Partnership Accounting (Reconstitution)-01

Reconstitution of a firm:

- Partnership works on the basis of agreement between the partners. Any change in the existing agreement between the partners amounts to '**Reconstitution of the partnership firm'**.
- As a result of reconstitution existing agreement among the partners comes to an end and a new agreement comes into existence with a changed relationship among the members of the partnership firm and/or their composition.
- However with reconstitution the firm continues to do its business.

The partners often resort to reconstitution of the firm in various ways such as

- admission of a new partner,
- change in profit sharing ratio,
- retirement of a partner,
- death or insolvency of a partner.

Adjustment on reconstitution of the firm:

a) Treatment of reserves, accumulated profits and undistributed losses

b) Revaluation of assets and re-assessment of liabilities

c) Treatment of Goodwill

d) Capital adjustment in new profit sharing ratio

a) Accounting treatment of Reserves, Accumulated Profits and Undistributed Losses:

- *Reserves, Accumulated Profits and Undistributed Losses are always distributed in the old profit ratio to the partners even if the question is silent.*
- *Machinery Replacement Fund is in the nature of Accumulated Depreciation. So, it is not distributed among the partners.*
- *Employees' Provident Fund (EPF) or Employees' State Insurance (ESI) is a statutory liability of the firm towards the employees. Hence, it is not an accumulated profit and is not distributed among the partners.*
- *If there are any claims arising out of reserves, the balance remaining if any after adjusting for the claims is transferred to the partners in their old profit sharing ratio.*
- *There are two treatments of reserves and accumulated profits and losses –*
  - ***These accounts are closed:***

    In case partners want that the reserves and accumulated profits appearing in the balance sheet of the old firm should be closed, then the same is closed by transferring to the capital accounts in their old profit sharing ratio.
  - ***These accounts are not closed:***

    If undistributed losses in the old balance sheet are to be continued in the new firm without distributing it, then sacrificing partner is debited and gaining partner is credited.

When Reserves, Accumulated Profits and Undistributed Losses are distributed (or when these accounts are closed):

In the Balance Sheet of a firm specific and general reserves may appear and also undistributed losses may be appearing in the Balance Sheet.

We will discuss the treatment of Specific Reserves later.

If following General Reserves, Accumulated Profits and Undistributed Losses appearing in the Balance Sheet of the firm at the time of reconstitution are distributed among the old partners in their old profit sharing ratio.

General Reserves and Balance of Accumulated Profits (appearing on the liabilities side)	**Undistributed Losses** (appearing on the assets side)
• General Reserve • Reserves • Contingency Reserve • Profit & Loss A/c	• Profit & Loss A/c • Preliminary Expenses • Advertisement Suspense A/c • Any other balance of Deferred Revenue Expenditure
Journal Entries	**Journal Entries**
General Reserve A/c Dr Reserves A/c Dr Contingency Reserve A/c Dr Profit & Loss A/c Dr To Partners' Capital A/c	Partners' Capital A/c Dr To Profit & Loss A/c To Preliminary Expenses To Advertisement Suspense A/c

1. Ajay, Vijay and Seema are partners in a firm sharing profits and losses in the ratio of 2:2:1. On 1st April, 2021 they decided to share profits in the ratio of 3:2:1. On this date General Reserve appeared in their books at ₹1,20,000. Give journal entry on the date of change in ratio.
2. Seema and Neena are partners in a firm sharing profits and losses equally. On 1st April, 2021 they decided to admit Tina as a new partner for equal share. On the date of admission General Reserve appeared in the books at ₹45,000. Give necessary journal entry on the admission of Tina.
3. Kapil, Sunita and Kunal are partners in a firm sharing profits and losses in the ratio of 3:2:1. Sunita retires from the firm due to her shifting abroad. The new profit sharing ratio of Kapil and Kunal was 2:1. On the date of her retirement general reserve appeared in the books at ₹90,000. Give journal entry on the retirement of Sunita.

4. Keshav and Aditya are partners in a firm sharing profits and losses equally. On 1st April, 2021 they decided to admit Alpana as a new partner for equal share. On the date of admission General Reserve appeared in the books at ₹60,000. It was also decided among the partners that general reserve should be maintained in the books of the new firm. Give necessary journal entry(ies) on the admission of Alpana under following two conditions:
   (a) General Reserve account is closed and raised at the same amount
   (b) General Reserve account is not closed
   (c) Partners decide to maintain General Reserve at ₹90,000
   (d) Partners decide to maintain General Reserve at ₹45,000.

5. A and B are partners in a firm sharing profits in the ratio of 3:2. They decided to share profits in the ratio equally w.e.f., April 1, 2021. On this date there was a general reserve of ₹60,000 in their books. Pass the necessary journal entry in the following cases:
   a) Partners decided to distribute the profits,
   b) Partners decided to increase the reserve to ₹80,000
   c) Partners decided to reduce the reserve to ₹50,000

6. A and B are partners in a firm sharing profits in the ratio of 3:2. On 1st April, 2021 they decided to admit C as a new partner, and the new profit sharing ratio between A, B and C was decided as 2:2:1. On the date of C admission there was a general reserve of ₹1,00,000 in their books. Pass the necessary journal entry in the following cases:
   a) Partners decided to distribute the profits,
   c) Partners decided to increase the reserve to ₹1,20,000
   d) Partners decided to reduce the reserve to ₹80,000
7. A and B are partners in a firm sharing profits in the ratio of 3:2. They decided to share profits in the ratio of 3:4 w.e.f., April 1, 2021. On that date there was a credit balance of ₹70,000 in their Profit and Loss Account. Pass the necessary journal entry assuming that partners decide to distribute the profits.

8. A, B and C are partners sharing profits and losses in the ratio of 2:2:1. From April 1, 2021, they decided to share the profits in the ratio of 1:1:1. On that date, profit and loss account disclosed a debit balance of ₹90,000. Record the necessary journal entries in the books of the firm.

9. Following was the balance sheet of A, B and C as on 31st March, 2021 when they decided to change their profit sharing ratio from 2:2:1 to 1:1:1.

Liabilities		Amt ₹	Assets	Amt ₹
Creditors		20,000	Cash & Bank	30,000
Bills Payable		10,000	Debtors	60,000
General Reserve		40,000	Stock	1,50,000
Capital Accounts			Plant & Machinery	2,60,000
A	2,00,000		Profit & Loss A/c	20,000
B	1,50,000			
C	1,00,000	4,50,000		
		5,20,000		5,20,000

Give necessary journal entries in the books of the firm assuming that partners want to distribute reserves and losses.

10. A, B and C are partners sharing profits and losses in the ratio of 2:2:1. From April 1, 2021, C retires from the firm. On that date, the balance sheet of the firm showed debit balance of profit and loss account ₹90,000 and general reserve at ₹1,50,000. Record the necessary journal entries in the books of the firm.

11. Khush and Sukh are partners in a firm sharing profits in the ratio of 5:4. On April 1, 2021, they admit Muskan as a new partner and the new ratio is agreed at 3:2:1. On that date there was a balance of ₹63,000 in the profit and loss account and balance of ₹45,000 in general reserve. Record the necessary journal entries.

12. A, B and C are partners in a firm sharing profits in the ratio of 2:2:1. C retires and the balance sheet of the firm on that date was as under:

Liabilities		Amount ₹	Assets	Amount ₹
Creditors		20,000	Sundry Assets	2,00,000
General Reserve		40,000	Profit & Loss A/c	20,000
Capital Accounts				
A	50,000			
B	40,000			
C	30,000	1,20,000		
		2,20,000		2,20,000

Show the necessary journal entries for the treatment of General Reserve and Profit & Loss Account balance on C's retirement.

13. A, B and C are partners sharing profits equally. On 1st April, 2021, B retired from the firm and the new profit sharing ratio of A and C was decided as 3:2. On that date, Profit and Loss Account showed a credit balance of ₹90,000. Give journal entries in the books of the firm.

14. A and B are partners in a firm sharing profits in the ratio of 3:2. On March 31, 2021, their balance sheet showed a general reserve of ₹54,000. On that day they decided to admit C as a new partner. The new profit sharing ratio between A, B and C will be 4:3:2. Pass necessary journal entry(ies) in the books of the firm.

15. A, B, C and D are partners sharing profits in the ratio of 4:3:3:2. C retires and the remaining partners decided to share future profits in 5:3:2. On the date of C's retirement there was a debit balance of ₹45,000 in the profit and loss account. Show necessary journal entry for the treatment of Profit & Loss A/c.

16. X, Y and Z were sharing profits and losses in the ratio of 5:3:2. They decided to share future profits and losses in the ratio of 2:3:5 w.e.f. 1.4.2021. Following balances appeared in their books:

(i)	Profit and Loss Account	₹24,000
(ii)	Advertisement Suspense Account	₹12,000

Pass necessary journal entry(ies).

17. X, Y and Z were sharing profits and losses in the ratio of 5:3:2. On 1st April, 2021 Y retires from the firm. On the date of retirement their books showed following balances:

(i)	Profit and Loss Account	₹36,000
(ii)	Advertisement Suspense Account	₹12,000
(iii)	General Reserve	₹60,000

Pass necessary journal entry(ies).

18. X, Y and Z are partners in a firm sharing profits in the ratio of 3:2:1. They decided to share future profits equally. The profit and loss account showed ₹60,000 and General Reserve ₹30,000. Give necessary journal entry(ies) if these are to be shown in the books of the firm.

19. X, Y and Z are partners in a firm sharing profits in the ratio of 3:2:1. They decide to share future profits equally. The profit and loss account showed debit balance of ₹60,000 and General Reserve ₹30,000. Give necessary journal entry(ies) if these are to be shown in the books of the firm.

20. X and Y were sharing profits and losses in the ratio of 5:3. On 1st April, 2021 they decided to admit Z as a new partner. The new profit sharing ratio was decided as 2:3:5. General Reserve and debit balance in Profit and Loss A/c appeared in the books at ₹48,000 and ₹12,000 respectively. Pass necessary entries in the books of the firm when partners decided to close the loss account but continue showing reserves at ₹60,000.