

PART 3

Owners' Equity in Business

Partnerships: Formation,
operation and reporting

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CHAPTER 8

Partnerships: Formation, operation and reporting

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ADDITIONAL PROBLEMS

Problem 8.1 Formation and allocation of profits – method 1

On 1 November 2002, Ken Langer and Ann Walters formed a partnership. Langer contributed some business assets and the liabilities assumed by the partnership, which are listed below at both fair value and carrying amount.

	Fair value	Carrying amount
Cash at bank	\$ 52 800	\$ 52 800
Marketable securities	47 520	36 960
Accounts receivable	54 000	56 760
Inventory	135 960	132 000
Equipment	342 000	33 000
Accounts payable	105 600	105 600

Walters contributed a building worth \$396 000, land worth \$138 000, and a \$330 000 mortgage was taken over by the partnership. They agreed to share profits and losses in the ratio of 6:4. During the first year of the partnership, Langer invested \$66 000 in the business and withdrew \$45 600. Walters invested \$96 000 and withdrew \$14 400. The partnership had a net profit of \$81 600. Retained Profits accounts are not used.

Required:

- Prepare the journal entries to record the initial investments of both partners.
- Prepare a statement of financial position as at 1 November 2002.
- Prepare a statement of partners' equity for the year ended 31 October 2003.

Solution

A.

LANGER AND WALTERS			
1/11/2002	Cash at Bank	52 800	
	Marketable Securities	47 520	
	Accounts Receivable	56 760	
	Inventory	135 960	
	Equipment	342 000	
	Accounts Payable		105 600
	Allowance for Doubtful Debts		2 760
	Langer, Capital		526 680
	Building	396 000	
	Land	138 000	
	Mortgage payable		330 000
	Walters, Capital		204 000

B.

LANGER AND WALTERS			
Statement of Financial Position			
as at 1 November, 2002			
<u>Assets</u>		<u>Liabilities and owners' equity</u>	
Cash at bank	\$52 800	Accounts payable	\$105 600
Marketable securities	47 520	Mortgage payable	330 000
Accounts receivable	56 760	Langer, Capital	526 680
Less: All. for doubtful debts	<u>2 760</u>	Walters, Capital	204 000
Inventory	135 960		
Machinery and Equipment	342 000		
Building	396 000		
Land	<u>138 000</u>		
	<u>\$1 166 280</u>		<u>\$1 166 280</u>

C.

LANGER AND WALTERS			
Statement of Partners' Equity (Method 1)			
for the year ending 31 October, 2003			
	Langer	Walters	Total
Capital balances, 1/11	\$526 680	\$204 000	\$730 680
Add: Additional investment	66 000	96 000	162 000
Net profit allocation	<u>48 960</u>	<u>32 640</u>	<u>81 600</u>
	641 640	332 640	974 280
Less: Drawings	<u>45 600</u>	<u>14 400</u>	<u>60 000</u>
Capital balances, 30/9	<u>\$596 040</u>	<u>\$318 240</u>	<u>\$914 280</u>



Problem 8.2**Allocation of profits – method 2**

Selected accounts from the trial balance as at 30 June 2003 of the partnership of W. Earp, J. Earp and D. Holliday are as follows:

	Debit	Credit
Loan – State Finance Ltd		\$13 050
Profit and loss summary (after usual adjusting and closing entries for net profit determination)		41 925
Salary, J. Earp	\$7 500	
W. Earp, Capital		49 500
W. Earp, Retained profits	1 050	
J. Earp, Capital		24 750
J. Earp, Retained profits		525
D. Holliday, Capital		16 500
D. Holliday, Retained profits		675
Advance, D. Holliday (repayable in October 2004)		6 600

Further adjustments for the financial year ended 30 June 2003 have yet to be made as follows:

- Interest accrued to State Finance Ltd – \$1100.
- The partnership accountant has duly paid J. Earp's agreed salary as part-time manager (\$7500 per annum) but was uncertain how to charge it.
- Partners have agreed to:
 - 6% per annum interest on fixed capitals.
 - 7% interest on total drawings for the year which were:

W. Earp \$12 000
J. Earp 6 750
D. Holliday 8 250
 - 6% per annum interest on advance from Holliday.
 - Profits/losses to be shared 1/2, 1/3, 1/6 to W. Earp, J. Earp and D. Holliday respectively.

Required:

- Complete the Profit and Loss Summary account.
- Prepare Profit Distribution account.
- Complete each partner's Retained Profits account after all adjustments.



Solution

A.

EARP, EARP AND HOLLIDAY**Profit and Loss Summary**

30/6	Interest on advance	396	30/6	Balance	41 925
30/6	Interest on loan	1 100			
30/6	Net profit for distribution	40 429			
		<u>\$41 925</u>			<u>\$41 925</u>

B.

Profit Distribution

30/6	Salary - J Earp	7 500	30/6	Net profit	40 429
30/6	Interest on capital:		30/6	Interest on drawgs	
	W Earp	2970		W Earp	840
	J Earp	1485		J Earp	473
	D Holliday	<u>990</u>		D Holliday	<u>578</u>
		5 445			1 891
30/6	Residual profits:				
	W Earp (1/2)	14 687			
	J Earp (1/3)	9 792			
	D Holliday (1/6)	<u>4 896</u>			
		<u>\$42 320</u>			<u>\$42 320</u>

C.

W. Earp, Retained Profits

1/7	Balance	1 050	30/6	Interest on capital	2 970
30/6	Interest on drawings	840	30/6	Residual profit	14 687
30/6	Drawings	12 000			
30/6	Balance	3 767			
		<u>\$17 657</u>			<u>\$17 657</u>
			30/6	Balance	3 767

J. Earp, Retained Profits

30/6	Drawings (inc. sal)	14 250	1/7	Balance	525
30/6	Interest on drawings	473	30/6	Interest on capital	1 485
30/6	Balance	4 579	30/6	Residual profit	9 792
			30/6	Salary	7 500
		<u>\$19 302</u>			<u>\$19 302</u>
			30/6	Balance	4 579

D. Holliday, Retained Profits

30/6	Drawings	8 250	1/7	Balance	675
30/6	Interest on drawings	578	30/6	Interest on capital	990
			30/6	Residual profit	4 896
			30/6	Balance	2 267
		<u>\$8 828</u>			<u>\$8 828</u>
30/6	Balance	2 267			



Problem 8.3**Formation of partnership, allocation of profit**

Jacqui Rander is the sole proprietor of Rander's Bookshop. Because she needs additional funds in the business and has an immediate personal need for \$24 000 in cash, Rander agreed on 31 March 2002 to join in partnership with Max Nelson.

It is agreed that Rander will contribute all non-cash assets of her bookshop to the partnership and will withdraw (from funds supplied to the business by Nelson) \$24 000 in cash. Nelson will invest \$34 800 in the business. The partnership contract provides that profits shall be divided 45% to Rander and 55% to Nelson.

Information as to the assets and liabilities of Rander's Bookshop at 31 March 2002 and their fair values is as follows:

	Carrying amount	Fair value
Accounts receivable	\$ 21 420	\$ 19 200
Allowance for doubtful debts	2 016	
Inventory	41 880	46 620
Shop equipment	7 800	5 520
Accumulated depreciation—shop equipment	(2 640)	
10% loan payable (dated 1 October 1997: due 30 September 2003)	15 120	15 840
Accounts payable	8 880	8 820

It is agreed that the new partnership of Rander–Nelson Bookshop will assume the present debts of Rander's Bookshop.

Required:

- Make the necessary journal entries to record the formation of Rander–Nelson Bookshop at 31 March 2002.
- At the end of April, after normal balance-day adjusting entries, the Profit and Loss Summary account of the partnership shows a credit balance of \$3480. The partners' Drawings accounts have debit balances as follows: Rander, \$1440; Nelson, \$1200. Make the journal entries necessary to complete the closing of the partnership books at the end of April. Retained Profits accounts are not used.
- Prepare a statement of partners' equity for the month of April.

Solution

A.

RANDER-NELSON BOOKSHOP

2002

Mar. 31	Accounts Receivable	21 420	
	Inventory	46 620	
	Shop Equipment	5 520	
	Allowance for doubtful debts		2 220
	Loan Payable		15 840
	Accounts Payable		8 820
	J Rander, Capital		46 680
	Cash at Bank	34 800	
	M Nelson, Capital		34 800
	J Rander, Capital	24 000	
	Cash at Bank		24 000

(continued)

B.

April 30	Profit and Loss Summary	3 480	
	Profit Distribution		3 480
	Profit Distribution	3 480	
	J Rander, Capital		1 566
	M Nelson, Capital		1 914
	J Rander, Capital	1 440	
	M Nelson, Capital	1 200	
	J Rander, Drawings		1 440
	M Nelson, Drawings		1 200

C.

RANDER-NELSON BOOKSHOP Statement of Partners' Equity for the month ended 30 April, 2002

	Rander	Nelson	Total
Capital balances (1/4/2002)	\$22 680	\$34 800	\$57 480
Net profit allocation	<u>1 566</u>	<u>1 914</u>	<u>3 480</u>
	24 246	36 714	60 960
Less: Drawings	<u>1 440</u>	<u>1 200</u>	<u>2 640</u>
Capital balances (30/4/X6)	<u>\$22 806</u>	<u>\$35 514</u>	<u>\$58 320</u>



WILEY

Problem 8.4 Determination and allocation of profits

Brown, Ball and Black are in partnership sharing profits and losses in the proportion of a half, one-third and one-sixth respectively. Their capitals at 1 July 2002, the date of commencement of business, were Brown \$84 000, Ball \$70 000 and Black \$35 000, all contributed in cash.

The partners did not keep a complete set of accounting records, and at 30 June 2003 their assets and liabilities were valued as follows before adjustments (a) to (d) below: Inventory \$115 500; Accounts Receivable \$49 560; Bills Receivable \$17 920; Plant and Equipment \$40 320; Premises \$64 400; Bills Payable \$8400; Accounts Payable \$34 160; Bank Overdraft \$18 620.

Drawings made by the partners in anticipation of profits for the year ended 30 June 2001 amounted to Brown \$7000, Ball \$5600 and Black \$4200. Brown paid in an additional \$16 800 capital on 1 January 2003.

Required:

- A. Prepare a statement of distribution of profit for the year to each partner after making the following adjustments:
 - (a) depreciation on plant and equipment, 10%, and on business premises, 2% (use straight-line method)
 - (b) allowance for doubtful debts equal to 4% of accounts receivable and bills receivable
 - (c) interest on drawings: Brown \$168; Ball \$154; Black \$140
 - (d) interest on capital at 6% per annum.
- B. Prepare a statement of financial position for the partnership as at 30 June 2003.

Solution

A.

BROWN, BALL AND BLACK

Total equity at start (1/7/00) = \$84 000 + \$70 000 + \$35 000 = \$189 000

Total equity at end (30/6/01) = Net assets at end

Net assets at end:

Inventory	\$115 500	
Accounts receivable	49 560	
Bills receivable	7 920	
Plant and machinery	40 320	
Business premises	64 400	
Bills payable	(8 400)	
Accounts payable	(34 160)	
Bank overdraft	(18 620)	
Allowance for doubtful debts	(2 699)	[4% × \$67 480]
Accumulated depreciation - plant	(4 032)	[10% × \$40 320]
Accumulated depreciation - premises	(1 288)	[2% × \$64 400]
	<u>\$218 501</u>	

Hence, partnership net profit can be calculated using the format of a statement of partner's equity:

Beginning equity	\$189 000	
+ Capital contribution	16 800	
+ Net profit	<u>29 501</u>	*missing figure
	235 301	
– Drawings	<u>16 800</u>	
Ending equity	<u>\$218 501</u>	

(continued)



WILEY

Allocation of \$29 501 net profit

	Brown	Ball	Black	Total
Interest on capital	\$5 544*	\$4 200	\$2 100	\$11 844
Less: Interest on drawings	(168)	(154)	(140)	(462)
Total net interest	5 376	4 046	1 960	11 382
Residual profit:				
Brown (1/2)	9 059			
Ball (1/3)		6 040		
Black (1/6)			3 020	18 119
	<u>\$14 435</u>	<u>\$10 086</u>	<u>\$4 980</u>	<u>\$29 501</u>

*(\$84 000 × 6% = \$5 040) + (\$16 800 × 6 × 6% mths = \$504) = \$5 544

B.

BROWN, BALL AND BLACK
Statement of Financial Position as at 30 June 2003

Partners' equity

A Brown, Capital (Incl additional capital)	\$100 800	
B Ball, Capital	70 000	
R Black, Capital	<u>35 000</u>	\$205 800
A Brown, Retained profits	7 435	
B Ball, Retained profits	4 486	
R Black, Retained profits	<u>780</u>	<u>12 701</u>
		218 501

Liabilities

Accounts payable	34 160	
Bills payable	8 400	
Bank overdraft	<u>18 620</u>	<u>61 180</u>
		<u>\$279 681</u>

Current assets

Inventory		\$115 500	
Accounts receivable	\$49 560		
Bills receivable	<u>17 920</u>		
	67 480		
Less: All. for doubtful debts	<u>2 699</u>	<u>64 781</u>	\$180 281

Non-current assets

Plant and equipment	\$40 320		
Accumulated depreciation	<u>4 032</u>	36 288	
Premises	64 400		
Accumulated depreciation	<u>1 288</u>	<u>63 112</u>	<u>99 400</u>
			<u>\$279 681</u>

Problem 8.5 Comprehensive problem

Able, Babel and Cable are in a hardware business trading as ABC Company. The partnership agreement includes the following provisions:

1. Interest on capital is to be allowed at 6% per annum.
2. Salaries are to be allowed: Able, nil; Babel, \$8000; Cable, \$6000.
3. Interest is to be allowed on advances by partners at 8% per annum.

A trial balance at 30 June 2003, after the activities of the preceding year had been recorded but before the stocktake, is shown below.

ABC COMPANY Trial Balance as at 30 June 2003		
	Debit	Credit
Cost of goods sold	\$300 000	
Cash at bank	6 000	
Accounts receivable	120 000	
Allowance for doubtful debts		\$ 3 000
Inventory	225 000	
Furniture, plant and equipment	200 000	
Accumulated depreciation—furniture, plant and equipment		125 000
Prepaid insurance	2 500	
Prepaid rent	4 000	
Accounts payable		100 000
Advance from Able (due for payment on 15 April 2002)		80 000
Able, Capital		80 000
Babel, Capital		40 000
Cable, Capital		40 000
Able, Retained profits		2 000
Babel, Retained profits		13 000
Cable, Retained profits		10 000
Sales revenue		440 000
Selling and general expenses	75 000	
Discount received		500
Proceeds from sale of motor vehicle		12 000
Carrying amount of motor vehicle sold	13 000	
	<u>\$945 500</u>	<u>\$945 500</u>

Additional information

1. Merchandise of \$400 purchased on credit was received on 30 June 2003, but had not been recorded in the accounts; nevertheless, it had been included in the physical stocktake of \$223 000.
2. Insurance and rents to be expensed were assessed at \$1200 and \$2200 respectively.
3. Depreciation expense to be brought to account, \$8700.
4. Wages owed but not paid amounted to \$3600.
5. Partners Babel's and Cable's salaries had not been brought to account.
6. Interest on Able's advance had not been brought to account.
7. Verification of accounts receivable revealed that the balance of the allowance for doubtful debts should be increased to \$3600. The increase is related to sales revenue recognised in the current period.

Required:

- A. Prepare the statement of financial performance for the period ended 30 June 2003.
- B. Prepare a Profit Distribution account for the same period.
- C. Set out the statement of financial position as at 30 June 2003, properly classified.

A.

ABC COMPANY
Statement of Financial Performance
for the year ended 30 June 2003

Sales revenue		\$440 000
Cost of goods sold		<u>300 000</u>
Gross profit		140 000
Proceeds from sale of motor vehicle		12 000
Discount received		<u>500</u>
		152 500
Expenses:		
Selling and general expenses	\$75 000	
Inventory losses (225 000 + 400 – 223 000)	2 400	
Carrying amount of motor vehicle sold	13 000	
Insurance expense	1 200	
Rent expense	2 200	
Depr. of furniture, plant and equipment	8 700	
Wages expense accrued	3 600	
Doubtful debts expense	600	
Interest on advance	<u>6 400</u>	<u>113 100</u>
Operating profit of partnership		<u><u>\$39 400</u></u>

B.

Profit Distribution

Salaries: Babel	8 000	Net profit	39 400
Cable	6 000		
Interest on capital:			
Able	4 800		
Babel	2 400		
Cable	2 400		
Residual Profit:			
Able	5 267		
Babel	5 267		
Cable	<u>5 266</u>		
	<u>39 400</u>		<u><u>39 400</u></u>

C.

ABC COMPANY
Statement of Financial Position
as at 30 June 2003

<u>Current assets</u>		
Cash at bank		6 000
Accounts receivable	120 000	
Allowance for doubtful debts	<u>3 600</u>	116 400
Inventory		223 000
Prepaid insurance		1 300
Prepaid rent		<u>1 800</u>
Total current assets		348 500
<u>Non-current assets</u>		
Furniture, plant and equipment	200 000	
Accumulated depreciation	<u>133 700</u>	<u>66 300</u>
Total assets		\$414 800
<u>Less Current Liabilities</u>		
Accounts payable	100 400	
Wages payable	3 600	
Advance from Able	80 000	
Interest payable in advance	<u>6 400</u>	
Total liabilities		<u>190 400</u>
Net assets		<u>\$224 400</u>
<u>Partners' equity</u>		
Able, Capital	80 000	
Babel, Capital	40 000	
Cable, Capital	<u>40 000</u>	160 000
Able, Retained profits*	12 067	
Babel, Retained profits*	28 667	
Cable, Retained profits*	<u>23 666</u>	<u>64 400</u>
Total partners' equity		<u>\$224 400</u>

* Retained profits for each partner:

	Able	Babel	Cable
Beginning balance	\$2 000	\$13 000	\$10 000
Salary	-	8 000	6 000
Interest on capital	4 800	2 400	2 400
Residual profits shared equally	5 267	5 267	5 266
	<u>12 067</u>	<u>28 667</u>	<u>23 666</u>