**Question 19**

Jane Harlow and Barbara Davis have invested equity of £30,000 and £20,000 respectively in a partnership.

On 1 January Year 2 their current account balances were Jane — £5,000 (Cr) and Barbara — £2,000 (Dr) respectively.

The partnership agreement states that:

(1) Interest is charged on drawings at 20% per annum. Partners are allowed to withdraw up to a maximum of 25% of their equity invested in any financial   
year.

(2) Interest on equity is payable at the rate of 10% per annum.

(3) A salary of £2,000 per quarter is payable to Barbara.

(4) Residual profits and losses are to be shared in the same ratio as equity   
invested.

Both partners withdrew maximum drawings during Year 2.

On 31 December Year 2, the business made a Profit for the Year of £18,000.

1. **Prepare** the Appropriation Account for the year ended 31 December Year 2. **7**

After the appropriation of the Profit for the Year, the following errors and omissions were found in the books of the partnership:

(1) Sales revenue for £320 had been incorrectly entered as £240.

(2) No entry had been made for the sale of a vehicle (net book value — £1,600)  
 for £1,200.

(3) Wages had been under-added by £1,500.

(4) Discount received of £100 had been entered as discount allowed.

(5) Inventory value at £400 had been omitted from closing inventory.

(6) VAT of £300 had been omitted on purchases.

(b) **Calculate:**

(i) the amended Profit for the Year **5**

(ii) **each** partner’s final share of profit or loss **3**

**Question 19 (continued)**

At the start of Year 3, Jane and Barbara agree to admit James Gilbert as a new partner under the following conditions:

(1) James is to provide £15,000 as his equity.

(2) Goodwill is to be valued at £6,000.

(3) A professional revaluation of existing assets and liabilities takes place,   
resulting in a loss on revaluation of £2,160.

(4) A goodwill account is not to be kept; goodwill is to be written off against the equity accounts of the **new** partnership.

(5) James is to receive or be liable for 25% of the residual profits or losses, the   
other partners are to share the remainder in the same relative proportions as before.

1. You are required to:

(i) **state** the new profit sharing ratio **2**

(ii) **calculate** the new equity account balances of each partner **8**

**Total marks (25)**

**Question 19 — solution**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **(a)** | **Appropriation Account for year ended 31 December Year 2** | | | | |  |  |
|  | | **£** |  | **£** |  |
| Profit for the Year | |  |  | 18,000 |  |
|  | |  |  |  |  |
| Add Interest on Drawings | |  |  |  |  |
| Jane (20% × £7,500) | | 1,500 | **(1)** |  |  |
| Barbara (20% × £5,000) | | 1,000 | **(1)** | 2,500 |  |
|  | |  |  | 20,500 |  |
|  | |  |  |  |  |
| Less Interest on Equity | |  |  |  |  |
| Jane (10% × £30,000) | | 3,000 | **(1)** |  |  |
| Barbara (10% × £20,000) | | 2,000 | **(1)** | 5,000 |  |
|  | |  |  | 15,500 |  |
| Less Salary — Barbara | |  |  | 8,000 | **(1)** |
| RESIDUAL PROFIT | |  |  | 7,500 |  |
|  | |  |  |  |  |
| Share of Profit: | |  |  |  |  |
| Jane — 3/5 × £7,500 | |  |  | 4,500 | **(1)** |
| Barbara — 2/5 × £7,500 | |  |  | 3,000 | **(1)** |
|  | |  |  | 7,500 |  |
|  |  | | | | |  | | **7** |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **(b)** | **(i)** | **Statement of Corrected profit** | | | |  |  |
|  |  |  | £ |  |  | |  |
| Original Profit for the Year | 18,000 |  |  | | |
| Add: |  |  |  | | |
| Error 1 — Sales Revenue | 80 | **(1)** |  | | |
| Error 4 — Discount | 200 | **(1)** |  | | |
| Error 5 — Closing Inventory | 400 | **(1)** |  | | |
|  | 18,680 |  |  | | |
|  |  |  |  | | |
| Less: |  |  |  | | |
| Error 2 — Loss on Sale | 400 | **(1)** |  | | |
| Error 3 — Wages | 1,500 | **(1)** |  | | |
| **Amended Profit for the Year** | 16,780 |  |  | | |
|  |  |  | **5** | | |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **(b)** | **(ii)** |  | | | |  |  |
| 18,000 − 16,780 = 1,220 reduction **(1)** | | |  |
|  | | |  |
| Jane — 4,500 − 3/5 × 1220 = 3,768 **(1)** | | |  |
| Barbara — 3,000 − 2/5 × 1220 = 2,512 **(1)** | | |  |
|  |  |  | | | | **3** |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **(c)** | **(i)** | **Profit sharing ratio** | | | | |  |  |
| James — 25%  Jane — 3/5 × ¾ = 9/20 or 45% or /20 or 9  Barbara — 2/5 × ¾ = 6/20 or 30% or 6/20 or 6 | | | **(1)**  **(1)** |
|  |  | **2** | | | | | |  |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **(ii)** | | **New Equity Account Balances** | | | | | | | |  |
|  |  | |  | | | | | | | |  |
|  | | Jane |  | Barbara |  | James |  | |  |
|  | | £ |  | £ |  | £ |  | |  |
| Opening Balance | | 30,000 |  | 20,000 |  | 15,000 | **line** | |  |
| Share of Goodwill | | 3,600 | **(1)** | 2,400 | **(1)** |  |  | |  |
|  | | 33,600 |  | 22,400 |  |  |  | |  |
| Share of Revaluation Loss | | 1,296 | **(1)** | 864 | **(1)** |  |  | |  |
|  | | 32,304 |  | 21,536 |  |  |  | |  |
| Share of Goodwill written down | | 2,700 | **(1)** | 1,800 | **(1)** | 1,500 | **(1)** | |  |
| Closing Balance | | 29,604 |  | 19,736 |  | 13,500 |  | | **8** |
|  | |  | | | | | | |  |
|  | |  | | | | | | |  |

**Total marks (25)**