

Change in profit Sharing ratio Among the Existing partners

* Meaning of Reconstitution :-

Any change in existing agreement of partnership or profit sharing ratio is called Reconstitution.

- A firm is reconstituted in the event of -
- (i) Change in the profit sharing ratio among the existing partners.
 - (ii) admission of a partner or partners.
 - (iii) Retirement of a partner.
 - (iv) Death of a partner.
 - (v) amalgamation of two or more partnership firms.

* Change in Profit Sharing Ratio Among the existing partners

- ➔ A change in profit sharing ratio means one or more partners acquires interest from another partner or partners. Here if share of one or more partner's increases then share of other (one or more) partner decreases to same extent.

➔ New profit sharing ratio :

The ratio in which partners are to share the profit in future on reconstitution is known as New profit sharing ratio.

➤ Adjustments for change in Profit Sharing Ratio:

1. Determination of Sacrificing and Gaining ratio
2. Accounting for Goodwill
3. Accounting of Reserves, accumulated Profits & Losses
4. Revaluation of assets and reassessment of Liabilities
5. Adjustment of Capital.

* Determination of Sacrificing ratio and Gaining Ratio:

⊙ $\text{SACRIFICING RATIO} = \text{Old profit share} - \text{New Profit share}$

⊙ $\text{GAINED PROFIT SHARE} = \text{New profit share} - \text{old profit share}$

* Accounting for Goodwill:

The compensation payable by the gaining partner for his gain to the sacrificing partner or partners is known as Goodwill or 'premium for Goodwill'.

⊙ Amount of compensation payable
 $= \text{Value of firm's goodwill} \times \text{Gained profit share}$

Case: 1.

When Goodwill is adjusted through partners' capital A/c

Gaining Partner's capital/current A/c. Dr

To sacrificing partner capital/current A/c

[Adjustment of Goodwill in Gaining/Sacrificing ratio]

Case: 2

When Goodwill is raised and written off

(a) Goodwill A/c ... Dr.
To Partner's capital/current A/c

[Goodwill is raised and distributed in old P&L ratio]

(b) Partner's Capital A/c ... Dr.
To Goodwill A/c

[Goodwill debited in New profit sharing ratio]

Case: 3

When Existing Goodwill is written off

All partners capital/current A/c ... Dr.
To Goodwill A/c

[old goodwill in old ratio]

* Accounting of Reserves, accumulated profits and losses

The Journal entries passed are -

Reserve ... Dr

Profit & Loss A/c (Co. Bal.) ... Dr

Workmen compensation Reserve A/c ... Dr

Investment fluctuating Reserve A/c ... Dr

To All partners' capital/current A/c's

[For transfer of Accumulated profits & Reserves]

In old profit-sharing Ratio

(ii) For transfer of Accumulated Loss:-

[In old profit-sharing ratio]

All partners' Capital/Current A/c's Dr.

To Profit & Loss A/c (Dr. Balance)

To Deferred Revenue expenditure A/c

⊙ Workmen Compensation Reserve:-

Workmen compensation Reserve is a reserve set aside (appropriated) out of firm's profits to meet possible liability (claim) on account of compensation to employees, if it arises (say, because of an accident).

Accounting treatment under different situations -

(i) When claim against workmen compensation Reserve does not exist.

Workmen Compensation Reserve A/c Dr.

To Partners' Capital/Current A/c's

(Workmen compensation Reserve credited to Partners' Capital/Current Accounts in their old profit-sharing ratio)

(ii) When claim for workmen compensation exists:

(a) Workmen compensation claim = Workmen Compensation Reserve

Workmen Compensation Reserve A/c Dr.

To workmen compensation claim A/c

[Being compensation claim Adjusted]

(b) Workmen compensation claim $<$ Workmen compensation Reserve

Workmen compensation Reserve A/c Dr.
 To Workmen compensation claim
 To Partners' capital/current A/cs

[Surplus workmen compensation reserve transferred to partners' capital/current A/c in old P&L ratio]

(c) Workmen compensation claim $>$ Workmen compensation Reserve

Workmen Compensation Reserve A/c Dr.
 Revaluation A/c Dr.

To Workmen compensation claim A/c
 (Amount of claim debited to workmen compensation reserve and revaluation A/c)

Partners' capital/current A/cs Dr [old ratio]
 To Revaluation A/c

(Loss on revaluation transferred to partner's capital/current A/c in their old-sharing ratio)

① Investment Fluctuation Reserve:

Investment fluctuation Reserve is a reserve set aside out of profits to meet fall in the market value of investment.

Investment are recorded in the books of the firm at cost. However, its market value may be equal to or higher than or lower than its book value.

* Accounting treatment :

(i) When market value of Investments = Book value

Investments fluctuation Reserve A/c - - - - - Dr.
To Partners' capital/current A/c's

(ii) When ^{fall in} Market value of Investment $<$ ^{Investment fluctuation} Book value Reserve

Investment fluctuation Reserve A/c Dr.
To Investments A/c [Book Value - Market Value]
To Partners' capital/current A/c's [In old Ratio]

(iii) When Market value - Book value =

(ii) When fall in value of Investment = Investment fluctuation Reserve

Investment fluctuation Reserve A/c Dr.
To Investment A/c

(iv) When fall in value of Investment $>$ Investment fluctuation Reserve

Investment fluctuation reserve A/c - - - - - Dr.
Revaluation A/c - - - - - Dr.
To Investment A/c

Partners' capital / current A/c's Dr. [In old ratio]
To Revaluation A/c

* Specimen of Revaluation Account :

D.D. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Assets A/c (individually)	—	By Asset A/c (individually)	—
- decrease in value on revaluation		- Increase in value on revaluation	
To Liabilities A/c (individually)	—	By Liabilities A/c (individually)	—
- Increase in value on reassessment		By unrecorded asset	—
To unrecorded liabilities A/c	—	By Loss* on revaluation	—
To Partner's capital A/c (Remuneration)	—	transferred to partner's capital & current A/c	*
To Cash/Bank A/c [Expenses]	—		
To Gain* (Profit) transferred to Partner's capital/current A/c	—		
	—		—
	—		—