**WEEK THREE AND FOUR**

**ADMISSION OF PARTNERS, GOODWILL AND REVALUATION OF ASSETS**

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**ADMISSION OF NEW PARTNERS**

This occurs when a new partner is admitted into an existing partnership business. The reasons for such admission usually are: expiration of old partnership agreement, to inject in more fund, bring in a specialist, death of an old partner, etc.

However, it will be unfair to the existing partners for a new person to come in and take part in the established prosperous business without any reward to the old partners. This compensation to the old partners is goodwill.

**GOODWILL ON ADMISSION OF A PARTNER**

**Definition of Goodwill:** Goodwill is the benefit and advantage attached to an old established business as a result of its good name, efficient management good connection, good location, etc which make it to earn more profit.

**REASONS FOR PAYMENT FOR GOODWILL**

Thus, a partner of an existing business or an incoming partner will be induced to pay for goodwill because of:

1. quality of goods and services (ii) favourable business location (iii) efficient and loyal work force (iv) efficient management (v) possession of monopoly power (vi) patents and trade marks (vii) successful research and development (viii) good public image, etc.

**TREATMENT OF GOODWILL**

Then goodwill will be brought into the business. This will be dealt with as follows:

1. **Raising and retaining Goodwill account in the books**: Here, the value of goodwill is debited to goodwill account and credited to the capital accounts in the partners old profit and loss sharing ratio.

Accounting Entries: Dr. Goodwill A/c

In partners’ OLD P & L sharing ratio

Cr. Partners capital A/c

Any cash introduced by the new partner as capital, Dr Cash A/c; Cr. Capital A/c

1. **Goodwill is written off**: If the business does not desire to retain the goodwill in the books, it will be necessary to write it off to the capital account of the partners in their NEW P&L sharing ratio

Accounting Entries – goodwill written off

In partners NEW P&L sharing ratio

Dr. Capital A/c; Cr. Goodwill A/c

**EXAMPLE:**

A and B are Partners who share profit equally. They decide to admit C by agreement, goodwill valued at N60,000 is to be introduced into the books. C is required to provide capital equal to that of B after he has been credited with his share of goodwill. The new profit sharing ratio is to be 4:3:3 to A, B and C respectively.

The partner’s balance sheet before the admission of C is as follows

**Balance sheet**

Capital: A 80,000 Building 80,000

B 40,000 Motor Vehicle 30,000

Furniture 40,000

Creditors 30,000 Cash 20,000

Other liabilities 20,000

170,000 170,000

**Prepare the following:**

1. Journal and Ledger entries for the admission of C if goodwill account is to be retained.
2. The new balance sheet as a result of admission of C and the retention of goodwill account.
3. Journal and Ledger entries for the admission of C if goodwill account is not retained.
4. New balance sheet showing C admission and goodwill not retained.

**Solution**

1. **Journal entries – goodwill account retained**

**JOURNAL**

Debit Credit

Good will Account 60,000

Capital Account – A 30,000

-- B 30,000

*Being goodwill introduced and shared based*

*on old profit sharing ratio*

Cash Account 70,000

Capital Account C 70,000

*Being capital contributed by C*

*Note:* Since B’s capital was N40,000 before the goodwill of N30,000, then B’s capital will now be N70,000. Hence, C must contribute same amount as stated in the question.

Ledger – goodwill account retained

**Goodwill Account**

N N

Capital: A 30,000

B 30,000 Bal c/d 60,000

60,000 60,000

Bal b/d 60,000

**Capital Account**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **A** | **B** | **C** |  | **A** | **B** | **C** |
| Bal c/d | N  110,000  110,000 | N  70,000  70,000 | N  70,000  70,000 | Bal b/d  Cash  Goodwill  Bal b/d | N  80,000  -  30,000  110,000  110,000 | N  40,000  -  30,000  70,000  70,000 | N  70,000  -  70,000  70,000 |

**Cash Account**

NN

Bal b/d 20,000

capital 70,000 Bal c/d 90,000

90,000 90,000

Bal b/d 90,000

**A, B and C**

**Balance Sheet**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | N | N | N |
| Goodwill |  |  |  | 60,000 |
| Fixed Assets |  |  |  |  |
| Building |  |  | 80,000 |  |
| Furniture |  |  | 40,000 |  |
| Motor vehicle |  |  | 30,000 | 150,000 |
|  |  |  |  | 210,000 |
| Current asset |  |  |  |  |
| Cash |  |  | 90,000 |  |
| **Current liabilities** |  |  |  |  |
| Creditors |  | 30,000 |  |  |
| Other liabilities |  | 20,000 | 50,000 |  |
| Net current asset |  |  |  | 40,000 |
|  |  |  |  | 250,000 |
| **Financed by** |  |  |  |  |
| Capital account |  |  |  |  |
| A |  |  |  | 110,000 |
| B |  |  |  | 70,000 |
| C |  |  |  | 70,000 |
|  |  |  |  | 250,000 |

**Journal entries – goodwill account not retained**

**JOURNAL**

|  |  |  |
| --- | --- | --- |
|  | Debit | Credit |
|  | N | N |
| Goodwill Account | 60,000 |  |
| Capital – A |  | 30,000 |
| B |  | 30,000 |
| Being creation of goodwill as agreed on |  |  |
| Admission of C |  |  |
| Cash account | 70,000 |  |
| Capital Account – C |  | 70,000 |
| Being Capital contributed by C |  |  |
| Capital Account – A | 24,000 |  |
| B | 18,000 |  |
| C | 18,000 |  |
| Goodwill Account |  | 60,000 |
| Being goodwill written off using new |  |  |
| Profit sharing ratio |  |  |

**Cash Account**

N N

Bal b/d 20,000

C’s – Capital 70,000 Bal c/d 90,000

90,000 90,000

Bal b/d 90,000

**Goodwill Account**

Capital Account – A 30,000 Capital Account – A 24,000

Capital Account – B 30,000 Capital Account – B 18,000

Capital Account – C 18,000

60,000 60,000

**Capital Account**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **A** | **B** | **C** |  | **A** | **B** | **C** |
|  | N | N | N | N | N | N | N |
| Goodwill  Bal c/d | 24,000  86,000  110,000 | 18,000  52,000  70,000 | 18,000  52,000  70,000 | Bal b/d  Cash  Goodwill  Bal b/d | 80,000  -  30,000  110,000  86,000 | 40,000  -  30,000  70,000  52,000 | -  70,000  -  70,000  52,000 |

**A, B and C**

**Balance Sheet**

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Account:** |  | **Fixed Assets** |  |
|  | N |  | N |
| A | 86,000 | Building | 80,000 |
| B | 52,000 | Furniture | 40,000 |
| C | 52,000 | Motor vehicle | 30,000 |
|  | 190,000 |  | 150,000 |
| **Current liabilities** |  | **Current asset** |  |
| Creditors | 30,000 | Cash | 90,000 |
| Other liabilities | 20,000 |  |  |
|  | 240,000 |  | 240,000 |

**EVALUATION**

1. Explain the term Goodwill.

2. List five circumstances that can give rise to the valuation of goodwill in partnership accounts.

**REVALUATION OF ASSETS ON ADMISSION OF A NEW PARTNER INTO A PARTNERSHIP**

The assets of a partnership should be revalued to show their current value in any of the following circumstances: (i) admission of a partner (ii) retirement of a partner (iii) changes occur in P & L sharing ratio of partners.

**ACCOUNTING ENTRIES**

1. **Open a Revaluation A/c;** 
   1. Dr. Assets A/c; Cr. Revaluation A/c with increase in value of asset
   2. Cr. Assets A/c; Dr. Revaluation A/c with reduction in value of assets.
   3. Dr. Revaluation A/c; Cr. Liabilities A/c with increase in value of liabilities
   4. Cr. Revaluation A/c; Dr. liabilities with reduction in the value of liabilities
2. **If Goodwill is introduced**

Dr. Goodwill A/c; Cr Revaluation A/c with the amount of the Goodwill

1. **Transfer of profit on revaluation to the old partners capital account:**

Dr. Revaluation A/c in the old P & L sharing ratio

Cr. Capital A/c in the P & L sharing ratio

1. **Transfer of loss on revaluation**

Cr. Revaluation A./c in the P & L sharing ratio

Dr. Capital A/c in the P & L sharing ration

1. **Goodwill to be written off**

Cr. Goodwill A/c in the NEW P & L sharing ration

Dr. Capital A/c in the P & L sharing ratio

In revaluation of assets, the following accounts will be prepared.

1. Revaluation b. Capital accounts of partners c. Balance sheet

**Example**

S & O are in partnership, sharing profits and losses equally. On 1/1/1995 they decided to admit J, who would be entitled to one quarter of any future profits, the balance being shared equally between S and O.

The financial position of the business before the admission of J was a follows:-

Freehold premises: N75, 000, Fixtures and fittings: N26, 000, Stock in trade: N105, 000 Debtors: N45, 000, Cash in hand: N12, 640, Creditors: N58, 940.

Additional information:

1. It is agreed to value and retain goodwill at N30,000, b. Revalue the other assets as follows: Freehold premise: N100,000, Fixtures and fittings: N24, 000, Stock: N103, 000, c. Provision for bad debts of N3, 000 is to be made d. Capital is contributed by S and O equally e. J is to bring N80, 000 into the business as capital. You are required to prepare: i. Revaluation account ii. Partners capital accounts in columnar form iii. Opening balance sheet of the new partnership of S, O and J.

**Solution**

The closing balance sheet of the partnership must be prepared to show the capital contributed by J and S.

**Balance Sheet**

N N

Capital: S 102,590

O 102,590 205, 180 Freehold premises 75, 000

Fixtures & fittings 26, 000

Creditors 58, 940 Stock 105, 480

Debtors 45, 000

Cash in hand 12, 640

264, 120 264, 120

Note: The question states that capital is contributed equally by S and O.

Dr. **Revaluation account**  Cr

N N

**Decrease invalue of assets Increase in value of asset**

Fixture and fittings 2,000 Freehold premises 25,000

Stock 2,480 Goodwill 30,000

Provision for bad debts 3,000

Share of profit:

S 23,760

O 23,760 47,520

55,000 55,000

Dr **Partners’ capital accounts** Cr

S O J S O J

Balance c/d 126,350 126,350 80, 000 Bal. b/f 102,590 102,590 -

Cash - - 80,000

Share of profit 23,760 23,760 -

126,350 126,350 80,000 126,350 126,350 80,000

Share of profit S (1/2 x 47,520)=23,760 O (1/2 x 47, 520)=23,760

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Balance Sheet as at 1st January, 1995** | | | | | | |
|  |  | N |  |  | N | N | N |
| **Capital:** |  |  |  | **Fixed Assets** |  |  |  |
|  | S | 126,350 |  | Goodwill |  | 30,000 |  |
|  | O | 126,350 |  | Freehold Premises |  | 100,000 |  |
|  | J | 80,000 | 332,700 | Fixtures and fittings |  | 24,000 | 154,000 |
|  |  |  |  | **Current Assets** |  |  |  |
| Creditors |  |  | 58,940 | Stock |  | 103,000 |  |
|  |  |  |  | Debtors | 45,000 |  |  |
|  |  |  |  | Less Provision | 3,000 | 42,000 |  |
|  |  |  |  | Cash balance |  | 92,640 | 237,640 |
|  |  |  | 391,640 |  |  |  | 391,640 |

**EVALUTION**

1. What is a revaluation account?

2. List five assets that may be revalued in partnership accounts.

**READING ASSIGNMENT**

Essential Financial Accounting by O.A. Longe, Pages 278-281

Financial Accounting with Ease by OnafowokanYombo, Pages 247-251

Simplified Bookkeeping & Accounting by F.L. Olatunji, Pages 303-307

**Weekend Assignment**

1. The double entry for the N5,000 salary paid to partner A is (a) Dr. Appropriation A/c N5,000, Cr A’s current A/c N5,000 (b) Dr. A’s Capital A/c N5,000,

Cr Appropriation A/c N5,000 (c) Cr Revaluation A/c N5,000; Dr. Salary A/c N5,000

(d) None of the above

2. Goodwill is (a) Fixed Asset (b) Current Asset (c) Current Liability (d) Intangible Asset

3. Goodwill can be classified into (a) Liquid (b) tangible (c) intangible (d) Inherent and purchased

4. \_\_\_\_\_\_\_\_\_ A/c is credited with increase in values of assets (a) goodwill

(b) capital (c) revaluation (d) current

5. For a reduction in the value of an asset \_\_\_ the asset A/c and debit Revaluation A/c (a) debit (b) credit (c) deduct (d) Add

**Theory**

1. Explain clearly but briefly the terms goodwill and revaluation of assets. Why and when are they necessary in accounting?

2. Give the journal entries for each of the following transactions:

(a) Goodwill A/c of N50,00 is to be retained in the books of A& B who share profits and losses in ratio 2:1 respectively.

(b) A&B admitted C and the new P & L sharing ratio is 2:2:1 respectively. Write of the goodwill A/c in (a) above

(c) N4,000 provision for bad debt is to be made on revaluation of assets.

(d) Reduction in provision for bad debt of N7,000 on revaluation

**GENERAL EVALUATION**

1. List six accounts found in the nominal ledger
2. State four reasons for the need for a bank reconciliation
3. Mention six items which must be contained in a partnership agreement
4. Mention four features of not-for-profit making organizations
5. Differentiate between adjustments and closing entries