NOTES

PART-I

ACCOUNTANCY

ACCOUNTING FOR PARTNERSHIP

BASIC CONCEPTS

12th

ACCOUNTING FOR PARTNERSHIP: BASIC CONCEPTS

INDEX

Chapter 2: Accounting for Partnership: Basic Concepts

Concepts Covered:

4.	Distribution of Profit among Partners ➢ Meaning of Profit and Loss Appropriation Account ➢ Specimen of Profit and Loss Appropriation Account ➢ Difference between Profit & Loss A/c and Profit & Loss Appropriation A/c ➢ Ratio of Appropriation when the Appropriations are more than Available Profit
5.	Guarantee of Profit to a Partner ➢ Meaning and Steps ➢ Accounting treatment of Guarantee of minimum profit to a partner in case of Loss ➢ Minimum earnings guaranteed by a partner Examples
6.	Past Adjustments ➢ Definition and adjustment entries ➢ Steps for the Calculation of Amount of Past Adjustment Entry Examples
7.	Mind Map (Colourful & Interactive/ Complete All Concept Covered)

Lets Begin

NATURE OF PARTNERSHIP

Meaning and Definition of Partnership

Meaning: Partnership is an association between two or more persons who agree to do business andshare its profits and losses.

Partnership is a business relationship among two or more persons to share profits and losses of the business, carried on by all or any of them acting for all.

Definition: Partnership is defined by Indian Partnership Act, 1932, Section 4 as follows: "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

Features and Characteristics of Partnership

Sharing of Profits - A partnership agreement specifies how the profits and losses of the firm will beshared by the partners.

Two or more persons to form partnership - To form a partnership, there must be at least 2 partners who are competent to contract and who are not minor, persons of unsound mind and persons disqualified by any law. The maximum number of the partners in the firm cannot exceed 50 vide Rule 10 of the Companies Rules, 2014 as prescribed by the CentralGovernment.

Agreement Between the Partners - It is a legal document signed by all the partners.
A written agreement containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed.

Existence of Business & Profit Motive - A partnership can be formed to carry on a legal business. Such business should be formed with an intention of earning profit.

Business carried on by all or any of them acting for all - Since, the partners are the agents as well as principals of the firm, such business of the partnership firm can be carried on by all or any of the partners acting for all.

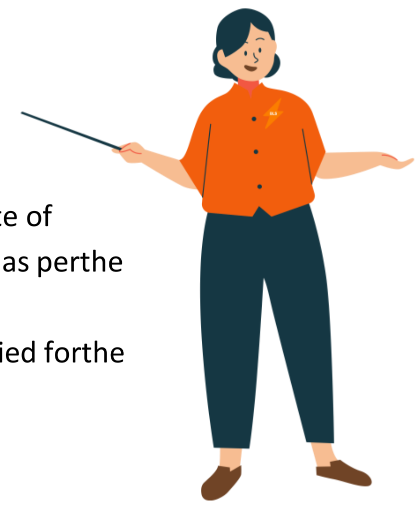
Principal & Agent Relationship - The principle of business partnership claims that all the partners are agents of each other. A partnership in business may be conducted by all partners or by individual partners, on behalf of others. This relationship of partners is the principle of agency.

Lawful Business: A partnership is formed to do a lawful business which includes trade, vocation and profession. Any type of charitable institution running as a not-for-profit organization will not be considered as a business.

Example 1 : Rishabh and Hariom purchased a piece of land jointly and sold after sometime at a profit. The profit earned from sale of land was shared by Rishabh and Hariom Equally. It will not be treated as partnership business.

Example 2 : Ravi and Juned are partners doing smuggling and share the amount earned equally. It is not a partnership business.

Rights of Partners



- ✓ to participate in the management of the business.
- ✓ to be consulted about the affairs of the business.
- ✓ to inspect the books of account and have a copy of it.
- ✓ to share profits and losses with others in the agreed ratio.
- ✓ to receive interest on the loan advanced by him to the firm at an agreed rate of interest. Where the rate is not agreed, interest is paid at the rate of 6% p.a. as per the provisions of Indian Partnership Act, 1932.
- ✓ to act according to his best judgment in case of emergency and be indemnified for the expenses incurred by him.
- ✓ not to allow the admission of a new partner.
- ✓ to retire from the firm after giving proper notice for the same.
- ✓ to get indemnified against the expenses incurred by him on the business or incurred by him on behalf of the firm.

Special Aspects of Partnership Accounts

A partnership is an association between two or more people who form a company and equally divide both the profits and the losses of that company. This type of business structure can include more than two people. The Indian Partnership Act defines a "partnership" as a "relationship between individuals" in which "all or any of them acting for all" carry out business activities with the intention of sharing profits. The term "partnership" is used to refer to this type of "relationship between individuals."

Recording of Partnership Transactions

Partnership Accounting – Entry for Interest on Capital

Particular		Amount (Debit)	Amount (Credit)
Interest on Capital A/c	Dr.	0	-
To Partner's Capital/Current A/c		-	0
(Being interest allowed on capital @________% p.a.)			
Profit & Loss Appropriation A/c	Dr.	0	-
To Interest on Capital A/c		-	0
(Being interest on capital transferred to Profit & Loss Appropriation A/c)			

Partnership Accounting – Entry for Interest on Drawings

Particular		Amount (Debit)	Amount (Credit)
Partner's Capital A/c	Dr.	0	-
To Interest on Drawings A/c		-	0
(Being interest on drawings charged)			
Interest on Drawings A/c	Dr.	0	-
To Profit & Loss Appropriation A/c		-	0
(Being interest on drawings transferred)			

Partnership Accounting – Entry for Salary or Commission Payable to a partner

Particular		Amount (Debit)	Amount (Credit)
Partner's Salary/Commission A/c	Dr.	0	-
To Partner's Capital A/c		-	0
(Being salary/commission allowed to partner)			
Profit & Loss Appropriation A/c	Dr.	0	-
To Profit & Loss Appropriation A/c		-	0
(Being interest on drawings transferred)			

Partnership Accounting – Entry for transferring a part of profit to reserve.

Particular		Amount (Debit)	Amount (Credit)
Profit & Loss Appropriation A/c	Dr.	0	-
To Reserve A/c		-	0
(Being reserve created)			

PARTNERSHIP DEED

Meaning and Contents of Partnership Deed

A Partnership is formed by an agreement. This agreement may be written or oral. In actual, Partnership deed is a written agreement signed by allthe partners. It is a document which contains all terms and conditions of partnership agreed by the partners. As we know that partnership is the result of agreement among the partners. The agreement may be written or oral. In absence of a written agreement,there may be dispute or conflicts among other partners regarding profits. Therefore, an agreement should be written and signed by all the partners. Partners can make changes in the clauses of partnership deed time to time with the consent of allpartners.

The partnership deed, generally, contains the following

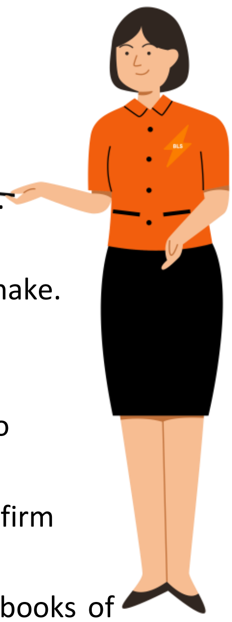
The partnership deed usually contains the following particulars:

- ✓ **Description of Partners:** Names, descriptions and addresses of the partners.
- ✓ **Description of Firm:** Names and addresses of the firm.
- ✓ **Principal Place of Business:** Address of the principal place of business or profession.
- ✓ **Nature of Business:** Nature of business or profession the firm proposes to carryon.
- ✓ **Commencement of Partnership:** Date of commencement of partnership.
- ✓ **Capital Contribution:** The amount of capital to be contributed by each partner andalso whether the capital accounts shall be fixed or fluctuating.
- ✓ **Interest on Capital:** Whether interest is to be allowed on capital or not should be written in the deed. If it is allowed, then the rate of interest should be mentioned.
- ✓ **Interest on Drawings:** The interest to be charged on drawings should be written inthe deed, along with the rate of interest to be charged.
- ✓ **Profit Sharing Ratio:** Ratio to share profits or losses agreed by the partners.
- ✓ **Interest on Loan:** If a partner has an advanced loan besides his capital, will interestbe allowed to him? If yes, then the rate should be mentioned.

- ✓ **Amount of Salary, Commission:** If a partner is to be paid salary, commission, etc., it should bewritten in the deed.
- ✓ **Death of Partner:** Whether the firm continues or dissolves after a partner dies should be mentioned.
- ✓ **Settlement of Accounts:** The manner in which accounts of partners shall be settled in case of retirement, death, or dissolution of the firm.
- ✓ **Rights and Duties of Partners:** The authority and duties of each partner should be mentioned.
- ✓ **Duration of Partnership:** The period for which partnership is established.
- ✓ **Bank Account:** Modes of operations of bank accounts by partners, i.e., jointly or individually.

Rules applicable in the absence of Partnership Deed

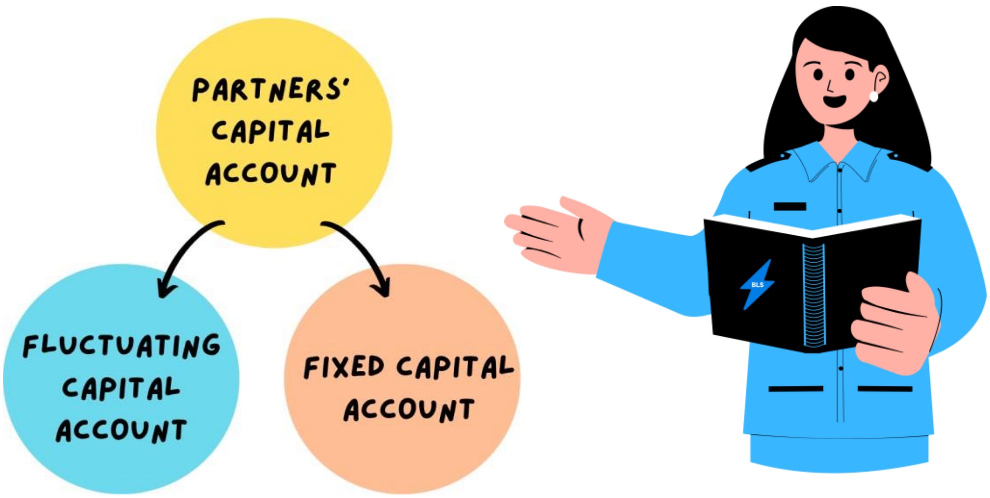
- ✓ **Sharing of Profits -** Every partner of the firm receives an equal share of the profits regardless of how much capital they contribute.
- ✓ **Salary/commission to the partners -** Unless otherwise provided in the partnership agreement, partners are not entitled to salary/ commission.
- ✓ **Interest on capital -** Partners cannot earn interest on their capital. When there is a profit, interest is only paid if it is allowed by the partnershipagreement. Interest is not paid in case of loss.
- ✓ **Interest on drawings -** The partners will not be charged interest on drawings theymake.
- ✓ **Interest on Loans -** Each of the firm's partners is entitled to six per cent interest on advancing money to the firm (as opposed to just his share capital).
- ✓ **Right to participate in the conduct of the business -** Each partner has the right to participate in the conduct of the business.
- ✓ **Admission of A new partner -** Admission of A new partner cannot be admitted into thefirm without the consent of all partners.
- ✓ **Right to inspect the books of the firm -** Every partner has the right to inspect the books of account and have a copy of it.



MAINTENANCE OF CAPITAL ACCOUNTS OF PARTNERS

Partners’ Capital Account

It is an account which represents the partner's interest in the business. In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partnersmay be maintained by following any of the following two methods:



Fixed Capital Account: Under the fixed method of maintaining partners’ capital accounts, the initialcapital invested by the partners remains constant throughout the lifetime of the business. The capital is affected only when additional capital is introduced by the partner or the capital is withdrawn by the partner. Under this method, two accounts are prepared:

a) **Capital Account:** The Capital Account records only those transactions that are related to capital or change in the capital (Additional Capital and Drawings). In the capital account, the capital brought in by the partner is credited and any drawing is debited.

b) **Current Account:** A separate account known as a Current Account or Drawings Account is opened to record all the other transactions related to partners, such as Interest on capital, Interest on drawings, salary, Profit/loss share, etc. Any income or profit of the partner is credited, and any expense or loss is debited to the current account.

Capital Accounts

(when the capitals are fixed)

Particulars	Partner A	Partner B	Particulars	Partner A	Partner B
To Cash/Bank A/C (permanent withdrawal of capital)	₹	₹	By balance b/d (opening balance)	₹	₹
To Balance c/d (Closing balance)	₹	₹	By Cash/Bank A/C (Additional Capital brought)	₹	₹
TOTAL	**₹₹**	**₹₹**	**TOTAL**	**₹₹**	**₹₹**

Current Accounts

Particulars	Partner A	Partner B	Particulars	Partner A	Partner B
To balance b/d (in case of debit opening balance)	₹	₹	By balance b/d (in case of credit opening balance)	₹	₹
To Drawings	₹	₹	By Interest on Capital	₹	₹
To Interest on Drawings	₹	₹	By Salary	₹	₹
To P&L A/C (in case of loss, distributed in the profit sharing ratio)	₹	₹	By Commission	₹	₹
To balance c/d (when the credit side is more than the debit side)	₹	₹	By P&L Appropriation A/C (in case of profit, distributed in the profit sharing ratio)	₹	₹
			By balance c/d (when the debit side is more than the credit side)	₹	₹
TOTAL	**₹₹**	**₹₹**	**TOTAL**	**₹₹**	**₹₹**

Note :

- ✓ Debit balance of Current Account is shown in Assets side of Balance Sheet.
- ✓ Credit balance of Current Account is shown in Liabilities side of Balance Sheet.
- ✓ Balance of Capital Accounts are always shown in Liabilities side of Balance Sheet as this account will always show a credit balance when capital is fixed

Example:

X and Y are partners in the firm sharing profits and losses in the ratio of 1:1 with a capital contribution of ₹5,00,000 and ₹3,60,000, respectively on 1st April, 2021. On 1st July, 2021, they decided that their capital should be ₹4,00,000 each. Necessary adjustments in the capital were made by withdrawing or introducing cash. The Partnership Deed provides for the followings:Interest

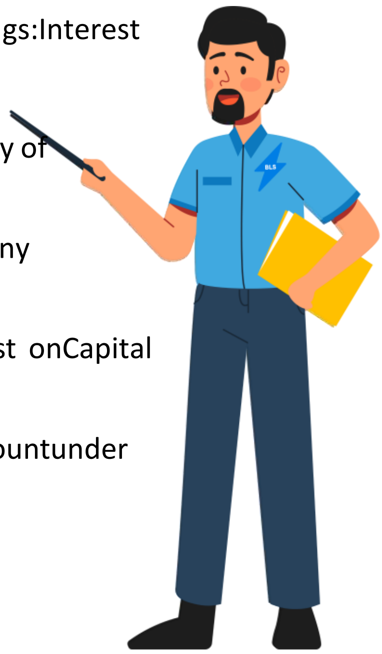
on Capital to be paid to each partner @8% p.a.

X is entitled to get an annual salary of ₹ 8,000 and Y is allowed a monthly salary of ₹1,600. It was found that Y withdraws his monthly salary regularly.

The manager of the firm is entitled to a commission of 10% of the profit before any adjustment.

The Net Profit for the year ending 31st March, 2022 before charging interest onCapital and salary was ₹1,60,000.

Prepare the Profit and Loss Appropriation Account and the Partners' Capital Accountunder Fixed Capital Method.



Solution:

Profit and Loss A/c

Dr. **for the year ending 31st March, 2022** **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Managers' Commission (10% of ₹ 1,60,000)	16,000	By Profit of the year	1,60,000
To Net Profit (Transferred to Profit and Loss Appropriation A/c)	1,44,000		
	1,60,000		**1,60,000**

Profit and Loss Appropriation A/c

Dr. **for the year ending 31st March, 2022** **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
To Interest on Capital: (W.No.1)			By Net Profit (as per Profit and Loss Account)	1,44,000
X	34,000			
Y	31,200	65,200		
To Salary:				
X	8,000			
Y (1,600×12)	19,200	27,200		
To Profit Transferred to:				
X's Current A/c	25,800			
Y's Current A/c	25,800	51,600		
		1,44,000		**1,44,000**

Fluctuating Capital Account

Under this method only one account is prepared i.e. Partners Capital Account. It may show Debit orCredit balance.

Credit Side Items :

- ✓ Balance of Capital or Capital Introduced by the partners
- ✓ Additional Capital (if any) contributed by the partners during the year
- ✓ Interest on capital (if any)
- ✓ Salary/Remuneration to the partners (if any)
- ✓ Commission/Bonus to the partners (if any)
- ✓ Share of Profit

MAINTENANCE OF CAPITAL ACCOUNTS OF PARTNERS

Debit Side Items

- ✓ Withdrawal of capital (if any)
- ✓ Drawings made during the year (if any)
- ✓ Interest on drawings (if any)
- ✓ Share of loss (if any)
- ✓ Closing balance

Capital Accounts

(When capitals are fluctuating)

Particulars	Partner A	Partner B	Particulars	Partner A	Partner B
To balance b/d (in case of debit opening balance)	₹	₹	By balance b/d (in case of credit opening balance)	₹	₹
To Drawings	₹	₹	By Interest on Capital	₹	₹
To Interest on Drawings	₹	₹	By Salary	₹	₹
To P&L A/C (in case of loss, distributed in the profit sharing ratio)	₹	₹	By Commission	₹	₹
To balance c/d (closing balance, when the credit side is more than the debit side)	₹	₹	By P&L Appropriation A/C (in case of profit, distributed in the profit sharing ratio)	₹	₹
			By Cash/Bank A/C (Additional Capital brought)	₹	₹
			By balance c/d (closing balance, when the debit side is more than the credit side)	₹	₹
TOTAL	₹₹	₹₹	**TOTAL**	₹₹	₹₹

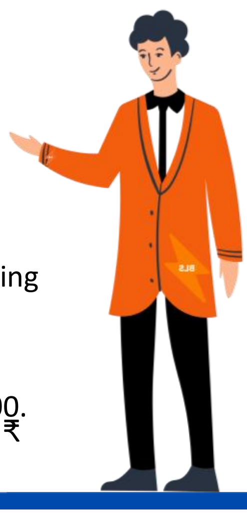
Example: A and B are the partners sharing profit and loss in the ratio of 2:1 with a capital of ₹5,00,000 and ₹ 2,50,000, respectively on 1st April, 2020. The Partnership Deed provides the following clause:

Interest on Capital to be paid to each partner @8% p.a.Salary of ₹

1,750 per month to be paid to B.

B is also entitled to receive a commission of 10% of the Net Profit remaining afterdeducting Interest on Capital and salary and after charging his commission.

The profit for the year ended 31st March, 2021, after charging B's salary was2,25,000. ₹



Prepare Partner's Capital Account under Fluctuating Capital Method.

Solution:

Profit and Loss Appropriation Account
for the year ending 31st March, 2021

Dr. | | | Cr.

Particulars		Amount (₹)	Particulars	Amount (₹)
To B's Salary (1,750×12)		21,000	By Net Profit (W.No.1)	2,46,000
To Interest on Capital				
A (5,00,000 @8%)	40,000			
B (2,50,000 @8%)	20,000	60,000		
To Commission to B (W.No.2)		15,000		
To Profit Transferred to:				
A's Capital A/c	1,00,000			
B's Capital A/c	50,000	1,50,000		
		2,46,000		**2,46,000**

Capital Account

Dr. | | Cr.

Date	Particulars	A (₹)	B (₹)	Date	Particulars	A (₹)	B (₹)
2020-21				2020-21 April 1	By Balance b/d	5,00,000	2,50,000
				March 31	By Salary	-	21,000
				March 31	By Interest on Capital	40,000	20,000
				March 31	By Commission	-	15,000
March 31	To Balance c/d	6,40,000	3,56,000	March 31	By Profit and Loss Appropriation A/c (Share of Profit)	1,00,000	50,000
		6,40,000	**3,56,000**			**6,40,000**	**3,56,000**

Working Note:

1. **Calculation of profit before charging B's salary:**

   Profit before charging B's salary = Profit after charging B's salary + B's salaryProfit

   before charging B's salary = 2,25,000+21,000

   Profit before charging B's salary = ₹ 2,46,000.

2. **Calculation of Partner's Commission:**

   Profit after charging Interest on Capital = Profit before charging Interest on Capital– Interest onCapital

   Profit after charging Interest on Capital= 2,25,000– 60,000

   Profit after charging Interest on Capital= ₹ 1,65,000

   B's Commission (after charging such commission) $= 1,65,000 \times \frac{10}{100+10}$

   B's Commission (after charging such commission)= ₹ 15,000.

Salary or Commission (Remuneration) to Partners

1) In order to compensate the partners for looking after the business, the firm pays salary or commission to the partners.
2) Such salary or commission can be allowed to the partners only if the Partnership Deed allows itto be paid.
3) Such amount paid to the partners is an appropriation of profit and not a charge against the profit. Therefore, it can be paid only if the firm is making profits during the year.
4) Salary to partners is normally stated as an amount, whereas, Commission to partners is normallystated as a percentage of profit where the profit considered can be either before commission or after commission.
5) Formula for computing commission under the 2 methods is as follows:

   a. **Percentage of Net Profit before charging Commission:**

      Net Profit (before commission) × Rate of commission ÷ 100

   b. **Percentage of Net Profit after charging Commission:**

      Net Profit (before commission) × Rate of Commission ÷ (100 + Rate of Commission)

6) **Accounting treatment:** Salary or Commission, is an appropriation of profit, therefore, accounting treatment will be as follows:

   a. **On allowing Salaries/Commissions to Partners:**

   Partners' Salaries/Commissions A/c ...Dr.

   To Partners' Current A/cs (when capitals are fixed)

   To Partners' Capital A/cs (when capitals are fluctuating)

   b. **On closure of Salaries/Commissions A/cs:**

   Profit and Loss Appropriation A/c ...Dr. To

   Partners' Salaries/ Commissions A/c

Interest on Partners' Drawings

1) Drawings are the amounts that are withdrawn, in cash or in kind, by partners for their personaluse.
2) These drawings can be out of capital or profits. When the amount withdrawn isa part of capital, it is referred to as drawings out of capital. While drawings out of profits are the amounts withdrawn against profit earned duringthe year.
3) If the Partnership Deed provides for charging interest on such amounts withdrawn by the partners against profits, such interest is termed as intereston drawings.

4) It is important to note that such interest is not charged on the drawings that are made againstcapital.
5) Such Interest charged on Drawings is credited to the Profit and Loss Appropriation Account anddebited to Partners' Capital Accounts or Partners' Current Accounts.
6) Calculation of such interest is to be done taking into consideration the time from the date of withdrawal till the end of the financial year.

Methods of Calculating Interest on Drawings

There are 2 methods of calculating interest on drawings which are explained as follows:

a) **Product Method:** This method is used when drawings of same amount or different amounts are withdrawn at irregular intervals. Again this method can be used in 2 ways namely, as simple method and product method.

- ✓ **Simple Method:** In this method, interest is calculated on each single drawing amount. For such calculation, period for which the amount has been utilised is to be considered.
- ✓ **Product Method:** In this method, amount of drawings is multiplied with the number of months or number of days it has been used. After this, the product so obtained is totaled and the interest is calculated thereon for one month (when period is considered in months) or for1 day (when period is considered in days). Formula is as follows:

  Interest = [Total of Product =(Rate of Interest ÷ 100) × (1 ÷ 12)], in case period is in terms ofmonths,

  Interest = [Total of Product =(Rate of Interest ÷ 100) × (1 ÷ 365)], in case period is in terms ofdays

b) Average Period Method: Interest on drawings is calculated using this method when:

- ✓ there are regular drawings or
- ✓ the amount of drawings is uniform and the time interval between the 2 drawings is uniform.

  Formula is as follows:

  Interest = [Total drawings × (Rate of Interest ÷ 100) × (Average period ÷ 12)], where Average

  period = (Months left after first drawings + Months left after last drawings) ÷ 2

Journal Entries to record interest on drawings

- **In case of Fixed Capital Accounts:**

a) Partners' Current A/cs ...Dr.
To Interest on Drawings A/c
(Being the interest charged on partners' drawings)

b) Interest on Drawings A/c ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest on drawings transferred to Profit and Loss Appropriation A/c)

Alternatively: only one entry can be passed in place of above 2 entries as follows:Partners'

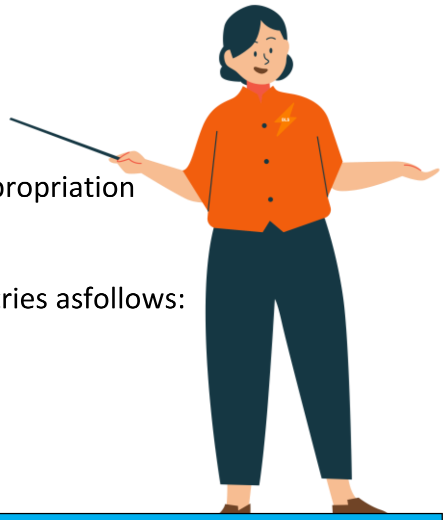
Current A/cs ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest charged on drawings of partners)

- **In case of Fluctuating Capital Accounts:**

  a) Partners' Capital A/cs ...Dr.

To Interest on Drawings A/c
(Being interest charged on partners' drawings)

b) Interest on Drawings A/c ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest on drawings transferred to Profit and LossAppropriation A/c)



Alternatively: only one entry can be passed in place of above 2 entries asfollows:

Partners' Capital A/cs ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest charged on drawings of partners)

Calculation of Interest on Opening Capital

- In case where the partner has not withdrawn capital or has not introduced additional capital during the year, closing balance of Capital Account of the previous year is the opening balance inthe Capital Account.
- Interest on Capital is allowed on the Opening Capital of the partner.

If the opening capital is not given, it can be determined by preparing Capital Accounts or with thehelp of following tables:

a) In case of Fixed Capital:

Calculation of Opening Capital	
Capital at the end of the year	....
Add: Withdrawal of Capital	....
	....
Less: Additional Capital Introduced during the year	....
Capital in the beginning of the year	....

b) In case of Fixed Capital:

Calculation of Opening Capital	
Capital at the end of the year	....
Add: Drawings Against Capital	....
Drawings Against Profit	....
Interest on Drawings	....
Share of Loss for the year*	....
	....
Less: Additional Capital introduced during the year	....
Partner's Salary/Remuneration	....

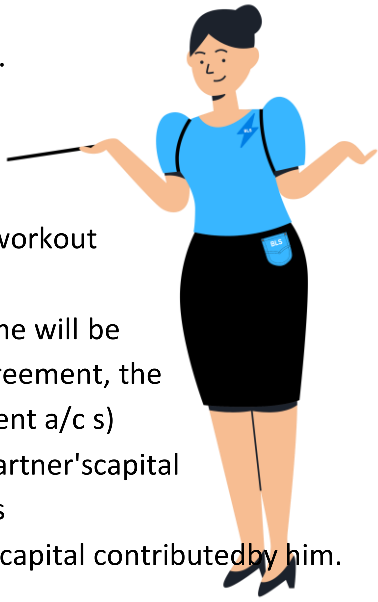
Share of Profit for the year*	....
Capital in the beginning of the year	....

* Either loss or profit will appear at a time.

Adjusted capital of old partners

The old partner's capital is then calculated on the basis of the capital that is brought by the new partner for his share of profit. This deficiency or the excess in the old partner's capital account is to be adjusted through the current accounts or through cash which may be brought in or withdrawn by the partners.

Adjustment of the capitals of the old partners on the basis of new partner's capital Steps:



- ✓ Calculate the total capital of the firm on the basis of new partner's capital and his share in profits. Total Capital/New Capital= New partner's capital x Reciprocal of the proportion of hisshare in profit
- ✓ Calculate the new capitals of all partners by dividing total capital in new ratio.
- ✓ Prepare old partners' capital a/cs (after all adjustments regarding Revaluation, General Reserve, Goodwill etc) and find out the actual balances of their capitals.
- ✓ Compare the new capitals as in (ii) with old capital balances as in (iii) and workout surplus or deficiency.
- ✓ Surplus will be paid back to the old partners and if there is deficiency the same will be contributed in cash by the old partners.(If it is specifically required under agreement, the surplus can be Cr to their current a/c s and deficiency can be Dr totheir current a/c s)
- ✓ If goodwill is not brought in cash, it can be adjusted either (i) through new partner'scapital a/c – this will reduce his original capital contributed by him or (ii) if it is adjusted through new partner's current a/c – this will not affect the original capital contributedby him.

DISTRIBUTION OF PROFIT AMONG PARTNERS

Profit of the firm is distributed among the Partners through the Profit and Loss Appropriation Account. It is important to understand the meaning and thespecimen of such Profit and Loss Appropriation Account explained as follows.

Meaning of Profit and Loss Appropriation Account

Such Profit and Loss Appropriation Account is an extension of the Profit and Loss Account andtherefore, the credit balance of the Profit and Loss Account is transferred to Profit and Loss Appropriation Account. Such amount is then utilized for the following:

- ✓ interest on the capitals of partners, if provided by the partnershipdeed;
- ✓ salaries or commissions to partners, if provided by the partnershipdeed;
- ✓ Transferring part of profit to Reserve;
- ✓ Distribution of profit among the partners in their profit sharing ratio.

Specimen of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account
or the year ended ...

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Profit and Loss A/c (Net loss transferred from Profit and Loss Account)		By Profit and Loss A/c (Net Profit transferred from Profit and Loss Account)	
To Interest on Capitals:		By Interest on Drawings:	
A		A	
B	....	B	....
To Partners' Salaries			
To Partners' Commissions			
To Reserve			
To Profit transferred to:			
*A's Capital A/c			
*B's Capital A/c			
	....		....

*In case of Fluctuating Capital Method, Profit will be transferred to Partners' Capital Accounts. Incase of Fixed Capital Method, Profit will be transferred to Partners' Current Accounts.

Difference between Profit & Loss A/c and Profit & Loss Appropriation A/c

S. No.	Basis	Profit and Loss Account	Profit and Loss Appropriation Account
1	**Stage Of Preparation**	It is prepared after Trading Account and therefore, starts with Gross Profit or Gross Loss transferred from the Trading Account.	It is prepared after Profit and Loss Account and therefore, Net Profit or Net Loss as transferred from the Profit and Loss Account.
2	**Objective**	It determines net profit earned or net loss incurred during the accounting year.	It shows appropriation i.e., distribution Of Net Profit for the accounting period among the partners.
3	**Nature Of Items**	It is debited with the expenses and credited with the income, not being business income to determine net profit for accounting period	It is debited with the items of appropriation of profit like salary, commission, interest on capital, transfer to reserve, etc. and credited with the items of income being debited to Partners' Capital Accountor Current Accounts such as interest on drawings.
4	**Partnership Deed**	This account is not guided by the Partnership Deed or Agreement.	This account is prepared as guided by the Partnership Deed or Agreement or provisions of Indian Partnership Act, 1932.
5	**Matching Principle**	It follows the Matching Principle where revenue is matched against expense.	It does not follow the Matching Principle.

Ratio of Appropriation when the Appropriations are more than Available Profit

In case where the total amount of appropriations is more than the amount of profit available, profit available for distribution among the partners is distributed in the ratio of appropriation to be made. The ratio of such appropriation is determined as follows:

- ✓ Calculate the amount of appropriation payable to each partner as per the Partnership Deed (ignoring the profit available for distribution among partners) like the salary, commission and interest on capital, etc.
- ✓ Calculate the total amount of appropriation (as per step (i) above) for each partner separately.
- ✓ Calculate the ratio of the Appropriations (as per step (ii) above) to be made to each partner.
- ✓ Lastly, ratio calculated in (iii) above shall be the ratio in which available profits shall be distributedamong the partners.
- ✓ It is important to note that no particular item like salary, commission, interest on capital, etc., haspriority over other items of appropriation.

Distribution of Profit and Losses in Partnership Examples

Example 1 : Divya, Trapti and Reena are partners sharing profits and losses in the ratio of 1 : 2 : 3 . They decide to share future profits in the ratio of 3 : 2 : 1 .They also decided to record the effect of the following without affecting their book values.

General reserve = 90,000 Rs.

Profit and loss A/c (cr) = 30,000 Rs.

Advertisement Suspense (Dr) = 60,000 Rs.

Solution:

Calculation of net effect of reserves and accumulated profits/losses

General reserve = 90,000 Rs.

(+) Profit and loss A/c(cr) = 30,000 Rs.

(-) Advertisement Suspense (Dr) = -60,000 Rs.Net

effect = 60,000 Rs.

Calculation of sacrificing/gaining share of partners:Sacrificing

ratio = Old share – New share

$$\text{Divya} = \frac{1}{6} - \frac{3}{6} = \frac{1-3}{6} = \frac{-2}{6}$$

$$\text{Trapti} = \frac{2}{6} - \frac{2}{6} = \frac{2-2}{6} = \frac{0}{0}$$

$$\text{Reena} = \frac{3}{6} - \frac{1}{6} = \frac{3-1}{6} = \frac{2}{6}$$

Proportionate share of gaining partner Divya

60,000 × $\frac{-2}{6} = -20{,}000\ (\text{Dr})$

Proportionate share of Sactrificing partner Reena

60,000 × $\frac{2}{6} = 20{,}000\ (\text{Dr})$

Divya capital A/c Dr.............20,000

To Reena capital A/c 20,000

Example 2 : Rishabh , Ravi and Hariom are partners sharing profits and losses in the ratio of 6 : 5 : 2 .They decide to share future profits in the ratio of 2 : 5 : 6 .They also decided to record the effect ofthe following without affecting their book values

Profit and loss A/c(cr) = 65,000 Rs.

Advertisement Suspense (Dr) = 13,000 Rs.

Solution:

Calculation of net effect of reserves and accumulated profits/losses

Profit and loss A/c(cr) = 65,000 Rs.

Less: Advertisement Suspense (Dr) = 13,000 Rs.Net

effect = 52,000 Rs.

Calculation of sacrificing/gaining share of partnersSacrificing

ratio = Old share – New share

$$\text{Rishabh} = \frac{6}{13} - \frac{2}{13} = \frac{6-2}{13} = \frac{4}{13}$$

$$\text{Ravi} = \frac{5}{13} - \frac{5}{13} = \frac{5-5}{13} = \frac{0}{0}$$

$$\text{Hariom} = \frac{2}{13} - \frac{6}{13} = \frac{2-6}{13} = \frac{-4}{13}$$

Proportionate share of gaining partner Hariom = 52,000 × $\frac{\overline{4}}{13}$ = -16,000 (Dr)

Proportionate share of Sactrificing partner Rishabh = 52,000 × $\frac{4}{13}$ = 16,000 (Dr)

Hariom capital A/c Dr............... 16,000

To Rishabh capital A/c 16,000

GUARANTEE OF PROFIT TO A PARTNER

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Meaning and Steps

At the time of admission of a partner, it is possible that the new partner is admitted in the firm with minimum guaranteed profits from the business. It means that the guaranteed partner shall get the minimum guaranteed profit even if the guaranteed partner's or new partner's share of profit is less than the guaranteed amount.

When profit is guaranteed to an existing or incoming partner, it can be done in 2 ways as follows:

A. Profit may be guaranteed by all the remaining partners in an agreed ratio: In this case, followingsteps are followed :

Step 1: Share of profit as per profit sharing ratio is determined, and

Step 2: Minimum guaranteed profit is determined.

Step 3: Higher of the above two amounts (in step 1 and step 2) is given to the guaranteed partner.

Step 4: If the share of profit is less than the guaranteed amount, the difference in theamount of profit (i.e., minimum guaranteed profit – share of profit of the guaranteed partner) is borne by the remaining partners in the agreed ratio
and where the agreed ratio is not given such difference is borne by thepartners in their profit sharing ratio.

B. Profit may be guaranteed by one or more of the existing or old partners: In thiscase, following steps are to be followed:

Step 1: Amount of profit is to be distributed among the partners as per theirprofit sharing ratio.

Step 2: In case 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 or partners who has guaranteed and it is added to the share of profit of the guaranteed partner.

Step 3: When two or more partners guarantee, the shortfall (deficiency) is shared by them in theagreed ratio or in their profit sharing ratio as the case may be.

Accounting treatment of Guarantee of minimum profit to a partner in case of Loss

In case where the firm is incurring losses and minimum guaranteed profit is to be paid to the partnerwho has been guaranteed minimum profit, adjustment will be made through Partners' Capital Accounts as follows:

i. Loss is distributed among the partners in their profit-sharing ratio.
ii. Capital Account of the guaranteed partner is credited with the guaranteed minimum profit plus amount of loss.
iii. The amount credited to the guaranteed partner's Capital Account is then debited to the remaining partners in their profit sharing ratio or to thedebit of the partner who has guaranteed minimum profit.

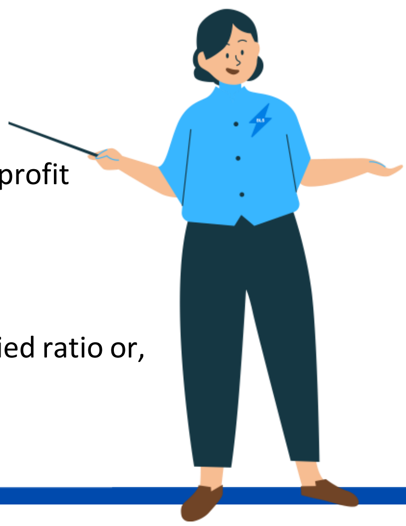
Minimum earnings guaranteed by a partner

This is a situation where, a partner (or partners) may guarantee minimum earnings to the firm and/or guarantee a profit to the firm. In such case, any shortfall in earnings is debited to the concerned Partner’s (Partners’) Capital Accounts or Current Accounts.

Examples

When a new partner is admitted to the partnership firm, he/she becomes eligible to share the profits earned by the firm in the agreed profit sharing ratio.

For Example – X and Y are partners in a firm and they admitted Z as a new partner as they wanted to expand their managerial expertise. Together X, Y and Z decided to share profits in the ratio of 3:2:1. During the year, the firm earned Rs 60,000 as profits. As per the agreement, the share of partner X = Rs 30,000 (3/6 of Rs 60,000), Y = Rs 20,000 (2/6 of Rs 60,000), and Z = Rs 10,000 (1/6 of Rs 60,000).



But in certain situations, a new partner can be admitted to the firmwith a guarantee that he/she shall receive a minimum amount in the form of profits of the firm. This minimum amount is known as the guaranteeof profit to a partner.

This assurance of guarantee of profit to a partner may be given either by –

- collectively all the existing (old) partners in a specified ratio or,
- by one of the existing (old) partners.

GUARANTEE OF PROFIT TO A PARTNER

This concept of guarantee of profit to a partner comes into play when the share of profit of the newpartner calculated on the basis of agreed profit sharing ratio is short of the minimum amount guaranteed.

Examples for situations:

A. If guarantee of profit to a partner was given collectively by all the old partners

X and Y are partners in a firm, and they decided to admit Z as a new partner. Together X and Ygave a guarantee of a minimum profit of Rs 20,000 to Z. The agreed profit-sharing ratio of the three partners is 3:2:1 and the firm earned Rs 60,000 as profits during the year.

As per the agreement, the share of partner X = Rs 30,000 (3/6 of Rs 60,000), Y = Rs 20,000 (2/6of Rs 60,000), and Z = Rs 10,000 (1/6 of Rs 60,000).

To calculate the amount that is short of the guaranteed amount, the following formula is used.

Deficit = Profits guaranteed – Profits calculated as per Profit sharing ratio

In the above example, Deficit = Rs 20,000 – Rs 10,000

Therefore, we can see that share of Z in profits is short by Rs 10,000 that what was guaranteed.This difference shall be made good by the old partners in their profit sharing ratio, i.e., 3:2.
Share of old partners in deficiency-X =
Rs 6,000 (3/5 of Rs 10,000)
Y = Rs 4,000 (2/5 of Rs 10,000)

Share of profits of old partners = Profits calculated as per profit sharing ratio – Share in deficiency

Now, the division of profits between the partners would be as follows -X = Rs 30,000 – Rs 6,000 = Rs 24,000
Y = Rs 20,000 – Rs 4,000 = Rs 16,000
Z = Rs 10,000 + Rs 6,000 + Rs, 4000 = Rs 20,000

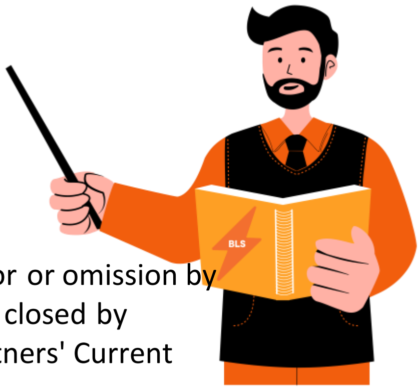
B. If one partner decides to give guarantee of profit to a partner

Following the above example, if instead of both X and Y, only X decides to give guarantee to Z of a minimum profit of Rs 20,000. Then the whole amount of deficiency of Rs 10,000 would be metby X only.
Distribution of profit in that case would be -X =
Rs 30,000 – Rs 10,000 = Rs 20,000
Y = Rs 20,000 – NIL = Rs 20,000
Z = Rs 10,000 + Rs 10,000= Rs 20,000

PAST ADJUSTMENTS

Definition and adjustment entries

It is possible that even after the books of accounts of the partnership firm are closed, some errors and omissions still exist. Such errors and omissions are to be rectified by adjusting the Capital Accounts of the affected partners by:



A. passing an adjustment entry: Here, a single adjustment entry is passed for the net amount of all past adjustment. An analytical table can be prepared for determining net effect of the past adjustments and passing the adjustment entry.

B. passing adjustment entries: Here, separate entry is to be passed for every adjustment. In this case, analytical table to determine the net effect is not prepared. Entries are passed for each and every error or omission by debiting or crediting Profit and Loss Adjustment Account which is then closed by debiting or crediting with the corresponding credit or debit tothe Partners' Current Accounts or Capital Accounts.

Accounting Entries to be passed when separate adjustment entries are passed through Profit and Loss Adjustment Account:

a) Entry for the items which are to be credited to the Partners' Capital/Current Accounts:

Profit and Loss Adjustment A/c ... Dr.

To Partners' Capital/Current A/cs

(Being the adjustment made for previously omitted, now recorded)

b) Entry for the items which are to be debited to the Partners' Capital/Current Accounts:

Partners' Capital/Current A/cs ... Dr.

To Profit and Loss Adjustment A/c

(Being the adjustment made for previously omitted, now recorded)

c) Entry for Net Profit/Loss due to above adjustments:For

Profit:

Profit and Loss Adjustments A/c... Dr.

To Partners' Capital/Current A/cs

(Being the profit on adjustment credited to Partners' Capital/Current Accounts)

For Loss:

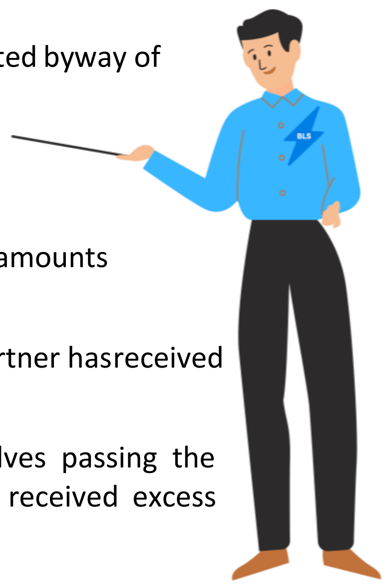
Partners' Capital/Current A/cs... Dr.

To Profit and Loss Adjustment A/c

(Being the loss on adjustment transferred to Partners' Capital/Current Accounts)

Steps for the Calculation of Amount of Past Adjustment Entry

The steps are as follows:



Step 1: The first step is to determine the amount which should have been credited byway of interest on capital, salary, commission, share of profit, etc.

Step 2: In the second step, the amount already credited by way of intereston capital, salary, commission, share of profit, etc., is calculated.

Step 3: The next step involves calculation of the difference between the amounts calculated in the above two steps.

Step 4: After calculating the difference, the company has to find out which partner hasreceived excess and which partner has received short.

Step 5: The last step of calculation of amount of adjustment entry involves passing the adjusting journal entry by debiting the Capital A/c of the partner who has received excess amount and crediting the Capital A/c of the partner who has received short.

Examples

Case 1: When Interest on Capital is less Charged:

Adjustment Table

Particulars		A	B	C
a) Interest on Capital which should have been credited (@ right rate of interest%)	(Cr.)	xxxx	xxxx	Xxxx
b) **Less:** Interest on Capital alredy credited (@ wrong rate of interest%) now debited	(Dr.)	(xxxx)	(xxxx)	xxxx
a) Amounts which should have been credited [a – b]	(Cr.)	xxxx	xxxx	Xxxx
b) **Less:** Amounts already creadited now debited (total amount of c)) in profit sharing ratio	(Dr.)	(xxxx)	(xxxx)	xxxx
Net Effect [c - d]		**xxxx**	**xxxx**	**Nil**

Adjustment Table

Particulars		A	B	Total
a) Interest on Capital which should have been credited (@ right rate of interest%)	(Cr.)	XXXX	XXXX	XXXX
b) **Less:** Interest on Capital already credited (@ wrong rate of interest%) now debited	(Dr.)	(XXXX)	(XXXX)	XXXX
c) Amounts which should have been credited [a - b]	(Cr.)	XXXX	XXXX	XXXX
d) **Less:** Amounts already credited now debited (total amount of c)) in profit sharing ratio	(Dr.)	(XXXX)	(XXXX)	XXXX
Net Effect [c - d]		**XXXX**	**XXXX**	**Nil**

Example: Gaurav, Kashish, and Vaibhav are partners in a firm sharing profits and losses in the ratio of 2:3:1. Their fixed capitals were ₹ 6,00,000; ₹ 2,00,000 and ₹ 4,00,000, respectively. Interest on capital for the year 2020-21 was credited to them @ 9% p.a. instead of 10% p.a. The profit for the year after charging interest was ₹ 5,00,000. Prepare the Adjustment Table and pass the AdjustmentEntry.

Solution:

Adjustment Table

Particulars		Gaurav	Kashish	Vaibhav	Total
a) Interest on Capital which should have been credited @ 10%	(Cr.)	60,000	20,000	40,000	1,20,000
b) **Less:** Interest on Capital already credited @ 9% now debited	(Dr.)	(54,000)	(18,000)	(36,000)	(1,08,000)
c) Amounts which should have been credited [a - b]	(Cr.)	6,000	2,000	4,000	12,000
d) **Less:** Amount already credited is now debited in 2:3:1	(Dr.)	(4,000)	(6,000)	(2,000)	(12,000)
Net Effect [c - d]		**2,000 (Cr.)**	**4,000 (Dr.)**	**2,000 (Cr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Kashish's Capital A/c	Dr.		4,000	
	To Gaurav's Capital A/c				2,000
	To Vaibhav's Capital A/c				2,000
	(Being interest less charged on capital, now rectified)				

Case 2: When Interest on Capital is more Charged:

Adjustment Table

Particulars		A	B	Total
a) Interest on Capital which should have been credited (@ right rate of interest%)	(Cr.)	XXXX	XXXX	XXXX
b) **Less:** Interest on Capital already credited (@ wrong rate of interest%) now debited	(Dr.)	(XXXX)	(XXXX)	XXXX
c) Amounts that should have been debited [a - b]	(Dr.)	XXXX	XXXX	XXXX
d) **Less:** Amounts already debited now credited (total amount of c)) in profit sharing ratio	(Cr.)	(XXXX)	(XXXX)	XXXX
Net Effect [c - d]		**XXXX**	**XXXX**	**Nil**

Example: Sahil, Vishal, and Anand are partners in a firm sharing profits and losses in the ratio of 2:1:2. Their fixed capitals were ₹ 3,00,000; ₹ 6,00,000, and ₹ 12,00,000, respectively. Interest on capital for the year 2020-21 was credited to them @ 10% p.a. instead of 8% p.a. The profit for the year after charging interest was ₹ 6,00,000. Prepare the Adjustment Table and pass the AdjustmentEntry.

Solution:

Adjustment Table

Particulars		Sahil	Vishal	Anand	Total
a) Interest on Capital which should have been credited @ 8%	(Cr.)	24,000	48,000	96,000	1,68,000
b) **Less:** Interest on Capital already credited @ 10% now debited	(Dr.)	(30,000)	(60,000)	(1,20,000)	(2,10,000)
c) Amounts that should have been debited [a - b]	(Dr.)	(6,000)	(12,000)	(24,000)	(42,000)
d) **Less:** Amount already debited is now credited in 2:1:2	(Cr.)	16,800	8,400	16,800	42,000
Net Effect [c - d]		**10,800 (Cr.)**	**3,600 (Dr.)**	**7,200 (Dr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Vishal's Capital A/c	Dr.		3,600	
	Anand's Capital A/c	Dr.		7,200	
	To Sahil's Capital A/c				10,800
	(Being interest more charged on capital, now rectified)				

Case 3: When Interest on Capital is not Charged:

Adjustment Table

Particulars		A	B	Total
a) Interest on Capital which should have been credited (@ right rate of interest%)	(Cr.)	XXXX	XXXX	XXXX
b) **Less:** Amount already credited is now debited (total amount) in profit sharing ratio	(Dr.)	(XXXX)	(XXXX)	(XXXX)
Net Effect [a - b]		**XXXX**	**XXXX**	**Nil**

Example: Sukant and Bijay are partners in a firm sharing profits and losses in the ratio 3:5. Their fixedcapitals were ₹ 10,00,000 and ₹ 18,00,000, respectively. After the closing of accounts of the year, itwas found that interest on capital @10% p.a. as provided in the partnership deed has not been credited to the Capital Accounts of the partners. Pass a necessary journal entry to rectify the error.

Solution:

Adjustment Table

Particulars		Sukant	Bijay	Total
a) Interest on Capital which should have been credited (@ 10%) b) **Less:** Amount already credited is now debited in 3:5	(Cr.) (Dr.)	1,00,000 (1,05,000)	1,80,000 (1,75,000)	2,80,000 (2,80,000)
Net Effect [a - b]		**5,000 (Dr.)**	**5,000 (Cr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Sukant's Capital A/c	Dr.		5,000	
	To Bijay's Capital A/c				5,000
	(Being interest omitted, now corrected)				

Case 4: When Interest on Drawings is not Charged:

Adjustment Table

Particulars		A	B	Total
a) Interest on Drawings which should have been debited (@ right rate of interest%) b) **Less:** Amount already debited is now credited (total amount) in profit sharing ratio	(Dr.) (Cr.)	XXXX (XXXX)	XXXX (XXXX)	XXXX (XXXX)
Net Effect [a - b]		**XXXX**	**XXXX**	**Nil**

Example: Akanksha, Sayeba, and Nupur are partners in a firm sharing profits and losses in the ratio 3:2:1. After the final accounts of the firm have been prepared, it was discovered that interest on drawings had not been taken into consideration. The interest on drawings of the partners was ₹ 500, ₹ 350, ₹ 200, respectively. Pass a necessary journal entry to rectify the error.

Solution:

Adjustment Table

Particulars		Akanksha	Sayeba	Nupur	Total
a) Interest on Drawings that should have been debited b) **Less:** Amounts already debited now credited in 3:2:1	(Dr.) (Cr.)	(500) 525	(350) 350	(200) 175	(1,050) 1,050
Net Effect [a - b]		**25 (Cr.)**	**-**	**25 (Dr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Nupur's Capital A/c	Dr.		25	
	To Akanksha's Capital A/c				25
	(Being adjustment of commission of interest on drawings)				

Case 5: When Profit is already distributed in deed ratio without adjustment of Interest on Capital, Salary, Commission, and Interest on Drawings:

Adjustment Table

Particulars		A	B	Total
a) Interest on Capital which should have been credited (@ right rate of interest%)	(Cr.)	XXXX	XXXX	XXXX
b) Salary which should have been credited	(Cr.)	XXXX	XXXX	XXXX
c) Commission which should have been credited	(Cr.)	XXXX	XXXX	XXXX
d) **Total of a + b+ c**	(Cr.)	XXXX	XXXX	XXXX
e) **Less:** Interest on Drawings which should have been debited	(Dr.)	(XXXX)	(XXXX)	(XXXX)
f) **d - e**	(Cr.)	XXXX	XXXX	XXXX
g) Balance of Profit distributed in profit sharing ratio (after all the adjustments)	(Cr.)	XXXX	XXXX	XXXX
h) Amounts that should have been credited (f + g)	(Cr.)	XXXX	XXXX	XXXX
i) **Less:** Amounts already credited now debited in deed profit sharing ratio	(Dr.)	(XXXX)	(XXXX)	(XXXX)
Net Effect [h - i]		**XXXX**	**XXXX**	**Nil**

Note: If Profit is given then it is taken on Adjustment.

Example: The net profit of a firm for the year ended 31st March 2020 was ₹ 1,20,000, which has been duly distributed amongst its partners Hardik, Sumit, and Shubham in their agreed proportions of 2:1:1, respectively. It was discovered on 10th April 2020 that the undermentioned transactions were not passed through the books of accounts of the firm for the year ended 31st March 2020, which stood duly closed on that date:

Interest on Capital @ 10% p.a.

Interest on Drawings: Hardik ₹ 1,400; Sumit ₹ 1,000; Shubham ₹ 600.Salary of ₹ 20,000 to Hardik and ₹ 30,000 to Sumit.

Commission due to A on a special transaction, ₹ 12,000

The capital accounts of the partners on 1st April 2019 were: Hardik ₹ 1,00,000; Sumit ₹ 80,000; Shubham ₹ 60,000. Suggest a journal entry that should be passed on 10th April 2020 that will not affect the Profit & Loss Account of the firm for 2019-20 and at the same time rectify the position ofthe partners.

Solution:

Adjustment Table (If Profit is taken)

Particulars		Hardik	Sumit	Shubham	Total
a) Interest on Capital which should have been credited @ 10%	(Cr.)	10,000	8,000	6,000	24,000
b) Salary which should have been credited	(Cr.)	20,000	30,000	-	50,000
c) Commission which should have been credited	(Cr.)	12,000	-	-	12,000
d) **Total of a + b+ c**	(Cr.)	42,000	38,000	6,000	86,000
e) **Less:** Interest on Drawings that should have been debited	(Dr.)	(1,400)	(1,000)	(600)	(3,000)
f) **d - e**	(Cr.)	40,600	37,000	5,400	83,000
g) Balance of Profit distributed in 2:1:1 (1,20,000 - 83,000)	(Cr.)	18,500	9,250	9,250	37,000
h) Amount that should have been credited (f + g)	(Cr.)	59,100	46,250	14,650	1,20,000
i) **Less:** Amounts already credited now debited in 2:1:1	(Dr.)	(60,000)	(30,000)	(30,000)	(1,20,000)
Net Effect [h - i]		**900 (Dr.)**	**16,250 (Cr.)**	**15,350 (Dr.)**	**Nil**

Adjustment Table (If Profit is not taken)

Particulars		Hardik	Sumit	Shubham	Total
a) Interest on Capital which should have been credited @ 10%	(Cr.)	10,000	8,000	6,000	24,000
b) Salary which should have been credited	(Cr.)	20,000	30,000	-	50,000
c) Commission which should have been credited	(Cr.)	12,000	-	-	12,000
d) **Total of a + b+ c**	(Cr.)	42,000	38,000	6,000	86,000
e) **Less:** Interest on Drawings which should have been debited	(Dr.)	(1,400)	(1,000)	(600)	(3,000)
f) **d - e**	(Cr.)	40,600	37,000	5,400	83,000
g) **Less:** Amounts already credited is now debited in 2:1:1	(Dr.)	(41,500)	(20,750)	(20,750)	(83,000)
Net Effect [f - g]		**900 (Dr.)**	**16,250 (Cr.)**	**15,350 (Dr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Hardik's Capital A/c	Dr.		900	
	Shubahm's Capital A/c	Dr.		15,350	
	To Sumit's Capital A/c				16,250
	(Being the adjustment for the ommission of interest on capital and salary)				

Case 6: When Profit already distributed in wrong ratio without adjustment of Interest on Capital, Salary, Commission, and Interest on Drawings:

Example: Ishika, Harshita, and Astha are partners in a firm with capital as ₹ 1,20,000; ₹ 60,000; and ₹ 60,000, respectively on 1st April 2021. As per the provisions of the deed:

1. Astha was to be allowed a remuneration of ₹ 12,000 p.a.
2. Interest at 5% p.a. was to be provided on capital.
3. Profits were to be divided in the ratio of 3:1:1.

Ignoring the above terms, net profit of ₹ 72,000 for the year ended 2021-22 was divided among thepartners equally. Prepare the Adjustment Table and pass an Adjustment Entry to rectify the error.

Solution:

Adjustment Table

Particulars		Ishika	Harshita	Astha	Total
a) Interest on Capital which should have been credited @ 5%	(Cr.)	6,000	3,000	3,000	12,000
b) Salary which should have been credited	(Cr.)	-	-	12,000	12,000
c) **Total of a + b**	(Cr.)	6,000	3,000	15,000	24,000
d) Balance of Profit ₹48,000 distributed in 3:1:1	(Cr.)	28,800	9,600	9,600	48,000
f) Amount which should have been credited	(Cr.)	34,800	12,600	24,600	72,000
g) **Less:** Profits already credited now debited in 1:1:1	(Dr.)	(24,000)	(24,000)	(24,000)	(72,000)
Net Effect [f - g]		**10,800 (Cr.)**	**11,400 (Dr.)**	**600 (Cr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Harshita's Capital A/c	Dr.		11,400	
	To Ishika's Capital A/c				10,800
	To Astha's Capital A/c				600
	(Being the adjustment for salary, interest on capital, and wrong distribution of profit)				

Case 7: Computation of Opening Capital (When Interest on Capital is not Given):

Example: Anshul, Abhinav, and Navya are partners in a firm sharing profits and losses in the ratio of2:3:5. After division of the profit for the year ended 31st March 2022 their capitals were ₹ 1,00,000; ₹ 1,20,000; and ₹ 1,40,000. During the year, they withdraw ₹ 40,000 each. The profit of the year was ₹ 40,000. The partnership deed provided that interest on capital will be allowed @10% p.a., but while preparing the final accounts interest on partners' capital was not allowed. Calculate the capital of Anshul, Abhinav, and Navya on 1st April 2021 and pass the necessary journal entry for providing Interest on Capital.

Solution:

Computation of Opening Capital as on 1st April 2021

Particulars	Anshul	Abhinav	Navya
Capital at the end **Add:** Drawings during the year	1,00,000 40,000	1,20,000 40,000	1,40,000 40,000
 Less: Profit (₹40,000 in 2:3:5)	**1,40,000** (8,000)	**1,60,000** (12,000)	**1,80,000** (20,000)
Capital at the Opening	**1,32,000**	**1,48,000**	**1,60,000**

Adjustment Table

Particulars		Anshul	Abhinav	Navya	Total
Interest on Capital (Opening) will be credited @10% p.a. **Less:** Amount already credited now debited in 2:3:5	(Cr.) (Dr.)	13,200 (8,800)	14,800 (13,200)	16,000 (22,000)	44,000 (44,000)
Net Effect		**4,400 (Cr.)**	**1,600 (Cr.)**	**6,000 (Dr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Navya's Capital A/c	Dr.		6,000	
	To Anshul's Capital A/c				4,400
	To Abhinav's Capital A/c				1,600
	(Being adjustment journal entry)				

Case 8: Changes in Profit Sharing Ratio:

Example: Nisha, Shreya, and Kanika were three partners in a firm sharing profits and losses in the ratio 1:3:4, respectively. Nisha wants that she should share equally in the profit with Shreya and Kanika, and she further wants that the change in profit-sharing ratio should come adjustment into effect, respectively for the last three years. Shreya and Kanika have no objection to this. The profit for the last three years were ₹ 10,000, ₹ 12,000 and ₹ 14,000. Show the adjustment of profit for the last three years with the help of journal entries.

Solution:

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Shreya's Capital A/c	Dr.		1,500	
	Kanika's Capital A/c	Dr.		6,000	
	To Nisha's Capital A/c				7,500
	(Being adjustment made)				

Working Notes:

Total Profit of the last 3 years = 10,000 + 12,000 + 14,000

= ₹ 36,000

Particulars	Nisha	Shreya	Kanika	Total
Amounts that should have been credited in the ratio 1:1:1 **Less:** Amount already credited now debited in 1:3:4	12,000 (4,500)	12,000 (13,500)	12,000 (18,000)	36,000 (36,000)
Net Effect	**7,500 (Cr.)**	**1,500 (Dr.)**	**6,000 (Dr.)**	**Nil**

Case 9: When Partnership Deed is not maintained:

Example: The capitals of Sabyasachi, Dharmendra, and Rishab as on 31st March 2021 amounted to ₹ 60,000; ₹ 2,20,000; and ₹ 4,40,000, respectively. The profits for the year 2020-21 was ₹ 1,20,000 and was distributed in the ratio 3:2:1 after allowing Interest on Capitals @ 10% p.a. During the year, each partner withdrew ₹ 80,000. The partnership deed was silent as to profit sharing ratio but provided for Interest on Capital @ 12%. Pass the necessary adjustment journal entry.

Solution:

Adjustment Table

Particulars		Sabyasachi	Dharmendra	Rishab	Total
I. Amount which should have been credited:					
Interest on Capital @12%	(Cr.)	8,640	28,080	54,000	90,720
Balance amount of Profit ₹29,280 in 1:1:1	(Cr.)	9,760	9,760	9,760	29,280
Total I.		**18,400**	**37,840**	**63,760**	**1,20,000**
II. Amount already credited now debited:					
Interest on Capital @10%	(Dr.)	7,200	23,400	45,000	75,600
Balance amount of Profit ₹44,400 in 3:2:1	(Dr.)	22,200	14,800	7,400	44,400
Total II.		**(29,400)**	**(38,200)**	**(52,400)**	**(1,20,000)**
Net Effect [I - II]		**11,000 (Dr.)**	**360 (Dr.)**	**11,360 (Cr.)**	**Nil**

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Sabyasachi's Capital A/c	Dr.		11,000	
	Dharmendra's Capital A/c	Dr.		360	
	To Rishab's Capital A/c				11,360
	(Being the short interest on capital provided and profits distributed in wrong ratio, now rectified)				

Working Notes:

Calculation of Interest on Capital already provided and Opening Capitals:

Particulars	Sabyasachi	Dharmendra	Rishab
A. Capital at the end	60,000	2,20,000	4,40,000
B. **Add:** Drawings already debited	80,000	80,000	80,000
C. **Less:** Profit already credited in 3:2:1	(60,000)	(40,000)	(20,000)
D. Capital at the Opening plus Interest on Capitals (A + B + C)	80,000	2,60,000	5,00,000
E. **Less:** Interest on Capitals (D x 10%)	(8,000)	(26,000)	(50,000)
F. Capital at the Opening (D - E)	**72,000**	**2,34,000**	**4,50,000**

Case 10: Adjusting Entry when Manager is treated as a Partner:

Particulars	Amount (₹)
A. Calculate the amount already credited to the Manager	XXXX
B.Calculate the amount which should have been given as a partner	(XXXX)
A - B	XXXX

Adjustment Journal Entry

Date	Particulars	L.F.	Amount (Dr.)	Amount (Cr.)
	Old Partner's Capital A/c (in old ratio) Dr.		XXXX	
	To Incoming Partner's Capital A/c (Credit still to be given)			XXXX
	(Being the adjustment made)			

Note: Revised profit for calculation Share of Profit = Given Profits + AMount already given as Manager - Amount to be given as Partner

Example: Arun and Anurag are partners sharing profits and losses in the ratio of 5:4. They employedBhavook as their manager to whom they paid a salary of ₹ 1,500 per month. Bhavook has deposited ₹ 40,000 on which interest was payable @9% p.a. At the end of 2020-21 (after division of the year'sprofits), it was decided that Bhavook should be treated as a partner with effect from 1st April 2017-18 with 1/6th share of profits, his deposit being considered as capital carrying interest at 6% p.a. like capitals of other partners. The firm's profits and losses after allowing interest on capitals were: 2017-18 Profit ₹ 1,18,000; 2018-19 Profit ₹ 1,25,200; 2019-20 Loss ₹ 8,000; 2020-21 Profits ₹ 1,56,000.
Record the necessary Journal Entries to give effect to the above.

Note: Interest on Capital is to be allowed as a charge

Solution:

Amount Received by Bhavook as Manager

Salary (18,000 x 4 = 72,000)	72,000
Less: Interest on Loan (9% on 40,000 = 3,600 x 4)	(14,400)
	57,600

Bhavook as a Partner entitled to get in 4 years

Interest on Capital: 6% on ₹40,000 = 2,400 x 4 1/6 shares in Profit: **Profits for this purpose is as follows:** Last Year Profits (1,18,000 + 1,25,200 - 8,000 + 1,56,000) **Add:** What Bhavook got as Manager **Less:** Interest on Capital (6% on 40,000 = 2,400 x 4) **Profit**	 3,91,200 57,600 (9,600) **4,39,200**	 9,600
Share of Bhavook in Profits 1/6 x 4,39,200		73,200
Share of Bhavook as a partner		**82,800**
Share of Bhavook as a Manager		(57,600)
Bhavook will be credited with		**25,200**

Share of Bhavook as a partner is ₹ 82,800, which is more than ₹ 57,600; i.e., ₹ 25,200. Therefore,Bhavook will be credited with ₹ 25,200, and Arun & Anurag will be debited in 5:4 ratio with ₹ 25,200.

Adjustment Entry

Date	Particulars		L.F.	Amount (Dr.)	Amount (Cr.)
	Bhavook's loan A/c	Dr.		40,000	
	To Bhavook's Capital A/c				40,000
	(Being Bhavook's loan converted into Capital)				
	Arun's Capital A/c	Dr.		14,000	
	Anurag's Capital A/c	Dr.		11,200	
	To Bhavook's Capital A/c				25,200
	(Being the adjustment made for the admission of Bhavook as existing manager as a partner)				

02

ACCOUNTING FOR PARTNERSHIP : BASIC CONCEPTS

MIND MAP