

## MEANING OF KEY TERMS USED IN THIS CHAPTER

1. <b>Reconstitution of Partnership</b>	Reconstitution of Partnership means change in relationship among the partners.
2. <b>Change in Profit-sharing Ratio</b>	Change in Profit-sharing Ratio means change in ratio in which profit or loss of the firm is shared by the partners.
3. <b>Sacrificing Partners</b>	The partners whose shares decrease as a result of change in profit-sharing ratio are known as <b>Sacrificing Partners</b> .
4. <b>Gaining Partners</b>	The partners whose shares increase due to change in profit-sharing ratio are known as <b>Gaining Partners</b> .
5. <b>Sacrificing Ratio</b>	Sacrificing Ratio is the ratio with which the profit share of the partners decrease.
6. <b>Gaining Ratio</b>	Gaining Ratio is the ratio with which the profit share of the partners increase.
7. <b>New Profit-sharing Ratio</b>	It is the ratio in which all partners (including incoming partner) are to share future profits.
8. <b>Accumulated Profits</b>	Accumulated Profits mean profits of the firm that have not been distributed among the partners.
9. <b>Reserve</b>	Reserve means amount set aside out of profits to meet a contingency or to strengthen the financial position of the firm.
10. <b>Revaluation of Assets</b>	Revaluation of Assets means change in value of assets, <i>i.e.</i> , present value being different from that of book value.
11. <b>Reassessment of Liabilities</b>	Reassessment of Liabilities means reassessing the liabilities, <i>i.e.</i> , whether the liability is more or less than that shown in the books of account.

## CHAPTER SUMMARY

- **Meaning of the Reconstitution of a Firm:** Any change in existing agreement of partnership amounts to the reconstitution of a firm.
- **Circumstances when Reconstitution of a Firm takes Place:**
  1. On change in the profit-sharing ratio of existing partners.
  2. On admission of a new partner.
  3. On retirement of an existing partner.
  4. On death of a partner.
  5. On amalgamation of two or more partnership firms.
- **Meaning of Change in Profit-Sharing Ratio:** A change in profit-sharing ratio implies a purchase of share of profit by one partner from another partner.

- **Sacrificing Partners:** The partners whose shares have decreased due to change in the profit-sharing ratio are known as **sacrificing partners**.
- **Gaining Partners:** The partners whose shares have increased due to change in the profit-sharing ratio are known as **gaining partners**.
- **Sacrificing Ratio:** The ratio in which one or more partners sacrifice their share in profit in favour of one or more partners is known as **sacrificing ratio**.
- **Gaining Ratio:** The ratio in which one or more partners gain in profit from the other partner or partners is known as **gaining ratio**.

$\text{Sacrificing/(Gaining) Share} = \text{Old Profit Share} - \text{New Profit Share}$ .

• **Adjustment Required at the Time of Change in Profit-Sharing Ratio:**

- (i) Adjustment of Goodwill.
- (ii) Adjustment of Gain (Profit)/Loss arising from the Revaluation of Assets and Reassessment of Liabilities.
- (iii) Adjustment of the Reserves, Accumulated Profits and Losses.
- (iv) Adjustment of Capital.
- Reserves, Accumulated Profits and Losses are distributed among the existing partners in their old profit-sharing ratio and will not be shown in the New Balance Sheet.

*When Reserves are to be shown in future or in the New Balance Sheet:* Gaining partners compensate the sacrificing partners for the share of reserves and profits which is proportionate to the share gained.

- **Revaluation of Assets and Reassessment of Liabilities at the time of change in profit-sharing ratio:** Any profit or loss arising on such revaluation is shared by the existing partners in their old profit-sharing ratio.

There are *two methods* of Revaluation of Assets and Reassessment of Liabilities:

1. **When revised (changed) values are to be recorded in the books:** Revaluation of assets and reassessment of liabilities is passed through **Revaluation Account**. The gain (profit) or loss on revaluation is transferred to the old partners' Capital (or Current) Accounts in their old profit-sharing ratio.
2. **When revised (changed) values are not to be recorded:** The net effect of revaluation of assets and reassessment of liabilities is adjusted through Capital (or Current) Accounts of partners. An adjustment entry is passed based on gain/sacrifice of partner.

### Accounting Treatment of Goodwill

**When Goodwill is adjusted through Partners' Capital Accounts:**

<i>In Case of Fluctuating Capitals</i>	<i>In Case of Fixed Capitals</i>
Gaining Partners' Capital A/cs ...Dr.	Gaining Partners' Current A/cs ...Dr.
To Sacrificing Partners' Capital A/cs (In sacrificing ratio)	To Sacrificing Partners' Current A/cs (In sacrificing ratio)

### Accounting Treatment of Existing Goodwill

Goodwill appearing in the Balance Sheet as on the date of reconstitution is written off in the old profit-sharing ratio unless the partners decide to carry the value in the books of account.

All Partners' Capital/Current* A/cs	...Dr.	[In old profit-sharing ratio]
To Goodwill A/c		[With existing book value of Goodwill]

\*In case of Fixed Capitals

**Notes:**

1. Write off the Existing Book Value of Goodwill (if any) appearing in the books of the firm. The Partners' Capital Accounts (in case of fluctuating capital) or their Current Accounts (in case of fixed capitals) are debited in the old ratio and Goodwill Account is credited. The following entry is passed:

Partners' Capital/Current A/cs	...Dr.	[In old ratio]
To Goodwill A/c		[Existing book value of goodwill]
(Existing goodwill written off)		

2. Unless stated otherwise, partners' capitals are assumed to be fluctuating. It means sacrificing partner or partners are compensated by crediting the capital accounts.