## 1. Details of Module and its structure

| Module Detail | |
|---|---|
| Subject Name | Accountancy |
| Course Name | Accountancy 03 (Class XII, Semester - 1) |
| Module Name/Title | Reconstitution of Partnership Firm-Admission of a Partner – Part 5 |
| Module Id | leac_10305 |
| Pre-requisites | Basic knowledge of Partnership – Fundamentals, Revaluation Account, Calculation of Ratios, etc. |
| Objectives | After going through this lesson, the learners will be able to understand recording of business transactions in the journal.<br>• Accounting Treatment of Hidden Goodwill<br>• Treatment of Accumulated Profits / Losses<br>• Revaluation of Assets & Liabilities |
| Keywords | Adjustment of Capital, Excess / Shortage adjustment – Cash / Current Account |

## 2. Development Team

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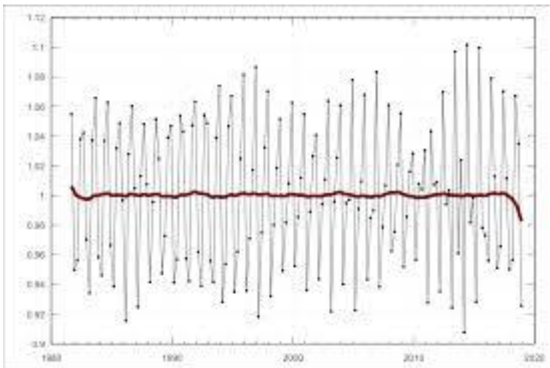
## 1. Adjustment of Capitals



Sometimes, at the time of admission, the partners may agree that their capitals should also be adjusted so as to be proportionate to their profit sharing ratio.

One situation can be when the capital of the new partner is given, and on the basis of that we have to calculate the new capitals of the old partners. The capitals thus as curtained should be compared with their old capitals after all adjustments relating to goodwill reserves and revaluation of assets and liabilities, etc. have been made; and then the partner whose capital falls short, will bring in the necessary amount to cover the shortage and the partner who has a surplus, will withdraw the excess amount of capital.

Now, let us first take an example on this point

**Example**

A and B are partners sharing profits in the ratio of 2:1. C is admitted into the firm for 1/4 share of profits. C brings in Rs. 20,000 in respect of his capital. The capitals of old partners A and B, after all adjustments relating to goodwill, revaluation of assets and liabilities, etc., are Rs. 45,000 and Rs. 15,000respectively. It is agreed that partners’ capitals should be according to the new profit sharing ratio.

Determine the new capitals of A and B and record the necessary journal entries assuming that the partner whose capital falls short, brings in the amount of deficiency and the partner who has an excess, withdraws the excess amount.

**Solution**

**Step 1**. Calculation of new profit sharing ratio:

Total Share = 1

C's Share =1/4

Remaining Shares =1-1/4=3/4

A's New Share =3/4x2/3=6/12

B's New Share =3/4x1/3=3/12

C's New Share = 1/4x3/3=3/12

Thus, new profit sharing ratio between A, B and C is 6:3:3 or 2:1:1.

**Step 2**. Required Capital of A and B

As C's capital (who has 1/4 share in profits) is Rs. 20,000. B's new share in profits1/4. Hence his capital will also be Rs. 20,000. A's new share is 2/4 which is double of C's share. Hence his capital will be Rs. 40,000.

**Alternatively**, based on C's capital, the total capital of the firm works out at

= Rs. 80,000 (4/1 × Rs.20,000).

Hence, based on their share in profits, the capital of A andB will be:

A's capital =2/4x80,000=40,000

B's capital =1/4x80.000=20.000

The capital of A and B after all adjustments have been made, are Rs. 45,000and Rs. 15,000 respectively. Hence, A will withdraw Rs. 5,000 (Rs. 45,000–Rs.40,000) from the firm whereas B will contribute additional amount of Rs. 5,000 (Rs. 20,000–Rs.15,000).

The journal entries will be :

A's Capital A/c Dr. 5,000

To Cash A/c 5,000

(Excess capital withdrawn by A)

Cash A/c Dr. 5,000

To B's Capital A/c 5,000

(Deficiency made good by additional amount brought in by B)

Sometimes, the total capital of the firm may clearly be specified and it is agreed that the capital of each partner should be proportionate to his share in profits. In such a situation each partner's capital (including the new partner's capital to be brought by him) is calculated on the basis of his share in profits.

By bringing in additional amount or withdrawal of excess amount, the final capital of each partner can be brought up to the required level.

It may be noted that subject to agreement among the partners, surplus or deficiency in each old partners' capital accounts can also be taken care of simply by transfer to their respective current accounts. (See the following Example)

**Example**

A, B and C are partners in a firm sharing profits the ratio of 3:2:1. D is admitted into the firm for 1/4 share in profits, which he gets as 1/8 from A and 1/8 from B. The total capital of the firm is agreed upon as Rs. 1,20,000 and D is to bring in cash equivalent to 1/4 of this amount as his capital. The capitals of other partners are also to be adjusted in the ratio of their respective shares in profits.

The capitals of A, B and C after all adjustments are Rs. 40,000, Rs. 35,000 and Rs. 30,000 respectively. Calculate new capitals of A, B and C, and record the necessary journal entries.

**Solution**

**1. Calculation of new profit sharing ratio**:

A =3/6-1/8=18/48

B =2/6-1/8=10/48

C will continue to get 1/6 =8/48 as his share in the profits.

D=1/4=12/48

Thus, the new profit sharing ratio between A, B, C and D will be:18:10:8:12 or 9:5:4:6

**2. Required capitals of all partners:**

A's Capital = Rs. 1,20,000x18/48=45,000B's Capital = Rs. 1,20,000x10/48=25,000

C's Capital = Rs. 1,20,000x8/48 =20,000D's Capital = Rs. 1,20,000x12/48=30,000

Hence, **A will bring** in Rs. 5,000 (Rs. 45,000 – Rs. 40,000), **B will withdraw** Rs. 10,000 (Rs. 35,000 – Rs. 25,000), **C will withdraw** Rs. 10,000 (Rs. 30,000 – Rs, 20,000) and **D will bring** in Rs. 30,000. Journal Entries will be:

Cash A/c Dr. 5,000

To A's Capital A/c 5,000

(Deficiency made good by additional amount brought in by A)

1. B's Capital A/c Dr. 10,000
   C's Capital A/c Dr. 10,000
   To Cash A/c 20,000

(Excess amounts withdrawn by B and C) 20,000

2. Cash A/c Dr. 30,000

To D's Capital A/c 30,000

(Cash brought in by D as Capital)

**Alternatively, the current accounts can be opened** and the amounts to be brought in or withdrawn by A, B and C will be transferred to their respective current accounts subject to the agreement among the partners. The journal entries in this regard will be recorded as follows:

**Books of A, B, C and D**

1. A's Current A/c Dr. 5,000

   To A's Capital A/c 5,000

   (Deficiency in A's capital transferred to A's Current Account)

2. B's Capital A/c Dr. 10,000

   C's Capital A/c Dr. 10,000

   To B's Current A/c 10,000

   To C's Current A/c 10,000

   (Excess Capital of B transferred to their current account)

**Que.** A and B are in partnership sharing profit and losses equally on 31st March 2019, their Balance Sheet stood as follows: -

**Balance Sheet as at 31.3.2019**

| **Liabilities** | | Rs. | **Assets** | Rs. |
|---|---|---|---|---|
| Creditors | | 80,000 | Cash | 30,000 |
| General Reserve | | 40,000 | Debtors | 2,30,000 |
| A's Capital | 1,50,000 | | Stock | 10,000 |
| B's Capital | 1,30,000 | 2,80,000 | Fixtures | 30,000 |
| | | | Land | 1,00,000 |
| | | 4,00,000 | | 4,00,000 |

On the same date, C was admitted into the firm subject to the following terms:

(a) C will be entitled to 1/3rd share of the profits;

(b) C will bring in Rs. 1,70,000 of which Rs. 5 0,000 will be treated as his share of goodwill;

(c) Rs. 10,000 is to be provided for Doubtful Debts;

(d) Fixtures is to be decreased by Rs. 6,000;

(e) Stock is to be revalued at Rs. 12,000;

(f) Capitals of old partners are to be re-adjusted on the basis of C's capital. (By Cash)

You are required to prepare the Revaluation Account, Partners' Capital Accounts, Cash Account and the Balance Sheet of the firm after the admission of C

**Solution:**

First of all we will make Revaluation account. All Losses will be debited & Gains will be credited. Let us start with Point no.(b). Mr. C will bring 1,70,000, Rs. 1,20,000 for Capital and Rs. 50,000 for Premium for Goodwill. C’s Capital will increase by 1,20,000 and 50,000 Premium will be distributed among Sacrificing (Old) Partners.

As regard Point no.(c), Prov. For doubtful debts will be made at10,000. All of them are being debited to Revaluation account, being a nominal account where all losses are debited and gains are credited.

And Similarly for Point no. (d), Fixtures, it is reduced by 6,000. This will be debited to Revaluation Account, being a loss.

Coming to Point no.(e), Stock will be increased by Rs. 2,000.

And in Point no. (f), Capital adjustments will be made.

A’s Capital before Capital Adjustment is Rs. 1,88,000 and as per the Final Adjustment in Working Note, it should be Rs. 1,20,000. So, he will withdraw Rs. 68,000, being Excess Capital.

And similarly, B’s Capital before Capital Adjustment is Rs. 1,68,000 and as per the Final Adjustment in Working Note, it should be Rs. 1,20,000. So, he will withdraw Rs. 48,000, being his Excess Capital.

Now, the final picture of Revaluation account, Capital account & Balance sheet will be like this:

Books of A, B and C

**Revaluation Account**

| **Particulars** | Rs. | **Particulars** | | Rs. |
|---|---|---|---|---|
| To Prov. for Doubtful Debts A/c | 10,000 | By Stock A/c | | 2,000 |
| To Fixtures A/c | 6,000 | By Loss transferred to | | |
| | | A's Capital A/c | 7,000 | |
| | | B's Capital A/c | 7,000 | 14,000 |
| | 16,000 | | | 16,000 |

Dr. Partners' capital Accounts Cr.

| Particulars | A Rs. | B Rs. | C Rs. | **Particulars** | **A Rs.** | B Rs. | **c Rs.** |
|---|---|---|---|---|---|---|---|
| To Rev.(Loss) | 7,000 | 7,000 | - | By Bal. b/d | 1,50,000 | 1,30,000 | - |
| To Cash(surplus | 68,000 | 48,000 | - | By Gen.Res. | 20,000 | 20,000 | - |
| | | | | By Cash A/c | - | — | 1,20,000 |
| To Balance c/d | 1,20,000 | 1,20,000 | 1,20,000 | By Goodwill | 25,000 | 25,000 | - |
| | 1,95,000 | 1,75,000 | 1,20,000 | | 1,95,000 | 1,75,000 | 1,20,000 |

Dr. Cash Account Cr.

| **Particulars** | Rs. | **Particulars** | **Rs.** |
|---|---|---|---|
| To Balance b/d | 30,000 | By A's Capital A/c | 68,000 |
| To C's Capital A/c | 1,20,000 | By B's Capital A/c | 48,000 |
| To Premium for Goodwill A/c | 50,000 | By Balance c/d | 84,000 |
| | 2,00,000 | | 2,00,000 |

Balance Sheet (After C's Admission) as at 31.3.2019

| Liabilities | | Rs. | Assets | | Rs. |
|---|---|---|---|---|---|
| Creditors | | 80,000 | Cash | | 84,000 |
| Capitals | | | Debtors | 2,30,000 | |

| | | | | | |
|---|---|---|---|---|---|
| A | 1,20,000 | | *Less:* Provision | 10,000 | 2,20,000 |
| B | 1,20,000 | | Stock | | 12,000 |
| C | 1,20,000 | 3,60,000 | Fixtures | | 24,000 |
| | | | Land | | 1,00,000 |
| | | 4,40,000 | | | 4,40,000 |

**Working Notes:**

**Calculation of Proportionate Capitals**

C's Capital = Rs. 1,20,000 for -rd share

Total Capital of the firm should be = Rs. 1,20,000 × 3 = Rs. 3,60,000

A's Capital = Rs. 1,20,000 (i.e. Rs. 3,60,000 × 1/3)

B's Capital = Rs. 1,20,000 (i.e. Rs. 3,60,000 × 1/3)

**Treatment of Goodwill**

| Date | Particulars | L.F. | Debit Rs. | Credit Rs. |
|---|---|---|---|---|
| 31.3.2019 | Cash A/c Dr. | | 1,70,000 | |
| | To C's Capital A/c | | | 1,20,000 |
| | To Premium for Goodwill A/c | | | 50,000 |
| | (Being cash brought in by C for his share of capital and goodwill) | | | |
| 31.3.2019 | Premium for Goodwill A/c Dr. | | 50,000 | |
| | To A's Capital A/c | | | 25,000 |
| | To B's Capital A/c | | | 25,000 |
| | (Being goodwill among A and B in sacrificing ratio) | | | |