Accounting for Partnership Firms — Fundamentals

* Partnership: (Indian partnership Act, 1932)
It is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

* Essentials of partnership:
- Minimum two and maximum 50 members.
- Carrying on a business (i.e. profit motive)
- Sharing of Profits
- Agreement
- Legal objects

* Partnership Deed / Agreement :
Partnership agreement is the mutual understanding on which some people decide to do a legal business to earn profits. It may be oral or written. The written are registered version of the agreement is also called partnership Deed.
It contains basically two types of matter:-

➢ 1. Management related matters — e.g. Name of the business, nature of the business, responsibilities of partners, ways of settlement of disputes etc.

2. Money related matters - e.g. capitals of partners, profit sharing ratios, interest on capital and drawings, interest on loans, remunerations to partners, method of valuation of goodwill and method of maintaining books of accounts etc.

* Provisions affecting Accounting Treatment in the **Absence** of Partnership Deed:

Sharing of Profit/loss	equal
Interest on capital	not allowed
Interest on Drawings	not charged
Any remuneration	not allowed
Interest on Loan	6% P.a.
Admission of Partner	not admitted

* Specimen of Profit and Loss Appropriation Account:

Dr. Cr.

Particulars		₹	Particulars		₹
To P&L A/c* (Net Loss)		----	By Profit&Loss A/c* (Net profit)		----
To Interest on capitals			By Interest on Drawings		
X -	----		X -	----	
Y -	----	----	Y -	----	----
To Partner's Salaries		----	By Loss transfered to:		
To Partner's Commission		----	X's capital A/c	----	
To Reserve			Y's capital A/c	----	----
To Profit transfered to:					
X's capital A/c	----				
Y's capital A/c	----	----			
		----			----

* Features of Profit and Loss Appropriation Account:

1. It is an extension of Profit and Loss A/c
2. It is prepared by partnership firms.
3. It shows the appropriation of net profit or net loss for the accounting period.
4. Entries in this account are passed giving effect to the partnership deed.

Partner's Capital Account

The partner's capital Accounts may be maintained by following methods:

1. **Fixed capital Accounts Method**

Capital Account

Credit with:
Further capital Introduced

Debit with:
Drawings against Capital

Current Account

Credit with:
Remuneration (Salary, commission)
Interest on capital
Shares of profit

Debit with:
Drawings (against profit)
Interest on Drawings
Share of loss

2. Fluctuating Capital Accounts Method

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Capital Account

Credit with	Debit with
• Further capital Introduced	• Drawings against capital
• Remuneration (Salary, commission)	• Drawings against profit
• Interest on Capital	• Interest on Drawings
• Share of Profit	• Share of loss

* Calculation of Interest on Drawings:

1. Product Method:

$$\Rightarrow \text{Total of Product} \times \frac{\text{Rate of Interest}}{100} \times \frac{1}{12} \text{ or } \frac{1}{365}$$

2. Average period Method:

$$\Rightarrow \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{\text{Average period}}{12}$$

* Calculation of opening capital

(a) When capitals are fixed:

Calculation of opening capital

	₹
Capital at the end of the year	---
Add: Withdrawal of capital	+(---)

Less: Additional capital introduced	(---)
Capital in the beginning of the year	---

(b) When capitals are fluctuating:

Calculation of Opening capital

		₹
Capital at the end of the year		---
Add: Withdrawal of capital		---
Drawings against profit		---
Interest on Drawings		---
Share of Loss for the year*		---

Less: Additional capital introduced	---	
Partner's Remuneration	---	
Interest on capital	---	
Share of Profit for the year*	---	(---)
Capital in the beginning of the year		---

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* Guarantee of Profits

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his her share in profits of the firm.

Case:1:
When Guarantee is given by firm (i.e. by all the partners of the firm).

* Share in actual profit < Guaranteed Amount
Then,
Guaranteed amount is first written off against the profits and then,
→ Remaining profits are distributed among the remaining partners in the remaining ratio.

Case:2
When Guarantee is given by a partner or partners to another partner.

1. * calculate the share in profits of the guaranteed partner (to whom guarantee is given).

2. * If Share in profit < Guaranteed amount
Then, find:

Guaranteed amount − Share in profit = ₹ x (let)

₹ x → Deficiency

Deficieny is borne (contributed) by other partners in certain ratio and is subtracted from their profit share.