

$$\begin{aligned} \text{Goodwill} &= \text{Super Profit} \times \text{Number} \\ &= ₹ 50,000 \times 2 = ₹ 1,00,000. \end{aligned}$$

Illustration 25. From the following information, calculate value of goodwill of M/s. Sharma and Gupta:

- (i) At three years' purchase of Average Profit.
- (ii) At three years' purchase of Super Profit.
- (iii) On the basis of Capitalisation of Super Profit.
- (iv) On the basis of Capitalisation of Average Profit.

Information:

- (a) Average Capital Employed — ₹ 10,00,000.
- (b) Net Profit/Loss of the firm for the past years: 2015—₹ 1,60,000 (Profit); 2016—₹ 1,40,000 (Profit); 2017—₹ 2,70,000 (Profit).
- (c) Normal Rate of Return on capital is 11%.
- (d) Remuneration to each partner for his service to be treated as a charge on profit—₹ 2,500 per month.
- (e) Assets (excluding goodwill)—₹ 11,00,000; Liabilities—₹ 1,00,000.

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Illustration 6 (Calculation of Opening Capital).

A and B are partners in a business and their capitals at the end of the year were ₹ 7,00,000 and ₹ 6,00,000 respectively. Calculate their opening capitals considering the following information:

- Drawings of A and B for the year were ₹ 75,000 and ₹ 50,000 respectively.
- B introduced capital of ₹ 1,00,000 during the year.
- Interest on drawings debited to the Capital Accounts of A and B were ₹ 7,500 and ₹ 5,000 respectively.
- Share of loss debited to each Partner's Capital Account was ₹ 20,000.

Solution:

CALCULATION OF OPENING CAPITAL

| Particulars | A ₹ | B ₹ |
|---|----------|----------|
| Capitals at the end | 7,00,000 | 6,00,000 |
| Add: Drawings during the year | 75,000 | 50,000 |
| Interest on Drawings | 7,500 | 5,000 |
| Share of Loss for the year | 20,000 | 20,000 |
| | 8,02,500 | 6,75,000 |
| Less: Capital Introduced during the year | — | 1,00,000 |
| Opening Capitals or Capitals in the beginning | 8,02,500 | 5,75,000 |

Alternatively, Capital Account of each partner may be prepared to determine Opening Capitals as follows:

| PARTNERS' CAPITAL ACCOUNTS | | | | | |
|---|----------|----------|---------------------------|----------|----------|
| Dr. | A | B | Particulars | A | B |
| | ₹ | ₹ | | ₹ | ₹ |
| To Drawings A/c | 75,000 | 50,000 | By Balance b/d | 8,02,500 | 5,75,000 |
| To Interest on Drawings A/c | 7,500 | 5,000 | (Balancing Figure) | | |
| To Profit and Loss A/c (Share of Loss) | 20,000 | 20,000 | By Cash/Bank A/c | — | 1,00,000 |
| To Balance c/d (Given) | 7,00,000 | 6,00,000 | (Add. Capital Introduced) | | |
| | 8,02,500 | 6,75,000 | | 8,02,500 | 6,75,000 |

X and Y are partners sharing profits and losses in the ratio of 3 : 2. They admit Z into partnership for $\frac{1}{4}$ th share in goodwill. Z brings in his 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:

2016 – Profit ₹ 50,000 (including profit on sale of assets ₹5,000).

2017 – Loss ₹ 20,000 (includes loss by fire ₹ 30,000).

2018 – Profit ₹ 70,000 (including insurance claim received ₹ 18,000 and interest on investments and Dividend received ₹ 8,000).

Calculate value of goodwill. Also,

A partnership firm earned net profits during the last three years ended 31st March, as follows: 2016 – ₹ 17,000; 2017 – ₹ 20,000; 2018 – ₹ 23,000.

The 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.

A partnership firm earned net profits during the past three years as follows:

| Year ended | 31st March, 2018 | 31st March, 2017 | 31st March, 2016 |
|----------------|------------------|------------------|------------------|
| Net Profit (₹) | 2,30,000 | 2,00,000 | 1,70,000 |

Capital investment in the firm throughout the above-mentioned period has been ₹ 4,00,000. Having regard to the risk involved, 15% is considered to be a fair return on the capital. The remuneration of the partners during this period is estimated to be ₹ 1,00,000 p.a. Calculate value of goodwill on the basis of two years purchase of average super profit earned during the above-mentioned three years.

(iii) To cover management cost, an annual charge of ₹ 24,000 should be made for the purpose of goodwill valuation.

(iv) In 2015-16, a machine having a book value of ₹ 10,000 was sold for ₹ 11,000 but the proceeds were wrongly credited to Profit and Loss Account. No effect has been given to rectify the same. Depreciation is charged on machine @ 10% p.a. on reducing balance method.

Average profit of the firm is ₹ 1,50,000. Total tangible assets in the firm are ₹ 14,00,000 and outside liabilities are ₹ 4,00,000. In the same type of business, the normal rate of return is 10% of the capital employed.

Calculate value of goodwill by Capitalisation of Super Profit Method.

Solution:

Capital Employed = Total Tangible Assets – Outside Liabilities

$$= ₹ 14,00,000 - ₹ 4,00,000 = ₹ 10,00,000$$

Normal Profit = Capital Employed × Normal Rate of Return/100

$$= ₹ 10,00,000 \times \frac{10}{100} = ₹ 1,00,000$$

Super Profit = Average Profit – Normal Profit

$$= ₹ 1,50,000 - ₹ 1,00,000 = ₹ 50,000$$

Goodwill = $\frac{\text{Super Profit} \times 100}{\text{Normal Rate of Return}}$

$$= \frac{₹ 50,000 \times 100}{10} = ₹ 5,00,000.$$

10. Average net profit expected in future by G. Lal and Co. is ₹ 30,000 per year. Average capital employed in the business by the firm is ₹ 2,00,000. Normal rate of return on capital employed in a similar business is 10%. Calculate goodwill of the firm by:

- (i) Super Profit Method on the basis of two years' purchase; and
- (ii) Capitalisation of Super Profit Method.

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- (ii) Capitalisation of Super Profit Method.