3.3 PARTNERSHIP FINAL ACCOUNTS

Advantages and Disadvantages of Partnerships

Advantages
- There is the possibility of increased capital
- Individual partners may be able to specialise areas of the business
- More cover for illness and holidays

Disadvantages
- Decisions take longer
- May be disagreements between partners
- Each partner is liable in law for the whole firm
- The retirement or death of one partner may affect the business

The accounting requirements of partnerships are:

- Follow the rules set out to the Partnership Act 1890
- Or the partners agree amongst themselves, by means of a partnership agreement

<u>The Partnership Act 1890</u>

- Profits and losses are to be shared equally between the partners
- No partners is entitled to a salary
- Partners are not entitled to receive interest on their capital
- Interest is not to be charged on partners' drawings

<u>Partnership Agreement Includes</u>

- Division of profits and losses between parties
- Partners' salaries/commission
- Whether interest is to be allowed on capital and at what rate
- Whether interest is to be charged on partners' drawings, and at what rate

The Partnership Act states that, *in the absence of an agreement to the contrary, profits and losses are to be shared equally*.

The capital amount is normally fixed, and only alters if a permanent increase or decrease in capital contribution by the partner takes place.

Dr	Partner Aye: Current Account Cr
Share of loss	Balance B/D
Drawings/Goods for own use	Share of profit
Interest charged on drawings	Salary/Commission
Balance C/D	Interest on Capital

BALANCE SHEET (EXTRACT) AS AT X

FINANCED BY	**£**	**£**
Capital Accounts		
Partner A	X	
Partner B	<u>X</u>	
		X
Current Accounts		
Partner A	X	
Partner B	<u>X</u>	
		X

<u>Commenting on Partnership Financial Statements</u>

- The terms of the Partnership Act 1890, regarding sharing profits and losses
- The merits of having a partnership agreement
- The circumstances under which partners use capital accounts only
- The arguments for and against the use of capital and current accounts

The distinction between a partner's loan account and capital account

3.6 CASH FLOW STATEMENTS

Reconciliation of profit from operations to net cash from operating activities for the year ended…	
Profit from operations	X
Adjustments for:	
Depreciation	X
Disposal of non-current assets	(X)
Dividends received	(X)
Inventories	X
Trade receivables	(X)
Trade payables	(X)
Cash generated from operations	X
Interest paid	(X)
Tax paid	(X)
Net cash from operating activities	X
Statement of cash flow for the year ended…	
Net cash from operating activities	
Investing Activities	
Purchases of non-current assets	(X)
Proceeds of disposal of non-current assets	X
Interest received	X
Dividends received	X
Net cash used in investing activities	(X)
Financing Activities	
Proceeds from issue of share capital	X
Bank loans	X
Dividends paid	(X)
Net cash used in financing activities	(X)
Net increase/decrease in cash and cash equivalents	X
Cash and cash equivalents at beginning of year	X
Cash and cash equivalents at end of year	X

Advantages

-Can alert users to liquidity problems
-Shows how good profit is converted to cash
-Not affected by accounting policies or estimates
-Can help users to predict future cash flows
-Easier to understand than profits

Disadvantages

-Cash balances can be manipulated
-It is possible to focus on cash flow instead of profits
-Historical information is not necessarily a reliable indicator of future cash flows

Assessing the statement of cash flows

- Has cash increased or decreased in the period?
- Does the entity have a positive or negative cash balance or an overdraft?
- Have inventories, receivables and payables increased or decreased?
- If there has been capital expenditure, where has the cash come from?
- Is debt increasing or decreasing?

Is the entity likely to need additional long term finance?