LESSON-22
PARTNERSHIP: AN INTRODUCTION

SUMMARY

When a business expands, it goes beyond the capacity of one person to provide the capital and manage the affairs of the expanded business. A need is felt to combine his/her efforts and capital with those of another person/persons. This gives rise to the partnership form of organisation.

PARTNERSHIP AND PARTNERSHIP DEED

Partnership is a form of business organisation, where two or more persons join hands to run a business. They share the profits and losses according to the agreement amongst them.

"Partnership is relation between persons who have agreed to share profits of a business carried on by all or any one of them acting for all".

Following are the characteristics of partnership

- Agreement
- Number of persons
- Business
- Sharing Profits
- Mutual Agency
- Unlimited liability
- Management
- Transferability of Share

CAPITAL ACCOUNT : MEANING AND PREPARATION

Partners contribute their share of capital in business. These are recorded in their respective accounts named as capital accounts. These accounts may be maintained in two ways

(a) Fixed Capital Account

(b) Fluctuating Capital Account

ACCOUNTING TREATMENT OF INTEREST ON CAPITAL AND INTEREST ON DRAWINGS

Interest on Capital

Interest is charged on the opening balance of the partner's capital account. When additional capital is introduced and some capital is withdrawn permanently, the interest will be calculated on the amount of the capital used in the business during a particular period

INTEREST ON DRAWINGS

When a partner withdraws cash from the firm for domestic use, the withdrawal of cash is termed as drawings. If the partnership deed has a provision of charging interest on drawings, the firm may charge interest on drawings from partners.

Calculation of interest on Drawings :

There are two methods of calculating interest on drawings:

A. Simple Average method

A fixed amount may be withdrawn every month/ half yearly/ annually. The calculation of amount of interest to be charged in different situations is shown as under:

- ⌘ **When Fixed Amounts are Withdrawn at Equal Time Intervals**
- ⌘ ***When money is withdrawn at the end of the period***
- ⌘ ***Withdrawal of Fixed amounts at equal time intervals (Beginning of each quarter)***
- ⌘ ***When fixed amount is withdrawn at the end of each quarter***
- ⌘ ***When fixed amount is withdrawn at the middle of each quarter***
- ⌘ ***When no specific period of drawing is given in the question***

B. Product method

- ⌘ **When different amounts are withdrawn at different intervals**

Under the product method, for each withdrawal, the money withdrawn is multiplied by the period for which it remained withdrawn during the financial year.

PROFIT AND LOSS APPROPRIATION ACCOUNT: MEANING AND PREPARATION

Profit and Loss Appropriation Account is merely an extension of the Profit and Loss Account of the firm. The journal entries for the preparation of Profit and Loss Appropriation Account are given below:

1. *For transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account*
2. *For Interest on Capital*
3. *For Interest on Drawings*

4. For Partner's Salary
5. For Partner's Commission
6. For Transfer of agreed amount to General Reserve
7. For share of Profit or Loss appropriation

GUARANTEE OF PROFIT

Sometimes, a partner is admitted in the firm on guarantee in respect of his minimum share of profit from the business. Such a gurantee can be given even to an existing partner also. Such a guarantee to the incoming partner is given either by:

(a) the firm *i.e.* by all the old partners in an agreed ratio, or

(b) some of the old partners or any one of the old partners

When all the partners guarantee that one of the partners shall be given a minimum amount of profit, we should calculate the following two amounts separately:

i. Share of profit of the guaranted partner as per profit sharing ratio, and

ii. Minimum guaranteed amount of profit of the guanteed partner.

ACTIVITY

Make use of your communication skills to obtain Partnership Deed of five firms. Go through partnership deed of such firms. Identify the provisions which are not common. Also find out the important items that you would like to include in one of the partnership deeds.