Fundamental of Partnership

2 CHAPTER

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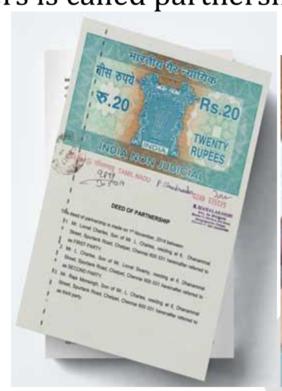
1. **Partnership** according to section 4, of the Indian partnership act, 1932, 'Partnership is the **relation between** person who have agreed to **share the profits** of a **business carried on by all or any of them acting for all**;.

2. The persons who have entered into a partnership with one another are individually called **partners** and partners collectively are known as a partnership firm.

3. Features/characteristics of partnership
   i. Two or more persons
   ii. Agreement
   iii. Business
   iv. Mutual agency
   v. Sharing of profits
   vi. Limited liability
   vii. Management and control
   viii. Registration

4. **Partnership deed** the document containing t6he agreement in writing among partners is called partnership need.



5. **Content of partnership deed** a partnership deed generally contains the following details
   i. Name and address o all the partners
   ii. Name and address of the firm
   iii. Principal place of business
   iv. Nature of business
   v. Date of commencement of the partnership
   vi. Rule regarding operation of bank accounts
   vii. Capital to be contributed by each partner
   viii. Interest on capitals and drawings
   ix. Salary/commission to partners
   x. Profit and loss sharing ratio, etc.

6. **Importance of partnership** deed partnership deed and its registration is not compulsory but it is always better to have the agreement in writing for the following reasons.
   i. It helps in setting any dispute or doubt with regard to the terms of partnership.
   ii. It serves as an evidence in the court of law.
   iii. It regulates the duties and powers of each partner.

7. **Provision of the Indian partnership act, 1932 in the absence of partnership deed**

In the absence of partnership deed, the relevant provisions of the Indian partnership act, 1932 are as follows

i. Sharing of profits/losses — Equally
ii. Interest on capital — not allowed
iii. Salary/commission to a partner — not allowed
iv. Interest on advances or loan by a partners6% per annum
v. Interest on drawings — not charged

8. **Maintenance of capital accounts of partners**

Capital accounts of partners can be maintained of the following two methods

i. **Fixed capital method** : under this method, two accounts are maintained namely partners capital accounts and partners' current account.
Transactions related to introduction and withdrawal of capital are recorded in capital accounts, rest of the transactions are recorded in current accounts.
Capital account will always have credit balance and account may have credit or debit balance

Dr. **Partners' capital account** **cr.**

Particulars	X	Y	Z	Particulars	X(	Y	Z
To cash/bank/ a/c (withdrawal of capital)	…	…	…	By balance b/d	…	…	…
To balance c/d	…	…	…	By cash/bank a/c (additional capital introduced	…	…	…
	…	…	…		…	…	…

Dr. **Partners current account** **cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To balance b/d Debit opening balance)	....	....	....	*by balance b/d (in cash of credit opening balance)	....	....	....
To drawings a/c	....	....	....	By interest on capital a/c	....	....	....
To interest on drawings a/c	....	....	....	By commission a/c	....	....	....
To profit and loss Appropriation a/c (loss)	....	....	....	By salary a/c	....	....	....
*to balance c/d				By profit and loss Appropriation a/c (profit)	....	....	....
				By balance c/d	....	....	....
	....	....	....		....	....	....

ii. **Fluctuating capital method** : under fluctuating capital method, one account is maintained i.e., partners capital account.
All transactions including introduction and withdrawal of capital are recorded in capital account. Generally capital accounts have credit but in exceptional cases it may have debit balance due to heavy loss or drawings.

Partners' capital account

Particulars	X	Y	Z	Particulars	X	Y	Z
To balance b/d (in cash of debit opening balance)	....	....	....	*by balance b/d (in case of credit opening balance)	....	....	.....
To drawings a/c	....	....	....	By cash/bank a/c (additional capital introduced)	....	....	.....
To interest on drawings a/c	....	....	....	By interest on capital a/c	....	.....	.....
To profit and loss Appropriation a/c (loss)	....	....	....	By commission a/c	....	....	.....
To balance c/d	....	....	....	By profit and loss appropriation a/c (profit	....	....	.....
				*by balance c/d	....	.....	.....
	....	....	....		....	.....	......

9. **Interested on capital** :interest on capital is an appropriation of profits and is provided only if there is profit. It will be provided in case of loss also only if partnership deed says so or it is to be treated as a charge against profits.

Different cases related to interest on capital

The various cases related to interest non capital are

Case 1: when partnership agreement is silent about interest on capital -not allowed

Case 2: when partnership agreement provides that interest on capital is to be allowed.

Situation 1 in case there is a loss - not provided

Situation 2 in case there are sufficient profits - fully allowed

Situation 3 if there are insufficient profits - profits are to be distributed in the ratio of capita

Case 3:when partnership agreement says interest on capital is to be provided as a charge – fully allowed

10. **Interest on partner's drawings**

Case 1 when fixed amount is withdrawn at fixed intervals

$$\text{Interest on drawings} = \text{annual drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{average period}}{12}$$

Quick view on value of time under different circumstance

	Monthly Drawing for 12 months	Quarterly drawings for 12 months	Half-yearly drawings for 12 months	Monthly drawings for 6 months
When drawing are made in the beginning of each period	6.5	7.5	9	3.5
When drawing are made in the middle of each period	6	6	6	3
When drawing are made in the end of each period	5.5	4.5	3	2.5

Case 2 when unequal amount is withdrawn at different dates
Here, interest on drawings is calculated with the help of simple method or product method.

i. **Simple method** in this method. Interest on drawings is calculated for every individual drawings considering the time for which it is used.

$$\text{Interest on drawings} = \text{amount of drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{months remaining}}{12}$$

ii. **Product method** in this method, individual drawings are multiplied by the months remaining in the year and interest for one month is calculated on total of such products.

$$\text{Interest on drawings} = \text{total of products} \times \frac{\text{Rate of interest}}{100} \times \frac{1}{12}$$

11. **Accounting treatment of interest on partner's loan** to the firm interest on partner's loan is a charge against the profits and not an appropriation out of profits and hence, must be transferred to the debit of profit and loss account and not to the debit of profit and loss appropriation account.

12. **Accounting treatment of salary or commission** to a partner salary or commission to a partner is to be salary or commission to a partner is an appropriation out of profits and not a charge against the profits, i.e., they are to be allowed only if there are profits and hence must be transferred to the debit of profit and loss appropeiation account and not to the debit of profit and loss account.
    i. Commission as percentage of net profit before charging such commission

$$= \text{net profit before commission} \times \frac{\text{Rate of commission}}{100}$$

    ii. Commission as percentage of net profit after charging such commission

$$= \text{net profit before commission} \times \frac{\text{Rate of commission}}{100 + \text{rate of commission}}$$

13. **Rent paid to a partners it is a charge against the profit** and not as appropriation out of profits. It is therefore debited to profit and loss account and credited to partners current in case of fixed capitals or to partners' capital account when capital when capitals are fluctuating.

14. **Distribution of profit among partners through Profit and loss appropriation account** profit and loss appropriation account is an extension of the profit and loss account. It is an account that is prepared to distribute the profits in accordance with the agreement among the partners. It is an account that a shows appropriation distribution of profits.

Profit and loss appropriation account

Dr. **For the year ended…**

cr.

Particulars	Amt (rs.)	Particulars	Amt (rs.)
To Interest On Capital A/Cs		By Profit And Loss A/C	….
A ….		(Net Profit Subject To	
B ….	….	Appropriations)	
To Partners' Salaries A/C	….	By Interest On Drawings A/C	
To Partners' Commission A/C	….	A ….	
To Reserve A/C	….	B ….	….
To Profit Transferred To			
**A'scapitala/C ….			
***(Or A's Current A/C)			
**B'scapitala/C ….	….		
*** (Or B's Current A/C)			
	….		….

15. **Past adjustments** if after closing the accounts of a partnership firm, some errors or omissions are discovered in the accounts e.g. Interest on capital or drawings may not have been allowed or charged, charged or allowed a higher or lower rate etc. Then under such circumstance, the accounts once closed are not reopened. Such errors and omissions are rectified by recording an adjusting entry. Such adjustments are called past adjustment as they related to past period.

    A simple format of adjustment table is given below.
    Statement showing adjusting to be made

Particulars	**X (rs.)**	**Y (rs.)**	**Total**
A. Amount already recorded (e.g.)			
Interest on capital	…	….	…
Interest on drawings	(…)	(…)	(…)
Salary/commission to partner	….	…	…
Share of profit	….	…	….
	….	….	….
B. Amounts which should have been recorded (e.g.)	….	….	….
Interest on capital	(…)	….	(…)
Interest on drawings	….	….	….
Salary/commission to partner	….	….	….
Share of profit	….	….	….
	….	….	….
Net effect (a-b)			
Journal			

Date	Particulars	Lf	Amt (dr.)	Amt(cr.)
	Gaining partners' capital a/c (who received excess) ..Dr. To sacrificing partners' capital a/c (who received short)			

16. **Guarantee of profits to a partner** a partner may be admitted into the firm with a guarantee of minimum profit. Which means that if this share of profit is less than that of guaranteed profit, then he would be paid the guaranteed share of profit. The deficiency (difference between guaranteed profit and actual profit) is borne by the firm or partner or partners who have guaranteed the profit in agreed ratio.

Different cases regarding guarantee of profits

Different cases regarding guarantee of profits are

i. Guarantee by the firm to a partner
ii. Guarantee by one partner to another partner
iii. Guarantee given by the partner to the firm
iv. Simultaneous by the firm to the partner and by partner to the firm.

Steps involved in the distribution of profits under guarantee arrangement are

The steps involved in the distribution of profits under guarantee arrangement are:

Step 1 calculate the actual share of profit/loss of guaranteed partner
Step 2 calculate the guaranteed amount
Step 3 calculate the amount of deficiency
Deficiency = guaranteed amount – actual share of profit
Step 4 distribute the deficiency among the guaranteeing partners in their guaranteeing ratio.
Step 5 distribute the actual profits/losses among all the partners in their profit sharing ratio as if there is no guarantee arrangement.
Step 6 recover share of deficiency (as per step 3) from the guaranteeing partners and give credit for the same to guaranteed partner.