

ACCOUNTING FOR PARTNERSHIP FIRMS

- When two or more persons join hands to set up a business and share its profits and losses, are said to be a partnership.

★ FEATURES

- 1) Two or more persons : There must be at least two persons to form a partnership.
But section 464 of Indian Companies Act 2013, restricts the maximum numbers of partners to 50.
- 2) Agreement : Partnership is the result of an agreement between two or more persons to do business. Partnership agreement can be either oral or written. But, to avoid disputes, it is preferred written document. The partnership agreement is writing, the document which contains terms of the agreement called Partnership Deed.
- 3) Existence of Business : Partnership can be formed for the purpose of carry on some business with intention of earning profits. Co-ownership of a property does not amount of partnership.
- 4) Sharing of profit : The agreement between partners must be to ~~share~~ aimed at sharing the profits and losses of a business. If some persons joins hands for the purpose of some charitable activity, it will not be termed as partnership.

5) Relationship of Principal and Agent: Each partner is an agent and principal of firm. An agent, because he can bind the other partners by his acts and a principal, because he himself can be bound by the acts of other partners.

6) Business carried on by all or any of them acting for all

7) A partnership firm has no separate existence between partners and firm.

* Limited Liability Partnership (LLP)

→ The LLP in India came into existence with the enactment of 'LLP Act 2008' which lay down the law for the formation and regulation of Limited Liability Partnerships.

→ It means where each partner has limited personal liability for debt or claims. Partners of a LLP are not held responsible for the acts of other partners.

→ Indian ~~Parliament~~ Partnership Act 1932 shall not be apply to a LLP.

* PARTNERSHIP DEED

→ A written document which contains the terms and conditions of agreements is called partnership deed.

→ It is also called Articles of Partnership.

- The partnership deed should contain the following points:
- (i) The name and address of the firm and partners.
 - (ii) The type and nature of the business the firm proposes to do.
 - (iii) Amount of capital to be contributed by each partner, interest on capital and drawing.
 - (iv) Profit sharing ratio and salary paid for work.
 - (v) Duration of partnership.
 - (vi) Rules to be followed in case of admission of a partner.

→ Importance of Partnership Deed:

- (i) It regulates the rights, duties and liabilities of partner.
- (ii) It helps to avoid any misunderstanding amongst the partners.
- (iii) Any disputes amongst the partners may be settled easily.

→ Rules Applicable in the absence of Partnership Deed:

- (i) Profit and losses are to be shared equally.
- (ii) No interest on capitals.
- (iii) No interest is to be charged on drawings.
- (iv) No partner is entitled to any salary or commission.
- (v) Interest on loan @ 6% per annum is to be allowed.
- (vi) Without the consent (permission) of all existing partners no new partners can be admitted.
- (vii) Each partner can participate in business.
- (viii) Each partner can inspect the books of firm and can take a copy of the same.

★ RECORDING OF PARTNERSHIP TRANSACTIONS

→ In partnership firm the profits of the partnership firm are divided among partners. Usually, for this purpose a newly-opened account, named PROFIT and LOSS APPROPRIATION ACCOUNT.

→ P&L Appropriation A/c follow the nature of Nominal A/c.

PROFIT AND LOSS APPROPRIATION A/C
for the year ended _____

Dr.

Particulars (भित्त)	₹	Particulars (भित्त)	₹
To P&L A/c (Net loss)	xxx	By P&L A/c (Net profit)	xxx
To interest on capital A _____ B _____	xxx	By interest on drawing A _____ B _____	xxx
To salary (partner)	xxx		
To commission (partner)	xxx		
To Reserve (Saving)	xxx		
To PROFIT transferred to partner's capital/current A/c	xxx		
	xxx		xxx

• The journal entries of items shown in P&L Appropriation

① P&L A/c Dr.
To P&L Appro. A/c

② Interest on drawing A/c Dr.
To P&L Appro. A/c

③ P&L Appro. A/c Dr.
To P&L A/c

(N) P & L Appro. A/c Dr.
To interest on capital

P & L Appro. A/c Dr.
To salary

P & L Appro. A/c Dr.
To commission

P & L Appro. A/c Dr.
To reserve

P & L Appro. A/c Dr.
To PROFIT transferred to partner's
capital / current A/c

BASIS	PROFIT AND LOSS ACCOUNT	PROFIT AND LOSS APPROPRIATION ACCOUNT
Stage of preparation	It is prepared after Trading A/c hence starts with gross profit	It is prepared after P & L A/c, hence starts with net profit.
Objective	It's prepared to find net profit or net loss.	It is prepared to distribute profit of the year among partners.
Open/Closing Balance	Account has neither opening nor closing balance.	Account may have opening as well as closing balance.
Charge or Appropriation	Expense Dr. are charge against profits	Expense Dr. are appropriation of profit
Matching principle	Matching principle is followed.	Matching principle is not followed.

* CAPITAL ACCOUNTS OF PARTNERS

- 1) Fixed capital account → Capital A/c
- 2) Fluctuating capital account → Current A/c

Dr. CAPITAL A/C (when capital are fixed)

Particulars	A	B	C	Particulars	A	B	C
To cash/bank A/C	-	-	-	By bal. b/d	-	-	-
(drawing against profit/ permanent withdrawal of capital)				(opening balance)			
To bal. c/d	-	-	-	By cash/bank A/C	-	-	-
(closing balance)				(additional capital)			
	-	-	-				

Firm को
बताना है।

↓ Liability A/C ↑

Dr. — CURRENT A/C (when capital are fixed)

Particulars	A	B	C	Particulars	A	B	C
To bal. b/d	-	-	-	By bal. b/d	-	-	-
(debit opening balance)				(credit opening balance)			
To drawing	-	-	-	By interest on capital	-	-	-
(drawing against profit)				By commission	-	-	-
To interest on drawing	-	-	-	By salary	-	-	-
To P&L A/C	-	-	-	By P&L Appro. A/C	-	-	-
(loss)				(profit)			
To bal. c/d	-	-	-				

Ques. - CAPITAL A/C (when capitals are fluctuating + Cr.)

Particulars	A	B	C	Particulars	A	B	C
To bal. b/d (debit opening balance)	-	-	-	By bal b/d (credit opening balance)	-	-	-
To cash/bank A/C (drawing against capital)	-	-	-	By cash/bank A/C (additional capital)	-	-	-
To drawing (drawing against profit)	-	-	-	By interest on capital	-	-	-
To interest on drawing	-	-	-	By commission	-	-	-
To P&L A/C (Loss)	-	-	-	By salary	-	-	-
To bal. c/d	-	-	-	By P&L Apprs. A/C (Profit)	-	-	-
	-	-	-		-	-	-

★ Distinction between Fixed Capital and Fluctuating Capital A/C

BASIS	FIXED CAPITAL ACCOUNT	FLUCTUATING CAPITAL ACCOUNT
No. of Accounts	Two accounts are made for each partner - fixed capital A/C and current A/C	Only one A/C is prepared for each partner → capital A/C.
Change in capital	Balance remains unchanged, capital are fixed. Except when further capital is introduced or withdrawal.	Balance changes with every transaction of partner with the firm.
Transferring of transactions	Transactions relating capital transferred to fixed capital A/C and other transactions in current A/C	All transactions whether capital, drawing, salary, commission, etc are recorded in capital A/C.

Balance	Capital A/c has credit balance.	Fluctuating has both credit and debit balance.
Can A/c shows -ve balance	Fixed capital A/c can never show negative balance.	Fluctuating capital A/c can show a negative balance.

Ques - Mr X introduced capital of 1,00,000 on 1st April 2020. On 1st July he introduced additional capital ₹20,000. On 30 Nov he withdrawal ₹40,000 from capital. Calculate interest on capital @ 12% p.a. for the year ended 31st March.

Ans -

1 April 20	1 July (+20000)	30 Nov (-40000)
100000	120000	80000
3M	5M	4M

$$\begin{aligned}
 & \frac{100000 \times 12}{100} \times \frac{3}{12} + \frac{120000 \times 12}{100} \times \frac{5}{12} + \frac{80000 \times 12}{100} \times \frac{4}{12} \\
 &= 3000 + 6000 + 3200 \\
 &= \boxed{12,200}
 \end{aligned}$$

* Sometimes questions 'doesn't provide OPENING CAPITAL' then first we have to calculate it and then proceed in normal manner.

→ In case of fixed capital (Dr +) then (Cr -)

Opening capital = withdrawal cap. + closing cap. - additions

→ In case of fluctuating capital

Opening capital = withdrawal + drawing + interest on drawing + share of loss + closing cap. - additions - salary / commission - interest on capital - share of profit

Journal Entries (Fluctuating Capital)

- | | |
|--|---|
| 1> For introduction of capital | Debit A/C Dr.
To partners capital |
| 2> For charging interest on capital | Interest on capital A/C Dr.
To partners capital A/C |
| 3> For interest on capital / salary / commission | Interest on Cap. / S / Com A/C Dr.
To partners capital |
| 4> For transfer of capital / salary / commission | P & L App. A/C Dr.
To Int on capital / Sal. / Com. |
| 5> For charging drawing interest. | Partners capital A/C Dr.
To Int. on capital. |
| 6> Transfer of interest on drawing on Cr. side of App. | Interest on drawing A/C Dr.
To P & L App. A/C |
| 7> Entry for drawing | Partners capital Dr.
To drawing |
| 8> For distribution of profit | P & L App. A/C Dr.
To partners capital |
| 9> For distribution of loss. | Partners capital Dr.
To P & L App. A/C |

Ques - X and Y are 3:2 partners. Find interest on capital @ 12% p.a.

	X	Y
Closing capital (31 march 2021)	5,00,000	7,00,000
Withdrawal capital (1 Dec 2020)	60,000	80,000
Additional capital (30 June 2020)	40,000	60,000
drawing (1 May 2020)	20,000	30,000

Profits for the year was ₹ 50,000

① Assume Fixed Capital.

② Assume Fluctuating Capital.

Ans - ① Case 1

Opening capital $X+Y = \text{closing} + \text{withdrawal} - \text{additional} - \text{profit capital}$

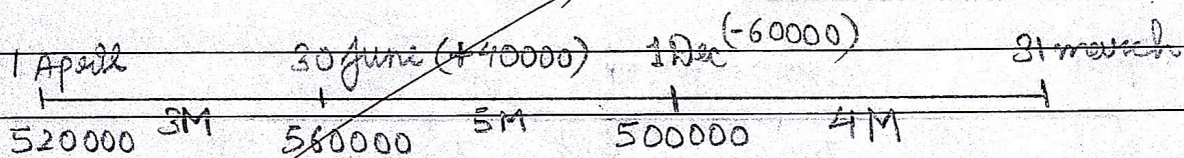
$$X = 5,00,000 + 60,000 - 40,000$$

$$= 5,60,000 - 40,000 = \boxed{5,20,000}$$

$$Y = 7,00,000 + 80,000 - 60,000$$

$$= 7,80,000 - 60,000 = \boxed{7,20,000}$$

For X

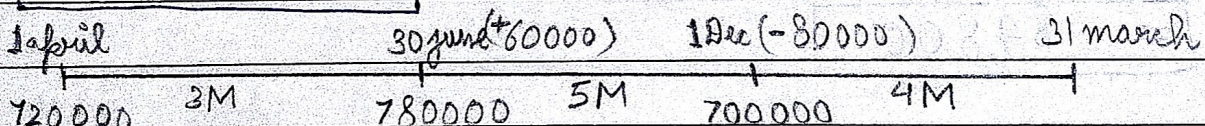


$$5,20,000 \times \frac{12}{100} \times \frac{3}{12} + 5,60,000 \times \frac{12}{100} \times \frac{5}{12} + 5,00,000 \times \frac{12}{100} \times \frac{4}{12}$$

$$= 15,600 + 28,000 + 20,000$$

$$= \boxed{63,600}$$

For Y



$$7,20,000 \times \frac{12}{100} \times \frac{3}{12} + 7,80,000 \times \frac{12}{100} \times \frac{5}{12} + 7,00,000 \times \frac{12}{100} \times \frac{4}{12}$$

$$= 21,600 + 39,000 + 28,000$$

$$= \boxed{88,600}$$

⑪ Case 2

Opening Capital = closing + withdrawal + drawing - additions
- profit (3:2)

$$X = 500000 + 60000 + 20000 - 40000 - 30000$$

$$\# \quad \cancel{+ 300000} - 70000 = 580000 - 70000$$

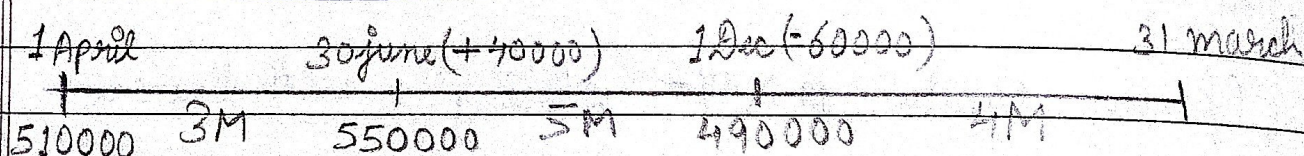
$$\# \quad \cancel{30000} \quad \boxed{= 5,10,000}$$

$$Y = 700000 + 80000 + 30000 - 60000 - 20000$$

$$= 810000 - 80000$$

$$\boxed{= 7,30,000}$$

For X

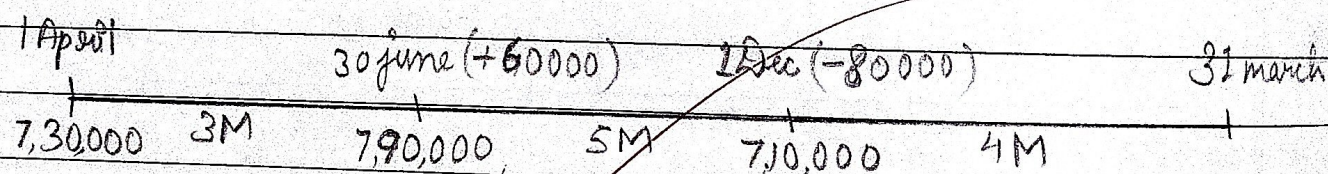


$$= 510000 \times \frac{12}{100} \times \frac{3}{12} + 550000 \times \frac{12}{100} \times \frac{5}{12} + 490000 \times \frac{12}{100} \times \frac{4}{12}$$

$$= 15300 + 27500 + 19600$$

$$\boxed{= 62400}$$

For Y



$$= 730000 \times \frac{12}{100} \times \frac{3}{12} + 790000 \times \frac{12}{100} \times \frac{5}{12} + 710000 \times \frac{12}{100} \times \frac{4}{12}$$

$$= 21,900 + 39,500 + 28,400$$

$$\boxed{= 89,800}$$

Interest on Drawing

Date 12-04-20

- ① Mr. A withdrew ₹10,000, @ rate of drawing is 10% p.a.

Ans - When date is not given interest on drawing is calculated for 6 months

$$IOD = 10000 \times \frac{10}{100} \times \frac{6}{12} = 500$$

- ② Mr. A withdrew ₹10000 on 1st Oct 20, interest on drawing is 10%.

Ans - $IOD = 10000 \times \frac{10}{100} = 1000$

- ③ Mr. A withdrew ₹10000 on 1st July, interest on drawing is 10% p.a.

Ans - $IOD = 10000 \times \frac{10}{100} \times \frac{3}{12} = 750$

- ④ When particular amount is withdrawn on monthly basis.

Ans - ① Mr. A withdrew ₹2000 per month. Calculate IOD @ 12% p.a.

- a) when amount is withdrawn in beginning of each month
b) when amount is withdrawn at the end of each month

Ans - a) Total drawing = $2000 \times 12 = 24000$
Period = $\frac{12+1}{2} = \frac{13}{2} = 6.5 \left(6\frac{1}{2}\right)$

$$IOD = 24000 \times \frac{12}{100} \times \frac{6.5}{12}$$

$$= 24000 \times \frac{12}{100} \times \frac{13}{2} \times \frac{1}{12} = 120 \times 13$$

$$= 1560$$

$$b) \text{ Total drawing} = 2000 \times 12 = 24000$$

$$\text{Period} = \frac{12-1}{2} = \frac{11}{2} = 5.5$$

$$IOD = \frac{24000}{100} \times \frac{12}{100} \times \frac{11}{2} \times \frac{1}{12} = 120 \times 11$$

$$\boxed{= 1320}$$

⑤ When particular amount is withdrawn on quarterly basis.

Mr A withdrew ₹ 2000 quarterly. Calculate IOD @ 12% p.a.

a) when amount is withdrawn in the beginning of each quarter

b) when amount is withdrawn ~~in~~ at the end of each month

Ans a) $\text{Total drawing} = 2000 \times 4 = 8000$

$$\text{Period} = \frac{12+3}{2} = \frac{15}{2} = 7.5$$

$$IOD = \frac{8000}{100} \times \frac{12}{100} \times \frac{15}{2} \times \frac{1}{12} \quad \boxed{= 600}$$

b) $\text{Total drawing} = 2000 \times 4 = 8000$

$$\text{Period} = \frac{12-3}{2} = \frac{9}{2} = 4.5$$

$$IOD = \frac{8000}{100} \times \frac{12}{100} \times \frac{9}{2} \times \frac{1}{12} = 40 \times 9$$

$$\boxed{= 360}$$

⑥ When particular amount is withdrawn on half yearly basis,

when Mr. A withdrew the amount ^{₹2000} on half-yearly basis. Calculate IOD @ 12% p.a.

Appropriation of profit → distribution

- a) At the beginning of each 6 months
b) At the ending of each 6 months

$$\text{a) Total drawing} = \cancel{2000} \times 2000 \times 2$$
$$\text{Period} = \frac{12+6}{2} = \frac{18}{2} = 9$$

$$\text{IOD} = 4000 \times \frac{12}{100} \times \frac{9}{12} = 360$$

$$\text{b) Total drawing} = 2000 \times 2$$
$$\text{Period} = \frac{12-6}{2} = \frac{6}{2} = 3$$

$$\text{IOD} = 4000 \times \frac{12}{100} \times \frac{6}{12} = 180$$
$$= 120$$

- ⑦ When particular amount is withdrawn in the middle of each month / quarter / ~~year~~ half-year. In all above cases interest on drawing will be calculated for 6 months.

* Manager's Commission

- a) On profit before charging such commission.

$$\text{Manager's Commission} = \frac{\text{profit} \times \text{rate of commission}}{100}$$

- b) On profit after charging such commission.

$$\text{Commission} = \frac{\text{profit} \times \text{rate of commission (ROC)}}{100 + \text{ROC}}$$

RESERVES (Saving)

↓
% of Net Profit

↓
% of divisible profits

- * Create reserves @ 10% of Net Profit.
P & L A/C

Particulars	₹	Particulars	₹
To IOC	10,000	By P & L A/C	1,00,000
To salary	20,000		NP ↑
To reserve	10,000		
To profit	60,000		
	1,00,000		1,00,000

- * Create reserves @ 10% of divisible profits
P & L Appropriation A/C

Particulars.	₹	Particulars	₹
To IOC	10,000	By P & L A/C	1,00,000
To salary	20,000	= 1,00,000 - 30,000	
To reserve	7,000	= 70,000 / 10%	
To profit	63,000	divisible profit	
	1,00,000		1,00,000

* Methods of calculating Interest on Drawings:

1) Simple method

$$IOD = \text{Amount of Drawings} \times \frac{\text{Rate}}{100} \times \frac{\text{Months}}{12}$$

2) Product method

$$IOD = \text{Total of product} \times \frac{\text{Rate}}{100} \times \frac{1}{12}$$

Illustration 23. (Pg-240)

①

SIMPLE METHOD

Date	Amount	Period (months)	Interest @ 9%
May 1	20000	11	1,650
July 31	10000	8	600
September 30	30000	6	1,350
November 30	40000	4	1,200
January 1	20000	3	450
March 31	25000	0	0
	1,45,000		5,250

PRODUCT METHOD

Date	Amount (₹)	Period (months)	Product
May 1	20000	11	2,20,000
July 31	10000	8	80,000
Sep 30	30000	6	1,80,000
Nov 30	40000	4	1,60,000
Jan 1	20000	3	60,000
March 31	25000	0	0
	1,45,000		7,00,000

$$\begin{aligned}
 \text{IOD} &= \text{Total Product} \times \frac{R}{100} \times \frac{1}{12} \\
 &= 1750 \times \frac{93}{100} \times \frac{1}{12} \\
 &= 1750 \times 3 \\
 &= \boxed{5,250}
 \end{aligned}$$

* Calculation of New ratio

- 1) A and B are partners sharing profit in the ratio 3:2. They admitted Mr C for $\frac{1}{4}$ share. Calculate their new profit sharing ratio.

Ans- Step 1: Let the profit of firm be 1

Step 2: Balance profit = Step 1 - profit share of new partner

$$= 1 - \frac{1}{4}$$

$$= \frac{3}{4}$$

Step 3: New ratio = Old ratio $\times$ Step 2 (Balance profit)

$$A = \frac{3}{5} \times \frac{3}{4} = \frac{9}{20}$$

$$B = \frac{2}{5} \times \frac{3}{4} = \frac{6}{20}$$

$$C = \frac{1}{4} \times \frac{5}{5} = \frac{5}{20}$$

$$\text{New ratio} = 9:6:5$$

- ★ Interest on Partner's Loan to the Firm
It is charge against profits and hence will be debited to PROFIT & LOSS A/C, even if the firm incurs a loss.
- ★ Interest on loan taken by a Partner from the Firm
It is a gain for the firm and is recorded on the Credit side of PROFIT & LOSS A/C.
- ★ Rent paid to a Partner.
It's an expense. Hence, it's charge against profits and will be Debited to PROFIT & LOSS A/C. Even if the firm incurs a loss.
- ★ In Case of Loss to the Firm
If the firm incurs loss during the year, partner will neither be allowed any interest on capital nor any salary. Profit & loss Appropriation will not be prepared, loss will distributed through Profit & loss A/C.
- ★ When Appropriations are more than Profits
The profit will be distributed in ratio of appropriation.
- ★ Past adjustments
Sometimes, after the accounts of the firm have been closed. It's discovered there have been some error or omission in A/C. It's rectify by passing a single adjustment.