CHAPTER 15

PARTNERSHIPS: FORMATION, OPERATION, AND CHANGES IN MEMBERSHIP

ANSWERS TO QUESTIONS

Q15-1 Partnerships are a popular form of business because they are easy to form (informal methods of organization), and because they allow several individuals to combine their talents and skills in a particular business venture. In addition, partnerships provide a means of obtaining more equity capital than a single individual can invest and allow the sharing of risks for rapidly growing businesses. Partnerships are also allowed to exercise greater freedom in their choice of accounting methods.

Q15-2 The major provisions of the Uniform Partnership Act (UPA) of 1997 have been enacted by most states to regulate partnerships operating in those states. The UPA 1997 describes many of the rights of each partner and of creditors during creation, operation, or liquidation of the partnership.

Q15-3 The types of items that are typically included in the partnership agreement include:

a. The name of the partnership and the names of the partners
b. The type of business to be conducted by the partnership and the duration of the partnership agreement
c. The initial capital contribution of each partner and how future capital contributions are to be accounted for
d. A complete discussion of the profit or loss distribution, including salaries, interest on capital balances, bonuses, limits on withdrawals in anticipation of profits, and the percentages used to distribute any residual profit or loss
e. Procedures used for changes in the partnership such as methods of admitting new partners and procedures to be used on the retirement of a partner
f. Other aspects of operations the partners decide on, such as the management rights of each partner, election procedures, and accounting methods

Q15-4 (a) Separate business entity means that the partnership is a legal entity separate and distinct from its partners. The partnership can own property in its own name, can sue, be sued, and can continue as an entity even though the membership of the partners changes with new admissions or with partner dissociations

(b) Creditors view each partner as an agent of the partnership capable of transacting in the ordinary course of the partnership business. Creditors may use this reliance unless the creditors receive a notification that the partner lacks authority for engaging in a specific type of transaction that would be used between the creditor and that partner. The partnership should file a Statement of Partnership Authority to specifically state any limitations of authority of specific partners. This voluntary statement is filed with the Secretary of State and the clerk of the county in which the partnership operates. The Statement of Partnership Authority is sufficient notice to state a partner's authority for real estate transactions.

(c) In the event the partnership fails and its assets are not sufficient to pay its liabilities, each partner has joint and several personal liability for the partnership obligations. Each partner with a capital account that has a debit balance must make a contribution to the partnership to reduce the debit balance to zero. These contributions are then used to settle the remaining amounts of the partnership liabilities. If a partner fails to make the required contribution, then all other partners must make additional contributions, in proportion to the ratio used to allocate partnership losses, until the partnership obligations are settled. Thus, a partner can be held legally responsible to make additional contributions to a partnership in dissolution if one or more other partners fail to make a contribution to remedy their capital deficits.

Q15-5 A deficiency in a partner's capital account would exist when the partner's share of losses and withdrawals exceeds the initial capital account balance and share of profits. A deficiency is usually eliminated by additional capital contributions.

Q15-6 The percentage of profits each partner will receive, along with the allocation of $60,000 profit, is calculated as follows:

	Percentage of Profits		Profit to be Allocated		Allocation
Partner 1	4/15 = 26.67%	x	$60,000	=	$16,000
Partner 2	6/15 = 40.00%	x	$60,000	=	$24,000
Partner 3	5/15 = 33.33%	x	$60,000	=	$20,000

Q15-7 The choices of capital balances available to the partners include beginning capital balances, ending capital balances, or an average (usually weighted-average) capital balance for the period. The preferred capital balance is the weighted-average capital balance because this method explicitly recognizes the time span each capital level was maintained during the period.

Q15-8 Salaries to partners are generally not an expense of the partnership because salaries, like interest on capital balances, are widely interpreted to be a result of the respective investments and are used not in the determination of income, but rather in the determination of the proportion of income to be credited to each partner's capital account. This treatment is based on the proprietary concept of owners' equity that interprets salaries to partners as equivalent to a withdrawal in anticipation of profits. Salaries are sometimes specified in the partnership agreement; however, in larger partnerships, salaries are typically determined by a partners' compensation committee. And also, under the old partnership law, a partnership was not an independent legal entity, but rather an aggregation of some of the rights of the individual partners. With the advent of the UPA 1997 which defines a partnership as a separate legal entity, a theoretical argument could be made that salaries and capital interest paid to partners does cross the entity border and could be accounted for as a business expense. Few partnerships need audited financial statements prepared in accordance with GAAP so the financial statement treatment of partners' salaries has not been a major issue because the financial reporting for partnerships is more focused on meeting the information needs of the partners.

Q15-9 In most cases a partner's dissociation does not result in the dissolution and winding up of the partnership. The UPA 1997 provides for a process whereby the dissociating partner's interest in the partnership can be purchased by the partnership. The buyout price of a dissociated partner's partnership interest is computed as the estimated amount that would have been distributable to the dissociating partner if the assets of the partnership were sold at the greater of the liquidation value or the value based on the sale of the entire business and the partnership was wound up, including payment of all partnership liabilities. There are some specific events that cause dissolution and winding up of the partnership business. These events are covered in Section 801 of the UPA 1997 and will be discussed at length in chapter 16. Students wishing to expand their understanding of dissolution are encouraged to examine Section 801 of the Act.

Q15-10 The book value of a partnership is the total value of the capital, which is also the difference between total assets and total liabilities. The book value may or may not represent the market value of the partnership.

Q15-11 The arguments for the bonus method include preservation of the historical cost principle and the accounting principles stated in **ASC 350**. The arguments against the bonus method include a necessity for a fair valuation of the partnership assets and the partners may dislike having to "share" part of their capital account balances with other partners.

Q15-12 The new partner's capital credit is equal to the investment made when (1) the investment equals the proportionate present book value, (2) the assets of the partnership are revalued prior to admission of the new partner, or (3) goodwill is recognized for the present partners. The new partner's capital credit is not equal to the tangible investment made when bonus is recognized or when goodwill is recognized for the new partner.

Q15-13 Aabel's bonus is $3,000 ($20,000 x 0.15) if the bonus is computed as a percentage of income before the bonus. Aabel's bonus is $2,608.70 [Bonus = 0.15($20,000 - Bonus)] if the bonus is computed as a percentage of income after deducting the bonus.

Q15-14 The implied fair value of the ABC partnership is $36,000 ($12,000 / 0.33333…). The entry the ABC partnership would make upon the admission of Caine follows.

Cash	12,000	
Goodwill [$36,000 - ($12,000 + $21,000)]	3,000	
Other Partners' Capital Accounts		3,000
Caine, Capital		12,000

Q15-15A The basis of Horton's contribution for tax purposes is $3,500 and is calculated as follows:

$5,000 book value less ($2,000 assumed liability x 0.75) = $3,500

The basis of Horton's contribution for GAAP purposes is $8,000 and is calculated as follows:

$10,000 market value less $2,000 assumed liability = $8,000

Q15-16B A joint venture is a short-term association of two or more parties to fulfill a specific project. Corporate joint ventures are accounted for on the books of the investor companies by the equity method of accounting for investments in common stock.

SOLUTIONS TO CASES

C15-1 Partnership Agreement

a. The partnership agreement should be as specific as possible to avoid later differences of opinion. In addition, the partnership agreement should be written as a formal agreement and signed by all partners. The basic elements of a partnership agreement should include the following:

   1. The name of the partnership and the names of the partners
   2. The type of business to be conducted and the term, if any, of the partnership
   3. The initial capital contribution of each partner and the method(s) of accounting for future capital contributions
   4. The income or loss sharing procedures
   5. Procedures for changes in the partnership such as admission of new partners or retirements of present partners
   6. Any other specific procedures important to the partners

b. Salaries and bonuses to partners are part of the income distribution process regardless of how they are reported by the partnership. Some partnerships prefer to report these within the partnership's income statement in order to compare the results of the partnership with other business entities.

c. Not recording salaries and bonuses to partners in the income statement reflects the true nature of these items and reports income from the partnership before any distributions. Thus, the income statement reflects the total profit to be distributed to the partners.

d. The partnership agreement should state the following if interest is to be provided on invested capital:

   1. The capital balance to be used as the base for interest: Beginning of period, average (simple or weighted) for the period, or ending-of-period balances.
   2. The rate of interest to be paid, or the basis by which the rate is to be determined.
   3. When interest is to be determined in the profit or loss distribution process. For example, should salaries and bonuses be added to the capital accounts before interest is computed?

C15-2 Comparisons of Bonus and Goodwill / Asset Revaluation Methods

MEMO to BGA Partnership:

This memo discusses the two alternative methods of accounting for the admission of Newt, a new partner. To state the present positions, Bill favors the bonus method, George favors the goodwill method, and Anne favors the revaluation of existing tangible assets. Technically, the goodwill and asset revaluation methods both involve revaluing the balance sheet. While the goodwill method records a previously unrecorded asset (goodwill), the revaluation method revalues existing assets on the balance sheet to their fair values. For purposes of this memo, we discuss these similar options separately. These methods are all used in practice to account for the admission of a new partner.

The bonus method is a realignment of present partnership capital. No additional capital, beyond the tangible investment of the new partner, is created in the admission process. Some partners prefer this approach because it immediately states the proper capital relationships on the admission of the new partner and does not require the write-up of assets.

The goodwill method results in the recognition of goodwill, either the goodwill generated by the prior partners during the existence of the old partnership, or the goodwill being contributed by the new partner. Goodwill is subject to an impairment test under the provisions of **ASC 350**. Any future impairment loss recognitions will affect all partners' capital accounts in proportion to their profit and loss sharing ratios in the future periods as goodwill impairments are recognized. If new partners are allowed into the partnership, or a present partner withdraws, the effect on each partner's capital account will be different than if the bonus method is used. New partners will have to share in the write-off of goodwill, even goodwill created before a new partner's admission.

The revaluation of existing assets could be done under either of the two above cases. This provides for the proper recognition of the assets and the distribution of any holding gain to the partners who were part of the partnership while the market increase took place. For example, the assets could be revalued to their market value on the basis of appraisals and then the bonus or goodwill method could be used. This would preclude a new partner from sharing in the holding gain that was appreciated before the new partner's admission.

The final decision must be made by the partners. All partners should agree to the specific method, or methods, to be used to account for the admission of Newt. The decision should be formalized, written, and signed by all partners.

C15-3 Uniform Partnership Act Issues

This solution uses the Uniform Partnership Act of 1997 (UPA 1997) for its references. This Act is available on the Internet and can be found using most internet search engines.

a. Section 301 of the UPA 1997 specifies that every partner does have the right to act as an agent of the partnership for carrying on in the ordinary course the partnership business, unless the partner has in fact no authority to act for the partnership in the particular manner, and the person with whom the partner is dealing has knowledge of the fact that the partner has no such authority.

b. Section 306 of the UPA 1997 specifies that a new partner is not personally liable for any partnership obligation incurred before the person's admission as a partner. But, the new partner may still lose the capital contribution made to be admitted to the partnership. The key point is that the new partner is not at risk beyond the capital contribution made for admission

c. Section 403 of the UPA 1997 specifies that each partner, their agents and attorneys, may inspect the partnership's books and records, and copy any of them, during normal business hours.

d. Section 406 of the UPA 1997 specifies that if the initial term of the partnership is completed, and the partnership continues, the rights and duties of the partners remain the same but the partnership is now viewed as a partnership at will. A partnership at will means that the partners are not committing to a term of time or to a project. A partner in a partnership at will has more legal protection from possible damages from the other partners if he or she wishes to dissociate from the partnership. A new partnership agreement is not needed for the continuation, but is a good idea to make sure that all continuing partners are in agreement with the ongoing partnership efforts.

e. While it is very easy to form a partnership, it is not easy to simply leave a partnership. Sections 601 through 603 of the UPA 1997 discuss a partner's dissociation and its effect on the partnership. A partner expressing the request to no longer be in the partnership may be subject to damages from a wrongful dissociation. This suggests that the initial partnership agreement should include any specific provisions on resignations of partners if the partners feel the UPA's guidelines are not sufficient for their partnership.

f. The items to be included in the partnership agreement are dependent upon the wishes of the initial partners. The partnership agreement should include any items that the partners want to reach agreement on as a basis of the partnership, its operations, and its possible future dissolution. It is better to have agreement on many of the difficult items "up front" rather than ignoring them and then having them turn into large problems later on. If an item is not included in the partnership agreement, then the state's laws on partnerships regulate the rights and responsibilities of the partners and the rights of third-parties, including creditors. There are some nonwaivable provisions of the UPA 1997 as presented in Section 103 of the Act. A partnership agreement may not reduce or change any of the rights and responsibilities stated in Section 103.

C15-4 Defining Partners' Authority

TO: Cathy

RE: Authority of partners to engage in transactions

Your partnership will be regulated by our state's laws on partnership. Our state has enacted the provisions of the Uniform Partnership Act of 1997 (UPA 1997) which is the most recent model act on partnership laws. The UPA 1997 states, in its Section 301, that,

> "Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority."

This means that each partner can bind the partnership for transactions that would be expected to take place in the type of business in which the partnership would be engaged. The issue of notice to third parties is important. Section 303 of the UPA 1997 encourages all partnerships to file a Statement of Partnership Authority with the Secretary of State and also place a copy with the county clerk. This statement lists the specific authorities for partners and the Act specifies that the filed statement is sufficient notice for partners engaging in partnership real estate transactions. However, the statement of authority is not sufficient notice for other types of transactions. For these other types of transactions, such as purchasing items from suppliers, ordering goods online, or acquiring equipment for the business, suppliers may presume any partner has the authority to transact unless that supplier is given notification of a restriction on a partner's authority to that supplier. This notice is best provided by written statement. But this may be difficult to do on a proactive basis because you may not know with whom an individual partner is transacting in the partnership's name.

You should also require that the specific authority of each partner be specified in the partnership agreement. If a partner breaches that agreement, you will have legal recourse against the partner, but that would mean seeking a legal judgment for that breach. That would take time and involve costs.

You should have a frank and open discussion with both Adam and Bob expressing your concerns. If they are not interested in working with you to find ways to alleviate your concerns and take actions to avoid potential future problems of the nature you discuss, then it may be best for you not to become a partner in the business. If agreements cannot be worked out prior to the formation of a partnership, it is highly doubtful they will be worked out after the partnership is formed. Once you are in a partnership it may be difficult and costly to dissociate (leave) the partnership.

There are online sources of examples of partnership agreements, the Uniform Partnership Act of 1997, a Statement of Partnership Authority, and you can find our state's partnership regulations through our Secretary of State's website. I urge you to be sure to satisfy your concerns before you enter the partnership. Joining a partnership is a significant decision that involves potential personal liability for the partnership's obligations, including those incurred by the other partners. Alternative business forms are available such as incorporating, for which you should consult with an attorney who has had experience in working with small business corporations.

C15-5 Preferences of Using GAAP for Partnership Accounting

TO: Jason and Richard

RE: Your Questions on Using GAAP for Your Partnership

Each of your questions will be addressed in this memo, but first, a few general comments regarding accounting for your partnership. We have discussed that you may select accounting methods other than those specified by generally accepted accounting principles (GAAP). For example, you may wish to use accounting methods consistent with those used for preparing your partnership's tax-based statement of income and computing your taxable distributable amounts. In anticipation of preparing your annual tax returns, I keep a running list of the tax implications of your major transactions and if it would be helpful to you, I can discuss these tax implications with you in planning future transactions and evaluating transactions as they occur during the year. But, as we have discussed, tax-based accounting methods focus on determining what you will owe for taxes, not the economic foundation or the financial position you have both built since you started your partnership.

We have also discussed the partnership's need to obtain additional debt financing to increase the net assets needed for new areas of growth. Bankers and other lenders prefer financial statements prepared using GAAP because these persons understand how to properly evaluate the financial position and performance of your business if GAAP is used. They are familiar with GAAP and their requirement for audited financial statements prior to a larger loan will allow your business to be eligible for an unqualified audit opinion from the independent auditors. Thus, GAAP will provide these lenders with financial statements which they may have confidence fairly report your business' financial positions. If GAAP is not used, the lenders may have to ask a lot of questions about our financial position and performance that will take us much time to analyze and properly answer.

Now to your three questions:

a. Salaries to partners: The Uniform Partnership Act of 1997 governs partnerships in our state. Section 401 (h) of that Act states that, "A partner is not entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the business of the partnership." Salaries to partners are considered to be a distribution in anticipation of profits and thus are recorded directly against each partner's capital account. The profit allocation schedules prepared each year include salaries as specified by your partnership agreement. Including salaries on the Statement of Income would be similar to including dividends on the Statement of Income. Thus, it is more acceptable to show salaries as part of the distribution of income rather than an expense of the partnership.

b. Using GAAP to account for admission of a new partner: GAAP provides for recognizing impairment losses on long-lived assets held and used in the business, does not allow the recognition of holding gains by increasing the value of these assets on the balance sheet. These long-lived assets are used in the production process of the business and you do not expect to sell them before their useful lives are substantially employed in the business. Instead of increasing the basis of the long-lived assets at the time of admitting a new partner, you could increase the investment required of the new partner and allocate a "bonus" to your capital accounts as the prior partners during the increase in fair value of these long-lived assets. This is a relatively straight-forward process that is used by many partnerships.

C15-5 (continued)

c. Analyzing the partnership's liabilities prior to admission of a new partner: First, Section 306 (b) of the Uniform Partnership Act of 1997 states that, "A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner." The person you are considering asking to join the partnership will expect the partnership to have all of its liabilities recognized and correctly measured in order to properly calculate the personal liability of the new partner for only obligations generated after that new partner's admission. Furthermore, as negotiations develop with the potential new partner, you will most certainly be asked to provide statements regarding the financial position of the partnership. You do not want to misrepresent the correct financial position and be personally liable for potential future damages sought by the new partner who based the decision of whether or not to invest in your partnership was based on your financial representations. And, by analyzing our recognized liabilities we may not only discover some unrecognized liabilities, but also we can make sure that the proper documentation is available on all liabilities to show the background of the transaction generating the liability, but also the basis of the amount and the account. We will need these if we get into a disputed claim from one of our vendors. And we will need these to clearly document any loans made to the partnership by its current partners. You can think of this analysis as a form of insurance against potential future problems concerning the status of the partnership's liabilities at the time of admitting the new partner.

Please do not hesitate to ask me questions about any aspect of accounting and financial reporting for your partnership. We can discuss the reasons for using specific methods and the possible alternatives from which you may select in order to have the financial reports and statements be the most meaningful to each of you as you transact your business and continue to grow into the future.

SOLUTIONS TO EXERCISES

E15-1 Multiple-Choice Questions on Initial Investment [AICPA Adapted]

1. **a** –

2. **c** –

3. **d** –

4. **b** – $330,000 = $50,000 + ($310,000 - $30,000)

5. **d** –

E15-2 Division of Income — Multiple Bases

a. Distribution of $80,000 income:

	Angela	Dawn	Total
Profit percentage	70%	30%	100%
Average capital	$ 50,000	$ 30,000	
Net income			$ 80,000
Interest on average capital (10%)	$ 5,000	$ 3,000	(8,000)
Salary	25,000	15,000	(40,000)
Residual income			$ 32,000
Allocate 70%:30%	22,400	9,600	(32,000)
Total	$ 52,400	$ 27,600	$ -0-

b. Distribution of $20,000 income:

	Angela	Dawn	Total
Profit percentage	70%	30%	100%
Average capital	$ 50,000	$ 30,000	
Net income			$ 20,000
Interest on average capital (10%)	$ 5,000	$ 3,000	(8,000)
Salary	25,000	15,000	(40,000)
Residual income (deficit)			$ (28,000)
Allocate 70%:30%	(19,600)	(8,400)	28,000
Total	$ 10,400	$ 9,600	$ -0-

Section 401 of the UPA 1997 states that, "Each partner is entitled to an equal share of the partnership profits and is chargeable with a share of the partnership losses in proportion to the partner's share of the profits."

E15-3 Division of Income – Interest on Capital Balances

Computation of average capital:

Average capital for Left

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$30,000	3	$ 90,000
4/3		$8,000	38,000	5	190,000
8/23	$6,000		32,000	2	64,000
10/31		6,000	38,000	2	76,000
Total				12	$420,000

Average capital ($420,000 / 12 months)	$ 35,000

Average capital for Right

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$50,000	2	$100,000
3/5	$9,000		41,000	4	164,000
7/6		$7,000	48,000	3	144,000
10/7		5,000	53,000	3	159,000
Total				12	$567,000

Average capital ($567,000 / 12 months)	$ 47,250

Distribution of $50,000 income:

	Left	Right	Total
Profit percentage	50%	50%	100%
Average capital	$35,000	$47,250	
Net income			$ 50,000
Interest on average capital (8%)	$ 2,800	$ 3,780	(6,580)
Residual income			$ 43,420
Allocate 50%:50%	21,710	21,710	(43,420)
Total	$24,510	$25,490	$ -0-

E15-4 Distribution of Partnership Income and Preparation of a Statement of Partners' Capital

a. Distribution of partnership net income for 20X5:

	Apple	Jack	Total
Profit percentage (if positive)	70%	30%	100%
Profit percentage (if negative)	50%	50%	100%
Net income			$ 80,000
Interest on average capital balances(see Schedule 1)	$ 3,123	$ 7,220	(10,343)
			$ 69,657
Bonus on net income before the bonus but after interest (see Schedule 2)	6,966		(6,966)
			$ 62,691
Salaries	25,000	30,000	(55,000)
			$ 7,691
Residual income — allocate 70:30	5,384	2,307	(7,691)
Total	$40,473	$39,527	$ -0-

Schedule 1: Partners' average capital balances for 20X5:

	Capital Balance	Months Out-standing	Months x Capital Balance
Apple — January 1 to April 1	$ 40,800	3	$ 122,400
— April 1 to December 31	$ 55,800	9	502,200
Total		12	$ 624,600
Average capital balance ($624,600 / 12)			$ 52,050
Interest rate			x 0.06
Interest on average capital balance			$ 3,123
Jack — January 1 to August 1	$112,000	7	$ 784,000
— August 1 to December 31	$132,000	5	660,000
Total		12	$1,444,000
Average capital balance ($1,444,000 / 12)			$ 120,333
Interest rate			x 0.06
Interest on average capital balance			$ 7,220

Schedule 2: Bonus on net income after interest on capital

Bonus = 0.10(net income - interest on capital)

= 0.10($80,000 - $10,343)

= $6,966

E15-4 (continued)

b.

Apple — Jack Partnership
Statement of Partners' Capital
For the Year Ended December 31, 20X5

	Apple	Jack	Total
Balance, January 1, 20X5	$ 40,800	$112,000	$152,800
Add: Additional investment	15,000	20,000	35,000
Net income distribution	40,473	39,527	80,000
	$ 96,273	$171,527	$267,800
Less: Withdrawals	(20,800)	(20,800)	(41,600)
Balance, December 31, 20X5	$ 75,473	$150,727	$226,200

c.

Apple — Jack Partnership
Distribution of $80,000 Net Income

	Apple	Jack	Total
Profit percentage (if positive)	70%	30%	100%
Profit percentage (if negative)	50%	50%	100%
Net income			$ 80,000
Interest on average capital balances (see Schedule 1)	$ 3,123	$ 7,220	(10,343)
			$ 69,657
Bonus on net income before the bonus and after interest (see Schedule 2)	6,966		(6,966)
			$ 62,691
Salaries	30,000	35,000	(65,000)
			(2,309)
Residual loss — allocate 50:50	(1,155)	(1,154)	2,309
Total	$38,934	$41,066	$ -0-

E15-5 Matching Partnership Terms With Their Descriptions

1. F
2. E
3. H
4. C
5. G
6. A
7. I
8. D
9. M
10. B
11. J
12. L
13. J
14. D
15. B

E15-6 Admission of a Partner

a. Determine required payment if no bonus or goodwill recognized:

2/3 total resulting capital	$ 400,000
Total resulting capital ($400,000 / 0.66666…)	$ 600,000
Total net assets prior to admission	(400,000)
Required contribution ($600,000 x 0.3333)	$ 200,000

Therefore, Elan must invest $200,000 for a 1/3 interest.

b. Elan invests $80,000 for a one-fifth interest; goodwill recorded:

Investment in partnership	$ 80,000
New partner's proportionate book value [($400,000 + $80,000) x 0.20]	(96,000)
Difference (investment cost < book value)	$ (16,000)

Method: Goodwill to new partner

Step 1:	
4/5 estimated total resulting capital	$ 400,000
Estimated total resulting capital ($400,000 / 0.80)	$ 500,000

Step 2:	
Estimated total resulting capital	$ 500,000
Total net assets not including goodwill ($400,000 + $80,000)	(480,000)
Estimated goodwill to new partner	$ 20,000

Cash	80,000	
Goodwill	20,000	
Elan, Capital		100,000

$100,000 = $500,000 x 0.20

E15-6 (continued)

c. Elan invests $200,000 for a 20 percent interest; total capital specified as $600,000:

Investment in partnership	$ 200,000
New partner's proportionate book value [($400,000 + $200,000) x 0.20]	(120,000)
Difference (investment cost > book value)	$ 80,000

Method: Goodwill or bonus to prior partners

Specified total capital	$ 600,000
Total net assets not including goodwill ($400,000 + $200,000)	(600,000)
Estimated goodwill	$ -0-

Therefore, bonus method is used because no additional capital is created.

Cash	200,000	
Mary, Capital ($80,000 x 0.60)		48,000
Gene, Capital ($80,000 x 0.30)		24,000
Pat, Capital ($80,000 x 0.10)		8,000
Elan, Capital ($600,000 x 0.20)		120,000

d. Section 306 of the UPA 1997 states that "A person admitted into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner." Although Elan would not be personally liable, she does have the risk of losing her investment in the partnership.

E15-7 Admission of a Partner

a. Gerry invests $50,000 and goodwill is to be recorded:

Investment in partnership	$ 50,000
New partner's proportionate book value [($160,000 + $50,000) x 0.20]	(42,000)
Difference (investment cost > book value)	$ 8,000

Method: Goodwill to prior partners

Step 1:	
0.20 estimated total resulting capital	$ 50,000
Estimated total resulting capital ($50,000 / 0.20)	$ 250,000

E15-7 (continued)

Step 2:

Estimated total resulting capital	$ 250,000	
Total net assets not including goodwill ($160,000 + $50,000)	(210,000)	
Estimated goodwill to prior partners	$ 40,000	

Cash	50,000	
Goodwill	40,000	
Pam, Capital ($40,000 x 0.75)		30,000
John, Capital ($40,000 x 0.25)		10,000
Gerry, Capital ($250,000 x 0.20)		50,000

NON- GAAP: Recognition of goodwill at the time a new partner is admitted is not GAAP. Under GAAP, goodwill is to be recognized only when acquired. An entity cannot recognize internally generated goodwill.

b. Gerry invests $50,000; total capital is to be $210,000:

Investment in partnership	$ 50,000
New partner's proportionate book value [($160,000 + $50,000) x 0.20]	(42,000)
Difference (investment > book value)	$ 8,000

Method: Goodwill or bonus to prior partners

Specified total resulting capital	$ 210,000
Total net assets not including goodwill ($160,000 + $50,000)	(210,000)
Estimated goodwill	$ -0-

Therefore, bonus of $8,000 to prior partners

Cash	50,000	
Pam, Capital ($8,000 x 0.75)		6,000
John, Capital ($8,000 x 0.25)		2,000
Gerry, Capital ($210,000 x 0.20)		42,000

GAAP: Partners are legally able to allocate their capital interests however they choose.

c. Direct purchase from Pam; thus, only reclassify capital:

Pam, Capital	32,000	
Gerry, Capital ($160,000 x 0.20)		32,000

GAAP: A purchase of a partnership share made directly from a present partner is an allocation of that partner's capital interest. Note that the partnership did not receive the $50.000 cash.

E15-7 (continued)

d. Gerry invests $35,000; total capital to be $195,000:

Investment in partnership	$ 35,000
New partner's proportionate book value	
[($160,000 + $35,000) x 0.20]	(39,000)
Difference (investment < book value)	$ (4,000)

Method: Goodwill or bonus to new partner

Specified total resulting capital	$ 195,000
Total net assets not including goodwill	
($160,000 + $35,000)	(195,000)
Estimated goodwill	$ -0-

Therefore, bonus of $4,000 to new partner

Cash	35,000	
Pam, Capital ($4,000 x 0.75)	3,000	
John, Capital ($4,000 x 0.25)	1,000	
Gerry, Capital ($195,000 x 0.20)		39,000

GAAP: Partners may allocate capital among themselves, including new capital received from a partner being admitted into the partnership.

e. Gerry invests $35,000 and goodwill to be recorded:

Investment in partnership	$ 35,000
New partner's proportionate book value	
[($160,000 + $35,000) x 0.20]	(39,000)
Difference (investment < book value)	$ (4,000)

Method: Goodwill to new partner

Step 1:	
0.80 estimated total resulting capital	$ 160,000
Estimated total resulting capital	
($160,000 / 0.80)	$ 200,000

Step 2:	
Estimated total resulting capital	$ 200,000
Total net assets not including goodwill	
($160,000 + $35,000)	(195,000)
Estimated goodwill to new partner	$ 5,000

Cash	35,000	
Goodwill	5,000	
Gerry, Capital		40,000

$40,000 = $200,000 x 0.20

NON- GAAP: Recognition of goodwill at the time a new partner is admitted is not allowed under GAAP.

E15-7 (continued)

f. Gerry invests $35,000; inventory write down of $20,000 recognized

Write down inventory to LOCOM prior to admission of new partner. Reduction of $20,000 to market.

Pam, Capital ($20,000 x 0.75)	15,000	
John, Capital ($20,000 x 0.25)	5,000	
Inventory		20,000

Investment in partnership	$ 35,000
New partner's proportionate book value [($140,000 + $35,000) x 0.20]	(35,000)
Difference (investment = book value)	$ -0-

Method: No bonus or goodwill stated.

Cash	35,000	
Gerry, Capital ($175,000 x .20)		35,000

GAAP: Note that the write down of inventory to its lower-of-cost-or-market value is proper under GAAP. This results in the prior partners' capital of $140,000 ($160,000 less $20,000 write down). Any revaluations of assets or liabilities that are proper under GAAP should be made before determining the prior partners' capital that is used in computing the new partner's proportionate book value of the total resulting capital of the partnership.

E15-8 Multiple-Choice Questions on the Admission of a Partner

1. **d** – Specified no bonus or goodwill:

5/6 estimated total resulting capital	$ 150,000
Estimated total resulting capital ($150,000 / 5/6)	$ 180,000
Required investment ($180,000 x 1/6)	$ 30,000

2. **d** – Direct purchase; reclassify Claire's capital only.

3. **c** – Scott invests $36,000 for a 1/5 interest:

Investment in partnership	$ 36,000
New partner's proportionate book value [($120,000 + $36,000) x 0.20]	(31,200)
Difference (investment > book value)	$ 4,800

Method: Goodwill to prior partners

Step 1:

1/5 estimated total resulting capital	$ 36,000
Estimated total resulting capital ($36,000 / 0.20)	$ 180,000

Step 2:

Estimated total resulting capital	$ 180,000
Total net assets not including goodwill ($120,000 + $36,000)	(156,000)
Estimated goodwill to prior partners	$ 24,000

4. **b** – Lisa invests $40,000 and total capital specified as $150,000:

Investment in partnership	$ 40,000
New partner's proportionate book value [($110,000 + $40,000) x 1/3]	(50,000)
Difference (investment < book value)	$ (10,000)

Method: Bonus or goodwill to new partner

Specified total resulting capital	$ 150,000
Total net assets not including goodwill ($110,000 + $40,000)	(150,000)
Estimated goodwill	$ -0-

Therefore, bonus of $10,000 to new partner
Boris' capital = $54,000 = $60,000 - ($10,000 x 6/10)

E15-8 (continued)

5. **c** – Pete invests $17,000; no goodwill recorded:

Investment in partnership	$ 17,000
New partner's proportionate book value [($60,000 + $17,000) x 1/5]	(15,400)
Difference (investment > book value)	$ 1,600

Method: Bonus to prior partners

Pete's capital credit = $77,000 x 1/5 = $15,400

6. **b** – Direct purchase and computation of gain to prior partners:

Selling price	$132,000
Book value of interest sold [($139,000 + $209,000 + $96,000) x 1/5]	(88,800) *
Gain to Ella and Nick	$ 43,200

*Tony acquired a one-fifth interest in the net assets of the partnership.

7. **b** – Lute invests $25,000 and total capital specified as $90,000:

Investment in partnership	$ 25,000
New partner's proportionate book value [($65,000 + $25,000) x 1/3]	(30,000)
Difference (investment < book value)	$ (5,000)

Method: Bonus or goodwill to new partner

Specified total resulting capital	$ 90,000
Total net assets not including goodwill ($65,000 + $25,000)	(90,000)
Estimated goodwill	$ -0-

Therefore, bonus of $5,000 to new partner

Cash	25,000	
Fred, Capital ($5,000 x 0.70)	3,500	
Ralph, Capital ($5,000 x 0.30)	1,500	
Lute, Capital ($90,000 x 1/3)		30,000

E15-9 Withdrawal of a Partner

a. Karl receives $38,000 and no goodwill is recorded:

Bonus to withdrawing partner:

Payment	$ 38,000
Karl's capital account	(30,000)
Bonus paid	$ 8,000

Karl, Capital	30,000	
Luis, Capital ($8,000 x 0.80)	6,400	
Marty, Capital ($8,000 x 0.20)	1,600	
Cash		38,000

b. Karl receives $42,000 and only the withdrawing partner's share of goodwill is recognized:

Payment to Karl	$ 42,000
Karl's capital account	(30,000)
Karl's share of goodwill	$ 12,000

Goodwill	12,000	
Karl, Capital	30,000	
Cash		42,000

c. Recognize all implied goodwill on payment of $35,000:

Karl's share of goodwill ($35,000 - $30,000 capital)	$ 5,000
1/6 Total estimated goodwill	$ 5,000
Total estimated goodwill ($5,000 / 0.16666…)	$30,000

Record goodwill:

Goodwill	30,000	
Luis, Capital ($30,000 x 0.6667)		20,000
Marty, Capital ($30,000 x 0.1667)		5,000
Karl, Capital ($30,000 x 0.1667)		5,000

Withdrawal of Karl:

Karl, Capital	35,000	
Cash		35,000

d. Section 701 of the UPA 1997 defines the buyout price of a dissociated partner's interest in the partnership as the estimated amount that would be distributable to that partner if the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership was wound up including all partnership obligations paid. Thus, the buyout price is equivalent to what the dissociating partner would have received if the partnership had wound up and terminated.

E15-10 Retirement of a Partner

Case 1: Bonus of $10,000 to Eddy:

Eddy, Capital	70,000	
Cobb, Capital ($10,000 x 3/5)	6,000	
Davis, Capital ($10,000 x 2/5)	4,000	
Cash		80,000

Case 2: Distribution of Eddy's share of goodwill:

Goodwill	4,000	
Eddy, Capital		4,000

Eddy, Capital	74,000	
Cash		74,000

Case 3: Bonus of $5,000 distributed to remaining partners:

Eddy, Capital	70,000	
Cash		65,000
Cobb, Capital ($5,000 x 3/5)		3,000
Davis, Capital ($5,000 x 2/5)		2,000

Case 4: Recognize total implied goodwill:

Goodwill	24,000	
Cobb, Capital ($24,000 x 3/6)		12,000
Davis, Capital ($24,000 x 2/6)		8,000
Eddy, Capital ($24,000 x 1/6)		4,000

Eddy, Capital	74,000	
Cash		74,000

Case 5: Other assets disbursed:

Other Assets	60,000	
Cobb, Capital ($60,000 x 3/6)		30,000
Davis, Capital ($60,000 x 2/6)		20,000
Eddy, Capital ($60,000 x 1/6)		10,000

Eddy, Capital	80,000	
Cash		40,000
Other Assets		40,000

Case 6: Davis directly purchases Eddy's capital interest:

Eddy, Capital	70,000	
Davis, Capital		70,000

SOLUTIONS TO PROBLEMS

P15-11 Admission of a Partner

a. Wayne purchases one-half of Merina's investment for $90,000:

Merina, Capital	80,000	
Wayne, Capital		80,000

b. Wayne invests amount for one-third interest; no goodwill or bonus:

2/3 Total resulting capital	$ 360,000
Total resulting capital ($360,000 / 2/3)	$ 540,000
Amount to be invested by Wayne ($540,000 x 1/3)	$ 180,000

Cash	180,000	
Wayne, Capital		180,000

c. Wayne invests $110,000 for a one-fourth interest; goodwill:

Investment in partnership	$ 110,000
New partner's proportionate book value [($360,000 + $110,000) x 1/4]	(117,500)
Difference (investment cost < book value)	$ (7,500)

Method: Goodwill to new partner

Step 1:

3/4 estimated total resulting capital	$ 360,000
Estimated total resulting capital ($360,000 / 3/4)	$ 480,000

Step 2:

Estimated total resulting capital	$ 480,000
Total net assets not including goodwill ($360,000 + $110,000)	(470,000)
Estimated goodwill to new partner	$ 10,000

Cash	110,000	
Goodwill	10,000	
Wayne, Capital		120,000

$120,000 = $480,000 total resulting capital x 1/4

d. Wayne invests $100,000 for a one-fourth interest; some inventory is obsolete:

Investment in partnership	$ 100,000
New partner's proportionate book value [($360,000 + $100,000) x 1/4]	(115,000)
Difference (investment cost < book value)	$ (15,000)

Method: Asset revaluation decrease to prior partners

P15-11 (continued)

Step 1:

1/4 estimated total resulting capital	$ 100,000
Estimated total resulting capital ($100,000 / 1/4)	$ 400,000

Step 2:

Estimated total resulting capital	$ 400,000
Total net assets before inventory write-down ($360,000 + $100,000)	(460,000)
Inventory write-down required	$ (60,000)

Record write-down:

Debra, Capital ($60,000 x 0.60)	36,000	
Merina, Capital ($60,000 x 0.40)	24,000	
Inventory		60,000

Record admission of Wayne:

Cash	100,000	
Wayne, Capital		100,000

$100,000 = 1/4 of $400,000 resulting total capital after write-down

e. Wayne purchases one-fourth interest directly from Debra and Merina; land revalued:

New partner's proportionate book value ($360,000 x 1/4)	$ 90,000

Method stated: Increase land valuation

Step 1:

1/4 estimated total resulting capital ($80,000 + $60,000)	$ 140,000
Estimated total resulting capital ($140,000 / 1/4)	$ 560,000

Step 2:

Estimated total resulting capital	$ 560,000
Total net assets before land revaluation ($200,000 + $160,000)	(360,000)
Increase in value of land	$ 200,000

Revalue land:

Land	200,000	
Debra, Capital ($200,000 x 0.60)		120,000
Merina, Capital ($200,000 x 0.40)		80,000

Reclassification of capital for admission of Wayne:

Debra, Capital ($320,000 x 0.25)	80,000	
Merina, Capital ($240,000 x 0.25)	60,000	
Wayne, Capital		140,000

$140,000 = 1/4 of $560,000 total resulting capital after recording increase in value of land.

P15-11 (continued)

f. Wayne invests $80,000 for a one-fifth interest; total capital specified as $440,000:

Investment in partnership	$ 80,000
New partner's proportionate book value [($360,000 + $80,000) x 1/5]	(88,000)
Difference (investment cost < book value)	$ (8,000)

Method: Bonus or goodwill to new partner

Specified total resulting capital	$ 440,000
Total net assets not including goodwill ($360,000 + $80,000)	(440,000)
Estimated goodwill	$ -0-

Therefore, bonus of $8,000 to new partner

Cash	80,000	
Debra, Capital ($8,000 x 0.60)	4,800	
Merina, Capital ($8,000 x 0.40)	3,200	
Wayne, Capital ($440,000 x 1/5)		88,000

g. Wayne invests $100,000 for a one-fifth interest; goodwill recorded.

Investment in partnership	$ 100,000
New partner's proportionate book value [($360,000 + $100,000) x 1/5]	(92,000)
Difference (investment cost > book value)	$ 8,000

Method: Goodwill to prior partners

Step 1:

1/5 estimated total resulting capital	$ 100,000
Estimated total resulting capital ($100,000 / 1/5)	$ 500,000

Step 2:

Estimated total resulting capital	$ 500,000
Total net assets not including goodwill ($360,000 + $100,000)	(460,000)
Estimated goodwill to prior partners	$ 40,000

Record goodwill:

Goodwill	40,000	
Debra, Capital ($40,000 x 0.60)		24,000
Merina, Capital ($40,000 x 0.40)		16,000

Admission of Wayne:

Cash	100,000	
Wayne, Capital		100,000

$100,000 = 1/5 of $500,000 total resulting capital after recording goodwill of $40,000.

P15-11 (continued)

Balance Sheet Format (Not Required)

Prior to admission of new partner: Wayne	Net Assets	$360,000	Prior partner's capital	$360,000
New partner's cash investment	Cash	100,000	New tangible capital	100,000
Capital prior to recognizing goodwill		$460,000		$460,000
Estimated new goodwill	Goodwill	40,000	Capital from goodwill	40,000
Total resulting capital	Net Assets	$500,000	Total resulting capital	$500,000

P15-12 Division of Income

a. Distribution of $78,960 income:

	Eastwood	North	West	Total
Profit ratio	3	3	4	10
Ending capital	$28,000	$40,000	$48,000	
Net income				$ 78,960
Salary	$15,000	$20,000	$18,000	(53,000)
Bonus[a]	3,760			(3,760)
Interest on ending capital balance (10%)	2,800	4,000	4,800	(11,600)
Residual income				$ 10,600
Allocate 3:3:4	3,180	3,180	4,240	(10,600)
Total	$24,740	$27,180	$27,040	$ -0-

[a] Bonus = 0.05(Net Income - Bonus)
B = 0.05($78,960 - B)
20B = $78,960 - B
21B = $78,960
B = $3,760

b. Distribution of $68,080 net income:

Average capital for Eastwood

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$30,000	4	$120,000
5/1		$6,000	36,000	4	144,000
9/1	$8,000		28,000	4	112,000
Total				12	$376,000

Average capital ($376,000 / 12 months) $ 31,333

Average capital for North

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$40,000	2	$ 80,000
3/1	$9,000		31,000	4	124,000
7/1		$5,000	36,000	2	72,000
9/1		4,000	40,000	4	160,000
Total				12	$436,000

Average capital ($436,000 / 12 months) $ 36,333

P15-12 (continued)

Average capital for West

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$50,000	3	$150,000
4/1		$7,000	57,000	2	114,000
6/1		3,000	60,000	2	120,000
8/1	$12,000		48,000	5	240,000
Total				12	$624,000

Average capital ($624,000 / 12 months) $ 52,000

Distribution of $68,080 income:

	Eastwood	North	West	Total
Profit ratio	1	1	1	3
Average capital	$31,333	$36,333	$52,000	
Net income				$ 68,080
Interest on average capital balance (10%)	$ 3,133	$ 3,633	$ 5,200	(11,966)
Salary	24,000	21,000	25,000	(70,000)
Bonus[a]		4,280		(4,280)
Residual income (deficit)				$(18,166)
Allocate 1:1:1	(6,055)	(6,055)	(6,056)	18,166
Total	$21,078	$22,858	$24,144	$ -0-

[a]Bonus = 0.10(Net Income - Bonus - North's Salary)
B = 0.10($68,080 - B - $21,000)
B = 0.10($47,080 - B)
10B = $47,080 - B
11B = $47,080
B = $4,280

c. Distribution of $92,940 net income:

	Eastwood	North	West	Total
Profit ratio	8	7	5	20
Beginning capital	$30,000	$40,000	$50,000	
Net income				$ 92,940
Bonus[a]			6,490	(6,490)
Salary	21,000	18,000	15,000	(54,000)
Interest on beginning capital balance (10%)	3,000	4,000	5,000	(12,000)
Residual income				$ 20,450
Allocate 8:7:5	8,180	7,158	5,112	(20,450)
Total	$32,180	$29,158	$31,602	$ -0-

[a] Bonus = 0.20(Net Income - Bonus - Salaries)
B = 0.20($92,940 - B - $54,000)
B = 0.20($38,940 - B)
5B = $38,940 - B
6B = $38,940

B = $6,490

P15-13 Determining a New Partner's Investment Cost

a. $200,000 (No goodwill or bonus recorded)

Cash	200,000	
Snider, Capital ($800,000 x 1/4)		200,000

0.75 estimated total resulting capital	$ 600,000
Estimated total resulting capital ($600,000 / 0.75)	$ 800,000
Prior capital	(600,000)
Cash contribution required from Snider	$ 200,000

b. $210,000 (Goodwill of $30,000 to prior partners)

Goodwill	30,000	
Der, Capital ($30,000 x 0.40)		12,000
Egan, Capital ($30,000 x 0.30)		9,000
Oprins, Capital ($30,000 x 0.30)		9,000

Cash	210,000	
Snider, Capital ($840,000 x 1/4)		210,000

0.75 estimated total resulting capital	$ 630,000
Estimated total resulting capital ($630,000 / 0.75)	$ 840,000
Prior capital after goodwill recognition	(630,000)
Cash contribution required from Snider	$ 210,000

c. $232,000 (Bonus of $24,000 to be paid by Snider)

Cash	232,000	
Der, Capital ($24,000 x 0.40)		9,600
Egan, Capital ($24,000 x 0.30)		7,200
Oprins, Capital ($24,000 x 0.30)		7,200
Snider, Capital ($832,000 x 1/4)		208,000

0.75 estimated total resulting capital ($600,000 + $24,000 bonus)	$ 624,000
Estimated total resulting capital ($624,000 / 0.75)	$ 832,000
Prior capital before bonus from Snider	(600,000)
Cash contribution required from Snider	$ 232,000

d. $190,000 (New partner given $10,000 of goodwill)

Cash	190,000	
Goodwill	10,000	
Snider, Capital ($800,000 x 1/4)		200,000

0.75 estimated total resulting capital	$ 600,000
Estimated total resulting capital ($600,000 / 0.75)	$ 800,000
Prior capital	(600,000)

Capital credit to Snider	$ 200,000
Goodwill to Snider	(10,000)
Cash contribution required from Snider	$ 190,000

P15-13 (continued)

e. $220,000 (Other assets increased by $20,000 and goodwill of $40,000 allocated to prior partners)

Other Assets	20,000	
Goodwill	40,000	
Der, Capital ($60,000 x 0.40)		24,000
Egan, Capital ($60,000 x 0.30)		18,000
Oprins, Capital ($60,000 x 0.30)		18,000

Cash	220,000	
Snider, Capital ($880,000 x 1/4)		220,000

0.75 estimated total resulting capital ($600,000 + $60,000 revaluation and goodwill)	$ 660,000
Estimated total resulting capital ($660,000 / 0.75)	$ 880,000
Prior capital after recognition of asset revaluation and goodwill to prior partners	(660,000)
Cash contribution required from Snider	$ 220,000

f. $220,000 (No goodwill; total resulting capital is $820,000)

Cash	220,000	
Der, Capital ($15,000 x 0.40)		6,000
Egan, Capital ($15,000 x 0.30)		4,500
Oprins, Capital ($15,000 x 0.30)		4,500
Snider, Capital ($820,000 x 1/4)		205,000

Specified total resulting capital	$ 820,000
Prior capital	(600,000)
Cash contribution required from Snider	$ 220,000

Investment in partnership	$ 220,000
New partner’s proportionate book value [($600,000 + $220,000) x 0.25]	(205,000)
Difference (investment > book value)	$ 15,000

Method: Bonus of $15,000 to prior partners

P15-13 (continued)

g. $140,000 (Other assets decreased $20,000; bonus of $40,000 to new partner)

Der, Capital ($20,000 x 0.40)	8,000	
Egan, Capital ($20,000 x 0.30)	6,000	
Oprins, Capital ($20,000 x 0.30)	6,000	
Other Assets		20,000

Cash	140,000	
Der, Capital ($40,000 x 0.40)	16,000	
Egan, Capital ($40,000 x 0.30)	12,000	
Oprins, Capital ($40,000 x 0.30)	12,000	
Snider, Capital ($720,000 x 1/4)		180,000

0.75 estimated total resulting capital after asset write-downs and bonus to new partner ($600,000 - $60,000)	$ 540,000
Estimated total resulting capital ($540,000 / 0.75)	$ 720,000
Prior capital after asset write-downs and bonus to new partner	(540,000)
Capital credit to Snider	$ 180,000
Bonus to Snider	(40,000)
Cash contribution required from Snider	$ 140,000

P15-14 Division of Income

a. Distribution of $64,260 net income:

Average capital for Luc

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$50,000	3	$150,000
4/1		$ 5,000	55,000	4	220,000
8/1	$15,000		40,000	5	200,000
Total				12	$570,000
Average capital ($570,000 / 12 months)					$ 47,500

Average capital for Dennis

Date	Debit	Credit	Balance	Months Maintained	Months x Dollar Balance
1/1			$70,000	6	$420,000
7/1	$10,000		60,000	2	120,000
9/1		$22,500	82,500	4	330,000
Total				12	$870,000
Average capital ($870,000 / 12 months)					$ 72,500

	Luc	Dennis	Total
Profit ratio	3	2	5
Average capital	$47,500	$72,500	
Net income			$ 64,260
Salary	$24,000	$28,000	(52,000)
Interest on average capital (10%)	4,750	7,250	(12,000)
Bonus[a]	3,060		(3,060)
Residual income			$ (2,800)
Allocate 3:2	(1,680)	(1,120)	2,800
Total	$30,130	$34,130	$ -0-

[a]Bonus = 0.05(Net Income - Bonus)
B = 0.05($64,260 - B)
20B = $64,260 - B
21B = $64,260
B = $3,060

P15-14 (continued)

b. Distribution of $108,700 income:

	Luc	Dennis	Total
Profit ratio	1	1	2
Ending capital balance after deducting salaries of $24,000 for Luc and $28,000 for Dennis	$16,000	$54,500	
Net income			$108,700
Salary	$24,000	$28,000	(52,000)
Interest on ending capital balance (10%)	1,600	5,450	(7,050)
Bonus[a]	4,200		(4,200)
Residual income			$ 45,450
Allocate 1:1	22,725	22,725	(45,450)
Total	$52,525	$56,175	$ -0-

[a]Bonus = 0.08(Net Income - Bonus - Salaries)
B = 0.08($108,700 - B - $52,000)
12.50B = $56,700 - B
13.50B = $56,700
B = $ 4,200

c. Distribution of $76,950 income:

	Luc	Dennis	Total
Profit ratio	4	2	6
Beginning capital balance	$50,000	$70,000	
Net income			$ 76,950
Salary	$24,000	$28,000	(52,000)
Interest on beginning capital balance (10%)	5,000	7,000	(12,000)
Bonus[a]	8,550		(8,550)
Residual income			$ 4,400
Allocate 4:2	2,933	1,467	(4,400)
Total	$40,483	$36,467	$ -0-

[a]Bonus = 0.125(Net Income - Bonus)
B 0.125($76,950 - B)
8B $76,950 - B
9B $76,950
B $8,550

P15-15 Withdrawal of a Partner under Various Alternatives

a. Spade's capital interest was acquired in a personal transaction with Jack.

Spade, Capital	120,000	
Jack, Capital		120,000

b.

Amount paid by Jack for Spade's capital interest	$ 150,000
Recorded amount of Spade's capital interest	(120,000)
Goodwill attributable to Spade	$ 30,000
Spade's share of profits/losses	50%
Implied value of the partnership's goodwill ($30,000 / 0.50) – allocated to all partners in the ratio 20:30:50	$ 60,000

Goodwill	60,000	
Ace, Capital (0.20 x $60,000)		12,000
Jack, Capital (0.30 x $60,000)		18,000
Spade, Capital (0.50 x $60,000)		30,000

Spade, Capital ($120,000 + 30,000)	150,000	
Jack, Capital		150,000

c. The partnership paid a bonus to Spade upon retirement. Total capital of the partnership after Spade's retirement was $290,000.

Amount paid to Spade upon retirement	$ 180,000
Spade's capital credit	(120,000)
Bonus paid to Spade — allocated to Ace and Jack in the ratio 40:60	$ 60,000

Spade, Capital	120,000	
Ace, Capital (0.40 x $60,000)	24,000	
Jack, Capital (0.60 x $60,000)	36,000	
Cash		180,000

Capital balances after retirement:	
Ace, Capital ($150,000 - $24,000)	$ 126,000
Jack, Capital ($200,000 - $36,000)	164,000
Total capital	$ 290,000

P15-15 (continued)

d. Spade was given cash and land. Capital of the partnership after Spade's retirement was $310,000.

	Ace	Jack	Spade
Profit ratio	20%	30%	50%
Capital balances before Spade's retirement	$150,000	$200,000	$ 120,000
Gain recognized on transfer of land to Spade ($120,000 minus $100,000)	4,000	6,000	10,000
Capital balances after allocation of gain	$154,000	$206,000	$ 130,000

Amount paid to Spade ($60,000 cash and $120,000 land)	$ 180,000
Spade's capital interest — see above schedule	(130,000)
Bonus to Spade allocated between Ace and Jack in the ratio 40:60	$ 50,000

Land	20,000	
Ace, Capital (0.20 x $20,000)		4,000
Jack, Capital (0.30 x $20,000)		6,000
Spade, Capital (0.50 x $20,000)		10,000

Spade, Capital	130,000	
Ace, Capital (0.40 x $50,000)	20,000	
Jack, Capital (0.60 x $50,000)	30,000	
Cash		60,000
Land		120,000

Capital balances after Spade's retirement:

Ace, Capital ($154,000 - $20,000)	$ 134,000
Jack, Capital ($206,000 - $30,000)	176,000
Total capital	$ 310,000

e. Spade was given $150,000 upon retirement, and the goodwill attributable to Spade was recognized.

Amount paid to Spade	$ 150,000
Spade's capital interest	(120,000)
Goodwill attributable to Spade	$ 30,000

Spade, Capital	120,000	
Goodwill	30,000	
Cash		150,000

P15-15 (continued)

f. Spade was given $150,000 upon retirement, and goodwill applicable to the entire business was recorded.

Amount paid to Spade	$ 150,000
Spade's capital interest	(120,000)
Goodwill attributable to Spade	$ 30,000
Spade's share of profits/losses	50%
Goodwill attributable to the entire partnership $30,000/0.50 — allocated to all the partners in the ratio 20:30:50	$ 60,000

Goodwill	60,000	
Ace, Capital (0.20 x $60,000)		12,000
Jack, Capital (0.30 x $60,000)		18,000
Spade, Capital (0.50 x $60,000)		30,000

Spade, Capital	150,000	
Cash		150,000

g. Spade was given land and a note payable upon retirement. Capital of the partnership after Spade's retirement was $360,000.

	Ace	Jack	Spade
Profit ratio	20%	30%	50%
Capital balances before Spade's retirement	$150,000	$200,000	$ 120,000
Allocation of gain on transfer of land ($100,000 - $60,000 = $40,000)	8,000	12,000	20,000
Capital balances before Spade's retirement, adjusted for gain	$158,000	$212,000	$ 140,000
Amount paid to Spade ($100,000 of land + $50,000 note)			$ 150,000
Spade's capital interest — adjusted			(140,000)
Bonus given to Spade — allocated between Ace and Jack in the ratio 40:60			$ 10,000

Land	40,000	
Ace, Capital (0.20 x $40,000)		8,000
Jack, Capital (0.30 x $40,000)		12,000
Spade, Capital (0.50 x $40,000)		20,000

Spade, capital	140,000	
Ace, Capital (0.40 x $10,000)	4,000	
Jack, Capital (0.60 x $10,000)	6,000	
Land		100,000
Note Payable		50,000

Capital balances after Spade's retirement:

Ace, Capital ($158,000 - $4,000)	$154,000
Jack, Capital ($212,000 - $6,000)	206,000
Total capital	$360,000

P15-16 Multiple Choice Questions — Initial Investments, Division of Income, Admission and Retirement of a Partner [AICPA Adapted]

1. **d** – The contribution of noncash property into a partnership should be recorded by crediting the partner's capital account for the fair value of the property contributed. In effect, the partnership is acquiring the property from the partner at its fair value.

2. **b** – The capital balances of William and Martha at the date of partnership formation are determined as follows:

	William	Martha
Cash	$20,000	$ 30,000
Inventory	-	15,000
Building	-	40,000
Furniture and equipment	15,000	-
Total	$35,000	$ 85,000
Less mortgage assumed by partnership		(10,000)
Amounts credited to capital	$35,000	$ 75,000

3. **d** –

Total of old partners' capital	$ 80,000
Investment by new partner	15,000
Total of new partnership capital	$ 95,000
Capital amount credited to Johnson ($95,000 x 0.20)	$ 19,000

4. **c** – The capital balances of each partner are determined as follows:

	Apple	Blue	Crown
Cash	$50,000		
Property		$ 80,000	
Mortgage assumed		(35,000)	
Equipment			$ 55,000
Amount credited to capital accounts	$50,000	$ 45,000	$ 55,000

P15-16 (continued)

5. **d** – Because both partners have equal capital balances, Norbert's capital has to be increased to equal that of Moon's. Since Moon's capital balance is $60,000 and Norbert's is $20,000, an additional $40,000 has to be credited to Norbert's capital to make it equal Moon's capital. This additional amount credited to Norbert's capital is the goodwill that Norbert is bringing to the partnership.

6. **a** – Moon's share of the net income of $25,000 is 60%, or $15,000.

7. **d** – Crowe and Dagwood are getting a bonus from Elman, since the amount of Elman's investment into the partnership exceeds the amount credited to Elman's capital account. The bonus should be allocated to Crowe and Dagwood in their respective profit and loss ratio before the admission of Elman——the old profit and loss ratio.

8. **b** – The net income of $80,000 is allocated to Blue and Green in the following manner:

	Blue	Green	Net Income
			$ 80,000
Salary allowances	$ 55,000	$45,000	(100,000)
Remainder			$ (20,000)
Allocation of the negative remainder in the 60:40 ratio	(12,000)	(8,000)	20,000
Allocation of net income	$ 43,000	$37,000	$ -0-

9. **c** – Jill received a bonus when she retired from the partnership. The bonus is being given to Jill by Bill and Hill, which means that the bonus is allocated to Bill's and Hill's capital accounts in their respective profit and loss sharing ratio.

P15-17 Partnership Formation, Operation, and Changes in Ownership

a. Entries to record the formation of the partnership and the events that occurred during 20X7:

Cash	110,000	
Inventory	80,000	
Land	130,000	
Equipment	100,000	
Mortgage payable		50,000
Installment Note Payable		20,000
Jordan, Capital ($60,000+ $80,000 + $100,000 - $20,000)		220,000
O'Neal, Capital ($50,000 + $130,000 - $50,000)		130,000

(1)

Inventory	30,000	
Cash		24,000
Accounts Payable		6,000

(2)

Mortgage Payable	5,000	
Interest Expense	2,000	
Cash		7,000

(3)

Installment Note Payable	3,500	
Interest Expense	2,000	
Cash		5,500

(4)

Accounts Receivable	21,000	
Cash	134,000	
Sales		155,000

(5)

Selling and General Expenses	34,000	
Cash		27,800
Accrued Expenses Payable		6,200

(5)

Depreciation Expense	6,000	
Accumulated Depreciation		6,000

(6)

Jordan, Drawing ($200 x 52)	10,400	
O'Neal, Drawing	10,400	
Cash		20,800

(8)

Sales	155,000	
Income Summary		155,000

(7)

Cost of Goods Sold	90,000	
Inventory		90,000

$90,000 = $80,000 beginning inventory + 30,000 purchases - 20,000 ending inventory

P15-17 (continued)

(8)	Income Summary	134,000	
	Cost of Goods Sold		90,000
	Selling and General Expenses		34,000
	Depreciation Expense		6,000
	Interest Expense		4,000

(8)	Income Summary	21,000	
	Jordan, Capital		10,500
	O'Neal, Capital		10,500

(8)	Jordan, Capital	10,400	
	O'Neal, Capital	10,400	
	Jordan, Drawing		10,400
	O'Neal, Drawing		10,400

Schedule to allocate partnership net income for 20X7:

	Jordan	O'Neal	Total
Profit percentage	60%	40%	100%
Beginning capital balance	$220,000	$130,000	$350,000
Net income ($155,000 revenue - $134,000 expenses)			$ 21,000
Interest on beginning capital balances (3%)	$ 6,600	$ 3,900	(10,500)
			$ 10,500
Salaries	12,000	12,000	(24,000)
			$(13,500)
Residual deficit	(8,100)	(5,400)	13,500
Total	$ 10,500	$ 10,500	$ -0-

b.

Jordan — O'Neal Partnership
Income Statement
For the Year Ended December 31, 20X7

Sales		$155,000
Less: Cost of Goods Sold:		
Inventory, January 1	$ 80,000	
Purchases	30,000	
Goods Available for Sale	$110,000	
Less: Inventory, December 31	(20,000)	(90,000)
Gross Profit		$ 65,000
Less: Selling and General Expenses	$ 34,000	
Depreciation Expense	6,000	(40,000)
Operating Income		$ 25,000
Nonoperating Expense – Interest		(4,000)
Net Income		$ 21,000

P15-17 (continued)

c.

Jordan — O'Neal Partnership
Balance Sheet
At December 31, 20X7

Assets		
Cash		$158,900
Accounts Receivable		21,000
Inventory		20,000
Land		130,000
Equipment (net)		94,000
Total Assets		$423,900
Liabilities and Capital		
Liabilities:		
Accounts Payable		$ 6,000
Accrued Expenses Payable		6,200
Installment Note Payable		16,500
Mortgage Payable		45,000
Total Liabilities		$ 73,700
Capital:		
Jordan, Capital	$220,100	
O'Neal, Capital	130,100	
Total Capital		350,200
Total Liabilities and Capital		$423,900

d.

Hill's investment into the partnership	$ 99,800
Prior partners' capital	350,200
Total capital of the new partnership	$450,000
Hill's capital credit (0.20 x $450,000)	$ 90,000
Bonus allocated to Jordan and O'Neal in the ratio 60:40	$ 9,800

January 1, 20X8 journal entry:

Cash	99,800	
Jordan, Capital (0.60 x $9,800)		5,880
O'Neal, Capital (0.40 x $9,800)		3,920
Hill, Capital		90,000

P15-18A Initial Investments and Tax Bases [AICPA Adapted]

a. Entry to record initial investments using GAAP accounting:

Cash	50,000	
Computers and Printers	18,000	
Office Furniture	23,000	
Library	7,000	
Building	60,000	
Notes Payable		25,000
Mortgage Payable		36,000
Delaney, Capital		32,000
Engstrom, Capital		22,000
Lahey, Capital		15,000
Simon, Capital		28,000

Record initial investments in DELS partnership.

b. Tax bases:

	Delaney	Engstrom	Lahey	Simon
Tax basis of assets contributed	$40,000	$26,000	$ 33,000	$26,000
Add: Partner's share of other partners' liabilities assumed by the partnership:				
$36,000 from Delaney x 1/4		9,000	9,000	9,000
$10,000 from Engstrom x 1/4	2,500		2,500	2,500
$15,000 from Lahey x 1/4	3,750	3,750		3,750
Less: Partner's liabilities assumed by other partners:				
$36,000 x 3/4	(27,000)			
$10,000 x 3/4		(7,500)		
$15,000 x 3/4			(11,250)	
Total	$ 19,250	$31,250	$ 33,250	$41,250

P15-19 Formation of a Partnership and Allocation of Profit and Loss

Part I:

Haskins and Sells Partnership
Balance Sheet
At January 2, 20X3

Assets		
Current assets:		
Cash		$ 55,000
Temporary Investments		81,500
Trade Accounts Receivable	$70,000	
Less: Allowance for uncollectible accounts	(4,500)	65,500
Note Receivable		50,000
Inventories		62,500
Total Current Assets		$314,500
Property, Plant, and Equipment:		
Building (less accumulated depreciation of $230,000)		370,000
Intangible Assets:		
Customer Lists		60,000
Total Assets		$744,500
Liabilities and Partnership Capital:		
Current Liabilities:		
Current Portion of Mortgage Payable		$ 25,000
Long-term Liabilities:		
Mortgage Payable, less current portion		150,000
Partnership Capital:		
Haskins, Capital	$327,000	
Sells, Capital	242,500	569,500
Total Liabilities and Partnership Capital		$744,500

P15-19 (continued)

Part II:

a. Haskins and Sells Partnership
Income Statement
For the Year Ended December 31, 20X3

Revenues	$ 650,000
Less: Cost of Goods Sold	(320,000)
Gross Profit	$ 330,000
Operating Expenses:	
Selling, General, and Administrative Expenses	(70,000)
Net Income	$ 260,000

Note that salaries paid to partners and the bonus paid to Haskins are distributions of partnership net income and are not expenses of the partnership.

b. Description	Haskins	Sells	Total
10% bonus to Haskins	$ 26,000		$ 26,000
Salaries to each partner	90,000	$ 70,000	160,000
Residual net income: $74,000	14,800	59,200	74,000
Total	$130,800	$129,200	$260,000

	Capital		
c. Description	Haskins	Sells	Total
Capital balances, January 3, 20X3	$327,000	$242,500	$569,500
Add: Net income for 20X3	130,800	129,200	260,000
Withdrawals made during the year*	(110,000)	(80,000)	(190,000)
Capital balances at December 31, 20X3	$347,800	$291,700	$639,500

*Note that the salaries were also withdrawn during the year, so Haskins' total withdrawals are $110,000 ($100,000 salary+ $10,000) and Sells' were $80,000 ($75,000 salary + $5,000).

d. To find out what partnership net income would have to be for each partner to receive the same amount of income, determine the amount of income difference that would go to each partner for each additional dollar of partnership net income. To illustrate, assume that partnership net income was $261,000 instead of $260,000. How would this incremental $1,000 affect the distribution of net income? To find out the answer to this question, see the computation below.

Description	Haskins	Sells	Total
Bonus to Haskins	$ 26,100		$ 26,100
Salaries to each partner	90,000	$ 70,000	160,000
Remainder to each partner ($74,900)	14,980	59,920	74,900
Total	$131,080	$129,920	$261,000

The increase of $1,000 in partnership net income resulted in a $280 increase in Haskins' share of net income and a $720 increase in Sells' share of net income. Another way to look at this is that for a $1,000 increase in partnership net income, Sells will receive $440 more, or 44% more, than Haskins ($720 minus $280 = $440 divided by $1,000).

Take this information and use it to answer the question. At partnership net income of $260,000, Haskins will receive $1,600 more net income than Sells ($130,800 minus $129,200). Take the difference between these two incomes and divide it by 0.44. Dividing $1,600 by 0.44 equals $3,636. Add this amount to $260,000 to get $263,636, the amount of partnership net income that would result in each partner receiving the same amount of net income.