Admission of a Partner: Meaning, Accounting Treatment & More

The admission of a partner is a significant undertaking for a partnership firm. It essentially changes the structure of the firm, and along with that comes the necessity of making certain adjustments and recalculating values to ensure a smooth transition. In this article, we'll explain the meaning of admission of a partner, the reasons a partner may have been admitted, and the adjustments that may take place.

What is Admission of a Partner?

The admission of a new partner refers to the situation when a new person joins the existing partnership of any firm. The other members of the partnership need to adjust their capital on the basis of their profit-sharing ratio after the admission of this new partner.

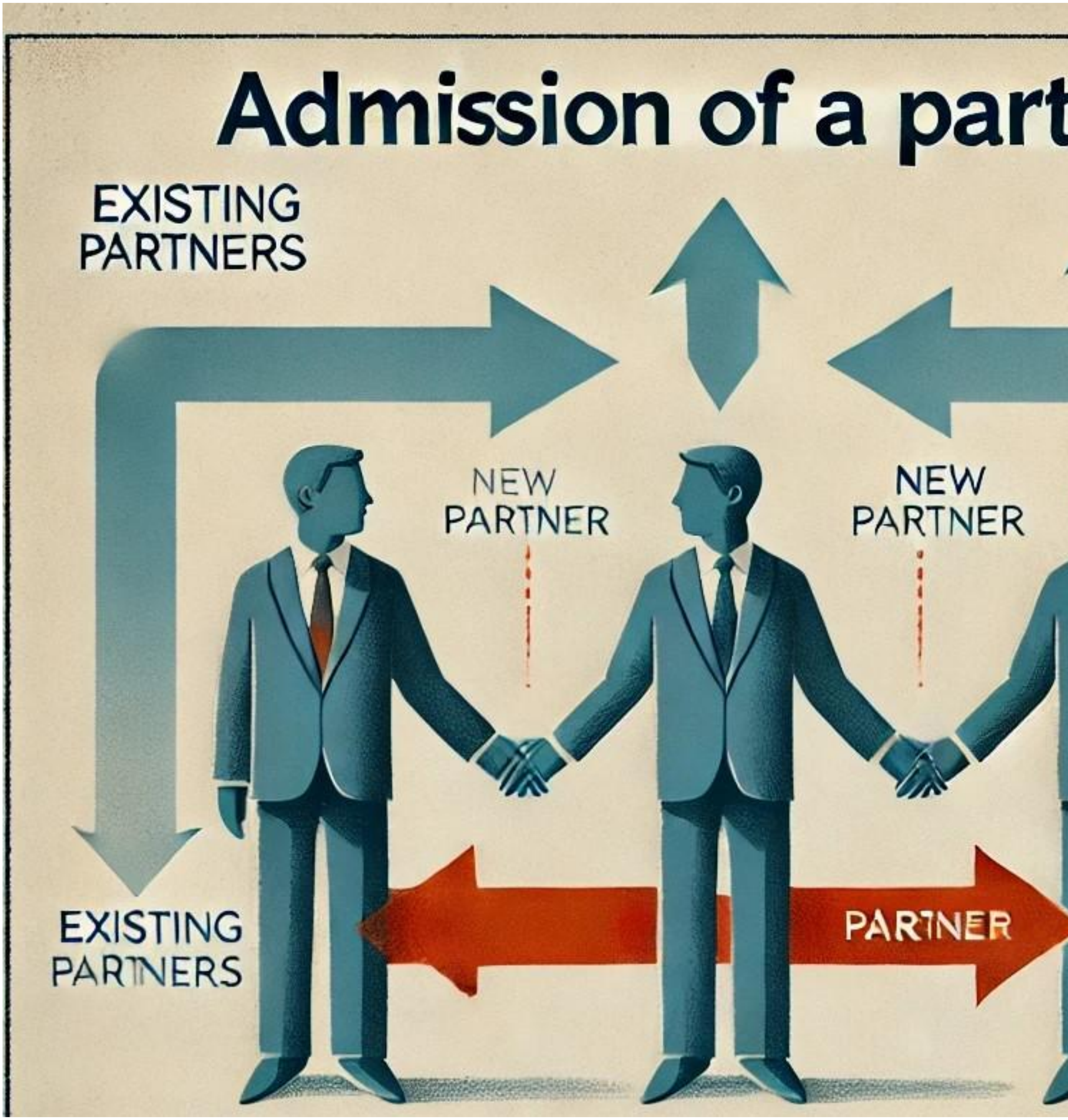
In other words, it is the event of adding a new partner to the existing partnership firm. A partner is admitted into the firm in return for a portion of the firm's profits, a claim on its assets, and is personally responsible for the firm's liabilities. When admitting a new partner, the existing partners intend to expand operations. According to the **Indian Partnership Act 1932,** the reasons for admission of new partners and also the rights of the partner after admission. The rights of the new partner involve the right to share the profits of the partnership firm and the right to share in the assets of the firm. Moreover, he also becomes liable for any liability incurred on the firm after his admission to it.

Reasons for Admission of a Partner

A new partner may be introduced when a firm wishes to expand or enhance its capabilities. The most common reasons for admitting a new partner into a partnership include:

- **Expansion of Business:** To grow and expand the business operations, a new partner with additional capital or new ideas may be required.
- **Capital Requirements:** When a firm needs more funds for working capital or investment, a new partner can bring in the necessary finances.
- **Specialized Skills and Expertise:** Sometimes, a new partner is admitted because they possess special skills, expertise, or market knowledge that can benefit the firm.

- **Sharing of Responsibilities:** As businesses grow, existing partners may find it hard to manage everything on their own, and a new partner can help share the managerial and operational responsibilities.



Changes to Be Made on Admission of a Partner

On the admission of a partner, the following are the changes that need to be done on the financial books of the firm. Such changes promote equity among all partners.

- **Revaluation of Assets and Liabilities:** Assets and liabilities of the firm are revalued at current market value. This ensures that the older asset values do not benefit or disadvantage the new partner unfairly.
- **Goodwill Adjustment:** Goodwill is the reputation of the firm and its ability to generate profits in the long run. Once a new partner joins, goodwill must be worked out, and the current partners are compensated for the sacrifices that they must undergo when sharing the profit.
- **Profit Sharing Ratio:** The profit sharing ratio must be recalculated as the new partner's share of profit. The old partner's capital can also be compromised by reducing a part of their share of profit for the new partner.
- **Reserves and Accumulated Profits:** Reserves, profits, or losses accumulated before admitting a new partner are distributed between the old partners following the old profit-sharing ratio.

Calculation of New Profit-Sharing Ratio

This is one of the most important adjustments during the admission of a new partner. So, as to determine through the new ratio how the profits are going to be shared by the new and existing partners.

There are two common methods for calculating the new profit ratio:

Sacrifice Ratio Method

The present partners consent to sacrifice a specific proportion of their profit in place of the new partner. The amount sacrificed by each partner is defined as the sacrifice ratio.

Formula for Sacrificing Partner's Ratio

Old Ratio − New Ratio

Gaining Ratio Method

If existing partners want to give up their share in a different proportion than they currently hold, then a gaining ratio is calculated.

Formula for Gaining Partner's Ratio

New Ratio − Old Ratio

Accounting Treatment for Admission of a Partner

During admission, the new partner brings his shares of goodwill and capital with him. There are some necessary adjustment of capitals made on the entry of a new partner in the firm. These adjustments are as follows:

Goodwill Adjustment:

Treatment of goodwill on the admission of a new partner will be based on the following conditions:

If the new partner brings in goodwill in cash, the journal entry is:

- **Bank A/C** Dr.
  - **To Goodwill A/C**

If goodwill is adjusted through the total capital accounts:

- **New Partner's Capital A/C** Dr.
- **To Existing Partners' Capital A/Cs** (in sacrifice ratio)

- **Bank A/C** Dr.
- **To Goodwill A/C**

- **New Partner's Capital A/C** Dr.
- **To Existing Partners' Capital A/Cs** (in sacrifice ratio)

Revaluation of Assets and Liabilities:

Any change in the value of Assets or Liabilities is dealt with by the Revaluation Account. However, it results in gain/loss being shared amongst the current profit-sharing ratio of the existing partners.

If there is an increase in the value of assets:

- **Asset A/C** Dr.
  - **To Revaluation A/C**

If there is a decrease in the value of assets or an increase in liabilities:

- **Revaluation A/C** Dr.
  - **To Asset/Liability A/C**

Profit or loss on revaluation is distributed among the existing partners in their old profit-sharing ratio.

- **Asset A/C** Dr.
- **To Revaluation A/C**

- **Revaluation A/C** Dr.
- **To Asset/Liability A/C**

Adjustment of Reserves and Accumulated Profits:

Reserves and profits earned before the admission are transferred to the capital accounts of the existing partners:

- **Reserve A/C** Dr.
- **To Old Partners' Capital A/Cs** (in the old profit-sharing ratio)

New Partner's Capital Contribution:

- When the new partner contributes capital, it is credited to their capital account:
    - **Bank A/C** Dr.
    - **To New Partner's Capital A/C**

Conclusion

Admission of a new partner is a significant event in the life of a partnership firm, which calls for several adjustments regarding profit-sharing, goodwill, and revaluation of assets. It provides a proper structure for treatment so that there are no disputes uncomfortable feelings or sensations with whether the new partner is being treated rightly, and the existing partners are compensated for their sacrifices made. Only accurate accounting treatment can reflect the changes in the books of the firm, which ensures transparency for maintaining the balance among all partners.

Admission of a Partner FAQs

1. What is meant by admission of a partner?

Admission of a partner is admitting a new partner in an existing firm, changing its structure, profit-sharing ratios, and responsibilities for earning profits and losses.

2. Why should a partnership admit a new partner?

A partnership firm may admit a new partner for various reasons, like expanding the scope of business operations, securing additional capital, acquiring specialized skills, and accomplishing managerial responsibilities by sharing among them.

3. What changes are to be made if a new partner is admitted?

Revaluation of assets and liabilities, change in goodwill, changes in profit-sharing ratios. Of course, the transfer of reserves and accumulated profits amongst existing partners.

4. How will the new profit-sharing ratio be arrived at?

A new profit-sharing ratio is arrived at either on a sacrifice ratio (how much existing partners give up) or on a gaining ratio (how much existing partners gain), with the new partner's share being the denominator.), with the new partner's share being the denominator.