1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 03 (Class XII, Semester - 1)
Module Name/Title	Nature of Partnership, Partnership Deed and Special Aspects of Partnership Accounts – Part 1
Module Id	leac_10301
Pre-requisites	Basic knowledge of Partnership - Fundamentals
Objectives	After going through this lesson, the learners will be able to understand recording of business transactions in the journal. • Meaning of Reconstitution • New Ratio & Sacrificing Ratio and their Calculation
Keywords	Various Aspect of Reconstitution, Admission – 1st Aspect of Reconstitution, New & Sacrificing Ratio

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Rejaul Karim Barbhuiya	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Prof. Shipra Vaidya	DESS, NCERT New Delhi
Course Co-Coordinator / Co-PI	Dr. Nidhi Gusain	CIET, NCERT, New Delhi
Subject Matter Expert (SME)	CA. Sanjay Mutreja	ICAI, New Delhi.
Review Team	Ms. Preeti Sharma Mr. Vinay Setia	Kendirya Vidyalaya, Sec 24, Noida Indraprastha Global School, New Delhi
Technical Team	Mr. Shobit Saxena Ms. Khushboo Sharma	CIET, NCERT, New Delhi CIET, NCERT, New Delhi

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1. Introduction of the chapter

Partnership is an agreement between two or more persons (called partners) for sharing the profits/ losses of a business carried on by all or any of them acting for all.

Image-1

Any change in the existing agreement amounts to reconstitution of the partnership firm. This will result in an end of the existing partnership agreement and a new agreement will come into effect with a changed relationship among the remaining members of the partnership firm (including New). However, the firm and the Business continue.

The partners often resort to reconstitution of the firm in various ways like Admission of a new partner, Change in profit sharing ratio, Retirement of a partner, Death or Insolvency of a partner.

In this chapter we are going to have a brief idea about all these and in Detail particularly about the Accounting implications of Admission of a new partner and change in the profit sharing ratio.

2. Various Modes of Reconstitution of a Partnership Firm

Let us discuss about various Modes of Reconstitution First

Mode 1. Admission of a new partner*:* A new partner may be admitted whenever the firm needs Additional capital or Managerial help. According to the provisions of Partnership Act 1932 unless it is otherwise provided in the partnership deed a new partner can be admitted only when the existing partners unanimously agree for it.

For example, A and B are partners sharing profits in the ratio of3:2. On April 1, 2017 they admitted C as a new partner with 1/6 share in profits of the firm. With this change, now there are three partners of the firm and it is said to be a New Reconstituted Firm.

Mode 2. Change in the profit sharing ratio among the existing partners*:* Sometimes the partners of a firm may decide to change their existing profit sharing ratio. This may happen an account of a change in the existing partners' role in the firm or May be someone not feeling well, Health issues, etc.

For example, Ram, Mohan and Sohan are partners in a firm sharing profits in the ratio of 3:2:1. With effect from April 1,2020 they decided to share profits equallyas Sohanis bringing in Additional capital. Now, this results in a change in the existing agreement leading to reconstitution of the firm.

Mode 3. Retirement of an existing partner*:* It means withdrawal by a partner from the business of the firm which may be due to his bad health, old age or change in business interests. In fact a partner can retire any time if the partnership is at will.

For example, A, B and C are partners in the firm sharing profits in the ratio of 2:2:1. On account of illness, B retired from the firm on March 31,2020. This will result in reconstitution of the firm now, as they are having only two partners.

Mode 4. Death of a partner*:* Partnership may also stand reconstituted on death of a partner, if the remaining partners decide to continue the business of the firm as usual.

For example, X, Y and Z are partners in a firm sharing profits in the ratio3:2:1.X died on March 31, 2020. Y and Z decide to carry on the business sharing future profits equally. The continuity of business by Y and Z sharing future profits equally leads to reconstitution of the firm.

3. Now, Let us discuss Admission of a New Partner in Detail

Image-2 (Two Partners Welcoming Third Partner)

Whenever the firm requires additional capital or managerial help or both for the purpose of expansion of its business a new partner may be admitted to supplement its existing resources. According to the Partnership Act 1932, a new partner can be admitted into the firm only with the consent of all the existing partners unless otherwise agreed upon. With the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm.

A newly admitted partner acquires two main rights in the firm–

1. Right to share the assets of the partnership firm; and
2. Right to share the profits of the partnership firm.

For the right to acquire share in the assets and profits of the partnership firm, the partner brings an agreed amount of capital either in cash or in kind.

Moreover, in the case of an established firm which may be earning more profits than the normal rate of return on its capital the new partner is required to contribute some additional amount known as Premium or Goodwill. This is done primarily to compensate the existing partners for loss of their share in Future Super Profits of the firm.

Following points require attention at the time of admission of a new partner:

A. New profit-sharing ratio;
B. Sacrificing ratio;
C. Valuation and adjustment of goodwill;
D. Revaluation of assets and Reassessment of liabilities;
E. Distribution of accumulated profits (reserves); and
F. Adjustment of partners' capitals. (On the basis of Old Partners or New Partner)

Now, this particular Video Tutorial will be concentrating on the first two topics, that is

A. New profit-sharing ratio;
B. Sacrificing ratio;

Let us begin with the very first Topic

A. New profit-sharing ratio

When new partner is admitted he acquires his share in profits from the old partners. In other words, on the admission of a new partner, the old partners sacrifice a share of their profit in favour of the new partner. But, what will be the share of new partner and how he will acquire it from the existing partners is decided mutually among the old partners and the new partner. However, if nothing is specified as to how the new partner will acquire his share from the old partners it may be assumed that he gets it from them in their existing (Old) profit sharing ratio.

In any case, on admission of a new partner, the profit sharing ratio among the old partners will change keeping in view their respective contribution to the profit sharing ratio of the incoming partner. Hence, there is a need to ascertain the new profit sharing ratio among all the partners. This will depend upon how the new partner will acquire his share from the old partners for which there are many possibilities.

Let us understand these various situations with the help of the following Examples.

Example1.

A and B are partners sharing profits in the ratio of 3:2. They admitted C as a new partner for 1/5 share in the future profits of the firm. Calculate new profit sharing ratio of A, B and C.

Solution

C's share =1/5

Remaining share =1-1/5 =4/5

A new share =3/5of4/5=12/25 AND **B**'s new share =2/5of4/5=8/25

So, now the New profit sharing ratio of A, B and C will be 12:8:5.

Note*:* As **Nothing was mentioned** about the Old partner's sacrifice or any change in Ratio, it has been **assumed** that the new partner will acquire his share from old partners **in the same old ratio.**

Let us take an example where we can understand this concept of **mentioning something else regarding the Ratio.**

<u>Example 2.</u>

A and B are partners sharing profits in the ratio of 3:2. They admit D as a new partner for 1/5th share in the future profits of the firm **which he gets equally from A and B**. Calculate new profit sharing ratio of A, B and D.

Solution

D share =1/5or2/10

A share =3/5-1/10= 5/10

B share =2/5-1/10=3/10

So, New profit sharing ratio between A, B and D will be 5:3:2.

<u>Example 3.</u>

M and N are partners sharing profits in the ratio of 3:2. They admitted O as a new partner for 3/10 share which he acquired 2/10 from M and1/10 from N. Calculate the new profit sharing ratio of M, N and O.

Solution

Old Partner's New Share= Old share – Share Surrendered

O new share =3/10

M new share =3/5- 2/10= 4/10

N new share = 2/5-1/10= 3/10

So, Now the new profit sharing ratio between M, N and O will be 4 : 3 : 3.

<u>Example 4.</u>

Y and Z are partners in a firm sharing profits in the ratio of 3:2. They admit G as a new partner. Y surrenders 1/4 of his share and Z 1/3 of his share in favour of G. Calculate new profit sharing ratio of Y, Z and G.

Solution

Y old share =3/5 and Share surrendered by Y =1/4of3/5= 3/20.

So, Y new share =3/5- 3/20= **9/20**.

Similarly, Share surrendered by Z =1/3of2/5= 2/15

Z new share =2/5- 2/15= **4/15**

G new share = Y sacrifice + Z Sacrifice=3/20+ 2/15= 17/60

So, New profit sharing ratio among Y, Z and G will be 27:16:17

<u>Example 5</u>.

D and S are partners in a firm sharing profits in 4:1 ratio. They admitted P as a new partner for 1/4 share in the profits, which he acquired wholly from D. Determine the new profit sharing ratio of the partners.

Solution

P share =1/4

D new share = Old Share – Share Surrendered

=4/5- 1/4= 11/20

S new share =1/5 (Same)

So, Now the new profit sharing ratio among D, S and P will be 11:4:5.

Coming to the second Topic, Sacrificing Ratio

B. Sacrificing Ratio

The ratio in which the old partners agree to sacrifice their share of profit in favour of the New incoming partner is called Sacrificing ratio. The sacrifice by a partner is equal to:

Sacrifice= Old Share of Profit – New Share of Profit

As stated earlier, the new partner is required to compensate the old partner's for their loss of share in the profits of the firm for which he brings in an additional amount known as premium or goodwill. This amount is shared by the existing partners in the ratio in which they forego their shares in favour of the new partner which is called **Sacrificing ratio**.

The ratio is normally clearly given as agreed among the partners which could be the old ratio, an equal sacrifice, or may be a specified ratio. The difficulty arises where the ratio in which the new partner acquires his share from the old partners is not specified. Instead, the new profit sharing ratio is given. In such a situation, the sacrificing ratio has to be worked out by deducting each partner's new share from his old share.

Example 6.

R and M are partners in a firm sharing profits in the ratio of 5:3. They admit B as a new partner for 1/7 share in the profit. The new profit sharing ratio will be 4:2:1. Calculate the sacrificing ratio of R and M.

Solution

R old share =5/8R new share =4/7

R sacrifice =5/8- 4/7= 3/56

M old share =3/8 M new share =2/7

M sacrifice =3/8- 2/7= 5/56

Sacrificing ratio among R and M will be 3:5.

Example 7

A and B are partners sharing profits in the ratio of 3:2. They admitted M as a new partner for 1/4 share. The new profit sharing ratio between A and B in future will be 2:1. Calculate their sacrificing ratio.

Solution

M share =1/4 So, the Remaining share =1-1/4=3/4

Now, this 3/4 share will be shared by A and B in the ratio of 2:1(Now onwards)

Therefore, A new share =2/3 x 3/4= 6/12

B new share = 1/3 x 3/4 = 3/12

New profit sharing ratio of A, B and M will be 2:1:1.

A sacrifice = Old- New= 3/5-6/12= 6/60

B sacrifice =Old- New= 2/5-3/12= 9/60

Sacrificing ratio among A and B will be 6:9 OR 2:3.

Let us take example where a New partner is Admitted and the Old Partner is RETAINING his Old Share.

Example 8

K, L and M are partners sharing profits in the ratio of 3:2:1. They admit N for 1/6th share. M would retain his original share. Find out the new ratio.

Solution

N share =1/6   So, the Remaining share =1-1/6= 5/6

M share will be his ORIGINAL share = 1/6

Now, the Remaining share (after M and N) =1-1/6-1/6= 4/6

Now, this 4/6 share will be shared by K and L

Therefore, K new share =4/6 x 3/5= 12/30

And L new share = 4/6 x 2/5 = 8/30

New profit sharing ratio of K, L, M and N will be 12:8:5:5