GURU GOBIND SINGH PUBLIC SCHOOL SECTOR – V
BOKARO STEEL CITY

SUBJECT – ACCOUNTANCY
CLASS – XII

ACCOUNTING FOR PARTNERSHIP FIRMS : Fundamentals

STUDY NOTES AND SELF ASSIGNMENT

1. **MEANING OF PARTNERSHIP :-**
   Accounting to Section 4 of the Indian Partnership Act, 1932, "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".

2. **PARTNERSHIP DEED :-**
   The document containing the agreement in writing among partners is called partnership deed. It generally contains the details about all the aspects affecting the relationship between the partners.

   Importance of Partnership Deed

   A firm should have a partnership deed because

   i) It regulates the right, duties and liabilities of the partners.
   ii) It avoids disputes in future by acting as a proof or guiding document.
   iii) It helps to avoid any misunderstanding among the partners.

3. **Provisions of the Indian partnership Act, 1932 in the Absence of Partnership Deed**

i)	Sharing of profit/losses	-	Equally
ii)	Interest on Capital	-	Not Allowed
iii)	Salary/Commission to a partner	-	Not Allowed
iv)	Interest on advances or loan by a partner	-	6% per annum
v)	Interest on drawings	-	Not charged

4. **Maintenance of Capital Accounts of Partners**
   Capital accounts of partners can be maintained by the following two methods

   i) **Fixed Capital Method** Under this method, Two accounts are maintained namely, capital account and current account.
   Format of Fixed Capital Method

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

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X(₹)	Y (₹)	Z (₹)
To Cash/Bank A/c	---	--	---	By Balance b/d	--------	--------	-------
(Withdrawal of Capital)				By Cash/Bank A/c	--------	--------	-------
To Balance c/d	----	----	----	(Additional Capital Introduced)			
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Dr. **Partner's Current Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X(₹)	Y (₹)	Z (₹)
To Balance b/d (In case of debit opening balance)	---	--	---	By Balance b/d (In case of credit opening balance)	----	-----	----
To Drawings A/c	----	----	---	By Interest on Capital A/c	----	----	----
To Interest on Drawings A/c	----	----	----	By Commission A/c	----	----	----
To Profit and Loss	----	----	-----	By Salary A/c	-----	-----	-----
Appropriation A/c (Loss)				By Profit and Loss Appropriation A/c (Profit)	----	-----	-----
To Balance c/d	----	----	----	By Balance c/d	----	----	----
	-----	-----	----		-----	-----	-----

ii) Fluctuating Capital Method Under fluctuating capital method, one account is maintained i.e. capital account.

Format of Fluctuating Capital Method

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

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X(₹)	Y (₹)	Z (₹)
To Balance b/d (In case of debit opening balance)	---	--	---	By Balance b/d (In case of credit opening balance)	----	-----	----
To Drawings A/c	----	----	---	By Cash/Bank A/c (Additional capital introduced)	----	----	----
To Interest on Drawings A/c	----	----	----	By Salary A/c	----	----	----
To Profit and Loss	----	----	-----	By Interest on Capital A/c	-----	-----	-----
Appropriation A/c (Loss)				By Commission A/c	----	-----	-----
To Balance c/d	----	----	----	By Profit and Loss Appropriation A/c (Profit)	----	----	----
				By Balance c/d	-----	-----	-----
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5. **Interest on Capital**

It is generally allowed to compensate partners for contributing capital to the firm in excess of profit sharing ratio. It is an appropriation of profits and is provided only if there is profit. It will be provided in case of loss also only if partnership deed so provides or it is to be treated as a charge against profits.

Different Cases Related to Interest on Capital

The various cases related to interest on capital are

Case I When partnership agreement is silent about interest on capital : Not allowed

Case II When partnership agreement provides that interest on capital is to be allowed.

i) In case, there is a loss	-	Not provided
ii) In case, there are sufficient profits	-	Fully allowed
iii) If there are insufficient profits	-	Proportionately allowed to the extent of available profits in the ratio of capital of each partner

Case III When partnership agreement states that interest on capital is to be provided as a charge : Fully allowed irrespective of profits or losses.

Notes :- Interest on capital is always calculated on the opening balance of capital in a year. In case, closing capital is given, then opening capital will be calculated first by using the following formula.
Opening Capital = Closing Capital – Profits + Drawings – Additional Capital

6. **Interest on Drawings :-**

The amount withdrawn by the partners in cash or in kind for their personal use is termed as drawings. When the partnership deed is silent, no interest on drawings is charged. Interest on drawings is calculate with reference to the time period for which money was withdrawn.

Case I When fixed amount is withdrawn at fixed intervals

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

Value of time under different circumstances will be as under

	Monthly Drawings for 12 Months	Quartely Drawings for 12 Months	Half-yearly Drawings for 12 Months	Monthly Drawings for 6 Months	Monthly Drawings for 9 Months
When drawings are made in the beginning of each period	6.5	7.5	9	3.5	5
When drawings are made in the middle of each period	6	6	6	3	4.5
When drawings are made in the end of each period	5.5	4.5	3	2.5	4

Case II When unequal amount is withdrawn at irregular intervals

i) Simple Method

Interest on Drawings = Amount of Drawings X $\frac{Rate\ of\ Interest}{100} \times \frac{Months\ Remaining}{12}$

ii) Product Method

Interest on Drawings = Total of Products X $\frac{Rate\ of\ Interest}{100} \times \frac{1}{12}$

Note :- When the rate of interest is given without the suffix per annum, interest will be charged without considering time or date of drawings.
If the date of withdrawal is not given, in that case the interest on total drawings for the year is calculated for six months on an average basis.

7. Accounting Treatment of Interest on Partner's Loan to the firm

Interest on partner's loan is a charge against the profits and not an appropriation out of profits and hence, must be transferred to the debit of profit and loss account and not to the debit of profit and loss appropriation account.

Note :-

- If there is an agreement as to the rate of interest, a partner is entitled to an interest on loan at an agreed rate of interest.
- If there is no agreement as to the rate of interest, partner is entitled to interest on loan @ 6% per annum.
- Interest on partner's loan is not recorded in the partner's capital/current account but it should be recorded to the credit side of partner's loan account.

8. Accounting Treatment of Salary or Commission to a Partner

Salary or commission to a partner is to be allowed, if the partnership agreement provides for the same. Salary or commission to a partner is an appropriation out of profits and not a charge against the profits, i.e, they are to be allowed only if there are profits and hence, must be transferred to the debit of profit and loss appropriation account and not to the debit of profit and loss account.

Calculation of Commission based on Profit

i) Commission as Percentage of Net Profit before Charging such Commission

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

ii) Commission as Percentage of Net Profit after Charging such commission

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

Note : Charges such as interest on partners' loans, manager's salary and commission must be deducted from profit before transferring it to profit and loss appropriation account.

9. Distribution of Profit among Partners : Profit and Loss Appropriation Account

Profit and loss appropriation account is an extension of the profit and loss account. It is prepared to show appropriation or distribution of net profit among the partners.

Format of Profit and Loss Appropriation Account

Profit and Loss Appropriation Account

Dr. **for the year ended .....** **Cr.**

Particular	Amt. (Rs.)	Particulars	Amt. (Rs.)
To Interest on Capital A/c		By Net Profit as per Profit and Loss A/c	
A ------		(Net Profit subject to appropriations)	------
B ------	--------	By Interest on Drawings A/c	
To Partners' Salaries A/c	--------	A -----	
To Partners' Commission A/c	--------	B -----	------
To Reserve A/c	--------		
To Profit Transferred to			
A's Capital A/c* (or A's Current A/c)** ----			
B's Capital A/c* (or B's Current A/c)** ----	------		
	------		--------

Note Students should note that profit and loss appropriation account will never show loss under any situation.

10. Past Adjustments

If after closing the accounts of a partnership firm, some errors or omissions are ddiscovered in the accounts, e.g. interest on capital or drawings may not have been allowed or charged; charged or allowed at a higher or lower rate, etc. Then under such circumstances, the accounts once closed are not reopened. Such errors and omissions are rectified by recording an adjusting entry. Such adjustments are called past adjustments as they relate to past period.

Format of Adjustment Table

Statement Showing Adjustment to be made

Particulars	X (Rs.)	Y (Rs.)	Total
A. Amounts already Recorded			
Interest on Capital	…….	……..	…….
Interest on Drawings	(……)	(……)	(……)
Salary/Commission to Partner	…….	…….	…….
Share of Profit	…….	…….	…….
	…….	…….	…….
B. Amounts which should have been Recorded			
Interest on Capital	…….	……..	…….
Interest on Drawings	(……)	(……)	(……)
Salary/Commission to Partner	…….	…….	…….
Share of Profit	…….	…….	…….
	…….	…….	…….
Net Effect (A – B)	…….	…….	…….

JOURNAL

Date	**Particulars**	**LF**	**Amt. (Dr.)**	**Amt. (Cr.)**
	Gaining Partners' Capital A/c (Who received excess) Dr. To Sacrificing Partners' Capital A/c (who received less)			

11. Guarantee of Profits to a Partner

A partner may be admitted into the firm with a guarantee of minimum profit which means that if his share of profit is less than that of guaranteed profit, then he would be paid the guaranteed share of profit. The deficiency (difference between guaranteed profit and actual profit) is borne by partner or partners who have guaranteed the profit in agreed ratio.

Different Cases Regarding Guarantee of Profits

i) Guarantee by the firm to a partner
ii) Guarantee by one partner to another partner
iii) Guarantee given by a partner to the firm.
iv) Simultaneous guarantee by the firm to a partner and by a partner to the firm.

01. Give one reason why interest on capital is allowed to Partner.

02. Give one reason why partners are charged interest on drawing.

03. Rent paid to partner is Debited to profit/loss Account why?

04. A partnership deed provides for the payment of interest on capital but there was a loss instead of profit during the year 2010-11. At what rate will the interest be allowed?

05. Interest on Advance paid to partner Debited to P/L A/c why.

06. What is meant by 'unlimited liability of a partner'?

07. X and Y are partners sharing profits and losses in the ratio of 2:3 with a capitals of ₹ 2,00,000 and ₹ 1,00,000 respectively. Show distribution of profits/losses for the year ended 31st March, 2016by preparing relevant accounts in each of the alternative cases.

Case 1: If partnership Deed is silent as to the interest on capital and the profits for the year is ₹ 20,000.

Case 2 : If Partnership Deed is silent for interest on capital @ 6% p.a. and loss for the year is ₹ 20,000.

Case 3: If partnership Deed provides for interest on capital @ 6% p.a. and the trading profit for the year is ₹ 21,000.

08. *(interest on Capital when profit is inadequate)* : A and B contribute ₹ 40,000 and ₹ 20,000 respectively by way of capital on which they agree to pay interest @ 6% p.a. Their respective share of profit is 2:3 and the business (before interest) for the year is ₹ 3,000. Show the relevant account to allocate interest on capitals:

(i) if the Partnership Deed is silent about the treatment of interest on capital, and

(ii) if interest is a charge as per the Partnership Deed.

09. From the following Balance Sheet of X and Y, calculate interest on capital @ 6% p.a. payable to Y for the year ended 31st March, 2016.

Liabilities	₹	Assets	₹
X's capital A/c	50,000	Sundry Assets	1,10,000
Y's Capital A/c	40,000		
Profit and loss appreciation A/c 2015-16	20,000		
	1,10,000		1,10,000

During the year, Y's drawing were ₹ 15,000 and profit during 2015- 16 was ₹ 30,000.

10. From the following Balance Sheet of Long and Short, calculate interest on capital @ 8% p.a. ended 31st March, 2015.

Liabilities	₹	Assets	₹
Long's capital A/c	1,60,000	Fixed Assets	3,00,000
Short's Capital A/c	1,40,000	Drawings – Long	40,000
Profit and loss appreciation A/c (2014-15)	1,00,000	Others Assets	60,000
	4,00,000		4,00,000

During the year, Long's drawing were ₹ 40,000 and Short Drawing were ₹ 50,000. Profit for the year was ₹ 1,50,000.

11. A, B and C are partners in a firm sharing profits in the ratio of 3:2:1. They earned a profit of ₹ 30,000 during 2015-16. Distribution profit among A, B and C if:
    (a) C's share of profit is guaranteed to be ₹ 6,000 per minimum.
    (b) Minimum profit payable to C amounting to ₹ 6,000 is guaranteed by A.
    (c) Guaranteed minimum profit of ₹ 6,000 payable to C is guaranteed by B.
    (d) Any deficiency after making payment of guaranteed ₹ 6,000 will be borne by A and B in the ration of 3 : 1.

12. X, Y and Z entered into partnership on 1st October, 2015 to share profits and losses in the ratio of 4:3:3. X, however, personally guaranteed that Z's share profit after charging interest on capital @ 10% p.a. would not be less than ₹ 80,000 in any year. The capital contribution X – ₹ 3,00,000, Y – ₹ 2,00,000 and Z – ₹ 1,50,000.
    The profit for the year ended 31st March, 2016 amounted to ₹ 1,60,000. Prepare Profit and loss Appropriation Account.

13. Ankur and Bobby were into the business of providing software solutions in India. They were sharing profits and losses in the ratio 3:3. They admitted Rohit for a 1/5 share on the firm. Rohit, an alumni of IIT, Chennai would help them to expand their business to various South African countries where he had been working earlier. Rohit is guaranteed a minimum profit of ₹ 2,00,000 for the year. Any deficiency in Rohit's share is to be borne by Ankur and Bobby in the ration 4 : 1. Losses for the year were ₹ 10,00,000. Pass the necessary Journal entries.

14. *(Guarantee of profit to a partner in case of Loss).* A and B are partners having capitals of ₹ 10,00,000; ₹ 8,00,000 and ₹ 6,00,000 respectively in a firm and sharing profits and losses equally. C is guaranteed a minimum profits of ₹ 1,00,000 as share of profit every year. The firm incurred a loss of ₹ 3,00,000 for the year ended 31st March, 2016.

    You are required to show the necessary accounts for division of loss and giving effect to minimum guaranteed profit to C.

15. A, B and C were partners in a firm. On 1st April, 2008 their fixed capitals stood at ₹ 50,000, ₹ 25,000 and ₹ 25,000 respectively.
    As per the provisions of the Partnership Deed:
    (i) B was entitled for a salary of ₹ 5,000 p.a.
    (ii) All the partners were entitled to interest on capital @ 5% p.a.
    (iii) Profits were to be shard in the ratio of capitals.
    The net profits for the year ended 31st March, 2009 of ₹ 33,000 and 31st March, 2010 of ₹ 45,000, was divided equally without providing for the above terms.
    Pass an adjustment journal entry to rectify the above error.

16. A, B and C were partners. Their capitals were A – ₹ 30,000; B – ₹ 20,000 and C – ₹ 10,000 respectively. According to the Partnership Deed, they were entitled to an interest on capital at 5% p.a. In addition B was also entitled to draw a salary of ₹ 500 per month. C was entitled to a commission of 5% on the profits after charging the interest on capital, but before charging the salary payable to B. Net profit for the year was ₹ 30,000 distributed in the ratio of capitals without providing for any of the above adjustments. The profits were to be shared in the ratio 5 : 2 : 3. Pass necessary adjustment entry showing the workings clearly.

17. On 31st March, 2014, the balance in the capitals Accounts of Saroj, Mahinder and Umar after making adjustments for Profits and drawings etc., were ₹ 80,000, ₹ 60,000 and ₹ 40,000 respectively. Subsequently, it was discovered that the interest on capital and drawings has been omitted.

(a) The profit for the year ended 31st March, 2014 was ₹ 80,000.
(b) During the year Saroj and Mahinder each withdrew a sum of ₹ 24,000 in equal installments in the end of each month and Umar withdrew ₹ 36,000.
(c) The interest on drawings was to be charged @ 5% p.a. and interest on capital was to be allowed @ 10% p.a.
(d) The profit – sharing ratio among partners was 4:3:1.

Showing your workings clearly, pass the necessary rectifying entry.

18. On 31st March, 2014, the balance in the Capital Accounts of Ekta, Ankit and Chahat after making adjustments for profits and drawing were ₹ 1,50,000, ₹ 2,10,000 and ₹ 2,70,000 respectively. Subsequently, it was discovered that the interest on capital and drawings had been omitted.
(a) The profit for the year ended 31st March, 2014 was ₹ 1,20,000.
(b) During the year Ekta withdrew ₹ 24,000 and Ankit and Chahat each withdrew a sum of ₹ 24,000in equal installments in the middle of each quarter.
(c) The interest in drawings was to be charged @ 5% p.a. and interest on capital was to be allowed @ 10% p.a.
(d) The profit – sharing ratio among the partners was 1:2:3.

Showing your working notes clearly, pass the necessary rectifying entry.

19. Amal, Bimal and Kamal are three partners. On 1st April, 2015, their Capitals stood as : Amal ₹ 40,000, Bimal ₹ 30,000 and Kamal ₹ 25,000. It was decided that :
(a) they would receive interest on Capital @5% p.a.
(b) Amal would get a salary of ₹ 250 per month.
(c) Bimal would receive commission @ 4% on the net profit after deduction of the commission from it interest on capital and salary and
(d) After deduction all of these 10% of the profits should be transferred to the General Reserve.

Before the above items were taken into account, the profits for the year ended 31st March, 2016 were ₹ 33,360. Prepare Profit and Loss Appropriation Account and the Capital Accounts of the Partners.

20. A and B are partners sharing profits and losses in the ratio of 3:1. On 1st April, 2015, their capitals were A ₹ 50,000 and B ₹ 30,000. During the year ended 31st March, 2016 they earned a net profit of ₹ 50,000. The terms of partnership are:
(a) Interest on capital is to be charged @6% p.a.
(b) A will get a commission @2% on turnover.
(c) B will get a salary of ₹ 500 per month.
(d) B will get commission of 5% after deduction of all expenses including such commission.

Partners' drawings for the year were : A ₹ 8,000 and B ₹ 6,000. Turnover for the year was ₹ 3,00,000.

After considering the above facts, you are required to prepare Profit and Loss Appropriation Account and Partners' capital Account.

21. Simran and Puneet are partners in a firm sharing profits and losses equally. On 1st April, 2015, capitals of the partners were : Simran – ₹ 2,00,000 and Puneet – ₹ 1,60,000. Profit and Loss Account of the firm showed net profit of ₹ 3,75,000 (before interest on Puneet's Loan) for the year ended 31st March, 2016. Considering following information, prepare Profit and Loss Appropriation Account of the firm and Partners' Capital Account:
(i) Interest on capital to be allowed @ 6% p.a.
(ii) Interest on Puneet's Loan Account of ₹ 1,00,000 for the whole year.
(iii) Interest on drawings of partners @6% p.a. Drawings being Simran – ₹ 40,000 and Puneet – ₹ 30,000
(iv) Transfer 10% of the distributable profit to Reserve.

22. A and B entered into partnership on 1st April, 2009 without any Partnership Deed. They introduced capitals of ₹ 5,00,000 and ₹ 3,00,000 respectively. On 31st October, 2009, A advanced ₹ 2,00,000 by way of loan to the firm without agreement as to interest.
The profits and Loss Accounts for the year ended 31st March, 2010 showed a profit of ₹ 4,30,000, but the partners could not agree upon the amount of interest on loan to be charged and the basis of division of profits.
Pass a Journal entry for distribution of the profits between the partners and prepare Capital Accounts of both the partners and loan Account of A.

23. Anwar, Biswas and Divya are partners in a firm. Their capital Accounts stood at ₹ 8,00,000; ₹ 6,00,000 and ₹ 4,00,000 respectively on 1st April 2013. They shared profits and losses in the ratio of 3:2:1 respectively. Partners are entitled to interest on capital @ 6% per annuma nd salary to Biswas and Divya @ ₹ 4,000 per month and ₹ 6,000 per quarter respectively as per the provisions of Partnership Deed.

24. *(Guarantee by the firm as well as by Partner).* A, B, C and D are partners sharing profits and losses in the ratio of 4 : 3 : 2 : 1. Their capital as on at 1st April, 2015 were ₹ 3,00,000; ₹ 2,50,000; ₹ 1,50,000 and ₹ 1,00,000 respectively.
D's share of profits excluding interest has been guaranteed by the firm to be not less than ₹ 2,50,000. C's share of profits including interest on capital and salary guaranteed by A is not less than ₹ 2,60,000.
The profits for the year ended 31st March, 2016 were ₹ 9,00,000 before interest in capital @ 10% and salary to C @ ₹ 10,000 per month.
Prepare Profit and Loss Appropriation Account and distribute the profits.

25. Anjur, Bhavna and Disha are partners in a firm. On 1st April, 2015, the balance in their capital accounts stood at ₹ 14,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. They shared profits in the proportion of 7:3:2 respectively. Partners are entitled to interest on capital @ 6% per annum and salary to Bhavna @ ₹ 50,000 p.a. and a commission of ₹ 3,000 per month to Disha as per the provisions of the Partnership Deed. Bhavna's share of profit (excluding interest on capital) is guaranteed at not less than ₹ 1,70,000 p.a. Disha's share of profit (including interest on capital but excluding salary) is guaranteed at not less than ₹ 1,50,000 p.a. Any deficiency arising on that account shall be met by Ankur. The profits of the firm for the year ended 31st March 2016 amounted to ₹ 9,50,000.

26. Asgar, Chaman and Dholu are partners in a firm. Their Capital Accounts stood at ₹ 6,00,000, ₹ 5,00,000 and ₹ 4,00,00 respectively on 1st April, 2015. They shared profits and Losses in the proportion of 4:2:3. Partners are entitled to interest on capital @8% per annum and salary to Chaman and Dholu @ ₹ 7,000 per month and ₹ 10,000 per quarter respectively as per the provision of the Partnership Deed. Dholu's share of profit (excluding interest on capital but including salary) is guaranteed at a minimum of ₹ 1,10,000 p.a. Any deficiency arising on that account shall be met by Asgar. The Profits for the year ended 31st March, 2016 amounted to ₹ 4,24,000.
Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2016.