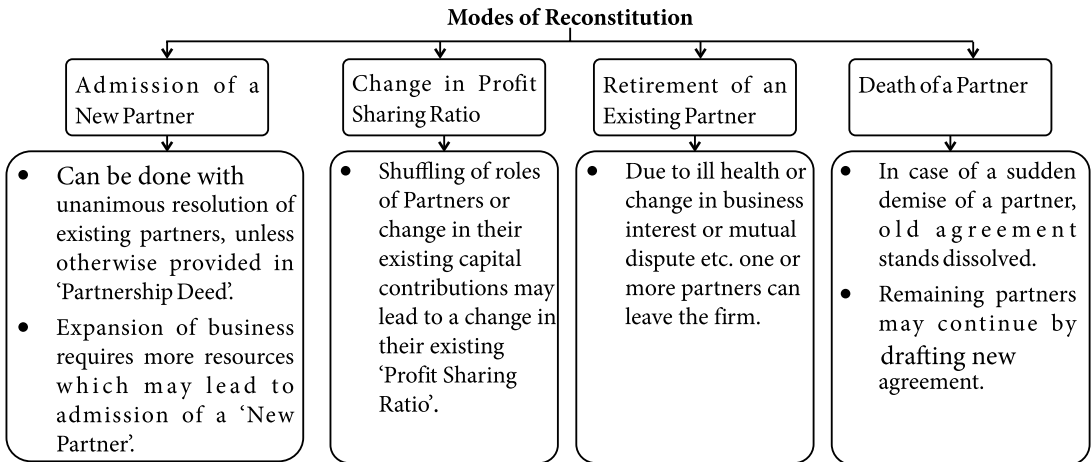


**QUICK RECAP**

**MODES OF RECONSTITUTION OF A PARTNERSHIP FIRM**

- ▶ **Reconstitution** : Partnership is the outcome of an agreement. Whenever there is change in any of the terms and conditions of the 'Partnership Deed' affecting the relationship among partners, it is termed as reconstitution of partnership. Reconstitution leads to the end of 'Old agreement' and drafting (execution) of 'New Deed'.

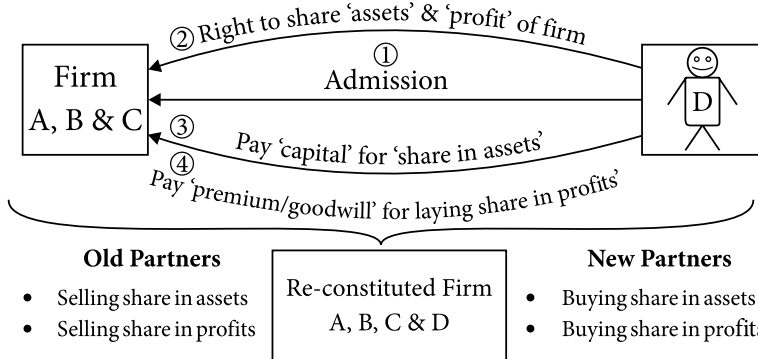


**ADMISSION OF A NEW PARTNER**

- ▶ An expansion program may require additional funds managerial, technical or legal competencies and experience in a particular field etc., such a need leads to admission of worthy persons to the existing business.

Admission of a partner leads to reconstitution of partnership and a new agreement is entered into by all partners including the incumbent.

Whenever a new partner joins, the rights of old and new partners need to be adjusted.



The admission of a partner is given effect to by adjusting the following :

1. New profit sharing ratio
2. Sacrificing ratio
3. Valuation and adjustment of goodwill
4. Distribution of accumulated profits (reserves) or losses if any
5. Revaluation of assets and reassessment of liabilities and
6. Capital adjustments

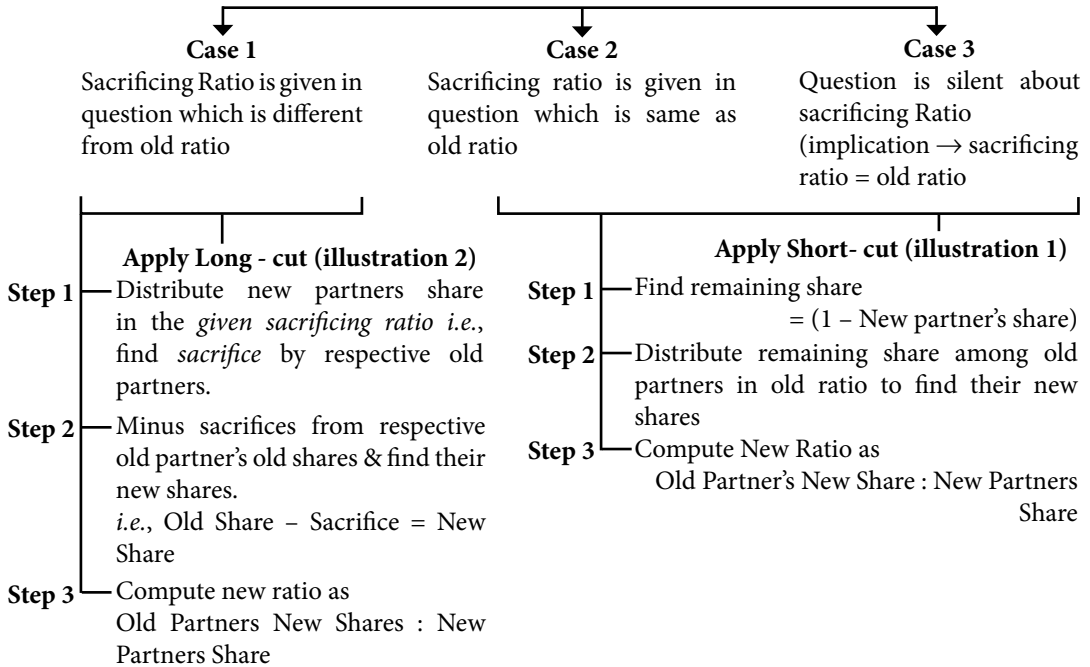
**Required so that one may not become rich at the expense of another partner**

**NEW PROFIT SHARING RATIO**

► When a new partner is admitted, a certain share in profit shifts from old partners to new partner. This gives rise to a new ratio of division of profit among partners including the new partner. The new partner may buy his/her share in profits from one or more

partners depending upon the information given in the respective case.

At admission of a new partner, a need arises to compute new profit sharing ratio. How to calculate the new ratio depends upon the ratio of sacrifice mentioned/not mentioned in question.



**Note :**

1. Sometimes instead of sacrificing ratio, directly *sacrificing* of old partners are given. In such a case step 1 above (Illustration 3)
2. Sometimes instead of sacrificing ratio and direct sacrifices question mentions an indirect way to find sacrifices (eg. Old partner 1 surrenders 1/4<sup>th</sup> of his share & old partner 2 surrenders 1/3<sup>rd</sup> of his share in favour of 'New Partner'.) In such a case find sacrifices using given info. (Illustration 4)

**Illustration 1 :** A & B are partners sharing profits in (Case 2 & 3) the ratio of 3:2. They admit C as a new partner for 1/5<sup>th</sup> share. Calculate new PSR.

**Solution : Step 1 :** Remaining share =  $1 - \frac{1}{5} = \frac{4}{5}$

**Step 2 :** Old Partners New Shares

$$A \frac{4}{5} \times \frac{3}{5} = \frac{12}{25}, \quad B \frac{4}{5} \times \frac{2}{5} = \frac{8}{25}$$

**Step 3 :** New Ratio ⇒

A's New Share : B's New share : C's Share

$$\frac{12}{25} : \frac{8}{25} : \frac{1 \times 5}{5 \times 5} = \frac{5}{25}$$

⇒ 12 : 8 : 5

**Illustration 2 :** Assume in illustration no. 1, that C (Case 1) acquires his share in the ratio of 1:1 equally from old partners. Calculate new PSR.

**Solution : Step 1 : Find sacrifices by Old Partners**

- Sacrificing Ratio = 1:1
- A & B each sacrifices =  $\frac{1}{5} \times \frac{1}{2} = \frac{1}{10}$

**Step 2 : Old Partners New Shares**

(Old Share - Sacrifice) = New Share

$$A \Rightarrow \frac{3}{5} - \frac{1}{10} = \frac{5}{10}$$

$$B \Rightarrow \frac{2}{5} - \frac{1}{10} = \frac{3}{10}$$