11 ADMISSION OF A PARTNER AND GOODWILL ACCOUNT

Objectives

At the end of this chapter, students should be able to:

- Explain how new partners are admitted;
- Determine a new profit and loss sharing ratio for partners;
- Show goodwill account in the partners book;
- Prepare a new partnership account.

11.1 Introduction

The formation of partnership business allows a new partner to be brought in to the existing one and, as a matter of fact, a new partner cannot be admitted without the consent of all the existing partners. When this happens in law, the old partnership profit or loss sharing ratio, valuation of asset and preparation of account would be upgraded to reflect the partnership terms.

11.2 Admission of New Partners

When a partnership continues to operate and for any reason wants to admit a new partner, then the old partnership is terminated and a new firm is formed.

Generally, the following reasons always cause the need for changes in partnership:

(i) **Expiration of old partnership agreement:** When an agreement expires, there is need for a new agreement and at such a part additional partner might be introduced.

(ii) **Economy of Scale:** There may be need to increase the partners by bringing specialised experts as partners. Furthermore, the new partner might be brought in because of additional need of fund for expansion of the old firm.

(iii) **Death or Retirement of an Old Partner:** At the death or Retirement of an old partner, there may be need to admit a new partner to replace the dead or retired partner for continuity of the firm.

(iv) **Amalgamation:** When a business has been purchased or joined to another firm. The existing partnership would be merged with another partners.

11.3 Profit and Loss Sharing Ratio

When there is admission of new partner, there may be change in profit sharing ratio as a result to changes in managerial skill, poor health condition of partners or old age. However, the profit or loss could be shared in the following manner:

(i) Same ratio as that which capital is contributed. For example, Abia and Chike are in partnership and they contributed a capital of N200,000 and N100,000 respectively. The profit will be shared in ratio of 2:1.

(ii) As per agreed ratio by the partners.

(iii) In the absence of any agreement, profit or loss could be shared equally.

There is no limit to the extent to which a partner may be liable for losses except in the case of a limited partnership. Even in this case, only the limited partner has the privilege of limited liability.

11.4 Goodwill Account

Goodwill can be defined as benefit and advantage of the good name, reputation and connections of a business, which enables it to earn more profits than formally expected on the capital employed in the business. When such benefit is valued, it is usually classified as intangible assets, that is, it does not possess physical characteristics. It is usually identified as a thing that differentiate an old established business from a new business at its first start.

There are many reasons why a purchaser will be willing to pay for Goodwill and it may arise from:

(i) Personal characteristics of the owner(s): such as business acumen to managerial skill.

(ii) Quality of goods sold and reputation of its service. The durability and standard of a company's product can bestow good name on it.
(iii) Possession of efficient and contented employees.
(iv) Location of the business premises especially when the business is carried on in a busy high street or area.
(v) Possession of partial monopoly rights: For example, a company may be appointed as the main agent in the area.
(vi) A firm of car manufacturer with no competitor.
A firm's good past record. Past profits are generally regarded as the basis for most goodwill calculations. Some felt that past profits are a very sound basis for valuation.

11.5 Calculation of Goodwill

The method of valuating goodwill varies from trade to trade. It may be directly related to the business or it may just be an arbitrary figure agreed by the parties.
Even at times, the determination of the goodwill value is governed by the custom of the particular trade in which the business is engaged. The common and usual basis of valuation are average annual profit, gross annual profit, annual super-profit and capitalisation method.

One should remember that goodwill should never appear in the books of a business unless:
(i) It has been purchased.
(ii) It is necessary to raise it in connection with the admission of a new partner.
(iii) The death or retirement of an existing partner makes it necessary to determine the true value of such partner's share.
Old partners are credited with their respective share of the N

Example 11.1

Abia and Chike are in partnership, sharing profits and losses in ratio 2:1. They agree to admit Kalu as a partner with 1/5 share on condition that he bring in N20,000.00 capital and goodwill estimated at 12,000.00. Abia and Chike are to maintain between themselves the same profit and loss sharing ratio. Make the necessary entries in the books and state the partner's future proportions of profit respectively.

Solution

Journal

	Dr ₦	Cr ₦
Goodwill	12,000	
Abia, capital		8, 000.00
Chike, capital		4, 000.00

To record share of goodwill to partners

Cash Book (Extract)

Date	Particulars	Folio	Amount ₦	Date	Particulars	Folio	Amount ₦
	Kalu Capital		20,000				

Kalu Capital Acount (extract)

	Cash ₦ 20,000

Note: Assets recognised in the transaction are goodwill valued at N12,000 and cash for N20,000 brought an increase of N8,000 and N4,000. to the capitals of Abia and Chike respectively. The capital account of Kalu is N20,000.

11.6 Revaluation Account

It is very pertinent that some assets other than goodwill may have appreciated in value whilst others may have been over or under depreciated. These assests are often revalued with a change in partnership to show the current value.

Revaluation of assets occur when:

(i) A new partner is introduced into the business.

(ii) A partner relieve or dies.

(iii) There is change in profit sharing ratio.

The revaluation account will be credited when there is increase in assets value and any decrease in value of asset will be debited to the revaluation account. Any profit on revaluation is credited to the old partners, capital account and loss on revaluation would be debited in their profit and loss sharing ratio.

Accounting Entries for Revaluation Account

Posting of difference in the revaluation account.

1. Increase in value of asset	Decrease in the value of asset
Debit: Asset A/c	Debit: Revaluation A/c
Credit: Revaluation A/c	Credit: Asset A/c
2. Increase in value of liabilities	Decrease in value of Liabilities
Debit: Revaluation A/c	Debit: Liabilities A/c
Credit: Liabilities A/c	Credit: Revaluation A/c
3. Introduction of goodwill	
Debit: Goodwill A/c	
Credit: Revaluation A/c	
4. Profit on Revaluation*	Loss on Revaluation*
Debit: Revaluation A/c	Debit: Capital A/c
Credit: Capital A/c	Credit: Revaluation A/c

(* In the old profit sharing ratio)

When a partner pays for his share of goodwill Debit: Bank/Cash A/c Credit: Capital A/c

Example 11.2

Adeolu and Dada have been in partnership for many years, sharing profits and losses in the ratio of 3:2 respectively. Their balance sheet as at 31st December 2009 is as follow:

Adeolu and Dada Balance Sheet as at 31st Dec. 2009

		₦		₦
Capital:	Adeolu	50, 000.00	Plant and Machinery	18, 000.00
	Dada	40, 000.00	Goodwill	20, 000.00
			Stock	19, 600.00
Sundry creditors		9, 800.00	Debtors	31, 300.00
			Cash in bank	10, 900.00
		99, 800.00		99, 800.00

On January 1st, 2010, they decided to admit Kehinde as a partner on the condition that he contributed N30,000.00 as his capital. You are require to show:
The ledger entries dealing with the above in the following accounts:
(i) Goodwill Account.
(ii) Cash Book.
(iii) Capital Accounts of a new firm.
The balance sheet of the partnership immediately after the admission of Kehinde.
(a) **Solution**
Goodwill A/c

		₦	
	Balance b/d	20,000	

(b) **Cash Book** (Bank Column)

Date	Particulars	Folio	Amount ₦	
	Balance b/d		10,900	
	Kehinde (capital)		30, 000	
			40, 900	

(c) Capital a/c-Adeolu

Balance b/d	₦50,000	

(d) Capital a/c-Dada

Balance b/d	₦40,000	

(e) **Capital a/c-Kehinde**

Bank	₦30,000	

(b) Adeolu, Dada and Kehinde
Balance Sheet as at 1 January 2010

	₦	Assets:	₦
CapitalAdeolu	50, 000.	Plant and Machinery	18,000
Dada	40, 000	Goodwill	20,000
Kehinde	30, 000	Stock	19, 600
	120,000	Debtors	31,300
Sundry creditors	9, 800	Cash in bank	40,900
	129, 800		129,800

11.7 Summary

In this chapter, students have learnt that:

1. The reasons for admission of a new partner(s) include: economy of scale, expiration of old partnership agreement, death of a former partner.
2. The process of admitting new partners include the calculation of goodwill. Goodwill has been defined as the value arising from the reputation, connections or other advantages possessed by a business organisation. The value of such goodwill have to be agreed upon by the parties in the new partnership.
3. Once a new partnership is formed there will be need for a new profit and loss sharing ratio, This ratio may be based on the capital contributed, agreement of the partners or in the absence of any agreement it should be equal distribution. The new partnership balance will consist of the contribution of the old and new partners.
4. The revaluation of asset is necessary in the business to show the current value in the book because it may be greater or lesser than the current value.

11.8 Revision Questions

1 a. What is Goodwill?
   b. Explain the reasons why it is necessary to value goodwill when a partner is to be admitted.
2. Identify four factors that create goodwill for any organisation.
3. List and explain four reasons that may cause changes in partnership.
4. Alpha, Bank and Cyron are partners. They agreed to share profit in the ratio 3:2:1 respectively. The balances in their books as at 31st December 2009 were as follows:

	₦
Trading income	88, 000
Bank interest received	2, 600
Salaries	25, 000
Rent	7, 000
Stationery and printing	2, 500
Accountancy and audit fees	1, 630
Subscription to trade association	5, 060
Traveling expenses	700
Sundry office expenses	800
Debtors	30, 000
Investment interest	6, 000
Capital a/c: Alpha	2, 400 Cr
Blank	1, 600 Cr
Cyron	800 Cr
Current a/c: Alpha	1, 200 Dr
Blank	800 Dr
Cyron	400 Dr

Additional Information

I. Outstanding creditors: Stationery N70.00, Sundry Office expenses N240
II. Cyron is to be credited with a partnership salary of N6,000.00
III. 5% interest on capital is allowed for the full year and no interest on capital is allowed for the full year and no interest allowed on current account.
IV. Provide 2% of debtors as bad debt. You are required to prepare:
(i) Profit and Loss Account.
(ii) Profit and Loss Appropriation Account for 31st December 2009.
5. The balance sheet of Ojo and Haruna, who share profits and losses in the ratio of:
Balance Sheet as at 30th April 2005

	₦	Fixed Assets		₦
Capital: Ojo	36, 000	Motor vehicles		30, 000
Haruna	12, 000	Furniture and fittings		18, 000
	48, 000			48, 000.
Current Liability		**Current Assets**		
Creditors	12, 000	Stock	2, 500	
		Debtors	8, 500	
		Cash	1, 000	12, 000
	60, 000			60, 000

Okoro was admitted as a partner on 1st May 2005 and he was to contribute N12, 000 as capital to give him one-fifth share of the new firm.
You are required to prepare the balance sheet of the new firm, assuming that Okoro brought in furniture valued at N5,000.00 and the balance in cash.

6. Abiola and Babatunde have been in partnership for many years sharing profit and losses in the ratio of 3:2 respectively. The following was their Balance Sheet as at 31st December 2008:

	₦		₦
Capital: Abiola	4,000	Goodwill	2, 000
Babatunde	3,000	Plant and Machinery	1, 800
	7,000	Stock	1, 960
Sundry creditors	980	Debtors	2, 130
		Cash at bank	90
	7, 980		7, 980

On 1st January 2009, they decided to admit Chike as a partner on the condition that he contributed N2,000 as his capital but that the plant and machinery and stock should be received at N2,000 and N1,900 respectively. The other assets, expecting goodwill remaining at their present book value. The goodwill was agreed to be valueless.
You are required to show:
I. The ledger entries dealing with the above in the following accounts:
(i) Goodwill Account
(ii) Revaluation Account
(iii) Capital Account
II. The Balance Sheet of the partnership immediately after the admission of Chike.
7. Goodwill is taken into account in partnership when __________.
A. the business has good customer relations
B. the business is making huge profit
C. a new partner is admitted
D. a partner becomes dormant
8. Which of the following is NOT a debit item in the partnership profit and loss appropriation account?
A. Interest on partners drawing
B. Partners' salaries

C. Interest on partners capital
D. Share of profit
9. An example of intangible asset is __________.
A. furniture
B. accruals
C. goodwill
D. stock
10. In a partnership business, the net profit services has opening figure for ____________.
A. trading account
B. profit and loss account
C. current account
D. appropriation account
11. All the following are the reasons for admitting new partner in the partnership business EXCEPT:
A. Economy of scale
B. Expiration of old partnership
C. Realisation of huge profit
D. Death of a partner
12. ___________ is the process of bringing into record the actual or current market value of the assets and liabilities in a business.
A. Evaluation
B. Appropriation
C. Revaluation
D. Goodwill
13. The excess of the purchases consideration over the total value of assets less liabilities is termed ___________.
A. accruals
B. goodwill
C. realisation
D. Premium