CHAPTER 12

Accounting for Partnerships

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Identify the characteristics of the partnership form of business organization.	1, 2, 3, 4, 12		1		
2. Explain the accounting entries for the formation of a partnership.	5	1, 2	2, 3	1A	1B
3. Identify the bases for dividing net income or net loss.	6, 7, 8, 9, 10	3, 4, 5	4, 5	2A	2B
4. Describe the form and content of partnership financial statements.	11		6, 7	1A, 2A	1B, 2B
5. Explain the effects of the entries to record the liquidation of a partnership.	12, 13, 14, 15, 16	6	8, 9, 10	3A	3B
*6. Explain the effects of the entries when a new partner is admitted.	17, 18, 19, 20	7, 8	11, 12, 15	4A	4B
*7. Describe the effects of the entries when a partner withdraws from the firm.	20, 21, 22, 23	9, 10	13, 14, 15	5A	5B

***Note:** All **asterisked** Questions, Exercises, and Problems relate to material contained in the appendix to the chapter.

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare entries for formation of a partnership and a balance sheet.	Simple	20–30
2A	Journalize divisions of net income and prepare a partners' capital statement.	Moderate	30–40
3A	Prepare entries with a capital deficiency in liquidation of a partnership	Moderate	30–40
*4A	Journalize admission of a partner under different assumptions.	Moderate	30–40
*5A	Journalize withdrawal of a partner under different assumptions.	Moderate	30–40
1B	Prepare entries for formation of a partnership and a balance sheet.	Simple	30–40
2B	Journalize divisions of net income and prepare a partners' capital statement.	Moderate	30–40
3B	Prepare entries and schedule of cash payments in liquidation of a partnership.	Moderate	30–40
*4B	Journalize admission of a partner under different assumptions.	Moderate	30–40
*5B	Journalize withdrawal of a partner under different assumptions.	Moderate	30–40

BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the characteristics of the partnership form of business organization.		Q12-1 Q12-2 Q12-3 Q12-4 Q12-12 E12-1				
2. Explain the accounting entries for the formation of a partnership.			Q12-5 BE12-1 BE12-2 E12-2 E12-3 P12-1A P12-1B			
3. Identify the bases for dividing net income or net loss.		Q12-6 Q12-7 Q12-9	Q12-8 Q12-10 BE12-3 BE12-4 BE12-5 E12-4 E12-5 P12-2A P12-2B			
4. Describe the form and content of partnership financial statements.		Q12-11	E12-6 E12-7 P12-1A P12-2A P12-1B P12-2B			
5. Explain the effects of the entries to record the liquidation of a partnership.		Q12-12 Q12-13 Q12-14	Q12-15 Q12-16 BE12-6 E12-8 E12-9 E12-10 P12-3A P12-3B			
*6. Explain the effects of the entries when a new partner is admitted.		Q12-17 Q12-18	Q12-19 Q12-20 BE12-7 BE12-8 E12-11 E12-12 E12-15 P12-4A P12-4B			
*7. Describe the effects of the entries when a partner withdraws from the firm.		Q12-22 Q12-23	Q12-20 Q12-21 BE12-9 BE12-10 E12-13 E12-14 E12-15 P12-5A P12-5B			
Broadening Your Perspective		Exploring the Web Decision Making Across the Organization			Communication All About You	Decision Making Across the Organization Ethics Case

ANSWERS TO QUESTIONS

1. (a) Association of individuals. A partnership is a voluntary association of two or more individuals based on as simple an act as a handshake. Preferably, however, the agreement should be in writing. A partnership is both a legal entity and an accounting entity, but it is not a taxable entity.
   (b) Limited life. A partnership does not have unlimited life. A partnership may be ended voluntarily or involuntarily. Thus, the life of a partnership is indefinite. Any change in the members of a partnership results in the dissolution of the partnership.
   (c) Co-ownership of property. Partnership assets are co-owned by all the partners. If the partnership is terminated, the assets do not legally revert to the original contributor. Each partner has a claim on total assets equal to his or her capital balance. This claim does not attach to specific assets the individual partner contributed to the firm.

2. (a) Mutual agency. This characteristic means that the act of any partner is binding on all other partners when engaging in partnership business. This is true even when the partners act beyond the scope of their authority, so long as the act appears to be appropriate for the partnership.
   (b) Unlimited liability. Each partner is personally and individually liable for all partnership liabilities. Creditors' claims attach first to partnership assets and then to personal resources of any partner, irrespective of that partner's equity in the partnership.

3. The advantages of a partnership are: (1) combining skills and resources of two or more individuals, (2) ease of formation, (3) freedom from governmental regulations and restrictions, and (4) ease of decision making. Disadvantages are: (1) mutual agency, (2) limited life, and (3) unlimited liability.

4. A limited partnership is used when a general partner(s) wish to raise cash without involving outside investors in management of the business. Limited partners in this case have limited personal liability for business debts as long as they don't participate in management.

5. The capital balance should be $102,000, comprised of land $65,000, and equipment $57,000, less debt $20,000.

6. When the partnership agreement does not specify the division of net income or net loss, net income and net loss should be divided equally.

7. Factors to be considered in determining how income and loss should be divided are: (1) a fixed ratio is easy to apply and it may be an equitable basis in some circumstances; (2) capital balance ratios when the funds invested in the partnership are considered the most critical factor; and (3) salary allowance and/or interest allowance coupled with a fixed ratio. This last approach gives specific recognition to differences that may exist among partners by providing salary allowances for time worked and interest allowances for capital invested.

8. The net income of $36,000 should be divided equally—$18,000 to M. Carson and $18,000 to R. Leno.

9. (a) Account debited: Income Summary; accounts credited: S. McMurray, Capital and F. Kohl, Capital.
   (b) Account debited: S. McMurray, Drawing; account credited: Cash.

10. Division of Net Income

	T. Evans	R. Meloy	Total
Salary Allowance	$30,000	$25,000	$55,000
Deficiency: ($10,000) ($45,000 – $55,000)			
T. Evans (60% X $10,000)	(6,000)		(6,000)
R. Meloy (40% X $10,000)		(4,000)	(4,000)
Total division	$24,000	$21,000	$45,000

11. The financial statements of a partnership are similar to those of a proprietorship. The differences are due to the number of partners involved. The income statement for a partnership is identical to the income statement for a proprietorship except for the division of net income. The owners' equity statement is called the partners' capital statement. This statement shows the changes in each partner's capital account and in total partnership capital during the year. On the balance sheet each partner's capital balance is reported in the owners' equity section.

12. Liquidation of a partnership ends both the legal and economic life of the entity. Partnership dissolution occurs whenever a partner withdraws or a new partner is admitted. Dissolution does not necessarily mean that the business ends. If the continuing partners agree, operations can continue without interruption by forming a new partnership.

13. No, Bobby is not correct. All gains and losses on liquidation should be allocated to the partners on the basis of their income ratio. However, final cash distributions should be based on their capital balances.

14. Yes, Bill is correct. Capital balances are used because they represent the individual partner's equity in the partnership. The objective of the distribution is to eliminate the balance in each partner's capital account.

15.

Total cash after paying liabilities	$109,000
Total capital balances ($34,000 + $31,000 + $28,000)	93,000
Excess (gain on sale of noncash assets)	$ 16,000
Allocated to Keegan ($16,000 X 3/10)	$ 4,800
Cash to Keegan ($31,000 + $4,800)	$ 35,800

16.

Capital deficiency, M. Jeter	$ 8,000
Loss allocated to: L. Pattison, capital ($8,000 X 3/8)	$ 3,000
Cash to L. Pattison ($12,000 – $3,000)	$ 9,000

***17.** This transaction represents the purchase of an existing partner's interest. It is a personal transaction that has no effect on partnership net assets.

***18.** Partnership net assets increase $25,000. No, Steve Renn does not necessarily acquire a 1/6 income ratio. Unless stated otherwise, net income or net loss is divided evenly among all partners.

***19.**

Grant, Capital	66,000	
Kate Robidou, Capital		66,000

***20.**

Tracy Harper, Capital	39,000	
Kim Remington, Capital		39,000

***21** Newlin's share of the bonus is $3,000 computed as follows:

Partnership assets		$85,000
Capital credit, Perry		77,000
Bonus to retiring partner		8,000
Allocated to:		
Garland: $8,000 X 5/8 =	$5,000	
Newlin: $8,000 X 3/8 =	3,000	8,000
		$ 0

***22.** Recording the revaluations violates the cost principle, which requires that assets be stated at original cost. It is also a departure from the going-concern assumption, which assumes the entity will continue indefinitely.

***23.** When a partner dies, it is usually necessary to determine the partner's equity at the date of death by: (1) determining the net income or loss for the year to date, (2) closing the books, and (3) preparing financial statements. The partnership agreement may also require an audit of the financial statements by independent auditors and a revaluation of assets by an appraisal firm.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 12-1

Cash	10,000	
Equipment	5,000	
Stanley Farrin, Capital		15,000

BRIEF EXERCISE 12-2

Accounts Receivable	$16,000	
Less: Allowance for doubtful accounts	2,500	$13,500
Equipment		11,000

Accumulated depreciation should not be shown because a new company cannot have any accumulated depreciation.

BRIEF EXERCISE 12-3

The division is: Held $42,000 ($70,000 X 60%) and Bond $28,000 ($70,000 X 40%). The entry is:

Income Summary	70,000	
Held, Capital		42,000
Bond, Capital		28,000

BRIEF EXERCISE 12-4

Division of Net Income

	Espino	Sears	Utech	Total
Salary allowance	$15,000	$ 5,000	$ 5,000	$25,000
Remaining income, $30,000: ($55,000 – $25,000)				
C ($30,000 X 50%)	15,000			
S ($30,000 X 30%)		9,000		
N ($30,000 X 20%)			6,000	
Total remainder				30,000
Total division	$30,000	$14,000	$11,000	$55,000

BRIEF EXERCISE 12-5

Division of Net Income

	Joe	Sam	Total
Salary allowance	$15,000	$10,000	$25,000
Interest allowance	7,000	5,000	12,000
Remaining deficiency, ($9,000):			
[($25,000 + $12,000) – $28,000]			
Joe ($9,000 X 50%)	(4,500)		
Sam ($9,000 X 50%)		(4,500)	
Total remainder			(9,000)
Total division	$17,500	$10,500	$28,000

BRIEF EXERCISE 12-6

A, Capital	8,000	
L, Capital	7,000	
F, Capital	4,000	
Cash		19,000

*BRIEF EXERCISE 12-7

Cox, Capital	10,000	
Day, Capital		10,000

*BRIEF EXERCISE 12-8

Cash	52,000	
Menke, Capital (50% X $11,900*)	5,950	
Hibbett, Capital (50% X $11,900)	5,950	
Kosko, Capital (45% X $142,000)		63,900

*[($40,000 + $50,000 + $52,000) X 45%] – $52,000 = $11,900.

*BRIEF EXERCISE 12-9

Denny, Capital	18,000	
Messer, Capital		9,000
Isch, Capital		9,000

*BRIEF EXERCISE 12-10

Denny, Capital	18,000	
Messer, Capital (50% X $6,000)	3,000	
Isch, Capital (50% X $6,000)	3,000	
Cash		24,000

SOLUTIONS TO EXERCISES

EXERCISE 12-1

1. False. A partnership is an association of *two* or more persons to carry on as co-owners of a business for profit.
2. False. Partnerships are fairly easy to form; they can be formed simply by a verbal agreement.
3. False. A partnership *is* an entity for financial reporting purposes.
4. False. The net income of a partnership is *not* taxed as a separate entity.
5. True.
6. True.
7. False. When a partnership is dissolved, the assets do *not* revert to the original contributor.
8. True.
9. False. Mutual agency is a *disadvantage* of the partnership form of business.

EXERCISE 12-2

(a)	Cash	50,000	
	Meissner, Capital		50,000
	Land	15,000	
	Building	80,000	
	Cohen, Capital		95,000
	Cash	9,000	
	Accounts Receivable	32,000	
	Equipment	19,000	
	Allowance for Doubtful Accounts		3,000
	Hughes, Capital		57,000

(b) $50,000 + $95,000 + $57,000 = $202,000

EXERCISE 12-3

Jan. 1	Cash	12,000	
	Accounts Receivable	14,000	
	Equipment	13,500	
	Allowance for Doubtful Accounts		3,000
	Jack Herington, Capital		36,500

EXERCISE 12-4

(a) (1)

DIVISION OF NET INCOME

	F. Calvert	G. Powers	Total
Salary allowance	$20,000	$12,000	$32,000
Interest allowance			
F. Calvert ($50,000 X 10%)	5,000		
G. Powers ($40,000 X 10%)		4,000	
Total interest			9,000
Total salaries and interest	25,000	16,000	41,000
Remaining income, $9,000 ($50,000 – $41,000)			
F. Calvert ($9,000 X 60%)	5,400		
G. Powers ($9,000 X 40%)		3,600	
Total remainder			9,000
Total division	$30,400	$19,600	$50,000

(2)

DIVISION OF NET INCOME

	F. Calvert	G. Powers	Total
Salary allowance	$20,000	$12,000	$32,000
Interest allowance	5,000	4,000	9,000
Total salaries and interest	25,000	16,000	41,000
Remaining deficiency, ($5,000) ($41,000 – $36,000)			
F. Calvert ($5,000 X 60%)	(3,000)		
G. Powers ($5,000 X 40%)		(2,000)	
Total remainder			(5,000)
Total division	$22,000	$14,000	$36,000

(b)

(1)	Income Summary	50,000	
	F. Calvert, Capital		30,400
	G. Powers, Capital		19,600
(2)	Income Summary	36,000	
	F. Calvert, Capital		22,000
	G. Powers, Capital		14,000

EXERCISE 12-5

(a)	Income Summary	70,000	
	O. Guillen, Capital ($70,000 X 45%)		31,500
	K. Williams, Capital ($70,000 X 55%)		38,500
(b)	Income Summary	70,000	
	O. Guillen, Capital [$30,000 + ($15,000 X 45%)]		36,750
	K. Williams, Capital [$25,000 + ($15,000 X 55%)]		33,250
(c)	Income Summary	70,000	
	O. Guillen, Capital		36,000
	K. Williams, Capital		34,000

Guillen: [$40,000 + $6,000 – ($20,000 X 50%)]
Williams: [$35,000 + $9,000 – ($20,000 X 50%)]

(d) Guillen: $60,000 + $36,000 – $18,000 = $78,000
Williams: $90,000 + $34,000 – $24,000 = $100,000

EXERCISE 12-6

(a)

STARRITE CO.
Partners' Capital Statement
For the Year Ended December 31, 2008

	G. Stark	J. Nyland	Total
Capital, January 1	$20,000	$18,000	$38,000
Add: Net income	15,000	15,000	30,000
	35,000	33,000	68,000
Less: Drawings	8,000	5,000	13,000
Capital, December 31	$27,000	$28,000	$55,000

EXERCISE 12-6 (Continued)

(b)

STARRITE CO.
Partial Balance Sheet
December 31, 2008

Owners' equity		
G. Stark, Capital	$27,000	
J. Nyland, Capital	28,000	
Total owners' equity		$55,000

EXERCISE 12-7

THE STOOGES PARTNERSHIP
Balance Sheet
December 31, 2008

Assets			
Current Assets			
Cash		$37,000	
Accounts Receivable	$36,000		
Less: Allowance for Doubtful Accounts	(4,000)	32,000	
Supplies		3,000	
Total current assets			$ 72,000
Property, Plant and Equipment			
Land		$18,000	
Building		75,000	
Equipment		47,000	
Total property, plant, and equipment			140,000
Total assets			$212,000
Liabilities and Owners' Equity			
Long-term Liabilities			
Mortgage Payable			$ 20,000
Owners' Equity			
Moe, Capital		$55,000	
Larry, Capital		73,000	
Curly, Capital		64,000	
Total owners' equity			192,000
Total liabilities and owners' equity			$212,000

EXERCISE 12-8

THE BEST COMPANY
Schedule of Cash Payments

Item	Cash	+ Noncash Assets	= Liabilities	+ Rodriguez Capital	+ Escobedo Capital
Balances before liquidation	$ 20,000	$100,000	$55,000	$45,000	$20,000
Sale of noncash assets and allocation of gain	110,000	(100,000)		6,000	4,000
New balances	130,000	0	55,000	51,000	24,000
Pay liabilities	(55,000)		(55,000)		
New balances	75,000	0	0	51,000	24,000
Cash distribution to partners	(75,000)			(51,000)	(24,000)
Final balances	$ 0	$ 0	$ 0	$ 0	$ 0

EXERCISE 12-9

		Debit	Credit
(a)	Cash	110,000	
	Noncash Assets		100,000
	Gain on Realization		10,000
(b)	Gain on Realization	10,000	
	Rodriguez, Capital ($10,000 X 60%)		6,000
	Escobedo, Capital ($10,000 X 40%)		4,000
(c)	Liabilities	55,000	
	Cash		55,000
(d)	Rodriguez, Capital	51,000	
	Escobedo, Capital	24,000	
	Cash		75,000

EXERCISE 12-10

(a)	(1)	Cash	4,000	
		Farley, Capital		4,000
	(2)	Newell, Capital	17,000	
		Jennings, Capital	15,000	
		Cash		32,000
(b)	(1)	Newell, Capital ($4,000 X 5/8)	2,500	
		Jennings, Capital ($4,000 X 3/8)	1,500	
		Farley, Capital		4,000
	(2)	Newell, Capital ($17,000 – $2,500)	14,500	
		Jennings, Capital ($15,000 – $1,500)	13,500	
		Cash		28,000

*EXERCISE 12-11

(a)	J. Lynn, Capital ($30,000 X 50%)	15,000	
	D. Duran, Capital		15,000
(b)	M. Oller, Capital ($26,000 X 50%)	13,000	
	D. Duran, Capital		13,000
(c)	F. Tate, Capital ($18,000 X 33 1/3%)	6,000	
	D. Duran, Capital		6,000

*EXERCISE 12-12

(a)	Cash	90,000	
	G. Olde, Capital (6/10 X $12,000)		7,200
	R. Young, Capital (4/10 X $12,000)		4,800
	K. Twener, Capital		78,000

Total capital of existing partnership	$170,000
Investment by new partner, Twener	90,000
Total capital of new partnership	$260,000
Twener's capital credit (30% X $260,000)	$ 78,000

*EXERCISE 12-12 (Continued)

Investment by new partner, Twener	$ 90,000
Twener's capital credit	78,000
Bonus to old partners	$ 12,000

(b)	Cash	50,000	
	G. Olde, Capital (6/10 X $16,000)	9,600	
	R. Young, Capital (4/10 X $16,000)	6,400	
	K. Twener, Capital		66,000

Total capital of existing partnership	$170,000
Investment by new partner, Twener	50,000
Total capital of new partnership	$220,000

Twener's capital credit (30% X $220,000)	$ 66,000

Investment by new partner, Twener	$ 50,000
Twener's capital credit	66,000
Bonus to new partner	$ 16,000

*EXERCISE 12-13

1.	S. Nguyen, Capital	32,000	
	B. Cates, Capital		16,000
	V. Elder, Capital		16,000
2.	S. Nguyen, Capital	32,000	
	V. Elder, Capital		32,000
3.	S. Nguyen, Capital	32,000	
	B. Cates, Capital		32,000

*EXERCISE 12-14

1.	R. Fisk, Capital	60,000	
	H. Barrajas, Capital ($8,000 X 5/8)	5,000	
	T. Dingler, Capital ($8,000 X 3/8)	3,000	
	Cash		68,000

Capital balance of withdrawing partner		$60,000
Payment to withdrawing partner		68,000
Bonus to retiring partner		$ 8,000
Allocation of bonus		
Barrajas, Capital ($8,000 X 5/8)	$5,000	
Dingler, Capital ($8,000 X 3/8)	3,000	$ 8,000

2.	R. Fisk, Capital	60,000	
	H. Barrajas, Capital ($4,000 X 5/8)		2,500
	T. Dingler, Capital ($4,000 X 3/8)		1,500
	Cash		56,000

Capital balance of withdrawing partner		$60,000
Payment to withdrawing partner		56,000
Bonus to remaining partners		$ 4,000
Allocation of bonus		
Barrajas, Capital ($4,000 X 5/8)	$2,500	
Dingler, Capital ($4,000 X 3/8)	1,500	$ 4,000

*EXERCISE 12-15

		Debit	Credit
(a)	Cash	80,000	
	Stewart, Capital		70,000
	($280,000 X 25%)		
	Carson, Capital		5,000
	($10,000 X 50%)		
	Letterman, Capital		3,000
	($10,000 X 30%)		
	O'Brien, Capital		2,000
	($10,000 X 20%)		

		Debit	Credit
(b)	Carson, Capital	100,000	
	Letterman, Capital	12,000	
	($20,000 X 3/5)		
	O'Brien, Capital	8,000	
	($20,000 X 2/5)		
	Cash		120,000

SOLUTIONS TO PROBLEMS

PROBLEM 12-1A

(a)	Jan. 1	Cash	14,000	
		Accounts Receivable	17,500	
		Merchandise Inventory	28,000	
		Equipment	23,000	
		Allowance for Doubtful Accounts		4,500
		Notes Payable		18,000
		Accounts Payable		22,000
		Patrick, Capital		38,000
	1	Cash	12,000	
		Accounts Receivable	26,000	
		Merchandise Inventory	20,000	
		Equipment	16,000	
		Allowance for Doubtful Accounts		4,000
		Notes Payable		15,000
		Accounts Payable		31,000
		Samuelson, Capital		24,000
(b)	Jan. 1	Cash	5,000	
		Patrick, Capital		5,000
	1	Cash	19,000	
		Samuelson, Capital		19,000

(c)

PASA COMPANY
Balance Sheet
January 1, 2008

Assets

Current assets		
Cash ($14,000 + $12,000 + $5,000 + $19,000)		$ 50,000
Accounts receivable ($17,500 + $26,000)	$43,500	
Less: Allowance for doubtful accounts ($4,500 + $4,000)	8,500	35,000
Merchandise inventory ($28,000 + $20,000)		48,000
Total current assets		133,000
Property, plant, and equipment		
Equipment ($23,000 + $16,000)		39,000
Total assets		$172,000

Liabilities and Owners' Equity

Current liabilities		
Notes payable ($18,000 + $15,000)		$ 33,000
Accounts payable ($22,000 + $31,000)		53,000
Total current liabilities		86,000
Owners' equity		
Patrick, Capital ($38,000 + $5,000)	$43,000	
Samuelson, Capital ($24,000 + $19,000)	43,000	
Total owners' equity		86,000
Total liabilities and owners' equity		$172,000

PROBLEM 12-2A

(a) (1)	Income Summary	30,000	
	Reese Caplin, Capital ($30,000 X 60%)		18,000
	Phyllis Newell, Capital ($30,000 X 30%)		9,000
	Betty Uhrich, Capital ($30,000 X 10%)		3,000
(2)	Income Summary	37,000	
	Reese Caplin, Capital ($15,000 + $4,000)		19,000
	Phyllis Newell, Capital ($10,000 + $4,000)		14,000
	Betty Uhrich, Capital ($0 + $4,000)		4,000

Net income	$37,000
Salary allowance	
Caplin	(15,000)
Newell	(10,000)
Remainder	$12,000
To each partner ($12,000 X 1/3)	$ 4,000

(3)	Income Summary	19,000	
	Reese Caplin, Capital ($4,800 + $12,000 – $1,100)		15,700
	Phyllis Newell, Capital ($3,000 – $1,100)		1,900
	Betty Uhrich, Capital ($2,500 – $1,100)		1,400

Net income	$19,000
Interest allowance	
Caplin ($48,000 X 10%)	(4,800)
Newell ($30,000 X 10%)	(3,000)
Uhrich ($25,000 X 10%)	(2,500)
Balance	8,700
Salary allowance	
Caplin	(12,000)
Remainder	$ (3,300)
To each partner ($3,300 X 1/3)	$ (1,100)

PROBLEM 12-2A (Continued)

(b) **DIVISION OF NET INCOME**

	Reese Caplin	Phyllis Newell	Betty Uhrich	Total
Salary allowance	$12,000			$12,000
Interest allowance				
Reese Caplin ($48,000 X 10%)	4,800			
Phyllis Newell ($30,000 X 10%)		$3,000		
Betty Uhrich ($25,000 X 10%)			$2,500	
Total interest				10,300
Total salaries and interest	16,800	3,000	2,500	22,300
Remaining deficiency, ($3,300)				
Reese Caplin ($3,300 X 1/3)	(1,100)			
Phyllis Newell ($3,300 X 1/3)		(1,100)		
Betty Uhrich ($3,300 X 1/3)			(1,100)	
Total remainder				(3,300)
Total division	$15,700	$1,900	$1,400	$19,000

(c)

CNU COMPANY
Partners' Capital Statement
For the Year Ended December 31, 2008

	Reese Caplin	Phyllis Newell	Betty Uhrich	Total
Capital, January 1	$48,000	$30,000	$25,000	$103,000
Add: Net income	15,700	1,900	1,400	19,000
	63,700	31,900	26,400	122,000
Less: Drawings	23,000	14,000	10,000	47,000
Capital, December 31	$40,700	$17,900	$16,400	$ 75,000

PROBLEM 12-3A

(a)

(1)

Cash		55,000	
Allowance for Doubtful Accounts		1,000	
Accumulated Depreciation		5,500	
Loss on Realization		19,000	
Accounts Receivable			25,000
Merchandise Inventory			34,500
Equipment			21,000

Noncash assets (net)	$74,000
Sale proceeds	55,000
Loss on sale of noncash assets	$19,000

(2)

M. Mantle, Capital ($19,000 X 5/10)	9,500	
W. Mays, Capital ($19,000 X 3/10)	5,700	
D. Snider, Capital ($19,000 X 2/10)	3,800	
Loss on Realization		19,000

(3)

Notes Payable	13,500	
Accounts Payable	27,000	
Wages Payable	4,000	
Cash		44,500

(4)

Cash	800	
D. Snider, Capital ($3,800 – $3,000)		800

(5)

M. Mantle, Capital ($33,000 – $9,500)	23,500	
W. Mays, Capital ($21,000 – $5,700)	15,300	
Cash		38,800

PROBLEM 12-3A (Continued)

(b)

Cash

Bal.	27,500	(3)	44,500
(1)	55,000	(5)	38,800
(4)	800		
	83,300		83,300

M. Mantle, Capital

(2)	9,500	Bal.	33,000
(5)	23,500		
	33,000		33,000

W. Mays, Capital

(2)	5,700	Bal.	21,000
(5)	15,300		
	21,000		21,000

D. Snider, Capital

(2)	3,800	Bal.	3,000
		(4)	800
	3,800		3,800

(c)

(1)	M. Mantle, Capital ($800 X 5/8)	500	
	W. Mays, Capital ($800 X 3/8)	300	
	D. Snider, Capital		800
(2)	M. Mantle, Capital ($23,500 – $500)	23,000	
	W. Mays, Capital ($15,300 – $300)	15,000	
	Cash ($38,800 – $800)		38,000

*PROBLEM 12-4A

(a)	(1)	T. Gomez, Capital	9,000	
		D. Atchley, Capital		9,000
	(2)	J. Kensington, Capital	18,000	
		D. Atchley, Capital		18,000
	(3)	Cash	66,000	
		S. Seger, Capital (50% X $9,000)		4,500
		J. Kensington, Capital (40% X $9,000)		3,600
		T. Gomez, Capital (10% X $9,000)		900
		D. Atchley, Capital		57,000

Total capital of existing partnership	$124,000
Investment by Atchley	66,000
Total capital of new partnership	$190,000
Atchley's capital credit ($190,000 X 30%)	$ 57,000
Investment by new partner, Atchley	$ 66,000
Atchley's capital credit	57,000
Bonus to old partners	$ 9,000

(4)	Cash	46,000	
	S. Seger, Capital ($5,000 X 50%)	2,500	
	J. Kensington, Capital ($5,000 X 40%)	2,000	
	T. Gomez, Capital ($5,000 X 10%)	500	
	D. Atchley, Capital		51,000

Total capital of existing partnership	$124,000
Investment by Atchley	46,000
Total capital of new partnership	$170,000

***PROBLEM 12-4A (Continued)**

Atchley's capital credit .... ($170,000 X 30%)	**$51,000**
Investment by new partner....................................	**$46,000**
Atchley's capital credit	**51,000**
Bonus to new partner............	**$ 5,000**

(b)	**(1)**	**Total capital after admission ($32,000 ÷ 20%)**	**$160,000**
		Total capital before admission	**124,000**
		Cash investment by Atchley...	**$ 36,000**
	(2)	**Decrease in Kensington's equity ($54,000 – $32,000)** ..	**$ 22,000**
		Kensington's income ratio...	**40%**
		Bonus to new partner ($22,000 ÷ 40%)	**$ 55,000**

*PROBLEM 12-5A

(a)

(1)	K. Durham, Capital	26,000	
	J. Fagan, Capital		13,000
	P. Ames, Capital		13,000
(2)	K. Durham, Capital	26,000	
	P. Ames, Capital		26,000
(3)	K. Durham, Capital	26,000	
	J. Fagan, Capital ($8,000 X 5/8)	5,000	
	P. Ames, Capital ($8,000 X 3/8)	3,000	
	Cash		34,000

Durham's capital balance	$26,000
Payment to Durham	34,000
Bonus to Durham	$ 8,000

(4)	K. Durham, Capital	26,000	
	J. Fagan, Capital ($4,000 X 5/8)		2,500
	P. Ames, Capital ($4,000 X 3/8)		1,500
	Cash		22,000

Durham's capital balance	$26,000
Payment to Durham	22,000
Bonus to old partners	$ 4,000

(b)

(1)	Ames's capital after withdrawal	$42,400
	Ames's capital before withdrawal	40,000
	Bonus to Ames	2,400
	Ames's income ratio with Fagan	3/8
	Total bonus ($2,400 ÷ 3/8)	$ 6,400
(2)	Durham's capital balance	$26,000
	Total bonus to other partners	(6,400)
	Cash paid to Durham	$19,600

PROBLEM 12-1B

(a)	Jan. 1	Cash	9,500	
		Accounts Receivable	15,000	
		Merchandise Inventory	32,000	
		Equipment	28,000	
		Allowance for Doubtful Accounts		3,500
		Notes Payable		25,000
		Accounts Payable		20,000
		Free, Capital		36,000
	1	Cash	6,000	
		Accounts Receivable	23,000	
		Merchandise Inventory	21,000	
		Equipment	18,000	
		Allowance for Doubtful Accounts		5,000
		Accounts Payable		37,000
		Will, Capital		26,000
(b)	Jan. 1	Cash	3,000	
		Free, Capital		3,000
	1	Cash	13,000	
		Will, Capital		13,000

PROBLEM 12-1B (Continued)

(c)

FREE-WILL COMPANY
Balance Sheet
January 1, 2008

Assets		
Current assets		
Cash		$ 31,500
($9,500 + $6,000 + $3,000 + $13,000)		
Accounts receivable		
($15,000 + $23,000)	$38,000	
Less: Allowance for doubtful accounts		
($3,500 + $5,000)	8,500	29,500
Merchandise inventory		
($32,000 + $21,000)		53,000
Total current assets		114,000
Property, plant, and equipment		
Equipment ($28,000 + $18,000)		46,000
Total assets		$160,000
Liabilities and Owners' Equity		
Current liabilities		
Notes payable		$ 25,000
Accounts payable ($20,000 + $37,000)		57,000
Total current liabilities		82,000
Owners' equity		
Free, Capital ($36,000 + $3,000)	$39,000	
Will, Capital ($26,000 + $13,000)	39,000	
Total owners' equity		78,000
Total liabilities and owners' equity		$160,000

PROBLEM 12-2B

(a) (1)	Income Summary	40,000	
	J. Reno, Capital ($40,000 X 50%)		20,000
	L. Augustine, Capital ($40,000 X 30%)		12,000
	J. Fritz, Capital ($40,000 X 20%)		8,000
(2)	Income Summary	30,000	
	J. Reno, Capital ($11,000 + $3,000)		14,000
	L. Augustine, Capital ($10,000 + $3,000)		13,000
	J. Fritz, Capital ($0 + $3,000)		3,000

Net income	$30,000
Salary allowances	
Reno	(11,000)
Augustine	(10,000)
Remainder	$ 9,000
To each partner ($9,000 X 1/3)	$ 3,000

(3)	Income Summary	27,000	
	J. Reno, Capital ($3,300 + $18,000 + $900)		22,200
	L. Augustine, Capital ($2,000 + $900)		2,900
	J. Fritz, Capital ($1,000 + $900)		1,900

Net income	$27,000
Interest allowance	
Reno ($33,000 X 10%)	(3,300)
Augustine ($20,000 X 10%)	(2,000)
Fritz ($10,000 X 10%)	(1,000)
Balance	20,700
Salary allowance	
Reno	(18,000)
Remainder	$ 2,700
To each partner ($2,700 X 1/3)	$ 900

PROBLEM 12-2B (Continued)

(b) **DIVISION OF NET INCOME**

	J. Reno	L. Augustine	J. Fritz	Total
Salary allowance	$18,000			$18,000
Interest allowance				
J. Reno ($33,000 X 10%)	3,300			
L. Augustine ($20,000 X 10%)		$2,000		
J. Fritz ($10,000 X 10%)			$1,000	
Total interest				6,300
Total salaries and interest	21,300	2,000	1,000	24,300
Remaining income, $2,700				
J. Reno ($2,700 X 1/3)	900			
L. Augustine ($2,700 X 1/3)		900		
J. Fritz ($2,700 X 1/3)			900	
Total remainder				2,700
Total division	$22,200	$2,900	$1,900	$27,000

(c)

RAF COMPANY
Partners' Capital Statement
For the Year Ended December 31, 2008

	J. Reno	L. Augustine	J. Fritz	Total
Capital, January 1	$33,000	$20,000	$10,000	$63,000
Add: Net income	22,200	2,900	1,900	27,000
	55,200	22,900	11,900	90,000
Less: Drawings	12,000	9,000	4,000	25,000
Capital, December 31	$43,200	$13,900	$ 7,900	$65,000

PROBLEM 12-3B

(a)

SHAWNEE COMPANY
Schedule of Cash Payments

Item	Cash	+	Noncash Assets	=	Liabilities	+	Neeley	+	Hannah	+	Doonan
Balances before liquidation	$28,000	+	$53,000	=	$42,000	+	$23,000	+	$11,200		$4,800
Sale of noncash assets and allocation of loss (1) + (2)	43,000	+	(53,000)	=			(5,000)	+	(3,000)		(2,000)
New balances	71,000	+	0	=	42,000	+	18,000	+	8,200		2,800
Pay liabilities (3)	(42,000)			=	(42,000)						
New balances	29,000	+	0	=	0	+	18,000	+	8,200		2,800
Cash distribution to partners (4)	29,000		0	=	0		(18,000)	+	(8,200)		(2,800)
Final balances	$ 0		$ 0		$ 0		$ 0		$ 0		$ 0

PROBLEM 12-3B (Continued)

(b)

(1)

Apr. 30	Cash	43,000	
	Allowance for Doubtful Accounts	1,000	
	Accumulated Depreciation	10,000	
	Loss on Realization	10,000	
	Accounts Receivable		19,000
	Merchandise Inventory		28,000
	Equipment		17,000

Noncash assets (net)	$53,000
Sale proceeds	43,000
Loss on sale of noncash assets	$10,000

(2)

30	Neeley, Capital ($10,000 X 50%)	5,000	
	Hannah, Capital ($10,000 X 30%)	3,000	
	Doonan, Capital ($10,000 X 20%)	2,000	
	Loss on Realization		10,000

(3)

30	Notes Payable	16,000	
	Accounts Payable	24,000	
	Wages Payable	2,000	
	Cash		42,000

(4)

30	Neeley, Capital ($23,000 – $5,000)	18,000	
	Hannah, Capital ($11,200 – $3,000)	8,200	
	Doonan, Capital ($4,800 – $2,000)	2,800	
	Cash		29,000

PROBLEM 12-3B (Continued)

(c)

Cash

4/30 Bal.	28,000	4/30 (3)	42,000
30 (1)	43,000	30 (4)	29,000
	71,000		71,000

Hannah, Capital

4/30 (2)	3,000	4/30 Bal.	11,200
30 (4)	8,200		
	11,200		11,200

Neeley, Capital

4/30 (2)	5,000	4/30 Bal.	23,000
30 (4)	18,000		
	23,000		23,000

Doonan, Capital

4/30 (2)	2,000	4/30 Bal.	4,800
30 (4)	2,800		
	4,800		4,800

*PROBLEM 12-4B

(a) (1)

Rothlisberger, Capital	12,000	
Wamser, Capital		12,000

(2)

Norrison, Capital	13,000	
Wamser, Capital		13,000

(3)

Cash	46,000	
Alexander, Capital ($12,000 X 5/10)	6,000	
Norrison, Capital ($12,000 X 3/10)	3,600	
Rothlisberger, Capital ($12,000 X 2/10)	2,400	
Wamser, Capital		58,000

Total capital of existing partnership	$ 99,000
Investment by Wamser	46,000
Total capital of new partnership	$145,000
Wamser's capital credit ($145,000 X 40%)	$ 58,000
Investment by new partner, Wamser	$ 46,000
Wamser's capital credit	58,000
Bonus to new partner	$ 12,000

(4)

Cash	30,000	
Alexander, Capital ($4,200 X 5/10)		2,100
Norrison, Capital ($4,200 X 3/10)		1,260
Rothlisberger, Capital ($4,200 X 2/10)		840
Wamser, Capital		25,800

Total capital of existing partnership	$ 99,000
Investment by Wamser	30,000
Total capital of new partnership	$129,000

***PROBLEM 12-4B (Continued)**

Wamser's capital credit .... **($129,000 X 20%)**	**$25,800**
Investment by new partner, Wamser	**$30,000**
Wamser's capital credit	**25,800**
Bonus to old partners	**$ 4,200**

(b)	**Total capital after admission ($27,000 ÷ 15%)**	**$180,000**
	Total capital before admission	**99,000**
(1)	**Cash investment by Wamser**	**$ 81,000**
	Increase in Rothlisberger's equity ($27,000 – $24,000)	**$ 3,000**
	Rothlisberger's income ratio	**2/10**
(2)	**Total bonus to old partners ($3,000 ÷ 2/10)**	**$ 15,000**

*PROBLEM 12-5B

			Debit	Credit
(a)	(1)	B. Jack, Capital	20,000	
		A. King, Capital		10,000
		L. Queen, Capital		10,000
	(2)	B. Jack, Capital	20,000	
		L. Queen, Capital		20,000
	(3)	B. Jack, Capital	20,000	
		A. King, Capital ($6,000 X 6/9)	4,000	
		L. Queen, Capital ($6,000 X 3/9)	2,000	
		Cash		26,000

Jack's capital balance	$20,000
Payment to Jack	26,000
Bonus to Jack	$ 6,000

			Debit	Credit
	(4)	B. Jack, Capital	20,000	
		A. King, Capital ($9,000 X 6/9)		6,000
		L. Queen, Capital ($9,000 X 3/9)		3,000
		Cash		11,000

Jack's capital balance	$20,000
Payment to Jack	11,000
Bonus to remaining partners	$ 9,000

(b)	(1)	Queen's capital after withdrawal	$32,000
		Queen's capital before withdrawal	30,000
		Bonus to Queen	$ 2,000
		Queen's income ratio with King	3/9
		Total bonus ($2,000 ÷ 3/9)	$ 6,000
	(2)	Jack's capital balance	$20,000
		Total bonus to remaining partners	(6,000)
		Cash paid to Jack	$14,000

BYP 12-1 EXPLORING THE WEB

Students' answers will depend upon the firm selected and the timing of their exploration.

BYP 12-2 DECISION MAKING ACROSS THE ORGANIZATION

(a) The major disadvantages of a partnership are mutual agency, limited life, and unlimited liability. Mutual agency means that each partner acts on behalf of the partnership when engaging in partnership business. The act of any partner is binding on all other partners, even when the partners act beyond the scope of their authority, so long as the act appears to be appropriate for the partnership. A partnership does not have unlimited life. A partnership may be ended voluntarily or involuntarily. For the partnership discussed here, limited life does not appear to be a major drawback. Unlimited liability means that each partner is personally and individually liable for all partnership liabilities. Creditors' claims attach first to partnership assets, then to the personal resources of any partner, irrespective of that partner's capital equity in the company. This is a major limitation of a partnership.

(b) The written partnership agreement, often referred to as the articles of co-partnership, is needed. It should contain such basic information as the name and principal location of the firm, the purpose of the business, and date of inception. In addition, the following should be specified: (1) names and capital contributions of partners, (2) rights and duties of partners, (3) basis for sharing net income or net loss, (4) provision for withdrawals of assets, (5) procedures for submitting disputes to arbitration, (6) procedures for the withdrawal or addition of a partner, and (7) rights and duties of surviving partners in the event of a partner's death.

(c) The best approach would be to give Richard an interest allowance for the additional investment. This approach would therefore permit each party to share equally in net income or net loss after the interest allowance.

(d) The computer equipment should be depreciated on the books of the partnership, not on Richard's personal tax return. The computer is owned by the partnership, and only Richard's share of net income should be reported on his tax return. The computer would be reported at its fair market value when invested in the partnership, less the accumulated depreciation as of the end of the taxable year.

BYP 12-2 (Continued)

(e) To facilitate the payment from partnership assets of the deceased partner's equity, some companies obtain life insurance policies on each partner with the partnership as the beneficiary. The proceeds from the insurance policy on the deceased partner are then used to settle the estate.

BYP 12-3 COMMUNICATION ACTIVITY

To: Daniel Ortman
Sue Stafford

From: Your Accountant

Subject: Partnership Agreement for Pasta Shop

There are many important issues that should be included in your partnership agreement. Prior to our meeting next Tuesday, in my office, it would be helpful for you to consider the following matters.

1. Facts about the business; i.e., name, location, purpose, and date of inception.

2. Facts about the partners; i.e., the name and address of each partner, the beginning capital contribution of each partner, and the rights and duties of partners with respect to: (a) making business decisions, (b) active participation in the partnership (full/part-time), and (c) allowances for vacations and sick leave.

3. Basis for sharing net income or net loss. The Uniform Partnership Act specifies that the basis will be equal unless another basis is stated in the partnership agreement. The basis may include provisions for partnership salaries and interest on capital balances with the remainder being divided on a proportionate basis.

4. Provision for withdrawals of assets. There are two kinds of withdrawals: one is called drawings; the other is called a withdrawal of capital. The former relates to providing each partner with cash for normal living expenses. You may provide for periodic drawings of a fixed amount such as $1,000 a month, or an amount not to exceed a specified amount such as $1,500 or $2,000. Withdrawals of capital can affect the future of the partnership. Thus, you may want to provide for consultation with an attorney, a financial advisor, and/or a CPA and a formal approval procedure.

BYP 12-3 (Continued)

5. **Procedures for submitting disputes to arbitration. Inevitably, disagreements will occur between partners. The partnership contract should provide a framework for resolving them. You may want to include some or all of the outside parties mentioned above in an arbitration committee.**

6. **Procedures for the withdrawal or addition of a partner. At this time, consideration of this issue may seem premature. However, it is still useful to have basic procedures in place. For withdrawals, consideration should be given to both voluntary and "forced" withdrawals and the basis of determining and paying the capital equity of the partner who is leaving the firm. For additions, you may wish to state whether each admission must have the unanimous approval of existing partners and the terms of admission.**

7. **Rights and duties of surviving partners. The death of a partner is often a traumatic experience. Thus, it is advisable that the partnership agreement specify the responsibilities of the surviving partners, assuming the business is continued, or if the business is terminated. Also, procedures should be included for determining the deceased partner's equity in the firm. The procedures might include an audit of the financial statements and a revaluation of assets by an independent appraisal firm.**

I look forward to a productive session with both of you next Tuesday.

BYP 12-4 ETHICS CASE

(a) The stakeholders in this situation are Elizabeth and Laurie.

(b) The consequences of Elizabeth's actions are that they cause significant differences in the time worked between the partners and in the amount of drawings made by each partner. Sooner or later, Laurie is going to become annoyed with Elizabeth's actions and this could cause friction between the partners.

The differences here emphasize the importance of a written partnership agreement. Time to be worked by each partner and allowable drawings are two subjects that should be in the agreement.

Based on the information given, ethical considerations rest primarily on the issue of fairness. Elizabeth is not trying to hide anything from Laurie. However, her actions do not seem to be fair.

(c) For the differences in time worked, two changes in the partnership agreement should be considered. First, Laurie could be given a higher salary allowance than Elizabeth. Second, because Laurie is contributing more to net income than Elizabeth, she could be given a higher percentage of net income after deducting salary allowances.

For the differences in drawings, the partnership agreement could be altered to allow for interest on average monthly "net" partners' capitals. Net partners' capitals would be the difference between the balances of the capital and drawing accounts at the end of each month. If this is not agreeable to Elizabeth, then the partnership agreement should be changed to limit the drawings of each partner to a fixed amount.

BYP 12-5 ALL ABOUT YOU ACTIVITY

Given that the students may come up with variety of answers that are correct, there is no single correct solution to this problem. You may wish to have a show of hands on each question to see whether any consensus has developed on any of the questions.