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Accounting for Partnership : Basic Concepts

Question 1:

Define Partnership Deed

ANSWER:

Partnership Deed is a written agreement among the partners of a partnership firm. It includes agreement on profit sharing ratio, salaries, commission of partners, interest provided on partner's capital and drawings and interest on loan given or taken by the partners, etc. Generally following details are included in a partnership deed.

1. Objective of business of the firm

2. Name and address of the firm

3. Name and address of all partners

4. Profit and loss sharing ratio

5. Contribution to capital by each partner

6. Rights, types of roles and duties of partners

7. Duration of partnership

8. Rate of interest on capital, drawings and loans

9. Salaries, commission, if payable to partners.

10. Rules regarding admission, retirement, death and dissolution of the firm, etc

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Question 2:

Why it is considered desirable to make the partnership agreement in writing.

ANSWER:

Partnership agreement may be oral or written. It is not compulsory to form partnership agreement in writing under the Partnership Act, 1932. However, written partnership deed is desirable than oral agreement as it helps in avoiding disputes and misunderstandings among the partners. Also, it helps in settling disputes (as the case may be) among the partners, as written partnership deed can be referred to anytime. If written partnership deed is duly signed and registered under Partnership Act, then it can be used as evidence in the court of law.

Question 3:

List the items which may be debited or credited in the capital accounts of the partners when:

(i) Capitals are fixed

(ii) Capitals are fluctuating
ANSWER:

(i)***When Capitals are fixed***

The following items are credited in the Partner's Capital Account when capital accounts are fixed.

(a) Opening balance of capital

(b) Additional capital introduced during an accounting year

The following items are debited in the Partner's Capital Account when capital accounts are fixed.

(a) Part of capital withdrawn

(b) Closing balance of capital

(ii) *When Capitals are fluctuating*

The following items are credited in the Partner's Capital Account when capital accounts are fluctuating.

(a) Opening balance of capital.

(b) Additional capital introduced during an accounting year

(c) Salaries to the partners

(d) Interest on capital

(e) Share of profit

(f) Commission and bonus to the partners

The following items are debited in the Partner's Capital Account when capital accounts are fluctuating.

(a) Drawings made during the accounting period

(b) Interest on drawings.

(c) Share of loss.

(d) Closing balance of capital.

Question 4:

Why is Profit and Loss Adjustment Account prepared? Explain.
ANSWER:

The Profit and Loss Adjustment Account is prepared because of the following two reasons.

1. ***To record omitted items and rectify errors if any***- After the preparation of Profit and Loss Account and Balance Sheet, if any error or omission is noticed, then these errors or omissions are adjusted by opening Profit and Loss Adjustment Account in the subsequent accounting period without altering old Profit and Loss Account.

2. ***To distribute profit or loss between the partners***- Sometimes, besides adjusting the items and rectifying errors, this account is also used for distribution of profit (or loss) among the partners. In this situation, this account acts as a substitute for Profit and Loss Appropriation Account. The main rationale to prepare the Profit and Loss Adjustment Account is to ascertain true profit or loss.

Question 5:

Give two circumstances under which the fixed capitals of partners may change.
ANSWER:

The following are the two circumstances under which the fixed capitals of partner may change.

(i) If any additional capital is introduced by the partner during the year.

(ii) If any part of capital is permanently withdrawn by the partner from the firm.

Question 6:

If a fixed amount is withdrawn on the first day of every quarter, for what period

the interest on total amount withdrawn will be calculated?
ANSWER:

If a fixed amount is withdrawn on the first day of every quarter, then the interest is calculated on the amount withdrawn for a period of seven and half ($7\frac{1}{2}$) months.

Example:

If a partner withdraws Rs 5,000 in the beginning of each quarter and the interest is charged @ 10% on the drawings, then interest on drawings is calculated as:

Total drawings made by the partner during the whole year are Rs 20,000, i.e. Rs 5000× 4.

Interest on drawings $= 20,000 \times \frac{10}{100} \times \frac{7\frac{1}{2}}{12} = 1,250$

Question 7:

In the absence of partnership deed, specify the rules relating to the following:

(i) Sharing of profits and losses.

(ii) Interest on partner’s capital.

(iii) Interest on Partner’s drawings.

(iv) Interest on Partner’s loan

(v) Salary to a partner.

ANSWER:

(i) ***Sharing of profits and losses*****:** If the partnership deed is silent on sharing of profit or losses among the partners of a firm, then according to the Partnership Act of 1932, profits and losses are to be shared equally by all the partners of the firm.

(ii) ***Interest on partner's capital*****:** If the partnership deed is silent on interest on partner's capital, then according to the Partnership Act of 1932, **no** interest on capital should be given to the partners of the firm.

(iii) ***Interest on partner's drawings*****:** If the partnership deed is silent on interest on partner's drawings, then according to the Partnership Act of 1932, **no** interest on drawing should be charged from the partners of the firm for the amount of capital withdrawn in form of drawings.

(iv) ***Interest on partner's loan*****:** If the partnership deed is silent on interest on partner's loan, then according to the Partnership Act of 1932, the partners are entitled for 6% p.a. interest on the loan forwarded by them to the firm.

(v) ***Salary to a partner*****:** If the partnership deed is silent on salary to a partner, then according to the Partnership Act of 1932, **no** salary should be given to any partner.