

VIDYA BHAWAN BALIKA VIDYA PITH

शक्ति उत्थान आश्रम लखीसराय बिहार

class 12 commerce Sub. ACT. Date 28.5.2020

Teacher name – Ajay Kumar Sharma

Reconstitution of a Partnership Firm – Admission of a Partner

Illustration 15

1. The goodwill of a firm is to be worked out at three years' purchase of the average profits of the last five years which are as follows:

<i>Years</i>	<i>Profits (Loss)</i> <i>(Rs.)</i>
2002	10,000
2003	15,000
2004	4,000
2005	(5,000)
2006	6,000

2. The capital employed of the firm is Rs. 1,00,000 and normal rate of return is 8%, the average profits for last 5 years are Rs. 12,000 and goodwill is to be worked out at 3 years' purchase of super profits,

3. Rama Brothers earn an average profit of Rs. 30,000 with a capital of Rs. 2,00,000. The normal rate of return in the business is 10%. Using capitalisation of super profits method work out the value the goodwill of the firm.

Solution

$$1. \text{ Total Profits} = \text{Rs. } 10,000 + \text{Rs. } 15,000 + \text{Rs. } 4,000 + \text{Rs. } 6,000 - \text{Rs. } 5,000 \\ = \text{Rs. } 30,000$$

$$\text{Average Profits} = \text{Rs. } 30,000/5 = \text{Rs. } 6,000$$

$$\text{Goodwill} = \text{Average Profits} \times 3 = \text{Rs. } 6,000 \times 3 = \text{Rs. } 18,000$$

$$2. \text{ Average Profit} = \text{Rs. } 12,000$$

$$\text{Normal Profit} = \text{Rs. } 1,00,000 \times \frac{8}{100} = \text{Rs. } 8,000$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal profit} = \text{Rs. } 12,000 - \text{Rs. } 8,000 \\ = \text{Rs. } 4,000$$

$$\text{Goodwill} = \text{Super Profit} \times 3 = \text{Rs. } 4,000 \times 3 = \text{Rs. } 12,000$$

$$3. \text{ Normal Profit} = \text{Rs. } 2,00,000 \times 10/100 = \text{Rs. } 20,000$$

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit} = \text{Rs. } 30,000 - \text{Rs. } 20,000 \\ = \text{Rs. } 10,000$$

$$\text{Goodwill} = \text{Super Profit} \times 100/\text{Normal Rate of Return} \\ = 10,000 \times 100/10 = \text{Rs. } 1,00,000.$$

3.5.5 Treatment of Goodwill

As stated earlier, the incoming partner who acquires his share in the profits of the firm from the existing partners brings in some additional amount to compensate them for loss of their share in super profits. It is termed as his share of goodwill (also called premium). Alternatively he may agree that goodwill account be raised in the books of the firm by giving the necessary credit to the old partners. Thus, when a new partner is admitted, goodwill can be treated in two ways: (1) By Premium Method, and (2) By Revaluation Method.

3.5.5.1 Premium Method

This method is followed when the new partner pays his share of goodwill in cash. The amount of premium brought in by the new partner is shared by the existing partners in their ratio of sacrifice. If this amount is paid to the old partners directly (privately) by the new partner, no entry is made in the books of the firm. But, when the amount is paid through the firm, which is generally the case, the following journal entries are passed:

(i)	Cash A/c To Goodwill A/c (Amount brought by new partner as premium)	Dr.		
(ii)	Goodwill A/c To Existing Partners Capital A/c (Individually) (Goodwill distributed among the existing partners in their sacrificing ratio)	Dr.		