Chartered Accountancy – BL 01

Financial Accounting

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Partnership Accounts

Partnership Businesses

- Partnership is a business carried out by more than 01 person (2 – 20) with the motive of earnings a profit.
- Applicable law is 1890 Partnership ordinance.
- A partnership can be started with or without an agreement.

Partnerships

Desc.	With an Agreement	Without an Agreement
Applicable Law	Terms of the Agreement	Section 24 of 1890 Partnerships Ordinance
Capital	All the partners contribute to Capital. Agreement states the capital from each partner along with minimum capital to be maintained.	All the partners shall equally contribute to the capital.
Profit Sharing	Any profit-sharing basis can be agreed (E,g. Capital contribution basis)	The Profit shall be shared among the partners on an equal basis.

Partnerships

Desc.	Without an Agreement	Without an Agreement
Interest on Capital	An interest can be entitled based on capital contributed. The interest rate shall be mentioned in the agreement,.	Interest on Capital is not entitled.
Salaries for Partners	Salaries for partners can be entitled. However, this is not an expense of the partnership. This is a profit distribution. The objective of paying a salary is to distribute a fair basic income before the year end profit distribution.	Partners are not entitled for a salary

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Partnerships

Desc.	Without an Agreement	Without an Agreement
Drawings	Partners can draw their profits. An interest on drawings can be enforced to discourage the drawings.	Drawings can be made. However, interest on drawings cannot be charged.
Partners providing Loans	Partners can provide loans to the partnership. It's considered as an external liability.	
Interest on Partner's Loans	An agreed loan interest can be charged upon loans provided by the partners. It's an expense of the partnership and not a profit distribution.	A 5% annual loan interest can be charged. It's an expense of the partnership and not a profit distribution.

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Question 01

Sun, Moon and Earth partnership is sharing the profits on 7 : 3 : 5 respectively. If the partnership has earned a profit of Rs.150,000, how much of profit belong to each partner?

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Question 02

Bill and Ben partnership is sharing the profits on 2 : 1 respectively. Partners have agreed for an annual salary of Rs.10,000 each. If the partnership has earned a profit of Rs.26,000 before reduction of salaries, how much of profit belong to each partner?

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What is the difference in Financial Statements of a Partnership vs Sole Proprietorship?

1. Separately showing the investment contribution of each partner separately.
2. Appropriation of profits among the partners as per terms of the partnership agreement.

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Capital Accounts

The capital invested by each partner to the partnership is separately shown in the capital accounts.

- Partners are entitled to receive the capital invested. Therefore, it's an internal liability. This is shown in capital accounts.
- Mostly, the capital account balances are fixed in nature.

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Current Accounts

Current accounts are used show the profit kept within the business by the partners.

- In general, there's a credit balance in current accounts.
- Current account balance will increase when business making profits and balance will decrease when making drawings.

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Items in a Current Account

Item	Increase or Decrease Balance
Profits	⇧
Losses	⇩
Partner Salaries	⇧
Drawings	⇩
Interest on Capital	⇧
Interest on Drawings	⇩

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Guaranteed Minimum Profit Share

There can be condition where a minimum profit share promised to a partner.

Question 03

Susith, Pramith and Malith are running a partnership sharing profits on 4 : 3 : 3 basis. Susith and Pramith is entitle for an annual salary of Rs.30,000. Rs.120,000 minimum profit has been guaranteed to Susith. If the net profit for the year is Rs.260,000, show the appropriation.

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Drawings Account

- Drawings account is used to identify the drawings made by each partner separately.
- The balances of drawings account are transferred to the current accounts at the end of the year

Current Account Debit

Drawings Account Credit

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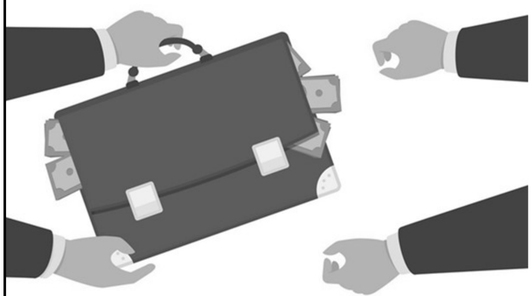

Loans provided by Partners to the business

- Partners may provide loans other than the capital
- Loans are not part of capital. Therefore, these are not reflected in capital. Instead, it's accounted as an external liability.
- Depending on the settlement period, these liabilities will be classified as either current or non-current.

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Loan Interest

An interest can be charged on partners loans as per the partnership agreement. If the agreement is silent about it, as per 24^{th} section of 1890 partnership ordinance a 5% annual interest shall be provided.

- Interest is not a profit appropriation. It's an expense of the business.
- Interest will be credited to current accounts.

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Appropriation of Profit or Loss

The net profit of the business shall be shared among the partners as per the terms of partnership agreement. This is done through a profit appropriation account.

Step 01	Calculate the net profit or loss. Transfer it to the appropriation account. Profit or Loss Debit Appropriation of Profit Credit
Step 02	Transfer the interest on capital accounts and salaries of partners to the current accounts. Appropriation of Profits Debit Current Accounts Credit

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Appropriation of Profit or Loss

Step 03	If interest on drawings are agreed, transfer them to current account. Current Accounts Debit Appropriation of Profits Credit
Step 04	Remaining profit shall be shared among the partners using the profit-sharing ratios. Remaining profit = Net Profit + Interest on Drawings – Interest on Capital - Salaries of Partners Appropriation of Profits Debit Current Accounts Credit

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Question 04

Pawan, Vinith and Dinesh runs a partnership sharing profits on 4 : 3 : 3 basis. Following information was extracted from financials ended 31 October 20X9.

Capital Account balances

Pawan	20,000
Vinith	30,000
Dinesh	24,000

Current Account Balances

Pawan	15,000
Vinith	10,000
Dinesh	13,000

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Question 04

5% annual interest is given for the capital account balances. The net profit for the year ended 31 October 20X9 is Rs.2,300.

1. Calculate the interest on capital accounts for the year.
2. Show the appropriation of profits among the partners.

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Question 05

Gavesh and Lasal runs a partnership sharing profits on 7 : 3 basis. Following information was extracted from financials ended 31 May 20X9.

Capital Account balances

Gawesh 200,000

Lasal 140,000

Opening Current Account Balances

Gawesh 15,000

Lasal 13,000

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Question 05

Drawings from the business bank account for the year ended 31 May 20X9 is as follows.

	Gawesh	Lasal
20X8 August 31	10,000	7,000
20X8 November 30	10,000	7,000
20X9 February 28	10,000	7,000
20X9 Mays 31	10,000	7,000

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Question 05

As per the partnership agreement an annual interest of 12% is charged on drawings.

Capital and Current account balances are eligible for an interest of 12% per annum.

Salary of Lasal is Rs.15,000 per annum.

Net profit for the year ended 31 May 20X9 is Rs.102,940.

1. Calculate the interest on drawings for the year.
2. Show the appropriation of profits among the partners.
3. Prepare the current accounts.

Question 06

Kasun, Sanuka and Nimal is running a partnership sharing profits on 5 : 3 : 2 basis. Capital and current account balances as at 01 January 20X5 are as follows.

	Capital Accounts	Current Accounts
Kasun	24,000	2,000
Sanuka	18,000	(1,000)
Nimal	13,000	1,500

Question 06

Capital accounts are entitled for a 10% annual interest.

Rs.8,000 annual salary is paid for Sanuka and Nimal.

Kasun has provided Rs.20,000 to the business as a loan on 1st July 20X5. The annual interest of the loan is 15%. Interest is entitled semi annually.

The profit before interest for the year ended 31 December 20X5 is Rs.63,000.

Drawings of the partners

Kasun	16,000
Sanuka	16,500
Nimal	19,000

Drawings are subject to an interest of 10% for the year end balance.

Question 06

1. Show the appropriation of profits among the partners.
2. Prepare the current accounts.
3. Prepare the capital accounts.

Question 07

Sasanka, Dilan and Nuwan are running a partnership sharing profits on 3 : 2 : 1 basis. The terms of the partnership agreement are as follows.

1. The annual interest on capital accounts is 12%
2. Nuwan is entitled for an annual salary of Rs.6,000.
3. 5% interest is charged on closing drawings balance.
4. 5% interest is paid for the loan provided by Sasanka.

Extracts from the statement of financial position for the year ended 31 December 20X5 is as follows. Rs.000'

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Question 07

Capital Accounts		
Sasanka	20,000	
Dilan	8,000	
Nuwan	6,000	34,000
Current Accounts		
Sasanka	3,500	
Dilan	(700)	
Nuwan	1,800	4,600
Loan by Sasanka		6,000
		44,600

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Question 07

Drawings for the year ended 31 December 20X6 is as follows.

	Rs.000
Sasanka	6,000
Dilan	4,000
Nuwan	7,000

Net profit before interest is Rs.24,530.

1. Show the appropriation of profits for the year ended 31 December 20X6, among the partners.
2. Prepare the current accounts.
3. Prepare the capital accounts

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Changes in a Partnership

- Retirement of a Partner
- Admission of a New Partner

Such a change will alter the agreement terms including profit sharing.

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Profit Appropriation Steps in a Change

Step 01	Identify the time before and after the change
Step 02	Divide the profit among before and after change • Unless otherwise stated, assume the profit is evenly accrued throughout the year.
Step 03	Appropriate the divided profit among previous and new terms of the agreement.

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Question 08

Harry and William is sharing profits equally. Kate was admitted as a new partner on 01 October 20X8. The profit is shared as 4 : 4 :2 from that date onwards.

Profit for the year ended 31 December 20X8 is Rs.150,000. Show how this profit is appropriated among the partners.

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Goodwill

A goodwill is created when a business has lasted for a long time period with the

- Quality of the service offered
- Customer loyalty gained
- Employee loyalty gained
- Customer popularity etc.

Retention and repetitive purchases of the customers are higher as a result of a goodwill.

Goodwill = Value of Business − Net Assets Value in Statement of Financial Position

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Question 09

Babanis and Sobanis partnership has decided to admit Jabanis as a new partner.

The value of the partnership on that date is Rs.750,000. As per the statement of financial position, the value of net assets on the same date is Rs.375,000. How much is the Goodwill?

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Goodwill in a Partnership

- When there is a change in ownership of a partnership, the goodwill created up to the date of change shall be shared among the partners prior to change.
- Same goodwill will be written off among the partners after the change.
- Thereby, the Goodwill will not be recorded in the books. Share of goodwill belong to partners prior to change will be obtained from the partners after the change.

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Question 10

Information in Question number 08 will remain the same.

If, Goodwill of Harry, William and Kate partnership on 01 October 20X8 is Rs.300,000, show how this will be recorded in the capital accounts.

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Question 11

Ashen and Dasun is running a partnership sharing profits on 1 : 1 basis. Naveen joined the partnership as a new partner on 01 January 20X9.

The capital account balances of Ashen and Dasun on that date were Rs.12,000 and Rs.9,000.

The goodwill on that date was Rs.5,000.

Naveen invested Rs.3,000 as his capital.

The new profit-sharing basis was 2 : 2 : 1.

Prepare the Goodwill account and Capital accounts.

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