ST. LAWRENCE HIGH SCHOOL

A Jesuit Christian Minority Institution

Study Materials 3

Sub: Accountancy **Class: XII**

Chapter: Unit I: Introduction to Partnership

Topic: Past Adjustment, Guarantee of Profit & Goodwill **Date: 18/06/2020**

PAST ADJUSTMENTS

Sometimes after closing the accounts of a partnership firm, i.e. after preparing the financial statements or final accounts, some errors or omissions in the accounts of earlier years come to light. This errors or omission may be rectified by passing a single adjustment entry with the net effect of the errors or omission.

Types of errors or omission:

1. Related to interest on capital.
2. Related to interest on drawings.
3. Related to partners salaries and commission.
4. Related to profit sharing ratio (PSR).

Adjustment Entry must be passed either in Partners Current Account or Partners Capital Account. If Capital is fixed then this entry must be passed in Partners Current Account. If Capital is fluctuating then adjustment entry must be passed in Partners Capital Account.

GUARANTEE OF PROFIT

A partner sometimes is admitted with the assurance of a minimum profit. This amount of assured minimum profit is called Guaranteed Profit.

Guaranteed Profit:

1. When given by the Firm
2. When given by partner(s)

1. When given by the Firm

In this case we need to follow the following steps.

Step 1: Calculate the share of profit ignoring the guaranteed profit.

Step 2: Calculate minimum guaranteed profit.

Step 3: Compare actual share of profit with the minimum guaranteed profit.

Step 4: If the actual share of profit is more, then ignore the guaranteed profit. The share of profit of each partner will equal to profit as calculated in step 1 above.

Step 5: If the actual share of profit is less than the guaranteed profit, first the amount of guaranteed profit is set aside and then the balance profit is distributed among all the remaining partners in their profit sharing ratio.

2. When given by Partner(s)

When guarantee of profit is given by an individual partner, the following steps are to be followed for distribution of profit.

Step 1: Calculate share of profit in the usual manner if there is no guarantee of profit.

Step 2: Calculate difference between actual profit and guaranteed profit. If the actual share of profit is more than the guaranteed profit, no further adjustment is required. If the actual share of profit is less than the guaranteed profit, the following adjustment entry is to be passed for the difference between Guaranteed Profit and Actual Profit.

Partners' Capital Account…………………Dr. (who had given the guarantee)

To, Partners' Capital Account (to whom guarantee was given)

GOODWILL

Meaning of Goodwill: Goodwill is the value of benefit or advantage that a business has because of the factors that helps in increasing its profitability.

"Goodwill is nothing more than the profitability that the old customers will resort to the old place."

-Lord Eldon

"When a man pays for goodwill, he pays for something which places him in the position of being able to earn more than he would be able to do by his own unaided efforts."

-Dicksee

Nature of Goodwill:

(1) Intangible Asset.
(2) Value of Goodwill is dependent on the valuer.
(3) Value is not fixed.
(4) The value may be affected with the change in market condition.
(5) Purchased or Self Generated.
(6) It's existence not separated from business.
(7) It has intangible force.
(8) Leads to earn super profit.

Factors affecting the Value of Goodwill:

(1) Efficient Management.
(2) Favorable Location.
(3) Favorable Contracts.
(4) Longer establishment of business.
(5) Access to supplies.
(6) Quality.
(7) Market situation.
(8) Risks associated with business.
(9) Nature of Business.
(10) Past performance.