ACCOUNTING FOR PARTNERSHIPS

Prepared by

Dr. Sameh Othman Mohamed Yassin

Ph.D. in Accounting

University of Bremen - Germany

Dr. Ali Abdelkarim Rawy

Dr. Abdelmohsen M. Desoky

Ph.D. in Accounting

Hull – England

Preface:

we sincerely thank Almighty ALLAH who gave us the ability to complete this textbook. This text is designed in a clear and simple form to help students in understanding various issues related to accounting in partnerships.

The textbook is divided into several chapters to facilitate the partitioning of the subjects covered. Chapter one deals with a general overview of the partnership form of organisations. Formation of partnership is the interest of the second chapter, while the third one focuses on partners' current accounts. Chapter four deals with partnership capital modifications and chapter five concentrates on the admission of a new partner. Retirement of a Partner and liquidation of a partnership are the interest of the last two chapters, chapter six and chapter seven.

Sure, there might be some errors in this textbook whether typographical or conceptual. We hope readers to excuse the author regarding these errors and convey their valuable comments and corrections to the authors.

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CHAPTER ONE

Partnerships – An Overview

1.1 Introduction:

In Egypt, like most countries, three types of business organization are common. These types are as follows:

- the sole proprietorship,
- the partnership, and
- the corporation.

Partnership is a common form of organization because this type of organisations provides suitable, inexpensive means of combining the capital and the special capabilities of two or more persons (they are called partners).

In most types of small business and also in the various professions, the partnership form of organization is widely used.

1.2 Definition of a Partnership:

A partnership is often referred to as a firm; also, in most cases, the name of the firm includes the word "company", such as “A & B Company”.

In Egypt, the Civil Law defines a partnership as a company between two or more with intention of trading as co-partners on a certain address or a name for this company.

Also in the United States of America, nearly in the same way, the Uniform Partnership Act (UPA) of 1914, which has been the general governing authority for partnerships and adopted by most states, defines a partnership as "an association of two or more persons to carry on, as co-owners, a business for profit."

The above definition which suggested by the American UPA includes several separate factors:

- Association of two or more persons. Those persons are usually individuals; however, they could be corporations or other partnerships.
- To carry on as co-owners. A partnership is an aggregation of partners' individual rights. This suggests that all persons or partners are co-owners of partnership property and also are co-owners of the profits or losses of their partnership.
- Business for profit. A partnership might be formed to perform any legal business, profession, trade, or other service. However, the partnership should attempt to create a profit.

1.3 Formation of a Partnership:

First of all, “Ease of formation” can be considered as a primary advantage of the partnership form of organisation. The agreement to form a partnership may be as informal as a handshake or as formal as an agreement of several pages.

Each partner must agree to the formation agreement, and partners are strongly advised to have a formal written agreement in order to avoid potential problems that might arise during the operation of their business.

In addition to essential legal provisions, the partnership agreement should address the following points:

1- Names and addresses of the partners.

2- The partnership's exact name and designated place of business.

3- The date that the partnership was formed.

4- The partnership's business purpose and its duration.

5- The basis of accounting to be used and its accounting year-end.

6- Amount to be invested by each partner and a list of the assets contributed by each partner and their agreed values.

7- Duties and rights of each partner, effective the specified date of formation of the partnership.

8- A complete specification of the profit or loss distribution, including salaries, interest on capital balances, bonuses, and the percentages used to distribute any residual profit or loss.

9- Withdrawals to be allowed for each partner and any conditions for withdrawals (for example, a certain amount per month or an amount up to a percentage of current period earnings).

10- Additional capital contributions. Provisions for making future capital infusions should the firm have financial difficulties.

11- Designation of a managing partner or executive committee. Provisions for designating a managing partner or an executive committee and the authority granted to such partner and committee.

12- Procedures used for changes in the partnership, such as admission of new partners and the retirement of a partner.

Lastly, all partners should sign the partnership agreement to show their acceptance of the terms of agreement. A well and carefully prepared partnership agreement could prevent or at least reduce many of the more common types of problems and disputes that may arise in the future operations of the partnership.

1.4 Nature of Partnership:

A partnership is a contractual association of two or more persons (normally called partners) to undertake a form of lawful business activity. This association might form either by oral or written agreement and the relationship is subject to all requirements of the law of contracts. Basically, only individuals or natural persons may become partners under this association.

Legally, a partnership is created if a person engages in business with one or more other persons and permits himself to be represented to the public as a partner, even if there is no explicit contract between those parsons (partners).

Practically, there are a number of types of partners recognized by law or usage. The "general" partner is one having unqualified rights and status. In other words, general partner is a partner in a limited partnership who has the traditional rights and responsibilities of a partner, including mutual agency and unlimited personal liability for the debts of the business. In the other hand, “limited partner” or “silent partner” is a partner in a “limited partnership” or a “simple bequest company” who has the right to participate in profits, but whose liability for losses is limited to the amount he or she invested and who does not have the right to participate in management of the business.

Furthermore, the role of this type of partners, limited partners, in the business is that of an investor rather than of a normal partner.

In some other business environment such as the US business environment, there are several types of partners. For example, in addition to the above types of partners, there are the "silent" or "dormant" partner, the “junior” partner, the “secret” partner, and the “nominal” partner. The "silent" or "dormant" partner is a member of the partnership who takes no active part in management; the "junior" partner is a member whose share in the business is small and who exert a minor influence upon partnership activities; the "secret" partner is one whose existence or identity is not known to outsiders; while the "ostensible" or "nominal" partner is one who appears to be a partner, although he may not actually he a member of the firm.

The partnership, unlike the corporation, has no independent existence as a legal entity, and accordingly has no powers or obligations in its own right. The assets of the Firm are owned by the partners, not the partnership, and the liabilities of the firm are the personal liabilities of the partners, jointly and severally. This means that if the firm assets are insufficient to meet the indebtedness of the business, other assets belonging to the partners may be levied upon by the creditors, and without regard to the relative investments in the firm.

An outstanding disadvantage of the partnership form of organisation as compared with the corporation lies in this condition of unlimited liability. The partnership is also at a disadvantage as a business enterprise with respect to continuity; the partnership might be subject to liquidation upon the retirement, bankruptcy or death of any partner, while in general the corporation is not affected by transfers of stock or any change in the status of the particular stockholder.

On the other hand, the partnership as such is not subject to income taxation and is freer than the corporation at various points from government supervision and interference. The control of the partners over operations is also more direct and flexible than that of the stockholders.

1.5 Major Features of a Partnership:

Despite the fact that the partnership does not constitute an independent legal entity, it usually represents a separate business enterprise, and in general the accounts of the firm should be restricted to the affairs of the partnership undertaking and exclude the outside interests and activities of the members or partners. This type of systems, however, has its limitations as means of furnishing information to firm creditors, and in special circumstances supplementary data may have to be made available.

The unique features of partnership accounting arise primarily in connection with the equities of the partners. As a rule two or more accounts are required for each partner. Such accounts could be:

- A capital account, which needed to show the amount of the original capital contribution and the changes, if any, arising from additional commitments or withdrawals of funds.

- A current account, which also needed to register the assignment of profit or loss to the particular partner and to record ordinary drawings.

The use of these two accounts makes it possible to draw a distinction between capital status and income balance.

In addition to the above two accounts, a third type of partner's account is useful wherever the partner enters into a relation with the firm in some capacity other than that of a proprietor. If the partner becomes in effect an employee, for example, a special account may be set up to show the amount accruing in his/her favour as salary or wages and the amounts disbursed or drawn against such accrual. In a similar way, if a partner borrows from or loans to the company, makes purchases from or sales to the company, or enters into any other transaction in which he or she is one party and the partnership as a whole is the other, the use of a separate account, suitably labelled, is desirable.

It is helpful before taking up the accounting problems related to partnerships, to consider briefly some of the distinctive characteristics of the partnership form of organization. These characteristics (such as limited life and unlimited liability) all stem from the concept that a partnership is not a separate legal entity in itself but merely a voluntary association of individuals (partners).

1. Ease of Formation: Forming a partnership is a relatively simple process. A partnership can be created without any legal formalities. When two or more persons agree to become partners, such agreement constitutes a contract and a partnership is automatically created. The contract should be in writing in order to minimize the chances for misunderstanding future disagreement. The voluntary aspect of a partnership agreement means that no one can be forced into a partnership or forced to continue as a partner.

Thus, in comparison with the corporation form of organisation, a partnership need not prepare articles of incorporation, write bylaws, print stock certificates, prepare minutes of the first meeting of the board of directors, pay state incorporation fees, or register stock.

2. Limited Life:

In some cases, according to the partnership contract, it is possible that a partnership may be ended at any time by the death or withdrawal of any member of the firm.

Other factors which may bring an end to a partnership include the bankruptcy of a partner, the expiration of the period specified in the partnership contract, or the completion of the project for which the partnership was established.

As explained earlier, a partnership might be legally terminated as a business entity each time there is a change in membership. This legal termination is called a "dissolution of the partnership". Most partnerships include provisions in their articles of co-partnership for changes in membership so that the business is not interrupted. These provisions provide procedures for electing new partners and for valuing a partner's capital balance at the time of death or retirement, thus ensuring continued business operations during the period of change.

3. Mutual Agency:

In partnership form of organisation, each partner acts as an agent of the partnership, with authority to enter into contracts for the purchase and sale of goods and services. The partnership is bound by the acts of any partner as long as these acts are within the scope of normal operations.

Each partner is a co-owner of the partnership assets and liabilities. So outsiders view each partner as an agent of the partnership. The factor of mutual agency suggests the need for exercising great caution in the selection of a partner. To be in partnership with an irresponsible person or one lacking in integrity is an intolerable situation.

4. Unlimited Liability:

If a partnership’s assets are insufficient to pay its creditors, the creditors have recourse to the personal assets of any and all general partners of the partnership. This means that each partner is personally responsible for all the debts of the company. The lack of any ceiling on the liability of a partner may deter a wealthy person from entering a partnership.

In case of a new member joining an existing partnership, he or she may or may not assume liability for debts incurred by the firm prior to his or her admission. A partner withdrawing from membership must give adequate public notice of withdrawal; otherwise the former partner may be held liable for partnership debts incurred subsequent to his or her withdrawal. The retiring partner remains liable for partnership debts existing at the time of withdrawal unless the creditors agree to a release of this obligation.

Generally, creditors will take action against the partner with the most liquid assets. This means that any individual partner may be required to pay the partnership's creditors from personal assets in an amount exceeding his or her capital balance in the partnership. This unlimited liability of partners differs from the corporate form of business in which a stockholder’s responsibility is limited to the amount invested in the corporation's stock.

5. Co-ownership of Partnership Property:

In partnership form of organisation, when a partner invests a building, inventory, or other property in a partnership, he or she does not retain any personal right to the assets contributed. The property becomes jointly owned by all partners.

6- Sharing Profits and Losses:

Profits and losses are shared among the partners in any manner to which they agree. This means that each member of a partnership has an ownership right in the profits.

7- Difficulty in Disposing of Interest:

A partner’s ownership interest in a partnership is a personal asset, as is the ownership of stock in a corporation. No formal established marketplace exists for the sale of a partnership interest, however, as exists for the sale of stock in a publicly owned corporation.

Accordingly, a partner who wishes to sell or assign his or her partnership interest has more difficulty finding a buyer than a shareholder who wishes to sell stock in a publicly owned corporation.

To make this process even more difficult, the person buying a partnership interest does not have the automatic right to participate in the business management as the consent of the remaining partners is necessary.

8- Non-taxable Status:

A partnership, unlike a corporation, does not pay income taxes. Instead, each partner reports and pays taxes on his or her share of the partnership's taxable income. These procedures eliminate the undesirable "double taxation" which is a disadvantage of corporations. That is, a corporation's earnings are taxed and then its dividends are also taxed, while partnership income is taxed only once, at the individual partner level.

1.6 Advantages and Disadvantages of a Partnership:

The opportunity to bring together sufficient capital to carry on a business is possibly considered as the most important advantage of most partnerships. The opportunity to combine special skills, as, for example, an engineer and an accountant, may also induce individuals to join forces in a partnership.

Undoubtedly, to form a partnership is much easier and less expensive than to organize a corporation. Members of a partnership enjoy more freedom from government supervision and regulation and more flexibility of action than do the owners of a corporation.

The partners may withdraw funds and make business decisions of all types without the necessity of formal meetings or legalistic procedures.

Also, operating as a partnership may in some cases produce income tax advantages as compared with doing business as a corporation. The partnership itself is not a legal entity and does not have to pay income taxes as does a corporation, even though the individual partners pay taxes on their respective shares of the firm's income.

If a business is to require a large amount of capital, the partnership is a less effective device for raising funds than is a corporation. Many individuals who invest freely in common stocks of corporations are unwilling to enter a partnership because of the unlimited liability imposed on partners.

Limited Partnerships

In the Egyptian economic environment, there are a number of businesses that have been organized as limited partnerships (simple bequest companies). However, this form of partnership, limited partnerships, is not appropriate for businesses in which the owners intend to be active managers.

A limited partnership must have at least one general partner as well as one or more limited partners. The general partners are partners in the traditional sense, with unlimited liability for the debts of the business and the right to make managerial decisions. However, the limited partners are basically investors rather than traditional partners. They have the right to participate in profits of the business, but their liability for losses is limited to the amount of their investment.

Also, limited partners do not actively participate in management of the business. So, the concepts of unlimited liability and mutual agency can be applied only to the general partners in a limited partnership.

1.7 Rights & Duties of Partners:

In partnership form of organisation, partners have several rights and duties that can be introduced in the following points.

Rights of Partner

- All general partners have the right to take part in the management of the partnership. It is not necessary that each partner should participate in the conduct of business, but the right of participation is available to each partner.
- Partners have the right to be consulted. Every partner has an inherent right to be consulted in all matters affecting the business of partnership and express his/her views to other partners.
- Partners have the right to have access to boobs. Every partner has a right to have access to and inspect and copy any of the books of the company. This right also include the right of free access to all records and accounts.
- Partners have the right to share profits. Partners are entitled to share in the profits earned and to contribute to the losses incurred. The partnership contract should clearly refer to the percentages to be used in distribution of these profits and losses among partners.
- Partners have the right to get interest on capital. Ordinarily, interest on capital is not payable to the partners. A partner can charge interest on capital only when it is allowed by the partnership agreement.
- Partners have the right to the use of partnership property. In the absence of any contract to the contrary each partner is presumed to have an equal share in the partnership property and is entitled to have the partnership property held and used exclusively for the purpose of the business.
- Partners have the right to know new partner to be introduced. No person can be introduced as a partner into a firm without the consent of all the existing partners.

- No liability before joining the partnership. A partner does not have any liability for any act of the firm done before he became a partner, unless there is a contract to the contrary.
- Partners have the right to retire. Every partner has the right to retire. Also, they have the right not to be expelled from the partnership by any majority of the partners.

Duties of Partner:

- Partners should observe good faith. A partnership contract is a contract of absolute good faith, and therefore, partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm or any partner or his/her legal representative.
- Partners should attend to their duties diligently. Every partner is bound to attend diligently to his duties in conducting the business of the firm. He or she has no right to receive any compensation for taking part in the conduct of the business.
- Partners should share losses. Each partner is liable to contribute for the firm's losses equally, in the absence of any contract to the contrary.
- Partners liable to account for private profits. A partner shall be liable to account for and pay to the firm any private profits derived from the transactions of the firm or from the use of the property or goodwill of the firm.
- Partners should be liable jointly and severally. Every partner is liable, jointly with all the other partners and also severally, for all the acts of the firm done while he or she is a partner. A retired partner continues to be liable for the debts of the firm incurred till he gives public notice of his retirement.

1. 8 Types of Partnerships:

Generally speaking, there are several types of partnerships. These types can be classified according to the legal form and the scope of activity.

1.8.1. According to their legal form:

According to their legal form, partnerships can be classified into three types of partnerships.

- Ordinary Partnerships:

In which all partners are responsible for all debits of the company towards third party, i.e., we can get from any one of them the rights of third party even from his own special money or property, and in case of not enough money to meet right of other people, the partners being bankrupted.

- Limited Partnerships:

In which units there are two types of partners, Partners who are liable to third party for all debits of their company, thus, those partners having the right to be managers and take decisions. Those partners who have big responsibility need to save their company and save their money against risks and bad decisions. In the other hand, other sleeping partner(s) or silent partners can work as an employee with a salary or a compensation but out of responsibility areas.

A third type is **the Joint Venture** which works without being known to the society, only known among its owners.

1.8.2. According to their activity:

- Commercial units:

These companies are concerned with collection and distributing commodities, take profit from such transactions through selling at higher prices than costs. This type can be seen in retail & wholesale activities.

- Industrial units:

Such units are concerned with getting raw materials, machine power, systems of production, processing and producing finished goods, then selling it either direct or indirect.

* Directly by selling to final consumer saving profits of middlemen or intermediation.

* Indirectly by selling to people who are specialist to work as middlemen getting commissions or profits.

- Agricultural firms:

These are very specialised firms, as they work in agricultural field.

- Service units:

These units appear in many forms such as:

- Educational.
- Medical (Service only).
- Transportation.
- Other units rendering services.

all of these service units have their own items of revenues, expenses, own accounts, and lastly so specialised reports.

Key Terms of the Chapter

A partnership: A company between two or more with intention of trading as co-partners on a certain address or a name for this company. In most cases, profits are the aim of this form of organisation.

General partner: A partner in a limited partnership who has the traditional rights and responsibilities of a partner, including mutual agency and unlimited personal liability for the debts of the business.

Limited partner: ***(bequest partner or silent partner)*** A partner in a limited partnership who has the right to participate in profits, but whose liability for losses is limited to the amount he or she has invested and who does not have the right to participate in management of the business. A limited partner's role is that of an investor rather than that of a traditional partner.

Limited partnership: A partnership which has one or more limited partners as well as one or more general partners. Limited partnerships are used primarily to attract investment capital from the limited partners.

Liquidation of a partnership: The process of breaking up and discontinuing a partnership, including the sale of assets, payment of creditors, and distribution of remaining assets to the partners.

Mutual agency: Authority of each partner to act as agent for the partnership within its normal scope of operations and to enter into contracts which bind the partnership.

Partnership contract: An agreement among partners on the formation and operation of the partnership. Usually includes such points as a plan for sharing profits, amounts to be invested, and provision for dissolution.

Unlimited Liability: If a partnership's assets are insufficient to pay its creditors, the creditors have recourse to the personal assets of any and all general partners of the partnership. This means that each partner is personally responsible for all the debts of the company.

<u>Chapter's Questions</u>

First: <u>Listed below are some technical accounting terms</u>

A- Unlimited liability. *B- Liquidation.*

C- General partner. *D- Limited partner.*

E- Partnership contract. *F- Drawing account.*

G- Capital account.

Each of the following statements may (or may not) describe one of these technical terms. For each statement indicate the accounting term described.

1- This account is increased for the fair value of non-cash assets invested by a partner.

2- This account is increased when a partner takes assets out of the partnership in anticipation of partnership net income.

3- The process of breaking up and discontinuing a partnership, including the sale of assets, payment of creditors, and distribution of remaining assets to the partners.

4- A partner whose financial responsibility does not exceed the amount of his or her investment and who does not actively participate in management of the partnership.

5- Serves to identify partners and their addresses, specify capital contributions, and establish profit-sharing formula.

6- A partner who actively participate in management of the partnership and is personally liable for the debts of the partnership.

7- If a partnership's assets are insufficient to pay its creditors, each general partner is personally responsible for all the debts of the company.

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Second- Determine whether each of the following statements is true or false:

1- In Egypt, like most countries, two types of business organization are common. These types are the sole proprietorship and the partnership. (   )

2- Partnership is a common form of organization because this type of organisations provides suitable, inexpensive means of combining the capital and the special capabilities of two or more persons. (   )

3- In most types of small business and also in the various professions, the partnership form of organization is widely used. (   )

4- In Egypt, the Civil Law defines a partnership as a company between two or more with intention of trading as co-partners on a certain address or a name for this company. (   )

5- In Egypt, the Civil Law defines a partnership as a company between three or more with intention of trading as co-partners on a certain address or a name for this company. (   )

6- The agreement to form a partnership may be as informal as a handshake or as formal as an agreement of several pages. (   )

7- The agreement to form a partnership may not be as informal as a handshake or as formal as an agreement of several pages. (   )

8- All partners should sign the partnership agreement to show their acceptance of the terms of agreement. (   )

9- It is not important that all partners should sign the partnership agreement to show their acceptance of the terms of agreement. (   )

10- A partnership is a contractual association of two or more persons (normally called partners) to undertake a form of lawful business activity. (   )

11- A partnership is a contractual association of three or more persons (normally called partners) to undertake a form of lawful business activity. (   )

12- General partner is a partner in a limited partnership who has the traditional rights and responsibilities of a partner, including mutual agency and unlimited personal liability for the debts of the business. (   )

13- Limited partner is a partner in a limited partnership who has the traditional rights and responsibilities of a partner, including mutual agency and unlimited personal liability for the debts of the business. (   )

14- “limited partner” or “silent partner” is a partner in a “limited partnership” or a “simple bequest company” who has the right to participate in profits, but whose liability for losses is limited to the amount he or she invested. (   )

15- General partner is a partner in a “limited partnership” or a “simple bequest company” who has the right to participate in profits, but whose liability for losses is limited to the amount he or she invested. (   )

16- The role of limited partners in the business is that of an investor rather than of a normal partner. (   )

17- The role of general partners in the business is that of an investor rather than of a normal partner. (   )

18- The partnership, unlike the corporation, has no independent existence as a legal entity. (   )

19- The corporation, unlike the partnership, has no independent existence as a legal entity. (   )

20- The assets of the Firm are owned by the partners, not the partnership, and the liabilities of the firm are the personal liabilities of the partners, jointly and severally. (   )

21- The partnership might be subject to liquidation upon the retirement, bankruptcy or death of any partner. (   )

22- The partnership might not be subject to liquidation upon the retirement, bankruptcy or death of any partner. (   )

23- In general the corporation is not affected by transfers of stock or any change in the status of the particular stockholder. (   )

24- The control of the partners over operations is also more direct and flexible than that of the stockholders.   (   )

25- Forming a partnership is a relatively simple process. (   )

26- Forming a corporation is a relatively simple process. ( )

27- A partnership can be created without any legal formalities. ( )

28- When two or more persons agree to become partners, this constitutes a contract and a partnership is automatically created. ( )

29- In some cases, according to the partnership contract, it is possible that a partnership may be ended at any time by the death or withdrawal of any member of the firm. ( )

30- In all cases, according to the partnership contract, it is possible that a partnership may be ended at any time by the death or withdrawal of any member of the firm. ( )

31- A partnership might be legally terminated as a business entity each time there is a change in membership. ( )

32- In the partnership form of organisation, each partner acts as an agent of the partnership. ( )

33- In the corporation form of organisation, each partner acts as an agent of the partnership. ( )

34- The factor of mutual agency suggests the need for exercising great caution in the selection of a partner. ( )

35- Unlimited liability means that each partner is personally responsible for all the debts of the company. ( )

36- Unlimited liability of partners differs from the corporate form of business in which a stockholder's responsibility is limited to the amount invested in the corporation's stock. ( )

37- When a partner invests a building, inventory, or other property in a partnership, he or she does not retain any personal right to the assets contributed. ( )

38- A partner who wishes to sell or assign his or her partnership interest has more difficulty finding a buyer than a shareholder who wishes to sell stock in a publicly owned corporation. ( )

39- A partner who wishes to sell or assign his or her partnership interest has less difficulty finding a buyer than a shareholder who wishes to sell stock in a publicly owned corporation. (   )

40- A partnership, unlike a corporation, does not pay income taxes. (   )

41- Each partner reports and pays taxes on his or her share of the partnership's taxable income. (   )

42- To form a partnership is much easier and less expensive than to organize a corporation. (   )

43- To form a corporation is much easier and less expensive than to form a partnership. (   )

44- Members of a partnership enjoy more freedom from government supervision and regulation and more flexibility of action than do the owners of a corporation. (   )

45- Members of a partnership enjoy less freedom from government supervision and regulation and less flexibility of action than do the owners of a corporation. (   )

46- The partnership itself is not a legal entity and does not have to pay income taxes as does a corporation. (   )

47- Limited partnerships, is not appropriate for businesses in which the owners intend to be active managers. (   )

48- General partnerships, is not appropriate for businesses in which the owners intend to be active managers. (   )

49- A limited partnership must have at least one general partner as well as one or more limited partners. (   )

50- limited partners are basically investors rather than traditional partners. (   )

51- Limited partners do not actively participate in management of the business. (   )

52- General partners do not actively participate in management of the business. (   )

53- All general partners have the right to take part in the management of the partnership. (   )

54- It is not necessary that each partner should participate in the conduct of business, but the right of participation is available to each partner. (   )

55- Partners have the right to have access to boobs. (   )

56- Partners have no rights to have access to boobs. (   )

57- Every partner has a right to have access to and inspect and copy any of the books of the company. (   )

58- Partners are entitled to share in the profits earned and to contribute to the losses incurred. (   )

59- No person can be introduced as a partner into a firm without the consent of all the existing partners. (   )

60- A partner does not have any liability for any act of the firm done before he became a partner, unless there is a contract to the contrary. (   )

61- Every partner has the right to retire. (   )

62- None of partners has the right to retire in the partnerships. (   )

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CHAPTER TWO

Formation of Partnerships

2.1 Introduction:

This chapter will discuss accounting issues that are unique to formation of a partnership. Practically, there is more than one way to form a partnership. Partners can pay their shares in the partnership in cash, in asset(s), in a group of assets and liabilities, or in transferring an existing sole proprietorship to partnership.

When forming a partnership, it is very important to assign a proper value to the non-cash assets and liabilities contributed by the partners. An item contributed by a partner becomes partnership property co-owned by all partners. Also, the partnership must clearly distinguish between capital contributions and loans made to the partnership by one or more partners. Reason for this is that loan arrangements should be evidenced by promissory notes or other legal documents needed to show that a loan arrangement exists between the partnership and an individual partner or more.

Assets presented should be valued at their fair values, which might require appraisals or other valuation techniques. Liabilities assumed by the partnership should be valued at the present value of the remaining cash flows. Partners must agree to the percentage of equity that related to each partner in the net assets of the partnership. In general, the proportionate share of each partner's capital contribution determines the capital balance.

For instance, if partners X and Y agree to form a partnership of LE 100,000, and partner X contributes LE 60,000 or 60 % of the net assets of the partnership, and Y contributes the rest (LE 40,000 or 40 %), this means that X will have a 60 percent capital share and Y will have a 40 percent capital share.

In respect of intangible shares, such as a partner's special expertise or necessary business connections with outsiders, partners may agree to any proportional division of capital. So, before recording the initial capital contribution, partners must agree on the valuation of the net assets and on each partner's capital share.

As mentioned earlier, several ways can be used when forming a partnership. These ways can be discussed as follows:

2.2 By Cash:

Forming a partnership using cash is considered as the simplest and most clear-cut case in partnership formation.

Assume, for instance, that A and B form a partnership, and that each partner, according to the partnership agreement, contributes LE 50,000 in cash. Then the opening journal entries should be:

Cash	**100,000**	
To Capital Account		**100, 000**
A 50 000		
B 50 000		
or		
To A's Capital		**50,000**
B's Capital		**50,000**
Being capital contributions paid in cash by partners A and B.		

Example 2.1:

Assume that A, B and C agree to form and start their partnership at LE 120,000, and that partners' contributions are as follows: partner A LE 40,000, partner B LE 50,000 and partner C LE 30,000 in cash, on the first of January/ 2003. Partners paid their shares on time. You are required to prepare:

1- The needed journal entries.

2- The needed ledger accounts.

3- The Balance Sheet at that date.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
1/1/2003	**Cash**	**120,000**	
	To sundries:		
	A's Capital		**40,000**
	B's Capital		**50,000**
	C's Capital		**30,000**
	or		
	To capital account		**120,000**
	A 40,000		
	B 50.000		
	C 30,000		
	Being capital contributions paid by partners A, B, and C.		

2- Ledger accounts:

Dr. Cash Account **Cr.**

1/ 1/ 2003			
To capital:			
A	**40,000**		
B	**50,000**	**balance c/d**	**120,000**
C	**30,000**	**1/ 1/ 2003**	
	120,000		**120,000**

2.3 By Asset(s):

In other cases, one partner or more may prefer to introduce his or her share in asset(s) rather than in cash. In such cases, partner A, for example, might pay his share in cash, while partner B might prefer to pay his share in some different assets such assets land, building, cars, equipment, goods, … etc.

All partners should completely agree on the values of the presented assets to be recorded in the books of partnership.

Example 2.2:

On 1/3/2003 Rana and Rawan agreed to form and start their partnership at LE 80,000. They decided to pay their shares as follows: Rana pay a cash of LE 40,000, while Rawan pays her share by introducing the following assets land LE 10,000, building LE 10,000, equipment LE 15,000, and the rest in cash. They paid their shares on time.

Required:

1- Journal entries needed to record the above events.

2- Ledger accounts.

3- Balance Sheet 1/3/2003.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
1/3/2003	**Cash**	**40,000**	
	To capital a/c		**40,000**
	Rana		
1/3/2003	**By sundries:**		
	Land	**10,000**	
	Building	**10,000**	
	Equipment	**15,000**	
	Cash	**5,000**	
	To capital a/c		**40,000**
	Rawan		
	Being capital contributions paid by partners.		

2- Ledger accounts:

Dr. Cash Account **Cr.**

1/ 3/ 2003			
To capital (Rana)	**40,000**	**balance c/d**	
To capital (Rawan)	**5,000**	**1/ 3/ 2003**	**45,000**
	45,000		**45,000**

Dr. Land Account **Cr.**

1/ 3/ 2003		**balance c/d**	
To capital (Rawan)	**10,000**	**1/ 3/ 2003**	**10,000**
	10,000		**10,000**

Dr. Building Account **Cr.**

1/ 3/ 2003		**balance c/d**	
To capital (Rawan)	**10,000**	**1/ 3/ 2003**	**10,000**
	10,000		**10,000**

Dr. Equipment Account **Cr.**

1/ 3/ 2003		**balance c/d**	
To capital (Rawan)	**15,000**	**1/ 3/ 2003**	**15,000**
	15,000		**15,000**

Capital Account

2.4 By a Group of Assets and Liabilities or a Sole proprietorship:

In the above two cases, we dealt with formation of a partnership when one or more partners introduce his or her share as cash or some assets. This part of the chapter deals with the case when a partner or more introduce his or her share as a group of assets and liabilities or as a sole proprietorship (individual firm).

A clear agreement should be made regarding the values of the assets presented and whether or not the new partnership will bear the liabilities presented.

In such cases, partners agree that one or more partners offer his or her existing sole proprietorship as a share in the new partnership. Of course, this sole proprietorship or individual firm includes different assets and liabilities as well. It is necessary here to calculate the presented net assets (net assets = assets – liabilities) to compare it with the agreed share or capital of such partner.

In many cases, partners might agree to revaluate assets and liabilities presented, in such cases new agreed values of assets and liabilities should be taken into consideration.

Three different cases are expected. These cases can be illustrated as follows:

2.4.1 First Case, there is equality between the net assets presented and the agreed share offered to the partner. For instance, partners agree to give the partner a share of LE 100,000 and in the same time, this partner is presenting LE 120,000 assets and LE 20,000 liabilities meaning that he or she is presenting a net asset of (120,000 – 20,000 = 100,000). Here, there is no difference between his agreed share in the partnership and net assets presented. In such cases no action needed to be done by such partner.

Example 2.3:

On 1/7/2002 Mohamed and Omer agreed to establish a new partnership at LE 200,000. They decided to pay their shares (by 1/10/2002) as groups of assets and liabilities as follows: Mohamed introduced cars of LE 35,000, accounts receivable LE 30,000, accounts payable LE 10,000, land LE 15,000, building LE 10,000, and the rest in cash. Omer introduced share as cars of LE 15,000, accounts receivable LE 15,000, equipment LE 25,000, machines LE 20,000, cash LE 50,000, and accounts payable LE 20,000. They agree to revaluate cars presented by partner Mohamed to be only LE 30,000 and cars presented by Omer to be only 10,000.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet 1/10/2002.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
1/10/2002	**By sundries:**		
	Cars	**30,000**	
	A / R	**30,000**	
	Land	**15.000**	
	Building	**10,000**	
	Cash	**25,000**	
	To sundries:		
	A / P		**10,000**
	Capital a/c (Mohamed)		**100,000**
	To record the investment by Mohamed in the partnership.		
1/10/2002	**By sundries:**		
	Cars	**10,000**	
	A /R	**15,000**	
	Equipment	**25,000**	
	Machines	**20,000**	
	Cash	**50,000**	
	To sundries:		
	A / P		**20,000**
	Capital a/c (Omer)		**100,000**
	To record the investment by Omer in the partnership.		

Because the above two journal entries have the same date (1/10/2002), it is possible to re-write them in only one journal entry. This unique entry can be as follows:

Date	Details	Dr.	Cr.
1/10/2002	**By sundries:**		
	Cars	40,000	
	A / R	45,000	
	Land	15.000	
	Building	10,000	
	Equipment	25,000	
	Machines	20,000	
	Cash	75,000	
	To sundries:		
	A / P		30,000
	Capital a/c (Mohamed)		100,000
	Capital a/c (Omer)		100,000
	To record the investment by partners in the partnership.		

2- Ledger accounts:

Dr. Cars Account **Cr.**

1/ 10/ 2002			
To sundries	30,000	balance c/d	
To sundries	10,000	1/ 10/ 2002	40,000
	40,000		40,000

Dr. A / R Account **Cr.**

1/ 10/ 2002			
To sundries	30,000	balance c/d	
To sundries	15,000	1/ 10/ 2002	45,000
	45,000		45,000

Dr. Land Account **Cr.**

1/ 10/ 2002		**balance c/d**	
To sundries	**15,000**	**1/ 10/ 2002**	**15,000**
	15,000		**15,000**

Dr. Building Account **Cr.**

1/ 10/ 2002		**balance c/d**	
To sundries	**10,000**	**1/ 10/ 2002**	**10,000**
	10,000		**10,000**

Dr. Equipment Account **Cr.**

1/ 10/ 2002		**balance c/d**	
To sundries	**25,000**	**1/ 10/ 2002**	**25,000**
	25,000		**25,000**

Dr. Machines Account **Cr.**

1/ 10/ 2002		**balance c/d**	
To sundries	**20,000**	**1/ 10/ 2002**	**20,000**
	20,000		**20,000**

Dr. Cash Account **Cr.**

1/ 10/ 2002			
To sundries	**25,000**	**balance c/d**	
To sundries	**50,000**	**1/ 10/ 2002**	**75,000**
	75,000		**75,000**

Dr. A / P Account **Cr.**

balance c/d		**<u>1/ 10/ 2002</u>**	
<u>1/ 10/ 2002</u>		**By sundries**	**10,000**
	30,000	**By sundries**	**20,000**
	<u>30,000</u>		**<u>30,000</u>**

Dr. Capital Account (Mohamed) **Cr.**

balance c/d		**<u>1/ 10/ 2002</u>**	
<u>1/ 10/ 2002</u>	**100,000**	**By sundries**	**100,000**
	<u>100,000</u>		**<u>100,000</u>**

Dr. Capital Account (Omer) **Cr.**

balance c/d		**<u>1/ 10/ 2002</u>**	
<u>1/ 10/ 2002</u>	**100,000**	**By sundries**	**100,000**
	<u>100,000</u>		**<u>100,000</u>**

Assets **Balance Sheet as on 1/10/2002** **Liabilities**

<u>Fixed Assets</u>			***<u>Capital:</u>***		
Cars	**40,000**		**Mohamed**	**100,000**	
Land	**15,000**		**Omer**	**<u>100,000</u>**	**200,000**
Buildings	**10,000**				
Equipment	**25,000**		**<u>Current Liabilities</u>**		
Machines	**<u>20,000</u>**	**110,000**			
<u>Current Assets</u>			**A / P**	**<u>30,000</u>**	**30,000**
A / R	**45,000**				
Cash	**<u>75,000</u>**	**120,000**			
		<u>230,000</u>			**<u>230,000</u>**

<u>2.4.2 Second Case</u>, the net assets presented by the partner is **less than** the agreed share offered to the partner. For instance, partners agree to give the partner a share of LE 50,000 and in the same time, this partner is presenting LE 60,000 assets and LE 15,000 liabilities meaning that he or she is presenting a net asset of (60,000 – 15,000 = 45,000). Here, there is LE 5,000 difference between his agreed share in the partnership and net assets presented (his or her net assets are LE 5,000 less than the agreed share). In such cases, partners might ask this partner to pay the difference (LE 5,000) or this difference can be considered as a "goodwill" which will be transferred to the partnership.

<u>Example 2.4:</u>

On 1/10/2003 Alaa and Tarek agreed to form a new partnership at LE 250,000 (LE 150,000 Alaa, and 100,000 Tarek). The profit and losses sharing ratio is 2:1 respectively). They decided to transfer their individual firms to be a one partnership by 1/1/2004. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	Alaa	**Tarek**		**Alaa**	**Tarek**
<u>Fixed Assets</u>			**Capital**	**130,000**	**100,000**
Machines	**40,000**	**35,000**			
Land	**50,000**	**30,000**	**A / P.**	**45,000**	**45,000**
Cars	**45,000**	**15,000**	**Loans**	**10,000**	**10,000**
<u>Current Assets</u>					
A / R.	**20,000**	**5,000**			
Securities	**<u>30,000</u>**	**<u>70,000</u>**			
	<u>185,000</u>	**<u>155,000</u>**		**185,000**	**155,000**

They agreed to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet 1/1/2004.

4- Journal entries needed to close books of Alaa’s firm.

<u>Solution:</u>

1- Journal entries:

Date	Details	Dr.	Cr.
1/1/2004	**<u>By sundries:</u>**		
	Machines	**40,000**	
	Land	**50,000**	
	Cars	**45.000**	
	A / R	**20,000**	
	Securities	**30,000**	
	Goodwill	**20,000**	
	<u>To sundries:</u>		
	A / P		**45,000**
	Loans		**10,000**
	Capital a/c (Alaa)		**150,000**
	To record the investment by Alaa in the partnership.		
1/1/2004	**<u>By sundries:</u>**		
	Machines	**35,000**	
	Land	**30,000**	
	Cars	**15,000**	
	A / R	**5,000**	
	Securities	**70,000**	
	<u>To sundries:</u>		
	A / P		**45,000**
	Loans		**10,000**
	Capital a/c (Tarek)		**100,000**
	To record the investment by Tarek in the partnership.		

Also, because the above two journal entries were recorded in the same date (1/1/2004), it is possible to re-write them in only one journal entry.

2- Ledger accounts:

Dr. Machines Account **Cr.**

1/ 1/ 2004			
To sundries	**40,000**	**balance c/d**	
To sundries	**35,000**	**1/ 1/ 2004**	**75,000**
	75,000		**75,000**

Dr. Land Account **Cr.**

1/ 1/ 2004			
To sundries	**50,000**	**balance c/d**	
To sundries	**30,000**	**1/ 1/ 2004**	**80,000**
	80,000		**80,000**

Dr. Cars Account **Cr.**

1/ 1/ 2004			
To sundries	**45,000**	**balance c/d**	
To sundries	**15,000**	**1/ 1/ 2004**	**60,000**
	60,000		**60,000**

Dr. A / R Account **Cr.**

1/ 1/ 2004			
To sundries	**20,000**	**balance c/d**	
To sundries	**5,000**	**1/ 1/ 2004**	**25,000**
	25,000		**25,000**

Dr. Securities Account Cr.

1/ 1/ 2004		**balance c/d**	
To sundries	**30,000**	**1/ 1/ 2004**	**100,000**
To sundries	**70,000**		
	100,000		**100,000**

Dr. Goodwill Account Cr.

1/ 1/ 2004		**balance c/d**	
To sundries	**20,000**	**1/ 1/ 2004**	**20,000**
	20,000		**20,000**

Dr. A / P Account Cr.

balance c/d		**1/ 1/ 2004**	
1/ 1/ 2004	**90,000**	**By sundries**	**45,000**
		By sundries	**45,000**
	90,000		**90,000**

Dr. Loans Account Cr.

balance c/d		**1/ 1/ 2004**	
1/ 1/ 2004	**20,000**	**By sundries**	**10,000**
	20,000	**By sundries**	**10,000**
			20,000

Dr. Capital Account (Alaa) Cr.

balance c/d		**1/ 1/ 2004**	
1/ 1/ 2004	**150,000**	**By sundries**	**150,000**
	150,000		**150,000**

Dr.	Capital Account (Tarek)		**Cr.**
balance c/d		**<u>1/ 1/ 2004</u>**	
<u>1/ 1/ 2004</u>	**100,000**	**By sundries**	**100,000**
	<u>100,000</u>		**<u>100,000</u>**

3- The Balance sheet:

Assets Balance Sheet as on 1/1/2004 **Liabilities**

<u>Goodwill</u>	**20,000**	**20,000**	***<u>Capital:</u>***		
<u>Fixed Assets</u>			**Alaa**	**150,000**	
Machines	**75,000**		**Tarek**	**<u>100,000</u>**	**250,000**
Land	**80,000**				
Cars	**<u>60,000</u>**	**215,000**	**<u>Current Liabilities</u>**		
<u>Current Assets</u>			**A / P**	**90,000**	
A / R	**25,000**		**Loans**	**<u>20,000</u>**	**110,000**
Securities	**<u>100,000</u>**	**125,000**			
		<u>360,000</u>			**<u>360,000</u>**

4- Closing books of Alaa's firm:

Date	**Details**	**Dr.**	**Cr.**
1/1/2004	**<u>By sundries:</u>**		
	A / P	**45,000**	
	Loans	**10,000**	
	Capital a/c (Alaa)	**130,000**	
	<u>To sundries:</u>		
	Machines		**40,000**
	Land		**50,000**
	Cars		**45,000**
	A / R		**20,000**
	Securities		**30,000**
	To close books of Alaa's firm		

- In closing books of Alaa's firm, it was assumed that the same set of books would be used in the new partnership.

<u>Note:</u>

In the above example, it was supposed that the difference between the net assets (LE 130,000) presented by Alaa, which is less than the agreed share (LE 150,000) was considered as goodwill. However, other partner, Tarek, could ask Alaa to pay this difference (LE 20,000) in cash if they agreed to do so. If this is the case, goodwill could not be appeared while Alaa could pay LE 20,000 to cover the difference or complete assets presented.

<u>2.4.3 Third Case</u>, the net assets presented by the partner is **more than** the agreed share offered to the partner. For instance, partners agree to give the partner a share of LE 50,000 and in the same time, this partner is presenting LE 60,000 assets and LE 5,000 liabilities meaning that he or she is presenting net assets of (60,000 – 5,000 = 55,000). Here, there is LE 5,000 difference between his agreed share in the partnership and net assets presented (his or her net assets are LE 5,000 more than the agreed share). In such case, partners might ask this partner to withdraw the difference (LE 5,000) or this difference can be considered as a "capital reserve" which will be transferred to the partnership.

<u>Example 2.5:</u>

On 1/10/2004 A and B agreed to form a new partnership at LE 250,000 (LE 150,000 A, and 100,000 B). The profit and losses sharing ratio is 2:1 respectively). They decided to transfer their individual firms to be a one partnership by 1/1/2005. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	A	B		A	B
Fixed Assets			**Capital**	**170,000**	**100,000**
Machines	**40,000**	**35,000**			
Land	**50,000**	**30,000**	**A / P.**	**45,000**	**45,000**
Cars	**45,000**	**15,000**	**Loans**	**10,000**	**10,000**
Current Assets					
A / R.	**20,000**	**5,000**			
Securities	**70,000**	**70,000**			
	225,000	**155,000**		**225,000**	**155,000**

They agreed to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet as on 1/1/2005.

4- Journal entries needed to close books of A's firm.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
1/1/2003	**By sundries:**		
	Machines	**40,000**	
	Land	**50,000**	
	Cars	**45.000**	
	A / R	**20,000**	
	Securities	**70,000**	
	To sundries:		
	A / P		**45,000**
	Loans		**10,000**
	Capital a/c (A)		**150,000**
	Capital reserve		**20,000**
	To record the investment by A in the partnership.		
	By sundries:		
	Machines	**35,000**	
	Land	**30,000**	
	Cars	**15,000**	
1/1/2003	**A / R**	**5,000**	
	Securities	**70,000**	
	To sundries:		
	A / P		**45,000**
	Loans		**10,000**
	Capital a/c (B)		**100,000**
	To record the investment by B in the partnership.		

It is also because the above two journal entries were recorded in the same date (1/1/2005), it is possible to re-write them in only one journal entry.

2- Ledger accounts:

Dr. Machines Account **Cr.**

1/ 1/ 2003			
To sundries	**40,000**	**balance c/d**	
To sundries	**35,000**	**1/ 1/ 2003**	**75,000**
	75,000		**75,000**

Dr. Land Account **Cr.**

1/ 1/ 2003			
To sundries	**50,000**	**balance c/d**	
To sundries	**30,000**	**1/ 1/ 2003**	**80,000**
	80,000		**80,000**

Dr. Cars Account **Cr.**

1/ 1/ 2003			
To sundries	**45,000**	**balance c/d**	
To sundries	**15,000**	**1/ 1/ 2003**	**60,000**
	60,000		**60,000**

Dr. A / R Account **Cr.**

1/ 1/ 2003			
To sundries	**20,000**	**balance c/d**	
To sundries	**5,000**	**1/ 1/ 2003**	**25,000**
	25,000		**25,000**

Dr. Securities Account Cr.

1/ 1/ 2003			
To sundries	**70,000**	**balance c/d**	
To sundries	**70,000**	**1/ 1/ 2003**	**140,000**
	140,000		**140,000**

Dr. A / P Account Cr.

		1/ 1/ 2003	
balance c/d		**By sundries**	**45,000**
1/ 1/ 2003	**90,000**	**By sundries**	**45,000**
	90,000		**90,000**

Dr. Loans Account Cr.

		1/ 1/ 2003	
balance c/d		**By sundries**	**10,000**
1/ 1/ 2003	**20,000**	**By sundries**	**10,000**
	20,000		**20,000**

Dr. Capital Account (A) Cr.

balance c/d		**1/ 10/ 2002**	
1/ 10/ 2002	**150,000**	**By sundries**	**150,000**
	150,000		**150,000**

Dr. Capital Account (B) Cr.

balance c/d		**1/ 10/ 2002**	
1/ 10/ 2002	**100,000**	**By sundries**	**100,000**
	100,000		**100,000**

Dr.	Capital Reserve Account		**Cr.**
balance c/d		**<u>1/ 1/ 2003</u>**	
<u>1/ 1/ 2003</u>	**20,000**	**By sundries**	**20,000**
	<u>20,000</u>		**<u>20,000</u>**

3- The balance sheet:

Assets Balance Sheet as on 1/1/2005 **Liabilities**

			<u>Capital:</u>		
<u>Fixed Assets</u>			**A**	**150,000**	
Machines	**75,000**		**B**	**<u>100,000</u>**	**250,000**
Land	**80,000**		**<u>Current Liabilities</u>**		
Cars	**<u>60,000</u>**	**215,000**	**A / P**	**90,000**	
<u>Current Assets</u>			**Loans**	**<u>20,000</u>**	**110,000**
A / R	**25,000**				
Securities	**<u>140,000</u>**	**165,000**	**Capital R.**		**20,000**
		<u>380,000</u>			**<u>380,000</u>**

4- Closing books of A's firm:

Date	Details	Dr.	Cr.
1/1/2003	**<u>By sundries:</u>**		
	A / P	**45,000**	
	Loans	**10,000**	
	Capital a/c (A)	**170,000**	
	<u>To sundries:</u>		
	Machines		**40,000**
	Land		**50,000**
	Cars		**45,000**
	A / R		**20,000**
	Securities		**70,000**
	To close books of A's firm.		

Note:

In the above example, it was supposed that the difference between the net assets (LE 170,000) presented by A, which is more than the agreed share (LE 150,000) was considered as capital reserve. Other partner (B) could ask A to withdraw this difference (LE 20,000) in cash or in any type of assets if they agreed to do so.

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Exercises:

1- Nourhan, Gehan and Omer agree to start a new partnership at LE 180,000. Their contributions are as follows: partner Nourhan LE 80,000, partner Gehan LE 60,000 and partner Omer LE 40,000 in cash, on the first of May 2004. Partners paid their shares on the agreed time. You are required to prepare:

1- The journal entries needed to record the above.

2- The needed ledger accounts.

3- The Balance Sheet at that date.

==

2- On 1/10/2004 A and B agreed to establish a new partnership at LE 200,000 to be distributed equally between them. They decided to present their shares as follows: A pay a cash of LE 100,000, while B pays his share by introducing the following assets cars LE 40,000, building LE 20,000, equipments LE 10,000, and the rest in cash. Shares were received on time.

Required:

1- The needed journal entries.

2- Ledger accounts.

3- Balance Sheet after the formation.

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3- On 1/1/2005 Ahmed and Mohamed agreed to form a partnership at LE 300,000-sharing capital at 2:1 respectively. They decided to pay their shares (by 1/5/2004) as groups of assets and liabilities as follows: Ahmed introduced cars of LE 66,000, accounts receivable LE 35,000, accounts payable LE 22,000, land LE 25,000, building LE 34,000, and the rest in cash. Mohamed introduced his share as cars of LE 32,000, accounts receivable LE 33,000, equipment LE 24,000, machines LE 29,000, cash LE 10,000, and accounts payable LE 26,000. They agree to revaluate cars presented by partner Ahmed to be only LE 58,000 and cars presented by Mohamed to be only 30,000.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet 1/5/2005.

===

4- S and T agreed to establish an ordinary partnership on 1/1/2003 at LE 140,000 (LE 80,000 S, and LE 60,000 T). The profit and losses sharing ratio is 2:1 respectively). They decided to transfer their sole proprietorships to be a one new partnership by 1/2/2003. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	S	**T**		**S**	**T**
Fixed Assets			**Capital**	**70,000**	**50,000**
Machines	**21,000**	**28,000**			
Land	**33,500**	**26,000**	**Creditors**	**15,000**	**13,000**
Cars	**25,000**	**13,000**	**Loans**	**24,000**	**20,000**
Current Assets					
Debtors	**10,500**	**6,000**			
Securities	**19,000**	**10,000**			
	109,000	**83,000**		**109,000**	**83,000**

They agreed to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets. They agreed also to consider any difference between the presented net assets and the agreed share as goodwill or capital reserve.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet 1/2/2003.

4- Journal entries needed to close books of the sole proprietorship of S.

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5- A and B agreed to establish a partnership on 1/6/2004 at LE 280,000 (LE 160,000 A, and LE 120,000 B). They decided to transfer their individual firms to be a partnership by 1/8/2004. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	A	**B**		**A**	**B**
Fixed Assets			**Capital**	**180,000**	**110,000**
Land	**42,000**	**56,000**			
Buildings	**77,000**	**52,000**	**A / P**	**30,000**	**26,000**
Cars	**50,000**	**36,000**	**Loans**	**18,000**	**40,000**
Current Assets					
A / R	**21,000**	**12,000**			
Cash	**38,000**	**20,000**			
	228,000	**176,000**		**228,000**	**176,000**

They agreed to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets with the exception of buildings presented by partner A to be only LE 67,000 and cars presented by B to be only 26,000. They agreed also to pay or withdraw any difference between the presented net assets and the agreed share.

Required:

1- Journal entries needed to record the above.

2- The needed ledger accounts.

3- Balance Sheet 1/8/2004.

4- Journal entries needed to close books of the sole proprietorship of A.

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6- Tom and Jerry agreed to form a new partnership on 15/12/2002 at LE 100,000 (LE 50,000 Tom, and 50,000 Jerry). They decided to transfer their individual firms to be a one partnership by 1/1/2003. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	Tom	**Jerry**		**Tom**	**Jerry**
Fixed Assets			**Capital**	**85,000**	**50,000**
Land	**20,000**	**17,500**			
Cars	**25,000**	**15,000**	**A / P.**	**22,500**	**22,500**
Equipment	**22,500**	**7,500**	**Loans**	**5,000**	**5,000**
Current Assets					
Cash	**10,000**	**2,500**			
Bank	**15,000**	**15,000**			
N / R.	**20,000**	**20,000**			
	112,500	**77,500**		**112,500**	**77,500**

They agreed to transfer all the above balances with the exception of bank accounts to the new partnership and accepted values disclosed in the above balance sheets. They also agreed to pay or withdraw any difference between the presented net assets and the agreed share.

Required:

1- Journal entries needed to record the above.

2- Balance Sheet 1/1/2003.

3- Journal entries needed to close books of individual firms.

CHAPTER THREE

Partners' Current Accounts

3.1 Introduction:

In the past chapter, formation of a partnership whether by cash, assets, or a group of assets and liabilities was discussed together with several explanatory examples. In the current chapter we will discuss accounting issues related to partner' current accounts in the partnership form of organisation.

As we have seen in chapter one, the agreement of a partnership should clearly include some important information such as complete specification of the profit or loss distribution, salaries which may be paid to partner(s), interest on capital balances, bonuses, the percentages used to distribute any residual profit or loss, and withdrawals to be allowed to each partner and any conditions for these withdrawals.

Practically, there are a lot of dealings between partner(s) from one side and the partnership from the other. For instance, partner(s) might make withdrawals from the partnership whither money or goods in anticipation of profits. So, what the maximum of withdrawal, if any, is and the interest calculated regarding balances of these withdrawals. In the other hand, a partner or more can give or get a loan to or from the partnership. In the light of the above, it is recommended in establishing a partnership that the partnership agreement should indicate to all conditions related to such matters.

3.2 Partners' Accounts:

All issues related to the various dealings between partner(s) from one side and the partnership from the other (such as salaries, capital and interest on capital, loans, drawings and interest on drawings, interest on balance of partners' current accounts, distribution of profit and loss) can be recorded in several accounts for partners. The following are some of these partners' accounts:

3.2.1 Capital Accounts:

The initial investment of a partner any subsequent capital contributions and any withdrawals of capital by the partner are ultimately recorded in the partner's capital account. Each partner has one capital account or one column in a multi-column capital account which usually has a credit balance. On occasion, a partner's capital account may have a debit balance, called a deficiency or sometimes termed a deficit, which occurs because the partner's share of losses and withdrawals of capital exceeds his or her capital contribution and share of profits. A deficiency is usually eliminated by additional capital contributions. The balance in the capital account represents the partner's share of the net assets of the partnership.

3.2.2 Drawing Accounts:

Partners could make some withdrawals of assets (cash, goods, or any other assets) from the partnership during the year in anticipation of profits. All withdrawals, their interests, and such transactions are recorded in appropriate journals and ledger accounts (partners' current account). It is possible that a separate drawing account can be used, as alternative way, to record the periodic withdrawals and their interest then closed to the partner's capital account at the end of the period.

Non-cash drawings should be valued at their market values at the date of the withdrawal. A few partnerships make an exception to the rule of market value for withdrawals of inventory by the partners. They record withdrawals of inventory at cost, thereby not recording a gain or loss on these drawings.

3.2.3 Loan Accounts:

The partnership may look to its present partners for additional financing. Any loans between a partner and the partnership should always be accompanied by proper loan documentation such as a promissory note. A loan from a partner is shown as a payable on the partnership's books, the same as any other loan. Unless all partners agree otherwise, the partnership is obligated to pay interest on the loan to the individual partner. Interest on loans is recorded as an operating expense by the partnership.

On the other hand, the partnership may lend money to a partner; in such case it records a loan receivable from the partner. Also, unless it is otherwise agreed by all partners, these loans should bear interest and the interest income is recognized on the partnership's income statement. Also, it is possible to record interests on loans in appropriate journals and partners' current account instead.

In the light of the above, capital transactions between partners and partnership could be recorded in appropriate journals and capital account, while other transactions (such as capital interest, salaries, loans and their interest, bonuses, withdrawals and their interest, interest on balance of current account, … etc) could be recorded in appropriate journals and partners' current account. This means that it is possible to use only two accounts, namely capital account and partners' current account.

The balance of the first account, capital account, is credit by its nature and it is credited by capital contributions presented by partners, while it is debited by any reduction or withdrawals of partners' capital. On the other hand, the partners' current account is debited by withdrawals and their interest, loss share, and interest on debit current account balance, while it is credited by accrued salaries, accrued interest on loan, accrued bonuses, interest of capital, interest on credit balance of current account, and profit share.

Last but not least, we should notice that transactions between two or more partners, but the partnership is not involved, are not to be recorded in the books of the partnership. The following are examples of these two accounts:

Dr. Capital account Cr.

Details	**A**	**B**	**Total**	**Details**	**A**	**B**	**Total**
-Cash (capital reduction)	**X**	**X**	**X**	**Balance (1/1/ 01)**	**X**	**X**	**X**
-Balance (31/12/ 01)	**X**	**X**	**X**	**Cash (new contributions)**	**X**	**X**	**X**
	X	**X**	**X**		**X**	**X**	**X**
				New balance (1/1/ 02)	**X**	**X**	**X**

Dr. Partners' current account Cr.

Details	**A**	**B**	**Total**	**Details**	**A**	**B**	**Total**
- Balance (1/1/ 01)	**X**	**X**	**X**	**- Balance (1/1/ 01)**	**X**	**X**	**X**
- Interest on drawings	**X**	**X**	**X**	**- Interest on current a/c**	**X**	**X**	**X**
- Interest on current a/c	**X**	**X**	**X**	**- Interest on capital**	**X**	**X**	**X**
- Drawings	**X**	**X**	**X**	**- Salary**	**X**	**X**	**X**
- Balance (31/12)	**X**	**X**	**X**	**- Loan interest**	**X**	**X**	**X**
				- Balance (31/12)	**X**	**X**	**X**
New balance (1/1/02)	**X**	**X**	**X**	**New balance (1/1/02)**	**X**	**X**	**X**

3.3 Partners' Salaries:

As mentioned earlier, the partnership agreement should include all details about salaries that may be given monthly, quarterly, or annually to partner(s). Partners' salaries are frequently included as part of the plan of profit distribution to recognize and compensate for personal services partners provide to the partnership. Accountants in partnerships agree to treat partners' salaries not as operating expenses but rather as part of the profit distribution plan.

This accounting treatment is closely related to the proprietary concept of owner's equity. According to the proprietary theory, the proprietor invests capital and personal services in pursuit of income. In the partnership form of organisation, some partners invest capital, while others might invest personal time. Partners who invest capital are typically rewarded with interest on their capital balances; while those who invest personal time are rewarded with salaries.

It should be noted that both interest and salaries are a result of the particular investments and are used not in the determination of income, but rather in the determination of the proportion of income to be credited to each partner's current account. It should be noted that the net income of the business is not likely to be equal to salaries, interest on capital, and other distributions in a given year, but it could be more or less. Therefore, the profit & loss sharing should also specify a fixed ratio for dividing any profits or losses remaining after giving consideration to the agreed amount for salaries, interest on capital, …etc. (see: 3.9 of this chapter)

Regarding the accounting treatment of salaries, it should be noted that any salaries received from the partnership during the financial period must be recorded at date. Furthermore, the unpaid part of the salary should be credited to the partner’s current account, while the whole amount of the annual salary should be debited to the “profit & loss appropriation account” at the end of the financial period. The following example will explain the above treatments.

Example 3.1:

Assume that the partnership agreement provides for monthly salary of LE 2.000 to partner Mohamed for his efforts as a manager of the partnership. During the financial period, Mohamed received a cash of LE 15,000 (15/8/2002). You are required to record the above events and their effect on the relevant ledger accounts (31/12/2002).

Solution:

Date	Details	Dr.	Cr.
15/8/02	**Mohamed's salary**	**15,000**	
	To cash		**15,000**
	Being a salary paid to partner Mohamed.		
31/12/02	**P/L appropriation account**	**24,000**	
	To Mohamed's salary		**24,000**
	Closing Mohamed's salary at P/L appropriation account.		
31/12/02	**Mohamed's salary**	**9,000**	
	To Partners' current account (Mohamed)		**9,000**
	Recording the unpaid salary of partner Mohamed.		

Dr. Partners' current account Cr.

Details	-	Mohamed	Total	Details	-	Mohamed	Total
				- Balance	X	X	X
				- Salary	--	9,000	9,000

Dr. P/L appropriation account Cr.

To Mohamed' s salary	24,000	By P/L account	X

3.4 Interest on Capital Balances:

The articles of partnership agreement may provide for interest to be credited on the partners' current accounts as part of the distribution of profits. The rate of interest is often a stated percentage.

As stated earlier in this chapter, interest calculated on partners' capital balances is not an expense of operating the business, but it is profit distribution instead. The calculation is made after net income is determined in order to decide how the income is to be distributed. Specific caution must be exercised whenever interest on capital balances is included in the profit distribution plan.

Practically, few methods can be used in calculating interest on partners' capital. It can be computed on beginning capital balances, ending capital balances, or average capital balances for the period. Hence, the amount of the distribution can be significantly different depending on the method used.

Most provisions for interest on capital specify that a weighted-average capital should be used. This method explicitly recognizes the time span each capital level is maintained during the period.

Computing the interest on partners' capital balances helps in making balancing among partners especially when partners' capital contributions are not equally and/or sharing profit and loss is not belonging to partners' capital.

Again, the net income is not likely to be equal to amount needed for salaries, interest on capital, and other distributions in a given year, but it could be more or less. Therefore, the profit & loss sharing ratio should be applied in dividing any profits or losses remaining after giving consideration to the agreed amount for salaries, interest on capital, …etc.

It should be noted that interest on capital is not paid to partners during the financial period; instead, it is paid at end of financial period. Interest on capital is recorded, at the end of the period, by two journal entries. First, by making the profit and loss appropriation account debited and interest on capital account credited; second, by making interest on capital account debited while partners' current account credited. The following two journal entries explain the above accounting treatment:

Date	Details	Dr.	Cr.
31/12/xx	**Profit and loss appropriation**	**xx**	
	To Interest on capital a/c		**xx**
	(partner A)		
	(partner B)		
	Interest on capital a/c	**xx**	
31/12/xx	**(partner A)**		
	(partner B)		
	To Partners' current account		**xx**
	(partner A)		
	(partner B)		

Example 3.2:

X and Y are partners in a partnership. The agreed sharing profit & loss ratio is 1 : 1. According to the partnership agreement, annual interests on their capital balances at 7 % should be calculated. You are required to compute and record their annual interest, noting that their capital balances are LE 100,000 for partner X and LE 120,000 for partner Y at 31/12/2002, and the net profit is LE 35,400

Solution:

1- Calculating interest on capital for each partner:

Partner X = 100,000 x 7% = LE 7,000

Partner Y = 120,000 x 7% = LE 8,400

The remaining net profit = 35,400 – (7,000 + 8,400) = 20,000

According to the partnership agreement, this amount should be divided equally (1:1) between the two partners.

So, each partner will get a net profit distribution of LE 10,000.

Date	Details	Dr.	Cr.
31/12/02	**Interest on capital a/c**	15,400	
	(partner X) 7,000		
	(partner Y) 8,400		
	To Partners' current a/c		15,400
	(partner X) 7,000		
	(partner Y) 8,400		
	To record the interest on capital in partners' current account.		
31/12/02	**Profit & loss appropriation a/c**	15,400	
	To Interest on capital a/c		15,400
	(partner X) 7,000		
	(partner Y) 8,400		
	To close the annual interests on partners' capital on P/L Appropriation account.		
31/12/02	**Profit & loss appropriation a/c**	20,000	
	To Partners' current a/c		20,000
	X 10,000		
	Y 10,000		

Dr. Interest on capital a/c Cr.

Details	X	Y	Total	Details	X	Y	Total
Partners' current a/c 31/12/2002	7,000	8,400	15,400	Profit & loss appropriation a/c 31/12/2002	7,000	8,400	15,400
	7,000	8,400	15,400		7,000	8,400	15,400

Dr. Partners' current account Cr.

Details	X	Y	Total	Details	X	Y	Total
				Interest on capital a/c	**7,000**	**8,400**	**15,400**
				Profit & loss App. A/c	**10,000**	**10,000**	**20,000**

Dr. P/L appropriation account Cr.

31/12/2002		**By P/L account 31/12/2002**	**35,400**
Interest on capital	**15,400**		
X 7,000			
Y 8,400			
Partners current a/c	**20,000**		
X 10,000			
Y 10,000			
	35,400		**35,400**

Example 3.3:

A and B are partners in a partnership. According to the partnership agreement, annual interests on the weighted-average capital balances at 5 % should be calculated. You are required to compute and record their annual interest, noting that the capital balance was LE 100,000 for partner A (fixed during the period ended on 31/12/2002), while, for partner B, it was as follows:

January 1: 100,000

May 1: - 30,000 (Debit)

September 1: + 5,000 (Credit)

November 1: - 10,000 (Debit)

<u>Solution:</u>

1- Calculating interest on capital for each partner:

Partner A: 100,000 x 5% = LE 5,000

Partner B:

Date	Debit	Credit	Balance	Months	Months X LE balance
1 / 1				**4**	**400,000**
1 / 5	**30,000**		**100,000**	**4**	**280,000**
1 / 9		**5,000**	**70,000**	**2**	**150,000**
1 / 11	**10,000**		**75,000**	**<u>2</u>**	**<u>130,000</u>**
			65,000	**12**	**960,000**

Average capital = 960,000 / 12 months = 80,000

Interest = 80,000 X 5% = LE 4,000.

Date	Details	Dr.	Cr.
31/12/02	**Profit & loss appropriation a/c**	**9,000**	
	To Interest on capital a/c		**9,000**
	(partner A) 5,000		
	(partner B) 4,000		
	To record the annual interests on partners' capital		
	Interest on capital a/c	**9,000**	
31/12/02	**(partner A) 5,000**		
	(partner B) 4,000		
	To Partners' current account		**9,000**
	(partner A) 5,000		
	(partner B) 4,000		
	To close the interest on capital in partners' current account		

Dr. Interest on capital a/c Cr.

Details	**A**	**B**	**Total**	**Details**	**A**	**B**	**Total**
Partners' current a/c 31/12/2002	**5,000**	**4,000**	**9,000**	**Profit & loss appropriation a/c 31/12/2002**	**5,000**	**4,000**	**9,000**
	5,000	**4,000**	**9,000**		**5,000**	**4,000**	**9,000**

Dr. Partners' current account Cr.

Details	**A**	**B**	**Total**	**Details**	**A**	**B**	**Total**
				Interest on capital a/c	**5,000**	**4,000**	**9,000**

Dr. P/L appropriation account Cr.

To Interest on capital 31/12/2002	**9,000**	**By P/L account 31/12/2002**	**X**

3.5 Partners' Drawings:

In several cases, a particular partner may wish to draw funds - other than salary- from time to time, perhaps before income for the period has been determined, and there is the possibility that such drawings might exceed the partner's share in income. Another partner, in turn, may make no drawings before the end of the period.

In such cases, to maintain equity between partners it is accordingly necessary in the agreement either to restrict drawings to amounts already credited to current accounts or to provide for appropriate modification of the distribution of income.

Therefore, the partnership agreement should include articles that regulate both partners' drawings from the partnership whether in money, goods, or any other assets and interest on those drawings. For instance, in most cases, the articles may state that there is a maximum limit of partners' drawings and there is also a fixed rate of interest on drawings, if any.

The accounting treatment of partners' drawing and related interests is that partners' current account to be debited by drawings and also debited by their interests that should be calculated in accordance with a certain percentage taking into consideration the period of drawings. The following journal entries explain the accounting treatment for drawings and related interest:

Date	Details	Dr.	Cr.
	Drawings a/c	**xx**	
	To Cash (bank, or sales)		**xx**
	To record cash partners' drawings.		
Time of	**---**		
drawings	**Partners' current account**	**xx**	
	(partner A)		
	(partner B)		
	To Drawings a/c		**xx**
	To close the drawings a/c in partners' current a/c		
	________________________________		
	Interest on drawings a/c	**xx**	
-----------	**To Profit & loss Appropriation a/c**		**xx**
	--		
	Partners' current account	**xx**	
	(partner A)		
End of the year	**(partner B)**		
	To Interest on drawings a/c		**xx**

Example 3.4:

A and B are partners in a partnership. According to the partnership agreement, annual interests on the drawings balances at 5 % should be calculated. You are required to compute and record drawing and related interest, noting that the drawings were as follows:

A LE 10,000 on 1/3/2002 in cash.

B LE 7,000 on 1/5/2002 in cheque.

Solution:

1- Calculating interest on drawings for each partner:

Partner A: 10,000 x 10/12 x 5% = LE 416.7

Partner B: 7,000 x 8/12 x 5% = LE 233.3

Dr. Drawings a/c Cr.

Details	A	B	Total	Details	A	B	Total
To Cash 1/3/02	10,000		10,000	Partners' c. a. (A) 1/3/02	10,000		10,000
To Bank 1/5/02		7,000	7,000	Partners' c. a. (B) 1/5/02		7,000	7,000
	$\boxed{10,000}$	7,000	17,000		10,000	7,000	17,000

Dr. Interest on drawings a/c Cr.

Details	Total	Details	Total
Profit & loss appropriation a/c 31/12/02	650	Partners' c. account 31/12/2002	650
	650		650

Date	Details	Dr.	Cr.
1/3/02	Drawings a/c (A)	10,000	
	To Cash		10,000
	To record cash partners' drawings.		
	--		
1/3/02	Partners' current account	10,000	
	(partner A)		
	To Drawings a/c (B)		10,000
	To close the drawings a/c of A in partners' current a/c		
	--		
	Drawings a/c (B)	7,000	
1/5/02	To Bank		7,000
	To record bank partners' drawings.		
	--		
	Partners' current account	7,000	
	(partner B)		
1/5/02	To Drawings a/c (B)		7,000
	To close the drawings a/c of B in partners' current a/c		
	--		
	Interest on drawings a/c	650	
	To Profit & loss Appropriation a/c		650
	--		
31/12/02	Partners' current account	650	
	(partner A) 416.7		
31/12/02	(partner B) 233.3		
	To Interest on drawings a/c		650

Dr. Partners' current account Cr.

Details	A	B	Total	Details	A	B	Total
-Drawings a/c 1/3/02	**10,000**		**10,000**				
-Drawings a/c 1/5/02		**7,000**	**7,000**				
-Interest on drawings 31/12/02	**416.7**	**233.3**	**650**				

Dr. P/L appropriation account Cr.

		By P/L account 31/12/2002	**X**
		Interest on drawing 31/12/02	**650**

3.6 Partners' Bonuses:

Partners' bonuses are sometimes used as a means of providing additional compensation to a partner(s) who have provided services or special benefits to the partnership. Bonuses are typically stated as a percentage of income either before (the first case) or after (the second case) the bonus. Sometimes the partnership agreement requires a minimum income to be earned before a bonus is calculated. The bonus is easily calculated by deriving and solving an equation.

For example, a bonus of 10 % of income is to be credited to A's current account before distributing the remaining profit. In the first case (a percentage before the bonus) if the income is LE 10,000, it is easily computed as percentage of income before subtracting the bonus.

Bonus = 10,000 x 10% = LE **1,000**

In the second case, the bonus is computed as a percentage of income after subtracting the bonus.

Bonus = (10,000 – bonus) x 10 %

Bonus = 1,000 - .10 bonus

1.10 Bonus = 1,000

Bonus = 1,000 / 1.10 = LE **909**

The accounting treatment of partners' bonuses is that partners' current account to be credited by bonuses that should be calculated in accordance with the partnership agreement, while the profit & loss appropriation account to be debited.

3.7 Partners' Loan:

First: loans from the partnership to the partner:

In addition to indirect borrowing in the form of drawings a partner may borrow formally from the firm. In such cases by the end of each financial period, interest should be calculated and debited to partner's current account, otherwise he/she should pay -in cash- interest on the loan. Also, when the loan is due or expired partner should pay up the loan.

In the above case, the accounting treatment is that "partner's current account" to be debited by the interest on loans, while the "profit & loss account" should be credited by interest on loans. Also, in the time of introducing the loan, the "partner's loan account" should be debited while the 'cash account' should be credited.

Date	Details	Dr.	Cr.
Time of introducing a loan	**By Partner's loan a/c**	**xx**	
	To Cash (or bank)		**xx**
	To record partner's loan in cash.		
--------------	--		
End of the year	**By Partners' current account (partner A)**	**xx**	
--------------	**To Interest on Partner's Loan a/c**		**xx**
End of the year	--		
	By Interest on Partner's Loan a/c	**xx**	
	To profit & loss account		**xx**

Second: loans from a partner to the partnership:

In addition to what we have seen in the first case, the partnership may look to its present partners for additional financing. Any loans between a partner and the partnership should always be accompanied by proper loan documentation. A loan from a partner is shown as a payable on the partnership's books, the same as any other loan. Unless all partners agree otherwise, the partnership is obligated to pay interest on the loan to the individual partner.

In this case, interest on loan is recorded as an operating expense by the partnership. This interest should be calculated and credited to partner's current account; otherwise he/she may receive -in cash- interest on the loan. Also, when the loan is due or expired partnership should pay up the loan to partner.

In such case, the accounting treatment is that "partner's current account" to be credited by the interest on loans, while the "profit & loss account" should be debited by interest on loans. Also, in the time of introducing the loan, the "cash account" should be debited, while the "partner's loan account" should be credited.

Date	Details	Dr.	Cr.
Time of introducing a loan	**Cash (or bank)**	**Xx**	
	To Partner's loan a/c		**xx**
	To record partner's loan in cash.		
--------------	--		
End of the year	**By Interest on Partner's Loan a/c**	**xx**	
	To Partners' current account (partner A)		**xx**
--------------	---		
End of the year	**By Profit & loss a/c**	**xx**	
	To Interest on Partner's Loan a/c		**xx**

3.8 Interest on Balances of Current Accounts:

Balances of partners' current accounts may be debit or credit depending on the nature of dealings between the partner from one side and the partnership from the other. These balances may be subjected to an interest rate if partners agreed in the partnership agreement. If the balance of a partner's current account is debit, then interest should be debited to his/her current account. This interest is considered a credit interest for the partnership and its accounting treatment is as follows:

Date	Details	Dr.	Cr.
End of the Year	**By Interest on Current a/c**	**xx**	
	To P & L Appropriation a/c		**xx**
-----------	**--**		
End of the Year	**By Partners' Current a/c**	**xx**	
	To Interest on Current a/c (partner A)		**xx**

On the other hand, If the balance of a partner' current account is credit, and then interest should be credited to his/her current account. This interest is considered a debit interest for the partnership and its accounting treatment is as follows:

Date	Details	Dr.	Cr.
End of the Year	**By P & L Appropriation a/c**	**xx**	
	To Interest on Current a/c		**xx**
----------	**--**		
End of the Year	**By Interest on Current a/c**	**xx**	
	To Partners' Current a/c		**xx**

3.9 The Profit & Loss Sharing Ratio:

It is likely after distributing the realised profits to partners in the form of salaries, bonuses, and interests on partners' current accounts that there is still a balance in this account that need to be divided to existing partners.

Of course, this required that the partnership agreement to refer to the profit & loss sharing ratio applicable in such cases. It should be noted that, if there is no agreed upon ratio, the partners' capital balances should be considered as a basis for distributing the balance of the profit & loss appropriation account.

Example 3.5:

South valley partnership is of two partners whose name are A and B. Their capital are A LE 120,000 and B LE 80,000, and sharing profit & loss at 1 : 1 respectively.

* They agree to compute interest on capital at annual rate of 10%.

* Partner A is the manager whose salary is LE 1500 per month. During the financial period (on 1/4/2002), A received a cash of LE 8,000 as a salary.

* Partners' drawings in cash are: A LE 6,000 on 1/5/2002, while B LE 10,000 on 1/7/2002. The rate of interest on drawings is 10%.

* Balances of partners' current accounts are: A LE 1,000 (debit), while B LE 2,000 (credit). The rate of interest on partners' current accounts is 2%.

* Partner A introduced a loan of 8,000 for the partnership at 10% annual interest.

* There is a bonus to partner A equal to 10% of the net profits but after the bonus and the interest on capital.

* Net profits are LE 100,800.

Required: 1- Journal entries needed to record the above.

2- Profit & loss appropriation account.

3- Partners' current account.

Solution:

1- Calculating interest on capital for each partner:

Partner A: 120,000 x 10% = LE 12,000

Partner B: 80,000 x 10% = LE 8,000

2- Calculating salary of partner A:

Annual salary = 1,500 x 12 = 18,000.

But the partner received only 8,000 during the year meaning that his remaining salary

= 18,000 – 8,000 = LE 10,000 to be credited to his current account.

3- Calculating interest on drawings for each partner:

Partner A: 6,000 x 8/12 x 10 % = LE 400

Partner B: 10,000 x 6/12 x 10 % = LE 500

4- Calculating interest on partners' current a/c:

Partner A = 1,000 x 2% = LE 20 (debit)

Partner B = 2,000 x 2% = LE 40 (credit)

5- Calculating interest on A's loan

Interest = 8,000 x 10% = LE 800

6- Calculating A's bonus:

Net Profits = 100,800 - 800 (interest on loan) = 100,000

Bonus = [100,000 - 20,000 - bonus] 10%

Bonus = [80,000 - bonus] 10%

Bonus = [8,000 - .10 bonus]

1.10 bonus = 8000

Bonus = 8,000 / 1.10 = LE 7,272

1/4/02	**By A's Salary** **To Cash** **Being a salary paid to partner A.**	**8,000**	**8,000**
1/5/02	**By Drawings a/c** **To Cash** **To record A's drawings.**	**6,000**	**6,000**
1/7/02	**By Drawings a/c** **To Cash** **To record A's drawings.**	**10,000**	**10,000**
31/12/02	**By Profit & Loss App. a/c** **To A's Salary** **To close A's salary**	**18,000**	**18,000**
31/12/02	**By A's Salary** **To Partners' Current Acc. (A)** **Recording the unpaid salary of A.**	**10,000**	**10,000**
31/12/02	**By Partners' Current Account** **(partner A) LE 6,000** **(partner B) LE 10,000** **To Drawings a/c** **(partner A) LE 6,000** **(partner B) LE 10,000** **To close the drawings a/c of A in partners' current a/c**	**16,000**	**16,000**
31/12/02	**By Interest on Drawings a/c** **To Profit & Loss App. a/c**	**900**	**900**
31/12/02	**By Partners' Current a/c** **(partner A) 400** **(partner B) 500** **To Interest on Drawings a/c**	**900**	**900**

31/12/02	By P & L Appropriation a/c	20,000	
	To Interest on Capital a/c		20,000
	(partner A) 12,000		
	(partner B) 8,000		
	To record the annual interests on partners' capital.		
31/12/02	By Interest on Capital a/c		
	(partner A) 12,000	20,000	
	(partner B) 8,000		
	To Partners' Current a/c		
	(partner A) 12,000		20,000
	(partner B) 8,000		
	To close the interest on capital in partners' current account.		
31/12/02	By Partners' Current a/c (A)	20	
	To P & L Appropriation a/c		20
31/12/02	By P & L Appropriation a/c	40	
	To Partners' Current a/c (B)		40
31/12/02	By P & L account	800	
	To Interest on A's loan		800
31/12/02	By Interest on A's Loan	800	
	To Partners' Current a/c (A)		800
31/12/02	By P & L Appropriation a/c	7,272	
	To Partners' Current a/c (A)		7,272
31/12/02	By P & L Appropriation a/c	55,608	
	To Partners' Current a/c		55,608
	A 27,804		
	B 27,804		

Dr. P / L Account Cr.

Interest on A's Loan	**800**	**Balance**	**100,800**
Balance	**100,000**		
	100,800		**100,800**

Dr. P/L appropriation account Cr.

- Interest on capital	**20,000**	**- P/L account 31/12/2002**	**100,000**
A 12,000		**- Interest on drawings**	**900**
B 8,000		**A LE 400**	
- A's annual salary	**18,000**	**B LE 500**	
- Interest on partners' c. a/c	**40**	**- Interest on partners' c. a/c**	**20**
- A's bonus	**7,272**		
- Partners current account (the remaining profits 1:1)	**55,608**		
- A LE 27,804			
- B LE 27,804	**100,920**		**100,920**

Dr. Partners’ current account Cr.

Details	**A**	**B**	**Total**	**Details**	**A**	**B**	**Total**
Balance 1/1/02	**1,000**		**1,000**	**- Balance 1/1/02**		**2,000**	**2,000**
-Drawings a/c 1/5/02	**6,000**		**6,000**	**- Interest on capital**	**12,000**	**8,000**	**20,000**
-Drawings a/c 1/7/02		**10,000**	**10,000**	**31/12**			
-Interest on	**400**	**500**	**900**	**- A’s salary 31/12**	**10,000**		**10,000**
drawings				**- Interest on**		**40**	**40**
13/12/02	**20**		**20**	**partners’ c. a/c**			
- Interest on				**- Interest of A’ loan**	**800**		**800**
partners’ c. a/c				**- A’s Bonus**			
- Balance 31/12/02	**50,456**	**27,344**	**77,800**	**- P & L App. a/c**	**7,272**		**7,272**
				(Remaining profits)	**27,804**	**27,804**	**55,608**
	57,876	**37,844**	**95,720**		**57,876**	**37,844**	**95,720**

<u>Exercises:</u>

1- Suppose that according to the partnership agreement, there is a monthly salary of LE 1.200 to partner Ali for his work as a manager. During the year, he received a cash of LE 8,000 (1/9/2000). You are required to record the above events and their effect on the relevant ledger accounts (31/12/2000).

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2- J and K are partners in a partnership. The agreed sharing profit & loss ratio is 2 : 1. According to the partnership agreement, annual interests on their capital balances at 10 % should be calculated. You are required to compute and record their annual interest, noting that their capital balances are LE 80,000 for partner J and LE 40,000 for partner K at 31/12/2001, and the net profit is LE 18,300.

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3- M and N are partners in a partnership. There are annual interests on the weighted-average capital balances at 6 % should be calculated. You are required to compute and record their annual interest, noting that the capital balance was LE 70,000 for partner M (fixed during the period ended on 31/12/2001), while, for partner N, it was as follows:

January 1: 80,000

April 1: - 10,000 (Debit)

July 1: + 15,000 (Credit)

December 1: - 10,000 (Debit)

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4- S and T are partners in a partnership. According to the partnership agreement, annual interests on the drawings balances at 5 % should be calculated. You are required to compute and record drawing and related interest, noting that the drawings were as follows:

S LE 15,000 on 1/5/2002 in cash. / T LE 12,000 on 1/2/2002 in cheque.

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5- Rana partnership is of two partners whose name are Rana and Rawan. Their capital are Rana LE 200,000 and Rawan LE 150,000, and sharing profit & loss at 1 : 1 respectively.

* They agree to compute interest on capital at annual rate of 10%.

* Partner Rana is the manager whose salary is LE 1200 per month. During the financial period (on 1/5/2002), Rana received a cash of LE 6,000 as a salary.

* Partners' drawings in cash are: Rana LE 6,000 on 1/2/2002, while Rawan LE 5,000 on 1/9/2002. The rate of interest on drawings is 4%.

* Balances of partners' current accounts are: Rana LE 4,000 (credit), while Rawan LE 5,000 (credit). The rate of interest on partners' current accounts is 6%.

* Partner Rana introduced a loan of 20,000 for the partnership at 9% annual interest.

* There a bonus to partner Rana equal to 8% of the net profits but after calculating the bonus.

* Net profits are LE 150,000.

Required:

1- Journal entries needed to record the above.

2- Profit & **loss** appropriation account.

3- Partners' current account.

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CHAPTER FOUR

Partnership Capital Modifications

4.1 Introduction:

As we have seen in chapter one of this text, it is expected that some changes in the ownership may occurred in a business conducted as a partnership during its existence. Therefore, it is very important that the partnership agreement includes some provisions related to the regulation of various changes in the ownership of a partnership.

The expected changes in the ownership of a partnership might take one or more forms, among these forms are the capital modifications whether capital increase or capital decrease (the focus of the current chapter), the admission of a new partner (chapter 5), and the retirement of a partner (chapter 6).

Regarding capital modifications (increase or decrease in the capital), several methods can be used to increase or decrease capital.

4.2 Capital increase:

In general, it is favourable that partner(s) must pay any balance of debit current account before taking part in the capital increase. Furthermore, it should be noted that, in all cases of capital increase, capital account should be credit in the journal entry. One or more of the following methods may be used to achieve the capital increase:

4.2.1 By Cash or Asset(s):

In such case, when partners agree to increase their capitals by introducing cash or asset(s), they should clearly determine the share of each partner. The following journal entry can be made to record the above transaction.

Date	Details	Dr.	Cr.
1/ 1/ 0X	**Cash or Asset(s)**	**xx**	
	To Capital Account		**xx**
	(partner A) xx		
	(partner B) xx		
	To record the capital increase by introducing cash or assets.		

4.2.2 By Credit Current Accounts:

Here, partners may agree to increase their capitals by using the credit balances of current account. This can be recorded by the following journal entry.

Date	Details	Dr.	Cr.
1/ 1/ 0X	**Partners Current a/c**	**xx**	
	(partner A) xx		
	(partner B) xx		
	To Capital Account		**xx**
	(partner A) xx		
	(partner B) xx		
	To record the capital increase by using the balances of current account.		

4.2.3 By General Reserve:

Partners might keep a specific part of their profits to be generally used in future or to support the financial position of their partnership. This amount is called the general reserve and should be shown together with capital account and in the same side in the Balance Sheet.

Partners can use this reserve to increase their capitals. It must be divided among partners according to the profit & loss sharing ratio because they are the only owners of it. This can be recorded as follow:

Date	Details	Dr.	Cr.
1/ 1/ 0X	**General reserve**	**xx**	
	To Capital Account		**xx**
	(partner A) xx		
	(partner B) xx		
	To record the capital increase by using the general reserve.		

4.2.4 By Partner's Loan:

One or more partners might give the partnership a loan. Partners may agree, if needed, to use their loan in increasing their share of capital in the partnership. This can be recorded as follow:

Date	Details	Dr.	Cr.
1/ 1/ 0X	**A's Loan**	**xx**	
	To Capital Account		**xx**
	(partner A)		
	To record the capital increase by using the partner's loan.		

Example 4.1:

A, B and C are partners in a partnership. They decided to increase their capitals in the partnership by LE 50,000 each. The profit and losses sharing ratio is 1:1:1. They agreed to use the general reserve in this capital increase, and also use the balances of partners' current account. The agreement includes that partners need to pay the rest in cash with the exception of partner A who will pay in the bank. The balance sheet of their partnership was as follows:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Cars	**100,000**		**A**	**100,000**	
Buildings	**30,000**		**B**	**100,000**	
Equipment	**70,000**	**200,000**	**C**	**100,000**	**300,000**
Current Assets					
A / R	**60,000**		**General Reserve**		**90,000**
Securities	**40,000**		**Current a/c**		
Bank	**75,000**		**B**	**10,000**	
Cash	**10,000**	**185,000**	**C**	**5,000**	
Current a/c A		**20,000**			**15,000**
		405,000			**405,000**

Required: 1- Journal entries needed to record the above agreement.

2- The new Balance Sheet after this agreement.

Solution:

Calculations:	**A**	**B**	**C**
General reserve	**+30,000**	**+ 30,000**	**+30,000**
Partners' current a/c	**-20,000**	**+10,000**	**+ 5,000**
Cash (to complete shares)	**---**	**+10,000**	**+15,000**
Bank (to complete share)	**+40,000**	**----**	**----**
Added shares	**50,000**	**50,000**	**50,000**

Date	Details	Dr.	Cr.
	By General Reserve	**90,000**	
	To Capital a/c		**90,000**
	A 30,000		
	B 30,000		
	C 30,000		
	To record the capital increase by using the general reserve.		
	By Partners' Current a/c	**15,000**	
	To Capital a/c		**15,000**
	B 10,000		
	C 5,000		
	To record the capital increase by using the balances of current a/c.		
	By Cash	**25,000**	
	To Capital a/c		**25,000**
	B 10,000		
	C 15,000		
	To record completing the capital increase by cash.		
	By Bank	**40,000**	
	To Sundries		
	Capital a/c (A)		**20,000**
	Partners' Current a/c (A)		**20,000**
	To record completing the capital increase of partner (A).		

Assets		Balance Sheet after the agreement			**Liabilities**
Fixed Assets			**Capital a/c**		
Cars	**100,000**		**A**	**150,000**	
Buildings	**30,000**		**B**	**150,000**	
Equipment	**70,000**	**200,000**	**C**	**150,000**	
Current Assets					**450,000**
A / R	**60,000**				
Securities	**40,000**				
Bank	**115,000**				
Cash	**35,000**	**250,000**			
		450,000			**450,000**

4.2.5 By Revaluation of Assets & Liabilities:

Partners may prefer to increase their capital balances in the partnership through the revaluation of assets and liabilities of their partnership. In such cases, partners see that the assets are underestimated, and, on the other hand, the liabilities are overestimated. Hence, they may decide to revaluate items of the balance sheet of their partnership to reflect true and fair values.

To record this revaluation process, we need first to prepare one of the following two accounts. First, the Revaluation Account; Second, Revaluation Profit & Loss Account. In fact, there are no much differences between these two accounts as the two accounts give the same results. In the following paragraphs a brief explanation will be given regarding these two accounts.

1- The Revaluation Account:

Dr. The Revaluation Account Cr.

Assets	**X**	**Assets**	**X**
(original values)	**X**	**(new values)**	**X**
Liabilities	**X**	**Liabilities**	**X**
(new values)	**X**	**(original values)**	**X**
Other items or	**X**	**Other items or**	**X**
provisions (losses)	**X**	**provisions (profits)**	**X**
To Capital a/c (net profit)	***X***	***By Capital a/c (net loss)***	***X***
Partner A ---		***Partner A ---***	
Partner B ---		***Partner B ---***	
	XX		**XX**

Notes:

- Assets (original values) are closed in debit side of the revaluation account, while they are reopened (new values) in the credit side of the same account.
- Similarly, liabilities (original values) are closed in credit side of the revaluation account, while they are reopened (new values) in the debit side of the same account.
- Other items like the current assets (debts, securities, and goods) may need special provisions (such assets provision for bad debts, and provision for doubtful debts). Changes in such items should be appeared in the debit side of the account in case of losses, while should be appeared in the credit side in case of profits.

2- The Revaluation P & L Account:

Dr. The Revaluation Profit & Loss Account Cr.

Decrease in assets' values (losses)	**X** **X**	**Increase in assets' values (profits)**	**X** **X**
Increase in liabilities' Values (losses)	**X** **X**	**Decrease in liabilities' Values (profits)**	**X** **X**
To Capital a/c (net profit)		***By Capital a/c (net loss)***	
Partner A ---	***X***	***Partner A ---***	***X***
Partner B ---	**—**	***Partner B ---***	—
	XX		**XX**

Notes:

- When using this way, the revaluation profit & loss account, we do not need to close accounts of different assets and liabilities with their original values and re-opened them again, because we leave these accounts opened while the adjustments be done in the asset's account or liability's account itself. In other word, what is treated and appeared in the P&L account is the differences between the original or old values and the new values of various assets and liabilities namely the increase and the decrease in these values.

- In all circumstances, the final results of both the "Revaluation Account" and the "Revaluation Profit and Loss Account" should be closed in the "Capital Account". Capital will be increase by the profits, while will be decrease by the losses.

Examples of this method will be given later in this chapter.

4.3 Capital Decrease:

Capital decrease may also be accomplished through one or more of the following methods:

4.3.1 By Cash:

Partners might agree to decrease their capitals by the withdrawing of cash or asset(s). Several reasons can be behind this decrease, among them is that partners find their shares in the partnership are more than what the partnership needs of money. The following journal entry can be made to record the above.

Date	Details	Dr.	Cr.
1/ 1/ 0X	**By Capital Account** **(partner A) xx** **(partner B) xx** **To Cash or Asset(s)** **To record the capital decrease.**	xx 	 xx

If one partner or more prefer to credit his current account in the partnership by his share in the capital decrease instead of withdrawing it in cash, two journal entries shall be made as follows:

Date	Details	Dr.	Cr.
1/ 1/ 0X	**By Capital Account** **(partner A) xx** **(partner B) xx** **To Partners' current a/c** **(partner A) xx** **(partner B) xx** **To record the capital decrease through partners' current a/c.**	xx	 xx
1/ 3/ 0X	**By Partners' current a/c** **(partner A) xx** **(partner B) xx** **To Cash** **To record partners' drawings from the partners' current a/c.**	 xx	 xx

4.3.2 By Debit Current Accounts:

Here, partners may agree to decrease their capitals by using the debit balances of current account. This can be recorded by the following journal entry.

Date	Details	Dr.	Cr.
1/ 1/ 0X	**By Capital Account** **(partner A) xx** **(partner B) xx** **To Partners Current a/c** **(partner A) xx** **(partner B) xx** **To record the capital decrease by the balances of current account.**	**xx**	**xx**

4.3.3 By Revaluation of Assets & Liabilities:

Similar to the case of capital increase, partners may prefer to decrease their capital balances in the partnership through the revaluation of assets and liabilities of their partnership. In such cases, partners see that the assets are overestimated, and, on the other hand, the liabilities are underestimated. So, they may decide to revaluate items of the balance sheet of their partnership to reflect true and fair values.

Also, to record this revaluation process, it is possible to use whether the Revaluation Account or the Revaluation Profit & Loss Account.

Example 4.2:

A, B and C are partners in a partnership and the profit and losses sharing ratio is 1:1:1. They decided by 31/12/0X to reduce their capitals in the partnership because they found that there is money and other assets in excess for their business. The capital reduction amounts are as follows: A (LE 20,000), B (LE 10,000), and C (LE 14,000). They agreed to withdraw LE 24,000 in cash, LE 10,000 from the bank account, and the rest in goods.

Required: Recording the above agreement.

Solution:

Date	Details	Dr.	Cr.
31/12/0X	**By Capital a/c**	**44,000**	
	A 20,000		
	B 10,000		
	C 14,000		
	To Sundries		
	Cash		**24,000**
	Bank		**10,000**
	Goods		**10,000**
	To record the capital increase by using the general reserve.		

Example 4.3:

X and Y are partners in a partnership. They share profit and loss equally. It was decided to revaluate assets and liabilities of their partnership and to record the results of the revaluation process in the books of the partnership. The following is the balance sheet assets on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Machines	**40,000**		**X**	**60,000**	
Cars	**60,000**	**100,000**	**Y**	**50,000**	**110,000**
Current Assets					
Goods		**13,000**	**A/P**		**28,000**
A/R	**14,000**		**Tax provision**		**2,000**
Provision for doubtful debts	**- 2,000**	**12,000**			
Securities		**12,000**			
Cash		**3,000**			
		140,000			**140,000**

The revaluation agreement included the following changes:

Machines to be LE 32,000, cars to be LE 64,000, goods to be LE 10,000, bad debts LE 2,000, the doubtful debts are LE 3,000, securities LE 11,000, and lately, one of the suppliers disclaimed amount of LE 1,000 and the tax provision should be LE 4,000.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the Revaluation P&L account.

3- Prepare the new Balance Sheet after this agreement.

Solution:

Dr. The Revaluation Profit & Loss Account Cr.

To:		**By:**	
Machines	**8,000**	**Cars**	**4,000**
Goods	**3,000**	**A/P (suppliers)**	**1,000**
A/R (bad debts)	**2,000**		
Provision for doubtful debts	**1,000**	***Capital a/c (net loss)***	**12,000**
Provision for the decrease on sec. prices	**1,000**	***X 6,000***	
Tax provision	**2,000**	***Y 6,000***	
	17,000		**17,000**

The Journal Entries:

Date	Details	Dr.	Cr.
	By Revaluation P&L a/c	**17,000**	
	To Sundries		
	Machines		**8,000**
	Goods		**3,000**
	A/R (bad debts)		**2,000**
	Provision for Doubtful Debts		**1,000**
	Provision for the Decrease on securities Prices		**1,000**
	Tax Provision		**2,000**
	To record losses of the revaluation.		
	By Sundries		
	Cars	**4,000**	
	A/P	**1,000**	
	To Revaluation P&L a/c		**5,000**
	To record profits of the revaluation.		
	By Capital a/c	**12,000**	
	X 6,000		
	Y 6,000		
	To Revaluation P&L a/c		**12,000**
	To record the capital decrease by the net results of revaluation process.		

Assets Balance Sheet after the agreement **Liabilities**

Fixed Assets			**Capital a/c**		
Machines	**32,000**		**X**	**54,000**	
Cars	**64,000**	**96,000**	**Y**	**44,000**	**98,000**
Current Assets					
Goods		**10,000**	**A/P**		**27,000**
A/R	**12,000**		**Tax provision**		**4,000**
(-) Provision for d. debts	**(-) 3,000**	**9,000**			
Securities	**12,000**				
(-) Provision	**(-) 1,000**	**11,000**			
Cash		**3,000**			
		129,000			**129,000**

Exercises:

1- M and N are partners in a partnership. They decided to increase their capitals by LE 40,000 (for partner M), and by LE 25,000 (for partner N). Partner M will use the credit balance of his current account which is LE 15,000 and will pay the remaining in cash. Partner N who has a debit balance of current account of LE 10,000 will pay his share in the capital increase by introducing LE 8,000 goods and will pay the remaining in the bank a/c.

Required: Journal entries needed to record the above capital increase.

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2- J, K and L are partners in a partnership and the profit and losses sharing ratio is 2:1:2 respectively. They decided to revaluate the assets of their partnership as follows:

- Equipment to be increased by LE 5,000.
- Cars to be increased by LE 14,000.
- Machines to be decreased by LE 6,000.
- A/R to be decreased by LE 1,000.
- A/P to be increased by LE 2,000.

Required: Prepare the Revaluation P&L account and record by the needed journal entries.

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3- A, B and C are partners in a partnership and the profit and losses sharing ratio is 2:1:1 respectively. They decided to reduce their capitals in the partnership because they found that there is money and other assets in excess for their business. The capital reduction amounts are as follows: A (LE 38,000), B (LE 20,000), and C (LE 25,000). They agreed to withdraw LE 45,000 in cash, LE 22,000 from the bank account, and the rest in goods.

Required*:* Recording the above agreement.

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4- The following is the B/S of a partnership owned by three partners, R, S and T. The P&L sharing ratio is 3:3:4 respectively.

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Cars	**140,000**		**R**	**60,000**	
Machines	**30,000**		**S**	**80,000**	
Equipment	**50,000**	**220,000**	**T**	**120,000**	**260,000**
Current Assets					
A / R	**46,000**		**Loans**		**20,000**
Goods	**60,000**		**A/P**		**66,000**
Cash	**20,000**	**126,000**			
		346,000			**346,000**

Partners agreed to revaluate items of the B/S as follows:

Cars LE 120,000, Machines LE 24,000, Equipment LE 45,000, Goods LE 62,000, bad debts LE 6,000, the doubtful debts 10%, and revaluation expense LE 1000.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the Revaluation P&L account.

3- Prepare the new Balance Sheet after this agreement.

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5- A and B are partners in a partnership. The profit and loss sharing ratio is 1:2 respectively. It was decided to revaluate assets and liabilities of their partnership and to record the results of the revaluation process in the books of the partnership. The following is the balance sheet as on that date:

Assets **Liabilities**

Fixed Assets				**Capital a/c**		
Furniture		**35,000**		**A**	**40,000**	
Buildings		**28,000**		**B**	**80,000**	**120,000**
Cars	**40,000**					
(-) Depreciation	**(10,000)**	**30,000**		**A/P**		**32,000**
			93,000	**Loans**		**48,000**
Current Assets				**Tax provision**		**12,000**
Goods			**22,000**			
A/R		**38,000**				
Provision for doubtful debts		**- 3,000**	**35,000**			
Securities			**32,000**			
Cash			**30,000**			
			212,000			**212,000**

The revaluation agreement included the following changes:

Furniture to be LE 32,000, cars depreciation to be LE 12,000, goods to be LE 25,000, bad debts LE 8,000, the doubtful debts are 10%, securities LE 30,000, and lately, one of the suppliers disclaimed amount of LE 2,000 and the tax provision should be LE 14,000.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the Revaluation P&L account.

3- Prepare the new Balance Sheet after this agreement.

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CHAPTER FIVE

Admission of a New Partner

5.1 Introduction:

This chapter of is devoted to the accounting treatments of the admission of a new partner. As we have seen in the past chapter, the expected changes in the ownership of a partnership might take several forms. The admission of a new partner is one of these forms.

Practically, partners may find that it is, in certain cases, necessary to admit a new partner to the partnership. Reasons behind that could be their need for additional capital or their need for the new partner’s experiences or personal relationships.

The admission of a new partner requires the agreement of all partners in the partnership and also leads to the dissolution of the original partnership and the formation of a new partnership instead with a new agreement or contract. Also, all legal procedures should be followed to apply this change in the ownership of a given partnership.

Whether or not it is necessary to revaluate assets and liabilities of the partnership when admitting a new partner, and the accounting treatment of goodwill, if any, are the most important issues that should be covered in this chapter. The following pages will explain the accounting treatments of the admission of a new partner.

5.2 First Case: Admission of a New Partner & Revaluating Assets and Liabilities of the Partnership:

In many cases, both old partners and the new partner can agree to revaluate the assets and liabilities of the partnership. However, an important question may be arising. This question is whether or not the revaluation results will be recorded in the books of the partnership.

Partners may or may not agree to record the revaluation results. So, two different cases can be explained.

5.2.1 Recording the Revaluation:

Here, old partners may agree with the new one to revaluate assets and liabilities of the partnership, and to record the revaluation in the books of the partnership. Therefore, assets and liabilities should be recorded by the new values, and a "Revaluation P&L A/C" must be prepared. Only old partners must be the beneficiaries or the bearers of the final result of the revaluation process whether profits or losses. This means that shares of old partners will be changed according to the results of the revaluation process.

Regarding the share of the new partner, he or she may buy a share of one or more old partners, or, in the other hand, pay new investment in the partnership such as cash or goods…etc. The following two examples will explain the accounting treatment of these two cases.

Example 5.1:

L and M are partners in a partnership. The profit and loss sharing ratio is 1:1. The following is the B/S of their partnership as on 30/6/2002:

Assets **Liabilities**

Goodwill		**10,000**	**Capital a/c**		
Fixed Assets			**L**	**80,000**	
Cars		**80,000**	**M**	**60,000**	**140,000**
Buildings		**60,000**			
Equipment		**30,000**	**Loans**		**40,000**
Current Assets			**A/P**		**70,000**
A / R	**26,000**				
(-) Provision for doubtful debts	**6,000**	**20,000**			
Goods		**40,000**			
Cash		**10,000**			
		250,000			**250,000**

On 1/7/2002, partners agreed for the admission of N to be a new partner in the partnership according to the following:

1- They agreed to revaluate some assets as follows:

Goodwill LE 20,000, Cars LE 70,000, Buildings LE 80,000, Equipment LE 26,000, bad debts LE 1,000, provision for doubtful debts 10%, and A/P LE 68,500.

2- It was decided to record the revaluation in the books of the partnership.

3- The new profit and loss sharing ratio is 1:1:1.

4- L & M accepted to sell half of their shares to the new partner (N) against amount of LE 80,000 which will be paid outside the partnership.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the Revaluation P&L account & the Capital Account.

3- Prepare the new Balance Sheet after this agreement.

Solution:

Date	Details	Dr.	Cr.
1/7/2002	By Revaluation P&L a/c	15,000	
	To Sundries		
	Cars		10,000
	Equipment		4,000
	A/R (bad debts)		1,000
	To record losses of the revaluation.		
1/7/2002	By Sundries		
	Goodwill	10,000	
	Buildings	20,000	
	Provision for Doubtful Debts	3,500	
	A/P	1,500	
	To Revaluation P&L a/c		35,000
	To record profits of the revaluation.		
	By Revaluation P&L a/c	20,000	
1/7/2002	To Capital a/c		20,000
	L 10,000		
	M 10,000		
	To close the net result of revaluation process in capital a/c of old partners.		
1/7/2002	By Capital a/c	80,000	
	L 45,000		
	M 35,000		
	To Capital a/c (N)		80,000
	To record the sale of half share of L & M to the new partner (N).		

Dr. The Revaluation Profit & Loss Account Cr.

To:		**By:**	
Cars	**10,000**	**Goodwill**	**10,000**
Equipment	**4,000**	**Buildings**	**20,000**
A/R (bad debts)	**1,000**	**Provision for doubtful debts**	**3,500**
Capital a/c (net profit)		**A/P**	**1,500**
L 10,000	**20,000**		
M 10,000			
	35,000		**35,000**

Assets Balance Sheet as on 1/7/2002 **Liabilities**

Goodwill		**20,000**	**Capital a/c**		
Fixed Assets			**L**	**45,000**	
Cars		**70,000**	**M**	**35,000**	
Buildings		**80,000**	**N**	**80,000**	
Equipment		**26,000**			**160,000**
Current Assets					
A / R	**25,000**		**Loans**		**40,000**
(-) Provision for doubtful debts	**2,500**	**22,500**	**A/P**		**68,500**
Goods		**40,000**			
Cash		**10,000**			
		268,500			**268,500**

Note:

- Payment of the share of the new partner (LE 80,000) to the old partners will be outside the partnership, so no journal entry needed for this payment.

In the above example we assumed that the new partner pays amount against his share to old partners outside the partnership, and hence no journal entry was made to record this payment and also original shares of old partners will be decreased by what the new partner will buy. In other cases, old partners may agree to ask new partner to pay his share assets new investment in the business. This mean that shares of old partners will not be affected by the admission of a new partner, as he/she will give new investment to the partnership. Also, the total capital of the partnership will be increased by share presented by the new partner. Recording in this case will be similar to that of the formation of a new partnership. The following example will explain the accounting treatment of the above.

Example 5.2:

L and M are partners in a partnership. The profit and loss sharing ratio is 1:1. The above is the B/S of their partnership as on 30/6/2002. On 1/7/2002, partners agreed for the admission of N to be a new partner in the partnership according to the following:

Assets			**Liabilities**		
Goodwill		**10,000**	**Capital a/c**		
Fixed Assets			**L**	**80,000**	
Cars		**80,000**	**M**	**60,000**	**140,000**
Buildings		**60,000**			
Equipment		**30,000**	**Loans**		**40,000**
Current Assets			**A/P**		**70,000**
A / R	**26,000**				
(-) Provision for doubtful debts	**6,000**	**20,000**			
Goods		**40,000**			
Cash		**10,000**			
		250,000			**250,000**

1- They agreed to revaluate some assets as follows:

Goodwill LE 20,000, Cars LE 70,000, Buildings LE 80,000, Equipment LE 26,000, bad debts LE 1,000, provision for doubtful debts 10%, and A/P LE 68,500.

2- It was decided to record the revaluation in the books of the partnership.

3- The new profit and loss sharing ratio is 1:1:1.

4- Partners agreed that the new partner (N) to buy and pay amount equal to half of the total capital after the revaluation. Payment, which in the bank account, will be as new investment in the partnership.

Require:

1- Record the above agreement in the partnership books.

2- Prepare the “Capital account” and the “Revaluation P&L account”.

3- Prepare the new Balance Sheet after this agreement.

Solution:

Date	Details	Dr.	Cr.
	By Revaluation P&L a/c	**15,000**	
	To Sundries		
	Cars		**10,000**
	Equipment		**4,000**
	A/R (bad debts)		**1,000**
	To record losses of the revaluation.		
	By Sundries		
	Goodwill	**10,000**	
	Buildings	**20,000**	
	Provision for Doubtful Debts	**3,500**	
	A/P	**1,500**	
	To Revaluation P&L a/c		**35,000**
	To record profits of the revaluation.		
	By Revaluation P&L a/c	**20,000**	
	To Capital a/c		**20,000**
	L 10,000		
	M 10,000		
	To close the net result of revaluation process in capital a/c of old partners.		
	By Bank	**80,000**	
	To Capital a/c (N)		**80,000**
	To record payment of the new partner's share in the bank.		

Dr. The Revaluation Profit & Loss Account Cr.

To:		**By:**	
Cars	**10,000**	**Goodwill**	**10,000**
Equipment	**4,000**	**Buildings**	**20,000**
A/R (bad debts)	**1,000**	**Provision for doubtful debts**	**3,500**
Capital a/c (net profit)		**A/P**	**1,500**
L 10,000	**20,000**		
M 10,000			
	35,000		**35,000**

Assets Balance Sheet as on 1/7/2002 **Liabilities**

Goodwill		**20,000**	**Capital a/c**		
Fixed Assets			**L**	**90,000**	
Cars		**70,000**	**M**	**70,000**	
Buildings		**80,000**	**N**	**80,000**	
Equipment		**26,000**			**240,000**
Current Assets					
A / R	**25,000**		**Loans**		**40,000**
(-) Provision for doubtful debts	**2,500**	**22,500**	**A/P**		**68,500**
Goods		**40,000**			
Cash		**10,000**			
Bank		**80,000**			
		348,500			**348,500**

Note:

- Payment of the share of the new partner (LE 80,000) was inside the partnership as new investment, so original shares of old partners did not affected by the new partner.

5.2.2 Without Recording the Revaluation:

In contrast of the above case, old partners may agree with the new one to revaluate assets and liabilities of the partnership, and to keep the original values meaning that they will not record the revaluation in the books of the partnership. Therefore, assets and liabilities should be shown by their original values. Hence there is no need for preparing a “Revaluation P&L A/C”. Because old partners must be the beneficiaries or the bearers of the final result of the revaluation process whether profits or losses and in the same time this result will not be recorded the books, new partner need to give some money to old partners as he/she will be benefited from the revaluation profit that will not be recorded.

Example 5.3:

Maha and Mai are partners in a partnership. They share profit and loss equally. The following is the B/S of their partnership as on 1/10/2003

Assets **Liabilities**

Goodwill		**5,000**	**Capital a/c**		
Fixed Assets			**Maha**	**75,000**	
Cars		**30,000**	**Mai**	**75,000**	**150,000**
Land		**50,000**			
Buildings		**60,000**	**Loans**		**17,000**
Current Assets			**A/P**		**30,000**
A / R	**33,000**		**N/P**		**20,000**
(-) Provision for doubtful debts	**1,000**	**32,000**			
Goods		**20,000**			
Bank		**20,000**			
		217,000			**217,000**

On 5/10/2003, partners accepted the admission of 'Manar' to be a new partner in the partnership according to the following:

1- They agreed to revaluate some assets as follows:

Goodwill LE 11,000, Cars LE 37,000, Land LE 75,000, Buildings LE 70,000, provision for doubtful debts 0%, A/P LE 28,000 and N/P LE 21,000.

2- It was decided to keep the book values of the revaluated assets and liabilities (no recording for the revaluation in the books of the partnership), and the new partner "Manar" will pay against her share in the revaluation profits to old partners in cash to be credited to their current accounts.

3- The new profit and loss sharing ratio is 3:3:4 for Maha, Mai and Manar respectively.

4- They agreed that the new partner 'Manar' will pay LE 100,000 (cash) in the partnership as her share.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the new Balance Sheet after this agreement.

Solution:

Determining the result of the revaluation process:

The profits (increase in assets and decrease in liabilities)

Goodwill 6,000 + Cars 7,000 + Land 25,000 + Buildings 10,000 + provision for D.D. 1,000 + A/P 2,000 = LE 51,000

The losses (decrease in assets and increase in liabilities)

N/P = LE 1,000

The net result is (profits) = 51,000 – 1,000 = LE 50,000

- Because partners agreed to not record this result in the books, the new partner should give some money to the old partners. This payment can be calculated as follows:

	Maha	Mai	Manar
- Distributing revaluation profits to old partners according to the old ratio (1:1)	**25,000**	**25,000**	**--**
- Distributing revaluation profits to all partners according to the new ratio (3:3:4)	**15,000**	**15,000**	**20,000**
- Differences representing what the new partner should pay to old ones	**-10,000**	**-10,000**	**+20,000**

So, partner "Manar" needs to pay LE 20,000 (LE 10,000 to each partner) in cash to be credited to old partners current account.

Date	Details	Dr.	Cr.
5/10/03	**By Bank a/c**	**20,000**	
	To Partners current a/c		**20,000**
	Maha 10,000		
	Mai 10,000		
	To record payment by the new partner to old ones against profits of revaluation process.		
	By Cash		
5/10/03	**To Capital a/c (Manar)**	**100,000**	
	To record payment by the new partner for his share in the partnership.		**100,000**

Assets		B/S as on 5/10/03			**Liabilities**
Goodwill		**5,000**	**Capital a/c**		
Fixed Assets			**Maha**	**75,000**	
Cars		**30,000**	**Mai**	**75,000**	**250,000**
Land		**50,000**	**Manar**	**100,000**	
Buildings		**60,000**	**Partners Current a/c**		
Current Assets			**Maha**	**10,000**	
A / R	**33,000**		**Mai**	**10,000**	**20,000**
(-) Provision for					
doubtful debts	**1,000**	**32,000**	**Loans**		**17,000**
Goods		**20,000**	**A/P**		**30,000**
Bank		**40,000**	**N/P**		**20,000**
Cash		**100,000**			
		337,000			**337,000**

Note:

- Partners can agree that partner "Manar" pays the amount of LE 20,000 to old partners outside the company, no journal entries needed in this case.

- Practically, there are several methods for the accounting treatment in such case, but to use one of them depends on the agreement between the old partners and the new partner.

5.3 Second Case: Admission of a New Partner Without Revaluating Assets and Liabilities of the Partnership:

In several cases, old partners may agree to accept a new partner without doing revaluation of assets and liabilities of their partnership. In other words, the admission of a new partner will be based on the book values of assets and liabilities of the partnership.

This means that the new partner will pay amount against his/her share in the partnership to old partner(s) or to the partnership depending on the agreement that they accepted earlier. The amount paid by the new partner might be equal, more than, or less than his/her share in the partnership (noting that this share is calculated according to the book values of assets and liabilities.

In the following pages, several examples will be presented to explain these different cases.

5.3.1 New Partner's Payment is Equal to his/her Share in the Capital of the Partnership:

When the new partner pays amount equal to his/her share in the partnership (this share is calculated according to the book values), no problem will be faced in the accounting treatment of the admission of this new partner. All that we need here is only one journal entry to record the admission of this partner.

Example 5.4:

'Mohamed' and 'Amro' are partners in a partnership sharing profit and loss equally and their capital are LE 120,000 and LE 80,000 respectively. On 1/1/2003 partners accepted the admission of 'Aatef' to be a new partner in the partnership. The new partner will pay LE 100,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

1- Record the above agreement in the partnership books.

Solution:

Calculating the total capital after the admission of 'Aatef':

120,000 + 80,000 + 100,000 = LE 300,000

Then Aatef's share in the partnership = 300,000 X 1/3 =

LE 100,000

This means that payment paid by the new partner (100,000) is equal to his share in the partnership (1/3 of the total capital or 100,000).

The needed journal entry is:

Date	Details	Dr.	Cr.
1/ 1/ 03	**Cash** **To Capital account (Aatef)** **To record payment by the new partner.**	**100,000**	**100,000**

5.3.2 New Partner's Payment is More than his/her Share in the Capital of the Partnership:

When the new partner pays amount more than his/her share in the partnership, the difference can be treated as: (1) a bonus from the new partner to old partners in company (because the partnership has extra profits or able to gain extra profits) or (2) undisclosed goodwill that the company has and this difference is the share of the new partner in this goodwill (note that this goodwill increases old partners' capitals).

5.3.2.1 The Bonus Method:

Here, the difference will be treated as a bonus from the new partner to old partners in company.

Example 5.5:

A and B are partners in a partnership sharing profit and loss equally and their capital are LE 120,000 and LE 80,000 respectively. On 1/1/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 130,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference as a bonus.

Solution:

Calculating the total capital after the admission of C:

120,000 + 80,000 + 130,000 = LE 330,000

Then C's share in the partnership = 330,000 X 1/3 =

LE 110,000 while he paid LE 130,000 to the partnership

This means that payment paid by the new partner C (130,000) is more than his share in the partnership (1/3 of the total capital or 110,000). This difference (LE 20,000 is considered as a bonus from partner C to partners A and B who will share it according to their old profit and loss sharing ratio (1:1).

The needed journal entries are:

Date	Details	Dr.	Cr.
1/ 1/ 03	**Cash**	**130,000**	
	To Capital account		**130,000**
	A 10,000		
	B 10,000		
	C 110,000		
	To record payment by the new partner C including a bonus to old partners.		

Note:

- The new balances of capital account will be (A 120,000 + 10,000 = 130,000), (B 80,000 + 10,000 = 90,000), and (C 110,00 that is 1/3 the total capital).

<u>5.3.2.2 The Goodwill Method:</u>

Here, the difference will be treated as undisclosed goodwill that the company has, and this difference is the share of the new partner in this goodwill. Partners may agree to record the goodwill in full, in only the new partner's share, or to keep it undisclosed.

<u>Example 5.6:</u>

A and B are partners in a partnership sharing profit and loss equally and their capital are LE 120,000 and LE 80,000 respectively. On 1/1/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 130,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference, if any, as undisclosed goodwill or capital reserve.

Solution:

- Calculating the total capital after the admission of C:

120,000 + 80,000 + 130,000 = LE 330,000

Then C's share in the partnership = 330,000 X 1/3 =

LE 110,000 while he paid LE 130,000 to the partnership

This means that payment paid by the new partner C (130,000) is more than his share in the partnership (1/3 of the total capital or 110,000). This difference (LE 20,000 is considered as new partner's share in the undisclosed goodwill.

- As the new partner will have 1/3 of the capital, then total undisclosed goodwill = 20,000X 3/1 = LE 60,000.

The needed journal entries are:

Date	Details	Dr.	Cr.
1/ 1/ 03	**Goodwill**	**60,000**	
	To Capital account		**60,000**
	A 30,000		
	B 30,000		
	To increase old partners' capitals by goodwill.		
1/ 1/ 03	**Cash**	**130,000**	
	To Capital account (partner C)		**130,000**
	To record payment by the new partner C for his share.		

Note:

- The new balances of capital account will be (A 120,000 + 30,000 = 150,000), (B 80,000 + 30,000 = 110,000), and (C 130,000 that is 1/3 the total capital).
- The goodwill was recorded by the total value that was only for old partners and so was divided equally between them and was credited to their capital account.

5.3.3 New Partner’s Payment is Less than his/her Share in the Capital of the Partnership:

Similar to the past case (5.3.2), when the new partner pays amount less than his/her share in the partnership, the difference can be treated as: (1) a bonus from the old partners to the new partner (because the new partner has much experience or goodwill) or (2) capital reserve meaning that assets of the partnership are overestimated and this difference is the share of the new partner in this reserve (note that this reserve decreases old partners’ capitals).

5.3.3.1 The Bonus Method:

Here, the difference will be treated as a bonus from old partners to the partner.

Example 5.7:

A and B are partners in a partnership sharing profit and loss equally and their capital are LE 120,000 and LE 80,000 respectively. On 1/1/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 70,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

1- Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference as a bonus.

Solution:

Calculating the total capital after the admission of C:

120,000 + 80,000 + 70,000 = LE 270,000

Then C's share in the partnership = 270,000 X 1/3 =

LE 90,000 while he paid only LE 70,000 to the partnership.

This means that payment paid by the new partner C (70,000) is less than his share in the partnership (1/3 of the total capital or 90,000). This difference (LE 20,000 is considered as a bonus from old partners who will share it according to their old profit and loss sharing ratio (1:1) to partner C.

The needed journal entries are:

Date	Details	Dr.	Cr.
1/ 1/ 03	**By Sundries**		
	Cash	**70,000**	
	Capital a/c	**20,000**	
	(A) 10,000		
	(B) 10,000		
	To Capital account (C)		**90,000**
	To record payment by the new partner C.		

Note:

- The new balances of capital account will be (A 120,000 - 10,000 = 110,000), (B 80,000 - 10,000 = 70,000), and (C 90,000 that is 1/3 the total capital).

- Although partner C paid only LE 70,000, he has got a share of LE 90,000 in the partnership as he was given a bonus from old partners.

5.3.3.2 The Capital Reserve Method:

Here, the difference will be treated as capital reserve, meaning that assets of the partnership are overestimated, and this difference is representing the share of the new partner in this reserve (note that the capital reserve will decrease capitals of only old partners).

Example 5.8:

A and B are partners in a partnership sharing profit and loss equally and their capital are LE 120,000 and LE 80,000 respectively. On 1/1/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 70,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference, if any, as undisclosed goodwill or capital reserve.

Solution:

- Calculating the total capital after the admission of C:

120,000 + 80,000 + 70,000 = LE 270,000

Then C's share in the partnership = 270,000 X 1/3 =

LE 90,000 while he paid only LE 70,000 to the partnership.

This means that payment paid by the new partner C (70,000) is less than his share in the partnership (1/3 of the total capital or 90,000). This difference (LE 20,000 is considered as new partner's share in the capital reserve which the new partner might bear because of this reserve.

- As the new partner will have 1/3 of the capital, then total capital reserve which affects on capitals of old partners = 20,000X 3/1 = LE 60,000.

The needed journal entries are:

Date	Details	Dr.	Cr.
1/ 1/ 03	**By Capital account**	**60,000**	
	A 30,000		
	B 30,000		
	To Capital reserve		**60,000**
	To decrease old partners' capitals by capital reserve.		
1/ 1/ 03	**Cash**		
	To Capital account (partner C)	**70,000**	
	To record payment by the new partner C for his share.		**70,000**

Note:

- The new balances of capital account will be (A 120,000 - 30,000 = 90,000), (B 80,000 - 30,000 = 50,000), and (C 70,000 that is 1/3 the total capital).

- The capital reserve was recorded by the total value that was only for old partners and so was divided equally between them and was debited to their capital account.

Exercises:

1- J and K are partners in a partnership. The profit and loss sharing ratio is 1:1. The following is the B/S of their partnership as on 31/12/2002

Assets **Liabilities**

Goodwill		**7,000**	**Capital a/c**			
Fixed Assets				**J**	**75,000**	
Land		**77,000**		**K**	**75,000**	**150,000**
Machines		**57,000**				
Equipment		**29,000**	**Loans**			**25,000**
Current Assets			**A/P**			**40,000**
A / R	**13,000**					
(-) Provision for doubtful debts	**3,000**	**10,000**				
Goods		**25,000**				
Bank		**10,000**				
		215,000				**215,000**

On 1/1/2003, partners agreed for the admission of L to be a new partner in the partnership according to the following:

1- They agreed to revaluate some assets as follows:

Goodwill LE 17,000, Land LE 67,000, Machines LE 77,000, Equipment LE 25,000, bad debts LE 1,000, provision for doubtful debts 10%, and A/P LE 38,500.

2- It was decided to record the revaluation in the books of the partnership.

3- The new profit and loss sharing ratio is 1:1:1.

4- J & K accepted to sell half of their shares to the new partner (L) against amount of LE 65,850 which will be paid outside the partnership.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the Revaluation P&L account.

3- Prepare the new Balance Sheet after this agreement.

2- A and B are partners in a partnership. The profit and loss sharing ratio is 1:1. The below is the B/S of their partnership as on 31/12/2004.

Assets **Liabilities**

Goodwill		**8,000**	**Capital a/c**		
Fixed Assets			**A**	**70,000**	
Land		**40,000**	**B**	**50,000**	**120,000**
Buildings		**30,000**			
Equipment		**15,000**	**Loans**		
Current Assets			**A/P**		**3,000**
A / R	**26,000**				
(-) Provision for doubtful debts	**6,000**	**20,000**			**40,000**
Goods		**40,000**			
Bank		**10,000**			
		163,000			**163,000**

On 1/1/2003, partners agreed for the admission of C to be a new partner in the partnership according to the following:

1- They agreed to revaluate some assets as follows:

Goodwill LE 6,000, Land LE 35,000, Buildings LE 40,000, Equipment LE 13,000, bad debts LE 6,000, provision for doubtful debts 5 %, and A/P LE 38,500.

2- It was decided to record the revaluation in the books of the partnership.

3- The new profit and loss sharing ratio is 1:1:1.

4- Partners agreed that the new partner (C) to buy and pay amount equal to half of the total capital after the revaluation. Payment, which in the bank account, will be as new investment in the partnership.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the “Capital account” and the “Revaluation P&L account”.

3- Prepare the new Balance Sheet after this agreement.

3- A and B are partners in a partnership and sharing profit and loss equally. The following is the B/S of their partnership as on 31/12/2002

Assets **Liabilities**

Goodwill		**2,500**	**Capital a/c**		
Fixed Assets			**A**	**40,000**	
Cars		**15,000**	**B**	**35,000**	**75,000**
Buildings		**25,000**			
Machines		**30,000**	**Loans**		**3,500**
Current Assets			**A/P**		**15,000**
A / R	**17,000**		**N/P**		**15,000**
(-) Provision for doubtful debts	**1,000**	**16,000**			
Cash		**20,000**			
		108,500			**108,500**

On 1/1/2003, partners accepted C as a new partner in the partnership according to the following:

1- They agreed to revaluate some assets as follows:

Goodwill LE 4,500, Cars LE 12,100, Buildings LE 45,000, Machines LE 28,000, bad debts LE 2000, provision for doubtful debts 10 %, A/P LE 17,000 and N/P LE 16,000.

2- It was decided to keep the book values of the revaluated assets and liabilities (no recording for the revaluation in the books of the partnership), and the new partner "C" will pay against his share in the revaluation profits to old partners in cash to be credited to their current accounts.

3- The new profit and loss sharing ratio is 3:3:4 for A, B and C respectively.

4- They agreed that the new partner (C) will pay LE 44,000 (cash) in the partnership as his share.

Required:

1- Record the above agreement in the partnership books.

2- Prepare the new Balance Sheet after this agreement.

4- E and F are partners in a partnership sharing profit and loss equally and their capital are LE 60,000 and LE 40,000 respectively. On 1/7/2003 partners accepted the admission of G to be a new partner in the partnership. Partner G will pay LE 50,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

Record the above agreement in the partnership books.

5- A and B are partners in a partnership sharing profit and loss equally and their capital are LE 90,000 and LE 70,000 respectively. On 1/10/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 110,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

Required:

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference as a bonus.

6- S and T are partners in a partnership sharing profit and loss equally and their capital are LE 200,000 and LE 150,000 respectively. On 1/3/2003 partners accepted the admission of U to be a new partner in the partnership. Partner U will pay LE 250,000 (in cash) to the partnership against a share of half of the total capital after the admission.

Required:

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference as a bonus.

7- A and B are partners in a partnership sharing profit and loss equally and their capital are LE 240,000 and LE 160,000 respectively. On 1/9/2003 partners accepted the admission of C to be a new partner in the partnership. Partner C will pay LE 140,000 (in cash) to the partnership against a share of one third of the total capital after the admission.

<u>Required:</u>

Record the above agreement in the partnership books. Supposing that partners agreed to treat the difference as a bonus.

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CHAPTER SIX

Retirement of a Partner

6.1 Introduction:

Expected changes in the ownership of a partnership might take several forms. Chapters four and five of this text concentrated on two forms of these changes, the capital modification and the admission of a new partner. Therefore, the current chapter is devoted to the last issue of these changes in the ownership of partnership that is the retirement of a partner. Partner's retirement may be a result of death, bankruptcy, agreement between partners, or law.

Practically, when a partner retires or withdraws from a partnership, the partnership is dissolved but other remaining partners might wish to continue in the business. The partnership agreement should include all rules and procedures to be followed to treat such events.

The most important step in the accounting treatment of the retirement of a partner is the accurate measurement of the retiring partner's rights. Also, the determination of the method by which retiring partner will receive his/her rights is very important too.

6.2 Determining Rights of the Retired Partner:

When determining various rights of the retired or dead partner, it is needed to open an account containing all rights of the retired partner. This account is called "Retired Partner Account". In other words, the Retired partner a/c includes all rights of the retired partner in the credit side, while it includes all liabilities towards the partnership in its debit side.

Rights and liabilities of retired partner might include his/her share in some or all of the following items:

- Capital; or net assets of the partnership at the time of retirement;
- Profits or losses realized from the commencement of the financial year until the retirement date;
- Profits or losses of previous years;
- The general or other reserves
- Salaries, interest on capital, loans, drawings and related interests, balances of current account;
- Goodwill;
- Insurance policy.

After the determination of rights (the credit side of the retired partner account) and liabilities (the debit side of the same account) related to the retired partner, it is important to decide how the partnership will pay for the retired partner.

6.2.1 Partner's Share in Capital:

Capital share of retired partner is that share shown in the capital account as a balance of that partner at the date of the retirement or death. This share should be closed in the credit side of the "Retired Partner Account" by using the following journal entry:

Date	Details	Dr.	Cr.
	By Capital Account (C)	**xx**	
	To Retired Partner a/c		**Xx**
	To close the capital account of the retired partner C.		

6.2.2 Partner's Share in Net Assets of the Partnership at the Time of Retirement:

Retired partner's share in the net assets of the partnership can be determined by two ways. First, without revaluation of items of the balance sheet of the partnership. In this case, right of the retired partner is only his capital balance at the date of retirement (determined in 6.2.1 above). Second, with revaluation of items of the balance sheet. In such case, it is needed to prepare a Revaluation P&L a/c[1] and close its result in the Capital a/c. In some other texts, share of the retired partner in the results of the Revaluation P&L a/c is closed in the Retired Partner a/c instead.

6.2.3 Profits or Losses Realised from the Commencement of the Financial Year until the Retirement Date:

The determination of this item is depending on what other partners agree with the retired partner. They may agree to determine his/her right:

(1) As a certain accepted amount to be paid to the retired partner and credited to the Retired Partner a/c.

(2) By preparing final accounts at the time of retirement.

(3) By agreement that the average of last few years profits or losses to be the basis of the profit of the current year.

Using any of the above ways is depends on the agreement between the retired partner from one side and other partners from the other. In all cases, right of the retired partner should be credited to Retired Partner a/c. Moreover, when preparing final accounts to determine right of the retired partner, the same rules should be applied, and the net result is carried to P&L Appropriation a/c and his/her share is closed in Capital a/c.

[1] The preparation of such account is similar to that one made in the last two chapters.

6.2.4 Profits or Losses of Previous Years:

Profits or losses of previous years are rights or liabilities of all partners, therefore share of the retired partner in this profit should credited to the Retired Partner a/c. For instance, if there is a balance of retained earnings, this retained earnings should be divided into partners according to the P&L sharing ratio and should be credited to their capital accounts by using the following journal entry:

Date	Details	Dr.	Cr.
	By Retained Earnings	**xx**	
	To Capital a/c		**xx**
	A (xx)		
	B (xx)		
	C (xx)		
	To close the balance of retained earnings in the capital a/c.		

Conversely, if this balance for losses instead of retaining earnings, it should be also closed in the Capital a/c by the following journal entry:

Date	Details	Dr.	Cr.
	By Capital a/c	**xx**	
	A (xx)		
	B (xx)		
	C (xx)		
	To Losses a/c		**xx**
	To close the balance of losses in the capital a/c.		

6.2.5 The General Reserves:

All reserves in the partnership should be divided into partners to determine the right of the retired partner in these reserves. So, the balance of the general reserves is closed in the capital a/c by the following journal entry:

Date	Details	Dr.	Cr.
	By General Reserve	**xx**	
	To Capital a/c		**xx**
	A (xx)		
	B (xx)		
	C (xx)		
	To close the balance of the general reserve in the capital a/c.		

6.2.6 Salaries, Interest on Capital, Loans, Drawings, and Related Interests, Balances of Current Account:

When there are some rights of retired partner such as salaries, interest on capital, loans, and balances of current account, it is possible to close all of these rights in the credit side of the Retired Partner a/c by the following journal entry:

Date	Details	Dr.	Cr.
	By Temp. Distribution a/c	**xx**	
	Accrued salaries xx		
	Interest on capital xx		
	Bonus xx		
	To Retired Partner a/c		**xx**
	To close temp. distribution a/c in the retired partner a/c.		

On the contrary, balances of liabilities of retired partner towards the partnership should be closed and debited to the Retired Partner a/c by the following journal entry:

Date	Details	Dr.	Cr.
	By Retired Partner a/c **To Temporary distribution a/c** **Interest on drawings xx** **To close the temp. dis. a/c in the retired partner a/c.**	**xx**	 **xx**

6.2.7 Goodwill:

Retired partner has a right in the goodwill, if any, according to the P&L sharing ratio whether or not the goodwill is shown in the books of partnership. Hence, two cases can be faced regarding the determination of retired partner's share in the goodwill.

First case, goodwill is recorded in the books of the partnership. In such case, goodwill should be treated as any other asset included in the B/S. Therefore, changes in the value of the goodwill should be treated in the Revaluation P&L a/c.

Second case, goodwill is not recorded in the books of the partnership. Here, partners may agree to do one of the following:

(1) To record goodwill in full. This requires opening an account for goodwill (that will be divided into partners according to the P&L sharing ratio) and to be debited by its full value, while capital a/c to be credited.

Date	Details	Dr.	Cr.
	By Goodwill **To Capital a/c** **A (xx)** **B (xx)** **C (xx)**	**xx**	 **xx**

(2) To record goodwill by only the share of retired partner. Similar to the above case, this requires opening an account for goodwill (by goodwill equal to the share of the retired partner) and to be debited, while capital a/c to be credited.

Date	Details	Dr.	Cr.
	By Goodwill	**xx**	
	To Capital a/c Retired C (xx)		**xx**

(3) To keep the goodwill unrecorded. In this case, partners agree to not record goodwill. Therefore, the B/S will not include any goodwill, but there is a right in the unrecorded goodwill for the retired partner. So, partners should pay an amount to the retired partner. Payment may be through their partner's current a/c or their capital a/c.

Date	Details	Dr.	Cr.
	By Partners' current a/c	**xx**	
	A (xx)		
	B (xx)		
	To Capital a/c C (xx)		**xx**

Or

Date	Details	Dr.	Cr.
	By Capital a/c	**xx**	
	A (xx)		
	B (xx)		
	To Capital a/c C (xx)		**xx**

Finally, partners can agree to pay for the retired partner outside the partnership so that no entries needed for recording this payment.

6.2.8 Insurance Policy:

If the case is partner's death and there is insurance policy, the partnership will receive amount from the insurance company. This can be recorded as follows:

Date	Details	Dr.	Cr.
	By Bank a/c	**xx**	
	To Insurance policy a/c		**xx**

Similar to the case of goodwill, insurance policy may or may not be recorded in the books of the partnership. So, it should be treated as the above section (6.2.8).

6.3 Payment for the Retired partner:

After determining rights and liabilities of the retired partner through the preparing of a special account namely "Retired Partner a/c", a significant question arises that is how partners, or the partnership pays for the retired partner.

Payment may be made (1) through cash or cheque from the partnership to the retired partner; (2) through cash or cheque from partners (their own money as capital increase) if the partnership has no enough resources for this payment; or (3) through the agreement with retired partner to consider his rights as a loan that the partnership bears and to be repaid by several instalments with some agreed interests.

The following journal entries can be used to record the above:

(1) Cash or cheque from the partnership to the retired partner:

Date	Details	Dr.	Cr.
	By Retired Partner a/c	**xx**	
	To Cash / Bank a/c		**xx**

(2) Cash or cheque from partners (their own money as capital increase) if the partnership has not enough resources:

Date	Details	Dr.	Cr.
	By Retired Partner a/c	**xx**	
	To Capital a/c		**xx**
	A xx		
	B xx		
	C xx		

(3) Loan that the partnership bears and to be repaid to the retired partner by several instalments with some agreed interests:

Date	Details	Dr.	Cr.
	By Retired Partner a/c	**xx**	
	To Sundries		
	Cash a/c		**xx**
	Loan a/c		**xx**

General Example:

A, B, and C are partners in a partnership. The profit and loss sharing ratio is 1:1:1. On 30/6/2003, partner C decided to retire from the partnership. Accordingly, partners agreed to revaluate assets and liabilities of the partnership, and to prepare accounts for the period from 1/1/2003 to 30/6/2003 (the retirement date). The following is the B/S of their partnership as on 30/6/2003:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Land		**10,800**	**A**	**24,000**	
Buildings		**12,000**	**B**	**21,000**	
Cars		**12,000**	**C**	**18,000**	**63,000**
Equipment		**9,000**	**General res.**		**9,000**
Current Assets			**A/P**		**12,600**
A / R	**9,300**		**Current a/c**		
(-) Pro. for d. d.	**630**	**8,670**	**B 2,100**		
Bank		**33,930**	**C 1,500**		**3,600**
Current a/c (A)		**1,800**			
		88,200			**88,200**

You have given the following information:

1- They agreed to revaluate some assets as follows: Buildings LE 13,200, Cars LE 10,000, Equipment LE 8,000, bad debts LE 1,200, provision for doubtful debts 10%.

2- Books declared that rights of the retired partner were:

* his share in the profits from 1/1/03 to 30/6/03 is LE 2,700.

* interest on capital is LE 600.

* interest on drawings is LE 200.

* accrued salaries are LE 300.

3- Payment for the retired partner was made through the bank a/c.

Required:

1- Record the above events in the partnership books.

2- Prepare the Revaluation P&L a/c, the Capital a/c, Partners' Current a/c, and the Retired Partner a/c.

3- Prepare the Balance Sheet after this agreement.

Solution:

Date	Details	Dr.	Cr.
30/6/03	By Revaluation P&L a/c To Sundries Cars Equipment A/R (bad debts) Provision for Doubtful Debts To record losses of the revaluation.	4,380	 2,000 1,000 1,200 180
30/6/03	By Buildings To Revaluation P&L a/c To record profits of the revaluation.	1,200	 1,200
30/6/03	By Capital a/c A 1,060 B 1,060 C 1,0 60 To Revaluation P&L a/c To close the net result of revaluation in capital a/c.	3,180	 3,180
30/6/03	By General reserve To Capital a/c A 3,000 B 3,000 C 3,000 To record the distribution of general reserve.	9,000	 9,000
30/6/03	By Current a/c (C) To Retired partner a/c To close the retired partner's current a/c in the retired partner a/c	1,500	 1,500
30/6/03	By Temporary distribution a/c Profits 2,700 Interest 600 Salaries 300 To Retired partner a/c To record profits, interest, and salaries of the retired partner.	3,600	 3,600
30/6/03	By Retired partner a/c To Temporary distribution a/c (interest on drawings) To record interest on drawings of the retired partner.	200	 200

30/6/03	**By Capital a/c** **To Retired partner a/c** **To close the capital a/c of retired partner.**	**19,940**	 **19,940**
30/6/03	**By Retired partner a/c** **To Bank a/c** **To record payments to the retired partner by bank.**	**24,840**	 **24,840**

Dr. Revaluation Profit & Loss Account Cr.

To:		**By:**	**1,200**
Cars	**2,000**	**Buildings**	**3,180**
Equipment	**1,000**	**Capital a/c**	
A/R (bad debts)	**1,200**	**A 1,060**	
Provision for d.d.	**180**	**B 1,060**	
		C 1,060	
	4,380		**4,380**

Dr. Retired Partner Account Cr.

To:		**By:**	
Temporary dist. a/c	**200**	**Capital a/c (C)**	**19,940**
Bank	**24,840**	**Temporary dist. a/c**	**3,600**
		Profits 2,700	
		Interest 600	
		Salaries 300	
		Current a/c (C)	**1,500**
	25,040		**25,040**

Assets Balance Sheet as on 1/7/2002 **Liabilities**

Fixed Assets				**Capital a/c**			
Land			**10,800**		**A**	**25,940**	
Buildings			**13,200**		**B**	**22,940**	**48,880**
Cars			**10,000**				
Equipment			**8,000**	**A/P**			**12,600**
Current Assets				**Current a/c**			
A / R		**8,100**		**B 2,100**			**2,100**
(-) Pro. for d. d.		**810**	**7,290**				
Bank			**9,090**				
Current a/c (A)			**1,800**				
Temporary Dist. a/c			**3,400**				
			63,580				**63,580**

Exercises:

1- L, M, and N are partners in a partnership. The profit and loss sharing ratio is 4:3:3 respectively. On 30/6/2002, partner N decided to retire from the partnership. Therefore, they agreed to revaluate items of the B/S, and to prepare accounts for the period from the beginning of the financial period to the retirement date. The following is their B/S as on 30/6/2003:

Assets **Liabilities**

Goodwill		**21,600**	**Capital a/c**		
Fixed Assets			**L**	**48,000**	
Buildings		**24,000**	**M**	**42,000**	
Cars		**24,000**	**N**	**36,000**	**126,000**
Equipment		**18,000**			
Current Assets			**General res.**		**18,000**
A / R	**18,600**		**A/P**		**25,200**
(-) Pro. for d. d.	**1,260**	**17,340**	**Current a/c**		
Bank		**67,860**	**M 4,200**		
Current a/c (L)		**3,600**	**N 3,000**		**7,200**
		176,400			**176,400**

You have given the following information:

1- They agreed to revaluate some assets as follows:

Goodwill LE 19,600, Buildings LE 26,400, Cars LE 22,000, Equipment LE 16,000, provision for doubtful debts need to be doubled, A received letter from the bank informing that the actual balance should be LE 67,620.

2- Books confirmed that rights of the retired partner were:

* his share in the profits from 1/1/03 to 30/6/03 is LE 2,000.

* interest on capital is LE 900.

* accrued salaries are LE 800.

3- Payment for the retired partner was made through two ways, first half by cheque, while the second half by a loan that will be paid during the next two years.

Required:

1- Record the above events in the partnership books.

2- Prepare the Revaluation P&L a/c, the Capital a/c, Partners' Current a/c, and the Retired Partner a/c.

3- Prepare the Balance Sheet after this agreement.

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2- A, B, and C are partners in a partnership. They are sharing profit and loss equally. The following is their B/S as on 30/9/2004:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Cars		**10,000**	**A**	**28,000**	
Equipment		**16,000**	**B**	**28,000**	
Current Assets			**C**	**28,000**	**84,000**
Goods		**18,000**			
A / R	**30,000**		**A/P**		**7,000**
(-) Pro. for d. d.	**4,000**	**26,000**	**P/L App. A/c**		**9,000**
Bank		**30.000**			
		100,000			**100,000**

On the same day (30/9/2004), partner C decided to retire from the partnership. So, they revaluated some items of the B/S as follows:

Cars LE 7,000, Equipment LE 15,000, provision for doubtful debts LE 5,000, Goods 20,000. Partners A and B decided to buy the share of the retired partner (c) equally.

Required:

1- Record the above events in the partnership books according to the following assumptions:

- Partners A and B pay for the retired partner C through their own money in the bank account of the partnership.

- Partners A and B pay for the retired partner C through their own money outside the partnership.

2- Prepare the Balance Sheet after this agreement for each of the above two cases.

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CHAPTER SEVEN

Liquidation of a Partnership

7.1 Introduction:

Liquidation can mean the termination of a partnership's business activities. Practically, several reasons may be behind the liquidated of partnerships. For instance, its original agreed-upon term of existence has expired, it is marginally profitable, or it is in serious financial difficulty.

Generally, in the liquidation process, the partnership is a "quitting concern" not a "going concern", meaning that income statements are not prepared for periods in which an entity is liquidating; so there is no need to match asset costs into the proper time period, and also all assets and liabilities become current.

In many respects, liquidation process for partnerships is identical to the liquidation process for corporations. For example, over a period of time, all assets (with the exception of cash assets) are transformed into cash, creditors are paid to the extent possible, and any remaining funds, if any, are distributed to the partners or owners.

However, liquidation in the partnership form of business differs from that of corporate in some respects. For instance, as a result of the unlimited liability in the partnership form of business, any partner may be required to contribute additional funds to the partnership if its assets are insufficient to satisfy liabilities or creditors' claims.

7.2 Reasons behind Liquidations:

There are several reasons behind the liquidation or dissolution of partnerships. The most important reasons might be:

1- The arrival at the end of the specified period in the partnership agreement;

2- Finishing of the main purpose of the partnership;

3- The bankruptcy or insolvency of one or more partners in the partnership;

4- Legal liquidation or dissolution (court statement);

5- The willingness of the partners to liquidate or dissolve the partnership;

6- Death, long disappearance, or the retirement of one or more partners[2];

7- the merger of the partnership in other enterprise.

In the light of the above reasons, we can conclude that: although there are some reasons under the control of partners, other reasons are out of the partners' control. This means that there are certain circumstances, if happen, the partnership is liquidated or dissolved whatever the desire of the partners may be.

7.3 Types of Liquidations:

Practically, two main types of liquidations can be categorized. These types are lump-sum liquidation (quick liquidation) and instalment liquidations.

7.3.1 Lump-sum Liquidation:

In lump-sum liquidations, all items in the B/S are to be ended and accounts are to be closed. No distributions are made to one or more partners until the realization process is completed when the full amount of the realization gain or loss is known. In other words, the sale process of non-cash assets will be achieved on one or several times but during a short period of time.

[2] Note: In some cases partners may agree that the partnership is being continued in the business.

7.3.2 Instalment Liquidation:

In instalment liquidations, distributions are made to some or all of the partners as cash becomes available. So, cash distributions are made to partners before the full amount of the realization gain or loss is known. In other words, the sale process of non-cash assets will be achieved on several times during different periods of time. Within each category, a variety of situations may arise concerning the ability of the partnership and the individual partners to satisfy the claims of partnership creditors.

7.4 Liquidation Procedures & Payment Priority:

When the liquidation decision - whether mandatory or voluntary - is been taken, some procedures should be followed. These procedures start with the appointment of a person who will be responsible for the completion of the liquidation process. This person is called the “syndic” or the “liquidator”. After the appointment of the syndic, managers loss their authorities and the syndic become a representative of partners and the partnership. It is possible that a partner or a manager to become responsible for the liquidation process instead of the appointment of outsider syndic.

As a responsible for the liquidation process, the syndic will start with all legal procedures needed for liquidation and the opening of the needed liquidation accounts. Furthermore, he starts to sell off the non-cash assets and collect other balances such as the A/R and the N/R. Also, he pays for liabilities such as the A/P, the N/P, and accrued expenses. The next step is to calculate the final result of the liquidation and distribute any remaining money to partners using the P/L sharing ratio.

Certain costs incurred during the liquidation process should be treated as a reduction of the proceeds from the sale of non-cash assets—for example, sales commissions and shipping costs related to the disposal of inventory, and costs of removing equipment, either liquidation costs should be treated as expenses. Making a reasonable estimate of these expenses at the beginning of the liquidation process and recording an estimated liability in the general ledger at that time are preferable, adjusting the liability as necessary during the liquidation process.

When finishing the liquidation process, the syndic should prepare a detailed sheet that includes all details about liquidation operations such as liquidation detailed expenses, selling the non-cash assets and collecting money. Such sheet will be presented to partners and may be to some governmental bodies.

After completing the sale of non-cash assets and collecting money from A/R, N/R, and other similar accounts, the syndic now is ready to make payment needed to finish the liquidation process. He or she must follow certain priority in the payment. This priority is legally supported. To follow this priority is the most important duty of syndic.

Syndic is asked to respect the following priority:

1- Liquidation expenses including the syndic fee and any expenses resulting from the completion of liquidation;

2- Taxes and amounts due to the state or any other governmental bodies; salaries & wages due to workers and employees with a maximum of 6 months; rent with a maximum of 2 years;

3- Mortgage loans in accordance with its priority;

4- Ordinary debts;

6- Amounts due to one or more partners;

5- Any remaining money should be distributed to partners according to the profit and loss sharing ratio.

7.5 Liquidation Accounts:

To complete the liquidation process, it is necessary to prepare some accounts. One of the most important accounts needed for liquidation is "Liquidation Account". In addition to the above main account, there are some possible accounts - such as Bank account, Cash account, Partners' Current account, Capital account - which can be prepared too.

7.5.1 Liquidation Account:

"Liquidation account" can be considered as a final account of the liquidation process to show the final result of selling the various non-cash assets in the partnership. Here, the liquidation account may play the same role as the Profit & Loss account. In other way, it may play the same role as the Trading account. In the latter case, the liquidation account is debited with book values of all non-cash assets and is credited with sales values of these non-cash assets.

It should be noted that the result in each of the above two ways - the liquidation account as a Trading account or as a Profit & Loss account - would be the same. In the following pages, more detailed explanation will be given regarding the above two ways of the preparation of liquidation account:

7.5.1.1 Liquidation Account as a Trading Account:

When preparing the Liquidation account as a Trading account, it should be debited with the book value of non-cash assets of the partnership at the date of liquidation, while it should be credited with money collected from the sale of these assets whether in total or in details. In addition to the above, this account should be debited with the liquidation expenses as well. It should be noted that assets shown in the debit side of the account must be in the net value (after deducting related accumulated depreciations or other provisions).

In more details, the liquidation account is debited with:

1- The book value of non-cash assets using the following journal entry:

Date	Details	Dr.	Cr.
	By Liquidation a/c	**xx**	
	To Sundries		
	Land		**xx**
	Equipment		**xx**
	Buildings		**xx**
	Goods		**xx**
	A/R		**xx**
	N/R		**xx**
	Goodwill		**xx**

Remember: in addition to the above assets, others such as Cash account and Bank account are not shown in the liquidation account. Also, the balances of both losses and Partners' Current account are not shown in the account because they are closed in the Capital account using the profit and loss sharing ratio.

2- The Liquidation Expenses:

These expenses include the syndic or liquidator fees and any other expenses related to the completion of the liquidation process such as the court fees and other fees paid to various governmental bodies. Such expenses might be recorded using the following journal entry:

Date	Details	Dr.	Cr.
	By Liquidation a/c	**xx**	
	To Bank a/c		**xx**
	(Liquidation expenses)		

3- Other losses or expenses related to liquidation such as compensations. Also, such losses or expenses can be recorded using the following journal entry:

Date	Details	Dr.	Cr.
	By Liquidation a/c **To Bank a/c** **(Liquidation compensations)**	**xx**	 **xx**

The same account will be credited with the following:

1- Money collected from the sale of assets and from the collection of A/R and N/R. This is recorded by the following journal entry:

Date	Details	Dr.	Cr.
	By Bank a/c **To Liquidation a/c**	**xx**	 **xx**

2- Assets taken by one or more partners:

Date	Details	Dr.	Cr.
	By Capital a/c (A) **To Liquidation a/c** **(Liquidation expenses)**	**xx**	 **xx**

3- Accumulated depreciation of fixed assets and other provisions (Note that this item is shown only when we record the fixed assets in the other side of the account by the gross value). Such depreciation or provisions can be recorded using the following journal entry:

Date	Details	Dr.	Cr.
	By Sundries		
	Cars Depreciation a/c	**xx**	
	Buildings Depreciation a/c	**xx**	
	Provision of for Doubtful Debts	**xx**	
	To Liquidation a/c		**xx**

4- Other revenues related to the liquidation process:

Date	Details	Dr.	Cr.
	By Bank a/c	**xx**	
	To Liquidation a/c		**Xx**

5- Disclaims from the creditors or A/P:

Date	Details	Dr.	Cr.
	By A/P a/c	**Xx**	
	To Liquidation a/c		**Xx**

Finally, the Liquidation account might be shown as follow:

Dr. Liquidation Account Cr.

To:		**By:**	
-Land a/c	**xx**	**-Bank a/c (sale value)**	**xx**
-Furniture a/c	**xx**	**-Capital a/c (value of assets**	
-Buildings a/c	**xx**	**taken by partners)**	**xx**
-Goods a/c	**xx**	**-Depreciations**	**xx**
-A/R a/c	**xx**	**(fixed assets)**	
-N/R a/c	**xx**	**-Provisions**	**xx**
-Bank a/c (Liq. expense)	**xx**	**-A/P (Disclaims)**	**xx**
-Bank a/c (Compensations)	**xx**		
-Capital a/c (Liquidation profit)	**xx**	**-Capital a/c (Liquidation loss)**	**xx**
A xx		**A xx**	
B xx		**B xx**	
	xx		**xx**

7.5.1.2 Liquidation Account as a P & L Account:

It is possible to prepare the Liquidation account as a P/L account. In this case, the aim of liquidation account (To show the result of liquidation process) is the same as that of the last case (Liquidation account as a trading account). The liquidation account as a P/L account is nearly similar to the above one (the liquidation account as trading account).

However, the main difference between the two ways for preparing the account is that the liquidation account as a P/L account does not show the book values of non-cash assets and their sale value, but it shows the profits or losses of selling each asset. Therefore, losses resulting from the sale of one or more assets should be in the debit side of the account. This needs the opening of a separate account for each asset of the non-cash assets to calculate the related loss or profit. Also, this account is been debited with liquidation expenses and other liabilities or losses discovered at the liquidation time. On the other hand, it should be credited with any profits resulted from the sale of asset(s). In addition to the above, this account should be credited with accumulated depreciations or other provisions and also with disclaims from debtors or A/R.

Finally, the Liquidation account might be shown as follow:

Dr. Liquidation Account Cr.

Losses:		**Profits:**	
-Land a/c	**xx**	**-Cars a/c**	**xx**
-Buildings a/c	**xx**	**-Securities**	**xx**
-A/R a/c	**xx**	**-Depreciations (of fixed assets**	
-Bank a/c (Liq. expense)	**xx**	**if not deducted)**	**xx**
-Bank a/c (Compensations)	**xx**	**-Provisions**	**xx**
		-A/P (Disclaims)	**xx**
-Capital a/c (Liquidation profit)	**xx**	**-Capital a/c (Liquidation loss)**	
A xx		**A xx**	
B xx		**B xx**	
	xx		**xx**

In addition to the liquidation account, some other accounts need to be prepared such as bank a/c, Capital a/c, Partners' Current a/c, …. etc. These accounts are prepared in the normal way. The following example of one of these accounts, Bank a/c, in more details.

7.5.2 Bank Account:

prepared during the liquidation process. This account represents the movement of money resulting from liquidation process whether payments or collection.

The debit side of this account shows:

1- Cash balance (cash a/c or bank a/c) at the liquidation time;

2- Money collected from the sale or collection of non-cash assets;

3- Any payments by one or more partners.

While the credit side shows:

1- Liquidation expenses and any expenses resulting from the completion of liquidation;

2- Taxes and amounts due to the state or any other governmental bodies; salaries & wages due to workers and employees with a maximum of 6 months; rent with a maximum of 2 years;

3- Mortgage loans in accordance with its priority;

4- Ordinary debts;

6- Amounts due to one or more partners;

5- Any remaining money should be distributed to partners according to the profit and loss sharing ratio.

Dr. Bank Account Cr.

-Balance	**xx**		
To:		**By:**	
-Liquidation a/c (Land)	**xx**	**-Liq. a/c (liq. expense)**	**xx**
-Liquidation a/c (Furniture)	**xx**	**-A/P**	**xx**
-Liquidation a/c (Buildings)	**xx**	**-N/P**	**xx**
-Liquidation a/c (Goods)	**xx**	**-Loans**	**xx**
-Liquidation a/c (A/R)	**xx**		
-Capital a/c	**xx**	**-Capital a/c**	**xx**
A xx		**A xx**	
B xx		**B xx**	
	xx		**xx**

7.6 Results of Liquidation:

The completion of the liquidation process will show the final result of the liquidation. This result might be one of the following:

1- The liquidation result is profit;

2- The liquidation result is loss that is less than the total capital of the partnership;

3- The liquidation result is loss that is more than the total capital of the partnership and all general partners are solvent;

4- The liquidation result is loss that is more than the total capital of the partnership and there are at least one or more general partners who are solvent;

5- The liquidation result is loss that is more than the total capital of the partnership and all general partners are insolvent.

The following examples will give the reader more explanation regarding each of the above cases of the liquidation results:

1- The liquidation result is profit:

In such case, the liquidation process realises some profits. Therefore, partners will receive more than their shares in the partnership. This means that they will receive their original shares in addition to their shares in profits resulting from the liquidation.

Example 7.1

Maha and Mai are partners in a partnership. The profit and loss sharing ratio is 1:1. On 31/12/2003, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
-Equipment	**6,000**		**A**	**15,000**	
-Buildings	**9,000**		**B**	**15,000**	**30,000**
-Furniture	**3,000**				
-Cars	**6,000**	**24,000**	**A/P**		**30,000**
Current Assets			**N/P**		**15,000**
-Goods	**10,800**		**B's Loan**		**9,000**
-A / R	**44,400**		**B's Current account**		**1,500**
(-) Pro. for doubtful d.	**(2,400)**				
	42,000				
-Bank	**4,200**				
-A's Current account	**1,200**				
-Losses	**3,300**	**61,500**			
		85,500			**85,500**

You have given the following information:

1- All assets (with the exception of furniture) were sold at LE 39,900;

2- A/R were collected with the exception of LE 300.

3- Partner A got the furniture at LE 2,100.

4- A/P disclaimed LE 960.

5- Liquidation expenses were LE 900.

6- Liabilities and partners' shares were paid in cash.

Required:

1- Record the above events in the partnership books.

2- Prepare the liquidation accounts.

Solution:

Date	Details	Dr.	Cr.
31/12/03	By Liquidation a/c	79,200	
	To Sundries		
	Equipment a/c		6,000
	Buildings a/c		9,000
	Furniture a/c		3,000
	Cars a/c		6,000
	Goods a/c		10,800
	A/R		44,400
	To close the non-cash assets.		
31/12/03	By Provision of D. D., a/c	2,400	
	To Liquidation a/c		2,400
	To close the provision of D.D a/c.		
31/12/03	By Bank a/c	84,000	
	To Liquidation a/c		84,000
	To record the sale of non-cash assets.		
31/12/03	By Liquidation a/c	960	
	To Bank a/c		960
	To record the payment of liquidation expenses.		
31/12/03	By Capital a/c (A)	2,100	
	To Liquidation a/c		2,100
	To record the furniture taken by partner A.		
31/12/03	By A/P a/c	30,000	
	To Sundries		
	Liquidation a/c		960
	Bank a/c		29,400
	To record payment to A/P after having disclaim of LE 960.		
31/12/03	By Liquidation a/c	9,360	
	To Capital a/c		9,360
	A 4,680		
	B 4,680		
	To record liquidation profits.		

Date	Details	Dr.	Cr.
31/12/03	**By N/P a/c** **To Bank a/c** **To record payment for A/P.**	**15,000**	 **15,000**
31/12/03	**By B's loan a/c** **To Bank a/c** **To record payments for B's loan.**	**9,000**	 **9,000**
31/12/03	**By Capital a/c (A)** **To Partners' Current a/c (A)** **To close the debit current account in the capital account.**	**1,200**	 **1,200**
31/12/03	**By Partners' Current a/c (B)** **To Capital a/c (B)** **To close the credit current account in the capital account.**	**1,500**	 **1,500**
31/12/03	**By Capital a/c** **A 1,650** **B 1,650** **To Loss a/c** **Distribution of loss.**	**3,300**	 **3,300**
31/12/03	**By Capital a/c** **A 14,730** **B 19,530** **To Bank a/c** **Payments of the final settlement to partners.**	**34,260**	 **34,260**

Dr. Liquidation Account Cr.

To:		**By:**	
-Equipment a/c	**6,000**	**-Bank a/c (sale value)**	
-Buildings a/c	**9,000**	**-Capital a/c (A)**	**84,000**
-Furniture a/c	**3,000**	**(fixed assets)**	
-Cars	**6,000**	**-Provisions for D.D.**	**2,100**
-Goods a/c	**10,800**	**-A/P (Disclaims)**	**2,400**
-A/R a/c	**44,400**		**960**
-Bank a/c (Liq. expense)	**900**		
-Capital a/c (Liquidation profit)			
A 4,680	**9,360**		
B 4,680			
	89,460		**89,460**

Dr. Bank Account Cr.

-Balance	**4,200**	**-Liq. a/c (liq. expense)**	**900**
-Liquidation a/c (various assets)	**84,000**	**-A/P**	**29,040**
		-N/P	**15,000**
		-B's Loan	**9,000**
		-Capital a/c	**34,260**
		A 14,730	
		B 19,530	
	88,200		**88,200**

Dr. B's Loan A/C Cr.

To Bank a/c	**9,000**	**Balance**	**9,000**
	9,000		**9,000**

Dr. Partners' Current A/C Cr.

	A	B		A	B
Balance	**1,200**		**Balance**		**1,500**
To Capital a/c		**1,500**	**By Capital**	**1,200**	
	1,200	**1,500**		**1,200**	**1,500**

Dr. Capital A/C Cr.

	A	B		A	B
P. current a/c	**1,200**		**Balance**	**15,000**	**15,000**
Loss a/c	**1,650**	**1,650**	**P. current a/c**		**1,500**
Liquidation a/c	**2,100**		**Liquidation a/c (liq. profits)**	**4,680**	**4,680**
Bank a/c	**14,730**	**19.530**			
	19,680	**21,180**		**19,860**	**21,180**

<u>2- The Liquidation Result is Loss that is Less than the Total Capital of the Partnership:</u>

In this case, it is supposed that the liquidation result is loss which is less than partners' shares. Here, each partner will receive his share, but it is an incomplete share. The shortage in each share represents the partner's share in the liquidation losses.

Example 7.2

A, B and C are partners in a limited partnership. The profit and loss sharing ratio is 4:3:3 respectively. On 31/12/2003, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

-Goodwill		**60,000**	**Capital a/c**		
Fixed Assets			**A**	**120,000**	
-Land	**112,000**		**B**	**120,000**	
-Furniture	**36,000**		**C (Limited partner)**	**80,000**	**320,000**
-Cars	**26,000**	**174,000**			
Current Assets			**A/P**		**44,000**
-Goods	**74,000**		**A's Current a/c**		**24,000**
-A / R	**60,000**		**Accrued exp.**		**2,000**
-Bank	**10,000**	**144,000**			
-C's Current a/c		**12,000**			
		390,000			**390,000**

You have given the following information:

1- land, furniture and cars were sold at LE 94,000.

2- A/R were collected with the exception of L 6,000.

3- Partner A got the goods at the book value.

4- Liquidation expenses were LE 16,000.

5- The accrued expense is workers' wages for the last four months before the liquidation.

6- The syndic paid liabilities and partners' shares in cash.

Required:

1- The needed journal entries.

2- Prepare the liquidation accounts.

Solution

Date	Details	Dr.	Cr.
31/12/03	By Liquidation a/c	368,000	
	To Sundries		
	Land a/c		112,000
	Furniture a/c		36,000
	Cars a/c		26,000
	Goodwill a/c		60,000
	Goods a/c		74,000
	A/R		60,000
	To close the non-cash assets.		
31/12/03	By Bank a/c	54,000	
	To Liquidation a/c		54,000
	To record the collection of A/R		
31/12/03	By Bank a/c	94,000	
	To Liquidation a/c		94,000
	To record the sale of non-cash assets.		
31/12/03	By Liquidation a/c	16,000	
	To Bank a/c		16,000
	To record the payment of liquidation expenses.		
31/12/03	By Capital a/c (B)	74,000	
	To Liquidation a/c		74,000
	To record the goods taken by B.		
31/12/03	By Accrued expenses a/c	2,000	
	To Bank a/c		2,000
	To record payment of accrued expenses.		
31/12/03	By N/P a/c	44,000	
	To Bank a/c		44,000
	To record payment for A/P.		
31/12/03	By Capital a/c	162,000	
	A 64,800		
	B 48,600		
	C 48,600		
	To Liquidation a/c		162,000
	To record liquidation loss.		
31/12/03	By Capital a/c (C)	12,000	
	To Partners' Current a/c (C)		12,000
	To close C's current a/c.		

Date	Details	Dr.	Cr.
31/12/03	By Partners' Current a/c (A) To Capital a/c (A) To close the credit current account of A in the capital account.	24,000	24,000
31/12/03	By Bank a/c To Capital a/c (B) To record payment by B for the difference between his share in capital and goods.	2,600	2,600
31/12/03	By Capital a/c A 79,200 C 19,400 To Bank a/c Payments of the final settlement to partners.	98,600	98,600

Dr. Liquidation Account Cr.

To:		By:	
Land a/c	112,000	Bank a/c (sale value)	94,000
Furniture a/c	36,000	Bank a/c (A/R)	54,000
Cars a/c	26,000	Capital a/c (B) (goods)	74,000
Goodwill a/c	60,000	Capital a/c (Liq. profit)	162,000
Goods a/c	74,000	A 64,800	
A/R	60,000	B 48,600	
Bank a/c (Liq. expense)	16,000	C 48,600	
	384,000		384,000

Dr.		Bank A/C	Cr.
-Balance	**10,000**	**Liq. a/c (liq. expense)**	**16,000**
-Liquidation a/c	**94,000**	**Accrued expenses**	**2,000**
-liquidation a/c	**54,000**	**A/P**	**44,000**
-Capital a/c (B)	**2,600**	**Capital a/c**	**98,600**
		A 79,200	
		C 19,400	
	160,600		**160,600**

Dr. Partners' Current A/C Cr.

	A	B	C		A	B	C
Balance			**12000**	**Balance**	**24000**		
Capital a/c	**24000**			**Capital a/c**			**12000**
	24000		**12000**		**24000**		**12000**

Dr. Capital A/C Cr.

	A	B	C		A	B	C
P. current a/c			**12000**	**Balance**	**120000**	**120000**	**80000**
Liquidation		**74000**		**P. Current a/c**	**24000**		
Liquidation	**64800**	**48600**	**48600**	**Bank a/c**		**2600**	
Bank a/c	**79200**		**19400**				
	144000	**122600**	**80000**		**144000**	**122600**	**80000**

<u>Note:</u>

1- Accrued expenses (workers' wages LE 2,000) was paid in its order, as it was paid after the liquidation expenses (LE 16,000) but before the ordinary liabilities (LE 44,000). Workers' wages are for the last four months (less than the maximum limit of 6 months).

2- The current account of the limited partner was closed in his capital account. The final settlement for this partner was as follow: the current account is LE 12,000 + his share in the liquidation loss is LE 48.600 = LE 60,600, while his share in the capital is 80,000. Therefore, this partner will receive LE 19,400 from the bank account.

<u>3- The liquidation Result is Loss that is More than the Total Capital of the Partnership and All General Partners Are Solvent:</u>

In this case, the liquidation result is also loss and there are one or more solvent partners. In the above case, we supposed that the value of this loss is less than the total capital, but here we suppose that the value of this loss is bigger than the total capital. Here, because of the existence of solvent partner(s) all liabilities will be paid, and the syndic has the ability to pay various liabilities. It should be noted that solvent partner(s) will pay from his/their own money.

Example 7.3

S and T are partners in a partnership. The profit and loss sharing ratio is 1:1. On 31/12/203, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Buildings	**50,000**		**S**	**30,000**	
(-) Accumulated Dep.	**10,000**	**40,000**	**T**	**30,000**	**60,000**
Furniture	**12,000**				
(-) Accumulated Dep.	**2,000**	**10,000**	**A/P**		**116,000**
Goods		**50,000**	**S's Loan**		**10,000**
A / R	**12,000**	**10,000**	**T's Current Account**		**10,000**
(-) Pro. for doubtful debts	**2,000**	**34,000**			
Bank		**12,000**			
S's Current a/c		**40,000**			
Losses					
		196,000			**196,000**

You have given the following information:

1- The syndic collected LE 90,000 through the sale of assets and the collection of A/R;

2- A/P disclaimed LE 4,000.

5- Liquidation expenses were LE 2,000.

Required:

1- The needed journal entries.

2- Prepare the liquidation accounts.

Solution:

Date	Details	Dr.	Cr.
31/12/03	**By Liquidation a/c**	**125,000**	
	To Sundries		
	Buildings a/c		**50,000**
	Furniture a/c		**13,000**
	Goods a/c		**50,000**
	A/R		**12,000**
	To close the non-cash assets.		
31/12/03	**By Sundries**		
	Accumulated Dep. of Buildings	**10,000**	
	Accumulated Dep. of Furniture	**3,000**	
	Provision of D. Debts a/c	**2,000**	
	To Liquidation a/c		**15,000**
	To close the provisions.		
31/12/03	**By Bank a/c**	**90,000**	
	To Liquidation a/c		**90,000**
	To record the sale of non-cash assets.		
31/12/03	**By Liquidation a/c**	**2,000**	
	To Bank a/c		**2,000**
	To record the payment of liquidation expenses.		
31/12/03	**By A/P a/c**	**116,000**	
	To Sundries		
	Liquidation a/c		**4,000**
	Bank a/c		**112,000**
	To record payment to A/P after having disclaim of LE 4,000.		
31/12/03	**By Capital a/c**	**18,000**	
	S 9,000		
	T 9,000		
	To Liquidation a/c		**18,000**
	To record liquidation loss.		

Date	Details	Dr.	Cr.
31/12/03	By Capital a/c (S) To Partners' Current a/c (S) To close the debit current account in the capital account.	12,000	12,000
31/12/03	By Partners' Current a/c (T) To Capital a/c (T) To close the credit current account in the capital account.	10,000	10,000
31/12/03	By Capital a/c S 20,000 T 20,000 To Loss a/c Distribution of loss.	40,000	40,000
31/12/03	By S's Loan To Capital a/c (S) To close the loan of partner S in his capital account.	10,000	10,000
31/12/03	By Bank a/c To Capital a/c (S) Payment by S for the final settlement.	1,000	1,000
31/12/03	By Capital a/c (T) To Bank a/c Payments of the final settlement to partner (T).	11,000	11,000

Dr. Liquidation Account Cr.

To:		**By:**	
Buildings a/c	**50,000**	**Accumulated Dep. of Buildings**	**10,000**
Furniture a/c	**13,000**	**Accumulated Dep. of Furniture**	**3,000**
Goods a/c	**50,000**	**Provision of D. Debts a/c**	**2,000**
A/R	**12,000**	**Bank a/c (sale value)**	**90,000**
Bank a/c (Liq. expense)	**2000**	**A/P (Disclaims)**	**4,000**
		Capital a/c (Liquidation loss)	**18,000**
		S 9,000	
		T 9,000	
	127,000		**127,000**

Dr. Bank Account Cr.

-Balance	**34,000**	**Liq. a/c (liq. expense)**	**2,000**
Liquidation a/c (various assets)	**90,000**	**A/P**	**112,000**
Capital a/c (S)	**1,000**	**Capital a/c (T)**	**11,000**
	125,000		**125,000**

Dr. Partners' Current A/C Cr.

	S	**T**		**S**	**T**
Balance	**12,000**		**Balance**		**10,000**
To Capital a/c		**10,000**	**By Capital**	**12,000**	
	12,000	**10,000**		**12,000**	**10,000**

Dr. Capital A/C Cr.

	S	T			S	T
Loss a/c	**20,000**	**20,000**		**Balance**	**30,000**	**30,000**
Liquidation a/c	**9,000**	**9,000**		**P. current a/c**		**10,000**
P. current a/c	**12,000**			**S's loan**	**10,000**	
Bank a/c		**11,000**		**Bank a/c**	**1,000**	
	41,000	**40,000**			**41,000**	**40,000**

Note:

1- As a result of the liquidation process, there is a debit balance of the capital account of partner S. This debit balance is LE 11,000 (the total of debit side LE 41,000 – the capital balance LE 30,000). Therefore, partner S is asked to pay LE 1,000 as he already has a loan of LE 10,000. Also, because of the solvency of partner S he was able to pay LE 1,000.

2- The remaining money in the bank is equal to what is needed for partner T.

4- The liquidation result is loss that is more than the total capital of the partnership and there are at least one or more general partners who are solvent.

5- The liquidation result is loss that is more than the total capital of the partnership and all general partners are insolvent.

Exercises:

1- M and N are partners in a partnership. The profit and loss sharing ratio is 1:1. On 1/1/2004, they decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
-Land	**10,000**		**M**	**30,000**	
-Buildings	**14,000**		**N**	**30,000**	**60,000**
-Machines	**6,000**				
-Cars	**18,000**	**48,000**	**A/P**		**60,000**
Current Assets			**N/P**		**30,000**
-Goods	**21,600**		**N's Loan**		**18,000**
-A / R	**88,800**		**N's Current account**		**3,000**
(-) Pro. for doubtful d.	**(4,800)**				
	84,000				
-Bank	**8,400**				
-M's Current account	**2,400**				
-Losses	**6,600**	**123,000**			
		171,000			**171,000**

You have given the following information:

1- Non-cash assets (with the exception of machines) were sold at LE 79,800;

2- A/R were collected with the exception of LE 600.

3- Partner A got the machines at LE 4,200.

4- A/P disclaimed LE 1920.

5- Liquidation expenses were LE 1,800.

6- Liabilities and partners' shares were paid in cash.

Required: 1- The necessary journal entries.

2- Liquidation accounts.

2- Ahmed, Amr and Amged are partners in a limited partnership. The profit and loss sharing ratio is 4:3:3 respectively. On 30/6/2004, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

-Goodwill		**80,000**	**Capital a/c**		
Fixed Assets			**Ahmed**	**240,000**	
-Land	**164,000**		**Amr**	**240,000**	
-Machines	**112,000**		**Amged (Limited partner)**	**160,000**	**640,000**
-Cars	**72,000**	**348,000**			
Current Assets			**A/P**		**48,000**
-Goods	**128,000**		**Ahmed's Current a/c**		**48,000**
-A / R	**140,000**		**Accrued exp.**		**4,000**
-Bank	**20,000**	**288,000**			
Amged's Current a/c		**24,000**			
		740,000			**740,000**

You have given the following information:

1- land, machines and cars were sold at LE 188,000;

2- A/R were collected with the exception of L 12,000.

3- Partner A got the goods at the book value, while the market value was LE 155,000.

4- Liquidation expenses were LE 32,000.

5- The accrued expense is workers' wages for the last six months before the liquidation.

6- The syndic paid liabilities and partners' shares in cash.

Required:

1- The needed journal entries.

2- Prepare the liquidation accounts.

3- Anwer and Ragab are partners in a partnership. The profit and loss sharing ratio is 1:1. On 31/12/2000, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Machines	**150,000**		**Anwer**	**90,000**	
(-) Accumulated Dep.	**30,000**	**120,000**	**Ragab**	**90,000**	**180,000**
Cars	**36,000**				
(-) Accumulated Dep.	**6,000**	**30,000**	**A/P**		**348,000**
Goods		**150,000**	**Anwer's Loan**		**30,000**
A / R	**36,000**		**Ragab's C. Account**		**30,000**
(-) Pro. for doubtful debts	**6,000**	**30,000**			
Bank		**102,000**			
Anwer's Current a/c		**36,000**			
Losses		**120,000**			
		588,000			**588,000**

You have given the following information:

1- The syndic collected LE 270,000 through the sale of assets and the collection of A/R;

2- A/P disclaimed LE 12,000.

5- Liquidation expenses were LE 6,000.

Required:

1- The needed journal entries.

2- Prepare the liquidation accounts.

4- Hafez and Mokhtar are partners in a partnership. The profit and loss sharing ratio is 1:1. On 31/12/2000, partners decided to dissolve and liquidate the partnership. The following is the B/S of their partnership as on that date:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Machines	**150,000**		**H**	**90,000**	
(-) Accumulated Dep.	**30,000**	**120,000**	**M**	**90,000**	**180,000**
Cars	**36,000**				
(-) Accumulated Dep.	**6,000**	**30,000**	**A/P**		**348,000**
Goods		**150,000**	**H's Loan**		**30,000**
A / R	**36,000**		**M's C. Account**		**30,000**
(-) Pro. for doubtful debts	**6,000**	**30,000**			
Bank		**102,000**			
H's Current a/c		**36,000**			
Losses		**120,000**			
		588,000			**588,000**

You have given the following information:

1- The syndic collected LE 340,000 through the sale of assets and the collection of A/R;

2- A/P disclaimed LE 12,000.

5- Liquidation expenses were LE 6,000.

Required:

1- The needed journal entries.

2- Prepare the liquidation accounts.

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