

# Admission of a Partner Ch 2

## Reconstitution

### 1. What is Reconstitution ?

Change in existing relations of partners.

Four events :

- (a) Admission of a new partner <- Ch 2
- (b) Retirement / death of partner ( Ch 3 )
- (c) Change in profit sharing ratio
- (d) Dissolution of firm ( Ch 4 )

### 2. The Six Adjustments

- ① New PSR
- ② Sacrificing Ratio
- ③ Goodwill Treatment
- ④ Revaluation A/c Assets & Liab
- ⑤ Distribute Reserves + Acc P&L

### 6. Capital Adjustment

\*\*\* Framework for every admission Q !

### 3. New Profit Sharing Ratio

#### Case A : Default ( old PSR )

If source not specified, new partner takes from old in OLD PSR.

$$\text{New old share} = \text{Old} \times (1 - \text{new})$$

Eg.  $A:B = 3:2$  ;  $C = 1/4$

Remaining =  $3/4$

$$A = 3/5 \times 3/4 = 9/20$$

$$B = 2/5 \times 3/4 = 6/20$$

$$C = 5/20$$

$$\text{New PSR} = 9 : 6 : 5$$

#### Case B : Specific Fractions

Subtract surrendered share from each old partner's old share directly.

#### Case C : Fractions of Each

Eg. surrenders  $1/3$  of A's +  $1/4$  of B's

Compute each surrender and subtract.

## 4. Sacrificing Ratio

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

If new partner takes from old in old PSR  $\rightarrow$  Sacrificing Ratio = Old PSR.

### Used for

- (i) Distributing goodwill premium \*
- (ii) Change in PSR ( mirror = gain ratio )

## 5. Goodwill - Definition

Present value of future super profits.

Captures reputation, brand, customers.

\*\*\* AS-26 : self-generated goodwill  
CANNOT be shown on balance sheet.  
Write off existing ~~revaluation~~ goodwill  
first !

## 6. Goodwill Methods

### Method 1 : Average Profit

$$G = \text{Avg Profit} \times \text{Yrs Purchase}$$

Eg. Avg = 52000, 4 yrs  $\Rightarrow$  G = 208000

### Method 2 : Super Profit

Super Profit = Actual - Normal

Normal = Capital Emp  $\times$  Rate/100

$$G = \text{Super Profit} \times \text{Yrs Purchase}$$

### Method 3 : Capitalisation

Cap Value = Avg Profit  $\times$  100 / r

$$G = \text{Cap Value} - \text{Cap Emp}$$

\*\*\* Cap Emp = Net Assets (not gross)  
always subtract liab !

## 7. Goodwill Treatment

### (a) Brought in Cash

Cash/Bank A/c Dr.

To Premium for Goodwill A/c

Premium for Goodwill A/c Dr.

To Sacrificing Partners' Cap A/cs

( in sacrificing ratio )

### (b) Hidden Goodwill\*

Can't bring in cash -> use cap A/cs :

New Partner's Cap A/c Dr.

To Sacrificing Partners' Cap A/cs

### (c) Existing Goodwill

WRITE OFF FIRST :

Old Partners' Cap A/cs ( OLD PSR ) Dr.

To Goodwill A/c

### (d) Paid Privately

\*\*\* NO ENTRY in firm's books !

## 8. Revaluation A/c

### Rules

Asset UP  $\rightarrow$  Credit Reval

Asset DOWN  $\rightarrow$  Debit Reval

Liab UP  $\rightarrow$  Debit Reval

Liab DOWN  $\rightarrow$  Credit Reval

Unrecorded Asset  $\rightarrow$  Credit Reval

Unrecorded Liab  $\rightarrow$  Debit Reval

New Provision  $\rightarrow$  Debit Reval

Net gain/loss  $\rightarrow$  OLD PARTNERS  
in OLD PSR.

\*\*\* Mnemonic : Asset UP = Credit  
( what you have is more = good )

## 9. Reserves & Acc P&L

Distribute in OLD PSR before admission.

Cr balance P&L = profit  $\rightarrow$  credit old

Dr balance P&L = loss  $\rightarrow$  debit old

## 10. Capital Adjustment

Method 1 : Based on New Capital

$$\text{Total Cap} = \text{New Cap} / \text{New Share}$$

Each old partner's required cap =

$$\text{Total Cap} \times \text{new share.}$$

Adjust difference via cash/current A/cs.

## 11. Hidden Goodwill

When new partner brings capital but amount is more than his share warrants.

$$\text{Implied Total} = \text{New Cap} / \text{New Sh}$$

Eg. R brings 25k for 1/4 share.

$$\text{Implied Total} = 100k.$$

$$\text{IF Actual} = 120k \rightarrow \text{Hidden GW} = 20k.$$

## 12. Worked Example

A:B = 3:2 ; admit C for 1/4 with cap  
100k and goodwill 60k. Reval profit 27k.  
Reserves 16k existing.

### Step-by-Step

- (1) New PSR = 9 : 6 : 5
- (2) Sac Ratio = 3 : 2 ( = old )
- (3) Goodwill 60k  $\rightarrow$  A : 36k, B : 24k
- (4) Reval 27k  $\rightarrow$  A : 16200, B : 10800
- (5) Reserves 16k  $\rightarrow$  A : 9600, B : 6400
- (6) Final capitals computed.

## 13. Revision Map

Six adjustments framework

Sacrifice = Old - New

AS-26 : write off existing goodwill

3 GW methods : Aug / Super / Cap

Reval : Asset UP = Credit

Old PSR : \* Reval + Reserves + Acc P&L