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Lectures in

Accounting for Partnerships

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IN THE NAME OF ALLAH, THE MOST GRACIOUS, THE MOST MERCIFUL

THIS TEXTBOOK IS DEDICATED TO
THE MEMORY OF MY FATHER AND MY MOTHER
&
MY WIFE AND MY CHILDREN

Preface:

I sincerely thank Almighty ALLAH who gave me 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 the nature of partnerships form of organizations and Formation of partnership, while the second one focuses on partners' accounts and operations of a partnership. Chapter three is dealing with partnerships' capital modifications. Chapter four concentrates on the admission of a new partner. Retirement or withdrawal of a Partner and liquidation of a partnership are the interest of the last two chapters, chapter five and chapter six.

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

CHAPTER ONE

THE NATURE OF PARTNERSHIPS

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1.1 Partnerships:

Generally, a ***partnership*** is an ungrouped or unincorporated business owned by two or more ***partners***. It is a contractual association of more than one person. A ***partner*** may be either an individual (person) or a corporation.

A partnership is defined as an *"association of two or more persons to carry on as co-owners a business for profit"* (Baker, Lembke and King, 2005) This definition includes three distinct factors:

1. *Association of two or more persons*. The ***persons*** are usually individuals; however, they could be corporations or other partnerships.

2. *To carry on as co-owners.* A partnership is an aggregation of partners' individual rights. This means that all partners are co-owners of partnership property and are co-owners of the profits or losses of the partnership.

3. *Business for profit.* A partnership may be formed to perform any legal business' trade, profession, or other service. Nevertheless, the partnership must attempt to make a profit; hence, not-for-profit organizations, such as fraternal or brotherly groups (societies), may not be partnership.

In practice, partnerships are the least common form of business organization, maybe because they often end of or wind up with *too many bosses*. Nevertheless, they are widely used for professional practices, such as medicine, law, and public accounting. Furthermore, partnerships also are used for many small businesses, especially those which are family-owned.

For accounting purposes, a partnership is viewed as an entity separate from the other activities of its owners. But under the law, the partnership is not ***"separate"*** from its owners. Rather, the law regards the partners as personally ***and jointly*** responsible for the activities of the business. The assets of a partnership do not belong ***"to the business***. Rather, they belong jointly to all of the partners. Unless special provisions are made, each partner has unlimited personal liability for the debts of the business. From a legal standpoint, partnerships have ***limited lives***. A partnership ends upon the withdrawal or death of an existing partner. Admission of a new partner terminates the ***old*** partnership and creates a new legal entity.

Nevertheless, this is only a legal distinction or difference. Most partnerships have ***continuity of existence*** extending beyond the participation of individual partners. Partnership agreements often have provisions that make the retirements of partners and the admission of new partners' ***routine events*** that do not affect the operations of the business (Meigs, et al., 1996).

1.2 Formation of a Partnership:

A chief advantage of the partnership form of entity is ease of formation. Accordingly, the agreement to form a partnership may be as informal as a handshake or as formal as a several-paged agreement typically termed the ***articles of co-partnership***. Each partner must agree to the formation agreement, and partners are strongly advised to have a formal written agreement to avoid potential problems that may arise or emerge during the operation of the business. The articles of co-partnership should include the following items (Larsen, 2000; Baker, Lembke and King, 2005):

1) The name of the partnership and the names of the partners.

2) The type of business to be conducted by the partnership and the duration of the partnership agreement.

3) The initial capital contribution of each partner and the method by which to account for future capital contributions. The procedure for valuing noncash investments and the penalties for a partner's failure to invest and maintain the agreed amount of capital.

4) A complete specification of the profit or loss distribution, including salaries, interest on capital balances, bonuses, limits on withdrawals in anticipation of profits, and the percentages used to distribute any residual profit or loss

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

6) Other aspects of operations the partners decide on, such as the management rights of each partner, election procedures, and accounting methods.

7) Insurance on the lives of partners, with the partnership or surviving partners named as beneficiaries.

8) Provision for liquidation of the partnership at the end of the term specified in the contract or at the death or retirement of a partner.

Each partner should sign the partnership agreement to indicate acceptance of the terms. A carefully prepared partnership agreement can eliminate many of the more common types of problems and disputes that may arise in the partnership's future operations.

1.3 Major Characteristics of Partnerships:

Actually, partnerships have several features or characteristics that distinguish them from other forms of business organizations.

1.3.1 Limited Life:

A partnership legally terminates as a business entity each time there is a change in membership. This legal termination is called ***"dissolution of the partnership."*** Most partnerships encompass provisions in their articles of copartnership 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. The most common causes of partnership's dissolution are the death, retirement, bankruptcy, or incapacity of a partner. As mentioned in the previous sections, the admission of a new partner to the partnership legally ***dissolves*** the former partnership and establishes a new one.

1.3.2 Ease of Formation:

In contrast with a corporation, partnership may be created by an oral or a written contract between two or more persons, or may be ***implied by their conduct***. This advantage of convenience and minimum cost of formation of a partnership in some cases may be offset by certain difficulties inherent in such an informal organizational structure.

1.3.3 Co-Ownership of Partnership Assets and Earnings:

When individuals invest assets in a partnership, they retain no claim to those specific assets but acquire ownership ***equity in net assets*** of the partnership. Every member of a partnership also has an interest in partnership earnings; in fact, participation in earnings and losses is one of the tests of the existence of a partnership.

1.3.4 Agency Relationship (Mutual Agency):

As mentioned above, each partner is a co-owner of the partnership assets and liabilities. So, creditors view each partner as an agent of the partnership capable of transacting business in the partnership's name. consequently, any partner can bind or oblige the partnership when acting within the scope of the partnership activities. for example, partner ***A*** can sign a lease in the partnership name even though the articles of co-partnership specify that only partner ***B*** may sign leases. The partnership is still bound by the lease because the other party to the lease can assume or commit mutual agency of each partner. Any legal remedy is strictly between partners ***A*** and ***B***.

Accordingly, each partner has the authority to act for the partnership and to enter into contracts on its behalf. However, acts beyond the normal scope of business operations, such as the obtaining of a bank loan by a partner, generally do not bind the partnership unless specific authority has been given to the partner to enter into such transactions.

1.3.5 Unlimited Liability:

Since partnerships are not incorporated, all partners in a ***general partnership*** (شركة التضامن) have unlimited liability. In the event the partnership fails and its assets are not sufficient to pay its liabilities, partnership creditors may take recourse by obtaining liens (حق الحجز) or attachments (حجز أو مصادرة) against the personal assets of any or all of the partners. 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 an investor's ultimate loss is limited to the amount invested in the corporation's stock.

Several persons view unlimited liability as the major disadvantage of the partnership form of business. For this reason, sometimes people become ***limited partners*** (***silent partners*** ***شريك موصي***) in a ***limited partnership*** (***simple bequest***

partnership* شركة توصية بسيطة**). The liability of *limited partners* is limited to the amount of their investment, but they are restricted as to the types of management acts they may perform. They cannot actively participate in the management of the partnership, but their personal assets are not placed in jeopardy (legal risk) as a result of their membership. *Limited partners* must be identified as such to creditors and others doing business with the partnership. All partnerships must have at least one ***general or ordinary partner (**شريك متضامن**) whose liability is not limited.

1.4 Types of Partnerships:

It was discussed that a partnership is an unincorporated business owned by two or more *partners*. A partnership often is referred to as a **firm, enterprise, company, and so on.**

Practically and in order to satisfy the various needs of different groups of investors interested in the investment fields, different types of partnerships have been developed. The term ***partnership*** actually includes three distinct types of organizations: *general partnerships, limited partnerships, and limited liability partnerships* (Meigs, 1996; Larsen, 2000; and Baker, Lembke, and King, 2005).

1.4.1 General Partnerships:

The *general partnership* is the traditional form of partnership, in which ***all*** partners have unlimited personal liability for unpaid debts of the partnership. In a **general partnership**, each partner has rights and responsibilities similar to those of a sole proprietor. For instance, each ***general partner*** can withdraw cash and many other assets from the business at will, except real estate, as title to real estate is held in the name of the partnership and, accordingly, cannot be sold or withdrawn by any partner at will.

Furthermore, each partner has the full ***"authority of an owner"*** to negotiate contracts binding upon the business. This concept is called *mutual agency* (الوكالة أو المسئولية المشتركة أو التبادلية). Hence, every partner also has ***unlimited personal liability*** for the debts of the firm.

Aggregating the characteristics of unlimited personal liability and mutual agency makes a *general partnership* a potentially dangerous form of business organization. For example, assume that you enter into a general partnership with Sami Ahmed. You agree to split (distribute) profits and losses ***"50-50"***. While you are on vacation, Sami commits the partnership to a contract that it simply does not have the resources to complete. Your firm's failure to complete the contract causes large financial losses to the customer. The customer sues or appeals (يقاضي أو يرفع دعوة) your firm and is awarded a judgment of L.E.5,000,000 by the court.

Sami has few financial resources and declares personal bankruptcy (إفلاس). The holder of the judgment against your firm can hold ***you personally liable for the whole L.E.5,000,000.*** The fact that you and Sami agreed to appropriate everything ***"50-50"*** does *not* lessen or minimize your personal liability to your firm's creditors. You may have a legal claim against Sami for his half of the debt, but so what? Sami is bankrupt.

To sum up, general partnerships involve the same unlimited personal liability as sole proprietorships. Such risk is intensified, however, because you may be held financially responsible for your partner's actions, as well as for your own.

1.4.2 Partnerships That Limit Personal Liability:

The modified forms of partnerships include ***"limited"*** partnerships and ***"limited liability"*** partnerships. The purpose of these modified forms of partnerships is to ***place limits*** upon the potential liability of individual partners.

1.4.2.1 Limited Partnerships:

A ***limited partnership (شركة التوصية البسيطة)*** has one or more *"general partners"*, and also one or more *"limited partners"*. The general partners are partners in the traditional sense or meaning, with unlimited personal liability for the debts of the business, and also the right to make managerial decisions.

The **limited partners** are basically *“passive or silent partners”*. Silent or passive partners (الشركاء الموصون) share in the profits of the business, but they don’t participate actively in management and are ***not*** personally liable fore debts of the business. Thus, if the firm *“goes under”* or sinks, the losses incurred by the limited partners are ***“limited”*** to the amounts they have invested in the business.

For example, Pyramids, the professional football team, is organized as a publically owned limited partnership. This means you can easily purchase a partnership interest in the team. As one of the limited partners, you can participate in all distributions of the team’s profits. But you cannot make management decisions: You can’t hire players, send in plays, or fire the head coach. On the other hand, if the Pyramids cannot pay their bills, the team’s creditors won’t come after you.

In the past, limited partnerships were widely used for various *“investment ventures”* (الاستثمارات المغامرة أو الاستثمار بالمضاربة) such as drilling for oil, developing real estate, or making a motion picture. These businesses often lost money-at least in the early years; if they were profitable, the profits come in later years. For such ventures, the limited partnership concept had great appeal to investors. Limited partners financial risk was limited to the amount of their equity investment.

1.4.2.2 Limited Liability Partnerships:

A ***limited liability partnership (شركة أشخاص محدودة)*** is a relatively new form of business organization. Over the years, many professional partnerships have grown in size. Several public accounting firms, for example, now have thousands of partners and operate in countries all over the world. Also, lawsuits against professional firms have increased greatly in number and in pound amount. To prevent these lawsuits from bankrupting *'innocent'* partners, the concept of the limited liability partnership has emerged. In this type of partnerships, each partner has unlimited personal liability for his or her ***own*** professional activities, but not for the actions of other partners. Unlike a limited partnership, all of the partners in a limited liability partnership may participate in management of the firm.

Many public accounting and other professional services now have the letters ***LLP*** after the name of their partnership. The ***LLP*** means that the partnership is a ***limited liability partnership***. The limited liability partnership provides that the partners are not personally liable for any debt, obligation, or liability that chargeable to the partnership. Also, the partners are still liable up to the amount of their capital accounts, but their personal assets are protected from the partnership's creditors.

1.5 Accounting for the Formation of a Partnership:

At the formation of a partnership, it is necessary to assign a proper value to the noncash assets and liabilities presented or contributed by the partners. Practically, an item contributed by a partner becomes partnership property co-owned by all partners. As a result, the partnership must clearly and sharply distinguish between capital contributions and loans made to the partnership by individual partners. Legally, loan arrangements should be evidenced by promissory notes or other legal documents necessary to show that a loan arrangement exists between the partnership and an individual partner.

The provided or contributed assets should be valued at their fair values, which may require appraisals or other valuation techniques. Liabilities born or assumed by the partnership should be valued at the present value of the remaining cash flows.

Of course, the individual partners must agree to the percentage of equity that each will have in the net assets of the partnership. In general, the capital balance is determined by the proportionate share of each partner's capital contribution. For example, if ***A*** contributes 60% of the net assets in a partnership with ***B***, then ***A*** will have a 60 percent capital share and ***B*** will have a 40 percent capital share.

In recognition of intangible factors, such as a partner's special expertise or necessary business connections, however, partners may agree to any proportional division of capital. Therefore, before recording the initial capital contribution, all partners must agree on the valuation of the net assets and on each partner's capital share.

In the real world, when a partner contributes his or her capital share, he/she may introduce cash amount, cash and other assets, or a sole proprietorship (both assets and liabilities).

Illustration of Accounting for Partnership Formation:

As discussed previously, accounting in a partnership is similar to that in a sole proprietorship, except that separate capital accounts are maintained for each partner. These capital accounts show for each partner the amounts invested, the amounts withdrawn, and the appropriate share of partnership net income. Hence, each partner is provided with a history of his or her equity in the firm.

Separate drawing accounts also are maintained for each partner. These drawing accounts are debited to record all withdrawals of cash or other assets including the use of partnership funds to pay a partner's personal debts.

<u>Illustration 1.1:</u>

To illustrate the opening entries for a newly formed partnership, assume that on January 1, 2025, Hassan and Husain, who operate competing retail stores, decide to form a partnership by consolidating their two businesses. A capital account will be opened for each partner and credited with the agreed valuation of the ***net assets*** (total assets less total liabilities) that the partner contributes.

<u>Instructions:</u>

Prepare the journal entries to open the accounts of the partnership of Hassan and Husain.

Solution

<u>Journal entries:</u>

Date	Description	Dr.	Cr.
<u>2025</u> Jan. 1	Cash…………………….. Accounts Receivable…… Inventory……………….. Accounts Payable……….. Hassan, Capital…………. To record the investment by Hassan in the partnership of Hassan and Husain.	200000 300000 450000	 150000 800000
	Cash………………….. Inventory……………..	50000 300000	

Jan. 1	Land………………….. Building……………… Accounts Payable…………….. Husain Capital………………….. To record the investment by Husain in the partnership of Hassan and Husain.	300000 500000	 350000 800000

Additional Investments:

Assume that after five months of operation, the organization is in need of more cash, and the partners make additional investments of L.E.100,000 each on June 1. These additional investments are credited to the capital accounts as presented below:

2025 June 1	Cash…………… Hassan, Capital…… Husain, Capital…… To record additional investments.	200000	 100000 100000

Illustration 1.2:

Alaa, a sole proprietor, has been developing software for several types of computers. The business has the following account balances as of December 31, 2024 (L.E.):

Cash………..	60000	Liabilities…..	200000
Inventory…...	140000	Alaa, Capital..	300000
Equipment….	400000		
Accumulated Depreciation: Equipment…..	(100000)		
Total	500000	***Total***	500000

Alaa needs additional technical assistance to meet the increasing sales and offers Basim an interest in the business. Alaa and Basim agree to form a partnership. Alaa's business is audited, and its net assets are appraised. The audit and appraisal disclose that L.E.20,000 of liabilities has not been recorded, inventory has market value of L.E.180,000, and the equipment has a fair value of L.E.380,000.

On January 1, 2025, Alaa and Basim prepare and sign articles of copartnership that include all significant operating polices. Basim will contribute L.E.200,000 cash for a one-third (⅓) capital interest. The AB Partnership is to acquire all of Alaa's business and assume its debts.

Instructions:

1- Prepare the journal entry to record the initial capital contribution on the partnership's books, and the journal entry to close Alaa's business records.

2- Prepare the opening balance sheet of AB Partnership on January 1, 2025.

Solution

Calculations:

New value of Alaa's net assets = assets – liabilities = cash + inventory + equipment – liabilities.

= 60,000 + 180,000 + 380,000 – 220,000

= 620,000 – 220,000 = L.E.400,000.

1. Journal entries:

Date	Description	Dr.	Cr.
2025	Cash……………..	260000	
Jan.	Inventory………..	180000	
1	Equipment……….	380000	
	Liabilities……..		220000
	Alaa, Capital…..		400000
	Basim, Capital…		200000
	Formation of AB Partnership by capital contributions of Alaa and Basim.		
	Accumulated depreciation-Equip.	100000	
Jan.	Liabilities………..	200000	
1	Alaa, Capital……..	300000	
	Cash…………….		60000

	Inventory………..		140000
	Equipment……….		400000
	To close Alaa's business accounts.		

2. Opening Balance Sheet of AB Partnership:

AB Partnership
Balance Sheet
January 1, 2025

Cash………..	260000	Liabilities…..	220000
Inventory…...	180000	Alaa, Capital….	400000
Equipment….	380000	Basim, Capita….	200000
Total	**820000**	***Total***	**820000**

<u>Basic Observations from Illustration:</u>

1) Note that the partnership is an accounting entity separate from each of the partners and that the assets and liabilities are recorded at their market values at the time of contribution. No accumulated depreciation is carried forward from the sole proprietorship to the partnership. All liabilities are recognized and recorded.

2) The partnership's capital is L.E.600,000. This is the sum of the individual partners' capital accounts and is the value of the partnership's assets less liabilities. The fundamental accounting equation-assets less liabilities equals capital- is used often in partnership accounting. Basim is to receive a one-third capital interest in the partnership with a contribution of L.E.200,000. In this case, his capital interest equals his capital contribution.

3) Each partner's capital amount recorded does not necessarily have to equal his or her capital contribution. The partners could decide to divide the total capital equally regardless of source of the contribution. For example, although Alaa contributed L.E.400,000 of the L.E.600,000 partnership capital, he could agree to L.E.300,000 as his initial capital balance and permit Basim the remaining L.E.300,000 as a capital credit. On the surface this may not seem to be a reasonable action by Alaa, but is possible that Basim has some particularly important business experience needed by the partnership and Alaa agrees to the additional credit to Basim in recognition of his experience and skills. The key point is that the partners may allocate the capital contributions in any manner they desire. The accountant must be sure that all partners agree to the allocation and then record it accordingly.

Key Accounting Practices in Partnerships:

In most respects, partnership accounting is similar to that in a sole proprietorship, except there are more owners. Accordingly, a separate capital account, drawing account, and current account is maintained for each partner.

Partnerships, like sole proprietorships, recognize no salaries expense for services provided to the enterprise by the partners. Amounts paid to partners are recorded by debiting the partner's drawing account.

The statement of owner's equity is replaced by a ***statement of partners' equity***, which shows separately the changes in each partner's capital account. In some cases, especially in firms with a large number of partners, this statement is condensed to show only the changes in ***total*** partners' equity. A typical statement of partners' equity appears below:

HASSAN AND HUSAIN
Statement of Partners' Equity
For the Year Ended December 31, 2024

	Hassan	**Husain**	**Total**
Balances, Jan. 1, 2024 L.E.	800000	800000	1600000
Add: Additional investments	50000	50000	100000
Net income for the year	150000	150000	300000
Subtotals…………………..	1000000	1000000	2000000
Less: Drawings……………	120000	80000	200000
Balance, Dec. 31, 2024	880000	920000	1800000

<u>Illustration 1.3:</u>

A and B are sole proprietors. On January 1, 2025, they agree to form a partnership. Capital shares for A and B are L.E.750,000 and L.E.500,000, respectively. They decided to transfer their individual firms' assets and liabilities to AB Partnership. On that date, their individual proprietorships' accounts show the following balances (amounts in L.E.):

Details	**A**	**B**	**Details**	**A**	**B**
<u>Fixed Assets</u>			**Capital**	**650000**	**500000**
Machine	**200000**	**175000**	**A. Payable**	**225000**	**225000**
Land	**250000**	**150000**	**Loans**	**50000**	**50000**
Cars	**225000**	**75000**			
<u>Current Assets</u>					
A. Receivable	**100000**	**25000**			
Securities	**50000**	**350000**			
Total	**925000**	**775000**	***Total***	**925000**	**775000**

A and B agree to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets. They also agree to pay or withdraw the difference between agreed capital share and presented net assets in cash.

Instructions:

1- Journal entries needed to record the above agreement.
2- Balance Sheet 1/1/2025.
3- Journal entries needed to close books of A's firm.

Solution

Calculations:

A's net assets = assets - liabilities

= 925,000 - 275,000 = L.E.650,000.

The difference between agreed capital share and presented net assets, which will be paid in cash is =

= 750,000 - 650,000 = L.E.100,000

1. Journal Entries:

Date	**Description**	**Dr.**	**Cr.**
2025 Jan. 1	Cash…………………… Accounts Receivable….. Securities……………… Machine……………….	100000 125000 500000 375000	

Jan. 1	Cars…………………….
	Land…………………….
	    Accounts Payable……
	    Loans………………..
	    A, Capital…………...
	    B, Capital…………...
	Formation of AB Partnership by capital contributions of A and B.
		300000
		400000
			
			450000
			100000
			750000
			500000

	A, Capital…………….
	Accounts Payable…….
	Loans…………………
	    Machine…………….
	    Land………………..
	    Cars…………………
	    Accounts Receivable.
	    Securities…………..
	To close A's business accounts.
		650000
		225000
		50000
			
			200000
			250000
			225000
			100000
			150000

Note that formation of AB partnership could be recorded by two journal entries as follows:

Date	**Description**	**Dr.**	**Cr.**

<u>2025</u>
Jan.
1
	Cash…………………….
	Accounts Receivable…..
	Securities………………
	Machine………………
	Cars…………………….
	Land…………………….
	    Accounts Payable……
	    Loans………………..
	    A, Capital…………...
		100000
		100000
		150000
		200000
		225000
		250000
			
			225000
			50000
			750000

	Capital contribution of A in formation of AB Partnership.		
Jan. 1	Accounts Receivable…..	25000	
	Securities………………	350000	
	Machine……………….	175000	
	Cars……………………	75000	
	Land……………………	150000	
	Accounts Payable……		225000
	Loans………………..		50000
	B, Capital…………..		500000
	Capital contribution of B in formation of AB Partnership .		

2. Opening Balance Sheet of AB Partnership:

AB Partnership
Balance Sheet
January 1, 2025

Cash………………	100000	Accounts Payable.	450000
Accounts Receivable	125000	Loans……………	100000
Securities…………	500000	A, Capital………	750000
Machine…………..	375000	B, Capita……….	500000
Cars………………	300000		
Land…………….	400000		
Total	**1800000**	***Total***	**1800000**

Illustration 1.4:

On January 1, 2025, Ahmed, a sole proprietor, has been developing spare parts for several types of cars. Ahmed needs additional technical assistance to meet the increasing sales' volume and offers Sami an interest in the business. Ahmed and Sami agree to form a partnership.

Capital shares for Ahmed and Sami are L.E.600,000 and L.E.400,000, respectively. They decided to transfer their individual firms' assets and liabilities to AS Partnership. On that date, their individual proprietorships' accounts show the following balances (amounts in L.E.):

Assets **Liabilities & Owners' Equity**

Details	Ahmed	Sami	Details	Ahmed	Sami
Cash	280000	280000	A Payable	180000	180000
A Receivable	80000	20000	Bonds Payable	40000	40000
Inventory	200000	120000	Capital	680000	400000
Machine	160000	140000			
Cars	180000	60000			
Total	900000	620000	***Total***	900000	620000

Ahmed and Sami agree to transfer all the above balances to the new partnership and accepted values disclosed in the above balance sheets. They also agree to pay or withdraw the difference between agreed capital share and presented net assets in cash.

Instructions:

1- Journal entries needed to record the above agreement.

2- Balance Sheet 1/1/2025.

3- Journal entries needed to close books of Ahmed's firm.

Solution

Calculations:

Ahmed's net assets = assets – liabilities

= 900,000 – 220,000 = L.E.680,000.

The difference between agreed capital share and presented net assets, which will be withdrawn in cash is =

= 680,000 – 600,000 = L.E.80,000

1. Journal Entries:

Date	Description	Dr.	Cr.
2025	Cash……………………	480000	
Jan.	Accounts Receivable…..	100000	
1	Inventory………………	320000	
	Machine………………	300000	
	Cars……………………	240000	
	Accounts Payable……		360000
	Bonds Payable………..		80000
	Ahmed, Capital……….		600000
	Sami, Capital…………		400000
	Formation of AS Partnership by capital contributions of Ahmed		

Jan. 1	and Sami.		
	Ahmed, Capital……….	680000	
	Accounts Payable…….	180000	
	Ponds Payable……….	40000	
	Machine.……………..		160000
	Cars………………..		180000
	Inventory…………………		200000
	Accounts Receivable.		80000
	Cash………………..		280000
	To close Ahmed's business accounts.		

Note that formation of AS partnership could be recorded by two journal entries as follows:

Date	Description	Dr.	Cr.
2025	Cash……………………	200000	
Jan.	Accounts Receivable…..	80000	
1	Inventory……………..	200000	
	Machine………………	200000	
	Cars……………………	180000	
	Accounts Payable……		180000
	Ponds Payable………..		40000
	Ahmed, Capital……….		600000
	Capital contribution of Ahmed in formation of AS Partnership.		
	Cash…………………..	280000	
Jan.	Accounts Receivable…..	20000	
1	Inventory………………	120000	
	Machine………………	140000	
	Cars……………………	60000	
	Accounts Payable……		180000
	Ponds Payable……….		40000

	Sami, Capital……….. Capital contribution of Sami in formation of AS Partnership.		400000

2. Opening Balance Sheet of AS Partnership:

AS Partnership
Balance Sheet
January 1, 2025

Cash……………….	480000	Accounts Payable.	360000
Accounts Receivable	100000	Bonds Payable.…	80000
Inventory………….	320000	Ahmed, Capital...	600000
Machine…….…...	300000	Sami, Capita.…..	400000
Cars……………..	240000		
Total	**1440000**	***Total***	**1440000**

<u>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.</u>

Note: when a partner or more introduce his or her share as a group of assets and liabilities or as a sole proprietorship (individual firm), three different cases are expected. These cases can be illustrated as follows:

<u>First Case</u>: 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 assets 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.

Illustration 1.5:

On 1/7/2024 Mohamed and Omer agreed to establish a new partnership at LE 200,000. They decided to pay their shares (by 1/10/2024) as groups of assets and liabilities as follows: Mohamed introduced cars of LE 35,000, accounts receivable LE 30,000, and 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.

Instructions:

1- Journal entries needed to record the above.

2- Balance Sheet 1/10/2024.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
2024	By sundries:		
Oct.	Cars	30,000	
1	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.		
	By sundries:		
	Cars	10,000	
	A /R	15,000	
	Equipment	25,000	
	Machines	20,000	
Oct.	Cash	50,000	
1	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 (1/10/2024), it is possible to re-write them in only one journal entry. This unique entry can be as follows:

Date	Details	Dr.	Cr.
2024	By sundries:		
Oct. 1	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.		

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

balance c/d 1/ 10/ 2024	**100000**	**1/ 10/ 2024 By sundries**	**100000**
	100000		**100000**

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

balance c/d 1/ 10/ 2024	**100000**	**1/ 10/ 2024 By sundries**	**100000**
	100000		**100000**

Assets Balance Sheet as on 1/10/2024 Liabilities

Fixed Assets			***Capital:***		
Cars	**40000**		**Mohamed**	**100000**	
Land	**15000**		**Omer**	**100000**	
Buildings	**10000**				**200000**
Equipment	**25000**		**Current**		
Machines	**20000**	**110000**	**Liabilities**		
Current Assets			**A / P**		**30000**
A / R	**45000**				
Cash	**75000**	**120000**			
		230000			**230000**

Second Case: The net assets presented by the partner are **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 assets 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.

Illustration 1.6:

On 1/10/2024 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 1/1/2025. Balance sheet of each of their sole proprietorships was as follows:

Assets Liabilities

	A	B		A	B
Fixed Assets			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
Current Assets					
A / R.	20,000	5,000			
Securities	30,000	70,000			
	185,000	155,000		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.

Instructions:

1- Journal entries needed to record the above.

2- Balance Sheet 1/1/2025.

3- Journal entries needed to close books of A’s firm.

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
2025	By sundries:		
Jan. 1	Machines	40,000	
	Land	50,000	
	Cars	45.000	
	A / R	20,000	
	Securities	30,000	
	Goodwill	20,000	
	To sundries:		
	A / P		45,000
	Loans		10,000
	Capital a/c (A)		150,000
	To record the investment		
	by A in the partnership.		
	By sundries:		
Jan. 1	Machines		
	Land		
	Cars	35,000	
	A / R	30,000	
	Securities	15,000	
		5,000	
	To sundries:	70,000	
	A / P		
	Loans		
	Capital a/c (B)		45,000
	To record the investment		10,000
	by B in the partnership.		100,000

Also, because the above two journal entries were recorded in the same date (1/1/2025), it is possible to re-write them in only one journal entry.

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

balance c/d **1/ 1/ 2025**	**150000**	**1/ 1/ 2025** **By sundries**	**150000**
	150000		**150000**

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

balance c/d **1/ 1/ 2025**	**100000**	**1/ 1/ 2025** **By sundries**	**100000**
	100000		**100000**

2- The Balance sheet:

Assets The Balance Sheet as on 1/1/2025 **liabilities**

Goodwill		**20000**	***Capital:***		
Fixed Assets			**A**	**150000**	
Machines	**75000**		**B**	**100000**	**250000**
Land	**80000**				
Cars	**60000**	**215000**	**Current**		
Current Assets			**Liabilities**		
A / R	**25000**		**A / P**	**90000**	
Securities	**100000**	**125000**	**Loans**	**20000**	**110000**
		360000			**360000**

3- Closing books of A's firm:

Date	Details	Dr.	Cr.
2025 **Jan. 1**	**By sundries:**		
	A / P	**45000**	
	Loans	**10000**	
	Capital a/c (A)	**130000**	

	To sundries: **Machines** **Land** **Cars** **A / R** **Securities** **To close books of A's firm.**		**40000** **50000** **45000** **20000** **30000**

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

Note:

In the above illustration, it was supposed that the difference between the net assets (LE 130,000) presented by A, which is less than the agreed share (LE 150,000) was considered as goodwill. However, other partner, B, could ask A 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 A could pay LE 20,000 to cover the difference or complete assets presented.

Third Case: The net assets presented by the partner are **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 a 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>Illustration 1.7:</u>

On 1/10/2024 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 1/1/2025. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities**

	A	B		A	B
Fixed Assets			Capital	170000	100000
Machines	40000	35000			
Land	50000	30000	A / P.	45000	45000
Cars	45000	15000	Loans	10000	10000
Current Assets					
A / R.	20000	5000			
Securities	70000	70000			
	225000	155000		225000	155000

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

Instructions:

1- Journal entries needed to record the above.

2- Balance Sheet as on 1/1/2025.

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

Solution:

1- Journal entries:

Date	Details	Dr.	Cr.
2025	**By sundries:**		
Jan. 1	**Machines**	**40000**	
	Land	**50000**	
	Cars	**45000**	
	A / R	**20000**	
	Securities	**70000**	
	To sundries:		
	A / P		**45000**

	Loans		10000
	Capital a/c (A)		150000
	Capital reserve		20000
	To record the investment by A in the partnership.		
	By sundries:		
	Machines	35000	
Jan. 1	Land	30000	
	Cars	15000	
	A / R	5000	
	Securities	70000	
	To sundries:		
	A / P		45000
	Loans		10000
	Capital a/c (B)		100000
	To record the investment by B in the partnership.		

It is also because the above two journal entries were recorded in the same date (1/1/2025), it is possible to re-write them in only one journal entry.

2- The balance sheet:

Assets The Balance Sheet as on 1/1/2025 Liabilities

Fixed Assets			**Capital:**		
Machines	75000		A	150000	
Land	80000		B	100000	250000
Cars	60000	215000	Current Liabilities		
Current Assets			A / P	90000	
A / R	25000		Loans	20000	110000
Securities	140000	165000	Capital R.		20000
		380000			380000

3- Closing books of A's firm:

Date	Details	Dr.	Cr.
2025	**By sundries:**		
Jan. 1	**A / P**	**45000**	
	Loans	**10000**	
	Capital a/c (A)	**170000**	
	To sundries:		
	Machines		**40000**
	Land		**50000**
	Cars		**45000**
	A / R		**20000**
	Securities		**70000**
	To close books of A's firm.		

Note:

In the above illustration, it was supposed that the difference between the net assets (LE 170000) presented by A, which is more than the agreed share (LE 150000) was considered as capital reserve. Other partner (B) could ask A to withdraw this difference (LE 20000) in cash or in any type of assets if they agreed to do so.

1.6 Questions:

CONCEPTUAL QUESTIONS:

1. What are the two factors that make ownership of an interest in a general partnership particularly risky?

a. Mutual agency and unlimited personal liability.

b. Limited life and unlimited personal liability.

c. Limited life and mutual agency.

d. Double taxation and mutual agency.

2. Which of the following types of business owners do ***not*** take an active role in the daily management of the business? (Indicate all correct answers.)

a. General partners.

b. Limited partners.

c. Sole proprietors.

d. Stockholders in a publicly owned corporation.

3. What is meant by the term ***mutual agency***?

4. Distinguish among a general partnership, a limited partnership, and a limited liability partnership.

5. Which form of partnership would be most appropriate for law practice? Explain.

TRUE OR FALSE:

For each of the following statements, circle the **T** or the **F** to indicate whether the statement is **True** or **False**.

(1) **T F** The three major types of business organizations are sole proprietorship, partnerships, and corporations.

(2) **T F** Owners of sole proprietorships and general partnerships are personally liable for the debts of the business.

(3) **T F** A partnership may be created merely by two or more persons agreeing to act as partners.

(4) **T F** All partners are legally entitled to participate or share equally in the earnings of a partnership.

(5) **T F** No partner can enter into a contract on behalf of a partnership without a majority vote of all the partners.

(6) **T F** In a general partnership, every partner has full authority to negotiate contracts that are binding on the business.

(7) **T F** A limited partner generally does not participate in management of the partnership.

(8) **T F** A partnership ceases its existence on the death or withdrawal of one of the partners.

(9) **T F** If a limited partnership defaults or fails on a debt, the creditor may ***not*** look to any of the individual partners for payment.

(10) **T F** A popular form of business organization for attorneys and CPAs is the limited liability partnership.

(11) **T** **F** When a partner contributes noncash assets to a partnership; the assets are valued at their fair market values.

(12) **T** **F** If a partnership pays for a personal expense of a partner, the amount should be recorded in the partner's drawing account.

<u>MULTIPLE CHOICE:</u>

Choose the best answer for each of the following questions and circle the identifying letter.

1. Which of the following investors don have unlimited liability for the debts of the business?

- **A** An owner of a sole proprietorship.
- **B** A partner of a general partnership.
- **C** A general partner of a limited partnership.
- **D** A stockholder of a corporation.

2. Which of the following is ***not*** a characteristic of a general partnership?

- **A** Mutual agency.
- **B** Unlimited liability for business debts.
- **C** Owned by general and limited partners.
- **D** Limited life.

3. Which of the following is the most important disadvantage of the general partnership form of business organisations?

- **A** Limited life.
- **B** Multiple owners.
- **C** Unlimited personal liability for business debts.
- **D** Taxation of business profits.

4. The characteristic of a general partnership known as ***mutual agency*** means that:

- **A** All partners may bind the partnership to contract.
- **B** All partners participate in the profits of the partnership.
- **C** All partners have unlimited personal liability for the debts of the partnership.
- **D** All partners are reasonable for payment of income taxes on partnership profits.

5. Which of the following types of business organizations is most appropriate for a group of CPAs?

- **A** A sole proprietorship.
- **B** A limited partnership.
- **C** A limited liability partnership.
- **D** A general partnership.

6. Title to the assets of a partnership is held by:

- **A** The partnership.
- **B** The managing partner.
- **C** The individual partners that contributed the assets.
- **D** The board of directors of the par partnership.

7. Which of the following is ***not*** a characteristic of a general partnership?

- **A** Each partner has the authority to bind the partnership to contracts.
- **B** Each partner's liability is limited to the amount he/she invested.

- **C** Ease of formation.
- **D** Partnership must pay income taxes on its net income.

8. Each partner of a general partnership may be held personally liable for:

- **A** Business debts equal to the balance of that partner's capital account.
- **B** Only the amount that the partner originally invested in the business.
- **C** All debts of the business.
- **D** All debts of the business and all personal debts of the other partner.

9. Which of the following types of business organizations has a legal existence separate and apart from its owner(s)?

- **A** A sole proprietorship.
- **B** A general partnership.
- **C** A public corporation.
- **D** A limited partnership.

10. Which of the following forms of business organizations are normally treated as a going concern from an accounting standpoint?

- **A** A sole proprietorship.
- **B** A partnership.
- **C** A corporation.
- **D** All of the above are treated as going concerns.

11. Which of the following is ***not*** true about the accounting procedures when a partnership is formed?

- **A** The amount credited to each partner's capital account depends upon the agreed-upon profit-sharing provision.
- **B** The individual assets invested and liabilities assumed are recorded in the partnership accounting records.
- **C** Individual partners' capital accounts may be credited with unequal amounts.
- **D** Values assigned to noncash assets in the accounts of the new partnership should be the fair market value at the date of formation, even if the fair market value is below cost.

12. Which of the following transactions should ***not*** be recorded by debiting a partner's drawing account?

- **A** Payment of authorized salary to a partner.
- **B** Use of partnership funds to pay personal debts of a partner.
- **C** Cash collected by a partner on behalf of the firm but retained by the partner personally.
- **D** Payment of a partnership liability by a partner out of personal funds.

13. Each of the following is recorded by debiting Partner Adel's drawing account, ***except:***

- **A** Partner Adel collects an account receivable owed to the partnership but keeps the money for personal use.
- **B** Partner Adel makes his mortgage payment by writing a check from the partnership checking account.

- **C** Partner Adel pays the utility bill for the partnership out of his personal checking account.
- **D** Partner Adel withdraws L.E.120,000 during the year, but his share of partnership net income is larger than L.E.120,000.

14. Adams invests in a partnership a piece of property which he inherited from his father. The property cost his father L.E.100,000 and was worth L.E.175,000 when Adams inherited it 10 years ago. The property is currently appraised at L.E.250,000, and the partners believe that planned improvements will make it worth L.E.475,000 within a year. The property should be recorded in the books of the partnership at:

- **A** L.E.100,000.
- **B** L.E.175,000.
- **C** L.E.250,000.
- **D** L.E.475,000.

15. On January 1, 2020, Jamal and Alam formed a partnership and agreed to share profits and losses in the ratio of 3:7 respectively. Jamal contributed a parcel of land that cost him L.E.500,000. Alam contributed L.E.2,000,000 cash. The land was sold for L.E.900,000 immediately after formation of the partnership. What amount should be recorded in Jamal's capital account on formation of the partnership?

- **A** L.E.900,000.
- **B** L.E.870,000.
- **C** L.E.750,000.

- **D** L.E.500,000.

16. On January 1, 2020, Jimmy and Shaban formed a partnership. Jimmy contributed cash. Shaban, previously a sole proprietor, contributed property other than cash, including realty subject to a mortgage, which the partnership assumed. Shaban's capital account at January 1, 2020, should be recorded at:

- **A** Shaban's book value of the property at January 1, 2020.
- **B** Shaban's book value of the property less the mortgage payable at January 1, 2020.
- **C** The fair value of the property less the mortgage payable at January 1, 2020.
- **D** The fair value of the property at January 1, 2020.

17. A partnership is formed by two individuals who were previously sole proprietors. Property other than cash that is part of the initial investment in the partnership is recorded for financial purposes at the :

- **A** Proprietors' book values or the fair value of the property at the date of the investment, whichever is higher.
- **B** Proprietors' book values or the fair value of the property at the date of the investment, whichever is lower.
- **C** Proprietors' book values at the date of the investment.
- **D** Fair value of the property at the date of the investment.

18. M & J formed a partnership on January 1 and contributed the following assets:

Details	M	J
Cash Land	L.E.750,000	L.E. 250,000 1,550,000

The land was subject to a L.E.150,000 mortgage, which the partnership assumed. Under the partnership agreement, M and J will share profit and loss in the ratio of one-third and two-thirds, respectively. J's capital account at January 1 should be:

- **A** L.E.1,500,000.
- **B** L.E.1,650,000.
- **C** L.E.1,700,000.
- **D** L.E.1,800,000.

19. One January 1, El-Mazzini and El-Aqad formed a partnership, agreeing to share profits and losses in the ratio of 4:6, respectively. El-Mazzini contributed a parcel of land that cost him L.E.500,000. El-Aqad contributed L.E.1,000,000 cash. The land was sold for L.E.1,000,000 on January 1, five hours after formation of the partnership. How much should be recorded in El-Mazzini's capital account on the partnership formation?

- **A** L.E.200,000.
- **B** L.E.400,000.
- **C** L.E.500,000.
- **D** L.E.1,000,000.

EXERCISES AND PROBLEMS:

(1) A business owned by Fatah Douglas was short of cash. Douglas, therefore, decided to form a partnership with Andréa Makah, who would contribute cash to the new partnership. The assets contributed by Douglas appeared as follows in balance sheet of his business: cash, L.E.6,000; accounts receivable, L.E.349,000; inventory, L.E.450,000; and store equipment, L.E.216,000. Douglas had recorded depreciation of L.E.18,000 during his use of the store equipment in his sole proprietorship.

Douglas and Makah agreed that the accounts receivable had a fair value of L.E.331,000. They also agreed that a fair value for the inventory was its replacement cost of L.E.540,000 and that the fair value of the store equipment was L.E.190,000.

Instructions:

You are required to open the partnership accounts by making a general journal entry to record the investment by Douglas.

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(2) The partnership of Effendi and Pasha was formed on January 1, 2025, when Mira Effendi and Dinah Pasha agreed to invest equal amounts and to share profit and losses equally. The investment by Effendi consists of L.E.300,000 cash and an inventory of merchandise valued at L.E.560,000.

Pasha also is to contribute a total of L.E.860,000. However, it is agreed that her contribution will consist of the following assets of her business along with the transfer to the partnership of her business liabilities. The agreed values of the various items as well as their carrying values on Pasha's records are listed below. Pasha also contributes enough cash to bring her capital account to L.E.860,000.

Investment by Pasha

Description	**Balances on Pasha's Records**	**Agreed Value**
Accounts receivable	816800	796000
Inventory	114000	128000
Office equipment-net	143000	90000
Accounts payable	248000	248000

Instructions:

a. Prepare general journal entries to record the investments of Effendi and Pasha in the new partnership.

b. Prepare the beginning balance sheet of the partnership on January 1, 2025, reflecting the above transfers to the firm.

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(3) On January 1, 2025, Samira and Samar agreed to establish general partnership of L.E.700,000 as initial investments (S&S Partnership). Capital shares for Samira and Samar are L.E.400,000 and L.E.300,000, respectively. They decided to transfer their sole proprietorships to be a one new partnership. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities & O. Equity**

Details	**Samira**	**Samar**	**Details**	**Samira**	**Samar**
Machine	**105000**	**140000**	**Capital**	**350000**	**250000**
Cars	**167500**	**130000**	**A Payable**	**75000**	**65000**
Inventory	**125000**	**65000**	**Bonds**		
A Receivable	**52500**	**30000**	**Payable**	**120000**	**100000**
Bank	**95000**	**50000**			
	545000	**415000**		**545000**	**415000**

They agreed to transfer all the above balances to the S&S Partnership and accepted values disclosed in the above balance sheets. They agreed also to pay or withdraw any difference between the presented net assets and the agreed shares of capitals.

Instructions:

1. Prepare the journal entry to record the initial capital contribution on the partnership's books, and the journal entry to close Samira's business records.
2. Prepare the opening balance sheet of S&S Partnership on January 1, 2025.

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(4) On January 1, 2025, Nadir and Hider agreed to form a partnership with an initial investment of L.E.1,400,000, L.E.800,000 and L.E.600,000 for Nadir and Hider, respectively. They decided to transfer their individual enterprises to be N&H Partnership. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities & O. Equity**

Details	Nadir	Hider	Details	Nadir	Hider
Land	210000	280000	Capital	900000	550000
Buildings	385000	260000	A Payable	150000	130000
Inventory	250000	180000	Loans	90000	200000
A Receivable	105000	60000			

Cash	**190000** **1140000**	**100000** **880000**		**1140000**	**880000**

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 Nadir to be only L.E.335,000. The market fair value of inventory presented by Hider is L.E.130,000. They agreed also to pay or withdraw any difference between the presented net assets and the agreed capital shares.

Instructions:

1. Prepare the journal entry to record the initial capital contribution on the partnership's books, and the journal entry to close Hider's business records.

2. Prepare the opening balance sheet of N&H Partnership on January 1, 2025.

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(5) On January 1, 2025, Tamer and Jabir agreed to form a new partnership with an initial investment of L.E.500,000, divided equally between Tamer and Jabir. They decided to transfer their individual firms to be a T&J Partnership. Balance sheet of each of their sole proprietorships was as follows:

Assets **Liabilities & O. Equity**

Details	Tamer	Jabir	Details	Tamer	Jabir
Equipment	100000	87500	Capital	425000	250000
Cars	125000	75000	A Payable	112500	112500
N Receivable	100000	100000	Bonds	25,000	25000
Inventory	112500	37500			
Cash	50000	12500			
Bank	75000	75000			
Total	562500	387500		562500	387500

They agreed to transfer all the above balances with the exception of cars 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 capital shares.

Instructions:

i. Prepare the journal entry to record the initial capital contribution on the partnership's books, and the journal entry to close Tamer's business records.

ii. Prepare the opening balance sheet of T&J Partnership on January 1, 2025.

CHAPTER TWO

Partners' Accounts and Operations of a Partnership

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2.1 Introduction:

Practically, like sole proprietorship, a partnership provides services or sells products in pursuit of profit. These transactions are recorded in the appropriate journals and ledger accounts. Many partnerships use accrual accounting and generally accepted accounting principles to keep their books because GAAP result in better measures of income than alternative accounting methods such as the cash basis or modified cash basis.

Partnership financial statements are prepared for the partners and occasionally for partnership creditors. Accountants often encourage the use of GAAP for financial statements purposes because the partners may then compare the partnership's financial statements with those of other business firms (Baker, Lembke, and King (2005).

2.2 Ledger Accounts for Partners:

Accounting for partnership differs from accounting for a single proprietorship or a corporation with regarding the sharing of net income and losses and the maintenance of the partners' ledger accounts. Although it could be possible to maintain partnership accounting records with only one ledger account for each partner, the common application or practice is to keep a group of accounts.

The partnership may maintain several accounts for each partner in its accounting records. These partnership accounts consist of ***(1) capital*** accounts, ***(2) drawing*** or ***personal-current-*** accounts, and ***(3)*** accounts for ***loans*** to and from partners. These ***partners' accounts*** are as follows:

2.2.1 Capital Accounts:

The initial investment of a partner, any subsequent capital contributions, profit or loss distributions, and any withdrawals of capital by the partner are ultimately recorded in the partner's capital account. The original investment by each partner is recorded by debiting the assets invested, crediting any liabilities assumed by the partnership, and crediting partner's capital account with current fair value of the ***net assets*** invested. 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 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 partnership's net assets.

2.2.2 Drawing Accounts:

Generally, partners make withdrawals of assets from the partnership during the year in anticipation of profits. A separate drawing account often is used to record the periodic withdrawals and is then closed to the partner's capital account at the end of the period. For example, the following entry is done in the H&H Partnership's books for a L.E.15,000 cash withdrawn by Hassan on May 1, 2024:

May1, 2024 Hassan Drawing Cash Withdrawal of L.E.15,000 cash be Hassan.	15000	15000

Noncash 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 partners' withdrawals of inventory. They record withdrawals of inventory at cost, by which they not record a gain or loss on these drawings.

2.2.3 Loans Accounts:

Partnership may look to its present partners for additional financing. This is considered a loan rather than an increase in the partner's capital account balance. This transaction is recorded by a credit to Loans Payable to Partners and generally is accompanied by the issuance of a promissory note.

Conversely, a partner may receive cash from the partnership with the intention of repaying this amount. Such a transaction may be debited to the Loans Receivable from Partners ledger account rather than to the partner’s drawing account. Loans receivable from partners are displayed as asset in the partnership balance sheet and loans payable to partners are displayed as liabilities.

Any loans between a partner and the partnership should always be accompanied by proper loan documentation. Unless all partners agree otherwise, the partnership is obligated to pay interest on the loan to the individual partner for loan payable. On the contrary, interest is ***not*** required to be paid on capital investments unless the partnership agreement states that capital interest is to be paid. The partnership records interest on loans payable as an operating expense. On the other hand, the interest income is recognized on the partnership’s income statement concerning loans receivable. The following journal entry is made to record a L.E.20,000, 10%, one-year loan from Husain to the partnership on July 1, 2024:

July 1, 2024		
Cash	20000	
Loan Payable to Husain		20000
Sign loan agreement with partner Husain.		

The loan payable to Husain is recorded in the partnership's balance sheet. A loan from a partner is a related-party transaction for which separate footnote disclosure is required, and it must be reported as a separate balance sheet item, not included with other liabilities.

If a substantial unsecured loan has been made by a partnership to a partner and repayment appears doubtful, it is appropriate to offset the receivable against the partner's capital account balance.

2.2.4 Partners' Current Account:

In practice, partners' capital accounts can be maintained either on ***fixed capital system,*** or ***fluctuating (changing) capital system.***

Fixed Capital System:

In case of a fixed capital system, there are two accounts for each partner:

a) Partner's Capital Account.

b) Partner's Current Account

The capital account for each partner remains year by year at the figure of capital put into the firm by the partners. The partner's capital account is credited with the original amount of capital introduced by the partner into the business. It is to be credited subsequently with extra capital introduced by the partner or debited with the amount of capital permanently withdrawn by the partner. No other adjustments are made in this account.

The partner’s current account is maintained for making all entries relating to interest, share of profit, drawings, etc. Accordingly, the profits, interest on capital and the salaries to which the partner may be entitled are then credited to a separate current account for the partner, and the drawings and interest on drawings are debited to it. The balance of the current account at the end of each financial year will then represent the amount of undrawn (or withdrawn) profits. A credit balance will be undrawn profits, while a debit balance will be drawings in excess of the profits to which the partner was entitled. The balance in this account will go on fluctuating but the balance of the capital account will remain fixed.

Fluctuating Capital System:

In case of fluctuating capital system, there is only one account for each partner. This account is termed as capital account. All entries relating to initial capital, drawings, interest, profit etc. are made in this account. The balance in the capital account, therefore, goes on fluctuating.

2.3 Allocation Profit or Loss to Partners:

Profit or loss is allocated to the partners at the end of each period in accordance with the partnership agreement. If no partnership agreement exists, all partners are to share profits and losses equally. Practically, all partnerships have a profit or loss allocation agreement. The agreement must be followed precisely, and if it is unclear, the accountant should make sure that all partners agree to the profit or loss distribution. Many problems can be avoided by carefully specifying the profit or loss distribution in the articles of copartnership (agreement or contract).

In the business world, a wide range of ***profit distribution plans*** is found. Some partnerships have straightforward distribution plans; others have extremely complex ones. It is the accountant's responsibility to distribute the profit or loss according to the partnership agreement regardless of how simple or complex that agreement is. A profit distribution is similar to dividends for corporation: These distributions ***should not be included in the income statement (or profit & loss account)*** regardless of how the profit is distributed. Profit distributions are recorded directly into the partner's personal account (whether capital or current account), not as expense items.

The many possible plans for sharing of net income or loss among partners of a partnership may include the following categories:

(1) Equally, or in some other ratio.

(2) In the ratio of partners' capital account balances on a particular date, or in the ratio of average capital account balances during the year.

(3) Allowing interest on partners' capital account balances and dividing the remaining net income or loss in a specified ratio.

(4) Allowing salaries to partners and dividing the resultant net income or loss in a specified ratio.

(5) Bonus to managing partner based on income.

(6) Allowing salaries to partners, allowing interest on capital account balances, and dividing the remaining net income or loss in a specified ratio.

The alternative income-sharing plans emphasize that the value of personal services rendered by individual partners may vary widely, as may the amounts of capital invested by each partner. The amount and quality of managerial services rendered and the amount of capital invested often are important factors in the success or failure of a partnership. Therefore, provisions may be made for salaries to partners and interest on their respective capital account balances as a preliminary step in the division of income or loss. Any remaining income or loss then may be distributed in a specified ratio.

Another factor affecting the success of a partnership may be that one of the partners has large personal financial resources, thus giving the partnership a strong credit rating. Similarly, partners who are well known in a profession or an industry may contribute importantly to the success of the partnership even though they may not participate actively in the operations of the partnership. These two factors may be incorporated in the income-sharing plan by carful selection of the ratio in which any remaining net income or loss is divided (Larsen, 2000).

Most partnerships use one or more of the following distribution methods:

1. Preselected ratio.

2. Interest on capital balances.

3. Salaries to partners.

4. Bonuses to partners.

Preselected Ratio:

Preselected ratios are usually the result of negotiations between the partners. Ratios for profit distributions may be based on the percentage of total partnership capital, time and effort invested in the partnership, or a variety of other factors. Smaller partnerships often split or distribute profits evenly among the partners. Furthermore, some partnerships have different ratios if the firm suffers a loss rather than earns a profit. The partnership form of business allows a wide selection of profit distribution ratios to meet the partner's individual desires.

For example, suppose the capitals were Ali L.E.200,000 and Peter L.E.100,000, many people would share the profits in the ratio of two-thirds to one-third, even though the work to be done by each partner is similar. A look at the division of the first few years' profits on such a basis would be:

Years	**One L.E.**	**Two L.E.**	**Three L.E.**	**Four L.E.**	**Five L.E.**	**Total L.E.**
Net profits	36000	48000	60000	60000	72000	
Shared:						
Ali ⅔	24000	32000	40000	40000	48000	184000
Peter ⅓	12000	16000	20000	20000	24000	92000

Ali would receive L.E.184,000, or L.E.92,000 more than Peter. Equitably the difference between the two shares of profit in this case, as the duties of the partners are the same, should be adequate to compensate Ali for contributing extra capital into the firm. It is obvious that L.E.92,000 extra profits is far more than adequate for this purpose. Consider too the position of capital ratio sharing of profits if one partner put in L.E.9,900,000 and the other put in L.E.100,000 as capital. To overcome the difficulty of compensating for the investment of extra capital, the concept of interest on capital was introduced or devised.

Interest on Capital Balances:

Distributing partnership income based on interest on capital balances recognizes the contribution of the partners' capital investments to the partnership's profit-generating capacity. This interest on capital is not an expense of the partnership; it is a distribution of profits. If the work to be done by each partner is of equal value but the capital contributed is unequal, it is equitable to grant interest on the partners' capitals. This interest is treated as a deduction prior to the calculation of profits and their distribution according to the profit-sharing ratio.

The rate of interest is a matter of agreement between the partners, but it should theoretically equal the return which they would have received if they had invested the capital elsewhere. Taking Ali & Peter again, but sharing the profits equally after charging 5% annual interest on capital, the appropriation of profits would become:

Years	One L.E.	Two L.E.	Three L.E.	Four L.E.	Five L.E.	Total L.E.
Net profits	36000	48000	60000	60000	72000	
Interest on capitals						
Ali	10000	10000	10000	10000	10000	50000
Peter	5000	5000	5000	5000	5000	25000
Shared:						
Ali 1/2	10500	16500	22500	22500	28500	100500
Peter 1/2	10500	16500	22500	22500	28500	100500

Summary	***Ali***	***Peter***
Interest of capital	L.E. 50,000	25,000
Balance of profits	100,500	100,500
	150,500	125,500

Ali has thus received L.E.25,000 more than Peter, this being adequate return (in the partners' estimation) for having invested an extra L.E.100,000 in the firm for five years.

Salaries or Bonuses to Partners:

If one or more of the partners' services are important to the partnership, the profit distribution agreement may provide for salaries or bonuses. For example, one partner may have more responsibility or tasks than the others. As a reward for this, rather than change the profit and loss sharing ratio, he/she may have a salary which is deducted before sharing the balance of profits. Again, ***these salaries paid to partners are a form of profit distribution, not an expense of the partnership.***

Interest on Drawings:

It will obviously be in the best interests of the business if cash is withdrawn from the partnership by the partners in accordance with the two basic principles of (Wood, 1993):

a. As little as possible.

b. As late as possible.

The more cash that is left in the business the more expansion can be financed. To deter or prevent the partners from taking out cash, partners can be charged interest on each withdrawal, calculated from the date of withdrawal to the end of the financial year. The amount charged to them helps to swell or inflate the profits distributable between the partners. Suppose that Ali and Peter have decided to charge interest on drawings at 5% annually, and that their yearend was 31 December. The following drawings are made:

Drawings		***Ali Interest***	***L.E.***
1 January	L.E.1,000	1000 × 5% × 12 months =	50
1 March	2,400	2400 × 5% × 10 months =	100
1 May	1,200	1200 × 5% × 8 months =	40
1 July	2,400	2400 × 5% × 6 months =	60
1 October	800	800 × 5% × 3 months =	10
		Interest charged to Ali =	260

Drawings		***Peter Interest***	***L.E.***
1 January	L.E. 600	600 × 5% × 12 months =	30
1 August	4,800	4800 × 5% × 5 months =	100
1 December	2,400	2400 × 5% × 1 months =	10
		Interest charged to Peter =	140

The amount of profit may be arrived at after making adjustments for interest on capital, interest on drawings, and salaries to partners. The profit or loss distribution is recorded with a closing entry at the end of each period. The revenue and expenses are closed into an income summary account. In the following examples, an income summary account is used, the balance of which is net income or net loss after the revenue and expense accounts are closed and before the income or loss is distributed to the partners' personal accounts.

The entries for each one of the distribution items will be as follows:

Items	Description	Dr	Cr
1. Interest on Capital	Profit and Loss Appropriation Account Partners' Current or Capital Accounts	xx	 xx
2. Interest on Drawings	Partners' Current or Capital Accounts P & L Appropriation or Distribution a/c	xx	 xx
3. Salaries to Partners	P & L Appropriation or Distribution a/c Partners' Current or Capital Accounts	xx	 xx
4. Bonuses to Partners	P & L Appropriation or Distribution a/c Partners' Current or Capital Accounts	xx	 xx
5. Distribution of net profit or net loss	P & L Appropriation or Distribution a/c Partners' Current or Capital Accounts In case of loss the entry will be reversed.	xx	 xx

Illustration 2.1:

During 2024, the A&B Partnership earns L.E.90,000 of revenue and incurs L.E.70,000 in expenses, leaving a profit of L.E.20,000 for the year. Amine maintains a capital balance of L.E.40,000 during the year, but Baker's capital investment varies during the year as follows:

Date	Debit	Credit	Balance
January 1			L.E.20000
May 1	L.E.6000		14000
September 1		L.E.1000	15000
November 1	2000		13000
December 31			13000

The debits of L.E.6,000 and L.E.2,000 are recorded in Baker's drawing account; the additional investment is credited to his capital account.

Calculating Profit Sharing Ratio:

The partners agree to share profits or losses in the ratio of 60% to Amine and 40% to Baker (this ratio is specified as 3:2). The following schedule illustrates how the net income is distributed using a 3:2 profit sharing ratio:

	Amine	**Baker**	**Total**
Profit sharing percentage	60%	40%	100%
Net income			L.E.20,000
Allocate 60:40	L.E.12,000	L.E.8,000	(20,000)
Total	L.E.12,000	L.E.8,000	L.E. 0000

This schedule shows how net income is distributed to the partners' capital accounts. The actual appropriation is accomplished by closing the ***Income Summary*** account. Additionally, the drawing accounts are closed to the personal accounts (capital or current accounts) at the end of the period.

Date	Description	Dr	Cr
2024 Dec. 31	Baker, Capital…………..	8000	
	Baker, Drawings………		8000
	Close Baker's drawing account.		
	Revenue…………………	90000	
	Expenses…………….		70000
	Income Summary……		20000
	Close revenue and expenses.		
	Income Summary………..	20000	
	Amine, Capital (or Current a/c)		12000
	Baker, Capital (or Current a/c)		8000
	Distribute profit in accordance with partnership agreement.		

Calculating Interest on Capital Balances:

As stated earlier, the articles of copartnership may provide for interest to be credited on the partners' capital balances as part of the distribution of profits. The rate of interest is often a stated percentage. Again, interest calculated on partners' capital is not an expense of operating the business. The calculation is made after net income is determined in order to decide how appropriate the income. Special caution must be exercised whenever interest on capital balances is encompassed in the profit appropriation plan. For instance, the amount of the distribution can be significantly different depending on whether the interest is calculated on opening capital balances, closing balances, or average capital balances for the period.

Most terms for interest on capital determine that a weighted-average capital should be used. This method explicitly recognizes the time span for which each capital level is maintained during the period. Accordingly, Baker's weighted-average capital balance for 2024 is calculated as follows:

Date	**Debit**	**Credit**	**Balance**	**Months Maintained**	**Months Times (×) Pound Balance**
Jan. 1			20000	4	L.E. 80000
May 1	6000		14000	4	56000
Sep. 1		1000	15000	2	30000
Nov. 1	2000		13000	2	26000
Total				12	L.E.192000
Average capital (192000 ÷ 12 months)					L.E. 16000

If Amine and Baker agreed to allow interest of 15% on the weighted-average capital balances with any remaining profit to be divided in the 60:40 ratio, the appropriation of the L.E.20,000 profit would be calculated as follows:

	Amine	Baker	Total
Profit sharing percentage	60%	40%	100%
Average capital	L.E.40000	L.E.16000	
Net income			L.E.20000
Interest on average Capital (15 %)	L.E. 6000	L.E. 2400	(8400)
Residual income			L.E.11600
Allocate 60:40	L.E. 6960	L.E. 4640	(11600)
Total	L.E. 12960	L.E. 7040	L.E.0000

Calculating Salaries:

As stated earlier, salaries to partners are often included as part of the profit appropriation plan to recognize and reward for differing amounts of personal services provided by partners to firm. A general concept of partnership accounting is that salaries to partners are not operating expenses but are part of the profit distribution plan. This approach or concept 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. The earnings are a result of those two investments.

Logically, the same idea applies to the partnership form of organization. Some partners invest capital while others invest personal time. Those who invest capital are typically compensated with interest on their capital balances; those who invest personal time are rewarded with salaries. Nevertheless, both interest and salaries are a result of the respective investments and are used not in the determination of income but in the determination of the proportion or division of income to credit to each partner's personal account (capital or current account).

On the other hand, an interesting question arises if the partnership experiences losses. Can salaries to the partners during the year be treated as a distribution of profits? Although any amounts actually paid to partners during the year are really drawings made in anticipation of profits, the agreed salary amounts usually are added to the loss and that total is then distributed to the partners' capital or current accounts.

To examine partnership salaries, assume that the partnership agreement provides for salaries of L.E.4,000 to Amine and L.E.10,000 to Baker. Any residual is to be distributed in the profit and loss-sharing ratio of 60:40 percent. The profit distribution is computed as below:

	Amine	Baker	Total
Profit percentage	60%	40%	100%
Net income			L.E.20000
Salary	L.E.4000	L.E.10000	(14000)
Residual income			L.E. 6000
Allocate 60:40	L.E.3600	L.E. 2400	(6000)
Total	L.E.7600	L.E.12400	L.E. 0000

Calculating Bonuses:

Sometimes, bonuses are used as a means of providing additional compensation to partners who have provided services to the partnership. Bonuses are typically stated as a percentage of income either before or after 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 instance, a bonus of 10% of income in excess of L.E.10,000 is to be credited to Baker's personal account before appropriating the remaining profit.

Case (1): The bonus is computed as a percentage of income ***before*** subtracting the bonus. Accordingly, the bonus is calculated as follows:

Bonus = X% (NI – MIN)

Where: *X%* = the bonus percentage.

NI = net income before bonus.

MIN = minimum amount of income before bonus.

Bonus = 10% (20000 – 10000) = L.E.1,000.

Case (2): The bonus is calculated as percentage of income ***after*** subtracting the bonus. Accordingly the bonus is computed as follows:

Bonus = *X%* (NI – MIN – Bonus)

= 10% (20,000 – 10,000 – Bonus)

= 10% (10,000 – Bonus)

= 1000 – .10 Bonus

1.10 Bonus = 1000

Bonus = $\frac{1000x10}{11}$ = L.E.910.

The distribution of net income based on ***Case (2)*** is calculated as follows:

	Amine	Baker	Total
Profit percentage	60%	40%	100%
Net income			L.E.20000
Bonus to partner		L.E. 910	(910)
Residual income			L.E.19090
Allocate 60:40	L.E.11454	L.E.7636	(19090)
Total	L.E.11454	L.E.8546	L.E.0000

Multiple Bases of Profit Allocation:

In the real world, a partnership agreement may provide a combination of several allocation procedures to be used to distribute profit. For example, the profit and loss agreement of the A&B Partnership specifies the following allocation method:

1. Interest of 15% on weighted-average capital balances.

2. Salaries of L.E.4,000 for Amine and L.E.10,000 for Baker.

3. A bonus of 10% to be paid to Baker on partnership income exceeding L.E.10,000 before subtracting the bonus, partners' salaries, and interest on capital balances.

4. Any residual to be allocated in the ratio of 60% to Amine and 40% to baker.

The partnership agreement should also contain a provision to determine the allocation process in the event that partnership income is not sufficient to satisfy all allocation procedures. Some partnerships specify a profit distribution to be followed to whatever extent is possible. Most agreements specify that the entire process is to be completed and any residual is to be allocated in the profit and loss ratio as illustrated in the following schedule:

	Amine	**Baker**	**Total**
Profit percentage	60%	40%	100%
Average capital	L.E.40000	L.E.16000	
Net income			L.E.20000
Step 1:			
Interest on average			
Capital (15 %)	L.E. 6000	L.E. 2400	(8400)
Residual after step 1			L.E.11600
Step 2:			
Salary	4000	10000	(14000)
Deficiency after step 2			(2400)
Step 3:			
Bonus		1000	(1000)
Deficiency after step 3			(3400)
Step 4:			
Allocate 60:40	(2040)	(1360)	3400
Total	L.E. 7960	L.E.12040	L.E. 0000

In this case, the first two distribution steps created a deficiency. The A & B partnership agreement provided that the entire profit allocation process must be completed and any deficiency distributed in the profit and loss ratio. A partnership agreement could specify that the profit distribution process stop at any point in the event of any operating loss or the creation of a deficiency.

Illustration 2.2:

Ant & Bee Partnership has a net income of L.E.300,000 for the year ended December 31, 2024, the first year of operations. The partnership contract provides that each partner may withdraw L.E.5,000 cash on the last day of each month; both partners did so during 2024. the drawings are recorded by debits to the partners' drawing accounts and are not a factor in the division of net income or loss; all other withdrawals, investments, and net income or loss are entered directly in the partners' capital accounts.

Partner Ant invested L.E.400,000 on January 1, 2020, and an additional L.E.100,000 on April 1. Partner Bee invested L.E.800,000 on January 1, and withdrew L.E.50,000 on July 1. These transactions and events are summarised in the following Capital, Drawings, and Income Summary ledger accounts:

Ant, Capital

		2024	
		Jan. 1	400,000
		Apr. 1	100,000

Bee, Capital

2024		2024	
July 1	50,000	Jan. 1	800,000

Ant, Drawing

2024			
Jan.-Dec.	60,000		

Bee, Drawing

2024			
Jan.-Dec.	60,000		

Income Summary

		2024	
		Dec. 1	300,000

Allocation of Earnings Equally:

The net income of L.E.300,000 for Ant & Bee Partnership is transferred by a closing entry on December 31, 2024, from the Income Summary ledger account to the partners' capital accounts, and also the drawing accounts are closed to the partners' capital accounts, by the following journal entries:

Date	Description	Dr	Cr
2024 Dec. 31	Income Summary….. Ant, Capital……. Bee, Capital…… To record allocation of net income for 2024.	300,000	 150,000 150,000
	Ant, Capital………… Bee, Capital……….. Ant, Drawing……. Bee, Drawing……. To close drawing accounts	60,000 60,000	 60,000 60,000

After the drawing accounts are closed, the balances of the partners' capital accounts show the ownership equity of each partner on December 31, 2024. If Ant & Bee Partnership has a net loss of, for example, L.E.200,000 during the year ended December 31, 2024, the Income Summary ledger account would have a debit balance of L.E.200,000. This loss would be transferred to the partners' capital accounts-or current accounts- by a debit to each capital account for L.E.100,000 and a credit to the Income Summary account for L.E.200,000.

Allocation of Earnings in Ratio of Partners' Capital Account Balances:

Allocation of partnership net income in proportion to the capital invested by each partner is most likely to be found in partnerships in which substantial investment is the principal ingredient for success. To avoid controversy, it essential that the partnership contract specify whether the income-sharing ratio is based on ***(1)*** the original capital investments, ***(2)*** the capital account balances at the beginning of each year, ***(3)*** the balances at the end of each year (before the distribution of net income or loss) or ***(4)*** the average balances during each year.

Assume that the partnership contract of Ant & Bee Partnership stipulates for division of net income in the ratio of ***original capital investments***. The net income of L.E.300,000 for 2024 is distributed as follows:

Ant = 300,000 × $\frac{400{,}000}{1{,}200{,}000}$ = L.E.100,000.

Bee = 300,000 × $\frac{800{,}000}{1{,}200{,}000}$ = L.E.200,000.

Assume that the net income is allocated in ratio of capital account balances at the ***end of the year*** (before drawings and the distribution of net income), the net income of L.E.300,000 for 2024 is divided as follows:

Ant = 300,000 × $\frac{500,000}{1,200,000}$ = L.E.120,000.

Bee = 300,000 × $\frac{750,000}{1,200,000}$ = L.E.180,000.

2.4 Partnership Financial Statements:

For accounting purposes, a partnership is a separate reporting entity. If the sales, stock and expenses of partnership were exactly the same as that of a sole trader, then the trading and profit and loss account (income statement) would be identical with that as prepared for the sole trader. Nevertheless, a partnership would have an extra section shown under the profit and loss account. This section is called the ***Profit and Loss Appropriation Account***, and it is in this account that the distribution of profits is shown.

The three financial statements-income statement (or trading and profit and loss account), balance sheet, and statement of cash flows-typically are prepared for the partnership at the end of each reporting period. In addition to the three principal financial statements, a ***statement of partners' capital (equity)*** is usually prepared to show the changes in the partners' capital accounts for the period.

Income Statement:

Sometimes explanations of the distribution of net income (or loss) among partners may be included in the partnership's income statement or in a note to the financial statements. Such information is referred to as the ***division of net income section*** of the income statement. Accordingly, the income statement for a partnership differs from that of a sole proprietorship in only one respect: a final section may be added to show the allocation of the net income among the partners, as illustrated below for the partnership of Basil & Waal, for the year ended December 31, 2024:

BASIL AND WAAL
INCOME STATEMENT
For the Year Ended December 31, 2024

Sales………………………. L.E.		1,200,000
Cost of goods sold…………		800,000)
Gross profit on sales……….		400,000
Operating expenses:		
Selling expenses………….	200,000	
General & Administrative expenses	80,000	280,000

Net income………………..		***120,000***
Division of net income:		
To Basil (50%)…………	60,000	
To Waal (50%)…………	60,000	120,000

Statement of Partners' Capital:

Partners and other users of partnership financial statements generally want a complete explanation or picture of the changes in the partners' capital accounts each year. To meet this requirement, a ***statement of partners' capital*** is prepared. For example, the statement of partners' capital for the A&B Partnership for 2024 is a follows:

A & B PARTNERSHIP
Statement of Partners' Capital
For the Year Ended December 31, 2024

	Amine	Baker	Total
Balance, January 1, 2024	L.E.40000	20000	60000
Add: Additional investment		1000	1000
Net income distribution	7960	12040	20000
	47960	33040	81000
Less: Withdrawal		(8000)	(8000)
Balance, December 31, 2024	L.E.47960	25040	73000

Illustration 2.3:

Beginning balances in the partners' capital accounts were Adam, L.E.160,000, and Eve, L.E.40,000. At year-end, the Income Summary account showed a credit balance of L.E.96,000, representing the net income for the year. The net income will be distributed in the light of the following assumptions:

1. Salaries to Partners, with Remainder in a Fixed Ratio:

Because partners often contribute different amounts of personal services, partnership agreements often provide for partners' salaries as a factor in the distribution of profits. For example, assume that Adam and Eve agree to annual salary allowances of L.E.12,000 for Adam and L.E.60,000 for Eve. These salaries, which total L.E.72,000 per year, are agreed upon by the partners in advance. Of course, the net income of the business is ***not*** likely to be exactly L.E.72,000 in a given year. Accordingly, the profit-and-loss sharing agreement should also determine a fixed ratio for allocating any profit or loss remaining after giving consideration to the agreed-upon salary allowances. It is assumed that Adam and Eve agree to divide any remaining profit or loss equally.

The appropriation of the L.E.96,000 in partnership net income between Adam and Eve is illustrated in the following schedule. The first procedure is to divide to each partner his or her agreed-upon salary allowance. This procedure allocates L.E.72,000 of the partnership net income. the residual L.E.24,000 is then distributed in the agreed-upon fixed ratio (50-50).

Allocation of Partnership Net Income

Description	**Adam**	**Eve**	**Net Income**
Net income to be allocated			96,000
Salary allowance to partners	12,000	60,000	(72,000)
Remaining income after salary allowances			24,000
Allocated in a fixed ratio:			
Adam (50%)…….	12,000		
Eve (50%)……….		12,000	(24,000)
Total share to each partner	24,000	72,000	00000

The amount of cash or other assets that a partner withdraws from the partnership may be greater than or less than the partner's salary allowance. Even if a partner decides to withdraw an amount of cash equal to his or her "salary allowance," the withdrawal should be recorded by debiting the partner's drawing account, ***not by debiting an expense account.***

Salary allowances to partners should not be recorded as expenses of the business.

2. Interest Allowances on Partners Capital, with Remainder in a Fixed Ratio:

For example, assume that Adam and Eve agree that both partners are to be allowed interest at ***15%*** on their beginning capital balances, with any remaining profit or loss to be distributed equally. Net income to be divided is L.E.96,000, and the opening capital balances are Adam, ***L.E.160,000***, and Eve, ***L.E.40,000.***

Allocation of Partnership Net Income

Description	**Adam**	**Eve**	**Net Income**
Net income to be allocated			96,000
Interest allowances on opening capital:			
Adam (160,000 × 15%)…	24,000		
Eve (40,000 × 15%)…		6,000	
Total allocated as interest allowances………..			(30,000)
Remaining income after interest allowances			66,000
Allocated in a fixed ratio:			
Adam (50%)…….	33,000		
Eve (50%)……….		33,000	(66,000)
Total share to each partner	57,000	39,000	00000

3. Salary Allowances, Interest on Capital, and Remainder in a Fixed Ratio:

Allocation of Partnership Net Income

Description	**Adam**	**Eve**	**Net Income**
Net income to be allocated			96,000
Salary allowances to partners	12,000	60,000	(72,000)
Income after salary allowances			24,000
Interest allowances on opening capital:			
Adam (160,000 × 10%)…	16,000		
Eve (40,000 × 10%)…		4,000	
Total allocated as interest allowances………..			(20,000)
Remaining income after salary and interest allowances….			4,000
Allocated in a fixed ratio:			
Adam (50%)…….	2,000		
Eve (50%)……….		2,000	(4,000)
Total share to each partner	30,000	66,000	-0-

4. Authorized Salary and Interest Allowance in Excess of Net Income:

Suppose that the net income had been only L.E.30,000. If the partnership agreement provides for salaries and interest on invested capital, these provisions are to be followed even though the net income for the year is ***less*** than the total of the authorized salaries and interest. If the net income of the partnership of Adam and Eve amounted to only

L.E.30,000, this amount would be allocated as shown below:

Allocation of Partnership Net Income

Description	**Adam**	**Eve**	**Net Income**
Net income to be allocated			30,000
Salary allowances to partners	12,000	60,000	(72,000)
Residual loss after salary allowances…………….			(42,000)
Interest allowances on beginning capital:			
Adam (160,000 × 10%)…	16,000		
Eve (40,000 × 10%)…		4,000	
Total allocated as interest allowances………..			(20,000)
Residual loss after salary and interest allowances….			(62,000)
Allocated in a fixed ratio:			
Adam (50%)…….	(31,000)		
Eve (50%)……….		(31,000)	62,000
Total share to each partner	(3,000)	33,000	-0-

Illustration 2.4:

Tamer and Camel are in partnership sharing profits and losses in the ratio of Tamer 3/5 (three fifths), Camel 2/5 (two fifths) or 3:2 (60%:40%). They are entitled to 5% annually interest on capitals, Tamer having L.E.40,000 capital and Camel L.E.120,000. Camel is to have a salary of L.E.10,000. They charge interest on drawings, Tamer being charged L.E.1,000 and Camel L.E.2,000. The net profit, before any distributions to the partners, amounted to L.E.100,000 for the year ended December 31, 2024.

Instructions:
Prepare profit and loss distribution plan in the form of: ***a.*** Appropriation Statement

b. Appropriation Account.

Solution
TAMER & CAMEL PARTNERSHIP
(a.) Profit and Loss Appropriation Statement
For the Year Ended December 31, 2024

Description	**L.E.**	**L.E.**	**L.E.**
Net profit			100,000
Add: Charged for interest on drawings:			
Tamer		1000	
Camel		2000	3,000
Subtotal			103,000
Less: Salary: Camel		10000	
Interest on capital :			
Tamer	2000		
Camel	6000	8000	(18000)
Balance of profit			85,000
Shared:			
Tamer 3/5 (or 60%)		51000	
Camel 2/5 (or 40%)		34000	(85,000)
			-0-

The L.E.100,000 net profits have therefore been shared:

	Tamer	Camel
Balance of profits	51,000	34,000
Interest on capital	2,000	6,000
Salary	-	10,000
Subtotal	*53,000*	*50,000*
Less: Interest on drawings	(1,000)	(2,000)
	52,000	48,000

TAMER & CAMEL PARTNERSHIP
(b.) Profit and Loss Appropriation Account
For the Year Ended December 31, 2024

Salary: Camel		10,000	Net Profit		100,000
Interest on capital			Interest on drawings:		
Tamer	2,000		Tamer	1,000	
Camel	6,000	8,000	Camel	2,000	3,000
Remaining profit:					
Tamer 3/5	51,000				
Camel 2/5	34,000	85,000			
Total		***103,000***	***Total***		***103,000***

Note: As stated earlier, the partners' capital accounts can be maintained as ***fixed*** or ***fluctuated***. Fixed capital accounts are preferred in comparison to fluctuated ones. When applying the fixed base, the partners' personal accounts can be shown as follows:

Tamer, Capital

		2024 Jan. 1 Balance b/d	40,000

Camel, Capital

		2024 Jan. 1 Balance b/d	120,000

Tamer, Current Account

2024		2024	
Dec. 31 Cash: Drawings	40,000	Dec. 31 Profit and loss	
,, Profit and loss App.:		appropriation account:	
Interest on drawings	1,000	Interest on capital	2,000
,, 31 Balance c/d	**12,000**	Share of profits	51,000
	53,000		53,000
		2025	
		Jan 1 Balance b/d	**12,000**

Camel, Current Account

2024		2024	
Dec. 31 Cash: Drawings	40,000	Dec. 31 Profit and loss	
,, 31 Profit and loss appropriation:		appropriation account:	
		Interest on capital	6,000
Interest on drawings	2,000	Share of profits	34,000
,, 31 Balance c/d	**8,000**	Salary	10,000
	50,000		50,000
		2025	
		Jan 1 Balance b/d	**8,000**

Notice that the salary of Camel was not paid to him, it was merely credited to his account. If in fact it was paid in addition to his drawings, the L.E.10,000 cash paid would have been debited to the current account changing the L.E.8,000 credit balance into a L.E.2,000 debit balance.

Sometimes, the capital accounts and current accounts are shown in columnar form. For the preceding accounts of Tamer and Camel these would appear as follows:

Capital Accounts

Description	Tamer	Camel	Description	Tamer	Camel
			2024 Jan 1 Balance b/d	**40,000**	**120,000**

Current Accounts

Description	Tamer	Camel	Description	Tamer	Camel
2024			2024		
Dec 31:			Dec 31:		
Cash: Drawings	40,000	40,000	Interest on capital	2,000	6,000
Interest on drawings	1,000	2,000	Share of profits	51,000	34,000
Dec 31 Balance c/d	**12,000**	**8,000**	Salary		10,000
	53,000	**50,000**		**53,000**	**50,000**
			2025 Jan 1 Balance b/d	**12,000**	**8,000**

On the other hand, when applying the ***fluctuating*** base, the partners' capital accounts can be shown as follows:

Tamer, Capital Account

2024		2024	
Dec. 31 Cash: Drawings	40,000	Jan 1 Balance b/d	40,000
,, 31 Profit and loss		Dec. 31 Profit and loss	
appropriation:		appropriation account:	2,000
Interest on drawings	1,000	Interest on capital	51,000
,, 31 Balance c/d	**52,000**	Share of profits	
	53,000		93,000
		2025	
		Jan 1 Balance b/d	**52,000**

Camel, Capital Account

2024		2024	
Dec. 31 Cash: Drawings	40,000	Jan 1 Balance b/d	120,000
,, 31 Profit and loss		Dec. 31 P & L appropriation	
appropriation:		a/c:	
		Interest on capital	6,000
Interest on drawings	2,000	Share of profits	34,000
,, 31 Balance c/d	**128,000**	Salary	10,000
	170,000	2025	170,000
		Jan 1 Balance b/d	**128,000**

Illustration 2.5:

Maher and Rashid started a partnership on January 1, 2024, with capitals of L.E.150,000 and L.E.100,000 respectively. On June 30, 2024, Maher introduced a further capital of L.E.50,000. Drawings during the year amounted to L.E.30,000 and L.E.20,000 respectively for Maher and Rashid. Interest on capital is to be allowed at 5% annually. No interest is to be charged on drawings. Rashid is to be allowed a salary of L.E.5,000 per month. The profit for the year before charging salary and interest amounted to L.E.200,000.

Instructions:

You are required to prepare the accounts of the partnership and partners presuming:

a. Capitals to be fixed, and

b. Capitals to be fluctuating.

Solution

Calculations:

Interest on capital:

Maher = 150000 × 5% + 50000 × 5% × $\frac{6}{12}$ **=** L.E.8750.

Rashid = 100000 × 5% = L.E.5000.

MAHER & RASHID PARTNERSHIP
Profit and Loss Appropriation Account
For the year ending December 31, 2024

Interest on capital:		Net profit for the year	200,000
Maher 8,750			
Rashid 5,000	13,750		
Salary: Rashid	60,000		
Share of net profit:			
Maher 63,125			
Rashid 63,125	126,250		
	200,000		**200,000**

a. When capitals are fixed:

Capital Accounts

Details	Maher	Rashid	Details	Maher	Rashid
2024			2024		
			Jan 1 Cash	150,000	100,000
			June 30 Cash	50,000	
Dec 31 Balance c/d	**200,000**	**100,000**			
	200,000	**100,000**	2025	**200,000**	**100,000**
			Jan 1		
			Balance b/d	**200,000**	**100,000**

Current Accounts

Details	Maher	Rashid	Details	Maher	Rashid
2024			2024		
Dec 31:			Dec 31:		
Drawings	30,000	20,000	Interest on capital	8,750	5,000
			Salary		60,000
Dec 31 Balance c/d	**41,875**	**108,125**	Share of profits	63,125	63,125
	71,875	**128,125**		**71,875**	**128,125**
			2025		
			Jan 1 Balance b/d	**41,875**	**108,125**

b. When capitals are fluctuating:

Capital Accounts

Details	Maher	Rashid	Details	Maher	Rashid
2024			2024		
Dec 31:			Jan 1 Cash	150,000	100,000
Drawings	30,000	20,000	June 31 Cash	50,000	
			Dec 31:Interest	8,750	5,000
			Salary		60,000
Balance c/d	**241,875**	**208,125**	Share of profit	63,125	63,125
	271,875	**228,125**		**271,875**	**228,125**
			2025 Jan 1		
			Balance b/d	**241,875**	**208,125**

2.5 Questions and Practical Problems:

TRUE OR FALSE QUESTIONS :

For each of the following statements, circle the **T** or the **F** to indicate whether the statement is **True** or **False**.

(1)T F Two expenses normally found in the income statement of a partnership are salaries to partners and interest on partners' capital.

(2)T F When partnership net income is allocated based on a fixed ratio; all partners should be allocated an equal share of net income.

(3)T F Salary allowances to partners are recorded as salary expense by the partnership.

(4) T F The amount of cash that a partner withdraws from the partnership may be greater or less than the partner's salary allowance.

(5) T F Partnership profit sharing agreements often call for salary allowances and interest on capital accounts to account for the different contributions by its partners.

(6) T F If a partnership contract provides for salaries to partners and interest on invested capital, these provisions are to be followed even though the net income of the year is less than the total of the authorized salaries and interest.

(7) T F Although a partnership operates at a profit, it is possible that one partner's share of this profit will be a loss, resulting in a debit to the partner's capital or current account.

(8) **T F** Current accounts are maintained in case of Fluctuating Capital System.

(9) **T F** In the absence of any contract to the contrary partners are required to share profits and losses equally.

MULTIPLE CHOICE QUESTIONS:

Choose the best answer for each of the following questions and circle the identifying letter.

1. The income statement of a partnership:

- **A** Includes among revenues the total amount of interest on drawings made by the partners during the year.
- **B** Includes among expenses the total amount of drawings made by the partners during the year.
- **C** May show the division of net income among the partners.
- **D** Must include as salary expense the salary allowances to partners in the division of net income.

2. Which of the following accounts is ***not*** closed in the closing process for a partnership?

- **A** Depreciation Expense.
- **B** Tamer, Capital.
- **C** Income Summary.
- **D** Tamer, Drawing.

3. The nature of salary and interest allowances in a partnership profit-and-loss-sharing agreement is best described as:

- **A** The amount upon which each partner will have to pay personal income taxes.
- **B** Expenses of the business to be deducted from revenue in determining net income.
- **C** A means of allocating net income in relation to services rendered and capital invested by the partners.
- **D** A method of determining how much each partner can withdraw each month.

4. When partners contribute varying amounts of capital and personal services, their partnership agreement logically should provide for:

- **A** Partners' salaries and interest on capital investment as factors in profit sharing.
- **B** Equal division of profits.
- **C** A bonus to old partners upon the admission of a new partner.
- **D** Limiting withdrawals to the amount of net income.

5. A partnership agreement which allows the partners credit for interest on their capital balances:

- **A** Is a means of splitting some portion of partnership income in proportion to each partner's investment in the business.
- **B** Increases each partner's share of the total income.
- **C** Results in showing a smaller net income in the partnership income statement.
- **D** Requires the showing of interest expense in the partnership income statement.

6. Sami and Jawad are the only two partners in the partnership of Sami, Jawad & Co. At the beginning of September, the amounts in their capital accounts were L.E.80,000 and L.E.120,000 for Sami and Jawad, respectively. During the month of September, Sami withdrew L.E.10,000 and Jawad withdrew L.E.12,000 from the partnership. The net income of the partnership for the month was L.E.12,000. Assuming that profits and losses are split equally, what is the balance in the partners' capital accounts at the end of September (fluctuating capital method)?

- **A** Sami, L.E.64,000 and Jawad, L.E.102,000.
- **B** Sami, L.E.70,000 and Jawad, L.E.110,000.
- **C** Sami, L.E.76,000 and Jawad, L.E.114,000.
- **D** Sami, L.E.86,000 and Jawad, L.E.126,000.

7. In the current year, Ream invested an additional L.E.20,000 in cash in a partnership. Her share of partnership net income for the year was L.E.64,000, of which she withdrew only L.E.34,000. The amount of partnership income that must be included in the profit and loss appropriation account for Ream

- **A** L.E.64,000.
- **B** L.E.34,000.
- **C** L.E.44,000.
- **D** L.E.10,000

8. Partner Said' s capital account at the beginning of the year had a credit balance of L.E.96,000. Early in the year, Said invested an additional L.E.60,000 cash in the partnership.

Although his share of partnership net income for the year was L.E.166,000, Said withdrew only L.E.140,000 during the year. The amount of partnership income that must be shown on the profit and loss distribution plan for Said is:

- **A** L.E.140,000.
- **B** L.E.166,000.
- **C** L.E.86,000.
- **D** L.E.26,000.

9. Refer to the above data in 8. The statement of partners' capital for the year would show Said's capital balance at the end of the year at (fluctuating capital method):

- **A** L.E.322,000.
- **B** L.E.146,000.
- **C** L.E.96,000.
- **D** L.E.182,000.

10. The statement of partners' capital for the current year shows that in June Partner Rose invested an additional L.E.40,000 cash in the partnership. Rose's share of partnership net income for the year was L.E.120,000, and she withdrew L.E.4,000 cash each month during the year. If Rose's capital balance at the end of the year is L.E.230,000, what was her capital balance at the beginning of the year?

- **A** L.E.342,000.
- **B** L.E.112,000.
- **C** L.E.70,000.
- **D** L.E.118,000.

11. At the beginning of the current year, Belal invested an additional L.E.80,000 in cash in a partnership. His share of partnership net income for the year was L.E.136,000, of which he withdrew only L.E.60,000. The amount of partnership income that must be credited to Belal personal account for the current year is:

- **A** L.E.60,000.
- **B** L.E.80,000.
- **C** L.E.76,000.
- **D** L.E.136,000.

12. Nasser and Gasser are partners in a partnership. During the current year, the partnership earned net income of L.E.304,00. How much of this net income should be allocated to Gasser, assuming that the partnership contract calls for an equal split of net income after salary allowances of L.E.110,000 and L.E.130,000 for Nasser and Gasser respectively?

- **A** L.E.152,000.
- **B** L.E.130,000.
- **C** L.E.32,000.
- **D** L.E.162,000.

13. The profit-sharing agreement for Haney and Lamey is as follows: Haney and Lamey agree to share residual profits and losses 75% to Haney and 25% to Lamey after salary allowances and interest at 10% on beginning capital balances. Salary allowances are L.E.80,000 to Haney and L.E.110,000 to Lamey. Capital balances at the beginning of the year were Haney, L.E.120,000 and Lamey, L.E.80,000. If partnership net income for the current year is L.E.610,000, Lamey’s share of partnership net income is:

- **A** L.E.153,000.
- **B** L.E.100,000.
- **C** L.E.218,000.
- **D** L.E.270,400.

14. Refer to the above data in 13. If partnership net income for the current year is L.E.170,000, Lamey’s share of partnership net income is:

- **A** L.E.105,000.
- **B** L.E.108,000.
- **C** L.E.42,500.
- **D** L.E.100,000.

15. Prince and King are partners in a construction firm, having capital balances at the beginning of the current year as follows: Prince, L.E.180,000 and King, L.E.120,000. Partnership net income for the current year is L.E.285,000. The profit-sharing agreement provides for interest of 15% on beginning capital balances, salary allowance to Prince of L.E.120,000 and to King of L.E.40,000, and any remaining profit or loss to be divided 75% to Prince and 25% to King. According to this agreement, partnership net income of L.E.285,000 for the current year is allocated:

- **A** Prince, L.E.207,000; King, L.E.78,000.
- **B** Prince, L.E.213,750; King, L.E.71,250.
- **C** Prince, L.E.387,000; King, L.E.198,000.
- **D** Cannot determine without knowing how much each partner has withdrawn during the year.

16. Refer to the above data in 15. The profit-sharing agreement provides for interest of 15% on beginning capital balances, salary allowance to Prince of L.E.200,000 and to King of L.E.100,000, any residual profit or loss to be distributed 60% to Prince and 40% to King. According to this agreement, partnership net income of L.E.285,000 for the current year is allocated:

- **A** Prince, L.E.171,000; King, L.E.114,000.
- **B** Prince, L.E.187,000; King, L.E.98,000.
- **C** Prince, L.E.191,000; King, L.E.94,000.
- **D** Cannot determine without knowing how much each partner has withdrawn during the year.

17. Andrew and Bakery agree to share residual partnership net income or loss equally after salaries and interest at 10% on beginning capital balance. Salary allowances for the current year are L.E.72,000 to Andrew and L.E.120,000 to Bakery. Beginning capital balances for Andrew and Bakery were L.E.160,000 and L.E.200,000, respectively. If partnership net income for the current year is L.E.252,000, Andrew's share of this net income is:

- **A** L.E.126,000.
- **B** L.E.12,000.
- **C** L.E.100,000.
- **D** L.E.110,000.

18. Refer to the above data in 17. If partnership net income for the current year is L.E.192,000, Andrew's share of this net income is:

- **A** L.E.96,000.

- **B** L.E.70,000.
- **C** L.E.18,000.
- **D** L.E.72,000.

EXERCISES AND PROBLEMS:

(1) The partnership agreement of Jud and Hood has the following provision:

a. The partners are to earn 8% interest on the average capital.

b. Jud and Hood are to earn salaries of L.E.35,000 and L.E.25,000, respectively.

c. Any remaining income or loss is to be divided between Jud and Hood in a 60-40 ratio.

d. Jud's average capital is L.E.100,000, and Hood's is L.E.60,000.

Instructions:

Prepare an income distribution schedule assuming the income of the partnership is ***(1)*** L.E.100,000 and ***(2)*** L.E.40,000.

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(2) West and East are partners. Their capital accounts during 2020 were as follows:

West, Capital

Aug. 1	12,000	Jan. 1	60,000
		Apr. 1	16,000
		Oct. 31	12,000

East, Capital

March. 1	18,000	Jan. 1	100,000
		July. 1	14,000
		Oct. 1	10,000

Partnership net income is L.E.100,000 for the year. The partnership agreement provides for the division of income as follows:

1. Each partners is to be credited 8% interest on his or her average capital.

2. Any residual income or loss is to be divided equally.

Instructions:

Prepare an income appropriation plan.

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(3) The income statement for the Apple & Orange Partnership for the year ended December 31, 2024, follows:

APPLE & ORANGE PARTNERSHIP
Income Statement
For the Year Ended December 31, 2024

Net Sales	L.E. 600,000
Cost of Goods Sold	(380,000)
Gross Margin	L.E. 220,000
Operating Expenses	(60,000)
Net Income	L.E. 160,000

Additional Information for 2024:

1. Apple began the year with a capital balance of L.E.81,600.

2. Orange began the year with a capital balance of L.E.224,000.

3. On April 1, Apple invested an additional L.E.30,000 into the partnership.

4. On August 1, Orange invested an additional L.E.40,000 into the business the partnership.

5. Throughout 2024, each partner withdrew L.E.800 per week in anticipation of partnership net income. The partners agreed that these withdrawals are not to be included in the computation of average capital balances for the purposes of income distributions.

Apple and Orange have agreed to distribute partnership net income according to the following plan:

	Apple	Orange
1. Interest on average capital balances	6%	6%
2. Bonus on net income before the bonus but after interest on average capital balances	10%	
3. Salaries	L.E.50,000	L.E.60,000
4. Residual (if positive)	70%	30%
Residual (if negative)	50%	50%

Instructions:

1. Prepare a schedule that presents the division of partnership net income for 2024. Show supporting calculations in good form. Round to the nearest pound.
2. Prepare the statement of partners' capital at December 31, 2024, supposing that fluctuating capital method is adopted.
3. How would your answer to part ***1*** change if all the provisions of the income distribution plan were the same except that the salaries were L.E.60,000 to Apple and L.E.70,000 to Orange?

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(4) Sunday and Friday, both of whom are CPAs, form a partnership, with Sunday investing L.E.200,000 and Friday, L.E.160,000. They agree to share net income as follows:

1. Salary allowances of L.E.160,000 to Sunday and L.E.120,000 to Friday.

2. Interest allowances at 15% of beginning capital account balances.

3. Any partnership earnings in excess of the amount required to cover the interest and salary allowances to be divided 60% to Sunday and 40% to Friday.

The partnership net income for the first year of operations amounted to L.E.494,000 before interest and salary allowances.

Instructions:

Show how this L.E.494,000 should be divided between the two partners. Use a three-column schedule. List on separate lines the amounts of interest, salaries, and the residual amount divided.

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(5) A small food shop was organized as a partnership with Hanna investing L.E.160,000 and Shefa investing L.E.240,000. During the first year, net income amounted to L.E.220,000.

Instructions:

1. Determine how the L.E.220,000 net income would be divided under each of the following three independent assumptions as to the agreement for sharing profits and losses.
   a. Net income is to be divided in fixed ratio: 40% to Hanna and 60% to Shefa.
   b. Interest at 15% to be allowed on beginning capital investments and balance to be divided equally.
   c. Salaries of L.E.72,000 to Hanna and L.E.112,000 to Shefa; interest at 15% to be allowed on beginning capital investments; balance to be divided equally.
2. Prepare the Journal entry to close the Income Summary account, using the allocation of net income developed in **1(c),** above. Prepare, also Partners' Current account (fixed capital method).

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(6) Financial Consultants has three partners-A, B, and C. During the current year their capital balances were: A, L.E.360,000; B, L.E.280,000; and C, L.E.160,000. The partnership agreement provides that partners shall receive salary allowances as follow: A, L.E.20,000; B, L.E.100,000; C, L.E.56,000. The partners shall also be allowed 12% interest annually on their capital balances. Residual profit or loss is to be divided: A, one-half; B, one-third; C, one-sixth.

Instructions:

Prepare separate schedules showing how income will be distributed among the three partners in each of the following cases. The figure given in each case is the annual partnership net income or loss to be allocated among the partners.

1- Income of L.E.1,052,000.

2- Income of L.E.134,000.

3- Loss of L.E.64,000.

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(7) A and B are in partnership, sharing profits and losses in the ratio 3:2. The following information was

taken from their records for the year ended December 31, 2024, before the completion of their profit and loss appropriation account.

Current accounts (January 1, 2024)		L.E.
	A	6,400 Dr
	B	3,300 Cr
Drawings	A	30,000
	B	20,000
Net trading profit		68,100
Interest on capital	A	5,400
	B	7,200
Salary	A	20,000
Interest on drawings	A	2,700
	B	1,800

<u>Instructions:</u>

Prepare, for the year ended December 31, 2024:

a. The Profit & Loss Appropriation account of A & B.

b. The Current accounts in the ledger for A & B.

CHAPTER THREE

CAPITAL MODIFICATIONS AND CHANGES IN MEMBERSHIP OF THE PARTNERSHIP

CHAPTER THREE

CAPITAL MODIFICATIONS AND CHANHES IN MEMBERSHIP OF THE PARTNERSHIP

3.1 Introduction:

Changes in the membership of a partnership occur with the addition (admission) of new partner(s) or the retirement (withdrawal) of present partner(s). From a legal viewpoint a partnership is ***dissolved*** by the retirement or death of a partner or by the admission of a new partner. Although a partnership is ended in a legal sense when a partner withdraws or a new partner is admitted, the partnership often continues operations with little outward evidence of change.

A partner's interest often is considered a share in the partnership that may be transferred, much as shares of a corporation's capital stock are transferred among stockholders, without disturbing the continuity of the partnership. Changes in the ownership of a partnership raise a number of accounting and managerial issues. Among these issues are the setting of terms for admission of a new partner, the possible revaluation of existing partnership assets, the development of a new plan for the allocation of net income or loss, and the determination of the amount to be paid to a retiring partner.

Of course, new partners are often a primary source of additional capital or needed business expertise. The legal structure of a partnership requires that the ***admission of a new partner*** be subject to the unanimous approval of the present partners. Additionally, public announcements are typically made about new partner admission so that third parties transacting business with the partnership are aware of the partnership change.

The ***retirement*** or ***withdrawal of a partner from a partnership*** results in the legal dissolution of the partnership. Dissolution does not require termination of the business; it means that the partnership's records are brought up to date through any necessary adjusting entries and the withdrawing partner's capital account is determined as of the date of the withdrawal. Appropriate recognition then is given to the withdrawal of the partner.

The admission of a new partner or retirement of a present partner results in a new partnership, however daily operations of the business generally are not affected. Because a new partnership is formed, many partnerships use the transactions surrounding the change as evidence for revaluing the partnership's existing assets or for recording previously unrecognized ***goodwill.*** This procedure of ***asset revaluation*** and ***goodwill recognition*** constitutes a common practice in partnership form of business organizations.

The justification given to revaluing assets at the time of the change in partnership membership is to state fully the true economic condition of the partnership at the time of the change and to assign the changes in assets values and goodwill to the partners who have been managing the business during the time the changes in values occurred. It is believed that this revaluation is necessary to value properly each partner's present equity in the partnership.

Also, changes in the ownership of a partnership may take the form of capital modifications whether capital increase or capital decrease (the focus of the current chapter), the admission of a new partner and the retirement of a partner, will be highlighted in the following chapters.

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

3.2 Capital increase:

In general, it is favorable 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:

3.2.1 By means of 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	Explanation	Debit	credit
2024 Jan. 1	By Cash or Assets To Capital Account Partner A xxx Partner B xxx To record capital increase by introducing cash or other assets	Xxx	 xxx

3.2.2 Using 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	Explanation	Debit	credit
2024 Jan. 1	By Partners current a/c To Capital Account Partner A xxx Partner B xxx To record capital increase by using credit balances of partners current accounts.	xxx	 xxx

3.2.3 Using 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	Explanation	Debit	credit
2024 Jan. 1	By General Reserve a/c To Capital Account Partner A xxx Partner B xxx To record capital increase by using general reserve.	xxx	 xxx

3.2.4 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	Explanation	Debit	credit
2024 Jan. 1	By A's Loan a/c To Capital Account (Partner A) To record capital increase by using partner's loan.	xxx	 xxx

Illustration 3.1:

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

<u>Instructions:</u>

1- Journal entries needed to record the above agreement.

2- The new Balance Sheet after this agreement.

Solution:

<u>Calculations:</u>	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)	<u>+40,000</u>	<u>----</u>	<u>----</u>
Added shares	50,000	50,000	50,000

<u>Journal entries:</u>

Date	Explanation	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 <u>general reserve.</u>		
	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 <u>balances of current a/c.</u>		
	By Cash	25,000	
	To Capital a/c		25,000
	B 10,000 C 15,000 To record completing the <u>capital increase by cash.</u>		
	By Bank	40,000	
	<u>To Sundries</u>		
	Capital a/c (A)		20,000
	Partners' Current a/c (A)		20,000
	To record completing the capital increase of partner (A).		

The Balance Sheet after the agreement

Assets Liabilities

Fixed Assets			Capital a/c		
Cars	100000		A	150000	
Buildings	30000		B	150000	
Equipments	70000	200000	C	150000	450000
Current Assets					
A / R	60000				
Securities	40000				
Bank	115000				
Cash	35000	250000			
		450000			450000

3.2.5 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 to prepare Revaluation Profit & Loss Account. In the following paragraphs a brief explanation will be given regarding this account.

The Revaluation Profit & Loss Account

Dr. Cr.

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

<u>Notes:</u>

- What is treated and appeared in the Revaluation Profit & Loss 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 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.

3.3 Capital Decrease:

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

3.3.1 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 are those partners finding 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	Particulars	Dr.	Cr.
202x	By Capital account Partner A xxx Partner B xxx To Cash / Assets To record 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	Account title & explanation	Dr.	Cr.
202x Jan. 1	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
Mar. 1	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

3.3.2 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	Particulars	Dr.	Cr.
202x Jan. 1	By Capital Account (partner A) xx (partner B) xx To Partners Current a/c (partner A) xx (partner B) xx	xx	 xx

	To record the capital decrease by the balances of current account.		

3.3.3 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 3.2:

A, B and C are partners in a partnership and the profit and losses sharing ratio is 1:1:1. They decided by December 31, 2024 to reduce their capitals in the partnership because they found that there is money and other assets in excess of 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.

Instructions: Record the above agreement.

Solution:

Date	Details	Dr.	Cr.
2024 Dec. 31	By Capital a/c A 20,000 B 10,000 C 14,000 To Sundries: Cash Bank Goods To record the capital increase by using the general reserve.	44,000	 24,000 10,000 10,000

Example 3.3:

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			**A/P**		**28,000**
Goods		**13,000**	**Tax provision**		**2,000**
A/R	**14,000**				
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.

Instructions:

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. 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**		
Provision for decrease on securities prices	**1,000**	***Capital a/c (net loss)***	**12,000**
Tax provision	**2,000**	***X 6,000***	
		Y 6,000	
	17,000		**17,000**

Date	Details	Dr.	Cr.
202x	By Revaluation P&L account	17000	
	To sundries:		
	Machines		8000
	Goods		3000
	Accounts R (bad debts)		2000
	Provision for doubtful debts		1000
	Provision for decrease on securities prices		1000
	Tax provision		2000
	To record losses of revaluation.		
	By sundries:		
	Cars	4000	
	Accounts Payable	1000	
	To Revaluation P&L account		5000
	To record profits of revaluation.		
	By Capital account	12000	
	X 6000		
	Y 6000		
	To Revaluation P&L a/c		12000

	To record capital decrease by net results of revaluation process.		

The Balance Sheet after the agreement

Assets **Liabilities**

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

3.4 Exercises and Practical Problems:

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.

Instructions:

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.

Instructions:

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.

Instructions*:*

Record 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			**Loans**		**20,000**
A / R	**46,000**		**A/P**		**66,000**
Goods	**60,000**				
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.

Instructions:

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			**A/P**		**32,000**
10,000	**30,000**	**93,000**	**Loans**		**48,000**
			Tax		
Current Assets			**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.

Instructions:

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.

CHAPTER FOUR
ADMISSION OF A NEW PARTNER

CHAPTER FOUR

ADMISSION OF A NEW PARTNER

4.1 INTRODUCTION:

This chapter 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 require 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.

4.2 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.

4.2.1 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.

Illustration 4.1:

L and M are partners in a partnership. The profit and loss sharing ratio is 1:1. The following is the balance sheet of their partnership as on June 30, 2025:

Assets			**Liabilities**		
Goodwill		**10000**	**Capital a/c**		
Fixed Assets		**80000**	**L**	**80000**	
Cars		**60000**	**M**	**60000**	**140000**
Buildings		**30000**	**Loans**		**40000**
Equipment			**A/P**		**70000**
Current Assets					
A / R	**26000**				
(-) Provision for doubtful debts	**6000**	**20000**			
Goods		**40000**			
Cash		**10000**			
		250000			**250000**

On July1, 2025, 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.

Instructions:

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	Account title & explanation	Dr.	Cr.
2025	**By Revaluation P&L a/c**	**15000**	
July 1	**To Sundries**		
	Cars		**10000**
	Equipment		**4000**
	A/R (bad debts)		**1000**
	To record losses of revaluation.		
	By Sundries		
July 1	**Goodwill**	**10000**	
	Buildings	**20000**	
	Provision for Doubtful Debts	**3500**	
	A/P	**1500**	
	To Revaluation P&L a/c		**35000**
	To record profits of the revaluation.		
	By Revaluation P&L a/c		
	To Capital a/c	**20000**	
July 1	**L 10000**		**20000**
	M 10000		
	To close the net result of revaluation process in capital a/c of old partners.		
	By Capital a/c		
	L 45000		
	M 35000	**80000**	
July 1	**To Capital a/c (N)**		
	To record the sale of half share of L & M to the new partner (N).		**80000**

Dr. Revaluation Profit & Loss Account Cr.

To sundries:		**By sundries:**	
Cars	**10000**	**Goodwill**	**10000**
Equipment	**4000**	**Buildings**	**20000**
A/R (bad debts)	**1000**	**Provision for doubtful debts**	**3500**
Capital a/c (net profit)	**20000**	**A/P**	**1500**
L 10,000			
M 10,000			
	35000		**35000**

Dr. Capital Account Cr.

Details	L	M	N	Total	Details	L	M	N	Total
					Balance 30/6	80000	60000	….	140000
Balance 1/7	90000	70000	….	160000	By Revaluation	10000	10000	….	20000
	90000	70000	….	160000		90000	70000	….	160000
To capital (N)	45000	35000	….	80000	Balance 1/7	90000	70000	….	160000
Balance 1/7	45000	35000	80000	160000	By capital (L&M)	……	……	80000	80000
	90000	70000	80000	240000		90000	70000	80000	240000

Assets Balance Sheet as on July1, 2025 Liabilities

Goodwill		**20000**	**Capitals**		
Fixed Assets			**L**	**45000**	
Cars		**70000**	**M**	**35000**	
Buildings		**80000**	**N**	**80000**	**160000**
Equipment		**26000**	**Loans**		**40000**
Current Assets			**A/P**		**68500**
A / R	**25000**				
(-) Provision for doubtful debts	**2500**	**22500**			
Goods		**40000**			
Cash		**10000**			
		268500			**268500**

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 illustration, 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 by assets as 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 illustration will explain the accounting treatment of the above.

Illustration 4.2:

L and M are partners in a partnership. The profit and loss sharing ratio is 1:1. The following is the balance sheet of their partnership as on June 30, 2025.

Assets **Liabilities**

Goodwill		**10000**	**Capital a/c**		
Fixed Assets		**80000**	**L**	**80000**	
Cars		**60000**	**M**	**60000**	**140000**
Buildings		**30000**	**Loans**		**40000**
Equipment			**A/P**		**70000**
Current Assets					
A / R	**26000**				
(-) Provision for doubtful debts	**6000**	**20000**			
Goods		**40000**			
Cash		**10000**			
		250000			**250000**

On July 1, 2025, partners agreed to admit 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- 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 a new investment in the partnership.

Instructions:

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	Account title & explanation	Dr.	Cr.
2025	By Revaluation P&L a/c	15000	
July 1	To Sundries		
	Cars		10000
	Equipment		4000
	A/R (bad debts)		1000
	To record losses of revaluation.		
	By Sundries		
July 1	Goodwill	10000	
	Buildings	20000	
	Provision for Doubtful Debts	3500	
	A/P	1500	
	To Revaluation P&L a/c		35000
	To record profits of the revaluation.		
	By Revaluation P&L a/c		
	To Capital a/c	20000	
July 1	L 10000		20000
	M 10000		
	To close the net result of revaluation process in capital a/c of old partners.		
	By Bank a/c	80000	
	To Capital a/c (N)		80000
July 1	To record payment of new partner's share in the bank.		

Dr. Revaluation Profit & Loss Account Cr.

To sundries:		By sundries:	
Cars	10000	Goodwill	10000
Equipment	4000	Buildings	20000
A/R (bad debts)	1000	Provision for doubtful	
Capital a/c (net profit)	20000	debts	3500
L 10,000		A/P	1500
M 10,000			
	35000		35000

Dr. Capital Account Cr.

Details	L	M	N	Total	Details	L	M	N	Total
					Balance 30/6	80000	60000	….	140000
Balance 1/7	90000	70000	….	160000	By Revaluation	10000	10000	….	20000
	90000	70000	….	160000		90000	70000	….	160000
					Balance 1/7	90000	70000	….	160000
Balance 1/7	90000	70000	80000	240000	By Bank	……	……	80000	80000
	90000	70000	80000	240000		90000	70000	80000	240000

Assets Balance Sheet as on July1, 2025 Liabilities

Goodwill		20000	Capitals		
Fixed Assets			L	90000	
Cars		70000	M	70000	
Buildings		80000	N	80000	240000
Equipment		26000	Loans		40000
Current Assets			A/P		68500
A / R	25000				
(-) Provision for doubtful debts	2500	22500			
Goods		40000			
Cash		10000			
Bank		80000			
		348500			348500

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.

4.2.2 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.

Illustration 4.3:

Maha and Mai are partners in a partnership. They share profit and loss equally. The following is the balance sheet of their partnership as on October 1, 2025

Assets **Liabilities**

Goodwill		**5000**	**Capital a/c**		
Fixed Assets			**Maha**	**75000**	
Cars		**30000**	**Mai**	**75000**	**150000**
Land		**50000**			
Buildings		**60000**	**Loans**		**17000**
Current Assets			**A/P**		**30000**
A / R	**33000**		**N/P**		**20000**
(-) Provision for doubtful debts	**1000**	**32000**			
Goods		**20000**			
Bank		**20000**			
		217000			**217000**

On October 5, 2025, 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.

Instructions:

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)	**25000**	**25000**	**---**
- Distributing revaluation profits to all partners according to the new ratio (3:3:4)	**15000**	**15000**	**20000**
- Differences representing what the new partner should pay to old ones	**-10000**	**-10000**	**+20000**

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	Account title & explanation	Dr.	Cr.
2025 **Oct. 5**	**By Bank a/c** **To Partners' current account** **Maha 10000** **Mai 10000** **To record payment by new partner to old ones against profits of revaluation.**	**20000**	 **20000**

Oct. 5	**By Cash a/c** **To Capital a/c (Manar)** **To record payment by the new partner for his share in the partnership.**	**100000**	 **100000**

Balance Sheet as on October 5, 2025

Assets **Liabilities**

Goodwill		**5000**	**<u>Capital a/c</u>**		
<u>Fixed Assets</u>			**Maha**	**75000**	
Cars		**30000**	**Mai**	**75000**	
Land		**50000**	**Manar**	**<u>100000</u>**	**250000**
Buildings		**60000**	**Loans**		**17000**
<u>Current Assets</u>			**A/P**		**30000**
A / R	**33000**		**N/P**		**20000**
(-) Provision for			**<u>Partners'</u>**		
doubtful debts	**<u>1000</u>**	**32000**	**<u>Current a/c</u>**		
Goods		**20000**	**Maha**	**10000**	
Bank		**40000**	**Mai**	**<u>10000</u>**	**20000**
Cash		**100000**			
		<u>337000</u>			**<u>337000</u>**

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.

4.3 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 (1) equal, (2) more than, or (3) 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 illustrations will be presented to explain these different cases.

4.3.1 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.

Illustration 4.4:

'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 January1, 2025 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.

Instructions: 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.
2025 **Jan. 1**	**By Cash a/c** **To Capital account (Aatef)** **To record payment by the new partner.**	**100000**	 **100000**

4.3.2 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).

4.3.2.1 The Bonus Method:

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

Illustration 4.5:

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 January 1, 2025 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.

Instructions:

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 is = 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 entry is:

Date	Details	Dr.	Cr.
2025 **Jan. 1**	**By Cash a/c** **To Capital account:** **A 10000** **B 10000** **C 110000** **To record payment by the new partner C including a bonus to old partners.**	**130000**	 **130000**

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).

4.3.2.2 The Goodwill Method:

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.

Illustration 4.6:

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 January 1, 2025 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.

Instructions:

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 is = 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.
<u>2025</u> **Jan. 1**	**By Goodwill a/c** **To Capital account:** **A 30000** **B 30000** **To increase old partners' capital by goodwill.**	**60000**	 **60000**
 Jan. 1	**By Cash a/c** **To Capital account: (partner C)** **To record payment by the new partner C for his/her share.**	**130000**	 **130000**

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.

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

Similar to the past case (4.3.2), 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).

4.3.3.1 The Bonus Method:

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

<u>Illustration 4.7:</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 January 1, 2025, 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.

Instructions:

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 is = 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 entry is:

Date	Details	Dr.	Cr.
2025	**By Sundries:**		

Jan. 1	**Cash a/c** **Capital a/c** **(A) 10000** **(B) 10000** **To Capital account: (C)** **To record payment by the new partner C.**	**70000** **20000**	 **90000**

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.

4.3.3.2 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).

Illustration 4.8:

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 January 1, 2025, 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.

Instructions:

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 is = 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 capitals of old partners = 20,000X 3/1 = LE 60,000.

The needed journal entries are:

Date	Details	Dr.	Cr.
2025 Jan. 1	**By Capital account** **A 30000** **B 30000** **To Capital reserve** **To decrease old partners' capital by capital reserve.**	**60000**	**60000**
Jan. 1	**By Cash a/c** **To Capital account: (partner C)** **To record payment by the new partner C for his/her share.**	**70000**	**70000**

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.

4.3 Exercises and Practical Problems

(1) A and B are partners in a partnership, sharing profits and losses equally. The following is the B/S of their partnership as on December 31, 2024.

Assets			**Liabilities**		
Cash		50000	Creditors		200000
Inventory		125000	Bank Loan		125000
Debtors	65000				
Less: Provision			Capital:		
for D. Debts	15000	50000	A	375000	
Land		385000	B	375000	750000
Machine		285000			
Equipment		145000			
Goodwill		35000			
		1075000			1075000

On January1, 2025, C admitted to the partnership according to the following:

a. Partnership's assets are revaluated as follows (L.E.): Goodwill 85,000, Land 335,000, Machine 385,000, Equipment 125,000, Debtors 60,000, provision for doubtful debts 10%, and Creditors 192,500.

b. C directly purchases a one-half-capital interest from A and B for an amount of L.E.329,250, which will be personally paid to A and B, after recording revaluation results. Profits and losses will be shared equally after C’s admission to the partnership.

Instructions:

Record C’s admission to the partnership, prepare the Revaluation Profit and Loss Account, Partners’ Capital Accounts, and prepare the partnership’s balance sheet upon the admission of C, as on January 1, 2025.

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(2) A and B are partners in a partnership, sharing profits and losses equally. The following is the B/S of their partnership as on December 31, 2024.

Assets			**Liabilities**		
Cash		**50000**	**Creditors**		**200000**
Inventory		**200000**	**Bank Loan**		**15000**
Debtors	**130000**				
***Less*: Provision**			**Capital:**		
for D. Debts	**30000**	**100000**	**A**	**350000**	
Land		**200000**	**B**	**250000**	**600000**

Buildings	**150000**		
Equipment	**75000**		
Goodwill	**40000**		
	815000		**815000**

On January1, 2025, C admitted to the partnership according to the following:

a. Partnership's assets and liabilities are revalued as follows (L.E.): Goodwill 30,000, Land 175,000, Buildings 200,000, Equipment 65,000, Debtors 100,000, provision for doubtful debts 5%, and Creditors 192,500.

b. C Purchases and invests an amount equal to a one-half of the total capital of the partnership after revaluation, but before the admission of C, paid in cash. Profits and losses will be shared equally after C's admission to the partnership.

Instructions:

Record C's admission to the partnership, prepare the Revaluation Profit and Loss Account, Partners' Capital Accounts, and prepare the partnership's balance sheet upon the admission of C, as on January 1, 2025.

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(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 December 31, 2024:

Assets			**Liabilities**		
Goodwill		**2500**	**Capital a/c**		
Fixed Assets			**A**	**40000**	
Cars		**15000**	**B**	**35000**	**75000**
Buildings		**25000**			
Machines		**30000**	**Loans**		**3500**
Current Assets			**A/P**		**15000**
A / R			**N/P**		**15000**
(-) Provision for	**17000**				
doubtful debts	**1000**	**16000**			
Cash		**20000**			
		108500			**108500**

On January 1, 2025, 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.

Instructions:

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 July 1, 2025 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.

Instructions:

Record the above agreement in the partnership books.

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(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 October 1, 2025, 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.

Instructions:

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

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(7) 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 March 1, 2025, 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.

Instructions:

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

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(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 September 1, 2025 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.

Instructions:

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

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CHAPTER FIVE

WITHDRAWAL OR RETIREMENT OF A PARTNER

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WITHDRAWAL OR RETIREMENT OF A PARTNER

5.1 INTRODUCTION:

Expected changes in the ownership of a partnership might take several forms. Chapters three and four 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 or withdrawal may be as 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.

5.2 Determining Rights of the Retired Partner:

From the legal standpoint, when a partner retires or withdraws from a partnership, the partnership is dissolved, but the remaining partners may wish to continue operating the firm. The articles of co-partnership (agreement or contract) must determine the procedures to be followed by the partnership to insure that the agreement of the partners is carried out.

The key accounting issue is the proper measurement of the retiring partner's capital account. This sometimes requires a determination of the partnership's fair value when the partner retires, including the computation of the partnership income since the end of the last fiscal period. A partner retiring from a partnership usually receives cash or other assets from the partnership. It is also possible that a retiring partner might arrange for the sale of partnership interest to one or more of the continuing partners or to an outsider.

On the other hand, the retiring partner is still personally liable for any partnership debts accumulated before the withdrawal date but is not responsible for any partnership debts incurred after the retirement date. Accordingly, it is especially important to determine all liabilities that exist on the retirement date.

Generally, the existing partners buy out the retiring partner either by making a direct acquisition or by having the partnership acquire the retiring partner's interest. If the present partners directly acquire the retiring partner's interest, the only entry on the partnership's books is to record the reclassification of capital among the partners. If the partnership acquires the retiring partner's interest, the partnership must record the reduction of total partnership capital and the corresponding reduction of assets paid to the retiring partner.

For example, assume that A retires from the ABC Partnership when his/her capital account has a balance of L.E.550,000 after recording all increases in the partnership's net assets including income earned up to the date of the retirement. The journal entry passed by the ABC Partnership is as follows:

A, Capital………………. Cash………………….. Retirement of A from the partnership.	550,000	 550,000

If the partnership is unable to pay the total of L.E.550,000 to A at the time of retirement, it must recognize a liability for the remaining portion. For example, if the partnership is able to pay only L.E.400,000 out of the L.E.550,000 and the remaining amount of L.E.150,000 (550,000 - 400,000 = L.E.150,000), would be considered as a loan payable to A. this can be recorded by the following journal entry:

A, Capital………………. Cash………………….. Loan Payable to A…… Retiring of A from the partnership.	550,000	 400,000 150,000

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; and
- 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.

5.2.1 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 the following journal entry:

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

5.2.2 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 5.2.1 above). Second, is 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.

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

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

(1) As a certain accepted amounts 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.

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

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.

5.2.4 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 these profits should be credited to the Retired Partner a/c. For instance, if there is a balance of retained earnings, these 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 retained earnings, it should be also closed in the Capital a/c by the following journal entry:

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

5.2.5 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 **To Capital a/c** **A (xx)** **B (xx)**	**xx**	 **xx**

	C (xx) **To close the balance of the general reserve in the capital a/c.**		

5.2.6 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 Temporary Distribution a/c **Accrued salaries xx** **Interest on capital xx** **Bonus xx** **To Retired Partner a/c** **To close temp. distribution a/c in the retired partner a/c.**	**xx**	**xx**

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**

5.2.7 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	**xx**	
	To Capital a/c		**xx**
	A (xx)		
	B (xx)		
	C (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 **A (xx)** **B (xx)** **To Capital a/c, C (xx)**	**xx**	 **xx**

Or:

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

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

5.2.8 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 **To Insurance policy a/c**	**xx**	 **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 (5.2.7).

5.3 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 no 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 Illustration:

A, B, and C are partners in a partnership. The profit and loss sharing ratio is 1:1:1. On June 30, 2025, 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 January 1, 2025 to June 30, 2025 (the retirement date). The following is the Balance Sheet of their partnership as on June 30, 2025:

Assets **Liabilities**

Fixed Assets			**Capital a/c**		
Land		**10800**	**A**	**24000**	
Buildings		**12000**	**B**	**21000**	
Cars		**12000**	**C**	**18000**	**63000**
Equipment		**9000**	**General res.**		**9000**
Current Assets			**A/P**		**12600**
A / R	**9300**		**Current a/c**		
(-) Pro. For d. d.	**630**	**8670**	**B**	**2100**	
Bank		**33930**	**C**	**1500**	**3600**
Current a/c (A)		**1800**			
		88200			**88200**

You have given the following information:

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

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

* Partner share in the profits from 1/1/25 to 30/6/25 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.

Instructions:

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	Explanation	Dr.	Cr.
2025 June 30	By Revaluation P&L a/c To Sundries: Cars Equipment A/R (bad debts) Provision for Doubtful Debts To record losses of the revaluation.	4380	 2000 1000 1200 180
June 30	By Buildings To Revaluation P&L a/c To record profits of the revaluation.	1200	 1200
June 30	By Capital a/c: A 1060 B 1060 C 10 60 To Revaluation P&L a/c To close the net result of revaluation in capital a/c.	3180	 3180
	By General reserve	9000	

June 30	To Capital a/c A 3000 B 3000 C 3000 To record the distribution of general reserve.		9000
June 30	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	1500	1500
June 30	By Temporary distribution a/c Profits 2700 Interest 600 Salaries 300 To Retired partner a/c To record profits, interest, and salaries of the retired partner.	3600	3600
June 30	By Retired partner a/c To Temporary distribution (interest on drawings) To record interest on drawings of the retired partner.	200	200
June 30	By Capital a/c To Retired partner a/c To close the capital a/c of retired partner.	19940	19940
June 30	By Retired partner a/c To Bank a/c To record payments to the retired partner by bank.	24840	24840

Dr. The Revaluation P & L Account Cr.

To:		By:	
Cars	2000	Buildings	1200
Equipment	1000	Capital a/c	3180
A/R (bad debts)	1200	A 1060	
Provision for D. D.	180	B 1060	
		C 1060	
	4380		4380

Dr. Partners' Current Account Cr.

Details	A	B	C	Details	A	B	C
Balance 30/6	1800			Balance 30/6		2100	1500
Retired partner			1500				
Balance 30/6		2100		Balance 30/6	1800		
	1800	2100	1500		1800	2100	1500

Dr. Capital Account Cr.

Details	A	B	C	Total	Details	A	B	C	Total
Revaluation	1060	1060	1060	3180	Balance 30/6	24000	21000	18000	63000
Retired Partner			19940	19940	General Re.	3000	3000	3000	9000
Balance 30/6	25940	22940		48880					
	27000	24000	21000	72000		27000	24000	21000	72000
					Balance 1/7	25940	22940		48880

Dr. Retired Partner Account Cr.

To:		By:	
Temporary dist. a/c	200	Capital a/c (C)	19940
		Temporary dist. a/c	3600
Bank	24840	Profits 2700	
		Interest 600	
		Salaries 300	
		Current a/c (C)	1500
	25040		25040

Assets Balance Sheet as on 1/7/2025 Liabilities

Fixed Assets			**Capital a/c**		
Land		10800	A	25940	
Buildings		13200	B	22940	48880
Cars		10000			
Equipment		8000	A/P		12600
Current Assets			**Current a/c**		
A / R	8100		B 2100		2100
(-) Pro. For D D	810	7290			
Bank		9090			
Current a/c (A)		1800			
Temporary Dist. a/c		3400			
		63580			63580

5.4 Exercises and Practical Problems

(1) L, M, and N are partners in a partnership. The profit and loss sharing ratio is 4:3:3 respectively. On June 30, 2025, 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 Balance Sheet as on June 30, 2025:

Assets			Liabilities		
Goodwill		**21600**	**Capital a/c**		
Fixed Assets			**L**	**48000**	
Buildings		**24000**	**M**	**42000**	
Cars		**24000**	**N**	**36000**	**126000**
Equipment		**18000**	**General res.**		**18000**
Current Assets			**A/P**		**25200**
A / R	**18600**		**Current a/c**		
(-) Pro. for d. d.	**1260**	**17340**	**M**	**4200**	
Bank		**67860**	**N**	**3000**	**7200**
Current a/c (L)		**3600**			
		176400			**176400**

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, Equipments 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/her share in the profits from January 1, 2025 to June 30, 2025 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.

Instructions:

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 Balance Sheet as on September 30, 2025:

Assets			Liabilities		
Fixed Assets			**Capital a/c**		
Cars		**10000**	**A**	**28000**	
Equipment		**16000**	**B**	**28000**	
Current Assets			**C**	**28000**	**84000**
Goods		**18000**	**A/P**		**7000**
A / R	**30000**		**P/L App.**		
(-) Pro. For D D	**4000**	**26000**	**A/c**		**9000**
Bank		**30000**			
		100000			**100000**

On the same day (30/9/2025), partner C decided to retire from the partnership. So, they revaluated some items of the B/S as follows:

Cars LE 7,000, Equipments 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.

Instructions:

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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(3) A, B and C partners in a business sharing profits in the ratio of 3:2:1. Their balance sheet on December 31, 2020 is as below:

ABC PARTNERSHIP
Balance Sheet as on December 31, 2020

Cash	50,000	Sundry Creditors	100,000
Sundry Debtors	100,000	Loan from D	200,000
Stock	200,000	Capital:	
Plant	500,000	A	200,000
		B	200,000
		C	150,000
Total	850,000	*Total*	850,000

C retires on January 1, 2021. The following arrangement is agreed upon:

1. The value of the firm's goodwill is L.E. 150,000. C's share of the goodwill is to be adjusted in the capital accounts of A and B.

2. The assets are revalued as follows (L.E.): Stock 250,000 and Plant 520,000.

3. A provision for bad debts is to be created of 10% on debtors.

4. The amount due to C is to be transferred to a loan account in his/her name.

Instructions:

You are required to prepare the Revaluation Profit and Loss Account, Partners' Capital Accounts, and the Balance Sheet of the firm.

Solution

Revaluation Profit and Loss Account

Provision for bad debts	10,000	Stock	50,000
Capital Accounts:		Plant	20,000
A 30,000			
B 20,000			
C 10,000	60,000		
	70,000		**70,000**

Capital Account

Details	A	B	C	Details	A	B	C
C's Capital (GW)	15000	10000		Balance b/d	200000	200000	150000
Balance c/d	215000	210000		Revaluation P & L a/c	30000	20000	10000
C's Loan a/c			185000	A & B Cap. a/c (GW)			25000
	230000	220000	185000		230000	220000	185000

AB PARTNERSHIP

Balance Sheet as on January 1, 2021

Cash	50,000	Sundry Creditors	100,000
Debtors 100,000		Loan from D	200,000
- Provision (10,000)	90,000	Loan from C	185,000
Stock	250,000	Capital:	
Plant	520,000	A	215,000
		B	210,000
Total	*910,000*	*Total*	*910,000*

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(4) ABC & Co. is a partnership concern with three partners, A, B, and C, sharing profits and losses of the firm in the ratio of 4:2:2. The Balance Sheet of the business as on March 31, 2025, is as follows:

ABC & CO. PARTNERSHIP
Balance Sheet as on March 35, 2020

Assets		**Liabilities**	
Cash/Bank	37100	Creditors	128000
Debtors	181000	Provision For Expenses	32600
Fixed Assets	110000	Bank Loan	81000
Prepaid Expenses	11300	Capital Accounts:	
Furniture	82400	A 114000	
B's Drawings a/c	34800	B 49000	
		C 52000	215000
Total	**456600**	*Total*	**456600**

It was agreed between the partners that B will retire and D will join the partnership with effect from 1st April 2025. For the purpose of reconstitution of the business as above, the partners agreed to the following agreement:

a. A, C, and D will share the future profits and losses of the firm in the ratio of 3:2:1 and their capital will be in the same ratio in which they share the profits. It was also agreed that the total capital of the partners would be L.E.240,000.

b. To determine the share of outgoing (retiring) partner, goodwill of the firm is valued at L.E.180,000 and it was agreed that the amount of goodwill shall not appear as an asset in the books of the partnership after its reconstitution.

c. Fixed assets and Furniture are valued at L.E.170,000 and L.E.91,000 respectively at the time of reconstitution. 7% of the debtors are considered bad and doubtful and hence the amount is to be written off.

d. Out of the amount payable to B on account of his retirement, a sum of L.E.40,000 will be paid in cash and the balance account, if any, is to be retained as his loan to the firm. D will bring in L.E.61,000 as his share of capital and the balance amount, if any, payable by him towards capital will be debited to a separate loan account to be opened in his name. A and C will also retain any surplus in their capital accounts as loans to firm.

Instructions:

You are required to prepare:

1) Revaluation Account,

2) Capital Accounts of A, B, C, and D,

3) Balance Sheet of the firm after reconstitution, and

4) Cash/Bank Account.

Solution

Revaluation Account

Debtors	12,670	Fixed Assets	60,000
Partners' Capital a/c:		Furniture	8,600
A 27,965			
B 13,983			
C 13,982	55,930		
	68,600		**68,600**

Capital Accounts

Details	A	B	C	D	Details	A	B	C	D
Draw.	-	34800	-	-	B b/d	114000	49000	52000	-
GW	90000	-	60000	30000	GW	90000	45000	45000	-
Cash	-	40000	-	-	R a/c	27965	13983	13982	-
Loan	21965	33183	-	-	Cash	-	-	29018	61000
B c/d	120000		80000	40000	Loan	-	-	-	9000
	231965	**107983**	**140000**	**70000**		**231965**	**107983**	**140000**	**70000**

ACD & CO. PARTNERSHIP
Balance Sheet as on April 1, 2025

Assets		Liabilities	
Cash/Bank	87118	Creditors	128000
Debtors	168330	Provision For Expenses	32600
Prepaid Expenses	11300	Bank Loan	81000
D's Loan	9000	Capital Accounts:	
Fixed Assets	170000	A 120000	
Furniture	91000	C 80000	

		D 40000	240000
		Loan Accounts:	
		A 21965	
		B 33183	55148
Total	**536748**	*Total*	**536748**

Cash/Bank Account

Balance b/d	37100	B's Capital	40000
C's Capital a/c	29018	Balance c/d	**87118**
D's Capital a/c	61000		
	127118		**127118**

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(5) A, B, and C are in a partnership sharing profits and losses in the ratio of 2:3:5. A retires on March 31st, 2025 and D is admitted to partnership on the same date. The new profit sharing ratio between B, C, and D will be 2:3:1. The following is the partnership's Balance Sheet on that date:

ABC & CO. PARTNERSHIP
Balance Sheet as on March 31, 2025

Assets		**Liabilities**	
Cash/Bank	95000	Creditors	50000
Debtors	30000	Loan from D	50000
Stock	20000	General Reserve	40000
Machinery	30000	Capital Accounts:	
Building	10000	A 10000	
		B 15000	
		C 20000	45000
Total	**185000**	*Total*	**185000**

D is admitted on the following terms:

1. Machinery is to be depreciated by L.E.3,000.

2. Building is revaluated at L.E.30,000.

3. Stock is to be written off to the extent of L.E.5,000.

4. Provision of 5% for Bad Debts is to be made.

5. General Reserve is to be appropriated among the partners.

6. The firm's goodwill is to be valued by two years' purchase of the average profits for the last three years. The figures are: For the year ended March 31st, 2022, L.E.20,000 (profit), for the year ended March 31st, 2023, L.E.15,000 (loss), and for the year ended March 31st, 2024, L.E.40,000 (profit).

7. The amount due to A is retained in the business as loan.

8. D's capital contribution should be 20% of the combined capital of B and C after making the above adjustment. D's share of capital will be transferred from his/her Loan Account.

9. The Goodwill Account is to be written off from the books after D's admission.

Instructions:

Prepare journal entries to effect the preceding agreement.

Solution

Journal Entries

Description	**Dr L.E.**	**Cr L.E.**
Revaluation a/c……………..	9,500	
Machinery a/c……………		3,000
Stock a/c…………………		5,000
Provision for Bad Debts a/c		1,500
Recording revaluation's losses.		
Building a/c…………………	20,000	
Revaluation a/c…………..		20,000
Recording revaluation's profits.		
Revaluation a/c………………	10,500	
A, Capital a/c……………..		2,100
B, Capital a/c……………..		3,150
C, Capital a/c……………..		5,250
Revaluation's net profits distributed on old partners in the ratio of 2:3:5.		
General Reserve a/c…………	40,000	
A, Capital a/c……………..		8,000
B, Capital a/c……………..		12,000
C, Capital a/c……………..		20,000
General Reserve transferred to partner's capital accounts in the ratio of 2:3:5.		
Goodwill a/c…………………	30,000	
A, Capital a/c………………		6,000
B, Capital a/c………………		9,000

C, Capital a/c……………… Raising goodwill in the books on A's retirement and before D's admission.		15,000
A, Capital a/c………………… A, Loan a/c………………… Transferring A's Capital Account to his/her Loan Account on retirement.	26,100	26,100
D, Loan a/c…………………. D, Capital a/c……………. Transferring of D's capital contribution on his/her admission from his/her loan account.	19,880	19,880
B, Capital a/c…………………. C, Capital a/c…………………. D, Capital a/c…………………. Goodwill a/c……………….. To write off of goodwill after D's admission in the ratio of 2:3:1.	10,000 15,000 5,000	30,000

Calculations:

a. *Computation of goodwill:*

Profit (loss) for the previous		L.E.
three years ending March 31st	2022	20,000
	2023	(15,000)
	2024	40,000
Total		45,000

Average profits = 45,000 ÷ 3 = L.E.15,000.

Goodwill at 2 years' purchase = 2 × 15,000 = L.E.30,000.

b. *Computation of D's Capital(which is 1/5 of B's and C's Capital):*

	B's Capital	C's Capital
As per Balance Sheet	15,000	20,000
Credit for:		
General Reserve	12,000	20,000
Revaluation profit	3,150	5,250
Goodwill	9,000	15,000
Totals	39,150	60,250

Total Capital of B & C = L.E.99,400.

D's Capital = 99,400 × 20% = L.E.19,880.

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CHAPTER SIX

LIQUIDATION OF A PARTNERSHIP

6.1 Introduction:

Liquidation means the termination of a partnership's business activities. Practically, several reasons may be behind the liquidation 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.

6.2 Reasons behind Liquidation:

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.

6.3 Types of Liquidation:

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

6.3.1 Lump-sum (quick) 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

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

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.

6.3.2 Installment (gradual) Liquidation:

In installment or gradual liquidation, 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.

6.4 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 becomes 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.

6.5 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 also be prepared.

6.5.1 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 later 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:

6.5.1.1 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	**xxx**	
	To Sundries:		
	Land		**xxx**
	Equipment		**xxx**
	Buildings		**xxx**
	Goods		**xxx**

	A/R **N/R** **Goodwill**		**xxx** **xxx** **xxx**

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 **To Bank a/c** **(Liquidation expenses)**	**xxx**	 **xxx**

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	**xxx**	
	To Bank a/c		**xxx**
	(Liquidation compensations)		

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	**xxx**	
	To Liquidation a/c		**xxx**

2- Assets taken by one or more partners:

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

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	**xxx**	
	Buildings Depreciation a/c	**xxx**	
	Provision for Doubtful Debts	**xxx**	
	To Liquidation a/c		**xxx**

4- Other revenues related to the liquidation process:

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

5- Disclaims from the creditors or A/P:

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

Finally, the Liquidation account might be shown as follow:

Dr. Liquidation Account Cr.

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

6.5.1.2 Liquidation Account as a Profit & Loss 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	**xxx**	**-Cars a/c**	**xxx**
-Buildings a/c	**xxx**	**-Securities**	**xxx**
-A/R a/c	**xxx**	**-Depreciations (of fixed assets if not deducted)**	**xxx**
-Bank a/c (Liq. Exp.)	**xxx**	**-Provisions**	**xxx**
-Bank a/c (Compensations)	**xxx**	**-A/P (Disclaims)**	**xxx**
-Capital a/c	**xxx**		

(Liquidation profit) **A xx** **B xx**		**-Capital a/c** **(Liquidation loss)** **A xx** **B xx**	**xxx**
	xxx		**xxx**

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 theses accounts, Bank a/c, in more details.

6.5.2 Bank Account:

It is prepared during the liquidation process. This account represent 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;

5- Amounts due to one or more partners;

6- 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. Exp.)**	**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**	**(or)**	
-Capital a/c		**-Capital a/c**	
A xx		**A xx**	
B xx	**xx**	**B xx**	**xx**
	xx		**xx**

6.6 Results of Liquidation:

By completing of the liquidation process, the final result of the liquidation will be shown. 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 a profit:

In such case, the liquidation process will result in 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 6.1

Maha and Mai are partners in a partnership. The profit and loss sharing ratio is 1:1. On December 31, 2024, partners decided to dissolve and liquidate their partnership. The following is the B/S of their partnership as on that date:

Assets			Liabilities		
Fixed Assets			**Capital a/c**		
-Equipment	6000		A	15000	
-Buildings	9000		B	15000	30000
-Furniture	3000				
-Cars	6000	24000	A/P		30000
			N/P		15000
			B's Loan		9000
Current Assets			B's Current Account		1500
-Goods	10800				
-A / R 44,400 (-) Pro. for doubtful d. 2,400	42000				
-Bank	4200				
-A's Current account	1200				
-Losses	3300	61500			
		85500			85500

You have given the following information:

1- All assets (with the exception of furniture) were sold at LE 39900;

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

3- Partner A got the furniture at LE 2100.

4- A/P disclaimed LE 960.

5- Liquidation expenses were LE 900.

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

Instructions:

1- Record the above events in the partnership books.

2- Prepare the liquidation accounts.

Solution:

Date	Particulars	Dr.	Cr.
2024	**By Liquidation a/c**	**79200**	
Dec. 31	**To Sundries:**		
	Equipment a/c		**6000**
	Buildings a/c		**9000**
	Furniture a/c		**3000**
	Cars a/c		**6000**
	Goods a/c		**10800**
	A/R		**44400**
	To close non-cash assets.		
	By Provision of D. D. a/c	**2400**	
Dec. 31	**To Liquidation a/c**		**2400**
	To close the provision of D.D a/c.		
	By Bank a/c	**84000**	

Dec. 31	**To Liquidation a/c** **To record the sale of non-cash assets.**		**84000**
Dec. 31	**By Liquidation a/c** **To Bank a/c** **To record the payment of liquidation expenses.**	**960**	**960**
Dec. 31	**By Capital a/c (A)** **To Liquidation a/c** **To record the furniture taken by partner A.**	**2100**	**2100**
Dec. 31	**By A/P a/c** **To Sundries:** **Liquidation a/c** **Bank a/c** **To record payment to A/P after having disclaim of LE 960.**	**30000**	 **960** **29040**
Dec. 31	**By Liquidation a/c** **To Capital a/c** **A 4680** **B 4680** **To record liquidation profits.**	**9360**	**9360**
Dec. 31	**By N/P a/c** **To Bank a/c** **To record payment for A/P.**	**15000**	**15000**
Dec. 31	**By B's loan a/c** **To Bank a/c** **To record payments for B's loan.**	**9000**	**9000**
Dec. 31	**By Capital a/c (A)** **To Partners' Current a/c (A)** **To close the debit current account in the capital account.**	**1200**	**1200**
Dec. 31	**By Partners' Current a/c (B)** **To Capital a/c (B)** **To close the credit current account in the capital account.**	**1500**	**1500**

Dec. 31	By Capital a/c A 1650 B 1650 To Loss a/c Distribution of loss.	3300	3300
Dec. 31	By Capital a/c A 14730 B 19530 To Bank a/c Payments of the final settlement to partners.	34260	34260

Dr. Liquidation Account Cr.

To: -Equipment a/c -Buildings a/c -Furniture a/c -Cars -Goods a/c -A/R a/c -Bank a/c (Liq. expense) -Capital a/c A 4680 B 4680 (Liquidation profit)	 6000 9000 3000 6000 10800 44400 900 9360	By: -Bank a/c (sale value) -Capital a/c (A) (fixed assets) -Provisions for D.D. -A/P (Disclaims)	 84000 2100 2400 960
	<u>89460</u>		<u>89460</u>

Dr. Bank Account Cr.

-Balance	4200	-Liq. a/c (liq. expenses)	900
-Liquidation a/c (various assets)	84000	-A/P -N/P -B's Loan -Capital a/c	29040 15000 9000 34260

		A 14730 **B 19530**	
	88200		**88200**

Dr. B's Loan A/C Cr.

To Bank a/c	**9000**	**Balance**	**9000**
	9000		**9000**

Dr. Partners' Current A/C Cr.

	A	B		A	B
Balance	**1200**		**Balance**		**1500**
To Capital a/c		**1500**	**By Capital**	**1200**	
	1200	**1500**		**1200**	**1500**

Dr. Capital A/C Cr.

	A	B		A	B
P. current a/c	**1200**		**Balance**	**15000**	**15000**
Loss a/c	**1650**	**1650**	**P. current a/c**		**1500**
Liquidation a/c	**2100**		**Liquidation a/c**	**4680**	**4680**
Bank a/c	**14730**	**19530**	**(liq. profits)**		
	19680	**21180**		**19860**	**21180**

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

In this case, it is supposed that the liquidation result is loss whish 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.

Illustration 6.2

A, B and C, are partners in a limited partnership. The profit and loss sharing ratio is 4:3:3 respectively. On December 31, 2024, partners decided to dissolve and liquidate the partnership. The following is the Balance Sheet of their partnership as on that date:

Assets			Liabilities		
-Goodwill		**60000**	**Capital a/c**		
			A	**120000**	
-Land	**112000**		**B**	**120000**	
-Furniture	**36000**		**C (Limited partner)**		
-Cars	**26000**	**174000**		**80000**	**320000**
			A/P		**44000**
Current Assets			**A's Current a/c**		**24000**
-Goods	**74000**				
-A / R	**60000**		**Accrued exp.**		
-Bank	**10000**	**144000**			
-C's Current a/c		**12000**			**2000**
		390000			**390000**

You have given the following information:

1- Land, furniture and cars were sold at LE 94000.

2- A/R was collected with the exception of L 6000.

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

4- Liquidation expenses were LE 16000.

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.

Instructions:

1- The needed journal entries.

2- Prepare the liquidation accounts.

Date	Particulars	Dr.	Cr.
2024 Dec. 31	**By Liquidation a/c**	**368000**	
	To Sundries:		
	Land a/c		**112000**
	Furniture a/c		**36000**
	Cars a/c		**26000**
	Goodwill a/c		**60000**
	Goods a/c		**74000**
	A/R		**60000**
	To close non-cash assets.		
	By Bank a/c	**54000**	
Dec. 31	**To Liquidation a/c**		**54000**
	To close the collection of A/R		
	By Bank a/c	**94000**	
	To Liquidation a/c		**94000**
	To record the sale of non-cash		
Dec. 31	**assets.**		
	By Liquidation a/c	**16000**	
	To Bank a/c		**16000**
Dec. 31	**To record the payment of**		

	liquidation expenses.		
Dec. 31	By Capital a/c (B) To Liquidation a/c To record the goods taken by partner B.	74000	74000
Dec. 31	By Accrued expenses a/c To Bank a/c To record payment of accrued expenses.	2000	2000
	By Note Payable a/c To Bank a/c To record payment of A/P.	44000	44000
Dec. 31	By Capital /c A 64800 B 48600 C 48600 To Liquidation a/c To record liquidation loss.	162000	162000
Dec. 31	By Capital a/c (C) To Partners' Current a/c (C) To close C's current A/C	12000	12000
Dec. 31	By Partners' Current a/c (A) To Capital a/c (A) To close the credit current account of A in the capital account.	24000	24000
Dec. 31 Dec. 31	By Bank a/c To Capital a/c (B) To record payment by B for the difference between his/her share in capital and goods.	2600	2600
Dec. 31	By Capital a/c A 79200 C 19400 To Bank a/c Payments of the final settlement to partners.	98600	98600

Dr. Liquidation Account Cr.

To:		By:	
Land a/c	1126000	Bank a/c (sale value)	94000
Furniture a/c	36000	Bank a/c (A/R)	54000
Cars a/c	26000	Capital a/c (goods by B)	74000
Goodwill a/c	60000	Capital a/c (Liq. Loss):	162000
Goods a/c	74000	A 64800	
Accounts R a/c	60000	B 48600	
Bank a/c (Liq. expense)	16000	C 48600	
	384000		**384000**

Dr. Bank Account Cr.

Balance	10000	Liq. a/c (liq. expenses)	16000
Liquidation a/c	94000	Accrued Exp.	2000
Liquidation a/c	54000	A/P	44000
Capital a/c (B)	2600	Capital a/c	98600
		A 79200	
		C 19400	
	160600		**160600**

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**

Note:

1- Accrued expenses (workers' wages LE2000) was paid in its order, as it was paid after the liquidation expenses (LE 16000) but before the ordinary liabilities (LE 44000). 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 12000 + his share in the liquidation loss is LE 48600 = LE 60600, while his share in the capital is 80000. Therefore, this partner will receive LE 19400 from the bank account.

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

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.

Illustration 6.3

S and T are partners in a partnership. The profit and loss sharing ratio is 1:1. On December 31, 2024, partners decided to dissolve and liquidate the partnership. The following is the Balance Sheet of their partnership as on that date:

Assets			**Liabilities**		
Fixed Assets			**Capital a/c**		
Buildings	**50000**		**S**	**30000**	
(-)Accumulated Dep.	**10000**	**40000**	**T**	**30000**	**60000**
Furniture	**12000**		**A/P**		**116000**
(-)Accumulated Dep.	**2000**	**10000**	**S's Loan**		**10000**
Goods		**50000**	**T's Current Account**		**10000**
A / R	**12000**				
(-) Pro. for doubtful debts	**2000**	**10000**			
Bank		**34000**			
S's Current a/c		**12000**			
Losses		**40000**			
		196000			**196000**

You have given the following information:

1- The syndic collected LE 90000 through the sale of assets and the collection of A/R;

2- A/P disclaimed LE 4000.

5- Liquidation expenses were LE 2000.

Instructions:

1- The needed journal entries.

2- Prepare the liquidation accounts.

Solution:

Date	Particulars	Dr.	Cr.
2024 Dec. 31	By Liquidation a/c	125000	
	To Sundries:		
	Buildings a/c		50000
	Furniture a/c		13000
	Goods a/c		50000
	Accounts Receivable		12000
	To close the non-cash assets.		
Dec. 31	By Sundries:		
	Accumulated Dep. of Buildings	10000	
	Accumulated Dep. of Furniture	3000	
	Provision of D. Debts a/c	2000	
	To Liquidation a/c		15000
	To close the provisions.		
Dec. 31	By Bank a/c	90000	
	To Liquidation a/c		90000
	To record the sale of non-cash assets.		
Dec. 31	By Liquidation a/c	2000	
	To Bank a/c		2000
	To record the payment of liquidation expenses.		
Dec. 31	By Accounts Payable a/c	116000	
	To Sundries:		
	Liquidation a/c		4000
	Bank a/c		112000
	To record payment to A/P after having disclaim of LE 4000.		
Dec. 31	By Capital a/c	18000	
	S 9000		
	T 9000		
	To Liquidation a/c		18000
	To record liquidation loss.		
Dec. 31	By Capital a/c (S)	12000	
	To Partners' Current a/c (S)		12000
	To close the debit current		

	account in the capital account.		
Dec. 31	By Partners' Current a/c (T) To Capital a/c (T) To close the credit current account in the capital account.	10000	10000
Dec. 31	By Capital a/c S 20000 T 20000 To Loss a/c Distribution of loss.	40000	40000
Dec. 31	By S's Loan To Capital a/c (S) To close the loan of partner S in his capital account.	10000	10000
Dec. 31	By Bank a/c To Capital a/c (S) Payment by S for the final settlement.	1000	1000
Dec. 31	By Capital a/c (T) To Bank a/c Payments of the final settlement to partner (T).	11000	11000

Dr. Liquidation Account Cr.

To:		By:	
Buildings a/c	50000	Accumulated Dep. of Buildings	10000
Furniture a/c	13000	Accumulated Dep. of Furniture	3000
Goods a/c	50000	Provision of D. D. a/c	2000
Accounts Receivable	12000	Bank (sale value)	
Bank (Liq. expense)	2000	A/P (Disclaims)	90000
		Capital a/c: S 9000	4000
		T 9000	18000
		(Liquidation loss)	
	127000		**127000**

Dr. Bank Account Cr.

Balance	34000	Liquidation a/c (expenses)	2000
Liquidation a/c (various assets)	90000	Accounts Pay.	112000
Capital a/c (S)	1000	Capital a/c (T)	11000
	125000		125000

Dr. Partners' Current A/C Cr.

Details	S	T	Details	S	T
Balance	12000		Balance		10000
To Capital		10000	By Capital	12000	
	12000	10000		12000	10000

Dr. Capital A/C Cr.

Details	S	T	Details	S	T
Loss a/c	20000	20000	Balance	30000	30000
Liquidation	9000	9000	P. current		10000
P. current a/c	12000		S's loan	10000	
Bank a/c		11000	Bank a/c	1000	
	41000	40000		41000	40000

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 11000 (the total of debit side LE 41000 – the capital balance LE 30000). Therefore, partner **S** is asked to pay LE 1000 as he already has a loan of LE 10000. Also, because of the solvency of partner **S** he was able to pay LE 1000.

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 is 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:

6.7 Exercises and Practical Problems:

(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	**10000**		**M**	**30000**	
Buildings	**14000**		**N**	**30000**	**60000**
Machines	**6000**		**Accounts P.**		**60000**
Cars	**18000**	**48000**	**Notes P.**		**30000**
Current Assets			**N's Loan**		**18000**
Goods	**21600**		**N's Current account**		**3000**
A / R 88800					
(-) Pro. for					
D. D. 4800	**84000**				
Bank	**8400**				
M's Current a/c	**2400**				
Losses	**6600**	**123000**			
		171000			**171000**

You have given the following information:

1- Non-cash assets (with the exception of machines) were sold at LE 79800;

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

3- Partner A got the machines at LE 4200.

4- A/P disclaimed LE 1920.

5- Liquidation expenses were LE 1800.

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

<u>Instructions:</u>

1- The necessary journal entries.

2- Liquidation accounts.

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(2) Ahmed, Amr and Amged are partners in a limited partnership. The profit and loss sharing ratio is 4:3:3 respectively. On June 30, 2025, partners decided to dissolve and liquidate the partnership. The following is the Balance Sheet of their partnership as on that date:

Assets			Liabilities		
Goodwill		**80000**	**Capital a/c**		
Land	**164000**		**Ahmed**	**240000**	
Machines	**112000**		**Amr**	**240000**	
Cars	**72000**	**348000**	**Amged (Limited partner)**	**160000**	**640000**
Current Assets					
Goods	**128000**		**A/P**		**48000**
A / R	**140000**				
Bank	**20000**	**288000**	**Ahmed's Current a/c**		**48000**
Amged's Current a/c		**24000**	**Accrued exp.**		**4000**
		740000			**740000**

You have given the following information:

1- land, machines and cars were sold at LE 188000;

2- A/R were collected with the exception of L 12000.

3- Partner A got the goods at the book value, while the market value was LE 155000.

4- Liquidation expenses were LE 32000.

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.

Instructions:

1- The needed journal entries.

2- Prepare the liquidation accounts.

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(3) Anwer and Ragab are partners in a partnership. The profit and loss sharing ratio is 1:1. On December 31, 2024, partners decided to dissolve and liquidate the partnership. The following is the Balance Sheet of their partnership as on that date:

Assets					**Liabilities**
Fixed Assets			**Capital a/c**		
Machines (-)	**150000**		**Anwer**	**90000**	
Accumulated			**Ragab**	**90000**	**180000**
Dep.	**30000**	**120000**	**A/P**		**348000**
Cars (-)	**36000**		**Anwer's**		
Accumulated			**Loan**		**30000**
Dep.	**6000**	**30000**	**Ragab's C.**		
Goods		**150000**	**Account**		**30000**
A / R (-)	**36000**				
Pro. for					
doubtful	**6000**	**30000**			
debts					
Bank		**102000**			
Anwer's					
Current a/c		**36000**			
Losses		**120000**			
		588000			**588000**

You have given the following information:

1- The syndic collected LE 270000 through the sale of assets and the collection of A/R;

2- A/P disclaimed LE 12000.

5- Liquidation expenses were LE 6000.

Instructions:

1- The needed journal entries.

2- Prepare the liquidation accounts.

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(4) Abdelaaty and Mokhtar are partners in a partnership. The profit and loss sharing ratio is 1:1. On December 31, 2024, partners decided to dissolve and liquidate the partnership. The following is the Balance Sheet of their partnership as on that date:

Assets			Liabilities		
Fixed Assets			**Capital a/c**		
Machines (-)	150000		Abdelaaty	90000	
Accumulated Dep.	30000	120000	Mokhtar	90000	180000
Cars (-)	36000		Account P		348000
Accumulated Dep.	6000	30000	Abdelaaty's Loan		30000
Goods		150000	Mokhtar's Current Account		30000
A / R (-)	36000				
Pro. for doubtful debts	6000	30000			
Bank		102000			
Abdelaaty's Current a/c		36000			
Losses		120000			
		588000			588000

You have given the following information:

1- The syndic collected LE 340000 through the sale of assets and the collection of accounts receivables;

2- A/P disclaimed LE 12000.

5- Liquidation expenses were LE 6000.

Instructions:

1- The needed journal entries.

2- Prepare the liquidation accounts.

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