

VIDYA BHAWAN BALIKA VIDYA PITH

शक्ति उत्थान आश्रम लखीसराय बिहार

class 12 commerce Sub. ACT. Date 27.5.2020

Teacher name – Ajay Kumar Sharma

Reconstitution of a Partnership Firm – Admission of a Partner

Illustration 13

The capital of the firm of Anu and Benu is Rs. 1,00,000 and the market rate of interest is 15%. Annual salary to partners is Rs. 6,000 each. The profits for the last 3 years were Rs. 30,000; Rs. 36,000 and Rs. 42,000. Goodwill is to be valued at 2 years purchase of the last 3 years' average super profits. Calculate the goodwill of the firm.

Solution

$$\begin{aligned} \text{Interest on capital} &= 1,00,000 \times \frac{15}{100} = \text{Rs. } 15,000 \dots\dots\dots \text{₹} \\ \text{Add: partner's salary} &= \text{Rs. } 6,000 \times 2 = \text{Rs. } 12,000 \dots\dots\dots \text{₹} \end{aligned}$$

Admission of a Partner

129

$$\begin{aligned} \text{Normal Profit(i+ii)} &= \text{Rs. } 27,000 \\ \text{Average Profit} &= \text{Rs. } 30,000 + \text{Rs. } 36,000 + \text{Rs. } 42,000 = \text{Rs. } \frac{1,08,000}{3} \\ &= \text{Rs. } 36,000 \\ \text{Super Profit} &= \text{Average Profit} - \text{Normal Profit} \\ &= \text{Rs. } 36,000 - \text{Rs. } 27,000 \\ &= \text{Rs. } 9,000 \\ \text{Goodwill} &= \text{Super Profit} \times \text{No of years' purchase} \\ &= \text{Rs. } 9,000 \times 2 \\ &= \text{Rs. } 18,000 \end{aligned}$$

3.5.4.3 Capitalisation Methods

Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

(a) *Capitalisation of Average Profits:* Under this method, the value of goodwill is ascertained by deducting the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return. This involves the following steps:

- (i) Ascertain the average profits based on the past few years' performance.
- (ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:

$$\frac{\text{Average Profits} \times 100}{\text{Normal Rate of Return}}$$

- (iii) Ascertain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).

$$\text{Capital Employed} = \text{Total Assets (excluding goodwill)} - \text{Outside Liabilities}$$

- (iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e. (ii) – (iii).

Illustration 14

A business has earned average profits of Rs. 1,00,000 during the last few years and the normal rate of return in a similar business is 10%. Ascertain the value of goodwill by capitalisation average profits method, given that the value of net assets of the business is Rs. 8,20,000.

Solution

$$\begin{aligned} &\text{Capitalised Value of Average Profits} \\ \text{Rs. } &\frac{1,00,000 \times 100}{10} = \text{Rs. } 10,00,000 \end{aligned}$$

$$\begin{aligned}\text{Goodwill} &= \text{Capitalised value} - \text{Net Assets} \\ &= \text{Rs. } 10,00,000 - \text{Rs. } 8,20,000 \\ &= \text{Rs. } 1,80,000\end{aligned}$$

(b) *Capitalisation of Super Profits:* Goodwill can also be ascertained by capitalising the super profit directly. Under this method there is no need to work out the capitalised value of average profits. It involves the following steps.

- (i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.
- (ii) Calculate normal profits on capital employed.
- (iii) Calculate average profit for past years, as specified.
- (ii) Calculate super profits by deducting normal profits from average profits.
- (iii) Multiply the super profits by the required rate of return multiplier, that is,

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

In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

For example, using the data given in illustration 14 where the average profits are Rs. 1,00,000 and the normal profits are Rs. 82,000 (10% of Rs. 8,20,000), the super profits worked out as Rs. 18,000 (Rs. 1,00,000 - Rs. 82,000), the goodwill will be Rs. 18,000 ×

$$\frac{100}{10} = \text{Rs. } 1,80,000.$$