TOPIC_-VALUATION OF GOODWILL

(1)What do you mean by goodwill?

Answer: Goodwill is the estimated value of the reputation which the business builds up through its efficient service to its customers, good quality of its products, good relationships, efficient functioning of the business and good moral conduct of the proprietor(s).Goodwill is an intangible asset and helps in earning extra profits.
According to Lord Eldon ,"Goodwill is nothing more than the profitability that the old customers will resort to the old place"

(2)Mention the features/nature/characteristics of goodwill.

Answer: Following are the nature of goodwill:
Goodwill is an intangible asset that represents the value of a business's reputation, brand, customer base, and other intangible factors that contribute to its ongoing success. Here are some features, nature, and characteristics of goodwill:

1. **Intangible Nature: Goodwill lacks physical presence and cannot be touched or seen. It exists only in the perception of customers and stakeholders.**
2. **Customer Loyalty: Goodwill often arises from a strong customer base and loyalty. It reflects the likelihood that customers will continue to choose the business over competitors.**
3. **Reputation and Brand Value: A good reputation and a strong brand image contribute significantly to goodwill. This includes factors like brand recognition, quality perception, and trustworthiness.**
4. **Relationships with Suppliers and Employees: Goodwill may also encompass positive relationships with suppliers, distributors, and employees. These relationships can enhance the business's ability to operate smoothly and profitably.**
5. **Market Position: A business's market position, including its competitive advantage, market share, and industry standing, contributes to its goodwill.**
6. **Future Earnings Potential: Goodwill reflects the expectation of future earnings and cash flows. A business with strong growth prospects and a history of profitability typically has higher goodwill.**
7. **Non-Competitive Advantage: Goodwill can provide a competitive edge beyond tangible assets like machinery or inventory. It's what sets a business apart from its competitors in the eyes of customers.**
8. **Valuation Challenges: Determining the value of goodwill can be challenging, as it involves subjective factors and future projections. It's often assessed during business acquisitions or when calculating the overall value of a company.**
9. **Subject to Impairment: Goodwill is subject to impairment tests regularly. If the fair value of a business falls below its carrying amount, goodwill must be written down, reflecting a decrease in its value.**

10. Legal and Regulatory Considerations: Accounting standards (e.g., Generally Accepted Accounting Principles or International Financial Reporting Standards) require businesses to account for and disclose goodwill appropriately, ensuring transparency and accuracy in financial reporting.
11. Enhances Asset Value: Goodwill can significantly enhance a company's overall value, especially in industries where intangible assets play a crucial role in generating revenue and sustaining competitive advantage.
12. Cultural and Ethical Considerations: Goodwill can also encompass cultural and ethical aspects, such as a company's commitment to social responsibility, environmental sustainability, and ethical business practices, which can enhance its reputation and goodwill among stakeholders.

Understanding and managing goodwill is essential for businesses as it directly influences their market position, financial performance, and long-term sustainability.

(3)Mention the factors/elements affecting goodwill of a firm.

Answer: Following are the factors affecting goodwill of a partnership firm:

Goodwill is an intangible asset that represents the reputation, brand value, customer loyalty, and other non-physical assets of a firm. Several factors or elements can affect the goodwill of a firm:

1. Brand Reputation: The perception of the firm's brand in the market significantly influences goodwill. Positive brand reputation enhances customer loyalty and trust, ultimately contributing to goodwill.
2. Customer Satisfaction: Providing quality products or services and maintaining good customer relations can enhance goodwill. Positive experiences lead to repeat business and positive word-of-mouth recommendations.
3. Market Position: A firm's position within its industry, including market share and competitiveness, affects goodwill. Dominance in the market can lead to higher goodwill due to perceived stability and reliability.
4. Intellectual Property: Ownership of patents, trademarks, copyrights, and other intellectual property rights can add value to a firm's goodwill. These assets provide a competitive advantage and may contribute to brand recognition and market position.
5. Management Team: Competent and experienced management can enhance goodwill by making sound strategic decisions, fostering innovation, and effectively managing operations and risks.
6. Employee Skills and Morale: Skilled and motivated employees contribute to the success of a firm, which in turn affects goodwill. Positive workplace culture and employee satisfaction can translate into better products, services, and customer experiences.
7. Customer Base: The size, loyalty, and demographics of a firm's customer base influence its goodwill. A diverse and loyal customer base is considered an asset, as it provides a stable revenue stream and potential for growth.
8. Industry Trends and Economic Conditions: Changes in industry dynamics, market trends, and economic conditions can impact a firm's goodwill. Adapting to

changing environments and staying ahead of trends can help maintain or enhance goodwill.

9. **Legal and Regulatory Compliance: Adherence to laws, regulations, and ethical standards is crucial for maintaining goodwill. Legal compliance and responsible corporate behavior build trust and credibility with stakeholders.**
10. **Social Responsibility: Engaging in socially responsible practices, such as environmental sustainability, community involvement, and ethical sourcing, can enhance goodwill by demonstrating a firm's commitment to broader societal interests.**

These factors interact with each other and can vary in importance depending on the nature of the business, its industry, and the broader economic and social context.

(4)Mention the situations when valuation of goodwill becomes necessary.

Answer: Following are the situations:

Valuation of goodwill becomes necessary in various situations, typically when a business undergoes certain changes or transactions. Some common situations include:

1. **Mergers and Acquisitions (M&A): When one company acquires another, the acquiring company needs to determine the fair value of the acquired company's assets and liabilities, including any goodwill associated with the transaction.**
2. **Purchase or Sale of a Business: Both buyers and sellers may need to assess the value of goodwill when negotiating the sale of a business. This helps in determining a fair price for the business being bought or sold.**
3. **Partnership Dissolution: If a partnership is dissolved, the value of goodwill may need to be determined to allocate the assets among the partners fairly.**
4. **Restructuring or Reorganization: In the event of a company restructuring or reorganizing its operations, the value of goodwill may need to be reassessed to reflect changes in the business.**
5. **Impairment Testing: Companies are required to periodically assess whether the value of their goodwill is impaired, meaning it has decreased in value. If impairment is identified, the goodwill must be written down to its fair value, leading to a charge against earnings.**
6. **Brand Recognition and Reputation: In industries where brand recognition and reputation play a significant role, such as consumer goods or technology, valuation of goodwill may be necessary to accurately reflect the value of the brand in financial statements.**
7. **Initial Public Offerings (IPOs): When a company decides to go public, it may need to determine the fair value of its assets, including any goodwill, to comply with regulatory requirements and to accurately represent the company's financial position to potential investors.**
8. **Litigation or Dispute Resolution: In legal proceedings, such as shareholder disputes or divorce settlements involving business interests, the value of goodwill may be a contentious issue that requires expert valuation.**

In all these situations, valuation of goodwill is crucial for making informed decisions, ensuring compliance with accounting standards and regulations, and accurately reflecting the financial health and value of the business.

(5)Why is goodwill considered as an intangible asset but not a fictitious asset?

Answer: Goodwill is considered as intangible assets because it cannot be seen and touched but it can be felt. But it is not a fictitious asset because fictitious assets do not have a value whereas goodwill has a value and it can be purchased or sold with any other asset.

(6)What are the different methods of valuation of goodwill?

Answer: The various methods of valuation of goodwill are:
(1)Average Profit Method
(a)Simple average profit method (b) Weighted average profit method.
(2)Super Profit Method
(3)Capitalization Method
(a) Capitalization of Average profit (b) Capitalization of super profit.
(4) Annuity Method.
(5) Arbitary method.

(7)What is average profit and super profit?

Answer: Average profit is the average of the profits of past few years. Normal rate of return is not considered in the calculation of average profit.
Average Profit= Total Profit/Number of years.
Super Profit is the difference between actual profit and normal profit. Normal rate of return is considered while calculating super profit.

(8)Explain the average profit method of valuation of goodwill.

Answer: This is very simple and widely followed method of valuation of goodwill.
Steps for calculating the value of goodwill under average profit method are:
Step 1: Calculate the total profit of the agreed number of years.
Step 2: Calculate the average profits;
Average Profit= Total Profits/ Number of years
Step 3: Calculate the value of goodwill.
Goodwill= Average Profits * Number of years agreed.

(9) Explain the super profit method of valuation of goodwill.

Answer: Steps for calculating the value of goodwill under super profit method are as follows:
Step1: Calculation of average profit.
Step 2: Calculation of normal profit.
Normal Profit= Capital Employed * Normal Rate of Return/100
Step 3: Calculation of super profit.
Super Profit=Average Profit – Normal Profit.
Step 4: Calculation of Goodwill.
Goodwill= Super Profit * Number of years purchased.

(10) Explain the capitalization method of valuation of goodwill.

Answer: Under this method, goodwill can be calculated in 2 ways:

(1) Capitalization of Average profit Method: It involves the following steps:

Step 1: Ascertain the average profit.
Step 2: Ascertain the total value of the business.
Value of the business= Average Profit * 100/ Normal Rate of Return.
Step 3: Ascertain the net tangible assets or net capital employed.
Step 4: Ascertain the value of goodwill.
Goodwill= Total value of business – Net Tangible Assets.

(2) Capitalization of Super Profits Method: It involves the following steps:

Step1: Calculation of super profit.
Step 2: Calculation of capitalized value of super profit.
Capitalized value of super profit= Super profit * 100/Normal Rate of Return.
Step 3: Value of Goodwill.
Goodwill= capitalized value of super profit- Net tangible assets.

(11) Explain the accounting treatment of goodwill when goodwill account already appears in the books of the firm and new partner brings his share of goodwill in cash.
Answer: If a partner brings his share of goodwill in cash and if the goodwill already appears in the books of the firm, first of all the existing goodwill account will have to be written off. For this purpose, old partner's capital accounts are debited in their old profit sharing ratio and goodwill account is credited.

(12)What is hidden goodwill?
Answer: Hidden Goodwill is the excess of desired total capital of the firm over the actual combined capital of all partners. In other words, when the value of goodwill of the firm is not specifically given, the value of goodwill has to be calculated on the basis of net worth of the firm.

(13) What is premium for goodwill?
Answer: Premium for goodwill is the compensation paid by the incoming partner to the sacrificing partner. The nature of premium for goodwill account is liability. It represents the liability of the firm towards the sacrificing partner.

(14) What are the types of goodwill?

Answer: Goodwill can be classified into the following types:

(a) **Purchased Goodwill= Purchased goodwill arises when a firm purchases part of assets or whole business of another firm.**
(b) **Non- purchased or inherent Goodwill= Non – purchased goodwill is the goodwill of the firm created through its own effort and excellence.**
(c) **Positive Goodwill= If the real worth of the net assets of a firm is more than their book value, then it is said that the firm is having a goodwill which is called positive goodwill.**
(d) **Negative Goodwill= In case the real worth of the net assets is less than the book value, then it is a case of negative goodwill.**

(e) Dog- Goodwill= Dog has affinity to person concerned so the goodwill which is very much personal is called dog goodwill.
(f) Cat- Goodwill= Cat has affinity to the house and not to a person. Goodwill, which is based on the activity of the firm as a whole is called cat- goodwill.
(g) Rat-Goodwill= Rat-goodwill is not a goodwill in the true sense. Such a goodwill is very temporary in nature created through temporary attraction.

(15) What are the need for valuation of goodwill?

Answer: Valuation of goodwill is crucial for various reasons, encompassing financial reporting, strategic decision-making, and stakeholder communication. Here are ten points highlighting the need for goodwill valuation:

1. **Financial Reporting: Goodwill valuation is essential for accurate financial reporting, particularly for companies involved in mergers, acquisitions, or business combinations. It ensures that the balance sheet reflects the true value of assets and liabilities.**
2. **Investment Decisions: Investors rely on goodwill valuation to assess the overall value of a company and its potential for future growth. This information helps them make informed investment decisions.**
3. **Mergers and Acquisitions: In mergers and acquisitions, goodwill represents the premium paid above the fair market value of tangible assets. Valuing goodwill helps companies determine the appropriate purchase price and negotiate favorable terms.**
4. **Impairment Testing: Companies are required to assess goodwill for impairment regularly. Valuation provides insights into whether the carrying value of goodwill exceeds its fair value, indicating potential impairment.**
5. **Taxation Purposes: Goodwill valuation is essential for tax planning and compliance. It determines the tax implications of transactions involving goodwill, such as mergers, acquisitions, or asset sales.**
6. **Financial Performance Evaluation: Valuation of goodwill enables stakeholders to evaluate the financial performance of a company accurately. It helps assess the return on investment and the effectiveness of strategic decisions.**
7. **Regulatory Compliance: Many regulatory bodies, such as the Financial Accounting Standards Board (FASB) and the International Financial Reporting Standards (IFRS), require companies to report goodwill accurately. Valuation ensures compliance with regulatory guidelines.**
8. **Stakeholder Communication: Goodwill valuation facilitates transparent communication with stakeholders, including investors, creditors, and regulatory authorities. It provides clarity regarding the financial health and prospects of the business.**
9. **Litigation and Disputes: During legal proceedings, such as shareholder disputes or valuation disputes, the accurate assessment of goodwill is essential for determining equitable resolutions.**
10. **Strategic Planning: Valuation of goodwill aids in strategic planning by providing insights into the intangible assets' contribution to the company's overall value. It helps management formulate growth strategies and allocate resources effectively.**

In conclusion, the valuation of goodwill is indispensable for financial transparency, strategic decision-making, regulatory compliance, and stakeholder confidence in businesses. It ensures that companies accurately reflect the value of intangible assets and make informed decisions that drive long-term success.

Valuation Of Shares

(1) What do you mean by share?

Answer: According to Section 2(84) Of the Companies Act, 2013, 'share' means a share in the share capital of a company and includes stock. A person who owns a share is called shareholder. The sum total of the values of all shares in a company is called share capital.

(2) What do you mean by value of a share?

Answer: Value of a share means the money value attached to the share. It may be the book value or the price at which it can be sold or purchased.

(3) What are the different types of share value?

Answer: The different types of share value are:

I. **Book Value= Book value of share is the value stated in the Articles of Association. It is shown in the books of accounts and Balance Sheet. Book Value is commonly known as Face value or nominal value.**
II. **Par Value= Par value is nothing but the nominal or face value of a share.**
III. **Value at a premium= If shares are sold or issued at a price which is more than the book value, then it is called value at a premium.**
IV. **Value at a Discount= If shares are sold or issued at a price which is lower than their book or face value, it is called Value at a Discount.**
V. **Quoted Value= Quoted Value is the value of a share stated by the stock exchange at the end of a day's trade.**
VI. **Market value= Market value of a share is the price at which the share is purchased or sold in the market. Generally, stock exchange quoted price is taken as the market price.**
VII. **Fair Market Value= It is the price of a share that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.**

(4) What are the different methods of Valuation of equity shares?

Answer: Following are the different methods of Valuation of equity shares:

a) **Assets backing method or Intrinsic Value method or Net Assets Method.**

b) **Yield method or Capitalization of profit method.**
c) **Fair Value method/ Hybrid method.**

(5) Write notes on following:

(a) Assets Backing Method-

Answer= This method is also known as intrinsic value method, net assets method , equity method , assets balancing method or assets valuation method. Generally, under this method, value of one equity share= Net assets/ number of equity shares.

An estimate of worth of the net assets is made by deducting the liabilities from the total realizable assets. Net backing for each share is obtained by dividing the worth of the net assets by the number of outstanding shares.

Merits:

- **This method can be fairly used to value shares when the firm is liquidated.**
- **This method takes into account the real worth of the business.**
- **This method is related to the market value of assets.**

Demerits:

- **It is difficult to estimate the realizable value of shares in case of going concern under this method.**
- **As the company is treated as going concern, there is no possibility of its liquidation in future.**
- **This method does not give any weight to earning capacity and dividend.**

(b) Yield Method-

Answer= Yield refers to the earning or productivity of a firm in relation to its investments. In the context of valuation of equity shares, yield means the profits available to the equity shareholders. Such profit to the equity shareholders may be in terms of earning yield or dividend yield.

Earning Yield= Total profits available to equity shareholders/ Total paid up equity share capital.

Thus, Earning yield is the rate of return in terms of profit to the equity shareholders on their holding. Earning yield can also be expressed in terms of Earning Per Share (EPS).

EPS= Profits available to equity shareholders/ Number of equity shares issued and subscribed.

Dividend Yield= Total dividend on equity share capital / Total paid up equity share capital * 100.

Dividend yield can also be expressed in terms of Dividend Per Share (DPS).

DPS= Total dividend on equity share capital/ Number of equity shares issued and subscribed.

Dividend yield method is generally suitable for valuing small block of company's shares because these shareholders are more interested in the rate of dividend declared by the company rather than earnings of the company.

(c) Fair value / Hybrid method.

Answer= Fair Value of equity shares is the average of the intrinsic value and yield value of equity shares that is . Fair Value= (Intrinsic Value+ yield Value)/2. Therefore, for the purpose of ascertaining the fair value, the intrinsic value and the yield value of the shares are to be ascertained first.

(6) Briefly discuss the methods of valuation of shares of a company.

Answer= Same as question no 5 (a) , (b) ,(c).

(7) What are the purposes for valuation of shares? Or

When and why valuation of shares need to be made? Or

State the circumstances in which there may be need for valuation of shares. OR

Mention the situations where the need for valuation of shares arises.. OR

Mention the need for valuation of shares.

Answer= The following are the situations when there is a necessity to value shares:

1. **Investment Decision Making: Valuation helps investors in making informed decisions about buying, holding, or selling shares. It provides insights into whether a stock is undervalued, overvalued, or fairly priced.**
2. **Capital Raising: For companies, accurate valuation of shares is crucial when raising capital through equity financing. It determines the price at which new shares are issued, ensuring that the company receives adequate funds without diluting existing shareholders' value excessively.**
3. **Mergers and Acquisitions (M&A): In M&A transactions, both acquiring and target companies need to determine the fair value of shares. Valuation aids in negotiating the exchange ratio or purchase price, facilitating a fair deal for all stakeholders involved.**
4. **Financial Reporting: Valuation is necessary for financial reporting purposes, particularly for publicly traded companies. Fair value accounting standards**

require companies to regularly assess the value of their investments, including shares, and report them accurately in financial statements.

5. **Employee Stock Options: Many companies offer stock options or equity-based compensation to employees as part of their remuneration packages. Valuation helps in determining the value of these options, ensuring fairness to employees and compliance with accounting regulations.**
6. **Litigation and Disputes: Valuation of shares becomes crucial in legal matters such as shareholder disputes, divorce settlements, and estate planning. It helps in determining the equitable distribution of assets and resolving conflicts related to ownership rights.**
7. **Strategic Planning: Valuation assists companies in strategic decision-making processes, such as expansion, diversification, or divestiture. By understanding the value of their shares, companies can devise effective strategies to enhance shareholder wealth and achieve long-term objectives.**
8. **Risk Management: Investors use valuation techniques to assess the risk associated with investing in a particular stock. Understanding the intrinsic value of shares enables investors to manage their investment portfolios prudently and mitigate potential losses.**
9. **Regulatory Compliance: Regulatory authorities often require companies to disclose accurate valuations of their shares, especially in industries like banking and insurance. Compliance with regulatory guidelines ensures transparency and accountability in financial markets.**
10. **Market Efficiency: Valuation contributes to the overall efficiency of financial markets by providing reliable pricing information. Efficiently priced shares reflect the true value of underlying assets, reducing market distortions and promoting fair competition among market participants.**

In conclusion, the need for valuation of shares is multifaceted, serving the interests of investors, companies, regulators, and the broader financial ecosystem. Whether for investment decisions, capital raising, strategic planning, or regulatory compliance, accurate valuation plays a pivotal role in driving transparency, fairness, and efficiency in financial markets.

(8) What are the factors influencing valuation of shares?

Answer=The valuation of shares, which represents the worth of a company's equity, is influenced by various factors. These factors include:

1. **Earnings and Profitability: The company's past and projected earnings are crucial in determining its valuation. Investors often assess metrics like earnings per share (EPS), profit margins, and revenue growth to gauge profitability.**
2. **Market Conditions: Overall market conditions, including economic indicators, interest rates, and investor sentiment, can significantly impact share valuations. Bull markets generally lead to higher valuations, while bear markets may depress them.**
3. **Industry and Sector Performance: Different industries and sectors have varying growth prospects and risk profiles, influencing how investors value shares within those sectors. For example, technology stocks may command higher valuations due to perceived growth potential compared to traditional sectors like utilities.**

4. **Competitive Positioning: A company's competitive advantage, market share, and ability to innovate can influence its valuation. Strong market leadership and differentiation often lead to higher valuations.**
5. **Dividend Policy: Companies that pay dividends or have a history of increasing dividends may be valued more favorably by income-oriented investors. Dividend yield, payout ratio, and dividend growth rate are key considerations.**
6. **Financial Health and Stability: Factors such as debt levels, cash flow generation, and balance sheet strength impact a company's perceived risk and hence its valuation. Companies with low debt and strong cash reserves are often valued more highly.**
7. **Management Quality and Governance: Investor confidence in management's ability to execute the business strategy, allocate capital efficiently, and maintain good corporate governance practices can influence valuation.**
8. **Market Position and Growth Potential: Companies with a sizable market share and significant growth potential in expanding markets tend to attract higher valuations.**
9. **Regulatory Environment: Changes in regulations affecting the company's industry can impact its valuation by altering costs, revenue streams, or competitive dynamics.**
10. **Macroeconomic Factors: Factors like inflation, currency fluctuations, geopolitical events, and trade policies can affect the broader economic environment and consequently impact share valuations.**
11. **Perceived Risk and Uncertainty: Investor perception of risk, including factors such as volatility, litigation risks, and regulatory compliance issues, can influence valuation multiples.**
12. **Technological Disruption: Companies facing or driving technological disruption may experience changes in their valuations due to shifts in market dynamics and competitive pressures.**
13. **Mergers and Acquisitions Activity: M&A activity within an industry can impact share valuations, as investors anticipate potential consolidation or competition.**

Understanding and analyzing these factors help investors and analysts in valuing shares and making informed investment decisions. Different valuation methods, such as discounted cash flow (DCF), price-to-earnings (P/E) ratio, price-to-book (P/B) ratio, and others, may be applied depending on the context and industry characteristics.

(11) Explain the procedure for valuation of shares under Intrinsic Value Method.

Answer= The following procedure should be followed for calculation of the value of each equity shares:

- **Assets should be taken at book value , only when market value or realizable value is not available.**
- **Adequate provision should be maintained for depreciation.**
- **For investment outside the firm and inventory, current market price should be applied.**

- **In case of bills receivables and trade debtors, adequate provision for bad and doubtful debts should be made.**
- **Fictitious assets or any unamortized expenses or deferred revenue expenses should not be taken into account.**
- **If there is any unrecorded asset which can be realized , it should be considered. In the same way, all unrecorded liabilities should also be provided.**
- **From the total value of all realizable assets, the value of all liabilities is to be deducted.**
- **From the figures ascertained as above, the paid up amount of preference share capital , if any and the unpaid amount of preference dividend are deducted to obtain the value of net assets available for equity shareholders,.**
- **The value of net assets available for equity shareholders is divided by the number of equity shares to ascertain the value of each equity share.**