

PARTNERSHIP ADMISSION DR.PADMA SOMNATHE



ADMISSION OF A PARTNER

Treatment of Goodwill

Goodwill refers to the value attached to the capacity of a business to earn above normal profits. Goodwill which is an intangible asset depends on a number of factors, some of which are:

- Past profits
- Present profit earning capacity
- Future prospects of the business
- Quality of goods and services
- Monopoly power enjoyed
- Employee efficiency
- Efficiency of management, etc....

In case of a partnership firm goodwill is valued and taken into account when there is reconstitution of the firm.

When a new partner is admitted he gets a share in the future profits of the business and this will reduce the share of profits available to the existing partners. Thus old partners sacrifice in favour of the new partner and the new partner gets a share in the profits of the business.

For enjoying the right to participate in the future profits of the firm, the incoming partner has to pay compensation to the old partners who sacrifice a portion of their own respective share of profit. This compensation is called Premium or Goodwill.

The goodwill of the firm is valued according to the agreement between the existing partners and the new partner.

Methods of treatment of Goodwill

- As per AS 10 goodwill should be recognised in the books only when some consideration in money or money's worth has been paid for it
- Whenever a business is acquired for a price, which is in excess of the value of the net assets of the business taken over, the excess should be termed as goodwill
- AS 26 on intangible assets also states that internally generated goodwill should not be recognised as an asset
- On admission the value of goodwill should not be raised in the books, rather it should be adjusted through concerned partner's capital account

Accounting Treatment For Goodwill

A] New partner brings in his share of goodwill in cash and is retained in the business.

- For bringing goodwill in cash:

Cash A/c Dr.

To new partner's capital A/c

- For distribution of goodwill among old partners [in the sacrifice ratio]

New partner's Capital A/c Dr.

To Old partners Capital A/c

B] Goodwill already appears in the books and it is revalued.

- To write off the existing goodwill

Old partner's Capital A/c Dr.

To Goodwill A/c (in the old ratio)

- Goodwill revalued[to the extent of new partner's share]

New partner's capital A/c Dr.

To old partner's capital A/c (sacrifice ratio)

B] Goodwill already appears in the books and it is revalued.

- To write off the existing goodwill

Old partner's Capital A/c Dr.

To Goodwill A/c (in the old ratio)

- Goodwill revalued[to the extent of new partner's share]

New partner's capital A/c Dr.

To old partner's capital A/c (sacrifice ratio)

C] Goodwill already appears in the books and the new partner brings his share of goodwill in cash.

- To write off existing goodwill

Old partner's capital A/c Dr.
 To Goodwill A/c (old ratio)

- For goodwill brought in cash

Bank A/c Dr.
 To new partner's capital A/c

- For distribution of goodwill among old partners (sacrifice ratio)

New partners capital A/c Dr.
 To old partner's capital A/c