

Source B for Question 2

Ada and Brian had been in partnership for thirty years, sharing profits and losses in the ratio of 3:2 respectively. They agreed to sell their business to W Limited on 1 January 2025. W Limited took over all the assets except cash at bank. Trade payables were fully settled by the partnership at \$76 000.

The statement of financial position immediately prior to the sale of the partnership business was as follows:

Statement of financial position at 31 December 2024		
	\$	\$
Non-current assets		
Equipment	186 000	
Motor vehicles	55 000	241 000
Current assets		
Inventory	73 000	
Trade receivables	94 000	
Cash at bank	14 000	181 000
Total assets		422 000
Capital account		
Ada	200 000	
Brian	150 000	350 000
Current account		
Ada	(10 000)	
Brian	5 000	(5 000)
Current liabilities		
Trade payables		77 000
Total equity and liabilities		422 000

The following information is also available.

- The value of assets taken over by W Limited was agreed upon as:

	\$
Equipment	174 000
Motor vehicles	48 000
Inventory	89 000
Trade receivables	91 000

- The value of goodwill of the partnership was agreed at three times the average profit for the past three years. The profits of the partnership for the past three years were:

Year	\$
2024	37 100
2023	41 300
2022	44 600

- The purchase consideration was fully satisfied by the issue of new ordinary shares of W Limited at a value of \$1.75 per share. The shares were to be allocated to the partners according to their profit and loss sharing ratio. Before the takeover, W Limited had five million \$1 ordinary shares in issue.



2 Read Source B in the insert.

(a) State **three** differences between goodwill and a tangible asset.

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(b) Calculate the purchase consideration payable by W Limited.

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..... [3]

(c) Complete the capital accounts of Ada and Brian on **page 9**, showing the final settlement with the partnership's cash at bank account.





Capital accounts

	Ada \$	Brian \$		Ada \$	Brian \$

Workings:





(d) Prepare the journal entry of W Limited to record the acquisition of the partnership business.

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Additional information

In negotiating the terms of the sale of the business, Ada and Brian initially requested that goodwill be valued at five times the average profit of the last three years, but W Limited only offered two times. They finally reached an agreement of three times.

(e) Explain why W Limited did **not** accept the initial request for five times the average profit. Support your answer with relevant calculations.

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Question	Answer	Marks
1(c)	<p>Advise whether or not CF Limited has made a good decision to take over the delivery services. Justify your answer.</p> <p>Good decision (max 2) In-house costs should be lower as no profit for contractors (1) Provide better service (on time / speedy) to the customers (1) No need to renew service contract with the transportation company (1)</p> <p>Bad decision (max 2) Negative impact on the cash flows (1) Need additional finance / interest may have to be paid (1) Incur additional expenses such as salaries for drivers and depreciation (1)</p> <p>Decision supported with a comment (1)</p> <p>Accept other valid responses.</p>	5

Question	Answer	Marks												
2(a)	<p>State <u>three</u> differences between goodwill and a tangible asset.</p> <table border="1"> <tr> <td>Goodwill</td><td>Tangible asset</td><td></td></tr> <tr> <td>No physical existence</td><td>Has physical existence</td><td>(1)</td></tr> <tr> <td>Cannot be sold separately</td><td>Can be sold separately</td><td>(1)</td></tr> <tr> <td>The value tends to be subjective</td><td>The value tends to be objective</td><td>(1)</td></tr> </table> <p>Max 3</p> <p>Accept other valid responses.</p>	Goodwill	Tangible asset		No physical existence	Has physical existence	(1)	Cannot be sold separately	Can be sold separately	(1)	The value tends to be subjective	The value tends to be objective	(1)	3
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2(b)	<p>Calculate the purchase consideration payable by W Limited.</p> <table><tr><td></td><td>\$</td><td></td></tr><tr><td>Total value of assets taken over</td><td>402 000</td><td>(1)</td></tr><tr><td>Goodwill W1</td><td>123 000</td><td>(1)</td></tr><tr><td>Purchase consideration</td><td><u>525 000</u></td><td>(1)OF</td></tr></table> <p>W1 (\$37 100 + \$41 300 + \$44 600)/3 = \$41 000 \$41 000 × 3 = \$123 000</p>		\$		Total value of assets taken over	402 000	(1)	Goodwill W1	123 000	(1)	Purchase consideration	<u>525 000</u>	(1)OF	3																																																																						
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2(e)	<p>Explain why W Limited did not accept the initial request for five times the average profit. Support your answer with relevant calculations.</p> <p>W Limited can pay less purchase consideration / issue fewer shares to acquire the partnership business. (1) The future profit is only estimated on the basis of the profits of past years. (1) The partnership's financial statements have not been audited. (1) It is difficult to estimate whether the partnership's profit can sustain at its current level for the coming 5 years as proposed by Ada and Brian (1) There are uncertainties in the future, such as economic outlook, trend, demand, technology and political issues. (1) The profit of the partnership is in the declining trend in the last 3 years. (1)</p> <p>Goodwill = 2 × \$41 000 = \$82 000 (1) Goodwill = 5 × \$41 000 = \$205 000 (1)</p> <p>Max 2 marks for calculations. Max 2 marks for comments Accept other valid responses.</p>	4																											

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Question	Answer	Marks
2(f)	<p>Evaluate whether or not Ada and Brian made the right decision to choose option 1. Justify your answer.</p> <p>They are only minor shareholders and cannot make any decision (1) Given that the value of each share has a premium of \$0.75, this implies that the prospect of W Limited is promising (1) They can enjoy dividend / increase in share value (1) They may not receive dividend / share value may fall (1) They can use the cash for any other purposes (1) After running the partnership business for thirty years, it is better for them to keep cash for their retiring life. (1) It may be difficult for Ada and Brian to realise their shareholdings. (1)</p> <p>Max 4 Decision supported with a comment (1) Accept other valid responses.</p>	5