

Reconstitution of Partnership

1. **Answer:** b) To determine the share of profits that the existing partners give up when the profit-sharing ratio changes

Explanation: The sacrificing ratio is calculated when the profit-sharing ratio among the existing partners changes. It represents the portion of profits that the old partners are willing to give up to accommodate the new partner. The sacrificing ratio is important for calculating the goodwill adjustment, ensuring that the existing partners' compensation reflects the change in their share of profits. It helps in adjusting the capital accounts of the existing partners when new partners are admitted, and it can be found by calculating the difference between their old and new profit-sharing ratios.

2. **Answer:** b) The share of profits that the existing partners gain when the profit-sharing ratio changes

Explanation: The gaining ratio refers to the share of profits that the existing partners gain when the profit-sharing ratio is revised in the reconstitution of the partnership. It helps in determining how much of the sacrificed share of profits each partner will receive. The gaining ratio is important for adjusting the capital accounts of existing partners when a new partner is admitted, ensuring that the profits are allocated correctly among the old partners based on their new profit-sharing ratio.

3. **Answer:** b) They are divided among the existing partners based on the new profit-sharing ratio

Explanation: When a partnership is reconstituted, reserves and accumulated profits are generally distributed among the existing partners based on their new profit-sharing ratio. This ensures that the distribution of profits reflects the changes in the partners' share of the business. The distribution of reserves allows the partners to receive their fair share of the profits or accumulated funds, which could have been accumulated over time as part of the business's earnings. This treatment is important to ensure equity between the partners after the reconstitution process.

4. **Answer:** c) It is valued using the average profit method, super profit method, or multiplier method

Explanation: When a new partner is admitted, goodwill is typically valued using one of the following methods: the average profit method, super profit method, or multiplier method. The average profit method calculates goodwill based on the average profits of the firm over a specified period. The super profit method determines the excess profits over normal profit, and the multiplier method calculates goodwill by multiplying the excess profits by a predetermined factor. The method chosen depends on the nature of the business and the circumstances of the admission.

5. **Answer:** d) It is done through the revaluation account and affects the partners' capital accounts

Explanation: During the reconstitution of a partnership, assets and liabilities are revalued to bring them to their current market values. Any changes in the value of assets or liabilities are recorded in a revaluation account. The revaluation account helps in adjusting the capital

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accounts of the partners based on the gains or losses from the revaluation. This ensures that the financial statements of the firm reflect the true value of the assets and liabilities at the time of reconstitution. The revaluation process is important for accurate reporting and fair distribution of profits and losses.

6. **Answer:** b) They are credited with the value of goodwill

Explanation: When goodwill is admitted by the new partner, the value of the goodwill is credited to the capital accounts of the existing partners. The existing partners are compensated for the goodwill built up in the firm before the new partner joined. The distribution is typically done in the old profit-sharing ratio unless otherwise agreed upon. The new partner will contribute an amount equal to the goodwill share they are acquiring, which will be distributed among the old partners based on their respective shares in the goodwill.

7. **Answer:** a) To reflect the change in the firm's ownership structure

Explanation: Adjusting capital accounts during the admission of a new partner is necessary to reflect the change in the ownership structure of the partnership. This process ensures that the capital accounts of all partners, including the new one, are accurate and reflect the agreed-upon share of profits, losses, and capital contributions. It also ensures that the new partner's capital contribution is properly incorporated into the firm's financial framework, and the previous partners' interests are adjusted accordingly based on the agreed-upon terms in the partnership deed.

8. **Answer:** b) They are distributed to the remaining partners according to their new profit-sharing ratio

Explanation: When a partner retires or passes away, the accumulated profits or reserves are typically distributed among the remaining partners based on their new profit-sharing ratio. This ensures that the remaining partners receive their fair share of the business's accumulated earnings. The distribution of these reserves is part of the process of settling the retiring partner's or deceased partner's account and ensures that the financial records reflect the accurate distribution of the business's accumulated profits.

9. **Answer:** d) It is shared between the retiring or deceased partner and the remaining partners according to their profit-sharing ratio

Explanation: When a partner retires or passes away, the goodwill of the firm is generally shared between the retiring/deceased partner and the remaining partners according to their respective profit-sharing ratio. This ensures that the retiring partner or their heirs are compensated for the goodwill built up during their time in the firm. The amount of goodwill to be distributed is typically calculated and then adjusted in the capital accounts of all partners to reflect the changes in the partnership structure.

10. **Answer:** d) It redistributes the capital among the remaining partners

Explanation: When a partner retires, the capital they have invested in the firm is either withdrawn or adjusted against the retiring partner's share of the firm's net worth. The remaining partners typically redistribute the total capital of the firm based on their new profit-sharing ratio.

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The remaining partners may decide to adjust their capital contributions to maintain the proportion of capital based on the new partnership agreement. This ensures that the capital structure of the firm is aligned with the revised ownership percentages after the retirement of the partner.

11. **Answer:** b) Revaluation is recorded in the revaluation account and credited to the retiring partner's capital account

Explanation: When a partner retires or passes away, the assets and liabilities are revalued to reflect their current market value. The increase or decrease in the value of assets and liabilities is transferred to a revaluation account. This revaluation amount is then credited or debited to the capital accounts of the remaining partners based on their profit-sharing ratio. In the case of a retirement or death, the retiring or deceased partner's share of the revaluation profit or loss is transferred to their capital account, ensuring they receive their fair share of the adjustment.

12. **Answer:** b) The assets and liabilities of the firm are revalued to their current market values

Explanation: During the admission of a new partner, the assets and liabilities of the firm are typically revalued to reflect their current market values. This is done to ensure that the new partner's contribution is based on the firm's true value. Any gain or loss arising from the revaluation of assets or liabilities is transferred to a revaluation account and is credited or debited to the existing partners' capital accounts. This ensures the new partner enters the partnership on fair terms and that the firm's financial position is accurately represented.

13. **Answer:** b) $\text{Goodwill} = \text{Super profit} \times \text{Number of years' purchase}$

Explanation: In the super profit method, goodwill is calculated by multiplying the super profit by the number of years' purchase. The super profit is the excess of the firm's actual profit over the normal expected profit (based on an average industry return). The number of years' purchase is a multiplier that reflects how many years of super profits the partners are willing to pay for the goodwill of the firm. This method is used to assess the value of a business based on its ability to generate profits above a normal return.

14. **Answer:** b) To distribute the profits among partners as per the partnership deed

Explanation: The profit and loss appropriation account is used to allocate the net profits or losses of the firm among the partners according to their profit-sharing ratio, as per the partnership deed. It takes into account items like the partners' salaries, interest on capital, and other special provisions outlined in the partnership agreement. The appropriation account also helps in adjusting any undistributed profits, ensuring that the allocation of profits is done fairly among the partners based on their agreement. This process ensures that the distribution is in line with the partners' rights and obligations.

15. **Answer:** b) The new partner's capital is credited to the capital accounts of existing partners in their profit-sharing ratio

Explanation: When a new partner is admitted to a partnership, the capital account of the new partner is credited with their capital contribution to the firm. The new partner's share in the partnership is calculated based on their agreed-upon profit-sharing ratio, and this capital is

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typically distributed to the existing partners in their old profit-sharing ratio. This ensures that the ownership structure of the partnership reflects the new contribution, and the capital structure is adjusted accordingly. The new partner's contribution is also used to adjust the total capital of the firm.

16. **Answer:** b) Goodwill is shared among the existing partners in their old profit-sharing ratio

Explanation: When a new partner is admitted and the existing partners' profit-sharing ratio changes, the goodwill is typically shared among the existing partners in their old profit-sharing ratio. This adjustment compensates the existing partners for the value they have contributed to the goodwill of the firm before the new partner joined. The new partner's contribution toward goodwill is credited to the old partners' capital accounts in the ratio in which they are sacrificing their share of profits. This ensures a fair distribution of the goodwill based on the previous partnership terms.

17. **Answer:** d) The capital of the remaining partners is adjusted to reflect the profit-sharing ratio

Explanation: When a partner retires, their share of the capital is withdrawn from the firm. To maintain the capital structure of the partnership, the remaining partners usually adjust their capital contributions in accordance with their new profit-sharing ratio. This ensures that the capital structure remains proportionate to the new distribution of profits and losses among the remaining partners. The amount due to the retiring partner is settled either through their capital account or by the transfer of assets or liabilities, depending on the partnership agreement.

18. **Answer:** b) The retiring partner is paid their share of goodwill

Explanation: When a partner retires, their share of goodwill is paid to them by the remaining partners. The amount of goodwill is calculated based on the agreed-upon method (average profit, super profit, etc.) and is then shared according to the profit-sharing ratio that existed before the retirement. This compensates the retiring partner for the value they brought to the business in terms of goodwill. The retiring partner's share of goodwill is credited to their capital account and settled by the continuing partners, who may adjust their capital accounts accordingly.

19. **Answer:** b) A change in the partnership's financial structure without dissolving it

Explanation: The term "reconstitution of partnership" refers to any changes in the partnership's structure that occur without dissolving the firm. These changes could include the admission of a new partner, the retirement or death of an existing partner, or the alteration of the profit-sharing ratio among the partners. The reconstitution process involves adjusting the capital accounts, profit-sharing ratios, and the allocation of goodwill, assets, and liabilities. It does not involve winding up the firm, but rather modifying its internal arrangement to reflect the new partnership structure.

20. **Answer:** b) Their capital accounts are adjusted based on the new profit-sharing ratio

Explanation: After the retirement of a partner, the capital accounts of the remaining partners

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are adjusted according to the new profit-sharing ratio. This adjustment reflects the change in the profit-sharing arrangement and ensures that the capital structure aligns with the revised distribution of profits and losses. The retiring partner's share of capital is either withdrawn or transferred to the continuing partners based on their new profit-sharing ratio. This ensures a fair and equitable distribution of the firm's assets and liabilities among the remaining partners.

21. **Answer:** b) It reflects the share of profit a partner is willing to give up to accommodate a new partner

Explanation: The "sacrificing ratio" is the proportion in which existing partners agree to sacrifice their share of profits to make room for a new partner. It is calculated when a new partner is admitted, and it helps determine how the old partners' profit-sharing ratios are adjusted. The sacrificing ratio is essential in calculating how much goodwill is shared between the old partners and the new partner, ensuring that the existing partners contribute their part in accommodating the new partner's entry into the business.

22. **Answer:** a) The new partner's share in profits is based on the agreed-upon profit-sharing ratio

Explanation: When a new partner is admitted to the firm, their share of profits is based on the agreed-upon profit-sharing ratio. This ratio is typically negotiated and reflects the new partner's contribution to the partnership in terms of capital and effort. The admission of a new partner often leads to a change in the existing partners' profit-sharing ratios. The new partner contributes capital and is expected to share in the profits according to the terms set out in the partnership agreement.

23. **Answer:** b) To measure the percentage of profits the remaining partners will gain after the retirement or death of a partner

Explanation: The gaining ratio is used to determine how much profit the remaining partners will gain as a result of the retirement or death of a partner. It represents the increase in profit share for each of the continuing partners. The gaining ratio is calculated by comparing the old and new profit-sharing ratios of the continuing partners. The partners who gain from the change in profit-sharing ratios must compensate the retiring partner for their share of goodwill based on the calculated gain.

24. **Answer:** c) $\text{Goodwill} = \text{Average profit} \times \text{Number of years' purchase}$

Explanation: The average profit method is used to calculate goodwill by determining the average profit of the business over a specific period. Once the average profit is calculated, it is multiplied by the number of years' purchase to determine the total value of goodwill. The number of years' purchase reflects the business's potential longevity and the number of years over which the profit is expected to continue. This method provides a straightforward calculation of goodwill based on past performance and future expectations.

25. **Answer:** b) The deceased partner's share of goodwill is paid to their heirs

Explanation: When a partner dies, their share of the business's goodwill is typically paid to their heirs or legal representatives. The amount of goodwill is calculated based on the agreed

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method (e.g., average profit, super profit, etc.), and the deceased partner's share is determined based on their profit-sharing ratio. The remaining partners may adjust their capital accounts to reflect the deceased partner's share of goodwill, ensuring that the deceased partner's heirs are compensated fairly for their contribution to the firm's goodwill.

26. **Answer:** b) Reserves are distributed among the remaining partners based on their new profit-sharing ratio

Explanation: When a partner retires, their share of the firm's accumulated reserves is distributed among the remaining partners according to their new profit-sharing ratio. This ensures that the retiring partner receives their fair share of the reserves accumulated during their tenure in the partnership. The distribution of reserves is an important aspect of the reconstitution process, ensuring that all financial elements of the firm are adjusted to reflect the new partnership structure.

27. **Answer:** b) The capital of the new partner is used to adjust the old partners' capital accounts based on their sacrificing ratio

Explanation: When a new partner is admitted, their capital contribution is typically used to adjust the capital accounts of the old partners. The amount contributed by the new partner is distributed among the existing partners in the ratio in which they are willing to sacrifice their share of profits, known as the sacrificing ratio. This ensures that the capital accounts of the old partners reflect the changes in the profit-sharing ratios, while also compensating the existing partners for allowing the new partner to join the firm.

28. **Answer:** b) The retiring partner is paid their share of goodwill by the remaining partners

Explanation: During the retirement of a partner, the goodwill of the firm is usually calculated based on an agreed method (average profit, super profit, etc.). The retiring partner's share of goodwill is then paid to them by the remaining partners, who may adjust their capital accounts to reflect the distribution. The retiring partner receives compensation for their contribution to the firm's goodwill, and this adjustment ensures that their exit is financially balanced with the value they brought to the business.

29. **Answer:** c) To allocate the firm's profits and losses among the partners in the new partnership structure

Explanation: The "new profit-sharing ratio" is crucial for determining how profits and losses will be allocated among the partners after a reconstitution event, such as the admission of a new partner, the retirement of a partner, or the death of a partner. This ratio reflects the revised distribution of the firm's profits based on the new partnership agreement. It ensures that the remaining partners share profits and losses according to the updated agreement, which may be influenced by the changes in capital contributions or responsibilities after the reconstitution.

30. **Answer:** b) The firm's assets increase by the new partner's capital contribution

Explanation: When a new partner is admitted, their capital contribution is added to the firm's total assets. This additional capital injection may be used to expand the firm's operations, pay off liabilities, or improve its financial position. The firm's assets are typically revalued to reflect

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the new partner's contribution and the updated market value of any assets. The capital contribution of the new partner increases the total equity of the firm, ensuring that their stake in the business is properly accounted for.

31. **Answer:** c) To update the value of assets and liabilities to their current market value, ensuring fairness in the reconstitution process

Explanation: The revaluation of assets and liabilities is a critical part of the reconstitution process. When changes occur—such as the admission, retirement, or death of a partner—the firm's assets and liabilities are revalued to reflect their current market values. This ensures that all partners receive their fair share of the firm's value. Any increase or decrease in the value of assets or liabilities is recorded in the books and is adjusted to the capital accounts of the partners based on their profit-sharing ratios.

32. **Answer:** c) Accumulated profits are shared among the old partners according to their old profit-sharing ratio

Explanation: During the admission of a new partner, the accumulated profits (reserves) of the firm are generally shared between the old partners in their old profit-sharing ratio. The new partner is not entitled to any share in the accumulated profits unless otherwise agreed upon. The distribution ensures that the old partners are compensated for the reserves they have accumulated, and the new partner's entry does not disrupt the financial balance of the firm.

33. **Answer:** b) They are adjusted based on the new profit-sharing ratio and capital contribution of the new partner

Explanation: When a new partner is admitted to the partnership, the capital accounts of the existing partners are adjusted. This adjustment is made to reflect the new profit-sharing ratio and the capital contribution made by the new partner. If necessary, the existing partners may have to either withdraw or contribute more capital to maintain an equitable capital structure according to the agreed terms. The new partner's capital contribution and share in the profit determine how much each existing partner's capital is adjusted.

34. **Answer:** c) The retiring or deceased partner's share of goodwill is paid to them or their heirs

Explanation: When a partner retires or passes away, their share of the goodwill is calculated based on the agreed valuation method (such as the average profit method or super profit method). This share of goodwill is then paid to the retiring partner or their heirs. The amount paid is based on the retiring or deceased partner's share of the goodwill in proportion to their profit-sharing ratio. This ensures that the partner or their heirs are compensated for the value they brought to the firm's goodwill.

35. **Answer:** a) The partners adjust their capital according to their current profit-sharing ratio

Explanation: "Adjustment of capital" refers to the process where the partners' capital accounts are revised based on the new profit-sharing ratio. This may involve additional capital contributions by the partners or withdrawals to ensure that each partner's capital is in proportion to their revised share of profits. If a partner's capital is not in line with their profit-sharing ratio,

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they may be required to either bring in more capital or adjust their existing capital account to align with the new profit-sharing arrangement.

36. **Answer:** b) Super Profit Method

Explanation: The Super Profit Method is based on the concept of expected future profits. Under this method, the firm's average profit is compared with the normal profit (which is based on the capital employed or assets of the firm). The excess profit over and above the normal profit is considered "super profit." This super profit is then used to calculate goodwill. This method is most appropriate for firms that have consistent future profitability and is commonly used to determine the firm's intangible value based on expected profits.

37. **Answer:** b) Goodwill is shared among the partners based on the sacrificing ratio

Explanation: When there is a change in the profit-sharing ratio among the existing partners, goodwill is shared among them according to the sacrificing ratio. The sacrificing ratio is calculated by determining the difference between the old and new profit-sharing ratios. The partners who are sacrificing part of their share of profits compensate the others for their contribution to the firm's goodwill. This ensures that the partners who give up a portion of their profit share are compensated for the goodwill that they contributed to the business.

38. **Answer:** d) The retiring partner's share of goodwill is paid to them by the continuing partners

Explanation: When a partner retires, their share of the goodwill is calculated and paid to them by the continuing partners. The goodwill is valued based on an agreed-upon method, such as the average profit or super profit method. The amount calculated as the retiring partner's share is paid by the remaining partners, who adjust their capital accounts accordingly. This ensures that the retiring partner is compensated fairly for their contribution to the business's goodwill.

39. **Answer:** c) Reserves are distributed among the continuing partners according to their old profit-sharing ratio

Explanation: When a partner retires or passes away, the reserves of the firm are typically distributed among the remaining partners based on their old profit-sharing ratio. This ensures that the retiring or deceased partner's share of accumulated profits (reserves) is adjusted fairly before the reconstitution of the firm. The distribution of reserves is a crucial part of settling accounts and ensuring that all partners are compensated for their contributions to the firm's past success.

40. **Answer:** b) A change in the allocation of profits among the existing partners

Explanation: The change in the profit-sharing ratio involves the redistribution of profits among the existing partners of the firm. This typically occurs when a new partner is admitted, a partner retires, or a partner dies. The new profit-sharing ratio reflects how profits and losses will be divided among the partners moving forward. The change is usually agreed upon by all partners and is calculated to reflect each partner's new contribution or stake in the business after the event.

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41. **Answer:** c) It refers to the ratio in which the old partners give up their share of profits to the new partner(s)

Explanation: The Sacrificing Ratio is the ratio in which existing partners give up their share of profits to accommodate the new profit-sharing ratio. This typically occurs when a new partner is admitted. The sacrificing ratio is calculated by determining the difference between the old and new profit-sharing ratios of each old partner. The total of the sacrificing ratio will be equal to the new partner's share in the profits.

42. **Answer:** c) The ratio in which the old partners gain a larger share of the profits

Explanation: The Gaining Ratio is used when there is a change in the profit-sharing ratio among the existing partners. It reflects the proportion in which the old partners gain a larger share of the profits after some partners sacrifice part of their share. The gaining ratio is calculated by determining the difference between the new profit-sharing ratio and the old profit-sharing ratio of each existing partner. The gain made by each partner is the difference in their share of profit.

43. **Answer:** b) The deceased partner's capital is paid to their heirs immediately

Explanation: Upon the death of a partner, the capital account of the deceased partner is settled by transferring their share of the capital, accumulated profits, and goodwill (if applicable) to their heirs or legal representatives. This settlement is based on the terms agreed upon in the partnership deed. The deceased partner's share in the business is valued, and the remaining partners must pay the due amount to the legal heirs, adjusting for any outstanding amounts.

44. **Answer:** c) Goodwill is shared among the existing partners according to their old profit-sharing ratio

Explanation: When a new partner is admitted, the existing partners share the goodwill of the firm based on their old profit-sharing ratio. The new partner does not typically contribute to the goodwill at this point. Instead, the existing partners are compensated for the value they have contributed to the goodwill, and the amount is adjusted in their capital accounts. This treatment ensures fairness and compensates the old partners for their contributions to the firm's success.

45. a) Based on the new profit-sharing ratio agreed upon by the partners

Explanation: When a new partner is admitted, their share of profits is calculated according to the new profit-sharing ratio agreed upon by all partners. The new partner's share is typically proportional to the capital they contribute to the firm and the value they bring to the business. The profit-sharing ratio is adjusted accordingly, and the new partner's entitlement to profits begins once the new ratio is applied. This ensures that all partners share profits in a way that reflects their contributions to the business.

46. **Answer:** b) Based on the amount of capital contributed by the new partner

Explanation: The capital of the new partner is generally calculated based on the amount they are willing to contribute to the firm. This amount is agreed upon by the existing partners and is proportionate to the new partner's share of profits. The new partner's capital may also be

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adjusted if the firm's total capital needs to be balanced between all partners. The new partner's share in profits will be in line with the agreed-upon profit-sharing ratio.

47. **Answer:** b) To adjust the capital accounts of the partners

Explanation: The Profit and Loss Appropriation Account is used to distribute the profits among the partners in accordance with the agreed profit-sharing ratio. In the context of reconstitution, this account is also used to record adjustments related to changes in the profit-sharing ratio. It may also be used to adjust any reserves, retained earnings, and profits generated during the accounting period. In the case of admission, retirement, or death of a partner, the appropriations are adjusted according to the new arrangement.

48. **Answer:** b) It is added to the capital accounts of the continuing partners

Explanation: In the case of a partner's retirement, the retiring partner's share of the goodwill is paid to them by the remaining partners. The share of goodwill is calculated based on the agreed valuation method, and the amount is distributed among the continuing partners in accordance with their new profit-sharing ratio. The goodwill is added to the capital accounts of the continuing partners, which ensures that the retiring partner is compensated fairly for their contribution to the firm's intangible assets.

49. **Answer:** c) The withdrawn partner's share of profits is redistributed among the continuing partners based on their new profit-sharing ratio

Explanation: When a partner withdraws from the partnership, their share of the profits and capital is redistributed among the remaining partners. The remaining partners may agree to revise the profit-sharing ratio to reflect the changes in the partnership. The withdrawn partner's share of profits and capital is adjusted according to the new agreement, and the withdrawn partner is compensated for their contributions to the firm.

50. **Answer:** b) It outlines the terms for the treatment of goodwill, capital adjustments, and profit-sharing ratios

Explanation: The Partnership Deed is a crucial document in the reconstitution process, as it outlines the terms and conditions under which the partnership operates. It specifies how changes in the profit-sharing ratio, capital adjustments, and the treatment of goodwill are handled. The deed helps clarify the rights and responsibilities of the partners, ensuring that any changes due to the admission, retirement, or death of a partner are executed according to the agreed terms. This ensures smooth transitions and avoids disputes during the reconstitution of the partnership.