

I. PARTNERSHIP LIQUIDATIONS

A. Issues:

1. Convert non-cash assets to cash with minimum loss of value in a timely manner;
2. Make distributions of cash to creditors
3. Make distributions of cash to partners in such a way as to insure that sufficient cash will remain to satisfy the claims of creditors

B. Procedures:

1. Reduce partners capital accounts by loans from the partnership to the partners (rule of offset)

NOTE: Loans from partners to the partnership are not offset i.e. added to capital balance; they are treated as liabilities and are satisfied after arms-length liabilities and before distributions of capital.

2. Close all nominal accounts to partners capital accounts in accordance with the P/L ratio
3. Check partnership agreement for stipulations regarding the required balances of partners capital and/or disposition of capital accounts upon liquidation.
4. Establish a liquidation schedule

A. Two types of liquidation are possible:

1. One Step (Complete) Liquidation: A one-step liquidation exists if the all partnership non-cash assets are converted to cash in a single transaction.
2. Installment (piecemeal) Liquidation: An installment liquidation exists if partnership assets are converted to cash over a period of time in a piecemeal manner.

B. Liquidation schedule procedures:

1. Take a post closing trial balance to insure equality of debits and credits;
2. Insure that all nominal accounts have been closed to proper capital accounts IAW the partnership P/L ratio.
3. Check partnership agreement for special agreements with respect to the final liquidation of partnership assets;
4. Record realizations by reducing the balance in non-cash assets and increasing cash on hand balance;
5. Distribute gains and losses on realizations to the partners IAW partnership P/L agreement; partners with deficit (debit) balance in capital are removed from the liquidation schedule and losses must be absorbed by remaining partners IAW adjusted P/L ratio. The balances of the accounts at this point are the Predistribution Balances and represent the actual account balances.
6. This step makes a hypothetical distribution of loss based on the assumption that the remaining assets are worthless. This procedure insures that distributions of cash are not made to partners who would become insolvent (and therefore not eligible to receive distributions) if the remaining assets were worthless. This hypothetical distribution of loss is accomplished by assuming that any remaining assets are worthless ("assume the worst") and makes a hypothetical distribution of the loss to the remaining partners IAW adjusted P/L ratio; as in step 5, partners with deficit (debit) balance in capital are removed from the liquidation schedule and losses must be absorbed by remaining partners IAW adjusted P/L ratio (Note that partners removed from the realization schedule in this hypothetical step will be returned to the liquidation schedule after the actual distribution of cash because the assumption that caused them to go into deficit capital balance (that the remaining assets were worthless) was hypothetical only).
7. Actual distributions are made in accordance with the schedule; capital accounts of partners receiving distributions are reduced by the amount of distribution received; This distribution is an actual distribution of cash as opposed to the hypothetical distribution of loss in step 6 above.
8. Future distributions are made in the same manner and steps 4 through 7 are repeated until all non-cash assets are converted into cash and the cash distributed to partners.

C. Partnership Liquidation Illustrated:

Situation One: One Step (Complete) Liquidation

1. Assume that the XY partnership has the following account balances after closing all nominal accounts to capital accounts IAW the P/L ratio of .7 and .3 respectively:

Cash.....	15,000	Liabilities.....	15,000
Non-cash assets.....	<u>72,000</u>	X Loan.....	10,000
Total assets.....	<u>87,000</u>	Y Loan.....	24,000
		X Capital.....	20,000
		Y Capital.....	<u>18,000</u>
		Total equities.....	<u>87,000</u>

2. All non-cash assets are sold in a single sale for \$40,000 cash.

Liquidation Schedule: One Step (Complete) Liquidation

P/L Ratio				.7		.3			
	Cash	Non-Cash	Total	Liab.	X Loan	Y Loan	X Cap	Y Cap	Total
Balance:	15,000	72,000	87,000	(15,000)	(10,000)	(24,000)	(20,000)	(18,000)	(87,000)
Cash Realization	40,000	(72,000)	(32,000)				22,400	9,600	32,000
Balance:	55,000	-0-	55,000	(15,000)	(10,000)	(24,000)	2,400	(8,400)	(55,000)
Offset Deficit:					2,400		(2,400)		
Pre-Dist Bal.	55,000	-0-	55,000	(15,000)	(7,600)	(24,000)	-0-	(8,400)	(55,000)
Cash Distrib:									
Creditors--	(15,000)		(15,000)	15,000					15,000
Loans--	(31,600)		(31,600)		7,600	24,000			31,600
Partners--	(8,400)		(8,400)					(8,400)	8,400
Post-Dist Bal.	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-

Situation Two: Installment (Piecemeal) Liquidation

1. Assume that the XYZ partnership has the following account balances after closing all nominal accounts to capital accounts IAW the P/L ratio of .7 and .3 respectively:

Cash.....	-0-	Liabilities.....	3,000
Non-cash assets.....	<u>61,000</u>	X Capital.....	28,000
Total assets.....	<u>61,000</u>	Y Capital.....	18,000
		Z Capital.....	<u>12,000</u>
		Total equities.....	<u>61,000</u>

2. Non-cash assets are sold in three installments:

- Realization #1: \$40,000 non-cash assets are sold for \$10,000;
- Realization #2: \$15,000 non-cash assets are sold for \$ 6,000;
- Realization #3: Remaining non-cash assets are sold for \$5,000

D. Preplanned Liquidation Schedule (Schedule of Safe Payments or Cash Predistribution Plan)

1. Purpose:

- a. Establish the order of elimination of each partner by computing the maximum loss that each partner can absorb before becoming insolvent (and therefore ineligible for further distributions).
- b. Permits partners to establish how cash received in a liquidation plan will be distributed based on current capital balances and current P/L distribution agreements.

2. Procedure:

- a. Apply rule of offset by adjusting capital accounts for loans to partners and partners drawing accounts;
- b. Adjust capital accounts IAW P/L ratio to reflect all anticipated gains and losses;
- c. Determine the order of elimination of each partner by computing the **Maximum Loss Absorbable** by each partner:

$MLA = \frac{\text{Partners final adjusted capital balance}}{\text{Partner's P/L Ratio}}$

- d. Prepare a cash predistribution plan

E. Cash Predistribution Plan Illustrated

1. Assume the following facts:

<u>Partners</u>	<u>P/L Ratio</u>	<u>Capital Balance</u>	<u>Drawing</u>
A	25%	\$ 50,000	\$10,000
B	15	49,950	
C	60	<u>90,000</u>	
		<u>\$ 189,950</u>	

- Partnership liabilities.. \$ 4,200
- Cash on Hand..... 1,000
- Net loss during year..... 10,000

Required:

- 1. Compute order of partnership elimination;
- 2. Prepare a cash distribution table detailing how cash can safely be distributed when available;

Solution:

1. Table 1: order of partnership elimination:

Partners	Beginning Capital	Drawing	Distribution of Partnership Loss	Ending Capital	P/L Ratio	Maximum Loss Absorbable	Order of Elimination
	Balance			Balance			
A	\$ 50,000	\$(10,000)	(.25)(15,000) = (\$3,750)	\$ 36,250	/ 25% =	\$ 145,000	2nd
B	49,950		(.15)(15,000) = (2,250)	47,700	/ 15 =	318,000	3rd
C	<u>90,000</u>		(.6)(15,000) = (9,000)	<u>81,000</u>	/ 60 =	135,000	1st
	<u>\$189,950</u>			<u>\$164,950</u>			

ABC Partnership Loss Distribution Schedule

	Non-Cash Assets	Cash	Liabilities	A Capital	B Capital	C Capital
Beginning Bal:	168,150	1,000	(4,200)	(36,250)	(47,700)	(81,000)
Loss to Elim C	(135,000) See Table 1			33,750 (135,000)(.25)	20,250 (135,000)(.15)	81,000 (135,000)(.6)
Balance:	33,150	1,000	(4,200)	(2,500)	(27,450)	-0-
Loss to Elim A	(4,000) (25/40)X = 2,500 X=4,000			2,500 (25/40)(4,000)	1,500 (15/40)(4,000)	
Balance:	29,150	1,000	(4,200)	-0-	(25,950)	-0-

ABC Partnership Cash Distribution Schedule

	Cash	Liabilities	A Capital	B Capital	C Capital
First	(4,200)	4,200			
Next	(25,950)			25,950	
Next	(4,000)		2,500		1,500
Additional Gains			25%	15%	60%