FYBCOM
Subject: Accountancy - I

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UNIT -1

ADMISSION OF A PARTNER

Introduction

- Definition

According to Section 4 of the Partnership Act 1932,

“ Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all,”

Four essentials

1. There must be an agreement entered into by all the persons

   minimum 2 members are required and maximum 20 (in case of a banking business not more than 10)
2. There must be a business- trade, profession or occupation.
3. It must be carried on for the purpose of earning profits.
4. It is principal-agent relationship.

Why the admission of a new partner?

- To obtain additional capital, managerial expertise or some other facility.

Problems on admission of a new partner

1. Calculation of new profit-sharing ratio.
2. Calculation of sacrificing ratio.
3. Revaluation of assets and liabilities
4. Adjustment regarding accumulated reserves, profit or losses.
5. Adjustment regarding goodwill of the firm.
6. Adjustment regarding capitals

Calculation of New Profit-sharing Ratio

- Case 1: if the question states the share of the new partner then the presumption is that remaining profit must be shared by the old partners in the old ratio.

  Ex.1 X and Y are partners sharing profits in the ratio of 7:3. Z was admitted on 3/7ths share in the profits. Calculate new profit sharing ratio of the partners.

Calculation of New Profit-sharing Ratio

- Case 2: in certain case new partner purchase his share from other partners in a particular ratio. In that case old partners' new share will be determined by deducting that proportion which he has surrendered in favour of the new partner.
- Ex.2, X and Y sharing the profits in the ratio of 7:3 admit Z on $3/7^{th}$ share in the new firm which he takes $2/7^{th}$ from X and $1/7^{th}$ from Y. calculate new ratio.

Calculation of New Profit-sharing Ratio

- Case 3: in certain cases, old partners surrender a particular fraction of their shares in favour of a new partner.
- In that case, what has been surrendered is to be calculated and then same must be deducted from old partner's share to get his new share.
- New partner's share will be the total of all that has been surrendered by all the old partners.

Calculation of New Profit-sharing Ratio

- Ex. 3, A and B are partners in a firm sharing profits and losses in the ratio of 3:2. A new partner C is admitted. A surrenders 1/5th share of his profit and B 2/5th of his share in favour of C. calculate new profit sharing ratio.

Calculation of sacrificing ratio

- This is the ratio in which old partners have agreed to sacrifice some of their old shares in favour of the new partner.
- It is computed to determine the amount of compensation payable by the new partner to the old partners who have sacrificed their shares in his favour.
- Sacrifice ratio= old ratio- new ratio.

Revaluation of assets and liabilities

It takes two forms:

1. When revised values are to be recorded in the books.

   - adjustments are done with the help of the Revaluation Account or Profit and Loss Adjustment Account.

   - Journal entries are done.

   - then Revaluation a/c is prepared.

Revaluation of assets and liabilities Revaluation Account

- To decrease in the value of assets

- By increase in the value of the assets

Revaluation of assets and liabilities

2. When revised values are not to be recorded in the books.

- All entries passed through Revaluation a/c are reversed and t gives a rise to Memorandum Revaluation A/c.

Adjustment regarding accumulated reserves, profit or losses

- It is essential to close all reserves, accumulated profits and losses by transferring them to old partners in their old profit sharing ratio.

Adjustment regarding Goodwill of the firm

- Two Methods of valuing goodwill

1. Simple profit Method

   Goodwill=Average profit * Number of years

2. Super Profit Method

   Super profit= Average profit- Normal Profit

Ex of Simple Profit

- X and Y are sharing the profits equally. They admit Z for 1/3rd share in the business. Z will pay the amount of goodwill in cash. The profit of the last three years are Rs.5,000, Rs.10,000 and Rs.15,000 respectively. Calculate the value of goodwill based on two years purchase of last three years average profit.

Adjustment regarding Goodwill of the firm

- (a) Purchase of Super Profit Method:

  goodwill= Super Profit * no. of years

- (b) Capitalization of Super Profit:

  Goodwill= Super Profit * 100/ Normal rate of profit

Ex of Super Profit

- X and Y are sharing the profits equally. They admit Z for 1/3rd share in the business. Z will pay the amount of goodwill in cash. The profit of the last three years are Rs.5,000, Rs.10,000 and Rs.15,000 respectively. Normal profit of the firm is Rs.6,000.Calculate the value of goodwill based on three years purchase of Super profit. If the normal rate of return is 10%, then calculate the value of goodwill as per Capitalization of Super Profit Method.

Adjustment regarding Goodwill of the firm

- Methods for treatment of Goodwill at Admission

1. Revaluation method
2. Memorandum Revaluation method
3. Premium method
4. Alternative method

Revaluation method

1. The amount of full goodwill of the firm is calculated.
2. The difference between the full amount of goodwill so calculated and the amount of goodwill already shown in the balance sheet is found out.
3. The entry for difference is made.
4. Goodwill a/c is debited and Old partners' capital a/cs are credited in the old profit sharing ratio.

Memorandum Revaluation Method

- The amount of goodwill is first raised as discussed under Revaluation Method and then it is written off among all partners (including new partner) in the new profit sharing ratio.
- Capital a/cs of all the partners are debited and goodwill a/c is credited.

Premium Method

- It is adopted when the new partner brings in cash the amount equal to his share of goodwill.
- It can take two forms

1. When the amount of premium is paid privately, no journal entry is required.
2. When the amount of premium is retained in the business, two journal entries are required.

   if amount of premium is withdrawn by old partners, journal entry s required.