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A REPUTATION FOR EXCELLENCE

ACCOUNTING
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Revision Notes

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Taken from the UNISA study guide and the prescribed textbook.
Berry, PR et al. About Financial Accounting. Volume 2, 3rd edition 2009

CHAPTER 1 **PARTNERSHIPS**

A partnership can generally be defined as a legal relationship between two or more persons up to a maximum of 20 persons, who jointly carry on a lawful business to which each makes a contribution in the form of cash, assets, knowledge, etc. The objective of a partnership is to make a profit, which is to be shared between the partners according to a partnership agreement.

A partnership is not a legal entity and has no independent legal existence separate from its members. Therefore the partnership does not pay tax. The profit of the partnership is taxed in the hands of the individual partners. Another important characteristic of a partnership is that the partners are jointly and severally liable for the debts of the partnership. (“Jointly and severally liable” means that the partners are liable as a group but also as individuals.)

When a partnership is established each partner is likely to contribute capital in the form of cash or any other assets.

The partnership agreement is a contract between the partners and is advisable that it should be in writing. A partnership agreement should, amongst others, cover the following aspects:

- Capital contributions
- Profit sharing ratio
- Interest to be paid or charged on capital, current accounts and drawings
- Partners’ salaries and bonuses
- Withdrawals by partners

Capital contributions

Partners do not necessarily contribute equal capital amounts. The capital contributions may be used for the profit sharing ratio if so stated in the partnership agreement.

Profit sharing ratio

If the partnership agreement omits the ratio of profit sharing, it is assumed that the profit will be shared in the ratio of the capital contribution. Otherwise the ratio will be stated or the capital contribution may be used as the ratio.

Interest on capital accounts

Where capital amounts are not equal the partnership agreement may state that interest on capital is to be calculated at a certain percentage before profits and or losses are shared in the stated ratio.

Interest on current accounts

The partnership agreement may also stipulate that interest, at a certain percentage, is to be allowed or charged on the opening balances of the partners’ current accounts. The nature of the current account balance, which is whether the account has a debit or credit balance, is important. A current account with a debit balance will be debited and a current account with a credit balance will be credited with the interest. The interest is calculated and brought into account in the profit and loss account.

Interest on drawings

Drawings by partners include amounts drawn from the bank account of the partnership for personal use. In order to discourage the partners from drawing large amounts of cash from the partnership there may be a clause in the partnership agreement, which stipulates that interest has to be paid on any money which is withdrawn. Interest on drawings is calculated and debited to the current accounts of the partners and credited to the profit and loss account.

Salaries and bonuses awarded to partners

In partnerships it is often found that one or more of the partners is unable to be actively involved in the affairs of the partnerships, apart from supplying capital and sharing in the profits of the partnership. It can therefore be stipulated that the partners who are actively engaged in running the partnership will receive a salary as payment for services rendered. Likewise, a bonus may be allowed to a partner because she/he is for example, the managing partner. The salary or bonus is shown as an ordinary expense in the profit and loss account.

Capital accounts

Each partner's capital contribution is recorded in the individual partner's capital account and represents their **fixed capital**. Unless capital is withdrawn or added, the balances on the capital accounts remain unchanged. This contribution is kept separate from the current events and is not influenced by the profit/loss or drawings as in the case of a sole proprietorship.

The balances on the capital accounts are totalled in the statement of changes of equity and shown as a single amount on the balance sheet of the partnership.

Current accounts

A current account is opened in the ledger for each partner and contains all the adjustments according to the partnership agreement **which have not yet been paid to or by the partners**, which is the partners' salaries, bonuses, interest on capital, interest on current accounts, interest on drawing and share of the profit/loss.

Withdrawals of cash or merchandise during the year are debited to the partners' drawings accounts. At the end of the financial year the balances on the partners' drawings accounts are closed off the respective **current accounts** of the partners.

The credit balances of current accounts are totalled on the statement of changes in equity and shown as a single amount under capital and reserves on the balance sheet of the partnership.

EXAMPLE

The following information relates to M Masters and S Stern, trading as equal partners:

1. Balances at 31 March 2006

| | R |
|---|------------|
| Capital accounts (fixed): | |
| M Masters | 50,000.00 |
| S Stern | 60,000.00 |
| Current accounts: 1 April 2005: | |
| M Masters (Dr) | 2,000.00 |
| S Stern (Cr) | 5,000.00 |
| Long-term loan from Ace Bank | 40,000.00 |
| Sundry accounts receivable | 53,300.00 |
| Accumulated depreciation: 1 April 2005: | |
| Furniture and equipment | 3,500.00 |
| Furniture and equipment at cost | 35,000.00 |
| Provision for bad debts: 1 April 2005 | 2,000.00 |
| Bad debts recovered | 105.00 |
| Inventory (merchandise): 1 April 2005 | 80,500.00 |
| Purchases | 200,500.00 |
| Interest expense on long-term loan | 1,800.00 |
| Stationery | 600.00 |
| Salaries and wages | 6,500.00 |
| Rent expense | 2,000.00 |
| Cash in bank | 43,405.00 |
| Investment at cost | 15,000.00 |
| Sundry accounts payable | 5,000.00 |

1. Additional information:

a. Make provision for:

Interest on capital at 9% per annum.

Interest on current accounts (opening balances) at 7% per annum.

A managerial salary of R6 000 per annum to S Stern.

A bonus equal to 10% of the distributable profit to M Masters

b. Bad debts to be written off, R300.

c. The provision for bad debts must be maintained at 5% of trade accounts receivable.

d. Interest must be provided for at 12% per annum for the whole year on the long-term loan from Ace Bank.

e. Provide for depreciation at 15% per annum on furniture and equipment on the diminished balance.

f. Inventories on hand at 31 March 2006:

| | R |
|-------------|--------|
| Merchandise | 61 000 |
| Stationery | 100 |

g. The profit mark-up is 20% on sales.

REQUIRED:

Prepare the following statements for the partnership M Masters and S Stern in accordance with GAAP (AC101):

1. The income statement for the year ended 31 March 2006
2. The statement of changes in equity for the year ended 31 March 2006
3. The balance sheet at the 31 March 2006.

Notes are not required. Show all calculations

SOLUTION**M Masters and S Stern****Income statement for the year ended 31 March 2006**

| | R |
|--|-------------|
| Revenue (a) | 275,000.00 |
| Less: Cost of sales | 220,000.00 |
| Inventory (1 April 2005) | 80,500.00 |
| Purchases | 200,500.00 |
| | 281,000.00 |
| Less: Inventory (31 March 2006) | (61,000.00) |
| Gross profit | 55,000.00 |
| Add: Other income: | 105.00 |
| Bad debts recovered | 105.00 |
| | 55,105.00 |
| Less: Selling, administrative and general expenses: | 14,675.00 |
| Stationery R(600 - 100) | 500.00 |
| Salaries and wages | 6,500.00 |
| Rent expense | 2,000.00 |
| Bad debts | 950.00 |
| Depreciation | 4,725.00 |
| Profit from operations | 40,430.00 |
| Less: Finance costs: | 4,800.00 |
| Interest on long-term loan (12% x 40 000) | 4,800.00 |
| Profit for the year | 35,630.00 |

Calculations

| | |
|--------------------------------|-------------------|
| (a) Gross profit | R |
| Profit mark-up is 20% on sales | |
| Thus: Cost price = 80% | 220,000.00 |
| Profit = 20% (220 000 x 20/80) | 55,000.00 |
| Sales = 100% | <u>275,000.00</u> |

| | |
|-------------------------|-------------|
| (b) Interest on capital | |
| M Masters: 9% x R50 000 | 4500 |
| S Stern: 9% x R60 000 | 5400 |
| | <u>9900</u> |

| | |
|----------------------------------|-------------|
| (c) Interest on current accounts | |
| M Masters: 7% x R2 000 (dr) | 140 |
| S Stern: 7% x R5 000 (cr) | -350 |
| | <u>-210</u> |

M Masters and S Stern
Statement of changes in equity for the year ended 31 March 2006

| | Capital | | Current accounts | | Appropriation | Total |
|----------------------------------|---------------|---------------|------------------|---------------|---------------|----------------|
| | M Masters | S Stern | M Masters | S Stern | | |
| Balances 1 April 2005 | 50 000 | 60 000 | (2 000) | 5 000 | | 113 000 |
| Profit for the year | | | | | 35 630 | 35 630 |
| Partners share of profit | | | 8 784 | 8 784 | (17 568) | |
| Salaries to Partners | | | | 6 000 | (6 000) | |
| Interest on capital account | | | 4 500 | 5 400 | (9 900) | |
| Interest on current account | | | -140 | 350 | (210) | |
| Bonus | | | 1 952 | | (1 952) | |
| Balances at 31 March 2006 | 50 000 | 60 000 | 13 096 | 25 534 | - | 148 630 |

M Masters and S Stern**Balance sheet at 31 March 2006**

| ASSETS | Note | |
|--|------|-------------------|
| Non-current assets | | 41,775.00 |
| Property, plant and equipment | 1 | 26,775.00 |
| Investment at cost | | 15,000.00 |
| Current assets | | 154,855.00 |
| Inventories | | 61,100.00 |
| Trade and other receivables | | 50,350.00 |
| Cash and cash equivalents | | 43,405.00 |
| Total assets | | <u>196,630.00</u> |
| EQUITY AND LIABILITIES | | |
| Capital and reserves | | 148,630.00 |
| Capital | | 110,000.00 |
| Current accounts | | 38,630.00 |
| Non-current liabilities | | |
| Interest bearing borrowings | | 40,000.00 |
| 12% Long term loan - Ace Bank | | 40,000.00 |
| Current liabilities | | 8,000.00 |
| Trade and other payables (5 000 + 3 000) | | 8,000.00 |
| Total equity and liabilities | | <u>196,630.00</u> |

Comments

Additional partners can always be admitted to an existing partnership if the existing partners so agree. The admission of the new partner can be made by either buying an interest directly from an existing partner or by making a direct investment in the partnership.

Theoretically the death or retirement of a partner may cause the dissolution of the partnership but legal steps can be taken to ensure the survival of the entity.

Admission of a partner

If all the existing partners agree, a new partner may be admitted to the partnership in one of the following ways:

- The person may buy an interest from one or more of the existing partners.
- The person contributes cash and/or assets to the existing partnership in exchange for the acquisition of an interest.
- The new partner may be admitted without any form of payment.

The old partnership ceases to exist as soon as a new partner is admitted. It is not, however, necessary to wind up the books of the partnership, since the enterprise still exists. The necessary entries have merely to be made to give effect to the admission of the new partner and the new partnership agreement.

The underlying problem is normally to allocate profits, capital, appreciation or depreciation of assets and liabilities, as well as secret reserves which were built up during the old partnership, to a new partner for an equitable consideration. This amounts to a revaluation of existing assets and liabilities and the recording of such revaluation.

EXAMPLE

The partnership Alpha and Botha owns a building which cost them R50 000 and in which the partners have an equal interest.

In terms of the partnership agreement the partners Alpha and Botha annually withdraw their total net profit, which is derived from the rental income of the building, so that their balance sheet at the end of each year remains constant and takes the following form:

ALPHA AND BOTHA PARTNERSHIP BALANCE SHEET AT 28 FEBRUARY 2006

| | R |
|-------------------------------------|---------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | <u>50 000</u> |
| Total assets | <u>50 000</u> |
| EQUITY AND LIABILITIES | |
| Capital: | |
| Alpha | 25 000 |
| Botha | <u>25 000</u> |
| Total equity and liabilities | <u>50 000</u> |

For some years the two partners had been running the risk that the value of the partnership's assets could drop as a result of depreciation in the value of the building due to obsolescence. However, what happened was that the land values rose much faster than the value of the building dropped, as a result of the increasing demand for business premises, so that at a certain stage the market value of the property amounted to R75 000.

If the partners were to sell the building at that price, they would obviously be entitled to equal shares of the profit of R25 000.

Suppose that at this stage they decided to admit Cross to the partnership. It would be unfair to Alpha and Botha to expect them to admit Cross for a consideration based on the original cost price or carrying amount of the property. They would first have to adjust their balance sheet to the true position, and then use this as the basis for determining the price that Cross would have to pay.

The journal entry would then be:

| | Dr R | Cr R |
|---|-----------------|-----------------|
| Land and buildings | 25 000 | |
| Capital: Alpha | | 12 500 |
| Capital: Botha | | 12 500 |
| Revaluation of assets at market value before admission of Cross | | |

The assets of the partnership are now worth R75 000. Suppose Cross is admitted and acquires a $\frac{1}{5}$ share in the partnership. He therefore has to pay R15 000 (ie $\frac{1}{5}$) x R75 000) for his share.

This amount may be paid to the partnership if the funds are to be kept in the enterprise with a view to future expansion, or it could be paid directly to the old partners.

If this sum were put into the enterprise, the balance sheet of the new partnership would be:

**ALPHA, BOTHA AND CROSS PARTNERSHIP
BALANCE SHEET AT 28 FEBRUARY 2006**

| | R |
|--|---------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment at valuation | 75 000 |
| Current asset | |
| Cash and cash equivalents | <u>15 000</u> |
| Total assets | <u>90 000</u> |
| EQUITY AND LIABILITIES | |
| Capital | |
| Alpha | 37 500 |
| Botha | 37 500 |
| Cross | <u>15 000</u> |
| | <u>90 000</u> |

Notes:

- It is apparent from the above that the existing accounting records have not been wound up, but merely adjusted.
- After adjustment of the valuation of the land and buildings. Cross was able to pay his rightful share of $\frac{1}{5} \times R75\,000 = R15\,000$ into the partnership.

Changes in the profit-sharing ratio

The manner in which the profits and losses of a partnership will be distributed should be specified in the partnership agreement. The profit or loss made is calculated in the same manner as that of companies and close corporations. With partnerships, however, the profit or loss should be distributed among the partners in a predetermined manner.

This profit or loss may be distributed in any way the partners decide on. Profit-sharing need not necessarily be linked to the partners' capital ratios.

If a new partner joins the partnership it is logical that the new partner should obtain a share of the profit which was previously allocated to the old partners.

In the example previous Alpha and Botha divided profits equally, or in other words, in a ratio of 50:50 or 1:1 or $\frac{1}{2} : \frac{1}{2}$. When Cross (C) entered the partnership he became entitled to $\frac{1}{5}$ of the profit. The problem which arises is to determine what part of the profit accrues to Alpha (A) and Botha (B).

$$\begin{aligned} C &= \frac{1}{5} \\ A + B &= \frac{4}{5} (1 + 4) = 5 \end{aligned}$$

The new profit-sharing ratio is as follows:

$$\begin{aligned} A: & \frac{1}{2} \times \frac{4}{5} = \frac{4}{10} = \frac{2}{5} \text{ (A and B share the } \frac{4}{5} \text{ equally)} \\ B: & \frac{1}{2} \times \frac{4}{5} = \frac{4}{10} = \frac{2}{5} \\ C: & \frac{1}{5} \end{aligned}$$

$$\text{We can test this by saying } \frac{2}{5} + \frac{2}{5} + \frac{1}{5} = \frac{5}{5} = 1$$

The profit-sharing ratio after the admission of C becomes 2:2:1.

If this sum is invested in the enterprise, the balance sheet of the new partnership would be:

**ALPHA, BOTHA AND CROSS PARTNERSHIP
BALANCE SHEET AT 28 FEBRUARY 2006**

| | |
|--|---------------|
| ASSETS | |
| Non-current assets | R |
| Property, plant and equipment at valuation | 75 000 |
| Current asset | |
| Cash and cash equivalents | <u>15 000</u> |
| Total assets | <u>90 000</u> |
| EQUITY AND LIABILITIES | |
| Capital: | R |
| Alpha | 37 500 |
| Botha | 37 500 |
| Cross | <u>15 000</u> |
| Total equity and liabilities | <u>90 000</u> |

The capital ratio in the partnership would, however, be $37\frac{1}{2} : 37\frac{1}{2} : 15$. The partners are free to leave the matter there, but if they prefer to bring the capital accounts into line with the profit-sharing ratio, the old partners would withdraw the purchase sum paid by Cross, in the proportion in which they ceded their interests to Cross. Since Alpha and Botha ceded equal portions to Cross, Alpha and Botha would each withdraw R7 500. The capital accounts would then be as follows:

| | |
|---|--------|
| | R |
| A | 30 000 |
| B | 30 000 |
| C | 15 000 |

This capital ratio now corresponds to their profit-sharing ratio, namely 2:2:1.

If the payments were made directly to the old partners and the assumption is that they should cede an equal share of their interests to C the following journal adjustment would be made in the books of the partnership:

| | Dr R | Cr R |
|-----------------------|-----------------|-----------------|
| Capital: Alpha | 7 500 | |
| Capital: Botha | 7 500 | |
| Capital: Cross | | 15 000 |
| Adjustment of capital | | |

A further problem could arise if the original profit-sharing ratio between Alpha and Botha is disturbed because they have not sold equal shares of their interests to Cross.

Suppose the R15 000 paid into the partnership by Cross is withdrawn by Alpha and Botha, but it is withdrawn in the ratio 1:5, that is to say Alpha contributed $\frac{1}{6}$ and Botha $\frac{5}{6}$ of the interest bought by Cross. If Alpha and Botha withdraw the cash for the interest they sold to Cross, the journal entry would be:

| | Dr R | Cr R |
|--|-----------------|-----------------|
| Capital: Alpha ($\frac{1}{6} \times R15\ 000$) | 2 500 | |
| Capital: Botha ($\frac{5}{6} \times 15\ 000$) | 12500 | |
| Cash | | 15 000 |
| Withdrawal of interest sold to Cross | | |

The capital accounts would then be:

| | R |
|-------|--------------------------|
| Alpha | 35 000 (37 500 – 2 500) |
| Botha | 25 000(37 500) – 12 500) |
| Cross | 15 000 |

The capital ratio is:

| | A | B | C |
|-----------------|----------------|----------------|----------------|
| | 35 000 | 25 000 | 15 000 |
| Divide by 5 000 | 7 | 5 | 3 |
| Divide by 15 | $\frac{7}{15}$ | $\frac{5}{15}$ | $\frac{3}{15}$ |

You can therefore see that Cross will still be entitled to $\frac{3}{15}$ or $\frac{1}{5}$ of the profits, but that the profit-sharing ratio as regards A and B has changed.

Revaluation of assets and liabilities

Since the new partner has to pay for his or her share of the profits of the partnership, and this amount is calculated from the “value” of the old partnership, it is important that all assets and liabilities of the old partnership should be correctly valued. These changes will result in the adjustment of assets and liabilities and the reflection of such adjustments in the capital accounts.

The assets and liabilities which are generally revalued include accounts receivable, inventories, creditors, land and buildings, plant and machinery and other movable assets.

These adjustments to assets and liabilities are effected by means of a revaluation account.

- If the value of an asset increases:
 - Dr – Asset account
 - Cr – Revaluation account
- If the value of an asset decreases:
 - Dr – Revaluation account
 - Cr – Asset account

The balance (profit/loss upon revaluation) on the revaluation account is then allocated to the old partners in the profit-sharing ratio.

There is another important entry to be made, accumulated reserves (general reserve, non-distributable reserves) also have to be written back to the old partners' capital accounts in the old profit-sharing ratio since these services belong to the old partners.

Partners occasionally decide to keep these “new” asset values on the books. In this case it is not necessary to write the assets back to the old values after the admission of the new

partner. The opposite may also apply, namely that the partners decide to keep the assets at the old values in the books of the partnership, with the result that the revaluations have to be written back in the new partners' profit-sharing ratio.

Work carefully through the following two examples which provide a fuller explanation of the above two options.

EXAMPLE

A and B are in partnership and divide profits and losses in the ratio of 3:2 respectively. Cross was admitted as a partner on 28 February 2006. The new profit-sharing ratio between A, B and C will be 3:2:1 respectively.

A AND B PARTNERSHIP BALANCE SHEET AT 28 FEBRUARY 2006

| | R |
|-------------------------------------|----------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 30 000 |
| Current assets | 90 000 |
| Inventories | 44 000 |
| Trade and other receivables | 26 000 |
| Cash and cash equivalents | 20 000 |
| Total assets | 120 000 |
| EQUITY AND LIABILITIES | |
| Capital | 100 000 |
| Alpha | 60 000 |
| Botha | 40 000 |
| Current liabilities | |
| Trade and other payables | 20 000 |
| Total equity and liabilities | 120 000 |

Additional information:

For the purpose of the change in ownership the following agreement was reached:

1. Provision would be made for bad debts at 10% of the outstanding (carrying) amount of accounts receivable. *
2. Inventories would be valued at R50 000.
3. Land and buildings would be valued at the market value of R50 000.
4. Cross would bring R20 000 into the business in cash.
5. Tangible assets would be shown at the revalued amounts. **

** Tangible assets refer to property, plant and equipment and inventory.

Required:

Prepare the following ledger accounts of the partnership at 28 February 2006.

- Land and buildings
- Inventories
- Trade accounts receivable
- Provision for bad debts
- Bank
- Revaluation account
- Capital accounts A, B and C

GENERAL LEDGER

| Land and buildings | | | |
|--------------------|-------------|-----|--------------------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 30 000 |
| 28 | Revaluation | | 20 000 |
| | | | R(50 000 – 30 000) |
| Feb 28 | Balance | b/d | 50 000 |

| Inventories | | | |
|-------------|-------------|-----|--------------------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 44 000 |
| 28 | Revaluation | | 6 000 |
| | | | R(50 000 – 44 000) |
| Feb 28 | Balance | b/d | 50 000 |

| Trade accounts receivable | | | |
|---------------------------|---------|-----|----------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 26 000 |

| Provision for bad debts | | | |
|-------------------------|-------------|--|-----------------|
| 2006 | | | R |
| Feb 28 | Revaluation | | 2 600 |
| | | | R(26 000 x 10%) |

| Bank | | | |
|--------|------------------------|-----|----------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 20 000 |
| 28 | C capital (introduced) | | 20 000 |
| Feb 28 | Balance | b/d | 40 000 |

| Revaluation account | | | | | | |
|---------------------|---|--|---------------|--------|--------------------|---------------|
| 2006 | | | R | 2006 | | R |
| Feb 28 | Provision for bad debts | | 2 600 | Feb 28 | Land and buildings | 20 000 |
| | Capital – A (³ / ₅) | | 14 040 | 28 | Inventories | 6 000 |
| | – B (² / ₅) | | 9 360 | | | <u>26 000</u> |
| | | | <u>26 000</u> | | | <u>26 000</u> |

| Capital: A | | | |
|------------|-------------|-----|----------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 60 000 |
| | Revaluation | | 14 040 |
| Feb 28 | Balance | b/d | 74 040 |

| Capital: B | | | |
|------------|-------------|-----|----------|
| 2006 | | | R |
| Feb 28 | Balance | b/d | 40 000 |
| | Revaluation | | 9 360 |
| Feb 28 | Balance | b/d | 49 360 |

Capital: C

| | | |
|--------|------|----------|
| 2006 | | R |
| Feb 28 | Bank | 20 000 |

Notes:

- The adjusted balance sheet after the admission of C would be as follows:

**A, B AND C PARTNERSHIP
BALANCE SHEET AT 28 FEBRUARY 2006**

| R | |
|---|----------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 50 000 |
| Current assets | |
| Inventory | 113 400 |
| Trade and other receivables R(26 000 – 2 600) | 50 000 |
| Cash and cash equivalents | 23 400 |
| | 40 000 |
| Total assets | 163 400 |
| EQUITY AND LIABILITIES | |
| Capital | |
| A | 143 400 |
| B | 74 040 |
| C | 49 360 |
| | 20 000 |
| Current liabilities | |
| Trade and other payables | 20 000 |
| Total equity and liabilities | 163 400 |

- The "profit" on the revaluation account of $R26\ 000 - 2\ 600 = R23\ 400$ is allocated to A and B in the ratio of 3:2.
- The tangible assets are shown at the "new values" in the books.

EXAMPLE

X and Y are in partnership and share profits and losses in the ratio of 2:1 respectively. Z is admitted as a partner on 30 June 2006. the new profit-sharing ratio between X, Y and Z will be 2:1:1 respectively.

**X AND Y PARTNERSHIP
BALANCE SHEET AT 30 JUNE 2006**

| | R |
|-------------------------------------|----------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 80 000 |
| Current assets | 90 000 |
| Inventories | 44 000 |
| Trade and other receivables | 26 000 |
| Cash and cash equivalents | 20 000 |
| Total assets | 170 000 |
| EQUITY AND LIABILITIES | |
| Capital and reserves | 150 000 |
| Capital – X | 80 000 |
| Capital – Y | 40 000 |
| General reserve | 30 000 |
| Current liabilities | |
| Trade and other payables | 20 000 |
| Total equity and liabilities | 170 000 |

Additional information:

For the purposes of the change in ownership the following agreement was reached:

- (1) Bad debts should be provided for at 5% of the carrying amount of accounts receivable.
- (2) Inventories should be valued at R60 000.
- (3) Land and buildings should be valued at market value, namely R120 000.
- (4) C would bring R40 000 in cash into the business.
- (5) Tangible assets should not be shown at the revalued amounts.

Required:

Prepare the following ledger accounts for the partnership as at 30 June 20.5:

- Revaluation account
- General reserve
- Capital accounts X, Y and Z

Revaluation account

| 2006 | | | 2006 | | |
|---------|---|---------------|---------|---|---------------|
| | | R | | | R |
| June 30 | Trade accounts receivable | 1 300 | June 30 | Land and buildings | 40 000 |
| | R(26 000 x 5%) | | | R(120 000 – 80 000) | |
| 30 | Capital – X (² / ₃) | 36 467 | 30 | Inventories | 16 000 |
| | – Y (¹ / ₃) | 18 233 | | R(60 000 – 44 000) | |
| | | <u>56 000</u> | | | <u>56 000</u> |
| June 30 | Land and buildings | 40 000 | June 30 | Trade accounts receivable | 1 300 |
| 30 | Inventories | 16 000 | 30 | Capital – X (² / ₄) | 27 350 |
| | | | | – Y (¹ / ₄) | 13 675 |
| | | | | – Z (¹ / ₄) | 13 675 |
| | | <u>56 000</u> | | | <u>56 000</u> |

General reserve

| 2006 | | | 2006 | | |
|---------|---|---------------|---------|---|------------|
| | | R | | | R |
| June 30 | Capital – X (² / ₃) | 20 000 | June 30 | Balance | b/d 30 000 |
| | – Y (¹ / ₃) | 10 000 | | | |
| | | <u>30 000</u> | June 30 | Capital – X (² / ₄) | 15 000 |
| | | | | – Y (¹ / ₄) | 7 500 |
| | | | | – Z (¹ / ₄) | 7 500 |
| | | | June 30 | Balance | b/d 30 000 |

Capital: X

| 2006 | | | 2006 | | |
|---------|-----------------|----------------|---------|-----------------|----------------|
| | | R | | | R |
| June 30 | Revaluation | 27 350 | June 30 | Balance | b/d 80 000 |
| 30 | General reserve | 15 000 | 30 | Revaluation | 36 467 |
| 30 | Balance | c/d 94 117 | 30 | General reserve | 20 000 |
| | | <u>136 467</u> | | | <u>136 467</u> |
| | | | June 30 | Balance | b/d 94 117 |

Capital: Y

| 2006 | | | 2006 | | |
|---------|-----------------|---------------|---------|-----------------|---------------|
| | | R | | | R |
| June 30 | Revaluation | 13 675 | June 30 | Balance | b/d 40 000 |
| 30 | General reserve | 75 000 | 30 | Revaluation | 18 233 |
| 30 | Balance | c/d 47 058 | 30 | General reserve | 10 000 |
| | | <u>68 233</u> | | | <u>68 233</u> |
| | | | June 30 | Balance | b/d 47 058 |

Capital: Z

| 2006 | | | 2006 | | |
|---------|-----------------|---------------|---------|---------|---------------|
| | | R | | | R |
| June 30 | Revaluation | 13 675 | June 30 | Bank | 40 000 |
| 30 | General reserve | 7 500 | | | |
| 30 | Balance | c/d 18 825 | | | |
| | | <u>40 000</u> | | | <u>40 000</u> |
| | | | June 30 | Balance | b/d 18 825 |

Notes:

1. The adjusted balance sheet after the admission of Z will be:

**X, Y AND Z PARTNERSHIP
BALANCE SHEET AT 30 JUNE 2006**

| | R |
|-------------------------------------|----------------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 80 000 |
| Current assets | 130 000 |
| Inventories | 44 000 |
| Trade and other receivables | 26 000 |
| Cash and cash equivalents | 60 000 |
| Total assets | 210 000 |
| EQUITY AND LIABILITIES | |
| Capital and reserves | 190 000 |
| Capital – X | 94 117 |
| Capital – Y | 47 058 |
| Capital – Z | 18 825 |
| General reserve | 30 000 |
| Current liabilities | |
| Trade and other payables | 20 000 |
| Total equity and liabilities | 210 000 |

2. The tangible assets are still shown in the books at the “old values”.
3. The general reserve is “allocated” to the *old* partners in the *old* profit-sharing ratio and then “restored” to the *new* partners in the *new* profit-sharing ratio.

Goodwill

For the purposes of our discussion, goodwill can be regarded as the good name of the firm. Goodwill is **not** a tangible asset but many indirect advantages are nevertheless derived from goodwill, such as the assurance of a good turnover. (People always return to a business from which they have received good service or good products). A businessman who has already built up the good name of his business has also built up an asset in the form of goodwill. If he were to sell his business or take in a partner, he would add the monetary value of his goodwill, which is the assurance of its survival and continued ability to generate income to the net value of his tangible assets. The businessman would not sell his business without receiving remuneration for his goodwill.

When a new partner is admitted, the businessman would also require the incoming partner to make some tangible contribution in return for the existing goodwill. This charge paid by the incoming partner should be seen as a *premium* he has to pay to the old partners or sole owner for the privilege of being admitted to the partnership, by which means he acquires a share in the partnership assets and a future share in the net profits of the business.

As in the case of the revaluation of assets and liabilities, partners may decide either to show goodwill in the books or to write it back after the admission of the new partner.

EXAMPLE

X and Y are partners and share profits and losses in the ratio of 2:3 respectively. Z is admitted as a partner and it is agreed that he should pay R60 000 for his one-third interest in the partnership. Goodwill will not be shown in the books of the partnership. The capital will be in the same ratio as the profit-sharing ratio. At the date of admission of Z, X and Y's capital is R40 000 and R60 000 respectively, and other fixed property is R100 000.

Journal entry upon admission of new partner:

| | Dr R | Cr R |
|-------------------------------|---------|---------|
| Goodwill | 20 000 | |
| Capital: X ($\frac{2}{5}$) | | 8 000 |
| Y ($\frac{3}{5}$) | | 12 000 |
| Creation of goodwill | | |
| Capital: X ($\frac{4}{15}$) | 5 333 | |
| Y ($\frac{6}{15}$) | 8 000 | |
| Z ($\frac{5}{15}$) | 6 667 | |
| Goodwill | | 20 000 |
| Sharing of goodwill | | |

CONDENSED BALANCE SHEET AFTER ADMISSION OF Z

| | R | |
|---|---------|---------------------|
| ASSETS | | |
| Non-current assets – Property, plant and equipment | 100 000 | |
| Current assets – Cash and cash equivalents | 60 000 | |
| | 160 000 | |
| EQUITY AND LIABILITIES | | |
| Capital: X R(40 000 + 8 000 – 5 333) | 42 667 | } ($\frac{2}{3}$) |
| Y R(60 000 + 12 000 – 8 000) | 64 000 | |
| Z R(60 000 – 6 667) | 53 333 | } ($\frac{1}{3}$) |
| | 160 000 | |

Retirement of a partner and dissolution of partnership

There are various possible reasons for the retirement of a partner. From a legal point of view, partnerships would be dissolved in the following circumstance:

- Voluntary action by partners
 - agreement among partners
 - conclusion of period for which partnership was originally formed
 - achievement of purpose for which partnership was established
- Unilateral notice by a partner

A partnership is automatically dissolved upon the death of a partner or the liquidation of the partnership.

Retirement of a partner

A partner can retire from an existing partnership by selling his assets to a new partner. Prior consent must, however, be obtained from the other partners. The partner could also sell his interest to the remaining partners.

As we explained previously, all assets and liabilities have to be revalued and any revaluation surplus or deficit which may result must be transferred to the capital accounts in the correct profit-sharing ratio. The remaining partners can then decide whether they want to show the assets and liabilities in the partnership's books at the revalued figures or whether they want to write back the revaluation surplus or deficit.

If the remaining partners take over the interests of the retiring partner, they are entitled to settle the retiring partner's interest by utilizing partnership funds.

EXAMPLE

A, B and C are in a partnership and share profits and losses in the ratio of 2:2:1 respectively. A decides to retire from the partnership on 28 February 2006. B and C decide to admit a new partner, D, to the partnership on the same day.

The new profit-sharing ratio for the partners B, C and D will be 3:2:1 respectively.

CONDENSED BALANCE SHEET OF THE PARTNERSHIP AT 28 FEBRUARY 2006

| | R |
|--|---------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment – Land and buildings | 80 000 |
| Current assets | 102 000 |
| Inventories | 48 000 |
| Trade accounts receivable | 36 000 |
| Cash and cash equivalents | 18 000 |
| Total assets | 182 000 |
| EQUITY AND LIABILITIES | |
| Capital: | 168 000 |
| Capital - A | 56 000 |
| Capital - B | 74 000 |
| Capital - C | 38 000 |
| Current liabilities | |
| Trade creditors | 14 000 |
| Total equity and liabilities | 182 000 |

Additional information

- (1) The following agreement was reached for the purpose of the change of ownership:
- 1.1 Goodwill will be calculated at three times the average fee income for the past two years. Goodwill should not be shown as an asset.
 - 1.2 Bad debts should be provided for at 10% of the carrying amount of the trade accounts receivable.
 - 1.3 Inventories should be valued at R60 000.
 - 1.4 Land and buildings are valued at market value, namely R140 000.
- (2) Fee income for the past two years was R65 000 and R73 000 respectively.
- (3) D will contribute R80 000 in cash to the business.
- (4) Tangible assets must be shown at the revalued amounts.

Required:

Prepare the partners' capital accounts at 28 February 2006, as well as the revaluation account at that date.

Capital accounts

| | A R | B R | C R | D R | | A R | B R | C R | D R |
|----------------------------------|---------|---------|--------|--------|---------------------|---------|---------|--------|--------|
| Balance c/d | 166 160 | 184 160 | 93 080 | - | Balance b/d | 56 000 | 74 000 | 38 000 | - |
| | | | | | Goodwill | 82 800 | 82 800 | 41 400 | - |
| | | | | | Revaluation account | 27 360 | 27 360 | 13 680 | - |
| | 166 160 | 184 160 | 93 080 | - | | 166 160 | 184 160 | 93 050 | - |
| Goodwill - not shown as an asset | - | 103 500 | 69 000 | 34 500 | Balance b/d | 166 160 | 184 160 | 93 080 | - |
| Loan account: A | 166 160 | 80 660 | 24 080 | 45 500 | Bank | | | | 80 000 |
| Balance c/d | 166 160 | 184 160 | 93 080 | 80 000 | | 166 160 | 184 160 | 93 080 | 80 000 |
| | | | | | Balance b/d | - | 80 660 | 24 080 | 45 500 |

Revaluation account

| | | | |
|---|----------|------------------------|----------|
| | R | | R |
| Decrease in trade accounts receivable (36 000 x 10%) | 3 600 | Increase - inventories | 12 000 |
| Capital - A | 27 360 | R(60 000 - 48 000) | |
| - B | 27 360 | Land and buildings | |
| - C | 13 680 | R(140 000 - 80 000) | |
| | 68 400 | | |
| | 72 000 | | 72 000 |

Loan account: A

| | |
|-----------------|----------|
| | R |
| Capital account | 166 160 |

Calculation

| | |
|----------------|------------------------|
| Goodwill | R |
| Profit 20.6 | 65 000 |
| Profit 20.7 | 73 000 |
| Total profit | <u>138 000</u> |
| Average profit | 138 000 ÷ 2 = R 69 000 |
| Goodwill | 69 000 x 3 = R207 000 |

Notes:

Since there are not sufficient funds available in the partnership at this stage, the partner's interest is transferred to a loan account. The partners can then reach an agreement on the repayment conditions and the applicable interest rate.

In the event of the death of a partner, the net balance in his capital account is transferred to an estate account, for example *Estate – B*. the same principles also apply when a partner retires.

Dissolution of the partnership

As we said previously, a partnership is dissolved when it is liquidated. Other reasons for dissolution may be an increase in membership to over 20 partners. A partnership may also be dissolved on the strength of a court order at the request of the partners. This could happen where good relations between the partners broke down as a result of misconduct or negligence on the part of some of the partners.

Liquidation means the complete dissolution and termination of the partnership. The assets have to be converted into money (realization of the assets). All the available funds are then used to discharge the debts of the partnership.

All profits and losses arising from the liquidation process are transferred to the partners according to their *profit-sharing ratio*. The remaining cash after all debts have been discharged is paid to the partners in accordance with the *balances on the capital accounts*.

EXAMPLE

A and B were in partnership for 8 years. They divided profits and losses in the ratio of 2:1. On 30 June 2006 they decided to dissolve the partnership at 30 June 2002:

Trial Balance as at 30 June 2006

| | Dr R | Cr R |
|------------------------------------|-----------------|-----------------|
| Capital: A | | 120 000 |
| Capital: B | | 90 000 |
| Land and buildings at valuation | 500 000 | |
| Furniture at carrying amount | 82 000 | |
| Vehicles at carrying amount | 200 000 | |
| Goodwill | 120 000 | |
| General reserve | | 60 000 |
| Reservation on revaluation of land | | 210 000 |
| Inventories | 45 000 | |
| Trade accounts receivable | 68 000 | |
| Trade creditors | | 145 000 |
| Cash and cash equivalents | | 90 000 |
| Mortgage on land and buildings | | 300 000 |
| | 1 015 000 | 1 015 000 |

Additional information

- (1) The property was sold for R850 000 at a public auction. The proceeds were immediately used to cover the mortgage loan. The sales commission payable to the auctioneer amounted to R10 000.
- (2) Since there were only two vehicles in the partnership, the partners decided to take one each. The value of the vehicle taken over by A was estimated at R60 000 and that of B at R70 000.
- (3) Furniture was sold for R60 000 and the inventories realized R50 000.
- (4) All trade accounts receivable paid their accounts after the partnership decided to allow a rebate of 20% on all outstanding accounts.
- (5) A and B negotiated with the trade creditors and were permitted a rebate of 20% on outstanding accounts. All accounts were then paid.
- (6) Final payments to the partners were made on 30 June 2006.

Required:

Prepare the realisation account, the bank account and the partners' capital accounts in order to record the dissolution of the partnership at 30 June 2006.

Realisation account

| | R | | R |
|-------------------------------|-----------|-----------------------------|-----------|
| Land and buildings | 500 000 | Bank - Land | 840 000 |
| Vehicles | 200 000 | Capital account – A | 60 000 |
| Furniture | 82 000 | – B | 70 000 |
| Inventories | 45 000 | Bank – Furniture | 60 000 |
| Trade accounts receivable | 68 000 | – Inventories | 50 000 |
| Bank – Trade accounts payable | 116 000 | – Trade accounts receivable | 54 400 |
| Capital – A ($\frac{2}{3}$) | 178 933 | Trade accounts payable | 145 000 |
| – B ($\frac{1}{3}$) | 89 467 | | |
| | 1 279 400 | | 1 279 400 |

Bank

| | R | | R |
|---|-----------|------------------------------|-----------|
| Realisation | | Balance b/d | 90 000 |
| – Land and buildings (850 000 – 10 000) | 840 000 | Mortgage loan | 300 000 |
| – Furniture | 60 000 | Realisation | |
| – Inventories | 50 000 | – Trade accounts payable | 116 000 |
| – Trade accounts receivable [68 000 – (20% of 68 000)] | 54 400 | [145 000 – (20% of 145 000)] | |
| | 1 004 400 | Capital – A | 338 933 |
| | | – B | 159 467 |
| | | | 1 004 400 |

Capital account – A

| | R | | R |
|----------------------------|---------|--|---------|
| Realisation – Vehicle | 60 000 | Balance b/d | 120 000 |
| Goodwill ($\frac{2}{3}$) | 80 000 | General reserve ($\frac{2}{3}$) | 40 000 |
| Bank * | 338 933 | Reserve on revaluation ($\frac{2}{3}$) | 140 000 |
| | | Realisation account | 178 933 |
| | 478 933 | | 478 933 |

Capital account – B

| | R | | R |
|----------------------------|---------|--|---------|
| Realisation – Vehicle | 70 000 | Balance | 90 000 |
| Goodwill ($\frac{1}{3}$) | 40 000 | General reserve ($\frac{1}{3}$) | 20 000 |
| Bank * | 159 467 | Reserve on revaluation ($\frac{1}{3}$) | 70 000 |
| | | Realisation account | 89 467 |
| | 269 467 | | 269 467 |

* Balancing figure

Notes:

Please note that the profit in the realisation account is apportioned to the partners according to their profit-sharing ratio. The balance in the bank account is not, however, distributed in the same proportion but is used to pay back the balances on the various capital accounts.

Insolvency of a partner

It occasionally happens that when a partnership dissolves one of the partners' capital accounts has a debit balance for one reason or another. In such cases the partner is expected to repay to the partnership the amount of the deficit in his capital account. It is possible that this partner will prove to be insolvent and unable to meet his or her obligation towards the partnership.

If this is the case, the remaining partners naturally have to bear the loss of this shortfall in the insolvent partner's capital.

If, after all the adjustments, a partner's capital account were to have a debit balance, the partner would be obliged to repay the amount to the partnership. If the partner is insolvent and cannot pay the amount, the remaining partners would have to carry the loss according to their usual profit-sharing ratio.

EXAMPLE

Suppose A, B and C are partners in the ratio of 3:2:1 and C is insolvent and has a debit balance of R500 in his capital account. This R500 which C is unable to repay to the partnership will be carried as follows by A and B:

Journal

| | Dr R | Cr R |
|--|---------|---------|
| Capital account: A ($\frac{3}{5}$) | 300 | |
| Capital account: B ($\frac{2}{5}$) | 200 | |
| Capital account: C | | 500 |
| Transfer of loss as a result of shortfall in C's capital, C being insolvent | | |

This transaction closes C's capital account and the available cash and/or assets can now be divided normally between A and B.

Typically in an insolvency the insolvent partner's estate, when it becomes available pays certain dividend, for example 25c, 50c or so, in the Rand to the creditors. The deficit on the insolvent partner's capital account naturally means that the partnership is a creditor. If a dividend is received from the insolvent partner, this receipt is naturally credited to his capital account, so that only the remaining balance will have to be carried by the solvent partners in their ordinary profit-sharing ratio.

EXAMPLE

Love, Brand and Peters are in partnership and divide profits and losses in the ratio of 2:2:1.

On 30 June 2006 they decided to dissolve the partnership. At that date their balance sheet was as follows:

**LOVE, BRAND AND PETERS
BALANCE SHEET AT 30 JUNE 2006**

| | R |
|-------------------------------------|----------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 6 000 |
| Current assets | |
| Cash and cash equivalents | 900 |
| | 6 900 |
| Total assets | |
| EQUITY AND LIABILITIES | |
| Capital: | 4 300 |
| Capital – Love | 3 000 |
| Capital – Brand | 300 |
| Capital - Peters | 1 000 |
| Current liabilities | |
| Trade accounts payable | 2 600 |
| Total equity and liabilities | 6 900 |

Sundry assets were sold for R3 000. Brand was insolvent and unable to contribute to his deficit.

Required:

Prepare the journal entries required to close off the books of the partnership. (All cash items should also be shown in the form of journal entries).

Journal entries

| | Dr R | Cr R |
|--|-----------------------|-----------------|
| Realisation account Property, plant and equipment Transfer of sundry balances | 6 000 | 6 000 |
| Cash Realisation account Sale of sundry assets | 3 000 | 3 000 |
| Capital: Love ($\frac{2}{5}$) Capital: Brand ($\frac{2}{5}$) Capital: Peters ($\frac{1}{5}$) Realisation account Transfer and division of losses at dissolution in the Profit-sharing ratio | 1 200 1 200 600 | 3 000 |
| Capital: Love Capital: Peters Capital: Brand Transfer of Brand's deficit to Love and Peter in the profit-sharing ratio | 600 300 | 900 |
| Trade creditors Capital: Love Capital: Peters Bank Sundry payments in order to close the books | 2 600 1 200 100 | 3 900 |

If the cash received upon realisation of the assets is insufficient to pay the creditors in full the partners are jointly and individually responsible for all the debts of the partnership and this means that, if the proceeds of the dissolution of the partnership are insufficient to settle all debts to creditors, the partners are obliged to provide funds from their private resources to make up the deficit. Remember that all creditors have to be paid in full, irrespective of the proceeds of the partnership.

If there is a deficit in the cash required to pay the creditors, the assumption would be that there would also be a pronounced deficit at dissolution, because it would be unthinkable that there could be a deficit in the cash. In this case the partner's capital accounts would naturally be debited with their respective share in the loss at dissolution. This transfer of the loss would cause at least one of the partner's capital accounts to show a debit balance, and it is quite possible that all the partner's' capital accounts would show negative balances. In this event the partners would each have to pay to the partnership the amount of the deficit in their capital accounts. This payment would then provide the necessary cash to pay the creditors in full. In these circumstances there would be no sum available in cash to distribute amongst the partners.

Piecemeal liquidation

In practice when a partnership is dissolved it is not always possible to realise the assets within a relatively brief period. The partners may therefore decide to liquidate their business piecemeal, in which case the business continues normally, but on a steadily decreasing scale. This creates the opportunity to sell inventories and other assets at the most favourable prices and to collect debts in the ordinary course of business.

As the assets in the business are realised, cash funds will accumulate which will not be used for business purposes again. These funds are the property of the partners and they are entitled to make periodic capital withdrawals from the funds. In order to ensure that the respective interests of the partners are not prejudiced in any way, these periodic capital withdrawals have to take place in a very orderly and systematic way, the more so because profits and losses on the activities that are still in progress continue to accumulate and especially where one partner's capital is relatively low in relation to his share of the profits.

There are two main recognised methods according to which capital payments can be made, namely the surplus capital method and the loss absorption capacity method.

Surplus capital method

According to this method the amount realised for assets which are sold from time to time is used as follows:

- Firstly, in settlement of creditors' claims which are payable and realisation costs to date, and as a reserve for creditors' claims which are not yet payable.
- Then, to pay to the partners the amounts in their capital accounts which exceed their profit-sharing ratio
- Lastly, as a distribution to partners in accordance with their profit-sharing ratio after the capital accounts have been reduced to the profit-sharing ratio

EXAMPLE

The balance sheet of P, Q and R, who share profits and losses in ratio of 5:3:2, was as follows at 30 June 2006.

P, Q AND R BALANCE SHEET AT 30 JUNE 2006

| | R |
|-------------------------------------|--------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 18 000 |
| Total assets | 18 000 |
| EQUITY AND LIABILITIES | |
| Capital: | 15 000 |
| Capital – P | 8 000 |
| Capital – Q | 5 000 |
| Capital - R | 2 000 |
| Current liabilities | |
| Trade creditors | 3 000 |
| Total equity and liabilities | 18 000 |

The assets are being liquidated piecemeal, and as soon as cash becomes available from the realisation of assets it is paid to the partners.

The sundry assets realised as follows:

| | | | | | |
|--------------------|---|-----------------|----------------|---------------|----------------|
| First realisation | : | Carrying amount | R 2 500 | Cash received | R 2 500 |
| Second realisation | : | Carrying amount | R 5 600 | Cash received | R 5 000 |
| Third realisation | : | Carrying amount | R 6 000 | Cash received | R 6 000 |
| Fourth realisation | : | Carrying amount | R 3 900 | Cash received | R 4 000 |
| | | | <u>R18 000</u> | | <u>R17 500</u> |

Step 1

Determine the amounts of the partners' capital which exceeded the profit-sharing ratio as follows:

- Determine partners; profit-sharing ratio (PSR)
- Determine partners' original capital balances
- Divide each partner's capital by his profit-sharing ratio figure [see (a)]
- Multiply the lowest capital by each partner's profit-sharing figure, to give the partners' capital in the highest profit-sharing ratio [see (b)]
- Subtract partner's capital in the profit-sharing ratio from their original capitals which will give you capitals that exceed the profit-sharing ratio [see (c)]
- Follow the same procedure as above in respect of excess capitals, eliminate the partners one by one and then calculate the final excess capital where the capital of one partner exceeds that of all the others [see (d), (e) and (f)]

| | Refer- ence A | P 5 | Q 3 | R 2 |
|---|---------------------|---------|---------|---------|
| Original capital balances | B | R 8 000 | R 5 000 | R 2 000 |
| (a) Divided by the profit-sharing figure (B ÷ A) | C | 1 600 | 1 666 | 1 000 |
| (b) Multiply the lowest capital, that of R, by the profit-sharing ratio figures, i.e. (1 000 x A) which will give you the maximum Capital in the profit-sharing ratio | D | 5 000 | 3 000 | 2 000 |
| (c) Subtract from original capital balances and obtain the first excess of capitals above the Profit-sharing ratio (B – D) | E | 3 000 | 2 000 | - |
| (d) Divide by profit-sharing ratio figures (E ÷ A) | F | 600 | 666 | - |
| (e) Multiply lowest capital, that of P, by the Profit-sharing ratios of P and Q (F x A) | G | 3 000 | 1 800 | - |
| (f) Subtract from excess capitals per E above and obtain final excess of Q (E – G) | H | - | 200 | - |

Step 2*Arrange partners' capitals for repayment*

| | Refer- ence | R | R | R |
|---|----------------|-------|-------|-------|
| 1 st : Q – final excess | H | - | 200 | - |
| 2 nd : P and Q excess in PSR | G | 3 000 | 1 800 | - |
| 3 rd : P, Q and R in PSR | D | 5 000 | 3 000 | 2 000 |
| | B | 8 000 | 5 000 | 2 000 |
| | | | | |

Step 3*Distribution of available cash*

| | Cash available | Allocated | | | |
|--|-------------------|---------------------|--------|--------|--------|
| | | Accounts Payable | P | Q | R |
| First realisation | R 2 500 | R 2 500 | R - | R - | R - |
| Second realisation | 5 000 | | | | |
| Final amount to creditors | 500 | 500 | | | |
| First option (H) | 200 | | | 200 | |
| Second option (G) | | | | | |
| P $\left(\frac{3000}{3000+1800}\right) \times (5\,000 - 500 - 200)$ | 2 688 | | 2 688 | | |
| Q $\left(\frac{1800}{3000+1800}\right) \times (5\,000 - 500 - 200)$ | 1 612 | | | 1 612 | |
| Third realisation | | | | | |
| Balance of second option (G) | 6 000 | | | | |
| $(3\,000 + 1\,800) - (2\,688 + 1\,612) = 500$ | | | | | |
| P $(3\,000 - 2\,688)$ | 312 | | 312 | | |
| Q $(1\,800 - 1\,612)$ | 188 | | | 188 | |
| Third option (D) | | | | | |
| P $\left(\frac{5000}{5000+3000+2000}\right) \times (6\,000 - 312 - 188)$ | 2 750 | | 2 750 | | |
| Q $\left(\frac{3000}{5000+3000+2000}\right) \times (6\,000 - 312 - 188)$ | 1 650 | | | 1 650 | |
| R $\left(\frac{2000}{5000+3000+2000}\right) \times (6\,000 - 312 - 188)$ | 1 100 | | | | 1 100 |
| Fourth realisation | 4 000 | | | | |
| P $\left[4000 \times \left(\frac{5000}{5000+3000+2000}\right)\right]$ | 2 000 | | 2 000 | | |
| Q $\left[4000 \times \left(\frac{3000}{5000+3000+2000}\right)\right]$ | 1 200 | | | 1 200 | |
| R $\left[4000 \times \left(\frac{2000}{5000+3000+2000}\right)\right]$ | 800 | | | | 800 |
| | 17 500 | 3 000 | 7 750 | 4 850 | 1 900 |

Notes:

You will note that a loss amount to R500 resulted from the realisation of assets
R(18 000 – 17 000)

2. This loss of R500 was borne as follows by the partners:

$$P : 8\,000 \text{ (capital)} - 7\,750 \text{ (cash)} = R250 \left(\frac{5}{10} \times 500\right)$$

$$Q : 5\,000 \text{ (capital)} - 4\,850 \text{ (cash)} = R150 \left(\frac{3}{10} \times 500\right)$$

$$R : 2\,000 \text{ (capital)} - 1\,900 \text{ (cash)} = R100 \left(\frac{2}{10} \times 500\right)$$

3. The creditors did not bear any of the "loss"

Loss absorption capacity method

This method is based on the assumption that the assets that are unrealized after the first realisation are worthless. The resultant deficit is divided among the partners in their profit-sharing ratio and every resultant debit balance which appears in any partner's capital account is redistributed among the remaining partners in accordance with their profit-sharing ratio. The cash realised is then used as follows:

- firstly, the claims by creditors which are payable are met, as are the realisation costs
- secondly, an amount equivalent to claims by creditors which are not yet payable is set aside
- lastly, the remaining cash balance is used to pay to partners the amounts in credit in their capital accounts after the above adjustment.

At each successive realisation the original balances on partners' capital accounts are adjusted as follows in the profit-sharing ratio:

- firstly, all profits and losses on realisation to date are transferred to capital accounts
- all unrealised assets are then assumed to be worthless and the resulting deficit is then distributed among the partners, as was mentioned above
- lastly, all distributions made to date are debited to the capital accounts

The realisation proceeds are used in the manner described above. This procedure is followed until all the assets have been realised.

EXAMPLE

The balance sheet of A, B C who share profits and losses in the ratio of 5:3:2 respectively, appeared as follows at 30 June 2006.

**X, Y AND Z
BALANCE SHEET AT 30 JUNE 2006**

| | R |
|-------------------------------------|--------|
| ASSETS | |
| Non-current assets | |
| Property, plant and equipment | 18 000 |
| Total assets | 18 000 |
| EQUITY AND LIABILITIES | |
| Capital: | 15 000 |
| Capital – A | 8 000 |
| Capital – B | 5 000 |
| Capital – C | 2 000 |
| Current liabilities | |
| Trade creditors | 3 000 |
| Total equity and liabilities | 18 000 |

The assets are liquidated piecemeal and as soon as cash is available from the realisation of assets, it is paid to the partners.

The sundry assets were realised as follows:

| | | |
|--------------------|---------------------------------|-----------------------------|
| First realisation | : Carrying amount R2 000 | Cash received R2 500 |
| Second realisation | : Carrying amount R5 600 | Cash received R5 000 |
| Third realisation | : Carrying amount R6 000 | Cash received R6 000 |
| Fourth realisation | : Carrying amount <u>R3 900</u> | Cash received <u>R4 000</u> |
| | <u>R18 000</u> | <u>R17 500</u> |

Procedure at the time of realisation

- Open the applicable accounts in columnar form with the balances as at the commencement of liquidation.
- Divide the cash received from each realisation according to the prescribed rank order.
- Apportion the profits or losses which arise after each realisation of assets to the capital accounts of the partners according to their profit-sharing ratio.
- After each realisation, draw up a liquidation schedule to determine what amount can be paid out to each partner.
- Assume the assets that have not yet been realised as worthless and apportion the "potential deficit" to the partners in their profit-sharing ratio.
- Any deficit which may arise in a partner's capital account must be transferred to the remaining partners' capital accounts according to their respective profit-sharing ratios.
- Transfer the amounts as calculated in the liquidation schedule to the partner's capital accounts.
- Once the partnership accounts have reached the point where they correspond to the partners' profit-sharing ratio, all the succeeding payments to partners can be allocated in that proportion

| | Bank | Trade creditors | Property, Plant and equipment | A | B | C |
|---|---------|-----------------|-------------------------------|---------|---------|---------|
| | R | R | R | R | R | R |
| Profit-sharing ratio | | | | | | |
| Balances at the commencement of liquidation | | (3 000) | 18 000 | (8 000) | (5 000) | (2 000) |
| Sale of assets | 2 500 | | (2 500) | | | |
| Payment of creditors | (2 500) | 2 500 | | | | |
| Sale of assets and allocation of loss | 5 000 | | (5 000) | 300 | 180 | 120 |
| Payment of creditors | (500) | 500 | | | | |
| | 4 500 | - | 9 900 | (7 700) | (4 820) | (1 880) |
| Distribution from liquidation schedule [see (a) below] | (4 500) | | | 2 688 | 1 812 | |
| | - | | 9 900 | (5 012) | (3 008) | (1 880) |
| Sale of assets | 6 000 | | (6 000) | | | |
| | 6 000 | | 3 900 | (5 012) | (3 008) | (1 880) |
| Distribution from liquidation schedule [see (b) below] | (6 000) | | | 3 062 | 1 838 | 1 100 |
| | - | - | 3 900 | (1 950) | (1 170) | (780) |
| Sale of assets and allocation of profits | 4 000 | | (3 900) | (50) | (30) | (20) |
| | 4 000 | - | - | (2 000) | (1 200) | (800) |
| Distribution to partners | (4 000) | | | 2 000 | 1 200 | 800 |
| <i>Liquidation schedule</i> | | | | | | |
| (a) Balances before first distribution | 4 500 | | 9 900 | (7 700) | (4 820) | (1 880) |
| Possible deficit (5:3:2) | | | (9 900) | 4 950 | 2 970 | 1 980 |
| | 4 500 | | - | (2 750) | (1 850) | 100 |
| Transfer deficit to remaining partners | | | | 62 | 38 | (100) |
| $\left(\frac{5}{5+3}\right) \left(\frac{3}{5+3}\right)$ | | | | | | |
| | 4 500 | | | (2 688) | (1 812) | - |
| Transfer to accounts | (4 500) | | | 2 688 | 1 812 | - |
| (b) Balance before second distribution | 6 000 | | 3 900 | (5 012) | (3 008) | (1 880) |
| Possible deficit (5:3:2) | | | (3 900) | 1 950 | 1 170 | 780 |
| Transfer to accounts | 6 000 | | - | (3 062) | (1 838) | (1 100) |
| | (6 000) | | | 3 062 | 1 838 | 1 100 |

QUESTION A1

The following information relates to B Brown and R Ruby:

Pre-adjustment trial balance at 30 September 2004

| | Debit R | Credit R |
|--|------------|-------------|
| Capital accounts (fixed): | | |
| B Brown | | 20 000 |
| R Ruby | | 5 000 |
| Current accounts at 1 October 2003 | | |
| B Brown | | 1 060 |
| R Ruby | | 2 800 |
| Drawings during the year: | | |
| B Brown | 9 000 | |
| R Ruby | 3 000 | |
| 6% Mortgage loan | | 10 000 |
| Trade creditors | | 24 150 |
| Bank overdraft | | 6 160 |
| Land and buildings (cost) | 19 500 | |
| Plant and equipment (cost) | 19 840 | |
| Accumulated depreciation – 30 September 2003 | | |
| Plant and equipment | | 5 000 |
| Motor vehicles (cost) | 900 | |
| Accumulated depreciation – 30 September 2003 | | |
| Motor vehicles | | 500 |
| Office furniture (cost) | 350 | |
| Accumulated depreciation – 30 September 2003 | | |
| Office furniture | | 50 |
| Inventory (merchandise) at 30 September 2004 | 21 069 | |
| Trade accounts receivable | 16 020 | |
| Provision for bad debts | | 600 |
| Cash on hand | 32 | |
| Trading account (gross profit) | | 34 628 |
| Advertising | 4 409 | |
| Office salaries and wages | 12 189 | |
| Office expenses | 622 | |
| Insurance | 364 | |
| Delivery expenses | 2 203 | |
| Interest on mortgage loan | 450 | |
| | 109 948 | 109 948 |

Additional information**Terms of the partnership agreement**

- (1) The partners of B Brown and R Ruby share profits and losses in the ratio of their (fixed) capitals
- (2) Interest at 5% per annum is to be allowed on the opening balances of the partners' capital and current accounts.
- (3) Interest is to be charged at 5% per annum on the average monthly amount outstanding on the partners' drawings accounts.
Amounts are given, see item (7) under "Year-end adjustments required" below.
- (4) R Ruby is entitled to a salary of R1 000 per annum plus a management commission of 10% on the net profit after his salary is debited and after adjustments for the interest on the capital, current and drawings accounts.

Year-end adjustments required

- (1) An outstanding debt of R20 is irrecoverable and must be written off
- (2) The provision for bad debts must be adjusted to 5% of outstanding trade accounts receivable balances.
- (3) Depreciation is to be provided for as follows:

| | |
|----------------------|--|
| Plant and equipment: | 15% per annum on the diminished balance (NB: A new machine was purchased on 1 April 2004 for R1 560) |
| Motor vehicles: | 20% on cost |
| Office furniture | 10% per annum on the diminished balance |
- (4) Interest has been paid on the mortgage loan up to 30 June 2004.
- (5) Office salaries of R69 have not been paid or taken into account in the trial balance.
- (6) The following expenses have been prepaid:

| | |
|-------------|------|
| Insurance | R 62 |
| Advertising | R948 |
- (7) Interest calculated on the partners' drawings accounts amounted to R320 for B Brown and R80 for R Ruby.
- (8) In terms of the partnership agreement, the following must be provided for:
 - interest on the partners' capital and current accounts
 - R Ruby's salary and management commission. NB: Salary, bonus and commission to partners are regarded as operating expenses.

Required:

Prepare:

1. A summary of the partners' current accounts for the year ended 30 September 2004 in columnar form; and
2. The following statements in respect of the partnership of B Brown and R Ruby for the financial year ended 30 September 2004.
 - (a) Income statement
 - (b) Statement of changes in equity
 - (c) Balance sheet

NB: Notes and basic calculations must be shown.

QUESTION A2 (19 marks / 34 minutes)

The following information relates to the partnership of C Crown and K Kronin

1. Balances at 31 March 2004

| | R |
|--|---------|
| Capital accounts (fixed): | |
| C Crown | 100 000 |
| K Kronin | 75 000 |
| Current account balances – 31 March 2003 | |
| C Crown (cr) | 12 500 |
| K Kronin (cr) | 18 750 |
| Drawings: | |
| C Crown | 62 500 |
| K Kronin | 37 500 |
| Land and buildings at cost | 300 000 |
| Office furniture at cost | 80 000 |
| Vehicles at cost | 75 000 |
| Accumulated depreciation: | |
| Office furniture | 26 875 |
| Vehicles | 23 750 |
| Long-term loan (unsecured) | 87 500 |
| Accounts receivable | 48 000 |
| Accounts payable | 218 750 |
| Bank (dr) | 35 500 |
| Provision for bad debts | 5 000 |
| Accrued interest on loan | 4 275 |
| Stationery on hand | 1 150 |
| Inventory on hand | 37 500 |
| Net income for the year | 104 750 |

2. Additional information:

- 2.1 A further R500 from accounts receivable must still be written off as irrecoverable and the provision for bad debts must be maintained at 10% of outstanding accounts receivable balances.
- 2.2 The partnership agreement stipulates that:
- 2.2.1 Interest of 10% per annum be paid on fixed capitals
 - 2.2.2 Interest of 8% per annum be paid or charged on opening balances of current accounts
 - 2.2.3 A bonus be paid to C Crown – R7 500
 - 2.2.4 C Crown and K Kronin are to share profits and losses in the ratio of 4:3 respectively

Required:

1. Calculation of profits and losses shared by the partners.
2. Statement of changes in equity.
3. Balance sheet of C Crown and K Kronin at 31 March 2004.

QUESTION A3 (23 marks / 42 minutes)

The following information relates to the partnership Brand and Bond.

1. Balances at 28 February 2004:

| | R |
|---|----------|
| Capital accounts (fixed) | |
| B Brand | 225 000 |
| B Bond | 270 000 |
| Current account balances – 28 February 2003: | |
| B Brand (dr) | 13 500 |
| B Bond (cr) | 45 000 |
| Drawings: | |
| B Brand | 27 000 |
| B Bond | 21 600 |
| Net income for the year | 127 130 |
| Provision for bad debts | 1 688 |
| Accounts Receivable | 33 638 |
| Accounts Payable | 23 625 |
| Inventory | 52 650 |
| Land and buildings at cost | 630 000 |
| Furniture and equipment at cost | 14 630 |
| Vehicles at cost | 47 250 |
| Accumulated depreciation: | |
| Furniture and equipment | 2 475 |
| Vehicles | 23 625 |
| Mortgage loan (secured by a bond over land and Buildings) | 112 500 |
| Bank overdraft | 3 375 |
| Income received in advance | 4 500 |
| Accrued expenses | 1 350 |

2. Additional information:

2.1 The partnership agreement stipulates that:

- 2.1.1 B Brand is entitled to a salary of R55 000 per year and B Bond to a salary of R60 000 per year. Bond's salary has been paid to him monthly and charged to the administrative salaries account, but no entries have been made in the books in respect of Brand's salary.
- 2.1.2 Commission is paid to Brand – R11 250.
- 2.1.3 Interest on fixed capital is paid at 12% per annum.
- 2.1.4 Interest on opening balances of current accounts be charged or paid at 10% per annum.
- 2.1.5 Interest is charged annually on drawings. The amounts for the year are as follows:

| | |
|-----------|--------|
| B Brand - | R2 700 |
| B Bond - | R2 160 |
- 2.1.6 Brand and Bond are to share profits/losses equally.

Required:

1. Complete the income statement of Brand and Bond for the year ended 2 February 2004.
2. Statement of changes in equity of Brand and Bond for the year ended 28 February 2004.
3. The balance sheet of Brand and Bond at 28 February 2004.



QUESTION A4 (20 marks / 26 minutes)

The following information relates to the partnership I Ivan and Oban:

| | | |
|----|--|----------|
| 1. | Balance at 28 February 2004: | R |
| | Capital accounts (fixed) : | |
| | I Ivan | 202 500 |
| | O Oban | 101 250 |
| | Current accounts 28 February 2003: | |
| | I Ivan (debit) | 6 800 |
| | O Oban (credit) | 9 000 |
| | Drawings: | |
| | I Ivan | 20 000 |
| | O Oban | 13 500 |
| | Profit and loss account (net income for the year) | 128 475 |
| | Tools and equipment at cost | 135 000 |
| | Furniture and fittings at cost | 112 500 |
| | Land and buildings at cost | 202 500 |
| | Accumulated depreciation: | |
| | Tools and equipment | 56 250 |
| | Furniture and fittings | 20 250 |
| | Investment at cost (Super Building Society) | 31 500 |
| | Inventory (merchandise) | 4 500 |
| | Bank overdraft | 6 750 |
| | Accounts payable | 4 500 |
| | Accounts receivable | 24 750 |
| | Provision for bad debts | 1 237 |
| | Interest due by Super Building Society | 1 260 |
| | Accrued expenses | 450 |
| | Prepaid expenses | 652 |
| | 9% Mortgage loan (secured by bond over land and buildings) | 22 500 |

2. Additional information

2.1 The partnership agreement provides for:

- 2.1.1 Interest on fixed capital balances at 10% per annum.
- 2.1.2 Interest on opening balances of current accounts at 5% per annum.
- 2.1.3 Interest on drawings. The applicable amounts for the current year are as follows:
 - I Ivan – R945
 - O Oban – R515
- 2.1.4 A salary of R45 000 per annum to I Ivan.
- 2.1.5 Profits/losses to be shared equally.

Required:

1. The current accounts of I Ivan and O Oban, properly balanced at 28 February 2004.
2. Statement of changes in equity of Ivan and Oban for the year ended 28 February 2004.
3. The balance sheet of I Ivan and O Oban at 28 February 2004.

QUESTION A5 (15 marks 27 minutes)

The following information relates to the partnership of Truman:

1. Balance at 31 March 2004

| | R |
|--|-----------|
| Capital (fixed): | |
| T Trump | 120 000 |
| L Mantis | 80 000 |
| Current account balances - 31 March 2003 | |
| T Trump | 23 000 |
| L Mantis | 13 400 |
| Drawings: | |
| T Trump | 29 200 |
| L Mantis | 19 600 |
| 15% long-term loan from UK Bank | 160 000 |
| Land and buildings at cost | 140 000 |
| Furniture and equipment at cost | 40 000 |
| Bank overdraft | 32 000 |
| Accumulated depreciation – 31 March 2003 | |
| Furniture and equipment | 30 000 |
| Inventory – 1 April 2003 | 22 000 |
| Accounts receivable | 70 000 |
| Accounts payable | 49 000 |
| Interest on drawings paid: | |
| T Trump | 600 |
| L Mantis | 400 |
| Sales | 1 200 000 |
| Salaries and wages | 88 200 |
| Insurance | 3 000 |
| Provision for bad debts – 31 March 2003 | 3 500 |
| Railage on purchases | 8 000 |
| Administrative expenses | 109 800 |
| Sales returns | 6 000 |
| Purchases | 900 000 |

2. Additional information:

- 2.1 Inventory at 31 March 2004 amounted to R30 000.
- 2.2 The insurance relates to the annual premium paid on a policy taken out on 1 October 2003.
- 2.3 Provision must still be made for depreciation on furniture and equipment at 10% p.a. on the diminished balance.
- 2.4 Bad debts of R3 000 must still be written off.
- 2.5 The provision for bad debts must be maintained at 5% of outstanding accounts receivable balances.
- 2.6 Interest on the loan must still be provided for.
- 2.7 The partnership agreement stipulates that:
 - 2.7.1 Interest of 12% p.a. be paid on fixed capitals.
 - 2.7.2 Interest of 5% p.a. be charged or paid on the opening balances of current accounts.

2.7.3 Monthly salaries be paid to partners:

T Trump – R 900

L Mantis – R1 300

These salaries have been paid and posted to the salaries and wages account

2.7.4 Partners share profits/losses in the ratio of their fixed capitals.

Required:

The income statement of Truman for the year ended 31 March 2004.

1. Income statement
2. Statement of changes in equity.



QUESTION A6 (12 marks / 22 minutes)

The following information relates to the partnership I Ivan and U Uris:

1. Balances at 31 December 2004:

| | R |
|---|---------|
| Capital accounts (fixed): | |
| I Ivan | 100 000 |
| U Uris | 150 000 |
| Current account balances - 31 December 2003 | |
| I Ivan (cr) | 14 000 |
| U Uris (dr) | 18 000 |
| Drawings: | |
| I Ivan | 21 000 |
| U Uris | 14 000 |
| Fixed assets at cost | 300 000 |
| Accumulated depreciation on fixed assets | 83 250 |
| Accounts receivable | 87 650 |
| Provision for bad debts | 4 380 |
| Merchandise inventory | 72 000 |
| Stationery inventory – 31 December 2004 | 3 480 |
| Accounts payable | 51 640 |
| Bank (dr) | 4 860 |
| Profit and loss account (net income for the year before taking into account the additional information) | 117 720 |

2. Additional information:

- 2.1 The following information has not been taken into account in the calculation of the net income:
- 2.1.1 Stationery used during the year – R2 230.
 - 2.1.2 Included in salaries is an amount of R36 000 regarding a part payment of I Ivan's annual salary.
 - 2.1.3 The water and electricity account for December 2004, R1 230, was received in January 2005 and has not been paid.
 - 2.1.4 Part of the building was let from 1 September 2004 at R600 per month payable on the first day of every month. The rent for January 2005 was included in the amount of rent received during December and taken into account when calculating the net income.
- 2.2 The partnership agreement stipulates that:
- 2.2.1 Interest on capital be calculated at 12% per annum.
 - 2.2.2 Interest on opening balances of current accounts be calculated at 8% per annum.
 - 2.2.3 Interest on drawings be charged annually. The amounts calculated for the current year are:

| | |
|--------|--------|
| I Ivan | R1 050 |
| U Uris | 700 |
 - 2.2.4 I Ivan is entitled to a salary of R60 000 per annum and U Uris to a salary of R50 000 per annum.
 - 2.2.5 I Ivan and U Uris share profits and losses in the ratio of their capital contributions.

Required:

1. The calculation of the adjusted net income.
2. Statement of changes in equity for the year ended 31 December 2004.
3. The current account of I Ivan, properly balanced at 31 December 2004.



QUESTION A7 (16 marks / 29 minutes)

The following information relates to the partnership Comet and Planet:

1. Trial balance at 30 June 2004:

| | R | R |
|--|---------|---------|
| Capital accounts (fixed) : | | |
| S Comet | | 40 000 |
| D Planet | | |
| Current account at 30 June 2003: | | |
| S Comet | 980 | |
| D Planet | | 1 500 |
| Drawings: | | |
| S Comet | 5 000 | |
| D Planet | 6 000 | |
| Vehicles at cost | 40 000 | |
| Machinery and equipment at cost | 56 000 | |
| Inventory | 56 000 | |
| Accounts receivable | 43 000 | |
| Cost of sales | 115 130 | |
| Petty cash | 100 | |
| Sales | | 202 140 |
| Accounts payable | | 38 660 |
| Sales returns | 7 240 | |
| Bad debts | 5 100 | |
| Rent | 6 170 | |
| Provision for bad debts – 30 June 2003 | | 5 000 |
| Administration expenses | 13 170 | |
| Discounts | 8 670 | 3 920 |
| Salaries | 27 160 | |
| Bank overdraft | | 15 000 |
| Receiver of Revenue – VAT | | 4 500 |
| Accumulated depreciation at 30 June 2003 | | |
| Vehicles | | 20 000 |
| Machinery | | 24 000 |
| | 389 720 | 389 720 |

2. Additional information:

- 2.1 The provision for bad debts must be adjusted to 5% of outstanding accounts receivable balances.
- 2.2 Depreciation on machinery must be provided for at 10% per annum on cost. Machinery to the amount of R6 000 was purchased on 1 January 2004.
- 2.3 Salaries still outstanding at 30 June 2004 – R1 380.
- 2.4 Rent prepaid – R650.
- 2.5 The vehicle was valued at R10 000.
- 2.6 The partnership agreement provides for:
 - 2.6.1 Interest on fixed capitals at 6% per annum.
 - 2.6.2 Interest on opening balances of current accounts at 5% per annum.

- 2.6.3 Interest on drawings. The amounts for the current year are:
S Comet – R120
D Planet – R140
- 2.6.4 A bonus of 20% of the net income to S Comet.
- 2.6.5 Profits/losses to be shared equally.

Required:

1. The income statement of Comet and Planet for the year ended 30 June 2004.
2. Statement of changes in equity for year ended 30 June 2004.



QUESTION A8 (23 marks / 41 minutes)

The following information relates to the partnership of J James and J John.

1. Balances at 30 June 2004:

| | R |
|--|--------|
| Capital accounts (fixed): | |
| J James | 80 000 |
| J John | 40 000 |
| Current accounts – 30 June 2003 | |
| J James (cr) | 4 000 |
| J John (dr) | 3 000 |
| Drawings: | |
| J James | 49 000 |
| J John | 36 000 |
| Land and buildings at cost | 90 000 |
| Tools and equipment at cost | 60 000 |
| Furniture and fittings at cost | 50 000 |
| Accumulated depreciation: | |
| Tools and equipment | 25 000 |
| Furniture and fittings | 19 000 |
| Investment at cost | 14 000 |
| Inventory | 2 000 |
| Accounts payable | 13 500 |
| Bank overdraft | 1 500 |
| Accounts receivable | 11 000 |
| Provision for bad debts | 550 |
| Interest receivable | 560 |
| Accrued expenses | 200 |
| Prepaid expenses | 290 |
| 9% mortgage - secured | 40 000 |
| Profit and loss account (net income for the year) | 92 100 |

2. Additional information:

- 2.1 The partnership agreement stipulates that:
- 2.1.1 Interest on fixed capital is paid at 20% per annum.
- 2.1.2 Interest is paid or charged on the opening balances of the current accounts at 15% per annum.
- 2.1.3 Interest is charged on drawings. The amounts due for the year are:
 J James – R4 320
 J John – R3 130
- 2.1.4 Salaries for the year to be paid as follows:
 J James – R25 000
 J John – R30 000
 R15 000 of J John's salary was paid to him during the year.
 This amount was included in the amount in respect of salaries and wages in the profit and loss section of the income statement.
- 2.1.5 J James and J John are to share profits and losses equally.

Required:

The following for the partnership J James and J John:

1. Calculate the net income for the year ended 30 June 2004.
2. Current accounts of J James and J John, in columnar form, for the year, properly balanced.
3. Balance sheet at 30 June 2004.



QUESTION A9 (24 marks / 44 minutes)

The following information relates to the partnership S Sand and W Wedge:

1. Balances at 28 February 2004:

| | |
|---|----------|
| Capital accounts (fixed): | R |
| S Sand | 312 500 |
| W Wedge | 112 500 |
| Current account balances – 28 February 2004: | |
| S Sand (credit) | 35 000 |
| W Wedge (debit) | 16 000 |
| Land buildings at cost | 287 500 |
| Furniture at cost | 125 000 |
| Vehicles at cost | 162 500 |
| Accumulated depreciation – 28 February 2004: | |
| Furniture | 75 000 |
| Vehicles | 80 000 |
| 15% loan (secured by a mortgage over land and buildings) | 118 500 |
| Inventory: | |
| Merchandise | 168 750 |
| Printing | 7 250 |
| 11% fixed deposit | 22 500 |
| Bank (favourable) | 24 000 |
| Accounts receivable | 66 210 |
| Accounts payable | 38 750 |
| Drawings: | |
| S Sand | 67 500 |
| W Wedge | 30 000 |
| Net income for the year | 198 760 |
| Repayment on current account – W Wedge on 31 August 2003 | 6 200 |

2. Additional information:

2.1 The following must still be provided for:

- 2.1.1 Interest on fixed deposit for the full year.
 2.1.2 Depreciation for the year as follows:
 Furniture – at 10% p.a. on cost price.
 Vehicles – at 26% p.a. on the diminished balance.

2.2 The partnership agreement stipulates that:

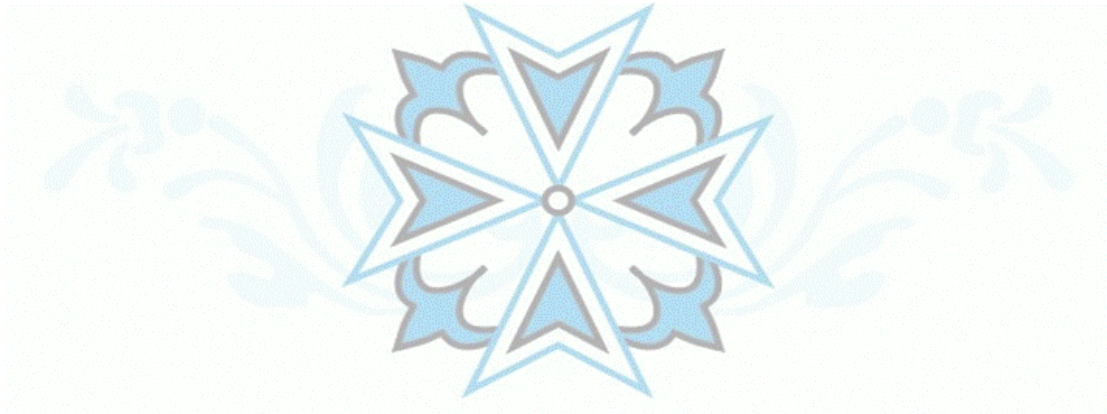
- 2.2.1 Interest on fixed capital be calculated at 12% per annum.
 2.2.2 Interest on opening balances of current accounts be calculated at 15% per annum. In the event of a repayment interest must be calculated on the opening balance up to the date of repayment and thereafter with due allowance for the repayment.
 2.2.3 Interest be charged annually on drawings. Amounts to be charged for the current year are as follows:

S Sand – R6 750
 W Wedge – R4 500

- 2.2.4 S Sand is entitled to a bonus of R10 000 per annum and W Wedge to a salary of R15 000 per annum.
- 2.2.5 S Sand and W Wedge to share profits and losses in the ratio 3:1 respectively.

Required:

1. Calculate the net income of the partnership, S Sand and W Wedge for the year ended 28 February 2004.
2. Statement of changes in equity for year ended 28 February 2004. The balance sheet of the partnership, S Sand and W Wedge at 28 February 2004.



QUESTION A10

The following information relates to the partnership T Tobias and P Prince:

1. Income statement for the year ended 28 February 2004

| | R | | R |
|---------------------------|---------|-------------------------------|---------|
| Administrative expenses | 33 750 | Sales | 100 000 |
| Returns inwards | 800 | Discount received | 1 050 |
| Inventory on 1 March 2003 | 21 530 | Returns outwards | 850 |
| Purchases | 44 000 | Inventory on 28 February 2004 | 19 100 |
| Discount allowed | 1 900 | | |
| Bad debts | 2 440 | | |
| Drawings: | | | |
| T Tobias | 3 880 | | |
| P Prince | 1 800 | | |
| Depreciation: | | | |
| Furniture and fittings | 940 | | |
| Motor vehicles | 3 000 | | |
| Interest on capital: | | | |
| T Tobias | 2 140 | | |
| P Prince | 1 070 | | |
| Net profit | 3 690 | | |
| | 121 000 | | 121 000 |

2. Balance sheet at 28 February 2004

| | R | | R |
|--------------------------------|---------|---------------------------|---------|
| Motor vehicles at cost | | Capital account balances | |
| Furniture and fittings at cost | | 28 February 2003 | |
| Sundry accounts receivable | | T Tobias | 40 000 |
| Land and buildings | | P Prince | 20 000 |
| Inventory: Merchandise | | Bank overdraft | 4 922 |
| Current account balances | | Accumulated depreciation: | |
| 28 February 2003 | | Furniture and fittings | 5 298 |
| R Tobias | | Motor vehicles | 14 800 |
| P Prince | | Net profit | 3 690 |
| | | Provision for bad debts | 2 300 |
| | | Interest on capital | 3 210 |
| | | Accounts Payable | 17 500 |
| | 111 720 | | 111 720 |

3. Additional information:

- (a) T Tobias and P Prince share profits and losses in the ratio of 2:1.
 (b) On 28 February 2004, salaries for services rendered according to the partnership agreement were paid to the partners as follows:
 T Troy: R6 000 and P Prince: R4 000. Both these amounts were, however, included in administrative expenses.

Required:

Prepare the following regarding the partnership of T Tobias and P Prince for the year ended 28 February 2004:

- 1.1 The income statement.
 1.2 The statement of changes in equity.
 1.3 The balance sheet.
 1.4 The note on property, plant and equipment. (No other notes are required).

QUESTION A11

The following information relates to F Freddie and J Jason, trading as equal partners:

1. Balances at 31 March 2004.

| | R |
|--|----------|
| Capital accounts (fixed) | |
| F Freddie | 50 000 |
| J Jason | 60 000 |
| Current accounts on 1 April 2003 | |
| F Freddie (Dr) | 2 000 |
| J Jason (Cr) | 5 000 |
| Long-term loan from J Jason | 40 000 |
| Sundry accounts receivable | 53 300 |
| Accumulated depreciation on 31 March 2003 | |
| Furniture and equipment | 3 500 |
| Furniture and equipment at cost | 35 000 |
| Provision for bad debts: Balance 31 March 2003 | 2 000 |
| Bad debts recovered | 105 |
| Inventory (merchandise) on 1 April 2003 | 80 500 |
| Purchases | 200 500 |
| Interest paid on long-term loan from J Jason | 1 800 |
| Stationery | 600 |
| Salaries and wages | 6 500 |
| Rent paid | 2 000 |
| Cash in bank | 53 405 |

2. Additional information

- (a) Make provision for:
- Interest on capital at 9% per annum.
 - Interest on current accounts (opening balances) at 7% per annum.
 - A managerial salary of R6 000 per annum to J Jason (Regard the salary as an opening expense)
 - A bonus equal to 10% of the distributable profit to F Freddie
- (b) Bad debts to be written off, R300.
- (c) The provision for bad debts must be maintained at 5% of sundry accounts receivable.
- (d) Interest must be provided for at 12% for the whole year on the long-term loan from J Jason.
- (e) Provide for depreciation at 15% per annum on furniture and equipment on the diminished balance.
- (f) Inventories on hand at 31 March 2004:
- | | |
|-------------|--------|
| | R |
| Merchandise | 61 000 |
| Stationery | 100 |
- (g) The profit mark-up is 20% on sales.

Required:

Prepare the following statements of the partnership F Freddie and J Jason for the year ended 31 March 2004:

- 2.1 The income statement
2.2 The statement of changes in equity.

Notes are not required. Show all calculations.

QUESTION A12

The following information relates to the partnership S Sharp and S Streak:

1. Balances at 28 February 2004:

| | R |
|--|----------|
| Land and buildings at cost | 100 000 |
| Motor vehicles at cost | 99 000 |
| Accounts Receivable | 82 000 |
| Inventory | 135 000 |
| Bank (Dr) | 98 000 |
| Accumulated depreciation on vehicles: 1 March 2003 | 49 000 |
| Provision for bad debts at 1 March 2003 | 1 000 |
| Capital accounts: | |
| S Sharp | 240 000 |
| S Streak | 160 000 |
| Current accounts at 1 March 2003 | |
| S Sharp (Cr) | 50 000 |
| S Streak (Dr) | 40 000 |
| Drawings during the year: | |
| S Sharp | 55 000 |
| S Streak | 11 000 |
| Administrative expenses | 80 000 |
| Gross profit for the year | 200 000 |

2. Additional information:

- (a) The partnership agreement stipulates that:
- interest is to be calculated at 7,5% per annum on the fixed capital accounts;
 - interest is to be calculated at 10% per annum on the opening balances of the current accounts;
 - S Streak is entitled to a monthly salary of R1 250; and
 - profit/losses are to be shared equally
- (b) Depreciation on motor vehicles is to be provided for at 30% per annum on the carrying amount.
- (c) Bad debts to the amount of R2 000 are to be written off.
- (d) The provision for bad debts must be maintained at 5% of the outstanding accounts receivable balances.
- (e) Interest on drawings for the current year amounts to R5 000 for S Sharp and S Streak.

Required:

Prepare the following financial statements of the partnership S Sharp and S Streak for the year ended 28 February 2004.

- 3.1 The income statement
3.2 The statement of changes in equity

Notes are not required.

QUESTION A13 (68 marks / 82 minutes)

The following information relates to the partnership JackDaw Traders:

1. Balances at 31 March 2004:

| | R |
|--|----------|
| Capital accounts (fixed): | |
| D Jack | 300 000 |
| D Daw | 250 000 |
| Current accounts – 31 March 2001: | |
| D Jack (Dr) | 27 500 |
| D Daw (Cr) | 15 000 |
| Drawings: | |
| D Jack | 60 000 |
| D Daw | 55 000 |
| Office furniture at cost | 190 000 |
| Vehicles at cost | 200 000 |
| Accumulated depreciation: | |
| Office furniture – 30 September 2003 | 73 200 |
| Vehicles – 31 March 2003 | 10 800 |
| Long-term loan (unsecured) | 125 000 |
| Trade accounts receivable | 100 000 |
| Trade creditors | 74 000 |
| Bank overdraft | 9 800 |
| Provision for bad debts | 2 550 |
| Stationery on hand = 31 March 2003 | 3 250 |
| Sales | 462 800 |
| Inventory – 31 March 2003 | 42 500 |
| Profit on sale of office furniture | 3 480 |
| Delivery expenses in respect of sales | 3 450 |
| Discount allowed | 5 620 |
| Purchases | 391 643 |
| Delivery expenses in respect of purchases | 6 500 |
| Sales returns | 7 000 |
| Purchases returns | 2 585 |
| Discount received | 1 523 |
| Rent expense | 27 000 |
| Bank charges | 1 475 |
| Depreciation (office furniture) | 1 280 |
| Interest paid on long-term loan | 21 250 |
| Salaries and wages | 155 000 |
| Telephone expenses | 3 620 |
| Maintenance and repairs – office furniture | 1 250 |
| Fuel and sundry vehicle expenses | 14 400 |
| Bonus – D Jack | 5 000 |
| Stationery - purchases | 2 540 |
| Marketing fees | 5 460 |

2. Additional information:

- 2.1 Stationery on hand at 31 March 2004 – R450.
- 2.2 Inventory on hand at 31 March 2004 – R39 700
- 2.3 On 30 September 2003 office furniture with a cost price of R20 000 was sold for R15 000. On the same date office furniture was purchased for R40 000 on credit in order to replace the sold furniture. All the necessary accounting entries in respect of these transactions were made.

- 2.4 Provide for the following (outstanding) amounts.
- 2.4.1 Depreciation:
On the office furniture – at 20% per annum on the diminished balance.
On the vehicles – According to the straight-line method. The expected lifespan of the vehicles is 10 years. The residual value is estimated at R20 000. No vehicles were acquired during the year.
- 2.4.2 The long-term loan was acquired at 1 April 2003. Interest is payable at a rate of 18% per annum.
- 2.5 Bad debts of R5 000 must be written off. The closing balance of the provision for bad debts account must be maintained at 5% of the closing balance of the trade accounts receivable.
- 2.6 The partnership agreement stipulates that:
- 2.6.1 Interest on the capital accounts at 8,5% per annum must be paid.
- 2.6.2 Interest on the current accounts (on opening balances) at 15% per annum must be paid/charged.
- 2.6.3 A salary of R15 000 per annum must be paid to D Daw. The salary has been paid and is included in the salaries and wages.
- 2.7 Drawings still to be accounted for:
- D Jack – trading inventory, R2 500
D Daw – stationery inventory, R235
- At the end of each financial year the drawings accounts must be closed off against the applicable current accounts.

Required:

Prepare the following statements to comply with Generally Accepted Accounting Practice:

- 1.1 the income statement of JackDaw Traders for the year ended 31 March 2004.
- 1.2 The statement of changes in equity of JackDaw Traders for the year ended 31 March 2004.
- 1.3 The balance sheet of JackDaw Traders at 31 March 2004.

QUESTION A14 (90 marks / 108 minutes)

The following information relates to the partnership of W Water and G Gate, trading as Watergate Traders:

Pre-adjustment trial balance at 31 August 2004:

| | Debit | Credit |
|--|---------|---------|
| Capital accounts (fixed): | | |
| W Water | | 100 000 |
| G Gate | | 125 000 |
| Current accounts at 1 September 2003 | | |
| W Water | 23 500 | |
| G Gate | | 17 300 |
| Drawings (cash) during the year: | | |
| W Water | 9 800 | |
| G Gate | 7 260 | |
| 15% Long-term loan from W Water (unsecured) | | 25 000 |
| Trade accounts payable | | 17 753 |
| Bank | 15 489 | |
| Land and buildings at cost | 102 007 | |
| Furniture and equipment at cost | 135 300 | |
| Vehicles at cost | 189 600 | |
| Inventory – 31 August 2003 | 34 455 | |
| Trade accounts receivable | 35 246 | |
| Sales | | 847 681 |
| Railage on purchases | 16 420 | |
| Sales returns | 15 231 | |
| Purchases returns | | 7 566 |
| Purchases | 458 951 | |
| Advertising costs | 16 455 | |
| Bank charges | 2 415 | |
| Salaries and wages | 180 000 | |
| Maintenance and repair: | | |
| Vehicles | 12 459 | |
| Furniture and equipment | 1 500 | |
| Stationery consumed | 5 468 | |
| Bad debts | 3 647 | |
| Water and electricity | 1 752 | |
| Personnel refreshments | 455 | |
| Accumulated depreciation – 1 September 2003: | | |
| Furniture and equipment | | 27 060 |
| Vehicles | | 75 050 |
| Realisation account: Vehicle | | 25 000 |

2. Additional information:

- 2.1 Inventory – 31 August 2004: R28 690.
- 2.2 An additional amount of bad debts must be written off, R1 526.
- 2.3 Due to the relatively large amount of bad debts that had to be written off during the year, the partners decided to create a provision for bad debts account. The balance of the account must be equal to 5% of the closing balance of the trade accounts receivable.

- 2.4 The long-term loan was obtained at 30 June 2004. The outstanding interest must be provided for.
- 2.5 A vehicle purchased at 1 March 2002 for R45 000 was sold for R25 000 cash on 28 February 2004. Apart from the bank account that was debited with the selling price, and the realisation account that was credited accordingly, no other entries regarding this transaction have as yet been made in the books.
- 2.6 Furniture and equipment was purchased on credit at 31 August 2004 at a cost price of R29 360. Additional delivery and installation fees amounted to R400 and R800 respectively, these amounts are still payable. This purchase as well as the additional costs must still be taken into account.
- 2.7 Depreciation must be provided for as follows:
 - 2.7.1 At 20% per annum on furniture and equipment, calculated on the diminished balance.
 - 2.7.2 At 25% per annum on the vehicles, according to the straight line method.
- 2.8 Included in the salaries and wages is the amount of R84 000 paid to the partners as salaries during the year. Each partner received a salary of R3 500 per month.
- 2.9 At the end of the financial year the drawings account of the partners must be closed off to their current accounts.
- 2.10 The partnership agreement stipulates that:
 - 2.10.1 Interest be calculated at 9% per annum on the fixed capital accounts.
 - 2.10.2 Interest be calculated at 13% per annum on the opening balances of the current accounts.
 - 2.10.3 Interest be calculated on drawings made during the year. It amounted to the following during the current financial year:
W Water: R900
G Gate: R650
 - 2.10.4 Salaries:
W Water: R54 000 per annum
G Gate: R46 000 per annum
 - 2.10.5 G Gate is entitled to a bonus of 20% of the distributable profit of the partnership; that is, after all of the abovementioned additional information has been taken into account.
 - 2.10.6 W Water and G Gate share their profits/losses in the ratio of 4:6 respectively.

Required:

- 1.1 Draw up the income statement of W Water and G Gate, trading as Watergate Traders, for the year ended 31 August 2004 according to generally accepted accounting practice.
- 1.2 Draw up the statement of changes in equity of W Water and G Gate trading as Watergate Traders for the year ended 31 August 2004.
- 1.3 Draw up the balance sheet of W Water and G Gate, trading as Watergate Traders, at 31 August 2004 according to generally accepted accounting practice.

QUESTION A15

A and B are in partnership and share profits and losses equally. They decide to admit C as a partner and sell him $\frac{1}{5}$ share which A and B will give to C equally. The profit-sharing ratio between A and B will remain the same.

Required:

Calculate the new profit-sharing ratio.

QUESTION A16

D and E are in partnership and share profits and losses equally. They decide to admit F as a partner and sell him $\frac{1}{5}$ interest. The profit-sharing ratio between D and E must be changed to 3:2 respectively.

Required:

Calculate the new profit-sharing ratio.

QUESTION A17

G and H are in partnership and share profits and losses equally. They decide to admit J as a partner and sell him $\frac{1}{5}$ interest which will be contributed by G and H in the proportion of 1:5 respectively.

Required:

Calculate the new profit-sharing ratio.

QUESTION A19

The partners Amos and Glen, who share profits and losses in the ratio 3:2, admit Prior to the partnership. The new profit-sharing ratio between Amos, Glen and Prior will be 2:1:1. Prior's contribution to the partnership consists of the net value of his motor vehicles, furniture, inventories, cash in the bank and trade creditors. The partners agree that goodwill in Prior's enterprise is worth R3 000.

The following is a summary of Prior's balance sheet at the date of entry:

| | Carrying amount | Actual value |
|---------------------------------------|-------------------|-------------------|
| | R | R |
| Equity | 16 200 | - |
| Property, plant and equipment | 8 300 | 6 500 |
| Motor vehicles | 6 500 | 5 200 |
| Furniture | 1 800 | 1 300 |
| Current assets | 13 000 | 12 200 |
| Inventories | 8 000 | 7 800 |
| Trade debtors | 4 200 | 3 600 |
| Cash and cash equivalents | 800 | 800 |
| Current liabilities – Trade creditors | 21 300 (5 100) | 18 700 (5 100) |
| Goodwill | 16 200 NIL | 13 600 3 000 |

Required:

1. Calculate the value of Prior's capital contribution.
2. Prepare the journal entries in the books of the new partnership to record Prior's assets and liabilities which the new partnership has taken over.
3. Prepare the journal entries in which Prior's goodwill is written off in the books of the partnership.

QUESTION A20

Lomas and Weaver are in partnership and share profits and losses in the ratio of two-thirds and one-third respectively, after allowing for interest at 5% per annum on the balance of their capital accounts as at 1 July of each year.

They took out a partnership insurance policy to the value of R15 000; the annual premium of R480 was debited to the profits of the partnership.

The partnership agreement provides that in the event of the death of one of the partners goodwill should be determined at twice the average net profit of the past three full years, before calculating the abovementioned insurance premiums.

Weaver died on 31 March 2004.

Additional information

1. At 1 July 2003 Weaver's capital was R18 000.
2. The net profit which was distributed between the partners was as follows:

| | |
|----------------------|--------|
| Year ended 30/6/2001 | R7 100 |
| Year ended 30/6/2002 | R8 300 |
| Year ended 30/6/2003 | R9 170 |

3. The net profit of the firm up to the date of Weaver's death was estimated by the auditor and Weaver's share thereof was R2 600.
4. Weaver's withdrawals up to the date of his death amounted to R1 260.

Required:

Prepare Weaver's capital account to show the amount owed to or by his executor at 31 March 2004.

QUESTION A21

John and Kevin have been in partnership for years and share profits and losses in the ratio of 2:1 respectively. Due to old age and poor health, Kevin decides to retire from the business with effect from 31 May 2004.

The following list of balances was compiled from the books after the ordinary entries had been made in respect of partners' salaries and interest for the period, but before any adjustments had been made in terms of the partnership agreement in respect of Kevin's retirement from the business.

List of balances at 31 May 2004

| | Debit R | Credit R |
|---|------------|-------------|
| Goodwill at cost price | 2 100 | |
| Land and buildings at cost price | 8 000 | |
| Plant and equipment at carrying amount | 2 900 | |
| Endowment insurance policy at surrender value | 20 000 | |
| Inventories | 7 000 | |
| Trade debtors | 4 400 | |
| Prepaid operating costs | 600 | |
| Cash and cash equivalents | 1 500 | |
| Trade creditors | | 4 200 |
| Arrear operating costs | | 300 |
| Unsecured loan from Kevin | | 6 000 |
| General reserve | | 5 100 |
| Current accounts: | | |
| John | | 1 600 |
| Kevin | 700 | |
| Capital accounts: | | |
| John | | 12 000 |
| Kevin | | 18 000 |
| | 47 200 | 47 200 |

In terms of the partnership agreement all assets and liabilities must be revalued to determine the extent of the partner's interest at the date of his retirement and the remaining partner must take over the assets and liabilities at those values. The outgoing partner's interest is payable to him upon receipt of the cash proceeds of the endowment insurance policy.

The values of the following assets were the only ones changed by the revaluation:

| | R |
|---|--------|
| Goodwill – at revaluation | 12 000 |
| Land and buildings – at revaluation | 14 000 |
| Trade debtors – at revaluation | 4 100 |
| Inventories – at revaluation | 6 400 |
| Endowment insurance policy – revalued at the estimated proceeds as disclosed by the insurance company | 29 000 |

In view of the forthcoming retirement of Kevin, John entered into an agreement with Eddie, a trader in an adjacent township, with the objective of merging their businesses into a partnership with effect from 1 June 2004, subject to the following conditions:

1. John was to contribute his business at the values agreed upon at the time of Kevin's retirement.
2. Eddie was to contribute his assets and liabilities at 31 May 2004 at the following values:

| | R |
|--|-------|
| Goodwill | 4 000 |
| Plant and equipment at carrying amount | 2 600 |
| Inventories | 1 800 |
| Trade debtors – carrying amount R1 500, guaranteed by Eddie to be collectable up to a sum of at least | 1 300 |
| Trade creditors | 2 700 |

3. John and Eddie would share profits and losses in the ratio of 3:1.
4. No goodwill was to be shown in John and Eddie's balance sheet.
5. Capital accounts were to be fixed in the profit-sharing ratio at a joint amount of R20 000. Any amount above the initial capital brought in by the partners and the abovementioned R20 000 was to be transferred to the general reserve. Any other surplus/deficit was to be transferred to their current accounts.

Required:

1. Show the journal entries used to wind up the books of John and Kevin at 31 May 2004.
2. Show the journal entries used to open the books of John and Eddie on 1 June 2004.