**CLASS –XII**

SUBJECT: ACCOUNTANCY

# CHAPTER -1 **ACCOUNTING FOR PARTNERSHIP FIRMS FUNDAMENTALS**

## (THEORY)

**According to Section -4 of the Indian Partnership Act, 1932:**
"Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all"

**Features of Partnership**

1. **Two or more persons:** There must be at least two persons to form a valid partnership. The maximum number of partners cannot exceed the number of partners prescribed by companies Act, 2013 which is 50 in any business whether banking or non- banking.

2. **Agreement :**Partnership comes into existence by an agreement (either written or oral among the partners. The written agreement among the partners is called Partnership Deed.

3. **Existence of business and profit motive :**A partnership can be formed for the purpose of carrying on legal business with the intention of earning profits. A joint ownership of some property by itself cannot be called a partnership.

4. **Sharing of Profits :** An agreement between the partners must be aimed at sharing the profits. If some persons join hands to run some charitable activity, it will not be called partnership. Further, if a partner is deprived of his right to share the profits of the business, he cannot be called as partner.

5. **Business carried on by all or any of them acting for all :** It means that each partner can participate in the conduct of business and each partner is bound by the acts of other partners in respect to the business of the firm.

6. **Relationship of Principal and Agent :** Each partner is an agent ad well as a partner of the firm. An agent, because he can bind the other partners by his acts and principal, because he himself can be bound by the acts of the other partners.

**PARTNERSHIP DEED**

Since partnership is the outcome of an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions mat be either written or oral. The law doesnot make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

**The partnership deed is a written agreement among the partners which contains the terms of agreement. It is also called '** ***Articles of Partnership'*** **. A partnership deed should contain the following points:**

1. Name and address of the firm as well as partners.
2. Name and addresses of the partners.
3. Nature and place of the business.
4. Duration, if any of partnership.
5. Capital contribution by each partner.

6. Interest on capital.
7. Drawings and interest on drawings.
8. Profit sharing ratio.
9. Interest on loan.
10. Partner's Salary/commission etc.
11. Method for valuation of goodwill and assets.
12. Accounting period of the firm and duration of partnership
13. Rights and duties of partners how disputes will be settled.
14. Decisions taken if some partner becomes insolvent.
15. Opening of Bank Account – whereas it will be in the name of firm or partners.
16. Rules to be followed in case of admission & Settlement of accounts or retirement or death of partner.

17. Revaluation of assets & liabilities, if any to be done.
18. Method of recording of firm's accounts
19. Auditing
20. Date of commencement of partnership

**BENEFITS OF PARTNERSHIPDEED**

(1) It regulates the rights, duties and liabilities of each partner.

(2) It helps to avoid any misunderstanding amongst the partners because all the terms and conditions of partnership have been laid down before hand in the deed.

(3) Any dispute amongst the partners may be settled easily as the partnership deed may be readly referred to.

Hence, it is always best course to have a written partnership deed duly signed by all the partners and registered under the Act.

**RULES APPLICABLE IN THE ABSENCE OF PARTNERSHIP DEED**

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| Profit sharing Ratio | Equal, Irrecspective of capital contribution. |
| Interest on Capital | No Interest on Capital is to be allowed to any Partner |
| Interest on Drawings | No interest on Drawings is to be charged to any partner |
| Salary or Commission to a Partner | Not allowed to any partner |
| Interest on loan by a Partner | Interest is allowed @ 6% per annum. |

**DISTRIBUTION OF PROFITS AMONG PARTNERS**

Transactions of the partnerhsip firm are recorded according to the principles of Double- entry book keeping system, and as in the case of a sole proprietorship concern a partnership firm will also prepare Trading account, Profit & Loss account and Balance Sheet at the end of every year. The only difference between accounting of a sole trader and partnership firm is that the profits of the partnership firm ar divided amongst the partners.

A Profit and Loss Appropriation Account is prepared to show the distribution of profits among partners as per the provision of Partnership Deed (or as per the provision of Indian Partnership Act, 1932 in the absence of Partnership Deed). It is an extension of profit and Loss Account. It is nominal account. It records entries for interest on capital, Interest on Drawings, Salary to the partner, and division of profits among the partners.