

CH-2

Goodwill : Nature & Valuation(V.V.V.V.V.
V.V. Simple)

→ Goodwill is nothing but the probability that old customers will resort to the old place.

→ Characteristics of Goodwill (3 Marks)

(a) It is an intangible asset

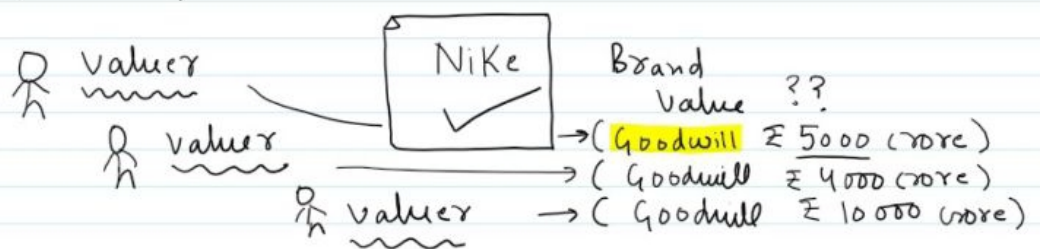
(b) It is not fictitious asset

(Real asset)

काल्पनिक asset
(imaginary)

(c) It helps in earning higher profits.

(d) Its value is a subjective matter and depends upon valuer.



→ Nature of Goodwill : It is an intangible asset

→ Need for valuing Goodwill (3 Marks)

a) When there is change in Profit sharing Ratio (CH-3)

b) When new partner admits (CH-4)

c) When a partner retires or dies (CH-5) * (CH-6)

- (R) { d) When partnership firm is sold
- (R) { e) When two or more firms amalgamate $P_A + P_B = P_{AB}$
- (R) { f) When partnership firm is converted into company

→ Factors affecting value of Goodwill (3 Marks)

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(a) Efficient Management

→ experienced, capable + competent

☐ G.W 😊 ↑

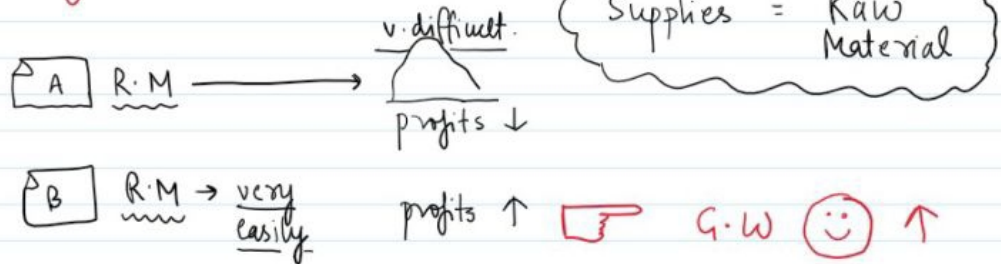
(b) Favourable Location

→ G.W 😊 ↑

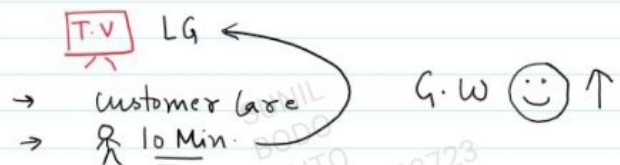
(c) Favourable Contracts - Sometimes, a firm has long term contracts for sale + purchase of goods at favourable prices.



(d) Access to Supplies - When Supplies of material are difficult to get, there will be high goodwill of the firm which can arrange for regular supplies.



(e) After Sale Service



(f) Quality of Product.

→ A firm enjoys good reputation for the quality of products delivered.

the 'quality' of products delivered.

→ Classification of Goodwill

① Purchased Goodwill

→ It is the goodwill for which the firm has paid consideration in cash or kind.



→ It is recorded in the books of Accounts as per AS-26

→ $\text{Goodwill} = \text{Purchase Consideration} - \text{Net Assets}$

→ Accounting (Refer example)

② Self-generated Goodwill

→ It is not recorded in the books (AS-26)

→ It is earned by efforts of management.

→ Its valuation is a subjective matter

Accounting for Purchased Goodwill (Refer Issue of Shares chapter)

a) Sundry Assets A/c Dr. (agreed value)
Goodwill A/c Dr.
To Sundry liabilities A/c — agreed value
To Vendor — purchase consideration

(being business purchased)

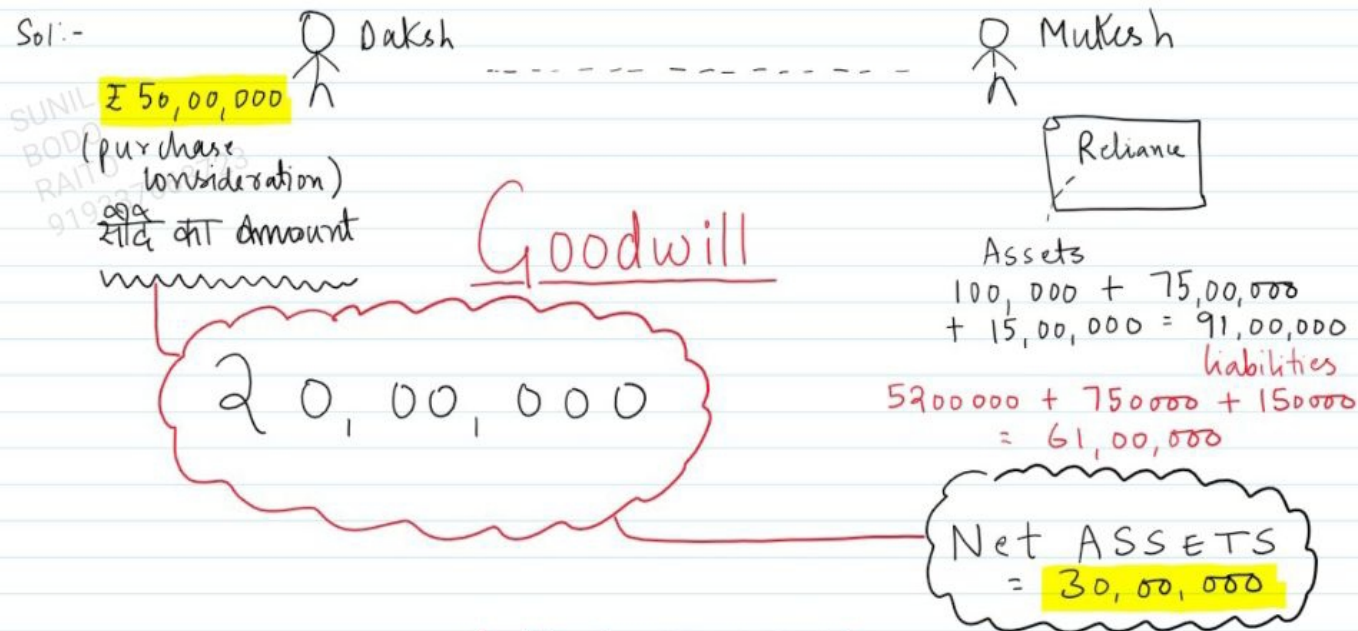
b) Vendor A/c Dr. xx
To Bank A/c — xx
(being cheque paid)

eg ① Daksh acquired the business of Mukesh Ambani for a purchase consideration of ₹ 50,00,000 paid by cheque. Following assets & liabilities are taken over :-

Dr. Furniture	100,000	Creditors	52,00,000	Cr
Dr. Stock	75,00,000	Dr. O/S expense	7,50,000	Cr
Dr. Debtors	15,00,000	Dr. Bills payable	1,50,000	Cr

Journalise.

Sol:-



In the books of Daksh

Sol:- (a)

Furniture A/c	Dr. 1,00,000
Stock A/c	Dr. 75,00,000
Debtor A/c	Dr. 15,00,000
GOODWILL A/c (bal..)	Dr. 20,00,000

B/S Asset	To Creditor A/c	52,00,000
G.W 20L	To O/S expense	7,50,000
AS-26	To B/P	1,50,000
	To Mukesh Ambani (P.C)	50,00,000

(b)

Mukesh Ambani	Dr. 50,00,000
To Bank A/c	50,00,000

CONCEPT

* Methods of Valuation of Goodwill *

① Average Profit method

① Average Profit method

- a) Simple Average profit method
- b) Weighted Average profit method

② Super Profit Method

③ Capitalisation Method

- a) Capitalisation of Average profit
- b) Capitalisation of Super profit

I

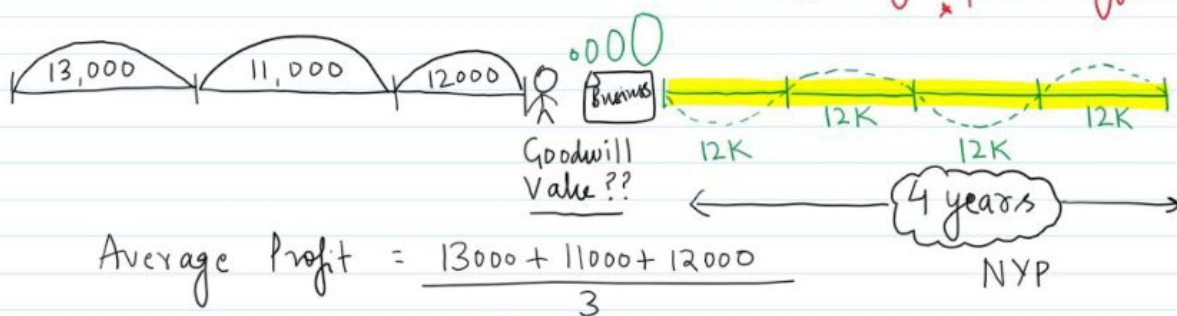
Average Profit Method

(SIMPLE Average Profit)

$$\text{Goodwill} = \text{Average profit} \times \text{Number of years purchase (NYP)}$$

Future Maintainable profits

The number of years for which the firm is likely to earn similar profit after change in ownership because of past efforts.



$$\text{Average Profit} = \frac{13000 + 11000 + 12000}{3}$$

$$= 12,000 \text{ p.a.}$$

$$\text{Goodwill} = \text{Avg Profit} \times \text{NYP} = 12000 \times 4 = 48,000$$

** FUTURE MAINTAINABLE PROFITS - 100%

Profits (Given - मिलावटी)

Add :- Abnormal Losses (Loss by theft or fire)	XX
Add :- Loss on Sale of fixed asset	XX
Add :- Over valuation of opening Stock	XX
Add :- Under valuation of closing Stock	XX
Add :- Non recurring expenses (i.e. expenses)	XX

Add :-	Over valuation of opening stock	xx
Add :-	Under valuation of closing stock	xx
Add :-	Non recurring expenses (i.e. expenses which will not be there in future)	xx
Add :-	Capital expenditure treated as Revenue expenditure (eg:- Machine purchased is shown in P&L A/c as expense)	xx
Add :-	Depreciation on this for all the years	xx
Less :-	Abnormal Gains (eg Gain on sale of fixed asset)	(xx)
Less :-	Overvaluation of closing stock	(xx)
Less :-	Under valuation of opening stock	(xx)
Less :-	Non recurring incomes (i.e. incomes not expected in future)	(xx)
Less :-	Income from Non Trade Investments	(xx)
Less :-	Management lost (eg Partner's remuneration)	(xx)
Less :-	Future expenses like Insurance premium to be paid from future years	(xx)
Less :-	Revenue Expenditure treated as capital expenditure (eg purchase of stationery is treated as asset etc)	(xxx)
Less :-	Depreciation on this for all the years	(xx)

Future Maintainable Profits (FMP) add

⊛ We take average of future Maintainable profits and then find value of Goodwill.

x ——— x ——— x ——— x ——— x ——— x ——— x ——— x

Practice

✓ Goodwill is to be valued at three years' purchase of four years' average profit. Profits of the firm for last four years ending 31st March, were:

2020—₹ 12,000; 2021—₹ 18,000; 2022—₹ 16,000; 2023—₹ 14,000.

Calculate amount of Goodwill.

[Ans.: Goodwill—₹ 45,000.]

NYP = 3 years

$$\begin{aligned}
 \text{Sol:- Average Profit} &= \frac{14,000 + 16,000 + 18,000 + 12,000}{4} \\
 &= 15,000 \text{ p.a.}
 \end{aligned}$$

$$\begin{aligned}\text{Goodwill} &= \text{Average Profit} \times \text{NYP} \\ &= 15,000 \times 3 \\ &= 45,000\end{aligned}$$

✓ 2. Profits for the five years ending 31st March, are as follows:

Year 2019—₹ 4,00,000; Year 2020—₹ 3,98,000; Year 2021—₹ 4,50,000; Year 2022—₹ 4,45,000 and Year 2023—₹ 5,00,000.

Calculate goodwill of the firm on the basis of 4 years' purchase of 5 years' average profit.

(NCERT, Modified)

$$\text{NYP} = 4$$

[Ans.: Goodwill—₹ 17,54,400.]

$$\begin{aligned}\text{Sol:- Average profit} &= \frac{400,000 + 398,000 + 450,000 + 445,000 + 500,000}{5} \\ &= \frac{21,93,000}{5} = 4,38,600\end{aligned}$$

$$\begin{aligned}\text{Goodwill} &= \text{Average profit} \times \text{NYP} \\ &= 4,38,600 \times 4 \\ &= 17,54,400\end{aligned}$$

★ 3M

3. Annu, Baby and Chetan are partners in a firm sharing profits and losses equally. They take Deep into partnership from 1st April, 2023 for 1/5th share in the future profits. For this purpose, goodwill is valued at 100% of the average annual profit of the previous three or four years, whichever is higher.

The annual profits for the purpose of goodwill for the past four years were:

Year Ended	Profit (₹)
31st March, 2023	2,88,000;
31st March, 2022	1,81,800;
31st March, 2021	1,87,200;
31st March, 2020	2,53,200.

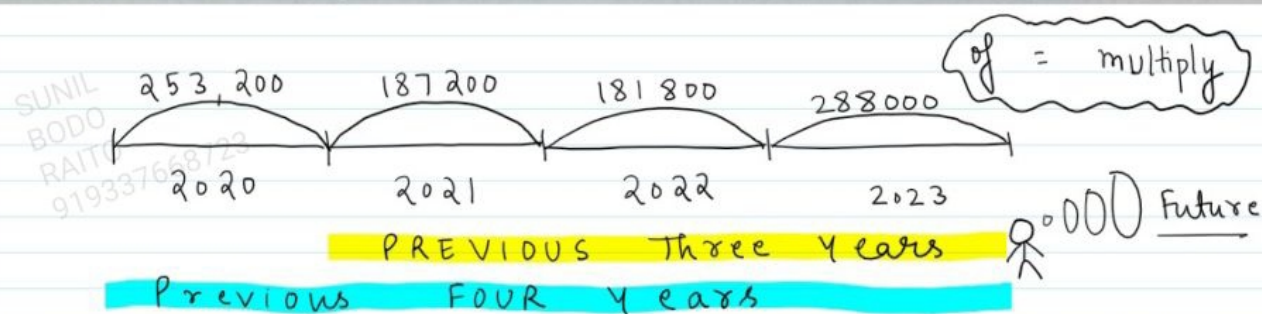
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31st March, 2023	2,88,000;
31st March, 2022	1,81,800;
31st March, 2021	1,87,200;
31st March, 2020	2,53,200.

Calculate the value of goodwill.

[Ans.: Goodwill—₹ 2,27,550.]



Sol:-

Average profits of previous 3 years

$$= \frac{187200 + 181800 + 288000}{3}$$

$$= \frac{657000}{3}$$

$$= 2,19,000$$

Average profit of previous 4 years

$$= \frac{253200 + 187200 + 181800 + 288000}{4}$$

$$= \frac{910,200}{4}$$

$$= 227,550$$

Higher

$$\begin{aligned} \text{Goodwill} &= 100\% \text{ of Average Annual profit} \\ &= \frac{100}{100} \times 227,550 = 2,27,550 \end{aligned}$$

4/ Purav and Purvi are partners in a firm sharing profits and losses in the ratio of 2 : 1. They admit Parv into partnership for 1/4th share on 1st April, 2023. For this purpose, goodwill is to be valued at four times the average annual profit of the previous four or five years, whichever is higher. The agreed profits for goodwill purpose of the past five years ended 31st March, are:

Year	2019 ✓	2020 ✓	2021 ✓	2022 ✓	2023 ✓
Profits (₹)	14,000	15,500	10,000	16,000	15,000

4. Purav and Purvi are partners in a firm sharing profits and losses in the ratio of 2 : 1. They admit Parv into partnership for 1/4th share on 1st April, 2023. For this purpose, goodwill is to be valued at four times the average annual profit of the previous four or five years, whichever is higher. The agreed profits for goodwill purpose of the past five years ended 31st March, are:

Year	2019 ✓	2020 ✓	2021 ✓	2022 ✓	2023 ✓
Profits (₹)	14,000	15,500	10,000	16,000	15,000

Calculate the value of goodwill. [Ans.: Goodwill—₹ 56,500.]

Sol:- Average profit of previous 4 years

$$= \frac{15,500 + 10,000 + 16,000 + 15,000}{4}$$

$$= \frac{56,500}{4}$$

$$= 14,125$$

Higher

Four times = 4 ×

Average profit of previous 5 years

$$= \frac{14,000 + 15,500 + 10,000 + 16,000 + 15,000}{5}$$

$$= \frac{70,500}{5}$$

$$= 14,100$$

Goodwill = Four times of Average profit

$$= 4 \times 14,125$$

$$= 56,500$$

CONCEPT

IMP. POINTS

① Trade Investment (निवेश)

Those investments that are made in another enterprise for furtherance of own business

Advancement of scheme

Maruti ₹10,00,000 → invest

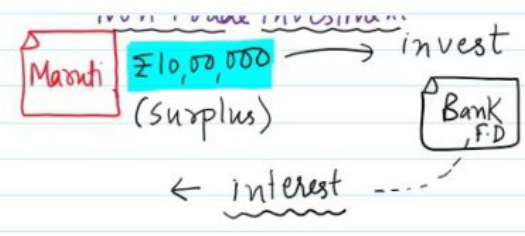
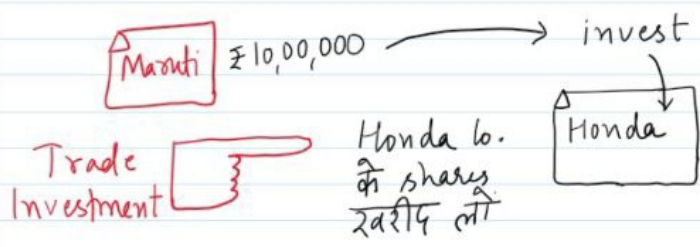
VS

Non Trade Investment (निवेश)

Those investments that are made to earn revenue by investing surplus funds and not for purpose of furtherance of own business

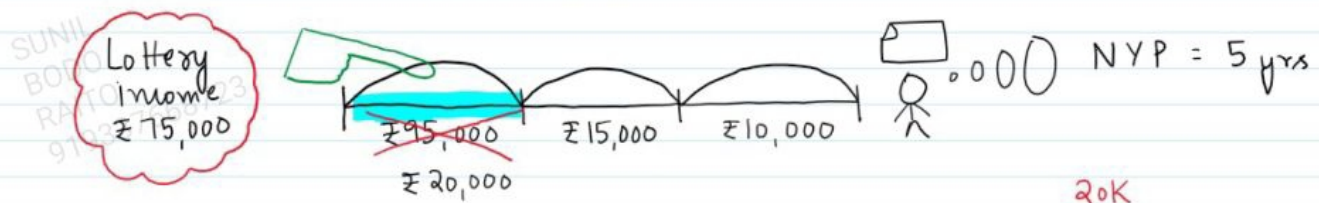
"Non Trade Investment"

Maruti ₹10,00,000 → invest



* If Q is silent then always assume investments as **NON-TRADE Investments**

② Abnormal Gains and Abnormal losses



Goodwill = A.P × NYP
 = 40000 × 5
 = **200,000**

15,000 × 5
 = **75,000**
 (सही)

Avg Profit = $\frac{20K + 95K + 10K}{3}$
 = $\frac{125K}{3}$
 = **41,666 p.a**

Given profits (मिलावटी)	95,000
(-) Abnormal Gain	(75,000)
	<u>20,000</u>

Given profits (मिलावटी)	xx
(+) Abnormal loss	xx
	<u>xxx</u>

→ Abnormal Gains are deducted from the given profits + Abnormal losses are added back to the given profits.

③ Capital expenditure is treated as Revenue Expenditure

Imp: ↓
Error of principle
 (गलती)

assumed figure

error of principle

(गलती)

assumed figure

P & L A/c			
To Repairs	10,000	By G. Profit	200,000
To P & S	15,000		
To Bad debt	10,000		
सही → To Net profit	165,000		
	<u>200,000</u>		<u>200,000</u>

eg:- Machine purchased ₹ 60,000 but charged to revenue. Depreciation 10%.

Dr. in P & L A/c
(Revenue expenditure)

Asset
(Capital expenditure)

Expense
Revenue expenditure

P & L A/c		Cr	
To Repairs	10,000	By G. Profit	200,000
To P & S	15,000		
To Bad debt	10,000		
To Machine	60,000		
To Net profit	105,000		
	<u>2,00,000</u>		<u>2,00,000</u>

गलत

profit (Given)	105,000
(+) C. E treated as R. E	60,000
सही profit	= 165,000
(-) Depreciation	(-) 6,000
	<u>159,000</u>

→ We have to add back this error in the given profits and deduct its depreciation from all years.

④

Revenue Expenditure is treated as Capital expenditure

(upper wale ③ की opposite)

→ We have to deduct this error in the given profits and Add its depreciation in all years.

→ We have to **deduct** this error in the given profits and **Add** its depreciation in all years.

Practice

6. Madhu and Vidhi are partners sharing profits in the ratio of 3 : 2. They decided to admit Manu as a partner from 1st April, 2023 on the following terms:

(i) Manu will be given 2/5th share of the profit.

(ii) Goodwill of the firm will be valued at **two years' purchase** of three years' normal average profit of the firm.

Profits of the previous three years ended 31st March, were:

2023—Profit ₹ 30,000 (after debiting loss of stock by fire ₹ 40,000) Abnormal Loss

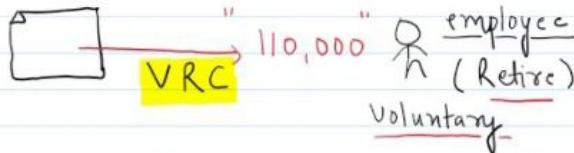
2022—Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000) Abnormal Loss

2021—Profit ₹ 1,10,000 (including a gain (profit) of ₹ 30,000 on the sale of fixed assets).

Calculate the value of goodwill.

Abnormal Gain

[Ans.: Goodwill—₹ 1,20,000.]



Sol:-

	2023	2022	2021
Given Profit (मिलावटी)	30,000	(-) 80,000	110,000
(i) Loss of Stock	(+) 40,000		
(ii) V R C		(+) 110,000	
(iii) Gain on Sale of fixed asset			(-) 30,000
FMP	70,000	30,000	80,000

$$\begin{aligned} \text{Now Average Profit} &= \frac{70,000 + 30,000 + 80,000}{3} \\ &= \frac{180,000}{3} = 60,000 \end{aligned}$$

$$\begin{aligned} \text{Goodwill} &= \text{Average profit} \times \text{NYP} \\ &= 60,000 \times 2 \\ &= \mathbf{120,000} \end{aligned}$$

$$= 60,000 \times 2$$

$$= 120,000$$

Prepaid Insurance = asset.

- ✓ Tarang purchased Jyoti's business with effect from 1st April, 2023. Profits shown by Jyoti's business for the last three financial years ended 31st March, were:
- 2021 : ₹ 1,00,000 (including an abnormal gain of ₹ 12,500).
- 2022 : ₹ 1,25,000 (after charging an abnormal loss of ₹ 25,000).
- 2023 : ₹ 1,12,500 (excluding ₹ 12,500 as insurance premium on firm's property—now to be insured).
- Calculate the value of firm's goodwill on the basis of two years' purchase of the average profit of the last three years.
- NYP = 2 [Ans.: Goodwill—₹ 2,25,000.]

P&L A/c (assumed)		2023	
Bad debts	20,000	Gross profit	200,000
Depreciation	10,000		
Repairs	50,000		
Printing	7,500		
Net profit	112,500		
	200,000		200,000

Insurance premium 12,500

20000 गलत बात

गलत बात

Insurance premium 12,500
 रकम गलत गयी

गलत

Sol:-

	2021	2022	2023
Given Profit (प्रतिवर्ष)	1,00,000	125,000	112,500
Abnormal Gain	(-) 12,500		
Abnormal Loss		(+) 25,000	
Insurance premium			(-) 12,500
FMP	87,500	150,000	100,000

Now Average Profit = $\frac{87500 + 150000 + 100000}{3}$

= $\frac{337500}{3}$ = 112,500

∴ G.W = AP × NYP

$$\therefore G.W = \overset{3}{AP} \times NYP$$

$$= 112500 \times 2 = 225,000$$

✓ 9. Bhaskar and Pillai are partners sharing profits and losses in the ratio of 3 : 2. They admit Kanika into partnership for 1/4th share in profit. Kanika brings her share of goodwill in cash. [Goodwill for this purpose is to be calculated at two years' purchase of the average normal profit of past three years. Profits of the last three years ended 31st March, were:

2021—Profit ₹ 50,000 (including profit on sale of assets ₹ 5,000). Abnormal Gain

NYP = 2

2022—Loss ₹ 20,000 (including loss by fire ₹ 30,000). Abnormal Loss

2023—Profit ₹ 70,000 (including insurance claim received ₹ 18,000 and interest on investments and Dividend received ₹ 8,000). Abnormal Gain

Calculate the value of goodwill. Also, calculate goodwill brought by Kanika.

[Ans.: Goodwill—₹ 66,000; Kanika shall bring 1/4th of ₹ 66,000, i.e., ₹ 16,500 as Goodwill.]

Sol:-

	2021	2022	2023
Given profits	50,000	(-) 20,000	70,000
profit on Sale of asset	(-) 5,000		
Loss by fire		(+) 30,000	
Insurance claim			(-) 18,000
Dividend received			(-) 8,000
F M P	45,000	10,000	44,000

$$\therefore \text{Average profits} = \frac{45,000 + 10,000 + 44,000}{3}$$

$$= \frac{99,000}{3} = 33,000$$

$$\text{Now Goodwill of the firm} = A.P \times NYP$$

$$= 33,000 \times 2$$

$$= 66,000$$

$$\text{Kanika's share of Goodwill} = 66,000 \times \frac{1}{4}$$

$$= 16,500$$

✓ 10. Sumit purchased Amit's business on 1st April, 2023. Goodwill was decided to be valued at two years' purchase of average normal profit of last four years. The profits for the past four years were:

10. Sumit purchased Amit's business on 1st April, 2023. Goodwill was decided to be valued at **two years purchase** of average normal profit of last four years. The profits for the past four years were:

Year Ended	31st March, 2020	31st March, 2021	31st March, 2022	31st March, 2023
Profits (₹)	80,000	1,45,000	1,60,000	2,00,000

Books of Account revealed that:

- Abnormal loss of ₹ 20,000 was debited to Profit and Loss Account for the year ended 31st March, 2020.
- A fixed asset was sold in the year ended 31st March, 2021 and gain (profit) of ₹ 25,000 was credited to Profit & Loss Account. (Abnormal Gain)
- In the year ended 31st March, 2022 assets of the firm were not insured **due to oversight**. Insurance premium not paid was ₹ 15,000. (भूल जाना)

Calculate the value of goodwill.

[Ans.: Goodwill—₹ 2,82,500.]

Soln:-

	2020	2021	2022	2023
Given Profits	80,000	145,000	160,000	2,00,000
Abnormal Loss	(+) 20,000			
Abnormal Gain		(-) 25,000		
Insurance Premium			(-) 15,000	
FMP	100,000	120,000	145,000	200,000

$$\therefore \text{Avg profit} = \frac{100,000 + 120,000 + 145,000 + 200,000}{4}$$

$$= \frac{565,000}{4} = 1,41,250$$

$$\text{Goodwill} = \frac{4}{1} \text{ A.P} \times \text{NYP} = 141,250 \times 2 = \mathbf{282,500}$$

- * 8. Abhay, Babu and Charu are partners sharing profits and losses equally. They agree to admit Daman for equal share of profit. For this purpose, the value of goodwill is to be calculated on the basis of **four years purchase** of average profit of last five years. These profits for the year ended 31st March, were:

Year	2019	2020	2021	2022	2023
Profits/Loss (₹)	1,50,000	3,50,000	5,00,000	7,10,000	(5,90,000)

On 1st April, 2022, a **car for ₹ 1,00,000** was purchased and debited to **Travelling Expenses Account** on which depreciation is to be charged @ 25% p.a. Interest of ₹ 10,000 on Non-trade Investments is credit to Income for the year ended 31st March, 2022 and 2023.

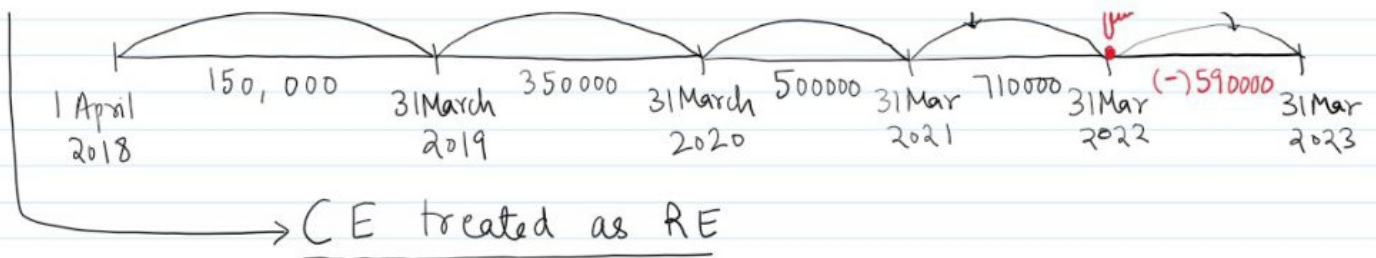
Calculate the value of goodwill after adjusting the above.

Abnormal Gain

[Ans.: Goodwill—₹ 9,40,000.]

1 April 2022





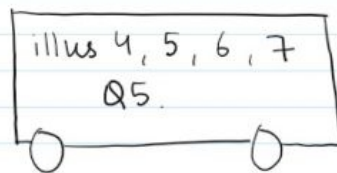
	31 March 2019	31 Mar 2020	31 March 21	31 March 2022	31 March 2023
Given profits	150,000	350,000	5,00,000	710,000	(-)590,000
Car purchased					(+) 100,000
Depreciation 25%					(-) 25,000
Interest				(-) 10,000	(-) 10,000
FMP	150,000	350,000	5,00,000	7,00,000	(-) 525,000

$$\text{Avg Profit} = \frac{150,000 + 350,000 + 5,00,000 + 7,00,000 - 525,000}{5}$$

$$= \frac{11,75,000}{5} = 2,35,000$$

$$\therefore \text{Goodwill} = \text{A.P} \times \text{NYP}$$

$$= 2,35,000 \times 4 = 9,40,000$$



Practice

Q

11. Profits of a firm for the year ended 31st March for the last five years were:

Year Ended	31st March, 2019	31st March, 2020	31st March, 2021	31st March, 2022	31st March, 2023
Profits (₹)	20,000	24,000	30,000	25,000	18,000

Calculate value of goodwill on the basis of **three years' purchase** of Weighted Average Profit after assigning **weights 1, 2, 3, 4 and 5** respectively to the profits for years ended 31st March, 2019, 2020, 2021, 2022 and 2023.

[Ans.: Goodwill—₹ 69,600.]

Sol:-

Year ended	Profits	Weights	Product
31. 3. 2019	20,000	1	20,000
31. 3. 2020	24,000	2	48,000
31. 3. 2021	30,000	3	90,000

31.3.2019	20,000	1	20,000
31.3.2020	24,000	2	48,000
31.3.2021	30,000	3	90,000
31.3.2022	25,000	4	100,000
31.3.2023	18,000	5	90,000
		15	348,000

$$\text{Weighted Avg Profit} = \frac{\text{Total product}}{\text{Total weights}}$$

$$= \frac{348,000}{15} = 23,200$$

SUNIL
BODO
RAITO
919337668723

$$\therefore G.W = WAP \times NYP$$

$$= 23,200 \times 3 = 69,600$$

- ✓ 12. Raman and Daman are partners sharing profits in the ratio of 60 : 40 and for the last four years they have been getting annual salaries of ₹ 50,000 and ₹ 40,000 respectively. The annual accounts have shown the following net profit before charging partners' salaries: We have to pay the salaries
Year ended 31st March, 2021—₹ 1,40,000; 2022—₹ 1,01,000 and 2023—₹ 1,30,000.

On 1st April, 2023, Zeenu is admitted to the partnership for 1/4th share in profit (without any salary). Goodwill is to be valued at four years' purchase of weighted average profit of last three years (after partners' salaries); Profits to be weighted as 1, 2 and 3, the greatest weight being given to the last year. Calculate the value of Goodwill. [Ans.: Goodwill—₹ 1,28,000.]

Sol:-

Year ended	Profits after Salaries	Weights	Product
31.3.2021	50,000 *	1	50,000
31.3.2022	11,000 *	2	22,000
31.3.2023	40,000 *	3	120,000
		6	192,000

$$WAP = \frac{192,000}{6} = 32,000$$

$$\therefore \text{Goodwill} = WAP \times NYP$$

$$= 32,000 \times 4 = 1,28,000$$

Concept

⑤

Over valuation of Closing Stock

- Error

= 2141

(5) Over valuation of Closing Stock - Error

ज्यादा

Trading A/c			
Dr		Cr	
opening stock	20,000	Sales	100,000
Purchase	60,000		
Direct expense	10,000	closing Stock	40,000
Gross profit	50,000		
	140,000		140,000

सही profit होना चाहिए

मूल profit का रकम 80,000

Trading A/c			
Dr		Cr	
opening stock	20,000	Sales	100,000
Purchase	60,000		
Direct expense	10,000	<u>closing Stock</u>	40,000 70,000
Gross profit	80,000		
	170,000		170,000

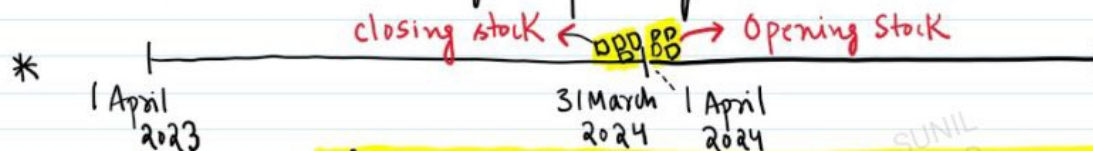
① गलती over valuation of closing stock by ₹ 30,000

→ Due to this error profits has been increased erroneously (गलती से) by ₹ 30,000

∴

Given profit (मिलावटी)	80,000
(-) overvaluation of stock	(30,000)
	<u>50,000</u>

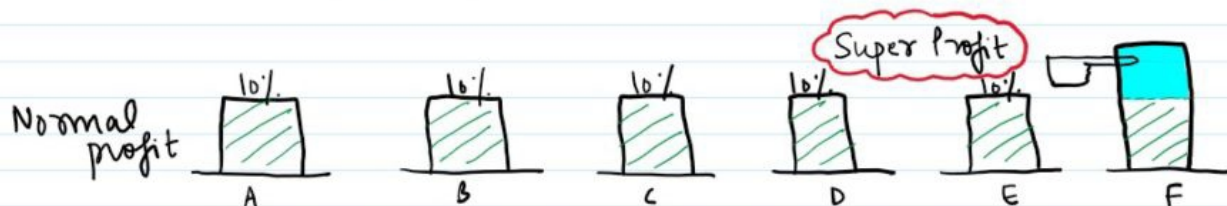
- * Under valuation of closing stock
 - * Over valuation of opening stock
 - * Under valuation of opening stock
- } "Logically same"



Closing stock of Previous year = Opening stock of Current year

II SUPER PROFIT METHOD

II SUPER PROFIT METHOD



INDUSTRY (CARS)

Step 1 :- Average Capital employed = $\frac{\text{Opening Capital employed} (+) \text{ closing Capital employed}}{2}$

* Capital employed = $\text{Capitals} (+) \text{ Reserves} (-) \text{ Fictitious assets} (-) \text{ Non Trade Investment} (-) \text{ Goodwill (existing)}$

OR

= $\text{Total assets} (-) \text{ Outside liabilities} (-) \text{ Fictitious assets} (-) \text{ Non Trade Investment} (-) \text{ Goodwill (existing)}$

Step 2 :- Normal Profit = $\text{Average Capital employed} \times \text{Normal Rate of Return}$

Step 3 :- Average Profit = We use (HAMP (Method 1))

Step 4 :- Super Profit = $\text{Average Profit} (-) \text{ Normal Profit}$

Step 5 :- Goodwill = $\text{Super Profit} \times \text{NYP}$

⊗ If Average Capital employed cannot be calculated then simply calculate Capital employed.

⊗ If Super profit is negative (Normal profit > Average profit) then there is NO Goodwill of the firm.

x ————— x ————— x ————— x ————— x

✓ 13. The capital of the firm of Anuj and Benu is ₹ 10,00,000 and the market rate of interest is 15%. Annual salary to the partners is ₹ 60,000 each. The profit for the last three years were ₹ 3,00,000, ₹ 3,60,000 and ₹ 4,20,000. Goodwill of the firm is to be valued on the basis of two years' purchase of last three years average super profit. Calculate the goodwill of the firm. (CBSE 2019)

[Ans.: Goodwill—₹ 1,80,000.]

Sol:- Capital of the firm = 10,00,000

Normal Rate of Return = 15% (NRR)

"Future"

Future Remaining expenses of the firm Partners' Salaries = 1,20,000 Rate of Return (NRR) = 15%
Q'n लिखेगा नहीं

Step 1 :- Average Capital employed = 10,00,000

Step 2 :- Normal profit = Avg Capital employed $\times$ NRR
 $= 10,00,000 \times 15\%$
 $= 10,00,000 \times \frac{15}{100} = 150,000$

Step 3 :- Average profit
 $= \frac{180000 + 240000 + 300000}{3}$
 $= \frac{720000}{3} = 240,000$

Step 4 :- Super profit = Average profit (-) Normal profit
 $= 240,000 (-) 150,000$
 $= 90,000$

$\therefore$ Goodwill = Super profit $\times$ NYP
 $= 90,000 \times 2$
 $= 180,000$

✓ 15. Total capital of the firm of Sakshi, Mehak and Megha is ₹ 1,00,000 and the market rate of interest is 15%. The net profits for the last 3 years were ₹ 30,000; ₹ 36,000 and ₹ 42,000. Goodwill is to be valued at 2 years purchase of the last 3 years' super profit. Calculate the goodwill of the firm. (Delhi 2017 C)
 [Ans.: Goodwill—₹ 42,000.]

Sol:- (i) Average Capital employed = 100,000
 (ii) Normal profit = 100000 $\times$ 15%
 $= 15,000$
 (iii) Average Profit = $\frac{30000 + 36000 + 42000}{3}$
 $= 108000 = 36,000$

$$= \frac{108000}{3} = 36,000$$

$$(iv) \text{ Super profit} = 36,000 - 15,000 = 21,000$$

$$\therefore G.W = SP \times NYP$$

$$= 21,000 \times 2$$

$$= 42,000$$

Q6. A business earned an average profit of ₹ 8,00,000 during the last few years. The normal rate of profit in the similar type of business is 10%. The total value of assets and liabilities of the business were ₹ 22,00,000 and ₹ 5,60,000 respectively. Calculate the value of goodwill of the firm by super profit method if it is valued at 2½ years' purchase of super profit. (Delhi 2014 C)

↓
NYP = 2.5

[Ans: Net Assets = ₹ 22,00,000 - ₹ 5,60,000 = ₹ 16,40,000; Normal Profit—₹ 1,64,000; Super Profit—₹ 6,36,000; Goodwill—₹ 15,90,000.]

Sol:- (i) Avg C.E = Total assets (-) Outside liabilities

$$= 22,00,000 (-) 5,60,000$$

$$= 16,40,000$$

(ii) NP = 16,40,000 × 10% = 1,64,000

(iii) AP = 8,00,000 (given)

(iv) S.P = 8,00,000 (-) 1,64,000

$$= 6,36,000$$

$$\therefore \text{Goodwill} = SP \times NYP$$

$$= 6,36,000 \times 2.5$$

$$= 6,36,000 \times \frac{5}{2}$$

$$= 15,90,000$$

Q21. Average profit earned by a firm is ₹ 1,00,000 which includes undervaluation of stock of ₹ 40,000 on an

21. Average profit earned by a firm is ₹ 1,00,000 which includes undervaluation of stock of ₹ 40,000 on an average basis. The capital invested in the business is ₹ 6,30,000 and the normal rate of return is 5%. Calculate goodwill of the firm on the basis of 5 times the super profit. (AI 2015 C)
- [Ans.: Goodwill—₹ 5,42,500.]

* Undervaluation of Stock
ALWAYS assume opening (x) closing (✓)
 Undervaluation of closing stock = 40,000

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Average profit (correct) = 1,00,000 + 40,000 = 1,40,000

Add

(i) Avg C.E = 6,30,000
 (ii) NOP = 6,30,000 × 5% = 31,500
 (iii) A.P = 1,40,000*

(iv) S.P = 1,40,000 (–) 31,500
 = 1,08,500

∴ Goodwill = 5 times the Super Profit
 = 5 × 1,08,500
 = 5,42,500

deduct

22. Average profit earned by a firm is ₹ 7,50,000 which includes overvaluation of stock of ₹ 30,000 on an average basis. The capital invested in the business is ₹ 42,00,000 and the normal rate of return is 15%. Calculate goodwill of the firm on the basis of 3 times the super profit. closing
- [Ans.: Goodwill—₹ 2,70,000.]

Sol:-
 (i) Avg C.E = 7,50,000
 (ii) NOP = 42,00,000 × 15%
 = 6,30,000
 (iii) A.P = 7,50,000*
 (iv) S.P = 7,50,000 (–) 6,30,000
 = 1,20,000

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$$= 90,000$$

$$\therefore G.W = 3 \text{ times the S.P}$$

$$= 3 \times 90,000$$

$$= 270,000$$

x ————— x ————— x ————— x ————— x ————— x

Practice

10. On 1st April, 2023, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. Its creditors amounted to ₹ 5,000 on that date. The firm had a Reserve of ₹ 10,000 while Partners' Capital Accounts showed a balance of ₹ 60,000. If Normal Rate of Return is 20% and goodwill of the firm is valued at ₹ 24,000 at four years' purchase of super profit, find average profit per year of the existing firm.

[Ans.: Capital Employed—₹ 70,000; Normal Profit—₹ 14,000; Super Profit—₹ 6,000;
Average Profit = Normal Profit + Super Profit = ₹ 20,000.]

$$NRR = 20\%$$

$$\text{Goodwill of firm} = 24,000$$

$$NYP = 4$$

liabilities	B/S	Assets.	
Creditors	5000	Cash	5000
Reserve	10000	other than cash	70000
Capitals	60000		75000
	75000		

$$75000(-) 5000$$

$$CE = \text{Total asset} (-) \text{liability}$$

(OR)

$$\text{Capitals} + \text{Reserves}$$

$$60000 + 10000$$

$$\text{Goodwill} = \text{Super Profit} \times NYP$$

$$\text{Goodwill} = (AP - NP) \times NYP$$

$$\text{Goodwill} = (AP - \text{Avg CE} \times NRR) \times NYP$$

$$24000 = (AP - 70,000 \times 20\%) \times 4$$

$$24000 = (AP - 14000) \times 4$$

$$\frac{24000}{4} = AP - 14000$$

$$6000 = AP - 14000$$

$$\therefore AP = 6000 + 14000$$

$$= 20,000$$

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$$AP = 6000 + 14000$$

$$= 20,000$$

18. A partnership firm earned net profits during the last three years ended 31st March, as follows:
 2021—₹ 17,000; 2022—₹ 20,000; 2023—₹ 23,000.

Capital investment in the firm throughout the above-mentioned period has been ₹ 80,000. Having regard to the risk involved, 15% is considered to be a fair return on the capital. Calculate value of goodwill on the basis of two years' purchase of average super profit earned during the above-mentioned three years.

NYP = 2

[Ans.: Goodwill—₹ 16,000.]

Sol:-

$$\begin{aligned} \text{Goodwill} &= S.P \times NYP \\ &= (AP - NP) \times NYP \\ &= \left(\frac{17000 + 20000 + 23000}{3} (-) \text{Avg CE} \times \text{NRR} \right) \times NYP \\ &= \left(\frac{60000}{3} (-) 80000 \times 15\% \right) \times 2 \\ &= (20000 (-) 12000) \times 2 \\ &= 8000 \times 2 \\ &= 16,000 \end{aligned}$$

CONCEPT

III

CAPITALISATION METHOD

NO NEED OF NYP

(a) Capitalisation of Average Profit (if Q is Silent)

Step 1 : Calculate Average Profit (We are CHAMP)

Step 2 : Capitalised Value = Average $\times$ Inn

$$\text{Step 2 : Capitalised Value of Business} = \frac{\text{Average Profit}}{\text{NRR}} \times 100$$

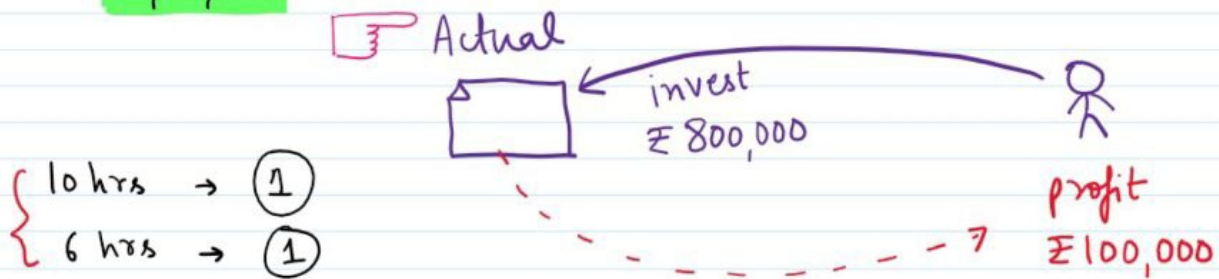
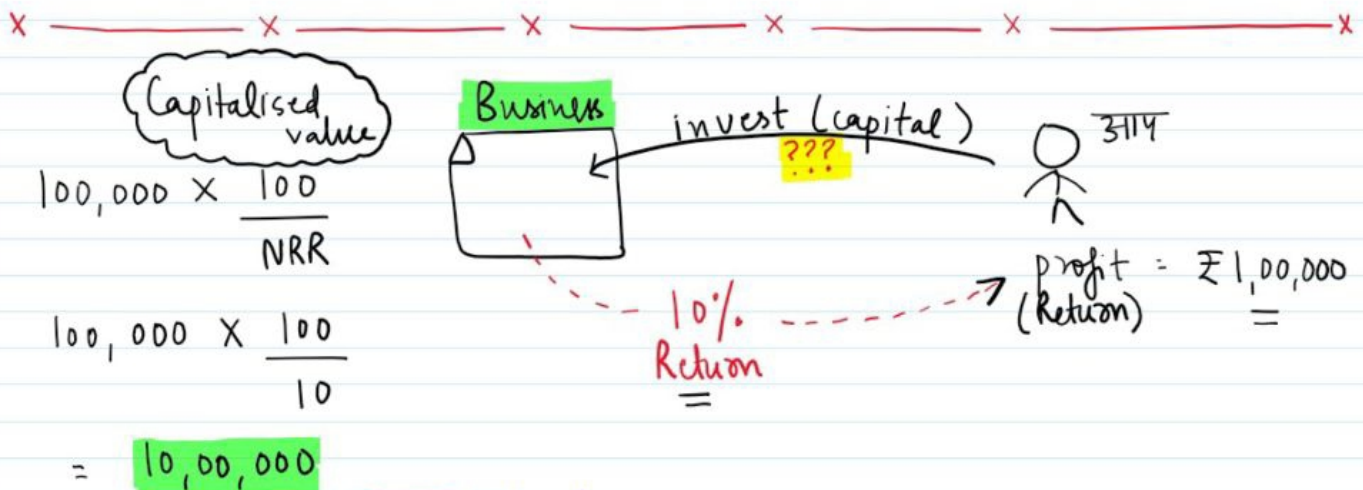
$$\text{Step 3 : Net Assets} = \text{Same as "Capital employed" formula}$$

$$\text{Step 4 : Goodwill of the firm} = \text{Capitalised Value} - \text{Net Assets}$$

(b) Capitalisation of Super profit

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$$\text{Goodwill} = \text{Super Profit} \times \frac{100}{\text{NRR}}$$



$$\text{Goodwill} = \begin{array}{l} \text{लगाता चकते थे} \\ 10,00,000 \end{array} - \begin{array}{l} \text{लगाए सितने} \\ 800,000 \end{array}$$

$$= \text{Capitalised value} - \text{Net Assets}$$

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$$= 200,000$$

Practice

- ✓ 24. From the following information, calculate value of goodwill of the firm by applying Capitalisation Method:
 Total Capital of the firm ₹ 16,00,000. Capital employed -
 Normal rate of return 10%.
 Profit for the year ₹ 2,00,000. = AP [Ans.: Goodwill—₹ 4,00,000.]

Sol:-

$$\begin{aligned} \text{Goodwill} &= \text{Capitalised Value} (-) \text{Net Assets} \\ &= \text{Average profit} \times \frac{100}{\text{NRR}} (-) \text{Net Assets} \\ &= 200,000 \times \frac{100}{10} (-) 16,00,000 \\ &= 20,00,000 (-) 16,00,000 \\ &= 4,00,000 \end{aligned}$$

*

$$\text{Net Assets} = 400,000$$

*

$$\text{Capital employed} = 4,80,000$$

What will you use in formula??

Net Assets (✓)

*

*

- ✓ 28. From the following particulars, calculate value of goodwill of a firm by Capitalisation of Average Profit Method:
 (i) Profits of last five consecutive years ending 31st March, are:
 2023—₹ 54,000; 2022—₹ 42,000; 2021—₹ 39,000; 2020—₹ 67,000 and 2019—₹ 59,000.
 (ii) Capitalisation rate 20% = NRR
 (iii) Net assets of the firm ₹ 2,00,000. ✓ [Ans.: Goodwill—₹ 61,000.]

$$\text{Sol:- Goodwill} = \text{Capitalised Value} (-) \text{Net Assets}$$

$$= \text{Avg Profit} \times \frac{100}{\text{NRR}} (-) \text{Net Assets}$$

$$= \frac{54000 + 42000 + 39000 + 67000 + 59000}{5} \times \frac{100}{\text{NRR}}$$

(-) Net Assets

$$= \frac{261000}{5} \times \frac{100}{\text{NRR}} (-) \text{Net Assets}$$

$$= 52,200 \times \frac{100}{20} (-) 200,000$$

$$= 261,000 (-) 200,000$$

$$= 61,000$$

29. A business has earned average profit of ₹ 4,00,000 during the last few years and the normal rate of return in similar business is 10%. Find value of goodwill by:

(i) Capitalisation of Super Profit Method, and

(ii) Super Profit Method if the goodwill is valued at 3 years' purchase of super profits. NYP = 3

Assets of the business were ₹ 40,00,000 and its external liabilities ₹ 7,20,000.

(Delhi 2013)

[Ans.: (i) Goodwill—₹ 7,20,000; (ii) Goodwill—₹ 2,16,000.]

$$\text{Sol:- Case (i) Goodwill} = \text{Super Profit} \times \frac{100}{\text{NRR}}$$

$$G.W = (AP - NP) \times \frac{100}{\text{NRR}}$$

$$= (AP - C.F \times \text{NRR}) \times 100$$

$$= \left(AP - C.E \times \frac{NRR}{100} \right) \times \frac{100}{NRR}$$

$$= \left(400000 - 32,80,000 \times \frac{10}{100} \right) \times \frac{100}{10}$$

$$= (400,000 - 3,28,000) \times 10$$

$$= 72,000 \times 10$$

$$= 720,000$$

Super profit

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Case (ii) Goodwill = S.P × NYP

$$= 72000 \times 3$$

$$= 2,16,000$$

- ✓ 30. A firm earns profit of ₹ 5,00,000. Normal Rate of Return in a similar type of business is 10%. The value of total assets (excluding goodwill) and total outsiders' liabilities as on the date of goodwill are ₹ 55,00,000 and ₹ 14,00,000 respectively. Calculate value of goodwill according to Capitalisation of Super Profit Method as well as Capitalisation of Average Profit Method.
- [Ans.: Goodwill—₹ 9,00,000 in both cases.]

Sol:- (i) Capitalisation of Average profit

$$\begin{aligned} G.W &= \text{Capitalised Value} (-) \text{Net Assets} \\ &= A.P \times \frac{100}{NRR} (-) \text{Net Assets} \\ &= 500000 \times \frac{100}{10} (-) 41,00,000 \\ &= 50,00,000 (-) 41,00,000 \\ &= 9,00,000 \end{aligned}$$

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$$= 20,00,000 - 11,00,000$$

$$= 9,00,000$$

(ii) Capitalisation of Super Profit

$$G.W = S.P \times \frac{100}{NRR}$$

$$= (AP - NP) \times \frac{100}{NRR}$$

$$= \left(AP - CE \times \frac{NRR}{100} \right) \times \frac{100}{NRR}$$

$$= \left(500000 - 4100000 \times \frac{10}{100} \right) \times \frac{100}{10}$$

$$= (500000 - 4,10,000) \times 10$$

$$= 90,000 \times 10$$

$$= 900,000$$

32. Average profit of a firm during the last few years is ₹ 1,50,000. In similar business, the normal rate of return is 10% of the capital employed. Calculate the value of goodwill by capitalisation of super profit method if super profits of the firm are ₹ 50,000.

(CBSE 2020 C)

[Ans.: Goodwill—₹ 5,00,000.]

Sol:-

$$G.W = S.P \times \frac{100}{NRR}$$

$$= 50,000 \times \frac{100}{10}$$

$$= 5,00,000$$

35. Average profit of GS & Co. is ₹ 50,000 per year. Average capital employed in the business is ₹ 3,00,000. If the normal rate of return on capital employed is 10%, calculate goodwill of the firm by:

(i) Super Profit Method at three years' purchase, and $N \times P = 3$

(ii) Capitalisation of Super Profit Method.

[Ans.: Goodwill—(i) ₹ 60,000; (ii) ₹ 2,00,000.]

Sol:-

$$\text{Super Profit} = \text{Avg Profit} - \text{Normal Profit}$$

$$\begin{aligned}
 \text{Sol:- Super Profit} &= \text{Avg Profit (-) Normal Profit} \\
 &= A.P (-) C.E \times \frac{NRR}{100} \\
 &= 50,000 (-) 300,000 \times \frac{10}{100} \\
 &= 50,000 (-) 30,000 = 20,000
 \end{aligned}$$

Capitalisation of S.P method

$$\begin{aligned}
 G.W &= S.P \times \frac{100}{NRR} \\
 &= 20,000 \times \frac{100}{10} \\
 &= 200,000
 \end{aligned}$$

S.P method

$$\begin{aligned}
 G.W &= S.P \times NYP \\
 &= 20,000 \times 3 \\
 &= 60,000
 \end{aligned}$$

36. A business has earned average profit of ₹ 8,00,000 during the last few years and the normal rate of return in similar business is 10%. Find value of goodwill by:

(i) Capitalisation of Super Profit Method; and

(ii) Super Profit Method if the goodwill is valued at 3 years' purchase of super profit.

Assets of the business were ₹ 80,00,000 and its external liabilities ₹ 14,40,000.

[Ans.: Goodwill—(i) ₹ 14,40,000; (ii) ₹ 4,32,000.]

NYP = 3

Capital employed (Net assets) = 65,60,000

$$\begin{aligned}
 \text{Super Profit} &= A.P - N.P \\
 &= A.P - C.E \times \frac{NRR}{100} \\
 &= 8,00,000 - 65,60,000 \times \frac{10}{100} \\
 &= 8,00,000 - 6,56,000 \\
 &= 1,44,000
 \end{aligned}$$

$$(i) \quad GW = SP \times \frac{100}{NRR}$$

$$= 144000 \times \frac{100}{10}$$

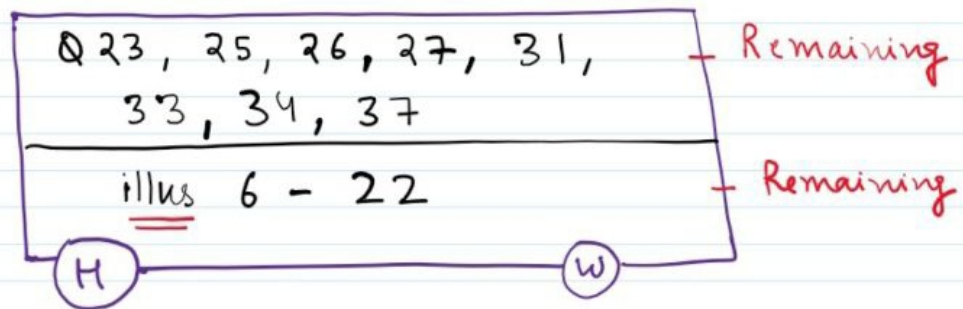
$$= 14,40,000$$

$$(ii) \quad GW = SP \times NYP$$

$$= 144000 \times 3$$

$$= 4,32,000$$

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