Illustration 1 (*Weighted Average Profit Method when Past Adjustments are Made*).

Sahil and Anupam are partners sharing profits in the ratio of 3 : 2. They admit Amit into partnership. It was agreed to value goodwill at three years' purchase on the basis of Weighted Average Profit of the past five years. Weights being assigned to each year were:

31st March, 2019–1, 31st March, 2020–2, 31st March, 2021–3, 31st March, 2022–4 and 31st March, 2023–5.

The profits for these five years were:

Year Ended	Profits (₹)
31st March, 2019	1,80,000;
31st March, 2020	1,60,000;
31st March, 2021	2,50,000;
31st March, 2022	3,00,000;
31st March, 2023	3,50,000.

Scrutiny of books of account revealed that:

1. An abnormal gain of ₹ 20,000 was earned in the year ended 31st March, 2020.
2. An abnormal loss of ₹ 10,000 was incurred in the year ended 31st March, 2021.
3. Expense of ₹ 50,000 incurred to overhaul a machine on 1st April, 2021 was debited to Profit & Loss Account instead of being debited to Machinery Account. Depreciation is charged on Machinery @ 20% on Written Down Value Method.
4. Closing Stock as on 31st March, 2022 was undervalued by ₹ 20,000.

Calculate value of goodwill.

Solution:

CALCULATION OF NORMAL (ADJUSTED) PROFIT

Year Ended	Profit (₹)	Adjustment (₹)	Normal Profit (₹)
31st March, 2019	1,80,000	...	1,80,000
31st March, 2020	1,60,000	(20,000)	1,40,000
31st March, 2021	2,50,000	10,000	2,60,000
31st March, 2022	3,00,000	60,000*	3,60,000
31st March, 2023	3,50,000	(28,000)**	3,22,000

CALCULATION OF WEIGHTED PROFIT

Year Ended	Normal Profit (₹)	Weights	Weighted Profit (₹)
31st March, 2019	1,80,000	1	1,80,000
31st March, 2020	1,40,000	2	2,80,000
31st March, 2021	2,60,000	3	7,80,000
31st March, 2022	3,60,000	4	14,40,000
31st March, 2023	3,22,000	5	16,10,000
		15	42,90,000

$$\text{Weighted Average Profit} = \frac{\text{Total of Weighted Profit}}{\text{Total of Weights}} = \frac{₹\ 42,90,000}{15} = ₹\ 2,86,000$$

$$\text{Value of Goodwill} = \text{Weighted Average Profit} \times \text{Number of Years' Purchase}$$
$$= ₹\ 2,86,000 \times 3 = ₹\ 8,58,000.$$

**Calculation of Adjustment to profit for the year ended 31st March, 2022:*

	₹
1. Capital expenditure (Overhaul of Machinery) Wrongly debited to Profit & Loss Account to be added to profit for the year	50,000
2. Closing stock being undervalued reduced the profit by that much amount. Hence, to be added to profit for the year	20,000
	70,000
3. *Less:* Depreciation @ 20% on ₹ 50,000, being depreciation on ₹ 50,000	10,000
	60,000

***Calculation of Adjustment to Profit for the year ended 31st March, 2023:*

	₹
1. Depreciation on Machinery @ 20% of ₹ 40,000 (₹ 50,000 – ₹ 10,000, depreciation for the year ended 31st March, 2022). Profit will be reduced by ₹ 8,000.	(8,000)
2. Closing Stock as at 31st March, 2022 was undervalued by ₹ 20,000. Closing Stock of previous year becomes Opening Stock of next year. It means Opening Stock was carried to next year by ₹ 20,000 less. Thus, profit for the year ended 31st March, 2023 is higher by ₹ 20,000. Hence, profit will be reduced by ₹ 20,000.	(20,000)
	(28,000)

Illustration 2 (*Weighted Average Profit Method when Past Adjustments are Made*).

Calculate goodwill of the firm on the basis of three years' purchase of the weighted average profit of the last four years. Profits of these four years ended 31st March, were:

Year Ended	31st March, 2020	31st March, 2021	31st March, 2022	31st March, 2023
Profits (₹)	40,400	49,600	40,000	60,000

The weights assigned to each year ended 31st March, are: 2020—1; 2021—2; 2022—3 and 2023—4.

You are provided with the following additional information:

(i) On 31st March, 2022, a major plant repair was undertaken for ₹ 12,000 which was charged to revenue. The said sum is to be capitalised for goodwill calculation subject to adjustment of depreciation of 10% p.a. on Reducing Balance Method.

(ii) The Closing Stock for the year ended 31st March, 2021 was overvalued by ₹ 4,800.

(iii) To cover management cost an annual charge of ₹ 9,600 should be made for the purpose of goodwill valuation.

Solution:

CALCULATION OF ADJUSTED PROFIT

Particulars	31st March, 2020 (₹)	31st March, 2021 (₹)	31st March, 2022 (₹)	31st March, 2023 (₹)
Given Profits	40,400	49,600	40,000	60,000
Less: Annual Management Cost	9,600	9,600	9,600	9,600
	30,800	40,000	30,400	50,400
Add: Capital Expenditure on Plant	...	...	12,000	...
	30,800	40,000	42,400	50,400
Less: Unprovided Depreciation on Plant	...	...	...	1,200
	30,800	40,000	42,400	49,200
Less: Overvaluation of Closing Stock	...	4,800	...	...
	30,800	35,200	42,400	49,200
Add: Overvaluation of Opening Stock	...	...	4,800	...
Adjusted Profits	30,800	35,200	47,200	49,200

CALCULATION OF WEIGHTED PROFIT

Year Ended	Profits (₹)	Weights	Weighted Profit (₹)
31st March, 2020	30,800	1	30,800
31st March, 2021	35,200	2	70,400
31st March, 2022	47,200	3	1,41,600
31st March, 2023	49,200	4	1,96,800
Total		10	4,39,600

$$\text{Weighted Average Profit} = \frac{\text{Total of Weighted Profit}}{\text{Total of Weights}} = \frac{₹\ 4,39,600}{10} = ₹\ 43,960$$

$$\text{Goodwill} = \text{Weighted Average Profit} \times \text{Number of Years' Purchase}$$
$$= ₹\ 43,960 \times 3 = ₹\ 1,31,880.$$

Working Notes:

1. Depreciation on Plant for the year ended 31st March, 2022 is Nil as the major repairs were carried out on 31st March, 2022 itself.
2. Depreciation on Plant for the year ended 31st March, 2023 = 10% of ₹ 12,000 = ₹ 1,200.
3. Closing Stock of the year ended 31st March, 2021 will become Opening Stock of the year ended 31st March, 2022.

Illustration 3 (*Capital Employed and Valuation of Goodwill When Trade Investments are given*).

Balance Sheet of Grand Sales as at 31st March, 2023 was as follows:

Liabilities		₹	Assets	₹
Capital A/cs:			Furniture	1,00,000
Kanchan	2,50,000		Computers	3,00,000
Karuna	2,50,000	5,00,000	Investments (Trade)	1,50,000
Sundry Creditors		2,50,000	Stock	1,50,000
Bills Payable		50,000	Sundry Debtors	2,00,000
Bank Overdraft		2,00,000	Bills Receivable	20,000
			Cash in Hand	80,000
		10,00,000		10,00,000

Average profit of the firm for the year was ₹ 1,75,000. Calculate the value of goodwill of the firm by Super Profit Method at 2 years' purchase of Super Profit, if the Normal Rate of Return is 20%.

Solution:

(i) **Capital Employed by Liabilities Side Approach:**

Partners' Capitals:	₹	₹
Kanchan	2,50,000	
Karuna	2,50,000	5,00,000

(ii) **Capital Employed by Assets Side Approach:**	₹	₹
Total Assets		10,00,000
Less: Sundry Creditors	2,50,000	
Bills Payable	50,000	
Bank Overdraft	2,00,000	5,00,000
		5,00,000

Normal Profit = 20% of ₹ 5,00,000 = ₹ 1,00,000

Super Profit = Average Profit – Normal Profit

= ₹ 1,75,000 – ₹ 1,00,000 = ₹ 75,000

Value of Goodwill = Super Profit × No. of Years' Purchase = 2 × ₹ 75,000 = ₹ 1,50,000.

Illustration 4 (*Capital Employed and Valuation of Goodwill When Non-trade Investments are given*). Balance Sheet of M/s Super Stores as at 31st March, 2023 was as follows:

Liabilities		₹	Assets	₹
Capital A/cs:			Land and Building	4,00,000
Alia	1,50,000		Computers	70,000
Ranbir	1,50,000		Furniture	30,000
Rishi	1,50,000	4,50,000	Investments	1,00,000
Reserves		2,50,000	Stock	2,00,000
Sundry Creditors		3,00,000	Sundry Debtors	1,50,000
Outstanding Expenses		10,000	Bills Receivable	50,000
Bank Overdraft (Cash Credit)		90,000	Cash in Hand	50,000
			Deferred Revenue Expenditure:	
			Advertisement Suspense	50,000
		11,00,000		11,00,000

Average Profit was ₹ 1,25,000. You are to calculate goodwill at 3 years' purchase of Super Profits, if the Normal Rate of Return is 15% of Capital Employed.

(i) **Capital Employed by Liabilities Side Approach:**	₹	₹
Partners' Capitals:		
Alia	1,50,000	
Ranbir	1,50,000	
Rishi	1,50,000	4,50,000
Add: Reserves		2,50,000
		7,00,000
Less: Investments (Note)	1,00,000	
Deferred Revenue Expenditure (Advertisement Suspense)	50,000	1,50,000
Capital Employed		5,50,000

(ii) **Capital Employed by Assets Side Approach:**	₹	₹
Total Assets		11,00,000
Less: Investments (Note)	1,00,000	
Deferred Revenue Expenditure (Advertisement Suspense)	50,000	1,50,000
		9,50,000
Less: Current Liabilities:		
Sundry Creditors	3,00,000	
Outstanding Expenses	10,000	
Bank Overdraft (Cash credit)	90,000	4,00,000
Capital Employed		5,50,000

Normal Profit = 15% of ₹ 5,50,000 = ₹ 82,500

Average Profit = ₹ 1,25,000

Super Profit = ₹ 1,25,000 – ₹ 82,500 = ₹ 42,500

Goodwill = No. of Years' Purchase × Super Profit

= 3 × ₹ 42,500 = ₹ 1,27,500.

Note: Unless investments are specified to be trade investments, they are considered to be Non-trade Investments. They are, therefore, deducted to calculate Capital Employed.

Illustration 5.

From the following Balance Sheet of Vinod Enterprises as at 31st March, 2023, calculate the value of goodwill by capitalisation of Super Profits, if the normal rate of return is 20% of the Capital Employed and Average Profit is ₹ 1,50,000:

Liabilities		₹	Assets	₹
Capital A/cs:			Computers	1,50,000
Vinod	2,00,000		Furniture	50,000
Vimal	3,00,000	5,00,000	Goodwill	1,50,000
Reserves		3,00,000	Investments	2,00,000
Bank Overdraft		2,00,000	Sundry Debtors	5,00,000
Sundry Creditors		3,00,000	Stock	2,50,000
Outstanding Expenses		50,000	Cash in Hand	50,000
		13,50,000		13,50,000

Solution:

(i) **Capital Employed (Liabilities Side Approach):**	₹	₹
Capital A/cs:		
Vinod	2,00,000	
Vimal	3,00,000	5,00,000
Add: Reserves		3,00,000
		8,00,000
Less: Investments being Non-trade Investments	2,00,000	
Goodwill	1,50,000	3,50,000
		4,50,000

(ii) **Capital Employed (Assets Side Approach):**	₹	₹
Total Assets		13,50,000
Less: Investments (Being Non-trade)	2,00,000	
Goodwill	1,50,000	3,50,000
		10,00,000
Less: Bank Overdraft	2,00,000	
Sundry Creditors	3,00,000	
Outstanding Expenses	50,000	5,50,000
		4,50,000

$$\text{Normal Profit} = \frac{\text{Capital Employed} \times \text{Normal Rate of Return}}{100}$$

= ₹ 4,50,000 × 20/100 = ₹ 90,000

Average Profit = ₹ 1,50,000

Super Profit = Average Profit – Normal Profit

= ₹ 1,50,000 – ₹ 90,000 = ₹ 60,000

$$\text{Goodwill} = \frac{\text{Super Profit} \times 100}{\text{Normal Rate of Return}} = \frac{₹\ 60,000 \times 100}{20} = ₹\ 3,00,000.$$

Illustration 6 (*Weighted Average Profit Method when Past Adjustments are Made*).

Ganesh and Mahesh are partners sharing profits equally. They admitted Dinesh into partnership. It was agreed to value goodwill at three years' purchase following Weighted Average Profit Method on the basis of past five years' profits. Weights assigned to each year would be—years ended 31st March, 2019–1, 2020–2, 2021–3, 2022–4 and 2023–5.

Year Ended	31st March, 2019	31st March, 2020	31st March, 2021	31st March, 2022	31st March, 2023
Profits (₹)	90,000	80,000	1,25,000	1,50,000	1,75,000

Scrutiny of books of account revealed the following:

1. There was an abnormal loss of ₹ 15,000 during the year ended 31st March, 2019.
2. There was an abnormal gain of ₹ 10,000 during the year ended 31st March, 2021.
3. Closing Stock as on 31st March, 2022 was overvalued by ₹ 15,000.

Calculate value of goodwill.

Solution:

CALCULATION OF NORMAL PROFIT

Year Ended	Profit (₹)	Adjustment (₹)	Normal Profit (₹)
31st March, 2019	90,000	15,000	1,05,000
31st March, 2020	80,000	...	80,000
31st March, 2021	1,25,000	(10,000)	1,15,000
31st March, 2022	1,50,000	(15,000)*	1,35,000
31st March, 2023	1,75,000	15,000*	1,90,000

*Closing Stock being overvalued on 31st March, 2022 means that profit for the year ended 31st March, 2022 is shown at higher amount. It has effect on the profit for the next year, *i.e.*, Profit for the year ended 31st March, 2023 is shown at lower amount as Closing Stock of previous year is carried forward as Opening Stock of next year.

CALCULATION OF WEIGHTED PROFIT

Year Ended	Profit (₹)	Weights	Weighted Profit (₹)
31st March, 2019	1,05,000	1	1,05,000
31st March, 2020	80,000	2	1,60,000
31st March, 2021	1,15,000	3	3,45,000
31st March, 2022	1,35,000	4	5,40,000
31st March, 2023	1,90,000	5	9,50,000
		15	21,00,000

$$\text{Weighted Average Profit} = \frac{\text{Total of Weighted Profit}}{\text{Total of Weights}} = \frac{₹\ 21,00,000}{15} = ₹\ 1,40,000$$

∴ Value of Goodwill = Weighted Average Profit × Number of Years' Purchase

= ₹ 1,40,000 × 3 = ₹ 4,20,000.

Illustration 7.

J and *K* are partners in a firm. Their capitals are: *J* ₹ 3,00,000 and *K* ₹ 2,00,000. During the year ended 31st March, 2010 the firm earned a profit of ₹ 1,50,000. Assuming that the normal rate of return is 20%, calculate the value of goodwill of the firm:

(i) By Capitalisation Method; and

(ii) By Super Profit Method if the goodwill is valued at 2 years' purchase of super profit.

(*Foreign 2011*)

Solution:

(i) *Capitalisation Method:*

Total Capitalised Value of the Firm

$$= \frac{\text{Average Profit} \times 100}{\text{Normal Rate of Return}} = \frac{₹\ 1,50,000 \times 100}{20} = ₹\ 7,50,000$$

Goodwill = Total Capitalised Value of Business – Capital Employed

= ₹ 7,50,000 – ₹ 5,00,000* = ₹ 2,50,000.

*Capital Employed = Capitals of *J* and *K* = ₹ 3,00,000 + ₹ 2,00,000 = ₹ 5,00,000.

(ii) *Super Business Profit Method:*

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

= ₹ 5,00,000 × 20/100 = ₹ 1,00,000

Average Business Profit = ₹ 1,50,000

Super Profit = Average Profit – Normal Business Profit

= ₹ 1,50,000 – ₹ 1,00,000 = ₹ 50,000

Goodwill = Super Business Profit × Number of Years' Purchase

= ₹ 50,000 × 2 = ₹ 1,00,000.

Illustration 8 (*Calculation of Normal Rate of Return*).

M/s Hi-Tech India has assets of ₹ 5,00,000 whereas liabilities are: Partners' Capitals—₹ 3,50,000, General Reserve—₹ 60,000 and Sundry Creditors—₹ 90,000. If normal rate of return is 10% and goodwill of the firm is valued at ₹ 90,000 at 2 years' purchase of super profit, find average profit of the firm.

Solution:

Goodwill = Super Profit × Number of Years' Purchase

₹ 90,000 = Super Profit × 2

$$\therefore \quad \text{Super Profit} = \frac{₹\ 90,000}{2} = ₹\ 45,000$$

Capital Employed = Assets – Outside Liabilities (Creditors)

= ₹ 5,00,000 – ₹ 90,000 = ₹ 4,10,000

Or

= Partners' Capitals + General Reserve

= ₹ 3,50,000 + ₹ 60,000 = ₹ 4,10,000

Normal Rate of Return = 10%

$$\therefore \quad \text{Normal Profit} = ₹\ 4,10,000 \times \frac{10}{100} = ₹\ 41,000$$

Super Profit = Average Profit – Normal Profit

Average Profit = Super Profit + Normal Profit

= ₹ 45,000 + ₹ 41,000 = ₹ 86,000.

Illustration 9.

Annu, Baby and Chetan are partners in a firm sharing profits and losses equally. They take Deep into partnership from 1st April, 2024 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, 2024	2,88,000;
31st March, 2023	1,81,800;
31st March, 2022	1,87,200;
31st March, 2021	2,53,200.

Calculate the value of goodwill.

Solution:

Year Ended	Profit (₹)
31st March, 2024	2,88,000
31st March, 2023	1,81,800
31st March, 2022	1,87,200
31st March, 2021	2,53,200

Average Business Profit for 4 years = $\frac{₹\ 9,10,200}{4}$ = ₹ 2,27,550

Average business profit of last three years = $\frac{₹\ 6,57,000}{3}$ = ₹ 2,19,000

Average business profit of four years is more than average business profit of three years.

Goodwill = ₹ 2,27,550.

Illustration 10.

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:

2022—Profit ₹ 50,000 (including profit on sale of assets ₹ 5,000).

2023—Loss ₹ 20,000 (including loss by fire ₹ 30,000).

2024—Profit ₹ 70,000 (including insurance claim received ₹ 18,000 and interest on investments and Dividend received ₹ 8,000).

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

Solution:

	₹
Normal Business Profit for the Year ended 31st March, 2022 (₹ 50,000 – ₹ 5,000)	45,000
Normal Business Profit for the Year ended 31st March, 2023 (₹ 30,000 – ₹ 20,000)	10,000
Normal Business Profit for the Year ended 31st March, 2024 (₹ 70,000 – ₹ 18,000 – ₹ 8,000)	44,000
Total Profit for 3 years	**99,000**

Average Business Profit = ₹ 99,000 × 1/3 = ₹ 33,000

∴ Goodwill = Average Business Profit × Number of Years' Purchase

= ₹ 33,000 × 2 = ₹ 66,000.

Kanika should bring goodwill for 1/4th share = ₹ 66,000 × 1/4 = ₹ 16,500.

Illustration 11.

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

(ii) Capitalisation of Super Profit Method.

Solution:

(i) Average Business Profit= ₹ 50,000

Normal Business Profit = ₹ 3,00,000 × $\frac{10}{100}$ = ₹ 30,000

Super Profit = Average Business Profit – Normal Business Profit

= ₹ 50,000 – ₹ 30,000 = ₹ 20,000

Goodwill = Super Profit × Number of Years' Purchase

= ₹ 20,000 × 3 = ₹ 60,000.

(ii) Goodwill = $\frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$ = ₹ 20,000 × $\frac{100}{10}$ = ₹ 2,00,000.

Illustration 12.

Total Capital of the firm of Sakshi 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*)

Solution: Average Business Profit = $\frac{₹\ 1,08,000}{3}$ = ₹ 36,000

Normal Business Profit = ₹ 1,00,000 × 15/100 = ₹ 15,000

Super Profit = Average Business Profit – Normal Business Profit
= ₹ 36,000 – ₹ 15,000 = ₹ 21,000

Goodwill = Super Profit × Number of Years' Purchase
= ₹ 21,000 × 2 = ₹ 42,000.

Illustration 13.

A business has earned average profit of ₹ 1,00,000 during the last few years and the normal rate of return in similar business is 10%. Find out the 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 ₹ 10,00,000 and its external liabilities ₹ 1,80,000. (*Delhi 2011*)

Solution:

(i) *As per Capitalisation of Super Profit Method:*

$$\text{Goodwill} = \frac{\text{Super Profit} \times 100}{\text{Normal Rate of Return}} = \frac{₹\ 18,000 \times 100}{10} = ₹\ 1,80,000.$$

(ii) *As per Super Profit Method:*

Goodwill = Super Profit × Number of Years' Purchase
= ₹ 18,000 × 3 = ₹ 54,000.

Working Notes:

1. Capital Employed = Assets – External Liabilities
= ₹ 10,00,000 – ₹ 1,80,000 = ₹ 8,20,000.

2. Normal Business Profit = Capital Employed × $\frac{\text{Normal Rate of Return}}{100}$ = ₹ 8,20,000 × $\frac{10}{100}$ = ₹ 82,000.

3. Super Profit = Average Business Profit – Normal Business Profit
= ₹ 1,00,000 – ₹ 82,000 = ₹ 18,000.

Illustration 14.

Madhu and Vidhi are partners sharing profits in the ratio of 3 : 2. They decided to admit Manu as partner from 1st April, 2025 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:

2025—Profit ₹ 30,000 (after debiting loss of stock by fire ₹ 40,000).

2024—Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

2023—Profit ₹ 1,10,000 (including a gain (profit) of ₹ 30,000 on the sale of fixed assets).

Calculate the value of goodwill.

Solution:

Normal Business Profits of the Previous three years:

CALCULATION OF NORMAL BUSINESS PROFIT

Year Ended	Profit/(Loss) (₹)	Adjustment (₹)	Normal Business Profit (₹)
31st March, 2024	30,000	40,000 (Abnormal Loss)	70,000
31st March, 2023	(80,000)	1,10,000 (Abnormal Expenses)	30,000
31st March, 2022	1,10,000	(30,000) (Abnormal Gain)	80,000

Total Normal Business Profit for last 3 years = ₹ 70,000 + ₹ 30,000 + ₹ 80,000 = ₹ 1,80,000

$$\text{Average Business Profit} = \frac{₹\ 1,80,000}{3} = ₹\ 60,000$$

∴ Goodwill = Average Business Profit × Number of Years' Purchase

= ₹ 60,000 × 2 = ₹ 1,20,000.

Illustration 15.

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*)

Solution:

$$\text{Net Assets or Capital Employed} = \text{Total Assets} - \text{Liabilities}$$
$$= ₹\ 22,00,000 - ₹\ 5,60,000 = ₹\ 16,40,000$$
$$\text{Normal Business Profit} = ₹\ 16,40,000 \times \frac{10}{100} = ₹\ 1,64,000$$
$$\text{Super Profit} = \text{Average Business Profit} - \text{Normal Business Profit}$$
$$= ₹\ 8,00,000 - ₹\ 1,64,000 = ₹\ 6,36,000$$
$$\text{Goodwill} = \text{Super Profit} \times \text{Number of Years' Purchase}$$
$$= ₹\ 6,36,000 \times 5/2 = ₹\ 15,90,000.$$

Illustration 16 (*Super Profit Method when Adjustments are Made*).

Alok and Aakash are partners in M/s Mega Enterprises. They admit Ashish as partner *w.e.f.* 1st April, 2025. They agreed to value goodwill at 3 years' purchase by Super Profit Method for which they decided to take average of last 5 years profits. Profits for the last five years were:

Year ended	₹	
31st March, 2021	2,00,000	(Including gain of ₹ 25,000 from sale of fixed asset);
31st March, 2022	1,70,000	(Including abnormal loss of ₹ 50,000);
31st March, 2023	2,10,000;	
31st March, 2024	2,30,000;	
31st March, 2025	2,50,000.	

Capital employed in the firm is ₹ 15,00,000 and normal rate of return in similar business is 10%. Calculate value of goodwill.

Solution:

1. CALCULATION OF ACTUAL NORMAL BUSINESS PROFIT

Year Ended	Profit (₹)	Adjustment (₹)	Normal Business Profit (₹)
31st March, 2021	2,00,000	(25,000)	1,75,000
31st March, 2022	1,70,000	50,000	2,20,000
31st March, 2023	2,10,000	...	2,10,000
31st March, 2024	2,30,000	...	2,30,000
31st March, 2025	2,50,000	...	2,50,000
			10,85,000

$$\text{Average Business Profit} = \frac{\text{Total Normal Business Profit}}{\text{Number of Years}} = \frac{₹\,10,85,000}{5} = ₹\,2,17,000.$$

2. *Calculation of Normal Business Profit:*

Capital Employed = ₹ 15,00,000

Normal Rate of Return = 10%

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

∴ = ₹ 15,00,000 × 10/100 = ₹ 1,50,000.

3. *Calculation of Super Profit:*

Super Business Profit = Actual Average Business Profit – Normal Business Profit

= ₹ 2,17,000 – ₹ 1,50,000 = ₹ 67,000.

4. *Value of Goodwill:*

Goodwill = Super Profit × Number of Years' Purchase

= ₹ 67,000 × 3 = ₹ 2,01,000.

Note: Abnormal gain on sale of land will be deducted from profit to determine normal profits. Abnormal loss will be added in profit to determine normal profit.