

10. PARTNERSHIP ACCOUNTS & LLP

UNIT 2 : TREATMENT OF GOODWILL

CONCEPT 1 : INTRODUCTION

Meaning

- Goodwill is the value of reputation of the firm in respect of profits

Features

- 1) It helps earn higher profits
- 2) It's an intangible asset
- 3) It's an estimate

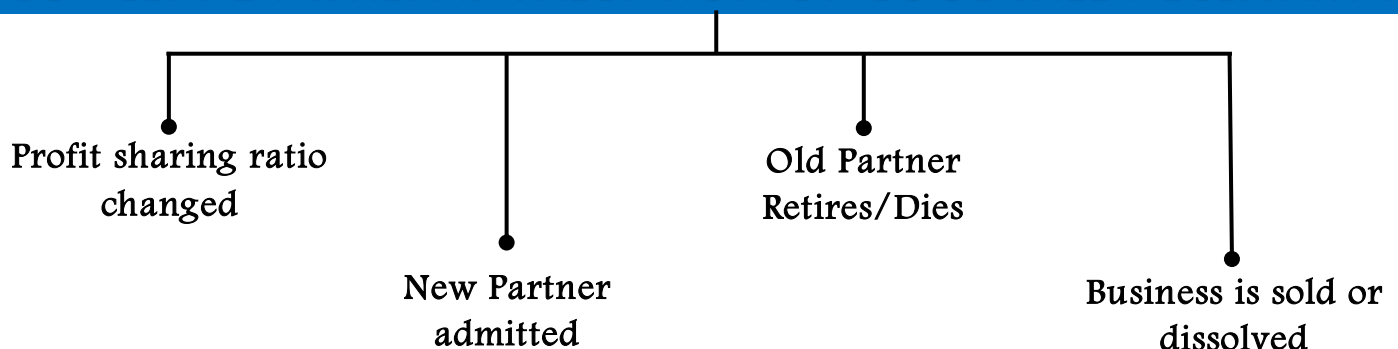
Guidance by AS 26

- Only record intangible asset if :
 - 1) Characteristics of an asset
 - 2) Future Economic Benefits
 - 3) Reliable Estimate

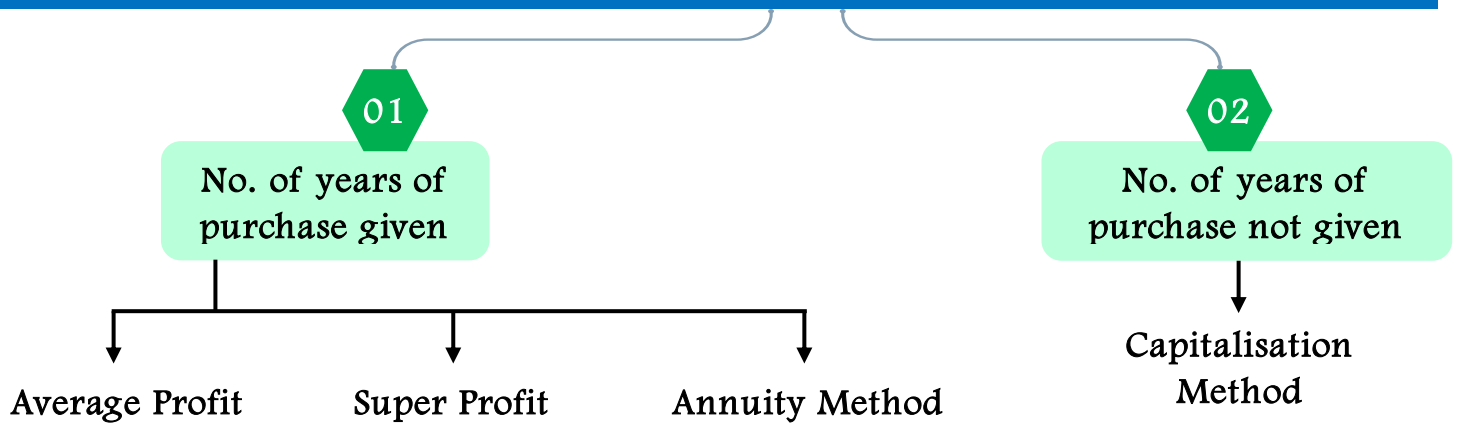
Remember :

- Self-Generated Goodwill is not allowed to be recorded.
- Goodwill by the way of business purchase is allowed to be recorded.

CONCEPT 2 : WHEN IS VALUATION OF GOODWILL NECESSARY ?

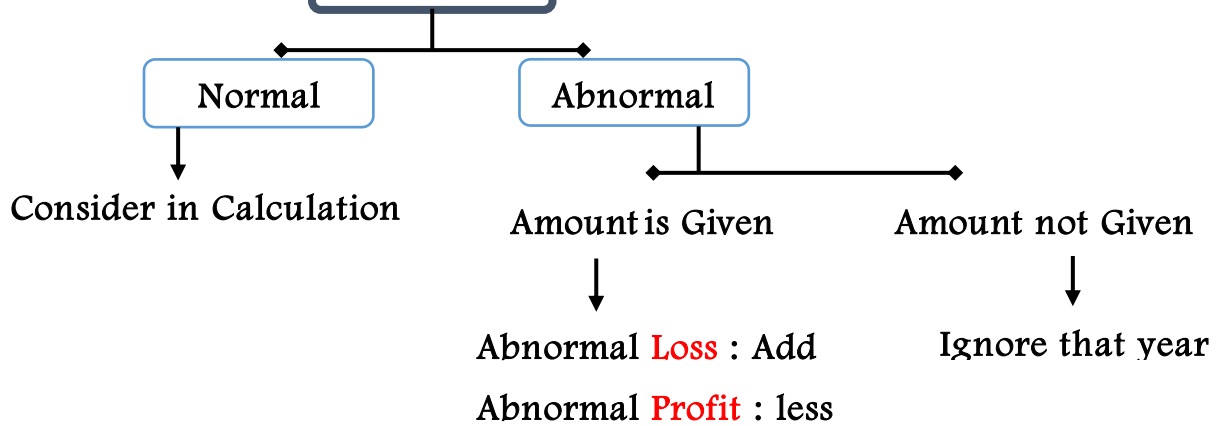


CONCEPT 3 : METHODS OF GOODWILL VALUATION



1] Average Profit

Goodwill = Average Profit × No. of years of Purchase



2] Super Profit

Sr. No.	Particulars	Formula
11	Goodwill	Super Profit × No. of year of Purchase
21	Super Profit	Actual Profit – Normal Profit (Capital is same)
31	Normal Profit	Capital Employed × NRR

3] Annuity Method

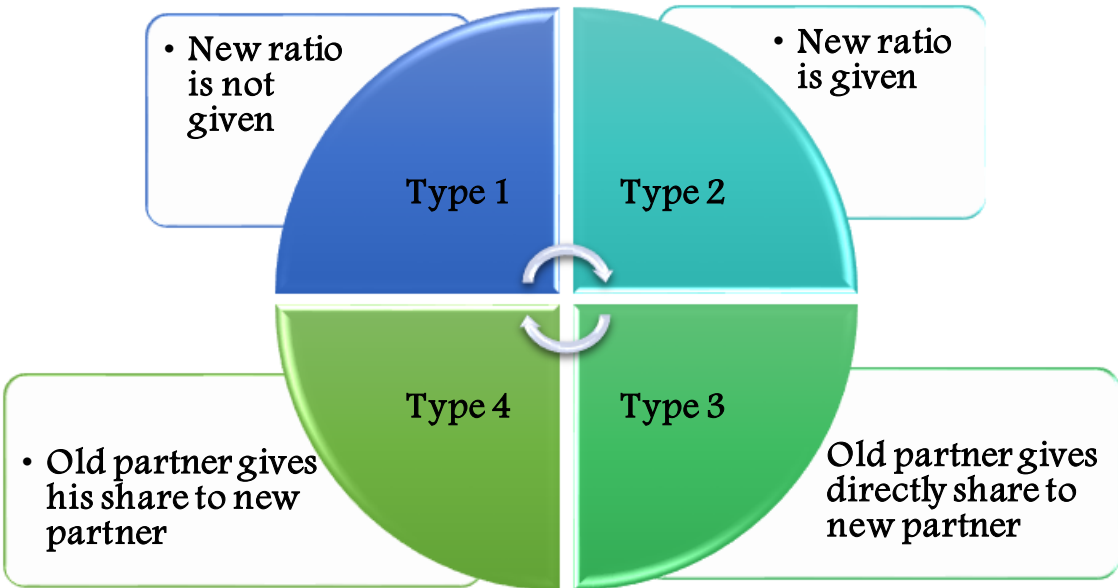
Sr. No.	Particulars	Formula
1]	Goodwil	Super Profit × P.V.A.F

4] Capitalization Method

=> Capital of 2 firms having same profit are compared.

Sr. No.	Particulars	Formula
1]	Goodwill	Normal Capital – Actual Capital
	Normal Capital	$\frac{\text{Actual Profit}}{\text{NRR}}$
OR		
2]	Goodwill	$\frac{\text{Super Profit}}{\text{NRR}}$

CONCEPT 4 : TYPES OF RATIOS



1] Type 1 : A&B = 3:2. C new partner = 1/4

Calculate new ratio & sacrificing ratio. Prove that Old Ratio = Sacrificing Ratio

Ratio	A	B	C
Old	$\frac{3}{5} \times \frac{4}{4} = \frac{12}{20}$	$\frac{2}{5} \times \frac{4}{4} = \frac{8}{20}$	
(-) New	$\frac{3}{4} \times \frac{3}{5} = \frac{9}{20}$	$\frac{3}{4} \times \frac{2}{5} = \frac{6}{20}$	$\frac{1}{4} \times \frac{5}{5} = \frac{5}{20}$
Sacrificing Ratio	$\frac{3}{2}$ Giver So Credit	$\frac{2}{2}$ Giver So Credit	$\frac{5}{2}$ Receiver So Debit

2] Type 2 : Old Ratio = 3 : 2

C is admitted with $\frac{1}{6}$ th Share & remaining Share is divided in the ratio of 2 : 3.

Ratio	A	B	C
Old	$\frac{3}{5} \times \frac{6}{6} = \frac{18}{30}$	$\frac{2}{5} \times \frac{6}{6} = \frac{12}{30}$	
(-)	$\frac{5}{6} \times \frac{2}{5} = \frac{10}{30}$	$\frac{5}{6} \times \frac{3}{5} = \frac{15}{30}$	$\frac{1}{6} \times \frac{5}{5} = \frac{5}{30}$
Sacrificing Ratio	$\frac{8}{3}$ Giver So Credit	$\frac{3}{3}$ Receiver So Debit	$\frac{5}{3}$ Receiver So Debit

3] Type 3 : A & B = 3 : 2. C is admitted with 1/6th Share
B is given 1/18th & remaining by A.

$$\frac{1}{6} = \frac{3}{18}$$

$\frac{2}{18}$ **A**
 $\frac{1}{18}$ **B**

Ratio	A	B	C
	$\frac{3 \times 18}{5 \times 18} \quad \frac{2 \times 5}{1 \times 5}$ $= \frac{44}{90}$	$\frac{2 \times 18}{5 \times 18} \quad \frac{1 \times 5}{18 \times 5}$ $= \frac{31}{90}$	$\frac{1 \times 15}{6 \times 15}$ $= \frac{15}{90}$

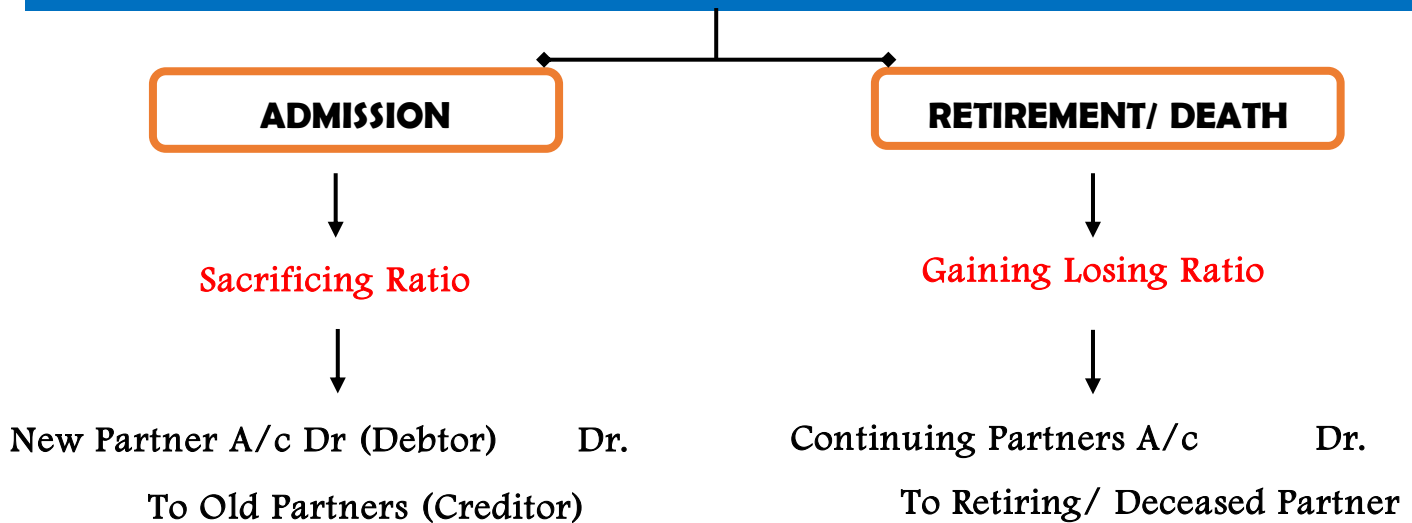
Ratio	A	B	C
Old	$\frac{3}{5} \times \frac{1}{1} - \frac{5}{9}$	$\frac{2}{5} \times \frac{1}{1} - \frac{3}{9}$	
(-) New	$\frac{4}{9}$	$\frac{3}{9}$	$\frac{1}{9}$
Sacrificing Ratio	$\frac{1}{9}$ Giver So Credit	$\frac{5}{9}$ Giver So Credit	$\frac{1}{9}$ Receiver So Debit

4] Type 4 : A&B = 3 : 2.

A given $\frac{1}{3}^{\text{rd}}$ of his share & B given $\frac{2}{3}^{\text{rd}}$ of his share.

Ratio	A	B	C
Old	$\frac{3}{5} \times \frac{3}{3} = \frac{9}{15}$	$\frac{2}{5} \times \frac{3}{3} = \frac{6}{15}$	
(-) New	$\frac{6}{15}$	$\frac{2}{15}$	$\frac{7}{15}$ $\frac{3}{15} + \frac{4}{15}$
Sacrificing Ratio	$\frac{3}{5} \times \frac{1}{3} = \frac{3}{15}$	$\frac{2}{5} \times \frac{2}{3} = \frac{4}{15}$	$\frac{7}{15}$ Receiver

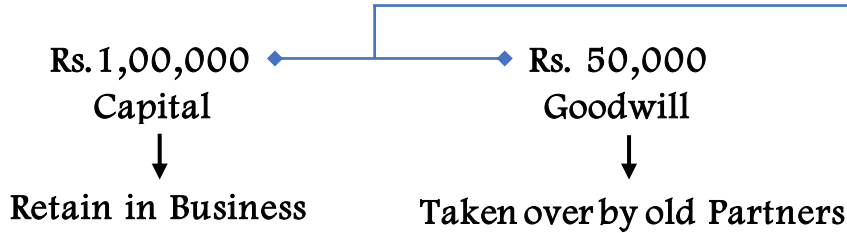
CONCEPT 5 : ACCOUNTING OF GOODWILL



I] ADMISSION

Entries for Admission

Year	Particulars	Rs	Rs
	<u>Cash brought in by new partner (DS).</u>		
	Cash A/c Dr	1,50,00	
	To DS Capital A/c		1,50,00



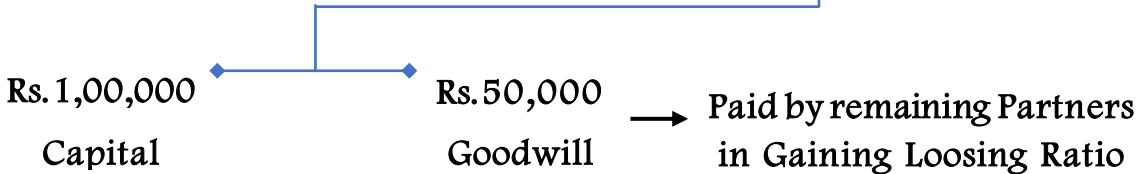
Entries for Goodwill brought by DS

Year	Particulars	Rs	Rs
	<u>Option I : Raised in Old Ratio + Written off in New Ratio</u>		
	Goodwill A/c Dr	Full	
	To Old Partner's Capital A/c		Old
	(Goodwill Raised)		
	All Partner's Capital A/c Dr	New Ratio	
	To Goodwill A/c		Full Amount
	(Goodwill Written Off)		
	<u>Option II : Sacrificing Ratio</u>		
	New Partner's Capital A/c Dr	His Share	
	To Old Partner's Capital A/c		Sacrificing Ratio
	(Goodwill Raised + Written Off)		

II] RETIREMENT/DEATH

Entries for Retirement/ Death

Year	Particulars	Rs	Rs
	<u>Cash paid to retired or deceased partner.</u>		
	Mr. P A/c Dr	1,50,000	
	To Cash A/c		1,50,000



Entries for Goodwill paid to Mr. P

Year	Particulars	Rs	Rs
	<u>Option I : Raised in Old Ratio + Written off in New Ratio</u>		
	Goodwill A/c Dr	Full	
	To All Partner's Capital A/c		Old
	(Goodwill Raised)		
	Remaining Partner's Capital A/c Dr	New Ratio	
	To Goodwill A/c		Full Amount
	(Goodwill Written Off)		
	<u>Option II : Gaining Losing Ratio</u>		
	Goodwill A/c Dr	Full	
	To All Partner's Capital A/c		Old
	(Goodwill Raised)		