CHAPTER 1

Partnership Accounts—Fundamentals

MEANING OF KEY TERMS USED IN THE CHAPTER

1. Partnership

Partnership is a relationship between persons who have agreed to share profits and losses of business carried on by all or any of them acting for all.

2. Partners

Partners are the persons who have agreed to do business and share its profits and losses.

3. Firm

Partners carrying on the business are collectively known as **firm**. The name under which the business is carried on is called **firm's name**.

4. Partnership Deed

Partnership Deed is a written agreement among the partners detailing the terms and conditions of the partnership.

5. The Indian Partnership Act, 1932

It is an Act that governs the partnership firms. In case, Partnership Deed is silent on any issue, provisions of the Act apply.

6. Capital

Capital is the amount in credit of Partner's Capital Account. It may be contributed by the partners in the firm and/or credited by way of his or her share of profit, salary, commission and interest on capital. Capitals of the partners may be fixed or fluctuating.

7. Fixed Capitals

Fixed Capitals mean that capitals of the partners remain fixed and change only with the introduction or withdrawal of capital. When capitals are fixed two accounts for each partner are maintained, *i.e.*, Capital Account and Current Account.

8. Fluctuating Capitals

Fluctuating Capitals mean that capitals of the partners do not remain fixed but change with each entry. When capitals are fluctuating only one account is maintained for each partner, *i.e.*, Capital Account.

9. Drawings

Drawings means withdrawal by the partner from the firm in cash or kind for his or her personal use.

10. Profit-sharing Ratio

Profit-sharing Ratio is the ratio in which the partners have agreed to share profits and losses of the firm. In the absence of agreement, it is as provided in the Indian Partnership Act, 1932, *i.e.*, equal.

11. Capital Ratio

Capital Ratio means the ratio in which the partners shall maintain their capitals in the firm.

12. Guarantee of Profit

Guarantee of Profit means minimum profit guaranteed to a partner or partners of the firm. Guarantee may be given by a partner or partners or the firm.

13. Past Adjustments

Past Adjustments means adjustment made either for the errors or omissions in the books of the firm or for the wrong or incorrect distribution of profits made in the past year or years.

SUMMARY OF THE CHAPTER

Meaning of Partnership as per Section 4 of 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."

Nature: A partnership firm has no separate legal entity apart from the partners constituting it.

Partners, Firm and Firm Name: The persons who have entered into partnership with one another are individually called **partners** and collectively a **firm**. The name under which the business of the firm is carried on is called the **firm name**.

Essential Elements, Main Features or Characteristics of Partnership

1. There must be two or more persons.
2. There must be an agreement.
3. There must be a lawful business.
4. There must be sharing of profits of business.
5. There must be a mutual agency, *i.e.*, the business must be either carried on by all or any of them acting for all.

Partnership Deed: The document containing the terms and conditions of the agreement between/among partners, is known as the **Partnership Deed**. The Partnership Deed usually includes the following:

(*i*) Name and address of the firm.
(*ii*) Names and addresses of all partners.
(*iii*) Date of commencement of partnership.
(*iv*) Capital to be contributed by each partner.
(*v*) Whether interest is to be allowed on capitals.
(*vi*) Whether any partner is to be allowed salary.
(*vii*) The profit-sharing ratio.
(*viii*) The duties of each partner.
(*ix*) Mode of settlement of accounts in case of retirement/death of a partner.

Benefits or Advantages of having a Partnership Deed

(*i*) It facilitates functioning of the business.
(*ii*) It is helpful in the settlement of all disputes arising among the partners.
(*iii*) It helps to avoid misunderstandings among the partners.

Provisions Applicable in the Absence of Partnership Agreement/Partnership Deed

1. Interest is not allowed on Partners' Capitals or charged on Drawings.
2. Partner is not entitled to salary or remuneration for the work done for the firm.
3. Interest @ 6% p.a. is allowed on the loans advanced by any partner.
4. Profit or loss is distributed equally among the partners.

Profit and Loss Appropriation Account is an *extension* of the Profit and Loss Account. The purpose of this account is to show how Net Profit is appropriated and distributed among the partners.
It is credited with Net Profit and interest on drawings.

It is debited with interest on capitals, salary or commission to partners as per the terms of Partnership Deed.

Its balance is transferred to the Partners' Capital (or Current) Accounts in their agreed profit-sharing ratio (or equally if there is no agreed profit-sharing ratio).

- **Salary or Commission to a Partner:** Salary or Commission to a partner is allowed if the Partnership Deed provides for it.

A: *Commission as a percentage of the Net Profit before charging such commission*

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

B: *Commission as a percentage of Net Profit after charging such commission*

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

Salary or commission to a partner *being an appropriation of profits* is transferred to the *debit of the Profit and Loss Appropriation Account* and not to the *debit of the Profit and Loss Account*.

- **Interest on Capital:** Interest on capital is calculated on time basis, taking into consideration any additional capital introduced or any existing capital withdrawn.
- **Interet on Current Account:** Interest on Current Account is allowed (in case of Credit Balance) and charged (in case of debit balance) on Opening Balance.

  It is allowed or charged if instructed in the question.
- **Interest on Drawings:** If the Partnership Deed so provides, interest on drawings is charged from the partners. The interest so charged is credited to the Profit and Loss Appropriation Account and debited to the Partners' Capital or Current Accounts.

  If the date of Drawings is not given, the Interest on total Drawings is calculated for 6 months.

  Interest @ 10% without the word 'per annum' means interest is calculated without any reference to time period.
- **Interest on Loan by Partner to the Firm:** If a partner gives a loan to the firm, he is entitled to interest on such loan at an agreed rate of interest. If there is no agreement as to the rate of interest on loan, the partner is entitled to interest on loan @ 6% p.a. Interest on loan by partner is a 'charge' against the profit and is credited to his/her Loan Account.
- **Interest on Loan by the Firm to a Partner:** Firm is entitled to receive interest on loan given to a partner. However, the firm will charge interest on loan advanced to a partner only, if it is provided in the Partnership Deed or is agreed to charge interest along with the rate of interest among the partners. It is a gain to the firm and is credited to Profit and Loss A/c.

Methods of Maintaining Capital Accounts of Partners

The Partners' Capital Accounts may be maintained according to *Fixed Capital Method* or *Fluctuating Capital Method*.

Fixed Capital Method: Under this method, the capital of partners *remains unchanged* except under special circumstances. In case of the fixed capital, *two* accounts are maintained for each partner, *viz.*, (*i*) Fixed Capital Account and (*ii*) Current Account. All adjustments regarding drawings, interest on drawings, salary, interest on capital, commission and share of profit or loss are recorded in *Current Account*. The Fixed Capital Account cannot have a negative balance.

Fluctuating Capital Method: Capital Accounts are called **fluctuating** when the balances of Capital Accounts change with each transaction. All adjustments relating to interest on capital, drawings, salary and profit are recorded in the Capital Accounts. Under this method, only one account is opened for each partner, *i.e.*, Capital Account.

In the absence of any instruction, Partners' Capital Accounts are prepared following Fluctuating Capital Method.

- **Guarantee of Minimum Profit to a Partner:** A partner may be guaranteed a minimum amount of his share in profits. Guarantee may be provided by one or some or all of the partners in an existing profit-sharing ratio or in some other agreed ratio. If in any year, the actual share of profit is less than the guaranteed amount, the deficiency is borne by the guaranteeing partners in their agreed ratio.
- **Past Adjustments:** Sometimes after closing the accounts of a partnership firm for a certain period, certain omissions or errors may be discovered. For example, interest on capital or interest on drawings may have been omitted or interest has been calculated at a different rate than agreed, or profits may have been distributed in a different manner than agreed among the partners. Corrections of these errors are generally done through the Partners' Capital Accounts by means of a single adjusting Journal entry. No attempt is made to reopen the accounts of the previous accounting period(s). Such adjustments are called **past adjustments** as these are related to past periods.

Solved Questions

Illustration 1 (*Provisions of the Indian Partnership Act, 1932*).

X and *Y* are partners in a firm. They do not have Partnership Deed. What shall be the position in the following cases?

(*i*) *X* devotes more time than *Y* in the business. *X* claims that he should get a salary of ₹ 6,000 per month for it.

(*ii*) *Y* has provided a capital of ₹ 50,000 whereas *X* has provided ₹ 5,000 only as capital. *X*, however, has advanced ₹ 10,000 as loan to the firm. What interest, if any, will be given to *X* and *Y*?

(*iii*) *X* wants to introduce his son *Z* into their business. *Y* objects to his proposal.

Solution:

In the absence of Partnership Deed, provisions of the Indian Partnership Act, 1932 shall apply to settle the disputes:

(*i*) Salary is not payable to any partner. Therefore, *X* is not entitled to any salary.

(*ii*) Interest on capital is not payable to any partner. Therefore, *X* and *Y* will not get interest on their capitals. Interest on Loan is allowed @ 6% p.a. Thus, *X* will get interest ₹ 600 (*i.e.*, 6% of ₹ 10,000).

(*iii*) A person cannot be introduced as partner without the consent of all the partners. Therefore, *Z* cannot be admitted into partnership because *Y* objects to it.

Illustration 2.

Ann and Rose are partners and they do not have Partnership Deed. They have different opinion on issues relating to sharing of profits, interest on capital, etc. They approach you for advice to know the correct position. You are to give your opinion, with reasons. The issues are:

(*i*) Ann devotes time to the partnership business and, therefore, claims salary. Rose opposes it.

(*ii*) Rose invested ₹ 2,50,000 less than Ann in the capital of the firm. Ann claims interest on ₹ 2,50,000 which also Rose opposes.

(*iii*) Rose proposes that interest be charged by the firm on the drawings. Ann opposes it.

(*iv*) Ann has advanced a loan of ₹ 2,00,000 to the firm and claims interest @ 8% p.a.

(*v*) Ann claims to share profits in their capital ratio, to which Rose does not agree and proposes that the profits be shared equally.

Solution:

It is important to note that Ann and Rose do not have Partnership Deed. Therefore, provisions of the Indian Partnership Act, 1932 will apply as follows:

(*i*) The Indian Partnership Act, 1932 provides that salary is not to be allowed to a partner, if the Partnership Deed does not exist or allow it. Therefore, the claim of Ann is not acceptable.

(*ii*) Ann cannot claim interest on ₹ 2,50,000 being excess capital contributed. The Indian Partnership Act, 1932 provides that interest is not to be allowed on capital, if the Partnership Deed does not exist or allow it.

(*iii*) The Indian Partnership Act, 1932 provides that interest on drawings is not to be charged if not so provided for in the Partnership Deed. Therefore, the proposal of Rose is not justified.

(*iv*) Ann is justified in claiming interest on the loan advanced by her. Since, Partnership Deed does not exist, interest on loan by a partner is a charge against profit and is allowed @ 6% p.a. as is provided for in the Indian Partnership Act, 1932.

(*v*) Ann is not right in claiming profits to be shared in their capital ratio. It is so because the Indian Partnership Act, 1932 provides that profits shall be shared equally in the absence of agreement on profit-sharing ratio.

Illustration 3 (*Partnership Deed does not Exist*).

A and *B* are partners from 1st April, 2017 without a Partnership Deed and they introduced capital of ₹ 7,00,000 and ₹ 4,00,000 respectively. On 1st October, 2017, *A* advanced loan of ₹ 3,75,000 to the firm without an agreement as to interest. *B* allows the firm to carry on business from premises owned by him for a yearly rent of ₹ 1,20,000. Profit as per the Profit and Loss Account for the year ended 31st March, 2018 was ₹ 7,97,390 before charging rent. The partners do not agree on allowing of interest and the basis of division of profits. You are required to divide the profits giving reasons for your method.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Profit transferred to Capital A/cs:			By Profit and Loss A/c	6,66,140
A	3,33,070		(After rent and interest on loan)	
B	3,33,070	6,66,140	(₹ 7,97,390 – ₹ 1,20,000 – ₹ 11,250)	
		6,66,140		6,66,140

Reasons:

1. **Rent is a charge on profit** hence, is to be debited to Profit and Loss Account.
2. Since there is no Partnership Deed, *A* will be allowed interest @ 6% for six months, (₹ 3,75,000 × 6/100 × 6/12 = ₹ 11,250), because the loan has been advanced on 1st October, 2017. **Interest on Partner's Loan is a charge against profit** hence, is to be debited to Profit and Loss Account.
3. In the absence of Partnership Deed, **profit-sharing ratio will be equal**.

Illustration 4 (*Interest on Capital when Profit is Inadequate*).

A and *B* contribute ₹ 4,00,000 and ₹ 2,00,000 respectively as capital on which they agree to pay interest @ 6% p.a. They are to share profit in the ratio of 2 : 3. Business profit (before interest) for the year is ₹ 30,000. Show the relevant account to allocate interest on capitals:

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

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

Solution:

(*i*) *When Partnership Deed is silent in treating interest as a charge or appropriation:*

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Profit for the year)	30,000
A	20,000			
B	10,000	30,000		
		30,000		30,000

Working Note:

Interest on *A*'s Capital and *B*'s Capital is ₹ 24,000 and ₹ 12,000 respectively. Thus, total interest is ₹ 36,000. Since, the profit before interest is only ₹ 30,000, interest on capital will be shared in the ratio of interest allowable, *i.e.*, ₹ 24,000 : ₹ 12,000 or 2 : 1. Interest on Capital allowed to respective partner will be:

$$A = \frac{₹\,30{,}000 \times ₹\,24{,}000}{₹\,36{,}000} = ₹\ 20{,}000;\ B = \frac{₹\,30{,}000 \times ₹\,12{,}000}{₹\,36{,}000} = ₹\ 10{,}000.$$

(*ii*) *When Interest is a charge as per Partnership Deed:*

Dr. PROFIT AND LOSS ACCOUNT *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit before Interest		30,000
A	24,000		By Loss transferred to Capital A/cs:		
B	12,000	36,000	*A*	2,400	
			B	3,600	6,000
		36,000			36,000

Note: Profit and Loss Appropriation Account shall not be prepared because interest on capital is a charge against profit. Since, the profit is less than interest on capital, deficit (after interest) shall be treated as loss.

Illustration 5.

A, *B* and *C* are in partnership and during the year ended 31st March, 2018 earned profit of ₹ 83,000. *A* and *B* are entitled to 5% p.a. interest on their capitals of ₹ 60,000 and ₹ 1,00,000 respectively while *C*, who has no capital in the firm, is entitled to a salary of ₹ 12,000 p.a. *C* is also entitled to a commission of 5% on the balance profits, *i.e.*, after charging interest, salary and commission. It is further agreed that out of the remaining profit 20% shall be donated to Prime Minister's National Relief Fund and balance profit will be shared equally by the partners. Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2018.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. *Cr.*

Particulars		₹	Particulars	₹
To *C*'s Salary A/c		12,000	By Profit and Loss A/c (Profit)	83,000
To Interest on Capital A/cs:				
A	3,000			
B	5,000	8,000		
To *C*'s Commission A/c [5/105 (₹ 83,000 – ₹ 12,000 – ₹ 8,000)]		3,000		
To Donation A/c [20% of ₹ (83,000 – 23,000)]		12,000		
To Profit transferred to Capital A/cs:				
A	16,000			
B	16,000			
C	16,000	48,000		
		83,000		83,000

Illustration 6 (*Calculation of Opening Capital*).

A and *B* are partners in a business and their capitals at the end of the year were ₹ 7,00,000 and ₹ 6,00,000 respectively. Calculate their opening capitals considering the following information:

(*a*) Drawings of *A* and *B* for the year were ₹ 75,000 and ₹ 50,000 respectively.

(*b*) *B* introduced capital of ₹ 1,00,000 during the year.

(*c*) Interest on drawings debited to the Capital Accounts of *A* and *B* were ₹ 7,500 and ₹ 5,000 respectively.

(*d*) Share of loss debited to each Partner's Capital Account was ₹ 20,000.

Solution:

CALCULATION OF OPENING CAPITAL

Particulars	*A* ₹	*B* ₹
Capitals at the end	7,00,000	6,00,000
Add: Drawings during the year	75,000	50,000
Interest on Drawings	7,500	5,000
Share of Loss for the year	20,000	20,000
	8,02,500	6,75,000
Less: Capital Introduced during the year	...	1,00,000
Opening Capitals or Capitals in the beginning	8,02,500	5,75,000

Alternatively, Capital Account of each partner may be prepared to determine Opening Capitals as follows:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* ₹	*B* ₹	Particulars	*A* ₹	*B* ₹
To Drawings A/c	75,000	50,000	By Balance *b/d*	**8,02,500**	**5,75,000**
To Interest on Drawings A/c	7,500	5,000	**(Balancing Figure)**		
To Profit and Loss A/c	20,000	20,000	By Cash/Bank A/c	...	1,00,000
(Share of Loss)			(Add. Capital Introduced)		
To Balance *c/d* (Given)	7,00,000	6,00,000			
	8,02,500	6,75,000		8,02,500	6,75,000

Illustration 7.

Akhil and Bhuvi are partners sharing profits and losses in the ratio of 3 : 1. On 1st April, 2018, their capitals were: *A* ₹ 5,00,000 and *B* ₹ 3,00,000. During the year ended 31st March, 2019, they earned net profit of ₹ 5,00,000. The terms of partnership are:

(*i*) Interest on capitals is to be allowed @ 6% p.a.

(*ii*) Akhil will get commission @ 2% on net sales.

(*iii*) Bhuvi will get a salary of ₹ 5,000 per month.

(*iv*) Bhuvi will get commission of 5% on profit after deduction of interest, salary and commission (including his own commission).

Partners' drawings during the year were: Akhil ₹ 80,000 and Bhuvi ₹ 60,000. Net sales for the year were ₹ 30,00,000. After considering the above factors, you are required to prepare Profit and Loss Appropriation Account and Capital Accounts of the Partners.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2019* *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c	5,00,000
Akhil (₹ 5,00,000 × 6/100)	30,000		(Net Profit)	
Bhuvi (₹ 3,00,000 × 6/100)	18,000	48,000		
To Bhuvi's Salary A/c (₹ 5,000 × 12)		60,000		
To Commission A/c:				
Akhil (WN 1)	60,000			
Bhuvi (WN 2)	15,810	75,810		
To Profit transferred to Partners' Capital A/cs:				
Akhil (3/4)	2,37,142			
Bhuvi (1/4)	79,048	3,16,190		
		5,00,000		5,00,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	Akhil ₹	Bhuvi ₹	Date	Particulars	Akhil ₹	Bhuvi ₹
2019				2018			
March 31	To Drawings A/c	80,000	60,000	April 1	By Balance *b/d*	5,00,000	3,00,000
March 31	To Balance *c/d*	7,47,142	4,12,858	2019			
				March 31	By Interest on Capital A/c	30,000	18,000
				March 31	By Profit and Loss Appropriation A/c (Salary)	...	60,000
				March 31	By Commission A/c	60,000	15,810
				March 31	By Profit and Loss Appropriation A/c (Profit)	2,37,142	79,048
		8,27,142	4,72,858			8,27,142	4,72,858

Working Notes:

1. Akhil's Commission = 2/100 × ₹ 30,00,000 = ₹ 60,000.
2. *Bhuvi's Commission:*

   Net profit after charging interest, salary and Akhil's Commission but before charging Bhuvi's commission = ₹ (5,00,000 – 48,000 – 60,000 – 60,000) = ₹ 3,32,000

   Bhuvi's Commission after charging his own Commission = 5/105 × ₹ 3,32,000 = ₹ 15,810.

Illustration 8.

On 1st April, 2019, Precious, Noble and Perfect entered into partnership with capitals of ₹ 60,000; ₹ 50,000 and ₹ 30,000 respectively.

Perfect advanced ₹ 10,000 as loan to the partnership on 1st October, 2019. The Partnership Deed contained the following clauses:

(*i*) Interest on capitals @ 6% p.a.

(*ii*) Interest on drawings @ 6% p.a. Each drew ₹ 4,000 at the end of each quarter commencing from 30th June, 2019.

(*iii*) Working partners Precious and Noble to get salaries of ₹ 200 and ₹ 300 per month.

(*iv*) Interest on loan was given to Perfect @ 6% p.a.

(*v*) Profits and losses are to be shared in the ratio of 4 : 2 : 1 up to ₹ 70,000 and above ₹ 70,000 equally.

Net profit of the firm for the year ended 31st March, 2020 (before above adjustments) was ₹ 1,11,000.

Prepare Profit and Loss Appropriation Account and Personal Accounts of the Partners assuming capitals to be fixed. (*ISC 1996, Modified*)

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. Particulars		₹	Particulars		₹ *Cr.*
To Interest on Capital A/cs:			By Profit and Loss A/c		1,10,700
Precious	3,600		(₹ 1,11,000 – ₹ 300		
Noble	3,000		being Interest on Loan by Perfect)		
Perfect	1,800	8,400	By Interest on Drawings A/cs (Note 1):		
To Partners' Salary A/cs:			Precious	360	
Precious		2,400	Noble	360	
Noble		3,600	Perfect	360	1,080
To Balance *c/d*		97,380			
		1,11,780			1,11,780
To Profit trfd. to Current A/cs:			By Balance *b/d*		97,380
First ₹ 70,000:					
Precious (4/7)		40,000			
Noble (2/7)		20,000			
Perfect (1/7)		10,000			
Next ₹ 27,380 (*i.e.*, ₹ 97,380 – ₹ 70,000):					
Precious (1/3)		9,127			
Noble (1/3)		9,127			
Perfect (1/3)		9,126			
		97,380			97,380

PARTNERS' CAPITAL ACCOUNTS

Dr. Particulars	Precious ₹	Noble ₹	Perfect ₹	Particulars	Precious ₹	Noble ₹	Perfect ₹ *Cr.*
To Balance *c/d*	60,000	50,000	30,000	By Bank A/c	60,000	50,000	30,000

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Particulars	Precious ₹	Noble ₹	Perfect ₹	Particulars	Precious ₹	Noble ₹	Perfect ₹
To Drawings A/c	16,000	16,000	16,000	By Interest on Capital A/c	3,600	3,000	1,800
To Interest on Drawings A/c	360	360	360	By Partners' Salary A/cs	2,400	3,600	...
To Balance *c/d*	38,767	19,367	4,566	By P and L App. A/c (Profit)	49,127	29,127	19,126
	55,127	35,727	20,926		55,127	35,727	20,926

Notes: 1. *Interest on Drawings of each Partner:* On ₹ 4,000 for 9 months: ₹ 180 + on ₹ 4,000 for 6 months: ₹ 120 + on ₹ 4,000 for 3 months: ₹ 60.
Total Interest on Drawings = ₹ 180 + ₹ 120 + ₹ 60 = ₹ 360.
No Interest will be charged on last drawings since it is at the end of the accounting year.
2. Interest on Loan by Perfect ₹ 300 should be credited to Loan by Perfect Account.

Illustration 9.

A, *B* and *C* are partners in a firm. Their terms of agreement are:

Particulars	*A*	*B*	*C*
Interest on Capital	@ 6% p.a.	@ 6% p.a.	@ 6% p.a.
Interest on drawings (except salary) is to be charged	@ 6% p.a.	@ 6% p.a.	@ 6% p.a.
Salary	@ ₹ 500 p.m.	...	...
C is entitled to receive commission on the profits after charging such commission and making above adjustments	...	...	5%

On 1st April, 2019, *A*, *B* and *C* had capitals of ₹ 15,000; ₹ 20,000 and ₹ 12,000 respectively. *B* withdrew ₹ 2,000 on 31st December, 2019 and *C* introduced ₹ 2,000 on 1st March, 2020. *A* had no drawings except salary of ₹ 500 per month. *B*'s drawings were ₹ 500 on 1st August and ₹ 700 on 30th November, 2019. *C* regularly drew at the rate of ₹ 200 at the end of each month. The profit before making above adjustments for the financial year ended 31st March, 2020 was ₹ 22,245. Prepare Profit and Loss Appropriation Account. (*ISC, Modified*)

Solution: PROFIT AND LOSS APPROPRIATION ACCOUNT
Dr. *for the year ended 31st March, 2020* *Cr.*

Particulars		₹	Particulars			₹
To Interest on Capital A/cs (WN 1):			By Profit and Loss A/c (Net Profit)			22,245
A	900		By Interest on Drawings A/cs:			
B	1,170		*B* (₹ 500 × 8/12 × 6/100)	20		
C	730	2,800	(₹ 700 × 4/12 × 6/100)	14	34	
To Salary A/c (A)		6,000	*C* (₹ 2,400 × 5.5/12 × 6/100) (WN 2)		66	100
To Commission A/c (C) (₹ 13,545 × 5/105)		645				
To Profit trfd. to Capital A/cs:						
A	4,300					
B	4,300					
C	4,300	12,900				
		22,345				22,345

Working Notes:

1. *Calculation of Interest on Capitals:*

		₹
Interest on *A*'s Capital for 1 year @ 6% p.a.		900
Interest on *B*'s Capital of ₹ 20,000 for 9 months @ 6% p.a.	900	
Interest on *B*'s Capital of ₹ 18,000 for 3 months @ 6% p.a.	270	1,170
Interest on *C*'s Capital of ₹ 12,000 for 11 months @ 6% p.a.	660	
Interest on *C*'s Capital of ₹ 14,000 for 1 month @ 6% p.a.	70	730

2. Interest on *C*'s drawings is calculated for 5.5 months on total drawings because he regularly drew at the rate of ₹ 200 at the end of each month.

Illustration 10.

Rahul, Shyam and Tarun are partners sharing profits and losses in proportion to their capitals in the beginning of the year. They are entitled to draw annually ₹ 3,000; ₹ 2,500 and ₹ 2,000 respectively against their anticipated share of profit. Any drawings in excess of these amounts are to be regarded as advances taken from the firm and are to be subject to interest @ 18% p.a. The capitals in the beginning of the year is to be allowed interest @ 15% p.a.

The capitals of the partners in the beginning of the year were Rahul ₹ 40,000; Shyam ₹ 30,000 and Tarun ₹ 20,000. The credit balances of their Current Accounts were Rahul ₹ 1,152; Shyam ₹ 1,864 and Tarun ₹ 576. Their drawings during the year were Rahul ₹ 7,000; Shyam ₹ 9,500 and Tarun ₹ 3,000. Net profit for the year ended 31st March, 2019 was ₹ 30,420.

Prepare Profit and Loss Appropriation Account, Capital and Current Accounts of the partners for the year ended 31st March, 2019.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *for the year ended 31st March, 2019* *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit)		30,420
Rahul	6,000		By Interest on Drawings A/cs (Note):		
Shyam	4,500		Rahul on ₹ 4,000	360	
Tarun	3,000	13,500	(₹ 7,000 – ₹ 3,000)		
To Profit trfd. to Current A/cs:			Shyam on ₹ 7,000	630	
Rahul (4/9)	8,000		(₹ 9,500 – ₹ 2,500)		
Shyam (3/9)	6,000		Tarun on ₹ 1,000	90	1,080
Tarun (2/9)	4,000	18,000	(₹ 3,000 – ₹ 2,000)		
		31,500			31,500

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	Rahul ₹	Shyam ₹	Tarun ₹	Date	Particulars	Rahul ₹	Shyam ₹	Tarun ₹
2019					2018				
Mar. 31	To Balance *c/d*	40,000	30,000	20,000	Apr. 1	By Balance *b/d*	40,000	30,000	20,000
		40,000	30,000	20,000			40,000	30,000	20,000

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Date	Particulars	Rahul ₹	Shyam ₹	Tarun ₹	Date	Particulars	Rahul ₹	Shyam ₹	Tarun ₹
2019					2018				
Mar. 31	To Drawings A/c	7,000	9,500	3,000	Apr. 1	By Balance *b/d*	1,152	1,864	576
Mar. 31	To Interest on Drawings A/c	360	630	90	2019				
Mar. 31	To Balance *c/d*	7,792	2,234	4,486	Mar. 31	By Interest on Capital A/c	6,000	4,500	3,000
					Mar. 31	By Profit and Loss Appropriation A/c	8,000	6,000	4,000
		15,152	12,364	7,576			15,152	12,364	7,576

Note: In the absence of actual dates of drawings, interest thereon has been calculated for the average period, *i.e.*, 6 months.

Illustration 11.

Asif and Ravi are partners in a firm, sharing profits and losses in the ratio of 3 : 2. Their fixed capitals as on 1st April, 2016, were ₹ 6,00,000 and ₹ 4,00,000 respectively.

Their Partnership Deed provides for the following:

(*a*) Partners are to be allowed interest on their capital @ 10% per annum.

(*b*) They are to be charged interest on drawings @ 4% per annum.

(*c*) Asif is entitled to a salary of ₹ 2,000 per month.

(*d*) Ravi is entitled to a commission of 5% of the correct net profit of the firm before charging such commission.

(*e*) Asif is entitled to a rent of ₹ 3,000 per month for the use of his premises by the firm.

The net profit of the firm for the year ended 31st March, 2017, before providing for any of the above clauses was ₹ 4,00,000.

Both partners withdrew ₹ 5,000 in the beginning of every month for the entire year.

You are required to prepare Profit and Loss Appropriation Account for the year ended 31st March, 2017. (*ISC 2018*)

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit) (WN 1)		3,64,000
Asif	60,000		By Interest on Drawing A/cs:		
Ravi	40,000	1,00,000	Asif	1,300	
To Asif's Salary A/c		24,000	Ravi	1,300	2,600
To Ravi's Commission A/c (5% of ₹ 3,64,000)		18,200			
To Profit transferred to:					
Asif's Current A/c	1,34,640				
Ravi's Current A/c	89,760	2,24,400			
		3,66,600			3,66,600

Working Notes:

1. Rent of ₹ 36,000 payable to Asif for the use of his premises is a charge against profit. Therefore, it is deducted before transferring the profit to Profit and Loss Appropriation Account. Thus, Amount transferred to Profit and Loss Appropriation Account ₹ 3,64,000 (*i.e.*, ₹ 4,00,000 – ₹ 36,000).

2. *Interest on Drawings:*

$$\text{Asif} = ₹\ 5{,}000 \times 12 \times \frac{6.5}{12} \times \frac{4}{100} = ₹\ 1{,}300;$$

$$\text{Ravi} = ₹\ 5{,}000 \times 12 \times \frac{6.5}{12} \times \frac{4}{100} = ₹\ 1{,}300.$$

Illustration 12.

A, *B* and *C* are partners sharing profits and losses in the ratio of 4 : 3 : 2. Their Capital Account balances as on 31st March, 2016 are as follows:

A—₹ 4,25,000 (Cr.); *B*—₹ 2,75,000 (Cr.); *C*—₹ 3,05,000 (Cr.).

Following further information is provided:

(*i*) ₹ 55,600 is to be transferred to General Reserve.

(*ii*) *A*, *B* and *C* are paid monthly salary in cash amounting to ₹ 6,000; ₹ 4,000 and ₹ 4,500 respectively.

(*iii*) Partners are allowed interest on their closing capital balances at 6% p.a. and are charged interest on drawings @ 8% p.a.

(*iv*) *A* and *B* are entitled to commission at 8% and 10% respectively on the Net profit before making any appropriation.

(*v*) *C* is entitled to commission at 15% of the Net profit before charging Interest on Drawings but after making all other appropriations.

(*vi*) During the year, *A* withdrew ₹ 5,000 in the beginning of every month, *B*—₹ 4,375 at the end of every month and *C*—₹ 3,125 in the middle of every month.

(*vii*) Firm's Accountant is entitled to a salary of ₹ 5,000 per month and a commission of 12% of Net profit after charging such commission.

Net profit of the firm for the year ended 31st March, 2016, before providing for any of the above adjustments was ₹ 6,90,000. You are required to prepare Profit and Loss Appropriation Account for the year ended on 31st March, 2016.

Solution:

PROFIT AND LOSS ACCOUNT
for the year ended 31st March, 2016

Dr. *Cr.*

Particulars	₹	Particulars	₹
To Accountant's Salary (Note 1) (₹ 5,000 × 12)	60,000	By Net Profit *b/d*	6,90,000
To Accountant's Commission (Note1) 12/112 (₹ 6,90,000 – ₹ 60,000)	67,500		
To Net Profit trfd. to P and L Appropriation A/c	5,62,500		
	6,90,000		6,90,000

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2016* *Cr.*

Particulars		₹	Particulars		₹
To General Reserve A/c		55,600	By Net Profit (trfd. from Profit and Loss A/c)		5,62,500
To Partners' Salary:			By Interest on Drawings:		
A (₹ 6,000 × 12)	72,000		*A* (₹ 60,000 × 8/100 × 6.5/12)	2,600	
B (₹ 4,000 × 12)	48,000		*B* (₹ 52,500 × 8/100 × 5.5/12)	1,925	
C (₹ 4,500 × 12)	54,000	1,74,000	*C* (₹ 37,500 × 8/100 × 6/12)	1,500	6,025
To Interest on Capital A/cs:					
A (₹ 4,25,000 × 6/100)	25,500				
B (₹ 2,75,000 × 6/100)	16,500				
C (₹ 3,05,000 × 6/100)	18,300	60,300			
To Partners' Commission:					
A (₹ 5,62,500 × 8/100)	45,000				
B (₹ 5,62,500 × 10/100)	56,250				
C (Note 2)	25,703	1,26,953			
To Net Profit transferred to Capital A/cs:					
A (₹ 1,51,672 × 4/9)	67,410				
B (₹ 1,51,672 × 3/9)	50,557				
C (₹ 1,51,672 × 2/9)	33,705	1,51,672			
		5,68,525			5,68,525

Notes:

1. Salary and Commission to firm's Accountant are charge against firm's profits, and not an appropriation of profit. Hence, these items have been debited to Profit and Loss Account.
2. *C*'s Commission = 15/100 (₹ 5,62,500 – ₹ 55,600 – ₹ 1,74,000 – ₹ 60,300 – ₹ 1,01,250) = ₹ 25,703.

Illustration 13.

A, *B* and *C* are partners sharing profits and losses in proportion to their capitals in the beginning of the year. They are entitled to draw annually ₹ 30,000; ₹ 25,000 and ₹ 20,000 respectively out of their anticipated share of profit. Any drawings in excess of these amounts are to be regarded as advances taken from the firm and are to be subject to interest @ 18% p.a. The capitals in the beginning of the year is to be allowed interest @ 15% p.a.

Capitals of the partners in the beginning of the year were: *A* ₹ 4,00,000; *B* ₹ 3,00,000 and *C* ₹ 2,00,000. The credit balances of their Current Accounts were: *A* ₹ 11,520; *B* ₹ 18,640 and *C* ₹ 5,760. Their drawings during the year were: *A* ₹ 70,000; *B* ₹ 95,000 and *C* ₹ 30,000. The profit for the year was ₹ 3,04,200 before making any adjustments for interest as above.

Draw up Profit and Loss Appropriation Account, Capital and Current Accounts of the partners for the year ended 31st March, 2016.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2016

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital:			By Profit and Loss A/c (Net Profit)		3,04,200
A's Current A/c	60,000		By Interest on Drawings (Note):		
B's Current A/c	45,000		*A* on ₹ 40,000	3,600	
C's Current A/c	30,000	1,35,000	*B* on ₹ 70,000	6,300	
To Profit transferred to Current A/cs:			*C* on ₹ 10,000	900	10,800
A (4/9)	80,000				
B (3/9)	60,000				
C (2/9)	40,000	1,80,000			
		3,15,000			3,15,000

PARTNERS' CAPITAL ACCOUNTS

Dr. | *Cr.*

Date	Particulars	*A* ₹	*B* ₹	*C* ₹	Date	Particulars	*A* ₹	*B* ₹	*C* ₹
2016					2015				
Mar. 31	To Balance *c/d*	4,00,000	3,00,000	2,00,000	Apr. 1	By Balance *b/d*	4,00,000	3,00,000	2,00,000
		4,00,000	3,00,000	2,00,000			4,00,000	3,00,000	2,00,000

PARTNERS' CURRENT ACCOUNTS

Dr. | *Cr.*

Date	Particulars	*A* ₹	*B* ₹	*C* ₹	Date	Particulars	*A* ₹	*B* ₹	*C* ₹
2016					2015				
Mar. 31	To Drawings A/c	70,000	95,000	30,000	April 1	By Balance *b/d*	11,520	18,640	5,760
	To Interest on Drawings A/c	3,600	6,300	900	2016 Mar. 31	By Interest on Capital A/c	60,000	45,000	30,000
	To Balance *c/d*	77,920	22,340	44,860		By Profit and Loss App. A/c	80,000	60,000	40,000
		1,51,520	1,23,640	75,760			1,51,520	1,23,640	75,760

Note: In the absence of actual dates of drawings, interest thereon has been calculated for the average period, *i.e.*, 6 months.

Illustration 14.

A, *B* and *C* are partners in a firm. According to the Partnership Deed, the partners are entitled to draw ₹ 700 per month. On the 1st day of every month, *A*, *B* and *C* draw ₹ 700, ₹ 600 and ₹ 500 respectively. Interest on capitals and interest on drawings are fixed @ 8% and 10% respectively. Profit during the year 2017–18 was ₹ 75,500, out of which a sum of ₹ 20,000 is to be transferred to General Reserve. *B* and *C* are entitled to receive salary of ₹ 3,000 and ₹ 4,500 p.a. respectively and *A* is entitled to receive commission @ 10% on the net distributable profit after charging such commission. On 1st April, 2017, the balances of their Capital Accounts were ₹ 50,000; ₹ 40,000 and ₹ 35,000 respectively.

You are required to show Profit and Loss Appropriation Account for the year ended 31st March, 2018 and Capital Accounts of Partners in the books of the firm.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2018

Dr. *Cr.*

Particulars		₹	Particulars		₹
To General Reserve A/c		20,000	By Profit as per Profit and Loss A/c		75,500
To Interest on Capital A/c:			By Interest on Drawings A/c:		
A	4,000		*A* (₹ 8,400 × 10/100)	840	
B	3,200		*B* (₹ 7,200 × 10/100)	720	
C	2,800	10,000	*C* (₹ 6,000 × 10/100)	600	2,160
To Partners' Salaries A/c:					
B	3,000				
C	4,500	7,500			
To *A*'s Capital A/c (Commission)		3,651			
To Profit transferred to Capital A/cs:					
A	12,170				
B	12,170				
C	12,169	36,509			
		77,660			77,660

PARTNERS' CAPITAL ACCOUNTS

Dr. *Cr.*

Particulars	*A* ₹	*B* ₹	*C* ₹	Particulars	*A* ₹	*B* ₹	*C* ₹
To Drawings A/c	8,400	7,200	6,000	By Balance *b/d*	50,000	40,000	35,000
To Interest on Drawings A/c	840	720	600	By Interest on Capital A/c	4,000	3,200	2,800
To Balance *c/d*	60,581	50,450	47,869	By Partners' Salaries A/c	...	3,000	4,500
				By Profit and Loss Appropriation A/c (Commission)	3,651	...	...
				By Profit and Loss Appropriation A/c	12,170	12,170	12,169
	69,821	58,370	54,469		69,821	58,370	54,469

Working Notes:

1. Interest on Capitals and Interest on Drawings are fixed @ 8% and 10% (and not 8% p.a. and 10% p.a.). Therefore, the time factor is ignored.
2. Unless otherwise stated in the Partnership Deed, all partners are deemed to be equal partners. Thus, profit of the year has been divided among partners equally.
3. *Commission payable to A is calculated as:*

   A's Commission after charging his own Commission

$$= \frac{10}{110} \times (₹\ 75{,}500 + ₹\ 2{,}160 - ₹\ 10{,}000 - ₹\ 7{,}500 - ₹\ 20{,}000) = ₹\ 3{,}651.$$

Master Questions

Illustration 15.

Vivek, Naman and Akash started their partnership firm on 1st April, 2018 sharing profits and losses in the ratio of 4 : 3 : 2. Their capital accounts are as follows since the firm was started:

Vivek—₹ 8,00,000, Naman—₹ 6,00,000, and Akash—₹ 4,00,000.

Balances in their Current Accounts in the beginning of the year were as follows:

Vivek—₹ 1,00,000, Naman—₹ 80,000, and Akash—₹ 60,000 (Debit).

The Partnership Deed provides as under:

(i) Vivek will get annual salary of ₹ 60,000; Naman will get monthly salary of ₹ 4,000, while Akash will get commission @ 5% on net profit.

(ii) Interest on balances in current accounts will be charged/paid @ 10% p.a.

(iii) Interest on Capital will be allowed @ 6% p.a. whereas interest will be charged on drawings @ 10% p.a.

(iv) An amount equal to 10% of the net profit will be transferred to General Reserve.

(v) Interest on Loan to a partner will be charged at the rate of interest allowed on loan by the partner.

(vi) Akash was guaranteed minimum yearly profit of ₹ 2,00,000 by Vivek and Naman. Shortfall in share of profit was to be borne by Vivek and Naman equally.

Additional Information:

(ii) Naman had advanced a loan of ₹ 1,00,000 to the firm on 1st September, 2019.

(ii) Advance was given to Akash of ₹ 1,00,000 on 1st October, 2019.

(iii) Vivek had allowed the firm to use his property for business for a monthly rent of ₹ 10,000 payable at the end of the year.

(iv) Vivek withdrew ₹ 1,00,000 against capital on 1st December, 2019.

(v) Akash introduced further capital of ₹ 1,00,000 on 1st October, 2019.

(vi) Vivek withdrew regularly ₹ 5,000 per month in the beginning of each month; Naman withdrew regularly ₹ 5,000 per month in the middle of each month and Akash withdrew regularly ₹ 5,000 per month at the end of each month.

(vii) Divisible profit of the last year amounting to ₹ 7,20,000 was distributed equally among the partners before allowing interest on capital.

(viii) Profit for the year before the above adjustments was ₹ 12,60,000.

Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2020.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars		₹
To Partners' Salaries:			By Profit and Loss A/c (Net Profit) (WN 1)		11,39,500
Vivek	60,000		By Interest on Current A/c:		
Naman	48,000	1,08,000	Akash		7,600
To General Reserve (10% of ₹ 11,39,500)		1,13,950	By Interest on Drawings:		
To Akash's Commission (5% of ₹ 11,39,500)		56,975	Vivek	3,250	
To Interest on Current A/cs:			Naman	3,000	
Vivek	14,800		Akash	2,750	9,000
Naman	4,800	19,600			
To Interest on Capital A/cs:					
Vivek	46,000				
Naman	36,000				
Akash	27,000	1,09,000			
To Profit transferred to Current A/cs:					
Vivek	3,32,700				
Less: Transferred to Akash	16,825	3,15,875			
Naman	2,49,525				
Less: Transferred to Akash	16,825	2,32,700			
Akash	1,66,350				
Add: Deficiency met by Vivek	16,825				
Deficiency met by Naman	16,825	2,00,000			
		11,56,100			11,56,100

Working Notes:

1. *Calculation of Net Profit transferred to Profit and Loss Appropriation Account:*

PROFIT AND LOSS ACCOUNT

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

Particulars	₹	Particulars	₹
To Rent (12 × ₹ 10,000)	1,20,000	By Profit (Given)	12,60,000
To Interest on Loan by Naman (₹ 1,00,000 × 6/100 × 7/12)	3,500	By Interest on Loan to Akash (₹ 1,00,000 × 6/100 × 6/12)	3,000
To Net Profit transferred to Profit and Loss Appropriation A/c	11,39,500		
	12,63,000		12,63,000

2. *Adjustment Table:*	Vivek (₹)	Naman (₹)	Akash (₹)
Divisible Profit (₹ 7,20,000) wrongly appropriated equally now taken back	(2,40,000)	(2,40,000)	(2,40,000)
Interest on Capital @ 6% p.a.	48,000	36,000	24,000
Profit to be credited in 4 : 3 : 2	2,72,000	2,04,000	1,36,000
Deficiency in Akash's Share	(32,000)	(32,000)	64,000
	48,000	(32,000)	(16,000)

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Naman's Current A/c ...Dr.		32,000	
	Akash's Current A/c ...Dr.		16,000	
	To Vivek's Current A/c			48,000
	(Being the adjustment entry passed)			

3. *Current A/c Balances and Interest thereon:*

	Vivek (₹)	Naman (₹)	Akash (₹)
Given	1,00,000	80,000	(60,000)
Add/Less: Adjustment	48,000	(32,000)	(16,000)
	1,48,000	48,000	(76,000)
Interest on Current A/cs @ 10% p.a.	14,800	4,800	(7,600)

4. Divisible Profit = ₹ 7,48,575

   Akash's Share of Profit (Actual) = ₹ 1,66,350

   Whereas, his Guaranteed Share of Profit = ₹ 2,00,000

   Deficiency in Akash's Share of Profit = ₹ 33,650, which will be met by Vivek and Naman equally.

Illustration 16.

Karan, Hari and Ashish commenced business on 1st April, 2019 as partners with capitals of ₹ 2,00,000; ₹ 6,00,000 and ₹ 3,00,000. They mutually agreed for:

(i) 10% p.a. interest on capitals;

(ii) 15% p.a. interest on drawings;

(iii) Karan will get 5% commission on sales;

(iv) Hari will get ₹ 25,000 per month as salary; and

(v) Balance of profit to be distributed in the ratio of 2 : 2 : 1.

Ashish also provided a loan of ₹ 1,00,000 @ 16% p.a. to the firm.

Total sales during the first year (*i.e.*, year ended 31st March, 2020) was ₹ 40,00,000 and the net profit at the end of the year was ₹ 10,86,250 (after providing interest on loan).

During the year, Karan introduced ₹ 6,00,000 to the firm as additional capital on 30th September, 2019 but Hari withdrew ₹ 1,00,000 out of his capital on the same date Their drawings were:

Partners	On 30th Jun, 2019 (₹)	On 30th September, 2019 (₹)	On 31st December, 2019 (₹)
Karan	50,000	90,000	1,00,000
Hari	80,000	80,000	80,000
Ashish	90,000	30,000	60,000

You are required to prepare Profit and Loss Appropriation Account for the year ended 31st March, 2020 and Partners' Capital and Current Accounts.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars		₹
To Interest on Capital A/c (WN 1):			By Profit and Loss A/c (Net Profit)		10,86,250
Karan's Current A/c	50,000		By Interest on Drawings A/cs (WN 2):		
Hari's Current A/c	55,000		Karan's Current A/c	16,125	
Ashish's Current A/c	30,000	1,35,000	Hari's Current A/c	18,000	
To Karan's Current A/c (Commission) (5% of ₹ 40,00,000)		2,00,000	Ashish's Current A/c	14,625	48,750
To Hari's Current A/c (Salary) (₹ 25,000 × 12)		3,00,000			
To Profit transferred to Current A/cs:					
Karan (₹ 5,00,000 × 2/5)	2,00,000				
Hari (₹ 5,00,000 × 2/5)	2,00,000				
Ashish (₹ 5,00,000 × 1/5)	1,00,000	5,00,000			
		11,35,000			11,35,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	Karan ₹	Hari ₹	Ashish ₹	Date	Particulars	Karan ₹	Hari ₹	Ashish ₹
2019					2019				
Sept. 30	To Bank A/c	...	1,00,000	...	Apr. 1	By Bank A/c	2,00,000	6,00,000	3,00,000
2020					Sept. 30	By Bank A/c	6,00,000	...	...
Mar. 31	To Balance *c/d*	8,00,000	5,00,000	3,00,000					
		8,00,000	6,00,000	3,00,000			8,00,000	6,00,000	3,00,000

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Date	Particulars	Karan ₹	Hari ₹	Ashish ₹	Date	Particulars	Karan ₹	Hari ₹	Ashish ₹
2019					2020				
June 30	To Drawings A/c	50,000	80,000	90,000	Mar. 31	By Interest on Capital A/c	50,000	55,000	30,000
Sept. 30	To Drawings A/c	90,000	80,000	30,000					
Dec. 31	To Drawings A/c	1,00,000	80,000	60,000	Mar. 31	By P and L Appropriation A/c (Commision)	2,00,000	...	...
2020									
Mar. 31	To Interest on Drawings A/c	16,125	18,000	14,625	Mar. 31	By Profit and Loss Appropriation A/c (Salaries)	...	3,00,000	...
Mar. 31	To Balance *c/d*	1,93,875	2,97,000	...	Mar. 31	By Profit and Loss Appropriation A/c (Profit)	2,00,000	2,00,000	1,00,000
					Mar. 31	By Balance *c/d*	...	...	64,625
		4,50,000	5,55,000	1,94,625			4,50,000	5,55,000	1,94,625

Working Notes:

1. *Calculation of Interest on Capitals:*

Partner	Interest on Capitals	Total (₹)
Karan	On ₹ 2,00,000 @ 10% for 1 year + On ₹ 6,00,000 @ 10% for 6 months	50,000
Hari	On ₹ 6,00,000 @ 10% for 6 months + On ₹ 5,00,000 @ 10% for 6 months	55,000
Ashish	On ₹ 3,00,000 @ 10% for 1 year	30,000
	Total	**1,35,000**

2. *Calculation of Interest on Drawings:*

Partner	Interest on Drawings	Total (₹)
Karan	On ₹ 50,000 @ 15% for 9 months + On ₹ 90,000 @ 15% for 6 months + On ₹ 1,00,000 @ 15% for 3 months	16,125
Hari	On ₹ 80,000 @ 15% for 9 months + On ₹ 80,000 @ 15% for 6 months + On ₹ 80,000 @ 15% for 3 months	18,000
Ashish	On ₹ 90,000 @ 15% for 9 months + On ₹ 30,000 @ 15% for 6 months + On ₹ 60,000 @ 15% for 3 months	14,625
	Total	**48,750**

Illustration 17.

Sachin and Saurabh are partners in a firm. Their profit-sharing ratio is 3 : 2. On 1st April, 2019, their Capital and Current Account balances were:

Partners	Capital Account ₹	Current Account ₹
Sachin	2,00,000	50,000
Saurabh	1,00,000	20,000

The partners are entitled to interest on capital @ 10% p.a. on monthly basis. They are also allowed to make withdrawals at any time during the year but they have agreed to charge interest on drawings @ 10% p.a. also on monthly basis.

The withdrawals of the partners were as under:

Partners	1st July, 2019 (₹)	1st January, 2020 (₹)
Sachin	10,000	18,000
Saurabh	8,000	4,000

On 1st October, 2019 Sachin took an old furniture from the firm at a value of ₹ 40,000 and Saurabh introduced in the business another furniture valued at ₹ 25,000.

On 1st January, 2020 Sachin introduced some stock into the business valued at ₹ 20,000.

On 1st February, 2020 Saurabh took some stock from the business for his personal use valued at ₹ 5,000.

The net profit for the year ended 31st March, 2020 was ₹ 70,000.

Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2020 and Partners' Capital and Current Accounts.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs (WN 1):			By Profit and Loss A/c (Net Profit)		70,000
Sachin	18,500		By Interest on Drawings A/cs (WN 2):		
Saurabh	11,250	29,750	Sachin	1,200	
To Share of Profit trfd. to Current A/cs:			Saurabh	783	1,983
Sachin	25,340				
Saurabh	16,893	42,233			
		71,983			71,983

PARTNERS' CAPITAL ACCOUNTS

Dr. *Cr.*

Date	Particulars	Sachin ₹	Saurabh ₹	Date	Particulars	Sachin ₹	Saurabh ₹
2019				2019			
Oct. 1	To Furniture A/c	40,000	...	April 1	By Balance *b/d*	2,00,000	1,00,000
2020				Oct. 1	By Furniture A/c	...	25,000
Mar. 31	To Balance *c/d*	1,80,000	1,25,000	2020			
				Jan. 1	By Purchases A/c (Stock)	20,000	...
		2,20,000	1,25,000			2,20,000	1,25,000

PARTNERS' CURRENT ACCOUNTS

Dr. *Cr.*

Date	Particulars	Sachin ₹	Saurabh ₹	Date	Particulars	Sachin ₹	Saurabh ₹
2019				2019			
July 1	To Bank A/c (Drawings)	10,000	8,000	April 1	By Balance *b/d*	50,000	20,000
2020				2020			
Jan. 1	To Bank A/c (Drawings)	18,000	4,000	March 31	By Interest on Capital A/c	18,500	11,250
Feb. 1	To Purchases A/c (Goods Withdrawn)		5,000	March 31	By Profit and Loss Appropriation A/c (Share of Profit)	25,340	16,893
March 31	To Interest on Drawings A/c	1,200	783				
March 31	To Balance *c/d*	64,640	30,360				
		93,840	48,143			93,840	48,143

Working Notes:

1. *Interest on Capital:* ₹

Sachin:

		₹
(*i*)	On ₹ 2,00,000 for 6 months (1st April, 2019 to 30th September, 2019) @ 10% p.a.	10,000
(*ii*)	On ₹ 1,60,000 for 3 months (1st October, 2019 to 31st December, 2019) @ 10% p.a. (₹ 2,00,000 – ₹ 40,000 for furniture taken over)	4,000
(*iii*)	On ₹ 1,80,000 for 3 months (1st January, 2020 to 31st March, 2020) @ 10% p.a. (₹ 1,60,000 + ₹ 20,000 for stock introduced)	4,500
Total		**18,500**

Saurabh

		₹
(*i*)	On ₹ 1,00,000 for 6 months (1st April, 2019 to 30th September, 2019) @ 10% p.a.	5,000
(*ii*)	On ₹ 1,25,000 for 6 months (1st October, 2019 to 31st December, 2019) @ 10% p.a. (₹ 1,00,000 + ₹ 25,000 for furniture introduced)	6,250
Total		**11,250**

2. *Interest on Drawings:*

Sachin:

(*i*) On ₹ 10,000 @ 10% p.a. for 9 months	750
(*ii*) On ₹ 18,000 @ 10% p.a. for 3 months	450
Total	**1,200**

Saurabh:

(*i*) On ₹ 8,000 @ 10% p.a. for 9 months	600
(*ii*) On ₹ 4,000 @ 10% p.a. for 3 months	100
(*iii*) On ₹ 5,000 @ 10% p.a. for 2 months	83
Total	**783**

Unsolved Questions

1. Anita, Lalita and Manju are partners in a firm sharing profits and losses equally with fixed capital of ₹ 2,50,000 each. On 1st January, 2020, Anita and Lalita gave loans of ₹ 1,50,000 each to the firm whereas Manju took a loan of ₹ 1,00,000 from the firm on the same date. It was agreed among the partners that Manju will pay interest @ 6% p.a. Interest on loan from partners was paid on 30th April, 2020. The firm closes its books on 31st March each year. Pass the Journal entries in the books of the firm for the year ended 31st March, 2020.

2. Akhil and Supreet entered into partnership on 1st April, 2018. They agreed that out of profits:

(i) Akhil will receive a salary of ₹ 500 per month;

(ii) Interest on capitals will be allowed @ 6% p.a.; and

(iii) Remaining profits will be divided equally.

Akhil contributed a capital of ₹ 50,000 on 1st April, 2018 but Supreet brought in his capital of ₹ 1,00,000 on 1st July, 2018. During the year ended 31st March, 2019, the drawings were: Akhil ₹ 15,000 and Supreet ₹ 20,000. Profit before salary and interest was ₹ 50,000. Prepare Profit and Loss Appropriation Account and the Capital Accounts of the partners.

3. Satish and Parkash are partners in a business with fixed capitals of ₹ 50,000 and ₹ 30,000 respectively. They are entitled to interest on the fixed capitals @ 5% p.a. but not on Current Account. Satish is entitled to a salary of ₹ 100 per month which is not yet drawn. Drawings are permitted interest free to the extent of opening credit balance in the Current Account. Drawings in excess of the limit are subject to interest at a flat rate of 8% irrespective of the date of withdrawal. The opening balances in the current accounts are Satish ₹ 1,500 and Parkash ₹ 2,000 respectively. Drawings of each partner are ₹ 3,000.

Net profit for the year ended 31st March, 2019 was ₹ 15,000. Divisible profits are to be shared—Satish 60% and Parkash 40% up to first ₹ 4,000. Balance is shared equally.

Prepare Profit and Loss Appropriation Account and Partners' Capital and Current Accounts.

4. Ram, Shyam and Mohan are partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1. During the half year ended 30th September, 2019, their Capital Accounts remained unchanged at ₹ 3,00,000; ₹ 2,00,000 and ₹ 1,50,000 respectively.

Their Current Account balances on 1st April, 2019 were:

Ram	:	₹ 60,000 (Cr.);
Shyam	:	₹ 42,750 (Dr.);
Mohan	:	₹ 32,750 (Dr.).

During the half year ended 30th September, 2019 Ram withdrew ₹ 1,000 in the beginning of each month, Mohan withdrew ₹ 2,000 at the end of each month while Shyam withdrew ₹ 9,000 during the period of six months.

Their Partnership Deed provides that:

(i) Partners are allowed interest on capital @ 5% p.a.

(ii) Partners are allowed or charged interest on Current Account balances @ 4% p.a.

(iii) Interest on drawings is charged @ 6% p.a.
(iv) Mohan is entitled to a salary of ₹ 2,500 per month.
(v) Ram is entitled to commission of 5% of the net profit of the firm.
(vi) Shyam is entitled to commission of 5% of the net profit of the firm after charging such commission.

During the half year ended 30th September, 2019 net profit of the firm was ₹ 10,35,000 after charging Mohan's salary which had been debited to Wages and Salaries Account.

You are required to prepare Profit and Loss Appropriation Account of the firm only.

5. Prateet, Namrata and Shubhrata are partners sharing profits in the ratio of 5 : 3 : 2. Their other terms of agreement are:

Particulars	Prateet	Namrata	Shubhrata
Interest on Capital	@ 6% p.a.	@ 6% p.a.	@ 6% p.a.
Interest on drawings (except salary) is to be charged	@ 6% p.a.	@ 6% p.a.	@ 6% p.a.
Salary	@ ₹ 1,000 p.m.	...	...
Shubhrata is entitled to receive commission on the profits after charging such commission and making above adjustments	...	...	5%

On 1st April, 2019, Prateet, Namrata and Shubhrata have capitals of ₹ 30,000; ₹ 40,000 and ₹ 24,000 respectively. Namrata withdrew ₹ 4,000 on 31st December, 2019 and Shubhrata introduced ₹ 4,000 on 1st March, 2020. Prateet had no drawings except salary of ₹ 1,000 per month. Namrata's drawings were ₹ 1,000 on 1st August and ₹ 1,400 on 30th November, 2019. Shubhrata regularly drew ₹ 400 at the end of each month. Net profit for the year ended 31st March, 2020 was ₹ 44,490.

Prepare Profit and Loss Appropriation Account.

6. *X*, *Y* and *Z* commenced business on 1st April, 2017 as partners with capitals of ₹ 4,00,000; ₹ 12,00,000 and ₹ 6,00,000. They mutually agreed for:

(*i*) 10% p.a. interest on capitals;
(*ii*) 15% p.a. interest on drawings;
(*iii*) *X* will get 5% commission on sales;
(*iv*) *Y* will get ₹ 50,000 per month as salary and
(*v*) Balance of profit to be distributed in the ratio of 2 : 2 : 1.

Z also provided a loan of ₹ 2,00,000 @ 8% p.a. to the firm.

Total sales during the first year (*i.e.*, 2017–18) were ₹ 80,00,000 and the net profit at the end of the year was ₹ 21,72,500 (after providing interest on loan).

During the year, *X* introduced ₹ 12,00,000 to the firm as additional capital on 30th September, 2017 but *Y* withdrew ₹ 2,00,000 out of his capital on the same date.

Their drawings were:

Partners	On 30th June, 2017 (₹)	On 30th Sept., 2017 (₹)	On 31st Dec., 2017 (₹)
X	1,00,000	1,80,000	2,00,000
Y	1,60,000	1,60,000	1,60,000
Z	1,80,000	60,000	1,20,000

You are required to prepare Profit and Loss Appropriation Account for the year ended 31st March, 2018 and Partners' Capital and Current Accounts.

7. *X*, *Y* and *Z* started business on 1st April, 2017 with capitals of ₹ 1,00,000; ₹ 60,000 and ₹ 40,000 respectively. Their Partnership Deed provides that:

(*i*) interest on partners' capitals should be provided @ 5% p.a.
(*ii*) interest on partners' drawings should be charged @ 10% p.a.
(Drawings: *X*—₹ 10,000; *Y*—₹ 6,000 and *Z*—₹ 4,000)
(*iii*) the partners are entitled to a partnership salary of ₹ 5,000 each per annum.
(*iv*) *X* is entitled to a commission @ 10% on the profit before charging the above provisions.

(*v*) *Z* is entitled to a commission @ 10% on the net profit (after charging the above provisions) and after charging his commission.

(*vi*) 25% of the net profit (after charging all the above provisions) should be transferred to the Reserve Fund.

(*vii*) Partners will share profits and losses in the ratio of their capitals.

The profit for the year ended 31st March, 2018 amounted to ₹ 60,000.

You are required to prepare Profit and Loss Appropriation Account and Partners' Capital Accounts.

8. Dhoni, Modi and Soni are in partnership, sharing profits and losses in the ratio of 2 : 2 : 1 respectively. Interest is charged on Partners' Drawings @ 6% p.a. and credited to Partners' Capital Account Balances @ 6% p.a.

Modi is the firm's Marketing Manager and for his specialised services, he is credited with a salary of ₹ 5,000 per quarter.

During the year ended 31st March, 2018, net profit of the firm was ₹ 1,55,000 and the partners' drawings were:

		₹
Dhoni	:	30,000
Modi	:	20,000
Soni	:	20,000

In each case, the above drawings were made in two equal instalments on 30th September, 2017 and 31st March, 2018.

On 30th September, 2017, the firm agreed that Dhoni should withdraw ₹ 25,000 from his capital account and that Soni should subscribe a similar amount to his Capital Account.

The balances of the partners' accounts on 1st April, 2017 were:

		All Credit Balances	
		Capital Accounts	*Current Accounts*
		₹	₹
Dhoni	:	2,00,000	16,000
Modi	:	1,75,000	14,000
Soni	:	1,50,000	12,000

Transfer 5% of the net profit to the Reserve Fund of the firm.

Required:

(*i*) Prepare firm's Profit and Loss Appropriation Account for the year ended 31st March, 2018.

(*ii*) Prepare Partners' Capital and Current Accounts for the year ended 31st March, 2018.

(*ISC 1993, Modified*)

9. *A*, *B* and *C* are partners in a firm. *A* and *B* sharing profits in the ratio of 5 : 3 and *C* receiving a salary of ₹ 150 per month, plus a commission of 5% on the profits after charging such salary and commission or 1/5th of the profits of the firm, whichever is larger. Any excess of the latter over the former is, under the partnership agreement, to be borne personally by *A*.

The profits for the year ended 31st March, 2018 amounted to ₹ 10,710 after charging *C*'s salary.

Prepare Profit and Loss Appropriation Account showing the division of the profits of the year.

10. The partners of a firm distributed the profit for the year ended 31st March, 2020, ₹ 90,000 in the ratio of 3 : 2 : 1 without providing for the following adjustments:

(i) Akash and Bhupesh were entitled to a salary of ₹ 1,500 p.a. each.

(ii) Bhupesh was entitled to a commission of ₹ 4,500.

(iii) Bhupesh and Chander had guaranteed a minimum profit of ₹ 35,000 p.a. to Akash.

(iv) Profits were to be shared in the ratio of 3 : 3 : 2.

Pass necessary Journal entry for the above adjustments in the books of the firm.

GUIDE TO ANSWERS

1. Interest credited to Anita's and Lalita's Loan Accounts—₹ 2,250 each; Interest debited to Manju's Current Account—₹ 1,500.

[**Hints:** 1. Interest on loan from partners is not paid. It will be credited to their respective Loan Accounts.

2. Interest on loan given to Manju will be debited to her Current Account, as the capitals are fixed.]

2. Share of Profit: Akhil—₹ 18,250; and Supreet—₹ 18,250; Capital Accounts: Akhil—₹ 62,250; Supreet—₹ 1,02,750.

3. Share of Profit: Satish—₹ 5,400; Parkash—₹ 4,600; Capital Accounts: Satish—₹ 50,000; Parkash—₹ 30,000; Satish's Current Account (Cr.) ₹ 7,480 and Parkash's Current Account (Cr.) ₹ 5,020; Interest on Drawings: Satish—₹ 120, Parkash—₹ 80.

4. Share of Profit: Ram—₹ 3,66,780; Shyam—₹ 3,66,780 and Mohan—₹ 1,83,390; Ram's Commission—₹ 52,500; Shyam's Commission—₹ 50,000; Interest on Drawings: Ram—₹ 105, Mohan—₹ 150 and Shyam—₹ 135.

5. Share of Profit: Prateet—₹ 12,900; Namrata—₹ 7,740; Shubhrata—₹ 5,160.

6. Share of Profit: *X*—₹ 4,00,000; *Y*—₹ 4,00,000; *Z*—₹ 2,00,000; Interest on Drawings: *X*—₹ 32,250; *Y*—₹ 36,000 and *Z*—₹ 29,250; Balance of Partners' Capital Accounts: *X*—₹ 16,00,000; *Y*—₹ 10,00,000 and *Z*—₹ 6,00,000; Balance of Partners' Current Accounts: *X*—₹ 3,87,750; *Y*—₹ 5,94,000; *Z*—₹ 1,29,250 (Dr. Balance).

7. Net Distributable Profit—₹ 20,455; Transferred to Reserve Fund—₹ 6,818; Share of Profit: *X*—₹ 10,228; *Y*—₹ 6,136; *Z*—₹ 4,091; *Z*'s Commission—₹ 2,727; Closing Balances of Capital Accounts: *X*—₹ 1,15,728; *Y*—₹ 67,836; *Z*—₹ 49,618.

8.

Particulars	Dhoni (₹)	Modi (₹)	Soni (₹)
Share of Profit	38,720	38,720	19,360
Interest on Drawings	450	300	300
Interest on Capital	11,250	10,500	9,750
Capital Accounts (Balance)	1,75,000	1,75,000	1,75,000
Current Accounts (Balance)	35,520	62,920	20,810

9. Share of Profit: *A*—₹ 6,183; *B*—₹ 3,825; *C*—₹ 2,502; Deficiency borne by *A*—₹ 192.

10. Akash's Capital A/c (Dr.)—₹ 8,500; Bhupesh's Capital A/c (Cr.)—₹ 4,500; Chander's Capital A/c (Cr.)—₹ 4,000.