Accounting Principles

Thirteenth Edition

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Chapter 12

Accounting for Partnerships

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Chapter Outline

Learning Objectives

LO 1 Discuss and account for the formation of a partnership.

LO 2 Explain how to account for net income or net loss of a partnership.

LO 3 Explain how to account for the liquidation of a partnership.

Forming a Partnership

Partnership, an association of two or more persons to carry on as co-owners of a business for profit.

Type of Business:

- Small retail, service, or manufacturing companies
- Accountants, lawyers, and doctors

Characteristics of Partnerships

Association of Individuals

- Legal entity
- Accounting entity
- Net income not taxed as a separate entity

Mutual Agency

- Act of any partner is binding on all other partners, so long as act appears to be appropriate for partnership

Characteristics of Partnerships

Limited Life

- Dissolution occurs whenever a partner withdraws or a new partner is admitted
- Dissolution does not mean business ends

Unlimited Liability

- Each partner is personally and individually liable for all partnership liabilities

Characteristics of Partnerships

Co-Ownership of Property

- Each partner has a claim on total assets
- Claim does not attach to specific assets
- All net income or net loss is shared equally by partners, unless otherwise stated in partnership agreement

Characteristics of Partnerships

Which of the following is **not** a characteristic of a partnership?

a. Taxable entity

b. Mutual agency

c. Co-ownership of property

d. Limited life

Organizations with Partnership Characteristics

Special forms of business organizations are often used to provide protection from unlimited liability.

Special partnership forms are:

- Limited Partnerships,
- Limited Liability Partnerships, and
- Limited Liability Companies.

HELPFUL HINT In an LLP, all partners have limited liability. There are no general partners.

Organizations with Partnership Characteristics

Regular Partnership

Major Advantages

- Simple and inexpensive to create and operate

Major Disadvantages

- Owners (partners) personally liable for business debts

Organizations with Partnership Characteristics

"Ltd.," or "LP"

Major Advantages

- Limited partners have limited personal liability for business debts as long as they do not participate in management
- General partners can raise cash without involving outside investors in management of business

Major Disadvantages

- General partners personally liable for business debts
- More expensive to create than regular partnership
- Suitable for companies that invest in real estate

Organizations with Partnership Characteristics

"LLP"

Major Advantages

- Mostly of interest to partners in old-line professions such as law, medicine, and accounting
- Owners (partners) are not personally liable for the malpractice of other partners

Major Disadvantages

- Partners remain personally liable for many types of obligations owed to business creditors, lenders, and landlords
- Often limited to a short list of professions

Organizations with Partnership Characteristics

"LLC"

Major Advantages

- Owners have limited personal liability for business debts even if they participate in management

Major Disadvantages

- More expensive to create than regular partnership

Advantages and Disadvantages of Partnerships

Advantages

- Combining skills and resources of two or more individuals
- Ease of formation
- Freedom from governmental regulations and restrictions
- Ease of decision-making

Advantages and Disadvantages of Partnerships

Disadvantages

- Mutual agency
- Limited life
- Unlimited liability

The Partnership Agreement

Should specify relationships among the partners.

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 withdrawal or addition of a partner.
7. Rights and duties of surviving partners in event of a partner’s death.

Accounting for a Partnership Formation

Illustration: Assume that A. Rolfe and T. Shea combine their proprietorships to start a partnership named U.S. Software. Rolfe and Shea have the following assets prior to the formation of the partnership.

	Book Value		Fair Value	
	A. Rolfe	T. Shea	A. Rolfe	T. Shea
Cash	$8,000	$9,000	**$8,000**	**$9,000**
Equipment	5,000		**4,000**	
Accumulated depreciation	(2,000)			
Accounts receivable		4,000		**4,000**
Allowance for doubtful accounts		(700)		**(1,000)**
	$11,000	$12,300	**$12,000**	**$12,000**

ILLUSTRATION 12.3

Accounting for a Partnership Formation

Illustration: Prepare the journal entry to record the investment in A. Rolfe.

Cash	8,000	
Equipment	4,000	
A. Rolfe, Capital		12,000

Prepare the entry to record the investment of T. Shea.

Cash	9,000	
Accounts Receivable	4,000	
Allowance for Doubtful Accounts		1,000
T. Shea, Capital		12,000