

## this chapter covers . . .

*In this chapter we continue our study of partnerships by looking at the principles involved and the accounting entries, for:*

- *admission of a new partner*
- *retirement of a partner*
- *death of a partner*
- *changes in profit-sharing ratios*
- *partnership changes when there are split years*

*Before we look at each of these, we need to consider the goodwill of the business, which features in all of the changes listed above.*

## **NVQ PERFORMANCE CRITERIA COVERED**

### **unit 5: MAINTAINING FINANCIAL RECORDS AND PREPARING ACCOUNTS**

#### **element 5.2**

#### **collecting and collating information for the preparation of final accounts**

*E correctly identify, calculate and record appropriate adjustments*

#### **element 5.3**

#### **preparing the final accounts of sole traders and partnerships**

*B prepare final accounts of partnerships in proper form and in compliance with the partnership agreement, from the trial balance*

*C observe the organisation's policies, regulations, procedures and timescales in relation to preparing final accounts of sole traders and partnerships*

*D identify and resolve or refer to the appropriate person discrepancies, unusual features or queries*

## GOODWILL

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The balance sheet of a partnership, like that of many businesses, rarely indicates the true 'going concern' value of the business: usually the recorded figures underestimate the worth of a business. There are two main reasons for this:

- **Prudence** – if there is any doubt about the value of assets, they are stated at the lowest possible figure.
- **Goodwill** – a going concern business will often have a value of goodwill, because of various factors, eg the trade that has been built up, the reputation of the business, the location of the business, the skill of the workforce, and the success at developing new products.

### definition of goodwill

Goodwill can be defined formally in accounting terms as:

*the difference between the value of a business as a whole, and the net value of its separate assets and liabilities.*

For example, an existing business is bought for £500,000, with the separate assets and liabilities being worth £450,000 net; goodwill is, therefore, £50,000.

Thus goodwill has a value as an intangible fixed asset to the owner or owners of a going concern business, whether or not it is recorded on the balance sheet. As you will see in the sections which follow, a valuation has to be placed on goodwill when changes take place in a partnership.

### valuation of goodwill

The valuation of goodwill is always subject to negotiation between the people concerned if, for instance, a partnership business is to be sold. It is, most commonly, based on the profits of the business – eg the average net profit over the last, say, three years and multiplied by an agreed figure, perhaps six times.

We will now see how goodwill is created when changes are made to partnerships, such as the admission of a new partner or retirement of an existing partner. For these changes, a value for goodwill is agreed and this amount is temporarily debited to goodwill account, and credited to the partners' capital accounts in their profit-sharing ratio. After the change in the partnership, it is usual practice for the goodwill to be written off – the partners' capital accounts are debited and goodwill account is credited. Thus a 'nil' balance remains on goodwill account and, therefore, it is not recorded

on the partnership balance sheet. This follows the prudence concept, and is the method commonly followed when changes are made to partnerships.

## ADMISSION OF A NEW PARTNER

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A new partner – who can only be admitted with the consent of all existing partners – is normally charged a premium for goodwill. This is because the new partner will start to share in the profits of the business immediately and will benefit from the goodwill established by the existing partners. If the business was to be sold shortly after the admission of a new partner, a price will again be agreed for goodwill and this will be shared amongst all the partners (including the new partner).

To make allowance for this benefit it is necessary to make book-keeping adjustments in the partners' capital accounts. The most common way of doing this is to use a goodwill account which is opened by the old partners with the agreed valuation of goodwill and, immediately after the admission of the new partner, is closed by transfer to the partners' capital accounts, including that of the new partner.

The procedures on admission of a new partner are:

- **agree a valuation for goodwill**
- **old partners: goodwill created**
  - debit goodwill account with the amount of goodwill
  - credit partners' capital accounts (in their old profit-sharing ratio) with the amount of goodwill
- **old partners + new partner: goodwill written off**
  - debit partners' capital accounts (in their new profit-sharing ratio) with the amount of goodwill
  - credit goodwill account with the amount of goodwill

The effect of this is to charge the new partner with a premium for goodwill.



### Case Study

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## AL AND BEN: ADMISSION OF A NEW PARTNER

### situation

Al and Ben are in partnership sharing profits and losses equally. Their balance sheet as at 31 December 2004 is as follows:

**BALANCE SHEET OF AL AND BEN as at 31 December 2004**

|                   | £             |
|-------------------|---------------|
| Net assets        | <u>80,000</u> |
| Capital accounts: |               |
| Al                | 45,000        |
| Ben               | <u>35,000</u> |
|                   | <u>80,000</u> |

On 1 January 2005 the partners agree to admit Col into the partnership, with a new profit-sharing ratio of Al (2), Ben (2) and Col (1). Goodwill has been agreed at a valuation of £25,000. Col will bring £20,000 of cash into the business as his capital, part of which represents a premium for goodwill.

**solution**

The accounting procedures on the admission of Col into the partnership are as follows:

- goodwill has been valued at £25,000
- old partners: goodwill created
  - debit goodwill account           £25,000
  - credit capital accounts (in their old profit-sharing ratio)
    - Al                                   £12,500
    - Ben                                 £12,500
- old partners + new partner: goodwill written off
  - debit capital accounts (in their new profit-sharing ratio)
    - Al                                   £10,000
    - Ben                                 £10,000
    - Col                                 £5,000
  - credit goodwill account         £25,000

The capital accounts of the partners, after the above transactions have been recorded, appear as:

|                      | <b>Partners' Capital Accounts</b> |        |        |                  |        |        |        |
|----------------------|-----------------------------------|--------|--------|------------------|--------|--------|--------|
| Dr                   | Al                                | Ben    | Col    |                  | Al     | Ben    | Col    |
|                      | £                                 | £      | £      |                  | £      | £      | £      |
| Goodwill written off | 10,000                            | 10,000 | 5,000  | Balances b/d     | 45,000 | 35,000 | -      |
| Balances c/d         | 47,500                            | 37,500 | 15,000 | Goodwill created | 12,500 | 12,500 | -      |
|                      |                                   |        |        | Bank             | -      | -      | 20,000 |
|                      | 57,500                            | 47,500 | 20,000 |                  | 57,500 | 47,500 | 20,000 |
|                      |                                   |        |        | Balances b/d     | 47,500 | 37,500 | 15,000 |

The balance sheet, following the admission of Col, appears as:

| <b>BALANCE SHEET OF AL, BEN AND COL as at 1 January 2005</b> |                |
|--|----------------|
|  | £              |
| Net assets (£80,000 + £20,000)                               | <u>100,000</u> |
| Capital accounts:  |                |
| Al     (£45,000 + £12,500 – £10,000)                         | 47,500         |
| Ben   (£35,000 + £12,500 – £10,000)                          | 37,500         |
| Col   (£20,000 – £5,000)                                     | <u>15,000</u>  |
|  | <u>100,000</u> |

In this way, the new partner has paid the existing partners a premium of £5,000 for a one-fifth share of the profits of a business with a goodwill value of £25,000.

Although a goodwill account has been used, it has been fully utilised with adjusting entries made in the capital accounts of the partners, as follows:

| Dr  |          | <b>Goodwill Account</b> |     | Cr          |               |
|-----|----------|-------------------------|-----|-------------|---------------|
|     |          | £                       |     |             | £             |
| Al  | goodwill | 12,500                  | Al  | goodwill    | 10,000        |
| Ben | created  | 12,500                  | Ben | written off | 10,000        |
|     |          | <u>25,000</u>           | Col |             | <u>5,000</u>  |
|     |          |                         |     |             | <u>25,000</u> |

## RETIREMENT OF A PARTNER

When a partner retires it is necessary to calculate how much is due to the partner in respect of capital and profits. The partnership agreement normally details the procedures to be followed when a partner retires. The most common procedure requires goodwill to be valued and this operates in a similar way to the admission of a new partner, as follows:

- **agree a valuation for goodwill**
- **old partners: goodwill created**
  - debit goodwill account with the amount of goodwill
  - credit partners' capital accounts (in their old profit-sharing ratio) with the amount of goodwill
- **remaining partners: goodwill written off**
  - debit partners' capital accounts (in their new profit-sharing ratio) with the amount of goodwill
  - credit goodwill account with the amount of goodwill

The effect of this is to credit the retiring partner with the amount of the goodwill built up whilst he or she was a partner. This amount, plus the retiring partner's capital and current account balances can then be paid out of the partnership bank account. (If there is insufficient money for this, it is quite usual for a retiring partner to leave some of the capital in the business as a loan, which is repaid over a period of time.)

## Case Study

### JAN, KAY AND LIL: RETIREMENT OF A PARTNER

#### situation

Jan, Kay and Lil are in partnership sharing profit and losses in the ratio of 2:2:1 respectively. Partner Jan decides to retire on 31 December 2004 when the partnership balance sheet is as follows:

| <b>BALANCE SHEET OF JAN, KAY AND LIL as at 31 December 2004</b> |                |
|---|----------------|
|   | £              |
| Net assets  | <u>100,000</u> |
| Capital accounts:   |                |
| Jan   | 35,000         |
| Kay   | 45,000         |
| Lil   | <u>20,000</u>  |
|   | <u>100,000</u> |

Goodwill is agreed at a valuation of £30,000. Kay and Lil are to continue in partnership and will share profits and losses in the ratio of 2:1 respectively. Jan agrees to leave £20,000 of the amount due to her as a loan to the new partnership.

#### solution

The accounting procedures on the retirement of Jan from the partnership are as follows:

- goodwill has been valued at £30,000
- old partners: goodwill created
  - debit goodwill account   £30,000
  - credit capital accounts (in their old profit-sharing ratio of 2:2:1)

|     |         |
|-----|---------|
| Jan | £12,000 |
| Kay | £12,000 |
| Lil | £6,000  |

- remaining partners: goodwill written off
  - debit capital accounts (in their new profit-sharing ratio of 2:1)
 

|     |         |
|-----|---------|
| Kay | £20,000 |
| Lil | £10,000 |
  - credit goodwill account £30,000

The capital accounts of the partners, after the above transactions have been recorded, appear as:

| Dr                   | <b>Partners' Capital Accounts</b> |               |               | Cr               |               |               |               |
|----------------------|-----------------------------------|---------------|---------------|------------------|---------------|---------------|---------------|
|                      | Jan                               | Kay           | Lil           |                  |               |               |               |
|                      | £                                 | £             | £             |                  |               |               |               |
| Goodwill written off | –                                 | 20,000        | 10,000        | Balances b/d     | 35,000        | 45,000        | 20,000        |
| Loan account         | 20,000                            |               |               | Goodwill created | 12,000        | 12,000        | 6,000         |
| Bank                 | 27,000                            |               |               |                  |               |               |               |
| Balances c/d         | –                                 | 37,000        | 16,000        |                  |               |               |               |
|                      | <b>47,000</b>                     | <b>57,000</b> | <b>26,000</b> |                  | <b>47,000</b> | <b>57,000</b> | <b>26,000</b> |
|                      |                                   |               |               | Balances b/d     | –             | 37,000        | 16,000        |

Note: After recording goodwill, the balance of Jan's capital account is £47,000 (ie £35,000 + £12,000, being her share of the goodwill). Of this, £20,000 will be retained in the business as a loan, and £27,000 will be paid to her from the partnership bank account.

The balance sheet, after the retirement of Jan, appears as follows:

| <b>BALANCE SHEET OF KAY AND LIL as at 1 January 2005</b> |               |
|--|---------------|
|  | £             |
| Net assets (£100,000 – £27,000 paid to Jan)              | 73,000        |
| Less Loan account of Jan                                 | 20,000        |
|  | <u>53,000</u> |
| Capital accounts:  |               |
| Kay (£45,000 + £12,000 – £20,000)                        | 37,000        |
| Lil (£20,000 + £6,000 – £10,000)                         | 16,000        |
|  | <u>53,000</u> |

The effect of this is that the remaining partners have bought out Jan's £12,000 share of the goodwill of the business, ie it has cost Kay £8,000, and Lil £4,000. If the business was to be sold later, Kay and Lil would share the goodwill obtained from the sale in their new profit-sharing ratio.

## DEATH OF A PARTNER

The accounting procedures on the death of a partner are very similar to those for a partner's retirement. The only difference is that the amount due to the deceased partner is placed in an account called 'Executors (or Administrators) of X deceased' pending payment.

## CHANGES IN PROFIT-SHARING RATIOS

It may be necessary, from time-to-time, to change the profit-sharing ratios of partners. A partner's share of profits might be increased because of an increase in capital in relation to the other partners, or because of a more active role in running the business. Equally, a share of profits may be decreased if a partner withdraws capital or spends less time in the business. Clearly, the agreement of all partners is needed to make changes, and the guidance of the partnership agreement should be followed.

Generally, a change in profit-sharing ratios involves establishing a figure for goodwill, even if the partnership is to continue with the same partners; this is to establish how much goodwill was built up while they shared profits in their old ratios. Each partner will, therefore, receive a value for the goodwill based on the old profit-sharing ratio.

### Case Study

## DES AND EVE: CHANGES IN PROFIT-SHARING RATIOS

### situation

Des and Eve are in partnership sharing profits and losses equally. The balance sheet at 31 December 2004 is as follows:

#### BALANCE SHEET OF DES AND EVE as at 31 December 2004

|                   |                    |
|-------------------|--------------------|
| Net assets        | £<br><u>60,000</u> |
| Capital accounts: |                    |
| Des               | 35,000             |
| Eve               | <u>25,000</u>      |
|                   | <u>60,000</u>      |

The partners agree that, as from 1 January 2005, Des will take a two-thirds share of the profits and losses, with Eve taking one-third. It is agreed that goodwill shall be valued at £30,000.

### solution

The accounting procedures on the change in the profit-sharing ratio are as follows:

- goodwill has been valued at £30,000
- old profit-sharing ratio: goodwill created
  - debit goodwill account £30,000
  - credit capital accounts (in their old profit-sharing ratio of 1:1)
 

|     |         |
|-----|---------|
| Des | £15,000 |
| Eve | £15,000 |
- new profit-sharing ratio: goodwill written off
  - debit capital accounts (in their new profit-sharing ratio of 2:1)
 

|     |         |
|-----|---------|
| Des | £20,000 |
| Eve | £10,000 |
  - credit goodwill account £30,000

The capital accounts of the partners, after the above transactions have been recorded, appear as:

| Dr                   | Partners' Capital Accounts |        |                  |        | Cr     |  |
|----------------------|----------------------------|--------|------------------|--------|--------|--|
|                      | Des                        | Eve    |                  | Des    | Eve    |  |
|                      | £                          | £      |                  | £      | £      |  |
| Goodwill written off | 20,000                     | 10,000 | Balances b/d     | 35,000 | 25,000 |  |
| Balances c/d         | 30,000                     | 30,000 | Goodwill created | 15,000 | 15,000 |  |
|                      | 50,000                     | 40,000 |                  | 50,000 | 40,000 |  |
|                      |                            |        | Balances b/d     | 30,000 | 30,000 |  |

The balance sheet at 1 January 2005 appears as:

| <b>BALANCE SHEET OF DES AND EVE as at 1 January 2005</b> |               |
|--|---------------|
|  | <b>£</b>      |
| Net assets   | <u>60,000</u> |
| Capital accounts:  |               |
| Des (£35,000 + £15,000 – £20,000)                        | 30,000        |
| Eve (£25,000 + £15,000 – £10,000)                        | <u>30,000</u> |
|  | <u>60,000</u> |



The effect is that Des has 'paid' Eve £5,000 to increase his share of the profits from half to two-thirds. This may seem unfair but neither partner is worse off in the event of the business being sold, assuming that the business is sold for £90,000 (£60,000 assets + £30,000 goodwill). Before the change in the profit-sharing ratio they would have received:

Des £35,000 capital + £15,000 half-share of goodwill = £50,000

Eve £25,000 capital + £15,000 half-share of goodwill = £40,000

After the change, they will receive:

Des £30,000 capital + £20,000 two-thirds share of goodwill = £50,000

Eve £30,000 capital + £10,000 one-third share of goodwill = £40,000

As far as the realisation amounts are concerned, the position remains unchanged: it is only the profit-sharing ratios that will be different as from 1 January 2005. Also, any increase in goodwill above the £30,000 figure will be shared in the new ratio.

## PARTNERSHIP CHANGES: SPLIT YEARS

Any of the changes in partnerships that we have looked at so far in this chapter may occur during the course of an accounting year, rather than at the end of it.

For example, part-way through the year:

- the partners may decide to admit a new partner
- a partner might retire, or die
- the partners may decide to change their profit-sharing ratios

To avoid having to prepare final accounts at the date of the change, it is usual to continue the accounts until the normal year-end. Then, when profit for the year has been calculated, it is necessary to apportion the profit between the two parts of the financial year, ie to split the year into the period before the change, and the period after the change. This is often done by assuming that the profit for the year has been earned at an equal rate throughout the year.

The apportionment is done by dividing the appropriation account between the two time periods.

**Case  
Study****RAJ AND SAM: SPLIT YEARS****situation**

Raj and Sam are in partnership; their partnership agreement states:

- interest is allowed on partners' capital accounts at the rate of ten per cent per annum
- Sam receives a partnership salary of £18,000 per annum
- the balance of partnership profits and losses are shared between Raj and Sam in the ratio 2:1 respectively

At the beginning of the financial year, on 1 January 2004, the balances of the partners' capital accounts were:

Raj    £70,000

Sam    £50,000

During the year ended 31 December 2004, the net profit of the partnership was £50,500 before appropriations. The profit arose uniformly throughout the year.

On 1 October 2004, Raj and Sam admitted Tom as a partner. Tom introduced £40,000 of cash into the business as his capital.

The partnership agreement was amended on 1 October 2004 as follows:

- interest is allowed on partners' capital accounts at the rate of ten per cent per annum
- Sam and Tom are each to receive a partnership salary of £12,000 per annum
- the balance of partnership profits and losses are to be shared between Raj, Sam and Tom in the ratio of 2:2:1 respectively

*Note:* no accounting entries for goodwill are to be recorded.

**solution**

The appropriation account of the partnership for the year is shown on the next page.

**PROFIT AND LOSS APPROPRIATION ACCOUNT OF RAJ, SAM AND TOM  
for the year ended 31 December 2004**

|                                      | 9 months to<br>30 September | 3 months to<br>31 December | Total<br>for year |
|--------------------------------------|-----------------------------|----------------------------|-------------------|
|                                      | £                           | £                          | £                 |
| <b>Net profit</b>                    | 37,875                      | 12,625                     | 50,500            |
| <b>Less appropriation of profit:</b> |                             |                            |                   |
| Salaries:                            |                             |                            |                   |
| Sam £18,000 pa x 9 months            | 13,500                      | –                          |                   |
| £12,000 pa x 3 months                |                             | 3,000                      | 16,500            |
| Tom £12,000 pa x 3 months            |                             | 3,000                      | 3,000             |
| Interest on partners' capitals:      |                             |                            |                   |
| Raj £70,000 @ 10% pa x 9 months      | 5,250                       | –                          |                   |
| £70,000 @ 10% pa x 3 months          | –                           | 1,750                      | 7,000             |
| Sam £50,000 @ 10% pa x 9 months      | 3,750                       | –                          |                   |
| £50,000 @ 10% pa x 3 months          | –                           | 1,250                      | 5,000             |
| Tom £40,000 @ 10% pa x 3 months      | –                           | 1,000                      | 1,000             |
|                                      | *15,375                     | **2,625                    | 18,000            |
| <b>Share of remaining profit:</b>    |                             |                            |                   |
| Raj                                  | (2/3) 10,250                | (2/5) 1,050                | 11,300            |
| Sam                                  | (1/3) 5,125                 | (2/5) 1,050                | 6,175             |
| Tom                                  | –                           | (1/5) 525                  | 525               |
|                                      | 15,375                      | 2,625                      | 18,000            |

\* Raj and Sam shared profits 2:1 respectively

\*\* Raj, Sam and Tom shared profits 2:2:1 respectively

## RECORDING PARTNERSHIP CHANGES

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The accounting effects of partnership changes usually have a significant impact upon partners' capital accounts and the ratio in which they share profits and losses. Before implementing changes, the accounts assistant must check that the correct actions are being taken. This may mean referring issues to the appropriate person – such as the accounts supervisor, the manager of the partnership, one or more of the partners.

The accounts assistant must take note of:

- the terms of the partnership agreement
- the policies, regulations, procedures and timescales of the partnership

If there are any discrepancies, unusual features or queries they should be identified and, where possible, resolved – any outstanding issues will need to be referred to the appropriate person.

## CONFIDENTIALITY PROCEDURES

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The financial details of changes to partnerships should always be treated with confidentiality. In particular:

- details of the amount of goodwill should be discussed only with existing or new partners; as it normally does not appear on the balance sheet, the valuation of goodwill is confidential
- new partners will expect details of the amount of capital they are bringing in to an existing partnership to be kept confidential, and also the premium paid for goodwill
- all partners, existing or new, will expect details of changes made to the ratios in which they share profits and losses to be kept confidential

Very few details of partnerships need be revealed to other people; the Inland Revenue, lenders, and solicitors involved with the legal aspects are the only professionals outside the partnership who may need to have details of changes being made. Any disclosures should only be made with the prior approval of the partners.

## Chapter Summary

- Goodwill is an intangible fixed asset.
- With partnerships, goodwill is normally valued for transactions involving changes in the structure of the business to cover:
  - admission of a new partner
  - retirement of a partner
  - death of a partner
  - changes in profit-sharing ratios

A goodwill account is normally created just before the change, and then written off immediately after the change, ie it does not appear on the partnership balance sheet.
- When partnership changes take place part-way through the financial year, it is necessary to apportion the profit between the two parts of the financial year, usually by assuming that the profit has been earned at a uniform rate throughout the year.

## Key Terms

|                             |   |
|-----------------------------|---|
| <b>goodwill</b>             | the difference between the value of a business as a whole, and the net value of its separate assets and liabilities |
| <b>goodwill account</b>     | an account to which goodwill, an intangible fixed asset, is debited   |
| <b>premium for goodwill</b> | amount charged to a new partner who joins an existing partnership   |

## Student Activities

- 15.1** Where changes in partnerships take place, a goodwill account is opened, usually temporarily. After the change has taken place, goodwill account is usually written off. This follows the accounting concept of:
- (a) prudence
  - (b) accruals
  - (c) going concern
  - (d) consistency

Answer (a) or (b) or (c) or (d)

**15.2** Andrew and Barry are in partnership sharing profits equally. Colin is admitted to the partnership and the profit sharing ratios now become Andrew (2), Barry (2) and Colin (1). Goodwill at the time of Colin joining is valued at £50,000. What will be the goodwill adjustments to Andrew's capital account?

- (a) debit £25,000, credit £25,000
- (b) debit £20,000, credit £25,000
- (c) debit £20,000, credit £20,000
- (d) debit £25,000, credit £20,000

Answer (a) or (b) or (c) or (d)

**15.3** Jim and Maisie are in partnership sharing profits and losses in the ratio 3:2 respectively. At 31 December 2004 the balances of their capital accounts are £60,000 and £40,000 respectively. Current accounts are not used by the partnership.

On 1 January 2005, Matt is admitted into the partnership, with a new profit-sharing ratio of Jim (3), Maisie (2) and Matt (1). Goodwill has been agreed at a valuation of £48,000. Matt will bring £28,000 of cash into the business as his capital and premium for goodwill. Goodwill is to be eliminated from the accounts.

For the year ended 31 December 2005, the partnership profits amount to £60,000, and the partners' drawings were:

|        | £      |
|--------|--------|
| Jim    | 12,000 |
| Maisie | 12,000 |
| Matt   | 8,000  |

You are to show the partners' capital accounts for the period from 31 December 2004 to 1 January 2006.

- 15.4** Reena, Sam and Tamara are in partnership sharing profits in the ratio 4:2:2 respectively. Sam is to retire on 31 August 2004 and is to be paid the amount due to him by cheque.

The balance sheet drawn up immediately before Sam's retirement was as follows:

|                   |               |
|-------------------|---------------|
|                   | £             |
| Fixed assets      | 50,000        |
| Current assets    | 10,000        |
| Bank              | 25,000        |
|                   | <u>85,000</u> |
| Creditors         | (10,000)      |
|                   | <u>75,000</u> |
| Capital Accounts: |               |
| Reena             | 33,000        |
| Sam               | 12,000        |
| Tamara            | 30,000        |
|                   | <u>75,000</u> |

Goodwill is to be valued at £16,000. No goodwill is to remain in the accounts after Sam's retirement.

In the new partnership Reena and Tamara are to share profits equally.

Note that current accounts are not used by the partnership.

**Task 1**

Prepare the partners' capital accounts, showing the amount Sam is to be paid upon retirement.

**Task 2**

Show the balance sheet immediately after Sam's retirement from the partnership.

- 15.5** Dave and Elsa are in partnership sharing profits and losses equally. Their balance sheet at 30 September 2004 is as follows:

| <b>BALANCE SHEET OF DAVE AND ELSA as at 30 September 2004</b> |                |
|---|----------------|
|   | £              |
| Net assets  | 130,000        |
| Capital Accounts:   |                |
| Dave  | 80,000         |
| Elsa  | <u>50,000</u>  |
|   | <u>130,000</u> |

The partners agree that, as from 1 October 2004, Dave will take a two-thirds share of the profits and losses, with Elsa taking one-third. It is agreed that goodwill should be valued at £45,000. No goodwill is to remain in the accounts following the change.

Note that current accounts are not used by the partnership.

**Task 1**

Show the journal entries to record the creation of goodwill and its subsequent write-off for the change in the profit-sharing ratio.

**Task 2**

Show the partners' capital accounts with the entries to record the change in the profit-sharing ratio.

**Task 3**

Show the balance sheet of Dave and Elsa after the change in the profit-sharing ratio.

