3

Valuation of Goodwill

1. Introduction

In practical reconstruction of a partnership firm as per the circumstances, assets and liabilities are revalued at the time of the reconstruction of a partnership. Issue of valuation of goodwill is taken place with revaluation of assets and liabilities. In this chapter, we will study about goodwill and its several aspects.

Firm has two types of assets : (1) Non-current assets (2) Current assets.

Intangible assets, fixed assets and long-term investment are included in non-current assets. Goodwill, patent, trademark, copyright etc. are included in intangible assets. These type of assets can not seen, but they have a value in the market. Goodwill is also an intangible asset which can not be seen but it has its value.

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections, which benefits the business. In accounting, monetary value of such advantage is known as 'Goodwill'.

2. Meaning of Goodwill

In simple words, "Goodwill is an intangible asset which shows the reputation of a firm in the market."

"Goodwill is the value of the reputation of a firm in respect to the profit earning over and above the expected profit."

A firm has a goodwill which has the capacity to earn more profit than a common firm and it is due to its own reputation, specific stable customer and other reasons. Value of goodwill depends on the profit earning capacity of a firm. In short we can say that goodwill does not exist in those businesses which earn normal profit or incur loss. Goodwill is shown in the balance sheet on the assets side under the head of non-current assets as intangible assets.

3. Factors Affecting Valuation of Goodwill

The valuation of goodwill depends on the earning ability of a firm. Business location, business period, types of business, competitiveness of business etc. are the factors that affect the business profit. Therefore, the same reasons also affect the valuation of goodwill. Following are the factors that affect the valuation of goodwill.

(1) Nature of business : Goodwill exists when a firm earns more profit than the expected profit, it earns profit due to a high value added product, it has more profit margin due to stable sales or it earns more profit due to some other reasons.

(2) Location of business : Often, the profit earning capacity of the business depends upon the business location. If the business is centrally located or it is at a place having heavy customer traffic then more profit earning can be seen in the business. The value of goodwill is high at such centrally located businesses. Thus, business location also affects the value of goodwill.

(3) Period of business : Generally, older the firm, higher the reputation in the market. Because majority of the customers are familiar and they have very close and long term relations with that particular business unit. Consequently, the value of such business is bound to be high. Thus, the period of business also has an impact on the value of goodwill.

(4) Market situation : The monopoly condition or limited competition enables the concerned firm earn to high profit. Therefore the value of goodwill is high in such business. Thus, the value of goodwill also depends on the situation of the business in the market.

(5) Efficiency of managers : The efficient management of a business increase the productivity and decreases the cost of a firm. Due to it, profit increase, which increase the value of goodwill.

(6) Other special benefits : Goodwill exists when a company enjoys special benefits and the overall profitability increases. For e.g. if a company can acquire license, patent or trademark or earn more profit or has been earning more profit, it is valued of having higher goodwill.

Apart from the above given factors, services after sales, past achievements of a firm, good labour relations etc. also become the reasons to earn more profit. Due to which the goodwill comes into existence.

4. Necessity for Goodwill Valuation

Normally, the need for valuation of goodwill arises at the time of the sale of a business. In the context of a company, the need for valuation of goodwill arises at the time of amalgamation and absorption. In the context of a partnership firm it may also arise in the following circumstances :

(1) Change in the profit sharing ratio amongst the existing partners

(2) Admission of new partner

(3) Retirement of a partner from existing partners

(4) Death of a partner from existing partners

(5) Conversion of partnership firm into a company

(6) Amalgamation of a partnership firm

Amalgamation means two partnership firm join to start a new firm.

5. Methods of Valuation of Goodwill

Since goodwill is an intangible asset, there are specific methods to determineits value. Valuation of goodwill depends on a profit earning capacity of a firm or a business. Prospective earning capacity means future maintainable profit. However, while determining the future maintainable profit, past year's profits are considered as the base. Various methods are available for the valuation of a goodwill. Generally, following methods are used for the valuation of a goodwill.

(1) Average profit method

(2) Weighted average profit method

(3) Super profit method

(4) Capitalization of profit method

(1) Average Profit Method : Under this method, the average of the past certain years are taken into consideration. Average profit is to be multiplied by the certain number of years for the valuation of goodwill. It is based on the assumption that a new business will take certain number of

years to earn the same profit. Therefore, the business purchaser is ready to pay the value of goodwill equal to the number of years of average profit. Generally, the multiplication of average profit and the number of years during which the anticipated profits are expected is known as goodwill.

(1) Average profit $= \frac{\text{Total profit of given years}}{\text{No. of years}}$

(2) Goodwill = Average profit × No. of years of purchase (defined years)

For example, if the past five years average profits of a business is ₹ 1,20,000. Three years are required to earn ₹ 1,20,000 annual profit for a new businessman. Under this method the value of goodwill is ₹ 1,20,000 × 3 = 3,60,000. Thus, profit receivable after three years is started from the current year.

Illustration 1 : Determine the value of goodwill based on 3 years purchase of last 5 years average profit, from the following information of a partnership firm of Nilesh and Nikunj. Last five years' profit information is as under :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000

Ans. :

Year	Profit
2011-12	2,00,000
2012-13	2,10,000
2013-14	1,90,000
2014-15	2,15,000
2015-16	2,20,000
Total	**10,35,000**

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{10,35,000}{5}$$

Average profit = 2,07,000

Goodwill = Average profit × No. of years purchased

= 2,07,000 × 3

Goodwill = 6,21,000

Illustration 2 : Hasu and Vasu are partners of a firm. They contemplate to change their profit and loss distribution ratio from 2:1 to 1:1. Therefore, it is determined for valuation of goodwill. From the following information, determine the value of the firm's goodwill. As per the agreement of the partnership, the value of goodwill is to be computed at 5 years purchase of the average profit of last 4 years.

Year	Profit/Loss (₹)
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000

Ans. : Here loss is incurred in the year 2014-15. We must take the loss into consideration while calculating the average profit.

Note : Amount mentioned in ( ) is '–' means loss indication. In account whenever amount is mentioned in ( ) then it is called '–'.

Year	Profit
2012-13	1,00,000
2013-14	1,20,000
2014-15	(40,000)
2015-16	60,000
Total	**2,40,000**

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{2,40,000}{4}$$

Average profit = 60,000

Goodwill = Average profit × No. of years purchased

= 60,000 × 5

Goodwill = 3,00,000

In simple average method, calculation of goodwill is based on the assumption that no change in the overall situation of profit is expected in future. This method does not consider the increasing and decreasing trends of profits. Capital employed is also not considered. To eliminate these limitations, various methods are used.

(2) Weighted Average Profit Method : We have seen that in simple average method the trend of profit is neglected. Sometimes, it can be seen that there is continuous increasing trend in profit. Under such circumstances, we should give more weightage to the profit of recent years and give comparatively less weightage to the profits of previous years. Generally the weightage of different year's profit are numbered as 1, 2, 3, 4,...

Average workout after giving weightage to different year's profit, it is called weightage average profit. If the computation of goodwill is made on the basis of weighted average profit then it is called weighted average method of goodwill.

If specific instruction is given that compute as per weighted average method or every year profit increasing or decreasing trend then compute goodwill as per the weighted average method.

As per this method, computation of goodwill should be done as shown on page number 93.

Step No. 1 : To prepare table.

Statement Showing Weighted Average Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	✓	1	✓
2013-14	✓	2	✓
2014-15	✓	3	✓
2015-16	✓	4	✓
		10	✓
		↑	↑
		Total weight	Total profit (product)/weighted

Step No. 2 : Weightage average profit $= \frac{\text{Total weighted profit}}{\text{Total weight}}$

Step No. 3 : Goodwill = Weightage average profit × No. of years of purchase

Note : Average or weightage average method for computation of goodwill should be specified clearly.

Illustration 3 : From the following information find out weighted average profit.

Year	Profit
2013-14	40,000
2014-15	50,000
2015-16	60,000
2016-17	70,000

Ans. : In this illustration it can be seen that every year profit is increasing, it means the trend of profit is increasing. It can be also estimated that profit will be increased in future. In this type of circumstances, weightage average method for valuation of goodwill is a proper method. Here, the highest weight will be given to recent year (2016-17) or the highest profit is in this year. Gradually less weight will be given to the previous years.

It means 1 weight to year 2013-14, 2 wieght to year 2014-15, 3 weight to year 2015-16 and 4 weight to year 2016-17 will be given.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2013-14	40,000	1	40,000
2014-15	50,000	2	1,00,000
2015-16	60,000	3	1,80,000
2016-17	70,000	4	2,80,000
	Total	**10**	**6,00,000**

Step No. 2 : Weighted average profit $= \frac{\text{Total weighted profit}}{\text{Total weight}}$

$= \frac{6,00,000}{10}$

Weighted average profit = 60,000

Illustration 4 : From the following information compute the value of goodwill of Mina and Bhadresh's firm at three years' purchase of weighted average profit on the basis of last five years.

Year	Profit
2012-13	80,000
2013-14	1,20,000
2014-15	1,40,000
2015-16	1,60,000
2016-17	1,70,000

Ans. : Here, the profit of last five years has upward trend, therefore the application of weighted average method for the computation of goodwill is relevant. Though, weighted average method for valuation of goodwill is specified in the example.

Step No. 1 : To prepare table.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Product (weighted profit)
(1)	(2)	(3)	(4)
2012-13	80,000	1	80,000
2013-14	1,20,000	2	2,40,000
2014-15	1,40,000	3	4,20,000
2015-16	1,60,000	4	6,40,000
2016-17	1,70,000	5	8,50,000
	Total	**15**	**22,30,000**

Step No. 2 : Weighted average profit $= \frac{\text{Total weighted profit}}{\text{Total weight}}$

$= \frac{22,30,000}{15}$

Weighted average profit = 1,48,666.67

= ₹ 1,48,667

Step No. 3 : Goodwill = Weighted average profit × No. of years purchase

= 1,48,667 × 3

Goodwill = 4,46,001

(3) Super Profit Method : In this method, capital employed by business, expected rate of return, expected profit, average profit etc. are used for super profit. The excess of average profit over the expected profit is called 'Super profit'. So, when a business earns excess profit over average profit,

then the amount of excess profit is called super profit. On the basis of this super profit, valuation of goodwill is made.

(1) Capital employed = Total assets ✓
− Total external liabilities ✓
✓

(2) Expected rate of return (It is given in example.)

(3) Expected profit = $\frac{\text{Capital employed} \times \text{Expected rate of return}}{100}$

(4) Average profit = (After adjustment)

(5) Super profit = Average profit − Expected profit

(6) Goodwill = Super profit × No. of years of purchase

Note : Capital employed is also known as net assets.

Illustration 5 : Pratibha and Pushpa are the partners of a firm. They want to change the profit and loss sharing ratio from 3:2 to 1:1. They decided to determine the valuation of goodwill.

On the basis of the firm's profit and other information, determine the valuation of goodwill on the basis of three years purchase of super profit.

Assets ₹ 12,00,000

Liabilities ₹ 4,00,000

Expected rate of return 10 %

Actual profit

Year	Profit (₹)
2014-15	1,30,000
2015-16	1,10,000
2016-17	1,20,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars		Amount (₹)
(1)	Capital employed :		
	Total assets =	12,00,000	
	− Total liabilities	4,00,000	
	Net assets / capital employed	8,00,000 →	8,00,000
(2)	Expected rate of return		10 %
(3)	Expected profit = Capital employed × Expected rate of return		80,000
	= 8,00,000 × 10 %		
(4)	Average profit :		1,20,000
	Year	**Profit (₹)**	
	2014-15	1,30,000	
	2015-16	1,10,000	
	2016-17	1,20,000	
		3,60,000	

	Average profit $= \frac{\text{Total profit}}{\text{No. of years}}$ $= \frac{3,60,000}{3}$ **Average profit = 1,20,000**	
(5)	Super profit = Average profit − Expected profit = 1,20,000 − 80,000 = 40,000	40,000
(6)	Goodwill = Super profit × No. of years of purchase = 40,000 × 3 Goodwill = 1,20,000	1,20,000

Illustration 6 : Pooja and Prarthna's firm capital is ₹ 8,00,000 and expected rate of return is 12 %. Last three year's profit are ₹ 1,00,000, ₹ 1,40,000 and ₹ 90,000 respectively. Determine the value of goodwill of the firm on the basis of 2 yeras purchase of last three years average super profit.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	8,00,000
(2)	Expected rate of return (Interest rate in the market)	12 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 12 %	96,000
(4)	Average profit : **Year** — **Profit** 1 — 1,00,000 2 — 1,40,000 3 — 90,000 **3,30,000** Average profit $= \frac{\text{Total profit}}{\text{No. of years}}$ $= \frac{3,30,000}{3}$ **Average profit = 1,10,000**	1,10,000
(5)	Super profit = Average profit − Expected profit = 1,10,000 − 96,000 = 14,000	14,000
(6)	Goodwill = Super profit × No. of years of purchase = 14,000 × 2 Goodwill = 28,000	28,000

(4) Capitalization of Profit Method : In this method, average profit of a business is computed and it is used to determine its capitalised value on the basis of normal / expected rate of return of the business. This type of profit received is called capitalisation of profit. Thus, capitalised profit means capitalised value of average profit on the basis of the expected rate of return.

$$\text{Capitalised profit} = \frac{\text{Expected profit}}{\text{Expected rate of return}} \times 100 \textbf{ or } = \frac{\text{Average profit}}{\text{Expected rate of return \%}}$$

e.g. Average profit of business is ₹ 90,000 and expected rate of return is 10 %. Capitalised profit will be found as under.

$$\text{Capitalised profit} = \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$$

$$= \frac{90{,}000}{10} \times 100$$

Capitalised profit = ₹ 9,00,000

Capitalised profit is compared with the capital employed in the business. If capitalised profit amount is more than the capital employed, then the difference amount is called goodwill. If capitalised amount is equal to the capital employed or less, then there is no goodwill of the business.

Goodwill = Capitalised profit − Capital employed

e.g. Capital employed is ₹ 7,00,000 and capitalised profit is ₹ 9,00,000, then goodwill is ₹ 2,00,000.

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 7,00,000

Goodwill = ₹ 2,00,000

Following explanation is not expected for exam.

Capitalised profit means how much net assets (capital employed) is required to earn average profit on the basis of expected rate of return. In this question expected rate of return is 10 %. Average profit is ₹ 90,000. So ₹ 9,00,000 net assets (capital employed) is required to earn ₹ 90,000 on the basis of 10 %. But actual net assets are ₹ 7,00,000. So ₹ 70,000 profit must be received on ₹ 7,00,000 at 10 %.

₹ 90,000 × $\frac{100}{10}$ = ₹ 9,00,000 net assets required

− ₹ 70,000 × $\frac{100}{10}$ = ₹ 7,00,000 actual net assets

₹ 20,000 × $\frac{100}{10}$ = ₹ 2,00,000 difference of asset is called goodwill

(a) If capital employed is ₹ 9,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 9,00,000

Goodwill = 0

(b) If capital employed is ₹ 10,00,000, then

Goodwill = Capitalised profit − Capital employed

= 9,00,000 − 10,00,000

Goodwill = −1,00,000

There is no goodwill in (a) and (b). Capital employed and capitalised profit both are equal in (a). There is no goodwill in (b) because capital employed is more than capitalised profit.

In short, following steps are used for the computation of the valuation of the goodwill as per the capitalisation profit method.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	✓
	Total assets ✓	
	− Total liabilities ✓	
	Net assets / capital employed ✓	
(2)	Expected rate of return	✓
(3)	Average profit	✓
(4)	Capitalised profit $= \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	✓
(5)	Goodwill = Capitalised profit − Capital employed	✓

Note : If answer of step no. 5 is '0' (zero) or negative then no goodwill exists in that business.

Illustration 7 : From the following information of Manoj and Harish's firm, determine the value of goodwill by capitalised average profit method.

Year	Profit (₹)
2012-13	90,000
2013-14	1,00,000
2014-15	1,10,000
2015-16	1,30,000
2016-17	1,50,000

Additional information : (1) Assets of business ₹ 13,40,000 (2) Liabilities of business ₹ 3,40,000 (3) Normal expected rate of return of business is 10 %.

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed :	10,00,000
	Assets = 13,40,000	
	− Liabilities 3,40,000	
	Net assets / capital employed 10,00,000	
(2)	Expected rate of return	10 %
(3)	Weighted average profit (As per note no. 1)	1,26,000
(4)	Capitalised profit $= \frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$	12,60,000
	$= \frac{1,26,000}{10} \times 100 =$ **12,60,000**	

(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 10,00,000 **Goodwill = 2,60,000**	2,60,000

Note no. 1 : Calculation of weighted average profit

In this example, profit is continuously increasing since last five years. Therefore, average profit will be computed as per the weighted average method.

Statement Showing Computation of Weighted Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,00,000	2	2,00,000
2014-15	1,10,000	3	3,30,000
2015-16	1,30,000	4	5,20,000
2016-17	1,50,000	5	7,50,000
	Total	**15**	**18,90,000**

$$\text{Weighted average profit} = \frac{\text{Total weighted profit}}{\text{Total weight}}$$

$$= \frac{18,90,000}{15}$$

Weighted average profit = ₹ 1,26,000

Super profit capitalization method : Super profit can be capitalised directly and can determine the value of goodwill. It is not required to capitalised the average profit under this method. Following computation should be done to determining value of goodwill.

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed : Total assets ✓ − Total liabilities ✓ Capital employed ✓	✓
(2)	Expected rate of return	✓
(3)	Expected profit = Capital employed × Expected Rate of return	✓
(4)	Average profit	✓
(5)	Super profit (Average profit − Expected profit)	✓
(6)	Goodwill = $\frac{\text{Super profit}}{\text{Expected rate of return}} \times 100$	✓

Note : If super profit is zero or negative (−), then it is no goodwill exists in the business.

Illustration 8 : Determine the value of goodwill of Virat and Anushka's firm as per the capitalisation of super profit method.

(1) Capital employed = 7,80,000

(2) Expected rate of return = 12 %

(3) Last 5 years profit :

Year	Profit (₹)
2012-13	2,00,000
2013-14	2,70,000
2014-15	2,40,000
2015-16	2,50,000
2016-17	2,30,000

Ans. :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed	7,80,000
(2)	Expected rate of return	12 %
(3)	Expected profit = Capital employed × Expected rate of return = 7,80,000 × 12 % = 93,600	93,600
(4)	Average profit :	2,38,000
	Year — **Profit** 2012-13 — 2,00,000 2013-14 — 2,70,000 2014-15 — 2,40,000 2015-16 — 2,50,000 2016-17 — 2,30,000 **11,90,000** Average profit = $\frac{\text{Total profit}}{\text{No. of years}} = \frac{11,90,000}{5}$ = 2,38,000	
(5)	Super profit = Average profit − Expected profit = 2,38,000 − 93,600 = 1,44,400	1,44,400
(6)	Goodwill = $\frac{\text{Super profit}}{\text{Expected rate of return}} = \frac{1,44,400}{12\ \%}$ = 12,03,333.33 Goodwill = 12,03,333	12,03,333

Special Illustration :

Illustration 9 : Harpal, Rajesh and Jayesh's firm's information is as under :

(1) Business assets : ₹ 10,00,000

(2) Business liabilities : ₹ 2,00,000

(3) Expected rate of return : 10 %

(4) Firm's last five years profit are as under :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000

From the above information, determine the value of goodwill of the firm.

(1) Calculate the goodwill of the firm equal to five years average profit.

(2) On the basis of 3 years purchase of average profit.

(3) On the basis of 2 years purchase of weighted average profit.

(4) On the basis of 4 years purchase of super profit (Weighted average basis).

(5) As per capitalisation profit method. (Weighted average basis).

(6) As per capitalisation of super profit. (Weighted average basis).

Ans. :

(1) As per last five years average profit method :

Goodwill :

Year	Profit (₹)
2012-13	90,000
2013-14	1,10,000
2014-15	1,20,000
2015-16	1,30,000
2016-17	1,40,000
	5,90,000

$$\text{Average profit} = \frac{\text{Total profit}}{\text{No. of years}}$$

$$= \frac{5,90,000}{5}$$

Average profit = 1,18,000

Goodwill = Average profit

$\therefore$ **Goodwill = 1,18,000**

(2) Goodwill is equal to 3 years purchase of average profit :

Average profit = 1,18,000 [5,90,000 / 5]

(As per previous calculation)

Goodwill = Average profit × No. of years of purchase

= 1,18,000 × 3

Goodwill = 3,54,000

(3) Goodwill as per weighted average profit method :

Statement Showing Computation of Weighted Average Profit

Year	Profit (₹)	Weight	Weighted profit (₹)
(1)	(2)	(3)	(4) (2 × 3)
2012-13	90,000	1	90,000
2013-14	1,10,000	2	2,20,000
2014-15	1,20,000	3	3,60,000
2015-16	1,30,000	4	5,20,000
2016-17	1,40,000	5	7,00,000
	Total	**15**	**18,90,000**

$$\text{Weighted average profit} = \frac{\text{Total weighted profit}}{\text{Total weight}}$$

$$= \frac{18,90,000}{15}$$

Weighted average profit = ₹ 1,26,000

Goodwill = Weighted average profit × No. of years of purchase

= 1,26,000 × 2

Goodwill = 2,52,000

(4) On the basis of 4 years purchase of super profit :

Statement Showing Computation of Goodwill

Step No.	Particulars		Amount (₹)
(1)	Capital employed		8,00,000
	Total assets	10,00,000	
	− Total external liabilities	2,00,000	
	Capital employed	8,00,000	
(2)	Expected rate of return		10 %
(3)	Expected profit = Capital employed × Expected rate of return		80,000
	= 8,00,000 × 10 % = 80,000		
(4)	Average profit : (Weighted average profit)		1,26,000
	Note : Here, weighted average profit ₹ 1,26,000 will be calculated as per previous method.		
(5)	Super profit = Average profit − Expected profit		46,000
	= 1,26,000 − 80,000 = 46,000		

(6)	Goodwill = Super profit × No. of years of purchase = 46,000 × 4 Goodwill = 1,84,000	1,84,000

(5) Profit capitalisation method :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Average profit (Weighted average) (As per previous method)	1,26,000
(4)	Capitalised profit = $\frac{\text{Average profit}}{\text{Expected rate of return}} \times 100$ = $\frac{1,26,000}{10} \times 100$ = **12,60,000**	12,60,000
(5)	Goodwill = Capitalised profit − Capital employed = 12,60,000 − 8,00,000 **Goodwill = 4,60,000**	4,60,000

(6) Super profit capitalisation method :

Statement Showing Computation of Goodwill

Step No.	Particulars	Amount (₹)
(1)	Capital employed Total assets 10,00,000 − Total external liabilities 2,00,000 Capital employed 8,00,000	8,00,000
(2)	Expected rate of return	10 %
(3)	Expected profit = Capital employed × Expected rate of return = 8,00,000 × 10 % = 80,000	80,000
(4)	Average profit (Weighted average) (As per previous method)	1,26,000
(5)	Super profit = Average profit − Expected profit = 1,26,000 − 80,000 = 46,000	46,000
(6)	Goodwill = $\frac{\text{Super profit}}{\text{Expected rate of return}} \times 100 = \frac{46,000}{10} \times 100$ Goodwill = 4,60,000	4,60,000

Note : (1) Value of goodwill is zero where super profit is zero or negative (−), it means no existence of goodwill. (2) If there is loss in business, then there is no existence of goodwill.

EXERCISE

1. Select the correct answer for each question :

(1) 'Goodwill' is which type of asset ?

(a) Tangible asset (b) Intangible asset

(b) Current asset (d) Fictitious asset

(2) Goodwill depends on which aspect ?

(a) On employee of business enterprise

(b) On management of business enterprise

(c) On assets of business enterprise

(d) On future maintainable profit

(3) Goodwill is a financial value of ..... .

(a) investment (b) prestige of business enterprise

(c) fixed assets (d) competition

(4) Goodwill is ..... where individual skill is important.

(a) more (b) less

(c) zero (d) negative

(5) Which method is appropriate for the computation of goodwill when every year profit is increasing ?

(a) Simple average (b) Weighted average

(c) Annual growth rate (d) Compound growth rate

(6) Expected profit = ...

(a) Capital employed × Expected rate of return

(b) Average profit × Expected rate of return

(c) Weighted average profit × Expected rate of return

(d) Assets × Expected rate of return

(7) Super profit means ..... .

(a) Capital employed − Expected profit (b) Expected profit − Capital employed

(c) Average profit − Expected profit (d) Expected profit − Average profit

2. Answer the following questions in one sentence :

(1) What is goodwill ?

(2) What is revaluation of goodwill ?

(3) Which type of asset is 'goodwill' ?

(4) Under which head goodwill is shown in the balance sheet ?

(5) What is capitalised profit ?

(6) What is super profit ?

(7) What is average profit ?

(8) What is weighted average profit ?

3. Answer the following questions :

(1) Give the meaning of goodwill and explain the factors affecting to its valuation.

(2) Explain the nature of goodwill.

(3) Explain the simple average method for the valuation of goodwill.

(4) Explain the weighted average method for the valuation of goodwill.

(5) Explain the super profit method for the valuation of goodwill.

(6) Explain the profit capitalisation method for the valuation of goodwill.

4. From the following information of Bhavesh and Vipul's firm, compute the value of goodwill on the basis of 4 years purchase of last five years average profit. Information of last five years profit is as under :

Year	Profit (₹)
2011-12	1,00,000
2012-13	1,10,000
2013-14	1,80,000
2014-15	2,00,000
2015-16	1,50,000

5. Mahendra and Pravin are partners of a firm sharing profit and loss in the ratio of 3:2. They want to change their profit-loss sharing ratio to 1:1. Therefore, they decided to make valuation of goodwill. As per partnership agreement, value of goodwill to be determine on the basis of 5 years purchase of last 4 years average profit.

Year	Profit (₹)
2013-14	60,000
2014-15	80,000
2015-16	(20,000)
2016-17	30,000

6. From the following information find out weighted average profit :

Year	Profit (₹)
2013-14	60,000
2014-15	70,000
2015-16	90,000
2016-17	1,10,000

7. From the following information of Babulal and Kantilal's firm, determine the value of goodwill on the basis of 3 years purchase of last five years weighted average profit :

Year	Profit (₹)
2012-13	40,000
2013-14	60,000
2014-15	75,000
2015-16	90,000
2016-17	1,20,000

8. Pushpa, Pratibha and Bhavna are partners of a partnership firm. They decided to change their profit-loss sharing ratio from 3:2:1 to 1:1:1. Therefore they decided to make the valuation of goodwill. On the basis of partnership firm's profit and other information, determine the value of goodwill on the basis of three years purchase of super profit.

Assets : ₹ 6,00,000; Liabilities : ₹ 2,50,000; Expected rate of return : 10 %

Actual profit :

Year	Profit (₹)
2014-15	80,000
2015-16	70,000
2016-17	90,000

9. Capital of Meena and Manju's firm is ₹ 4,00,000 and expected rate of return is 10 %. Last three year's profits are ₹ 1,20,000, ₹ 1,10,000 and ₹ 1,00,000 respectively. Compute the value of goodwill two times of super profit on the basis weighted average method..

10. From the following information of Nairutva and Rutvik's firm determine the value of goodwill of partnership firm on the basis of capitalisation of weighted average profit method.

Year	Profit (₹)
2012-13	45,000
2013-14	50,000
2014-15	65,000
2015-16	75,000
2016-17	90,000

Additional information :

(1) Business assets : ₹ 6,00,000 (2) Business liabilities : ₹ 1,70,000

(3) Normal expected return of business is 10 %.

11. Determine the value of goodwill of Prabha and Prabhu's firm on the basis of capitalised super profit method.

(1) Capital employed : ₹ 9,00,000 (2) Expected rate of return : 12 %

(3) Last five years profit :

Year	Profit (₹)
2012-13	1,00,000
2013-14	1,40,000
2014-15	1,30,000
2015-16	1,50,000
2016-17	1,80,000

12. Rajesh and Harish are partners of a partnership firm. On the basis of their partnership firm's profit and other information, determine the value of goodwill on the basis of two years purchase of super profit.

(1) Capital employed : ₹ 8,00,000 (2) Expected rate of return : 12 %

(3) Previous years profit :

Year	Profit (₹)
2014-15	1,20,000
2015-16	90,000
2016-17	1,50,000