

Centre4knowledge

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XII ACCOUNTANCY

Assignment 4

Topic: Valuation of Goodwill

A firm of A and B earned the following profits during the past four accounting years:

Year	2017-18	2016-17	2015-16	2014-15
Profits/(Loss) (₹)	6,00,000	5,00,000	4,00,000	3,00,000

- Q. 1(a) Calculate simple average profits from the above
- Q. 1(b) Calculate weighted average profit from the above. The weights being 4,3,2 and 1 respectively.
- Q. 1(c) Calculate goodwill on the basis of 5 years purchase of simple average profits.
- Q. 1(d) Calculate goodwill on the basis of 5 years purchase of weighted average profits.
- Q. 1 (e) Analyse the value of goodwill on the basis of the two methods and write the reasons for deviations.
- Q. 2 Why do we add abnormal expenses/losses and deduct abnormal incomes/gains in the actual profits to ascertain the future maintainable profits?
- Q. 3 X purchased the business of A B & Associates (A firm) on 1st April, 2018. It was agreed that the firm's goodwill is to be valued at two years purchase of normal average profits of the last three years. The profits of the firm's business for the last three years were:

2015-16: ` 1,20,000 (A land costing `70,000 was sold at a profit of 25% on cost)

2016-17: ` 1,80,000 (Including dividend received on shares ` 45,000)

2017-18: ` 70,000 (after debiting loss of stock by fire ` 1,30,000)

Due to severe loss of stock during 2017-18, it is decided that the stock must be insured now onwards at an insurance premium of ` 25,000 p.a.

You are required to calculate the value of the firm's goodwill.

Q. 4. A and B are partners sharing profits in the ratio of 3:2. They decided to admit C as a partner from 1st April, 2018 on the following terms:

- i. C 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 profits of the firm.

Profits of the previous three years ended 31st March were:

2017-18: Profit ` 80,000 (stock lost by fire ` 40,000 insurance claim received ` 15,000).

2016-17: Loss ` 2, 40,000 (includes voluntary retirement compensation paid ` 1, 30,000).

2015-16: Profit ` 1, 10,000 (Land costing ` 30,000 was sold at a profit of 100% on cost).

You are required to value of the firm's goodwill and C's share of goodwill.

Q. 5 (a). AB & Associates has the following balance sheet as at 31st March, 2018:

Liabilities	Amount	Assets	Amount
Partners' Capital		Plant and Machinery	2,90,000
A	60,000	Furniture	85,000
B	50,000	Sundry Debtors	75,000
C	80,000	Cash at Bank	80,000
General Reserve	2,60,000	Advertisement Suspense	30,000
Sundry Creditors	70,000		
Bills Payable	40,000		
	5,60,000		5,60,000

The normal rate of return in the industry is 15%. The firm has earned the following profits during the last three years:

2015-16 ` 75,000

2016-17 ` 82,000

2017-18 ` 83,000

You are required to calculate the value of the firm's goodwill on the basis of the 4 years purchase of the Super Profits.

Q. 5 (b). Calculate the value of the firm's goodwill in the above question on the basis of capitalisation of the Average Profits.

Q.5 (c). Calculate the value of the firm's goodwill in the above on the basis of capitalisation of the Super Profits.

Q 5 (d). Calculate the value of goodwill in all the above cases if you are informed that the normal rate of return in the industry is 25% instead of 15%. Write your observation with respect to this change.

Q. 6. Goodwill of a firm is agreed to be calculated at 5 years purchase of the weighted average profits of the past four years. The appropriate weights to be used are:

2013-14: 1; 2014-15: 2; 2015-16: 3; 2016-17: 4.

The profits for these years are: `60,000, `75,000, `85,000 and `90,000 respectively.

On a scrutiny of the accounts, the following matters are revealed:

- i. On 1st October, 2015 a major repair was made in respect of the plant incurring ` 70,000 that was charged to revenue. The paid sum is agreed to be

capitalized for goodwill calculations subject to adjustment of depreciation of 20% p.a. on written down value method.

- ii. The closing stock for the year 2015-16 is undervalued by ₹ 25,000.
- iii. To cover management cost an annual charge of ₹ 25,000 should be made for the purpose of goodwill valuation.

Calculate the value of goodwill.

Q 7 A and B were sharing profits in the ratio of 1:4. They decided to admit C into the partnership for 1/5 share of the future profits. Goodwill, valued at 4 times the average super profits of the firm, was ₹ 36,000. The firm had Assets worth ₹ 15,00,000 and Liabilities ₹ 12,00,000. The normal earning capacity of such firms is expected to be 15% p.a. Find Average Profit/Actual Profit earned by the firm during the last 4 years.

Q. 8 The value total assets (excluding goodwill) and total outsiders' liabilities as on the date of goodwill valuation are ₹ 27,50,000 and ₹ 7,00,000. The normal rate of return in a similar type of business is 10%. The value of goodwill according to Capitalisation of Average Profit is ₹ 4,50,000. Find out actual profit earned by the business.

Q. 9 On April 1, 2017 an existing firm had assets of ₹ 15,00,000 including patents of ₹ 3,00,000 now considered to be of no value. Outside liabilities were ₹ 4,00,000. If the normal rate of return is 15% and goodwill of the firm is valued at ₹ 6,00,000 at 4 years purchase of super profits, find the average profits of the firm.