1.3 PROVISIONS OF THE PARTNERSHIP ACT-LAWS OF KENYA

This is a preview of the basic issues in Partnership Act Laws of Kenya. You need this background knowledge to enable you to provide necessary advise on fundamental legal issues of formation, operations, reorganisation, conversions and if necessary dissolution of partnerships. For a detailed understanding, please examine the Act itself.

1.4 TREATMENT OF GOODWILL IN PARTNERSHIP

1.4.1 Definition and Causes of Goodwill

Goodwill has received various legal definitions e.g. "The benefit arising from old connections and reputation". "It is the benefit and advantage of the good name, reputation and connection of business". "It is the attractive force which brings in customers. It is one thing which distinguishes an old established business from a new business at its first start. Goodwill is composed of variety of elements. It differs in its composition in different trades and in different businesses in the same trade."

A business builds up some reputation after it has continued for some time. If the reputation is good, it acquires good clientele. This is a very valuable asset which one cannot touch, feel, or see. The asset, in other words, is an intangible one but certainly nor fictitious. To the Accountant, Goodwill may be said to be that element arising from the reputation, connection or other advantages possessed by a business which enables it to earn greater profit than the return normally to be expected on the capital employed in the business. The reputation of the firm depends on various factors, such: -

1) Personal reputation of partners and management of the firm;
2) The reputation of the goods dealt in and the quality of service rendered to the clientele;
3) The location or site of the business in relation to customers;
4) Monopoly nature of business;
5) Special advantage enjoyed in respect of supplies and sales of products;
6) Possession of efficient and contended staff;
7) Ownership or agency of valuable patents, copyrights or trade marks which are widely known etc.

hitherto enjoying in full. Such premium is called "Goodwill" and that is quite a distinct from any amount that he may have agreed to bring in as capital. Goodwill may thus be looked upon as a compensation paid by new comer in an established business to the existing partners for their past efforts and the risk of capital undertaken to bring the business in the present stage of reputation and profit earning capacity and in return for their agreeing to forgo a share of future profits for his benefit.

(1) <u>Methods of treatment of Goodwill on admission of a new partner</u>
The various methods are as under-:

(a) <u>The new partner brings goodwill in cash which is left in business</u>
The entries are-:

(i) Debit: Cash/Bank	xx	
Credit: Goodwill Account		xx
(b) Debit: Goodwill Account	xx	
Credit: Old Partner's A/c		xx

(With the ratio in which old partners suffer on admission of new partner.)

(2) <u>The new partner brings Cash which old partners withdraw.</u> The entries are same As (a) above except that on additional entry is required when cash is withdrawn.

Debit: Old Partner's Capital A/cs	xx	
Credit: Cash/Bank		xx

(With cash withdrawn by the old partner.)

(3) <u>The amount of goodwill is paid by the new partner to the old partners privately</u>

No entry is required. The cash is shared by the old partners in the proportion In which they lose.

(4) <u>Goodwill is not brought in cash but is raised in the books of the firm. If is called</u> "Revaluation method". The entries are:

Debit: Goodwill Account	xx
Credit: Old partner's capital A/cs.	xx

(In their profit sharing proportions)

Note: Full value of goodwill appears in the balance sheet on asset sides.

(5) <u>Goodwill is raised in the books and is immediately written off. All partners</u> (both old and new) will be debited in the new profit sharing proportions. This is called "Memorandum Revaluation method". The entries are:

Debit: Goodwill Account xx

	(Being of appreciation in value of Land and Building)			
Dec. 31	General Reserve Account A/c Dr Profit and Loss Adjustment A/c (Being the transfer of Reserve to Profit and Loss Adjustment)		4000	4000
Dec. 31	Profit and Loss Adjustment A/c Dr Alexander's Capital A/c Robert's Capital A/c (*Being the transfer of Profit arising from adjustments to partner's capital A/c in their profit sharing proportions*)		6100	4575 1525
Dec. 31	Bank Account Dr John's Capital A/c *(Being the amount brought in by John as his capital)*		10000	10000
Dec. 31	Alexander's Capital A/c Dr Alexander's current A/c (*Being the transfer of excess of capital over his profit sharing proportion to his C/D/A/c)*		19,575	19,575
Dec. 31	Robert's Capital A/c Dr Robert's Current A/c (*Being the transfer of excess of capital over his profit sharing to C/D/A/c)*		12425	12525
Dec. 31	Alexander's Current A/c Dr Robert's Current A/c Dr Bank (*Being the amount withdrawn by partners from their current A/cs)*		19575 12525	32100

Dr PROFIT AND LOSS ACCOUNT (B) (– Yr9) Cr

Particulars		Shs	Particulars	Shs
Stock		2000	Land Buildings	5000
Office Furniture		100	General Reserve	4000
Reserve for Doubtful Debts to				
Capital A/cs:		800		
Alexander ¾	4,575			
Robert ¼	1,525	6100		
		9000		**9000**

Dr ALEXANDER's CAPITAL ACCOUNT Cr

Yr 9	Particulars		Rob	Alex	Yr 9	Particulars	John	Rob	Alex
Jan 1	Current A/c		12,525	19575	Jan 1	Balance b/d		16,000	30000
Jan 1	Balance c/d	10,000	10,000	30000		Goodwill A/c		5,000	15000
						P/L Adj. A/c		1,525	4575
						Bank A/c	10,000		
		10,000	10,000	30,000			10,000	22,525	49.575
						Balance b/d	10,000	10,000	30000

Dr GOODWILL ACCOUNT (D) Cr

Yr 9	Particulars	Shs	Yr 9	Particulars	Shs

	(being the amount of general reserve credited to partners Capital A/cs)			
July 1	Kintu's Capital A/c Dr Muwanga's Capital A/c Dr Bank *(being the amount of extra capital withdrawn by the partners in cash)*		14250 16750	 31000

PROFIT AND LOSS ADJUSTMENT ACCOUNT AS AT 1ST JULY Yr 8

		Shs		Shs
Sundry Assets – reduction			Land and Buildings – appreciation	7500
Stock	4,000			
Furniture	200			
Reserve/ Doubtful debts	2,300	6,500		
Kintu's Capital A/c	750			
Muwanga's Capital A/c	250	1,000		
		7,500		7,500

CAPITAL (Tamale, Muwanga & Kintu) A/cs

Yr 8	Particulars	Tam	Mwg	Kintu	Yr 8	Particulars	Tama	Mwg	Kintu
July 1	To Bank	-	16,750	14,250	July 1	Bal. b/d		32,000	60,000
July 1	To Bal c/d	20,000	20,000	60,000		P/ L Adj. A/c		250	-
						Goodwill		1,250	750
					July 1	Tama-Current		1,250	3750
						General Resv		2,000	3750
						Bank A/c	20,000	-	-
					July 1	Balance b/d			6000
		20,000	36,750	74,250			20,000	36,750	74250
						Balance b/d	20,000	20,000	60,000

TAMALE's CURRENT ACCOUNT

Yr 8	Particulars	Shs	Yr 8	Particulars	Shs
ly 1	Kintu's Capital a/c	3,750	July 1	Balance c/d	5,000
July 1	Muwanga's Capital a/c	1,250			
		5,000			5,000
July 1	Balance b/d	5,000			

Jalang'o and Kavuma are in Partnership, with capital of shs 7,000/= and Shs 1,000/= respectively. The creditors are Shs 23,000/=. The assets realized Shs 19,000/= partners share profits and losses equally.

Required:
Close the books of the firm, Kavuma having brought in the amount due by him.

<u>Illustration: 4 - Insolvency of Partners – Gamer vs. Murray</u>

<u>Where, on dissolution, partner's capital account is in debit, and he is unable to discharge his indebtedness, so that the rule in Garner Vs Murray applies</u>

Alibhai, Baxter and Rubia are partners sharing profits ½ 1/3 and 1/6. On 31st December Year 7, the following was the balance Sheet of the firm and it was decided to dissolve the partnership on that day.

BALANCE SHEET AS AT 31ST DECEMBER YEAR 7

Liabilities	Shs	Assets	Shs
Creditors	2,500	Cash at Bank	2,000
Capital:		Sundry Assets	15,000
Alibhai	12,000	Rubia Capital Account	3,500
Baxter	6,000		
	20,500		20,500

Alibhai took over the business paying Shs 12,000/= for the "Sundry Assets".
The goodwill of the firm was valued at Shs 6000/=. Show the final adjustments amongst the partners:

(a) Where Rubia is Solvent and satisfied with hid indebtedness,
(b) Where Rubia is insolvent and unable to bring in anything against his deficiency.

Gradual Realization and Piecemeal Distribution upon Dissolution

In real life, partnerships are not sold once and cash realised immediately as we have illustrated above. Many times the assets will take a while to realise the cash expected out of them. Besides the buyers will take some more time to remit the purchase price. More so the very agreed cash price may take the three agreed instalment payment system. In this scenario, a piecemeal realisation account or schedule is necessary to keep track of the payment received and the disbursement plan.

Cash is distributed as and when it is realised following the steps below: (i) In payment of all third party creditors; (ii) If surplus remains, any loans given to teh partnership by partners, over and above the partners capital contribution. This amount is paid proportionately to all