

Chapter 3- Valuation of goodwill

COMMON ERRORS

1. Students are not able to distinguish between normal expenses and abnormal losses.
2. Sometimes adjustments for expenses and incomes are made in normal profits in place of average profits.
3. In Case of weighted average profit method students are not able to understand which year should be given maximum weightage.
4. For transactions like change in value of closing stock students forget to give the effect of transactions in two years.

Questions

1. What is Goodwill ?
2. What is the nature of goodwill ?
3. Why do we need to calculate goodwill ?
4. "Goodwill does not have existence separate from that of the firm." Do you agree ?
5. Does goodwill help in earning higher profits ?
6. How does location affect goodwill of the firm ?
7. How do favorable contracts affect goodwill of the firm ?
8. How does access to supplies affect goodwill of the firm ?
9. What factors affect goodwill of the firm ?
10. How does efficient management affect goodwill ?
11. In what categories can we classify goodwill ?
12. Why is valuation of goodwill considered to depend on subjective judgement ?
13. What does AS 26 state with regards to self generated goodwill ?
14. What are the different methods of valuation of goodwill ?
15. What does negative super profit imply ?
16. What is meant by no. of years purchase ?
17. What is meant by weighted average profit ?
18. Why is weighted average profit method better than average profit method ?
19. Why are higher weights assigned to recent year profit ?
20. What is meant by super profits ?
21. Why is goodwill considered intangible and not fictitious ?
22. Discuss the features of goodwill ?
23. Distinguish between average profits and the super profits ?
24. A and B are equal partners. On 31st March 2019 they admit C as equal partner. Since April 2016 profits have shown 100% increase every year. Profits for the year ended 31st March 2017 were ₹ 80,000. It was decided to value the goodwill at 3 years purchase of average profit of last 4 years. Find out the value of goodwill.

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25. Goodwill of a firm is valued at three year's purchase of the average profits of the last five years. The profits are as under :-

Year	₹	Year	₹
2012	50,000 Profit	2015	60,000 Profit
2013	20,000 Loss	2016	80,000 Profit
2014	10,000 Profit		

Calculate the value of goodwill.

26. Meena purchased Simmi's business from The Profits disclosed by
2015 ₹ 40,000 (Including an Abnormal gain of ₹ 5,000)
2016 ₹ 50,000 (After Charging an Abnormal Loss of ₹ 10,000)
2017 ₹ 45,000 (Excluding Rs 5,000 as Insurance Premium of firm's Property now Insured)

Calculate the Value of firm's goodwill on the basis of 2 years Purchase of the average Profits for the last three years.

27. X sold his business to Y. Calculate the value of Goodwill taking into consideration the following factors :

i) Goodwill is valued at three years of the average profits of the last four years. Profit of the last four years were as : year 2010 - ₹ 40,000, Year 2011 - ₹ 58,000, Year 2012 - ₹ 53,000, Years 2013 - ₹ 62,000.

ii) Abnormal loss of ₹ 2,000 due to theft has reduced the profits of the year 2010.

iii) Profit for the year 2011 include abnormal profit of ₹ 4,000.

iv) A speculative and lottery profit of Rs 5,000 was received during the year 2012 which was included in that year's profit.

v) Profits of the year 2013 were reduced by Rs 10,000 of the depreciation on such a machinery which was destroyed by fire during the year.

Weighted Average Profit Method :

28. Profit of a partnership firm for the last 5 years are as follows.

Year	Profit (₹)
2010-11	70,000
2011-12	84,000
2012-13	1,05,000
2013-14	87,500
2014-15	63,000

Evaluate the goodwill on the basis of 5 years purchase of weighted average profits based on weights 1, 2, 3, 4, 5 respectively for profits from year 2010 to 2015.

Weighted Average Profit with Additional Information :

29. Compute the value of the goodwill of the firm on the basis of 3 years purchase of the weighted average profits of the last years. Profits for the past 4 years were –

Year	Profit
2011	36,360

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2012	44,640
2013	36,000
2014	54,000

The weights assigned to each year are 1, 2, 3 & 4. Following are some information provided to you after checking of accounts.

- (i) On September 2013, a major machinery was repaired for ₹ 10,800 but was charged as revenue. It is to be capitalized for the purpose of calculation of goodwill. Subject to depreciation of 10% p.a. by W.D.V. method.
- (ii) Closing Stock for the year 2012 was over-valued by ₹ 4320.
- (iii) Annual charges of Rs 8640 should also be made to cover the management cost for the purpose of calculation of goodwill.

30. XY & Co. a partnership firm, intend to estimate the value of its Goodwill on the basis of three year's purchase of super profit of the firm. The capital employed in the firm is ₹ 1,50,000 and the normal rate of return is 20%. Profits for the last four years were :

2015 - ₹ 35,000	2016 - ₹ 38,000
2017 - ₹ 42,000	2018 - ₹ 45,000

31. A firm earns ₹ 80,000 as its average profits. The rate of normal profit being 10%, the assets of the firm amounted to ₹ 10,00,000 and liabilities are ₹ 4,40,000. Calculate the value of Goodwill according to capitalization of Average Profit Method.

32. X and Y are partners sharing profits equally. They decide to admit Z for an equal share. For this purpose, the Goodwill is to be valued on the basis of capitalization of average profit. The net asset of the firm ₹ 3,20,000. Average maintainable profit of the firm is ₹ 45,000. The normal rate of return may be taken as 12% p.a. Calculate the value of Goodwill according to Capitalisation of Average Method.

33. The average net profits expected in the future by XYZ firm are Rs 36,000 per year. The average capital invested in this business is ₹ 2,00,000 and normal rate of return of the business is 10%. The remuneration of the partners is estimated to be ₹ 6,000 per annum. Find out the values of Goodwill on the basis of two years purchase of super profits.

34. A firm earns a profit of ₹ 2,00,000. The 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 valuation of Goodwill are ₹ 22,00,000 and ₹ 5,60,000 respectively. Calculate the value of Goodwill according to Capitalisation of Super Profit Method.

35. The capital employed by a firm is 3,00,000. The annual profit of the firm is 60,000 including 9,600 received as compensation. The money could be invested in the bank for 5 years @ 10% p.a. Considering 2% as fair compensation for the risk involved in the firm, compute goodwill of the firm on the basis of capitalization of super profits.

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36. The capital of a firm of Arpit and Prajwal is Rs. 10,00,000. The market rate of return is 15% and the goodwill of the firm has been valued Rs. 1,80,000 at two years purchase of super profits. Find the average profits of the firm.

37. The following information relates to a firm of Yuvraj, Maharaj and Raghuraj :

- (a) Profits for the last four years :

2015	₹ 2,50,000 (Profit)
2016	₹ 2,70,000 (Profit)
2017	₹ 1,80,000 (Loss)
2018	₹ 5,24,000 (Profit)
- (b) Remuneration to each partner ₹ 1,000 p.m.
- (c) Average Capital employed in the business ₹ 8,00,000.
- (d) Normal Rate of Return 15%.
- (e) Assets (excluding goodwill) ₹ 8,75,000; Liabilities ₹ 32,000.

You are required to calculate the value of goodwill:

- (i) At 2 year's purchase of Average Profits.
- (ii) At 3 year's purchase of Super Profits.
- (iii) On the basis of Capitalisation of Super Profits.
- (iv) ON the basis of Capitalisation of Average Profits.

Answers :

Ans24: 4,50,000

Ans25: 1,08,000

Ans26: 90,000

Ans27: 1,62,000

Ans28: 2,43,600

Ans29: 1,18,411

Ans30: 30,000

Ans31: 240,000

Ans32: 55,000

Ans33: 20,000

Ans34: 3,60,000

Ans35: 1,20,000

Ans37: (i) ₹ 3,60,000; (ii) ₹ 1,80,000; (iii) ₹ 4,00,000 (iv) ₹ 3,75,000]

