ACCOUNTANCY

CLASS - XII

UNIT 2: ACCOUNTING FOR PARTNERSHIP FIRMS – FUNDAMENTALS

According to Section -4 of the Indian Partnership Act, 1932:

"Partnership is the relations between two or more persons who have agreed to share the profits of a business carried on by all or any one of them acting for all"

Features of Partnership

1. Two or more persons: There must be at least two persons to form a valid partnership. The maximum number of partners cannot exceed the number of partners prescribed by Companies Act, 2013 which is 50 in any business whether banking or non- banking.

2. Agreement: Partnership comes into existence by an agreement (either written or oral among the partners. The written agreement among the partners is called Partnership Deed.

3. Existence of business and profit motive: A partnership can be formed for the purpose of carrying on legal business with the intention of earning profits. A joint ownership of some property by itself cannot be called a partnership.

4. Sharing of Profits: An agreement between the partners must be aimed at sharing the profits. If some persons join hands to run some charitable activity, it will not be called partnership. Further, if a partner is deprived of his right to share the profits of the business, he cannot be called as partner.

5. Business carried on by all or any of them acting for all: It means that each partner can participate in the conduct of business and each partner is bound by the acts of other partners in respect to the business of the firm.

6. Relationship of Principal and Agent: Each partner is an agent ad well as a partner of the firm. An agent, because he can bind the other partners by his acts and principal, because he himself can be bound by the acts of the other partners.

Partnership Deed

Since partnership is the outcome of an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions may be either written or oral. The law does not make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

The partnership deed is a written agreement among the partners which contains the terms of agreement. It is also called ' *Articles of Partnership'*. A partnership deed should contain the following points:

1. Name and address of the firm as well as partners.
2. Name and addresses of the partners.
3. Nature and place of the business.
4. Duration, if any of partnership.
5. Capital contribution by each partner.
6. Interest on capital.

7. Drawings and interest on drawings.
8. Profit sharing ratio.
9. Interest on loan.
10. Partner's Salary/commission etc.
11. Method for valuation of goodwill and assets.
12. Accounting period of the firm and duration of partnership
13. Rights and duties of partners how disputes will be settled.
14. Decisions taken if some partner becomes insolvent.
15. Opening of Bank Account – whereas it will be in the name of firm or partners.
16. Rules to be followed in case of admission & Settlement of accounts or retirement or death of partner.
17. Revaluation of assets & liabilities, if any to be done.
18. Method of recording of firm's accounts
19. Auditing
20. Date of commencement of partnership

Benefits of Partnership Deed

(1) It regulates the rights, duties and liabilities of each partner.
(2) It helps to avoid any misunderstanding amongst the partners because all the terms and conditions of partnership have been laid down before hand in the deed.
(3) Any dispute amongst the partners may be settled easily as the partnership deed may be readily referred to.
Hence, it is always best course to have a written partnership deed duly signed by all the partners and registered under the Act.

Rules applicable in the absence of partnership deed

- ✓ Profit sharing Ratio Equal, irrespective of capital contribution.
- ✓ No Interest on Capital is to be allowed to any Partner.
- ✓ No interest on Drawings is to be charged to any partner.
- ✓ No Salary or Commission to a Partner allowed to any partner.
- ✓ Interest @ 6% per annum on loan by a Partner to the firm.

Charge against Profit and Appropriation of Profit

Payment made or due to a partner may be a charge against profit or an appropriation of profit.
Charge against Profit means that it is an expense for the firm and is paid whether the firm earns profit or incurs loss. On the other hand, appropriation of profit means that they are allowed, if the firm earns profit during the year.
Interest on Loan by Partner, Rent Payable to a partner and Manager's Commission, etc., are charge against profit and are payable whether the firm earns profit or incurs loss.
On the other hand, **Salary/Commission to partners, interest on capitals and transfer of profit to Reserves** are appropriations.

Difference between Charge Against Profit and Appropriation of Profit

Basis	Charge Against Profit	Appropriation of Profit
1. Nature	It is an expense hence deducted from revenue to determine net profit or loss for the year.	It means distribution of net profit for the year among partners under different heads as per the Partnership Deed.
2. Recording	It is debited to Profit and Loss Account.	It is debited to Profit and Loss Appropriation Account.
3. Priority	It is allowed before Appropriation of Profit.	It is appropriated after accounting of all charges.
4. Examples	Rent paid to a partner, interest on loan by partner, etc	Salary to partners, interest on capital, transfer of profit to General Reserve, etc.

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Special Aspects of Partnership Accounts

In Partnership Accounts, there are some aspects that require discussion. They are:
1. Partners' Capital Accounts;
2. Interest on Partners' Capitals;
3. Interest on Partners' Drawings;
4. Adjustments for Incorrect Appropriations of Profits in the Past (Past Adjustments); and
5. Guarantee of Profit.

Distribution of Profits among Partners

The Journal Entries regarding Profit and Loss Appropriation Account are as follows:

1.) For transfer of balance of Profit and Loss Account

Profit and Loss A/c Dr.
To Profit and Loss Appropriation A/c
(Being profit transferred to Profit and Loss Appropriation A/c)

2.) For Interest on Capital

For allowing Interest on capital
a) Interest on Capital A/c Dr.
To Partner's Capital/Current A/cs
(Being interest on capital allowed @ % p.a.)

b) For transferring Interest on Capital to P&L Appropriation A/c.
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c.
(Being interest on capital transferred to P&L Appropriation A/c)

3.) For Salary or Commission payable to a partner

i.) For allowing Salary or Commission to a partner:
Partners Salary/Commission A/c Dr.
To Partner's Capital/Current A/cs
(Being salary/commission payable to a partner)

ii.) For transferring Partner's Salary/Commission A/c to Profit and Loss Appropriation A/c:
Profit and Loss Appropriation A/c Dr.
To Partner's Salary/Commission A/c

4.) For transfer of Reserves:

Profit and Loss Appropriation A/c Dr.
To Reserve A/c
(Being reserve created)

5.) For Interest on Drawings:

1.) For charging interest on a partner's drawings:
Partner's Capital/Current A/c. Dr.
To Interest on Drawings A/c
(Being interest on drawings charged @ % p.a.)

2.) For transferring interest on drawings to Profit and Loss Appropriation A/c
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c
(Being interest on drawings transferred to P&L appropriation A/c)

6.) For transfer to Profit (i.e. Credit Balance of Profit and Loss Appropriation Account
Profit and Loss Appropriation A/c Dr.
To Partners Capital/Current A/cs
(Being profits distributed among partners)

SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Profit and Loss Appropriation Account
Dr. for the year ending on **Cr.**

Particulars	Rs.	Particulars	Rs.
To Interest on Capital: A B To Partner's Salary/Commission To Reserves To Profits transferred to capital A/cs of: A B		By Profit and Loss A/c (Net Profits transferred from P & L A/c) By Interest on drawings: A B	

Partner's Capital Accounts

Partner's Capital Accounts: It is an account which represents the partners interest in the business. In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by any of the following two methods.
1. Fixed Capital Accounts
2. Fluctuating Capital Accounts
1. Fixed Capital Accounts
Under this method the original capitals invested by the partners remain constant, unless additional capital is introduced by an agreement. All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account which is called as Current Account. Thus, the following two accounts are maintained:
(i) When capitals are fixed - Capital Account
This account will always show a credit balance. Balance of Capital account remains fixed, it does not change every year that is why it is called fixed capital method and only the following two transactions are recorded in the Fixed Capital Accounts:
-Permanent Additional Capital Introduced
-Permanent Capital Withdrawn or Drawings out of Capital only

Dr. **Partner's Capital A/Cs** **Cr.**

Particulars	X (Rs.)	Y (Rs.)	Particulars	X (Rs.)	Y (Rs.)
To Cash/Bank A/c (Capital Withdrawn) To Balance c/d			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c		

(Closing balance)			(Additional Capital Introduced)		

(ii) Current Account

The Current account may show a debit or credit balance. All the usual adjustments such as interest on Capital, partner's salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account. All the Current Year's adjustments are recorded in this account, that is why it is called Current account.

Dr. Partner's Current A/Cs Cr.

Particulars	X (Rs.)	Y (Rs.)	Particulars	X (Rs.)	Y (Rs.)
To Balance b/d (Opening Dr. Balance) To Drawings (out of Profits)			By Balance b/d (Opening Cr. Balance) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c		

Note:

1. Debit balance of Current Account is shown in Assets side of Balance Sheet.

2. Credits balance of Current Account A/c is shown in Liabilities side of balance Sheet.

3. Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet as it will be always be credit balance.

2. Fluctuating Capital Accounts

In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustment such as interest on capital interest on drawings etc, are recorded in this account under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account. In this method the capitals are not fixed.

In the absence of information, the Capital Accounts should be prepared by this method.

Dr. Partner's Capital A/cs Cr.

Particulars	X (Rs.)	Y (Rs.)	Particulars	X (Rs.)	Y (Rs.)
To Balance b/d (Opening Dr. Balance) To Cash/Bank A/c (Capital Withdrawn) To Drawings (out of profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c (Additional Capital Introduced) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c (Share in Profits)		

(Closing credit Balance)			By Balance c/d (Closing Dr. Balance)		

INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. If interest on capital is to be allowed as per the agreement, it should be calculated with respect to the time, rate of interest and the amount of capital.

Interest on Capital can be treated as either:

a. An Appropriation of profit; or

b. A charge against profit.

A. Interest on Capital: An Appropriation of Profits:

- In case of Losses - Interest on Capital is NOT ALLOWED
- In cases of Sufficient Profits - Interest on Capital is ALLOWED IN FULL
- In case of Insufficient Profits - Interest will be restricted to the amount of profit. Hence, profit will be distributed in the ratio of interest on capital of each partner.

B. Interest on Capital: As a Charge against Profits:

Interest on Capital is always allowed in full irrespective of amount of profits of losses.

Note: Interest on Capital is always calculated on the OPENING CAPITAL.

If Opening Capital is not given in the question; it should be ascertained as follows:

Particulars		Rs.
Capital at the End		xxxx
Add: **1.** Drawing	xxxx	
2. Interest on Drawings	xxxx	
3. Losses during the year	xxxx	xxxx
Less: **1.** Additional Capital Introduced	xxxx	
2. Profits during the year	xxxx	
3. Any salary/commission received	xxxx	xxxx
Opening Capital		xxxx

INTEREST ON DRAWINGS

Interest on drawing is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn.

There are two cases in which calculation of interest on drawings may arise:

Case 1: When Rate of Interest on Drawings is given in %

Interest on Drawings is calculated on flat rate irrespective of period.

Case 2: When Rate of Interest on Drawings is given in % p.a.

1. When date of Drawing is not given

$$\text{Interest on Drawing} = \text{Total Drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{6}{12}$$

Note: Interest is calculated for a period of 6 months, we assume drawings have been done evenly during the year, that is why we take average six months tenure.

2. When date of Drawings is given

$$\text{Interest on Drawing} = \text{Total Drawings} \times \frac{\text{Rate of interest}}{100} \times \frac{\text{Time left after first drawings (in months)}}{12}$$

Case 3: When different amounts are withdrawn on different dates:

We have the following two methods to calculate the amount of interest on Drawing:

1. Simple Interest Method

In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn till the close of accounting period.

2. Product Method

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period; Thereafter the products are added and interest is calculated on the total of products so arrived at for one month. The advantage of this system is that separate calculations are not required each time.

The above mentioned two methods can be explained with the help of the following example:

Date	**Drawings (Rs.)**
May 1	12000
July 31	6000
September 30	9000
November 30	12000
January 1	8000
March 31	7000

Interest on drawings is to be charged @ 9% p.a.

SIMPLE METHOD

DATE	**AMOUNT**	**PERIOD**	**INTEREST @ 9% p.a.**
1 MAY	12000	11	990
31 JULY	6000	8	360
30 SEP	9000	6	405
30 NOV	12000	4	360
1 JAN	8000	3	180
31 MAR	7000	0	00
TOTAL	54000		**2295**

PRODUCT METHOD

DATE	**AMOUNT**	**PERIOD**	**PRODUCT**
1 MAY	12000	11	132000
31 JULY	6000	8	48000
30 SEP	9000	6	54000
30 NOV	12000	4	48000
1 JAN	8000	3	24000
31 MAR	7000	0	00
TOTAL	**54000**		**306000**

Interest = Total of products * 9/100* 1/12= 306000*9/100*1/12 = Rs. 2295/-.

Case 4: When an equal amount is withdrawn regularly

Interest on Drawing can be calculated using either Product Method or Direct Method (i.e. Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:

1. Amount should be same throughout the period

2. Date of Drawings should be same throughout the period

3. Drawings should be made regularly without any gap.

4. Interest on Drawing = Total Drawings x $\frac{\text{Rate of interest}}{100}$ x $\frac{T}{12}$

T = Time (in months) for which interest is to be charged

$$T = \frac{\text{Time left after first drawing} + \text{Time left after last drawing}}{2}$$

Value of T under Different circumstances will be as under:

Monthly Drawings for 12 Months	**Quarterly Drawings for 12 Months**	**Half yearly Drawings for 12 Months**	**Monthly Drawings for 06 Months (last 6 months)**
6.5 (beginning of the month)	7.5 (beginning of every quarter)	9 (beginning of every month for six months in the beginning of 6 months)	3.5 (beginning of the month for last six month)
6 (middle of very month)	6 (middle of every quarter)	6 (middle of every month for six months in the beginning of 6 months)	3 (middle of the month for last six month)
5.5 (end of every month)	4.5 (end of every quarter)	3 (end of every month for six month in the beginning of 6 months)	2.5 (end of the month for last six month)

INTEREST ON PARTNER'S LOAN

If a partner has given loan to the firm, he is entitled to receive interest on such loan at an agreed rate.
It is a charge against profits. It is always Debited to Profit and Loss A/c.
It is provided irrespective of profits or loss. It will also be provided in the absence of Partnership Deed @ 6% per annum.

The following entries are passed to record the interest on partner's loan

1.) For allowing Interest on loan:
Interest on Partner's Loan A/c Dr.
To Partner's Loan A/c
(Being interest on loan allowed @ % p.a.)
2.) For transferring Interest on Loan to Profit and Loss A/c:
Profit and Loss A/c Dr.
To Interest on Loan A/c
(Being Interest on loan transferred to P & L A/c)

Rent Paid to Partner.

Rent paid to a partner is also a charge against profits and it will also be **Debited to Profit and Loss A/c.**

Manager's Commission

Like Rent paid to a partner, Manager's Commission is also a charge against profits and it will also be **Debited to Profit and Loss A/c.** It is calculated in following two ways:

1.) As % profit before charging commission

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate}}{100}$$

2.) As % profit after charging commission

$$\text{Commission} = \text{Profit before commission} \times \frac{\text{Rate}}{100 + \text{Rate}}$$

PAST ADJUSTMENTS

Sometimes after closing the accounts of a partnership firm, *i.e.*, preparing the financial statements, some errors or omissions in the accounts of the earlier years are noticed. For example, interest on capital or drawings is omitted, allowed or charged at higher or lower rate, profits or losses are distributed among the partners in a wrong ratio and so on. These errors and omissions are rectified by adjusting the Capital Accounts of the affected partners by passing (a) an adjustment entry, or (b) adjustment entries.

(A) When an Adjustment Entry (Single Adjustment Entry) is passed: In this case, net effect of the errors is determined and an adjustment entry is passed by debiting and crediting the Partners' Capital/Current Accounts.

Let us take an example to understand it better. Following is the Profit and Loss Appropriation Account of a firm in which *A*, *B* and *C* are equal partners:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2020* Cr.

Particulars	Rs.	Particulars	Rs.
To Profit transferred to: *A*'s Capital A/c 1,00,000 *B*'s Capital A/c 1,00,000 *C*'s Capital A/c 1,00,000	3,00,000	By Profit and Loss A/c—Net Profit	3,00,000
	3,00,000		3,00,000

After preparing the financial statements, it was noticed that interest on capital was not allowed to *A*— Rs. 12,000, *B* — Rs. 9,600 and *C*— Rs. 10,500 and also interest was not charged on drawings of *A* and *B*
amounting to Rs. 1,200 and Rs. 900 respectively.

Correct Profit and Loss Appropriation Account giving effect to the above omissions would have been as follows:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2020* *Cr.*

Particulars		Rs.	Particulars		Rs.
To Interest on Capital A/cs:			By Profit and Loss A/c—Net Profit		3,00,000
A	12,000		By Interest on Drawings A/cs:		
B	9,600		*A*	1,200	
C	10,500	32,100	*B*	900	
To Profit transferred to:					2,100
A's Capital A/c	90,000				
B's Capital A/c	90,000				
C's Capital A/c	90,000	2,70,000			
		3,02,100			3,02,100

From the corrected Profit and Loss Appropriation Account, following is observed:

	A's Capital A/c (Rs.)	*B*'s Capital A/c (Rs.)	*C*'s Capital A/c (Rs.)
I. Credited Short for Interest on Capitals	12,000	9,600	10,500

II. Debited Short for Interest on Drawings	(1,200)	(900)	---
III. Credited Excess as Share of Profit [32,100 (Interest on Capital) – 2,100 (Interest on Drawings) Equally]	(10,000)	(10,000)	(10,000)
Net Effect	800 Short Credited	(1,300) Excess Credited	500 Short Credited

An adjustment entry rectifying the above errors can be passed as follows:

Date	Particulars	L.F.	Dr.	Cr.
2020 March31	*B*'s Capital A/c Dr. To *A*'s Capital A/c To *C*'s Capital A/c (Interest on capital not allowed and Interest on drawings not charged, now adjusted)		1,300	 800 500

(B) When Adjustment Journal Entries (in Place of one Adjustment Entry) are passed: In this situation, analytical table to determine the net effect of all the adjustments is not prepared instead Journal entries are passed for each error or omission by debiting or crediting Profit and Loss Adjustment Account. After passing the entries for adjustment of errors and omissions, Profit and Loss Adjustment Account is closed by debiting or crediting (as the situation is) with the corresponding credit or debit to the Partners' Current Accounts, if Fixed Capital Accounts Method is followed or Partners' Capital Accounts, if Fluctuating Capital Accounts Method is followed.

Accounting Entries

Following Journal entries shall be passed through Profit and Loss Adjustment Account:

(i) Adjustment entries for the items which are to be credited to the Partners' Capital/Current Accounts:

Profit and Loss Adjustment A/c Dr.
To Partners' Capital/Current A/cs
(Adjustment made for previously omitted, now recorded)

(ii) Adjustment entries for the items which are to be debited to the Partners' Capital/Current Accounts:

Partners' Capital/Current A/cs Dr.
To Profit and Loss Adjustment A/c
(Adjustment made for previously omitted, now recorded)

(iii) For Net Profit/Loss due to above adjustments:

(a) For Profit

Profit and Loss Adjustment A/c Dr.
To Partners' Capital/Current A/cs
(Profit on adjustment credited to Partners' Capital/Current Accounts)

(b) For Loss

Partners' Capital/Current A/cs Dr.
To Profit and Loss Adjustment A/c
(Loss on adjustment transferred to Partners' Capital/Current Accounts)

Note: If capitals of the partners are fixed, adjustment entries are passed through Partners' Current Accounts.

GUARANTEE OF PROFITS TO A PARTNER

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be or as may have been decided by an agreement.

Note: Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum share in profits, then the actual profits will be allowed to the partner.

Case: 1. When guarantee is given by FIRM (i.e. by all the Partners of the firm)

1. If share in actual profits is less than the guaranteed amount then. Guaranteed amount to a partner is first written off against the profits and then,

2. Remaining profits are distributed among the remaining partners in the remaining ratio.

Case: 2. When guarantee is given by a partner or partners to another partner.

1. Calculate the share in profits for the partner to whom guarantee is given.

2. If share in profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.

3. If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as deficiency.

Deficiency is contributed by the partner or partners who guaranteed in certain ratio and subtracted from his or their respective shares.

Accounting Entries:

1.) On Distributing the Profit as if there is no Guarantee Agreement:

Profit and Loss Appropriation A/c Dr.

To All Partners' Capital A/cs

2.) On Charging Deficiency to Guaranteeing Partner(s):

Guaranteeing Partners' Capital A/cs Dr.

To Guaranteed Partner's Capital A/c

IMPORTANT QUESTIONS

Q1. Radha and Raman are partners in a firm sharing profit and losses in the ratio of 5:2. Capital contributed by them is Rs. 50,000 and Rs. 20,000 respectively. Radha was given salary of Rs. 10,000 and Raman

Rs. 7,000 per annum. Radha advanced loan of Rs. 20,000 to firm without any agreement to rate of interest in deed while in deed rate of interest on capital was mentioned as 6% p.a. Profits for the year are Rs. 29,400. Prepare Profit and Loss Appropriation Account for the year ending 31st March 2019.

Solution:

Profit and Loss Appropriation account

Dr. For the year ending on 31.03.2019 Cr.

Particulars		Rs.	Particulars		Rs.
To Interest on Capital:			By Profit and Loss A/c		
Radha	3,000		(Net Profit)	29,400	
Raman	1,200	4,200	Less: Interest		
To Partner's Salary			On Radha's loan	1,200	28,200
Radha	10,000				
Raman	7,000	17,000			
To Profits transferred to capital					
A/cs of:					
Radha	5,000				

Raman	2,000	7,000		
		28,200		28,200

Note: When appropriation are more than available profits, in such case available profits are distributed in the ratio of appropriation.

Q2. Ram & Sham are partners sharing profit & losses in ratio of 3:2. Ram being nonworking partner contributes Rs. 20,00,000 as his capital & Shyam being a working partner, gets a salary of Rs. 8000 per month. As per partnership deed interest is paid @ 8% p.a. & salary is allowed. Profits before providing that for year ending 31st March 2019 were Rs. 80,000. Show the distribution of profits.

Solution:

Profit & Loss Appropriation Account

Dr. for the year ended 31.3.19 Cr.

Particulars	Rs.	Particulars	Rs.
To Ram's Capital A/c (Interest)	50,000	By Profit & Loss A/c (Net Profits)	80,000
To Shyam's Capital A/c (Salary)	30,000		
	80,000		80,000

Working Notes:

Interest on capital = 8 % of Rs. 20,00,000 = Rs. 1,60,000 Salary = Rs. 8,000 x 12 = Rs. 96,000

Total Rs. 2,56,000

Ratio of Interest & Salary = Rs. 1,600,000: Rs. 96,000 = 5: 3 Profit share given to Ram = Rs. 80,000 x $\frac{5}{8}$ = Rs. 50,000

Shyam = Rs. 80,000 x $\frac{3}{8}$ = Rs. 30,000

Q3. Amit and Sumit commenced business as partners on 01.04.2018. Amit contributed Rs. 40,000 and Sumit Rs. 25, 000 as their share of capital. The partners decided to share their profits in the ratio of 2:1. Amit was entitled to salary of Rs. 6,000 p.a. Interest on capital was to be provided @ 6% p.a. The drawings of Rs. 4,000 was made by Amit and Rs. 8,000 was made by Sumit. The profits after providing salary and interest on capital for the year ended 31st March, 2019 were Rs. 12,000.

Draw up the capital accounts of the partners in the following cases:

1. When capitals are fluctuating
2. When capitals are Fixed

Solution:

1. When capitals are fluctuating

Capital Accounts of Amit and Sumit

Dr. Cr.

Particulars	Amit (Rs.)	Sumit (Rs.)	Particulars	Amit (Rs.)	Sumit (Rs.)
To Drawing A/c	4,000	8,000	By Bank A/c	40,000	25,000
To Balance c/d	52,400	22,500	By Salary A/c	6,000	-----
			By Interest on capital A/c	2,400	1,500
			By Profit and Loss Appropriation A/c	8,000	4,000
	56,400	30,500		56,400	30,500

2. When capital are Fixed Capital accounts

Capital Accounts of Amit and Sumit

Dr. Cr.

Particulars	Amit (Rs.)	Sumit (Rs.)	Particulars	Amit (Rs.)	Sumit (Rs.)
To Balance c/d	40,000	25,000	By Bank A/c	40,000	25,000
	40,000	25,000		40,000	25,000

Current Accounts of Amit and Sumit

Dr. Cr.

Particulars	Amit (Rs.)	Sumit (Rs.)	Particulars	Amit (Rs.)	Sumit (Rs.)
To Drawing A/c	4,000	8,000	By Salary A/c	6,000	------
To Balance c/d	12,400	-----	By Interest on capital A/c	2,400	1,500
			By Profit and Loss Appropriation A/c	8,000	4,000
			By Balance c/d	-----	2,500
	16,400	8,000		16,400	8,000

Q4. X and Y invested Rs. 20,000 & Rs. 10,000. Interest on capital is allowed @ 6% per annum. Profits were shared in ratio of 2 : 3. Profit for year ending 31.3.2019 amounted to Rs. 1,500.
Show allocation of profits in the following cases:
(a) Allows interest on capital & deed is silent on treating interest as charge.
(b) Interest is charge against profit.

Solution:

(a) When partnership deed is silent on treating interest as a charge

Profit and Loss Appropriation A/c

Dr. for the year ending on 31.03.2019 Cr.

Particulars		Rs.	Particulars	Rs.
To Interest on Capital			By Profit & Loss A/c (Net Profits)	1,500
X	1000			
Y	500	1,500		
		1,500		1,500

Working Notes: Interest on X's Capital = 6 % of Rs. 20,000 = Rs. 1200 Y's Capital = 6 % of Rs. 10,000 = Rs. 600
Total Interest = Rs. 1800
Ratio of Interest = 1200: 600 = 2 : 1
Interest allowed to partner = Available Profit x $\frac{\text{Interest payable to partner}}{\text{Total Interest}}$

Interest to X = 1,500 x $\frac{1,200}{1,800}$ = Rs. 1000

Interest to Y = 1,500 x $\frac{1,200}{1,800}$ = Rs. 500

(b) Interest is charge on profit – In such case full interest will be given & loss is transferred to partner's capital accounts.
Profit & Loss Appropriation is not prepared in this case instead profit & Loss Account is prepared & deficit is treated as loss.

Profit and Loss A/C

Dr. for the year ending on 31.03.2019 Cr.

Particulars	Rs.	Particulars	Rs.
To Interest on Capital X 1,200 Y 600	1,800	By Profit & Loss A/c (Net Profits) By Loss transferred to Capital A/cs: X 120 Y 180	1,500 300
	1,800		1,800

Q5. Manoj Sahil and Dipankar are partners in a firm sharing profit and losses equally. They have omitted interest on Capital @ 10% per annum for three years ended on 31st March, 2017, 2018 and 2019. Their fixed capital on which interest was to be calculated throughout were:

Manoj Rs. 3,00,000

Sahil Rs. 2,00,000

Dipankar Rs. 1,00,000

Give the necessary adjusting journal entry with working notes.

Solution:

Books of Manoj, Sahil and Dipankar

Journal

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
31.3.2019	Dipankar's Current A/c Dr. To Manoj's Current A/c (Being adjustment entry passed)		30,000	 30,000

STATEMENT SHOWING ADJUSTMENT

Particulars	Manoj (Rs.)	Sahil (Rs.)	Dipankar (Rs.)	Firm (Rs.)
Amount to be given	90,000	60,000	30,000	1,80,000
----- Interest on Capital				
Amount already given to be taken	60,000	60,000	60,000	1,80,000
	30,000 (Cr.)	nil	30,000 (Dr.)	

Q6. A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than Rs. 25,000. Total profits of the firm for the year ended 31st March, 2019 were Rs. 90,000. Calculate share of profits for each partner in each of the following cases:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally.

Solution:

Case 1. When Guarantee is given by firm.

Profit and Loss Appropriation A/c

Dr. for the year ending on 31.03.2019 Cr.

Particulars	Rs.	Particulars	Rs.
To A's Capital A/c (3/6 of Rs. 65,000)	39,000	By Profit & Loss A/c (Net Profits)	90,000
To B's Capital A/c (2/6 of Rs. 65,000)	26,000		

To C's Capital A/c (1/6 of Rs. 90,000 or Rs. 25,000 whichever is more)	25,000		
	90,000		90,000

Case 2. When Guarantee is given by A.

Profit and Loss Appropriation A/c
for the year ending on 31.03.2019

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To A's Capital A/c (3/6 of Rs. 90,000) Less : Deficiency Borne for C	45,000 (10,000)	 35,000	By Profit & Loss A/c (Net Profits)	90,000
To B's Capital A/c (2/6 of Rs. 90,000)		30,000		
To C's Capital A/c (1/6 of Rs. 90,000) Add : Deficiency Recover form A	15,000 10,000	 25,000		
		90,000		90,000

Case: 3. When Guarantee is given by A & B equally.

Profit and Loss Appropriation A/c
for the year ending on 31.03.2019

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To A's Capital A/c (3/6 of Rs. 90,000) Less: Deficiency Borne for C (1/2 of Rs.10,000)	45,000 5,000	 40,000	By Profit & Loss A/c (Net Profits)	90,000
To B's Capital A/c (2/6 of Rs. 90,000) Less: Deficiency Borne for C (1/2 of Rs. 10,000)	30,000 5,000	 25,000		
To C's Capital A/c (1/6 of Rs. 90,000) Add: Deficiency Recover form A Deficiency Recovered from B	15,000 5,000 5,000	 25,000		

	90,000		90,000