

PARTNERSHIPS CHANGES IN OWNERSHIP STRUCTURE

Study unit 3

FAC1601

OVERVIEW

- ◉ Valuation adjustments
- ◉ Goodwill
- ◉ Calculation of profit-sharing ratios
- ◉ Recording change in ownership structure
 - Personal transaction
 - Transaction with partnership

VALUATION ADJUSTMENT (1)

- ◉ Value of partnership
 - Fair value of net assets
 - Fair value of assets LESS fair value of liabilities
- ◉ Valuation adjustment
 - Any adjustment recorded in
 - EXISTING asset or liability account
 - Of EXISTING partnership
 - In preparation of its dissolution
- ◉ Recording valuation adjustment
 - Valuation account
 - Balance closed of to capital accounts of each partner
 - Apportion based on profit sharing ratio

REVERSING VALUATION ADJUSTMENT

- ◉ New partnership
- ◉ Reverse valuation adjustment in books of 'new' partnership
- ◉ Legal perspective
 - Fair value of assets & liabilities → cost for 'new' partnership
 - Do not reverse values in asset/liability accounts
- ◉ Close of valuation account to capital accounts of new partners
 - Use 'new' profit-sharing ratios

PREPARATION OF VALUATION ACCOUNT

Record valuation adjustments

- Dr Valuation account; Cr Asset (Asset value ↓)
- Dr Asset; Cr Valuation account (Asset value ↑)

Valuation account

- Appropriate balancing figure to partners' capital account
- Existing partner capital accounts & ratios

Reversal

- Reverse valuation account
- Appropriate to 'new' partners in 'new' profit-sharing ratio.

GOODWILL

○ Definition

- Future economic benefits arising from assets
- Not individually identified & separately recorded

○ Calculation

- Capital contribution of incoming partner
- MULTIPLIED by inverse of incoming partner's share in net assets
- MINUS total equity of new partnership

○ Accounting entry

- Dr Goodwill (Intangible asset)
- Cr 'Old' partners' capital accounts

○ If goodwill amount is given

- Change in value → valuation account

PROFIT RATIOS

ADMISSION OF NEW PARTNER

- ◉ Decrease existing partners' interest
- ◉ Calculation
 - Current profit-sharing ratio
 - LESS
 - (Profit-sharing ratio of new partner
 - MULTIPLY by ratio to which new partner's profit-share is relinquished)
- ◉ Always convert to fractions
 - *Example 3.3 (p85 of text book)*

PROFIT RATIOS

RETIREMENT/DEATH OF PARTNER

- ⦿ Increase remaining partners' interest
- ⦿ Agreed upon ratio
- ⦿ Calculation
 - Individual previous profit-sharing ratio
 - PLUS
 - ⦿ (New Profit-sharing ratio
 - ⦿ MULTIPLY by ratio to which 'old' partner's profit-share is relinquished)

CHANGE IN OWNERSHIP PERSONAL TRANSACTION

- ◉ Existing partner sell directly to other person
 - Happens ‘outside’ partnership
- ◉ No valuation adjustment or goodwill
- ◉ Close-off ‘old’ partner’s
 - Capital
 - Current
 - Drawing accounts
- ◉ Open new ones for ‘new’ partner

CHANGE IN OWNERSHIP PARTNERSHIP TRANSACTION LEGAL PERSPECTIVE - OLD PARTNERSHIP

1. Close off books & prepare preliminary statement of financial position
2. Close off current accounts to capital accounts
3. Apportion reserves to capital accounts
4. Record valuation adjustments
5. Record goodwill initially acquired
6. Record dissolution of partnership

CHANGE IN OWNERSHIP PARTNERSHIP TRANSACTION LEGAL PERSPECTIVE - NEW PARTNERSHIP

7. Record formation of new partnership
 - Assets, liabilities contributed by remaining partners
 - Apportion according to capital contribution ratio NOT profit-sharing ratio
8. Reinstate reserves
 - Apportion to capital accounts
 - 'new' profit-sharing ratio
9. Adjust capital accounts