

- (3) New partner contributes an agreed amount of capital in cash or in kind and acquires right on the assets of the firm.
- (4) Balances of accumulated profits and losses, reserves and fictitious assets appearing in the books on the date of admission is distributed to the old partners in their old profit sharing ratio.
- (5) Assets are revalued and liabilities are reassessed and net change is adjusted in the old partners' capital accounts.
- (6) The goodwill of the firm is revalued and new partner contributes his share of goodwill in a cash or kind and its accounting effect is given.
- (7) Accounting effect is also given for maintaining agreed capital in the new firm among the old partners, if decided in the new partnership agreement.

Thus, at the time of admission of a new partner following adjustments are required to be made :

- (1) Calculation of new profit and loss sharing ratio and old partners' sacrificing ratio.
- (2) Accounting effects relating to goodwill.
- (3) Accounting effect of profits/losses arising from revaluation of assets and reassessment of liabilities.
- (4) Accounting effect of accumulated profits, losses and reserves
- (5) Adjustment of change in capital.

Let us now discuss each of the above cases :

### 3. Change in Profit Sharing Ratio

The new partner acquires some share out of the future profit of the firm, which is sacrificed by the old partners. Consequently new profit sharing ratio of all the partners and sacrificing ratio of old partners come into existence after the admission of a new partner. Thus following two ratios are required to be calculated at the time of admission of a new partner.

- (A) Calculation of new profit-loss sharing ratio
- (B) Calculation of sacrificing ratio

Now let us discuss the computation of both the proportion in detail.

#### **Calculation of new profit-loss sharing ratio and sacrificing ratio :**

New profit sharing ratio means ratio in which all partners including the new partner decide to share future profit or loss of the firm.

New profit-loss sharing ratio can be calculated as per the following circumstances :

**(1) When sacrificing share or sacrificing ratio of old partners is not given (In other words, when old ratio of old partners and profit share to be given to the old partner is given) :**

When old profit-loss sharing ratio of old partners and profit share of new partner is given it is assumed that the remaining profit after giving share in profit to new partner will be distributed among old partners in their old profit-loss sharing ratio.

**Illustration 1 :** A and B are the partners in a firm sharing profit & loss in the ratio of 3:2. C is admitted for  $\frac{1}{4}$ th share in the profit. Calculate the new profit sharing ratio.

**Ans. :** Old sharing ratio of A and B = 3:2

Let the total share of profit = 1

C's share =  $\frac{1}{4}$ , after giving  $\frac{1}{4}$ th share to C,

$$\begin{aligned}\text{Remaining share of A and B} &= \text{Total profit} - \text{Share of new partner} \\ &= 1 - \frac{1}{4} \\ &= \frac{4-1}{4} \\ &= \frac{3}{4}\end{aligned}$$

Remaining share for A and B is  $\frac{3}{4}$  which is to be distributed in their old sharing ratio 3:2.

New share of old partners = Remaining share of profit  $\times$  Share in old ratio

$$\text{A's new share} = \frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$$

$$\text{B's new share} = \frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$$

$$\text{C's new share} = \frac{1}{4}, \text{ Making denominator equal } \frac{1}{4} \times \frac{5}{5} = \frac{5}{20}$$

$\therefore$  New profit sharing ratio of A, B and C = 9:6:5

**Explanation :** Here it is assumed that the old partners will maintain their relative old ratio even after the admission of a new partner. It means profit share to be given to the new partners will be sacrificed by the old partners in their old ratio only. Therefore, Relative old ratio = Sacrificing ratio = New ratio.

Sacrificing ratio of old partners can be calculated in illustration 1 as under :

	A	B	C
Old ratio	3	2	—
Old share	$\frac{3}{5}$	$\frac{2}{5}$	—
New ratio	9	6	5
New share	$\frac{9}{20}$	$\frac{6}{20}$	$\frac{5}{20}$

Sacrifice = Old share — New share

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

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

So, sacrificing ratio of A and B = 3:2.

**Note :** When sacrificing share or sacrificing ratio is not given and the old ratio of old partners and new partners' share is given, relative old ratio of old partners will be their sacrificing ratio.

**(2) When the old ratio of old partners, share of new partner and the new ratio of old partners are given :**

**Illustration 2 :** A and B are the partners of a firm sharing profit in the ratio of 2:1. C is admitted for  $\frac{1}{5}$  share in the profit. In future, the profit sharing ratio of A and B would be 2:3.

Calculate the new profit sharing ratio.

**Ans. :** Assume that total share of profit = 1

Remaining share for A and B = Total share — New partners' share

$$\begin{aligned} &= 1 - \frac{1}{5} \\ &= \frac{5-1}{5} \\ &= \frac{4}{5} \end{aligned}$$

Remaining share of A and B is  $\frac{4}{5}$  which will be distributed by A and B in their new ratio, that is 2:3.

New share of old partners = Remaining share of profit  $\times$  Share in new ratio

$$\text{A's new share} = \frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$$

$$\text{B's new share} = \frac{4}{5} \times \frac{3}{5} = \frac{12}{25}$$

$$\text{C's new share} = \frac{1}{5}, \text{ Making denominator equal, } \frac{5}{25}$$

$\therefore$  New profit-loss sharing ratio of A, B and C = 8:12:5

### (3) When a new partner acquires specific share from old partners :

When sacrifice made by old partners is given, new share of old partners can be obtained by subtracting sacrificing share from old share.

Thus, new share of old partners = Old share — Sacrifice

**Illustration 3 :** A and B are the partners in a firm sharing profits and losses in the ratio of 4:3.

They admitted C as a new partner with  $\frac{1}{7}$  share. C obtained  $\frac{2}{21}$  share from A, and  $\frac{1}{21}$  from B.

Calculate the new profit sharing ratio.

**Ans. :** Old profit sharing of A and B = 4:3 means  $\frac{4}{7} : \frac{3}{7}$

$$\text{Share of C} = \frac{1}{7}$$

C obtains  $\frac{2}{21}$  share from A and  $\frac{1}{21}$  share from B.

$$\therefore \text{A's sacrifice} = \frac{2}{21} \text{ (from their own share)}$$

$$\text{B's sacrifice} = \frac{1}{21} \text{ (from their own share)}$$

New share = Old share — Sacrifice

$$\text{A's new share} = \frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$$

$$\text{B's new share} = \frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$$

$$\text{C's new share} = \frac{1}{7}, \text{ Making denominator equal, } \frac{3}{21}$$

$\therefore$  New profit-loss sharing ratio of A, B and C = 10:8:3

**Explanation :** (1) C's  $\frac{1}{7}$ th share must be equal to the sacrifice of A and B. It means,

$$\begin{aligned}\text{C's share} &= \text{A's sacrifice} + \text{B's sacrifice} \\ &= \frac{2}{21} + \frac{1}{21} \\ &= \frac{3}{21} \\ &= \frac{1}{7}\end{aligned}$$

(2) A's sacrifice is  $\frac{2}{21}$  and B's sacrifice is  $\frac{1}{21}$ . If the sacrificing ratio of A and B is to be ascertained, it will be  $\frac{2}{21} : \frac{1}{21}$  it means 2:1.

Thus, sacrifice and sacrificing ratio are two different things. In the above illustration, sacrificing ratio is given instead of sacrifice of A and B, means it is given that A and B will sacrifice C's  $\frac{1}{7}$ th share in the ratio of 2:1, it is first necessary to calculate the sacrifice of A and B.

$\text{Sacrifice} = \text{New partners' share} \times \text{Sacrificing ratio of old partners}$

$$\text{A's new share} = \frac{1}{7} \times \frac{2}{3} = \frac{2}{21}$$

$$\text{B's new share} = \frac{1}{7} \times \frac{1}{3} = \frac{1}{21}$$

New profit-loss sharing ratio can be ascertained only after calculating sacrificing share.

$\text{New share} = \text{Old share} - \text{Sacrifice}$

$$\text{A's new share} = \frac{4}{7} - \frac{2}{21} = \frac{12-2}{21} = \frac{10}{21}$$

$$\text{B's new share} = \frac{3}{7} - \frac{1}{21} = \frac{9-1}{21} = \frac{8}{21}$$

$$\text{C's new share} = \frac{1}{7}, \text{ Making denominator equal, } \frac{3}{21}$$

$\therefore$  New profit-loss sharing ratio of A, B and C = 10:8:3

#### (4) When sacrificing ratio of old partners is given :

When sacrificing ratio of old partners is given, sacrificing share of old partners is to be ascertained first with the help of the following formula :

$\text{Sacrifice of old partners} = \text{Share of new partner} \times \text{Sacrificing ratio of old partner}$

After calculating the sacrifice of old partners, new profit-loss sharing ratio of all partners is to be ascertained with the help of the following formula :

$\text{New share} = \text{Old share} - \text{Sacrifice}$

**Illustration 4 :** A and B are the partners of a firm sharing profits and loss in the ratio of 5:3. They admit C, a new partner, who acquires  $\frac{1}{4}$ th share in the firm. C obtains his share from A and B in the ratio of 3:1. Find out new profit-loss sharing ratio.

**Ans. :** Old profit sharing ratio of A and B = 5:3 means  $\frac{5}{8} : \frac{3}{8}$ .

C's share =  $\frac{1}{4}$ , C obtains his share from A and B in the ratio of 3:1.

$\text{Sacrifice of old partners} = \text{New partners' share} \times \text{Sacrificing ratio of old partner}$



$$\therefore \text{A's sacrifice} = \frac{1}{4} \times \frac{3}{4} = \frac{3}{16}$$

$$\text{B's sacrifice} = \frac{1}{4} \times \frac{1}{4} = \frac{1}{16}$$

New share of old partners = Old share – Sacrifice

$$\therefore \text{A's new share} = \frac{5}{8} - \frac{3}{16} = \frac{10-3}{16} = \frac{7}{16}$$

$$\text{B's new share} = \frac{3}{8} - \frac{1}{16} = \frac{6-1}{16} = \frac{5}{16}$$

and C's new share =  $\frac{1}{4}$ , Making denominator equal,  $\frac{4}{16}$

$\therefore$  New profit-loss sharing ratio of A, B and C = 7:5:4

**(5) When old partners sacrifice particular fraction of their share in favour of the new partner :**

**Illustration 5 :** A and B are partners. They admit C as a new partner. 'A' sacrifices  $\frac{1}{5}$ th of his share and B sacrifices  $\frac{1}{4}$ th of his share in favour of C. Calculate new profit and loss sharing ratio and sacrificing ratio.

**Ans. :** Old profit sharing ratio of A and B = 1:1 means  $\frac{1}{2} : \frac{1}{2}$

A sacrifices  $\frac{1}{5}$ th of his share to C

$\therefore$  A's sacrifice = A's old share  $\times$  Share of his sacrifice

$$\therefore \text{A's sacrifice} = \frac{1}{2} \times \frac{1}{5} = \frac{1}{10}$$

B sacrifices  $\frac{1}{4}$ th of his share to C.

$\therefore$  B's sacrifice = B's old share  $\times$  Share of his sacrifice

$$\therefore \text{B's sacrifice} = \frac{1}{2} \times \frac{1}{4} = \frac{1}{8}$$

New share = Old share – Sacrifice

$$\therefore \text{A's new share} = \frac{1}{2} - \frac{1}{10} = \frac{5-1}{10} = \frac{4}{10}$$

$$\text{B's new share} = \frac{1}{2} - \frac{1}{8} = \frac{4-1}{8} = \frac{3}{8}$$

A and B sacrifice some of their share in favour of C. Therefore share of A and B will reduce, which is received by C. Sacrifice of A and B will be deducted from their old share and sacrifice of A and B will be received by C.

$$\text{C's new share} = \frac{1}{10} + \frac{1}{8} = \frac{4+5}{40} = \frac{9}{40}$$

$$\begin{aligned} \therefore \text{New profit-loss sharing ratio of A, B and C} &= \frac{4}{10} : \frac{3}{8} : \frac{9}{40}; \text{ Making denominator equal,} \\ &= \frac{16}{40} : \frac{15}{40} : \frac{9}{40} = 16 : 15 : 9 \end{aligned}$$

Now, ascertainment of sacrificing ratio of A and B,

$$\therefore \text{A's sacrifice} = \frac{1}{10}$$

$$\text{B's sacrifice} = \frac{1}{8}$$

$$\begin{aligned} \therefore \text{Sacrificing ratio of A and B} &= \frac{1}{10} : \frac{1}{8}; \text{ Making denominator equal} = \frac{4}{40} : \frac{5}{40} \\ &= 4 : 5 \end{aligned}$$

**(6) When old partners sacrifice some share out of their share in favour of the new partner :**

**Illustration 6 :** A and B are the partners of a firm sharing profit-loss in the ratio of 2:1. C is admitted as a new partner from 1-4-2017.

'A' sacrifices  $\frac{1}{12}$  from his share while 'B' sacrifices  $\frac{1}{6}$  from his share to C.

Determine the sacrificing ratio and the new profit-loss sharing ratio.

**Ans. : Sacrificing ratio :**

A's sacrifice =  $\frac{1}{12}$  and B's; sacrifice =  $\frac{1}{6}$ . Making denominator equal,  $\frac{1}{12}$  and  $\frac{2}{12}$ .

∴ Sacrificing ratio is 1:2

C's share (A's sacrifice + B's sacrifice)

$$\therefore \frac{1}{12} + \frac{1}{6} = \frac{1}{4}$$

**New profit-loss sharing ratio :**

$$\begin{array}{lcl} \text{A's old share } \frac{2}{3} - \text{share of sacrifice } \frac{1}{12} = \frac{8-1}{12} = \frac{7}{12} \\ \text{B's old share } \frac{1}{3} - \text{share of sacrifice } \frac{1}{6} = \frac{2-1}{6} = \frac{1}{6} \\ \text{C's share} = \frac{1}{4} = \frac{1}{4} \end{array} \quad \left. \begin{array}{l} \\ \\ \end{array} \right\} \text{ Making denominator equal,}$$

New ratio of A, B and C = 7 : 2 : 3

**(7) When one partner from old partners retains his old share after the admission of a new partner :**

**Illustration 7 :** A, B and C are the partners of a firm. Their profit sharing ratio is  $\frac{1}{2}$ ,  $\frac{3}{10}$  and  $\frac{1}{5}$  respectively. They admit D, as a new partner for  $\frac{1}{6}$ th share. C would retain his original share after D's admission. Calculate new profit-loss sharing ratio.

**Ans. :** Old ratio of A, B and C =  $\frac{1}{2} : \frac{3}{10} : \frac{1}{5}$   
= 5:3:2 (Making denominator equal)

New partner D's share =  $\frac{1}{6}$

After admission of D, share of C =  $\frac{1}{5}$  will be maintained

∴ Remaining share for A and B = Total share – C's share – D's share

$$\begin{aligned} \therefore \text{Remaining share for A and B} &= 1 - \frac{1}{5} - \frac{1}{6} \text{ or } 1 - \left(\frac{1}{5} + \frac{1}{6}\right) \\ &= \frac{30-6-5}{30} = \frac{19}{30} \text{ or } \frac{30-(6+5)}{30} = \frac{19}{30} \end{aligned}$$

A and B will acquire remaining share  $\frac{19}{30}$  in their relative ratio of 5:3.

$$\therefore \text{A's new share} = \frac{19}{30} \times \frac{5}{8} = \frac{95}{240}$$

$$\left. \begin{aligned} \text{B's new share} &= \frac{19}{30} \times \frac{3}{8} = \frac{57}{240} \\ \text{C's new share} &= \frac{1}{5} = \frac{48}{240} \\ \text{D's new share} &= \frac{1}{6} = \frac{40}{240} \end{aligned} \right\} \text{(Making denominator equal)}$$

∴ New ratio of profit and loss = 95 : 57 : 48 : 40

**(8) When sacrifice made by some old partners is given and sacrifice made by other old partners is not given :**

**Illustration 8 :** A and B are partners sharing in the ratio of 3:2. They admitted C for  $\frac{1}{5}$ th of the profits.

Out of which he takes  $\frac{1}{20}$ th from A and remaining share from B. Calculate new profit and loss sharing ratio.

**Ans. :** B's sacrifice = C's share – A's sacrifice

(C's share is  $\frac{1}{5}$  out of which he acquires  $\frac{1}{20}$  from A and remaining B's sacrifice.)

$$= \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$$

New share = Old share – Sacrifice

$$\therefore \text{A's new share} = \frac{3}{5} - \frac{1}{20} = \frac{12-1}{20} = \frac{11}{20}$$

$$\text{B's new share} = \frac{2}{5} - \frac{3}{20} = \frac{8-3}{20} = \frac{5}{20}$$

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

∴ New ratio of profit and loss = 11 : 5 : 4

**Illustration 9 :** A and B are the partners in a firm sharing profit-loss in the ratio of 4:1. C is admitted as a new partner for  $\frac{1}{4}$ th share in the firm. 'A' sacrificed  $\frac{1}{4}$ th of his share in favour of C. While 'B' sacrificed remaining share of C's share. Calculate new profit & loss sharing ratio.

**Ans. :** Old profit sharing ratio of A and B = 4:1 or  $\frac{4}{5} : \frac{1}{5}$

Share of new partner C =  $\frac{1}{4}$

'A' sacrificed  $\frac{1}{4}$ th of his share in favour of C.

$$\therefore \text{A's sacrifice} = \frac{4}{5} \times \frac{1}{4} = \frac{4}{20} = \frac{1}{5}$$

(C's share is  $\frac{1}{4}$ , C receives  $\frac{1}{5}$  from A, So, remaining share of  $\frac{1}{4}$ th, he will received from B)

∴ B's sacrifice = C's share – A's sacrifice

$$= \frac{1}{4} - \frac{1}{5} = \frac{5-4}{20} = \frac{1}{20}$$

New share = Old share – Sacrifice

$$\therefore \text{A's new share} = \frac{4}{5} - \frac{1}{5} = \frac{3}{5}$$

$$\text{B's new share} = \frac{1}{5} - \frac{1}{20} = \frac{4-1}{20} = \frac{3}{20}$$

$$\text{C's new share} = \frac{1}{4}$$

$$\begin{aligned}\therefore \text{New profit-loss sharing ratio} &= \frac{3}{5} : \frac{3}{20} : \frac{1}{4} \\ &= \frac{12}{20} : \frac{3}{20} : \frac{5}{20} \\ &= 12 : 3 : 5\end{aligned}$$

#### 4. Accounting Treatment of Goodwill as per Accounting Standard-26

Goodwill is an intangible asset. When a firm earns higher profit than normal profit, which is earned by its competitors, super profit arises. Goodwill arises due to the super profit earned by the firm. Goodwill arises in the firm because of the efforts made by old partners in past. On the admission of a new partner, old partners sacrifice some of their profit share in favour of the new partner. To compensate the profit share acquired by the new partner, he is required to give his share in goodwill of the firm, which is called as premium for goodwill. Premium for goodwill is distributed among the old partners in the sacrificing ratio.

Sometimes, on the admission of a new partner :

- (i) If profit sharing ratio of an old partner does not change, even after the admission of a new partner, it means that he does not sacrifice and therefore he will not receive any amount for goodwill.
- (ii) If new profit share of an old partner is more than the old profit share, he gains some profit share. On the other hand, other old partner sacrifices in favour of new partner as well as old partner. Therefore the old partner who gains will have to give goodwill by his share of gain which is calculated by taking new partners' share in goodwill as base. The sacrificing partners' capital account is credited and gaining partners' capital account is debited.

Now, let us discuss accounting treatments of goodwill on the admission of a new partner.

Before studying accounting treatment of goodwill at the time of the admission of a new partner, it is very important to refer , the accounting standard 26. Accounting standard for intangible assets, issued by the Institute of Chartered Accountants of India.

According to para 35 of accounting standard-26, “Internally generated goodwill should not be recognised as an asset.” Which means that internally generated goodwill should not be shown in the books of accounts.

As per para 36 of this Accounting Standard, “Internally generated goodwill is not recognised as an asset because it is not an identifiable resource.” (i.e. It is not separable nor does it arise from contractual or other legal rights.) It is controlled by the entity that can be measured reliably at cost.)

Reference : [resource.cdn.icai.org/27292\\_abs-as-26.pdf](http://resource.cdn.icai.org/27292_abs-as-26.pdf).

Thus as per AS-26, internally generated goodwill does not arise due to a contract or any legal rights which are controlled by the firm and its cost can be decided specifically. Thus AS-26 specifies clearly that goodwill should be shown as an asset in the books only when some consideration is paid for goodwill. Internally generated goodwill should not be shown in the books of accounts.

At the time of the admission of a partner, goodwill is valued on the basis of internal resources of the firm like profit, capital employed; expected rate of return etc. Therefore, goodwill can not be shown as an asset in the balance sheet of the firm. Looking to this fact, old goodwill appearing in the balance sheet of the old firm must be written off among old partners in their old profit sharing ratio because old partnership is dissolved and a new partnership is reconstituted (reconstructed).

From the accounting point of view goodwill is a compensation for the profit sacrificed by old partners in favour of new partner. Therefore new partners' share in goodwill is received by old partners in their sacrificing ratio, and if any goodwill appears in the balance sheet of the old firm it must be written off in old profit-loss sharing ratio among the old partners.

From the accounting point of view, there may be different situations relating to treatment of goodwill. These are :

- (1) When goodwill is paid privately by the new partner.
- (2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business.
- (3) When premium of goodwill is brought in cash by the new partner and it is withdrawn by the old partners fully or partly.
- (4) When the new partner does not bring his share in goodwill in cash.
- (5) When the new partner brings his share in goodwill partly in cash.
- (6) When valuation of goodwill is made on the basis of partners' capital (hidden goodwill)

Let us study all these different situations related to the treatment of goodwill in detail.

**(1) When the goodwill premium is paid privately by the new partner :**

When the goodwill premium is paid privately by the new partner to the old partners, no entry is recorded in the books of accounts of the firm.

**(2) When premium for goodwill is brought in cash or kind by the new partner and it is retained in the business :**

The amount of goodwill brought in cash or kind by the new partner is shared by the sacrificing partners (old partners) in their sacrificing ratio.

**Accounting entries :**

- (1) When premium for goodwill brought in cash by the new partner :

Cash/Bank A/c ..... Dr

To Premium for goodwill A/c

- (2) (i) **When premium for goodwill brought in by the new partner i.e. personal land, building, motor car brought in firm as a goodwill :**

Land and building A/c .....Dr

Motor car A/c .....Dr

Other assets A/c .....Dr

To Premium for goodwill A/c

**Note :** Instead of above two entries, we can pass one combined entry :

Cash/Bank A/c .....Dr

Land/Building A/c .....Dr

Motor car A/c .....Dr

Other assets A/c .....Dr

To Premium for goodwill A/c

- (ii) **For the distribution of premium for goodwill among the partners in their sacrificing ratio :**

Premium for goodwill A/c .....Dr

To Old partners capital/current A/c

**OR**

If out of old partners, any partner gains in new profit-loss sharing ratio compared to old profit-loss sharing ratio, i.e. if sacrifice of an old partner is negative, he is also required to give goodwill by his share of gain to other sacrificing partners. Under this situation following journal entry is passed.

Premium for goodwill A/c ....Dr

Old partners' (gaining partners') capital/current A/c ....Dr

To Old partners' (sacrificing partners') capital/current A/c

**Note :** Goodwill appearing in the books (Balance sheet) of old partners is written off among the old partners in their old profit-loss sharing ratio for which following journal entry is passed :

Old partners' capital/current A/c ....Dr

To Goodwill A/c (shown in old balance sheet)

**Note :** (1) In every situation of accounting treatment of goodwill, old goodwill shown in the books of old firm is written off by debiting old partners capital / current accounts because old partnership comes to an end and new goodwill is valued for which accounting treatment is given as per AS-26.

(2) If it is specifically mentioned that capital accounts of partners are maintained on fixed capital accounts method, goodwill should be transferred to partners' current account. If it is not mentioned specifically, it is assumed that the partners maintain their capital accounts by fluctuating capital method and the effect of goodwill should be given to partners' capital account only.

**When sacrificing share or sacrificing ratio of old partners is not given (old ratio of old partners and new partners' profit share are given) :**

**Illustration 10 :** Aahna and Amina are partners sharing profit-loss in the ratio of 3:2. They admitted Aman as a new partner for  $\frac{1}{4}$ th share. The goodwill of the firm is valued at ₹ 1,20,000. Aman has to bring ₹ 50,000 as capital and his share of premium for goodwill in cash. Pass journal entries regarding goodwill.

**Ans. :**

#### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr To Aman's capital A/c To Premium for Goodwill A/c [Being cash brought by Aman for capital and for premium for goodwill.]		80,000	50,000 30,000
(2)	Premium for goodwill A/c Dr To Aahna's capital A/c To Amina's capital A/c [Being premium for goodwill distributed by old partners in their sacrificing ratio of 3:2.]		30,000	18,000 12,000

**Explanation (1)** New profit-loss sharing ratio :

Suppose total share of profit = 1

$$\text{Share of Aman} = \frac{1}{4}$$

$$\therefore \text{Remaining share of Aahna and Amina} = 1 - \frac{1}{4} = \frac{4-1}{4} = \frac{3}{4}$$

Remaining share of  $\frac{3}{4}$  is distributed between Aahna and Amina in the ratio of 3:2.

$$\therefore \text{New share of Aahna} = \frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$$

$$\text{New share of Amina} = \frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$$

$$\text{New share of Aman} = \frac{1}{4} = \frac{5}{20}$$

$$\therefore \text{New profit-loss sharing ratio} = 9:6:5$$

**(2)** Sacrificing ratio :

Sacrifice = Old share – New share

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

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

$$\therefore \text{Sacrificing ratio} = 3:2$$

**Note :** When new sharing ratio or sacrificing ratio is not given, sacrificing ratio will be the old profit sharing ratio.

$$\begin{aligned} \text{Share of goodwill of Aman} &= ₹ 1,20,000 \times \frac{1}{4} \\ &= ₹ 30,000 \end{aligned}$$

Capital of Aman ₹ 50,000 and goodwill ₹ 30,000, total cash ₹ 80,000.

**(3)** Distribution of premium for goodwill in sacrificing ratio :

$$\text{Aahna} : ₹ 30,000 \times \frac{3}{5} = ₹ 18,000$$

$$\text{Amina} : ₹ 30,000 \times \frac{2}{5} = ₹ 12,000$$

**When old ratio of old partners, new partners' share and profit-loss sharing ratio of all partners are given.**

**Illustration 11 :** Aayush and Aaditya are the partners sharing profit and loss in the ratio of 5:3. They admitted Parth as a new partner in the firm for  $\frac{1}{4}$ th share. Parth brings land and building worth ₹ 1,00,000, motor car ₹ 50,000 and cash ₹ 30,000 for his capital and premium for goodwill. Goodwill of the firm is valued ₹ 1,60,000. The new profit and loss ratio is decided at 2:1:1. Give necessary journal entry.

Ans. :

### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Land and building A/c Dr Motor car A/c Dr Cash A/c Dr To Parth's capital A/c To Premium for Goodwill A/c [Being Parth brought in the firm land-building, motor car and cash as capital and premium for goodwill.]		1,00,000 50,000 30,000	1,40,000 40,000
(2)	Premium for goodwill A/c Dr To Aayush's capital A/c To Aaditya's capital A/c [Being premium for goodwill distributed between old partners in their sacrificing ratio 1:1.]		40,000	20,000 20,000

**Explanation (1) Sacrificing ratio :**

Old profit-loss sharing ratio of Aayush and Aaditya = 5:3

New profit-loss sharing ratio of Aayush, Aaditya and Parth = 2:1:1

Sacrifice = Old share – New share

$$\text{Aayush} = \frac{5}{8} - \frac{2}{4} = \frac{5-4}{8} = \frac{1}{8}$$

$$\text{Aaditya} = \frac{3}{8} - \frac{1}{4} = \frac{3-2}{8} = \frac{1}{8}$$

∴ Sacrificing ratio = 1:1

(2) Share of Parth in goodwill :

$$\text{Parth's share in goodwill} = ₹ 1,60,000 \times \frac{1}{4} = ₹ 40,000$$

(3) Capital brought by Parth :

Parth's share in capital = Land and building	₹ 1,00,000
Motor car	₹ 50,000
Cash	₹ 30,000
Total	₹ 1,80,000

**Less :** Amount of premium for goodwill brought by Parth ₹ 40,000

∴ Capital brought by Parth ₹ 1,40,000

(4) Distribution of premium for goodwill in sacrificing ratio :

$$\text{Aayush} : ₹ 40,000 \times \frac{1}{2} = 20,000$$

$$\text{Aaditya} : ₹ 40,000 \times \frac{1}{2} = 20,000$$



**When old partners sacrifice some part of their share :**

**Illustration 12 :** X and Y are the partners of a firm. They admitted Z as a new partner on 1 April, 2016.

X sacrificed  $\frac{1}{2}$  of his share and Y sacrificed  $\frac{3}{4}$ th of his share in favour of Z. X and Z maintain their accounts as per fixed capital method. Z brought in ₹ 60,000 for his capital and ₹ 20,000 for his share of premium for goodwill in cash. Goodwill appeared in the books of the firm at ₹ 30,000 as on 31-3-2016. Give necessary journal entries at the time of Z's admission.

**Ans. :**

**Journal Entries**

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	X's current A/c Dr Y's current A/c Dr To Goodwill A/c [Being old goodwill written off among old partners in their old profit-loss ratio.]		15,000 15,000	30,000
(2)	Cash A/c Dr To Z's capital A/c To Premium for Goodwill A/c [Being Z brought cash as goodwill and capital.]		80,000	60,000 20,000
(3)	Premium for goodwill A/c Dr To X's current A/c To Y's current A/c [Being premium for goodwill distributed between X and Y in their sacrificing ratio.]		20,000	8000 12,000

**Explanation :** Sacrificing ratio :

Old sharing ratio of X and Y = 1:1 (X sacrificed  $\frac{1}{2}$  this share while Y sacrificed  $\frac{3}{4}$  his share)

Sacrifice of X =  $\frac{1}{2} \times \frac{1}{2} = \frac{1}{4} \times \frac{2}{2} = \frac{2}{8}$  (Making denominator equal)

Sacrifice of Y =  $\frac{1}{2} \times \frac{3}{4} = \frac{3}{8}$

∴ Sacrificing ratio of X and Y =  $\frac{1}{4} : \frac{3}{8} = 2:3$  Goodwill will be distributed between X and Y in this ratio.

**When an old partner gains due to the admission of a new partner :**

**Illustration 13 :** X and Y are the partners in a firm sharing profit and loss in the ratio of 4:3. They admitted Z as a new partner on 1 April 2016. At the time of admission of Z, balance of capital of X and Y are ₹ 30,000 and ₹ 40,000 respectively. They decide their new profit sharing ratio at 2:4:1. Z brought ₹ 50,000 as his capital and share of his goodwill in cash. On the date of admission of Z, goodwill of the firm was valued at ₹ 84,000. Goodwill appeared in the balance sheet of X and Y at ₹ 35,000.

Pass necessary journal entries and prepare all three partners' capital accounts.

Ans. :

### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	X's capital A/c Dr Y's capital A/c Dr To Goodwill A/c [Being old goodwill is written off among old partners A and B in their old ratio.]		20,000 15,000	35,000
(2)	Cash/Bank A/c Dr To Z's capital A/c To Premium for goodwill A/c [Being Z, the new partner brought his capital and goodwill in cash.]		62,000	50,000 12,000
(3)	Premium for goodwill A/c Dr Y's capital A/c Dr To X's capital A/c [Being the goodwill premium of Z and share in goodwill of Y's gain debited to their capital accounts and credited to X's capital account.]		12,000 12,000	24,000

### Capital Accounts of Partners

Dr

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Date	Particulars	X (₹)	Y (₹)	Z (₹)	Date	Particulars	X (₹)	Y (₹)	Z (₹)
1-4-16	To Goodwill A/c	20,000	15,000	—	1-4-16	By Balance b/d	30,000	40,000	—
1-4-16	To X's capital A/c	—	12,000	—	1-4-16	By Cash A/c	—	—	50,000
1-4-16	To Balance c/f	34,000	13,000	50,000	1-4-16	By Premium for goodwill A/c	12,000	—	—
					1-4-16	By Y's capital A/c	12,000	—	—
		<b>54,000</b>	<b>40,000</b>	<b>50,000</b>			<b>54,000</b>	<b>40,000</b>	<b>50,000</b>

Old and new profit-loss sharing ratios are given. Premium for goodwill is distributed in sacrificing ratio by deducting new share from old share.

Due to the admission of Z, sacrifice of X is  $\frac{2}{7}$ , while Y gains instead of sacrifice. Therefore Y's share in goodwill is debited to his capital account. Premium for goodwill and Y's share in goodwill, both will be credited to X's capital account.

**Explanation (1)** Sacrificing ratio :

Old profit sharing ratio of X and Y = 4:3

New profit sharing ratio of X, Y and Z = 2:4:1

Sacrifice = Old share – New share

$$X's \text{ sacrifice} = \frac{4}{7} - \frac{2}{7} = \frac{2}{7}$$

$$Y's \text{ sacrifice} = \frac{3}{7} - \frac{4}{7} = -\frac{1}{7} \text{ (ratio of gain)}$$

(2) Distribution of premium for goodwill :

$$Z's \text{ share in goodwill} = ₹ 84,000 \times \frac{1}{7} = 12,000$$

Y gains in new profit-loss ratio, therefore Y will also give goodwill to X by his share of gain.

$$\text{Goodwill payable by Y} = 84,000 \times \frac{1}{7} = 12,000$$

(3) Goodwill receivable by X :

$$X's \text{ sacrifice} = \frac{2}{7}$$

$$\text{Goodwill receivable by X} = \frac{2}{7} \times 84,000 = 24,000$$

(4) Old goodwill will be written off among old partners in their old ratio :

$$X : ₹ 35,000 \times \frac{4}{7} = 20,000$$

$$Y : ₹ 35,000 \times \frac{3}{7} = 15,000$$

**(3) When new partner brings his share of goodwill premium in cash and it is withdrawn by the old partners :**

When premium of goodwill is brought in cash by a new partner and it is withdrawn by the old partners, following journal entries are passed in the books of the firm :

#### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When old goodwill of the firm appears in the balance sheet of the firm, it is written off between old partners' capital A/c in their old profit sharing ratio : Old partners' capital A/c Dr To Goodwill A/c [Being old goodwill written off between old partner in their old profit sharing ratio.]		.....	.....
(2)	When new partner brings his share of goodwill and his capital in cash : Cash A/c Dr To New partners' capital A/c To Premium for goodwill A/c [Being new partner brought cash for his share of goodwill and capital.]		.....	..... .....

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(3)	When premium for goodwill is distributed between old partners in their sacrificing ratio : Premium for goodwill A/c Dr To Old partners' capital A/c [Being premium for goodwill distributed between old partners' in their sacrificing ratio.]		.....	.....
(4)	When premium for goodwill fully or partly withdrawn by old partners in cash : Old partners' capital A/c Dr To Cash A/c [Being old partners' withdrew their share of premium for goodwill fully or partly in cash.]		.....	.....

**Illustration 14 :** A, B and C are partners sharing profit and losses in the ratio of 3:2:1. They admitted D as a new partner. D brought ₹ 80,000 as capital and ₹ 60,000 as goodwill in cash. New profit sharing ratio of A, B, C and D is decided at 4:3:2:3. Old partners withdrew 50 % of their share of goodwill in cash. Pass necessary journal entries. Partners maintain their capital accounts by fixed capital method.

#### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr To D's capital A/c To Premium for goodwill A/c [Being D brought his share of goodwill and capital in cash.]		1,40,000	80,000 60,000
(2)	Premium for goodwill A/c Dr To A's current A/c To B's current A/c [Being premium for goodwill is distributed between old partners in their sacrificing ratio.]		60,000	40,000 20,000
(3)	A's current A/c Dr B's current A/c Dr To Cash A/c [Being 50 % goodwill withdrawn by old partners in cash.]		20,000 10,000	30,000

**Explanation :**

Old and new profit-loss sharing ratio is given, therefore goodwill will be distributed in the sacrificing ratio by deducting new share from old share.

Sacrificing ratio :

Sacrifice = Old share – New share

Old profit sharing ratio of A, B and C = 3:2:1

$$A = \frac{3}{6} - \frac{4}{12} = \frac{6-4}{12} = \frac{2}{12}$$

New profit sharing ratio of A, B, C and D = 4:3:2:3

$$B = \frac{2}{6} - \frac{3}{12} = \frac{4-3}{12} = \frac{1}{12}$$

$$C = \frac{1}{6} - \frac{2}{12} = \frac{2-2}{12} = 0$$

∴ Sacrificing ratio of A and B = 2:1

**(4) When the new partner is not able to bring his share of premium for goodwill in cash :**

If a new partner does not bring his share of goodwill in cash, the new partners' capital account is debited by his share of goodwill and the sacrificing partners' capital accounts are credited in their sacrificing ratio. The following journal entries are recorded.

**Journal Entries**

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When new partner brings his capital in cash : Cash A/c Dr To New partners' capital A/c [Being new partner brought his capital in cash.]		.....	.....
(2)	When new partners' share of goodwill is debited to his capital A/c and distributed between old partners in their sacrificing ratio : New partners' capital A/c Dr To Old partners' capital A/c [Being new partners' capital A/c debited by his share of goodwill and old partners' capital accounts are credited in their sacrificing ratio.]  <b>Note :</b> There is no difference in journal entries for old goodwill written off and withdrawn in cash.		.....	.....

**Illustration 15 :** A and B are the partners sharing profit and loss in the ratio of 3:2. They admitted C as a new partner for  $\frac{1}{6}$ th share of profit. C brought ₹ 1,00,000 in cash as capital. But he is not able to bring in his share of goodwill. The goodwill of the firm is valued at ₹ 3,00,000 at the time of admission of a new partner. Pass necessary journal entries.

Ans. :

### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c Dr To C's capital A/c [Being C brought cash as his capital.]		1,00,000	1,00,000
(2)	C's capital A/c Dr To A's capital A/c To B's capital A/c [Being C's share in goodwill distributed to A and B in their sacrificing ratio.]		50,000	30,000 20,000

**Explanation :** (1) : C's share in goodwill =  $\frac{1}{6} \times 3,00,000 = ₹ 50,000$

(2) : C's share of goodwill received by A and B in their sacrificing ratio :

$$A : 50,000 \times \frac{3}{5} = ₹ 30,000$$

$$B : 50,000 \times \frac{2}{5} = ₹ 20,000$$

**Note :** Here, old ratio = Sacrificing ratio = 3:2

**(5) When only a part of the premium for goodwill is brought by a new partner in cash :**

When only part of the premium for goodwill is brought by a new partner in cash the premium for goodwill account is credited for the amount of premium brought in cash by him. Thereafter his capital account is debited by the amount of goodwill not brought in cash and premium for goodwill account is debited by the amount of goodwill brought in cash and total share of new partner in goodwill is credited to old partners' capital accounts in their sacrificing ratio. Journal entries for old goodwill to write off and goodwill withdrawn by old partners will remain the same as in the earlier cases. Journal entries for new partners' share in goodwill in this situation are as follows :

### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	When part of share in goodwill and his capital brought in by new partner in cash : Cash A/c Dr To New partners' capital A/c To Premium for goodwill A/c (Goodwill brought in cash) [Being new partner brought capital and his share of goodwill in cash.]		.....	..... .....

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	Premium for goodwill A/c Dr (Goodwill brought in cash) New partners' capital A/c Dr (Goodwill not brought in cash) To Old partners' capital A/c [Being new partners' goodwill is distributed between old partners in their sacrificing ratio.] <b>Note :</b> There is no change in writing off old goodwill among old partners in their old profit- loss sharing ratio.		.....  .....	.....

**Illustration 16 :** A and B are the partners in a firm sharing profit and loss in the ratio of 2:1. They admitted C as a new partner for  $\frac{1}{3}$ rd share in the profit of the firm. C brought ₹ 70,000 as capital and ₹ 30,000 as premium for goodwill in cash. Goodwill of the firm valued at ₹ 1,20,000 at the time of admission of a new partner. Goodwill appeared in the balance sheet of A and B at ₹ 60,000. New profit sharing ratio of all three partners is to be 1:1:1.

**Ans. :**

#### Journal Entries

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	A's capital A/c Dr B's capital A/c Dr To Goodwill A/c [Being old goodwill written off between old partners in the old ratio.]		40,000 20,000	60,000
(2)	Cash A/c Dr To C's capital A/c To Premium for goodwill A/c [Being C brought part of his share of goodwill and capital in cash.]		1,00,000	70,000 30,000
(3)	Premium for goodwill A/c Dr C's capital A/c Dr To A's capital A/c [Being C's share of goodwill credited to A's capital A/c.]		30,000 10,000	40,000

**Explanation (1) :** C's share of goodwill =  $1,20,000 \times \frac{1}{3} = 40,000$

Goodwill not brought in cash by C

= ₹ 40,000 – ₹ 30,000 brought in cash

= ₹ 10,000

(2) : Sacrificing ratio :

Old profit sharing ratio of A and B = 2:1

New profit sharing ratio of A, B and C = 1:1:1

Sacrifice = Old share – New share

$$A : \frac{2}{3} - \frac{1}{3} = \frac{1}{3}$$

$$B : \frac{1}{3} - \frac{1}{3} = 0$$

Only A will receive goodwill brought by C.

**(6) When goodwill is valued on the basis of net worth or capital of partners (Hidden goodwill)**

When the amount of goodwill is not given, at the time of admission of a partner, goodwill of the firm is valued on the basis of net worth of the firm or capital of partners. For example, A and B whose capitals in the firm are at ₹ 50,000 and ₹ 30,000 respectively. They admit C as a new partner for  $\frac{1}{5}$ th share of profits and he brings in ₹ 40,000 as his share of capital. The sacrificing ratio of A and B is equal. In this case, the total capital of the firm should be ₹ 2,00,000 by taking C's capital as base.

$$(\frac{1}{5}\text{th share} = ₹ 40,000 \text{ capital})$$

$$1 \text{ share} = ?$$

$$= ₹ 40,000 \times 5 = ₹ 2,00,000$$

But the combined capital of all three partners or net worth is ₹ 1,20,000.

$$(₹ 50,000 + ₹ 30,000 + ₹ 40,000)$$

Goodwill of the firm = Net worth of firm on the basis of new partner C's capital –  
New worth of the firm excluding goodwill

$$= ₹ 2,00,000 - ₹ 1,20,000$$

$$= ₹ 80,000$$

$$\text{C's share of goodwill} = ₹ 80,000 \times \frac{1}{5}$$

$$= ₹ 16,000$$

C's share of goodwill ₹ 16,000 will be distributed between A and B in equal proportion, i.e. in their sacrificing ratio.

**Illustration 17 :** A and B are the partners sharing profit and loss in the ratio of 3:2. Their capital is ₹ 1,00,000 and ₹ 1,50,000 respectively as on 31-3-2016. On that day the balance sheet of the firm shows general reserve of ₹ 30,000. They admitted C as a new partner for  $\frac{1}{4}$ th share in profit on 1-4-2016. C brings ₹ 1,20,000 as a capital. Pass journal entries for goodwill. Show necessary calculation.

**Ans. :**

**Journal Entries**

Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(1)	Cash A/c To C's capital A/c [Being C brought capital in cash.]		1,20,000	1,20,000



Date/No.	Particulars	L.F.	Debit (₹)	Credit (₹)
(2)	C's capital A/c Dr To A's capital A/c To B's capital A/c [Being C's share of goodwill distributed between A and B in their sacrificing ratio.]		20,000	12,000 8000

**Explanation (1) :** Calculation of goodwill of the firm :

Net worth of the firm (including goodwill) on the basis of C's capital

$$\frac{1}{4} = ₹ 1,20,000$$

$$1 = (?)$$

$$= ₹ 1,20,000 \times 4 = ₹ 4,80,000$$

Net worth of the firm (excluding goodwill) = Old partners' capital + General reserve

+ New partner's capital

$$= ₹ 1,00,000 + ₹ 1,50,000 + ₹ 30,000 + ₹ 1,20,000$$

$$= 4,00,000$$

$$\text{Goodwill of the firm} = ₹ 4,80,000 - ₹ 4,00,000$$

$$= ₹ 80,000$$

$$\text{C's share of goodwill} = ₹ 80,000 \times \frac{1}{4}$$

$$= ₹ 20,000$$

**(2) :** Distribution of C's goodwill :

C's share of goodwill will be distributed between A and B in their sacrificing ratio 3:2.

(Old ratio = Sacrificing ratio = 3:2)

$$\text{Goodwill receivable by A} = ₹ 20,000 \times \frac{3}{5} = ₹ 12,000$$

$$\text{Goodwill receivable by B} = ₹ 20,000 \times \frac{2}{5} = ₹ 8000$$

## 5. Revaluation of Assets and Reassessment of Liabilities and its Accounting Effects

Fixed assets are recorded in the books of the firm at cost less depreciation. Book value of assets at the time of the admission of a new partner may be more or less than its market value. Some assets may not have been recorded in the books. Same thing is possible in the case of liabilities. Actual amount payable may be more or less than its book values. New partner is not entitled to receive any share in the profit due to the change in the values of assets and liabilities till the date of his admission. He will also not share such losses. Therefore, assets and liabilities are revalued at the time of the admission of a partner. To record the change in the values of assets and liabilities on account of their revaluation, an account called "Revaluation Account" is opened. It is also called as profit and loss adjustment A/c. Changes in the values of assets and liabilities are recorded in this account. Net profit or net loss of revaluation account is distributed among the old partners in their old profit sharing ratio.

Revaluation of assets and liabilities are recorded by two methods :

- (1) When assets and liabilities are to be shown in the books of the new firm at their new values (Revaluation account)
- (2) When assets and liabilities are to be shown in the books at their old values (Memorandum revaluation account)