Accounting for Partnership- Fundamentals

Meaning of Partnership

A partnership is made by an agreement. Partnership agreement may be in written or oral. The agreement should be to share the profits of the business. The firm's business may be carried on by all the partners or any one of them acting for all. As per the law, it is not necessary to have a written agreement but to avoid the trouble in managing the affairs of the partnership firm; it is always advisable to have a written agreement which should be signed by all the partners.

In other words, when **two or more than two persons** are **agreed** to run a **lawful business** by **sharing its profit** which is **carried on by all or any of them acting for all**.

Definition of Partnership

Definition according to Section 4 of the Indian Partnership Act, 1932:

“Partnership is the relationship between two or more than two 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 Than Two Persons
2. Agreement
3. Lawful Business
4. Sharing of Profits
5. Business carried on by all or any of them acting for all

Partnership Deed

Partnership deed is a written document contains all the terms and conditions agreed by all partners and signed by all of them.

Subject Matter or Clauses of Partnership Deed

1. Name and Address of Partnership Firm
2. Name and Address of Partners
3. Nature of Business
4. Commencement of Partnership
5. Capital Contribution
6. Interest of Capital
7. Interest on Drawing
8. Profit Sharing Ratio
9. Interest on Loan
10. Remuneration to Partners
11. Valuation of Goodwill
12. Valuation of Assets
13. Settlement of Accounts
14. Rights and Duties of Partners
15. Duration of Partnership Firm
16. Operation of Bank Account
17. Settlement of Disputes
18. Death of a Partner

Importance of Partnership Deed

1. It Governs the rights and duties of each partner.
2. Disputes arising, if any, among the partners are settled on the basis of Partnership Deed.

Is it necessary to have a Partnership Deed?

Partnership Deed is not essential or necessary for a partnership firm. In the absence of partnership deed the provisions of Indian Partnership Act, 1932 will be applied.

Provisions of Partnership Act in the absence of Partnership Deed

- **Profit sharing:-** In the absence of partnership deed or if deed is silent on profit sharing, profits will be distributed equally.
- **Interest on Capital:-** No interest on capital is allowed to partners.
- **Interest on Drawing:-** No interest on drawing is charged from the partners.
- **Interest on Partner's Loan:-** Interest on partner's loan is provided @ 6% p.a.
- **Salary and Commission:-** No salary or commission is given to any partner for their extra work.

Some other important Provisions of the Indian Partnership Act, 1932

- If all the partners agree, a minor may be admitted for the benefit of partnership.
- A person may be admitted as a partner either with the consent of all the existing partners or in accordance with an express agreement among the partners.
- A partner may retire from the firm either with the consent of all the other partners or in accordance with an express agreement among the partners.
- Registration of the firm is optional and not compulsory.
- Unless otherwise agreed by the partners in the Partnership Deed, a firm is dissolved on the death of a partner.

Preparation of P & L Appropriation A/c

Learning Objectives:-

Students will be able

- **To make journal entries of interest on capital, interest on drawing, salary, commission paid to a partner.**
- **To prepare P & L Appropriation Account.**

DISTRIBUTION OF PROFIT AMONG PARTNERS: PROFIT AND LOSS APPROPRIATION ACCOUNT

A partnership firm, like a proprietorship firm, prepares Trading Account, Profit and Loss Account and Balance Sheet. In addition, a partnership firm prepares Profit and Loss Appropriation Account to which *net profit* or *net loss* as per the Profit and Loss Account is transferred to appropriate it as per the agreement among partners. This account, is an *extension of the Profit and Loss Account*, and is credited with the amount of Net Profit or debited with the amount of Net Loss (transferred from Profit and Loss Account). It is credited with the amount of interest on drawings of the partners (which is loss to the partners but an income for the firm) and debited with interest on the capitals of the partners, partners' salaries and commissions, etc., (which are losses for the firm and incomes for the partners).

If the partners decide, an amount is transferred to Reserve and the balance profit (Divisible Profit) is distributed between/among the partners in their profit-sharing ratio.

It should be noted that profit is appropriated up to the amount available for distribution, *i.e.*, Divisible Profit. Thus, if after transfer of net loss and credit of interest charged on drawings to Profit and Loss Appropriation Account, the balance is loss, appropriation is not made. The loss is distributed among the partners in their profit-sharing ratio. But if it results in profit, appropriation is made up to the amount of profit.

Net Profit *is the profit earned by an enterprise from its operating and non-operating activities. It is the net effect of operating and non-operating revenues and expenses that are charge against profit. It is determined by preparing Profit and Loss Account.*

Divisible or Distributable Profit

Divisible or Distributable Profit *is the profit that is available for distribution among partners after allowing remuneration (Salary, Commission, etc.) to partners, interest on capitals, transfer to reserve and charging interest on drawings. It is determined by preparing Profit and loss Appropriation Account.*

Profit and Loss Appropriation Account is an extension of the Profit and Loss Account. Net profit or loss as per Profit and Loss Account is transferred to Profit and Loss Appropriation Account.

Following are considered as appropriation of profit and therefore are transferred (posted) to the debit of Profit and Loss Appropriation Account:

(i) Salary/Commission to Partners;

(ii) Interest on Capitals of Partners; and

(iii) Transfer to Reserves.

Interest on Drawings is transferred (posted) to the credit of Profit and Loss Appropriation Account.

Preparation of P & L Appropriation

The journal entries for preparation of P&L Appropriation A/c and making various adjustments:-

- If Profit and Loss A/c shows Cr. balance (net profit)

  Profit and Loss A/c Dr.

  To Profit and Loss Appropriation A/c

- If Profit and Loss A/c shows Dr. balance (net loss)

  Profit and Loss Appropriation A/c Dr.

  To Profit and Loss A/c

- Interest on Capital
- For crediting interest on capital to capital account

  Interest on Capital A/c Dr.

  To Partners Capital/Current A/c
- For transferring interest on capital to Profit and Loss Appropriation A/c

  P&L Appropriation A/c Dr.

  To Interest on Capital A/c
- Interest on Drawings
- For charging interest on drawing

  Partner's Capital/Current A/c Dr.

  To Interest on Drawing
- For transferring interest on drawing to Profit and Loss Appropriation A/c

  Interest on Drawing A/c Dr.

  To P&L Appropriation A/c

- Salary or Commission to the partner
- For crediting salary or commission to partner's capital account

  Salary or Commission A/c Dr.

  To Partner's Capital/Current A/c

- For transferring salary or commission to Profit and Loss Appropriation A/c

  P&L Appropriation A/c Dr.

  To Salary or Commission A/c

- Share of profit or loss after appropriation
- In case of profit

  P&L Appropriation A/c Dr.

  To Partner's Capital/Current A/c

- In case of loss

  Partner's Capital/Current A/c Dr.

  To P&L Appropriation A/c

Format of Profit & Loss Appropriation A/c

Profit & Loss Appropriation Account

Particulars	Amount	Particulars	Amount
To Profit and Loss A/c (Loss) To Interest on Capital To Salary to Partner To Commission to Partner To Transfer to Reserve (if any) To Profit transfer to capital/current a/c	…………. …………. ………….. ………….. ………….. ………….. __________ ………….. __________	By Profit and Loss A/c (Profit) By Interest on Drawing By Loss transfer to capital/current a/c	……….. ……….. ……….. ……….. _________ …………. _________

Fixed v/s Fluctuating Capital

Fixed Capital

Under the fixed capital, the capital of the partners will remain fix unless additional capital is introduced or part of capital is withdrawn as per the agreement among the partners. It will always show the credit balance. The remaining items except capital like, drawing, interest on drawing, interest on capital, salary or commission to partner etc. are recorded in a separate account, called Current Account. It may show debit or credit balance. In capital account the capital of partner will remain same year after year unless no additional capital introduced or a part of capital withdrawn.

Format of Capital A/c

Capital Account

Particulars	Amount	Particulars	Amount
To Bank A/c (permanent capital withdrawn)	………….	By Balance b/d (opening balance)	………..
To Balance c/d (closing balance)	…………..	By Bank A/c (fresh capital introduced)	………..
	________		________
	…………..		…………..
	________		________

Format of Current A/c

Current Account

Particulars	Amount	Particulars	Amount
To Balance b/d (opening Dr. balance)	…………	By Balance b/d (opening Cr. Balance)	……….
To Drawings	………….	By Interest on Capital	………..
To Interest on Drawings	………….	By Salary to Partners	………..
To P&L Appropriation A/c (Loss)	………….	By Commission to Partners	………..
		By P&L Appropriation A/c (Profit)	………..
To Balance c/d (closing Cr. Balance)	………….	By Balance c/d (closing Dr. balance)	………..
	………….		…………

Fluctuating Capital

Under this capital, only one account i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawing, salary or commission to partners etc. are recorded directly in the capital account of partners. This makes the balance in the capital account to fluctuate from time to time. In this method the balance of the capital may debit or credit.

Format of Capital A/c when Capital is Fluctuating

Capital Account

Particulars	Amount	Particulars	Amount
To Balance b/d (opening Dr. balance)	………….	By Balance b/d (opening Cr. Balance)	……….
To Drawings	………….	By Interest on Capital	………..
To Interest on Drawings	………….	By Salary to Partners	………..
To P&L Appropriation A/c (Loss)	………….	By Commission to Partners	………..
To Balance c/d (closing Cr. Balance)	………….	By P&L Appropriation A/c (Profit)	………..
		By Balance c/d (closing Dr. balance)	………..
	________ …………. ________		________ …………. ________

Appropriation of Profits and Partner’s Capital A/c

Learning Objectives:-

Students will be able

- **To know how to treat when appropriations are more than available profit.**
- **To determine the ratio of appropriation.**
- **To explain about partner’s capital.**
- **To differentiate between Fixed and Fluctuating Capital**

Appropriations are more than Available Profit

It is also a possibility that total amount of appropriation as per the Deed is more than the amount of profit available for appropriation. In this situation, profit available for distribution among partners is distributed in the ratio of appropriation to be made.

The ratio of appropriation is determined as follows:

(i) Determine the amount payable as appropriation to each partner as per the Partnership Deed (ignoring the profit available for distribution among partners). For example, salary payable, commission payable and interest on capital, etc., payable to each partner is determined.

(ii) Total the amount of appropriation (as per Step (i) above) for each partner separately.

(iii) Ratio of the Appropriations (as per Step (ii) above) is the ratio in which profit is appropriated.

It should be kept in mind that no particular item like salary, commission, interest on capital, etc., has priority over other items of appropriation.

Illustration:-

Ajay and Vijay are partners sharing profits in the ratio of 3 : 2. Ajay is a non-working partner and contributes ` 20,00,000 as his capital. Vijay is a working partner of the firm. The Partnership Deed provides for interest on capital @ 8% p.a. and salary to every working partner @ ` 8,000 per month. Profit before providing for interest on capital and partner's salary for the year ended 31st March, 2020 was ` 80,000. Show the distribution of profit.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars	₹	Particulars	₹
To Ajay's Capital A/c (Interest on capital)	50,000	By Profit and Loss A/c (Net Profit)	80,000
To Vijay's Capital A/c (Salary)	30,000		
	80,000		80,000

Note:

Interest on Ajay's Capital = Rs.20,00,000 × 8/100 = Rs.1,60,000; Salary to Vijay = Rs.8,000 × 12 = Rs.96,000; Thus, Interest on Ajay's Capital + Salary to Vijay = Rs.1,60,000 + Rs.96,000 = Rs.2,56,000.

Since both interest on capital and salary to partners are appropriations and the profit available for distribution is Rs.80,000, *i.e.*, less than the amount of appropriations to be made, the available profit is distributed in the ratio of appropriations to be made to Ajay and Vijay, *i.e.*, Rs.1,60,000 (interest on capital): Rs.96,000 (salary), or 5 : 3.

Partner's Capital

A partnership firm has more than one owners (partners) and Capital Account is maintained for each partner separately. It is so because each partner has separate transactions with the firm. For example, if *Atul, Amit and Akhil* are three partners in a firm, there shall be three Capital Accounts, one each for *Atul, Amit and Akhil*.

The Partners' Capital Accounts may be maintained by following either:

(i) Fixed Capital Accounts Method; or

(ii) Fluctuating Capital Accounts Method.

Fixed Capital

Under the fixed capital, the capital of the partners will remain fix unless additional capital is introduced or part of capital is withdrawn as per the agreement among the partners. It will always show the credit balance. The remaining items except capital like, drawing, interest on drawing, interest on capital, salary or commission to partner etc. are recorded in a separate account, called Current Account. It may show debit or credit balance. In capital account the capital of partner will remain same year after year unless no additional capital introduced or a part of capital withdrawn.

Format of Capital A/c

Capital Account

Particulars	Amount	Particulars	Amount
To Bank A/c (permanent capital withdrawn) To Balance c/d (closing balance)	…………. ………….. __________ ………….. __________	By Balance b/d (opening balance) By Bank A/c (fresh capital introduced)	……….. ………… _________ …………. _________

Format of Current A/c

Current Account

Particulars	Amount	Particulars	Amount
To Balance b/d (opening Dr. balance) To Drawings To Interest on Drawings To P&L Appropriation A/c (Loss) To Balance c/d (closing Cr. Balance)	………… …………. …………. …………. …………. _________ …………. _________	By Balance b/d (opening Cr. Balance) By Interest on Capital By Salary to Partners By Commission to Partners By P&L Appropriation A/c (Profit) By Balance c/d (closing Dr. balance)	………. ………… ………… ………… ………… ………… ________ …………. ________

Fluctuating Capital

Under this capital, only one account i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawing, salary or commission to partners etc. are recorded directly in the capital account of partners. This makes the balance in the capital account to fluctuate from time to time. In this method the balance of the capital may debit or credit.

Format of Capital A/c when Capital is Fluctuating

Capital Account

Particulars	Amount	Particulars	Amount
To Balance b/d (opening Dr. balance)	…………	By Balance b/d (opening Cr. Balance)	……….
To Drawings	………….	By Interest on Capital	………..
To Interest on Drawings	………….	By Salary to Partners	………..
To P&L Appropriation A/c (Loss)	………….	By Commission to Partners	………..
		By P&L Appropriation A/c (Profit)	………..
To Balance c/d (closing Cr. Balance)	………….	By Balance c/d (closing Dr. balance)	………..
	_________		________
	………….		………….
	_________		________

Charge against Profit and Appropriation of Profit

Learning Objectives:-

Students will be able

- **To understand the meaning of charge against profit and appropriation of profits.**
- **To make journal entries of Interest on Loan and Rent paid to partners.**
- **To make accounting treatment of Loan paid by firm to a partner.**
- **To make accounting treatment of manager's commission.**

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.

Interest on loan by partner is credited to his Loan Account and not to his Capital Account. Journal entries passed are:

- (i) *To provide Interest on Loan by Partner:*

  Interest on Loan by Partner A/c ...Dr.

  To Loan by Partner A/c

- (ii) *To close the Interest on Loan by Partner A/c:*

  Profit and Loss A/c ...Dr.

  To Interest on Loan by Partner A/c

- **It is important to distinguish Loan Account and Capital Account of a partner because:**

1. As per the Indian Partnership Act, 1932, loan by a partner is repayable on dissolution before repayment of capital to partners; and
2. In the absence of any agreement, partners get interest @ 6% p.a. on loan advanced whereas they are not entitled to interest on capital.

Illustration

Amit, Bimal and Chaman are partners sharing profits and losses equally. Amit and Chaman gave loans to the firm on 1st October, 2019 of ` 1,00,000 and ` 1,50,000 respectively. It is agreed that interest @ 9% p.a. will be paid on loan. Books of account of the firm are closed on 31st March every year. Interest on loan is yet to be paid as on 31st March, 2020.

Pass Journal entries in the books of account of the firm.

Journal Entries

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2019					
Oct. 1	Bank A/c	...Dr.		2,50,000	
	To Loan by Amit A/c				1,00,000
	To Loan by Chaman A/c				1,50,000
	(Loan from partners Amit and Chaman)				
2020					
March 31	Interest on Loan by Partners A/c	...Dr.		11,250	
	To Loan by Amit A/c				4,500
	To Loan by Chaman A/c				6,750
	(Interest on loan by partners provided @ 9% p.a.)				
March 31	Profit and Loss A/c	...Dr.		11,250	
	To Interest on Loan by Partners A/c				11,250
	(Interest on Loan by Partners Account transferred to Profit and Loss Account)				

Interest on Loan by the Firm to Partner

A firm may give loan to a partner. It will charge interest on the loan given at the rate agreed among the partners. If the Partnership Deed does not provide for charging interest on loan given or agreement to charge interest does not exist, interest is not charged on the loan given.

If interest is charged on loan by the firm to a partner, interest is transferred to the credit of Profit and Loss Account and debit of Partner's Capital Account (if Capital Accounts are maintained following Fluctuating Capital Accounts Method) or Partner's Current Account

(if Capital Accounts are maintained following Fixed Capital Accounts Method).

The Journal entries are:

(i) For Charging Interest on Loan to Partner:

Partner's Capital/Current A/c ...Dr.

To Interest on Loan to Partner A/c (Given)

(ii) For Transfer of Interest on Loan to Partner Account:

Interest on Loan to Partner A/c ...Dr.

To Profit and Loss A/c

Rent Paid or Payable to a Partner

Rent paid or payable to a partner, is also a charge against profit and not an appropriation of profit. It is a charge on profit because rent is payable to a partner for letting the firm use his personal property for business. Rent may be paid (either in cash or by cheque) during the year to the partner or it may have become due but is not yet paid, i.e., is still payable. When it is paid or payable, it is debited to Rent Account and credited to Cash/Bank Account or Rent Payable Account. At the end of the year. Rent Account is transferred or debited to Profit and Loss Account (not to the Profit and Loss Appropriation Account).

Journal entries in this case will be as follows:

(i) *When rent is paid in cash or by cheque:*

Rent A/c ...Dr.

To Cash/Bank A/c

(Rent paid in cash/cheque for ...)

(ii) *When rent is payable:*

Rent A/c ...Dr.

To Rent Payable A/c

(Rent payable for ...)

(iii) *When Rent Account is transferred to Profit and Loss Account:*

Profit and Loss A/c ...Dr.

To Rent A/c

(Rent Account transferred to Profit and Loss Account)

Manager's Commission

Manager is an employee of the firm. Therefore, the amount due to him as commission is payable whether the firm earns profit or incurs loss. Stating differently, Manager's Commission is a charge against profit and transferred to the debit of Profit and Loss Account.

Interest on Partner’s Capital

Interest on Capital

Interest on Capital is allowed to compensate a partner for contributing capital to the firm in excess of the profit-sharing ratio. It is calculated at the agreed rate with to the time capital has been used in the business.

Interest on capital is computed on the opening balance of capital. If additional capital is introduced then interest on this capital is provided for the time, it is used in the business and if capital is withdrawn then the part of capital which is withdrawn, the interest will not be paid to the partner on capital withdrawn from the date of withdrawn.

Provisions Related to the Interest on Capital

Sr. No.	Case	Provisions
1	When Partnership Deed does not exist or Partnership Deed does not have a clause as to interest on capital	No interest on capital is provided
2	When the Partnership Deed provides for interest on capital but is silent as to the treatment of interest as a charge or appropriation	Interest on capital is treated as appropriation of profit. Interest on capital is allowed only if there is profit. There are 3 possible cases:- i) - ii) i) In case of loss ii) In case of profit is equal or more than the interest iii) In case profit is less than int… • i) No int. on capital • ii) Interest is allowed at the agreed rate • • iii) Interest is

Illustration

A and B are partners sharing profits and losses in the ratio of 3:2 with capitals of Rs.2,00,000 and Rs.1,00,000 respectively. Pass necessary journal entry in the following cases:-

1. If partnership deed is silent as to the interest on capital and profit for the year is Rs.20,000.

Journal Entries:-

Profit and Loss A/c Dr.	20,000	
To Profit and Loss Appropriation A/c		20,000
Profit and Loss Appropriation A/c Dr.	20,000	
To A's Capital A/c		12,000
To B's Capital A/c		8,000

2. If partnership deed provides for interest on capital @ 6% p.a. and loss for the year is Rs.15,000.

A's Capital A/c Dr.	9,000	
B's Capital A/c Dr.	6,000	
To Profit and Loss A/c		15,000

1.

3. If partnership deed provides for interest on capital @ 6% p.a. as a charge on profit and the profit for the year is Rs.20,000

Profit and Loss A/c Dr. 18,000

To A's Capital A/c 12,000

To B's Capital A/c 6,000

(For the interest on capital allowed as a charge on profit @ 6% p.a.)

Profit and Loss A/c Dr. 2,000

To Profit and Loss Appropriation A/c 2,000

(For net profit transferred to P&L Appropriation A/c)

Profit and Loss Appropriation A/c Dr. 2,000

To A's Capital A/c 1,200

To B's Capital A/c 800

(For profit distributed between A and B in 3:2)

4. If partnership deed provides for interest on capital @ 6% p.a. as a charge on profit and the profit for the year is Rs.2,000.

Profit and Loss A/c Dr.	18,000	
To A's Capital A/c		12,000
To B's Capital A/c		6,000

(For the interest on capital allowed as a charge)

A's Capital A/c Dr.	6,400	
B's Capital A/c Dr.	9,600	
To Profit and Loss A/c		16,000

(For loss transferred to partner's capital account)

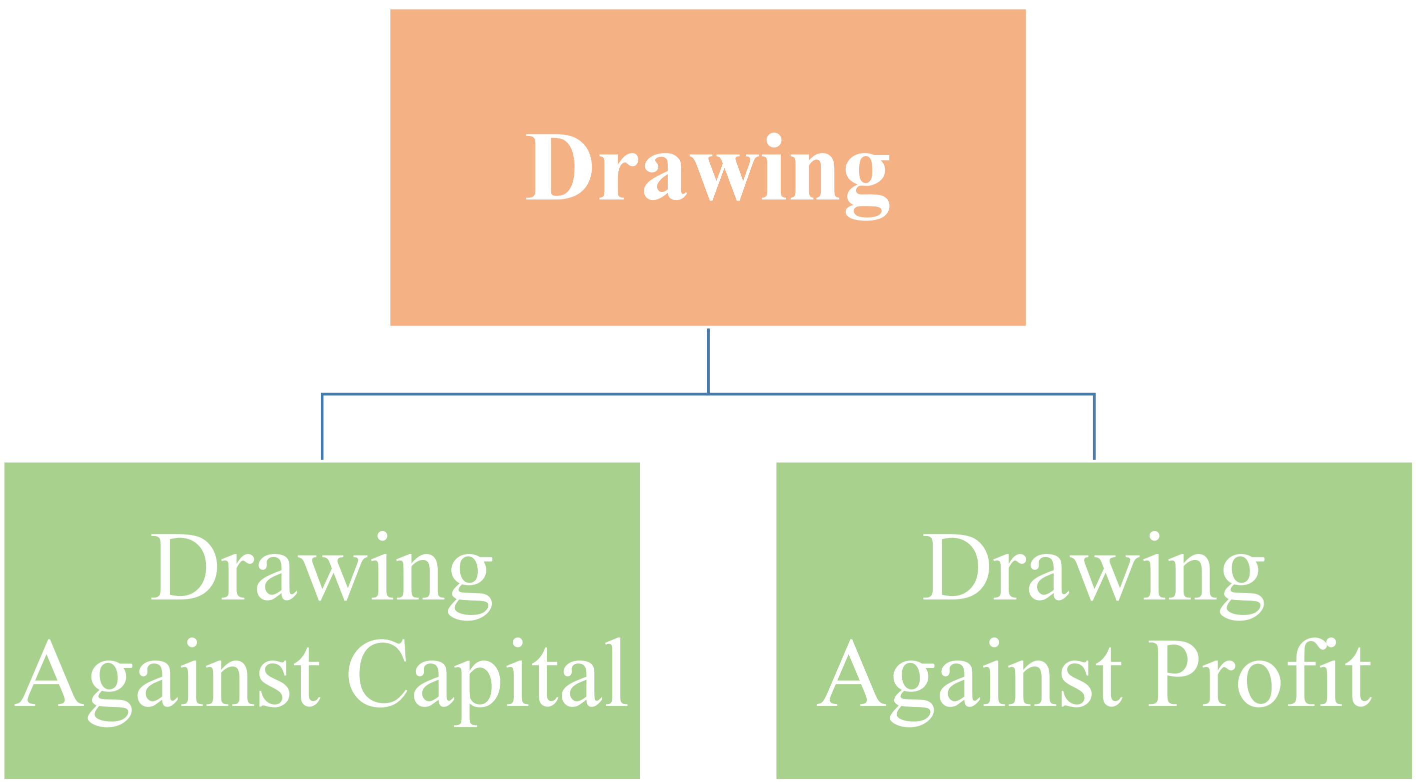
5. If partnership deed provides for interest on capital @ 6% p.a. and the profit for the year is Rs.21,000.

Profit and Loss A/c Dr.	21,000	
To Profit and Loss Appropriation A/c		21,000
(For net profit transferred to P&L Appropriation A/c)		
Profit and Loss Appropriation A/c Dr.	18,000	
To A's Capital A/c		12,000
To B's Capital A/c		6,000
(For interest on capital allowed to the partners)		
Profit and Loss Appropriation A/c Dr.	3,000	
To A's Capital A/c		1,800
To B's Capital A/c		1,200
(For profit transferred to partner's capital account)		

Interest on Drawing

Drawing

Amount withdrawn by the partner for his personal or private use from business is called drawing



Calculation of Interest on Drawing

There are two methods to calculate interest on Drawing:-

When drawing withdrawn at different dates or an unequal amount then interest on drawing is calculated with Product Method or Simple Method.

1. Product Method

2. Simple Method

Illustration

Calculate interest on drawing @12% p.a. for following drawings

Date	**Amount**	**Time Period**		**Simple Method**	**Product Method**
1	**2**	**3**		**(2×3)**	
01.05.2018	2,000	11		22,000	
01.08.2018	4,000	8		32,000	
31.10.2018	3,000	5		15,000	
31.01.2018	5,000	2		10,000	
01.03.2018	1,500	1	15	1,500	
	Total interest and Product			**Rs.805**	**80,500**

Interest on Drawing in Product Method

1

Calculation of Interest on Drawing by Average Period Method

This method is used when there is regular drawing or when

1. The amount of drawing is same; and
2. The time interval between the two drawings is also same.

Interest on Drawing

There may be different situations for calculating interest on Drawing

For monthly Drawings:-

1. When a partner withdraws fixed amount in the beginning of every month

    Average Time Period

2. When a partner withdraws fixed amount at the end of every month

    Average Time Period

3. When a partner withdraws fixed amount in the middle of every month

    Average Time Period

For Quarterly Drawings:-

1. When a partner withdraws fixed amount in the beginning of each quarter

   Average Time Period

2. When a partner withdraws fixed amount at the end of each quarter

   Average Time Period

3. When a partner withdraws fixed amount in the middle of each quarter

   Average Time Period

Illustration

The partner P draws Rs.1,000 per month and Q draws Rs.1,500 per quarter. Under the partnership deed, interest on drawing is to be charged @15% p.a. Calculate interest on drawing in the following cases when drawing is made:-

1. in the beginning of every month by P
2. at the end of every month by P
3. in the middle of every month by P
4. in the beginning of every quarter by Q
5. at the end of every quarter by Q
6. in the middle of every quarter by Q

Solution

P’s Total Drawing = Rs.1,000 (for monthly drawing)

1. Time period

    Interest on Drawing

2. Time Period

    Interest on Drawing

3. Time Period

    Interest on Drawing

Q's Total Drawing = Rs.1,500 (for quarterly drawing)

4. Time Period

Interest on Drawing

5. Time Period

Interest on Drawing

6. Time Period

Interest on Drawing

Past Adjustments

Past Adjustments

Some times after closing the accounts of partnership firm some errors or omissions in the accounts of the earlier years are found. For example, interest on capital, interest on drawing, salary or commission of a partner is omitted or charged at high or lower rate. The profit or loss distributed among the partners in a wrong ratio. These errors or omissions are rectified by adjusting the capital account of partners by passing an adjustment entry.

Past Adjustments

Past adjustment is made for:-

1. Interest on capital or interest on drawing is omitted.
2. Salary and commission is omitted to provide to the partner.
3. Interest on Capital provided more than the agreed rate of interest.
4. Interest on Capital provided less than the agreed rate of interest.
5. Profit distributed among the partners in a wrong ratio.

Table Showing Adjustment

1

• Particulars	• A		• B		• Firm	
	• Dr.	• Cr.	• Dr.	• Cr.	• Dr.	• Cr.
• Interest on Capital • Partner’s Salary • Partner’s Commission • Interest on Drawing • Profit already distributed • Profit should be distributed						
• Balance to be adjusted (net effect)						

1. A and B are partners sharing profits in the ratio of 3:2 with a capital of Rs2,00,000 and Rs.1,00,000. They have agreed to provide interest on capital @ 10% p.a. Pass necessary adjustment entry.

Table Showing Adjustment

Particulars	A		B		Firm	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Interest on Capital		20,000		10,000	30,000	
Division of Loss in 3:2	18,000		12,000			30,000
Balance to be adjusted (Net effect)		2,000	2,000			

(For interest on capital not provided, now adjusted)

2.

2. Rahul, Anil and Naveen are partners in a firm. Their capital account stood at Rs.60,000; Rs.30,000 and Rs.30,000 respectively on 1st April, 2019. As per the partnership deed Naveen was to allowed a salary of Rs.6,000 per annum, interest @ 5% p.a. was to provided on capital and profits were to distributed in the ratio of 2:2:1. Ignoring the above terms, net profit of Rs.36,000 for the year ended 31st March, 2020 was distributed among the three partners equally. Pass necessary Journal Entry to rectify the error.

Table Showing Adjustment

Particulars	Rahul	Anil	Naveen	Total
Naveen's Salary			6,000	6,000
Interest on capital	3,000	1,500	1,500	6,000
Remaining Profit (36,000-6,000-6,000)=Rs.24,000 divided in 2:2:1	9,600	9,600	4,800	24,000

Adjustment Entry:-

Anil's Capital A/c	Dr.	900	
To Naveen's Capital A/c			300
To Rahul's Capital A/c			600

(For adjustment made for omission in previous year)

3. Mukesh and Ratan are partners sharing profits in the ratio of 3:2 with a capital of Rs2,00,000 and Rs.1,00,000. They have agreed to provide interest on capital @ 10% p.a. But the interest on capital was provided 12% p.a. instead of 10% p.a. Pass necessary adjustment entry.

Table Showing Adjustment

Particulars	Mukesh		Ratan		Firm	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Interest on Capital (12%-10%)=2%	4,000		2,000			6,000
Division of Profit in 3:2		3,600		2,400	6,000	
Balance to be adjusted (Net effect)	400			400		

(For interest on capital provided more, now adjusted)

2.

Guarantee of Profit

Guarantee of minimum profit to a partner

Sometimes a partner may be guaranteed a minimum amount of his share in Profit. Such a partner to whom such guarantee has been provided is called guaranteed partner and the partner who had given such guarantee is called guaranteeing partner. Such minimum amount is called guaranteed amount.

Steps to Provide Minimum Guarantee of Profit to a Partner

Step 1: Calculate the Actual share of Profit/Loss of Guaranteed Partner for the given accounting period.

Illustration:-Vikas and Vivek were partners in a firm sharing profits in the ratio of 3:2. On 1st April, 2014 they admitted Vandana as a new partner for 1/8th share in the profits with a guaranteed profit of Rs.1,50,000. The new profit sharing ratio between Vikas and Vivek will remain same but they decided to bear any deficiency on account of guarantee to Vandana in the ratio of 2:3. The profit of the firm for the year ended 31st March, 2015 was Rs.9,00,000. Prepare Profit and Loss Appropriation Account of Vikas, Vivek and Vandana for the year ended 31st March, 2015.

Net Profit= Rs.9,00,000

Step 2: Calculate the amount of deficiency as follows: Deficiency = Guaranteed amount - Actual share of profits

Step 3: Distribute the amount of deficiency among the guaranteeing partners in their guaranteed ratio.

Amount of Deficiency = Rs.37,500
(will be born by Vikas and Vivek in 2:3

Step 4: Distribute the actual profit/loss among all the partners in their profit sharing ratio as if there is no guarantee arrangement

Vikas's Share of Profit

Vivek's Share of Profit

Vandana's Share of Profit

Step 5: Recover share of deficiency (as per step 3) from the guaranteeing partners and give credit for the same to the guaranteed partner.

The deficiency of Rs.37,500 in the share of Vandana will be recovered from Vikas and Vivek in 2:3

From Vikas =Rs.15,000 and;

From Vivek =Rs.22,500

Vikas's Share=4,72,500-15,000=Rs.4,57,500

Vivek's Share=3,15,000-22,500=Rs.2,92,500

Working Note:-

Calculation of New Profit Sharing Ratio:-

Let Total Profit = 1

Profit and Loss Appropriation A/c

Particualrs	Rs.	Particulars	Rs.
To Profit transfer to partner's cap.		By Profit	9,00,000
Vikas 4,72,500			
Less: 15,000 (given to Vandana)	4,57,500		
Vivek 3,15,000			
Less: 22,500 (given to Vandana)	2,92,500		
Vandana 1,12,500			
Add: From Vikas 15,000			
From Vivek 22,500	1,50,000		
	9,00,000		9,00,000
	========		========