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23

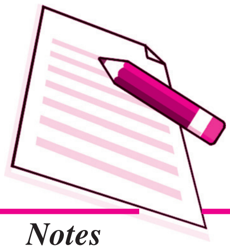
ADMISSION OF A PARTNER

Kapil and Krish are running a partnership firm dealing in toys. They are one of the most successful businessmen in the locality. They now decide to start manufacturing toys that are electronically operated to diversify their business. For this they need more capital and also technical expertise. Mohit; their friend is an electronic engineer and has capital also. They have persuaded him to join their firm. In case, he joins the partnership firm, this will be a case of admission of a partner. As a result, he may need to bring in capital and share of goodwill. In this lesson, you will learn about goodwill and other ajustments at the time of admission of a partner. Mohit will bring in capital and share of goodwill. Some changes in the value of some assets and liabilities of the existing firm are needed to bring them at their realistic value, on his admission. There may be other issues involing finance on his admission. All this need accounting treatment. In this lesson you will learn accounting treatment and adjustments to be made on the admission of a partner.

OBJECTIVES

After studying this lesson, you will be able to :

- state the meaning of admission of a partner;
- calculate new profit sharing ratio and sacrificing ratio;
- state the meaning and factors affecting goodwill;
- explain the methods of valuation of goodwill;
- describe accounting treatment of goodwill;



Notes

- explain the need for revaluation of assets and reassessment of liabilities;
- illustrate the accounting treatment of changes arising from revaluation of assets and reassessment of liabilities;
- describe accounting treatment of undistributed profits and reserves;
- explain the treatment of various adjustments in partners' capitals; and
- prepare Revaluation Account, Partners' Capital Accounts and balance sheet of the reconstituted firm.

23.1 ADMISSION OF A PARTNER

Meaning, New Profit Sharing Ratio and Sacrificing Ratio

Meaning

An existing partnership firm may take up expansion/diversification of the business. In that case it may need managerial help or additional capital. An option before the partnership firm is to admit partner/partners. When a partner is admitted to the existing partnership firm, it is called admission of a partner.

> *According to the Partnership Act 1932, a person can be admitted into partnership only with the consent of all the existing partners unless otherwise agreed upon.*

On admission of a new partner, the partnership firm is reconstituted with a new agreement. For example, Rekha and Nitesh are partners sharing profit in the ratio of 5:3. On April 1, 2014 they admitted Nitu as a new partner with 1/4th share in the profit of the firm. In this case, with the admission of Nitu as partner, the firm stands reconstituted.

On the admission of a new partner, the following adjustments become necessary:

(i) Adjustment in profit sharing ratio;

(ii) Adjustment of Goodwill;

(iii) Adjustment for revaluation of assets and reassessment of liabilities;

(iv) Distribution of accumulated profits and reserves; and

(v) Adjustment of partners' capitals.

Adjustment in Profit sharing Ratio

When a new partner is admitted he/she acquires his/her share in profit from the existing partners. As a result, the profit sharing ratio in the new firm is decided mutually between the existing partners and the new partner. The incoming partner acquires his/her share of future profits either from one or more existing partner. The existing partners sacrifice a share of their profit in the favour of new partner, hence the calculation of new profit sharing ratio becomes necessary.

Sacrificing Ratio

At the time of admission of a partner, existing partners have to surrender some of their share in favour of the new partner. The ratio in which they agree to sacrifice their share of profits in favour of incoming partner is called sacrificing ratio. Some amount is paid to the existing partners for their sacrifice. The amount of compensation is paid by the new partner to the existing partners for acquiring the share of profit which they have surrendered in favour of the new partner.

Sacrificing Ratio is calculated as follows:

Sacrificing Ratio = Existing Ratio – New Ratio

Following cases may arise for the calculation of new profit sharing ratio and sacrificing ratio:

(i) Only the new partner's share is given

In this case, it is presumed that the existing partners continue to share the remaining profit in the same ratio in which they were sharing before the admission of the new partner. Then, existing partner's new ratio is calculated by dividing remaining share of the profit in their existing ratio. Sacrificing ratio is calculated by deducting new ratio from the existing ratio.

Illustration 1

Deepak and Vivek are partners sharing profit in the ratio of 3 : 2. They admit Ashu as a new partner for 1/5 share in profit. Calculate the new profit sharing ratio and sacrificing ratio.

Solution:

Calculation of new profit sharing ratio:

Let total Profit = 1

New partner's share = 1/5
Remaining share = 1 – 1/5 = 4/5
Deepak's new share = 3/5 of 4/5 i.e. 12/25
Vivek's new share = 2/5 of 4/5 i.e. 8/25
Ashu's Share = 1/5

The new profit sharing ratio of Deepak, Vivek and Ashu is :
= 12/25 : 8/25 : 1/5 = 12 : 8 : 5/25 = 12 : 8 : 5
So Deepak Sacrificed = 3/5 – 12/25 = 15 – 12/25 = 3/25
Vivek Sacrificed = 2/5 – 8/25 = 10 – 8/25 = 2/25
Sacrificing Ratio = 3 : 2

Sacrificing ratio of the existing partners is same as their existing ratio.

(ii) The new partner purchases his/her share of the profit from the Existing partner in a particular ratio.

In this case : the new profit sharing ratio of the existing partners is to be ascertained after deducting the sacrifice of share agreed from his share. It means the incoming partner has purchased some share of profit in a particular ratio from the existing partners.

Illustration 2

Neha and Parteek are partners, sharing profit in the ratio of 5 : 3. They admit Nisha as a new partner for 1/6 share in profit. She acquires this share as 1/8 from Neha and 1/24 share from Parteek. Calculate the new profit sharing ratio and sacrificing ratio.

Solution :

Neha's and Parteek's existing ratio is 5 : 3
Neha's new share = 5/8-1/8 = 4/8 or 12/24
Parteek's new share = 3/8-1/24 = 8/24
Nisha's share = 1/8+1/24 =4/24

The new profit sharing ratio of Neha, Parteek and Nisha is
12/24 : 8/24 : 4/24
= 12 : 8 : 4 = 3 : 2 : 1
(ii) Sacrificing ratio = 1/8 : 1/24 or 3 : 1

(iii) Existing partners surrender a particular portion of their share in favour of a new partner.

In this case, sacrificied share of the each partner is to be ascertained. This is ascertained by multiplying the existing partner's share in the ratio of their sacrifice. The share sacrificed by the existing partners should be deducted from his existing share. Therefore, the new share of the existing partners is determined. The share of the incoming partner is the sum of sacrifice by the existing partners.

Illustration 3

Him and Raj shared profits in the ratio of 5:3. Jolly was admitted as a partner. Him surrendered 1/5 of his share and Raj 1/3 of his share in favour of Jolly. Calculate the new profit sharing ratio.

Solution :

Him surrenders 1/5 of his share, i.e., = 1/5 of 5/8 = 1/8
Raj surrenders 1/3 of his share, i.e., = 1/3 of 3/8 = 1/8
So, sacrificing ratio of Him and Raj is 1/8 : 1/8 or equal.

Him's new share	=	5/8 – 1/8 = 4/8
and Raj's new share	=	3/8 – 1/8 = 2/8
Jolly's share	=	1/8 + 1/8 = 2/8

New profit sharing ratio of Him, Raj and Jolly is

= 4/8 : 2/8 : 2/8 or 4 : 2 : 2 or 2 : 1 : 1.

INTEXT QUESTIONS 23.1

I. Fill in the blanks with appropriate word/words :

(i) Sacrificing ratio is calculated by deducting .... share of profit from .... share of profit of the existing partners.

(ii) On admission of a new partner, the partnership firm is ....

(iii) The ratio in which partners surrender their profits is known as ....

(iv) The new ratio of existing partners is calculated by dividing remaining share of the profit in their ....

II. If Tarun and Nisha are partners sharing profits in the ratio of 5:3. What will be their sacrificing ratio if Rahul is admitted for 1/8 share of profit in the firm?

23.2 GOODWILL : MEANING, FACTORS AFFECTING GOODWILL AND VALUATION

Meaning of Goodwill

Over a period of time, a business firm develops a good name and reputation among the customers. This help the business earn some extra profits as compared to a newly set up business. In accounting, capitalised value of this extra profit is known as goodwill. For example, your firm earns say ₹1200 and the normal rate of profit expected to be earned by other similar firms in this industry is 10% say at this rate normal profit of your firm is ₹ 700 goodwill is ascertained as under :

Step 1 : Excess profit = Actual profit – Desired normal profit

$1200 - 700 = 500$

Step 2 : Goodwill $= 500 \times \dfrac{100}{10} =$ ₹ 5000

In other words, goodwill is the value of the reputation of a firm in respect of the profit earned in future over and above the normal profit. It may also be defined as the present value of the capacity to earn future profits. This means that a firm can be said to have goodwill only if it has capacity to earn profit in future. A firm earning only normal profits like similar firms cannot claim to have any goodwill.

Factors affecting the Goodwill

The factors affecting goodwill are as follows:

1. **Location :** If the firm is located at a central place, resulting in good sale, the goodwill tends to be high.
2. **Nature of Business :** A firm that produces high value products or having a stable demand is able to earn more profits and therefore has more goodwill.
3. **Efficient management :** A well managed firm earns higher profit and so the value of goodwill will also be high.
4. **Quality :** If a firm is known for the quality of its products the value of goodwill will be high.
5. **Market Situation :** The monopoly condition leads to earn high profits which leads to higher value of goodwill.
6. **Special Advantages :** The firms which have special advantages like importing licenses, long term contracts for supply of material, patents, trademarks, etc. enjoy higher value of goodwill.

Methods of Valuation of Goodwill

The methods of valuation of goodwill are generally decided by the partners among themselves while preparing partnership deed. The following are the important methods of valuing the goodwill of a firm :

(i) Average Profit Method

(ii) Super Profit Method

(iii) Capitalisation Method

Let us learn about these methods.

1. **Simple Average Profit Method :** Under this method, average of the profits of certain given years is calculated. The value of the goodwill is calculated at an agreed number of years purchase of the average profit. Thus the goodwill is calculated as follows :

   Value of goodwill = Average Profit × Number of year of purchase

   For example, the average profits of a firm of say 3 years is ₹ 25,000 and the goodwill is to be calculated at 2 years purchase of the average profit. The value of the goodwill will be ₹ 50,000[₹ 25,000 × 2]. Thus goodwill = average profits × Number of years purchase.

Illustration : 4

The profit for the last five years of a firm were as follows Year 2001 ₹ 1,20,000: Year 2002 ₹ 1,50,000: Year 2003 ₹ 1,70,000: Year 2004 ₹ 1,90,000: Year 2005 ₹ 2,00,000. Calculate goodwill of the firm on the basis of 3 years purchases of 5 years average profits.

Solution :

Year	*Profit (₹)*
2001	1,20,000
2002	1,50,000
2003	1,70,000
2004	1,90,000
2005	2,00,000
Total	**8,30,000**

Average Profit	=	Total Profit/No. of Years
	=	₹ 8,30,000/5 = ₹ 1,66,000
Goodwill	=	Average Profits × No. of years purchased
	=	₹ 1,66,000 × 3 = ₹ 4,98,000

2. **Super Profit Method :** Super profit is the excess of actual profit over the normal profit. If a new business earns certain percentage of the capital employed, it is called 'normal profit'. The value of the goodwill is calculated at an agreed number of years purchase of super profit by multiplying the Super Profit by the certain number of years. Normal profit is that profit which is, earned by other business unit of the same business. Normal profit will be calculated as follows:

Normal profit = Capital employed × normal rate of return/100

Actual Profit : These are the profit earned during the year or it is also taken as the average of the last few years profit.

Super Profit = Actual Profit – Normal Profit

For example, A firm earns profit of ₹ 65,000 on a capital of ₹ 4,80,000 and the normal rate of return in similar business is 10%. Then the normal profit is ₹ 48,000[10% of the ₹ 4,80,000]. The actual profit is ₹ 65,000. Thus,

Super profit	=	Actual profit – Normal profit
	=	₹ 65,000 – ₹ 48,000
	=	₹ 17,000

If value of Goodwill is calculated by 3 years' purchase of super profit then goodwill is equal to ₹ 51,000[₹ 17,000 × 3].

Weighted average method : This method is a modified version of average profit method. In this method each year profit is assigned a weight i.e. 1, 2, 3, 4 etc. Thereafter each year profit is multiplied by the weight and find product. The total of products is divided by the total of weight. As a result we find the weighted average profit. After this the value of goodwill is calculated multiplying the weighted average profit by the agreed number of year's purchase. Thus the goodwill is calculated as follows :

$$\text{Weighted average profit} = \frac{\text{Total product of profit}}{\text{Total of weights}}$$

Notes

Value of goodwill = Weighted average profit × number of year of purchase

(Note : This method is used when we observe that there is a tendency to increase the annual profits. Latest year profit is assigned the highest weight.

Illustration : 5

The profit of firm for past years were as follow :

	Profit ₹
2002	80,000
2003	85,000
2004	90,000
2005	1,00,000
2006	1,10,000

The weight to be used are 1, 2, 3, 4, and 5 for the years from 2002 - 2006.

Calculate the value of goodwill on the basis of two year's purchase of weighted average profit.

Solution :

Year	*Profit*	*Weight*	*Products*
2002	80,000	1	80,000
2003	85,000	2	1,70,000
2004	90,000	3	2,70,000
2005	1,00,000	4	4,00,000
2006	1,10,000	5	5,50,000
		15	14,70,000

Weighted Average Profit = $\frac{14,70,000}{15}$ = ₹ 98,000

Goodwill = ₹ 98000 × 2 = ₹ 1,96,000

Illustration : 6

A firm earned the following net profits during the last 4 years

	₹
2003	90,000

2004	1,20,000
2005	1,60,000
2006	1,80,000

Capital employed in the firm is ₹10,00,000. The normal rate of profit is 10%. Calculate the value of the goodwill on the basis of 4 year purchase of super profit.

Notes

Solution :

Total profit of 4 years = ₹ 90,000 + ₹ 1,20,000 + ₹ 1,60,000 + ₹ 1,80,000
= ₹ 5,50,000

Average annual profit = ₹ 5,50,000/4
= ₹ 1,37,500

Normal Profit = 10% of ₹ 10,00,000 = ₹ 10,00,000 × 10/ 100
= ₹ 1,00,000

Super profit = ₹ 1,37,500 – ₹ 1,00,000
= ₹ 37,500

Value of goodwill at 4 years' purchase = ₹ 37,500 × 4 = ₹ 1,50,000

3. **Capitalisation Method :** In this method, goodwill is the amount of capital saved. Normally businessmen invest capital to operate business activities, and earn profit with the efficient utilisation of capital. If the business earns more profit by investing lesser amount of capital as compared to other business, who earned same amount of profit with more amount of capital, the saved amount is assumed to be goodwill.

   Under this method, the Goodwill is calculated in two ways:

   i. Capitalisation of Average profit

   ii. Capitalisation of Super profit

   i. ***Capitalisation of Average Profit :*** In this method, the value of goodwill is assumed to be excess of the capital value of average profit over the actual capital employed.

   Following formula is applied for Calculation of capital employed:

   Capital employed = Total Assets – Outsider Liabilities

Following formula is applied for calculation of capitalised value of profit :

Capitalised Value of Profit = Average Profit × 100/ Normal Rate of Profit

Goodwill = Capitalised Value of Profits – Capital Employed

Illustration : 7

A firm earned average profit during the last few years is ₹ 40,000 and the normal rate of return in similar business is 10%. The total assets is ₹ 3,60,000 and outside liabilities is ₹ 50,000. Calculate the value of goodwill with the help of Capitalisation of Average profit method.

Solution :

Capital employed = Total assets - Outside liabilities
= ₹ 3,60,000 - ₹ 50,000
= ₹ 3,10,000

Capitalised value of average profit = Average Profit × 100/ Normal rate of profit
= ₹ 40,000 × 100/10
= ₹ 4,00,000

Goodwill = Capitalised value – Capital employed
= ₹ 4,00,000 – ₹. 3,10,000
= ₹ 90,000

Illustration : 8

The capital invested in a firm is ₹ 4,60,000 and the rate of return in the similar business is 12%. The firm earns the following profit in the last 4 years:

2003	₹ 60,000	2005	₹ 80,000
2004	₹ 70,000	2006	₹ 90,000

Calculate the value of goodwill by Capitalisation method.

Solution :

Total Profit = ₹ 60,000 + ₹ 70,000 + ₹ 80,000 + ₹ 90,000/4

Average Profit = ₹ 3,00,000/4
= ₹ 75,000

Notes

Capitalised Value = Average profit × 100/12
= ₹ 75,000x100/12
= ₹ 6,25,000

Goodwill = Capitalised value – Capital employed
= ₹ 6,25,000 – ₹ 4,60,000
= ₹ 1,65,000

ii. ***Capitalisation of Super Profit :*** In this method, the value of goodwill is calculated on the basis of super profit method. Goodwil is the capitalised value of super profit. Following formula is applied for Calculation of capitalised value *i.e.,* goodwill.

Goodwill = Super Profit × 100/Normal Rate of Profit

Illustration : 9

A firm earns a profit of ₹ 26,000 and has invested capital amounting to ₹ 2,20,000. In the same business normal rate of earning profit is 10%. Calculate the value of goodwill with the help of Capitalisation of super profit method.

Solution :

Actual profit = ₹ 26,000

Normal profit = ₹ 2,20,000 x 10/ 100 = ₹ 22,000

Super Profit = Actual Profit – Normal Profit
= ₹ 26,000 – ₹ 22,000
= ₹ 4,000

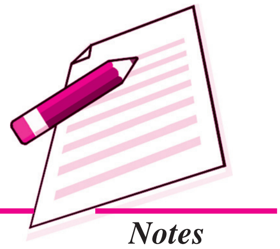
Goodwill = Super profit × 100/normal rate of profit
= ₹ 4,000 × 100/10
= ₹ 40,000

INTEXT QUESTIONS 23.2

I. Fill in the blanks with appropriate word/words :

(i) Goodwill is an .... asset.

(ii) The amount of goodwill is generally brought in by .... Partner.



Notes

(iii) Super Profit = Actual Profit – ....

(iv) The methods of calculating goodwill are .... and ....

(v) Capital employed = Total assets minus ....

II. (a) From the following information, Calculate average profit :

Year	*Profit (₹)*	*Loss (₹)*
2001	80,000	
2002	90,000	
2003	—	30,000
2004	1,10,000	

Average Profit = ₹

(b) Calculate value of goodwill at two year's purchase of average profit, ascertained in II(a) above.

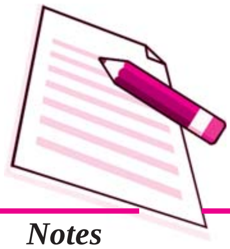
23.3 TREATMENT OF GOODWILL

The new partner acquires his/her share of profit from the existing partners. This will result in the reduction of the share of existing partners. Therefore, he/she compensates the existing partners for the sacrifices. He/she compensates them by making payment in cash or in kind. The payment is equal to his/her share in the goodwill.

As per Accounting Standard 10(AS-10) that goodwill should be recorded in the books only when some consideration in money has been paid for it. Thus, if a new partner does not bring necessary cash for goodwill, no goodwill account can be raised in the books. He/she should pay for goodwill in addition to his/her contribution for capital.

If, he/she does not pay for goodwill, then amount equal to his/her share of goodwill will be deducted from the capital. The amount brought in by him/her as goodwill or amount of goodwill deducted from his/her capital is divided between the existing partners in their sacrificing ratio. At the time of admission of a new partner any goodwill appearing in the books, will be written off in existing ratio among the existing partners.

There are different situations relating to treatment of goodwill at the time of admission of a new partner. These are discussed as under:



Notes

1. When the amount of goodwill is paid privately by the new partner.
2. When the new partner brings his/her share of goodwill in cash.
3. When the new partner does not bring his/her share of goodwill in cash.

1. The amount of goodwill is paid privately by the new partner : If the amount of goodwill is paid by the new partner to the existing partner privately, no journal entries are made in the books of the firm.

2. The new partner brings his/her share of goodwill in cash and the amount of goodwill is retained in the Business : When, the new partner brings his/her share of goodwill in cash. The amount brought in by the new partner is transferred to the existing partners in the sacrificing ratio. If there is any goodwill account in the balance sheet of existing partners, it will be written off immediately in existing ratio among the partners. The journal entries are as follows:

(i) The existing goodwill in the books of the firm will be written off in existing profit ratio as;

Existing Partners Capital A/c Dr. [individually]
    To Goodwill A/c
(Existing goodwill written off)

(ii) For bringing cash for Capital and goodwill

Cash/Bank A/c Dr.
    To Goodwill Premium A/c
    To New partner's Capital A/c
(Cash brought in for capital and goodwill)

(iii) For amount of goodwill transferred to existing partner capital account:

Goodwill A/c Dr.
    To Existing Partner's Capital/current A/c [individually]
(The amount of goodwill credited to existing partner's capitals in sacrificing ratio)

Illustration : 10

Tanaya and Sumit are partners in a firm sharing profit in the ratio 5 : 3. They admitted Gauri as a new partner for 1/4th share in the profit. Gauri brings ₹ 30,000 for her share of goodwill and ₹ 1,20,000 for capital. Make journal entries in the books of the firm after the admission of Gauri. The new profit sharing ratio will be 2 : 1 : 1.

Notes

Solution :

Books of Tanaya, Sumit and Gauri

Date	*Particulars*		*LF*	*Debit Amount (₹)*	*Credit Amount (₹)*
1.	Bank A/c	Dr.		1,50,000	
	To Goodwill Premium A/c				30,000
	To Gauri's Capital A/c				1,20,000
	(cash brought by Gauri for her share of goodwill and capital)				
	Goodwill Premium A/c	Dr.		30,000	
	To Tanaya's Capital A/c				15,000
	To Sumit's Capital A/c				15,000
	(Goodwill transferred to existing partners capital account in their sacrificing ratio)				

Working Note:

Calculation of sacrificing ratio [existing ratio – new ratio]

Partners	*Existing Ratio*	*New Ratio*	*Sacrifice*	*Sacrificing Ratio*
Tanaya	5/8	2/4	5/8 – 2/4 = 1/8	Tanaya : Sumit
Sumit	3/8	1/4	3/8 – 1/4 = 1/8	1 : 1

The amount of goodwill is withdrawn by the existing partners:

(iv) Existing Partners Capital/current A/c Dr. [individually]
To Cash/Bank A/c
(The amount of goodwill withdrawn by the existing partners)

It is to be noted that sometimes partner's withdraw only 50% or 25% amount of goodwill. In such a case, entry will be made for the withdrawn amount only.

Illustration : 11

In previous illustration, it is assumed that the full amount of goodwill is withdrawn by Tanaya and Sumit . Make journal entry in the books of the firm.

Notes

Solution :

Books of Tanaya, Sumit and Gauri

Date	*Particulars*		*LF*	*Debit amount* ₹	*Credit amount* ₹
	Tanaya's Capital A/c	Dr.		15,000	
	Sumit's Capital A/c	Dr.		15,000	
	To Bank A/c				30,000
	(Amount of Goodwill is withdrawn by them)				

3. **New partner does not bring his/her share of goodwill in cash :** When the goodwill of the firm is calculated and the new partner is not able to bring his/her share of goodwill in cash, goodwill will be adjusted through new partner's capital accounts. In this case new partner's capital account is debited for his/her share of goodwill and the existing partner's capital accounts are credited in their sacrificing ratio. The journal entry is as under:

   New Partner's Capital A/c Dr.

   To Existing Partner's Capital A/c [individually in sacrificing ratio]

   (New partner's share in goodwill credited to exisitng partner's in sacrificing ratio)

Goodwill appears in the books of the firm and new partner does not bring his/her share of goodwill in cash

If the goodwill account appears in the books of the firm, and the new partner is not able to bring goodwill in cash. In this case, the amount of goodwill existing in the books is written off by debiting the capital account of existing partners in their existing profit sharing ratio.

Illustration 12

Ashmita and Sahil are partners sharing profit in the ratio of 3 : 2. They agree to admit Charu for 1/5 share in future profit. Charu brings ₹ 2,50,000 as capital and unable to bring her share of goodwill in cash, the goodwill of the firm to be valued at ₹ 1,80,000. At the time of admission goodwill existed in the books of the firm at ₹ 80,000. Make necessary journal entries in the books of the firm.

Solution :

Books of Ashmita, Sahil and Charu

Date	*Particulars*	*LF*	*Debit amount* ₹	*Credit amount* ₹
	Bank A/c Dr.		2,50,000	
	To Charu's Capital A/c			2,50,000
	[Cash brought by Charu for her capital]			
	Ashmita's Capital A/c Dr.		48,000	
	Sahil's Capital A/c Dr.		32,000	
	To Goodwill A/c			80,000
	[Goodwill written off before Charu's admission]			
	Charu's Capital A/c Dr.		36,000	
	To Ashmita's Capital A/c			21,600
	To Sahil's Capital A/c			14,400
	[Existing partners capital a/c credited for goodwill on Charu's admission in sacrificing ratio]			

Working Note :

Ashmita and Sahil sacrifice their profit in favour of Charu in their existing profit sharing ratio i.e. 3 : 2. Therefore, the sacrificing ratio is 3 : 2.

Value of Goodwill = ₹ 1,80,000

Charu's share in Profit = 1/5

Charu's share of Goodwill = ₹ 1,80,000 × 1/5 = ₹ 36,000

New partner brings in only a part of his share of goodwill

When new partner is not able to bring the full amount of his/her share of goodwill in cash and brings only a part of cash. In this case, the amount of goodwill brought by him is credited to goodwill account. At the time of goodwill transferred to capital account of existing partner's, new partner's capital account is debited with his unpaid share of goodwill besides debiting goodwill account with the amount of goodwill is paid by him. The journal entries is as

Notes

Bank A/c Dr.
To Goodwill Premium A/c
[Part Amount of goodwill brought by new partnerI

Goodwill Premium A/c Dr.
New Partner's Capital A/c Dr.
To Existing Partner's Capital A/c [individually in sacrificing ratio]
[Credit given to sacrificing partner by new partner's in full share of goodwill]

Illustration 13

Tanu and Puneet are partners sharing profit in the ratio of 5 : 3. They admit Tarun into the firm for 1/6 share in profit which he takes 1/ 18 from Tanu and 2/ 18 from Puneet. Traun brings ₹ 9,000 as goodwill out of his share of ₹ 12,000. No goodwill account appears in the books of the firm. Make necessary journal entries in the books of the firm.

Solution :

Journal

Date	*Particulars*	*LF*	*Debit Amount ₹*	*Credit Amount ₹*
	Bank A/c Dr To Goodwill Premium A/c [A part of his share of goodwill brought in by Tarun]		9,000	 9,000
	Goodwill Premium A/c Dr. Tarun Capital A/c Dr. To Tanu's Capital A/c To Puneet's Capital A/c [Goodwill credited to Tanu and Puneet in their sacrificing ratio i.e 1 : 2]		9,000 3,000	 4,000 8,000

INTEXT QUESTIONS 23.3

I. Fill in the blanks with appropriate word/words

(a) When Goodwill is paid privately, ... will be made.

(b) If the new partner brings amount of goodwill, the amount of goodwill brought by him is .... to goodwill account.

(c) The amount brought in by the new partner is transferred to the existing partner in the .... ratio

(d) Goodwill appearing in the books of the firm is at the time of admission of a new partner ....

(e) If the new partner is not able to bring his share of goodwill, The new partner's capital account is .... for his share of goodwill

II. Match the appropriate entry of Column B with that of Column A. by writing the correct numbers of the column B in the space provided.

Column A	*Column B*
1. Goodwill is paid privately	i. Existing Partners Capital A/c To Goodwill A/c
2. New partner is not able to bring cash for Goodwill.	ii. Goodwill Premium A/c Dr. To Existing partner's Capital A/c
3. At the time of admission the goodwill appearing in the books is written off.	iii. New Partner's Capital A/c Dr. To Existing Partner's Capital A/c To Existing Partner's Capital A/c
4. At the time of admission the amount of goodwill brought by the new partner is transferred to sacrificing partners' capital A/c.	iv. No Entry

ACCOUNTING TREATMENT OF RESERVES AND ACCUMULATED PROFITS/LOSSES

When There is Change in Profit Sharing Ratio of Existing Partner's

Case (i) When Reserves and Accumulated Profits/Losses are to be transferred to Capital Accounts :

If, at the time of change in the profit sharing ratio, there are Reserves or Accumulated profits/losses existing in the books of the firm, these should be transferred to the Partner's Capital Accounts (if capitals are fluctuating) or to partners Current Account

Notes

(if capitals are fixed) in their old profit sharing ratio. The reason for such transfer is that these reserves and accumulated profits/losses have come into existence before the change in profit sharing ratio and hence belong to the partners in their old profit sharing ratio. Following entries are passed for this purpose :

i. For Transfer of Reserves and Accumulated Profits :

Reserve A/c	Dr.	
Profit & Loss A/c	Dr.	
Workmen's Compensation Reserve A/c	Dr.	(Excess of Reserve over Actual Liability)
Investment Fluctuation Reserve A/c	Dr.	(Excess of Reserve Over difference between Book value and Market value)
To Old Partner's Capital or Current A/cs	Dr.	(in Old Profit Sharing Ratio)
(Being the undivided Profit/Reserves transferred to Partners Capital Current A/c)		

ii. For Transfer of Accumulated Losses :

Old Partner's Capital or Current A/cs.	Dr.	(in Old Profit Sharing Ratio)
To Profit & Loss A/c		
To Deferred Revenue Expenditure A/c	(for example Advertisement Suspense A/c)	
(Being the Losses/................ on assets transferred to partner capitals/................)		

Illustration 14

Sita and Geeta are partners sharing profits and losses in the ratio of 2 : 1. From April 1, 2013, they decided to share the profits in the ratio of 3 : 2. On that date, profit and loss account showed a debit balance of ₹ 6,00,000. Record the necessary journal entry for the distribution of the balance in the Profit and Loss Account.

Solution :

Journal

Date	*Particulars*		*L.F.*	*Dr. (₹)*	*Cr. (₹)*
2013					
Apr. 1	Sita's Capital A/c (2/3)	Dr.		4,00,000	
	Geeta's Capital A/c (1/3)	Dr.		2,00,000	
	To Profit and Loss A/c				6,00,000
	(Transfer of undistributed loss on change in profit sharing ratio)				

Illustration 15

A, B and C are partners sharing profits in the ratio of 4 : 3 : 2. From April 1, 2014 they decided to share the profits equally. On that date their books showed a credit balance of ₹ 36,00,000 in the Profit and Loss Account and a balance of ₹ 9,00,000 in the General Reserve. Record the necessary journal entry for the distribution of profits and the general reserve.

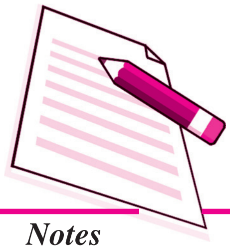
Solution :

Journal

Date	*Particulars*		*L.F.*	*Dr. (₹)*	*Cr. (₹)*
2014					
April 1	Profit & Loss A/c	Dr.		36,00,000	
	General Reserve A/c	Dr.		9,00,000	
	To A's Capital A/c (4/9)				20,00,000
	To B's Capital A/c (3/9)				15,00,000
	To C's Capital A/c (2/9)				10,00,000
	(Transfer of undistributed profit and general reserve on change in profit sharing ratio)				

Illustration 16

X, Y and Z sharing profits and losses in the ratio of 3 : 2 : 1, decide to share future profits and losses in the ratio of 4 : 3 : 2 with effect from 1st April, 2014. Following an extract of their Balance Sheet as at 31st March, 2014 :



Notes

Liabilities	₹	Assets	₹
Workmen Compensation Reserve	3,00,000		

Show the accounting treatment under the following alternative case :

Case (i) If there is no other information.

Case (ii) If a claim on account of workmen's compensation is estimated at ₹ 1,20,000

Solution :

Journal

Date	*Particulars*	*L.F*	*Dr. (₹)*	*Cr. (₹)*
2014				
April 1	*Case (i)*			
	Workmen Compensation Reserve A/c Dr.		3,00,000	
	To X's Capital A/c			1,50,000
	To Y's Capital A/c			1,00,000
	To Z's Capital A/c			50,000
	(Transfer of Workmen Compensation Reserve to partner's capital accounts in their old profit sharing ratio)			
	Case (ii)			
	Workmen Compensation Reserve A/c Dr.		3,00,000	
	To Provision for Workmen Compensation Claim A/c			1,20,000
	To X's Capital A/c			90,000
	To Y's Capital A/c			60,000
	To Z's Capital A/c			30,000
	(Transfer of excess Compensation Reserve to partner's capital accounts in their old profit sharing ratio)			

Case (ii) When Reserves and Accumulated Profit/Loss are not to be transferred to Capital Accounts or to be continued in future Balance Sheet :

If, in case of change in profit sharing ratio, there are reserves and accumulated profits appearing in the old Balance Sheet and the partners decide to leave the reserves and accumulated profits undistributed, it will be necessary to pass an adjusting entry for the same. This is, because, at present the partners are entitled to share such reserves and profits in the old profit sharing ratio whereas in future they will be entitled to share such reserves and profits in the new profit sharing ratio. Hence, the gaining partner must compensate the sacrificing partner that share of reserves and profits which is proportionate to the share gained by him/her. For example, suppose P and Q sharing profits in the ratio of 2 : 1 decide to share future profits in equal proportion. Reserves appearing in the Balance Sheet amount to ₹ 6,00,000 and the partners do not want to distribute them. In such a case a present P is entitled to ₹ 4,00,000 and Q ₹ 2,00,000 of such reserves but in future, after the change in the profit sharing ratio, each would be entitled to ₹ 3,00,000. Hence, Q must compensate P to the extent of ₹ 1,00,000. This amount is proportionate to the $\frac{1}{6}$th share $(i.e. \frac{1}{2} - \frac{1}{3})$ gained by him.

The adjustment for this amount is usually made by passing the following adjustment entry :

	Particulars	*L.F.*	*Dr.* (₹)	*Cr.* (₹)
	Q's Capital A/c Dr.		1,00,000	
	To P's Capital A/c			1,00,00
	(Being adjustment made in the capital A/cs of the partner for Reserves)			

Illustration 17

M and N are partners in a firm sharing profits in the ratio of 4 : 3. On March 31, 2014 their Balance Sheet showed a General Reserve of ₹ 7,00,000. On that date they decided to change their profit sharing ratio which will be 5 : 3. Record necessary journal entries in the books of the firm under the following circumstances :

i. When they decided to transfer the general reserve to their capital accounts.

Notes

ii. When they don't want to transfer general reserve in their capital A/c but prefer to record an adjustment entry for the same.

Solution :

Alternative (i) When General Reserve in transferred to Capital Accounts:

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
2014 Mar. 31	General Reserve A/c Dr.	7,00,000	
	To M's Capital A/c		4,00,000
	To N's Capital A/c		3,00,000
	(General reserve transferred to the Capital A/c of partners on the reconstitution of the firm)		

Alternative (ii) When General Reserve is not transferred to Capital Accounts:

Old Profit Sharing Ratio of M and N = 4 : 3

New Profit Sharing Ratio of M and N = 5 : 3

Sacrifice or Gain :

$$M = \frac{4}{7} - \frac{5}{8} = \frac{32-35}{56} = \frac{3}{56} \text{ gain}$$

$$N = \frac{3}{7} - \frac{3}{8} = \frac{24-21}{56} = \frac{3}{56} \text{ sacrifice}$$

Therefore, M's Capital A/c will be debited & N's capital A/c will be credited with $\frac{3}{56}$th proportions.

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
	M's Capital A/c Dr.	37,500	
	To N's Capital A/c		37,500
	(Adjustment to General Reserve A/c when it is not to be closed)		

Illustration 18

X and Y were partners in a firm sharing profits in the ratio of 3 : 1. With effect from 1st January 2014 they agreed to share profits in the ratio of 2 : 1. For this purpose the goodwill of the firm was valued at ₹ 5,00,000. General reserves appear in the books at ₹ 4,00,000. Partners neither want to show goodwill in the books nor want to distribute the reserves. You are required to record the change by passing a single journal entry.

Solution :

	₹
Value of goodwill	5,00,000
General Reserve	4,00,000
	9,00,000

Old Ratio of X and Y 3 : 1

New Ratio of X and Y 2 : 1

Sacrifice or Gain :

$$X = \frac{3}{4} - \frac{2}{3} = \frac{9-8}{12} = \frac{1}{12} \text{ (Sacrifice)}$$

$$Y = \frac{1}{4} - \frac{1}{3} = \frac{3-4}{12} = \frac{1}{12} \text{ (Gain)}$$

X will be compensated by Y to the extent of $\frac{1}{12}$ of ₹ 9,00,000 = ₹ 75,000

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
2014 Jan. 1	Y's Capital A/c Dr. To X's Capital A/c (Adjustment for goodwill and reserves on change in profit sharing ratio)	75,000	 75,000

Illustration 19

P, Q and R are partner sharing profits and losses in the ratio of 2 : 3 : 4. They decided to share future profits and losses in the ratio of 4 : 3 : 2. They alsio decided to record the effect of the following without affecting their book values:

Notes

	₹
General Reserve	4,00,000
Profit & Loss A/c	2,00,000
Advertisement Suspense A/c	1,50,000

You are required to give the necessary single adjustment entry for the same.

Solution :

Calculation of Net Effect of Accumulated Profit/Losses :

	₹
General Reserve	4,00,000
(+) Profit & Loss A/c	2,00,000
(-) Advertisement Suspense A/c	1,50,000
Net Amount	4,50,000

Calculation of Sacrifice or Gain :

Old Ratio of P, Q and R $\frac{2}{9}:\frac{3}{9}:\frac{4}{9}$

New Ratio of P, Q and R $\frac{4}{9}:\frac{3}{9}:\frac{2}{9}$

Sacrifice or Gain :

P $\frac{2}{9}-\frac{4}{9}=\frac{2}{9}$ (Gain)

Q $\frac{3}{9}-\frac{3}{9}=0$ (No Profit no loss)

R $\frac{4}{9}-\frac{2}{9}=\frac{2}{9}$ (Sacrifice)

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	P's Capital A/c (2/9 of 4,50,000) Dr.		1,00,000	
	To R's Capital A/c (2/9 of 4,50,000)			1,00,000
	(Adjustment for general reserve, profit & loss account balance and advertisement suspense account on change in profit sharing ratio)			

Notes

Illustration 20

A, B and C sharing profits and losses in the ratio of 1 : 2 : 2, decided to share future profits equally with effect from 1st April, 2013. On that date, Profit & Loss Account showed a credit balance of ₹ 2,40,000. Partners do not want to distribute the profit but prefer to record the change in the profit sharing ratio by passing an adjustment entry. You are required to give the adjusting entry.

Solution :

Old Ratio of A, B and C $\frac{1}{5}:\frac{2}{5}:\frac{2}{5}$

New Ratio of A, B and C $\frac{1}{3}:\frac{1}{3}:\frac{1}{3}$

Sacrifice or Gain :

$A = \frac{1}{5}-\frac{1}{3} \quad = \quad \frac{3-5}{15} \quad = \quad$ (Gain)

$\frac{2}{5}\ \frac{1}{3}$

$B = \quad = \quad \frac{6-5}{15} \quad = \quad$ (Sacrifice)

$C = \frac{2}{5}-\frac{1}{3} \quad = \quad \frac{6-5}{15} \quad = \quad$ (Sacrifice)

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2014				
Apr. 1	A's Capital A/c (2/15 of 2,40,000) Dr.		32,000	
	To B's Capital A/c (1/15 of 2,40,000)			16,000
	To C's Capital A/c (1/15 of 2,40,000)			16,000
	(Adjustment for Profit and Loss Account balance on change in profit sharing ratio)			

23.4 ACCOUNTING TREATMENT OF GOODWILL WHEN THERE IS CHANGE IN THE PROFIT SHARING RATIO OF EXISTING PARTNERS

A change in profit sharing ratio basically implies that one partner is purchasing from another partner, a share of profits previously belonging to the latter. The purchasing

Notes

or gaining partner must compensate the sacrificing partner by paying the proportionate amount of goodwill. In other words, the gaining partner should pay the sacrificing partner that share of goodwill which is equal to the share gained by him. For example, suppose A and B are sharing profits in the proportion of $\frac{4}{5}:\frac{1}{5}$. If it is decided that in future they will share porfits in the proportion of $\frac{3}{5}:\frac{2}{5}$, it implies that A is selling $\frac{1}{5}$th $\left(\frac{4}{5}-\frac{3}{5}\right)$ of his share to B. If the profits of the firm are ₹ 1,00,000 p.a. A will lose ₹ 20,000 and B will gain ₹ 20,000 annually. This must be compensated by B by paying to A an amount equal to $\frac{1}{5}$th of total present value of goodwill of the firm. If the goodwill is valued at ₹ 5,00,000 B must pay to A $\frac{1}{5}$th of ₹ 5,00,000 *i.e.,* ₹ 1,00,000.

Such an adjustment is made by passing an adjustment entry wherein B's Capital Account will be debited and A's Capital Account will be Credited by ₹ 1,00,000.

Illustration 21

M and N were partners in a firm sharing profits in the ratio of 3 : 2. With effect from 31st March 2014 they agreed to share profits equally. For this purpose the goodwill of the firm was valued at ₹ 3,00,000. Pass the necessary adjustment entry :

Solution :

Old Ratio of M and N	=	3 : 2
New Ratio of M and N	=	1 : 1

Sacrifice or Gain :

$$M = \frac{3}{5}-\frac{1}{2}=\frac{6-5}{10}=\frac{1}{10} \text{ (Sacrifice)}$$

$$N = \frac{2}{5}-\frac{1}{2}=\frac{4-5}{10}=\frac{1}{10} \text{ (Gain)}$$

Since M has sacrificed, he will be credited by $\frac{1}{10}$ of ₹. 3,00,000 i.e. ₹ 30,000

Notes

Since N has gained, he will be debited by $\frac{1}{10}$ of ₹ 3,00,000 i.e. ₹ 30,000

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
2014 Mar.31	N's Capital A/c Dr. To M's Capital A/c (Adjustment for goodwill due to change in profit sharing ratio)	30,000	 30,000

Illustration 22

A, B and C are partners sharing profits equally. They decided that in future C will get $\frac{1}{5}$th share in profits. On the day of change, firms's goodwill has been valued at ₹ 6,00,000. Make the necessary adjustment entry for the treatment of goodwill.

Solution :

Old Ratio of A, B and C $= \frac{1}{3} : \frac{1}{3} : \frac{1}{3}$

New Ratio of A, B and C $= \frac{2}{5} : \frac{2}{5} : \frac{1}{5}$

Sacrifice or Gain :

$$A = \frac{1}{3} - \frac{2}{5} = \frac{5-6}{15} = \frac{1}{15} \text{ (Gain)}$$

$$B = \frac{1}{3} - \frac{2}{5} = \frac{5-6}{15} = \frac{1}{15} \text{ (Gain)}$$

$$C = \frac{1}{3} - \frac{1}{5} = \frac{5-3}{15} = \frac{2}{15} \text{ (Sacrifice)}$$

Calculation of share of Loss or gain of Goodwill

Total Goodwill ₹ 6,00,000

A's Share of loss = $\frac{1}{15}$ of ₹ 6,00,000 = ₹ 40,000

Notes

B's Share of loss = $\frac{1}{15}$ of ₹ 6,00,000 = ₹ 40,000

C's Share of Gain = $\frac{2}{15}$ of ₹ 6,00,000 = ₹ 80,000

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
	A's Capital A/c (1/15 of 6,00,000) Dr.	40,000	
	B's Capital A/c (1/15 of 6,00,000) Dr.	40,000	
	To C's Capital A/c (2/15 of 6,00,000)		80,000
	(C compensated by A and B for the sacrifice made by him)		

Illustration 23

P, Q and R are partners sharing profits and losses in the ratio of 5 : 4 : 1. It was decided that with effect from 1st January 2014 the profit sharing ratio will be 9 : 6 : 5. Goodwill is to be valued at 2 year's purchase of average of 3 year's profits. The profits for 2011, 2012 and 2013 were ₹ 96,000; ₹ 84,000 and ₹ 1,20,000 respectively.

Pass the necessary journal entry for the treatment of goodwill without opening Goodwill Account.

Solution :

Average Profit = ₹ $\frac{96,000+84,000+1,20,000}{3}$ = ₹ 1,00,000

Value of Goodwill at 2 year's purchase = ₹ 1,00,000 x 2 = ₹ 2,00,000

Old Ratio of P, Q and R = 5 : 4 : 1

New Ratio of P, Q and R = 9 : 6 : 5

Sacrifice or Gain :

P = (Sacrifice)

$Q = \frac{4}{10} - \frac{6}{20} = \frac{8-6}{20} = \frac{2}{20}$ (Sacrifice)

$$R = \frac{1}{10} - \frac{5}{20} = \frac{2-5}{20} = \frac{3}{20} \text{ (Gain)}$$

Since P has sacrificed, he will be credited by $\frac{1}{20}$ of ₹ 2,00,000 = ₹ 10,000

Since Q has sacrificed, he will be credited by $\frac{2}{20}$ of ₹ 2,00,000 = ₹ 20,000

Since R has gained, he will be debited by $\frac{3}{20}$ of ₹ 2,00,000 = ₹ 30,000

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2014				
Jan. 1	R's Capital A/c	Dr.	30,000	
	To P's Capital A/c			10,000
	To Q's Capital A/c			20,000
	(Treatment for goodwill due to change in profit sharing ratio)			

Illustration 24

A, B and C are partners sharing profits in the ratio of 3 : 2 : 1. It is now agreed that they will share the future profits equally. Goodwill of the firm is valued at ₹ 3,00,000. The goodwill of the firm does not appear in the books. Pass necessary adjustment entry for the treatment goodwill.

Solution :

Old Ratio of A, B and C = 3 : 2 : 1

New Ratio of A, B and C = 1 : 1 : 1

Sacrifice or Gain :

$$A = \frac{3}{6} - \frac{1}{3} = \frac{3-2}{6} = \frac{1}{6} \text{ (Sacrifice)}$$

$$B = \frac{2}{6} - \frac{1}{3} = \frac{2-2}{6} = 0$$

$$C = \frac{1}{6} - \frac{1}{3} = \frac{1-2}{6} = \frac{1}{6} \text{ (Gain)}$$

Notes

Since A has sacrificed, he will be credited for $\frac{1}{6}$ of ₹ 3,00,000 = ₹ 50,000

Since C has gained, he will be debited for $\frac{1}{6}$ of ₹ 3,00,000 = ₹ 50,000

Journal

Date	*Particulars*	*Dr. (₹)*	*Cr. (₹)*
2014			
Jan. 1	C's Capital A/c Dr.	50,000	
	To A's Capital A/c		50,000
	(Adjustment for goodwill due to change in profit sharing ratio)		

Illustration 25

Ram and Ramesh were partners sharing profits and losses in the ratio of 3 : 1. They decided that with effect from 1st January 2013, they would share profits and losses in the ratio of 5 : 3. The partnership deed provides that in the event of any change in profit sharing ratio, the goodwill should be valued at the total of two year's profits preceding the date the decision became effective. The profits for 2010, 2011 and 2012 were ₹ 6,00,000; ₹ 7,00,000 and ₹ 9,00,000 respectively. Pass the necessary Journal entry to give effect to the above arrangement.

Solution :

Value of goodwill = ₹ 7,00,000 + ₹ 9,00,000 = ₹ 16,00,000

Calculation of Sacrifice or Gain :

Old Ratio = 3 : 1

New Ratio = 5 : 3

Ram = $\frac{3}{4}-\frac{5}{8}=\frac{6-5}{8}=\frac{1}{8}$ (Sacrifice)

Ramesh = $\frac{1}{4}-\frac{3}{8}=\frac{2-3}{8}=\frac{1}{8}$ (Gain)

Since Ram has sacrificed, he will be credited by $\frac{1}{8}$ of ₹ 16,00,000 = ₹ 2,00,000

Since Ramesh has gained, he will be debited by $\frac{1}{8}$ of ₹ 16,00,000 = ₹ 2,00,000

Journal

Date	*Particulars*	*Dr. (₹)*	*Cr. (₹)*
2013			
Jan. 1	Ramesh's Capital A/c Dr.	2,00,000	
	To Ram's Capital A/c		2,00,000
	(Adjustment for goodwill due to change in profit sharing ratio)		

Notes

23.5 REVALUATION OF ASSETS AND LIABILITIES

On admission of a new partner, the firm stands reconstituted and consequently the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner. If the values of the assets are raised, gain will increase the capital of the existing partners. Similarly, any decrease in the value of assets, i.e. loss will decrease the capital of the existing partners. For this purpose a'Revaluation Account' is prepared. This account is credited with all increases in the value of assets and decrease in the value of liabilities. It is debited with decrease on account of value of assets and increase in the value of liabilities. The balance of this account shows a gain or loss on revaluation which is transferred to the existing partner's capital account in existing profit sharing ratio.

Accounting for Revaluation of Assets and Liabilities when there is a Change in the Profit Sharing Ratio of Existing Partners

Assets and liabilities of a firm must also be revalued at the time of change in profit sharing ratio of existing partners. The reason is that the realisable or actual value of assets and liabilities may be different from those shown in the Balance Sheet. It is possible that with the passage of time some of the assets might have appreciated in value while the value of certain other assets might have decreased and no record has been made of such changes in the books of accounts. Similarly there may be some unrecorded assets & libilities that may have to be accounted for. Revaluation of assets and reassessments of liabilities becomes necessary because the change in the value of assets and liabilities belongs to the period to change in profit sharing ratio and hence must be shared by the partners in their old profit sharing ratio.

Revaluation of assets and reassessment of liabilities may be given effect to in two different ways :

(a) When revised values are to be recorded in the books, and

(b) When revised values are not to be recorded in the books.

When revised values are to be recorded in the books

In such a case revaluation of assets and reassessment of liabilities is done with the help of a new account called **'Revaluation Account'**. Sometimes this account is also called as **'Profit & Loss Adjustment A/c'**. If there is a loss due to revaluation, revaluation account is debited and if the revaluation results in a profit, the revaluation account is credited.

The following journal entries made for this purpose are:

(i) For increase in the value of assets:

Asset A/c	Dr. (individually)
To Revaluation A/c	

(ii) For decrease in the value of Asset

Revaluation A/c	Dr. (individually)
To Asset A/c	
[Decrease in the value of assets]	

(iii) For increase in the value of Liabilities:

Revaluation A/c	Dr. (individually)
To Liabilities A/c	
[Increase in the value of Liabilities]	

(iv) For decrease in the value of Liabilities:

Liabilities A/c	Dr.
To Revaluation A/c	
[Decrease in the value of Liabilities]	

(v) For unrecorded Assets

Asset A/c [unrecorded]	Dr.
To Revaluation A/c	
[Unrecorded asset recorded at actual value]	

(vi) For unrecorded Liability :

Revaluation A/c	Dr.
To Liability A/c [unrecorded]	
[Unrecorded Liability recorded at actual value]	

(vii) For transfer of gain on revaluation:

Revaluation A/c Dr.

To Existing Partner's Capital/Current A/c

[Profit on revaluation transferred to capital account in existing ratio]

(viii) For transfer of loss on revaluation:

Existing Partner's Capital/Current A/c Dr.

To Revaluation A/c

[Loss on revaluation transferred to capital account in existing ratio]

(a) When revaluation account shows gain :

Revaluation A/c Dr.

To Partner's Capital A/c (Old Profit Sharing Ratio)

(Profit on revaluation credited to Partner's Capital A/c)

(b) Above entry is reversed when revaluation account shows loss :

Partners Capital A/cs (Old Profit Sharing Ratio) Dr.

To Revaluation A/c

(Loss on revaluation debited to Partner's Capital A/cs)

Proforma of Revaluation Account is given as under:

Revaluation Account

Dr. Cr.

Particulars	₹	*Particulars*	₹
To Decrease in value of assets	....	By Increase in value of assets	....
To Increase in value of liabilities	....	By Decrease in value of liabilities	....
To Unrecorded liabilities	....	By Unrecorded assets	....
To Gain on Revaluation transferred to partner's capital accounts (in old ratio)	....	By Loss on Revalution transferred to partner's capital accounts (in old ratio)	....
	....		....

Illustration 26

P, Q and R are partners sharing profits and losses in the ratio of 3 : 3 : 2. Their balance sheet as on 31st March 2013 was as follows :

Notes

Liabilities		₹	Assets	₹
Sundry Creditors		2,40,000	Cash at Bank	3,70,000
General Reserve		3,60,000	Sundry Debtors	4,40,000
Capital Accounts :			Stock	12,00,000
P	20,00,000		Machinery	15,90,000
Q	15,00,000		Building	20,00,000
R	15,00,000	50,00,000		
		56,00,000		56,00,000

Partners decided that with effect from 1st April 2013, they would share profits and losses in the ratio of 4 : 3 : 2. It was agreed that :

i. Stock be valued at ₹ 11,00,000

ii. Machinery is to be depreciated by 10%.

iii. A provision for doubtful debts is to be made on debtors @5%.

iv. Building to be appreciated by 20%.

v. A liability for ₹ 25,000 included in sundry creditors is not likely to arise.

Partners agreed that the revised values are to be recorded in the books. They do not, however want to distribute the general reserve. You are required to pass journal enteries, prepare capital accounts of the partners and the revised balance sheet.

Solution :

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
	Revaluation A/c	Dr.	2,81,000	
	To Stock A/c			1,00,000
	To Machinery A/c			1,59,000
	To Provision for Doubtful Debts A/c			22,000
	(Decrease in the value of assets and provision made for doubtful debts)			
	Building A/c	Dr.	4,00,000	
	Sundry Creditors A/c	Dr.	25,000	
	To Revaluation A/c			4,25,000
	(Increase in the value of building and decrease in creditors)			

	Revaluation A/c Dr. (1)	1,44,000	
	To P's Capital A/c		54,000
	To Q's Capital A/c		54,000
	To R's Capital A/c		36,000
	(The transfer of gain on revaluation to the capital accounts of partners in old ratio)		
	P's Capital A/c Dr.(2)	25,000	
	To Q's Capital A/c		15,000
	To R's Capital A/c		10,000
	(The adjustment for general reserve on change in profit sharing ratio)		

Working Note :

(1) Revaluation Account

Particulars	₹	*Particulars*	₹
To Stock A/c	1,00,000	By Building A/c	4,00,000
To Machinery A/c	1,59,000	By Sundry Creditors A/c	25,000
To Provision for doubtful debts A/c	22,000		
To Gain on Revaluation transferred to :			
P's Capital A/c (3/8)	54,000		
Q's Capital A/c (3/8)	54,000		
R's Capital A/c (2/8)	36,000		
	4,25,000		4,25,000

(2) Adjustment for General Reserve :

Old Ratio of P, Q and R 3 : 3 : 2

New Ratio of P, Q and R 4 : 3 : 2

Sacrifice or Gain :

$$P = \frac{3}{8} - \frac{4}{9} = \frac{5}{72} \text{ (Gain)}$$

$$Q = \frac{3}{8} - \frac{3}{9} = \frac{3}{72} \text{ (Sacrifice)}$$

Notes

$$R = \frac{2}{8} - \frac{2}{9} = \frac{2}{72} \text{ (Sacrifice)}$$

Since P has gained, he will be debited for $\frac{5}{72}$ of General Reserve

or ₹ 3,60,000 = ₹ 25,000

Since Q has Sacrificed, he will be credited for $\frac{3}{72}$ of General Reserve

or ₹ 3,60,000 = ₹ 15,000

Since R has sacrificed, he will be credited for $\frac{2}{72}$ of General Reserve

or ₹ 3,60,000 = ₹ 10,000

Capital Accounts

Particulars	*P* ₹	*Q* ₹	*R* ₹	*Particulars*	*P* ₹	*Q* ₹	*R* ₹
To Q's Capital A/c	15,000			By Balance b/d	20,00,000	15,00,000	15,00,000
To R's Capital A/c	10,000			By Revaluation A/c	54,000	54,000	36,000
To Balance C/d	20,29,000	15,69,000	15,46,000	By P's Capital A/c		15,000	10,000
	20,54,000	15,69,000	15,46,000		20,54,000	15,69,000	15,46,000

Balance Sheet
as at 1st April 2013

Liabilities		₹	*Assets*		₹
Sundry Creditors		2,15,000	Cash at Bank		3,70,000
General Reserve		3,60,000	Sundry Debtors	4,40,000	
Capital Accounts :			*Less :* Provision for doubtful debts	22,000	4,18,000
P	20,29,000		Stock		11,00,000
Q	15,69,000		Machinery		14,31,000
R	15,46,600	51,44,000	Building		24,00,000
		57,19,000			57,19,000

Illustration 27

Ram, Mohan and Sohan are partners sharing profits and losses in the ratio of 3 : 2 : 1. Their balance sheet as at 31st December 2012 was as follows :

Liabilities		₹	*Assets*		₹
Creditors		8,700	Cash		3,000
Reserves		4,200	Debtors	6,200	
Profit & Loss A/c (Profits)		2,100	*Less:* Provision for		
Capital Accounts :			doubtful debts	200	6,000
Ram	30,000		Stock		18,000
Mohan	30,000		Furniture		3,000
Sohan	5,000	65,000	Plant		20,000
			Building		30,000
		80,000			80,000

The partners agreed that from 1st January 2013 they will share profits and losses in the ratio of 4 : 4 : 1. They agreed that :

i. Stock is to be valued at 20% less.

ii. Provision for doubtful debts to be increased by ₹ 150.

iii. Furniture is to be depreciated by 20% and plant by 15%.

iv. ₹ 350 are outstanding for salaries.

v. Building is to be valued at ₹ 35,000.

vi. Goodwill is valued at ₹ 4,500.

Partners do not want to record the altered values of assets and liabilities in the books and want to leave the reserves and profits undistributed. They also decided not to show goodwill in the books.

You are required to pass a single journal entry to give effect to the above. Also prepare the revised balance sheet.

Solution :

Workings :

Loss due to decrease in the value of Stock	3,600
Loss due to provision for doubtful debts	150
Loss due to decrease in the value of Furniture	600
Loss due to decrease in the value of Plant	3,000
Loss due to unrecorded liability (*i.e.* Outstanding salary)	350
	7,700

Notes

Gain due to increase in the value of Building	5,000
Loss on Revaluation	(-) 2,700
Adjustment for Reserves	(+) 4,200
Adjustment for Profit & Loss A/c (Profit)	(+) 2,100
Adjustment for Goodwill	(+) 4,500
Net Gain	(+) 8,100

Old Ratio of Ram, Mohan and Sohan 3 : 2 : 1

New Ratio of Ram, Mohan and Sohan 4 : 4 : 1

Sacrifice or Gain :

Ram = $\frac{3}{6}-\frac{4}{9}=\frac{1}{18}$ (Sacrifice) $8{,}100\times\frac{1}{18}$ = ₹ 450 (Cr.)

Mohan = $\frac{2}{6}-\frac{4}{9}=\frac{2}{18}$ (Gain) $8{,}100\times\frac{2}{18}$ = ₹ 900 (Dr.)

Sohan = $\frac{1}{6}-\frac{1}{9}=\frac{1}{18}$ (Sacrifice) $8{,}100\times\frac{1}{18}$ = ₹ 450 (Cr.)

Journal

Date	*Particulars*		*Dr.* (₹)	*Cr.* (₹)
2013				
Jan. 1	Mohan's Capital A/c	Dr.	900	
	To Ram's Capital A/c			450
	To Sohan Capital A/c			450
	(The adjustment for revaluation of assets and liabilities and for reserves, profits and goodwill on change in profit sharing ratio)			

Illustration 28

Saroj, Charu and Sangita are partners in a firm in the ratio of 5 : 4 : 2. On 1st April, 2014 they decided to share profits in future in the ratio of 4 : 3 : 2. On this date general reserve was ₹ 3,49,000 and loss on revaluation of assets and liabilities was ₹ 52,000. It was decided that adjustment should be made without altering the figures of assets and liabilities in the Balance Sheet. Make adjustment by a single journal entry.

Solution :

	₹
General Reserve	3,49,000
(-) Loss on Revaluation	52,000
Net amount of gain	2,97,000

Old Ratio of Saroj, Charu and Sangita 5 : 4 : 2

New Ratio of Saroj, Charu and Sangita 4 : 3 : 2

Sacrifice or Gain :

$$\text{Saroj} = \frac{5}{11} - \frac{4}{9} = \frac{1}{99} \text{ (Sacrifice)} \qquad 2{,}97{,}000 \times \frac{1}{99} = ₹\ 3{,}000 \text{ (Cr.)}$$

$$\text{Charu} = \frac{4}{11} - \frac{3}{9} = \frac{3}{99} \text{ (Sacrifice)} \qquad 2{,}97{,}000 \times \frac{3}{99} = ₹\ 9{,}000 \text{ (Cr.)}$$

$$\text{Sangita} = \frac{2}{11} - \frac{2}{9} = \frac{4}{99} \text{ (Gain)} \qquad 2{,}97{,}000 \times \frac{4}{99} = ₹\ 12{,}000 \text{ (Dr.)}$$

Journal

Date	*Particulars*		*Dr. (₹)*	*Cr. (₹)*
2014				
Apr. 1	Sangita's Capital A/c	Dr.	12,000	
	To Saroj's Capital A/c			3,000
	To Charu Capital A/c			9,000
	(The adjustment for general reserve and loss on revaluation of assets and liabilities on change in profit sharing ratio)			

Illustration 29

A, B and C are partners sharing profits and losses in the ratio of 3 : 3 : 2. Their Balance Sheet as at 31st March, 2014 was as follows :

Liabilities		₹	*Assets*	₹
Sundry Creditors		2,400	Cash at Bank	3,700
General Reserve		3,600	Sundry Debtors	4,400
Capital Accounts :			Stock	12,000
A	20,000		Machinery	15,900

B	15,000		Building	20,000
C	15,000	50,000		
		56,000		56,000

Notes

Partners decided that with effect from 1st April, 2014 they would share profits and losses in the ratio of 4 : 3 : 2. It was agreed that :

i. Stock be valued at Rs. 11,000.

ii. Machinery is to be depreciated by 10%.

iii. A provision for doubtful debts is to be made on Debtors @5%.

iv. Building to be appreciated by 20%.

v. A liability for ₹ 250 included in Sundry Creditors is not likely to arise.

Partners agreed that the revised values are not to be recorded in the books. They also do not want to distribute the general reserve. You are required to pass Journal Entries, prepare Capital Account of the partners and the Balance Sheet.

Solution :

Journal

Date	*Particulars*	*Dr. (₹)*	*Cr. (₹)*
2014			
April 1	A's Capital Ac/ Dr.	350	
	To B's Capital A/c		210
	To C's Capital A/c		140
	(Being adjustment for revaluation of assets and liabilities and for general reserve made on change in profit-sharing ratio)		

Partners' Capital Accounts

Dr. Cr.

Particulars	*A*	*B*	*C*	*Particulars*	*A*	*B*	*C*
To B's Capital A/c	210	-----	------	By Balance b/d	20,000	15,000	15,000
To C's Capital A/c	140	-----	------	By A's Capital A/c	----	210	140
To Balance c/d	19,650	15,210	15,140				
	20,000	15,210	15,140		20,000	15,210	15,140

Balance Sheet
as at 1st April 2014

Liabilities		₹	*Assets*	₹
Sundry Creditors		2,400	Cash at Bank	3,700
General Reserve		3,600	Sundry Debtors	4,400
Capital Accounts :			Stock	12,000
A	19,650		Machinery	15,900
B	15,210		Building	20,000
C	15,140	50,000		
		56,000		56,000

Working Notes :

(1)

Particulars	₹	₹
Loss due to decrease in the value of Stock	1,000	
Loss due to decrease in the value of Machinery	1,590	
Loss due to Provision for Doubtful Debts	220	2,810
Gain due to increase in the value of Building	4,000	
Gain due to decrease in Sundry Creditors	250	4,250
Gain on Revaluation	1,440	
+ General Reserve	3,600	5,040

(2) Old Ratio of A, B and C 3 : 3 : 2

New Ratio of A, B and C 4 : 3 : 2

Sacrificing Ratio = Old Share - New Share

$A = \frac{3}{8} - \frac{4}{9} = \frac{5}{72}$ (Gain) ₹ $5{,}040 \times \frac{5}{72}$ = ₹ 350 (Dr.)

$B = \frac{3}{8} - \frac{3}{9} = \frac{3}{72}$ (Sacrifice) ₹ $5{,}040 \times \frac{3}{72}$ = ₹ 210 (Cr.)

$C = \frac{2}{8} - \frac{2}{9} = \frac{2}{72}$ (Sacrifice) ₹ $5{,}040 \times \frac{2}{72}$ = ₹ 140 (Cr.)

Notes

Illustration 30

Karan and Tarun are partners sharing profit and losses in the ratio of 2 : 1. Their Balance Sheet was as follows:

Balance Sheet of Karan and Tarun as at December 31,2014

Liabilities		₹	*Assets*	₹
Creditors		10,000	Cash in hand	7,000
Bills payable		7,000	Debtors	26,000
			Building	20,000
Capitals:			Investment	15,000
Karan	40,000		Machinery	13,000
Tarun	30,000	70,000	Stock	6,000
		87,000		87,000

Nikhil is admitted as a partner and assets are revalued and liabilities reassessed as follows:

(i) Create a Provision for doubtful debt on debtors at ₹ 800.

(ii) Building and investment are appreciated by 10%.

(iii) Machinery is depreciated at 5%

(iv) Creditors were overestimated by ₹ 500.

Make journal entries and Prepare revaluation account before the admission of Nikhil.

Solution :

Journal

Date	*Particulars*		*L.F.*	*Debit* (₹)	*Credit* (₹)
	Revaluation A/c	Dr.		800	
	To Provision for Doubtful Debts				800
	[Provision made for doubtful debts]				
	Building A/c	Dr.		2,000	
	Investment A/c	Dr.		1,500	
	To Revaluation A/c				3,500
	[Increase in the value of Building & Investment]				

	Revaluation A/c Dr. To Machinery A/c [Decrease in the value of machinery]		650	 650
	Creditors A/c Dr. To Revaluation A/c [Value of creditors reduced by ₹ 500]		500	 500

Revaluation account

Dr. Cr.

Particulars	₹	*Particulars*	₹
Provision for Doubtful Debts	800	Building	2,000
Machinery	650	Investment	1,500
Profit transferred to		Creditors	500
Karan's Capital 1,700			
Tarun's Capital 850	2,550		
	4,000		4,000

23.6 ADJUSTMENTS OF RESERVES AND ACCUMULATED PROFIT OR LOSSES

Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner, is credited in the existing partner's capital account in existing profit sharing ratio. If there is any loss, the same will be debited to the existing partner in the existing ratio. For this purpose the following journal entries are made:

(i) For distribution of undistributed profit and reserve.

Reserves A/c Dr
Profit & Loss A/c(Profit) Dr.
To Partner's Capital A/c [individually]
[Reserves and Profit & Loss (Profit) transferred to all partners capitals A/c in existing profit sharing ratio]

(ii) For distribution of loss

Partner's Capital A/c Dr. [individually]
ToProfit and Loss A/c [Loss]
[Profit & Loss (loss) transferred to all partners capitals A/c in existing profit sharing ratio]

Notes

Illustration 31

Rohit and Soniya are partners sharing profit in the ratio of 4:3. On lst April 2006 they admit Meena as a new partner for 1/4 share in profits. On that date the balance sheet of the firm shows a balance of ₹ 70,000 in general reserve and debit balance of Profit and Loss A/c of ₹ 21,000. make the necessary journal entries.

Solution :

Journal

Date	*Particulars*	*L.F.*	*Debit (₹)*	*Credit (₹)*
	General Reserve Dr		70,000	
	To Rohit's Capital A/c			40,000
	To Soniya's Capital A/c			30,000
	[Transfer of general reserve to the existing partner's capital accounts]			
	Rohit's Capital A/c Dr.		12,000	
	Soniya's Capital A/c Dr.		9,000	
	To Profit & Loss A/c			21000
	[Transfer of accumulated Loss to existing partner's capital A/c]			

Illustration : 32

Bhanu and Etika are partners sharing profit and losses in the ratio of 3:2 respectively. Their Balance Sheet as at March 31, 2014 was as under:

Balance Sheet of Bhanu and Etika as at December 31,2014

Particulars		₹	*Particulars*	₹
Creditors		28,000	Cash in hand	3,000
Capitals :			Cash at Bank	23,000
Bhanu	70,000		Debtors	19,000
Etika	70,000	1,40,000	Buildings	65,000
			Furniture	15,000
			Machinery	13,000
			Stock	30,000
		1,68,000		1,68,000

Notes

On that date, they admit Deepak into partnership for 1/3 share in future profit on the following terms:

(i) Furniture and stock are to be depreciated by 10%.

(ii) Building is appreciated by ₹ 20,000.

(iii) 5% provision is to be created on Debtors for doubtful debts.

(iv) Deepak is to bring in ₹ 50,000 as his capital and ₹ 30,000 as goodwill.

Make necessary ledger accounts and balance sheet of the new firm.

Solution :

Revaluation Account

Dr. Cr.

Particulars	₹	*Particulars*	₹
Provision for Doubtful Debts	950	Building	20,000
Furniture	1,500		
Stock	3,000		
Profit transferred to			
Bhanu's Capital A/c 8,730			
Etika's Capital A/c 5,820	14,550		
	20,000		20,000

Capital Account

Dr. Cr.

Particulars	*Bhanu* (₹)	*Etika* (₹)	*Deepak* (₹)	*Particulars*	*Bhanu* (₹)	*Etika* (₹)	*Deepak* (₹)
Balance c/d (closing)	96,730	87,820	50,000	Balance b/d (closing)	70,000	70,000	—
				Revaluation (Profit)	8,730	5,820	—
				Bank A/c	—	—	50,000
				Goodwill Premium A/C	18,000	12,000	—
	96,730	87,820	50,000		96,730	87,820	50,000

Notes

Balance Sheet of Bhanu , Etika and Deepak
as on December 31, 2014

Liabilities		*Amount* (₹)	*Assets*		*Amount* (₹)
Creditors		28,000	Cash in hand		3,000
Capitals :			Cash at Bank		1,03,000
Bhanu	96,730		Debtors	19,000	
Etika	87,820		*Less:* Provision	950	18,050
Deepak	50,000	2,34,550	Stock		27,000
			Furniture		13,500
			Machinery		13,000
			Building		85,000
		2,62,550			2,62,550

Illustration 33

Ashu and Pankaj are partners sharing profit in the ratio of 3 : 2, their Balance sheet on March 31, 2014 was as follows:

Balance Sheet of Ashu and Pankaj
as at March 31,2014

Liabilities		*Amount* (₹)	*Assets*	*Amount* (₹)
Creditors		38,000	Cash in hand	15,000
Bills Payable		40,000	Cash at Bank	62,000
Salaries outstanding		5,000	Debtors	58,000
Profit & Loss		40,000	Stock	85,000
Capitals:			Machinery	1,45,000
Ashu	1,50,000		Goodwill	38,000
Pankaj	1,30,000	2,80,000		
		4,03,000		4,03,000

They admitted Gurdeep into partnership on the following terms on March 31, 2014.

(a) New profit sharing ratio is agreed as 3 : 2 : 1.

(b) He will bring in ₹ 1,00,000 as his share of capital and ₹ 30,000 as his share of goodwill.

(c) Machinery is appreciated by 10%

(d) Stock is valued at ₹ 87,000.

(e) Creditors are unrecorded to the extent of ₹ 6,000.

(f) A provision for doubtful debts is to be created by 4% on debtors.

Prepare Revaluation account, Capital Accounts, Bank account and Balance Sheet of the new firm after admission of Gurdeep.

Solution :

Revaluation Account

Dr. Cr.

Particulars	(₹)	*Particulars*	(₹)
Provision for Doubtful Debts	2,320	Machinery	14,500
Creditors	6,000	Stock	2,000
Profit transferred to			
Ashu's Capital A/c 4,908			
Pankaj's Capital A/c 3,272	8,180		
	16,500		16,500

Capital Account

Dr. Cr.

Particulars	*Ashu* (₹)	*Pankaj* (₹)	*Gurdeep* (₹)	*Particulars*	*Ashu* (₹)	*Pankaj* (₹)	*Gurdeep* (₹)
Goodwill A/c	22,800	15,200	—	Balance b/d	1,50,000	1,30,000	—
Balance c/d	1,74,108	1,46,072	1,00,000	Profit & Loss A/c	24,000	16,000	—
				Revaluation A/c (Profit)	4,908	3,272	
				Bank A/c	—	—	1,00,000
				Goodwill Premium A/c	18,000	12,000	—
	1,96,908	1,61,272	1,00,000		1,96,908	1,61,272	1,00,000

Notes

Balance Sheet of Ashu Pankaj and Gurdeep
as at March 31,2014

Liabilities		*Amount (₹)*	*Assets*		*Amount (₹)*
Creditors		44,000	Cash in hand		15,000
Bills Payable		40,000	Cash at Bank		1,92,000
Salaries outstanding		5,000	Debtors	58,000	
Capitals:			*Less:* Prov. of		
Ashu	1,74,108		doubtful debts (-)	2,320	55,680
Pankaj	1,46,072		Stock		87,000
Gurdeep	1,00,000	4,20,180	Machinery		1,59,500
		5,09,180			5,09,180

Bank Account

Dr. Cr.

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
Balance b/d	62,000	Balance c/d	1,92,000
Gurdeep's Capital A/c	1,00,000		
Goodwill A/c	30,000		
	1,92,000		1,92,000

Working Note:

Sacrificing Ratio = Existing Ratio – New Ratio

Partners	*Existing Ratio*	*New Ratio*	*Sacrifice*	*Sacrificing Ratio*
Ashu	3/5	3/6	$\frac{18-15}{30}=\frac{3}{30}$	Ashu : Pankaj
Pankaj	2/5	2/6		3 : 2

Illustration 34

Himani and Harsha are partners in a firm. Their Balance Sheet on March 31, 2014 was as follows:

Balance Sheet of Himani and Harsha
as at March 31,2014

Liabilities	*Amount* (₹)	*Assets*	*Amount* (₹)
Provision for Doubtful Debts	3,000	Cash	20,000
Creditors	36,000	Sundry Debtors	90,000
Bills Payable	15,000	Stock	45,000
Outstanding Expenses	2,000	Machinery	41,000
Capitals:		Building	1,10,000
Himani 1,70,000		Goodwill	40,000
Harsha 1,20,000	2,90,000		
	3,46,000		3,46,000

On April 1, 2014 they admitted Charu as a Partner on the following terms:

(i) Charu brings ₹ 90,000 as her share of capital and she is unable to bring any amount for goodwill.

(ii) Goodwill is valued at 2 Years purchase of the average profit of last 4 years. The Profit of last 4 years amounted to ₹ 20,000; ₹ 30,000; ₹ 30,000; ₹ 40,000 Respectively.

(iii) New Profit sharing ratio between Himani's, Harsha's and Charu are 3 : 2 : 1.

(iv) Outstanding Expenses to be brought down to ₹ 500.

(v) The provision for doubtful debts is to be increased upto 5% on Debtors.

(vi) Machinery is depreciated by 10% and Stock is valued at ₹ 47,000.

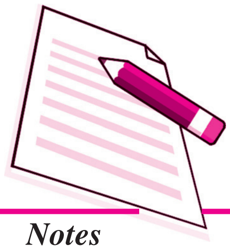
Prepare Revaluation Account, Partners Capital account and opening Balance sheet of the New firm.

Solution:

Revaluation Account

Dr. Cr.

Particulars	*Amount* (₹)	*Particulars*	*Amount* (₹)
Provision for Doubtful Debts	1,500	Outstanding Expenses	1,500
Machinery	4,100	Stock	2,000



Notes

		Loss on revaluation transferred to :	
		Himani's Capital A/c 1,050	
		Harsha's Capital A/c 1,050	2,100
	5,600		5,600

Capital Account

Dr. Cr.

Particulars	*Himani* (₹)	*Harsha* (₹)	*Charu* (₹)	*Particulars*	*Himani* (₹)	*Harsha* (₹)	*Charu* (₹)
Goodwill A/c	20,000	20,000	—	Balance b/d	1,70,000	1,20,000	—
Revaluation A/c (loss)	1,050	1,050		Charu's Capital A/c	—	10,000	—
Harsha's Capital			10,000	Bank A/c	—	—	90,000
Balance c/d	1,48,950	1,08,950	80,000				
	1,70,000	1,30,000	90,000		1,70,000	1,30,000	90,000

Balance Sheet of Himani,Harsha and Charu
as at March 31,2014

Liabilities		*Amount* (₹)	*Assets*	*Amount* (₹)
Provision for Doubtful Debts		4,500	Cash	70,000
			Bank	90,000
			Sundry Debtors	90,000
Creditors		36,000	Stock	47,000
Bills Payable		15,000	Machinery	36,900
Outstanding Expenses		500	Building	1,10,000
Capitals:				
Himani	1,48,950			
Harsha	1,08,950			
Charu	80,000	2,90,000		
		3,93,900		3,93,900

Working Note:

(i) Valuation of Goodwil l:

Notes

Total Profit = ₹ 20,000 + ₹ 30,000 + ₹ 30,000 + ₹ 40,000

Average Profit = ₹ 1,20,000/4 = ₹ 30,000

Goodwill = ₹ 30,000 × 2 = ₹ 60,000

Charu's Share of Goodwill = ₹ 60,000 × 1/6 = ₹ 10,000

(ii) Sacrificing Ratio = Existing Ratio – New Ratio

Himani's sacrifice = = 0

Harsha's sacrifice =

Only Harsha sacrificed his share of profit.

INTEXT QUESTIONS 23.4

I. Fill in the blanks with suitable word/words :

i. Revaluation account is debited for an increase in the value of ....

$$\frac{3-2}{6} = \frac{1}{6}$$

ii. Revaluation account is credited for an increase in the value of ....

iii. Revaluation account is credited for an decrease in the value of ....

iv. Revaluation account is debited for an decrease in the value of ....

v. Profit on revaluation is transferred to the .... of the partners' capital account.

vi. Reserve should be distributed amongst the existing partners in ....

vii. Accumulated Losses are .... in the existing partner's capital account in existing profit sharing ratio.

II. Choose the correct option :

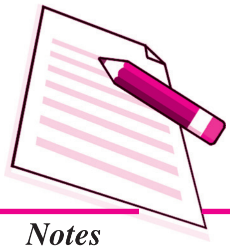
i. On change in the profit sharing ratio on the existing partners the accumulated profit will be transferred to the capital accout/current accounts of the existing partners in

a) Old Profit Sharing Ratio b) Equally

c) New Profit Sharing Ratio d) Gaining/Sacrificing Ratio

ii. On change in the profit sharing ratio of the existing partners the accumulated loss will be

a) debited to the capital accounts of the partners in old profit sharing ratio.



Notes

b) credited to the capital accounts of the partners in old profit sharing ratio.

c) debited to the capital accounts of the partners in new profit sharing ratio.

d) credited to the capital accounts of the partners in new profit sharing ratio.

iii. If profit sharing ratio of A & B is 3 : 2. They want to share profits equally. What is the sacrifice of A.

a) 1/10 b) 1/20 c) 1/15 d) 1/5

iv. If profit sharing ratio of A & B is 4 : 5. They agreed to share profit equally. What is the sacrifice of B.

a) 1/18 b) 1/10 c) 5/18 d) 7/18

v. If profit sharing ratio of A & B is 5 : 4. They agreed to share profit equally. What is the Gain of B.

a) 2/9 b) 1/18 c) 1/8 d) 4/9

III. State whether the revaluation account will be debited or credited on the revaluation of the following assets at the time of change in profit sharing ratio of the existing partners :

i. Increase in the value of land

ii. Increase in the value of stock

iii. Decrease in the value of machinery

iv. Decrease in the value of furniture.

IV. State whether the following statements are ture :

i. Revaluation account is credited on depreciation in machinery.

ii. Revaluation account is credited for depreciation in plant.

iii. Revaluation account is debited for the amount of provision for bad and doubtful debts.

iv. For recording the value of an unrecorded assets revaluation account is debited.

23.7 ADJUSTMENT OF PARTNER'S CAPITAL

Sometime, at the time of admission, the partners' agree that their capitals be adjusted in proportion to their profit sharing ratio. For this purpose, the capital accounts of the existing partners are prepared, making all adjustments, on account of goodwill, general-reserve, revaluation of assets and resettlement of liabilities. The actual capital so adjusted will be compared with the amount of capital that should be kept in the business after the admission of the new partner. The excess if any, of adjusted actual capital over the proportionate capital will either be withdrawn or transferred to current account and vice versa.

The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital account balances.

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

If the capital of the new partner is given, the entire capital of the new firm will be determined on the basis of the new partner's capital and his profit sharing ratio. Therefore the capital of other partners is ascertained by dividing the total capital as per his profit sharing ratio.

If the existing capital of the partner after adjustment is in excess of his new capital, the excess amount is withdrawn by partner or transferred to the credit of his current account. If the existing capital of the partner is less than his new capital, the partner brings the short amount or makes transfer to the debit of his current account. The journal entries are made as under:

(i) When excess amount is withdrawn by the partner or transferred to current account.

Existing Partner's Capital A/c Dr.
    To Bank A/c or Partner Current A/c
(Excess amount is withdrawn by the partner or transferred to current account)

(ii) For bringing in the Deficit amount or Balance transferred to current account.

Bank A/c or Partner Current A/c Dr.
    To Existing Partner's Capital A/c
(Bringing the Deficit amount or Balance transferred to current account)

Notes

Illustration 35

Asha and Boby are partners sharing profit in the ratio of 5:3 with capital of ₹80,000 and ₹ 70,000 respectively. They admit a new partner Nitin. The new profit sharing ratio of Asha, Boby and Nitin is 5:3:2 respectively. Nitin brings ₹40,000 as capital. The profit on revaluation of assets and reassessment of liabilities is ₹6,400. it is agreed that capitals of the partner's should be in the new profit sharing ratio. Calculate new capital of each partner.

Solution :

Actual Capital of Asha and Boby

	Asha (₹)	Boby (₹)
Balance in Capital A/c	80,000	70,000
Add Profit on Revaluation (5 : 3)	4,000	2,400
Capital after Adjustment	84,000	72,400

Calculation of new capital of the firm and existing partner's capital

Nitin's Share in the firm = 2/10

Nitin's brings ₹ 40,000 for 2/10 Share

Total capital of the new firm in terms of Nitin's capital = ₹40,000 × 10/2

= ₹ 2,00,000

Asha's share in New Capital = ₹ 2,00,000 × 5/10 = ₹ 1,00,000

Boby's share in New Capital = ₹ 2,00,000 × 3/10 = ₹ 60,000

On comparing Asha's adjusted capital with the new capital we find that the Asha brings ₹ 16,000 [₹ 1,00,000 - ₹ 84,000] or the amount may be debited to her current account.

On comparing the Boby's adjusted capital with the new capital, we find that the Boby is to withdraw ₹ 12,400 [₹ 72,400 - ₹ 60,000] or the amount may be credited to his current account.

2. When the capital of the new partner is calculated in proportion to the total capital of the new firm.

Sometimes the capital of the new partner is not given. He/she is required to bring an amount proportionate to his/her share of profit. In such a case, new partner's capital will be calculated on the basis of adjusted capital of the existing partners.

For example, the capital accounts of Sumit and Anu show the balance after all adjustments and revaluation as ₹ 90,000 and ₹ 60,000 respectively. They admit Rohit as a new partner for 1/4 share in the profits. Rohit's capital is calculated as follows:

Total share = 1
Rohit's share in the profit = 1/4
Remaining share = 1 – 1/4 = 3/4

3/4 share of profit combined capital of Sumit and Anu
= ₹ 90,000 + ₹ 60,000 = ₹ 1,50,000

Total Capital of the firm = ₹ 1,50,000 × 4/3
= ₹ 2,00,000

Rohit's capital for 1/4 share of profits = ₹ 2,00,000 × 1/4 = ₹ 50,000

Rohit brings in ₹ 50,000 as his Capital

Illustration 36

Manoj and Hema are partner sharing profit and losses in the ratio of 7 : 3. On March 31, 2014, their Balance Sheet was as follows:

Balance Sheet of Manoj and Hema
as at March 31, 2014

Liabilities		*Amount (₹)*	*Assets*	*Amount (₹)*
Capital :			Bank	12,000
Manoj	88,000		Sundry Debtors	45,000
Hema	64,000	1,52,000	Bills Receivable	30,000
Sundry creditors		32,000	Stock	35,000
Bills Payable		38,000	Investment	13,000
Reserve		18,000	Machinery	40,000
			Building	45,000
			Goodwill	20,000
		2,40,000		2,40,000

Notes

They admit Tarun into partnership on the following terms:

(i) Stock is revalued at ₹ 40,000.

(ii) Building, Machinery and Investment are depreciated by 12%.

(iii) Prepaid Insurance is ₹ 1,000.

(iv) Tarun brings ₹ 40,000 as his capital and ₹ 12,000 for goodwill for 1/6 share of profit of the firm.

(v) Capital of the partners shall be proportionate to their profit sharing ratio. Adjustment of Capitals to be made by Cash.

Prepare Revaluation Account, Partners' Capital Account , Cash Account and Balance Sheet of the new firm.

Solution :

Revaluation Account

Dr. Cr.

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
Building	5,400	Stock	5,000
Machinery	4,800	Prepaid Insurance	1,000
Investment	1,560	Loss transferred to	
		Manoj's Capital 4,032	
		Hema's Capital 1,728	5,760
	11,760		11,760

Capital Account

Dr. Cr.

Particulars	*Manoj (₹)*	*Hema (₹)*	*Tarun (₹)*	*Particulars*	*Manoj (₹)*	*Hema (₹)*	*Tarun (₹)*
Goodwill	14,000	6,000		Balance b/d	88,000	64,000	
Revaluation A/c	4,032	1,728		Reserve	12,600	5,400	
(loss)				Goodwill A/c	8,400	3,600	
Bank A/c		5,272		Bank A/c	49,032		40,000
Balance c/d	1,40,000	60,000	40,000				
	1,58,032	73,000	90,000		1,58,032	73,000	90,000

Notes

Balance Sheet of Manoj, Hema and Tarun
as at March 31, 2014

Liabilities		*Amount* (₹)	*Assets*	*Amount* (₹)
Bills Payable		38,000	Bank	1,07,760
Sundry creditors		32,000	Bills Receivable	30,000
Capitals A/c:			Sundry Debtors	45,000
Manoj	1,40,000		Stock	40,000
Hema	60,000		Investment	11,440
Tarun	40,000	2,40,000	Prepaid Insurance	1,000
			Machinery	35,200
			Building	39,600
		3,10,000		3,10,000

Bank Account

Dr. Cr.

Particulars	*Amount* (₹)	*Particulars*	*Amount* (₹)
Balance b/d	12,000	Hema's Capital A/c	5,272
Manoj's Capital A/c	49,032	Balance c/d	1,07,760
Goodwill A/c	12,000		
Tarun's Capital A/c	40,000		
	1,13,032		1,13,032

Working Note:

(a) Calculation of New profit Sharing Ratio:

Total Profit = 1

Tarun gets = 1/6

Remaining Profit = 1 – 1/6 = 5/6 shared by Manoj and Hema in their existing profit sharing ratio.

Manoj's new share = 5/6 × 7/10 = 7/12

Notes

Hema's new shares = $5/6 \times 3/10 = 3/12$

New profit sharing ratio of Manoj, Hema and Tarun

= $7/12 : 3/12 : 1/6$ or $7 : 3 : 2$.

(b) Adjustment of Capital:

Tarun brought capital for 1/6 share = ₹ 40,000

Total Capital of the firm = ₹ 40,000 × 6/1 = ₹ 2,40,000

Manoj's Capital = ₹ 2,40,000 × 7/12 = ₹ 1,40,000

Hema's Capital = ₹ 2,40,000 × 3/12 = ₹ 60,000

Tarun's Capital = ₹ 2,40,000 × 2/12 = ₹ 40,000

INTEXT QUESTIONS 23.5

Tanu and Anu are partner's sharing profit in the ratio 3:2. They admit Sumit as a new partner for 1/5 share in the profit and brings ₹50,000 for his capital. The Capital of Tanu and Anu after all the adjustments are ₹ 95,000 and ₹90,000 respectively. Calculate the total capital of the new firm and capital of each partner on the basis of the new partner's capital.

WHAT YOU HAVE LEARNT

- **Admission of a Partner – Meaning :** When a partner is admitted to the existing partnership firm, it is called admission of a partner.

  On the admission of a new partner, the following adjustments become necessary:

  (i) Adjustment in profit sharing ratio;

  (ii) Adjustment of Goodwill;

  (iii) Adjustment for revaluation of assets and reassessment of liabilities;

  (iv) Distribution of accumulated profits and reserves; and

  (v) Adjustment of partners' capitals.

- **Adjustment in Profit sharing Ratio :** When new partner is admitted he/she acquires his/her share in profit from the existing partners. As a result, the profit sharing ratio in the new firm is decided mutually between the existing partners and the new partner.

- **Sacrificing Ratio :** At the time of admission of an incoming partner, existing partners have to surrender some of their share in favour of the new partner. The ratio in which they surrender their profits is known as sacrificing ratio.
- **Meaning of Goodwill :** Any established firm develops wide business connections. This helps the firm to earn more profits as compared to a new firm. The monetary value of such advantage is known as "Goodwill".
- **Methods of valuation of Goodwill :** (i) Average Profit Method (ii) Super Profit Method (iii) Capitalisation Method
- **Revaluation of Assets and Liabilities :** On admission of a new partner, the firm is reconstituted and the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner.
- **Adjustments of Reserves and Accumulated Profit or Losses :** Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner, are credited in the existing partner's capital account in existing profit sharing ratio. If there is any loss, the same will be debited to the existing partners in the existing ratio.
- **Adjustment of Partner's Capital :** Sometimes, at the time of admission, the partners' agreed that their capitals are adjusted in proportionate to their profit sharing ratio. The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital accounts.
- At the time of change in profit sharing ratio of the existing partners the Reserves and accummulated profits/losses existing in the books are transferred to the capital/current accounts of the partners in their old profit sharing ratio.
- In case the partners decide to leave the reserves and profits/losses undistributed then an adjustment entry passed to give effect to the change in the profit sharing ratio. This is done by debiting the capital accounts of the partner(s) who have gained and crediting the capital accounts of the partners who have sacrificed proportionately.
- A change in profit sharing ratio of the existing partners implies that one partner is purchasing from another partner, a share of profit previously belonging to the latter. Therefore, the purchasing or gaining partner must compensate the sacrificing partner by paying the proportionate amount of goodwill. The following journal entry is passed for treatment of goodwill on change in the profit sharing ratio of the existing partners.

Notes

Gaining Partners' Capital A/c Dr.
To Sacrificing partner's Capital A/c
(Treatment of goodwill on change in profit sharing ratio of exising partners)

- On change in profit sharing ratio of the existing partners it is desirable to revalue assets and reassess the liabilities. The reason is that the realisable value of assets may be different from the book value. Similarly the amount payable on account of third party liabilities may be different from the book value of the liabilities.
- Revaluation of assets and reassessment of liabilities may be given effect in two different ways : (a) When revised values are recorded in the books and; (b) When revised values are not recorded in the books.
- In the first case the revaluation is done by preparing Revaluation Account. Gain or Loss on revaluation is transferred to the capital accounts of the partners in their old profit sharing ratio.

TERMINAL EXERCISE

1. State the meaning of Sacrificing Ratio.
2. State the meaning of Goodwill.
3. Explain the methods of valuation of goodwill.
4. Explain 'Revaluation Account'. Why assets and liabilities are revalued at the time of admission of a new partner?
5. Explain the treatment of accumulated profit or losses and Reserves at the time of admission of a new partner.
6. Explain the calculation of the proportionate capital of the new partner in case of admission of a partner.
7. A and B are partners sharing profit in the ratio of 5 : 3 C is admitted to the partnership for 1/4 share of future profit . Calculate the new profit sharing ratio and sacrificing ratio.
8. Rohit and Meena are partners sharing profits and losses in the ratio of 7 : 3. Rohit surrenders 1/7 of his share and Meena surrenders 1/3 of her share in favour of Teena,a new partner. Calculate the new profit sharing ratio.

Notes

9. A firm has earned ₹3,00,000 as average profit for the last few years. Normal rate of return in the class of business is 15%. Find out goodwill according to Capitalisation of Super profit, if the value of net assets amounted to ₹16,00,000.

10. The following is the Balance Sheet of Tarun and Ashima sharing profit and losses in the ratio of 2 : 1.

Liabilities		*Amount* (₹)	*Assets*	*Amount* (₹)
Capitals :			Cash	12,000
Tarun	50,000		Sundry Debtors	60,000
Ashima	40,000	90,000	Stock	12,000
Sundry creditors		20,000	Furniture	6,000
			Building	20,000
		1,10,000		1,10,000

They agreed to admit Sunita into partnership on the following terms:

(i) Sunita to pay ₹ 9,000 as Goodwill.

(ii) Sunita bring ₹ 11,000 as her Capital for 1/4 share of profit in the business.

(iii) Building and furniture to be depreciated at 5%. Stock is reduced by ₹ 1,600 and Bad Debt Reserve ₹ 1,300 to be provided for.

Prepare necessary ledge accounts and balance sheet after admission.

11. A and B are partner in a firm sharing profit in the ratio 2 : 1. C is admitted into the firm with 1/4 share in profits. He will bring in ₹ 60,000 as capital and capital of A and B are to be adjusted in the profit sharing ratio. The Balance sheet of A and B as on March 31, 2014 was as under:

Balance Sheet of A and B

as on March 31,2014

Liabilities		*Amount* (₹)	*Assets*	*Amount* (₹)
Sundry creditors		16,000	Cash in Hand	4,000
Bills Payable		8,000	Cash at Bank	20,000
General Reserve		12,000	Sundry Debtors	16,000
Capitals:			Stock	20,000
A	1,00,000		Furniture	10,000

B	64,000	1,64,000	Machinery	50,000
			Building	80,000
		2,00,000		2,00,000

Other terms of agreement are as under:

i. C will bring in ₹ 24,000 as his share of Goodwill.

ii. Building was valued at ₹ 90,000 and Machinery at ₹ 46,000

iii. A provision for bad debts is to be created @ 6% on Debtors.

iv. The capital account of A and B are to be adjusted through cash.

Prepare necessary accounts and Balance Sheet after C's admission.

12. A and B were partners in a firm sharing profits in 3 : 2 ratio. From 1.4.2014 they decided to share profits equally. For this purpose the goodwill of the firm was valued at ₹ 50,000. Pass necessary adjustment entry for the treatment of goodwill due to change in profit sharing ratio between A and B.

13. X and Y were partners sharing profits in 5 : 3 ratio. From 1.1.2013 they decided to change the profit sharing ratio. The new ratio will be 3 : 5. For this purpose the goodwill of the firm was valued at ₹ 1,60,000. Pass necessary adjustment entry for treatment of goodwill on change in profit sharing of X and Y.

14. Alka, Jyoti and Sonam were partners sharing profits in 3 : 2 : 1 ratio. They decided to share the profits in future equally. For this purpose the goodwill of the firm was valued at ₹ 1,20,000.

    Pass necessary adjustment entry in the books of Alka, Jyoti and Sonam for the treatment of goodwill due to change in profit sharing ratio.

15. Akhil, Nikhil and Shakeel were partner in a firm sharing profits in 5:3:2 ratio. From 1.4.2014 they decided to share the profits in 3 : 5 : 2 ratio. For this purpose the goodwill of the firm was valued at ₹ 2,00,000.

    Pass the necessary journal entry for the treatment of goodwill on change in profit sharing ratio of Akhil, Nikhil and Shakeel.

16. Kumar and Janki were partners in a firm sharing profits in 3 : 2 ratio. On 31.3.2013 their balance sheet showed general reserve of ₹ 30,000. On that date they decided to share future profits equally.

    Pass necesary jorunal entry for the treatment of general reserve on the occassion of change in profit sharing ratio.

Notes

17. Ravi and Kanta were partners sharing profits in 3 : 1 ratio. On 31.3.2013 their books showed a debit balance of ₹ 40,000 of profit and loss account. They decided to share the profits in 3 : 2 ratio.

    Pass necessary journal entry for the treatment of the above balance.

18. Karan and Kartik were partners in a firm sharing profits in 3 : 2 ratio. Their balance sheet showed a general reserve of ₹ 15,000. They decided to share future profit in 3 : 1 ratio.

    Pass necessary journal entries for the treatment of general reserve on change in profit sharing ratio of Karan and Kartik.

19. Mamta, Jyoti and Ruchi were partners in a firm sharing profits in 3 : 2 : 1 ratio. They decided to share the future profits equally. At the time of change in profit sharing ratio they had a debit balance of ₹ 60,000 in their profit and loss account. They decided not to distribute the loss among themselves and give effect to the same by passing an adjustment entry.

20. P and Q were partners in a firm sharing profits in 3 : 4 ratio. They decided to share the profits equally from 1.4.2013. The following revaluation of assets and reassessment of liabilities was agreed upon between the partners on this occassion :

    i. Building was depreciation by ₹ 2,000.

    ii. A provision of 5% on debtors which were ₹ 10,000 was created for bad and doubtful debts.

    iii. Land was appreciated by ₹ 70,000.

    iv. Stock was depreciated by ₹ 30,000.

    Pass necessary journal entries for the above and prepare revaluation account.

21. Pass necessary journal entries and prepare revaluation account for the revaluation of the following items on change in profit sharing ratio of L and M from 2 : 3 to 4 : 5.

    i. There was an unrecorded Computer of ₹ 7,000 which was taken into account.

    ii. A creditor of ₹ 5,000 was not likely to be paid.

    iii. A piece of land purchased 5 years ago for ₹ 20,000 was valued at ₹2,00,000.

Notes

ANSWERS TO INTEXT QUESTIONS

23.1 I. (i) New, Existing (ii) Reconstituted
(iii) Sacrificing ratio (iv) Existing ratio

II. Sacrificing ratio 5 : 3.

23.2 I. (i) intangible (ii) incoming (iii) Normal Profit
(iv) Average profit, super profit and Capitalisation
(v) Outsider liabilities

II. (a) ₹ 62,500 (b) ₹ 1,25,000

23.3 I. (i) no entry (ii) credited (iii) sacrificing
(iv) debited (v) written off

II. 1. IV 2. III 3. I 4. II.

23.4 I. (i) Liabilities, (ii) Assets, (iii) Liabilities,
(iv) Assets, (v) Credit side (vi) Existing ratio
(vi) debited

II. (i) a (ii) a (iii) a (iv) a (v) b

III. (i) Credit (ii) Credit (iii) Debit (iv) Debit

IV. (i) False (ii) False (iii) True (iv) False

23.5 Total Capital of the new firm ₹ 2,50,000
Capital of Tanu's ₹ 1,20,000, capital of Anu's ₹ 80,000

ANSWERS TO TERMINAL EXERCISE

7. New profit sharing ratio 15 : 9 : 8, Sacrificing ratio 5 : 3.
8. New profit sharing ratio 3 : 1 : 1
9. Goodwill ₹ 4,00,000
10. Loss on Revaluation ₹ 4,200, Total of Balance Sheet ₹ 1,25,800
11. Profit on Revaluation ₹ 5,040, Capital of A ₹ 1,20,000, B & C ₹ 60,000 each, Balance sheet Total ₹ 2,64,000

Notes

ACTIVITY

Talk to the owners of five such business organisations which are doing good business and have built up good reputation in the market. Write against each firm the factor that have contributed to its goodwill

Name of the firm	*Nature of Business*	*Factors contributing to the goodwill of the firm*