

Accounting Notes

Partnerships, Allocating Income, Add/Remove Partners, Liquidation

Characteristics of a Partnership:

Partnership agreement - Contract between partners that specifies such items as (1) the name, location, and nature of the business; (2) the name, capital investment, and duties of each partner; and (3) how profits and losses are to be shared.

Limited life - Life of a partnership is limited by the length of time that all partners continue to own a part of the business. When a partner withdraws from the partnership the partnership must be dissolved.

Mutual agency - Every partner can bind the business to a contract within the scope of the partnership's regular business operations.

Unlimited personal liability - When a partnership can not pay its debts with the business's assets, the partners must use their own personal assets to pay off the remaining debt.

Co-ownership of property - All assets that a partner invests in the partnership become the joint property of all the partners.

No partnership income taxes - The partnership is not responsible to the payment of income taxes on the net income of the business. Since the net income is divided among the partners, each partner is personally liable for the income taxes on their share of the business's net income.

Partners owners equity accounts - Each partner has their own capital and withdraw account.

Initial Investment by Partners:

Cash	Amount invested
Asset	MV of assets contributed
Liabilities	MV of liabilities assumed by the partnership
Partner, Capital	Total Investment

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Sharing of Profits and Losses:

Based on a stated fraction or percentage:

Income Summary	Net Income
Partner A, Capital	Net Income * xx%
Partner B, Capital	Net Income * xx%

Accounts would be reversed if the partnership had a Net Loss instead of a Net Income.

Based on the capital contributions of the partners:

Step 1: Add the capital account balances for all the partners together to find the total capital of the business

Partner A, Capital	\$xxxxx
Partner B, Capital	xxxxx
Total Capital	<u>\$xxxxx</u>

Step 2: Divide each partner's capital balance by the total capital to find each partner's investment percentage

Partner A, Capital	Account Balance / Total Capital = xx%
Partner B, Capital	Account Balance / Total Capital = xx%

Step 3: Allocate the net income or loss to each partner by multiplying their investment percentage to the amount of net income or loss

Partner A's share	Net Income * xx% = \$xxxx
Partner B's share	Net Income * xx% = <u>xxxxx</u>
	<u>\$xxxxx</u>

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Sharing of Profits and Losses:

Based on Salary allowances and Interest

	Partner A	Partner B	Total
Net Income			\$xxxxx ←
Allocation of Salaries:			
Partner A	\$xxxxx		
Partner B		\$xxxxx	
Total			(xxxxx)
Net Income remaining			<u>\$xxxxx</u>
Allocation of Interest on capital balances			
Partner A (cap bal * %)	xxxx		
Partner B (cap bal * %)		xxxx	
Total			(xxxxx)
Net Income remaining			<u>\$xxxxx</u>
Remainder shared equally			
Partner A (remainder/2)	xxxx		
Partner B (remainder/2)		xxxx	
Total			(xxxxx)
Net Income remaining			<u>-0-</u>
Net Income allocated	\$xxxxx	\$xxxxx	\$xxxxx ←

Amounts must be the same

Recording the withdraws of partners:

Partner A, Withdraws	Amount withdrawn	
Partner B, Withdraws	Amount withdrawn	
Cash (or other asset)		Total withdrawn

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Admission of New Partners:

By the purchasing of an existing partners interest:

The new partner gains admission by buying an existing partner's capital interest with the approval of all other partners

Old Partner, Capital	Capital bal. of old partner	
New Partner, Capital	Capital bal. of old partner	

By investing into the partnership:

The new partner invests assets into the business and receives a capital interest in the partnership that is less than the total market value of the investment.

Step 1: Determine the bonus to the old partners

Partnership capital of existing partners	\$xxxxx
New partner's investment	xxxxx
Total partnership capital including new partner	\$xxxxx
New partner's capital interest (total capital * %)	xxxxx
Bonus to existing partners (total cap. - new partner)	\$xxxxx

Step 2: Allocate bonus to existing partners based on percentage

Bonus to existing partners	\$xxxxx
Partner A's share (Bonus * %)	xxxxx
Partner B's share (Bonus * %)	xxxxx

Step 3: Record journal entry

Cash	Amount invested
Partner C, Capital	New partner's interest
Partner A, Capital	Partner's share of bonus
Partner B, Capital	Partner's share of bonus

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Admission of New Partners:

The new partner invests assets into the business and receives a capital interest that is more than the market value of the assets invested.

Step 1: Determine the bonus for the new partner

Partnership capital of existing partners	\$xxxxx
New partner š investment	xxxxx
Total partnership capital	\$xxxxx
New partner š capital interest (total part. Cap. * %)	xxxxx
Bonus to new partner (total cap. - new partner š interest)	\$xxxxx

Step 2: Allocate the new partner š bonus to the old partners

Bonus to new partner	\$xxxxx
Partner A š share (Bonus * xx%)	xxxxx
Partner B š share (Bonus * xx%)	xxxxx

Step 3: Record journal entry

Cash		Amount invested	
Partner A, Capital		Partner š share	
Partner B, Capital		Partner š share	
Partner C, Capital			Capital interest received

Revaluation of assets before the withdrawal of a partner:

If the value of the assets went down:

Partner A, Capital	Loss * xx%	
Partner B, Capital	Loss * xx%	
Partner C, Capital	Loss * xx%	
Asset		Amount of Loss

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Revaluation of assets before the withdraw of a partner:

If the value of the assets went up:

Asset	Amount of Gain
Partner A, Capital	Gain * xx%
Partner B, Capital	Gain * xx%
Partner C, Capital	Gain * xx%

Withdraw of a partner from the business:

Partner withdraws receiving an amount equal to their capital balance:

Partner C, Capital	Capital balance
Cash	Amount received

Partner withdraws receiving an amount less than their capital balance:

Partner C, Capital	Capital balance
Cash	Amount received
Partner A, Capital	Difference * xx%
Partner B, Capital	Difference * xx%

Note: the difference between what the leaving partner receives and what their capital balance was is treated as a bonus to the remaining partners paid by the leaving partner

Partner withdraws receiving an amount more than their capital balance:

Partner C, Capital	Capital balance
Partner A, Capital	Difference * xx%
Partner B, Capital	Difference * xx%
Cash	Amount received

Note: the difference between what the leaving partner receives and what their capital balance was is treated as a bonus to the leaving partner paid by the remaining partners

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Liquidation of a Partnership:

Step 1: Sell all of the noncash assets - any gain or loss recognized is split between the partners

Journal Entry:

Cash	Amount received	
Noncash Assets		Book Value of assets
Partner A, Capital		Gain * partner %
Partner B, Capital		Gain * partner %

Note: if there was a loss on the sale of the noncash assets, then the partner's capital account would have been debited for their share of the loss instead of credited.

Step 2: Pay off all partnership liabilities

Journal Entry:

Liabilities	Amount owed	
Cash		Amount owed

Step 3: Distribute the remaining cash to the partners

Journal Entry:

Partner A, Capital	Partner's Capital balance	
Partner B, Capital	Partner's Capital balance	
Cash		Total cash paid to partners

Note: if there was not enough cash to pay off the liabilities, then the partners would have been responsible for investing more cash into the partnership so that the liabilities could be paid off.

Journal Entry:

Cash	Amount of additional cash needed	
Partner A, Capital		Amount Partner A invested
Partner B, Capital		Amount Partner B invested

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Liquidation Summary Worksheet:

	Cash	+	Noncash		+	Capital				
			Assets	=		Liabilities	Partner A	Partner B	Partner C	
						(%)	+	(%)	+	(%)
Bal. Before sale of assets	\$xxx		\$xxx		\$xxx	\$xxx		\$xxx		\$xxx
Sale of assets & splitting of gain	xxx		(xxx)			xx		xx		xx
Balances	\$xxx		-0-		\$xxx	\$xxx		\$xxx		\$xxx
Payment of Liabilites	(xxx)				(xxx)					
Balances	\$xxx		-0-		-0-	\$xxx		\$xxx		\$xxx
Disbursement of cash to partners	(xxx)					(xxx)		(xxx)		(xxx)
Balances	-0-		-0-		-0-	-0-		-0-		-0-