

Partnership Accounting Case Study #1 Part 1:

Structure of Equity Accounts

Many individuals set up investment entities (partnerships, LLC's, and trusts) to manage their wealth and minimize their liability to lawsuits and estate taxes. Financial Navigator is an effective way to account for these entities and can produce reports that investors are able to understand.

This document consists of four sections:

- Partnership Transactions
- Partnership Reporting
- Case Study #1, Part 1 – Partnership Structure (this document)
- Case Study #1, Part 2 – Big Picture Holding Company Example

Partnership Equity Accounts

One of the critical decisions to be made when doing partnership accounting is the decision of how to structure the partnership's equity accounts. This decision is critical because there are many different ways to set up accounts for partners' equity and once the decision has been made it may be difficult to switch to another approach. Most of the ways could be considered correct. Or, least they would not be considered wrong. However, over time you may find that certain approaches meet your reporting needs better than others.

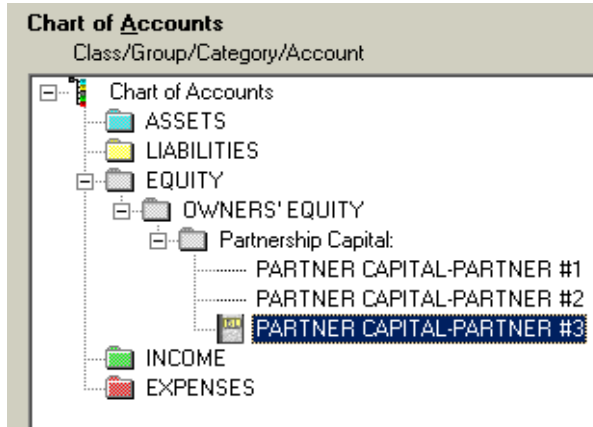
The real question becomes: What is the best way to structure the equity accounts for YOUR partnership?

The correct answer to the question depends on your partnership's situation. This is clearly a case where you want your account structure to be sophisticated enough to meet your needs, but not any more complicated than it needs to be.

This lesson illustrates several approaches to structuring equity accounts starting with a simple approach and adding more complexity to meet certain needs.

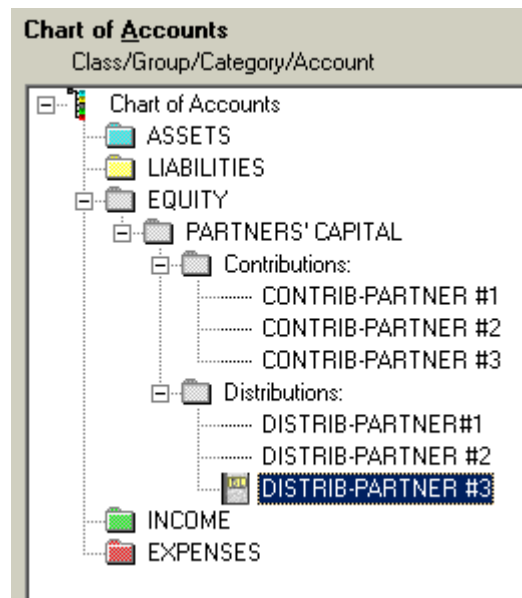
Simple Method

The simplest method is to have one equity account per partner and use it for all transactions involving the equity for that partner. This means you use one Group and one Category and list the account under that Category. The Equity section appears as:

**Category Breakout Method**

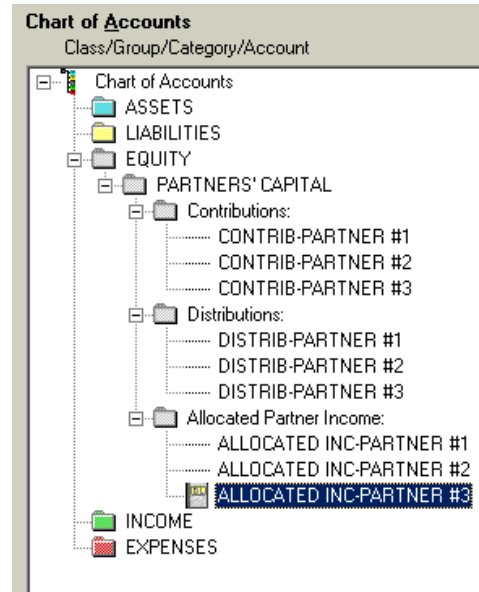
This method means you use Categories to classify the different types of equity accounts. You create categories for the major types of equity accounts and place one account for each partner under each category.

The Equity section appears as follows:

**Distribution of Net Income**

In the examples above, we have let the net income for the partnership entity accumulate in the Net Income account for the entity. Often with partnerships, each partner likes to see his (or her) share of the net

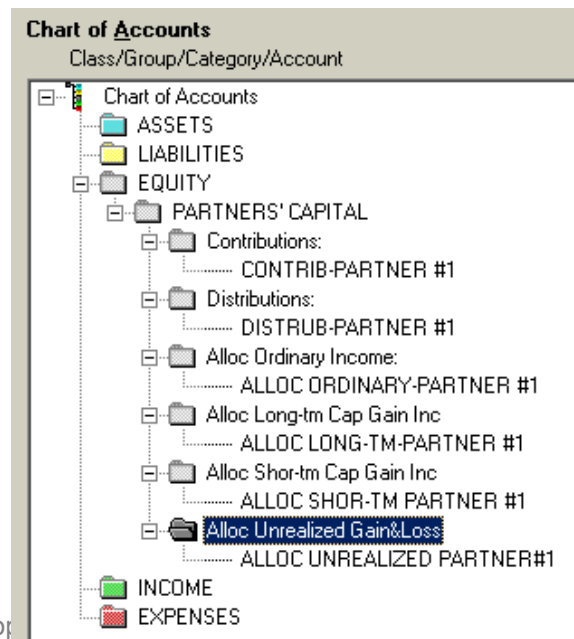
income allocated to his own equity accounts. One way to do this is to set up Allocated Income accounts for each partner and enter transactions that distribute the income to each partner. To do this, you can use the same approach described above and add a Category for Allocated Partners' Income. The equity section would be same as above with the following additional category added:



This topic is focused strictly on equity account structure. Therefore, describing the transactions to allocate Net Income from the entity's equity section to the accounts for each partner is covered in another topic.

Different Forms of Income

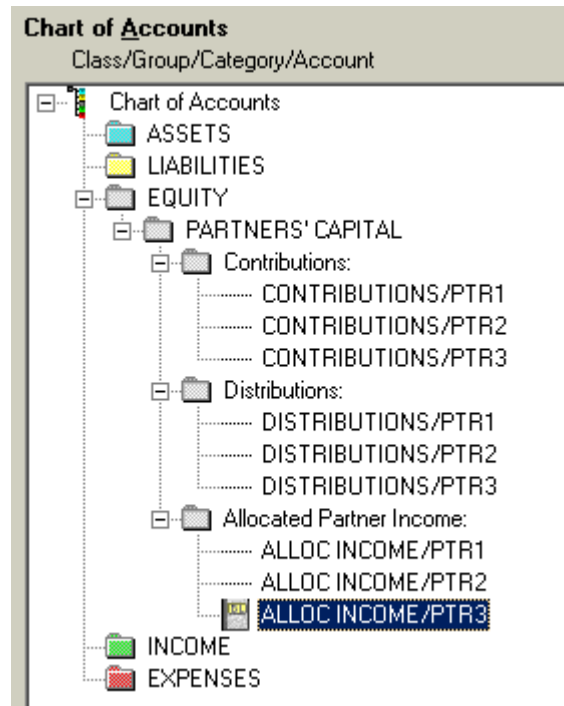
The example above describes allocating income to one Net Income account for each partner. In certain circumstances, it may be required to have a different account for several different types of net income. For example, each partner may have an account for each of these forms of income:



Since each partner needs all of these accounts, a partnership with 5 partners would have 30 equity accounts.

Use of Account Qualifiers

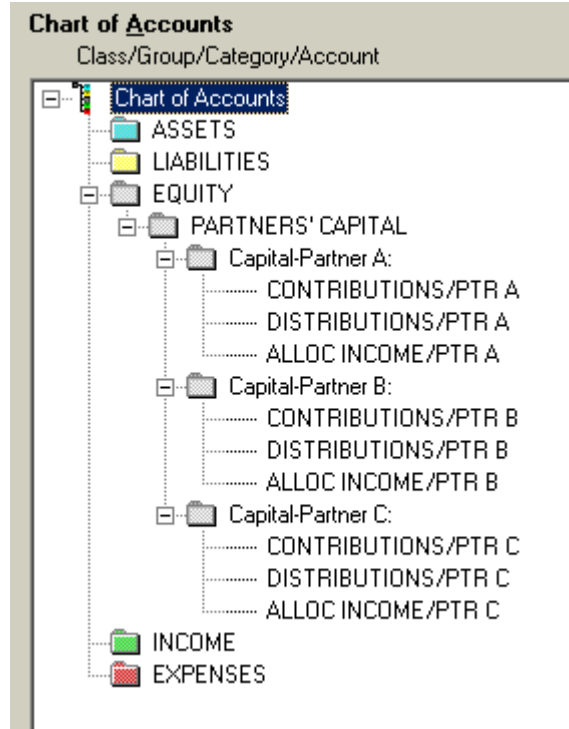
The account structures described above can accurately track the equity values for each partner and properly show them on the Balance Sheet. However, some times you want to produce special reports that show all of the equity accounts for just one partner. You can easily do this by assigning account qualifiers to each partner's accounts. Using qualifiers, the Equity section appears as follows:



Since the account qualifiers can easily be 5 or 6 characters, this allows you to have a large number of partners and still give them individual reports that show their equity account balances.

Partner as Category Name

Another technique in structuring the Chart of Accounts is to have a Category for each partner. By customizing the Category names and setting the report options to show Category subtotals, the partner's name will appear as the title and there will be a subtotal for his or her section of the equity accounts.



This approach allows you to run a summary balance sheet and show the total equity by partner without showing the detail equity accounts.

Conclusion

FN has many capabilities to allow you to structure your equity accounts in a way to meet your needs. The biggest challenge is knowing what information you want to show when you report equity account balances. As with many things in life, you want it to be as simple a possible, but sophisticated enough to meet all of our needs.

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