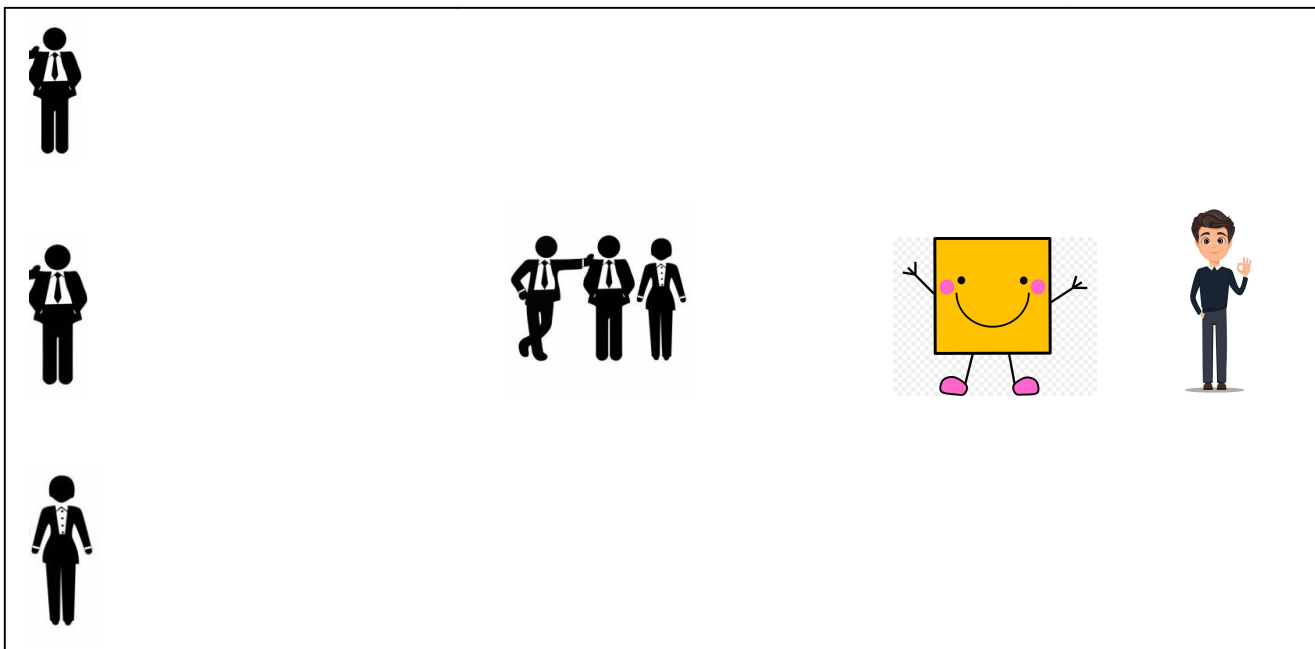




# **ACCOUNTING FOR PARTNERSHIP - FUNDAMENTALS**

## **Topic 1 – Basics of Partnership**

- Partnership refers to the relation between **two or more persons** who agree to **carry on business** and **share profits and losses**.
- From an accounting point of view, **a partnership is a separate legal entity** from its partners. (From a legal point of view, a partnership is not a separate legal entity from its partners)
- The minimum number of partners partnership = 2. Maximum number of partners in a partnership = 50.
- The partners share profits and losses of the business. (It is not essential that all partners may share losses)



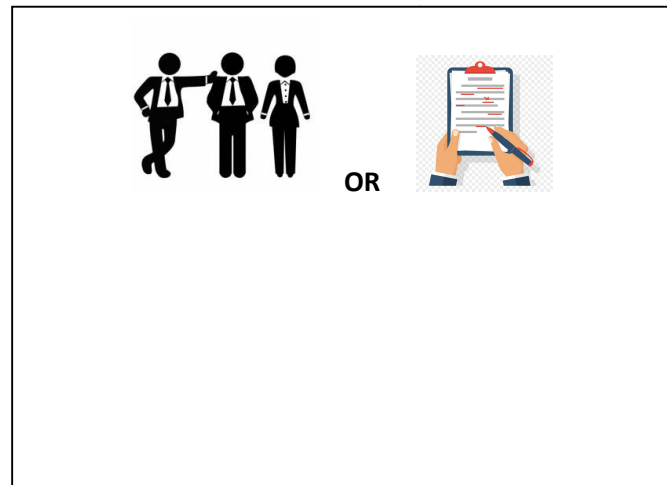
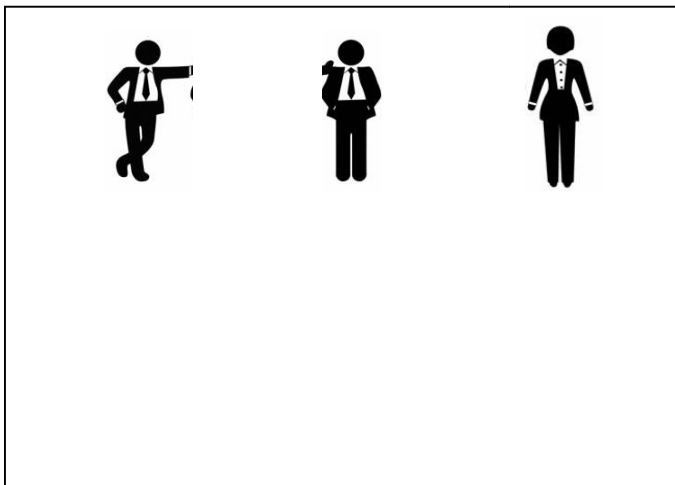
- A partnership deed is a **written agreement** that **contains the terms and conditions** of the partnership. The partnership deed contains-
  - Name of partners and firm
  - Address of partners and firm
  - Interest on capital
  - Interest on drawings
  - Profit-sharing ratio



- Salary and commission to partners
- Interest on loans, etc.

It is preferred to have a partnership deed so that there is a written contract and any disputes in the future can be settled.

- **Partners are agents as well as principles.** As an agent, the partner represents other partners. As a principal, he is bound by the acts of other partners.
- All the minor decisions (such as regular business decisions) of the partnership taken by any partner bounds the other partners. Any major decisions (such as admission or retirement or dissolution) should be taken by consent of all partners or as per partnership deed.

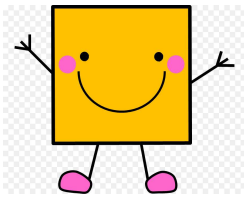


## **Topic 2 - Absence of partnership**

If there is a partnership deed, it should be followed.

In case there is **no partnership deed** or if **the partnership deed is silent**, the following provisions of the **Indian Partnership Act, 1932** apply:

<b><u>Matter</u></b>	<b><u>Solution</u></b>
Profit-sharing ratio	<b>Equal</b>
Interest on capital	<b>Zero</b>
Interest on drawings	<b>Zero</b>
Salary/Commission to partner	<b>Zero</b>
Interest on loan	<b>6% per annum</b>



### **Topic -3 Format of P/L appropriation a/c**

P/L appropriation account is an account in which the **distribution of profit or loss** takes place.

It is **prepared after Profit and loss account**.

It is a **nominal account**.

#### **P/L Appropriation A/c**

<u>Particulars</u>		<u>Amounts</u>	<u>Particulars</u>		<u>Amounts</u>
To Interest on capitals			By Net Profit	XXX	
A	XXX		(-) Interest On loan	XXX	
B	XXX	XXX	(-) Rent to partner	XXX	
To salary			(-) Managers commission	XXX	XXX
A	XXX				
B	XXX	XXX	By Interest on Drawings		
To commission			A	XXX	
A	XXX		B	XXX	XXX
B	XXX	XXX			
To Reseves		XXX			
To Divisible profit					
A	XXX				
B	XXX	XXX			
		XXX			XXX

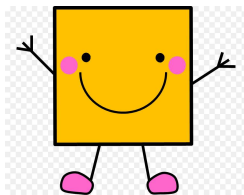


## **Topic 4 - Charge against profit v/s Appropriation of profit**

<b><u>Charge against profit</u></b>	<b><u>Appropriation of profit</u></b>
Charge against profit means those expenses which are paid <b>irrespective of the business earning profit or loss.</b>	Appropriation of profit refers to expenses that are paid <b>only when the business earns profits.</b>
Charges against profit are <b>paid even in case of losses.</b>	Appropriation of profit is paid <b>only in case of profits.</b>
Charges against profit are debited in <b>Profit and loss account.</b>	Appropriations of profit are debited in <b>Profit and Loss appropriation account.</b>
Examples - <b>interest on loan, rent paid to a partner, managers Commission,</b> etc.	Examples - <b>interest on capital, salary/ Commission paid to partner, transfer to general reserve.</b>

## **Topic 5 - Interest on Loan (IOL)**

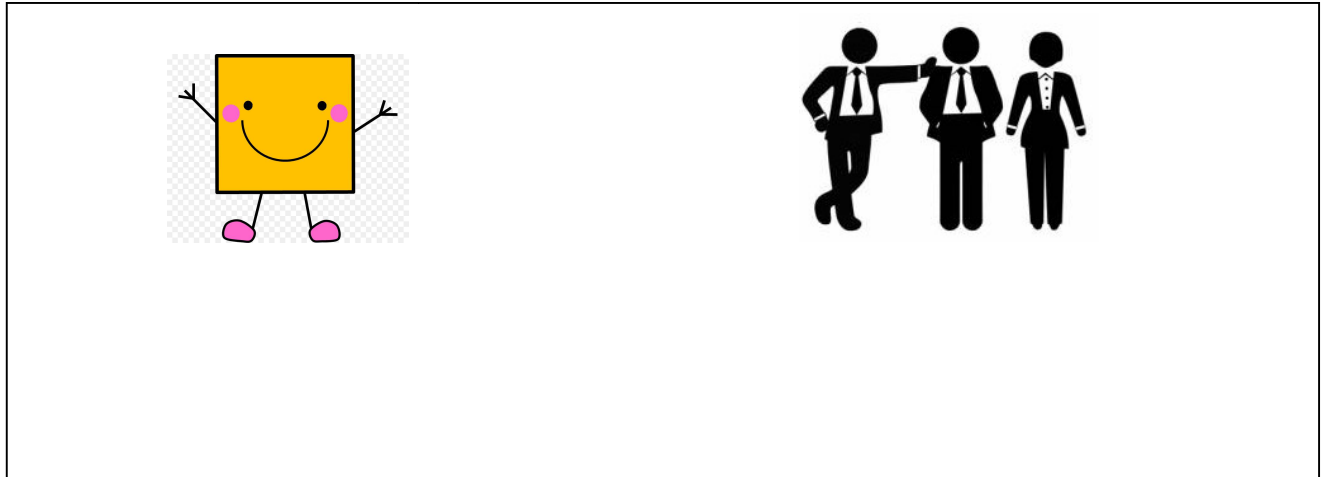
- Interest on loan refers to interest paid by the firm to partners for a loan taken by the firm.
- IOL is a **charge against profit**. It means that it has to be paid irrespective of firm earning profit or loss. It is **shown in Profit and loss a/c**.





## **Topic 6 – Interest on capital**

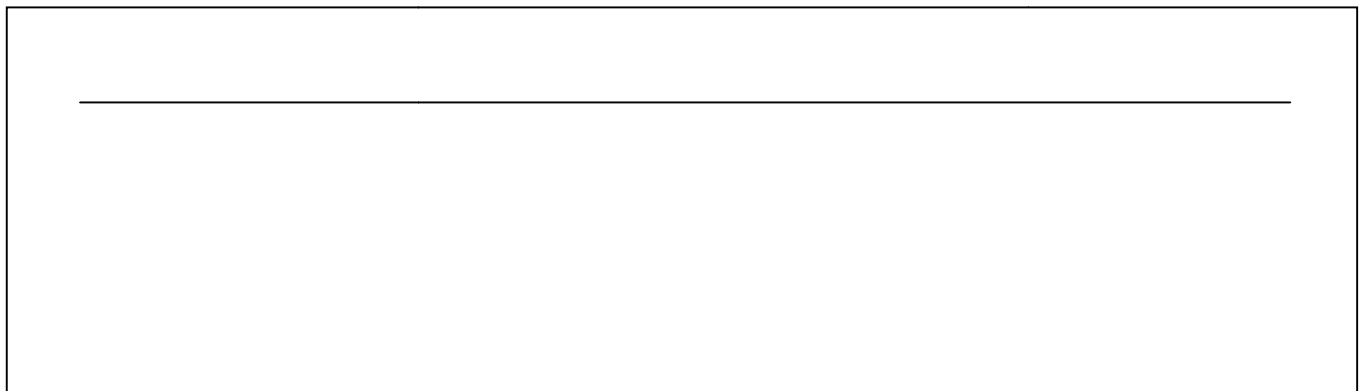
- Interest on capital refers to interest paid by the business to its partners for contributing capital in the business.
- If partnership deed does not exist it is silent, **interest on capital is not allowed.**



- Interest on capital is an **appropriation of profit**. It is allowed only when the business earns a profit.
- Interest on capital is always calculated on **opening capital**. In case if additional capital is introduced, interest is allowed on that capital for the period it remains the business.

Note –If opening is not given, it is calculated using-

**Closing capital = Opening capital + Additional capital – Drawings + Profit – Losses**





- In case, partnership deed treats interest on capital as a charge against profit, then interest on capital is allowed even if there is a loss.
- Journal entries-

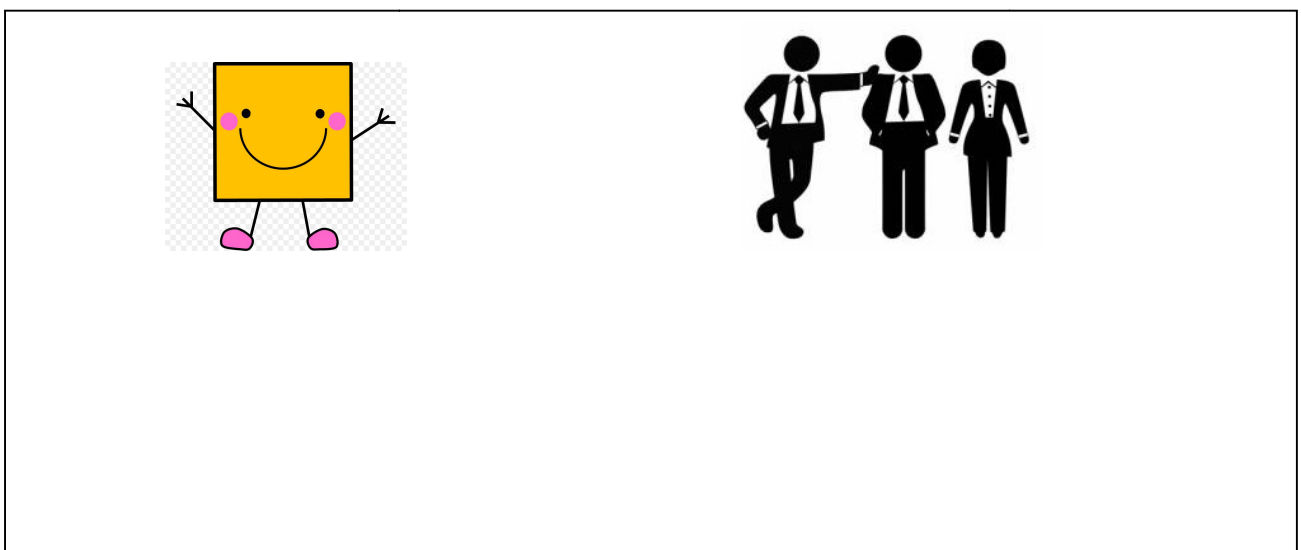
Date	Particulars	Debit	Credit
	P/L Appropriation A/c ...Dr	XXX	
	To Interest on Capital		XXX
	(Being Interest charged)		
	Interest on capital A/c ...Dr	XXX	
	To A's Cap a/c		XXX
	To B's Cap a/c		XXX
	(Being interest credited to partners)		

- Partners Capital A/c-

Partners capital A/c					
Particulars	A	B	Particulars	A	B
			By Interest On capital A/c		

## Topic 7 - Interest on Drawings

- Interest on Drawings (IOD) refers to amount paid by partners to the firm for the amount withdrawn by them.





- Interest on Drawings is **charged even if the firm incurs losses.**
- In case drawings are done multiple times with same amount and with uniform timings, then we calculate IOD using-

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate of Interest}}{100} \times \frac{\text{AVERAGE PERIOD}}{12}$$

Average period is calculated as:

$$\text{Average Period} = \frac{\text{Months after first drawings + Months after last drawing}}{2}$$

till end of the year                      till end of the year

Situations	Average Period
Drawings are at the beginning of the month	6.5
Drawings are at the end of the month	5.5
Drawings are at the middle of the month	6
Drawings are at the beginning of the quarter	7.5
Drawings are at the end of the quarter	5.5
Drawings are at the middle of the quarter	6

- Journal entries

Date	Particulars	Debit	Credit
	Interest on Drawings ...Dr	XXX	
	To P/L Appropriation A/c		XXX
	(Being Interest charged)		
	A Capital A/c ...Dr	XXX	
	B Capital A/c ...Dr	XXX	
	To Interest on Drawings A/c		XXX
	(Being interest credited to partners)		

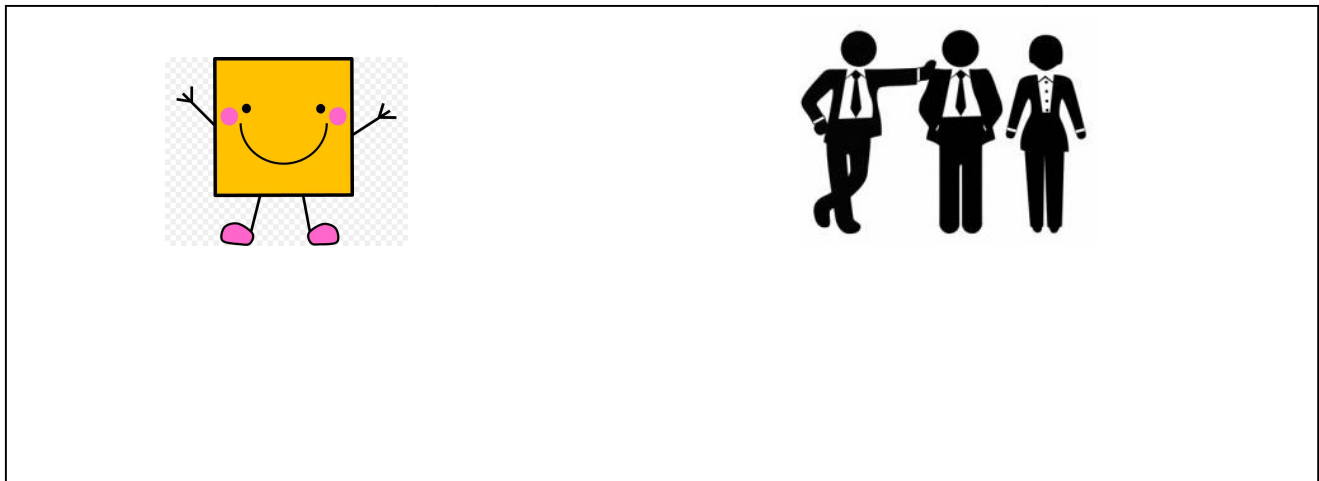
- Partners Capital A/c-

Partners Capital A/c					
Particulars	A	B	Particulars	A	B
To Interest On Drawings A/c	XXX	XXX			



## **Topic 8 - Partner salaries/Commission**

- Partner salaries refer to salaries paid by the firm to the partners. Partner commission refers to commission paid by the firm to the partners. These are appropriation of profit. It means that they are paid only when the firms has profits.



- Calculation of commission:

Commission is 10% of net profit BEFORE charging such commission = Net profit X  $\frac{10}{100}$

Commission is 10% of net profit AFTER charging such commission = Net profit X  $\frac{10}{110}$

- In case, partnership deed treats salary/commission as a charge against profit, then interest on capital is allowed even if there is a loss.





- Journal entries-

Date	Particulars	Debit	Credit
	P/L Appropriation A/c ...Dr	XXX	
	To Salaries/ Commission a/c		XXX
	(Being Interest charged)		
	Salaries/ Commission a/c ...Dr	XXX	
	To A's Cap a/c		XXX
	To B's Cap a/c		XXX
	(Being interest credited to partners)		

- Partners Capital A/c-

Partners capital A/c					
Particulars	A	B	Particulars	A	B
			By Salaries/ Commission a/c	XXX	XXX

## **Topic 9 - Maintenance of capital accounts**

Capital Accounts can be maintained using **two** methods:

1. **Fluctuating Capital account method** – In this method, only one account is prepared i.e. capital a/c. All the transactions are entered into one a/c only.

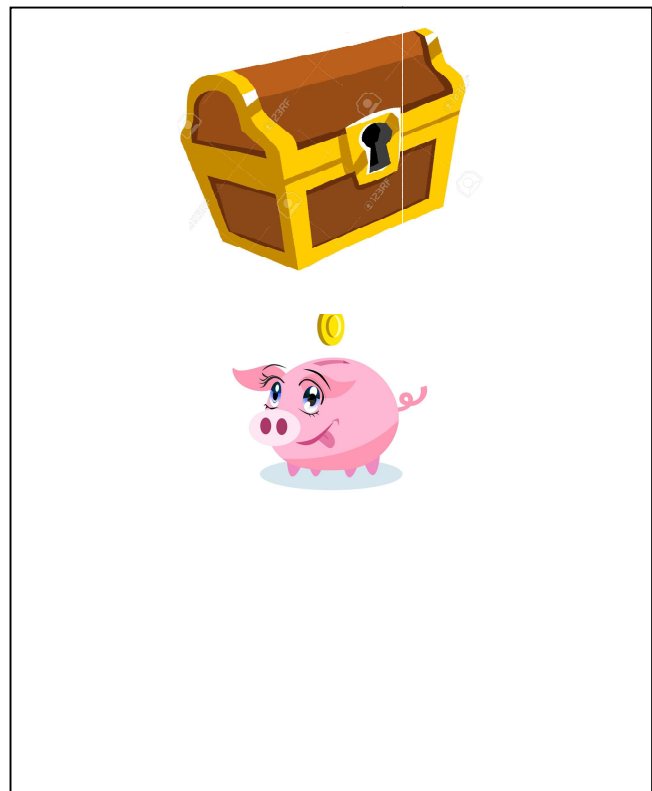
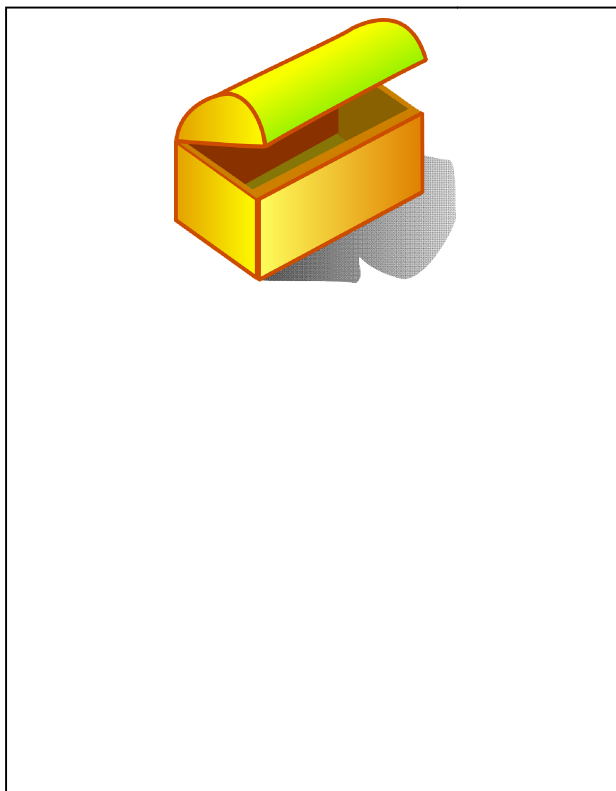
Partners capital A/c					
Particulars	A	B	Particulars	A	B
To Drawings a/c	XXX	XXX	By balance b/d	XXX	XXX
To Interest on drawings a/c	XXX	XXX	By Cash a/c (additional capital)	XXX	XXX
To P/L appropriation a/c (Loss)	XXX	XXX	By Interest on capital a/c	XXX	XXX
			By Salaries/ Commission a/c	XXX	XXX
			By P/L appropriation a/c (Profit)	XXX	XXX
To balance c/d	XXX	XXX			
	XXX	XXX		XXX	XXX



2. **Fixed Capital account method** – In this method, two accounts are maintained i.e. Capital a/c and current a/c.

Partners capital A/c					
Particulars	A	B	Particulars	A	B
To Cash a/c (Permanent drawin	XXX	XXX	By balance b/d	XXX	XXX
			By Cash a/c (additional capital)	XXX	XXX
To balance c/d	XXX	XXX			
	XXX	XXX		XXX	XXX

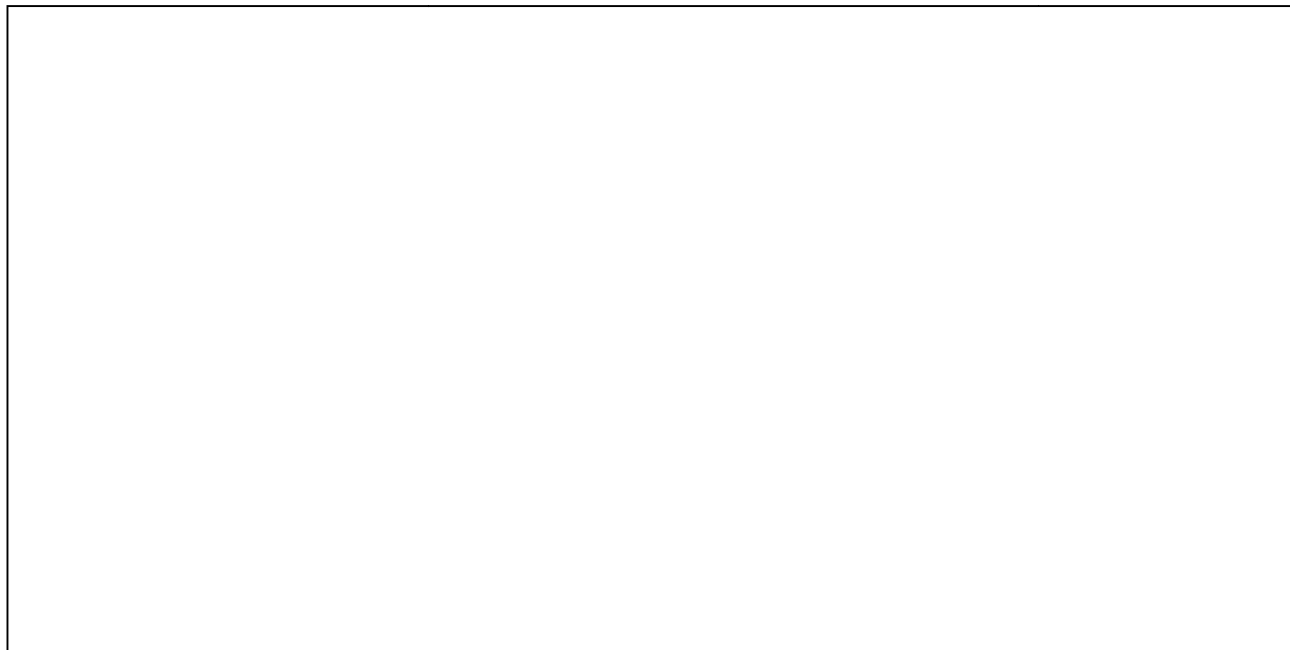
Partners Current A/c					
Particulars	A	B	Particulars	A	B
To Drawings a/c	XXX	XXX	By balance b/d	XXX	XXX
To Interest on drawngs a/c	XXX	XXX	By Interest on capital a/c	XXX	XXX
To P/L appropriation a/c (Loss)	XXX	XXX	By Salaries/Commission a/c	XXX	XXX
			By P/L appropriation a/c (Profit)	XXX	XXX
To balance c/d	XXX	XXX			
	XXX	XXX		XXX	XXX





## **Topic 10 - When appropriations are more than profits**

In case appropriations are more than profits, then profits are distributed in proportion of appropriations.





## **Topic 11 - Past adjustments**

Whenever there are past errors or omissions, we prepare Past adjustment table to rectify those and pass a single journal entry.

Partiulars	Firm		A		B		C	
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
IOC given								
IOD taken								
Profit (Balancing fig.)								
Total								



## **Topic 12 - Guarantee of profit**

Whenever a partner is guaranteed a profit, it means that he will be given that a minimum of that profit irrespective of amounts of profits earned.

A guarantee can be given by:

- All the remaining partners/By the firm
- By some partners in specific ratio
- By a particular partner

*Note:* In guarantee of profit, prepare P/L appropriation a/c normally and adjust guarantee in the end.

