

UNIT TWELVE: PARTNERSHIP ACCOUNTS

After you have studied this unit, you should be able to:

- Define a partnership
- State the legal position of a partnership
- Outline the contents of a partnership agreement
- State the provisions of the Partnership Act 1890 where an agreement does not exist
- Explain the bookkeeping and accounting techniques of preparing partnership accounts
- Explain an appropriation account
- Explain the items included in the appropriation account
- Draw up the partnership profit and loss appropriation account
- Explain the preparation of the balance sheet
- Explain the use of fixed and fluctuating capital accounts
- Record the drawings and profits appropriated in partners' capital and current accounts.
- Explain the treatment of interest on loans from existing partners.
- Draw up the partnership trading and profit and loss account and the balance sheet
- Explain the need for a revaluation of assets
- Explain how the profit or loss on revaluation is shared
- Draw up a revaluation account
- Identify the reasons for admitting a new partner
- Explain the accounting treatment of the premium paid on admission
- Define Goodwill
- Identify the sources of goodwill
- Explain the bookkeeping entries for goodwill on admission of a partner
- Draw up a balance sheet after admission of a partner
- Define partnership amalgamation
- Account for amalgamation changes in each business
- Draw up an opening balance sheet of the amalgamated businesses
- Outline the reasons for dissolution of partnership
- State the order in which proceeds from the sale of assets are applied in settling debts
- State the double entries for closing the books of account, and the discharge of third party liabilities and partners' accounts.
- Explain the Garner and Murray precedence.
- Prepare the ledger accounts to close the books and discharge all liabilities.

WHAT IS A PARTNERSHIP?

Partnership is an association of two or more persons carrying on business in common with a view to profit. A partnership is not a corporate entity but a collection of individuals jointly carrying on business.

PARTNERSHIP AGREEMENT

The basis of a partnership is an agreement and trust. An agreement may be created in the following ways:

- By deed
- By writing
- By word of mouth
- By cause of dealing

However it is better to have a written agreement to which reference may be made by all partners. A partnership agreement governs the relationship between partners. The important matters covered in the agreement includes:

- i) Capital to be contributed by partners
- ii) Distribution of profits (losses) between partners
- iii) Rate of interest, if any, to be given on capital before the profits are shared
- iv) Rate of interest, if any, to be charged on partners' drawings
- v) Salaries to be paid to partners
- vi) Dissolution arrangements on death or retirement of a partner
- vii) Settling of disputes etc.

WHERE PARTNERSHIP AGREEMENT DOES NOT EXIST

Where no agreement exists, section 24 of the partnership Act 1890 requires that:

- Profits and losses have to be shared equally
- No interest is to be allowed on capital
- No interest is to be charged on drawings
- Salaries are not allowed
- If a partner puts a sum of money into a firm, in excess of the capital he has agreed to subscribe, he is entitled to interest at the rate of 5% per annum on that amount.

PREPARING FINAL ACCOUNTS OF A PARTNERSHIP

The basic bookkeeping and accounting techniques used to present final accounts of a sole trader are generally applicable to partnerships as well.

Profit and loss account

In the profit and loss account, the difference lies in the fact that the partnership profit and loss account has an extra section called an appropriation account.

An **appropriation account** is a ledger account dealing with the allocation of net profit between the partners. The account is credit with the net profit and debited with the net profit brought down from the profit and loss account, and on the debit side shows the division of that profit among the partners.

- i) **Interest on capital:-** where work carried out is of equal value but the capital contributed by the partners is not the same, an interest on partners' capital is introduced to compensate the partner who puts in more capital. The rate of interest charged is a matter of agreement among the partners, though it should reasonably be equal to what the partners would have got had they invested the capital elsewhere.

This interest on capital is an appropriation of profit and not an expense to the partnership.

- ii) **Salaries:-** if one partner has an extra task or a particular responsibility that others do not have, he should be credited with a salary to compensate him for the extra task. The salary to a partner is appropriation of profits and not an expense to the partnership.
- iii) **Interest on drawings:-** the reason for providing for a notional interest charge on drawings is to make sure that those partners who draw out **more** cash than their colleagues in the **early part** of the year should suffer. The interest charged is calculated from the date of withdrawal to the end of the financial year. Interest on drawings is merely a negative profit share.
- iv) **Share of residue:-** this is simply the balance of profits or losses that remain after the above appropriations. The residue is shared in accordance with the agreed profit sharing ratio.

Example:

Short and Long are in partnership and have the following profit sharing arrangements:

- Interest on capital is to be provided at a rate of 8% per annum
- Short and Long are to receive salaries of K10 000 000 and K12 000 000 per annum respectively.
- The balance of profit or loss is to be divided between Short and Long in the ratio 3: 2.

Net profit for the year ended 31st December 2004 amounted to K40 000 000 and capital balances were Short K24 000 000 and Long K18 000 000.

Required: Prepare the profit and loss appropriation account for the partnership for the year.

Solution:

<i>Short and Long</i>		
<i>Partnership appropriation account for the year ended 31st December 2004.</i>		
	K'000	K'000
Net profit		40 000
Less appropriations:		
Interest on capital:		
Short	1 920	
Long	1 440	
Salaries:		
Short	10 000	
Long	<u>12 000</u>	
		<u>25 360</u>
Balance to be shared		<u>14 640</u>
Share of residue:		
Short ($\frac{3}{5}$)	8 784	
Long ($\frac{2}{5}$)	<u>5 856</u>	
		<u>14 640</u>

The balance sheet

In the balance sheet, the difference lies in the capital section of a partnership. The capital employed in the business is usually divided into partners' capital and current accounts, the balances on which are shown separately in the balance sheet.

Fixed or fluctuating capital accounts

A partnership firm has a choice to use either fixed or fluctuating capital accounts.

a) Fixed capital accounts

With this method, the capital accounts of the partners remain fixed at the amounts put into the business by each partner. The only entries that can also be posted these accounts are the profits or losses arising on revaluation and goodwill adjustments.

The shares of residue profits, interest on capital, salaries, drawings and interest on drawings are all recorded in the current accounts. The balances in the current accounts are transferred at the end of the year to the capital section of the balance sheet and shown separately.

b) Fluctuating capital accounts

With this method, the share of residue profits, and all the appropriations are posted to the capital accounts. This means that the balance in the capital accounts will keep on changing each year (fluctuating).

Example:

Small and Large set up in partnership and have the following profit sharing arrangements:

- Interest on capital is to be provided at a rate of 10% per annum
- Interest is charge on drawings at 8% per annum.
- Small and Large are to receive salaries of K14 000 000 and K16 000 000 per annum respectively.
- The balance of profit or loss is divided between Small and Large equally.

Net profit for their first year of trading ended 31st December 2004 amounted to K48 000 000. Capitals contributed were Small K30 000 000 and Large K20 000 000. Drawings for the year were Small K500 000 and Large K1 000 000.

Required:

- a) Prepare the partnership appropriation account for the year.
- b) Prepare a balance sheet extract using:
 - i) Fixed capital accounts
 - ii) Fluctuating capital accounts

Solution:

a)

<i>Small and Large</i>		
<i>Partnership appropriation account for the year ended 31st December 2004.</i>		
	K'000	K'000
Net profit		48 000
Add: interest on drawings:		
Small	40	
Large	<u>80</u>	
		<u>120</u>
		48 120
Less appropriations:		
Interest on capital:		
Small	3 000	
Large	2 000	
Salaries:		
Small	14 000	
Large	<u>16 000</u>	
		<u>35 000</u>
Balance to be shared		<u>13 120</u>
Share of residue:		
Small ($\frac{1}{2}$)	6 560	
Large ($\frac{1}{2}$)	<u>6 560</u>	
		<u>13 120</u>

b)

i) **Fixed capital accounts**

<i>Small and Large</i>		
<i>Balance sheet extract as at 31st December 2004.</i>		
	K'000	K'000
Financed by:		
Capital accounts (w1):		
Small	30 000	
Large	<u>20 000</u>	
		50 000
Current accounts (w2):		
Small	23 020	
Large	<u>23 480</u>	
		<u>46 500</u>
		<u>96 500</u>

Workings:

1.

Capital accounts

Date	Details	F	Small		Large	
			Dr K'000	Cr K'000	Dr K'000	Cr K'000
2004 Jan. 1	Bank			30 000		20 000

2.

Current accounts

Date	Details	F	Small		Large	
			Dr K'000	Cr K'000	Dr K'000	Cr K'000
2004						
Dec. 31	Drawings		500		1 000	
Dec. 31	Interest on drawings		40		80	
Dec. 31	Interest on capital			3 000		2 000
Dec. 31	Salary			14 000		16 000
Dec. 31	Share of residue profits			6 560		6 560
Dec. 31	Balance c/d		<u>23 020</u>		<u>23 480</u>	
			<u>23 560</u>	<u>23 560</u>	<u>24 560</u>	<u>24 560</u>
	Balance b/d			23 020		23 480

ii) Fluctuating capital accounts

Small and Large
Balance sheet extract as at 31st December 2004.

	K'000	K'000	K'000
Financed by:			
Capital accounts (w1):			
Small		53 020	
Large		<u>43 480</u>	
			<u>96 500</u>

Workings:

1.

Capital accounts

Date	Details	F	Small		Large	
			Dr	Cr	Dr	Cr
2004			K'000	K'000	K'000	K'000
Jan. 1	Bank			30 000		20 000
Dec. 31	Drawings		500		1 000	
Dec. 31	Interest on drawings		40		80	
Dec. 31	Interest on capital			3 000		2 000
Dec. 31	Salary			14 000		16 000
Dec. 31	Share of residue profits			6 560		6 560
Dec. 31	Balance c/d		<u>53 020</u>		<u>43 480</u>	
			<u>53 560</u>	<u>53 560</u>	<u>44 560</u>	<u>44 560</u>
	Balance b/d			53 020		43 480

ACTIVITY 1

L, H and B are in partnership trading under the partnership name of LIHEBU, and sharing profits and losses in the ratio 2: 2: 1 respectively. Interest is charged on partners' drawings at the rate of 5% per annum and credited on the partners' capital account balances at the rate of 5% per annum. H is the firm's sales manager and for his specialised services he is credited with a salary of K1 600 000 per annum.

During the year ended 31st March 2005, the net profit of the firm was K12 400 000 and the partners' drawings were:

L	K2 400 000
H	K1 600 000
B	K1 600 000

In each case, the above drawings were withdrawn in two equal installments on 30th September 2004 and 31st March 2005. On 30th September 2004, the firm agreed that L should withdraw K2 000 000 from his capital account and that B should subscribe a similar amount to his capital account.

The balance of the partners' accounts at 1st April 2004 were as follows:

(All credit balances)

	Capital accounts	Current accounts
	K'000	K'000
L	16 000	1 280
H	14 000	1 120
B	12 000	960

You are required to prepare the firm's profit and loss appropriation account and the partners' current and capital accounts for the year ended 31st March 2005 in columnar form.

Feedback to this activity is at end of module

ACTIVITY 2

John and James are in partnership sharing profits and losses equally. The following is their trial balance as at 30th June 2005:

	Dr K'000	Cr K'000
Buildings (cost K75 000 000)	50 000	
Fixtures and fittings at cost	11 000	
Provision for depreciation- fixtures		3 300
Debtors	16 243	
Creditors		11 150
Cash at bank	677	
Stock at 30 th June 2004	41 979	
Sales		123 650
Purchases	85 416	
Carriage outwards	1 288	
Discounts allowed	115	
Loan interest:- Howard	4 000	
Office expenses	2 416	
Salaries and wages	18 917	
Bad debts	503	
Provision for bad debts		400
Loan from Howard		40 000
Capital accounts: John		35 000
James		29 500
Current accounts: John		1 306
James		298
Drawings: John	6 400	
James	5 650	
	<u>244 604</u>	<u>244 604</u>

Additional information available:

- i) Stock, 30th June 2005 K56 340 000
- ii) Expenses to be accrued: office expenses K96 000; wages K200 000.
- iii) Depreciate fixtures 10% on reducing balance basis, buildings K1 000 000.
- iv) Reduce provision for bad debts to K320 000.
- v) Partnership salary: K800 000 to John. Not yet entered.
- vi) Interest on drawings: John K180 000; James K120 000
- vii) Interest on capital account balances at 10% per annum.

Required:

Prepare a trading and profit and loss appropriation account for the year ended 30th June 2005 and a balance sheet as at that date.

Feedback to this activity is at end of module

REVALUATION OF ASSETS

Whenever there is a change in a partnership (which could be when a new partner is admitted, an old partner retires or partners change their profit sharing ratios), the assets of the partnership need to be revalued. This is so because any change in a partnership affects the partners' rights to profits and assets as well. The entitlement to one third share of profits means an entitlement to a one third share in assets which exist in the partnership as well.

To the extent that the current worth of the assets is different from their book value, a profit or loss will have accrued on the asset from the date of acquisition of the asset to the date of the partnership change. This profit or loss will need to be allocated to partners in their old profit sharing ratio.

A revaluation account is used to record the changes in value of the assets. A revaluation account is simply a collecting account for profits or losses on revaluation. The account is credited with profits and debited with losses arising from revaluation. The profits or losses on revaluation belong to the old partners in their old profit sharing ratio. To close the revaluation account, the profits or losses are transferred to the credit and debit side of the old partners' capital accounts respectively.

Example:

X, Y and Z are in partnership sharing profits in the ratio 4: 3: 3. As at 1st January 2005 they decided to change their profit sharing ratio so that profits or losses are shared equally.

The balance sheet of the partnership as at 31st December 2004 was:

	K'000	K'000
Fixed assets:		
Land and buildings		70 000
Plant and machinery		30 000
Fixtures and fittings		<u>25 000</u>
		125 000
Current assets:		
Stock	35 000	
Debtors	28 000	
Bank	<u>17 000</u>	
	80 000	
Less: current liabilities:		
Creditors	<u>27 250</u>	
		<u>52 750</u>
		177 750
Financed by:		
Capital accounts: X	50 000	
Y	53 750	
Z	65 000	
Current accounts: X	2 000	
Y	4 000	
Z	<u>3 000</u>	<u>177 750</u>

For the purposes of the revaluation the assets of the partnership are to be revalued as follows:

	K'000
Land and buildings	80 000
Plant and machinery	27 500
Fixtures and fittings	32 100
Stock	36 350
Debtors	27 750

You are required to show:

- the revaluation account
- the partners' capital accounts
- the balance sheet of the partnership as at 1st January 2005.

Solution:

a)

Revaluation account

	K'000		K'000
Plant and machinery	2 500	Land and buildings	10 000
Debtors	250	Fixtures and fittings	7 100
Profit on revaluation:		Stock	1 350
X (⁴ / ₁₀)	6 280		
Y (³ / ₁₀)	4 710		
Z (³ / ₁₀)	4 710		
	<u>18 450</u>		<u>18 450</u>

b)

Partners' capital accounts

	X	Y	Z		X	Y	Z
	K'000	K'000	K'000		K'000	K'000	K'000
Balance c/d	56 280	58 460	69 710	Balance b/d	50 000	53 750	65 000
	<u>56 280</u>	<u>58 460</u>	<u>69 710</u>	Revaluation profit	<u>6 280</u>	<u>4 710</u>	<u>4 710</u>
					<u>56 280</u>	<u>58 460</u>	<u>69 710</u>

c)

X, Y and Z
Balance sheet as at 1st January 2005

	K'000	K'000
Fixed assets:		
Land and buildings		80 000
Plant and machinery		27 500
Fixtures and fittings		<u>32 100</u>
		139 600
Current assets:		
Stock	36 350	
Debtors	27 750	
Bank	<u>17 000</u>	
	81 100	
Less: current liabilities:		
Creditors	<u>27 250</u>	
		<u>53 850</u>
		193 450
Financed by:		
Capital accounts: X	56 280	
Y	58 460	
Z	69 710	
Current accounts: X	2 000	
Y	4 000	
Z	<u>3 000</u>	
		<u>193 450</u>

ADMISSION OF A NEW PARTNER

A partnership may find it desirable to bring in a new partner. The reasons for this may be:

- The need for more capital
- To have additional help in the supervision of the business
- The new partner may possess some skill that will be helpful to the business

When a new partner enters into an existing business, he/she becomes entitled to a share of goodwill that has been created by the old partners. Therefore, the new partner will be required to make an additional payment to the capital contributed for his/her share of goodwill or to compensate the old partners for what they lose. Such a payment made in addition to capital contributed is called a **premium on admission**.

Two situations may arise on admission of a partner:

- a) the new partner pays the premium on admission, or
- b) the new partner may fail to raise the premium on admission

a) The new partner pays the premium on admission

The premium on admission of a partner may be dealt with in one of the following ways:

- i) The premium is paid privately to the old partners in their profit sharing ratio. In such a case, the only record made in the books of the partnership is the capital introduced by the new partner. The double entry being:

Dr - Cash book

Cr - New partner's capital account

Example:

G and H trading in equal partnership, each with a capital of K60 000 000, admit J as a partner on his introduction of K30 000 000 as capital and paying K1 000 000 as premium for admission to the firm. The premium is paid direct to G and H. The new firm share profits and losses as follows: $G^{2/5}$, $H^{2/5}$ and $J^{1/5}$.

Record the admission of the new partner in the partnership books.

Solution:

Bank account

	K'000	K'000
Capital - J	30 000	

Partners' capital accounts

	G	H	J		G	H	J
	K'000	K'000	K'000		K'000	K'000	K'000
Balance c/d	60 000	60 000	30 000	Balance b/d	60 000	60 000	-
				Bank			30 000
	<u>60 000</u>	<u>60 000</u>	<u>30 000</u>		<u>60 000</u>	<u>60 000</u>	<u>30 000</u>

ii) The premium is paid to the old partners through the firms' books for record only but is later withdrawn by the old partners. The book keeping entries are as follows:

- Payment of capital and premium
 - Dr- Cash book
 - Cr - New partner's capital account
 - Cr - Old partners' capital accounts with the share of premium
- Withdrawal of the premium by the old partners
 - Dr - old partners' capital accounts
 - Cr - Cash book

Example:

Using the same example in (i) above, but assuming that the premium was paid into that firm's bank and later withdrawn by the partners, record the admission of the partner in the partnership books.

Solution:

Bank account

	K'000		K'000
Capital - J	30 000	Capital - G	500
Premium - G & H	1 000	H	500

Partners' capital accounts

	G	H	J		G	H	J
	K'000	K'000	K'000		K'000	K'000	K'000
Bank	500	500		Balance b/d	60 000	60 000	-
Balance c/d	60 000	60 000	30 000	Bank			30 000
	<u>60 500</u>	<u>60 500</u>	<u>30 000</u>	Share of premium	<u>500</u>	<u>500</u>	<u>30 000</u>
					<u>60 500</u>	<u>60 500</u>	<u>30 000</u>

iii) The premium is paid into the firm and is left in the business. The book keeping entries are as follows:

- Payment of capital and premium
 - Dr- Cash book
 - Cr - New partner's capital account
 - Cr - Old partners' capital accounts with the share of premium

Example:

Using the same example in (i) above, but given that the premium was to remain in the business, record the admission of the partner in the partnership books.

Solution:**Bank account**

	K'000	K'000
Capital - J	30 000	
Premium - G & H	1 000	

Partners' capital accounts

	G	H	J		G	H	J
	K'000	K'000	K'000		K'000	K'000	K'000
Balance c/d	60 500	60 500	30 000	Balance b/d	60 000	60 000	-
				Bank			30 000
				Share of premium	<u>500</u>	<u>500</u>	
	<u>60 500</u>	<u>60 500</u>	<u>30 000</u>		<u>60 500</u>	<u>60 500</u>	<u>30 000</u>

ACTIVITY 3

Chicken and Egg are in partnership sharing profits and losses in proportion to their capitals, which are respectively, K50 000 000 and K30 000 000. They admit Cock as a partner on his bringing into the business K30 000 000, which sum was duly paid into the firm's bank account. Of this sum, K20 000 000 represents Cock's capital and K10 000 000 his premium for admission to the partnership. The premium is paid out to the partners.

Record Cock's admission and the payment out of premium in the partnership books.

Feedback to this activity is at end of module

ACTIVITY 4

Small and Tall trading in partnership and sharing profits equally have each a capital of K20 000 000. Short is admitted as a partner on condition that he brings into the new business a sum of K17 000 000. Of this amount K15 000 000 is short's capital and K2 000 000 is the premium for his admission to the firm. The premium is to remain in the business.

Record the admission of Short in the firm's books.

Feedback to this activity is at end of module

b) **The new partner fails to raise the premium on admission**

Where a new partner fails to raise the premium, the old partners must be compensated in some way. In such cases, a goodwill account is raised.

Goodwill is an intangible asset the value of which can only be estimated or "guest at". FRS 10 defines goodwill as 'the difference between the value of a business as a whole and the fair value of its separable net assets'. There are two types of goodwill, namely:

- Purchased goodwill:- goodwill established as a result of the purchase of a business.
- Non-purchased goodwill:- is any other goodwill other than purchased goodwill.

Goodwill represents (or arises from) a number of factors such as:

- Excellent reputation of goods or services
- Strategic location
- Name of the business
- Market dominance
- Superior management etc

Valuing Goodwill: there is no exact formula for valuing goodwill. However, there are a number of methods used to value goodwill and most of them are related to the profit of the business. (e.g. Goodwill is to be valued at three times last year's profit of K6 million. The total value for goodwill is K24 million). Because of the difficulty of quantifying goodwill, partners do not normally wish to show goodwill as an asset in their books. If this is the case, goodwill is normally written off in the books of the new partnership immediately after admission in the new profit sharing ratio.

The book keeping entries for goodwill are as follows:

- Raising of goodwill
 Dr- Goodwill
 Cr - Old partners' capital accounts (in OPRS)
- If goodwill is not to be included as an asset in the new firm
 Dr - Partners' capital accounts (in NPRS)
 Cr - Goodwill account

NOTE: It is also possible for a new partner to pay for his share of Goodwill and for Goodwill to be recognised.

Example:

L, M and S are in partnership. They share profits in the ratio 3: 4: 3. It is decided to admit R. It is agreed that goodwill was worth K10 000 000, but it was not appear as an asset in the new firm. R will bring K14 000 000 cash into the business for capital. The new profit sharing ratio is to be L3: M3: S2: R2.

The balance sheet before R was introduced was as follows:

	K'000	K'000
Fixed assets		18 000
Stock		13 000
Cash		<u>12 500</u>
		<u>43 500</u>
Capitals:		
L	13 000	
M	15 000	
S	<u>14 000</u>	
		42 000
Creditors		<u>1 500</u>
		<u>43 500</u>

You are to show:

- The entries in the capital accounts of partners in columnar form.
- The balance sheet after R has been admitted.

Solution:

a)

Partners' capital accounts

	L	M	S	R		L	M	S	R
	K'000	K'000	K'000	K'000		K'000	K'000	K'000	K'000
Goodwill	3 000	3 000	2 000	2 000	Balance b/d	13 000	15 000	14 000	-
Balance c/d	13 000	16 000	15 000	12 000	Bank				14 000
					Goodwill	<u>3 000</u>	<u>4 000</u>	<u>3 000</u>	<u>-</u>
	<u>16 000</u>	<u>19 000</u>	<u>17 000</u>	<u>14 000</u>		<u>16 000</u>	<u>19 000</u>	<u>17 000</u>	<u>14 000</u>

b)

Balance sheet after admission

	K'000	K'000
Fixed assets		18 000
Current assets:		
Stock	13 000	
Cash	<u>26 500</u>	
	39 500	
Less: current liabilities:		
Creditors	<u>1 500</u>	
		<u>38 000</u>
		<u>56 000</u>
Capitals:		
L	13 000	
M	16 000	
S	15 000	
R	<u>12 000</u>	
		<u>56 000</u>

ACTIVITY 5

A, B and C are in partnership sharing profits 5: 3: 2. As at 1st January 2005, D is to be admitted to the partnership; thereafter profits are to be shared equally. D is to introduce capital of K40 million, of which K10 million represents a payment for his share of the goodwill, which is subsequently to be disclosed in the books.

The partnership's balance sheet as at 31st December 2004 shows the following:

	K'000	K'000
Fixed assets:		
Land and buildings		42 500
Plant and machinery		16 750
Fixtures and fittings		<u>12 800</u>
		72 050
Current assets:		
Stock	15 800	
Debtors	29 471	
Bank	<u>18 623</u>	
	63 894	
Less: current liabilities:		
Creditors	<u>24 713</u>	
		<u>39 181</u>
		<u>111 231</u>
Financed by:		
Capital accounts: A	61 237	
B	18 476	
C	<u>31 518</u>	
		<u>111 231</u>

For the purposes of the revaluation the assets of the partnership are to be revalued as follows:

	K'000
Land and buildings	75 000
Plant and machinery	21 250
Fixtures and fittings	11 000

You are required to show:

- the revaluation account
- the partners' capital accounts
- the balance sheet of the partnership as at 1st January 2005.

Feedback to this activity is at end of module

PARTENRSHIP AMALGAMATION

A partnership amalgamation involves two partnerships, or one partnership and a sole trader merging their businesses to form a new business.

A partnership amalgamation is a similar type of transaction to the admission of a partner except that amalgamation is more complex. Before amalgamation takes place, the parties involved will have to agree on which assets and liabilities to take into the new business and at what values. The amalgamation procedure is as follows:

- i) Incorporate the agreed amalgamation values of assets in each firm's books so that the partners get the 'profit' due to them. Thus, revalue all assets including goodwill and transfer the profit or loss on revaluation to partners' accounts in their old profit sharing ratio.
- ii) Make transfers to the new firm of the assets and liabilities taken over by the new business (at their revalued amounts). Also make transfers from the partners' accounts to the partners' capital and/or current accounts of the new firm. This is either given or can be derived from constructing the new firm's balance sheet.

Where the goodwill revalued in the old firms is not to appear in the balance sheet of the new firm, then the balances transferred from the old partners' accounts to the new firm's books must be greater than the required balance sheet amount. This is because goodwill is to be written off in the new profit sharing ratios against these brought down balances to arrive at the agreed balance sheet amounts.

- iii) Any balances remaining on the partners' accounts will be dealt with by cash transfers in the new firm's books.

Example:

Mary and Mercy are in partnership sharing profits and losses equally. Margie and Mildred are also in partnership sharing profits and losses in the ratio 3: 2 respectively. The two firms agree to amalgamate under the name of Quartet Sisters General Dealers with profits in the new firm being shared:

Mary	25%
Mercy	30%
Margie	25%
Mildred	20%

The balance sheets of the two firms immediately prior to the amalgamation were:

	Mary and Mercy		Margie and Mildred	
	K'000	K'000	K'000	K'000
Fixed assets:				
Land and buildings		30 000		40 000
Plant and machinery		20 000		30 000
Motor vehicles		<u>40 000</u>		<u>60 000</u>
		90 000		130 000

Current assets:		
Stock	42 000	120 000
Debtors	20 000	10 000
Bank	<u>48 000</u>	<u>20 000</u>
	110 000	150 000
Less: current liabilities:		
Creditors	<u>10 000</u>	<u>20 000</u>
	<u>100 000</u>	<u>130 000</u>
	<u>190 000</u>	<u>260 000</u>
Financed by:		
Capital accounts: Mary	70 000	
Mercy	<u>120 000</u>	
Margie		120 000
Mildred		<u>140 000</u>
	<u>190 000</u>	<u>260 000</u>

For the purposes of the amalgamation the assets of the partnerships were revalued as follows:

	Mary and Mercy	Margie and Mildred
	K'000	K'000
Land and buildings	40 000	60 000
Motor vehicles	-	70 000
Goodwill	40 000	60 000
Stock	56 000	90 000

The motor vehicles owned by Mary and Mercy were old and so were not taken over by the new firm. These vehicles were taken over by Mary and Mercy at agreed values of K20 million and K28 million respectively. All other assets and liabilities were taken over by the new firm at the revalued amounts. Goodwill is not to be left into the business.

You are required to show:

- the closing entries in the books of the old partnerships.
- the amalgamated balance sheet of the new firm.

Solution:

In the books of Mary and Mercy

Land and Buildings account

	K'000		K'000
Balance b/d	30 000	Transfer to new firm	40 000
Revaluation	<u>10 000</u>		<u>40 000</u>
	<u>40 000</u>		

Plant and machinery account

	K'000		K'000
Balance b/d	<u>20 000</u>	Transfer to new firm	<u>20 000</u>
	<u>20 000</u>		<u>20 000</u>

Motor vehicles account

	K'000		K'000
Balance b/d	40 000	Partners' capital accounts:	
Revaluation	8 000	Mary	20 000
	<u>48 000</u>	Mercy	<u>28 000</u>
			<u>48 000</u>

Goodwill account

	K'000		K'000
Revaluation	<u>40 000</u>	Transfer to new firm	<u>40 000</u>
	<u>40 000</u>		<u>40 000</u>

Stock account

	K'000		K'000
Balance b/d	42 000	Transfer to new firm	56 000
Revaluation	<u>14 000</u>		<u>56 000</u>
	<u>56 000</u>		

Debtors account

	K'000		K'000
Balance b/d	<u>20 000</u>	Transfer to new firm	<u>20 000</u>
	<u>20 000</u>		<u>20 000</u>

Bank account

	K'000		K'000
Balance b/d	<u>48 000</u>	Transfer to new firm	<u>48 000</u>
	<u>48 000</u>		<u>48 000</u>

Creditors account

	K'000		K'000
Transfer to new firm	<u>10 000</u>	Balance b/d	<u>10 000</u>
	<u>10 000</u>		<u>10 000</u>

Partners' capital accounts

	Mary K'000	Mercy K'000		Mary K'000	Mercy K'000
Motor vehicles	20 000	20 000	Balance b/d	70 000	120 000
Transfer to new firm	<u>86 000</u>	<u>128 000</u>	Revaluation profit	<u>36 000</u>	<u>36 000</u>
	<u>106 000</u>	<u>156 000</u>		<u>106 000</u>	<u>156 000</u>

Revaluation account

	K'000		K'000
Profit on revaluation:		Land and buildings	10 000
Mary ($\frac{1}{2}$)	36 000	Motor vehicles	8 000
Mercy ($\frac{1}{2}$)	36 000	Goodwill	40 000
	<u>72 000</u>	Stock	<u>14 000</u>
			<u>72 000</u>

In the books of Margie and Mildred

Land and Buildings account

	K'000		K'000
Balance b/d	40 000	Transfer to new firm	60 000
Revaluation	<u>20 000</u>		<u>60 000</u>
	<u>60 000</u>		

Plant and machinery account

	K'000		K'000
Balance b/d	<u>30 000</u>	Transfer to new firm	<u>30 000</u>
	<u>30 000</u>		<u>30 000</u>

Motor vehicles account

	K'000		K'000
Balance b/d	60 000	Transfer to new firm	70 000
Revaluation	<u>10 000</u>		
	<u>70 000</u>		<u>70 000</u>

Goodwill account

	K'000		K'000
Revaluation	<u>60 000</u>	Transfer to new firm	<u>60 000</u>
	<u>60 000</u>		<u>60 000</u>

Stock account

	K'000		K'000
Balance b/d	120 000	Revaluation	30 000
		Transfer to new firm	<u>90 000</u>
	<u>120 000</u>		<u>120 000</u>

Debtors account

	K'000		K'000
Balance b/d	<u>10 000</u>	Transfer to new firm	<u>10 000</u>
	<u>10 000</u>		<u>10 000</u>

Bank account

	K'000		K'000
Balance b/d	<u>20 000</u>	Transfer to new firm	<u>20 000</u>
	<u>20 000</u>		<u>20 000</u>

Creditors account

	K'000		K'000
Transfer to new firm	<u>20 000</u>	Balance b/d	<u>20 000</u>
	<u>20 000</u>		<u>20 000</u>

Partners' capital accounts

	Margie K'000	Mildred K'000		Margie K'000	Mildred K'000
Transfer to new firm	156 000	164 000	Balance b/d	120 000	140 000
	<u>156 000</u>	<u>164 000</u>	Revaluation profit	<u>36 000</u>	<u>24 000</u>
				<u>156 000</u>	<u>164 000</u>

Revaluation account

	K'000		K'000
Stock	30 000	Land and buildings	20 000
Profit on revaluation:		Motor vehicles	10 000
Mary ($\frac{3}{5}$)	36 000	Goodwill	60 000
Mercy ($\frac{2}{5}$)	<u>24 000</u>		<u>90 000</u>
	<u>90 000</u>		

New firm's books

Workings:

1.

Partners' capital accounts

Mary K'000	Mercy K'000	Margie K'000	Mildred K'000		Mary K'000	Mercy K'000	Margie K'000	Mildred K'000
Goodwill				Balance b/d				
Written off	25 000	30 000	25 000	from old firms	86 000	128 000	156 000	164 000
Balance c/d	<u>61 000</u>	<u>98 000</u>	<u>131 000</u>					
	<u>86 000</u>	<u>128 000</u>	<u>156 000</u>		<u>86 000</u>	<u>128 000</u>	<u>156 000</u>	<u>164 000</u>

2. Bank account

	K'000		K'000
Balance b/d		Balance c/d	68 000
from old firms:			
Mary and Mercy	48 000		
Margie and Mildred	<u>20 000</u>		
	<u>68 000</u>		<u>68 000</u>

3. Goodwill account

	K'000		K'000
Transfers from old firms:		Partners' capital accounts:	
Mary and Mercy	48 000	Mary	25 000
Margie and Mildred	20 000	Mercy	30 000
		Margie	25 000
		Mildred	<u>20 000</u>
	<u>100 000</u>		<u>100 000</u>

***Quartet Sisters General Dealers
Balance sheet after amalgamation***

	K'000	K'000
Fixed assets:		
Land and buildings (40 + 60)		100 000
Plant and machinery (20 + 30)		50 000
Motor vehicles		<u>70 000</u>
		220 000
Current assets:		
Stock (56 + 90)	146 000	
Debtors (20 + 10)	30 000	
Bank (w2)	<u>68 000</u>	
	244 000	
Less: current liabilities:		
Creditors (10 + 20)	<u>30 000</u>	
		<u>214 000</u>
		434 000
Financed by:		
Capital accounts (w1): Mary	61 000	
Mercy	98 000	
Margie	131 000	
Mildred	<u>144 000</u>	
		<u>434 000</u>

ACTIVITY 6

A and B, trading as partners and sharing profits equally, agree to amalgamate their partnership with the firm of C and D to form ABCD partnership. C and D share profits in the ratio 4: 1 respectively.

The balance sheets of the two firms at the date of amalgamation were as follows:

	AB K'000	CD K'000
Fixed assets:		
Land and buildings	10 000	-
Plant and machinery	4 000	7 000
Motor vehicles	<u>3 000</u>	<u>-</u>
	17 000	7 000
Current assets:		
Stock	4 000	3 000
Debtors	2 000	1 000
Bank	<u>2 000</u>	<u>4 000</u>
	<u>25 000</u>	<u>15 000</u>
Current liabilities:		
Creditors	5 000	6 000
Long-term liabilities:		
Loan from G	2 000	
Capital accounts: A	7 000	
B	8 000	
C		3 000
D		3 000
Capital accounts: A	2 000	
B	1 000	
C		2 000
D	<u> </u>	<u>1 000</u>
	<u>25 000</u>	<u>15 000</u>

ABCD was to take over all the assets and liabilities of the two partnerships except:

	AB K'000	CD K'000
Goodwill	9 000	3 000
Land and buildings	14 000	-
Motor vehicles	3 000	6 000
Stock	4 000	2 000
Debtors	2 000	1 000

Trade creditors were taken over at their book value. The profit sharing ratio in the new firm was to be 2: 2: 1: 1 between A: B: C: D. Goodwill was not to appear in the new firms' balance sheet. The capital accounts of the partners after adjustments for goodwill were to be:

A	K8 000 000
B	K8 000 000
C	K4 000 000
D	K4 000 000

There will be no initial balances in the current accounts.

You are required to show:

- a) In the books of AB and CD:
 - i) the revaluation account
 - ii) the partners' accounts
- b) the balance sheet of the partnership following amalgamation.

Feedback to this activity is at end of module

PARTNERSHIP DISSOLUTION

The partnership may be dissolved due to any of the following reasons:

- i) By mutual agreement between partners.
- ii) On the termination of the special undertaking for which the partnership was formed (i.e. performance).
- iii) On death of a partner
- iv) Bankruptcy
- v) Insanity of a partner
- vi) Conversion of a partnership into a limited company.

Order of repayment

On dissolution the assets of the partnership are disposed off and any profits realised on disposal would be distributed in the profit sharing ratios. The proceeds are then applied to repay liabilities in the following order:

- a) to pay outside third party creditors
- b) to repay advances or loans from partners
- c) to repay the partners' capitals

Realisation account

This account acts as the profit and loss account for the disposals. Assets are transferred at book values to the debit of this account, and the realisation proceeds or agreed take over values are credited. The balance remaining represents the profit or loss on disposals, which is transferred to the partners' accounts in the profit sharing ratio.

The books are finally by the settlement of cash among the partners, which will eliminate the remaining balance.

Accounting entries

The accounting entries for closing the books of account of a partnership are:

- a) Transfer all assets to a realisation account
 - Dr - Realisation account
 - Cr - Assets account except for bank/cash accounts
- b) Proceeds from sale of assets and dissolution expenses
 - i) Assets that realise cash
 - Dr - Cash book
 - Cr - Realisation account
 - ii) Assets taken over by partners
 - Dr - Partners' accounts
 - Cr - Realisation account
 - iii) Dissolution expenses
 - Dr - Realisation account
 - Cr - Cash book
- c) Pay off outside third party creditors
 - Dr - Creditors accounts
 - Cr - Cash book

- d) Pay off loans or advances from the partners
 - Dr - Loans/advances accounts
 - Cr - Cash book
- e) Share of profit or loss on realisation
 - i) For the profit
 - Dr - Realisation account
 - Cr - Partners' accounts
 - ii) For the loss
 - Dr - Partners' accounts
 - Cr - Realisation account
- f) Clear off the partners' accounts
 - i) If a partner has a credit balance
 - Dr - Partner's account
 - Cr - Cash book
 - ii) If a partner has a debit balance
 - Dr - Cash book
 - Cr - Partner's account

Garner v Murray (1904) Precedence

A partner with a deficiency on his account, after giving effect to realisation, must pay cash into the firm's bank account to clear his debit balance. If a partner with the deficiency is bankrupt and cannot pay in, a loss has arisen, and this loss must be borne by the remaining partners. It was decided in *Garner v Murray* 1904 that the remaining partners should bear the loss in the **capital-sharing ratio**. The capital figures to take into account will be those based on the last normal balance sheet of the firm.

The double entry for the adjustments is:

- Dr - Remaining partners in capital sharing ratio
- Cr - Insolvent partner with any deficiency

Example:

X and Y who share profits and loss equally decide to dissolve their partnership as at 31st March 2005. Their balance sheet on that date was as follows:

	K'000
Buildings	8 000
Fixtures and fittings	8 500
Debtors	28 000
Cash at bank	<u>18 000</u>
	<u>62 500</u>
Capital accounts:	
X	20 000
Y	15 000
Creditors	<u>27 500</u>
	<u>62 500</u>

On dissolution of the partnership, debtors realised K27 000 000, buildings K4 000 000 and fixtures and fittings K9 500 000. Dissolution expenses were K1 000 000 and discounts totalling K2 000 000 were received from creditors.

Prepare the accounts necessary to show the results of the realisation and the disposal of cash.

Solution:

Buildings account

	K'000		K'000
Balance b/d	<u>8 000</u>	Realisation	<u>8 000</u>
	<u>8 000</u>		<u>8 000</u>

Fixtures and fittings account

	K'000		K'000
Balance b/d	<u>8 500</u>	Realisation	<u>8 500</u>
	<u>8 500</u>		<u>8 500</u>

Debtors account

	K'000		K'000
Balance b/d	<u>28 000</u>	Realisation	<u>28 000</u>
	<u>28 000</u>		<u>28 000</u>

Creditors account

	K'000		K'000
Bank	25 500	Balance b/d	27 500
Realisation	<u>2 000</u>		
	<u>27 500</u>		<u>27 500</u>

Realisation account

	K'000		K'000
Buildings	8 000	Bank: Buildings	4 000
Fixtures and fittings	8 500	Fixtures and fittings	9 500
Debtors	28 000	Debtors	27 000
Realisation expenses	1 000	Creditors: discount received	2 000
		Partners accounts: X	1 500
		Y	<u>1 500</u>
	<u>45 500</u>		<u>45 500</u>

Bank account

	K'000		K'000
Balance b/d	18 000	Realisation expenses	1 000
Realisation:		Creditors	25 500
Buildings	4 000	Partners accounts:	
Fixtures and fittings	9 500	X	18 500
Debtors	<u>27 000</u>	Y	<u>13 500</u>
	<u>58 500</u>		<u>58 500</u>

Partners' capital accounts

	X	Y		X	Y
	K'000	K'000		K'000	K'000
Realisation loss	1 500	1 500	Balances b/d	20 000	15 000
Bank	<u>18 500</u>	<u>13 500</u>			
	<u>20 000</u>	<u>15 000</u>		<u>20 000</u>	<u>15 000</u>

ACTIVITY 7

Milimo and Chisanga have been in partnership as general dealers sharing profits and losses 3: 2 respectively.

Their balance sheet as at 31st December 2004 was as follows:

	K'000	K'000	K'000
Fixed assets:			
Freehold premises			60 000
Fixtures and fittings			17 000
Motor vehicle			<u>5 000</u>
			82 000

Current assets:			
Stock		3 000	
Debtors		<u>6 000</u>	
		9 000	
Less: Current liabilities:			
Creditors	2 100		
Bank overdraft	45 900		
General expenses accrued	<u>600</u>		
		<u>46 800</u>	
			<u>(39 600)</u>
			<u>42 400</u>
Financed by:			
Capital accounts: Milimo		19 580	
Chisanga		7 180 (Dr)	
Loan from Milimo		<u>30 000</u>	
		<u>42 400</u>	

The partnership was dissolved on 31st December 2004 it being agreed that:

- i) Milimo was to take over the stock of goods for K3 100 000 and part of the fittings and fixtures for K6 000 000.
- ii) Chisanga should take over the motor vehicle for K4 000 000.

During January 2005,

- i) Freehold premises were sold were sold realising K68 000 000.
- ii) K4 800 000 was collected from debtors (the balance was irrecoverable).
- iii) The balance of the fixtures and fittings were sold for K14 000 000.
- iv) All creditors were paid in full.
- v) Dissolution expenses amounted to K1 200 000.
- vi) All amounts receivable or payable by Milimo and Chisanga were settled.

You are required to:

- a) Prepare the realisation account
- b) Prepare the bank account for January 2005
- c) Prepare the partners' capital accounts (in columnar form) showing the final settlement on dissolution.

Feedback to this activity is at end of module