ANSWERS TO QUESTIONS

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

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

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

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

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

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

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

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

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

10. Division of Net Income

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

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

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

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

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

15.

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

16.

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

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

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

***19.**

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

***20.**

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

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

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

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

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