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Class 12 commerce Sub. ACT. Date 30.6.2020

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Reconstitution of a Partnership Firm

Retirement/Death of a Partner

Treatment of Goodwill

The retiring or deceased partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners. Hence, at the time of retirement/death of a partner, goodwill is valued as per agreement among the partners the retiring/ deceased partner compensated for his share of goodwill by the continuing partners (who have gained due to acquisition of share of profit from the retiring/ deceased partner) in their gaining ratio. The accounting treatment for goodwill in such a situation depends upon whether or, not goodwill already appears in the books of the firm.

When Goodwill does not Appear in the Books

When goodwill does not appear in the books of the firm there are four ways in which the retiring partner can be given the necessary credit for loss of his share of goodwill, these are as follows:

(a) Goodwill is raised at its full value and retained in the books as such: In this case, Goodwill Account is debited will its full value and all the partner's (including the retired/deceased partner) capital accounts are credited in the old profit sharing ratio. The full value of goodwill will appear in the balance sheet of the reconstituted firm.

(b) Goodwill is raised at it's full value and written off immediately: If it- decided that goodwill should not be refrained and shown in the balance sheet of the reconstituted firm then, after raising goodwill at its value by crediting all the partners' capital accounts (including that of the retired/ deceased partners, it should be written off by debiting the remaining partners in their new profit sharing ratio and crediting the goodwill account with its full value.

(c) Goodwill is raised to the extent of retired/deceased partner's share and written off immediately: In this case goodwill account is raised only to the extent of retired/deceased partner's share by debiting goodwill account with the proportionate amount and credited only to the retired/deceased partner's capital account. Thereafter, the remaining partners capital accounts are debited in their gaining ratio and goodwill account/credited to write it off.

(d) No goodwill account is raised at all in firm's books: If it is decided that the goodwill account should not appear in firm's books at all, in that case it is adjusted discretely through partners capital accounts by recording the following journal entry.

Continuing partners' capital A/c Dr.

(individually in their gaining ratio)

To retiring/Deceased Partner's Capital A/c

(Retiring/deceased in the remaining partners'

capital accounts into their gaining ratio)

Let us take an example and clarity the treatment of goodwill on retirement or death of a partner using all the above alternatives. A, B. and C are partners in a firm sharing profits in the ratio of 3:2:1 B retires. The goodwill of the firm is valued at Rs. 60,000 and the remaining partners A and C continue to share profits in the ratio of 3:1. The journal entries passed under various alternatives

shall be as follows:

(a) If goodwill is raised at full value and retained in books

Goodwill A/c Dr. 60,000

To A's capital A/c 30,000

To B's capital A/c 20,000

To C's capital A/c 10,000

(Goodwill raised at full value and credited to all the partners in their old profit sharing ratio)

(b) If goodwill is raised at full value and written off immediately.

(i). Goodwill A/c Dr. 60,000

To A's capital A/c 30,000

To B's capital A/c 20,000

To C's capital A/c 10,000

(Goodwill raised at full value and credited to all partners in old ratio) (ii). A’s capital A/c Dr. 45,000

C’s capital A/c Dr. 15,000

To Goodwill A/c 60,000

(Goodwill written off and debited to remaining partners in the new ratio)

(c) If goodwill is raised to the extent of retiring partner’s share and written off immediately.

(i) Goodwill A/c Dr. 20,000

To B’s capital A/c 20,000

(Goodwill raised to the extant of B’s share)

(ii) A’s capital A/c Dr. 15,000

C’s capital A/c Dr. 5,000

To goodwill A/c 20,000

(Goodwill written off by debiting remaining partners’ in gaining ratio)

(d) If goodwill is not to after in firm’s books at all

A’s capital A/c Dr. 15,000

C’s capital A/c Dr. 5,000

To C’s capital A/c 20,000

(B’s share of goodwill adjusted to remaining partners’ capital accounts in gaining ratio)

It may also happen that as a result of decision on the new profit sharing ratio among the remaining partners, a continuing partner may also sacrifice a part of his share in future profits. In such a situation his capital account will also be credited along with the retiring/deceased partner’s capital account in proportion to his sacrifice and the other continuing partners’ capital accounts will be debited based on their gain in the future profit ratio.