Partnerships

Theory

1. An agreement between two or more people to carry on a business in order to make a profit.

2. Advantages:

    a. Raise more capital
    b. More skills & knowledge
    c. Share the work

3. Disadvantages

    a. Profits must now be shared
    b. Disagreements can occur
    c. Partners cannot act independently

4. According to the Partnership Act 1890, in the <u>*absence*</u> of a partnership agreement:

    a. All partners contribute equal capital
    b. Partners are not entitled to interest on capital or salaries
    c. Partners will not be charged interest on drawings
    d. Profits or losses will be shared equally
    e. Partners are entitled to 5% interest on a loan they make to the partnership

Special accounts for partnerships

1. APPROPRIATION ACCOUNT

    - Continues from the Profit and Loss Account and shows how the profit or loss will be treated between the partners.

    - Items under the Appropriation Account:

        i. Partners' SALARIES
        ii. INTEREST ON CAPITAL
        iii. INTEREST ON DRAWINGS
        iv. SHARE OF THE REMAINING PROFIT

Example:

Trading and Profit and Loss and Appropriation Account

Net Profit			*20 000*
ADD Interest on Drawings	: Abrahams	2 000	
	: Peterson	3 000	5 000
			25 000
LESS Interest on Capital	: Abrahams	4 000	
	: Peterson	2 000	
		6 000	
LESS Salaries	: Abrahams	9 000	15 000
			10 000
Share of Profit	:Abrahams(1/2)	5 000	
	: Peterson (1/2)	5 000	10 000

2. DRAWINGS

- Each partner has their own Drawings account.

3. CAPITAL ACCOUNTS

- Each of the partners will have their own Capital accounts
- The capital accounts may either be:
    - *Fluctuating Capital Accounts* – all the items in the Appropriation account are entered into the Capital accounts of the partners; the Drawings account of each partner is closed off to the partners Capital accounts.
    - *Fixed Capital Accounts* – The capital account balances do not change unless a partner contributes more capital. The items in the Appropriation account now get entered into the *partners' Current Accounts.*

4. CURRENT ACCOUNTS

- Each partner has their own Current Account *if the Capital accounts are fixed*.
- These accounts are used to complete the double entry from the Appropriation account (salaries, interest on capital, interest on drawings, profit share).
- The drawings account of each partner is closed off to the partners' Current account.
- The current account may also be credited with any interest on a loan made by the partner to the business. BE CAREFUL! The *interest on a loan* made by a partner to the business appears as a *normal expense in Profit and Loss.*

Example:

Current account: Abrahams

Dec 31	Interest on Drawings	2 000	Jan 1	Balance b/d	6 000
	Drawings	8 000	Dec 31	Interest on Capital	4 000
				Salary: Abrahams	9 000
				Share of Profit	5 000
Dec 31	Bal. c/d	17000		*Interest on Loan*	*3 000*
		27000			27000
			Jan 1	Bal. b/d	17000

Note that the balance brought down on the credit side of 17000 is the amount owed by the business to Abrahams. If the bal. b/d falls on the debit side then this would be the amount owing to the business by the partner. This usually happens when the partner takes too many drawings.