1

General Introduction to Partnership

Learning objectives :

After studying this chapter you would be able to understand :

- Meaning, Definition, Need, Features and Types of Partnership
- Partnership Deed : Meaning, Contents, Rules in the absence of Partnership Deed.
- Partners' Capital Accounts : Fixed and Fluctuating - Its difference
- Distributions of Profits among Partners - P & L Appropriation Account.
- Calculation & Accounting for amount of Interest on Partners' Capital and Interest on Drawings under Different Conditions.
- Past Adjustments / Adjustments in Closed Accounts.
- Guarantee of Minimum Profit to a Partner.

Meaning & Definition of Partnership

The Law of Partnership is contained in the Indian Partnership Act, 1932, which came into force on 1-10-1932. It extends to the whole of India except for Jammu & Kashmir. Prior to this Act, the Law of Partnership was dealt with under the Indian Contract Act, 1872.

Partnership is an association of two or more persons who have agreed to combine their Financial resources and managerial abilities to run a legal business and share profit in an agreed ratio.

Sir Fredrick Pollock : "Partnership is the relation between two or more persons, who have agreed to share the profits of the business carried on by all or any of them acting for all." According to section 4 of the Indian Partnership Act, 1932, "Partnership is the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all."

The persons who have entered into a partnership with one another individually are called partners and collectively a firm. The name under which the business is carried is called firm name.

Need of Partnership : To overcome the limitations of sole proprietorship namely limited capital, lack of managerial efficiency and uncertain existence, partnership is desirable.

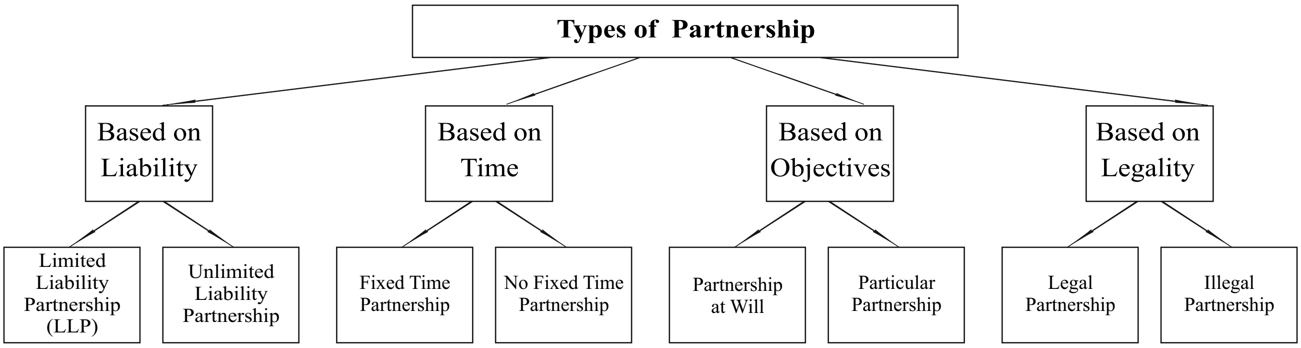
Characteristics of Partnership :

The essential characteristics of partnership are as under :

1. **Two or more than two persons :** There must be at least two persons to form a partnership and all such persons to be competent to contract. According to Indian Contract Act, 1872 a minor, persons of unsound mind and persons disqualified by any Law are not competent to contract. If any time the numbers of partners in a firm gets reduced to one the firm is dissolved. The Partnership Act does not prescribe the maximum number of partners in a firm. However section 464 of the Companies Act, 2013 empowers the Government to prescribe maximum number of partners in a firm subject to maximum of 100. The Government has prescribed maximum number of partners in a firm to be 50 vide rule 10 of the Companies (Miscellaneous) Rules, 2014.

2. **Agreement among partners :** Partnership comes into existance by an agreement**.** Such an agreement can be either oral or in writing. But to avoid any dispute it is better to have written agreement called partnership deed. According to Section 5 of Indian Contract Act, partnership arises from contract and not from status. Where there is no agreement there can not be a partnership.

   Partnership even does not arise from operation of law or from inheritance.
3. **Sharing of profits :** The object of partnership must be to make profit. Profit must be distributed among the partners in an agreed ratio**.** Usually partners also share losses in the ratio of profits, but it is not essential that all the partners must share the losses also. Example : a minor partner gets share in profits but not in loss.
4. **Carrying on a business :** A partnership is formed to do a lawful business. Business includes every trade, vocation & profession.
5. **Carried on by all or any of them acting for all :** The partnership business must be carried on by all or any of them acting for all. Every partner while carrying on the business of the firm stands in the position of an agent as well as principal. As an agent he by his acts binds the firm. As a principal he is bound by the acts of other partners.
6. **Act :** Business partnership is governed by the Indian partnership Act, 1932.
7. **Unlimited liability :** The liability of a partner for acts of the firm is unlimited. All the partners are liable jointly and severally to third party for all the acts of the firm.
8. **No separate existence :** A partnership firm is not a separate legal entity from its partners.



1. Partnership according to liability :-

(A) Limited liability partnership - Limited liability partnership (L.L.P.) is corporate under Partnership Act, 2008. It is an artificial person. It has separate entity and perpetual existence. It has a common seal, which is based on limited liability. Under L.L.P. liability of a partner is limited and firm has no right over partners personal property.

(B) Unlimited Liability Partnership - The type of partnership in which liability of all the partners' is unlimited.

2. Partnership according to time :-

(A) Fixed time partnership : When duration of partnership is fixed by the partner by an agreement it is said to be a partnership for a fixed period. Such partnership comes to on end on the expiry of the term.

(B) Non fixed time partnership : It is a partnership for which no duration has been fixed.

3. Partnership according to objects :-

(A) Partnership at will : If all the partners wish to continue the business even after the expiry of the fixed term the partnership becomes partnership at will.

(B) Particular partnership : When a partnership is formed for a particular adventure or undertaking, it is called a particular partnership. Such partnership comes to an end on the completion of the adventure or undertaking.

4. Partnership according to legality :-

(A) Legal partnership : Partnership established under rules and regulation of the country.

(B) Illegal partnership : Partnership, which is not according to rules and regulations of the country. Under the following circumstances partnership is deemed illegal :

(1) When partnership is established for illegal purpose.

(2) When number of partners is less than 2 or more than 50.

(3) When the business of the firm is against public policy/international policy.

(4) When a person of an alien nation is admitted as a partner in firm.

Partnership Deed : The written agreement among the partners is known as partnership deed. The partnership deed contains the following items :

(1) The name and address of the firm
(2) Name and address of the partners.
(3) Nature of business.
(4) Profit sharing ratio
(5) Capital contribution
(6) Interest on capital
(7) Drawings
(8) Interest on drawings
(9) Method of recording of firm's accounts
(10) Salary, Commission
(11) Auditing of accounts
(12) Duration of partnership
(13) Interest on partner's loan
(14) Methods of maintaining partner's capital accounts
(15) Rights, duties and liabilities of partners
(16) Settlement of disputes
(17) Rules to be followed in case of admission of a new partner
(18) Method of valuation and accounting treatment of goodwill in case of admission, retirement and death of a partner
(19) Rules to be followed while settling the accounts on retirement / death
(20) Modes and cases of distribution of firm
(21) Settlement of Accounts on dissolution of firm
(22) Use the decision under Garner v/s Murray Rule

Rules applicable in absence of partnership deed :

1. Profits are to be shared equally.
2. No interest on capital shall be allowed to the partners.
3. No interest is to be charged on drawings.
4. No partner is entitled to any salary or commission for taking part in running the firm's business.
5. Interest @ 6% p.a. is to be allowed on a partner's loan to the firm.
6. Each partner can participate in the conduct of business.
7. Each partner can inspect the books of firm and can take a copy of the same.

Capital accounts of partners:

The partner's capital accounts are maintained in two ways.

Capital Accounts

- Fixed Capital A/c Method
  - Partners Capital A/c
  - Partners Current A/c
- Fluctuating Capital A/c Method
  - Partners Capital A/c

Partners capital accounts :

1. Fixed capital accounts method : Under this system amount of capital does not fluctuate. The capital remains fixed. In this system two accounts are maintained :

(i) Partner's also capital accounts; **(ii)** Partner's current accounts.

(i) Partner's capital cccount : The partner's capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital.

(ii) Partner's current account : Current account is maintained to record transactions other than transactions relating to capital such as drawings, interest on capital, interest on drawings, salary or commission payable to partner, share of profit or losses. As a result the balance of current account fluctuates. The partner's current account may show a debit or a credit balance.

Format

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

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Cash/Bank A/c (Permanent withdrawal of capital) To Balance c/d	xx xx	xx xx	By Balance b/d By Cash/Bank (Additional capital introduced)	xx xx	xx xx
	xx	**xx**		**xx**	**xx**

Dr. **Partner's Current A/c** Cr.

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Balance b/d To Drawings To interest on drawings To P&L Appropriation A/c (Loss) To Balance c/d	xx xx xx xx xx	xx xx xx xx xx	By Balance b/d By interest on capital By Salary By Commission By P & L Appropriation A/c (Profit)	xx xx xx xx xx	xx xx xx xx xx
	xx	**xx**		**xx**	**xx**

Note : If balance of partner's current accounts are given in the balance sheet, it implies that fixed capital account method is followed.

2. Fluctuating capital accounts method : All transactions of a partner capital introduced or withdrawn, salary or commission, interest on capital, interest on drawings, share of profits or loss etc., are recorded in his capital account, as a result balance in the capital account fluctuates with every transaction.

Note : In the absence of any instruction, the capital accounts should be prepared by fluctuating capital accounts method.

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

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Balance b/d To Drawings To Cash / Bank (Permanent withdrawal of capital) To Interest on drawing To P&L Appropriation A/c (Loss) To Balance c/d	xx xx xx xx xx xx	xx xx xx xx xx xx	By Balance b/d By Cash / Bank A/c (Additional capital introduced) By Interest on capital By Salary By Commission By P & L Appropriation A/c (Profit)	xx xx xx xx xx xx	xx xx xx xx xx xx
	xx	**xx**		**xx**	**xx**

Note : The balance may be on the opposite side also.

Difference between Fixed Capital A/c & Fluctuating Capital A/c Method

Basis of difference	Fixed Capital A/c Method	Fluctuating Capital A/c Method
1. Number of accounts	Two accounts are maintained for each partner, fixed capital A/c and current A/c	Only one account(i.e.capital A/c)for each partner is maintained.
2. Change in balance of capital A/c	When the capital accounts are fixed, the balance in capital accounts usually remain unchanged during the life time of business, except when capital is introduced or withdrawn permanently.	When the capital accounts are fluctuating the balance of capital accounts changes from one year to another year.
3. Balance of capital A/c	It always shows credit balance in capital account.	Fluctuating capital accounts may show credit or debit balance.
4. Recording of transactions	Transactions relating to drawings, interest on drawings, interest on capital, salary, share of profits or loss etc. are not made in capital account but are entered in current account	In this case all transactions relating to partners are made directly in the capital accounts itself.

Distribution of profits among the partners :

After having determined the net profit by the Profit and Loss Account, Profit and Loss Appropriation Account, is prepared to show appropriation of net profit. The profit is distributed among partners as per provisions of the partnership deed.

Profit & Loss Appropriation Account : It is an extension of Profit and Loss Account. It is a nominal account. It is credited with net profit and interest on drawings of the partners and debited with interest on capital of the partners, partner's salaries and commissions and transfer to reserves. The balance profit is distributed between the partners in their profit sharing ratio.

Format : Profit & Loss Appropriation Account

For the year ended..........................

Dr. Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To P&L A/c (Net Loss for the year)		By P&L A/c (Net profit for the year)	
To Interest on capital		By Interest on drawings	
A xx		A xx	xx
B xx	xx	B xx	
To Partner's salary		By Partner's Capital A/c /	
A xx		Current A/c (share of Loss)	
B xx	xx	A xx	xx
To Partner's commission		B xx	
A xx		(Balancing figure)	
B xx			
To Reserve A/c (Transfer)	xx		
To Partner's Capital A/c / Current A/c	xx		
(share of profit) (Balancing figure)			
A xx			
B xx			
	xx		xx

Note : (i) If profit after charging any item is given then any such amount is not shown in P & L Appropriation Account, but such items are posted in Partners Capital or Current Account. **(ii)** If profit before charging any items is given then such item is shown in both Profit & Loss Appropriation Account and Partners Capital Account/Current Account. **(iii)** The following items are treated as charge on profits, hence it is shown in Profit & Loss Account not in Profit & Loss Appropriation Account. e.g. Managers Commission, interest on partners, loan rent of building. **(iv)** If capital account is prepared by fixed capital method then except capital other items will be shown in Partners Current Account.

Journal Entries

Relating to Profit and Loss Appropriation Account :

	Transaction	Accounting Entries
1)	For Interest on capital -	Interest on Capital A/c Dr. To Partner's Capital A/c (Being interest allowed on capital)
2)	For interest on capital transfer to P & L Appropriation A/c	Profit & Loss Appropiation A/c Dr. To Interest on Capital A/c (Being transfer of interest to P/L App. A/c)
	Single entry for above 1 and 2 entries	Profit and Loss Appropriation A/c Dr. To Partner's Capital A/c (Being interest on capital allowed to partners)
3)	For interest on drawings	Partner's Capital A/c Dr. To Interest on Drawings A/c (Being interest on drawings transferred to Capital A/c)

4)	For interest on drawings transfer to P & L Appropriation A/c	Interest on Drawings A/c Dr. To Profit & Loss Appropriation A/c (Being transfer of interest on drawings to P/L Appropriation A/c)
5)	Combined entry may be passed	Partner's Capital A/c Dr. To Profit & Loss Appropriation A/c (Being interest on drawings charged)
6)	For partner's salaries / commission -	Partner's Salary/Commission A/c Dr. To Partner's Capital A/c (Being Partner's Capital A/c credited with salary...... ..)
7)	on closure of salary / commission A/c combined entry may be passed	Profit and Loss Appropriation A/c Dr. To Partner's Salary A/c To Partner's Commission A/c (Being transfer of partner's salary/commission to P/L Appropriation A/c)
8)	For transfers to reserve -	Profit and Loss Appropriation A/c Dr. To Reserve/Reserve Fund A/c (Being transfer of profit to Reserve A/c)
9)	For distribution of net profit -	Profit and Loss Appropriation A/c Dr. To Partner's Capital A/c (Being profit distributed among/between partners)
10)	For distribution of net Loss -	Partner's Capital A/c Dr. To Profit and Loss Appropriation A/c (Being Partner's Capital A/c debited with loss on P/L Appropriation A/c)

Note : In case of fixed capital A/C method....partner's current account is used in place of partner's capital account.

Example 1 :

Ajay and Vijay started a partnership business on 1st April, 2016. Their capital contributions were ₹ 2,00,000 and 3,00,000 respectively. The partnership deed provided : (i) Interest on capital at 10% p.a.(ii) Ajay to get a salary of ₹ 2000 p.m. and Vijay ₹ 36000 p.a. (iii) Interest on drawing amounted ₹ 2000 for Ajay and ₹ 3000 for Vijay. (iv) Profits are to be shared in the ratio of 3:2 (v) During the year drawing of Ajay and Vijay amounted to ₹ 30000 and ₹ 40000 respectively. The profit for the year ended 31st March, 2017 before making above appropriations was ₹ 2,45,000. Prepare Profit and Loss Appropriation Account.

Solution :

Profit and Loss Appropriation A/c
For the year ended 31st March, 2016

Dr. Cr.

Particulars		Amount ₹	Particulars		Amount ₹
To Interest on Capital:			By Profit before Adjustments		2,45,000
Ajay	20, 000		By Interest on Drawings:		
Vijay	30, 000	50, 000	Ajay	2,000	
To Partner's Salaries:			Vijay	3,000	5,000
Ajay	24, 000				
Vijay	36, 000	60, 000			
To Partner's Capital:					
Ajay	84, 000				
Vijay	56, 000	1,40,000			
		2,50,000			**2,50,000**

Example 2 :

K and R were partners sharing profits in the ratio of 3:2. Following terms were agreed upon between the partners : (1) Interest on Capital @ 10% per annum (2) Interest on drawings @ 5%. (3) Salary to K for conducting business of the firm ₹5000 per month. Following informations are available for the accounting year ended 31st March, 2017 : Capital of K on 01.04.2016 ₹ **2,00,000 ;** Capital of R on 01.04.2016 ₹ **1,20,000;** Current Account of K on 01.04.2016 ₹ **12,000 (Cr.);** Current Account of R on 01.04.2016 ₹ **4,000 (Dr.)**; Additional Capital by K on 01.10.2016 ₹ **80,000**; Drawings during the year by K ₹ **20,000**; Drawings during the year by R ₹ **20,000**; Profit for the year ₹ **1,34,000**.

Pass journal entries, prepare Profit and Loss Appropriation Account and show Capital Accounts of Partners assuming capitals are fixed.

Solution : **Journal**

Date	Particulars	L.F.	Dr. Amount ₹	Cr. Amount ₹
2016 Oct.,1	Bank A/c Dr. To K's Capital A/c (Additional capital contributed)		80,000	 80,000
	K's Drawings A/c Dr. R's Drawings A/c Dr. To Bank (Drawing made)		20,000 20,000	 40,000
2017 Mar., 31	Interest on Capital A/c Dr. To K's Current A/c To R's Current A/c (Interest charged)		36,000	 24,000 12,000
	K's Current A/c Dr. R's Current A/c Dr. To Interest on Drawings (Interest charged on Drawings)		1,000 1,000	 2,000
	K's Current A/c Dr. To K's Drawings A/c (Transfer drawings to Partner's Current Accounts)		20,000	 20,000
	R's Current A/c Dr. To R's Drawings A/c (Transfer of drawings to Partner's Current Accounts)		20,000	 20,000
	K's Salary A/c Dr. To K's Current A/c (Salary payable to K)		60,000	 60,000
	Profit and Loss A/c Dr. To Profit and Loss Appropriation A/c (Net Profit transferred to Profit and Loss Appropriation A/c)		1,34,000	 1,34,000
	Profit and Loss Appropriation A/c Dr. To Interest on Capital A/c To K's Salary A/c (Interest on Capital and salary transferrred to Profit and Loss Appropriation A/c)		96,000	 36,000 60,000
	Interest on Drawings A/c Dr. To Profit and Loss Appropriation A/c (Interest on Drawings transferred)		2,000	 2,000
	Profit and Loss Appropriation A/c Dr. To K's Current A/c To R's Current A/c (Balance of P & L Appropriation Account Transferred to Partners Current Account)		40,000	 24,000 16,000

Dr. **Profit and Loss Appropriation A/c for the year ended 31st March 2017** Cr.

Particulars		Amount ₹	Particulars		Amount ₹
To Interest on Capital A/c			By Profit & Loss A/c (Net Profit)		1,34,000
K	24,000		By Interest on Drawings A/c		
R	12,000	36,000			
To K's Salary A/c		60,000	K	1,000	
To Profit Transferred to Current A/c			R	1,000	2,000
To K	24,000				
To R	16,000	40,000			
		1,36,000			1,36,000

Partner's Capital Account

Date	Particulars	K ₹	R ₹	Date	Particulars	K ₹	R ₹
2017				2016			
Mar.,31	To Balance c/d	2,80,000	1,20,000	Apr.,01	By Balance b/d	2,00,000	1,20,000
				Oct.,01	By Bank A/c	80,000	
		2,80,000	**1,20,000**			**2,80,000**	**1,20,000**

Partner's Current A/c

Date	Particulars	K ₹	R ₹	Date	Particulars	K ₹	R ₹
2016				2016			
Apr., 1	To Balance b/d		4,000	Apr., 01	By Balance b/d	12,000	--
2017				2017			
Mar.,31	To Drawings A/c	20,000	20,000	Mar.,31	By Int. on capital A/c	24,000	12,000
Mar.,31	To Interest on Drawings A/c	1,000	1,000	Mar.,31	By Salary A/c	60,000	--
				Mar.,31	By Profit & Loss Appropriation A/c (Share of Profit)	24,000	16,000
Mar,31	To Balance c/d	99,000	3,000				
		1,20,000	**28,000**			**1,20,000**	**28,000**

Interest on Partner's Capital

Interest on capital is allowed only if it is mentioned under partnership deed. It is computed at the agreed rate with reference to the time the capital has been used in the business. Interest on capital is computed on the opening balance of the partner's capital. But if additional capital is introduce during the year, interest is allowed on it for the period it has remained in the business.

Capital at the end	xxx
Add: Drawings	xxx
Less: Additional Capital	xxx
Less Current year Profit	xxx

Opening Capital	xxx

$$\text{Interest on Capital} = \frac{\text{Amount of Capital} \times \text{Rate} \times \text{Period}}{100 \times 12}$$

Note : If additional capital is introduced during the year or withdrawal of capital during the year then interest capital will be calculate by product method.

$$\text{Interest on Capital} = \frac{\text{Total of Products} \times \text{Rate}}{100 \times 12}$$

Note : If capital is fixed then interest on Capital will be calculate on fixed capital.

Provisions relating to interest on capital :-

Situation	Provision
I. When partnership deed is silent in respect of interest on capital	Interest on capital is not allowed.
II. When the partnership deed provides for interest on capital but it is silent with regards to its treatment as charge or appropriation.	Interest on capital is allowed only if there is profit : **i.** In case of loss : Interest on capital is not allowed. **ii.** In case profit before interest is equal to or more than the interest, interest on capital is allowed at the agreed rate. **iii.** In case profit before interest is less than the interest, interest is allowed only to the extent of profit in the ratio of interest
III. Partnership deed provides interest on Capital as a charge against profit.	Interest on Capital is allowed even if there is a loss. (under such case interest on capital is debited to P & L A/c instead of P & L Appropriation A/c)

Example : 3

X and Y are partners sharing the profits and losses in the ratio of 3 : 2 with capitals of ₹ 2,00,000 and ₹ 1,00,000 respectively. Show the distribution of profits in each of the following alternative cases :

(1) If the partnership deed is silent as to the interest on Capital and the profit for the year is ₹ 60,000.

(2) If the partnership deed provides for interest on capital @ 10% p.a. and the loss for the year is ₹ 60,000.

(3) If the partnership deed provides for interest on capital @ 10% p.a. and the profit for the year is ₹ 60,000.

(4) If the partnership deed provides for interest on capital @ 10% p.a. and the profit for the year is ₹ 18,000.

(5) If the partnership deed provides for interest on capital @ 10% p.a. and the profit for the year is ₹18,000.

Solution :

Interest on capital is charged on Profit, in Conditions 3, 4, 5 only.

(1) **Dr.** **Profit and Loss Appropriation A/c** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Partner's Capital (Profit) X 36,000 Y 24,000	60,000	By Profit & Loss A/c	60,000
	60,000		60,000

(2) **Dr.** **Profit and Loss Appropriation A/c** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To P&L A/c (Loss)	60,000	By Partner's Capital A/c X 36,000 Y 24,000	60,000
	60,000		60,000

Note: Interaction capital is allowed if there is a profit in case of loss interest on capital is not allowed.

(3) **Dr.** **Profit and Loss Appropriation A/c** **Cr.**

Particulars	Amount ₹	Particulars	Amount ₹
To Interest on Capital X 20,000 Y <u>10,000</u>	30,000	By P&L A/c	60,000
To Partner's Capital A/c X 18,000 Y <u>12,000</u>	30,000		
	60,000		60,000

(4) **Dr.** **Profit and Loss A/c** **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Interest on Capital A/c		By P&L A/c	18,000
X 18,000 x $\frac{2}{3}$	12,000		
Y 18,000 x $\frac{1}{3}$	6,000		
	18,000		18,000

Note: Profits are distributed between partners in the ratio of interest payable to him.

(5) **Dr.** **Profit and Loss A/c** **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Interest on Capital		By Profit for the year	18,000
X 20,000			
Y 10,000	30,000	By Partner's Capital A/c	
		X 12,000 x $\frac{3}{5}$	7,200
		Y 12,000 x $\frac{2}{5}$	4,800
	30,000		**30,000**

Note: Interest on capital is treated as change on profits therefore debited to P&L A/C.

Illustration 4 :

Ram, Shyam and Mohan started a partnership firm. Ram introduced capital of ₹1,00,000 for the whole year and Shyam introduced at the begining ₹50,000 and at the end of 3 months, increased his capital to ₹60,000 and at the end of 8 months he withdrew ₹5,000. Mohan introduced ₹70,000 as his capital at the begning and withdrew at the end of 4 months ₹20,000. Profit for the year is ₹5,10,000. Distribute profit among partners on the basis of their capital.

Solution : Calculation the ratio of effective capital employed during the year

Ram :	₹ 1,00,000	for 12 months	₹ 12,00,000	Shyam :	₹ 50,000	for 3 months	₹ 1,50,000
Mohan:	₹ 70,000	for 4 months	₹ 2,80,000		₹ 60,000	for 5 months	₹ 3,00,000
	₹ 50,000	for 8 months	₹ 4,00,000		₹ 55,000	for 4 months	₹ 2,20,000
Capital ratio = 120 :67 : 68			₹ 6,80,000				₹ 6,70,000

Dr. **Profit and Loss Appropriation A/c** **Cr.**

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Partner's Capital		By Net Profit	5,10,000
Ram $\frac{5,10,000 \times 120}{255}$	2,40,000		
Shyam $\frac{5,10,000 \times 67}{255}$	1,34,000		
Mohan $\frac{5,10,000 \times 68}{255}$	1,36,000		
	5,10,000		**5,10,000**

Interest on Drawings

Drawings means the amount withdrawn by partners in cash or kind for their personal use. If the partnership deed so provides interest on drawings is charged. Interest on drawings is an income of firm.

(Methods of calculation of Interest on Drawings)

- When unequal amount is withdrawn on different dates
  - Simple Method
  - Product Method
- When equal amount is withdrawn at regular interval
  - Average period method
    - Drawings is made on monthly basis
    - Drawings is made on quarterly basis

I. When unequal amount is withdrawn on different dates :

(i) Simple Method : Interest on drawings under this method is computed on each single drawing with reference to period of utilisation of money.

$$\text{Interest} = \text{Amount withdrawn} \times \frac{\text{Rate of Interest}}{100} \times \frac{\text{months}}{12} \text{ or } \frac{\text{days}}{365}$$

(ii) Product Method : Under this method the amount of drawings is multiplied by the number of months or number of days it has been used. The product so obtained is totaled and the interest is calculated there on for one month, if the period taken is in months and for one day if the period taken is in days.

Date of Drawings	Amount ₹	Period (months/days) from date of drawing to date of year ended	Product (Amount x Period)
			Total Product

$$\text{Interest on Drawings} = \text{Total of Product} \times \frac{\text{Rate of Interest}}{100} \times \frac{1}{12} \text{ or } \frac{1}{365}$$

Illustration 5 :

Calculate interest on drawings of Ram @ 12% p.a. for the year ended 31-12-2016 by simple method.

Date	Amount ₹
31.05.2016	2,000
30.09.2016	3,000

Solution : Interest on drawing $= 2{,}000 \times \frac{7}{12} \times \frac{12}{100} = ₹\ 140$ $\quad 3{,}000 \times \frac{3}{12} \times \frac{12}{100} = ₹\ 90$

Illustration 6 :

A partner withdraws the following amounts on different dates :

Date of Drawings	Amount ₹	Date of Drawings	Amount ₹
01-04-16	1,000	30-06-16	1,200
31-12-16	1,500	31-03-17	2,0000

Calculate interest on drawings @ 12% p.a. by product method for the year ended on 31.3.2017

Solution :

Date of Drawings	Amount ₹	Months	Product
01-04-16	1,000	12	12,000
30-06-16	1,200	9	10,800
31-12-16	1,500	3	4,500
31-03-17	20,000	0	0
			27,300

$$\text{Interest on Drawings} = \frac{\text{Total of Product x Rate x Interest}}{100 \times 12} = \frac{27{,}300 \times 12}{100 \times 12} = ₹\ 273$$

II. When equal amount is withdrawn at regular interval :

$$\text{Interest on Drawings} = \frac{\text{Total Drawings} \times \text{Rate of Interest} \times \text{Average period}}{100 \times 12}$$

Formulas for calculation of Average Period

Situation	n=No. of months	Drawings made for 12 months	Drawings made for 9 months	Drawings made for 6 months
I. Monthly drawings (a) At the beginning of every month.	$\frac{n+1}{2}$	$\frac{12+1}{2} = 6.5$	$\frac{9+1}{2} = 5$	$\frac{6+1}{2} = 3.5$

(b) At the end of every month. (c) In the middle of every month.	$\frac{n-1}{2}$ $\frac{n}{2}$	$\frac{12-1}{2} = 5.5$ $\frac{12}{2} = 6$	$\frac{9-1}{2} = 4$ $\frac{9}{2} = 4.5$	$\frac{6-1}{2} = 2.5$ $\frac{6}{2} = 3$
II. Quarterly drawings (a) At the beginning of each quarter. (b) At the end of each quarter.. (c) In the middle of each quarter.	$\frac{n+3}{2}$ $\frac{n-3}{2}$ $\frac{n}{2}$	$\frac{12+3}{2} = 7.5$ $\frac{12-3}{2} = 4.5$ $\frac{12}{2} = 6$	$\frac{9+3}{2} = 6$ $\frac{9-3}{2} = 3$ $\frac{9}{2} = 4.5$	$\frac{6+3}{2} = 4.5$ $\frac{6-3}{2} = 1.5$ $\frac{6}{2} = 3$
III. If the date of drawings is not given.	$\frac{n}{2}$	$\frac{12}{2} = 6$	$\frac{9}{2} = 4.5$	$\frac{6}{2} = 3$

Note : When rate of interest is given without the word "per annum" interest is charged without considering the time factor.

Illustration 7 : G, S and T are partners in a firm. You are informed that :

a. G draws ₹ 2,000 at the beginning of every month.

b. S draws ₹ 3,000 at the end of every month.

c. T draws ₹ 1,000 in the middle of every month.

Interest on drawings is to be charged @ 12% p.a. Calculate interest on drawings.

Solution :

G Total Drawings 2,000 x 12 = ₹ 24,000

S Total Drawings 3,000 x 12 = ₹ 36,000

T Total Drawings 1,000 x 12 = ₹12,000

Interest on Drawing = 24,000 x $\frac{6.5}{12}$ x $\frac{12}{100}$ = ₹ 1,560

Interest on Drawing = 36,000 x $\frac{5.5}{12}$ x $\frac{12}{100}$ = ₹ 1,980

Interest on Drawing = 12,000 x $\frac{6}{12}$ x $\frac{12}{100}$ = ₹ 720

Illustration 8 :

P, Q and R started business on 01.07.2016. Calculate interest on drawings @ 12% p.a. on the following drawings for the year ended on 31.03.2017

a. P draws ₹ 500 at the beginning of every month.

b. Q draws ₹ 600 in the middle of every month.

c. R draws ₹700 at the end of every month.

Solution :

P Total Drawings 500 x 9 = ₹ 4,500

Q Total Drawings 600 x 9 = ₹ 5,400

R Total Drawings 700 x 9 = ₹ 6,300

Interest on Drawing = 45,00 x $\frac{5}{12}$ x $\frac{12}{100}$ = ₹ 225

Interest on Drawing = 5,400 x $\frac{4.5}{12}$ x $\frac{12}{100}$ = ₹ 243

Interest on Drawing = 6,300 x $\frac{4}{12}$ x $\frac{12}{100}$ = ₹ 252

Illustration 9 :

R, S and T are partners in a firm. Each partner withdrew ₹ 2,000 per month. Calculate interest on drawings @ 10% p.a. when

a. R withdrew at the beginning of every month.

b. S withdrew in the middle of every month

c. T withdrew at the end of every month.

Solution :

R Total Drawings 2,000 x 6 = ₹ 12,000

S Total Drawings 2,000 x 6 = ₹ 12,000

T Total Drawings 2,000 x 6 = ₹ 12,000

Interest on Drawing = $12,000 \times \frac{3.5}{12} \times \frac{10}{100}$ = ₹ 350

Interest on Drawing = $12,000 \times \frac{3}{12} \times \frac{10}{100}$ = ₹ 300

Interest on Drawing = $12,000 \times \frac{2.5}{12} \times \frac{10}{100}$ = ₹ 250

Illustration 10 :

A, B and C are partners in a firm. Calculate interest on drawings @ 12% p.a. on the following drawings for the year ended on 31.03.2017,

a. A withdrew ₹ 3,000 at the beginning of each quarter.

b. B withdrew ₹ 4,000 in the middle of each quarter.

c. C withdrew ₹ 2,500 at the end of each quarter.

Solution :

	Total drawings	Average Period	Interest on Drawings
A	3,000 x 4 = ₹ 12,000	7.5 months	Interest on Drawing = $12,000 \times \frac{7.5}{12} \times \frac{12}{100}$ = ₹ 900
B	4,000 x 4 = ₹ 16,000	6 months	Interest on Drawing = $16,000 \times \frac{6}{12} \times \frac{12}{100}$ = ₹ 960
C	2,500 x 4 = ₹ 10,000	4.5 months	Interest on Drawing = $10,000 \times \frac{4.5}{12} \times \frac{12}{100}$ = ₹ 450

Illustration 11 :

Calculate interest on drawings of Virat @ 10% p.a. for the year ended on 31.03.2017

(a) If his drawings during the year were ₹ 20,000

(b) If he withdrew ₹ 2,000 per month during the year

Solution :

(a) Interest on Drawing = 20,000 x 10/100 = ₹ 2,000

(b) Total drawings 2,000 x 12 = ₹ 24,000 Interest on Drawing = 24,000 x10/100 = ₹ 2,400

Note : Rate of interest is given without the word 'p.a.', therefore interest is calculate for the whole year.

Example 12 :

R and S are partners sharing profits in the ratio of 3 : 2. R is a non-working partner. He contributed ₹ 5,00,000 as his capital. S did not contribute any capital. The partnership deed provides interest on capital @ 10% p.a. and salary to S as ₹ 2,500 p.m. The net profit before providing interest on capital and salary amounts to ₹ 40,000 for the year ended 31st March 2017. Show the distribution of profit for the year.

Solution :

Profit & Loss Appropriation A/c

Dr. For the year ended 31st March 2017 Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Interest on R's Capital To S's Salary	25,000 15,000	By Net Profit (as per P & L A/c)	40,000
	40,000		40,000

Note : Total appropriation (interest on capital and salary) of profit is ₹ 80,000, but available net profit is ₹ 40.000, So it should be divided between R and S in the ratio of 5:3. (interest on capital to salary ratio)

Example 13 :

R and S are partners with capitals of ₹ 80,000 and ₹ 60,000 respectively. The profit for the year ended 31st March, 2017 amounted to ₹ 47,500 before considering the following : (i) Interest on capital to be allowed @ 5% p.a. (ii) Interest on drawings to be charged @ 5% p.a. Drawings R – ₹ 16,000, S- ₹ 12000 (iii) R had advanced loan to the firm amounting to ₹ 20,000 (iv) R was allowed commission @ 2% on sales, which was ₹ 2,00,000. S was allowed commission @ 10% on divisible profit (before charging his commission but after charging R's commission.) (v) It was decided to transfer 10% of divisible profit to Reserve Account. Prepare Profit & Loss Appropriation Account.

Solution :

Profit & Loss Account

Dr. for the year ended 31st March, 2017 Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Interest on R's Loan	1,200		
To Net Profit trans. to P. & L. App. A/c	46,300	By Profit for the year	47,500
	47,500		**47,500**

Profit & Loss Appropriation Account

for the year ended 31st March,2017

Particulars		Amount ₹	Particulars		Amount ₹
To Interest on Capital :			By Profit and Loss A/c		46,300
R	4,000		By Interest on Drawings :		
S	3,000	7,000	R	400	
To Commission to R 2,00,000 x 2%		4,000	S	300	700
To Commission to S 36,000 x 10%		3,600			
To Reserve 32,400 x 10%		3,240			
To Capital Accounts					
R	14,580				
S	14,580	29,160			
		47,000			**47,000**

Note : As the rate of interest on drawings (IOD) is mentioned with the term "p.a.", IOD is calculated for 6 months.

Past Adjustments in Closed Partnership Accounts

Some times profit of the firm is distributed among the partners for a particular period without giving consideration to the terms and conditions laid down in the partnership deed. Such ignored or omitted terms and conditions are required to be adjusted after the close of the accounting period. Since some accounting treatment is required to correct the past errors or omissions, the such treatment is called "Past Adjustment, situation for past adjustment arise when :

1. Interest on capital is completely omitted or charge in the books at more or less rate.
2. Interest on drawings is omitted
3. Salary / Commission payable to partner is omitted.
4. Profits have been divided in wrong ratio
5. Profit sharing ratio is changed with retrospective effect.

Methods of Adjustment

(Past Adjustment by Passing Single Entry) (Past Adjustment through P & L Adjustments A/c)

I. Past Adjustment by passing single entry : Under this method the capital account of the partner, who had been credited in excess would be debited and the capital account of the partner who had been credited less amount would be credited making an entry for net effect :

Gaining Partner's Capital A/c Dr. (Received more amount)
  To Sacrificing Partner's Capital A/c (Received less amount)

II. Adjustment through Profit and Loss Adjustment Account :

(i) For omission of interest on capital, partner's salary, commission.

P & L Adjustment A/c Dr.
  To Partner's Capital/Current Account

(ii) For omission of interest on drawings

Partner's Capital/Current A/c Dr.
  To P & L Adjustment A/c

(iii) The net effect of the above entries will be either net Profit or Loss

(For this prepare profit and Loss adjustment A/c)

a. P & L Adjustment A/c Cr. If profit (i.e. credit balance of P & L Adjustment A/c)

P & L Adjustment A/c Dr.

To Partner's Capital/Current Account

b. P & L Adjustment A/c Dr. If loss (i.e. debit balance of P & L Adjustment A/c)

Profit & Loss Adjustment A/c

For the year ended..........................

Particulars		Amount ₹	Particulars		Amount ₹
To Interest on Capital			By Interest on Drawings		
A	xx		A	xx	
B	xx	xx	B	xx	xx
To Partner's Salary			By Partner's Capital A/c		
			Current A/c (share of Loss)		
A	xx		A	xx	
B	xx	xx	B	xx	xx
To Partner's Commission			(Balancing Figure)		
A	xx				
B	xx	xx			
To Partner's Capital A/c/Current A/c					
(Share of Profit)					
A	xx				
B	xx	xx			
		xx			xx

Note : If capital of the partners are fixed, adjustment entries are passed through partner's current A/c.

Example 14 : R, S and T are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. On March 31st, 2017 their capital accounts show balances-R ₹ 1,15,000, S ₹ 70,000 and T ₹ 42,000 respectively after making all the necessary adjustments in connection with drawings and net profit. After closing the books of accounts it was found that interest on capital and drawings @ 10% was not provided. The drawings of the partners were- ₹ 15,000, S ₹ 10,000 and T ₹ 8,000 respectively and the interest thereon amounted to ₹ 1000, 600 and 400 respectively. The net profit for the year before considering above interest on capital and drawings amounted to ₹ 60,000. Make necessary adjustment entries.

Solution : **Statement showing opening capital (1.4.2016) and interest on capital**

Particulars	R ₹	S ₹	T ₹
Capital as on 31.03.2017	1,15,000	70,000	42,000
Add : Drawings during the year	15,000	10,000	8,000
	1,30,000	80,000	50,000
Less: Profit already credited	30,000	20,000	10,000
Capital as on 01.04.2016	1,00,000	60,000	40,000
Interest on Capital @ 10 % p.a.	10,000	6,000	4,000

Journal (Adjustment Entries)

				₹	₹
2017 Mar,31	P & L Adjustment A/c	Dr.		20,000	
	To R's Capital A/c				10,000
	To S's Capital A/c				6,000
	To T's Capital A/c				4,000
	(Adjustment of interest on capital not done in the Profit & Loss Account)				

Mar,31	R's Capital A/c	Dr.	1,000	
	S's Capital A/c	Dr.	600	
	T's Capital A/c	Dr.	400	
	To P & L Adjustment A/c			2,000
	(Adjustment for Interest on drawings not done in the P & L Account)			
Mar,31	R's Capital A/c	Dr.	9,000	
	S's Capital A/c	Dr.	6,000	
	T's Capital A/c	Dr.	3,000	
	To P & L Adjustment A/c			18,000
	(Loss on account of adjustments distributed among partners in their profit sharing ratio.)			

Dr. **Profit and Loss Adjustment Account (For the year ended on 31 March 2017)** Cr.

Particulars		Amount ₹	Particulars		Amount ₹
To Interest on Capital :			By Interest on Drawings:		
R	10,000		R	1,000	
S	6,000		S	600	
T	4,000	20,000	T	400	2,000
			By Partner's Capital A/c :		
			R	9,000	
			S	6,000	
			T	3,000	18,000
		20,000			**20,000**

Partner's Capital Accounts

Particulars	Amount ₹ R	S	T	Particulars	Amount ₹ R	S	T
To P & L Adjustment a/c (Interest on Drawings)	1,000	600	400	By Balance b/d	1,15,000	70,000	42,000
To P & L Adjustment a/c (Loss on Adjustments)	9,000	6,000	3,000	By P&L Adjustment a/c (Interest on Capital)	10,000	6,000	4,000
To Balance c/d	1,15,000	69,400	42,600				
	1,25,000	**76,000**	**46,000**		**1,25,000**	**76,000**	**46,000**

The above adjustment will be made by passing a single entry. Adjusted Amount will be calculated from the analytical table.

Analytical Table

Particulars	R		S		T		Firm	
	Dr. ₹	**Cr. ₹**	**Dr. ₹**	**Cr. ₹**	**Dr. ₹**	**Cr. ₹**	**Dr. `**	**Cr. ₹**
Interest on Capital	--	10,000	--	6,000	--	4,000	20,000	
Interest on Drawings	1,000	--	600	--	400	--	--	2,000
							20,000	2,000
Loss of ₹ 18,000 debited to partners in the ratio 3: 2 :1	9,000	--	6,000	--	3,000	--	--	18,000
Total	10,000	10000	6,600	6,000	3,400	4,000	20,000	20,000
Final Adjustment		--	600 (Dr.)	--		600 (Cr.)		

Particulars		Amount ₹ Dr.	Cr.
S's Capital A/c	Dr.	600	
To T's Capital A/c			600
(Adjustment of Partner's Accounts made)		**600**	**600**

Dr. **Partner's Capital Account** **Cr.**

Particulars	Amount ₹ R	S	T	Particulars	Amount ₹ R	S	T
To T's Capital A/c		600		By Balance b/d	1,15,000	70,000	42,000
To Balance c/d	1,15,000	69,400	42,600	By S's Capital A/c			600
	1,15,000	**70,000**	**42,600**		**1,15,000**	**70,000**	**42,600**

Guarantee of Profit to a Partner

Sometimes a new partner may be admitted in the firm with minimum guaranteed profit from business. The profit may be guaranteed to an existing or an incoming partner.

Types of Guarantee : (i) Guarantee by firm **(ii)** Guarantee by partners **(iii)** Guarantee by partner to firm **(iv)** Simultaneous guarantee by the partner to the firm and by the firm to the partner.

1. Guarantee by firm or by all the partners- Divisible profit is firstly distributed among the partners in their profit sharing ratio. Deficiency of guaranteed partner (if any) is adjusted through capital accounts of remaining partners in their profit sharing ratio.

Note : (1) When the guaranteed partner's share of profit is more than the guaranteed amount his actual share of profit is given to him instead of the guaranteed amount of profit. (2) The partner will get his guaranteed amount of profit even if there is loss. (3) If the deficiency sharing ratio is given then deficiency of profit will be adjusted in given ratio.

2. Guarantee by partners- When one of the partners guarantee a minimum profit the adjustment is made through the partner's capital account .The following, steps are to be followed :

(a) Distribute the profit among the partner's as per their profit sharing ratio.

(b) If the share of profit of the guaranteed partner is less than the minimum guaranteed profit, the difference is deducted from the share of profit of the partner who had guaranteed and it is added to the share of profit of the guaranteed partner.

Example 15 :

X and Y are partners in a firm sharing profit and loss in the ratio of 3 : 2. They decided to admit Z with 1/5 the share in profits with a guaranteed amount of ₹ 50,000. They decided that the profit sharing ratio between X and Y will not change. The firm earned profits of ₹ 1,50,000 for the year 2016-17. Prepare Profit & Loss Appropriation Account when -: (1) Guarantee is provided by firm (2) Guarantee is provided only by X.

Solution : 1 **Profit & Loss Appropriation A/c (for the year ended 31st March 2017)**

Particulars		Amount ₹	Particulars	Amount ₹
To X's Capital	72,000		By Profit for the year	1,50,000
Less guarantee to Z	12,000	60,000		
To Y's Capital	48000			
Less guarantee to Z	8,000	40,000		
To Z's Capital	30,000			
Add guarantee by X	12,000			
Add guarantee by Y	8,000	50,000		
		1,50,000		**1,50,000**

Note : New Ratio 12 : 8 : 5

Alternative Method :

Total Profit ₹ 1,50,000

Z's share ₹ 50,000

Remaining Profit ₹ 1,00,000

₹ 1,00,000 will be shared by X and Y in ratio - 3 : 2

X's share ₹ 1,00,000 x 3/5 = ₹ 60,000

Y's share ₹ 1,00,000 x 2/5 = ₹ 40,000

Dr. **P & L Appropriation A/c** Cr.

Particulars		Amount ₹	Particulars	Amount ₹
To Capital A/c			By Net Profit	1,50,000
X	60,000			
Y	40,000			
Z	50,000	1,50,000		
		1,50,000		1,50,000

2. When Guarantee is provided only by X.

Dr. **P & L Appropriation A/c** Cr.

Particulars		Amount ₹	Particulars	Amount ₹
To Capital A/c			By Net Profit	1,50,000
X	72,000			
Less guarantee to Z	20,000	52,000		
Y		48,000		
Z	30,000			
Add guarantee from X	20,000	50,000		
		1,50,000		1,50,000

3. Guarantee by a partner to firm : A partner may guarantee minimum earnings to the firm or guarantee a profit to the firm. In such a situation, shortfall is debited to the capital account of the partner who gives certain amount guaranter.

Example 16 :

A, B and C are partners sharing profit in ratio of 5:3:2. C gives guarantee to firm of minimum ₹60,000 earnings but C could earn only ₹ 40,000 for the firm. Total profit earned by the firm is ₹ 1,00,000. Prepare Profit & Loss Appropriation account for distribution of profit among partners.

Dr. **Profit and Loss Appropriation Account** Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Partners capital A/c		By Profit & Loss Account	1,00,000
A	60,000	By C' s capital A/c	20,000
B	36,000	(guaranteed amount)	
C	24,000		
	1,20,000		1,20,000

Note : Ultimately C will receiving only ₹ 4,000 as his share of profit.

4. Simultaneous guarantee by the partner to the firm and by the firm to the partner : In such a situation first the guarantee by the partner is adjusted then guarantee by the firm is adjusted.

Example 17 :

A, B and C are Partner, sharing profit in ratio of 3 : 2 : 1. It was agreed that **(1)** C would get minimum profit ₹ 1,50,000 **(2)** B made guarantee to the firm that the firm would earn minimum ₹ 2,40,000. Firm earned ₹ 7,60,000 for the current year Which included ₹ 1,60,000 earned by B.

Dr. **Profit and Loss Appropriation Account** Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Partners Capital A/c		By Profit & Loss Account	7,60,000
A	4,14,000	By B' s capital A/c (guaranteed amount)	80,000
B	2,76,000		
C	1,50,000		
	8,40,000		**8,40,000**

Working Note : (1) Deficiency recovered from B is ₹ 80,000; (2) C was guaranteed a minimum sum of ₹ 1,50,000. Hence deficiency of ₹ 10,000 will be borne by A and B in the ratio 3 : 2.

Example 18 :

On 1st January, 2016 the balances of capital a/cs of A, B and C were ₹ 10,000, ₹ 18,000, and ₹15,000 respectively. They decided to make following adjustments before distributing profit & loss :

(i) ₹ 1000 per months is to be given to A as salary. (ii) 10% P.A. interest on capital is to be given to all partners (iii) After adjusting one to three adjustments, 10% commission is to be given to A on balance of profit. (iv) After adjusting one to four adjustments, 1/4 part of balance of profit is to given to B. (v) Balance of profit is to be divided in 3:2 ratio between A and C. On 31st December, 2016, the profit of the firm was ₹ 44,900 before above adjustments. Prepare Profit and Loss Appropriation Account of the firm and Partners Capital Accounts.

Solution : **Profit and Loss Appropriation Account**

Dr. for the year ended 31 December, 2016 Cr.

Particulars		Amount ₹	Particulars	Amount ₹
To Salary to A		12,000	By Profit & Loss A/c	44,900
To Interest on Capital				
A	1,000			
B	1,800			
C	1,500	4,300		
To Commission to A $\left(28,600 \times \frac{10}{110}\right)$		2,600		
To Partner's Capital A/c				
B $\left(26,000 \times \frac{1}{5}\right)$	5,200			
C $\left(20,800 \times \frac{3}{5}\right)$	12,480			
D $\left(20,800 \times \frac{2}{5}\right)$	8,320	26,000		
		44,900		**44,900**

Dr. **Partners Capitals Accounts** Cr.

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
2016	To Balance c/d	38,080	25,000	24,820	2016	By Balance b/d	10,000	18,000	15,000
31Dec,					31Dec,	By Salary A/c	12,000	-	-
					31Dec,	By Int. on Capital A/c	1,000	1,800	1,500
					31Dec,	By Commission A/c	2,600	-	-
					31Dec,	By P&L App. a/c	12,480	5,200	8,320
		38,080	**25,000**	**24,820**			**38,080**	**25,000**	**24,820**

Example 19 :

A, B and C entered into partnership on 1st January, 2016 to share profit in the ratio of 2 : 1 :1. It was provided in the deed that C's share of profit will not be less than ₹ 70,000 p.a.. The loss for the year ended 31st December, 2016 where ₹ 2,00,000 before allowing interest ₹ 9,000 to A, which is due for the current year. Prepare Profit and Loss Appropriation A/c for the year ended 31st December, 2016.

Solution :

In case of Loss, P & L Account will be prepared instead of P & L Appropriation Account.

Profit and Loss Account
for the year ended 31 Dec., 2016

Dr. Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Loss before Interest on A's Loan	2,00,000	By Net Loss transferred to:	
To interest on A's Loan	9,000	A's Capital A/c (2/3)	1,86,000
To C's Capital A/c (Minimum share of Profit)	70,000	B's Capital A/c (1/3)	93,000
	2,79,000		**2,79,000**

Important Points

- According to section 4 of the Indian Partnership Act, 1932 " Partnership is the relationship between persons who have agreed to share profits of the business carried on by all or any of them acting for all."
- The persons who have entered into a partnership with another individual are called partners and collectively a firm. The name under which the business is carried is called firm name.
- It resolves the limitations of sole proprietorship.

Features of partnership :

1. Two or more persons, maximum 50.
2. There should be an agreement between the partners.
3. The agreement between the partners must be with the object of sharing profits among all the partners. An agreement to share losses is not essential.
4. Law ful Business.
5. Business can be carried on by all or any of them acting for all.
6. Regulation of partnership according to Indian Partnership Act, 1932.
7. Unlimited liability of partners.
8. Partnership does not have a separate entity from its partners.
9. A written document containing the terms of agreement between the partners pertaining to the rights and duties of a partners is known as partnership deed. It is better to have written agreement to avoid any dispute.
10. Rules applicable in absence of partnership deed : No interest will be allowed on capital, no interest will be charged on drawings, remuneration (salary, commission) is not paid to any partner and interest on loan is paid @ 6% p.a.

There are two methods to deal with partners capital Account :

1. **Fluctuating Capital Account Method :** Under this method the partners maintain capital account and all transactions (including capital) are made in the capital account.
2. **Fixed Capital Account Method :** Under this system two accounts are maintained (a) Partner's Capital Account (b) Partner's Current Account. All transactions (other then capital) are made in Partners Current A/c.

- **Profit and Loss Appropriation Account :** Distribution of profits among the partners is made through P & L Appropriation Account. P & L Appropriation Account is the extension of P & L A/c.
- **Interest on Capital :** Interest on capital will be allowed when it is provided by partnership deed. It will be allowed only when there is profit.
- **Interest on Drawings :** Interest on drawings is to be charged if partnership deed provides so. There are two methods of calculation of interest on drawings (a) Product Method (b) Average Period Method

Treatment of Past Adjustments : After the final accounts have been prepared, some omission are noticed then necessary adjustments can be made in partner's capital account by passing an adjustment entry.

Guarantee of Profit to a Partner : In such a situation when the share of profit of the new or existing partner is less than the minimum guaranteed amount the deficiency is met by all the partners or any one of the existing partners.

Glossary

Partnership	Partnership is the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all.
Partners	The persons who have entered into partnership are called partners.
Name of Firm	The name under which the business is carried is called firm name.
Partnership Deed	It is written agreement between partners.
Partners Capital	The amount contributed by partners in a firm is called partners capital.
Fixed Capital	Fixed capital means capital invested by each partner in the firm remains fixed or unaltered.
Fluctuating Capital	All transactions of a partner (including capital) are recorded in his capital account. As a result balance in the capital account fluctuates.
Drawings	Drawings means the amount withdrawn by partners in cash or kind for their personal use.
Profit Sharing Ratio	The ratio in which profits of firm are distributed among partners.
Profit & Loss Appropriation Account	P & L Appropriation Account is an extension of P & L A/c. It is prepared to show how net profit has been distributed among the partners

Questions for Exercise

Multiple choice questions :

1. In the absence of Partnership Deed the interest on loan is payable at:
   (a) 6% p.m. (b) 0. 5% p.m. (c) 5% p.a. (d) 4% p.a.
2. In absence of Partnership Deed profit sharing ratio is:
   (a) capital ratio (b) equally (c) sacrificing ratio (d) as decided by the partners
3. Calculate the Interest on Ram's drawings @ 10% if he withdrew ₹24,000 during the year.
   (a) ₹ 1,200 (b) ₹ 1,800 (c) ₹ 2,400 (d) ₹ 1,600
4. In absence of partnership deed:
   (a) Interest on capital is given (b) Interest on drawing is charged
   (c) Salary is given (d) Provided share in profits
5. In a partnership firm maximum number of partners is :
   (a) 2 (b) 10 (c) 20 (d) 50
6. Partners are not entitled to receive -------- in the absence of partnership agreement:
   (a) salaries (b) interest on capital (c) fees and commission (d) all the above
7. The balance of partners capital account will reduce with ------
   (a) Interest on capital (b) Interest on drawings (c) Salaries (d) Interest on partners loan
8. Partnership Deed is the agreement between the partners in:
   (a) Oral (b) written (c) Implied (d) None of these
9. The persons who form the partnership are individually known as :
   (a) Firm (b) Partners (c) Sole trader (d) Conventurers
10. Interest on Drawings is ---------- for firm:
    (a) Income (b) Expenses (c) Income and Expense both (d) none of these

Very Short Answer Type Questions :

1. What is the minimum and maximum limit on number of partners in a firm?
2. What do you understand by Partnership Firm?
3. What do you mean by Profit and Loss Appropriation Account ?

4. Give two circumstances in which fixed capital of partners may change.
5. What Accounts are opened: (a) When the capitals are fixed. (b) When the capitals are fluctuating.
6. What is meant by unlimited liabilities of partner ?
7. State any three items of charge on Profits.
8. State any two points regarding need of partnership.
9. What items are shown on the credit side of Fluctuating Capital Account ?
10. What items are shown on the debit side of Fluctuating Capital Account ?
11. Name any two items which are shown on the credit side of Profit and Loss Appropriation Account.
12. Name any two items which are shown on the debit side of Profit and Loss Appropriation Account.
13. Shipra and Shruti are partners in a firm. After preparing the Final Account it was found that salary of ₹ 2000 was not given to shipra. Give Journal entry for rectification.
14. The Firm of A, B & C earned a profit of ₹ 20,000 during the year, which was distributed among the partners in the ratio of 2 : 1 : 1, whereas it should be in the ratio of 1 : 2 : 2. Give Journal entry for rectification.
15. Write the names of methods regarding adjustment in closed partnership accounts. (RBSE 2008)
16. How would you calculate interest on drawings of equal amounts drawn in the middle of every month?

Very Short Answer type Questions :

1. Name any two items which are shown on the credit side of Profit and Loss Appropriation Account.
2. In the absence of partnership deed, what are the rules relating to :
   (A) Interest on partner's Capital (B) Interest on partner's Drawings (C) Interest on partner's Loan
   (D) Partner's profit sharing Ratio (E) Salaries of partners
3. Rashmi & Ashish are two partners of a firm. Rashmi withdraws ₹ 1000 at the beginning of each month whereas, Ashish withdraws ₹ 2000 at the end of each months during the whole year. Interest on drawings is charged @ 12% per annum. Calculate the amount of interest at the end of the year. (RBSE 2005)
4. What is meant by Guarantee of profit to a Partner?
5. For how much period, interest on drawings will be calculated, if the equal amounts are drawn for 6 months ended on (i) Ist date of every month. (ii) End of every month. (iii) Middle of every month?
6. Chandra, Surya and Kiran are partners in a firm. During the year 2016, their drawings were as follows :

(Date)	(Chandra) ₹	(Surya) ₹	(Kiran) ₹
01-02-16	1,000	-	2,000
01-05-16	3,000	4,000	1,000
01-08-16	-	4,000	3,000
01-12-16	6,000	2,000	4,000

   Calculate the interest on drawings @6% p.a. for the year ended on 31st December, 2016 by 'Product Method'
   Ans. : Interest on Drawings ₹ 205; ₹ 270 and ₹ 245.
7. Ram, Rahim and Roja are partners sharing profit and loss in the ratio of 3 : 2: 1. As per partnership deed Roja's minimum profit will be ₹ 10,000 p.a. The profit for the half year ended on 31st March 2017 was ₹ 24,000. Pass necessary Journal entry for the distribution of the profit and prepare Profit and Loss Appropriation Account.
   Ans. : N.P. divided ₹ 11,400, ₹ 7,600 and ₹ 5,000). (RBSE2010)
8. X, Y and Z have Capital of ₹ 40,000, ₹ 30,000 and ₹ 20,000. For the year 2016; Interest was credited to them @ 12% p.a. instead of @ 10% p.a. With what amount you will pass the adjustment entry?
   Ans. : A's Capital A/c Dr. ₹ 200; C's Capital A/c Cr. ₹ 200.
9. X, Y and Z are partners sharing profit in ratio 5 :3:2. Z gives guarantee to firm of minimum ₹ 1,20,000 earnings but Z could earn only ₹ 80,000 for the firm. Total profit earned by the firm is ₹ 2,00,000. Prepare Profit & Loss Appropriation Account for distribution of profit among partners.

Ans. : Profit X ₹ 1,20,00, Y ₹ 72,000, Z ₹ 48,000.

10. P, Q and R are partner sharing profit in ratio 3 : 2 : 1. It was agreed that : 1. R would get minimum profits ₹ 3,00,000 2. Q made guarantee to the firm that he would earn minimum ₹ 4,80,000. Firm earned ₹ 15,20,000 for the current year. It included ₹ 3,20,000 earned by Q. Prepare Profit & Loss Appropriation Account for distribution of profit among partners.

    Ans. : Profit P ₹ 8,28,000, Q ₹ 5,52,000, R ₹ 3,00,000.

Essay Type Questions :

1. Define partnership and discuss it's characteristic.
2. What do you mean by fixed and fluctuating Capital Accounts? Point out the difference between the fixed and fluctuating Capital Accounts. Prepare partner's current account by using imaginary figures.
3. What is partnership deed? What points are included in it from accounting point of view?
4. Describe various types of partnership.
5. What do you mean by guarantee of profit to a partner? Explain the two types of such guarantee.
6. How would you adjust the omission disclosed after closing the partnership accounts?

Question No.	1	2	3	4	5	6	7	8	9	10
Answer	B	B	A	D	D	D	B	B	B	A

Numerical Questions :

1. Ram, Mohan and Sohan were partners. Their capital on 1st january 2016 were ₹ 40,000, ₹ 60,000 and ₹ 1,00,000 respectively. Before division of profit, Ram is entitled for salary of ₹ 12,000 and Mohan ₹ 18,000 per annum. Interest is allowed on Capital @ 10% per annum. Out of net divisible profits, first ₹ 40,000 will be divided in their captial ratio and the balance of profit is to be divided equally. The profit of the firm for the year ended on 31st December, 2016 amounted to ₹ 1,20,000 before making all the above adjustments. Prepare Profit & Loss Appropriation A/c, the partner's capital account on 31st December 2016 and Pass a Journal entry for distribution of profit.

   Ans. : Profit divided Ram ₹ 18,000, Mohan ₹ 22,000 and Sohan ₹ 30,000 respectively.

2. Ram, Shyam and Mohan were partners, their capital on 1st January 2016 were ₹ 50,000, ₹ 30,000 and ₹ 20,000 respectively. Before division of profit, Shyam is entitled for salary of ₹ 3,000 and Mohan ₹ 2,000 per annum. Interest is allowed on Capital @ 10% per annum. Out of net divisible profits, first ₹ 50,000 will be divided in their captial ratio and the balance of profit is to be divided equally. The profit of the firm for the year ended on 31st December, 2016 amounted to ₹ 95,000 before making all the above adjustments. Prepare P & L Appropriation A/c and give Journal entries.

   Ans. : N.P. divided Ram ₹ 35,000, Shyam ₹ 25,000 and Mohan ₹ 20,000.

3. A, B and C were partners. Their capital as on 1st January 2016 was ₹ 40,000, ₹ 27,800 and ₹ 15,900 respectively. Before division of profit, B is entitled for salary of ₹ 2,500 and C for ₹ 2,000 per annum. Interest is allowed on Capital @ 5% per annum. Out of net divisible profits, first ₹ 10,000, A will receive 40%, B-35% and C-25%. Profits in excesses to that are shared equally. For the year ended on 31st December, 2016 after debiting salary but before charging interest the profits were ₹ 23,170. Prepare Profit & Loss Appropriation A/c.

   Ans. : N.P. divided A ₹ 6,995, B ₹ 6,495 and C ₹ 5,495.

4. P and S started a partnership firm on 1st January 2016 with a capital of ₹ 1000, ₹ 10,000 respectively. On 1st March, 2016 P introduced additional capital of ₹ 4,000. On that day S withdrew ₹ 3,000 from his capital. C entered in the firm on 1st July 2016 with a capital of ₹ 15,000. On that day P and S introduced additional capital of ₹ 6,000 and ₹ 5,000 respectively. Profit-Loss are distributed in capital ratio. The profits for the year 2016 were ₹ 29,800. Prepare Profit & Loss Appropriation A/c by giving detailed calculations.

   Ans. : Capital Ratio- 44 : 60 : 45, N.P. divided P ₹ 8,800, S ₹ 12,000 and C ₹ 9,000.

5. A and B are partners sharing profits in the ratio of 7 : 3. On 1st April 2016, their capitals were ₹ 1,00,000, ₹ 40,000 respectively. Interest is to be charged on capital and drawings at 10% per annum. B is to be allowed salary ₹ 1,000 per month. A and B withdrew ₹ 1,000 and ₹ 600 per month respectively on the first day of every month. The profits for the year, prior to calculation of interest on capitals and drawings, but after charging B's salary, amounted to ₹ 54,960. A provision for to commission A at 5% on net profit (after charging such commission) is to be made. Prepare Profit & Loss Appropriation Account for the year ended 31st March, 2017.

   Ans.: Interest on Drawings ₹ 650 and ₹ 390, N.P. A ₹ 28000, B ₹ 12000 and A's Commission ₹ 2000.

6. X and Y are partners sharing profits in the ratio of 3 : 2. On 1st April 2016 their capital is ₹ 3,00,000 and ₹ 2,00,000 respectively. The partnership deed provided interest on capital @10% p.a. and salary to Y as ₹ 2,500 p.m. The net profit before providing interest on capital and salary amounts to ₹ 40,000 for the year ended 31st March, 2017. Show the distribution of profit for the year.

   Ans.: X Interest on Capital ₹ 15,000, Y Interest on Capital ₹ 10,000, Y's Salary ₹ 15,000.

7. Ruchi and Prashant are partners sharing profits and losses in the ratio of 3:1. On 1st April 2016 their capitals were ₹ 50000, and ₹ 40,000 respectively. During the year ended 31st March 2017 the profit of the firm amounted to ₹ 57,500 before taking into consideration the following :

   1. Interest on capital is to be allowed @ 5 % p.a. 2. Ruchi will get commission of 2% on sales. Sales for the year were ₹ 1,25,000 3. Prashant will get a salary of ₹ 250 p.m. 4. Prashant is entitled to a rent of ₹ 625 per month for the use of his premises by the firm 5. 10% of the divisible profit is to be transferred to General Reserve. You are required to prepare the Profit and Loss Appropriation Account.

   Ans. : Profit before P & L Appropriation ₹ 50,000, Profit Ruchi ₹ 27,000, Prashant ₹ 9000.

8. A, B and C are partners sharing profit and loss in 3 : 2 : 1 ratio. A withdraws ₹ 2,000 at the beginning of every month, B withdraws ₹ 1,500 in the middle of every month, whereas, C withdraws ₹ 1,000 at the end of every month. Interest on Capitals and drawings is to be charged @ 10% p.a. C is also to be allowed a salary of ₹ 800 per month. After deducting salary but before allowing all types of interest, the profit for the year ended 31st December 2016 was ₹ 1,22,150. Prepare Profit and Loss Account and Capital Accounts and Current Accounts of the partners from the additional informations given below.

	A ₹	B ₹	C ₹
Capital as on 1st Jan., 2016	2,00,000	1,50,000	1,00,000
Additional Capital introduced on 1st April, 2016	50,000	30,000	-
Withdral on 1st Oct., 2016	-	-	20,000
Current Account on 1st Jan. 2016	12,200	5,500	4,100 (Dr.)
Loan Accounts on 1st Jan. 2016	40,000	-	-

   Ans. : Profit before P & L Appropriation ₹ 1,19,750, Profit A ₹ 36,000 , B ₹ 24,000, C ₹ 12,000, Current A/c Balance A ₹ 46,650, B ₹ 27,850, C ₹ 14,450.

9. Manish, Navan and Vaibhav are partners in a firm. Balance of their capital accounts as on 1st April, 2016 were : ₹ 4,00,000, ₹ 3,00,000 and ₹ 2,00,000 respectively. The partnership agreement provides :

   A. Vaibhav shall be credited for ₹ 40,000 of salary per annum. **B.** After providing Vaibhav salary, 10% p.a. interest on capital to all partners and extra remuneration to Vaibhav as provided in this paragraph 'B' Vaibhav shall be entitled to 10% of all profits in excess of ₹ 35,000 p.a.. **C.** Manish is to have one third of the profits after charging all amount under 'A', 'B','C', **D.** The Balance is to be divided between Navan and Vaibhav in the ratio 4 : 1. The profits for the year ended 31st March, 2017 (before making any provision for the above) was ₹ 3,30,000. You have to prepare Profit & Loss Appropriation Account and Partners Capital Accounts for the year ended 31st March, 2017. During the year Manish, Navan and Vaibhav withdrew the amount for personal use ₹ 20,000, ₹ 15,000 & ₹ 10,000 respectively.

   Ans.: Vaibhav Remuneration ₹ 15,000, Profit Manish ₹ 46,250, Navan ₹ 1,11,000, Vaibhav ₹ 27,750, Capital

Balance Manish ₹ 4,66,250, Navans ₹ 4,26,000, Vaibhav ₹ 2,92,750 .

10. A, B and C are equal partners in a firm. Their capitals on 1st January 2016 were ₹ 50,000, ₹ 40,000 and ₹ 30,000 respectively. After closing the accounts of the year 2016, it was found that according to the partnership agreement interest at 10% per annum on partners capitals, a salary of ₹ 3,000 per year to A and a commission of ₹ 6,000 to C were not provided before distribution of profits. It was agreed among the partners to make the adjustment entry at the beginning of the next year rather than to alter the Balance Sheet. Pass one Journal entry in the books of the firm showing the working of adjustments assuming that capitals are fixed.

    Ans. : 'B' Dr. ₹ 3,000, 'A' Cr. ₹ 1,000, 'C' Cr. ₹ 2,000.

11. X, Y, and Z are partners in a firm sharing profit and loss in the ratio of 2 : 2: 1. On 31st March, 2006 after recording drawings and distribution of profits ₹ 30,000, their capitals were ₹ 60,000, ₹ 45,000, and ₹ 30,000 respectively. After this it was found that 5% interest on capital and interest on drawings was omitted to be recorded. Drawings were as follows : X- ₹ 6,000, Y- ₹ 4,500, and Z- ₹ 3,600; Interest on which is to be charged ₹ 120, ₹ 90 and ₹ 45 respectively. Pass necessary Journal entries for the above omissions and prepare adjusted partners capital accounts.

    Ans. : Opening Capital X ₹ 54,000, Y ₹ 37,500 and Z ₹ 27,600, Loss X ₹ 2,280, Y ₹ 2,280, Z ₹ 1,140. Capital Balance X ₹ 60,300, Y ₹ 44,505, Z ₹ 30,195.

12. P, Q and R are partners in a firm. Their capital accounts stood at ₹ 90,000, ₹ 45,000 and ₹ 45,000 respectively on 31st March, 2017. **1.** R was to be allowed a remuneration of ₹ 9000 p.a.. **2.** Interest at 5% p.a. was to be provided on capitals **3.** Profits were to be divided in the ratio of 2 : 2 : 1. Ignoring the above items, net profit of ₹ 54000 for the year ended 31.03.2017. It was divided among the three partners equally. Make journal entry for rectification and show workings.

    Ans. : Opening Capital P ₹ 72000, Q ₹ 27000, R ₹ 27000, Q Dr. ₹ 1170, P Cr ₹ 1080, R Cr. ₹ 90.

13. Satish, Nitin and Ajay are partners with a fixed capital ₹ 1,00,000, ₹ 75,000, and ₹ 75,000 respectively. Their current account balances were Satish ₹ 5,000 (Cr.), Nitin ₹ 4,000 (Cr.), and Ajay ₹ 2,500 (Dr.). The partnership deed provided as under :

    1. Interest on capital @ 5% p.a. **2.** Nitin was entitled for rent @ ₹ 500 p.m. for providing his premises to the firm. **3.** Ajay was entitled to a salary of ₹ 1,000 p.m. The profits of the firm were to be distributed as follows : **A-** The first ₹ 20,000 in proportion to their capitals. **B-**Next ₹ 20,000 in the ratio 2:2:1. **C-** Remaining profits to be shared equally. The net profit before the above adjustments for the year was ₹ 85,500. Prepare Profit & Loss Appropriation Account, Capital Accounts and Current Accounts of the partners.

    Ans. : Profit before P& L Appropriation ₹ 79,500, Profit Satish ₹ 21,000, Nititn ₹ 19,000, Ajay ₹ 15,000, Current Account Balance Satish ₹ 31,000, Nitin ₹ 32,750, Ajay ₹ 28,250.

14. X, Y and Z are partners in a firm. Their profit sharing ratio is 5 : 3: 2. However, Z is guaranteed a minimum amount of ₹ 10,000 as share of profit every year. Any deficiency arising on that account shall be met by Y. The profit for the two years ended 31st December, 2015 and 2016 were ₹ 40,000 and ₹ 60,000 respectively. Prepare Profit & Loss Appropriation Account for the two years.

    Ans. : Share of Profit 2015 - X ₹ 20,000 , Y ₹ 10,000, Z ₹ 10,000 ; 2016 - X ₹ 30,000, Y ₹ 18,000, Z ₹ 12,000.

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