VIDYA BHAWAN BALIKA VIDYA PITH

शक्ति उत्थान आश्रम लखीसराय बिहार

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Teacher name – Ajay Kumar Sharma

Reconstitution of a Partnership Firm –Admission of a Partner

Illustration 17

Vijay and Sanjay are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Ajay into partnership with 1/4 share in profits. Ajay brings in Rs. 30,000 for capital and the requisite amount of premium in cash. The goodwill of the firm is valued at Rs. 20,000. The new profit sharing ratio is 2:1:1. Vijay and Sanjay withdraw their share of goodwill. Give necessary journal entries.

Solution

(a) Ajay will bring Rs. 5,000 (1/4 of Rs. 20,000) as his share of goodwill (premium)

(b) Sacrificing Ratio is 2:3 as calculated below:

For Vijay, old ratio is 3/5 and the new ratio is 2/4, hence, his sacrificing ratio is

$$= \frac{3}{5} - \frac{2}{4} = \frac{12-10}{20} = \frac{2}{20}$$

For Sanjay, old ratio is 2/5 and the new ratio is 1/4, hence, his sacrificing ratio is $= \frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$

Books of Vijay and Sanjay
Journal

Date	*Particulars*		*L.F.*	*Debit (Rs.)*	*Credit (Rs.)*
1.	Cash A/c	Dr.		35,000	
	To Ajay's Capital A/c				30,000
	To Goodwill A/c				5,000
	(The amount of capital and goodwill brought by Ajay)				
2.	Goodwill A/c	Dr.		5,000	
	To Vijay's Capital A/c				2,000
	To Sanjay's Capital A/c				3,000
	(the amount of goodwill brought by Ajay shared by Vijay and Sanjay in their sacrificing ratio)				
3.	Vijay's Capital A/c	Dr.		2,000	
	Sanjay's Capital A/c	Dr.		3,000	
	To Cash A/c				5,000
	(Cash withdrawn by Vijay and Sanjay for their share of goodwill)				

Note: Alternatively, journal entries (1) and (2) could be as follows:

Books of Vijay and Sanjay
Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
1.	Cash A/c Dr. To Ajay's Capital A/c (Ajay brought in Rs. 30,000 for capital and Rs. 5,000 as goodwill)		35,000	 35,000
2.	Ajay's Capital A/c Dr. To Vijay's Capital A/c To Sanjay's Capital A/c (Amount of goodwill brought in by Ajay shared by Vijay and Sanjay in their sacrificing in the ratio of 2:3)		5,000	 2.000 3,000

When goodwill already exists in books: The above treatment of goodwill was based on the assumption that there was no goodwill account in the books of the firm. However, It is quite possible that when a new partner brings in his share of goodwill in cash, some amount of goodwill already exists in books. In that case, after crediting the old partners by the amount of goodwill brought in by the new partner, the existing goodwill must be written off by debiting the old partners in their old profit sharing ratio. But, if it is decided that the goodwill may continue to appear in the books at its old value, the amount to be brought in by new partner will have to be proportionately reduced i.e., He will be required to bring cash only for this share of the excess of the agreed value of goodwill over the amount of goodwill already appearing in books. For example,

In illustration 17, the goodwill of the firm is valued at Rs. 20,000 and Ajay who is admitted to 1/4 share in its profits, brings in Rs. 5,000 as his share of goodwill. Suppose, goodwill already appeared in books at Rs. 10,000 and there is no decision to retain it. In that case, after crediting Vijay and Sanjay for the amount of goodwill brought in by Ajay, the following additional journal entry shall be recorded for writing off the existing amount of goodwill.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
	Vijay's Capital A/c Dr. Sanjay's Capital A/c Dr. To Goodwill A/c (Goodwill written-off in old ratio)		6,000 4,000	 10,000

In case, however, the partners decide to maintain the Goodwill Account as it is, the new partner is required to bring in as his share of goodwill only in respect of the difference between its total value and the book value. In other words, Ajay will be required to bring in Rs. 2,500 only [1/4 of Rs. 10,000 (Rs 20,000 – Rs. 10,000)]. Which will be credited to old partners in their sacrificing ratio, and no entry will be recorded for writing off the existing amount of goodwill.