concept no.6

Capitalisation Method

Under this method, goodwill can be calculated in two ways :

- **Capitalisation of Average Profits Method :** Under this method first of all we calculate the average profits and then we assess the capital needed for earning such average profits on the basis of normal rate of return. Such capital is also called capitalized value of average profits. It is calculated as under :

Capitalized Value of Average Profits = *Average Profit* $\times \frac{100}{Normal\ Rate\ of\ Return}$

Goodwill = *Capitalized Value of Average Profits - Actual Capital Employed*

- **Capitalization of Super Profit Method :** Under this method first of all we calculate the Super Profits and then we assess the capital needed for earning such super profits on the basis of normal rate of return. Such capital is actually the amount of goodwill. Following formula is used to calculate goodwill :

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

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concept no.6

Questions

Q.1). The average profits of a firm is ₹48,000. The total assets of the firm are ₹ 8,00,000. Value of other liabilities is ₹ 5,00,000. Average rate of return in the same business is 12%.Calculate goodwill from capitalization of average profits method.

[Ans. . Value of Goodwill ₹ 1,00,000.]

COMMERCE RAMA

concept no.6

Questions

Q.2.). Anupma, Pumima and Ruchika are partners in a business. Balances in their Capital and Current Accounts as on 31st March, 2023 were :

	(₹)	(₹)
Anupma	6,00,000	60,000 (Dr.)
Pumima	5,00,000	30,000 (Dr.)
Ruchika	5,00,000	10,000 (Cr.)

The firm earned an average profit of ₹2,40,000. If the normal rate of return is 12%, find the value of goodwill by Capitalization of Average Profit Method.

[Ans. Value of Goodwill ₹4,80,000.]

concept no.6

Questions

Q.3.).The following information relates to a partnership firm :

(a) Profits/Losses for the last six years :

1st year	₹20,000 Profit	4th year	₹60,000 Profit
2nd year	₹60,000 Profit	5th year	₹50,000 Profit
3rd year	₹ 10,000 Loss	6th year	₹72,000 Profit

(b) Average Capital Employed is ₹2,00,000.

(c) Rate of normal profit is 15%.

Find out the value of goodwill on the basis of:

(i) Four year's purchase of average profits.

(ii) Four year's purchase of super profits.

(iii) Capitalization of super profits

[Ans. . (i) On the basis of average profits = ₹ 1,68,000

(ii) On the basis of super profits = ₹ 48,000

(iii) On the basis of capitalization of super profits = ₹ 80,000]

COMMERCE RAMA

concept no.6

Questions

Q.4.).Varun and Kuber are partners in a business. Balance in Capital and Current Accounts on 31 st March, 2019

	Capital Account	Current Account
Varun	₹5,00,000	₹80,000
Kuber	₹3,50,000	₹20,000 (Dr.)

(Profits of the last five consecutive years ending 31 st March were : 2019 ₹60,000; 2020 Loss ₹40,000; 2021 ₹ 1,30,000; 2022 ₹2,00,000 and 2023 ₹2,50,000.General Reserve appeared in the books at ₹50,000.
If the normal rate of return is 10%, find the value of goodwill by Capitalisation of Average Profit Method.
[Ans. Value of Goodwill ₹ 2,40,000.]

END OF CONCEPT-6

END OF CHAPTER-2