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# Basics of Partnership

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Partnership is a legal business agreement involving at least two and up to fifty partners who agree to share the profits of a business carried on by all or any of them acting for all. It is governed by the Indian Partnership Act, 1932. The key components include capital accounts, goodwill, partnership deeds, profit sharing, and advantages of partnership.

## Key Definitions and Features:

- **Meaning:** Partnership is a relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
- **Number of Partners:** Minimum two, maximum fifty as per Rule 10 of Company (Miscellaneous) Rules, 2014.
- **Agreement:** Can be oral or written; partnership arises from contract, not status.
- **Mutual Agency:** Each partner acts as agent and principal for the others.
- **Business:** Must be lawful and profit-oriented.
- **Profit Sharing:** Partners agree to share profits and losses.
- **Liability:** Partners are jointly and severally liable; personal assets can be used to pay firm debts.

**Examples:** A firm with partners Ram and Shyam sharing profits and losses as per agreement.

## Practice Set:

- Explain the importance of mutual agency in partnership.
- What is the maximum number of partners allowed in a partnership firm?
- Discuss the implications if a partnership agreement is oral.

## Answer Key:

- Mutual agency means each partner can bind the firm by their actions, ensuring business continuity.
- Maximum number of partners is 50.
- Oral agreements are valid but may lead to disputes due to lack of written evidence.

**Quick Reference:** Partnership = Contract + Profit Sharing + Mutual Agency + Liability.

**Glossary:** *Mutual Agency* - Each partner acts on behalf of others; *Joint and Several Liability* - Each partner is individually responsible for firm debts.

## Partnership Deed

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A partnership deed is a contract between partners defining their mutual rights and duties. It can be registered or unregistered and should be comprehensive to avoid disputes.

### Contents of Partnership Deed:

- Name and address of partners and firm
- Nature and place of business
- Capital contribution
- Interest on capital and drawings
- Profit and loss sharing ratio
- Partner's salary and commission
- Goodwill valuation method
- Admission, retirement, and death of partners
- Dispute resolution and arbitration clauses

### Applicable Provisions in Absence of Deed:

- Interest on partner's loan @ 6% p.a.
- No interest on capital or drawings
- No salary or commission to partners

- Profits shared equally

**Example:** Ram and Shyam have no partnership deed; interest on loan is allowed at 6%, no salary or interest on capital/drawings is allowed, and profits are shared equally.

#### Practice Set:

- List five essential contents of a partnership deed.
- What happens if the partnership deed is silent about interest on drawings?
- Explain the legal effect of a partnership deed.

#### Answer Key:

- Contents include capital, profit sharing ratio, interest on capital, partner's salary, and dispute resolution.
- No interest on drawings is charged if deed is silent.
- It governs the rights and duties of partners and overrides default legal provisions.

**Quick Reference:** Partnership Deed = Contract + Rules + Rights + Duties.

**Glossary:** *Partnership Deed* - Agreement defining partnership terms; *Registered Deed* - Officially recorded agreement.

## Capital Accounts of Partners

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Capital accounts record the financial interest of partners in the firm. There are two methods:

- **Fluctuating Capital:** Capital account changes with every transaction including profits, drawings, interest, salary, and additional capital.

- **Fixed Capital:** Capital remains constant; separate current account records drawings, profits, and other adjustments.

**Example:** Partners Sameer and Yasmin with capitals ₹15,00,000 and ₹10,00,000 respectively maintain accounts under both methods showing transactions like additional capital, interest, salary, and drawings.

#### Practice Set:

- Differentiate between fixed and fluctuating capital accounts.
- Record a transaction of additional capital under both methods.
- Explain the purpose of current account in fixed capital method.

#### Answer Key:

- Fixed capital remains unchanged; fluctuating capital changes with transactions.
- Additional capital is credited to capital account in fixed method; in fluctuating method, it increases capital balance.
- Current account tracks operational transactions separate from capital.

**Quick Reference:** Capital Account = Investment + Adjustments; Current Account = Operational Transactions.

**Glossary:** *Capital Account* – Partner's investment record; *Current Account* – Tracks drawings, profits, and expenses.

## Profit and Loss Appropriation Account

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This account is prepared to adjust net profit for interest on capital, drawings, salary, commission, and to distribute profits among partners.

## Journal Entries:

Transaction	Entry
Transfer net profit to Appropriation Account	Profit & Loss A/c Debit To Profit & Loss Appropriation A/c
Interest on capital credited	Interest on Capital A/c Debit To Partners' Capital/Current A/c
Interest on capital transferred	Profit & Loss Appropriation A/c Debit To Interest on Capital A/c
Salary/Commission to partners	Salary/Commission A/c Debit To Partners' Capital/Current A/c
Salary/Commission transferred	Profit & Loss Appropriation A/c Debit To Salary/Commission A/c
Interest on drawings charged	Partners Capital/Current A/c Debit To Interest on Drawings A/c
Interest on drawings transferred	Interest on Drawings A/c Debit To Profit & Loss Appropriation A/c
Profit transferred to reserve	Profit & Loss Appropriation A/c Debit To Reserve A/c
Profit distributed among partners	Profit & Loss Appropriation A/c Debit To Partners Capital/Current A/c

**Example:** Brij and Nandan share profits 2:3 with capitals ₹10,00,000 and ₹15,00,000 and interest on capital 12%. Profit ₹2,00,000 is appropriated accordingly.

### Practice Set:

- Prepare Profit & Loss Appropriation Account for given data.
- Explain the treatment of interest on drawings.
- How is partner's salary treated in profit appropriation?

### Answer Key:

- Interest on drawings is charged to partners and credited to appropriation account.
- Salary is an appropriation of profit, debited to appropriation account, not profit & loss account.

**Quick Reference:** Appropriation Account adjusts net profit for partner-specific items before distribution.

**Glossary:** *Appropriation* - Allocation of profits; *Interest on Drawings* - Charge on partner's withdrawals.

## Interest on Drawings

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Interest on drawings is charged to partners for amounts withdrawn from the firm. Methods of calculation include:

- **Simple Interest Method:** Interest calculated on each drawing from date of withdrawal to closing date.
- **Product Method:** Interest calculated on total product of amount and time.
- **Average Period Method:** Used when equal amounts withdrawn at regular intervals; interest calculated using average period.

**Formulas:**

$$\text{Interest on Drawings} = \frac{\text{Drawings Amount} \times \text{Rate} \times \text{Time (months)}}{100 \times 12}$$

$$\text{Average Period} = \frac{\text{Months after first drawing} + \text{Months after last drawing}}{2}$$

**Example:** Himanshu withdrew ₹20,000 on 1st May, ₹10,000 on 1st June, ₹5,000 on 1st Nov, and ₹5,000 on 1st Dec. Calculate interest @ 6% p.a. on 31st March.

## Practice Set:

- Calculate interest on drawings using simple interest method for given withdrawals.
- Explain average period method with example.
- What if date of withdrawal is not given?

## Answer Key:

- Interest calculated on each amount for respective months and summed.
- Average period method assumes uniform withdrawals; interest calculated on average time.
- If date not given, interest calculated for six months on total drawings.

**Quick Reference:** Interest on Drawings = Drawings × Rate × Time / (100 × 12).

**Glossary:** *Drawings* – Amounts withdrawn by partners; *Interest on Drawings* – Charge for use of firm's funds.

## Goodwill

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Goodwill is an intangible asset representing the reputation and earning capacity of a firm above normal profits.

### Factors Affecting Goodwill:

- Competent management
- Favourable location
- Favourable contracts
- Past business performance
- Quality of products

- Nature of business

### Need for Valuation:

- Admission of new partner
- Retirement or death of partner
- Change in profit sharing ratio
- Sale of goodwill on dissolution

### Methods of Valuation:

- **Average Profit Method:**  $\text{Goodwill} = \text{Average Profit} \times \text{Number of Years Purchase}$
- **Super Profit Method:**  $\text{Goodwill} = \text{Super Profit} \times \text{Number of Years Purchase}$ , where  $\text{Super Profit} = \text{Actual Average Profit} - \text{Normal Profit}$
- **Capitalisation Method:**  $\text{Goodwill} = \text{Capitalised Value} - \text{Net Assets}$ , where  $\text{Capitalised Value} = \text{Actual Average Profit} \times 100 / \text{Normal Rate of Return}$

### Practice Set:

- Calculate goodwill using average profit method given past profits.
- Explain super profit method with formula.
- When is goodwill valuation necessary?

### Answer Key:

- Goodwill is calculated by multiplying average profit by years of purchase.
- Super profit method considers excess profit over normal profit.
- Valuation is needed on admission, retirement, death, or change in profit sharing.

**Quick Reference:** Goodwill = Intangible Asset representing firm's reputation and earning capacity.

**Glossary:** *Goodwill* – Value of reputation; *Super Profit* – Excess profit over normal profit.

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