

Partnership Accounts - Ch 1

Basic Concepts

1. Definition

Sec 4 of the Indian Partnership Act, 1932 :

"Partnership 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."

Persons = partners ; collectively = firm.

2. Eight Characteristics *

- (1) Two or more persons (min 2, max 50)
- (2) Agreement (oral / written / implied)
- (3) Lawful business (not co-ownership)
- (4) Sharing of profits (equal if no deed)
- (5) Mutual agency <- TRUE TEST
- (6) Unlimited liability (joint & several)
- (7) Non-transferable share
- (8) No separate legal entity

3. Partnership Deed

Written + signed + stamped agreement.

Records all terms of partnership.

Why writing is better :

Commercial : avoids disputes.

Legal : primary evidence (Evidence Act)

Tax : Sec 184 Income Tax Act 1961 needs written deed for concession rate.

4. IF NO Deed = Sec 13 Defaults

(i) Profits & losses : EQUALLY

(ii) Interest on capital : NONE

(iii) Interest on drawings : NONE

(iv) Interest on loan : 6% p.a. (CHARGE)

(v) Salary to partner : NONE

*** Only ~~partner salary~~ loan interest is allowed -- and it is a CHARGE not appropriation.

5. Capital Accounts

Method A : Fluctuating

ONE Capital A/c per partner.

All entries flow through it.

Balance changes every year.

Method B : Fixed

TWO accounts per partner :

Capital A/c -- opening + additional
+ permanent withdrawal

Current A/c -- IOC, salary, profit,
drawings, IOD share.

*** NEVER mix : if fixed, put IOC and
salary in CURRENT not capital !

6. P&L Appropriation A/c

Made AFTER P&L A/c.

Distributes Net Profit among partners.

Charge vs APPROPRIATION (cardinal rule)

7. Interest on Capital

$$\text{IOC} = \text{Capital} \times R/100 \times T/12 \quad \leftarrow \text{pro-rata}$$

Eg. Capital Rs 60000 ; $R = 10\%$; $T = 12\text{m}$

$$\text{IOC} = 60000 \times 10/100 \times 12/12 = 6000$$

8. Interest on Drawings

Method 1 : Direct (one-off)

$$\text{Int} = D \times R/100 \times t/12$$

Method 2 : Product (irregular)

$$\text{Int} = (\text{Sum } D \times t)/12 \times R/100$$

Method 3 : Average Period (equal regular)

$$\text{Int} = \text{Total } D \times R/100 \times \text{AvgP}/12$$

*

9. Six Standard Avg Periods

*
Beginning of every month $\rightarrow 6 \frac{1}{2}$ m

Middle of every month $\rightarrow 6$ m

End of every month $\rightarrow 5 \frac{1}{2}$ m

*
Beginning of every quarter $\rightarrow 7 \frac{1}{2}$ m

Middle of every quarter $\rightarrow 6$ m

End of every quarter $\rightarrow 4 \frac{1}{2}$ m

Memory hint

opp ends differ by 3 mo

monthly : 6.5 / 5.5 (diff 1)

quarterly : 7.5 / 4.5 (diff 3)

10. Guarantee of Min Profit

A partner is guaranteed at least a fixed minimum profit. If his ratio share is less, the DEFICIENCY is borne by other partner(s) in agreed ratio.

Three Steps

- ① Compute guarantee partner's ratio share
- ② Find deficiency = guarantee - ratio share
- ③ Debit deficiency to guaranteeing partner(s) in agreed ratio. Credit guaranteed partner.

Solved Example

Ram, Raj, George 5:3:2. George guaranteed Rs 10000. Profit Rs 40000.

$$\text{Ratio share} = 40000 \times \frac{2}{10} = 8000$$

$$\text{Deficiency} = 10000 - 8000 = 2000$$

11. Past Adjustments

Omissions noticed AFTER profit distributed. Pass ONE combined journal entry to correct partners' capital balances.

Five-Step Framework

- ① Compute correct entitlement per partner
(IOC + Salary + Comm - IOD + share)
- ② Note original credit (old PSR of profit)
- ③ Net effect = correct - original
- ④ Sign rule: -ve = Dr ; +ve = Cr
- ⑤ Column sum MUST be zero (check !)

*** If sum $\neq 0$ \rightarrow arithmetic error
Re-check before journal entry !

12. Worked Example - P&L App

A and B share 3:2. Capitals 400000 & 200000. Net profit 120000. Deed :
 IOC 8%, Salary A 3000 pm, IOD A 3600, B 2400.

Working

IOC : A = 32000 ; B = 16000

Salary A = 36000

Divisible : $120000 + 6000 - 32000 - 16000 - 36000 = 42000$

Split 3:2 : A = 25200 ; B = 16800*

13. Final Revision Map

Definition : Sec 4 PA Act 1932

Deed : Sec 184 IT tax cut

No deed : Sec 13 equal, 6% loan

Methods : Fixed / Fluctuating

Guarantee : ratio share \rightarrow deficiency

Past adj : single entry ; sum = 0