

Chapter 3

Change in Profit sharing ratio of Partners

Reconstitution of Partnership

1: Amit and Kajal were partners in a firm sharing profits in the ratio of 3:2. With effect from January 1, 2015 they agreed to share profits equally. For this purpose the goodwill of the firm was valued at Rs. 60,000. Pass the necessary journal entry.

Solution:

Old ratio of Amit and Kajal = 3:2

New ratio of Amit and Kajal = 1:1

Sacrifice or Gain

$$\text{Amit} = \frac{3}{5} - \frac{1}{2} = \frac{6}{10} - \frac{5}{10} = \frac{1}{10} \text{ (Sacrifice)}$$

$$\text{Kajal} = \frac{2}{5} - \frac{1}{2} = \frac{4}{10} - \frac{5}{10} = \frac{1}{10} \text{ (gain)}$$

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 jan. 1	Kajal capital A/c $\left(60,000 \times \frac{1}{6}\right)$ Dr. To Amit's Capital A/c $\left(60,000 \times \frac{1}{6}\right)$ (Adjustment for goodwill on change in profit sharing ratio).		6,000	6,000

Accounting Treatment of Reserves and Accumulated Profits

Case (i) When reserves and accumulated profits/losses are to be distributed

At the time of change in profit sharing ratio, if there are some reserves or accumulated profits/losses existing in the books of the firm, these should be distributed to partners in their old profit sharing ratio.

Journal Entries

(i) For Transfer of Reserves & Accumulated Profits

Reserve A/cDr.

Profit & Loss A/cDr.

Workmen's Compensation Reserve A/cDr. Excess of reserves over Actual Liability

Investment Fluctuation Reserve A/cDr. (Excess of Reserves over difference between Book Value & Market Value)

To old Partner's Capital or Current A/c (in old ratio)

(ii) For transfer of accumulated Losses.

Old Partner's Capital or Current A/csDr. (in old ratio)

To Profit & Loss A/c (Dr. Balance)

To Deferred Revenue Expenditure A/c (e.g. Advertisement expense)

2: Vaishali, Vinod and Anjali are partners sharing profits in the ratio of 4:3:2. From April 1, 2015; they decided to share the profits equally. On the date their book their books showed a credit balance of Rs. 3,60,000 in the profit an loss account and a balance of Rs. 90,000 in the General reserve. Record the journal entry for distribution of these profits and reseves.

Solution:

Journal

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Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 Apr. 1	Profit & Loss A/cDr. General Reserve A/cDr. To Vaishali's Capital A/c To Vinod's Capital A/c To Anjali's Capital A/c (Profit and general reserve distributed in old ratio)		 3,60,000 90,000	 2,00,000 1,50,000 1,00,000

3: Anjun and Kanchan are partner sharing profits and losses in the ration of 3:2, From April 1, 2015 they decided to share the profits in the ratio of 2:1 On that date, profit and loss account showed a debit balance of Rs. 1,20,000. Record the Journal for transferring this to partner's capital accounts.

Solution:

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 Apr. 1	Anjun's capital A/cDr. Kanchan's capital A/cDr. To Profit and Loss A/c (Undistributed losses transferred to partners' capital accounts in old ratio)		 72,000 48,000	 1,20,000

Case (ii) : When accumulated profits/losses are not be distributed at the time of change in ratio

Partners may decide that reserves and accumulated profits/losses will not affected and remains in the books with same figure. In this case, the gaining partner must Compensate the sacrificing partner by the share gained by him i.e.

Gaining Partner's Capital A/c.Dr.

To Sacrificing Partner's Capital A/c

4: Keshav, Meenakshi and Mohit sharing profit and losses in the ratio of 1:2:2, decide to share future profit equally with effect from April 1, 2015. On that date general reserve showed a balance of Rs. 40,000. Partners do not want to distribute the reserves. You are required to give the adjusting entry.

Solution : Keshav; Meenakshi; Mohit

Old ratio $1/5 : 2/5 : 2/5$

New ratio $1/3 : 1/3 : 1/3$

Sacrifice or Gain

$$\text{Keshav} = 1/5 - 1/3 = \frac{3}{15} - \frac{5}{15} = -\frac{2}{15} \text{ (gain)}$$

$$\text{Meenakshi} = 2/5 - 1/3 = \frac{6}{15} - \frac{5}{15} = \frac{1}{15} \text{ (Sacrifice)}$$

$$\text{Mohit} = 2/5 - 1/3 = \frac{6}{15} - \frac{5}{15} = \frac{1}{15} \text{ (Sacrifice)}$$

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 Apr. 1	Keshav's capital A/c $\left(2,40,000 \times \frac{2}{15}\right)$ Dr. To Meenakshi capital A/c $\left(2,40,000 \times \frac{1}{15}\right)$ To Mohit's capital A/c $\left(2,40,000 \times \frac{1}{15}\right)$ (Adjustment for General reserve on change		32,000	16,000 16,000

	in profit sharing ratio)			
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5 : Neha, Niharika, and Nitin are partners sharing profits and losses in the ratio of 2:3:4. They decided to change their ratio and their new ratio is 4:3:2. They also decided to pass a single journal entry to adjust the following without affecting their book values.

(Rs.)

Profit & Loss account 80,000

General Reserve 40,000

Advertisement Suspense A/c 30,000

You are required to give the single journal entry to adjust the above.

Solution :

Profit & Loss Account 80,000

Add : General Reserve 40,000

Less : Advertisement Suspense 1,20,000

Total amount to be adjusted 30,000

90,000

Neha Niharika Nitin

Old ratio 2/93/94/9

New ratio 4/93/92/9

Sacrifice or Gain

Neha = $\frac{2}{9} - \frac{4}{9} = \frac{2}{9}$ (Gain)

Niharika = $\frac{3}{9} - \frac{3}{9} = 0$ (No change)

Nitin = $\frac{4}{9} - \frac{2}{9} = \frac{2}{9}$ (Sacrifice)

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
	Neha's capital A/c $\left(90,000 \times \frac{2}{9}\right)$ Dr. To Nitin's capital A/c $\left(90,000 \times \frac{2}{9}\right)$ (Adjustment for Profit & Loss A/c, General Reserves and Advertisement Suspense A/c)		20,000	20,000

Accounting treatment for Revaluation of Assets and Reassessment of Liabilities on change in Profit sharing ratio :

At the time of change in profit sharing ratio of existing partners, Assets and liabilities of a firm must be revalued because actual realizable value of assets and liabilities may differ from their book values. Change in the assets and liabilities belongs to the period to change in profit sharing ratio and therefore it must be shared in old profit sharing ratio.

Revaluation of assets and liabilities may be treated in two ways:

- (i) When revised values are to be shown in the books.
- (ii) When revised values are not to be shown in the books.

When revised values are to be shown in the books :

In this case revaluation of assets and liabilities is completed with the help of "Revaluation Account". This account is also known as "Profit and Loss Adjustment Account". All losses due to revaluation are shown in debit side of this account and all gains due to revaluation are shown in credit side of this account.

6: Piyush, Puja and Praveen are partners sharing profits and losses in the ratio of 3:3:2. Their balance sheet as on March 31st 2015 was as follows :

Liabilities	(Rs.)	Assets	(Rs.)
Sundry creditors		Cash at bank	74,000
Bank Loan	48,000	Sundry debtors	88,000
Capital:	72,000	Stock	2,40,000
Piyush 4,00,000	10,00,000	Machinery	3,18,000
Puja 3,00,000		Building	4,00,000
Praveen <u>3,00,000</u>	11,20,000		11,20,000

Partners decided that with effect from April 1, 2015, they would share profits and losses in the ratio of 4:3:2. It was agreed that :

(i) Stock be valued at Rs. 2,20,000.

(ii) Machinery is to be depreciated by 10%

(iii) A provision for doubtful debts is to be made on debtors at 5%.

(iv) Building is to be appreciated by 20%

(v) A liability for Rs. 5,000 included in sundry creditors is not likely to arise. Partners agreed that the revised value are to be recorded in the books. You are required to prepare journal, revaluation account, partner's capital Accounts and revised Balance Sheet.

Solution:

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 Apr. 1	Revaluation A/c Dr. To Stock To Provision for doubtful debts A/c (Revaluation of assets)			20,000 31,800

April 1	Building A/c	56,200	4,400
	Sundry creditor A/c	80,000	85,000
	To Revaluation A/c	5,000	10,800
	(Revaluation of assets and liabilities)	28,800	10,800
April 1	Revaluation A/c		7,800
	To Piyush's capital A/c		
	To Pooja's capital A/c		
	To Praveen's capital A/c		
	(Profit on revaluation)		

Revaluation Account

Particulars	(Rs.)	Particulars	(Rs.)
To Stock		By Building By Sundry creditors	
To Machinery	20,000		
To Provision for doubtful Debts	31,800		80,000
To Profits transferred to	4,400		5,000
To Piyush's capital A/c	28,800		
To Pooja's capital A/c			
To Praveen's capital A/c			
	85,000		85,000

Partner's Capital A/cs

Dr. Cr.

Particulars	Piyush	Pooja	praveen	Particulars	Piyush	Pooja	Praveen
To balance b/d	4,10,800	3,10,800	3,07,200	By bal. b/d			
				By Revaluation A/c	4,00,000	3,00,000	3,00,000
					10,800	10,800	7,200

	4,10,800	3,10,800	3,07,200		4,10,800	3,10,800	3,37,200

Balance Sheet

As on April 1, 2015

Liabilities	(Rs.)	Assets	(Rs.)
Sundry creditors		Cash at bank	74,000
Bank Loan	43,000	Sundry debtors 88,000	83,600
Capital account :	72,000	Less : provision 5% <u>4,400</u>	2,20,000
Piyush's 4,10,800	10,28,800	Stock	2,86,200
Pooja's 3,10,800		Machinery	4,80,000
Praveen's <u>3,07,200</u>	11,43,800	Building	11,43,800

When revised values are not to be shown in the books.

7 : In 6, Partners agreed that the revised value of assets and liabilities are not to be shown in the books. You are required to record the effect by passing a single journal entry. Also prepare the revised Balance Sheet.

Solution :

Gain due to revaluation

Building		80,000
Sundry creditors		5,00
Less : Loss due to revaluation		85,000
Stock	Total A	20,000
Machinery	Total B	31,800
Provision for doubtful debts	Total (A – B)	4,400
Net gain from revaluation		56,200

	28,800
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Old Ratio = 3:3:2

New Ratio = 4:3:2

Sacrifice or Gain

Piyush = $\frac{3}{8} - \frac{4}{9} = -\frac{5}{72}$ (Gain)

Pooja = $\frac{3}{8} - \frac{3}{9} = \frac{3}{72}$ (Sacrifice)

Praveen = $\frac{2}{8} - \frac{2}{9} = \frac{2}{72}$ (Sacrifice)

Amount to be adjusted :

Piyush = $28,800 \times \frac{5}{72}$ = Rs. 2,000 Debit

Pooja = $28,800 \times \frac{3}{72}$ = Rs. 1,200 Credit

Praveen = $28,800 \times \frac{2}{72}$ = Rs. 800 Credit

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2015 Apr. 1	Piyush's capital A/c Dr. To Pooja's capital A/c To Praveen's capital A/c (Adjustment for profit on revaluation)		2,000	-----

Journal

Particulars	Piyush	Pooja	praveen	Particulars	Piyush	Pooja	Praveen
To Pooja's To Praveen	1,200	-	-	By balance			

Capital A/c	800	-	-	b/d	4,00,000	3,00,000	3,00,000
To Balance	3,98,000	3,01,200	3,09,800	By Piyaush's	-	1,200	-
b/d				Capital A/c			
	4,10,800	3,10,800	3,07,200		4,00,000	3,01,200	3,00,200

Balance Sheet

As on April 1, 2015

Balance Sheet of Vijay, Vivek and Vinay

Abilities	(Rs.)	Assets	(Rs.)
Sundry creditors		Cash at bank	74,000
Bank Loan	43,000	Sundry Debtors	88,000
Capital account:	72,000	Stock	2,40,000
Piyush's 3,98,000	10,10,000	Machinery	3,18,000
Pooja's 3,01,200		Building	4,00,000
Praveen's 3,00,800	11,20,000		11,20,000