Subject: Financial Accounting

Class: B.com IV sem

Topic Name: Valuation of Goodwill

For the calculation of goodwill various methods are use which is as follow by the given chart and as per examination all the methods are important:-

1)Average profit Method	Average annual profit = $\frac{\text{Total net profit}}{\text{No. of years}}$ Goodwill = Average Profit x times
2)Super Profit Method Capital employed =Asset Market value-Ex.liabilities	1 Average Profit = $\frac{\text{Total net profit}}{\text{No. of years}}$ 2. Normal Profit = Capital employed x rate of Return 3.Super Profit = Average Profit -Normal Profit 4. Goodwill = Super profit x times
3)Annuity Method	1 Average Profit = $\frac{\text{Total net profit}}{\text{No. of years}}$ 2. Normal Profit = Capital employed x rate of Return 3.Super Profit = Average Profit -Normal Profit 4. Goodwill = Super profit x annuity rate
4)Capitalisation Method (By average Profit)	1 Average Profit = $\frac{\text{Total net profit}}{\text{No. of years}}$ 2. Capitalisation = or $\frac{\text{Average Profit}}{\text{Normal Rate}}$ x100 3. Goodwill = Capitalised Value – Capital employed
4)Capitalisation Method (By super profit)	1 Average Profit = $\frac{\text{Total net profit}}{\text{No. of years}}$ 2. Normal Profit = Capital employed x rate of Return 3.Super Profit = Average Profit -Normal Profit 4. Goodwill = $\frac{\text{Super Profit}}{\text{Normal Rate}}$ x 100

Q1. From the following Balance Sheet of ABC Co. Ltd. as on 31-3-2000 estimate the value of goodwill:-

Balance Sheet

Liabilities	`	**Assets**	`
50,000 Equity shares of `10 each	5,00,000	Building	2,50,000
		Machinery	2,00,000
6% Debenturs of ` 500 each	50,000	Accounts receivable	60,000
Creditors	75,000	Stocks in Trade	90,000
Provision for taxes	35,000	Furniture	25,000
Dividend declared	50,000	Cash	75,000
P & L account	90,000	Bank	1,00,000
	8,00,000		**8,00,000**

Following value of assets is estimated:-

Building	3,00,000
Stock	80,000
Furniture	30,000
Machinery	1,70,000

Goodwill is to be assessed 2 times on the basis of average super profit of last five years. Reasonable rate of returns on Capital invested in business is 12%.

Profits for the last five years are as follows:-

	`
Year ended 31-3-2009	1,08,000
Year ended 31-3-2008	1,15,000
Year ended 31-3-2007	1,17,000
Year ended 31-3-2006	1,03,000
Year ended 31-3-2005	77,000

Ans. Calculation of Goodwill by average super profit Method

(1) Average Profit = Total Profit/ No. of Years

=1,08,000+1,15,000+1,17,000+1,03,000+77,000=5,20,000/5

$$= \frac{5,20,000}{5}$$

=1,04,000

(2) Normal Profit = Average Capital employed x Normal Rate

Average Capital employed= Assets at Market Rate

Building	3,00,000
Machinery	1,70,000
Stock	80,000
Debtors	60,000
Furniture	30,000
Cash	75,000
Bank	1,00,000
Total	**8,15,000**

(-) Less External Liabilities=

Debentures	50,000
Creditors	75,000
Provision for Tax	35,000
Total	**1,60,000**
Capital Employed	**6,55,000**

=6,55,000 x 12% =78,600

(3) Super Profit = F.M.P. – Normal Profit =1,04,000 – 78,600

= 25,400

(4)Goodwill =Super Profit x times

= 25,400 x 2

=` 50,800

Q2. The following particulars are available in respect of the business carried on by a trader:-

1)Profit earned for the year:

2010- ` 50,000

2011- ` 60,000

2012- ` 55,000

2) Normal rate of Profit- 10%

3) Capital employed- ` 3,00,000

4)Present value of Annuity of one `for five year at 10% ` 3.78

5) The profit for the year 2011 includes a non recurring profit of ` 9,000

You are required to calculate goodwill as per

(a) five years purchase of super profit
(b) Capitalisation of super profit
(c) Annuity method

Ans :-Average Profit = Total Profit/ No. of Years

2000 = 50,000

2001 51,000 (60,000-9,000)

2002 55,000

=1,56,000

= 1,56,000/3

=52,000

(2) Normal Profit = Capital employed x Rate

3,00,000 x 10%

=30,000

(3) Super Profit = Average Profit – Normal Profit

= 52,000 – 30,000

= 22,000

(a)Goodwill by Super Profit method = Super profit x No. of Years

= 22,000 x 5 =1,10,000

(b)Goodwill by Capitalization method $= \frac{\text{Super profit}}{\text{Rate}} \times 100$

$= \frac{22{,}000}{10} \times 100 = 2{,}20{,}000$

Goodwill by Annuity method =Super profit x Annuity rate

=22,000 X 3.78

= 83,160