Treatment of Goodwill

1 Mark Questions

1. Under what circumstances will the premium for goodwill paid by the incoming partner not be recorded in the books of accounts.   (Compartment 2014)

Ans. When the incoming partner pays his share of goodwill privately to the sacrificing partners, outside the business, then no entry is passed in the books of the firm.

2. State the need for treatment of goodwill on admission of a partner. (Delhi 2010)

Ans. When a new partner is admitted, his share in future profits of the firm is equal to the sacrifice of profit by an existing partner or partners of the firm. The amount he pays to compensate this sacrifice, is in the form of goodwill. Therefore, it is important to treat goodwill at the time of admission of a partner.

2 Marks Question

3. A and B are partners with capitals of Rs. 90,000 and Rs. 1,00,000 respectively. They decide to admit C into the partnership for 1/4 th share in the future profits. C is to bring a sum of Rs. 80,000 as his capital. Calculate the amount of goodwill. (All India 2008)

A's capital	=	90,000
B's capital	=	1,00,000
C's capital	=	80,000
Total capital of partners	=	₹ 2,70,000

Calculation of total capital on C's admission taking his capital as base

$$C's\ share = \frac{1}{4}\ th$$

C brings as capital = 80,000

$$For\ \frac{1}{4}\ th\ share,\ capital = 80,000$$

$$Total\ capital = 80,000 \times 4 = ₹\ 3,20,000$$

$$Hidden\ goodwill = 3,20,000 - 2,70,000 = ₹\ 50,000$$

$$\therefore C's\ share\ of\ goodwill = 50,000 \times \frac{1}{4} = ₹\ 12,500$$

4. Hemant and Nishant were partners in a firm sharing profits in the ratio of 3 : 2. Their capitals were Rs. 1,60,000 and Rs. 1,00,000 respectively. They admitted Somesh on 1st April, 2013 as a new partner for 1/5 share in the future profits. Somesh brought Rs. 1,20,000 as his capital. Calculate the value of goodwill of the firm and record necessary journal entries for the above transactions on Somesh's admission.
(All India 2014)

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
2013 Apr 1	Bank A/c Dr		1,20,000	
	To Somesh's Capital A/c			1,20,000
	(Being the cash brought in by Somesh for his capital)			
Apr 1	Somesh's Capital A/c Dr		44,000	
	To Hemant's Capital A/c			26,400
	To Nishant's Capital A/c			17,600
	(Being the credit given for goodwill to Hemant and Nishant on Somesh's admission)			

Working Note

Calculation of Hidden Goodwill

Somesh's capital $= ₹\ 1,20,000$ for $\dfrac{1}{5}$ share

(a) Total capital of new firm $= 1,20,000 \times \dfrac{5}{1} = ₹\ 6,00,000$

(b) Hemant, Nishant and Somesh's capital $= 1,60,000 + 1,00,000 + 1,20,000 = ₹\ 3,80,000$

Goodwill of the firm $(a - b) = 6,00,000 - 3,80,000 = ₹\ 2,20,000$

Somesh's share $= 2,20,000 \times \dfrac{1}{5} = ₹\ 44,000$

5. Abhay and Beena are partners in a firm. They admit Chetan as a partner with l/4th share in the profits of the firm. Chetan brings Rs. 2,00,000 as his share of capital. The value of the total assets of the firm is Rs. 5,40,000 and outside liabilities are valued at Rs. 1,00,000 on that date. Give the necessary entry to record goodwill at the time of Chetan's admission. Also show your working notes.

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Chetan's Capital A/c Dr		40,000	
	To Abhay's Capital A/c			20,000
	To Beena's Capital A/c			20,000
	(Being Chetan's share of goodwill adjusted in existing partners' capital accounts)			

(i) Calculation of Chetan's Share of Goodwill

  (a) New firm's capital on the basis of Chetan's capital and his share $= 2,00,000 \times \frac{4}{1} = 8,00,000$

  (b) Adjusted Capitals of Old Partners = Assets – Liabilities

$$= 5,40,000 - 1,00,000 = 4,40,000$$

    (+) New partner's capital $= 2,00,000$

                                      ₹ 6,40,000

  Value of hidden goodwill (a + b) $= 8,00,000 - 6,40,000 = 1,60,000$

$$\text{Chetan's share} = 1,60,000 \times \frac{1}{4} = ₹40,000$$

6. Asin and Shreyas are partners in a firm. They admit Ajay as a new partner with l/5th share in the profits of the firm. Ajay brings Rs. 5,00,000 as his share of capital. The value of the total assets of the firm was Rs. 15,00,000 and outside liabilities were valued at Rs. 5,00,000 on that date. Give the necessary journal entry to record goodwill at the time of Ajay's admission. Also, show your workings. (All India 2013)

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Ajay's Capital A/c Dr		2,00,000	
	To Asin's Capital A/c			1,00,000
	To Shreya's Capital A/c			1,00,000
	(Being adjustment entry passed for goodwill)			

Working Note

(i) Calculation of Ajay's Share of Goodwill

  (a) New firm's capital on the basis of Ajay's capital and his profit share

$$= 5,00,000 \times \frac{5}{1} = ₹25,00,000$$

  (b) Adjusted Capital of Old Partners = Assets – Liabilities

    $= 15,00,000 - 5,00,000$ $= ₹10,00,000$

    (+) New partner's capital $= ₹ 5,00,000$

                               ₹ 15,00,000

  Value of hidden goodwill (a – b) $= 25,00,000 - 15,00,000 = 10,00,000$

$$\text{Ajay's share} = 10,00,000 \times \frac{1}{5} = ₹2,00,000$$

7. A and B were partners in a firm sharing profits and losses in the ratio of 3 : 2. They admitted C as a new partner for 3/7th share in the profits and the new profit sharing ratio will be 2 : 2 : 3. C bought tRs. 2,00,000 as his capital and Rs. 1,50,000 as premium for goodwill. Half of their share of premium was withdrawn by A and B from the firm. Calculate sacrificing ratio and pass necessary journal entries for the above transactions in the books of the firm. (All India 2009)

Old ratio between A and B = 3 : 2

New ratio among A, B and C = 2 : 2 : 3

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

∴

$$\text{A's sacrifice} = \frac{3}{5} - \frac{2}{7} = \frac{21-10}{35} = \frac{11}{35}$$

$$\text{B's sacrifice} = \frac{2}{5} - \frac{2}{7} = \frac{14-10}{35} = \frac{4}{35}$$

Sacrificing ratio between A and B = 11 : 4

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Date	Particulars		LF	Amt (Dr)	Amt (Cr)
	Cash A/c	Dr		3,50,000	
	To C's Capital A/c				2,00,000
	To Premium for Goodwill A/c				1,50,000
	(Being cash brought in for capital and goodwill by C)				
	Premium for Goodwilll A/c	Dr		1,50,000	
	To A's Capital A/c				1,10,000
	To B's Capital A/c				40,000
	(Being amount of goodwill credited to old partners in their sacrificing ratio i.e. 11 : 4)				
	A's Capital A/c	Dr		55,000	
	B's Capital A/c	Dr		20,000	
	To Cash A/c				75,000
	(Being half goodwill withdrawn by A and B in sacrificing ratio)				

8. A and B were partners in a firm sharing profits in the ratio of 4 : 3. They admitted C as a new partner for 3/7th share in the profits of the firm. The new profit sharing ratio will be 2 : 2 : 3. C brought Rs. 2,00,000 as his capital and Rs. 60,000 for his share of premium as goodwill, half of which was withdrawn by A and B from the firm. Calculate sacrificing ratio and pass necessary journal entries in the books of the firm for the above transactions. (All India 2009)

Old ratio between   A and B = 4 : 3

New ratio among A, B and C = 2 : 2 : 3

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

∴ A's sacrifice $= \dfrac{4}{7} - \dfrac{2}{7} = \dfrac{2}{7}$;   B's sacrifice $= \dfrac{3}{7} - \dfrac{2}{7} = \dfrac{1}{7}$

∴ Sacrificing ratio between A and B = 2 : 1

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Cash A/c Dr		2,60,000	
	To C's Capital A/c			2,00,000
	To Premium for Goodwill A/c			60,000
	(Being cash brought in for capital and goodwill by C)			
	Premium for Goodwill A/c Dr		60,000	
	To A's Capital A/c			40,000
	To B's Capital A/c			20,000
	(Being goodwill credited to old partners in their sacrificing ratio i.e. 2 : 1)			
	A's Capital A/c Dr		20,000	
	B's Capital A/c Dr		10,000	
	To Cash A/c			30,000
	(Being half goodwill withdrawn by A and B in sacrificing ratio)			

6 Marks Question

9. A and B were partners in a firm sharing profits and losses in the ratio of 5 : 3. They admitted C as a new partner. A surrendered l/3rd of his share in favour of C and B surrendered 1/4 th of his share in favour of C. C brought Rs. 1,50,000 for his capital and Rs. 58,000 for his share of goodwill. Calculate new profit sharing ratio of A, B and C, sacrificing ratio of A and B and pass necessary journal entries for the above transactions on C's admission. (Delhi 2008)

Old ratio between A and B = 5 : 3

$$\text{A surrendered} = \frac{1}{3} \times \frac{5}{8} = \frac{5}{24} \times \frac{4}{4} = \frac{20}{96}$$

$$\text{B surrendered} = \frac{1}{4} \times \frac{3}{8} = \frac{3}{32} \times \frac{3}{3} = \frac{9}{96}$$

∴   Sacrificing ratio = 20 : 9

Calculation of New Profit Sharing Ratio

$$\text{A's new share} = \frac{5}{8} - \frac{20}{96} = \frac{60-20}{96} = \frac{40}{96}$$

$$\text{B's new share} = \frac{3}{8} - \frac{9}{96} = \frac{36-9}{96} = \frac{27}{96}$$

$$\text{C's new share} = \frac{20}{96} + \frac{9}{96} = \frac{29}{96}$$

∴   New ratio = 40 : 27 : 29

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Date	Particulars		LF	Amt (Dr)	Amt (Cr)
	Cash A/c	Dr		2,08,000	
	To C's Capital A/c				1,50,000
	To Premium for Goodwill A/c				58,000
	(Being cash brought in for capital and goodwill by C)				
	Premium for Goodwill A/c	Dr		58,000	
	To A's Capital A/c				40,000
	To B's Capital A/c				18,000
	(Being goodwill credited to old partners in their sacrificing ratio i.e. 20 : 9)				

10. B and C were partners in a firm sharing profits and losses in the ratio of 4 : 3. They admitted D as a new partner for I/4th share in the profits which he acquired from B and C in 3 : 4 ratio. D brought Rs. 1,80,000 for his capital and Rs. 42,000 for his 1/4th share in goodwill. Calculate new profit sharing ratio of B, C and D and pass necessary journal entries for the above transactions on D's admission in the books of the firm. (Delhi 2008)

Old ratio between B and C = 4 : 3

$$D's\ share = \frac{1}{4}\ th$$

$$B's\ sacrifice = \frac{1}{4} \times \frac{3}{7} = \frac{3}{28}$$

$$C's\ sacrifice = \frac{1}{4} \times \frac{4}{7} = \frac{4}{28}$$

Sacrificing ratio = 3 : 4

Calculation of New Profit Sharing Ratio

$$B's\ new\ share = \frac{4}{7} - \frac{3}{28} = \frac{16-3}{28} = \frac{13}{28}$$

$$C's\ new\ share = \frac{3}{7} - \frac{4}{28} = \frac{12-4}{28} = \frac{8}{28}$$

$$D's\ new\ share = \frac{3}{28} + \frac{4}{28} = \frac{7}{28}$$

New ratio = 13 : 8 : 7

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Cash A/c Dr		2,22,000	
	To D's Capital A/c			1,80,000
	To Premium for Goodwill A/c			42,000
	(Being cash brought in for capital and goodwill by D)			
	Premium for Goodwill A/c Dr		42,000	
	To B's Capital A/c			18,000
	To C's Capital A/c			24,000
	(Being goodwill credited to old partners in their sacrificing ratio)			

11. K and Y were partners in a firm sharing profits in 3 : 2 ratio. They admitted Z as a new partner for I/3rd share in the profits of the firm. Z acquired his share from K and Y in 2 : 3 ratio. Z brought Rs. 80,000 for his capital and Rs. 30,000 for his I/3rd share as premium. Calculate the new profits sharing ratio of K, Y and Z and pass necessary journal entries for the above transactions in the books of the firm. (All India 2008)

Old ratio between K and Y $= 3 : 2$

$$Z\text{'s share} = \frac{1}{3} \; ;$$

$$K\text{'s sacrifice} = \frac{2}{5} \times \frac{1}{3} = \frac{2}{15} \; ;$$

$$Y\text{'s sacrifice} = \frac{3}{5} \times \frac{1}{3} = \frac{3}{15}$$

$\therefore$ Sacrificing ratio $= 2 : 3$

Calculation of New Profit Sharing Ratio

$$K\text{'s new share} = \frac{3}{5} - \frac{2}{15}$$

$$= \frac{9-2}{15} = \frac{7}{15}$$

$$Y\text{'s new share} = \frac{2}{5} - \frac{3}{15}$$

$$= \frac{6-3}{15} = \frac{3}{15}$$

$$Z\text{'s new share} = \frac{2}{15} + \frac{3}{15} = \frac{5}{15}$$

New ratio $= 7 : 3 : 5$

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Date	Particulars	LF	Amt (Dr)	Amt (Cr)
	Cash A/c Dr		1,10,000	
	To Z's Capital A/c			80,000
	To Premium for Goodwill A/c			30,000
	(Being cash brought in for capital and goodwill by Z)			
	Premium for Goodwill A/c Dr		30,000	
	To K's Capital A/c			12,000
	To Y's Capital A/c			18,000
	(Being goodwill credited to old partners in their sacrificing ratio *i.e.*, 2 : 3)			