

ADMISSION OF A PARTNER

23.1 INTRODUCTION

In the previous lesson, you have studied about the meaning and characteristics of partnership firms. New partner may be admitted to a sole-trader's business or to an existing partnership firm. In both the cases, terms and conditions are settled at the time of admission. Admission of a partner means to allow a person to join a business to share its future profits and losses as per the mutual consent of the existing and the new partners.

A new partner is, usually, admitted to strengthen the financial position of a business and to manage the business affairs more effectively.

In this lesson, you will study in detail the accounting treatment of all the adjustments at the time of admission of a partner.

23.2 OBJECTIVES

After studying this lesson, you will be able to :

- state the concept of admission of a partner;
 - calculate new profit sharing ratios;
 - calculate sacrificing ratio;
 - state the meaning of goodwill;
 - illustrate the methods of valuation of goodwill;
 - describe accounting treatment of goodwill through journal and accounting vouchers;
 - explain the need for revaluation of assets and liabilities at the time of admission of a partner;
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- illustrate the accounting method (through journal and accounting vouchers) of recording changes arising from revaluation of assets and liabilities;
- describe accounting treatment of undistributed profits and reserves through journal and accounting vouchers;
- explain adjustment in partners' capital A/cs;
- prepare Revaluation account, Partners capital accounts, and Balance sheet on the basis of given information.

23.3 ADMISSION OF A PARTNER – MEANING AND ADJUSTMENT IN PROFIT SHARING RATIO

A new partner may be admitted to a business due to many reasons. Usually, a new partner is admitted to strengthen the financial position of a business and to manage the business affairs more effectively.

According to Section 31 (1) of the Indian Partnership Act, (1932), a new partner can be admitted only with the consent of all the existing partners. On the admission of a new partner, the old partnership agreement comes to an end and the firm is reconstituted under a fresh agreement.

On the admission of a new partner, one or more of the following adjustments become necessary -

- I Adjustment in profit sharing ratio;
- II Adjustment in goodwill;
- III Adjustment for revaluation of assets and liabilities;
- IV Adjustment for reserves and other accumulated profits;
- V Adjustment for capital.

Now, we shall study about each of these adjustments in detail.

I Adjustment in Profit-sharing Ratio

When a new partner joins, he or she gets certain share in the future profits and losses of the firm. As a result of this, the profit-sharing ratio of all the partners of the new firm is decided upon as per the mutual agreement.

The profit sharing ratio given to the new partner may be sacrificed by one or more existing partners. If nothing is mentioned about the proportion of sacrifice by the existing partners, it will be presumed that the existing partners have contributed towards the new partner's profit sharing ratio in their old ratio.

Sacrificing Ratio and New Ratio

Sacrificing ratio is calculated when a new partner is admitted to partnership firm. The right of new partner to share the profits of the business will reduce the profits available for the existing partners as the same profits will now be divided amongst all partners, including the new partner. Old partners require the new comer to make a payment for the benefit which he acquires from the old partners in the form of share in future profits. In lieu of the right to share future profits, the new partner is requested to pay some amount to the old partners which is considered as a price of premium established by the old partners. This payment is made for the purpose of enjoying the fruits of efforts of other partners.

Such price is calculated on the basis of total value of firm's reputation (i.e., goodwill) and share of profit to be given to the new partner. This price is shared by the old partners according to the share of profit sacrificed by them in favour of a new partner, or in other words in their sacrificing ratio. Sacrificing ratio is the difference between partners' old share of profit and new share of profit.

Following cases may arise while calculating the sacrificing ratio:

1. If the new partner's share is given and nothing else is mentioned in the question.

In such a case, it is presumed that old partners will share the rest of the profits in the old ratio. Then, old partners' new ratio is calculated by dividing rest of the profit in their old ratio and sacrificing ratio is calculated by deducting new ratio from the old. Let us, take an illustration

ILLUSTRATION 1

Atul and Amrik are partners, sharing profits and losses in the proportion of 2 : 1. They admit a new partner Varun to whom they give $\frac{1}{6}$ share in profits. Calculate the new profit sharing ratio.

Solution

Suppose, the total share be 1. The new partner Varun takes $\frac{1}{6}$ share out of 1. Rest of the share $\frac{5}{6} = \frac{5}{6}$.

$$\text{Atul's new share} = \frac{5}{6} \times \frac{2}{3} = \frac{10}{18}$$

$$\text{Amrik's new share} = \frac{5}{6} \times \frac{1}{3} = \frac{5}{18}$$

$$\text{Atul : Amrik : Varun} = \frac{10}{18} : \frac{5}{18} : \frac{3}{18}$$

$$\text{New profit sharing ratio} = 10 : 5 : 3.$$

$$\begin{aligned} \text{So, Atul has sacrificed} &= 2/3 - 10/18 = 2/18 \\ \text{and Amrik has sacrificed} &= 1/3 - 5/18 = 1/18 \\ \text{Sacrificing Ratio} &= 2 : 1. \end{aligned}$$

You will see that this sacrificing ratio is same as their old ratio. This will always be so when old partners continue to share rest of the profit. (i.e., total profits less profit given to the new partner), in the old ratio. So, we come to the conclusion that if new partner's share of profit is given in the total profit of the firm and nothing else is mentioned, new ratio will be calculated by dividing the remaining profit among old partners in old ratio.

Sacrificing ratio of the old partners will be the same as their old ratio.

II. If new partner purchases his share of profit from the old partners in a particular ratio.

ILLUSTRATION 2

Shambu and Hari are partners sharing profits and losses in the proportion of 7 : 5. They agree to admit Harnam to partnership who is to get 1/6th share in profits. He acquires this share as 1/24th from Shambu and 1/8th share from Hari Calculate new profit sharing ratio.

Solution

In this problem, Shambu sacrifices 1/24 the share in favour of Harnam and Hari sacrifices 1/8 the share in favour of Harnam So, their sacrificing Ratio is 1/24 : 1/8, i.e., 1 : 3.

Shambu and Hari's old ratio is 7 : 5.

Shambu's new share = $7/12 - 1/24 = 13/24$

Hari's new share = $5/12 - 1/8 = 7/24$ and

Harnam's share = $1/24 + 1/8 = 4/24$

Now, the new profit sharing ratio of Shambu, Hari and Harnam is 13/24 : 7/24 : 4/24 = 13 : 7 : 4.

III. In some cases, the old partners surrender a particular portion of their share in favour of a new partner.

ILLUSTRATION 3

Asif and Shiva shared profits in the ratio of 7 : 3. John was admitted as a partner. Asif surrendered 1/7th of his share and Shiva 1/3rd of his share in favour of John. Find the new profit sharing ratio.

Solution

Asif surrenders $\frac{1}{7}$ th of his share, i.e., = $\frac{1}{7}$ of $\frac{7}{10}$ = $\frac{1}{10}$

Shiva surrenders $\frac{1}{3}$ rd of his share, i.e., = $\frac{1}{3}$ of $\frac{3}{10}$ = $\frac{1}{10}$

So, sacrificing ratio of Asif and Shiva is $\frac{1}{10} : \frac{1}{10}$ or equal.

Now Asif's new share = $\frac{7}{10} - \frac{1}{10} = \frac{6}{10}$

and Shiva's new share = $\frac{3}{10} - \frac{1}{10} = \frac{2}{10}$,

and John's new share = $\frac{1}{10} + \frac{1}{10} = \frac{2}{10}$.

So, new profit sharing ratio of Asif, Shiva and John is = $\frac{6}{10} : \frac{2}{10} : \frac{2}{10}$
or 3 : 1 : 1.

INTEXT QUESTIONS 23.1

- I. Fill in the blanks with suitable word or words:
- Sacrificing ratio is calculated by deducting share of profit from share of profit of the old partners.
 - At the time of admission, old partners' new share of profit is calculated by deducting..... from their old share of profit.
 - The sacrificing ratio of the old partners remains..... if nothing is mentioned in the agreement deed.
 - The new partner's profit sharing ratio is the sum of sacrificed by the existing partners.
- II. If X and Y are carrying partnership business sharing profits in the ratio of 3 : 2, What will be their sacrificing ratio if Z is admitted for $\frac{1}{6}$ th share of profit in the firm?
- III. Complete the following table at the time of Hari's admission by filling appropriate new ratio and sacrificing ratio.

	Old Ratio	New Ratio	Sacrificing Ratio
	Ram : Shyam	Ram : Shyam : Hari	Ram : Shyam
i)	3 : 2	3 : 2 : : 1
ii)	6 : 4	5 : 3 : 2
iii)	4 : 3	3 : 2 : 2

23.4 GOODWILL - MEANING AND VALUATION

Meaning of Goodwill

There are many tea producing concerns in India. But, you must have observed that most of people prefer to buy Taj Mahal tea or Tata tea. Why is it so?

Some of you might say that the shops selling these two brands of tea are located in each locality and so are easily accessible to customers. Some others may say that these brands of tea have maintained high standard of quality so people have more faith in them. In short, we can say that these brands have better reputation by virtue of which they can attract more customers than those attracted by others.

Not only customers, but investors also want to invest in a reputed concern, so that they can get good return on their investment. Suppliers want to supply materials to a reputed concern because they can get their payments in time. Before granting loan, creditors also verify the reputation of a concern, so as to be sure of the payment of interest and repayment of loan in time. This reputation of a concern, in accounting terminology, is known as Goodwill. So, we can say that goodwill is the strength of a business which attracts customers, investors, creditors, suppliers towards it. Goodwill helps a firm in earning more profits than by other firms in the same industry. Thus, goodwill can be called as the present value of profits expected in future over and above the normal rate of profits.

Valuation of Goodwill

The method of valuation of goodwill is generally decided by the partners among themselves while preparing partnership deed. The following are the main methods of valuing the goodwill of a business:

- i. Average Profit Method
- ii. Super Profit Method
- iii. Capitalisation Method

Let us learn about each of these methods:

1. Average Profit Method

Under this method, average of the profits of certain given years is calculated. The average profit is then multiplied by the numbers of years in which the expected profit will be available. We take average profit because in a business what profits are likely to accrue in future depend upon its average performance in the past.

Let us consider the following illustration:

ILLUSTRATION 4

The profits of 1995, 1996, and 1997 are Rs.8,000, Rs.10,000, and Rs.12,000 respectively and goodwill is to be valued at twice the average of the last three years' profits.

Solution

$$\text{Total Profit} = \text{Rs.}8,000 + \text{Rs.}10,000 + \text{Rs.}12,000 = \text{Rs.}30,000$$

$$\text{Average Profit} = 30,000/3 = \text{Rs.}10,000$$

$$\text{Value of Goodwill} = \text{Rs.}10,000 \times 2 = \text{Rs.}20,000$$

ILLUSTRATION 5

Profit/Loss for the last four years are as :-

$$1990 - \text{Profit} = \text{Rs.}6,000$$

$$1991 - \text{Profit} = \text{Rs.}8,000$$

$$1992 - \text{Loss} = \text{Rs.}4,000$$

$$1993 - \text{Profit} = \text{Rs.}6,000$$

Calculate value of goodwill at 3 years' purchase of the average profit of last four years.

Solution

$$\begin{aligned} \text{Total Profit} &= \text{Rs.}6,000 + \text{Rs.}8,000 + \text{Rs.}6,000 \\ &= \text{Rs.}20,000 - \text{Rs.}4,000 = \text{Rs.}16,000 \end{aligned}$$

$$\text{Average Profit} = 16,000/4 = \text{Rs.}4,000$$

$$\text{Value of Goodwill} = \text{Rs.}4,000 \times 3 = \text{Rs.}12,000.$$

2. Super Profit Method

Excess of profits earned over normal profit is called super profit. It directly indicates the value of goodwill as it highlights the special abilities of the business concern. Normal profit is that profit which is earned by other units of the same industry. Rate of normal profit is ascertained on the capital employed in a business. Suppose, capital employed in a business is Rs.1,00,000. Normal rate of profit in such a business is 10%, but this particular business is earning profit at the rate of 15%. It means its profit is Rs.15,000 whereas other units are earning Rs.10,000, i.e., 10% of 1,00,000 at the normal rate.

The unit, earning at the rate of 15% is earning super profit of Rs.5,000. To ascertain goodwill the super profit is multiplied by a given number of years.

This method has been explained with the help of the following illustrations:

ILLUSTRATION 6

A firm earned the following net profits during the last 3 years

1st year - Rs.18,000

2nd year - Rs.20,000

3rd year - Rs.22,000

The capital investment of the firm is Rs. 60,000. The rate of normal profit is 10%. Calculate the value of goodwill on the basis of 2 years' purchase.

Solution

Total profit of 3 years = Rs.18,000 + Rs.20,000 + Rs.22,000
= Rs.60,000.

Average annual profit = $60,000/3 = \text{Rs.}20,000$

Normal Profit = 10% of Rs. 60,000 = Rs.6,000

Annual Super Profit = Rs.20,000 - Rs.6,000 = Rs.14,000

Value of Goodwill at 2 years' purchase = Rs.14,000 × 2 = Rs.28,000

ILLUSTRATION 7

Capital invested in the firm is Rs. 1,00,000. Normal rate of profit is 10%. Actual profits are Rs.15,000 and goodwill is to be calculated at four year's purchases of super profits.

Solution

Normal profits of the firm = Rs.1,00,000 × 10/100 = Rs.10,000

Super Profit = Actual Profit - Normal Profit = Rs.15,000 - Rs.10,000
= Rs.5,000

Value of Goodwill = Rs.5,000 × 4 = Rs.20,000.

3. Capitalisation Method

Under this method, the total value of the firm is ascertained.

This can be calculated with the help of the following formula:

$$\frac{\text{Profit earned} \times 100}{\text{Normal rate of Profit}}$$

In order to find the amount of goodwill, the net value of assets is deducted from the total value of the firm with the help of the formula, where net value of assets can be calculated by deducting total liabilities from the total assets.

ILLUSTRATION 8

A firm has Rs.40,000 as its annual profit, the rate of normal profit being 10%. The assets of the firm amounting to Rs.2,80,000 and liabilities to Rs.1,60,000.

Calculate the value of goodwill by Capitalisation Method.

Solution

$$\begin{aligned} \text{Total Value of the firm} &= \frac{\text{Actual Profit} \times 100}{\text{Normal Rate of Profit}} \\ &= \frac{40,000 \times 100}{10} = \text{Rs.4,00,000} \end{aligned}$$

$$\begin{aligned} \text{Net Assets of the firm} &= \text{Total Assets} - \text{Total Liabilities} \\ &= \text{Rs.2,80,000} - \text{Rs.1,60,000} = \text{Rs.1,20,000} \end{aligned}$$

$$\begin{aligned} \text{Goodwill} &= \text{Total Value of the Business} - \text{Net Assets of the firm} \\ &= \text{Rs.4,00,000} - \text{Rs.1,20,000} = \text{Rs.2,80,000} \end{aligned}$$

INTEXT QUESTIONS 23.2

- I. Fill in the blanks with suitable word or words :
- The concern enjoying more goodwill are expected to earn higher
 - The amount of goodwill is generally brought in by partner.
 - The three methods of calculating goodwill are, and
 - Excess of profit earned over normal profit is called.....
 - Net value of Assets = Total Assets minus
- II. (i) Calculate average profit from the following :-
- 1990 Profit = Rs.10,000
 1991 Profit = Rs.12,000
 1992 Loss = Rs.4,000
 1993 Profit = Rs.8,000
- Average Profit =
- (ii) Calculate value of goodwill at 3 years' purchase of average profit, ascertained in II(i) above.

- III. A. Calculate super profit if actual profit is Rs.2,000 and normal profit is 15% and capital employed is Rs.10,000.
- B. Pick up the right words from the bracket and fill in the blanks in the following formula of Capitalisation Method.
- (i) Total value of the firm = $\frac{(\dots\dots\dots) \times 100}{\text{Normal Rate of Profit}}$
(Super profit, Actual profit, Average profit)
- (ii) Total value of the firm minus = Value of goodwill
(Fixed Asset, Current Assets, Net Assets)

23.5 ACCOUNTING TREATMENT FOR GOODWILL

The Problem of goodwill on admission of a new partner can be dealt with under the following situations :-

- A. Goodwill being brought in cash by the new partner.
- B. Goodwill being raised in the books at the time of admission of a partner.

A. Goodwill being brought in Cash

Depending upon the agreement, the new partner may be asked to bring his share of goodwill in cash. If this is so, the cash brought in by new partner on account of goodwill, is adjusted amongst the old partners in their sacrificing ratio. This can take the following two forms:-

- I When goodwill is paid privately by new partner to the old partners.
- II When the new partner brings his share of goodwill in cash in the firm.
- I. When goodwill is paid privately

In this case, the new partner passes his share of goodwill in cash to old partners privately and, therefore, no accounting treatment for goodwill is required in the books of the firm. But, it is important to note that for the amount of capital brought in by the new partner, a credit voucher is prepared and capital A/c of new partner is credited. The journal entry for credit voucher will also be passed by debiting Cash/Bank A/c and crediting new partner's capital A/c.

II. When goodwill is brought in cash in the business

In this case, the new partner brings cash in the firm for his share of goodwill. This case can be dealt with by two methods:

(i) When Goodwill is retained in the firm:

The amount of cash brought in for goodwill by the new partner is retained in the business and is used as additional capital. The accounting treatment for goodwill is summarised in the following steps :-

1. On bringing the amount of goodwill by the new partner

A credit voucher is prepared for bringing cash for goodwill by the new partner. This is done as follows :-

Name of the Firm		Date _____
Voucher No. _____	Amount (Rs.)	
Credit	New Partner's Capital A/c (Being cash brought in by the new partner on account of goodwill)	
Sd/- Manager	Sd/- Accountant	

The journal entry for the above credit voucher will be as under :-

Bank A/c Dr.

 To New Partner's Capital A/c
(Being cash brought in by the new partner on account of goodwill)

2. On adjusting the amount of goodwill amongst the old partners

A transfer voucher is prepared. The capital account of the new partner is debited and the capital accounts of the old partners are credited. This is done as follows :

Firm's Name		Date _____
Voucher No. _____	Amount (Rs.)	
Debit	New Partner's Capital A/c	
Credit	Old Partners' capital A/cs (Being goodwill brought in by new partner adjusted amongst the old partners, i.e., sacrificing partners in their sacrificing ratio.)	
Sd/- Manager	Sd/- Accountant	

The journal entry for the above transfer voucher will be as under:-

New Partner's capital A/c Dr.
 To Old Partners' Capital A/cs
 (Being goodwill brought in by new partner
 adjusted amongst the old partners, i.e.,
 sacrificing partners in their sacrificing ratio.)

It is important to note that goodwill is in fact a compensation to the old partners for the share of future profit which they agree to surrender to the new partner. The amount of goodwill should, therefore, be adjusted amongst the old partners in their sacrificing ratio. This ratio can be calculated by deducting the old partners' new ratio from their respective old ratio, i.e.,
 Sacrificing Ratio = Old Ratio - New Ratio.

3. When the amount of goodwill is withdrawn by old partners.

In this case, the old partners withdraw their respective share of cash brought in by new partner as goodwill. Here, in addition to the two steps taken earlier the following additional step is needed:

On withdrawal of the amount of goodwill by old partners, a debit voucher is prepared. The Capital A/cs of old partners are debited. This is done through the following voucher :

Received Rs. Stamp	Name of Firm	
	Voucher No. _____	Date _____
	Amount (Rs.)	
Debit	Old Partner's Capital A/c (Being withdrawal of their respective share of goodwill by old partners)	
Sd/- Manager	Sd/- Accountant	

The journal entry for the above debit voucher will be as under :-

Old Partners' Capital A/cs Dr.
 To Cash/Bank A/c
 (Being withdrawal of their respective
 share of goodwill by old partners.)

It is important to note that sometimes the old partners withdraw only a part of cash brought in on account of goodwill by the new partner. In that case

treatment is to be done for the proportionate withdrawn amount only.

ILLUSTRATION 9

Nishant and Harshit are partners sharing profits in the ratio 3:1. They admit Neelaksh as partner for 1/4th share. His share of goodwill is Rs.18,000/-. Neelaksh brought Rs.40,000 as his capital. Record goodwill in the following cases :-

- (i) When the amount of goodwill is paid privately.
- (ii) When the amount brought in for goodwill is retained in the business.
- (iii) When the amount brought in for goodwill is withdrawn by old partners.

Solution

Case I (Goodwill is paid privately)

No accounting treatment is required, since the goodwill is paid privately by the new partner to the old partners. But a credit voucher for capital brought in by new partner is prepared as :-

Name of the Firm		Date _____
Voucher No. _____		Amount (Rs.)
Credit	Neelaksh's Capital A/c (Being amount of capital brought in cash by the new partner)	40,000
		40,000
Sd/- Manager		Sd/- Accountant

The journal entry for the above credit voucher will be as under :-

Cash/Bank A/c Dr. 40,000

 To Neelaksh's capital A/c 40,000
(Being amount of capital brought in by the new partner).

Case II Amount of goodwill brought in cash and retained in the business.

Steps

- (i) On bringing the amount of goodwill by Neelaksh

The new partner bring Rs.40,000 as capital and Rs.18,000 as goodwill. A

credit voucher is to be made for Rs.58,000 crediting the Capital A/c of Neelaksh. This is done as follows :-

Name of the Firm		Date _____
Voucher No. _____		Amount (Rs.)
Credit	Neelaksh's Capital A/c (Being the amount brought in by Neelaksh for goodwill Rs.18000 and for capital Rs.40,000)	58,000
		58,000
Sd/- Manager		Sd/- Accountant

The journal entry for the above credit voucher will be as under :-

Cash or Bank A/c Dr. 58,000

To Neelaksh's Capital A/c 58,000

(Being the amount brought in by Neelaksh for goodwill Rs.18,000 and for capital Rs.40,000)

The new partner brought Rs.58000, out of this Rs.18000 is on account of goodwill. This amount of goodwill will be transferred to the capital of Nishant and Harshit in their sacrificing ratio. This is done through a transfer voucher in the following manner:-

Name of Firm		Date _____
Voucher No. _____		Amount (Rs.)
Debit	Neelaksh's Capital A/c	18,000
		18,000
Credit	Nishant's Capital A/c Harshit's Capital A/c (Being the amount of goodwill credited to Nishant and Harshit in the sacrificing ratio of 3:1)	13,500
		4,500
		18,000
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under:

Neelaksh's Capital A/c	Dr.	18,000
To Nishant's Capital A/c		13,500
To Harshit's Capital A/c		4,500
(Being the amount of goodwill credited to Nishant and Harshit in the sacrificing ratio of 3 : 1.)		

Case III Cash brought in on account of goodwill being withdrawn by the old partners.

Steps

- (i) Same as in Case II
- (ii) Same as in Case II
- (iii) For withdrawal of cash on account of goodwill.

A debit voucher for Rs.18,000 is prepared as under :-

Received Rs..... Stamp	Name of Firm	Date _____
	Voucher No. _____	Amount (Rs.)
	Debit	13,500
	Nishant's Capital A/c Harshit's Capital A/c (Being the amount of goodwill withdrawn by Nishant and Harshit)	4,500 18,000
Sd/- Manager	Sd/- Accountant	

The journal entry for the above debit voucher will be as under :

Nishant's Capital A/c	Dr.	13,500
Harshit's Capital A/c	Dr.	4,500
To Cash/Bank A/c		18,000
(Being the amount of goodwill withdrawn by Nishant and Harshit.)		

B. When Goodwill is Raised in the Books

Under this situation, the new partner does not bring his share of goodwill in cash. In this case, a goodwill account is raised in the books of the firm.

This is done by debiting goodwill at its full value and crediting the capital accounts of old partners in their old profit sharing ratio. A transfer voucher is prepared in the following manner:

Voucher No. _____		Name of Firm _____	Date _____
			Amount (Rs.)
Debit	Goodwill A/c		
Credit	Old Partners' Capital A/c (Being the amount of goodwill raised to the full value)		
Sd/- Manager		Sd/- Accountant	

The journal entry for the above transfer voucher will be as under :

Goodwill A/c	Dr.
	To old Partner's Capital A/c
	(Being the amount of goodwill raised to the full value)

If the books of the firm already show the Goodwill A/c at some value, the above treatment should be done only for the differences between the full value of goodwill and that shown in the books. It is possible that the full value of goodwill is less than the book value. In this case, there has been a loss of goodwill for which the capital accounts of old partners are debited and goodwill A/c is credited by difference between the full value of goodwill and goodwill shown in the Balance Sheet.

ILLUSTRATION 10

A, B, and C are three partners sharing profits in the ratio of 5 : 5 : 4. D is admitted to the firm. His share will be 1/8. Goodwill of the firm is agreed at Rs.64,400. Adjust goodwill through accounting voucher, if

- there is no goodwill in the books of accounts.
- Goodwill A/c appears at Rs.22,400.
- Goodwill A/c appears at Rs.81,200.

Solution :

- No goodwill appears in the books**

A transfer voucher is prepared. Goodwill is debited by Rs. 64,400 and capital A/cs of A, B, and C are credited by Rs.23,000, Rs.23,000 and Rs.18,400 respectively. Note that goodwill is adjusted amongst A, B and C in their old ratio, i.e., 5 : 5 : 4.

Name of Firm		
Voucher No. _____		Date _____
		Amount (Rs.)
Debit	Goodwill A/c	64,400
		64,400
Credit	A's Capital A/c	23,000
	B's Capital A/c	23,000
	C's Capital A/c	18,400
	(Being the amount of goodwill raised to its full value by Rs.64,400)	64,400
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under:

Goodwill A/c Dr. 64,400

To A's Capital A/c 23,000

To B's Capital A/c 23,000

To C's Capital A/c 18,400

(Being the amount of goodwill raised to its full value of Rs.64,400).

(b) Goodwill A/c appears at Rs.22,400

Goodwill A/c is debited by Rs.42,000 (Rs. 64,400 - Rs.22,400) and the Capital A/c of A, B and C are credited by Rs.15,000, Rs.15,000 and Rs.12,000 respectively. Goodwill is adjusted amongst A, B and C in their old ratio, i.e., 5 : 5 : 4.

Name of Firm		
Voucher No. _____		Date _____
		Amount (Rs.)
Debit	Goodwill A/c	42,000
		42,000
Credit	A's Capital A/c	15,000
	B's Capital A/c	15,000
	C's Capital A/c	12,000
	(Being the amount of goodwill raised by Rs.42,000)	42,000
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under:

Goodwill A/c	Dr. 42,000	
To A's Capital A/c		15,000
To B's Capital A/c		15,000
To C's Capital A/c		12,000
(Being the amount of goodwill raised by Rs. 42,000).		

(c) **Goodwill Account appears at Rs.81,200.**

Find the difference between Rs.81,200 and Rs.64,400, i.e., Rs.16,800. A's B's and C's Capital A/cs are debited by Rs.6,000, Rs.6,000 and Rs.4,800 in their old ratio respectively and Goodwill A/c is credited by Rs.16,800. A Transfer voucher is prepared as follows:

Name of Firm		Date _____
Voucher No. _____		
		Amount (Rs.)
Debit	A's Capital A/c	6,000
	B's Capital A/c	6,000
	C's Capital A/c	4,800
		16,800
Credit	Goodwill A/c (Being the excess amount of goodwill written off in old ratio)	
		16,800
Sd/- Manager	Sd/- Accountant	

The journal entry for the above Transfer voucher will be as under:

A's Capital A/c	Dr. 6,000	
B's Capital A/c	Dr. 6,000	
C's Capital A/c	Dr. 4,800	
To Goodwill A/c		16,800
(Being the excess amount of goodwill written off in old ratio).		

It is important to note that in all the three cases goodwill is to be shown on the assets side at Rs. 64,400 in the new Balance Sheet to be prepared after admission.

INTEXT QUESTIONS 23.3

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

Column A	Space for Answer	Column B
1. Goodwill brought in cash by new partner.		I. Transfer Voucher is prepared.
2. Payment for Goodwill privately made by new partner to old partner.		II. No entry for Goodwill.
3. Old partners withdrawing their share of cash brought in for goodwill by new partner.		III. Credit Voucher is prepared, crediting new partner's capital account.
4. Raising goodwill A/c in the books of the firm.		IV. Debit voucher is prepared debiting the capital accounts of old partners.

- B. Below are given certain situations relating to goodwill. You are required to identify the nature of transaction and accordingly the name of voucher to be prepared, the account to be debited and/or credited, and the amount of transaction. On the basis of above information complete the following table :

Transaction	Amount	Name of Voucher	Amount to be	
			Debited	Credited
i) Sushil on his admission in the partnership, paid Rs.40,000 as goodwill privately.				
ii) In Balance Sheet, Goodwill A/c is appearing at Rs. 80,000. At the time of admission of Pramod the goodwill is valued at Rs. 1,00,000. Earlier Sumeet and Amit were partners sharing profit in the ratio of 1 : 1.				
iii) In the above case, let us assume that in Balance Sheet no goodwill A/c appears.				
iv) Continuing with the same example, let us assume that Balance Sheet shows a Goodwill A/c balance of Rs.1,30,000				
v) On his admission, Diwakar has brought Rs. 30,000 as goodwill being distributed between Ganesh and Vinay in 3 : 2.				
vi) Vinay and Ganesh have withdrawn the amount.				

23.6 REVALUATION OF ASSETS AND LIABILITIES

Need for Revaluation

At the time of admission, the partners may agree to revalue the assets and liabilities, as the existing book values may not represent their true market value. Revaluation of assets and liabilities is aimed at ascertaining whether assets and liabilities of the firm are shown in books at their correct values.

If these are over - stated or understated, these are revalued and any profit or loss arising on account of such revaluation must be adjusted in the old partners' capital accounts in their old profit sharing ratio.

Recording of Changes Arising from Revaluation of Assets and Liabilities

The adjustments on account of revaluation of assets and Liabilities are done through "Revaluation Account" or "Profit and Loss Adjustment Account".

i) For increase in value of Assets

Any increase in the value of assets is credited to Revaluation Account and debited to Assets account. A transfer voucher is prepared for this purpose as follows :-

Name of Firm		Date _____
Voucher No. _____	Amount- (Rs.)	
Debit	Assets A/c	
Credit	Revaluation A/c (Being the amount of increase in the value of assets.)	
Sd/- Manager	Sd/- Accountant	

The journal entry for the above transfer voucher will be as under :

Assets A/c Dr.
 To Revaluation A/c
 (Being the amount of increase in the
 value of assets).

ii) For decrease in the Value of Assets

Any decrease in the value of assets is debited to Revaluation Account and credited to relevant Assets Accounts. A transfer voucher is prepared for this purpose as follows:-

The journal entry for the above transfer voucher will be as under :-

Revaluation A/c Dr.
 To Assets A/cs
 (Being the amount of decrease in the value of assets.)

iii) For Increase in the value of Liabilities.

Any increase in the value of liabilities is debited to Revaluation A/c and credited to relevant Liabilities Accounts. A transfer voucher is prepared for this purpose as follows:

Name of Firm		Date _____
Voucher No. _____		Amount (Rs.)
Debit	Revaluation A/c	
Credit	Liabilities A/c (Being the amount of increase in the value of Liabilities debited to Revaluation A/c.)	
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under :-

Revaluation A/c Dr.

To Liabilities A/c

(Being the amount of increase in the value of Liabilities debited to Revaluation A/c).

iv) For Decrease in the value of Liabilities

Any decrease in the value of Liabilities is credited to Revaluation Account and debited to relevant Liabilities Accounts. A transfer voucher is prepared for this purpose:-

Name of Firm		Date _____
Voucher No. _____		Amount (Rs.)
Debit	Liabilities A/c	
Credit	Revaluation A/c (Being the amount of decrease in the value of Liabilities credited to Revaluation A/c.)	
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under :-

Liabilities A/cs Dr.

To Revaluation A/c

(Being the amount of decrease in the value
of Liabilities credited to Revaluation A/c).

PREPARATION OF REVALUATION ACCOUNT

Revaluation Account is prepared on the basis of various transfer vouchers. On the debit side of this account, we record all decreases in the value of assets and all increases in the value of liabilities on the credit side. If the debit side of this account is more than the credit side, there is a loss on revaluation of Assets and Liabilities. On the other hand, if the credit side of this account is more than the debit side, there is a profit on revaluation. This profit or loss is distributed amongst the old partners in the old profit sharing ratio.

For profit on revaluation, a transfer voucher is prepared. Revaluation Account is debited and the capital Accounts of the old partners are credited by their respective shares of profits in old ratio. This is done as follows :-

Name of Firm		
Voucher No. _____	Date _____	Amount (Rs.)
Debit	Revaluation A/c	
Credit	Old Partners' Capital A/c (Being the amount of profit on Revaluation transferred to old partners' A/cs in old ratio)	
Sd/- Manager		Sd/- Accountant

The journal entry for the above transfer voucher will be as under :-

Revaluation A/c Dr.

To Old Partners Capital A/cs
(Being the amount of profit on Revaluation
transferred to old partners' A/cs in old ratio.)

For Loss on Revaluation, a transfer voucher is prepared. The Capital Accounts of old partners are debited by their respective share of losses in old ratio and the Revaluation Account is credited by the total amount of loss.

Name of Firm		
Voucher No. _____		Date _____
		Amount (Rs.)
Debit	Old Partners' Capital A/c	
Credit	Revaluation A/c (Being the amount of loss on Revaluation is distributed amount old partners in old Ratio)	
Sd/- Manager		Sd/- Accountant

The journal entry for the above voucher will be as under :-

Old Partners Capital A/c Rs.

To Revaluation A/c

(Being the amount of loss on revaluation is
distributed amongst old partners in old ratio).

Adjustments for reserves and Accumulated Profit or Losses

Sometimes, a firm may have reserves and/or some accumulated profits or losses on the date of admission of a new partner. The incoming partner is not entitled to any share in such accumulated balances of the firm. Hence, these balances appearing in the form of reserve or profit and loss account should be transferred to the capital accounts of the old partners in their old profit sharing ratio.

For this purpose, a transfer voucher is prepared debiting relevant reserve and accumulated profit and crediting the capital A/cs of the old partners by their respective shares in old ratio. In case, of accumulated loss, i.e., debit balance of profit and loss Account, partners' (old) capital accounts are debited and Accumulated loss A/c i.e., profit and loss A/c (Dr. balance) is credited.

Let us make clear the above adjustments with the help of the following illustration :

ILLUSTRATION 11

Ram and Mohan are partners, sharing profits and losses in the ratio of 3 : 1. Ram's Capital is Rs.60,000 and Mohan's Capital is Rs.20,000. They agreed to admit Sohan into the Partnership firm. At the time of Sohan's admission, there was a General Reserve for Rs.20,000 appearing in the Balance Sheet of the firm.

Following revaluation of assets and liabilities took place :-

- i) Building was appreciated by Rs.25,000.
- ii) Machinery was depreciated by Rs.10,000
- iii) Provision for Rs.1500 was made for an outstanding bill for repairs.
- iv) An item of Rs.2,000 which was included in creditors is not likely to arise. You are required to make the
 - a) Accounting Vouchers.
 - b) Revaluation A/c.
 - c) Partners' Capital A/cs.

Solution

(a) Accounting Vouchers

(i) Building was appreciated by Rs.25,000/-

For increase in Assets

M/s. Ram & Mohan		Date _____
Voucher No. 01		Amount (Rs.)
Debit	Building A/c	25,000
		25,000
Credit	Revaluation A/c (Being the amount of increase in the value of Building Credited to Revaluation A/c.)	25,000
		25,000
Sd/- Manager		Sd/- Accountant

- (ii) Machinery was depreciated by Rs.10,000/-.

For decrease in Assets

M/s. Ram & Mohan		Date _____
Voucher No. 02		Amount (Rs.)
Debit	Revaluation A/c	10,000
		10,000
Credit	Machinery A/c (Being the amount of decrease in the value of Machinery debited to Revaluation A/c.)	10,000
		10,000
Sd/- Manager		Sd/- Accountant

- (iii) A provision for Rs.1,500 for an outstanding bill for repairs.

For increase in Liabilities.

M/s. Ram & Mohan		Date _____
Voucher No. 03		Amount (Rs.)
Debit	Revaluation A/c	1,500
		1,500
Credit	Outstanding Repairs A/c (Being a provision made for repair bill)	1,500
		1,500
Sd/- Manager		Sd/- Accountant

- (iv) An item of Rs.2,000 which was included in creditors is not likely to arise.

For decrease of Liabilities

M/s. Ram & Mohan		Date _____
Voucher No. 04		Amount (Rs.)
Debit	Creditors A/c	2,000
		2,000
Credit	Revaluation A/c (Being the amount of decrease in creditors credited to Revaluation A/c.)	2,000
		2,000
Sd/- Manager		Sd/- Accountant

Revaluation Account

Particulars	V. No.	Amount Rs.	Particulars	V. No.	Amount Rs.
To Machinery A/c	02	10,000	By Building A/c	01	25,000
To Outstanding Repair Bill	03	1,500	By Creditors	04	2,000
To Profit transferred to Capital A/cs of -	05				
Ram 11,625					
Mohan 3,875		15,500			
		27,000			27,000

For the distribution of Profit on Revaluation

M/s. Ram & Mohan		Date
Voucher No. 5		Amount (Rs.)
Debit	Revaluation A/c	15,500
		15,500
Credit	Ram's Capital A/c	11,625
	Mohan's Capital A/c	3,875
	(Being the amount of Profit on Revaluation credited to old partners A/cs in the old ratio)	15,500
Sd/- Manager		Sd/- Accountant

For distribution of General Reserve

M/s. Ram & Mohan		Date
Voucher No. 6		Amount (Rs.)
Debit	General Reserve A/c	20,000
		20,000
Credit	Ram's Capital A/c	15,000
	Mohan's Capital A/c	5,000
	(Being the amount of General Reserve transferred to partners' capital A/cs in old ratio)	20,000
Sd/- Manager		Sd/- Accountant

Ram's Capital A/c

Particulars	F	Amount Rs.	Particulars	F	Amount Rs.
		/	By Balance b/d		60,000
			By General Reserve		15,000
			By Revaluation A/c-profit		11,625
To Balance c/d		86,625			
		86,625			86,625
			By Balance b/d		86,625

Mohan's Capital A/c

Particulars	F	Amount Rs.	Particulars	F	Amount Rs.
		/	By Balance b/d		40,000
			By General Reserve		5,000
			By Revaluation A/c-profit		3,875
To Balance c/d		48,875			
		48,875			48,875
			By Balance b/d		48,875

INTEXT QUESTIONS 23.4

A. Fill in the blanks with suitable word or words:

- i) Revaluation A/c is debited for an increase in the value of _____.
- ii) Revaluation A/c is credited for an increase in the value of _____.
- iii) Profits on revaluations is debited to _____ and is credited to _____ partners' Capital A/cs in _____ ratio.
- iv) General Reserve should be distributed amongst the old partners in _____.
- v) A _____ voucher is prepared for the adjustment of debit balance of Profit & Loss A/c.

B. During the process of revaluation of assets and liabilities, the following changes are recorded. Specify to which side of the Revaluation A/c will these be recorded?

Transaction	Revaluation Account	
	Debit	Credit
i) Value of furniture is increased by Rs.20,000.		
ii) An unexpected claim of Rs.5,000 arises.		
iii) Machinery is depreciated by Rs.25,000.		
iv) In the books of accounts, building is valued at Rs.1,00,000. On revaluation it is found that the value of the building is Rs.1,75,000.		
v) One of creditor has given the concession to pay Rs.5,000 instead of Rs.5,500.		

23.7 ADJUSTMENT IN CAPITAL

Capital of partners may or may not be in profit sharing ratio. Sometimes, the partners agree to adjust their capitals on admission of a new partner to make them in profit sharing ratio. For this purpose, the capital accounts of the old partners are prepared, making therein all the adjustments necessitated by the admission of a new partner, e.g., of goodwill, general reserves, increase or decrease in values of assets and liabilities and so on. The actual capital will, then, 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 actual capital over the estimated 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 old partners' capital accounts.

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

Sometimes the capital to be brought by the new partner is not known. He/She is required to bring an amount proportionate to his/her share to profit. In such a case, we take the following steps to find out the capital of new partner/s.

Steps

- i) The new capitals of old partners are calculated after making adjustments with regard to goodwill, general reserve or any undistributed profit,

the result of revaluation of assets and liabilities or any other adjustments regarding capitals.

- ii) On the basis of newly arrived capitals of old partners the total new capital of the firm is calculated.
- iii) On the basis of total capital of the new firm, the share of new partner is calculated.

Let us understand it with the help of following illustration:

ILLUSTRATION 12

X and Y are partners in a business sharing profits and losses equally. Their original capitals were Rs.15,000 and Rs.10,000 respectively. They admit a new partner Z with 1/5th share in the profits. The revaluation of assets and liabilities show a profit of Rs.5,000. Goodwill has been valued at Rs.10,000. Z is required to bring proportionate capital. Show how much capital Z should bring.

Solution:

Steps

- i) New Capitals of X and Y

	X Rs.	Y Rs.
Original Capital	15,000	10,000
Profit on Revaluation	2,500	2,500
Goodwill	5,000	5,000
New Capitals	22,500	17,500

- ii) Total Capital of new firm

Total new capitals of X and Y is Rs.22,500 + Rs.17,500 = Rs.40,000. This is their capitals for 4/5th share (i.e., 1-1/5th Z's share) in the profits. Thus, the capital of the new firm should be:

If capitals for 4/5th part is = Rs.40,000

then full capital will be = Rs.40,000 × 5/4 = Rs.50,000.

- iii) Z's share

Z's capital = Rs.50,000 × 1/5th = Rs.10,000.

Firm's total capital = Rs.50,000

X's capital = Rs.22,500

Y's capital = Rs.17,500

Z's capital = Rs.10,000

II. Adjustment of old partners' capital on the basis of the capital of the new partner

The new partner may bring a fixed sum by way of capital and the capitals of the old partners may have to be adjusted on the basis of capital brought in by new partner. In such a case, we take the following steps to adjust the capitals:

- i) Find out the actual capitals of old partners

The Capital accounts of the old partners will have to be prepared after making all the adjustments necessitated by the admission of the new partner, e.g., for goodwill, reserves, accumulated profits or losses, etc. The capitals so calculated are known as their "Actual capitals".

- ii) Find out the required capitals of old partners

On the basis of the capital of the new partner, the required capitals of the old partners are calculated according to their profit sharing ratio.

For example, if Chetan brings in Rs.20,000 as capital and the new profit ratio is 5:4:1 amongst Ajit, Bishamber and Chetan respectively, then the capital adjustment will be as follows:

Partners	Ratio	Capital	
Ajit	5	1,00,000	(required)
Bishamber	4	80,000	(required)
Chetan	1	20,000	(given)
		2,00,000	

Here Ajit and Bishamber's capitals have been calculated on the basis of Chetan's capital.

- iii) Find out the surplus or Deficit in the capitals of old partners.

If actual capital is more than the required capital, the difference is called "Surplus". On the other hand, if required capital is more than the actual capital the difference is called "Deficit".

- iv) Accounting Treatment of Surplus or Deficit.

Any surplus in the capitals of old partners may either be withdrawn by such partners or may be transferred to their current account. If withdrawn, capital accounts of partners are debited and cash or bank account is credited by the amount of surplus. A debit voucher is prepared for this purpose as follows:

Accounting Treatment of Deficit

Any deficit in the capitals of old partners will be updated by bringing additional capital in cash. A credit voucher is prepared for this purpose as follows :-

Name of the Firm.....		
Voucher No. _____		Date _____
		Amount (Rs.)
Credit	Partners' Capital A/cs Being the amount of deficiency of capital brought in.	
Sd/- Manager		Sd/- Accountant

The journal entry for the above credit voucher will be as under:

Cash or Bank A/c Dr.

To Partners' Capital A/cs

(Being the amount of deficiency in capital brought in)

Illustration 13

Abhay and Bandhu share profits in the ratio of 3:2 and have a capital of Rs.40,000 and Rs.25,000 respectively. They admit a new partner Chinoy. The new profit sharing ratio of Abhay, Bandhu and Chinoy is 2:2:1 respectively. Chinoy is required to bring Rs.15,000 as capital. The loss of revaluation of assets and liabilities is Rs.5,000. It is agreed that capitals of partners should be in the new profit sharing ratio.

Solution :

1. Actual Capital of Abhay and Bandhu

	Abhay	Bandhu
Original capitals	40,000	25,000
Less. loss on revaluation	3,000	2,000
Actual capitals	<u>37,000</u>	<u>23,000</u>

2. Adjustments of Capitals.

Actual Capital	Required Capital	Result	Treatment
Abhay Rs.37,000	$15,000 \times 5/1 \times 2/5$ =Rs.30,000	surplus of Rs.7,000, i.e., (37,000-30,000)	Rs.7,000 may be with- drawn by Abhay or may be credited to his current A/c.
Bandhu Rs.23,000	$15,000 \times 5/1 \times 2/5$ = Rs.30,000	deficit of Rs.7,000, i.e., (30,000-23,000)	Bandhu may be asked to bring Rs.7,000 to cover his deficiency or his current A/c may be debited with this amount.

or

Chinoy's Capital = Rs.15,000 which is 1/5th share of total capital. Thus, total capital will be $15,000 \times 5/1 = 75,000$

Abhay's Capital will be $75,000 \times 2/5 = 30,000$

Bandhu's Capital will be $75,000 \times 2/5 = 30,000$

INTEXT QUESTIONS 23.5

Ajay and Vijay are partners. They admit Surbhi as a new partner. Their new profit sharing ratio is 3:2:1. The new capitals of Ajay and Vijay are Rs.4,00,000 and Rs.2,00,000 respectively.

Calculate :

- Total new capital of the new firm _____
 - Surbhi's share of capital _____
-

Some more illustrations

In the earlier sections of this lesson, you have learnt how goodwill is recorded in the books at the time of admission of a partner, how the treatment of revaluation of assets and liabilities takes place and how capital adjustments are recorded. Let us now take some more illustrations:

ILLUSTRATION 14

The following was the Balance Sheet of Vineet and Puneet who were sharing profit and loss in the ratio of 2:1 on 31st Dec., 1997:-

Balance Sheet
as at 31.12.97

Liabilities	Rs.	Assets	Rs.
Creditors	6,59,000	Buildings	5,00,000
General Reserve	3,00,000	Plant & Machinery	3,50,000
Capitals :		Stock	2,00,000
Vineet 3,00,000		Debtors	97,000
Puneet <u>2,00,000</u>	5,00,000	Cash in hand	12,000
		Bank	3,00,000
	<u>14,59,000</u>		<u>14,59,000</u>

On 1st January, 1998 Sumeet was admitted into partnership on the following terms :-

- (a) Sumeet was to bring Rs.1,50,000 as his capital and Rs.60,000 as goodwill for 1/4th share in the firm.
- (b) that the values of the stock and plant & machinery were to be reduced by 5%.
- (c) that a Reserve of Rs.7,500 was to be created in respect of Sundry Debtors.
- (d) that the Building Account was to be appreciated by 10%.
- (e) that goodwill money was to be retained in the business.

Prepare Revaluation Account, Partner's Capital Accounts and the Balance Sheet of the New Firm.

Solution

Revaluation Account

Dr.	Amount Rs.	Cr.	Amount Rs.
To Stock A/c	10,000	By Building A/c	50,000
To Plant and Machinery A/c	17,500		
To Reserve for Bad Debts A/c	7,500		
To Profit			
Vineet's Capital A/c 10,000			
Puneet's Capital A/c <u>5,000</u>	15,000		
	<u>50,000</u>		<u>50,000</u>

Note :

- Increase in assets is shown on credit side.
- Decrease in assets and increase in liabilities is shown on debit side.
- Profit is distributed among old partners in their old profit sharing ratio.

Vineet's Capital Account

Dr.

Cr.

Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
					1997 Dec.31		By Balance b/d		3,00,000
					Dec.31		By General- Reserve A/c		2,00,000
					Dec.31		By Sumeet's Capital A/c i.e. (Rs. $60000 \times \frac{2}{3}$ = Rs.40,000		40,000
							By Revalua- tion A/c		10,000
1997 Dec- 31		To Balance c/d		5,50,000					
				5,50,000					5,50,000
					1998 Jan.1		By Balance b/d		5,50,000

Note :

- General Reserve is divided between old partners in old profit sharing ratio.
- Rs.60,000 has been brought by Sumeet as goodwill which are divided between old partners in their Sacrificing ratio.

Puneet's Capital Account

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
				/	1997		By Balance b/d		2,00,000
					Dec.31				
					Dec.31		By General Reserve		1,00,000
					Dec.31		By Sumeet's Capital A/c i.e. (Rs.60,000×1/3 = Rs.20,000)		20,000
					Dec.31		By Revaluation A/c		5,000
		To Balance c/d		3,25,000					
				3,25,000					3,25,000
					1998		By Balance b/d		3,25,000
					Jan.1				

Sumeet's Capital Account

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1998		To Vineet's Capital A/c		40,000	1998		By Cash A/c		2,10,000
Jan.1					Jan.1				
Jan.1		To Puneet's Capital A/c		20,000					
Jan.1		To Balance c/d		1,50,000					
				2,10,000					2,10,000
					1998		By Balance b/d		1,50,000
					Jan.2				

New Balance Sheet As on 1st Jan. 1998.....

Liabilities	Rs.	Assets	Rs.
Creditors	6,59,000	Buildings	5,50,000
Capitals		Plant & Machinery	3,32,500
Vineet 5,50,000		Stock	1,90,000
Puneet 3,25,000		Debtors	89,500
Sumeet 1,50,000	10,25,000	Cash in hand	2,22,000
		Bank	3,00,000
	16,84,000		16,84,000

Note :

- All assets and liabilities will be shown at Changed Values.
- Sumeet has brought Rs.2,10,000 into business as cash. Thus the cash balance is increased by Rs.2,10,000

ILLUSTRATION 15

The following was the Balance Sheet of Mohit and Sumeet who were sharing profits in the ratio of 2:1 on 31st December, 1996.

Liabilities		Amount Rs.	Assets	Amount Rs.
Creditors		65,900	Cash in hand	1,200
Capitals			Debtors	9,700
Mohit	30,000		Stock	20,000
Sumeet	<u>20,000</u>	50,000	Plant	35,000
			Buildings	50,000
		<u>1,15,900</u>		<u>1,15,900</u>

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

- Shyam was to be given 1/3rd share in profits and was to bring Rs.15,000 as his capital and Rs.6,000 as his share of goodwill.
- That the values of stock and plant were to be reduced by 10%.
- that the provision of 5% was to be created for Doubtful Debts.
- that the Building Account was to be appreciated by Rs.9,600.
- Investments worth Rs.400 (not mentioned in the Balance Sheet) were to be taken into account.
- that the goodwill amount brought by Shyam was to be withdrawn by the old partners.

Prepare Revaluation Account, Capital Accounts and Balance Sheet of the three partners.

Solution

Revaluation Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Stock A/c	2,000	By Building A/c	9,600
To Plant A/c	3,500	By Investments A/c	400
To Provision for Bad Debts A/c	485		
To Profits			
Mohit's Capital A/c	2,677		
Sumeet's Capital A/c	1,338		
	4,015		
	10,000		10,000

Mohit's Capital Account

Dr.				Cr.			
Date	V. N.	Particulars	F Amount Rs.	Date	V. N.	Particulars	F Amount Rs.
1996		To Cash A/c	4,000	1996		By Balance b/d	30,000
			/	Dec.31		By Revaluation A/c	2,677
			/	Dec.31		By Shyam's Capital A/c i.e. (Rs.6,000×2/3 =Rs.4,000)	4,000
Dec.31		To Balance c/d	32,677				36,677
			36,677				
				1997		By Balance b/d	32,677
				Jan.1			

Sumeet's Capital A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1996 Dec.31		To Cash A/c		2,000	1996 Dec.31		By Balance b/d		20,000
					Dec.31		By Revaluation A/c		1,338
					Dec.31		By Shyam's Capital A/c i.e. (Rs.6,000×1/3 = Rs.2,000)		2,000
Dec.31		To Balance c/d		21,338					
				23,338					23,338
					1997 Jan.1	1	By Balance b/d		21,338

Shyam's Capital A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1996 Dec.31		To Mohit's Capital A/c		4,000	1996 Dec.31		By Cash A/c		21,000
Dec.31		To Sumeet's Capital A/c		2,000					
Dec.31		To Balance c/d		15,000					
				21,000					21,000
					1997 Jan.1		By Balance b/d		15,000

Cash A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1996 Dec.31		To Balance b/d		1,200	1996 Dec.31		By Mohit's Capital A/c		4,000
Dec.31		To Shyam's Capital A/c		21,000	Dec.31		By Sumeet's Capital A/c		2,000
					Dec.31		By Balance c/d		16,200
				22,200					22,200
1997 Jan.1		To Balance b/d		16,200					

**New Balance Sheet
As on 31 Dec.1986**

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	65,900	Cash	16,200
Capitals		Debtors	9,215
Mohit 32,677		Stock	18,000
Sumeet 21,338		Plant	31,500
Shyam <u>15,000</u>	69,015	Buildings	59,600
		Investment	400
	<u>1,34,915</u>		<u>1,34,915</u>

ILLUSTRATION 16

The following was the Balance Sheet of A, B and K sharing profits and losses in the proportion of 6/14, 5/14 and 3/14 respectively:-

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	18,900	Land & Building	50,400
Bills payable	6,300	Furniture	7,350
Capital Accounts:		Stock	29,400
A 39,900		Debtors	26,460
B 33,600		Cash	1,890
K <u>16,800</u>	90,300		
	<u>1,15,500</u>		<u>1,15,500</u>

They agree to take D into partnership and give him 1/8th share on the following terms:-

- (i) that D should bring in Rs.14,700 as his capital.
- (ii) that furniture be depreciated by Rs.920.
- (iii) that stock be depreciated by 10%.
- (iv) that a reserve of Rs.1,320 be made for outstanding repair bill.
- (v) that the value of land and building having appreciated be brought upto Rs.65,100.
- (vi) that goodwill account be raised at Rs.8,820 and be adjusted in old partner's capital accounts.

- (vii) that the capital A/cs of all the partners be adjusted on the basis of their profit sharing ratio arrangement.

Prepare Revaluation Account, Capital Accounts, Cash Account and Opening Balance Sheet of the firm as newly constituted.

Solution

Revaluation Account

Dr.		Cr.	
Particulars	Amount Rs.	Particulars	Amount Rs.
To Furniture A/c	920	By Land & Buildings A/c	14,700
To Stock A/c	2,940		
To Outstanding repair A/c	1,320		
To Profit :			
A's Capital A/c	4,080		
B's Capital A/c	3,400		
K's Capital A/c	2,040		
	14,700		14,700

A's Capital A/c

Dr.				Cr.			
Date	V. N.	Particulars	F Amount Rs.	Date	V. N.	Particulars	F Amount Rs.
1997 Dec31		To Cash A/c	3,660	Dec.31		By Balance b/d	39,900
			/	Dec.31		By Revaluation A/c	4,080
			/	Dec.31		By Goodwill A/c	3,780
Dec.31		To Balance c/d	44,100				/
			47,760				47,760
						By Balance b/d	44,100

B's Capital A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1997 Dec31		To Cash A/c		3,400	1997 Dec31		By Balance b/d		33,600
				/	1997 Dec31		By Revaluation A/c		3,400
Dec31		To Balance c/d		36,750	1997 Dec31		By Goodwill A/c		3,150
				40,150					40,150
					1998 Jan.1		By Balance b/d		36,750

K's Capital A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
				/	1997 Dec.31		By Balance b/d		16,800
					1997 Dec.31		By Revaluation A/c		2,040
1997 Dec.31		To Balance c/d		22,050	1997 Dec.31		By Goodwill A/c		1,890
				22,050	1997 Dec.31		By Cash A/c		1,320
									22,050
					1998 Jan.1		By Balance b/d		22,050

D's Capital A/c

Dr.					Cr.				
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1997 Dec31		To Balance c/d		14,700	1997 Dec.31		By Cash A/c		14,700
				14,700					14,700
					1998 Jan.1		By Balance b/d		14,700

Cash Account

Dr.				Cr.					
Date	V. N.	Particulars	F	Amount Rs.	Date	V. N.	Particulars	F	Amount Rs.
1997 Dec.31		To Balance b/d		1,890	1997 Dec.31		By A's Capital A/c		3,660
Dec.31		To D's Capital A/c		14,700	Dec.31		By B's Capital A/c		3,400
Dec.31		To K's Capital A/c		1,320	Dec.31		By Balance c/d		10,850
				17,910					17,910
1988 Jan.1		To Balance b/d		10,850					

New Balance Sheet

As on 31 Dec.1997

Dr.		Cr.	
Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	18,900	Cash	10,850
Bills Payable	6,300	Stock	26,460
Outstanding		Debtors	26,460
Repair Bill	1,320	Furniture	6,430
Capitals		Building	65,100
A	44,100	Goodwill	8,820
B	36,750		
K	22,050		
D	14,700		
	1,17,600		
	1,44,120		1,44,120

ILLUSTRATION 17

Ajay and Vijay are in partnership sharing profits in proportion of $\frac{3}{5}$ and $\frac{2}{5}$ respectively. Their Balance Sheet is as follows :

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital Accounts		Cash	65,000
Ajay 2,00,000		Debtors 1,00,000	
Vijay 1,00,000	3,00,000	Less Reserve 40,000	60,000
Creditors	40,000	Stock	1,50,000
		Plant	65,000
	3,40,000		3,40,000

They decide to admit Pradeep to $\frac{1}{3}$ rd share upon the terms that he is to pay into the business Rs.1,00,000 goodwill and $\frac{1}{3}$ rd of the total capital of the new firm. It was agreed that the Reserve for Bad Debts be reduced to Rs.10,000 and the stock be revalued at Rs.2,00,000 and that the Plant value be reduced to Rs.50,000.

Prepare the Balance Sheet of the new firm.

Solution :

Balance Sheet
(New Firm)

Liabilities	Amount Rs.	Assets	Amount Rs.
Capitals :		Cash	3,97,500
Ajay 2,99,000		Debtors 1,00,000	
Vijay 1,66,000		Less Reserve 10,000	90,000
Pradeep 2,32,500	6,97,500	Stock	2,00,000
Creditors	40,000	Plant	50,000
	7,37,500		7,37,500

Working Notes**(i) New Profit Sharing Ratio**

Let total Profit	=		1
Pradeep's share	=		1/3
(Ajay + Vijay)'s Share = $1 - \frac{1}{3}$	=		2/3
New Share of			
Ajay		$= \frac{2}{3} \times \frac{3}{5} = \frac{6}{15}$	
Vijay		$= \frac{2}{3} \times \frac{2}{5} = \frac{4}{15}$	
New Share of			
AJAY	VIJAY	PRADEEP	
6/15:	4/15:	1/3	
OR	6:	4:	5

(ii) Pradeep's Capital is calculated as follows :-

New Capital of -

Ajay	2,99,000
Vijay	1,66,000

Total New Capital of

Ajay & Vijay = Rs.2,99,000 + Rs.1,66,000 = Rs.4,65,000

Capital for 10/15 share = Rs.4,65,000

Capital for 1 share = $\frac{\text{Rs.4,65,000} \times 15}{10}$ Capital for 5/15 shares = $\text{Rs.4,65,000} \times \frac{15}{10} \times \frac{5}{15} = \text{Rs.2,32,500}$

Prepare the Revaluation Account and Capital Accounts in the same way as in previous example

23.8 WHAT YOU HAVE LEARNT

- While admitting a new partner to the partnership, various adjustments are required to be made.

These adjustments are related to :-

- profit sharing ratio;

- goodwill;
 - revaluation of assets and liabilities;
 - reserves and accumulated profits/losses;
 - capital.
- Goodwill may either be brought in by new partner in cash or goodwill account may be raised in the books of the firm.
 - While revaluating the assets and liabilities, increase in assets and decrease in liabilities are credited in Revaluation A/c and decrease in assets and increase in liabilities are debited to Revaluation A/c.
 - Accumulated or undistributed profit is transferred to old partners capital accounts in their old profit sharing ratio.
 - Capital of the new firm is calculated either on the basis of new partner's capital and his profit sharing ratio or on the basis of old partners' capitals.

23.9 TERMINAL QUESTIONS

1. State the meaning of Sacrificing Ratio.
2. Give the meaning of Goodwill and list the main methods of valuing goodwill.
3. What is the accounting treatment of goodwill when it is paid privately?
4. Explain the methods of recording goodwill on the admission of a partner under the following circumstances:
 - (a) when the new partner brings his share of goodwill in cash.
 - (b) when the new partner does not bring the goodwill in cash and goodwill account is raised in the books at the time of admission of a partner.
5. Explain 'Revaluation Account'. What is the objective of such an account? How is the balance of this account dealt with?
6. You are required to prepare the necessary vouchers to adjust goodwill in the following cases :

H and K are partners in a firm sharing profit and losses in the ratio of 3:2. They decide to take G in the firm giving him 1/4th share in the profit and loss. The goodwill of the firm is valued at Rs.12,000.

 - (i) If G gives his share of goodwill in cash to the old partners privately.

- (ii) If the amount of goodwill remains in the firm as extra capital.
- (iii) If the old partners draw the amount of goodwill.
7. Make the necessary vouchers to adjust goodwill in the following cases:-
- (a) Sunil and Anil are partners sharing profits in the ratio of 3:2. Rakesh is admitted paying a goodwill of Rs.2,000 for 1/4th share of the profits, shares of Sunil and Anil remaining as before. No goodwill account appears in the books.
- (b) Raja and Rana are partners sharing profits in the ratio of 3:2. Dinu is admitted paying a goodwill of Rs.2,400 for 1/4th share of profits 1/6th of which he acquires from Raja and 1/12th from Rana. No goodwill appears in the books.
8. On the admission of Rao, it was agreed that the goodwill of Murty and Shah should be valued at Rs.30,000. Rao is to get 1/4 th share of profits. Previously Murty and Shah shared profits in the ratio of 3:2. Rao cannot bring cash. Make the necessary vouchers in the books of Murty and Shah When -
- (a) there is no goodwill account.
- (b) goodwill appears at Rs.10,000 and
- (c) goodwill appears at Rs.40,000.
9. Raja and Roop are partners sharing profits in the ratio of 2:1. They admit Tilak into partnership. The Balance Sheet of Raja and Roop on the day of admission was as under.

Liabilities	Amount Rs.	Assets	Amount Rs.
CAPITALS:-		Cash at Bank	62,500
Raja	6,25,000	Stock in hand	5,00,000
Roop	3,75,000	Debtors	3,12,500
Creditors	4,70,000	Plant	2,50,000
General Reserve	30,000	Premises	3,75,000
Total	15,00,000	Total	15,00,000

- (i) Tilak is to bring Rs.4,00,000 for his capital.
- (ii) They agree to revalue the assets as under:-

Stock on hand Rs.4,50,000 Plant Rs.1,80,000 Premises Rs.5,00,000 and provision of 5% for doubtful debts is to be maintained. You are required to:-

- (a) Prepare Revaluation and Capital Accounts of Raja and Roop.
- (b) Prepare the new Balance Sheet after the admission of Tilak.

10. Rahul and Vicky are partners in a business sharing profits and losses in the ratio of 3:2. They admit Nitin into partnership. On the date of Nitin's admission it is decided to revalue the assets and liabilities as follows:-

- (a) Building, Plant and Stock to be increased by Rs.5,000, Rs.3,000 and Rs.2,000 respectively.
- (b) A provision for bad debts is to be created for Rs.1,000.
- (c) Sundry creditors to be increased by Rs.1,000.

You are required to make

- (i) the necessary journal entries for revaluing the assets and liabilities.
- (ii) Revaluation Account.

23.10 ANSWERS TO INTEXT QUESTIONS

- 23.1 I. (i) new; old; (ii) sacrificing ratio;
(iii) same/intact; (iv) proportion.
- II. Sacrificing ratio 3:2
- III. (i) Sacrificing ratio 3:2
(ii) Sacrificing ratio 1:1 or equal
(iii) Sacrificing ratio 1:1 or equal
- 23.2 I. (i) profit; (ii) new/incoming;
(iii) Average profit, Super Profit and Capitalisation;
(iv) Super Profit; (v) total liabilities.
- II. (i) Average Profit Rs.6,500/-
(ii) Goodwill Rs.19,500/-

- III. A. Super Profit Rs.500/-
 B. (i) Actual Profit
 (ii) Net Assets.
- 23.3 A 1. III 2. II
 3. IV 4. I
- B. (i) Rs.40,000-No. Voucher
 (ii) Rs.1,00,000 - Transfer Voucher - Rs.20,000 and RS.20,000
 (iii) Rs.1,00,000 - Transfer Voucher - Rs.1,00,000 and Rs.1,00,000
 (iv) Rs.1,00,000 - Transfer Voucher - Rs.30,000 and Rs.30,000
 (v) Rs.30,000 - Transfer Voucher - Rs.30,000 and Rs.30,000
 (vi) Rs.30,000 - Debit Voucher - Rs.30,000 only debit.
- 23.4 A. (i) liabilities; (ii) assets
 (iii) revaluation A/c, old, old (iv) old ratio
 (v) transfer
- B. (i) credit side (ii) debit side
 (iii) debit side (iv) credit side
 (v) credit side
- 23.4 A. (a) Rs.7,20,000 (b) Rs.1,20,000