MEANING OF KEY TERMS USED IN THIS CHAPTER

1. Admission of a Partner	Admission of a Partner means new partner being admitted in the firm.
2. New Profit-sharing Ratio	New Profit-sharing Ratio is the ratio in which all the partners, including the new or incoming partner, share future profits and losses of the firm.
3. Sacrificing Ratio	Sacrificing Ratio is the ratio in which the old or existing partners forego, *i.e.*, sacrifice their share in profits in favour of the new partner.
4. Goodwill	Goodwill is an intangible asset resulting from the efforts made in past by the existing (old) partners of the firm which results in continuous profits.
5. Revaluation of Assets	Revaluation of Assets means change in the value of assets, *i.e.*, present value being different from the book value of the assets.
6. Reassessment of Liabilities	Reassessment of Liabilities means reassessing the liabilities and determining the change, *i.e.*, whether the liability is more or less than that shown in the books of account.
7. Revaluation Account or Profit & Loss Adjustment Account	It is a nominal account to which increase in the value of assets and decrease in the amount of liabilities is credited. Decrease in the value of assets and increase in the amount of liabilities is debited. It is closed by transferring the profit or loss to the Capital Accounts of the old or existing partners in their old profit-sharing ratio.
8. Reserve	Reserve means Accumulated or undistributed profits. It is created out of profits for general or specific purpose.
9. Workmen Compensation Reserve	It is a reserve created out of profit for payment of compensation to workers.
10. Investments Fluctuation Reserve	It is a reserve created to meet the fall in the value of investment.

CHAPTER SUMMARY

- When the existing partners of a firm admit a person as a partner in the firm, it is **admission of a partner**.
- **Adjustments:** The matters that require *adjustment* at the time of admission of a new partner are:
  - (i) Adjustment for change in the Profit-sharing Ratio.
  - (ii) Adjustment for Goodwill.
  - (iii) Adjustment of Gain (Profit)/Loss arising from the Revaluation of Assets and Reassessment of Liabilities.
  - (iv) Adjustment of Deferred Revenue Expenditure.
  - (v) Adjustment of Reserves, Accumulated Profits and Losses.
  - (vi) Adjustment of Capital (if so agreed).

- The ratio in which all partners (including the incoming partner) share future profits and losses is known as the **new profit-sharing ratio**.
- The ratio in which the old (existing) partners have agreed to sacrifice their share in profits in favour of an incoming partner is called the **sacrificing ratio**.

Sacrificing Ratio = Old Ratio − New Ratio.

Notes: 1. Unless agreed otherwise, the **New Profit-sharing Ratio** of Old Partners will be the same as their **Old Profit-sharing Ratio**.

2. Unless agreed otherwise, **Sacrificing Ratio** of Old Partners will be the same as their old Profit-sharing Ratio.

- **Accounting Treatment of Goodwill:** New Partner has to compensate the sacrificing partners by paying them an amount, called **Goodwill** or **Premium for Goodwill**.

Note: *Write off the existing goodwill* (*if any*) *existing in the Balance Sheet of the firm by debiting the Old Partners' Capital Accounts* (*in case of fluctuating capital*) *or Partners' Current Accounts* (*in case of fixed capital*) *in their old profit-sharing ratio and crediting the Goodwill Account. Unless agreed otherwise, it is presumed that the old partners sacrifice in their old profit-sharing ratio.*

ACCOUNTING ENTRIES FOR GOODWILL

1. *Goodwill* (*Premium*) *Paid Privately*	*No Entry*	
2. *Goodwill brought in Cash*	Cash/Bank A/c	...Dr.
	To Premium for Goodwill A/c	
Distribution of Goodwill	Premium for Goodwill A/c	...Dr.
	To Sacrificing Partners' Capital A/cs	[In sacrificing ratio]
	Or	
	To Sacrificing Partners' Current A/cs (When Capitals are Fixed)	
3. *Goodwill withdrawn by the Sacrificing* (*Old*) *Partners*	Sacrificing Partners' Capital A/cs	...Dr.
	To Cash/Bank A/c	
4. *Goodwill not brought in Cash*	New Partner's Current A/c	...Dr.
	To Sacrificing Partners' Capital A/cs	[In sacrificing ratio]
5. *Goodwill brought in kind*	Assets A/c	...Dr.
	To Premium for Goodwill A/c	

Note: If incoming partner brings a part of his share of Goodwill in Cash then **unpaid share of goodwill** should be debited to his **Current Account**, Debit Balance of Current Account will appear in the Assets side of Balance Sheet.

There may be three different situations for adjustment of goodwill at the time of admission of a partner:

1. When the new partner brings his/her share of goodwill in cash.
2. When the new partner does not bring his/her share of goodwill.
3. When the new partner brings only a part of his/her share of goodwill.

Let us discuss the accounting treatment in each of the above situations.

1. ***When the New Partner brings his/her share of Goodwill in Cash (Premium for Goodwill)***

When the new partner brings cash for his share of capital and goodwill, the amount is credited to his Capital Account and Premium for Goodwill Account.

Accounting Entry:

(a) *For Capital and Premium for Goodwill brought in cash by the new partner:*

Cash/Bank A/c	...Dr.	
To New Partner's Capital A/c		[With capital]
To Premium for Goodwill A/c		[With share of goodwill]

IMPORTANT NOTE

Write off existing goodwill (if any) appearing in the books of the firm (Balance Sheet) by passing the following entry:

Old Partners' Capital/Current A/cs*	...Dr.	[In Old Profit-sharing Ratio]
To Goodwill A/c		[With Existing Book Value of Goodwill]

2. ***When the New Partner does not bring his/her Share of Goodwill:***

In this case, the following entry is passed:

Accounting Entry:

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

3. ***When the New Partner brings only a part of his/her Share of Goodwill:***

In this case, premium for goodwill brought by the new partner will be shared by the sacrificing partners in the sacrificing ratio.

Accounting Entries:

(a) *For the amount brought in by new (Incoming partner):*

Cash A/c/Bank A/c	...Dr.	[With capital and share of goodwill]
To New Partner's Capital A/c		[With capital]
To Premium for Goodwill A/c		[With share of goodwill brought]

(b) *For the amount not brought in cash*

New Partner's Current A/c	...Dr.	[With share of goodwill not brought in cash]
To Sacrificing Partners' Capital/Current A/cs		

- **Revaluation Account** or the **Profit & Loss Adjustment Account** is prepared to revalue the assets and reassess the liabilities of the firm at the time of reconstitution of the firm.

Dr. REVALUATION ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Decrease in Value of Assets	...	By Increase in Value of Assets	...
To Increase in amount of Liabilities	...	By Decrease in amount of Liabilities	...
To Unrecorded Liabilities A/c	...	By Unrecorded Assets A/c	...
To *Gain* (*Profit*)* trfd. to the Old Partners' Capital A/cs (in the old profit-sharing ratio)	...	By *Loss** trfd. to the Old Partners' Capital A/cs (in the old profit-sharing ratio)	...
	...		...

*Either of the two will appear.

- **Need to Revalue Assets and Reassess Liabilities:** Assets are revalued and liabilities are reassessed at the time of admission of a partner so that the new partner is not put to an advantage or a disadvantage because of changes in the value of assets and liabilities as on the date of admission.

- **Revaluation Account is prepared:**

  1. To ascertain the Gain (Profit)/Loss arising on account of Revaluation of Assets and Reassessment of Liabilities.

  2. To record the effect of Revaluation of Assets and Reassessment of Liabilities at their revised values.

- **Accumulated Profits** or **General Reserve** are also credited to the old partners in their old profit-sharing ratio. If there are any undistributed losses, they will be debited to the Old Partners' Capital Accounts.

- **Excess of Workmen Compensation Reserve over the Workmen Compensation Claim (Liability)** should be **credited to Old Partners' Capital Accounts** in their **Old Profit-sharing Ratio**.

- **Excess of Investment Fluctuation Reserve over difference between Book Value and Market Value** of investment should be **credited to Old Partners** in their **Old Profit-sharing Ratio.**

- **Adjustment of Capital:**

  (a) *Adjustment of old partners' capitals on the basis of new partner's capital:*

  Step 1. Calculate the total capital of the firm on the basis of capital of new partner.

  $$\text{Total Capital of the Firm} = \frac{\text{Capital of Incoming Partner}}{\text{Share of Profit of Incoming Partner}}.$$

  Step 2. Determine the new capital of each partner.

  New Capital of Old Partner = Total Capital of New Firm × Share of Profit of Old Partner.

  Step 3. Ascertain the present capitals of old partners (Adjusted).

  Step 4. Find out Surplus/Deficit Capital by comparing Step 2 and Step 3.

  Step 5. Adjust the surplus or deficit through Cash or Current Accounts (as the case may be).

  (b) *Calculation of new partner's capital on the basis of old partners' capitals:*

  Step 1. Determine the total adjusted capitals of the old partners.

  Step 2. Determine the total capital of the new firm.

  $$\text{Total Capital of New Firm} = \frac{\text{Total Adjusted Old Capital of Old Partners}}{\text{Total Combined New Share of Old Partners}}.$$

  Step 3. Determine the total capital of the incoming partner as follows:

  Total Capital of New Firm (Step 2) × Share of incoming partner.

Important Notes:

1. In the absence of an agreement, **Surplus or Shortage of Capital** is **adjusted in Cash** and not by transfer to Current Accounts.
2. There is a difference between '*Z* is to contribute 1/5th of the total Capital of the New Firm' and '*Z* is to contribute 1/5th of the combined capital of the old partners'.