CHAPTER 12 · PART 1 — FORMING, AND DIVIDING THE INCOME

1 WHAT EACH ONE BRINGS — and what their capital actually is

A PARTNER'S CAPITAL

capital = assets in − liabilities the firm takes over

assets come in at what they are WORTH today

an allowance for doubtful accounts is a CONTRA · it reduces

never the sticker price · always the NET

DAY ONE ON THE BOOKS

ONE capital account for EACH partner

a proprietorship has one · a partnership has one each

every later split lands in those same accounts

a separate DRAWING account per partner, closed at year end

2 HOW THE PROFIT SPLITS — the agreement, not the ownership

THE THREE LINES, IN ORDER

1 SALARY allowance → pays for HOURS

2 INTEREST allowance → pays for MONEY (% × capital)

3 WHATEVER IS LEFT → split as the agreement says

no agreement at all? everything is split EQUALLY

THE TWO CASES

income > allowances → a POSITIVE remainder

income < allowances → a NEGATIVE remainder

a negative remainder is shared exactly like a LOSS

allowances are never cancelled · both can still be positive

3 CLOSING THE YEAR — and what changed from a proprietorship

TWO CLOSING ENTRIES

1 revenue and every expense, BY NAME

→ each partner's CAPITAL, by their share

2 each partner's DRAWING account

→ that same partner's capital

WHAT CHANGED

one capital account → one EACH

one credit line → one per partner

one drawing account → one each

everything else is unchanged

THE ORDER

salary → interest → remainder

allowances always come FIRST

the remainder is what REMAINS

never the other way round

EXAM TRAPS: capital is the NET, never the sticker price · allowances come out BEFORE the remainder
a negative remainder is shared like a loss, it does NOT cancel an allowance · no agreement means EQUAL

CHAPTER 12 · PART 2 — SOMEONE JOINS, SOMEONE LEAVES

1 BEFORE ANYONE JOINS OR LEAVES — revalue, then ask the one question

REVALUE FIRST

assets to TODAY's values · the net change to the OLD partners

split it the way they split INCOME

no cash moves · the books catch up with the truth

the new partner buys into today's numbers, never last year's

THE ONE QUESTION

did the money go TO THE PARTNERS, or INTO THE BUSINESS?

to the partners → BUYING an interest

into the business → INVESTING in it

an exam tells you who got the cheque — never which door

2 ADMISSION — two doors, and the bonus that lives behind the second

DOOR A · BUYING AN INTEREST

Dr old partner, capital · Cr new partner, capital

credit the FRACTION of capital — never the price paid

cash never touches the books · total capital unchanged

no bonus, ever — the price is the partners' business

DOOR B · INVESTING IN THE BUSINESS

new total = old capital + investment · share = fraction × total

BONUS = paid − share

paid MORE → bonus to the OLD partners (credit them)

paid LESS → bonus to the NEW partner (debit the old ones)

3 WITHDRAWAL, AND DEATH — the same fork, run backwards

PAID MORE THAN CAPITAL

Dr his capital + Dr the others

(their share of HIS bonus)

Cr Cash, the full price

the bonus comes OFF the ones who stay

PAID LESS THAN CAPITAL

Dr his capital, in full

Cr Cash + Cr the others

(their bonus, by income ratio)

the ones who stay GAIN

DEATH OF A PARTNER

close the books on the DATE

revalue → fix his capital

Dr his capital · Cr PAYABLE to the estate

equity becomes a LIABILITY

EXAM TRAPS: BUYING an interest never touches cash · the bonus is paid − share, split by the INCOME ratio
a bonus to the leaver comes OFF the partners who stay · a dead partner's capital becomes a LIABILITY, not a drawing

CHAPTER 12 · PART 3 — WHEN THE PARTNERSHIP ENDS

1 LIQUIDATION — four steps, every time, in this order

THE FOUR STEPS

1 SELL the non-cash assets · 2 SPLIT the gain or loss

3 PAY the creditors, in full · 4 PAY the partners

step 2 uses the INCOME RATIO · step 4 uses the CAPITAL BALANCE

the check: cash left = total capital left, before step 4

THE STATEMENTS

partnership equity: start + share of income − withdrawals

liquidation schedule: one row per step, every column a balance

revenue per employee = revenue ÷ number of employees

higher is better · compares shops of different sizes

2 GAIN OR LOSS ON REALIZATION — the entries, and who they land on

SOLD AT A GAIN

Dr Cash (proceeds) · Cr Non-cash Assets (book) · Cr Gain

Dr Gain · Cr EACH partner's capital, by the income ratio

then Dr Liabilities / Cr Cash · then Dr each capital / Cr Cash

the last debits are the BALANCES — never ratio shares

SOLD AT A LOSS

Dr Cash (proceeds) · Dr Loss · Cr Non-cash Assets (book)

Dr EACH partner's capital, by the ratio · Cr Loss

a loss comes OFF the partners · a gain goes ON · same ratio

steps 3 and 4 are unchanged — creditors first, then balances

3 A CAPITAL DEFICIENCY — when a share of the loss is bigger than a capital

WHAT IT IS

share of the loss > capital balance

the account goes NEGATIVE

that partner OWES the partnership

the others are still paid by balance

IF SHE PAYS IT IN

Dr Cash · Cr her capital

her account closes at zero

everyone else is paid in full

the ratio is not used again

IF SHE CANNOT

Dr the OTHERS' capital

Cr her capital, to zero

split in THEIR ratio (5:3, not 5:3:2)

then pay what is left, by balance

EXAM TRAPS: the final cash goes by CAPITAL BALANCE, never by the ratio · the ratio splits the gain or loss ONLY
creditors are paid BEFORE any partner · a deficiency is absorbed in the OTHERS' ratio — the deficient partner drops out