**Advanced Financial Accounting**

**Partnership**

First Simister

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**The Accounting Cycle (Accounting Steps):**

1. Analyze and measure the transaction
2. Journalize (Record the entry)
3. Post (to T account and find the balance)
4. Prepare Unadjusted Trial Balance (adjustment entries not done yet)
5. Adjustment Entries
6. Prepare adjusted Trial Balance
7. Prepare Financial Statements (income statement Balance sheet)
8. Close Nominal Accounts
9. Post- closing trial balance
10. Reversing Entries (Opening entry for new year).

**Financial Statements:**

1. Income Statement
2. Balance Sheet
3. Owner's Equity Statement
4. Cashflow Statement

Notes to Financial Statements

(Trial Balance is NOT financial statement)

**Introduction to Advanced Fin. Accounting**

**1-Types of Ownership;**

There are three types of ownership:

A-Sole proprietorship

B-Partnership

C-Corporation

**A-Sole Proprietorship:**

In this kind of ownership, the company is owned by **one person** only. The owner called a Proprietor; he/she will often manage the business. The proprietor assumes all risks of the business and the owners’ personal assets can be taken to pay the creditor.

**B-Partnership:**

In this kind of ownership, the company is owned by more than one person, one or both partners manage the business. And their assets (personal assets) can be taken to pay the creditors; the owners of partnership share the risks of their decision.

**C-Corporation:**

In this kind of ownership, the stockholder's own the company, and there are many owners of the company.

The owners have **limited risk** to their investment; on the other hand they have little influence on the business decision.

**2Types of companies (firms):**

In general firms classified in two main types they are:

**A**-**Personal firms**: - which are

1. Sole proprietorship
2. Partnership.

**B-Fund company, it is sub-classified into:**

1-Corporation Company – Open (Public)

2-Corporation Company - Closed

The following graph shows types of company: -

**Types of company**

**A-Personal firms**

**B-Fund Company**

**Sole Proprietorship**

**Partnership**

**Corporation**

**(Open or Public)**

**Corporation**

**(Closed Co.**)

**Accounting for Sole proprietorship**

 It is a type of enterprise that is owned and run by one natural person and in which there is no legal distinction between the owner and the [business entity](https://en.wikipedia.org/wiki/Types_of_business_entity). The owner is in direct control of all elements and is legally accountable for the finances of such business and this may include debts, loans, loss,

**1 – Cash investment:**

Example:

Ahmed decided to go into business by investing $10,000 in cash.

Required: Prepare the journal entry and opening balance sheet.

Dr. Cash 10,000

 Cr. Capital 10,000

Investment to start the business

**2 – Cash and Other Assets Investment:**

Example:

Haval decided to go into business by investing $10,000 in cash, car $50,000, Land $30,000, Furniture $25 000.

Required: Prepare the journal entry and balance sheet

Dr. Cash 10,000

 Cars 50,000

 Land 30,000

 Furniture 25,000

 Cr. Capital 115,000

Investment to start new business

**Accounting for Partnership**

1-**Partnership definition**

Partnership is "an association of two or more persons to carry on a business as co-owners of the company and the result of the operation.

**2-Partnership Agreement:**

Partnership agreement must be in writing. Among the more important points to be covered by the partnership agreement are:

1- The date of formation of the partnership

2- The name of the partners and the nature of partnership

3- The capital to be invested by each partner.

4- The authority to be vested in each partner, and the rights and duties for each.

5- The accounting period to be used.

6- The plan for sharing profits and losses.

7- The salaries and drawings allowed to partners.

8- Insurance on the life of partners.

9- Liquidation of partnership at the end of the contract or at the death or withdrawal of a partner.

**3-Characteristic of Partnership:**

The basic characteristic of partnership is briefly summarized below:

**A-Ease of formation**: A partnership may be created by an oral or writing contract between two or more persons or may be implied by their contract.

**B**-**Mutual agency**:

Each partner has the authority to act for the partnership and to enter into contracts binding upon it.

C-**Limited life**:

A partnership may be ended by the death, retirement, bankruptcy. Also the admission of a new member to the partnership legally ends the former partnership and establishes a new one.

**D-Unlimited liability: -**

All the partners are personally responsible for debts of the firm and all have authority to act for the firm, each partner is personally responsible for the liabilities of the firm.

**E-Co-ownership of partnership’s Property, earnings**. When a partner invests assets in partnership it becomes joint property of all the partners and every partner has an ownership interest in earnings.

**4-Accounting for the investments:**

The investment of the partner in partnership may take the following forms:-

A. Cash investment.

B. Cash and other assets investment.

C. Investment of assets and liability.

D. Joining two sole proprietary to make partnership.

E. Intangible contribution.

**A-Cash investment**:

The partners may pay their share in partnership capital in cash as shown below:-

Example:

On 2nd September 2019 Azad and Ali agreed to go into business as partners, according to the agreement, Azad paid $55,000 cash and Ali contributed $45,000 cash.

Required: Prepare the journal entry and balance sheet on 2nd September 2019.

 Dr. Cash 100,000

 Cr. Capital Azad 55,000

 Cr. Capital Ali 45,000

 Azad and Ali investment in partnership

**Azad and Ali Partnership**

**Balance sheet**

**As of September 2, 2019**

|  |  |
| --- | --- |
| **Assets** | **Liabilities** **+ Capital** |
| Cash 100,000 | Azad capital 55,000Ali capital 45,000 |
|  **Total 100,000** | **Total 100,000**  |

**B-Cash and other assets investment:**

Partners may invest cash and other assets to make partnership. In this case we must revalue the assets in fair market value at the date of formation of partnership.

Example:

Mahmood and Omar joined together to make partnership on 1/ 2/ 2019 Mahmood invested $100,000 in cash and Omar paid $50,000 in cash and the following assets:

1. Inventory valued at $27,000

2. Office equipment valued at $23,000

3. Land valued at $35,000

Required: Prepare opening entry and opening balance sheet on 1/ 2/ 2019

**Solution:**

A. Mahmood investment

 Dr. Cash 100,000

 Cr. Mahmood capital 100,000

Mahmood investment

B. Omer investment

 Dr. Cash 50,000

 Dr. Inventory 27,000

 Dr. Office equipment 23,000

 Dr. Land 35,000

 Cr. Omar capital 135,000

Omer investment in partnership

**Mahmood and Omar partnership**

**Balance sheet as of 1-2-2019**

|  |  |
| --- | --- |
| **Assets** | **Liabilities + Capital** |
| Cash 150,000Inventory 27,000Office equipment 23,000Land 35,000 | Mahmood capital 100,000Omer capital 135,000 |
|  **Total 235,000** | **Total 235,000** |

**C-Investment of Assets and Liabilities:**

In a new partnership the partners may make their investment in assets and liabilities as shown in the following example:

Example3:

Ahmad and Ali formed a partnership for selling computers, they invested in the business as shown below:

Ahmad's Investment:

Cash $10,000, Inventory $50,000 Accounts payable (A\P) $25,000

Accounts receivable (A\R) $20,000 and allowance for doubtful accounts $5,000, Computer equipment costed $50,000, market value $45,000

Ali's Investment:

Cash $150,000, Computers costed $180,000, market value $100,000

Required: Prepare the opening entry and post the entry to the ledger and prepare beginning balance sheet for the new partnership.

Ahmed:

Dr. Cash 10,000

 Inventory 50,000

 Computer 45,000

 A/R 20,000

 Cr. A/P 25,000

 A.F.D.A 5,000

 Ahmed Capital 95,000

Investment by Ahmed

Ali:

Dr. Cash 150 000

 Computer 100 000

 Cr. Ali Capital 250 000

Investment by Ali

|  |
| --- |
| **Ahmed & Ali Partnership****Balance Sheet as of 1/1/2019** |
|  Assets | Liabilities & Owner's Equity |
| CashA/RA.F.D.ANet A/RInventoryComputer | 160,00020,000(5,000)15,00050,000145,000 | Liabilities:A/POwner's Equity:Ahmed CapitalAli Capital | 25,00095,000250,000 |
| Total | 370,000 | Total | 370,000 |

**D-Joining two sole proprietary to make partnership:**

Two or more sole proprietors may combine their businesses to form a partnership. Their balance sheet serves the basis for opening entries for investment of each partner.

**NOTE:**

The accumulated depreciation in sole proprietor balance sheet doesn’t enter to the opening entry of a new partnership, the assets may be revalued in fair market value.

Example 4:

On July 1, 2017 Jwan and Hemin combined their two businesses to form a partnership under the firm name of {Jwan and Hemin Partnership} the balance sheets of the two sole proprietorships are shown below:

**Jwan Company**

**Balance sheet As of June 30, 2017**

|  |  |
| --- | --- |
| **Assets** | **Liabilities + Capital** |
| Cash 460,000A\R 240,000AFDA (40,000)  Net A/R 200,000Inventory 200,000Store equipment 600,000Less accumulated dep. (300,000)  300,000 | A\P 400,000N\P 360,000Jwan capital 400,000 |
| **Total 1,160,000** | **Total 1,160,000** |

**Hemin Company**

**Balance sheet As of June 30, 2017**

|  |  |
| --- | --- |
| **Assets** | **Liabilities + Capital** |
| Cash 335,000A\R 415,000AFDA (25,000)  Net A/R 390,000Inventory 724,000Office equipment 800,000Less accumulated dep. (340,000) 460,000Store equipment 700,000Less: accumulated dep. (400,000) 300,000 | A\P 550,000N\P 600,000Hemin capital 1,059,000  |
| **Total 2,209,000** | **Total 2,209,000** |

A: The fair market value of Jwan's equipment is $300,000

B: The fair market value of Hemin's office equipment and equipment are $360,000 and $610,000 respectively.

Required: Prepare the opening entry for the formation of partnership as of July 1, 2017 and post the entry to the ledger and prepare opening balance sheet.

**Solution:**

**Jwan Company** Dr. Cash 460,000

 A/R 240,000

 Inventory 200,000

 Equipment 300,000

 Cr. N/P 360,000

 A/P 400,000

 A.F.D.F 40,000

 Jwan capital 400,000

Jwan Investment

**Hemin Co. Entry** Dr . Cash 335,000

 A/R 415,000

 Inventory 724,000

 Office Equipment 360,000

 Equipment 610,000

 Cr. N/P 600,000

 A/P 550,000

 A.F.D.F 25,000

 Hemin Capital 1,269,000

Hemin Investment

|  |  |  |
| --- | --- | --- |
| Jwan Capital | Hemin Capital | Cash |
| Debit | Credit | Debit  | Credit | Debit | Credit |
| 400,000 bal | 400,000 | 1,269,000 bal | 1,269,000 | 460,000335,000 | 795,000 bal |
| 400,000 | 400,000 | 1,269,000 | 1,269,000 | 795,000 | 795,000 |
|  |
|  |
| Inventory | A/R | Office Equipment |
| Debit | Credit | Debit  | Credit | Debit | Credit |
| 200,000724,000 | 924,000 bal | 240,000415,000 | 655,000 bal | 360,000 | 360,000 bal |
| 924,000 | 924,000 | 655,000 | 655,000 | 360,000 | 360,000 |

|  |  |  |
| --- | --- | --- |
| Equipment | A/P | N/P |
| Debit | Credit | Debit  | Credit | Debit | Credit |
| 300,000610,000 | 910,000 bal | 950,000 bal | 400,000550,000 | 960,000 bal | 360,000600,000 |
| 910,000 | 910,000 | 950,000 | 950,000 | 960,000 | 960,000 |
| A.F.D.A |
| Debit | Credit |
| 65,000 | 40,00025,000 |
| 65,000 | 65,000 |

**Jwan & Hemin Partnership**

**Balance sheet as of July 1, 2017**

|  |  |
| --- | --- |
| **Assets** | **Liabilities + Capital** |
| Cash 795,000A\R 655,000Less: allowance for doubtful  Accounts (65,000)Net A/R 590,000Inventory 924,000 Office equipment 360,000 Equipment 910,000  | A\P 950,000 N\P 960,000 Jwan Capital 400,000Hemin capital 1,269,000  |
| **Total** 3,579,000 | **Total** 3,579,000 |

**E-Intangible Contributions:**

In forming a partnership, the contributions made by one or more of the partners may go beyond assets and liabilities, accounting for such special contribution may be appropriately included as a provision of any partnership agreement.

Example:

Assume James and John have contributed a total of $80,000 to their new partnership, James paid $45,000 in cash; John paid his capital in assets as follows:

Inventory $15,000, land valued $20,000. Because of special skills of John the partners agreed to start the business in equal capital balances.

**Required:**

Prepare beginning entry for the formation of new partnership in:

* 1. Bonus method
	2. Goodwill method

**Solution:**

**A. Bonus Method:**

Dr. Cash 45,000

 Inventory 15,000

 Land 20,000

 Cr. James capital 40,000

 Cr. John capital 40,000

Investment for new partnership

**B. Goodwill Method:**

Goodwill = James capital – John investment

 = 45,000 – 15,000 – 20,000

 = 10,000

Dr. Cash 45,000

 Inventory 15,000

 Land 20,000

 Goodwill 10,000

 Cr. James capital 45,000

 John capital 45,000

Investment for new partnership

**5- Sharing Profit and Loss:**

The share of each partner should be determined in the partnership agreement.

If no arrangement has been specified, state partnership law normally holds that the partners share **equally** in any profit or losses earned by the business.

Methods of dividing profit and loss:-

1. Dividing profit and loss equally
2. Dividing profit and loss in some other agreed ratios
3. Dividing profit and loss in the ratio of partners capitals
4. Paying salaries to partners and dividing the remaining profit and loss in an agreed ratios
5. Paying salaries to partners, allowing interest on capitals, and dividing the remaining profit and loss in an agreed ratio.
6. **Dividing Profit and Loss Equally:**

**Example:**

Assume that Bawar and Hana formed a partnership by investing cash of $100,000, $80,000 respectively.

At the end of the first year of operation the partnership reported net income of $60,000 and partnership agreement based on **equal** sharing of profit and loss.

**Required:**

1-Prepare entry for the partners' investment

2-Prepare entry for sharing profit and loss equally

3-Prepare statement of partners' capital

**Solution:**

1. Dr. Cash 180,000

 Cr. Bawar capital 100,000

 Hana capital 80,000

Investment in new partnership

1. Dr. Income Summary 60,000

 Cr. Bawar capital 30,000

 Cr. Hana capital 30,000

Allocate profit equally

1.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Bawar** | **Hana** | **Total** |
| Opening Balance | 100,000 | 80,000 | 180,000 |
| Profit |  30,000 | 30,000 |  60,000 |
| **Total** | **130,000** | **110,00** | **240,000** |

**B- Sharing profit and loss in some other agreement ratio:**

Example:

In this illustration we shall assume that Bawar and Hana agreed to share profit and loss in the ratio of 40% for Bawar and 60% for Hana. The profit for the year was$100,000, Bawar and Hana invested $200,000 each.

**Required**: 1-Prepare entry for sharing profit and loss

 2-Prepare statement of partners' capital

**Solution:**

1. Bawar share = 100,000 x 40% = 40,000

 Hana share = 100,000 x 60% = 60,000

Dr. Income Summary 100, 000

 Cr. Bawar capital 40,000

 Cr. Hana capital 60,000

Allocate profit

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Bawar** | **Hana** | **Total** |
| Opening Balance | 200,000 | 200,000 | 400,000 |
| Profit |  40,000 |  60,000 | 100,000 |
| **Total** | **240,000** | **260,000** | **500,000** |

**C- Division of profit and loss on the ratio of partner's capital.**

Example:

Assume that Jim, Antonio, and Rico are partners, their capital balances at the beginning of the year are shown below, and also assume that the partners at the end of the year earned net profit of $30,000.

Jim capital 40,000

Antonio capital 60,000

Rico capital 50,000

Total 150,000

**Required:**

1- Allocate profit on the bases of the partner's capital and prepare the entries.

2- Prepare statement of partner's capital.

**Solution:**

1. Azad portion = 40,000/150,000 = 28% x30,000 = 14,000

Amir portion = 60,000 / 150,000 = 39% x 30,000 = 19,500

Rayan portion = 50,000/ 150,000 = 33% x 30,000 = 16,500

 50,000

Dr. Income Summary 50,000

 Cr. Jim Capital 14,000

 Antonio Capital 19,500

 Rico Capital 16,500

Dividing profit on partners

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Jim** | **Antonio** | **Rico** | **Total** |
| Opening Balance | 40,000 | 60,000 | 50,000 | 150,000 |
| Profit |  8,100 | 12,000 | 9,900 | 30,000 |
| **Total** | **48,100** | **72,000** | **59,900** | **180,000** |

**D- Paying salaries to the partner's and dividing the remaining profit and loss in an agreed ratio:**

Example:

Alan, Baban, and Yusif formed the partnership, and assume that the partnership agreement provides for annual salary of $10,000, $4,000, $6,000, respectively and remaining net income divided on the bases 2:2:1 respectively and the beginning capital balance is $100,000, $50,000, $200,000 assume that net income of this year was $70,000.

**Required**: Prepare the necessary entries for paying salary and dividing net income.

**Solution:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Alan** | **Baban** | **Yusif** | **Total** |
| Salary | 10,000 |  4,000 |  6,000 | 20,000 |
| Profit(70,000- 20,000)= 50,000 | 20,000(50,000x2/5) | 20,000(50,000x2/5) | 10,000(50,000x1/5) | 50,000 |
| **Total** | **30,000** | **24,000** | **16,000** | **70,000** |

Dr. Income Summary 70,000

 Cr. Alan capital 30,000

 Baban capital 24,000

 Yusif capital 16,000

Distributing salary and profit

**E- Paying salaries to the partner's and interest on their capitals and dividing the remaining profit and loss in an agreed ratio.**

Example:

By retaining to above example and assume the same information in addition to the partners agreement to give interest at the ratio of 10 % on partners' capital balance on the date of forming the partnership,

**Required:**

Prepare the necessary entries for paying salaries and interest on the beginning capital balance and dividing the remaining profit at the ratio of 3:2:1 respectively and prepare the capital statement.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Alan** | **Baban** | **Yusif** | **Total** |
| Salary | 10,000 |  4,000 |  6,000 | 20,000 |
| Interest | 10,000(100,000x10%) | 5000(50,000x10%) | 20,000(200,000x10%) | 35,000 |
| Profit(70,000 - 20,000 -35,000) = 15,000 | 7,500(15,000x3/6) | 5,000(15,000x2/6) | 2,500(15,000x1/6) | 15,000 |
| **Total** | **27,500** | **14,000** | **28,500** | **70,000** |

 Dr. Income Summary 70,000

 Cr. Alan capital 27,500

 Baban capital 14,000

 Yusif capital 28,500

Distributing salary, interest and profit

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Alan** | **Baban** | **Yusif** | **Total** |
| Opening Balance | 100,000 | 50,000 | 200,000 | 350,000 |
| Profit, Salary, Interest | 27,500 | 14,000 | 28,500 | 70,000 |
| **Total** | **127,500** | **64,000** | **228,500** | **420,000** |

**Partner's Drawings**

Partners sometimes need to receive cash or assets for personal use.

Most partnership agreement usually allows partners to withdraw cash or other assets from the business for personal use.

At the end of the business periods the closing entry credits each partners drawing and debits each partners capital account.

**Example:**

On 1st, 1, 2017 Lewis and Clark formed a partnership, Lewis invested $80,000 and Clark invested $120,000, and they agreed to share profit and loss **equally**.

Assume the following information:

1- Partners' monthly cash withdraw $3,500 each

2- At the end of the year the partnership earned $82,000 net income.

3- Lewis withdrew inventory an amount of $2,000 at the cost price, and Clark withdrew inventory at the market price an amount of $2,500.

**Required**: 1- Prepare the necessary entries for the above transactions

1. Prepare statement of capital

**Solution:**

Dr. Cash 200,000

 Cr. Lewis capital 80,000

 Clark capital 120,000

Opening entry

(1)

3,500 x 12 = $42,000 each partner withdraw yearly

Dr. Lewis withdraw 42,000

 Clark withdraw 42,000

 Cr. Cash 84,000

Partners withdrawal of cash.

(2)

Dr. Income summary 82,000

 Cr. Lewis capital 41,000

 Clark capital 41,000

Dividing net income equally.

(3)

 Dr. Lewis withdraw 2,000

 Cr. Inventory 2,000

Clark withdraw 2,500

 Sales 2,500

Partner withdrawal of inventory

At the end of year:

Dr. Lewis capital 44,000

 Cr. Lewis withdraw 44,000

 Dr. Clark capital 44,500

 Cr. Clark withdraw 44,500

Closing withdrawal account

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Lwis** | **Clark** | **Total** |
| Opening Balance |  |  |  |
| Profit, Salary, Interest |  |  |  |
| Withdraws |  |  |  |
| **Total** |  |  |  |

**Dissolution of Partnership**

A partnership dissolute in the following cases:

**A: Dissolution by act of partners.**

Certain acts by members of partnership result in dissolution. This case may include:

1. Termination of time or accomplishment of purpose.
2. Mutual agreement; partners may agree at any time to change in membership of their association.
3. Withdrawal of a partner.

**B: Dissolution by operation of the law**

A partnership is automatically dissolved upon the occurrence of certain contingencies recognized by a law normally:

1- Death of the partner.

2- Bankruptcy of any partners or of the partnership.

3- Any event that makes it unlawful for the business to carry on.

**C: Dissolution by judicial decrees:**

A court may decree dissolution for partnership upon evidence of any of the following cases:

1- The inability of a partner for any cause to fulfill his part of the partnership contract.

2- Conduct of partner that affects unfavorably the business being carried on.

3- The dispute among partners.

4- Non profitability condition of the business.

5- Other reasons.

**Accounting for Dissolution**

 In accounting we consider the following cases:

A: New partner.

B: The withdrawal of a partner.

C: The death of partner.

D: The incorporation of partnership.

**A: New partner**

A new partner may be admitted by agreement among the partners, when this happens the old partnership is dissolved and a new one formed.

The admission of new partner may be done by one of the following ways:-

1. Purchase of share.
2. Investment of new partner.
3. Investment with allowance of bonus or goodwill to old partner.
4. Investment with allowance of bonus or goodwill to new partner.
5. **Purchase of share:**

A partner has the power to sell part or all of his interest in the firm, when this happens the old partnership dissolved and a new one will be a raised.

**Example:**

Assume that Fisher and Ronald have a partnership that carries the following balance sheet.

Fisher& Ronald Partnership

Balance sheet

As of 1/2/2017

|  |  |
| --- | --- |
| Cash 40,000Other assets 360,000 | Total liability 120,000Fisher capital 110,000Ronald capital 170,000 |
| Total 400,000 | Total 400,000 |

The business is going so well that Fisher receives an offer from Barry to buy his $110,000 share in the business for $150,000 cash, Fisher agrees and Ronald approves Barry as a new partner.

**Required:** make entry to record the transfer Fisher capital to Barry and arrange a new balance sheet for the new partnership.

Solution:

Dr. Fisher capital 110,000

 Cr. Barry capital 110,000

Fisher sold his share to Barry

Barry& Ronald partnership

Balance sheet

As of Feb 1, 2017

|  |  |
| --- | --- |
| Cash 40,000Other assets 360,000 | Total liability 120,000Barry capital 110,000Ronald capital 170,000 |
| Total 400,000 | Total 400,000 |

**2- Investment of new partner:**

When an individual invests in a partnership by making an investment of assets, like (cash, inventory or equipment…etc.), the capital of the partnership is increased.

**Example :**

Assume that the partnership of Omar and Mahmoud has the following balance sheet:

Omer and Mahmoud Partnership

Balance Sheet

As of 1/2/2017

|  |  |
| --- | --- |
| Cash 20,000Other assets 200,000 | Liabilities 60,000Omar capital 70,000Mahmoud capital 90,000  |
| Total 220,000 | Total 220,000 |

Azad offers to invest equipment (other assets) with a market value of 80,000, Omar and Mahmud accepted to dissolve partnership and to start up with a new business and they agreed to continue sharing profit and loss equally.

**Required**:

1. Make the entry to record Azad's investment.
2. Prepare the new partnership balance sheet.

**Solution**:

Dr. Other assets 80,000

 Cr. Azad capital 80,000

Investment of Azad

Omer, Mahmoud& Azad Partnership

Balance Sheet

As of 1/2/2017

|  |  |
| --- | --- |
| Cash 20,000Other assets 280,000 | Liabilities 60,000Omar capital 70,000Mahmoud capital 90,000Azad capital 80,000 |
| Total 300,000 | Total 300,000 |

**3- Investment with allowance of bonus or goodwill to old partners.**

When a partnership has operated with considerable success, the partners may admit a new member with provision that part of the new partner's investment shall be allowed as a bonus to the old partners.

**Bonus method:**

Example:

Suppose that Hero and Sozan are partners in a partnership which earned above average profit for 10 years. The two partners share profit and loss equally, the partnership balance sheet carries the following amounts: -

Hero& Sozan Partnership

Balance sheet as of 1/2/2017

|  |  |
| --- | --- |
| Cash 40,000Other assets 210,000 | Liabilities 100,000Hero capital 70,000Sozan capital 80,000 |
| Total 250,000 | Total 250,000 |

The partners agreed to admit Ali to one fourth interest with his cash investment of 90,000.

**Required**:

1. Make entry to record Ali's investment
2. Prepare the balance sheet for a new partnership.

**Solution**: Total capital = 70,000+80,000+90,000 = 240,000

 Ali capital = 240,000 X 1/4 = 60,000

Dr. Cash 90,000

 Cr. Hero capital 15,000

 Sozan capital 15,000

 Ali capital 60,000

Investment of Ali with bonus to partners

Hero, Sozan & Ali Partnership

Balance sheet as of 1/2/2017

|  |  |
| --- | --- |
| Cash 130,000Other assets 210,000 | Liabilities 100,000Hero capital 85,000Sozan capital 95,000Ali capital 60,000 |
| Total 340,000 | Total 340,000 |

**4- Investment with allowance of bonus for new partner: -**

Partnership may be in urgent need of additional funds or they may desire the services of a certain individual for this reason a new member may be admitted with provision. Part of the capitals of the old partners shall be allowed as bonus to the new partner.

**Example**: Suppose that Azad and Ali are partners in a partnership according to their agreement the two partners share profit and loss in a ratio 50% (equally)

Azad and Ali Partnership

Balance Sheet as of 1/3/2017

|  |  |
| --- | --- |
| Assets | Liabilities and Capital |
| Cash 140,000Other assets 360,000 | Liabilities 120,000Azad capital 230,000Ali capital 150,000 |
| Total 500,000 | Total 500,000 |

Azad and Ali agree to admit Ahmad as a partner with 1/3interest in exchange for his cash investment of $100,000.

**Required**: Make the entry to record Ahmad’s investment in a new partnership. And prepare the balance sheet for a new partnership by using bonus methods (For a new partner).

**Solution**: Total capital = 230,000 + 150,000+100,000= 480,000

 Ahmad share = 480,000 x 1/3 = 160,000

Dr. Cash 100,000

 Azad capital 30,000

 Ali capital 30,000

 Cr. Ahmad capital 160,000

Investment of Ahmad with bonus

Azad, Ali& Ahmad Partnership

Balance Sheet as of 1/3/2017

|  |  |
| --- | --- |
| Assets | Liabilities and Capital |
| Cash 240,000Other assets 360,000 | Liabilities 120,000Azad capital 200,000Ali capital 120,000Ahmad capital 160,000 |
| Total 600,000 | Total 600,000 |

**The withdrawal of partners.**

A partner may withdraw from partnership for many reasons, including retirement or dispute with the other partners.

The withdrawal of partners dissolves the old partnership.

**Example:**

Assume that Mahmood is retiring in the mid-year from partnership of (Ali, Omer and Mahmood) after the books have been closed the balance sheet reports the following data:

Ali, Omer, Mahmood Partnership

Balance Sheet as of 1/7/2017

|  |  |
| --- | --- |
| Assets | Liabilities + Capital |
| Cash 59,000Inventory 44,000Land 55,000Building 95,000Less: Accumulated Dep. (35,000)  60,000 | Total liabilities 100,000Ali capital 54,000Omer capital 43,000Mahmood capital 21,000 |
| Total 218,000 | Total 218,000 |

The partners agreed to revalue the assets in a market price, for this reason the assets valued as following: Inventory 38,000, Land 101,000, Building 72,000 The partners share the differences between market values and book values on the basis of their profit and loss ratio which is **(1:2:1)** respectively

**Required:**

1. Prepare the entry to record the revaluation of the assets and prepare the partnership balance sheet after the revaluation.
2. Prepare entry to record Mahmood’s withdrawal from the business in the following cases:
3. Mahmood withdrawal at a new book value.
4. Mahmood withdrawal after he take’s cash amount of 31,000
5. Mahmood withdrawal in partnership after he takes 43,000
6. Prepare the balance sheet for a new partnership in case C

**Solution:**

Inventory = 38 000 – 44 000 = (6000)

Land = 101 000 – 55 000 = 46 000

Building = 72 000 – 60 000 = 12 000

Total 52 000

Ali capital = 52 000 x 1/4 = 13 000

Omer capital = 52 000 x 2/4 = 26 000

Mahmoud capital = 52 000 x 1/4 = 13 000

The entry will be :

 Dr. Land 46,000

 Building 12,000

 Cr. Inventory 6,000

 Ali capital 13,000

 Omer capital 26,000

 Mahmoud capital 13,000

Adjustment of assets after revaluation

Ali, Omer, Mahmood Partnership

Balance Sheet as of 1/7/2017

|  |  |
| --- | --- |
| Assets | Liabilities + Capital |
| Cash 59,000Inventory 38,000Land 101,000Building 72,000 | Liabilities 100,000Ali capital 67,000Omer capital 69,000Mahmood capital 34,000 |
| Total 270,000 | Total 270,000 |

* 1. Dr. Mahmoud capital 34,000

 Cr. Cash 34,000

Paid Mahmoud's share

**B**- 34,000 – 31,000 = 3,000

 Ali capital = 3,000 X 1/3 = 1,000

 Omer capital = 3,000 X 2/3 = 2,000

Dr. Mahmoud capital 34,000

 Cr. Cash 31,000

 Ali capital 1,000

 Omer capital 2,000

Paid Mahmoud's share for less

**C**- 43,000 – 34,000= 9,000

 Ali capital = 9,000 X 1/3 = 3,000

 Omer capital = 9,000 X 2/3 = 6,000

Dr. Mahmoud capital 34,000

 Ali capital 3,000

 Omer capital 6,000

 Cr. Cash 43,000

Paid Mahmoud's share for more

Ali and Omer Partnership

Balance Sheet as of 1/7/2017

|  |  |
| --- | --- |
| Assets | Liabilities + Owner’s Equity |
| Cash 16,000Inventory 38,000Land 101,000Building 72,000 | Liabilities 100,000Ali capital 64,000Omer capital 63,000 |
| Total 227,000 | Total 227,000 |

 **The Death of partner:**

Like any other form of partnership withdrawal, dissolves a partnership. The partners' accounts are adjusted to measure net income or loss for the part of the year up to the date of the death then closed to determine the partner’s capital balance on the date.

 **Incorporation of partnership:**

Partners may decide to incorporate in order to secure the advantages found in the corporate form organization, there are two methods:

1. Wind Up
2. Merging the corporation will act to acquire the net assets of the partnership in exchange for its stock.

The stock received by the partnership is distributed to the partners in settlement of their equities. The corporation thus takes over the assets and assumes the liabilities of the partnership:

**Liquidation of a Partnership**

Liquidation of partnership includes four basic steps:

1. Sell the assets and allocate the gain or loss to the partners' capital accounts on the bases of the profit and loss ratio.
2. Pay the partnership liabilities.
3. Pay the liquidation expenses.
4. Allocate the remaining cash to the partners on the basis of their capital balance ratio.

**Example**:

Following is a balance sheet for the partnership of Balen and Bewar as of the termination date.

The revenue, expense and drawing accounts have been closed out as preliminary step in terminating the business

Balen & Bewar Partnership

Balance Sheet as of 30/11/2017

|  |  |
| --- | --- |
| Assets | Liabilities and Capital |
| Cash 45,000  A/R 12,000Inventory 22,000Land, building and equipment(net) 45000Acc. Dep. (4,000)Net book value 41,000 | Liabilities 32,000Balen capital 50,000Bewar capital 38,000 |
| Total assets 120,000 | Total 120,000 |

Balen and Bewar allocate all profit and loss on a ratio (3:2) respectively:

1. The inventory is sold for $15,000
2. The total A/R 9,000 is collected with the remainder being written off.
3. The fixed assets are sold for a total of $29,000
4. All partnership liabilities are paid
5. Paid total of $3,000 in liquidation expenses is paid to cover costs such as accounting and legal fees

All remaining cash is distributed to the owners based on their final capital account balance. **Required**:

1. Prepare the necessary entries
2. Prepare statement of partnership liquidation.

**Solution**:

1. Inventory = 15,000 – 22,000 = (7,000)

Balen capital = 7,000 X 3/5 = 4,200

Bewar capital = 7,000 X 2/5 = 2,800

Dr. Cash 15,000

 Balen capital 4,200

 Bewar capital 2,800

 Cr. Inventory 22,000

Sold inventory by cash

1. A/R= 9,000-12,000 = (3,000)

Balen capital = 3,000 X 3/5 = 1,800

Bewar capital = 3,000 X 2/5 = 1,200

Dr. Cash 9,000

 Balen capital 1,800

 Bewar capital 1,200

 Cr. A/R 12,000

Received A/R for less

1. Fixed assets = 29,000 – 41,000 = (12,000)

Balen capital = 12,000 X 3/5 = 7,200

Bewar capital = 12,000 X 2/5 = 4,800

Dr. Cash 29,000

 Acc. Dep. 4,000

 Balen capital 7,200

 Bewar capital 4,800

 Cr. Fixed assets 45,000

Sold fixed assets for less

1. Liabilities:

Dr. Liabilities 32,000

 Cr. Cash 32,000

Paid liabilities by cash

1. Expenses:

Balen capital = 3,000 X 3/5 =1,800

Bewar capital = 3,000 X 2/5 = 1,200

Dr. Balen capital 1,800

 Bewar capital 1,200

 Cr. Cash 3,000

Paid liquidation expenses by cash

1. Distribution of cash:

Dr. Balen capital 35,000

 Bewar capital 28,000

 Cr. Cash 63,000

Distribution of cash to partners

|  |  |  |
| --- | --- | --- |
| Cash | A/R | Inventory |
| Debit | Credit | Debit | Credit | Debit | Credit |
| 45,00015,0009,00029,000 | 32,0003,00063,000 Bal | 12,000 | 12,000 | 22,000 | 22,000 |
| 98,000 | 98000 | 12,000 | 12,000 | 22,000 | 22,000 |
| Fixed Assets | Liabilities | Balen capital |
| Debit | Credit | Debit | Credit | Debit | Credit |
| 41,000 | 41,000 | 32,000 | 32,000 | 4,2001,8007,2001,80035,000 Bal | 50,000 |
| 41,000 | 41,000 | 32,000 | 32,000 | 50,000 | 50,000 |
| Bewar capital |
| Debit | Credit |
| 2,8001,2004,8001,20028,000 Bal | 38,000 |
| 38,000 | 38,000 |

Preparation for Final Exam