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Reconstitution of a Partnership Firm – Admission of a Partner

Illustration 11

Calculate goodwill of a firm on the basis of three year' purchase of the weighted average profits of the last four years. The profit of the last four years were: 2003 Rs. 20,200; 2004 Rs. 24,800; 2005 Rs. 20,000 and 2006 Rs. 30,000. The weights assigned to each year are : 2003 - 1; 2004 - 2; 2005 - 3 and 2006 - 4.

You are supplied the following information:

1. On September 1, 2005 a major plant repair was undertaken for Rs. 6,000, which was charged to revenue. The said sum is to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on reducing balance method.
2. The Closing Stock for the year 2004 was overvalued by Rs. 2,400.
3. To cover management cost an annual charge of Rs. 4,800 should be made for purpose of goodwill valuation.

Solution

Calculation of Adjusted Profit	2003 Rs.	2004 Rs.	2005 Rs.	2006 Rs.
Given Profits Less Management Cost	20,200 4,800	24,800 4,800	20,000 4,800	30,000 4,800
Add: Capital Expenditure Charged to Revenue	15,400 -	20,000 -	15,200 6,000	25,200 -
	15,400	20,000	21,200	25,200
Less: Unprovided Depreciation	-	-	200	580
	15,400	20,000	21,000	24,620
Less; over valuation of Closing Stock	-	2,400	-	-
	15,400	17,600	21,000	24,620
Add: over value of opening stock	-	-	2,400	-
Adjusted Profits	15,400	17,600	23,400	24,620

Calculation of weighted average profits:

(Rs.)

Year	Profit	Weight	Product
2003	15,400	1	15,400
2004	17,600	2	35,200
2005	23,400	3	70,200
2006	24,620	4	98,480
Total		10	2,19,280

$$\text{Weight Average Profit} = \text{Rs. } \frac{2,19,280}{10} = \text{Rs. } 21,928$$

$$\text{Goodwill} = \text{Rs. } 21,928 \times 3 = \text{Rs. } 65,784$$

Notes to Solution

- (i) Depreciation of 2005 = 10% of Rs. 6000 for 4 months
= $\text{Rs. } 6000 \times 10/100 \times 4/12 = \text{Rs. } 200$
- (ii) Depreciation of 2006 = 10% of Rs. 6000 - Rs. 200 for one year
= $\text{Rs. } 5800 \times 10/100 + \text{Rs. } 580$
- (iii) Closing Stock of 2004 will become opening stock for the year 2005.