

Admission of Partner

It means reconstitution of the firm whereby Inclusion of a person as a partner to an existing partnership firm is called admission of a partner. When a firm requires additional capital or managerial help or both for the expansion of its business, a firm can admit a person as a partner to an existing firm. The new person admitted is called as incoming partner. On admission, old partnership agreement comes to an end and with a new agreement the business will continue.

According to Partnership Act, 1932, a person can be admitted as a new partner with the consent of all the existing partners. Usually a new partner is admitted when the firm needs additional capital or managerial help or both.

While admitting a new partner he acquires the right to share the assets of the firm and to share the future profits of the firm. **In order to get the first right the new partner has to bring an agreed amount of capital and for acquiring the second right he has to bring his share of goodwill (also called premium) which will be shared among the old partners, as they sacrifice a part of their profit in favor of the incoming partner.**

- **Effects of admission of a Partner:** Following are the effects of admission of a new partner:
 - i. New partnership comes into existence.
 - ii. Old partnership comes to an end but the firm continues.
 - iii. New partner is entitled to share of future profits.
 - iv. The combined share of old partners gets reduced.
 - v. New partner contributes an agreed amount towards the capital of the firm.
 - vi. To increase the goodwill and reputation of the business by taking a reputed and renowned
 - vii. Incoming partner is entitled to the rights in the assets of the firm and also liable for the liabilities
 - viii. To encourage a capable employee by taking him into the partnership.
 - ix. To expand and boost up the business.
 - x. To reduce the competition.
- **Rights and liabilities of the newly admitted partner:**
 - When a partner is newly admitted into the partnership, the new partner gets the following rights:
 - i. Right to share the future profits of the firm, and
 - ii. Right to share in the assets of the firm.

- At the same time, the newly admitted partner becomes liable for any liability of the business incurred after his admission and any loss incurred by the firm.

Accounting Treatment

At the time of reconstitution of firm due to admission of a partner, the right, duties and obligation of partners are necessary to be change then following accounting adjustment to be required in the books of firm

- (1) Determination of New profit sharing Ratio
- (2) Determination of sacrificing ratio and gaining ratio.
- (3) Valuation of goodwill and Accounting for goodwill.
- (4) Accounting treatment of reserves and accumulated profits.
- (5) Accounting for revaluation of assets and liabilities.
- (6) Adjustment of capitals.

Ascertainment of New Ratio and Sacrificing Ratio

Change in Profit Sharing Ratio in the event of admission of a Partner: In the event of admission of a partner in the existing firm, the incoming partner becomes entitled to share future profits of the firm. Such share is acquired by the incoming partner from old partners; therefore, it is necessary to determine new profit sharing ratio and also the gaining or sacrificing ratio. The new partner may acquire his share from old partner or partners in old ratio, in a particular ratio (sacrificing ratio) or in a particular fraction from old partners.

a. New Profit Sharing Ratio

On admission of a partner, the profit sharing ratio among old partners will change keeping in view their respective contribution to the profit sharing ratio of the new partner. Hence, there is a need to ascertain the New Profit Sharing Ratio.

b. Sacrificing Ratio

The ratio in which the old partners agreed to sacrifice their share of profit in favors of the incoming partners is called sacrificing ratio.

$$\text{Sacrificing Ratio} = \text{Old Ratio} - \text{New ratio}$$

Calculation of New Profit Sharing Ratio

Generally at the time of Admission of a partner, new profit sharing ratio of the firm is to be determine under different situation

Case-1 When new partner acquires his share from the old partners in their old ratio OR

(The new share of the incoming partner is given without mentioning the details of sacrifice made by the old partners).

When only the ratio of new partner is given in the question, then in the absence of any instructions. It is presumed that the old partner will continue to share the remaining profits in the same ratio in which they were sharing before the admission of a new partner.

Note: In this case sacrificing ratio is same as old ratio-the reason is that in this case, the incoming partner acquires his share from old partners in their old ratio. So old partner's sacrifice for the new partner is same as their old ratio.

Calculation of New share:

Total Share of all partners (100%) = 1/1 or 1. On admission old partners admit a person as a partner by giving a portion of share in the business.

So remaining share for old partners = Total share i.e 1 – New Partner's

Share New Share of old partner's = Remaining Share x Old Share

Example:- . Anil and Sunil are partners sharing profits and losses in the ratio of 3:2. They admits Mahesh for $\frac{1}{4}$ shares. Calculate new ratio and sacrificing ratio.

Sacrificing ratio = Old share – New share

Old ratio of Anil and Sunil = 3:2

Mahesh Share = $1/4$

Remaining portion = $1 - 1/4 = 3/4$ (Anil+Sunil) ($1/1 - 1/4$ or $4/4 - 1/4$)

This $3/4$ portion is remaining for Anil and Sunil. It is to be shared by Anil and Sunil in their old ratio. Hence there new share will be

Anil's new share = Remaining portion X Anil's old ratio
= $3/4 \times 3/5 = 9/20$

Sunil's new share = Remaining portion X Sunil's old ratio
= $3/4 \times 2/5 = 6/20$

Mahesh share = $1/4$ or $5/20$

The new ratio between Anil, Sunil and Mahesh = $9/20:6/20:5/20$

Sacrificing Ratio = Old Share – New Share

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Anil's Sacrifice = Anil's old share – Anil's New Share

$$= \frac{3}{5} - \frac{9}{20} \text{ or } \frac{12}{20} - \frac{9}{20} = \frac{3}{20}$$

Sunil's Sacrifice = Sunil's Old Share – Sunil's New Share

$$= \frac{2}{5} - \frac{6}{20} \text{ or } \frac{8}{20} - \frac{6}{20} = \frac{2}{20}$$

Sacrificing ratio of Anil and Sunil = $\frac{3}{20} : \frac{2}{20}$ or 3:2

In this case sacrificing ratio is same as old ratio.

Note: When the new share of the incoming partner is given without mentioning the details of sacrifice made by the old partners, in such a case it is assumed that the old partners make their sacrifice in the old profit sharing ratio. In this case sacrificing ratio is same as old ratio. So in this case, students should not waste their time in calculating sacrificing ratio.

Case-2 When the new partner acquires his share of profit in any other

agreed ratio from the old partners (When the new share of the incoming partner and how he acquires the share from the old partners are given)

In such cases the new profit sharing ratio of the old partners will be calculated after deducting the sacrifice made by a partner from his existing share of profit.

New Profit Ratio = Old Ratio – Sacrifice

Example1: Arun & Varun are partners sharing profit and losses in the ratio of 7:5. They admit Tharun into partnership for $\frac{1}{6}$ share, which he acquires $\frac{1}{24}$ from Arun and $\frac{1}{8}$ from Varun. Find out the new ratio and sacrificing ratio.

Old ratio of Arun and Tharun = 7:5

Tharun's share = $\frac{1}{6}$ which he acquires $\frac{1}{24}$ from Arun and $\frac{1}{8}$ from Tharun

Arun's new share = $\frac{7}{12} - \frac{1}{24}$ or $\frac{14}{24} - \frac{1}{24} = \frac{13}{24}$

Varun's new share = $\frac{5}{12} - \frac{1}{8}$ or $\frac{10}{24} - \frac{3}{24} = \frac{7}{24}$

Tharun's share = $\frac{1}{6}$ or $\frac{4}{24}$

New ratio of Arun, Varun and Tharun = 13:7:4

Sacrificing ratio of Arun and Varun

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Sacrificing Ratio = Old Share – New Share

Arun's sacrifice = $7/12 - 13/24$ or $14/24 - 13/24 = 1/24$

Varun's sacrifice = $5/12 - 7/24$ or $10/24 - 7/24 = 3/24$

Sacrificing ratio = 1:3

Example 2: A & B are partners sharing profit and losses in the ratio of 4:3. They admit C into partnership for 2/7 share, which acquires equally ($2/7 * 1/2 = 2/14$ or $1/7$) from A & B. Calculate new ratio and sacrificing ratio.

Old ratio of A & B = 4:3

C's Share = $2/7$ which he acquires equally, i.e $1/7$ from A and $1/7$ from B.

So A's new share = A's old share – A's share acquired by C

$$= 4/7 - 1/7 = 3/7$$

B's new share = B's old share – B's share acquired by C

$$= 3/7 - 1/7 = 2/7$$

C's share = $2/7$

So new ratio of A,B and C = 3:2:2

Sacrificing ratio of A & B (In this problem C acquires his share $2/7$ equally from A & B, so there sacrifice is 1:1)

Sacrificing Ratio = Old Share – New Share

A's Sacrifice = A's old share - A's new share

$$= 4/7 - 3/7 = 1/7$$

B's Sacrifice = B's old share - B's new share

$$= 3/7 - 2/7 = 1/7$$

Sacrificing ratio of A & B = 1:1

Case-3 When the new partner acquires his share of profit from one partner only: in this case the share of new partner is deducted from the old profit sharing ratio of sacrificing partner, the remaining share is treated as new share of sacrificing partner And the share of remaining partners is kept as usual

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Example: A & B are partners in a firm sharing profits and losses in the ratio of 4:1.C is admitted into the partnership with $\frac{1}{4}$ shares in profits which he acquires wholly from A. Calculate the new profit sharing ratio of partners and sacrificing ratio of A & B.

Old ratio of A & B = 4:1

C's share = $\frac{1}{4}$ which he acquires wholly from A

So A's new share = A's old share – A's share acquired by C

$$= \frac{4}{5} - \frac{1}{4} \text{ or } \frac{16}{20} - \frac{5}{20} = \frac{11}{20}$$

B's new share = $\frac{1}{5}$ or $\frac{4}{20}$ (No change)

C's share = $\frac{1}{4}$ or $\frac{5}{20}$

New ratio of A,B and C = 11:4:5

Sacrificing Ratio = Old Share – New Share

$$\text{A's sacrifice} = \frac{4}{5} - \frac{11}{20} \text{ or } \frac{16}{20} - \frac{11}{20} = \frac{5}{20}$$

$$\text{B's sacrifice} = \frac{1}{5} - \frac{4}{20} \text{ or } \frac{4}{20} - \frac{4}{20} = 0$$

In this case A made the complete sacrifice. Ratio is 5/20:0/20 or 5:0

Case -4 when old partners surrender a part of their share in favour of the new partner.

In this case, it is necessary to find out new ratio and sacrificing ratio. Here old partners surrender a portion of their share in favor of the new partner. Surrendered portion of each partner is ascertained by multiplying their old share with ratio of their sacrifice. The new profit sharing ratio of existing partner's is determined by deducting sacrificed portion from old share.

Surrendered portion = Old Share x Ratio of sacrifice

Old Partner's new share = Old Share - Surrendered portion

Sacrificing Ratio = Old Share – New Share

Example: A and B are partners sharing profits equally. They took C into partnership. A surrendered $\frac{1}{3}$ of his share and B surrendered $\frac{1}{4}$ of his share in favor of C.Calculate new profit sharing ratio and sacrificing ratio.

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Old ratio of A & B = 1:1

A surrendered 1/3 of his share in favour of C,i.e, $1/2 \times 1/3 = 1/6$

So A's new share = Old share – Surrendered portion

$$= 1/2 - 1/6 \text{ or } 3/6 - 1/6 = 2/6$$

B surrendered 1/4 of his share in favour of C,i.e, $1/2 \times 1/4 = 1/8$

So, B's new share = $1/2 - 1/8 \text{ or } 4/8 - 1/8 = 3/8$

C's share = Surrendered portion of A + surrendered portion of B
 $= 1/6 + 1/8 \text{ or } 8/48 + 6/48 = 14/48$

A's new share = $2/6 \text{ or } 16/48$, B's new share = $3/8 \text{ or } 18/48$, C's share = $14/48$

New ratio of A,B and C = $16:18:14$ or $8:9:7$

Sacrificing Ratio = Old Share – New Share

A's sacrifice = $1/2 - 8/24 \text{ or } 12/24 - 8/24 = 4/24$

B's sacrifice = $1/2 - 9/24 \text{ or } 12/24 - 9/24 = 3/24$

Sacrificing ratio = 4:3

Case-5 when new partner's share and new profit sharing ratio between old partners are given

In this case also, it is necessary to find out new ratio and sacrificing ratio. In this case incoming partners share directly given. Old partner's old ratio and their proportionate new ratio are referred here.

1. Find out remaining portion ($1 - \text{New partner's share}$)

2. Calculate new ratio of old partners = Remaining portion \times New proportionate ratio between old partners.

3. Find out the new ratio of all partners

4. Calculate Sacrificing Ratio = New Share – Old Share

Example Veeran and Velu are partners in a firm sharing profits and losses in the ratio of 3:2. They admitted Vijay as a new partner for 1/4 share. The new profit sharing ratio between Veeran and Velu will be 2:1. Calculate new profit sharing ratio and sacrificing ratio.

Old ratio of Veeran and Velu = 3:2

Whole (full) share for all partners = 1/1 i.e 100%

Vijay's share = 1/4

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Remaining portion = $1 - \frac{1}{4} = \frac{3}{4}$

New profit sharing ratio between Veeran and Velu = 2:1

New ratio of Veeran = Remaining portion X new ratio of Veeran

$$= \frac{3}{4} \times \frac{2}{3} = \frac{6}{12}$$

New ratio of Velu = $\frac{3}{4} \times \frac{1}{3} = \frac{3}{12}$

Vijay's share = $\frac{1}{4}$ or $\frac{3}{12}$

So New ratio of Veeran, Velu and Vijay = 6:3:3 or 2:1:1

Sacrificing Ratio = Old Share – New Share

Veeran's sacrifice = $\frac{3}{5} - \frac{2}{4}$ or $\frac{12}{20} - \frac{10}{20} = \frac{2}{20}$

Velu's sacrifice = $\frac{2}{5} - \frac{1}{4}$ or $\frac{8}{20} - \frac{5}{20} = \frac{3}{20}$

Sacrificing ratio of Veeran and Velu = 2:3

Valuation and Accounting Treatment of Goodwill

At the time of admission of a partner, treatment of Goodwill is necessary to compensate the old partners for their sacrifice. The incoming partner must compensate the existing partners because he is going to acquire the right to share future profits and his share is sacrificed by old partners. If goodwill (Premium) is paid to old partners privately or outside the business by the new partner then on entry is required in the books of the firm.

- **Accounting treatment of such Goodwill has been explained with respect to 6 situations which may arise in the event of partner's admission which are as follows:**
 - i. Goodwill (Premium on Goodwill) is paid privately;
 - ii. Goodwill (Premium on Goodwill) is brought in cash or by cheque by the new or Incoming Partner and is retained in business;
 - iii. Goodwill (Premium on Goodwill) is brought in cash or by cheque by the new or Incoming Partner and is withdrawn by Sacrificing Partners fully or partly;
 - iv. Goodwill (Premium on Goodwill) is brought in kind(Assets)
 - v. Goodwill (Premium on Goodwill) is not brought in full or a part by the new or Incoming Partner.
 - vi. Hidden/Inferred Goodwill

Methods of Recording Goodwill

The methods for the treatment of goodwill on the admission of a new partner are given below.

1. Premium Method

2. Revaluation Method

1. Premium Method- Under this method, when the incoming partner brings his share of goodwill in cash, the existing partners share it in the sacrificing ratio. However, when the amount of goodwill is paid privately by the new partner to old partners privately in cash, no entry is passed in the books of the firm

2. Revaluation Method- Under this method, when the new partner decides not to bring his share of goodwill in cash. Thus, we need to raise the goodwill account in the books by debiting Goodwill account and crediting old partners' capital accounts in the old profit-sharing ratio.

New Partner's Capital A/c To Old Partners' Capital A/c (Goodwill amount of the new partner distributed among the old partners in their sacrificing ratio)	Dr. (With the whole amount of goodwill that is <u>not</u> brought in by the new partner)
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NOTE: As per Accounting Standard 26 or New Indian AS 38, goodwill is recorded in the books only when some consideration in money or money's worth has been paid for it. This practice is mandatory to follow. In case of admission, retirement, death or change in profit sharing ratio among existing partners, Goodwill Account cannot be raised as no consideration is paid for it.

CASE-1 When the goodwill (premium) is paid privately (i.e., outside the business) by the new partner to the old partners

Sometimes, the new partner brings in his share of goodwill in cash and the same is paid to the old partners privately, i.e., outside the business. In such a case no entry is made in the books of account of the firm.

CASE2:- Accounting Treatment when Goodwill (Premium on Goodwill) is brought in cash or by cheque by the new or Incoming Partner and is retained in business:

Amount brought in by the new or Incoming Partner is transferred to Capital Accounts of the sacrificing partners in their sacrificing ratio. Following entries are to be passed:

- i. Premium for goodwill brought in cash by the new or incoming partner:
Cash/Bank A/c ...Dr. [With share of Goodwill]
To Premium for Goodwill A/c

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ii. Capital brought in cash by the new or Incoming Partner:

Cash/Bank A/c ...Dr. [With Capital brought in Cash]

To New Partner's Capital A/c

Alternatively, instead of above 2 entries, a combined single entry can be passed as follows:

Cash/Bank A/c ...Dr. [With Share of Capital and Goodwill]

To New Partner's Capital [With Capital]

To Premium for Goodwill A/c [With Share of Goodwill]

iii. Goodwill brought in by new partner distributed among the sacrificing partners:

Premium for Goodwill A/c ...Dr. [With Share of Goodwill]

To Sacrificing Partners' Capital/Current A/c[In sacrificing Ratio]

CASE3: Accounting Treatment when Goodwill (Premium on Goodwill) is brought in cash or by cheque by the new or Incoming Partner and is withdrawn by Sacrificing Partners fully or partly:

Such amount of premium brought in by the new or incoming partner is shared by the sacrificing partners in the sacrificing ratio. These sacrificing partners may withdraw the premium amount fully or partly. Following entries are to be passed:

I. Premium for goodwill brought in cash by the new partner:

Cash/Bank A/c ...Dr. [Amount of premium]

To Premium for Goodwill A/c

II Goodwill brought in by new partner distributed among the sacrificing partners:

Premium for Goodwill A/c ...Dr. [Amount of premium]

To Sacrificing Partners' Capital A/c [Sacrificing ratio]

III Withdrawal of premium/Goodwill money fully/partly:

Sacrificing Partners' Capital A/c ...Dr. [Amount withdrawn]

To Cash/Bank A/c

CASE4: Accounting Treatment when Goodwill (Premium on Goodwill) is brought in kind:

In such situation, the assets brought in are debited individually with their values and Premium for Goodwill Account is credited with his share of goodwill and also new Partner's Capital Account with his capital. Such Premium for Goodwill is transferred to the Capital Accounts of the sacrificing partners in their sacrificing ratio. Following are the accounting entries to be passed:

i. Assets brought in by New Partner FOR AMOUNT OF CAPITAL & GOODWILL

Assets A/c ...Dr. [Individually]

To New Partners' Capital A/c [With amount of Capital]

To Premium for Goodwill A/c [With share of Goodwill brought in]

II. Goodwill brought in by new partner distributed among the sacrificing partners

Premium for Goodwill A/c ...Dr.

To Sacrificing Partners' Capital A/c [In Sacrificing Ratio]

CASE 5: When the new partner is unable to bring in his share of goodwill in cash or kind

The new partner does not bring in cash or kind for goodwill as such; but an adjustment entry is passed by which the new partner's capital account is debited with his share of goodwill and the amount is credited to old partners' capital accounts in the ratio of sacrifice. This entry reduces the capital of the new partner by the amount of his *share of goodwill and results in payment for goodwill by the new partner to the old partners.*

i. Capital brought in cash by the new or Incoming Partner:

Cash/Bank A/cDr. [With Capital brought in Cash]
To New Partner's Capital A/c

ii. Amount of Goodwill adjusted or distributed among old partners in sacrificing ratio

New Partner's Capital A/C..... Dr. (new partner's share of goodwill)

To Sacrificing Partner's Capital A/C (Sacrificing ratio)

Case6- Hidden or Inferred Goodwill: It is possible that the value of Goodwill of the firm is not given and such value of goodwill is to be inferred based on the net worth (capital of the firm). Such inferred value of Goodwill is termed as Hidden or Inferred Goodwill. In order to identify the value of hidden goodwill, following steps are to be followed:

Step-(1) Calculate Net Worth /Total Capital of the new firm on the basis of capital contributed by the new partner

Net worth (Total Capital) = New partner's Capital x Reciprocal of new partner's profit share

Step-(2) to determination of Total capital of the Firm

Total capital (Combined capital) = Aggregate capital of old partners + Capital of new partner

Value of Goodwill = (1) – (2)

Total capital of New firm – Combined Capital

Net worth = Sundry Assets – Outside Liabilities or
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Net worth = Capitals of all partners + Accumulated profits and reserves – Accumulated losses
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Goodwill appearing in the book at the time of admission

If goodwill appears in the Balance Sheet of a firm before the new partner is admitted, it would be desirable to close the goodwill account by debiting the existing partner's capital account and crediting the goodwill account in their old profit sharing ratio.

Journal Entry: : To write off existing goodwill

Old Partners Capital A/C (old ratio)

To Goodwill Account (Value of goodwill recorded in the balance sheet)

(Being existing goodwill written off)

Revaluation of assets and liabilities

At the time of admission of a partner, assets and liabilities of a firm must be revalued. It is necessary because actual realizable value of assets and actual liabilities may be different from their book values. The outcome of revaluation may be revaluation profit or loss. Profit or loss arising on account of such revaluation up to the date of admission of a new partner may be ascertained and adjusted in the old partners' capital accounts in their old profit sharing ratio since it belongs to the old partners and not to the new partner. Effect of revaluation can be ascertained by preparing a revaluation account.

Revaluation Account

Revaluation account is a nominal account prepared to bring the assets and liabilities of the firm to their true (market) values and to find out profit or loss on revaluation of assets and reassessment of liabilities. Revaluation account is credited with increase in the value of assets, decrease in the amount of liabilities and unrecorded assets. Revaluation account is debited with decrease in the value of assets, increase in the value of liabilities and unrecorded liabilities. The balance of Revaluation account represents the profit or loss on revaluation and is transferred to the old partners' capital accounts in their old profit sharing ratio.

Note: Revaluation account records only changes in values of assets and liabilities, not book value or real value.

Journal Entry –Revaluation of Assets and Liabilities**Particulars****Journal Entry**Increase in the value of AssetsAssets A/c Dr
To Revaluation A/CDecrease in the value of AssetsRevaluation A/C Dr
To AssetsIncrease in the value of LiabilityRevaluation A/C Dr
To LiabilitiesDecrease in the value of LiabilityLiabilities A/C Dr
Revaluation A/CUn Recorded AssetsAssets A/C Dr
To RevaluationUnrecorded LiabilitiesRevaluation A/C Dr
To LiabilitiesFor Distribution of Revaluation ProfitsRevaluation A/C Dr
To Old Partners' Capital A/cFor Distribution of Revaluation LossOld Partner's Capital A/C Dr
To Revaluation**Revaluation Account**

Particulars	Amount	Particulars	Amount
To Assets Decrease (-)	XXXX	By Assets Increase (+)	XXXX
To Liability Increase (+)	XXXX	By Liabilities Decrease (-)	XXXX
To Unrecorded Liability (+)	XXXX	By Unrecorded Assets (+)	XXXX
To Old partners 'Capital Accounts (Profit, old ratio)	XXXX	By Old partners 'Capital Accounts (Loss, old ratio)	XXXX
	XXXX		XXXX

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Accounting Adjustment of accumulated Reserve and profits/losses

At the time of admission of a partner, any reserve or accumulated profits/losses exists in the books of the firm, these should be transferred to old partners' Capital accounts (if capitals are fluctuating) or Current Accounts (If capitals are fixed) in their old profit sharing ratio since the reserves, accumulated profits/losses up to the date of admission of a new partner belong to the old partners and not to the new partner.

(A) Distribution of Accumulated Reserve and Profit

General Reserve A/C Dr

Profit & Loss A/C Dr

To Old Partners Capital A/C (Old ratio, individually)

(Being Accumulated profit transferred to old partners capital A/C in their old ratio)

5. (B) Distribution of Accumulated Losses

Old Partners' Capital A/C..... Dr

To Profit & Loss A/C

(Being Accumulated Loss transferred to Old partner's capital A/C in their old ratio)

Adjustments of capitals

The capitals of the partners may be adjusted in any one of the following ways.

1. Adjusting the capitals of Old Partners on the basis of the Capitals of Incoming Partner when the Total Capital of New Firm is not given
2. Determining the new partner's capital on the basis of combined capital of Old Partners'

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Adjusting the capitals of Old Partners, when the Total Capital of New Firm is not given

Step-1 Calculate Total capital of the new firm on the basis of new partner's capital

Total Capital = New partner's Capital X Reciprocal of proportion of share of new partner

Step-2 Calculate new profit sharing ratio

Step-3 Calculate new capital of old partners on the basis of total capital and new profit sharing ratio

New capital of all partners = Total Capital x New profit sharing ratio of each partner

Step-4 Compute the total capital (present) of the old partners after giving effect to all adjustments.

Step-5 Calculate surplus/deficit of old partners' capital account by comparing the new capital with adjusted old capital

If, Present Capital > Proportionate Capital = Surplus and

If, Present Capital < Proportionate Capital = Deficit

Step6- Adjust the surplus by paying off or by transfer to the credit of his current account and adjust the deficiency by asking the concerned partner to bring in the required amount or by transfer to the debit of his current account.

Journal Entry (1) when adjusted old capital is less than the new capital

Cash/ Particular Partner's Current A/C Dr

To Particular partner's Capital A/C

(Being shortage brought in /adjusted by.....)

Journal Entry (2) when adjusted old capital is more than the new capital

Particular Partner's Capital A/C Dr.

To Cash / Particular Partner's Current A/C Dr

(Being excess amount withdrawn by.....)

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Note: In the absence of any contract, surplus/deficit should be adjusted in cash and not by transfer to current account

2. Determining the new partner's capital on the basis of combined capital of Old Partners'

The various steps involved in the determination of capital of Old Partners are:

Step-1 Calculate the adjusted (after all adjustments have been made) old capital of old partners

Step-2 Calculate the total capital of the new firm on the basis of combined capital of old partners

Total Capital = Combined adjusted old capital of old partners x Reciprocal proportion of share of old partners in new firm

Step-3 Calculate new partner's capital

New partners capital = Total capital x new partner's share

Workmen Compensation Reserve:

- **Meaning:**
 - i. It is a reserve that is set aside or appropriated out of firm's profits to meet any of the possible liabilities with respect to employees' compensation, if it arises.
 - ii. Claim with respect to such liabilities may or may not arise.
 - iii. The amount of claim may or may not be equal to the amount of reserves.
 - **Accounting Treatment of Workmen Compensation Reserve under different situations:** Following are the journal entries for explaining accounting treatment of Workmen Compensation Reserve under different situation:
 - a. **When claim against workmen compensation reserve does not exist:**
In this situation, amount of this reserve is transferred to Partners' Capital Accounts in their old profit sharing ratio. Entry to be passed is:

Workmen Compensation Reserves A/c ...Dr.

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To Partners' Capital (or Current) A/c

(Being workmen compensation reserves credited to partners' capital or current accounts in their old profit sharing ratio)

b. When claim for workmen compensation reserve exists: In such situation, treatment shall depend on the amount of liabilities:

i. **Claim is equal to reserves:** Amount of reserves is transferred to Provision for Workmen Compensation Claim Account. Entry to be passed:

Workmen Compensation Reserves A/c ...Dr.

To Provision for Workmen Compensation

Claim A/c

(Being the provision made for estimated

compensation claim)

ii. **Claim amount is lower than the reserve:** Excess of Workmen Compensation Reserve over the Workmen Compensation Claim is credited to all partners in their old profit sharing ratio. Entry is:

Workmen Compensation Reserve A/c ...Dr.

To Provision for Workmen Compensation Claim A/c

To Old Partners' Capital or Current A/c

(Being the surplus of Workmen Compensation Reserve transferred to Old Partners' Capital or Current Account in their old profit sharing ratio)

iii. **Claim amount is higher than the reserve:** Amount in excess of reserve is debited to Revaluation Account as the loss is to be borne by the partners in old profit sharing ratio. Entry is:

a. Workmen Compensation

Reserve A/c ...Dr.

Revaluation A/c ...Dr.

To Provision for Workmen Compensation Claim A/c

(Being amount of estimated claim debited to Workmen Compensation Reserve and Revaluation Account)

b. Old Partners' Capital or Current A/c ...Dr. (In Old Ratio)

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To Revaluation A/c
(Being the loss on revaluation transferred to Capital or Current Account of partners in their old profit sharing ratio)

Investments Fluctuation Reserve:

- **Meaning:**

- i. It is a reserve which is set aside out of the profits to meet fall in the market value of investments.
- ii. In order to decide the treatment of this reserve, it is necessary to first determine whether the book value and the market value are same or different and if different, which value is higher and which is lower.

- **Accounting Treatment of Investment Fluctuation Reserve:**

- i. **When Book Value and Market Value are same:** Entry has to be passed to transfer the amount of Investment Fluctuation Reserve to Partners' Capital or Current Accounts in their old profit sharing ratio as below:

Investment Fluctuation Reserve A/c ...Dr.

To Partners' Capital (or Current) A/c [In Old Ratio]

- ii. **When Market Value is less than the Book Value:** In this case, treatment of Investments Fluctuation Reserve shall depend on the quantum of decrease, which has 3 possibilities as follows:

- a. **Fall in Value is less than Investments Fluctuation Reserve:** The amount of Investment Fluctuation Reserve to the extent of fall in value, is transferred to Investment Account and balance is distributed among the partners in their old profit sharing ratio for which following entry is to be passed:

Investment Fluctuation Reserve A/c ...Dr.

To Investment A/c [Book Value – Market Value]

To Old Partners' Capital (or Current) A/c [In OldRatio]

- b. **Fall in Value is Equal to Investments Fluctuation Reserve:** In this case, amount of Investment Fluctuation Reserve is transferred to Investment Account and no amount is distributed among the partners. Entry for the same is as follows:

Investment Fluctuation Reserve A/c ...Dr.

To Investment A/c

- c. **Fall in Value is More than Investments Fluctuation Reserve:** In this

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case, amount of Investments Fluctuation Reserve along with balance amount of fall in value is transferred to Investment Account and the amount in excess of reserve is debited to the Revaluation Account for which following entries are passed:

- Investment Fluctuation
 - Reserve A/c ...Dr. Revaluation A/c ...Dr.
 - To Investment A/c
- Partners' Capital (or Current) A/cs ...Dr. [In Old Ratio]
 - To Revaluation A/c

iii. **When there is an Increase in Market Value of Investment:** In this case, total amount of Investment Fluctuation Reserve is distributed among partners and increase in value of investment is credited to Revaluation Account for which following entry is to be passed:

- Investment Fluctuation Reserve A/c ...Dr.
 - To Partners' Capital (or Current) A/c [In Old Ratio]
- Investment A/c ...Dr.
 - To Revaluation A/c [Investment Brought up to Market Value]
- Revaluation A/c ...Dr.
 - To Partners' Capital (or Current) A/c [In old Ratio]

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