Session 4 – Accounting for Partnerships

Learning Objectives

- Identify and explain the characteristics of partnership.
- Describe the main features of partnership agreement and the rules governing partnerships in Ghana.
- Explain the purpose of and be able to prepare a profit and loss appropriation account.
- Prepare current accounts, capital accounts and financial statements of a partnership.

What Partnership is

- Incorporated Private Partnership Act of 1962, Act 152 (IPPA) governs partnership in Ghana.

- It is "the association of two or more individuals carrying on business jointly for the purpose of making profits". S.3 (1) of IPPA

- Maximum number of persons is 20. S.4 (2) of IPPA

- Formed by formal agreement (partnership agreement).

What Partnership is not

A family ownership or co-ownership of property whether or not the family or co-owners share any profits made by the use of that property.

The remuneration of a servant or agent of a person engaged in business by a share of profits of the business shall not necessary make the servant or agent a partner.

Nature of Partnership

Firm (as a corporate body) is distinct from the partners.

Formed by formal agreement (partnership agreement).

Partners are jointly and severally liable.

- The partnership is liable if any individual partner acting in *normal course of business* carries out any wrong doing.
- If one partner is sued for wrong doing, the other partners may be sued also.

Liability is unlimited.

Relationship between partners is a fiduciary one.

Every partner is also an agent of the firm.

Partnership Agreement

NAME AND NATURE OF BUSINESS OF THE FIRM.

THE AMOUNT OF CAPITAL TO BE CONTRIBUTED AND MAINTAINED BY EACH PARTNER.

THE RATE OF INTEREST (IF ANY) TO BE PAID ON CAPITAL.

THE EXTENT TO WHICH DRAWINGS ARE ALLOWED AND THE RATE OF INTEREST (IF ANY) TO BE CHARGED ON DRAWINGS.

THE REMUNERATION (IF ANY) TO BE PAID TO PARTNERS FOR THEIR SERVICES

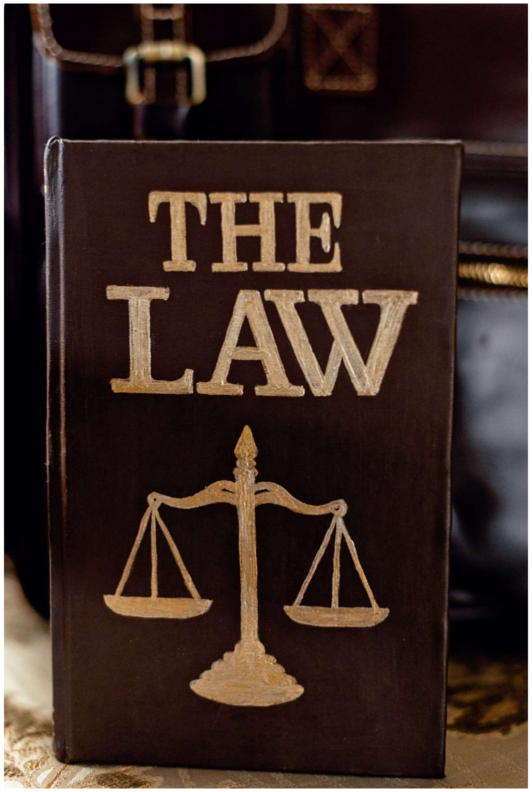
THE RATIO IN WHICH PROFITS AND LOSSES ARE TO BE SHARED.

KEEPING OF BOOKS AND ACCOUNTS.

ARRANGEMENTS FOR ADMISSION OF NEW PARTNERS.

- **The Partnership Deeds should provide some information on how the partnership will be run.**

Rules in the Absence of Partnership Agreement. [Section 35]



- All partners are to share equally in capital, profits and losses.
- No interest is allowed to be charged on capital.
- No remunerations are to be paid to partners.
- Any advance made by a partner in excess of his agreed shared capital will receive an interest of 5% p.a.
- Every partner may take part in the management of the business of the firm
- No partner shall be entitled to remuneration for acting in the firm's business
- No person may be introduced as a partner without his consent and the consent of all the existing partners
- The partnership books and accounts shall be kept at the place of business of the firm

Accounting Requirements

- Every firm shall cause to be kept proper accounts with respect to:

- its financial position and changes therein,

- the control of, and accounting for, all property acquired.

Partnerships and Other Forms of Businesses

- Now lets compare partnerships with other forms of business organizations.

Partnership vs. Sole Proprietor

- Risk is spread and shared.
- Partners provide a range of specialised skills.
- More capital available.

- Some partners work harder for the firm than others.
- There may be disputes.
- Slow decision making.
- Joint and several liability.

Partnership vs. Companies

- Less formal set up.
- No company formalities (e.g. statutory audits and accounts filing).

- Much easier to sell shares than to realise capital in a partnership.
- Partnership structure can be cumbersome.
- Liabilities are unlimited.

Differences in Financial Statements

Statement of Profit or Loss

- Profit and loss appropriation account

Statement of Financial Position

- Capital accounts for each partner
- Current accounts for each partner

Profit and Loss Appropriation Account

- Typical appropriations are:

  - interest on capital (%) – gives recognition to partners contributing different amounts of capital to the firm
  - salary (annual) – not to be confused with salaries paid to employees (which are an expense in the Profit and loss)
  - Interest on drawings
  - Interest on current accounts
  - Share of profit and loss

Format of Appropriation Account

Profit and Loss Appropriation account for the year ended …		
Net Profit b/d		xxx
Add: Interest on drawings		
A	xx	
B	xx	xx
Interest on current accounts		
B (DR)		xx
		xxx
Less: Interest on capital		
A	xx	
B	xx	(xx)
Interest on current accounts		
A (CR)		(xx)
Partner's salary: B		(xx)
Profit to be shared		xxx
Share of profit		
A		xxx
B		xxx
		xxx

Capital Account

- Account maintained to record the capital contributions of the individual partners.
  - It is credited with contributions from partners and debited with withdrawals from capital by partners.

- Fixed Capital Account
  - Only capital increases and decreases are recorded in the capital account.
- Floating/ Fluctuating Capital Account
  - Records all other resource flow, to and from the partners.

Current Account

- When a fixed capital account method is used, the current account takes care of all the short-term interests or otherwise of the partners in the firm. This relieves the capital account of the details such as share of profit, interest on capital and drawings, partners' salaries among others.

A Typical Current Account In Columnar Form

Details/Particulars	A	B	Details/Particulars	A	B
Balance b/d	-	xx	Balance b/d	xx	-
Interest on drawings	xx	xx	Interest on capital	xx	xx
Drawings (cash/goods)	xx	xx	Interest on current a/c	xx	-
Balance c/d	-	xx	Partners salaries	xx	xx
			Share of profit	xx	xx
			Balance c/d	xx	-
	xx	**xx**		**xx**	**xx**
Balance b/d	xx		Balance b/d	-	xx

Partner’s Loan Account

- Where a partner gives a loan to the firm or makes an advance in excess of the agreed capital contribution, the amount should be credited to a separate loan account and not included in the capital account:

  – Such advances attracts an interest rate of 5% **per annum**.

  (S 35 of ACT 152)

  – On the winding up of the firm, repayment of partners’ loans rank at a higher priority to that of partners’ capital.

Taylor and Clarke share profits in the ratio: Taylor, three-fifths; Clarke, two-fifths.

They are entitled to 5% interest on capital.

Taylor invested £20,000 capital and Clarke invested £60,000 capital.

Clarke receives a salary of £15,000.

Taylor is to be charged £500 interest on drawings and Clarke £1,000.

Net profits amounted to £50,000.

Drawing of £15,000 and £26,000 for Taylor and Clarke respectively

	£	£	£
Net profit			50,000
Add Charged for interest on drawings:			
Taylor		500	
Clarke		1,000	
			1,500
			51,500
Less Salary: Clarke		15,000	
Interest on capital:			
Taylor	1,000		
Clarke	3,000		
		4,000	
			(19,000)
Balance of profits			32,500
Shared:			
Taylor $^3/_5$		19,500	
Clarke $^2/_5$		13,000	
			32,500

Try this

Black, Brown and Cook are partners. They share profits and losses in the ratios of 2/9, 1/3 and 4/9 respectively. For the year ended 31 July 20X2, their capital accounts remained fixed at the following amounts:

	£
Black	60,000
Brown	40,000
Cook	20,000

They have agreed to give each other 6 per cent interest per annum on their capital accounts. In addition to the above, partnership salaries of £30,000 for Brown and £18,000 for Cook are to be charged. The net profit of the partnership, before taking any of the above into account was £111,000. You are required to draw up the appropriation account of the partnership for the year ended 31 July 20X2.

- Assignment
- 41.9 of Frank wood

Example

Question 1 in Worksheet 4