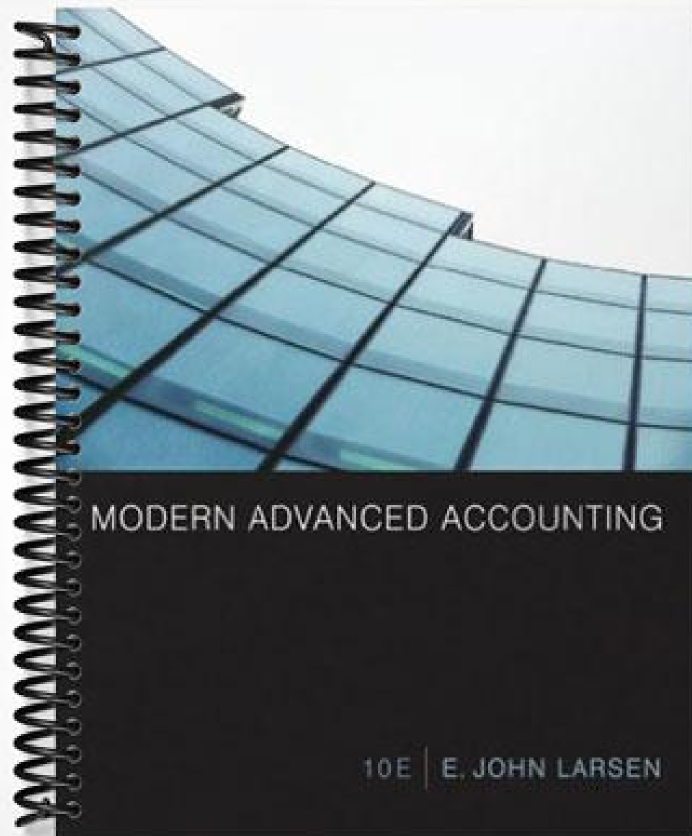
SOLUTIONS MANUAL
MODERN ADVANCED ACCOUNTING
10E
E. JOHN LARSEN

CHAPTER 2
PARTNERSHIPS: ORGANIZATION AND OPERATION

The title of each problem is followed by the estimated time in minutes required for completion and by a difficulty rating. The time estimates are applicable for students using the partially filled-in working papers.

Pr. 2–1 ***Oscar, Paul & Quinn LLP* (20 minutes, easy)**

Journal entries for various transactions and events of a limited liability partnership and adjusting entry for accrued interest on note payable to partner.

Pr. 2–2 ***Gee, Hawe & Ivan LLP* (20 minutes, easy)**

Journal entries for admission of new partner to a limited liability partnership (with goodwill allowed to new partner) and for partners' salaries and division of net income.

Pr. 2–3 ***Ross & Saye LLP* (20 minutes, easy)**

Preparation of income statement (including supporting exhibit for division of net income between partners) and statement of partners' capital for a limited liability partnership.

Pr. 2–4 ***Lucas & May LLP* (30 minutes, easy)**

Division of net income of limited liability partnership under four alternative income-sharing plans.

Pr. 2–5 ***Alex, Baron & Crane LLP* (20 minutes, easy)**

Division of income among partners of a limited liability partnership, including partners' salaries and interest on average capital account balances. Preparation of statement of partners' capital.

Pr. 2–6 ***Chu, Dow & Eng LLP* (30 minutes, easy)**

Journal entries for retirement of a partner from a limited liability partnership under four alternative assumptions: bonus to retiring partner; bonus to continuing partners; write-off of impaired goodwill of partnership; and loss on plant asset of partnership that was transferred to retiring partner.

Pr. 2–7 ***Yee & Zane LLP* (60 minutes, medium)**

Change from direct write-off method of accounting for doubtful accounts expense to the allowance method prior to admission of new partner to a limited liability partnership. Journal entry to record admission of new partner under bonus method.

Pr. 2–8 ***Alef, Beal & Clarke LLP* (60 minutes, strong)**

Preparation of statement of cash flows for a limited liability partnership from which a partner retired during the year.

Pr. 2–9 ***Southwestern Enterprises* (60 minutes, strong)**

Preparation of income statement, statement of partners' capital, balance sheet, and statement of cash flows for a limited partnership, including net income per unit and partners' capital per unit.

Pr. 2–10 ***Noble & Roland LLP* (50 minutes, strong)**

Correcting journal entries for a limited liability partnership, and corrected balance sheet. Research of professional pronouncements required.

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ANSWERS TO REVIEW QUESTIONS

1. Nonmonetary assets should be recognized by the limited liability partnership at current fair value on the date invested to provide a realistic and consistent measurement of the capital invested by all partners, whether the investment is in the form of cash or nonmonetary assets. Later disposal of the nonmonetary assets by the partnership may result in gains or losses. These gains or losses will reflect changes in value of the assets from the date of their acquisition by the partnership, rather than changes in value that occurred prior to the beginning of the partnership.
2. There is little difference between a professional corporation and a limited liability partnership (LLP) other than income tax status. Partners of an LLP are responsible for their own conduct and that of employees under their supervision; they are not responsible for acts of other partners of the LLP. In this respect, LLPs resemble professional corporations. However, an LLP is not subject to income taxes as is a professional corporation; partners of an LLP escape the "double taxation" characteristic of stockholders of a professional corporation. Thus, the choice between a professional corporation and an LLP (assuming state laws permit both types of organization for a professional enterprise) often is based on income tax considerations rather than liability of the owners.
3. Loans to partners typically are displayed in the limited liability partnership balance sheet as assets, either current or noncurrent, depending on the expected time of repayment and other issues. If the amount of a loan to a partner is substantial and repayment appears doubtful, offsetting of the loan balance against the partner's capital account balance may be justified. Loans from partners may be displayed as current or noncurrent liabilities, depending on their maturity. Loans to and from partners, being **related party** items, require separate disclosure and should not be included with trade notes receivable or trade notes payable.

   Interest on loans to partners is displayed with revenue or gains in the income statement; interest on loans from partners is an operating expense. In essence, a debtor-creditor relationship may exist between a partnership and one or more of its partners.
4. Partners' salaries generally are regarded as an expense of a partnership. Consequently, partners' salaries may appropriately be displayed as an operating expense in the income statement of a limited liability partnership.
5. Among the items that should be included in a limited liability partnership contract are the following (only five are required):

   (1) The date of formation and the planned duration of the partnership, the names of the partners, and the name and business activities of the partnership.

   (2) The assets to be invested by each partner, the procedure for valuing noncash investments, and the penalties for a partner's failure to invest and maintain the agreed amount of capital.

   (3) The authority of each partner and the rights and duties of each.

   (4) The accounting period to be used, the nature of accounting records, financial statements, and audits by independent public accountants.

   (5) The plan for sharing net income or loss, including the frequency of income measurement and the distribution of the income or loss among the partners.

   (6) The salaries and drawings allowed to partners and the penalties, if any, for excessive withdrawals.

   (7) Insurance on the lives of partners, with the partnership or surviving partners named as beneficiaries.

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(8) Provision for arbitration of disputes and the liquidation of the partnership at the end of the term specified in the contract or at the death or withdrawal of a partner. Especially important in avoiding disputes is agreement on procedures such as binding arbitration for the valuation of the partnership net assets and the method of settlement with the estate of a deceased partner.

6. Some possible plans for sharing of net income among partners of a limited liability partnership are the following (only five are required):

(1) Equally

(2) In some other ratio, such as 3:2:1

(3) In the ratio of partners' capital account balances on a specified date or in the ratio of average capital account balances during the year

(4) Allowing salaries to partners, with resultant net income or loss divided in a specified ratio

(5) Allowing salaries to partners, allowing interest on capital account balances, and dividing the remaining net income or loss in a specified ratio

(6) Allowing a bonus to a managing partner, computed as a percentage of income before deduction of the bonus or as a percentage of net income after deduction of the bonus (The bonus plan may be combined with any of the preceding plans.)

7. The offer to Paul Craig is not clearly defined. It does not necessarily mean that Craig would be entitled to one-third of the partnership net income or losses because the ratio in which partners share net income or losses may be different from the ratio of their equities in the firm. To clarify the offer, it is necessary to state the percentage of net income or losses Craig would receive and the proportion of a specified total partnership capital he would own.

8. The division of net income or losses would be the same under the two proposals. There is no reason to allow interest on capital account balances if the remaining income or loss also is to be divided in the ratio of partners' capital account balances.

9. The income-sharing plan for Peel & Quay LLP fails to make clear whether the $2,000 to be drawn monthly by each partner is a reduction in capital or is to be recognized as salaries expense of the limited liability partnership. Assume, for example, that the partnership has income of $100,000 without regard to any "salaries" or "drawings" by partners. One interpretation of the contract would require division of the $100,000 between Peel and Quay in an 80:20 ratio, that is, $80,000 to Peel and $20,000 to Quay. The drawings of $24,000 for each partner would be closed to the partners' capital accounts under this interpretation and would not affect the division of net income.

An alternative interpretation of the contract would divide the income of $100,000 as follows:

	Peel	**Quay**	**Combined**
Salaries expense	$24,000	$24,000	$ 48,000
Net income ($100,000 – $48,000) divided in 80:20 ratio	41,600	10,400	52,000
Totals	$65,600	$34,400	$100,000

Under the latter interpretation, Peel receives $14,400 ($80,000 – $65,600 = $14,400) less than under the former interpretation. To avoid disputes among partners, it is imperative that the partnership contract be complete and specific in distinguishing between drawings and salaries.

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10. The $10,000 should be accounted for as a prior period adjustment recognized after the income-sharing ratio was changed from 50:50 to 70:30. Because the cash received related to the prior year when the partners shared net income and losses equally, a logical argument exists for an equal division of the $10,000. However, the possibility of this settlement should have been considered when the income-sharing ratio was changed, and specific agreement reached as to the division of any amounts received from the settlement of the dispute. If no such agreement was reached, Muir is in a strong position to insist that the settlement was realized in 2005, with the $10,000 to be divided in the new 70:30 ratio. This situation points out the need for a careful review of asset valuations and uncompleted transactions at the time of a change in the income-sharing ratio of a limited liability partnership.

11. It is not always necessary or desirable that the accounting records of a limited liability partnership be restated to carry net assets at current fair value for every change in membership of the firm. In determining whether a change in asset valuations is appropriate, an accountant should consider the substance of the event rather than its form. How significant is the change in ownership? Does the need for consistency and continuity in the accounting records outweigh the argument that a change in ownership has established a new accounting basis for the partnership's assets?

    For example, assume that partners A and B share net income and losses of A & B LLP equally, and they sell a 90% interest in the partnership to C for an amount equal to twice the carrying amount of the partnership's net assets. There are strong reasons to revise the accounting records to show the current fair values acquired by the new partnership in which C is the dominant owner.

    In contrast, assume that partners X and Y share net income and losses of X & Y LLP equally, and that Z is to be admitted to the partnership by the transfer of a 5% interest from Y's capital account. This minor change in ownership probably does not warrant changing the carrying amount of the partnership's assets.

    Finally, the amount paid to a retiring partner (or the investment required by a new partner) may be set at an amount that reflects current fair values without a change in asset valuations in the accounting records of the partnership.

12. The admission of a new partner to a limited liability partnership by an investment of cash in excess of the carrying amount of the equity acquired might be recorded by recognizing a bonus to the continuing partners, or by recognizing goodwill implied by the amount invested by the new partner. The bonus method has the advantage of adhering to the valuation principle and is consistent with the concept that the partnership is a going concern. The goodwill method is supported by the argument that it permits recognition of all assets, intangible as well as tangible, at current fair value at the time a new partner is admitted. The author does not consider the goodwill method acceptable when the new partner invests only cash because goodwill attaches only to a business **as a whole.**

13. If the partnership contract is silent concerning the withdrawals of $50,000 by each partner, the withdrawals may be considered either as loans to partners or as drawings in anticipation of income. If the withdrawals are considered loans, the balance sheet will include $100,000 of loans receivable from the partners. If the withdrawals are considered drawings, each partner's drawing account should be closed to that partner's capital account, which would result in a debit balance of $48,000 for each partner in the partners' capital section of the balance sheet. Disclosure of the circumstances causing such debit balance in the capital accounts may be made in a note to the financial statements of the limited liability partnership.

14. Because the reporting entity on which the CPA firm is issuing an opinion is the limited partnership, it is not necessary to include the financial statements of the corporate general partner. However, the financial statements for the partnership should indicate that it is a limited partnership, and the name of the corporate general partner should be disclosed.

15. The financial statements of a limited partnership differ from those of a limited liability partnership primarily in the disclosure of **per-unit** amounts for net income and partners' capital.

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In addition, the interests of limited partners in net assets and net income are shown in total rather than individually.

16. Partners of a **limited liability partnership (LLP)** are responsible for only their own acts and the acts of employees under their supervision; they are not responsible for acts of their partners. A **limited partnership** has one or more general partners with unlimited liability for the partnership's debts and one or more limited partners whose liability is limited to their investment and who have no role in the operation of the limited partnership.

SOLUTIONS TO EXERCISES

Ex. 2–1

1. *a*
2. *a*
3. *c*
4. *c*
5. *b*
6. *a*
7. *b* ($10,000 bonus to Cato is charged $7,000 to Adonis and $3,000 to Brutus)
8. *d*
9. *d*
10. *b*
11. *a*
12. *c*
13. *c*

Ex. 2–2 Journal entries for Carle & Dody LLP, Jan. 31, 2005:

Partners' Salaries Expense	5,000	
Carle, Capital		2,500
Dody, Capital		2,500
To provide for partners' salaries for January, 2005: $30,000 ÷ 12 = $2,500.		
Income Summary ($20,000 - $5,000)	15,000	
Carle, Capital		7,525
Dody, Capital		7,475
To record division of net income for January, 2005:		

(continued)

	Carle	Dody
Interest on beginning capital account balances:		
Carle: $80,000 x 0.005	$ 400	
Dody: $70,000 x 0.005		$ 350
Remainder ($15,000 – $750 = $14,250) divided equally	7,125	7,125
Totals	$7,525	$7,475

Ex. 2–3 Division of net income of Webb & Yu LLP for 2005:

	Webb	Yu	Combined
a. Equally (in absence of agreement)	$24,000	$24,000	$48,000
b. $\frac{50}{120}$ to Webb and $\frac{70}{120}$ to Yu (on basis of average capital account balances*)	20,000	28,000	48,000
c. In 40:80 ratio (on basis of beginning capital account balances)	16,000	32,000	48,000
d. In 60:40 ratio (on basis of ending capital account balances)	28,800	19,200	48,000

*Average capital account balances:	
Webb: ($40,000 x $\frac{1}{2}$) + ($60,000 x $\frac{1}{2}$)	$ 50,000
Yu: ($80,000 x $\frac{3}{4}$) + ($40,000 x $\frac{1}{4}$)	70,000
Total average capital balances for Webb and Yu	$120,000

Ex. 2–4 Alternative interpretations of bonus provision in partnership contract of Ray, Stan & Todd LLP:

The bonus clause in the partnership contract might be interpreted to mean that (1) Ray is entitled to receive 20% of net income without deduction of the bonus or (2) Ray is entitled to receive a bonus of 20% of income after deduction of the bonus. The latter interpretation is more logical because net income is total revenue less total expenses (including bonus), although for a partnership a bonus based on pre-bonus income is included in the division of net income.

Under the first interpretation, the division of net income would be:

	Ray	Stan	Todd	Combined
Income before bonus				$127,200
Bonus to Ray ($127,200 x 0.20)	$25,440			$ 25,440
Remainder—40%, 40%, 20%	40,704	$40,704	$20,352	101,760
Totals	$66,144	$40,704	$20,352	$127,200

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Under the second interpretation, the division of net income would be:

	Ray	Stan	Todd	Combined
Income after bonus				$127,200
Bonus expense to Ray ($127,200 x $\frac{1}{6}$)	$21,200			$ 21,200
Remainder—40%, 40%, 20%	42,400	$42,400	$21,200	106,000
Totals	$63,600	$42,400	$21,200	$127,200

Ex. 2–5 Computation of each partner's share of net income:

	Jones	King	Lane	Combined
Bonus to Jones ($90,000 x 0.20)	$18,000			$ 18,000
Interest on average capital account balances	15,000	$30,000	$45,000	90,000
Remainder shared equally	(6,000)	(6,000)	(6,000)	(18,000)
Totals	$27,000	$24,000	$39,000	$ 90,000

Ex. 2–6 Journal entries for Ann, Bud & Cal LLP, Dec. 31, 2005:

	Debit	Credit
Partners' Salaries Expense ($40,000 + $35,000 + $30,000)	105,000	
Bonus Expense ($110,000 x $\frac{1}{11}$)	10,000	
Ann, Capital ($40,000 + $10,000)		50,000
Bud, Capital		35,000
Cal, Capital		30,000
To accrue salaries to partners and bonus after salaries and bonus to Ann.		
Income Summary ($215,000 – $105,000 – $10,000)	100,000	
Ann, Capital ($100,000 x 0.30)		30,000
Bud, Capital ($100,000 x 0.20)		20,000
Cal, Capital ($100,000 x 0.50)		50,000
To record division of net income for year.		

Ex. 2–7 Journal entries for Bates & Carter LLP, Dec. 31, 2005:

	Debit	Credit
Partners' Salaries Expense ($40,000 + $60,000)	100,000	
Bates, Capital		40,000
Carter, Capital		60,000
To accrue salaries to partners.		
Income Summary ($200,000 – $100,000)	100,000	
Bates, Capital		42,400
Carter, Capital		57,600

(continued)

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To record division of net income as follows:

	Bates	Carter	Combined
Interest	$48,000	$60,000	$108,000
Remainder	(5,600)	(2,400)	(8,000)
Totals	$42,400	$57,600	$100,000

	Debit	Credit
Bates, Capital	40,000	
Carter Capital	60,000	
Bates, Drawing		40,000
Carter, Drawing		60,000
To close drawing accounts.		

Ex. 2–8 Journal entry for Neal, Drew & Drew LLP:

	Debit	Credit
Sally Drew, Capital ($200,000 x $\frac{1}{5}$)	40,000	
Paula Drew, Capital		40,000
To record the transfer of one-fifth of Sally Drew's capital account balance to the new partner, Paula Drew.		

No change has occurred in the assets or liabilities of the limited liability partnership. The transaction between Sally Drew and her daughter is a personal transaction between them. The price and the easy payment terms may reflect nonbusiness considerations. Consequently, this sale of a 20% interest in the partnership at a price above the carrying amount of partnership net assets does not provide a reliable basis for a revaluation of partnership net assets.

Ex. 2–9 Journal entries for Logan, Marsh, Noble, Ross & Clemon LLP, Jan. 31, 2005:

	Debit	Credit
Logan, Capital ($120,000 x 0.20 x $\frac{1}{2}$)	12,000	
Ross, Capital		12,000
To record transfer of one-half of Logan's capital to Ross.		
Cash	20,000	
Logan, Capital ($6,000 x 0.25)		1,500
Marsh, Capital ($6,000 x 0.35)		2,100
Noble, Capital ($6,000 x 0.40)		2,400
Clemon, Capital [($120,000 + $20,000) x 0.10]		14,000
To record investment by Clemon for a 10% interest in capital, with bonus to continuing partners divided in their prior income-sharing ratio.		

Ex. 2–10 Journal entries for admission of Cope to Arne, Bolt & Cope LLP:

	Debit	Credit
a. Cash	30,000	
Arne, Capital ($10,000 x 0.75)		7,500
Bolt, Capital ($10,000 x 0.25)		2,500
Cope, Capital [($30,000 + $20,000 + $30,000) x 0.25]		20,000
To record admission of Cope; bonus of $10,000 ($30,000 – $20,000 = $10,000) from Cope to Arne and Bolt is divided in 3:1 ratio.		

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b. Cash	30,000	
Inventories	16,000	
Arne, Capital [($10,000 + $16,000) x 0.75]		19,500
Bolt, Capital [($10,000 + $16,000) x 0.25]		6,500
Cope, Capital		20,000

To record admission of Cope; increase of $16,000 in the carrying amount of the inventories, and bonus of $10,000 from Cope to Arne and Bolt divided in 3:1 ratio.

Ex. 2–11 Computation of capital account balances of Lamb, Meek, & Niles LLP after admission of Niles, June 30, 2005:

	Lamb, Capital	**Meek, Capital**	**Niles, Capital**
Balances June 30, 2005, before admission of Niles	$70,000	$60,000	
Admission of Niles for $\frac{1}{3}$ interest in total partnership capital; bonus from Lamb and Meek to Niles allocated in 60:40 ratio	(6,000)	(4,000)	$60,000
Balances June 30, 2005, after admission of Niles	$64,000	$56,000	$60,000

Ex. 2–12 Journal entries for bonus method and revaluation of net assets method of accounting for admission of Jason Crade to Austin, Bradford & Crade LLP:

***a.* Bonus Method**

Cash	34,000	
Austin, Capital [($38,000 – $34,000) x $\frac{1}{2}$]	2,000	
Bradford, Capital [($38,000 – $34,000) x $\frac{1}{2}$]	2,000	
Crade, Capital [($80,000 + $34,000) x $\frac{1}{3}$]		38,000

To record investment by Crade for a one-third interest in capital, with bonus of $4,000 from Austin and Bradford.

***b.* Revaluation of Net Assets Method**

Austin, Capital ($12,000 x $\frac{1}{2}$)	6,000	
Bradford, Capital ($12,000 x $\frac{1}{2}$)	6,000	
Inventories [$80,000 – ($34,000 x 2)]		12,000

To write down carrying amount of inventories.

Cash	34,000	
Crade, Capital		34,000

To record admission of Crade for a one-third interest in net assets [($80,000 – $12,000 + $34,000) x $\frac{1}{3}$) = $34,000].

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Ex. 2–13 Journal entries for Logan, Major & Nelson Limited Liability Partnership:

Date	Account	Debit	Credit
2005			
Aug. 31	Cash	60,000	
	Logan, Capital ($8,000 x $\frac{2}{5}$)		3,200
	Major, Capital ($8,000 x $\frac{3}{5}$)		4,800
	Nelson, Capital [($80,000 + $120,000 + $60,000) x 0.20]		52,000
	To record investment by Nelson for a 20% interest in capital, with bonus to continuing partners divided in their prior income-sharing ratio.		
Sept. 30	Income Summary	50,000	
	Logan, Capital ($50,000 x 0.80 x 0.40)		16,000
	Major, Capital ($50,000 x 0.80 x 0.60)		24,000
	Nelson, Capital ($50,000 x 0.20)		10,000
	To record division of net income for September, 2005.		

Ex. 2–14 Journal entries for Lon, Mac, Nan & Ole LLP, Jan. 31, 2005:

Account	Debit	Credit
Inventories	60,000	
Lon, Capital ($60,000 x 0.50)		30,000
Mac, Capital ($60,000 x 0.20)		12,000
Nan, Capital ($60,000 x 0.30)		18,000
To write up carrying amount of inventories to current fair value.		
Cash	40,000	
Lon, Capital ($12,000 x 0.50)	6,000	
Mac, Capital ($12,000 x 0.20)	2,400	
Nan, Capital ($12,000 x 0.30)	3,600	
Ole, Capital [($(30,000) + $120,000 + $70,000 + $60,000 + $40,000) x 0.20]		52,000
To record investment by Ole for a 20% interest in capital, with bonus of $12,000 from continuing partners.		

Ex. 2–15 Journal entries for Jay, Kaye & Loy LLP:

Date	Account	Debit	Credit
2004			
May 31	Identifiable Tangible and Intangible Net Assets	600,000	
	Goodwill	60,000	
	Loy, Capital		660,000
	To record admission of Loy; goodwill is assigned to single proprietorship invested by Loy.		
2005			
May 31	Bonus Expense ($132,000 x $\frac{1}{11}$)	12,000	
	Loy, Capital		12,000
	To accrue bonus to Loy.		
31	Income Summary ($132,000 – $12,000)	120,000	
	Jay, Capital ($120,000 x 0.30)		36,000
	Kaye, Capital ($120,000 x 0.20)		24,000
	Loy, Capital ($120,000 x 0.50)		60,000
	To record division of net income for year		

Ex. 2–16 Correcting journal entries for Fox, Gee & Hay LLP, Aug. 31, 2005:

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	Debit	Credit
Fox, Capital	32,500	
Gee, Capital	97,500	
Hay, Capital	20,000	
Goodwill		150,000

To correct journal entry for admission of Hay. No goodwill should have been recognized. Bonus of $20,000 {$50,000 – [($100,000 + 50,000) x 0.20] = $20,000} from Hay is divided $5,000 (25%) to Fox and $15,000 (75%) to Gee; debit to Fox, $37,500 – $5,000 = $32,500; debit to Gee, $112,500 – $15,000 = $97,500.

	Debit	Credit
Fox, Capital	8,000	
Gee, Capital	24,000	
Hay, Capital		32,000

To correct division of net income for year ended Aug. 31, 2005, as follows:

	Fox	**Gee**	**Hay**
Salary expense			$ 40,000
Net loss ($30,000 – $40,000 = $10,000 loss) in 1:3:1 ratio	$(2,000)	$ (6,000)	$ (2,000)
Totals	$(2,000)	$ (6,000)	$38,000
Less: Income as divided	6,000	18,000	6,000
Correction (debit) or credit	$(8,000)	$(24,000)	$32,000

Ex. 2–17 Journal entries for King, Lowe & More LLP, June 30, 2005:

	Debit	Credit
Plant Assets (net) ($260,000 – $200,000)	60,000	
King, Capital ($60,000 x 0.20)		12,000
Lowe, Capital ($60,000 x 0.20)		12,000
More, Capital ($60,000 x 0.60)		36,000

To adjust plant assets carrying amount to current fair value of $260,000.

	Debit	Credit
Loan Payable to King	15,000	
King, Capital ($70,000 + $12,000)	82,000	
Lowe, Capital ($10,000 x $\frac{20}{80}$)	2,500	
More, Capital ($10,000 x $\frac{60}{80}$)	7,500	
Cash ($92,000 + $15,000)		107,000

To record retirement of King; bonus of $10,000 is debited to Lowe and More capital accounts in 20:60 ratio.

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Ex. 2–18 Journal entry for Nunn, Owen, Park & Quan LLP, May 31, 2005:

Park, Capital	70,000	
Nunn, Capital ($20,000 x $\frac{20}{80}$)		5,000
Owen, Capital ($20,000 x $\frac{20}{80}$)		5,000
Quan, Capital ($20,000 x $\frac{40}{80}$)		10,000
Cash		50,000
To record retirement of Sam Park for an amount less than carrying amount of Park's equity, with a bonus to Nunn, Owen, and Quan.		

Journal entry for Nunn, Owen, Quan & Reed LLP, May 31, 2005:

Cash	20,000	
Nunn, Capital ($2,000 x $\frac{20}{80}$)	500	
Owen, Capital ($2,000 x $\frac{20}{80}$)	500	
Quan, Capital ($2,000 x $\frac{40}{80}$)	1,000	
Reed, Capital [($250,000 – $50,000 + $20,000) x 0.10]		22,000
To record investment by Reed for a 10% interest in capital, with bonus of $2,000 from continuing partners.		

Ex. 2–19 Journal entry for Tan, Ulm & Vey LLP, Jan. 31, 2005:

Tan, Capital	12,500	
Ulm, Capital	17,500	
Goodwill		30,000
To write off goodwill improperly recognized on retirement of partner Ross Vey, and to correct capital account balances of continuing partners as follows:		

	Tan	**Ulm**
Amounts improperly credited to partners' capital by recognition of goodwill	$ 7,500	$10,500
Add: Allocation of $12,000 bonus to Vey on his retirement, in ratio 25:35	5,000	7,000
Correction	$12,500	$17,500

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Ex. 2–20 **MACCO COMPANY (a limited partnership)**
Statement of Partners' Capital
For Year Ended December 31, 2005

	General partner		Limited partners		Combined	
	Units	**Amount**	**Units**	**Amount**	**Units**	**Amount**
Initial investments, beginning of year	10	$100,000	40	$400,000	50	$500,000
Add: Net income	—	60,000	—	240,000	—	300,000
Subtotals	10	$160,000	40	$640,000	50	$800,000
Less: Drawing		(24,000)				(24,000)
Redemption of units	—		(10)	(160,000) *	(10)	(160,000)
Partners' capital, end of year	10	$136,000	30	$480,000	40	$616,000

* (10 x $10,000) + (10 x (240,000 ÷ 40))

CASES

Case 2–1 Arguments in favor of recognizing salaries awarded to partners of a limited liability partnership as operating expenses of the partnership include the following:

(1) Limited liability partnerships are economic and accounting entities separate from the general partners. Therefore, salaries awarded to general partners as compensation for their services are operating expenses of the partnership just as salaries of partnership employees are.

(2) Salaries awarded to stockholder-officers of corporations are recognized as operating expenses of the corporations; salaries to partners of a limited liability partnership should be treated in the same fashion.

Arguments opposed to recognizing salaries awarded to partners of a limited liability partnership as operating expenses of the partnership include the following:

(1) The amounts of partners' salaries may be set at levels that do not represent reasonable compensation for partners' services to the partnership.

(2) All methods for rewarding partners of limited liability partnerships are in substance designed to share partnership net income or losses and thus are significantly different from operating expenses incurred from goods or services provided by outsiders.

Case 2–2 The recognition of goodwill in the February 1, 2004, journal entry for Arnold, Bright & Carle LLP is not in accordance with generally accepted accounting principles. As pointed out in **Statement of Financial Accounting Standards No. 141** (paragraphs 43 and B101), goodwill, defined as the excess of the cost of an acquired company over the sum of its identifiable assets, attaches only to a business as a whole. The admission of Carla Carle to Arnold, Bright & Carle LLP does not constitute the acquisition of a company; thus, goodwill should not have been recognized for the admission.

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Case 2–3 There is no support for student Ronald's suggestion that interest on partners' capital account balances, allocated in accordance with the limited liability partnership contract, be recognized as an operating expense of the partnership. Interest is the cost of borrowing; partners' capital investments are not loans to the partnership. The partnership's operating expenses would be overstated, and its net income understated, if interest on partners' capital account balances were recognized as an operating expense of the partnership.

Case 2–4 Dale's investment of cash in the new Arch, Bell, Cole & Dale LLP would increase the partnership's net assets and thus enhance the financial position of the partnership—especially its current, quick, and debt-to-equity ratios. However, if Dale is awarded a capital account balance different from the amount of cash invested by Dale, either bonuses must be awarded to Arch, Bell, and Cole or to Dale, or the net assets of Arch, Bell & Cole LLP must be revalued before the admission of Dale.

If Dale acquires one-fourth of the interests of partners Arch, Bell, and Cole, no adjustment or other change in the total assets, total liabilities, or total partners' capital of Arch, Bell, Cole & Dale LLP would be required. However, the net assets of the partnership would not be increased; the cash paid by Dale would go to the partners rather than the partnership. The partnership thus would lose the opportunity for growth through the admission of a new partner.

Case 2–5 ***Statement of Financial Accounting Concepts No. 6*****,** "Elements of Financial Statements," par. 80, defines **expenses** as follows (footnote omitted):

> Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

Statement of Financial Accounting Standards No. 109**,** "Accounting for Income Taxes," par. 289, defines **income tax expense** as the sum of current tax expense and deferred tax expense. It further defines **current tax expense** as follows:

> The amount of income taxes paid or payable . . . for a year as determined by applying the provisions of the enacted tax law to the taxable income . . . for that year.

In view of the foregoing definitions, the recognition of "partners' income taxes expense" by Nue & Olde LLP does not comply with generally accepted accounting principles. Enacted tax law of the United States of America and the income-tax–assessing governmental entities it comprises specifically exclude partnerships from taxation. Instead, the partners are taxed, in their individual income tax returns, on their shares of partnership income. Because Nue & Olde LLP is not a taxable entity, it should not recognize income taxes payable by its partners as a partnership expense. Instead, a note to the financial statements of Nue & Olde LLP might indicate that the partnership is not subject to income taxes, but the partners must include their shares of partnership income in their taxable income on their individual income tax returns.

Case 2–6 The nature of a loss (whether from operations or from impairment of an asset) does not affect its recognition. Changes in value of assets after the assets are invested in a limited liability partnership are to be expected and generally represent gains or losses to be divided in the ratio prescribed by the partnership contract.

However, the promissory note for $20,000 invested by Partner Dee was indorsed by Dee when it was invested in the partnership. Indorsement of the note in blank made Dee contingently liable for its payment because Dee's indorsement was not "without recourse." If the maker, Sasha Company, is unable to pay, the partnership should be reimbursed by Dee as indorser.

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No such issue arises with respect to the patent. Its valuation was agreed to by the partners at the time Partner Ern invested it in the partnership, and no guarantee of its continuing value was given by Partner Ern. The subsequent impairment loss of $10,000 is a loss of the partnership, and prompt recognition of the loss by a write-off of the patent is necessary.

The appropriate division of net income at the end of the first year therefore is one-third of the $20,000 net income ($30,000 operating income minus $10,000 loss on patent) to each partner, and a $20,000 account receivable from Partner Dee would be recognized. If this receivable could not be collected, it might be offset against the capital account balance of Partner Dee.

Case 2–7 On a going-concern basis, a limited liability partnership balance sheet should display a capital balance or deficit for each partner. Thus, absent a formal plan to liquidate the Nobis, Ortho & Parr Partnership, Jack Julian may not ethically comply with the partners' request. To do so would reduce the debt-to-equity ratio to 275.9% ($800,000 ÷ $290,000 = 275.9%); that ratio, while high, is significantly less than the 470.6% ratio that is of concern to the partners. Further, Partner Ortho admittedly is in an illiquid personal financial position; to display her capital deficit as an asset without disclosure of such illiquidity through a doubtful account allowance would appear to be misleading. Such an allowance would reduce total partners' capital.

Case 2–8 Jean Rogers may **not** ethically comply with Charles Harder's request. The three partners' authorization of payment of loan principal and interest by the limited liability partnership in substance makes the loan to Harder a liability of the partnership rather than of Harder. The latter's request to Rogers appears an effort on his part to "window dress" the partnership's balance sheet by understating its liabilities and overstating its partners' capital. **Partners' capital** in a balance sheet should denote the total equity of the partners, not of **partners** and **lending institutions.**

Case 2–9 Because of the ambiguities in the partnership contract for Dobbs & Ellis LLP, it is not possible to determine the appropriate division of net income for 2005 without making the following assumptions:

(1) The ***capital ratio*** is based on capital account balances ($50,000 for Dobbs and $100,000 for Ellis) on January 2, 2005, the date of formation of the partnership.

(2) The authorized monthly withdrawals of $1,000 for each partner are to be treated as ***drawings*** rather than as ***salaries*.**

(3) Ellis's withdrawal of the remaining securities that had constituted a part of his original investment in the partnership represented a permanent reduction in his capital account balance rather than an authorized drawing.

(4) In accordance with paragraph 18 of ***APB Opinion No. 29*,** "Accounting for Nonmonetary Transactions," Ellis's capital account should have been reduced by $62,000—the current fair value of the securities he withdrew—and a gain of $21,000 ($62,000 – $41,000 = $21,000) included in net income of the partnership for 2005.

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In accordance with the foregoing assumptions, net income of $45,000 ($24,000 + $21,000 = $45,000) should be divided between Dobbs and Ellis in the ratio of $50,000: $100,000, or $15,000 to Dobbs and $30,000 to Ellis. Prior to such division, the following correcting journal entry should be made:

Ellis Capital	21,000	
Gain on Disposal of Investments Available for Sale		21,000
To recognize gain on investments withdrawn by Ellis.		

Case 2–10 One method by which the admission to Betty Naylor to Lewis, Marlin & Naylor LLP might be recorded by the partnership is to reflect the allegation by Naylor that the partnership's trade accounts receivable and inventories were overstated. Because Naylor is to be given a one-third interest in net assets and net income for a cash investment of $40,000, the implied value of the remaining two-thirds of the net assets of Lewis & Marlin LLP is $80,000 ($40,000 x 2 = $80,000). Because the total capital of Lewis & Marlin LLP is $110,000 prior to the admission of Naylor, the Allowance for Doubtful Accounts and Inventories ledger accounts of Lewis & Marlin LLP must be credited for a total of $30,000 ($110,000 – $80,000 = $30,000), with offsetting debits of $15,000 each to Lewis, Capital and Marlin, Capital. Then, the recording of Naylor's admission to Lewis, Marlin & Naylor LLP with a debit to Cash and a credit to Naylor, Capital, both in the amount of Naylor's investment of $40,000, would result in total capital of $120,000 ($80,000 + $40,000 = $120,000) for Lewis, Marlin & Naylor LLP, of which Naylor's $40,000 capital account balance represents a one-third interest ($120,000 x $\frac{1}{3}$ = $40,000).

An alternative method of recording the admission of Naylor, which is preferable because it avoids the necessity of, in this case, questionable adjustments in carrying amounts of the net assets of Lewis & Marlin LLP, is to allow Naylor a $10,000 ***bonus***, debited $5,000 each to the capital accounts of Lewis and Marlin, so that Naylor's capital account balance would be $50,000 ($40,000 cash investment plus $10,000 bonus equals $50,000), giving Naylor a one-third interest in the net assets (total capital) of Lewis, Marlin & Naylor LLP [($110,000 + $40,000) x $\frac{1}{3}$ = $50,000].

Case 2–11 The objections of Ed Loeser to changing the method of valuing inventories of Lowyma Company LLP from last-in, first-out to first-in, first-out in connection with the retirement of partner Herman Martin might be either supported or refuted by reference to ***APB Opinion No. 20*****,** "Accounting Changes." Paragraph 15 thereof states that "there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type." However, according to paragraph 16, "The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative accounting principle on the basis that it is preferable."

Because Lowyma Company LLP has begun managing inventories by the just-in-time system, inventory levels may be low, and differences between first-in, first-out and last-in, first-out cost of the inventories may be negligible. Probably, after the just-in-time system was installed, so-called "lifo liquidations" had occurred, in which reduction of inventory levels resulted in old costs being included in cost of goods sold. This would have resulted in higher net income, and a resultant larger capital account balance for Martin, giving approximately the same balance as would have resulted form the use of first-in, first-out cost.

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Concluding, the question of changing the method of inventory valuation for Lowyma Company LLP in connection with the retirement of Martin might be moot. However, if the change is made, the cumulative effect thereof cannot be recognized as a **gain** by the partnership. Instead, in accordance with paragraph 27 of **APB Opinion No. 20,** prior periods' income statements must be restated, with a resultant revision of the pre-retirement balance of the Herman Martin, Capital, ledger account.

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20 minutes, Easy

Oscar, Paul & Quinn LLP **Pr. 2–1**

OSCAR, PAUL & QUINN LLP				
Journal Entries				
2005				
Jan	2	Cash	10000	
		Note Payable to Oscar		10000
		To record cash advance from Oscar on a 12% demand promissory note.		
	6	Quinn, Drawing	5200	
		Inventories		4000
		Gain on Disposal of Merchandise		1200
		To record Quinn's withdrawal of merchandise in lieu of regular cash drawing.		
	13	Loss on Worthless Patent	6000	
		Patents		6000
		To write off worthless patent.		
	27	Trade Accounts Payable	2000	
		Paul, Capital		2000
		To record payment of trade account payable by Paul.		
	31	Interest Expense ($10,000 x 0.12 x 1/12)	100	
		Interest Payable		100
		To accrue interest on note payable to Oscar.		

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20 minutes, Easy

Gee, Hawe & Ivan LLP **Pr. 2-2**

Gee, Hawe & Ivan LLP				
Journal Entries				
a.				
20	05			
Jan	2	Current Assets	70000	
		Plant Assets	230000	
		Goodwill ($120,000 – $100,000)	20000	
		Liabilities		200000
		Lisa Ivan, Capital		120000
		To record admission of Lisa Ivan to partnership		
		Goodwill is assigned to single proprietorship invested		
		By Ivan.		
b.				
20	05			
Dec	31	Salaries Expense ($10,000 + $15,000 + $20,000)	45000	
		Bonus Expense [($78,000 – $45,000) x 1/11]	3000	
		Louis Gee, Capital		10000
		Ray Hawe, Capital		15000
		Lisa Ivan, Capital ($20,000 + 3,000)		23000
		To accrue salaries to partners and bonus based on		
		income after salaries and bonus to Ivan.		
	31	Income Summary ($78,000 – $45,000 – $3,000)	30000	
		Louis Gee, Capital ($30,000 x 0.30)		9000
		Ray Hawe, Capital ($30,000 x 0.40)		12000
		Lisa Ivan, Capital ($30,000 x 0.30)		9000
		To record division of net income for 2005.		

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Ross & Saye LLP **Pr. 2–3**

a. Ross & Saye LLP		
Income Statement		
For Year Ended February 28, 2005		
Sales		$500,000
Cost of goods sold		280,000
Gross margin on sales		$220,000
Partners' salaries	$42,000	
Other operating expenses	58,000	100,000
Net income		$120,000
Division of net income (**Exhibit A**):		
Roberta Ross	$66,000	
Samuel Saye	54,000	
Total	$120,000	

Exhibit A—Division of net income:	**Ross**	**Saye**	**Combined**
Interest on average capital account balance:			
Ross ($150,000 x 0.10)	15,000		15,000
Saye ($180,000 x 0.10)		18,000	18,000
($60,000 x 0.10 x 4/12)		2,000	2,000
Subtotal			$35,000
Remainder ($120,000 – $35,000) dividend 60:40	51,000	34,000	85,000
Totals	$66,000	$54,000	$120,000

b. Ross & Saye LLP			
Statement of Partners' Capital			
For Year Ended February 28, 2005			
	Ross	**Saye**	**Combined**
Original investments, beginning of year	$150,000	$180,000	$330,000
Additional investment of capital		60,000	60,000
Balances before salaries, net income, and drawings	$150,000	$240,000	$390,000
Add: Salaries	18,000	24,000	42,000
Net income	66,000	54,000	120,000
Subtotals	$234,000	$318,000	$552,000
Less Drawings	18,000	24,000	42,000
Partners' capital, end of year	$216,000	$294,000	$510,000

30 minutes, Easy

Lucas & May LLP **Pr. 2–4**

Lucas & May LLP
Division of Net Income
For Year Ended December 31, 2005

	Lucas	May	Combined
a. Net income (including extraordinary gain)			
equally in absence of specific agreement	$ 34,800	$ 34,800	$ 69,600
b. Salaries	$ 20,000	$ 30,000	$ 50,000
Allowance for interest (**Exhibit A** for			
computation of average capital account			
balances):			
Lucas ($125,000 x 0.10)	12,500		12,500
May ($175,000 x 0.10)		17,500	17,500
Subtotals	$ 32,500	$ 47,500	$ 80,000
Remainder ($80,000 – $57,600),			
divided equally	(11,200)	(11,200)	(22,400)
Extraordinary gain, divided in ratio of original			
investments, or 40% and 60%	4,800	7,200	12,000
Totals	$ 26,100	$ 43,500	$ 69,600
c. Income before extraordinary items, divided			
on basis of average capital account			
balances, or 125/300 and 175/300 (**Ex. A**)	$ 24,000	$ 33,600	$ 57,600
Extraordinary gain, dividend in ratio of			
original investments, or 40% and 60%	4,800	7,200	12,000
Totals	$ 28,800	$ 40,800	$ 69,600
d. Bonus to May ($57,600 x 0.16 2/3) (a bonus			
of 20% of net income after the bonus is			
equal to a bonus of 16 2/3% of income			
before the bonus)		$ 9,600	$ 9,600
Remainder of income before extraordinary			
item, divided equally	$ 24,000	24,000	48,000
Extraordinary gain, divided in ratio of original			
investments, or 40% and 60%	4,800	7,200	12,000
Totals	$ 28,800	$ 40,800	$ 69,600

Exhibit A—Computation of average capital account balances	**Capital account balance**	**Fraction of year unchanged**	**Average capital account balance**
Lucas: Jan. 3 – May 1	$ 120,000	4/12	$ 40,000
May 1 – Nov.1	135,000	6/12	67,500
Nov. 1 – Dec. 31	105,000	2/12	17,500
Average capital account balance for Lucas			$ 125,000
May: Jan. 2 – July 1	$ 180,000	6/12	$ 90,000
July 1 – Nov. 1	195,000	4/12	65,000
Nov. 1 – Dec. 31	120,000	2/12	20,000
Average capital account balance for May			$ 175,000
Total average capital account balances for Lucas and May			$ 300,000

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Alex, Baron & Crane LLP **Pr. 2–5**

a.

Alex, Baron & Crane LLP
Salaries and Division of Net Income
For Year Ended December 31, 2005

	Alex	Baron	Crane	Combined
Salaries	$ 14,400	$ 12,000	$ 13,600	$ 40,000
Interest on average capital account balances (**Exhibit A**)	12,960	17,280	24,840	55,080
Remainder divided 40:30:30	(1,200)	(900)	(900)	(3,000)
Totals (net income)	$ 11,760	$ 16,380	$ 23,940	$ 52,080

Exhibit A—Computation of interest on average capital account balances:

Alex	($ 96,000 x 0.12 x 6/12)	$ 5,760	
	($120,000 x 0.12 x 6/12)	7,200	$ 12,960
Baron	($144,000 x 0.12)		17,280
Crane	($216,000 x 0.12 x 9/12)	$ 19,440	
	($180,000 x 0.12 x 3/12)	5,400	24,840
	Total interest on average capital account balances		$ 55,080

b.

Alex, Baron & Crane LLP
Statement of Partners' Capital
For Year Ended December 31, 2005

	Alex	Baron	Crane	Combined
Original investments, Jan. 2	$ 96,000	$ 144,000	$ 216,000	$ 456,000
Additional investment (withdrawal) of capital	24,000		(36,000)	(12,000)
Balances before salaries, net income, and drawings	$ 120,000	$ 144,000	$ 180,000	$ 444,000
Add: Salaries	14,400	12,000	13,600	40,000
Net income (see ***a***)	11,760	16,380	23,940	52,080
Subtotals	$ 146,160	$ 172,380	$ 217,540	$ 536,080
Less: Drawings	(15,000)	(15,000)	(15,000)	(45,000)
Partners' capital, end of year	$ 131,160	$ 157,380	$ 202,540	$ 491,080

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Chu, Dow & Eng LLP **Pr. 2–6**

Chu, Dow & Eng LLP				
Journal Entries				
a.				
20	05			
July	10	Eng, Capital	50000	
		Chu, Capital ($4,000 x 0.60)	2400	
		Dow, Capital ($4,000 x 0.40)	1600	
		Cash		54000
		To record withdrawal of Eng. Bonus of $4,000 to Eng		
		is charged to Chu and Dow in 3:2 ratio.		
b.				
20	05			
July	10	Eng. Capital	50000	
		Cash		45000
		Chu, Capital ($5,000 x 0.60)		3000
		Dow, Capital ($5,000 x 0.40)		2000
		To record withdrawal of Eng. Bonus of $5,000 from		
		Eng is divided between Chu and Dow in 3:2 ratio.		
c.				
20	05			
July	10	Eng, Capital	50000	
		Chu, Capital ($30,000 x 0.50)	15000	
		Dow, Capital ($30,000 x 0.33 1/3)	10000	
		Cash		45000
		Goodwill		30000
		To record withdrawal of Eng, whose share of reduction		
		in goodwill, $5,000, is equal to 1/6 of the total implicit		
		impairment reduction in goodwill, $30,000 ($5,000 ÷		
		1/6 = $30,000).		
d.				
20	05			
July	10	Eng, Capital ($40,500 + $9,000 + $500)	50000	
		Chu, Capital ($3,000 x 0.50)	1500	
		Dow, Capital ($3,000 x 0.33 1/3)	1000	
		Accumulated Depreciation of Equipment ($30,000 x		
		0.60)	18000	
		Equipment		30000
		Cash		40500
		To record withdrawal of Eng, who received cash of		
		$40,500 and equipment with a current fair value of		
		$9,000 or $3,000 less than carrying amount; loss of		
		$3,000 is divided in 3:2:1 ratio, and amount paid to		
		Eng is equal to Eng's equity (after the loss on disposal		
		of equipment is allocated to the partners, including		
		$500 to Eng).		

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60 minutes, Medium

Yee & Zane LLP **Pr. 2–7**

a. **Yee & Zane LLP**

Journal Entry

Date		Account	Debit	Credit
2005				
Dec	31	Yee, Capital	3530	
		Zane, Capital	2970	
		Allowance for Doubtful Accounts		6500
		To record change to allowance method of accounting for doubtful accounts, as follows:		

Corrections to capital accounts

		Yee	Zane
Doubtful accounts expense applicable to 2002 through 2004 ($1,200 + $200 + $1,500 + $1,300 + $600 + $450 + $1,800 + $1,400 + $1,250)	$9,700		
Less: Expense recognized ($2,700 + $3,300)	6,000		
Additional expense, 2002 through 2004 (divided equally)	$3,700	$1,850	$1,850
Doubtful accounts expense applicable to 2005 ($2,200 + $4,800)	$7,000		
Less: Expense recognized	4,200		
Additional expense, 2005 (divided 60:40)	$2,800	1,680	1,120
Corrections (debits) to capital accounts		$3,530	$2,970

b. **Yee Zane & Arne LLP**

Journal Entry

Date		Account	Debit	Credit
2005				
Dec	31	Cash	30000	
		Arne, Capital [(48,000 + $22,000 + $30,000) x 0.20]		20000
		Yee, Capital ($10,000 x 0.60)		6000
		Zane, Capital ($10,000 x 0.40)		4000
		To record admission of Arne to partnership for a 20% interest in total capital, with a bonus to Yee and Zane.		

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Alef, Beal & Clarke LLP
Statements of Cash Flows
For Year Ended December 31, 2005

Net cash provided by operating activities **(Exhibit 1)**		$ 45804
Cash flows from investing activities:		
Disposal of equipment	$ 1200	
Acquisition of equipment	(6210)	
Investment in cash surrender value of life insurance	(1785)	
Cancellation of life insurance policy on retired partner's life	3420	
Net cash used by investing activities		(3375)
Cash flows from financing activities:		
Borrowing from bank	$ 3330	
Payment to retiring partner for part of equity	(20000)	
Payments on equipment contract	(1200)*	
Partners' drawings	(37265)	
Net cash used by financing activities		(37135)
Net increase in cash		$ 5294
Cash, beginning of year		3295
Cash, end of year		8589
Exhibit 1 Cash flows from operating activities		
Net income	$ 49710	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	3220	
Gain on disposal of equipment	(600)	
Increase in net trade accounts receivable	(4087)†	
Increase in supplies	(571)	
Decrease in trade accounts payable	(1303)	
Decrease in accrued liabilities	(565)	
Net cash provided by operating activities		$ 45804
Exhibit 2 Noncash investing and financing activities:		
Acquisition of equipment on equipment contract		$ 9000
Issuance of 5%, five-year promissory note to retiring partner for part of equity		$ 10000

* $300 x 4 = $1,200

† $3,881 gross increase in trade accounts receivable + $206 decrease in allowance for doubtful accounts = $4,087

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Southwestern Enterprises **Pr. 2–9**

Southwestern Enterprises (a limited partnership) Income Statement For Year Ended December 31, 2005		
Net sales		$1400000
Cost and expenses:		
Cost of goods sold	$700000	
Operating expenses	140000	
Total costs and expenses		840000
Net income		$560000
Division of net income:		
To general partner ($500 per unit based on 400 weighted average		
units outstanding)	$200000	
To limited partners ($480 per unit based on 750* weighted average		
units outstanding)	360000	
Total	$560000	
* (800 x 6/12) + (700 x 6/12) = 750		

Southwestern Enterprises (a limited partnership) Statement of Partners' Capital For Year Ended December 31, 2005	General Partner		Limited Partners		Combined	
	Units	Amount	Units	Amount	Units	Amount
Initial investment, beginning of year	400	$400000	800	$800000	1,200	$1200000
Add: Net income		200000		360000		560000
Subtotals	400	$600000	800	$1160000	1,200	$1760000
Less: Redemption of units			200	260000	200	260000
Partners' capital, end of year	400	$600000	600	$900000	1,000	$1500000

Southwestern Enterprises (a limited partnership) Balance Sheet December 31, 2005		
Assets		
Current assets:		
Cash		$20000
Trade accounts receivable (net of $10,000 allowance for doubtful accounts)		80000
Inventories		100000
Total current assets		$200000
Plant assets (net of $100,000 accumulated depreciation)		1400000
Total assets		$1600000
Liabilities & Partners' Capital		
Current liabilities:		
Note payable to bank		$20000
Trade accounts payable		50000
Accrued liabilities		30000
Total current liabilities		$100000
Partners' capital ($1,500 per unit based on 1,000 units outstanding):		
General partner	$600000	
Limited partners	900000	1500000
Total liabilities and partners' capital		$1600000

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Southwestern Enterprises (a limited partnership)
Statement of Cash Flows
For Year Ended December 31, 2005

Net cash provided by operating activities (Exhibit 1)		$560000
Cash flows from investing activities:		
Acquisition of plant assets		(1500000)
Cash flows from financing activities:		
Net increase in short-term borrowings	$ 20000	
General partner's investment	400000	
Limited partners' investments	800000	
Limited partners' redemptions	(260000)	
Net cash provided by financing activities		960000
Net increase in cash (cash at end of year)		$ 20000

Exhibit 1 Cash flows from operating activities:		
Net income	$560000	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	100000	
Increase in net trade accounts receivable	(80000)	
Increase in inventories	(100000)	
Increase in trade accounts payable	50000	
Increase in accrued liabilities	30000	
Net cash provided by operating activities		$560000

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Noble & Roland LLP
Correcting Journal Entries
a. **June 30, 2005**

Account	Debit	Credit
Unrealized Loss on Investments Available for Sale	4000	
Short-Term Investments in Marketable Equity		
Securities		4000
To recognize unrealized loss on available-for-sale investments securities		
($10,000 – $6,000 = $4,000).		
Anne Noble, Capital ($5,000 x 0.60)	3000	
Janice Roland, Capital ($5,000 x 0.40)	2000	
Allowance for doubtful accounts		5000
To provide for doubtful accounts receivable		

Noble & Roland LLP
Corrected Balance Sheet
b. **June 30, 2005**

Current assets		
Cash and cash equivalents		$ 3000
Trade accounts receivable, less allowance for losses $5,000		35000
Short-term prepayments		1000
Total current assets		$ 39000
Investments available for sale, at fair value		6000
10% note receivable from partner Janice Roland		20000
Equipment, net of accumulated depreciation $4,000		50000
Total assets		$ 115000
Liabilities & Partners' Capital		
Current liabilities		
Trade accounts payable		$ 15000
Accrued liabilities		2000
Total current liabilities		$ 17000
Long-term debt		
8% note payable to partner Anne Noble, due June 30, 2009		5000
Total liabilities		$ 22000
Partners' capital		
Partner Anne Noble	$ 59000	
Partner Janice Roland	38000	
Accumulated other comprehensive income (loss)	(4000)	
Total partners' capital		93000
Total liabilities and partners' capital		$ 115000
See accountant's review report.		
Note to instructor: The corrected current ratio is $2.29 to $1		
($39,000 ÷ $17,000 = $2.29 to $1)		

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