

CHAPTER 1



PARTNERSHIP FINAL ACCOUNTS



Meaning of Partnership

A partnership firm is an association of two or more persons to carry on a legal business and share its profits or losses. The persons who join hands together to do a business are individually known as partners and collectively a firm.



- **According to Sec 4 of the Indian Partnership Act, 1932,**
"the term partnership is the relation between two or more persons who have agreed to share the profit of the business carried on by all or any of them acting for all.



Essential Elements of Partnership

1. At least two persons
2. Agreement
3. Legal Business
4. Profit Sharing
5. Mutual agency
6. Number of partners



Meaning of Partnership Deed

As stated above partnership is formed by an agreement. This agreement can be oral or written. Though the law does not expressly require that there should be an agreement in writing but the absence of written agreement may be the source of problem in managing the affairs of the partnership firm.



Contents of Partnership Deed

1. Name of the firm.
2. Name and addresses of all the partners.
3. Nature and place of the business.
4. Duration of partnership.
5. Date of commencement of partnership.
6. Amount of capital contributed by each partners.
7. Ratio in which profits and losses are to be shared.



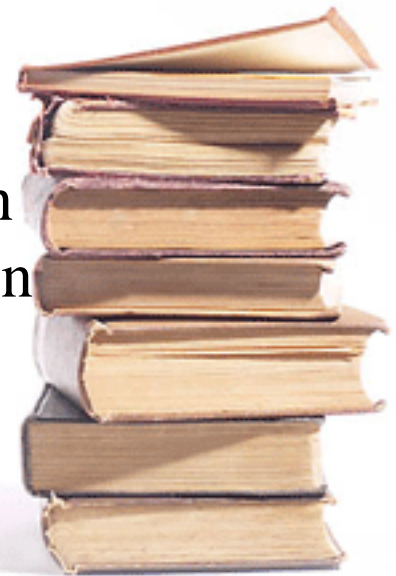
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8. Interest on partner's capital and drawings.
9. Interest on loan by the partner to the firm.
10. Salary, Commission, etc. if any payable to a partner.
11. Method of computation and treatment of Goodwill on the reconstitution of the firm.
12. Mode of settlement of accounts in case of retirement/death of a partner.
13. Mode of settlement of accounts in case of dissolution of the firm.



Rules in the absence of the Partnership Deed

- (i) The partners will share the profits and losses in the equal ratio.
- (ii) Interest on loan will be given @ 6% p.a. to the partners.
- (iii) No interest is allowed to partners on the capital invested by them.
- (iv) No partner is to get any remuneration such as salary, commission etc for participating in the business.
- (v) No interest will be charged on drawings made by the partners.



Meaning of Profit and Loss Appropriation Account:

Profit and Loss Appropriation Account is an extension of Profit and Loss Account that is prepared to distribute the net profit among the partners. All adjustments relating to partners like interest on capital, interest on drawings, commission to partners etc. are made in this Account.



Purpose of Profit & Loss Appropriation Account:

- The main purpose of preparing Profit & Loss Appropriation Account of a Partnership concern is to calculate and distribute the divisible Profit & Loss.

The Income Tax Act and the audit rule does not permit the partnership firm to consider the amount as business expenditure which is payable to the partners



Adjustments related to P&L Appropriation account

a) Interest on capital

P/L appro. a/c Dr.

 to partners capital/current a/c

(being interest payable)

b) Salary to partner

P/L appro. a/c Dr.

 to partners capital/current a/c

(being salary payable)



c) Interest on Drawings

Partners capital/current a/c Dr.
to P/L appro.

(being interest provided)

d) Interest on partners loan

P/L appro. a/c Dr.
to partners capital/current a/c

(being interest payable)



e) Distribution of final net profit

i. If there is net profit

P/L appro. a/c Dr.

to partners capital/ current a/c

(being profit transferred.)

ii. If there is net loss

partners capital/current a/c Dr.

to P/L appro. a/c

(being loss transferred)



Methods of maintaining capital accounts

1. Fixed capital method
2. Fluctuating Capital Method



Fixed capital method

- Two accounts are maintained for each partner :

1. Partners capital account

1. Partners current account

all adjustments are done in partners current account.



Fluctuating Capital Method

Separate capital accounts are maintained for each partner.

All adjustments are done in same capital accounts.



Provisions Relating to Accounting

- 1. Partner's salary:** no salary
- 2. Interest on capital:** no interest
- 3. Interest on partners loans:** 6%
- 4. Share of profit or loss:** equal



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5. Interest on drawings: no interest.

For calculation for interest on drawings following points should be remembered:

- i. **At the beginning of every month:**
total drawings \times rate% \times 6.5/ 12
- ii. **At the end of every month:** total
drawings \times rate% \times 5.5/12
- iii. **At the middle of every month:**
total drawings \times rate % \times 6/12



Adjustments of Profits/Loss on Admission or Retirement/Death

On admission of partner:

- i. Admitted on the first day of the accounting year- will get profit for entire year

- ii. Admitted on any day of the accounting year- will get profit for after the date of admission till the date of final accounts



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On retirement/Death of partner:

- i. If retires on the last date of the accounting year: will get profit for entire year
- ii. If retires on the beginning of the accounting year: no profit
- iii. If retires during the accounting year: will get profit up to the date of retirement



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- **On death of a partner:**

The procedure of finding out amount due to deceased partner is the same as in the case of retirement.



Calculation of new Profit Sharing Ratio

- **Sacrifice ratio =**
Old ratio – New ratio
- **New ratio =**
Partner's old ratio X Balance
ratio
- **Balance ratio=**
1- new partner's share



Types of adjustments

1. Open adjustments
2. Hidden adjustments
3. Effects already given in trial balance



For Query

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Thank you

