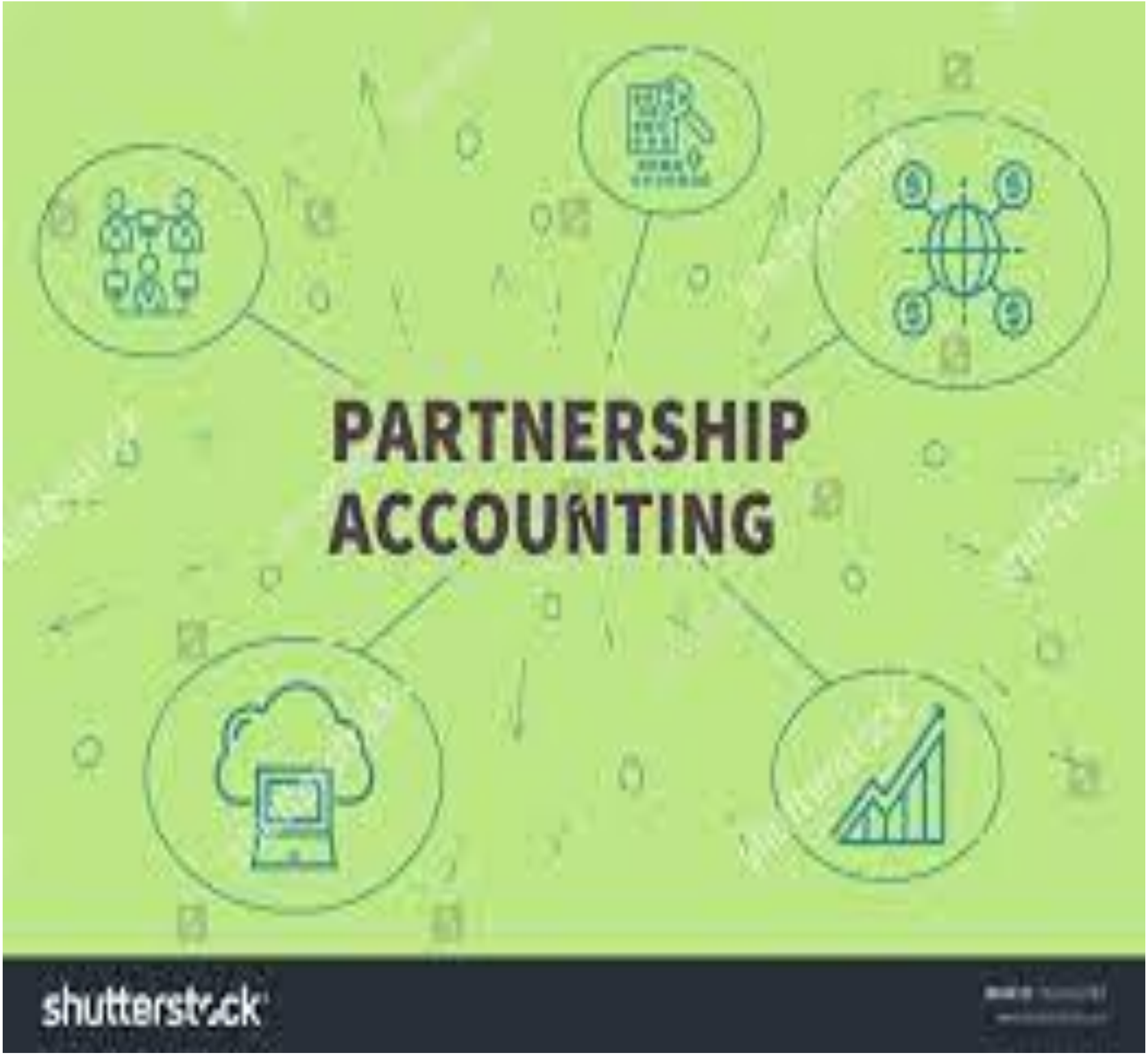
PARTNERSHIP ACCOUNTS



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PARTNERSHIP ACCOUNTING

Partnership Accounting is one of the foremost topics as far as Accountancy exam preparations are concerned. For practical knowledge as well, Partnership Accounting is considered as a significant part of the syllabus for Accounting aspirants. In the following article, we shall discuss Partnership Accounting in detail with respect to the basic concepts, important terminologies, accounting rules, etc. for Accountancy preparations.

To begin with, Partnership is one of the forms of business organization alongside sole proprietorship and joint stock company. Partnership is based on mutual agreement and in such a form of business, the individuals agree to share the capital, profits, and losses of the business. Such individuals agreeing to enter into the partnership form of business are known as partners.

Partnership form of business is governed by the Indian Partnership Act of 1932. As per the Section 4 of the Act, Partnership is defined as "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."

Features of Partnership

Knowing the basic features of partnership is very important for accounting aspirants. The following features describe the partnership form of business:

- It is an association of two or more individuals
- A partnership is established through an agreement between the individuals
- Partners must share the profits and losses of the business among themselves
- The business should be conducted as per the law in order to earn profits
- Partnership business can be carried by all or any one of the partners on behalf of all.

Important Provisions under the Indian Partnership Act of 1932

Section	Description
Section 30	A minor may be admitted for the benefit of partnership if all the partners agree

Section 31	A person may be admitted as a partner either with the consent of all the existing partners or in accordance with an express agreement among the partners
Section 32	A partner may retire from the firm either with the consent of all the other partners or in accordance with an express agreement among the partners
Section 35	Unless otherwise agreed by the partners in the Partnership Deed, a firm is dissolved on the death of a partner
Section 69	Registration of the firm is option and not compulsory

Partnership Deed

A partnership deed is an agreement between the partners of a firm. The deed enlists the terms and conditions of the partnership among the partners involved. These terms are also called the "Articles of Partnership".

The partnership deed outlines various terms and detailed information regarding the profit/ loss ratio, salary, drawings, admission of a new partner, interest on capital, and so on. A partnership deed must cover the following points:

- Name and address of the firm as well as that of the partners
- Nature and place of the business
- Interest on capital
- Duration of the partnership
- Profit sharing ratio
- Interest on loan
- Capital contribution by each partner
- Partner's salary/ commission, etc.
- Rights and duties of the partners
- Drawings and interest on drawings

- Method of goodwill and assets valuation

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Benefits of the Partnership Deed

- Regulates the rights, liabilities, and duties of each partner
- Helps avoid any misunderstandings among the partners due to the terms and conditions of the business
- Enables easy and quick settlement of disputes among partners

Therefore, it is always recommendable for the partners to have a written agreement in the form of a partnership deed, duly signed and registered under the Partnership Act.

Important Guidelines in the absence of the Partnership Deed

Following are the important guidelines or rules to be followed by the partners in case there is no partnership deed prepared by the partners.

- Profit-sharing Ratio: Equal, irrespective of the partners' capital contribution
- Interest on Capital: No interest on capital to be allowed to any partner
- Interest on Drawings: No interest on drawings to be charged on any partner
- Partners' Salary/ Commission: Not allowed to any Partner
- Interest on loan by a Partner: Interest to be allowed at 6% per annum

Profit and Loss Appropriation Account

All the transactions of the partnership firm are mandatorily recorded as per the double-entry system of book-keeping. That means, a partnership firm shall prepare a Trading Account, Profit & Loss Account, and a Balance Sheet at the end of each accounting year.

Additionally, a Profit and Loss Appropriation Account is also prepared in Partnership Accounting so as to show the distribution of the profits among the partners. This is done as per the provision of the Partnership Deed. The Profit and Loss Appropriation Account is nothing but an extension of the Profit and Loss Account. Hence, it is also a type of nominal account.

The Profit and Loss Appropriation Account is used to record entries for interest on capital, interest on drawings, salary/ commission of the partner, and division of profits among the partners.

Journal Entries for Profit & Loss Appropriation Account

In this section, let us have a quick look to understand how the journal entries are recorded in the profit and loss appropriation account for a partnership firm.

Sr. No.	Transaction	Entry

No.		
1.	For transfer of balance of Profit & Loss Account	Profit and Loss A/c Dr. To Profit and Loss Appropriation A/c
2.	To charge Interest on Capital	Interest on Capital A/c Dr. To Partner's Capital/ Current A/cs (Being interest on capital allowed @ % p.a.)
3.	For transferring Interest on Capital to Profit & Loss Appropriation A/c.	Profit and Loss Appropriation A/c Dr. To Interest on Capital A/c. (Being interest on capital transferred to Profit & Loss Appropriation A/c)
4.	For Salary or Commission payable to a partner	i. For allowing Salary or Commission to a partner: Partners Salary/ Commission A/c Dr. To Partner's Capital/ Current A/cs (Being salary/ commission payable to a partner) ii. For transferring Partner's Salary/ Commission A/c to Profit and Loss Appropriation Account Profit and Loss Appropriation A/c Dr.

		Dr. To Partner’s Salary/Commission A/c (Being partners’ salary/ commission transferred to P&L Appropriation Account)
5.	For transfer of Reserves	Profit and Loss Appropriation A/c Dr. To Reserve A/c (Being reserve created)
6.	For Interest on Drawings:	i. For charging interest on a partner’s drawings: Partner’s Capital/Current A/c. Dr. To Interest on Drawings A/c (Being interested in drawings charged @ % p.a.) ii. For transferring interest on drawings to Profit and Loss Appropriation A/c Interest on Drawings A/c Dr. To Profit and Loss Appropriation A/c (Being interest on drawings transferred to P&L appropriation A/c)

7.	For transfer to Profit (i.e. Credit Balance of Profit and Loss Appropriation Account	Profit and Loss Appropriation A/c Dr. To Partners' Capital/Current A/cs (Being profits distributed among partners)

Specimen of Profit & Loss Appropriation Account

Profit & Loss Appropriation Account

For the year ended...

Dr.

Cr.

Particulars	Amt. (INR)	Particulars	Amt. (INR)
To Profit & Loss A/c (Net loss transferred from Profit & Loss Account)	...	By Profit & Loss A/c (Net Profit transferred from Profit & Loss Account)	... ...
To Interest on Capitals A ... B ...	... ...	By Interest on Drawings: A ... B ...	

To Partners' Salaries To Partners' Commission To Reserves To Profit transferred to: A's Capital A/c … B's Capital A/c …			
Total	…	Total	…

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Limited Liability Partnership (LLP)

A Limited Liability Partnership (LLP) is a corporate business system that drives professional expertise and entrepreneurial initiative together to operate in a flexible, efficient, and innovative way. It provides the benefits of a limited liability while allowing the members the flexibility of organizing their internal structure as a partnership firm.

Features of LLP

Feature	Meaning
Separate legal entity	An LLP is considered as a separate legal entity and hence the LLP and its partners are different from each other.
Minimum Capital	The minimum capital of a Limited Liability Partnership is not specified and hence it is up to the partners of the LLP to decide the amount of capital to be contributed by each of them.
Minimum Number of Members	An LLP is required to have a minimum of 2 members.
Audit is not mandatory	The audit of an LLP is not mandatory if the contributions exceed INR 25 lakhs or the annual turnover of the LLP is more than INR 40 lakhs.

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How to Calculate Interest on Drawings?

The methods of calculating interest on drawings are divided into Product Method and Average Period Method. The Product Method is further divided into Simple Method and Product Method.

Let's see the methods of calculating interest on drawings in detail in the below section:

1. **Product Method:** It is used when drawings of the same amount or different amounts are withdrawn at irregular intervals.**a. Simple Method:** In this, interest is calculated on each single drawing amount. For that, the period for which the amount has been utilized is taken into accountb. **Product Method:** The amount of drawings is multiplied with the number of months or days it has been in use. The product obtained is totalled and the interest is calculated thereon for one month (when the period is considered in months) or for 1 day (when the period is considered in days). The formula to calculate as per product method is:*Interest = [Total of product x (Rate of Interest / 100) x (1/12], in case the period is in*

months.

Interest = [Total of product x Rate of Interest /100) x (1/365)] if the period is in days.

- **Average Method: Interest on drawings is calculated using this method when:**

1. There are regular drawings or
2. The amount of drawings as well as the time interval between the two drawings is uniform. The formula used is:*Interest = [Total drawings x (Rate of Interest /100) x*

(Average Period/ 12)], where

Average Period = (Months left after first drawings + Months left after last drawings) / 2

How to Calculate Interest on Opening Capital?

- In case the partner has not withdrawn capital or has not introduced any additional capital during the year, the *closing balance of the Capital Account* of the previous year becomes the *opening balance in the Capital*

Account.

- Interest on capital is allowed on the Opening Capital of the partner
- If the opening balance of the capital is not given, then it can be determined by preparing Capital Accounts or through the following information:

In case of Fixed Capital:

Calculation of Opening Capital	
Capital at the end of the year Add: Capital withdrawn	… …
Less: Additional capital introduced during the year	… …
Capital in the beginning of the year	…

In case of Fluctuating Capital:

Calculation of Opening Capital	
Capital at the end of the year	…
Add:	
Drawings against capital	…
Drawings against profit	…
Interest on drawings	…
Share of Loss for the year	…
Less:	
Additional capital introduced during the year	…
Partners' salary/ remuneration	…
Interest on capital	…
Share of profit for the year	…
Capital at the beginning of the year	…