Business Purchase

This section deals with a Limited Company purchasing an unincorporated business (sole trader or a Partnership).

1. Difference between the purchase of another businesses' assets and the purchase of a business?

When a company buys the assets of another business, the other business ceases to exist and its' customers have to find another supplier.

When a company buys a business, the company takes over it's assets and liabilities as well as it's customers with whom it continues to trade. This usually involves the purchase of Goodwill. A company often issues shares to the business owner(s) as payment. The shares may be issued at a premium.

Sometimes, a sole trader or a partnership may CONVERT their business into a Limited Company – which then purchases the sole trader or partnership.

2. Goodwill

This is the amount paid for the new business **over and above** the fair value of it's Net Assets (assets taken over less liabilities taken over).

Calculation of Goodwill: PURCHASE PRICE – (NET ASSETS TAKEN OVER)

Goodwill must be shown as an Intangible asset on the Company Balance Sheet.

If the amount paid for the business is less than the Net Assets taken over then this is known as *Negative Goodwill*. Negative Goodwill is shown as a *negative amount* under Intangible Assets on the Balance Sheet of the Company.

3. Journal Entry in the Company Books:

DEBIT All Assets Taken over by the Company (including any Goodwill) at their

NEW AGREED UPON VALUES

CREDIT *All liabilities Taken over by the Company*

Cash (paid for the business)

Ordinary Share Capital (or Preference Share capital or Debentures)

Share Premium (if shares were issued at a premium)

Example of a journal entry:

	Debit	Credit
Land and Buildings	80 000	
Vehicles	44 000	
Stock	5 000	
Debtors	3 000	
Goodwill	**20 000**	
Creditors		2 000
Cash		20 000
Ordinary Share Capital		100 000
Share premium		30 000

If the Company is buying a Partnership Business and the Company is going to take over a Loan that one of the partners had made to the partnership (usually by issuing Debentures to the partner) , then the partner must receive the same rate of Debenture interest that he was receiving for the loan to the partnership.

Calculation: $\dfrac{\textbf{rate of interest on loan}}{\textbf{Rate of Interest on Debenture}}$ **X Loan amount**

4. Balance Sheet of the Company

The Assets and Liabilities bought over by the company must be added to their own Assets and Liabilities when drawing up the new Balance Sheet. Any CASH paid for the business must be subtracted from the Cash Balance of the Company's Cash account.

5. Return on Investment

It is important that a company purchasing another business succeeds in making the new business as profitable as possible. This means that they want the highest possible return on their investment.

Return on Investment is calculated: $\dfrac{\textbf{PROFIT}}{\textbf{PRICE PAID FOR THE BUSINESS}}$ **X100**