

### Partnership Accounting Case Study #2:

# SuperLedger Mgmt Company

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 five sections:

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

#### General Background

To understand how they approach partnership accounting, it is helpful to know the overall structure and mission of the fictitious family office called SuperLedger Management Company (SMC).

SMC administers the investment management and accounting functions for a third and fourth-generation family office. They track a total of 45 entities divided into the following types:

- Individual clients
- Businesses
- Foundations
- Partnerships

#### Partnerships

A partnership may have from 2 to 60 investors. In general, the individual clients are the investors in the partnerships. In some

cases a partnership will be an investor in other partnerships. We divided them into two groups:

- Nine partnerships hold marketable securities
- Two partnerships invest in venture capital

This case study focuses only on the nine partnerships that hold securities.

### **Partnerships Holding Marketable Securities**

These partnerships can again be divided into two groups:

- Three are called "nominee partnerships"
- Six are Limited Liability Partnerships (LLPs)

The three nominee partnerships operate like mutual funds where each has one money manager who manages separate portfolios for SMC clients. These partnerships simply hold assets on behalf of their partners with no legal objectives except an ability to pool assets. There are no annual tax returns for these partnerships; income is reported to the partners on 1099s. And, like a mutual fund, when you buy into one of the managed portfolios, you buy into existing capital gains/losses to a certain extent.

The six LLPs are more specialized than the nominee partnerships in that each LLPs holds a portfolio of a certain type of securities. There is a partnership for each of the following six security types:

- Large Cap Growth Fund
- Large Cap Value Fund
- Small/Mid Cap Growth Fund
- Small/Mid Cap Value Fund
- International Fund and
- A Hedge Fund

In some cases a partnership will hold two or more separate portfolios where each portfolio has its own money managers. These LLPs will also sometimes invest in other partnerships. The legal structure of these partnerships mandates that SMC keep track of unrealized gains per partner and allocate realized gains in a complex way.

### **Investment and Liquidity Objectives**

By having partnerships hold assets this way, family members can select an asset allocation policy that is appropriate for them by "mixing and matching" their investments in the different partnerships. At the same time, the partnerships provide the family with maximum leverage by pooling their funds in order to have separately managed accounts with money managers, resulting in substantially discounted fees.

But in doing this they had to be careful about not severely restricting the flow of cash in and out of the partnerships. They try to limit withdrawals and contributions to a quarterly basis but can accommodate monthly cash flows when absolutely necessary.

### Accounting Practices

Internally, they do not keep track of all the individual securities owned by each of the money managers. They have two outside firms who provide all the custody, accounting, and performance monitoring services for us on each manager. Internally, the job is to reconcile those accounts and do the accounting on FN at a partnership level so that they can keep track of each partner's ownership and allocate total income to each partner appropriately.

### Accounting Challenges

Using partnerships in this way means they must address many different serious accounting issues including:

- Posting stock purchases and sales in aggregate – They enter purchases and sales as a monthly total amount from the statements sent by the investment firm.
- Unrealized gains and losses – They must keep track of the unrealized gains and losses, locking them in and applying them as realized gains to their original partners as the securities increase and decrease in value and as cash flows occur.
- Allocated quarterly income – Distribute income to partners each quarter.
- In-kind Contributions - The two largest partnerships were created by partners contributing appreciated securities rather than cash. That means that the tax basis of their partnership investment should reflect the low basis of the securities they contributed. For these partnerships, they must keep track of those individually contributed securities by partner. So when these assets are sold within the partnership, the realized gains get allocated back to the partner who contributed the stock to the extent of the unrealized gain that was locked in at the time the stock was contributed.
- Nested Partnerships – This occurs when a partnership has an investment in another partnership. This means all of the income and tax basis must be distributed to the first partnership as an investor. Then that partnership distributes it to its investors. This nesting of ownership introduces some complex tax accounting issues.

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