**CLASS –XII**

SUBJECT: ACCOUNTANCY

# CHAPTER -1 **ACCOUNTING FOR PARTNERSHIP FIRMS FUNDAMENTALS (THEORY)**

**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.

**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.

**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(a) Part of capital withdrawn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.

**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 a 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.

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

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.

**6. 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.

**7. What is partnership? What are its chief characteristics? Explain**

**According to the Section 4 of the Partnership Act, 1932,** partnership is an agreement between two or more persons who have agreed to share profits or losses of a business that will be carried by all or any one of them acting for all.

Person who joined their hands to set up the business are called 'partners' individually and 'firm' collectively and the name under which they carry out their business is termed as 'firm name'.

**Important Characteristics of Partnership**

The following are the important characteristics of partnership.

1.**Two or more persons:** Partnership is an agreement between two or more persons coming together for a common goal. There should be at least two persons to form a partnership. Although as per the Partnership Act of 1932, there is **no maximum limit** on the number of partners in a partnership firm, but as per the **Rule (10) of the Companies (Miscellaneous) Rules Act 2014, the maximum number of partners permissible is 50**. Therefore, in case the number of partners exceeds the aforesaid limit, then the concerned partnership is considered to be illegal. In this regards it must be noted that Section 464 of Companies Act 2013, the maximum number of partners permissible is one humdred. However, it must be noted that the maximum number of partners is not limited in case an association or partnership is formed by professionals such as chartered accountants, lawyers, company secretaries, etc. These professionals are governed by their the special laws as formed by their respective professional institutions. Prior to the enforcement of Companies Act of 2013, the earlier act of 1956, imposed restrictions on the maximum number of partners to 10 in case of banking business and 20 in case of any other kind of business. However, with effect from April 01, 2014, Companies Act of 1956 has been replaced by Companies Act of 2013.

2.**Partnership Deed:** The partnership among the partners should be backed up by a partnership deed. A partnership deed is an agreement among the partners governing them in carrying out the proposed business. The deed may be oral or written.

3.**Business:** A partnership is formed to carry out a legal business. Partnerships in smuggling, black marketing etc. are illegal business activities and hence, the partnership is also illegal.

4. **Sharing of profit:** The profit or loss earned by a partnership firm must be distributed as per the partnership deed or equally among the partners (in absence of partnership deed). It is a very important feature of partnership. If a group is formed for charitable purpose, not to earn profit then this group will not be regarded as a partnership.

5.**Liability:** Liability of a partnership firm is unlimited and each partner is liable for firm's liabilities whether individually and jointly with other partners to the third party. Moreover, each partner along with his/her co-partners is responsible for all the acts of the partnership firm.

6. **Mutual agency:** Partnership may be carried on by all or any one of them acting on behalf of all. It means all the partners of a firm are equally entitled to participate in the activities of the business or any one of them who is acting on behalf of all. Every partner acts as an agent for others and binds others by his/her act and in turn is bound by others by their act

**8. Discuss the main provisions of the Indian Partnership Act, 1932 that are relevant to partnership accounts if there is no partnership deed.**

**ANSWER:**

The following are the main provisions of the Indian partnership Act, 1932 that are relevant to the partnership accounts in absence of partnership deed.

1.**Profit Sharing Ratio:** 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.

2.**Interest on 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. However, interest on capital is given only out of the profits, if mutually agreed by all the partners.

3.**Interest on 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 the form of drawings.

4.**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.

5.**Salary to 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.