CHAPTER 5

ACCOUNTING FOR PARTNERSHIP

**Objectives**

After studying this unit, you should be able to:

* Understand the meaning of partnerships & their characteristics
* Describe the advantages & disadvantage of partnership
* Explain the accounting entries for the formation of a partnership
* Identify the methods for distributing net income or net loss
* Describe the formation of financial statement for partnership.
* Describe the accounting treatment, when partnership dissolves.
* Describe the accounting treatment for liquidation of partnership.

**5.1 ALTERNATE FORMS OF BUSINESS ENTITIES**

A variety of legal forms exist for forming and operating a business. The four mostcommon legal forms are proprietorships, corporations, partnerships, and limited liability corporations. In this section, we describe the characteristics of each of these business entities.

1. **PROPRIETORSHIPS**

A proprietorship is a business enterprise owned bya single individual. The most common type of proprietorships are professional serviceproviders, such as lawyers, architects, realtors, and physicians.

A proprietorship is simple to form. Indeed, you may already be a proprietor. For example, a person providing child-care services for friends of the family is a proprietor.There are no legal restrictions or forms to file in forming a proprietorship.The ease of forming a proprietorship is one of its main advantages. In addition, theindividual owner can usually make business decisions without consulting others.This ability to be one’s own boss is a major reason why many individuals organizetheir businesses as proprietorships.

A proprietorship is a separate entity for accounting purposes, and when the ownerdies or retires, the proprietorship ceases to exist. For federal income tax purposes,however, the proprietorship is not treated as a separate taxable entity. The incomeor loss is said to “pass through” to the owner’s individual income tax return. Thus,the income from a proprietorship is taxed only at the individual level.

A primary disadvantage of a proprietorship is the difficulty in raising large amounts of capital. Investment in the business is limited to the amounts that the owner canprovide from personal resources, plus any additional amounts that can be raisedthrough borrowing. In addition, the owner is personally liable for any debts or legalclaims against the business. In other words, if the business fails, creditors have rightsto the personal assets of the owner, regardless of the amount of the owner’s actualinvestment in the enterprise.

1. **CORPORATIONS**

The major benefits of the corporate form are its abilityto provide limited liability to its owners and its potential for raising large amounts of capital through issuing stock. For these reasons, most large businesses use thecorporate form of entity.However, corporations also have disadvantages. Forming a corporation requireslegal filings to and approvals by state regulatory agencies. In addition, corporationsare more complex to manage and must be operated in accordance with the corporatebylaws. Corporations are taxed as a separate entity. Thus, when earnings aredistributed to shareholders in the form of dividends, they are also taxed again atthe individual level.

To avoid the double taxation of dividends, a business may organize an S Corporation.Under an **S corporation**, the IRS allows income to pass through the corporationto the individual stockholders without the corporation having to pay taxes onthe income. However, the S corporation has a number of legal limitations, includinga limitation on the number of stockholders. In recent years, the S corporation hasbecome less popular due to the emergence of the limited liability corporation andits many advantages, which we will discuss later in this chapter.

1. **PARTNERSHIPS**

A ***partnership*** is an association of two or more persons who own and manage abusiness for profit. Partnerships have several characteristics with accounting implications.A partnership has a**limited life**. A partnership dissolves whenever a partner ceases to be a member of the firm. For example, a partnership is dissolved if a partner withdrawsdue to bankruptcy, incapacity, or death. Likewise, admitting a new partner dissolvesthe old partnership. When a partnership is dissolved, the remaining partnersmust form a new partnership if operations of the business are to continue.

A partnership is relatively easy and inexpensive to organize, requiring only anagreement between two or more persons. A partnership has the advantage of bringingtogether more capital, managerial skills, and experience than does a proprietorship.Since a partnership is a nontaxable entity, the combined income taxes paidby the individual partners may be lower than the income taxes that would be paidby a corporation, which is a taxable entity.

A major disadvantage of the partnership is the unlimited liability feature for partners.Other disadvantages of a partnership are that its life is limited, and one partnercan bind the partnership to contracts. Also, raising large amounts of capital is moredifficult for a partnership than for a corporation. To overcome these limitations, otherhybrid forms of organization, such as limited liability corporations (LLCs), have beenreplacing partnerships as a means of organization.

1. **LIMITED LIABILITY CORPORATIONS**

A ***limited liability corporation (LLC)*** is a relatively new business entity form that combines the advantages of the corporate and partnership forms. Many features ofa partnership are retained in an LLC. The owners of an LLC are termed “members”rather than “partners.” The members must create an **operating agreement**, whichis similar to a partnership agreement. For example, the operating agreement normallyindicates how income is to be distributed to the members. Thus, unlike a corporation,income need not be distributed according to the number of shares ownedby each member. Instead, income might be distributed according to the amount oftime each member devotes to the business.

For tax purposes, an LLC may elect to be treated as a partnership. In this way,income passes through the LLC and is taxed on the individual members’ tax returns.Thus, the LLC may avoid the double taxation characterized by the corporate form.Unless specified in the operating agreement, LLCs have a limited life and mustdissolve when a member withdraws. In addition, the members may elect to operatethe LLC as a “member-managed” entity, which allows individual members tolegally bind the LLC, like partners bind a partnership.

LLCs also have some features of a corporation. One of the most important corporatefeatures is that LLCs provide limited liability for the members, even if theyare active participants in the business. Thus, members’ personal assets are not subjectto claims by creditors of the LLC.

Like a corporation, LLCs must file “articles of organization” with state governmentalauthorities. In addition, the LLC may elect to be “manager-managed” ratherthan “member-managed.” In a “manager-managed” structure, only authorized membersmay legally bind the LLC. This allows members to share in the income of theLLC without being concerned about managing the business, much like stockholdersof a corporation.

**LIMITED PARTNERSHIPS AND JOINT VENTURES**

Two other common forms of association that are a type of partnership or similarto a partnership are limited partnerships and joint ventures.

**Limited Partnerships - Alimited partnership** is a special type of partnershipthat, like corporations, confines the limited partner’s potential loss to the amountof his or her investment. Under this type of partnership the unlimited liabilitydisadvantage of a partnership can be overcome. Usually, the limited partnershiphas a general partner who has unlimited liability but allows other partners to limittheir potential loss. The potential loss of all partners in an ordinary partnership islimited only by personal bankruptcy laws.

**Joint Ventures -**In today’s global environment, more companies are looking to form alliances similar to partnerships, called *joint ventures,* with other companies rather than to venture out on their own. A **joint venture** is an association of two or more entities for the purpose of achieving a specific goal, such as the manufacture of a product in a new market. Many joint ventures have an agreed-upon limited life. The entities forming joint ventures usually involve companies but can sometimes involve governments, especially in emerging economies. A joint venture brings together the resources, technical skills, political ties, and other assets of each of the parties for a common goal. Profits and losses are shared on an agreed-upon basis.

**COMPARISON OF ALTERNATE ENTITYCHARACTERISTICS**

Exhibit 1 summarizes the four business entity forms discussed in this section. The columns of Exhibit 1 are the major characteristics of the organizational forms: easeof formation, legal liability, taxation, limitation on life of the entity, and access tocapital. As one expert who has been involved in a number of start-up businessesreplied when asked what structure makes the most sense: “It depends. Each situationI’ve been involved with has been different. You can’t just make an assumptionthat one form is better than another.”6 Generally, the corporate form will be preferredif the business is risky and requires access to capital. Otherwise, the otherthree forms all have their advantages, depending on the need for simplicity, liabilitylimitation, flexibility, and tax considerations.

**Exhibit 1: Characteristics of Organizational Forms**



**5.2 CHARACTERISTICS OF PARTNERSHIPS**

A partnership is a voluntary association of individuals rather than a legal entity in itself. Therefore, a partner is responsible under the law for his or her partners’ actions within the scope of the business. A partner also has unlimited liability for the debts of the partnership. Because of these potential liabilities, a partner must be allowed to choose the people who join the partnership. A person should select partners individuals who share his or her business objectives.

1. **Partnership Agreement** A partnership is easy to form. Two or more competent people simply agree to be partners in a common business purpose. Their agreement is known as a **partnership agreement.** The partnership agreement does not have to be in writing. However, good business practice calls for a written document that clearly states the details of the arrangement, including the name, location, and purpose of the business; the names of the partners and their respective duties; the investments of each partner; the method of distributing income and losses; and the procedures for the admission and withdrawal of partners, the withdrawal of assets allowed each partner, and the liquidation (termination) of the business.
2. **Limited Life** Because a partnership is formed by an agreement between partners, it has a **limited life.** It may be dissolved when a new partner is admitted; when a partner withdraws, goes bankrupt, is incapacitated (to the point that he or she cannot perform as obligated), retires, or dies; or when the terms of the partnership agreement are met (e.g., when the project for which the partnership was formed is completed). However, if the partners want the partnership to continue legally, the partnership agreement can be written to cover each of these situations. For example, the partnership agreement can state that if a partner dies, the remaining partner or partners must purchase the deceased partner’s capital at book value from the heirs.
3. **Mutual Agency** Each partner is an agent of the partnership within the scope of the business. Because of this **mutual agency,** any partner can bind the partnership to a business agreement as long as he or she acts within the scope of the company’s normal operations. For example, a partner in a used-car business can bind the partnership through the purchase or sale of used cars. But this partner cannot bind the partnership to a contract to buy men’s clothing or any other goods that are not related to the used-car business. Because of mutual agency, it is very important for an individual to choose business partners who have integrity and who share his or her business objectives.
4. **Unlimited Liability** All partners have **unlimited liability** for their company’s debt, which means that each partner is personally liable for all the debts of the partnership. If a partnership cannot pay its debts, creditors must first satisfy their claims from the assets of the business. If these assets are not enough to pay all debts, the creditors can seek payment from the personal assets of each partner. If one partner’s personal assets are used up before the debts are paid, the creditors can claim additional assets from the remaining partners who are able to pay. Each partner, then, can be required by law to pay all the debts of the partnership.
5. **Co-Ownership of Partnership Property** When individuals invest property in a partnership, they give up the right to their separate use of the property. The property becomes an asset of the partnership and is owned jointly by the partners.
6. **Participation in Partnership Income** Each partner has the right to share in the company’s income and the responsibility to share in its losses. The partnership agreement should state the method of distributing income and losses to each partner. If the agreement describes how income should be shared but does not mention losses, losses are distributed in the same way as income. If the agreement does not describe the method of income and loss distribution, the partners’ must by law share income and losses equally.

Characteristics

**Advantages and Disadvantages of a Partnership**

The partnership form of business ownership has several advantages and disadvantages.

Advantages of a partnership are:

* It is relatively easy and less expensive to organize, requiring only an agreement between two or more persons.
* As if two or more persons involved, the formation of capital and managerial skills are more than would a sole proprietorship.
* The partnership business is non-taxable entity.
* It is relatively free from Government regulations.
* Ownership and management remain the same, in the case of a corporation it is different case.

The Disadvantages of partnership are:

* It has limited life
* Each partner has unlimited liability
* One partner can bind partnership to contracts.
* It is difficult to raise more capital compared to corporation.

 **The Partnership Agreement**

A partnership is created by a contract expressing the voluntary agreement of two or more individuals by written or oral agreement. The written agreement, often referred to as the partnership agreement or Articles of Co-Partnership contains such basic information as;

* The name and principal location of the firm
* The date of the business formed
* The purpose of the business
* Capital contributions of partners
* Rights and duties of partners
* Provisions for withdrawals of assets
* Rights and duties of surviving partners in the event of partner’s death, etc.

**5.3 FORMATION OF PARTNERSHIP**

The accounting for a partnership is the same as the accounting for any other form of business organization. The chart of account of partnership is similar to sole proprietorship business except Drawing and Capital accounts for each partner. The formation, income distribution, Dissolution and Liquidation of partnership are common transactions.

**Recording Investment**

A separate entry is required for the original investment of each partner in a partnership. The various original assets (Cash or other Assets) contributed by a partner are debited to the proper assets accounts. Assets other than cash invested in a partnership should be recorded at their fair market values of the assets at the date of their transfer to the partnership. All of the partners must agree on the values assigned. Any liability assumed by the partnership is recorded as credits to the appropriate liability account. The partners’ capital accounts should be credited for the net amount (excess of assets over liabilities).

**Illustration 1: Recording Initial Investment of Partners**

Assume that Alemu&Biya, who are sole owners of competing hardware stores; agree to combine their business in a partnership named as Alemu&Biya partnership business. Each partner is contributed the following assets and liabilities:

 **Alemu**  **Biya**

  **Book Market Book Market**

 Cash Br. 16,000 Br 16,000 Br 15,000 Br 15,000

 Accounts Receivable 7,000 7,000 7,000 7,000

 Merchandise inventory 4,000 4,500 6,000 5,000

 Store equipment 5,000 4,000 7,000 6,500

 Allowances for doubtful accounts (500) (500) (300) (300)

 Accounts Payable (3.000) (3,000) (4,000) (4,000)

**Required:** Prepare journal entry to record the investments.

**Solution:**

1. ***To record the investment of Alemu:***

Cash………………………………………………. 16,000

 Accounts Receivable…………………………….. 7,000

 Merchandise inventory…………………………… 4,000

 Store Equipment…………………………………. 4,500

 Allowances for doubtful accounts……………. 500

 Accounts Payable…………………………….. 3,000

 Alemu, Capital……………………………….. 28,000

1. ***To record the investment of Biya:***

Cash ……………………………………………….. 15,000

Accounts Receivable……………………………..… 8,000

Merchandise inventory……………………………… 5,000

Store Equipment……………………………………. 6,500

 Allowances for doubtful accounts…................... 300

 Account Payable ………………………………. 4,000

 Biya Capital……………………………………. 30,200

Note that the accounts receivables contributed to the partnership by the partners are recorded at their market value. The credit of Br. 500 and Br 300 to allowances for doubtful accounts is the provision for possible future un-collectability of the accounts receivable contributed to partnership by Alemu and Biya.

**5.4 METHODS OF DISTRIBUTING PARTNERSHIP INCOME OR LOSS**

The Equity of a partner in the net assets of partnership should be distinguished from a partner’s share in earning. If each of two partners were to contribute equal services and amount of capital and equal sharing in partnership net income would be equitable. (Or) If the partnership agreement failed to specify the basis of sharing net income or loss, it is assumed that they will share equally. However, if one partner is to contribute a larger portion of capital than the other does, provision for unequal capital contributions should given recognition in the agreement for dividing net income. Alternatively, if services of one partner are much more valuable to the partnership than those of the other, provision for unequal service contributions should be given recognition in their agreement.

**Distribution of Income based on some fixed ratio or equally**

**Illustration 2:** Alex &Biya partnership business that had net income of Br 50,000 for the year ended December 31, 2001. The partners agreed to share net income or loss in the ratio 2:3.

**Required:** a) Compute the share of net income for each partner.

 b) Prepare the journal entry to record the share of net income.

**Solution:**

a) Share of Net income: Partner Alex = Br. 50,000 x 2/5= Br.20, 000

 Partner Biya = Br. 50,000 x 3/5 = Br.30, 000

b) After the share of net income, it will be transferred to partners’ respective capital accounts and it closes income summary account as:

 Income Summary ……………………50,000

 Alex Capital………………………………20,000

 Biya Capital………………………………30,000

Continuing with the previous illustration, assume that the partnership is silent on the method of sharing net income or net loss.

**Solution:**

If the partnership agreement is silent on the method of income distribution between the two partners, Alex and Biya partners are going to share equally as;

a) Share of Net Income: Partner Alex = Br. 50,000 x 1/2= Br.25, 000

 Partner Biya= Br. 50,000 x 1/2= Br. 25,000

b) After the share of net income, each partner’s share of net income should be transferred to the respective capital accounts & it closes the income summary account as follows:

Income summary ………………………50,000

 Alex Capital…………………………….25,000

 Biya Capital…………………………….25,000

**Distribution of Income Based on the Ratio of Partners’ Capital Account Balance at the Beginning and Ending of the Period:**

**Illustration 3:** Suppose Jemal&Hamdu have capital balance in the year 2001 as follows:

 **Jemal Hamdu**

Capital balance as on January 1, 2001 Br. 60,000 Br 40,000

Capital balance as on December 31, 2001 65,000 35,000

The net income of the partnership is Br. 50,000 for the year 2001.

**Required:** Compute the share of net income for Jemal&Hamdu under the following conditions,                if

1. Jameal&Hamdu agree to share net income or loss on the basis of Beginning capital account balances or
2. Jemal&Hamdu agree to share net income or loss based on ending capital account balances.

**Solution:**

a) Jemal and Hamdu shares net income based on Beginning Capital account balances:

* Beginning Capital Balances of Jemal&Hamdu = 60,000 + 40,000= Br100,000
* Net income of the partnership= Br 50,000
* Share of net income for Jemal= Br.50,000 x 60,000/100,000= Br.30,000
* Share of Net Income for Hamdu= Br.50,000 x 40,000/100,000= Br. 20,000

Journal entry to record partners’ share of net income and to close the income summary account would be:

 Income Summary……………………….. 50,000

 Jemal Capital ……………………….... 30,000

 Hamdu Capital………….…………..... 20,000

b) Jemal and Hamdu shares net income based on Ending Capital account balances

* Ending Capital Balances of Jemal&Hamdu = 65,000 + 35,000= Br 100,000
* Net income of the partnership = Br 50,000
* Share of net income for Jemal = Br.50,000 x 65,000/100,000= Br.32,500
* Share of Net Income for Hamdu = Br.50,000 x 60,000/100,000= Br. 17,500

Journal entry to record partners’ share of net income and to close the income summary account would be as follows:

 Income Summary………………………… 50,000

 Jemal Capital …………………………. 32,500

 Hamdu Capital………………………… 17,500

**Distribution of Income based on Salaries Allowed to Partners (for Services) and the Remaining NetIncome or Net Loss Divided in the Specified Ratio.**

Salaries and drawing are not the same thing, because the term ‘ Salaries’ suggests weekly or monthly cash payments for personal services that are recognized as operating expenses by the partnership for measuring net income or loss. The term ‘Drawings’ in only one sense: a withdrawal of cash or other assets that reduces the partner’s equity but has no part in the division of net income.

**Illustration 4:**

Samuel &Tofiq partnership contract provides annual salary allowance for Samuel Br.100, 000 and Tofiq Br. 60,000 respectively. The net income for the year is Br.300, 000. Assume that the salaries are paid monthly during the year.

**Required:** Compute the share of net income for each partner.

**Solution:**

 **Samuel Tofiq Total**

Salary allowance (for 12 months) Br100, 000 Br 60,000 Br 160,000

Remaining net income divide equally 70,000 70,000 140,000

Journal entry to record partners’ share of net income and to close income summary account:

 Income Summary ……………………………….. 300,000

 Samuel, Capital ……………………………….. 170,000

 Tofiq, Capital ……………………………….. 130,000

 **Income Division Recognizing Services of Partners and Investment:**

This plan of sharing net income or loss is more appropriate as, it recognizes services provided by the partner and different amount of capital contributed by each partner.

Partners may agree that the most equitable plan of income sharing to allow salaries based on the services rendered and to allow interest on the capital investments and the remainder then shared in some other ratio.

**Illustration 5:**

Sultan and Tilahun partnership contract provides, that Sultan and Tilhanu (i) have monthly salaries of Br. 2,500 and Br. 2,000 respectively; (ii) are allowed interest at 12% on their capital balances at January 1 of the current fiscal year, which amounted to Br. 80,000 and Br. 60,000 respectively; and (iii) divide the remainder of net income equally. The partnership generated net income for the year is Br. 75,000.

**Required:** Divide the above net income for Partners of Sultan &Tilahun for the year.

**Solution:**

 Net income………………………………………….. Br.75, 000

***Division of Net Income:***

 **Sultan Tilhanu Total**

 Salary allowances…. (for 12 months)...… Br 30,000 Br 24,000 Br 54,000

 Interest allowances……………………… 9,600 7,200 16,800

 Remaining income—(share equally) … 2,100 2,100 4,200

 **Net income……………………………… Br 41,700 Br 33,300 Br 75,000**

**Income Division—Allowances Exceeds Net Income:**

**Illustration 6:**Assume the above illustration continuous, and the partnership generated net income for the year is Br. 50,000.

**Required:** Divide the above net income for partners of Sultan &Tilahun for the year.

**Solution:**

 Net income ………………………………………. Br.50, 000

***Division of Net income:***

 **Sultan Tilahun Total**

 Salary allowances---- (for 12 months) ------ Br 30,000 Br 24,000 Br 54,000

 Interest allowances---------------------------- 9,600 7,200 16,800

 Total--------------------------------------------- 39,600 31,200 70,800

 Excess of allowance over income (loss) (10,400) (10,400) (20,800)

 Net income--------------------------------------- 29,200 20,800 50,000

**Withdrawalsby Partners in the Partnership**:

It refers taking out the cash or other assets from the partnership business. Partners generally make withdrawals of assets from the partnership during the year in anticipation of salary or profits. A separate drawing account often is used to record the period’s withdrawals and is then closed to the partner’s capital account at the end of the period.

For example, the following entry is in the Alemu&Biya made partnership’s books for Br. 3000 cash withdrawal by Biya on May 1, 2001:

 Biya Drawing ………………….……. 3,000

 Cash ……………………..………… 3,000

At the end of the year Biya’s drawing account closes with Biya capital account as;

 Biya capital ………………………………… 3,000

 Biya Drawings …………………………………………3,000

**5.5 FINANCIAL STATEMENT FOR A PARTNERSHIP**

A partnership is a separate reporting entity for accounting purpose, and three financial statements—Income statement, Balance sheet and Statement of cash flow—typically are prepared for the partnership at the end of each reporting period. The financial statements for a partnership are similar to those of a sole proprietorship. In addition to the three basic financial statements, a detailed of the changes in the owner’s equity of a partnership during the period should also be presented in a **Statement of owners’ equity.** The purposes of this statement and the data included in it correspond to those of the statement of owner’s equity for a sole proprietorship.

**Illustration 7:**

The capital accounts of Ayele and Betel have balance of Br 50,000 and Br. 70,000 respectively on January 1, 2001, the beginning of the current fiscal year. On March 1, Betel invested additional Br. 15,000 during the year. Ayele and Betel withdrew Br. 36,000 and Br. 30,000 respectively, and net income for the year was Br. 90,000. Both partners are going to share net income or loss in the ratio of 2:1.

**Required:** Prepare a statement of owner equity for the current year.

**Solution:**

* Total net income for year: Br 90,000
* Share of net income in the ratio of 2:1 as

 Partner Ayele: Br. 90,000 x 2/3 = Br. 60,000

 Partner Betel Br. 90,000 x 1/3 = Br. 30,000

Statement of owner equity stated as follows:

**Ayele and Betel Partnership**

**Statement of Owner’s Equity**

**For the year ended December 31, 2001.**

 **Ayele Betel Total**

Capital, January 1, 2001……………… Br 50,000 Br 70,000 Br 120,000

Additional investment during the year \_\_\_\_\_ 15,000 15,000

 **Sub total** Br 50,000 Br 85,000 Br 135,000

Net income for the year (2:1 above) 60,000 30,000 90,000

 Br110,000 Br 115,000 Br 225,000

Withdrawals during the year 36,000 30,000 66,000

**Capital, December 31, 2001 Br 74,000 Br 85,000 Br 159,000**

**5.6 DISSOLUTION OF A PARTNERSHIP**

One of the basic characteristic of the partnership form of organization is its limited life. Any change in the personnel of the ownership results in the **dissolution** of the partnership. The admission of a new partner dissolves the old firm. Similarly, death, bankruptcy, or withdrawal of a partner causes dissolution. Dissolution of the partnership is not necessarily followed by the winding up of the affairs of the business. When a partnership is dissolved, a new partnership may be formed and the new article of partnership should be prepared. The changes in the personal ownership (dissolution) are the result of the following:

**Admission of a Partner:**

An additional person may be admitted to a partnership enterprise only with the consent of all the current partners. Under common law if a partner’s interest was transferred, the partnership was automatically dissolved. Under the Uniform Partnership Act, a partner’s capital interest cannot be transferred without the consent of the remaining partners.

* An additional person may be admitted to a partnership through either of two procedures:
1. By purchase of an interest from one or more of the current partners
2. By contribution of assets to the partnership.

**a) Admission of a new partner by purchasing capital interest from one or more of the existing partners**

When an additional person is admitted to a firm by purchasing an interest from one or more of the partners, the purchase price is paid directly to the selling partner. It is a personal transaction between the buying partner and selling partner. Due to this *neither the total assets nor the total owner’s equity of the business is affected.*

Hence, the purchasing interest is personal transaction and the only entry needed in the book of the partnership is the transfer of the proper amounts of owner’s equity from the capital accounts of the selling partner to the capital account established for the incoming (new) partner. The selling partner or partners’ capital account balances are debited and purchasing partner or partners’ capital account balances are credited.

**Illustration 9:** Assume that partners Tezera&Umer have capital balance of Br. 50,000 each (a total Br. 100,000) on June 1. Each sells one-fifth (1/5) of the respective equity to Solomon for Br. 10,000 in cash.

**Required:**

1. Prepare journal entry to record the admission of Solomon.
2. Compute the total capital of the partnership after admission.

**Solution:**

***(i) Journal entry:***

 **June 1** Tezera Capital (1/5 th ) ……………. 10,000

 Umer Capital ( 1/5 th)………………. 10,000

 Solomon Capital ………………………… 20,000

***(ii) Total capital of the partnership after admission of Solomon:***

Solomon Capital ………………………………………….. Br. 20,000

 Tezera Capital ( 50,000—10,000 )....................................... 40,000

 Umer Capital ( 50,000—10,000).......................................... 40,000

 **Total Capital …………………………………................... Br 100,000**

Note that the total capital of the partnership is remained unchanged, as Br. 100,000 remain same. Only the change is that old partners decreased capital interest (selling partners), and their capital balances are adjusted with new partner Solomon.

**b) Admission by contribution of assets in a partnership**

Instead of buying an interest from the current partners, the incoming partner may contribute assets to the partnership. In this case, both the total assets and the total owner’s equity of the partnership business are increased. The investment by the new partner may be cash, equipment, furniture, stock, or other assets. If the partners contribute assets to the partnership other than cash, those assets valued with market value.

**Illustration 10:** Assume Hamdu and Sabir are partners, share net income or loss equally and that each has a capital account balance of Br. 60,000. Assume also that the carrying amounts of partnership assets are approximately equal to current fair values. On June 1, Fikadu invests own land that had a cost of Br. 30,000 and Br. 20,000 cash. Hamdu and Sabiragree to admit Fikadu to the partnership by investment of land and cash; net income and losses of the new partnership are to be shared equally. The land has a market value of Br. 40,000.

**Required:**

1. Compute the partnership total capital before admission of Fikadu
2. Prepare the entry to record Fikadu’s admission.
3. Determine total capital of the partnership after admission.

**Solution:**

1. Partnership capital before admission of Fikadu

Hamdu Capital ……………………………… Br. 60,000

Sabir Capital ……………………………….. 60,000

 Total Capital ………………………………. **Br. 120,000**

2. Computation of Fikadu’s investment in the partnership:

 Cash ……………………………………….. Br. 20,000

 Land (Market value) ……………………… Br. 40,000

 Total investment of assets ………………… **Br. 60,000**

Note that new partner assets other than cash are valued (recognized) at current market value.

Entry to record admission of Fikadu would be:

 Cash ………………………………… 20,000

 Land ………………………………… 40,000

 Fikadu Capital …………………..….. 60,000

3. Computation of the total capital of the partnership after admission of Fikadu:

Hamdu Capital …………………………….. Br. 60,000

Sabir Capital ……………………………… 60,000

Fikadu Capital ……………………………. 60,000

 **Total Capital ……………………………… Br.180, 000**

At the time of admitting new partner, the partnership assets should be re-valued with current market values and adjusted to existing partners’ capital balances in their income sharing ratio, if there is any difference between cost and market value of the existing partnership's assets and liabilities.

**Illustration 11:** Assume Siraj and Tilahun are partners, share net income or loss equally. Each has a capital account balance of Br. 50,000. Assume also that the carrying amounts of partnership assets are approximately equal to current fair values. On June 1, Umer invests Br. 50,000 cash. Siraj and Tilahun agreed to admit Umer. Assume that the balance of land account had been Br. 70,000 before Umer’s admission and its current market value is Br. 90,000.

**Required:**

* 1. Determine total capital of old partnership before dissolution.
	2. Prepare the entry to record the adjusted capital account balances after revaluation of assets.

**Solution:**

1. SirajCpaital ……………………………………… Br. 50,000

Tilahun Capital ……………………………………       50,000

 **Total capital** ………………………………………. **Br 100,000**

1. *Entry to record asset revaluation and adjusted capital balances*

Increase in land value = 90,000 – 70,000 = Br 20,000

Share equally to both partners as:

 To Siraj …………………… Br. 10,000

 To Tilahun ………………... Br. 10,000

***Journal entry:***

 Land ……………………………………… 20,000

 Siraj Capital ……………………….……….. 10,000

 Tilahun Capital ……………………..………. 10,000

**Goodwill**

When a new partner is admitted to a partnership, goodwill attributable either to the old partners or to the incoming partner may be recognized. Although there are various methods of estimating goodwill, bargaining abilities of the partners will influence the final determination. The amount of goodwill agreed upon is recorded as an asset, with a corresponding credit to the appropriate capital accounts.

**Goodwill to old Partners**

**Illustration 12:** Assume that on March 1 the partnership of Hamdu&Jemal admitted Israel, who is to contribute cash of Br. 15,000. After the tangible assets of the old partnership have been adjusted to current market prices, the capital balances of Hamdu&Jemal are Br. 20,000 and Br. 24,000 respectively and both partners were sharing equally. Israel& old partners agree, however, the enterprise is worth of Br. 65,000 after his admission.

**Required:**

1. Compute the capital investment of the partners after the admission of Israel.

1. Compute the amount of goodwill recognized.
2. Prepare journal entry for admission of Israel.

**Solution:**

*1. Computation of total original investment:*

 Hamdu capital……………………………… Br. 20,000

 Jemal Capital………………………………. 24,000

 Israel investment (Cash)…………………… 15,000

 **Total investment-------------------------------- Br 59,000**

*2. Computation of the amount of goodwill recognized:*

 Net worth of the business enterprise ………. Br. 65,000

 Original capital invested by partners ………. 59,000

 **Amount of goodwill recognized …………… Br. 6,000**

Note that net worth means, the amount of capital that are available to the partners after paying liabilities. (Assets = Liabilities + Capital or Net Assets = Capital or net worth).

1. *Journal entry to record the admission of Israel to the partnership:*

 Cash …………………………………. 15,000

 Israel capital………………….. 15,000

Goodwill is treated as intangible asset. Goodwill increases the total assets of the partnership by Br.6,000, shared by Hamdu&Jemal equally, and credited to their respective capital balances as shown below

 **March 1**. Goodwill …………………………… 6,000

 Hamdu Capital ………………................ 3,000

 Jemal Capital …………………………… 3,000

**Goodwill to New [or Incoming] Partner**

If a partnership admits a new partner who is expected to improve the earnings of the firm in future, the parties might agree to recognize this high earnings potential as goodwill to the new partner.

**Illustration 13:** Assume that Chemda is to be admitted to the partnership of Alemu and Birhanu for an investment of Br.30, 000 cash. Even though Chemeda contributed Birr 30,000 to the partnership, Alemu and Birhanu agreed to provide him a capital balance of Br 35,000.

**Required:** 1. Compute the amount of goodwill recognized for Chemda

 2. Pass the necessary journal entry for the admission of Chemeda.

**Solution:**

1. Chemeda Capital in the partnership……………………. Br. 35,000

 Chemeda’s Contribution (cash)…………………… ……. 30,000

 Goodwill recognized for Chemeda …………………… **Br. 5,000**

2. Cash ………………………………………. 30,000

 Goodwill ………………………………….. 5,000

 Chemeda Capital …………………………………….. 35,000

 ۞ Note that goodwill recognized and recorded as asset (intangible).

**5.7 WITHDRAWAL OF A PARTNER**

A partner may withdraw from a partnership **voluntarily**by selling his or her equity in the firm or **involuntarily** by reaching mandatory retirement age or dying. The withdrawal of a partner, like the admission of a partner, legally dissolves the partnership. The legal effects may be recognized in accounting for a withdrawal by dissolving the firm. However, it is customary to record only the economic effects. As indicated earlier, the partnership agreement should specify the terms of withdrawal. The withdrawal of a partner may be accomplished by:

 (1) Payment from partner’s personal assets or

 (2) Payment from partnership assets

**(1) Payment from Partner’s Personal Assets**

when a partner retires or for some other reason wishes to withdraw from the firm, one or more of the remaining partners may purchase the withdrawing partner’s interest and the business may be continued without apparent interruption. In such case, settlement for the purchase and sales is made between the partners as individuals, in a manner similar to the admission of a new partner by purchase of an interest, and thus is not recorded by the partnership. The only entry required by the partnership is debit to the capital account of the partner withdrawing and a credit to the capital account of the partner or partners acquiring the interest.

**Illustration 14:**Amanuel, Belachew&Chemeda have capital balances of Br 50,000, Br 60,000 and Br 45,000 respectively. Assume further that Belachew decided to withdraw from the partnership, and Amanual and Chemeda agreed to buy Belachew's ownership equity in the partnership. Each of them agreed to pay Belachew Br 35,000 in exchange for one-half of Belachew's ownership interest of Br 60,000.

**Required:**

a. Compute the total capital before Belachew's withdrawal.

b. Prepare the entry to record Belachew's withdrawal

c. Determine the capital balance of each partner and total capital after Belachew's withdrawal.

**Solution:**

1. *Total Capital before withdrawals:*

Amanual capital…………………………….. Br 50,000

Belachew Capital …………………………… 60,000

Chemda Capital …………………………….. 45,000

Total Capital ………………………………… **155,000**

1. *The entry to record the withdrawal of Belachew from the partnership:*

Belachew capital ……………………………. 60,000

 Amanual capital ………………………. 30,000

 Chemda capital ……………………….. 30,000

1. *Capital balances of each partner and total capital of the partnership after withdrawal of Belachew:*

Amanual capital (50,000 + 30,000) …………... Br 80,000

Chemeda Capital (45,000 + 30,000) …………..       75,000

 Total Capital …………………………………... **Br 155,000**

When the partner or partners withdraw by payment from partnership assets, the effect is to reduce the assets of the firm and the withdrawing partner(s) capital. To determine the ownership equity of the withdrawing partner, the asset accounts should be adjusted to current market prices. The net amount of the adjustments should be divided among the capital accounts of the partners according to the income- sharing ratio. In the event that the cash or the other available assets are insufficient to make complete payment at the time of withdrawal, a liability account should be credited for the balance owned to the withdrawing partner.

**Death of a Partner:**

The death of a partner dissolves the partnership, but provision generally is made for the surviving partners to continue operations. When a partner dies, it usually is necessary to determine the partner’s equity at the date of the death as;

1. Determine the net income or loss for the year to date,
2. Closing the books, and
3. preparing financial statements

The surviving partners may agree either to: (i) Purchase the deceased partner’s equity from their personal assets or (ii) use partnership assets to settle with deceased partner’s estate.

**5.8 LIQUIDATION OF A PARTNERSHIP**

The **Liquidation** of a partnership terminates the business. When a partnership goes out of business, it usually sells the assets, pays the creditors, and distributes the remaining cash or other assets to the partners according to their claims. The winding up process may be generally termed as ***Liquidation*.**

When ordinary business activities are discontinued as the partnership goes out of business, the accounts should be adjusted and closed according to the customary procedures of the periodic summary. The only accounts remaining open then will be the various assets, contra assets, liabilities, and owner equity accounts.

The sale of noncash assets for cash is called **realization,** and the difference between book value and the cash proceeds is called the **gain or loss on realization.** As the cash is realized, it is applied first to the payment of the claims of creditors. After all liabilities have been paid, the remaining cash is distributed to the partners, based on their ownership equities as indicated by their capital accounts in the partnership business.

If the assets are sold in installment basis, the cash realization on assets also installment receipts, the liquidation process may extend over a considerable period of time. This situation creates no special problem; however, the distribution of cash to the partners is delayed until all of the assets have been sold. These situations are illustrated below:

**Case 1: Gain on Realization**

**Illustration:**Fikadu, Girma&Hailu shares income and losses in a ratio of 5:3:2 (5/10, 3/10, 2/10). On April 9, after discontinuing the ordinary business operations of their partnership and closing the accounts, the following summary of the general ledger is prepared:

 Cash ……………………………………… Br 11,000

 Non-cash assets ………………………….. 64,000

 Liabilities ………………………………… Br 9,000

 Fiakdu Capital…………………………….. 22,000

 Giram Capital …………………………….. 22,000

 Hailu Capital ……………………………… 22,000

 Total………………………………………..  **75,000 Br 75,000**

Between April 10 and April 30 of the current year, Fikadu , Girma&Hailu sell all noncash assets for Br. 72,000, realizing gain of Br. 8,000 (Br 72,000 — Br 64,000).

**Required:**

1. Prepare statement of partnership liquidation.
2. Prepare the entry to record transactions in the liquidation process.

**Solution:**

1) **Statement of Partnership Liquidation**;

**Fikadu, Girma&Hailu**

**Statement of Partnership Liquidation**

**For the period April 10th to 30th, 2001**

 **Assets = Liabilities + Capital \_**

 **Cash + Noncash Fikadu + Girma +Hailu**

 **[50%] [30%] [20%]**

Balances before realization Br 11,000 Br 64,000 Br 9,000 Br 22,000 Br 22,000 Br 22,000

Sale of non cash assets and

division of gain Br 8.000 +72,000 -64,000          ------ +4,000 +2,400 +1,600

Balances after realization Br 83,000 0 Br 9,000 Br 26,000 Br 24,400 Br 23,600

Payment of liabilities - 9,000 - 9,000 , --- --- ---

Balances after payment

of liabilities Br 74,000 0 0 Br 26,000 Br 24,400 Br 23,600

Distribution of cash

to partners -74,000 ------ ----\_ - 26,000 - 24,400 - 23,600

**Final balances 0**   **0 0\_\_ 0 \_ 0\_\_ 0\_\_\_**

The statement of partnership liquidation is organized around the basic accounting equation. The gain of Br.8,000 on sale of non cash assets ( Br 72,000 – Br 64,000) is distributed and credited to (+) all partners in their income sharing ratio as; Gain to

Fikadu = Br. 8,000 x 5/10 = Br 4,000

 Girma = Br. 8,000 x 3/10 = Br 2,400

 Hailu = Br. 8,000 x 2/10 = Br 1,600

After cash is realized from the sale of non-cash assets, first, it is applied for the payment of liabilities; the remaining amount is distributed to the partners according to the balances (credit) in their capital accounts.

2. **Entries to records the transactions in the liquidation:**

*a) Sale of Assets and Recognition of Gain on Realization:*

 Cash…………………………………….. 72,000

 Noncash Assets……………………………… 64,000

 Gain on Realization………………………….. 8,000

1. *Entry to Record the Division of Gain on Realization to the Partners:*

 Gain on Realization ……………………. 8,000

 Fikadu Capital ……………………............. 4,000

 Girma Capital …………………………….. 2,400

 Hailu Capital …………………………….. 1,600

 *c) Entry to Record the Payment of Liabilities:*

 Liabilities …………………………………………. 9,000

 Cash ………………………………………. 9,000

*d) Entry to Record Distribution of Cash to Partners According to the Balances in their Capital Accounts:*

 Fikadu Capital ……………………………………. 26,000

 Girma Capital …………………………………….. 24,400

 Hailu Capital ……………………………………… 23,600

 Cash …………………………………………………… 74,000

**Case 2: Loss on Realization; No Capital Deficit**

**Illustration:**Fikadu, Girma&Hailu shared income and losses in the ratio of 5:3:2 [5/10, 3/10, 2/10]. On April 9, after discontinuing the ordinary business operations of their partnership and closing the accounts, the following summary of the general ledger is prepared:

 Cash Br 11,000

 Non cash assets 64,000

 Liabilities Br 9,000

 Fiakdu Capital 22,000

 Giram Capital 22,000

 Hailu Capital \_\_ 22,000

 **Total Br 75,000 Br 75,000**

Between April 10 and April 30 of the current year, Fikadu , Girma&Hailu sell all noncash assets for Br. 44,000, incurring a loss of Br. 20,000 (Br 64,000— Br 44,000).

**Required:**

1. Prepare statement of partnership liquidation.

2. Prepare the entry to record transactions in the liquidation process.

**Solution:**

 (1) **Statement of Partnership Liquidation**;

**Fikadu, Girma&Hailu**

**Statement of Partnership Liquidation**

**For the period April 10th to 30th, 2001**

 **Assets \_\_\_\_\_\_\_ = Liabilities + Capital\_\_\_\_\_\_\_\_\_\_\_**

 **Cash + Noncash Liabilities Fikadu + Girma + Hailu**

 **50% 30%\_ 20%**

Balances before realization Br 11,000 Br 64,000 Br 9,000 Br 22,000 Br 22,000 Br 22,000

Sale of non cash assets and

 division of loss +44,000 -64,000 ------- 10,000 -6,000 -4,000

Balances after realization Br 55,000 0\_\_ Br 9,000 Br12,000 Br 16,000 Br 18,000

Payment of liabilities - 9,000 0\_\_ -9,000 --- ---\_ ---\_\_

Balances after payment

of liabilities Br 46,000 0 0 Br 12,000 Br 16,000 Br18,000

Distribution of cash

to partners - 46,000\_ -- \_--- - 12,000 - 16,000 - 18,000

**Final balances 0\_\_\_          \_\_0 \_ 0\_- - 0 0 0\_**

The loss of Br.20,000 on sale of non cash assets ( Br 64,000 – Br 44,000) distributed and debited to (or deducted from) all partners in their income sharing ratio as; Loss to:

 Fikadu = Br. 20,000 x 5/10 = Br 10,000

 Girma = Br. 20,000 x 3/10 = 6,000

 Hailu = Br.20,000 x 2/10 = 4,000

After realizing cash from non cash assets, first it is paid to settle liabilities; the remaining amount is distributed to the partners according to the balances (Credit) in their capital accounts.

(2) **Entries to record the transactions in the liquidation:**

*a) Entry to Record the Sale of Noncash Assets and Realization of Loss:*

 Cash …………………………………… 44,000

 Loss on Realization ………………….. 20,000

 Noncash Assets …………………….. 64,000

*b) Entry to Record Division of Loss on Realization among the Partners:*

 Fikadu Capital…………………………….. 10,000

 Giram Capital …………………………….. 6,000

 Hailu Capital……………………………… 4,000

 Loss on realization ………………………… 20,000

*c) Entry to Record the Payment of Liabilities:*

 Liabilities …………………………………. 9,000

 Cash ……………………………………….. 9,000

*d) Entry to Record Distribution of cash to the Partners According to their Capital Balances:*

 Fikadu Capital ……………………………. 12,000

 Girma Capital …………………………….. 16,400

 Hailu Capital ……………………………… 18,000

 Cash …………………………………………….. 46,000

.

**Case 3: Loss on Realization; Capital Deficiency**

In the above example, the capital account of each partner was more than sufficient to absorb the appropriate share of the loss from realization. The partners shared in the distribution of cash to the extent of the remaining credit balance (positive) in their respective capital accounts. However, the share of the loss chargeable to a partner may be such that it exceeds that partner’s equity. The resulting debit balance in the capital account, called a***Deficiency***, is a claim of the partnership against the partner. Pending collection from deficient partner, the partnership cash will not be sufficient to pay the other partners in full. In such cases, the available cash should be distributed in such a manner that, if the claim against the deficient partner cannot be collected, each of the remaining capital balances will be sufficient to absorb the appropriate share of the deficiency.

**Illustration:** Assume that in the above example, Fikadu, Girma&Hailu sell all non cash assets for Br. 10,000, incurring a loss of Br. 54,000 (Br 64,000—Br 10,000). Prepare a statement of Realization & Liquidation, and journal entries for the liquidation.

**Solution:**

Loss from sale of assets: Br. 54,000 allocate to all partners in their income-sharing ratio as

 Fiakdu = Br. 54,000 x 5/10 = Br 27,000

 Girma = Br. 54,000 x 3/10 = Br 16,200

 Hailu = Br. 54,000 x 2/10 = Br 10,800

 **\_\_\_\_\_\_\_\_\_\_\_\_\_\_Capital\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** **Fikadu( 50%) Girma( 30%) Hailu( 20%) Total**

Balance before realization Br. 22,000 Br 22,000 Br 22,000 66,000

Division of loss on realization –27,000 – 16,200 – 10,800 – 54,000

Balance after realization –5,000 5,800 11,200 12,000

Division of potential

 additional deficiency 5,000 –3,000 – 2,000 ---\_\_\_

**Claims to partnership cash 0 \_ 2,800 9,200 12,000**

The part of the loss allocable to Fiakadu, Br 27,000 (50% of Br. 54,000), exceeds the Br.22,000 balance in Fikadu’s capital account. This deficiency of Fiakdu is a potential deficiency to Girma and Hailu and must be temporarily divided between them in their income sharing ratio of 3:2 (3/5 and 2/5). The capital balances remaining represent their claims on the partnership cash.

 **Fikadu, Girma & Hailu**

**Statement of Partnership Liquidation**

**For the period April 10th to 30th, 2001**

 **Assets \_\_\_\_\_\_\_\_\_\_ = Liabilities + Capital\_\_\_\_\_\_\_\_\_\_\_**

 **Cash + Noncash Liabilities Fikadu + Girma + Hailu**

 **50% 30%\_ 20%**

Balances before realization Br 11,000 Br 64,000 Br 9,000 Br 22,000 Br 22,000 Br 22,000

Sale of non cash assets and

 division of loss +44,000 -64,000 ------ - 10,000 -6,000 -4,000

Balances after realization Br 55,000 0\_\_ Br 9,000 Br12,000 Br 16,000 Br 18,000

Payment of liabilities - 9,00 0\_\_ -9,000 --- ---\_ ---\_\_

Balances after payment

 of liabilities Br 46,000 0 0 Br 12,000 Br 16,000 Br18,000

Distribution of cash

 to partners - 46,000 \_ -- \_ --- - 12,000 - 16,000 - 18,000

**Final balances 0\_\_\_         \_\_0 \_ 0\_-- 0 0 0\_**

2. **Entries to records the transactions in the liquidation:**

*a) Entry to Record the Sale of Noncash Assets and Realization of Loss:*

 Cash……………………………………. 10,000

 Loss on Realization ………………… 54,000

 Noncash Assets ………………………………. 64,000

b) *Entry to Record Division of Loss on Realization among the Partners in the ratio of 5:3:2*

 Fikadu Capital ………………………….. 27,000

 Giram Capital …………………………… 16,200

 Hailu Capital …………………………… 10,800

 Loss on realization ……………………………… 54,000

*c) Entry to Record the Payment of Liabilities:*

 Liabilities ………………………………. 9,000

 Cash ……………………………………….. 9,000

d) *Entry to Record Distribution of cash to the Partners According to their Capital Balances:*

 Girma Capital…………………………… 2,800

 Hailu Capital …………………………… 9,200

 Cash ……………………………………….. 12,000

The affairs of the partnership are not completely closed until the claims among the partners are settled. As you know the partners liability is unlimited, payments to the firm by the deficient partner are credited to the partner’s capital account. Any uncollectible deficiency becomes a loss to the partnership and is written off against the capital balances of the remaining partners. Finally, the cash received from the deficient partner is distributed to the other partners according to their ownership claims.

**Illustration:** Assume the above problem continuous,

***Assumption 1:***Fikadu pays the entire amount of the Br. 5,000 deficiency to the partnership (no loss).

**Solution:** The receipt of the Br. 5,000 paid by Fikadu to the partnership and the distribution of the Br. 5,000 to partners (Girma&Hailu) are indicated in the following statement of partnership liquidation:

**Fikadu, Girma & Hailu**

**Statement of Partnership Liquidation**

**For the period April 10 to 30th, 2001**

 **Assets = Liabilities + Capital\_\_\_\_\_\_\_**

 **Cash + Noncash Fikadu + Girma + Hailu**

 **[50%] [ 30%] [20%]**

Balances 0 0 0 5,000(Dr) 3,000 2,000

Receipt of deficiency + 5,000 --- ---- +5,000 --- -\_\_

Balances 5,000 0 0 0 3,000 2,000

Distribution of cash to partners – 5,000 -- ---- ---- -3,000 -2,000

**Final balances 0 \_\_0\_\_ 0 0 0 0\_\_**

The entries to record the final settlement are as follows:

1. ***Entry to record receipt of cash from the deficient partner (i.e., from Fikadu):***

 Cash …………………………………… 5,000

 Fikadu Capital ………………………….… 5,000

1. ***Entry to record the distribution of cash to partners Girma&Hailu:***

 Girama Capital ………………………… 3,000

 Hailu Capital ………………………….. 2,000

 Cash …………………………………………… 5,000

After the two transactions above are completed, all of the partnership’s assets will have been distributed, the liabilities paid, and the partners’ capital balances reduced to Zero.

**Assumption 2:**Fikadu pays Br. 3,000 of the deficiency to the partnership and the remainder is considered to be uncollectible (Br. 2,000 loss).

Solution:

**Fikadu, Girma & Hailu**

**Statement of Partnership Liquidation**

**For the period April 10 to 30th, 2001**

 **Assets = Liabilities + Capital\_\_\_\_\_\_\_\_\_**

 **Cash + Noncash Fikadu + Girma + Hailu**

 **[50%] [ 30%] [ 20%]**

Balances 0 0 0 Br 5,000(Dr) Br 3,000 Br 2,000

 Receipt of deficiency + 3,000 --- ---- +3,000 --- ---

Balances 3,000 0 0 2,000(Dr) 3,000 2,000

Distribution of cash to partners – 3,000 ---- --- ---- – 1,800 –1,200

Final balances 0\_\_ \_\_0\_\_ 0\_ 0 0 0

It should be noted that the Br.2,000 loss was divided between Girma and Hailu in their income sharing ratio of 3:2 ( 3/5 and 2/5).

The entries to record the final settlement are as follows;

***a) Entry to record the receipt of cash from the deficient partner (i.e., from Fikadu):***

 Cash ……………………………………. 3,000

 Fikadu Capital ……………………….. 3,000

***b) Entry to record the division of loss to the remaining partners of Girma and Hailu in their income sharing ratio of 3:2***

 Girama Capital …………………………. 1,200

 Hailu Capital …………………………… 800

 Fiakdu Capital …………………. 2,000

1. ***Entry to record distribution of cash to partners (i.e., Girma and Hailu) as per their capital interest in the business:***

Girma Capital ………………………….. 1,800

Hailu Capital …………………………… 1,200

 Cash ………………………………………. 3,000

After the two transactions above are completed, all of the partnership’s assets will have been distributed, the liabilities paid, and the partners’ capital balances reduced to Zero.

***Assumption 3***: Fikadu is unable to pay any part of the Br.5,000 deficiency ( Br. 5,000).

**Fikadu, Girma & Hailu**

**Statement of Partnership Liquidation**

**For the period April 10 to 30th, 2001**

 **Assets = Liabilities + Capital \_**

 **Cash + Noncash Fikadu + Girma + Hailu**

 50% 30% 20%

Balances 0 0 0 5,000(Dr) 3,000 2,000

Division of loss --- --- ---- +5,000 -3,000 -2,000

**Final balances 0 \_\_0\_\_ 0 0 0 0\_**

The Br. 5,000 loss was divided between Girma and Hailu in their income sharing ratio of 3:2 (3/5 and 2/5). The following entry that reduces the partnership account balances to Zero.

**Division of loss:**

 Girma Capital …………………………….. 3,000

 Hailu Capital ……………………………… 2,000

 Fikadu Capital …………………….. 5,000.

**Exercises**

1. Samuel and Tigist are partners who share in net income equally and have capital balances of Br. 60,000 and Br. 62,000 respectively. Samuel with the consent of Tigist, sells one third of his interest to Jemal. What entry is required by the partnership if the sale price is (a) Br. 10,000? (b) Br. 30,000?
2. The capital account of Mitiku and Elias have balances of Br. 56,000 and Br. 100,000 respectively. Alex and Juhar are to be admitted to the partnership. Alex purchases one fourth of Mitiku's interest for Br. 22,500 and one fifth of Elias's interest for Br. 30,000. Juhar contributes Br. 60,000 cash to the partnership, for which he is to receive ownership equity of Br. 60,000.

 **Required:**

 a) Present the entries to record and admission of Alex and Juhar.

b) What are the capital balances of each partner after the admission of the new partner?

1. Chemda and Dawit have decided to form a partnership. They have agreed that Chemda is to invest Br. 60,000 and the Dawit is to invest Br. 30,000. Chemda is to devote one half time to the business and Dawit is to devote full time. the following plans for the division of income are being considered:

 a) Equal division

 b) In the ratio of original investments

 c) In the ratio of time devoted to the business

d) Interest of 12% on original investments and the remainder equally.

e) Interest of 12% on original investments, salaries of Br 20,000 to Chemda and Br. 30,000 to Dawit and remainder equally.

1. After the accounts closed on April 3, prior to liquidating the partnership, the capital accounts of Engda, Fikru and Girma are Br. 20,000, Br. 30,000 and Br. 10,000 respectively. Cash and noncash assets total Br 2,000 and Br 61,000 respectively. Amount owed to creditors total Br. 30,000. The partners share income and losses in the ratio of 2:1:1. Between April 3 and April 25, the non cash assets are sold for Br. 21,000, the partner with the capital deficiency pays his deficiency to the partnership, and the liabilities are paid.

 **Required:**Prepare a statement of liquidation.

1. Alex and Biya have capital balances of Br 40,000 and Br 60,000, respectively, in a Partnership. The partnership agreement indicates that the net income or net loss should be shared equally. If the net come for a partnership is Br 20,000, how should the net income be divided? Prepare the entry to record the division of net income.
2. Chali and Mulluneh, currently formed a partnership, investing Br 50,000 and Br 100,000 respectively. Determine their participation in the year's net income of Br 60,000 under each of the following assumptions: A) No agreement concerning division of net income. B) Divided in the ratio of original capital investment; C) Interest at the rate of 12% allowed on 15,000 and 30,000 respectively, and the balance divided equally; D) Allowances of interest at the rate of 12% on original investments, salary allowances of Br 15,000 and Br 30,000 respectively, and the remainder divided equally.
3. Hiwot&Getachew shares income on a 3:2 basis. They have capital balances of Br 30,000 & Br 40,000 respectively, when Israel is admitted to the partnership.

Prepare journal entry to record the admission of Israel under each of the following assumptions:

a) Purchased of one-half of Hiwot's equity for Br 25,000

b) Purchased one-half of Getachew’s equity for Br 18,000

1. Jemal and Anwar share income on a 3:2 basis. They have capital balances of Br 45,000 and Br 35,000, respectively, when Biya is admitted to the partnership.

Prepare journal entry to record the admission of Biya under each of the following assumptions:

1. Investment of Br 40,000 cash for a one-fourth ownership interest with bonuses to the existing partners.
2. Investment of Br 20,000 cash for a one-fourth ownership interest with a bonus to the new partner.
3. Shiran, Tilahun&Umer have capital balances of Br 50,000, Br 30,000 and Br 24,000 respectively, and their income sharing ratios are 5:3:2. Umer withdraws from the partnership under each of the following independent conditions:

(a) ShiranTilahun agreed to purchase Umer’s equity by paying Br 15,000 each from their personal assets. Each of them receives 50% of Umer's equity.

(b) Tilahun agreed to purchase all of Umer's equity by paying Br 20,000 cash from his personal assets.

 **Required:** Prepare journal entries for the withdrawal of Umer under each of the above.

1. After closing the accounts on June 1, prior to liquidating the partnership, the capital account balances of Girm, Helen and Israel are Br. 13,000, 26,000 and 31,000 respectively. Cash, noncash assets, and liabilities total Br. 17,000, 83,000 and Br 30,000 respectively. Between June 1 and June 30, the noncash assets are sold for Br 41,000, the liabilities are paid, and the remaining cash is distributed to the partners. The partners share net income and loss in the ratio of 1:2:3.

 **Required:** Distribute the cash for each partner and record the necessary journal entries to liquidate the partnership for the period June 1- 30.

1. Radcliffe, Sonders, and Towers, who share in income and losses in the ratio of2:3:5, decided to discontinue operations as of April 30 and liquidate their partnership.After the accounts were closed on April 30, the following trial balancewas prepared:

Cash………………………………………………….. 5,900

Noncash Assets ……………………………………109,900

Liabilities ……………………………………………26,800

Radcliffe, Capital ……………………………………14,600

Sonders, Capital ……………………………………27,900

Towers, Capital …………………………………….46,500

 Between May 1 and May 18, the noncash assets were sold for $27,400, and theliabilities were paid.

 **Instructions**

 1. Assuming that the partner with the capital deficiency pays the entire amount owedto the partnership, prepare a statement of partnership liquidation.

 2. Journalize the entries to record (a) the sale of the assets, (b) the division of losson the sale of the assets, (c) the payment of the liabilities, (d) the receipt of thedeficiency, and (e) the distribution of cash to the partners.