Class-12 Accountancy
Chapter 4 – Admission of a Partner

Introduction

When a new partner is admit ed in a running business due to the requirement of more capital or may be to take advantage of the experience and competence of the newlyadmit ed partner or any other reason, it is cal ed admission of a partner in partnership firm. According to section 31(1) of Indian partnershipAct,1932, "A new partner can be admitted only with the consent of al the existing partners." At the time of admission of a new partner, fol owing adjustments are required:

1. Calculation of new profit sharing ratio and sacrificing ratio.

2.Accounting treatment of Goodwil .

3. Accounting treatment of accumulated profit.

4. Accounting treatment of revaluation of assets and reassessment of liabilities. 5.Adjustment of capital in newprofit sharing ratio

'Section 31 of the Indian Partnership Act 1932' ______

Provides that a new partner can be admitted into a firm with the consent of all the partners. When a new partner is admitted, the existing partnership agreement comes to an end and a new agreement comes into effect. This is called reconstitution of partnership.

The Main Rights of a new partner:

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

Effects of admission of a Partner

1. Old partnership agreement comes to an end, and a new partnership agreement takes place.
2. He will share the future profits of the firm.
3. He will contribute capital and his share of premium for goodwill.
4. Goodwill of the firm is valued , assets are revalued, liabilities are Re-assessed and necessary adjustments are made.

Calculation of Ratios

Meaning of Sacrificing Ratio : Ratio in which partners sacrifice their share of profit in favour of a new partner or incoming partner is called sacrificing ratio. It is the difference of old share and new share of the partners.

Formula of Sacrificing Ratio

Sacrificing Ratio = Old Ratio - New Ratio

Formula of new ratio :

New Ratio = old Ratio – Sacrificing ratio

Difference Between Sacrificing Ratio and New Ratio

Basis	Sacrificing Ratio	New Ratio
Meaning	Ratio in which old partners sacrifice in favour of the new partner	Ratio in which all partners share the future profits of the firm (including new partner)
Purpose	Main purpose is to know the sacrifice made by the partners	Main purpose is to know the new ratio in which future profits are to be shared
Relation with the partners	Related to old partners only	Related to all partners (including new partner)
Formula	Old Ratio - New Ratio	Old Ratio – Sacrificing Ratio

Treatment of Goodwill

At the time of admission of a new partner goodwill is valued and Old goodwill (purchased goodwill) is written off by the old partners. Goodwill is the result of hard work and the efforts made by the existing partners. At the time of the admission of a new partner who will share the future profits of the firm, he must compensate the existing partners by making payment to them. This compensation is called premium for goodwill. From accounting point of view, there may be different situations related to treatment of goodwill which are given below :

1. **When premium for goodwill is paid privately.**
   When premium for goodwill brought by a new partner is paid privately by new partner to the old partners without bringing that money into the business, In such a Case, no entry will be recorded in the books of Accounts.

2. **When premium brought in cash and retained in the business.**
   Following journal entries are required in this case:

Date	Particulars	L.F	Debit	Credit
	Cash/Bank A/c Dr. **To New Partners Capital A/c** **To Premium for Goodwill A/c** **(Being capital and premium brought by the new partner)**		**xxxx**	 **xxxx** **xxxx**
	Premium for Goodwill A/c Dr. **To Sacrificing Partners Capital A/c's** **OR** **To Sacrificing Partners Current A/c's** **(when capitals are fixed)**		**xxxx**	 **xxxx**

3. **Goodwill appearing in the balance sheet.**
   At the time of admission of a new partner goodwill appearing in the balance sheet should be written off by the old partners in their old profit ratio.

Journal entries

Date	Particulars	L.F	Debit	Credit
	<u>When capitals are fluctuating :</u> **Old Partners Capital A/c Dr.** **To Goodwill A/c** **(Being goodwill account written off)** **<u>When Capitals are Fixed :</u>** **Old Partners Current A/c Dr.** **To Goodwill A/c** **(Being goodwill account written off)**			

4. **When premium is brought in kind**

A new partner instead of bringing in cash may bring his share of premium in the form of assets. Following journal entries are recorded for the same:

Date	Particulars	L.F	Debit	Credit
	Assets A/c Dr. **To Premium for Goodwill A/c** **To New partner's Capital A/c** **(Being capital and premium brought by the new partner)** **Premium for Goodwill A/c Dr.** **To Sacrificing partners capital A/c** **Or** **To Sacrificing Partners Current A/c** **(Being premium transferred to sacrificing partners Current Account)**			

5. **When premium is withdrawn by the sacrificing partners fully or partly**

Sometimes the sacrificing partners may decided to withdraw the premium brought by the new partners either fully or partly.

Date	Particulars	L.F	Debit	Credit
	Cash/Bank A/c Dr. **To New Partners Capital A/c** **To Premium for Goodwill A/c** **(Being capital and premium brought by the new partner)** **Premium for Goodwill A/c Dr.** **To Sacrificing Partners Capital A/c's** **OR** **To Sacrificing Partners Current A/c's** **(when capitals are fixed)** **(Being premium credited to sacrificing partners)** **Sacrificing partners Capital A/c Dr.** **To Cash/Bank A/c** **(Being premium withdrawn by the sacrificing partners)**			

6. **When new partner brings in only a part of his share of goodwill**

   Sometimes a new partner may not be in a position to bring the full amount of his share of goodwill/premium in cash and brings only a portion in cash. In such a case, new partner's current account will be debited for the remaining amount.

Date	Particulars	L.F	Debit	Credit
	Cash/Bank A/c Dr. **To New Partners Capital A/c** **To Premium for Goodwill A/c** **(Being capital and premium brought by the new partner)** **Premium for Goodwill A/c Dr.** **To Sacrificing Partners Capital A/c's** **OR** **To Sacrificing Partners Current A/c's** **(when capitals are fixed)** **(Being premium credited to sacrificing partners)** **New partners Current A/c Dr. (unpaid goodwill)** **To Sacrificing Partners Capital A/c's** **OR** **To Sacrificing Partners Current A/c's** **(Being premium transferred to sacrificing partners and new partner debited for unpaid amount of goodwill)**			

7. **When new partner is not able to bring his share of goodwill in cash**

   If a new partner is unable to bring goodwill in cash, in such a case his capital account will be debited and sacrificing partner's capital accounts will be credited. If capitals are fixed, new partners current account will be debited and sacrificing partners current accounts will be credited.

Date	Particulars	L.F	Debit	Credit
	Cash/Bank A/c Dr. **To New Partners Capital A/c** **(Being capital brought by the new partner)** **New partners Current A/c Dr. (unpaid goodwill)** **To Sacrificing Partners Capital A/c's** **OR** **To Sacrificing Partners Current A/c's** **(Being premium transferred to sacrificing partners and new partner debited for unpaid amount of goodwill)**			

8. Hidden Goodwill

When the value of Goodwill is not mentioned, it is assumed that goodwill is hidden or to be calculated. At the time of admission of a new partner the total goodwill of the firm is calculated to know the share of new partners. In such a case goodwill is calculated on the basis of an inferred method of profit sharing ratio or capitalisation method.

Calculation of Hidden Goodwill

Step 1. Calculate closing capital of old partner's. (Through Capital Accounts)

Step 2. Calculate combined Capital :

Combined Capital = Closing Capitals of old partners + Capital of new partner

Step 3. Calculate Total Capital of the Firm :

Total Capital = New partner's Capital x Reciprocal of his share

For example if he brings Rs.20,000 as capital for 1/5th share in profits.
Total capital of the firm will be : 20,000 x 5/1 = 1,00,000

Step 4. Calculate Goodwill :
Goodwill = Total Capital of the firm – Combined Capital

Note : This method is known as inferred method of Goodwill.

Revaluation of Assets and Re-assessment of liabilities

When a new partner is admitted to the partnership firm, he brings capital and his share of premium for goodwill. He acquires the ownership rights of the assets and also makes himself responsible for the firms liabilities. He can access freely all records and books of accounts, to know that assets and liabilities are correctly valued or revalued. At this time there may be increase or decrease in the value of assets and liabilities. Such increase or decrease are treated as partnership profits or losses and should be distributed among the old partners in old ratio. For recording this, a separate account is opened, which is known as Profit and Loss Adjustment Account or Revaluation Account.

Following journal entries are recorded on Revaluation of assets and Re-assessment of liabilities.

1. For increase in the value of Assets :

   Asset A/c Dr.
   To Revaluation A/c
2. For Decrease in the value of Asset :
   Revaluation A/c Dr.
   To Asset A/c
3. For increase in the value of liabilities :
   Revaluation A/c Dr.
   To Liability A/c
4. For Decrease in the value of liabilities :
   Liability A/c Dr.
   To Revaluation A/c
5. When unrecorded assets are recorded :
   Asset A/c Dr.
   To Revaluation A/c
6. When unrecorded liabilities are recorded :
   Revaluation A/c Dr.
   Liability A/c
7. When profit on revaluation transferred to old partners :
   Revaluation A/c Dr.
   To Old partners Capital A/c's
8. When loss on revaluation transferred to old partners :
   Old partner's Capital A/c's
   To Revaluation A/c

Proforma of Revaluation Account:

Particulars	Amount	Particulars	Amount
To Decrease in value of Asset To Increase in value of liabilities To unrecorded liabilities To profit on revaluation transferred to old partners in old ratio.	xxxx xxxx xxxx xxxx	By Increase in value of asset By decrease in value of liabilities By unrecorded Assets By Loss on revaluation transferred to old partners in old ratio.	xxxx xxxx xxxx xxxx
	xxxx		xxxx

Treatment of Reserve and Accumulated profits

At the time of admission of a new partner, A firm may have Reserves and accumulated profits or losses. All free Reserves and profits given in the liabilities side should be credited to partners capital accounts or Current Accounts (if capitals are fixed) and all fictitious Assets/Accumulated losses should be debited to the partners capital account or current Account (if capitals are fixed). A new partner is not entitled to any share in such accumulated balances of the firm while transferring these reserves and profits/ losses to the partners capital accounts, student must remember that these Reserves and profits/losses are only for old partners and should be transferred to them only, in old ratio. Following journal entries are recorded in the books of accounts:

Journal entries

Date	Particulars	L.F	Debit	Credit
	General Reserve Dr. Profit and Loss Dr. Workmen's Compensation Reserve Dr. To Old Partners Capital A/c's (Being Reserves and Accumulated profits credited to old partners in their old Ratio) Old Partner's Capital A/c's Dr. To Preliminary Expense To Advertisement Suspense To Profit and Loss A/c To Goodwill (Being Accumulated losses and fictitious assets debited to old partners in their old ratio)			

Note : Do not distribute

1) E.P.F or employee provident fund
2) Taxation reserve
3) Machinery replacement fund

Adjustment of Capital

It is obvious to adjust the capitals at the time of admission of a new partner. When a new partner is admitted, the partners decide to adjust their capitals according to the new profit sharing ratio. Partners can adjust their capitals according to capital of the new partner, but sometimes a new partner may required to bring capital according to his share in profits of the firm. When the capital of new partner is given, total capital of the firm can be calculated easily.

For example if new partner brings Rs.50,000 as capital for 1/5 share in the profits, than total capital of the firm can be found as 50,000 x 5/1 = 2,50,000 (Total capital of firm)
After calculating total capital of the firm , Capital of the other partners can also be calculated on the basis of total capital. For example if ratio between three partners is 2 : 2 : 1
A's Capital = 2,50,000 x 2/5 = 1,00,000
B's Capital = 2,50,000 x 2/5 = 1,00,000
C's Capital = 50,000

After calculating these capitals, show these capitals as balance c/d in the partners capital A/c.
And now see the difference coming on the debit side or credit side. If difference on debit side it means it is excess and should be withdrawn by the partner if difference on credit side it means partner will bring more capital (Adjust Difference through Cash A/c).
But sometime excess or deficiency is adjusted through current Accounts. There are different cases for the adjustment of capital.

1. When new partner's Capital is given and old partners adjust their capitals according to new partner's capital. Excess and deficiency will be adjusted though cash A/c.

2. When new partner's Capital is given and old partners adjust their capitals according to new partner's capital. Excess and deficiency will be adjusted though current A/c.

3. When new partner's Capital is not given.

4. When new partner's capital is not given and old partners also adjusting their capitals.

5. When Total capital of the firm is given in the adjustment.

Note :
To find out the total capital of the firm use following formula:
New partner's x Raciprocal of new partners share