VALUATION OF GOODWILL

Meaning of Goodwill — It is said that it is very difficult to define but very easy to clarify the word goodwill. Any person, place or anything have their goodwill in the form of reputation, popularity and honesty. But in commercial term, goodwill is an intangible fixed asset which can not be seen but can be realised on the basis of earning capacity of profit in the business. It is the benefit and advanges of a goodname, popularity and reputation concerning any business/enterprise resulting from quality production, punctuality, social responsibility, harmonious relationship with the workers, dealers and customers integrity and honesty.

Goodwill reflects the monetrial value of business. Goodwill can be converted into cash at the time of sale of business to another concern or at the time of dissolution of firm. Goodwill reveals the level of profits of any enterprise, that business, at what level, is earning profit as average or normal or superprofit. It is said that any business enterprise that earns normal profit or incurring losses has no goodwill. Therefore average profit shows better than the normal profit and super profit proves the best level of goodwill..

NATURE OF Goodwill — Four natures of goodwill.

(I) Goodwill of Cat's nature
(II) Goodwill of Dog's nature
(III) Goodwill of Rat's nature
(IV) Goodwill of Strange nature

(I) Cat's nature Goodwill — (Stable goodwill) The value of this type of goodwill is very high.

(II) Dog's nature Goodwill — (Faithful goodwill) - Its value is very less. because goodwill goes away with the owner,

(III) Rat's nature Goodwill — (Running goodwill) — This type of goodwill does not has any value or has a little value.

(IV) Strange natured goodwill :- (Conditional goodwill) - This type of goodwill depends upon customer's brain.

Factors Affecting The Value of Goodwill - Following factors affect the Value of goodwill -

(1) Place of Business (2) Nature of Business (3) Risk of Business (4) Uncertainty of Business (5) Monopolistic Business (6) Management of Business (7) Personality of Businessmen (8) Volume of Capital (9) Popularity of Trademark (10) Volume of Profit (11) other Factors - (i) Effective advertising policy (ii) Quality of products (iii) customers Service (v) Government Policy (vi) Industrial relation (vii) Political Environment (ix) Principles of development. etc.

CASES FOR VALUATION OF GOODWILL

(A) **In case of Sole Proprietorship** - (I) on Sale of business (II) To convert the sole business into partnership firm (III) On Amalgamation of business with any other business (IV) on aquirement (take-over) of business by the government.

(B) **In case of Partnership Firm:** - (I) on admission of a new partner (II) on retirement of a partner (III) On conversion of partneship firm into a company (IV) On Amalgamation of partnership firms (V) on change of profit & loss sharing ratio of partners.

(C) **In case of Company:** - (I) Amalgamation of two or more companies (II) on purchase of shares of a subsidiary company by a holding company (III) on compulsory take-over of a company by government (IV) on valuation of shares of company (V) on purchase of a company by another company.

Accounting Characterstics of Goodwill:

(1) Capital Expenditure - Expenses on goodwill is a type of capital expenditure.

(2) Depreciation – No depreciation charged like other Fixed assets.

(3) Writting-off Goodwill – Goodwill is written off from statement of Profit & loss. Good business-men do not like to show the goodwill in the balance sheet more years.

(4) Profit – The Super profit earnings shows the value of goodwill in a business.

(5) Actual Value of goodwill – Actual value of goodwill is received on sale of business.

(6) Fluctuation in the amount of goodwill – Increase or decrease in the volume of profit shows the fluctuation in the amount of goodwill

METHODS OF VALUATION OF GOODWILL.

I **Average Profit Method**
- (i) Simple Average Profit Method.
- (ii) Weighted Average Profit Method

II **Super Profit Method**.
- (i) Simple Super Profit Method
- (ii) Capitalisation of Super Profit Method
- (iii) Super Profit Annuity Method.

I Average Profit Method.

(1) **Simple Average Profit Method**.

Process:–

(i) Calculation of Adjusted Profits for the years:-

Net Profit/Loss during the year	–	+/-
Add (a) Abnormal loss (already charged to P&L A/c.	–	
Add (b) Normal Income (Not yet credited to P&L A/c	–	+
Less – (a) – Abnormal Gain (already charged to P&L A/c	–	+
(b) – Income from Non-trade investment (already credited to P&L A/c)	–	
(c) – Normal Expenses (Not yet debited to P&L A/c.	–	–
Adjusted Profit		+

(ii) Calculion of Total Adjusted Profit of given years (as TAAP)

(iii) Average of TAAP — $\frac{TAAP}{\text{No. of years}}$ = A.A.P

(iv) Calculation of Goodwill —

G.W = AAP × years of Purchase (P.Y); or

G.W = AAP × P.Y.

Note – (1) If amount of managerial remuneration not given in the question but stated ~~in~~ about this in the question, will be assumed as an appropriate amount.

(2) If years of purchase not given in the question, will be assumed as half of the given No. of years.

Weighted Average Profit Method

Process —

(I) Calculation of Adjusted Profits for the years – than weight should be given as 1, 2, 3 4, 5 ..... for each year's profits. as follows —

Years	Adj. Profits (AP)	W	W×A.P
1	—	1	—
2	—	2	—
3	—	3	—
4	—	4	—
		ΣW =	ΣWAP

(II) Average weighted Profit (AWP) = $\frac{\Sigma WAP}{\Sigma W}$.

(III) Calculation of Goodwill —

G.W = AWP × P.Y.

II SUPER PROFIT METHOD

(1) Simple Super Profit Method —

(2) Capitalisation of Super Profit Method —

(3) Annuity Method (Present Value of Annuity = P.V)

(1) **Simple Super Profit Method** —

Process —

(i) Calculation of Average of Adjusted Profits (A.A.P) — as mentioned in Simple Average Profit Method.

(ii) **Calculation of Average Capital Employed (ACE)** —

Non-current Assets (at present Value) (Excluding goodwill)		—
+ Current Assets (at present Value)		—
less (i) External Fixed Liabilities	—	+
less (ii) Current Liabilities and Provisions.	—	—
Capital Employed		—
less - 50% (½) of current year's Adjusted Profit.		—
ACE = Average Capital Employed.		=

(iii) Calculation of Normal Profit (N.P.) —

N.P = ACE × Normal Rate of Return (N.R.R)

(iv) Super Profit (S.P.) —

S.P. = AAP − N.P.

(V) **Goodwill — G.W = S.P. × P.Y**

(2) **Capitalisation of Super Profit Method** —

$$G.W. = \frac{S.P. \times 100}{N.R.R.}$$

(3) Annuity Method — G.W — (P.V. Method)

(i) If annuity value is more than ₹ 1.00,

G.W = S.P × Annuity Value (P.V.)

(ii) If annuity value is less than ₹ 1.00 :— $G.W = \frac{S.P}{\text{Annuity Value (P.V)}}$