Accounting For Partnership Firms: Fundamentals

* Nature of partnership firms :-

Partnership is a relation of mutual trust and faith. Partnership accounts should present a true and fair picture of the partnership business.

*Definition :-

When two or more persons enter in to agreement for setting up a business, to run it and share the profit and losses, it is termed as partnership

"According to partnership act 1932 ,as per section 4,
It is a relationship between persons who have agreed to share the profit of a business. Carried on by all or any of them acting for

This definition highlights following elements
There must be two or more persons.
There must be an agreement..
There must be sharing of profits of business.
There must be a mutual agency, *i.e.*, the business must be either carried on by all or any of them acting for all.

• Characteristics of Partnership

Following are the essential features or characteristics of partnership:

i. **Two or more persons:** To form a partnership, there must be at least 2 partners who are competent to contract and who are not minor, persons of unsound mind and persons disqualified by any law. The maximum number of the partners in the firm cannot exceed 50 vide Rule 10 of the Companies Rules, 2014 as prescribed by the Central Government.
ii. **Agreement:** It is a legal document signed by all the partners. A written agreement containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed.
iii. **Lawful Business:** A partnership is formed to do a lawful business which includes trade, vocation and profession. Any type of charitable institution running as a not-for-profit organization will not be considered as a business.
iv. **Profit-Sharing:** A partnership agreement specifies how the profits and losses of the firm will be shared by the partners.
v. **Mutual Agency**:- Business can be carried on by all or any of the Partners Acting for All: Since, the partners are the agents as well as principals of the firm, such business of the partnership firm can be carried on by all or any of the partners acting for all, that is there must be mutual agency
vi. **No separate Entity**:-partnership does not have a separate entity from its partners.
vii. **Unlimited LIABILITY**:- The liability of all the partners of a firm are unlimited like the sole proprietorship.
viii. **No Transfer of interest without consent**:- A partner cannot transfer his interest in the firm without the consent of all other partners.

Rights of Partners:

Every Partner has the right:

i. to participate in the management of the business.
ii. to be consulted about the affairs of the business.
iii. to inspect the books of account and have a copy of it.
iv. to share profits and losses with others in the agreed ratio.
v. to receive interest on the loan advanced by him to the firm at an agreed rate of interest. Where the rate is not agreed, interest is paid at the rate of 6% p.a. as per the provisions of Indian Partnership Act, 1932.
vi. to act according to his best judgment in case of emergency and be indemnified for the expenses incurred by him.
vii. not to allow the admission of a new partner.
viii. to retire from the firm after giving proper notice for the same.
ix. to get indemnified against the expenses incurred by him on the business or incurred by him on behalf of the firm.

<u>**Kind of Partnership**</u>

1. <u>On the basis of liability</u>

(a) <u>**Limited partnership**</u>:- when the liability of any partner is limited to the extent of share in profit and the invested amount as capital. The personal assets of partner are not used for payment of debts.

(b) <u>**Unlimited partnership:-**</u> when the liability of all partners is un- limited in the favor of creditors. the personal assets of partners may be used for payment of debts.

2. On the basis of Object(Purpose)

(a)**Partnership as Will:-** when the partnership starts for Indefinitely for any business

(b) **Particulars (specific) partnership**:- When the partnership starts for any specific purpose and work. When specific work completed then it end automatically

3. On the basis of Time(term)

(a)**Fixed term partnership**:- when the partnership starts for fixed period (like 6 months, 5 years etc)

(b)Non fixed partnership:- When the partnership starts for indefinitely period and not have any specific objects.

4. On the basis of legality

(a)Registered partnership:- When the partnership is registered by Indian partnership act 1932

(b)Legal partnership:- When the partnership business running according to Indian partnership act 1932 and follows rules of act

C) Illegal partnership:- When the partnership business is not running according to Indian partnership act 1932 and not follow rules of act

Important definitions

1. **Partner:-** The persons who have entered in to partnership with one another individually ,are called partner
2. **Firm:-** The group of partners which the business is carried on is called firm
3. **Firm Name:-** The name under which the business of the partners is carried on is called the Firm Name
4. **Partnership Business:-** A partnership is a form of business where two or more people share ownership as well as the responsibilities for managing the business and the income or losses the business generates to be called partnership business
5. **Types of Partner:-** Generally ,There are two types of the partner

   (a) **Active partner:** A partner who contributes capital and takes an active part in the management of the partnership.

   (b) **Sleeping partner:** A partner who merely contributes capital for the business but does not take part in the management of the partnership business

***Partnership Deed :** 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. Other word, it is a written document containing the terms of agreement between the partners pertaining to the rights, duties and obligation of the partner. It is also known as Articles of partnership.

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.

A written document containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed. It is a legal document signed by all the partners and has the following clauses:

i. **Description of the Partners:** It contains names, description and addresses of the partners.
ii. **Description of the Firm:** It contains name and address of the firm.
iii. **Principal Place of Business:** It contains address of the principal place of business.
iv. **Nature of Business:** It specifies the nature of business that the firm shall carry on.
v. **Commencement of Partnership:** Date of commencement of partnership is specified in this clause.
vi. **Capital Contribution:** It mentions the amount of capital that each partner contributes whether capital accounts are fixed or fluctuating.
vii. **Interest on Capital:** It specifies the interest on capital if such interest is allowed to be paid.

viii. **Interest on Drawings:** It specifies the rate of interest on drawings if such interest is charged on drawings.
ix. **Profit-Sharing Ratio:** It specifies the ratio in which the profits and losses of the firm are shared by the partners.
x. **Interest on Loan:** It specifies the rate of interest paid on the loan by the partner to the firm.
xi. **Remuneration to Partners:** It specifies the amounts of salary, commission, etc. payable to the partners.
xii. **Valuation of Goodwill:** It specifies the method by which the goodwill of the firm will be valued in the event of reconstitution of the partnership.
xiii. **Valuation of Assets:** It specifies the manner in which assets of the firm shall be valued in the event of reconstitution of the partnership.
xiv. **Settlement of Accounts:** It specifies the manner in which the accounts of the partner(s) shall be settled in case of partners' retirement or death or in the event of dissolution of the firm.
xv. **Accounting Period:** It specifies the date on which accounts of the firm are closed every year.
xvi. **Rights and Duties of Partners:** It specifies the rights and duties of the partners.
xvii. **Duration of Partnership:** It specifies whether the partnership is for a specified period or for a venture or at will.
xviii. **Bank Account Operation:** It specifies how the bank accounts should be operated; whether by any of the partners or jointly by all partners.
xix. **Death of a Partner:** It specifies whether the firm will continue or dissolve in the event of death of a partner.
xx. **Settlement of Disputes:** It specifies how the disputes among the partners shall be settled, if any arises.

Importance of Partnership Deed:

i. An important legal document.
ii. Defines relationship between the partners.
iii. Governs the rights, duties and liabilities of each partner and therefore, avoids and settles possible disputes among the partners.
iv. In case of any dispute among partners, partnership deed is considered as the basis for settlement of such dispute.
v. Not essential but desirable to have a Partnership Deed
vi. Where there is no partnership deed, provisions of Indian Partnership Act, 192 will be applied.

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

Provisions of the Indian Partnership Act, 1932 shall be applicable when there is no Partnership Deed or if the Partnership Deed is silent. Following are the matters for which provisions of this Act shall be applicable, if the partnership deed is silent on the same:

i. **Sharing of Profits/Losses:** Profits/Losses are shared equally by the partners.
ii. **Interest on Capital:** No such interest on capital is allowed to partners.
iii. **Interest on Drawings:** No such interest on drawings is charged from partners.
iv. **Interest on Advance/Loan by a Partner:** Interest shall be paid at the rate of 6%p.a. Such interest shall be payable even if there is a loss from business as it is a charge against profit.
v. **Remuneration to Partners:** No partner shall be paid such remuneration as salary, commission, etc. if the partnership deed is silent on such matter.
vi. **Liabilities of Partners:** Subject to agreement among the partners:
    a. **Profit from a similar business:** In case if a partner earns profit from a business that is similar to that of the firm in competition with the firm, then such profit earned from such business shall be paid to the firm.
    b. **Profit earned for self from firm's business:** In case if the partner earns profit for self from any business transaction of the firm or from the use of firm's property or business connection, the profit so earned shall be paid to the firm.

Limited Liability Partnership (LLP):

- **Meaning:** An LLP is a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership.

The concept of Limited Liabilities partnership comes into existence with enactment of Limited Liabilities partnership act 2008

Main features of LLP:-

(1) Name of LLP is approved is approved by the registrar of the company (ROC)
(2) The LLP comes into existence by entering into agreement by the partners which are determined respective duties and responsibilities and also the profit – sharing ratio.
(3) The agreement is filled with the registrar of the companies (ROC)
(4) In this case the liabilities of the partner is limited to the extent of their capital
(5) At least two persons should be appointed DESIGNATED persons one of whom must be a partner
(6) LLP must file a SOLVENCY CERTIFICATE with the registrar of companies every year