Teacher Manual/Guide
GOODWILL ACCOUNTS

PERFORMANCE OBJECTIVES

At the end of this chapter, students should be able to meet the following objectives:
1. Define goodwill
2. Explain why goodwill exists in business
3. Explain the treatment of goodwill when there are changes in partnership

INTRODUCTION

Goodwill is being referred to as intangible asset because it cannot be seen or touched. It has been defined by several authors. According to Lord Elton (1890), it is defined as "the probability that the customers will continue to patronize old business even when there is change in ownership". It is also the excess of the purchase consideration over the total value of assets and liabilities.

REASONS FOR GOODWILL IN BUSINESS

(a) To retain a large number of customers who will like to continue with the new owner.
(b) It shows that a business concern has a good reputation.
(c) It means a firm has highly experience, efficient and reliable employees.
(d) It is a proof that a business is well-situated for easy access of customers.
(e) It has good contacts with suppliers.
(f) It also shows that a business has a well-known brand that is more valuable and treated as assets

TREATMENT OF GOODWILL WHEN THERE ARE CHANGES IN PARTNERSHIP AGREEMENT

Changes can occur in partnership when:
- There is a change in the profit or loss sharing ratio.
- A partner retires or dies
- A new partner is admitted
- Partnership is dissolved
- Amalgamation of partnership

Goodwill may be introduced when there is a change in partnership as a result of any of the above mentioned reasons:

1. **Treatment of goodwill when there is change in profit or loss sharing ratio.**

When partners decide to alter or change the profit or loss sharing ratio, this may necessitate the introduction of goodwill into the business. Sharing ratio may also change if the contribution of partners changes.

a. **When goodwill is brought into the business:** When goodwill is to be retained in the books, goodwill account will be opened and the value debited into it. The capital account will be credited with the share of goodwill in old sharing ratio.
   Procedures for entering ledgers:
   Debit: Goodwill Account
   Credit: Capital Account in old profit sharing ratio

b. **When goodwill is written off**: If goodwill is to be written off, the capital account will be debited in new profit sharing ratio while the goodwill account will be credited.

Worked Exercise 1

The Balance Sheet of Joel, Jacob and James as at 31st December was as follows:

Balance Sheet

	#		#
Capital:		Assets	7,000
Joel	3,000		
Jacob	1,500		
Sam	2,500		
	7,000		7,000

The partners shared profit in the ratio 3:2:1. They decided to alter the profit sharing ratio to Joel 4: Jacob 2: Sam 1. Goodwill of #25,000 was introduced into the business.

You are required to show the balance sheet on 1st January, 2004 after goodwill has been taken into consideration if:

i) Goodwill account was opened

ii) Goodwill is to be written off.

Solution:

i) Goodwill account was opened:

Goodwill is shared in old profit sharing ratio:

Joel – 3/6 X 25,000 = #12,500

Jacob – 2/6 X 25,000 = #8,333

Sam– 1/6 X 25,000 =#4,167

Partners' Capital Account

	Joel **#**	**Jacob** **#**	**Sam** **#**		**Joel** **#**	**Jacob** **#**	**Sam** **#**
Balance c/d	15,500	9,833	6,667	Balance b/f	3,000	1,500	2,500
				Goodwill	12,500	8,333	4,167
	15,500	9,833	6,667		15,500	9,833	6,667

Balance Sheet

	#		#
Capital:		Assets	7,000
Joel	15,500	Goodwill	25,000
Jacob	9,833		
Sam	6,667		
	32,000		32,000

(ii) Goodwill is written off

Goodwill is shared in new profit sharing ratio

Joel – $^{4}/_{7}$ X 25,000 = #14,286

Jacob – $^{2}/_{7}$ X 25,000 = #7,143
Sam– $^{1}/_{7}$ X 25,000 =#3,571

Partners' Capital Account

	Joel #	Jacob #	Sam #		Joel #	Jacob #	Sam #
Goodwill	14,286	7,143	3,571	Balance b/f	3,000	1,500	2,500
				Balance c/d	11,286	5,643	1,071
	14,286	7,143	3,571		14,286	7,143	3,571

Balance Sheet

		#		#
Capital:			Goodwill	25,000
	Joel	14,286	Assets	(7,000)
	Jacob	5,643		
	Sam	1,071		
		18,000		18,000

Note: Assets were separated from the goodwill since goodwill has been written off in the partners' capital account.

2. Treatment of goodwill when a partner retires or dies

When a partner retires or dies, the amount due to him will be claimed. This sum due to him must be paid in his share of goodwill.

Procedures are:

- If the amount due to him is paid:
  Debit: Capital Account
  Credit: Cash Account
- If the payment has not been made, it can be treated as loan:
  Debit: Capital Account
  Credit: Loan Account

Worked Exercise 2

Akeem, Hammed and Yusuf had been partners in business for the past twenty years. Akeem gave notice of retirement effective from 1st January 2008. Hammed and Yusuf agree to take over Akeem's share of the business on Akeem's terms which were:

a. Cash payments for half of his entitlement

b. Conversion of remaining entitlement to loan at the rate of 10% p.a.

The partners revalued the assets of the company resulting in the creation of Goodwill of #24,000. The balance sheet of Akeem, hammed and Yusuf as at 31st December is as follows;

Balance Sheet

		#	#		#	#
Capital Account:	Akeem	60,000		Fixed Assets		
	Hammed	60,000		Land & Building		60,360
	Yusuf	60,000	180,000	Plant & Machinery		84,280
				Office equipment		16,250
						192,720
Current Account:	Akeem	5,300		Current Assets:		
	Hammed	10,380		Stock	10,460	
	Yusuf	9,060	24,780	Debtors	9,000	
Creditors			54,140	Cash	46,740	66,200
			258,920			258,920

Partners shared profit and losses equally before and after the retirement of Akeem.
You are required to prepare:
i) Necessary Journal Entries
ii) Akeem's capital account before retirement
iii) Balance Sheet of the new partnership as at 1st January 2008.

Solution:
(a)
Journal Entries

	Dr #	Cr #
Goodwill Account	24,000	
Capital Account: Akeem		8,000
Hammed		8,000
Yusuf		8,000
Capital Account: Akeem	36,670	
Cash Account		36,670
Capital Account: Akeem	36,670	
Loan Account		36,670

(b)

Partners' Capital Account

	Akeem #	Hammed #	Yusuf #		Akeem #	Hammed #	Yusuf #
Cash	36,670	-	-	Balance b/f	60,000	60,000	60,000
Hammed	36,670	-	-	Current	5,340	10,380	9,060
Bal. c/d	-	78,380	77,060	Goodwill	8,000	8,000	8,000
	73,340	78,380	77,060		73,340	78,380	77,060

c)

Balance Sheet as at 1st January 2008

	#	#		#	#
Capital Account: Hammed	78,380		**Fixed Assets:**		
Yusuf	77,060	155,400	Land & Building		60.360
			Plant & Machinery		84,280
Current Liabilities:			Office equipment		16,250
Creditors	54,140		Motor Vehicle		31,560
Loan – Akeem	36,670	90,810			192,720
			Goodwill		24,000
					216,720
			Current Assets:		
			Stock	10,460	
			Debtors	9,000	
			Cash (iv)	10,070	29,530
		246,250			246,250

Note: (i) Goodwill is shared equally i.e. #24,000 divided by 3

(ii) Mr. Akeem was paid half of his capital in cash i.e. #73,340 divided by 2 = #36,670 while the remaining half was made loan at the rate of 10% p.a.

(iii) Partners' capital account was in a combined form to make it easy to prepare balance sheet

(iv) Cash total = #46,670- #36,670 = #10,070

3. Treatment of goodwill when a new partner is admitted

On the admission of a new partner, goodwill can be introduced into the business based on the agreement of the partners. When a new partner is admitted, the old partners will give up part of their profit. So as to compensate them, new partner will bring in goodwill.

i) When goodwill is to be retained in the books:

Procedures for entering ledgers:
Debit: Goodwill Account
Credit: Partners capital account in the old profit sharing ratio

ii) When goodwill is written off:

Procedures for entering ledgers:
Debit: Capital Account in the new profit sharing ratio
Credit: Goodwill Account

Worked Exercise 3:

Ola and Sayo are in partnership. They share profit equally, it was decided to admit Tolu and he brought #7,000 as capital. It was agreed that goodwill was #15,000. The new profit sharing ratio is to be Ola 3: Sayo 2 Tolu 2

The balance sheet before Aluko was introduced was as follows:

		#		#
Capital:	Ola	20,000	Net Assets	40,000
	Sayo	20,000		
		40,000		40,000

Show the balance sheet on 1st January 2000 after goodwill has been taken into consideration if:

a. Goodwill was to be opened
b. Goodwill account was written off

Solution

a. Goodwill account was opened

Goodwill is divided in their old profit sharing ratio

Ola's share ½ X #15,000 = #7,500

Sayo's Share ½ X #15,000 = #7,500

Partners' Capital Account

	Ola #	**Sayo** #	**Tolu** #		**Ola** #	**Sayo** #	**Tolu** #
Balance c/d	27,500	27,500	7,000	Balance b/f	20,000	20,000	-
				Cash	-	-	7,000
				Goodwill	7,500	7,500	-
	27,500	27,500	7,000		27,500	27,500	7,000

Balance Sheet

	#		#

Capital:		Net Assets	40,000
Ola	27,500	Cash	7,000
Sayo	27,500	Goodwill	15,000
Tolu	7,000		
	62,000		62,000

Solution

a. Goodwill account was opened

Goodwill is divided in their old profit sharing ratio

Ola's share 3/7 X #15,000 = #6,428

Sayo's Share 2/7 X #15,000 = #4,286

Tolu's share 2/7 X #15,000 =#4,286

Partners' Capital Account

	Ola #	Sayo #	Tolu #		Ola #	Sayo #	Tolu #
Goodwill w/o	6,428	4,286	4,286	Balance b/f	20,000	20,000	-
Balance c/d	21,072	23,214	2,714	Cash	-	-	7,000
				Goodwill	7,500	7,500	-
	27,500	27,500	7,000		27,500	27,500	7,000

Balance Sheet

	#		#
Capital:		Net Assets	40,000
Ola	21,072	Cash	7,000
Sayo	21,072		
Tolu	2,714		
	47,000		47,000

MODULE QUESTIONS

1 (i) Define the term Goodwill

(ii) Why do businesses value goodwill?

2 Adigun and Alabi entered into partnership each contributing capital of#6,000. Olawale was admitted as a new partner and brought #3,000 as capital and #8000 as premium (Goodwill) for his admission to the firm. The new firm shares profits as follows: Adigun $^2/_5$, Alabi $^2/_5$ and Olawale $^1/_5$. The premium is paid directly to Adigun and Alabi. **Required:** Show necessary entries on the admission of the new partner and a balance sheet suppose Net Assets is totalled #12,000 if:

a. Goodwill account was to be opened

b. Goodwill account was to be written off

3 Yemi and Joke entered into partnership with capitals of #5,000 and #4,000 respectively. They share profits in the proportion of their capital. On March 31st, they decided to change their sharing ratio to Yemi 1: Joke 2. Goodwill of #2,700 was thus introduced and Net Assets totalled #9,000.

You are required to make necessary entries in the book and prepare the balance sheet if:

a. Goodwill account was to be opened

b. Goodwill account was to be written off.

4 Ola, Ojo and Ajayi were into partnership with a capital of #8,000 each sharing profits equally. Ola gave notice of retirement effective from 1st September 2013. Ojo and Ajayi agree to take over Ojo's share of the business on Ola's terms which were:

(i) Cash payments for one-third of his entitlement

(ii) Conversion of the remaining entitlement to loan at the rate of 5% per annum

The partners revalued the assets of the company leading to the provision of Goodwill of #30,000. If their Fixed Assets were #15,000 and stock at close was valued at #3,000. You are required to show Ola's capital before retirement and their balance sheet thereafter.

5 A new partner has joined the business during the year and has paid in £10,000 for 'goodwill'. This #10,000 has been credited by the bookkeeper to the account of the new partner. The senior partner had objected to this, but the bookkeeper had replied: 'Why not credit the #10,000 to the account of the new partner? It is his money after all.'

Required:

Give your advice as to the proper treatment of this #10,000. Explain your reasons fully.

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6 John and James are in partnership, sharing profits and losses equally. They decide to admit Stephen. By agreement, goodwill valued at #40,000 is to be introduced into the business books. Stephen is required to provide capital equal to that of James after he has been credited with his share of goodwill. The new profit sharing ratio is to be 8:3:5 respectively for John, James and Stephen. The balance sheet before admission of Stephen showed:

#

Fixed and current assets (other than cash)	160,000
Cash	1,000
	161,000
Current liabilities	(41,000)
	120,000
Capital – John	70,000
Capital –James	50,000
	120,000

Show:

(a) Journal entries for admission of Smart.
(b) Opening balance sheet of new business.
(c) Journal entries for writing off the goodwill which the new partners decided to do soon after the start of the new business.

7 The partners have always shared their profits in the ratios of Vanessa 3: Angela 2: Florence 5. They are to alter their profit ratios to Vanessa 4: Angela 1: Florence 3. The last balance sheet before the change was:

Balance Sheet as at 31 March 2013

	#
Net Assets (not including goodwill)	100,000
	100,000
Capitals:	
Vanessa	30,000
Angela	20,000
Florence	50,000
	100,000

The partners agree to bring in goodwill, being valued at #24,000 on the change. Show the balance sheets on 1st April 2013 after goodwill has been taken into account if:

(a) Goodwill account was opened.
(b) Goodwill account was not opened.