

Chapter 2- Accounting for Partnership Firms- Fundamentals

Question 1

Define Partnership.

Answer:

A partnership agreement is an agreement between two or more individuals who sign a contract to start a profitable business together. In the Partnership agreement, the partners are equally responsible for the debt of an organization. Even if one person withdraws his/her partnership, they are liable for an already existing debt, and future liability if they do not provide with proper notice of retirement. Sometimes, a partnership can also exist without signing any scripted agreement, in such cases law that regulates partnership would apply.

Question 2

Partners' Current Accounts are opened when their capital accounts are

- (1) Fixed
- (2) Fixed and Fluctuating both
- (3) Fluctuating
- (4) None of these

Answer: Fixed

Question 3

The interest on capital accounts of partners under the fluctuating capital account method is credited to

- (1) Interest Account
- (2) Profit and Loss Account
- (3) Partners' Capital Accounts
- (4) None of these

Answer: Partners' Capital Accounts

Question 4

In the absence of an agreement to the contrary, partners share profits and losses in the

- (1) Ratio of their capitals at the beginning of the year
- (2) Ratio of their capitals at the end of the year

- (3) Ratio of average capital
- (4) Equal ratio

Answer: Equal ratio

Question 5

In the absence of an agreement to the contrary, the partners are

- (1) Entitled for 6% interest on their capitals, only when there are profits
- (2) Entitled for 9% interest on their capitals, only when there are profits
- (3) Entitled for interest on capital on the bank rate, only when there are profits
- (4) Not entitled for any interest in their capitals

Answer: Not entitled for any interest in their capitals

Question 6

The current account of a partner

- (1) Will always have a credit balance
- (2) Will always have a debit balance
- (3) May have a debit or credit balance
- (4) Can never have a debit balance

Answer: May have a debit or credit balance

Question 7

Interest payable on the capitals of the partners is changed to

- (1) Profit and Loss Account
- (2) Profit and Loss Adjustment Account
- (3) Realization Account
- (4) Profit and Loss Appropriation Account

Answer: Profit and Loss Appropriation Account

Question 8

Interest on partner's drawing under a fluctuating capital account is debited to

- (1) Partner's Capital Account
- (2) Profit and Loss Account
- (3) Drawing Account

(4) None of the above

Answer: Partner's Capital Account

Question 9

Explain the importance of partnership agreement

Answer: A partnership agreement is vital to keep away the disagreement, confusion or any changes that might occur in the course of business tenure. Below are a few points that describe why a partnership agreement is essential:

- To form distinguished roles and responsibilities for each partner.
- To avoid tax problems, the tax status shows that the partner is dispensing profits to each partner based on accounting practice and acceptable tax
- To avoid liability and legal issue, if there is any with any of the partners
- It helps to deal with any lifestyle or circumstance changes of any partners. They usually deal with buy-out agreement with individual partners
- To surpass non-compete agreements and conflict of interest with partners
- To overrule the state law

Question 10

What is a Partnership Deed?

Answer: A partnership deed, also called as a partnership agreement, is a record that outlines in detail the rights and functionalities of all parties to a business operation. It has the force of law and is designed to guide the partners in the conduct of the business.

Question 11

Explain two types of partnership.

Answer: The two types of partnership are.

- **General Partnership:** It is formed when two or more individual enters into an agreement to run a business and make profits. Generally, no written agreements are made in this partnership but share all joint and various liabilities of the partner.
- **Limited Partnership:** The partner invest money but do not operate or involve themselves in operating a business. This partnership is formed legally and by creating an agreement.

Question 12

Define different types of partners in a partnership.

Answer: The different types of partners in a partnership are.

- **General and limited partners:** General partners manage and participate in the partnership and also have liability for debts. Whereas, limited partners invest in the business but do not interfere in the management.
- **Salaried partners and Equity partners:** In partnership, some partners are paid salaries, while the equity partners have a share in the business.
- **Different levels of partners:** Here, the job role, responsibilities, investment, level of inputs may be different.

Question 13

Explain nature of partnership.

Answer: The vital features of the partnership are :

- **2 or More Persons:** In order to manifest a partnership, there should be at least 2 persons possessing a common goal. To put it in other words, the minimal number of partners in an enterprise can be 2. However, there is a constraint on their maximum number of people. By the uprightness of Section 464 of the Companies Act 2013, the Central Government is authorized to stipulate a maximum number of partners in an enterprise; however, the number of partners cannot exceed 100. The Central government has stipulated the maximum number of partners in an enterprise to be 50, under Rule 10 of the Companies (Miscellaneous) Rules, 2014. Hence, a partnership enterprise cannot have more than 50 people (partners)
- **Agreement:** Partnership is the outcome of an accord between 2 or more people to regulate business and share its gains and losses. The agreement (accord) becomes the basis of the association between the partners. Such an agreement is in the written form. An oral agreement is evenhandedly legitimate. In order to avoid controversies, it is always good, if the partners have a copy of the written agreement
- **Sharing of Profit:** Another significant component of the partnership is, the accord between partners has to share gains and losses of a trading concern. However, the definition held in the Partnership Act elucidates – partnership as an association between people who have consented to share the gains of a

business, the sharing of loss is implicit. Hence, sharing of gains and losses is vital.

Question 14

How is Partner's Contribution & Percentage Distributed?

Answer: While distributing partner's contribution & percentage below-mentioned points are followed.

- Partner contribution can be in a different amount and type including cash, idea, partner's time on a job. In this regards, each partner's contribution need not necessarily be in cash. That means the partners may make uniform inputs to the business, have equal rights, but the inputs may not be in cash but other different forms
- Since each partner has distinct responsibilities and strength, partnership share is 100 percent impartial from a financial point of view
- The partnership percentage can be estimated by calculating the total cash required to invest in starting a new business and dividing each partner share with that total
- The role each partner plays in starting a company and the amount of work and time contributed can also dictate a percentage of proprietorship as much as financial offerings
- If partners have a corporate entity, create a total stock that has equal worth as the business, if 1000 stock is 100 percent ownership divide and calculates each partner share

Question 15

Explain the format of the profit and loss appropriation account

Answer:

Dr. Profit and Loss Appropriation Account		Cr.	
Particulars	₹	Particulars	₹
To Profit and Loss A/c (Net Loss transferred from Profit and Loss Account)	– – –	By Profit and Loss A/c (Net Profit transferred from Profit and Loss Account)	– – –
To Interest on Capital	–	By Interest on Drawings	

Abhay –	–	Abhay –	
Bhaskar –	–	Bhaskar –	
To Partners' Salaries			
To Partners' Commission			
To Reserve			
To Profit transferred to			
*Abhay's capital A/c			
(or Abhay's current A/c) –			
*Bhaskar's Capital A/			
(or Bhaskar's current A/c) –			