

UNIT 02 / 06 · LEARN & TRY

Goodwill and a change in sharing ratio

Name: _____ Date: _____

Learn

Goodwill represents benefits such as reputation, customer relationships and location that can support earnings beyond an ordinary return. A valuation method estimates a settlement amount; it does not automatically justify recognising self-generated goodwill as an asset. Under average-profit valuation, use adjusted maintainable profits and the specified years of purchase. Super profit is maintainable profit less a normal return on capital employed. When existing partners change their sharing ratio, compare old and new shares partner by partner. A positive old share minus new share is a sacrifice; a negative result is a gain. Gaining partners compensate sacrificing partners according to the agreed goodwill valuation. Do not confuse the new ratio with the sacrificing ratio. The exercise must state whether goodwill is adjusted through capital accounts or retained as an asset. These tasks use capital-account adjustment without retaining self-generated goodwill.

Worked example

Adjusted annual profits are ₹40,000, ₹50,000 and ₹60,000. Average ₹50,000; two years' purchase values goodwill at ₹1,00,000. A:B changes from 3:2 to 1:1. A sacrifices $\frac{1}{10}$ and B gains $\frac{1}{10}$. B compensates A ₹10,000: B capital Dr ₹10,000; A capital Cr ₹10,000.