Chapter 8
Business Purchase and Merger

A buyer may decide to purchase a business for several reasons. They may include-

1. An attractive purchase price
2. An opportunity to expand business activities
3. An opportunity to acquire profit making business-

Usually the purchaser does not takeover all the assets and liabilities of the vendor (i.e.) the vendor will retain the cash and be left to pay off some or all of the liabilities.
Assets and liabilities may be revalued when a business is sold.
Because it reflects the fair value of assets and liabilities for the purpose of ascertaining the purchase consideration

Purchase consideration: This is the price to be given by the purchaser to the vendor. The purchaser and the vendor will calculate this price together (usually on the basis of the assets and liabilities taken over by the purchaser) or on the basis of the average profit of the business during the past years.

Calculation of Goodwill: Sometimes the purchaser will have to pay for Goodwill. Goodwill is the difference between net assets and business purchase price.
Goodwill = Business Purchase Price – Net Assets (Positive figure is goodwill)

Factors / reasons for Good will

A person has to pay for goodwill when taking over a business or when admitted as a partner because of
- Profitability
- Reputation
- Locality
- Public relation

Types of merger

1. Merger of two or more sole traders' businesses to form a partnership
2. Merger of a sole trader's business with an existing partnership to form an enlarged partnership
3. Acquisition of a sole trader's business or partnership by a limited company

Note

Net assets are always taken from buyer's point of view
Purchase price is given in the form of ordinary shares, preference shares, debentures and cash

1. Merger of two or more sole traders' businesses to form a partnership

Past Paper questions

Q # 1 Aneeqa and Emilita are two sole traders who decided to form a partnership combining their businesses. At 31 March 2010 their balances were as follows:

Statement of financial position as at 31 March 2010

	Aneeqa			Emilita	
	$	$	$	$	$
Non-current (fixed) assets					
Premises		–			86 000
Equipment		12 000			19 000
Fixtures		6 000			3 000
Motor vehicle		8 200			–
		26 200			108 000
Current assets					
Inventory (stock)	15 000			5 700	
Trade receivables (debtors)	17 000			18 000	
Cash and cash equivalents (bank)	9 050			–	
	41 050			23 700	
Current liabilities					
Trade payables (creditors)	11 000		12 000		
Cash and cash equivalents (bank)	–		10 850		
				22 850	
Net current assets		30 050			850
		56 250			108 850
Capital		56 250			108 850

The new partnership was formed on 1 April 2010 when their assets were valued at:

	Aneeqa	Emilita
	$	$
Premises	–	120 000
Equipment	16 000	20 000
Fixtures	6 500	2 800
Motor vehicle	12 100	–
Inventory (stock)	14 800	5 100
Goodwill	9 000	5 000

It was agreed that a provision for doubtful debts of 5% would be created, that the bank accounts would be amalgamated and that goodwill would not be retained in the books.

From 1 April 2010:
Interest on capital was to be 10%.
Partners' salaries were to be $10 000 each.
Profits were to be shared between Aneeqa and Emilita in the ratio 2:3 respectively.

REQUIRED

(a) Prepare the balance sheet of the partnership at the start of business on 1 April 2010. [17]

As sole traders Aneeqa and Emilita had earned annual profits of $16 000 and $34000 respectively. They expect the profits of the partnership to be 10% higher in the first year.

REQUIRED

(b) Calculate the amount of income each partner has gained or lost by the creation of the partnership. State which partner has benefitted in terms of income [9]

June 2010

Q # 2 Fernando and Gurdip have been in business for several years as sole traders and have decided to merge their businesses into a partnership.
Their statements of financial position at 30 June 2015 were as follows.

	Fernando		Gurdip	
	$	$	$	$
Assets				
Non-current assets		60 000		220 000
Current assets				
Inventories	32 500		15 350	
Trade receivables	35 000		28 000	
Cash and cash equivalents	-	67 500	14 150	57 500
Total assets		127 500		277 500
Capital and liabilities				
Capital		94 450		259 000
Current liabilities				
Trade payables	23 000		18 500	
Cash and cash equivalents	10 050	33 050	-	18 500
Total capital and liabilities		127 500		277 500

The partnership commenced trading on 1 July 2015. The profit sharing ratio was agreed between Fernando and Gurdip to be 1 : 2.
On that date the assets of both sole traders were revalued as follows:

1 The non-current assets were valued at 10% higher than the net book value.

2 The inventories were valued at 2% lower than their book value.

3 Trade receivables were taken over at book value less a 3% provision for irrecoverable debts.

On 1 July 2015 goodwill was valued at Fernando $7000 and Gurdip $20 000. No goodwill account was to be maintained in the books of account.

REQUIRED

(a) Prepare the opening statement of financial position for the partnership at 1 July 2015. [11]

Additional information

The other terms of the partnership agreement were:
Interest on capital – 4% per annum
Interest on drawings – 6% per annum
Annual salaries – Fernando $30 000 and Gurdip $20 000
Annual drawings – Fernando $27 000 and Gurdip $20 000
The budgeted profit for the year ending 30 June 2016 is $80 000

REQUIRED

(b) Prepare the budgeted appropriation account of the partnership for the year ending 30 June 2016 [4]

Additional information

The partners have been advised that in future it may be beneficial to 'incorporate' their business.

REQUIRED

(c) State what is meant by the term 'incorporation'. [1]

(d) Advise the partners whether or not they should convert their business into a limited company. Justify your answer by analysing **two** benefits and **two** limitations to the partners. [9]

March 2016

Q # 3 Armfield and Bonetti are sole traders. Their statements of financial position at 31 December 2016 are shown below:

	Armfield	Bonetti
	$	$
Assets		
Non-current assets	85000	135000
Current assets		
Inventories	8000	12000
Trade receivables	6000	9000
Cash and cash equivalents	4000	5000
	18000	26000
Total assets	103000	161000
Capital and liabilities		
Capital accounts	100000	150000
Current liabilities		
Trade payables	3000	11000
	103000	161000

They have decided to merge their two businesses into a partnership on 1 January 2017. All assets and liabilities, with the exception of cash and cash equivalents, were transferred to the new partnership at the following agreed values:

	Armfield	Bonetti
	$	$
Non-current assets	80000	145000
Inventories	7000	11000
Trade receivables	5000	8000
Trade payables	3000	11000

REQUIRED

(a) State the meaning of the term 'capital account'. [2]
(b) Prepare the capital accounts of Armfield and Bonetti to close their existing businesses. Transfer the balances on their capital accounts to new partnership capital accounts. [6]

Additional information

Each partner will either invest or withdraw cash to achieve a balance of $125 000 to carry forward on their partnership capital account.

REQUIRED

(c) Prepare the partnership capital accounts clearly showing each partner's adjustment for cash. [3]

(d) Prepare the opening statement of financial position for the partnership at 1 January 2017. [5]
Additional information

Profit for the year ended 31 December 2016 of Armfield was $80 000 and Bonetti was $120 000. The profit for the year of the partnership for the year ending 31 December 2017 is expected to be $200000. The partners agreed to share the profits and losses equally.

REQUIRED

(e) Discuss whether or not the merger of the two businesses has been beneficial to each partner. [5]

Additional information

After the first year's successful trading as a partnership the partners were advised to consider incorporating their business. Both partners are close to retirement age and have family.

(f) Discuss two advantages to the partners of incorporating their business. [4]

Nov 2017

Q # 4 Ephraim and Fikriyah are sole traders. They agreed to merge their two businesses into a partnership on 1 October 2017 sharing profits and losses equally.
Ephraim and Fikriyah's statements of financial position at 30 September 2017 were as follows:

	Ephraim	Fikriyah
	$	$
Non-current assets	45 000	110 000
Current assets		
Inventories	7 500	11 500
Trade receivables	9 000	15 500
Cash and cash equivalents	6 500	1 000
	23 000	28 000
Total assets	68 000	138 000
Capital	60 000	120 000
Current liabilities		
Trade payables	8 000	18 000
	68 000	138 000

The agreed valuations for the merger were:

	Ephraim	Fikriyah
	$	$
Non-current assets	55 000	115 000
Inventories	8 000	10 500
Goodwill	10 000	6 000

All other assets and liabilities were transferred at their book value.
Goodwill was not to be retained in the books of account.

Required

(a) Prepare the opening statement of financial position for the partnership at 1 October 2017. [13]

Additional information

The average annual profit earned by Ephraim for the past three years was $60 000.
The average annual profit earned by Fikriyah for the past three years was $40 000.
The budgeted profit for the partnership for its first year's trading is expected to be $100 000. In each of the following three years it is expected to be 10% less than the previous year. This is as a result of the increasing competition.

(b) Discuss the benefits and limitations of the merger to each partner. Justify your answer using both financial and non-financial factors. [12]

June 2018

Q # 5 Jenny and Thomas are two sole traders. Their statements of financial position at 31 March 2019 were as follows:

	Jenny	Thomas
	$	$
Non-current assets	150 000	90 000
Current assets		
Inventory	27 500	11 000
Trade receivables	17 500	6 500
Cash and cash equivalents	9 750	3 750
	54 750	21 250
Total assets	204 750	111 250
Capital and liabilities		
Capital accounts	170 000	100 000
Current liabilities	34 750	11 250
Total capital and liabilities	204 750	111 250

They agreed to merge their two businesses into a partnership with effect from 1 April 2019.

The terms of the merger were as follows:
1 The value of the non-current assets of both sole traders had increased by 10%.
2 Inventory was valued at $27 000 for Jenny and $10 000 for Thomas.
3 Both sole traders expected 5% of their trade receivables to be written off.
4 All other assets and liabilities, except cash and cash equivalents, were transferred to the partnership at their book value.

Required

(a) Prepare the revised capital accounts of each sole trader at 31 March 2019 to show the transfer to the partnership. [8]

Additional information

The new partnership commenced on 1 April 2019 with total opening capital of $360 000 in the ratio of Jenny 2, Thomas 1. Each partner introduced cash to achieve this.

(b) Calculate the amounts of additional cash that each partner introduced. [2]

(c) Prepare the opening statement of financial position of the new partnership on 1 April 2019. [6]

Additional information

The partners agreed to take equal salaries of $10 000 per annum. The residual profits were to be shared in the ratio of 2:1 respectively.
It is expected that the profit before appropriation for the first year's trading will give a return of 13.5% on the total opening capital balances.
The average profit of Jenny over the last three years as a sole trader was $35 000 per annum.

(d) (i) Calculate Jenny's total share of the expected profit for the first year of trading. [3]

(ii) State one advantage and one disadvantage to Jenny of forming the partnership. [2]

May 2019

6. Jack and Paul were two sole traders. They decided to merge their businesses and form a partnership on 1 July 2018. Their statements of financial position at 30 June 2018 were as follows

	Jack $	Paul $
Non-current assets		
Plant and equipment	118 000	103 700
Current assets		
Inventory	36 000	47 000
Trade receivables	31 500	29 500
Bank	6 200	3 400
	73 700	79 900
Current liabilities		
Trade payables	27 700	33 100
Net assets	164 000	150 500
Capital 1 July 2017	160 000	150 000
Profit for the year	44 000	20 500
Drawings	(40 000)	(20 000)
	164 000	150 500

The following was agreed for the purpose of the merger.

1 The value of each business was: Jack $195 000; Paul $152000.

2 Jack's plant and equipment would be revalued at $128 000.

3 Paul's inventory would be revalued at $40 000.

4 Paul's trade receivables would be reduced by 2% for making allowance for doubtful debts.
All other assets and liabilities would be transferred at the book value

(a) Calculate the value of total goodwill arising from the terms of the merger. [3]

Additional information

The following were the terms of the partnership.

1 Initial capital contributed by Jack and Paul would be $200 000 and $160 000 respectively, to be settled by net assets transferred and cash.

2 The profit and loss sharing ratio between Jack and Paul will be 3 : 2.

3 Goodwill arising from the merger is to be written off against each partner's capital account immediately after the merger.

(b) Prepare the statement of financial position for the partnership at 1 July 2018. [10]

Additional information

The partners also agreed to the following terms of the partnership.

1 Partners' salaries will be $24 000 each.

2 Each partner will take their salary and share of profit as drawings.
The profit for the year ended 30 June 2019, before appropriation, was $66 000.

(c) Prepare the current account for each partner for the year ended 30 June 2019. [5]

(d) Calculate, to two decimal places, the return on capital employed (ROCE) for the year ended 30 June 2019. [2]

(e) Evaluate whether or not Jack and Paul have benefited financially from merging their businesses. Justify your answer. [5]

Nov 2019

Q # 7 Ahmed and Omar were sole traders in the same trade. They decided to merge their businesses to form a partnership on 1 January 2020
The books of account of Ahmed and Omar had the following balances of assets and liabilities at 1 January 2020

	Ahmed	Omar
	$	$
Plant and equipment	203000	134000
Motor vehicles	74000	46000
Inventories	51000	36500
Cash at bank	Nil	28600
Trade receivables	59700	53800
Trade payables	42500	34100
Bank overdraft	8900	Nil

The following was also agreed.

1 The values of each sole trader's business at 1 January 2020 were:

	$
Ahmed	400000
Omar	300000

2 The partnership would take over all the assets and liabilities of both businesses at the following values:

	Ahmed	Omar
	$	$
Plant and equipment	230000	144000
Motor vehicles	71000	40000
Inventories	52500	34400
Cash at bank	Nil	28600
Trade receivables	58000	52000
Trade payables	42500	34100
Bank overdraft	8900	Nil

(a) Calculate the value of goodwill of each of Ahmed's and Omar's businesses. [6]

(b) Prepare the statement of financial position of the partnership at 1 January 2020 if goodwill is included. [6]

Additional information

The profit and loss sharing ratio between Ahmed and Omar is 3:2.
Both partners also agreed that goodwill would not be maintained in the books of account

(c) Calculate the capital account balance of each partner after goodwill is eliminated. [2]

(d) Explain the meaning of the term 'goodwill'. [3]

(e) Explain why the goodwill account is not maintained in the books of the partnership. Support your answer by reference to the accounting concepts. [4]

Additional information

The partners plan to purchase additional equipment costing $80000. They are considering making loans to the partnership or applying for a bank loan.

(f) State one advantage and one disadvantage to the partnership of each option. [4]

March 2020

2. Acquisition of a sole trader's business or partnership by a limited company

Past Paper Questions

Q # 1 Suck and Blow were in partnership and decided to retire and sell the business to Harmonica Ltd on 1 October 2004. The partnership Balance Sheet at 30 September 2004 was as follows:

	Cost $000	Depreciation $000	Net Book Value $000
Fixed assets			
Freehold premises	400	300	100
Plant and machinery	270	190	80
Motor vehicles	100	76	24
Office equipment	60	50	10
	830	616	214
Current assets			
Stock		55	
Debtors		61	
Bank		28	
		144	
Current liabilities			
Creditors		73	71
			285
Long term liability			
Loan from Suck at 12% per annum			50
			235
Partners' capital accounts			235

The assets and liabilities were valued as follows for the sale:

	$000	$000
Freehold premises		200
Plant and machinery		60
Motor vehicles		18
Office equipment		5
		283
Stock	40	
Debtors	50	
	90	
Creditors	73	17
		300

Harmonica Ltd did not take over the partnership bank account.
The consideration for the purchase of the partnership was $400 000 and was satisfied as follows:
1 The issue to Suck of an amount of 8% debentures which would ensure that he would continue to receive the same amount of interest as he had received from the partnership.
2 A cash payment of $60000.
3 200000 ordinary shares in Harmonica Ltd for the balance of the purchase consideration

Harmonica Ltd's Balance Sheet at 30 September 2004 was as follows:

	Cost $000	Depn. $000	N.B.V. $000
Fixed assets			
Freehold premises	1000	200	800
Plant and machinery	500	300	200
Motor vehicles	230	170	60
Office equipment	100	60	40
	1830	730	1100
Current assets			
Stock		78	
Debtors		90	
Bank		120	
		288	
Current liabilities			
Creditors		112	176
			1276
Share capital and reserves			
Ordinary shares of $1			1000
General reserve			200
Retained profit			76
			1276

REQUIRED

(a) Prepare Harmonica Ltd's Balance Sheet at 1 October 2005 after the acquisition of the partnership business and before any other transactions had occurred. [17]

November 2005

Q # 2 A & U Ltd is a company formed to take over the partnership business of Amal and Ushi on 1 November 2009. Profits and losses are shared equally. The partnership statement of financial position (balance sheet) at that date was as follows:

Statement of Financial Position at 31 October 2009

			$	$
Non-current assets (net book value)				60 000
Current assets				
	Inventory		34 000	
	Trade receivables		41 000	
	Cash equivalents		9 650	
			84 650	
Less Current liabilities				
	Trade payables		21 300	
Net current assets (working capital)				63 350
				123 350
Less Non-current liabilities				
	Loan from Ushi at 10% per annum			20 000
				103 350
Financed by:				
Capital accounts:		Amal	60 000	
		Ushi	40 000	100 000
Current accounts:		Amal	2 000	
		Ushi	1 350	3 350
				103 350

The terms of the sale of the partnership business to A & U Ltd are:

1 All the assets and liabilities of the partnership are to be taken over by A & U Ltd. The assets are to be valued as shown below.

	$
Non-current assets	85000
Inventory	31000
Trade receivables	37650

2 The consideration for the partnership business is to be $170 000 satisfied as follows:

Amal will be issued with 8% debenture stock sufficient to ensure that she receives the same amount of interest annually as she had received on her own loan to the partnership.

100000 ordinary shares of $1 issued as fully paid to Amal and Ushi in proportion to the balances on their capital accounts in the partnership at 31 October 2009.

Any balances remaining on the partners' capital accounts to be settled in cash through the company's bank accounts.

After purchasing the partnership business, the company will issue 20 000 ordinary shares of $1 each to their friend Djamel on the same terms as those issued to Amal and Ushi.

REQUIRED

(a) Calculate the value of the goodwill and the shares issued to Djamel and show the relevant entries in the partners' capital accounts to dissolve the partnership. [11]

(b) Calculate the balance on the bank account and prepare the statement of financial position of A & U Ltd, as it will appear immediately after the above transactions have been completed. [10]

SP 2010

Q # 3 Prescott, Rohini and Singh have been in partnership for many years with a profit sharing ratio of 2:2:1. Their statement of financial position (balance sheet) at 30 June 2011 was as follows:

Prescott, Rohini and Singh
Statement of Financial Position (Balance Sheet) at 30 June 2011

			$	$
Non-current assets				
Land and buildings			100 000	
Fixtures and fittings			34 500	
Motor vehicles			16 750	151 250
Current assets				
Inventories			23 500	
Trade receivables			14 850	
Bank			7 595	
			45 945	
Current liabilities				
Trade payables			9 450	36 495
				187 745
Non-current liabilities				
Loan from Prescott at 12%				(25 000)
				162 745
Financed by:				
Capital Accounts	Prescott	70 345		
	Rohini	54 250		
	Singh	38 150		162 745

The partners sold their business to Ashburton Ltd on 1 July 2011 for $215 000. Ashburton Ltd took over all of the assets and liabilities except the bank account.

The purchase consideration was satisfied by:

1 The issue of 100 000 ordinary shares of $1 at a premium of $0.50.

2 The issue of 8% debentures redeemable at par in 2020 to Prescott to ensure that he receives the same amount of annual interest that he received from the loan.

3 The balance was paid by cash.

On 1 July 2011 the partnership assets were revalued as follows

	$
Land and buildings	115 000
Fixtures and fittings	32 000
Motor vehicles	15 000
Inventories	22 000
Trade receivables	13 500

Ashburton Ltd's statement of financial position (balance sheet) at 30 June 2011 was as follows:

Ashburton Ltd
Statement of Financial Position (Balance Sheet) at 30 June 2011

	$	$
Non-current assets		
Land and buildings	125 000	
Fixtures and fittings	67 750	
Motor vehicles	24 975	217 725
Current assets		
Inventories	22 875	
Trade receivables	14 363	
Bank	28 462	
	65 700	
Current liabilities		
Trade payables	14 630	51 070
		268 795
Financed by:		
Ordinary shares of $1		200 000
Share premium		20 000
Retained profit		48 795
		268 795

REQUIRED

(a) Prepare Ashburton Ltd's statement of financial position immediately **after** the acquisition of the partnership [22]

November 2011

Q # 4 Brian Mills and Beryl Smart had been in partnership for many years. Accounts were prepared to 30 April. It was decided that the partners would retire on 30 April 2012 and the business was sold to Chipperfield Ltd. The partnership's statement of financial position at 30 April 2012 was as follows:

	$	$
Non-current assets		
Property		85 000
Fixtures and fittings		27 500
Plant and machinery		14 750
		127 250
Current assets		
Inventories	28 800	
Trade receivables	10 950	
Bank	5 450	
		45 200
Total assets		172 450
Current liabilities		
Trade payables		13 950
Non-current liabilities		
Loan from Brian Mills at 8% per annum	15 000	
Loan from Beryl Smart at 6% per annum	10 000	25 000
Net assets		133 500
Capital accounts		
Brian Mills		76 000
Beryl Smart		57 500
		133 500

Chipperfield Ltd's statement of financial position at 30 April 2012 was as follows:

	$	$
Non-current assets		
Property		145 000
Fixtures and fittings		57 750
Plant and machinery		18 750
		221 500
Current assets		
Inventories	39 450	
Trade receivables	12 380	
Bank	69 675	
		121 505
Total assets		343 005
Current liabilities		
Trade payables		18 675
Net assets		324 330
Equity		
300 000 Ordinary shares of $0.50		150 000
Share premium		75 000
Retained earnings		99 330
		324 330

Chipperfield Ltd purchased the business on 1 May 2012 for $160 000. The company took over all of the assets (except the bank account) together with the current liabilities.
The purchase consideration was:

1. 120 000 ordinary shares of $0.50 nominal value issued at a premium of $0.10

2 30 000 6% non-redeemable preference shares of $0.50

3 10% debentures redeemable in 2020 issued so that Brian and Beryl receive the same interest payments as in the partnership.

4 The balance paid from the bank account.

The partnership assets were re-valued as follows:

	$
Property	95 000
Fixtures and fittings	24 500
Plant and machinery	12 500
Inventories	27 500
Trade receivables	10 250

REQUIRED

(a) Prepare Chipperfield Ltd's statement of financial position at 1 May 2012, after the partnership had been acquired. [22]

June 2012

Q # 5 Alvin, Bertram and Chana are in partnership preparing accounts to 30 June. They share profits and losses in the ratio 4:3:1. On 30 June 2013, the partners decided to convert the business to a new limited company, Albech Ltd.

Statement of Financial Position at 30 June 2013

		$	$
Assets			
Non-current assets (NBV)			250 000
Current assets			
Inventories		89 345	
Trade receivables		53 485	
Cash and cash equivalents		9 250	
			152 080
Total assets			402 080
Equity			
		$	$
Capital account	Alvin	75 000	
	Bertram	90 000	
	Chana	60 000	
			225 000
Current account	Alvin	24 840	
	Bertram	44 950	
	Chana	18 555	
			88 345
Total equity			313 345
Liabilities			
Non-current liabilities			
Alvin 8% loan account		40 000	
Current liabilities			
Trade payables		48 735	
Total liabilities			88 735
Total equity and liabilities			402 080

The terms of the transfer were as follows:

1 The agreed valuation of the business was $475 000.

2 Consideration was to be satisfied as follows.

200 000 ordinary shares of $1 each

200 000 8% non-redeemable preference shares of $0.50 each

Sufficient 10% long term debentures to enable Alvin to receive the same amount of annual interest he currently receives on his loan.

The balance to be cash in the form of a long term bank loan

3 The ordinary shares and cash were allocated in the profit sharing ratio whilst the preference shares were allocated in the ratio of the capital account balances at 30 June 2013.

4 All assets and liabilities were transferred to the new company with the exception of trade receivables, trade payables and the cash and cash equivalents.

5 A bad debt of $720 was written off.

6 Discounts of $3060 were agreed with the suppliers.

7 All other assets were transferred at their book value.

8 The loan from Alvin was repaid to him.

REQUIRED

(a) Prepare the partnership realisation account. [8]

(b) Prepare the bank account. [8]

(c) Prepare the partners' capital accounts to close the partnership. [8]

(d) Prepare the opening statement of financial position of Albech Ltd at 1 July 2013. [10]

November 2013

Q # 6 On 1 October 2013, Rezwan Limited agreed to purchase the net assets, excluding cash and cash equivalents, of Nimra, a sole trader.
Nimra provided the following information at 30 September.

	2013	2012
Assets	$	$
Non-current assets		
Land and buildings	110 000	110 000
Plant and equipment	76 500	85 000
	186 500	195 000
Current assets		
Inventory	21 000	17 000
Trade receivables	34 000	28 000
Cash and cash equivalents	11 000	3 500
	66 000	48 500
Total assets	252 500	243 500
Equity capital		
Balance	207 500	201 500
Profit for the year	58 000	54 000
	265 500	255 500
Drawings	54 000	48 000
Total equity	211 500	207 500
Liabilities		
Current liabilities		
Trade payables	41 000	36 000
Total equity and liabilities	252 500	243 500

Additional information

On 1 October 2013:

1 The land and buildings are revalued at $170 000.
2 Additional depreciation of $8500 is provided on the plant and equipment.
3 Inventory valued at 15% of the total is written off.
4 Bad debts equal to 10% of the trade receivables are written off.

Required

(a) Calculate the value of the net assets acquired by Rezwan Limited. [6]

Additional information

The directors of Rezwan Limited agreed to pay Nimra five times the average profit for the year for the last two years. They made a payment in cash of $100 000 and issued new $1 ordinary shares to Nimra at a premium of $0.50 for the balance of the purchase price.

Required

(b) Calculate the amount the directors of Rezwan Limited paid for Nimra's business. [2]

(c) Calculate the number of new $1 shares issued by Rezwan Limited. [4]

Additional information

Rezwan Limited's statement of financial position at 30 September 2013 before it acquired Nimra's business and assets is as follows:

Statement of financial position at 30 September 2013

	$
Assets	
Non-current assets	
Land and buildings	120 000
Plant and equipment	60 000
	180 000
Current assets	
Inventory	45 000
Trade receivables	24 000
Cash and cash equivalents	132 000
	201 000
Total assets	381 000
Equity	
Ordinary shares of $1 each	200 000
Share premium	20 000
Retained earnings	110 000
Total equity	330 000
Liabilities	
Current liabilities	
Trade payables	51 000
Total equity and liabilities	381 000

REQUIRED

(d) Prepare Rezwan's statement of financial position at 1 October 2013 immediately after acquiring Nimra's business. [14]

(e) Explain why the directors of Rezwan Limited are prepared to pay more for the assets acquired than their book value. [6]

June 2014

Q # 7 Ayanda and Bola have been in partnership for many years, sharing profits in the ratio of 3:2 respectively. The annual profit has been $60 000 for some years.
On 1 June 2013 the partnership books of account showed the following balances.

		$
Capital account	Ayanda	40 000
	Bola	25 000
Current account	Ayanda	17 000 Cr
	Bola	2 500 Dr
Bank		3 500 Dr
Trade payables		4 000

On that date the business was sold to Hetl Limited for a purchase consideration of $140 000.
This consisted of 50 000 $1 ordinary shares in Hetl Limited with a market value of $1.80, to be shared equally, and the balance in cash. Hetl Limited took over all the assets and liabilities of the business with the exception of the bank account and the trade payables

REQUIRED

(a) Calculate the gain on realisation arising from the sale of the partnership. [5]

(b) Calculate the amount in cash due to **each** partner on the sale of the partnership. [5]

(c) Prepare the partnership bank account showing the entries to close the account. [5]

Additional information

Bola thinks it is unfair that Ayanda received more cash than she did.

REQUIRED

(d) Give four reasons **why** it is fair that Ayanda received more cash than Bola. [4]

Additional information

Hetl Limited pays a dividend of $0.25 per share each year. Surplus funds can be put on deposit in a bank and earn 6% interest a year.
Ayanda has accepted a job with Hetl Limited at a salary of $20 000 a year.

REQUIRED

(e) Compare Ayanda's current income with his earnings as a partner. [5]

(f) Suggest **one** non-financial reason why Ayanda might prefer to be an employee rather than a partner. [1]

SP 2016

Q # 8 Anjali and Bailey trade as partners. They share profits and losses in the ratio 3:2.
At 30 April 2016 the statement of financial position of the partnership was as follows:

	$
Assets	
Non-current assets	
Premises	115 000
Machinery	40 000
Vehicles	78 000
	233 000
Current assets	
Inventory	15 000
Trade receivables	4 000
	19 000
Total assets	252 000
Capital and liabilities	
Capital	
Anjali	130 000
Bailey	110 000
	240 000
Current liabilities	
Trade payables	7 500
Cash and cash equivalents	4 500
	12 000
Total capital and liabilities	252 000

The partners agreed to form a limited company, XY Limited, to take over their business.

Additional information

The following information relates to the partnership.
1 Two vehicles were taken over by the partners at the following valuations.

	$
Anjali	15 000
Bailey	12 500

2 The remaining assets were transferred to XY Limited at the following agreed values.

	$
Premises	170 000
Machinery	30 000
The remaining vehicles	35 000
Inventory	9 000

3 Cash collected from trade receivables was $3900.

4 Trade payables accepted $7100 in full settlement of amounts due to them.

5 Costs involved in dissolving the partnership were $3800.

6 The purchase consideration for the partnership of Anjali and Bailey was $255 000. This was made as follows: 60000 7% preference shares of $1 each distributed in profit-sharing ratios.
The balance as ordinary shares of $1 at a premium of $0.25 per share distributed to the partners in proportion to their capital account balances at 30 April 2016.

7 Anjali and Bailey agreed to pay into the business bank account sufficient money to cover any deficit on their capital accounts after the shares had been issued.

REQUIRED

(a) (i) Prepare the realisation account for Anjali and Bailey. [7]

(ii) Prepare the capital accounts of Anjali and Bailey on the realisation of the partnership. [7]

(iii) Calculate the **total** amount of share premium payable to Anjali and Bailey. [2]

(b) Assess the effect for Anjali and Bailey if the ordinary shares have been distributed in the profit sharing ratio rather than in proportion to their capital balances. [4]

(c) Explain whether or not Anjali and Bailey made the correct decision to form a limited company. Justify your answer. [5]

June 2016

Q # 9 Husna had been a sole trader for many years and has decided to retire. Her statement of financial position at 30 June 2016 was as follows:

Statement of Financial Position at 30 June 2016

Assets	$
Non-current assets	
Premises	120 000
Equipment	14 600
	134 600
Current assets	
Inventory	29 500
Trade receivables	17 200
	46 700
Total assets	181 300
Capital and liabilities	
Opening capital	162 100
Profit for the year	41 600
	203 700
Drawings	36 000
Closing capital	167 700
Current liabilities	
Bank	2 000
Trade payables	11 600
	13 600
Total capital and liabilities	181 300

On 30 June 2016 Husna sold her business to FLF Limited.

The statement of financial position of FLF Limited at 30 June 2016 **before** the sale was as follows:

Statement of Financial Position at 30 June 2016

Assets	**$**
Non-current assets	
Premises	815 100
Equipment	190 900
Vehicles	81 500
	1 087 500
Current assets	
Inventory	103 600
Trade and other receivables	99 400
Cash and cash equivalents	7 100
	210 100
Total assets	1 297 600
Equity and liabilities	
Equity	
800 000 ordinary shares of $1 each	800 000
Retained earnings	322 500
General reserve	80 000
Total equity	1 202 500
Current liabilities	
Trade and other payables	95 100
Total equity and liabilities	1 297 600

For the sale of the business, Husna's premises were revalued at $280 000 and trade receivables balances of $1200 were written off.

FLF Limited took over all the assets and liabilities of Husna's business **except** the bank account.

The total purchase consideration was $440 000. This was made up as follows:

Cash	$70 000
8% debentures (2025)	$120 000
$1 ordinary shares issued at a premium	100 000 shares

At the same time as the business purchase, the directors of FLF Limited decided to have their own premises revalued. The premises were revalued at $1 000 000.

REQUIRED

(a) Prepare the statement of financial position of FLF Limited on 1 July 2016 immediately **after** the purchase of Husna's business. [16]

Additional information

FLF Limited's dividend yield is 3%. A bank deposit account pays interest of 4%.
Husna's young nephew is disappointed with his aunt's decision to sell the business. He says that if she wanted to retire she could have appointed him to manage the business at an annual salary of $20000.

REQUIRED

(b) Assess whether Husna made the right decision in selling the business. Support your answer with calculations. [9]

Nov 2016

Q # 10 Alex and Brown were in partnership sharing profits and losses in the ratio of 3 : 2 respectively. They provided the following information at 31 October 2016:

	$	$	$
Land and buildings			320 000
Plant and machinery			135 000
Motor vehicles			110 000
Inventory			38 000
Trade receivables			54 000
Cash and cash equivalents			19 000
Trade payables			(39 000)
			637 000
	Alex	Brown	
Capital accounts	300 000	200 000	500 000
Current accounts			
Balance at 1 November 2015	72 000	57 000	
Partners' salaries	30 000	45 000	
Interest on capital	15 000	10 000	
Share of residual profit	36 000	24 000	
Drawings	(77 000)	(75 000)	
Balance at 31 October 2016	76 000	61 000	137 000
			637 000

C Limited purchased this partnership business on 1 November 2016. They took over all the assets and liabilities with the exception of:
Cash and cash equivalents
One motor vehicle which was taken over by Alex at an agreed value of $28 000

The remaining assets taken over by C Limited had the following values:

	$
Land and buildings	450 000
Plant and machinery	120 000
Motor vehicles	60 000
Inventory	49 000
Trade receivables	52 000

The purchase consideration was five times the partnership profit for the year ended 31 October 2016. This purchase consideration was settled by C Limited as follows:

1 $127500 cash was paid into the partnership bank account.

2 Alex and Brown were issued an amount of 8% debentures. Both will continue to receive the same amount of interest as they had received from the interest on capital.

3 The balance of the purchase consideration was settled by an issue of $1 ordinary shares at a price of $1.80 each. The shares were distributed between the partners in their profit and loss sharing ratios.

REQUIRED

(a) State what is meant by 'goodwill'. [1]

(b) Calculate the value of goodwill paid for by C Limited. [4]

(c) Calculate the total profit on realisation due to the partners. [4]

(d) Prepare the partners' capital accounts to close their business. [11]

Additional information

The capital employed of C Limited at 31 October 2016 before purchasing the partnership business was as follows:

	$
Ordinary shares of $1 each	3400 000
Share premium	300 000
Retained earnings	816 000
	4 516 000

The company made a profit for the year ended 31 October 2016 of $352000.
The directors of C Limited estimate that the profit for the coming year after purchasing the partnership business will be increased to $540 000.

REQUIRED

(e) Discuss the advantages to C Limited, other than increase in the profit, of purchasing Alex and Brown's business. [5]

June 2017

Q # 11 Wembo and Bob are in partnership. They share profits and losses in the ratio 3:2. Another business, C Limited, has been trading for many years.
At 31 March 2017 the summarised statements of financial position of both businesses were as follows:

	Wembo and Bob	C Limited
	$	$
Premises	80 000	282 000
Machinery	45 000	112 000
Vehicles	28 000	–
Inventory	15 000	49 000
Trade receivables	6 000	36 000
	174 000	479 000
Capital accounts		
Wembo	100 000	
Bob	60 000	
Equity and reserves		
Ordinary shares of $1 each		300 000
Share premium		75 000
Revaluation reserve		25 000
Retained earnings		40 000
		440 000
Trade payables	9 000	26 000
Bank overdraft	5 000	13 000
	174 000	479 000

REQUIRED

(a) State what is meant by the term 'revaluation reserve'. [1]

Additional information

The directors of C Limited have decided to purchase Wembo and Bob's partnership on 31 March 2017.

The following information relates to the purchase of Wembo and Bob's partnership.

1 Two vehicles were taken over by the partners at the following agreed values:

	$
Wembo	11 000
Bob	12 500

2 The following partnership assets, excluding the partnership overdraft, were transferred to C Limited at the following agreed values:

	$
Premises	90 000
Machinery	36 000
Other vehicles	3 500
Inventory	13000

3 Cash collected from trade receivables was $4900.

4 Trade payables accepted $8100 in full settlement of amounts due to them.

5 Costs involved in dissolving the partnership were $3800.

6 The purchase consideration for the partnership was $155 000. This was made up as follows: $60000 was from the issue of 7% cumulative preference shares of $1 each distributed in profit-sharing ratio.
The balance was by the issue of ordinary shares of $1 at a premium of $0.25 per share.
These shares were distributed to the partners in proportion to their capital account balances at 31 March 2017.

REQUIRED

(b) Prepare the partners' capital accounts at 31 March 2017 to show the closing entries for the partnership. [16]

(c) Prepare the equity and reserves section of the statement of financial position for C Limited at 31 March 2017 immediately after the purchase of the partnership. [4]

(d) Explain **one** benefit to Wembo and Bob of receiving:

(i) Ordinary shares

(ii) Cumulative preference shares. [4]

Nov 2017

Q # 12 R Limited has been trading for one year and is considering whether or not to purchase the business of Joe Tu, a sole trader.
The draft statements of financial position for both businesses at 31 December 2017 are shown below:

	R Limited	Joe Tu
	$	$
Non-current assets (at net book value)		
Land and buildings	454 000	128 000
Plant and equipment	294 000	30 000
	748 000	158 000
Current assets		
Inventory	98 000	35 000
Trade receivables	123 000	39 000
Cash and cash equivalents	58 000	2 800
	279 000	76 800
Total assets	1 027 000	234 800
Equity and liabilities		
Equity		
Ordinary shares of $1 each	800 000	
Capital at 1 January 2017		160 000
Profit for the year	132 000	19 800
Drawings		(12 000)
	932 000	167 800
Current liabilities		
Trade payables	95 000	67 000
Total equity and liabilities	1 027 000	234 800

The following information is also available.
Robert and Paul are the only shareholders and directors of R Limited. As part of the purchase agreement, Joe Tu will be appointed as a director of R Limited with an annual director's fee of $30000, the same amount as Robert and Paul each receive.

The sales revenue and gross margin for both businesses for the year ended 31 December 2017 were:

	R Limited	Joe Tu
Sales revenue	$1 500 000	$250 000
Gross margin	50%	45%

Robert is in favour of buying Joe Tu's business and of him becoming a director. He believes that for the year ended 31 December 2018:

Combined sales revenue can be increased by 20%, earning a gross margin of 50%.
Combined operating expenses, other than directors' fees, can be reduced by 30%.
However, Paul is not happy about buying Joe Tu's business or him becoming a director.

Required

(a) (i) Prepare a statement to calculate the operating expenses for each business for the year ended 31 December 2017. [4]

(ii) Prepare a statement to calculate the expected additional profit R Limited will make for the year ended 31 December 2018 if it buys Joe Tu's business. [4]

Additional information

1 Purchase consideration will be $180 000 payable to Joe Tu by issuing 150 000 ordinary shares of R Limited.

2 R Limited will take over Joe Tu's assets and liabilities, except the bank account, at the following values:

	$
Land and buildings	139 000
Plant and equipment	14 000
Inventory	40 000
Trade receivables	36 000
Trade payables	67 000

3 The directors of R Limited will also revalue their own land and buildings upwards by $28 000.

(b) State why a business may revalue its assets when it is being purchased by another business. [1]

(c) Prepare the statement of financial position of R Limited at 31 December 2017 if Joe Tu's business was purchased by it on that date. [11]

(d) Advise Robert and Paul whether or not they should buy Joe Tu's business. Justify your answer by discussing the non-financial advantages and disadvantages of this action. [5]

March 2018

Q # 13 Alfie and Bob have been in partnership sharing profits and losses in the ratio of 3 :2.
On 1 January 2018, the partnership business was acquired by G Limited.
The statements of financial position at 31 December 2017 for both businesses were as follows:

	G Limited	Alfie and Bo
	$	$
Assets		
Non-current assets		
Land and buildings	625 000	320 000
Plant and machinery	254 000	178 000
	879 000	498 000
Current assets		
Inventory	142 000	112 000
Trade receivables	251 000	130 000
Cash and cash equivalents	92 000	–
	485 000	242 000
Total assets	1 364 000	740 000
Equity and liabilities		
Equity		
Ordinary shares of $5 each	1 000 000	–
Capital accounts: Alfie	–	285 000
Bob	–	274 000
Retained earnings	194 000	–
	1 194 000	559 000
Current liabilities		
Trade payables	170 000	155 000
Bank overdraft	–	26 000
	170 000	181 000
Total equity and liabilities	1 364 000	740 000

The following information is also available.

1 All assets and liabilities of the partnership, except the bank overdraft, were taken over by G Limited at the following values:

	$
Land and buildings	350 000
Plant and machinery	170 000
Inventory	110 000
Trade receivables	125 000
Trade payables	153 000

2 Goodwill of the partnership at 1 January 2018 was valued at twice the value of average profits for the last two years. The profits for the year for 2016 and 2017 were $13 000 and $17 000.

3 The purchase consideration was satisfied with 100 000 ordinary shares in G Limited at $6 per share. The remaining balance was paid in cash.

4 Ordinary shares of G Limited were issued to Alfie and Bob according to their profit sharing ratio.

Required

(a) State one reason why the assets and liabilities may be revalued when a partnership is sold. [1]

(b) Calculate for the sale of partnership:

(i) the total purchase consideration [3]

(ii) the amount paid to partners in cash. [2]

(c) Prepare the statement of financial position of G Limited at 1 January 2018 immediately after the purchase of the partnership. [10]

(d) Prepare the capital accounts of Alfie and Bob to close the partnership business. [4]

Additional information

The profit for the year ended 31 December 2017 for G Limited was $69 000. The directors expect that this will increase for the following year to $100 000 after the partnership business is acquired.

(e) Evaluate whether or not the directors were right to acquire the partnership. Support your answer with reference to the change in return on capital employed, as a result of the acquisition of the partnership. [5]

Nov 2018

Q # 14 X Limited acquired the partnership business of Amy and Beth on 1 January 2018. The statement of financial position of each business at 31 December 2017 was as follows**:**

	Amy and Beth	X Limited
	$	$
Non-current assets	142 000	654 000
Current assets		
Inventory	38 000	82 000
Trade receivables	49 000	83 700
Cash and cash equivalents	4 000	98 400
	91 000	264 100
Total assets	233 000	918 100
Equity and liabilities		
Ordinary shares of $1 each		700 000
Retained earnings		144 500
Capital account		
Amy	120 000	
Beth	80 000	
	200 000	
Current account		
Amy	3 500	
Beth	(1 500)	
	2 000	
Current liabilities		
Trade payables	31 000	73 600
Total equity and liabilities	233 000	918 100

The following information is also available.
1 X Limited took over all the assets and liabilities of the partnership business, except the cash and cash equivalents, at the following values

	$
Non-current assets	148 000
Inventory	41 000
Trade receivables	47 000
Trade payables	30 000

2 The purchase consideration was $240 000. This consisted of an issue of 90000 ordinary shares divided equally between the partners. Each ordinary share had a market value of $2.50 at 1 January 2018. The balance was paid in cash.

3 Amy and Beth share profits and losses in a ratio of 4:3

Required

(a) Calculate the profit or loss made by the partners on the sale of their business to X Limited. [4]

(b) Prepare the capital accounts of Amy and Beth to show the closure of their partnership business. [5]

(c) Prepare the statement of financial position of X Limited at 1 January 2018 immediately after the acquisition of the partnership. [9]

(d) State two advantages to a company of purchasing another business. [2]

Additional information

Retained earnings of X Limited at 31 December 2017 and 31 December 2018 were as follows

	31 December 2017	31 December 2018
	$	$
Retained earnings – start of the year	81 500	144 500
Profit for the year	168 000	145 000
Dividend paid	(105 000)	(97 500)
Retained earnings – end of the year	144 500	192 000

(e) Assess whether or not X Limited has made the right decision to acquire the partnership business. Support your answer using relevant calculations. [5]

Nov 2019

Q # 15 Alice and Bruno had been in partnership for some years when they decided to sell their business to D Limited on 31 December 2018.
The statements of financial position of the two businesses on that date were as follows

	Alice and Bruno $000	D Limited $000
Non-current assets		
Land and buildings	80	320
Equipment	20	77
	100	397
Current assets		
Inventory	25	68
Trade receivables	15	41
Bank	7	76
	47	185
Total assets	147	582
Equity		
Capital accounts		
Alice	75	
Bruno	30	
	105	
Current accounts		
Alice	24	
Bruno	6	
	30	
Ordinary share capital ($1 shares)		300
Retained earnings		153
		453
Non-current liabilities		
Debentures		100
Current liabilities		
Trade payables	12	29
Total equity and liabilities	147	582

The following information is also available:

1 Return on capital employed (ROCE) before acquisition and before revaluation of assets was:

Alice and Bruno	8%
D Limited	6%

2 The purchase consideration for the acquisition of the partnership was $266 000. This consisted of the following:
$56 000 in cash
$60 000 in 8% debentures repayable in 2026

100 000 ordinary shares of $1 each in D Limited at a premium

3 The partnership land and buildings were taken over at a valuation of $195 000. All other assets and liabilities except bank were taken over at book value

Required

(a) Prepare, in the books of D Limited, the journal entry needed to record the acquisition of the partnership on 31 December 2018. A narrative is not required. [9]

(b) Calculate the gearing ratio of D Limited:

(i) Before the acquisition [2]

(ii) After the acquisition. [2]

(c) Calculate, to two decimal places, the ROCE of D Limited after the acquisition of the partnership. [5]

(d) Advise the directors of D Limited whether or not they made a good decision in acquiring the partnership. Justify your answer, making reference to your answers to parts (b) and (c). [5]

(e) State two advantages of being a shareholder in a limited company instead of being a partner in a partnership. [2]

Nov 2019