

Chapter 1 · Partnership Fundamentals

CBSE Class 12 Accountancy (055) · Part A · Unit 1 = 36 marks (the largest unit in the paper) · Ultimate Revision Sheet

60-SECOND RECALL

Definition	Relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all . — Indian Partnership Act, 1932, Sec 4
Features (5)	Two or more persons · Agreement · Lawful business · Profit sharing · Mutual agency
No deed → defaults	Profit share EQUAL · Interest on capital NIL · Interest on drawings NIL · Salary NIL · Interest on partner's loan 6% p.a.
Killer rule	Interest on partner's LOAN = CHARGE (P&L). Interest on CAPITAL = APPROPRIATION (P&L Appropriation).
Fixed capital	TWO accounts: Capital (never changes) + Current. Capital A/c is always Cr.
Fluctuating capital	ONE account. Everything goes into Capital A/c.

1. Meaning & Features

WRITE THIS VERBATIM Partnership is 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. — Section 4, Indian Partnership Act, 1932

1. **Two or more persons** — minimum 2; maximum 50 (Companies Act 2013, Rule 10).
2. **Agreement** — partnership arises from an **agreement**, not from status or operation of law.
3. **Lawful business** — must carry on a legal business with a profit motive.
4. **Profit sharing** — profits (and losses) shared in an agreed ratio.
5. **Mutual agency** — the real test of partnership. Every partner is both an **agent** (can bind the firm) and a **principal** (bound by others' acts).

EXAMINER TRAP If a 1-mark question asks for the **real / conclusive test** of partnership, the answer is **mutual agency** — not profit sharing. A person may share profits without being a partner (e.g. an employee on commission).

2. Partnership Deed & the Act's Default Rules

A **partnership deed** is the written agreement among partners. It is **not compulsory**, but in its absence the Indian Partnership Act 1932 applies.

Matter	If the deed is silent
Profit sharing ratio	EQUAL , regardless of capital contributed
Interest on capital	NOT allowed
Interest on drawings	NOT charged
Salary / commission to a partner	NOT allowed
Interest on partner's loan to the firm	6% per annum — and it is a CHARGE , payable even in a loss

Admission of a new partnerOnly with the **consent of ALL** existing partners**THE SINGLE BIGGEST TRAP IN THIS CHAPTER** *Charge vs Appropriation.*

- Interest on partner's **LOAN** @6% → **CHARGE** → debited to **Profit & Loss A/c** → paid even if there is a loss.
- Interest on **CAPITAL**, salary, commission → **APPROPRIATION** → debited to **P&L Appropriation A/c** → allowed only out of profits.

Getting this backwards loses the whole question, because the profit figure carried down changes.

3. Fixed vs Fluctuating Capital

Basis	FIXED capital	FLUCTUATING capital
No. of accounts	Two — Capital A/c and Current A/c	One — Capital A/c only
Capital balance	Stays unchanged unless fresh capital is introduced or withdrawn	Changes every year
Where adjustments go	Interest, salary, drawings, profit share → Current A/c	All of them → Capital A/c
Can it be negative?	Capital A/c is ALWAYS Credit . Current A/c may be Dr or Cr.	Capital A/c may show a Debit balance
If method not stated	Assume FLUCTUATING — this is the default in the exam	

4. Profit & Loss Appropriation AccountA **CHARGE** is deducted **whether or not there is profit** — it is a cost of doing business.An **APPROPRIATION** is only a **distribution of profit** — no profit, nothing to appropriate.

The pair that catches everyone:

Interest on partner's **LOAN** → **CHARGE** (P&L A/c), fixed at **6% p.a.** if the deed is silentInterest on partner's **CAPITAL** → **APPROPRIATION**, and **NOT** allowed at all if the deed is silent

Two accounts, two stages. Put an item in the wrong stage and every figure after it is wrong.

FORMAT — REPRODUCE EXACTLY *Profit & Loss Appropriation A/c for the year ended ...*

Particulars	₹	Particulars	₹
To Interest on Capital A/c A ... B ...	...	By Profit & Loss A/c (net profit transferred)	...
To Partner's Salary / Commission A/c	...	By Interest on Drawings A/c A ... B ...	...
To Reserve / General Reserve A/c	...		
To Profit transferred to Capital A/cs A ... B ...	...		
	XXX		XXX

Order on the debit side is fixed: Interest on Capital → Salary/Commission → Reserve → Profit shared.

TRAP P&L A/c vs P&L Appropriation A/c. Rent to a partner, interest on partner's loan, manager's commission and all business expenses go in the **P&L A/c** (charges). Only interest on capital, partner's salary/commission, reserve transfer and profit distribution go in the **Appropriation A/c**.

5. Interest on Capital — When Profit is Insufficient

Interest on Capital = Opening Capital × Rate × Period

Opening capital must be worked back when only the closing figure is given:

Opening Capital = Closing Capital – Additional Capital + Drawings – Profit already credited

Situation	Treatment
Loss	No interest on capital is allowed at all
Profit ≥ interest due	Full interest allowed
Profit < interest due , deed silent	Interest is restricted to the available profit and distributed in the ratio of interest due (not the PSR)
Deed says interest is a charge	Full interest allowed even in a loss ; debited to P&L A/c

6. Interest on Drawings

THE THREE CASES — know which formula applies

When drawings are...	Average period
Equal amount, beginning of each month	6.5 months
Equal amount, end of each month	5.5 months
Equal amount, middle of each month	6 months
Equal, beginning of each quarter	7.5 months
Equal, end of each quarter	4.5 months
Unequal amounts / irregular dates	Use the Product Method
Date not given	Take 6 months average

Interest on Drawings = Total Drawings × Rate × (Average months / 12)

Product Method: Interest = (Σ of Amount × Months) × Rate × 1/12

WORKING NOTE — SHOW THIS, IT CARRIES MARKS Even if the final figure is wrong, a clearly labelled working note earns method marks. Always write:

WN1: Interest on A's drawings = $60,000 \times 6/100 \times 6.5/12 = ₹1,950$

Never write a bare number in the ledger with no supporting calculation.

7. Guarantee of Profit

A partner may be guaranteed a **minimum profit**. If his actual share falls short, the **deficiency** is borne by the guaranteeing partner(s).

STEPS — follow in this order 1. Distribute profit among all partners in the normal PSR.

2. Compare the guaranteed partner's share with the guaranteed amount.

3. Deficiency = Guaranteed amount – Actual share.

4. Recover the deficiency from the guarantor(s):

- guarantee by **one** partner → he alone bears it
- guarantee by **all** → borne in their **remaining PSR**
- a **specified ratio** is given → use that ratio

TRAP When the guaranteed partner's actual share **exceeds** the guarantee, **no adjustment is made**. Students often force the guaranteed figure anyway and lose the mark.

8. Past Adjustments

Errors found after the accounts are closed — interest on capital omitted, salary not given, wrong ratio used. Corrected through a **single adjusting entry**.

METHOD — the adjustment table

Particulars	A	B	C
Amount that should have been credited	...	...	...
Amount already credited (wrongly)	(...)	(...)	(...)
Difference → Dr or Cr	...	...	...

The net of all differences must be **ZERO**. If it is not, the table is wrong — check before writing the entry.

Adjusting entry: partner(s) with an **excess** credit are **Debited**; partner(s) short are **Credited**.

9. Case-Study / Question Triggers

what the wording is really asking

If the question says...	Do this
"the deed is silent" / "no partnership deed"	Apply the six default rules (equal PSR, no interest, loan @6%)
"partner advanced a loan to the firm"	Interest 6% p.a., CHARGE to P&L A/c, not appropriation
"capitals are fixed"	Open Current A/c as well; keep Capital A/c unchanged
"nothing is said about capital method"	Assume fluctuating
"profit is insufficient to allow interest"	Restrict interest to available profit, share in ratio of interest due
"interest on capital is a charge"	Allow in full even in loss ; goes to P&L A/c
"drew ₹X at the beginning of every month"	Average period 6.5 months
"drew ₹X at the end of every month"	Average period 5.5 months
"drawings on different dates / unequal"	Product method

"guaranteed a minimum of ₹X"	Distribute normally first, then transfer the deficiency
"omitted / wrongly recorded in earlier years"	Past adjustment table, then one adjusting entry
"rent paid to a partner"	Charge — P&L A/c, not appropriation
"manager's commission"	Charge — deduct before the Appropriation A/c

MOST-ASKED BOARD QUESTIONS

1. [6M] Prepare the P&L Appropriation A/c and Partners' Capital A/cs.
2. [4M] Calculate interest on drawings by the product method / average period.
3. [4-6M] Guarantee of profit to a partner — distribute and pass the entry.
4. [3-4M] Past adjustment — prepare the table and pass the single adjusting entry.
5. [3M] Distinguish between fixed and fluctuating capital accounts.
6. [1M] At what rate is interest on a partner's loan allowed when the deed is silent? → **6% p.a.**
7. [1M] What is the real test of partnership? → **Mutual agency**

THE HABIT THAT SCORES — In every numerical, write **WN1, WN2, WN3** below the account. Examiners award method marks for a visible calculation even when the final figure is wrong. A correct answer with no working scores less than a wrong answer with clear working.