

PARTNERSHIP

CHAPTER 1 ACCOUNTING FOR PARTNERSHIPS (Basic Considerations and Formation)

Definition

In a contract of partnership two or more persons bind themselves to contribute money, property, or industry to a common fund, with the intention of dividing the profit among themselves. Two or more persons may also form a partnership for the exercise of a profession (Civil Code of the Philippines, Article 1767).

An association of two or more persons to carry on, as co-owners, a business for profit (Uniform Partnership Act, Section 6).

The partnership has a juridical personality separate and distinct from that of each of the partners (Civil Code of the Philippines, Article 1768). Thus, for example, where Fabella and Neis established a partnership, three persons are involved, namely; the partnership and the partners, Fabella and Neis.

Partnerships resemble sole proprietorships, except that there are two or more owners of the business. Each owner is called a **partner**. Partnerships are often formed to bring together various talents and knowledge. Partnerships provide a means of obtaining more equity capital than a single individual can obtain and allow the sharing of risks for rapidly growing businesses.

A profession is an occupation that involves a higher education or its equivalent, and mental rather than manual labor. Strictly speaking, the exercise of a profession is not a business or an enterprise for profit but the law allows two or more persons to act as partners in the practice of their profession. Partnerships are generally associated with the practice of law, public, accounting, medicine and other professions. Partnerships of this nature are called **general professional partnerships**. On the other hand, service industries, retail trade, wholesale and manufacturing enterprises may also be organized as partnerships.

CHARACTERISTICS OF A PARTNERSHIP

The characteristics of partnerships are different from the sole proprietorships already studied in basic accounting. Some of the more important characteristics are as follows:

Mutual Contribution. There cannot be a partnership without contribution of money, property or industry (i.e. work or services which may either be personal manual efforts or intellectual) to a common fund.

Division of Profits or Losses. The essence of partnership is that each partner must share in the profits or losses of the venture.

Co-Ownership of Contributed Assets. All assets contributed into the partnership are owned by the partnership by virtue of its separate and distinct juridical personality. If one partner contributes an asset to the business, all partners jointly own it in a special sense.

Mutual Agency. Any partner can bind the other partners to a contract if he is acting within his express or implied authority.

Limited Life. A partnership has a limited life. It may be dissolved by the admission, death, insolvency, incapacity, and withdrawal of a partner or expiration of the term specified in the partnership agreement.

Unlimited Liability. All partners (except limited partners), including industrial partners, are personally liable for all debts incurred by the partnership. If the partnership cannot settle its obligations, creditors'

claims will be satisfied from the personal assets of the partners without prejudice to the rights of the separate creditors of the partners.

Income Taxes. Partnerships, except general professional partnerships, are subject to tax at the rate of 30% (per R.A. No. 9337) of taxable income.

Partners' Equity Accounts. Accounting for partnerships is much like accounting for sole proprietorships. The difference lies in the number of partners' equity accounts. *Each* partner has a capital account and a withdrawal account that serves similar functions as the related accounts for sole proprietorships.

ADVANTAGES AND DISADVANTAGES OF A PARTNERSHIP

A partnership offers certain advantages over a sole proprietorship and a corporation. It also has a number of disadvantages. They are as follows:

Advantages versus Proprietorships

1. Brings greater financial capability to the business.
2. Combines special skills, expertise and experience of the partners.
3. Offers relative freedom and flexibility of action in decision making.

Advantages versus Corporations

1. Easier and less expensive to organize.
2. More personal and informal.

Disadvantages

1. Easily dissolved and thus unstable compared to a corporation.
2. Mutual agency and unlimited liability may create personal obligations to partners.
3. Less effective than a corporation in raising large amounts of capital.

PARTNERSHIP DISTINGUISHED FROM CORPORATION

Manner of Creation. A partnership is created by mere agreement of the partners while a corporation is created by operation of law.

Number of Persons. Two or more persons may form a partnership; in a corporation, at least five (5) persons, not exceeding fifteen (15).

Commencement of Juridical Personality. In a partnership, juridical personality commences from the execution of the articles of partnership; in a corporation, from the issuance of certificate of incorporation by the Securities and Exchange Commission.

Management. In a partnership, every partner is an agent of the partnership if the partners did not appoint a managing partner; in a corporation, management is vested on the Board of Directors.

Extent of Liability. In a partnership, each of the partners except a limited partner is liable to the extent of his personal assets; in a corporation, stockholders are liable only to the extent of their interest or investment in the corporation.

Right of Succession. In a partnership, there is no right of succession; in a corporation, there is right of succession. A corporation has the capacity of continued existence regardless of the death, withdrawal, insolvency or incapacity of its directors or stockholders.

Terms of Existence. In a partnership, for any period of time stipulated by the partners; in a corporation, not to exceed fifty (50) years but subject to extension.

CLASSIFICATION OF PARTNERSHIPS

1. According to **object**:
 - A. Universal partnership of **all present property**. All contributions become part of the partnership fund.
 - B. Universal partnership of **profits**. All that the partners may acquire by their industry or work during the existence of the partnership and the use of whatever the partners contributed at the time of institution of the contract belong to the partnership. If the articles of universal partnership did not specify its nature, it will be considered a universal partnership of profits.
 - C. Particular partnership. The object of the partnership is determinate—its use or fruit, specific undertaking, or the exercise of a profession or vocation.
2. According to **liability**:
 - A. General. All partners are liable to the extent of their separate properties.
 - B. Limited. The limited partners are liable only to the extent of their personal contributions. In a limited partnership, the law states that there shall be **at least** one general partner.
3. According to **duration**:
 - A. Partnership with a fixed term or for a particular undertaking.
 - B. Partnership at will. One in which no term is specified and is not formed for any particular undertaking.
4. According to **purpose**:
 - A. Commercial or trading partnership. One formed for the transaction of business.
 - B. Professional or non-trading partnership. One formed for the exercise of profession.
5. According to **legality of existence**:
 - A. De jure partnership. One which has complied with all the legal requirements for its establishment.
 - B. De facto partnership. One which has failed to comply with all the legal requirements for its establishment.

KINDS OF PARTNERS

1. **General partner**. One who is liable to the extent of his separate property after all the assets of the partnership is exhausted.
2. **Limited partner**. One who is liable **only** to the extent of his capital contribution. He is not allowed to contribute industry or services only.
3. **Capitalist partner**. One who contributes money or property to the common fund of the partnership.
4. **Industrial partner**. One who contributes his knowledge or personal service to the partnership.
5. **Managing partner**. One whom the partners have appointed as manager of the partnership.
6. **Liquidating partner**. One who is designated to wind up or settle the affairs of the partnership after dissolution.
7. **Dormant partner**. One who does not take active part in the business of the partnership and is not known as a partner.
8. **Silent partner**. One who does not take active part in the business of the partnership though may be known as a partner.
9. **Secret partner**. One who takes active part in the business but is not known to be a partner by outside parties.
10. **Nominal partner or partner by estoppel**. One who is actually not a partner but who represents himself as one.

ARTICLES OF PARTNERSHIP

A partnership may be constituted orally or in writing. In the latter case, partnership agreements are embodied in the **Articles of Partnership**. The following essential provisions may be contained in the agreement:

1. The partnership name, nature, purpose and location;

2. The names, citizenship and residences of the partners;
3. The date of formation and the duration of the partnership;
4. The capital contribution of each partner, the procedure for valuing non-cash investments, treatment of excess contribution (as capital or as loan) and the penalties for a partner's failure to invest and maintain the agreed capital.
5. The right and duties of each partner.
6. The accounting period to be adopted, the nature of accounting records, financial statements and audits by independent public accountants;
7. The method of sharing profit or loss, frequency of income measurement and distribution, including any provisions for the recognition of difference in contributions;
8. The drawings or salaries to be allowed to partners;
9. The provision for attribution of disputes, dissolution, and liquidation.

A contract of partnership is void whatever immovable property or real rights are contributed and a signed inventory of the said property is not made and attached to a public instrument.

SEC REGISTRATION

When the partnership capital is P3,000 or more, in money or property, the public instrument must be recorded with the Securities and Exchange Commission (SEC). Even if it not registered, the partnership having a capital of P3,000 or more is still valid and therefore has legal personality.

The SEC shall not register any corporation organized for the practice of public accountancy (The Philippine Accountancy Act of 2004, Sec 28).

The purpose of the registration is to set "a condition for the issuance of the licenses to engage in business or train. In this way, the tax liabilities of big partnerships cannot be evaded, and the public can also determine more accurately their membership and capital before dealing with them." (Dean Capistrano, IV Civil Code of the Philippines).

To register a partnership with the SEC, here are the basic steps to follow:

- Have your proposed business name verified in the verification unit of SEC;
- Submit the following documents:
 - Articles of Partnership
 - Verification Slip for the Business name if required
 - Written undertaking to change business name if required
 - Tax identification number of each partner and/or that of the partnership
 - Registration data sheet for partnership duly accomplished in six copies
 - Other documents that may be required
- Pay the registration/filing and miscellaneous fees;
- Forward documents to the SEC Commissioner for signature.

ACCREDITATION TO PRACTICE PUBLIC ACCOUNTANCY

Certified public accountants (CPAs), firms and partnerships of CPAs, engaged in the practice of public accountancy, including the partners and staff members thereof, shall register with the Professional Regulation Commission and the Professional Regulatory Board of Accountancy. The registration shall be renewed every three years (The Philippine Accountancy Act of 2004, Sec. 31). The rules and regulations covering the accreditation for the practice of public accountancy are specified in Annex 8 of The Rules and Regulations Implementing Republic Act 9298 otherwise known as the Philippine Accountancy Act of 2004.

ACCOUNTING FOR PARTNERSHIPS

Owners' Equity Accounts

In Basic Accounting, generally accepted accounting principles were discussed in the context of a sole proprietorship. These accounting principles also apply to a partnership. Thus, the recording of assets, liabilities, income and expenses is consistent for both proprietorship and another as a partnership, there will be no marked difference in their operation.

However, differences arise between the two forms of business concerning owners' equity. For a proprietorship, there is only a single owner. Therefore, there is only one capital account and one drawing account. On the other hand, since a partnership has two or more owners separate capital and drawing accounts are established for *each partner*.

A partner's **capital** account is credited for his initial and additional net investments (assets contributed *less* liabilities assumed by the partnership), and credit balance of the drawing account at the end of the period. It is debited for his permanent withdrawals and debit balance of the drawing account at the end of the period.

Typically, partners do not wait until the end of the year to determine how much of the profits they wish to withdraw from the partnership. To meet personal living expenses, partners customarily withdraw money on a periodic basis throughout the year. A partner's **drawing** account is debited to reflect assets temporarily withdrawn by him from the partnership. At the end of each accounting period, the balances in the drawing accounts are closed to the related capital accounts.

Partner's Capital Account	
<i>Debit</i>	<i>Credit</i>
1. Permanent withdrawals. 2. Debit balance of the drawing account at the end of the period.	1. Original investment. 2. Additional investment. 3. Credit balance of the drawing account at the end of the period.
Partner's Drawing Account	
<i>Debit</i>	
1. Temporary withdrawals. 2. Share in loss (this may be debited directly to Capital).	1. Share in profit (this may be credited directly to Capital).

Permanent withdrawals are made with the intention of permanently decreasing the partner's capital while temporary withdrawals are regular advances made by the partners in anticipation of their share in profit.

The use of drawing accounts for temporary withdrawals provides a record of each partner's drawings during an accounting period. Hence, drawings in excess of the allowed amounts as stated in the partnership agreement may be controlled.

Notice that profit or loss is credited or debited either to the drawing account or to the capital account. The choice of the account to credit or debit depends on the intention of the partners. If they wish to maintain their capital accounts for investments and permanent withdrawals, then profit or loss should be entered in the drawing account.

On the other hand, if the purpose of the partners is to make profit or loss part of their capital, then the capital account should be used. In either case, the resulting partners' ending capital balances will be the same.

On Sept. 6, 2007, the International Accounting Standards Board (IASB) issued a revised International Accounting Standards (IAS) No. 1. *Presentation of Financial Statements*. This standard supersedes the 2003 version of IAS 1 as amended in 2005. It's common to encounter "profit or loss" rather than usual "net income or net loss" as the descriptive term used in the Statement of Comprehensive Income (the new title of the Income statement per revised IAS No. 1). The balance sheet is called the Statement of Financial Position. The complete set of financial statements will be discussed in Chapter 2.

Loans Receivable from or Payable to Partners

If a partner withdraws a substantial amount of money with the intention of repaying it, the debit should be to Loans Receivable-Partner account instead of to Partner's Drawing account. This account should be classified separately from the other receivables of the partnership.

A partner may lend amounts to the partnership in excess of his intended permanent investment. These advances should be credited to Loans Payable-Partner account and not to Partner's Capital account classified among the liabilities but separate from liabilities to outsider. This distinction is important in case of liquidation. Loans payable to partners must be paid after the claims of outside creditors have been paid in full. These loans have priority over partners' equity.

PARTNERSHIP FORMATION

Valuation of Investments by Partners

The books of the partnership are opened with entries reflecting the net contributions of the partners to the firm. Asset accounts are debited for assets contributed to the partnership, liability accounts are credited for any liabilities assumed by the partnership and separate capital accounts are credited for the amount of each partner's net investment (assets less liabilities).

Partners may invest cash or non-cash assets in the partnership. When a partner invests non-cash assets, they are to be recorded at values agreed upon by the partners. In the absence of any agreement, the contributions will be recognized at their fair market values at the date of transfer to the partnership.

The **fair market value** of an asset is the estimated amount that a willing seller would receive from a financially capable buyer for the sale of the asset in a free market. Per International Financial Reporting Standards (IFRS) No. 3, **fair value** is the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties.

Adjustment of Accounts Prior to Formation

In cases where the prospective partners have existing businesses, their respective book will have to be adjusted to reflect the fair market values of their assets or to correct misstatements in the accounts. If the adjustments will not be made, the initial capital balances of the partners may be inequitable.

Illustration. A reconditioned printing equipment invested by Luz Un was recorded incorrectly in the partnership books at P730,000—its book value from the partnership's records. If the partnership immediately sold the printing equipment for its fair market value of P800,000, the resulting P70,000 gain would increase the capital balances of both Partners Luz Un and Dennis Sandoval. The printing equipment should have been recorded at P800,000 and Un's capital credited with P800,000. Simply stated, increases in asset values accruing *before* formation should be for the benefit of the contributing partner.

The adjustments of the assets and liabilities prior to formation will be similar to the adjustments that we are already familiar with. However, when the adjustment involves a debit or credit to a nominal account,

the Capital account would instead be debited or credited. This is so because the business has ceased to be a going concern. A business is not viewed as a going concern if liquidation appears imminent. For example, two sole proprietorships will cease operations because of their agreement to enter into a partnership. Both proprietorships have ceased to be going concerns.

Illustration. Emerita Geron and Emerita Modesto formed a general professional partnership. Emerita Geron will invest sufficient cash to get an equal interest in the partnership while Emerita Modesto will transfer the assets and liabilities of her business. The account balances on the books of Modesto prior to partnership formation follows:

	Debit	Credit
Cash	180,000	
Accounts Receivable	300,000	
Office Equipment	1,500,000	
Accumulated Depreciation		600,000
Accounts Payable		155,000
Salaries Payable		25,000
Emerita Modesto, Capital		1,200,000

It is agreed that for purposes of establishing Emerita Geron's interest, the following adjustments shall be made in the books of Emerita Modesto:

1. An allowance for uncollectible accounts of 5% of accounts receivable is to be established.
2. Prepaid expenses amounting P30,000 were omitted by the accountant. This is to be recognized.
3. Additional salaries payable in the amount of P10,000 is to be established.

The accounting equation states that assets must *always* equal liabilities and owner's equity. The basic accounting model is:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Note that the assets are on the left side of the equation opposite the liabilities and owner's equity. This explains why increases and decreases in assets are recorded in the opposite manner as liabilities and owner's equity are recorded. The equation also explains why liabilities and capital follow the same rules of debit and credit. The logic of debiting and crediting is related to the accounting equation.

Accounting is based on a double-entry system which means that the *dual effects* of a business transaction are recorded. A debit side entry must have a corresponding credit side entry. For every transaction, there must be one or more accounts debited and one or more accounts credited. Each transaction affects at *least* two accounts. The total debits for a transaction must always equal the total credits.

The account type determines how increases and decreases in it are recorded. *Increases in assets* are recorded as *debits* (left side of the account) while decreases in assets are recorded as credits (on the right side). Conversely, *increases in liabilities and owner's equity* are recorded by *credits*; decreases in liabilities and owner's equity are recorded by debits.

The rules of debit a credit for income and expense accounts are based on the relationship of these accounts to owner's equity. Income increases owner's equity and expense decreases owner's equity. Hence, increases in income are recorded as credits and decreases as debits. Increases in expenses are recorded as debits and decreases as credits. These are the **rules of debit and credit**.

Using the accounting equation approach of analysis, the adjustments are as follows:

	Assets	=	Liabilities	+	Owner's Equity
1.	-P15,000	=		+	-P15,000
2.	+ 30,000	=		+	+ 30,000

3.		=	<u>+P10,000</u>	+	<u>- 10,000</u>
	<u>+P15,000</u>	=	<u>+P10,000</u>	+	<u>+P 5,000</u>
	<u>+P15,000</u>			+	<u>+P15,000</u>

Entries and Explanations:

1. An allowance of 5% of P300,000 or P15,000 needs to be established. The account Allowance for Uncollectible Accounts is a contra-asset account. When this account is increased, the effect is to decrease the related asset account. The owner's equity is also decreased since this provision for uncollectibles is considered as an expense in the ordinary course of business.

Emerita Modesto, Capital	15,000
Allowance for Uncollectible Accounts	15,000

2. An omission to record the asset—prepaid expenses will denote that the expenses of the business are overstated. When the expenses are overstated, profit and correspondingly the owner's equity are understated. To recognize the prepaid expense, the entry will be:

Prepaid Expenses	30,000
Emerita Modesto, Capital	30,000

3. The establishment of additional salaries payable will increase liabilities. It can be deduced that the salaries expenses are understated and to correct the misstatement the owner's equity will be decreased.

Emerita Modesto, Capital	10,000
Salaries Payable	10,000

The adjustments prior to formation will entail debits or credits to asset or liability accounts. To maintain the double entry system of accounting, a corresponding debit or credit to owner's equity account will be made. The following T-account will serve to summarize the necessary adjustments to the capital account:

Owner's Equity Account

<i>Debit</i>	<i>Credit</i>
1. Decrease in asset. 2. Increase in liability. 3. Increase in contra-asset	1. Increase in asset. 2. Decrease in liability. 3. Decrease in contra-asset

Opening Entries of a Partnership upon Formation

A partnership may be formed in any of the following ways:

1. Individuals with no existing business form a partnership.
2. Conversion of a sole proprietorship to a partnership.
 - a. A sole proprietor and an individual without an existing business form a partnership.
 - b. Two or more sole proprietors form a partnership.
3. Admission or retirement of a partner (to be covered in Chapter 3).

Individuals with No Existing Business Form a Partnership

The opening entry to recognize the contributions of each partner into the partnership is simply to debit the assets contributed, and to credit the liabilities assumed and the capital account of each partner.

Illustration. On July 1, 2014, Nilo Burgos Helenita Ruiz agreed to form a partnership. The partnership agreement specified that Burgos is to invest cash of P700,000 and Ruiz is to contribute land with a fair market value of P1,300,000 with P300,000 mortgage to be assumed by the partnership. The entries are as follows:

Cash	700,000	
Land	1,300,000	
Mortgage Payable		300,000
Nito Burgos, Capital		700,000
Helenita Ruiz, Capital		1,000,000
To record the initial investments of Burgos and Ruiz.		

After the formation, the statement of financial position (*the new title of the balance sheet per revised IAS No. 1*) of the newly formed partnership is:

Burgos and Ruiz
Statement of Financial Position
July 1, 2014

Assets		
Cash		P 700,000
Land		<u>1,300,000</u>
Total Assets		<u>P2,000,000</u>
Liabilities and Owners' Equity		
Mortgage Payable		P 300,000
Nito Burgos, Capital		700,000
Helenita Ruiz, Capital		<u>1,000,000</u>
Total Liabilities and Owners' Equity		<u>P2,000,000</u>

Illustration. Suppose that Burgos and Ruiz formed another partnership with Dr. Debbie Ablog-Adriano. Burgos and Ruiz considered Adriano who has a vast business network in Bicol as an industrial partner. The partnership did not receive any asset from Adriano. In this case, only a memorandum entry in the general journal will be made.

A Sole Proprietor and another Individual Form a Partnership

A sole proprietor may consider forming a partnership with an individual who has no existing business. Under this type of formation, the assets and the liabilities of the proprietorship will be transferred to the newly formed partnership at values agreed upon by all the partners or at their current fair prices.

Illustration. The statement of financial position of Galicano Del Mundo on Oct. 1, 2014, before accepting Christine Resultay as partner is shown as follows:

Galicano Del Mundo Statement of Financial Position Oct. 1, 2014		
Assets		
Cash		P 60,000
Notes Receivable		30,000
Accounts Receivable	P240,000	
Less: Allowance for Uncollectible Accounts	<u>10,000</u>	230,000
Merchandise Inventory		80,000
Furniture and Fixtures	P60,000	
Less: Accumulated Depreciation	<u>6,000</u>	<u>54,000</u>
Total Assets		<u>P454,000</u>
Liabilities and Owner's Equity		
Notes Payable		P 40,000
Accounts Payable		100,000
Galicano Del Mundo, Capital		<u>314,000</u>
Total Liabilities and Owner's Equity		<u>P454,000</u>

Christine Resultay offered to invest cash to get a capital credit equal to one-half of Galicano Del Mundo's capital after giving effect to the adjustments below. Del Mundo accepted the offer.

1. The merchandise is to be valued at P74,000.
2. The accounts receivable is estimated to be 95% collectible.
3. Interest accrued on the notes receivable will be recognized. P10,000, 12% dated July 1, 2014 and P20,000, 12% dated August 1, 2014.
4. Interest on notes payable to be accrued at 14% annually from April 1, 2014.
5. The furniture and fixtures are to be valued at P46,000.
6. Office supplies on hand that have been changed to expense in the past amounted to P4,000. This will be used by the partnership.

New Books for the Partnership (required per National Internal Revenue Code)

The following procedures may be used in recording the formation of the partnership:

Books of Galicano Del Mundo:

1. Adjust the assets and liabilities of Galicano Del Mundo in accordance with the agreement. Adjustments are to be made to his capital account.
2. Close the books.

Books of the Partnership:

1. Record the investment of Galicano Del Mundo.
2. Record the investment of Christine Resultay.

Following the procedures, the entries are:

Books of Galicano Del Mundo

(1)

Galicano Del Mundo, Capital ⁶	14,100	
Office Supplies	4,000	
Interest Receivable ³	700	
Merchandise Inventory ¹		6,000
Allowance for Uncollectible Accounts ²		2,000
Interest Payable ⁴		2,800
Accumulated Depreciation ⁵		8,000
To record adjustments to restate Del Mundo's capital.		

(2)

Note Payable	40,000	
Accounts Payable	100,000	
Interest Payable	2,800	
Allowance for Uncollectible Accounts	12,000	
Accumulated Depreciation	14,000	
Galicano Del Mundo, Capital	299,900	
Cash		60,000
Notes Receivable		30,000
Accounts Receivable		240,000
Interest Receivable		700
Merchandise Inventory		74,000
Office Supplies		4,000
Furniture and Fixtures		60,000
To close the books of Del Mundo.		

Books of the Partnership

(1)

Cash	60,000	
Notes Receivable	30,000	
Accounts Receivable	240,000	
Interest Receivable	700	
Merchandise Inventory	74,000	
Office Supplies	4,000	
Furniture and Fixtures ⁷	46,000	
Notes Payable		40,000
Accounts Payable		100,000
Interest Payable		2,800
Allowance for Uncollectible Accounts		12,000
Galicano Del Mundo, Capital		299,900
To record the investment of Del Mundo.		

(2)

Cash ⁸	149,950	
Christine Resultay, Capital		149,950
To record the investment of Resultay		

Computations:

- | | |
|-----------------------------------|----------------|
| Merchandise Inventory, per ledger | P80,000 |
| Merchandise Inventory, as agreed | <u>74,000</u> |
| Decrease in Merchandise Inventory | <u>P 6,000</u> |
- | | |
|-------------------------------------|----------------|
| Accounts Receivable, net per ledger | P230,000 |
| Accounts Receivable, net as agreed | |
| (P240,000 x 95%) | <u>228,000</u> |
| Increase in Allowance | <u>P 2,000</u> |
- | | |
|--|-------------|
| Interest accrued on Notes Receivable: Interest = Principal x Rate x Time | |
| On P10,000 P10,000 x 12% x 3/12 | P300 |
| On P20,000 P20,000 x 12% x 2/12 | <u>400</u> |
| | <u>P700</u> |
- | | |
|------------------------------------|---------------|
| Interest accrued on Notes Payable: | |
| On P40,000 P40,000 x 14% x 6/12 | <u>P2,800</u> |
- | | |
|--|----------------|
| Furniture and Fixtures, net per ledger | P54,000 |
| Furniture and Fixtures, net as agreed | <u>46,000</u> |
| Increase in Accumulate Depreciation | <u>P 8,000</u> |
- | | |
|--|------------------|
| Net effect of adjustments on Capital: | |
| Decrease in Merchandise Inventory | P (6,000) |
| Increase in Allowance for Uncollectibles | (2,000) |
| Increase in Interest Receivable | 700 |
| Increase in Interest Payable | (2,800) |
| Increase in Accumulated Depreciation | (8,000) |
| Increase in Office Supplies | <u>4,000</u> |
| Decrease in Capital | <u>P(14,100)</u> |
- | | |
|--|---------------|
| Furniture and Fixtures, cost per books | P60,000 |
| Furniture and Fixtures, cost as agreed | <u>46,000</u> |

Writedown of Furniture and Fixtures	<u>P14,000</u>
8. Galicano Del Mundo, Capital before adjustment	P314,000
Net Adjustments to Capital	<u>14,100</u>
Galicano Del Mundo, Capital after adjustment	P299,900
Agreed Capital Credit for Christine Resultay	<u>50%</u>
Cash Investment of Christine Resultay	<u>P149,950</u>

After the formation, the statement of financial position of the newly formed partnership is:

Del Mundo and Resultay
Statement of Financial Position
Oct. 1, 2014

Assets		
Cash		P209,950
Notes Receivable		30,000
Accounts Receivable	P240,000	
Less: Allowance for Uncollectible Accounts	<u>12,000</u>	228,000
Interest Receivable		700
Merchandise Inventory		74,000
Office Supplies		4,000
Furniture and Fixtures		<u>46,000</u>
Total Assets		<u>P592,650</u>
Liabilities and Owners' Equity		
Notes Payable		P 40,000
Accounts Payable		100,000
Interest Payable		2,800
Galicano Del Mundo, Capital		299,900
Christine Resultay, Capital		<u>149,950</u>
Total Liabilities and Owners' Equity		<u>P592,650</u>

Note that furniture and fixtures are now recorded in the partnership books at the agreed amount of P46,000 which represented the cost of the asset to the partnership. On the other hand, the accounts receivable is still recorded at gross amount of P240,000 with a related allowance for uncollectible accounts of P12,000. The P12,000 is only a provision for possible uncollectibles.

Two or More Sole Proprietors Form a Partnership

Illustration. On June 30, 2014, Deogracia Corpuz and Esterlina Gevera, friendly competitors in a certain line of business, decided to combine their talents and capital to form a partnership. Their statements of financial position are as follows:

Deogracia Corpuz
Statement of Financial Position
June 30, 2014

Assets		
Cash		P 50,000
Accounts Receivable		100,000
Merchandise Inventory		80,000
Furniture and Fixtures		<u>60,000</u>
Total Assets		<u>P290,000</u>
Liabilities and Owner's Equity		
Accounts Payable		P 30,000
Deogracia Corpuz, Capital		<u>260,000</u>
Total Liabilities and Owner's Equity		<u>P290,000</u>

Esterlina Gevera
Statement of Financial Position
June 30, 2014

Assets		
Cash		P 40,000
Accounts Receivable		80,000
Merchandise Inventory		100,000
Delivery Equipment		<u>90,000</u>
Total Assets		<u>P310,000</u>
Liabilities and Owner's Equity		
Accounts Payable		P 60,000
Esterlina Gevera, Capital		<u>250,000</u>
Total Liabilities and Owner's equity		<u>P310,000</u>

The conditions and adjustment agreed upon by the partners for purpose of determining their interests in the partnership are:

1. Actual count and bank reconciliation on Corpuz proprietorship's cash account revealed cash short and unrecorded expenses of P3,500.
2. Establishment of a 10% allowance for uncollectible accounts in each book.
3. The merchandise inventory of Gevera is to be increased by P10,000.
4. The furniture and fixtures of Corpuz are to be depreciated by P6,000.
5. The delivery equipment of Gevera is to be depreciated by P9,000.

New books for the Partnership (required per National Internal Revenue Code)

The following procedures may be used in recording the formation of the partnership:

Books of Deogracia Corpuz and Esterlina Gevera:

1. Adjust the accounts of both parties in accordance with the agreement.
Adjustments are to be made to their respective capital accounts.
2. Close the books.

Books of the Partnership:

1. Record the investment of Deogracia Corpuz.
2. Record the investment of Esterlina Gevera.

Following the procedures, the entries are:

Books of deogracia Corpuz

(1)

Deogracia Corpuz, Capital	19,500	
Cash		3,500
Allowance for Uncollectible Accounts		10,000
Accumulated Depreciation		6,000
To record adjustments to restate Corpuz's capital.		

(2)

Accounts Payable	30,000	
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Allowance for Uncollectible Accounts	10,000	
Accumulated Depreciation	6,000	
Deogracia Corpuz, Capital	240,500	
Cash		46,500
Accounts Receivable		100,000
Merchandise Inventory		80,000
Furniture and Fixtures		60,000
To close the books of Corpuz.		

Books of Esterlina Gevera

(1)

Merchandise Inventory	10,000	
Esterlina Gevera, Capital	7,000	
Allowance for Uncollectible Accounts		8,000
Accumulated Depreciation		9,000
To record adjustments to restate Gevera's capital.		

(2)

Accounts Payable	60,000	
Allowance for Uncollectible Accounts	8,000	
Accumulated Depreciation	9,000	
Esterlina Gevera, Capital	243,000	
Cash		40,000
Accounts Receivable		80,000
Merchandise Inventory		110,000
Delivery Equipment		90,000
To close the books of Gevera.		

Books of the Partnership

(1)

Cash	46,500	
Accounts Receivable	100,000	
Merchandise Inventory	80,000	
Furniture and Fixtures	54,000	
Accounts Payable		30,000
Allowance for Uncollectible Accounts		10,000
Deogracia Corpuz, Capital		240,500
To record the investment of Corpuz.		

(2)

Cash	40,000	
Accounts Receivable	80,000	
Merchandise Inventory	110,000	
Delivery Equipment	81,000	
Accounts Payable		60,000
Allowance for Uncollectible Accounts		8,000
Esterlina Gevera, Capital		243,000
To record the investment of Gevera.		

After the formation, the statement of financial position of the newly formed partnership is:

Corpuz and Gevera
Statement of Financial Position
June 30, 2014

Assets		
Cash		P 86,500
Accounts Receivable	P180,000	
Less: Allowance for Uncollectible Accounts	<u>18,000</u>	162,000
Merchandise Inventory		190,000
Furniture and Fixtures		54,000
Delivery Equipment		<u>81,000</u>
Total Assets		<u>P573,000</u>
Liabilities and Owners' Equity		
Accounts Payable		P 90,000
Deogracia Corpuz, Capital		240,500
Esterlina Gevera, Capital		<u>243,000</u>
Total Liabilities and Owners' Equity		<u>P573,500</u>