Year 3's income of $160,000 would be distributed as follows: Darin and Peter would receive salaries of $44,000 and $22,000 respectively. All partners would receive 10% interest on their beginning capital balances. Darin, Peter, and Karen had beginning capital balances of $102,375, $14,625, and $39,000 respectively. Karen O'Neil was to receive a bonus of all income earned over $40,000, after salaries and interest had been distributed, of up to $15,000. Karen was a silent partner and as a result, any remaining balance would be shared by Darin and Peter according to their beginning capital ratios of 7:1.

**DISTRIBUTING INCOME**

| | Darin Jones | Peter Smith | Karen O'Neil | |
|---|---|---|---|---|
| Year 4's Income | | | | $160,000 |
| Salary Distribution: | | | | |
| Darin Jones | $44,000.00 | | | |
| Peter Smith | | $22,000.00 | | 66,000 |
| Balance to be distributed. | | | | $94,000 |
| 10% Interest to All Partners | | | | |
| Darin Jones ($102,375)(.10)= | 10,237.50 | | | |
| Peter Smith ($14,625)(.10) = | | 1,462.50 | | |
| Karen O'Neil($39,000)(.10) = | | | $3,900 | 15,600 |
| Balance to be distributed. | | | | $78,400 |
| Bonus to Karen O'Neil | | | 15,000 | 15,000 |
| Balance to be distributed. | | | | $63,400 |
| Darin Jones (.875)($63,400)= | 55,475.00 | | | |
| Peter Smith (.125)($63,400)= | | 7,925.00 | | 63,400 |
| Balance to be distributed. | | | | 0 |
| Distributed to each Partner | $109,712.50 | $31,387.50 | $18,900 | $160,000 |

| | | DR. | CR. |
|---|---|---|---|
| Dec. 31. | Income Summary | 160,000 | |
| | Capital, Darin Jones | | 109,712.50 |
| | Capital, Peter Smith | | 31,387.50 |
| | Capital, Karen O'Neil | | 18,900.00 |
| | To distribute Year 3 earnings. | | |

## II. BONUS TO WITHDRAWING PARTNER

On January 15 of Year 5, Karen O'Neil withdrew from the partnership and was bought out by the partnership for $60,000. Because of interest and bonus, her original capital had grown to $58,400.

| | | DR. | CR. |
|---|---|---|---|
| Jan. 15 | Capital, Karen O'Neil | 58,400 | |
| | Capital, Darin Jones | 1,400 | |
| | Capital, Peter Smith | 200 | |
| | Cash | | 60,000 |
| | To record withdrawal of Karen O'Neil. | | |
| | Darin Jones ($60,000-$58,400)(.875) = $1,400 | | |
| | Peter Smith ($60,000-$58,400)(.125) = $ 200 | | |

**NOTE:** Had Karen O'Neil sold her interest to someone outside the partnership, no partnership cash would have been involved. The only entry would be to eliminate Karen's capital and create the new partner's capital.

## III. LIQUIDATION

Time passed and both stores were less profitable. The partnership was liquidated on February 1 of Year 6. Capital Ratios had been maintained at .875 and .125 or 7:1. While $25,000 was lost on the sale of $270,000 of inventory, other assets valued at $120,000 were sold for $257,000. Liabilities of $46,000 were paid, and all proceeds were distributed to the partners.

**BALANCE SHEET BEFORE LIQUIDATION SALE**

| | |
|---|---|
| ASSETS | |
| Cash | $ 8,000 |
| Merchandise Inventory | 270,000 |
| Various Assets | 120,000 |
| Total Assets | $398,000 |
| Liabilities and Owner's Equity | |
| Accounts Payable | $ 46,000 |
| Capital, Jones | 308,000 |
| Capital, Smith | 44,000 |
| | $398,000 |

**BALANCE SHEET AFTER LIQUIDATION SALE**

| | |
|---|---|
| ASSETS | |
| Cash | $464,000 |
| OWNER'S EQUITY | |
| Capital, Darin Jones | $406,000 |
| Capital, Peter Smith | 58,000 |
| Total | $464,000 |

| | | DR. | CR. |
|---|---|---|---|
| Feb. 1 | Cash | 245,000 | |
| | Gain or Loss on Liquidation | 25,000 | |
| | Merchandise Inventory | | 270,000 |
| | To record Sale of Inventory. | | |
| Feb. 1 | Cash | 257,000 | |
| | Various Assets | | 120,000 |
| | Gain or Loss on Liquidation | | 137,000 |
| | To record Sale of Various Assets. | | |
| Feb. 1 | Gain or Loss on Liquidation | 112,000 | |
| | Capital, Peter Smith | | 14,000 |
| | Capital, Darin Jones | | 98,000 |
| | To close Gain or Loss on Liquidation. | | |
| | ($112,000)(.125) = $14,000. | | |
| | ($112,000)(.875) = $98,000. | | |
| Feb. 1 | Accounts Payable | 46,000 | |
| | Cash | | 46,000 |
| | To pay liabilities. | | |
| Feb. 1 | Capital, Darin Jones | 406,000 | |
| | Capital, Peter Smith | 58,000 | |
| | Cash | | 464,000 |
| | To distribute Proceeds from Liquidation. | | |