cash**

  Bank/ Cash A/c- Dr.

  To Premium for goodwill A/c

  (For the amount of Premium for goodwill brought in cash)
- **Entry for the amount of goodwill not brought in cash**

  New Partner's Current A/c- Dr.

  To Sacrificing Partner's Capital A/c

  (In Sacrificing Ratio)

  (For the amount of Premium credited to old Partner's Capital A/c in Sacrificing Ratio.)

Case (VI) When Goodwill A/c already appears in the books of firm: In such case, this is called *Old Goodwill* and it is written off among old partners in their old Profit Sharing Ratio. The following journal entry is passed.

Old Partner's Capital A/c- Dr.

To Goodwill A/c

(For old goodwill written off in old Profit Sharing Ratio)

ACCOUNTING TREATMENT FOR GOODWILL AS PER *AS - 26*

Goodwill is an intangible assets. Accounting Standard -26 is related with accounting treatment of intangible asset. It specifies that goodwill can be recorded in the books of firm when some consideration in money or money's worth has been paid for it. It simply means that only purchased goodwill can be recorded in the books of the firm. So, at the time of admission, retirement and death of partner or in case of change in profit sharing among the existing partners, goodwill account can't be raised in the books of firm because it is not purchased goodwill and no consideration in money or money's worth is paid for it. So, when goodwill of firm is evaluated and the new partner doesn't bring his share of goodwill in cash, in such a case goodwill is adjusted through Partner's Capital A/c and for this purpose the following journal entry is made.

New Partner's Current A/c- Dr.

To Sacrificing Partner's Capital A/c

(For Adjustment entry made for goodwill)

ACCOUNTING TREATMENT OF REVALUATION OF ASSETS AND LIABILITIES

When a New Partner is admitted into partnership firm, the assets and liabilities of the firm are revalued. The reason is that, it may be possible that value of assets and liabilities may be more or less than their book value. A New Partner does not want to suffer a loss because of reduction in the value of assets and he doesn't want to get benefits by increase in the value of assets. For avoiding this conflict assets and liabilities are revalued. For this purpose a separate account is opened named Revaluation Account.

Revaluation A/c : In all the cases of reconstitution of firm, all the assets and liabilities are revalued, for this purpose Revaluation Account is opened. It is a *Nominal Account*. So, it is prepared on the same concept of Nominal Account. Increase in the value of assets and decrease in the value of liabilities are income for firm, so they are credited in this account and decrease in the value of assets and increase in value of liabilities are loss for the firm, so they are debited to this account. The balance of this account shows *Profit or Loss on Revaluation* which is transferred to Partner's Capital A/c in their old profit sharing ratio. This account is also known as *Profit and Loss Adjustment Account.*

Revaluation Account

Particulars	Amount	Particulars	Amount
To Sundry Assets A/c (*Net decrease in the value of Assets)* To Sundry Liabilities A/c (*Net increase in value of liability)* To Unrecorded liabilities (Liabilities not recorded in books) To Profit transferred to A's Capital/Current A/c …. B's Capital/Current A/c ….	……….. ………. ………. ……….. **………..**	By Sundry Assets A/c (*Net increase in value of assets*) By Sundry Liabilities A/c (*Net decrease in the value of liability)* By Unrecorded Assets (Assets not recorded in books) By Loss transferred to A's Capital/Current A/c …. B's Capital/Current A/c ….	……….. ……….. ………. ……….. ……….. **……….**

Old Partner's Capital Account

Particulars	Amounts	Particulars	Amounts
To Revaluation A/c (*Share in Revaluation Loss*) To Profit & Loss A/c (Dr.) (*Share in Accumulated loss*) To Bank/ Cash A/c (*Goodwill withdrawn*) To Goodwill A/C (Share in old goodwill W/O) To Balance c/d (Surplus)	……….. ………... ……….. ……….. ………..	By Balance b/d *(Opening balance of Capital)* By Revaluation A/c *(Share in Revaluation Profit)* By Reserve Fund *(Share in reserve fund)* By Premium for goodwill *(Share in Goodwill)* By New Partner's Current A/C *(Share in goodwill not brought in cash)* By Profit and Loss A/c (Cr.) *(Share in Accumulated Profit)*	……….. ……….. ………. ……….. ……….. ………..
	……….		**………..**

Hidden Goodwill: Sometimes amount of goodwill is not given in question clearly, but it has to be calculated on the basis of new partner's capital and his share of profit given to him. Thus, when the value of goodwill is calculated on the basis of capital which is contributed by new partner and his share of profit in the firm, it is called *hidden goodwill.* This goodwill is also known as undisclosed goodwill or inferred goodwill.

The following steps are taken to calculate the amount of hidden goodwill.

- First of all, *Total Capital of New firm* is calculated on the basis of *New Partner's Capital and his Share of Profit.*
  *Thus, **New Capital of firm** = New Partner's Capital x Reverse Share of New Partner*
- After that, Total Capital of the firm is ascertained.
  *Thus, **Total Capital of firm** = Adjusted Capital of old Partners + Capital of New Partner*
- At last, goodwill is calculated by deducting the Amount of total Capital of firm from New Capital of firm.

*Thus, **Goodwill** = New Capital of firm – Total Capital of firm.*

Adjustment of Capital

When a New Partner is admitted into partnership firm the capital of firm is re-adjusted. After re-adjustment of capital, it is known that whether the capital of Partners in firm is sufficient or not. Generally there are two methods for Adjustment of Capital.

A. Adjustment of Capital of Old Partner's on the basis of New Partner's Capital.

B. Adjustment of Capital of New Partner's on the basis of old Partner's Capital.

(A) Adjustment of Capital of Old Partner on the basis of New Partner's Capital:

When the Capital of old Partner is adjusted on the basis of New Partner's Capital, the following steps are taken:-

Case (I) First of all, New Capital of firm is ascertained on the basis of New Partner's Capital and his share of profit is given**.**

Total Capital of firm = Capital of New Partner X Reverse ratio of share of New Partner.

Case (II) After that New Capital of firm is distributed among all the Partners (old + new) in their New Profit Sharing Ratio, the obtained amount is known as New Capital of old Partners.

Note :- ***If the information regarding sacrifice of Old Partners in the question is given then, new capital of firm will be divided in New Ratio. Otherwise, if the information of sacrifice of Old Partners are not given, in such a case New Partner's Capital A/c will be deducted from the New Capital of the firm and balance amount will be distributed among Old Partners in their old profit sharing ratio. The obtained amount will be the New Capital of Old Partners.***

Case (III) After that Adjusted Capital of Old Partner's is calculated.

OLD PARTNER'S CAPITAL A/C

Particulars	A	B	Particulars	A	B
To Revaluation A/c *(Share in Revaluation loss)*	....	....	By Balance b/d	....	....
			By Reserve Fund (Share in reserve fund)	....	....
To Goodwill A/c *(Old Goodwill W/O)*	....	....	By Revaluation A/c *(Share in Revaluation profit)*	....	....
To Profit & Loss A/c (Dr.) *(Share in Accumulated loss)*	....	....	By Premium for Goodwill *(Share in Goodwill)*	....	....
To Balance c/d *(Adjusted Capital)*	....	....	By Profit & Loss A/c (Cr.) *(Share in Profit)*	....	....
	....	....		....	....
To Bank A/c (Surplus) Or, Current Account A/c	....	....	By Balance b/d	....	....
To Balance c/d	....	....	By Bank A/c (Deficit) Or Current A/c	....	....
	....	....		....	....

Case (IV) *At last, Surplus or deficiency is found out by deducting the Amount of Adjusted Capital from New Capital of old Partners. So, if the amount New Capital is less than Adjusted Capital then, it will be Surplus and Refunded to Partners***.**

Following Journal entry is passed:

Old Partner's Capital A/c- *Dr.*
To Bank A/c Or Current Account A/C
(For excess amount refunded to Old Partner or transferred to Current A/c)

But, if the Amount of New Capital is more than that of Adjusted Capital, the difference amount will be treated as deficiency and it is brought by Old Partner.

Following Journal entry is passed:

Bank A/c Or Current A/C- *Dr.*
To Old Partner's Capital A/c
(For amount brought by Old Partners)

Case(V) *At last, New balance of Cash is found out before preparing Balance Sheet and it is ascertained as follow:-*

Calculation of Cash Balance

Opening balance of Cash	……..
Add:- Amount brought by New Partner as goodwill and Capital	……..
Amount brought by Old Partners (if any)	…......
Less:- Amount withdrawn by Old Partners	..……...
Cash Balance	**……**

(B) Adjustment of Capital of New Partner on the basis of Old Partner's Capital.

If the amount of Capital of New Partner is not given in question, in such a case the amount of Capital of New Partner's is adjusted on the basis of Old Partner's Capital. The following steps are taken in this regard:

(i) **First of all, Adjusted Capital of Old Partner is calculated:**

Calculation of Adjusted Capital

	A	B
Opening Balance	....	....
Add:- Share in Reserve fund	....	....
Share in Premium for goodwill A/c	....	....
Share in Revaluation Profit	....	....
Share in Profit & Loss A/c (Cr.)	....	....
Less:- Share in Revaluation Loss	....	....
Share in Profit & Loss A/c (Dr.)	....	....
Share in Old Goodwill written off	....	....
Net Adjusted Capital	_..............	_..............

Old Partner's Capital A/c

Particulars	Amount	Particulars	Amount
To Revaluation A/c (Share in Revaluation loss)	…………	By Balance b/d (Opening Capital)	………
To Goodwill A/c (Share in old goodwill)	………	By Reserve fund (Share in Reserve fund)	……….
To Profit & Loss A/c (Dr.) (Share in Accumulated loss)	………	By Premium for Goodwill A/c (Share in Goodwill)	……….
To Balance c/d *(Net Adjusted Capital)*	……….	By New Partner's Capital A/c (Share in goodwill not brought in cash by New Partner)	..…….. ………
		By Revaluation A/c (Share in Revaluation Profit)	………
		By Profit & Loss A/c (Cr.) (Share in Accumulated Profit)	……….
	……….		**………**
To Bank/ Cash A/c Or Current Account *(Surplus)*	………	By Balance b/d	………
To Balance c/d (New Capital)	**………..**	By Bank/Cash A/C Or Current A/c *(Deficit Amount)*	……….
	………		**……….**

(ii) After calculation of Adjusted Capital of Old Partners they are totaled and thus we get *Combined Capital of old Partners.*

(iii) At last, New Partner's Capital is calculated on the basis of Combined Capital of Partners. But before this the following two important points should be considered.

(a) If, it is given in question clearly that Capital of New Partner will be ascertained at certain percent or a certain portion of *Combined Capital of Old Partners*, in such a case Capital of New Partner will be calculated by applying the following formula.

New Partner's Capital = Combined Capital of Old Partners x Share of New Partner.

(b) But, if it is given in question that New Partner's Capital will be Proportionate Capital of Old Partner, in such case following steps are taken:

(i) First of all, New Capital of firm is calculated by applying the following formula.

New Capital of firm *= Combined Capital of old Partners x Reverse Share Ratio of Remaining Partner's Share.*

(ii) After calculation of New Capital of firm, Capital of New Partner is calculated.

New Partner's Capital *= New Capital of firm* ***X*** *Share of New Partner*.

Note: Adjustment of Surplus or Deficiency through Partner's Current Account:-Sometimes it is clearly mentioned in question that Surplus or Deficiency in Partner's Capital Account will be adjusted through Partner's Current Account. In that case, in place of *"Cash or Bank Account"* the term "Current Account" will be used. The following Journal entry will be passed.

(a) If the amount of Adjusted Capital is less than the New Capital or in case of Deficiency.

Partner's Current A/c *Dr.*
To Partner's Capital A/c
(For deficiency adjusted through Partner's Current A/c)

(b) If the amount of Adjusted Capital is more than the New Capital or in case of Surplus.

Partner's Capital A/c *Dr.*
To Partner's Current A/c
(For surplus adjusted through Partner's Current A/c)

Notes:
1. ***If Current Account shows Credit balance, it will be shown in Liabilities Side of Balance Sheet.***
2. ***If Current Account shows Debit balance, it will be shown in Assets Side of Balance Sheet.***
3. ***In the absence of any agreement, Surplus or Deficiency should be adjusted through Cash or Bank Account and not through Current Account.***

Memorandum Revaluation Account

When New Partner is admitted into partnership firm, the Assets & Liabilities of firm are revalued. The results (Profit or Loss) of this account is transferred to Partner's Capital Account in old profit sharing ratio. Sometimes, Partners decide to revalue the assets and liabilities of firm but they don't want to show its effect in revised balance sheet. In such a case *memorandum revaluation A/c* is prepared. Memorandum Revaluation A/c is divided into two parts:-

First Part **:-** In the first part, the increase & decrease in the value of assets & liabilities are recorded. So, this part is similar to Revaluation Account. So, Profits or losses from this A/c is transferred to Partner's Capital A/c in their old profit sharing ratio.

Second Part **:-** In second part, all entries made in the first part of this account is reversed. It means those entries which are made in Dr. side of Revaluation Account are shown in Cr side of Memorandum Revaluation Account and those entries which are made in Cr side of Revaluation Account are shown in Dr. side of Memorandum Revaluation Account. Balance of this Account (i.e., Profits or Losses) is transferred

Memorandum Revaluation Account

Particulars	Amount	Particulars	Amount
To Stock A/c	……….	By Plant A/c (Increase in value of Assets)	……….
To Furniture A/c	……….	By Creditors A/c (decrease in value of Liabilities)	……….
To Building A/c	………		
To Debtors A/c (decrease in value of Assets)	………		
To Profit transferred to Capital A/c			
A's Capital A/c ……			
B's Capital A/c ………	……….		
	…………….		……….
To Plant A/c	……….	By Stock A/c	……….
To Creditors A/c	…………	By Furniture A/c	……….
		By Building A/c	…………
		By Debtors A/c	………
		By Loss transferred to	……….
		A's Capital A/c …….	
		B's Capital A/c …….	……….
	………..		……….

DIFFERENCE BETWEEN REVALUATION AND MEMORANDUM OF REVALUATION ACCOUNT

Revaluation Account	Memorandum Revaluation Account
• It is prepared to record the effect of revaluation of assets & liabilities and the revised value is shown in balance sheet.	• It is prepared to record the effect of revaluation of assets & liabilities and shown at their old value but not revised value.
• It is not divided into two parts.	• It is divided into two parts. So, items of first part are reverse in the second part.
• The profit and loss shown by revaluation account is transferred to Partner's Capital Account in their old Profit Sharing Ratio.	• The profit or loss shown by the second part is transferred to all Partner's Capital Account in their New Profit Sharing Ratio.