

LESSON-23 ADMISSION OF PARTNER

SUMMARY

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.

ADMISSION OF A PARTNER

MEANING

'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 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.

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.

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.

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

TREATMENT OF 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.

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

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.

- (a) When revised values are to be recorded in the books, and
- (b) When revised values are not to be recorded in the books.

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 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.

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.*
- (ii) *For distribution of loss*

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

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.