

You have learnt about the preparation of final accounts for a sole proprietary concern. As the business expands, one needs more capital and larger number of people to manage the business and share its risks. In such a situation, people usually adopt the partnership form of organisation. Accounting for partnership firms has its own peculiarities, as the partnership firm comes into existence when two or more persons come together to establish business and share its profits. On many issues affecting distribution of profits, there may not be any specific agreement between the partners. In such a situation the provisions of the Indian Partnership Act 1932 apply. Similarly, calculation of interest on capital, interest on drawings and maintenance of partners capital accounts have their own peculiarities. Not only that a variety of adjustments are required on the death of a partner or when a new partner is admitted and so on. These peculiar situations need specific treatment in accounting that need to be clarified.

The present chapter discusses some basic aspects of partnership such as distribution of profit, maintenance of capital accounts, etc. The treatment of situations like admission of partner, retirement, death and dissolution have been taken up in the subsequent chapters.

2.1 Nature of Partnership

When two or more persons join hands to set up a business and share its profits and losses, they are said to be in partnership. Section 4 of the Indian Partnership Act 1932 defines partnership as the

'relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'

Persons who have entered into partnership with one another are individually called 'partners' and collectively called 'firm'. The name under which the business is carried is called the 'firm's name'. A partnership firm has no separate legal entity, apart from the partners constituting it. Thus, the essential features of partnership are:

1. **Two or More Persons:** In order to form partnership, there should be at least two persons coming together for a common goal. In other words, the minimum number of partners in a firm can be two. There is however, a limit on their maximum number. By virtue of Section 464 of the Companies Act 2013, the Central Government is empowered to prescribe maximum number of partners in a firm but the number of partners can not be more than 100. The Central government has prescribed the maximum number of partners in a firm to be 50 under Rule 10 of the Companies (Miscellaneous) Rules, 2014. So, a partnership firm cannot have more than 50 partners.
2. **Agreement:** Partnership is the result of an agreement between two or more persons to do business and share its profits and losses. The agreement becomes the basis of relationship between the partners. It is not necessary that such agreement is in written form. An oral agreement is equally valid. But in order to avoid disputes, it is preferred that the partners have a written agreement.
3. **Business:** The agreement should be to carry on some business. Mere co-ownership of a property does not amount to partnership. For example, if Rohit and Sachin jointly purchase a plot of land, they become the joint owners of the property and not the partners. But if they are in the business of purchase and sale of land for the purpose of making profit, they will be called partners.
4. **Mutual Agency:** The business of a partnership concern may be carried on by all the partners or any of them acting for all. This statement has two important implications. First, every partner is entitled to participate in the conduct of the affairs of its business. Second, that there exists a relationship of mutual agency between all the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He can bind other partners by his acts and also is bound by the acts of other partners with regard to business of the firm. Relationship of mutual agency is so important that one can say that there would be no partnership, if the element of mutual agency is absent.
5. **Sharing of Profit:** Another important element of partnership is that, the agreement between partners must be to share profits and losses of a business. Though the definition contained in the Partnership Act describes partnership as relation between people who agree to share the profits of a business, the sharing of loss is implied. Thus, sharing of profits and

losses is important. If some persons join hands for the purpose of some charitable activity, it will not be termed as partnership.

6. **Liability of Partnership:** Each partner is liable jointly with all the other partners and also severally to the third party for all the acts of the firm done while he is a partner. Not only that the liability of a partner for acts of the firm is also unlimited. This implies that his private assets can also be used for paying off the firm's debts.

Limited Liability Partnership

Limited Liability Partnership (LLP) is an incorporated partnership formed and registered under the Limited Liability Partnership Act., 2008 with limited liability and perpetual succession.

It is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its partners the flexibility of organising their internal structure as a partnership based on a mutually arrived agreement.

Salient Features

The salient features of Limited Liability Partnership are as follows :

1. Limited Liability Partnership is a corporate and a legal entity separate from its partners.
2. Every Limited Liability Partnership shall have at least two partners and shall also have at least two individuals as designated partners, of whom at least one shall be a resident in India.
3. The Indian Partnership Act, 1932, shall not be applicable to Limited Liability Partnership.
4. The Limited Liability Partnership has a perpetual succession.
5. The Central government has the power to investigate into the affairs of a Limited Liability Partnership, if required, by appointment of a Competent Inspector for the purpose.

2.2 Partnership Deed

Partnership comes into existence as a result of agreement among the partners. The agreement can be either oral or written. The Partnership Act does not require that the agreement must be in writing. But wherever it is in writing, the document, which contains terms of the agreement is called 'Partnership Deed'. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.

The clauses of partnership deed can be altered with the consent of all the partners. The deed should be properly drafted and prepared as per the provisions of the Stamp Act and preferably registered with the Registrar of Firms.

- Amount of capital to be contributed by each partner;
- The accounting period of the firm;
- The date of commencement of partnership;
- Rules regarding operation of Bank Accounts;
- Profit and loss sharing ratio;
- Rate of interest on capital, loan, drawings, etc;
- Mode of auditor's appointment, if any;
- Salaries, commission, etc. if payable to any partner;
- The rights, duties and liabilities of each partner;
- Treatment of loss arising out of insolvency of one or more partners;
- Settlement of accounts on dissolution of the firm;
- Method of settlement of disputes among the partners;
- Rules to be followed in case of admission, retirement, death of a partner; and
- Any other matter relating to the conduct of business.

Normally, the partnership deed covers all matters affecting relationship of partners amongst themselves. However, if there is no express agreement on certain matters, the provisions of the Indian Partnership Act, 1932 shall apply.

2.2.1 Provisions Relevant for Accounting

The important provisions affecting partnership accounts are as follows:

- Profit Sharing Ratio:** If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners, irrespective of their capital contribution in the firm.
- Interest on Capital:** No partner is entitled to claim any interest on the amount of capital contributed by him in the firm as a matter of right. However, interest can be allowed when it is expressly agreed to by the partners. Thus, no interest on capital is payable if the partnership deed is silent on the issue. Further the interest is payable only out of the profits of the business and not if the firm incurs losses during the period.
- Interest on Drawings:** No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.
- Interest on Advances:** If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall be entitled to get an interest on the amount at the rate of 6 per cent per annum.
- Remuneration for Firm's Work:** No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm unless there is a provision for the same in the Partnership Deed.

Apart from the above, the Indian Partnership Act specifies that subject to contract between the partners:

- If a partner derives any profit for him/her self from any transaction of the firm or from the use of the property or business connection of the firm or the firm name, he/she shall account for the profit and pay it to the firm.
- If a partner carries on any business of the same nature as and competing with that of the firm, he/she shall account for and pay to the firm, all profit made by him/her in that business.