Revision Notes for CBSE Class 12 Accountancy Chapter 1, Accounting for Partnership: Basic Concepts

What is Partnership?
Partnership can be defined as "Relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all".

Nature of Partnership
(i) Two or more persons are required to form a partnership
(ii) It is created by an agreement
(iii) The agreement should be for carrying on some legal business
(iv) sharing of profits and losses
(v) relationship of mutual agency among the partners
(vi) Each partner is equally liable for all the losses, profits, and decisions

Which law governs Partnership in India?
Indian Partnership Act of 1932 is applied in India for looking at the peculiarities of partnership firms and governing the methods of partnership in the country**.**

What is Partnership Deed?
The document that consists of terms of agreement for a partnership is called a partnership deed. It does not necessarily have to be written, but a written one is preferred. A partnership can come into existence only after all the partners have signed the deed.

Contents of Partnership Deed
• Names and Addresses of the firm and its main business
• Names and Addresses of all partners
• Amount of capital to be contributed by each partner
• The accounting period of the firm
• The date of commencement of partnership
• Rules regarding operation of Bank Accounts
• Profit and loss sharing ratio
• Rate of interest on capital, loan, drawings, etc
• Mode of auditor's appointment, if any
• Salaries, commission, etc, if payable to any partner
• The rights, duties and liabilities of each partner
• Treatment of loss arising out of insolvency of one or more partners
• Settlement of accounts on dissolution of the firm
• Method of settlement of disputes among the partners
• Rules to be followed in case of admission, retirement, death of a partner
• Any other matter relating to the conduct of business. Normally, the partnership deed covers all matters affecting relationship of partners amongst themselves. However, if there is no express agreement on certain matters, the provisions of the Indian Partnership Act, 1932 shall apply

Important Provisions of Partnership Act
- If partnership deed is silent on profit sharing ratio, all the partners will receive equal profits irrespective of their capital distribution in the firm
- No interest on capital is payable if the partnership deed is silent on the issue
- No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed
- If any partner has advanced loan to the firm for the purpose of business, he/she shall be entitled to get an interest on the loan amount at the rate of 6 per cent per annum.
- No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm unless there is a provision for the same in the Partnership Deed.
- If a partner derives any profit for him/her self from any transaction of the firm or from the use of the property or business connection of the firm or the firm name, he/she shall account for the profit and pay it to the firm.

- If a partner carries on any business of the same nature as and competing with that of the firm, he/she shall account for and pay to the firm, all profit made by him/her in that business.

Special Aspects of Partnership Accounts

- Maintenance of Partners' Capital Accounts- Capital accounts of partners are maintained by two methods. Fixed capital Method and Fluctuating Capital Method.
- Distribution of Profit and Loss among the partners
- Adjustments for Wrong Appropriation of Profits in the Past
- Reconstitution of the Partnership Firm
- Dissolution of Partnership Firm

What is Fixed Capital method?

In fixed capital method, the capital of the partners remains same unless an additional capital is introduced or withdrawn as per the partnership deed. The capitals of the partners shall remain fixed unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners. They always appear on the liabilities side in the balance sheet.

What is Partner's Current Account?

The account that maintains a record of all items like share of profit or loss, interest on capital, drawings, interest on drawings, etc is called Partner's Current Account. It shows the debit as well as credit balance. Partners' current account's balance shall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.

What is Fluctuating Capital method?

In fluctuating capital method, only one account i.e capital account is maintained. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time.

Differences between Fixed and Fluctuating Capital method

Differences between fixed and fluctuating capital method are:

Fixed Capital Method	**Fluctuating Capital method**
Two accounts are maintained (Current account and Capital account)	Only one account is maintained, i.e. Capital account
The balance remains fixed unless there is an addition or withdrawal of capital	The balance keeps fluctuating every year
Drawings, salary, interest on capital etc are transferred in current account instead of capital account	All the adjustments are recorded in capital account
Capital account is responsible for showing credit balance	It can show debit as well as credit balance

What is Profit and Loss Appropriation Account?

Profit and Loss Appropriation Account is an extension of the Profit and Loss Account of the firm. It shows how the profits are appropriated or distributed among the partners. All adjustments in respect of partner's salary, partner's commission, interest on capital, interest on drawings, etc. are made through this account. It starts with the net profit/net loss as per Profit and Loss Account.

Guarantee of profit to a partner

Sometimes a partner is admitted into the firm with a guarantee of certain minimum amount by way of his share of profits of the firm. Such assurance may be given by all the old partners in a certain ratio or by any of the old partners, individually to the new partner. The minimum guaranteed amount shall be paid to such new partner when his share of profit as per the profit sharing ratio is less than the guarnteed amount.

Past Adjustments

Sometime, the errors or omissions in the journal entries or balances might get detected after the accounts are closed for the year. In such conditions, additional journal entries are passed to make the past adjustments. These entries are made through two methods:

(a) Profit and Loss Adjustment Account

(i)	Profit and Loss Adjustment A/c	Dr.	9,000	
	To Rameez's capital A/c			3,000
	To Zaheer's capital A/c			6,000
	(Interest on capital)			

Example:

(ii)	Rameez's capital A/c	Dr.	4,500	
	Zaheer's capital A/c	Dr.	4,500	
	To Profit and Loss Adjustment A/c			9,000
	(Loss on adjustment)			

(b) Directly in the capital accounts of the concerned partners- For direct adjustment in partners' capital accounts first a statement to ascertain the net effect of omission on partners' capital accounts will be worked out as follows and then the adjustment entries can be recorded.

Statement Showing Net Effect of Omitting Interest on Capital

Details	*Rameez (Rs.)*	*Zaheer (Rs.)*
(i) Amount which should have been credited as interest on capital	3,000 (Cr.)	6,000 (Cr.)
(ii) Amount actually credited by way of share of profit (Rs. 9,000 divided equally)—	4,500 (Dr.)	4,500 (Dr.)
(iii) Difference between (i) and (ii) (Net effect)	**Dr. 1,500 (Excess)**	**Cr. 1,500 (Short)**

The statement shows that Rameez has got excess credit of Rs. 1,500 while Zaheer's account has been credited less by Rs. 1,500. In order to rectify the error Rameez's capital account should be debited and that of Zaheer, credited with Rs. 1,500 by passing the following journal entry;

journal entry.

Rameez's Capital A/c	Dr.	1,500	
To Zaheer's Capital A/c			1,500
(Adjustment for omission of interest on capital)			

Journal Entries:

Distribution of Profit Among Partners- Profit and Loss Appropriation Account Journal Entries

- Transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account

(a) If Profit and Loss Account shows a credit balance (net profit):
Profit and Loss A/c Dr.
To Profit and Loss Appropriation A/c

(b) If Profit and Loss Account shows a debit balance (net loss)
Profit and Loss Appropriation A/c Dr.
To Profit and Loss A/c

- Interest on capital

(a) For Allowing interest on capital:
Interest on Capital A/c Dr.
To Partner's Capital/Current A/cs (individually)

(b) For transferring interest on capital to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c

- Interest on drawings

(a) For charging interest on drawings to partners' capital accounts:
Partners Capital/Current A/c's (individually) Dr.
To Interest on Drawings A/c

(b) For transferring interest on drawings to Profit and Loss Appropriation Account:
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c

- Partner's Salary

(a) For Allowing partner's salary to partner's capital account:
Salary to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)

(b) For transferring partner's salary to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Salary to Partner's A/c

- Partner's Commission

(a) For crediting commission allowed to a partner, to partner's capital account:
Commission to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)

(b) For transferring commission allowed to partners to Profit and Loss Appropriation Account.
Profit and Loss Appropriation A/c Dr.
To Commission to Partners Capital/Current A/c

- Share of Profit or Loss after appropriations

(a) If Profit:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c's (individually)

(b) If Loss:
Partner's Capital/Current A/c (individually)
To Profit and Loss Appropriation A/c

Formulas to be used:
Interest on drawings:

- *When Fixed Amounts was Withdrawn Every Month*

A) When the amount is withdrawn at the beginning of each month

$$\text{Average Period} = \frac{\text{No. of months of 1 drawings + No. of month of last drawings}}{2} =$$

$$\frac{12+1}{2} = 6\frac{1}{2} \text{ months.}$$

B) When the amount is withdrawn at the end of each month

$$\text{Average Period} = \frac{\text{No. of months of 1 drawings + No. of months of last drawings}}{2} =$$

$$\frac{11+0}{2} = 5\frac{1}{2} \text{ months}$$

C) When money is withdrawn in the middle of the month

$$\text{Average Period} = \frac{\text{No. of months of 1 drawings + No. of month of last drawings}}{2} = \frac{11.5+0.5}{2} =$$

6 months

- *When Fixed Amount is withdrawn Quarterly*

A) If the amount is withdrawn at the beginning of each quarter

Statement Showing Calculation of Interest on Drawings

Date	*Amount (Rs.)*	*Time Period*	*Interest (Rs.)*
April 1, 2019	30,000	12 months	$30,000 \frac{8}{100}$ 1 = 2,400
July 1, 2019	30,000	9 months	$30,000 \frac{9}{12} \frac{8}{100}$ = 1,800
Oct. 1, 2019	30,000	6 months	$30,000 \frac{6}{12} \frac{8}{100}$ = 1,200
Jan. 1, 2020	30,000	3 months	$30,000 \frac{3}{12} \frac{8}{100}$ = 600
Total	**1,20,000**		**= Rs. 6,000**

Alternatively, the interest can be calculated on the total amount withdrawn during the accounting year, i.e. Rs. 1,20,000 for a period of 7½ months (12+9+6+3)/4. as follows:

$$\text{Rs. } 1,20,000 \quad \frac{8}{100} \times \frac{15}{2} \times \frac{1}{12} = \text{Rs. } 6,000.$$

B) If the amount is withdrawn at the end of each quarter

Statement Showing Calculation of Interest on Drawings

Date	*Amount (Rs.)*	*Time Period*	*Interest (Rs.)*
June 30, 2019	30,000	9 months	$30,000 \; \frac{9 \times 8}{12 \times 100}$ = 1,800
September 30, 2019	30,000	6 months	$30,000 \; \frac{6}{12} \; \frac{8}{100}$ = 1200
December 31, 2019	30,000	3 months	$30,000 \; \frac{3}{12} \; \frac{8}{100}$ = 6,000
March 31, 2020	30,000	0 months	
Total	**1,20,000**		**= 3,600**

Alternatively, the interest can be calculated on the total amount withdrawn during the accounting year, i.e., Rs. 1,20,000 for a period of 4½ months (9 + 6 + 3 + 0)/4 months as follows:

$$= \text{Rs. } 1,20,000 \; \frac{8}{100} \times \frac{9}{2} \times \frac{1}{12} = \text{Rs. } 3,600$$

- *When Varying Amounts are Withdrawn at Different Intervals*

$$\text{Total of products} \times \text{Rate} \times \frac{1}{12}$$

- *When Dates of Withdrawal are not specified*

year. *For example;* Shakila withdrew Rs. 60,000 from partnership firm during the year ending March 31, 2020 and the interest on drawings is to be charged at the rate of 8 per cent per annum. For calculation of interest, the period would be taken as six months, which is the average period assuming, that amount is withdrawn evenly in the middle of the month, throughout the year. The amount of interest on drawings works out to be Rs. 2,400 as follows:

$$\left(\text{Rs.}60,000 \times \frac{8}{100} \times \frac{6}{12}\right) = \text{Rs. } 2,400$$