



# St. Lawrence High School



A Jesuit Christian Minority Institution

Study Material 1

Sub: ACCOUNTANCY

Class 12

Chapter: Unit 2: Reconstitution of Partnership

Date: 08/08/2020

Topic: Change in Profit Sharing Ratio (PSR) -1

## Section A: Change in Profit Sharing Ratio

From time to time it may be necessary to change the profit sharing ratio of the partners. A change in the profit sharing ratio between the partners is a change in the constitution of partnership. In effect, the old partnership is dissolved and a new partnership is formed, though the books of accounts are maintained in the usual manner. The account of a partner will be debited when he makes a gain in his share of profit. Conversely, his account will be credited when he makes sacrifice.

In case of change in profit sharing ratio we need to consider the following points:

1. Change in the share of profit
2. Revaluation of Assets and Liabilities
3. Distribution of Reserves and Accumulated Profits
4. Goodwill

### Sacrificing Ratio:

It is the ratio at which different existing partners are sacrificing their share of profit in favour of other partner or partners.

$$\text{Sacrificing Ratio} = \text{Old Ratio} - \text{New Ratio}$$

Example 1: A, B, C and D are partners sharing profits and losses in the ratio 4:3:2:1. They have decided mutually that the profit sharing ratio will be equal from coming accounting period. Calculate their sacrificing/gaining ratio.

Solution: As we know that Sacrificing Ratio = Old Ratio – New Ratio. If the result is coming positive is called sacrifice and in case of negative result is known as gaining. Based on this concept it can be calculated as follows.

$$A = 4/10 - \frac{1}{4} = \frac{16-10}{40} = \frac{6}{40}$$

$$B = 3/10 - \frac{1}{4} = \frac{12-10}{40} = \frac{2}{40}$$

$$C = 2/10 - \frac{1}{4} = \frac{8-10}{40} = \frac{(2)}{40}$$

$$D = 1/10 - \frac{1}{4} = \frac{4-10}{40} = \frac{(6)}{40}$$

Here, sacrificing ratio between A and B is 6:2 i.e. 3:1.

### **Gaining Ratio**

It is the ratio at which different existing partners are gaining their share of profit from the other partner or partners. In our previous example C and D are the gaining partners. The gaining ratio in between them as C:D = 2:6 i.e. 1:3.

#### **1. Change in the Share of Profit**

A change in the share of profit ratio results in a new partnership, although daily operations of the firm currently are not affected. One or more partner may be entitled to an additional share of future profits. At the same time, the combined shares of the remaining partners will be reduced by the same proportion.

#### **2. Revaluation of Assets & Liabilities**

At the time of change in constitution of partnership it is necessary to revalue the assets and reassess the liabilities. Accounting entries in this regards are as follows:

When the values of assets and liabilities are to be shown in the Balance Sheet at revalued figure:

##### **(a) Increase in assets and decrease in liabilities:**

Assets A/C..... Dr.

Liabilities A/C..... Dr.

To, Revaluation A/C

##### **(b) Decrease in assets and increase in liabilities:**

Revaluation A/C..... Dr.

To, Assets A/C

To, liabilities A/C

##### **(c) Profit on revaluation:**

Revaluation A/C ..... Dr.

To, Partners Capital A/C (old ratio)

##### **(d) Loss on revaluation**

Partners' capital A/C ..... Dr.(old ratio)

To, Revaluation A/C

When the values of assets and liabilities are to be shown in the Balance Sheet at original figure:

In this situation it is required to open Memorandum Revaluation A/C and the following accounting entries are required.

##### **(a) Profit on revaluation:**

Memorandum Revaluation A/C ..... Dr.

To, Partners capital A/C (old ratio)

##### **(b) Writing-off the amount of profit:**

Partners Capital A/C ..... Dr.(new ratio)

To, Memorandum Revaluation A/C

##### **(c) Loss on revaluation:**

Partners Capital A/C ..... Dr.(old ratio)

To, Memorandum Revaluation A/C

**(d) Writing-off the amount of loss:**

Memorandum Revaluation A/C ..... Dr.  
To, Partners capital A/C (new ratio)

**3. Distribution of Reserves and Accumulated Profits**

If any undistributed reserve or accumulated profit is appearing in the last Balance Sheet that must be distributed among the partners in their old profit sharing ration. Accounting treatment in this regards are as follows:

**(a) Distribution of Profits & Reserves:**

General Reserve A/C ..... Dr.  
Other Reserve A/C ..... Dr.  
Profit & Loss A/C ..... Dr.  
To, Partners Capital A/C (old ratio)

**(b) Distribution of losses:**

Partners Capital A/C ..... Dr.  
To, Profit & Loss A/C (old ratio)

In case of writing-off profits and losses we need to pass reverse entries in new profit sharing ratio.

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