1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 03 (Class XII, Semester - 1)
Module Name/Title	Reconstitution of Partnership Firm-Retirement of a Partner – Part 2
Module Id	leac_10402
Pre-requisites	Basic knowledge of Partnership – Fundamentals, Retirement of Partnership, Ratios.
Objectives	After going through this lesson, the learners will be able to understand recording of business transactions in the journal. • Meaning of Goodwill • Accounting Treatment of Goodwill • Hidden Goodwill
Keywords	Reconstitution – Retirement, Accounting Treatment of Goodwill, Hidden Goodwill

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Rejaul Karim Barbhuiya	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Prof. Shipra Vaidya	DESS, NCERT New Delhi
Course Co-Coordinator / Co-PI	Dr. Nidhi Gusain	CIET, NCERT, New Delhi
Subject Matter Expert (SME)	Ms. Deepti Madhura	Amity Institute of Education, New Delhi
Review Team	Ms. Preeti Sharma Mr. Vinay Setia	Kendirya Vidyalaya, Sec 24, Noida Indraprastha Global School, New Delhi
Technical Team	Mr. Shobit Saxena Ms. Khushboo Sharma	CIET, NCERT, New Delhi CIET, NCERT, New Delhi

Table of Contents:

1. Treatment of goodwill on retirement/ death

In case of Retirement/Death, Retiring or Legal heirs (executors) of Deceased partner will lay a claim in the share of goodwill of the firm because Retiring or Deceased partner must have worked hard to earn goodwill of the firm.

After Retirement or Death, remaining partners will also be getting that share of Goodwill of retiring or deceased partner. So, proper compensation should be given to the retiring or executors of the deceased partners by the remaining partners.

Again this is Based on that golden rule that '**Gaining partners should compensate the sacrificing partners to the extent of their gain'.**

Once again let us refer to the Accounting Standard issued by ICAI which clearly states that Goodwill is to be recorded in the books only when some consideration in money or money's worth has been paid for it. It also states in clear words that Internally Generated Goodwill should not be recorded as an asset.

Sometimes at the time of retirement or death of a partner goodwill of the firm has to be evaluated. In that case, Value of goodwill should be adjusted through partners' capital accounts instead of being Raised in the books.

Accounting treatment of goodwill will depend on the the situation, whether Goodwill already appears in the books of firm or not. Let us examine the Accounting Treatment in Both cases

Accounting treatment of goodwill in books

Case A. When goodwill is not appearing in the books

In this case Retiring or Deceased partner's share will be credited to his capital account and Gaining partner's capital accounts will be debited accordingly in gaining ratio by way of the following journal entry:

Gaining Partner’s Capital, A/c Dr. (In gaining ratio)

To Retiring/Deceased Partner”s Capital A/c (Share of outgoing Partner)

(Being Retiring/Deceased Partner's share of goodwill debited to gaining partners’ Capital Acc.)

Note: As per AS issued by ICAI, Retiring/Deceased partner's capital account is credited without raising goodwill in the books because no money or money's worth has been paid for it.

Let us understand this by way of an Example

Example. (When All the Remaining Partners Gain)

A, B and C are partners, sharing profits and losses in the ratio of 2:2:1. B retired on 31/3/ 2020. On this date, Goodwill of the firm is valued at Rs. 75000. There is no goodwill account in the books. Pass Journal Entries.

Solution: Books of A, B and C Journal

Date	**Particulars**	L.F.	Debit (Rs.)	Credit (Rs.)
2020				
March 31	A's Capital A/c Dr.		20,000	
	C's Captial A/c Dr.		10,000	
	To B's Capital A/c			30,000
	(Being goodwill adjusted through capital accounts of the remaining partners in gaining ratio i.e., 2:1)			

Example. (When All Remaining Partners Gain AND Goodwill Already Appear in Books)

A, B and C are sharing profits in the ratio of 3:2:1. Goodwill is appearing in the books at a value of Rs. 60,000. B retires and on the day of B's retirement, goodwill is valued at Rs. 1,50,000. A and C decided to share future profits in the ratio of 3:2. Pass the necessary journal entries.

Solution: First of All, we write off the Existing Goodwill AND then compensate B, with his share of Goodwill. **Books of A, B and C**

JOURNAL

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2020	A's Capital A/c Dr.		30,000	
March 31	B's Capital A/c Dr.		20,000	
	C's Capital A/c Dr. To Goodwill A/c		10,000	 60,000
	(Being Old Goodwill written off among partners)			
March 31	A's Capital A/c Dr.		15,000	
	C's Captial A/c Dr.		35,000	
	To B's Capital A/c			50,000
	(Being goodwill adjusted through capital accounts of the remaining partners in gaining ratio i.e.3:7)			

Working Note:

Calculation of Gaining Ratio= (New Share – Old Share)

A's Gain=3/5 – 3/6=3/30C's Gain=2/5 – 1/6=7/30 So, Gaining Ratio= 3:7

NOW, there can be a case When one/some of the remaining partner also sacrifice in addition to the retiring partner. In that case, All the Gaining will compensate those who are Sacrificing, (Means the Retiring Partner and the Partner(s) who is/(are) Sacrificing.)

Let us understand this by way of an Example

Example

A, B, C and D are partners sharing profits in the ratio of 3:3:2:2 respectively. D retires and A, B and C decide to share the future profits in the ratio of 3:2:1. Goodwill of the firm is valued at Rs. 12,00,000. Goodwill already appears in the books at Rs. 9,00,000. Give the necessary Journal Entries to record Goodwill. Show your calculations clearly.

Solution: First of All, we write off the Existing Goodwill AND then A and B will compensate to D (Retiring) and C (Sacrificing) in the Process, with their Sacrificing share of Goodwill.

Books of A, B, C and D

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
2020	A's Capital A/c Dr.		2,70,000	
March 31	B's Capital A/c Dr.		2.70,000	
	C's Capital A/c Dr.		1,80,000	
	D's Capital A/c Dr.		1,80,000	
	To Goodwill A/c			9,00,000
	(Being Old Goodwill written off among all partners in their old ratio)			
March 31	A's Capital A/c Dr.		2,40,000	
	B's Captial A/c Dr.		40,000	
	To B's Capital A/c			2,40,000
	To B's Capital A/c			40.000
	(Being goodwill adjusted through capital accounts of the remaining partners in gaining ratio i.e.3:7)			

Working Note:

1. **D's share of Goodwill** = 12,00,000 x 2/10 = Rs. 2,40,000

Also, A and B will compensate C to the extent of sacrifice made by him.

12,00,000 x 2/60 = Rs. 40,000

2. Calculation of Gaining Ratio= (New Share – Old Share)

A's Gain=3/6 – 3/10= 12/60. **Gain** B's Gain=2/6 – 3/10= 2/60. **Gain**

C's Gain=1/6 – 2/10= **(-) 2/60. This is Sacrifice.** **So, Gaining Ratio= A:B = 12:2.**

BUT, If the Question specifically mention to Raise Goodwill Account, and there is No Goodwill existing in the Books, then the following Journal Entry will be made:

Goodwill A/c Dr.

To Old Partners' Capital A/c (in Old Ratio)

As this Goodwill belongs to Old Partners for their Efforts in the past, it is simply Credited to them. Let us understand this by way of an Example

Example.

X, Y and Z are partners, sharing profits and losses in the ratio of 2:2:1. Y retired on 31/3/ 2020. On this date, Goodwill of the firm is valued at Rs. 75000. There is no goodwill account in the books. Pass Journal Entries if the Firm want to Raise the Goodwill Account.

Solution: Books of X, Y and Z Journal

Date 2020	**Particulars**	L.F.	Debit (Rs)	Credit (Rs)
March 31	Goodwill A/c Dr.		75,000	
	To X's Captial A/c			30,000
	To Y's Capital A/c			30,000
	To Z's Capital A/c			15,000
	(Being goodwill adjusted through capital accounts of old partners in old ratio 2: 2:1)			

Now, there can be a case that Goodwill is already existing and still the new firm want to raise the Goodwill. Now, there can be two situations:

Situation No.1

Existing Goodwill is LESS than the Current Value **OR**

Situation No.2

Existing Goodwill is MORE than the Current Value

Let us understand both these situations by way of Examples

Example. (Situation No.1)

X, Y and Z are partners, sharing profits and losses in the ratio of 2:2:1. Y retired on 31/3/ 2020. On this date, Goodwill of the firm valued at Rs. 75,000. Goodwill account existing in the books.

At Rs. 40,000

Pass Journal Entries if the Firm want to Raise / Maintain the Goodwill Account at 75,000

Solution:

Existing Goodwill is LESS (40,000) than the Current Value (75,000)

Books of X, Y and Z

Journal

Date	Particulars	L.F.	Debit (Rs)	Credit (Rs)
2020				
March 31	Goodwill A/c Dr.		35,000	
	To X's Capital A/c			14,000
	To Y's Capital A/c			14,000
	To Z's Capital A/c			7,000
	(Being remaining goodwill raised in the capital accounts of old partners in old ratio 2: 2:1)			

Example. (Situation No.2)

X, Y and Z are partners, sharing profits and losses in the ratio of 2:2:1. Y retired on 31/3/ 2020. On this date, Goodwill of the firm valued at Rs. 75,000. Goodwill account existing in the books.

At Rs. 1,00,000

Pass Journal Entries if the Firm want to Raise / Maintain the Goodwill Account at 75,000

Solution:

Existing Goodwill is MORE (1,00,000) than the Current Value (75,000)

Books of X, Y and Z

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs)
	X's Capital A/c Dr.		10,000	
	Y's Capital A/c Dr.		10,000	
	Z's Capital A/c Dr. To Goodwill A/c		5,000	 25,000
	(Being excess Goodwill written off among all partners in their old ratio)			

Case B. When goodwill is already appearing in the books

In this particular case, the existing goodwill should always be written off among all partners in their old ratio by way of the following journal entries:

All Partner's Capital/Current A/c Dr. (In old ratio)

To Goodwill A/c (Value of existing Goodwill in Books)

(Being old goodwill written off among all partners in their old ratio)

And Now the same adjustment entry, Crediting the Outgoing (Sacrificing) AND Debiting the Gaining Partners by following the same Golden Rule. Remember. Yes, gaining should compensate the Sacrificing.

Gaining Partner's Capital, A/c Dr. (In gaining ratio)

To Retiring/Deceased Partners' Capital A/c (Share of outgoing partner)

(Being retiring/deceased partner's share of goodwill adjusted in gaining partner's Capital acc.)

Always Remember

Raising of Goodwill as an asset should be avoided and if at all Goodwill Account is Raised in the books (if given in the Question), it should be written off at the Earliest, as a matter of Financial Prudence, it being a non-productive Asset.

Also, according to AS 26 "Intangible Assets" issued by ICAI, specifically states that "Internally generated goodwill should not be recognized as an asset as it is not an identifiable resource controlled by the entity which can be measured **"Reliably".**

Let us understand this Point by way of an Example

Example.

A, B and C were partners sharing profit & losses in the ratio of 4:3:3. B retires and the goodwill of the firm is valued at Rs. 50,000. Assuming that A and C will share the future profits in the ratio of 3:2. Pass the journal entries if Goodwill account appears in the books at Rs. 20,000.

Solution:

Books A, B and C

Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	A's Capital A/c	Dr.		8,000	
	B's Capital A/c	Dr.		6,000	
	C's Capital A/c To Goodwill A/c	Dr.		6,000	 20,000

	(Being old goodwill written off among all partners in their old ratio)			
	A's Capital A/c Dr.		10,000	
	C's Capital A/c Dr.		5,000	
	To B's Capital A/c			15,000
	(Being B's share of goodwill adjusted among the continuing partners in their gaining ratio 2:1)			

Working Notes

Calculation of Gaining Ratio

A gain = 3/5 – 4/10 = 2/10 C gain = 2/5 – 3/10 = 1/10

So, the Gaining Ratio of A and C = 2:1

Now, we are moving to our new Topic

2. Concept of hidden goodwill

'Hidden Goodwill' is the Excess of amount payable to Retiring/Deceased partner over and above what is actually due to him on account of his Capital, Accumulated profit/losses, Revaluation Profit or Losses, etc. That Excess payment is called GOODWILL.

Let us take an example to understand this Concept.

Example: X, Y and Z were partners sharing profits in the ratio of 3:2:1. Y retires. Y's capital after considering his Capital and all adjustments relating to Accumulated Profits, etc was 7,00,000. However, his account was settled by giving Rs. 7,60,000 in full and final settlement.

Solution

Now, In this case the excess of Rs. 60,000 (Rs.7,60,000 – Rs. 7,00,000) shall be treated as his share of goodwill. Journal entry will be made by crediting Y's capital account with Rs. 60,000 and debiting X's and Z's capital accounts in their gaining ratio,

X's Capital A/c Dr. 45,000

Z's Capital A/c Dr. 15,000

To Y's Capital A/c 60,000

(Being Y's share of goodwill adjusted in capital accounts of X and Z in their gaining ratio i.e. 3:1)