

Accounting -- Episode 1
A Partnership Business and Accounts Payable

10:32	<i>FADE IN ---RADIO SHOW THEME MUSIC</i>
Glenn	Good day everyone. Welcome to Radio Glencoe Podcasting. I'm your host Glenn Coe.
McGraw	And I'm your host, McGraw Hill. Today, on Accounting Away , we're on location in sunny Santa Monica, California, talking with the owners of <i>Under the Sun Skate Shop</i> , Terry Wheelright and Rebecca Rollins.
Terry (male)	Thanks for coming to our skate shop. It's a real thrill to have our business profiled on your show.
Glenn	We're always interested in talking to young entrepreneurs like you.
McGraw	So tell us, how'd you two end up in the skate rental business?
Terry	Well, I've been blading since I was in high school and loved it so much that in college, I decided to major in Sports Management. Then after college, I took a course in starting a business where I met Rebecca.
McGraw	And Rebecca, what was your background before you met Terry?
Rebecca	I was an accounting major in college and I always wanted to start my own business too, so I took that same class. Terry and I had to create an imaginary business together and guess what – it turned out to be this business.
McGraw	Forgive my pun, but what did it take to get your shop rolling?
Terry	Well, first we spent a few months picking out a store to rent. Once we chose this place, our next task was to purchase lots of skating equipment, like about 60 pairs of skates, and of course helmets, kneepads, wrist guards, and elbow pads.
McGraw	Sounds like you've made a sizable investment. Did you have cash on hand for these purchases?
Rebecca	Not quite. We decided to purchase all the equipment on account. This means that our creditors allowed us certain terms to pay the amounts due over the following months.
McGraw	Let's see, if memory serves me from my own accounting education, the accounting entry would be an increase to an asset account and an increase to a liability account?
Rebecca	Pretty good, McGraw. The actual entry would be a debit to an asset account called Rental Equipment and an equal credit to Accounts Payable for each purchase. That balances out the entries.
McGraw	Did you need to make other purchases on account too?
Terry	We also purchased some office equipment like a phone, a computer, and a multifunction printer. But by buying all this on account, we saved our cash for more immediate needs like insurance and advertising.
McGraw	That's was smart thinking. How long do you have until you need to pay your Accounts Payable?
Rebecca	The equipment company allows 60 days, but the office supply company allows only 30 days before we begin paying interest. But our business takes in a lot of cash daily from rentals, so we expect to be able to pay our creditors on time as promised.
McGraw	Rebecca, out of curiosity, tell me the accounting involved when you pay your Accounts Payable.
Rebecca	You mean, what happens with Accounts Payable when we pay off a bill

	on account? Well, since the account is being paid, Accounts Payable is debited, or decreased. Of course, when we make a cash payment, we credit the account called Cash in Bank. I have to admit, it's really cool to watch our Accounts Payable get smaller and smaller.
Glenn	Do you two sell any merchandise, like skates and helmets?
Rebecca	No, we decided not to become a merchandising business, because we didn't have a big enough credit line to purchase inventory -- and also we didn't really have the storage room for it either. So we're a service business only, providing everything our customers need – skates, lessons, even a van ride if they want to skate in a different location.
Glenn	I understand that the two of you decided to form a partnership. How did you make that decision?
Rebecca	Terry and I chose the partnership form of business because we wanted to pool our skills as well as our money. Neither of us wanted to run this as a sole proprietorship who then would hire the other as an employee.
McGraw	What about the corporate form of business ownership?
Terry	We considered it, but we decided not to do that because of the cost and the amount of paperwork you have to do to incorporate a business in California.
Glenn	Did the two of you write up a formal partnership agreement?
Rebecca	We sure did, and we got a lawyer to look it over too. We both agreed that it was very important for us to have a partnership agreement that details the duties, rights and responsibilities of each partner. This helped us get a firm understanding of which tasks are mine and which belong to Terry.
McGraw	What about investments and profits?
Terry	The partnership agreement spells out how much we each agreed to invest in the business, which is called our capital investment. It also indicates how we will split the partnership net income and losses and how much we will each withdraw per year.
Glenn	Are there any downsides to choosing the partnership form of business?
Terry	There are a few you have to watch out for. For example, the partners may not always agree on decisions, and that could cause a conflict that breaks up the partnership. But Rebecca and I are doing pretty well on managing our business together and making decisions.
Rebecca	Let me mention though, that another downside is that the partners have what's called <i>unlimited liability</i> . That means that in the event of a problem, we are each financially responsible for whatever happens to the entire partnership to the full extent of our own private assets.
McGraw	Oh yes, that right. That's a big difference between a partnership and a corporation. A corporation's stockholders are protected because their liability extends to only the assets of the corporation itself, not to their private assets.
Rebecca	Terry and I are aware of this though and we purchased comprehensive business insurance to protect ourselves. We also had our lawyer draft a personal injury waiver statement that every renter has to sign. That way, if someone rents skates from us and falls, we're not responsible for their injury.
McGraw	How do you handle your taxes? Does the partnership file a tax return and pay taxes for you?
Rebecca	No, that's another difference between a partnership and a corporation. A partnership only files what's called an informational tax return that tells

	the IRS how much income each partner received from the partnership. Then each partner has to file his or her own individual tax return and pay taxes based on their income.
Terry	Yeah, a corporation handles taxes differently. First, the corporation itself pays taxes on its profits. But it also pays the stockholders dividends, and then the stockholders have to declare those dividends on their own individual tax returns and pay taxes on them.
Glenn	Sounds like the two of you have really researched your new business and made the right decisions for yourselves.
Rebecca	Yeah, we spent a lot of time before we opened our doors, beginning with that entrepreneurship class we both took. It was instrumental in getting us to write down our business goals, work out our partnership agreement, and talk to some professionals like a lawyer and a CPA.
McGraw	Well, Terry and Rebecca, it's been great interviewing you and finding out about your skate rental business. That's our time for today, so this is McGraw Hill in Santa Monica, California saying Happy Rollerblading Everyone.
Glenn	And this is Glenn Coe signing off too. Join us next time for another segment of Accounting Away , where we will go on location to more interesting businesses. Hey Terry, can you teach me how to do this rollerblading thing?
	<i>FADE OUT ---RADIO SHOW THEME MUSIC</i>

7:00