

Business acquisition and merger A2

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Read first: **Preparation of financial statements, Accounting for non-current assets, Regulatory and ethical considerations**

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What you need to know

By the end of this topic you should be able to:

1. **Explain what a merger is and why businesses merge.** Know the kinds of combination: two or more sole traders joining to form a partnership or a limited company, a sole trader joining an existing partnership to form a new partnership, and a limited company buying (acquiring) a sole trader's business or a partnership.
2. **Record a merger or an acquisition with journal entries and ledger accounts,** in the books of the business that is sold (the realisation account, the owners' capital accounts and the bank account) and in the books of the business that buys it or is formed.
3. **Calculate goodwill** when one business acquires another: the price paid minus the fair value of the net assets taken over, or a value agreed from past profits.
4. **Prepare the statement of profit or loss and the statement of financial position** of the new or enlarged business after the merger or acquisition, for example a company straight after it has bought a partnership.
5. **Weigh up the advantages and disadvantages** of an acquisition or merger for everyone involved, and use the figures to give advice and make a decision.

Dissolving a partnership for other reasons, and changes in partners (admission, retirement), belong to "Preparation of financial statements" at A Level. Here the business is always sold to, or joined with, another business.

Understand it

Merger or acquisition?

A **merger** is when two or more businesses join together as equals to form **one new business**. The old owners all become owners of the new one: two sole traders might become partners, or form a company and become its shareholders; a sole trader might join a partnership as a new partner.

An **acquisition** (a takeover or business purchase) is when one business **buys** another. In this syllabus the buyer is a limited company, and the seller (the **vendor**) is a sole trader or a partnership. The vendor's business closes, and its owners are paid with cash, shares or debentures in the company.

Why businesses join together

For the buyer or the merged business	For the owners who sell or merge
Growth without building a business from nothing	A price for the goodwill they built up over the years
Economies of scale and synergy: bulk buying, one office, one set of staff, so lower costs	Limited liability as a shareholder, instead of unlimited liability
More customers and market share; a rival is removed	Shares may pay dividends and may rise in value
New markets or products (diversification), new locations	Debentures pay fixed interest , even when there is no profit
Skills and experience of the new owners and staff	Cash to retire on, or to start something new; less work and risk
Control over a supplier or a customer (vertical integration)	Risk and losses shared with other partners (in a merger)

And against:

For the buyer or the merged business	For the owners who sell or merge
Goodwill is hard to value; the buyer may overpay	Loss of control : a small shareholder or a minority partner has little say
Future profits are only estimates, and may not arrive	Dividends are not guaranteed; the share price may fall

For the buyer or the merged business	For the owners who sell or merge
Culture clash , staff unrest, redundancy costs	Profit is shared ; disagreements with new partners
Issuing shares dilutes the existing shareholders' control	Shares in a private company may be hard to sell
Borrowing or debentures raise gearing and interest costs	Staff made redundant may harm the owners' reputation

Purchase consideration and goodwill

The **purchase consideration** is the total price the buyer pays. It can be made up of cash, the buyer's ordinary shares, its debentures, or a mix.

The buyer usually pays **more** than the value of the separate assets less liabilities it takes over. The extra is **purchased goodwill**: the amount paid for the business's reputation, loyal customers, location, skilled staff and good supplier relationships, which will bring future profits.

$$\text{goodwill} = \text{purchase consideration} - \text{fair value of the net assets taken over}$$

Fair value means the agreed (revalued) figures, not the vendor's book values. For example, a company pays \$300 000 for a business whose assets are agreed at \$320 000 and whose liabilities taken over are \$45 000. Net assets = 320 000 – 45 000 = 275 000, so goodwill = 300 000 – 275 000 = 25 000.

Often the **goodwill is agreed first**, as a multiple of the average profit of recent years, and the consideration is built from it:

$$\text{purchase consideration} = \text{agreed value of the net assets taken over} + \text{goodwill}$$

For example, profits of \$40 000, \$44 000 and \$48 000 give an average of \$44 000; at two times average profit, goodwill is \$88 000. Past profit is used because it is evidence of what the business can earn in future. But it is only evidence: profits may be falling, the figures may not be audited, and the future (demand, competition, the economy) is uncertain. That is why a buyer resists a high multiple.

Goodwill is an **intangible asset**: an identifiable non-monetary asset without physical substance. Compared with a tangible asset such as machinery:

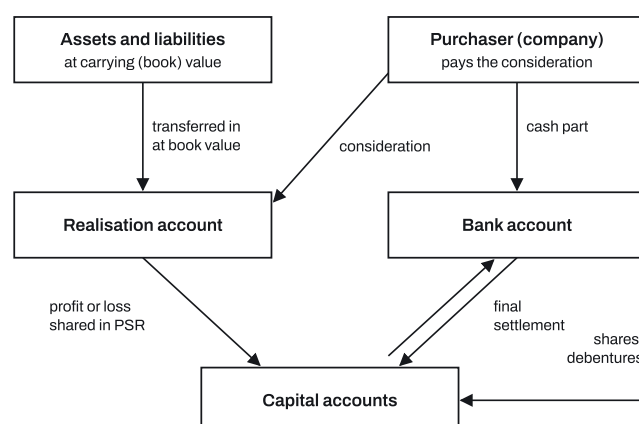
Goodwill	Tangible asset
No physical form	Has physical form
Cannot be sold on its own, separately from the business	Can be sold separately
Its value is subjective and can change quickly	Its value can be checked more objectively (a price, a valuation)

Inherent goodwill (goodwill a business has built up itself) is **never recorded** in the books, because there is no reliable figure for it: it has not been bought. Only **purchased goodwill** is recorded, by the buyer, as a non-current asset. When partners merge and agree a value for goodwill but decide not to keep it in the books, they create it in the capital accounts and then write it off again (see "Merging into a new partnership").

The seller's side: closing the books

When a sole trader or partnership is sold, every account is closed. Three accounts do the work:

1. **Realisation account.** It collects the assets and liabilities taken over, at their **book (carrying) values**, and compares them with what is received. The difference is the **profit or loss on realisation**, shared between the partners in their profit-sharing ratio (all of it to a sole trader).
2. **Capital accounts.** Each owner's capital (plus current account) balance, plus their share of the realisation profit, is paid out to them with shares, debentures, assets they keep, and finally cash.
3. **Bank account.** It receives the cash part of the consideration, pays any costs of the sale and any liabilities the buyer did not take over, and pays each owner what is left, so it closes at nil.



The entries in the realisation account:

Debit realisation account	Credit realisation account
Each asset taken over or kept by a partner, at book value (not the bank, if the seller keeps it)	Each liability taken over by the buyer, at book value
Costs of the sale paid by the seller: legal fees, redundancy pay (credit bank)	The purchase consideration (debit the buyer's account)
Profit on realisation , to the capital accounts	Assets taken over by a partner, at the agreed value (debit that partner's capital)
	Discount received when the seller pays its own payables for less than the book value
	A loss on realisation, if the debit side is bigger

Profit on realisation can also be found in one line, which is useful as a check:

profit = consideration + agreed value of assets kept by partners + discounts received – book value of net assets transferred – costs of the sale

Shares and debentures received are shared between the partners as the agreement says: in the profit-sharing ratio, equally, or in proportion to their capital balances. Read that sentence of the question carefully.

Shares issued at a premium

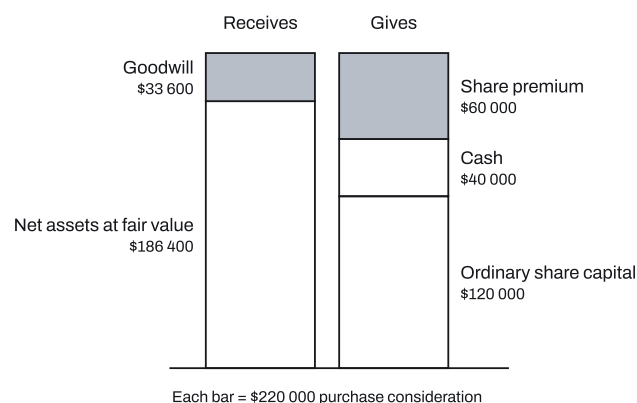
A company often pays with its own ordinary shares valued **above their nominal value**. For example, 120 000 shares of \$1 each, valued at \$1.50, are worth \$180 000. In the company's books, the **nominal value** goes to ordinary share capital (\$120 000) and the **excess to share premium** (120 000 × \$0.50 = \$60 000). In the seller's books the shares simply count at their full value, \$180 000. The number of shares to issue is value ÷ issue price: shares worth \$238 000 at \$1.40 each means 170 000 shares.

The buyer's side

The company records what it has bought and what it has given, in one journal entry:

Debit	Credit
Each asset taken over, at its agreed (fair) value	Each liability taken over, at its agreed value
Goodwill (the balancing figure)	Ordinary share capital (nominal value of the shares issued)
	Share premium (the excess over nominal value)
	Debentures (their nominal value)
	Bank (the cash paid)

The company's statement of financial position afterwards is its **old** figures plus the assets and liabilities taken over at agreed values, plus goodwill under non-current assets (intangible), with the new share capital and share premium, and the bank reduced by any cash paid.



The diagram is Worked example 1: both sides are worth \$220 000, which is why the journal balances.

Merging into a new partnership

When a sole trader joins a partnership, or two sole traders merge, each owner brings their own business. To be fair to everyone before the new profit-sharing ratio starts:

1. **Revalue each business's assets and liabilities.** A gain or loss belongs to the owners of **that** business only, shared in **their old** ratio.
2. **Value each business's goodwill** and credit it to the owners of **that** business only, in their old ratio.
3. If goodwill is **not** to be kept in the books, write the **total** goodwill off by debiting **all** the new partners in the **new** ratio.
4. Deduct any asset a partner takes for private use.

The new business's statement of financial position adds the two businesses' assets and liabilities together at their **revalued** figures, with no goodwill and without any asset a partner took. For a first-year statement of profit or loss of the merged business, add the two businesses' revenues and costs line by line, then apply any savings the merger brings (for example "administrative expenses will fall by 10%").

Key facts and formulas

The 9706 exam has no formula list, so every formula here is **Learn it**.

Formula	Status
Net assets taken over = assets taken over – liabilities taken over	Learn it
Goodwill = purchase consideration – fair value of net assets taken over	Learn it
Goodwill = multiple × average profit of the stated years	Learn it
Purchase consideration = agreed net assets + goodwill; or cash + value of shares + debentures	Learn it
Profit on realisation = credits – debits of the realisation account (see the one-line version above)	Learn it
Share capital = number of shares × nominal value; share premium = number of shares × (issue price – nominal value)	Learn it
Number of shares = value to be settled in shares ÷ issue price	Learn it
Cash to (or from) a partner = capital + current account + share of realisation profit – shares and debentures received – assets taken	Learn it
Dividend per share = profit for the year ÷ dividend cover ÷ number of shares	Learn it
Dividend yield = dividend per share ÷ market price per share × 100%	Learn it

Signs to remember: book values go into the realisation account; agreed values go into the buyer's journal; an asset a partner keeps is at its agreed value on both sides of its entry (credit realisation, debit capital).

How to do it

In the Paper 3 questions we have tagged for this topic (17 questions, 2021–2025, 15 different because two appeared in two papers), the types came up this often. Every one is a 25-mark question that mixes several types, so the counts add up to much more than 17.

Question type	Questions
Close the seller's capital accounts (final settlement)	11
Advise the seller	11
Calculate purchase consideration or goodwill	7
Explain goodwill	7
Journal entry in the buyer's books	6
Realisation account or profit on realisation	6
Reasons for, or benefits of, an acquisition or merger	5
Advise the buyer	5
Merger into a new partnership: each partner's new capital	4
Financial statements of the merged business	4
The seller's bank account, or the account of the buyer	4
Other short theory	4

Question type	Questions
The buyer's statement of financial position after the acquisition	3

1. Close the seller's capital accounts (11 questions)

1. **Set up columnar capital accounts**, one column per partner on each side.
2. **Credit** the opening capital balances. Transfer the **current accounts**: a credit balance is credited to capital; a **debit (overdrawn)** balance is **debited**.
3. **Credit** each partner's share of the **profit on realisation** (debit it for a loss).
4. **Debit** any asset a partner takes over, at its **agreed** value.
5. **Debit** the shares and debentures each partner receives, at their full (issue) value, split as the question says.
6. **Balance each column with bank**. If the credit side is bigger, the business pays the partner (debit bank in the capital account, "Bank"); if the debit side is bigger, the partner **pays in** (credit "Bank").

Variations you will meet:

- **A statement instead of accounts** ("calculate the cash payable to each partner"): the same figures in a list, adding and subtracting, ending with cash.
- **The current account balances are not given**: work them out. Total of capital and current accounts = net assets at book value, so current accounts total = net assets – capital accounts. Then split as the question says. Or build them up: opening balance + interest on capital + share of profit – drawings.
- **The buyer takes the bank account too**: then there is no cash to pay out, so partners with too much in their accounts are paid by partners with too little (each column is closed with "Ada" or "Brian"), or the company pays the balance.
- **Debentures to replace income**: for example debentures at 8% sized so that the interest equals the partner's old interest on capital: $12\,000 \div 8\% = 150\,000$, so \$150 000 of debentures.
- **Number of shares**: the value each partner receives divided by the issue price.

2. Advise the seller (11 questions)

Usually 5 marks: up to 2 for points **for**, up to 2 **against**, and 1 for a clear **decision with a reason**.

1. **Do any calculation the question asks for first**, and use it in the argument. Common ones:
 - dividend per share = company profit $\div$ dividend cover $\div$ number of shares, times the partner's shares, compared with their old share of profit;
 - dividend income from the shares compared with interest the cash could earn elsewhere (value of shares $\times$ interest rate);
 - share of the merged business's profit compared with the old business's profit;
 - return on capital employed of each business before a merger.
2. **Points for**: limited liability; dividends that may rise; the share price may rise; free to work elsewhere or retire; cash for retirement or a new business; shared risk and skills in a merger.
3. **Points against**: less income; no control as a small shareholder or minority partner; dividends and share prices can fall; shares may be hard to sell; conflict with partners; competition with the company the partner has just sold to.
4. **Decide**, and say why, linking to the question's situation ("as Malcolm has retired and wants a steady income...").

3. Calculate purchase consideration or goodwill (7 questions)

1. **Average profit** = sum of the stated years' profits $\div$ number of years. Multiply by the agreed number of times.
2. **Agreed net assets** = each asset taken over at its **agreed** value, less liabilities taken over. Leave out anything the seller keeps (usually the bank, and any vehicle a partner takes).
3. Consideration = net assets + goodwill; or goodwill = consideration – net assets.

Variations you will meet:

- **Profits given as a growth rate**: if profit grew by 15% a year and this year's was \$21 160, last year's was $21\,160 \div 1.15 = 18\,400$ and the year before $18\,400 \div 1.15 = 16\,000$.
- **Consideration made of parts**: add the value of the shares, cash, debentures and any asset the buyer hands over.
- **Cash still to pay**: consideration – value of shares – debentures = cash the buyer pays.
- **Receivables less an allowance, payables less a discount**: use the net figures when finding fair value.

4. Explain goodwill (7 questions)

- **How purchased goodwill arises**: one business buys another and pays more than the fair value of its separately identifiable net assets.

- **Why it is paid for:** reputation, loyal customers, location, brand, skilled staff; it brings future profit or cash flows.
- **Why it is hard to value:** no active market for it; it depends on future profits; any formula is a matter of agreement, not fact. Inherent goodwill has no objective value, so it is not recorded.
- **Why based on profit:** profit over several years shows what the business earns and is a fair basis both sides can check.
- **Goodwill versus a tangible asset:** always give **both sides** of each difference (see the table above).
- **Why the buyer refused a higher multiple:** show both goodwill figures (for example 2 times and 5 times the average), then explain: it would pay more or issue more shares; future profits are uncertain; profits are falling; the accounts may not be audited.

5. Journal entry in the buyer's books (6 questions)

1. **Debit** each asset at its **agreed** value; **credit** each liability taken over.
2. **Credit** ordinary share capital at nominal value, share premium with the excess, debentures, and bank with the cash paid.
3. **Goodwill** is the balancing debit. (If the consideration is less than net assets, the difference is a credit; this is rare.)
4. Head the columns **Debit** and **Credit**, and add both to show they are equal.
5. Add a **narrative** if asked: "Being the purchase of the business of ... on ... for a consideration of ...".

6. Realisation account or profit on realisation (6 questions)

1. **Debit** every asset transferred, at **book** value. Leave out the bank if the seller keeps it.
2. **Debit** costs of the sale paid by the seller (legal fees, redundancy pay).
3. **Credit** liabilities the buyer takes over, the consideration, assets partners take (agreed value) and any discount on payables the seller settles itself.
4. The balancing figure is the profit (on the debit side) or loss (on the credit side); split it in the profit-sharing ratio.

Variations you will meet:

- **Only the profit is asked:** book value of net assets = total of capital and current accounts — bank. Then profit = consideration — net assets transferred — costs.
- **Payables settled by the seller:** they don't go into the realisation account; only the discount does.
- **Irrecoverable debts or discounts allowed** found on collecting receivables: debit them to realisation.

7. Reasons for, or benefits of, an acquisition or merger (5 questions)

"State" needs a short point each. "Explain" earns 1 mark for the point and 1 for developing it, so give a consequence: "economies of scale (point), as bulk buying lowers the cost of inventory and so raises profit (development)." Use the table in "Why businesses join together", and link to the business in the question.

8. Advise the buyer (5 questions)

- **Should the company have paid more than the net assets?** For: the goodwill will bring future profit above what was paid. Against: goodwill is hard to value and may not last.
- **Should it keep buying businesses?** One disappointing year is too short to judge; synergy takes time; but predictions may have been too optimistic, and culture clash is a real risk.
- **Should it issue shares to a seller?** Work out each shareholder group's percentage before and after (shares held ÷ total shares). If the existing owners fall below 50%, they lose control. Shares save cash and bring the seller's experience.
- **Debentures or shares to raise funds?** Debentures: fixed interest, higher gearing and risk, no loss of control, may need security. Shares: no fixed charge, but dividends are expected and control can pass to the new shareholder.

9. Merger into a new partnership: each partner's new capital (4 questions)

Lay it out as a statement with one column per partner:

	Partner 1	Partner 2	New partner
Capital (and current account) balance	✓	✓	✓
Gain or loss on revaluing their own business (old ratio)	✓	✓	✓
Goodwill of their own business (old ratio)	✓	✓	✓
Goodwill written off (total, new ratio)	()	()	()
Asset taken for private use	()		

	Partner 1	Partner 2	New partner
New capital			

Work out each revaluation as (revalued total — book total) for that business's assets and liabilities.

10. Financial statements of the merged business (4 questions)

1. **Statement of financial position:** add the two businesses' assets and liabilities line by line at **revalued** amounts. No goodwill if it is written off. Leave out assets taken by a partner. The capital section lists each partner's new capital from type 9. Check the total equals net assets.
2. **Total assets only:** same, without the liabilities.
3. **Forecast statement of profit or loss:** combine revenues, cost of sales and expenses line by line; apply the stated savings (for example admin expenses $\times 0.9$); remove anything that ends with the merger (for example a loan's interest).

11. The seller's bank account, or the account of the buyer (4 questions)

- **Bank:** debit the opening balance (or credit an overdraft), the cash from the buyer and any money partners pay in; credit the costs of the sale, liabilities the seller pays itself and the cash paid to partners. It must close at nil, which checks your capital accounts.
- **Buyer's account** (for example "DB plc account"): debit the consideration (from realisation); credit the cash received (to bank) and the shares received (to capital).

12. Other short theory (4 questions)

- **Partner versus shareholder:** unlimited (joint and several) liability versus limited liability; share of profit versus dividends; the partnership ends when a partner dies, the company carries on; partners run the business, shareholders vote and appoint directors.
- **Realisation account versus revaluation account:** realisation is used when the business is sold and ownership of the assets passes to someone else; revaluation records changes in value while the business carries on and can happen many times.
- **Stewardship:** the directors look after the business on behalf of the shareholders, so any purchase must be in the shareholders' best interests.
- **A provision for costs arising from the acquisition** (for example future redundancy pay for the staff taken over): name **IAS 37** (provisions and contingent liabilities). If an obligation is **probable** (more than 50% likely) and can be estimated, the company records a **provision** in its own financial statements. If it is only **possible**, it is a **contingent liability**, disclosed in a **note** to the statements. If it is **remote**, no action is needed. The directors must judge how likely the redundancies are, and they may decide an amount that is not **material** to a company of that size needs no provision.

13. The buyer's statement of financial position after the acquisition (3 questions)

1. Start from the company's own statement before the purchase.
2. **Add** each asset and liability taken over at agreed value, and **goodwill** as an intangible non-current asset.
3. **Increase** share capital and share premium (and debentures) by what was issued; **reduce** bank by the cash paid (it may become an overdraft, a current liability).
4. Apply any other stated changes, such as costs of the purchase charged against retained earnings, or new shares the directors buy for cash.

Worked examples

The bold codes show where marks are earned, as in Cambridge mark schemes. The number is how many marks.

- **B1** mark for a correct result on its own, with no method needed.

Example 1

Kofi is a sole trader. His statement of financial position at 30 June 2025 was:

	\$
Premises	120 000
Equipment (including a car, carrying value 9000)	34 000
Inventory	18 500
Trade receivables	21 400

	\$
Bank	6 300
Total assets	200 200
Capital	176 200
Trade payables	24 000
Total capital and liabilities	200 200

On 1 July 2025 LM Limited bought the business for \$220 000, paid as \$40 000 cash and 120 000 ordinary shares of \$1 each, valued at \$1.50 each. LM Limited took over all the assets and liabilities except the bank and the car. Kofi kept the car at an agreed value of \$7500. Kofi paid selling costs of \$2500. LM Limited valued the assets it took over at: premises \$150 000, equipment \$23 000, inventory \$17 000, trade receivables \$20 400. Trade payables were taken over at book value.

(a) Prepare the realisation account in Kofi's books. [6]

(b) Prepare Kofi's capital account, showing the final settlement. [4]

(c) Prepare the journal entry in LM Limited's books to record the purchase. A narrative is not required. [5]

(a) Realisation account

Debit	\$	Credit	\$
Premises	120 000	Trade payables	24 000
Equipment	34 000	LM Limited (consideration)	220 000
Inventory	18 500	Capital (car)	7 500
Trade receivables	21 400		
Bank (selling costs)	2 500		
Capital (profit on realisation)	55 100		
	251 500		251 500

B1 assets at book value, including the whole equipment figure; **B1** selling costs; **B1** payables; **B1** consideration; **B1** car at the agreed value; **B1 OF** profit $251\,500 - 196\,400 = 55\,100$.

(b) Capital account

Debit	\$	Credit	\$
Realisation (car)	7 500	Balance b/d	176 200
LM Limited (shares)	180 000	Realisation (profit)	55 100
Bank	43 800		
	231 300		231 300

B1 car; **B1** shares at their full value, $120\,000 \times \$1.50$; **B1 OF** profit; **B1 OF** bank.

Check with the bank account: $6300 + 40\,000 - 2500 = 43\,800$, the amount paid to Kofi, so the bank closes at nil.

(c) Journal of LM Limited

	Debit \$	Credit \$
Premises	150 000	
Equipment	23 000	
Inventory	17 000	
Trade receivables	20 400	
Goodwill	33 600	
Trade payables		24 000
Bank		40 000
Ordinary share capital		120 000

	Debit \$	Credit \$
Share premium		60 000
	244 000	244 000

B1 assets at agreed values; **B1** payables; **B1** bank; **B1** share capital and premium split ($120\,000 \times \$0.50 = 60\,000$); **B1** goodwill $220\,000 - (210\,400 - 24\,000) = 220\,000 - 186\,400 = 33\,600$.

Example 2

Lena and Musa were partners sharing profits and losses 3 : 2. Their statement of financial position at 31 December 2025:

	\$
Machinery	90 000
Vehicles	30 000
Inventory	26 000
Trade receivables	32 000
Bank	18 000
Total assets	196 000
Capital accounts: Lena 110 000, Musa 60 000	170 000
Current accounts: Lena 6 000, Musa (4 000)	2 000
Trade payables	24 000
Total capital and liabilities	196 000

PQ Limited bought the business on 1 January 2026, taking over all the assets except the bank, at these values: machinery \$84 000, vehicles \$27 000, inventory \$25 000, trade receivables \$30 000. Goodwill was agreed at two times the average profit of the last three years, which were \$33 000, \$36 000 and \$39 000. The consideration was paid entirely in ordinary shares of \$1 each, issued at \$1.40, shared in the profit-sharing ratio. The partnership paid its trade payables \$23 400 in full settlement.

(a) Calculate the purchase consideration. **[3]**

(b) Calculate the profit on realisation and each partner's share. **[4]**

(c) Prepare the partners' capital accounts, showing the final settlement. **[7]**

(d) Musa's average share of profit was \$14 400 a year. PQ Limited expects to pay a dividend of \$0.08 per share. Advise Musa whether he should keep his shares in PQ Limited. Justify your answer. **[5]**

(a) Average profit = $(33\,000 + 36\,000 + 39\,000) \div 3 = 36\,000$; goodwill = $2 \times 36\,000 = 72\,000$. **B1**

Agreed assets = $84\,000 + 27\,000 + 25\,000 + 30\,000 = 166\,000$. **B1**

Purchase consideration = $166\,000 + 72\,000 = 238\,000$. **B1 OF**

(b) Book value of assets transferred = $90\,000 + 30\,000 + 26\,000 + 32\,000 = 178\,000$. **B1**

Discount on payables = $24\,000 - 23\,400 = 600$. **B1**

Profit = $238\,000 + 600 - 178\,000 = 60\,600$. **B1 OF**

Lena $60\,600 \times \frac{3}{5} = 36\,360$; Musa $60\,600 \times \frac{2}{5} = 24\,240$. **B1 OF**

(c) Shares: $238\,000 \div 1.40 = 170\,000$ shares. Lena $170\,000 \times \frac{3}{5} = 102\,000$ shares worth \$142 800; Musa 68 000 shares worth \$95 200.

Capital accounts

Debit	Lena \$	Musa \$	Credit	Lena \$	Musa \$
Current account		4 000	Balance b/d	110 000	60 000
PQ Limited (shares)	142 800	95 200	Current account	6 000	
Bank	9 560		Realisation (profit)	36 360	24 240
			Bank		14 960

Debit	Lena \$	Musa \$	Credit	Lena \$	Musa \$
	152 360	99 200		152 360	99 200

B1 opening balances; **B1** both current accounts, on the correct sides; **B1 OF** realisation profits; **B1** shares for both; **B1 OF** Lena is paid 9 560; **B1 OF** Musa pays in 14 960; **B1** totals.

Check with the bank: $18\,000 + 14\,960 - 23\,400 - 9560 = 0$.

(d) Calculation. Musa's dividend = $68\,000 \times 0.08 = 5440$, so \$5440 a year, much less than his old profit share of \$14 400. **(1)**

Keep. He no longer works in the business, so he can earn a salary elsewhere, and \$5440 is income for no work. **(1)** His liability is now limited, and the share price may rise above \$1.40. **(1)**

Sell. The dividend is not guaranteed and could fall. **(1)** Selling at \$1.40 gives $68\,000 \times 1.40 = 95\,200$, so \$95 200 in cash, which could earn a safer return or fund his own business. **(1)**

Decision. Musa should keep the shares: he is now free to earn a salary elsewhere, so the \$5440 is extra income, and he keeps the chance of a rise in the share price. **(1)** (Selling is also acceptable if a reason supports it.)

Example 3

Hana and Ivan were partners sharing profits equally. On 1 April 2026 they merged with Jae, a sole trader, to form a new partnership sharing profits Hana 2 : Ivan 2 : Jae 1. Their statements of financial position on 31 March 2026:

	Hana and Ivan \$	Jae \$
Premises	100 000	–
Equipment	30 000	40 000
Inventory	15 000	9 000
Trade receivables	12 000	14 000
Bank	8 000	5 000
Total assets	165 000	68 000
Capital: Hana 80 000, Ivan 70 000; Jae 60 000	150 000	60 000
Trade payables	15 000	8 000
Total capital and liabilities	165 000	68 000

Hana and Ivan's premises were revalued at \$120 000 and their inventory at \$13 000. Jae's equipment was revalued at \$35 000 and his trade receivables at \$13 000. Goodwill was valued at 1.5 times average annual profit: \$30 000 for Hana and Ivan, \$10 000 for Jae. Goodwill was not to be kept in the books.

(a) Calculate each partner's capital in the new partnership. **[8]**

(b) Prepare the statement of financial position of the new partnership at 1 April 2026. **[5]**

(a) Revaluation. Hana and Ivan: $+20\,000 - 2000 = +18\,000$, so +9000 each. Jae: $-5000 - 1000 = -6000$. **B1 B1**

Goodwill. Hana and Ivan $1.5 \times 30\,000 = 45\,000$, so 22 500 each; Jae $1.5 \times 10\,000 = 15\,000$. **B1 B1**

Write-off. Total goodwill 60 000, in the new ratio 2 : 2 : 1: Hana 24 000, Ivan 24 000, Jae 12 000. **B1 OF**

	Hana \$	Ivan \$	Jae \$
Capital	80 000	70 000	60 000
Revaluation	9 000	9 000	(6 000)
Goodwill of own business	22 500	22 500	15 000
Goodwill written off	(24 000)	(24 000)	(12 000)
New capital	87 500	77 500	57 000

B1 B1 B1 OF for each new capital.

(b) Hana, Ivan and Jae: statement of financial position at 1 April 2026

	\$	\$
Non-current assets		
Premises		120 000
Equipment (30 000 + 35 000)		65 000
		185 000
Current assets		
Inventory (13 000 + 9000)	22 000	
Trade receivables (12 000 + 13 000)	25 000	
Bank (8000 + 5000)	13 000	60 000
Total assets		245 000
Capital accounts		
Hana	87 500	
Ivan	77 500	
Jae	57 000	222 000
Current liabilities		
Trade payables (15 000 + 8000)		23 000
Total capital and liabilities		245 000

B1 non-current assets at revalued amounts; **B1** inventory and receivables; **B1** bank; **B1** payables; **B1 OF** capitals, with totals that agree.

Example 4

Before buying Kofi's business (Example 1), LM Limited's statement of financial position showed: property, plant and equipment \$400 000, inventory \$50 000, trade receivables \$45 000, bank \$60 000; ordinary shares of \$1 each \$300 000, share premium \$20 000, retained earnings \$185 000, trade payables \$50 000.

Prepare LM Limited's statement of financial position immediately after the purchase. **[8]**

LM Limited: statement of financial position at 1 July 2025

	\$	\$
Non-current assets		
Goodwill		33 600
Property, plant and equipment (400 000 + 150 000 + 23 000)		573 000
		606 600
Current assets		
Inventory (50 000 + 17 000)	67 000	
Trade receivables (45 000 + 20 400)	65 400	
Bank (60 000 – 40 000)	20 000	152 400
Total assets		759 000
Equity		
Ordinary shares of \$1 each (300 000 + 120 000)		420 000
Share premium (20 000 + 60 000)		80 000
Retained earnings		185 000
		685 000
Current liabilities		
Trade payables (50 000 + 24 000)		74 000
Total equity and liabilities		759 000

B1 goodwill; **B1** property, plant and equipment; **B1** inventory; **B1** receivables; **B1** bank; **B1** share capital; **B1** share premium; **B1** payables.

Common mistakes

- **Not splitting shares into share capital and share premium** in the buyer's journal or statement of financial position. Examiners note this almost every year. Nominal value to share capital, the rest to share premium.
- **Mixing up book values and agreed values.** Book values go into the seller's realisation account; agreed values go into the buyer's journal and its statement of financial position, and into the consideration. Adding the carrying value instead of the agreed value to find the consideration loses the mark.
- **Putting both the agreed values of the assets and the consideration** in the realisation account. The consideration already replaces the assets' agreed values; only book values go on the debit side.
- **Leaving out goodwill** from the consideration, the journal or the statement of financial position, or adding goodwill again after the profit on realisation already includes it.
- **The asset a partner keeps:** it is credited to realisation at the **agreed** value (not its book value, and not its loss) and debited to that partner's capital. Forgetting it, or including it in the new business's total assets, is common.
- **Forgetting the discount on payables** when the seller settles its own payables for less than book value. The discount is a credit in the realisation account.
- **Current accounts on the wrong side.** An overdrawn (debit) current account reduces the partner's capital; it is debited.
- **Treating goodwill in a merger the wrong way round.** Credit each business's goodwill to **its own** owners in their old ratio; debit the write-off to **all** partners in the **new** ratio.
- **Advice that ignores the question.** Generic points about sole traders or companies earn little; use the business's own figures (dividend versus old profit, interest versus dividend) and give a decision.
- **Differences listed on one side only.** "Goodwill has no physical form" is half an answer; say what the tangible asset is like too.

How to get the marks

- **Label every figure** in ledger accounts with the other account's name ("Realisation", "LM Limited", "Bank"), not "balance" for the final settlement.
- **Columnar capital accounts:** use one column per partner; a figure in the wrong column loses the mark.
- **Journals:** head the columns Debit and Credit, total them, and write the narrative only when asked.
- **Show your workings** for goodwill, net assets, profit on realisation and the shares split. Most marks are **own figure (OF)**: a wrong profit on realisation used correctly still earns the capital account marks.
- **"Calculate":** give the answer with the working and \$. **"Prepare":** a full account or statement with a proper title and date ("Statement of financial position at 1 April 2026").
- **"State":** a short point each. **"Explain":** a point plus a developed consequence. **"Discuss" / "Assess" / "Evaluate":** points on both sides.
- **"Advise" / "Justify":** usually up to 2 marks for, up to 2 against, 1 for the decision. The decision mark needs a reason; a one-word answer earns nothing.
- **"Support your answer with calculations":** the calculations carry marks of their own (often up to 3); show them clearly, then use them in the argument.
- **"Financial and non-financial factors":** marks are capped for each, so give both.

Quick check

1. A business has profits of \$42 000, \$48 000 and \$51 000 in the last three years. Goodwill is valued at 2.5 times average profit, and the net assets taken over are agreed at \$310 000. Find the goodwill and the purchase consideration.
2. BR Limited buys a business with net assets at fair value of \$205 000. It pays \$25 000 cash and 150 000 ordinary shares of \$1 each valued at \$1.50. Find the goodwill, and the amounts credited to share capital and share premium.
3. A partnership (profit-sharing ratio 3 : 1) is sold for \$200 000. Its assets other than the bank have a book value of \$184 000, including a car of \$7000 that a partner keeps at an agreed value of \$6000. The buyer takes over all the other assets and the trade payables of \$21 000. Costs of the sale are \$3000. Find the profit on realisation and each partner's share.
4. Zara receives 40 000 shares valued at \$1.60 each. The company pays a dividend of \$0.08 per share. Find the dividend yield, and compare Zara's dividend with the interest she could earn at 4% a year if she sold the shares at \$1.60.
5. State two differences between a realisation account and a revaluation account.

Answers

1. Average profit = $(42\,000 + 48\,000 + 51\,000) \div 3 = 47\,000$. Goodwill = $2.5 \times 47\,000 = 117\,500$ (\$117 500). Consideration = $310\,000 + 117\,500 = 427\,500$ (\$427 500).
2. Consideration = $25\,000 + 150\,000 \times 1.50 = 250\,000$. Goodwill = $250\,000 - 205\,000 = 45\,000$ (\$45 000). Share capital = $150\,000 \times 1 = 150\,000$ (\$150 000); share premium = $150\,000 \times 0.50 = 75\,000$ (\$75 000).
3. Debit side: assets $184\,000 + \text{costs } 3\,000 = 187\,000$. Credit side: consideration $200\,000 + \text{payables } 21\,000 + \text{car } 6\,000 = 227\,000$. Profit = $227\,000 - 187\,000 = 40\,000$ (\$40 000), shared 3 : 1 as \$30 000 and \$10 000.
4. Dividend yield = $0.08 \div 1.60 \times 100\% = 5\%$. Dividend = $40\,000 \times 0.08 = 3\,200$ (\$3 200). Shares sold for $40\,000 \times 1.60 = 64\,000$ (\$64 000) would earn $64\,000 \times 4\% = 2\,560$ (\$2 560). The dividend is \$640 more, but it is not guaranteed, while interest is more certain.
5. A realisation account is used when the business is sold or closed and its assets pass to new owners; it records book values against the consideration. A revaluation account is used while the business carries on (for example when a partner joins or leaves); it records only increases and decreases in value, and can be used many times.

Past questions to try

- **9706/31/O/N/23 Q2**: a sole trader sold to a company: realisation account, capital account and the buyer's journal.
- **9706/32/M/J/23 Q3**: a partnership sold to a company, with current accounts to work out first.
- **9706/32/O/N/22 Q2**: the seller's ledger accounts, then the buyer's statement of financial position and advice on keeping shares.
- **9706/33/M/J/21 Q3**: a sole trader merging with a partnership: new capitals, total assets and advice.