Class 12

Accountancy

Chapter - 2

Reconstitution of a Partnership Firm

Admission of a Partner

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Reconstitution of Partnership Firms

Reconstitution of Partnership Firms

A change in the nature of relationship among the members, effected through a fresh agreement under which the existing business continues is called reconstitution

Modes of Reconstitution

- Admission of a partner
- Change in profit sharing ratio
- Retirement of a partner
- Death of a partner

Admission of a Partner

Admission of a Partner

A new partner can be admitted 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

Rights of a new Partner

1. Right to share the assets of the firm

2. Right to share future profits of the firm

Rights of a new Partner

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

Rights of a new Partner

In the case of an established firm which may be earning more profits than the normal rate of return on its capital (super profit) the new partner is required to contribute some additional amount known as premium or goodwill

Such an amount of premium (goodwill) is to be shared among the old partners in their sacrificing ratio in order to compensate them for loss of their share in super profits of the firm in future

Accounting Treatments on Admission

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Accounting Treatments - Admission

1. Capital of the new partner

2. Calculation of new profit sharing ratio

3. Calculation of sacrificing ratio

4. Treatment of Goodwill

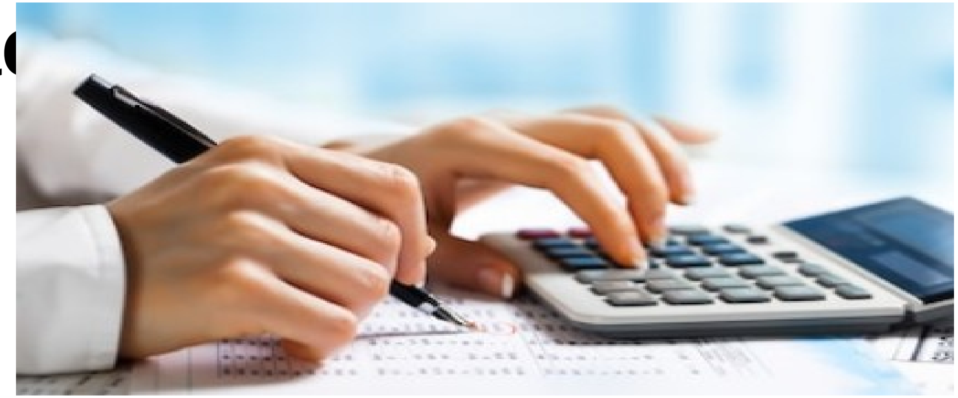
Accounting Treatments - Admission

5. Revaluation of Assets and Liabilities.

6. Adjustment of reserves and other accumulated profits and losses.

7. Adjustment of capital ac

partners.



Accounting Treatments - Admission

Capital of the new partner

The new partner may bring his capital either by **cash** or in the form of **assets**

Accounting Treatments - Admission

Capital of the new partner

1. When a new partner brings cash as capital

Cash **Capital**

Cash A/c Dr

To New Partner's Capital A/c

Accounting Treatments - Admission

Capital of the new partner

2. When the new partner brings cash and other assets

Cash | **Assets** | **Capital**

Cash A/c Dr

Assets A/c (individually) Dr

To New partner's capital A/c

Calculation of New Ratio

Calculation of New Ratio

Incoming partner acquires his share of profit from the old partners

New ratio is determined by considering how the new partner acquires his share of profit from the old partners

Calculation of New Ratio

Possibilities:

1. He may acquire it from the old partners in the old ratio

Old Ratio

Calculation of New Ratio

Possibilities:

2. Equally from the old partners

1 : 1

Calculation of New Ratio

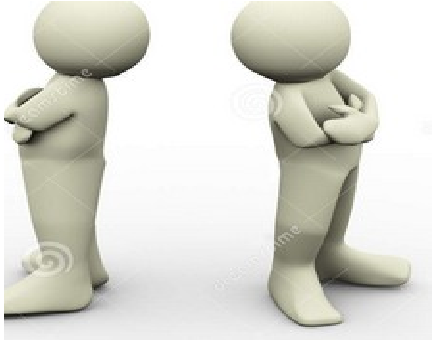
Possibilities:

3. At some agreed ratio

Calculation of New Ratio

Possibilities:

4. He may acquire it wholly from one or more partners



Calculation of New Ratio

Possibilities:

5. He may acquire it in the form of certain fraction of old partners' share in profits

(Eg. A surrendered 1/32 of his share and B 3/32 of his share in favour of C)

1/32

Calculation of New Ratio

If the partnership **deed is silent** regarding this matter, the new partner acquires his share in profits from the old partners in the **old ratio**, and the old partners continue to share the remaining profits in the old ratio

Old Ratio

Calculation of Sacrificing Ratio

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Sacrificing Ratio

Ratio in which the old partners have agreed to sacrifice their share of profits in favour of the new partner

Calculation of Sacrificing Ratio

While admitting a new partner, he is required to compensate the old partners for his right to share in the future profits of the firm

If it is made in cash, it can be shared by the old partners in their sacrificing ratio

Calculation of Sacrificing Ratio

Sacrificing Ratio = Old Ratio – New Ratio

SR = OR - NR

Goodwill

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Goodwill

Goodwill is the value of reputation of a firm

It is in respect of the profits expected in future over and above the normal profits

Goodwill

Over a period of time a well established business develops an advantage of good name, reputation and wide business connections which help the business to earn more profits

In accounting, the monetary value of such advantage is known as goodwill

Factors Affecting Goodwill

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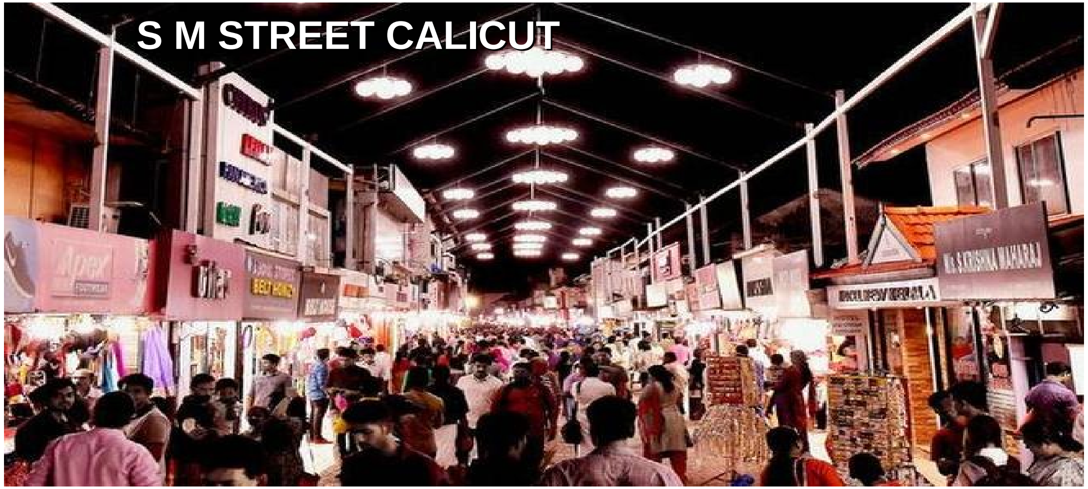
Factors Affecting Goodwill

1. Location of Business



If it is centrally located in a place having more customer traffic, the goodwill tends to be high

Factors Affecting Goodwill

2. Nature of Business

The firm which produces the products having a **stable demand** is able to earn more profits and therefore has more goodwill

Factors Affecting Goodwill

3. Efficiency of Management

Based on the efficiency of management, the **productivity and the profitability** of an organization be higher and it determines the value of goodwill

Factors Affecting Goodwill

4. Time Factor

A business concern running profitably for a **longer period** will have more goodwill since it is better known to the customers

Factors Affecting Goodwill

5. Market Situation

Windows

The **monopoly** or limited competition enables the business to earn more profit, which leads to higher goodwill

Factors Affecting Goodwill

6. Special Advantages

Import licenses, well known foreign collaboration, patents, trademarks etc. will help to earn more profit which leads to higher goodwill for the firm

Factors Affecting Goodwill

1. Location of Business
2. Nature of Business
3. Efficiency of Management
4. Time Factor
5. Market Situation
6. Special Advantages

Need for Valuation of Goodwill

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Need for Valuation of Goodwill

1. Change in profit sharing ratio among the existing partners

~~1 : 1~~

1 : 2

Need for Valuation of Goodwill

2. Admission of a partner

Need for Valuation of Goodwill

3. Retirement of a partner

Need for Valuation of Goodwill

4. Death of a partner

Need for Valuation of Goodwill

5. Dissolution of a firm or sale of partnership business

Need for Valuation of Goodwill

6. Amalgamation of firms

Need for Valuation of Goodwill

1. Change in profit sharing ratio among the existing partners.
2. Admission of a partner.
3. Retirement of a partner.
4. Death of a partner.
5. Dissolution of a firm or sale of partnership business.
6. Amalgamation of firms.

Methods of Valuation of Goodwill

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Average Profit Method

Methods of Valuation of Goodwill

1. Average Profit Method

$$\frac{10 + 20 + 30}{3} = 20$$

Here the goodwill is valued at an agreed number of 'years' purchase of the average profits of the past a few years

Methods of Valuation of Goodwill

Average Profit Method

$$\frac{10 + 20 + 30}{3} = 20$$

This method is based on the assumption that a new business will not be able to earn any profits during the first few years of its operations

Methods of Valuation of Goodwill

Average Profit Method

Eg: Net profit of a business for the last 3 years was Rs. 10000, 20000 and 30000, the partners decided to calculate the goodwill based on 2 years purchase of average profit

:. Average Profit =

(10000 + 20000 + 30000) / 3 = 20000

Goodwill = 20000 x 2 = 40000

Weighted Average Profit Method

Methods of Valuation of Goodwill

2. Weighted Average Profit Method

Year	Profit	Weight
2010	10000	1
2011	15000	2
2012	20000	3

Here weights are assigned for each year's profit

Methods of Valuation of Goodwill

Weighted Average Profit Method

Year	Profit	Weight	Product
2010	10000	1	10,000
2011	15000	2	30,000
2012	20000	3	60,000
2013	25000	4	100,000
	Total	**10**	**200,000**

Weighted Average Profit = 200,000 / 10 = 20,000

Goodwill = 20,000 x 3 = 60,000

(Based on 3 years purchase of weighted average profit)

Methods of Valuation of Goodwill

Weighted Average Profit Method

Steps:

1. Assign the weights for each year - 1, 2, 3 etc.
2. Find the Product - Weight X Profit
3. Find the Total of Products
4. Divide the Total of Products by Total Weights
5. Multiply the Weighted Average Profit X No. of Years Purchase

Super Profit Method

Methods of Valuation of Goodwill

3. Super Profit Method

Super Profit means the excess of the actual profits earned by a business unit over and above the normal return expected on investment in similar class of business

A	B	C	D	E
10%	10%	15%	10%	10%

Methods of Valuation of Goodwill

Super Profit Method

Under this method:

Super Profit = Actual Profit – Normal Profit
Normal Profit = Capital Employed x NRR / 100
Goodwill = Super Profit X No. of years

Actual Profit may be the Average Profit
NRR = Normal Rate of Return

Methods of Valuation of Goodwill

Super Profit Method

Example:

Average Profit - 20,000, Capital Employed – 200,000 and NRR = 8% Goodwill based on 2 years purchase.

Super Profit = Actual Profit – Normal Profit

Normal Profit = Capital Employed x NRR / 100

= 200,000 X 8/100 = 16,000

Super Profit = 20,000 – 16,000 = 4,000

Goodwill = Super Profit X No. of years

= 4,000 x 2 Yrs = 8,000

Capitalisation Method

Capitalisation of Average Profit

Capitalisation of Super Profit

Capitalisation of Average Profit

Methods of Valuation of Goodwill

4. Capitalisation of Average Profit

Here the goodwill is ascertained by deducting **actual capital employed** (net assets) from the **capitalized value of average profits**

Goodwill = Capitalised value of average profit – Actual capital employed

Methods of Valuation of Goodwill

Capitalisation of Average Profit

Capitalised value of Avg. Profit =

Average Profit x 100 / Normal Rate of Return

Capital Employed =

Total Assets (Excluding Goodwill) – Outside Liabilities

Methods of Valuation of Goodwill

Capitalisation of Average Profit

Example:

Average Profit – 50,000, NRR – 10%,

Total Assets – 400,000 and Liabilities – 50,000

Capitalised value of average profit =

50,000 x 100/10 = 500,000

Capital Employed (net assets) =

400,000 – 50,000 = 350,000

Goodwill = 500,000 – 350,000 = 150,000

Capitalisation of Super Profit

Methods of Valuation of Goodwill

5. Capitalisation of Super Profit

Goodwill is ascertained by capitalizing super profit

Goodwill =

Super Profit x 100 / Normal Rate of Return

Methods of Valuation of Goodwill

Capitalisation of Super Profit

Example:
Super Profit = 20000 and NRR = 10%

Goodwill =
Super Profit x 100 / Normal Rate of Return

:.Goodwill = 20000 x 100/10 = 200,000

Treatment of Goodwill

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Treatment of Goodwill

At the time of admission of a new partner, he gets his share of profit from the existing partners, for which he has to compensate them

Treatment of Goodwill

To compensate the old partners, he has to bring in his share of goodwill (premium) in cash

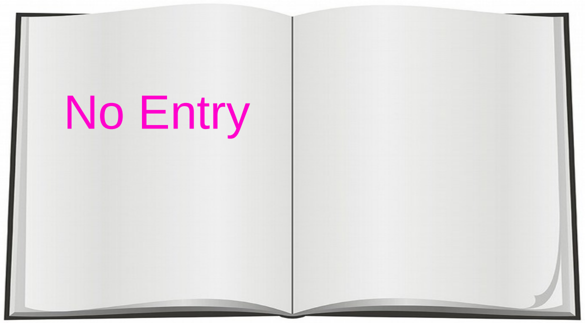
The goodwill thus brought in by the new partner is shared by the old partners in their sacrificing ratio

Treatment of Goodwill

Accounting Treatment

A. If this amount is paid to the old partners privately, ie; outside the business:

No entry is to be passed in the books of the firm



Treatment of Goodwill

Accounting Treatment

B. If the amount is paid through the firm and the same is retained in the business:

1. Cash Account Dr
   To Goodwill Account.

(Amount brought in by the new partner as goodwill)

Treatment of Goodwill

Accounting Treatment

B. If the amount is paid through the firm and the same is retained in the business:

2. Goodwill Account Dr

To Old Partners' Capital Account (individually)

(Goodwill transferred to the old partners' capital account in their sacrificing ratio)

Treatment of Goodwill

Accounting Treatment

C. If the new partner brings in his share of goodwill in cash and the same in full or part is withdrawn by the old partners:

Old Partner's Capital Account Dr

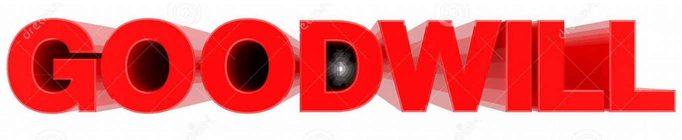
To Cash Account

(The amount of goodwill withdrawn by the old partners)

Treatment of Goodwill

Alternative Method:

The cash premium brought in by the new partner can be directly credited to old partners’ capital accounts



Treatment of Goodwill

Alternative Method:

In such a case only one journal entry is enough instead of entry 1 and 2

Cash Account Dr

To Old Partners' Capital Account

(Cash brought in for goodwill by the new partner credited to old partners in their sacrificing ratio)

Premium (Share of Goodwill) Brought in Kind

Treatment of Goodwill

Premium (Share of Goodwill) Brought in Kind

Step – 1:

If the new partner brings his share of premium in the form of assets, instead of cash the amount of assets brought in by the new partner will be debited and credit is given for the premium account

Assets A/c

Premium A/c

Treatment of Goodwill

Premium (Share of Goodwill) Brought in Kind

Step – 2:

Then the premium amount should be transferred to the old partners' capital account in their sacrificing ratio

Premium A/c

Capital A/c
(Old Partners)

Treatment of Goodwill

Premium (Share of Goodwill) Brought in Kind

Journal Entry – 1:

Capital and goodwill brought in by the new partner in the form of asset:

Assets A/c

Premium A/c

Assets (individually) Account Dr
To New Partner's Capital Account
To Goodwill (Premium) Account.

Treatment of Goodwill

Premium (Share of Goodwill) Brought in Kind

Journal Entry – 2:

The premium brought in by the new partner shared among the old partners capital account:

Premium A/c

Capital A/c
(Old Partners)

Goodwill Account Dr
To Old Partners' Capital Account
(In their sacrificing ratio)

Treatment of Goodwill

Premium (Share of Goodwill) Brought in Kind

Journal Entry – 2:

The premium brought in by the new partner shared among the old partners capital account:

Goodwill Account Dr

To Old Partners' Capital Account

(In their sacrificing ratio)

New Partner brings only a portion of Goodwill in cash

Treatment of Goodwill

New Partner brings in only a portion of the goodwill in cash

In case the new partner may not be in a position to bring the full amount of his share of goodwill in cash, the balance amount may be adjusted from his capital account or current account

Treatment of Goodwill

New Partner brings in only a portion of the goodwill in cash

Journal Entry:

1. The new partner brings a portion of his share of goodwill in cash:

Cash Account Dr
To Goodwill Account

Treatment of Goodwill

New Partner brings in only a portion of the goodwill in cash

Journal Entry:

2. To share the premium among the old partners and the deficit of goodwill adjusted from the new partner's capital account:

Goodwill account Dr

New Partner's Capital Account Dr

To Old Partners' Capital Account

New Partner is not in a position to bring Goodwill in Cash

Treatment of Goodwill

New Partner is not in a position to bring goodwill in Cash

In case, the new partner is not in a position to bring any amount as goodwill premium, the entire amount of his share of goodwill is to be adjusted from his capital account or current account

Treatment of Goodwill

New Partner is not in a position to bring goodwill in Cash

Journal Entry:-

New Partner’s Capital Account Dr
To Old Partners’ Capital Account

(Goodwill adjusted from New partner's Capital A/c)

Goodwill existing in the books at the time of admission

Treatment of Goodwill

Goodwill existing in the books at the time of admission

If Goodwill appearing in the books at the time of admission, it would be desirable to close the goodwill account

Treatment of Goodwill

Goodwill existing in the books at the time of admission

Journal Entry:

Old Partners' Capital Account Dr (old ratio)

To Premium Account

(The amount of goodwill appearing in the books written off)

Hidden Goodwill

Treatment of Goodwill

Hidden Goodwill

If the value of goodwill is not specified, it is to be inferred from the arrangement of capital and that such an amount of goodwill is treated as hidden goodwill

Treatment of Goodwill

Hidden Goodwill

Example:

Anju and Manju are partners with the capitals of Rs.40000 and Rs.50000. They admit Sanju for 1/3 share in profit. Sanju brings Rs.50000 as his capital

Treatment of Goodwill

Hidden Goodwill

Example:

In this case, the total capital of the firm can be computed on the basis of Sanju's capital and his share of profit as follows:

Treatment of Goodwill

Hidden Goodwill

Example:

Total Capital of the new firm =

50000 x 3/1 = 150000

Actual capital of Anju, Manju and Sanju =

40000+50000+50000= 140000

:. Total Goodwill of the firm =

150000 – 140000 = **10000**

Revaluation of Assets and Liabilities

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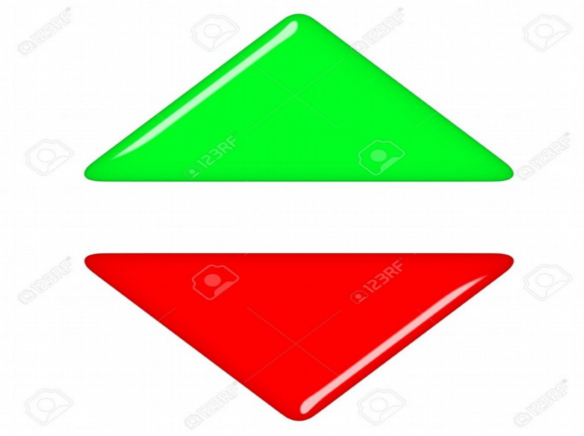
Revaluation of Assets and Liabilities

It is better to ascertain that whether the assets and liabilities of the firm are shown at their correct value at the time of admission

Revaluation of Assets and Liabilities

If they are overstated or understated, they must be revalued and any profit or loss should be adjusted to the old partners in their old ratio



Revaluation of Assets and Liabilities

The new partner is not affected by the revaluation of assets and liabilities as he is not concerned with the pre-admission profit or loss

Revaluation of Assets and Liabilities

All the adjustments regarding revaluation of assets and liabilities are affected through **revaluation account** or the Profit and Loss Adjustment Account

Dr **Revaluation A/c** **Cr**

Date	Particulars		Amount	Date	Particulars	Amount
	Provision		500		Stock in trade	6000
	Furniture and Fixtures		1000			
	Claim for damages		1500			
	Partners' Capital A/c 1:1:1					
	A	1000				
	B	1000				
	C	1000	3000			
			6000			6000

Revaluation of Assets and Liabilities

Revaluation account is a Nominal Account as it reveals the profit or loss on revaluation of assets and liabilities

Dr — **Revaluation A/c** — **Cr**

Date	Particulars		Amount	Date	Particulars	Amount
	Provision		500		Stock in trade	6000
	Furniture and Fixtures		1000			
	Claim for damages		1500			
	Partners' Capital A/c 1:1:1					
	A	1000				
	B	1000				
	C	1000	3000			
			6000			6000

Revaluation of Assets and Liabilities

Revaluation A/c is **credited** with

1. The increase in the value of asset
2. Decrease in the value of liability
3. Any unrecorded asset

Revaluation of Assets and Liabilities

Revaluation A/c is **debited** with

1. The decrease in the value of assets
2. Increase in the value of liability
3. Unrecorded liabilities

Revaluation of Assets and Liabilities

Balance in the revaluation account (gains or loss) should be transferred to the old partners' capital account in their old ratio

Revaluation A/c

Dr					Cr
Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
	Provision	500		Stock in trade	6000
	Furniture and Fixtures	1000			
	Claim for damages	1500			
	Partners' Capital A/c 1:1:1				
	A 1000				
	B 1000				
	C 1000	3000			
		6000			6000

Need for Preparing Revaluation A/c

Revaluation of Assets and Liabilities

a. To bring the assets and liabilities of the firm to their true values

b. To find out the profit or loss arising out of revaluation

Revaluation of Assets and Liabilities

Journal Entries:-

Increase in the value of asset:

Asset Account Dr

To Revaluation Account

Revaluation of Assets and Liabilities

Journal Entries:-

Decrease in the value of asset:

Revaluation Account Dr

To Asset Account

Revaluation of Assets and Liabilities

Journal Entries:-

Increase in the value of liability

Revaluation account Dr

To Liability Account

Revaluation of Assets and Liabilities

Journal Entries:-

Decrease in the value of liability:

Liability Account Dr

To Revaluation Account

Revaluation of Assets and Liabilities

Journal Entries:-

Unrecorded Asset:

Asset Account Dr

To Revaluation Account

Revaluation of Assets and Liabilities

Journal Entries:-

Unrecorded Liability:

Revaluation Account Dr

To Unrecorded Liability Account

Revaluation of Assets and Liabilities

Journal Entries:-

In case unrecorded assets are realized and unrecorded liabilities are paid off, the debit or credit aspect will be “CASH” or “BANK” instead of ASSETS and LIABILITIES

~~Assets or Liabilities~~

Cash or Bank

Revaluation of Assets and Liabilities

Journal Entries:-

Transfer of balance in Revaluation account (profit and loss adjustment account):

a. If the revaluation account shows a credit balance ie; profit

Revaluation account Dr

To Old Partners' Capital (individually) account

Revaluation of Assets and Liabilities

Journal Entries:-

Transfer of balance in Revaluation account (profit and loss adjustment account):

b. If the revaluation account shows a debit balance, ie; Loss.

Old Partners' capital account Dr

To Revaluation account

Proforma:

Revaluation Account

Particulars	Amount	Particulars	Amount
Decrease in Asset	XX	Increase in Asset	XX
Increase in Liabilities	XX	Decrease in Liability	XX
Unrecorded Liability	XX	Unrecorded Asset	XX
Old Partners' Capital A/c (Profit on Revaluation - individually)	XX	Old Partners' Capital A/c (Loss on Revaluation - individually)	XX
	XXX		XXX

ADJUSTMENT FOR RESERVES AND ACCUMULATED PROFIT OR LOSS

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Reserves and Accumulated Profit or Loss

At the time of change in profit sharing ratio, some undistributed profits and reserves may stand in the books

Balance Sheet				
Liabilities		**Amount**	**Assets**	**Amount**
Creditors		5,000	Cash in hand	2,000
Reserve		**30,000**	Cash at bank	41,000
Capitals:			Stock	20,000
A	10000		Debtors	5,000
B	15000		Bills receivable	8,000
C	20000	45,000	Furniture and fixtures	4,000
		80,000		80,000

Reserves and Accumulated Profit or Loss

It should be shared among the partners in their old profit sharing ratio before reconstitution takes place

This is to be done even if the question is silent in this regard

Reserves and Accumulated Profit or Loss

Journal Entry:

Undistributed profits or Reserves:

Profit and Loss Account Dr
Reserves Account Dr
To Old Partners’ Capital Account

Reserves and Accumulated Profit or Loss

Journal Entry:

Undistributed Losses:

Old Partners' Capital Account Dr

To Profit and Loss Account

Balance Sheet				
Liabilities		**Amount**	**Assets**	**Amount**
Creditors		5,000	Cash in hand	2,000
Bank Loan		30,000	Cash at bank	41,000
Capitals:			Stock	20,000
A	10000		Debtors	5,000
B	15000		P&L A/c (Accumulated Loss)	8,000
C	20000	45,000	Furniture and fixtures	4,000
		80,000		80,000

Reserves and Accumulated Profit or Loss

Same treatment may be followed for **Workmen's Compensation fund** and **Investment Fluctuation Fund**

Balance Sheet				
Liabilities		**Amount**	**Assets**	**Amount**
Creditors		5,000	Cash in hand	2,000
Workmen's Compensation Fund		10,000	Cash at bank	41,000
Investment Fluctuation Fund		20,000	Stock	20,000
Capitals:			Debtors	5,000
A	10000		P&L A/c (Accumulated Loss)	8,000
B	15000		Furniture and fixtures	4,000
C	20000	45,000		
		80,000		80,000

Reserves and Accumulated Profit or Loss

Employees Provident Fund cannot be transferred to capital account, as it is an external liability of the firm

Balance Sheet					
Liabilities		**Amount**	**Assets**	**Amount**
Creditors		5,000	Cash in hand	2,000
Workmen's Compensation Fund		10,000	Cash at bank	41,000
Employees Provident Fund		20,000	Stock	20,000
Capitals:			Debtors	5,000
A	10000		P&L A/c (Accumulated Loss)	8,000
B	15000		Furniture and fixtures	4,000
C	20000	45,000		
		80,000		80,000

ADJUSTMENT OF CAPITAL ACCOUNTS OF PARTNERS

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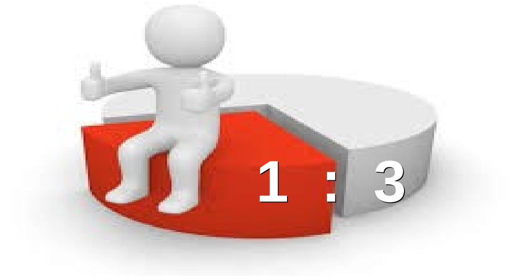
Adjustment of capital

At the time of admission, sometimes the partners may agree to adjust their capital in proportion to their profit sharing ratio



It can be done either on the basis of new partner's capital or on the basis of old partners' capital

Adjustment of capital

1. Based on new partner's capital:

If the new partner's capital is given, it can be taken as the base for calculating the old partners' new capital

Adjustment of capital

1. Based on new partner's capital:

If there is any shortage or excess of capital for any partner, he should either bring the necessary amount or withdraw the excess amount

Adjustment of capital

1. Based on new partner's capital:

Example:

C's Capital for 1/6th share	**= 30,000**
:. Total Capital of the new firm	= 30000 x 6/1
	= 180,000
New Ratio (A:B:C)	= 3: 2: 1
:. A's new capital	= 180000 x 3/6
	= 90,000
:. B's new capital	= 180000 x 2/6
	= 60,000

Adjustment of capital

If the total capital of the firm is given, the capital of each partner including new partner can be calculated on the basis of their new ratio

Total Capital of the new firm	**= 180,000**
New Ratio (A:B:C)	= 3: 2: 1
:. A's Capital	= 180000 x 3/6
	= 90,000
:. B's Capital	= 180000 x 2/6
	= 60,000
:. C's Capital	= 180000 x 1/6
	= 30,000

Adjustment of capital

Alternatively, the surplus or deficiency in each partner's capital account can be transferred to their respective current account subject to the agreement between the partners

Adjustment of capital

2. Based on old partners' capital

In certain cases the new partner(s) may be required to bring the capital which is proportionate to his share of profit

Adjustment of capital

2. Based on old partners' capital:

In such a situation the combined capital of old partners (after all adjustments) is taken as the base to determine the capital to be contributed by the new partner

Adjustment of capital

2. Based on old partners' capital:

Example:

Dasan and Vijayan are partners, their ratio is 3:2, admit Gafoor with 1/5th share.
The capitals of Dasan and Vijayan after all adjustment are Rs. 20000 and Rs.16000 respectively.

Capital of Mr. Gafoor ?

Adjustment of capital

Capital of Mr. Gafoor

The combined capital of the old partners = 36000

This Rs.36000 constitute the remaining share

Ie; 1 – 1/5 = 4/5

Therefore, Total Capital = 36000 x 5/4 = 45000

From this the new partner's capital can be calculated, ie;

45000 x 1/5 = **9000**

Change in Profit Sharing Ratio Among the Existing Partners

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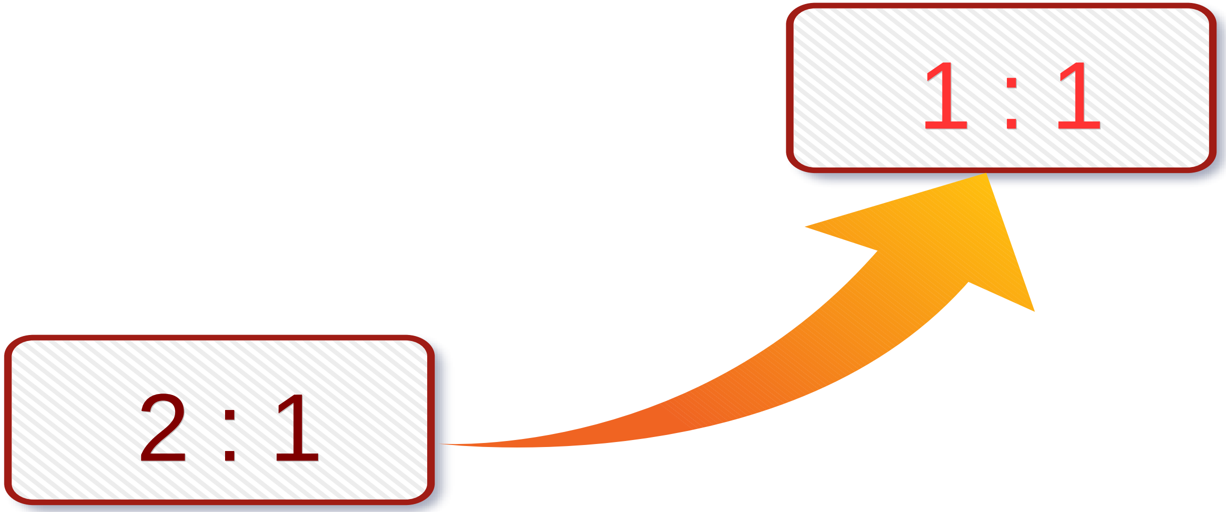
Change in Profit Sharing Ratio

In certain cases the partners in a firm may change their existing profit sharing ratio



Change in Profit Sharing Ratio

By this, some partners will gain in future profits while others will lose

Change in Profit Sharing Ratio

In such a case the gaining partner should compensate the sacrificing partner

Change in Profit Sharing Ratio

Example:

A and B are partners sharing profits in the ratio of 3:2, they decide to change the ratio into 1:1. In this case,

A loses 1/10th ie; 3/5 – 1/2 and B gains this 1/10th ie; 1/2 - 2/5

Change in Profit Sharing Ratio

Example:

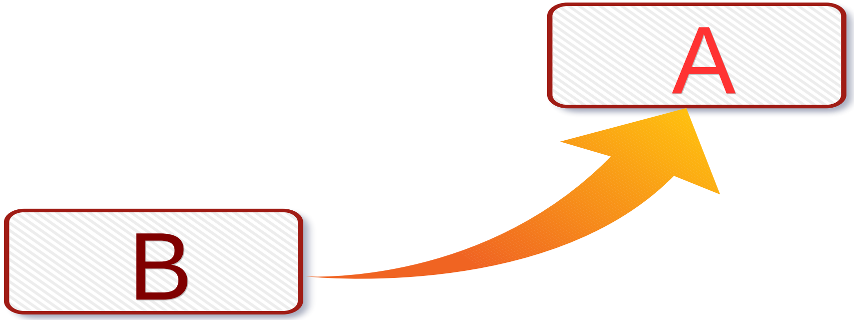
Here B has to compensate with A and it will be the proportionate amount of goodwill

Suppose the total value of goodwill is Rs.50,000, then B should pay Rs.5000 ie; 50000 x 1/10 to A as compensation

Change in Profit Sharing Ratio

Journal entry:

B's Capital Account Dr	5000	
To A's Capital Account		5000



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thank you!