

CHAPTER 1.10 FINANCIAL STATEMENTS OF PARTNERSHIP

QUESTION 1

State three advantages for existing partners of trading as a partnership rather than as sole traders [3]

O/N 10/P23 Q1(c), M/J 11/P21 Q1(c), M/J 12/P22 Q2(d) M/J 15/P22 Q2(c), M/J 16/P22 Q2(c),
M/J 19/P31 Q2(d (i))

OR Advise whether or not Hamid and Patel should enter into a partnership with each other rather than continuing to trade on a consignment basis. Justify your answer. [4]

O/N 16/P33/Q4(c)

OR Advise Greaves and Hurst whether or not they should form a partnership. Justify your answer by discussing advantages and disadvantages of forming the partnership. [6]

M/J 17/P31/Q3(d)

SOLUTION

Mark Scheme

- More capital is available;
- Different partners may have different skills that are beneficial to the business;
- The management of the business can be shared;
- The business is more efficient
- There are more ideas
- The responsibility is shared, so less stress
- Losses can be shared;
- Liquidity is improved.

Two marks per valid point to maximum of 8. [8]

Suggested Solution

The advantages of a partnership compared to a sole trader are:

- availability of additional capital
- sharing of managerial responsibilities resulting in shared workload and less stress
- spread of risk as losses will be shared
- different skills of different partners may be beneficial to the business
- more ideas from more partners
- subject to limited government regulations
- economies of scale

QUESTION 2

State three disadvantages of operating as a partnership rather than being in business as a sole trader. [6]

M/J 18/P22 Q1(a), M/J 19/P31 Q2(d (i))

SOLUTION

Mark Scheme

- Profits will be shared in the partnership, whereas as sole traders the individuals would be entitled to all the profits earned by their respective businesses;
- Decision making may take longer / some ideas may be abandoned because both partners will be need to agree, whereas as sole traders the individuals would be in the total control of all decisions in their respective businesses.
- There is the risk of disagreement which could be seriously affect the smooth running of the business, whereas sole traders would not have to gain the approval of anyone else.
- The death or serious illness of a partners could cause the business to cease trading.

1 mark for stating + 1 mark for development Three disadvantages required.

Suggested Solution

- Limited ability to raise capital
- Unlimited liability of partners for all partnership's debts.
- Delayed decisions due to lack of coordination or disagreement between partners.
- Lack of continuity as it may dissolve due to various reasons.
- No transfer of a partner's share without the consent of other partners.
- Each partner acts as an agent of the partnership with power to bind the partners and partnership to contracts with other parties, which may affect negatively the personal interest of the other partners

QUESTION 3

State four disadvantages a partnership has compared with a Limited company. [4]
M/J 99/P2 Q2(a)

SOLUTION

- First and foremost shareholders of a company enjoy limited liability whereas liability of the partners for debts of their firm is unlimited.
- Companies have more opportunities to raise capital as compared to partnership and consequently also enjoy economies of scale.
- A company enjoys perpetual existence as it continues in spite of death or insolvency of shareholders, whereas death or insolvency of partner(s) dissolves the partnership.
- A shareholder can transfer his shares without the consent of other shareholders but a partner cannot do so.

QUESTION 4

Identify non-financial factors, which a sole trader should consider when making his decision of forming partnership. [5]
M/J 96/P1/Q4(C)

SOLUTION

Sole trader should remember that after forming the partnership the business is no longer under his control and new partner may disagree on policy matters and he will be legally bound by the acts of the new partner and can be held individually responsible for all of the partnership debts.

QUESTION 5

State two items which may be included in a partnership agreement (other than the share of profit)
(i) which will affect the appropriation account [2]
(ii) which will **not** affect the appropriation account. [2]
O/N 16/P23 Q1(e)

OR

State three items that may appear in a partnership agreement. [3]
O/N 17/P23 Q3(d), O/N 18/P23 Q2(c), O/N 19/P21/Q3(g)

SOLUTION**Mark Scheme****Affect appropriation account**

- Interest on capital
- Partners' salaries
- Interest on drawings

1 mark × 2 [2]

Will not affect appropriation account

- Interest on loans
- Amount of fixed capital
- Annual limit on drawings

1 mark × 2**Others**

- Duties of each partner

Suggested Solution**Items affecting appropriation account**

- Interest on capital
- Partners' salaries
- Bonuses to partners
- Interest on drawings
- Profit sharing

Items not affecting appropriation account

- Interest on partners' loans
- Amount of fixed capital
- Rent on partner's owned building
- Annual limit on drawings

Others

- Duties of each partner
- Rules regarding admission or retirement of a partner
- Amount of fixed capital

QUESTION 6

State **three** items that may be included in the appropriation account before the division of residual profit. **[3]**

O/N 18/P21/Q3(d)**SOLUTION****Mark Scheme**

- Interest on capital (1)
- Interest on drawings (1)
- Partners' salaries (1)

Suggested Solution

- Interest on partners' capital
- Interest on partners' drawings
- Partners' salaries
- Partners' bonuses and commissions

QUESTION 7

State three financial rules, which apply to a partnership, if no partnership agreement has been drawn up. **[3]**

O/N 98/P2/Q3(a), M/J 17/P22/Q3(a), M/J 20/P21/Q1(a)**SOLUTION****Mark Scheme**

- Share profits and losses equally (1)

- Partners are not entitled to salaries (1)
- Partners are not charged interest on their drawings (1)
- Entitled to contribute equally to the capital of the partnership (1)
- Partners are entitled to interest at 5% p.a. on loans they make to the partnership (1)
- Partners are not entitled to interest on the capital they have contributed (1) **Max 4**

SOLUTION

- Equal shares in capital, profits and losses.
- No interest on capital and drawings.
- 5% interest is allowed on partners' loans.

QUESTION 8

- (i) State **two** reasons why the partners are charged interest on drawings. [2]
 (ii) State **two** reasons why the partners receive interest on capital. [2]
O/N 14/P22/Q2 [e (i&ii)], O/N 19/P21/Q3(e&f)]

SOLUTION**Mark Scheme**

- (i) To try to limit partners' drawings (1)
 Reward partner with lower drawings (1)
 Ensure cash is retained in the business (1)
Maximum 2 [2]
- (ii) Reward the partner for business investment (1)
 Encourage partners to introduce more capital (1)
 Reward partners for the lost opportunity cost of capital invested (1)
Maximum 2 [2]

Suggested Solution

- (i) To ensure that cash is retained and reinvested within the business
 To restrict partners' drawings
 To reward partner with lower drawings
- (ii) To reward the partner for business investment
 To encourage partners to introduce more capital
 To reward partners for the lost opportunity cost of capital invested

QUESTION 9

Explain two reasons why you would recommend partners to have a written agreement, other than stating a ratio for sharing profits and losses. [4]
M/J 20/P21/Q1(b)

SOLUTION**Mark Scheme**

- Avoidance of disputes (1).
 - The deed usually states management responsibilities (1) and also agreed limits on drawings and agreed amounts of fixed capital (1).
 - Ensure partners are properly rewarded (or penalised) for their contributions (1).
 - The deed may include rewards for partners who have undertaken more management responsibilities/provided more capital/and penalised partners whose drawings have been the most (1)
- Max 2 reasons (2 marks per reason, 1 mark for identifying + 1 mark for developing)**
Accept other valid responses

Suggested Solution

- reduces the impact of disputes
- outlines entry and exit plans
- clarifies roles and responsibilities
- avoids unwanted dissolution
- helps to avoid costly legal proceedings

QUESTION 10

Explain **two** reasons why a partner might wish to keep separate capital and current accounts. [6]
 O/N 97/P1/Q3(b), O/N 08/P2/ Q1(c), O/N 10/P43/ Q1(e), M/J 16/P21/ Q1(d), M/J 16/P23/
 Q1(d), M/J 16/P22/ Q2(d), O/N 18/P23/ Q2(d) ,O/N 19/P22/ Q3(c)

OR

State **two** advantages to the partners of keeping Current accounts in addition to Capital accounts. [2]
 M/J 00/P2/Q2(c)

SOLUTION**Mark Scheme**

- To keep capital invested separate from profit and drawings
- To help avoid the possibility of partners overdrawing
- To reward the partner who has invested more with interest on the amount invested
- To identify partners' drawings in order to calculate interest on drawings
- Capital accounts are fixed and reflect long term investment in the partnership
- Current accounts are fluctuating accounts and reflect short term investment in the partnership.
- Capital accounts change when a new partner joins, an existing partner leaves or on dissolution
- Current accounts reflect the profit appropriation and drawings.
- Current accounts enable the business to monitor if a partner becomes overdrawn.

Max 3 marks [3]

Suggested Solution

- Separate Capital accounts show long-term investment made by the partners.
- Separate capital account also facilitates the calculations of interest on capital.
- Capital accounts only show the structural change in partnership such as with additional injection of capital, goodwill or revaluation of assets.
- Current accounts show transactions between partners and partnership on ongoing basis due to business operations like drawings, interest on drawings, share of residue profits, interest on capital and partnership salaries.
- Separate current account roughly specifies a limit up to which drawings may be made.
- Current accounts reflect the profit appropriation and drawings.
- Capital accounts change when a new partner joins, an existing partner leaves or on dissolution whereas Current accounts reflect the profit appropriation and drawings

QUESTION 11

Explain how a debit (overdrawn) balance may arise on a partner's current account. [2]
 M/J 12/P41 Q2(a), M/J 16/P21 Q1(c & d)

SOLUTION**Mark Scheme**

A debit balance on a current account arises when a partner has withdrawn more money than he is entitled to and is therefore in debt to the partnership. [2]

Suggested Solution

- A debit balance on a current account arises when a partner has withdrawn more money than he is entitled to and is therefore in debt to the partnership.
- An overdrawn current account balance may also be due to running of partnership business in continued losses

QUESTION 12

Suggest **two** reasons why the partners may have decided to have Loan Accounts as well as Capital Accounts. [3]

O/N 97/P1/Q3(c)

SOLUTION:**Suggested Solution:**

- (i) To enjoy high rate of return than capital
- (ii) To ensure to have fixed returns even in case of losses.
- (iii) Partners' loans could be repaid before partners' capitals.

QUESTION 13

Advise **three** ways to partners in which they could improve the cash position of the business. [3]

M/J 18/P23/Q1(f)

SOLUTION**Mark Scheme**

- The partners could reduce their salaries
- The partners could reduce their drawings
- Additional capital could be introduced by the existing partners
- A new partner, or partners, could be admitted to the partnership
- A term loan could be negotiated
- The partnership could dispose of surplus non-current assets

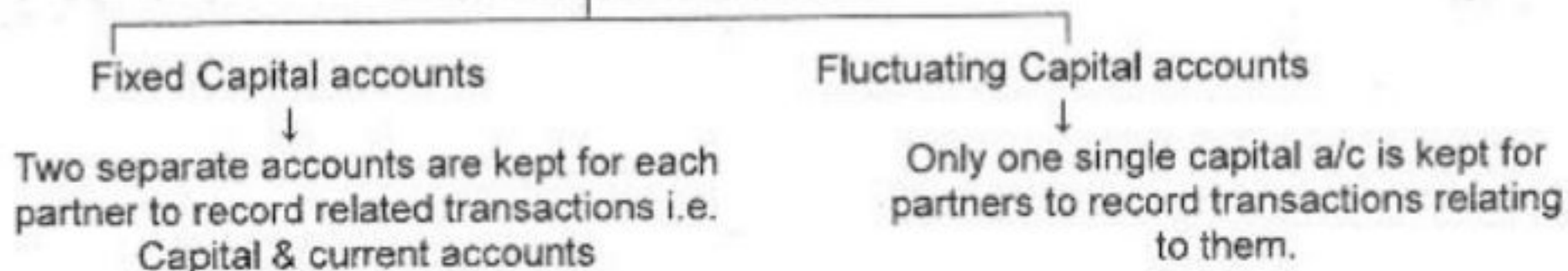
1 mark per valid point to max of 3

Suggested Solution:

- Reduction in partners' drawings
- Introduction of additional capital by the exiting partners
- Admitted of a new partner, or partners, to the partnership
- Borrowing of new term loans
- The partnership could dispose of surplus non-current assets

Name of partnership			
Appropriations a/c for the year ended-----			
		\$	\$
Net profit (after all income statement expenses)			xxx
Add Interest on drawings	A	xxx	
	B	<u>xxx</u>	<u>xxx</u>
			xxx
Less Interest on capital	A	xxx	
	B	xxx	
Partner's salary, bonus, commission		<u>xxx</u>	<u>(xxx)</u>
			<u>xxx</u>
Profit share	A	xxx	
	B	<u>xxx</u>	<u>xxx</u>

Partner's Capital accounts



Partner's Capital accounts (when fluctuating)

	A (\$)	B (\$)		A (\$)	B (\$)
Transfer to loan	xxx	xxx	Balance b/f	xxx	Xxx
Drawings	xxx	xxx	Assets (additional capital)	xxx	Xxx
Interest on drawings	xxx	xxx	Profit share	xxx	Xxx
Loss share	xxx	xxx	Interest on capital	xxx	Xxx
Balance c/d	xxx	xxx	Interest on partner's loan	xxx	Xxx
			Partner's bonus	xxx	Xxx
			Partner's salary	xxx	Xxx
			Partner's commission	xxx	Xxx
			Other payables to partners	xxx	Xxx
	<u>xxx</u>	<u>xxx</u>		<u>xxx</u>	<u>Xxx</u>

Partner's Capital accounts (when fixed)

	A (\$)	B (\$)		A (\$)	B (\$)
Transfer to loan	xxx	xxx	Balance b/f	xxx	Xxx
Balance c/d	<u>xxx</u>	<u>xxx</u>	Assets (additional capital)	<u>xxx</u>	<u>Xxx</u>
	<u>xxx</u>	<u>xxx</u>		<u>xxx</u>	<u>Xxx</u>

Partner's Current accounts

	A (\$)	B (\$)		A (\$)	B (\$)
Balance b/f (Dr)	xxx	xxx	Balance b/f (Cr)	xxx	Xxx
Drawings	xxx	xxx	Profit share	xxx	Xxx
Interest on drawings	xxx	xxx	Interest on capital	xxx	Xxx
Loss share	xxx	xxx	Interest on partner's loan	xxx	Xxx
Balance c/d	xxx	xxx	Partner's bonus	xxx	Xxx
			Partner's salary	xxx	Xxx
			Partner's commission	xxx	Xxx
	<u>xxx</u>	<u>xxx</u>		<u>xxx</u>	<u>Xxx</u>