2

Admission of New Partner

Learning objectives :

After studying this chapter you should be able to understand the followings :

- Concept and the ways of reconstitution of a partnership firm.
- Effects of admission of a new partner.
- Find out the new profit sharing ratio and calculate the sacrifice ratio.
- Meaning, features, nature, types of goodwill, methods of valuation of goodwill and accounting treatment of goodwill.
- Accounting for revaluation of assets and reassessment of liabilities, revaluation account and memorandum revaluation etc.
- Distribution of accumulated profits/losses and reserves.
- Adjustment of capital; adjustment of old partners capital on the basis of new partner's capital, determination of capital of new partner on the basis of old partner's capital.
- Meaning and accounting treatment of change in profit sharing ratio among existing partners.

Reconstitution of Partnership firm

Any change in the existing partnership arrangement among the partners is called reconstitution of partnership firm. The reconstitution of the firm takes place in the following circumstances:

1. Admission of a new partner.
2. Change in the profit sharing ratio among the existing partners.
3. Retirement of an existing partner.
4. Death of a partner.
5. Amalgamation of two partnership firms.

Admission of a new partner

Admission of a new partner means admission of a new member as a owner of firm, resulting in increase in number of the partners in the firm.

According to section 31 of the Indian Partnership Act, 1932, a person may be admitted as a partner in the firm with the consent of existing partners. At the same time he becomes answerable for all the activities of the firm. The person so admitted as a partner shall not be liable for the past acts of the firm. After admission the new partner gets the following two rights –

(i) Right to share in the asset of the firm, and

(ii) Right to share in future profits of the firm.

New partner brings in capital to get right in the assets of the firm. The amount he pays for share in future profits is called goodwill.

Main adjustments at the time of admission of a new partner :

1. Calculation of new profit sharing ratio.
2. Calculation of sacrifice ratio.
3. Valuation and accounting for goodwill.
4. Revaluation of assets and re-assessment of liabilities.
5. Adjustment of accumulated profits, reserves and losses.
6. Adjustment of capital.

Calculation of new profit sharing ratio and sacrifice ratio

New Profit Sharing Ratio (NPSR) : New profit sharing ratio in which all partners including new partner share future profits of the firm.

The incoming partner acquires his share of profit from the old partners so profit share of old partners is changed. Thus it is essential that new profit sharing ratio of partners be computed.

Sacrifice Ratio (SR) : Sacrifice ratio is the ratio in which old partners sacrifice their share of profit in favour of the new partner. Goodwill is paid to the Sacrificing partners in their sacrifice ratio at the time of admission of a new partner.

Sacrifice Ratio (S.R.) = Old Profit Sharing Ratio (OPSR) – New Profit Sharing Ratio (NPSR)

New Profit Sharing Ratio = Old Profit sharing Ratio (OPSR) – Sacrifice Ratio (SR)

New profit sharing ratio can be calculated in the following ways –

I. When only the ratio of the new partner is given in the question **:**

(i) A and B are partners sharing profits in the ratio 3 : 1. C is admitted for 1/4th share in the profits. Calculate new profit sharing ratio and sacrifice ratio.

Suppose total profit of the firm be = 1

C's share ¼ , so remaining profit will be 1-¼ = ¾

It is shared by A and B in their old profit sharing ratio.

A's new share = $\frac{3}{4} X \frac{3}{4} = \frac{9}{16}$ B's new share = $\frac{3}{4} X \frac{1}{4} = \frac{3}{16}$

New profit sharing ratio of A, B and C = $\frac{9}{16} : \frac{3}{16} : \frac{1}{4} = \frac{9 : 3 : 4}{16}$ $= 9 : 3 : 4$

Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

$A = \frac{3}{4} - \frac{9}{16} = \frac{3}{16}$; $B = \frac{1}{4} - \frac{3}{16} = \frac{1}{16}$ Sacrifice ratio = $\frac{3}{16} : \frac{1}{16} = 3 : 1$

Note : When share of new partner is given without the detail of sacrifice made by the old partners. In this case the sacrifice ratio will always be old profit sharing ratio.

(ii) When a new partner purchases his share of profits from the old partners equally. In such cases the new profit sharing ratio of the old partners will be ascertained by deducting the sacrifice made by them from the existing share of profit.

A and B are partners sharing profits in ratio of 7 : 5. They admit C for 1/6th share, which he acquires in equal proportions from both. Find the new profit sharing ratio and sacrificing ratio.

Calculation of sacrifice ratio :

A's sacrifice = $\frac{1}{6} X \frac{1}{2} = \frac{1}{12}$ B's sacrifice = $\frac{1}{6} X \frac{1}{2} = \frac{1}{12} \frac{1}{12} : \frac{1}{12} = 1 : 1$

Calculation of new profit sharing ratio :

New profit sharing ratio = Old profit sharing ratio – Sacrifice ratio

A's new share = $\frac{7}{12}-\frac{1}{12}=\frac{6}{12}$ B's new share = $\frac{5}{12}-\frac{1}{12}=\frac{4}{12}$ C's new share = $\frac{1}{12}$ or $\frac{2}{12}$

Thus new profit sharing ratio of A, B and C will be = $\frac{6}{12}:\frac{4}{12}:\frac{1}{6}=\frac{6:4:2}{12}=3:2:1$

(iii) When new partner acquire his share of profits from the old partner in different proportions :

A and B are partners in a firm sharing profits in the ratio of 3 : 2. C is admitted for 1/5th share in profits of the firm. He gets it from A and B in the ratio of 1 : 2. Calculate new profit sharing ratio and sacrifice ratio.

A's sacrifice = $\frac{1}{5}X\frac{1}{3}=\frac{1}{15}$ B's sacrifice = $\frac{1}{5}X\frac{2}{3}=\frac{2}{15}$ Sacrifice ratio = $\frac{1}{15}:\frac{2}{15}=1:2$

New profit sharing ratio = Old profit sharing ratio – sacrificing ratio

A's new share = $\frac{3}{5}-\frac{1}{15}=\frac{8}{15}$; B's new share = $\frac{2}{5}-\frac{2}{15}=\frac{4}{15}$; C's new share = $\frac{1}{5}$ or $\frac{3}{15}$

Thus new profit sharing ratio of A, B and C will be = $\frac{8}{15}:\frac{4}{15}:\frac{1}{5}$ $=8:4:3$

(iv) When new partner acquires his share wholly from one partner.

(i) A and B are partners in a firm sharing profits in the ratio of 7 : 3. C is admitted for 1/10th share in profits. C gets it wholly from A. Calculate new profit sharing ratio and sacrifice ratio.

Sacrificing ratio :

A's sacrifice = $\frac{1}{10}$ A's new share $=\frac{7}{10}-\frac{1}{10}=\frac{6}{10}$ B's new share = $\frac{3}{10}$ C's new share = $\frac{1}{10}$

Thus new profit sharing ratio of A, B and C will be = $\frac{6}{10}:\frac{3}{10}:\frac{1}{10}=6:3:1$

Sacrifice ratio = $\frac{1}{10}:0=1:0$

(ii) A and B are partners in a firm sharing profits in the ratio of 3 : 2. They admit C and D as partners with 1/5th and 1/5th share respectively. C acquires his entire share from A and D acquires his entire share from B. Find new profit sharing ratio.

A's sacrifice = $\frac{1}{5}$ B's sacrifice = $\frac{1}{5}$; A's new share = $\frac{3}{5}-\frac{1}{5}=\frac{2}{5}$;

B's new share = $\frac{2}{5}-\frac{1}{5}=\frac{1}{5}$ C's new share = $\frac{1}{5}$ D's new share = $\frac{1}{5}$

Thus new profit sharing ratio of A, B, C and D will be = $\frac{2}{5}:\frac{1}{5}:\frac{1}{5}:\frac{1}{5}=2:1:1:1$

(v) When new partner purchases his share from old partners in a particular ratio.

A and B are partners sharing profits in the ratio of 3 : 2. They admit C for 1/4th share, which he takes 4/24 from A and 2/24 from B. Calculate new profit sharing ratio and sacrifice ratio.

A's sacrifice = $\frac{4}{24}$ B's sacrifice = $\frac{2}{24}$

A's new share = $\frac{3}{5}-\frac{4}{24}=\frac{52}{120}$ B's new share = $\frac{2}{5}-\frac{2}{24}=\frac{38}{120}$ C's new share = $\frac{1}{4}$ or $\frac{30}{120}$

Thus new profit sharing ratio of A, B and C will be :

$=\frac{52}{120}:\frac{38}{120}:\frac{30}{120}=52:38:30=26:19:15$ Sacrifice ratio = $\frac{4}{24}:\frac{2}{24}$ = 4 : 2 or 2 : 1

(vi) When old partners surrender a particular fraction of their share in favour of the new partner.

(a) A and B are partners sharing profits in the ratio of 3 : 2. C is admitted as new partner. A surrenders 1/5th of his share and B 2/5th of his share in favour of C. Find the new profit sharing ratio and sacrifice ratio.

Sacrifice ratio

A's sacrifice = $\frac{3}{5}X\frac{1}{5}=\frac{3}{25}$ B's sacrifice = $\frac{2}{5}X\frac{2}{5}=\frac{4}{25}$ Sacrifice ratio = $\frac{3}{25}:\frac{4}{25}$ = 3 : 4

A's new share = $\frac{3}{5}-\frac{3}{25}=\frac{12}{25}$ B's new share = $\frac{2}{5}-\frac{4}{25}=\frac{6}{25}$ C's new share = $\frac{3}{25}+\frac{4}{25}=\frac{7}{25}$

Thus new profit sharing ratio of A, B and C will be = $\frac{12}{25}:\frac{6}{25}:\frac{7}{25}=12:6:7$

(b) A and B are partners in a firm sharing profits in the ratio of 3 : 2. C is admitted as new partner. A surrenders 1/3rd of his share while B surrenders 1/10th from his share in favour of C. Calculate new profit sharing ratio and sacrifice ratio.

A's sacrifice $= \frac{3}{5} X \frac{1}{3} = \frac{1}{5}$ B's sacrifice $= \frac{1}{10}$

A's new share $= \frac{3}{5} - \frac{1}{5} = \frac{2}{5}$ or $\frac{4}{10}$ B's new share $= \frac{2}{5} - \frac{1}{10} = \frac{3}{10}$ C's new share $= \frac{1}{5} + \frac{1}{10} = \frac{3}{10}$

Thus new profit sharing ratio of A, B and C will be :$= \frac{4}{10} : \frac{3}{10} : \frac{3}{10} = 4 : 3 : 3$

Sacrifice ratio $= \frac{1}{5} : \frac{1}{10} = \frac{2:1}{10}$ or 2 : 1

1. A, B and C are partners in the ratio of 3 : 2 : 1. D is joining the firm as a new partner for 1/6th share in profit. C would retain his original share. Find new profit sharing ratio.

   C's new share $= \frac{1}{6}$ D's new share $= \frac{1}{6}$

   Combined share of C and D $\frac{1}{6} + \frac{1}{6} = \frac{2}{6}$ Remaining share $1 - \frac{2}{6} = \frac{4}{6}$

   A's new share $= \frac{4}{6} X \frac{3}{5} = \frac{12}{30}$ B's new share $= \frac{4}{6} X \frac{2}{5} = \frac{8}{30}$

   Thus new profit sharing ratio of A, B, C and D will be $= \frac{12}{30} : \frac{8}{30} : \frac{1}{6} : \frac{1}{6} = \frac{12:8:5:5}{30}$ = 12:8:5:5

2. A and B are partners sharing profits in the ratio of 3 : 2. C is admitted for 1/4th share. A and B decide to share equally in future. Find new profit sharing ratio and sacrifice ratio.

   C's share $= \frac{1}{4}$ The remaing share $1 - \frac{1}{4} = \frac{3}{4}$

   A's new share $= \frac{3}{4} X \frac{1}{2} = \frac{3}{8}$ B's new share $= \frac{3}{4} X \frac{1}{2} = \frac{3}{8}$

   Thus new profit sharing ratio of A, B and C = $\frac{3}{8} : \frac{3}{8} : \frac{1}{4}$ = 3 : 3 : 2

   Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

   Sacrifice made by A= $\frac{3}{5} - \frac{3}{8} = \frac{9}{40}$ Sacrifice made by B= $\frac{2}{5} - \frac{3}{8} = \frac{1}{40}$

   Sacrifice ratio $= \frac{9}{40} : \frac{1}{40}$ =9 : 1

3. A and B are partners sharing profits in the ratio 3 : 2. They admitted C as a partner. Ratio between B and C will be same as the ratio between A and B.

   A : B   B : C
   3 : 2   3 : 2
   x 3   x 2
   9 : 6   6 : 4

   Thus new profit sharing ratio = 9 : 6 : 4

4. A and B are partners sharing profits in the ratio of 3 : 2. They admitted C for 1/5th share. C gets his ½ share from A and gets his remaining share from A and B equally. Find new profit sharing ratio and sacrifice ratio.

   A's sacrifice $\frac{1}{5} X \frac{1}{2} = \frac{1}{10}$ Remaining share of C $\frac{1}{5} - \frac{1}{10} = \frac{1}{10}$

   againA's sacrifice $\frac{1}{10} X \frac{1}{2} = \frac{1}{20}$ B's sacrifice $\frac{1}{10} X \frac{1}{2} = \frac{1}{20}$

   Total sacrifice of A $\frac{1}{10} + \frac{1}{20} = \frac{3}{20}$ Sacrifice ratio $\frac{3}{20} : \frac{1}{20}$ = 3 : 1

   New profit sharing ratio = old profit sharing ratio – sacrifice ratio

   A $\frac{3}{5} - \frac{3}{20} = \frac{12-3}{20} = \frac{9}{20}$ B $\frac{2}{5} - \frac{1}{20} = \frac{8-1}{20} = \frac{7}{20}$ So new profit sharing ratio = $\frac{9}{20} : \frac{7}{20} : \frac{1}{5}$ or 9 : 7 : 4

5. A, B and C are partners sharing profits as 3:2:1. They admit D, who gets 1/4th of his share from A. B surrenders 1/4th of his share and C surrenders 1/5th of his share. Find new profit sharing ratio.

   B's sacrifice $\frac{2}{6} x \frac{1}{4} = \frac{2}{24}$ C's sacrifice $\frac{1}{6} x \frac{1}{5} = \frac{1}{30}$

Total sacrifice of B and C $\frac{2}{24}+\frac{1}{30}=\frac{10+4}{120}=\frac{14}{120}$

A's sacrifice is 1/4th of D's share i.e 3/4th of D's share is sacrificed by B and C.

Thus A's sacrifice is $\frac{14}{120}\text{X}\frac{4}{3}\text{X}\frac{1}{4}=\frac{14}{360}$

Sacrifice ratio A: B: C

$\frac{14}{360}:\frac{2}{24}:\frac{1}{30}=\frac{14:30:12}{360}$

New profit sharing ratio = old profit sharing ratio – new profit sharing ratio

A $\frac{3}{6}-\frac{14}{360}=\frac{180-14}{360}=\frac{166}{360}$ B $\frac{2}{6}-\frac{2}{24}=\frac{8-2}{24}=\frac{6}{24}$ C $\frac{1}{6}-\frac{1}{30}=\frac{5-1}{30}=\frac{4}{30}$

D's share $\frac{14}{360}+\frac{2}{24}+\frac{1}{30}=\frac{56}{360}$

A:B:C:D = $\frac{166}{360}:\frac{6}{24}:\frac{4}{30}:\frac{56}{360}=\frac{166:90:48:56}{360}$ or 83 : 45 : 24 : 28

6. A and B are partners sharing profit in the ratio of 3:2. C is admitted as new partner. The new profit sharing ratio among A,B and C is 5:3:2. Find sacrifice ratio.
   sharing ratio = old profit sharing ratio – new profit sacrifice ratio

   A=$\frac{3}{5}-\frac{5}{10}=\frac{1}{10}$ B=$\frac{2}{5}-\frac{3}{10}=\frac{1}{10}$ Sacrifice Ratio= 1 : 1

Goodwill :

Goodwill is an intangible asset. Goodwill is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation and connection of a Business. It is the attractive force which brings in the customers.

"Goodwill is nothing more than the probability that the old customers will resort to the old place"

-Lord Eldon

Characteristics of Goodwill :

1. It is an intangible asset.
2. It is a valuable asset.
3. It helps to earn higher profits.
4. It is an attractive force which brings in customers to old place of business.
5. Its value is fluctuating.

Factors affecting the value of Goodwill :

1. Favourable location of the business
2. Efficiency of management.
3. The longevity of the business.
4. Nature of goods.
5. Possession of licence.
6. Monopoly.
7. Risk involved
8. Trend of profit.
9. Future competition.
10. Capital required.
11. Quality of products.

Need for the valuation of Goodwill :

The need for valuation of goodwill in partnership arises in following circumstances:-

1. When a partner is admitted.
2. When there is a change in profit sharing ratio among the existing partners.
3. When partner retired or dies
4. When the firm is sold.
5. When two firms amalgamate.

Types of Goodwill

Purchased Goodwill

Self Generated Goodwill

1. **Purchased Goodwill :** It is the goodwill which is acquired by making payment. For example, when a business is purchased the excess of purchase consideration over its net assets (i.e. Assets-Liabilities) is the value of purchased goodwill.
   a) It arises on purchase of business.
   b) It is recorded in the books of accounts because consideration is paid for it.
   c) It is shown in the balance sheet as an asset
2. **Self Generated Goodwill :**
   a) It is internally generated over a long period of time.
   b) As per accounting standard 26 and Indian A.S 38 it is not recorded in the book of accounts.

Nature of Goodwill

1. Institutional Goodwill or Cat Goodwill

2. Personal Goodwill or Dog Goodwill

3. Goodwill related to casual event or Rat Goodwill

1. **Institutional Goodwill or Cat Goodwill :** Such type of goodwill exists due to reputation, good name and quality of goods of the entity. There are customers who continue to visit the old business place even if the ownership changes. It is also called cat goodwill because cat does not leave the house even if the master leaves the house. The value of goodwill of such business will be very high.
2. **Personal Goodwill or Dog Goodwill :** When goodwill exists in business due to personality, efficiency and conduct of the owner then such goodwill is called personal goodwill. The customers will go to the old proprietor where he goes. It is also known as Dog Goodwill. A dog is faithful animal. Dogs are attached to the master. It follows its master. Value of such goodwill is less than the institutional goodwill. This type of goodwill exists in entity of professional nature.
3. **Goodwill related to Casual Events or Rat Goodwill :** Under this, value of goodwill of the business is not fixed but fluctuating in nature. Meaning that value of goodwill may change due to insignificant events. It is also known as 'Rat Goodwill.' Rat is attached neither to the master nor to the house. Rat is very flexible and moves frequently. Similarly, some customers have attachment neither to the person nor to the place. The value of such goodwill is very low.

Methods of Valuation of Goodwill :

1. **Years purchase method :** Under this method average profit as calculated is multiplied by number of years purchase to arrive at the value of goodwill.
2. **Average Profit Base :**
   a) **Simple Average Profit** : Under this method average profit of the past few years is taken into consideration. The following adjustments should be taken into account while calculating the average profits.
      a) Abnormal income/ profit of a year should be deducted from of net profit of that year.
      b) Abnormal loss/expenses of a year should be added back to the net profit of that year.
      c) Income from non trade investments should be deducted out of the net profit of that year.

$$\text{Average Profit} = (\text{AP}) = \frac{\text{Total Adjusted Profits}}{\text{No. of years}}$$

Actual Average Profit (AAP)= Average Profits – partner's remuneration

Goodwill = Actual Average Profit X No. of years purchase

1. Goodwill of a firm is valued at two years purchase of the average profits of the last five years.

Years	2012	2013	2014	2015	2016
Profits (₹)	15,000	18,000	7,000 (Loss)	10,000	14,000

Calculate value of goodwill.

Average Profit $= \frac{Total\ Profits}{No.of\ Years} = \frac{15000+18000-7000+10000+14000}{5} = \frac{50000}{5}$ = ₹ 10000

Goodwill = Actual Average Profit X No. of years purchase

= 10000 x 2 = ₹ 20,000

2. Goodwill of a firm is valued at two year's purchase of the average of last 3 years.

Years	Profits ₹	
2014	40000	(including an abnormal gain ₹ 10000)
2015	30000	(after charging an abnormal loss of ₹ 5000)
2016	33000	(including interest on investments of ₹ 8000)

Average profit $= \frac{30000+35000+25000}{3} = \frac{90000}{3}$ = ₹ 30,000

Goodwill = A.P. X No. of years purchase = 30000 X 2 = ₹ 60,000

3. Goodwill of a firm is valued of 3 years purchase of the average profit of last 3 years.

Years	Profits ₹	
2012	25000	(Include speculative profits of ₹ 5000)
2013	(-) 5000	(After debiting loss of stock of ₹ 40000)
2014	22000	(Including profit on sale of assets of ₹ 2000)

Salary of the partner ₹ 5000 p.a.

Calculate the value of goodwill. Average Profit $= \frac{20000+35000+20000}{3} = \frac{75000}{3}$ = ₹ 25,000

Actual Average profit = ₹ 25,000 & ₹ 5,000 = ₹ 20,000 Goodwill = ₹ 20,000 x 3 = ₹ 60,000

b) Weighted Average Profit : This method is preferred when the profits over the past years have been continuously rising or falling. Under this method each year's profit is assigned a weight. Like 1,2,3,4....respectively.

Calculate the value of goodwill on the basis of two years purchase.

Purchase of weighted average profits of past 5 years.

Years	Profits		Weight		Product(PxW)
2012	10000	x	1	=	10000
2013	12000	x	2	=	24000
2014	15000	x	3	=	45000
2015	20000	x	4	=	80000
2016	30000	x	5	=	150000
			15		**309000**
			Total Weight		Total Product of Profits

Weighted Average Profit(WAP) $= \frac{Total\ product\ of\ profits}{Total\ of\ weight}$

$= \frac{309000}{15}$ = ₹20,600

Goodwill = ₹ 20,600 X 2 = ₹ 41,200

(1) Calculate the value of goodwill on the basis of 3 years purchase of the weighted average profit.

Years	Profits		Weight		Product (P X W)
2013	5000	X	1	=	5000
2014	7000	X	2	=	14000
2015	10000	X	3	=	30000
2016	15000	X	4	=	60000
		∑W	10	∑P	1,09,000

Weighted Average Profit (W.A.P.) = $\frac{\sum P}{\sum W}$ = $\frac{109000}{10}$ = ₹ 10,900

Goodwill = 10900 X 3 = ₹ 32,700

(iii) Compute the value of goodwill on the basis of 3 years purchase of weighted average profits of last 4 years.

Years	Profits ₹	Weight
2012-13	20200	1
2013-14	24800	2
2014-15	20000	3
2015-16	30000	4

On scrutiny of the accounts the following matters are revealed :-

(i) On 1-12-2014 a major repair was made in respect of the plant incurring ₹ 6000 which amount was charged to revenue. The paid sum is agreed to be capitalised for goodwill. Calculate subject to adjustment of depreciation of 10% p.a. on reducing balance method.

(ii) The closing stock for the year 2013-14 was over valued by ₹ 2400.

(iii) To cover the management cost an annual charge of ₹ 4800 should be made for the purpose of goodwill valuation.

Years	**2012-13₹**	**2013-14₹**	**2014-15₹**	**2015-16₹**
Profits	20200	24800	20000	30000
(-) Managerial Cost	4800	4800	4800	4800
(+) Capital Expenditure Charge to revenue	-	-	6000	-
(-) Dep. (Not Provided)	-	-	200	580
(-) Over Valuation of closing Stock	-	2400	-	-
(+) Over Valuation of Opening stock	-	-	2400	-
Adjusted Profits	**15400**	**17600**	**23400**	**24620**

3. **Super Profit Base :** The excess of actual profit over the normal profit is called super profit.

Super profit = Actual Average Profit – Normal Profit

S.P = A.A.P – N.P   Normal Profit = Capital Employed x NRR

Normal Rate of Return (NRR) : Normal rate of return refers to the rate of return normally earned by other firms in the same industry.

Normal Rate of return (NRR) = Rate of Interest + Risk Factor

Note : If super profit is zero or negative then there will be not goodwill.

Goodwill = super profit x no. of years purchase;

(i) The capital of the firm is ₹ 50000 and normal rate of return is 10%. Actual average profit is ₹ 9000. Calculate goodwill at 4 times the super profit.

Normal profit = Capital Employed x N.R.R. = ₹ 50000 x 10 /100 = ₹ 5000

S.P. = AAP - NP

= ₹ 9000 - ₹ 5000 = ₹ 4000

Goodwill = SP X 4 = ₹ 4000 X 4 = ₹ 16000

(ii) Capital of the firm of A and B is ₹ 200000 and the normal rate of return is 10%. Annual sales to the partners are ₹ 6000 each. The profits of the last three years were ₹ 4000, ₹ 35000 and ₹ 45000 respectively. Goodwill is to be valued at two years purchase of last 3 years super profit.

Average Profit = $\frac{40000 + 35000 + 45000}{3} = \frac{120000}{3}$ = 40000 - 12000 (Salary to partners) = ₹ 28000

Normal profit = Capital Employed x N.R.R. → = ₹ 2, 00,000 x 10 /100 = ₹ 20000

S. P. = AAP – NPSP = 28000 - 20000 = ₹ 8000   Goodwill= SP X 2 = 8000 X 2 = ₹ 16000

(iii) On 1-4-2017 an existing firm had asset of ₹ 200000 including cash of ₹ 10000. Its creditors amounted to ₹ 10000 on that date. The firm had a reserve of ₹ 30000, while partner's capital account showed a balance of ₹ 160000. Rate of interest is 8% and risk factor is 2%. Goodwill of the firm is valued at ₹ 33000 at three years purchase of super profit. Find actual average profit of the firm.

Capital Employed = Assets – Liabilities = 200000 – 10000 = ₹ 190000

Normal rate of return = rate of interest + Risk factor = 8% + 2% = 10%

Normal profit = Capital Employed x N.R.R. = 190000 X 10 /100 = ₹19000

Goodwill = SP X 3 = ₹ 33000   33000 = SP X 3   S.P. = 33000/3 = ₹ 11000

S.P = AAP-NP   ₹ 11000 = AAP-19000   AAP=₹30,000

(iv) Profits of last three years of firm were ₹ 20000, ₹ 17000, ₹ 23000 respectively, Capital employed is ₹ 100000 and normal rate of return is 12%. Find goodwill on the basis of three years purchase of super profit.

Average Profit=$\frac{20000+17000+23000}{3}$ = $\frac{60000}{3}$ = ₹ 20,000

Normal Profit = Capital Employed X N.R.R. = 100000 X 12 /100 = ₹ 12000

S.P = AAP - NP = 20000 - 12000 = ₹ 8000   Goodwill = SP X 3 = 8000 X 3 = ₹ 24000

(2) **Capitalisation method :** Under this method goodwill can be calculated in 2 ways :

(i) By Capitalising the Average Profit, or

(ii) By Capitalising the Super Profits.

(iii) **Capitalisation of Average Profit Method :**

Capitalised value of Average Profit = $\frac{Average\ Profit\ X\ 100}{Normal\ Rate\ of\ Return}$

Goodwill = Capitalised value of profits – Capital Employed

Note : If the capitalised value of business less capital employed is zero or negative there will be no goodwill.

a. From the figures given below, calculate goodwill by capitalisation of average profit method.

(a) Actual Average Profits ₹ 15000

(b) Capital of firm ₹ 100000 (c) NRR 10%

Goodwill = $\frac{AAP\ X\ 100}{NPR}$ – Capital Employed = $(\frac{15000\ X\ 100}{10})$ – ₹ 100000

Goodwill = 150000 – 100000 ₹ 50,000

b. From the figures given below, calculate goodwill by capitalisation of average profit method.

(a) Actual Average Profits ₹ 46000

(b) NRR 10%

(c) Assets ₹ 500000

(d) Liabilities ₹ 100000

Goodwill = $\frac{AAP\ X\ 100}{NRR}$ – Capital Employed = $(\frac{46000\ x\ 100}{10})$ – 400000 = ₹ 60,000

(ii) Capitalisation of Super Profit Method

Goodwill = $\frac{Super\ Profit\ X\ 100}{NRR}$

(a) Actual Average Profit ₹ 1,00,000, NRR 10%

Capital Employed ₹ 800000

Normal Profit = Capital Employed x N.R.R. = 800000 x 10 /100 = ₹ 80,000

S.P.=100000 - 80000 = ₹ 20000 ; Goodwill = $\frac{S.P.X\ 100}{NRR}$ = $\frac{20000\ X\ 100}{10}$ = ₹ 2,00,000

(b) Assets ₹ 300000, Liabilities ₹ 50000, NRR 10%, AAP ₹ 30000

Normal Profit = Capital Employed x N.R.R. = 250000 X 10 /100 = ₹ 25,000

Super Profit = AAP – NP = ₹ 30,000 – ₹ 25,000 = ₹ 5,000

Goodwill = $\frac{S.P.X\ 100}{NRR} = \frac{5000\ X\ 100}{10}$ = ₹ 50,000

(c) A.A.P. ₹ 50,000; NRR 10%; Capital Employed ₹ 3,00,000. Calculate goodwill by Capitalisation of Average Profit and Super Profit Method.

i) on the basis of Average Profit

Goodwill = $(\frac{\text{AP X 100}}{\text{NRR}})$ – Capital Employed = $(\frac{\text{50000 X 100}}{10})$ – 300000 = ₹2,00,000

ii) on the basis of Super Profit

Normal Profit = Capital Employed x N.R.R. = 300000 x 10 /100 = ₹ 30000

S.P = AAP - NP = 50000 – 30000 = ₹ 20000

Goodwill = $\frac{S.P.X\ 100}{NRR} = \frac{20000\ X\ 100}{10}$ = ₹ 200000

(4) Hidden Goodwill Method :

Total capital of the firm will be calculated according to new partner's share of profit.

Goodwill of the firm = Total capital – Adjusted capital of the old partners– Capital of new partner

Adjusted Capital = Balance of capital A/C + Reserves + Profits – Loss

(i) A and B are partners in a firm. Their capitals are ₹ 20000 and ₹ 30000 respectively. They admit C for $1/5^{th}$ share. ₹ 15000 is brought by C as his share of capital. Find the value of firm's goodwill.

Total Capital of the firm on the basis of C's capital $15000 \text{ X } \frac{5}{1} =$ ₹ 75,000

Goodwill = Total capital – Adjusted capital of A and B – C's capital

= 75000 – 50000 – 15000 = ₹ 10000

(ii) A and B are partners in a firm. Their capital are ₹ 10,000 and ₹ 20,000. Undistributed reserves ₹10,000. C is admit for $1/4^{th}$ share. ₹ 20,000 is brought by C as his capital. Find the value of firm's goodwill.

Total capital of the firm $\frac{20000 \text{ x } 4}{1}$ = ₹ 80000

(-) Adjusted capital of A (10000 + 5000) = 15000

(-) Adjusted capital of B (20000 + 5000) = 25000

(-) C's capital = 20000

Goodwill of the firm ₹ 20000

(5) Purchase Consideration Method :

Goodwill = Purchase Consideration – Net Assets

Illustration : Assets ₹ 200000 Liabilities ₹ 50,000

Purchase consideration ₹ 1,70,000

Find the value of Goodwill.

Net Assets = Assets – Liabilities = 200000 – 50000 = ₹ 1,50,000

Goodwill = Purchase Consideration - Net Assets= 170000 – 150000 = ₹ 20,000

(6) Annuity Method :

Goodwill= Super Profit X Present Value of Annuity

$$\text{Present Value of Annuity} = \frac{1 - \left(\frac{100}{100+r}\right)^{n}}{\frac{r}{100}}$$

n = no. of years r = normal rate of return

Illustration : n = 3, r = 10%

$$\text{Present Value of Annuity} = \frac{1 - \left(\frac{100}{100 + 10}\right)^{3}}{\frac{10}{100}} = 2.487$$

(i) AAP = ₹ 20,000, Capital Employed = ₹ 1,50,000, NRR = 10%, P.V. A = 2.487

Find value of the Goodwill by Annuity Method

Normal profit = Capital Employed x N.R.R. = 150000 x 10 /100 = ₹ 15,000

S.P. = AP - NP = 20000 – 15000 = ₹ 5,000

Goodwill = S.P. x P.V.A. = 5000 x 2.487 = ₹ 12,435

Accounting Treatment of Goodwill (Premium)

The following are the situations at the time of admission of a new partner related to treatment of goodwill.

1. Goodwill is paid by the incoming partner privately.
2. Incoming partner brings his share of goodwill.
3. New partner does not bring his share of goodwill in cash.
4. New partner brings in only part of his share of goodwill in cash.
5. Incoming partner brings his share of goodwill in kind.
6. Treatment of hidden goodwill.
7. Treatment of goodwill at the time of change in profit sharing ratio.

Note : When goodwill A/c already appeared in the books.

Old Partner's Capital A/c Dr.(OPSR)

To Goodwill A/c

(Being existing goodwill account is written off in old profit sharing ratio)

(i) Goodwill is paid by the incoming partner privately :

If the amount of goodwill is paid by the incoming partner privately, no journal entry is required in the books of accounts.

(ii) When new partner brings his share of goodwill in cash :

(a) For goodwill brought in cash

Cash A/c Dr.

To Goodwill A/c

(Being amount of goodwill brought in cash)

(b) On the distribution of amount of goodwill among sacrificing partners :

Goodwill A/c Dr.

To Sacrificing partner's capital A/c

(Being amount of goodwill transferred to sacrificing partner's capital A/c)

(c) Amount of goodwill is withdrawn by the sacrificing partners:

Sacrificing partner's capital A/c Dr.

To Cash A/c

(Being amount of goodwill withdrawn by sacrificing partners)

(iii) When new partner does not bring his share of goodwill in cash :

New partner's current A/c Dr.

To Sacrificing partner's capital A/c

(Being share of goodwill of new partner adjusted through capital A/c)

Note : New partner's current A/c has been debited instead of his capital A/c, so that his capital is not reduced.

(iv) When new partner brings in only a part of his share of goodwill –

(a) Goodwill brought in cash by the new partner

Cash A/c Dr.

To Goodwill A/c

(Being amount of goodwill brought in cash)

(b) Goodwill credited to sacrificing partners

Goodwill A/c Dr.

New partner's current A/c Dr.

To Sacrificing partner's capital A/c

(Being amount of goodwill transferred to sacrificing partner's capital A/c)

(v) Incoming partner brings his share of goodwill in kind –

(a) For assets brought in by new partner

Asset A/c Dr.

To Goodwill A/c

(Being assets contributed by new partner for his share of goodwill)

(b) For giving credits of incoming partner's share of goodwill to sacrificing partners

Goodwill A/c Dr.

To Sacrificing partner's capital A/c

(Being goodwill transferred to sacrificing partner's capital A/c)

(vi) Treatment of hidden goodwill :

New partner's current A/c Dr.

To Sacrificing partner's capital A/c

(Being amount of goodwill adjusted through sacrificing partner's capital A/c)

(vii) Treatment of goodwill at the time of change in profit sharing ratio

Gaining partner's capital A/c Dr.

To Sacrificing partner's capital A/c

(Being adjustment goodwill due to change in profit sharing ratio)

Note : (i) Term premium is used for goodwill sometimes.

(ii) Amount of goodwill brought in by a new partner is distributed between sacrificing partners in their sacrificing ratio.

(ii) According to A.S. 10, 26/ Indian A.S. 38 Goodwill should be recorded in the books only when consideration in money or money's worth has been paid for it. i.e. when goodwill is purchased.

Self-Generated Goodwill : If goodwill is evaluated at the time of change in constitution of the firm (by way of admission/retirement/death/changes in profit sharing ratio) brought in books since it is self- generated goodwill. The value of goodwill in this situation should be adjusted through partner's Capital or Current Account

Treatment of Goodwill

Where amount of Goodwill brought in

- **Paid Privately pass No Entry**
- **Paid through Firm**
  - (i) Amount of Goodwill brought in Cash
    Cash A/c Dr.
        To Goodwill A/c
  - (ii) Goodwill transfer to old partner's capital A/c
    Goodwill A/C Dr.
        To Sacrificing partners' capital A/c
  - (iii) Goodwill withdrawn by old partner's
    Sacrificing Partners' Capital A/c Dr.
        To Cash A/c

When new partner does not bring Goodwill in

New Partners' Current A/c Dr.
    To Sacrificing Partner's Capital A/c

When only part of the Goodwill is bring in

(i) Cash A/c Dr.
    To Goodwill A/c
(ii) Goodwill A/c Dr.
New Partner's Current A/c Dr.
    To Sacrificing Partner's Capital A/c

When Goodwill brought in kind

(iii) Asset A/c Dr.
    To Goodwill A/c
(iv) Goodwill A/c Dr.
    To Sacrificing Partner's Capital A/c

Hidden Goodwill

New Partner's Current A/ C Dr.
    To Sacrificing Partner's Capital A/c
(Usually this does not bring in Amount of Goodwill in Cash)

When change in Profit Sharing

Gaining Partner's Capital A/c Dr.
    To Sacrificing Partner's Capital A/c

Note: In all the above conditions Goodwill already appearing in the Books will be written off among old partners.

(i) A and B are partners in a firm sharing profits in the ratio of 3:2. They admit C as a partner for 1/4th share in profit. He brings ₹20,000 as goodwill. Pass the necessary journal entries when –

(a) Goodwill is retained in the business.

(b) Goodwill is withdrawn by sacrificing partners.

(a) (i) Cash A/c Dr. 20000
  To Goodwill A/c 20000
(Being amount of goodwill brought in cash)

(ii) Goodwill A/c Dr. 20000
  To A'S Capital A/c 12000
  To B'S Capital A/c 8000
(Being amount goodwill distributed between sacrificing partners)

(**b**) A'S Capital A/c Dr. 12000
B'S Capital A/c Dr. 8000
  To Cash A/c 20000
(Being amount of goodwill withdrawn by the sacrificing partners)

(ii) A and B are partners in a firm sharing profits in the ratio of 3:2. A and B surrender ½ of their respective shares in favour of C. C is to brings his shared goodwill in cash. Goodwill of the firm is estimated at ₹40,000. 3/4th goodwill is withdrawn by A and B. Pass necessary journal entries.

C's share in goodwill = 40000 X ½ = ₹ 20,000.

A's sacrifice = $\frac{3}{5} \times \frac{1}{2} = \frac{3}{10}$ Sacrifice ratio = 3:2

B's sacrifice = $\frac{2}{5} \times \frac{1}{2} = \frac{2}{10}$ C's share in profit = $\frac{3}{10} + \frac{2}{10} = \frac{5}{10}\ or\ \frac{1}{2}$

Journal entries :

Cash A/c Dr. 20000
  To Goodwill A/C 20000
(Being amount of goodwill brought in cash)

Goodwill A/C Dr. 20000
  To A'S Capital A/c 12000
  To B'S Capital A/c 8000
(Being amount of goodwill distributed between sacrificing partners)

A'S Capital A/c Dr. 9000
B'S Capital A/c Dr. 6000
  To Cash 15000
(Being goodwill withdrawn by sacrificing partners)

(iii) A and B are partners sharing profits in the ratio 3:2. They admit C into the firm for 3/7th profit, which he takes 2/7th from A and 1/7th from B. C brings ₹30,000 for his share of goodwill. At the time of admission of C, goodwill appeared in the books at ₹ 20,000. Pass necessary journal entries.

Sacrificing Ratio = 2/7 : 1/7 = 2:1

Cash A/c Dr. 30000
  To Goodwill A/c 30000
(Being amount of goodwill brought in cash)

Goodwill A/c Dr. 30000
  To A'S Capital A/c 20000
  To B'S Capital A/c 10000
(Being amount of goodwill distributed in sacrifice ratio)

A'S Capital A/c	Dr.	12000	
B'S Capital A/c	Dr.	8000	
To Goodwill			20000

(Being goodwill A/c written off)

(iv) A and B are partners sharing profits in the ratio 3:2. C is admitted as a new partner. C brings ₹ 20,000 as goodwill. Treatment of goodwill made under the following conditions :

(a) C is admitted for $1/5^{th}$ share, which he gets entirely from A.

(b) C is admitted for $1/5^{th}$ share, which he gets entirely from B.

(c) C is admitted for $1/5^{th}$ share.

(d) C is admitted for $1/5^{th}$ share, which he gets equally from A and B.

(e) The new profit sharing ratio among A, B and C is 1:1:3.

(f) A contributes $3/20^{th}$ and B contributes $1/20^{th}$ share in favour of C.

Following entry is common in all cases:

Cash A/c	Dr.	20000	
To Goodwill A/c			20000

(Being amount of goodwill brought in cash)

(a) C gets his $1/5^{th}$ share entirely from A.

Goodwill A/c	Dr.	20000	
To A'S Capital A/c			20000

(Being amount of goodwill transferred to A's Capital A/c)

(b) C gets his $1/5^{th}$ share entirely from B.

Goodwill A/c	Dr.	20000	
To B'S Capital			20000

(Being amount of goodwill transferred to B's Capital A/c)

(c) C is admitted for $1/5^{th}$ share. In this condition OPSR = SR.

So sacrificing ratio = 3:2.

Goodwill A/c	Dr.	20000	
To A's Capital			12000
To B's Capital			8000

(Being amount of goodwill distributed between A and B in their sacrifice ratio)

(d) C gets his $1/5^{th}$ share equally from A and B. So in this condition the sacrificing ratio will be = 1:1

Goodwill A/c	Dr.	20000	
To A's Capital			10000
To B's Capital			10000

(Being amount of goodwill distributed between A and B in their sacrifice ratio)

(e) In this condition, sacrifice ratio of A and B = 2:1.

Goodwill A/c	Dr.	20000	
To A's Capital			13333
To B's Capital			6667

(Being amount of goodwill distributed between A and B in their sacrifice ratio)

(f) C gets $3/20^{th}$ share from A and $1/20^{th}$ share from B. In this condition the sacrifice ratio will be = 3:1.

Goodwill A/c Dr. 20000

To A's Capital A/c 15000

To B's Capital A/c 5000

(Being amount of goodwill distributed between A and B in their sacrifice ratio)

(v) A and B are partners in a firm sharing profits in the ratio of 4:3. They admitted C as a new partner. The new profit sharing ratio of A, B and C will be 3:2:2. The firm's goodwill on C's admission was valued at ₹ 28,000. C could not bring his share of goodwill in cash. Pass necessary journal entries.

Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

$A = \frac{4}{7} - \frac{3}{7} = \frac{1}{7};\ B = \frac{3}{7} - \frac{2}{7} = \frac{1}{7};$ Sacrifice ratio = 1:1

C's share = $\frac{1}{7} + \frac{1}{7} = \frac{2}{7}$ C's share in goodwill = 28000 X $\frac{2}{7}$ = ₹ 8,000

C's Current Account Dr. 8000

To A's Capital A/c 4000

To B's Capital A/c 4000

(Being C's share of goodwill adjusted)

(vi) A and B are partners in a firm sharing profits in the ratio of 2 : 1. They admitted C as a new partner. The new profit sharing ratio is 2:1:1. Goodwill of the firm is valued at ₹ 30,000. C is unable to bring in his share of goodwill in cash. At the time of admission of C, goodwill appeared in books at ₹ 15,000. Pass necessary journal entries.

Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

$A = \frac{2}{3} - \frac{2}{4} = \frac{2}{12};\ B = \frac{1}{3} - \frac{1}{4} = \frac{1}{12}$ SR = 2:1

A's Capital Dr. 10000

B's Capital Dr. 5000

To Goodwill A/c 15000

(Being goodwill account written off)

C's share in goodwill = 30000 x 1 /4 = ₹ 7500

C's Current Account Dr. 7500

To A's Capital A/c 5000

To B's Capital A/c 2500

(Being goodwill adjusted between A & B)

Note :– New partner's current a/c has been debited instead of his capital a/c so that his capital is not reduced.

(vii) A and B share profits in the ratio of 2:1. They admitted C for $1/4^{th}$ share in profits. C pays ₹ 3000 out of his share of ₹ 4200 for goodwill. The new profit sharing ratio among A, B and C will be 5 : 3 : 2. Pass necessary journal entries.

1. Cash A/c Dr. 3000

To Goodwill 3000

(Amount of goodwill brought in by C)

2. Goodwill Dr. 3000

C's Current A/c Dr. 1200

To A's Capital A/c 3500

To B's Capital A/c 700

(Being goodwill distributed between A & B)

Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

$A = \frac{2}{3} - \frac{5}{10} = \frac{5}{30};\ B = \frac{1}{3} - \frac{3}{10} = \frac{1}{30}$ SR = 5:1

(viii) A and B are partners in a firm. They admit C for 1/4th share in profit. C pays only ₹1000 out of his share of ₹ 1800 for goodwill. Goodwill account appeared in the books at ₹ 6000. Pass necessary journal entries.

1. Cash A/c Dr. 1000
To Goodwill 1000
(Being goodwill brought in cash)

2. Goodwill Dr. 1000
C's Current A/c Dr. 800
To A's Capital A/c 900
To B's Capital A/c 900
(Being goodwill distributed between A & B)

3. A's Capital A/c Dr. 3000
B's Capital A/c Dr. 3000
To Goodwill 6000
(Being goodwill account written off)

(ix) A and B are partners in a firm sharing profits in the ratio of 3:2. They admit C for 3/13th share in profit. The new profit sharing ratio will be 5:5:3. C contributed the following assets towards his capital and his share of goodwill.
Stock ₹20,000, furniture ₹ 10,000, machine ₹ 6,000 on the date of admission of C. The goodwill of the firm was valued at ₹ 2,60,000.
Pass necessary journal entries.
Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio
$\mathrm{A} = \frac{3}{5} - \frac{5}{13} = \frac{14}{65}$; $\mathrm{B} = \frac{2}{5} - \frac{5}{13} = \frac{1}{65} = 14:1$
C's share in goodwill = 2,60,000 x 3/13 = ₹ 60,000.

Stock	Dr.	20,000	
Furniture	Dr.	30,000	
Machine	Dr.	80,000	
To C's Capital A/c			70,000
To Goodwill A/c			60,000

(Being sundry assets contributed by new partner as his capital and his share of goodwill)

Goodwill A/c	Dr.	60,000	
To A's Capital A/c			56,000
To B's Capital A/c			4,000

(Being goodwill transferred to sacrificing partner's capital A/c)

(x) A and B are partners in a firm sharing profits in the ratio of 7:5. They admitted C for 1/6th share in profit. The new profit sharing ratio among A, B and C will be 13:7:4. C contributed the following assets towards his capital and his share of goodwill.
Stock ₹ 60,000, land and building ₹ 2,80,000, plant ₹ 1,20,000, on the date of C's admission. The goodwill of the firm was valued at ₹ 7,50,000.
Pass necessary journal entries.
Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio
$\mathrm{A} = \frac{7}{12} - \frac{13}{24} = \frac{1}{24}$; $\mathrm{B} = \frac{5}{12} - \frac{7}{24} = \frac{3}{24}$ =1:3
C's share in goodwill = 7,50,000x1/6 = ₹ 1,25,000.

Stock	Dr.	60,000	
Land & Building	Dr.	2,80,000	
Plant A/c	Dr.	1,20,000	
To C's Capital A/c			3,35,000
To Goodwill A/c			1,25,000

(Being sundry assets contributed by new partner as his capital and his share of goodwill)

Goodwill A/c Dr. 1,25,000

To A's Capital A/c 31,250

To B's Capital A/c 93,750

(Being goodwill transferred to sacrificing partner's capital A/c)

(xi) A and B are partners with capitals of ₹ 40,000 and ₹ 30,000 respectively. They admit C for 1/5th share, who contributes ₹ 20,000 as his share of capital. Calculate the amount of goodwill and pass necessary journal entries.

Goodwill of the firm :

Total capital on the basis of C's capital = $\frac{20000 \ X \ 5}{1}$	= ₹1,00,000
(−) Adjusted capital of A and B	= ₹70,000
(−) C's capital	= ₹20,000
Goodwill of the firm	= ₹10,000

C's share in Goodwill 10000 x 1 /5 = ₹ 2000

C's Current A/c Dr. 2000

To A's Capital A/c 1000

To B's Capital A/c 1000

(Being C's share of goodwill adjusted to sacrificing partner's capital)

(xii) A and B are partners in a firm sharing profits in the ratio 3:2. They agreed to share profits equally. For this purpose, the goodwill of the firm was valued at ₹ 60,000. Pass the journal entries for the treatment of goodwill.

Sacrifice ratio = Old profit sharing ratio – New profit sharing ratio

$\mathrm{A} = \frac{3}{5} - \frac{1}{2} = \frac{1}{10}$ (Loss); $\mathrm{B} = \frac{2}{5} - \frac{1}{2} = \left(\frac{1}{10}\right)$ (Gain) = 1:1

B's Capital A/c Dr. 6000

To A's Capital A/c 6000

(Being the goodwill adjusted on change in profit sharing ratio)

General entries when a new partner contributes capital :

(a) By bringing cash

Cash / Bank A/c Dr.

To New Partner's Capital A/c

(Being cash brought in by a new partner's towards capital)

(b) By bringing his existing business (by the way of assets and liabilities to firm)

Sundry Assets A/c Dr.

To Sundry Liabilities A/c

To New Partner's Capital A/c

(Being assets & liabilities brought in by new partner)

The difference between pre decided capital and net assets is brought in cash.

Sundry Assets A/c Dr.

Cash/Bank A/c Dr.

To Sundry Liabilities A/c

To New Partner's Capital A/c

(Being assets & liabilities brought in by new partner towards his share of capital)

Revaluation of Assets and Reassessment of Liabilities

The value of assets sometimes is different from the shown in value books because with the time value of some assets increases while of some other decreases. In the case of liabilities, it is possible that the amount payable is different from the value recorded in the books. It is also possible that some assets or liabilities are not recorded in the books. The value of assets and the liabilities payable need to be brought to their correct value so that incoming partner is not put any advantage or disadvantage. The value of assets and liabilities is adjusted through an account, called revaluation account or profit and loss adjustment account. This account is similar to a nominal account.

Entries passed for revaluation of assets and reassessment of liabilities

1. For increase in value of assets	Assets A/c Dr. To Revaluation A/c (Being increase in value of assets)	By increase in Value
2. Decrease in value of assets	Revaluation A/c Dr. To Assets A/c (Being decrease in value of assets)	By decrease in Value
3. For unrecorded assets	Unrecorded Assets Dr. To Revaluation A/c (Being unrecorded assets taken into account)	By Values of Assets
4. For increase in value of liabilities and provisions	Revaluation A/c Dr. To Liabilities/Provision A/c (Being increase in value of liabilities/provision)	By increase in Value
5. Decrease in value of liabilities and provisions	Liabilities/Provision A/c Dr. To Revaluation A/c (Being decrease in value of liabilities/provision)	By decrease in Value
6. For unrecorded liabilities	Revaluation A/c Dr. To Unrecorded Liabilities (Being unrecorded liabilities taken into account)	By Values of Liabilities
7. Profit on revaluation	Revaluation A/c Dr. To Old Partner's Capital (Being profit on revaluation credited to Old Partner's Capital A/c in their OPSR)	By Amount of Profit (in OPSR)
8. Loss on revaluation	Old Partner's Capital A/c Dr. To Revaluation A/c (Being loss on revaluation debited to old partner's capital account in their OPSR)	By Amount of Loss (in OPSR)

Format of Revaluation Account

Dr. **Revaluation / P & L Adjustment Account** Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Decrease in value of assets To Increase in the value of liabilities/ provision To Unrecorded liabilities To Profit on revaluation Transfer to old Partner's Capital A/c (In OPSR)		By Increase in value of assets By Decrease in the value of Liabilities/provision By Unrecorded assets By Loss on revaluation Transfer to old partner's capital A/c (In OPSR)	

Note : 1. Assets undervalued by --% = (Value as given X rate) / (100-rate)
2. Assets overvalued by --% = (Value of assets as given X rate) / (100 + rate)
3. If "Increased by" is given then increase by same amount.
4. If "Decreased to" is given then value of difference is taken.

Undistributed Profits Reserves, Undistributed Loss and Fictitious Assets

The value is credited or debited to the old partner's capital accounts/current accounts in their old profit sharing ratio.

(i) For distributing reserves and accumulated profits –

P&L A/c (Credit Balance) Dr.
Reserve Fund / General Reserve A/c Dr.
Workman Compensation Reserve A/c Dr. (Excess of reserve over actual liability)
Investment Fluctuation Reserve A/c Dr. (Excess of reserve over the difference between book value and market value)
To Old Partner's Capital A/c (In OPSR)

(ii) For distributing accumulated losses and fictitious assets –

Old Partner's Capital A/c Dr. (in OPSR)
To P & L (Dr. Balance)
To Deferred Revenue Expenditure A/c

Note : 1. Balance of Employees Provident Fund (E.P.F.) appearing on liabilities side of the balance sheet is not distributed among old partners, as this is not reserve but a statutory liability payable by the firm. 2. Deferred Revenue Expenditure i.e. Advertisement expenditure.

Adjustment of Partner's Capital

Adjustment of the old partner's capital accounts on the basis of the new partner's capital.	Calculating the capital of the new partner on the basis of capitals of the old partners.	When capital of the new firm is given.

1. Adjustment of the old partner's capital accounts on the basis of the new partner's capital :

Step (i) Calculate total capital of the firm on the basis of capital of the new partner.
Step (ii) Total capital is divided in their new profit sharing ratio.
Step (iii) Find adjusted capital of partner's
Step (iv) Compare adjusted capital and cash a/c or partner's current accounts.

Note : In absence of information adjustment is made through the cash account.

(i) A and B are partners sharing profits in the ratio of 3:1. They admitted C who brings in ₹ 40,000 for 1/4th share of profit. The adjusted capital of A and B are ₹1,00,000 and ₹25,000 respectively. It was decided that the capital accounts of old partners are to be adjusted on the basis of C's capital.

Solution :

Total capital of the firm (40000 X 4) / 1 = ₹1, 60,000

A's new share $\frac{3}{4} \times \frac{3}{4} = \frac{9}{16}$ B's new share $\frac{3}{4} \times \frac{1}{4} = \frac{3}{16}$ C's new share $\frac{1}{4}$ or $\frac{4}{16}$

A: B:C = $\frac{9}{16}:\frac{3}{16}:\frac{4}{16}$ = 9:3:4

A's capital = 16000 X $\frac{9}{16}$ = ₹90,000 B's capital = 16000 X $\frac{3}{16}$ = ₹30,000

C's capital = 16000 X $\frac{4}{16}$ = ₹40,000

A = 1,00,000 – 90,000 = 10,000 surplus capital B = 25,000 – 30,000 = 5,000 Deficiency

A's Capital A/c Dr. 10000

To Cash 10000

(Being cash withdrawn by A)

Cash A/c Dr. 5000

To B's Capital 5000

(Being cash brought in by B)

Calculation of the new partner's capital on the basis of capitals of the old partners.

Step (i) Determine total adjusted capital of the old partners.

Step (ii) Determine total capital of the new firm on the basis of total adjusted capital of old partners.

Step (iii) Determine capital of new partner.

I. A and B are in partnership with ₹40,000 and ₹20,000 as their adjusted capital. They admitted C as a partner for 1/6th share in profits.

(i) If new partner C is asked to bring in capital in proportion to his profit sharing ratio.

Total adjusted capital of A and B 40000 + 20000 = ₹ 60,000

Combined share of A and B 1 – 1/6 = 5/6

Total capital of the firm = (60000 X 6)/5 = ₹ 72,000

C's share in total capital = (72000 X 1)/6 = ₹ 12,000

(ii) If new partner C is to contribute 1/6th of the combined capital of A and B.

Combined capital of A and B ₹ 60,000

C's share in capital = 60000 X 1/6 = ₹ 10,000

Illustration1 :

A and B are partners sharing profits in ratio 3:1. Their Balance Sheet is as follows :

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	30,000	Cash at Bank	22,000
Bills Payable	6,000	Debtors	40,000
Outstanding Expenses	2,000	Stock	15,000
Employee's Provident Fund	6,000	Investments	12,000
General Reserve	12,000	Land & Building	50,000
Capitals		Plant & Machinery	30,000
A 80000		Furniture	16,000
B 70000	1,50,000	Trademark	5,000
		Patent	6,000
		Goodwill	10,000
	2,06,000		**2,06,000**

They decided to admit C on April 1st, 2017. New Profit Sharing Ratio will be equal :

(i) C Shall bring ₹10,000 share of premium (Goodwill) and ₹ 50,000 as his capital. **(ii)** A Liability of ₹ 4,000 included in creditors was not likely to arise **(iii)** investments valued at ₹15,000 **(iv)** Create P.B.D. 5% and Provision For Discount on Debtors 2%. **(v)** Land &Building undervalued by ₹5,000 **(vi)** Plant & Machinery overvalued by ₹10,000 **(vii)** Furniture is depreciated by 10% **(viii)** Trademark valued at ₹ 3000. **(ix)** Patents reduced to ₹ 2,000. **(x)** Outstanding salary ₹ 2,000 **(xi)** Prepaid Insurance ₹ 2,000. **(xii)** Claim for damages ₹ 2,000 is accepted **(xiii)** There is also a unforeseen liability for ₹ 5,000. **(xiv)** Stock is valued at ₹13,000 **(xv)** Unrecorded Assets ₹10,000 **(xvi)** A debtor whose due of ₹ 500 was written off as bad debts, paid ₹ 400 in full settlement. Prepare Revaluation Account.

Solution :

Dr. **Revaluation Account** Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To P.B.D. A/c	2000	By Creditors A/c	4000
To P.D.D. A/c	760	By Investments A/c	3000
To Plant & Machine A/c	10000	By Land & Building A/c	5000
To Furniture A/c	1600	By Prepaid Insurance	2000
To Trade Mark A/c	2000	By Unrecorded Assets	10000
To Patent A/c	4000	By Bad-debts recovered	400
To Outstanding Salary	2000	By Loss transferred to	
To Claim For damages	2000	A's Capital A/c 5220	
To Unforeseen liability	5000	B's Capital A/c 1740	6960
To Stock A/c	2000		
	31360		**31360**

Memorandum Revaluation Account

The partners may decide that the value of assets and liabilities will continue to appear in the books at the existing values, yet new partner be not put to any advantage or disadvantage because of change in values. In such a case, an increase or decrease in the amount of assets and liabilities is recorded in the memorandum revaluation account. This account is divided into two parts. First part is similar to the revaluation account and in the second part entries are reversed.

The balance of first part (profit or loss on revaluation) is transferred to the capital account of the old partners in their old profit sharing ratio. The balance of the second part is transferred to all the partners, including new partner, in the new profit sharing ratio.

For profit on revaluation:

1. Memorandum Revaluation A/c Dr.

   To Old Partner's Capital A/c

   (Profit on revaluation transferred to old partner's capital A/c)

2. All Partner's Capital A/c Dr.

   To Memorandum Revaluation A/c

   (Memorandum Revaluation Account closed by transferring to capital A/c's in NPSR)

   In relation to above in place of two entries one entry can be done.

3. All Partner's Capital A/c Dr.

   To Old Partners Capital A/c

   (Adjustment of revaluation made)

   Note : On revaluation loss reverse entry of the above will be done.

Illustration2 :

A and B are partners in a firm sharing profits in their capital ratio. Their Balance Sheet as on 31st March,2017 is as under:

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital:		Building	25,000
A 30,000		Stock	12,500

B 20,000	50,000	Debtors	7,000
Creditors	7,000	Profit & Loss A/c	2,500
		Cash Balance	10,000
	57,000		**57,000**

On 1st April,2017 they decide to admit C for 1/5th share on the following terms : **(i)** C will get his share equally from A and B. He brings cash ₹20,000 for capital. **(ii)** Firm's goodwill is valued at ₹ 15,000 and C brings his share in cash. **(iii)** Make a provision for bad debts @ 10% on debtors. **(iv)** Stock is to be valued ₹ 12,000 and the value of building is to be increased by ₹ 3,200 **(v)** Book values of assets and liabilities are not to be changed (Excluding Profit and Loss Account)

Prepare Memorandum Revaluation Account, Partner's Capital Account and Balance Sheet.

Dr. **Memorandum Revaluation A/c** Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To P.B.D.	700	By Building A/c	3,200
To Stock A/c	500		
To Profit	2,000		
	3,200		**3,200**
To A's Capital A/c	1,200	By A's Capital A/c	1000
To B's Capital A/c	800	By B's Capital A/c	600
		By C's Capital A/c	400
	2,000		**2,000**

Partner's Capital A/c

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Memorandum Revaluation A/c	1,000	600	400	By Balance b/d	30,000	20,000	--
To P & L	1,500	1,000	--	By Memorandum Revaluation	1,200	800	--
To Balance c/d	30,200	20,700	19,600	By Cash A/c	--	--	20,000
				By Goodwill A/c	1,500	1,500	--
	32,700	**22,300**	**20,000**		**32,700**	**22,300**	**20,000**

Balance Sheet as on 1st April, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital A/c		Building	25,000
A 30,200		Stock	12,500
B 20700		Debtors	7,000
C 19,600	70,500	Cash Balance	33,000
Creditors	7,000		
	77,500		**77,500**

Working Notes :

(1) Cash Balance 10,000 + 20,000 + 3,000 = ₹33,000

(2) C gets his share from A and B equally

Sacrifice of A=$\frac{1}{5} X \frac{1}{2} = \frac{1}{10}$; Sacrifice of B=$\frac{1}{5} X \frac{1}{2} = \frac{1}{10}$

New Profit sharing ratio = Old Profit sharing ratio – Sacrifice Ratio

A$\frac{3}{5} - \frac{1}{10} = \frac{5}{10}$;B $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$; NPSR = $\frac{5}{10} : \frac{3}{10} : \frac{1}{5}$= 5:3:2

Illustration : A and B are partners in a firm sharing profits in the ratio of 5:4. They admit C on 1-4-17 for 1/5 share in profits

Balance Sheet 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Workmen Compensation Reserve	9,000		

(i) If there is no other information:

Workmen Compensation Reserve A/c	Dr.	9,000	
To A's Capital A/c			5,000
To B's Capital A/c			4,000

(Being W.C.R. transfer to old Partner's Capital A/c in their old Profit Sharing Ratio)

(ii) If a claim on account of workmen compensation is estimated at ₹ 2,700

Workmen Compensation Reserve A/c	Dr.	9,000	
To Liability for Workmen compensation			2,700
To A's Capital A/c			3,500
To B's Capital A/c			2,800

(Being transfer of the surplus of WCR to Old Partner's Capital A/c in their old Profit Sharing Ratio)\

(iii) If a claim on account of workmen compensation is estimated at ₹ 13,500

(a)

Workmen Compensation Reserve A/c	Dr.	9,000	
Revaluation A/c	Dr.	4,500	
To Liability for Workmen compensation			13,500

(Being liability created and short fall charged to Revaluation Account)

(b)

A's Capital A/c	Dr.	2,500	
B's Capital A/c	Dr.	2,000	
To Revaluation A/c			4,500

(Being loss on revaluation transfer to Old Partner's Capital A/c)

(iv) If a claim on account of workmen compensation is estimated at ₹ 9,000

Workmen Compensation Reserve A/c	Dr.	9,000	
To Liability for Workmen compensation A/c			9,000

(Being liability created for workmen compensation)

(v) If there is no balance of Workmen Compensation Reserve Account in Balance Sheet but claim against workmen compensation reserve is estimated at ₹ 3,600

(a)

Revaluation A/c	Dr.	3,600	
To Liability for workmen compensation A/c			3,600

(Being liability created)

(b)

A's Capital A/c	Dr.	2,000	
B's Capital A/c	Dr.	1,600	
To Revaluation A/c			3600

(Being loss on revaluation transferred to Old Partner's Capital A/c)

Investment Fluctuation Reserve (IFR)

Investment fluctuation reserve is a reserve created out of profits to meet the fall in the market value of investments. The accounting treatment of investment fluctuation reserve is as follows :

Illustration : A and B are partner's in a firm sharing profits in the ratio of 3:2. They admit C on 1-4-17 for 1/5 share in profits

Balance Sheet as on 31 March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Investment Fluctuation Reserve	5,000	Investment	25,000

Show the accounting treatment of Investment Fluctuation Reserve under the following five alternative situations :

(i) If there is no other information

Investment Fluctuation Reserve A/c	Dr.	5,000	
To A's Capital A/c			3,000
To B's Capital A/c			2,000

(Being IFR transfer to old Partner's Capital A/c in their old ratio)

(ii) If the market value of investment is ₹ 25,000

"Same solution as given in Case (i)"

(iii) If the market value of investment is ₹ 22,000

Investment Fluctuation Reserve A/c	Dr.	5,000	
To Investment A/c			3,000
To A's Capital A/c			1,200
To B's Capital A/c			800

(Being excess IFR transfer surplus of WCR to Old Partner's Capital A/c)

(iv) If the market value of investment is ₹ 30,000

(a)

Investment Fluctuation Reserve A/c	Dr.	5,000	
To A's Capital A/c			3,000
To B's Capital A/c			2,000

(Being IFR transfer to old Partner's Capital A/c in their old ratio)

(b)

Investment A/c	Dr.	5,000	
To Revaluation A/c			5,000

(Being value of Investment brought upto market value)

(c)

Revaluation A/c	Dr	5,000	
To A's Capital A/c			3,000
To B's Capital A/c			2,000

(Being Profit on Revaluation transferred to Old Partner's Capital A/c)

(v) If the market value of investment is ₹ 18,000

(a)

Investment Fluctuation Reserve A/c	Dr.	5,000	
Revaluation A/c	Dr.	2,000	
To Investment A/c			7,000

(Being IFR transfer to old Partner's Capital A/c in their old Ratio)

(b)

A's Capital A/c		1,200	
B's Capital A/c			800
To Revaluation A/c			2,000

(Being loss on revaluation transfer to Old Partner's Capital A/c)

Illustration 3 :

Ramesh and Suresh are partners sharing profits in ratio of 5:3 respectively. Their Balance Sheet is as follows:

Balance Sheet

Liabilities	Amount (₹)	Assets		Amount (₹)
Creditors	28,000	Cash		8,000
General Reserve	4,000	Debtors	40,000	
Munesh's Loan	30,000	Less-Provision	1,600	38,400
Capital:		Stock		56,000
Ramesh	50,000	Investments		8,000
Suresh	40,000	P & L A/c		16,000
		Plant		25,600
	1,52,000			**1,52,000**

Munesh is admitted into partnership on the following terms : **(i)** The new profit sharing ratio will be 3:3:2 respectively. **(ii)** Munesh's loan should be treated as his capital. **(iii)** Goodwill of the firm is valued at ₹24,000 and he brings his share in cash. **(iv)** Investments were to be taken over by Ramesh and Suresh in their profit sharing ratio. **(v)** Stock be reduced upto ₹ 50,000 **(vi)** Provision for doubtful debts should be @ 5% on debtors. **(vii)** Suresh is to bring ₹ 10,000 **(viii)** Accrued income ₹ 800 **(ix)** Goodwill be retained in the business. Give Journal entries to record the above.

Solution :

Journal

Date	Particulars		L/F	Amount (₹) Dr.	Amount (₹) Cr.
1-4-17	Munesh's Loan A/c	Dr.		30,000	
	To Munesh's Capital A/c				30,000
	(Being Munesh's Loan A/c transferred to his capital A/c)				
	Cash A/c	Dr.		6,000	
	To Goodwill A/c				6,000
	(Being cash brought in for goodwill)				
	Goodwill A/c	Dr.		6,000	
	To Ramesh's Capital A/c				6,000
	(Being goodwill credited to Ramesh Capital A/c)				
	General Reserve A/c	Dr.		4,000	
	To Ramesh's Capital A/c				2,500
	To Suresh's Capital A/c				1,500
	(Being General Reserve distributed between old partner's in their OPSR)				
	Ramesh's Capital A/c	Dr.		10,000	
	Suresh's Capital A/c	Dr.		6,000	
	To P & L A/c				16,000
	(Being P & L A/c transferred to Old partner's capital A/c)				
	Ramesh's Capital A/c	Dr.		5000	
	Suresh 's Capital A/c	Dr.		3000	
	To Investments				8000
	(Being investments taken over by partners)				

	Revaluation A/c Dr. To Stock A/c To P.B.D. A/c (Being decrease value of stock and increase in PBD)		6,400	6,000 400
	Accrued Income A/c Dr. To Revaluation A/c (Being Accrued income transfer to Revaluation A/c)		800	800
	Ramesh's Capital A/c Dr. Suresh's Capital A/c Dr. To Revaluation A/c (Being loss on revaluation transferred to Old partner's Capital A/c)		3,500 2,100	5,600
	Cash A/c Dr. To Suresh's Capital A/c (Being cash brought in by Suresh)		10,000	10,000

Illustration 4 :

P and Q were partners in a firm sharing profits in the ratio of 7:5. Their Balance Sheet as on 31.3.2017 was as follows :

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Bank Overdraft	70,000	Cash	18,000
Creditors	40,000	Debtors	1,00,000
Provision For Bad Debts	2,000	Bills Receivable	38,000
General Reserve	48,000	Stock	44,000
S's Loan	80,000	Building	2,00,000
Capitals :		Land	60,000
P	1,20,000		
Q	1,00,000		
	4,60,000		**4,60,000**

On 1-4-2017 they admitted S as a new partner on the following conditions : **(i)** S will get 1/4th share in the profits of the firm. **(ii)** S's Loan will be converted into his capital. **(iii)** The goodwill of the firm was valued at ₹ 96,000 and S brought his share of goodwill (premium) in cash. **(iv)** Provision for bad debts was made equal to 5% on Debtors. **(v)** Stock was overvalued by 10%. **(vi)** Land was to be appreciated by 10%. **(vii)** Building was to be appreciated by 12.5%. Prepare Revaluation Account, Capital Accounts of P, Q & S and the Balance Sheet of the new firm as on 1-4-2017.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To P.B.D. A/c	3,000	By Land A/c	6,000
To Stock	4,000	By Building A/c	25,000
To profits transfer to Capital A/c:			
P 14,000			
Q 10,000	24,000		
	31,000		**31,000**

Dr. **Partner's Capital A/c** Cr.

Particulars	P (₹)	Q (₹)	S (₹)	Particulars	P (₹)	Q (₹)	S (₹)
To Balance c/d	1,76,000	1,40,000	80,000	By Balance b/d	1,20,000	1,00,000	--
				By S's Loan A/c	--	--	80,000
				By General Reserve	--	--	--
				By Revaluation	28,000	20,000	--
				By Goodwill	14,000	10,000	--
	1,76,000	**1,40,000**	**80,000**		**1,76,000**	**1,40,000**	**80,000**

Balance Sheet of the new firm
As on 1 April, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Bank Overdraft	70,000	Cash	42,000
Creditors	40,000	Debtors	1,00,000
Provision For Bad Debts	5,000	Bills Receivables	38,000
Capital A/c		Stock	40,000
P 1,76,000		Buildings	2,25,000
Q 1,40,000		Land	66,000
S 80,000	3,96,000		
	5,11,000		**5,11,000**

Working Note :

(1) Cash Balance 18,000 + 24,000 = 42,000 (2) Sacrifice ratio will be the same as old profit sharing ratio.

Illustration 5 :

X and Y are partners in a firm sharing profits in the ratio 3:2. They admit Z as a partner and decide the new profit sharing ratio as 5:3:2. Their Balance Sheet is as under before admission of Z :

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	33,000	Bank	4,000
General Reserve	10,000	Debtors 32,000	
Capital Accounts:		Less : Provision For D.D. (1,000)	31,000
X 60,000		Stock	32,000
Y 40,000	1,00,000	Furniture	20,000
		Plant & Machinery	56,000
	1,43,000		**1,43,000**

Other terms agreed were : **(i)** Z will bring ₹ 40,000 as his capital. **(ii)** Z is unable to bring his share of goodwill in cash. It is therefore, decided to compute goodwill on the basis of Z's share in profit and capital contributed by him in the firm. **(iii)** Plant and machinery is valued at ₹ 60,000 and stock at ₹35,000. However, provision for doubtful debt be maintained at 5% on debtors and furniture be depreciated by 10%. **(iv)** Rent outstanding ₹ 1,400 remained unrecorded. Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of the new firm.

Solution : **Revaluation A/c**

Particulars	Amount (₹)	Particulars	Amount (₹)
To P.B.D To Outstanding Rent	600	By Plant & Machine A/c	4,000

To Outstanding Rent	1,400	By Stock A/c	3,000
To Furniture	2,000		
To Profit Transfer to Capital A/c			
X 1,800			
Y 1,200	3,000		
	7,000		**7,000**

Dr. **Partner's Capital A/c** Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Balance c/d	72,500	49,900	40,000	By Balance b/d	60,000	40,000	--
				By Cash A/c	--	--	40,000
				By General Reserve	6,000	4,000	--
				By Revaluation A/c	1,800	1,200	--
				By Z'S Current A/c	4,700	4,700	--
	72,500	**49,900**	**40,000**		**72,500**	**49,900**	**40,000**

Balance Sheet of the new firm

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	33,000	Bank	4,000
Capital A/c		Cash	40,000
X 72,500		Debtors 32,000	
Y 49,900		Less - Provision 1600	30,400
Z 40,000	1,62,400	Stock	35,000
Outstanding Rent	1,400	Furniture	18,000
		Plant & Machine	60,000
		Z'S Current A/c	9,400
	1,96,800		**1,96,800**

Working Note :

(1) Sacrifice ratio = OPSR - NPSR

$X: \frac{3}{5} - \frac{5}{10} = \frac{5}{50}$ $\quad Y: \frac{2}{5} - \frac{3}{10} = \frac{5}{50}$ 5:5 or 1:1

(2) Calculation of hidden Goodwill:

Adjusted capital of X and Y

$X : 60{,}000 + 6{,}000 + 1{,}800 = 67{,}800; Y : 40{,}000 + 4{,}000 + 1{,}200 = ₹45{,}200$

Z's capital for $\frac{1}{5}$ share is ₹ 40,000

Goodwill of the firm = 2,00,000 (40,000 X$\frac{5}{1}$) – 67800 – 45,200 – 40,000 = ₹ 47,000

Z's share in goodwill = $47{,}000 \times \frac{1}{5} = ₹9{,}400$

Adjustment of Goodwill is made through current A/c

Illustration 6 :

A and B are partners. On 1st Jan,2017 they decide to admit C into partnership on the basis of the following Balance Sheet.

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	6,000	Cash at Bank	12,000
Outstanding Expenses	2,000	Debtors	16,000
Employee's Provident Fund	3,000	Stock	22,000
Workmen's Compensation Fund	4,000	Fixed Assets	43,000
Capital A/c A 50,000		Profit & Loss A/c	2,000
B 30,000	80,000		
	95,000		**95,000**

The following terms were agreed upon : **(i)** New profit sharing ratio should be 2:1:1 respectively and C brought in ₹ 20,000 as capital. **(ii)** Fixed Assets is to be appreciated by ₹ 12,000. **(iii)** Bad debts amounting to ₹ 2,000 to be written off. **(iv)** A Provision of 2% was to be made for discount on creditors. **(v)** Outstanding expenses be brought down to ₹ 1,800. **(vi)** The liability on Workman's compensation fund is determined at ₹ 1,000. **(vii)** Employee's provident fund be raised by ₹ 500. **(viii)** C is unable to bring goodwill in cash. Goodwill valued at ₹ 8,000. **(ix)** Stock is valued at ₹ 24,180. Prepare Partner's Capital Accounts and Balance Sheet of the new firm.

Solution:

Revaluation Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Debtors A/c	2,000	By Fixed Assets A/c	12,000
To Employee's Provident fund A/c	500	By Reserve for discount on Creditors	120
		By Outstanding Exp.	200
To Profit transferred to:		By Stock	2,180
A's Capital A/c 6,000			
B's Capital A/c 6,000	12,000		
	14,500		**14,500**

Dr. **Partner's Capital A/c** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To P & L	1,000	1,000	--	By Balance b/d	50,000	30,000	--
To Balance c/d	56,500	38,500	20,000	By Cash A/c	--	--	20,000
				By C's Current A/c	--	2,000	--
				By WCR	1,500	1,500	--
				By Revaluation	6,000	6,000	--
	57,500	**39,500**	**20,000**		**57,500**	**39,500**	**20,000**

Balance Sheet of the new firm as on 1st January 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors 6,000		Cash at Bank	12,000
(-) Reserve for Discount 120	5,880	Cash in hand	20,000
Outstanding Expenses	1,800	Debtors	14,000
Workmen Compensation Liabilities	1,000	Stock	24,180
Employee's Provident Fund	3,500	Fixed Assets	55,000
Capital A/c		C's current A/c	2,000
A 56500, B 38500, C 20,000	1,15,000		
	1,27,180		**1,27,180**

Working Notes :

(1) Sacrifice Ratio = OPSR – NPSR

A $\frac{1}{2}-\frac{2}{4}=$ Nil ; B $\frac{1}{2}-\frac{1}{4}=\frac{1}{4}$

(2) WCR ₹ 4,000 - ₹1,000 Liability = ₹ 3,000 . Surplus is distributed between A and B in their OPSR.

(3) Cash Balance: ₹ 20,000

Illustration7 :

P and Q were partners sharing profits in the ratio 3:1. Their Balance Sheet on 31st March,2017 was as follows :

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	40,000	Bank	7,000
Bills Payable	15,000	Debtors 30,000	
Capital		Less : Provision 1,000	29,000
P 85,000		Stock	40,000
Q 40,000	1,25,000	Fixed Assets	86,000
		Goodwill	8,000
		Profit & Loss A/c	10,000
	1,80,000		**1,80,000**

R is admitted as a partner on that date and new profit sharing ratio was agreed as 5:3:2. Other terms agreed were : **(i)** Create provision for doubtful debts on debtor's @5% and 2% provision for discount on debtors. **(ii)** Fixed Assets were valued at ₹ 80,000. **(iii)** Creditors include sum due to Ajay ₹ 2,500 for the last 4 years, who is not likely to claim. **(iv)** A provision for discount is required@ 2% on creditors. **(v)** Goodwill of the firm is valued at ₹ 20,000. **(vi)** R will pay ₹ 30,000 as capital and will bring his share of goodwill in cash and capital of P and Q be adjusted on the basis of R's capital. Adjustments in capital be made on cash basis. Prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of new firm.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To P.B.D. A/c	500	By Creditors A/c	2,500
To P.D.D A/c	570	By Reserve for discount on Creditors A/c	750
To Fixed Assets A/c	6,000	By Loss transfer to Capital A/c	
		P 2,865	
		Q 955	3,820
	7,070		**7,070**

Dr. **Partner's Capital A/c** Cr.

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To P's Capital	--	1,000	--	By Balance b/d	85,000	40,000	--
To P&L	7,500	2,500	--	By Cash A/c	--	--	30,000
To Revaluation	2,865	955	--	By Goodwill A/c	4,000	--	--
To Goodwill	6,000	2,000	--	By Q's Capital	1,000	--	--
To Balance c/d	75,000	45,000	30,000	By Cash A/c (Balancing figure)	1,365	11,455	--
	91,365	**51,455**	**30,000**		**91,365**	**51,455**	**30,000**

Balance Sheet of the new firm

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors		Bank	7,000
40,000 – 2,500 – 750	36,750	Cash	46,820
Bills payable	15,000	Debtors 30,000	
Capital A/c		Less : P.B.D. 1,500	
P 75,000		Less : P.D.D. 570	27,930
Q 45,000		Stock	40,000
R 30,000	1,50,000	Fixed assets	80,000
	2,01,750		**2,01,750**

Working Notes :

(1) Cash Balance 30,000 + 4000 + 1,365 + 11,455 = ₹46,820

(2) OPSR – NPSR = SR/GR

$\mathrm{P}: \frac{3}{4} - \frac{5}{10} = \frac{5}{20}\,(\mathrm{SR}) \quad \mathrm{Q}: \frac{1}{4} - \frac{3}{10} = (-)\,\frac{1}{20}\,(\mathrm{GR})$

(3) R’s share in Goodwill $20{,}000 \times \frac{2}{10} = ₹\,4{,}000$

Q's Capital Account will be debited by $20{,}000 \times \frac{1}{20} = ₹\,1{,}000$

Illustration 8 :

A and B were partners sharing profits in proportion of 5:3. Their Balance Sheet on 31st March, 2017 was as follows:

Balance Sheet

Liabilities		Amount (₹)	Assets	Amount (₹)
Creditors		24,000	Bank	4,000
Bills Payable		10,500	Debtors	25,000
General Reserve		12,000	Stock	45,000
Capitals			Investments	10,500
A	75,000		Machinery	30,000
B	50,000	1,25,000	Buildings	60,000
Current Accounts:			Goodwill	20,000
A		15,000		
B		8,000		
		1,94,500		**1,94,500**

They admit C on the following terms : **(i)** New profit sharing ratio of partners will be 4:2:1. C will bring in ₹30,000 as his capital. **(ii)** C is to pay in cash an amount equal to his share in firm’s goodwill, valued at twice the average profit of the last three years, which were ₹ 25,000, ₹ 36,000 and ₹ 44,000 respectively. **(iii)** 20% of the general reserve is to remain as provision for doubtful debts. **(iv)** Value of stock is found over valued by ₹ 5,000. **(v)** 50% of the amount of goodwill is withdrawn by old partners. **(vi)** That ₹ 1,000 is to be received as commission, hence to be accounted for. **(vii)** That ₹ 1,500 be provided for an unforeseen liability. **(viii)** Investments, the market value of which at the date of the balance sheet is ₹ 8,000. Prepare Revaluation Account, Capital Accounts and amended Balance Sheet.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Stock A/c	5,000	By Accrued Commission	1,000
To Provision for Unforeseen Liability	1,500	By Loss transfer to current A/c	
To Investments	2,500	A 5,000	
		B 3,000	8,000
	9,000		**9,000**

Dr. **Partner's Capital A/c** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance c/d	75,000	50,000	30,000	By Balance b/d	75,000	50,000	--
				By Cash A/c	--	--	30,000
	75,000	**50,000**	**30,000**		**75,000**	**50,000**	**30,000**

Dr. **Partner's Current A/c** Cr.

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Goodwill	12,500	7,500	By Balance b/d	15,000	8,000
To Revaluation	5,000	3,000	By Goodwill A/c	3,750	6,250
To Cash	1,875	3,125	By General Reserve	6,000	3,600
To Balance c/d	5,375	4,225			
	24,750	**17,850**		**24,750**	**17,850**

Balance sheet as on.........

Liabilities		Amount (₹)	Assets		Amount (₹)
Creditors		24,000	Cash		35,000
Bills payable		10,500	Bank		4,000
Provision for Unforeseen Liability		1,500	Debtors	25,000	
Capital A/c			Less – Provision	2400	22,600
A	75,000		Stock		40,000
B	50,000		Investments		8,000
C	30,000	1,55,000	Machinery		30,000
Current A/c			Buildings		60,000
A	5,375		Accrued Commission		1,000
B	4,225	9,600			
		2,00,600			**2,00,600**

Working Notes :

(1) Cash Balance 30,000+10,000-5,000= ₹ 35,000

(2) General Reserve A/c Dr 12,000

To P.B.D A/c 2,400

To A's Current A/c 6,000

To B's Current A/c 3,600

(3) SR = OPSR - NPSR

$$A: \frac{5}{8} - \frac{4}{7} = \frac{3}{56} \; ; B: \frac{3}{8} - \frac{2}{7} = \frac{5}{56} \; ; \quad 3:5$$

Illustration 9 :

The following is the Balance Sheet of A and B who share profits in the ratio of 2:1

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Bank Overdraft	12,000	Sundry Debtors	37,000
Reserve Fund	12,000	Stock	20,000
Investment Fluctuation Fund	3,000	Investments	33,000
Sundry Creditors	20,000	Buildings	25,000
Capitals		Patents	2,000
A	40,000		
B	30,000		
	1,17,000		**1,17,000**

They admitted C into partnership on this date. New profit sharing ratio is agreed as 3:2:1. C brings proportionate capital after the following adjustments : **(i)** C bring ₹10,000 in cash as his share of Goodwill. **(ii)** One Debtor for ₹ 500 is dead. Nothing will be recovered from him. **(iii)** There is an old Computer valued ₹ 2,600. It does not appear in the books of the firm. It is now to be recorded. **(iv)** Patents are valueless. **(v)** 2% discount is to be received from creditors. **(vi)** Investments valued at ₹ 28,000. Prepare Revaluation A/c, Partner's Capital A/c and the opening Balance Sheet.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Debtors	500	By Computer	2,600
To Patent	2,000	By Reserve for discount on creditors	400
To Investments	2,000	By Loss transfer to Capital A/c's	
		A 1000	
		B 500	1,500
	4,500		**4,500**

Dr. **Partner's Capital A/c** Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation	1,000	500	--	By Balance b/d	40,000	30,000	--
To Balance c/d	57,000	33,500	18,100	By Cash A/c	--	--	18,100
				By Goodwill A/c	10,000	--	--
				By Reserve Fund	8,000	4,000	--
	58,000	**34,000**	**18,100**		**58,000**	**34,000**	**18,100**

Balance Sheet of the new firm

Liabilities		Amount (₹)	Assets	Amount (₹)
Bank overdraft		12,000	Debtors	36,500
Sundry Creditors	20,000		Stock	20,000
Less – Provision	400	19,600	Investments	28,000
Capital A/c			Building	25,000
A 57000			Cash (18,100 + 10,000)	28,100
B 33500			Computer	2,600
C 18100		1,08,600		
		1,40,200		**1,40,200**

Working notes :

(1) SR = OPSR - NPSR

$A: \frac{2}{3} - \frac{3}{6} = \frac{1}{6}$; B: $\frac{2}{3} - \frac{2}{6} = \text{Nil}$; Note: Sacrifice is made by A only

(2) Adjustment of Capital:

Total adjusted capital of A and B: 57,000 + 33,500 = ₹90,500; C's share in profit $\frac{1}{6}$;

C's Capital $= 90{,}500 \times \frac{6}{5} \times \frac{1}{6} =$ ₹ 18,100

Illustration 10 :

Sakshi, Sindhu and Deepa were partners in a firm sharing profits in the ratio of 3:2:1. On 1st April, 2017 their Balance Sheet was as follows:

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Capitals		Land & Building	3,64,000
Sakshi 3,58,000		Plant & Machinery	2,95,000
Sindhu 3,00,000		Furniture	2,33,000
Deepa 2,62,000	9,20,000	Bills Receivable	38,000
General Reserve	48,000	Sundry Debtors	90,000
Creditors	1,60,000	Stock	1,11,000
Bills Payable	90,000	Bank	87,000
	12,18,000		**12,18,000**

On the above date Saniya was admitted on the following terms : **(i)** She will bring ₹1,00,000 for her capital and will get 1/10th share in the profits. **(ii)** She will bring necessary cash for her share of goodwill (Premium). The goodwill of the film was valued at ₹ 3,00,000. **(iii)** A liability of ₹18,000 will be created against bills receivables discounted. **(iv)** The value of stock and furniture will be reduced by 20%. **(v)** The value of land and building will be increased by 10% **(vi)** Half of the amount of General Reserve is withdrawn by the partners. **(vii)** Capital accounts of the partners will be adjusted on the basis of Saniya's capital in their profit sharing ratio by opening current accounts. Prepare Revaluation Accoun, a Partner's Capital Accounts and Balance sheet of the new firm.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars		Amount (₹)
To Liability for Bills discounted	18,000	By Land & Building A/c		36,400
To Furniture A/c	46,600	By Loss transfer to Capital A/c		
To Stock A/c	22,200	Sakshi	25,200	
		Sindhu	16,800	
		Deepa	8,400	50,400
	86,800			**86,800**

Dr. **Partner's Capital A/c** Cr.

Particulars	Sakshi ₹	Sindhu ₹	Deepa ₹	Saniya ₹	Particulars	Sakshi ₹	Sindhu ₹	Deepa ₹	Saniya ₹
To Revaluation	25,200	12,000	8,400	--	By Balance b/d	3,58,000	3,00,000	2,62,000	--
To Cash A/c	12,000	8,000	4000	--	By Cash A/c	--	--	--	1,00,000
To Current A/c (Balancing fig.)	--	12,000	1,12,600	--	By Goodwill A/c	15,000	10,000	5,000	--
To Balance c/d	4,50,000	3,00,000	150000	100000	By General Reserve	24,000	16,000	8,000	--
					By Current A/c (Balancing fig.)	90,200	--	--	--
	487200	**326000**	**275000**	**100000**		**487200**	**326000**	**275000**	**100000**

Balance Sheet of the new firm as on 1st April 2017

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital A/c			Land & Buildings	4,00,400
Sakshi	4,50,000		Plant & Machine	2,95,000
Sindhu	3,00,000		Furniture	1,86,400
Deepa	1,50,000		Bills Receivable	38,000
Saniya	1,00,000	10,00,000	Sundry Debtors	90,000
Creditors		1,60,000	Stock	88,800
Bills payable		90,000	Bank	87,000
Liability For Bills discounted		18,000	Cash	1,06,000
Current A/c			Sakshi's Current A/c	90,200
Sindhu	1,200			
Deepa	1,12,600	1,13,800		
		13,81,800		**13,81,800**

Working Notes :

(1) New Profit sharing Ratio Balance Profit $= 1 - \frac{1}{10} = \frac{9}{10}$

Sakshi= $\frac{9}{10} \times \frac{3}{6} = \frac{27}{60}$ Sindhu= $\frac{9}{10} \times \frac{2}{6} = \frac{18}{60}$ Deepa= $\frac{9}{10} \times \frac{1}{6} = \frac{9}{60}$

NPSR = $\frac{27}{60} : \frac{18}{60} : \frac{9}{60} : \frac{1}{10} = 27:18:9:6: \ or \ 9:6:3:2$

(2) Saniya's Capital for $\frac{1}{10}$ share is ₹ 1,00,000 : Total capital of the firm $\frac{1,00,000 \times 10}{1}$= ₹ 10,00,000

Sakshi 10,00,000 × $\frac{9}{20}$ = ₹ 4,50,000, Sindhu10,00,000 × $\frac{6}{20}$ = ₹ 3,00,000,

Deepa 10,00,000 × $\frac{3}{20}$ = ₹ 1,50,000 , Saniya = ₹ 1,00,000

Cash Balance 1,00,000 + 30,000 – 24,000 = ₹ 1,06,000

Illustration 11 :

Surendra and Mahendra are partners in a firm sharing profits in the ratio of 5:3. Their Balance Sheet on 31st December, 2016 was as follows :

Liabilities		Amount (₹)	Assets	Amount (₹)
Creditors		22,000	Cash	9,000
Provision for Doubtful Debts		1,000	Debtors	12,000
Bills Payable		18,000	Stock	25,000
Investment Fluctuation Reserve		2,000	Investments	10,000
General Reserve		16,000	Land & Buildings	55,000
Capitals			Goodwill	8,000
Surendra	35,000			
Mahendra	25,000	60,000		
		1,19,000		**1,19,000**

On 1st January, 2017 Ankur was admitted as partner. He brought ₹20,000 as capital.New Ratio will be 3 :3:2. On admission of new partner, following decisions were taken : **(i)** Ankur's share in firm's goodwill was decided as ₹ 10,000. He brought, the amount of goodwill in cash. **(ii)** Surendra took all investments for ₹ 8,000 **(iii)** A provision for Bad & Doubtful debts of ₹ 2,000 is to be made on Debtors and Land & Buildings is to be valued at ₹ 85,000 **(iv)** Stock is valued at ₹ 20,000 **(v)** Creditors have given up claim of ₹ 4,000. **(vi)** Adjustment of all partners' capital is to be done out of cash in new profit sharing ratio. Prepare Revaluation Account and Capital Account and Balance Sheet of the new firm.

Solution : **Revaluation A/c**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Provision for Bad Debts A/c		1,000	By Land & Buildings	30,000
To Stock A/c		5,000	By Creditors	4,000
To Profit transferred to :				
Surender's Capital A/c	17,500			
Mahendra's Capital A/c	10,500	28,000		
		34,000		**34,000**

Dr. **Partner's Capital A/c** Cr.

Particulars	Surendra ₹	Mahendra ₹	Ankur ₹	Particulars	Surendra ₹	Mahendra ₹	Ankur ₹
To Investment	8,000	--	--	By Balance b/d	35,000	25,000	--
To Goodwill	5,000	3,000	--	By Cash A/c	--	--	20,000
To Cash A/c	29,500	8,500	--	By Goodwill A/c	10,000	--	--
(Balancing figure)				By General Reserve	10,000	6,000	--
To Balance c/d	30,000	30,000	20,000	By Revaluation A/c	17,500	10,500	--
	72,500	**41,500**	**20,000**		**72,500**	**41,500**	**20,000**

Balance sheet of the new firm as on 01St January, 2017

Liabilities		Amount (₹)	Assets	Amount (₹)
Creditors		18,000	Cash	1,000
Bills Payable		18,000	Debtors	12,000
Provision for Bad Debts		2,000	Stock	20,000
Capital A/c			Land & Building	85,000
Surendra	30,000			
Mahendra	30,000			
Ankur	20,000	80,000		
		1,18,000		**1,18,000**

Working Notes :

(1) SR = OPSR - NPSR; Surendra $\frac{5}{8}-\frac{3}{8}=\frac{2}{8}$; Mahendra $\frac{3}{8}-\frac{3}{8}=$ Nil

(2) Adjustment of Capital:

Ankur's Capital for $\frac{2}{8}$ share is ₹ 20,000. Total capital of the firm $= 20{,}000 \times \frac{8}{2} =$ ₹ 80,000

Surendra Capital = $80{,}000 \times \frac{3}{8} = 30{,}000$; Mahendra Capital = $80{,}000 \times \frac{3}{8} = 30{,}000$; Ankur Capital = ₹ 20,000

(3) Cash Balance = 9,000 + 20,000 +10,000 - 29,500 - 8,500 = ₹ 1,000

(4) Investment Fluctuation Reserve A/c Dr. 2,000

To Investments A/c 2,000

Illustration12 :

Amit and Ashish were sharing profits in the ratio of 5:3. They admitted Shravan as a partner with 1/5th share in profits. He had to contribute proportionate capital. The financial position was as under:

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	19,000	Goodwill	10,000
Bills Payable	8,000	Land & Buildings	25,000
Capital :		Plant & Machinery	35,000
Amit	55,000	Stock	20,000
Ashish	30,000	Debtors	25,000
General Reserve	16,000	Investment	14,000
Provision for Bad debts	1,500	Cash	2,400
Outstanding Salary	2,400	Prepaid Insurance	500
	1,31,900		**1,31,900**

They agreed to admit Shravan on the following terms : **(i)** Goodwill of the firm was to be valued at ₹ 20,000. He will bring his share in cash. **(ii)** Land & Buildings was to be increased by ₹ 13,000 and Machinery was to be valued at ₹ 30,000 **(iii)** The provision for bad & doubtful debts was found in excess by ₹ 500. **(iv)** A liability for ₹ 1,200 included in sundry creditors was not likely to arise. **(v)** ₹ 500 for damages claimed by a customer had not been accepted by the firm and it was agreed at ₹ 100 by compromise between the customer and the firm. **(vi)** ₹10,000 investments were taken over by old partners in their profit sharing ratio. **(vii)** The capitals of the partners were to be adjusted in profit sharing ratio by opening current accounts. **(viii)** Ashish is to withdraw ₹ 2,400 in cash. Prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of the New Firm.

Solution :

Revaluation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Machinery A/c	5,000	By Land & Buildings A/c	13,000
To Provision for Claim	100	By P.B.D A/c	500
To Profit Transfer to Capital A/c		By Creditors A/c	1,200
Amit 6,000			
Ashish 3,600	9,600		
	14,700		**14,700**

Dr. **Partner's Capital A/c** Cr.

Particulars	Amit ₹	Ashish ₹	Shravan ₹	Particulars	Amit ₹	Ashish ₹	Shravan ₹
To Goodwill	6,250	3,750	--	By Balance b/d	55,000	30,000	--
To Cash A/c	--	2,400	--	By Cash A/c	--	--	23,050
To Investment	6,250	3,750	--	By Goodwill A/c	2,500	1,500	--
To Amit's Current A/c	3,375	--	--	By General Reserve	10,000	6,000	--
To Balance c/d	57,625	34,575	23,050	By Revaluation A/c	6,000	3,600	--
				By Ashish's Current A/c	--	3,375	--
	73,500	**44,475**	**23,050**		**73,500**	**44,475**	**23,050**

Balance Sheet of the new firm

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	17,800	Land & Buildings	38,000
Bills payable	8,000	Plant & Machinery	30,000
Provision for Claim	100	Stock	20,000

Outstanding salary	2400	Debtors 25,000	
Capital A/c		Less – P.B.D 1,000	24,000
Amit 57,625		Investments	4,000
Ashish 34,575		Prepaid Insurance	500
Sharvan 23,050	1,15,250	Cash (2,400+23,050,+4,000 – 2,400)	27,050
Amit's Current A/c	3,375	Ashish's Current A/c	3,375
	1,46,925		**1,46,925**

Working Notes :

(1) New Profit sharing Ratio Balance Profit $= 1 - \frac{1}{5} = \frac{4}{5}$

Amit = $\frac{4}{5} \times \frac{5}{8} = \frac{20}{40}$ Ashish= $\frac{4}{5} \times \frac{3}{8} = \frac{12}{40}$

NPSR = $\frac{20}{40} : \frac{12}{40} : \frac{1}{5} = 20:12:8 = 5:3:2$

(2) Adjustment of Capital:

Total Adjusted Capital of Amit = 73,500 – 12,500 = ₹ 61,000,

Total Adjusted Capital of Ashish = 41,100 – 9,900 = ₹ 31,200

61,000 + 31,200 = ₹ 92,200 $1 - \frac{1}{5} = \frac{4}{5}$ (Amit + Ashish)

Shravan's Share in Capital 92,200$\times \frac{5}{4} \times \frac{1}{5}$ = ₹ 23,050

(3) Total Capital of Firm 92,200$\times \frac{5}{4}$ = ₹ 1,15,250

Amit 11,5250$\times \frac{5}{10}$ = ₹ 57,625 ; Ashish11,5250$\times \frac{3}{10}$ = ₹ 34,575 ; Shravan11,5250$\times \frac{2}{10}$ = ₹ 23,050

Total capital of all three partners after new profit Sharing Ratio = ₹ 57,625, ₹ 34,575, ₹ 23,050

Illustration13 :

Suraj and Chanda are partners sharing profits in the ratio of 2:1. Their Balance Sheet as on 31st March, 2017 is as follows:

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	30,000	Cash Balance	20,000
Bank Loan	10,000	Bank Balance	20,000
General Reserve	30,000	Sundry Debtors 60,000	
Capitals		Less : Provision 24,000	36,000
Suraj 1,20,000		Stock	90,000
Chanda 60,000	1,80,000	Machine	29,000
		Furniture	10,000
		Goodwill	36,000
		Profit & Loss	9,000
	2,50,000		**2,50,000**

On 1st April, 2017 they admit Tara for 1/3rd share. She pays cash in the business for her share of goodwill and brings sufficient capital so that she can be given 1/3rd share of the total capital of the new firm. The goodwill of the firm is to be valued at three times of average profit of the last three years. Profit or loss of these three years were ₹30,000, ₹ 35,000 (Loss) and ₹ 50,000. It was also decided that the Provision on debtors be reduced ₹ 9,000 and Stock is to revalue at ₹ 1,20,000. The machine is to be reduced upto ₹ 20,000. Bank loan will be paid off. Pass Journal entries and prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of the new firm.

Solution : **Journal**

Date	Particulars		L/F	Amount (₹) Dr.	Amount (₹) Cr.
1-4-17	Cash A/c	Dr.		1,23,000	
	To Tara's Capital A/c				1,08,000
	To Goodwill A/c				15,000
	(Being cash brought in by Tara towards goodwill and capital)				
	General Reserve A/c	Dr.		30,000	
	To Suraj's Capital A/c				20,000
	To Chanda's Capital A/c				10,000
	(Being General Reserve transferred to old Partner's Capital A/c in their old Profit sharing ratio)				
	Suraj's Capital A/c	Dr.		24,000	
	Chanda's Capital A/c	Dr.		12,000	
	To Goodwill A/c				36,000
	(Being existing goodwill A/c written off)				
	Bank Loan A/c	Dr.		10,000	
	To Bank A/c				10,000
	(Being Bank Loan paid off)				
	Suraj's Capital A/c	Dr.		6,000	
	Chanda's Capital A/c	Dr.		3,000	
	To P & L A/c				9,000
	(Being P & L transferred to Old partner's capital A/c)				
	P.B.D. A/c	Dr.		15,000	
	Stock A/c	Dr.		30,000	
	To Revaluation A/c				45,000
	(Being decrease in PBD and increase in value of Stock)				
	Revaluation A/c	Dr.		9,000	
	To Machine A/c				9,000
	(Being decrease in value of machine)				
	Revaluation A/c	Dr.		36,000	
	To Suraj's Capital A/c				24,000
	To Chanda's Capital A/c				12,000
	(Being profit on revaluation transferred to old Partner's Capital A/c in their old profit sharing ratio)				
	Goodwill A/c	Dr.		15,000	
	To Suraj's Capital A/c				10,000
	To Chanda's Capital A/c				5,000
	(Being goodwill credited to old Partner's Capital A/c in their sacrifice ratio)				

Solution : **Revaluation A/c**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Machinery		9,000	By P.B.D. A/c	15,000
To Profit transferred to:			By Stock A/c	30,000
Suraj's Capital A/c	24,000			
Chanda's Capital A/c	12,000	36,000		
		45,000		**45,000**

Dr. **Partner's Capital A/c** Cr.

Particulars	Suraj ₹	Chanda ₹	Tara ₹	Particulars	Suraj ₹	Chanda ₹	Tara ₹
To Goodwill A/c	24,000	12,000	--	By Balance b/d	1,20,000	60,000	--
To P & L A/c	6,000	3,000	--	By Cash A/c	--	---	1,08,000
To Balance c/d	1,44,000	72,000	1,08,000	By Goodwill A/c	10,000	5,000	--
				By General Reserve	20,000	10,000	--
				By Revaluation A/c	24,000	12,000	--
	1,74,000	**87,000**	**1,08,000**		**1,74,000**	**87,000**	**1,08,000**

Balance Sheet of new firm as on 1 April, 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Creditors Capital A/c		30,000	Cash at Bank		1,43,000
Suraj	1,44,000		Bank Balance		10,000
Chanda	72,000		Debtors	60,000	
Tara	1,08,000	3,24,000	(-) Provision	9,000	51,000
			Stock		1,20,000
			Machinery		20,000
			Furniture		10,000
		3,54,000			**3,54,000**

Working Notes:

(1) New Profit sharing Ratio : Balance Profit $1-\frac{1}{3}=\frac{2}{3}$; Suraj $\frac{2}{3} X \frac{2}{3}=\frac{4}{9}$; Chanda $\frac{2}{3} X \frac{1}{3}=\frac{2}{9}$

Profit Sharing Ratio of all three $\frac{4}{9}:\frac{2}{9}:\frac{1}{3}$ = 4:2:3

(2) Valuation of Goodwill: Average Profit $=\frac{30{,}000-35{,}000+50{,}000}{3}=\frac{45{,}000}{3}$ = ₹15000;

Goodwill= 15000 x 3 = ₹ 45000 ; Tara's Share in Goodwill 45,000 x $\frac{1}{3}$ = ₹ 15,000

(3) Sacrifice ratio will be the same as old profit sharing ratio.

(4) Calculation of share of capital of Tara:

Total Adjusted capital of Suraj and Chanda is 1,44,000 +72,000= ₹ 2,16,000

$1-\frac{1}{3}=\frac{2}{3}$ Suraj and Chanda's share ; Tara's share in Capital 2,16,000 x $\frac{3}{2} x \frac{1}{3}=1{,}08{,}000$

(5) Cash Balance20,000 + 1,08,000 + 15,000 = ₹ 1,43,000

(6) Bank Balance 20,000 – 10,000 = ₹ 10,000

Change in Profit sharing ratio among existing partners

The partners of an existing firm may decide to change their profit sharing ratio. As a result some partners will gain in future (called gaining partners) while others will lose in future (called sacrificing partners). Thus the partners who gain due to change in profit sharing ratio must compensate the sacrificing partners. Following issues must be considered due to change in profit sharing ratio.

1. Determination of sacrifice ratio and gain ratio.
2. Accounting treatment of goodwill.
3. Accounting treatment of reserves, accumulated profits/losses.
4. Revaluation of assets and re assessment of liabilities.
5. Adjustment of capital.

1. Determination of sacrifice ratio and gain ratio.

Sacrifice Ratio (SR) = Old Profit Sharing Ratio (OPSR) – New Profit Sharing Ratio (NPSR)

Gain Ratio(GR) = New Profit Sharing Ratio (NPSR) – Old Profit Sharing Ratio (OPSR)

2. Accounting treatment of goodwill.

Gaining partner's capital/current A/c Dr.

To Sacrificing partner's capital/current A/c

(Being the adjustment made for goodwill on change in profit sharing ratio)

Illustration : A and B shared profits in the ratio of 3:2. They agreed to share profits equally. The goodwill the firm was valued at ₹30,000. Pass necessary journal entry for accounting for goodwill.

B's Capital A/c	Dr.	3000	
To A's Capital A/c			3000

[Bing the adjustment made for goodwill on change in profit sharing ratio {30000 × 1/10 = ₹ 3000}]

SR or GR = OPSR - NPSR

$A = \frac{3}{5} - \frac{1}{2} = \frac{1}{10}$ (SR); $B = \frac{2}{5} - \frac{1}{2} = (-)\frac{1}{10}$ (GR)

All partners capital/current A/c Dr.

To Goodwill A/c (In OPSR)

(Being existing goodwill written off in old profit sharing ratio)

Treatment for existing goodwill :

Goodwill appearing in the books of firm should be written off.

Illustration - A and B are partners in a firm sharing profits in the ratio of 5:3. They agreed to share profits equally. The goodwill of the firm was valued at ₹48,000. Goodwill already appeared in the books at ₹ 16,000. Pass necessary journal entry for accounting for goodwill.

1.	A's Capital A/c	Dr.	10000	
	B's Capital A/c	Dr.	6000	
	To Goodwill A/c			16000

(Being existing goodwill written off in old profit sharing ratio)

2.	B's Capital A/c	Dr.	6000	
	To A's Capital A'/'c			6000

(Being adjustment made for goodwill on change in profit sharing ratio 48000 × 1/8 = ₹ 6000)

OPSR – NPSR = SR/GR; $A = \frac{5}{8} - \frac{1}{2} = \frac{1}{8}$ (SR) ; $B = \frac{3}{8} - \frac{1}{2} = (-)\frac{1}{8}$ (GR)

Illustration : X, Y and Z are partners in a firm sharing profits in the ratio of 3:2:1. They decided that Z will get 1/3rd share in future profits. Goodwill of the firm was valued at ₹30,000. Pass the necessary journal entries.

Z's Capital A/c	Dr.	5000	
To X's Capital A/c			3000
To Y''s Capital A/c			2000

(Being adjustment made for goodwill on change in profit sharing ratio)

₹

Calculation of new profit sharing ratio $1 - \frac{1}{3} = \frac{2}{3}$

X's new share $= \frac{2}{3} \times \frac{3}{5} = \frac{6}{15}$;   Y's new share $= \frac{2}{3} \times \frac{2}{5} = \frac{4}{15}$;

New profit sharing ratio = $\frac{6}{15} : \frac{4}{15} : \frac{1}{3}$ = 6:4:5

SR or GR = OPSR – NPSR

X $= \frac{3}{6} - \frac{6}{15} = \frac{3}{30}$ SR;   Y $= \frac{2}{6} - \frac{4}{15} = \frac{2}{30}$ SR;   Z $= \frac{1}{6} - \frac{5}{15} = (-)\frac{5}{30}$ GR.

X's share $= 30000 \times \frac{3}{30}$ = ₹ 3,000 Y's share = ₹$30000 \times \frac{2}{30}$ = ₹2,000

Z.s share $= 30000 \times \frac{5}{30}$ = ₹ 5,000

3. Accounting treatment of reserves, accumulated profits/losses :

I. Reserves, profits and losses be cancelled.

II. Reserves, profits and losses are not to be cancelled.

(i) Reserves & Profits/Loss to be cancelled

General Reserve A/c Dr.
P & L A/c Dr.
Workmen Compensation Reserve A/c Dr.
Investment Fluctuation Reserve A/c Dr.
To partner's capital/current A/c (In OPSR)
(Being reserve & undistributed profits transferred to partner's capital A/c in OPSR)

(b) Partner's capital/current A/c Dr. (In OPSR)
To P & L A/c
To Deferred Revenue Expenditure
(Being undistributed loss transferred to partner's capital A/c in old Profit sharing Ratio)

(ii) Cancellation of losses/differed revenue expenses.

(a) For reserves and accumulated profits –
Gaining Partner's Capital/Current A/c Dr.
To Sacrificing Partner's Capital/Current A/c
(Being adjustments for profits on change in profit sharing ratio)

(b) For accumulated losses –
Sacrificing Partner's Capital/Current A/c Dr.
To Gaining Partner's Capital/Current A/c
(Being adjustment made for loss on change in profit sharing ratio)

Illustration : A, B and C are partners in a firm sharing profits in the ratio of 3:2:1. They decided to share profits equally in future. On that date they had ₹60,000 in profit and loss account and ₹ 30,000 in general reserve. Pass journal entry in the following cases.

(i) Firm decided to close the profit and loss account and general reserve account.

P & L A/c	Dr.	60000	
General Reserve A/c	Dr.	30000	
To A's Capital A/c			45000
To B's Capital A/c			30000
To C's Capital A/c			15000

(Being undistributed profits and General Reserve transferred to partner's capital A/c in OPSR)

(ii) Firm does not want to close the P & L a/c and general reserve a/c.

C's Capital A/c Dr. 15000

To A's Capital A/c 15000

(Being adjustment made for P&L A/c and General Reserve on change in profit sharing ratio)

SR or GR = OPSR – NPSR

A $= \frac{3}{6} - \frac{1}{3} = \frac{1}{6}$ (SR); $B = \frac{2}{6} - \frac{1}{3} = 0$; $C = \frac{1}{6} - \frac{1}{3} = (-)\frac{1}{6}$ (GR)

4. Accounting treatment for revaluation of assets and re assessment of liabilities :

(a) When revised values are to be recorded in the books - In such a case revaluation of assets and reassessment of the liabilities is done with the help of revaluation account.

(i) Profit on revaluation –

Revaluation A/c Dr.

To partner's capital/current A/c (In OPSR)

(ii) Loss on revaluation –

Partner's capital/current A/c Dr.

To Revaluation A/c

(b) When revised values are not to be recorded in the books or adjustments are made through partner's capital accounts.

(i) For profit on revaluation –

Gaining partner's capital/current A/c Dr. (in OPSR)

To Sacrificing partner's capital/current A/c

(ii) For loss on revaluation –

Sacrificing partner's capital/current A/c Dr.

To Gaining partner's capital/current A/c

Illustration : A, B and C are partners in a firm sharing profits in the ratio of 5:3:2. They decided to share future profits in the ratio of 2:3:5. On this date revaluation of assets and liabilities has was under :

	Book Value ₹	Revised Value ₹
Building	50000	60000
Plant	30000	50000
Creditors	20000	30000

Pass necessary journal entry under the following cases :

(i) When revised value are to be recorded in books –

Revaluation A/c Dr. 20000

To A's Capital A/c 10000

To B's Capital A/c 6000

To C's Capital A/c 4000

(Being profit on revaluation transferred to partner's capital A/c in their old Profit sharing ratio)

(ii) When revised value are not to be recorded in the books –

C's capital A/c Dr. 6000

To A's Capital A/c 6000

(Being adjustment of 20000 × 3/10 = ₹ 6000 made for profit on revaluation)

SR/GR $= \frac{5}{10} - \frac{2}{10} = \frac{3}{10}$; $B = \frac{3}{10} - \frac{3}{10} = 0$; $C = \frac{2}{10} - \frac{5}{10} = (-)\frac{3}{10}$

Illustration 14 :

Lara, Priyanka and Vashu are partners in a firm sharing profits in the ratio of 8:5:3 respectively. Their Balance Sheet as on 31st March, 2017 was as follows :

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
Partner's Capital A/c		Cash at Bank	10,000
Lara	40,000	Investments	15,000
Priyanka	32,000	Stock	40,000
Vashu	28,000	Bills Receivable	8,000
Partner's Loan A/c		Debtors	40,000
Lara	16,000	Furniture	28,000
Priyanka	12,000	Patents	15,000
Provident Fund	18,000	Prepaid Insurance Premium	2,000
General Reserve	16,000	Plant & Machinery	62,000
Creditors	40,000		
Bank Loan	14,000		
Provision For Bad Debts	4,000		
	2,20,000		**2,20,000**

They agreed to change their profit sharing ratio as 5 :6 : 5 from 1st April, 2017. For this purpose it is decided that : **(i)** Goodwill of the firm has been valued at three times of the average super profits of last four years. Average profits of the last four years are₹ 40,000, while the normal profits that can be earned with the capital employed are ₹ 24,000. **(ii)** Provident Fund to be raised by ₹ 2,000. **(iii)** The provision for doubtful debts was to be maintained upto ₹ 3,000 **(iv)** Priyanka is to withdrew ₹ 5,000 in cash. **(v)** The value of furniture is to be decreased upto ₹ 25,000 and stock is to be revalued at as ₹ 30,000 **(vi)** Outstanding wages ₹ 5,000 are to be shown in books. **(vii)** A provision for bad debts on Bills Receivable to be made 5% **(viii)** Sanni, an old customer whose account was written off as bad has promised to pay ₹ 800 in the settlement of his full claim. **(ix)** The present value of patents is NIL. The book values of the Assets, Liabilities and Reserves are not be altered. Prepare Capital Accounts and new Balance Sheet.

Solution :

Dr. **Partner's Capital A/c** Cr.

Particulars	Lara ₹	Priyanka ₹	Vashu ₹	Particulars	Lara ₹	Priyanka ₹	Vashu ₹
To Lara	--	1,900	3,800	By Balance b/d	40,000	32,000	28,000
To Cash	--	5,000	--	By Priyanka	1,900	--	--
To Balance c/d	45,700	25,100	24,200	By Vashu	3,800	--	--
	45,700	**32,000**	**28,000**		**45,700**	**32,000**	**28,000**

Balance sheet as on 1st April 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	40,000	Cash at Bank (10,000 – 5,000)	5,000
P.B.D	4,000	Investments	15,000
Bank Loan	14,000	Stock	40,000
Provident fund	18,000	Bills Receivable	8,000
General Reserve	16,000	Debtors	40,000

Partner's Loan		Furniture	28,000
Lara	16,000	Patent	15,000
Priyanka	12,000	Prepaid Insurance	2,000
Capital A/c		Plant & Machinery	62,000
Lara 45,700			
Priyanka 25,100			
Vashu 24,200	95,000		
	2,15,000		**2,15,000**

Working Notes :

(1) SR/GR = OPSR - NPSR

Lara $= \frac{8}{16} - \frac{5}{16} = \frac{3}{16}$ Priyanka$= \frac{5}{16} - \frac{6}{16} = -\frac{1}{16}$ Vashu$= \frac{3}{16} - \frac{5}{16} = -\frac{2}{16}$

(2) Valuation of Goodwill :

S.P. = A.P. – N.P.= 40,000 – 24,000= ₹16,000

Goodwill = 16,000×3= ₹ 48,000

(3) Net Profit / Loss on Revaluation :

Items of Loss		**Items of Profit**	
Furniture	3,000	PBD 1,000	
Stock	10,000	Debtors 800	1,800
Outstanding wages	5,000	Net Loss 35400 – 1800 =	33,600
Provision for Bills (8,000 × 5%)	400		
Patent	15,000		
P.F. A/c	2,000		
	35,400		**35,400**

Net Profit After adjustment = 48,000 + 16,000 – 33,600 = ₹30,400

Priyanka's Capital A/c	Dr.	1,900	
Vashu's Capital A/c	Dr.		3,800
To Lara Capital A/c			5,700

Lara = 30,400 × 3/16 = ₹ 5,700; Priyanka = 30,400 × 1/16 = ₹ 1,900; Vasu = 30,400 × 2/16 = ₹ 3,800

Illustration15 :

Dhoni and Dhavan are partners. Their balance sheet on 31-03-2017 was as follows :

Balance Sheet as on 31 March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	20,000	Cash at Bank	9,500
Workmen Compensation Reserve	8,000	Debtors 20,000	
Investment Fluctuation Reserve	3,000	(-) Provision 500	19,500
Bills Payable	3,000	Stock	6,000
Outstanding expenses	1,000	Investments	10,000
Employee's Provident fund	5,000	Land & Buildings	30,000
General Reserve	10,000	Plant & Machinery	36,000
Capital :		Furniture	10,000

Dhoni 40,000		Trade Marks	3,000
Dhavan 50,000	90,000	Patents	5,000
		Goodwill	5,000
		P & L (Dr.)	4,000
		Advertisement Expenses	2,000
	1,40,000		**1,40,000**

They decided to admit Virat on April 1st, 2017. New Profit Sharing Ratio will be equal : **(i)** Virat shall bring ₹ 6,000 as his Capital and ₹ 8,000 as share of premium & half of the goodwill is withdrawn by the partner. **(ii)** That unaccounted accrued income of ₹ 500 are provided for. **(iii)** The market value of investments was ₹ 9,000. **(iv)** A debtor whose due of ₹ 500 was written off as bad debts, paid ₹ 400 in full settlement. **(v)** Land & Buildings appreciate by 25%. **(vi)** Plant & Machinery undervalued by 10%. **(vii)** Furniture is depreciated by 10%. **(viii)** Trademarks valued at ₹ 2,500. **(ix)** Patents reduced to ₹ 3,000. **(x)** Liability against Workmen Compensation Reserve is ₹ 3,000 **(xi)** Prepaid Insurance ₹ 1,000. **(xii)** Outstanding Bills for Repair ₹ 1,000. **(xiii)** There is an old computer valued at ₹ 4,000. It does not appear in the books. It is now to be recorded. **(xiv)** Create Provision for Bad Debts 5% and Provision for Discount on Debtors 2%. **(xv)** Create Reserve for discount on creditors @ 5%. **(xvi)** Stock is overvalued by 20%. **(xvii)** Capital of the Partners shall be adjusted on the basis of Virat's Capital. Prepare Revaluation A/c, Partners' Capital A/c's and the Balance Sheet of the new firm.

Solution : **Revaluation A/c**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Furniture A/c	1000	By Accrued Income	500
To Trade Marks A/c	500	By Bad Debts Recovered	400
To Patents A/c	2000	By Land & Buildings A/c	7500
To Outstanding Repairs Bill	1000	By Plant & Machinery A/c	4000
To P.B.D. A/c	500	By Prepaid Insurance A/c	1000
To P.D.D A/c	380	By Computer A/c	4000
To Stock A/C	1000	By Reserve for discount on creditors A/c	1000
To Profit Transfer to			
Dhoni 's Capital 6010			
Dhavan 's Capital 6010	12020		
	18400		**18400**

Dr. **Partner's Capital A/c** Cr.

Particulars	Dhoni ₹	Dhavan ₹	Virat ₹	Particulars	Dhoni ₹	Dhavan ₹	Virat ₹
To Cash	2000	2000	--	By Balance b/d	40000	50000	--
To Goodwill	2500	2500	--	By Cash A/c	--	--	60000
To P&L	2000	2000	--	By Goodwill A/c	4000	4000	--
To Adv. Exp.	1000	1000	--	By Workmen Compensation Reserve A/c	2500	2500	--
To Cash A/c (Balancing fig.)	--	1010	--	By Investments Fluctuation Reserve A/c	1000	1000	--
To Balance c/d	60000	60000	60000	By General Reserve A/c	5000	5000	--
				By Revaluation A/c	6010	6010	--
				By Cash A/c (Balancing fig.)	8990	--	--
	67500	**68510**	**60000**		**67500**	**68510**	**60000**

Balance sheet as on 1st April 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors 20000		Cash at Bank	9,500
Less : Provision 1000	19,000	Cash in hand	72,380
Liability for workmen compensation	3,000	Debtors 20000	
Bills payable	3,000	Less : P.B.D. 1000	
Outstanding expenses	1,000	Less : P.D.D. 380	18,620
Outstanding Repairs bills	1,000	Stock	5,000
Employee's Provident Fund	5,000	Investments	9,000
Capital A/c		Land & Building	37,500
Dhoni 60000		Plant & Machinery	40,000
Dhavan 60000		Furniture	9,000
Virat 60000	1,80,000	Trade Mark	2,500
		Patent	3,000
		Prepaid Insurance	1,000
		Accrued Income	500
		Computer	4,000
	2,12,000		**2,12,000**

Working Notes :

1. Sacrifice ratio will be the same as old Profit Sharing Ratio.
2. WCR appear in Balance sheet ₹8000
   Less Liability against WCR ₹ 3000
   Surplus 5000
3. IFR ₹ 2000
   (-) Fall in market value of Investment ₹ 1000
   Surplus ₹ 1000
   Surplus is transferred to old painter's capital A/c, in their OPSR.
4. Dabit Balance of P&L A/c, Advertisement suspense A/c and Goodwill A/c are written off in old profit sharing ratio.
5. PBD: 20000 X 5% = ₹ 1000;
   PDD: 20000-1000 = 19000; 19000 X 2/100 = ₹ 380
6. Stock $\frac{6000X20}{120}$ = ₹ 1000
7. Plant & Machinery 36000 x $\frac{10}{90}$ = ₹ 4000
8. Adjustment for Capital: Virat's Capital for 1/3 share is ₹ 60,000
   Total Capital of the Firm $\frac{60000\ X\ 1}{3}$ = ₹ 1,80,000
   Dhoni1,80,000 X $\frac{1}{3}$ ₹ 60,000; Dhavan 1,80,000 X $\frac{1}{3}$ ₹ 60,000; Virat 1,80,000 X $\frac{1}{3}$ ₹ 60,000;
9. Cash in hand: 60000 + 8000 – 4000 + 400 + 8990 - 1010 = ₹ 72,380

Summary

1. **Reconstitution of a firm :** Any change in existing agreement of partnership amounts to reconstitution of a firm. Change in profit sharing ratios of existing partners, admission of a new partner, retirement/death of a partner, etc.
2. **Admission of a new partner :** When an existing partner of a firm allows a new person to become a partner in the firm, it is called admission of a new partner.
3. **New partner's profit sharing ratio :** The ratio in which all the partners including incoming partner share future

profits is known as the new profit sharing ratio.

4. **Sacrifice ratio :** The ratio in which the old partners have agreed to sacrifice their share in profits in favour of an incoming partner is called the sacrifice ratio.
5. **Goodwill :** Goodwill is the benefit and advantage of good name, reputation and connection of a business.
6. **Methods of valuation of goodwill :** 1. Average profit method 2. Super profit method, 3. Capitalisation method. The A.S. 10, 26/ Indian A.S. 38 prescribes that goodwill should be recorded in the books only when consideration in money or money's worth has been paid for it. i.e. when goodwill is purchased.
7. **Revaluation of assets and re assessment of liabilities :** Adjustment of partner's capital account.
   (i) Adjustment of the old partner's capital account on the basis of the new partner's capital account.
   (ii) Calculation the new partner's capital on the basis of capitals of the old partners.

Glossary

• Reconstitution of Partnership	Any change in existing agreement of partnership amounts to reconstitution of firm.
• Admission of a Partner	Admission of a partner refers to entry of a new member in the firm as owner.
• New Profit Sharing Ratio	The ratio in which all partners including the incoming partner share the future profits and losses is known as the new profit sharing ratio.
• Sacrifice Ratio	The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is known as the sacrifice ratio.
• Goodwill	Monetary valuation of reputation of business is called goodwill.
• Purchased Goodwill	It is the goodwill that is acquired by marking a payment.
• Self-Generated Goodwill	It is an internally generated goodwill. No consideration is paid for it.
• Average Profit	The sum of the profits of several years is divided by the number of years is called average profit.
• Super Profit	The excess of actual profit over normal profit.
• Capitalisation Method	Under this method goodwill is calculated by capitalisation of profit.
• Revaluation Account	Revaluation account is prepared to ascertain the Gain (Profit)/Loss arising on account of revaluation of assets and reassessment of liabilities.
• Reserve	Undistributed profit.
• Workmen Compensation Reserve	It is created out of firm's profit to meet likely liability to pay compensation to employees.
• Investments Fluctuation Reserve	It is created out of firm's profit to meet the fall in the market value of Investments.

Questions for Exercise

Multiple Choice Questions :

1. Super Profit is :
   (a) Normal Profit- Average Profit (b) Average Profit- Normal Profit
   (c) Normal Profit +Average Profit (d) None of these
2. A and b are equal partners with the capital of ₹ 16000 and ₹ 12000. C a new partner comes in for ¼ share and brings capital ₹ 15000. Find the value of the firm's goodwill?
   (a) ₹ 60,000 (b) ₹11200 (c) ₹ 17000 (d) ₹ 43000
3. Total assets and liabilities of the firm are ₹ 70000 and ₹ 10000. Average profit is ₹ 8000. NRR 10%. Calculate super profit?
   (a) ₹ 1000 (b) ₹ 2000 (c) 3000 (d) ₹ 4000

4. For getting share in profits, a new partners brings:
   (a) Capital (b) Loan (c) Goodwill (d) None of these
5. For getting share in assets of firm, a new partner brings:
   (a) Capital (b) Loan (c) Goodwill (d) Subsidy
6. Nature of revaluation account is:
   (a) Personal account (b) Nominal account (c) Real Account (d) None of these
7. When the partners decide to change the value of assets and liabilities, then the a/c prepared is:
   (a) Revaluation a/c (b) Realisation A/c (c) Memorandum revaluation (d) None of these.
8. All undistributed losses are transferred to capital account of the old partners in the ratio of:
   (a) New Profit Sharing Ratio (b) Gaining ratio (c) old Profit Sharing Ratio (d) Sacrifice ratio
9. Nature of goodwill is:
   (a) Cat Goodwill (b) Dog Goodwill (c) Rat Goodwill (d) All of them
10. A and B are partners sharing profits in ratio of 2:1. They admit C for 1/3 share in profits. The sacrifice ratio of A and B is:
    (a) 2:3 (b) 1:2 (c) 2:1 (d) 1:1

Very Short Answer Type Questions :

1. In which ratio amount of goodwill is divided among the old partners, when new partner brings cash for goodwill?
2. Write one difference between Super Profit and Average Profit.
3. What is meant by reconstitution of partnership?
4. What is the nature of revaluation account?
5. A and B are partners in a firm, sharing profits in the ratio of 3:2. C is admitted for 20% share in profits of the firm. Calculate New Profit Sharing Ratio and Sacrifice Ratio.
   Ans. : NPSR = 12:8:5 SR = 3:2
6. A, B and C are partners in a firm, sharing profits in the ratio of 5:3:2. D is admitted for 1/5th share in profits of the firm. Calculate New Profit Sharing Ratio and Sacrifice Ratio.
   Ans.: NPSR = 10 : 6 : 4 : 5 SR = 5 : 3 : 2
7. A, B and C are partners in a firm, sharing profits in the ratio of 3/6:2/6:1/6 . D is admitted for 1/6th share in profits of the firm. Calculate New Profit Sharing Ratio and Sacrifice Ratio.
   Ans. : NPSR = 15:10:5:6 SR = 3:2:1
8. A and B are partners in a firm, sharing profits of the firm. C is admitted for 1/4th share in profits of the firm. Calculate New Profit Sharing Ratio & Sacrificing ratio.
   Ans. : NPSR = 3:3:2 SR = 1:1
9. A and B are partners in a firm, sharing profits in the ratio of 2:1. C is admitted for 1/4th share in profits of the firm. After admission of C, D is admitted for 10% share in profits of the firm. Find New Profit Sharing Ratio after admission of D.
   Ans. : NPSR 18 : 9 : 9 : 4
10. A and B are partners in a firm, sharing profits in the ratio of 3:2. C is admitted for 1/5th share in profits of the firm, which he acquired in equal proportions from both A & B. Calculate New Profit Sharing Ratio and Sacrifice Ratio.
    Ans. : NPSR = 5:3:2 SR = 1:1
11. A, B and C are partners in a firm, sharing profits in the ratio of 3:2:1. D is admitted for 1/6th share in profits of the firm, which he acquired in equal proportion from A, B and C. Calculate New Profit Sharing Ratio.
    Ans.: NPSR = 8 : 5 : 2 : 3
12. A and B are partners in a firm, sharing profits in the ratio of 3:2. C is admitted for 1/4th share in profits of the firm

which he acquired from A and B in the ratio of 2:1. Calculate New Profit Sharing Ratio.

Ans. : NPSR = 26:19:15

13. A and B are partners in a firm, sharing profits in the ratio of 3:2. C is admitted for 1/5th share in profits of the firm, which he acquired entirely from B. Calculate New Profit Sharing Ratio.

    Ans.: NPSR = 3:1:1

14. A and B are partners in a firm, sharing profits in the ratio of 7:5. C is admitted for 1/6th share in profits of the firm. C acquires 1/24 from A and 1/8 from B. Calculate New Profit Sharing Ratio and Sacrifice Ratio.

    Ans.: NPSR = 13:7:4 SR = 1:3

15. A and B are partners in a firm, sharing profits in the ratio of 3:1. A new partner C is admitted. A surrenders 2/3 of his share and B surrenders 1/3 of his share in favour of C. Calculate New Profit Sharing Ratio and Sacrifice Ratio.

    Ans.: NPSR = 3:2:7 SR = 6:1

16. A and B are partners in a firm, sharing profits in the ratio of 2:1. A new partner C is admitted. A surrenders 1/3 from his share and B surrenders 1/3 of his share in favour of C. Calculate New Profit Sharing Ratio and Sacrifice Ratio.

    Ans.: NPSR = 3:2:4 SR = 3:1

17. A, B and C are partners in a firm, sharing profits in the ratio of 5:3:2 . D is admitted for 2/10 share in profits of the firm. C will retain his original share. Calculate New Profit Sharing Ratio.

    Ans.: NPSR = 15:9:8:8

18. A and B are partners in a firm, sharing profits. They admitted C and D for 1/5th and 1/6th shares in profits respectively. Calculate New Profit Sharing Ratio.

    Ans.: NPSR = 19:19:12:10

19. A, B and C are partners in a firm, sharing profits in the ratio of 3:2:1 . D is admitted as a new partner. D acquires ¼ of his share from C and A surrenders 3/10 of his share and B surrenders 1/10 of his share. Calculate New Profit Sharing Ratio and Sacrifice Ratio.

    Ans.: NPSR = 63:54:19:44 SR = 27:6:11

Short Answer Type Questions :

1. State the rights acquired by a newly admitted partner.
2. Why Profit and Loss Adjustment Account or Revaluation Account is prepared?
3. Goodwill of the firm is valued at three years purchase of average profits of last five years. The firm earned the following profits during last five years : ₹30,000, ₹ 25,000, ₹ 40,000, ₹ 35,000, ₹ 20,000. Calculate the value of goodwill of the firm.

    Ans.: ₹ 90,000

4. Goodwill of a firm is valued at two years purchase of average profits of last four years. The firm earned the following profits during last four years : 2013 - ₹ 10,000, 2014 ₹ 16,000, 2015 - ₹ 6,000 (Loss), 2016 – ₹ 12,000. Calculate the value of goodwill of the firm.

    Ans.: ₹ 16,000

5. Profits of the firm for last four years- 2013 – ₹ 20,000 (including ₹ 4,000 speculative profits); 2014 – Loss ₹ 2,000 (after charging an abnormal loss of ₹ 16,000); 2015 - ₹17,000 (closing stock overvalued by ₹ 2,000); 2016 – ₹19,000 (including profit on sale of machine ₹ 2,000) Goodwill of the firm is valued three times of average profits of last four years. Find value of goodwill.

    Ans. : ₹ 48,000

6. Profits of the firm for last five years are :

Year	2012	2013	2014	2015	2016
Profits (in₹)	10,000	12,000	15,000	19,000	29,000
Weight	1	2	3	4	5

Calculate value of goodwill on the basis of three years purchase of weighted average profits.

Ans.: ₹ 60,000

7. Capital of the firm is ₹ 2,00,000. Normal Rate of Return is 10% and average profit of the firm is ₹ 30,000. Goodwill is to be valued at three years purchase of super profits. Find value of goodwill.

   Ans.: ₹ 30,000

8. Capital of the firm is ₹ 1,80,000. Normal Rate of Return is 12% and average profit of the firm is ₹ 24,000. Calculate value of goodwill by capitalisation method.

   Ans.: ₹ 20,000

9. A and B are partners in a firm. Capital employed of the firm is ₹ 5,00,000. Normal Rate of Return is 10% and average profit of the firm is ₹ 80,000. Salary of each partner is ₹ 8,000 p.a. Calculate value of goodwill according to capitalisation of super profit method.

   Ans.: ₹ 1,40,000

10. Adjusted capital of X and Y is ₹ 30,000 and ₹ 25,000 respectively. Z brings in ₹ 25,000 as capital for ¼ share of profits in the firm. Calculate value of goodwill.

    Ans.: ₹ 20,000

11. Balance of Capital Accounts of A and B were ₹ 40,000 and ₹ 30,000 respectively. For the year ended 31–12–2016. Balance of General Reserve Stood at ₹ 20,000. C is admitted on 1 – 01 -2017 for 1/3rd share in profits. C brings in ₹ 50,000 for his share of capital. Calculate value of goodwill.

    Ans.: ₹ 10,000

12. Super Profit of a firm is ₹ 10,000. The present value of an annuity of ₹ 1 for five years at 10% per annum may be taken at ₹ 3.791. Find the value of goodwill of the firm.

    Ans.: ₹ 37,910

13. Purchase consideration of a business is determined at ₹ 3,50,000. Assets were ₹ 4,00,000 and liabilities were worth ₹ 80,000. Find the value of goodwill of the firm.

    Ans.: ₹ 30,000

14. A and B are partners in a firm sharing profits in the ratio of 2: 1. They admitted C as a new partner. C brought in ₹ 40,000 for his share of capital and ₹ 15,000 as goodwill for 1/6th share in profits of the firm. Goodwill withdrawn by A and B from the firm. On C's admission goodwill appeared in the books of the firm at ₹ 30,000. Record necessary Journal entries.

15. A and B are partners in a firm sharing profits in the ratio of 3:2. They admitted C as a new partner for 1/5th share in profits of the firm. C acquires his entire share from A. C brought in ₹ 50,000 as his capital and ₹ 10,000 as goodwill. On C's admission goodwill appeared in the books of the firm at ₹ 25,000. Record necessary Journal entries.

16. A and B are partners in a firm sharing profits in the ratio of 3:2. They admitted C as a new partner for 1/5th share in profits of the firm. On the date of C's admission goodwill was valued at ₹ 25,000. C contributed the following assets to his capital and his share of goodwill : Debtors ₹ 10,000 and Stock ₹ 15,000. Record necessary Journal entries.

17. A, B and C are partners in a firm sharing profits in the ratio of 3:2:1. They admitted D as a new partner for 1/7th share in profits of the firm. D brought in ₹ 1,00,000 as his capital and ₹ 45,000 as goodwill. Record necessary Journal entries.

18. L, M and N are partners in a firm sharing profits in the ratio of 2:2:1. They decided that N will get 1/4th share in future profits. Goodwill of the firm was valued at ₹ 80000. Goodwill already appeared in the books at ₹ 20000. Pass necessary journal entries.

    Ans. : L (SR), M 1/40 (SR), N 2/40 (GR)

19. X, Y and Z were partners sharing profits in the ratio of 5:3:2. They decided to share future profits in the ratio of 2:3:5 with effect from 1-04-2017. They decide to record the effect of the following without affecting their book value.

    1. Profit and Loss A/c ₹ 24000, 2. Advertisement Suspense A/c ₹ 12000. Pass the necessary adjustment entry.

    Ans. : Z (Dr.) ₹ 3600, X (Cr.) ₹ 3600

Essay type Questions :

1. What is meant by admission of a partner? Explain and illustrate the different methods of calculation of goodwill.
2. What is Revaluation Account? Why is it prepared? What entries are passed for revaluation of assets and re-assessment of liabilities on admission of a new partner?
3. What problems occur at the time of admission of a new partners, for this what adjustments are made? Explain.
4. What is Memorandum Revaluation Account? How does it differ from Revaluation Account?
5. State the treatment of goodwill at the time of admission of a new partner as per Indian AS- 26/ Indian AS-38.

Answers of multiple choice type questions

Question No.	1	2	3	4	5	6	7	8	9	10
Answer	B	C	B	C	A	B	A	C	D	C

Numerical Questions :

1. A & B are partners sharing profits in the ratio of 3:1. They admit C for 1/4th share in profits of the firm. Goodwill of the firm is valued at ₹40,000 on the date of admission of C. Pass Journal entries in the following cases :

   (a) C pays for his share of goodwill privately to A and B. **(b)** C brings his share of goodwill in cash. **(c)** C brings his share of goodwill in cash. A & B withdraws half of the goodwill. **(d)** C brings ₹ 6,000 in cash out of his share of goodwill. **(e)** C is unable to bring his share of goodwill in cash.

2. A and B shares the profits of a business in the ratio of 5: 3. They admitted C into the firm for 1/4th share in profits, which is to be contributed equally by A and B. On the date of admission of C the Balance Sheet of the firm was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
A's Capital	50,000	Goodwill	10,000
B's Capital	30,000	Machinery	35,000
General Reserve	16,000	Furniture	15,000
Creditors	14,000	Stock	10,000
Employees Provident Fund	10,000	Debtors	10,000
		Bank	40,000
	1,20,000		**1,20,000**

   Terms of C's admission were as follows : **(i)** C will bring ₹30,000 for his share of capital and goodwill. Half of the goodwill shall be withdrawn by the old partners. **(ii)** Goodwill of the firm has been valued at 3 years' purchase of the super profit ₹ 8,000. **(iii)** Machinery, furniture and stock are revalued at ₹ 30,000, ₹ 12,000 & ₹ 8,000 respectively. **(iv)** An old customer whose account was written off as bad debts has promised to pay ₹ 1,200. From the above prepare Revaluation account, Partners' Capital accounts and Balance Sheet of the new firm.

   If it has been agreed that assets and liabilities are to be shown at old values. Prepare Memorandum Revaluation A/c, Partner’s capital A/c and Balance Sheet.

   Ans. : (i) Loss on revaluation ₹ 8,800; A's capital ₹ 49,750; B's capital ₹ 30,450; C's capital ₹24,000;
   B/S ₹ 1, 28,200; **(ii)** B/S ₹1,37,000; Capital A/c : A ₹ 54,250; B ₹ 32,550; ₹ 26,200.

3. X and Y are partners sharing profits in the ratio of 2:1. Their Balance Sheet as on 31st March, 2017 is as under:

Balance Sheet (as on 31st March 2017)

Liabilities	Amount (₹)	Assets		Amount (₹)
Creditors	30,000	Bank Balance		17,200
Outstanding Salary	1,000	Debtors	16,000	

Workmen Compensation Reserve	6,000	Less : Provision 1,200	14,800
General Reserve	9,000	Stock	43,000
Capital:		Plant & Machinery	42,000
X 60,000		Buildings	36,000
Y 50,000	1,10,000	Goodwill	3,000
	1,56,000		**1,56,000**

They admitted Z in the firm from 1st April, 2017 for 1/4th share, which he will receives, from X. Following decisions were taken at that time : **(i)** Z brings ₹36,000 in cash and share of Ram Ltd. Worth ₹ 14,000 as his capital. **(ii)** The present value of firm's goodwill is ₹ 12,000. Z brings his share of goodwill in cash. **(iii)** Provision for bad debts on debtors be increased to 10% and outstanding salary is not required now. **(iv)** Plant and machinery overvalued by 5% and stock to be increased by ₹ 2,400. **(v)** Building undervalued by 10%. **(vi)** Sundry creditors were written back by ₹ 4,000. **(vii)** Liability against workmen Compensation determined at ₹ 9,000. Prepare Profit & Loss Adjustment Account, Partners' Capital Accounts and Balance Sheet on the admission of Z.

Ans. : (Profit on Revaluation ₹ 6,000; X's capital ₹ 71,000; Y's capital ₹ 54,000; Z's capital ₹ 50,000; B/S ₹ 2,10,000.)

4. L, M and N were partners in a firm sharing profits in the ratio of 3: 2: 1. Their Balance Sheet on 31.3.2017 was as follows :

Balance Sheet of L, M and N as on 31 March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,68,000	Bank	28,000
General Reserve	42,000	Debtors	40,000
Capitals :		Stock	2,20,000
L 1,20,000		Investments	60,000
M 80,000		Furniture	20,000
N 40,000	2,40,000	Machinery	70,000
		Profit & Loss	12,000
	4,50,000		**4,50,000**

On the above date O was admitted as a new partner and it was decided that : **(i)** The new profit sharing ratio between L, M, N and O will be 2: 2: 1: 1. **(ii)** Goodwill of the firm was valued at ₹1,80,000 and O brought his share of goodwill (premium) in cash. **(iii)** The market value of investments was ₹ 36,000. **(iv)** Machinery will be reduced to ₹ 58,000. **(v)** A creditor of ₹ 6,000 was not likely to claim the amount and hence was to be written off. **(vi)** O will bring proportionate capital so as to give him 1/6th share in the profits of the firm. **(vii)** Provision for doubtful debts to be maintained @ 5% and provision for discount on debtors be made @ 2%.Prepare Revaluation Account, Partner's Capital Accounts and Balance Sheet of the New Firm.

Ans. : Loss on Revaluation ₹ 32,760; B/S ₹ 4,82,688; Capital A/c L ₹ 1,48,620; M ₹ 79,080; N ₹ 39,540; O ₹ 53,448.

5. A and B shares the profits in the ratio of 5: 3. They admit C into firm for a 1/4th share in the profits to be contributed equally by A and B. Before admission of C, Balance Sheet of the firm is as follows :

Balance Sheet

Liabilities	Amount (₹)	Assets	Amount (₹)
A's Capital	40,000	Machinery	30,000
B's Capital	30,000	Furniture	20,000
Workmen Compensation Reserve	4,000	Stock	15,000

Provision for Doubtful Debts	1,000	Debtors	15,000
Creditors	2,000	Bank	7,000
Provident fund	10,000		
	87,000		**87,000**

Terms of C's admission were as follows : **(i)** C will bring ₹30,000 as his share of Capital and Goodwill. (ii) Goodwill of the firm has been valued at 3 times of the average super-profits of last four years. Average profits of the last four years are ₹ 20,000, while the normal profits that can be earned with the capital employed are ₹ 12,000. **(iii)** Furniture to be appreciated by ₹ 6,000 and the value of stock is to be reduced by ₹ 2,000. Provident fund be raised by ₹ 1,000. **(iv)** All debtors are good. **(v)** Liability against Workmen Compensation Reserve is determined at ₹ 2,000. Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm.

Ans. : Profit on Revaluation ₹ 4,000; Capital A/c : A ₹ 47,500; B ₹ 34,500 & C ₹ 24,000. B/S ₹ 1,21,000.

6. The following is the Balance Sheet of A and B, who are sharing profit in the proportion of 3: 1 on 31st March, 2017:

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	39,700	Cash at Bank	22,600
Provision For Bad Debts	300	Bills Receivable	3,000
General Reserve	4,000	Debtors	16,000
Capital:		Stock	20,000
A ₹ 30,000		Office Furniture	1,000
B ₹ 16,000	46,000	Land & Buildings	25,000
		Advertisement Expenses	2,400
	90,000		**90,000**

They agreed to take C in partnership on 1st April, 2017 on the following terms : (i) C will pay ₹14,000 as his capital and goodwill for 1/5th share in the future profits. **(ii)** That the goodwill of the firm be valued at ₹ 20,000. **(iii)** The stock and furniture will be reduced by 10% and the provision for doubtful debts will be created @ 5% on debtors. **(iv)** Value of Land & Building be appreciated by 20%. **(v)** That the capital accounts of the partners will be readjusted on the basis of new partners' capital and any excess or deficiency transferred to their current accounts. Prepare Revaluation account, Partner’s Capital accounts and Balance Sheet of the new firm.

Ans. : Profit on Revaluation ₹ 2,400; Capital A/c ; A ₹ 30,000; B ₹ 10,000 & C ₹ 10,000; B/S ₹ 1,04,500.

7. A and B distribute profit in 3:2 ratio. On 31st March, 2017 their Balance Sheet is as follows:

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets		Amount (₹)
Bills Payable	60,000	Cash and bank balance		25,000
Reserve Fund	15,000	Debtors	30,000	
Workmen Compensation Reserve	10,000	Less: Provision	2,000	28,000
Capital :		Stock		32,000
A	90,000	Goodwill		10,000
B	40,000	Buildings		1,20,000
	2,15,000			**2,15,000**

On 1st April, 2017 C was admitted in partnership on the following conditions: **(i)** New profit sharing ratio of partners will be 2: 1: 1. **(ii)** C pays ₹40,000 as his capital. **(iii)** Stock be decreased by ₹ 2,000. Provision for Doubtful debts is to be maintained up to ₹ 3,000. **(iv)** C's share in the goodwill of the firm be valued at ₹ 5,000. C brings cash for goodwill. **(v)** Prepaid insurance ₹ 1,000. **(vi)** Outstanding electricity bills ₹ 500. **(vii)** Buildings undervalued by ₹ 10,000. **(viii)** The capitals of all partners will be in their profit sharing ratio. Adjustment is to be done by cash. Prepare Capital Accounts and Balance Sheet of the new firm.

Ans. : Profit on Revaluation ₹ 7,500; Capital A/c A ₹ 80,000; B ₹ 80,000 & C ₹ 40,000. B/S ₹ 2,60,500; Cash & Bank Balance ₹ 72,500.

8. M and N are partners in a firm in equal profit sharing ratio. On 31st March, 2017 their Balance Sheet was as follows :

Balance Sheet (as on 31st March, 2017)

Liabilities	Amount (₹)	Assets	Amount (₹)
General Reserve	8,000	Cash in hand	1,500
Investment Fluctuation Reserve	2,000	Investments	30,000
Bank Overdraft	40,000	Debtors	57,000
Creditors	36,000	Furniture	4,000
Capital:		Stock	10,500
M 30,000		Buildings	30,000
N 20,000	50,000	Patents	3,000
	1,36,000		**1,36,000**

They admit O in the partnership on the following terms : **(i)** Create provision for doubtful debts by 10% on debtors. **(ii)** Furniture will be depreciated by 25%. **(iii)** Increase the value of Investment by ₹5,000. **(iv)** O shall bring ₹ 25,000 as his capital and his share in profit & loss will be 1/3rd and he will brings ₹ 5,000 as his share of goodwill. **(v)** A creditor for ₹ 1,700 is dead. No liability shall arise in future on this account. **(vi)** Patents are valueless. **(vii)** Buildings will be appreciated by 25%. Stock is reduced to ₹ 9,000. The capitals of old partners are also to be adjusted accordingly. Prepare Revaluation A/c, Partners' Capital A/c and Balance Sheet.

Ans. : Profit on Revaluation ₹ 3,000; Capital A/c : M ₹ 25,000; N ₹ 25,000 & O ₹ 25,000; B/S ₹ 1,49,300; Cash Balance ₹ 13,500.

9. Atal and Madan were partners in a firm sharing profits in the ratio of 5: 3. On 31.3.2017 they admitted Mehra as a new partner for 1/5th share in the profits. The new profit sharing ratio was 5: 3: 2. On Mehra's admission the Balance Sheet of the firm was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capitals :		Land and Buildings	1,50,000
Atal 1,50,000		Machinery	40,000
Madan 90,000	2,40,000	Patents	5,000
Provision for bad debts	1,200	Stock	27,000
Creditors	20,000	Debtors	47,000
Workmen Compensation Fund	32,000	Cash	4,200
		Profit and Loss Account	20,000
	2,93,200		**2,93,200**

On Mehra's admission it was agreed that : **(i)** Mehra will bring ₹40,000 as his capital and ₹ 16,000 for his share of goodwill (premium), half of which was withdrawn by Atal and Madan. **(ii)** A provision of 2 1/2 % for bad and doubtful debts was to be created. **(iii)** Included in the sundry creditors was an item of ₹ 2,500, 2.5% which was not to be paid. **(iv)** A provision was to be made for an outstanding bill for electricity ₹ 3,000. **(v)** A claim of ₹ 325 for damages against the firm was likely to be admitted. Provision for the same was to be made. After the above adjustments, the capitals of Atal and Madan were to be adjusted on the basis of Mehra's capital. Actual cash was to be brought in or to be paid off to Atal and Madan as the case may be. Prepare Revaluation Account, Capital Accounts of the partners and the Balance Sheet of the new firm.

Ans.: Loss on Revaluation ₹ 800; B/S ₹ 2,69,000; Capital A/c : Atal ₹ 1,00,000; Madan ₹ 60,000; Mehra's ₹ 40,000.

10. Shikhar and Rohit were partners in a firm sharing profits in the ratio of 7: 3. On 1st April, 2017 they admitted Kavi as a new partner for 1/4 share in profits of the firm. Kavi brought ₹ 4,30,000 as his capital and ₹ 25,000 for his share of goodwill (premium). The Balance Sheet of Shikhar and Rohit as on 1st April, 2017 was as follows:

Balance Sheet of Shikhar and Rohit as on 1st April, 2017

Liabilities		Amount (₹)	Assets		Amount (₹)
Capitals :			Land and Buildings		3,50,000
Shikhar	8,00,000		Machinery		4,50,000
Rohit	3,50,000	11,50,000	Debtors	2,20,000	
General Reserve		1,00,000	Less : Provision	20,000	2,00,000
Workmen's Compensation Fund		1,00,000	Stock		3,50,000
Creditors		1,50,000	Cash		1,50,000
		15,00,000			**15,00,000**

It was agreed that : **(i)** The value of Land and Buildings will be appreciated by 20%. **(ii)** The value of Machinery will be depreciated by 10%. **(iii)** The liabilities of Workmen's Compensation Fund was determined at ₹50,000. **(iv)** Capitals of Shikhar and Rohit will be adjusted on the basis of Kavi's capital and actual cash to be brought in or to be paid off as the case may be. Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm.

Ans. : Profit on Revaluation ₹ 25,000. Capital A/c : Shikhar ₹ 9,03,000; Rohit ₹ 3,87,000; Kavi ₹ 4,30,000; B/S ₹ 19,20,000; Cash Balance ₹ 5,45,000.

11. A and B are partners in a firm sharing profits in the ratio of 3:2. On 1st April 2017 they admit C in new firm for 1/5 share in profit. Their balance sheet was as follows:

Balance Sheet as on 31st March, 2017

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital Accounts:			Goodwill	5,000
A	60,000		Plant & Machinery	65,000
B	50,000	1,10,000	Furniture	15,000
General Reserve		10,000	Investments	20,000
Sundry Creditors		50,000	Stock	20,000
			Sundry Debtors	30,000
			Cash in hand	15,000
		1,70,000		**1,70,000**

C was admitted on the following terms : **(i)** C is to bring capital ₹40,000 and goodwill ₹ 15,000 **(ii)** Partners agreed to share the future profits in the ratio of 5:2:3 **(iii)** Investments will be appreciated by 20% and furniture depreciated by 10% **(iv)** One customer who owed the firm ₹ 2,000 becomes insolvent and nothing could be realised from him. **(v)** Creditors will be written off ₹ 2,000. **(vi)** Outstanding bills for repairs ₹ 1,000 will be provided for. **(vii)** Interest accrued on investments ₹ 2,000. **(viii)** Capitals of the partner's shall be in proportion to their profit sharing ratio. For this, adjustment to be made through cash. Prepare Revaluation Account, Capital

Accounts and the Balance Sheet of new firm.

Ans.: Profit on Revaluation ₹ 3,500. Capital A/c : A ₹ 1,00,000; B ₹ 60,000; C ₹ 40,000.

12. Ishu and Vishu are partners sharing profits in the ratio of 3:2. Their Balance Sheet as on 31st March 2017 was as follows:

Balance Sheet as on 31st March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	66,000	Cash at Bank	87,000
General Reserve	10,000	Debtors 42,000	
Investment Fluctuation Fund	4,000	Less : Prov. For D.D. 7,000	35,000
Capital :		Investments (Market Price 19,000)	21,000
Ishu 1,19,000		Buildings	98,000
Vishu 1,12,000	2,31,000	Plant & Machinery	70,000
	3,11,000		**3,11,000**

Nishu was admitted on that date for 1/6th share on the following terms : **(i)** Nishu will bring ₹56,000 as his share of capital. **(ii)** Goodwill of the firm is valued at ₹ 84,000 and Nishu will bring his share of goodwill in cash. **(iii)** Plant and Machinery be appreciated by 20%. **(iv)** All debtors are good. **(v)** There is a liability of ₹ 9,800 included in sundry creditors that is not likely to arise. **(vi)** Capital of Ishu and Vishu will be adjusted on the basis of Nishu's capital and any excess or deficiency will be made up by withdrawing or bringing in cash by concerned partner. Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after the above adjustments.

Ans. : Profit on Revaluation ₹ 30,800.

Capital A/c : Ishu ₹ 1,68,000; Vishu ₹ 1,12,000; Nishu ₹ 56,000; B/S ₹ 3,92,200.

13. A and B, who are partners in a firm share profits in the ratio of 3:2 on 31st December, 2016. The Balance Sheet was as follows:

Balance Sheet as on 31st December, 2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital Accounts :		Plant & Machinery	10,000
A 10,000		Land & Buildings	8,000
B 8,000	18,000	Debtors 12,000	
General Reserve	15,000	Less: Prov. For D.D. (1,000)	11,000
Workmen's Compensation Fund	5,000	Stock	12,000
Creditors	12,000	Cash	9,000
	50,000		**50,000**

They agreed to admit C into partnership for 1/5th share of profits on the following terms : **(i)** Provision for doubtful debts be increased by ₹2,000. **(ii)** The value of stock be increased by ₹ 4,000 and Land & Buildings be increased to ₹ 18,000. **(iii)** The liability against workmen's compensation fund is determined at ₹ 2,000. **(iv)** C brought in as his share of goodwill ₹ 10,000 in cash. **(v)** C would bring cash and would make his capital equal to 20% of combined capital of A & B, after the above revaluation and adjustments are carried out. Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after C's admission.

Ans. : Profit on Revaluation ₹ 12,000.

Capital A/c : A ₹ 34,000; B ₹ 24,000; C ₹ 11,600. B/S ₹ 83,600; Cash Balance ₹ 30,600.

14. P and Q are partners in a firm sharing profits in the ratio of 3 :1. Their Balance Sheet was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	11,000	Cash	4,000
Workmen's Compensation Fund	4,000	Debtors 16,000	
Investment Fluctuation Fund	1,000	Less : Prov. For D.D. (500)	15,500
General Reserve	2,000	Stock	18,500
Capital A/c:		Investments	6,000
P 16,000		Goodwill	4,000
Q 14,000	30,000		
	48,000		**48,000**

R is admitted for 1/5th share in profit on the following terms : **(i)** Market value of investments is taken as ₹4,200 **(ii)** Accrued Interest amounts to ₹ 200. **(iii)** Provision for doubtful debt was in excess to ₹ 200. **(iv)** A claim of Workmen's Compensation for ₹ 1,000 be provided. **(v)** R is to bring ₹ 10,000 as goodwill share. **(vi)** Total capital of the firm was agreed as ₹ 50,000 to be adjusted in their profit sharing ratio. R brings his capital in cash but capital of other partners be adjusted by opening current accounts. Prepare Revaluation Account, Capital Accounts and the Balance Sheet of new firm.

Ans. : Loss on Revaluation ₹ 400.

Capital A/c : P ₹ 30,000; Q ₹ 10,000 & R ₹ 10,000; B/S ₹ 68,650. Cash Balance ₹ 24,000.

15. A, B and C are partners sharing profits in the ratio 2:2:1. Their balance sheet on 31-3-2017 was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	30,000	Bank	30,000
General Reserve	68,000	Debtors 40,000	
Profit & Loss A/c	30,000	Less : Provision 2,000	38,000
Capital A/cs		Stock	50,000
A 40,000		Furniture	30,000
B 40,000		Plant	80,000
C 30,000	1,10,000	Deferred Revenue Expenditure	10,000
	2,38,000		**2,38,000**

The partners agreed to share profits in the ratio 1:1:1 from 1-4-2017. They further agreed that : **(i)** Stock be valued at 20% more. **(ii)** Doubtful debt provision be increased by ₹1,000. (iii) Depreciate furniture and plant by 10%. **(iv)** Rent outstanding is ₹ 2,000. **(v)** Goodwill of the firm is valued at ₹ 51,000.Partners decided not to alter the values of assets, liabilities and reserves. They also decided not to show goodwill in the books. Pass a single entry to give effect to above changes.

Ans. : Net profit by adjustment ₹ 1,35,000

C's Capital A/c	Dr.	18000	
To A's Capital			9000
To B's Capital			9000

16. Suresh, Ramesh and Mahesh share profits in the ratio of 3: 2: 1 respectively. Their Balance Sheet as on 1st April, 2017 was as-

Balance Sheet as on 1st April, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,60,000	Cash	1,40,000
General Reserve	1,08,000	Sundry Assets	4,80,000

Capital A/c		Profit & Loss A/c	36,000
Suresh 1,80,000			
Ramesh 1,20,000			
Mahesh 88,000	3,88,000		
	6,56,000		**6,56,000**

On that date they decided that Suresh, Ramesh and Mahesh will share profits in future in the ratio of 2: 2: 1 respectively. The goodwill of the firm was valued at ₹72,000 on that date. Prepare Partner's Capital Accounts and Balance Sheet of the firm.

Ans. : Capital A/c Suresh ₹ 2,23,200; Ramesh ₹ 1,39,200; Mahesh ₹ 97,600; B/S ₹ 6,20,000.
Suresh 3/30 (SR); Ramesh (-)2/30 (G/R); Mahesh(-)1/30 (GR).

17. Nardeep, Hardeep and Gagandeep were partners in a firm sharing profits in 2: 1: 3 ratio. Their Balance sheet as

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,00,000	Land	1,00,000
Bills Payable	40,000	Buildings	1,00,000
General Reserve	60,000	Plant	2,00,000
Capital :		Stock	80,000
Nardeep 2,00,000		Debtors	60,000
Hardeep 1,00,000		Bank	10,000
Gagandeep 50,000	3,50,000		
	5,50,000		**5,50,000**

From 1.4.2017, Nardeep, Hardeep and Gagandeep decided to share future profits equally. For this purpose it was decided that : **(a)** Goodwill of the firm be valued at ₹3,00,000. (b) Land be revalued at ₹ 1,60,000 and buildings be depreciated by 6%. **(c)** Creditors of ₹ 12,000 were not likely to be claimed and hence be written off. Prepare, Revaluation Account, Partners Capital Accounts and the Balance Sheet of the reconstituted firm.

Ans. : Profit on Revaluation ₹ 66,000. Capital A/c : Nardeep ₹ 2,42,000; Hardeep ₹ 71,000; Gagandeep ₹ 1,63,000; B/S ₹ 6,04,000; Hardeep (-) 1/6 (GR); Gagandeep 1/6 (SR).

18. A and B are partners sharing profits in the ratio of 3:2 in a firm. On 31.3.2017 their Balance Sheet was as follows:

Balance sheet as on 31 March, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	40,000	Cash at Bank	40,000
Provision for Bad-debts	2,000	Debtors	50,000
Employee's Provident fund	8,000	Stock	30,000
Bank Loan	40,000	Investments	10,000
P & L A/c	20,000	Buildings	1,00,000
General Reserve	10,000	Machinery	40,000
Capital :		Furniture	4,000
A 1,00,000		Patents	6,000
B 80,000	1,80,000	Goodwill	15,000
		Deferred Revenue Expenditure	5,000
	3,00,000		**3,00,000**

They decided to admit C for 1/5th share. He takes his share entirely from A. He had to contribute the proportionate capital. **(i)** Goodwill of the firm is valued at 2 years purchase of average profit of last 3 years, which was ₹ 10,000. C brings his share of goodwill in cash. **(ii)** Unrecorded Assets ₹ 10,000 **(iii)** Investment valued at ₹ 12,000 and taken by A. **(iv)** ½ of General Reserve withdrawn by the partners. **(v)** Land & Buildings appreciates by 10%. **(xi)** Plant & Machinery valued at 20% more. **(vii)** Furniture valued at 10% less. **(viii)** Outstanding Salary ₹ 2,000. **(ix)** Patent reduced by ₹ 3,000. **(x)** Liability of workmen compensation is ₹ 2,000. **(xi)** Prepaid insurance ₹ 1,000. **(xii)** Bank loan would be paid off. **(xiii)** A liability of ₹ 4,000 included in creditors was not likely to arise. **(xiv)** Bad debts ₹ 3,000. **(xv)** Stock is reduced to ₹ 26,000. Prepare Revaluation A/c, Partner's Capital Accounts and the Balance Sheet of the new firm.

Ans. : Profit on Revaluation ₹ 18,600; Capital A/c : A. ₹ 1,06,160; B. ₹ 89,400; C. ₹ 48,900; B/S ₹ 2,92,500; Cash Balance ₹ 47,900.

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