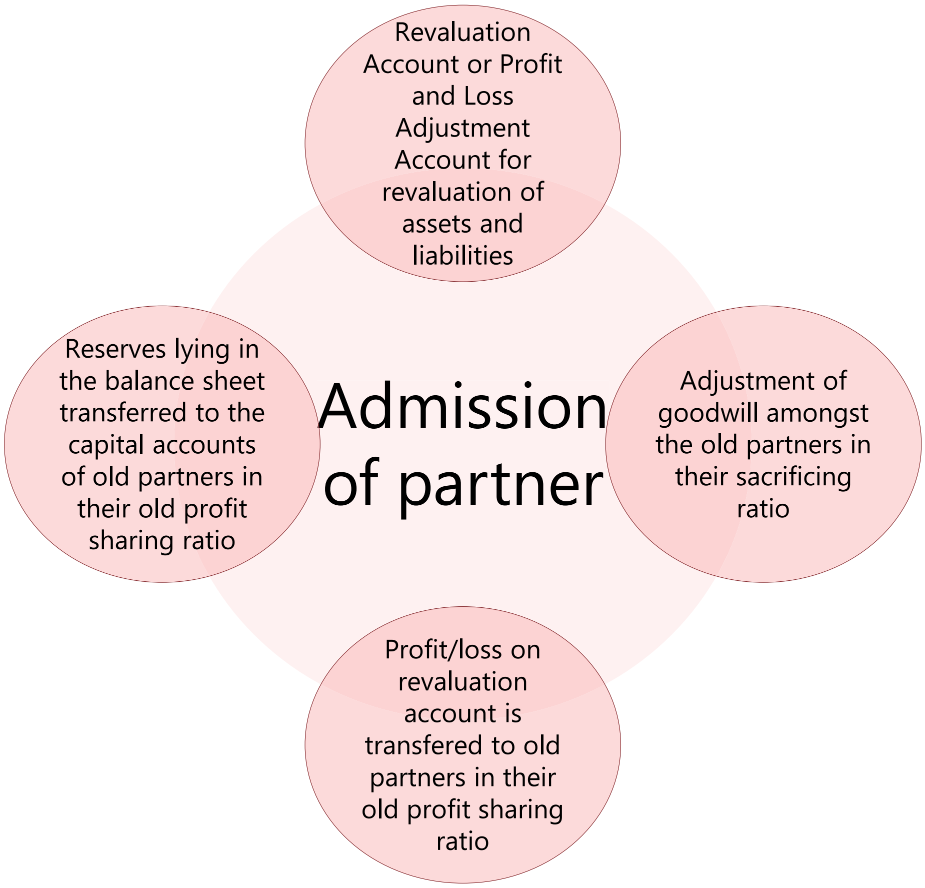
UNIT – 3: ADMISSION OF A NEW PARTNER

LEARNING OUTCOMES

After studying this unit, you would be able to:

- Understand the reasons for which revaluation of assets and re computation of liabilities is required in case of admission of a new partner. Also understand the logic of revaluation of assets and re computation of liabilities at the time of admission of a partner.
- Learn the accounting treatments under two circumstances:
  - (a) When revalued assets and recomputed liabilities are shown in the Balance Sheet, and
  - (b) When revalued assets and recomputed liabilities are not shown in the Balance Sheet.
- Learn the technique of treating reserve balance on admission of a partner.
- See the technique of arriving at new profit-sharing ratio.
- Observe the technique of inferring goodwill although figure of goodwill is not mentioned clearly.

UNIT OVERVIEW



3.1 INTRODUCTION

New partners are admitted for the benefit of the partnership firm. New partner is admitted either for increasing the partnership capital or for strengthening the management of the firm. When a new partner joins a firm, it is desirable to bring all appreciation or reduction in the value of assets into accounts as on the date of admission. Similarly, if the books contain any liability which has not been paid or if the books do not contain a liability which has to be paid, suitable entries should be passed. The purpose of such entries is to make an updated Balance Sheet on the date of admission. Also, all profits which have accrued but not yet brought into books and similarly, all losses which have occurred but not recorded, should now be brought into books so that the Capital Accounts of the old partners reflect the proper figure. As a result of passing of such entries, any subsequent profits or losses will be automatically shared by the incoming partner along with old partners.

Also the value of goodwill is to be assessed and proper accounting treatment is required to bring the value of goodwill into books of accounts. Treatment for goodwill has already been discussed in unit 2 of this chapter.

3.2 REVALUATION ACCOUNT OR PROFIT AND LOSS ADJUSTMENT ACCOUNT

When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in the value of assets and decrease in the value of liabilities. The difference in two sides of the account will show profit or loss. This is transferred to the Capital Accounts of old partners in the old profit sharing ratio. The entries to be passed are:

1.	Revaluation Account	Dr.	
	To Assets Account (individually which show a decrease)		with the reduction in the value of the assets
	To the Liabilities Accounts (Individually which have to be increased)		with the increase in the liabilities.
2.	Assets Account (Individually)	Dr.	with the increase in the value of the of assets.
	Liabilities Accounts	Dr.	with the reduction in the amount liabilities.
	To Revaluation Account		
3.	Revaluation Account	Dr.	with the profit in the old profit sharing ratio.
	To Capital A/cs of the old partners		
	or		
	Capital A/cs of the old partners	Dr.	with the loss in old profit sharing ratio.
	To Revaluation Account		

As a result of the above entries, the capital account balances of the old partners will change and the assets and liabilities will have to be adjusted to their proper values. They will now appear in the Balance Sheet at revised figures.

When the revised values are not to be Recognised in the books

Sometimes all the partners including the new partner may agree to keep the assets and liabilities at the old values even when they agree to revalue them. To record these, a Memorandum Revaluation Account is opened. This account is divided into two parts.

(a) In the first part the entries for the revaluation of assets and liabilities are made in the usual way as explained earlier. No record for the revaluation of assets and liabilities is made through the respective ledger accounts. The resultant profit or loss on revaluation in the first part of this account is transferred to the capital accounts of old partners only in the old profit and loss sharing ratio.

(b) In order to complete the double entry, entries made in the first part of Memorandum Revaluation Account are reversed in the second part so that the values of the assets and liabilities remain unchanged. The balance of the second part is transferred to the capital accounts of all the partners including new partner in their new profit and loss sharing ratio. Thus if there is a profit in the first part there will be a loss of the same amount in the second part. The only point to be remembered is that the result of the first part of Memorandum Revaluation Account is shared by old partners in the old profit sharing ratio, while the result of the second part is shared by all partners including the new one in the new profit sharing ratio.

Alternatively, the partners may agree that revalued figures will not be shown in the Balance Sheet and Assets and liabilities would appear in the Balance Sheet at their old values.

In this case, Memorandum Revaluation Account is opened. Any increase in the value of assets and/or decrease in the liabilities is credited to Memorandum Revaluation Account. The journal entry will be:

Assets Accounts	Dr.	(with increase in the value of individual assets)
Liabilities Accounts	Dr.	(With decrease in the value of individual liabilities)
To Memorandum Revaluation Account		

Similarly, any decrease in the value of assets and/or increase in the liabilities is debited to Memorandum Revaluation Account. The journal entry will be:

Memorandum Revaluation Account	Dr.	
To Assets Accounts		(with increase in the value of individual assets)
To Liabilities Accounts		(with decrease in the value of individual liabilities)

If the credit side of the Memorandum Revaluation Account is more than the debit side, there is a profit. This profit should be transferred to old Partner's Capital Accounts in the old profit sharing ratio. The journal entry will be:

Memorandum Revaluation Account	Dr.	
To Old Partners' Capital Accounts		

If the debit side of the Memorandum Revaluation Account is more than the credit side, there is a loss which is transferred to old Partner's Capital Accounts in the old profit sharing ratio. The journal entry will:

Old Partners' Capital Accounts	Dr.	
To Memorandum Revaluation Account		

After completing the above procedure, reverse entries are made for increase in the values of assets and/or decrease in the liabilities, and decrease in the values of assets and/or increase in the liabilities) in the later portion of the Memorandum Revaluation Account. The profit on revaluation is to be transferred to all Partners' Capital Accounts in the new profit sharing ratio. The journey entry will be:

Memorandum Revolution Account	Dr.	
To All Partners' Capital Accounts		(New profit and loss sharing ratio)

The loss on revaluation should be transferred to all Partners' Capital Accounts in the new profit sharing ratio. The journal entry will be:

All Partners' Capital Accounts	Dr.	(New profit and loss sharing ratio)
To Memorandum Revaluation Account		

It should be noted that if there is a profit in the first half of the Memorandum Revaluation Account, the later half of the Memorandum Revaluation Account must show a loss. Conversely, if the first half of the Memorandum Revaluation Account shows a loss, the later half of the Memorandum Revaluation Account must show a profit.

When a Memorandum Revaluation Account is prepared, the book values of assets and liabilities do not change. In effect, the resultant profit or loss on revaluation is adjusted through the Partners' Capital Accounts. In this way, the amount invested as a capital by the incoming partner may be set at a level that reflects the current fair value of the partnership, even though the book values of assets and liabilities of the existing partnership remain unchanged in the books of accounts.

In case partners desire to disclose assets and liabilities in the balance sheet at old figures without opening Revaluation account then the change (i.e. increase or decrease) in the value of assets and liabilities may be adjusted through Partners' Capital Accounts directly.

Difference between Revaluation Account and Memorandum Revaluation Account

1. Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities which of course are recorded at their old figures in the new balance sheet.

2. Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

3. The net result of revaluation of assets and liabilities in the revaluation account is transferred to old partners' capital accounts in the old profit sharing ratio. In the case of memorandum revaluation account the first part is used to record the changes in the values of assets and liabilities due to revaluation and in the second part the effect of the first part is cancelled. The balance of the first part is transferred to old partner's capital accounts in the old profit sharing ratio while the balance of the second part is transferred to all partners including the new partner in the new profit sharing ratio.

ILLUSTRATION 1

The following is the Balance Sheet of Ram and Mohan, who share profits in the ratio of 3:2 as on 1st January, 20222:

Liabilities	₹	*Assets*	₹
Trade payables	*15,000*	*Buildings*	*18,000*
Ram's Capital	*20,000*	*Plant and Machinery*	*15,000*
Mohan's Capital	*25,000*	*Inventories*	*12,000*
		Trade receivables	*10,000*
		Bank	*5,000*
	60,000		*60,000*

On this date Shyam was admitted on the following:

1. *He is to pay ₹ 25,000 as his capital and ₹ 10,000 as his share of goodwill for one fifth share in profits.*

2. *The new profits sharing ratio will be 5:3:2.*

3. *The assets are to be revalued as under:*

	₹
Building	*25,000*
Plant and Machinery	*12,000*
Inventories	*12,000*
Trade receivables (because of doubtful debts)	*9,500*

4. *It was found that there was a liability for ₹ 1,500 for goods received but not recorded in books.*

Give journal entries to record the above. Also, give the Balance Sheet of the partnership firm after Shyam's admission.

SOLUTION

Journal Entries

2022			**Dr. (₹)**	**Cr. (₹)**
Jan. 1	Bank Account	Dr.	35,000	
	To Shyam's Capital Account			35,000
	(Being amount brought in by Shyam for capital and goodwill)			
	Shyam's Capital Account	Dr.	10,000	
	To Ram's Capital Account			5,000
	To Mohan's Capital Account			5,000
	(Being Shyam's share of goodwill adjusted to existing partners' capital accounts in the profit sacrificing ratio 1:1)			
	Revaluation Account	Dr.	5,000	
	To Plant and Machinery Account			3,000
	To Provisions for Doubtful Debts Account			500
	To Trade payables Account			1,500
	(Being recording of the reduction in the value of assets and the liability which had been previously omitted)			
	Building Account	Dr.	7,000	
	To Revaluation Account			7,000
	(Being increase in the value of building brought into account)			

	Revaluation Account Dr.	2,000	
	To Ram's Capital Account		1,200
	To Mohan's Capital Account		800
	(Being profit on revaluation credited to Ram and Mohan in the old profit sharing ratio)		

Working Note:

Profit sacrificing ratio:

Ram = 3/5 - 1/2 = 1/10

Mohan = 2/5 - 3/10 = 1/10

Balance Sheet of Ram, Mohan and Shyam as at January 1, 2022

Liabilities	₹	₹	**Assets**	₹	₹
Trade payables		16,500	Buildings		25,000
Capital Accounts :			Plant and Machinery		12,000
Ram	26,200		Inventories		12,000
Mohan	30,800		Trade receivables	10,000	
Shyam	25,000	82,000	*Less* : Provision for		
			Doubtful Debts	(500)	9,500
			Bank		40,000
		98,500			98,500

ILLUSTRATION 2

A and B are partners sharing profits and losses in the ratio of 3:2. Their Balance Sheet as on 31.3.2022 is given below:

Liabilities	₹	***Assets***	₹
Trade payables	*50,000*	*Freehold premises*	*2,00,000*
Capital Accounts:		*Plant*	*40,000*
A	*2,00,000*	*Furniture*	*20,000*
B	*1,00,000*	*Office equipment*	*25,000*
		Inventories	*30,000*
		Trade receivables	*25,000*
		Bank	*10,000*
	3,50,000		*3,50,000*

On 1.4.2022 they admit C on the following terms:

(1) C will bring ₹ 50,000 as a capital and ₹ 10,000 for goodwill for 1/5 share;

(2) Provision for doubtful debts is to be made on Trade receivables @ 2%

(3) Inventory to be written down by 10%.

(4) Freehold premises is to be revalued at ₹ 2,40,000, plant at ₹ 35,000, furniture ₹ 25,000 and office equipment ₹ 27,500.

(5) Partners agreed that the values of the assets and liabilities remain the same and, as such, there should not be any change in their book values as a result of the above mentioned adjustments.

You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

SOLUTION

Memorandum Revaluation Account

	Particulars	₹		Particulars	₹
To	Provision for Bad Debts A/c	500	By	Freehold premises A/c	40,000
To	Inventory A/c	3,000	By	Furniture A/c	5,000
To	Plant A/c	5,000	By	Office equipment A/c	2,500
To	Profit on Revaluation A/c				
	A's Capital-3/5	23,400			
	B's Capital-2/5	15,600			
		47,500			47,500
To	Freehold premises A/c	40,000	By	Provision for Bad Debts A/c	500
To	Furniture A/c	5,000	By	Inventory A/c	3,000
To	Office equipment A/c	2,500	By	Plant A/c	5,000
				Loss on Revaluation A/c	
				A's Capital -12/25	18,720
				B's Capital-8/25	12,480
				C's Capital-5/25	7,800
		47,500			47,500

Partners' Capital Accounts

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To A's Capital A/c			6,000	By Balance b/d	2,00,000	1,00,000	-
To B's Capital A/c			4,000				
To Loss on revaluation A/c	18,720	12,480	7,800	By Bank A/c			60,000
To Balance c/d	2,10,680	1,07,120	42,200	By C's Capital A/c	6,000	4,000	-
				By Profit on revaluation A/c	23,400	15,600	-
	2,29,400	1,19,600	60,000		2,29,400	1,19,600	60,000

Note: Amount brought in by new partner shall be distributed among the old partner's in their profit sacrificing ratio, which is same as old profit sharing ratio in this case.

Balance Sheet as at April 1,2022

Liabilities	₹	Assets	₹
Trade payables	50,000	Freehold premises	2,00,000
		Plant	40,000
Capital A/c:		Furniture	20,000
A	2,10,680	Office equipment	25,000
B	1,07,120	Inventories	30,000
C	42,200	Trade receivables	25,000
		Bank	70,000
	4,10,000		4,10,000

ILLUSTRATION 3

A and B are partners in a firm, sharing profits and losses in the ratio of 3:2. The Balance Sheet of A and B as on 1.1.2022 was as follows:

Liabilities	₹	***Amount*** ₹	***Assets***	₹	***Amount*** ₹
Trade payables		*17,000*	*Building*		*26,000*
			Furniture		*5,800*
Bank overdraft		*9,000*	*Inventories*		*21,400*

Capital accounts:			*Trade receivables*	*35,000*	
A	*44,000*		*Less: Provision*	*(200)*	*34,800*
B	*36,000*	*80,000*	*Investment*		*2,500*
			Cash		*15,500*
		1,06,000			*1,06,000*

'C' was admitted to the firm on the above date on the following terms:

(i) C is admitted for 1/6 share in the future profits and to introduce a capital of ₹ 25,000.

(ii) The new profit sharing ratio of A, B and C will be 3:2:1 respectively.

(iii) 'C' is unable to bring in cash for his share of goodwill, they decide to calculate goodwill on the basis of C's share in the profits and the capital contribution made by him to the firm.

(iv) Furniture is to be written down by ₹ 870 and Inventory to be depreciated by 5%. A provision is required for trade receivables @ 5% for bad debts. A provision would also be made for outstanding wages for ₹ 1,560. The value of buildings having appreciated be brought upto ₹ 29,200. The value of investments is increased by ₹ 450.

(v) It is found that the trade payables included a sum of ₹ 1,400, which is not to be paid off.

Prepare the following:

(i) Revaluation account.

(ii) Partners' capital accounts.

SOLUTION

Revaluation Account

		₹			₹
To	Furniture	870	By	Building	3,200
To	Inventory	1,070	By	Trade payables	1,400
To	Provision for doubtful debts		By	Investment	450
	(₹ 1,750 – ₹ 200)	1,550			
To	Outstanding wages	1,560			
		5,050			5,050

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To A			4,500	By Balance b/d	44,000	36,000	–
To B			3,000	By Cash A/c	–	–	25,000
To Balance c/d	48,500	39,000	17,500	By C (working note 2)	4,500	3,000	–
	48,500	39,000	25,000		48,500	39,000	25,000

Working Notes:

1. Calculation of goodwill:

   C's contribution of ₹ 25,000 consists of only 1/6th of capital.

   Therefore, total capital of firm should be ₹ 25,000 x 6 = ₹ 1,50,000

   But combined capital of A, B and C amounts ₹ 44,000 + 36,000 + 25,000 = ₹ 1,05,000

   Thus, the hidden goodwill of the firm is ₹ 45,000 (₹ 1,50,000- ₹ 1,05,000).

   C's share 1/6th = 7,500

   Goodwill will be shared by A & B in their sacrificing ratio.

2. Calculation of sacrificing ratio

Partners	New share	Old share	Sacrifice	Gain
A	$\frac{3}{6}$	$\frac{3}{5}$	$\frac{-3}{30}$	-
B	$\frac{2}{6}$	$\frac{2}{5}$	$\frac{-2}{30}$	-
C	$\frac{1}{6}$	-	-	$\frac{1}{6}$

Therefore, A will get = ₹ 45,000 × $\frac{3}{30}$ = ₹ 4,500;

B will get = ₹ 45,000 × $\frac{2}{30}$ = ₹ 3,000; and

C will be debited on account of goodwill = ₹ 45,000 × $\frac{1}{6}$ = ₹ 7,500

3.3 RESERVES IN THE BALANCE SHEET

Whenever a new partner is admitted, any reserve etc. appearing in the Balance Sheet should be transferred to the Capital Accounts of the old partners in the old profit sharing ratio.

The necessary journal entry would be:

Debit: Reserves or Profit and Loss Account

Credit: Old Partners' Capital Accounts (In the old profit sharing ratio)

ILLUSTRATION 4

Dalal, Banerji and Mallick are partners in a firm sharing profits and losses in the ratio 2:2:1. Their Balance Sheet as on 31st March, 2022 is as below:

Liabilities		₹	***Assets***	₹
Trade payables		*12,850*	*Land and Buildings*	*25,000*
Outstanding Liabilities		*1,500*	*Furniture*	*6,500*
General Reserve		*6,500*	*Inventory of goods*	*11,750*
Capital Account :			*Trade receivables*	*5,500*
Mr. Dalal	*12,000*		*Cash in hand*	*140*
Mr. Banerji	*12,000*		*Cash at Bank*	*960*
Mr. Mallick	*5,000*	*29,000*		
		49,850		*49,850*

The partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2022 on the following terms:

(1) Mr. Mistri shall bring ₹ 5,000 towards his capital.

(2) The value of Inventory should be increased by ₹ 2,500 and Furniture should be depreciated by 10%.

(3) Reserve for bad and doubtful debts should be provided at 10% of the Trade receivables.

(4) The value of land and buildings should be enhanced by 20%.

(5) The value of the goodwill be fixed at ₹ 15,000.

(6) General Reserve will be transferred to the Partners' Capital Accounts.

(7) The new profit sharing ratio shall be: Mr. Dalal 5/15, Mr. Banerji 5/15, Mr. Mallick 3/15 and Mr. Mistri 2/15.

The outstanding liabilities include ₹ 1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books.

Prepare (i) Revaluation Account, (ii) The Capital Accounts of the partners, (iii) Balance Sheet of the firm after admission of Mr. Mistri.

SOLUTION

Revaluation Account

2022			₹	2022		₹
April 1	To Provision for bad and doubtful debts		550	April 1	By Inventory in trade	2,500
	To Furniture and fittings		650		By Land and Building	5,000
	To Capital A/cs: (Profit on revaluation transferred)					
	Dalal	2,520				
	Banerji	2,520				
	Mallick	1,260	6,300			
			7,500			7,500

Partners' Capital Accounts

Particulars	Dalal	Banerji	Mallick	Mistri	Particulars	Dalal	Benerji	Mallick	Mistri
	₹	₹	₹	₹		₹	₹	₹	₹
To Dalal				1,000	By Balance b/d	12,000	12,000	5,000	–
To Banerji				1,000	By General Reserve	2,600	2,600	1,300	
To Balance c/d	19,120	18,120	7,560	3,000	By Cash	–	–	–	5,000
					By Mistri	1,000	1,000	–	–
					By Outstanding Liabilities	1,000	–	–	
					By Revaluation A/c	2,520	2,520	1,260	–
	19,120	18,120	7,560	5,000		19,120	18,120	7,560	5,000

Working Note:

Calculation of sacrificing ratio

Partners	New share	Old share	Sacrifice	Gain
Dalal	$\frac{5}{15}$	$\frac{2}{5}$	$-\frac{1}{15}$	
Banerji	$\frac{5}{15}$	$\frac{2}{5}$	$-\frac{1}{15}$	
Mallick	$\frac{3}{15}$	$\frac{1}{5}$	No gain No loss	—
Mistri	$\frac{2}{15}$			$\frac{2}{15}$

Sacrifice by Mr. Dalal and Mr. Banerji= ₹ 15,000× $\frac{1}{15}$ = ₹ 1,000 each

Balance Sheet of M/s. Dalal, Banerji, Mallick and Mistri as on April 1, 2022

Liabilities		₹	Assets		₹
Trade payables		12,850	Land and Buildings		30,000
Outstanding Liabilities		500	Furniture		5,850
Capital Accounts of Partners :			Inventory of goods		14,250
Mr. Dalal	19,120		Trade receivables	5,500	
Mr. Banerji	18,120		*Less* : Provisions	(550)	4,950
Mr. Mallick	7,560		Cash in hand		140
Mr. Mistri	3,000	47,800	Cash at Bank		5,960
		61,150			61,150

3.4 COMPUTATION OF NEW PROFIT SHARING RATIO

When a new partner is admitted and there is no agreement to the contrary, it is supposed that old partners will continue to have inter se at the old profit sharing ratio.

For example, A and B are in partnership sharing profits and losses at the ratio of 3:2. They admitted C as 1/5 partner. For computation of new profit sharing ratio.

(i) Firstly, deduct the share offered to new partner from 1.

1 – 1/5 = 4/5

(ii) Divide the balance of share between A and B in the ratio of 3:2.

A = 4/5 x 3/5 = 12/25

B = 4/5 × 2/5 = 8/25

(iii) New profit sharing ratio is

	A	:	B	:	C
	12/25	:	8/25	:	1/5
or	12/25	:	8/25	:	5/25
	i.e. 12:8		: 5		

Computation of New profit sharing ratio- Cases

Case I: When new partner's share is given but the question is silent about the sacrifice made by the old partners: In this case it is assumed that the old partner will share the remaining share in their old profit sharing ratio.

Example: A and B are partners sharing profits in the ratio 3:2. They admit C for 1/3 share in future profits. Calculate the new ratio.

Solution

Share in Firm = 1

C's Share = 1/3

Remaining Profit = 1 - 1/3 = 2/3

This remaining share of 2/3 is divided between A and B in the ratio 3:2

So A's share = 2/3 × 3/5 = 6/15

B's share = 2/3 × 2/5 = 4/15

C's share = 1/3 × 5/5 = 5/15

New ratio = 6/15: 4/15: 5/15 = 6:4:5

Case II: When new partner purchases his share from old partner's in a particular ratio: In this case the new ratio of the old partners will be calculated by deducted the proportion given to the new partner from the shares of old partner.

Example: A and B are partners sharing in the ratio 3:2. They admit C as a new partner for 1/3rd share in future profits which he gets 1/9 from A and 2/9 from B. Calculate the new ratio.

Solution

A's old share = 3/5; A sacrifice in favour of C = 1/9

So A's new share = 3/5 – 1/9 = 22/45

B's old share = 2/5; B sacrifice in favour of C = 2/9

So B's new share = 2/5 – 2/9 = 8/45

C's new share = 3/9 x 5/15 = 15/45

New ratio = 22: 8: 15

Case III: When the old partners surrender a particular fraction of their share in favour of new partner: In this case following steps are followed:

1. Determine the share surrendered by the old partners.
2. Find the new share of the old partners by deducting share surrendered from their old share.
3. Calculate share of the new partner by taking the sum of surrendered share of old partners.
4. Calculate the new ratio.

Example

A and B are partners sharing in the ratio 3:2. They admit C as the new partner. A surrenders 1/3rd of his share and B surrenders 2/3rd of his share in favour of C. calculate the new ratio.

Solution

A's old share = 3/5; A surrender in favour of C = 3/5 x 1/3 = 3/15

A's new share = 3/5 - 3/15 = 6/15

B's old share = 2/5; B surrender in favour of C = 2/5 x 2/3 = 4/15

B's new share = 2/5 - 4/15 = 2/15

C's share = 3/15 + 4/15 = 7/15

New ratio = 6:2:7

Case IV: When the new partner acquires his share entirely from any one partner: In this case the sacrificing partner share is calculated by deducting his sacrifice from his old share.

Example: A and B are partners sharing in the ratio 3:2. They admit C for 1/5th share in profits which he acquires entirely from A. Calculate the new ratio.

Solution

A's old share = 3/5; Sacrifice in favour of C = 1/5

A's new share = 3/5 - 1/5 = 2/5

B's share = 2/5

C's share = 1/5

New ratio = 2:2:1

Case V: When the new partner acquires his share from the old partners in the certain ratio: In this the sacrifice of each partner is deducted from their old shares.

Example: A and B are partners sharing profits in the ratio 3:2. C is admitted for $1/5^{th}$ share which he acquires from A and B in the ratio of 2:1. Calculate the new ratio.

Solution

A's old share = 3/5, A's sacrifice = 1/5 × 2/3 = 2/15

A's new share = 3/5 - 2/15 = 7/15

B's old share = 2/5, B's sacrifice = 1/5 × 1/3 = 1/15

B's new share = 2/5 - 1/15 = 5/15

C's share = 1/5 × 3/3 = 3/15

New ratio = 7:5:3

Sacrificing Partner:

The partners whose shares have decreased as a result of change are known as sacrificing partners.

Sacrificing Ratio:

Ratio in which the old partners sacrifice their share in favour of new partner is called sacrificing ratio. This ratio is calculated by taking out the difference between old profit shares and new profit shares

Sacrificing ratio = Old Profit sharing ratio – New Profit sharing ratio

Gaining Partners

The partners whose shares have increased as a result of change are known as gaining partners.

Gaining Ratio

The ratio in which the partners have agreed to gain their shares in profit from the other partner or partners, is known as gaining ratio. This ratio is calculated by taking out the difference between new profit shares and old profit shares

Example: X and Y are partners in a firm sharing profits and losses in the ratio 5:3. They admit Z into partnership. The new ratio 3:2:1. Calculate the Sacrificing Ratio.

Solution

X's sacrifice = X's old share - X's new ratio = 5/8 – 3/6 = 6/48

Y's sacrifice = Y's old share - Y's new ratio = 3/8 – 2/6 = 2/48

Thus, sacrificing ratio = 6:2 or 3:1

Example: A, B and C are sharing profits and losses in the ratio of 5:3:2. Calculate the new profit sharing ratio and the sacrificing ratio in each of the following alternative cases:

Case (a) If C acquires 1/10th share from B

Case (b) If C acquired 1/10th share equally from A and B

Case (c) If C's share is increased by 1/10th share by acquiring from A.

Case (d) If C's share is increased to 3/10th by acquiring from B.

Case (e) if A, B and C decide to share future profits and losses in the ratio of 5:2:3.

Case (f) if A, B and C decide to share future profits and losses in the ratio of 2:3:5.

Case (g) if A, B and C decide to share future profits and losses in the ratio of 2:1:2.

Case (h) if A, B and C decide to share future profits and losses equally.

Case(i) If A , B and C decide that the future profit sharing ratio between B and C shall be the same as existing between A and B

Solution

Case (a)	**A**	**B**	**C**
Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-	-1/10	+1/10
Their new shares	5/10	2/10	3/10

New Profit sharing ratio of A, B and C = 5 : 2 : 3

Share sacrificed by B = 1/10

Case (b)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from A and B	-1/20	-1/20	+1/10
Their new shares	9/20	5/20	3/10

New Profit sharing ratio of A, B and C = 9 : 5 : 6

Sacrificing ratio of A and B = 1 : 1

Case (c)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-1/10	-	+1/10
Their new shares	4/10	3/10	3/10

New Profit sharing ratio of A, B and C = 4 : 3 : 3

Share sacrificed by A = 1/10

Share acquired by C = New Share – Old share = 3/10 -2/10 = 1/10

Case (d)	A	B	C
Their existing shares	5/10	3/10	2/10
Share acquired by C from B	-	-1/10	+1/10
Their new shares	5/10	2/10	3/10

New Profit sharing ratio of A, B and C = 5 : 2 : 3

Share sacrificed by B = 1/10

Case (e)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	5/10	2/10	3/10
	-	1/10	-1/10

C gains by 1/10th share and B sacrifice 1/10th Share

Case (f)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	2/10	3/10	5/10
	3/10	-	-3/10

C gains by 3/10th share and A sacrifice 3/10th Share

Case (g)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	2/5	1/5	2/5
	1/10	1/10	-2/10

C gains by 2/10th share and A sacrifices 1/10th Share &B sacrifices 1/10th share.

Case (h)	A	B	C
Their existing shares	5/10	3/10	2/10
Their new shares	1/3	1/3	1/3
	5/30	-1/30	-4/30

B gains by 1/30th share, C gains by 4/30th share and A sacrifices by 5/30th Share

Case (i)

Ratio of A and B= 5 : 3

Ratio of B and C should be 5 : 3

Since B's share in relation to A is 3/5 or 60% of A's share, C's share should also be 60% of B's share

Thus C's share (60% of 3) = 1.8

New ratio of A, B and C = 5 : 3 : 1.8 or 25 : 15 : 9

	A	B	C
Their existing shares	5/10	3/10	2/10
Their new share	25/49	15/49	9/49
	-5/490	-3/490	8/490

C sacrifices by 8/490 and A gains by 5/490 and B gains by 3/490

ILLUSTRATION 5

A and B are in partnership sharing profits and losses at the ratio 3:2. They take C as a new partner. Calculate the new profit sharing ratio if -

(i) C purchases 1/10 share from A

(ii) A and B agree to sacrifice 1/10th share to C in the ratio of 2: 3

(iii) Simply gets 1/10th share of profit.

SOLUTION

(i) New profit sharing ratio:

A = 3/5 – 1/10 = 5/10

B = 2/5 i.e. 4/10

C = 1/10

i.e. 5:4: 1

(ii) A's sacrifice 1/10× 2/5 = 2/50

B's sacrifice 1/10 × 3/5 = 3/50

New profit sharing ratio

A = 3/5 – 2/50 = 28/50

B = 2/5 – 3/50 = 17/50

C = 1/10 i.e. 5/50

i.e. 28:17: 5

(iii) Let total share be 1

C's share=1/10

Remaining share=1-1/10=9/10

Distribution:

A = 9/10 × 3/5 = 27/50

B = 9/10 × 2/5 = 18/50

C = 1/10. i.e. = 5/50

i.e. 27:18: 5

ILLUSTRATION 6

A and B are in the partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their balance sheet as on 31st March, 2022 was as follows:

Cash ₹ 1,000; trade receivables ₹ 25,000; Inventory ₹ 22,000; plant and machinery ₹ 4,000; trade payables ₹ 12,000; bank overdraft ₹ 15,000; A's capital ₹ 15,000; B's capital ₹ 10,000.

On 1st April, 2022, they admitted C into partnership on the following terms:

(i) C to purchase one–third of the goodwill for ₹ 2,000 and provide ₹ 10,000 as capital. Goodwill not to appear in books.

(ii) Further profits and losses are to be shared by A, B and C equally.

(iii) Plant and machinery is to be reduced by 10% and ₹ 500 is to be provided for estimated bad debts. Inventory is to be taken at a valuation of ₹ 24,940.

(iv) By bringing in or withdrawing cash, the capitals of A and B are to be made proportionate to that of C on their profit-sharing basis.

Set out entries to the above arrangement in the firm's journal and give the partners' capital accounts in tabular form.

SOLUTION

Journal Entries

as on 1st April, 2022

		Dr. (₹)	Cr. (₹)
Revaluation Account	Dr.	900	
To Plant and machinery Account			400
To Provision for bad debts Account			500
(Plant & machinery reduced by 10% and ₹ 500 provided for bad debts)			
Inventory Account	Dr.	2,940	
To Revaluation Account			2,940
(Value of inventory increased by ₹ 2,940)			
Revaluation Account	Dr.	2,040	
To A's capital Account			1,530
To B's capital Account			510
(Profit on revaluation transferred)			
Cash Account	Dr.	12,000	
To C's capital Account			12,000
(Cash brought in by C as his capital)			
C's Capital Account	Dr.	2,000	
B's capital Account	Dr.	500	
To A's capital Account			2,500
(Entry for goodwill purchased by B and C)			

A's capital Account	Dr.	9,030	
B's capital Account	Dr.	10	
To Cash Account			9,040
(Excess amount of capital withdrawn)			

Partners' Capital Accounts

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To A's capital A/c	-	500	2,000	By Balance b/d	15,000	10,000	–
To Cash	9,030	10		By Revaluation A/c	1,530	510	–
To Balance c/d	10,000	10,000	10,000	By Cash		–	12,000
				By C's Capital A/c	2,000		
				By B's Capital A/c	500		
	19,030	10,510	12,000		19,030	10,510	12,000

Working Note:

Calculation of goodwill

C pays ₹ 2,000 on account of goodwill for 1/3rd share of profit/loss. Total goodwill is ₹ 2,000 x 3 = ₹ 6,000.

Gaining ratio:

B: 1/3-1/4 = 1/12

C: 1/3

Goodwill to be paid to A:

By B ₹	6,000 x 1/12 =	₹ 500
By C ₹	6,000 x 1/3 =	₹ 2,000
Total		₹ 2,500

ILLUSTRATION 7

A and B are partners of X llp. sharing profits and losses in 3:2 ratio between themselves. On 31st March, 2022, the balance sheet of the firm was as follows:

Balance Sheet of X llp as at 31.3.2022

Liabilities	₹	₹	***Assets***	₹
Capital accounts:			*Plant and machinery*	*20,000*
A	*37,000*		*Furniture and fittings*	*5,000*
B	*28,000*		*Inventories*	*15,000*
		65,000	*Trade receivables*	*20,000*
Trade payables		*5,000*	*Cash in hand*	*10,000*
		70,000		*70,000*

X agrees to join the business on the following conditions as and from 1.4.2022:

(a) *He will introduce ₹ 25,000 as his capital and pay ₹ 15,000 to the partners as premium for goodwill for 1/3rd share of the future profits of the firm.*

(b) *A revaluation of assets of the firm will be made by reducing the value of plant and machinery to ₹ 15,000, Inventory by 10%, furniture and fitting by ₹ 1,000 and by making a provision of bad and doubtful debts at ₹ 750 on trade receivables.*

Prepare profit and loss adjustment account, capital accounts of partners including the incoming partner X assuming that the relative ratios of the old partners will be in equal proportion after admission.

SOLUTION

Profit and Loss Adjustment Account

2022, April 1	₹	**2022, April 1**				₹
To Plant and machinery A/c	5,000	By Partners' capital accounts				
To Inventory A/c	1,500	- Loss on revaluation				
To Furniture and fitting A/c	1,000		(3/5)	A	4,950	
To Provision for bad and doubtful debts	750		(2/5)	B	3,300	8,250
	8,250					8,250

Partners' Capital Accounts

	A	B	X		A	B	X
	₹	₹	₹		₹	₹	₹
To Profit & loss adjustment A/c	4,950	3,300	–	By Balance b/d	37,000	28,000	–
				By Cash A/c	–	–	40,000
To A's & B's capital A/cs	–	–	15,000	By X's capital A/c [W. N. (ii)]	12,000	3,000	–
To Balance c/d	44,050	27,700	25,000				
	49,000	31,000	40,000		49,000	31,000	40,000

Working Notes:

(i) New profit sharing ratio:

On admission of X who will be entitled to 1/3rd share of the future profits of the firm. A and B would share the remaining 2/3rd share in equal proportion i.e. 1:1.

A: 2/3 x 1/2 = 1/3

B: 2/3 x 1/2 = 1/3

X:1/3

A, B and X would share profits and losses in equal ratio.

(ii) Adjustment of goodwill:

X pays ₹ 15,000 as premium for goodwill for 1/3rd share of the future profits.

Thus, total value of goodwill is ₹ 15,000 x 3 i.e. ₹ 45,000

Sacrificing ratio:

A: 3/5 - 1/3 = 4/15

A: 2/5 - 1/3 = 1/15

Hence, sacrificing ratio is 4:1

Adjustment of X's share of goodwill through existing partners' capital accounts in the profit sacrificing ratio:

	₹
A: 15,000 x 4/5 =	12,000
B: 15,000 x 1/5 =	3,000
	15,000

3.5 HIDDEN GOODWILL

When the value of the goodwill of the firm is not specifically given, the value of goodwill has to be inferred as follows:

Particulars	₹
Incoming partner's capital x Reciprocal of share of incoming partner	xxx
Less: Total capital of old partners+Net Accumulated Profits and Reserves (if any) + capital brought in by incoming partner	xxx
Value of Goodwill	xxx

ILLUSTRATION 8

A and B are partners with capitals of ₹ 7,000 each. They admit C as a partner with 1/4th share in the profits of the firm. C brings ₹ 8,000 as his share of capital. Give the necessary journal entry to record goodwill.

SOLUTION

Journal Entry

Particulars	Dr. (₹)	Cr. (₹)
C's Capital A/c [₹ 10,000 x 1/4] Dr.	2,500	
To A's Capital A/c		1,250
To B's Capital A/c		1,250
(Being the share of C in the hidden goodwill adjusted through capital accounts by crediting sacrificing partners in their sacrificing ratio)		

Note: Hidden Goodwill= $8{,}000 \times \frac{4}{1}$ - (₹ 7,000 + ₹ 7,000+8,000) = ₹ 10,000

ILLUSTRATION 9

A and B are in partnership sharing profits and losses equally. The Balance Sheet M/s. A and B as on 31.12.2022, was as follows:

Liabilities	₹	*Assets*	₹
Capital A/cs		*Sundry Fixed Assets*	*60,000*
A	*45,000*	*Inventories*	*30,000*
B	*45,000*	*Bank*	*20,000*
Trade payables	*20,000*		
	1,10,000		*1,10,000*

On 1.1.2023 they agreed to take C as 1/3rd partner to increase the capital base to ₹ 1,35,000. C agrees to pay ₹ 60,000. Show the necessary journal entries and prepare partners' capital accounts.

SOLUTION

In the Books of M/s. A, B and C

Journal Entries

		₹	₹
Bank A/c	Dr.	60,000	
To C's Capital A/c			60,000
(Cash brought in by C for 1/3rd share)			
C's Capital A/c	Dr.	15,000	
To A's Capital A/c			7,500
To B's Capital A/c			7,500
A's Capital A/c	Dr.	7,500	
B's Capital A/c	Dr.	7,500	
To Bank A/c			15,000
(Amount of goodwill due to A and B withdrawn)			

Workings:

(1) Old Profit Sharing Ratio:1: 1

(2) New Profit Sharing Ratio: 1:1:1

(3) C's share of capital ₹ 1,35,000 × 1/3 = ₹ 45,000

(4) Goodwill ₹ 60,000 – ₹ 45,000 = ₹ 15,000 for 1/3rd share.

Total Goodwill:₹ 15,000 × 3 = ₹ 45,000

Partners' Capital A/cs

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To A			7,500	By Balance b/d	45,000	45,000	–
To B			7,500	By Bank	–	–	60,000
To Bank	7,500	7,500	–	By C	7,500	7,500	–
To Balance c/d	45,000	45,000	45,000				
	52,500	52,500	60,000		52,500	52,500	60,000

Note : In this problem it is mentioned that total capital should be at ₹ 1,35,000 hence excess capital is to be withdrawn by partners hence third entry is passed.

ILLUSTRATION 10

Leena and Meena were in business sharing profits and losses in the ratio of 2:3

Their Balance Sheet as on 31st March, 2022 was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Building	60,000
Leena	60,000	Plant	45,000
Meena	1,40,000	Furniture	23,500
General Reserve	40,000	Debtors	38,400
Creditors	42,600	Bills Receivable	12,500
Bills Payable	17,400	Stock	42,600
		Bank	78,000
	3,00,000		3,00,000

On 1st April, 2022, they decided to admit Neena into the partnership giving her a 1/5th share in future profits. She brings in ₹ 80,000 as her share of capital. Goodwill was valued at ₹ 1,00,000 at the time of admission of Neena. The partners decided to revalue the Assets as follows:

Plant ₹ 40,000, Debtors ₹ 38,000, Stock ₹ 42,000, Building ₹ 90,000, Furniture ₹ 20,000, Bills Receivable ₹ 12,000.

You are required to show the following accounts in the books of the firm:-

(a) Profit & Loss Adjustment Account

(b) Partners' Capital Accounts

(c) The Balance Sheet of the new firm.

SOLUTION

In the books of Leena, Meena and Neena

(a) **Profit & Loss Adjustment Account**

Particulars	₹	Particulars	₹
To Plant	5,000	By Building	30,000
To Debtors	400		
To Stock	600		

To Furniture	3,500		
To Bills receivable	500		
To Profit on revaluation			
Leena	8,000		
Meena	12,000		
	30,000		30,000

Partners' Capital A/c

Particulars	Leena	Meena	Neena	Particulars	Leena	Meena	Neena
To Leena, Meena Goodwil adjustment entry			20,000	By Balance b/d	60,000	1,40,000	
To Balance c/d	92,000	1,88,000	60,000	By Bank			80,000
				By Neena	8,000	12,000	
				By General Reserve	16,000	24,000	
				By Revaluation	8,000	12,000	
	92,000	1,88,000	80,000		92,000	1,88,000	80,000

Balance Sheet as on 1st April, 2022 (after admission)

Liabilities	₹	Assets	₹
Capital Accounts:		Building	90,000
Leena	92,000	Plant	40,000
Meena	188,000	Furniture	20,000
Neena	60,000	Debtors	38,000
Creditors	42,600	Bills Receivable	12,000
Bills Payable	17,400	Stock	42,000
		Bank	1,58,000
	4,00,000		4,00,000

ILLUSTRATION 11

Alpha and Beeta were partners in a LLP namely Meta-Chem LLP sharing profits and losses equally.

Balance Sheet of Meta-Chem LLP as on 31st March, 2022

Liabilities			₹	*Assets*	₹
Capital :				*Factory Building*	*4,78,000*
	Alpha	*3,00,000*		*Plant & Machinery*	*3,41,000*
	Beeta	*2,00,000*	*5,00,000*	*Office Furniture*	*55,850*
General Reserve			*1,80,000*	*Inventory*	*77,740*
Workmen compensation fund			*60,000*	*Trade Receivables*	*1,43,210*
Term loan from IDFC bank			*2,78,000*	*Bank*	*44,200*
Trade payables			*1,22,000*		
			11,40,000		*11,40,000*

They agreed to admit Gyama as partner from 1st April 2022 on the following terms:

1. *He shall have one-sixth share in future profits.*
2. *New profit sharing ratio would be 3:2:1*
3. *He shall bring ₹ 2,50,000 as his capital.*
4. *Goodwill of the firm is valued at ₹ 3,00,000*
5. *Factory Building is to be appreciated by 20% and inventory is revalued at ₹ 70,000.*
6. *Machinery to be appreciated by 20%.and Office furniture to be revalued at ₹ 50,000*
7. *Of the trade receivables ₹ 3,210 are bad and 5% be provided for bad & doubtful debts.*
8. *There is no actual liability towards workman.*

You are required to prepare:

1. *Revaluation account*
2. *Partners' capital accounts.*
3. *Bank account.*
4. *Balance Sheet after admission.*

SOLUTION

In the books of Meta-Chem LLP

Revaluation A/c

Liabilities	₹	Assets	₹
To Bad debts	3,210	By Factory Building	95,600
To Provision for Doubtful Debts	7,000	By Plant and Machinery	68,200

To Office Furniture	5,850		
To Inventory	7,740		
To Profit on revaluation			
Alpha 70,000			
Beeta 70,000	1,40,000		
	1,63,800		1,63,800

Partners' Capital A/c

Particulars	Alpha	Beeta	Gyama	Particulars	Alpha	Beeta	Gyama
To Beeta			50,000	By balance b/d	3,00,000	2,00,000	
To Balance c/d	4,90,000	4,40,000	2,00,000	By Bank			2,50,000
				By Gyama		50,000	
				By General Reserve	90,000	90,000	
				By Workman comp. fund	30,000	30,000	
				By Revaluation A/c	70,000	70,000	
	4,90,000	4,40,000	2,50,000		4,90,000	4,40,000	2,50,000

Bank A/c

Particulars	₹	Particulars	₹
To balance b/d	44,200	By Balance c/d	2,94,200
To Gyama's capital	2,50,000		
	2,94,200		2,94,200

Balance Sheet of Meta-Chem LLP as on 1st April 2022 (after admission)

Liabilities		₹	Assets		₹
Capital Accounts:			Factory Building		5,73,600
Alpha	4,90,000		Plant & Machinery		4,09,200
Beeta	4,40,000		Office Furniture		50,000
Gyama	2,00,000	11,30,000	Inventory		70,000
Term Loan from IDFC bank		2,78,000	Trade Receivables	1,40,000	

Trade Payables	1,22,000	*Less*: Provision for Doubtful Debts 7,000	1,33,000
		Bank	2,94,200
	15,30,000		15,30,000

Working Note:

Partner	New Share		Old Share		Difference
Alpha	1/2	–	3/6	=	0
Beeta	1/2	–	2/6	=	1/6
Gyama		–	1/6 (gain)	=	1/6 (gain)

SUMMARY

- New partners are admitted for the benefit of the partnership firm. New partner is admitted either for increasing the partnership capital or for strengthening the management of the firm.
- When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in the value of assets and decrease in the value of liabilities. The difference in two sides of the account will show profit or loss. This is transferred to the Capital Accounts of old partners in the old profit sharing ratio.
- Whenever a new partner is admitted, any reserve etc. appearing in the Balance Sheet should be transferred to the Capital Accounts of the old partners in the old profit sharing ratio.

TEST YOUR KNOWLEDGE

True or False

1. *A newly admitted partner does not have same rights as old partners.*
2. *When a new partner is admitted, old partners have to forego certain share in profits of the firm, this is called as sacrifice ratio.*
3. *Revaluation account is also called as Profit and Loss Adjustment Account.*

4. *Any appreciation in the value of an asset is credited to Revaluation account.*

5. *All the partners may decide not to change the values of assets and liabilities in the books of accounts.*

6. *New partner is entitled to have share in reserves appearing in the balance sheet prior to his admission.*

7. *If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners equally.*

8. *New partner brings necessary amount as his capital.*

9. *New partner is entitled to share in revaluation profit.*

Multiple Choice Questions

1. *A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?*

   (a) 35:42:17.

   (b) 35:21:24.

   (c) 49:22:29.

2. *A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5 from A and 1/10 from B, new profit sharing ratio will be:*

   (a) 5:6:3.

   (b) 2:4:6.

   (c) 17:11:12

3. *C was admitted in a firm with 1/4th share of the profits of the firm. C contributes ₹ 15,000 as his capital, A and B are other partners with the profit sharing ratio as 3:2. Find the required capital of A and B, if capital should be in profit sharing ratio taking C's as base capital:*

   (a) ₹ 27,000 and ₹ 16,000 for A and B respectively.

   (b) ₹ 27,000 and ₹ 18,000 for A and B respectively.

   (c) ₹ 32,000 and ₹ 21,000 for A and B respectively.

4. *A, B and C are partners sharing profits and losses in the ratio 6:3:3, they agreed to take D into partnership for 1/8th share of profits. Find the new profit sharing ratio.*

   (a) 12:27:36:42.

(b) 14:7:7:4.

(c) 1:2:3:4.

5. *A and B are partners sharing profits and losses in the ratio of 3:2 (A's Capital is ₹ 30,000 and B's Capital is ₹ 15,000). They admitted C and agreed to give 1/5th share of profits to him. How much C should bring in towards his capital?*

(a) ₹ 9,000.

(b) ₹ 12,000.

(c) ₹ 11,250.

6. *A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who brings in ₹ 25,000 against capital and ₹ 10,000 against goodwill. New profit sharing ratio is 1:1:1. In what ratio will this amount will be shared among the old partners A & B.*

(a) ₹ 8,000: ₹ 2,000.

(b) ₹ 5,000: ₹ 5,000.

(c) Old partners will not get any share in the goodwill brought in by C.

7. *A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring ₹ 25,000 against capital and ₹ 10,000 against goodwill. New profit sharing ratio is 1:1:1. C brought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.*

(a) Cash brought in by C will only be credited to his capital account.

(b) Goodwill will be raised to full value in old ratio.

(c) Goodwill will be raised to full value in new ratio.

8. *X and Y are partners sharing profits in the ratio of 3: 1. They admit Z as a partner who pays ₹ 4,000 as Goodwill the new profit sharing ratio being 2:1: 1 among X, Y and Z respectively. The amount of goodwill will be credited to:*

(a) X and Y as ₹ 3,000 and ₹ 1,000 respectively.

(b) X only

(c) Y only.

9. *P and Q are partners sharing Profits in the ratio of 2:1. R is admitted to the partnership with effect from 1st April on the term that he will bring ₹ 20,000 as his capital for 1/4th share and pays ₹ 9,000 for goodwill, half of which is to be withdrawn by P and Q. If profit*

on revaluation is ₹ 6,000 and opening capital of P is ₹ 40,000 and of Q is ₹ 30,000, find the closing balance of each capital.

(a) ₹ 47,000: ₹ 33,500: ₹ 20,000

(b) ₹ 50,000: ₹ 35,000: ₹ 20,000.

(c) ₹ 40,000: ₹ 30,000: ₹ 20,000

10. *Adam, Brain and Chris were equal partners of a firm with goodwill ₹ 1,20,000 shown in the balance sheet and they agreed to take Daniel as an equal partner on the term that he should bring ₹ 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ₹ 60,000 and the goodwill account is to be written off before admission. What will be the treatment for goodwill?*

(a) Write off the goodwill of ₹ 1,20,000 in old ratio.

(b) Cash brought in by Daniel for goodwill will be distributed among old partners in sacrificing ratio.

(c) Both (a) & (b)

Theory Questions

1. *Write short note on Revaluation account.*

2. *What is the difference between revaluation account and memorandum revaluation account?*

Practical Questions

1. *The following was the balance sheet of A, B and C who were equal partners on January 1, 2022*

Liabilities	₹	***Assets***	₹
Bills Payable	*3,000*	*Cash*	*1,000*
Creditors	*6,000*	*Debtors*	*10,000*
Capital Accounts :		*Stock*	*12,000*
A	*20,000*	*Furniture*	*5,000*
B	*15,000*	*Buildings*	*25,000*
C	*10,000*	*Bills Receivable*	*1,000*
	54,000		*54,000*

They agree to take D into partnership and give him a 1/4 share in the profits on the following terms:

(1) D should bring in ₹ 6,000 for goodwill and ₹ 10,000 as capital;

(2) one-half of the goodwill shall be withdrawn by old partners;

(3) stock and furniture be depreciated by 10%.

(4) a liability of ₹ 1,300 be created against bills discounted;

(5) the building be valued at ₹ 40,000;

(6) the values of liabilities and assets other than cash are not to be altered.

Give the necessary entries to give effect to the above arrangement; prepare revaluation account and opening balance sheet of the firm as newly constituted.

2. *Gopal and Govind are partners sharing profits and losses in the ratio 60:40. The firms' balance sheet as on 31.03.2022 was as follows:*

Liabilities	₹	***Assets***	₹
Capital accounts:		*Fixed assets*	*3,00,000*
Gopal	*1,20,000*	*Investments*	*50,000*
Govind	*80,000*	*Current assets*	*2,00,000*
Long term loan	*2,00,000*	*Loans and advances*	*1,00,000*
Current liabilities	*2,50,000*		
	6,50,000		*6,50,000*

Due to financial difficulties, they have decided to admit Guru as partner in the firm from 01.04.2022 on the following terms:

Guru will be paid 40% of the profits.

Guru will bring in cash ₹ 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows:

For the year ended 31.3.2020: profit ₹ 20,000 (includes insurance claim received of ₹ 40,000).

For the year ended 31.3.2021: loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.3.2022: profit of ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2022 as follows:

	₹
Fixed assets (net)	*4,00,000*
Investments	*Nil*
Current assets	*1,80,000*
Loans and advances	*1,00,000*

The new profit sharing ratio after the admission of Guru was 35:25:40.

Pass journal entries on admission, show goodwill calculation and prepare revaluation account, partners' capital accounts and balance sheet as on 01.04.2022 after the admission of Guru.

ANSWERS/HINTS

True or False

1. False: All the partners have same rights at all times, unless contrary is provided in the partnership deed/or agreed by the partners.

2. True: With every new partner, remaining old partners have to foregone a proportion in their share which is called as sacrificing ratio.

3. True: Revaluation is also called as profit and loss adjustment account.

4. True: Increase in asset is an income hence credited to revaluation account.

5. True: This can be done by opening Memorandum Revaluation Account.

6. False: New partner is not entitled to have any share in the reserves of the firm prior to his admission. Such reserves are distributed to old partners in their old profit sharing ratio.

7. False: If revaluation account shows credit balance then it represents profit and therefore it is credited to all partners in their profit sharing ratio and not equally.

8. True: Every incoming partner shall bring in some amount of capital for the firm.

9. False: New partner is not entitled to profit on revaluation, it belongs to old partners in their old profit sharing ratio.

Multiple Choice Questions

1.	(b)	**2.**	(c)	**3.**	(b)	**4.**	(b)	**5.**	(c)	**6.**	(a)
7.	(a)	**8.**	(b)	**9.**	(a)	**10.**	(c)				

Theoretical Questions

1. When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in the value of assets and decrease in the value of liabilities. The difference in two sides of the account will show profit or loss. This is transferred to the Capital Accounts of old partners in the old profit sharing ratio.

2. Difference between revaluation account and memorandum revaluation account

(i) Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities which of course are recorded at their old figures in the new balance sheet.

(ii) Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

Practical Problems

1.

		₹	₹
Cash Account	Dr.	16,000	
To D's Capital Account			16,000
(Amount of goodwill and capital brought in by D)			
D's Capital Account	Dr.	6,000	
To A's Capital Account			2,000
To B's Capital Account			2,000

To C's Capital Account			2,000
(Goodwill brought in by D credited to old partners in sacrifice ratio)			
A's Capital Account	Dr.	1,000	
B's Capital Account	Dr.	1,000	
C's Capital Account	Dr.	1,000	
To Cash Account			3,000
(Half the amount of goodwill withdrawn by existing partners)			
Memorandum Revaluation Account	Dr.	12,000	
To A's Capital Account			4,000
To B's Capital Account			4,000
To C's Capital Account			4,000
(Profit on revaluation credited to old partners)			
A's Capital Account	Dr.	3,000	
B's Capital Account	Dr.	3,000	
C's Capital Account	Dr.	3,000	
D's Capital Account	Dr.	3,000	
To Memorandum Revaluation Account			12,000
(The profit credited previously to old partners written off to all partners including D in the new profit-sharing ratio)			

Memorandum Revaluation Account

Stock	1,200	Buildings	15,000
Furniture	500		
Liability for bills discounted	1,300		
Profit transferred to capital accounts:			
A	4,000		

B	4,000		
C	4,000		
	15,000		15,000
Buildings	15,000	Stock	1,200
		Furniture	500
		Liability for bills discounted	1,300
		Loss transferred to capital accounts:	
		A	3,000
		B	3,000
		C	3,000
		D	3,000
	15,000		15,000

Balance Sheet of M/s. A, B, C and D

As on 1st January, 2022

Liabilities		₹	**Assets**	₹
Bills Payable		3,000	Cash	14,000
Creditors		6,000	Debtors	10,000
Capital Accounts:			Stock	12,000
A	22,000		Furniture	5,000
B	17,000		Buildings	25,000
C	12,000		Bills Receivable	1,000
D	7,000	58,000		
		67,000		67,000

2. (i) Calculation of Profit/ Loss for the year ended

	31.3.2020	**31.3.2021**	**31.3.2022**
Profit/(loss) for the year	20,000	(80,000)	1,05,000
Add/(*less*): Abnormal items	(40,000)	1,10,000	(25,000)
Net Profit/(loss)	(20,000)	30,000	80,000

$$\text{Average profit} = \frac{(20{,}000)+30{,}000+80{,}000}{3} = ₹\ 30{,}000$$

Two years' purchase of average profits= 30,000 x 2= ₹ 60,000

Goodwill to be brought in by Guru=₹ 60,000 x 40%=₹ 24,000

Goodwill brought in by Guru shared (at the profit sacrificing ratio) by:

	₹
Gopal (₹ 24,000 x 5/8)	15,000
Govind (₹ 24,000 x 3/8)	9,000
	24,000

(ii) Journal Entries

Date	Particulars		Dr. ₹	Cr. ₹
1.4.2022	Bank A/c	Dr.	1,24,000	
	To Guru's capital A/c			1,24,000
	(Amount of capital and goodwill brought in by Guru)			
1.4.2022	Guru's capital A/c	Dr.	24,000	
	To Gopal's capital A/c			15,000
	To Govind's capital A/c			9,000
	(Amount of goodwill brought in by Guru credited to capital accounts of the old partners in the profit sacrificing ratio 5:3)			
1.4.2022	Revaluation A/c	Dr.	70,000	
	To Investment A/c			50,000
	To Current assets A/c			20,000
	(Writing down the value of investments to nil and current assets from ₹ 2,00,000 to ₹ 1,80,000 on the occasion of admission of Guru)			
1.4.2022	Fixed assets A/c	Dr.	1,00,000	
	To Revaluation A/c			1,00,000
	(Writing up the value of fixed assets from ₹ 3,00,000 to ₹ 4,00,000 on the occasion of admission of Guru)			

1.4.2022	Revaluation A/c	Dr.	30,000	
	To Guru's capital A/c			18,000
	To Govind's capital A/c			12,000
	(Net revaluation profit credited to the capital accounts of the old partner in the old profit sharing ratio of 60:40)			

(iii) **Revaluation Account**

Particulars	₹	Particulars	₹
To Investments A/c	50,000	By Fixed assets A/c	1,00,000
To Current assets A/c	20,000		
To Partner's capital A/c:			
(Profit on revaluation)			
Gopal (60%)	18,000		
Govind (40%)	12,000		
	1,00,000		1,00,000

(iv) **Partner's Capital Accounts:**

Gopal's Capital Account

Particulars	₹	Particulars	₹
To Balance c/d	1,53,000	By Balance b/d	1,20,000
		By Bank A/c	15,000
		By Revaluation A/c	18,000
	1,53,000		1,53,000

Govind's Capital Account

Particulars	₹	Particulars	₹
To Balance c/d	1,01,000	By Balance b/d	80,000
		By Bank A/c	9,000
		By Revaluation A/c	12,000
	1,01,000		1,01,000

Guru's Capital Account

Particulars	₹	Particulars	₹
To Balance c/d	1,00,000	By Bank b/d	1,00,000
	1,00,000		1,00,000

Balance Sheet (after admission of Guru)
as on 1st April, 2022

Liabilities		₹	Assets	₹
Capital accounts:			Fixed assets	4,00,000
Gopal	1,53,000		Current assets	3,04,000
Govind	1,01,000		(including bank balance of ₹ 1,24,000)	
Guru	1,00,000	3,54,000		
Long term loan		2,00,000	Loans & advances	1,00,000
Current liabilities		2,50,000		
		8,04,000		8,04,000

Working Notes:

1. Calculation of profit sacrificing ratio

   Profit sacrificed by Gopal=60%-35%=25%

   Profit sacrificed by Govind =40%-25%=15%

   Sacrificing ratio =25%: 15% or 5:3

2. Bank balance after admission of Guru:

Bank Account

Particulars	₹	Particulars	₹
To Guru's capital A/c	1,24,000	By Balance c/d	1,24,000
	1,24,000		1,24,000