Goodwill

An intangible asset representing a business's reputation, customer loyalty, brand value, and earning capacity.

Why is Goodwill Valuable?

Attracts Customers

A strong reputation draws in and retains loyal customers.

Higher Profits

Generates earnings above the industry average.

Competitive Edge

Helps a business earn more than its competitors.

Business Events

Has measurable value during admission, retirement, or sale of a business.

When is Goodwill Valued?

Goodwill is formally assessed during key business transitions:

Admission of a Partner

Retirement of a Partner

Death of a Partner

Sale of Business

Change in Profit Sharing Ratio

Three Methods of Goodwill Valuation

Goodwill Valuation

Average Profit

Establish a baseline for financial performance.

Super Profit

Identify excess earnings beyond industry average.

Capitalization

Determine market value based on profitability.

Each method offers a different approach to calculating goodwill, depending on the nature of the business and available financial data.

Average Profit Method

Goodwill is calculated based on the **average profits** earned by the business in previous years.

01

Find Total Adjusted Profit

Adjust for abnormal items first.

02

Calculate Average Profit

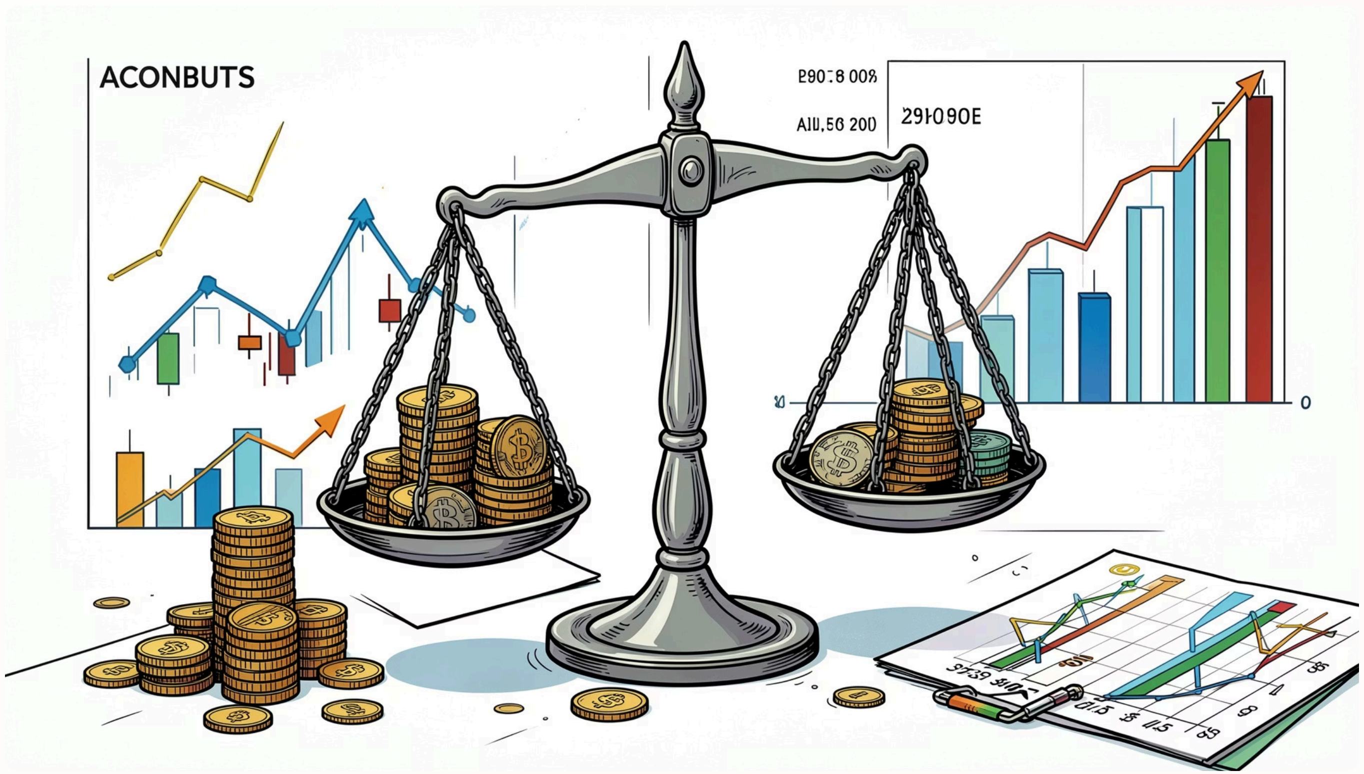
Total Adjusted Profit ÷ Number of Years

03

Multiply by Years of Purchase

Goodwill = Average Profit × Years of Purchase

Average Profit Method — Key Adjustments



Abnormal Items

Abnormal Loss → Add back

Non-recurring losses are added to profit.

Abnormal Gain → Deduct

Non-recurring gains are subtracted from profit.

Formula: Goodwill = Average Profit × Years of Purchase

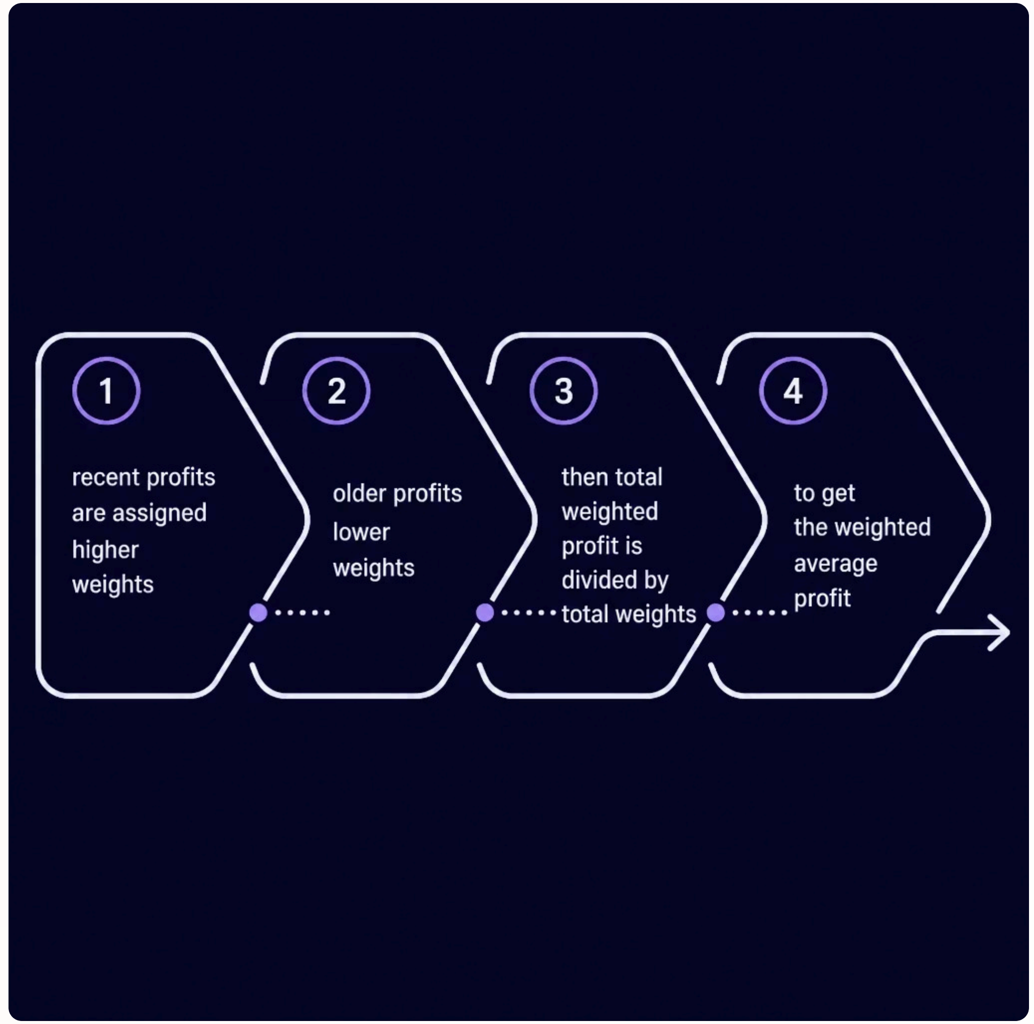
Weighted Average Profit Method

When to Use It

Applied when business profits are **consistently increasing or decreasing**. Recent profits are given more importance by assigning higher weights.

Formula

$$\text{Weighted Average Profit} = \frac{\text{Total Weighted Profit}}{\text{Total Weights}}$$



Super Profit Method

Super Profit is the **excess profit** earned over the normal expected profit.

Normal Profit

Capital Employed × NRR ÷ 100

Super Profit

Average Profit – Normal Profit

Goodwill

Super Profit × Years of Purchase

Example: Avg. Profit = ₹50,000 · Normal Profit = ₹40,000 → Super Profit = ₹10,000 → Goodwill (3 yrs) = **₹30,000**

Capitalization Method

Definition

Calculates goodwill by comparing the **capitalized value** of the business with its actual **net assets**.

Two Types

- Average Profit Capitalization Method
- Super Profit Capitalization Method

Formula

$$\text{Capitalized Value} = \text{Average Profit} \times \frac{100}{\text{NRR}}$$

$$\text{Goodwill} = \text{Capitalized Value} - \text{Net Assets}$$

Quick Revision

Average Profit Method

$$\text{Goodwill} = \text{Average Profit} \times \text{Years of Purchase}$$

Super Profit Method

$$\text{Goodwill} = \text{Super Profit} \times \text{Years of Purchase}$$

Capitalization Method

$$\text{Goodwill} = \text{Capitalized Value} - \text{Net Assets}$$

Normal Profit

$$\text{Normal Profit} = \text{Capital Employed} \times \text{NRR} \div 100$$