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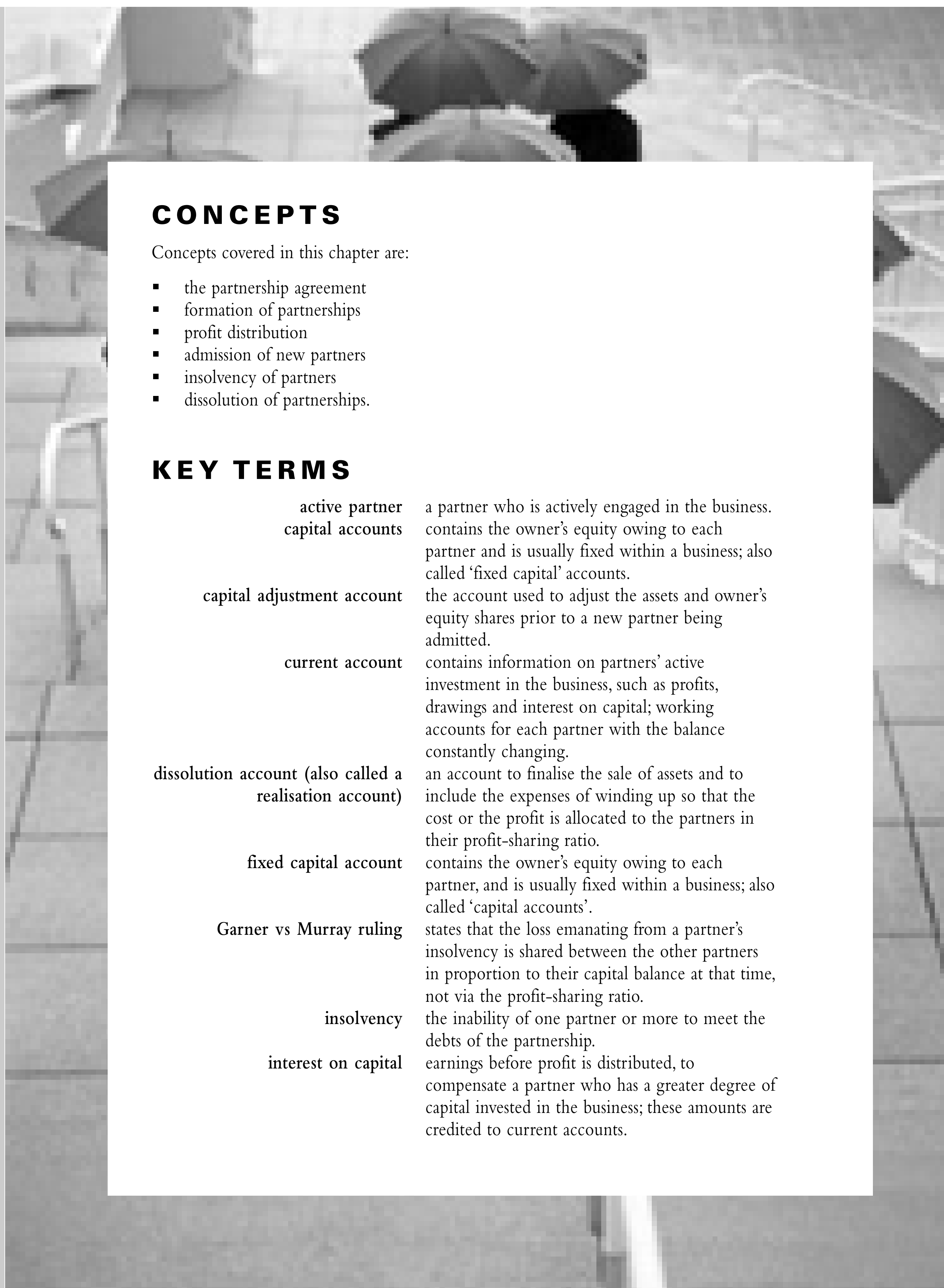
PARTNERSHIPS

LEARNING OUTCOME:
TO PRODUCE A FULL SET OF ACCOUNTS AND FINANCIAL REPORTS FOR PARTNERSHIPS FROM FORMATION TO DISSOLUTION.



CONCEPTS

Concepts covered in this chapter are:

- the partnership agreement
- formation of partnerships
- profit distribution
- admission of new partners
- insolvency of partners
- dissolution of partnerships.

KEY TERMS

active partner a partner who is actively engaged in the business.

capital accounts contains the owner's equity owing to each partner and is usually fixed within a business; also called 'fixed capital' accounts.

capital adjustment account the account used to adjust the assets and owner's equity shares prior to a new partner being admitted.

current account contains information on partners' active investment in the business, such as profits, drawings and interest on capital; working accounts for each partner with the balance constantly changing.

dissolution account (also called a realisation account) an account to finalise the sale of assets and to include the expenses of winding up so that the cost or the profit is allocated to the partners in their profit-sharing ratio.

fixed capital account contains the owner's equity owing to each partner, and is usually fixed within a business; also called 'capital accounts'.

Garner vs Murray ruling states that the loss emanating from a partner's insolvency is shared between the other partners in proportion to their capital balance at that time, not via the profit-sharing ratio.

insolvency the inability of one partner or more to meet the debts of the partnership.

interest on capital earnings before profit is distributed, to compensate a partner who has a greater degree of capital invested in the business; these amounts are credited to current accounts.

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interest on drawings	amounts added to the profit before it is distributed for partners who have drawn out money from the business in anticipation of profits; these amounts are debited to current accounts.
loan and advances	a separate loan account is opened to reflect any partners who have lent money to the business at an agreed interest rate.
Partnership Act	an Act that stipulates ways of proceeding if the partnership agreement does not sufficiently cover areas of dispute in the business.
partnership agreement	an agreement between the partners, preferably in writing, to show in detail how the partnership will operate, the duties and responsibilities of each partner, how profit and losses will be shared and the firm's relationship with other persons and organisations.
partnership funds	an alternative name for the owner's equity of a business.
profit and loss appropriation account. (also called a distribution account)	used for entering interest on capital and drawings profit and a final division of profit or losses in accordance with the partnership agreement.
profit distribution account (also called a profit and loss appropriation account)	used for entering interest on capital and drawings and a final division of profit or losses in accordance with the partnership agreement.
profit-sharing ratios	the agreed ratios at which partners share the profits and the losses.
realisation account (also called a dissolution account)	an account to finalise the sale of assets and to include the expenses of winding up so that the cost or the profit is allocated to the partners in their profit-sharing ratio.
realisation expenses	usually in the form of legal costs to wind up the partnership.
retained earnings/retained profits	alternative names for current accounts.
sleeping partner	a partner not actively involved in the business, who contributes capital but does not usually participate in business decisions.

INTRODUCTION

This chapter is divided into four sections: formation of a partnership, profit distribution, admission of a new partner or partners, and dissolution of a partnership. There is also a summary of partnership accounts at the end of the chapter.

GST AND PARTNERSHIP ACCOUNTING

GST is not needed for partnership formation. Profit distribution is after the GST has been calculated. For admission of a new partner, it is assumed that there are no GST considerations. However, GST is applicable to partnership dissolution. This is covered later in the chapter.

FORMATION OF A PARTNERSHIP

A partnership is defined in the Partnership Act as the relationship that exists between two or more people who are engaging in a business for profit.

A partnership agreement does not necessarily have to be in writing, so it is sometimes difficult to establish whether a partnership exists. There are three important factors that must be present in a partnership:

1. The partners must be carrying on a business, not one isolated venture or a single business transaction.
2. There must be agreement between two or more legally competent persons who must be co-owners of the business.
3. It must be the intention of the partners to make a profit.

Two or more people can form a partnership. Partnerships do not usually involve more than twenty people, but some professional partnerships, that are not companies, can exceed this number (e.g. some accountants, doctors or lawyers).

Partnerships are not legal entities as companies are, but it is common to consider a partnership as a separate accounting entity for trading purposes.

Owner's equity accounts are kept for each individual partner, as for a sole trader.

If an individual partner enters into a contract with another person or organisation, the partnership is legally bound to that contract as long as it involves the normal business of the partnership. However, if the same partner signed a contract to purchase a house, the partnership would not be bound, as this is not within the organisation's normal business.

Each partner has a right to share in the profits and manage the business. In doing so, the partners jointly own the business assets.

Similarly to a sole trader, each partner is responsible for the debts of the partnership. This can extend to acquiring the personal assets (e.g. home and vehicles) of a partner to cover the debts.

A partner who is not active in the business is referred to as a sleeping partner. The contribution of a sleeping partner is usually in the form of capital, either cash or assets, with no active management of the business.

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A partnership needs to complete income tax returns but is not taxed on profits. The tax return provides information about the distribution of profits to partners, who as individuals are personally liable for taxes.

PARTNERSHIP AGREEMENT

A partnership has unlimited liability, which means that each partner is liable for the debts of the business.

A partnership also has a limited life, which means that the partnership may be dissolved through death, the retirement of a partner or the insolvency of a partner. The partnership would then cease to exist or a new partnership agreement would need to be negotiated.

For these reasons and others, it is essential that a partnership agreement be prepared. Ideally it should be a written agreement, but it can be oral or implied from the actions of the partners.

Some of the matters to be covered in an agreement are:

Tutorial A

Why is it desirable for a partnership agreement to be in writing? State three important points to be considered in the agreement.

- the name of the business
- the details of each partner
- the nature of the business
- how profit and losses are to be divided
- capital contributions by each partner
- the authority, rights and duties of the partners
- details of salaries to be paid
- whether drawings are allowed and an interest rate chargeable for them
- whether interest will be paid for capital contributions
- arrangements concerning the management roles and rights of each partner
- voting and decision-making procedures
- accounting methods
- procedures for admission of a new partner
- procedures for resolution of disputes between partners
- provisions relating to bankruptcy, death or retirement of a partner.

PARTNERSHIP ACT

Where there is no partnership agreement in writing, or if the existing agreement does not sufficiently cover an area in dispute, the matter may be resolved by reference to the Partnership Act. For example, the Act states that all profits and losses are to be shared equally, so if a profit ratio is not clearly defined in an agreement, the Act is applied.

Another statement in the Act is that no partner may receive remuneration for managing the business. So if it had been orally agreed that a salary would be paid to a partner and it was later disputed, the Act's provisions would apply.

The Act's provisions apply only where there is no coverage or unclear coverage in the partnership agreement. Some clauses contain matters not favourable to a partner, so it is most important for the partnership agreement to be in writing and with a legal input in its preparation.

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ADVANTAGES AND DISADVANTAGES OF PARTNERSHIPS

Advantages

1. Creation and dissolution of a partnership is easier than for a company, as the legal costs are not as great.
2. There in no need to conform with Company Act requirements.
3. Resources can be pooled. The capital investment for a business is potentially much higher when there is more than one owner.
4. Expertise can be utilised. Two single-owner businesses can be merged into a partnership to take advantage of the expertise of both the owners, which will complement and enhance business opportunities.
5. There is co-ownership of assets.
6. The duties and responsibilities of the partnership are shared.

Disadvantages

1. Liability is unlimited. Each partner is responsible for the acts of other partners acting within the normal business activities and can be liable to the extent of their personal assets, for payment of business debts.
2. When a partner dies, retires or becomes bankrupt the partnership may cease, unless there is a clause in the partnership agreement that it is a continuing or unlimited partnership. If it is unlimited, the business can continue while the partnership ownership is reorganised.
3. Disagreements between the partners can occur. There should be a resolution process stated in the partnership agreement, but this may not be enough to solve fundamental disagreements between partners about the running of the business.
4. There may be limits to the raising of large amounts of capital to, say, expand the business operations.
5. Partners can be sued by creditors, jointly or individually.
6. Partners are likely to pay higher income tax, as the maximum marginal tax rate for an individual is higher than the company tax rate.

Tutorial B

A flower shop is considering amalgamating with a garden nursery. State three advantages of this for the flower-shop owner.

Try **Activity 6.1 (p 000).**

PARTNERSHIP ACCOUNTS

Similarly to a sole trader, in a partnership all business transactions must be shown separately from the owner's equity of the partners.

There are two types of capital accounts for each partner:

1. *Current accounts:* These are the working accounts containing details of profit or loss, drawings, and interest on the capital invested or on drawings. These accounts are also called 'retained earnings' or 'retained profits' accounts.

2 *Capital accounts:* The partner's original capital put into the business is generally considered to be 'fixed' (that is, the capital contributed as the original investment). The capital account of each partner is usually unchanged. An alternative name for this account is 'Fixed capital'.

Illustration 6A

On 1 April, Black and Blue pooled their resources to become 'The Bruise Brothers'. The contributions from each partner's resources are:

Assets	Black ($)	Blue ($)
Cash at bank	10 000	
Motor vehicle	25 000	11 000
Inventories	2 000	12 000
Prepaid expenses	200	
Furniture	7 000	2 000
Computer	200	3 000
Accounts receivable	500	3 000
Liabilities		
Accrued expenses	100	
Accounts payable	3 400	2 800
Bank overdraft		800
= Capital accounts	?	?

Additional information:

1. Profits were shared 60% Black and 40% Blue.
2. Net profit for the quarter ended 30 June was $8000.
3. Black contributed a further $1600 capital on 31 May.
4. Blue withdrew $1400 on 10 June in anticipation of profits.

The calculation of partnership funds (owner's equity) is:

	Black ($)	Blue ($)
Assets	44 900	31 000
less Liabilities	3 500	3 600
= Capital accounts	41 400	27 400

The capital and current accounts in columnar form are:

Capital—Black

Date	Details	Debit ($)	Credit ($)	Balance ($)
1 April	General journal		41 400 cr	
31 May	Cash		1600	43 000 cr

CAPITAL—BLUE

Date	Details	Debit ($)	Credit ($)	Balance ($)
1 April	General journal			27 400 cr

CURRENT—BLACK

Date	Details	Debit ($)	Credit ($)	Balance ($)
30 June	Profit and loss appropriation		4800	4800 cr

CURRENT—BLUE

10 June	**Drawings**	**1400**		**1400 dr**
30 June	Profit and loss appropriation		3200	1800 cr

Profit calculations: $8000 × 60% = $4800, and 40% × $8000 = $3200

Illustration 6B

If using T-shape accounts, they can be shown in a composite (combined) form. There is usually only sufficient space to show three partners accounts in a combined form. Information from Illustration 6A would be shown as follows:

CAPITAL ACCOUNTS

Date	Details	Black ($)	Blue ($)	Date	Details	Black ($)	Blue ($)
31/5	Balance	43 000	27 400	1/4	General jnl.	41 400	27 400
				31/5	Cash	1 600	
		43 000	27 400			43 000	27 400
				1/6	Balance	43 000	27 400

CAPITAL ACCOUNTS

Date	Details	Black ($)	Blue ($)	Date	Details	Black ($)	Blue ($)
10/6	Drawings		1400	30/6	Profit & loss appropriation	4800	3200
30/6	Balance	4800	1800				
		4800	3200			4800	3200
				1/7	Balance	4800	1800

Illustration 6C

The owner's equity of a sole trader is replaced by an alternative term, 'partnership funds', which summarises the amounts owed to the owners by the business.

From Illustration 6A and 6B, the Statement of Financial position extract at 30 June will show:

Partnership funds	$	$	$
Capital—Black	43 000		
Capital—Blue	27 400	70 400	
Current—Black	4 800		
Current—Blue	1 800	6 600	77 000

Sometimes it is shown under each partner's equity. For example, for Black:

	$	$
Black—Capital	43 000	
Black—Current	4 800	47 800

For consistency and to keep the part of the equity 'fixed' from the part 'current', the capital accounts will be shown separately from the current accounts, in one section for partnership funds.

T-shape ledger accounts will now be shown in the illustrations, with some composite accounts. Columnar ledger accounts will also be shown in the answers to activities.

CREATION OF NEW PARTNERSHIPS—ACCOUNTING ENTRIES

Partnerships can be created in two ways:

1. The introduction of cash only. This would be entered in the cash receipts journal.
2. The introduction of both cash and other assets and liabilities. General journal entries are raised for these entries.

Illustration 6D

Knife and Fork form a partnership on 1 June. They bring in the following items and decide that their profit sharing will be based on the capital ratios of this initial investment. Knife introduces cash of $5000, inventories of $8000, accounts receivable of $2000 and accounts payable of $1000. Fork brings in a motor vehicle valued at $15 000, a computer worth $2000, furniture worth $3000, inventories of $6000 and a bank overdraft of $5000.

GENERAL JOURNAL ENTRIES

	Knife				**Fork**		
Date	**Details**	**Debit ($)**	**Credit ($)**	**Date**	**Details**	**Debit ($)**	**Credit ($)**
1 June	Cash	5000		1 June	Motor vehicle	15 000	
	Inventories	8000			Computer	2 000	
	Accounts receivable	2000			Furniture	3 000	
	Accounts payable		1 000		Inventories	6 000	
	Capital		14 000		Bank overdraft		5 000
					Capital		21 000
	Capital invested by Knife				*Capital invested by Fork*		

Profit-sharing ratio:

$$\text{Knife} = \frac{14\,000}{\text{Total capital } 14\,000 + 21\,000}$$

$$= \frac{14\,000}{35\,000}$$

$$= 40\% \text{ or } 2/5$$

$$\text{Fork} = \frac{21\,000}{35\,000}$$

$$= 60\% \text{ or } 3/5$$

PROFIT DISTRIBUTION

PROFIT-SHARING RATIOS

Profit and losses are shared in the way that partners feel is the most appropriate. It is very important to state in the partnership agreement the way the profits or losses will be divided up by the partners—that is, the proportion that each will receive or be liable for.

There are various ways that the profit sharing can be determined:

1. Amounts are shared on the basis of the contribution of 'fixed capital' by each partner. For example, if A contributes $20 000 and B contributes $10 000, A will receive two-thirds of the profit and B will receive one-third.

2 Amounts are shared on the basis of the contribution of the capital balance held by each partner. If A's capital contribution is $50 000 and B's is $30 000, A receives five-eighths of the profit and B receives three-eighths.

3 A higher profit may go to a partner who is bringing into the business something of particular value, such as specialised expertise, or a patent for an invention to be marketed and produced. For example, A and B decide to take 25% of the profit each in order to attract C to the partnership with an offer of a 50% share of the profits (or losses).

See **Activity 6.2 (p 000).**

PROFIT AND LOSS APPROPRIATION ACCOUNT

This account is also called the profit distribution account.
The net profit or loss is transferred into this account from the profit and loss account.

Before the amount due is transferred to each partner, there may be some adjustment to the portion to be allocated.

The net profit is brought in by general journal entry and if there are no other adjustments the profit or loss is allocated to the partners at the agreed ratio.

Illustration 6E

Able, Bable and Cable share profits and losses 25%, 25% and 50% respectively and there are no adjustments to be made. The net profit is $16 000 at 30 June and the general journal entries and profit and loss appropriation account are as follows:

GENERAL JOURNAL

Date	Details	Debit ($)	Credit ($)
30 June	Profit and loss account	16 000	
	Profit and loss appropriation account		16 000
	Transfer of net profit		
	Profit and loss appropriation account	16 000	
	Current—Able*		4 000
	Current—Bable		4 000
	Current—Cable		8 000
	Allocation of net profit to the partners		

* The allocation is to the current account as it is the 'working' account; that is, it is not 'fixed'.

PROFIT AND LOSS APPROPRIATION ACCOUNT

Date	Details	Debit ($)	Date	Details	Credit ($)
30 June	Current—Able	4 000	30 June	Profit and loss	16 000
	Current—Bable	4 000			
	Current—Cable	8 000			
		16 000			16 000

The profit-sharing ratio of 25%, 25% and 50% can also be shown as a ratio of 1:1:2.

Allocations as authorised by the partnership agreement

Before the final profit or loss is distributed to the partners, the provisions of the partnership agreement must be complied with. The agreement may contain the following provisions:

1. Interest on capital is payable. Often partners do not contribute capital at the same level. Where there is an unequal 'fixed' capital, interest may be payable.
2. Interest may be charged for drawings taken out of the business by partners.
3. There may be a provision for the payment of a salary to a partner who is managing the business.
4. Interest may be payable on loans to partners by the business or loans by partners to the business. This must be specifically stated in the agreement, to be calculated after the profit or loss is determined.

Illustration 6F

Using the information in Illustration 6E, before the net profit is allocated these adjustments need to be made.

1. Cable's capital excess over the other two partners is $50 000. Pay interest on capital at a rate of 6% per annum.
2. Bable drew out $10 000 for a period of six months. Charge interest at a rate of 10% per annum.
3. Able is paid a salary of $5000, but not in cash.

The net profit is $16 000 at 30 June and the general journal entries and profit and loss appropriation account are as follows:

GENERAL JOURNAL

Date	Details	Debit ($)	Credit ($)
30 June	Profit and loss account	16 000	
	Profit and loss appropriation account		16 000
	Transfer of net profit		
	Profit and loss appropriation account	3 000	
	Current—Cable		3 000
	Interest paid at 6% on $50 000		
	Current—Bable	500	
	Profit and loss appropriation account		500
	Interest on drawings at 10% for six months		
	Profit and loss appropriation account	5 000	
	Current—Able		5 000
	Salary paid for managing the business		
	Profit and loss appropriation account	8 500	
	Current—Able*		2 125
	Current—Bable		2 125
	Current—Cable		4 250
	Allocation of net profit to the partners		

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PROFIT AND LOSS APPROPRIATION ACCOUNT

Date	Details	Debit ($)	Date	Details	Credit ($)
30 June	Interest on capital	3 000	30 June	Profit and loss	16 000
	Salary	5 000		Interest on drawings	500
	Current—Able	2 125			
	Current—Bable	2 125			
	Current—Cable	4 250			
		16 500			16 500

* Had the $5000 salary paid to Able been in cash, it would still have been debited to the profit and loss appropriation account, but the credit would be to 'Cash at bank' rather than to the current account of Able.

Loan accounts

Where a partner makes a loan to the business, the debit is to cash at bank and the credit to a loan account in the partner's name. Interest for this may be paid prior to the profit or loss being obtained, or if authorised by the partnership agreement as a debit in the profit and loss appropriation account.

Drawings

Where a partner withdraws cash from the business in anticipation of profits to be earned, this can be done by debiting the drawings account (in the partner's name) in the same way as for a sole trader. However, if the drawings have been made during the year, this depletes the amount of capital available to the business. The agreement may state that interest on drawings at an agreed rate is payable for that portion of the year that the drawings were out of the business.

Tutorial C

What is the purpose of a profit and loss appropriation account? Justify why interest on capital should be included.

Tutorial D

Why is there a need to separate current and capital accounts?

Illustration 6G

H. Henry draws cash of $5000 from the partnership on 1 September in anticipation of profit. The agreement states that partners are to be charged 6% for interest on drawings.

The drawings of cash of $5000 will be an entry in the cash payments journal. The general journal entry to record the interest as at 30 June is:

GENERAL JOURNAL

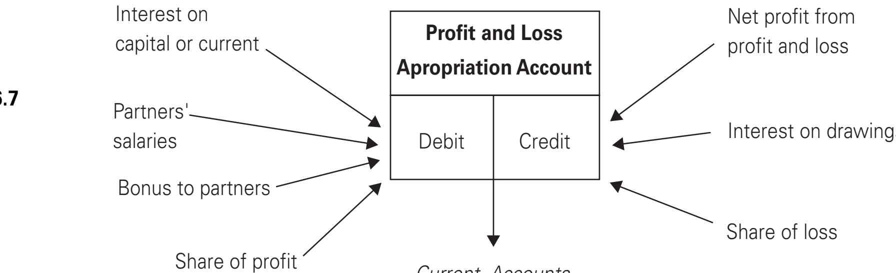
Date	Details	Debit ($)	Credit ($)
30 June	Current—H. Henry	250	
	Profit and loss appropriation account		250
	Interest on drawings at 6 % for ten months		

Calculation $5000 \times \frac{6}{10} \times \frac{10 \text{ months}}{12}$ (1 September to 30 June) $= \$250$

Try **Activities 6.3 to 6.7 (p 000).**

Summary

Figure 6.1 Summary of a profit and loss appropriation account



ADMISSION OF A NEW PARTNER OR PARTNERS

REASONS FOR A NEW PARTNERSHIP

There are several reasons why the partners' existing arrangements can vary. The introduction of a new partner or partners may be beneficial or necessary. It may:

- give new products and customers to the business
- add specialised expertise to the organisation
- give access to further capital for, say, expansion
- add desirable assets, such as a showroom in a great location
- add new business contacts
- be required due to the death, retirement or bankruptcy of an existing partner.

A NEW PARTNERSHIP AGREEMENT

A new agreement must be renegotiated to allow for the change in the business ownership and activities.

ADJUSTING THE EXISTING BUSINESS

No new partner can be admitted without the consent of the existing partners. *All* partners must agree to the admission of a new partner. A majority is not sufficient.

Before a new partner is included, the assets of the business should be revalued or devalued, to arrive at a fair value, so that the new partner does not benefit from any gains of the existing partnership not yet recorded in the books of account. To fail to do this would be to the detriment of the existing partners. For the new partner, the assets are then valued at realistic present-day values.

Liabilities also need to be reviewed for their accuracy in valuation. The new partner could be disadvantaged if the liabilities of the existing partnership exceed the expectation of the amounts owed.

Any gains and losses to the existing partners from adjusting the business values will be made at the existing profit-sharing ratio, prior to the new partner being admitted.

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RETIREMENT OF A PARTNER

The retirement of a partner should proceed in accordance with the terms and conditions outlined in the partnership agreement.

The retiring partner must give notice in writing and place an advertisement stating that he or she has withdrawn from the partnership.

GOODWILL

In Accounting Standard AASB 1013, goodwill is defined as 'future (financial) benefits from assets which cannot be individually identified. Goodwill is itself, therefore, an asset'.

Assets not identifiable include reputation in the marketplace, an existing strong customer data base, ability of the management, effective advertising leading to the business being well recognised and accepted, popular products, a desirable location for the business and advantages from monopolies or patents to a marketable invention.

Goodwill may be referred to as the 'monetary value attached to the expectation that the custom will continue in the future as it is in the present'. It has also been defined as 'the probability that existing customers will return'.

Goodwill is often considered in the sale of a business, or for the admission of a new partner, where that new person could be buying into an existing business with special features that are expected to earn the new partner extra profits.

Valuing goodwill

It is difficult to state any fixed rules for the valuation of goodwill; it is often the result of bargaining between the parties concerned.

Accounting standard AASB 1013 also states that 'goodwill is the excess of all acquisition costs over the fair value of the net identifiable assets acquired'. This means that where the fair value of net assets is considered to be lower than the agreed value of the business, the difference may be regarded as the value of the goodwill.

Accounting for goodwill

There are two methods of accounting for goodwill. In the first method, goodwill is recorded in the accounts. In the second method, goodwill is not recorded in the books.

Illustration 6H

Method 1

On entry, a new partner may be required to make a payment towards the existing goodwill of the business. In this example, goodwill is assessed to be $24 000, which is equally divided between partners A and B who share profits evenly.

GENERAL JOURNAL

Date	Details	Debit ($)	Credit ($)
	Goodwill	24 000	
	Capital A		12 000
	Capital B		12 000
	Division of goodwill on the admission of a new partner		

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Partner C is being admitted for a one-quarter share of profits and losses, so he or she will be required to contribute an extra $6000 as a premium on goodwill, to be retained in the business.

For a profit-sharing activity review **Activity 6.8 (p 000).**

The new profit-sharing ratios are:

A and B $\frac{1}{2}$ of $\frac{2}{3}$ = $\frac{3}{8}$ each

C = $\frac{1}{4}$ or $\frac{2}{8}$

The ratio of A, B and C is 3:3:2 respectively.

Method 2

As an alternative to the previous example, Partner C needs to contribute for his or her part of the goodwill—that is, $6000. This amount is paid directly to the existing partners, A and B, via the cash at bank account and is then divided between partners A and B.

GENERAL JOURNAL

Date	Details	Debit ($)	Credit ($)
	Cash at bank	6000	
	Capital A		3000
	Capital B		3000
	Contribution by new partner C to the goodwill of the business		

Goodwill can also be determined by deducting the net assets—that is, assets minus liabilities—from the overall worth of the business.

Illustration 6I

In a partnership, A, B and C share profits and losses equally. They have a capital balance of $25 000 each.

The business assets are valued at $100 000 less the liabilities of $20 000 = net assets of $80 000 less capital accounts $75 000 = goodwill of $5000.

See **Activity 6.9 (p 000)**.

In this book only Method 1 will be considered. In the illustrations and activities, the full value of goodwill represents the transfer value from the old partnership to the new one, and thus a goodwill account will be raised at its full value, as agreed by the partners.

It is also assumed that the goodwill has occurred through the efforts of the existing partners, although it is possible for a new partner to bring assets into the business that generate goodwill for the new partnership.

Goodwill is a non-current asset.

Tutorial E

Explain the term 'goodwill' and state why it arises.

ACCOUNTING STEPS TO BE TAKEN BEFORE A NEW PARTNER IS ADMITTED

1. Review the values of assets.
2. Consider whether goodwill is to be included.
3. Record changes in a general journal entry.
4. Open a capital adjustment account and enter the increases or decreases.

5. Calculate the profit or loss on adjustment and transfer this to the partners' capital accounts.
6. For the new partner, prepare an opening general journal entry if items other than cash are brought into the business. If it is 'cash' only, it is entered in the cash receipts journal.
7. Calculate the partners' new profit-sharing ratio.
8. Prepare a new Statement of Financial Position, amalgamating the new assets and liabilities with the existing accounts.

Tutorial F

Goodwill is to be valued at $10 000 and included in the books. What is the general journal entry to record this?

CAPITAL ADJUSTMENT ACCOUNT

This account is also called a valuation adjustment account. It is used to record changes in a business *before* the ownership structure is altered, to ensure that assets and liabilities are shown at a fair value in the books of account.

The debit side contains asset devaluations and new provisions and the credit side contains revaluations of assets. The difference between the two sides of the account is transferred to the existing partners' capital accounts, in accordance with their profit-sharing ratios.

This account is not in accordance with the accounting standards. However, as it is usually done with the agreement of the incoming partner, it is a convenient way of finishing an existing partnership before the ownership changes.

Illustration 6J

The following is an unclassified Statement of Financial Position for Apple and Pear who share profits and losses 2:1.

Assets	$	Liabilities	$
Cash at bank	12 000	Accounts payable	10 000
Motor vehicle	14 000	Mortgage on buildings	110 000
Land	50 000		
Buildings	200 000	**Partnership funds**	
Furniture	6 600	Capital, Apple	120 000
Inventories	11 000	Capital, Pear	60 000
Accounts receivable	6 400		
	300 000		300 000

Alterations required by the existing partners at 31 May:

1. A new provision for doubtful debts to be created at 5% on the balance of accounts receivable.
2. Land to be revalued by 20%.
3. A stocktake shows the inventories value to be $10 000.
4. The motor vehicle was overvalued by 8%.
5. A building valuation shows that the asset value has increased by $23 040.

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GENERAL JOURNAL ENTRIES

Date	Details	Debit ($)	Credit ($)
31 May	Land	10 000	
	Building	23 040	
	Capital Adjustment		33 040
	Revaluation of assets		
	Capital adjustment	2 440	
	Provision for doubtful debts		320
	Inventories		1 000
	Motor vehicle		1 120
	Devaluation of assets		
	Capital adjustment	30 600	
	Capital Apple		20 400
	Capital Pear		10 200
	Capital adjustment allocated to partners as per profit-sharing ratio		

CAPITAL ADJUSTMENT ACCOUNT

Date	Details	Debit ($)	Date	Details	Credit ($)
31 May	Provision for doubtful debts	320	31 May	Land	10 000
	Inventories	1 000		Building	23 040
	Motor vehicle	1 120			
	Capital Apple	20 400			
	Capital Pear	10 200			
		33 040			33 040

The difference between the two sides, $30 600, is divided between the two partners in the ratio of

$$==\frac{30\ 600}{3} \quad \$10\ 200 \quad \times = 2 \quad \$20\ 400$$ for Apple.

Illustration 6K

The new Statement of Financial Position for Illustration 6J before a new partner is admitted is:

Adjusted Statement of Financial Position for Apple and Pear as at 1 May

Assets		$	Liabilities	$
Cash at bank		12 000	Accounts payable	10 000
Motor vehicle		12 880	Mortgage on buildings	110 000
Land		60 000		
Buildings		223 040	**Partnership funds**	
Furniture		6 600	Capital Apple	140 400
Inventories		10 000	Capital Pear	70 200
Accounts receivable	6400			
less provision for doubtful debts	320	6 080		
		330 600		330 600

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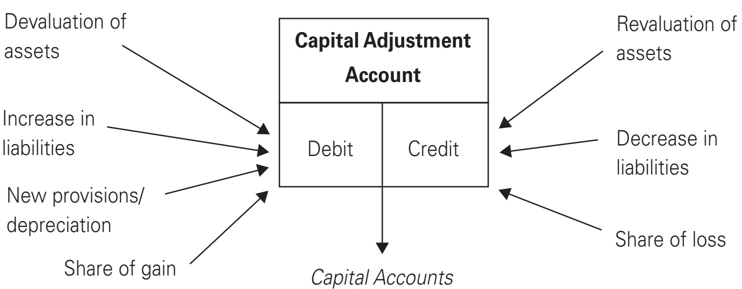
The ratio between Apple and Pear is still 2:1. $140 000 + 70 200 = $\frac{210\ 600}{3}$ = $70 200

Try **activities 6.10 to 6.14 (p 000)**.

SUMMARY

Figure 6.2 Contents of a capital adjustment account



Tutorial G

What is the purpose of the capital adjustment account? Why is it necessary to revalue or devalue assets?

PARTNERSHIP DISSOLUTION

REASONS FOR DISSOLVING A PARTNERSHIP

The Partnership Act states the circumstances under which partnerships may be dissolved:

- partners giving notice of intention to dissolve the partnership
- expiration of the time or purpose set for the partnership
- insolvency of a partner
- where the ownership changes, for example when converting to a company.

Other reasons include:

- inability to trade profitably
- death of a partner, where agreement has not been made for the business to continue
- a voluntary agreement by the partners to dissolve the agreement.

The courts may also rule that a partnership should be terminated when a partner becomes of unsound mind, is permanently incapable of performing the partnership agreement, or consistently breaches the agreement.

THE REALISATION ACCOUNT

The realisation account is also called a dissolution account. When a business finishes, its accounts are closed off and a realisation account is opened.

Debits to the realisation account include:

1. The book values of the assets to be sold. This would not include any 'cash' accounts.
2. Debts to be collected, such as accounts receivable.
3. Legal and other expenses for winding up the partnership.
4. Any accrued expenses, such as salaries owing to staff.
5. Gains on realisation transferred to the capital accounts in the proportion that partners share profits and losses.

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Credits to the realisation account include:

1. The cash value of assets sold.
2. Details of assets taken over by the existing partners.
3. The amounts collected for accounts receivable.
4. Existing provisions and accumulated depreciation.
5. Discount revenue from paying the accounts payable.
6. Where the purchaser takes over any liabilities, for example for the sale of a building if the purchaser also takes over the existing mortgage.
7. Losses on realisation transferred to the capital accounts in the proportion that partners share profits and losses.

Other points to consider:

- Note that the payment of liabilities, for example accounts payable, loans owing and the GST payable, are not part of the realisation account. These accounts are paid direct from the cash at bank account balance. Note that a liability, such as a mortgage on a building, may be taken over by the new owner. Where this occurs, the value of the liability is credited to the realisation account.
- Other liabilities, such as a partner's loan to the business, are paid out in cash before the final cash settlement to the partners.
- Any cash asset accounts, such as a petty cash fund and a change float, are closed by transferring the balance of the account to the cash at bank account.
- There is no need to account for bad debts. The accounts receivable balance is debited to the realisation and the credit is the amount actually collected from debtors. This is the same procedure as that for the sale of non-current assets.
- Current accounts with either debit or credit balances are closed to the relevant capital account of each partner.
- If the final capital account has a debit balance, this amount is to be paid in by cash. Where the final capital account has a credit balance, this amount is owed by the business to the partner.
- Note that the final cash payments in or out are the amounts actually owed by or due to partners and are not related to their profit-sharing ratios. The closing cash amounts will be altered if one of the partners is insolvent at the time of dissolution.
- This final action closes the partnership accounts.

Illustration 6L

The following is the unclassified Statement of Financial Position for Orange, Lime and Lemon, who share profits and losses 2:1:1.

Assets	$	Liabilities	$
Cash at bank	16 000	Accounts payable	12 500
Motor vehicle	26 000	Mortgage on buildings	50 000
Accumulated depreciation	(5 200 cr)		

Land and buildings	250 000	**Partnership funds**	
Furniture	10 000	Capital Orange*	195 000
Inventories	15 000	Capital Lime	50 000
Accounts receivable	6 000	Capital Lemon	15 000
Provision doubtful debts	(300 cr)		
Computer	5 000		
	322 500		322 500

* Note that partners' capital funds do not have to be related to the profit-sharing ratio. Orange's extra contribution would have been compensated for by receiving interest on capital, in the profit and loss appropriation account.

Information at the date of dissolution, 1 June:

1. $3400 was collected for accounts receivable.
2. The legal expenses of winding up were $1600.
3. The inventories were taken over by Orange at cost less 10%.
4. The computer was taken over by Lime at 60% of its cost.
5. The motor vehicle was taken over by Lemon for $14 000.
6. The land, buildings and furniture were sold for $200 000.
7. The accounts payable and the mortgage were paid in full.

The realisation account is:

Date	Details	Debit ($)	Date	Details	Credit $
1 June	Motor vehicle	26 000	1 June	Accumulated depreciation	5 200
	Land and buildings	250 000		Provision doubtful debts	300
	Furniture	10 000		Accounts receivable	3 400
	Inventories	15 000		Orange—Capital	13 500
	Accounts receivable	6 000		Lime—Capital	3 000
	Computer	5 000		Lemon—Capital	14 000
	Legal costs	1 600		Other assets—Cash	200 000
				Losses shared	
				Orange—Capital	37 100
				Lime—Capital	18 550
				Lemon—Capital	18 550
		313 600			313 600

Tutorial H

What is the purpose of a realisation account?

The difference between the two sides is $72400 divided by 4 = $18 550. Orange has a loss of 2 × $18 550 = $37 100 and Lime and Lemon have a loss of $18 550 each.

Illustration 6M

The capital accounts and final cash at bank account for Illustration 6L are:

ORANGE—CAPITAL

1 June	Realisation inventories	13 500	1 June	Balance	195 000
	Realisation loss	37 100			
	Cash	144 400			
		195 000			195 000

Tutorial I

After realisation has been completed, why are partners not paid out in their profit-sharing ratios?

LIME—CAPITAL

1 June	Realisation computer	3 000	1 June	Balance	50 000
	Realisation loss	18 550			
	Cash	28 450			
		50 000			50 000

LEMON—CAPITAL

1 June	Realisation motor vehicle	14 000	1 June	Balance	15 000
	Realisation loss	18 550		Cash	17 550
		32 550			32 550

CASH AT BANK

1 June	Balance	16 000	1 June	Accounts payable	12 500
	Accounts receivable	3 400		Mortgage on buildings	50 000
	Other assets—Cash	200 000		Legal costs	1 600
	Lemon—Capital	17 550		Orange—Capital	144 400
				Lime—Capital	28 450
		236 950			236 950

Lemon had to pay into the partnership $17 550 so that Orange and Lime can be paid the amounts due to them.

GST AND DISSOLUTION OF A PARTNERSHIP

There may be GST owing by a partnership at the time of it finishing. Added to this will be GST input tax credits on the legal costs of winding up the business and any final accounts not yet in the books, for example final rent paid. Note that if there are some accounts such as rates and taxes or wages to be included, these expenses are GST free.

On the basis that all items were acquired after GST commenced, there will be GST payable to the Australian Tax Office (ATO) on the sale of assets. There will be no GST on the collection of book debts, because GST was originally charged when the sales of trading stock or services were made. However, if not all debts are collected, there will be a GST input tax credit available for the bad debts, as these sales were originally paid as GST to the ATO.

The GST is not included in the realisation account, as this is for the contribution to the loss or gain for partners.

Illustration 6N

For convenience, only one combined GST account is used.

An example of dissolution on 1 May, including GST, is:

- GST owed to the ATO at the time of dissolution is $1700.
- Legal expenses of finishing the business are $1650 including GST.
- The final rental of $440, including GST, is not yet in the accounts.
- The final wages payment for staff, not yet included, is $1500 (no GST).
- Accounts receivable owed is $15 000, but $1100 cannot be collected and is written off as bad debts.
- Assets were sold for $159 500 including GST.

GOODS AND SERVICES TAX PAYABLE

Date	Details	Debit ($)	Date	Details	Credit ($)
1 May	Legal expenses	150	1 May	Balance	1 700
	Rent expense	40		Sale of assets	14 500
	Bad debts	100			
	Cash to the ATO	15 910			
		16 200			16 200

The incompleted realisation account (extract) is:

1 May	Legal expenses	1 500	1 May	Cash—Accounts receivable	13 900
	Rent expense	400		Cash—sale of assets	145 000
	Wages	1 500		Bad debts—GST	100
	Accounts receivable	15 000			

Try **Activity 6.15 (p 000).**

Explanations

1 Legal expenses $\frac{\$1650}{11} = \$150$ claimable by the partnership.

2 Rent expense $\frac{\$440}{11} = \$40$ available as an input tax credit.

3 'Wages' does not contain GST.

4 Of the bad debts of $1100, $100 is claimed back as an input tax credit because the amount was originally passed on to the ATO in sales of $1100 including GST.

5 Bad debts in the realisation account is the credit to the debit in the GST account.

6 GST on the sale of assets = $\frac{\$159\ 500}{11} = \$41\ \ 500$

GST is contained in the realisation activity, Activity 6.16.

WHEN A PARTNER IS INSOLVENT

Insolvency means that a partner is unable to contribute to the debts of the partnership because he or she has insufficient funds, is bankrupt, or has left the partnership and cannot be contacted.

In this case the other partners are legally obliged to share the financial deficiency of the insolvent partner to ensure that external liabilities are paid.

Where there are only two partners the other partner bears the whole of the loss. Where there are more than two partners the amount to be contributed is covered in the court case *Garner vs Murray*. The ruling in this case states that where a partner is insolvent, this loss is *not* shared in the profit-sharing ratios. The loss is shared by the partners in the *ratio of the capital balance at the time of dissolution*.

If solvent partners' capital accounts, as a result of this, transfer from a credit to a debit balance, then instead of receiving a cash payout, the partners will need to contribute from their private resources to the partnership loss.

Illustration 6O

Using the information in Illustrations 6L and 6M, partnership capital balances at the time of dissolution were:

Capital, Orange	195 000
Capital, Lime	50 000
Capital, Lemon	15 000

The capital balances prior to the final payout were:

Capital, Orange	144 400 cr
Capital, Lime	28 450 cr
Capital, Lemon	17 550 dr

Assuming that Lemon was insolvent, prior to the Garner vs. Murray ruling this loss of $17 550 would have been shared in a ratio of two-thirds Orange and one-third Lime, as the original profit-sharing ratio was 2:1:1. (Orange ⅔ of $17 550 = $11 700 and Lime ⅓ = $5850.)

Now the loss must be borne on the ratio of capital *at the commencement of dissolution:*

Tutorial J

What do you understand by the term 'insolvency'?

Capital, Orange	195 000
Capital, Lime	50 000
Total	245 000

The calculation of the loss due to Lemon's insolvency is:

$$\text{Orange} = \frac{\$195\,000 \times 17\,550}{245\,000} = \$31\,968$$

$$\text{Lime} = \frac{\$50\,000 \times 17\,550}{245\,000} = \$3\,582$$

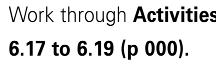
Tutorial K

When a partnership is wound up and debts are owing to the business, what happens if a partner cannot contribute his or her share of the losses?

WHEN ALL PARTNERS ARE INSOLVENT

Any funds available must be first used to pay the legal and other fees associated with winding up the partnership. Then funds are used to pay staff entitlements and amounts owed for accounts payable and loans. There are likely to be insufficient funds to clear the debts and a percentage in the dollar may be declared to pay-off creditors.

The liability of the existing partners is unlimited and legal recourse may be taken against them to recover partnership debts from the former owners' private resources.



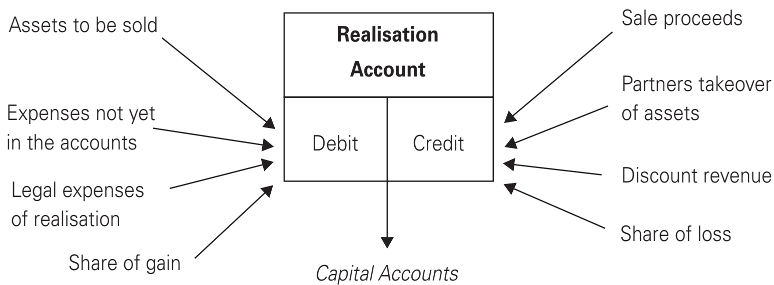
Work through **Activities 6.17 to 6.19 (p 000).**

WHEN THE PARTNERSHIP IS A GOING CONCERN

The new owners may take over all of the partnership assets and liabilities, except cash at bank. All assets and liabilities are then closed to the realisation account before the consideration provided by the new owner is split between the former partners in the proportions of their profit-sharing ratio.

CONTENTS OF A REALISATION ACCOUNT SUMMARISED

Figure 6.3 Summary of the contents of a realisation account



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SUMMARY OF PARTNERSHIP ACCOUNTS

The various sections of partnership accounting are common in the use of current capital and fixed capital accounts. The differences between partnership profit distribution, admission of a new partner and dissolution of partnerships lie in the different accounts, which are summarised here. In partnership accounting, if the contents of each main account can be determined, then it facilitates the use of these three ledger accounts and simplifies the accounting process.

Figure 6.4 Summary of partnership accounts

To calculate partner's share of the net profit or loss → Profit and loss appropriation account

To revalue or devalue assets before a new partner is admitted → Capital adjustment account

To wind up a partnership and distribute the assets to partners → Realisation account

Illustration 6P

Profit and loss appropriation account

Details	Debit	Details	Credit
Profit and loss (net loss)		Profit and loss (net profit)	
Interest on current capital		Interest on drawings	
Interest on fixed capital		Interest on loan by the business	
Salary to partners		Share of loss to each partner	
Bonus to a partner			
Interest on loan to the business			
Partners' special costs paid			
Share of profit to each partner			

The balance of this account is nil, as all surplus profits or losses are transferred to each partner.

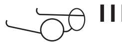


Illustration 6Q

Capital adjustment account

Details	Debit	Details	Credit
Decreases in the value of assets		Increases in the value of assets including raising a goodwill account	
Increases in provision for doubtful debts or accumulated depreciation		Decreases in provision for doubtful debts or accumulated depreciation	
Transfers to capital accounts of gains		Transfers to capital accounts of losses	

Illustration 6R

Realisation account

Details	Debit	Details	Credit
Value of assets to be sold		Accumulated depreciation	
Accounts receivable		Provision doubtful debts	
Legal costs of dissolution		Accounts receivable collections	
Accrued expenses (not yet in the books)		Cash for assets sold	
Profits shared by partners		Partners takeover of assets	
		Discount revenue	
		Liabilities taken over by the purchaser of assets	
		Losses shared by partners	

Finish with **Activity 6.20 (p 000).**

ACTIVITIES

Use your workbook to complete these activities.

ACTIVITY 6.1

WB p188

(See Workbook, page xx)

Tom Carr has a new and used car sales showroom. He is considering a partnership with Mick Canic who is operating a vehicle repair and service business nearby. List the advantages and disadvantages of Tom and Mick forming a partnership and locating the business at Tom's premises.

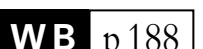
ACTIVITY 6.2

WB p188

(See Workbook, page xx)

Art, Bart and Cart have agreed to share profits based on their capital contributions, which are $185 000, $370 000 and $925 000 respectively. Calculate their profit-sharing ratio.

ACTIVITY 6.3



(See Workbook, page xx)

Art and Craft are partners sharing profits and losses 3:1.

Required

Insert the following items, if appropriate, into a profit and loss appropriation account as at 30 June.

Item	$
Net profit from the profit and loss account	17 800
Interest on capital—Art	7 500
Interest on capital—Craft	2 500
Drawings to Art	5 000
Interest on drawings—Art	500

ACTIVITY 6.4

WB p188

(See Workbook, page xx)

Peter Pan, Wendy and Beauty are in business manufacturing and retailing toys, sharing profits in the ratio 2:2:1 respectively.

The capital accounts balances at the start of the financial year have not altered and are:

Current account	$	Capital account	$
Peter Pan	500 dr	Peter Pan	10 000 cr
Wendy	1000 cr	Wendy	10 000 cr
Beauty	2000 cr	Beauty	20 000 cr

Peter Pan withdrew cash of $1000 on 1 October and Wendy $1000 on 1 January.

The net profit for the year ended 30 June was $116 090.

The partnership agreement states:

1. 12% interest to be charged on drawings (for the part of the year withdrawn) and on any overdrawn accounts
2. 10% interest to be paid on both current and capital credit balances.
3. Beauty, the sleeping partner, received no salary, but Wendy, the factory manager, is to receive a salary of $42 000 and Peter Pan, the travelling salesman, is to be paid $40 000.

Required

1. Prepare profit and loss appropriation account.
2. Prepare each partner's current account.

ACTIVITY 6.5

(See Workbook, page xx)

Lock, Stock and Barrel share profits and losses in a ratio of 4:3:2. Their partnership funds as at 1 January are:

Name	Current capital ($)	Fixed capital ($)
Lock	6200 dr	12 000 cr
Stock	3900 cr	9 000 cr
Barrel	4000 cr	6 000 cr

Lock withdrew $1200 cash on 1 March and Stock withdrew $3600 on 30 April.

The partnership agreement stated that for the six-month period:

1. Interest on drawings is 8% per annum.
2. Interest is to be paid on the opening balances of fixed capital plus or minus current capital, at a rate of 10% per annum.
3. Lock is to receive a salary for the six-month period of $9000 and Stock $6500.
4. Barrel is to be reimbursed $6000 for vehicle use.
5. Interest of $100 on a loan to the partnership by Lock is to be included.
6. Net profit for the six-month period 1 January to 30 June is $37 805.

Required

1. Process items 1 to 6 in the profit and loss appropriation account for the six-month period ended 30 June, showing the share of profits or losses
2. Prepare the current capital accounts for the three partners.

ACTIVITY 6.6

(See Workbook, page xx)

Paula Page owns a bookshop. She has no cash balance and needs additional funds and on 1 January agreed to a partnership with Boris Book, who will contribute cash of $27 000.

Paula's assets and liabilities at 1 January were:

Account	$
Accounts receivable	17 000
Provision for doubtful debts	2 800
Inventories	37 000
Furniture and fittings	6 200
Accumulated depreciation furniture and fittings	4 400
Loan payable, due to be repaid in 2 years	12 000
Accounts payable	7 000

Other information:

1 Drawings were Boris $3000 and Paula $1000 both on 1 April. Interest on drawings is set at 10% per annum and three months interest is to be included.
2 The partners agree to leave $25 000 each in their capital accounts, transferring any excess balance to their respective current accounts.
3 Partners are to receive 6% per annum on their six-month $25 000 capital investment.
4 The profit-sharing ratios are Paula 40% and Boris 60%.
5 Net profit was $16 000.
6 Closing inventories were $53 000.

Required

Prepare:

1 The general journal entries to record the formation of Page and Book, on 1 January, including a separate entry for Boris's contribution.
2 The profit and loss appropriation account as at 30 June.
3 The current accounts for each partner as at 30 June.
4 A classified Statement of Financial Position for the partnership as at 30 June. (Use Paula's account balances at 1 January but include closing instead of opening inventories. The cash balance is Boris's contribution less the drawings.)

ACTIVITY 6.7

(See Workbook, page xx)

Alpha, Beta and Gamma were operating a restaurant in partnership, sharing the profits and losses 4:2:1 respectively. Current accounts are used by the three partners. The net profit was $79 775 for the year ended 30 June.

Drawings were made by Alpha for $4000 on 1 October and also $3000 on 1 April. Interest is charged at 10% per annum and parts of the year are accounted for.

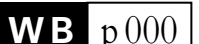
Interest on capital is payable at $7\frac{1}{2}$% per annum on the opening capital balances of Alpha $40 000, Beta $20 000 and Gamma $10 000.

Required

Show general journal entries at 30 June for:

1 Transfer of the net profit.
2 Interest on drawings.
3 Interest on capital.
4 Allocation of the share of profit or loss.

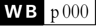
ACTIVITY 6.8



(See Workbook, page xx)

Calculate the new profit-sharing ratios in these three examples:

1 A and B share profits and losses equally and they admit C for a one-fifth share of profits.
2 A and B share profits and losses in a ratio of 3:2 and they admit C for a one-quarter share of profits.
3 A, B and C share profits and losses in a ratio of 3:2:1 and they admit D for a one-sixth share of profits.



ACTIVITY 6.9

(See Workbook, page xx)

Briefly describe the term 'goodwill' as applied to partnership accounting. Include in your answer examples of how goodwill can arise.

ACTIVITY 6.10

(See Workbook, page xx)

On 1 May, Pillow and Sheet who share profits and losses equally, decide to admit Mattress as a sleeping partner. Mattress is to contribute cash of $30 000 and will receive a one-fifth share of the profits or losses.

The unclassified Statement of Financial Position of Pillow and Sheet before the amalgamation on 30 April is:

Liabilities	**$**	**Assets**	**$**	**$**
Accounts payable	1 050	Cash at bank		1 550
		Accounts receivable	2350	
		Less provision for		
		doubtful debts	150	2 200
		Inventories		13 500
Partnership funds		Motor vehicles		26 800
Capital—Pillow	52 500	Building		62 000
Capital—Sheet	52 500			
Total	106 050			106 050

Adjustments to be made before amalgamation:

- Inventories valued at $500 to be written off.
- Provision for doubtful debts to be increased to $200.
- Pay out the accounts payable in cash.
- Motor vehicle to be depreciated by 20%.
- Building to be revalued by 22½%.
- No goodwill account to be raised.

Pillow and Sheet need to pay in to the business, or be paid by the business, sufficient cash to maintain their capital ratio in accordance with Mattress's one-fifth share.

Required

1 Prepare as at 30 April:

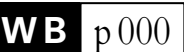
- General journal entries for the non-cash adjustments
- Capital adjustment account
- Capital accounts of Pillow and Sheet.

2 Prepare as at 1 May:

- Cash at bank account
- A combined classified Statement of Financial Position for the new partnership
- The new profit-sharing ratio for each partner.

ACTIVITY 6.11

(See Workbook, page xx)



Dog and Cat share profit and losses equally, with a capital balance of $40 000 each. They decide to admit a new partner, Koala, to widen their appeal, on 30 September.

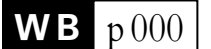
Koala requests the dollar value of assets needed to be brought in to obtain a three-eighths share, and what the new partnership ratio for sharing profits and losses will be. Koala will bring in the amount due in the form of inventories, cash and furniture, one-third of the amount each.

Required

1 Prepare the general journal entry to admit Koala for a three-eighths share of the profits and losses based on the total capital accounts of Dog and Cat.
2 Calculate the new profit-sharing ratios.
3 How much cash is needed to be refunded to Dog and Cat, to maintain the capital values as per the profit-sharing ratio.

ACTIVITY 6.12

(See Workbook, page xx)



Sole and Heel share profits and losses 3:2 respectively. They decide to admit Lace who is trading nearby, to tie up the partnership for a one-fifth share of the profits or losses.

All current and fixed capital accounts have a credit balance.

Their respective unclassified Statements of Financial Position as at the date of the amalgamation 1 June are:

Liabilities	**Lace ($)**	**Sole and Heel ($)**	**Assets**	**Lace ($)**	**Sole and Heel ($)**
Bank overdraft	680	0	Cash in hand	100	140
Accounts payable	3 200	6 850	Cash at bank	0	6 770
Mortgage	25 000	44 000	Accounts receivable	2 000	5 600
GST owing	320	390	Inventories	1 100	2 430
Advance by Sole		13 500	Plant	7 000	23 600
Current capital			Furniture and fittings	600	870
Sole		400	Computer	0	1 390
Heel		860	Land and buildings	36 000	54 000
			Motor vehicles	1 200	11 200
Fixed capital:					
Sole		24 000			
Heel		16 000			
Lace	18 800				
Total	48 000	106 000	**Total**	48 000	106 000

The terms of the amalgamation are:

1 Prior to the admission of Lace, Sole and Heel are to adjust their accounts as follows:
- Inventories increased to $2800.
- Plant decreased to $22 000.
- Furniture and fittings increased by $130.
- Land and buildings to increase to $60 000.
- Creation of a new provision for doubtful debts of $200.
- A goodwill account to be raised for $30 000.

2 Lace's assets and liabilities are to be brought in at the stated values, except:
   - Land and buildings to be increased by $6400.
   - Inventories to be decreased to $1000.
   - Accounts receivable subject to a new 5% provision for doubtful debts.
   - Lace's fixed capital to be recorded at $25 000.

3 The current capital accounts of Sole and Heel and the advance by Sole are to be eliminated by transfer to their fixed capital accounts.

4 The final fixed capital balances are the amounts to be entered into the balance sheet.

Required

Prepare:

1. Capital adjustment account for Sole and Heel.
2. Fixed capital accounts for Sole and Heel (use a composite account if preparing the T- shape method).
3. The general journal entry to admit Lace.
4. A combined classified Statement of Financial Position as at 1 June

ACTIVITY 6.13

(See Workbook, page xx)

Apple and Banana are sharing profits and losses in the ratio of 3:2.

Unclassified Statement of Financial Position of Apple and Banana as at 31 May

ASSETS	$	$	LIABLITIES	$	$
Accounts receivable	4 400		Bank overdraft	3400	
less Provision for doubtful debts	200	4 200	Mortgage on building	70 000	
Cash on hand for change		500	Accounts payable	5 600	79 000
Inventories		12 000			
Computer	5 800				
less Accumulated depreciation	2 400	3 400	**Partnership funds**		
Motor vehicle	32 000		Capital—Apple	74 460	
less Accumulated depreciation	5 000	27 000	Capital—Banana	49 640	124 100
Building		150 000			
Furniture		6 000			
		203 100			203 100

Prior to Cumquat being admitted to the partnership, the existing partners decide to:

1. Devalue the inventories by 8½%.
2. Add 12% to the value of the building.
3. Increase the provision for doubtful debts to $500.
4. Pay out the accounts payable in full from the bank overdraft.
5. Raise a goodwill account of $8000.

Cumquat is to bring in the following, for a one-sixth share of the profits and losses on 1 June.

Assets	$	Liabilities	$	Owner's equity	$
Plant and equipment	17 000	Accounts payable	8 000	Capital	30 000
Cash	20 000				
Computer	1 000				

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Required

1 Prepare the capital adjustment account for Apple and Banana.
2 The capital amount for Cumquat of $30 000 reflects the one-sixth share of the profit and losses in the new partnership. To maintain their existing ratio, Apple must have a share of the business of three-sixths and Banana two-sixths. Adjust the existing partners' capital accounts to reflect a balance commensurate with their profit-sharing ratios. (Note that the partners may have to bring in extra capital or be paid out in cash, to adjust their capital accounts to relate to Cumquat's one-sixth capital share of $30 000)
3 Prepare the capital accounts of Apple and Banana after all adjustments have been made.
4 Prepare the cash at bank account.
5 Prepare a classified Statement of Financial Position for the three partners as at 1 June, showing the working capital.

ACTIVITY 6.14

WB p000

(See Workbook, page xx)

Robin and Banks are in a growing business sharing profits and losses in a ratio of 4:1. The ledger accounts for Robin and Banks as at 31 March show the following:

Account	Debit ($)	Credit ($)
Tools of trade	2 500	
Business vehicle	16 000	
Accumulated depreciation motor vehicle		3 000
Plant	8 000	
Cash at bank	17 000	
Inventories	15 200	
Accounts receivable	7 300	
Accounts payable		15 200
Building	55 000	
Mortgage		23 000
Current capital—Robin		4 800
Fixed capital—Robin		60 000
Fixed capital—Banks		15 000
Total	**121 000**	**121 000**

Adjustments required before the new partner Capone is introduced:

1 There in no goodwill for Robin Banks.
2 Bad debts of $300 to be written off and a new provision for doubtful debts of 8% to be created on the remaining accounts receivable balance.
3 Buildings to be revalued to $60 000.
4 $2000 value of inventories destroyed.
5 Mortgage to be paid out in cash.

Capone is to be introduced on 31 March for $40 000 cash for a one-fifth share of the profits or losses.

Required

Prepare as at 31 March:

1 Capital adjustment account.

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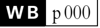
2 Capital accounts for Robin and Banks (use the composite account if preparing. T-shape accounts).
3 A classified Statement of Financial Position showing working capital as at 31 March
4 The new profit-sharing ratio of each partner.



ACTIVITY 6.15

(See Workbook, page xx)

Young, Old and Feeble are sharing profits and losses in a ratio of 6:3:1. As Young is nearing retirement, it was decided to disband the partnership on 1 July.

The trial balance on 1 July was:

Account	Debit ($)	Credit ($)
Capital—Young		84 000
Capital—Old		50 000
Capital—Feeble		3 000
Building	120 000	
Plant and equipment	40 000	
Mortgage loan		40 000
Computer and office machines	10 000	
Accounts receivable	9 000	
Accounts payable		16 000
Inventories	8 000	
Cash at bank	6 000	
Total	**193 000**	**193 000**

1 Assets taken over by the partners were:
- Young: a fridge $5000 and inventories a further $5000.
- Old: Inventories $200.
- Feeble: the computer for $3000.

2 Saleable assets and the accounts receivable fetched $145 000.
3 The costs of realisation were $1000.
4 The mortgage was paid off at its full value and the accounts payable were cleared for $15 500.

Required

As at 1 July, prepare ledger accounts for:
1 Realisation
2 Each partner's capital
3 Cash at bank.

ACTIVITY 6.16

(See Workbook, page xx)

Watch and Clock's partnership is to be wound up. Profits and losses are shared in the ratio 3:2. The unclassified Statement of Financial Position at the date of realisation, 30 May, was:

Liabilities	$	Assets	$
Accounts payable	500	Accounts receivable	7 000
Loan	1 500	Inventories	20 000

GST payable	1 300	Motor vehicle	7 800
FIXED CAPITAL		Buildings	42 000
Watch	40 000	Fixtures and fittings	4 000
Clock	40 000	Cash at bank	2 500
Total	83 300	**Total**	83 300

- The accounts receivable realised $5900. The other $1100 was written off as bad debts, including an input tax credit available for the business for the bad debt.
- Watch took over the motor vehicle at an agreed value of $4400. (No GST is payable.)
- The other saleable assets realised $55 000, including the full GST payable to the Australian Tax Office.
- Legal expenses of winding up were $1650 including 10% GST.
- An additional account, not yet included in the books, for rates and taxes $400 had not yet been paid, but no GST was applicable to this account.

Required

As at 30 May, prepare ledger accounts for:

1 Realisation
2 Goods and services tax payable
3 Cash at bank.

ACTIVITY 6.17

WB p000

(See Workbook, page xx)

Daffo Dill and Jon Quill are equal partners in a business that was once rosy but is not now blooming. They decide to stem the partnership by dissolving it on 1 April. The partners' fixed capital is equal. The assets and liabilities as at 1 April were:

Assets	**$**	**Liabilities**	**$**
Petty cash	60	Bank overdraft	1500
Accounts receivable	13 400	Accounts payable	16 300
Inventories	21 000	Mortgage	30 000
Fixtures	14 500	Accrued salaries	560
Building	54 000		
Tools	3 600		
Motor vehicle	13 800		
Total	120 360	**Total**	48 360

Additional information:

1 Expenses to wind up the business were $7200.
2 Rates of $1000 have not yet been included in the books of account.
3 Dill took over the motor vehicle at 90% of its book value.
4 Quill took over the inventories at 20% less than the book value.
5 95% of debts were collected.
6 Saleable assets realised $84 000.
7 The liabilities were paid out in cash.
8 The partners were paid out the amount owed, or need to pay in the amount due.
9 There is no GST to consider.

Required

Prepare:

1 The realisation account.
2 Capital accounts for both partners (use a composite account for the T-shape approach).
3 The cash at bank account.

ACTIVITY 6.18

(See Workbook, page xx)

Nice, Good and Bad were in partnership sharing profits and losses 3:2:1 respectively. At the date of dissolution, 1 May, their accounts showed:

Assets	**$**	**Liabilities**	**$**
Accounts receivable	10 000	Accounts payable	2 000
Inventories	12 000	Capital—Nice	22 500
Machinery	7 000	Capital—Good	7 500
Cash at bank	1 000	Capital—Bad (overdrawn)	(2 000)
Total	30 000	**Total**	30 000

Additional information:

1 The inventories were taken over by Nice at 85% of their book value.
2 Bad took over the machinery at its full value.
3 The accounts receivable realised $7300.
4 A discount revenue of 5% was received when paying the accounts payable.
5 The expenses of realisation were $4000.
6 After realisation, it was found that Bad had sold the machinery for his private gain and was insolvent, being unable to contribute his losses to the partnership.

Required

Prepare:

1 The general journal entries for the realisation account transactions (ignore 'Cash' transactions for the journal).
2 The realisation account.
3 The calculations to distribute Bad's loss to Nice and Good and the final cash amount owed to or by them.
4 The cash at bank account.

ACTIVITY 6.19

(See Workbook, page xx)

The partnership of Ship, Boat and Rudder has come adrift. The three partners share profits and losses equally. They dissolve the partnership on 22 May and ask you to prepare the accounts to close the partnership.

You reconstruct the partners' Statement of Financial Position as at 22 May and it shows:

Current liabilities	**$**	**Current assets**	**$**
Bank overdraft	6 900	Inventories	22 700
Advance made by Ship	54 000	Accounts receivable	40 000

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Accounts payable	15 800	Insurance prepaid	1 000
Wages accrued not yet paid	700		
Non-current liabilities		**Non-current assets**	
Mortgage	40 000	Land and buildings	60 900
		Plant and equipment	15 000
Partnership funds		Motor vehicle	12 000
Capital—Ship	24 000		
Capital—Boat	12 000		
Capital—Rudder (overdrawn)	(2 200)		
Current—Rudder	400		
Total	**151 600**	**Total**	**151 600**

Other information:

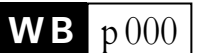
1 Inventories taken over by Ship for $15 000.
2 Boat buys the motor vehicle for $9000 cash.
3 The cash received for the other assets and accounts receivable was $123 300.
4 The prepaid insurance was refunded to the business.
5 Accounts payable were settled for $14 300.
6 The mortgage and accrued wages were paid in full.
7 Ship's advance was transferred to the capital account.
8 Realisation expenses were $1800.
9 After realisation, it was discovered that Rudder is bankrupt and cannot contribute to the partnership debts.
10 There is no GST to consider.

Required

Prepare:

1 The realisation account.
2 Each partner's capital account.
3 The cash at bank account.

ACTIVITY 6.20



(See Workbook, page xx)

A and B share the profits and losses of their business equally. Here are some transactions that occurred in their partnership:

Item	Amount ($)	Item	Amount ($)
Assets to be sold	200 000	Revaluation of assets	24 000
Accounts receivable to be collected	40 000	Assets taken over by a partner	20 000
Net profit from profit and loss	62 000	Realisation loss to partners	101 500
Discount revenue	500	Interest on drawings—A	50
Dissolution legal expenses	2 000	Drawings—A	500
Interest on capital—A	1 700	Cash received for sale of assets	120 000
Interest on capital—B	1 500	Salary—B	20 000
Devaluation of assets	6 000	Bonus of 1% net profit—A	620
New provision for doubtful debts	800	New goodwill account	6 000
Gain on capital adjustments	23 200		

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Required

Select from the above table the *relevant items* and enter them into the appropriate ledger account in either T-shape or columnar form. Balance each of the accounts as at 30 June:

1 Profit and loss appropriation.
2 Capital adjustment.
3 Realisation.

HOMEWORK QUESTIONS

Use your workbook to answer these homework questions.

HOMEWORK QUESTION 6.1

WB p188

(See Workbook, page xx)

Two businesses, Ay and Bee, agree to merge into a partnership as at 1 July. The assets and liabilities are as follows:

Ay: items	Debit ($)	Credit ($)	Bee: items	Debit ($)	Credit ($)
Cash at bank	2 300		Bank overdraft		4 000
Inventories	7 200		Inventories	14 600	
Accounts receivable	4 000		Furniture	10 900	
Provision for doubtful debts		300	Building	100 000	
Computer	3 300		Mortgage on building		97 000
Loan from bank		12 800	Equipment	12 000	
Goodwill	7 000		Accumulated depreciation equipment		6 600
Accounts payable		2 400	Accounts payable		7 400

Required

1. Write off bad debts of $800 for Ay, then calculate the opening capital account balances for both partners.
2. Prepare a combined classified Statement of Financial Position for both partners as at 1 July.
3. Show the profit-sharing ratios as a percentage for each partner, with the opening capital balances being the basis of the ratio.

HOMEWORK QUESTION 6.2

For the partnership of Gordon, Light and Foote, the share of profits was $30 000, $18 000 and $12 000 respectively. Gordon was charged interest on drawings of $500 and each of the three partners received an amount of $2000 for interest on capital. Gordon received a bonus of $1500 and Light a salary of $22 000. All entries were entered in the profit and loss appropriation account.

Required

Reconstruct the profit and loss appropriation account to show all of the above entries and the net profit.

HOMEWORK QUESTION 6.3

WB p000

(See Workbook, page xx)

Milligan, Secombe and Sellers form a partnership on 1 July for their new business 'Goon with the Wind'.

At the start of the year the partners' accounts showed the following credit balances:

Account	Milligan ($)	Secombe ($)	Sellers ($)
Current capital	3 000	0	15 000
Fixed capital	150 000	100 000	150 000

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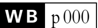
Drawings were Sellers $4000 on 1 October and Secombe $5000 on 1 April. Net profit for the year ended 30 June was $150 000.
According to the partnership agreement:

1 Drawings were to be accounted for by months withdrawn at an interest rate of 10% per annum.
2 Interest is to be paid on the opening balance of current capital at 10% per annum and 8% per annum on fixed capital.
3 A salary of $25 000 is to be paid to Secombe.
4 Sellers is to receive a bonus of 1% of the net profit.
5 Profit and loss shares are Milligan, Secombe and Sellers 2:1:2 respectively.

Required

1 Prepare a profit and loss appropriation account, showing the net profit, items 1 to 4 above, and each partner's share of the profit or loss, using the ratio as shown
2 Prepare current capital accounts for each partner.



HOMEWORK QUESTION 6.4

(See Workbook, page xx)

Required

Show general journal entries for the following:

1 Transfer net profit of $50 000 for the year ended 30 June
2 Interest on fixed capital at 9% per annum:
A: balance of $50 000
B: balance of $30 000
3 Interest on drawings at 12% per annum:
A: drawings of $1400 taken out for nine months
B: drawings of $1000 taken out for five months.
4 At a profit-sharing ratio of 5:3 for A and B respectively, transfer the profit or loss for the year ended 30 June.

HOMEWORK QUESTION 6.5

(See Workbook, page xx)

Burke and Wills share profits and losses 2:1 respectively in their business 'Walkabout Tours'.

On 1 October they agreed to admit Sturt and amalgamate his business 'Down the River Trips' for a one-quarter share of the profits and losses. Sturt contributed cash of $90 000 and inventories of $10 000.

Prior to admitting Sturt, the Statement of Financial Position of Burke and Wills is:

	$	$		$	$
Current liabilities			**Current assets**		
Bank overdraft	5 500		Accounts receivable	20 000	
Accounts payable	12 000		Inventories	36 000	
Short term loan	4 000	21 500	Tour material	12 500	68 500
Partnership funds			**Non-current assets**		
Capital—Burke	120 000		Equipment	36 000	
—Wills	80 000	200 000	Computer	3 000	
			Furniture	4 000	
			Motor vehicles	110 000	153 000
		221 500			221 500

It was agreed before Sturt commences to:

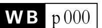
1 Devalue the equipment by $12 000.
2 Revalue furniture by $1000.
3 Provide for doubtful debts at 8% of the accounts receivable balance.
4 Depreciate motor vehicles at 20% on cost and the computer at 40% on cost (straight-line method).
5 Raise a goodwill account for $10 000.
6 Sturt is being introduced for a one-quarter share of the profits and losses with a total contribution of $100 000. The capital balances for Burke and Wills are to be increased, to reflect the new profit-sharing ratio. Burke and Wills will need to contribute further cash into the business to adjust their capital balances to equate with the one-quarter share for Sturt for $100 000.

Required

Prepare:

1 Capital adjustment account.
2 Capital accounts of Burke and Wills.
3 The new profit-sharing ratio for the three partners.
4 Cash at bank account.
5 Combined Statement of Financial Position of Burke, Wills and Sturt as at 1 October.

HOMEWORK QUESTION 6.6



(See Workbook, page xx)

Black and White share profits and losses 3:2. Their Statement of Financial Position as at 30 June shows:

	$	$		$	$
Current liabilities			**Current assets**		
Accounts payable		69 000	Cash at bank	96 000	
			Inventories	93 000	
Non-current liabilities			Accounts receivable	84 000	273 000
Loan by White		45 000			
			Non-current assets		
Partnership funds			Furniture	33 000	
Capital—Black	252 000		Buildings	246 000	279 000
—White	186 000	438 000			
		552 000			552 000

It was agreed to admit Green on 1 July. Her Statement of Financial Position at that date is:

	$	$		$	$
Current liabilities			**Current assets**		
Bank overdraft	57 000		Accounts receivable	69 000	
Accounts payable	54 000	111 000	Inventories	57 000	126 000
Partnership funds			**Non-current assets**		
Capital—Green		159 000	Furniture	18 000	
			Vehicles	24 000	
			Building	102 000	144 000
		270 000			270 000

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For Black and White, prior to the admission of Ms Green:

1. Provision for doubtful debts to be created to $600.
2. Inventories to be decreased to $84 000.
3. Building to be valued at $265 500.

For Ms Green the building was to be revalued at $165 000 and all other assets and liabilities brought in at the balance sheet amounts. She will need to bring in extra cash to increase her capital to $240 000 and have an equal share of the profits and losses with Black and White.

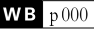
The loan by White is to be eliminated by transferring the amount to his capital account.

Black and White are to finish with capital balances of $240 000 each. It may be necessary for each partner to bring in cash or be paid out cash, to adjust to this capital balance.

Required

Prepare:

1. Capital adjustment account for Black and White.
2. Capital accounts for Black, White and Green.
3. The cash at bank account.
4. A combined classified Statement of Financial Position as at 1 July.



HOMEWORK QUESTION 6.7

(See Workbook, page xx)

Richie Robinson and Carol Caruso trade as Castaways Incorporated, sharing profit and losses in the ratio 3:2 respectively.

Their partnership is abandoned and they agree to terminate the arrangement on 31 May when their combined unclassified Statement of Financial Position shows:

Assets	$	$
Building	40 000	
Plant	7 500	
Inventories	8 750	
Accounts receivable	19 600	
Investments	20 800	
Cash at bank	3 630	100 280
***less* Liabilities**		
Accounts payable	5 280	
Loan by Ms Caruso to the business	15 000	20 280
Net assets		80 000
Partnership Funds		
Capital—Robinson	60 000	
Capital—Caruso	20 000	80 000

Other information:

1. The assets except cash and investments were sold and accounts receivable collected, for a total of $69 000.
2. The investments were taken over at their market value of $22 000 by Caruso.
3. Caruso was repaid her loan account in cash.
4. The expenses of dissolution were $1100.
5. The accounts payable accept $5030 in full settlement of the debt. The difference is discount.
6. There is no GST to consider.

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Required

Prepare ledger accounts for:

1 Realisation
2 Cash at bank
3 Robinson capital and Caruso capital
4 What is the position for Robinson, if Caruso was unable to contribute to the partnership debts?

HOMEWORK QUESTION 6.8

WB p000

(See Workbook, page xx)

Sue, Val and May share profits and losses in a boutique, 1:2:3 respectively.

After a dressing down by May, Sue and Val decide to leave the partnership, which is terminated at 31 July.

On 31 July their trial balance showed:

Account	Debit ($)	Credit ($)
Inventories	38 700	
Rent owing		4 000
Telephone owing		1 720
Lay-bys owing by customers	13 500	
Fittings and furniture	78 900	
Bank overdraft		66 500
Capital—Sue		10 000
Capital—Val		20 000
Capital—May		30 000
Current—Sue	5 000	
Current—Val	10 000	
Current—May	5 000	
Profit and loss appropriation		18 880
Total	151 100	151 100

Other information:

- All liabilities and expenses owing are paid out.
- May will buy the fittings, furniture and inventories for $100 000 cash.
- Sue will take over the lay-bys for $10 000 charged to her capital account.
- Current accounts are closed to capital accounts.
- The profit and loss appropriation is to be distributed in the profit-sharing ratio to the partners' capital accounts (calculations to the nearest dollar).
- There are no expenses of dissolution as May is continuing the business on her own.
- There is no GST to consider.

Required

To close the partnership, prepare:

1 General journal entries for all transactions affecting the realisation account, including cash items.
2 The partners' capital accounts.
3 The cash account.