ADMISSION OF PARTNER

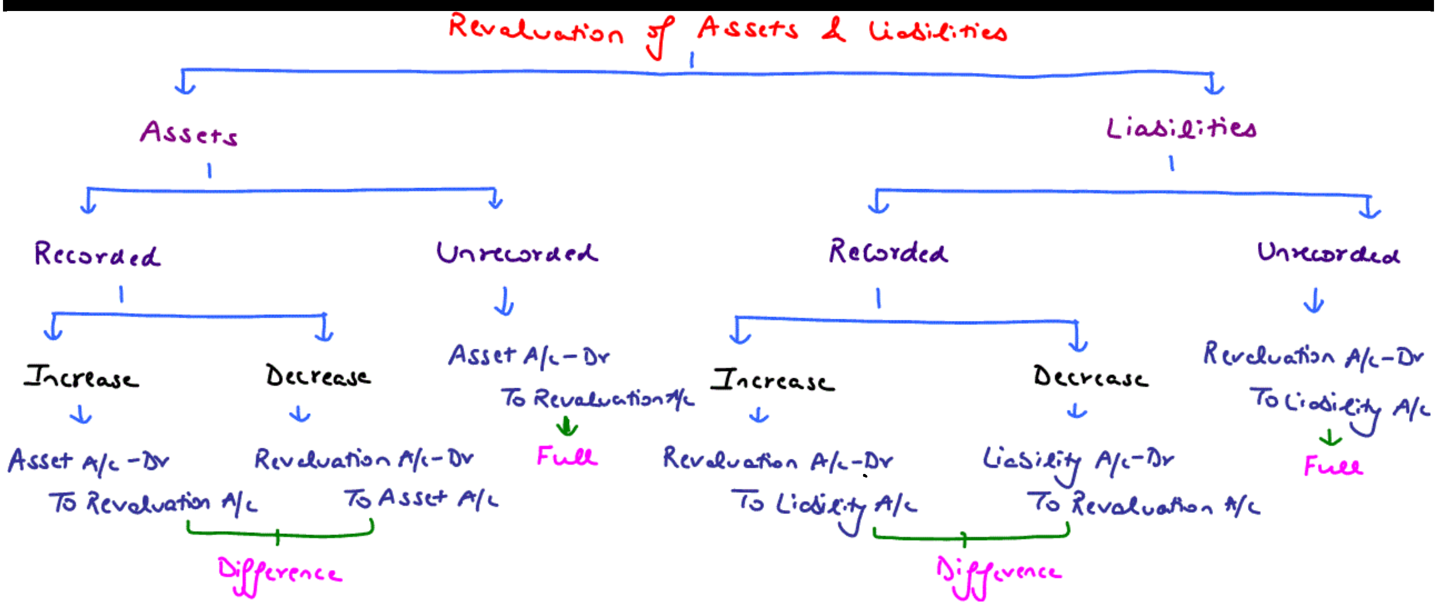
CONCEPT

New partners are admitted for the benefit of the partnership firm. New partner is admitted either for increasing the partnership capital or for strengthening the management of the firm.

Points to Note:

1) Calculation of New Ratio & Sacrificing Ratio
2) Revaluation of Assets & Liabilities
3) Treatement of Reserves
4) Treatment of Goodwill
5) Adjustment of Partners capital Accounts

Revaluation of Assets & Liabilities



Revaluation A/c

Particulars	**Amount**	**Particulars**	**Amount**
To Asset (Decrease)		By Asset (Increase)	
To Liabilities (Increase)		By Assets unrecorded	
To Liabilities unrecorded		By Liabilities (Decrease)	
To Revaluation profit (old partners in old ratio)		By Revaluation Loss (old partners in old ratio)	

Passing the entry through Capital A/c of Partners (Preparing Memorandum Revaluation Account)

1. Find the net gain or loss on Revaluation as follows
2. Entry:

Gaining partners capital A/c (in case of profits)
To Sacrificing partners capital A/c

Sacrificing partners capital A/c (in case of losses)
To Gaining partners capital A/c

Note: When profit/loss on revaluation of assets and liabilities is adjusted through capital accounts only then the assets & liabilities appear in B/sheet of new firm at their old figures.

Treatment of Reserves

Reserves

General Reserve (P&L A/c, etc.)

General Res./P&L A/c - Dr
To Partner's Capital A/cs
(OLD RATIO)

Specific Reserve (Investment fluctuation fund, workmen compensation reserve etc.)

If no other information given

Reserve A/c - Dr
To Partner's Cap. A/c

If Ques specifies liability against it

Reserve > Liability

Reserve A/c - Dr
To Liability A/c
To Partner's Cap. A/c

Reserve = Liability

Reserve A/c - Dr
To Liability A/c

Reserve < Liability

Reserve A/c - Dr
Revaluation - Dr
To Liability A/c

Note: Sometimes the partner may decide not to close the Reserves / P& L A/c but to record the adjustment entry.

Gaining Partners' capital A/c Dr.
To Sacrificing Partners capital A/c

TREATMENT OF GOODWILL

Treatment of Goodwill

Old G/W (Appearing in B/S)

Old Partner's Capital A/c - Dr
To Goodwill A/c

G/W Valued

1. Bring

Cash/Bank/Asset A/c - Dr
To New Partner's Cap. A/c
To Premium for G/W

2. G/W Adjustment

Premium for G/W A/c - Dr
New Partner's Cap. A/c - Dr
To Sacrificing Partner's Cap. A/c

3. Withdrawal of G/W

Sacrificing Partner's Cap. A/c - Dr
To Cash/Bank A/c

ADJUSTMENT OF CAPITAL

Example 1

A & B = 3 : 2. Capital of A & B after adjustments are Rs. 80,000 & Rs. 60,000 respectively C is admitted who brings Rs.35,000 as capital for 1/5th share of profit to be acquired equally from A & B. Capital of A & B are to be adjusted on the basis of C's capital.

$A = \frac{3}{5} - \frac{1}{10} = \frac{5}{10}$

$B = \frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

NR = 5 : 3 : 2

Total capital = $35000 \times \frac{5}{1}$ = 175000

A 5/10	B 3/10	C 2/10
87500	52500	35000
80000	60000	
7500 (Br.)	7500 (with.)	

Example 2

A & B = 3 : 2

Capitals of A & B after adjustments are Rs. 90,000 & Rs. 70,000. Calculate incoming partners proportionate capitals & surplus/shortage of existing capitals of old partners.

a) If C is to contribute proportionate capital for his 1/5th share or 1/5th of the total capital of new firm.

b) If C is to contribute 1/4th of the combined capitals of the existing partners.

c) If C is to contribute proportionate capital for his 1/5th share & capitals of all the partners are to be adjusted in new PSR 3:1:1

a) Total of A & B = 90000 + 70000 = 160000 (For 4/5th share)

Total capital = $160000 \times 5/4$ = 200000

C's capital = $200000 \times 1/5$ = 40000

b) C's capital = $160000 \times 1/4$ = 40000

c) Capital = 200000

	A	B	C
3:1:1	120000	40000	40000
	90000	70000	
	30000 (Br.)	30000 (WD)	

HIDDEN GOODWILL

Value of Goodwill:
Net worth (including goodwill) on the basis of capital brought by an incoming partner
(Incoming partners capital A/c x Reciprocal of his share)
Less: Net worth (excluding G/w of the firm)

Where, Net worth is Total Assets – Outsiders' Liabilities
OR
Capital of partners including new + Reserves + P & L (Cr. Bal.) - Miscellaneous expenditure

Example
A & B having PSR 3 : 2 are partners with capitals of Rs. 30,000 & Rs. 20,000 on date of C's admission for 1/5th share who brings Rs. 40,000. Following are the balances:
P & L (Cr.) = 6,000 Reserves = 55,000 Deferred Revenue Expenditure = 1,000
Find Goodwill.

Net worth (incl. G/w) $= 40000 \times \frac{5}{1} =$ 200000

Less Net worth
(30000 + 20000 + 40000 + 6000 + 55000 − 1000) (150000)

Goodwill 50000

C's share = $50000 \times 1/5$
= 10000

Question

A and B were partners of a firm sharing profits and losses in the ratio 2:1. The Balance Sheet of the firm as at 31st March, 2021 was as under:

Liabilities	**Amount**	**Assets**	**Amount**
Capital Accounts		Plant and Machinery	5,00,000
A	8,00,000	Building	9,00,000
B	4,00,000	Sundry Debtors	2,50,000
Reserves	5,25,000	Stock	3,00,000
Sundry Creditors	2,75,000	Cash	1,50,000
Bills Payable	1,00,000		
	21,00,000		**21,00,000**

They agreed to admit P and Q into the partnership on the following terms:

a) The firm's goodwill to be valued at 2 years' purchase of the weighted average of the profits of the last 3 years.
   The relevant figures are:
   Year ended 31.3.2018 - Profit Rs. 37,000
   Year ended 31.3.2019 - Profit Rs. 40,000
   Year ended 31.3.2020 - Profit Rs. 45,000
b) The value of the stock and Plant & Machinery were to be reduced by 10%.
c) Building was to be valued at Rs. 10,11,000.
d) There was an unrecorded liability of Rs. 10,000.
e) A, B, P & Q agreed to share profits and losses in the ratio 3:2:1:1.
f) The value of reserve, the values of liabilities and the values of assets other than cash were not to be altered.
g) P and Q were to bring Capitals equal to their shares of profit considering B' s Capital as base after all adjustments.

You are required to prepare:
1) Memorandum Revaluation Account,
2) Partner's Capital Accounts and
3) The Balance Sheet of the newly constructed firm

Solution

Memorandum Revaluation A/c

Particulars	**Rs.**	**Particulars**	**Rs.**
To Stock	30,000	By Building	1,11,000
To Plant & Machinery	50,000		
To Unrecorded Liability	10,000		
To Profit transferred to			
A's Capital A/c	14,000		
B's Capital A/c	7,000		
	1,11,000		**1,11,000**
To Building	1,11,000	By Stock	30,000
		By Plant & Machinery	50,000
		By Unrecorded Liability	10,000
		By Loss transferred to	
		A's Capital A/c	9,000
		B's Capital A/c	6,000
		P's Capital A/c	3,000
		Q's Capital A/c	3,000
	1,11,000		**1,11,000**

Capital Accounts

	A	B	P	Q		A	B	P	Q
To Memo. Rev	9,000	6,000	3,000	3,000	By Bal b/d	8,00,000	4,00,000	-	
To Reserve	2,25,000	1,50,000	75,000	75,000	By Memo Rev.	14,000	7,000	-	
To A&B	-	-	12,000	12,000	By Reserve	3,50,000	1,75,000	-	
To Bal c/d	9,50,000	4,30,000	2,15,000	2,15,000	By P&Q	20,000	4,000	-	
					By Cash (Bal Fig)	-	-	3,05,000	3,05,000
	11,84,000	**5,86,000**	**3,05,000**	**3,05,000**		**11,84,000**	**5,86,000**	**3,05,000**	**3,05,000**

Balance Sheet

Liabilities	Amount	Assets	Amount
Capital Account		Plant & Machinery	5,00,000
A	9,50,000	Building	9,00,000
B	4,30,000	Sundry Debtors	2,50,000
P	2,15,000	Stock	3,00,000
Q	2,15,000	Cash (1,50,000+3,05,000+3,05,000)	7,60,000
Reserve	5,25,000		
Creditors	2,75,000		
Bills Payables	1,00,000		
	27,10,000		**27,10,000**

Working Notes:

1. Calculation of Goodwill : Weighted Average Profit:

Year	Profit	Weight	Weighted Profit
2018	37,000	1	37,000
2019	40,000	2	80,000
2020	45,000	3	1,35,000
		6	**2,52,000**

Weighted Average Profit = Rs. 2,52,000/6= Rs. 42,000
Goodwill is valued at 2 year's purchase
Value of Goodwill: Rs. 42,000 × 2 = Rs. 84,000

2. Adjustment for goodwill

	A	B	C	D
Cr. in Old Ratio	56,000	28,000	-	-
Dr. in New Ratio	(36,000)	(24,000)	(12,000)	(12,000)
	20,000 Cr.	**4,000 Cr.**	**12,000 Dr.**	**12,000 Dr.**

3. Calculation of closing capitals of P and Q; B's capital is taken as base.
Closing capital of B after all adjustments is 4,30,000.
Total capital of firm will be= 4,30,000 x7/2 = 15,05,000
Hence, P's and Q's closing capital should be Rs. 2,15,000 (15,05,000 x 1/7) each i.e. at par with B (as per new profit and loss sharing ratio)

Question

A, B and C is a firm sharing profits and losses in the ratio 3:2:1. Their Balance Sheet as on 31st March, 2021 is as below:

Liabilities		Rs.	Assets	Rs.
Trade Payables		17,500	Land and Buildings	17,000
Outstanding liabilities		2,200	Furniture & Fixtures	7,200
Employer's Provident Fund		5,000	Stock	12,600
General reserve		1,800	Trade Receivables	10,700
Capital Account:			Cash & Bank	5,000
A	11,000			
B	8,000			
C	7,000	26,000		
		52,500		**52,500**

The partners have agreed to take D as a partner with effect from 1st April, 2021 on the following terms:
(1) D shall bring 10,000 towards his capital.
(2) The value of stock to be increased to Rs. 14,000 and Furniture & Fixtures to be depreciated by 10%.
(3) Reserve for bad and doubtful debts should be provided at 5% of the Trade Receivables.
(4) It is found that the trade payables included a sum of Rs.1,500, which is not to be paid off.
(5) The unaccrued income is Rs. 1,045.
(6) A claim on account of workmen's compensation for Rs. 300 to be provided for.
(7) Mr. X, an old customer whose account for Rs. 2,000 was written off as bad has promised in writing to pay 65% in settlement of his full debt.
(8) The value of land and buildings to be increased by 4,100 and the value of the goodwill be fixed at Rs. 18,000 and new partner bring his share of goodwill in cash.
(9) The new profit sharing ratio shall be divided equally among the partners

The outstanding liabilities include Rs. 700 due to Ram which has been paid by A. Necessary entries were not made in the books.
It was decided that the total capital of the firm after admission of new partner would be Rs. 40,000. Capital accounts of partners will be readjusted on the basis of their profit sharing ratio and excess or deficiency will be adjusted in cash.

Prepare
(i) Revaluation Account, and
(ii) The Capital Accounts of the partners, and
(iii) Balance Sheet of the firm after admission of D

Solution

Revaluation A/c

Particulars	Rs.	Particulars	Rs.
To Furniture & Fixtures	720	By Stock	1,400
To Provision for Doubtful Debts	535	By Trade Payables	1,500
To Unaccrued incomes	1,045	By Mr. X (Debtor)	1,300
To Workmen compensation claim	300	By Land & Building	4,100
To Profit transferred to			
A's Capital A/c 2,850			
B's Capital A/c 1,900			
C's Capital A/c 950	5,700		
	8,300		**8,300**

Capital Accounts

	A	B	C	D		A	B	C	D
To A & B Cap. A/cs			1,500	4,500	By Bal b/d	11,000	8,000	7,000	-
To Cash (Bal.Fig)	9,950	2,000		-	By Revaluation A/c	2,850	1,900	950	-
To Bal c/d	10,000	10,000	10,000	10,000	By Gen. Reserve	900	600	300	-
					By C & D Cap. A/cs	4,500	1,500	-	-
					By Cash	-	-	-	14,500
					By O/s Liability	700	-	-	-
					By Cash (Bal.Fig)			3,250	
	19,950	**12,000**	**11,500**	**14,500**		**19,950**	**12,000**	**11,500**	**14,500**

Balance Sheet

Liabilities	Amount	Assets		Amount
Capital Account		Land & Building		21,100
A	10,000	Furniture & Fixtures		6,480
B	10,000	Stock		14,000
C	10,000	Trade Receivables	10,700	
D	10,000	Less Prov. for Doubtful Debts	(535)	10,165
Trade Payables	16,000	Mr. X (Debtor)		1,300
Employers Provident Fund	5,000	Cash & Bank (5,000+14,500+3,250-9,950-2,000)		10,800
Outstanding Liabilities	1,500			
Workmen compensation Claim	300			
Unaccrued incomes	1,045			
	63,845			**63,845**

Working Notes:

1. Adjustment for goodwill

	A	B	C	D
Cr. in Old Ratio (3:2:1)	9,000	6,000	3,000	-
Dr. in New Ratio (1:1:1:1)	(4,500)	(4,500)	(4,500)	(4,500)
	4,500 Cr.	**1,500 Cr.**	**1,500 Dr.**	**4,500 Dr.**