Chapter 15
Partnerships: formation, operation and reporting

Learning checks

☐ A partnership is defined as a relationship that exists between two or more persons carrying on a business in common with a view to making a profit.

☐ Three essential attributes of a partnership are: (1) a verbal or written agreement between two or more legally competent persons to carry on a business; (2) the business is operated with a view to making a profit; and (3) all partners must be co-owners of the business.

☐ The advantages of the partnership include the pooling of capital, less costly to establish than a company, minimal government supervision and regulation, greater flexibility for partners as owners operating the business, and potential income tax advantages.

☐ The characteristics that may make the partnership form of business unattractive include the principle of mutual agency, unlimited liability, limited life, and the difficulty of transferring partnership interests.

☐ The purpose of a partnership agreement is to clearly establish the roles and responsibilities of all partners in operating the business.

☐ If there is no partnership agreement, the partnership is subject to the Partnership Act.

☐ A partnership agreement covers such things as the nature, location, and duration of the partnership; how profits and losses are shared; how the partnership is operated; the authority of partners in contractual situations; accounting practices; and dispute resolution.

☐ There are two ways to account for equity in a partnership:
  - method 1 uses a Capital account for each partner that records capital contributed and withdrawn and includes the partner’s drawings and share of profits and/or losses
  - method 2 uses Capital accounts only for the capital contributed and withdrawn, and records profits and/or losses and drawings in Retained Earnings accounts for each partner.

☐ When partners contribute assets and liabilities to a partnership, each asset and liability is recorded at fair value.

☐ When an incoming partner is given credit for a capital contribution greater than the fair value of the identifiable assets and liabilities contributed, the difference is recorded as goodwill.

☐ A Profit Distribution account is used to distribute the profit/loss to partners. The distributable profit is determined after recording adjustments to partners’ equity such as distribution of salaries, interest on capital, and interest on drawings.

☐ The end-of-period general journal closing entries depend on whether method 1 or method 2 is used to account for partners’ equity.

☐ Periodic drawings of profits by partners are recorded in a separate Drawings account for each partner.

☐ Each partners’ Drawings account is closed by transfer to each partners’ Capital account under method 1; under method 2 it is closed to the Retained Earnings account of each partner.

☐ Advances and loans from partners are recorded as current or non-current liabilities in an account called Advance from Partner or Loan from Partner.

☐ Interest paid on partners’ advances or loans is treated as an expense of the partnership.

☐ If a partnership is a reporting entity, it must prepare financial statements in accordance with relevant accounting standards.

☐ A statement of changes in partners’ equity is prepared showing details of all changes in each partner’s equity.
In a balance sheet, the equity of each partner is shown as the final balance of the Capital account under method 1; under method 2, the balances of both the Capital account and Retained Earnings account are disclosed.