

Class 12 Accountancy – Chapter 2 Notes

Goodwill: Nature and Valuation

1. Meaning of Goodwill

- Goodwill is an intangible asset that represents the reputation of a business.
- It enables a firm to earn higher profits compared to normal profits.
- It arises due to factors such as good customer relations, location, quality products, and efficient management.

2. Features of Goodwill

- It is an intangible asset.
- It cannot be seen or touched but has value.
- Its value may change over time.
- It helps a firm earn super profits.

3. Need for Valuation of Goodwill

- Change in profit sharing ratio among partners
- Admission of a new partner
- Retirement or death of a partner
- Amalgamation or sale of business

4. Factors Affecting Goodwill

- Nature of business
- Location of business
- Quality of products or services
- Efficiency of management
- Market conditions

5. Methods of Valuation of Goodwill

- Average Profit Method
- Super Profit Method
- Capitalization Method

6. Average Profit Method

- $\text{Goodwill} = \text{Average Profit} \times \text{Number of Years' Purchase}$
- $\text{Average Profit} = \text{Total Profits of Past Years} \div \text{Number of Years}$

7. Super Profit Method

- $\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$
- $\text{Normal Profit} = \text{Capital Employed} \times \text{Normal Rate of Return} / 100$
- $\text{Goodwill} = \text{Super Profit} \times \text{Number of Years' Purchase}$

8. Capitalization Method

- $\text{Capitalized Value of Business} = \text{Average Profit} \times 100 / \text{Normal Rate of Return}$
- $\text{Goodwill} = \text{Capitalized Value} - \text{Actual Capital Employed}$