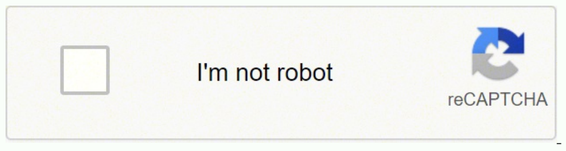

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Where there is no need for a fixed capital determination, the adjustments would be shown in the capital thus eliminating the need for a current account. Interest on capital Dr Appropriation Cr Current Acc 3. In the absence of a given ratio, the profit or loss is to be shared equally. In the absence of an agreed ratio, the profit is shared equally amongst the partners. There are some partnership sharing situations that are decided upon based on the initial capital sharing ratio, while others are based on the profit-sharing ratio. d. e. The appropriation account has two sections: (5) additions to the net income, i.e. interest charged on drawings; and (6) division of profits, i.e. interest paid on capital, and salary paid to partners. Items entered in the appropriation account usually have their double entry in the current account. Generally, the current account has a credit balance. They are also regarded as agents since they can act on the behalf of the members in the firm. The current account is usually prepared separately and the balance taken to the balance sheet. The Balance Sheet The balance sheet follows the same format as with a sole trader enterprise, except for the listing of the capital and current account balances under the owners' equity section. It shows the adjustments to the partners' equity or claim from the business, arising from the trading transaction. The current account would also include drawings as a debit entry. ii. Partner by Estoppel: not a partner in the general sense, but is held out to be such by his words or conduct. Quasi Partner: this is a former partner who still has vested interest in the firm, perhaps leaving a portion of his investment in the firm as a loan. 6 Solution to lecture question Adam, Walsh and Rose Statement of profit or loss and appropriation account for the year ending December 31, 2014 Sales less: Cost of goods sold Opening stock add: Purchases less: Closing stock 147,000 12,000 67,000 (15,000) Gross profit 83,000 less: Other expenses (25,000) Net profit add: Interest on Drawings Adam Walsh Rose less: Interest on Capital Adam Walsh Rose 58,000 300 150 200 650 5,000 4,000 3,000 (12,000) less: Salary Walsh Remainder of profits Adams Walsh Rose (64,000) (7,050) 39,600 16,500 13,200 9,900 (39,600) 0 7 Bal b/d Drawings Interest on drawings Bal c/d Adam Walsh 3,500 6,000 3,000 300 150 11,700 27,100 21,500 30,250 Current Account Rose Bal b/d 4,000 Interest on capital 200 Salary 10,900 Share of profits 15,100 Bal b/d Adam Walsh Rose 6,000 2,200 5,000 4,000 3,000 7,050 16,500 13,200 9,900 21,500 30,250 15,100 11,700 27,100 10,900 Adam, Walsh and Rose Statement of financial position as at December 31, 2014 Non-Current Assets Building Equipment Motor vehicle 80,000 30,800 45,000 155,800 Current Assets Closing stock Debtors 15,000 5,900 20,900 176,700 Equity Capital account Adams Walsh Rose Current account Adams Walsh Rose Current Liabilities Creditors Bank overdraft 50,000 40,000 30,000 120,000 11,700 27,100 10,900 49,700 3,000 4,000 7,000 176,700 8 Among these items are: 1. Salary to partners Dr Appropriation Cr Current Acc 4. The first set of consideration follows the same pattern as a sole trader: closing stock; adjustment to the expenses and revenue for amounts owing or prepaid; adjustment to the debtors for provision for bad debts; and adjustment to the non-current assets for depreciation. Non-Current Assets Same as before Cost Depn NBV Current Assets Same as before Total Assets Equity Capital Partner A Partner B Current (+ or -) Partner A Partner B X X X X X X X Non-Current Liability Same as before Current Liabilities Same as before Total Equity and Liabilities X 5 Lecture question The following trial balance was obtained from the books of Adams, Walsh, and Rose for the year ending December 31, 2014: DR Capital a/c: Current a/c: Sales Drawings: Adams Walsh Rose Adams Walsh Rose Adams Walsh Rose Purchases Building Equipment Motor vehicle Opening stock Debtors Creditors Bank overdraft Operating expenses CR 50,000 40,000 30,000 3,500 6,000 2,200 147,000 6,000 3,000 4,000 67,000 80,000 30,800 45,000 12,000 5,900 3,000 4,000 25,000 282,200 282,200 The following notes were also available: a. The second set of consideration is for items emanating from the partnership agreement: interest to be charged on drawings at x% p.a.; interest to be paid on capital at x% p.a.; salary to be paid to the partners; and the ratio by which profit or loss is to be shared. There are guidelines governing the maximum number of members in a partnership as well as the roles and responsibilities of each member. These are determined by such factors as: capital contribution (representing the partners claim as a principal in the firm), the level or degree of involvement in the business (this allows the partner to act as an agent of the firm), and the type of liability (or obligation for the debts, or losses that may be incurred). Hence a partnership may be regarded as a principal-agency relationship. Amongst the main types of partners are: a. Share of profit Dr Appropriation Cr Current Acc (reversed for a loss) These items are generally obtained from the footnotes to the trial balance. May be held liable for some aspects of the firm's obligations f. However, there are some disadvantages to the formation of a partnership: unlimited liability, potentials for conflict of interest, sharing of the profits, and the need for consultation amongst each other for decision making and control. Partnerships usually emerge from a sole trader, or are formed from professional practices such as accountants, lawyers, surveyors, or custom brokers, or from trades that require the owners to be the managers or the operators in the business. Interest on drawings Dr Current Acc Cr Appropriation 2. Profit sharing ratio is 5:4:3 Closing stock is valued at 15,000 Interest of 10% is to be paid on capital Interest on drawing is to be charged at 5% Salary of 7,050 is to be paid to Walsh Required: Prepare the final accounts of the partnership for the year. 2 i. The Statement of Profit or Loss and Appropriation Account Net Sales Same as before less Cost of Goods Sold Same as before Gross Profit add Other Revenue Same as before less Other Expenses Same as before Net Profit XX add: Interest on Drawings Partner A Partner B X X X less: Interest on Capital Partner A Partner B X X (X) less: Salary Partner A Remainder of Profits Partner A Partner B (X) XX X X (XX) - 3 The appropriation account is added to show how the net profit is adjusted and distributed amongst the partners. Most of the items in the current account are double entries for the items from the appropriation account as shown above. In some instances, there is an overdraft situation with the balance on the debit side either at the start or at the end. There are various types of partners in a partnership arrangement. There are two sets of considerations in the footnotes. As such he no longer has any direct liability for the obligations of the firm TYPE OF PARTNER General or Active (at least one member) Silent or Sleeping Nominal Limited Estoppel CONTRIBUTES CAPITAL (PRINCIPAL) INVOLVEMENT (AGENT) TYPE OF LIABILITY Yes Yes Unlimited Yes No Yes No No No Yes Some Unlimited Unlimited Limited Some FINAL ACCOUNTS OF A PARTNERSHIP The set of final accounts of a partnership is drawn from a given trial balance with footnotes. Limited Partner: contributes capital, is involved in the operations, and is assured limited liability or obligations e. The Statement of Profit or Loss and Appropriation Account The income statement is usually the same as that obtained in a sole trader, with the four general sections for (1) net sales, (2) cost of sales, (3) other income, and (4) other expenses. b. However, some textbooks show the adjustments inside the balance sheet. This type of business ownership offers the following advantages: pooling of expertise and financial resources, sharing of responsibility, increase capital base, while remaining a private concern. Nominal (Ostensible) Partner: Does not make a capital contribution, is not involved in the operations, but allows his name to be used or associated with the partnership, and has some liability for the obligations of the firm d. This is usually outlined in the Partnership Agreement, (or Partnership Deed or Articles of Partnership). It is maintained where the firm wishes to keep their initial capital contribution as a fixed sum. Partnerships are usually regulated in a general sense by means of the Partnership Act. c. The remainder of profit is distributed to the partners as the final share of profits based on their agreed profit-sharing ratio. The ending debit balance would be shown as a negative figure in the balance sheet. The Current Account The current account is a pre-extension of the balance sheet. INTRODUCTION TO FINANCIAL ACCOUNTING (ACC2001) LECTURE NOTES UNIT 3 – PARTNERSHIP ACCOUNTS The Partnership Act defines a partnership as the relationship which subsists between two or more persons carrying out a business in common with a view of making a profit. The members are generally regarded as principals in that they are co-owners in the firm. General (or Active, or Managing) Partner: contributes capital, is fully involved in the operations, and has unlimited liability b. 4 DR Current Account CR Partner A Partner B Partner A Partner B Bal b/d Drawings Interest on drawings Bal c/d Bal b/d Interest on capital Salary Share of profits Bal c/d Bal b/d (-) Bal b/d (+) iii. Situations not covered in the specific Partnership Agreement are usually dealt with according to the general ruling of the Partnership Act. Silent (or Sleeping, or Dormant) Partner: contributes capital, has no involvement in the regular operations, but has unlimited liability 1 c. However, each partnership may also establish its own set of specific terms of agreement, rules and guidelines for its respective members. The Agreement usually includes the following: the proportion of capital contribution, payment of interest on capital, payment of salary to the partners, limitations on drawings, interest charges on drawings, profit sharing ratio, the function of each member of the firm, the procedure to be followed whenever a partner is leaving or a new partner is to be admitted, etc.

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