

## CHAPTER 3

# Admission of a Partner

CBSE Class 12 · Accountancy Part I · Chapter 3  
· Reconstitution of a Partnership Firm

CBSE · Accountancy · Class 12

### WHAT THIS CHAPTER DOES

**A** Compute the new profit-sharing ratio and the sacrificing ratio.

**B** Treat goodwill correctly — premium method, hidden goodwill, AS-26.

Boards prep that builds confidence, not anxiety.

**TODAY'S MISSION**

# Today's mission

- 1 Compute the new profit-sharing ratio and the sacrificing ratio.
- 2 Treat goodwill correctly — premium method, hidden goodwill, AS-26.
- 3 Prepare the Revaluation Account in the right direction.
- 4 Distribute reserves in old ratio and prepare the reconstituted Balance Sheet.

## WHY THIS MATTERS

# Why this chapter matters

- 1 8-12 marks every CBSE board paper — among the two most reliable partnership numericals.
- 2 The same machinery (Revaluation, goodwill, capital adjustment) reappears in Retirement and Dissolution.
- 3 Real-world relevance: firms admit partners for capital and skills constantly — this is how the books are squared fairly.

TOPIC

**A**

# Reconstitution & the need to adjust

**THEOREM · LOAD-BEARING RESULT**

# What is reconstitution on admission?

Reconstitution is any change in the existing agreement among partners that ends the old firm and begins a new one without dissolving the business. Admission of a new partner is one such change — under Section 31 of the Indian Partnership Act 1932, a person can be admitted only with the consent of all existing partners.

**STATEMENT**

On admission, five items are adjusted: (1) the new profit-sharing ratio and the sacrificing ratio; (2) goodwill; (3) revaluation of assets and reassessment of liabilities; (4) distribution of accumulated

**WHY THIS MATTERS**

- The incoming partner acquires a right to share future profits
- The existing partners must be compensated for the share they give up (goodwill), and the firm's books must reflect true current values BEFORE he joins so that pre-admission gains and losses stay with the old partners alone.

**WATCH OUT FOR**

**NOTE** Admission does NOT dissolve the firm — business continues. Do not confuse 'reconstitution' (firm continues, agreement changes) with 'dissolution' (firm ends, books close).

TOPIC

**B**

# New ratio & sacrificing ratio

TOPIC

# Computing the new and sacrificing ratios

## NEW PROFIT-SHARING RATIO

When a partner is admitted he takes a share of future profits that must come out of the existing partners' shares. The new share of each old partner equals his old share minus the portion he surrenders to the incoming partner, and the new partner's share equals the total of all

## SACRIFICING RATIO

The sacrificing ratio is the ratio in which the OLD partners give up their share in favour of the new partner, computed as Old share minus New share for each old partner. It is the single most important ratio on admission because the incoming partner's goodwill premium is distributed in

## WHEN OLD = SACRIFICING

A frequent shortcut trap: if the question only says 'C is admitted for 1/4 share' without specifying who sacrifices how much, the assumption is that the new partner takes his share from the old partners in their OLD ratio — in which case the sacrificing ratio is the same as the old profit-sharing ratio. Students

## SACRIFICE VS GAIN

Sacrificing ratio (admission) and gaining ratio (retirement) are mirror images and must never be interchanged. On admission old partners SACRIFICE share to the newcomer, so  $\text{Sacrifice} = \text{Old} - \text{New}$ . On retirement the continuing partners GAIN the outgoing partner's share, so  $\text{Gain} = \text{New} -$

**WORKED EXAMPLE**

# New ratio & sacrificing ratio

- 1 A and B are partners sharing profits 3 : 2. They admit C for a  $\frac{1}{4}$  share (taken from A and B in their old ratio).
- 2 C's share =  $\frac{1}{4}$ . Remaining share for A and B together =  $1 - \frac{1}{4} = \frac{3}{4}$ .
- 3 A's new share =  $\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$ . B's new share =  $\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$ . C's share =  $\frac{1}{4} = \frac{5}{20}$ .
- 4 New profit-sharing ratio A : B : C = 9 : 6 : 5 (over a denominator of 20).
- 5 Sacrifice of A =  $\frac{3}{5} - \frac{9}{20} = \frac{12}{20} - \frac{9}{20} = \frac{3}{20}$ . Sacrifice of B =  $\frac{2}{5} - \frac{6}{20} = \frac{8}{20} - \frac{6}{20} = \frac{2}{20}$ .
- 6 SACRIFICING RATIO A : B = 3 : 2 (here it equals the old ratio because C's share was carved out in the old ratio).

TOPIC

C

# Treatment of goodwill

TOPIC

# How goodwill is adjusted on admission

## PREMIUM FOR GOODWILL METHOD

The most common case: the incoming partner brings, in addition to his capital, a sum of cash as PREMIUM for goodwill to compensate the old partners for the share of future profits he is taking from them. The cash entry splits the amount received into capital and premium, then the

## AS-26 — ONLY PURCHASED GOODWILL

Accounting Standard 26 (Intangible Assets) permits recording ONLY purchased goodwill; self-generated goodwill of the firm must NOT be raised in the books. Consequently, on admission, goodwill is never created as a balance-sheet asset — it is adjusted through

## HIDDEN (INFERRED) GOODWILL

Sometimes the new partner brings only capital and no premium, yet the capital he contributes implies a firm value larger than the sum of all partners' capitals — the gap is HIDDEN goodwill. Compute total implied capital of the firm as the new partner's capital divided by his

## PREMIUM WITHDRAWN BY OLD PARTNERS

After the premium for goodwill has been credited to the sacrificing partners, the question may state that they WITHDRAW that amount (fully or partly) in cash. The withdrawal is recorded by debiting the old partners' capital accounts and crediting Cash/Bank, which

**WORKED EXAMPLE**

# Goodwill premium distribution

- 1 A and B share profits 3 : 2. C is admitted for 1/4 share; sacrificing ratio of A : B = 3 : 2.
- 2 C brings ₹ 60,000 as capital and ₹ 20,000 as premium for goodwill in cash.
- 3 Cash/Bank A/c Dr ₹ 80,000; To C's Capital A/c ₹ 60,000; To Premium for Goodwill A/c ₹ 20,000.
- 4 Distribute premium in sacrificing ratio 3 : 2: A =  $20,000 \times \frac{3}{5} = ₹ 12,000$ ; B =  $20,000 \times \frac{2}{5} = ₹ 8,000$ .
- 5 Premium for Goodwill A/c Dr ₹ 20,000; To A's Capital A/c ₹ 12,000; To B's Capital A/c ₹ 8,000.
- 6 (AS-26: no goodwill asset is raised. Check:  $12,000 + 8,000 = ₹ 20,000 =$  premium received. ✓)

**WORKED EXAMPLE**

# Hidden goodwill

- 1 A's capital ₹ 1,00,000 and B's capital ₹ 60,000 (after all other adjustments). C is admitted for 1/4 share and brings ₹ 80,000 capital but NO premium.
- 2 Total capital of the firm implied by C's capital = C's capital  $\div$  C's share =  $80,000 \div (1/4) = ₹ 3,20,000$ .
- 3 Actual combined capital of all partners =  $1,00,000 + 60,000 + 80,000 = ₹ 2,40,000$ .
- 4 Hidden goodwill of the firm =  $3,20,000 - 2,40,000 = ₹ 80,000$ .
- 5 C's share of goodwill =  $80,000 \times 1/4 = ₹ 20,000$ , adjusted through C's Capital A/c in favour of the sacrificing partners.

TOPIC

**D**

# Revaluation of assets & reassessment of liabilities

TOPIC

# The Revaluation Account

## PURPOSE

Before the new partner joins, the firm's assets and liabilities are restated at their true current values so that any profit or loss arising from the restatement belongs to the OLD partners alone — they should not gift away (or burden the newcomer with) value changes that accrued under the old agreement

## DIRECTION OF ENTRIES

Revaluation Account follows nominal-account rules. A DECREASE in the value of an asset or an INCREASE in a liability (including creating a new provision such as provision for doubtful debts, or recording an unrecorded liability) is a LOSS and is DEBITED to the Revaluation Account. An INCREASE in an asset

## BALANCING & TRANSFER

After all increases and decreases are posted, the Revaluation Account is balanced: a credit balance is a profit, a debit balance is a loss. This balance is transferred to the OLD partners' capital accounts in their OLD profit-sharing ratio — the new partner gets no share and bears no part

## REASSESSMENT OF LIABILITIES

Reassessment means re-examining recorded liabilities and bringing in unrecorded ones at current value: an outstanding repair bill or unrecorded creditor not previously in the books is recorded as a loss and debited to Revaluation; a liability found to be overstated or no longer

**WORKED EXAMPLE**

# Revaluation Account

- 1** A and B share profits 3 : 2 and admit C. On admission: Stock is reduced by ₹ 2,000; a provision for doubtful debts of ₹ 1,000 is created; Building is appreciated by ₹ 15,000; an unrecorded outstanding repairs liability of ₹ 3,000 is brought into the books.
- 2** DEBIT (losses): Stock ₹ 2,000 + Provision for doubtful debts ₹ 1,000 + Outstanding repairs ₹ 3,000 = ₹ 6,000.
- 3** CREDIT (gains): Building appreciation ₹ 15,000.
- 4** Profit on revaluation =  $15,000 - 6,000 = ₹ 9,000$ .
- 5** Transfer to OLD partners in OLD ratio 3 : 2: A =  $9,000 \times \frac{3}{5} = ₹ 5,400$ ; B =  $9,000 \times \frac{2}{5} = ₹ 3,600$ .
- 6** (Check:  $5,400 + 3,600 = ₹ 9,000$ . ✓ The new partner C gets no share of this revaluation profit.)

TOPIC

**E**

# Reserves & adjustment of capitals

TOPIC

# Final adjustments before the new Balance Sheet

## ACCUMULATED RESERVES & PROFITS

Any general reserve, workmen-compensation reserve surplus, or credit balance of Profit & Loss Account (accumulated profit) appearing in the old Balance Sheet belongs to the OLD partners because it was earned under the old agreement; it is distributed among them

## ADJUSTMENT OF CAPITALS — PROPORTIONATE

The question may require existing partners' capitals to be made PROPORTIONATE to the new profit-sharing ratio. One common base takes the new partner's capital and his share to imply the firm's total capital, then allocates that total to the old partners in the new ratio; the difference

## BRINGING IN / WITHDRAWING CAPITAL

Where a partner's existing capital falls short of his required (proportionate) capital he brings in the deficiency in cash; where it exceeds, the surplus is paid out or transferred to his current account, as the question directs. When current accounts are used the capital accounts show

## RECONSTITUTED BALANCE SHEET

The final Balance Sheet of the reconstituted firm shows revised partners' capitals (after revaluation profit or loss, reserves, goodwill and capital adjustments) plus reassessed liabilities on the liabilities side, and revalued assets plus the updated cash balance (old cash + new partner's

## TOPIC

# Sacrificing vs gaining ratio

## TRAP → TRUTH

× **MISTAKE** Sacrificing ratio and gaining ratio are the same thing, just renamed.

✓ **CORRECT** They are OPPOSITE concepts for opposite events. On ADMISSION, old partners give up a part of their share to the incoming partner — that surrender is the SACRIFICING ratio (Old share – New share). On RETIREMENT, the continuing partners take over the outgoing partner's share — that gain is the GAINING ratio (New share – Old share). Use sacrificing ratio on admission to distribute the incoming partner's goodwill premium.

## TOPIC

# Who gets the goodwill premium

## TRAP → TRUTH

× **MISTAKE** Goodwill premium brought by the new partner is shared by all old partners in their OLD ratio.

✓ **CORRECT** Premium for goodwill is credited to the OLD partners in their SACRIFICING ratio, NOT the old profit-sharing ratio. Old ratio and sacrificing ratio coincide ONLY when the new partner's share is carved out of the old partners in their old ratio. The moment the new partner takes an unequal slice from each (e.g. 'A surrenders 1/5, B surrenders nothing'), the sacrificing ratio differs and old ratio gives the wrong answer.

## TOPIC

# Self-generated goodwill under AS-26

## TRAP → TRUTH

- × **MISTAKE** When a new partner is admitted, raise the firm's goodwill in the books at its full value.
- ✓ **CORRECT** Under AS-26 (Intangible Assets) only PURCHASED goodwill may be recorded; SELF-GENERATED goodwill must NOT be raised in the books. So goodwill is adjusted only THROUGH the partners' capital accounts (premium method / hidden goodwill), never created as an asset. If any existing goodwill already appears in the old Balance Sheet, it is first WRITTEN OFF among old partners in their OLD ratio before admission.

## TOPIC

# Revaluation profit/loss — who shares it

### TRAP → TRUTH

- × **MISTAKE** Profit or loss on revaluation is shared by ALL partners including the new one, in the new ratio.
- ✓ **CORRECT** Revaluation profit/loss reflects changes in asset/liability values that arose BEFORE the new partner joined — so it belongs to the OLD partners only, shared in their OLD ratio. The new partner has no claim on (and no liability for) pre-admission revaluation. The Revaluation Account's balance is transferred to old partners' capital accounts in old ratio.

## TOPIC

# Accumulated reserves and old ratio

## TRAP → TRUTH

× **MISTAKE** Existing reserves, accumulated profits and losses are distributed in the NEW ratio after admission.

✓ **CORRECT** Reserves, the credit balance of Profit & Loss A/c (accumulated profit) and the debit balance of P&L A/c (accumulated loss) all arose from PAST operations of the old firm — they are distributed among the OLD partners in the OLD ratio at the moment of admission, BEFORE the new ratio takes effect.

TOPIC

# Direction of the Revaluation entry

## TRAP → TRUTH

- × **MISTAKE** An increase in an asset is debited to the Revaluation Account.
- ✓ **CORRECT** Revaluation Account follows nominal-account rules: a DECREASE in an asset or an INCREASE in a liability is a LOSS → debit Revaluation A/c. An INCREASE in an asset or a DECREASE in a liability is a GAIN → credit Revaluation A/c. Mixing the direction flips the profit into a loss — the single most common –2 mark error.

## TOPIC

# Hidden goodwill

## TRAP → TRUTH

× **MISTAKE** If the new partner brings no goodwill in cash, the firm has no goodwill.

✓ **CORRECT** When the new partner brings only CAPITAL (no premium), the firm's goodwill is INFERRED ('hidden'). Total capital of the firm implied by the new partner's capital = New partner's capital ÷ his share. Hidden goodwill = that implied total capital – (combined adjusted capital of all partners INCLUDING the new partner's actual capital). The new partner's share of this hidden goodwill is then adjusted through his capital account in favour of the sacrificing partners.

TOPPER TEMPLATE · MARK-BY-MARK

# 6-8 mark: 'Prepare Revaluation A/c, Partners' Capital A/cs and the Balance Sheet of the

- |   |  |
|---|--|
| <p><b>1</b> <b>NEW RATIO + SACRIFICING RATIO (WORKING NOTE)</b><br/>1 m</p> | <p>Compute new share of each partner. Sacrificing ratio = Old share – New share for each old partner. Show on a common denominator in a labelled working note.</p>   |
| <p><b>2</b> <b>REVALUATION ACCOUNT</b><br/>2 m</p>                          | <p>Debit losses (asset decreases, liability increases, unrecorded liabilities, provisions created). Credit gains (asset increases, liability decreases, unrecorded assets). Transfer balancing profit/loss to OLD partners' capital A/cs in OLD ratio.</p>         |
| <p><b>3</b> <b>DISTRIBUTE RESERVES + GOODWILL PREMIUM</b><br/>1 m</p>       | <p>Reserves / accumulated P&amp;L → old partners in OLD ratio. Goodwill premium brought by new partner → sacrificing partners in SACRIFICING ratio (Premium A/c Dr, old partners' capital Cr).</p>   |
| <p><b>4</b> <b>PARTNERS' CAPITAL ACCOUNTS</b><br/>2 m</p>                   | <p>Open columnar capital accounts. Credit: opening capital, share of revaluation profit, share of reserves, goodwill premium, new partner's capital brought in. Debit: revaluation loss, accumulated losses, goodwill written off, drawings. Balance c/d each.</p> |
| <p><b>5</b> <b>BALANCE SHEET OF RECONSTITUTED FIRM</b><br/>2 m</p>          | <p>Liabilities: revised partners' capitals + revised liabilities (after reassessment) + outstanding items. Assets: revised asset values (after revaluation) + cash (old balance + new partner's capital + premium – amounts withdrawn). Totals MUST match.</p>     |

TOPPER TEMPLATE · MARK-BY-MARK

# 3-4 mark: 'Compute the new profit-sharing ratio and the sacrificing ratio.'

- 1 STATE OLD SHARES + NEW PARTNER'S SHARE**  
1 m

Write each old partner's old share and the share surrendered to / taken by the new partner. Bring all to a common denominator.
- 2 COMPUTE NEW SHARES**  
2 m

New share of each old partner = Old share – Share sacrificed. New partner's share = sum of sacrifices. Express as a single ratio over the common denominator.
- 3 SACRIFICING RATIO + STATE**  
1 m

Sacrificing ratio = Old share – New share for each old partner. State: 'New ratio = a : b : c; Sacrificing ratio = x : y.'

TOPPER TEMPLATE · MARK-BY-MARK

# 3-4 mark: 'Journal entries for treatment of goodwill when the new partner brings premium

- |   |  |
|---|--|
| <p><b>1</b></p> <p><b>CAPITAL + PREMIUM BROUGHT IN</b></p> <p><b>1 m</b></p>            | <p>Cash/Bank A/c Dr (capital + premium); To New Partner's Capital A/c (capital); To Premium for Goodwill A/c (premium).</p>  |
| <p><b>2</b></p> <p><b>DISTRIBUTE PREMIUM IN SACRIFICING RATIO</b></p> <p><b>2 m</b></p> | <p>Premium for Goodwill A/c Dr; To Old (sacrificing) Partners' Capital A/cs (in SACRIFICING ratio). Show each partner's amount.</p>                                    |
| <p><b>3</b></p> <p><b>ANY AMOUNT WITHDRAWN BY OLD PARTNERS</b></p> <p><b>1 m</b></p>    | <p>If old partners withdraw the premium: Old Partners' Capital A/cs Dr; To Cash/Bank A/c. State the AS-26 note: self-generated goodwill is not raised as an asset.</p> |

**PYQ PATTERNS**






# Top PYQ patterns to drill

<b>#1</b>	Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the reconstituted firm after admission of a new partner. (6-8 marks)	Annual — guaranteed appearance
<b>#2</b>	Calculate the new profit-sharing ratio and the sacrificing ratio. (3-4 marks)	Most years
<b>#3</b>	Pass journal entries for the treatment of goodwill when the new partner brings premium in cash (and the case where part is withdrawn by old partners). (3-4 marks)	Most years
<b>#4</b>	Hidden / inferred goodwill: the new partner brings capital but no goodwill; infer the firm's goodwill from the capital implied by his share. (3-4 marks)	2019, 2021, 2023
<b>#5</b>	Adjust old partners' capitals so that they are in the new profit-sharing ratio (taking new partner's capital as base). (3 marks)	2018, 2022, 2024

**MARKS DISTRIBUTION**

# 10-year marks distribution

**10-YEAR PYQ MARKS DISTRIBUTION**

Full numerical: Revaluation A/c + Partners' Capital A/cs + new Balance Sheet on admission		<b>60%</b>
Goodwill treatment (premium method / hidden goodwill / AS-26)		<b>28%</b>
Computation of new ratio + sacrificing ratio		<b>24%</b>
Distribution of accumulated reserves/ profits/losses in old ratio		<b>14%</b>
Theory: need for reconstitution, why goodwill is adjusted, sacrificing vs gaining		<b>10%</b>

**RECAP · MEMORISE THESE**

# Recap

**1** Ratios — Sacrifice = Old – New (admission). Premium for goodwill goes to old partners in the SACRIFICING ratio.

**2** Goodwill & AS-26 — Only purchased goodwill is recorded; self-generated goodwill is never raised. Use premium method or hidden goodwill through capital accounts.

**3** Old-ratio items — Revaluation profit/loss AND accumulated reserves/profits/losses are shared by OLD partners in the OLD ratio — the new partner gets none.

**WHAT'S NEXT**

# What's next

- Chapter 4 — Reconstitution: Retirement / Death of a Partner (same machinery, gaining ratio).
- Sit the 15-MCQ Quick Drill under a 20-min timer.
- Then the full Board-Pattern Paper — 40 marks, 75 min.

# You've mastered the most reliable partnership numerical.

Sacrificing ratio, goodwill, revaluation — now prove it.

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